STIMULATING RECOVERY

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Preface

STIMULATING RECOVERY

A recovery without jobs is not a recovery. And a job-rich recovery will, TASC argues, require a radically different strategy to the one currently being pursued. It will require an investment strategy – a strategy designed to boost demand and maximise job creation. In the absence of such a strategy, too many people will continue struggling with unemployment, or with the fear of unemployment – and many will continue struggling to keep their homes. Businesses will struggle to remain viable, and public services will continue to be stretched, trying to deliver more with less.

That is the analysis which underpinned the TASC Open Letter, published in the Irish Times in March and reproduced in this pamphlet, where we argued that:

"The Government has pursued deflationary policies, in particular public expenditure cuts. The most damaging are cuts in transfers to low-income groups which, along with general tax increases on low and average pay in 2009, have reduced spending power in the economy at a time when it was most needed. Equally damaging have been the cuts in public investment at a time when private investment has plummeted. This has laid the foundations for a low-growth, high-debt future where unemployment will remain high and inequality endemic. All the wrong options have been pursued."

In June, together with the Foundation for European Progressive Studies, we asked three of the signatories to the TASC Open Letter – economic consultant Michael Burke, Professor Ray Kinsella and TASC Head of Policy Sinéad Pentony – to deliver papers at a seminar held to analyse the current situation and identify ways to 'Stimulate Recovery'.

As Sinéad Pentony wrote in her paper:

"We need to change the direction we are going in because we are in a hole and we need to stop digging. There needs to be a realisation that resolving the jobs crisis will have to be a central element of any successful strategy to address our financial problems. There needs to be a targeted investment strategy focused on

generating employment in the short term, and addressing the serious economic and social deficits that are harming the economy's productive capacity in the medium and long term".

The papers gathered here are intended as a contribution to the growing debate on how we can achieve not merely a technical recovery, but a recovery based on sustainable job creation and sustained economic and social development.

Paula Clancy
Director
TASC

Open letter

Open letter from 28 economists, social scientists and economic analysts

8 MARCH 2010

The Government's economic strategy is failing. The Irish recession has been deeper and longer than almost any other in the industrialised world. Consumer spending has collapsed while at the same time unemployment and emigration have soared. Crucially, investment has plummeted off the chart. Not only have Government policies failed to stem this haemorrhage, they have actively contributed to this collapse.

The Government has pursued deflationary policies, in particular public expenditure cuts. The most damaging are cuts in transfers to low-income groups which, along with general tax increases on low and average pay in 2009, have reduced spending power in the economy at a time when it was most needed. Equally damaging have been the cuts in public investment at a time when private investment has plummeted. This has laid the foundations for a low-growth, high-debt future where unemployment will remain high and inequality endemic. All the wrong options have been pursued.

Budgetary policies have been short-termist and reactive. Instead of cutting real waste in the public sector by increasing productivity and efficiency, the Government has cut public services and the living standards of those who can least afford it, further reducing domestic demand and, thus, employment.

These policies are weakening the economy's ability to cope with growing debt levels. Without a strong recovery, tax revenues will fail to rise and future budgets will simply embed that deficit into the economy. This will depress economic activity even further. This explains why the Government's own forecasts for the deficit keep rising, not despite, but because of, its own deflationary measures. We are heading into a joyless, jobless recovery.

We require fundamentally different policies, a twin track strategy, which will maximise environmental and sustainable progress and restore employment while addressing the deficit. We urgently need measures to tackle five key areas which require fundamental reforms:

- our substantial physical infrastructure deficits;
- our poor social infrastructure – early childhood education is poorly developed, primary and community health care lag behind European norms, housing lists continue to lengthen, while Irish public transport remains inadequate and under-funded;
- our high levels of relative poverty and income inequality;
- our under-performing indigenous business sector - which needs appropriate support to contribute to our export base, R&D and innovation capacity; and
- our unsustainable reliance on carbon-heavy resources and activities.

It may seem astonishing that we face such economic and social deficits after fifteen years of boom but these are the consequences of pursuing a failed low-tax, low-spend model which sought short-term gains from the speculative activity of a small but powerful golden circle.

Only the modernisation of our economic and social base through a sustained investment programme and a transformation of our corporate governance practices can overcome past mistakes. This will need substantial back-up in the form of re-training and return to education to ensure people – whether managers or employees - have the skills to fully exploit the opportunities that investment in innovative enterprise generates. Educational investment, in particular, will be key to strengthening our export base. Driving competitiveness and productivity in the medium-term, while increasing employment in the short-term, is a win-win scenario.

We must mobilise all the resources available to accomplish this transformation. We still maintain a relatively low-debt status in the Euro zone, buttressed by the vast accumulated borrowings in our Exchequer cash balances (over €20 billion). We can employ the strength of our combined public enterprises – their off-balance sheet borrowing and investment capacity – to invest in our infrastructure and create new indigenous enterprises, both public and private.

We can further employ new funding vehicles – enterprise development bonds (e.g. Green Bonds), municipal bonds and the new National Solidarity

Bonds - which can leverage our current high savings ratio and international investment. All this becomes even more necessary given the potential capacity of NAMA to pile up considerable debt; at the same time there is little evidence of credit being freed up for investment purposes. The resources and labour to finance this modernisation drive are there. We just need the political vision and will to make it happen.

Addressing the deficit needs a long-term vision of what kind of taxation system we want. In the short-term we need to target the least deflationary sources of revenue so as not to weaken our recovery prospects. A comprehensive property tax – encompassing both housing and financial assets – should be introduced starting with high income groups and eventually extended to all incomes. Reform of regressive tax expenditures (i.e. tax breaks that disproportionately benefit high income groups), shown by TASC to be in the billions of euro, should be urgently undertaken to increase the income tax take. Extension of environmental taxes and incentives should be accelerated. An additional tax band at the higher level is needed.

In the medium term, we should explore the potential of social insurance and local taxation to broaden the tax base while providing real benefits in return. PRSI can be expanded to incorporate a comprehensive free healthcare system (in particular, primary care) as well as earnings-related pensions. Stronger local taxation powers have the potential to be more accountable while providing investment in services responsive to local needs.

On the expenditure side, it is time to make public sector workers partners in the process to increase productivity and efficiencies. As other countries have shown, employee-driven innovation (in both public and private sectors) has the capacity to reduce costs and increase output – much more so than crude, top-down employment and wage-slashing measures. We can afford neither wasteful policies nor wasteful practices. But elevating the ethos of public service and personal responsibility will require harnessing the collective resources of employees through an open and honest engagement by all stakeholders - one that is not afraid to find and, then, repair fault.

What is absolutely crucial is that these twin approaches – investing in sustainable growth and full employment while addressing the deficit – complement each other. This will require a level of fiscal management we have as yet not experienced. But it is do-able. Embedding investment, rather than debt, into the economy while restructuring taxation and expenditure in a progressive and expansionary manner to ensure a job-rich recovery – this, and not the current deflationary strategy, is the road to success.

Signed

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Paper 1

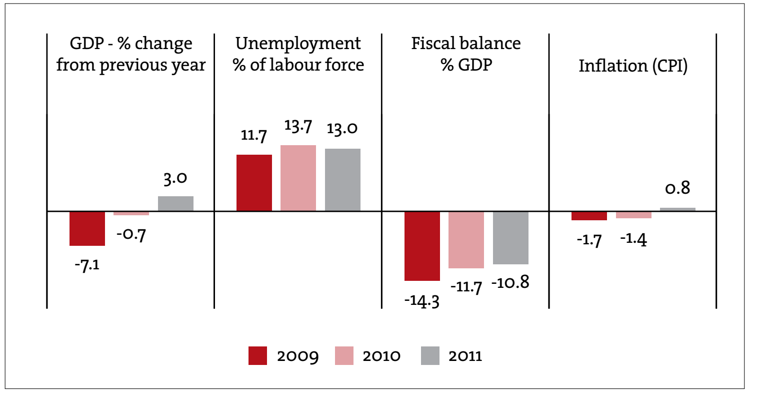
A Genuine Economic Recovery – The Case for Fiscal Stimulus

MICHAEL BURKE

BEHIND THE RECOVERY STORY

The Central Bank has recently added its voice to the more optimistic projections on the economy for the second half of this year. Below are the recent OECD projections for Ireland. On the face of it, all 2011 indicators are pointing in a positive direction - GDP up, unemployment down and the fiscal deficit narrowing.[1]

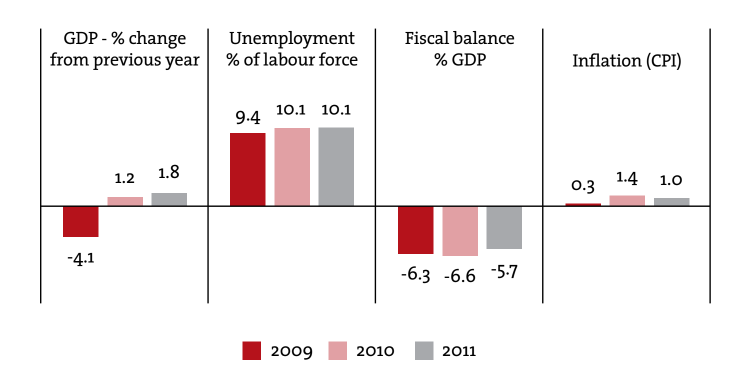
Chart 1. OECD Projections – Ireland



In assessing the relative strength of the economy and the role of policy, it is important to note that the recovery in the Euro Area as a whole began in mid-2009, a full year before Governor Honohan's current forecast, and the recession also began here a year earlier. Therefore, this recession will have lasted precisely two years longer than in the Euro Area as a whole, even if current forecasts prove correct. Below are the OECD's comparable forecasts for the Euro Area (Chart 2).

1. http://www.oecd.org/document/9/0,3343,en_2649_34573_45269961_1_1_1_1,00.html

Chart 2. OECD Projections – Euro Area



2009 is the decisive year regarding policy divergence, with the overwhelming majority of the Euro Area economies then adopting fiscal stimulus while the FF-led government adopted fiscal contraction. The cumulative effects of that policy divergence are shown in the table below.

Table 1. Ireland vs. Euro Area, End 2008-2011 (based on OECD projections)

	IRELAND	EURO AREA
Cumulative change in real GDP, %	-5.0	-1.2
Cumulative change in nominal GDP, %	-10.1	+1.1
Rise to peak in unemployment, %	+7.7	+2.6
Cumulative addition to fiscal deficits, % GDP	+36.8	+18.6
Cumulative change in price level (GDP deflator), %	-5.4	+2.3

Source: Calculated from OECD projections

There is, too, an important difference in the components of growth. While domestic demand rises in the Euro Area, the OECD's projection for Irish domestic demand sees a further contraction over the next two years, so that GDP growth is entirely dependent on net exports. Based on these OECD

forecasts, it is possible to calculate that nominal GNP will contract by a further 5.5 per cent in 2010 and rise by just 0.8 per cent in 2011- to leave it 22.5 per cent below its peak in 2007. This is an *Irish Depression.*

The impact of changes to the price level is an important factor in both growth and the deficit. In Ireland's data, the decline in real GDP is masked by outright deflation. Therefore, while inflation modestly reduces the cumulative rise in Euro Area deficits, here the debt burden piles up because of deflation. If all private incomes, both household and corporate, fall via deflation, so too government income (taxes) will be deflated. Yet the nominal debt burden for all sectors will be unchanged, thereby increasing the real debt burden for all.

DEBT & DEFICITS

The tax regime policy in this state is almost exclusively aimed at domestic activity, not export activity. At the same time, bond markets are dependent above all on the continuity of cash flows. Therefore a continued decline in the government cash flows, predominantly the taxes derived from GNP will only serve to increase the debt burden and tend to undermine its sustainability. Whereas the cumulative addition to the fiscal deficits is 36.8 per cent of GDP using OECD projections to 2008-2011, the cumulative addition to the deficits rises to 49.1 per cent of GNP.

There are a number of risk factors associated with this path of government finances. These include, but are not confined to:

- Nominal interest rates on government debt exceed the growth rate of taxation revenues;
- The volume of government debt interest payments plus government spending exceeds taxation revenues plus borrowing capacity;
- The growth rate of government debt (deficits) exceeds the prospective growth rate of taxation revenues.

In the course of the Depression here, all of these factors have appeared at one time or another. It is only NTMA's recent bond issuance which has prevented all three factors occurring simultaneously.

However, the focus of policy has been on just one of those variables: government spending. That has been with disastrous results. It begins with the double-bookkeeping assumption that cuts in government spending equal savings. There is no recognition of the fact that government spending is a component of GDP and a portion of investment. Policymaking works from the assumption that spending can be cut without depressing activity and the tax revenues which flow from it. Likewise, it is assumed that cutting welfare payment levels will produce savings - even as the numbers entitled to welfare payments rise.

The table below demonstrates that this proposition - that cuts equal savings - is false. It shows the relationship between economic growth and the key variables of government finances as reported in the Exchequer Statements. Although these are not comprehensive, they highlight the key relationships.

Table 2. Fiscal Variables 2008-2009

	€BN
Decline in tax revenues (a)	14.3
Increase in Govt. spending (b)	3.2
Govt. tax increases (c)	5.9
Govt. spending cuts (d)	4.6
Total (= a+b+c+d)	28
per cent of nominal GDP decline (€26.3bn)	106 per cent
per cent of nominal GNP decline (€29.8bn)	94 per cent

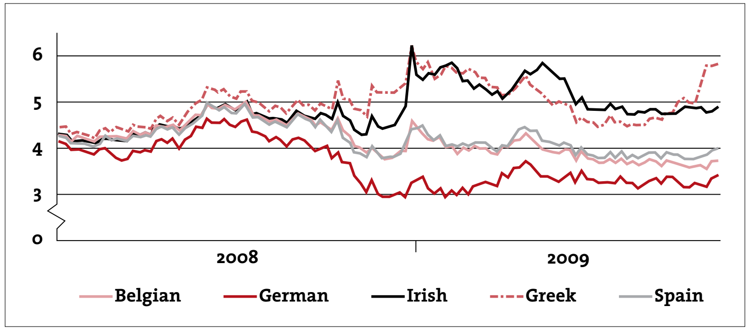
Source: calculated from DoF, CSO data

In the period 2008 to 2009, government finances deteriorated by €17.5bn overwhelmingly through lower tax receipts. At the same time, Government spending cuts and tax increases amounted to €10.5bn. If fiscal tightening amounted to savings, then the deterioration in the deficit would otherwise have amounted to €28bn. But then we arrive at the ludicrous situation where a deterioration of €28bn exceeds the total decline in GDP of €26.3bn, which is literally incredible.

Instead, €10.5bn amounts to 32.25 per cent of the decline in GNP, and is therefore likely to account for the same proportion of the deterioration in government finances, equivalent to €6.2bn. However, we have already seen that the damage done to government finances will persist long after the recovery is officially declared. So, too, will the fiscal damage resulting from the policy of fiscal tightening, thus negating any 'savings' whatsoever.

Unsurprisingly, and contrary to widespread claims, none of this has reassured financial markets. At the end of May 2010, Ireland's benchmark ten-year government bond yield was 4.9 per cent. In early 2008 this yield was just 4.3 per cent. At the same time, the cumulative decline in the price level has been 5.4 per cent with the result that real ten-year yields have risen by 6 per cent. To refer to one of the earlier metrics of unsustainable debt, the nominal ten-year yield has been above the growth rate of taxation revenues continuously since 2007. Ireland's yields are among the highest in the Euro Area, below only Greece and Portugal, ahead of Spain, Italy and the rest.

Chart 3. Selected Euro Area Government 10-Year Yields



Irish yields started 2008 as part of the core group, just above the German benchmark. They began to diverge in July 2008 as tax revenues weakened. The austerity measures of October 2008 and early 2009 were greeted by a surge in yields, helped on the by the size of the bank bailout and its blanket terms. In mid-February, 2009 Irish yields surged past Greek yields under the impact of austerity measures in March and stayed above Greece until its own crisis in November last year. They remain above all the other crisis-hit countries except Greece.

(For Spain, Italy and Portugal this recent crisis is not directly related to their deficits or debt levels. There has been no sudden deterioration of either in 2010, compared to 2008 and 2009. In a forthcoming paper, it will be shown that the 2010 crisis is a crisis of European banks, reflected in their rising inter-bank borrowing costs and falling share prices, and that their €750bn bailout is transfer of capital to them from European taxpayers, the poor and public sector workers. This is a multinational and multilateral version of NAMA).

CASE AGAINST STIMULUS

Greece, Spain, Portugal and Italy have all had austerity measures forced on them. The *Wall Street Journal* recently commended the Dublin government for showing the way, writing a riches-to-rags story for the Euro Area periphery in their role as boosters for neo-liberalism. However, this is not the remedy that the Euro Area 'core' has adopted, nor the US, China or Japan. They have all adopted fiscal stimulus packages, with varying degree of success dependent on the scope and content of the measures. In contrast, the policy of the Dublin government is fostering deflation and is clearly not reducing the deficit to manageable levels. Ireland has the highest deficit in the Euro Area. Without taking account of the negative impact of the latest austerity measures, the OECD forecast for 2011 is a deficit here equal to 10.8 per cent of GDP, nearly double the Euro Area deficit of 5.7 per cent. It is also considerably higher than the 2008 deficit of 7.3 per cent of GDP, which policy was supposed to reduce.

The most authoritative recent work on the effects of fiscal stimulus brings together seven different econometric models from the Fed (2), OECD, IMF, European Commission, ECB and Bank of Canada, (*The Effects of Fiscal Stimulus in Structural Models*, IMF WP/10/73). The main conclusion was that "the multipliers from government investment and government consumption [general government spending]... are clearly larger than..." all types of tax cuts and only " ....targeted transfers [to the poor] come close to having the same multipliers as government spending" (p.16). The researchers found that the fiscal multiplier from government investment was a cumulative 3:1 over two years.

Yet the case for fiscal stimulus remains a controversial one across Ireland, for whatever reason. The list of objections includes (but is not exhausted by) the following: we are a Small Open Economy, there will be 'leakage' in the form of increased import demand, there are no shovel-ready projects, fiscal multipliers do not exist/are very low in Ireland, and so on.

There is not space here to examine each of these claims in detail. But there is a practical critique of them which can be summarised in the following acronym: NDP.

Insofar as any of the claims has some merit, their net effects are rebutted by all evaluations of the impact of the National Development Plans. These have tended to focus both on infrastructure projects and education, increasing the effectiveness of both, to which we could add health care investment. All the objections to fiscal stimulus cited above must have been in force when the NDPs were implemented, if at all. Yet all evaluations of the NDP show that the multipliers are extremely large. The same is true for the multipliers attached to EU Community Structural Funds. Below is a compilation of some of the research on the NDPs, CSFs and others, all of it specifically relating to investment in this economy.

Table 3. Irish Evaluations/Assessments of Multipliers Attached to Government Investment

SOURCE	MULTIPLIER	TIME HORIZON
ESRI, Ex-Ante Evaluation of the Investment Priorities of the NDP, 2007-2013	1: 2.4 a	14 years
Fitzgerald & Morgenroth, Mid-Term Evaluation of NDP, 2003	1: 2.4 b	15 years
Lane & Benetrix, ESRI, Vol. 40.4, Autumn 2009	1: 2.2 c	6 years
ESRI, WP 287, April 2009	1: 2 d	7 years
Bradley, Morgenroth, Untiedt, Macro-Regional Evaluation of the Structural Funds Using the HERMIN modelling framework, 2003	1: 2.8 e	16 years

a. Average annual multiplier over 14 years. Based on assumptions of capacity constraints, notably in the labour market. Supply-side effects increasing once more after 14 years

b. Average annual.

c. Cumulative from a one-off permanent increase in government investment. Rises to 1: 4 if the one-off increase is later reversed.

d. Cumulative multiplier from one-off change in investment. Does not include long-term supply-side effects, which might be expected to double the multiplier to 1: 4

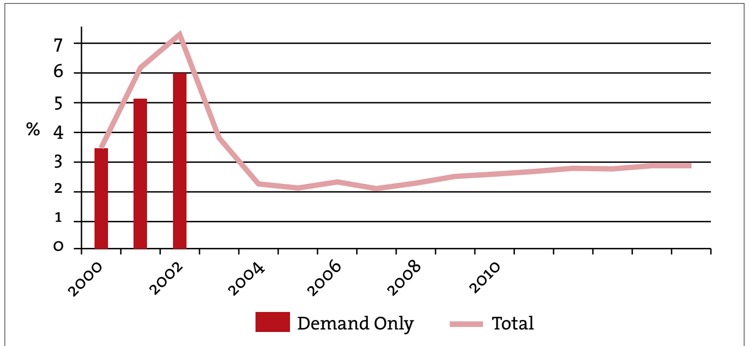
e. Average multiplier over 16 years.

The average multiplier in these estimates is just under 1: 2.4. In addition, the Mid-Term Evaluation places the average annual return on investment at between 14 and 18 per cent, depending on the composition of the investment. These returns are net of any effects arising from being a SOE, leakage, etc.

On the issue of import leakage, the multipliers associated with this economy are higher than for Greece, Spain, Portugal and the north of Ireland. The authors of the HERMIN analysis suggest this may be associated with the degree of openness. The lowest multipliers arise in Greece and NI, the two most closed economies examined, whereas this economy is the most open in Europe. Participation in the international division of labour is a key factor determining productivity and growth. Logically, the higher degree of participation would tend to increase the effects of all investment, and therefore tend to raise the level of the multipliers. Multiplier effects rise with openness, rather than declining as is frequently assumed.

To reiterate, all these evaluations are of the actual effects of state investment, including the NDP and CSFs. The characteristic effects are shown in the chart below, from the Mid-Term Evaluation of the NDP.

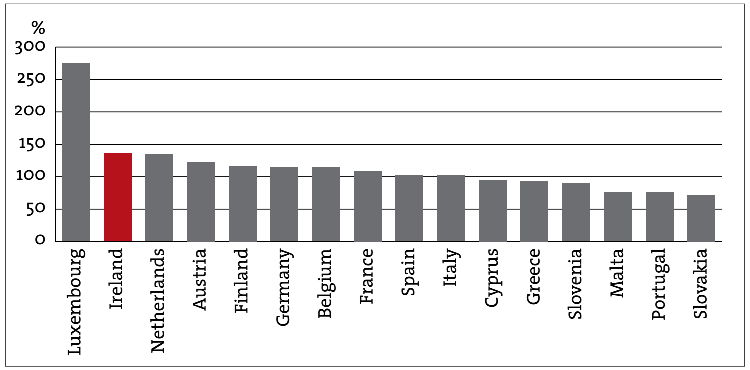
Chart 4. Total Effect of the NDP (per cent) on GNP



FUNDING INVESTMENT

Chart 5 below, is from the CSO's recently published *National Accounts and Value Added* data. It shows the relationship between Intermediate Consumption and final output, measured by GDP.

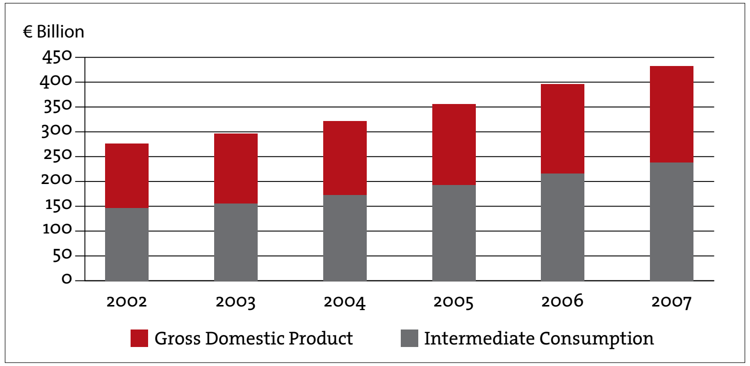
Chart 5. Euro Area (Euro-16): GDP (PPP Basis) 2008 (Euro Area = 100)



Source: Eurostat

The final argument against stimulus is that, while it might be fine in principle, it is simply unaffordable -'we're broke'. In Chart 6 below, taken from the Central Bank's latest report, Ireland's relative poverty is put into some perspective.

Chart 6. Components of Output (at market prices), 2002-2007



Published by the Central Statistics Office, Ireland.

In any modern advanced economy, this intermediate production usually exceeds final production by some way. In 2007 in this economy GDP amounted to €192bn, while intermediate consumption amounted to €240bn. This underlines the process by which fiscal multipliers work. A final output determined by government investment, say, construction of a new hospital, will require inputs, mainly from the private sector. These inputs will in turn require other inputs, and so on.

This is especially true of public sector investment since it automatically generates intermediate consumption in the private sector for most types of investment. The same process does not work in reverse - the public sector is not always obliged to increase its activity because of increased investment by the private sector. However, it may do so by virtue of increased taxation revenues arising from that investment activity.

But here is a key aspect of the problem. Taxes are too low in this jurisdiction. The table below reproduces the Resources and Uses table in the recent CSO National Accounts already cited.

Table 4. Resources and Uses in the National Accounts

		€ MILLION	
		2006	2007
	Resources		
P.1	Output		
P.11	Market output	328,897	359,414
P.12	Output for own final use	12,340	13,260
P.13	Other non-market ouput	32,840	36,319
P.1	Total Output	374,076	408,992
D.21	Taxes on products	23,388	23,997
-D.31	less subsidies on products	-1,052	-1,029
	Total resources (output at market prices)	396,412	431,960
	Uses		
P.2	Intermediate consumption	216,384	239,895
B.1*g	Gross Domestic Product	180,028	192,065
	Total Uses	396,412	431,960

Note: In this table Gross Domestic Product is given at market prices.

Taxes on products (less subsidies) as a proportion of GDP were just 12 per cent in 2007. Over the course of 2007, total output rose by 9 per cent and GDP rose by 6.7 per cent, yet taxes were barely changed. There are enormous flows in this economy which are not touched by taxation. A 1 per cent increase in the taxation on total output would have yielded €4.3bn in 2007, although that would be somewhat less in 2010.

The structure of the tax system is not simply unjust - it is damaging growth. In 2009, income taxes and VAT accounted for €22.5bn - more than two-thirds of total tax revenues. Yet wages and salaries account for just over half of net national income. By contrast, profits and rents account for 45 per cent of national income, yet together with the huge multinational sector they directly contribute just 15 per cent of total taxation revenues.

Rebalancing the tax system would both provide some of the necessary funds for government investment and stimulate the economy, given the higher propensity to consume of the poor compared to the rentier and the rich. Indeed, TASC's *Failed Design* (2010) is replete with examples of tax-raising measures that would not depress demand.

Total government revenues here have averaged 36.1 per cent of GDP in the period 1992-2009, whereas the average for the Euro Area is 45.3 per cent (source: European Commission). Finance Minister Lenihan has argued that the 12.5 per cent corporate tax rate *"is our international brand"*. The equity in this brand is limited; the next lowest rate in the OECD is Iceland's 15 per cent. The OECD weighted average corporate tax rate is over 35 per cent, with Germany at 30 per cent, France at 34 per cent and the US and Japan both over 39 per cent. An increase in the corporate tax rate to just 20 per cent would yield an additional €3.1bn at 2009's Depression-level of activity, with a return towards 2007 levels of output yielding an additional €5.1bn.

Applying just this additional source of revenue to government investment would yield a boost to growth equivalent to between €7.4bn and €12.2bn based on the average multiplier of 1:2.4 previously identified in Table 3. These are equivalent to between 4.5 per cent and 7.5 per cent of 2009 GDP and 5.6 per cent and 9.3 per cent of GNP respectively.

This rebound in activity would impact positively on government finances. Previously the DoF had assumed that the elasticity of taxation was 1:1.1, that is a 1 per cent decline in activity would lead to a 1.1 per cent decline in taxation revenues. We have previously seen in Table 2 that a €29.8bn decline in GNP led to an actual €14.3bn decline in tax revenues plus a €3.2bn increase in government spending (despite both tax increases and spending cuts). Assuming the same tax elasticity, a €7.4bn/€12.2bn increase in activity would lead to an improvement in government finances of between €4.3bn and €7.2bn. These new funds could either be used for additional investment, or to pay down the deficit, or some combination of the two.

In addition, there are stocks of assets in the NPRF and NTMA - both over-borrowing and holdings of foreign debt securities - which could be used in a temporary measure to provide a one-off boost to government investment. Finally, with bond investors fixated on cash flows, there is no borrowing restraint whatsoever on any investments which yielded between 14 per cent and 18 per cent, as estimated in the *Mid-Term Evaluation of the NDP*. Indeed, any business which repeatedly refused an approximate 16 per return when it can borrow at 5 per cent would soon go out of business, or more likely would sweep aside its current management.

Furthermore, a revival of investment is precisely what is required to overcome the recession. The Depression is entirely accounted for by the collapse in private sector investment. In real terms, gross fixed capital formation has fallen by over €20bn, whereas the aggregate decline in GDP is less than €19bn.

The reflationists, like the US, China, Japan, Germany, France and others, now have ten-year yields between 1 and 3 per cent below Irish yields. That there is no borrowing constraint on governments engaged in stimulus measures is demonstrated in the table below.

Table 5. Impact of Fiscal Policy on Borrowing Costs

STIMULUS (PER CENT)			CONTRACTION (PER CENT)		
	2-Yr Yields	10-Yr Yields		2-Yr Yields	10-Yr Yields
Belgium	0.98	3.49	Greece	8.35	8.30
France	0.55	3.00	Ireland	3.55	5.13
Germany	0.48	2.57	Italy	2.26	4.24
Japan	0.15	1.27	Portugal	3.28	5.29
Netherlands	0.47	2.90	Spain	2.82	4.59
US	0.72	3.20	-		

Source: data from Financial Times, Benchmark Government Bonds, June 4

CONCLUSION

The current policy is not working. Even if there is a statistical recovery in H2 2010, it will not generate either increased jobs or additional taxes. As a result, the fiscal position will remain a growth-sapping one, with potentially disastrous consequences. Fiscal stimulus works here, as the NDP and CSFs show. Their effectiveness demonstrates the mechanism for creating jobs, raising tax revenues and reducing the deficit. It is fiscal contraction that is unaffordable.

The private sector investment collapse is responsible for the crisis. Only government investment is capable of leading a genuine recovery.

APPENDIX

WHICH INVESTMENTS?

The areas for investment should be derived from an analysis both of their effectiveness and their desirability. There is no scope here to explore these issues, but the table below provides an excellent summary of certain aspects of these for specific types of investment and could be a productive starting-point for any investment decisions.

The table is taken from the ESRI evaluation of the NDP cited above (p.28). While this was compiled in 2003, and priorities change over time, the basic starting-point is a constructive one. Health care investment has the highest average score on these assessments, followed by housing, and then jointly by childcare and regional development.

Table 6 Classification of Investments

	PUBLIC GOOD	CORRECTIVE	TARGETED	REDISTRIBUTION	AVERAGE SCORE
	%	%	%	%	
Public Physical Infrastructure					
Transport (incl. Ports, Harbours, Airports)	80	20			0.59
Environmental Infrastructure	50	50			0.50
Housing	10			90	0.76
Sport & Arts	30	30	30	10	0.53
Human Resources					
Education	90	10			0.65
Training	10		70	20	0.58
R&D	30	10	60		0.47
Productive Sector					
Energy	20	70	10		0.50
Telecomunications	20	80			0.40
Agriculture, Forestry, Fishing	10	40	40	10	0.26
Tourism	40		60		0.24
Enterprise/Industry	10	10	80		0.43
Equality/Social Inclusion			50	50	0.62
Health	100				0.00
Childcare				100	0.70
Regional Urban and Rural Development	10		80	10	0.70

Source: Fitz Gerald et al. (2003)

Paper 2

Contribution to FEPS/TASC Seminar on Stimulating Recovery

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CROKE PARK JUNE 10TH 2010

> *"Following the European Economic Recovery Plan, endorsed by the European Council in December 2008, most Euro area Governments implemented significant fiscal stimulus measures."*

Source: ECB 2010

Thank you for the invitation to be here this morning. It is a privilege which I greatly appreciate. The issue that I would like to address this morning is this:

'Should Ireland give priority to promoting recovery as an integral part of its adjustment strategy aimed at returning to fiscal sustainability over the medium-term? More specifically, is such an approach feasible in terms of where the economy is now situated, and should the emphasis continue to be on deflating demand in order to accommodate to the EU 2014 deadline or should the emphasis be on rebuilding and developing the supply-side and promoting competitiveness?'

Let me first say this. A Government attempting to navigate the rapids of a recession unprecedented in modern Ireland – one hemmed in by uncertainty and volatility in the financial markets overcast by a possible sovereign debt crisis – will seek to take its people with it. It does not want the markets spooked by dissonant voices.

In addition, and to be fair, the Government has - at least for the present - put some distance between Ireland and the larger debt-ridden peripheral countries in the capital markets. It will want to put the past behind it and to 'let the dead bury their dead'. It will want individuals, domestic businesses and families – and representative bodies who speak on their behalf – to accept an adjustment process unprecedented in its severity compressed into the lead-up to 2014. Quietly.

It will want all stakeholders to accept its assumptions and policies – the expenditure cuts and the recapitalisations – all of which the Government deems to be necessary to mitigate recent policy mistakes and excesses which have occurred on their watch. They do not want to hear 'fog horns of negativity'.

THE CASE FOR PROMOTING ECONOMIC RECOVERY

All of this is understandable. But it is profoundly misconceived. What is needed now is an evidence-based consensus on how to promote recovery – one that is aligned with The Common Good and which resonates with the common sense of the great majority of people and businesses in the country who are experiencing severe pain. I believe this can be done - we have shown the capacity to do so before. In an op-ed for 'The Wall Street Journal' last year, I argued that:

'The resilience of the Irish economy and its capacity to leverage its very considerable natural advantages are well proven. It has the youngest population in Europe and is currently enjoying the largest growth in its birth rate since the 1850s. Its entrepreneurs are of the grow-quick and export-early school and have a proven pedigree, not least in the United States. Its location and its comparative advantages in natural renewable energy underpin a competitiveness that has been considerably enhanced by a significant fall in labour and utility costs. The Irish economy has the capacity to get back on its feet. To encourage the belief that a dependence on Europe is the key to healing its self-inflicted wounds is to make a serious economic miscalculation—and to sell its people short.'[1]

It is not happening within the present policy regime, and the urgency of a fundamental shift in policy could hardly be overstated. We may yet be overtaken by events in the eurozone and here at home. Within the eurozone there is a clear and present tension between, on the one hand, a hard Euro/strong adjustment regime involving a de facto fiscal union and, on the other hand, countries – the structure of whose economies – are quite different and which will be unable to live within such a regime. The structural problems confronting Portugal and Spain – problems that create significant difficulties for their creditor banks and for the sovereign debt markets – point to a crisis for the euro that cannot long be avoided.[2]

1. Ray Kinsella "Vote 'No' to Reinvigorate Europe: The EU deserves better than Lisbon" Wall Street Journal (Op. Ed.) October 2009.
2. This first appeared in the Irish Times, 'Recovery? We are still in deep, deep trouble' July 5th 2010, pg 18.

It is important that the policy trajectory on which the Government is intent is informed by what is happening to the supply-side of the economy. And what is happening is that capacity utilisation is low, many thousands of gifted individuals who want to work are being denied the opportunity, there is a significant growth in long-term unemployment (33 per cent of total unemployment compared with 22 per cent a year ago) and the rebuilding of the domestic economy, which is the ultimate and final determinate of adjustment, is being stymied.

RECOVERY: WHAT THE UN/EMPLOYMENT DATA SHOW

In this regard, it is important to stress that the single most important indicator of how an economy is performing relates to employment trends and numbers. In Ireland, the continued decline in employment and the catastrophic rise in unemployment reflect the sharpest fall in economic output since national income records began. The most recent data (for the final Quarter of 2009) show that over the twelve months, while the labour force declined by almost 70,000, there was a fall in employment – those in work – of 167, 000. The number of unemployed rose by close on 100,000.

The most disturbing feature is the rise in long-term unemployment. In 2009, more than half of the annual increase in unemployment was in long-term unemployment, which now amount to in excess of 90,000. At the end of 2009, the long-term unemployed accounted for fully one-third of total unemployment – a very significant increase of ten percentage points compared with a year earlier. A second feature relates to the fact that employment fell not just in construction, but in nine of the 14 main economic sectors. In industry for example, the numbers employed fell by almost 30,000, or 11 per cent.

To understand the significance of these developments for the economy – and for communities up and down the country – we have to take note of the fact that the decline in employment is, far and away, greater than for the average for all of the rest of Europe. Just to take one example, Ireland's employment level fell by some ten per cent in 2009, compared with a fall of just 2.3 per cent for the EU 27 Countries.

Turning to 2010, the numbers on the Live Register rose by 6,600 to just short of 400,040 in May. The loss of every single job means that an individual, or a family, is deprived of the opportunity to contribute their gifts to the community. It leaves individuals and families vulnerable to a sometimes catastrophic fall in living standards, and to an inability to maintain their homes and fulfill their responsibilities.

Unemployment, for those who have experienced it, involves an existential pain that is neither transferrable, nor capable of mitigation by social-welfare transfers or by 'schemes', important as these may be. Multiply the tragedy of one person unemployed by 100,000 and it conveys something of the cancer that is infecting our economy and our society. Little wonder that Pope John Paul II spoke of the 'scourge of unemployment'.

The greatest single threat to Ireland's economy and to social solidarity is the traumatic increase in Long-Term Unemployment: the percentage of total unemployment accounted for by Long-Term Unemployment has risen from 22 per cent to 33 per cent over the last year. In terms of its impact and implication, nothing comes close. This alone constitutes the most compelling case for a change in strategy and policy, including the prioritizing of recovery. Equally, a fall in the numbers employed means the closure of individual companies, which once gone cannot be reconstituted, and the loss of that company's capacity to support - through taxation and PRSI - the public services on which social solidarity depends.

We really should have been addressing vital issues such as these two years ago. Denmark, to take one example, incorporated a discretionary fiscal stimulus equivalent to 1 per cent of GDP as part of its stabilization and recovery program. A number of us argued against bleeding demand from an economy that was already operating on empty when the succession of emergency budgets was being introduced in 2008/2009. The case was not listened to.

What was needed was, firstly, the shrinking of an overextended state which had become bloated on the transfers from a credit-fuelled and increasing indebted private sector. Secondly, avoiding an excessive and counterproductive fiscal retrenchment just at the time when domestic demand was imploding and, thirdly, a well-structured stimulus package – including a Loan Guarantee Scheme to mitigate the effect of increased 'risk

premium' in the credit market and an increase in targeted investment in areas such as healthcare where there is a demonstrable economic as well as social return to capacity enhancement within a transformed health service.

Importantly – and indeed its importance could hardly be overstated - we also needed an appropriate timescale within which to return to fiscal balance, primarily by restructuring and growing the economy. It didn't happen, we missed out. Still, we have to begin from where we are.

My evaluation this morning is informed by a number of considerations:

- The final Research Paper which I wrote before leaving the Central Bank had to do with the mechanics of adjustment within an environment within which Ireland's debt/GDP ratio was in excess of 130 per cent. Ireland grew its way out of that crisis, assisted by a combination of fortuitous external events and robust policy making. That was when the IFSC was conceived and developed. This kind of vision and leadership is not there this time round.
- Since the first 'adjustment budget' was published by the Government in 2008, a policy of ferocious fiscal consolidation has been adopted. It was misconceived. It **ignored** the spontaneous adjustment that was occurring within the domestic economy: voluntary reductions in salary of upwards of 20 per cent, shorter working weeks, greater flexibility. All this was happening. Instead of going with the grain of this autonomous adjustment and supporting and facilitating this process, the Government chose both to ignore it and to squeeze demand out of an economy that was essentially running on empty, given that Government consumption, international trade and foreign direct investment have all shuddered to a halt.
- It is difficult to be convinced by recent forecasts of a 'resumption of growth' or of 'recovery' in the second part of this year and into 2011.[3] It does not necessarily signal a sustainable growth in the output of goods and services together with the kind of employment creation that is normally the feature of a recovery. Nor is it clear where the impetus for a sustained recovery which would make any kind of impression on unemployment – and in particular long-term unemployment – is

3. The case for this was made in the Irish Times, 'Recovery? We are still in deep, deep trouble' July 5th 2010, pg 18.

coming from. In a recent comment on the Irish economy, the Financial Times noted 'as Governments around Europe contemplate austerity measures, Ireland offers a not terribly encouraging example of how difficult it is, and how long it takes, to overcome a massive debt binge'.[4] What we are looking at here – and I will return to the point – is brute arithmetic rather than a stable and sustainable expansion in output. This is important: it colours and shapes our perceptions of the robustness, or otherwise, of policy.

HOW THE EU EXCESS DEFICIT PROCEDURE IS UNDERMINING RECOVERY

The current budgetary strategy is based on the adjustment program agreed with the EU Commission. Ireland has the second largest deficit next to Greece. This envisages a reduction in our current budget deficit from 13 per cent of GDP this year, to 3 per cent by 2014 (entailing a reduction equivalent to 8 percentage points of GDP between now and 2014). Not only will this not happen, but basing a budgetary strategy on such an **impossibly short timescale** will break the back of the domestic economy and cause wide-spread and wholly unnecessary social stress. Moreover, this is impacting upon an economy that, since 2007, has shrunk faster, and by a larger amount, than at any time since national records began. There is no objective basis for this. Nor is there any logic to the timeline. Nor can we sensibly talk about 'promoting recovery' or the role of a 'stimulus package' in this kind of *cul de sac*.

A further point is this. There will be a General Election in Ireland no later than 2012 – or before. Within the wider European Union there is a fault-line opening up between, on the one hand, Germany and France and, on the other hand, the UK and other countries who through conviction or because of structural weaknesses in their economy, are unable or unwilling to embrace the 'hard Euro'. In the wake of the EcoFin/Safety Net initiative last month, it seems clear that the EU has moved decisively towards budgetary harmonisation. There is a whole new institutional structure now taking shape, including a role for the IMF as an integral part of EU budgetary oversight/funding and adjustment. That is a change. We are talking about *de facto* political union within the 'inner zone 'of a twin-track EU.

4. The Financial Times, Lex Column, July 21st 2010, pg 14.

The point is that either or both of these developments will fundamentally change the context of fiscal consolidation and recovery in Ireland.

THE ROLE OF THE STIMULUS PACKAGE

The role of a stimulus package in mitigating a contraction of domestic demand and, more generally, as part of a broader adjustment strategy in the face of external 'shocks', is contentious. It is one domain in which economic theory – and specifically Keynesian economics – shapes policy perspectives. The Obama stimulus package was predicated on estimates of a multiplier of 1.6 per cent by his team. However, the values attached to the key parameters have been vigorously challenged. Estimating the size of the investment multiplier is fraught with difficulties – certainly in the case of an economy like Ireland.

Quite apart from the robustness or otherwise of the economic forecasts, the size of the multiplier effect will, in principle, depend on a number of factors:

- Whether, or not, the 'additional' Government discretionary spending/stimulus 'crowds-out' the private sector.
- The structure of the package and, in particular, whether it is funded by tax cuts or increases in Government spending in targeted areas.
- Leakages from the system which would mitigate the impact of any multiplier effect.
- Whether or not the stimulus necessitates additional borrowing and might, thereby, increase the costs of such borrowing. There is the associated issue of the costs of future tax increases which might negate any temporary increase in output and employment.

RECOVERY AND THE BANKS

The impact of Ireland's misconceived budgetary strategy which is aligned not to the productive capacity of the economy, but rather to *a wholly artificial time-line imposed by the EU Commission* has been *reinforced by the response of the credit institutions.* The epicenter of Ireland's economic crisis – and the resultant societal catharsis – is a banking system driven by a Business model which became completely detached both from the 'core' principles of the profession and the industry and with little or no regard for the impact on the society which they exist to serve. And, it should also be said, to their own staff and to those working within an industry which will inevitably have to contract significantly in the short-to-medium term.[5] At the same time, let us be balanced in any criticism, and forward looking in our perspectives. It makes no sense to criticise banks for lending without due regard to risk pricing, repayment capacity and large exposures during the epoch of 'The Great Excess' – and then criticise newly converted risk-averse financial institutions for not lending in the current environment.

Part of this problem could have been resolved through a **Loan Guarantee Scheme**, which would have allowed the banks to maintain appropriate limits on lending while, at the same time, reducing the 'Risk Premium' on targeted lending to businesses with a robust track record which are now suffering from a sharp withdrawal of facilities. Such a Loan Guarantee Scheme should be part of any 'proposed' stimulus. But it doesn't go deep enough.

THE NEGATIVE MULTIPLIER EFFECT OF CREDIT CONTRACTION

We need to consider the contraction in credit availability – which has reinforced the unnecessarily contractive budgetary policy – within a multiplier-type framework.

Consider, for the sake of argument, an unprecedentedly sharp contraction in domestic demand – with all components facing south. Consider further the fact that, in such circumstances, taxation receipts fall sharply while, at the same time, expenditure is stickier and there are escalating social welfare expenditures. This would give rise to a rapidly increasing budgetary deficit – leading to increases in sovereign borrowing and in the stock of debt. In such a scenario, the real economy would be characterised by both a sharp contraction in capacity utilisation and, also, by unmet investment needs with a positive net-present value.

Finally, let us consider that the Government has the capacity to borrow, and that this borrowing can be channeled to *either*:

- The resuscitation of credit institutions whose catastrophic failures are at the heart of the 'shock' or

5. See, for example, 'Core Banking Principles' BIS, 2006 and the Honohan Report, 2010. The ethical and organisational flaws embedded within the business model are set-out in Ray Kinsella 'Rebuilding Trust in Banking: Regulation, Corporate Governance and Ethics in Banking' 2009, Veritas (www.veritas.com)

- Mitigating the effects of falling demand and employment through selected investment in maintaining existing companies and in investing in the capacity needed to transform the productive base of the real economy over a realistic timeframe - by 2020.

If we look at the first option, channeling the borrowed resources to financial institutions leads to massive 'leakages'. Maintaining such banks will result, to a significant degree, in rebuilding their balance sheet while simultaneously facilitating a contraction in the availability of credit for businesses – leaving such businesses to effectively 'cannibalise' each other through excessive reliance on their creditors. What is in effect happening is that future tax payers are funding the rescue of banks, which then proceed to rebuild their institutions in the interests of shareholders and management – The Common Good simply doesn't feature.

Channeling the same quantum of borrowed funds to the private sector helps maintain jobs in companies that are already displaying a high degree of resilience and flexibility. It strengthens confidence and thereby reduces perceived risk and, in this way, almost certainly reduces the 'hurdle-rate' for investment. Targeted stimulus-type discretionary funding helps keep businesses at the cusp of failure in existence and trading. It mitigates the pressures on social transfers and thereby on the public finances and, by extension, on borrowing. It facilitates the working of the market mechanism and underpins desperately-needed entrepreneurship. Moreover, this positive-sum-gain is reinforced by the benefits of negative inflation, falling unit labour costs and increased labour market flexibility at the level of the individual business.

The point is this: the Government has given overriding priority to resuscitating, and restoring to health, the 'covered' financial institutions. To that end, it has, with the endorsement of the EU Commission, provided 'Deposit Guarantee Schemes' covering all of the liabilities of the Credit Institution Schemes. It has *nationalised* and *recapitalized*, and from the toxic balance-sheets of institutions exorcised loans that were made which were wholly contrary to the 'core principles' set out by the Basel Committee in banking in 2006.

It is not simply a matter of the enormity of the resources that the Government has borrowed to inject into the credit institutions; such borrowing was made possible only by swingeing reductions in domestic demand impacting on businesses and on capacity – and on lives, relationships and public services.

More than that, there is no – so far as I can see – limit to the amount of capital that the state is prepared to invest in resuscitating the banking system. A capital injection of some €10 billion may now subsequently cost upwards of €25 billion. At the level of our financial system, and particularly in light of the recent Report by the Governor of the Central Bank, Professor Patrick Honohan, the following question has to be asked. At what stage do we stop providing open-ended support, with money we don't have, to support a 'business model' in banks which has brought the economy to its knees? More specifically, there is now, I believe, the most compelling case for closing Anglo Irish Bank and accepting the consequences. It is no justification to argue that the cost of closing would be greater than those of continuing to keep it open: that simply howls at common sense. Nor is there any argument based on the distinctive attributes of Anglo Irish Bank in terms of the core competences of the bank. The economy has moved on to a very different place. There will be job losses – and it is certainly the case that the employees of Anglo deserved better than what has overtaken them. The banking industry, as already noted, will be shedding significant numbers of jobs as the economy itself contracts.

The larger question is how can such a 'policy' – we will not use the word 'strategy' – of open-ended unconditional support for the banks be subject to any kind of rigorous cost-benefit analysis? How can it be that a policy which is wholly open-ended in its support for institutions whose excesses have created the problem is being used to drive an adjustment process geared towards achieving the unjustified (convergence with the Stability and Growth Pact criteria) within a timeframe (namely by 2014) whose rationale has simply never been spelled out? This is not 'anti-bank': the covered institutions grew up with the Irish economy and played no small part in its development. The banks employ tens of thousands of professional and highly ethical individuals[6], many of whose savings have been all but wiped out. It's the mind-set and the 'Business Model' that are at issue.

At what stage do we ask why we are continuing savage cuts in health expenditure, which are destroying the whole fabric of the delivery of

6. This point was highlighted by the former regulator, Dr. Liam O'Reilly, in 2004

healthcare, in order to pour yet more money into institutions that have demonstrably failed to align their operation with The Common Good and the national interest? The priorities on which current policies are based will not deliver recovery. At what stage do we say that it is more important to support businesses and families, thereby lessening the pressure on the public finances and borrowing, than it is to provide unprecedented large borrowed resources to institutions whose essential purpose should be to serve the economy and the community?

Ireland needs to invest in the restructuring of our economy to assure the capacity to build export-driven companies that are equipped to prosper in a global economy which has shifted decisively away from the old world.

This will not be accomplished by 2014. It will take at least a decade – but knowing that we are at least going in the right direction rather than digging a deeper hole for ourselves will help rebuild confidence and trust and faith – without which there can be no recovery.

We need to do whatever it takes to help those companies which are at present just hanging on, with little or no assistance from banks whose corporate mind-set can only see risk written large in red letters, rather than supporting enterprise and hard work and employment. This may require a Loan Guarantee Scheme whereby the Government would subsidise the excessively high interest rates and onerous credit terms which are presently crippling business.

WHY WE NEED TO THINK DIFFERENTLY ABOUT BANKS

What emerges from all of the budgetary pain, all of the misconceived policies and all of the sacrifices is this:

Banks are utilities. If they were simply shareholder-driven PLCs, such support could not possibly be justified on economic or social grounds. But, they are utilities essential to the function of monetised economies. We need to think of them that way. But, if they are utilities, then their reference-point should be The Common Good. This is not happening. We need a new model of banking, and we lack the courage to even try and imagine what form this might take. More regulation, much as some of it is needed, will not resolve this problem. We need to go beyond regulation.

No serious consideration has been given to this issue. The resuscitation and restoration to profitability of a business model has been underwritten without any serious attempt to redirect their focus towards a perspective informed by social utility.

We need to ask the question: suppose a year ago TASC made an evidence-based pre-budget proposal that discretionary spending funded by borrowing of €10 billion be invested in maintaining existing business, in culturing new generations of businesses, in putting in place a three year Loan Guarantee-scheme, in rebuilding a new export capability within domestic firms specifically oriented towards the emerging economies. There is little doubt but that this would have been dismissed out of hand. It would have been argued that such discretionary spending could not be justified economically, that it would entail additional borrowings which would have to be funded by additional taxes into the future. And yet, the money has been found and channeled into Anglo Irish Bank.

To the now very well informed Irish public, this makes absolutely no sense. The application of a multiplier-type analysis only serves to reinforce the point that in a stand-off between, on the one hand, the prevailing economic orthodoxy in Ireland at this time and, on the other hand, common sense, common sense wins every time.

More generally, at what point do we re-evaluate policy? At what point do we ask whether spending an additional €1 billion – or €1 – on supporting brittle credit institutions is justified, when diverting these same resources to the real economy would have a demonstrably higher multiplier effect and would deliver an outcome that was less regressive and socially divisive?

We need to seriously address whether or not there is an alternative to the present banking model. It passes belief that in all the welter of analysis, no one has asked 'Is there a different model of banking which could lead rather than impede recovery, and whose commercial ethos could leverage the expertise of their staff to meet the needs of the country at this point in our history and the history of Europe?'

'GROWTH' AND 'RECOVERY' IN IRELAND AND THE EU

Recent forecasts envisage a return to 'growth' in the second half of 2010 and into 2011. They come with significant caveats relating to uneven recovery and considerable uncertainties. They should also come with a 'health warning'. At one level, such forecasts are certainly not sufficiently robust to defend the current and prospective budgetary 'adjustment' strategy.

But at quite another level, there are major uncertainties overhanging the prospects for turning around an economy that while benefitting from a stronger infrastructure, is trapped in a policy hiatus – driven by a malign orthodoxy which has imposed damaging and counterproductive 'cuts' as a substitute for the kind of supply-side and capacity building strategy that is needed. At the same time, the global recovery on which Ireland is so dependent is being driven largely by the emerging economies of China, India, Russia and Brazil - to which we have little exposure.

Within the eurozone, Germany is structurally a net exporter with little scope or disposition to engage in economic stimulus in order to promote recovery in economies such as Ireland. The UK, our largest and closest trading partner, is itself embarked on a long and protracted painful adjustment process.

There is little external 'horse power' available to pull Ireland out of the recession within which it is mired. The domestic economy is increasingly emaciated. A suffocating bureaucracy and a state that is semi-detached from the sharp-edge of risk-taking entrepreneurialism is no place to bring up a business - despite the best efforts of the Agencies. It is precisely in these circumstances that a targeted stimulus package to support domestic demand makes sense.

Over and above that, recovery in the EU is fraught with uncertainty. There is no clear exit strategy from the massive interventions that have occurred in the last two years. There is little prospect of a return to the normalisation of macro-economic policy – which leaves the EU highly vulnerable in the event of a second 'shock' arising from a sovereign debt crisis and the fall-out from such an event. There is now a massive overhang of contingent liabilities and, at the same time, the inevitability of a progressive rise in official interest rates.

LOOMING INSTABILITY WITHIN THE EU

Finally, there is a fault-line opening up across the EU triggered by a fundamental divergence of view about the stability of a Union encompassing structurally different economies and lacking the policy infrastructure to hold the Union together. Policy in the EU in the face of adjustment crisis is ad hoc and reactive: the EU is being stress-tested to an extent that was hardly conceivable at Maastricht. A forward-looking adjustment strategy for transforming the Irish economy must take into account the possibility of an implosion in the eurozone and across the wider EU.

In these circumstances, the overriding priority should be facilitating the adjustment that is already happening within the domestic economy and especially in the labour market and, crucially, shifting the balance of fiscal support from the banking sector to the real economy.

The orthodoxy within which the Government is trapped is the belief that deviation from what is an artificial timeframe for fiscal consolidation will be interpreted negatively by the financial markets and punished by an increase in borrowing rates. There is a different way of looking at this. What the markets are focused on is whether or not Governments achieve the targets set by the EU Commission. They have not questioned the targets themselves or the unnecessary shortness of the time-frame.

When it becomes apparent that Governments across Europe will be unable to meet the 2014 deadline, and that the efforts to do so have caused great damage to the long-term capacity to recover, it is almost inevitable that there will be another convulsion of confidence. Ireland will then be in the worst of all possible places. We will have given priority to the restoration of banks whose priorities are driven by their own agenda and not by The General Good - and the assumption that they necessarily coincide is demonstrably flawed- and who are operating in a punitively risk-averse manner in a low-trust and fragile economy and against the backdrop of a 'recovery' in Europe that is subverted by uncertainty about the future direction of the Union and the Euro.

In the absence of a radical shift in policy, Ireland will have wasted the opportunity to mitigate the contraction in the domestic economy and to rebuild an export-focused economy underpinned by an improvement in competitiveness, productivity and flexibility – an economy that is not polarised by the effects of regressive and counter-productive budgets aimed at placating capital markets who are themselves fixated on an artificial adjustment process.

Britain, partly fortuitously, is in a better position. It has a wider range of policy instruments and can choose the timescale over which to make the necessary adjustments to achieve fiscal sustainability. And, if one looks at the data, the capital markets are more impressed by the UK position than they are by economies now really beginning to really struggle with looming default problems within an over-stretched eurozone.

To date, the Government has put the resuscitation of the banking system first, followed by the consolidation of the public finances and then followed, at some considerable distance, by support for domestic companies and for families impacted by the crisis. Vital public services too, such as health where there is an unarguable economic, let alone social, case for investment, have been sacrificed to a regressive and counterproductive orthodoxy.[7]

This is the wrong way round. We need to put businesses and families first. This, in turn, will mitigate the negative impacts on the public finances which, in turn, will create a less risky environment within which, hopefully, a new generation of banks can function as they are intended to, namely to serve the interests of society and the economy upon which it is dependent.

A NEW POLITICS

Political philosophy matters, be it Communism or Corporate Capitalism – both of them malign and demeaning of the human person. Political philosophies shape public policies and mind-sets, often without the wider population necessarily being aware of it. This is all the more true within a society in which power is increasingly centralised.

More generally, it is not possible to build the new economy that Ireland is capable of creating on the basis of 'old adversarial politics' and an economic orthodoxy that has failed and is continuing to fail. The important point is this: the epicentre of the present financial/economic crisis is an ethical crisis.

7. It is nothing other than the truth that, in Ireland today, families are hungry and many, many individuals are fearful and apprehensive. It was the great and iconic John Kenneth Galbraith (economist, author and US Ambassador) who said that the true test of leadership is address the great anxieties of the day.

Unless, and until, Ireland develops a mature and forward-looking politics based on objective values and The Common Good, there will be no sustainable growth in the economy: maintaining the jobs that are there, and developing the tens of thousands of new jobs that our entrepreneurs are capable of delivering to mitigate the risk of institutionalising long-term unemployment.

What this means is a 'politics' that is not fixed on utilitarianism – which is shared alike by communism and by corporate capitalism, and by a consumerist materialist agenda based on which the talents of our people cannot be developed, and which cannot provide any answers to the questions in communities up and down the country where long-term unemployment is becoming institutionalised. 'Why is this happening? I have commitment, talents and education, why is there no work?'

A sustainable recovery involves, above all:

- Maintaining and generating new jobs.
- Ensuring credit flows to companies from institutions that were the epicentre of our crisis. This is not about 'blame'; rather, it's about understanding that the mind-set and the model of the prevailing banking system simply has to change if we are to learn the lesson that banks are utilities that are there to serve the community, and not to be resuscitated at the cost of deep cuts in our social fabric, including our ability to transform the economy. There is much to be learned – if we had the humility to do so – from the principles of Islamic banking. The establishment of a Loan Guarantee Scheme at an earlier stage would have done a great deal to maintain credit to companies that are categorized as 'high risk' but in practice are perfectly sound companies that need support to come through enormous difficulties that are not of their making.
- A systematic reduction in the enormous burden of bureaucracy that is suffocating entrepreneurialism and the day-to-day challenges facing businesses that are in effect carrying the economy on their shoulders. Much of this burden has no utility whatsoever – it is simply not necessary. It has no rationale beyond the activity itself and it is killing businesses. It is the product of a mindset within parts of the public sector that is unresponsive to the imperative of facilitating enterprise creation and maintaining jobs. Some time ago the Netherlands appointed an Office under the jurisdiction of the Prime Minister and with very clear guidelines aimed at reducing this burden: there is a model there to emulate.[8]
- There is an enormous amount that can – and indeed much that is already being – done at the level of local communities supported by micro-finance. This is important in itself and it is even more important when it is seen in the context of maintaining supporting communities around the country, maintaining positivity and drawing out the gifts and capabilities particularly of those who are unemployed and/or who have solid ideas for enterprise creation. In recent decades an unhealthy dependence upon the State – one that was encouraged – has developed and this is a fallacy that Ireland can ill afford in its present circumstances.
- Ireland is at a critical point in its history. To recover from the current crisis, we need to embrace a values-based programme of economic transformation, based on our natural resources, the capabilities of our people (and the willingness to invest at this time in these capabilities) and the values that will create a sustainable future for all. Ireland needs a coalition of those with no faith and those who share a theistic faith in order to push for a values-based programme of economic transformation.

CONCLUSION

Transformation is possible; the ideas and the capability are there. The current orthodoxy in Ireland and Europe, based on adherence to an impossibly short time period for reducing borrowing and indebtedness levels spawned by the near implosion of Europe's banking system and as its economy, is enormously damaging.

Perhaps most of all, we need the courage to focus on what is possible rather than be paralysed by the uncertainties that can so easily hem in our economy and our capacity to transform our economy at this stage.

Ireland needs as never before a new form of leadership and the courage to implement policies that can rebuild our economy. It needs them now. It needs them to address the enormous wastage of lives and talents; it needs

8. See Pat Farrell, Director General of the Irish Bankers' Federation (IBF)

them to help rebuild lives and communities decimated by unemployment and the prospect of unemployment. It needs them to bring the best out of our people and to empower them to participate in a recovery and the creation of a values-based Ireland rather than forcing them to turn their back on a country with such promise.

It needs to do all this now because the economy is caught in a cul-de-sac and because any further delay will leave Ireland even more vulnerable to the stresses and strains which are convulsing the European Union. We owe it to ourselves and to the European Union to demonstrate that the transformation to a values-based Europe is something of which we are capable.

There are specific measures which can act as catalysts for a wider recovery in the economy, but this cannot be done within a timescale limited to 2014. Ireland needs to make this point on its own behalf and within the interests of stability within the wider EU. There is a clear and present threat of instability within the eurozone and this needs to be debated.

But we need to focus on that which is in our own control, namely the domestic economy. The current budgetary strategy is misconceived and counter-productive and regressive. We need to tilt discretionary support away from an open-ended commitment to business models within the banking sector that have demonstrably failed and towards supporting existing and prospective new domestic companies.

Paper 3

Stimulating Recovery

SINÉAD PENTONY

I am going to speak for a few minutes about the current economic context. And in doing so, I will draw on work completed by TASC in recent months, which informs our analysis of the current context. I am also going to focus particularly on the jobs crisis and the need for investment

TASC'S PRINCIPLE OBJECTIVE

TASC's principle objective is to bring about greater economic equality in Ireland. When we talk about economic equality, we are talking about the need for a fairer distribution of society's resources, as part of a well-regulated social market economy. The imperative of economic equality underpins our analysis of what is happening in the economy. The conservative economic narrative is devoid of any reference to equality, and this was one of the key factors that informed our decision to host this event. We will not achieve a job-rich and inclusive recovery if we fail to address inequalities within the economy.

Today's event is also timely given that preparations for Budget 2011 are well underway at this stage, while information on key economic indicators released last week has generated debate on our economic performance, which is clearly demonstrating the impact of Government economic policy.

All policy options now need to be put on the table and debated publicly. Today's seminar is intended as a contribution to that process.

TURNING THE CORNER

In recent months, talk about the economy has been dominated by the rhetoric of 'turning the corner' and a 'return to economic growth'. But let us consider what many commentators mean by 'turning the corner'. They primarily mean that Ireland will technically exit recession by experiencing positive 'economic growth' for two consecutive quarters. I emphasise the word 'technical' because most people won't notice the difference – and the international evidence regarding historical collapses of this scale indicates we are likely to experience 'jobless growth' for some time to come. Many people will continue struggling with unemployment, or with the fear of unemployment – and many will continue struggling to keep their homes. Businesses will struggle to remain viable, and public services will continue to be stretched, trying to deliver more with less.

KEY QUESTIONS

While we are likely to technically exit recession at some point during 2010, there are a number of key questions that need to be answered:

- What is driving this recovery?
- What type of recovery are we going to have? And
- Who is going to benefit from this recovery...and who will be left behind?

MIXED NEWS ON THE ECONOMY

To shed some light on these issues we must examine what is happening in the economy. Firstly, with increased competitiveness and a weaker euro, net exports are up. Ireland is currently running a record trade surplus, although this is primarily a function of reduced demand leading to a 28% drop in imports. This is the main factor driving us towards a 'technical' recovery. Consumer confidence appears to have bottomed out, and the May tax figures show a slowdown in the rate of decline in retail purchases. Nonetheless, the May tax figures still remain 10% below last year's levels. In the context of the latest unemployment figures, that is hardly surprising.

Let's not forget: tax flows from economic activity, not from cutting the economy further

WHO WILL BENEFIT?

So at best, the signs are telling us that we are heading for a 'weak' technical recovery driven by export growth. It is unlikely that an improvement in the net export figures will be sufficient for a sustained recovery - certainly, it cannot by itself come close to delivering the hundreds of thousands of jobs that we now need. Ernst & Young, in their most recent economic forecast, identify the danger of a two-tier economy, with the export sector driving growth while the domestic economy lags behind. The sectors of the

economy most devastated are construction and retail. These sectors will not share in this export led growth. Preventing these (often unskilled) workers from falling into long term unemployment will require targeted strategies involving job creation as well as retraining and upskilling.

Also, as many other countries go down the road of imposing austerity measures, the level of aggregate demand internationally will decline. Needless to say, this will have a negative knock-on effect on any prospects for an already 'weak' recovery that is largely dependent on export growth. This recession has highlighted our vulnerability as a small open economy to the ups and downs of the global economy, and clearly demonstrates the need for a more diversified economy, with a stronger indigenous sector and a reduced dependency on the financial sector. Yet without access to credit, the domestic economy will continue to lag behind.

THE WORSENING SITUATION

The latest CSO figures released just last week indicate that the unemployment crisis is continuing to worsen – the unemployment rate now stands at 13.7%. This gives us the second highest unemployment rate in the Eurozone, and the third highest in the OECD. I alluded to last week's exchequer figures earlier. Tax revenues continue to fall, reflecting the impact of the Government's deflationary economic policy. A strategy focused single-mindedly on addressing the deficit at the expense of everything else – such as a coherent jobs strategy – risks strangling any nascent recovery.

Cutting public spending during a severe recession can have a perverse impact on the public finances, because much of what the Government saves by spending less; it loses, as a weaker economy depresses tax receipts. Both Michael and Ray talked about this in more detail. Larry Summers, the Director of President Obama's National Economic Council, recently stated that 'it is impossible to sensibly address either unemployment or long-run fiscal challenges in isolation'. This statement highlights the inter-relationship between unemployment and the deficit – and the fact that the deficit cannot be addressed in the absence of dealing with the unemployment crisis.

SO WHAT CAN WE DO?

Back in March, TASC co-ordinated an Open Letter from 28 economists and social scientists to the Government. The initial purpose of this letter was to generate debate. The letter argued that the Government's economic strategy is failing, and it warned that the current strategy of combining public spending cuts with tax increases on low and average income earners would lead to stagnation or at best a jobless recovery. Three months on from the publication of this letter, and our warnings are being borne out.

We need a sea change in current policy because we are in a hole and we need to stop digging. Specifically, there needs to be a targeted investment strategy focused on generating employment in the short term, and addressing the serious economic and social deficits that are harming the economy's productive capacity in the medium and long term. Investment coupled with a restructuring of taxation and expenditure in a progressive and expansionary manner to ensure a job-rich recovery – this, and not the current deflationary strategy, is the road to recovery and inclusive growth.

If we valued jobs as much as economic growth, we would measure the success of our economic policy by the employment rate (and of course the quality of those jobs), rather than crudely measuring national success as a function of increasing 'economic growth'. Full employment and quality of life should be the central goals of economic policy – not side-effects. There needs to be a realisation that resolving the jobs crisis will have to be a central element of any successful strategy to address Ireland's financial problems.

INVESTMENT

Investment in physical infrastructure and human capital is an investment in the future - and it creates jobs. A recent report from Davy Stockbrokers catalogues "pitiful" levels of investment by the private sector and states that, as a result of a "glut of investment in the wrong places", Ireland's technological capacity has "not advanced much over the last decade". The report also found that most of the increase in "core" productive capital stock was related to the State or semi-State sectors. Our infrastructure – think broadband – puts us at a distinct disadvantage when it comes to exploiting future economic opportunities.

The current environment is characterised by tight credit and by fragile confidence. This has implications for future levels of private investment. Consequently, the only realistic source of large scale investment in the economy is the state itself. A feasible short term solution to the jobs crisis would be a temporary increase in capital expenditure. Obviously, such an increase in investment must be carefully targeted at projects that are job-intensive and that will provide long-term economic and social benefits. All approved projects should, of course, pass a cost benefit analysis and such projects must have long term positive impacts on the country's productive capacity. Examples of these types of project include (but are not limited to):

- Improving the physical infrastructure in the areas of public transport, education and health;
- Developing a world class high-speed broadband network;
- Developing our green energy infrastructure – especially in areas such as wind and wave energy where Ireland has a competitive advantage;
- Regenerating deprived areas e.g., in Limerick or in parts of Dublin – in many cases, such regeneration projects had reached an advanced planning stage before being shelved and, of course, they are highly labour intensive.

We must invest in our capacity to recover and to re-invent ourselves. Otherwise we will be left behind. Recently, Craig Barrett from Intel specifically rejected the notion that Ireland could strengthen its competitiveness on the basis of cutting costs, emphasising instead the need to expand investment in the development of high-tech activities and in enhancing educational provision in science and maths. To quote him directly "…to be competitive, we need to be smart and innovative, not cheap". So, if we are going to have a job-rich and sustainable recovery, we need to look at the bigger picture.

THE BIGGER ISSUES

The big picture requires us to consider the question of what direction Ireland should take in order to secure a job-rich sustainable economic future. What's missing is a new vision for the economy that is:

- characterised by knowledge and by life-long learning;
- resource-efficient and environmentally sustainable;

- inclusive in the sense of fostering high-employment; and
- focused on the re-distribution of income and wealth generated by economic activity.

Policies to sustain demand and foster job creation should be a key priority of economic policy. Structural reforms of supply-side policies are essential to move towards smart, green and inclusive growth. There needs to be a holistic review of taxation policy – can we continue to afford to forego billions of lost revenue through tax breaks? The focus should move to sources of sustainable tax revenue – this means taxing wealth as well as taxing income. Moving towards a more diversified economy will also reduce Ireland's exposure to sectoral shocks.

FUNDING RECOVERY

Calls for investment are met with well worn responses of "the money isn't there" or "we can't afford to borrow". In the TASC Open Letter, we outlined a number of options that could be pursued. Examples included utilising the borrowing capacity of our public enterprises to invest in our infrastructure; using our cash balances and introducing solidarity and municipal bonds. The main point being that we have options and the current situation requires us to be as creative in finding the resources to invest in our capacity to recover as we have been in finding the resources to bail out financial institutions.

CONCLUSION – WHAT NEEDS TO BE DONE AND HOW IT CAN BE DONE

To conclude, I would like to re-iterate a number of points:

The rhetoric of 'turning the corner' will at best materialise into a weak 'technical' recovery that will be characterised by jobless growth. The benefits of this recovery will be felt mainly by the export sector, such as the large multinationals. The domestic economy (in particular SMEs) will continue to struggle. High levels of unemployment will be a key feature of the economy, the cost of which will place extreme pressure on the public finances. Few will benefit from this type of recovery and many will be left behind.

We need to change the direction we are going in because we are in a hole and we need to stop digging. There needs to be a realisation that resolving the jobs crisis will have to be a central element of any successful strategy

to address our financial problems. There needs to be a targeted investment strategy focused on generating employment in the short term, and addressing the serious economic and social deficits that are harming the economy's productive capacity in the medium and long term. We need investment coupled with a restructuring of taxation and expenditure in a progressive and expansionary manner to ensure a job-rich recovery. And we need to be creative about how we finance investment.

Finally – I said it earlier, but it bears repeating: revenue flows from economic activity, not from cutting the economy further.

In June 2010, FEPS (the Foundation for European Progressive Studies) and TASC co-hosted a roundtable event to bring together experts and other key stakeholders to discuss the role of an investment strategy in stimulating economic recovery and generating a sustainable job-rich growth. Ireland is out of step with all other Euro zone countries in its pursuit of deflationary economic policies from the outset of the recession. The aim of the event was to raise awareness and generate public debate on current economic policy, and on the role of alternative strategies in responding to the economic and fiscal crisis. This pamphlet gathers together the papers presented on that occasion.

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