

## **Austerity is Not Working**

**Congress meeting with IMF/ECB/EU**

**Dublin, April 11, 2011**

From poster child of economic success to collapse, Ireland's rise and fall has been spectacular. Yet in spite of the economic crash, Ireland's basic economy is performing surprisingly well<sup>1</sup>. Ireland's problem was not its level of public spending, but the collapse of its six private banks, which brought down the public finances. In the words of one commentator, "Ireland's fiscal calamity is not a cause of its crisis, but a consequence. The big failure was the behaviour of private lenders and borrowers."<sup>2</sup>

Congress has argued that Ireland is suffering from a five part crisis: economic, social, fiscal, banking and reputational. The previous Government focused only on the banking and fiscal elements - doing little or nothing about unemployment. In attempting to resolve the fiscal crisis, it passed four extremely harsh budgets which will take €20.6bn<sup>3</sup> out of the economy by end 2011.

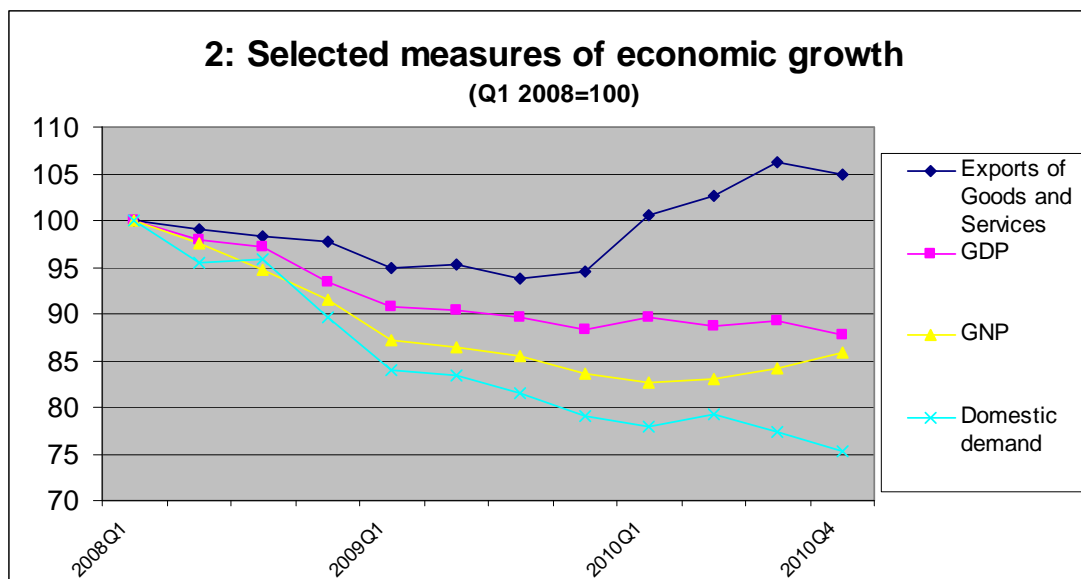
This is imparting such a deflationary shock that domestic demand has collapsed, with businesses going into liquidation and thousands of jobs being lost, as the graph below shows. Domestic demand, the lower line, had plummeted by a massive 25% between early 2008 and end 2010. And national income - whether measured by GNP or GDP - fell very substantially in the same period.

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<sup>1</sup> Excluding construction which had become bloated, but may have even shrunk below its natural level on its collapse.

<sup>2</sup> Martin Wolf, FT, 23 February, 2011.

<sup>3</sup> Equivalent to over 16% of GNP in 2010 or 2011.



Source: Irish Times from CSO data.

### Analysis of the Irish Crash and the Failed Recovery Programme

The economic Crash of 2008 was caused by deregulation, especially of banking; by 'tax shifting' from the late 1990s (cutting direct taxes on income and profits and relying on taxes from consumption, much of which was construction-boom related); tax-cutting during a massive boom (increased taxes then would have helped deflate the bubble) and massive tax subsidies to business, especially property. Congress consistently opposed all of these policies.

The two Budgets of 2010 and 2011 were introduced in the most difficult economic circumstances. In our view, both budgets were unnecessarily deflationary. Both were also pro-cyclical and made matters worse. We recognised the exceptionally difficult circumstances, but we differed very strongly with Government on the severity and the destructiveness of such huge cuts.

"We are now on the road to economic recovery," Mr Brian Lenihan, Minister for Finance said in the opening paragraph of his Budget 2010 speech (Dec. 9, 2009). He concluded by asserting that: "Our plan is working... we have turned the corner."

Nothing could have been further from the truth. For Budget 2011, initial leaks to the press were that cuts of as much as €3bn would be made. These were greeted with horror by many. However, this soon grew to €4bn and then to €6bn - 4.7% of GNP.

On the occasion of his next budget speech, Mr Lenihan was somewhat more subdued. He claimed that “there are clear signs of hope.” Yet he was introducing a highly deflationary Budget which would lay waste to domestic demand.

With the exception of exports, most economic indicators are **not** positive. Congress accepts a level of cuts and tax rises, but believes the previous Government erred far too much on the side of deflation and the new Coalition looks like it may make the same mistake.

### **Deflationary Spiral**

It is the view of Congress that the bailout package agreed with the IMF/EU/ECB - combined with the Government/EU/ECB approach to the banking crisis - makes the situation unmanageable. The deflationary impact of the measures in the bailout package is such that growth has no chance of reviving.

The one positive is exports (top line in graph). But exports alone are insufficient to drag the economy out of recession when domestic demand is being driven down. Without growth there will be no new jobs. Without new jobs the burden of austerity will overwhelm us.

Furthermore the interest rate on EU borrowing at 5.8 % is beyond what is sustainable. It is our view that because of the impact of the €6bn adjustment being imposed now, by the end of this year, most economic indicators will be worse than they are today.

To create more jobs we need growth and because the economy is so depressed, we need to substitute for the investment that would be happening if the situation was normal. We argued for the use of €2bn a year for three years from the National Pension Reserve Fund to invest imaginatively in training and upskilling and in infrastructure as well as other commercial projects, to save existing jobs and create new ones;

The last Government made insufficient and weak efforts to spread the burden of adjustment fairly, cutting social welfare, imposing higher taxes - especially on the low

paid, cutting the minimum wage by 12% when overall wages in the private sector remained stable in real terms, attacking the low wage pay determination systems of the labour market etc.

### **Ireland has an 'Enterprise Deficit'**

Congress has also argued that Ireland suffers an enterprise deficit. Many of our so called "enterprise leaders" have been exposed as charlatans and speculators. The boards of the six Irish banks are a veritable 'Who's Who' of the cream of Irish business leaders. Not alone did they destroy the whole banking system and destroy tens of billions in value, but they have also undermined the Irish state and laid waste to the Irish economy.

Thus any viable enterprise leadership must be cherished and we have some talent at least in our state owned companies. Ireland thus cannot afford to sell off these state companies and so dissipate this scarce talent. To do so in a 'fire sale' to fund failed banks would be doubly naïve.

There is a need to optimise the potential of our commercial state companies, which were the key to overcoming critical challenges in the past. They must be allowed to innovate and develop new businesses and projects. They must not be sold off or to be asset stripped by corporate vultures as Congress demonstrated in our Spring 2011 publication *Privatisation: Learning from the Eircom Debacle*.

<http://www.ictu.ie/publications/fulllist/learning-from-the-eircom-debacle/>

### **The Bank Bailout**

The interest rates charged by Europe are punitive. The Irish people are being punished for debts run up by private Irish banks. These debts were loans readily lent by European banks. Furthermore, since the disastrous bank guarantee of September 2008<sup>4</sup>, the ECB has willingly and knowingly lent money to Irish banks at 1% to repay all the bondholders in full, in most cases, and with interest. While it was providing

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<sup>4</sup> The government argues that if it guaranteed depositors (which it did up to €100,000) in law it could not distinguish from the bondholders or lenders to the banks. It could have changed the law or closed down the banks and moved the deposits to another facility or given all a haircut and repaid the depositors to the ceiling.

refinancing both for maturing bonds and for the depleting deposits, which prevented an immense and immediate crisis, its extension of credit was the saviour of the bondholders, many of which were European banks.

### **Solutions**

The solutions to Irish debt crisis, regrettably, must involve all of Europe. There is little or no moral hazard in assisting the Irish people for reckless behaviour by the Irish banks, which in turn were guaranteed by the previous government. It was not Irish citizens who ran up most of the debts. The bailout will rescue the Irish banks, but it also will save the bondholders which are German, French and other banks and thirdly and most importantly, it will prevent a sovereign default by Ireland, which could lead to instability in Europe and even the possible collapse of the Euro.

It seems that the crisis is dragging on interminably at a great cost to Europe. The continuing, prolonged crisis requires concerted actions by the member states and EU institutions to help those countries which, it seems, may have no choice but to default.

As the UK *Observer* editorial said of the IMF/EU/ECB MOU: “this deal is punitive, unjust and unsustainable... it is hard to avoid the conclusion that Irish interests are being sacrificed to the larger cause of saving the Euro.... The regime being imposed on Ireland is utterly unrealistic. A depressed and deeply indebted economy with just 1.8m at work cannot underwrite private banking liabilities of €200 billion.”<sup>5</sup>

The *Financial Times* was of a similar view: “Crucifying the Irish for the sins of their banks will not bring redemption, but more strains on sovereign debt. That is a greater threat to Europe’s banks than it applying capitalism to senior creditors. Ireland’s future depends on bigger forces than Dublin politics.”<sup>6</sup> Its main economic writer, Martin Wolf, has warned that the crisis “is beyond the ability of Ireland to manage without financial collapse and sovereign default.”<sup>7</sup>

Or as Joe Stiglitz and Michael Cragg wrote in the *Irish Times* on April 9: “A country with a debt to GDP ratio of 125% could easily have to pay 8% interest rates. This would mean that 10% of Ireland’s GDP would have to go forever to just service the

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<sup>5</sup> *Observer*, 27<sup>th</sup> February, 2011.

<sup>6</sup> *FT*, Editorial, 1 March 2011.

<sup>7</sup> *FT*, 23 February, 2011.

debt. This is a noose around the country's neck that will strangle it. It makes clear the IMF, ECB and Government must come to terms with imposing losses on the international lenders whose loose lending policies played a central role in the current crisis.”

But even the Irish may not be able to help save the Euro if we are forced into default, as uncertainty can spread very rapidly in fickle financial markets. Solidarity is the key. Congress is not claiming Irish victimhood, as we recognise the strength in the basic economy and the resilience of our people.

However, the combined problems of the socialised Irish private banking crisis and a severe deflationary programme mean that Ireland cannot resolve its deep economic crisis on its own on the existing terms on offer from the EU, from the ECB and the IMF.

The whole European project, which has been remarkably successful in so many ways in such a relatively short time, is under threat with this financial crisis. Together we can solve it, but only by working together.

### **Put solidarity at the heart of Recovery**

Ireland is in a deep crisis but it can and must put solidarity at the heart of its reforms. Congress has long argued that Ireland cannot achieve the 3% deficit target set under the MOU, but there is scope within the broad parameters of the programme for much more equitable policies. Such policies also work more effectively than deflationary cuts and regressive taxes. European institutions must play a major role, if the Euro is to survive by assisting Ireland in a real way on both interest rates and on the debts run up by private banks.

**Irish Congress of Trade Unions,  
April 2011**