Meeting with IMF/ECB/EU

Irish Congress of Trade Unions

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1. As Congress said in our last submission to you, it is likely that overall Ireland will again meet the onerous targets set under the Agreement with you, the Troika of the IMF/EU/ ECB for Q3, 2011. Again Congress reiterates that those on the other side of this Agreement, the institutions of the IMF/EU/ECB have failed to bring stability to international financial markets, to the Euro area, to European banks, to international confidence in Europe, all of which are required to both facilitate the return of Ireland to the financial markets and to eliminate the deep crisis in the Eurozone.

2. In our meeting with the Troika in 13th July 2011, we called on two of the three parties on the other side of this MOU Agreement - the EU and ECB - to address this crisis in a way which is credible. We stated then that the financial markets, in so far as they are an entity, do not believe that the EU Commission nor the ECB is in control, has the solutions, or is acting decisively or coherently in addressing the crisis. We are delivering; the EU and ECB are still failing.

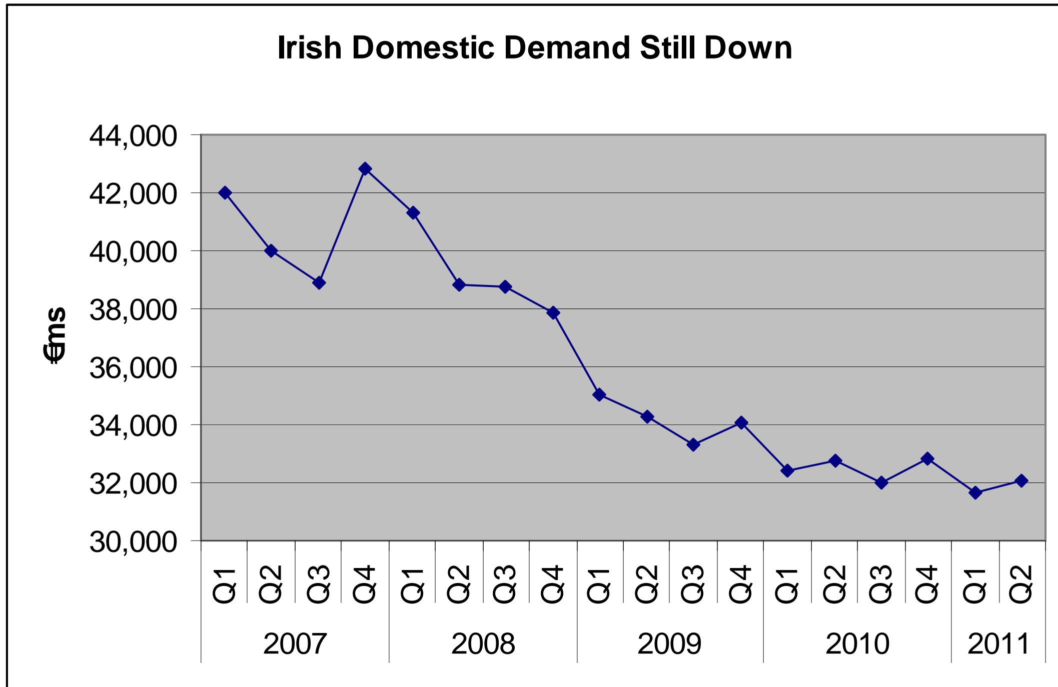
3. All commentators have recognised that the reason for the collapse in the Irish economy, necessitating this rescue by the Troika was poor corporate governance in the private sector. For example, the Lex column in the *Financial Times* on October 8, said: "Ireland's problem was not fiscal at the outset. It was the bank bail-out that pitched it into the abyss." There is a major focus on public sector reform which is necessitated by the fiscal deficit, but the core reason for the collapse is being ignored by reformers. This has been very bad practice in the Irish private sector. What is not being addressed is serious private sector reform. Congress is disappointed that the Troika ignored our emphasis on this crucial area in your reform negotiations on Ireland. It does appear that the reform programme is flawed when it ignores the key reason for the collapse of the Irish economy. We will return to private sector reform, to corporate governance of the private sector later.

Ireland Has Many Core Strengths

4. Congress would make the case that Ireland has many core strengths. It has a well educated workforce, but with such high unemployment skills are being lost and there is huge emigration. It one of the most open economies in the world; we export a high proportion of our GDP and these exports are high value added and seem to be recession-proof, and include a high proportion of service exports. We are running a balance of payments surplus. The programme of public sector reform is progressing well. In spite of the severely damaged reputation of Irish business, the World Bank listed Ireland as 9th best place to do business out of 183 countries. Taxes are extremely low on business and employers' social contributions are amongst the lowest in the world. Ireland has a barrage of state agencies devoted to assisting businesses. The rise in productivity was 12.5 percent last year and on the wider competitiveness criteria, Ireland performs very well, though there are issues with our international reputation for business, and also serious problems for domestic firms in access to credit and also due to the collapse in domestic demand. The official pro-business culture was so uncritical that it contributed in a major way to the economic collapse. That mindset needs to be addressed.

Austerity Is Not Working

5. Congress has argued that the bailout package agreed by the previous Government has made the economic recovery much more difficult. The deflationary impacts of the measures are such that growth has little chance of reviving. The most recent growth figures showed a rise in GDP which is not the best measure for Ireland, but even the rise in GNP of just over 1 percent disguised a decline of -2.2% in domestic demand.



Source: CSO National Income A/cs, Sept 2011.

6. The austerity programme imposed by the last Government, with the EU/ECB/IMF, has imparted a huge deflationary shock to the economy. This means that there is no growth in the real economy. The graph above shows how domestic demand has fallen so much and is still down. Without growth it is impossible to generate the primary surplus necessary to pay down debt.

7. Most conservatives have focused on the one positive economic development which is the performance of Irish exports. Exports have undoubtedly performed very well. However, exports alone are not sufficient to pull the economy out of recession when domestic demand is being driven down by domestic economic policies. Without growth there will be no new jobs. Without new jobs, generating incomes, taxation and confidence, the burden of austerity could overwhelm us.

8. Congress has argued consistently that the €6bn adjustment imposed in the last Budget will mean that by the end of this year, most economic indicators will be worse than they were a year earlier. Regrettably, this still appears to be the correct prognosis. Rises in volatile GDP are small comfort. Congress is taken aback at the recklessness of the new Fiscal Council which the Troika had proposed. It may of course have been part of a plan…. It is interesting that it

is industry and sectoral representative groups - employers and trade unions – who are in the real world of work in the economy that are urging caution on the level of adjustment. We may and do argue on its level and how it is to be achieved. However, it is the academics which are recklessly pursuing some idealised level of deficit reduction without care to the consequences.

9. The evidence that there is deep deflation in Ireland is very clear except to those who are ideologically committed to this programme. First, there has been 38 consecutive monthly falls in retail sales (annual change in value - excluding motors) since July 2008. Secondly, there has been soaring unemployment from a relatively stable 4.4 percent rate for many years to end 2007 to peak at 14.8 percent at end of last year. It is still over 14 percent now in spite of mass emigration, rapidly falling participation rates and restrictions on claimants signing-on. Thirdly, there is no real meaningful economic growth as we stated above. Fourthly, tax revenue has plummeted and is only stabilising because the taxes have been raised substantially – on a shrinking base.

Missing From MOU: Reform of Corporate Governance

10. In our previous submission in July, Congress stated that what is missing from the MOU was any reform of Corporate Governance of the rest of business, of Irish company law. The crisis was rooted in poor governance of Irish companies due to the narrow focus in Irish company law on maximising shareholder value/executive rewards.

11. The Reform programme is focusing only on governance areas like the professions and banking regulation which admittedly are important. However, Congress has urged the Government and the Troika that the whole issue of company law and overall governance, board membership etc. must be addressed, if we are not to repeat the crisis soon. While there is considerable progress being made on bank regulation here and in Europe, the core company law is not even on the Government or Troika agenda.

12. Corporate governance - the way organisations/firms are managed has been very poor in Ireland with a very small number of interlinked directors dominating the boards of the main companies. The Irish banks were badly run by herds of like-minded businessmen, who were not at all prudent. On the other side was the large financial regulator's office which also failed.

13. The Honahan report of November 2010 blamed :-

    a. the banks, borrowing externally and lending with abandon to anyone, especially in property.
    b. The directors and senior management of banks.
    c. It was also critical of leaving the top management in charge in the banks, after the taxpayer guarantee.
    d. Auditors and accountants (and it should have include the lawyers too)
    e. And also the Financial Regulator and the Central bank.
    f. The latter were the focus of its own report – eg "at no point throughout the period did the CBFSAI staff believe that any of the institutions were facing serious underlying difficulties, let alone potential insolvency problems – even at a late stage as the crisis neared." (P8).

14. However, no report has yet been commissioned of what went wrong in the boardrooms of the banks, the property companies and other firms which led to Ireland's Crash of 2008. This needs to be undertaken as part of the recovery, but more importantly, to prevent the next collapse. It was fine when private enterprise meant private enterprise. However, this new model Irish capitalism means that all reckless businesses can rely on the public sector to rescue them.

15. The Anglo-Saxon governance model is based almost exclusively on 'shareholder value'. To focus exclusively on 'shareholder value' leads to managements' interests dominating, especially where shareholders are diffused. It also leads to short-termism. But all in not lost. Things are changing and radically. However, in Ireland, we have hardly noticed.

16. Last year, the 'Father of Shareholder Value', Jack Welch, admitted that the whole basis of company law, based on shareholder value, was wrong. He said

17. Even with the existing narrow standards of Irish company governance, much of which is based on voluntary codes of practice, it is still poorly executed by companies. A Grant Thornton Governance review from last year, on the extent of compliance with the Combined Code by Irish Companies, found approximately 50 percent of Stock Exchange companies were non-compliant. It concluded that the voluntary approach to the Code has failed and that the only acceptable solution is to incorporate governance principles into legislation. The report pointed out that too many Irish companies are lacking in their standards of practice and adherence to the Combined Code or core principles of transparency and independence.

18. Add to this the numerous exemptions on disclosure of financial information in Ireland. Companies can avoid financial disclosure at will. They can opt for unlimited status for the holding company and avoid any disclosure or under lump all their operations in the EU into one ill informative set of accounts, thus avoiding informing their employees, creditors or suppliers or the public of how they are performing. There is not such concept as a 'public interest company'– one which is important to the public i.e. the main supermarkets who should publish their Irish accounts.

19. Congress would argue that if the major business which collapsed in Ireland in recent years - Larry Goodman, Sean Dunne, the Quinn Group and others - had had to publish their accounts in full, as major operations in Ireland, the resultant scrutiny might have alerted others to the unusual 'goings-on' in these companies. Financial disclosure may have even contributed to the prevention of one of their collapses, if more timely action has been taken.

Summary of Congress' View for the Budget 2012

20. The deficit in demand for labour is the first deficit to tackle¸ not the financial deficit, particularly the problem of long-term unemployment.

21. The Irish Congress of Trade Unions calls for a prudent approach to repairing the public finances through timely and appropriate adjustments to expenditure and revenue in such a way as to:

    a. Generate employment.

    b. Invest in infrastructure to facilitate sustainable growth.

    c. Protect the income of the most vulnerable in our society.

    d. Maintain and improve the quality of public services and thereby enhance competitiveness.

    e. Reduce the public sector deficit over time by increasing revenue through economic growth and a gradual increase in taxes starting with those on the highest income and,

    f. Move towards European average norms of taxation and public expenditure.

22. Our key argument is:

    a. The pursuit of fiscal austerity has caused deep and lasting damage to our economy and society. It is taking a serious toll on peoples' lives and on many communities.

    b. The 'low tax low spend' model has not served us well and the onset of recession in 2008 exposed the vulnerability of this model as revenues fell sharply and expenditure on social welfare rose in response to rising unemployment and a fall in wage income.

    c. We have alternatives in addressing the public finances and growing the economy. A short-term book-keeping approach based on further cuts to public spending is reckless and is not working.

    d. A new approach based on fiscal prudence and realism allied to social solidarity is urgently required to stop the corrosive effect of long-term unemployment among young and old.

e. The instability in the world and especially in Europe, the rising prices of Irish bonds, the lack of economic growth in Ireland, and the forecasted low growth projections for the world and European economy provide a good reason to extend the adjustment period to 2017.

f. Austerity is not working. Every projection of GDP and the public sector deficit has been 'off-target' over the last three years. Congress has been alone in our view that the level of the austerity programme has and is still killing off growth.

23. Prior to the EU-IMF 'bailout' of November 2010, it was an established aim of Government since the onset of recession to reduce the General Government Deficit to 3% of GDP by 2013. As previously optimistic growth forecasts are continually revised downwards, domestic economic activity remains in a slump and it proves increasingly difficult to get ahead of the recessionary curve by stimulating revenues. Instead, for every job lost and for every cut in living standards, tax receipts fall, mortgage and business loan defaults rise and expenditure automatically rises as a result of health and social welfare entitlements.

24. The socialisation of private banking debt by means of bank nationalisation and the generous under-writing of various liabilities after the 2008 bank guarantee must be changed. The level and timing of total public debt including transfers from the private sector is unfair, damaging and unsustainable. There must be significant re-structuring of this debt and the IMF, ECB and EU must assist Ireland in addressing this overwhelming issue in a way which is optimum for all parties.

25. Policy makers ignore the political and social impacts of short-term fiscal policies at our peril. The transfer of vast amounts of bank debt on to the balance sheet of the citizens of Ireland represents a huge shift in liability and will continue to drag down public finances for many years unless some significant re-scheduling of debt occurs.

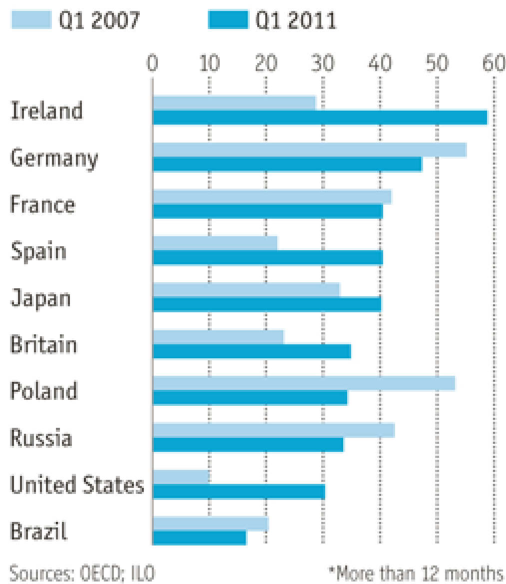
26. The possibility of prolonged instability and a continuing slump remains a very real prospect. It is not impossible that many countries including Ireland could

27. It is often assumed or claimed that public spending cuts are preferable to tax increases as a means of fiscal consolidation. The evidence for Ireland, limited as it is, suggests otherwise. ESRI estimates (Bergin *et al.* 2010) suggest that tax increases are more effective at reducing the deficit than reductions in public sector wages or employment.

28. Furthermore a new study by Laurence Ball of John Hopkins University and two IMF staff members warned that "slamming on brakes too quickly will hurt income and jobs."

29. They argued for the need to restore fiscal sustainability, but said it must be balanced. The IMF model found in countries without their own central bank (eg in the Euro area), austerity leads to cuts in incomes - twice as large as previously thought. It found flaws in "cuts are better than tax rises" argument in a monetary union and it found that the pain is not shared equally - wage earners were hurt most. For example their model found that wages fall by 0.9% with each 1% cut in GDP, whereas profits, rents fall by only 0.3% and they recover faster!

30. Long term unemployment is now 54% of the total in Ireland. As this table from the Economist magazine shows, Ireland is performing very poorly in this area. A reckless Budget of Austerity of an adjustment of in excess of €3bn will add to this dangerous level of long term unemployment.



31. No matter what wonderful technocratic argument some economists proffer in favour of such prolonged and severe austerity, they ignore the social costs which must be factored in by any reasonable person. Congress urges the Troika to wind down its demands on the Irish Government for the size of the adjustment for 2012, in the face of the poor economic outlook worldwide.

32. Ireland's regime of low corporate tax rates, combined with an unwillingness to treat capital gains as income, a continued refusal to treat much property or wealth as tax sources have resulted in an over-dependence on income tax, (31% of tax income), and consumption taxes, (VAT is 22% of tax income while Excise duties make up 10% of tax income). Yet tax based incentives, which are estimated to cost in excess of €11b per annum, have greatly narrowed the income tax base.

33. There should be a 'root and branch' evaluation of tax reliefs for the self-employed. It also requires specific measures such as an increase in the minimum tax scheme to be paid by the high earners to 35% and a reduction to €100,000 of the threshold at which this rate would apply.

34. If the Troika is to even consider not alone support social solidarity in Ireland, you must seek equitable taxes in your discussions with Government. Congress proposes a tax on wealth above €2 million, wealth being defined as current value of all assets, including the excess of €1m in the value of private houses.

35. Other changes which the Troika could insist Government implement include taxing the Irish Tax Fugitives. Citizenship is a two-way obligation. Those who avail of residency rules to avoid paying tax should be brought into the tax net. The 183-day requirement for tax residency should be cut to at least 90 days, as obtains in the United Kingdom.

36. A 12.5% oil and gas royalty tax - on production - should be reintroduced. This should be levied above a reasonable threshold, which would allow for all of the initial costs of exploration – up to a point- to be written off before any royalty is paid. Congress further urges the Government to consider introducing even higher royalties and taxes on profits if extraordinary large finds are made in the future, as part of any new set of terms agreed in the future.

37. The Government is to introduce a property taxes. One approach is to base an income related property tax on the notional rental income from that property or on a percentage of the value of the house. The value of properties can be put into broad bands, based on a number of factors including size, location, most recent sales of similar as adjusted by the housing index, etc.

38. There is a strong case for an additional State pension scheme into which savers can invest. This would give the State great sums of capital immediately and the savers a secure place to invest, with a real return and lower administrative charges.

39. The yields from Capital Acquisition Tax are low (just under €238m in 2010 and €391 in 2007). Income from all sources should be treated in the same way in so far is possible. Thus there is a strong case for a further reduction in the existing thresholds, especially in relation to the generous thresholds allowed in respect of agricultural and business reliefs (where, for example, a reduction from the current 90% exemption rate to 60% could yield an estimated €60m

40. Every citizen has been asked to contribute towards the cost of fiscal adjustment. Yet, the rate of tax on corporate profits remains unaltered while earnings and other incomes have been levied. There is an overwhelming case for a temporary levy of 2.5% on corporate profits in Budget 2012. As the effective rate of CT is well below the top rate of 12.5%, this is not onerous.

41. Congress long ago advocated the eliminating of the range of legacy property-based tax reliefs. Although these schemes were technically abolished in 2007, they are currently costing the State in excess of €500m per annum in lost taxation revenue. Various tax breaks which allow high earners and investors to reduce their tax liabilities for income, corporation, capital gains and capital acquisitions taxes should be progressively removed. We want annual reports on the costs of these schemes made public and that economic evaluations of these schemes are performed in advance of their introduction, extension, renewal, or amendment.

42. The reported demand by the Troika for the sell-off of €5bn in commercial State assets is ideological and a deeply flawed position. Why should our performing commercial indigenous firms be sold off to repay debts of the failed private banks? No-one believes that the sale of good firms is designed to "create jobs". Ireland has an enterprise deficit now that the top 4 companies have collapsed (the three banks and the largest private firm, Quinn Group). Such sell-offs will make the economy weaker, not stronger.

43. This is a better alternative to selling part of the ESB to raise "up to €2bn" as agreed with the Troika. This would be by extending the remit of the State Holding Company, New Era, to hold the shares of all commercial State companies, and raising "up to €2bn" by having private long term investors invest in bonds or preference share etc in this holding company to. Congress disagrees with selling off State assets but this is a far superior solution in the current crisis.

44. Congress holds that funding for investment can be paid for from the Pension Reserve; from auto-enrolment in a State pension scheme; from the sale of better marketed Solidarity Bonds which should be hypothecated for specific investment projects; from investment by pension funds as set out elsewhere in this submission; from a broader tax base; from private investment in New Era in expanding (not selling-off) our indigenous firms, etc.

45. On investment, Congress again proposes that €2bn a year should be taken for investment from the National Pension Reserve Fund until the €5.3bn remaining is invested in jobs in Ireland. Congress had suggested €2bn a year for three years when the fund totaled €25bn, but it has since been 'spent on the banks. It is imperative that the rest of our Pension Fund is used wisely that is - invested in the real economy of Ireland.

Irish Congress of Trade Unions, October 2011