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Researching Alternative Economic Policies

Tom Healy (tom.healy@eru.ie)

Director, Congress Economic Research Unit*[1]

I would like to begin by thanking the conference organisers for inviting me to speak here.

Speaking recently at the news conference held at the conclusion of the Troika visit and evaluation, István Székely of the European Commission made the following points:

> *I would encourage everyone to bring up evidence because this discussion should be evidence-based and not based on beliefs and definitely not driven by things other than this … it should help people who need help because they are unemployed or they are vulnerable and we will engage in this discussion and we will try our best to improve things if they need to be improved or take measures if more measures are needed….*

He went on to say:

> *let me reiterate our strong commitment to listen to social partners, to NGOs and to everyone in this society and if issues are raised and evidence is provided and there is a constructive way of working together we will work together with everyone to find solutions to difficult problems in relation to issues such as unemployment and the vulnerable.*

And this is exactly what the Congress Economic Research Unit proposes to do.

In this presentation I would like to begin to address the issue of how research could contribute to informing a very big debate that stretches from Morning Ireland to the Late Debate and beyond and can be overheard at kitchen tables, canteens, bus stops and in various taverns across the land. When will all of this end? Is there no alternative to what is happening already?

In this brief time I would like to merely touch on the following:

1. The demand and supply of labour
2. The domestic economy
3. The question 'Are we really being European?'
4. Realistic economic policy options

[1] Any views expressed in this paper do not necessarily reflect the views of the Irish Congress of Trade Unions or those trade unions sponsoring the Congress Economic Research Unit.

1 Demand and Supply of Labour

It is clear that there is a huge crisis in Europe today. It concerns the rising and horrendous levels of unemployment and under-employment in many, though not all, European societies. Within the army of unemployed there those who are (i) young (ii) migrant and (iii) otherwise members of the 'precariat' defined as people with little or no job security and little or no prospect of employment any time soon. Not counting under-employment the estimated monthly unemployment rate, here, was 14.6% in November 2011 while it was 10.3% in the EU17 (Chart A)[2]. Using qualitative research, Liam Delaney, Michael Egan and Nicola O'Connell in their recent Geary Institute working paper document the devastating psychological impacts of unemployment on people.

Not only are there large financial, health and well-being impacts arising from prolonged unemployment but research by Andrew Clark and other labour economists indicates a type of permanent scaring effect arising from periods of prolonged unemployment.

And there are huge, possibly hidden and impossible to quantify social costs stretching over the coming two decades. We need to create new work while recognising the economic value of all work – paid or unpaid. Without sufficient work we cannot maintain the goals of greater social equality, social cohesion, competitiveness and sustainable public finances. I very much share the view expressed by Dr John Sweeney of the National Economic and Social Council at the launch last year of 'Supports and Services for Unemployed Jobseekers':

'Ireland will not be a wonderful country in which to rear children or to grow old if it is not, in the first place, a great country in which to work'.

Especially hard hit are young people under the age of 25. The rate for that age-group, here, is now at 30% - notwithstanding the increase in educational participation and net outward migration since the onset of recession (Chart B).

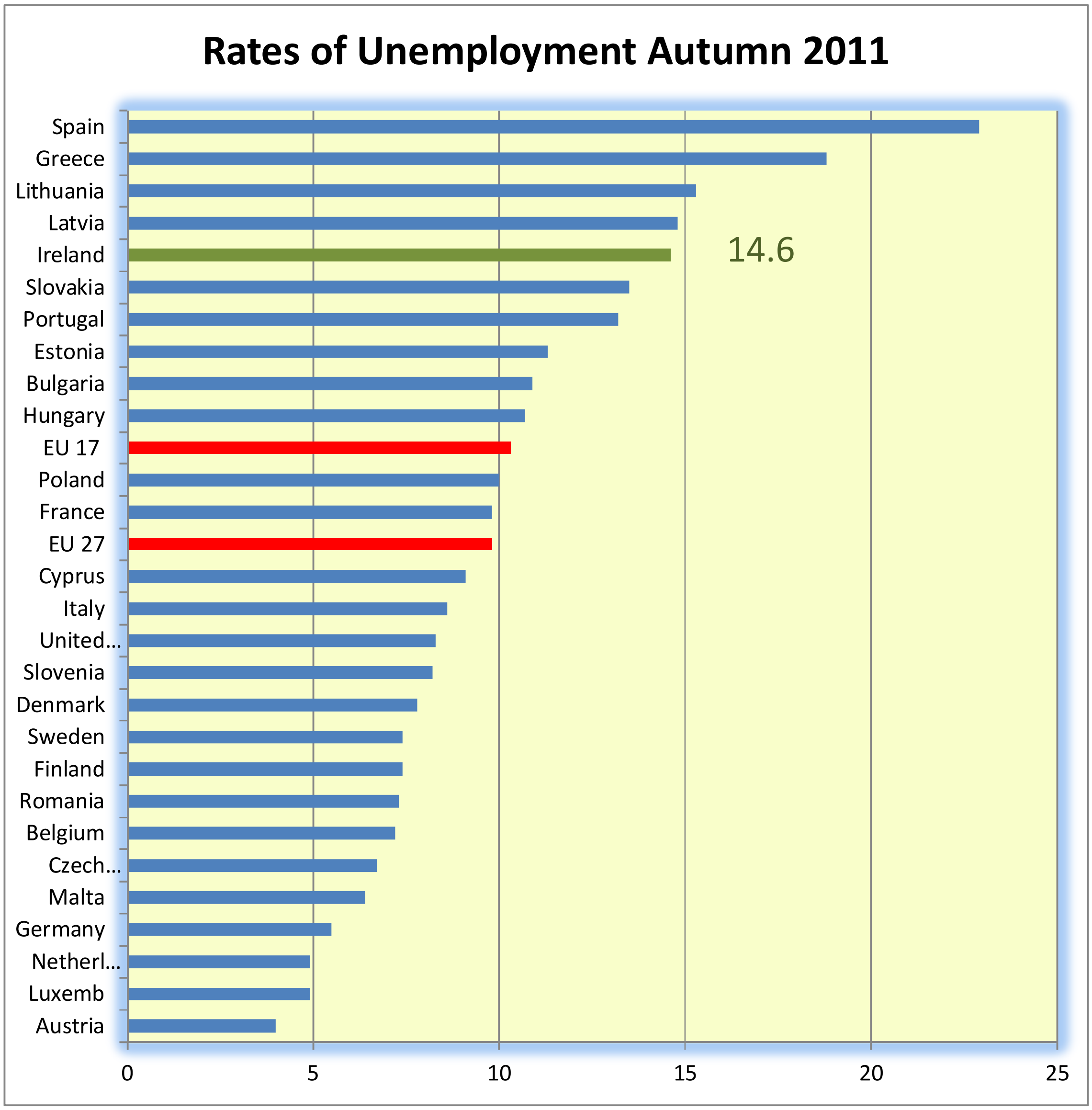
A Headline EU2020 indicator is the proportion of young people aged 18-24 who have left school early and are not currently in education and training. In 2010 the overall proportion of 18-24 year olds who were early school leavers was 10.5% in the Republic of Ireland. This compares favourably to an average of 14.1% for the EU27. However, behind this average is a truly shocking statistic which can be seen from online CSO data[3]. Using data for the third quarter of last year in the Quarterly National Household Survey it is possible to estimate that 48% of males who have dropped out of school early and who were not in education and training were unemployed and a further 33% were 'economically inactive'. By contrast, 60% of females who were early leavers and not in training were 'economically inactive' and 21% were unemployed. Only 19% of males and 19% of females were in employment. The combined proportion of unemployed for males and females was 36%. Although the total group of early leavers is relatively small (one in ten of those aged 18-24) they are highly

[2] The total level of under-employment is estimated by the CSO as 25% of the 'wide' Labour Force in Q3 of 2011. The measure used (S3) equals {unemployed plus marginally attached plus others not in education who want work plus underemployed part-time workers} as a percentage of {the Labour Force plus marginally attached plus others not in education who want work.}

[3] http://www.cso.ie/en/media/csoie/qnhs/documents/calendar/tableS9bcalq3.xls

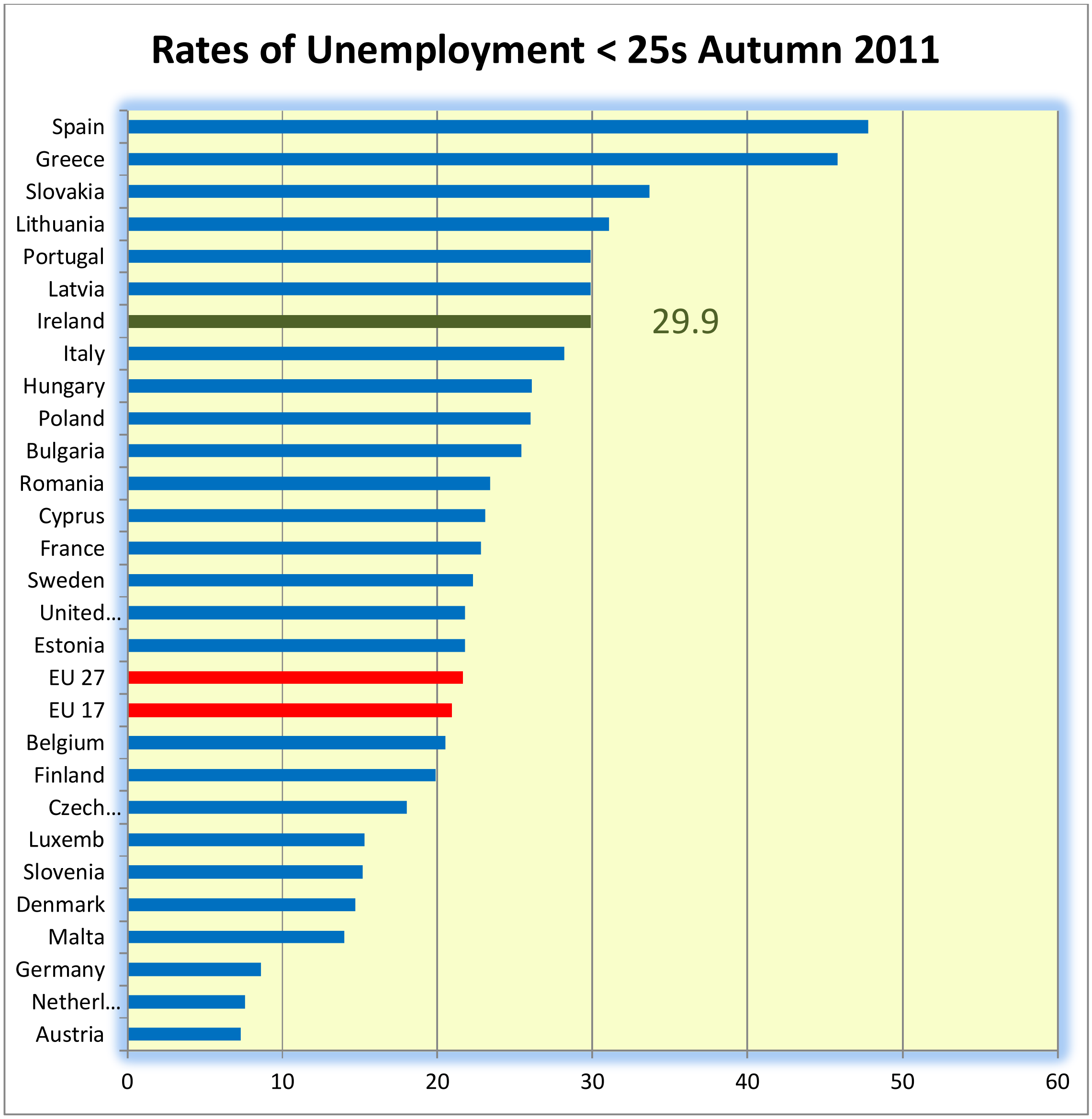
vulnerable. Another was of considering this is to say that 65% of early leavers who are actively seeking, and available for, work were unemployed (=36/55=0.65) in the third quarter of last year. In summary, the unemployment rate among young people (under 25 years of age) is 30% and for those who drop out of school early it is 65%. In absolute numbers, there are around 350,000 persons aged 18-24 and of these approximately 35,000 have left school early and very close to 30,000 of these are either unemployed or 'not economically active' and are not currently in education or training. It would seem unlikely that this group will not emigrate or find work in the short to medium term. Anyone concerned with a dashboard of warning indicators to assess long-term fiscal sustainability should be paying attention to these figures and trends.

Chart A



Source (Charts A): Eurostat (all data attributable to Eurostat in this paper may be downloaded from the Eurostat website - http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes)

Chart B



What future is there for these young people? The future of Europe is implicated I suggest. We are familiar with the concept of threshold bond yields beyond which a sovereign is in danger of being shut out of the market. There is a tipping point. It might be somewhere around 700 basis points. However, could a threshold be considered in relation to youth unemployment – especially where it becomes endemic and concentrated on particular groups at risk? In Chart B, above, there is perhaps a danger zone where countries between 20 and 40% youth unemployment are at greater risk. Beyond 40% and you get very serious trouble going by the recent evidence. On an alternative measure of risk we might consider a

YUS – a Youth Unemployment Spread over the German rate (213 YUS = (29.9-8.6)*10). A possible candidate for fiscal rules and early warning indicators?

Albert Einstein once commented that 'It is the theory which decides what we can observe'. If we believe that the current malaise of unemployment is primarily due to a deficiency in supply of labour at going market wage rates and associated income and benefit incentives then inevitably we tend to focus on some policy issues and solutions more than others, and, in a particular way. Activation, up-skilling, 'incentives', labour market 'reform' and 'flexibility' become the driving terms in the debate. If, instead, we believe that the unemployment problem is as much, and possibly more, about demand as it is about supply then other concepts come to the fore such as competitiveness on global markets, the state of domestic demand and employer incentives to hire labour (which still relates to the 'reform' agenda).

Combining Eurostat data on unemployment and job vacancies indicate a ratio of 26 unemployed for each job vacancy in Ireland compared to an EU-27 average ratio of 7[4]. The evidence for Ireland suggests that the rapid fall in employment and consequent growth in unemployment from 2008 onwards was associated, above all, with the collapse in key sectors of the domestic economy including construction but also other sectors impacted by the collapse in domestic demand.

[4] Notes on the Front

2 The collapse in domestic demand

The sight of boarded up shops, 'For Sale' and the latest news of a business closure are all too familiar. Taking a long view over the last two decades, the pattern of growth in GDP has been strongly linked to the performance of the domestic economy or final domestic demand. Chart C (below) provides an estimate of how changes in GDP have broken down into the domestic and external components for each year going back to 1990. What is striking about the growth in GDP from 1990 to 2007 is that the bulk of the increase in any year was related to domestic demand. Following the collapse in GDP from 2008 to 2009 domestic demand has contracted sharply (at a rate never recorded before since national accounts data were developed here in the 1940s) while net exports have continued to increase. Were it not for export growth GDP would have declined further in 2010 and in 2011. Some of the explanation for the growth in net export demand is the buoyancy in particular overseas markets and product lines as well as the contraction in imports in 2008-2009 as consumer demand plummeted in Ireland.

It is noticeable that the latest set of Government projections to 2015 (made in November 2011) are based on the assumption of a significant continuing growth in net exports as an offset for falling or stagnant domestic demand. Only by 2014 and 2015 is there any recovery in domestic demand. Even then, the projected annual growth rate is under 1%. As the weeks and months elapse the prospects of much growth, if any, in GDP or in world exports look bleak. From the first quarter of 2007 (peak) to the third quarter of 2011 total final domestic demand (personal consumption, government consumption and investment all combined) fell by 25.8% in real terms, whereas, GDP fell by 10.6%. Two stories lurk behind the aggregate headline figures:

- The remarkable performance of exports and their contribution to a stabilsation in GDP in 2010-2011;
- The disastrous and continuing collapse in domestic demand and associated increase in unemployment and under-employment.

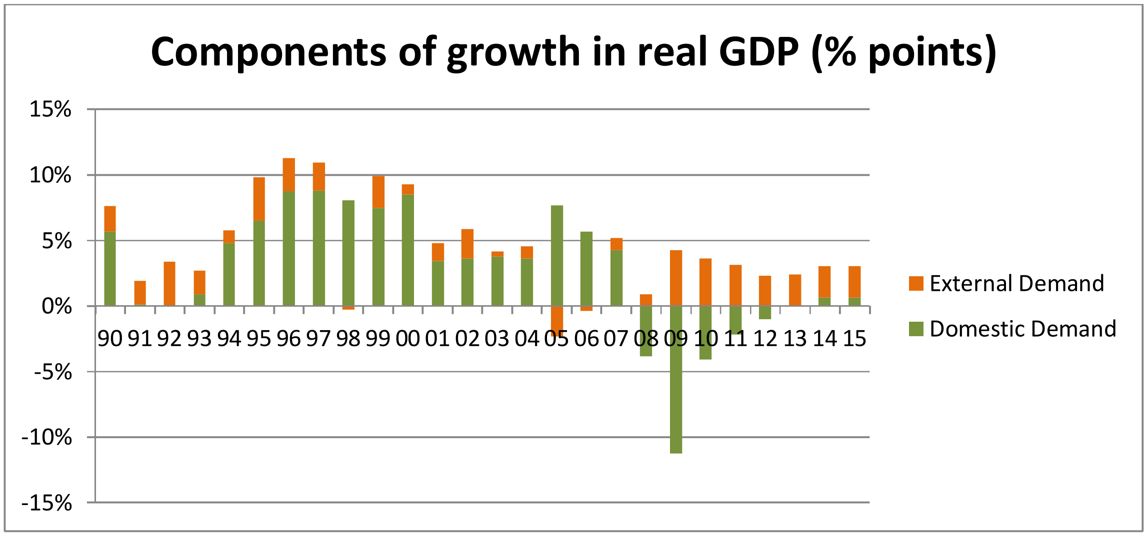
The drop in total domestic demand in the third quarter of 2011 – at 3.6% over the previous quarter – was the biggest quarterly drop since the beginning of 2009. Quite apart from international developments, the domestic economy continues to contract and the rate of contraction has not shown any signs of a turnabout.

Should anyone be surprised? The combined impact of falling disposable income, fears about the future, falling capital investment and continuing pro-cyclical fiscal policies ensure no recovery in the domestic economy. It's a text book recipe of pro-cyclicalism. Previous (optimistic) projections of growth in GDP and employment have proven wrong not because of weak export demand – export markets have been very buoyant. Rather, they have proven wrong because the evidence now emerging strongly suggests that the negative domestic economy impacts of fiscal contraction were under-estimated.

It seems very unlikely that employment levels will recover to any significant extent without a significant boost to domestic demand.

It is instructive to glance back at trends in the aftermath of the last recession in the mid-1980s. Following a period of 'jobless growth' in the early 1990s employment began to rise sharply from 1993 onwards – mainly in firms and sectors meeting domestic demand. Export growth also played a significant part.

Chart C Where the growth came from in the past and where it is projected to come from in the near future



Source: European Commission Ameco database for 1990-2010 and Economic and Fiscal Outlook, 2011 for 2011 and later years.

The first in this series of 'Crisis' conferences took place in January 2009 – three years ago to the month. Some weeks after that conference there was a supplementary budget for which the Department of Finance published Macroeconomic and Fiscal Framework (2009-2013). A combined fiscal adjustment of €3.3billion was made in that particular budget. Following a sharp expected contraction in GDP in 2009 and 2010 growth was projected to resume in 2011 reaching an annual rate of 4% by this year – 2012. Personal consumption and investment were set to resume growth by 2011 while exports were expected to grow by between 3 and 4% per annum. The rate of unemployment was expected to peak at 15.5% of the labour force in 2010 and fall to 13.5% in 2012. Many green shoots were sighted, corners were about to be turned and we saw a series of 'the last of the big tough budgets'.

But, it seemed like a case of Pro-cyclicals Anonymous.

Among the broad economics confraternity there was a sense of Augustinian pragmatism – 'let us be anti-austerity but not yet ….'. it was the wrong time: Ireland was a small open economy with low multipliers and we needed to hold on to the National Pension Reserve Fund for – well – pensions. The 'we are where we are' mantra was a moving target. Certainly the impact of The Great Bank Rescue complicated fiscal life over the entire period in question. The combined effect of discretionary fiscal adjustments totally some €24billion between late 2008 and now has not helped the state of our domestic economy or the levels of unemployment and under-employment. It is far from obvious that it has had a significant impact on the public sector borrowing requirement or annual government deficit. A general

Government deficit of 10.75% was projected for 2009 at the time of the supplementary budget in April of that year. The projected deficit for 2011 was – 8.6%. This is not to be confused with the projected or should we say current-day targeted figure of 8.6% in 2012. Perhaps the number 8.6 has magnetic attraction. Then in December 2009 the projected deficit for 2009 was estimated to be 11.7% and the projected figure in 2011 was 10%. Actually, the outturn for 2011 might not be too far in excess of this. However, the reaching of the magical deficit target of 3% has been pushed out and out – from 2013 to 2014 and then to 2015. It may very well be pushed out again if GDP growth heads south but few will admit that right now[5].

But if we had not made those cuts … it would have twice as bad?

We simply don't know for sure. But the empirical evidence is not reassuring about the supposed counter-factual as regards austerity and deficit reduction. For every cut in spending there is a loss in direct and indirect tax revenue. There is also, some negative multiplier impact from lower spending, lower employment and higher automatic spending for given levels of welfare provision and health care entitlements. So, a lot of lifting and pushing is needed to achieve even modest reductions in the deficit – at least as long as the domestic economy is on its knees. Various estimations of the impact of cutting spending or raising taxes – other policy shocks constant – have been made by the ESRI in a number of published working documents. I will cite just one – Bergin et al. (2010)[6]

The ESRI authors run through a number of budgetary scenarios including expenditure cuts and revenue increases. Using the HERMES model, it has been estimated by them that a cut of €1billion through a reduction of 18,000 in the public service would reduce the deficit by an estimated 0.2% of GDP in the first year and by 0.3% by the 7th year. In other words, the short-term impact of a reduction in current public spending through this particular example would yield a net saving of less than half the amount. The long-term impact is likely to be higher. The net impact of cutting current spending could be anything between one half and two-thirds of the initial adjustment depending on the area impacted. This seems to be consistent with the view taken by the IMF in its December 2011 Staff Paper when discussing the impact of the 2011 budget on the primary balance:

> *The realized increase in the primary balance will thus likely amount to only about three-fifths of the consolidation effort, which reflects the adverse impact of the contraction in domestic demand and the rise in unemployment, highlighting the challenge of implementing large fiscal consolidations when growth is weak.*

The simulations used by Bergin et al. (2010) point towards a likely negative impact on GDP of somewhere in the region of 0.4-0.5% for every €1bn in fiscal adjustment (=0.6% of GDP). For example a cut of €1bn (=0.6% of GDP) arising from lower employment lowers GDP by between 0.8% and 0.9% in the first four years following the adjustment. A cut of €1bn in capital spending lowers GDP by 0.1 and 0.3% (with the proviso that this is likely to be an

[5] Recent forecasts by NCB (January 2012) project a Government deficit of -9.2% in 2012 and -4.5% in 2015. These outcomes are broadly similar to the results of debt sensitivity analysis illustrated by a 1% lower than expected growth in nominal GDP in Table 5.5 of the Medium-Term Fiscal Statement, November 2011.

[6] Refer to page 18, table 7.

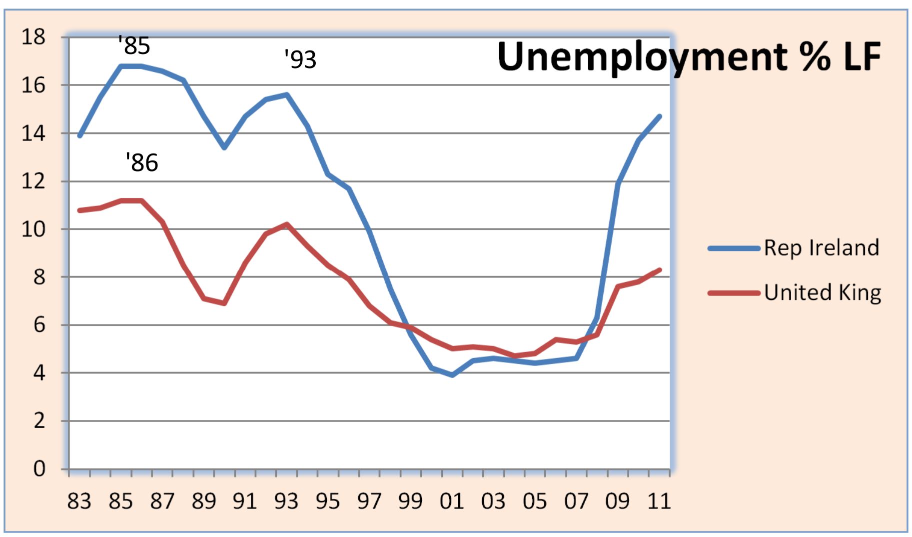
under-estimate as supply-side impacts are not accounted for[7]). A cut of €1bn in public sector wage rates would lower GDP by between 0.2 and 0.3%. A similar overall negative impact is likely for the same level of adjustment on the revenue side. All of these estimates are based on static conditions in regard to markets and credit conditions and reflect pre-2008 relationships.

If, for a given fiscal adjustment of €1bn (0.6% of GDP) GDP were to fall by 0.5% from what it would otherwise have been it could be assumed, based on sensitivity analysis[8] taken in conjunction with the results shown by Bergin et al. (2010), that the General Government deficit would be lower by only 0.2% of GDP.

In a static model a further adjustment of say €10bn would, other things constant, lower GDP by €7bn initially with an improvement in the public deficit position of around 2% of GDP (or €3bn). The net impact on the deficit is much less than that estimated by the IMF (cited above). Much depends on the dynamics involved in changes to domestic demand, the timing and composition of a fiscal adjustment as well as possible interactions between a policy shock and responses by various market actors from consumers to investors to financiers.

More sophisticated, timely and transparent macro-modelling including analysis of public finance impacts is required to throw further light on these impacts. At the very least it is possible to conclude that the impact of any given fiscal adjustment on the deficit is likely to be heavily muted in an already depressed domestic economy and in a very unstable international context.

Chart D: Trends in Unemployment Rates (ROI and UK)



Source: Eurostat database

[7] Bergin et al. (2010) state that: 'These simulations do not take account of the significant positive supply side effects from public investment'

[8] See Table 5.5 in the Medium-Term Fiscal Statement, Department of Finance, November 2011. It shows that for a 1% lower growth rate in nominal GDP the General Government Balance (GGB) is higher by 0.5% points (9.1-8.6) in the first year of a four year horizon. If GDP were to fall by 0.5% as a result of a 0.6% fiscal contraction then it could be assumed that the deficit is higher by approximately 0.25% in the first year. This is reasonably close, as a crude estimate, to the range of impacts on the GGB cited in Bergin et al. (2010).

3 Are we really being European?

Missing from much of the analysis and debate has been a consideration of where we stand in relation to the European Union at large and where we wish to go. What I mean is that there has been very little consideration given to the type of society and balance of public and private provision we envisage and how we should reform our structure of public expenditure *at the same time* as we seek to reduce the public deficit to below the compliance threshold of 3% of GDP. So, we have an agreement involving the 'Troika' that projects a sharp contraction in the size of State expenditure as a % of GDP over a four year period which is largely a transposition of the four-year fiscal plan published in November 2010. Chart E1 presents data on trends in total Government expenditure and revenue since the late 1990s and projected forward to 2015 in line with the most recent data contained in the Department of Finance's Economic and Fiscal Outlook (EFO) released in December 2011. The data include the one-off jump in total expenditure arising from the bank recapitalisation in 2010. Alternatively, Chart E2 shows the same data excluding the amount on bank recapitalisation in 2010. Three points are worth noting:

1. Total spending and total revenue were close to each other as a percentage of GDP for the entire period 1998-2007.
2. Expenditure increased sharply as a percentage of GDP in 2008 and 2009 because (i) GDP contracted sharply in these two years and (ii) the surge in unemployment significantly added to expenditure as the numbers of welfare recipients escalated.
3. The entire adjustment towards fiscal balance (to less than 3% of GDP by 2015) is on the expenditure side.

The first point, above, is worth drawing attention to because it seems to be assumed and asserted in some quarters that public expenditure was 'out of control' and that the growth in expenditure immediately prior to the onset of recession in 2008 was in some way associated with this. Let's be agreed about this much – expenditure was growing rapidly in the period up to 2008 but no faster than GDP. The yawning gap between expenditure and revenue from 2008 onwards was due to forces triggered by recession as indicated above (and of course reinforced by a very skewed tax base which was heavily reliant on property transaction taxes).

The second point, above, is worth recalling because notwithstanding the succession of contractionary budgets from the Autumn of 2008 onwards, spending continued to increase in no small way because the dole queues lengthened and revenue collapsed as people lost jobs and income fell.

In regard to the third point, it is important to acknowledge that the drive towards a smaller State and one that resembles more our neighbours to the East in Europe as I will show in a Chart below is a domestic choice and not an externally imposed one. Our creditors in the ECB, EU Commission and IMF are more interested (by varying degrees) in (i) saving the Euro (ii) saving and consolidating the European project and (iii) getting their money back – than in the specifics of how we model ourselves – whether on Scandinavia, or the UK or the some of the new accession Member States. The choice is ours and we cannot blame the British or the Catholic Church or the Troika or anyone else for this. We need to grow up and take responsibility for our own fiscal and societal choices. The Troika is in town not because we failed to pay our private banking debts but because we did pay up (and continue to do so with a large opportunity productivity investment cost).

Chart E1: Trends in Total General Government Expenditure and Revenue (1998-2015)

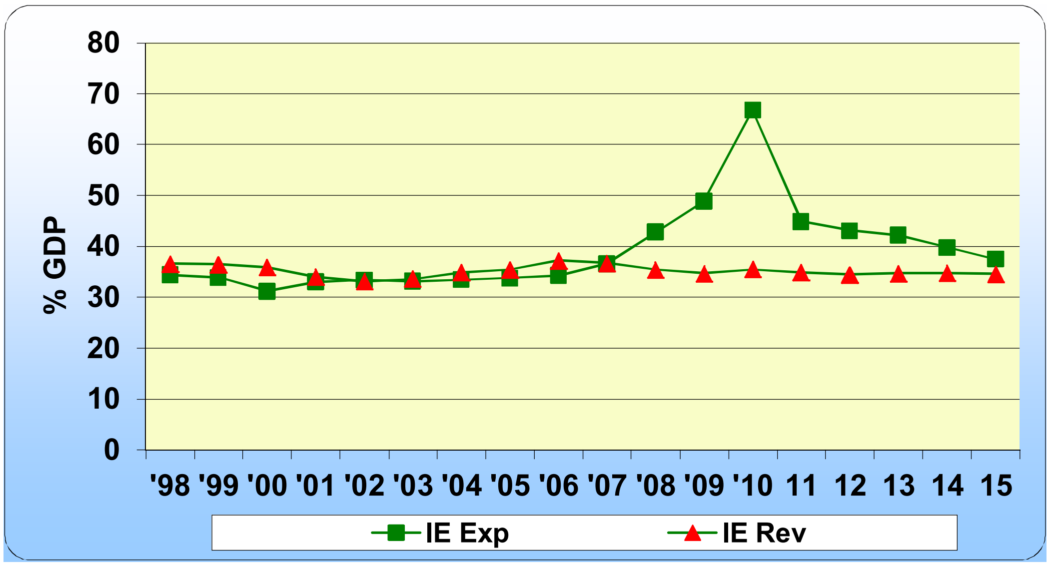
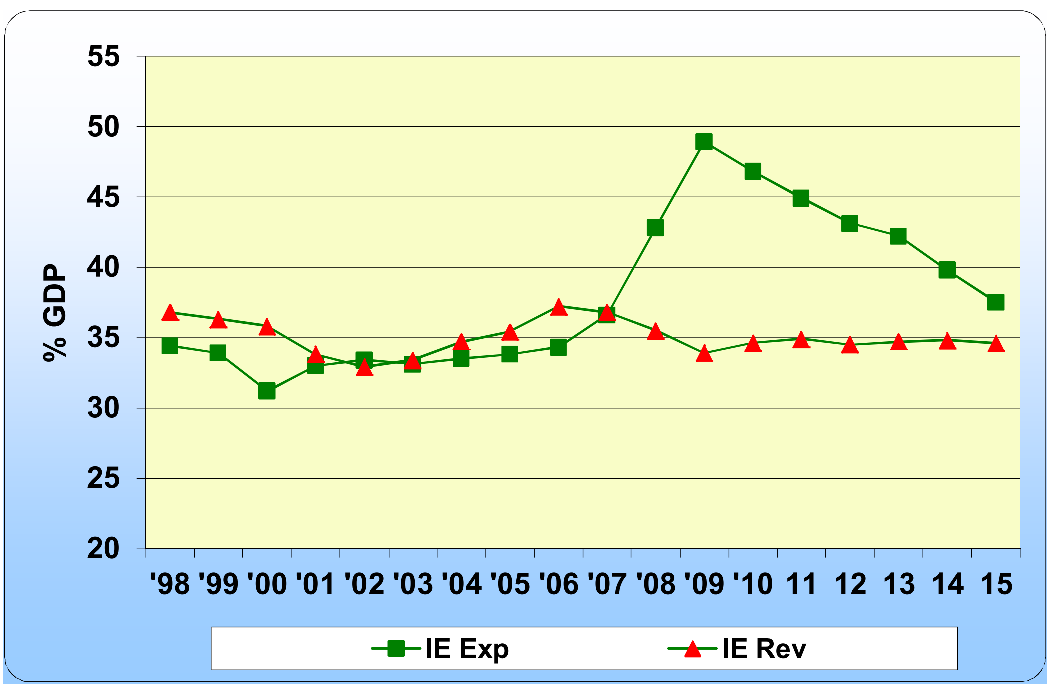


Chart E2: Trends in Total General Government Expenditure and Revenue (1998-2015) excluding bank recap in 2010



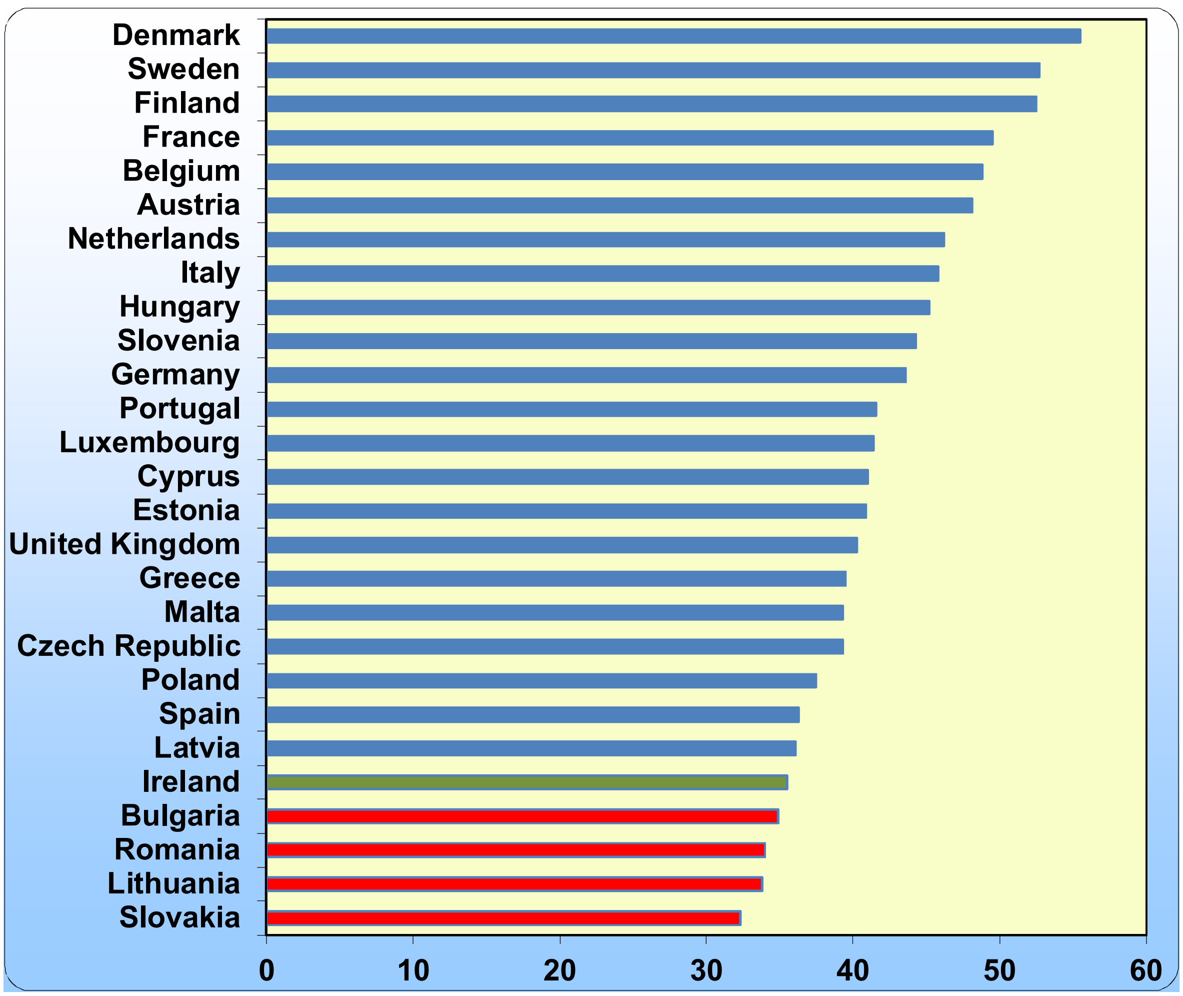
Source: Eurostat

http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/data/database

A striking feature of fiscal adjustment as pursued, here, both before and after the November 2010 Troika Agreement is that it has leaned on expenditure and not on tax. When measured as a percentage of GDP, the entire adjustment is on the expenditure side with the share of total revenue in GDP staying constant over the remainder of the adjustment period. In fact, total revenue is projected to fall – not increase – from an estimated level of 34.9% of GDP in 2011 to a slightly lower level of 34.6% in 2015 (page D.19 of EFO, Dec 2011). On the other hand, total spending is projected to fall sharply from an estimated level of 44.9% of GDP in 2011 to 37.5% in 2015. In other words, the entire burden of adjustment – when expressed as a target % of GDP in 2015 falls on expenditure.

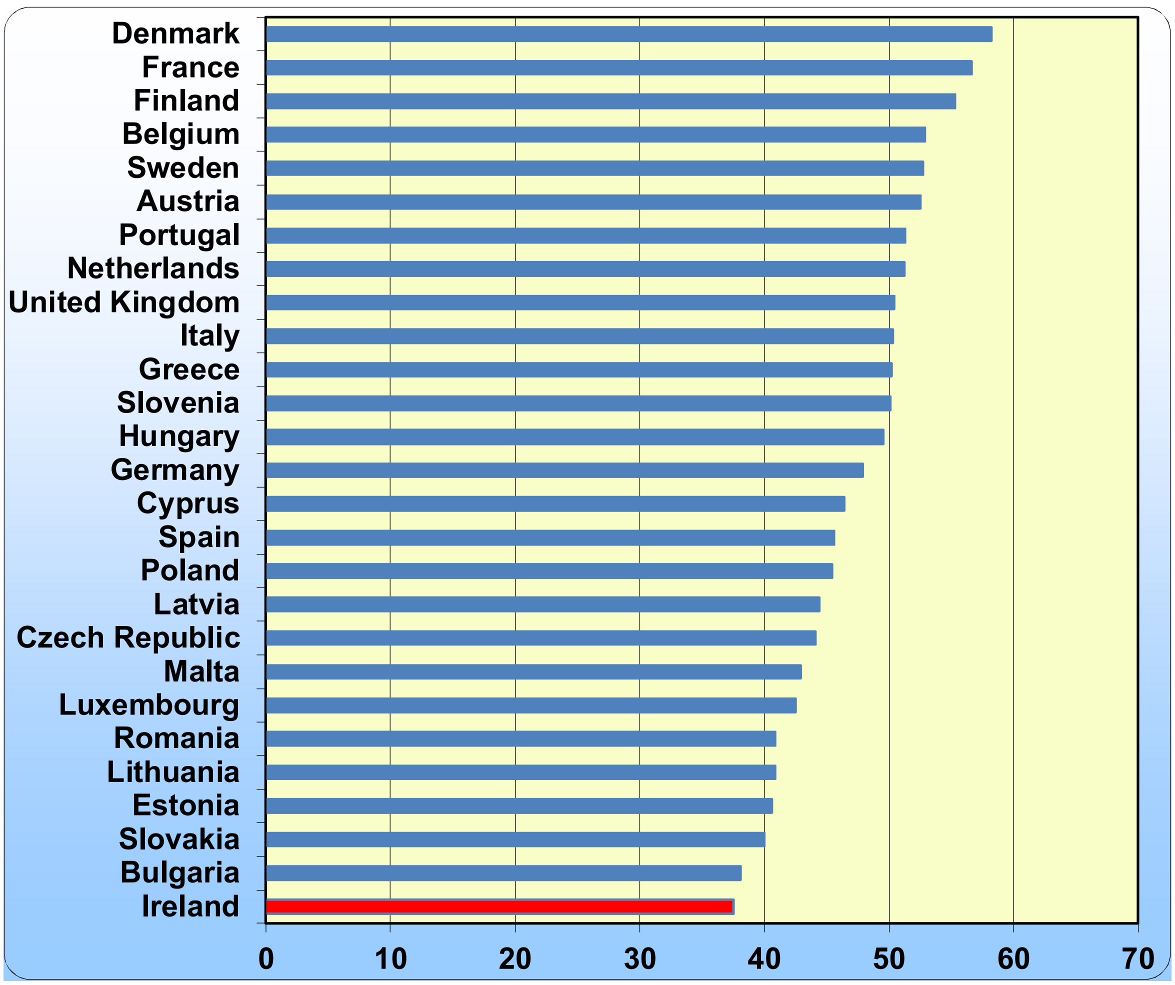
The implication of this adjustment, if carried through, will be to shrink the size of Government spending as % of GDP to a level shared by EU member states at the bottom end of the European public spending league. As Chart F, below, illustrates Ireland is already close to the 'red-bar States' shown in this Chart in 2010.

Chart F: Total Government Revenue as % of GDP in 2010



If it is assumed that all other EU Member States were to hold their current 2010 level of spending as a % of GDP to 2015, then Ireland would reach the bottom of the list in 2015 as the lowest spending State in the EU27. Put another way, the Republic of Ireland would move from being a low-revenue and low spend State to being the lowest spend State in the EU27 and still one of the lowest-revenue collecting States (Chart G below). That would be an odd outcome given the apparent desire to move towards greater harmony in regard to the public finances more generally across the European Union. So, with little or no public debate about domestic choices and alternatives the closing of the public sector deficit is set to happen in such a manner as to move us further away from the European norms of spending and revenue. We are not even considering 'Nordic' levels of spending and revenue which many commentators would regard as worthy long-term goals for a society founded on a social market economy model.

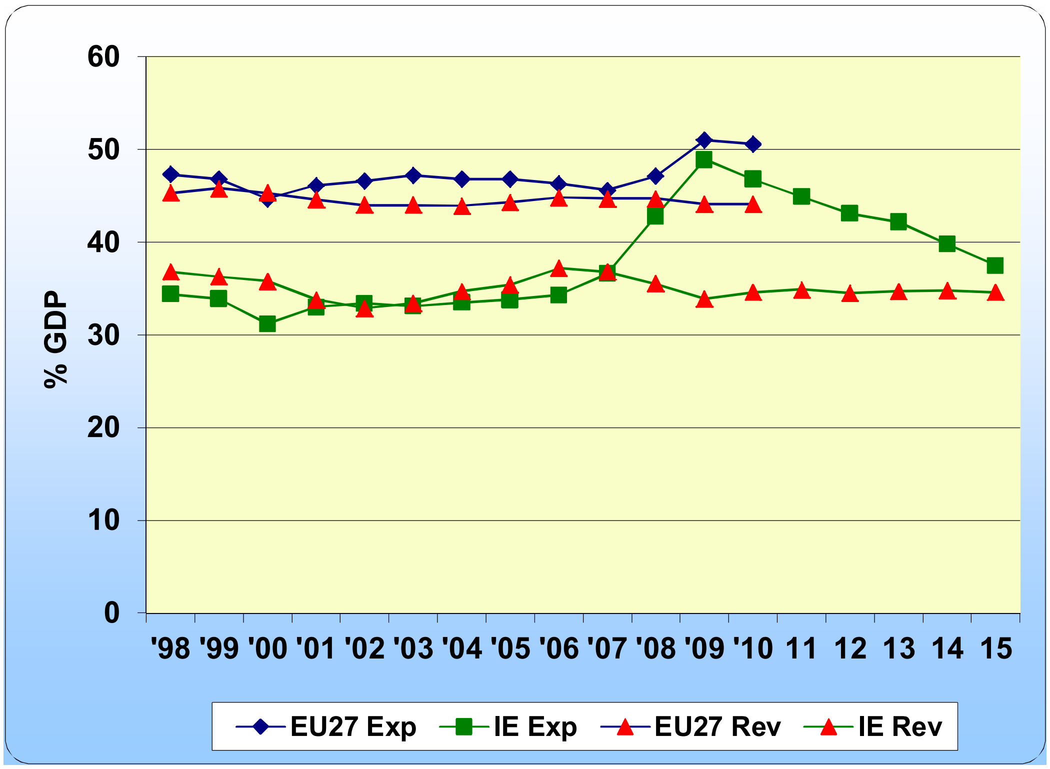
Chart G: Total General Government Expenditure in Ireland in 2015 (assuming no change in 2010 spend for rest of EU27)



Finally, it is useful to summarise trends in spending and revenue with the average across the Union (Chart H). Public expenditure, here, was below EU27 norms in the years prior to the recession of 2008. The gap was, typically, as much as 12 percentage points. A similar gap held in regard to total revenue as a % of GDP.

I suggest that we are not being very European especially as countries consider closer fiscal integration and harmony. This issue is not just about corporation taxes – it is about the overall size of the revenue take and its composition as between wages, profits, other income, consumption and capital as well as the structure of Government revenue at central and local government levels.

Chart H: Trends in Spending and Revenue EU27 and Ireland



Not infrequently, two objections are made to comparisons of this sort:

a) GDP, it is claimed, is a misleading guide to total available national income – instead GNP should be used in which case the share of public spending and revenue is much higher than is the case when GDP is used as the measure.
b) Ireland is unique in various respects with regards to its age-structure (older populations tend to spend more on areas such as health) and its relatively small military spend.

Point a) does not hold because included in total spending and revenue is the value of taxes paid by multi-national companies resident in Ireland. A precise figure is not available. However, it is likely to exceed €3bn per annum (total corporation taxes collected are likely to be in the region of €4n in 2012). GDP measures the total output, income or expenditure in a country in a given year. All profits earned in Ireland are, potentially, taxable. If GNP were to be used as a reference point then the value of corporation taxes, employers' social security and other payments by multinationals would need to be deducted from total spending or total revenue. As Collins (2011:90) has pointed out, to use only GNP in relation to comparisons of the tax burden ‘would exclude some of the national tax base, specifically the profits of multinational corporations, and consequently overstate the comparable scale of the national taxation burden’. Another consideration is that all EU fiscal targets including Stability Programme Updates work on GDP figures and not GNP figures.

In regard to point b), further research would be required to test this. Ireland’s age-structure is such as to require greater outlays of public funds on initial education – thus cancelling some of the effects of possibly lower health spending arising from a relatively younger population. Military spending does account for greater spending in other jurisdictions but the impact is not greater than 1-2% points. The average EU27 spend on defence was 1.6% of GDP in 2009 compared to 0.5% in Ireland. The highest proportion of GDP spent by public authorities on defence was in Greece at 3.6%.

In light of the above and judging by a cross-section of forecasts it is possible to claim that:

- Total revenue and taxes are low in Ireland – not least because taxes on profits and wealth are low;
- The low-tax/low-spend policy stance is more to do with domestic political choice than an externally imposed formula;
- The Republic of Ireland is set to see a sharp contraction in public spending as a share of total income with a likely loss in public services; and
- Unemployment is likely to remain at very high levels as domestic demand remains flat for most years to 2015 and possibly much later.

4 Realistic Economic Policy Options

The debate about the current economic crisis has focussed too narrowly on the state of public finances and the implosion of banking – vital and critical as this is (note the use of the singular in referring to public finances and banking). Clearly, the prospects of sustained economic recovery have been seriously undermined to the extent that a dysfunctional banking system continues to drag down Governments across Europe and spook markets in the process. However, the crisis must be understood as a complex interaction between a highly unstable – and at times – 'out-of-control' global financial system, fragile domestic economies, large and unsustainable trade, capital and private sector imbalances and a shortfall in demand for labour. Large levels of public sector borrowing reflect recession and not the other way round. Spain and Ireland – to take two of the more fragile EU economies – entered the current crisis with low levels of net public debt. Large and stubbornly high public sector deficits in many OECD countries mirror large net savings by households and the corporate sector as the latter deleverage or postpone consumption or investment due to uncertainty. The hoped-for expansionary fiscal contraction is failing to convince markets. Standard and Poors commented in their recent review of Eurozone countries (13 January):

> *we believe that a reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumers' rising concerns about job security and disposable incomes, eroding national tax revenues.*

The gamble followed in Europe is to get most or all countries to shrink public sector deficits and debt levels in the hope that, somehow, market and consumer confidence can grow. However, this risks being self-defeating as S&P say. All countries cannot export their way out of recession at the same time. To attempt this would be a modern version of beggar thy neighbour through domestic deflation and internal devaluation allied to external market capture. With depressed aggregate demand and a coordinated contraction across European States there is every likelihood that GDP will flat-line if not decline in many States this year – Ireland being one of them. Little or no growth means that public sector debt is likely to grow further as GDP growth falls short of real interest rates. The only way out of this 'debt trap' is for the public sector to act as investor of last resort. Whether this comes from quantitative easing, borrowing or redistribution of public expenditure it can be used to kick-start economies, generate employment and provide hope – some hope for those shut out from employment opportunities.

The prevailing thinking across Europe is that a country with a gross public debt of say 120% (Ireland) needs to reduce this debt mountain by 3 percentage points over 20 years to reach a compliance level of 60%. To that end a large toolbox of indicators and sanctions are proposed. If only life were that simple. There are at least three complications:

A **Democracy/social cohesion/cross-class consensus**

B **The real world of economies** does not always behave according to the dictats of short-term market sentiment and ratings – neither do they conform to automatic intervention of fiscal rules. Product, labour and capital markets have a mind of their own as the purveyors of economic central planning discovered in the last century.

C **Measurement is an imprecise science** and even if it were possible that every single economist from the Urals to Glens of Antrim were to agree on the definition and measurement of a structural deficit and every single legal expert were agreed on how to enshrine this in some battery of treaties, inter-governmental agreements or other legal instruments, there is the problem that GDP and everything associated with it including 'fiscal rules' does not equate to human well-being.

Point A is not a trivial one. A society – any society – this society – can be pushed and pushed but there comes a point where you cannot be sure of anything or assume anything. Perhaps people will continue taking the medicine for a long time – perhaps not. Right now there is a huge sense of fatalism combined with frozen anger – '*it's not fair but what can you do about it'* – '*we just have to accept the situation and hope that we can work our way out of it'*. I suggest that this is a potentially very dangerous scenario - what if the course of inflicted pain does not work out any time soon? What then? History is too full of failed promises, simplistic solutions and scapegoating.

Nobody can predict or model a social breakdown so large as to endanger democracy as we know it. Those of us of a more moderate persuasion might be rolled over and other forces – possibly very authoritarian – enter the stage. Signs are emerging across some European countries. This is for real. Economists, policy makers and others involved in this debate need to acknowledge the political and social economy risks.

Point B seems just a basic point that it never ceases to amaze me why people continue to think in a world where Governments can just fix the (public sector) deficit by making a precise fiscal adjustment of a given amount and composition. While downside and upside risks are acknowledged there is a reversion to the mean stance – 'we are on track' and this will be the approximate outcome. Who says so? And how does anyone know? The evidence to date suggests serious under-estimation of the negative impacts of fiscal contraction over and above the international export trends and the hugely negative and complicating impact of the various banking rescue measures.

Point C reflects a fundamental issue of belief and world view. If we believe that some quantitative measure of some aspects of economic activity is the ultimate measure of success, recovery and soundness underlying an economy then we need to think again radically. It has been said, correctly, that the European Community ideal was never just an economic one but a political one. I think we should add a third adjective – social. Europe will not hold together if it is not all of these three. Attempts to build a stronger and financially more sustainable European Union founded on a single currency will not succeed if the social pillar is not protected and put firmly in place.

The key to a more sustainable and equitable economic recovery, here, is tied up with international and European developments. As a small open economy heavily reliant on trade, reputation, continuing short-term credit and support of other European Member States our options are limited. For better, for worse, in economic sickness and health and till some catastrophic event might do us part, a clear majority of people, here, voted to pool sovereignty in 1972 and again in 1987 and in 1992 and in 2001 and in 2009. We are where we are and reverting to autarky or capital controls is not an option. Fiscal integration – if it means a codification and solidifying of the current march to an ever more neo-liberal Europe will probably not work either. Another way has to be found in collaboration with other Member States who could share similar values and concerns at this time.

The policy of coordinated deflation across Europe is destroying European economies, including our own, hollowing out public services and endangering social cohesion and thereby the whole European project itself. This has to be stopped and reversed before it is too late. If we need a European 'lender of last resort' – and many believe that this is the only way to save the Euro and possibly the European project itself then we need a European 'investor of last resort'. Why do we have a Troika here? How about a Quartet that includes the European Investment Bank which is mandated to ramp up its investment further in partnership with Governments and the private sector. Notwithstanding the sharp reductions in the Public Capital Programme since 2009 and evocative of the fiscal conservatism of the 1950s and late 1980s – would anyone here possibly disagree that we need more and better investment in infrastructure, sustainable energy, social development and health services? We may differ on how this can be best done and from what sources (public, private, European, other international funders). Ireland may be 'out of the markets' when it comes to sovereign borrowing but we don't have to be out of the market when it comes to new ideas, products, innovation and local initiative. And who knows – from China to the Gulf States to the EIB there may be potential sources for large-scale investment with a lasting impact on employment, productivity and sustainable development. Let cynics scoff. Remember Ardnacrusha. And remember that a major beneficiary of that scheme was Simens-Schuckert.

When confronted with controversy from within and without a former British Prime Minister famously once declared TINA – There is No Alternative. The phrase stuck and its central thrust is now invoked on a daily basis. But, there is, I suggest, an alternative.

Is féidir linn – yes we can.

This alternative should be focussed on the creation of sustainable employment as the only credible basis for long-term recovery in consumption and investor confidence. The key to employment is a combination of many policies including raising skills, better harnessing natural resources, investing in social and economic infrastructure and laying the basis for a stronger indigenous sector exporting services and products on global markets. Few would disagree with this. But why is it not happening on the scale and at the pace needed? One reason is the highly negative impact of continuing fiscal austerity. Any sensible policy maker needs a Plan B – just in case A does not work. And if A is patently not working policy should use B. How much more evidence in terms of destruction to lives, communities and businesses do we need before B becomes a serious option?

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