NEVIN ECONOMIC RESEARCH INSTITUTE

Building a Post-Pandemic Economy: A Playbook

Mac Flynn and McDonnell, (2022, Forthcoming)

Twitter:@NERI_research

Paul Mac Flynn and Tom McDonnell
14th June 2022
NERI/UCD Labour Market conference

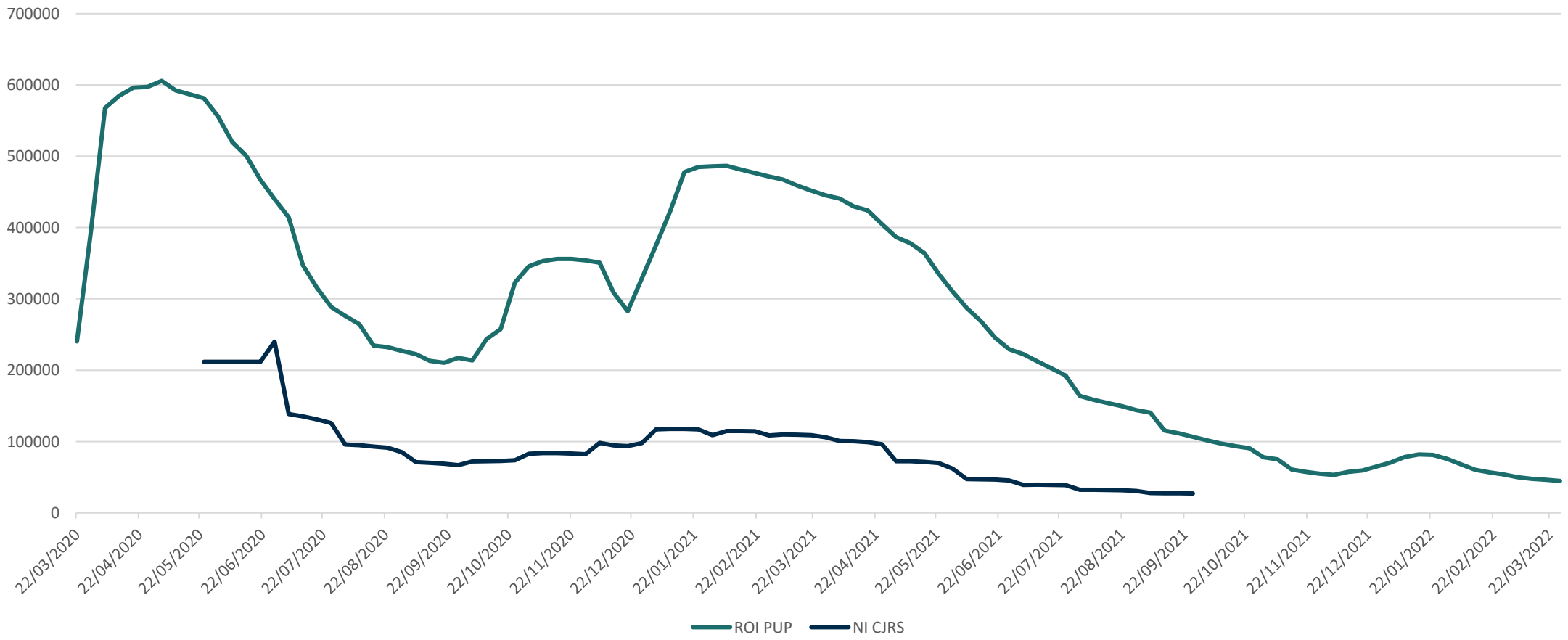
WEBSITE: www.nerinstitute.net

Part 1:
The Pandemic, its Fallout, and Lessons Learned

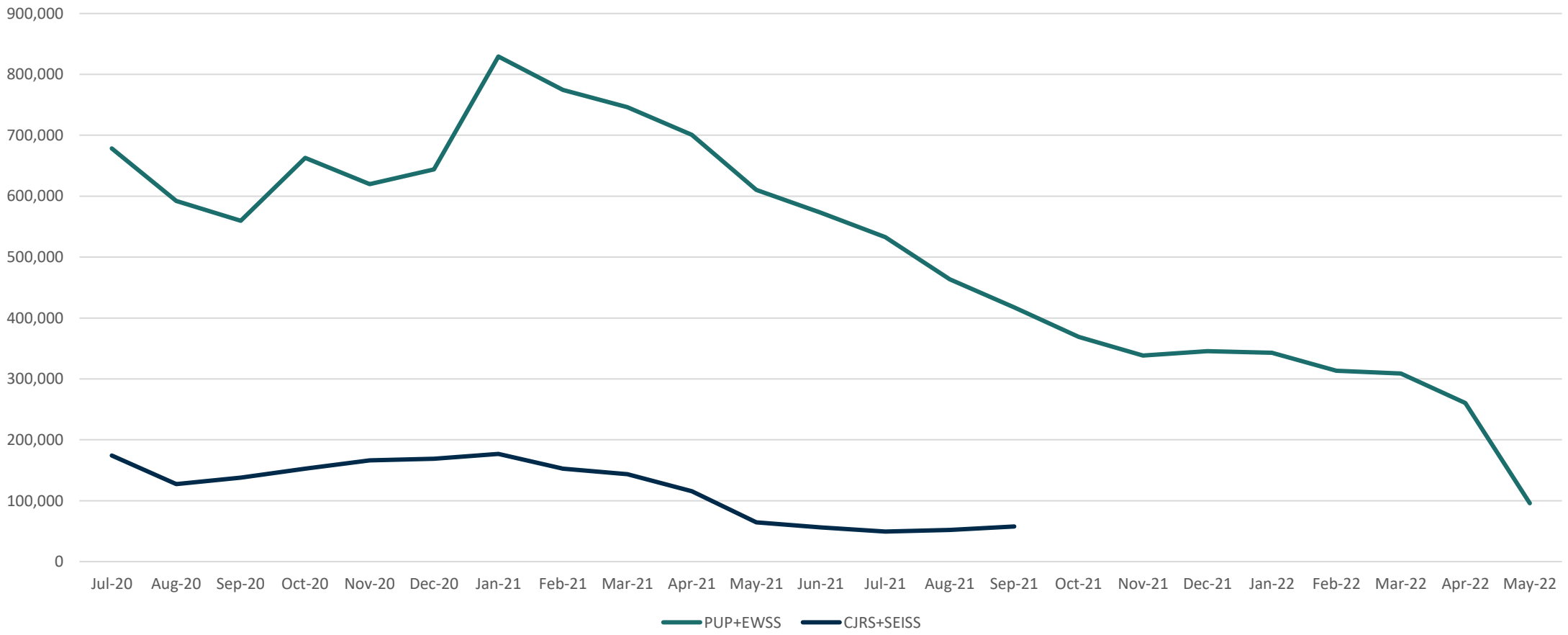
Income Protection

- Northern Ireland
  - The UK government introduced the Coronavirus Job Retention Scheme (CJRS) in April 2020. It provided for a government funded payment to the value of 80% of previous wages. Under the CJRS, workers were furloughed, meaning they remained employed by their employer, but were not 'at work'.
  - The UK government also introduced the Self-employment Income Support Scheme (SEISS) which provided the same for self-employed workers.
- Republic of Ireland
  - the process of supporting workers was more evolutionary and in the first instance focused on providing out of work support. The immediate response was to introduce a single flat rate Pandemic Unemployment Payment (PUP). It was initially set at the same level as the existing Job Seeker's Benefit of €203 per week, but it was quickly uprated to €350. The PUP was subsequently moved to a 4 tier payment linked to previous earnings.
  - The Irish government did introduce a form of furlough payment in the form of the Temporary Wage Subsidy Scheme (TWSS). The TWSS provided a subsidy worth up to 70% of the previous earned income. However, the cap of €410 per week was considerably lower than that of the UK scheme. The TWSS was eventually replaced by the Employer Wage Subsidy Scheme which offered even less generous payments.

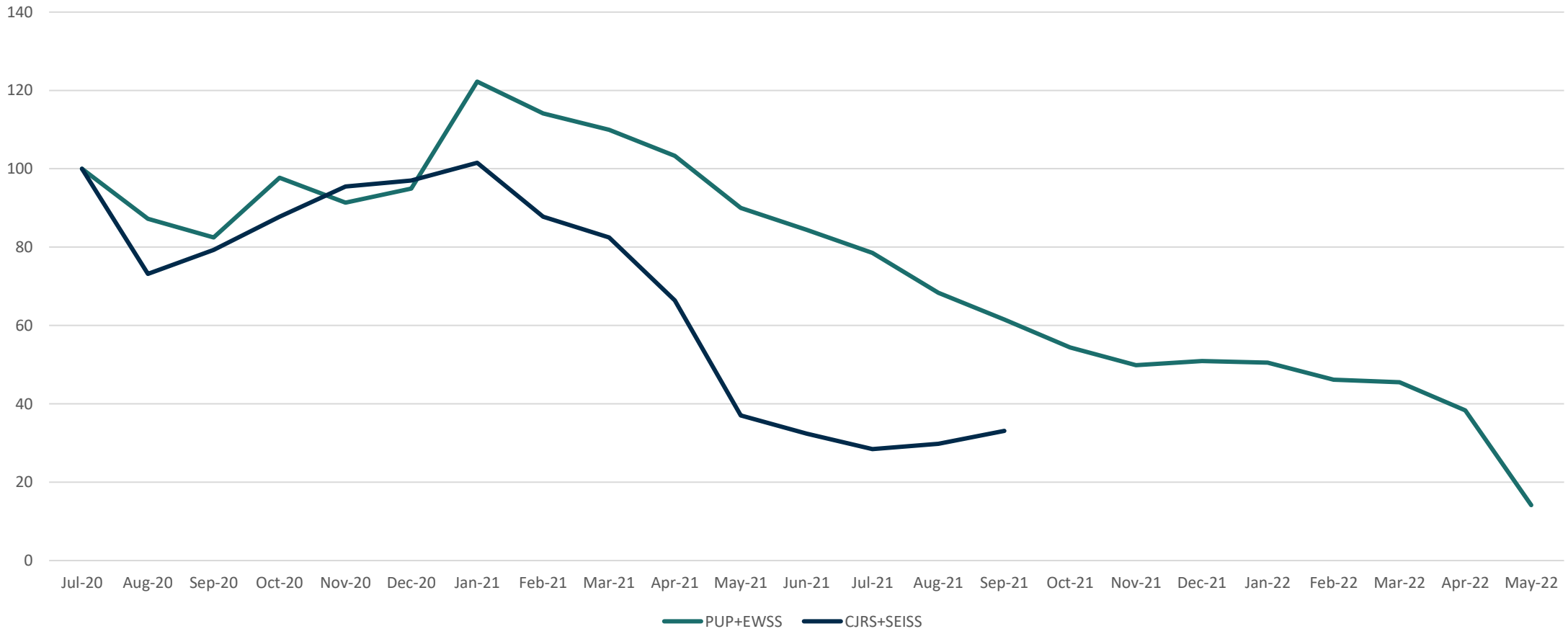
Response to Covid



Response to Covid



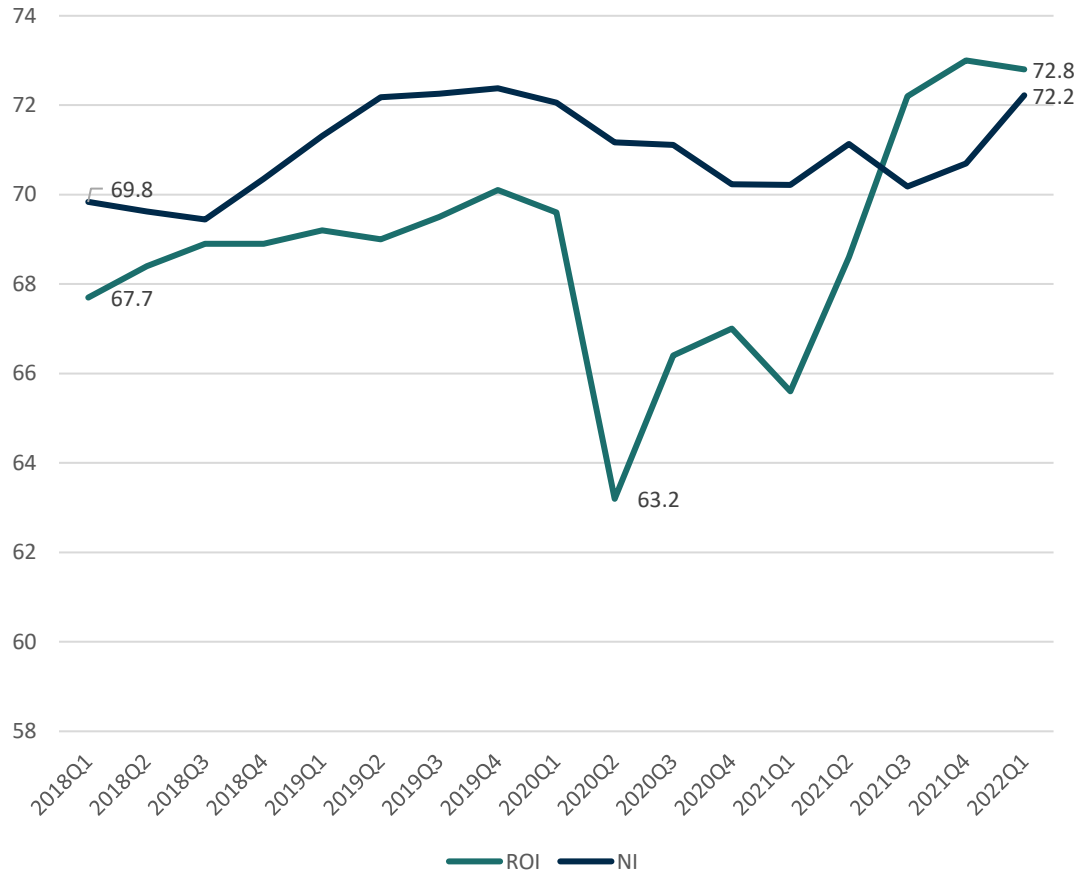
Response to Covid



Unemployment Rate N&S

- Both Have lower U rate than 2018
- Larger spikes in ROI
- Smaller pp gap between N&S by Q1 2022

Employment Rate N&S



- NI begins with higher rate and sees much shallower dip in 2020
- ROI drops significantly, but has much stronger recovery
- ROI rate higher than NI by Q3 2021

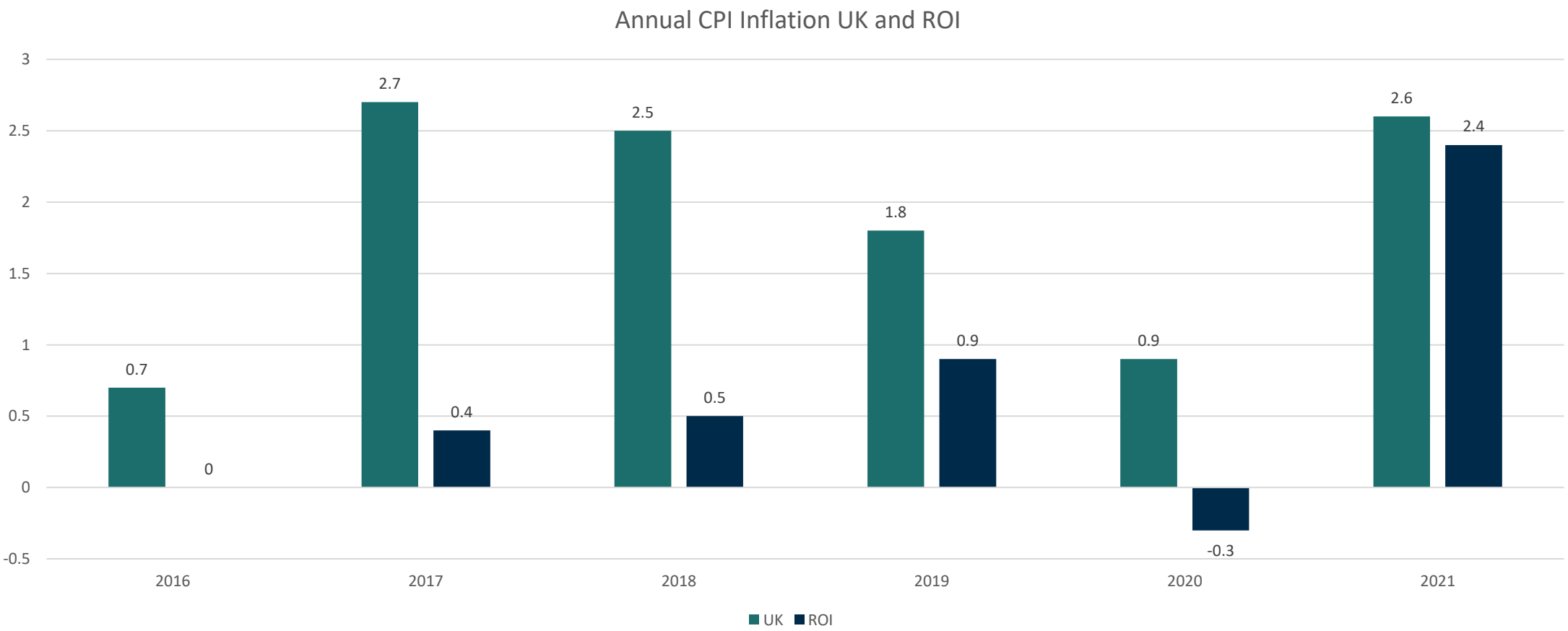
Participation Rate N&S

- NI has always had lower participation
- ROI drops significantly, but has much stronger recovery
- Gap between N&S significantly larger.
- ROI now looks more like GB

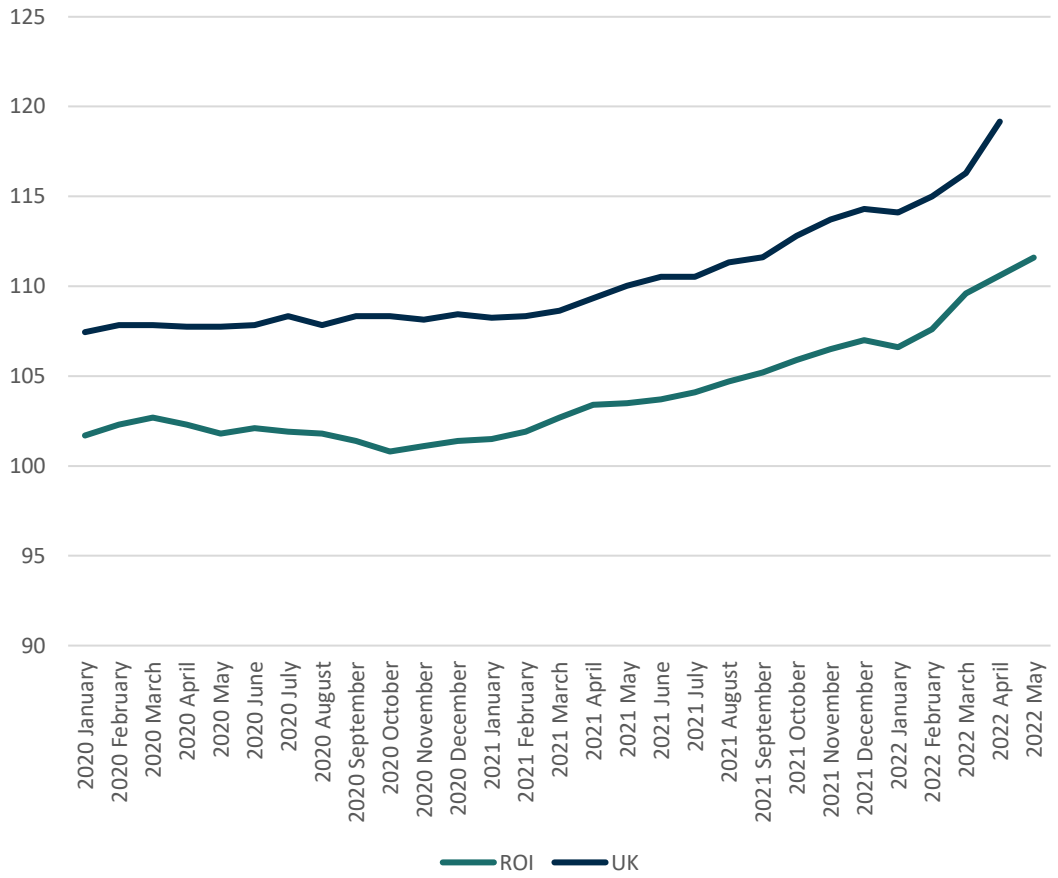
New models of Social Security

- What will Covid-19's legacy be for our labour market?
- The financial supports made available to workers in the UK and Ireland during the pandemic may seem extraordinary in comparison to the status quo, but in comparison to what is provided in peer countries, they are quite ordinary.
- For Ireland and the UK, the covid-19 pandemic has offered a glimpse of how an interventionist government can deal with the employment fallout from an economic crash.
- We have seen that, when faced with potentially mass unemployment, governments can act to transform welfare systems almost overnight.
- As we face climate crisis and necessary employment adjustments, such a system is needed in the longer term.

The next crisis



CPI Inflation ROI & UK (2016=100)



- Rate of growth much closer from 2021 onwards, but still higher in UK.
- Latest figures, 7.8% ROI, 9% UK.
- Latest UK forecast 11%.

Social Wage

- Ireland North and South favour market provision and individual consumption of goods and services provided collectively in other countries.
- This means more necessities are exposed to income volatility and this is why income protection is so important.
- However, income protection not enough, especially in current crisis.
- There is a need to move toward more collective provision.
- Childcare obvious example. No evidence that the current system can adequately anticipate demand or plan supply. Bottlenecks and price surges. Completely unnecessary and avoidable.
- Looking to future, and climate commitments, how can collective provision solve a collective action problem. Looking at new models of public transport provision. Free (Luxembourg) or subscription (Germany).

A Resilient State

- Whether it is income protection or service provision, there is a desire for a greater level of economic security.
- This requires a new social settlement.
- There does, however, need to be a conversation about how these policies might be funded.
- If we want to change our social settlement, we have to look at our fiscal settlement too.
- To achieve this we also need to look at building security into our economic model too.

Part 2:
A Playbook

Not all forms of growth are desirable

- Take an economic system that generates highly unequal growth.
- Such a system won't necessarily benefit much of society. It will also be inefficient at reducing poverty, will gradually erode social capital and trust, and is likely to prove politically unstable over the long-run.
- Other forms of economic growth are also undesirable. Growth that comes from environmentally damaging practices entails costs for current and future generations.
- These costs are rarely if ever captured in growth statistics and they may well outweigh the economic benefits. This is particularly so when we factor in long-term consequences.
- There are many additional examples of undesirable growth such as using tax cuts or monetary policy to temporarily and procyclically accelerate growth at a time when the economy is already performing strongly.
    - E.g. the Irish property boom of the mid-2000s.

- So, what should be our primary economic goal?

So what should be our primary economic goal?

- We propose that countries should strive for ‘sustainable’ and ‘inclusive’ improvements in living standards for everybody.
- If this is considered reasonable we next must consider the policies that might achieve this goal.
- What should our playbook look like?
- Let’s break down that playbook into three parts, namely,
    1. Growth in the economy’s productive capacity
    2. Progress in income adequacy, well-being and closer economic equality (income and wealth), and
    3. Long-run sustainability and resilience (across all dimensions e.g. environmental, fiscal, political).

A Segue: Extensive growth vs Intensive growth

- Growth in productive capacity can come from a number of different sources.
- The raw accumulation and deployment of inputs such as people, land, materials, infrastructure, machinery, and other capital goods.
  - Demographic and other resource limitations mean that this type of 'extensive' growth is constrained in the long-run.
- Growth can also come from productivity gains. This is known as 'intensive' growth and is the only form of growth compatible with environmental sustainability.
  - Productivity gains could arise from new knowledge embodied as technological change and innovation, from scale economies, or simply from more efficient use of resources.
  - Crucially, productivity-based growth allows us to obtain higher levels of output from the same volume of inputs or the same level of output using less inputs.
  - In other words, productivity-based growth does not rely on an ever-increasing use of resources and is potentially unconstrained in the long-run.

Extensive growth: Knowledge is power…. but the market will under-produce it

- Productivity is the ultimate determinant of average living standards - output per worker for a given effort
- Where does productivity come from?
- Learning, new knowledge, and the economic application of that knowledge are the ultimate sources of sustainable growth.
  - Joel Mokyr describes the generation and application of new knowledge or **new ideas** as the "wellspring or lever of riches that propels economies forward".
  - New ideas depend on human capital and interactions with other people
- What do we mean by a new idea?
  - In economics, a new idea is simply a 'new instruction or set of instructions' for transforming inputs into outputs, or more evocatively, for transforming nature to better suit human needs.
- Economics also has the related concept of innovations. Innovation is a catch-all-term for new ideas, or combinations of existing ideas, that manifest as a new product or service, a new production process, a new market, a new source of supply, or even a new organisation.
- But the characteristics of knowledge (e.g. uncertainty in production, inability to fully internalise the benefits) mean that the private market will under-produce the socially optimal amount

The innovation system and innovative capacity

- It is also misleading to think of innovation as being solely about the invention of new cutting-edge technologies. Instead, we should think of innovation as something that happens dynamically in a complex economic system in both low-tech and high-tech ways.
- What is an economic system?
- We can think of it as a multitude of interacting individuals and organisations, each with their own abilities and incentives and operating under their own set of evolving rules and constraints.
- The specific economic system relevant to the production and diffusion of innovation is the innovation system.
  - An economy's innovative capacity refers to the ability to generate original ideas and to communicate and assimilate existing innovations.
  - This capacity is a function of types and levels of education and skills, in the population of households, firms and government, of networks, of the cost of accessing knowledge, of R&D policies, and of the quality of capital markets, of the barriers to technology diffusion, among other things.
  - All of the above form part of the innovation ecosystem.

Innovative capacity: The driver of long-run productive capacity

- In practice, the driver of most productivity will be the spread or diffusion of technology
  - Fundamental to diffusion is communication
  - How can we facilitate 'knowledge flows' between individuals and organisations?
- The government will always be the most significant actor within the innovation system
  - Direct inputs – spending on science and education, on R&D, and on knowledge infrastructure
  - Sets the legislative and regulatory rules of the game
  - Also provide fiscal and other incentives for other actors
  - In this way, governments can counteract the structural market failures leading to slow diffusion and underproduction of knowledge and innovation
- Key policy levers:
  - Investment in education and re-skilling (human capital)
  - Investment in child poverty reduction (human potential)
  - Investment in machinery, equipment and infrastructure (physical capital)
  - Investment in the production and diffusion of new ideas (e.g. through public R&D, facilitating private R&D and technology adoption, building networks, communication)

Human capital: The long-game of development

- Human capital development, which is a life-long process, not only enhances labour productivity but is also a necessary input for and complement to innovation
- Spending on education generates positive externalities and strong education systems are empirically associated with faster long-run growth
    - The OECD contends that half of the growth achieved by OECD countries in the 2nd half of the 20th century, was driven by progress in education
- Skill levels for the population as a whole, as well as for the top of the achievement distribution, exert positive and independent effects on growth
- Population-wide improvements in human capital enable more inclusive growth. Crucially, the earlier the investment in human capital the larger the returns
- The early years are the most important for development
    - Poverty can have extremely damaging and lasting effects
    - Increasing the skills and learning ability of disadvantaged children may provide the largest potential dividend to society
- But Ireland's per pupil spending on education is well-below that of the average for high-income Europe and Ireland chronically under-spends on public R&D (€900 million gap)

Productive Investment and Participation

- Meta-analyses conclude that efficient investment in infrastructure is strongly related to long-run increases in the economy's productive capacity
- Machinery and equipment represent embodied knowledge that either improves the efficiency of transforming inputs into outputs or enables the production of new types of outputs
- Certain types of investment contribute to knowledge-based growth
  - E.g. school buildings, broadband infrastructure, research institutes such as universities and public labs
- Private investment:
  - Tax based incentives can distort investment decisions
  - Better to ensure that potential investors have access to finance and that barriers to investment are low
  - Reduce barriers to firm exit and entry – monopolies as double edged sword
  - Importance of independent regulation of sectors
- Not just productivity – barriers to employment/hours worked matter
  - Policy implication: reducing childcare costs, facilitating working at home and flexible hours, eliminating cliff edges in tax and welfare policy, avoiding high METRs, using countercyclical policies with strong automatic stabilisers

Challenges and fiscal choices

- There are a number of fiscal sustainability issues:
    1. Structural demographic change will reduce employment and significantly add to spending pressures
    2. The climate change transition will have significant investment costs in the next 2+ decades while GHG related tax receipts will (hopefully) vanish by the middle of the century
    3. High debt levels may become problematic if interest rates rise significantly
    4. Other commitments re housing and childcare costs, Sláintecare in ROI (what about social insurance and replacement rates)
    5. In ROI there is uncertainty about the sustainability of corporation tax receipts
- Choices - raise taxes or revenue more generally? Cut public spending elsewhere - services or income supports?
- Other choices? - Is it possible to structurally boost employment rates or structurally boost innovative capacity?

Inequality – fiscal policy

- Lower levels of inequality are associated with a range of quality of life and well-being benefits across the economy and society
    - Excessive inequality can lead to slower and more fragile growth (IMF)
- Fiscal policy is important as a corrective to market inequality (tax, welfare benefits, social insurance, provision of universal basic services – a 'social' wage)
        - Are there trade-offs between efficiency and equity?
            - Not necessarily (easy wins - taxes on wealth/land, eliminating tax expenditures)
            - We have to balance efficiency costs of taxation vs. the benefits from the resulting public spending (e.g. education)
- What about more radical proposals? E.g:
    - Free public transport for all (assists with climate and cost of living goals)
    - Universal basic income (very expensive if set at a meaningful level)
    - Guaranteed minimum income (have to be careful about METRs – best achieved through a tapered support)

Inequality – labour share

- Policies that increase the labour share of income will generally improve distributional equity – this is due to the fact that wealth (and capital income) is more concentrated than earned income (and labour income)
  - Wage floors
  - Enhance bargaining power of labour – collective bargaining and agreements, strong labour market institutions (international decline in trade union density is correlated with declining labour shares)
- There can still be significant market inequality even within the labour share
  - Valuing care work
  - Reducing gender pay gaps
  - Sectoral wage compression (role of trade unions and sectoral bargaining)

Growth is of mere temporary value if it is unsustainable

- Unsustainability has many dimensions – e.g. inappropriate fiscal policy or a property boom
- The current environmentally damaging economic model is manifestly unsustainable on a finite and fragile planet
- Future industrial strategy and growth policy will therefore need to focus on the just transition to a decarbonised economy
- Entire sectors ranging from agriculture to transport will be affected by this transition
- But a new growth model will be politically unsustainable if it leaves behind certain groups and regions
- A need for investment in clean and renewable energy production, in retrofitting buildings, in affordable and available public transport, in sustainable food production, in re-wilding, and in broadband and remote working
- Managing the demographic and climate challenges and making sufficient investments requires a consideration of the sufficiency of our revenue base

Conclusion

- 21st century high-level economic policy should take a multi-pronged approach three main dimensions
  - Enhance innovative capacity and remove employment barriers (growth)
  - Ensure income adequacy and adequacy of services and pursue greater economic equality (equality)
  - Engage in foresight to identify sustainability shocks and make strategic adjustments to policy to respond to those shocks in good time (sustainability)
- Its the overall system that matters
  - A particular policy might fail on some dimension, but this does not mean it should inherently be excluded from consideration (e.g. carbon tax is regressive but that should not preclude its increase)
- Important decisions ahead on fiscal sustainability

Questions?