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Economic Resilience

New Economic Model: Pillar 4

This is the 11th in the NERI's [long-read series](#). It is also the 2nd in our new discussion series outlining a high-level framework or 'New Economic Model' (NEM) for the twin economies on the Island of Ireland (North and South).

Here we address economic resilience which includes socio-economic and environmental stability and adaptive capacity. Economic resilience is one of the four mutually reinforcing pillars that underpin the NEM framework. In an uncertain world we need our economies and societies to be '[anti-fragile](#)', that is to say, capable of thriving and flourishing even while under external or internal stress. The other three pillars are considered elsewhere in this long-read series as well as in other NERI outputs.

The other pillars are:

- (A) Productivity, innovation and growth,
- (B) Participation and good or better jobs, and
- (C) [Economic security and well-being](#).

We should understand the pillars as complementary to and dependent on each other. Economic resilience is an essential foundation for a sustainable high productivity economy. High levels of productivity, in turn, enable the good jobs that

underpin economic security. Finally, a sense of economic security is a vital ingredient of any resilient economy, society and polity.

We start with a number of immediate problems and challenges for us to consider. The Republic of Ireland and the UK have skewed two-tier economies. High living costs, especially in the South, sit beside under-resourced public services in both jurisdictions. The Southern Irish economy, in particular, has repeatedly exhibited boom bust tendencies, although the UK, and by extension Northern Ireland, are also vulnerable to unwise macro-policies as the Truss premiership's swift collapse and denouement showed.

Many crises are unforeseeable events, but many are not. Economies are not self-regulating. Left unattended they will tend towards boom and bust and there will always be regions, communities and industries at risk of falling permanently behind. The identifiable future challenges are enormous. Both economies on the island of Ireland will have to be gradually reshaped over the next generation if they are to adequately make the green transition, while demographic change will increasingly exert profound growth and fiscal challenges.

Cognisant of these challenges, we can set out some key principles for policymakers. Crucially, we must avoid short-termism. Instead, the policy focus should be on the medium-to-long term, albeit we will need countercyclical macroeconomic triggers and capacities in place, available and ready to respond as needed to short-term crises.

Stability requires making choices that look ahead. In good times we should be preparing for turbulence, and in bad times we should be protecting living standards and safeguarding our productive capacity. We need to hardwire fiscal stability and embed price stability, and we must do all of this while fighting climate degradation and protecting incomes. Policy must be agile, willing and able to evolve as context and evidence changes, and, it must be sustainable across all relevant dimensions.

We must be clear. Stability does not preclude dynamism. Indeed, the alternative to dynamism is stagnation, and stagnation ultimately and understandably breeds political instability and discontent. People need to believe there is a better future and that their living standards will improve or at least be sustained. Our challenge then is to develop resilient, stable and sustainable economies that are also vibrant, innovative, inclusive and dynamic.

Some key issues we need to consider include:

- (1) The foreseeable global megatrends and why we need to change in order to successfully meet these challenges;

- (2) The design and identification of a set of principles and ingredients that can underpin a dynamic economy;
- (3) The need to design and hardwire a countercyclical but agile fiscal policy that reconciles sufficiency, efficiency, equity and sustainability;
- (4) The need to create structures and institutions that embed price stability in order to protect real wages and competitiveness and restrain damaging cost of living spirals;
- (5) The need to 'green' our overall package of policies in order to reverse climate degradation and biodiversity loss in the necessary timeframe and consistent with just transition principles, and finally;
- (6) The need to enhance democracy and public 'buy-in' to policies via increased local consultation, agency and empowerment, including greater subsidiarity of policies that affect people in specific regions and localities.

Many crises are unforeseeable. But many are not. In good times we must prepare for turbulence.

What are the foreseeable pressure points? [Climate change and biodiversity loss](#) will worsen absent dramatic policy changes and global warming will create more extreme events and disrupt food production. There will also be ongoing and potentially accelerating technological disruption. We may be in the early stages of a 4th industrial revolution characterised by the use of artificial intelligence (AI), machine learning, advanced robotics, developments in materials and life sciences, various new green technologies, and potentially a range of other advanced technologies including gene editing and nanotechnology. These disruptions will have various and uncertain implications for the structure of the economy, but will certainly alter the needed skills base in the labour market.

Demographic shifts are certain. An ageing population will mean weaker average annual growth and will generate additional fiscal costs. More positively, population ageing might create better leverage for workers to pursue real wage increases if labour supply becomes increasingly restricted.

De-globalisation is already taking place. Tariffs will become a more commonly used policy lever and the USA and the EU seem likely to shift the focus of their industrial policies away from free trade and towards the greater use of industrial subsidies,

other forms of direct state-aid, and the deliberate on-shoring of supply chains. De-globalisation policies are likely to exert downward pressure on trade levels which will have a negative impact on small open economies such as Northern Ireland, and especially the Republic of Ireland. However, de-globalisation could, in theory, shift the balance of power between capital and labour in favour of labour, at least to the extent that capital may become less footloose and less able to play countries and workforces off against each other in a race to the bottom on labour standards.

Climate change is going to impact the economy in many ways. For households there will be decarbonisation adjustment costs and in extreme cases the loss of built housing stock and land. There may be upward pressures on the cost of living while increased climate migration from the worst affected countries seems certain.

Businesses are vulnerable to the loss of assets and indeed certain business models and activities may not survive, at least in their current forms. There may be stranded assets in sectors such as energy production, transportation and agri-food. Supply chains will shift as will demand patterns. A successful green transition implies falling tax yields from green taxes such as carbon tax and fuel excises. Yet governments will need to fund the green transition costs while also shouldering much of the costs from more extreme weather events and rising sea levels.

The political economy of the green transition will be extremely difficult and the correct sequencing of transition measures will therefore be crucial. If the transition is mishandled or seen as unfair then reactionary policies may take hold. The emphasis of policy should, where possible, emphasise carrots more than sticks. Vulnerable groups will need to be protected or compensated. In particular, we will need to ensure the green transition is a 'just transition' based on transition income and infrastructure supports, appropriate re-skilling, and regional development strategies based on decent good quality jobs.

The green transition has profound implications for the labour market. Certain 'brown job' (polluting) sectors will fall into decline while we can expect greater investment and job creation in new or cleaner technologies, for example, in renewable energy, in green construction and housing retrofits, and in green public transport. However, it is not clear that the number of green jobs created will be sufficient to replace the lost brown jobs. There are also implications for agriculture practices and for land use. We will need to develop an attractive financial model for rural communities that will most likely entail the state paying significant annual sums to incentivise nature services and sustainable land use.

The debate about the pace and direction of **technological change** may become more heated as the implications of artificial intelligence (AI) and other technologies become clearer. There are concerns around rising insecurity including job loss and deteriorating job quality, and concerns about the threat of widening inequality were [capital instead of labour](#) to reap most of the benefits from changing production methods. Governments and regional bodies will need to ensure their populations have the requisite digital skills and policymakers will need to increasingly focus on the STEM disciplines (science, technology, engineering and mathematics) and indeed on other skill-sets that will benefit from the anticipated shifts in the structure of the economy (e.g. construction and care skills). This is true not just at second and third level but also in terms of our collective approach to and support for adult education.

We need to learn from past failures to manage new technology. The lack of regulatory policy around social media technologies has led to disinformation, deteriorating mental health, loss of privacy, widening inequality, increasing concentration of power and wealth and a fraying of democracy itself.

How can we ensure that the technologies of the future will be more socially beneficial? How do we ensure that new technologies will be complements to labour rather than substitutes for labour? If we can embed new technologies in ways that *complement* labour then these technologies will enhance labour productivity and living standards.

Conversely, technologies that *substitute for* labour will merely lead to job losses, to rising inequality, and potentially to greater social instability. The losers from the first three industrial revolutions were generally the workers that worked with their hands. This time it is white collar ‘knowledge’ workers in areas such as law, accountancy, finance, administration, and marketing that are, in general, more at risk. The political economy dynamics may, therefore, play out very differently from past technological shifts.

So how might we best protect high quality jobs from the potential downsides of automation and AI? There are no silver bullets. One part of the solution may be tax reforms that incentivise businesses to invest in workers skills and in staff retention as opposed to investing in labour replacing technologies. However, such an approach may not be practicable for an individual small country to do on its own as it may have consequences for attracting Foreign Direct Investment (FDI). The experiences of previous eras of technological change suggest that investments in lifelong adult education and in strong social safety nets will be the critical interventions for people at risk from technological change.

Demographic change will create challenges in a range of ways. One challenge will be a slowing in economic growth per person. We can think of real economic growth, or for that matter economic decline, as a combination of the changes in average labour productivity and total hours worked in the economy. Current projections for population change imply that the working age ratio will gradually decline over time across all advanced economies. A declining percentage of the population of traditional working age range implies slower annual growth per person in the absence of other changes. Growth will therefore increasingly depend on finding ways to improve average labour productivity and/or finding ways to encourage higher levels of net inward migration from other countries.

Other effects of a declining working age ratio may plausibly include labour capacity issues in certain sectors along with an increase in real average wages as available labour supply diminishes and labour markets tighten. An ageing population will also lead to changes in the composition of labour demand. We can expect long-term care and healthcare to grow as shares of total employment while employment in education will gradually decline unless there is a meaningful shift to greater emphasise adult education. An ageing population may also shift consumption patterns in other ways, for example there may be more spending on home improvements and eating in, and less on home building and eating out.

Overall, two labour market shifts we can anticipate are a decline in brown jobs and a growth in demand driven sectors like long-term care. Such shifts have significant implications for job quality, something that we discuss further in the forthcoming pillar 2 long-read.

Another implication of population ageing will be its effect on fiscal sustainability. There will be increased need for spending on pensions, on healthcare, and on long-term care and these costs will only be partially offset by reduced spending on childcare and education. A declining working age ratio also means less tax receipts will be yielded from employment. This suggests that two of the four major tax headings, namely income tax and social insurance, will, at best, grow more slowly in real terms in the future. Less employment income also implies less tax receipts from VAT and Excises.

De-globalisation has obvious implications for global trade and for FDI flows. This is of particular salience to the Republic of Ireland as it is one of the most open economies in the world and has benefited disproportionately in terms of employment and corporation tax receipts from US multinational investment into the country. The more open and export oriented a country is the more vulnerable it will be to tariff

wars and to the trade destruction and trade distortion that results. In addition, small countries will be unable to compete with larger countries in their capacity to offer subsidies to incentivise investment and this will create even further headwinds against inward FDI.

Changes to the corporation tax rate in the US, or indeed changes within the US that adequately deal with financial planning by US multinationals to avoid taxes, could have very significant fiscal implications for the Republic of Ireland to the extent that it might encourage the reallocation of Intellectual Property (IP) assets to the US. Such an occurrence would shift the geographic allocation of profits and thereby erode Ireland's corporation tax base. Overall, a reversal of globalisation creates a challenge to the Republic's core economic model but also reduces the incentive for regions such as Northern Ireland to push for a lowering of the corporation tax rate to attract FDI.

A potentially positive side-effect from de-globalisation could be a diminished ability of capital to play off countries and government against each other in a drive to reduce business costs including, notably, labour costs. Less pressure on governments to pursue labour market regimes hostile to workers could shift the balance of power between capital and labour in favour of labour, or at least make it less heavily skewed than it currently is in favour of capital. On the other hand, the lower flows of FDI implied by de-globalisation could potentially make race to the bottom dynamics even more intense. Its difficult to be sure.

Other trends are foreseeable but not inevitable such as the type of social fracturing observed in places such as the US, and the tensions over rural versus urban inequalities expressed in other countries. Covid-19 and a land war in Europe might have been unexpected, but it is clear that future pandemics, wars, and a range of other shocks are foreseeable in at least some form even if their precise nature and timing are uncertain. We must recognise that we cannot predict everything.

This means we must install economic, social, educational and innovation systems that are agile and responsive and that give people and regions the means to evade and/or bounce back from economic setbacks.

There are foreseeable and unforeseeable changes coming. We need a system that makes the economy and people resilient.

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Long-term resilience is not the same thing as unchanging stasis. On the contrary, economic and social stability requires people to believe that their living standards will improve, or at least that they can improve. In turn, improvements in living standards and well-being require the economic system to be dynamic, agile and ever more productive and inclusive. A focus on ‘protecting what we have’ can be politically popular in the short-run but is, nonetheless, a developmental trap and dead-end. A dynamic and flourishing economy is one that successfully embraces and manages flux, churn, evolution, transformation and change.

So how might we achieve continuous growth in living standards? Knowledge applied in new ways and in new contexts is the critical enabling input for sustainable long-term improvements in living standards. Sustainable growth policy essentially hinges on the production, diffusion and economic application of new ideas. We need to develop, nurture and safeguard the conditions in which the promethean fire of human creativity can thrive and be rewarded.

Economic growth can only sustainably occur over the longer-term via the introduction and expansion of new or improved innovations to the economy. This process causes the aggregate level of productivity in the economy to increase. The newer and more efficient ideas or technologies render older products and services obsolete while also raising the economy’s productive potential. Jobs, businesses, and even industries, which are unable to adapt to the new reality will eventually be replaced by those better able to exploit the newer more efficient and useful technologies. The process of economic upheaval and change is perpetual with newer technologies themselves replaced over time.

Economic change ebbs and flows along with what Joseph Schumpeter calls ‘creative gales of destruction’. Economic progress means turmoil ([Schumpeter, 1942](#))

and churn is part of the process of economic development. Economic change is not a reality that can be wished away. Change needs to be managed with appropriate transition supports but we cannot and should not seek to prevent it. Preventing such change is to embrace stagnation with a constant risk of individuals and regions being left behind. This makes 'just transition' management essential to any model of sustainable economic well-being. Its absence or failure as a policy can be seen in the development of economic rust belts in the US and in parts of continental Europe and in the UK.

More optimistically, economic growth based on 'new ideas' is sustainable ad infinitum as long as the process of creative and destructive innovation is allowed to continue indefinitely ([Aghion and Howitt, 2009](#)). Technology diffusion is an intrinsic part of the innovation process. We can think of diffusion as the process by which individuals and firms in an economy and society adopt novel ideas and technologies or replace older technologies with improved versions. Yet the diffusion process can take a long time and is not guaranteed to succeed. It depends on perceived benefits and costs, on factors related to the industrial, social and cultural environment, as well as on factors related to uncertainty and to the availability of information ([Hall, 2005](#)).

Notable factors that have influenced historical diffusion patterns include:

- (A) improvements in communication and transportation technologies;
- (B) increases in effective population size and density, and the growth of cities which tend to foster cosmopolitanism and exposure to different people with their own novel ideas and perspectives;
- (C) cultural shifts including greater openness to other people's idea and tolerance for risk;
- (D) improvements in population-wide education and human capital which enhances the populations' ability to generate, identify and absorb new ideas, and
- (E) changes in a society's legal and cultural 'rules of the game', or what [North \(1990\)](#) calls institutions.

The rules of the game condition the incentives, expectations, and behaviour of economic actors as well as the costs to generating, diffusing and applying knowledge. Examples include the strength and predictability of property rights; the education system; the financial system; the regulatory system; corruption levels; quality of governance and political stability; fiscal policy including taxation, and the legal system including patent law.

The system's ability to generate original ideas and to communicate, diffuse and assimilate existing innovations is referred to by [Furman, Porter and Stern \(2002\)](#) as its 'innovative capacity'. At a *national* level we can think of it as National Innovative Capacity (NIC) with each country or region having its own innovation system comprised of innovating organisations with various capacities and different linkages to each other, as well as to knowledge flows.

Enhancing national innovative capacity is central to the long-term performance of the two economies on the Island of Ireland. At an *organisational* level the idea of 'absorptive capacity' captures the ability of an organisation such as a firm or public agency to identify, value, assimilate and apply new knowledge. Small enterprises in particular may have weak capacities.

Policies for enhancing productivity and innovation are discussed in the forthcoming Pillar 1 long-read. For our current purposes we note simply the importance of fostering a dynamic and productive innovation system. This has implications for the design of fiscal policy, education policy, and enterprise and competition policy, and it has implications for the appropriateness of different supports and interventions. In particular, it points to the need to rethink enterprise policy in certain areas.

For example, tax reliefs that subsidise and promote low value-added business activities or failing business models, and policies that impede intergenerational equality of opportunity such as inheritance tax reliefs for business can both be understood as forestalling the processes of dynamic churn and economic development. Such policies carry fiscal and other opportunity costs and are likely to be counterproductive by producing slower growth in the long-run.

Instead, a dynamic economy and society should be understood as being based on openness and opportunity and on the economic security that encourages risk-taking. More fruitful policy options for improving national innovative capacity include but are not limited to:

- (1) allocating higher levels of per capita spending on public R&D and enhanced subsidies and tax breaks for private research;
- (2) creating of a safety net for entrepreneurship and risk-taking including via social insurance reforms and lenient bankruptcy laws;
- (3) establishing attractive career paths for STEM workers and for other researchers particularly at PhD level and beyond;

- (4) providing fiscal supports for ICT adoption and financial and other supports to encourage the life-long re-or-up-skilling of workers and managers more generally;
- (5) improving infrastructure especially in technologies that facilitate communication and learning such as broadband and artificial intelligence;
- (6) enacting patent reform at EU and UK levels to prevent the monopolisation or mothballing of technologies;
- (7) building out an entrepreneurial state in which the state takes a leading and activist innovation and entrepreneurship role as proposed for example by [Mazzucato \(2013\)](#);
- (8) encouraging inward migration in order to bring in a flow of new skills, new ideas and new perspectives into the economy;
- (9) promoting horizontal innovations from within organisations by encouraging a greater degree of employee voice and autonomy, more active learning by doing, and better communication of internal expertise, and
- (10) ensuring greater economic and social inclusivity including the elimination of child poverty and the other barriers to individuals fully participating and flourishing in the economy. Greater inclusivity allows everyone to potentially contribute to or exploit the sum of knowledge in the economy.

Resilience is not the same as stasis. Dynamism and innovation are the keys to long-term prosperity.

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e next need to consider the issues of resilience and stability across four key stability dimensions. We'll start with fiscal stability. Failure to properly manage the public finances has led to prolonged periods of

austerity, high unemployment, and economic malaise in both jurisdictions on the Island of Ireland.

The Republic and the UK have been plagued by procyclical and unsustainable fiscal policies that have arguably been the largest source of economic volatility over the last half century. For example, the Great Financial Crash at the end of the 2000s precipitated severe recessions which were amplified by governments withdrawing money from the economy in what was known as ‘austerity’. While austerity policies lengthened and deepened the downturns it was prior fiscal mistakes that had constrained governments ability to respond countercyclically with fiscal supports. Fiscal mismanagement was so severe in the Republic that economic sovereignty was de-facto ceded to a troika of international institutional lenders.

More recently, the UK’s experience under the Truss premiership illustrates that fiscal policy continues to have real constraints and not just for small countries. The UK’s public finances remain fragile. Surpluses can be illusory and there are legitimate concerns that current fiscal policy in the Republic is being insufficiently prudent with potentially transitory and fragile corporation tax revenues being used to balance the books.

Fiscal stability needs to be embedded and hardwired into the economic model. Yet great care is needed in the design of any fiscal rules so that other goals are not sacrificed. Most importantly, we need to define the goals our fiscal rules and frameworks are actually attempting to achieve and to then design a structure that can reconcile these multiple goals.

More goals mean more complex rules. How should fiscal rules interact with major economic transition costs? What are the appropriate protocols around the use of ‘once-off’ supports and what should trigger such supports? How should we treat tax windfalls? Ultimately, we want to ensure that policy is sustainable but also that it does not impede necessary investments in the long-term health of the economy. Common sense guidelines might include:

(A) Running meaningful current spending surpluses in the good and in the normal times, which then enable countercyclical current spending deficits either during a recession, as a response to clearly temporary shocks, or to unexpected but time bound spending pressures. Over the medium-term, a government’s *current* spending should be completely financed through taxation and not through debt;

(B) Applying a golden rule for investment that ensures sufficient and consistent allocation of resources to public capital spending across the economic cycle. Net

borrowing over the economic cycle should only be for infrastructure projects that add to the economy's productive capacity. The appropriate scale of public capital spending depends on a number of factors including the size and age of the existing capital stock; the possible need for infrastructure catch-up; capacity constraints and pressures; population growth and change, and the economy's growth potential. While a golden rule implies scope for a certain amount of borrowing as a percentage of GNI* (Republic) or GDP (UK) the precise level of borrowing would ideally be set somewhat below the economy's medium-term potential growth rate. Additional capital spending may be desirable but, if pursued, should be sourced from running surpluses of government revenue in excess of current spending;

(C) Quarantining potentially transitory revenues so that they are not available for use either to fund day-to-day spending or to finance tax cuts. All transitory revenues, for example the current excess corporation tax receipts in the Republic of Ireland, should be allocated either to long-term savings funds or to funding vehicles for future countercyclical investments in infrastructure. The [decision](#) of the Republic's government to put some of the potentially transitory corporation tax revenues towards a *Future Ireland Fund* (FIF) designed to part-fund longer-term expenditure pressures and an *Infrastructure, Climate and Nature Fund* (ICNF) designed to deal with the procyclicality of capital spending and the need to fund green infrastructure, is a welcome first step. Even so, the government's plans do not go far enough. *All* of the potentially transitory receipts should be allocated to the long-term funds. Other revenue sources may also prove transitory. For example, carbon taxes and other green taxes will decline over time to the extent that governments are successful in reducing the economy's carbon emissions. 'Temporary' receipts of this nature should not be used to finance ongoing current expenditure or tax cuts elsewhere but instead should be allocated to finance temporary transition costs such as spending on green infrastructure;

(D) Starting a mature debate about expenditure needs, fiscal sustainability, intergenerational equity and revenue sufficiency into the 2030s and beyond. Multi-annual and transparent fiscal planning needs to be a priority with government's fiscal projections shown up to 10 years in advance. The Republic's [Commission on Taxation and Welfare \(COTW\)](#) made 116 policy recommendations designed to ensure fiscal sustainability over the longer-term in the Republic. A similar commission should be established in the UK to address future expenditure and revenue needs. It is too simplistic to say taxes will need to go up. We also need to focus on tax design.

Fiscal stability needs to be hardwired into the economic model and we need a mature debate about expenditure needs and revenue sufficiency.

The COTW's recommendations and overall approach was framed through five design principles. These were sustainability, reciprocity, adequacy, equity and efficiency. The COTW's key message was that the Republic faces major fiscal sustainability challenges due to population ageing, the climate transition, and other factors. The Commission found that, over time, the overall level of taxation as a share of national income (GNI*) will have to *materially* increase. A similar conclusion would presumably apply just as much to the UK.

Perhaps the Commission's most notable finding in terms of the composition of the tax system is that tax expenditures (colloquially known as tax breaks) should only be used in extremis. The Commission argued that tax expenditures are generally non-transparent, economically distortive, regressive, and characterised by high levels of deadweight.

The Commission argued that such narrowing of the tax base was only justified where there was a clear and structural market failure and where the proposed tax break had passed full ex ante economic and social evaluations of likely impacts. Eliminating tax breaks would create scope to generate billions in additional revenue per annum.

The Commission's other main finding on the taxation side was that the most obvious scope for increasing certain taxes was with regard to capital and wealth. It noted potential competitiveness concerns regarding the impacts of higher labour taxes and the potentially regressive impact of most possible consumption tax increases. The main proposed increase in labour taxes was in relation to self-employed social insurance rates and the removal of various social insurance exemptions. The main proposed increases in consumption taxes relate to the elimination of fossil fuel subsidies and to increases in other green taxes such as those on carbon and congestion.

On the capital side the Commission proposed various reforms to increase yields from taxes on gifts and inheritance, from taxes on capital gains and from taxes on

property. They also proposed the introduction of a site value tax as a form of land tax. All of these proposals have merit. In general, the most growth friendly taxes are taxes on capital stocks (wealth) and property, and in particular those on immovable property and land. Such taxes therefore offer the most promising ‘low hanging fruit’ for increasing government revenue in a manner consistent with growth and equity goals, albeit the political challenges are considerable. The [Fiscal Council](#) has estimated that the Commission’s proposals would cumulatively raise over €14 billion annually in the Republic.

Budget sustainability is also an issue for Northern Ireland which has faced several budgetary crises over the years post-2010. However, there cannot be any real discussion of budget sustainability without a parallel discussion of fiscal sustainability. Fiscal sustainability captures a much wider measure of how various policies by all levels of government contribute to the stability of the public finances. It is not possible to divorce the budgetary decisions of an NI Executive from the budgetary decisions of the UK government. The contours of UK budgetary decisions determine the level of autonomy any devolved Executive has in determining its own budgetary decisions. While it is reasonable for the UK government to expect the NI Executive to commit to sustainable budgetary decisions, the same argument also applies in reverse. Fiscal sustainability is therefore a joint venture between both the UK government and the NI Executive and should be treated as so.

The scale of the long-term challenges in the Republic and in the UK is such that more than increases in the smaller yielding tax heads will be required. In practice this means changes to one or more of the four big tax heads. These are income tax, social insurance, corporation tax, and VAT. There is unlikely to be much ongoing scope for further sustainable rises in corporation tax receipts in the Republic given their already large existing size relative to GNI*, although there may be some scope in the UK. VAT increases would be regressive although some reforms are feasible, particularly in relation to raising certain reduced rates. Social insurance increases may be more politically achievable than increases to income tax to the extent that levels in the Republic and in the UK are currently very low relative to other European countries and that increases could be explicitly linked to expansions in the social wage. Indeed, the low level or ‘under-taxation’ of employer social insurance is of such scale that it effectively amounts to an ‘[elephant in the room](#)’ explaining the Irish and UK revenue gaps relative to Western European averages.

Long-term challenges are such that the overall level of taxation will have to materially increase.

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The second stability dimension is the need to protect and develop structures and institutions that embed price stability within the economy. This is necessary in order to protect competitiveness, real wages, and employment and to prevent or restrain damaging cost of living spirals. Monetary policy is of course central to price stability but it is worth discussing some additional policy levers.

First, we need to consider the promotion of competitiveness including the tackling of monopolies, market and regulatory failures and business costs. Competitiveness is inherently a relative concept. In the long-run it is productivity that matters for sustainable well-being improvements, albeit increases in prices will ultimately erode employment and economic activity if they become decoupled from productivity increases. So the core focus of a competitiveness agenda should be to raise productivity growth ([Draghi, 2024](#)). Policies for productivity growth are discussed in depth in the pillar 1 long-read as well as the earlier section on dynamism.

Second, we need to consider the appropriate set of macro-prudential rules and principles to prevent boom and bust cycles and price spirals in key sectors of the economy such as banking, energy and housing.

The Republic in particular has seen a long-term trend of rising living costs with these high costs imposing unnecessary burdens on households and enterprise. The Republic has notably high costs for housing, utilities and childcare. High housing costs are ultimately a function of inadequate housing supply though demand side subsidies and favourable tax treatment are also pushing up prices. Over the medium-term policymakers North and South should focus on creating [unitary housing systems](#) with

much more significant roles for the state in the direct provision of public housing. De-commodifying childcare via a public sector option at free or below market rates will be necessary to satisfactorily resolve the twin problems of cost and availability in that sector.

Despite these challenges the National Competitiveness and Productivity Council (NCPC) notes that the Republic [ranks highly](#) (4th out of 67) in the IMD World competitiveness rankings and best in the Euro area, albeit with a ranking of just 38th for basic infrastructure, 40th for entrepreneurial fear of failure, 46th for prices (cost of living) and 56th for relatively high consumption tax rates. The Republic's overall ranking is very likely skewed upwards by the presence of highly productive US multinationals. With regard to infrastructure the IMD notes weaknesses in water infrastructure, the road and rail network, and especially energy infrastructure. In addition, businesses in rural areas have additional constraints that impede their competitiveness. For example, [ESRI research](#) shows that while high speed broadband coverage is almost universal in urban areas in the Republic there are still significant gaps in rural areas.

The IMD ranked the UK just [29th in 2023](#) and 28th in 2024, declines in ranking from 18th in 2021. Basic infrastructure ranked just 38th in 2023 and 44th in 2024. The UK also ranked poorly in 2023 with regard to prices (63rd), tax policy (42nd) and management practices (38th). More positively, the UK ranks highly in terms of university education (2nd), scientific infrastructure (9th) and access to financial services (5th).

Despite its overall high ranking there are a number of areas where the Republic's cost base is likely to be impeding the enterprise base and its competitiveness. One of the most important of these is the cost of energy. For example, [electricity prices](#) (see Figure 3.2.8b) for non-household consumers (companies) was significantly higher than the EU average in 2023 and the 3rd highest in the EU. The NCPC argues that underinvestment in energy infrastructure including in the grid and storage capacity is undermining Irish competitiveness. Small market size, peripheral geographical position and geographically diffuse and low-density population are additional factors that may be contributing to the high costs. On the other hand, both economies on the Island may have a comparative advantage in the production of offshore wind energy. A massive programme of investment in renewable energy supply and grid upgrades should be a priority for both economies with large-scale direct state intervention and financing if necessary.

Other areas where businesses in the Republic are at a competitive disadvantage include access to and cost of capital and legal and insurance costs. With regard to

access to capital, policymakers in the Republic should strongly push for the creation of a pan-EU capital markets union (CMU) to improve competition in the supply of available funding for Irish companies. A CMU would also greatly benefit the EU economy, allow EU companies to more easily scale-up and compete on a more even playing field with US companies and assist with the green and digital transitions. Legal and insurance costs are also [often cited](#) as a competitive disadvantage for Irish businesses. A strategy for removing anti-competitive practices and structures in the economy should be a priority, with concrete steps taken to regulate and put downward pressure on legal and insurance costs. Other areas of market failure that push upward pressure on wages and business costs are childcare and housing. Their impacts on the labour market are both discussed in greater depth in the forthcoming pillar 2 long-read.

The second aspect of price stability is the need for macro-prudential policies that prevent boom bust cycles and price spirals developing. A preventative approach is key to embedding price stability just as it is key to preventing fiscal crises. There are numerous examples of such dynamics forming historically. We can use the Great Financial Crash (GFC) as an illustrative example in order to identify the type of policies that can help prevent boom bust dynamics.

The GFC was essentially caused by widespread failures in financial regulation and supervision as well as failures in corporate governance at numerous systemically important financial institutions. The period leading up to 2007-08 was characterised by deregulation, excessive borrowing and risk taking, and a lack of transparency. In the Republic, the crisis was exacerbated by procyclical fiscal policy and a swathe of housing related tax breaks and easy credit that combined to inflate a massive housing bubble which left banks critically exposed.

Design flaws in the architecture of European Monetary Union (EMU) would subsequently make euro area countries the epicentres of sovereign debt crises. Destabilising credit flows and the build-up of regional imbalances within the currency union had been allowed to expand unchecked prior to the crisis and there were no mechanisms in place to stop the crisis spiralling out of control. Notable design flaws included the absence of a centrally run banking union, the absence of a fiscal mechanism (Eurobonds) to soften asymmetric shocks, and the absence of a lender of last resort to sovereign borrowers. The euro crisis ultimately dragged on for a number of years. The Bank of England acts as a de-facto lender of last resort in the UK and has been able to respond quickly to combat shocks to the UK economy. A recent example was its ability to restore financial stability following the Truss tax cuts and subsequent market instability in 2022.

The main lesson for price stability is that a *preventative* regulatory approach is necessary with strict risk-based [macro-prudential regulations](#) in place to stop an unsustainable rise in credit before it happens and to safeguard financial stability. In addition, the Republic should actively seek to push to remedy the aforementioned design flaws within the EMU so that crisis backstops are in place when preventative regulation fails.

Finally, we need to consider how we might best link prices such as real wages to sustainable productivity gains and the potential role collective bargaining could play in this. In this context, the importance of managing business costs and prices needs to be set against the need for sustainable improvements in living standards which depends on positive real wage growth. The full significance of collective bargaining is considered more fully in the long-read on pillar 2 but for the present it is worth acknowledging collective bargaining's potential role as an anchor for price stability and competitiveness.

The core focus of a competitiveness agenda should be to increase productivity - but prices and the cost base must also remain anchored to productivity.

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The third stability dimension is the environment. Economic resilience cannot be separated from protection of our shared environment on the island. The economy does not exist apart from the planet at large. Rather, it is embedded within our atmosphere, local and planetary chemical cycles and ecosystems. Future prosperity and well-being are intimately tied to the preservation of our natural resources. As the old adage has it 'there are no jobs on a dead planet'.

The climate and ecological emergencies include historically rapid climate changes driven by human produced greenhouse gas emissions, disruption in natural chemical cycles, waste production and the permanent loss of many species of plants and

animals. Addressing these emergencies requires an all of economy and an all of society response. [NESC](#) have argued that the starting point for the transition to a climate-resilient, biodiversity-rich and climate-neutral economy is a vision that all stakeholders can agree to work collectively towards.

Large-scale green investment in energy, transport, and housing will be required. Much of this will need to be state driven. The [Irish Fiscal Advisory Council](#) (IFAC) estimate that government supports will cost between 0.6% and 1.1% of GNI* per annum out to 2030 and between 0.4% and 0.7% between 2031 and 2050. We can assume similar figures for the UK. IFAC have also pointed out that a successful transition means a reduction in tax receipts from fuel and energy use (e.g. carbon tax) and motor tax that could amount to 1.6% of GNI* per annum in the long-run. On the other hand, missing its EU-agreed targets would cost hundreds of millions in fines per annum. Additional costs arising from more extreme weather are also likely.

The Republic's [Climate Change Advisory Council](#) has made a range of recommendations including the cessation of government subsidies for fossil fuel consumption, greater funding for low-carbon technologies, expansion of wind and solar power and the planning reform to support this, financial supports to address business and household affordability issues, and a more integrated approach to policy development and integration. They also make sector specific recommendations for electricity production, energy and waste, transport, the built environment, and agriculture and land use.

A key element of the transition relates to energy systems on the island. Plans to reduce emissions are largely centred on the movement of energy from fossil fuel use – such as your petrol car or gas-powered heating system – to an expanded and greened electricity system. In light of these needs, policy should focus on two key areas to ensure coherence: 1) continued expansion of renewable energy sources within the existing generation system and 2) inducements to reduce energy demand across the economy. The first of these should entail support for private renewable generators but the state must also itself take an explicit role in new generation including offshore wind. The energy transition is too important to be left solely to market conditions.

Policy must adhere to [just transition](#) principles and ensure correct policy sequencing with an emphasis on carrots over sticks where possible. Key aspects of a just transition include meaningful public consultation, income protection for lost jobs, job creation in affected regions, significant investments in skills development and retraining supports for green and grey jobs, and addressing affordability barriers for

low income households and small businesses. Policymakers will also need to properly value and pay for natural capital including the provision of green assets and services.

[Mercier](#) identifies 11 lessons from just transition case studies. These emphasise the need for social dialogue and supporting institutional structures, preparation, skills audits and state investment. [Ní Lochlainn](#) notes that the capacity to bear the brunt of the transition will be unequal in Northern Ireland. She points out that a just transition will not happen by accident and that it will require significant action by the state, from consulting with workers and communities, to directly supporting those displaced and ensuring that the skills system is fit for purpose.

As an example of addressing affordability, energy prices could be ‘reshaped’ to favour low-income groups during the transition to a renewable energy regime. With a system of energy block tariffs, a set number of kilowatts of energy could be provided at below market rates to all households with higher volumetric tariffs above that threshold. This could significantly reduce energy poverty, incentivise decarbonisation and shift energy costs from low-income to high-income households.

Other policies for addressing affordability include generous subsidies for public transport use alongside substantial nationwide expansions of public transport services, significant up-front subsidies for housing retrofits and electric vehicles and a programme of state investment to retrofit the entire social housing stock. All of these measures will bear significant fiscal costs. However, using the state to fund the transition will socialise the cost in the most equitable way through progressive taxation and in so doing protect vulnerable households. Having such policies in place should neuter concerns about highly effective but regressive measures such as the annual increases in the carbon tax and the abolition of fuel subsidies.

As part of the green transition we should seek to construct an [eco-social welfare state](#). Aspects of this are described in the other Pillars and include greater income supports, universal basic services and facilitative childcare arrangements. Such changes, alongside measures to reduce energy and material demand, can reconcile ecological goals to general social welfare. The development of such an economy can also begin to redress regional imbalances.

Environmental policy is not just about greenhouse gas emissions. Greater funding is needed to reverse the deterioration in biodiversity and support the restoration of ecosystems. Both jurisdictions will have to address the environmentally problematic area of agriculture dominated by animal farming. This sector is a leading source of [greenhouse gas emissions](#) as well as [chemical runoff on the island](#), with outsized

impacts on climate, as well as our water quality and land-use. At the same time, the sector is a major source of employment, and farmers play a key role in society.

Governments will need to set aside substantial recurrent funding to provide farmers and other land owners with incentives to focus on more sustainable forms of agriculture, on nature restoration efforts to rebuild lost natural assets which can absorb carbon, and on the protection of biodiversity and other eco-services. In the Republic, the Climate Change Advisory Council has sensibly proposed that the government's new Infrastructure, Climate and Nature Fund should be deployed to protect and restore carbon-rich habitats on land and sea.

Global temperatures are rising and we will face increasingly catastrophic risks and disruptions.

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Finally, we must consider political economy as a fourth sustainability dimension. Policies need to have the support of the people. Workers need to feel they have a meaningful say in how they are governed and that their voice matters. They also need to feel they have dignity, recognition and esteem at work. If a policy does not have public support and acceptance then it will be continuously vulnerable to being reversed. Dialogue is essential.

[Sandel](#) talks about diminishing communal solidarity and a growing sense that people feel they are losing control of their lives. The dominance of the neoliberal worldview and its policies in Western countries over the last half century has delivered enormous rewards for some but has also left many other people and communities behind. Alienation and frustration have fomented a populist right-wing backlash in many countries. High housing and other living costs, weakly resourced public services and career and wage stagnation are all potential vectors of discontent. Yet the application of far-right populism to policy would simply further undermine the

resilience and stability of communities and societies. We need a better and more progressive way. A better and more inclusive economic model.

A truly resilient 21st century economic model and its underpinning policies have to be founded on inclusive consultation and transparency. We need to consider how best we can enhance regional; community and local decision making and provide an enhanced voice for communities and for workers. We need to strengthen local democracy and decision making with greater subsidiarity of decisions that affect local economies. There needs to be a renewed emphasis on community services such as housing, parks, public transport, healthcare and libraries and a renewed emphasis on life-long skills and meaningful quality economic opportunities for all. We're all in this together.

Our economic model needs to be based on dignity at work and communal solidarity.

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Based on the discussion we can identify a number of policy elements for resilience in the two economies which, while certainly not comprehensive and in many cases overlapping with the other pillars, can be broadly summarised as follows:

- A) Economies are not self-regulating. A laissez faire approach to economic transitions will not protect workers, sectors and even regions from falling behind. Resilience cannot be assumed. An activist 'mission' approach is needed if we are to build and protect a dynamic thriving economy;
- B) Economic change needs to be managed with appropriate transition supports but we cannot and should not seek to prevent it;
- C) We need to focus on policies that enhance innovative capacity and dynamism at national, organisational and individual levels;

- D) We should not persist with economic policies that seek to forestall the processes of economic change. An important example of what not to do is preferential subsidies for low value-added activities or for failing business models;
- E) A policy set designed to enhance dynamism and innovative capacity includes higher spending on R&D; safety nets to incentivise entrepreneurs; more attractive career paths for researchers; fiscal and other supports for technology adoption; significant improvements in infrastructure; patent reform; an activist entrepreneurial state; more open inward migration; greater employee voice and input, and systematic elimination of barriers to human development such as child poverty;
- F) Fiscal stability needs to be embedded and hardwired into the economic model. Fiscal policy should always be countercyclical, ideally with surpluses in good times, while transitory tax receipts should be saved;
- G) There should be a golden rule that ensures sufficient and consistent allocation of resources to public capital spending across the economic cycle;
- H) Mature debates are needed about expenditure needs, fiscal sustainability, intergenerational equity and revenue sufficiency. The broad thrust of the recommendations from the Republic's Commission on Taxation and Welfare should be adopted and a similar commission established in the UK and separately in Northern Ireland;
- I) We need to embed price stability in the economy. This includes dealing with existing high prices and market failures in electricity, childcare, housing, legal services and insurance. These high costs undermine competitiveness. There should be state intervention to diagnose and resolve these failures;
- J) Macro-prudential policies that prevent boom bust cycles and price spirals from developing must be retained. In particular, a preventative regulatory approach is needed to stop unsustainable rises in credit and asset prices before they happen;
- K) Addressing the climate and ecological emergencies will require an all of economy and an all of society response. Large-scale green investment in energy, transport and housing is needed;
- L) The green transition must be a 'just' transition with meaningful public consultation, income protection for lost jobs, and job creation and skills development for the regions and workers affected;
- M) The green transition should, where possible, emphasise carrots over sticks while acknowledging that policies such as carbon taxes and abolition of fuel subsidies are necessary. Generous subsidies to address affordability barriers will be

needed so that low income households and small businesses can make the green transition;

- N) Substantial recurrent funding will be needed to provide farmers and other land owners with incentives to focus on more sustainable forms of agriculture and nature-friendly practices;
- O) We need to reform the policy process to ensure there is more meaningful stakeholder, regional, and local involvement in decision-making.