



Research for new economic policies

NERI Working Paper Series

Why We Need an Economic Plan B

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Abstract

Economies across Europe are entering recession once again. Following a sharp fall in output and employment, here, in 2008-2010 and a continuing contraction in the 'domestic economy' - only temporarily counteracted by a surge in exports in the first half of 2011 - there are mounting concerns about future growth prospects. Unemployment is at crisis level especially as young people remain without work over a long period. This is proving very damaging to communities and individuals and is a major cost to the Exchequer.

The most recent Quarterly Economic Observer of the Nevin Economic Research Institute has cited the Nobel prize winning economist, Joseph Stiglitz, who described recent coordinated European austerity measures as a 'mutual suicide pact'. Keynesian economics demands flexibility for Governments to coordinate in such a way as to sustain aggregate demand and address trade, capital and public finance imbalances. The wrong time to impose greater austerity through fiscal or monetary tightening is when there is a large output gap and deficiency in demand across the major European markets. A similar policy is being pursued across European Member States. This may be described as Plan A. At a global level and over recent decades some of the key features of Plan A are:

- A gradual reduction in the wage share of total income;
- A curbing of the size of Government and its reduction in some cases through a race to lower taxes;
- A continuing liberalisation of labour and product markets;
- A 're-structuring' of welfare to 'incentivise' people to work and remove elements of universalist entitlement to services or payments (through means-testing or targetting); and
- Continuing Privatisation of public enterprises services in part or in full.

'Plan A' as implemented here in recent times has focussed on domestic deflation through pressure on real unit labour costs, cutting of public spending, raising of taxes and charges as well as growing exports as the preferred way to recovery over stopping the decline in domestic demand. It is argued, in this paper, that a 'Plan B' is urgently needed to stop the fall in domestic demand and generate growth through job creation, investment in priority infrastructure and measures to raise skills. It is possible to do this through a combination of measures allied to a gradual increase in the tax take arising from growth in the economy as well as taxes aimed specifically at high-wealth and high-income individuals and households. The choice of spending or taxing is a

domestic (Irish) one and not one that has been imposed externally. This has been confirmed on numerous occasions by the Troika. In the long-term a strategy to develop a much stronger and export-orientated indigenous sector offers a more sustainable approach to developing a social and economic model that fits the needs of a 21st century society.

1 Introduction

Fiscal austerity is not working. A range of economic indicators point to continuing contraction in the domestic economy as consumers and investors continue to cut back on spending in response to falling income and continued uncertainty. Ireland was to be the 'poster child' of fiscal austerity. First we were not Iceland. Then we were not Greece. Now we are not Spain or Portugal. Will we not be Ireland in the future?

Falling GDP in the two final quarters of 2011 along with a cumulative decline of 26% in real terms in domestic demand testifies to the failure of fiscal austerity to kick-start economic activity. A huge expectation has been placed on export performance to pull the economy out of recession and negate the impact of domestic contraction. However, export growth in the latter half of 2011 has not been sufficient to prevent a small, but significant, decline in Gross Domestic Product (GDP) over this period. The signs for 2012 are not encouraging as the Eurozone enters into a new recession.

Plan A had envisaged what economists refer to a 'competitive internal devaluation'. In other words, in the absence of currency devaluation and independent monetary policy, the expectation was that falling real wages coupled with fiscal adjustment (through cuts in public spending and increasing taxes) would boost exports, boost confidence and stimulate growth through consumption and investment. Contracting public investment and consumption would, somehow, allow space for 'expansionary fiscal contraction'. This idea rested on the notion that consumers and investors would feel a greater confidence about spending as they knew where they stood in regard to future taxes and as increased stability and certainty was restored to public finances and financial markets. Plan A has failed, to date, to deliver the promised fruits of growth, confidence and stability. The wider European financial and political crisis has continued and worsened as the years pass. Now entering its fifth year of consecutive domestic contraction, the economy of the Republic of Ireland has proved disappointing as an example to other European States struggling with debt, rising unemployment and stagnant economies.

The immediate fiscal outlook is extremely challenging.

Previous (optimistic) projections of growth in GDP and employment have proven wrong not because of weak export demand – export markets have been very buoyant

up to mid-2011. Rather, they have proven wrong because the evidence now emerging strongly suggests that the negative domestic economy impacts of fiscal contraction were under-estimated.

The provisional estimate of the 'headline' figure for the public sector deficit in 2011 stands at over 13.1% of Gross Domestic Product (Eurostat, 2012). This includes an estimated 3.7% of GDP in 'dead' payments by the exchequer to the banks to increase their capital. The underlying deficit was therefore likely to be in the region of 9.4% of GDP – down by 2.3% on the estimated underlying deficit of 11.7% in 2009¹. Notwithstanding a very large and cumulative fiscal adjustment of €25 billion since the autumn of 2008 the 'underlying deficit' remains stubbornly high. Part of the deficit is accounted for by the costs of servicing debt. This proportion is projected to increase from 3.3% of GDP in 2011 to 5.8% of GDP in 2014.

It is instructive to look back at trends in the aftermath of the last recession in the mid-1980s and forward to 2015 using the latest projections of aggregate demand. Chart 1 (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 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.

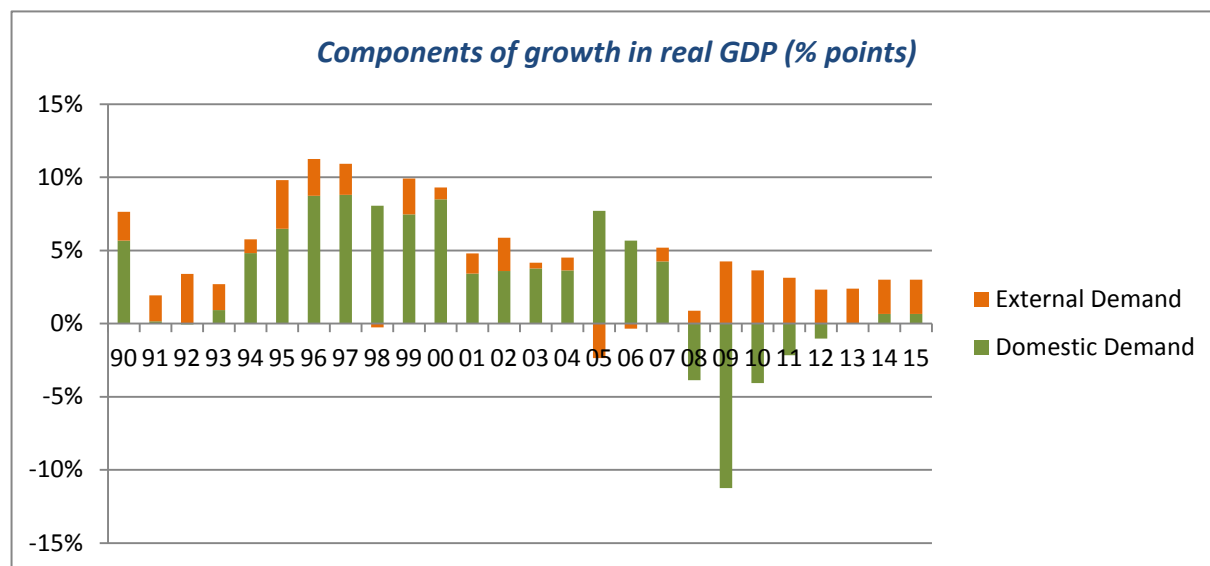
Following the collapse in GDP from 2008 to 2009 domestic demand has contracted sharply (at a rate never recorded before since national accounts data were developed here in the 1940s) while net exports have continued to increase. Were it not for export growth GDP would have declined further in 2010 and 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.

¹ Eurostat add a note of caution about these estimates in the most recent release of Euroindicators: 'Eurostat is expressing a specific reservation on the data reported by Ireland, due to the fact that the restructuring plans of Allied Irish Banks and Irish Life & Permanent are not yet finalised. These restructuring plans have been used by the Irish statistical authorities to calculate in the reported figures a (deficit increasing) capital transfer element of 3.7% GDP arising from the July 2011 government injections into the two banks. Eurostat awaits the finalisation of the restructuring plans, including approval by the EU competition authorities, so that the amount of the capital transfer element can be confirmed.'

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

Modelling 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 €1 billion 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 €1 billion in capital spending lowers GDP by 0.1 and 0.3% (with the proviso that this is likely to be an under-estimate as supply-side impacts are not accounted for²). A cut of €1 billion 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.

Chart 1 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.

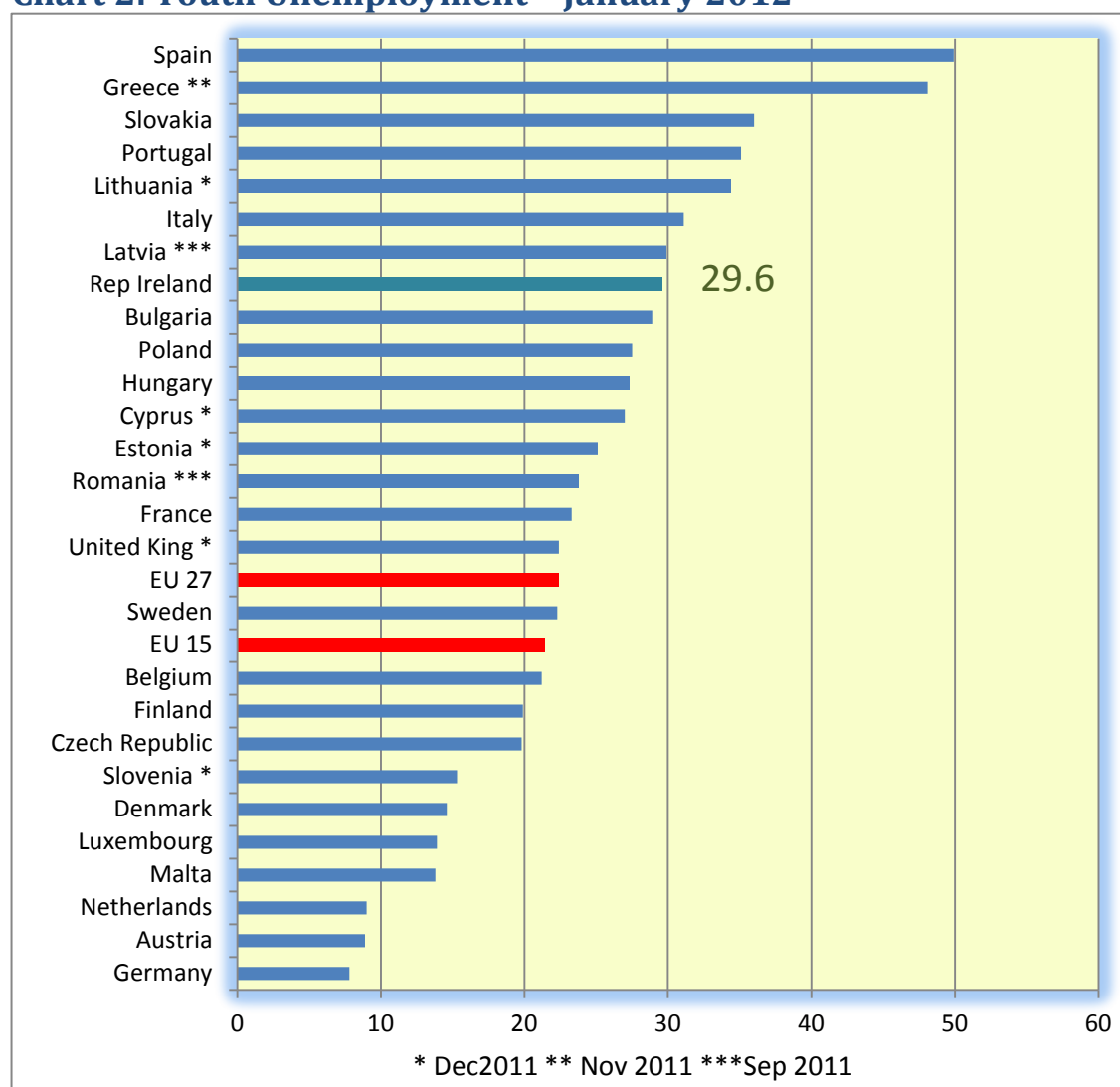
² Bergin et al. (2010) state that: 'These simulations do not take account of the significant positive supply side effects from public investment'

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 analysis³ 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 this paper, I propose that urgent consideration be given to an alternative which is referred to 'Economic Plan B'. If Plan A is failing to generate the needed growth in employment, output and government revenue it risks provoking a social backlash that will undermine democracy and social cohesion. A popular view in Ireland is that 'it could be worse; we are not Greece'. Without wishing to be unduly alarmist or negative it has to be recognised that the current trajectory of economic policy risks pushing countries such as Ireland into the extreme social situation in which Greece finds itself today. The scale and growth in youth unemployment testifies to the lack of realism in the current debates about which direction economic policy needs to take across Europe (Chart 2 below).

³ 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).

Chart 2: Youth Unemployment – January 2012



Indicator 2.2 – NERI Quarterly Economic Facts

2 A New Departure is Needed

An alternative economic Plan B rests on the idea that central to economic recovery is the creation of sustainable employment. Job creation will bring people back into gainful employment, boost revenues to Government and increase consumer and investor confidence. How can employment be generated? The core problem is lack of demand. Unemployment soared, here, in 2008 and 2009 as investment collapsed, consumption fell and fiscal contraction reinforced the downward spiral in domestic activity. This greatly added to the strains on public finances as the numbers claiming benefits rose and as eligibility for social transfers increased sharply. Every cut in spending by government added to the recessionary fire storms of 2009-2010 as consumers cut back on discretionary spending and as public authorities cut back on their budgets.

An Economic Plan B is proposed to reverse – not ameliorate – fiscal austerity. In other words such a Plan envisages bringing to a halt the process of cutting public spending. This is necessary to stop the haemorrhaging of domestic demand and restore confidence among consumers and investors. However, how can such a proposal stand up since public finances are in disorder and General Government debt is increasing to unsustainable levels? The key to a successful alternative economic strategy is that a combination of measures are needed to stimulate growth and, at the same time, begin to close the public sector deficit. Instead of cutting spending and raising taxes to remove the deficit – such as is the case under the current Plan A – an alternative approach is to hold spending at its current level and re-direct it into productive, growth-enhancing and equality-increasing areas. This implies a combination of fiscal measures which targets increases in spending power for low-income households and targets cuts in net income for high-income and high-wealth households better able to afford such adjustments. A timely and balanced series of adjustments can stimulate demand and, therefore, employment while redressing the worst effects of the recession on low-income households⁴.

Moreover there is an urgent need to link the immediate response to the current crisis to a long-term vision of where we need to go and what type of society is possible and desirable.

⁴ The most recent data on household income published by the Central Statistics Office indicate a sharp increase in income inequality in 2010. Refer to NERI Quarterly Economic Facts (section 4).

The NES model of the Developmental Welfare State provides an important conceptual reference. It is possible to become a more competitive and dynamic economy and move towards a model of taxation and welfare that guarantees a basic income, adequate education and healthcare. The Nordic countries have managed to achieve this. However, to move towards this type of model requires a huge change in mentality and in institutional culture. Citizens will not accept or vote for higher taxes and public spending without:

- a major change in the way public services are organised, controlled and funded so that they deliver in an efficient and equitable way what they are meant to;
- a fairer way of paying for public services so that those on high income or wealth pay relatively more taxes than those who do not.

It is very likely that disposable incomes will be squeezed for the next few years as a result of changes in wages, prices and taxes. There is a case for raising taxes on all but the lowest of incomes. However, this needs to be done in a staged way over a long period of time allowing for some growth in real income at the average to below-average threshold of income before significantly raising taxes on these.

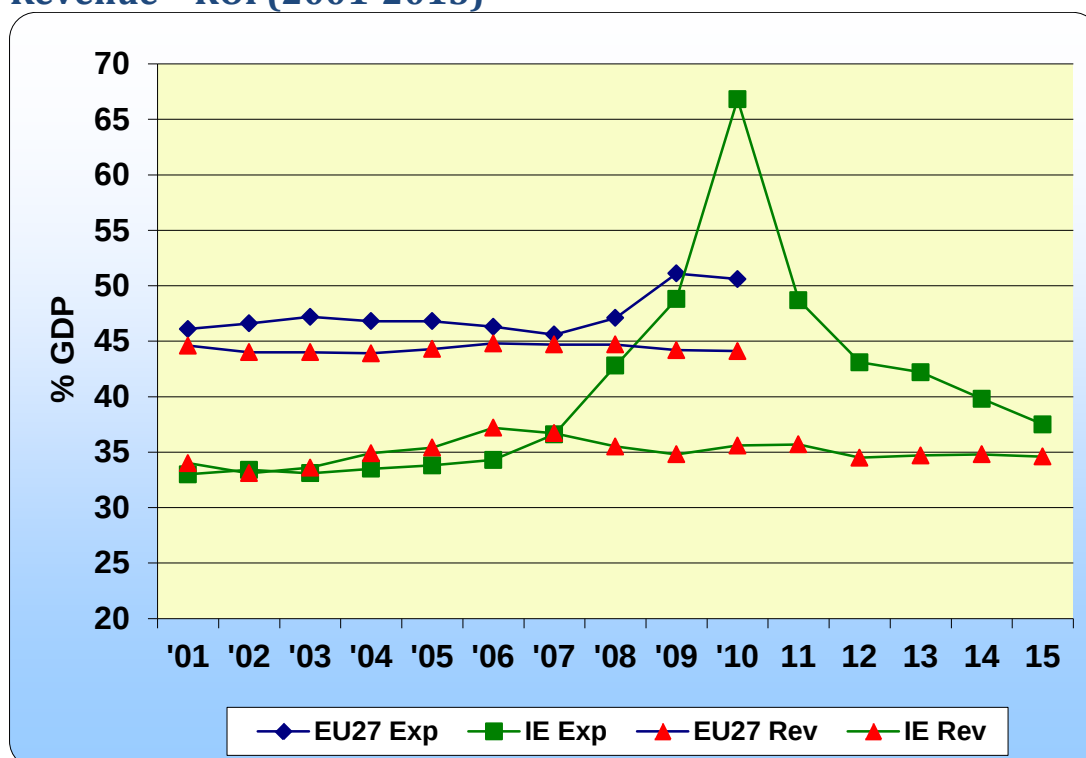
The fiscal crisis in Ireland points to the need for a new departure in spending and revenue collection:

- Ireland needs to move closer to European Union norms of spending and revenue-raising – the era of low taxes and widespread and inequitable tax reliefs must come to an end
- The structure of taxation needs to change towards higher taxes on immobile property, capital income and high-energy consumption

Our partners in the European Union and in the Troika are less concerned with the details and composition of expenditure and revenue than with the long-term sustainability of public finances and the need to comply with a pattern of moderate primary surpluses/deficits and sustainable levels of public debt. To arrive at this point, member states have choices on how to do it. In our case, we have chosen low levels of spending, low levels of revenue (as % of GDP) and a very cautious approach to debt and deficit financing – up to 2008. Ireland was the poster child for fiscal rectitude up to that year. However, the tax base was built to some degree on the sands of the property boom fuelled as it was by a galaxy of tax reliefs and incentives. The collapse in revenue accompanied by a sharp increase in welfare-related spending acted as a temporary stabiliser. However, the cumulative effect of cuts in spending and increases in taxes negated this impact.

Chart 3, below, presents data on trends in total Government expenditure. Spending and revenue (which includes taxes and other receipts) tracked each other up to 2007 at a low percentage of GDP by EU standards. The arrival of recession in 2008 suddenly depleted revenue and raised spending as a result of escalating unemployment. Far from there being an ‘explosion’ in public spending prior to the crisis in 2008, public spending tracked growth in GDP as did revenue – notwithstanding cuts in tax rates and increases in tax breaks in the course of the early part of the last decade.

Chart 3: Trends in Total General Government Expenditure and Revenue – ROI (2001-2015)



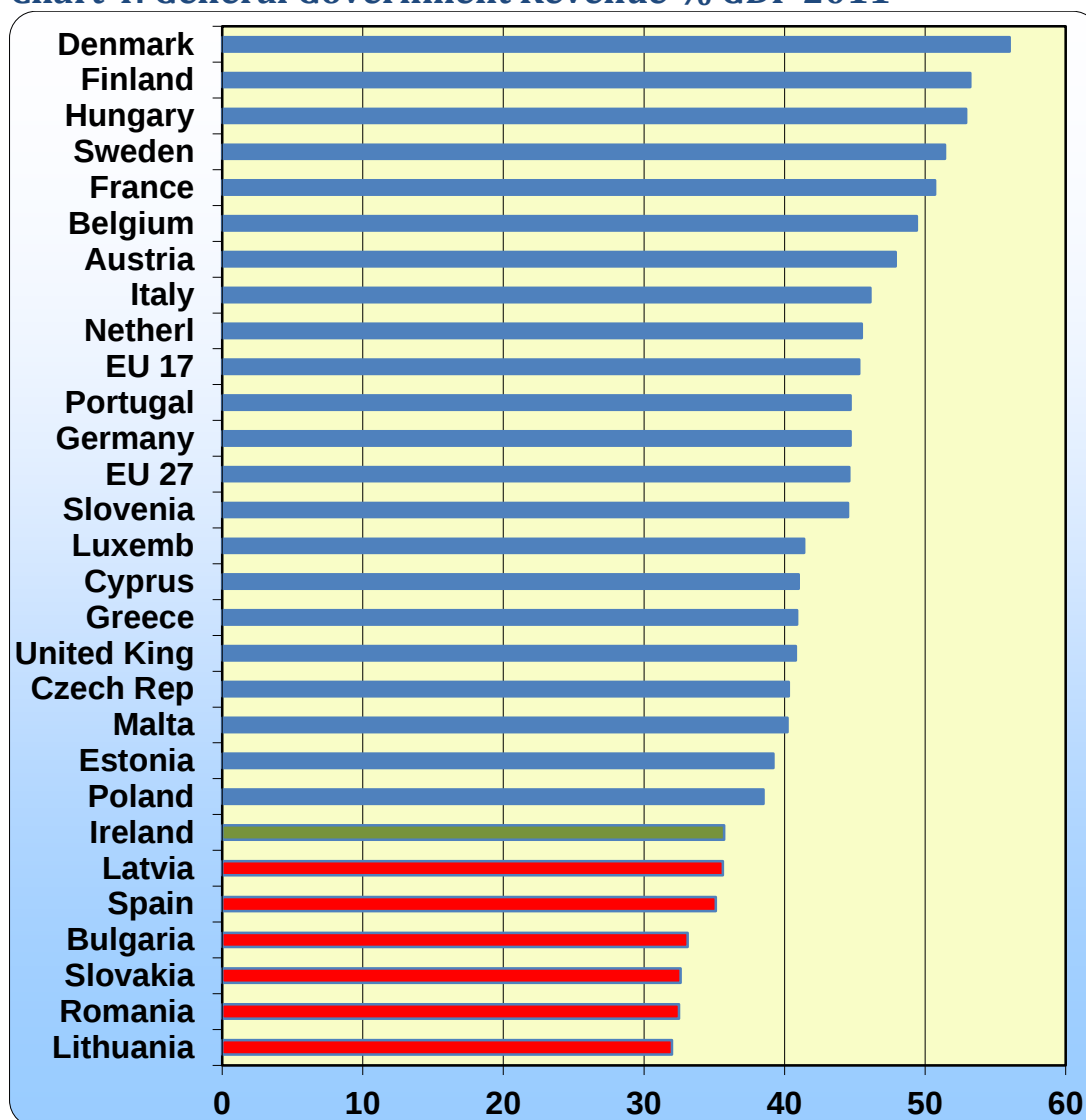
Source: Eurostat

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 was 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 Economic and Fiscal Outlook published by the Department of Finance in December 2011). On the other hand, total spending was 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. More recent data released by Eurostat (April 2012) has put the total amount of General

Government Expenditure at 48.7% of GDP in 2011. This includes an estimated 3.7 percentage points accounted for by the further recapitalisation of Irish Life and Permanent and AIB in July 2011.

The implication of the overall fiscal adjustment package, 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 league. Chart 4, below, compares EU States in terms of the percentage of GDP collected in Revenue. Clearly, Ireland is close to the red-bar states in this Chart in 2011.

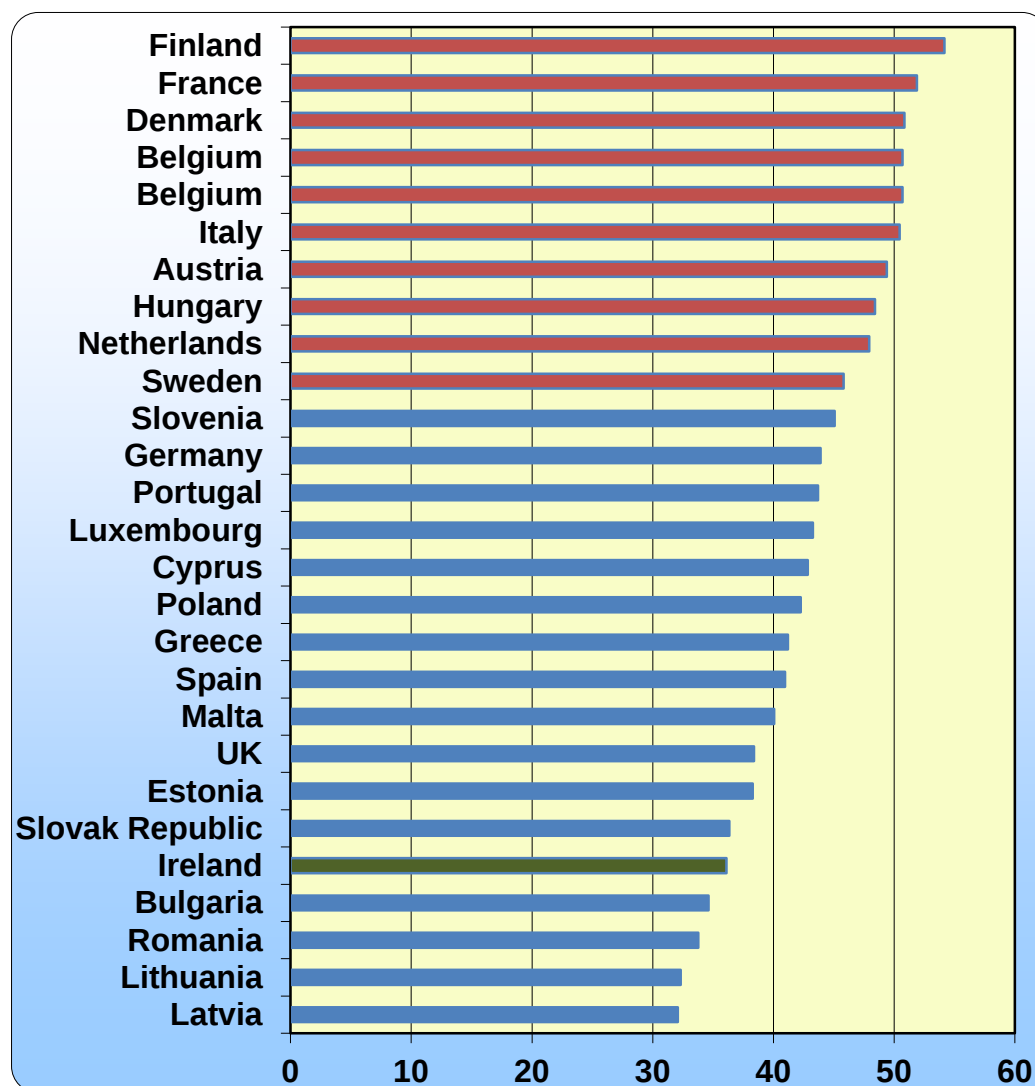
Chart 4: General Government Revenue % GDP 2011



Source: Eurostat

What are the consequences of pursuing a programme that leads on expenditure? Chart 5 shows data for total government spending in 2017 from the International Monetary Fund World Economic Outlook updated earlier this month. It is forecasted that 10 EU Member States will exceed 45% of GDP. Ireland languishes at 36% of GDP according to this forecast.

Chart 5: Projected General Government Expenditure % GDP 2017



Source: World Economic Observer, IMF

If, instead of pursuing the current strategy, public spending were held to 45% of GDP

Ireland would be very close to Germany in 2017 but still below 10 other Member States.

The spread of values in 2017 as in 2011 reflects national political choices as determined by voters.

3 The Seven Strands of an Economic Plan B

Economic Plan B is not about ‘spending our way out of recession’. Neither is it about ‘taxing our way of recession’. It is about a combination of policies which involves a State-led initiative to liberate under-employed resources and regenerate economic activity in the public and private sectors. However, it is not sufficient to envisage an economic stimulus. It is necessary to begin to undertake – or greatly reinforce – policies to reform enterprises and to create new enterprises capable of competing on world markets. There has been a singular and continuous failure to create a sustainable domestic economy capable of generating growth and employment. Instead, an excessive reliance on foreign direct investment, low corporation tax and the practice of private sector investment in unproductive assets and overseas equity has left the Irish domestic unduly exposed and vulnerable to adverse economic downturns as evidenced in the Great Recession of 2008-2009. A joined-up strategy must involve a balance of measures outlined below.

3.1 Do no further harm

Continuing cuts in public spending must be stopped. Instead, expenditure could be re-directed within the overall total to areas of greatest economic and social need in such a way as to increase income equality and boost domestic demand especially among low-income households. Part of total Government expenditure goes towards the cost of servicing debt. The proportion accounted for by interest payments will reach a high of 5.8% in 2014 according to Department of Finance estimates. If there is a resumption in economic growth over the coming years it is appropriate to ensure that total public spending does not fall as a proportion of GDP.

Non-debt service public spending should be ringfenced. Any increases in revenue arising from increased output should be directed towards priority current and capital spending that improve infrastructure or alleviate poverty and thereby stimulate domestic demand. The current policy approach is to make even further inroads into vital areas of public services as indicated in the Comprehensive Expenditure Review (Table 1).

Table 1: Medium-Term Public Expenditure Reductions (Comprehensive Expenditure Review, December 2011) € billion.

	2012	2013	2014	2015
Current	1.45	1.70	1.90	1.30
Capital	0.75	0.55	0.10	0.00
Total	2.20	2.25	2.00	1.30

Source: Comprehensive Expenditure Review

3.2 Invest in infrastructure

The latest NERI Quarterly Economic Observer has outlined a proposal for an ambitious programme of investment in much needed infrastructure over a five-year period.

Various agencies and commentators, including the National Competitiveness Council, the OECD and the European Commission, have identified telecommunications, energy and water infrastructure as key weaknesses for the economy of the Republic and sources of high cost for businesses. To this may be added the provision of a public, universal service of early childhood care and education, lifelong learning and health.

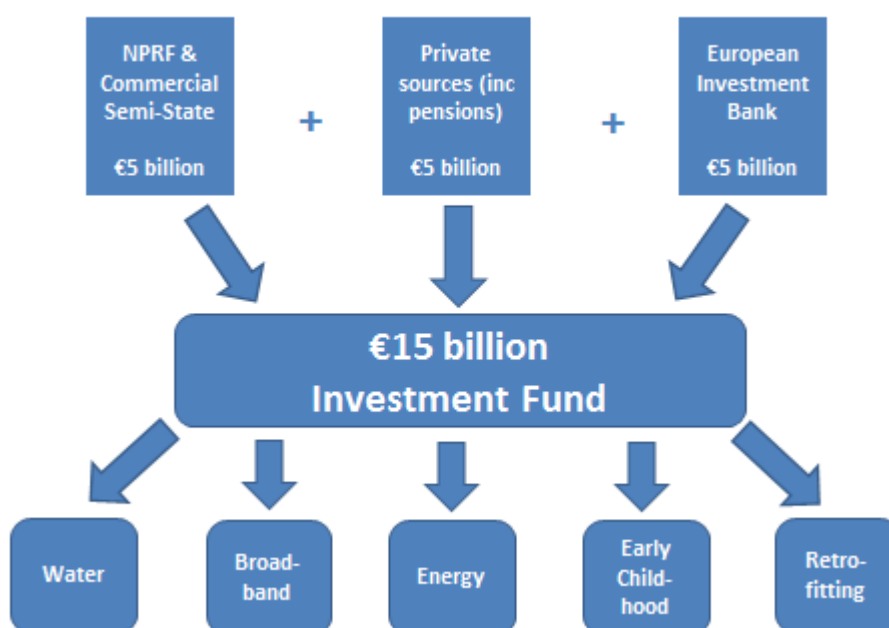
Established targets for a reduction in energy consumption based on imported fossil fuels must be adhered to. Public and private investment in new sources of energy are urgently needed to avoid a disruption in fuel supply arising from sudden economic or political turbulence which would leave both parts of Ireland extremely exposed.

There is an urgent need to generate hope through investment in people, communities and skills. This is the surest way in the long-term to restore confidence – in countries that flourishes economically and socially and that can trade and pay their way in the world.

In the latest Quarterly Economic Observer (NERI, 2012) NERI has proposed a targeted, frontloaded, strategic and temporary investment of €20 billion over five years – €15 billion in the Republic and €5 billion (=£4.2 billion) in Northern Ireland – to begin to reverse the negative impacts of fiscal austerity. It is not suggested that this policy initiative would solve the problem of unemployment immediately or that it would secure full economic recovery. However, together with other policy measures, it would help to re-start domestic economic activity, meet vital long-term infrastructure needs, give people greater hope and make serious inroads into long-term, structural unemployment.

The funds for such a stimulus can be sourced from a mix of public, private and European/International sources with no additions to General Government Debt and with a likely lowering in the public sector deficit as a result of higher revenues and lower payments as unemployment falls. An overview of how a five-year investment stimulus might be funded and targeted is provided in the Chart 6.

Chart 6: Overview of a Five-Year Capital Investment Stimulus in the Republic of Ireland – sources and uses



3.3 Afflict the comfortable

It is imperative that those in receipt of high-income or in ownership of large-scale wealth pay a higher proportion of their means. It is sometimes claimed that marginal taxes are already too high in Ireland and that there is a limited amount of net wealth that can be taxed. These claims overlook the fact that average or effective rates of tax are modest even for high-income earners over €100,000 per annum. The structure of taxes needs to be changed to increase the share of:

- Local taxes
- Social insurance charges
- Corporate taxes
- Taxes on carbon consumption

- Capital taxes including a new wealth tax

A funded social insurance scheme should allow citizens to pool some of their savings out of current income to pay for healthcare, pensions and periods of sickness or disability. In this way, wasteful tax expenditures and public subsidies for private health can be reduced. Taxes at the local level which are seen to go towards local public services should be more acceptable than a generalised increase in all taxes at a centralised level with little obvious ownership or control at the local level.

Proposals to tax wealth are frequently dismissed as impracticable or of very limited worth in raising additional revenue. Data on total wealth holdings and their distribution by type and household is very limited in Ireland. In the absence of a comprehensive audit of wealth it is not certain how much such a tax would raise.

In its 2012 Pre-Budget submission, the Irish Congress of Trade Unions has proposed a tax on wealth above €2 million, wealth being defined as current value of all assets, including the excess of €1m in the value of private houses. Based on a recent reply to a Parliamentary Question⁵, it is calculated that a levy on wealth at an annual rate of 1% on the net market value of the taxable wealth of ordinarily domiciled individuals, discretionary trusts and private non-trading companies, could yield at least €500m on the basis of €50bn in taxable wealth. This is probably a very modest estimate.

3.3 Comfort the afflicted

Since the onset of the current recession the burden of falling income and job losses has fallen on families and communities least able to bear it. It is particularly concerning that incomes of the lowest decile of households declined the most in 2010. The 2012 budget is likely to exacerbate this inequality further through its reliance on indirect taxes (value added tax) to boost revenue.

3.4 Begin a negotiated, orderly write-off of Anglo-Irish/INBS debt

The transfer of enormous sums of private banking debt to the Sovereign in 2009 and 2010 – much of it related to insolvent banks whose activities are still under criminal investigation raises enormous questions of fairness and probity. It is highly unlikely that the current level of General Government Debt is sustainable even under optimistic

⁵ This estimate is consistent with what was indicated by Minister Michael Noonan in the Dáil on the June 7, 2011.

assumptions on GDP growth, interest rates and inflation. A negotiated write-down and ring-fencing of debts arising in insolvent banks would ease the pressure on government debt in two ways – it would relieve the pressure from Promissory Notes associated with Anglo-Irish/INBS and would lower exchequer exposure to further bank recapitalisation arising from impaired loans in the remaining banks.

3.5 Strengthen a process of public and private sector reform

A strategy of investment, of itself, must be complemented by a deep and lasting reform of institutions and companies. Failures in corporate governance and lack of systems of accountability and democratic control are central to the emergence of the most serious economic crisis since the 1930s. Ireland's record is particularly worrying where it is apparent that failures in regulation, governance and corporate ethics lie at the centre of the implosion of banking and the devastating impact of the collapse in the construction and property sectors.

3.6 Develop a stronger, dynamic and competitive indigenous sector

The sources of new employment in the coming ten years must reflect a new approach to development – one that places greater reliance on indigenous enterprises producing products and services on world markets. New areas could be opened up from trade in health and education services to construction and engineering where skilled enterprises and workers could provide to markets in the new growth areas.

There is a strong case for a more diversified economy and one where demand for skills can be combined with new product areas that draw on the natural and human competitive advantages in Ireland.

A vibrant and competitive economy requires a working partnership between all sectors and contributors with the State playing a complementary role in supporting, facilitating and, in some cases, initiating development.

3.7 Reform banking

The failure of banking has been one of the most spectacular causes and outcomes of this recession. Lack of regulation, excessive and risky lending and the prevalence of unhealthy relationships at various levels has been well documented elsewhere.

It is doubtful that private banks based on shareholder value can lead the process of rebuilding the economy – especially as even during the boom times the banks did not contribute to the productive economy but rather property speculation. In a review of capital investment and wealth in Ireland, a report by Davy Research concluded:

Estimates of the capital stock show Ireland lagging behind. Irish residents would hardly claim that this country is wealthier than other small euro-area countries such as Finland or Belgium. Infrastructure – roads, rail, schools, hospitals and telecommunications – is far superior in those nations, even though Ireland is not far behind in the income per capita table. Ireland misallocated investment in 2000-2008. Infrastructure should be far better than it is today. Capital stock soared by 157% in real terms in 2000-2008, but housing accounted for almost two-thirds of increase (Years of High Income Largely Wasted, White, 2010)

We need to return to:

- ‘plain vanilla banking’ - retail banking for mainstream depositors and borrowers
- Investment banking for small and medium-sized enterprises and NewEra - Strategic Investment Bank: – short-term cash flow for SMEs combined with long-term business and infrastructural financing (including possible lending to Government for infrastructural building).

Bad banking needs to be dealt with by means of further negotiated write-downs, re-scheduling of debts plus imposed write-downs on unsecured, unguaranteed bondholders in all banks under state protection.

Consideration needs to be given to European Investment Bank loans backed by a new Strategic Investment Bank (as mentioned in the 2011 Programme of Government) - EIB investment portfolio goes beyond just physical infrastructure to include areas such as health, education, SME supports, etc.

An option worth considering is the conversion of one of the existing publicly-owned banks into a type of public enterprise bank – a commercial operation but with a different mission statement that includes serving the public interest with community dimension.

4 Moving Towards a Different Social Model

Plan A envisages a fall in public spending as a proportion of GDP up to 2017. Under this scenario total government revenue stays more or less constant at a rate of 34% of GDP while spending declines from its current level of 45% (excluding bank recapitalisation) to approximately 36% (World Economic Outlook, IMF). It is proposed that an alternative strategy should be pursued which involves defending the current public spending levels as a proportion of GDP while revenue is gradually increased from its present very low level of 35% up to 42%. It is also proposed that this upward shift in revenue happens more gradually over a period of five years instead of three years from now to 2015. This would allow more space in which a combination of measures could kick in to stimulate investment.

An important debate has already opened up in relation to social welfare universalism. In times of public resource scarcity and pressure on budgets is there a case for means-testing and targeting of scarce public funds? Should this principle be applied to areas such as child benefit, medical cards, higher education tuition fees, free travel for senior citizens? Why should those who can afford to pay be subsidised from taxes levied on the hard-earned income of the workers?

On the other hand there is a case for ‘universalism’ even in times of scarcity because:

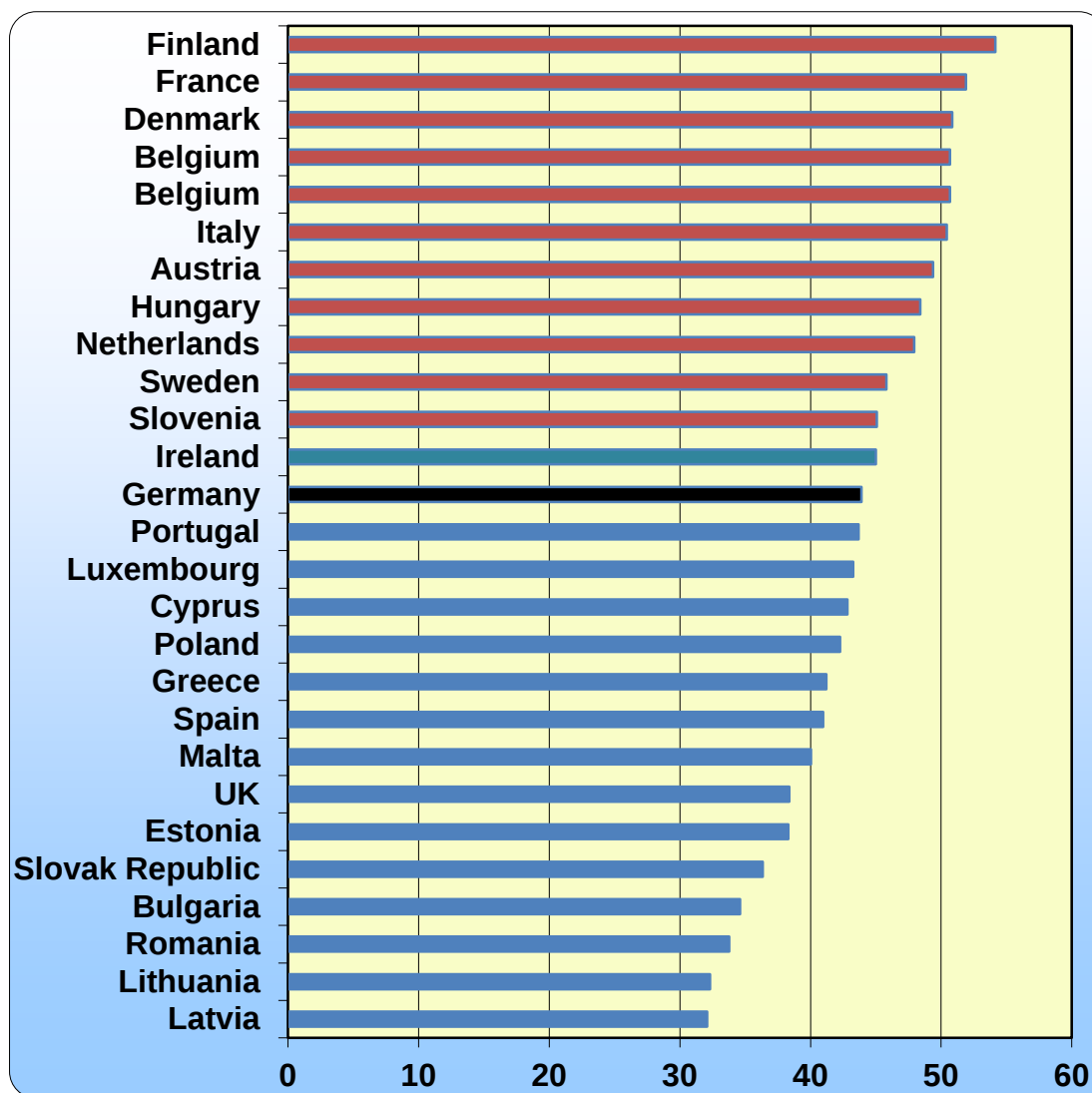
- Universalism in social goods provision engenders a strong social bond (e NHS introduction in post-war Britain) where everyone benefits and everyone contributes within their means
- Means-testing and ‘targetting’ can entail administrative costs and may miss the desired target for a number of reasons including low take-up, social stigma, inappropriate criteria, poor administrative data etc.

It is questionable that the debate is really about targetting in favour of the poor. Rather it is about taking from those already on average or high incomes while not improving the net position of the low-income households. The push to reduce the size of the State and the level of universal social provision is part of a concerted effort internationally

It goes against the ‘Nordic’ social contract where trust, cooperation and consensus are built around (i) high taxes (ii) generous social provision and (iii) solidarity across all social groups. The outcomes in terms of sustainable public finances, competitiveness and social cohesion are evident.

The alternative to this is to hold spending to a level close to the German level of about 45%. By doing this Ireland emerges in 2017 as in between the relatively high-spend countries in Scandinavia and low-spend countries in parts of central and Eastern Europe.

Chart 7: Projected General Government Expenditure % GDP 2017 with a new fiscal rule for Ireland



Source: World Economic Observer, IMF

5 Conclusion

The Nobel prize winning economist, Joseph Stiglitz, has appropriately summarised the recent coordinated European austerity measures as a ‘mutual suicide pact’. Keynesian economics demands flexibility for Governments to coordinate in such a way as to sustain aggregate demand and address trade, capital and public finance imbalances. The wrong time to impose greater austerity through fiscal or monetary tightening is when there is a large output gap and deficiency in demand across the major European markets.

Without a vision a society perishes. The ‘Nordic Model’ is not a panacea. There is no one model that can be plugged in and applied elsewhere. Still, lessons can be learned and aspects of social organisation in other countries can be used. It may be possible to explore the role of education and innovation in Finland. The Danish Flexicurity model could provide useful lessons here.

In Sweden the work of two economists – Gosta Rehn and Rudolf Meidner – played a crucial role in post-war Sweden. Rehn and Meidner developed an economic model based on the interaction of a strict fiscal discipline with a generous solidarity wage and social safety network coupled with an active labour market policy. Aspects of this model are worth exploring in the context of rebuilding Irish society and economy. Two important features need to be considered alongside the Scandinavian experience:

- The role of unpaid workers and carers the question of a basic income for all members of society
- The need to radically change the carbon content of production and consumption and develop alternatives to fossil fuel energy.

The timescale for change is typically long. However, now is a critical moment in history where, following the implosion of an old model of capitalism, a new or modified one is possible. We may not agree on the details of what it might look like or how it could be possible to get there. One thing is certain – doing nothing or waiting for the storms to lift and repeating the strategies that we thought worked in the past is not acceptable.

A ten year vision needs to be set for the implementation of a realistic and imaginative economic plan. Restoring economic growth and moving toward a different social model will take time. What vision of society do we have for the year 2022? Would it be possible to imagine and deliver a state of affairs where in 2022:

- Fundamental human rights – cultural, economic and social – are respected in both jurisdictions of the island?
- Some measure of lost economic sovereignty is restored following the ignominious events of Autumn 2010?
- That sovereignty is shared in a renewed European project based on stronger economic integration and democratic governance?
- Both parts of the island of Ireland take their place along with Britain and other Northern European States as an example of a social market economy based on the principles of freedom and human solidarity consistent with the aspirations of the Democratic Programme of the first Dáil?

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Notes

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