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THERE ARE MORE HARD DECISIONS TO BE MADE

Paper by David Begg, General Secretary,
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There are more hard decisions to be made but I suspect that some at least will be rather different and more far reaching than might now be apparent.

It has been well telegraphed that the spending review to be conducted in the autumn will result in somewhere between €3.6 billion and €4 billion being taken out of the economy. Since last week's EU summit the Government has been at pains to emphasise that this will not change.

This will compound the deflationary impact of the €20.6 billion that has been cut in three budgets since 2008. It is difficult to see how this will not seriously debilitate public services because this is cutting into muscle. To compound the problem demographic change means that the demand on public services will expand rather than contract over the next few years. An additional 280,000 people will reach the age of 65 in the next 5 to 10 years with the attendant problem that chronic illness will increase by 40 per cent by 2020, for example (VHI,2011).

This level of retrenchment is also profoundly mistaken in economic terms. Domestic demand has fallen by 25 per cent since 2008. When car sales are excluded retail sales in May were 5.2 per cent below the same month in 2010, the thirty seventh consecutive month that they have fallen. Car sales will no longer be a counterbalance with the end of the scrappage scheme. These problems of the retail sector are epitomised in the receivership of the

Superquinn company last week. Superquinn is a very long established player with an annual turnover in excess of €400 million and a 7 per cent share of the market.

It is true that exports are performing well and there will be a balance of payments surplus in 2011. But the jobs are in the domestic economy and in an evaluation of financial crises over 800 years published last year, Rogoff and Reinhart (2010) conclude that it is not possible for a country to recover through exports alone. And so unemployment will remain at over 14 per cent for the foreseeable future. Many people will fall into long term unemployment – half of those on the live register already are – becoming detached from the labour market. The price of austerity is a lost generation.

It would be hard to say that it is a price worth paying in any circumstances but, as it happens, austerity is not working. In the second quarter of this year GNP was down 4.3 per cent on the previous quarter. There is no growth in the economy and without growth to do some of the heavy lifting of adjustment it is not possible to generate the level of primary surplus necessary to allow for debt repayment. Markets know this very well which is why Moody's downgraded Irish debt to 'Junk' status on 12th July (Beesley and McManus, 2011). Only those addicted to the oxymoronic notion of expansionary fiscal contraction believe that we will return to growth any time soon. It is not working here and it is not working in the UK where similar austerity policies are being implemented.

Recently, the Minister for Finance was exhorting people to spend more to help domestic demand. There are compelling reasons why this won't work. Let me try to encapsulate what austerity means in practice in Ireland. For most people it is a loss of personal economic security. People are afraid of losing their jobs,

afraid of losing their homes, afraid of losing their pensions. Old people are afraid of not having anyone to look after them because the money to fund nursing homes has had to be spent on medicines. People who work in low wage sectors of the economy are afraid that statutory protection of minimum standards will be removed. These fears are entirely real and justified. The austerity programme imposed by the EU/ECB/IMF has imparted a huge deflationary shock to the economy.

I confronted the Troika with these facts when Congress met them recently. They had no answer. Indeed Mr Chopra of the IMF has since said publicly that a European solution is required. I don't think what we got last week is the solution. But, to coin a phrase, it might be the end of the beginning.

George Soros writing recently in The Financial Times observed that the Euro is an incomplete currency; it has a central bank but no treasury. He said its architects were fully aware of that deficiency but believed that when the need arose, the political will would be summoned to take the next step. (Soros, 2011). It wasn't, at least not yet anyway.

Soros (ibid) also said that the same people believed that markets would correct their own excesses which turned out not to be true. In his view the excesses were largely in the private sector, a view confirmed earlier this year in a report on the crisis by the Schuman Foundation. Specifically, comparing Greece and Ireland it said:

> "Ireland's problem is very different from that of Greece. In Athens the bankruptcy of the State and the public finances brought down the banks; in Ireland it was the banks and the private sector that brought down public finance".

(Corinne Deloy, 2011:2)

Some weeks ago I participated in the Brussels Economic Forum, an annual event organised by the Directorate General for Economic and Financial Affairs. The keynote address was given by Dr. Wolfgang Schauble, the German Finance Minister. He made a number of points which, from our perspective, were fairly chilling, viz:

- That the Eurozone did not have a crisis, just some peripheral countries;
- That his idea of solidarity was containing the problem in those countries and preventing contagion to others.

So let's not fool ourselves that the decision of the European Council last week was about us. It was about Italy and the possibility that it might be next. With €1.9 trillion of Sovereign debt – three times as much as Ireland, Greece, and Portugal combined – it is of a different order of magnitude. Contrary to what Dr. Schauble said the problem is systemic and last week's effort is not the complete answer.

The solution must eventually involve Europeanisation of the debt preferably by means of a common Euro Bond. The details of how this might work with appropriate incentives for both debtor and creditor countries has been proposed by Professor Paul De Grauwe of Leuven University (De Grauwe, 2011). Wolfgang Munchau of The Financial Times last week went so far as to say that Italy could only stay in the Eurozone if its interest rates were reduced and he doubted that anything other than a Euro Bond could achieve this (Manchau, 2011a).

No matter which way you look at it the European project is in trouble. The two most viable aspects of European integration, the Schengan Agreement and the

single currency, are both under threat. European integration is a political project in which there has been a huge investment. It is inconceivable that it would be let collapse. Preserving the Euro requires reform of the governance architecture of EMU beyond the immediate crisis. This problem can be traced back to unresolved debates between so called 'Monetarists' and 'Economists' in the 1960s and 1970s. The original 1969 Werner blueprint for the EMU contained proposals for institutions to manage both economic and monetary union. The Delors Report in 1989 recommended only the creation of a European system of central banks. (Verdun, 2010: Chapter 20).

I cannot see how the Euro will survive the crisis without creating institutions for fiscal and economic coordination. But the deeper integration which this implies is out of line with the political mood music in many Eurozone countries right now.

This is hardly surprising because, for all of the talk of reform, the perceived cause of the crisis – the European banking system – remains substantially unaltered. The hedge funds remain unregulated; there has been no reinstatement of the equivalent of the Glass-Stegall Act to separate retail and investment banking. The rating agencies still pronounce on the soundness of banks and countries as if they had no part in the crisis. And, of course, the bonus culture operates as it always did. Reform then is for the little people.

And what about the ECB? While all about it is chaos it pursues its Bundesbank inspired singular obsession with price stability even though the economies at the periphery are in meltdown and there is no evidence of wage inflation in the core countries. Apart from the lack of an economic justification for raising interest rates the consequences for people with high levels of personal debt are very severe. As of last week 50,000 people in this State, or 6 per cent of the total, are

already more than 90 days in arrears with their mortgage repayments. Compounding the suffering of citizens so needlessly makes no sense at all.

So Europe too has hard decisions to make and they involve politicians telling their constituents the facts of life about what is necessary to save the Euro. This will be hard because even as the heavily indebted countries are pushed towards insolvency, the numbers of disaffected in creditor countries is also growing as manifested in increasing support for Eurosceptic and nationalistic parties such as the True Finns in Finland. The reality though is that there is no way that countries like Ireland can meet the terms of the bailout agreements. More time is needed for fiscal consolidation to give growth a chance to take hold. While this latest development is helpful it is doubtful that it will be enough to make our debt sustainable. I have seen some commentators suggest that it would need to be reduced in value by 50 per cent for us as a sovereign country to be able to afford to borrow on bond markets again (Munchau, 2011b; Wolf, 2011).

However, if the endgame does involve some form of Europeanisation of debt it seems to me that it will also involve completion of economic and monetary union, meaning fiscal union. This is the "remorseless logic" of which George Osborne recently spoke. It is hardly likely that in such circumstance Ireland would be allowed to pursue an independent tax policy indefinitely. This is another hard decision because we will no longer be able to balance our industrial policy on the one legged stool of low corporation tax, at least not indefinitely. It is not a decision about which we are ultimately likely to be allowed much choice, even though it would be manifestly unjust to threat the periphery and the core of Europe exactly the same.

Deeper European integration presents perhaps the hardest decision for Ireland. The recent visits of Queen Elizabeth and President Obama were in a way a

manifestation of a foreign policy that sees Ireland as a multi-interface peripheral country (Ruane, 2010). We are in Europe but not necessarily of it. We balance our Eurozone involvement with equally important economic, and indeed cultural, relationships with Britain and the US. At the moment we have the same relationship to Europe as a hen has to the full Irish breakfast – we are involved! Shortly we may become more like the pig, fully committed! In any event deeper integration will foreclose the long running and unresolved Boston V Berlin debate.

In doing so it may open another. What kind of country will Ireland be in a more deeply integrated Eurozone? It is a sobering thought that three times in the last sixty years Ireland has looked into the abyss of economic catastrophe. In the mid-1950s we were rescued by the designs of the first programme for economic expansion (1958) and the adoption of export orientated industrialisation. In the mid-1980s we avoided the clutches of the IMF by embracing Social Partnership and by 1994 the economy was on the road to recovery. But before this recovery many people began to question whether Ireland was a viable political entity at all (MacSharry and White, 2000). Such thoughts were quickly discarded as the country began the most sustained period of economic expansion in its history.

Now that we are in difficulty again these troubling questions return. They will be less easily discarded on this occasion.

The doubts of an earlier era did cause some deeper reflection for a time. In 1991, The National Economic and Social Council asked a Norwegian academic, Prof. Lars Mjoset, to conduct a comparative study of Ireland and a number of small open Northern European economies to find out why we were doing so badly and they were doing so well. By the time his report (Mjoset, 1992) was

published the Irish economy had begun to take off and so it was more or less left on the shelf.

There is merit in looking again at this question because Ireland has more in common with the small open economics of Northern Europe in some respects than it has with Greece or Portugal. With exports worth about as much as it's GDP, Ireland is an extraordinarily open economy – far more so than Greece or Portugal (The Economist, 2011). In fact it is much more like Finland and Denmark, both of which happen also to be among the wealthiest countries in the world.

What distinguishes these small open economies is that they long ago decided that the external competitive threat was such that they had to confine domestic quarrels within certain limits (Karzenstein, 1985). Denmark is an exemplar of this approach. From the mid-1980s Danes began to realise that they needed to restructure their economy to deal with globalisation and the demands of European integration. Restructuring the public sector was seen as the key to making the private sector more efficient and competitive in export markets. Neoliberalism informed this process but never dominated it. Welfare and Labour market reform was tried unsuccessfully by conservative governments during the 1980s. However, the social democrat led government elected in 1992 did achieve some progress reflected in the much debated 'flexicurity' model. Reform was achieved via the work of tripartite commissions set up to consider different aspects of social and economic policy. This is defined in the academic literature as creating a 'negotiated economy' (Madsen, 2006; Kjaer and Penersen, 2001).

If you were to ask a selection of people what their hopes and aspirations were at this time I suspect that most would wish for the crisis to pass in a couple of years and to get back to the way we were, perhaps with less exuberance. I don't think that is either likely or desirable.

The deeper integration of Europe – at least in an economic sense – and the failure of our old development model both preclude it. In short we have to reinvent ourselves.

My long held belief is that we should try to emulate the Nordic countries, not just for their economic success but for the social sustainability and equality that is integral to their polity. It is a polity rooted in a political economy approach which holds that the economy is embedded in society and not the other way round. In a political sense these are social democratic countries which, even when governed by liberals or conservatives, largely adhere to a social democratic polity.

Social democracy has never taken root in Ireland. Twenty years ago, the ESRI explained this in the context of our history in which every issue since the foundation of the State was conceptualised in terms of independence. Even membership of the EEC was sold as a means of enhancing our independence notwithstanding the loss of sovereignty inherent in that decision. This militated against the emergence of a class based politics similar to other European countries. It explains perhaps why the Labour Party, which will be 100 years old next year, has never managed to lead a Government in this country (Breen et al, 1990).

When you think about it, our fleeting period of economic success was sub optimal in the type of society that accompanied it. While we achieved virtual full employment we remained a very unequal society. Its passing is not to be irrationally lamented. Better to look beyond this dark period and start imagining the future in its more promising terms.

As I said at the outset, the future does require some hard decisions – for Europe and for ourselves – and they are not the decisions that might be immediately apparent.

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