

THE IRISH ECONOMY – LOST IN TRANSITION

Address by David Begg, General Secretary, Irish Congress of Trade Unions

to Labour Party Conference, Kilkenny, 29 November, 2008

Introduction

The most remarkable thing about the onset of recession is the speed with which it has happened. It seems like only yesterday that scarcity was the story. Energy and commodity prices were heading into the stratosphere. The oil was running out, food shortages loomed, Russia was resurgent and China was marching into Africa amid a scramble for dwindling resources.

Now? Prices everywhere are falling as recession bites. Investment banks have disappeared; and the global credit system is on life support. The big threat is deflation rather than inflation. A year ago the British Government balked at nationalising Northern Rock. Last week the US Government nationalised Citigroup, the world's largest bank. Everywhere you look Keynes' demand management is replacing Adam Smith's invisible hand.

So what sort of a recession is it likely to be? The big fear is of an L-shaped recession, which is where the economy falls off the edge of a cliff and remains unconscious for a number of years thereafter. The classic example of an L-shape is the Great Depression of the 1930s, when the Wall Street crash of 1929 precipitated a four-year slump in American output that reduced national output by 25%.

While the current financial market crisis is the most acute since the 1930s, the determination to avoid the policy mistakes of that time makes a second Great Depression unlikely. This is because policy has been eased more quickly, banks have been rescued rather than being allowed to go to the wall.

A possibility is a V-shaped recession where a rapid decline is followed by an equally rapid recovery. This is also unlikely. More probable is a U-shaped recession which is really just a longer and more painful version of a V-shaped downturn. The longevity and the severity of the credit crunch suggest this.

In normal circumstances we could get some guidance about these matters, and make judgements about the likely length of the downturn, from the ESRI Medium Term Review. Although it was only published in May, 2008 this forecast, normally very accurate, is of no value because circumstances have changed so quickly.

In the absence of any data upon which to rely it is natural to look back at other periods of recession for comparison. For those of a certain age the 1980s spring to mind. But there are differences, both positive and negative, which make that an unreliable guide, viz:

- Our Gross National Product (GNP) is several multiples of what it was in the 1980s;
- The number of people at work has doubled;
- Our debt to GDP ratio is much better.

On the other hand:

- The development of an economy heavily dependent on services brings with it the previously unexperienced phenomenon of middle class redundancy with solicitors, architects and engineers being laid off. In all previous recessions redundancy was usually confined to manufacturing, construction and so forth;
- In all previous recessions there was somewhere else to go for work. That is a much less viable option today.

How prepared are we to meet this challenge?

Not very I suspect! For the last ten years we have been pursuing pro-cyclical economic policies – and we still are. In the good times we sought GDP growth almost for its own sake. We rarely questioned the consequences of high growth rates in relation to infrastructure, public services, population or the environment. It would, I think, have been more prudent to optimise growth in the context of sustainable development. What happened in banking, and the overexposure to developers and business models which relied on wholesale money markets rather than depositors, epitomises the brash addiction to growth for its own sake.

Likewise the belief that this could go on indefinitely, despite the lessons of history, accounts for a tax base 20 per cent of which was related to property transactions and which has now melted away.

Our addiction to property created a wealth effect which was illusory. Despite modest incomes many people had access to capital at cheap rates of interest with which they bought houses – sometimes for investment. Low inflation and low interest rates meant that they could afford the loans and capital appreciation caused the wealth effect.

All this is now in reverse. Negative equity in a falling market where incomes are stagnating means that many people are in serious difficulty. What was a wealth effect is now an albatross.

The British Economist, Graham Turner, argues in *The Credit Crunch* that housing bubbles were not an accident, spawned simply by careless regulatory oversight. They were a necessary component of the incessant drive to expand free trade at all costs. In the short run, housing bubbles can provide a stimulus to economic growth if they hoodwink people into believing they are wealthier.

It is likely, therefore, that the adjustment we are facing into will be difficult.

So what is to be done?

This is a period a bit like 1939. War has been declared but shots have not been fired. I have a sense of foreboding that things will deteriorate after Christmas. Any element of labour hoarding in the retail and other sectors in the hope of a quick bounce back will dissipate. The public will demand action and only a bold Government response has any chance of restoring the confidence which is central to getting the economy moving again.

In my opinion there are a number of strategic initiatives that need to be taken:

First of all a way has to be found to reflate the economy, Keynesian style. This is what Governments all over Europe and the US are trying to do. So far, however, our policy remains pro-cyclical. Moreover, we are in danger from the paradox of thrift in which people don't spend thinking that it is the patriotic thing to do. It is imperative to restore confidence so that people can feel that it is safe to start spending again.

The problems is that the room for fiscal manoeuvre seems to be limited given the limited scale of our tax base and its reliance on property related transaction taxes like stamp duty.

I see little early prospect of freeing up the housing market given that nobody wants to commit to buy a house they think might reduce in price. Therefore the only obvious road to reflation is to increase public spending by front loading more National Development Plan projects, like social housing, which are labour intensive and which are otherwise urgently required. Co-location should be abandoned with the state constructing increased hospital capacity directly. This would both save the taxpayers' money and provide crucial infrastructure.

We could also invest heavily in social capital by giving people the opportunity to get third level qualifications and to retrain for areas in which there is a better chance of sustainable employment.

Secondly, the banking crisis must be sorted. Two things are required of the banks:

- That they do not harm the economy;
- That they be open for business.

It is clear that the banks need to be recapitalised. They have been in denial about this for months but their share prices are a testament to the level of credibility given to these assertions by the markets. One word of caution though. Private equity funds are not suitable vehicles for this purpose. It would seem to be counter intuitive to resort to the type of finance that brought the global financial system to its knees in the first place. If that were not sufficiently convincing we can see what venture capitalists did to the strategic capability of eircom.

In fact it is not clear that any of the approaches to recapitalising the banks currently under discussion will get the oxygen of credit flowing to business again. There is a damning realisation that only Government direct control of banking will make this happen. That is why we have come out decisively in favour of nationalisation.

The third thing we need to do, albeit in a longer timeframe, is to set about the business of rebalancing our economy. The longer term path of the economy must be quite different to what it was in recent years. It seems to me that we cannot again ever return to the dominance of construction and financial services. The notion, popular up to now, that an economy can survive on services is looking decidedly suspect. We also need to consider what scale of economy is sustainable in our particular circumstances.

It seems to me that manufacturing, now constituting only 13 per cent of employment, must enjoy a renaissance. And in that process indigenous industry sectors with the capacity to be multinationals must be fostered. There is a lot of manufacturing in which

we cannot compete with low cost locations but food production is uniquely suited to our circumstances and it is a product for which there is an expanding world demand.

I want to say a special word about Waterford Glass. It is an iconic Irish product requiring highly skilled craftsmanship. Some months ago I asked the Government to guarantee a loan of €36 million to keep the factory going in Waterford. It was then facing very difficult trading conditions due to the weakness of the dollar. My request was refused on grounds of precedent. May I say that there is a lot of precedent under the bridge since then.

I find it ironic that billions can be spent bailing out banks but not a Euro can be spent to save a job in industry!

Thankfully, attitudes on this question are changing. The motor industry in America and Europe is now being regarded as strategic. President Sarkozy has embarked on a new phase of industrial activism in France and his ratings went up by 8 per cent in November! We have to get with the programme here in Ireland and take a more holistic view of what will be strategic as our economy evolves from this recession.

The final thing we need is a public service which is fit for purpose, flexible and geared towards peoples' needs and with a focus on outcomes. Public services are provided on a different basis to the rest of the economy. They are effectively rationed.

For a long time now there has been scant evidence in political discourse of the link between tax revenue and public expenditure on services. There has been even less regard for the evidence of the performance of public services. We cannot have European quality public services with Texas taxes and there needs to be some national consensus around what we want and what we are willing to pay for it. For the record my own view is that the best antidote to the ideologically motivated critics of the public sector is to make it so efficient and effective that the public will see it as part of their social wage and will brook no interference with it. Arguably the NHS enjoys that status in the UK.

It is important to gain acceptance that any proper evaluation of the challenge facing our country must be set in a political economy context. A purely economic approach would be flawed.

For the last twenty five years we have been told that the phenomenon of globalisation, and the financial system which underpins it, are unalterable. Free markets are possessed of an inherent and irresistible logic with which the state must not interfere. Economists, politicians, academics, commentators and business people of the neo-liberal school have foreclosed all debate about the subject asserting that 'There is no other way'.

Friedrich Hayek, widely recognised as the progenitor of neo-liberalism, published his most famous book *The Road to Serfdom* in 1944. By coincidence a Hungarian socialist, Karl Polanyi, published *The Great Transformation* in the same year. While Polanyi's work celebrated the New Deal in the United States precisely because it placed limits on the influence of market forces, Hayek's book insisted that the New Deal was the road to perdition. Hayek went on to be a tireless advocate of market liberalism in Britain and the US. He inspired such influential followers as Milton Friedman and was responsible for the policies of deregulation, liberalisation and privatisation pursued by Margaret Thatcher and Ronald Regan. In time they deconstructed the last vestigages of the New Deal leaving us with the catastrophe we have today.

Polanyi's great attraction for me lies in his concern to advance freedom and social justice. He believes that allowing the market to control the economic system was a fundamental error because it means no less than the running of society as an adjunct to the market. Instead of economy being embedded in social relations, social relations are then embedded in the economic system.

The problem we have to transcend is that many intelligent people who think of themselves as rational and urbane have put their faith in the idea of self-regulating markets as piously as others put their trust in God. Now that this God has failed perhaps

people will have the freedom to see things more clearly again, and to reclaim responsibility for their own lives and begin organising the future in its more promising terms.

But while these possibilities exist it would be foolish to think that the right will leave this space uncontested. Eric Hobsbaw's charting the rise of fascism indicates that it was a middle class response to the failure of *Laissez Faire* in the 1930s. I do not predict a return of fascism, although of course it could happen. A more likely possibility is that middle class disenchantment with the failure of the liberal paradigm and rising unemployment in the professions could manifest itself in support for parties advocating authoritarian models of capitalist not unlike those of South East Asia, Russia and China.

If you agree that this analysis is in any way valid you may also agree that the political left must offer a coherent and persuasive alternative.

What kind of country?

Up to now, apart from the Boston or Berlin debate it was hard, even on the left to get any serious consideration of what kind of country Ireland should aspire to be.

I have long felt that the Nordic model, with its high quality social cohesion and economic efficiency, was the one for us to emulate. The received wisdom was that Ireland would never embrace the tax platform necessary to achieve high quality social services. But recent surveys of opinion by TASC would seem to suggest that that is no longer an immutable truth. In time too voters will absorb the message that it is no longer a self evident truth that ever more liberal markets deliver painless prosperity.

The Nordic model is the best working model of social democracy in action. It is possible that these changed times might be a catalyst for a real debate about this possibility?

There is a compelling case for having that debate for another reason. We face enormous social policy challenges in the years ahead. Pension provision, childcare, care of the

elderly and proper funding of health care are all going to press down upon us. Whatever happens our existing approach to these questions is not viable and will have to change. Neither will the free market liberal paradigm of the last thirty years be recreated when the waters of the recession subside.

Something very big is happening. What started out as a series of pragmatic ad hoc responses by Governments and Central Banks is moving the boundary between states and markets. We are watching a bonfire of the old orthodoxies as well as the vanities.