PEM PAL 2013 BCoP Event

Study Visit on Spending Reviews

SIPTU

Organising for Fairness at Work and Justice in Society

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Overview

1. Background to the Economic crisis – changes in public expenditure were not the cause of the crisis but had to be part of the resolution.

2. The Fiscal Consolidation Experience –the expansionary fiscal contraction thesis was proved wrong.

3. Crisis induced reforms- an overhaul of the Public Service- partnership between Trades Unions and the Public sector is key in achieving greater productivity in the delivery of public services.

4. Lessons from Ireland

5. Budgetary process in Ireland: future challenges

1. Background to the Crisis

Ireland has experienced one of the steepest recessions and losses of employment in the advanced industrialised world since the Great Depression.

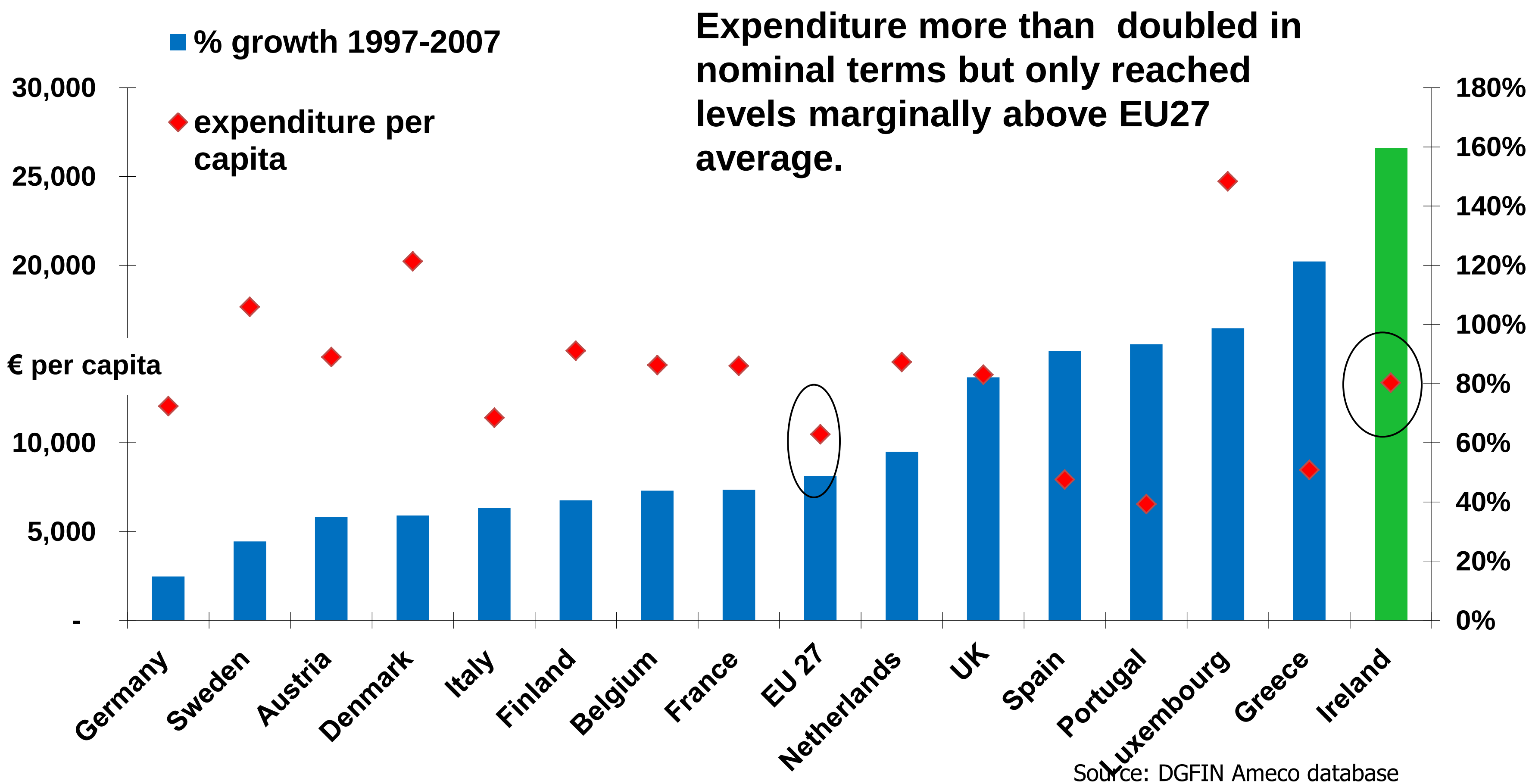
- Ireland ranks third to Greece and Latvia in terms of employment loss.
- Output fell by 12% but employment dropped by 14.6%.

Ireland's government debt to GDP ratio has increased by almost 100% -the entire size of the Irish economy in the six years since 2007/2008.

- This is the third largest increase in public debt across advanced industrialised countries since 1900.
- But it ranks as one of the fastest increases in public debt and is comparable to the massive jump in public debt in Japan during WW1 and in Britain during WW2.
- 30% of the increase in debt is attributable to the rescue of the banking system.

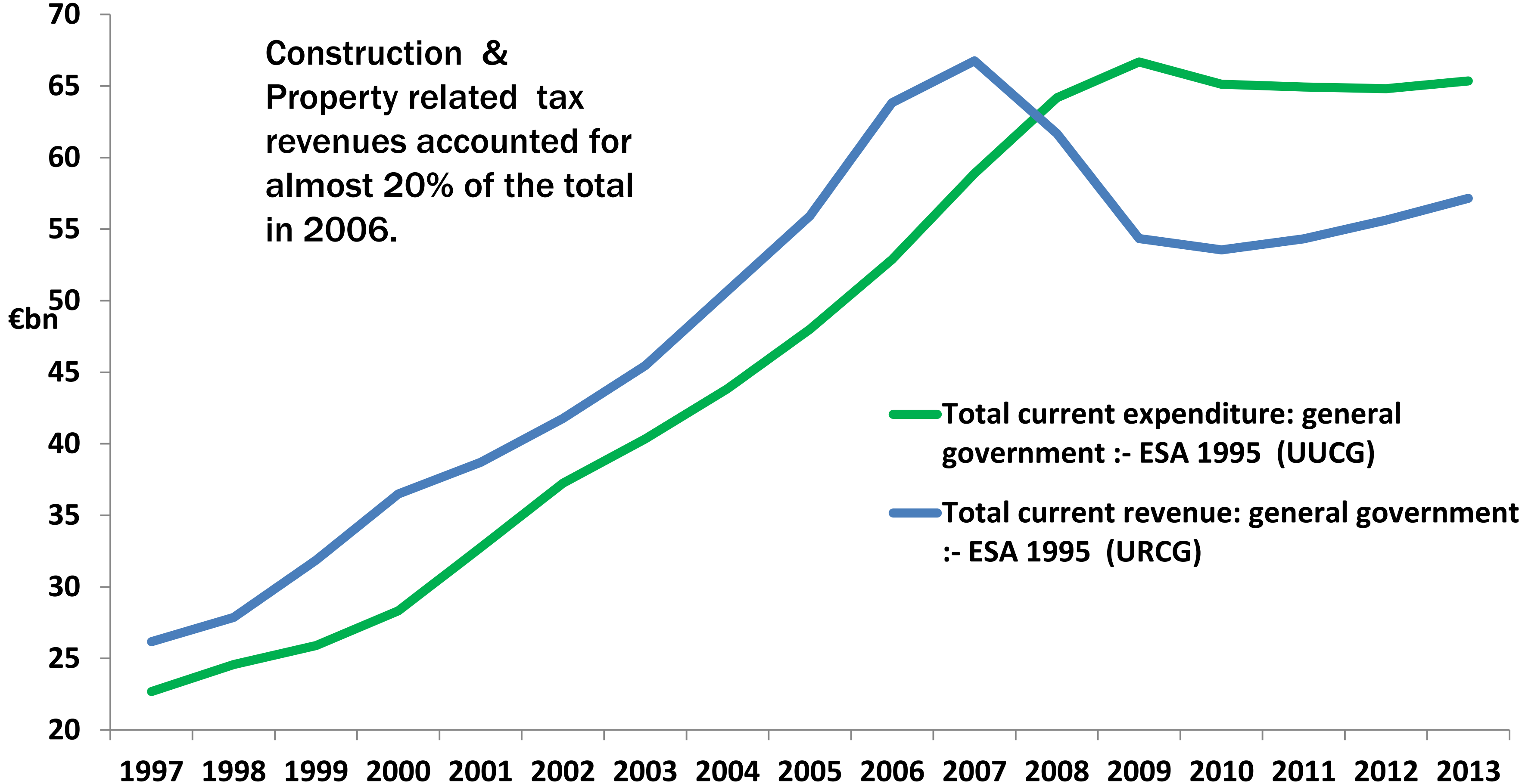
Source: Abbas et al, Historical patterns of public debt increase, IMF working paper, 2011.

Irish Government expenditure growth 1997-2007



Source: DGFIN Ameco database

Collapse in tax revenues post 2007



Source: DGFIN Ameco database

Government Policy in the years before the collapse

Largely pro-cyclical.

- Over the decade 1997-2007, Ireland experienced two booms- export led boom 1997-2001 and domestic economy construction and housing bubble 2002/2003-2007.
- Domestic economy boom prompted by a mix of cheap credit (reduction of interest rates due to membership of Eurozone), de facto financial deregulation which led to increased banking competition and large tax incentives for the property industry.
- Tax base was already narrow by international standards and was further eroded by the reduction in rates and exclusion of lower paid from the tax net.
- No contingency/ "rainy day" fund- budget current account surpluses averaged 4.6% per year between 1997 and 2007 and were largely recycled into capital investment and the paying down of the national debt from 64% as % GDP in 1997 to 23% in 2007.
- However a sovereign wealth fund was established in 2001 - the "National Pension Reserve Fund" was created to pre- fund pension expenditure post 2025. Close to 60% of the fund has since been used to rescue Irish banks, with little or no prospect of repayment.

2. The Fiscal Consolidation Experience

Tools of Adjustment for Ireland

1. Monetary X.

- No option to devalue exchange rate, drop interest rates or engage in quantitative easing, so the only option is to simulate internal devaluation.

2. Structural reforms √

- Attempts were made to reduce wage floors and dismantle wage bargaining systems to simulate an internal devaluation.
- Reform non traded sectors to improve entry levels into sector.

2. Fiscal √

- Large reliance on reduction in expenditure.

Structural reforms- simulating an internal devaluation (i)

1. Government unilaterally opted out of the National Pay Agreement and imposed two de facto pay cuts worth 14% to the average public sector worker across 2009 and 2010. A third round of pay reductions were agreed in 2013 – pay cuts for those earning above €65,000 and pay freezes for those earning below.

Economic impact: Other than a significant deflationary impact on the domestic economy there was little or no transmission effect to the private sector from the first two rounds of pay cuts. A reduction in the number of hours worked and a move to short time working were the main labour cost saving tools.

The Trade union movement's response: negotiated and signed two agreements with the Government; the "Croke Park" Public Services Agreement in Spring 2010 and the Haddington Road Public Service Agreement in Spring 2013.

Structural reforms- simulating an internal devaluation (ii)

2) National minimum wage was cut by almost 12%. The Government claimed that such a cut would ensure the viability of small and medium enterprises and would support job creation in those sectors where significant job losses have occurred.

The minimum wage cut has since been reversed after a sustained campaign to protect the lower paid. Employers' social security contributions for low paid workers has since been halved but this is due to expire at end 2013.

Structural reforms- simulating an internal devaluation (iii)

3) Troika insisted on review of the wage setting mechanisms (Employment Regulation Orders and Registered Employment agreements) in early 2011. This culminated with a High Court challenge by employers which found the system of Employment Regulation Orders to be unconstitutional in mid 2011. The wage setting mechanisms existed predominantly in low paid precarious employment sectors.

The Trade Union response: Legislation was signed into law in 2012 which will reinstate the mechanisms to set new wage agreements in particular sectors.

Fiscal adjustment

2008-2014: Fiscal consolidation has been imposed worth €30.7bn or 19% share of 2013's nominal GDP.

67% of the total adjustment has come from spending cuts.

- 70% of this has come from the current expenditure budget despite a fourfold increase in the numbers dependent on unemployment benefits.
- Pay cuts were the main tool for cutting public expenditure in the early years of the crisis. Payroll savings accounted for 33% of spending cuts between 2008 and 2010.

- Overall the Government committed €63bn (40% of GDP) to rescuing the Irish banks. Over €11bn of this came directly from Exchequer resources plus €3.1bn paid in net interest payments to the banks.

The impact of the Fiscal Adjustment

Deflationary impact

- Expansionary Fiscal Contraction thesis was a popular argument in the early days of the crisis. However, the Irish recovery in the 1980's was largely attributable to the devaluation of the Irish punt, the "Lawson Boom" in the UK plus significant EU structural funds flows. These conditions are largely absent in this crisis.
- Deflationary impact of budgets higher than originally estimated with successive downward revisions of growth forecasts and upward revisions of underlying deficit.

Distributional impact

- Incomes were disproportionately targeted in revenue raising measures- almost €3 out of every €4 raised in taxes was put on the shoulders of ordinary income tax payers up to Budget 2013. Over 20% of the taxes raised were targeted at the better off/stock of wealth in the country.
- Impact mitigated by 7.7% price deflation between late 2008 and early 2010. Consumer prices are now back at 2008 levels but average private sector post tax real incomes are down approx. 6.6% between 2008 and 2013.

3. Crisis induced reforms- an overhaul of the Public Service

Lessons learnt from 1980's experience- large scale and costly redundancy scheme in 1987/88 was followed by large re-employment of many of these workers in the early 1990's.

Two agreements between Trades Unions and the Government 2010 and in 2013.

In exchange for large-scale reform of the public services, changes to work practices, flexible redeployment and the downsizing of public sector numbers the Government committed to introducing:

- No more pay cuts over the lifetime of both agreements; 2010-2013/14, 2013-2015.
- No outsourcing of services without prior engagement at local level.
- No compulsory redundancies.

2010-2015 Public Sector reform

- 12% reduction in public service employment by voluntary redundancies and natural attrition by 2015.
- Rationalisation of State agencies- elimination of duplication.
- Shared services across agencies- IT systems, expertise.
- Move towards standardisation of terms and conditions of employment across public sector- sick pay, allowances etc.
- Redeployment within and across agencies and regions for staff who are surplus to requirements.

4. Lessons from Ireland

- The expansionary fiscal contraction hypothesis does not hold!

- For a small open economy, an export led recovery will do a lot of the heavy lifting, but the revival of the domestic economy is crucial to bolster the public finances and break the negative feedback loop between the depressed domestic economy and the financial markets.

- Cuts in the absence of reform provides only a limited boost to productivity and dampens the potential for longer term savings.

Ireland: future issues

Austerity will be a feature of Irish Budgets for the rest of this decade.

EU fiscal rules:

- **Debt reduction rule and structural deficit rule impose onerous burden on Irish public finances if the country fails to return to long term trend growth levels.**
- **Issue of adequacy of rules to return to public finance sustainability: during the boom years, rule targeting was a key flaw of the EU's Stability and Growth Pact as there was no counter cyclical rule built into the Pact. The EU's 6-pack and 2-pack are also pro-cyclical and threaten to further damage potential for recovery.**

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