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Making Choices - Choosing Futures: New Challenges for Social Partnership

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There are many who argue that our Social Partnership model, and the policy choices that have accompanied it, have been responsible for Ireland's remarkable economic transformation since the mid 1990's. Others disagree quite strongly, contending instead that for a proponent of Social Partnership to make such a claim is akin to a cockerel claiming credit for the sunrise. These sceptics argue that it was in fact the economic boom that held the Social Partnership together for so long, that it was the boom that delivered the additional resources and improvements in living standards, and that the social partners simply hung together to ensure they grabbed a share of the spoils. It's a worthy academic debate that, no doubt, will run for years and years to come. There is no debate however, about the economic reality that is unfolding right now. Everyone appears to agree that the boom is over.

Unemployment is rising sharply, particularly among men as the slump in the construction sector continues apace. Our Public Finances are deteriorating rapidly as capital gains tax, VAT, corporation taxes and excise duties slip further and further behind target every month. Overall tax receipts were running 725 million euro behind schedule after only the first four months of the year, and the fiscal trends for the rest of 2008 appear quite depressing. Living standards are being eroded by high prices, especially for food and energy. Inflation of 5 per cent has been embedded in the economy since the end of 2006. Consumer confidence is down, business confidence is low, and house prices are on the retreat. National economic competitiveness is being eroded by adverse currency movements on a daily basis. The values of both

sterling and the dollar have gone down by 18 per cent against the Euro between August 2007 and May 2008. That is a big hit for all exporting firms. Ireland's jobs boom has come to an end and the rate of inward migration is slowing. Internationally and domestically credit conditions have also tightened and capital markets have frozen. Ireland is losing out as the unprecedented surge in international oil prices means more and more of our hard earned wealth has to be handed over to oil rich nations for essential imports.

The litany of challenging economic statistics about Ireland is lengthening by the day. It doesn't all necessarily mean economic doom. Nevertheless some of the news is in such sharp contrast to the boom times we enjoyed for so many years that to some people it's certainly beginning to feel like gloom.

The big issue of course is how long this downturn is going to last, and how deep it is likely to be. A relatively short economic setback would be no big deal. The Irish economy after all could not continue to grow at a record pace for ever. A slowdown of sorts was inevitable at some stage and some might argue that socially and economically it is a good thing to take a break from the boom. Of course that is provided it is just a break and that the recessionary-style trends observed in some of the economic data do not become entrenched.

In this regard the most recent ESRI Medium-Term Economic Review 2008-2015 offered good reason for hope. It suggested the Irish economy would bounce back quite sharply when the global economy improves and that domestic economic growth averaging 3.75 per cent per annum would be sustained for some years to come. If this prognosis turns out to be true then the policy choices faced by the Social Partners in the next phase of Social Partnership could be relatively straight forward.

The core ESRI analysis would imply that our economy remains fundamentally sound and stable, that we have not suffered a major economic shock, and that the basic economic and social policy

framework outlined in the “Towards 2016” is as valid today as it was when it was first drawn up. In this case there ought to be nothing too controversial about the policy decisions that are now up for grabs at the Partnership negotiation table. The policies have in effect already been decided in broad measure in “Towards 2016”. So let’s get on with it. The Government, the Trade Unions, the employers, social groups, and all others, should not be deflected by short-term economic trends. Instead they should collectively focus on delivering the socio economic vision encompassed in the ten-year agreement. If money needs to be borrowed by the Central Exchequer to pay to deliver the vision then borrow it, subject of course to the borrowing rules of the EU Stability and Growth pact. After all, everybody around the negotiating table has already endorsed the central thrust of that 2016 document. Surely then all that needs to be decided is the sequencing of delivery. Should the social housing commitments be delivered before the primary health care teams? Should the improvements in education come before the commitments to old age pensioners? There could be lots of dilemmas about sequencing, and the debates required for settling such disagreements are just as likely to be heated as they are to be monotonous.

However, the situation and the choices faced by the social partners could turn out to be far more complicated and serious than that. The scenario painted by the ESRI medium term economic review is just that – a scenario. In reaching it, the Institute made some fairly big assumptions that not everyone would be prepared to endorse. For example, to achieve its positive prognosis for the Irish economy the Economic and Social Research Institute assumed that the international credit crisis will be short lived and will not develop into an international credit crunch. It also assumed that the International Monetary Fund was far too gloomy in its recent global economic report which outlined very serious concerns about the US and global economies along with a very downbeat assessment of how serious and far reaching the current international financial crisis could turn out to be. In effect the ERSI dismissed the IMF’s analysis and economic forecasts despite the very high standing and international credibility of

the International Monetary Fund. The ESRI also instructed the computer-based economic model it employs for medium-term forecasting to assume that the US economic recession would turn out to be neither deep nor long, and that the United States' economy would bounce back quite quickly. It also told its economic model to assume that the value of the Euro would revert to levels around one US dollar and forty cents. The Institute has also assumed that the high oil prices we have been experiencing will collapse and that oil which was recently trading above \$135 per barrel will fall back to 74 dollars per barrel by 2012. This is despite a very strong warning from the International Energy Agency of a real risk of a global oil supply-side crunch involving an abrupt escalation in oil prices by that date. By incorporating all of these assumptions into the parameters it set for its computer-based simulation of the performance of the Irish economy the ESRI has in one fell swoop assumed away all of the risk factors that keep international central bankers and many others awake at night. Arguably, the Irish based institute has dismissed and minimised the significance of the massive economic upheavals that have resulted in the collapse of Northern Rock bank in the United Kingdom and Bear Stearns, the sixth largest financial institution in the United States. They have also dismissed the significance of what the European Central Bank President Jean Claude Trichet described as a creeping but relentless oil price shock, one that has already resulted in truckers and fishermen in various European countries taking to the streets to register their protests.

In addition to all of these very big and major assumptions about the international economy, ESRI also based its benign assessment of Ireland's economic future on some new assumptions about the working of the Irish economy itself. Specifically it has assumed that the output of Ireland's business and financial services sector will become the key channel through which growth in the world economy is transmitted to the Irish economy. This is a new departure. The Institute has produced its Medium-Term economic forecasts on ten previous occasions and has never before made this assumption. Traditionally services output was assumed to be more heavily influenced by developments in the

domestic economy. The Business and Financial services sector that the ESRI says will now be the main conduit for global economic developments into Ireland includes hotels, pubs, restaurants, motor repairs, hairdressing and many more personal services, as well as banking, insurance, legal services, consultancy, and other professional services. It also includes IT services, and research and development. The ESRI may have good reason to change its understanding and assumptions about the way the global economy influences the Irish economy. But it is noteworthy that this new assumption about business and financial services has a huge effect on the outcome of its forecasting model. It plays a very big part in explaining why the Irish economy is predicted to prove so resilient in the future as long as the global economy picks up. Basically the ESRI's computer model now predicts that the biggest part of Ireland's service economy will bounce in line with the global economy because it has been reconfigured to make this assumption.

There is nothing illegitimate or problematic with the ESRI making any such assumptions about either the global economy or the way our domestic economy works. The institute is perfectly entitled to make any assumptions it considers to be reasonable and to work away in good faith (as it does) on that basis. But while there is no suggesting, even for a second, that the ESRI assumptions are wrong, equally there is no suggestion whatsoever that their assumptions are actually right. The reality is that the benign economic scenario painted by the ESRI's most recent medium-term economic review is every bit as likely to be wrong as it is to be right.

The Institute has made what many informed international observers from as far afield as the IMF, to the International Energy Agency, to major international dealing houses, and beyond, might consider are some very heroic assumptions to get to the conclusion that Ireland's future prosperity is in the bag. Not every one would feel so brave. Not everyone thinks it is reasonable to assume away the risk of global credit crunch, or of a significant recession in the United States, or that oil prices could continue to rise possibly to \$200 and maybe even more.

Not everyone would so easily dismiss the very considered opinion of a global economic institution like the International Monetary Fund, or accept that the trend towards a weaker value of the US dollar will be reversed and that such a reversal can be sustained out to 2015. Many might doubt that a computer based model is capable of accurately forecasting significant economic turning points. Evidence of a deepening economic downturn at home and abroad mounts by the day. Many would then consider it foolish to assume that Ireland's Social Partners can take it for granted that the resources to deliver on the objectives set out in the Towards 2016 agreement will be available on time. It seems more sensible to assume that some difficult choices will have to be made, that new priorities will have to be argued over, and that the deep values that underpin the socio-economic vision encapsulated in the agreement are going to be put to the test.

The Social Partners already know broadly where they want to go and the choices they need to make in the next phase of their joint endeavours. If the economy delivers the resources they require then they need only gear up to do battle about the order of socio-economic priorities. If the economy does not deliver, then, the problems that result could tear the very foundations of consensus apart. The sceptics who argued that the long survival of social partnership was the result of economic prosperity - rather than the cause of it - would be strengthened.

The next phase of Social Partnership is taking place now, and the key challenge the Partners face is how to deal with an economic downturn without knowing for sure how deep, or how long, or how serious the downturn is going to be. Given the potential consequences for all, of a longer than expected slump the best strategy might be to hope for the best, as outlined in the ESRI review, but prepare for something worse, as implied by the IMF and others. In that context urgent action is needed to deal with the deterioration in job prospects as a result of the slowdown in the construction sector, and the threat to competitiveness from high inflation and the strength of the euro. In addition a new focus on the positive potential of the all island economy could provide a

positive new home-grown spur to economic growth at a time of international economic challenge.

The construction sector has been the primary driver of male employment in Ireland throughout recent years. The building industry directly accounted for about 60 per cent of all net new male jobs created between 2002 and 2006. Since then the slowdown in the building industry has been stunning with the number of new house completions declining from almost 90,000 in 2006 to an estimated 48,000 this year. The direct result has been a sharp rise in unemployment among men. However it is not only men who are now at risk. The downturn in building has resulted in a major deterioration in the level of tax receipts accruing to the Government. This has led to a significant tightening in the public finances. This dip in exchequer resources is now threatening to halt the expansion in public sector employment that has been occurring in recent years. The employment sectors dominated by the public sector - health, education, public administration and defence - have been responsible for about 60 per cent of the growth in new jobs for women since 2002. The implication is that if public sector employment is likely to be curtailed by tighter budgetary conditions, then the main engine of employment for women in Ireland will also slow down.

It makes sense then for the Government to try to shore up as many jobs as possible in the construction sector. The obvious way is to significantly accelerate public housing programs. The National Pension Reserve Fund has billions of euros in resources, a large chunk of which could be invested in such infrastructural projects including public housing. Much greater effort and urgency ought to be put into finding rapid solutions in this area.

The sharp rise in unemployment among men so far this year highlights a problem in relation to unemployment payments. Throughout recent years on budget day the rise in weekly dole payments was deliberately kept to a minimum. In several years since 2000 significantly higher social welfare payment increases were afforded to old age pensioners

than were afforded to the unemployed. Meanwhile average wage rates increased strongly while taxes on income fell sharply. Nowadays, according to the OECD, Ireland has the third lowest combined tax and social insurance contribution rates for average workers in the OECD (after Mexico and Korea). The result has been that take home pay in Ireland has risen far faster in recent years than unemployment benefit. This means that the loss in income suffered by those who lose their jobs in the construction sector and elsewhere in Ireland is now enormous. This is occurring at a time when typical mortgages and rent payments are among the highest in Europe. It is a situation that does not sit easily with the spirit of social partnership at a time when so many jobs appear to be at risk.