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working to build a just society

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Social Justice Ireland

Policy Briefing September 2013

Investing for Growth, Jobs & Recovery

Austerity is not working for Ireland. Facing into Budget 2014, the economy remains depressed. Unemployment remains high and, although it is marginally decreasing, job creation has been limited, emigration has been growing and more than 58% of those without a job are long-term unemployed.

A new approach is needed, one which focuses on delivering growth, jobs and real recovery.

This Policy Briefing focuses on the case for a large scale multi-annual investment programme targeted at job intensive key sectors of the domestic economy.

It complements our June Policy Briefing on Budget Choices which provided our fully-costed proposals for Budget 2014. That Briefing is available on our website and is summarised later in this publication (see p. 8)

Since 2008, the collapse in investment in Ireland has been dramatic. Its level of investment is the lowest of any country in the EU; lower even than Greece or Cyprus or Portugal. This level of under-investment is unsustainable if Ireland is ever to recover (see p2).

Social Justice Ireland has consistently argued that without investment there will be no jobs and without jobs there will be no recovery (see p. 4).

In this Policy Briefing we argue that boosting investment can play a key role in generating much needed growth and employment.

We propose:

- a three-year €7bn investment programme
- funded from off-balance sheet sources including the Irish Strategic Investment Fund, commercial semi-state borrowings, domestic pension fund investment and funds from the European Investment Bank (see p. 5)
- structured as €2.5bn in 2014, €3bn in 2015 and €1.5bn in 2016 (see p. 5)
- focused on areas including renewable energy; new social housing units; primary care facilities; energy efficiency; school facilities; early childhood care and education; public healthcare facilities; non-national road improvements; and water services and facilities (see p.5)

This Briefing outlines how the implementation of this investment programme would (see pp. 6-7):

- boost economic growth by 2% in 2014, 2.3% in 2015 and 1.1% in 2016;
- generate between 56,000 and 84,000 additional jobs as the programme is being implemented;
- provide new and sustainable employment in the longer-term because of the availability of these new services and state assets;
- provide up to €2.9bn in additional tax revenues as a direct result of the stimulus;
- generate savings in other areas of state expenditure including rent supplement, healthcare spending and bank recapitalisations; and
- provide new lines of government revenue from water services and green energy sources.

Policy Briefing is a regular publication issued by Social Justice Ireland. It addresses a wide range of current policy issues. Comments, observations and suggestions on this briefing are welcome.

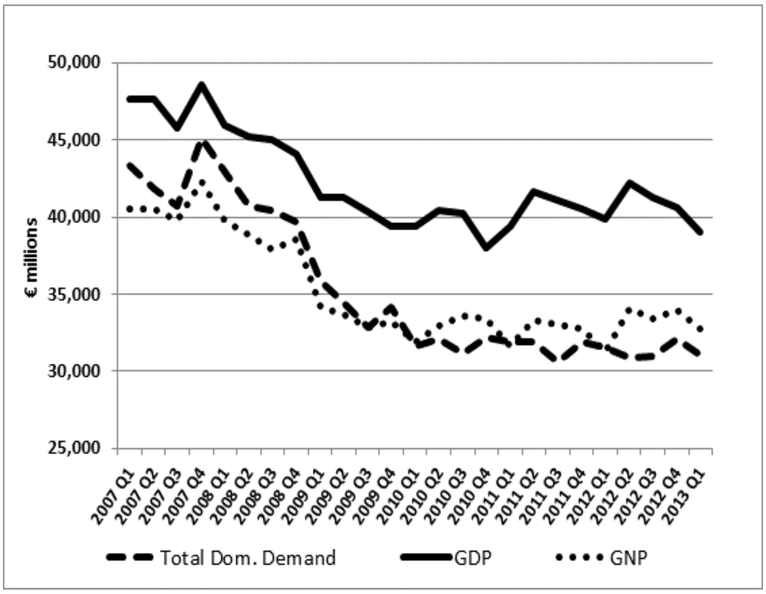
Contribution to growth and job creation

An investment programme such as this is not a panacea. However, it has the potential to assist in lifting growth, employment and the struggling domestic economy.

Government has proposed a smaller investment programme over a much longer time-frame. That programme will not produce anything close to the scale of job creation that Ireland currently needs if it is to really reduce unemployment and generate recovery.

Social Justice Ireland believes Budget 2014 should introduce a programme along the lines and on the scale we outline in this Briefing.

Chart 1: The Decline of Economic Activity, 2007-2013



Source: CSO National Accounts

Domestic economy decline and under-investment

Since the outset of Ireland's economic crash, the public policy focus has been on banks, debt, the sustainability of the euro and the specifics of the Troika Bailout agreement.

This has been to the detriment of the domestic economy. For the most part public policy has paid little attention to the consequences of this decline in the domestic economy.

This has been a major failure in the public policy process as the choices made by Government (and promoted by the 'troika') have impacted in a dramatically negative manner on the lives of many people and families.

As we have highlighted in other publications, the consequences of the recession have been severe on those who had least to do with its creation. This is a point we continue to make in our meetings with Government and Troika officials.

The impact of the recession alongside the cumulative impact of the €31 billion fiscal adjustments since 2008 has been severe on the domestic economy as well as on the individuals and families who have borne many of the consequences of the fiscal adjustment choices made by government over this period.

It is reflected in the huge growth in unemployment (see page 3) and the rapid decrease in national income - see chart 1.

As the chart shows, while the broadest measure of economic activity (GDP) has declined by just over 18%, there have been more severe declines in the measures of economic activity that most closely measure what is happening in the domestic economy.

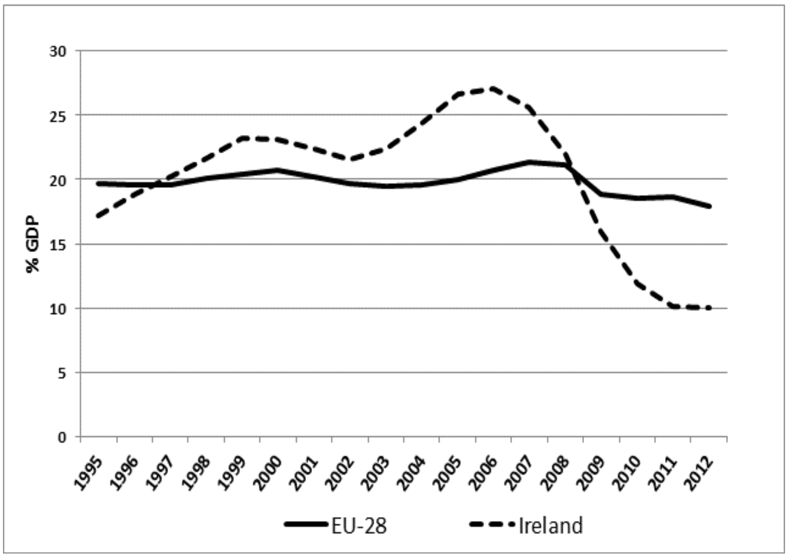
Since 2007 GNP has fallen by 19% and domestic demand (the combination of household spending, government current spending and investment) has fallen by almost 28%.

The decline in investment has been dramatic over this period falling from a level equivalent to just over 25% of GDP in 2007 to 10% in 2012 - the latest year for which data is available.

Given the residential and commercial property bubble, and the uncertainties in the domestic and international economies from 2008 onwards, some decline was to be expected.

However, as chart 2 shows Ireland has decreased its invest-

Chart 2: Investment as % GDP in Ireland compared to the EU,



Source: Eurostat Online Database

ment levels to well below any historic EU average or Irish figure experienced during most of the past two decades.

Public investment fell by 13.2 per cent in nominal terms between 2007 and 2010.

It subsequently fell by 31.8 per cent between 2010 and 2012. The overall reduction since 2007 is just over 40 per cent.

Within this huge fall in public investment direct investment by Government has fallen by 50 per cent while investment by state commercial companies in 2012 was 20 per cent less than in 2007.

(Source: Figures based on Budgetary and Economic Statistics, October 2012, Department of Finance; calculations done by NESC Secretariat.)

Lowest investment compared to EU countries

Eurostat data shows that Ireland's current level of investment (Gross fixed capital formation) is the lowest they have ever recorded for any EU country since 1995 (when collection of comparable data commenced).

Table 1 compares the levels of investment in EU countries in 2012. Ireland stands out at the bottom of the table.

All of the other countries experiencing crisis in recent years have substantially higher levels of investment than Ireland.

The on-going implications of under-investment on this scale are significant.

At its most basic, investment is needed to replace and update existing capital - the current figures for Ireland point towards a probability that even this minimum investment level is not being achieved.

Furthermore, investment is very significant if there are to be additional jobs in the economy.

This lack of investment prolongs periods of unemployment or underemployment for many people. It also undermines the skills base of people who are unemployed.

Our proposals in this document attempt to address these problems.

Without investment there will be no jobs.

Without jobs there will be no recovery.

Without recovery Ireland will remain stuck in austerity.

Table 1: Investment in the EU compared, 2012

Country	% GDP	Country	% GDP
Romania	26.7	Italy	18.2
Estonia	25.0	Germany	17.6
Czech Republic	23.6	Slovenia	17.4
Latvia	23.5	Hungary	17.2
Slovakia	21.5	Denmark	17.1
Bulgaria	21.4	Netherlands	16.8
Austria	21.4	Lithuania	16.7
Belgium	20.7	Portugal	15.8
Luxembourg	20.2	United Kingdom	14.4
France	19.8	Malta	14.3
Poland	19.4	Greece	13.1
Finland	19.4	Cyprus	12.8
Spain	19.1	**IRELAND**	**10.0**
Sweden	18.8		
Croatia	18.4	**EU-28**	**17.9**

Note: EU-28 includes Croatia, average for EU-27 is also 17.9

Source: Eurostat Online Database

Limited Government Investment Plan

Despite the on-going economic challenges, there has been limited movement by Government on the implementation of a structured multi-annual investment plan on the scale proposed in this document.

Most recently, in mid-June, Government once again announced its commitment to increasing investment but with limited specifics on the timing, scale and focus of these plans.

However, *Social Justice Ireland* does welcome the decision to reorient the National Pension Reserve Fund (NPRF) by creating a new investment fund using €6.4 billion from the NPRF's discretionary portfolio.

The fund, to be known as the Ireland Strategic Investment Fund (ISIF), will be formally established later in 2013. Its focus will be on commercial investment opportunities in areas such as water, energy and broadband.

While the ISIF offers potential, we regret Government has not taken a broader and more immediate approach to developing an investment programme of sufficient scale..

A broader perspective would facilitate investment in public services and facilities whose socio-economic benefits would far outweigh their costs over their lifetime - these may not be commercial, but would be beneficial to the state.

The immediate need for a substantial investment programme is obvious from the analysis of growth, unemployment and capital capacity outlined in this Briefing.

It must be noted that the most recent Government announcement on increasing investment adds to others, such as in mid 2012, which have heralded but not delivered a large scale multi-annual stimulus.

Our proposals in this document highlight how this should be introduced and achieved starting as soon as possible.

Budget parameters increase the challenge

The decline in domestic demand and limited investment in recent years are not the whole story. Budget 2014 is set to make the situation even more challenging.

The overall effect of the forthcoming Budget's proposed €3.1 billion adjustment to the Irish economy would be approximately €3.5 billion in reduced economic activity in Ireland in 2014.

The size of this effect is driven by both the direct reduction in government and consumer spending from the Budget's decisions and the indirect effect on the economy of the knock-on implications of these decisions (the multiplier effect).

Put simply, a reduction in government spending means there is less money circulating in the economy.

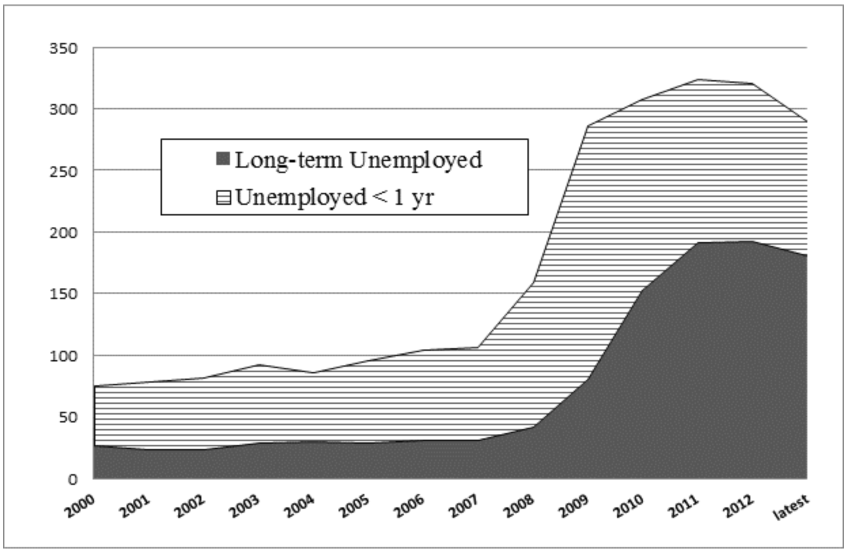
Taking this multiplier effect into account means that in 2014 for the Irish economy to stand still (achieve 0% GDP growth) it must replace through new economic activity (growth) the total effect of the Budget's adjustments which will be approximately €3.5 billion or 2% of GDP.

Growth forecasts not credible

Furthermore, for the economy to achieve the growth targets set out by the Department of Finance (2.4% GDP growth in 2014) the economy must replace the effect of Budget 2014 and generate a further €4 billion in additional economic activity in 2014.

Overall, this implies that Ireland must experience an underlying growth rate of 4.4% in 2014 - similar to the growth levels experienced in boom times. This does not seem credible and we believe it unlikely these Budget growth targets will be met.

Chart 3: Unemployment in Ireland, 2000-2013 (000s)



Source: CSO Quarterly National Household Survey

A reduction in borrowing of €3.1bn combined with continuing low investment in Ireland and slow growth or recession in many of our EU trading partners combined with the high level of personal debt means that the domestic economy is very unlikely to recover.

This further highlights the need for policy to focus on creating growth and we believe the investment programme proposed in this document represents a key opportunity to achieve this.

Without investment there will be no jobs. Without jobs there will be no recovery. Without recovery Ireland will be stuck in austerity for the foreseeable future.

We need credible economic forecasts and viable policy initiatives to move out of the present crisis.

Unemployment crisis persists

Ireland's unemployment crisis is stark and remains the major cost of the recent economic crash.

The rapid increase in unemployment in 2007 and 2008 reversed one of the great success stories of the past few decades - that Ireland succeeded in creating sufficient jobs for its population so that forced emigration was eliminated.

From being a society constantly characterised by high unemployment and emigration Ireland reached close to full employment, involuntary emigration ceased and it was replaced by net in-migration instead.

As chart 3 shows, over the past year there have been some reductions in the numbers unemployed. However there is little evidence to suggest that this change was being caused principally by an increase in the available of jobs. The composition of those signing on the Live Register points towards any falls in unemployment being driven by young unemployed people emigrating rather than significant job creation.

The latest data show that more than 58% of the unemployed are long-term unemployed (out of employment for more than 1 year).

This figure highlights the scale of the challenge ahead in creating jobs and preventing these 175,000 workers from falling out of touch with the labour market.

As we have pointed out in detail in our recently published Socio Economic Review '*What Would Real Recovery Look Like*', responses to this crisis need to be multi-faceted spanning retraining, job opportunities and growth.

Our proposal for a Part-time Job Opportunities Programme reflects this (see *Budget Choices* p12).

Similarly, an investment stimulus should play a core part in addressing the unemployment crisis.

Proposed Investment Package

Budget 2014 offers Government the opportunity to adopt a large scale multi-annual investment stimulus targeted at job intensive key sectors of the domestic economy.

Given the short-term and long-term socio-economic challenges facing Ireland which we have already identified, the need for policy to assist growth is more pronounced than ever.

Simultaneously, an investment package of substance offers the opportunity to address some of the social and infrastructural deficits which remain in Ireland.

We propose the immediate establishment of an investment fund totalling €7 billion targeted over the three years 2014-2016 on nine key socio-economic areas.

These include:

1. the development of renewable energy sources so that Ireland can reduce its dependence on imported and highly polluting fossil fuels;
2. the construction of additional social housing units across the country to address waiting lists which now total almost 100,000 households;
3. development of Primary Care facilities to enhance community healthcare provision and reduce the pressures on hospital occupancy and use;
4. retrofitting Local Authority and other social housing units with energy efficient products and devices so that the cost, morbidity and mortality benefits of this development can be accessed;
5. the construction of proper primary and secondary school education facilities so that all prefabs are eliminated by 2015;
6. the expansion of the early childhood care and education programme and facilities;
7. additional investment to develop community nursing facilities focused on supporting older people;
8. a large-scale programme aimed at improving our non-motorway roads and;
9. an investment programme to modernise our water services addressing leakages and ensuring the long-term stability of a nationwide (urban and rural) supply of clean water.

The funding, timing and economic evaluation of these projects are of critical importance.

An investment package of substance offers the opportunity to address some of the social and infrastructural deficits which currently exist in Ireland—many of which have been caused by the dramatic fall-off in investment in recent Budgets.

Financing

Given Ireland's budget deficit, the gap between government spending and income, any investment stimulus programme must be funded from off balance sheet sources - i.e. the money invested cannot be directly borrowed by Government.

Table 2: Proposed sources of finance for investment Programme

Irish Strategic Investment Fund / NPRF	**€3.00bn**
Commercial Semi-State Borrowing	**€1.25bn**
Domestic Pension Fund Investment	**€1.25bn**
European Investment Bank (EIB)	**€1.50bn**
	€7.00bn

We propose using the funding sources as set out in Table 2:

- The Irish Strategic Investment Fund / National Pension Reserve Fund (ISIF/NPRF) should provide €3bn of its resources towards the overall 2014-2016 €7bn Investment fund; the remaining funds in the ISIF are likely to be invested in subsequent years.
- Borrowing by Commercial semi state companies should provide €1.25bn;
- Incentives to get domestic pension funds, who manage over €70bn in Irish assets, involved should be provided on the proviso of a €1.25bn contribution.
- Finally, the European Investment Bank (EIB) has signalled a willingness to match funding for certain investment and infrastructural projects and should be approached to match €1.5bn from the other sources.

This would provide a total of €7.00bn over the three year period.

Timing

Social Justice Ireland's three year investment stimulus proposal is structured as outlined in Table 3.

The time required to prepare and evaluate non 'shovel ready' projects for implementation necessitates that investment expenditure will be greater in year 2 rather than year 1.

Table 3: Proposed annual allocation 2014-2016

2014	2015	2016	Total
€2.5bn	€3bn	€1.5bn	€7bn

Furthermore, as many of the projects will take more than 12 months to complete, those established in year 1 combine with new projects in year 2 to result a larger spend in that year.

The stimulus is phased out in year 3 as multi-year projects are completed and smaller one year investments undertaken.

Economic Evaluation

The investment areas outlined in this proposal offer obvious and key sectors where job-intensive investment is needed and where the returns from these investment will be recurring and substantial.

However, given the scale of these projects, *Social Justice Ireland* believes that the economic evaluation units within Government (Departments of Public Expenditure and Reform & Finance) should examine these investment proposals and establish a robust case for their funding.

These evaluations should be detailed and produced in a timely manner that does not impede the roll out of the investment programme.

Benefits of an investment programme

There will be both long and short-term returns to society from the adoption of an investment stimulus.

In the long-run the improvement of infrastructure, the reduction in energy imports and the improvement in living conditions and public services offer substantial returns to Irish society.

Ireland's productivity will also benefit. Returns on such investment are likely to overshadow the initial expenditure on the various projects.

There are also a series of short-term returns from the investment stimulus which are significant given the current economic climate and the poor economic and employment outlook. These returns include:

Economic Growth

Increasing spending in the economy will by itself lift economic growth rates.

The *Social Justice Ireland* proposed stimulus in 2014 (€2.5bn) is equivalent to 1.4% of GDP forecast by the Department of Finance for that year.

Added to this, the funds invested in the economy multiply through it creating further economic activity and growth.

While there is no consensus among economists as to the precise scale of this multiplier effect (and it will differ between sectors given their import intensity or labour intensity), most agree it is greater than 1 and likely to be between 1.4 and 1.6 times the initial investment.

Taking the lower value, the *Social Justice Ireland* investment programme would increase GDP growth rates by 2% in 2014, 2.3% in 2015 and 1.1% in 2016. In each case this would represent a significant boost to the weak domestic economy.

Jobs

As we have outlined earlier, addressing the unemployment crisis and creating jobs are key, and to date lacking, elements in Ireland recovery.

An investment stimulus would play an important role in boosting employment in the short-run as new infrastructure and facilities are constructed.

In the longer-term the availability of these new services and state assets will provide new and sustainable employment.

In its 2009 Investment Priorities document the Department of Finance outlined its estimates on the number of jobs likely to be created per €1m invested. They reported between 8-12 jobs are created during the construction phase for every €1m invested.

Applying this to the *Social Justice Ireland* Investment proposal suggest that between 56,000 and 84,000 additional jobs would be created during the period. The smaller of these figures equates to about 2.5% of the labour force.

Taxes and Government Spending

The additional jobs and economic activity resulting from an investment stimulus boost Government's tax revenues as more income and consumption taxes are paid. Estimates from the Nevin Economic Research Institute (NERI) suggest that €1bn in investment leads to additional taxes of €425m; a return particularly relevant given the off the books structure of the investment proposal. Over the three years, the €7bn investment could increase tax revenues by up to €2.9bn.

Savings also emerge from reduced social welfare expenditure as jobs are created and unemployment reduced.

A further benefit of the *Social Justice Ireland* investment stimulus derives from the areas where the stimulus is focused.

The provision of new social housing stock would allow reductions in expenditure on the expensive rent supplement scheme. Better public health facilities and primary care provision should reduce the pressure on hospitals and generate saving in either spending reductions or deferred increased expenditure.

Similarly, better water infrastructure and new sustainable renewable energy sources offer benefits, savings and potential revenue sources for the future.

Over three years, the €7bn investment could increase tax revenues by up to €2.9bn.

Investment positive for banking sector

A recent research paper from two economists at the Central Bank pointed towards a further very relevant benefit of an investment stimulus.

Kelly and McQuinn (2013) examined the implications of additional economic growth caused by an event such as a fiscal stimulus on the banking sector. They found that the additional employment and economic growth created by a stimulus had knock on implications for the banking sector - which is predominantly state owned.

Higher growth and lower unemployment results in less mortgage arrears and defaults, thereby improving the financial position of the banks.

The close association between unemployment rates and house prices also implies that as unemployment falls house prices increase, reducing the scale of future capital requirements the banks will need.

The paper estimated that the impact of a €2bn stimulus would be to reduce banks capital requirement by €660m.

Common practice internationally

State intervention to stimulate a weak domestic economy is far from uncommon internationally.

Such counter-cyclical policies have been common place in other countries as part of their response to weak domestic demand, low growth and short-term economic underperformance.

For example, both the US and UK have been undertaking large scale infrastructure investment to stimulate growth. A similar approach has emerged in Japan.

More recently there have been increasing calls within Europe for investment measures to stimulate growth and assist in bringing about a broader recovery.

This is particularly relevant given that to date the approach in Europe has been to collectively deflate and rely on export growth for recovery - something which is not possible given the predominance on inter-EU trade.

A recent study by two economists in the Central Bank concludes that a fiscal stimulus would be good for the banking sector. They calculated the impact of a €2bn stimulus would be to reduce banks' capital requirement by €660m.

There is nothing unusual about a large scale multi-annual investment stimulus targeted at job intensive key sectors of the domestic economy. Financed off-the-books, as we have outlined, there should be no reason for Ireland not to undertake one.

Austerity not working—IMF study

A recently published IMF working paper entitled 'The Distributional Effects of Fiscal Consolidation' shows that austerity does not work and will not work for Ireland.

The findings of the paper show that fiscal consolidation has had significant negative distributional effects by raising inequality, decreasing wage income shares and increasing long-term unemployment.

The full text of the study, which analyses 17 OECD countries over the period 1978-2009 may be accessed through our website at: http://www.socialjustice.ie/

The evidence presented in this study also shows that spending-based adjustments have had, on average, larger distributional effects than tax-based adjustments.

The impact of expenditure cuts on income inequality in the medium-term is about 1 percentage point compared with 0.6 percentage point for tax based measures.

Expenditure cuts impact most on those on low and middle incomes and this IMF study shows that these cuts impose medium and long-term distributional costs to those least capable of bearing it.

Social Justice Ireland has consistently pointed out to Government and the 'troika' that:

- At a moral level the current austerity approach is unethical because it was those on low and middle incomes who have borne the brunt of the adjustment rather than the rich and powerful.
- Austerity, in practice, is also a failure because it has simply produced a fractured society, a weak economy and persistently high unemployment.
- This IMF study is simply the latest in a wide range of studies that academically undermine the austerity approach currently being used in Ireland and beyond to deal with this crisis.

Social Justice Ireland has argued that austerity is not working for Ireland and that a new approach is needed.

In our policy briefing *Budget Choices 2014* we show how Government can reduce the deficit without imposing anymore expenditure cuts in the budget. The Briefing may be accessed on our website: www.socialjustice.ie.

Budget Proposals for 2014**

In June 2013 *Social Justice Ireland* published a Briefing detailing our fully-costed proposals for Budget 2014. The document, entitled *Budget Choices*, is available on our website.

In it we outlined our view that there should be no more expenditure cuts in Budget 2014.

We believe it is long past the time Government realised austerity is not working for Ireland. A new approach is needed.

In the document we set out a range of Budget measures that would:

- reduce Government's borrowing;
- protect the vulnerable;
- make the tax system fairer;
- set a minimum effective corporate tax rate;
- protect public services;
- increase domestic demand;
- increase social welfare rates and;
- distribute the 'hits' in Budget 2014 more fairly.

**Full details in Policy Briefing titled 'Budget Choices' published July 2013

Key Proposals

- No more cuts in expenditure (except where they flow from reforms and don't damage the social infrastructure).
- A reduction in borrowing of €3.1bn in 2014 as agreed with the 'troika'.
- A minimum effective corporation tax rate of 6% (i.e. no corporation would pay less than 6% of their profits in corporation tax).
- A Financial Transactions Tax of 0.01%.
- A universal state pension.
- An increase of €5 a week in the PAYE tax credit and in the basic social welfare rates.
- An investment stimulus, as outlined in this document, focused on developing physical and social infrastructure.
- Elimination of the fuel dyeing process for agricultural and industrial diesel.
- 21 further initiatives covering a wide range of policy areas.

In that *Policy Briefing* we outlined how all of these proposals can be financed while reducing borrowing by €3.1bn in 2014.

A Budget along these lines in 2014 would be good for the economy, good for those on low and middle incomes, and good for Ireland.

Recent Publications from *Social Justice Ireland*

What would Real Recovery Look Like? - Socio-Economic Review 2013

The Impact of the European Crisis - with a special focus on Greece, Ireland, Italy, Portugal and Spain. (2013)

Does the European Social Model Have a Future? (2012)

Policy Briefing on *Budget Choices 2014* (2013)

Sharing Responsibility in Shaping the Future (2011)

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Social Justice Ireland advances the lives of people and communities through providing independent social analysis and effective policy development to create a sustainable future for every member of society and for societies as a whole

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