1. Social developments in Ireland at the time of fiscal consolidation and challenges ahead[1]

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This paper is set out as follows:

1. Introduction

After more than a decade of very strong growth, the crisis hit Ireland severely. While the robust growth in the second half of the 1990s was based on healthy fundamentals, including competitive unit labour cost, the boom in the 2000s was over-reliant on the property market fuelled by easy credit. Domestic policy mistakes, as well as weaknesses of surveillance at the European level, allowed a major property and consumption bubble to emerge and burst. The flight to safety in global financial markets, accompanied by a fall in international trade and domestic demand, caused a sharp drop in GDP and subsequently in employment, also because private

[1] A version of this paper was presented at the *Social Justice Ireland* Policy Conference on 19 November 2013. The subject of the Conference was "A future Worth Living For".

[2] Authors gratefully acknowledge valuable input and comments from Q. Dupriez, D. Malvolti, J. Malzubris and G. Stull.

[3] Views expressed in this paper are those of the authors and do not necessarily reflect the official views of the European Commission. Neither the European Commission nor any person acting on its behalf may be held responsible for the use which may be made of the information contained in this note, or for any errors which, despite careful preparation and checking, may appear. This short paper is no way a substitute for a careful and thorough analysis of the social impact of the crisis and its management in Ireland; it only sketches out some of the main developments in this regard and the basic approach to this issue in the programme.

business embarked on a major productivity drive to restore profit margins. Budgetary and financial stability concerns led the government to implement austerity policies in 2008-09. Yet government bond spreads reached unsustainable levels, and banks found it increasingly difficult to access market funding and cover their losses.

The Irish authorities requested external financial assistance and agreed on policy conditionality with the European institutions and the IMF in 2010. The latter involved a comprehensive policy package for the period 2010-13. It aimed primarily to reform the banking system, restore healthy public finances and to introduce growth-enhancing structural reforms. The economic adjustment programme was backed by EUR 85 billion, which included EUR 45 billion contribution from the EU and EUR 22.5 billion from the IMF, as well as Ireland's own financial assets to the tune of EUR 17.5 billion. Ireland has since regained market access and is now on track to exit the current programme at the end of 2013.

Programme conditionality was fully based on Ireland's own economic recovery program, and all the programme documents were discussed and approved by the Irish Parliament. It was always up to the Irish authorities to formulate the actual measures, their nature, scope and size, in order to achieve the jointly agreed fiscal targets. The program's role was to ensure that these targets remain realistic. It helped the Irish government formulate a set of measures that are most conducive to growth, fair distribution of burden and financial stability. In fact, discussions with the Troika staff teams prior to budget day focused on reviewing possible measures, but the draft budget itself was shared with the Troika teams only when it was submitted to the Oireachtas on budget day.

Overall, the impact of fiscal adjustment on the population in Ireland has been progressive. Between 2008 and 2013, Ireland sought to minimise the negative impact of the deep crisis by opting for a combination of measures that not only achieved the necessary fiscal consolidation but, as the available social indicators suggest, overall also tried to protect the most vulnerable. As independent research shows, fiscal consolidation of the size carried out in Ireland unavoidably hurts people, therefore, the inevitable burden was distributed among different parts of society in a progressive manner (charts 12 and 13). As the timing of different measures depended on a number of factors, including political economy factors, the distributional impact may have changed over time. However, for an overall judgement, one should look into the cumulative impact of the programme.

The European Commission staff has consistently highlighted the importance of choosing measures which protect the most vulnerable in society and help maintain the social fabric[4]. The Commission staff's advice focused on the reduction of unemployment, as its analysis identified unemployment as the most important source of unequal distribution of adjustment burden in society. However, it also regularly analysed the effectiveness of the social support system, including whether it contributed to creating a poverty or unemployment trap. It emphasised the importance of fighting unemployment, particularly long-term and youth unemployment, also because of its strong and lasting negative impact on growth potential and social coherence. Moreover, the Troika regularly met those non-government organisations that worked in this area, including Social Justice Ireland, The Society of Saint Vincent de Paul, and the European Anti-Poverty Network in Ireland, and helped and encouraged them to convey their views to the government and the elected representatives of the Irish people. The Troika teams also regularly met TDs of the opposition parties and the technical group, and asked for their support for measures that distribute the inevitable burden of adjustment in an equitable manner.

As available indicators suggest, overall social transfers in Ireland provide notable income support to low-income households and have been largely effective in reducing poverty, particularly when compared to other crisis-hit countries (chart 10). It is important to ensure that social transfers are not only effective in protecting the most vulnerable, but also provide the right incentives to people to seek out employment possibilities and to fully benefit from active labour market measures, such as training or consultation. The fact that Ireland has so far not only reached all its fiscal targets but could at the same time maintain a rather efficient system of social transfers, shows that Ireland is on the right path.

Going forward, Ireland needs to remain focused on reducing unemployment as it is the principal determinant in poverty and deprivation. In particular, structural measures with respect to the long-term

[4] European Commission, Economic Adjustment Programme for Ireland, 2011-2013 Reviews, Occasional Economic Papers 84/2011, 88/2011, 93/2012, 96/2012, 115/2012, 127/2013, 131/2013, 154/2013. Special Box in the Winter 2012 Review on the effects of the crisis on income inequality in Ireland. István P. Székely, Troika's press conferences – see References.

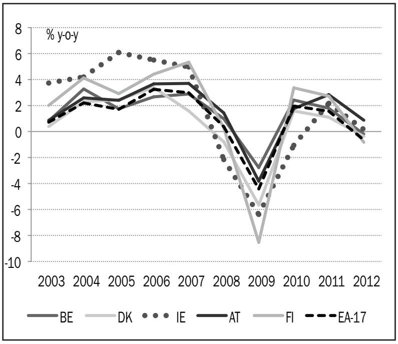
and youth unemployed are vital in their poverty-reducing potential. In addition, Ireland needs to further strengthen competitiveness in the labour and product markets. Only then will it be able to take full advantage of the adjustment and embark on a sustainable growth path, and to fight poverty and exclusion.

2. Development of the key social indicators in Ireland – an EU peer comparison

Ireland's social indicators deteriorated markedly in the aftermath of the crisis mainly as a direct consequence of the surge in unemployment. While the headline unemployment rate remained stable around 5% before the crisis, it peaked at 14.7% in 2012. The labour market situation became particularly worrying as the long-term unemployment rate reached 9.1%, a significant increase from a pre-crisis low of 1.5%. Moreover, a fall in participation rate of some 4 pps (percentage points) between 2007 and 2011 and outward migration masked the size of the unemployment challenge. An increasing share of the population found itself living in very low-work-intensity households on a long-term basis, which is reflected in deterioration of social indicators, such as the at-risk-of-poverty-or-social exclusion rate. Other indicators, such as income inequality or relative at-risk-of-poverty rate, did not deteriorate and emerged better compared to other EU countries.

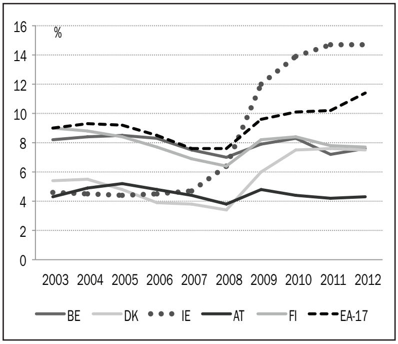
A benchmarking against economies of similar income levels and characteristics reveals that Ireland performs reasonably well in many aspects, considering the severity of the economic shock. For the purpose of this comparison, four countries with the closest level of income per capita are picked: Belgium (BE), Denmark (DK), Austria (NL) and Finland (FI). As nearly all EU Member States, these economies took a hit in 2009 and their real GDP contracted considerably (chart 1). With the economic slowdown, their unemployment rates inevitably grew, although not to the same extent as in Ireland (chart 2). The much larger increase in unemployment in Ireland than in the benchmark countries is explained by the collapse of the construction sector and the productivity drive in the rest of the economy that was necessary to restore lost cost competitiveness. Although Ireland clearly stands out as far as the impact of the crisis on the labour market is concerned, the analysis below shows that the associated social impact has been largely contained.

Chart 1: Real GDP annual growth



Source: Eurostat

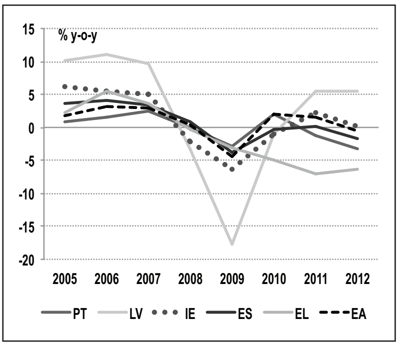
Chart 2: Unemployment (% of labour force)



Source: Eurostat

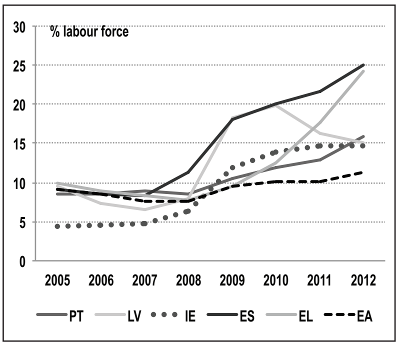
A benchmarking against other severely hit economies, which were in need of financial assistance, places Ireland among the "better" performers. Countries included in this comparison would be Portugal (PT), Latvia (LV), Spain (ES), and Greece (EL). Although this group of countries is quite heterogeneous, they face similar social challenges. Charts 3 and 4 below show the size of the economic contraction and resulting surges in unemployment. While Ireland contracted more than the other programme countries, it still managed to contain unemployment at comparably lower levels.

Chart 3: Real GDP annual growth



Source: Eurostat

Chart 4: Unemployment (% of labour force)

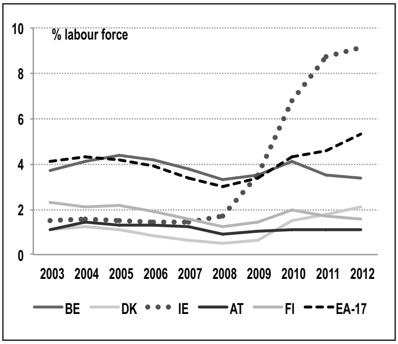


Source: Eurostat

The unemployment benefit system has helped alleviate the social impact of unemployment, mainly through the out-of-work income support scheme. While unemployment benefits have been reduced, the long duration of the benefits imply high long-term replacement rates as compared to other Member States. This acts as an unemployment trap and disincentive to work, especially for the low-skilled unemployed people with low wage potential.[5]

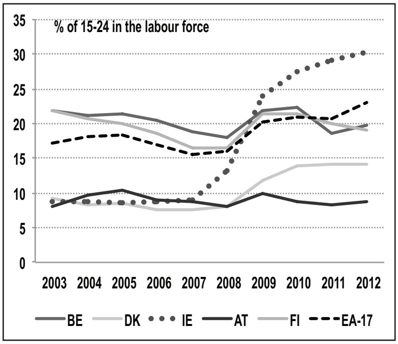
Long-term unemployment was identified as the single most important driver of absolute poverty, as long duration of unemployment often leads to social marginalisation and decreases the prospects of re-employment. In 2012, Ireland had the third highest long-term unemployment rate in the EU after Greece and Spain. Chart 5 shows that not only the level, but also the sudden increase was very marked compared to its peers.

Chart 5: Long-term unemployment rate



Source: Eurostat

Chart 6: Youth (15-24) unemployment rate



Source: Eurostat

A similar trend can be observed in the development of youth unemployment, which also increased substantially (chart 6), although not surprisingly compared to the increase in the overall unemployment rate. The evolution of these two indicators is particularly worrying as both long-term and youth unemployment increase significantly the probability of

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5 Callan, T.; Keane, C.; Savage, M.; Walsh, JR.; Timoney, K. (2012). "Work Incentives: New Evidence for Ireland". In T. Callan (ed.), Budget Perspectives 2013. ESRI, Dublin.

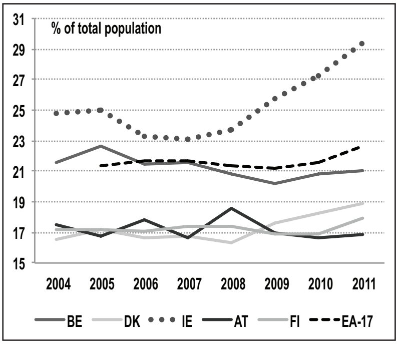
future unemployment and the likelihood of precarious employment, which may have a considerable negative impact on social indicators such as poverty or health.

The structural reform part of the adjustment programme put considerable emphasis on the need to address long-term and youth unemployment. Despite some recent improvements in this regard, long-term and youth unemployment remains the largest social threat in Ireland. The Commission also created so-called youth employment action teams, which visited the countries with the highest youth unemployment rates to reallocate and accelerate EU funding to support job opportunities for young people. Most recently, the Commission has started to help Member States set up a so-called Youth Guarantee, which is a new approach to tackling youth unemployment. It ensures that all young people below 25 years of age receive a good-quality, concrete offer within four months after leaving formal education or becoming unemployed. While these measures are expected to help fight this major social threat all across the European Union, they are no substitutes for determined policy actions at the national level.

Negative trends on the labour market translated into rising absolute level of poverty in Ireland. Reversing a long term trend, Ireland made substantial progress to reduce income inequality in the period prior to the current crisis. However, following the crisis, inequality started to increase again, largely due to deteriorating labour market conditions, which were harshest for low earners. Absolute measures of poverty, such as risk of poverty and social exclusion (AROPSE), have been trending upwards (chart 7). AROPSE is composed of three sub-indicators, which are the share of population that is either at risk of poverty, or living in a household with a very low work intensity, or severely deprived (chart 8).

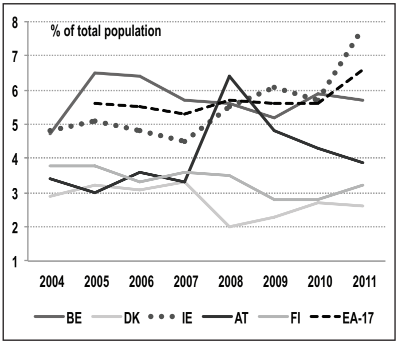
However, poverty rates measured in relative terms have not shown a substantial increase since the onset of the crisis, and compare favourably to peer countries. At-risk-of-poverty indicator (AROP) remains close to Ireland's peers and is below the EU average (chart 9). AROP measures the share of individuals whose equivalised disposable income falls below a given threshold (in this note, the standard cut-off point of 60% of the median income after social transfers is used). As such, AROP measures relative poverty and is thus a useful statistic describing the income distribution.

Chart 7: AROPSE



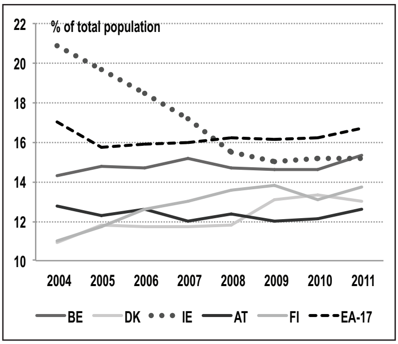
Source: Eurostat

Chart 8: Severe material deprivation



Source: Eurostat

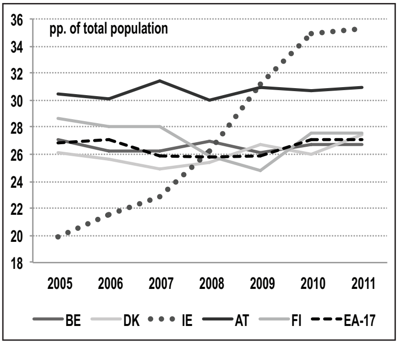
Chart 9: At risk of poverty



Source: Eurostat

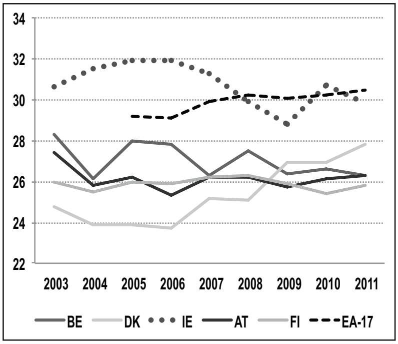
The economic adjustment programme placed an emphasis on labour activation, education and training in order to limit the negative social impact and path a way for a sustainable recovery. This is expected to pay dividends in the near future in terms of combatting poverty. In addition, headline social welfare rates and the safety net have been largely protected, and the poverty reducing effect of social transfers has been far greater than in the rest of the EU (chart 10). In this context, the programme funding has enabled a more gradual adjustment path than would have otherwise been the case.

Chart 10: Effectiveness of social transfers[6]



Source: Eurostat

Chart 11: Gini coefficient[7]



Source: Eurostat

Independent studies show that early consolidation measures in Ireland were strongly progressive. The Social Situation Observatory with input from the Economic and Social Research Institute (ESRI) shows in its study titled *The distributional effects of austerity measures: a comparison of six EU economies*[8], that the fiscal adjustment has put a relatively low burden on the low income households (chart 12). Ireland also performed relatively well in this respect compared to the other studied countries.

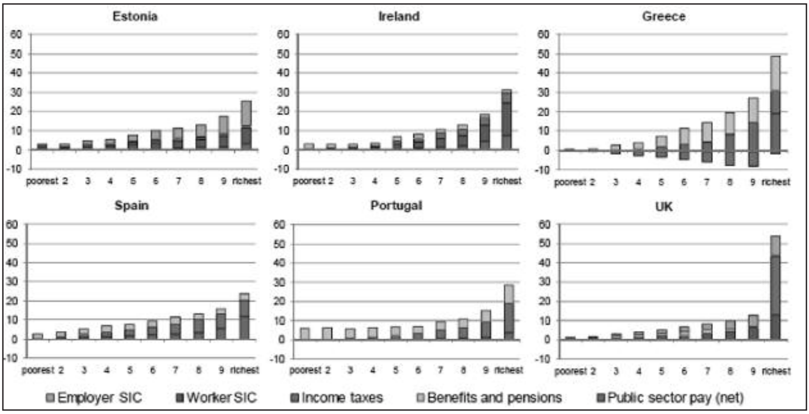
The crisis impacted to some extent the distribution of income, but Ireland's income inequalities remain close to the EA average. Compared to its peers, Ireland scores poorer in the Gini coefficient (chart 11). However, this reflects mainly the pre-crisis situation when income inequalities were already higher than in the peer countries.

[6] Measured as a difference in percentage points in at-risk-of-poverty rate before and after social transfers.

[7] This standard indicator of income inequality takes values between 0 and 100 – higher values imply a higher degree of inequality.

[8] Callan, T., Leventi, C., Levy, H., Matsaganis, M., Paulus, A., Sutherland, H. (2011). "The distributional effects of austerity measures: a comparison of six EU economies". Euromod Working Paper No. EM6/11.

Chart 12: Relative contribution to the 2009-2011 fiscal consolidation by type of austerity measure



Source: ESRI

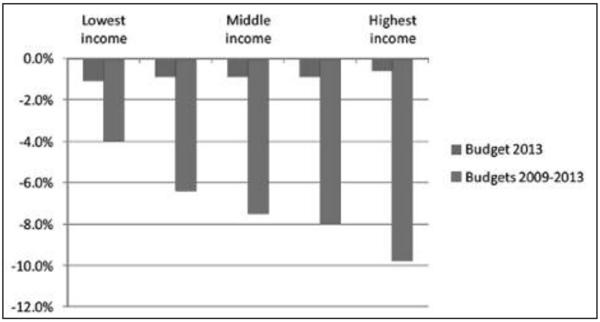
Despite the somewhat regressive impact of the 2013 budget, the cumulative impact of fiscal adjustment during 2009-2013 remained progressive. As mentioned earlier, the European Commission's staff review reports reiterated[9] the importance of choosing measures which protect the most vulnerable in society, and a fair sharing of the adjustment burden across income groups. An ESRI analysis of the 2013 fiscal consolidation measures shows that their impact on income distribution has been to some extent regressive (chart 13). However, it is also important to mention that the ESRI model does not include all the measures, some of which tend to have a more progressive impact (such as capital gains taxes, the deposit interest retention tax, and the change in the universal social charge for the elderly). Moreover, the analysis found that the cumulative consolidation efforts of the 2009-2013 period remained progressive. It is up to the Irish public to decide whether the apparent slight reversal in 2013 is acceptable or not, and to convey its views to the elected officials. The very thorough analysis of Social Justice Ireland will certainly be a helpful source of information in this regard, also concerning the 2014 budget[10]. In making this judgement, however, it is important not to rely on partial analysis, as fiscal measures

9 European Commission, Economic Adjustment Programme for Ireland, 2011-2013 Reviews, Occasional Economic Papers 84/2011, 88/2011, 93/2012, 96/2012, 115/2012, 127/2013, 131/2013, 154/2013.

10 Social Justice Ireland. (2013). "Budget 2014 Analysis & Critique".

also strongly impact poverty and income distribution through their effect on growth, labour supply and relative prices, which can only be captured by a full model of the economy, such as the one used by ESRI. In judging a particular budget or the impact of the entire adjustment path since the crisis broke out, it is also important to factor in all the measures, not only a subset. Caution is also needed in making a judgement about particular years, as some of the measures that played a major role in achieving a progressive distribution of burden cannot be repeated. In fact, it was one of the strengths of the Irish adjustment that these measures, such as the necessary correction of public sector wages, were taken early on.

Chart 13: Average percentage loss from budgetary policy, 2009-2013



Source: ESRI

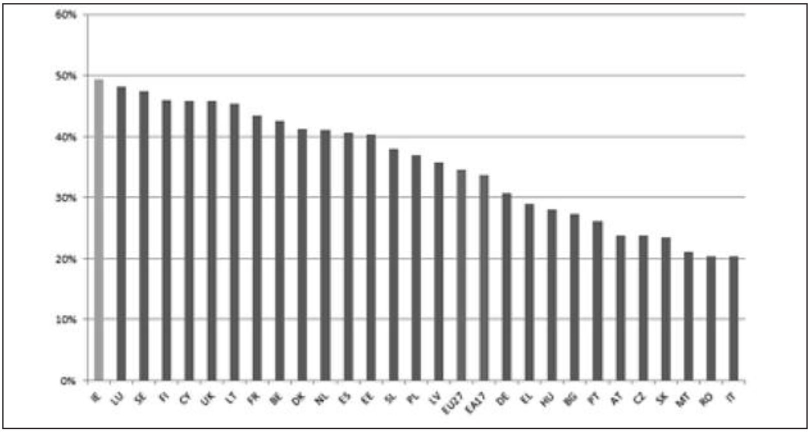
3. Challenges ahead

Outlook for economic growth remains crucial for improving the social dimension going forward. The Irish economy has returned to growth and the Commission's staff spring forecast projected a further pick-up in economic output for 2013–2014. Nevertheless, the latest macroeconomic data indicate that the recovery remains fragile. The growth outlook remains important for the success of the economic adjustment programme and is closely linked to the improvement in the social indicators discussed in this note.

Ireland is well placed to return to a sustainable growth path thanks to its strong fundamentals in terms of education and business environment. Nearly half of the Irish population have completed tertiary education and

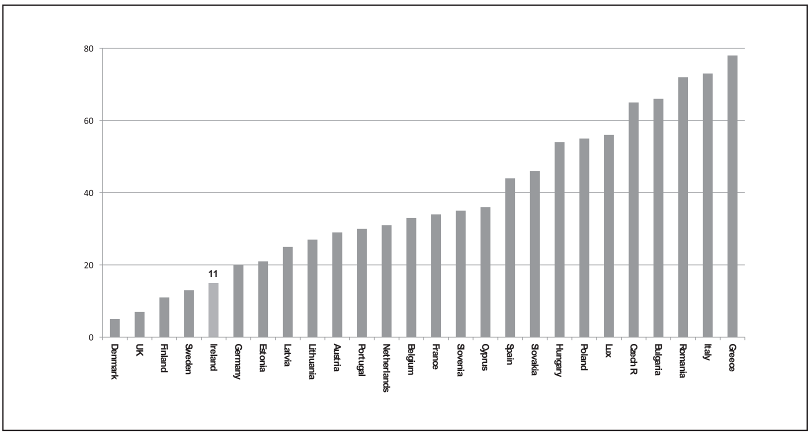
Ireland ranks 15th in the world (5th in the EU) at the ease of doing business – an index compiled by the World Bank. That is, Ireland has a highly-skilled labour force and a regulatory environment that is conducive to long-term growth and adjustment (charts 14 and 15). It has also largely restored its cost competitiveness (chart 16).

Chart 14: 30-34yr olds with tertiary education



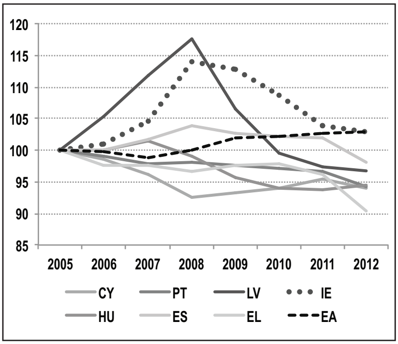
Source: Eurostat

Chart 15: Doing business ranking 2012



Source: World Bank

Chart 16: Relative real unit labour costs



Source: AMECO. Performance relative to the rest of 37 industrial countries; double export weights; Index 2005 = 100

Unemployment, including long-term unemployment, has also started to decline, albeit it still remains unacceptably high. Job creation was an important factor in bringing about this improvement. With stabilising house prices, in fact even somewhat increasing in Dublin, and an increasing unmet demand for certain type of homes in Dublin, the construction sector can be expected to gradually recover. The important work of the Central Bank of Ireland, as part of the programme, to push banks to find sustainable solutions for mortgage holders in a difficult situation; the continuously improving access of Irish banks to stable funding; and banks' faster-than-planned progress with rightsizing their balance sheets, will help create the necessary conditions for a rebound in mortgage lending and thus help the recovery of the construction industry. Such recovery will no doubt provide a major relief to unemployment, particularly to youth and long-term unemployment. (Charts 17 and 18 below show the size of the unemployment challenge in the programme countries). Continuous assessment of the effectiveness of active labour market policies, as well as corrective measures if necessary, will also be important to help unemployed people benefit from the improvement in economic conditions. The government may want to look into the study the World Bank did for Latvia in this area[11], using a careful analysis based on micro-level data, and conduct or commission a similar study if it finds it useful.

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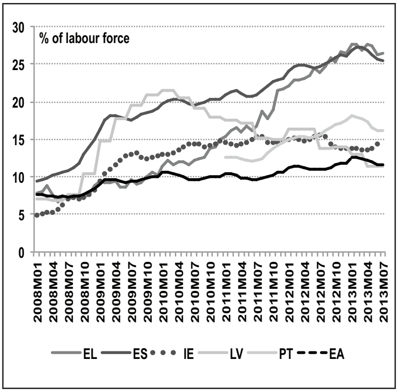
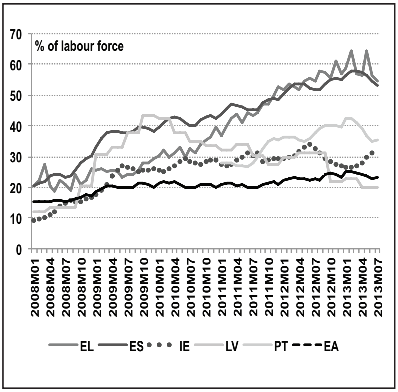
[11] The World Bank, European Social Fund Activity - Complex support measures No. 1DP//1.4.1.1.1./09/IPIA/NVA/001. "Latvia: Who is Unemployed, Inactive or Needy? Assessing Post-Crisis Policy Options".

Chart 17: Unemployment rate (monthly data)[12]



Source: Eurostat

Chart 18: Youth (15-24) unemployment rate



Source: Eurostat

Additional structural reforms are nevertheless needed to further strengthen competitiveness, foster growth and to significantly reduce long-term and youth unemployment. Notwithstanding major achievements so far, there is still room for improvement, particularly in the non-tradable sector, including for example further reforms regarding sheltered professions. In the fight against long-term and youth unemployment and social exclusion, several reform strands are critical mainly to: (1) finalise the implementation of active labour market policies; (2) provide the level and types of support needed by job seekers; (3) facilitate the re-skilling and up-skilling of the unemployed through the improved delivery of relevant further education and training programmes; and (4) pursue efforts to foster job creation. This will require continued determined efforts on the part of the authorities in the coming years, as some of the reforms that were initiated during the programme still remain to be completed.

12 Monthly data for PT is only available from January 2011

4. Conclusions

The burst of the bubble in Ireland created an unprecedented shock to the Irish economy, leading to a rapid increase in unemployment and a collapse in budget revenue. The inevitable fiscal adjustment no doubt added to the already strong pressure on the economy and made public funds scarce. Given the large imbalances that had built up prior to the crisis, the initial shock was largely unavoidable, and so was the large fiscal adjustment given the rapid increase in public debt. The performance of the Irish economy should be measured by how quickly it returned to growth and job creation after the initial shock, relative to other economies that experienced similar imbalances. Public policies should be judged based on how much they supported this recovery and helped mitigate the inevitable social impact of crisis. The financial assistance from the EU and the IMF helped ease the pressure on the budget by providing concessional credit and avoided a hasty fiscal adjustment in a period when the Irish government was cut off from the market. The programme was built on a carefully chosen gradual fiscal adjustment path, one that aimed to limit the fiscal adjustment burden in the early phase when the economy was very fragile. Within this framework, however, it was always up to the Irish authorities to choose the combination of measures that they thought was most supportive of their economic and social goals.

Thanks to its flexibility and healthy deep fundamentals, the economy rapidly restored its competitiveness and established a new set of relative prices, including asset prices, and hence created the foundations for growth and job creation. The structural reforms that were pursued as part of the programme also helped in this regard. Nevertheless, due to the large imbalances that had emerged prior to the crisis, the increase in unemployment, particularly in long-term and youth unemployment, was much greater in Ireland than in its peer economies, albeit significantly less than in other programme countries in Europe.

The resulting high unemployment was the main reason for the increase in absolute and relative poverty, while the scarcity of public funds limited the capacity of the government to mitigate the social implications of the crisis. Prior to the crisis, Ireland made major achievements in reducing poverty and social exclusion. Its performance in this regard compared favourably with its peer countries with similar income levels and social development indicators in Europe, perhaps with the exception of income distribution (Gini coefficient). The rapid increase in unemployment was not comparable to what the peer countries experienced. It led to a significant deterioration in social indicators relative to the peer countries, albeit probably much less than the size of the shock and the consequent increase in unemployment would have implied, thanks to an overall rather effective social transfer system. In this regard, the European Commission staff's structural policy advice focused on measures that can help improve employability and matching of supply and demand in the labour market, such as improvements in training and placement services for unemployed people. As the economy started to create jobs again, improvements in this area will undoubtedly bear fruit, even though more determined measures to improve placement services are needed.

During the programme, Troika staff teams regularly met those major non-governmental organisations which work in Ireland towards better social policies and encouraged them to convey their views and policy recommendations to the government and the elected representatives of the Irish people. Commission staff also repeatedly called attention to this aspect of crisis management in its reports and press conferences.

This short note is in no way a substitute for a careful and thorough analysis of the social impact of the crisis and its management in Ireland; it merely sketches out some of the main developments in this regard and the basic approach to this issue in the programme. It is for the Irish government and independent experts in Ireland and elsewhere to come to a final assessment, but perhaps such a final assessment should wait until the Irish economy is firmly back to normal and the effects of the policies in this area have fully played out. As always, the best way to assess a particular country, or government, is to compare them to the best performers among those who faced similar challenges. The role of the EU-IMF programme for Ireland in this regard is also best judged in this way.

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