1. Recovery and Transformation: Investing in a New Social Contract

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Beyond the Celtic Tiger

As Ireland sits on the edge of possible economic recovery, we face many of the same choices about the future as in the early 2000s. Having ducked those choices then, there is a real risk that we will make the same mistake in the crucial years before us. How can we avoid this?

It was not simply a case of ‘everyone partied’, nor of individual examples of bad behaviour in private and public institutions. In fact, in Ireland in the Celtic Tiger years there were deeper problems in the Irish model.

First, reduced capital gains tax and lax regulation gave private finance the power to make most of the investment decisions for society – which then mis-allocated most of the society’s resources to property development and financial speculation. The financial regulator was weak but the private institutions that were supposed to control this behaviour – the stock market, centralised management, market competition and credit rating agencies – also completely failed to do so (Ó Riain, 2014: Chapter 3).

Second, monetary union and integration of financial markets in Europe hollowed out the European model and made the Eurozone a playground for speculative finance. The European Union that had invested heavily in Ireland in the 1990s now enabled the financial flows that grew Ireland’s financial and property bubble out of all proportion to the size of its economy (Ó Riain, 2014: Chapter 4).

Third, Ireland’s economic and social model emphasised low rates of taxation on income and business and left Ireland’s public finances deeply vulnerable to economic shocks. Worse still, the facade of full employment masked low employment participation rates and a failure to invest in upskilling our

working age population. In the boom, rising levels of spending were built on the sand of a weak tax base. In the crisis, these foundations simply collapsed (Ó Riain, 2014: Chapter 5).

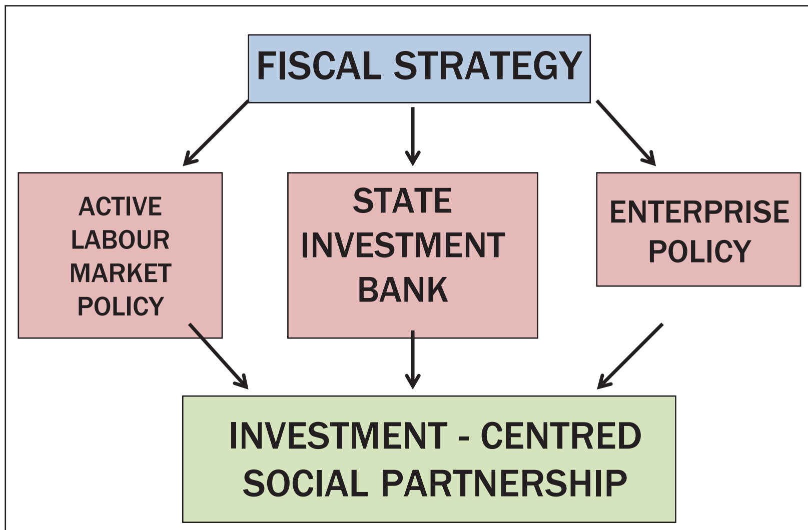
Ireland's strategy for recovery is based on getting public debts under control and boosting private sector competitiveness. Despite recent improvements, the recovery is fragile. Even more important, the old failings of the Irish model are returning. Private finance is back in Ireland and just as hungry for property as ever. Investment in domestic business and the real economy remains weak and there is little reason to expect that the same banks that offered weak support for such investment in the good times will do better now. Investment in European infrastructure and communities has been reduced when it was needed most and Europe's political power is used in a one sided manner to enforce discipline on its members while neglecting the potential to enable member states to rebuild towards a 'European model'. A key part of this European model has been social solidarity, underpinned by strong shared social services. Ireland is getting its deficit under control but at a huge cost to public services. At the peak of the bubble in June 2008 the OECD commented that Ireland had a small public service compared to most European countries – and public employment has fallen significantly since then. Furthermore, promises of tax cuts over a three year period pose a serious risk that Ireland will return to a model based on a thin revenue base and a weak social contract.

Most fundamentally, Ireland needs to recover through not only rebuilding the economy, but by also stitching a new social contract into the fabric of the economy itself. Furthermore, it needs to develop the capacities of both its private and public sectors in order to allow them to support this new 'investment-centred' social contract. There is no point looking to small firms to boost their social security payments if many of them are laden with debt and follow business models that rely on low wages and low tax wedges. There is little point looking to public services to boost productivity and social protection if their capacity to do so – financially and organisationally – is weak. Can Ireland break out of the vicious cycle of private and public weakness? This requires a new approach – but it is an approach that can build on significant capabilities already within Ireland's political economy and public agencies.

That new approach is built around an 'investment diamond' – a set of

interlocking policy areas that create new capacities for economic development, industrial upgrading, expanded revenues and enhanced social protection. Going back to Mjoset (1992), observers have warned of the dangers of the underdevelopment of Ireland's 'national system of innovation' – as Ireland begins the process of recovery, it is time to tackle this issue properly for the first time in her history. This paper tackles the key elements of the investment diamond that can address these issues. It briefly comments on the fiscal aspects of macroeconomic policy. It then goes on to explore in more detail the 'meso' level policy areas of labour market policy, financing and enterprise development – together forming an 'investment infrastructure' for the economy. Finally, it suggests a new form of social partnership that would bring these new capacities at the meso level into firms and workplaces.

Figure 1: The Investment Diamond



Fiscal Strategy

Ireland is operating under severe fiscal constraints. Nonetheless, trade-offs are possible. A variety of different approaches have been outlined in recent years, with different clashing projections of returns on investment and the medium-run effects of fiscal consolidation of various types.

Given the scale of Ireland's fiscal contraction, the question of whether fiscal consolidations are up to the task of restoring credit worthiness and growth or whether they are self-defeating is a central one in the Irish case. The question has received increasing attention in the Eurozone as the European economy has continued to stagnate, a full five years after the crisis began. A number of papers have examined the question, to the extent that EU Commissioner Ollie Rehn was moved in February 2013 to write a note to the ECB describing the wave of new studies of fiscal multipliers during an economic crisis as "unhelpful". The IMF report on the world economic outlook in 2012 brought a lingering debate into public view when it argued that austerity policies were at fault for the failure of Europe's economy to match the growth rates that have been forecast for it over the course of the crisis (IMF, 2012). The point was echoed by prominent economist Olivier Blanchard (Blanchard and Leigh, 2013), one of the papers which attracted direct attention from Commissioner Rehn. Other analyses carried out more extensive assessments. Holland and Portes (2012) argued that austerity in the Eurozone was self-defeating as the effect of cuts on growth weakened revenues to such an extent that they undermined the direct fiscal benefit of cuts in expenditure or increases in revenue. DeGrauwe and Ji (2013) showed that the countries to implement the largest austerity packages within the Eurozone were those that saw the greatest increases in their debt to GDP ratio in 2011.

Perhaps the most comprehensive analysis is that of IMF economists Eyraud and Weber (2013), who argued that fiscal multipliers in a crisis are much higher than in normal economic times and that the effect of fiscal consolidation under such conditions was in many cases to increase the debt ratio in the short term as "fiscal gains are partly wiped out by the decline in output" (2013:1). They argue that this effect is temporary and that debt eventually declines, although under certain scenarios this decline is only evident after between two and five years. These effects of delayed debt reduction are higher in high debt countries and in periods of crisis when multipliers are stronger (Eyraud and Weber, 2013; see also Irish Fiscal Advisory Council, 2012: 45). Arguably, the most accurate summary of this debate is that, compared to a scenario with no fiscal adjustment, fiscal contraction can ultimately reduce Government debt but only over an extended period and at extensive cost to economic output, social well-being and apparently political cohesion.

Although Ireland sometimes appears in these analyses as an outlier in that deficit reduction has occurred in the presence of significant fiscal consolidation, a significant aspect of this that is usually neglected is the now familiar gap between GDP and GNP in the Irish context. While GDP has seen growth in the crisis years, helping to reduce the debt ratio below what it might have been, GNP has continued to decrease until late 2012. The use of GDP for accounting purposes is important for Ireland but the ratio to GNP is arguably more reflective of the damaging effects of debt over-hang in the real economy.

The comparison of fiscal consolidation with a zero consolidation scenario tells us little about the choice between fiscal consolidation and some version of fiscal stimulus, whether as an alternative or a complement to consolidation in the public finances. The primary alternative identified to this strategy focuses first on providing a stimulus for tackling growth (Taft, 2010; NERI, 2012). NERI (2013; see also O'Farrell, 2012; Social Justice Ireland, 2012) argue that a stimulus programme centred on investment would generate the same fiscal savings without damaging the economy to the same extent as the strategy of fiscal consolidation. In addition, as Central Bank economists Kelly and McQuinn (2013) argue, fiscal multipliers may be even higher when the state is responsible for bank solvency: "Government policies which return distressed households back into employment are likely to yield an additional benefit above and beyond that traditionally considered. Namely, by alleviating levels of mortgage distress, the solvency position of these institutions is ameliorated, thereby reducing the Irish State's future capital obligations" (2013: 16).

Most fundamentally, it is disturbing that the debate on these issues has largely consisted of different actors talking past each other. It should be possible to model these scenarios together – under a variety of agreed assumptions (which will themselves be matters of debate). These models could include different mixes of taxation and spending changes, different investment packages and varying assumptions about multiplier effects over various time horizons. Such modelling exercises would provide a more nuanced set of potential policy mixes rather than silver bullet solutions. However, they would also greatly enhance the debate over macroeconomic management over the coming years – particularly when compared to the minimal information available on the implications of the budgetary decisions in 2014. While economics can never be reduced to technical

exercises, the expansion of our technical capacity in this area and the public application of that capacity to modelling fiscal and investment changes could greatly enhance democratic debate in this area. While the Fiscal Advisory Council does some work in this area, its focus is on fiscal stability and its organisational capacity to conduct detailed ongoing analysis is relatively weak. The Economic Evaluation service in the Department of Finance could play a key role here, raising the key democratic question of what the new expertise in mainstream economic analysis in the civil service will be used for.

Is this an argument for a 'free lunch'? Sadly, no. The societies with the highest levels of investment and social spending are the Nordic social democracies which also have the highest taxation revenues as a proportion of their economies. However, as Table 1 shows, it is those same economies that have the best fiscal records in recent decades – and indeed in their previous, apparently more 'Keynesian' eras in the 1960s and 1970s. Keynesian expansionary policy is often assumed to link to the 'social models' of free spending European economies, while monetarism has more intellectual and political purchase in the liberal Anglo-American economies. However, in practice, the opposite is the case. It is the 'tax and spend' Nordics and continental economies that are more conservative in their fiscal and monetary policy, rarely running public deficits and sticking to a hard currency. However, even stretching back to the 1960s it is the 'smaller' states of the US and UK that are more likely to run a deficit and to use monetary policy and currency policy to manage growth across the business cycle (see Ó Riain, 2014: Chapters 4 and 6). Expanded state capacity is clearly compatible with fiscal discipline, under the right conditions.

Labour Market Policy

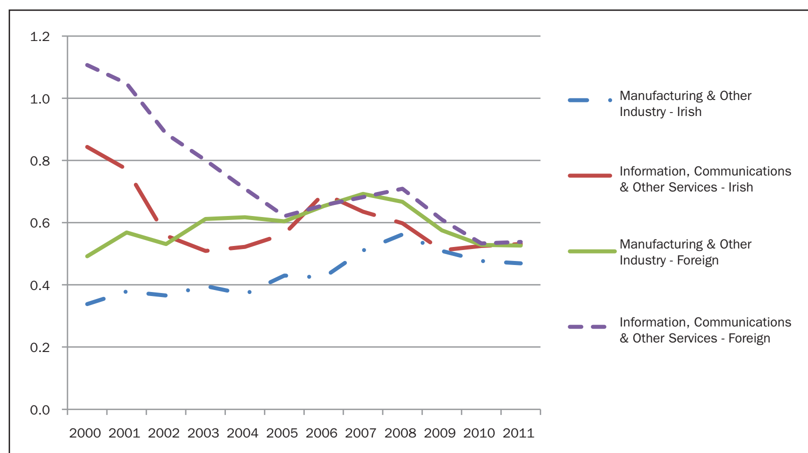
I provide only the briefest of discussions of policies relating to labour, education and training. At the start of the Celtic Tiger era in the mid-1990s Ireland's system was heavily focused on a single strand mainstream education system that worked primarily to generate a third level graduate workforce, with relatively underdeveloped 'second chance' education, weak vocational and apprenticeship strands, and small numbers of postgraduate students. The 1990s brought an increased effort in active labour market policy at the lower end of the labour and the 2000s brought increased take-up of apprenticeships (primarily in construction) and the creation of a postgraduate labour force, as well as increasing diversification of

undergraduate studies. In addition, company training spend has decreased overall – in absolute terms as well as relative to staff payroll costs – and particularly during the recession(see Figure 4).

Table 1: Social Spending and Fiscal Conservatism in the 2000s in Europe

	Social Spending, 2002 (% GDP)	**Average 'Structural' Fiscal Balance 1999-2007 (% 'potential' GDP)**
Nordic Social Democracies	36.6	0.3
Continental Christian Democracies	32.5	-1.7
Liberal (UK & Ireland)	27.5	-2.5
Mediterranean	26.6	-4.0

Figure 2: Cost of all Structured Training per person employed (€1000s)



Source: Forfás (2013) *2011 Annual Business Survey of Economic Impact*

In the wake of the crisis, some important reforms have been undertaken. While there are significant challenges at the graduate and postgraduate levels of the system, most reforms have been focused at the lower end – including the reform and outsourcing of labour market activation systems, an enhanced role for the former county vocational education committees and a proposed reform of apprenticeships, and the formation of technological universities from the Institutes of Technology. Recent announcements regarding the outsourcing of significant elements of the 'advising' function of labour market policy supports for the unemployed raise serious questions about two key aspects of the policy – first, whether the policy will be basically punitive or enabling, and second, whether (as seems highly likely) the labour market advising process will be essentially divorced from the provision of an integrated suite of supports across welfare, care, training and other domains that are crucial to tackling unemployment and broader issues of jobless households (NESC, 2014).

State Investment Bank

Even looking at more conventional targets of economic development policy, Ireland has historically low rates of productive investment. This is due to a variety of reasons that will remain, or even become more significant, if and when macro-economic stabilisation is achieved. Irish banks have a poor record in providing capital for investment. Even in the 1990s the contribution of the financial sector to growth was minimal (Honohan, 2006). The surge in bank lending in the 2000s systematically misallocated capital to the point where, in 2007, approximately two thirds of outstanding loans were related to property and another sixth to the financial sector itself (Ó Riain, 2009). The 'liberal' tax and regulatory regime around capital since the mid-1990s generated significant outflows, as well as speculative inflows, of capital.

There is little evidence that banking organisations have the relevant skills and orientation to promote productive investment. This is evident in the historical record of lending outcomes and practices (to the extent that we have information on the weak procedures around lending). Oversight by the private sector (bank shareholders, stock market, credit rating agencies) and by the public sector (Financial Regulator, Central Bank, ECB) failed significantly to tackle these organisational failures (Ó Riain, 2012).

The issue goes deeper into the organisational capabilities and practices of the banks themselves. The organisational practices that created the bubble are likely to be slow to change. In addition, the pressures for prudence in the re- capitalised banks are likely to create dis-incentives for business lending. Credit to businesses has recovered in recent years, but very slowly, and venture capital funding dropped precipitously until the past year.

The business lending expertise that exists among private institutions is at least as developed in the public agencies. Indeed, quite early in the course of the economic crisis, officials from Enterprise Ireland were sent to advise staff in the banking organisations on business lending (NESC, 2012). The engagement between state industrial development agencies and export oriented businesses over a period of some decades has resulted in significant organisational learning (Ó Riain, 2004). Comparative analysis of similar kinds of innovation and business development policies in Ireland, Israel and Taiwan suggests that it is this long-standing institutional commitment and learning that is crucial to an effective state role, as much as the direct funding that is provided (Breznitz, 2007).

The historical evidence in Ireland suggests no reason to expect that private lending and investment will lead recovery, even once conditions reach some degree of stability. Venture capital funding between 1997 and 1999 was led by public sources with private investors following only when growth was already underway – despite an environment which has been clearly stabilised and where the early signs of growth were well underway (Ó Riain, 2004, 2009). Similarly, it was public agencies that lead the recovery of venture funding after the dot.com bubble burst in 2001 (Ó Riain, 2010). Among Irish firms, five sectors showed an increase of 5% or more in new lending between Q3 2012 and Q3 2013 - Fishing and aquaculture; Manufacture of food, beverages and tobacco products; Sale, maintenance/repair of motor vehicles, retail sale of fuel; Other wholesale/retail; and Other business and administrative services. However, the most significant surge in credit provided is to non-Irish borrowers in Real Estate, Land and Development Activities with a 12.1% quarterly increase in transactions balance. The 'social structure of liquidity' that supported property and credit bubbles of the 2000s (Ó Riain, 2012) shows signs of persistence.

There are a variety of institutional mechanisms that shape the financing of development and that are open to public policy influence. These

mechanisms go well beyond the role of regulators to provide the institutionalized prudence that can control the 'irrational exuberance' of financial markets.

Some of these relate to investment incentives. When capital gains tax was cut to 20 per cent in 1998, capital flowed into the economy. But as is well known, the vast bulk of that capital went straight into property and, to a lesser extent, financial speculation. Even if capital gains had been reduced selectively, the gains from investment could have been channelled into more productive areas like R&D. As it was, the exceptionally low tax rate combined with various schemes promoting property investments channelled financing away from high tech and other export sectors just when many of them needed that financing most to build international scale operations. Policy will shape the incentive structures for investment, one way or another. The key issue is in what direction, and through what mechanisms.

Furthermore, a direct role in financing development is also a central issue – especially given the largely hidden but highly significant role of public investment agencies in a range of countries. A variety of institutions channel credit to business – including private investors, banks, venture capitalists, and others. In Ireland, the state agencies have been a particularly significant funding agency for high tech firms, have led the building of a venture capital industry and have made effective investments (but see Breznitz, 2012 for the difficulties with this model arising out of the insistence that the state investment programmes 'pay for themselves'). On the other hand, these investments fall well behind the scale of the investments in promising firms made by other countries – including the apparently 'non-interventionist' US (Block and Keller, 2009; Mazzucato, 2013).

Nonetheless, a wide range of public schemes provide financing for enterprise at present (Department of Finance, 2013) – the challenge is to use these schemes to both support a diverse range of enterprises and to drive change in the private financial system. Indeed, the Department of Finance has been increasingly active in developing sources of funding for enterprise in recent years – involving increasing efforts to create investment funds for different classes of firms in Ireland (including small start-ups, larger firms and distressed firms). The broad thrust of the approach has been to sidestep

the difficulties of the banks and to seek out non-bank sources of financing for enterprise. Alongside this, and sometimes entangled with it, has been a policy programme (in the Programme for Government) for developing a State Investment Fund, now in the process of turning in to a State Investment Bank. The re-organisation of the NTMA, NAMA and NPRF in principle facilitates this by providing a strategic investment mandate within this cluster of agencies and by institutionally connecting the finance-raising and lending and investment arms of the state financial agencies. A state investment bank can play a crucial role in raising funding, organising financing and linking development finance schemes, and coordinating non-financial supports with enterprise finance (Ó Riain and O'Sullivan, 2011). Support from the European Investment Bank and from the German state bank KfW has been offered. Table 2 outlines the key differences between the previous and emerging state financing institutions.

Table 2: Changing Policy Regimes in State Development Financing

	Pre-2013 Funds	**Ireland Strategic Investment Fund**	**Strategic Banking Corporation**
Mandate	Pension Fund Returns	Development Investment (national, strategic and commercial)	Development Investment and Sustainable Credit
Mechanism	Collection of Funds	Investment Committee	Banking Structure; Lending through 'On-Lenders' (retail banks and others)
Funding	*Static*	*Organisational Link to NTMA – can raise funds*	*ISIF* *EIB* *KfW*
Link to Rest of State System	*Informal*	*Indirect*	*Indirect*

At present, these tendencies co-exist within the financing area. Indeed, there are increasing initiatives around investment in property – for example,

establishing Real Estate Investment Trusts to attract small investors (with few similar opportunities for such investors to participate in similar mechanisms of investment in different sectors).

Enterprise Policy

Enterprise policy need not depend on a belief in all seeing government planners, nor must it be restricted to government doing little more than setting the framework conditions for private sector initiative. Even as they have spent the past decades lauding markets, government agencies around the world have been experimenting with new ways of supporting enterprise and figuring out how to connect research to industry, how to build skills and knowledge, and how to finance employment growth. In economies as different as Finland and the United States, as Israel and Taiwan, government has played a critical role in the growth of successful innovation economies (Breznitz, 2007; Block and Keller, 2009; Saxenian and Sabel, 2009; Rodrik, 2007).

These new experiments in industrial policy share a view, often unexpressed, of firms as embedded in the society around them. Firms are economic actors who depend deeply upon the social worlds of production around them, competing with others in those worlds but also sustained by the capabilities within them. As companies grow and develop, they draw on a wide variety of external supports – for skills, for technical and scientific background, for financing, for marketing and management, for information about industry developments, for widely held assessments of uncertain trajectories of change, and many more.

Ireland has a history and some institutional capacity in this regard. Ireland's focus on foreign investment and its formula for attracting it are well known and are not my focus here. The 1990s saw the development of new strategies for industrial upgrading and particularly the support of indigenous enterprise. Grant aid was comparatively small but was an access point for a network of supports that included R&D grants, management development, employment grants, mentoring networks, and more. State agencies sponsored the activities of industry associations and technology centres. The state played a critical role in constituting the social world of production within the industry (see Ó Riain, 2004 for a fuller account).

The existing evidence suggests that the work of public institutions has been effective. State aid to exporting companies has been found to have promoted manufacturing employment in the 1980s (O'Malley et al, 1991) and in the 1990s, where Girma et al (2007) showed that domestic companies were particularly likely to add employment when receiving public subsidies. Research into Irish-owned software firms in the 1990s showed that those firms that received the most state grant aid exported more, employed more people and grew faster – even when controlling for firm size (Ó Riain, 2004a).

While Ireland's industrial policy is activist, it is also highly restricted. The 'client base' of firms of the development agencies is small and the developmental impact of their activities is quite narrow. This raises questions of how policies can be applied more widely. Where government has been active in financing high tech, just as important will be ensuring the provision of working capital to viable enterprises through the recession, or to fund much smaller scale start-ups. Similarly, in the area of research and innovation, the importance of sources of innovation other than high end research must be incorporated into government policy. Hirsch-Kreinsen and Jacobson (2008) also argue persuasively that 'low tech' sectors can also drive development in Ireland and across Europe, and themselves depend upon innovation for competitive success.

Table 3 summarises some of the key trends in enterprise policy in the years since the crisis of 2008. Some of these trends focus on market mechanisms – including state stimulated private financing and the outsourcing of labour market activation systems. Others rely more on centralised state governance, whether largely disciplinary (the HEA and the universities) or accommodating (SFI and IDA work with foreign firms). There are also efforts to create institutions that can tackle major gaps in the network of enterprise supports – including Enterprise Ireland's extension of its mandate to additional firms, the integration of EI and the LEOs, and the reform of vocational education committees. I conclude with four sets of observations about these overall trends.

Table 3: Recent Institutional Trends in Enterprise Policy

	Capital	Labour	Innovation	Enterprise
Macro	Stimulating New Private Sector Financing State Investment Bank?	Intensified HEA control of universities	CSETs Research prioritisation	FDI Focus Extending footprint of Enterprise Ireland
Micro	Bank reform?	Education and Training Boards Apprenticeship Reform Outsourced ALMP	Technological Universities?	LEOs

First, there have been significant institutional changes and experiments since 2008, but these have followed in many respects the patterns of existing dominant institutional trends. Indeed, the focus on building coherent supports for the larger, primarily foreign firms while relying on framework conditions to support local business is indicated in the local weaknesses of financing and innovation policies. There is a genuine risk that each area may be undermined by the very institutional logic that weakened it in the 2000s. Innovation policy continues to be characterised by a narrowing of focus, driven by state and foreign investment policy. Financing brings a turn back to the market, albeit in a different form. The outsourcing of active labour market policy raises the same issues of lack of accountability and weak integration with welfare, enterprise and education that dogged it through the 2000s. The 'footprint' of Enterprise Ireland has extended in important and interesting ways but the required supports in financing and innovation may not be present and the local capacity to develop this system is still in question.

Second, there is an opportunity here to tackle some of the fundamental issues within the Irish innovation system. That system needs to be extended out from its narrow base, to bridge the domestic and export sectors. A start has been made here in the extended role of Enterprise Ireland but crucial gaps remain in financing, where banking reform cannot be avoided. Indeed a key role of a state investment bank could be not simply to fund large scale projects but to work through local banks to provide working and development capital, in the process reforming the organisational practice and culture of the banking organisations (as in the example of the KfW in Germany). Further gaps exist in innovation where changes in ITs may actually weaken locally available resources and where crucial reforms remain in education and apprenticeships. Integrating these institutions locally with central supports will be crucial to supporting newly emerging firms.

Furthermore, especially given indigenous strengths in cross-cutting areas such as IT services, transport and logistics, and business services, the system needs to open to creatively re-combining its resources and institutions to support emergent sectors. Will targeting of high level supports in innovation and finance weaken the ability to put together supports for the new sectors which will inevitably emerge and which will cross the boundaries of the research prioritisation areas?

There is a more fundamental question here as trends within the system include the outsourcing of elements of enterprise policy (e.g. private financing, activation), highly targeted state interventions (eg innovation policy) and more networked institutions and capabilities. Can these various organisational logics be integrated into flexible combinations of supports? In particular, the outsourcing of a developmental programme such as activation makes integration with supporting institutions much less likely (see the alternative approach in NESC, 2011). There are micro-choices to be made here that will have significant macro consequences.

Third, policy experimentation at home and internationally remains largely an untold story. Even the agencies that operate these policies do so under the cloak of other justifications of their activities. Sometimes they appeal to the spirit of enterprise among their client companies, even as their everyday practices show that such a spirit of enterprise still requires a significant network of financial, organisational and social supports. At other times, they appeal to the spirit of planning in reports that identify key

targets and measurable outcomes, even as everyday practices are, at their best, based on flexibility and iterative social learning. The Action Plan for Jobs (DJEI, 2013) sits between these with an extensive list of policy measures that are only loosely connected (at least explicitly within the Plan itself). The plan could be implemented in one or two ways. It might drive policy makers to focus narrowly on the delivery of discrete policy measures, operating (understandably) within policy silos. Or policy makers may seek each other out to connect across areas as the success of one measure is likely to depend heavily on the success of others. The impact of the Action Plan is likely to depend as much on these organisational questions as on the content of the plan's measures. This lack of a narrative of our own practice of policy comes at a cost. The debate is cast in terms that largely miss the point and the space for a serious discussion of how to develop our policies and practices was limited – even before the crisis.

Social Partnership Re-invented

After the economic crisis of 2008 'social partnership' was cast as one of the villains of the drama of Irish bubble and bust. However, partnership in various forms remains common across Europe's most successful economies and can play a key role in building a sustainable recovery here in Ireland.

Formal partnership arrangements fell apart in the crisis, although in practice many concessions have been made with very little conflict. Wages have been cut and so have public services. Cost advantages and efficiencies have been achieved but significant damage has been done to living standards and well-being and also to the capacities of our private companies and public institutions.

This will be a major issue in pushing forward the economic recovery that seems to be emerging, although in a very fragile form. There is a real danger that the recovery will be spread very unevenly - we already see that wages are recovering among managers and professionals but not across the whole economy. In the absence of some kind of national social bargain, the strongest can fight their corner in the open market or the political realm while the weakest will be left behind. We could end up with the worst of both worlds - increasing wage costs and rising inequality at the same time.

Furthermore, as we have seen, there are a range of issues that go beyond wages. Domestic business will be crucial to recovery but many SMEs still have a long way to go to compete with similar firms around Europe – and they are receiving little help from banks in accessing credit to build these capacities. On the public side, recent talk about lower taxes suggests that we have not learned the lessons of the bubble about sustainable public finances and the importance of sound, effective public services.

A new social partnership can address these issues and build recovery. But it cannot be the partnership of the Celtic Tiger years. Those partnership agreements traded worker wage restraint for tax cuts on the part of government. In the context of high tax rates and improving public finances these deals made sense for a period of time. Today they do not.

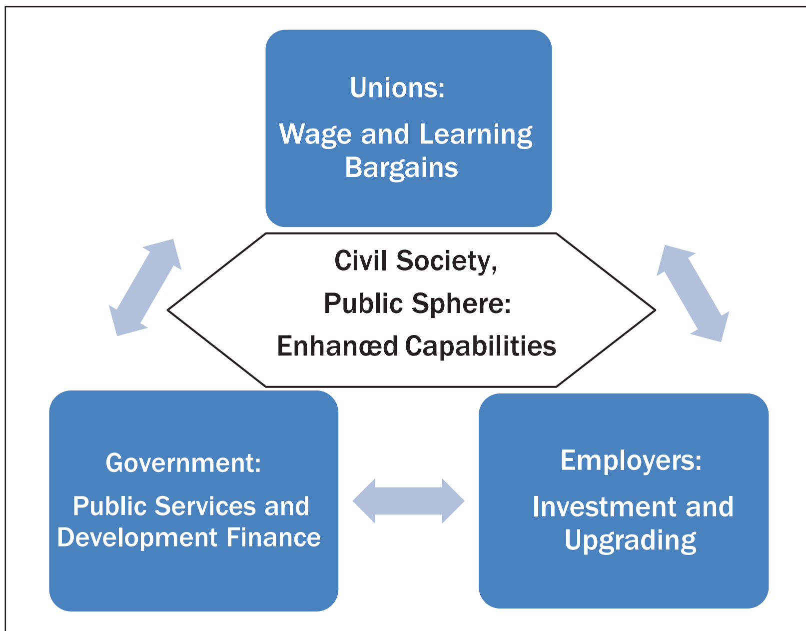
We now need a different partnership deal – one that is investment centred (see Figure 3). This would have three key elements. First, a national wage bargain that would provide wage increases that would be steady, more modest than the strongest employees could get on the open market but better than the raises that the weakest workers could negotiate. This would boost demand, support competitiveness and promote an egalitarian recovery.

Second, government can add to the benefits for workers through a better 'social wage' that is shared across all employees and in many cases all citizens. This typically is only loosely related to an employee's wages and takes the form of form of education and training, health and childcare, pension provisions or other benefits. A 'social wage' is crucial to protecting living standards, promoting opportunity in even the poorest families and investing in an active, skilled labour force.

Third, government can also promote a 'productivity dividend' through additional measures based on enabling credit for firms to invest and supports for upgrading the capabilities of companies and the skills of their workforces. Irish domestic business has long been hampered by low levels of investment in the upgrading of companies, weak financing for such investment and by poor supports for their workforces' skills and participation. A new model of partnership both challenges firms to upgrade and supports them in doing so.

At the core of the new model of partnership is not the drive towards cost competitiveness (although this is incorporated through the wage bargaining process and productivity improvements) but a broad-based enhancement of capabilities in the economy and society. This involves the construction of new 'spaces of learning' which consist of 'public spheres' in firms, regions and other economic spaces but also in communities, public institutions and the society as a whole. These are crucial to the learning economy and society (Lester and Piore, 2011). They do not emerge on their own however and the role of civil society – where the organisations of the community and voluntary sector are particularly important in Ireland – is critical here.

Figure 3: An Investment Centred Social Partnership



Partnership had significant weaknesses in the 2000s, failing to manage the balance between public and private sectors and between wages and growth. But there is plenty of blame to go around - it was primarily party politics,

weak regulation and planning, and poor central oversight of government finances that allowed the bubble to inflate. In the 1980s, partnership helped begin Ireland's recovery by delivering wage restraint and industrial peace during a deep economic crisis. In the 1990s, additional efforts were made to make creative investments in workers (through training and education), communities (through local area partnerships), companies (through enterprise policy and venture capital) and even in new policy institutions (when most policy innovation happened in new agencies, often disparaged as 'quangos').

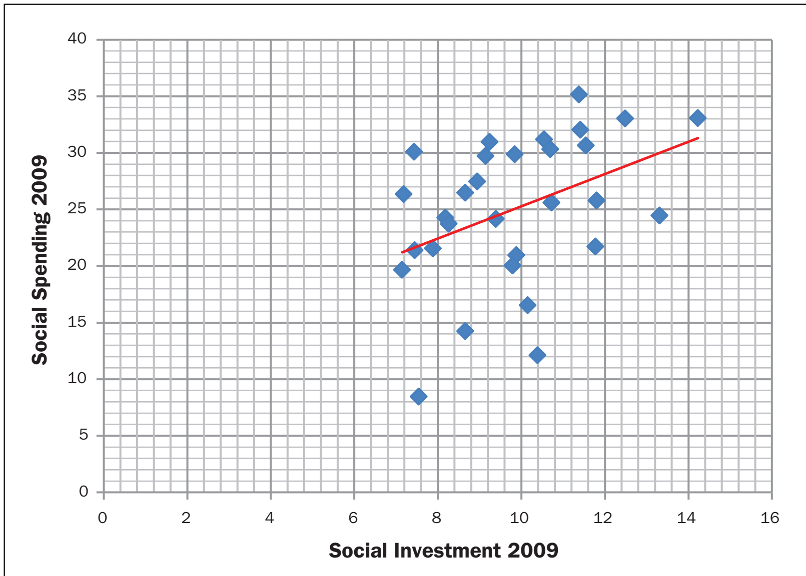
A new social partnership along the lines outlined above can re-capture these strengths of earlier periods without the failings of the 2000s. The most competitive and egalitarian economies in Europe operate on this model – supporting the development of their businesses, investing in their populations and protecting their societies. There are many forms that partnership agreements can take. It is time for a conversation about how a different partnership can help a sustainable recovery that will boost business development, improve well-being and invest in the future of businesses, citizens and communities.

Conclusion

Does an investment centred policy mean a downgrading of the social protection role of the state? Many critics have worried about this – and the response of An Taoiseach to the NESC (2014) report, arguing for active supports for jobless households, that it suggested the need to weaken passive welfare supports would encourage that view.

However, in practice, international experience is that social investment and social protection – where they operate in reality and not as ideological catchphrases – are closely linked. Figure 4 shows a strong association between higher rates of social investment (the combination of education, active labour market, R&D and family supports) and higher social spending (cash transfers and income support, health, pensions and other direct social services) in the OECD.

Figure 4: Social Spending and Social Investment in the OECD, 2009



This chapter has outlined some key steps that Ireland can take in moving towards a new model of political economy – and therefore society. Macroeconomic policy needs to become more strategic and creative, making selective investments and rebuilding both demand and competitiveness together. The new economic evaluation service should be able to provide the expertise to assess how we can combine key investments with management of the debt, if the will exists to examine and debate these questions seriously.

Ireland's capacity for investment needs to be greatly increased. For firms, an active enterprise policy focused on domestic business development is crucial. The decision to found a state investment bank is therefore very welcome but its success will depend on how well it can drive a change in culture and practices in the private banking sector.

For citizens, the current efforts to reform training and employment services will be crucial in supporting the development of the workforce and in tackling

exclusion and inequality in the labour market. Our choice is clear – do we put in place a UK-style system for ‘processing’ people off welfare or build a system that tackles people’s overall difficulties and properly supports them in getting back into the labour market by supporting those most in need.

Alongside this enhanced ability to organise investment, the public services that are crucial in developing the capabilities of the society must play a key role in recovery and reconstruction. A complex society and economy will require healthy, educated, active citizens and communities – and the societies that develop this best are those with effective and expansive public sectors.

Ultimately, a sensible but creative macroeconomic policy; key investments in firms and in citizens; and the ability to improve and expand our public services – and private firms - will be crucial to whether this fragile recovery falls into the same old failings or leads to a reconstruction that gives meaning to the sufferings of the past six years.

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