The Plan for Recovery

By Brian Lenihan, TD

Minister for Finance

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Causes Of The Crisis

If you look at what international commentators are saying, many are suggesting that the Celtic Tiger model has failed; the model is no longer sustainable in the Ireland of today. But in fact if you look at what happened in the 1990s, we saw huge export-led growth right up to the year 2000. That was the era that saw an alignment of our living standards with those of other European countries. Those exports are still there and still being made.

Our problems emerged due to over-dependence on house building. New house building as a share of national wealth grew dramatically. Up to 2002, growth met capacity but after 2002 growth in house supply led to a radical deterioration. That over-dependence on construction was caused by a number of factors. Naturally and understandably the Opposition will hold the Government to account for that. But I did not see the Opposition parties at the time hold the Government to account for this at all. Hindsight is a wonderful thing. It is clear that the Government should have taken far more steps to correct that housing bubble. But no alternative was propounded on the other side of the benches in Leinster House.

It is very clear that the fundamental problem we have been facing since the turn of the millennium, is a loss in competitiveness. Some of that can be accounted for by the fact that we are in a strong exchange rate area. But it is also due to excessive costs of labour, of public services and of sheltered sectors overcharging for goods and services. I am not certain that anybody in public life, Government or opposition, could have dealt with that competitiveness issue because we all know the sheer scale of the growth we saw in Ireland from the mid 90s on. If you have phenomenal growth year on year it is very difficult to prick that bubble, to get a soft landing or persuade people that competitiveness should transcend all other considerations. We have to create the Ireland of our dreams in terms of public services, health, education and welfare, but this all has to be paid for and it can only be paid for through the strength of the productive economy. That productive economy can only flourish if it's competitive in the wider world. We cannot expect the rest of the world to owe us a living. That is what independence meant in the 1920s as much as it means now.

During the years from 2003 to 2007, there were substantial benefits from what the Government did. There were social welfare increases of 7 to 10 per cent every year. There was huge spending on education. Spending per student rose by more than one-third at primary and secondary levels. Spending on health increased by 80 per cent. The numbers employed in the health sector rose by 15 per cent. Public sector wages rose 6 per cent every year. Capital expenditure of €31 billion took place during the boom years. We all know what was done, what is going on and still to be completed in terms of our national motorway networks. Income tax cuts of €3.5 billion were made and a Pension Reserve Fund of €21 billion was built up.

We have to face facts, we all got something out of the Celtic Tiger, or at least the vast majority got something out of the Celtic Tiger. It was not something for bankers and developers. It led to social welfare increases, public services and increased living standard for many citizens. That is something very welcome and something we all struggled for and wanted. Yes, the economy has been very badly affected, not just by domestic factors but by the worst global recession since the Great Depression. There is no point in being insular in our attitudes. If there is an imbalance in the public finances and we have gone a little bit too far, after two decades of unrivalled prosperity, in terms of our public services that can be corrected. But all this correction has to take place not in a uniquely national context but in an international context where many other countries are experiencing the exact same problems as ourselves. Ireland is not unique and when we study what has happened in other countries we learn from them. We do not, as Seán Lemass always said, feel sorry for ourselves all the time. We look at what we can do for ourselves when we are faced with a crisis which is not just a local crisis but also an international crisis.

Look at the position in the United Kingdom with a more than 4 per cent decline in national wealth this year. Look at the position in the United States where this is approaching a 2.5 per cent decline. Look at the position among our partners in the Euro area where the decline is almost 5 per cent. The idea that our problems are unique is a fallacy.

Remedies

What are the options? There is only one possible path to recovery and there are three elements to it. One is to have sustainable public finances, the second is to regain our competitiveness, boost our employment and create real jobs and the third is to repair our banking system. These remedies are complementary. If Ireland wants to pay its way in the world and get on as a country, then all these elements must be addressed.

Sustainable Public Finances

There is no point when discussing the public finances in suggesting that this has all been caused by bankers. If we had no banking problem, if we had no developer problem, we would still have a public finance problem. From 2000 to 2007, there was a broad match between revenue and spending. But since then there has been a marked deterioration. On the revenue side, there has been a deterioration because of the big decline in discretionary taxes and receipts from stamp duty, capital gains and other forms of tax. We harvested those taxes in the good times but they are not available to us now. Big amounts of them are not going to become available in the future because asset values have declined and hence capital gains tax receipts are not going to increase.

I have made it very clear that I do not intend to increase the burden of taxation to any great extent in the next Budget. It is not open to us to do it. Our income tax levels were increased in the September Budget last year and in the Supplementary Budget in April. That had to be done because of the scale of the decline in our income tax receipts. We had the lowest income tax in the world apart from two countries. But there is a limit to the extent to which you can increase income tax. There is a very definite limit because Ireland will not attract investment or any kind of economic development if we raise income tax to unsustainable levels.

We increased our expenditures to a level where there is now a €20 billion gap between spending and revenue. Some of that gap relates to investment expenditure which is very important such as investment in roads, infrastructure, science and technology. We can justify asking our children to pay interest on that borrowing. We cannot justify asking our children to pay the cost of our own salaries as public servants or the cost of welfare. We have to face that issue. And it is not an issue that can be postponed forever. Because we are doing it now and the interest payments mount up. In the end, when it comes to day-to-day expenditure, a state is like a household, it has to live within its means. We have lived within our means for two decades but we are not living within our means at present. Addressing that is a fundamental issue which any Irish Government has to face.

Regaining Competitiveness And Boosting Employment

The public finances are important, but not the only problem we face. We have to boost employment and create jobs. In recent years, we have been very successful in building up real jobs through export-driven industries. But our pay rates are way above all of the European averages. When I was appointed Minister for Finance we had the highest unit labour cost of any country in the Euro zone, way out of line with every other country. In the last year, we have seen rapid adjustments in our unit labour costs. The European Commission projects that Ireland will see this year an average 4 per cent reduction in unit labour costs; the EU average is a 3 per cent increase. So there has been a 7 per cent improvement in our unit labour competitiveness in the last year. That is a tremendous tribute to Irish workers, public servants and those in the private sector who have made huge adjustments. We all know what adjustments in the private sector have involved: people taking huge wage cuts to avoid unemployment, in some cases as high as 30 and 40 per cent. We also know that there are those who have taken more modest decreases or have taken pay freezes, giving up bonuses, overtime and the like. We also know that in the private sector there are still some sheltered sectors that have had pay increases so there has been a very wide divergence in private sector pay rates, between plus 3 and minus 30 or 40 per cent. We know in the public sector the pension levy averages out at a minus 6.8 per cent reduction in public salaries, higher for those at the top and lower for those at the bottom.

That is how you regain competitiveness in unit labour cost terms. It is something we have to do, and something no other European country is doing.

Repairing The Banking System

There is no doubt that the banks were utterly delinquent in borrowing vast sums overseas. The banks became increasingly stressed as the world banking system became stressed. Governments throughout the world have not had to face a banking crisis on this scale since 1929. Most of us heard about what happened in 1929 from our parents and grandparents. The Stock Exchange collapsed in New York in the famous Great Crash of 1929. In those days we did not have the type of technology we have now and it took a long time for signals of that stock crash to transmit themselves through different economic markets. In the United States, many banks had loaned money to Stock Exchange speculators much as they loaned money in Ireland to building speculators. The Stock Exchange speculators went bust very quickly. But the United States banking system tottered on until early 1930. Depositors then began to form queues at banks to demand their money back and the banking system went into collapse. Credit did not just dry up in the economy, it collapsed completely. The United States found itself by 1933 with 33 per cent unemployment. So when you let banks collapse it is not a cost free decision. If you decide to let a bank go to the wall, there are very big consequences. President Obama has spoken very well about this, pointing out that there is the natural and understandable wish to let those who loan the money to the banks suffer. But if you do let them suffer, the consequences spread the arc of suffering to a very wide degree. Because when a bank collapses, all its depositors and all those who the bank owes money to, lose their deposits. That means small businesses, cooperatives and individuals. It is right across the board. Bank deposits were guaranteed by the Government last September because we believed the only option was to give a very clear message to the outside world that Ireland was not going to follow the path of Iceland. Ireland's credit as such that we would stand behind those who had deposits in the banks, who had loaned to the banks and ensure that the banks did not collapse. And we succeeded in that.

We felt that it was important for the larger banks that everyone dealing with them understood that these banks were creditworthy and we stood behind them. We believed in the case of Anglo-Irish Bank that the country could not stand the strain of an €80 billion default. That is half our national wealth. Were we to go down that course, we would have a collapsed economy as well as a collapsed banking system. So there is no point pretending that these are easy decisions. It is very easy to be populist about them and say the wrong track was taken. We had to do it; we have to protect the reputation of this country because the Government is borrowing money to fund the country. The Government would not be able to borrow a cent if we permitted the banks to go into default. That is the reality of the fiscal position. Any high school economic analyst will tell you that.

What we had to do, having given the guarantee, is to reform the Irish banks, to remove the personnel at board and executive level who caused these problems. That cannot be done overnight. In addition, the State has had to invest in the banking system and get a definite rate of return as we have done. We had to nationalise Anglo-Irish Bank because it was such a mess. We had to take a 25 per cent in Bank of Ireland and Allied Irish Bank. We are getting an 8 per cent return on the € 7 billion we invested in the latter banks. That stake has gone up in value since I purchased it last February and will go straight into our National Pension Fund. We get something in return for the rescue we were obliged to carry out. I recall when Fine Gael was in Government in 1984, Allied Irish Bank was bailed out and not a penny came back to the tax-payer. That will not happen on my watch.

In every step I have taken in relation to the banking system I have made sure that the tax-payer gets a definite return; that as well as socialising losses we socialise gains. We do not have a choice about this and it is not unique. What we have done in Ireland is being done by the British Government, by the authorities in the United States and the recommended course of action of the G-7. We cannot have a repeat of 1929. We cannot have a position where we decide that the whole motor of the economy should seize up; we should simply close down banks and allow mass unemployment and a total cessation of economic activity take place. Of course, we have to ensure that banks never behave like this again, that the tax-payer and the public who invested in and rescued them are rewarded. We have to replace the irresponsible bonus-driven culture of reckless lending with a culture which encourages lending to people who create jobs in the economy, householders who want to make improvements to their houses and green changes that have to take place throughout our economy.

Banks cannot lend unless they attract funds. That is the core problem. If you do not give a guarantee that funds are safe you are not going to have any funds. If you do not clean up balance sheets and reassure the world that the banks are fit to lend to, you have continued uncertainty about the operation of these institutions. So we will issue paper to the banks under NAMA. The European Central Bank is willing to honour that paper, giving the banks cash for that paper. In return, the banks can focus on lending to small and medium-sized enterprises and households while NAMA works out the distressed loans over time.

NAMA will buy the loans at a discount. We have made it clear in the case of the two larger banks that if their losses are of a scale which requires fresh capital, we will invest that capital and minimise the risk to the taxpayer, and ensure that the taxpayer benefits from the upswing. Borrowers, those to whom the banks extended money, will remain fully liable for the full value of their loans. This is not a bailout for borrowers or developers as has been constantly misrepresented. NAMA will have to pay its own way. The interest received on the performing loans which are working out will roughly match the interest paid on the bonds and the proceeds on the loan repayments and the property sales will pay off the bonds in full. If there is any further shortfall at the end of ten years we can levy the banks.

Hope For The Future

There are real signs of hope. Our exports have proven resilient and they will drive growth and jobs as competitiveness improves. Our exports have seen a decline of 3 per cent but this is in contrast with much larger declines in other countries. Our exports have remained remarkably robust. Our pharmaceuticals, chemicals, ICT and other industries are still exporting vigorously and there is big demand for their products. Of course, agriculture is going through a very difficult patch and tourism has seen a decline in numbers. But the mere 3 per cent decline in exports suggests that there is an underlying strength in the Irish economy, a labour force which is hard-working prepared to take the pain. This is a labour force which is also one of the best educated in Europe; after Sweden it has the highest proportion of third level graduates.

Our external position is also moving into balance. Ireland from 2004 on began to have a big balance of payments deficit, we owed the world far more than the world owed us. This year the deficit has contracted to less than 1 per cent caused by the strength of our exports and of course by the weakness of consumer demand. But next year, the forecast is that we are going to have a balance of payments surplus. That is not what is happening in Iceland or Hungary or any of those countries that got into difficulties in Europe. mThis surplus is there because of the underlying strength in the Irish economy.

We cannot postpone the adjustment indefinitely but if we do the adjustment, have better public services and make them more efficient, improve our competitiveness and take the necessary adjustment now we will bequeath something very good to those who come after us. We did it before in 1987 after years of dithering. I grew to manhood in the late 70s and early 80s and I remember how successive governments of my own Party under Mr. Haughey and of Fine Gael under Dr. FitzGerald dithered and dithered, refusing to make decisions, pandering to vested interests. Then Ray McSharry and others in 1987 took steps that put this country on a road to recovery. That is what we is needed now, not dithering, posturing and postponement but facing up to the issues.

We were founded as an impoverished State in 1922 when the British cleared everything bar the typewriters out of the country. We built a successful State and I give all credit to the Cumann na nGaedhal element who founded the State to do that. In the 1930s, we had to face a crisis under de Valera, MacEntee and Lemass when we had an economic war. We fought through them. In the 1950s, we had an intellectual, cultural and economic stagnation and Seán Lemass led us out of it. We can bring ourselves out of this as well. This is not a case of us going back to the 80s, 70s and beyond but is a case of us facing up to the reality which Colm McCarthy has pointed out, which the World Bank have pointed out, which the European authorities have pointed out, which every economic commentator has pointed out, that we have gone that bit beyond what we can afford for ourselves.

We have the capacity to do that unlike a lot of bigger countries. IMF economists came here in May and they interrogated me at length. They said our policies are right, what is needed now for recovery is “determined execution” of NAMA and the Government’s budget plans. We will have that recovery. Let us make that bit of an extra effort now, doing it not just for our own sake but for the sake of our kids who want to live in an Ireland that is not Argentina defaulting on its debts or Uruguay pretending that it can have public services it cannot afford but a responsible country. That is, the country our forefathers fought for, a country that takes responsibility for itself in the best sense of that word, a Sinn Féin country, a country that believes not just in ourselves alone, but ourselves with others, working together, building up a community, building up public services we want but recognising where we are in the world and what we can afford.

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