

# 2009 Review

*Should we fold up, go home and concede the logic of market economics [...] that the only path to recovery is through cuts, more cuts, unemployment and a dramatic fall in living standards?*

**Writing about the Dublin Consensus, SLÍ EILE poses questions**

**JAMES WICKHAM** on the Ryanair model of development

**“Saving” vs. “creating” jobs: MARIE SHERLOCK** considers options

**MICHAEL BURKE** wonders why the rest of the world is out of step with Ireland

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## Preface

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JANUARY 2010

The progressive-economy@TASC blog was launched at the end of February 2009 in order, as I wrote at the time, “to reclaim ‘economics’ by rediscovering the political, social and cultural in ‘economics’”

With 20 regular contributors, as well as guest posters from a variety of backgrounds, progressive-economy@TASC has offered thought-provoking commentary on the events of a momentous year. 2009 saw, in quick succession, an ‘Emergency Budget’ introduced in April, the McCarthy Report in July, the report of the Commission on Taxation in September, the NAMA legislation introduced a few weeks later, the controversial collapse of public sector negotiations at the beginning of December and, just days later, one of the harshest Budgets in the history of the State.

Progressive-economy@TASC is an economics blog, but it is also more than that. It offers a snapshot of current economic issues viewed through different lenses – lenses belonging to academics from a range of economic and related disciplines, as well as trade union researchers and social activists.

As David Jacobson wrote on the very first day of progressive-economy@TASC:

“The primary argument underlying financial markets in the period leading up to the current collapse has been that markets work, and that they work best when “unimpeded” – by which is meant unregulated. Left to their own devices, the argument went, markets will reach “equilibrium”, which is the position closest to the optimum interest of the buyers and sellers.

All this of course ignores the extent to which markets are made by key players. Think of the answers to the following questions: Who sets the rules? Who monitors and inspects to ensure that the rules are followed? Do those rules in any case favour some players? How closely are the rules followed in practice? What happens to those who do not follow the rules? What are the social consequences of great wealth in the hands of the few who successfully manipulated the rules, without prosecution? If the trust

ii necessary for the successful operation of a banking system has broken down, how can it be rebuilt?"

During 2009, contributors to the blog attempted to answer these and other questions.

Alex Klemm edited the *progressive-economy@TASC 2009 Review*. TASC would also like to thank the members of the Review's Advisory Panel who helped edit this publication: Sara Burke, PJ Drudy and Gerry Hughes.

Of necessity, this Review offers only a small selection of the 400+ posts published during the year. We hope that this selection will whet readers' appetite for more: go to [www.progressive-economy.ie](http://www.progressive-economy.ie) to read the ongoing debate.

**PAULA CLANCY**

Director, TASC

## Contributors

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## **Advisory Panel**

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## **Editor**

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**ALEX KLEMM**

## February

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### 1. Trichet's narrow notions of competitiveness

**PAUL SWEENEY, FEBRUARY 27**

Yesterday, I got to shake the hand of the fifth most powerful man in the world – reluctantly!

Yesterday JC Trichet, the President of the European Central Bank – said by Newsweek magazine to be the fifth most powerful man in the world – made a speech in Dublin. As he left the meeting, I was introduced to him and shook his hand, but reluctantly. I suspect that he too was somewhat reluctant to shake my hand, as he heard I was with the Irish Congress of Trade Unions.

Here was a very powerful man in a world economy which is in deep crisis, who had just given a speech on competitiveness which was straight from the 1980s. It was not economics but pure political economy, serving the interests of the Irish employers and government in their attempts to cut wages. His main message was that we must keep labour costs down.

It was straight from the 1980s understanding of competitiveness because it was the kind of economics that Ireland left well behind, back then. The primary focus of this economics is cost competitiveness, while the secondary focus is on wages – with some reference to unit labour costs. “I believe there should be more public awareness that insufficient attention of wage setting to current and expected productivity developments makes any correction to previous losses of competitiveness more painful in terms of output and employment losses,” he said. He also said “As I mentioned before, wage restraint would help a lot.”

M Trichet did not, however, advocate cuts, like some indigenous economists. He called for “wage setting to take account of the competitiveness and labour market conditions” (not unreasonable) in what he termed a “responsible and timely manner”. And he said that “national authorities should pursue courageous policies of spending restraint, especially in the case of public wages.”

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So the government that messed up the economy with light regulation and pro-cyclical policies during the boom is now dubbed 'courageous'?

M Trichet pointed out that many of Ireland's fundamental economic strengths have not gone away, and that the economy is well placed when the international recovery occurs. But he said our success was due to a number of factors, including "a business-friendly regulatory environment." I thought, reading the papers and listening to the radio, that our business-friendly regulatory environment was the reason Ireland is in deep trouble. Clearly, I was misled – it's the overpaid workers!

Fortunately, Ireland developed a comprehensive view of what makes a country competitive in the late 1980s – and then Ireland moved on. For a while it became the Celtic Tiger, basing its economics on a whole world view of this complex issue. With a shared view of the holistic complexity of competitiveness, employers, unions and politicians worked together in a form of Social Partnership to push up employment massively, together with profits and real wages.

Back in 1982, in reaction to a government-sponsored report on Competitiveness by the 'Three Wise Men' I, with others in the 'Socialist Economists' network, published *Jobs and Wages: the True Story of Competitiveness*. In this booklet we set out the framework for a truly comprehensive understanding of what makes a country competitive – including productivity, a functioning banking and insurance systems, good roads and interconnectedness, and education. We even advocated Social Partnership.

The Irish government later actually set up a Social Partnership body called the National Competitiveness Council, as the behest of the employers, to analyse the issues on a continuous basis. It has produced excellent work in the area for many years.

However, in recent weeks, some Irish economists – who for some time avoided the area except for peppering reports with the word 'competitiveness' – have come back into it but, like M Trichet, have taken up where the so-called 'Three Wise Men' left off 30 years ago.

For a group of economists, the panacea for all our problems appears to be wage cuts (mainly for employees; only occasionally for others). Now, this is understandable because they can measure movements in wages – and economists love to measure things. They hate the impact of institutional and political factors on economies as they can't measure them. Wages are very measurable. One economist just sticks up a graph on total costs, which as we all know have been rising fast, and concludes, without blushing, that Ireland's competitiveness is heading south and wages should be cut (consumer costs are way above the EU average here – 14 per cent above the EU27 average for goods and 21 per cent above the average for services, with the differential reaching 33 per cent in the case of consumer services).

Irish costs are way above the EU average, but the reasons are far more complex than wages. On the other hand, wages have risen faster here than in other EU countries – and I will address this issue in some depth in a subsequent post.

The emphasis on wages by economists and by M Trichet is worrying. If we, as a country, are to redefine competitiveness simply as wages – or even unit labour costs, or even total costs – we will have lost our shared understanding of an important and real issue which is crucial to our economy.

It is the naked class nature of their analysis which is worrying. Will we soon stop shaking hands?

## March

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### 2. Liberal policy choices to blame for the crisis

**SEÁN Ó RIAIN, MARCH 2**

The dishonesty and incompetence of individuals in charge of running and regulating our financial system has been spectacular. However, it should not distract us from the roots of the current economic crisis in a set of policy decisions taken in the late 1990s, under the banner of economic liberalism. Fuelling the building bubble, giving a free hand to financial

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speculation, and cutting taxes failed to generate productive investment, weakened households and has ultimately brought us to the perilous state in which we now find ourselves.

Since the late 1990s, economic growth has become increasingly dependent on the speculative financial and property boom. Meanwhile, the tax structure became dependent on taxes linked to the boom – stamp duty, capital gains and VAT, among others. When the speculative bubble burst, both private and public investment were hard hit. Tackling the crisis will involve financial measures but, more importantly, a re-orientation of the economy towards development of productive and innovative firms, creating a more sustainable tax base and significant investment in the skills and well-being of the population. This crisis is so severe that we cannot cut our way out – although cuts will surely play a part, the core of a strategy has to be investment in growth through upgrading.

The booming Celtic Tiger of the late 1990s depended upon a whole set of measures to coordinate the economy – significant initial spending on social and regional infrastructures; social pacts that coordinated wages, taxation and employment; an industrial policy where state agencies worked closely with firms to develop them; and public subsidies for social services such as education, mortgage relief and pensions, that played an important part in the growth of the new middle classes. Just when we needed to invest further in strong international businesses and skilled workers, supported by better-resourced public services, we turned away. We rode a wave of property and financial speculation and cut taxes so the public finances became dangerously addicted to continuous growth.

In 1998 capital gains tax was cut from 40 to 20 per cent. Capital surged into the economy, with bank lending between 1998 and 2007 increasing almost five-fold. But where did this capital go? Sixty-seven per cent of the increased bank lending went into property (construction, developers, mortgages). A further 14 per cent of the increase went into lending between financial institutions. While the rest of the increase was spread across different sectors, relatively little investment went in to the productive sector. In 2007, less than 1 per cent of bank lending went in to high tech – computer hardware, software and research and development.

This showed up in investment. While capital investment increased from 22 per cent of GDP in 1998 to 26 per cent in 2006, that increase was entirely taken up with construction, as non-housing investment decreased as a percentage of economic activity. Spending on technology by manufacturing businesses increased only marginally between 1998 and 2007. Underneath the boom, the financial, speculative economy was overwhelming the productive, innovative economy.

But the boom also masked serious problems in the public finances. Irish tax revenues in both 2000 and 2006 were 32 per cent of GDP, well below the EU average of 40 per cent. What was more serious, however, was the changing structure of tax revenues. Revenues shifted so that an increasing proportion of taxes came from taxes on turnover and growth – the percentage of taxes from VAT, stamp duty and capital gains taxes grew from 35.7 per cent in 2001 to 44.3 per cent in 2006. By 2008, the tax structure was dangerously vulnerable – when growth slowed, the revenues from capital gains, corporate taxes, VAT and stamp duty collapsed.

Despite the rhetoric, the current crisis was not generated by excessive public spending. Irish public spending remains among the lowest in Europe. Public spending on health, education, pensions and social protection are all only around the OECD average, or worse. This despite the fact that we face massive accumulated infrastructure deficits, from twenty to thirty years of underspending – remember that in the 1990s around a third of public spending went to pay off the national debt.

In fact, this low public spending in Ireland threatens Ireland's future – when this crisis is over, the winners will be those who have weathered the storm and continued to build knowledge economies supported by high quality public services. But Ireland is now poorly placed to be among them, despite entering the millennium with a booming high tech sector, improving public investment, managed inflation and having resolved the public debt.

Where do we go from here? By all means, let us tackle waste in the public service – where it actually exists. But this is not the problem, nor the solution. To build the knowledge society that we have long been promised will require much greater investments in education, in innovation policy, in developing small firms, in child care, in supporting 'return to learning'

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among laid off workers, in providing the high quality public services that will sustain our workforce and benefit their employers. Our budget deficit may make it difficult to inject major additional financial stimulus this year, but we should use the maintenance of public services as a form of financial stimulus that will help us through the short-term and simultaneously be an investment in future development. A pause on foreclosures and other measures to maintain household living standards will improve both social and economic outcomes. As the crisis eases, we will need to rebuild the tax structure. The top rates of tax will have to be raised to generate more sustainable government revenues.

At the same time, we need to restructure the banking system so that investments in the productive economy are the main thrust of banking activities, rather than financial speculation. Unfortunately, the sale of the banks to private equity firms, whether privately or government held, seems to have come back on the policy agenda. If the banks receive significant private equity investment, we may well end up with a banking sector owned by international financiers and governments – but with their risks guaranteed by the Irish taxpayer. These private equity owned banks would be highly unlikely to make the kinds of investments in new and growing firms that have now been belatedly recognised as a critical contribution of the banking system. Ironically, while the government was promoting a speculative private financial system over the past decade, its own industrial development agencies have put their funds to much better use in growing firms and priming new funds for supporting start-up companies.

Choices were made in the late 1990s that diverted the economy away from industrial upgrading and new investment priorities onto a path of speculative booms, a weakening tax base and public finances that were dependent on boom-time growth rates. In tackling this crisis we must not reinforce the weaknesses this model has created. Trying to go back to where we were before the crisis will not generate the kind of growth we need to get through this time. Instead, we must take the opportunity to rebuild and extend private and public investment so that sustained economic and social development is possible.

### 3. What about R&D policy?

**PEADAR KIRBY, MARCH 26**

Amid all the focus on the flood of different reports on the Irish economy, and the battle between the slash-and-burn brigade and the stimulants, the new Science Foundation Ireland strategy on 'Powering the Smart Economy' seems to have slipped under the radar of many. This is surprising, as it now remains probably the only sector of Irish public spending that seems to be ring-fenced against spending cuts and, of course, it is officially viewed as central to trying to position Ireland for economic success once we get ourselves out of the current mess.

Yet, as with so many of the sacred cows of Celtic Tiger Ireland that few dared criticise (stimulating a booming economy, opening the flood gates of credit, establishing new agencies for any problem that emerged, national planning that was simply a list of goodies to be funded), current policy towards R&D does little to generate confidence that it can achieve the lofty goals it has set for itself. A more critical examination is greatly overdue.

I have little doubt that the huge increase in state spending, and the development of an elaborate institutional infrastructure for it, is stimulating worthwhile research. Yet, the links between this research and a wider project of national development are what require more critical interrogation. I have three main concerns:

1. It seems to have escaped notice that Ireland has chosen areas to prioritise for research spending that are exactly the same as those chosen by numerous other countries around the world. I was at a Unesco workshop on research policy in Paris last week, and was amazed to hear speaker after speaker referring to ICT and biotechnology as the two priority areas of research for their governments. At least this shows that Ireland isn't out on its own, but it raises major questions about the wisdom of concentrating major public spending on areas in which there is intense competition, some of it from countries with much more established research cultures than we have here. Do we not run the risk that the benefits of such research funding will be realised elsewhere with minimal benefits for the Irish economy?

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2. To realise its developmental promise, an active and well-resourced research culture requires national companies to avail of the research. In the past, developing countries often developed high-tech research capability not in their universities but in public companies. Yet, in an economy so dependent on foreign companies, it seems that much of our research funding ends up as a subsidy by the Irish taxpayer to the research and development capacity of multinationals. As these move their labour-intensive operations to lower-cost locations, we need a much more critical cost-benefit analysis of the developmental benefits to the Irish economy of the priorities that have been set as part of our research policy.
3. To the social scientist, the nature of the research culture that has grown up in Ireland appears far too technical in nature, as if technology alone can result in development. What is missing is any appreciation that all technological or scientific inventions are always embedded in social organisations (companies, services) which structure the ways they are utilised and who profits from them. Yet, to those who fund research in Ireland, these social dimensions seem of no importance. As a result, it is hardly surprising that we get islands of research excellence amid a society of growing social strains and inequalities.

Much more could be said about the nature of the official approach to developing research. Not least would be the observation that a highly instrumental view governs the whole process, which is the very antithesis of the creativity that should drive any true innovation, particularly an innovation concerned with broad and sustainable social outcomes. Perhaps the time has come to include research funding in those areas of public funding that require some critical scrutiny.

## April

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### 4. League tables and losing the plot

**PETER CONNELL, APRIL 21**

As the Irish economy has spiralled downwards over the past six months, those with an interest in attempting to understand what's happening and

evaluating the solutions being proposed are, at least, being exposed to an increasing informative public discourse. You may not always agree with what economists write as opinion pieces in the national media, over at Irish Economy, here at [www.progressive-economy.ie](http://www.progressive-economy.ie) or elsewhere in the blogosphere but, generally, you're presented with reasoned, well informed arguments that represent genuine attempts to enlighten.

Instinctively when you prepare to read an opinion piece on the solutions to the country's economic ills by Dr Ed Walsh, ex-president of the University of Limerick (UL), you know it will be written from a particular ideological perspective. No problem there. We all have ideological perspectives, whether acknowledged or not. Dr Walsh, since being appointed the first president of UL (then the National Institute for Higher Education) in 1970, has almost four decades of experience of public policy formation in Ireland and has held numerous influential positions in areas key to the country's economic development including chairperson of the Irish Council for Science Technology and Innovation that advises the government on science policy. So, you could reasonably expect to find some good ideas in Dr Walsh's piece in the Sunday's Business Post entitled ['Back to when we were winners'](#)<sup>1</sup>.

According to Dr Walsh it's all about competitiveness. We were winners in 2000 when we were the fourth most competitive country in the world. Then we 'lost the plot'. In 2007-8 we were back in 22nd place. And why are we down in 22nd place? The World Economic Forum said the poor quality of our infrastructure was the most problematic factor for those wanting to do business in Ireland. So, does Dr Walsh identify some innovative ways in which we can fund investment in our infrastructure? Or perhaps he has some insights into how we might convert the significant state investment in fourth level education into innovative, hi-tech enterprises? The strange thing is he doesn't mention the state of our infrastructure at all and, in this article at least, has nothing to say about the role that technology and innovation might play in growing jobs and creating wealth, an area in which he has considerable expertise. Instead, his piece identifies our overly generous welfare system, high wages in the public sector and failure to tax those on low incomes. Into the mix he adds rigid labour laws, the undue influence of teachers unions in curriculum development and the lack of

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1. Sunday Business Post, April 19, 2009

reform in local and national governance as being the cause of our problems. That's quite a list. And he backs his arguments up with some figures.

First of all, he suggests that we reduce the size of the public sector workforce by 85,600 to get us back to the 2000 level. Even at the crudest level we can say that, thankfully, we've about half a million more people in the country than we had in 2000. That's about 70,000 more children of school-going age who require teachers in schools that have some of the highest class sizes in the OECD, and it's up to 40,000 extra older people aged 70 and over who depend on public services more than other sections of the population. In 2000, our health service was just beginning to receive the investment it required to repair the damage done by cuts in the late 1980s. Since then an additional 9,000 nurses have been recruited, but I guess they're surplus to requirements if we're to 'get back to when we were winners'. Certainly, there's scope to reform the public sector, but not with a demolition ball.

Next up, public sector wages. Dr Walsh argues that 'benchmarking against other EU countries provides the framework within which Irish public sector salaries can be brought into line'. He goes on to claim that Irish teachers are paid 37 per cent more than their British counterparts and 26 per cent more than those in Germany. This claim appears to be a quote from Danny McCoy of IBEC [writing in the Irish Independent in November 2007](#).<sup>2</sup> The data is from 2004. But [OECD data from 2005](#)<sup>3</sup> shows something quite different (see pages 384-387). While Irish teacher's salaries were towards the top of the table internationally, they were lower than in Germany, somewhat higher than in England, but lower than in Scotland. The OECD report also shows teacher's salaries as a ratio of GDP per capita as a way of assessing the relative value of teacher's salaries across countries. A secondary school teacher in Ireland with 15 years experience earns a salary equal to 1.2 times GDP per capita. This places the Irish teacher at 14th in the international league table of 30 countries reviewed by the OECD.

Next, Dr Walsh, pleading the case of high earners, quotes the discredited statistic that the top 6.5 per cent of earners contribute half of all income tax collected, and that 38 per cent of the workforce paid no income tax at

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2. Irish Independent, November 8, 2007

3. Education at a Glance 2007, OECD

all. Colm Keena of the Irish Times, in an article I quoted in an [earlier post](#)<sup>4</sup>, presents an alternative perspective on the data on which these statistics are based focusing on individual earners rather than revenue cases. If Dr Walsh cares to examine the data, he will find that perhaps the most striking fact is that just 9,129 individuals earned €6.7 billion in income, while the lowest 1.2 million earners had an income of €13.3 billion between them.

And now we come to welfare fraud. According to Dr Walsh 'welfare fraud and welfare tourism are now a major burden on taxpayers'. And the evidence? Apparently, there are 1,044 welfare claimants at Ballyconnell Welfare Office and the town only has a population of 747 according to the 2006 census. This, he remarks, is an alarming statistic. The source of his information on the number of claimants is a Department of Social Welfare and Community Affairs press release issued by Mary Hanafin. And the implicit aim of the press release is to lay the blame for the doubling of unemployment rates in the border counties on fraudulent claimants.

Unfortunately the situation is worse than Dr Walsh thinks. The most recent figure for March 2009 is 1,161. This information is readily available from the CSO website, which is generally a more reliable source of information than ministerial press releases. Anyone who has ever dealt with a Social Welfare Office would also know that they serve wide hinterlands, not just small towns. Preliminary research suggests that the Ballyconnell office serves a population of about 14,000. It's one of two covering the whole of Co. Cavan. Unfortunately there are over 6,500 people now unemployed in the county, many of them young local men who worked in the construction industry.

Dr Walsh suggests that this welfare tourism is down to our over-generous welfare payments. I suggest he reads [Michael Taft's excellent piece](#)<sup>5</sup> on this topic over at Notes From the Front. Referring to another league table, he shows that we're in 13th position out of EU 15 when it comes to the level of unemployment benefit paid to a single claimant. Dr Walsh chooses to compare Irish rates with wages in Lithuania and Romania.

So, unfortunately I wasted seven or eight minutes reading Dr Walsh's piece in Sunday's Business Post. It's disappointing that one of our brightest

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4. [www.progressive-economy.ie](http://www.progressive-economy.ie), March 27, 2009

5. Education at a Glance 2007, OECD

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opinion formers didn't do his homework, but presented an argument based on press releases and snippets of information chosen to bolster a particularly extreme view of where we're at and how we can solve our problems.

In any case I'm not convinced that we should set our sights exclusively on climbing the competitiveness league table. We're now 22nd. Above us, in 20th place, is Iceland.

## May

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### 5. The Ryanair model of development?

**JAMES WICKHAM, MAY 5**

Ryanair is an Irish success story. Ryanair's high profile CEO, Michael O'Leary, is one of the country's home grown billionaires. And Ryanair's success can be taken as a metaphor for one unnoticed feature of the Celtic Tiger: the extent to which it succeeded by 'externalising' problems.

After all, part of the Ryanair experience is not only that you reach more places more cheaply than you ever thought possible, you are also asked to pay for things for which you never thought airlines could charge. Ryanair externalises costs onto its passengers, but also has expertise in externalising its other costs. The environmental costs of air travel are now well known, and Ryanair specialises in short-haul travel, which has the highest environmental impact. While campaigning against subsidies for state airlines, Ryanair has benefited massively from regional subsidies to local airports. Ryanair even ensures that its staff contribute to their own training costs.

The most obvious example of this externalisation process is the environment. What is remarkable about the Irish boom is how old-fashioned it was. Whereas for years it has been clear that economic growth can come in more or less energy-intensive forms, we accepted the old equation that economic growth equals environmental damage. In

particular, the boom led to massive urban sprawl – which in turn ensured high levels of private car usage with all the consequent environmental impacts. Dublin's sprawl was highlighted as an example of bad planning by the EU's [Environmental Protection Agency](#)<sup>6</sup>. Importantly, this was a political choice. Instead of an effective land use planning policy, we had a Ryanair policy – leave the mess for someone else to clear up.

Although it's probably politically incorrect to say so, immigration policy is another example of externalisation. Despite the massive increase in employment during the boom, Ireland never achieved the levels of employment normal in countries such as Denmark. For example, in 2006 the overall employment rate in Ireland was 68.6 per cent; in Germany it was not much lower at 67.5 per cent, but in Denmark it was 77.4 per cent. Ensuring that the unemployed, the very unskilled and many women could take up jobs would have required a proper 'activation' policy with counselling and training and it would have required a proper childcare policy. How much easier just to import labour!

And for all the propaganda about 'our wonderful education system', much of the need for skilled labour also came from a failure to motivate, train and educate people in Ireland. Thus whereas domestic technical education was originally expanded in order to facilitate high technology industry and services, Ian Bruff and I have shown how the Irish software sector rapidly became dependent on the import of qualified labour from around the world.<sup>7</sup>

Clearly, a small labour market such as Ireland's will always need to import some specialist labour, just as those with specialist qualifications will always be more likely to emigrate. However, to some extent immigration policy was a substitute for an effective educational policy, including the weakness of any formal vocational education system. In this sense, the educational costs of Irish growth were also externalised.

And I won't even mention the idea of economic development by competing in terms of 'light touch regulation'...

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6. [www.eea.europa.eu/publications/eea\\_report\\_2006\\_10/eea\\_report\\_10\\_2006.pdf](http://www.eea.europa.eu/publications/eea_report_2006_10/eea_report_10_2006.pdf)

7. 'Skill Shortages are not what they seem', *New Technology Work & Employment* vol 23, pp. 30-43

## 6. NAMA or nationalisation unlikely to achieve objectives

JIM STEWART, MAY 22

Banks are a vital part of any modern economy. They perform a number of key functions: (1) a repository and access to liquid assets; (2) transferring funds; (3) provision of short term credit and lending; (4) provision of financial services and retention of records. Policy actions to date have ensured banks continue to survive and can perform three of the four functions, but expecting banks to start lending is unrealistic. This has not happened in other countries, nor is it likely to happen here. Rather than lending to enterprises, eurozone banks have increased their purchase of government bonds. One estimate is that banks bought 75 per cent of the total of €77 billion of eurozone Government bonds issued in January.<sup>8</sup> The implications for Ireland is that a substantial proportion of recent issues of Irish Government debt was bought by banks, and in particular Irish banks. The ECB cannot lend directly to governments, but can lend to banks at low interest rates in exchange for many types of collateral including government debt. Banks are then in a position in turn to purchase government debt. This is how the government deficit can be financed. The ECB has recently announced further measures to increase liquidity which will again support both the banking sector and large borrowers such as Governments.

It is most unlikely that the NAMA will succeed in its stated objective of ensuring households can access credit or that funding will be provided to small and medium sized enterprises (Budget statement April, 2009). This is a similar objective to those stated in the plan to guarantee all the debts of banks last September (the stated aim was to ensure financial stability and “protect the real economy”<sup>9</sup>). In the announcement of the government recapitalization plan (February 11, 2009) it was stated that the “recapitalisation package will “reinforce the stability of our financial system, increase confidence in the banking system here, and facilitate the banks involved in lending to the economy”.

The reason this stated aim will be unsuccessful is that it is irrational to expect banks to provide funds to firms or individuals in the context

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8. Financial Times, March 4, 2009

9. Statement by the Minister for Finance, October 22, 2008

of falling personal incomes, rising unemployment and a rising level of insolvencies in the corporate sector. This is a feature not just of the Irish economy but of all the Eurozone economies. Table 1 below shows that the annual rate of increase in loans to the private sector, and in particular the two targeted sectors, Households and Non-financial corporations, has fallen consistently every month since May 2008. This in spite of all the State guarantees, arranged mergers, equity injections, and nationalisations. Much of the increase in lending could be 'rolled up' interest, as in the case of the Irish Nationwide Building Society.

TABLE 1: **Increase in Loans to private sector**  
12 month per cent change

	TOTAL INCREASE	HOUSEHOLDS	NON-FINANCIAL CORPORATIONS
May-08	10.5	4.9	14.2
Jun-08	9.9	4.2	13.6
Jul-08	9.3	4.1	13.2
Aug-08	8.8	3.9	12.6
Sep-08	8.5	3.8	12.2
Oct-08	7.8	3.3	11.9
Nov-08	7.1	2.5	11.1
Dec-08	5.7	1.6	9.5
Jan-09	5.0	1.2	8.8
Feb-09	4.2	0.7	7.6

Source: ECB, Monetary Developments in the Euro Area, Various issues.

This is particularly serious for small and medium sized enterprises because bank lending is the main source of finance in the euro zone area.

The most recent bank lending survey, 2009, reported higher loan margins and more restrictive collateral requirements for five Irish banks participating in the survey. The same survey also reported a decline in demand for loans due to a "reduction in the financing needs of enterprises".

Current policies have been successful in ensuring banks have survived and continue to perform many valuable services. But it is unlikely that either NAMA or nationalization of the banks would result in additional lending to small business because it is irrational for them to do so, given the overall objective of behaving in a commercial (for profit) way. NAMA or nationalization will be extremely costly. Changing ownership does not change the size of the deficit between the value of assets financed by borrowing and the amount borrowed and the likely required state contribution. It is doubtful that changing ownership would result in efficiency gains, for example in realising higher values for assets that are sold. It is also unlikely that a change in ownership would result in losses (transfers in value), other than those already incurred, to bondholders or preference share owners. This did not happen in the Anglo-Irish case (see statement issued by the Government on January 30, 2009, to the effect that nationalisation would have no effect on Tier 1 hybrid instruments. It is better to proceed cautiously now than pursue policies that pre-empt all other options because of their cost and size. An early example of delay being the best option was the proposal to seek mergers amongst banks. It was clear to some then, and to all now, that any bank that merged with either Anglo-Irish Bank or the Irish Nationwide Building Society would reduce the chances of the merged entity remaining viable.

But there is one area in which it is vital that immediate action is taken, and that is to ensure that credit and loans flow to small and medium sized enterprises, and not just those involved in exporting. Large corporate entities and the multinational corporate sector have other sources of finance. Some large firms have no need for additional borrowing. What is needed is a new entity designed to lend funds to the SME sector. Such an entity cannot be "for profit". It cannot be run on strictly commercial lines, because in the current crisis lending to SMEs is certain to result in losses. This new entity could be funded on the basis that 20 per cent of loans would fail. Lending is thus made with the knowledge that there is an explicit subsidy. The return to the State (and the economy) is indirect in terms of job preservation, so that when the economy recovers there is an existing base which is a potential source of growth and job creation. Such a policy could also act as a certification device to other banks. It would reduce risk to other banks provided claims on collateral were ranked below that of additional funding from other banks.

## 7. Why wage cuts are not a good thing

**TERRY MCDONOUGH, MAY 26**

When Ronald Reagan wanted to send a message to unionised workers across the American economy, he picked a group of public employees, the air traffic controllers, and broke their union. Ironically, this union was one of the few that had endorsed his candidacy for president. Margaret Thatcher followed a similar strategy with the miners. When the current coalition government decided that their only strategy for recovery was repairing Ireland's competitiveness through across-the-board wage cuts, there was only one way to announce their intentions. They picked on public sector workers and announced a wage cut.

Brian Lenihan has bragged that we Irish have an amazing capacity to take pain and that if such a cut had been announced in France there would have been riots. How did he get away with this in Ireland?

First, a carefully orchestrated campaign in the media stirred up begrudgery about public sector pensions. The pay cut was labelled a pension levy, and the impression was given that it would go to help pay for these 'Rolls Royce' public sector pensions. Public sector unions felt exposed by the lack of support from fellow citizens in the private sector, and accepted the cut. Support for the pension levy by private sector workers ignored the fact that they were next in the crosshairs. Irish private sector employers had got the message. It was now open season on wages.

Just as an ESRI report had earlier announced the start of the Irish recession, their latest report, predicting a 17 percent unemployment rate, amounts to official notice of an Irish depression. The ESRI's solution? They joined a chorus of other economists and commentators calling for a fall in wages. Garret FitzGerald's recent column in the Irish Times was headlined "reduced pay could be silver lining of crisis."<sup>10</sup> Despite this apparent consensus, there are sound economic reasons why wage cutting in the Irish economy is far from a good thing.

First, stable wage rates provide an anchor in the economy. All other prices are tied to them. Falling wages can cause falling prices which can trigger

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10. May 2, 2009

further falls in wages and prices. This is called deflation by economists. What's wrong with falling prices? Would you buy a product now if you expected it to be cheaper in the future? Would you pay today's prices to invest now if you could only eventually sell your product at tomorrow's lower prices? Deflation has the potential to seize up an economy.

Secondly, falling wages directly damage demand, cutting sales and creating further unemployment. An environment of wage-cutting creates insecurity and reduced spending.

Thirdly, falling wages will compound the problem of our high levels of indebtedness. Falling incomes means that debt payments will take an ever larger percentage of income.

Fourthly, inequality is at the root of the international crisis. Across-the-board wage cutting will make the problems worse. Stagnant wages led to low levels of demand for consumer goods, leading investors to put their money into financial markets instead of productive investment. This led to a flood of lending to cash-strapped consumers and fuelled the housing bubble. When this bubble burst, a credit crisis combined with stagnant wages to create a demand crisis. This demand crisis will still be with us even if the banks are repaired.

Fifthly and finally, falling wages will not recreate the Celtic Tiger. It is true that lower Irish wages initially contributed to attracting foreign investment. But it is not possible to wind the clock back to 1987. Much has changed. There are even lower wages available elsewhere and, with the enlargement of the EU, available not so far away. In the age of globalization, transnational corporations locate different parts of the production and distribution process in different kinds of places. Where they will find attractive for a particular function in the future is very hard to predict.

There are two lessons here. The first is that Ireland must be more self-reliant in the future. The second is that, against all the conventional wisdom, we should stop worrying about competitiveness. Rather, we should set about building the society we want. We should be seeking high levels of equality and well-being (recent scientific studies show the two are closely connected), high levels of health, high levels of education, and high levels of culture and self-expression. If we have a well-functioning society – not

just an economy – we will find that we have no trouble participating in the international economy and even attracting foreign investment, if that is one of the things we want. Now that Social Partnership is in trouble, there is no reason that unions and other social organisations can't still do their bit for recovery. They can contribute a great deal by doing their day job – defending working people's living standards and fighting for greater levels of social justice.

## June

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### 8. The efficiency of “saving” vs “creating” jobs

**MARIE SHERLOCK, JUNE 5**

As the country goes to the polls tomorrow, Live Register figures for the first five months of 2009 are due to be released. The question remains: is the stark downward trend in job losses and part-time work beginning to plateau out – whether this is the beginning of the end of the economic crisis – or is the live register going to rumble on well past the half a million mark?

Redundancy figures released earlier this week show that figures for the month of May breached the 8,000 mark, yet little can be interpreted from this as qualification for redundancy payment is confined to those working two or more years in the company. Nonetheless, in the absence of up-to-date QNHS data on sectoral employment levels, the redundancy figures do highlight the concentration of lay offs in what is termed “other services”, running well ahead of redundancies in construction and manufacturing.

The local and European election campaigns have naturally been dominated by the issues of job losses and the economic crisis. Ironically these are issues largely beyond the reach of both sets of institutions, but of course that hasn't prevented the turning of Friday's poll into a proxy general election. In that context, I thought it interesting to engage in a brief perusal of the various political parties' employment policies and intend that this be akin to throwing a ball into the debate, as opposed to a detailed treatise on active labour market policies.

Needless to say, all parties are singing off the one hymn sheet on the need to upskill and retrain those who now find themselves jobless, but the devil is in the detail and Fine Gael's approach of reallocating FÁS resources towards the enterprise-led Skillnets, and the limiting of the upskilling of workers within the context of existing industry, departs sharply from Labour's agenda for broadening access to upskilling, training and work experience for individual workers. This distinction in approach reflects a divergence in thinking regarding the possible sources of future economic recovery, and in some ways goes to the heart of the question about the efforts that should be made to retain existing jobs and businesses, and the separate question of promoting "job creation".

The trade union movement has long argued for some type of short time working mechanism to support existing firms effected by the economic downturn, who in less volatile economic trading conditions would be operating profitably. The criteria for entitlement to the support remains a moot point, with Sinn Féin proposing a trouble-shooting body to identify and advise troubled companies, along with a specific job retention fund of €300m. Labour's 'Earn and Learn' scheme most closely resembles the pilot project announced in the April Budget; however, the 277 places made available in the Government's pilot project makes the scheme wholly inadequate and in danger of being far too little too late to rescue potentially sustainable jobs.

In contrast, Fine Gael overlook the idea of direct support to retain existing jobs, and instead address the broader issue of operating costs in the country. Their preference for introducing direct wage subsidies to incentivise companies to recruit unemployed persons raises important questions as to the economic efficiency of such a measure vis-à-vis the retention of existing jobs. While sustaining those currently employed can arguably impose a deadweight cost by delaying the natural turnover of businesses, and can displace funding to support future job creation, these costs can arguably be minimised by imposing time limits to benefits and by imposing strict criteria for eligibility. In contrast, the economic efficiency of a wage subsidy to create jobs is much more questionable. Relieving 31 per cent of the cost of a minimum wage job is an attractive short term measure for those who wish to reduce unemployment figures overnight. But serious questions remain as to the long-term sustainability of these jobs after the two years, the deadweight cost to the Government of jobs that would have been

created anyway, and – most importantly – the possible displacement of both the funding and the take up of formal training and upskilling that is necessary for long-term economic growth.

## July

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### 9. The Dublin Consensus

**SLÍ EILE, JULY 1**

We recall the term ‘Washington Consensus’ as it was first coined in the 1980s. Dani Rodrik summed it up as:

[Stablize, Privatiser, Liberalise](#).<sup>11</sup>

Part of the recipe was to get your ‘macro balances in order’.

In Table 1 of his paper, Rodrik (a critic of same) lists the 10 Washington Consensus principles as:

1. Fiscal discipline
2. Reorientation of public expenditures
3. Tax reform
4. Financial liberalization
5. Unified and competitive exchange rates
6. Trade liberalization
7. Openness to DFI
8. Privatization
9. Deregulation
10. Secure Property Rights

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11. Dani Rodrik, Goodbye Washington Consensus, Hello Washington Confusion, Harvard University 2006

Sounds familiar? Rodrik outlines a supplementary list in the 'Augmented Washington Consensus' (sounds a bit less familiar) as follows:

11. Corporate governance
12. Anti-corruption
13. Flexible labor markets
14. WTO agreements
15. Financial codes and standards
16. "Prudent" capital-account opening
17. Non-intermediate exchange rate regimes
18. Independent central banks/inflation targeting
19. Social safety nets
20. Targeted poverty reduction

I suggest that there is, already, a real 'Dublin Consensus' and it goes as follows:

1. Sort out banking through some form of toxic-containment (folks differ on the details)
2. Frontload big, immediate cuts in nominal wages in the private and especially the public sectors (real 'plain vanilla' cuts and not just voluntary contributions from the judiciary, contrived 'pension' levies and various stealth charges)
3. Frontload big, immediate cuts in public spending across the board from pay (see above) to social welfare ('the highest in Europe' false claim) to 'wasteful' capital projects to other items
4. Bring the low and middle-income groups back into the tax net
5. Downsize and reform the public sector

There are a few supplementaries like privitising some state assets – but the core of the Dublin Consensus is captured in the above five points. This is a real, audible and visible consensus from the pages of the Irish Times to learned articles and conference papers to 'economics for the simple' on the public airways.

By the way, I completely disagree with the view that the 'left' is in any way winning the economic argument.

The right is winning hands down and we are looking at, potentially, the most deflationary fiscal stance since at least the 1950s and further erosion in our already weak public and social infrastructure – relative to the standard of provision and living standards people have become accustomed to following the Celtic Tiger.

So, when journalist Sarah Carey [writing in today's Irish Times](#)<sup>12</sup> argues that the ICTU should roll over and declare:

'Comrades, I have nothing to offer you but cuts and taxes. The deeper the pain now, the quicker all this will be over'

we have to ask:

- Is there no other show in town?
- Has the Dublin Consensus won?

Should we fold up, go home and concede that the logic of market economics, international finances, a failed domestic banking model and an overwhelming media, economics and political consensus that the only path to recovery is through cuts, more cuts, unemployment and dramatic falls in living standards? Nobody likes to say it quite like this – but that is what most people are assuming: there is no other way – we have to price ourselves back into markets, we have to balance the public books fast and hold on until the tide comes back in on an international recovery. The debate about jobs subsidies is a deflection.

Whether or not you think such subsidies will work is not the point. [My original blog](#)<sup>13</sup> questioned the evidence that they would work and implied that other uses of this expenditure would be more effective. At this point in time it is hard to cast judgment since we have no details or analysis beyond a few media leaks. And there is no certainty on where different interests stand on the various issues. The point is that we need to move away from

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12. Irish Times, July 1, 2009

13. [www.progressive-economy.ie](http://www.progressive-economy.ie), June 25, 2009

marginal debates about relatively marginal issues to confronting the real issues:

1. Domestic fiscal stimulus versus profound fiscal deflation for 2009-2012/13
2. Skills, innovation and growing the indigenous economy on world markets versus business as usual depending on FDI and a relatively protected and cosseted non-traded sector (as in price controls, costs and rigid work practices in the case of the public and civil service)
3. Corporate governance change versus cosmetic name change
4. Finding another way of dealing with banking rather than bleeding the whole country dry with a blanket cheque to recapitalise the failed (with the bail-out of Anglo-Irish ultimately costing more than an entire year's education budget)

This is where the real debate needs to be reclaimed and the Dublin Consensus challenged. Self-proclaimed progressive and left folk including public sectors unions need to get serious about reform of the public service (which is one area where the Dublin Consensus is partially right) – how can we expect people to buy-into Scandinavian tax levels and redistribution policies unless we reform, root and branch, a slowing-moving, under-funded, under-staffed (yes I meant under-staffed) and inefficient public service operating in a very inefficient manner and subject to all sorts of political constraints and centralisation that is out of line with 21st century public management.

## 10. Next Generation Broadband and the Smart Economy

**DONAL PALCIC, JULY 30**

I read with interest the recent first report of the DCENR's Knowledge Society Strategy process (entitled Technology Actions to Support the Smart Economy). The report claims that Ireland is now one of the "most advanced countries in the world for wireless and mobile broadband technologies" and that a "competitive market is delivering broadband speeds for Irish

consumers from a range of broadband providers”. The report goes on to detail a number of action areas that will deliver the critical next generation network (NGN) infrastructure necessary for the development of a smart economy. The majority of the report then devotes most of its space to describing initiatives such as the recently announced [Exemplar network](#).<sup>14</sup>

Nowhere in this report are any of the key issues surrounding the development of a true NGN mentioned or discussed. The report’s claim that we have a competitive broadband market is also highly questionable given Eircom’s dominance of the fixed-line market and Ireland’s perennial position towards the lower end of most EU/OECD broadband scorecards. [The Forfás response](#)<sup>15</sup> to last year’s NGN consultation paper shows that Ireland is currently not well placed to take advantage of future trends in broadband. Although the number of broadband subscribers has increased significantly since 2005, Ireland’s relative position has not improved as other countries are moving ahead at an even faster rate. The fastest speeds available in Ireland currently lag those of our European counterparts while the cost of our fastest broadband services is relatively higher.

A quick perusal of the latest ComReg quarterly market data (for Q1 2009) shows that there are now over 1.27 million broadband subscribers in Ireland. An examination of the breakdown of broadband subscriber numbers by subscription type presents some interesting facts:

DSL:	679,578	(79 per cent residential)
Cable:	112,966	(99.9 per cent residential)
Wireless:	116,461	(69.7 per cent residential)
Other:	8,487	(63.7 per cent residential)
Mobile:	354,674	(76.4 per cent residential)
Total:	1,272,166	(79.2 per cent residential)

DSL subscribers make up approximately 53 per cent of overall broadband subscribers in Ireland, while the mobile broadband market, which has recorded explosive growth in recent years (over 90 per cent increase in

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14. Irish Times, July 22, 2009

15. Response to the Department of Communications, Energy and Natural Resources’ Next Generation Broadband Consultation Paper, October 15, 2008, Forfás, IDA Ireland, Enterprise Ireland and Science Foundation Ireland

subscribers over the past year alone), accounts for some 28 per cent of subscribers. Eircom dominates the DSL market where it provides 96.6 per cent of DSL access either directly (Eircom retail) or indirectly (wholesale bitstream). Only 3.4 per cent of DSL access is from unbundled local loops (LLU), which is significantly behind the EU average where LLU constitutes 44 per cent of all lines supplied by competitors (ECTA Broadband Scorecard Q3 2008). The lack of local loop unbundling and the high price of line rental charged by Eircom is arguably a significant factor behind the considerable growth in mobile broadband subscribers (particularly in the residential market) and further evidence of Eircom's dominance in the fixed-line market.

So where do we actually stand in terms of developing a next generation network? The Knowledge Society Strategy report ignores the most important obstacle to developing a NGN in Ireland, namely Eircom's fixed-line network and the critical local loop (last mile) infrastructure. The last mile is a key area of concern given the lack of investment by Eircom in this area. The current local loop infrastructure, which is largely twisted pair copper, is fast becoming incapable of delivering currently available bandwidth-intensive services. The services of the future (3D TV etc.) will require even higher levels of bandwidth. While cable operators such as UPC are investing in infrastructure capable of providing speeds of up to 100Mbps, such services are only available to a relatively small (mainly urban) portion of society. In order to develop a true NGN, the deeper rollout of fibre across the national network (i.e. to the kerb (cabinet), to the home etc.) is necessary. Eircom's local loop infrastructure thus constitutes the most significant bottleneck in the future development of next generation broadband services.

Two possible options available to the Government are:

- I. Take Eircom's network infrastructure back under public ownership (or if a deal on obtaining the network alone cannot be reached, take Eircom as a whole back under public ownership, separate the network element from the remaining business elements which can then be sold off while retaining the network). Eircom's fixed line network should then be amalgamated with the entire portfolio of State telecoms assets (MANs, NBS, and the telecoms networks of the ESB, Bord Gáis, Irish Rail etc.) and managed by a new State-owned telecoms network company. The

new company can then provide network services to private operators on an open-access basis across every level of infrastructure (first, middle and last mile).

2. Amalgamate all of the existing State telecoms assets under a new public network utility as above and construct a new national NGN in a greenfield approach.

Option 1 need not cost the Exchequer significant sums of money. A new State-owned telecoms network utility will be able to finance investment through revenues generated and its own borrowings. Eircom is currently up for grabs for approximately €100 million. While there are obvious issues surrounding the level of Eircom's approximate €4 billion debt, the strategic importance of Eircom's network is simply too large for the Government not to take radical action now and bring Eircom's network back under public ownership. A failure to do so will simply ensure that Ireland falls further behind her European and international counterparts. Even if the Government has to take on some part of Eircom's debt in order to obtain the network, this does not have to add to our ever increasing national debt and can be managed by the new State-owned network. When Telecom Éireann was corporatised from the Civil Service back in 1984 it inherited a loss-making business, approximately IRPE1 billion in debt and a network in dire need of investment. As a commercial public enterprise, it returned the company to profitability within four years, spent significant sums of money upgrading the network and managed to deleverage its balance sheet, all without any assistance from the Exchequer.

While Option 2 does not involve taking Eircom's network back under public ownership (and therefore taking on some/all of Eircom's considerable debt), the problem of access to, and investment in, the local loop infrastructure remains. Given that the local loop is currently one of the key barriers to the development of high speed broadband services, Option 1 is arguably superior to Option 2.

Provision of access to a fully integrated national telecoms network on an open wholesale basis would facilitate increased customer choice without any requirement for the Government to re-enter the business of telecoms service provision. It would also facilitate improved competition amongst service providers and equitable investment in infrastructure, whereby a

State-owned network company can be mandated to invest in rural areas, preventing the deepening 'digital divide' which is already occurring as private operators only invest in more economically attractive, densely populated urban areas.

Given the rapid pace of technological development and the constantly increasing information needs of business and society, our telecoms infrastructure is as important, if not more important, than other strategically important infrastructure such as our road and rail networks. Simply put, high-speed broadband is now a necessity for everything from economic growth to social inclusion. While the initiatives outlined in the DCENR's latest Smart Economy report are to be welcomed, the issue with the local loop infrastructure is far more important. If the Government acts now it can create a realistic physical platform for a truly competitive telecoms market and the basis for growth towards a smart economy, and in doing so facilitate Ireland's future economic growth once it emerges from the current crisis.

## August

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### 11. Money, money everywhere (but here)

**MICHAEL TAFT, AUGUST 13**

If you took some commentators seriously, you'd be excused for believing that Ireland Ltd. is on the verge of going into liquidation. Whether it's defaulting on our debt, a growing inability to borrow more, or just despairing over that '€400 million we're borrowing every week – yes, you'd assume the country is out of dosh.

But that doesn't tally with the recent [US Treasury release of data](#)<sup>16</sup> identifying the major holders of Treasury Securities – that is, US debt. China is the biggest holder of US debt – about a quarter of the foreign total. Japan, the tax havens in the Caribbean and the UK (with its tax havens) are also up there. But guess who else is. Yes, poor ol' broke Ireland.

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16. [www.treas.gov/tic/mfh.txt](http://www.treas.gov/tic/mfh.txt)

Irish 'residents' hold \$50 billion worth of US Treasury securities. That's almost as much as Germany (even though German GDP is nearly 14 times larger than our own) and more than twice as much as French holdings. Our holdings are worth over \$12,000 for every man, woman and child.

Irish holdings have shot up recently. Only last year, Irish holdings amounted to \$15 billion. In just 12 months, \$35 billion fled Ireland for the safety of US debt. Yes, there's money swilling around – but it's not swilling here.

This is of a piece. [Irish holdings of foreign portfolio securities](#)<sup>17</sup> throughout the world amounted to €1.3 trillion at the end of 2007, with €440 billion held in foreign equity and another €575 billion in bonds and notes. The increase since 2000 has been substantial – up from about €500 billion.

To put this in some perspective, Ireland's €1.3 trillion held abroad compares to the [foreign holdings of French residents of €2 trillion](#)<sup>18</sup> – even though the French economy is more than ten times larger than the Irish economy.

Of course, it will be argued that Ireland's wealth holdings are too big to be maintained at home, given the limited domestic investment opportunities. Foreign Direct Investment may come here by the truckload, wooed by prospects of high returns – but not high enough to satisfy our own residents. They must go abroad to find financial satisfaction; US debt, for instance.

There's some validity to this argument but there's another picture. It's long been a complaint, by politicians and commentators, that money is tight here, but pretty loose everywhere else. Back in the 1950s [Flann O'Brien wrote](#)<sup>19</sup>:

*'It is almost a cliché that this country is chronically undercapitalised, that money for productive capital works cannot be got. The administration recently started capital works concerned with land reclamation and drainage and is about to clear all the rocks out of Connemara. With money borrowed from the banks deposited by thrifty farmers? Not on your life. With borrowed American dollars which are twice as costly as pounds.'*

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17. Resident Holdings of Foreign Portfolio Securities, December 31, 2008, CSO

18. [www.banque-france.fr/gb/publications/telechar/bulletin/174etud2.pdf](http://www.banque-france.fr/gb/publications/telechar/bulletin/174etud2.pdf)

19. Diarmuid Ferriter, *The Transformation of Ireland 1900 – 2000*, London: Profile Books, 2004

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Frank Aiken had his own run-ins. When he attempted to finance an expansionary programme shortly after the war, the Irish banks refused to loan, preferring to keep their money safe in the UK. He declared:

*'I regard their turning down of the request (to loan the government money) . . . as an act of undeclared war upon our people'.*

The banks won and Aiken surrendered unconditionally: the people paid the price.

[Patrick Honohan wrote](#)<sup>20</sup> only a couple of years before the financial crisis:

*' . . . despite the emergence of the International Financial Services Centre (IFSC) as a leading player in some subsectors of offshore finance; despite the high profitability and unusually high percentage of the banking system not domestically controlled; and despite the absence of any significant bank failures for over a century; there is little evidence to suggest either that recent Irish growth has been finance-rich in the sense understood by the literature, or that the previous low-growth experience was explicable in terms of a weak financial system.'*

Irish banking and financial investment played little role in the Celtic Tiger economy. They were too busy playing away and plotting the eventual chain of events which would lead us to the Carroll liquidation and NAMA.

[Michael Hennigan of Finfacts points out](#)<sup>21</sup> that between 2001 and 2007, nearly €41 billion left the economy in search of commercial property abroad, while only a fraction of that was invested in indigenous high-tech companies.

Of course, it would be too simplistic to point out that only a small percentage of these resident holdings abroad would be needed to pay off the entire national debt (of course). Or that even a smaller percentage would be needed to recapitalise the banks without taxpayer intervention (of course). To maintain such a position would betray a profound misunderstanding of capital flows in a highly globalised system (of course).

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20. Patrick Honohan, To What Extent has Finance been a Driver of Ireland's Economic Success? ESRI, 2006

21. [www.finfacts.ie](http://www.finfacts.ie), June 6, 2007

Besides, it's not as if Brian Lenihan is unaware of the problem of 'money flowing abroad'. Only recently, in a fit of patriotic fervour, he called on hard-pressed consumers not to go to Newry to shop. Unfortunately, Lenihan's 'Irish money for Irish business' is a pretty limited. I've not recalled him calling on Irish investors to stop crossing the oceanic border and buying US debt.

So the next time you hear a commentator or economist calling on the Government to slash social welfare spending, claiming that we have been paying ourselves too much; the next time you hear some politician saying we have to take 'tough-love measures' (usually without the love) because otherwise we'll go broke; just remember all those hundreds of billions of 'Irish money' circulating throughout the world Remember those billions that have fled the country in the last few months to buy US debt. Remember all the money that is going everywhere but here – to invest in our industries, enterprises, and infrastructure.

And if you think this is a curious way to run a modern economy, you'd be right.

## September

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### 12. Innovation and the smart economy

**DAVID JACOBSON, SEPTEMBER 9**

Innovation is universally accepted as extremely important for economic competitiveness. However, there is frequently confusion as to what is meant by innovation. The word 'innovation' appears 114 times in the recent policy document on the Smart Economy<sup>22</sup>; that's an average of more than once for every page. Yet nowhere in the document is there a clear definition.

Focusing only on the Smart Economy document, there are a number of different meanings that could be attributed to 'innovation'.

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22. Building Ireland's Smart Economy: A Framework for Sustainable Economic Renewal, December 2008

- It seems to be used as a synonym for 'ideas': "The Smart Economy combines the successful elements of the enterprise economy and the innovation or 'ideas' economy..."
- Innovation is also associated with research and commercialisation. The three together make up the 'ecosystem' of the Smart Economy. A 'key objective... is to make Ireland an innovation and commercialisation hub of Europe', that is, an attractive base for R&D intensive multinationals and for the incubation of Irish and other entrepreneurs. This it is hoped will generate economic development and quality, well-paid jobs. But what are the differences between research, innovation and commercialisation and how will the various policy instruments achieve these different results?
- Among the instruments is the 'Innovation Fund – Ireland'. Its function is "to support early stage R&D-intensive SMEs". This suggests that innovation is what is done by start-up businesses based on R&D.
- Another proposed instrument is the 'Manufacturing Forum'. This will support an increasing focus in manufacturing on competitive advantage "through innovation, R&D and design". So, in addition to undertaking R&D and design, our manufacturing firms must be innovative, whatever that is.

Elsewhere in the Smart Economy document, Ireland is said to be above average in innovative processes and products but behind in the "transformation of innovation into commercialisation"; the USA is said to be ahead in "innovation in terms of technology and services"; and Irish higher education is exhorted to produce more graduates "in key areas of Science, Engineering and Technology, while also nurturing an interest in innovation and setting up their own businesses". Again, it is not clear what is meant by innovation.

### **Defining Innovation**

Over the last 20 years or so, policy-focused economists in the Schumpeterian tradition have come to agree on a broad definition of innovation: an innovation is a new product, process or way of organising that is new to a place, or even to a particular firm, even though it may not be new to the world. Innovative firms are those that are good at creating, introducing or implementing such new products, processes or ways of

organising. On the basis of this definition, how does innovation differ from R&D? R&D is generally a formal process, measured by the amount of money that goes into the department or unit that is undertaking either the attempt to find a new product or way of making a product (research) or, if one of those has already been found, fine-tuning it for use or for market (development). R&D is an input, innovation is an output. But, and this is frequently not understood by Science, Technology and Innovation (STI) policy makers, the output of R&D is not necessarily innovation; even more importantly, innovation can – and frequently does – come out of various activities other than R&D.

What activities other than R&D can create innovation? At the simplest level a worker in a factory might see a better way of doing whatever she does. An office employee might process documents more efficiently by noticing distinct groupings. If this better way is introduced it is an innovation. He is innovative; his company, if it can quickly and smoothly implement the change, is innovative. This also applies to changes in the way a service company operates. And innovative people, firms, regions and countries can also express their innovativeness in these ways. A firm, region or country can as a result be highly innovative without having high levels of R&D. This does not mean that we should ignore R&D. High levels of R&D can be associated – as in Sweden and Israel – with innovativeness. But some successful regions, like Emilia Romagna in Italy, are highly innovative with low levels of R&D.

What about commercialisation? This focuses on the process of bringing innovations to the market. It applies most directly to new products. Successful commercialisation is where, for example, a new product – or some new variation on an existing product – can be protected by a patent, then brought into production and marketed in such a way as to meet its target sales. But many product variations, processes of production and ways of organising are not amenable to patent or other protection. Let us take such innovations as Just-In-Time – very important since the early 1990s. Groups of firms capable of introducing JIT and deriving all the benefits of reduced inventory, significantly improved their competitiveness. They could not commercialise this innovation because it is generally available, unprotectable knowledge. In relation to such innovations, success for an economy comes from the absence of such protection, from the rapid diffusion of the new way of organising.

Another concept used in Smart Economy in association with innovation is entrepreneurship. There is nothing wrong with entrepreneurship, and we could do with a lot more of it in Ireland. But again, it is not the same as innovation. Many innovative activities can clearly take place in existing businesses and don't need new start-ups in order to be implemented.

In response to the kind of thinking inherent in the Smart Economy, substantial funding has been allocated to universities and institutes of technology under the PRTL (Programme for Research in Third Level Institutes). The McCarthy report is quite dismissive of this programme, questioning its results. It may have improved academics' publications and universities' ranking but, McCarthy asks, what about innovation and commercialisation.

This article shows that confusing misconceptions of innovation seem to pervade the government's STI policy. Clarity will hopefully result in the development of new policy instruments better focused on achieving real innovation. It may also help to address the criticisms in the McCarthy report. Rather than adopting the short-termist strategy of removing funding for innovation, government should allocate the funding more appropriately to real innovation.<sup>23</sup>

### 13. 'Principle of revenue neutrality' proves Government's lack of vision

**MARY MURPHY, SEPTEMBER 11**

The average percentage of GDP spent on social protection in the EU-15 is 27.5 per cent ([Eurostat, 2007](#))<sup>24</sup>. The Irish rate of 18.2 per cent compares badly with high spenders France (31.1 per cent) and Sweden (30.7 per cent), with our nearest neighbour the UK at 26.4 per cent but also with countries like Greece (24.2 per cent) and Portugal (25.4 per cent). Ireland, to make any meaningful social or economic progress, should be moving toward a higher percentage of GDP on social protection.

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23. This is an expanded version of an article published in The Irish Times on September 4, 2009

24. [epp.eurostat.ec.europa.eu/](http://epp.eurostat.ec.europa.eu/)

However, the objective of a low tax economy and the principle of revenue neutrality that lie at the heart of the Commission on Taxation can only lead to one place: a low level of social expenditure that limits Irish social development and cohesion. Further, given that revenue has dropped substantially (by over 6 billion euro since 2007), a revenue neutral scenario locks Irish social expenditure into even lower levels than the relatively poor levels of 2007. This post argues that, despite the fact that there are revenue policy choices available to the government that could increase overall revenue for social expenditure, Government has made an explicit policy choice not to avail of these policy options but to instead let those on the lowest incomes bear the brunt of our crisis. This policy choice exposes the vision of this government. Quite simply, there is no social vision.

We grew accustomed to the government mantra that Government policy is to protect the most vulnerable. However, the new mantra is that because social welfare accounts for a third of social expenditure, it must contribute one-third of the savings in public expenditure required in this forthcoming budget (€1 billion in expenditure cuts). To justify this failure to ‘protect the vulnerable’, the government is selling two myths to the Irish public. The first myth; that the level of Irish welfare is problematic, the second; that cuts are inevitable.

First, the reality of poverty has been obscured by a deluge of myths: welfare is the most generous in Europe; it does not pay to work; the cost of living has fallen, welfare soared in recent years. Every one of these myths has been endlessly exposed. OECD figures show payments to single claimants in Ireland are the third lowest in the EU15, while a family with two children gets just above the EU15 average. Welfare is not ‘high’ or ‘generous’, and if you are living on it you are below the Government’s own ‘at risk of poverty threshold’. You are not better off on the dole – not only single people, but also those with large families, get higher incomes from working (through Family Income Supplement). This is true whether they are on the minimum wage or the average wage. While the overall cost of living is falling, the things that low income families buy more of (solid fuel, public transport, childcare) are rising. If you are interested in facts there are more on [The Poor Can't Pay website](#).<sup>25</sup>

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25. [www.thepoorcantpay.ie](http://www.thepoorcantpay.ie)

The second myth involves convincing the public that there is no alternative to cutting welfare payments. This is not true. The most plausible and realistic policy alternative to welfare cuts is to raise the €1 billion euro through taxation. However, from the very start the Commission on Taxation was asked to be 'revenue neutral' and McCarthy was told not to look at taxes – or pay. Ironically, the Commission on Taxation draws our attention to the multiple instruments government has available to increase government revenue – instruments with capacity to generate as much revenue as welfare cuts would save. These include a property tax, an increase in the top tax rate for high earners, the abolition of remaining discretionary tax allowances, a policy of standard-rating pension reliefs, increases in corporate taxes and the introduction of carbon taxes. However, in the context of a principle of 'revenue neutrality' none of these become viable policy alternatives to stave off cuts in welfare.

A leaked comment from April shows that the Cabinet believes that the €1 billion it could raise from property tax is 'probably not worth the bother'.<sup>26</sup> It is true that such tax reform would not be popular and those on middle and higher incomes would find life more difficult. Clearly, taking €1 billion from welfare recipients is an easier political option, and so worth the bother.

Minister Lenihan justifies his revenue neutral principle with the assumption that the 'burden of taxation in this economy is high enough' and assumes Irish people are unwilling to pay more taxes to tackle inequality and poverty. This is simply not true. A 2009 Behaviour and Attitudes poll commissioned by TASC shows 72 per cent of adults are concerned at the level of wealth inequality in Ireland and that 85 per cent of adults (60 per cent strongly) agree to government taking steps to reduce income inequality.

Irish people care more than their ministers about the 'burden of poverty'. Let us be clear: This Government is making a conscious choice. It is declining an opportunity to raise upwards of €1 billion in revenue. If this government cuts social welfare it is because it has chosen to do so, and because it has chosen not to develop alternative revenue raising tools. The Minister should think again.

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26. Irish Times, April 19, 2009

Crude welfare cuts do not make social, practical or moral sense. There are significant economic benefits from social welfare expenditure. In the short term every penny of social welfare expenditure is spent in the economy and stimulates demand. Cutting such expenditure is deflationary. In the longer term, social welfare expenditure and broader social inclusion policies are a vital part of every successful modern economy. Decent welfare enables workers be more flexible and adaptable in the face of global economic change. A cut in social welfare cuts competitiveness, reduces social cohesion and reduces our collective capacity to fight this recession. Restoring our competitiveness, saving jobs and closing the fiscal deficit can be achieved in ways other than forcing society's poorest families into deeper levels of poverty. This is about choices. Nothing is inevitable.

## 14. NAMA, the Commission on Taxation and rent reviews: the rogue's guide to Irish finance

**AN SAOI, SEPTEMBER 28**

I have refrained from making any comment on the Commission on Taxation Report to date, mainly because of its lack of any new content and silence about many issues, in particular VAT and property-based incentives. We now know why they ignored the property tax incentives – the Government's NAMA plan is dependent on the re inflation of the property bubble.

Ronan Lyons of Daft in [an analysis of NAMA](#)<sup>27</sup> points out that rents are continuing to fall. His earlier work, the [Daft Rental Report](#)<sup>28</sup> for Quarter 2 2009 showed the degree of the fall and also suggested that there was no sign of it reaching a floor. Any Government Minister who bothered to leave the bunker and take a stroll around Grafton St and surrounds would see the effects of inflexible rents described recently in the [Sunday Business Post](#)<sup>29</sup>.

The developers also seem happy to put it up to State and NAMA. [Real Estate Opportunities \(REO\) announced](#)<sup>30</sup> that they intend to go ahead with

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27. [www.ronanlyons.com](http://www.ronanlyons.com), September 17, 2009

28. [www.daft.ie/report/Daft-Rental-Report-Q2-2009.pdf](http://www.daft.ie/report/Daft-Rental-Report-Q2-2009.pdf)

29. Sunday Business Post, September 6, 2009

30. [www.realestateopportunities.biz/News.htm](http://www.realestateopportunities.biz/News.htm)

the development of the Ballymun town centre (to be called Spring Cross, not Ballymun) and are pressing for huge loans to commence the project next year. Now REO itself is hopelessly insolvent and intends, as part of this project, to add 35,000 m<sup>2</sup> of office space to an already oversupplied market, 60,000 m<sup>2</sup> to North Dublin, which already has a surplus of shops, and 360 apartments to an area where there are thousands vacant. Now this company has debts of over €1.7 billion on its balance sheet at 30th June and wants NAMA to pony up another €800 million. A quick look at their [interim accounts to June 2009](#)<sup>31</sup> paints the picture.

Dermot Ahern announced recently that he was not now going to ban upward-only commercial rent reviews. This again is another part of the vain attempts to prop up the silly levels of rents. Commercial rents need to fall dramatically, by at least 20 per cent to ensure retail businesses survive, and perhaps by 50 per cent to enable the retailers pass on meaningful price reductions to customers. Ronan Lyons' piece in [Friday's Irish Times](#)<sup>32</sup> explains simply as to how rental changes influence valuations.

Apart from the dud loans the State has already agreed to take over, it appears that NAMA will be expected to produce money to complete half-finished projects. NAMA also parks approx. €13 billion of small developer/builder/speculator loans, which remain with the banks. It also leaves the residential landlord outside the tent. They account for approx. 20 per cent of mortgage borrowing or around €30 billion of total mortgage debt. We can only presume that the banks will be back to get help with those too, particularly as the tenants continue to disappear.

Banks, builders and their shareholders have successfully transferred all their risk to the rest of us and we will pay for it for the next fifty years.

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31. [www.realestateopportunities.biz/Pics/2009InterimREO plc final.pdf](http://www.realestateopportunities.biz/Pics/2009InterimREO%20plc%20final.pdf)

32. Irish Times, September 25, 2009

## October

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### 15. Switching market principles on/off in NAMA

**BRENDAN WILLIAMS, OCTOBER 1**

The recently announced legislation on Nama, by allowing for the potential payment of a future market recovery price for assets, departs from accepted international market value standards. The government appears likely to be successful in passing its current banking proposals, including the marking up of NAMA valuations to the newly defined long-term economic value. In a declining property market, this presents an obvious risk for the taxpayer. Among the many concerns about these proposals, the critical issue of price to be paid raises questions as to whether this approach is appropriate and equitable.

The rationale for the proposals relating to the question of asset valuation suggest that we have a non-existent or distressed market. In fact, we have a market going through a significant downward shift which many interests are reluctant to accept. Such corrections have occurred periodically through previous cycles, with upward and downward shifts a feature of any analysis of property markets, and indeed may be expected to occur again in the future.

Proposals departing from market valuations to arranged and legislation-based prices may be an exercise in expediency and hope, rather than an exercise in market reality. Admittedly, the property market is less efficient than other markets, and the cyclical nature of its operations can be argued to both overvalue and undervalue assets at various points in the cycle.

However, the previous conventional wisdom was that attempts to manage or control property market price arrangements by legislation (such as that announced) can produce unintended or perverse results and distort markets. This occurs if the natural market process, change or correction is stalled. Then, a clearance of existing stock may not occur as vendors and lessors will not accept market prices, and eventual real recovery is delayed. A functioning market, by comparison, involves participants accepting the consequences of both the upward and downward shifts in the property

cycle. Being willing to take the profits, or accept the consequences when a trade decision is proved mistimed by later trends, should be a normal expectation of market participation.

Market price or value implies that a vendor is willing to take a property to the market and accept the best current price available from a willing purchaser which represents both the existing use and future 'hope' value. In a buoyant or upward market, there is a body of comparative evidence which forms the basis for the valuation of such assets. Thus, in the recent past, we effectively had a pattern of valuations following the transactions upwards. Purchasers of housing and rental occupiers from 2000-2006 may not have agreed with this process, but effectively had no option except to follow the upward-only market price trends.

When the market turned and the trend moved sharply downwards in terms of both volumes of transactions and prices achieved, there was been a considerable reluctance by vendors, lessors, financial and market interests to accept the consequences of a declining market on price levels. A period of lower or declining prices is to be expected as the property cycle sees excess supply in the new housing and commercial sectors, rather than excess demand as in the earlier period.

This has led to the quest for alternative pricing arrangements incorporating a concept related to future market recovery price levels, rather than current market values. This concept, developed in the NAMA legislation, is predicated on the idea that sales and transactions during a weak market period caused by the recession and credit difficulties are unfair. What constitutes a fair or reasonable price sought by industry interests is unclear, but is linked to an idea of construction or development cost plus a profit or return element.

The reverse of this debate occurred during the property boom. At that stage, cyclical shortages of residential property, particularly in Dublin, drove up market prices to unprecedented levels as purchasers bid up prices on the available stock, facilitated by a surge in credit availability. Similar arguments were made that these prices were unfairly high and not sustainable over the long-term. However, at that point the accepted argument was that any form of price arrangements or temporary controls restricts supply and damages the market process. And so it was, with a

free market in price terms facilitating and providing a major boost for housing and development land prices. In recent months, the continued use of optimistic or previously hoped-for values as a basis for valuation or business plans by consultants was severely criticised in High Court rulings.

It must also be remembered that the transactions and linked loans now being debated resulted in parties within the development process receiving large payments based on these loans. The return to the market of some of these interests who sold at the peak of the market with large capital reserves may occur when they assess that the market has stabilised, assisted by the government's interventions, or when the market conditions are considered favourable. It remains to be seen whether concepts related to arranged prices and giving a 'fair' basis of involvement to other parties involved in the process will be part of the eventual recovery process.

It may be argued that the current difficulties in the Irish-owned and managed banking sector necessitate a major intervention to secure their viability. This may be so. However, it is less certain that an upward property price intervention in a declining property market should be a central component of such a solution. In addition, assessing such prices presents very considerable difficulties due to the nature of the assets concerned. Included in such assets are completed and uncompleted developments in Ireland, and internationally, across all property sectors.

Attempting to define a valuation basis, other than market value, appropriate for all categories of property is extremely difficult – if not impossible. Every property is unique, and each sector and indeed sub sector experiences a market fragmentation process during a recession. This means that, in the upward market period, there is a tendency for the rising tide to lift all locations and sectors. The converse is that this linkage is weaker during a recession. In these periods, the price falls at weak speculative locations (particularly in development land) are very dramatic, while the falls in more established locations are proportionately less. Thus, as the market fragments, establishing general market adjustments is not appropriate and market value trends will vary greatly even within the residential sector.

While we can with some difficulty establish the economic, market, planning and legal context for the property valuation of completed projects,

the situation regarding incomplete developments is obviously much more complex. For example, an unfinished mixed use development, or development land in a weak location with little evidence of future demand, begs the question – will some of these developments ever be completed, and do the assets have significant market value now or in the future?

Further complexities arise in trying to establish the potential values of assets in more distant markets, such as in Eastern Europe and the Middle East, where complex legal and other issues may arise. This leads to the conclusion that the real market value of many such assets relating to the NAMA project would have to be subject to a very steep discount from previous levels if the process is to be transparent in relation to the treatment of assets transferred.

From a taxpayer perspective, if this process must happen then it is current market valuations and not a possible future price which should form the maximum basis of the valuation process. In fact, in the real market where a single purchaser is negotiating to purchase a complete package of impaired assets, a significant reverse premium or lower combined price than that assessed for individual assets would be negotiated.

In organising such interventions, a variety of forms of joint ventures and risk sharing arrangements exist and are used internationally in terms of property development project arrangements. The two central elements which emerge from any study of this area are negotiated risk sharing and staged payments structures. This normally involves only part of the current market valuation being paid up front. As this NAMA proposal is effectively a joint venture with the taxpayer as the reluctant partner, the second part of the payment representing the shared risk can be based on the remaining element of market value and/or agreed shares based on the uplift in future value when (and only if) this is achieved. This would represent a future incentive element for the financial institutions at completion of the NAMA process.

In addition, if we are to have a transparent process, the publication of details relating to the precise assets involved, valuations and the transactions or evidence base upon which such assessments were made is essential.

## 16. Green new deal – The neo-classical empire strikes back

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JOHN BARRY, OCTOBER 2

Over at Irish Economy, Richard Tol has attacked the [Comhar Green New Deal Report](#)<sup>33</sup>. What I particularly enjoyed about it, and found revealing, was the evident display of self-confident ‘expertise’ and ‘authority’.

To cite an example, Richard Tol opines that “Most experts reckon that the transition to a low-carbon economy will take 50 years (give or take a few decades)” – but sadly, we’re not told which experts, or that there is a world of a difference between using reformist, orthodox economic tools to encourage the transition to a low carbon (a gentle greening of ‘business as usual’) and what ought to be done to secure energy security, detox from fossil fuels and combat climate change. The comfortable and comforting assumption which runs right through Richard Tol’s analysis (and one, of course, shared by other orthodox economists) is that politics does not enter the equation and the most we can hope for is a ‘market-led’ transition to a low carbon economy.

Of course, not even all neo-classical economists shares this view – take Nicholas Stern’s view on the economics of climate change. [In a recent report](#)<sup>34</sup>, for the German Foreign Ministry, for the G20 summit, he stated that G20 members should “initiate and extend programmes that provide loans to home-owners and small and medium-sized enterprises for boosting energy efficiency in buildings”, and “undertake investments in electricity grid upgrades and extensions, public transportation, integrated freight transport systems and carbon dioxide pipelines for carbon capture and storage projects”. Failure to do so threatens global sustainable growth in his view. This report builds upon a previous [report](#)<sup>35</sup> by the London School of Economics’ Grantham Institute for Climate Change the Environment – ‘An Outline of the case for a ‘Green’ Stimulus’, which based its analysis using the IMF’s assesment that macro-economic stability and recovery required

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33. [www.irisheconomy.ie/index.php/2009/10/02/a-green-new-deal-for-ireland/](http://www.irisheconomy.ie/index.php/2009/10/02/a-green-new-deal-for-ireland/)

34. <http://www.lse.ac.uk/grantham>

35. <http://www.lse.ac.uk/grantham>

state stimulus packages, and provides empirical as well as theoretical evidence that spending is superior to tradition tax cuts.<sup>36, 37</sup>

Later in his post, without any supporting evidence, we are told “Green New Deal would raise the price of energy and keep labour taxes higher than needed, the economic recovery is slowed down and jobs are destroyed”, but the point of any GND would be to shift taxes from labour to carbon emission – something, of course, outlined in the report from the Commission on Taxation recently. And the whole point of the GND is to jump-start this transition because it makes long-term economic, ecological and energy security sense.

Why I enjoyed this post so much, and why I'll be using it in teaching students about the ethical underpinnings of any theory of political economy, is the following: “I would argue that pension funds should provide pensions, and to that end they need to invest in whatever gives the highest risk-adjusted return, regardless of whether it is green or blue or yellow.” – would that extend to investing in countries or companies that abuse human rights? use child labour? use slave labour? or engage in any number of ‘race to the bottom’ cost-saving measures which raise ethical objections? Neo-classical economics is as political and ethical as any other form of economics, to pretend it has a monopoly on what the economy is, and on how we should conceptualise economics. This is best expressed in the way neo-classical economists think and assume that their conception of the economy is not only the only ‘real’ one, but sets the standard and indeed ‘grammar’ by which ALL other forms of political economy should be judged. Ideological hegemony or what?

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36. Hemming, R, Mahfouz, S, and A Schimmelfennig (2002): ‘Fiscal policy and economic activity during recessions in advanced economies’ IMF Working Paper 02/87, May

37. Hemming, R, Kell, M, and S Mahfouz (2002): ‘The effectiveness of fiscal policy in stimulating economic activity – a review of the literature’ IMF Working Paper 02/208, December

## 17. Will there be a NAMA for personal debt?

STEPHEN KINSELLA, OCTOBER 21

No. The National Asset Management Agency, NAMA, is designed to remove the ‘impaired loans’ generated by excessive lending to the construction industry. NAMA will exchange bonds, backed by the taxpayer, for these impaired loans. The ECB will exchange the bonds for cash, injecting liquidity into the banking system and, [so the story goes](#)<sup>38</sup>, getting banks lending again.

I don't believe that NAMA in its current form will get banks lending again. Even if NAMA's critics are 100 per cent wrong, and NAMA succeeds brilliantly, bankers know that another set of ‘impaired loans’ are on the way, and so banks won't lend into the ‘real’ economy – to businesses and households – at reasonable rates of interest, because they expect that householders will begin to default en masse. NAMA will fail in its primary objective of ‘getting the banks lending again’.

When interest rates go up, as the European economy recovers, many households now barely making their monthly mortgage repayment will find themselves having to restructure their mortgages, or default entirely. What's going to happen when thousands of homeowners throw their keys back over the bankers' desks?

Banks, through the courts, have a set of procedures for dealing with the painful processes of individual mortgage defaults. There is no process for dealing with hundreds, and perhaps thousands, of mortgage defaults in a short space of time. Banks will be left with large swathes of bad debt, and will come looking for taxpayer assistance again if they can't raise funds on the interbank market to cover their losses. We will be back to square one, needing a NAMA II.

### Why?

Like banks, individual households are highly leveraged, meaning the ratio of their debt to their equity (for most people, their home) is large. The

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38. National Asset Management Agency, NAMA Prospective Business Model, Dublin 2009

recent [Law Reform Commission report](#)<sup>39</sup> puts the ratio of household debt to disposable income at 176 per cent. Just for this reason alone, the probability of large-scale household default is very high. There are, however, other reasons to be concerned about household debt.

First, the current level of mortgage repayment is low, because of historically low ECB interest rates. Mortgage repayments must, as I've mentioned, rise as the EU economy improves in the coming eighteen months and the ECB increases interest rates.

Second, the Central Bank forecasts unemployment to rise to 14 per cent, and perhaps above 14 per cent, in 2010. More and more households will therefore be unable to meet their mortgage payments.

Third, a recent study by [David Duffy](#)<sup>40</sup> of the ESRI puts the number of homes in negative equity at 196,000, implying a large pool of potential defaulters.

To get a very rough sense of the scale of the problem, multiply the 196,000 homes in negative equity by the [average mortgage price](#)<sup>41</sup> of a home today, around €235,260. We have €46,110,960,000 of potential bad debts for banks, just from this pool alone. €46 billion. If even 15 or 20 per cent of those homes, and only those homes, default, we will have another banking crisis, because banks won't have the capital to absorb so much bad personal debt at once.

Will there be a NAMA II for personal and household debt? Can banks and the government devise a formula to forgive part of the principal for homeowners, and absorb the losses partially through a combination of blanket restructuring, debt-equity swaps, swift personal bankruptcy processes, and refinancing? I don't think the combination of financial and regulatory innovation under political pressure is beyond our leaders, but it does seem like a lot to ask for, considering the NAMA I money will be well and truly spent in 18 months' time, and Ireland's national debt may be as high as 120 per cent of its national output.

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39. Irish Times, September 23, 2009

40. ESRI, Working Paper No. 319, October 2009

41. Permanent TSB / ESRI House Price Index, December 4, 2009

## November

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### 18. Why is the rest of the world out of step with Ireland?

**MICHAEL BURKE, NOVEMBER 5**

Ever have one of those moments when you just know everyone else has got it wrong and you've got it right? When you say, I don't care what the fashion is, showing off your brand of boxer shorts in public is plain daft? Well, have some sympathy then for those faced with the tricky task of formulating Ireland's economic policy. Everyone else may be going round recklessly attempting to reflate their economies, but you won't catch the leaders of Ireland's current economic direction doing that. Oh, no.

The arguments against reflation are that we are in a crisis (so is just about everyone else); we can't afford it, our deficit is ballooning (ditto), we are in the Euro (along with 15 other economies), we are an extremely open economy and stimulus will just stoke imports (so is Belgium), our debt is headed to 100 per cent of GDP (ditto, along with others), and our pay rates rose during the boom (as they did generally, so that Ireland is a middling Euro Area economy as far as relative pay rates are concerned).

Now, when outside observers don't chime with the Irish consensus, like Stiglitz they are labelled mavericks (unlike Roubini, who hadn't read the NAMA proposals) or David Blanchflower, who according to Philip Lane is [offering prescriptions](#)<sup>42</sup> that might work elsewhere but do not apply to Irish conditions.

The latest observer to fall into this trap seems to be veteran commentator Martin Wolf. Writing in the [Financial Times on November 3](#), on Ireland and others, he noted that "the deterioration in the fiscal position is a result of the cutback in the private sector's spending, not a cause of it. Not surprisingly, the fiscal deterioration is also biggest where the private sector has cut back most: in the post-bubble economies".

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42. [www.irisheconomy.ie](http://www.irisheconomy.ie), November 3, 2009

And, “Of course, governments could have tried to tighten fiscal positions in the teeth of the crisis. All that would have done is turn the recession into a depression. As a result, they would also have transformed part of the structural fiscal deficit into a cyclical one. This might well have lowered the private sector surplus, but only by destroying private income even faster than spending. This would have been a monstrous blunder. In a world in which the private sector is driven towards austerity, as now, governments must offset this behaviour, not reinforce it.”

This commentary is not mere rhetoric. Governments across the world have taken, and are continuing to take, steps to reflate their economies. The latest one is the new Rightist government in Germany with a rolling programme of tax cuts equivalent to 1 per cent of GDP, which follows previous measures equivalent to 3.3 per cent of GDP. Another government of the Right in France announced at the end of September a “Grand Loan” scheme to finance huge infrastructure projects amounting to €35 billion over two years. This will probably prove more effective than the German measures, as they tend to raise trend productivity and lower real wages. But both have said they will not attempt to bring the budget deficit below 3 per cent of GDP before 2014.

Against this, it is argued that Ireland must meet the deficit target in 2013, or it will face the wrath of the European Commission. But, how to justify picking on Ireland, when the leading economies have no intention of meeting the target by then? Alright, but the bond market will definitely take fright with deficits ballooning. Yet benchmark yields were unchanged after both the French and German announcements.

Even so, Ireland is not France or Germany. We are a small very open economy (our import bill is over 80 per cent of GDP), more easily pushed around by the Commission, with a public debt level spiralling towards 100 per cent of GDP. Well, so is Belgium. And it did come under pressure from the Commission for fiscal consolidation. Probably now regretting its own acquiescence in the light of the French and German announcements, the (Right-leaning coalition) government in Belgium responded with an increase in taxes on those that had been supported by rescue packages or those who are doing well during the recession (banks and insurers in the first case, energy producers in the second).

In not a single case is the policy of competitive wage cuts being adopted, even though, in every case, the size of the public sector is relatively greater in the rest of the Euro Area than in Ireland. And there is a reason for that.

As Martin Wolf says, that would have been a monstrous blunder.

## December

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### 19. Using the recession as an opportunity for Irish economic development

**TOM O'CONNOR, DECEMBER 17**

The ESRI expects national income GNP to fall by 9.4 per cent overall in 2009, and by a further 1.8 per cent in 2010, with growth returning in the last quarter of 2010. Accompanying these drops are falls in investment of 15.5 per cent in 2009 and 30.5 per cent in 2010. The ESRI prediction of a return to growth at the end of 2010 is consistent with Brian Lenihan's statement that, at the end of 2010, we will have turned the corner economically.

There is a dangerous complacency about these projections. Firstly, it is hard to see how growth will resume at the end of 2010 when the fall in investment is double what it was in 2009. The €4 billion taken out of the economy next year, given that it is in wages and social welfare, is likely to have the effect of taking €8 billion in spending power out of an economy which is also predicted to see investment fall by a massive 30 per cent.

The more likely outcome for 2010 is that GNP growth will not resume in the last quarter, and the outturn for the year is likely to see GNP fall by 4 per cent. The figure of a 30 per cent fall in investment would signal that there is no real expectation that the banks will start lending strongly in 2010. In fact, this has been strongly hinted at by senior bankers themselves.

As a consequence, we are unlikely to see live register unemployment fall below 400,000. The danger here is that, with combined business investment falls of 45 per cent over 2009 and 2010, positive investment may only start

in 2011 from a position where it has been going backwards for two years. This will delay significant reductions in unemployment, as existing and new businesses are starved of cash.

Prof. Patrick Honohan of the Irish Central Bank told a Dail Committee yesterday that the banks would need further capitalisation. He wasn't prepared to put a figure on this, or state whether it would be a 50 per cent ownership by the state or more. It is believed by many that the banks will need another €9 billion, and that this will come from the National Pension Reserve Fund.

The Bank of Ireland and Allied Irish Banks have been recapitalised by €7 billion to date. This is written down as an 'investment' by the NPRF in the banks. A further investment of €9 billion would leave €5 billion in the National Pension Reserve Fund. This capital injection is seen as the final intervention to fully stabilise the banks.

As a result of the choreography needed to put NAMA and recapitalisation in place, money will not start to flow; this underlies the ESRI projection of a 30 per cent fall in investment. In the meantime, there are viable investment opportunities available which will not happen unless a new source of investment is found.

There are about 350 incubated companies at the moment, mainly in the high knowledge area, and the government has been pouring (and continues to pour) €1 billion a year into them from exchequer funding. There are over 10,000 researchers, including PhDs, working here.

13 companies were 'spun out' as fully fledged trading companies. However, once they are spun out, they are at the mercy of venture capitalists to secure capital. This restricts their growth to employing only about eight people per company, as they need to grow slowly, resulting from venture and other capital investment in them as businesses – which is far too low. Indigenous small high-knowledge companies of this type are either kept small, or else bought up by huge global companies who can then make handsome gains on the research and development that was paid for by the Irish state.

This then further weakens our indigenous company base, and makes us more and more susceptible to global economic shocks where global

companies shut down and set up elsewhere. It also involves a knowledge-stripping of Irish companies which the Irish taxpayer has paid for, delivering the innovation profits to companies based in New York or elsewhere. This may make a handful of Irish entrepreneurs immensely wealthy overnight after the takeover of one of these Irish companies, but it delivers poor returns to the country.

Paradoxically, given the recession, we have an opportunity to try to redress this problem to some extent. If the Irish government were to use some or all of the €5 billion left in the National Pension Reserve Fund to spin hundreds of high knowledge companies onto the market with sufficient capital to allow them to become large players rather than fledgling ones employing less than 10 people, a significant opportunity for long-term sustainability of Irish-owned high knowledge companies could be created for the first time.

Fledgling companies are currently bought out by huge global companies because they are too small to survive, despite their excellent business ideas. They do not have the economies of scale to compete seriously. The government now has an opportunity to spin out large companies with a substantial capital and asset base to allow them to compete on their own on international markets.

These in turn, within a reasonably short period of time, can employ hundreds of workers each at the very least, and become internationally sustainable. In turn, this would contribute to an improvement in our balance of payments as these Irish companies would not engage in either transfer pricing or profit repatriation, which most of the large global Trans National Corporations do.

The alternative to not investing significant resources from the NPRF, and generating significant employment creation, is that most of the 10,000 researchers, including PhDs, will continue to do more post docs as they do now, or emigrate; there will still be only a trickle of a dozen, or less than 20 companies at most, which will be spun out into the market, and because of their small venture capital funding and small size they will employ less than 10 people – and then get taken over by TNCs who will reap the benefits of years of Research and Development which will have cost the state up to €3 billion. Thus, the Irish state acts as a nursery for global

capital. Once knowledge has been harvested, these companies may then locate elsewhere.

A plan of this nature could create thousands of jobs. It would create sustainable employment and start the process of making Ireland a leader and not a follower. It would be attractive to all social partners, benefitting workers and entrepreneurs. It would also give the country an opportunity to start breaking the high-risk twin dependency on both construction and global capital.

Global companies will always play a huge part in Irish economic development, but we need to start the process of taking control of our own economic affairs. Through large Irish companies, in high-knowledge areas going forward, such as sustainable energy, biomedical, telematics and food, we can start to insulate the country from the economic shocks which cause recessions. In this way, the current recession can be used as an economic opportunity.

## 20. Hunter commentators and the vanity of ignorance

**COLM O'DOHERTY, DECEMBER 17**

It's true, every cloud has a silver lining. The ongoing political crisis - stemming from the failure of politicians to increase social well-being in a period of economic growth and then reducing the well-being of vulnerable groups - creates an opportunity for hunter commentators in the media to "kill" those who stand in the way of the hunters.

As Bauman points out in *Liquid Times* [insert footnote: Zygmunt Baumann, *Liquid Times: Living in an Age of Uncertainty*, Polity Press, Cambridge 2007], hunters are unlike gardeners, not interested in social order or social progress. They are the economists whose sole task is another kill or financial coup big enough to fill their game bags to capacity. It is not their duty or responsibility to make sure that the forest or society is looked after and replenished. In fact, as one of their ilk declared yesterday in the *Irish Times*, it's not their responsibility to know anything about how society works – it's not her worry [...]

The culture of hunting in our society is very strong, and commentators receive their license to hunt from a media/ political establishment that likes to hunt in packs. It stands to reason that, in a world populated mostly by hunters, ignorance of the consequences or realities of individual actions becomes a source of pride or vanity. The 'I don't know what happened, I only want it fixed' attitude is an abdication of responsibility and a badge of honour for hunters. Yes, hunters do vote, but presumably they vote without taking any responsibility for how things pan out. Through their hunter-commentator platforms they provide perfect cover for the politicians who have run the country into the ground.

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