The Crisis of the Economy

Paula Clancy

Saturday 11 September 2010

Desmond Greaves Summer School

It is now almost a truism certainly among progressives to say that the crisis of the economy is first a crisis of society. So we have to start with the question: what kind of society do we **want?**

The Irish constitution actually sums up the answer close to perfectly.

It promises to ...*pursue the happiness and prosperity of the whole nation and all its parts, cherishing all the children of the nation* ***equally*****.**

Over the last 30 years, however, the idea that creating a society of equals is neither compatible with economic prosperity, nor even socially important, has instead carried all before it.

It is a view that was most memorably articulated by Michael McDowell, but Tony Blair comes a close second. In 2005 he said "*... I don't care if there are people who earn a lot of money. They're not my concern. I do care about people who are without opportunity, disadvantaged and poor".*

So economic inequality has never actually been on the agenda - even though there is very strong evidence that it does matter. In the much discussed *Spirit Level*, Richard Wilkinson and Kate Pickett have conclusively shown that adverse outcomes like ill-health, homicides and imprisonment occur much more frequently in unequal societies. We also know from people like Stiglitz and Fitoussi that, since 1980, income inequalities surged in most advanced countries. The median wage stagnated while high incomes took off.

And we know that widening economic inequality played a large part in causing the current international and national economic crisis.

Emmanuel Saez's 2009 work *'Evolution of top incomes in US'* shows the coincidence of widening inequalities with the crashes of 1929 and 2007.

Finally, it is the more equal societies across Europe which have weathered the crisis best. Countries likes Sweden, Denmark and Norway, which have high-tax, high-benefit welfare systems, have been able to use these as stabilisers to their economies.

So let's bring this analysis back to the Irish context. Economic equality hasn't figured on the political agenda here. Throughout the boom, inequality in Ireland remained relatively high. Although not the worst performer, using standard OECD comparators we are below average. Five percent of the population control 40 percent of Ireland's wealth. The top ten percent have a disposable income 11.4 times that of the bottom ten per cent.

What we were promised, of course, was an ever-bigger economic pie through constantly increasing growth. Sure, this would make very large fortunes for a few ... but also a reduction of poverty and a better standard for all.

But the atomised focus on economic growth did not lead to a better life for all. It's true that the incomes of most people rose above inflation. But for many, other factors - like high inflation in the private housing sector - eroded any gain.

And while absolute poverty did decline as employment, pensions and child benefit and other payments increased, even at the height of the boom – 2007 – a recent ESRI study shows that 16 per cent of us were at risk of poverty**.** The reasons, of course, are clear – Ireland followed the low tax/low spend model.

Ireland's level of tax receipts is around 10 percentage points lower than the E.U. 15 average.

And, following logically from this over the period 1995 to 2008, Ireland, at 34%, had the third lowest average level of public spending in the OECD. Ireland was in fact in the last three, falling behind UK and US. This has to be viewed in the context that Government expenditure in advanced countries typically accounts for between 30% and 60% of GDP – Sweden is the highest at 59%.

It is true that this comparatively low level of public spending in Ireland was, at least in part, because of low social welfare spending. We had full employment, and our demographics meant fewer pensioners. And we also had low debt interest repayments and defence spending.

However, we also failed to use these factors to allow us to invest adequately in any number of socially desirable ways - on health, or education, or poverty reduction, or childcare.

Neither did we use it to lay down a basis for a sustainable industrial development trajectory. For me, the most compelling indictment of the economic orthodoxy of the last 15 years came in a Davy stockbrokers report published some months ago. It shows Ireland's failure to invest in 'core' productive infrastructure. A failure that has left us much poorer than comparable EU countries who had nothing like the same income.

Keynesian economists argue that during periods of strong economic growth, public spending should be maintained at a lower level than the level of incoming revenues. The reason for this restraint is to allow enough funds to be built up, so that future negative shocks to the economy can be countered without severely damaging the public finances.

We, of course, didn't do this either.

And then the crisis hit.

The Irish recession turns out to be one of the worst in the industrialised world.

The latest CSO figures show a technical return to growth, but the IMF and the OECD are less sanguine – certainly it will be slower than elsewhere. Any return to growth we do have is largely driven by multinational companies and exports will have little impact on living standards. Irish output contracted by about 10 per cent over 2008-2009 – primarily in domestic consumption and investment.

Unemployment is running at nearly 14% and all the signs are that we have major structural problems in the labour force, while the international evidence indicates that growth this year will be largely jobless.

One recent study of about 100,000 companies has shown that 36 per cent are considered to run a high risk of failure in the near future. This is partly, of course, because of the 1,123 companies that went into liquidation this year and have left behind some €1billion of unpaid debt.

That's the backdrop…so what now?

Much has been said about the political opportunity presented by this latest crisis of capitalism. How conditions will never be better to make a radical shift in the way we think about our society, and about how we can now embrace an alternative – a flourishing society where a prosperous economy goes hand in hand with economic and social equality and a sustainable environment.

But it is becoming worryingly clear that the now very obvious failures will not lead automatically to the adoption of a radically different alternative

If anything, we are facing fundamental attacks on many of the gains hard won in previous decades: minimum wages; levels of unemployment benefit; child benefit; pensions etc. The *'we are broke'* mantra is threatening to trump all other considerations. It's a mantra which easily lends itself to propaganda and manipulation – and which can give rise to fear or desperation.

And there is plenty of reason to fear. Because of the massive increase in the unemployment rate and the collapse in GDP itself, public expenditure is set to escalate dramatically as a proportion of GDP. The IMF forecasts that Ireland will experience the largest increase in the government expenditure/GDP ratio of any OECD country.

And now we have to factor in the cost of the banking crisis, which is being absorbed into the exchequer deficit. To put this cost in context, the money that has gone into Anglo and Irish Nationwide means that it is now the fourth largest expenditure item in the public finances, after health, social welfare and education. €4bn will be spent each year for the next 10 years.

Where do we go from here?

So how do we respond to this crash, and how can we use the opportunity it presents to further the equality agenda and (at the very least) prevent its further erosion in the immediate future?

It seems to me that there are at least three things we need to do:

- We need to win the ideological argument about the assumption of a negative relationship between economic growth and equality
- We need to effectively address the 'we are broke and can't afford equality' argument
- And we have to at the very least hold the line to protect the public services we do have, particularly the universal elements

Let us take the first of these - the need to take on what is essentially an ideological argument about the supposed trade-off between economic growth and economic equality.

The assumption of a trade-off follows from the argument that more income equality requires higher levels of public spending. Higher public spending means higher levels of taxation, and higher levels of taxation will reduce investment and harm enterprise.

But there is as much evidence in the economic literature of a positive relationship between economic growth and spending as there is of a negative one. The relationship seems to depend on where that spending is actually directed. For example, expenditure on education is positively related to economic growth in the long term (although not in the short term).

Certainly the Nordic countries are an example of successful economies. In these countries high levels of productivity and economic growth are entirely compatible with high levels of public spending and high levels of taxation

Second, even if we win the argument that equality is a good idea in principle, we also have to take on the *'we are broke and we can't afford it right now'* line.

There is, of course, no denying the crisis in the balance between state expenditure and revenue.

But it's a crisis that requires a radically different fiscal framework to the one being pursued. The annual budgetary process provides us with the opportunity to do this. The budgetary process is central in setting out the parameters of public expenditure, investment and taxation - and the budget also plays a significant role in the organisation and distribution of society's resources.

In advance of Budget 2011, we in TASC are working to provide the evidence that will support a different set of economic choices, if there is the political will to take them. These choices, if taken, could put the economy on the road to recovery, while also starting to address the high level of inequality that exists in Irish society – economic and equality objectives are not mutually exclusive – even in times of crisis.

Third, and linked to the last point, we need to broaden out the discussion of economic inequality. Economic inequality is not purely a function of income inequality. Rather, it is determined by a range of factors - asset ownership, wealth, taxation, costs. And, critically, availability of and access to public services.

This last is an area which is under extreme pressure and will be again in the budget this year. Last year, starting in the run up to the budget, we had the attack on child benefit . This year, in recent weeks, we've seen proposals for the introduction of workfare – as though the problem was the unemployed, rather than unemployment. Then there are the ongoing battles about fees for third-level education, while leaving untouched state support for fee-paying second level education. Before that, we had the row over medical cards for the over 70s, now switched to kite flying about a reduction in the old age pension. And both of these while leaving relatively untouched the two-tiered approach to health and to pension provision.

Against this background, I think it is really important to restate the link between universal public services and equality. While egalitarians generally favour free access to public services, some think this policy to be ultimately counter-productive. The contention is that free access primarily benefits the middle classes. The middle classes for various reasons, 'work' the system better. The fact that we know that there are thousands of people who earn in excess of €100k who pay no income tax is proof of the capacity of those who earn high incomes to work the system. Nonetheless, *universal access* to free public services and benefits, as practised for example in the Scandinavian model, actually does significantly promote equality.

In fact, the greater the universality of access to free public services and benefits - the greater the redistributive effect. The universal system of cash benefits (especially pensions) reduces income inequality, and the universal system of free public services promotes the more long-term aim of reducing inequality in life chances.

This works because, first, the empirical evidence indicates that - where the services on offer to the poor are of adequate quality – the middle classes find way around tighter means-testing in order to avail of them. Second, means-tested benefits and services stigmatise, and thus deter those who need them from using them.

There is a sense that services for 'poor people' are generally poor services. The fact that middle and high income groups access universal public services makes it easier for low-income groups to retain a sense of dignity when accepting welfare benefits. Third**,** the universality debate is not merely about hard statistics - costs, take-up and outcomes. Swedish political scientist Bo Rothstein argues that institutions and public policies which treat all as equals create generalised trust and trust is a key characteristic of more equal societies. Fourth, universality gives middle and higher income groups a sense of tangible benefit from the taxes they pay, and therefore a motivation to defend the survival and quality of public services when they come under threat.

This kind of *'enlightened self-interest'* is consistent with the preferences of Irish householders.

A 2005 study (Delaney and O' Toole (2005) found that lower income adults were more in favour of government expenditure overall than those on higher incomes. More specifically, those on higher incomes were particularly less in favour of social welfare expenditure. Higher income earners were, however, much less hostile to education spending.

Conclusion

The challenge is to how all this information can be transformed into policies that generate political support and concrete and measurable change.

I think there are a couple of encouraging signs – notwithstanding, the seemingly overwhelming and unstoppable direction of current government strategy.

Every year in the annual TASC Equality Survey, we ask people how concerned they are about income inequality. The 2010 survey results show that 8 in 10 people are now concerned about economic inequality.

And many want the state to take an active role in doing something about it.

The second encouraging sign, and perhaps the more tangible one, is that there is a growing appetite among progressive NGOS, campaigning organisations, trade unions and political activists to mobilise behind a common agenda. I see more efforts to link specific issues and organisations behind a drive to create a compelling macro-economic case for organising our economy and society along radically different lines.

Generating this macro-economic case is in fact what TASC was set up for and what it is trying to do, and the fact that we are now getting support – financial and in other ways - is encouraging. But it remains a big challenge. One with no assurance that even working collectively we will make any difference.

There are many reasons for this. Lack of resources is one, the fact that Ireland's political culture is a difficult nut to crack is another – and, of course, even successful efforts take time to bear fruit.

Nonetheless, we need to do much better, faster. As the clock ticks down towards a change of régime, it is imperative that we as progressives work to ensure that the new régime is worth the change. It is almost inevitable that it is the Nordic countries that provide some kind of guide for us to follow.

Three of the four Nordic countries have right or centre-right governments currently in office, just as we do. The exception is Norway. Norway changed its right-wing government five years ago and elected a centre-left/left coalition. To do this, they had to go back to the grassroots and build a new consensus. It was a consensus based on the participation of NGOs, trade unions and the progressive parties...

And despite, (or perhaps because of), being the most radical and progressive government in recent decades, last year it was the first Norwegian government to be re-elected in almost 50 years. Now, the same political forces have mobilised in Denmark, Sweden and Finland. The result is that a progressive coalition programme has been (or is about to be) finalised in all three countries. And there is a good chance that they will be electorally successful. Even if we were to set ourselves more modest objectives, surely that must be a lesson for us here in Ireland.

ENDS