

A Sustainable Growth Model for the Irish Economy

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Introduction

- What Drives the Economy?
- Understanding what is actually going on
- Paths to Recovery
- Strategic Issues

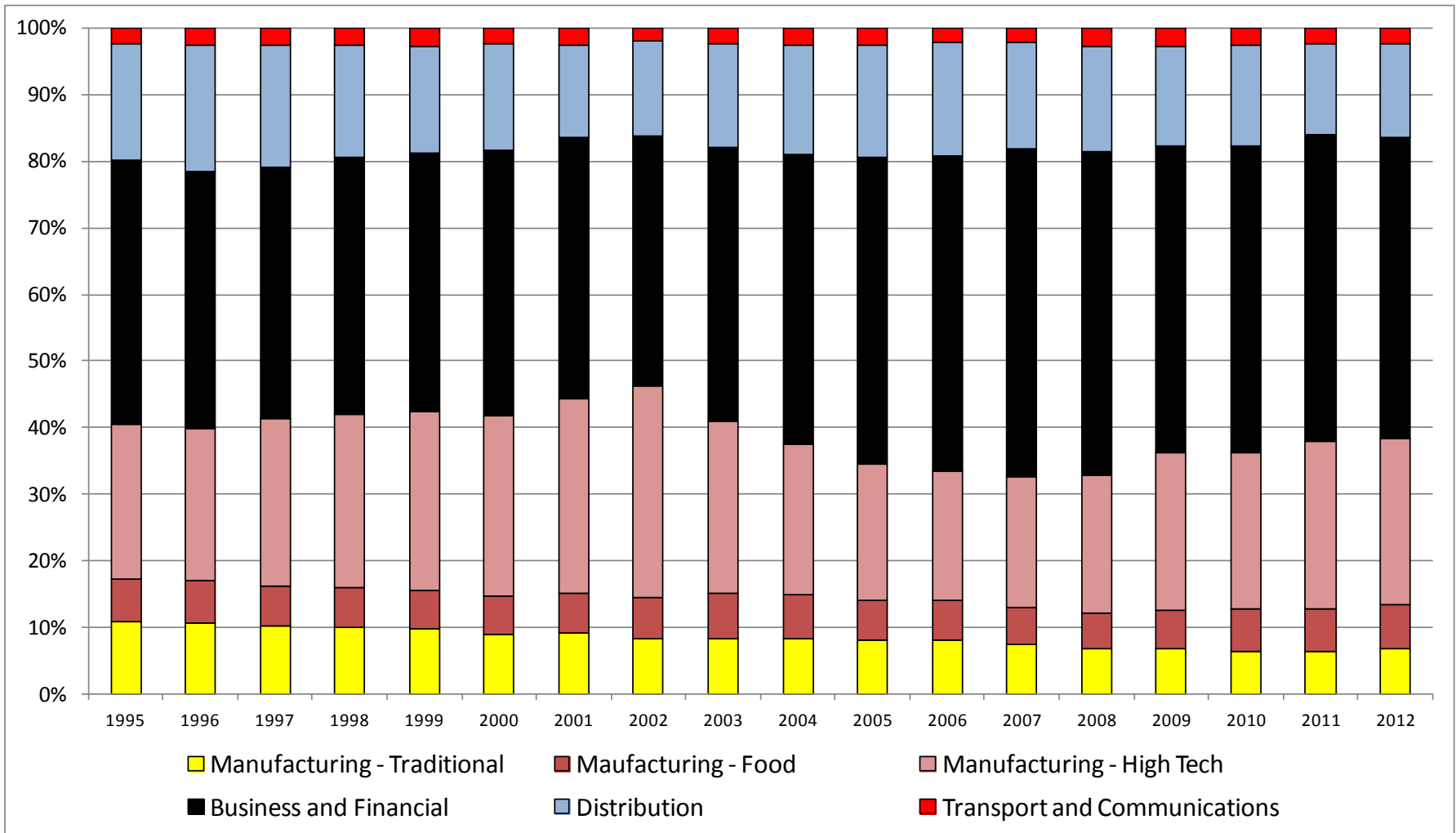
What Drives the Economy

- Is it broke or is it working?
- Tradable sector:
 - Manufacturing & Business & Professional Services
 - Ireland's Share of World Output
- The Labour Market
 - Market Clearing in long run
- Consumption and Housing Market
- The Public Sector
- The Current Account

Is Tradable Sector Broke?

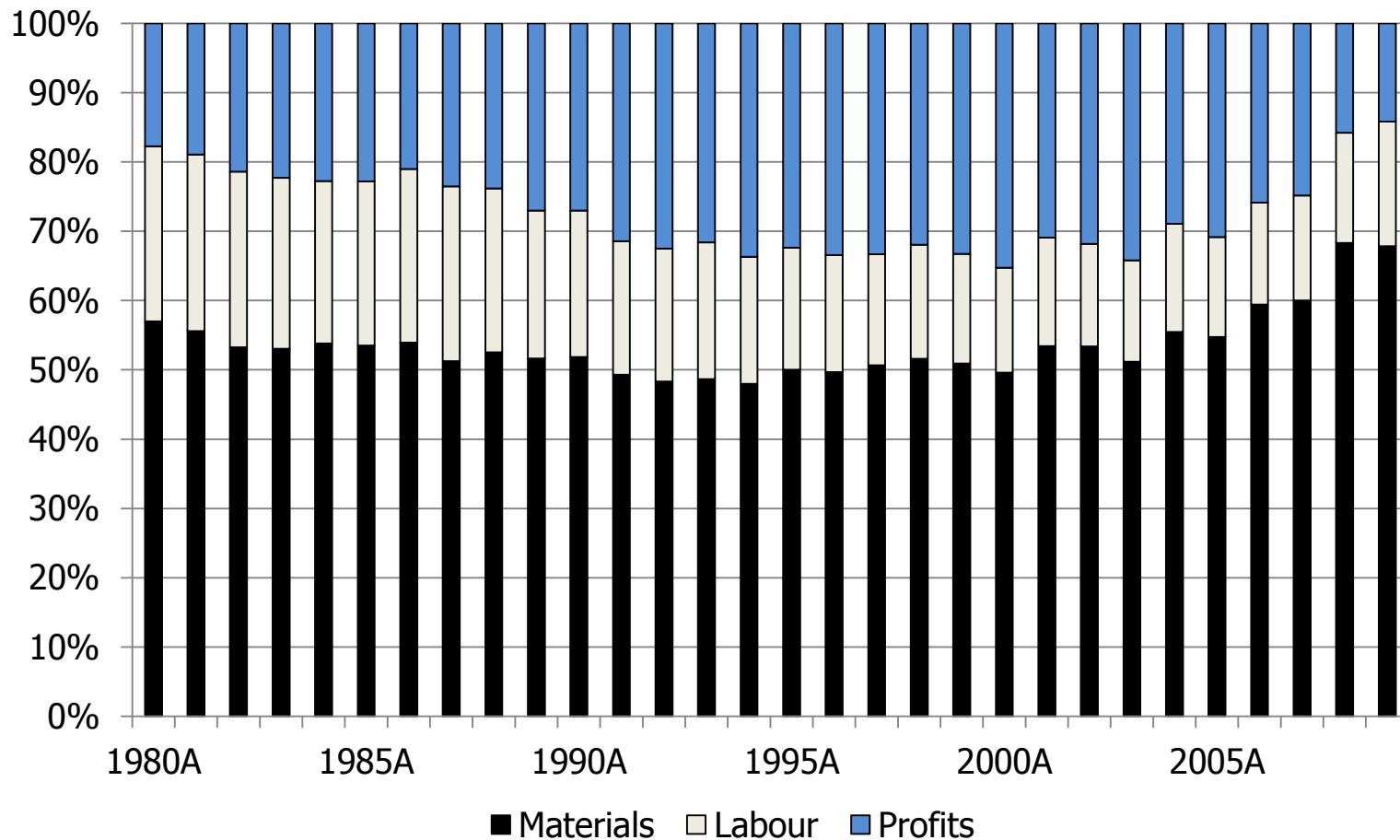
- Tradable sector has had quite a good crisis
 - Highly leveraged on world growth – the US
 - Competitiveness matters – to value added
- Tradable sector expanding in scope
 - All of services has a big tradable component
 - Exports of services exceed exports of goods
- Effects of indebtedness
 - Takes time to deleverage; Growth would speed it
- A broken banking system
 - So far not an obstacle – could become one

Tradable Sector: GVA



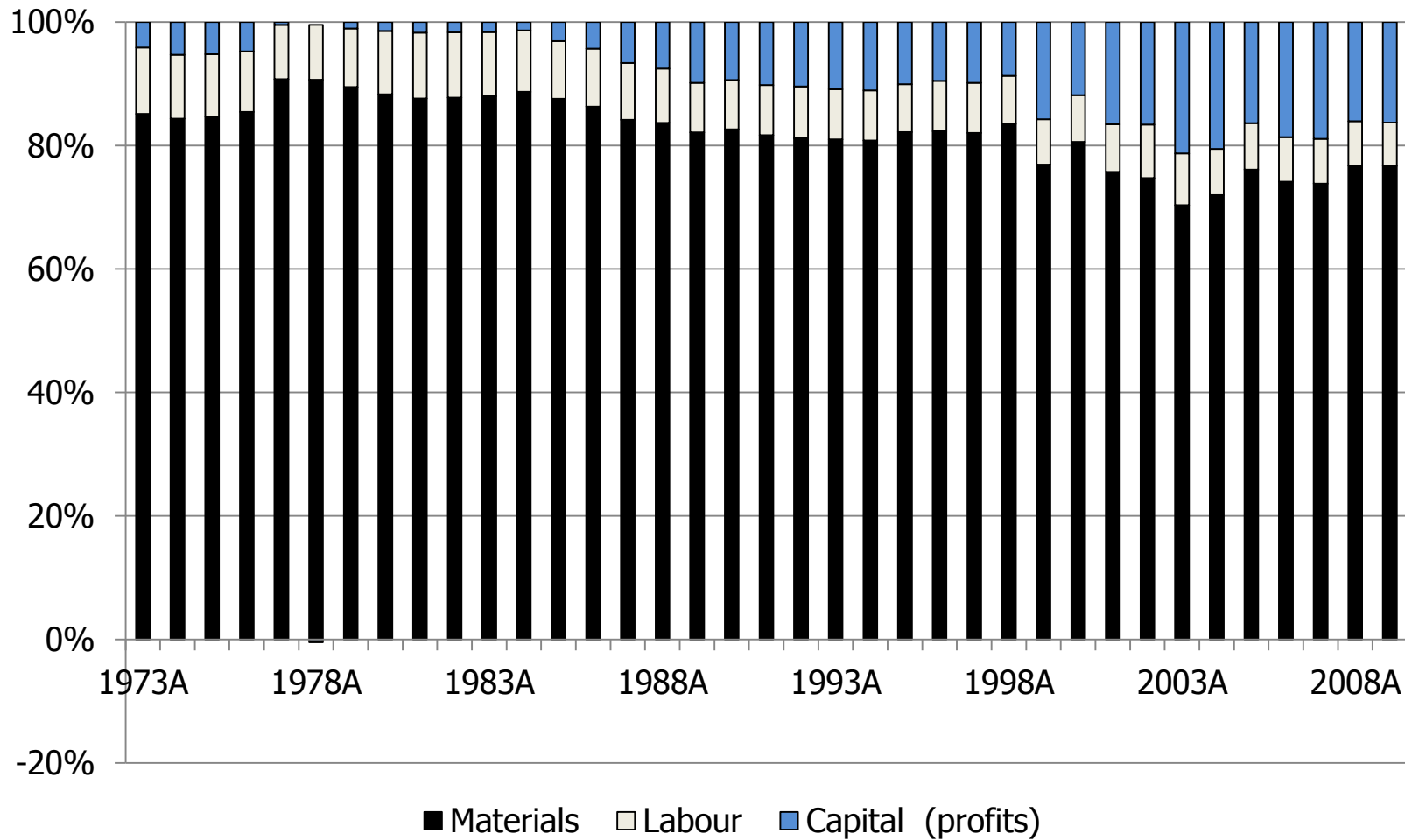
Traditional manufac. : Factor shares

Factor Shares, Traditional Manufacturing



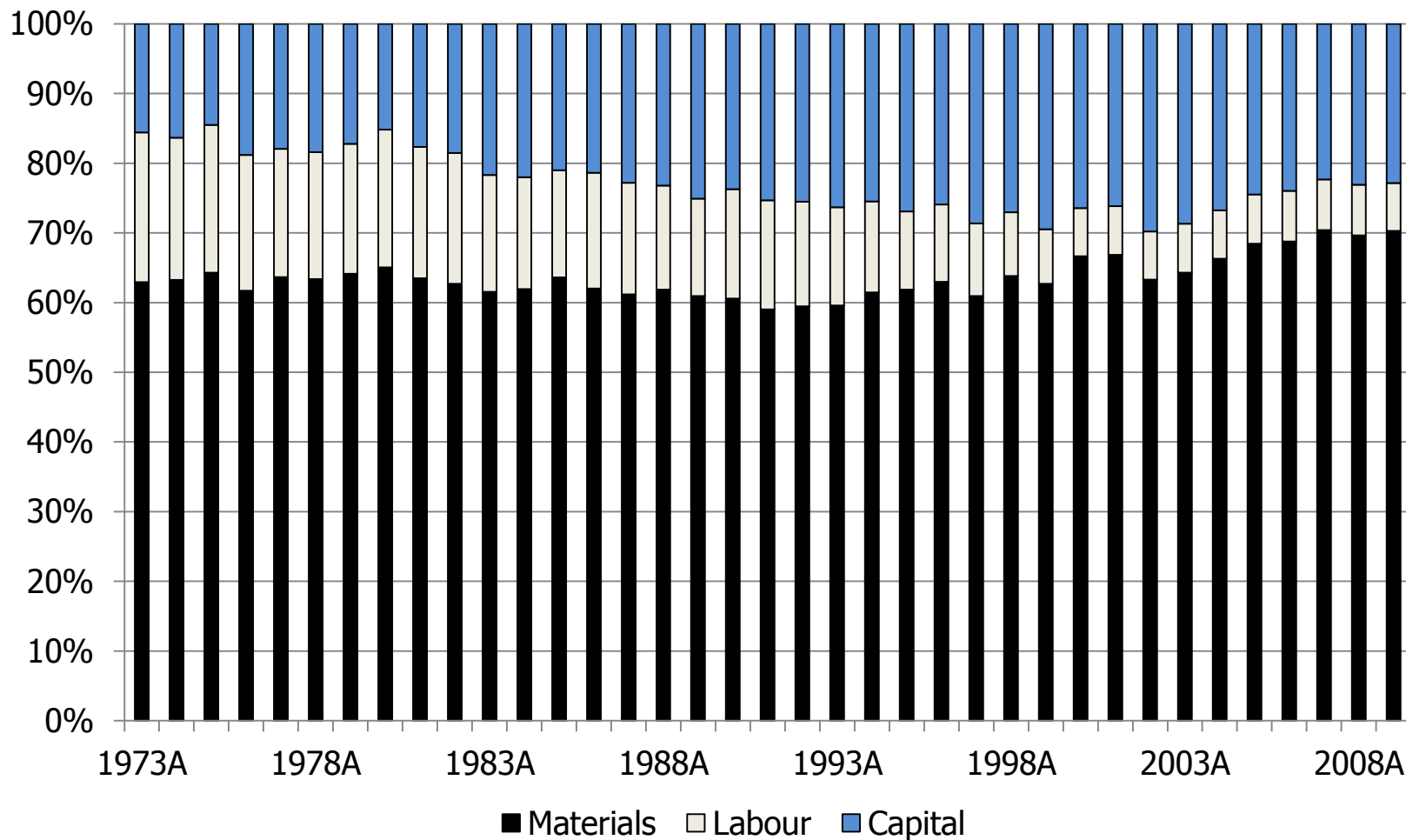
Food Manufacturing: Factor shares

Factor Shares, Food Manufacturing



High Tech. manufac. : Factor shares

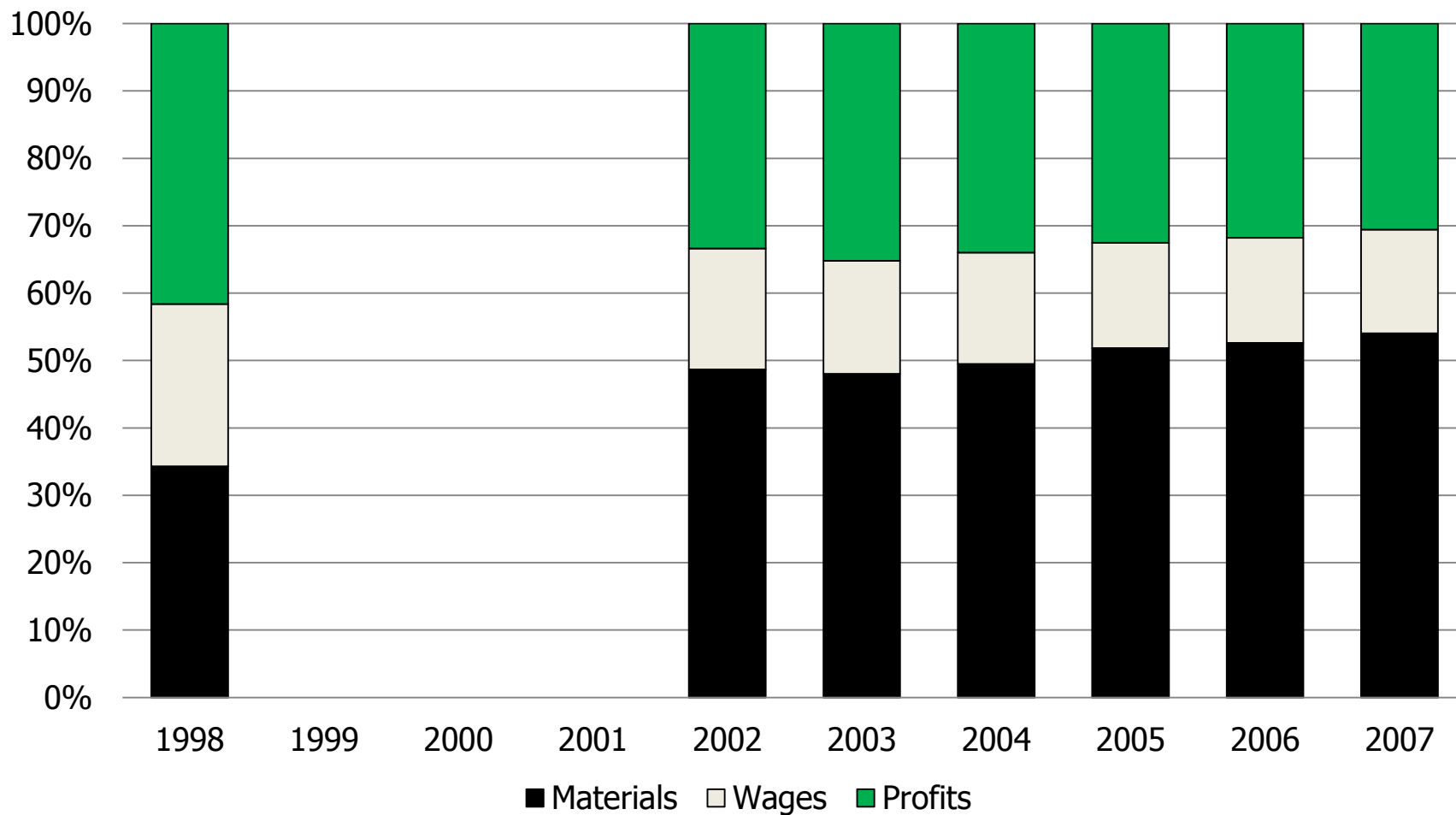
Factor Shares, High tech Manufacturing



Business and Financial Services



Shares of Gross Output, %



Overview – World Output +1%

- Output effects

	1990	2000	2009
Manufacturing	0.2	1.3	0.9
Industry	0.2	1.2	0.8
Market Services	0.6	1.1	1.4
Non-Market Services	0.0	0.0	0.0
GDP factor cost	0.4	1.0	0.9
GDP	0.3	0.9	0.8
GNP	0.5	0.7	0.8

- Employment effects

	1990	2000	2009
Manufacturing	2.1	0.8	1.0
Industry	1.5	0.6	0.5
Market Services	0.5	0.8	1.0
Non-Market Services	0.0	0.0	0.0
Total	0.6	0.5	0.6

Overview – World Output +1%

- Output effects
 - Through Manufacturing

- Output effects
 - Through Market Services

	1990	2000	2009
Manufacturing	0.2	1.3	0.9
Industry	0.2	1.2	0.8
Market Services	0.0	0.0	0.0
GDP factor cost	0.1	0.6	0.3
GDP	0.0	0.5	0.2
GNP	0.2	0.3	0.1

	1990	2000	2009
Manufacturing	0.0	0.0	0.0
Industry	0.0	0.0	0.0
Market Services	0.5	0.9	1.2
GDP factor cost	0.2	0.4	0.6
GDP	0.2	0.3	0.5
GNP	0.2	0.4	0.6

Tradable Sector: Conclusions

- Importance of focusing on value added
 - Gross output / exports do not reflect full competitiveness effects
- Importance of the services sector
 - World output may have more effect on economy through services
- Importance of modelling profit repatriations and imported services
- Cost of capital matters

Understanding What is Going On

- Measuring value added in multinationals
 - Measuring real value added in Ireland
 - Profit repatriations
 - Redomiciled Plcs.
 - Patent cliff
 - Tax engineering: Difficult to measure output

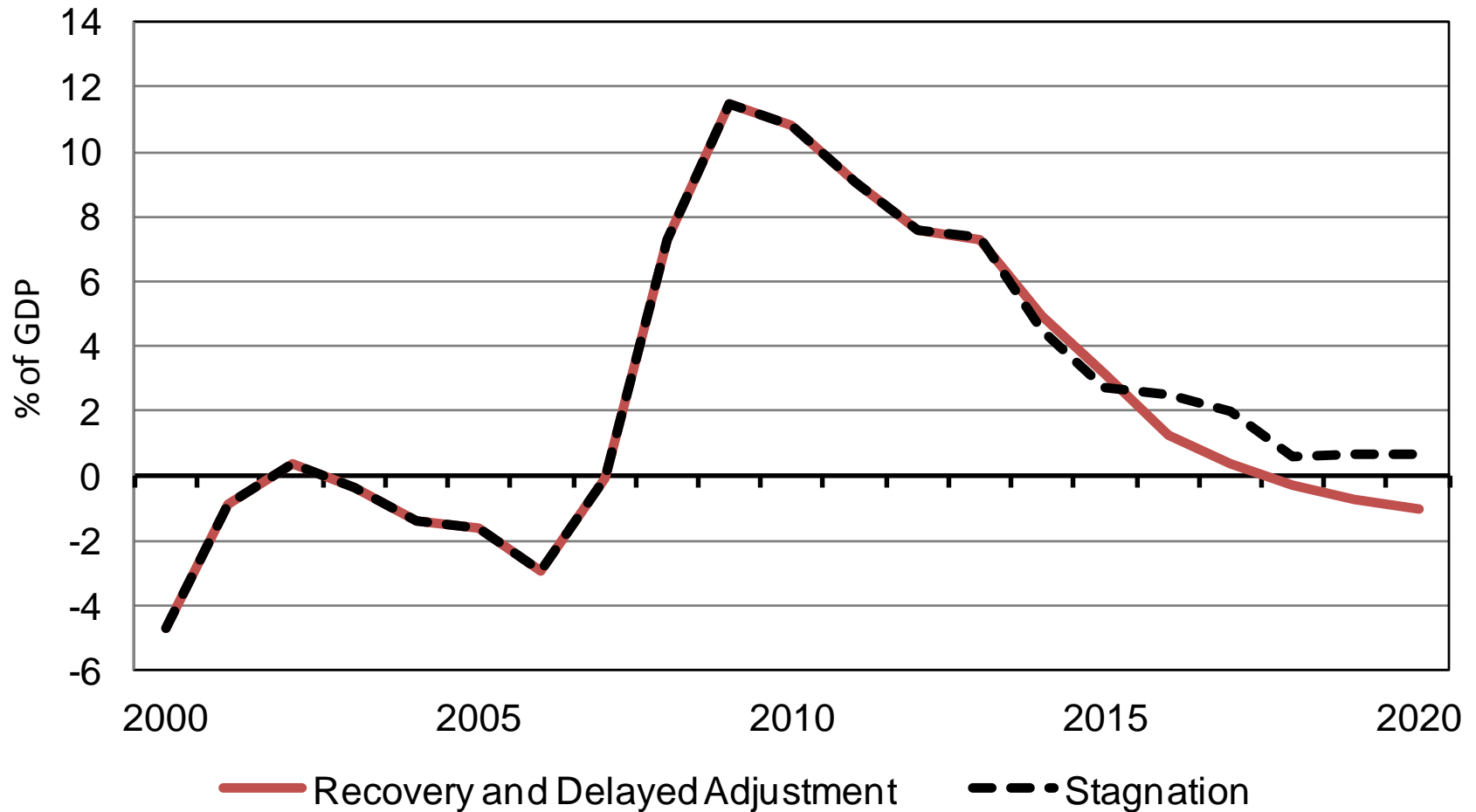
Paths to Recovery: Uncertainty

- Past MTRs
 - Central forecast with “fan chart” showing range
- Debt changes the picture
 - Different paths
 - The best guess is NOT half way between them
- Other extreme outcomes?
 - Euro break-up – low probability and analysis would require different methodology

Three Scenarios

- Recovery scenario
 - Recovery in the EU and, hence, in Ireland
 - Possible virtuous circle
- Delayed Adjustment scenario
 - EU recovery BUT domestic recovery delayed
 - Example: Failure to fix banks & provide credit, etc.
- Stagnation scenario
 - EU stagnation - cause would be external to Ireland
 - Possible vicious circle

Fiscal Assumptions: Government Borrowing



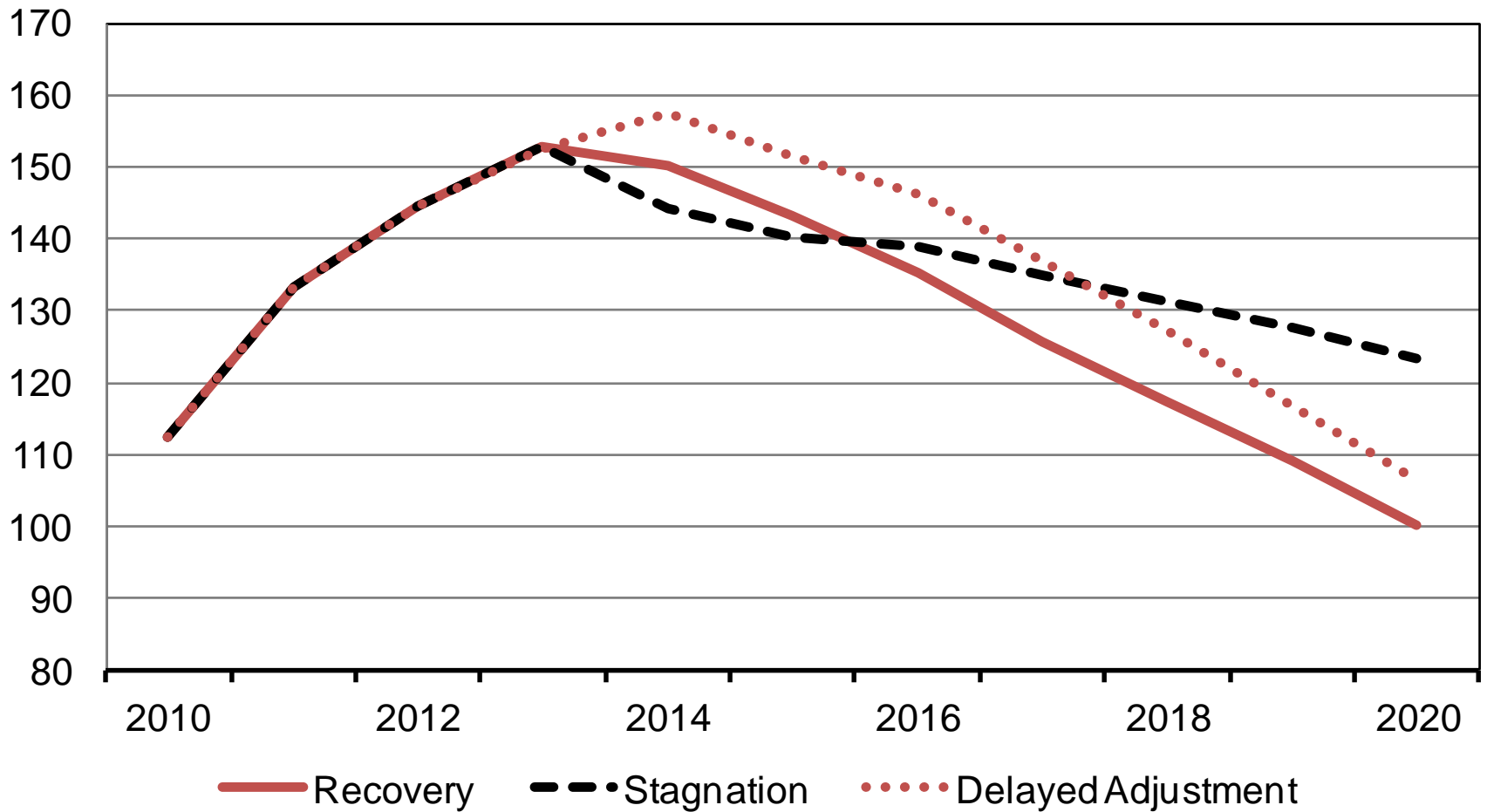
GNP, growth rate, %



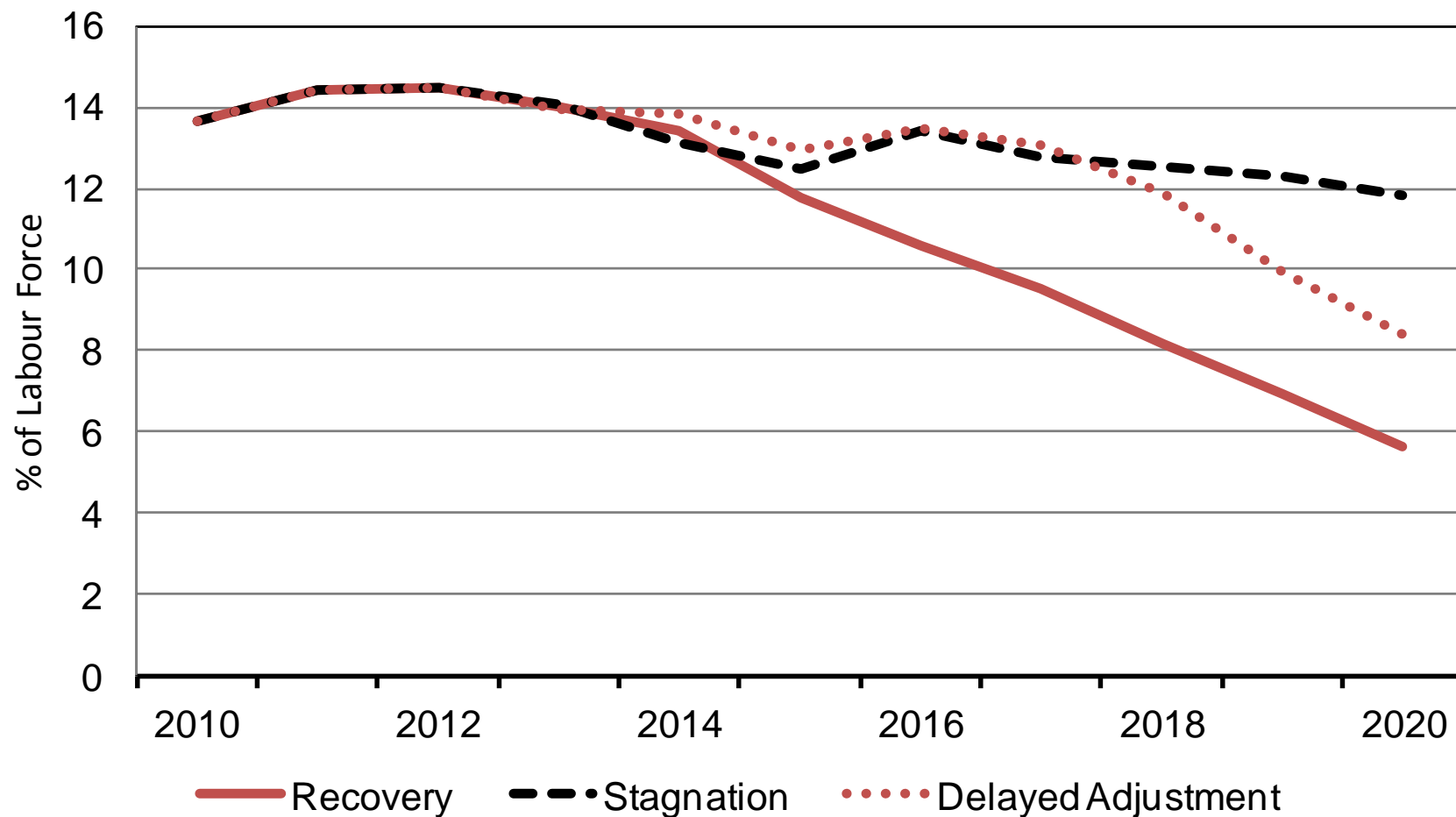
GNP Growth, %

	2013	2014	2015	2015-20
Recovery	1.2	0.5	4.3	3.6
Delayed Adjustment	1.3	-0.9	3.0	3.2
Stagnation	1.2	0.0	1.9	1.1

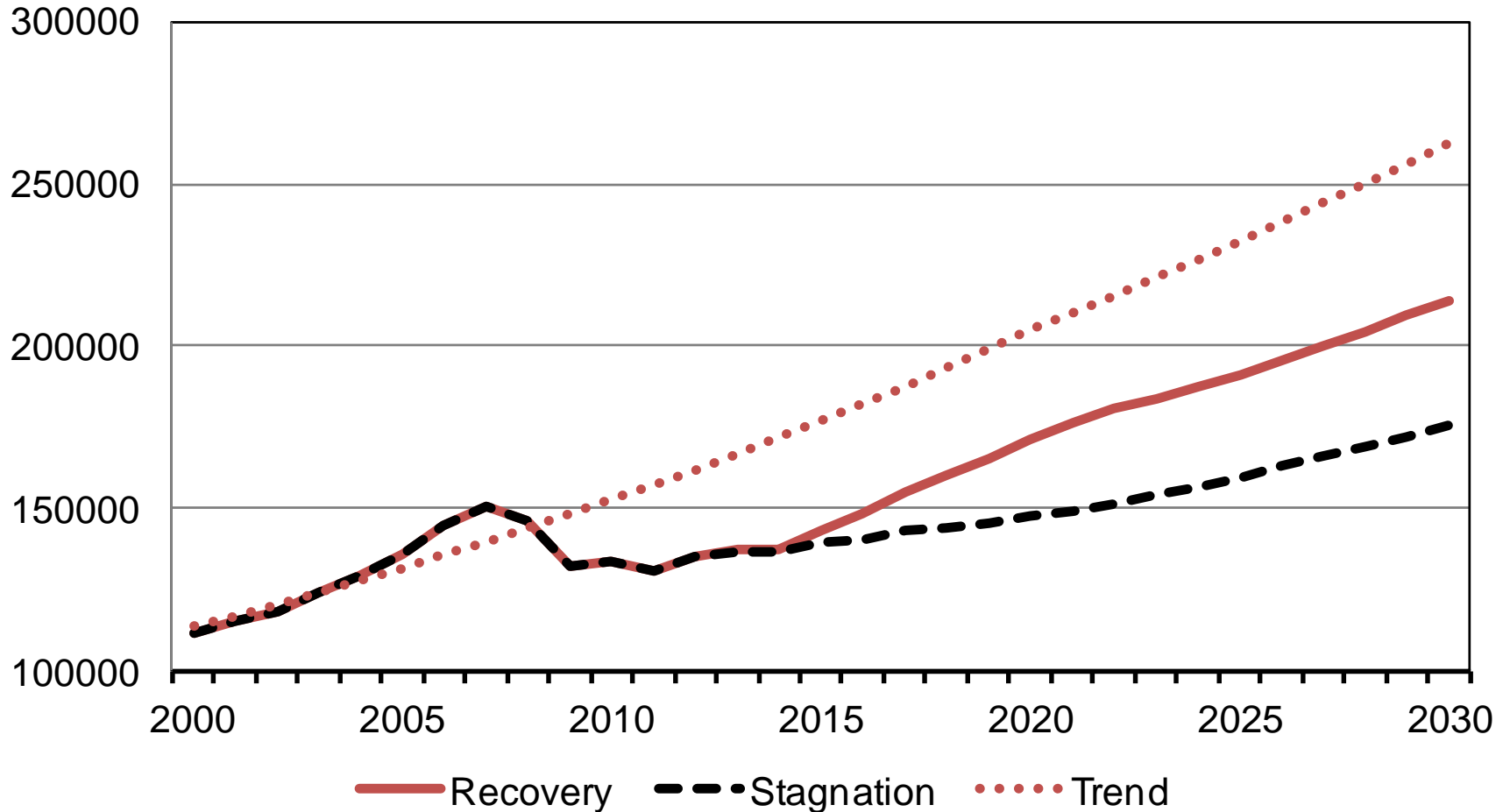
Debt / GNP Ratio



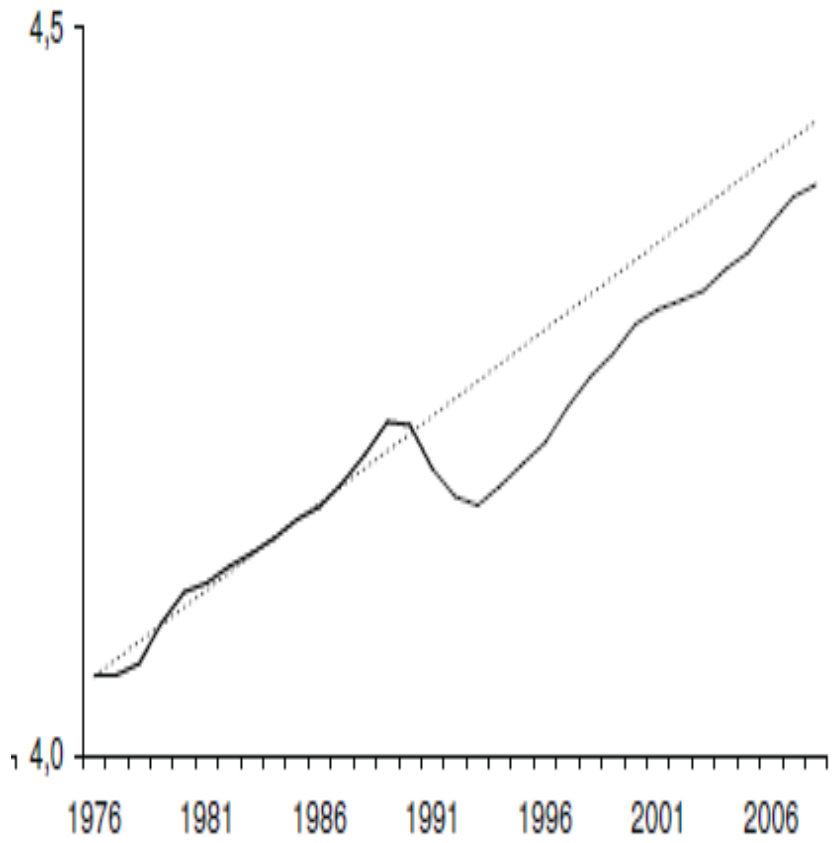
Unemployment Rate



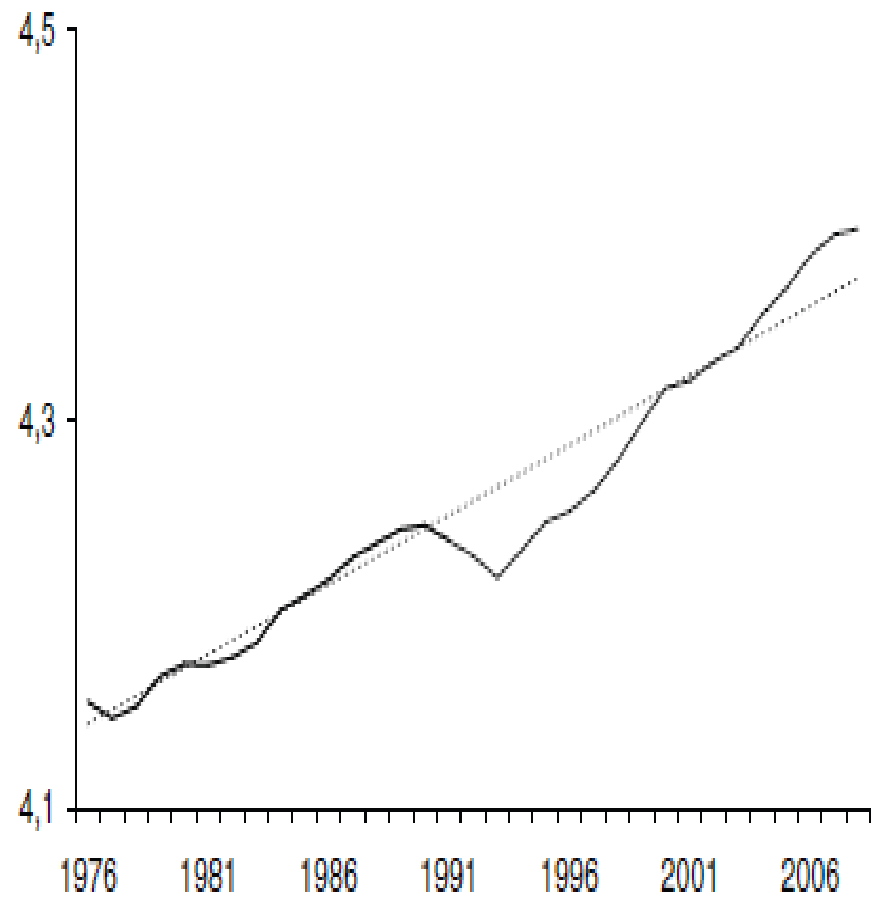
GNP and Trend GNP: Permanent Loss



Finland



Sweden



Paths to Recovery: Summary



Recovery Scenario

- Significant growth from 2015
- Government surplus 2018 with Neutral fiscal policy 2016-20
- Further benefits – realise financial assets

Delayed Adjustment Scenario

- Recovery delayed because financial system impaired
- Government Surplus in 2018 but only with tough budgets
- Unemployment remains in double digits

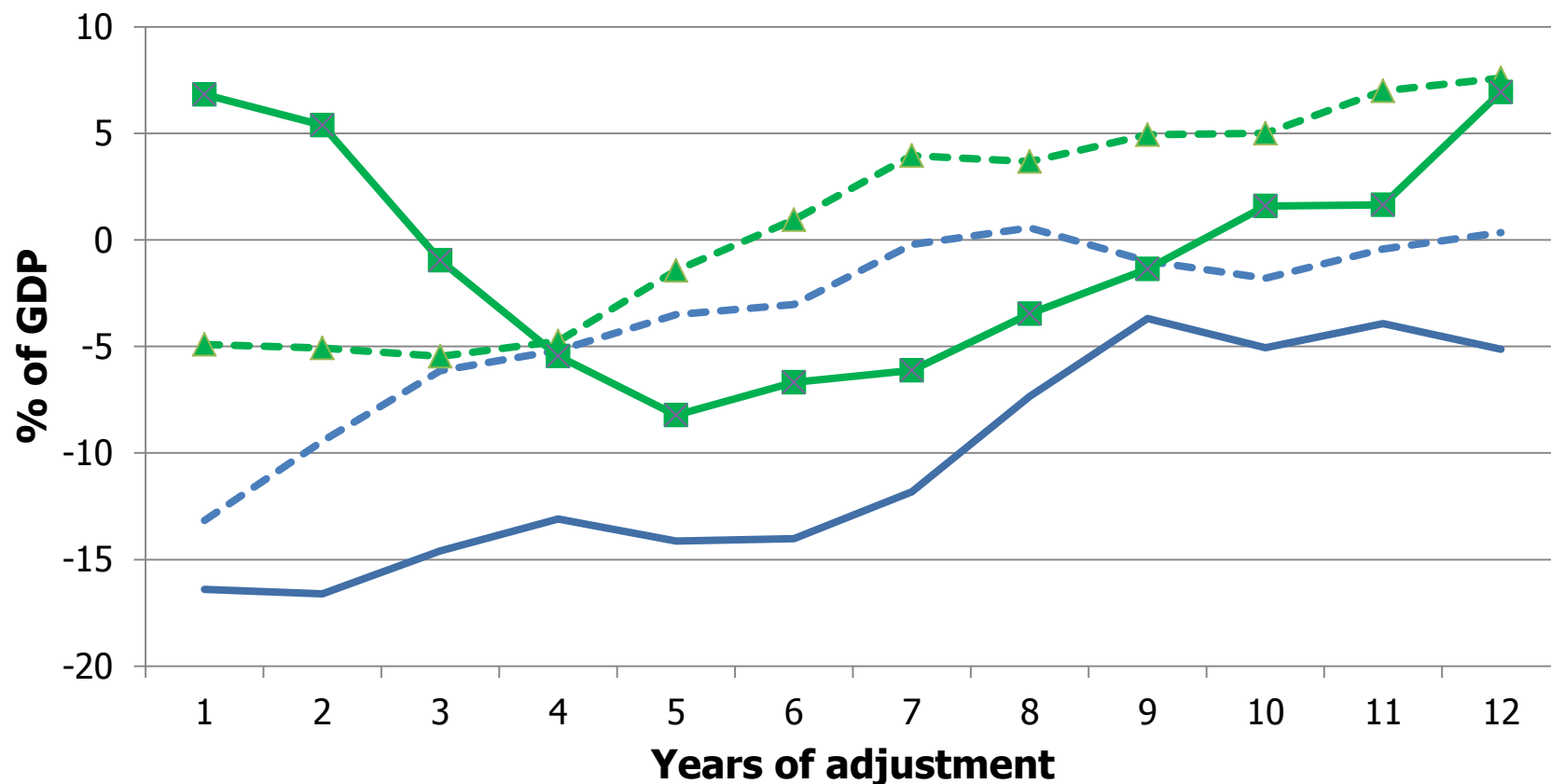
Stagnation Scenario

- Europe experiences prolonged slump (Japan 1990s)
- Tough budgets continue for rest of the decade
- Economy on a knife edge and vulnerable to shocks

Public Finances

- **Recovery:** Might not need cuts in 2015
- **Delayed Adjustment:** Need further cuts after 2014
- **Stagnation:** Need cuts in 2015 and MORE
- Don't know which scenario will transpire
- Adopt no regrets policy because:
 - Difficult to stop and then restart cuts
 - Therefore, go ahead with 2014 Budget cuts
- Fiscal Adjustment takes time

Ireland 1980s, Finland 1990s



-- Ireland Current Account

— Ireland Government Borrowing

--▲ Finland Current Account

--■ Finland Government Borrowing

Risks

- EU
 - Failure of EMU – unlikely
 - UK Exit
 - Zombie Europe – possible. EU Response?
 - Banking Union - essential
- Possible domestic policy failures
 - Making banking sector fit for purpose – fast
 - Getting a return on State's financial assets
 - Labour market?
 - Recalibration of industrial policy

Growth Strategy

- Demographic Change:
 - Implications of population growth
 - Ageing of the population
- Evolving Ireland's competitive advantage
 - Developing new areas
 - Reduced dependence on tax advantages
- Public Sector Reform
 - Taxation and Expenditure
- Labour Market Reform

Industrial Policy

- “Wean” economy off tax dependence
- Diversification v Concentration (e.g. Nokia)
- Features of comparative advantage?
- All that glitters is not gold
 - Contribution of some financial sector business limited
 - Some business comes with risk. What is the risk / return trade-off?
 - Domestic firms more important than they look

A More Suitable Tax System

- Less emphasis on Taxes on Income
 - In long-run incidence on employer
 - Damages output and employment
 - In short-run incidence may be on employee
 - Less effect of employment and output
- Taxation of property – CGT?
 - Browne, Conefrey and Kennedy, 2013
- Reduce dependence on low corporation tax
 - Sacrifice loop-holes to protect regime
- Taxation of financial sector?

Labour Market Policy



- Different from 1990s because unemployed generally well educated
- However, danger of continuing high long-term unemployment
- Need an economic recovery AND suitable policy response