

1. Introduction

In March 2009 the Council published a report entitled *Ireland's Five-Part Crisis: An Integrated National Response*. That report advanced four central arguments:

- ◆ There are five dimensions to Ireland's crisis: a credit and banking crisis, a fiscal crisis, an economic crisis of competitiveness and job losses, a social crisis of unemployment and income loss, and a reputational crisis;
- ◆ An integrated response is required that addresses all five dimensions, since partial and sequential measures, even where undoubtedly necessary, will not be sufficient and effective;
- ◆ To find a way through the crisis, it is necessary to combine unavoidable retrenchment with major reform in a range of policy areas and systems;
- ◆ The actions Ireland takes in 2009 and 2010 are likely to shape the country's long-term future; in particular, our actions now will, in large measure, determine whether Ireland achieves the ambition of economic and social performance equivalent to that in the leading small European countries—such as Denmark, Finland, Sweden and the Netherlands—or whether, in twenty years time, we will be an EU state that lags in prosperity and social cohesion and is burdened by fiscal deficits and debt.

Since early 2009 there has, indeed, been a very significant policy response to the crisis. Yet, for a variety of reasons, there is little easing of the crisis in banking, the fiscal position, the economy and the society. Indeed, despite important steps, an integrated, nationally-supported, and widely-understood response has yet to be achieved. This is the context in which, in the coming months, Irish society must make critical decisions on a number of fronts:

- ◆ How to address the serious fiscal crisis;
- ◆ How to stem the flow of job losses;
- ◆ How to support the unemployed and others suffering in the crisis.

In this context, the Council has recently discussed the evolving situation and sought to update its understanding of the five-part crisis. In order to facilitate the Council's discussion, the NESC Secretariat has undertaken a descriptive review of policy actions and other developments from April to September 2009. This is presented in the appendix to this report.

The Council now wishes to re-emphasise the inter-connected nature of the banking, fiscal, economic, social and reputational dimensions of the crisis and to explore ways in which an integrated, nationally-supported, response might be found.

Chapter 2 is a summary of the analysis and argument in the Council's report of March 2009. Chapter 3 offers the Council's reflections on the evolving crisis and discusses the continuing challenges of finding a coherent widely-understood and nationally-supported strategy across the five dimensions of the crisis.

For reasons outlined in Chapter 3, this short report is addressed not only to government but to the full range of economic, social and policy actors—all of whom have a role in finding and implementing a path through this national crisis.

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Summary of the Council's March
2009 Report *Ireland's Five Part Crisis:
An Integrated National Response*

2.1 Describing and Understanding the Crisis

In its report of March 2009, the Council sought to assist government in developing an integrated response to the crisis, by providing:

- (a) An accurate characterisation of the position in which Ireland found itself in March 2009;
- (b) A persuasive set of arguments that can build the widest possible shared understanding of the nature of the crisis;
- (c) An analysis of how Ireland might move from partial and sequential reactions to fast-moving events to an integrated national response that addressed the various dimensions of the crisis and could engage the Irish people in this critical period for our economy, society, reputation and independence.

The Council argued that there are five dimensions to Ireland's current crisis:

- ◆ A banking crisis;
- ◆ A fiscal crisis;
- ◆ An economic crisis;
- ◆ A social crisis; and
- ◆ A reputational crisis;

It suggested that the Irish crisis could be understood as a combination of the following elements:

- ◆ Declining competitiveness as a consequence of Ireland's prolonged boom;
- ◆ A property bubble which Irish financial institutions, a regulatory system and system of land management did not prevent; and
- ◆ An international credit crisis and world recession caused by structural weaknesses in the current globalisation process.

Analysing the unfolding crisis, the report noted that the pressure of events had forced the Irish government to react to various aspects of the unfolding crisis in late 2008 and early 2009. While these included high-profile actions—such as the bank guarantee and budgetary announcements—a range of other Irish policy reactions to the crisis were summarised in the report. A key question, the report argued, is how to progress from reactivity to response?

2.2 The Crisis as the Manifestation of Risks and Vulnerabilities

In its discussion of the crisis, the Council drew on its existing understandings, developed over the past two decades. These included the macroeconomics of a small open economy, the close relation between the monetary regime, fiscal policy and wage bargaining, the conditions for effective social partnership, the mechanisms of economic adjustment in EMU, and principles of fiscal policy. The Council's earlier analysis also encompassed the vulnerabilities inherent in Ireland's growth as a regional economy, the developmental welfare state, principles of sustainable housing and the need for active land management, and taxation policy. It argued that the crisis can be seen as a manifestation of risks, vulnerabilities and weakness—in three distinct senses.

First, it concluded that the severe current crisis can be seen, at least in part, as the manifestation of a range of the international risks inherent in Ireland's economic position, identified in earlier studies. These include our dependence on the growth of the international economy, an asymmetric shock within the euro zone, a weakness of sterling, and the relatively large impact on our 'regional' economy of international flows of real investment, finance and people. It was admitted, however, that NESCC had not envisaged that these risks would materialise simultaneously and in such a mutually-reinforcing way.

Second, it was noted that the crisis is also a manifestation of a number of risks that were not identified—or were considered unlikely to materialise. These included the massive recourse to overseas borrowing by the Irish banking system, in order to finance property development and purchase, and the dramatic collapse of the model of international finance and financial regulation that had developed in the past 20 years.

Third, the Council's analysis suggested that the crisis can be seen as the manifestation of a number of vulnerabilities, the exposure to which is significantly shaped by national policy frameworks, institutions and processes. A number of features of Ireland's approach to economic and social development, policy implementation, coordination and bargaining have not sufficiently protected the economy against some of the known vulnerabilities. Among these were:

- ◆ The system of public expenditure management, especially methods of project appraisal, output and outcome measurement and accountability;
- ◆ A tendency to erode the tax base, by over reliance on unsustainable tax revenues from construction-related activity, rather than more predictable taxes on income and assets;
- ◆ The system of land management, planning and housing;
- ◆ The approach to pensions;
- ◆ A social policy framework that does not sufficiently complement and support our adoption of an internationalised economy and a social model based on high levels of participation;
- ◆ A range of features of national policy and partnership, as analysed by the Council in *NESCC Strategy 2006* and the OECD, that give rise to an 'implementation problem' with many dimensions (NESCC, 2009: 35).

In thinking about a way out of the crisis, the Council considered it important and informative that aspects of the crisis are a materialisation of risks and vulnerabilities that we had identified, discussed and reached broad agreement on in recent years. It reiterates this view now, since it points to areas where crisis response must be combined with underlying reform.

2.3 The Characteristics of an Effective Irish Response

In the Council's view an effective Irish response to the crisis must have a number of characteristics. As outlined in the report of March 2009, the response must:

- ◆ Address all five dimensions of the crisis: banking and credit, fiscal, economic, social and reputational;
- ◆ Be based on social solidarity, seen as sharing the burden of adjustment fairly and yielding a fair economy and society in years to come;
- ◆ Involve a consistent combination of macroeconomic, distributional and structural measures;
- ◆ Be framed around a positive perspective on the future of Irish society;
- ◆ Combine high-level coherence with maximum engagement and local problem solving;
- ◆ Take short-term measures that move us in the correct long term direction; and
- ◆ Have a sequence and timing that enhances these characteristics.

In explaining these characteristics, the Council drew attention to some fundamental aspects of the crisis and some indispensable elements of an Irish recovery.

First, the crisis poses profound challenges to many existing theories and models. Indeed, the high degree of uncertainty—particularly about the impact of conventional policy measures—provides further reasons for constructive, collective discussion of problems and solutions. The Council argued that countries capable of conducting such dialogue and implementing a coherent and agreed response quickly are likely to come through current difficulties better than those in which profound and protracted debate on diagnosis and cure occurs (37).¹

Second, Ireland's response must be attuned to international economic realities. Among these is the unavoidable need to reverse Ireland's balance of trade and capital flows. This requires a restoration of competitiveness.

Third, it is important to recognise the degree of irreversibility created by the current crisis. History suggests that macroeconomic and financial crises are a harbinger of much wider economic change—in technology, markets, economic hegemony, regulation and the way in which the economy is socially and politically embedded. In short, although the international economy will (almost certainly) revive, there will not be a return to the global economy which prevailed from 1990 to 2008. Yet it was in that economy that Ireland made its greatest convergence towards the

1. Hereafter, page references in brackets refer to NESC 2009.

levels of prosperity in Western Europe. This seems likely to have profound, as yet unknown, implications for Ireland. Consequently, NESC argued that no economic or social organisation or interest within Ireland can safely absent itself from exploration of these implications (38).

Fourth, notwithstanding the degree of uncertainty and irreversibility, Ireland's response to the five-part crisis has to be based on a positive perspective on Ireland's economic future. This is necessary to motivate wide engagement with the retrenchments and reforms that are now imperative and to guide us in which adjustments to make and which to avoid. Indeed, the Council argued that we can identify some necessary and desirable features of Ireland's recovery and future prosperity. These include adjusting the public finances, re-establishing export-led growth, strengthening indigenous resources for knowledge-based economic activity and innovation, positioning Ireland to continue attracting inward investment in high-value activities and enhancing individual and social capabilities and social cohesion even through a severe downturn. Indeed, the Council argued that Ireland should draw encouragement from research which suggests that the global crisis is a harbinger of the full deployment of the information and communications technologies. This will create vast business, technical, environmental and social opportunities—but only in countries where there is widely-dispersed digital capability, entrepreneurship and participation (Perez, 2009, 2002).

Fifth, a central argument in the Council's March report was that an effective Irish response must combine high-level policy coherence, on the one hand, and urgent search for new solutions at all lower levels, on the other. Some of the critical elements of an effective response—macroeconomic policy, incomes policy, banking policy and social policy—urgently require a coherent and clear government policy and, ideally, agreed approaches across a range of high-level actors (government, the social partners, major regulatory agencies and the financial institutions). But other critically important policy areas—such as skill development, aspects of social policy and wider public sector reform—require central government to set the parameters and a wide range of actors to jointly search for practical responses to the problems we now face.

It was noted that lack of agreement on a high-level strategic response (most critically, on fiscal policy and incomes policy) would certainly lead to inconsistent national policy and could further diminish Ireland's international reputation. But, the Council argued that it is likely to also prevent or postpone lower-level engagement in the kind of problem solving which is urgently required. It is critical to enlist hundreds of agencies, units, firms and associations in devising effective and imaginative approaches to the challenges of employment protection, skill development and activation (41). Once an integrated national response is outlined, the success of public agencies, social partners and firms in dealing imaginatively at a local level with the challenges of solvency, employment or unemployment can contribute to the coherence and discipline at national level. In a general way, it can inspire confidence in, and cooperation at, the national level. More concretely, the harsh economic realities mean that at local level—in both private firms and some areas of public services—we face a trade-off between numbers employed and remuneration levels. Resolving this in favour of employment at the local level can make a significant contribution to solving the national-level problems of aggregate demand and the public finances (42).

Sixth, the logic of immediate measures that are in accord with long-term goals is strongly evident in the Government's document *Building Ireland's Smart Economy*. The main focus of that framework is infrastructure and innovation. An important argument in the Council's March report was that the same logic should be applied also to a range of other policy areas, including responses to unemployment, social policy, activation, pensions, infrastructure, land management and housing.

Seventh, the Council acknowledged that government must sequence its responses to the crisis. In some cases, this might involve large, early adjustments, for example, in order to limit the increase in public borrowing and to strengthen international credibility. In other cases, it will warrant gradual introduction of new measures. NESC's central argument was that both the rapid and gradual measures need to be embedded within a clear framework that illustrates that they are each part of a single, integrated, national project of adjustment, reform and recovery (44).

Finally, the Council argued that Ireland needs to combine retrenchment with reform. The severe reversal and pain could consist mainly of retrenchment, and be borne, reluctantly and passively, by all concerned. Or it could see the opportunity for major reform, enlisting the abilities and imagination of many organisations and individuals. The Council argued that Ireland needs to combine severe retrenchment with radical reform. This derives from the best available analyses of the five-part crisis. This, NESC argued, is the only context in which it will be possible to craft a persuasive set of arguments that can build a shared understanding on these policy actions and can engage a wide range of agencies and organisations in implementation and problem solving.

2.4 Towards An Integrated National Response

2.4.1 Limitations of Partial and Sequential Reactions

In March, the Council noted that it is possible to devise a set of further reactions to each of the five elements of the crisis. Indeed, the report considered a single-minded focus on, respectively, stabilising the banking system, correcting the public finances, addressing the crisis of competitiveness, closures and lay-offs, responding to increased social problems and restoring Ireland's reputation. That analysis certainly identified critical elements in each of these five areas, as we summarise below. But, in each case, the Council's analysis strongly suggested that a further series of partial and sequential measures, some of which are undoubtedly necessary, would not be sufficient and effective. This lack of effectiveness is likely for three related reasons:

- (a) Technically, action on each of the crises requires specific supportive and coordinated actions on several of the others;
- (b) It will be very difficult for leaders of various kinds to communicate the purpose of a series of partial and sequential reactions and how they amount to Ireland's overall response to the crisis;
- (c) Partial and sequential reactions are unlikely to achieve the central requirement for Ireland's survival: to energise Irish people to work together in a problem solving way, including adjusting our joint efforts in response to unforeseen successes and setbacks.

Consequently, the Council argued that Ireland needed to formulate an integrated response, an argument we return to below.

2.4.2 A Focus on Stabilising the Banking System

At the time of the March 2009 report the possibility of taking bad debts off banks' balance sheets was being explored.² NESC cautioned that this approach should not be used as a means of 'transferring capital to banks in a way that does not give the State an appropriate share of the potential future returns from the profitable parts of banks (48). NESC also counseled that 'an over hasty reduction in loan to deposit ratios should be avoided as it would add to deflationary pressure in the economy' (48).

While problems in financial institutions confront Government with an urgent problem to which it must react, the Council argued that there would be definite limitations to a national response which was dominated by a focus on recapitalising the banking system. First, as a response to the banking and credit crisis it is necessary but not sufficient. The policy response to the banking crisis needs also to address the following:

- ◆ The need to ensure that policy measures provide protection to the increasing number of households with mortgage arrears;
- ◆ The need to ensure that government action prompts a renewed flow of credit to businesses in Ireland;
- ◆ The need to convince Irish society as a whole, and particularly groups making visible sacrifices, that those who led Irish financial institutions into their current reliance on the state, and who were major beneficiaries of the boom, are being held accountable and bearing their share of the adjustment burden;
- ◆ The need to persuade our EU partners, other international institutions and the global financial market actors that a new regulatory regime and governance culture is being created in Ireland

Second, a dominant focus on the banking crisis would, of course, not address critical other dimensions of Ireland's crisis, notably the fiscal crisis and the economic crisis. Without progress on the crisis of competitiveness, business solvency and employment, even a fully repaired banking system is unlikely to see much increased credit creation.

2.4.3 A Concentration on the Public Finances

In March, the Council catalogued public finance measures taken since July 2008 and agreed that many further measures will be required to bring Ireland through this severe crisis. In January 2009, the government's objective of a GGD of 3.0 per cent in 2013 was endorsed by the social partners (*Framework for a Pact*, Department of An Taoiseach 2009) and the Council noted agreement that this should be achieved by a combination of expenditure reductions and tax increases.

It was argued that any combination of expenditure reductions, tax increases and increased borrowing needs to be assessed not only on how it narrows the gap

2. In its March 2009 report, the Council did not offer an opinion on the best technical approach to addressing the banking crisis. It simply identified a shared Council view on some factors which any technical approach should take into account and some requirements for an effective, sufficiently-understood, response.

between expenditure and revenue, but also on how it is likely to impact on key other dimensions of Ireland's challenge: the economic crisis, the social crisis and the country's reputation. This is particularly so, given that these crises call for major policy developments in pensions policy, labour market policy and activation.

It was noted that the tax share of GNP in Ireland had fallen by approximately 2.5 percentage points and is below the EU (15) average. The Council argued that in view of the large structural deficit in the public finances, and taking into account the undoubted scope for enhancing the effectiveness of expenditure, it seems certain that a medium-term strategy to restore balance to the public finances will require an increase in the tax share of GNP—from its reduced level in early 2009—if a satisfactory level of provision of services and benefits is to be achieved. In this regard, it noted that some, if not all, of our EU trading partners will increase their tax-take over the coming year. Changes to the tax system should not be considered solely in terms of revenue, but also in the light of principles of tax reform and the impact on economic growth.

In March, the Council argued that a strategy to restore sustainability to the public finances needs to take into account:

- ◆ The desirability of prioritising services and employment over remuneration in the adjustment period;
- ◆ The key role of the Special Group on Public Service Numbers and Expenditure Programmes in identifying opportunities for improved value for money;
- ◆ Ensuring the immediate retrenchment measures are consistent with desirable structural reform and long term goals;
- ◆ Ensuring that borrowing is kept at a manageable level; and
- ◆ Addressing the long-standing challenge of public sector reform to achieve a real improvement in value for money in the use of public resources.

The last point was emphasised strongly by the Council in its March report. It was noted that while increased expenditure during this decade was necessary to address long-standing deficits in services, it often took place without adequate arrangements to ensure that increased resources were used effectively. The Council again emphasised the need for much greater accountability by government departments and agencies for what is achieved with public money. Indeed, it argued that the work of the Special Group on Public Service Numbers and Expenditure Programmes should be closely aligned with the transformational goals set out in the Government's strategy in *Transforming Public Services: Citizen Centred – Performance Focused* (Government of Ireland, 2008).

The Council argued that the area of public spending and taxation illustrates more than any other the limits of partial and sequential reactions to the crisis and the need for individual measures to be placed within the framework of an integrated national response to the overall crisis. It observed that the cascade of expenditure reductions and tax increases in 2008 and early 2009, while understandable given the rapidly changing revenue and unemployment situation, had left most groups and individuals in the population confused. This confusion encompasses not only the

logic of particular measures but also the distribution of the burden of adjustment. In this context, it is relatively easy for groups to be persuaded that they are bearing the largest burden of adjustment. As noted in March, these observations were not made in a critical spirit. It was argued there that existing reactions to fast moving events have, probably unavoidably, been partial and sequential. The purpose of the observation was to underline the importance of finding and articulating a clear account of the crisis and elements of an integrated national response.

2.4.4 A Focus on Restoring Ireland's Competitiveness

A central argument of the Council's report of March 2009 was that we recognise and analyse not only the banking and fiscal crises, which have been discussed intensely since the crisis broke in 2008, but also the economic crisis—as evidenced in job losses, company closures and short-time working.

In arguing that a coordinated approach to income determination remains appropriate, the Council underlined the fact that this is premised on a shared analysis and understanding of Ireland's five-part crisis. This entails recognition that:

- ◆ Maintenance of employment, and minimisation of the increase in unemployment, are central concerns in an integrated national response to the five-part crisis;
- ◆ Over the coming years, Ireland's economy has to shift from growth driven by domestic demand, that prevailed from 2002 to 2007, to export-led growth, as achieved earlier;
- ◆ Economic recovery will be characterised by a fall in Ireland's price level and cost structure, relative to our trading partners.

It was noted that a difficult set of competing objectives confronts all those involved in finding a coordinated and integrated response to the crisis. It recognised that in the current context, a coordinated approach to income determination should take account of a wide range of factors, including employment, competitiveness, the fall in sterling, prices, domestic demand, state of the public finances, mortgage debt and social solidarity.

The encompassing view outlined above is one that places the highest priority on protection of employment and the problem of unemployment. It recognises that Ireland's price level will need to fall relative to that in our trading partners if Ireland is to restore its competitiveness. In the medium term it is not possible to envisage a path through the current crisis that does *not* include a significant improvement in Ireland's cost competitiveness. This is because the *price level* has to adjust if Ireland is to switch from growth driven by domestic demand (funded from overseas borrowing) to export-led growth. The Council was most anxious to emphasise that this will require that the full range of costs, charges, fees and rents that make up the Irish price level be reduced relative to those in trading partners. The Council emphasised that, not only for fairness, but also to achieve the necessary economic effect, it is vital that there be vigorous action to achieve reduction in prices, costs, fees and rents.

Consequently, the Council's analysis suggested that a coordinated approach to incomes—and other adjustments in the Irish private sector economy (in prices, costs, employment and working hours)—must be accompanied by at least six other policy approaches. Among these are:

- ◆ Stabilisation of the banking system in a way that re-established the provision of credit to business;
- ◆ A significant fiscal offset, in which temporary public borrowing supports key services and limits the contraction of domestic demand; and
- ◆ A re-targeting of NDP spending to support employment and enterprises.

This dependence of an effective response to the economic crisis on effective measures to address the banking, fiscal, social and reputational crises, underlines the need for an integrated, and clearly articulated, national plan.

2.4.5 A Focus on the Social Crisis

While the most prominent aspects of the current crisis are financial, fiscal and economic, the Council argued in March that the depth of these difficulties is giving rise to a significant social crisis. A single-minded focus on the social dimensions of the crisis would concentrate, first and foremost, on insulating the most vulnerable against the worst effects of the recession. As well as maintaining the existing infrastructures of care, this requires doing everything possible to continue with the reform agenda for Ireland's social policies and welfare state that tackles the deep social deficits which persisted during the period of strong economic growth; otherwise, in a period of recession, these deficits will only worsen.

NESC argued that a second area in which the crisis calls for major reform is activation policy. There is an urgent need to stimulate the search for practical measures that will re-order and re-fashion existing education, training and social welfare budgets in ways that more effectively help workers now losing their jobs and those seeking jobs for the first time during this recession. Only integration and innovation in how Ireland's educational system, training and labour-market policies, and welfare state respond at this time will ensure they are not scarred by the experience and that a new problem of long-term unemployment is not created. The aim must be to stimulate the creation of '21st century' equivalents to the special labour market programmes that were introduced in the late 1980s and early 1990s.

In particular, it was argued in the Council's March report that how jobless people access opportunities for retraining and further education should be immediately reviewed. For example, a large proportion of the people employed in sectors where job loss is particularly high in the current downturn—construction, retail, hotels and catering, and low-tech manufacturing—have a lower secondary education or less as their highest educational attainment. Urgent consideration should be given to measures that offer these people opportunities to upgrade their skills in a significant way and widen their options in a post-recession Ireland.

Overall, the Council urged the immediate establishment of a Jobs and Skills Summit at which the labour market authorities, and all bodies with a capacity to deliver high quality, market-relevant training and education programmes, would identify and implement a set of measures feasible and effective in meeting these goals. It argued that addressing the activation challenge requires a vigorous implementation of the Government's programme of public sector reform, cited above.

The Council also proposed that the economic recession and collapse of private construction provides an opportunity to address some outstanding housing issues. Among these was the proposal that intervention in the banking sector might be used to acquire public land banks on attractive terms.

2.4.6 The Reputational Crisis

In its March 2009 report, the Council reiterated its long-held view that Ireland's small size, location and model of economic development make it highly vulnerable if it were to lose influence or status in the EU or, worse still, if there was a return to a less rule-based international system. It was in no doubt that, as well as the banking, fiscal, economic and social crises, Ireland faced a reputational crisis. This makes itself felt in various ways. Among the most immediate is the increase in yields on Irish government bonds, as bond markets demand higher spreads to hold what are seen as riskier assets.

It was argued that the centrality of Ireland's reputational crisis in the grave overall situation is entirely consistent with some long-standing principles of Irish policy and with a modern understanding of sovereignty. In *The New Sovereignty*, Chayes and Chayes argue that for all but a few self-isolated nations, sovereignty no longer consists in the freedom of states to act independently, in their perceived self-interest, but in 'membership in reasonably good standing in the regimes that make up the substance of international life' (Chayes and Chayes, 1995: 27). If sovereignty is status or good standing, then Ireland undoubtedly faced a threat to its sovereignty. Perhaps the only consolation, the Council argued in March, is that most Irish people place a high value on our national status and independence, in this modern sense, and will want to restore it.

As in the case of the other crises discussed above, the Council argued that an effective response to the reputational crisis requires not only focused actions, but also that some wider conditions be met. Perhaps the most obvious of these is the need to persuade our EU partners, other international institutions and the global financial market actors that a new regulatory regime and governance culture is being created in Ireland's financial and business systems. Here, the Council argued, we come upon a most important aspect of the reputational crisis: the close connection between a country's international reputation and the domestic credibility and effectiveness of its governance arrangements. In the case of banking and financial regulation, the requirements for repairing Ireland's international reputation would seem to overlap with what is required to address several of our domestic crises. One requirement is the need to convince Irish society as a whole, and particularly groups making visible sacrifices, that those who led Irish financial institutions into their current reliance on the state, and who were major beneficiaries of the boom, are being held to account and bearing their share of the adjustment burden.

Indeed, the link between international reputation and the credibility and effectiveness of domestic governance goes much wider. International reputation is linked to the ability of a society to act collectively, recover and reinvent its economy. The more credible and effective are domestic governance, the higher is a country's international reputation. But it is also true that the more credible and effective are domestic governance, the less some aspects of international commentary matter. Countries with credible and effective domestic governance arrangements can have confidence that they will fix their problems.

2.5 Not Too Late to Find an Integrated Nationally-Supported Response

In summarising its analysis, the Council argued in March that it was not too late to formulate an integrated, nationally-supported, response to the five-part crisis.

The major scale of the crisis, and the fact that the crisis and its effects are likely to last for some years, means that it is a mistake to think that the reactions taken to date can constitute the main Irish or, indeed, EU response. It is not surprising that these reactions to fast-moving events do not yet constitute our full, considered, integrated and agreed response. Equally, the Council noted, while Government and some other actors have had to react to events, other processes have proved slow in responding. Furthermore, the analysis suggests that the crisis is likely to be deep and long, and will bring fundamental change in the economic and social system, in public policy and regulation and in international relations and governance.

While the paper argued that action on each of the five crises depends on action on the other four, it noted that some policies are effective in addressing certain problems and others at addressing other problems. This is why NESC identified five distinct, but related, crises. Each sphere and crisis requires to be analysed correctly.

The Council emphasised that the essential argument of its March 2009 report was that there is an analysis and understanding of the five distinct, but related, crises which suggests that Ireland needs an integrated, and clearly articulated, national response over the coming years. Consequently, Government should frame an integrated response, as far as possible in engagement with a range of Irish organisations. But, the Council, emphasised 'It is the shared analysis and understanding that warrants the integrated response, not the joint engagement that warrants an agreed response' (5).

An integrated response would be characterised by wide societal ownership of the need to respond to all five dimensions of the crisis and of the framing, implementation and adaptation of the response. It acknowledged that the Council's work in framing a shared analysis and understanding is only a first step in creating such wide ownership.

2.6 What is Our Ambition?

The Council argued that, in the midst of the severe difficulties Ireland is currently experiencing, it is important not to lose sight of the fact that states and societies with impressive social and economic achievements have, at various times, experienced similar setbacks. Among these are small countries such as Sweden, Denmark, Finland and the Netherlands.

Several things characterise these countries and should be kept in view in maintaining Ireland's ambitions despite the severity of our current difficulties. In Sweden, Denmark, Finland and the Netherlands, dynamic firms have emerged from an effective national system of innovation—although the nature and size of the firms and the national innovation systems differ significantly from one to another. Perhaps the most striking feature is that these countries—that have achieved greater enduring prosperity and high levels of inclusion and solidarity— have radically changed their public systems, in order to make them more effective in providing economic and social services that support both citizens and enterprises. This willingness of Sweden, Denmark, Finland and the Netherlands to change can be seen as a reflection of the high expectations they have of their public systems; in turn, this reflects the way in which social solidarity and well-being is achieved and expressed.

In March 2009, the Council argued that the actions Ireland takes in the next two years will, in large measure, determine whether it achieves the ambition of economic and social performance equivalent to that in the leading small European countries, or whether, in twenty years time, we will be an EU state that lags in prosperity, social cohesion and is burdened by fiscal deficits and debt.

3

Next Steps: Linking Economic, Social and Fiscal Policy

3.1 Introduction

In this section, we offer some overall observations on developments since the Council published *Ireland's Five-Part Crisis: An Integrated National Response*. Section 3.2 discusses the on-going challenge of finding an integrated, nationally-supported, way forward and notes a policy bind that could hamper progress to such an approach. Section 3.3 argues that the evolution of debate and policy on bank stabilisation may be instructive in this regard. While that debate has progressively widened, it cannot yet be said that a similarly engaged and evolving debate is occurring on the fiscal, social and the economic aspects of the crisis. Section 3.4 suggests that a way out of the possible policy bind lies in combining ideas and action at three levels: a vision of the kind of society and economy that Ireland wishes to become, knowledge and ideas on key aspects of economic and social development, and practical policy development and compromises. Finally, Section 3.5 discusses the key challenge now, namely embedding the economic and social focus in fiscal policy in the coming months and years. This requires the identification of the kind of agreed criteria that seem lacking in discussion of possible policy responses to the fiscal, economic and social dimensions of the crisis.³

3.2 Absence of an Integrated, Nationally-Supported, Way Forward

The evidence assembled in the Appendix shows that there has, indeed, been a very significant policy response to the crisis. Yet, for a variety of reasons, there is little easing of the crisis in banking, the fiscal position, the economy and the society. Some stabilisation of Ireland's reputation does seem to have been achieved, but the desired level of benefit from a recovering reputation have yet to materialise, for reasons that we discuss below.

The Secretariat's review of developments in banking, public finance, the economy and society, and the Council's own discussion, highlights major challenges within each of these areas. But it also brings to light the continuing challenge of achieving a coherent widely-understood and nationally-supported strategy across the five areas. Indeed, the review of developments since March 2009 confirms the Council's view that:

- ◆ a convincing approach to any one dimension of the crisis is, in part, dependent on a widely-understood approach to the overall national crisis; but equally,

3. As noted in earlier NESC reports, the Secretary General of the Department of Finance did not consider it appropriate to comment on matters of budgetary policy.

- ◆ a widely-understood approach to the overall crisis requires a clear and purposeful approach to each of the five elements, taken one by one.

This creates a danger that the policy approach to the whole crisis could be compromised by the lack of conviction about action on each of the parts, while support for action on each of the parts could be withheld because there remains confusion or disbelief about the effectiveness or fairness of the overall national response.

This inter-connection underlines the difficulty of finding a way through the crisis and the risks involved. The risks are of several kinds. First, attempts to address any one aspect of the crisis are likely to fail if they are not integrated with demonstrable and clearly-understood action on the other fronts. Second, in responding to the fiscal, economic and social crises, actions could be taken that damage the economy and/or society in the medium term. Third, sectional pressure on policy makers could result in failure to take sufficient or correct action, leading to prolonged crisis and/or national insolvency. Finally, unless they are seen as a part of an integrated and fair overall approach, actions in response to parts of the crisis might prompt conflict which could weaken social cohesion and the ability of Irish society to find a coherent path through the crisis. Indeed, these risks apply in both the short and long run. Recovery of economic activity, employment and revenue could be delayed in the coming years; and Ireland's potential for real economic and social development could be weakened, with consequences lasting decades.

3.3 Integrated and Non-Integrated Policy Debates: Bank Stabilisation and Fiscal Policy

The evolution of debate and policy on the banking crisis may be instructive in this regard. Telling points have been made from several sides and public understanding of the policy options has undoubtedly advanced. Independent of one's view on the core substantive issue, the debate on the banking crisis has progressively widened from deposit guarantees, to bank stabilisation, regulation, the accountability of senior bankers and, more recently, credit provision, and consideration of one of the long-term weaknesses in Irish policy, noted by the Council in March: the system of land management, planning and housing. Given the evolution of the debate, it may be the case that some of the difficulties in generating a shared understanding of the banking crisis arise from doubts and fears about how the other aspects of the crisis—fiscal, social, and economic—will be addressed in the coming years.

If debate and policy on bank stabilisation has evolved, and become increasingly informed by awareness of long-term weaknesses in Ireland's policy system, it cannot yet be said that a similarly-informed and evolving debate is occurring on the fiscal, social and, indeed, the economic aspects of the crisis. Policy and public discussion on these aspects of the crisis seem still dominated by short-term, immediate and zero-sum aspects; it has not proven possible to secure support for a perspective based on long-term mutual-gains. Yet a huge amount—in the next few years and coming decades—depends on addressing these difficulties

with short-term measures that can be shown to have a long-term logic. Indeed, as argued by the Council in March, the central requirement for Ireland's survival is to energise Irish people to work together in a problem solving way (47).

As reported in the Appendix, there have undoubtedly been significant developments in fiscal policy. The Government has achieved savings of €10.5 billion or 6.3 per cent of GDP and published the McCarthy report. Despite this, there continues to be a huge gap in the public finances. In 2009, tax revenues are forecast to be 27 per cent below 2007 levels and in the same period total gross voted expenditure, which excludes debt service, has increased by 13 per cent. As a result, Ireland's general government deficit in 2009 is likely to be around 12.2 per cent of GDP. Indeed, the likely level of exchequer borrowing in 2009 will be the region of 15.6 per of GDP. Because of increased borrowing, interest costs are forecast to rise from 4¹/₂ per cent of tax revenue in 2007 to around 11 per cent in 2009 and, based on Supplementary Budget forecasts, will account for around one-fifth of tax revenue by 2013. Growth forecasts for 2010 suggest that little automatic correction is likely in the near term; in any case, there is a significant structural as well as cyclical component in Ireland's budget deficit. The gravity of the public finance position means that significant budgetary measures will be required for 2010 in order to begin the process of reducing the very large deficit described above.

There remains a tendency for opinion on the fiscal crisis to polarise into two camps, with one stressing the need to reduce the gap between spending and revenue and the other the need to maintain existing services and conditions. These positions tend to cancel one another out, rather than pushing the debate into new terrain in ways that makes policy decision clearer and public understanding greater.

One of the reasons for the lack of progress might be that the fiscal debate may be seen as too 'fiscalist'. A single-minded focus on the necessity of addressing the growing budget deficit draws attention to the largest areas of programme expenditure—such as social welfare, health and education. Yet, framing a fiscal response in this way could be self-defeating, if it failed to *explain* why one set of options should be chosen over another, save for the fact that they are of a sufficient magnitude. The McCarthy report alluded to this problem when it noted that the commitment in the April 2009 Supplementary Budget to secure further expenditure savings needed to be 'matched with appropriate mechanisms to decide and deliver the savings at political and administrative levels' (McCarthy Report, 2009: 10). This suggests that proposals for budget adjustments need to be assessed against some set of criteria that offer both policy makers and the public reasons for adopting them, something we discuss further below.

The discussion on the banking and fiscal crises seem to differ because in the former proposals have broadened to include issues involving economic recovery, a social dividend and restoration of the banking sector's reputation. Not only does this begin to take account of the interdependence of the five crises, but it might also encourage action to address some of the long-term defects within Irish banking such as over-exposure to one particular market or product. The public response to the fiscal crisis has not yet witnessed a similar broadening. If it were to happen, the fiscal debate would need to extend to encompass issues of how fiscal consolidation

could aid the employment crisis, move in the direction of a developmental welfare state and, explore ways in which public sector reform can mitigate the impact of expenditure reductions and enhance the social investment character of social spending. Indeed, without full appreciation of the inter-dependence between the fiscal, social and economic dimensions of the crisis there is a tendency to insulate consideration of fiscal options from organisational and reform possibilities. In addition, it would also need to address in a convincing way some of the long-term defects in Ireland's fiscal system that have ensured that 'projections for expenditure are all-too-easily blown off course' (McCarthy Report, 2009: 10).

3.4 A More Integrated Consideration of Fiscal, Economic and Social Policies

Is it possible that consideration of policies to address the fiscal, economic and social aspects of the crisis could evolve, becoming more integrated? Could the policy approach to these aspects of the crisis be informed by both immediate pressures and longer-term understanding of the policy and institutional contradictions?

In emphasising the inter-connection between aspects of the crisis, and naming the policy bind that can result, the Council is aware that it has a duty to work with others to explore how we might escape from it. It suggests that the solution lies in combining ideas and action at three levels:

- ◆ A vision of the kind of society and economy that Ireland wishes to become in the decades ahead, and towards which responses to the crisis will help us move;
- ◆ Knowledge and ideas on key aspects of economic and social development: Ireland's structural position in the world economy, the sources of innovation, human development and skills, participation and the labour market, public services for the 21st century, the strengths and weaknesses of our policy and administrative systems, fiscal stabilisation, and taxation that is supportive of high participation;
- ◆ Practical policy development, compromise and implementation, based on the experience and capabilities of a wide range of people.

Below we briefly discuss why together these three may help escape from the possible policy bind described above.

3.4.1 A Vision of the Society We Want to Create in Ireland

First, an articulated vision of what a successful Irish society should look like can help by reassuring people that the undoubted sacrifices experienced already and further unavoidable costs will be worthwhile in the years and decades to come, because they are painful steps to a society people have reason to value. The crisis is clearly inflicting immediate damage on individuals, families, localities and enterprises. But the prospect of return to conditions of recent years is not a sufficient vision. For the crisis seems also to be depriving people of the prospect of some of the improvements, in services and life chances, that they had begun to expect, such as those aimed at in the National Disability Strategy. They will want to know whether the values and goals in these strategies are still shared, despite

the setback in progress towards them. Furthermore, the crisis has also made people aware of long-standing weaknesses in Ireland's social and economic policies, such as taxation, housing, land management and activation. They are unlikely to be motivated by the prospect of a society that does not fix these broken systems. A clear and credible statement of vision has the prospect of persuading diverse groups not only that current and forthcoming sacrifices are fair, but that the society that is to be achieved through sacrifice will be fair.

3.4.2 Knowledge and Ideas

Second, knowledge and ideas on a range of economic and social mechanisms are vital in choosing policies and reforms to address the crisis and, equally important, in avoiding crisis measures that unwittingly damage economic recovery, innovation, future skills and capabilities, economic participation and social cohesion. The necessary knowledge and medium-term perspectives to underpin each approach may be found in the following sources, among others:

- ◆ *The McCarthy report*, which includes an overview and catalogue of expenditures and explains the programmes, provisions and contracts that generate a given total expenditure in each programme and department;
- ◆ The Government's report *Transforming Public Services: Citizen Centred-Performance Focused* (2008), itself a response to the OECD's long-term analysis of Ireland's public service (OECD, 2008);
- ◆ *Building Ireland's Smart Economy* and associated knowledge on the sources and nature of innovation and on the green economy;
- ◆ *The Developmental Welfare State* and associated knowledge on labour markets and activation;
- ◆ Forfás' work on industrial development and policy, including *Ireland's International Engagement in Science, Technology and Innovation* and *Catching the Wave: A Services Strategy for Ireland* (Forfas, 2008a and b);
- ◆ *The Commission on Taxation, Report 2009*;
- ◆ The NESDO report *Ireland at Another Turning Point: Reviving Development, Reforming Institutions and Liberating Capabilities* (2009);
- ◆ Key knowledge on the role of land management in sustainable development—including the report of the All-Party Oireachtas Committee on the Constitution and Private Property (APOCC, 2009), the NESC study on housing (NESC, 2004) and the Department of the Environment, Heritage and Local Government policy statement *Delivering Homes, Sustaining Communities*.
- ◆ National and international evidence on fiscal policy, fiscal consolidation and associated public sector reform.

In different ways, these studies and bodies of knowledge throw light not only on immediate challenges, but also on relevant aspects of Ireland's structural position and some long-standing strengths and weaknesses of our public policies and institutions.

Indeed, the NESDO report, *Ireland at Another Turning Point*, notes the sense that this profound crisis is another turning point in national economic and social development (NESDO, 2009). In this context, it reflects on Ireland's past experience of crisis and our earlier approach to managing major turning points. That report argues that in both the 1950s and 1980s a way beyond the crisis was only found once recognition of the hard fiscal realities was combined with a revived developmental approach, institutional reform and some concentration of authority. In particular, at both these earlier turning points:

- ◆ the solution to the crisis was focused on development, both economic and social;
- ◆ the decision to make the crisis a turning point was marked by the reform of existing institutions and the creation of new ones;
- ◆ to the degree that the crisis-induced turning point involved a concentration of authority, this was done in order to liberate talent rather than increase control.

There are many reasons to believe that this Irish experience of dealing with crises and turning points in the late 1950s and late 1980s is relevant in current circumstances.

3.4.3 Practical Policy Development, Compromise and Problem Solving

Third, vision, principles and knowledge are of limited use if not reflected in practical policy development, appropriate compromises, effective implementation and joint search for new solutions to problems. This is true in general, for a number of reasons. Vision and principles are quickly seen as hot air if they are not expressed in practical action. Vision and principles can never anticipate all contingencies that practice must address; indeed, solving unanticipated problems can be the source of new vision and principles. Many concrete examples could be cited; one of the most striking and relevant is the way in which the crisis of the 1980s pushed Denmark to invent activation policies, which in turn prompted reforms of the welfare system. It was this search for practical responses to severe crisis that set Denmark on the road that eventually led to the 'principles' of flexicurity and the transition from a 'Keynesian welfare state' to what they now call 'an enabling welfare state' (Kristensen, 2009: 10). Practical policy development and compromises are especially important in Ireland right now. The depth of Ireland's problems and the need for immediate further responses means that any protracted wrangling over vision and principles will, correctly, be viewed with suspicion—as strategic rather than principled behaviour. Indeed, the severity and complexity of the crisis is such that practical policy development and compromise will have to be multi-annual, involving a sequence of actions, sacrifices and rewards. This is all the more reason why practical actions need to be placed within a framework of shared general goals and informed by the best available knowledge.

3.5 Key Challenges Now

3.5.1 Embedding the Economic and Social Focus in Fiscal Policy

In its review, the Secretariat reports very significant developments since March 2009. As noted in our introduction, the country now faces some immediate decisions on fiscal, economic and social aspects of the crisis. In this context, the most concrete requirement for an integrated, nationally-supported, approach is that a response to the social and economic aspects of the crisis be embedded in fiscal policy in the coming months and years.

From existing analyses, we know many ways in which our systems of social policy, activation, training and education are not sufficiently supportive of participation, up-skilling and inclusion. *The Developmental Welfare State* and many other studies give us guidance on ways in which income transfers, services and activation measures could be re-cast to achieve better outcomes. Indeed, adopting this reforming approach, it will often be possible to achieve better outcomes while achieving necessary budgetary adjustments.

From current experience—of firms, the newly-unemployed, departments, agencies, colleges, the social partners and other groups—we are beginning to see new ways in which existing policies and systems are not yet adequately addressing the problems thrown up by the crisis. A response to these economic and social problems also needs to be embedded in upcoming budgetary decisions and the fiscal adjustment of the coming years.

3.5.2 Criteria for Selecting and Designing Further Policy Responses

The Council believes that these considerations could aid the identification of the kind of agreed criteria that seem lacking in discussion of policy responses to the fiscal, economic and social dimensions of the crisis:

- ◆ **Economic/cyclical:** The measures should, as far as possible, contribute to the revival of economic activity and employment;
- ◆ **Developmental:** The measures should, as far as possible, strengthen the foundations of Ireland's economic and social development;
- ◆ **Fairness:** It should be possible to explain how the chosen tax, expenditure and other policies are as fair as possible;
- ◆ **Sustainability:** The adjustment process must be sustained until Ireland comes through the crisis, must yield a sustainable public finance approach, and should, as far as possible, put Ireland on a path that is sustainable—economically, socially and environmentally.

While these criteria might seem obvious and bland, they do differ in quite specific ways from other approaches to addressing the fiscal, economic and social crises.

- ◆ A narrow, fiscalist, view that considers only the budgetary arithmetic—concentrating on adjustments that have two kinds of certainty (i) cuts which will have known impact on total expenditure in the short term and/or (ii) cuts that can definitely be achieved since they are under direct control of central government;

- ◆ Special pleading that very particular programmes should be spared from budgetary adjustment;
- ◆ Generalised pleading, that all programmes with an ‘economic’ function or a ‘social’ function, depending on the point of view, should be left unchanged;
- ◆ Approaches which take an undifferentiated view of either the budgetary or demand effect of policy measures, not recognising that various elements of public spending have different effects on the national output, employment, social equality and development;
- ◆ A view which assesses all policy proposals mainly by reference to the *immediate burden/benefit* they might impose on households or firms, ignoring any deeper understanding of the economic and developmental criteria mentioned above.

While the four criteria—cyclical, developmental, fairness and sustainability—will, of course, leave policy options hotly debated, they do offer the possibility of a more coherent and widely-understood policy response. Indeed, the evolving debate on bank stabilisation, discussed above, can be seen as an example of these criteria coming increasingly and jointly into play.

3.5.3 A Challenge for Government and Others

We have argued above that an integrated, nationally-supported, approach now requires that responses to the social and economic aspects of the crisis be embedded in upcoming budgetary decisions and in fiscal policy in the coming years. These arguments suggest that in focusing on the severity of the fiscal position, thought might be given, as a matter of urgency, to finding structures and processes that are capable of selecting the tools to be used in each policy area. In selecting which approach to adopt in each area, account needs to be taken of the speed at which each tool can be designed and used; and the likely timing of its impact on the deficit, economy and society. It is then necessary to combine, sequence and implement the chosen changes. In selecting, combining, sequencing and implementing the chosen changes, such a process should aim to design fiscal, economic and social policy actions that are the start of a deeper process of reform, which will address the fiscal problem but also be socially inclusive and citizen-focused.

In making these observations, the Council acknowledges that finding an integrated, nationally-supported, response cannot be a task for government alone. The interconnected nature of the banking, fiscal, economic, social and reputational aspects of the crisis, inevitably means that the action and attitudes of many non-government organisations are critical in finding a way forward. The encompassing nature and severity of the crisis means that no economic or social organisation or interest can avoid its consequence or absent itself from the search for solutions. If the Council’s analysis is correct, the clearest and most purposeful government policies still require significant engagement of individuals, firms and non-government organisation to achieve their most beneficial effects.

For these reasons, this short report is addressed not only to government but to the full range of economic, social and policy actors—all of whom have a role in finding and implementing a path through this national crisis.