Policy Background Memo

Ireland, 2008-

Note: Policy background memos contain information from various sources on the political economy of a particular country and economic and social policy choices before, during, and after an economic crisis. The memos do NOT contain any original information or analyses, but rather summarize material from various sources. The material is at times quite raw – the text is often presented in bullet points and sources are often quoted verbatim. Thus, the background memos should primarily serve as an overview of 1) policy developments in a particular country, and 2) academic research on the subject.

1 Background

Economy

From 1987 to 2007 economic growth averaged 6.3% per year (Whelan 2014, 424). The growth has been attributed to several factors, but most importantly, Ireland was catching-up to the rest of the advanced democracies in terms of the proportion of the population in employment. Furthermore, Ireland benefited disproportionately from adopting the Euro and provided a competitive business climate (~low taxes) for US foreign investment in Europe(Hick 2014, 396). In tandem with exponential growth and the inflow of cheap capital, there was a massive housing (and construction) boom in lead up to crisis. Mortgage rates were greatly reduced and housing prices quadrupled between 1996 and 2007 (Whelan 2014, 424).

Politics

Traditional left/right or social class cleavage not a salient feature of Irish politics. Two biggest parties Fianna Fáil and Fine Gael, which are associated with taking the opposite sides on the Treaty of Independence in 1921. Both parties have cross-class appeals. Labour party has generally been the third biggest party (Dukelow 2011, 410). Fianna Fáil and Progressive Democrats formed a majority government from 1997 to 2007, with the Green party joining the coalition in 2007. In 2008, the Progressive Democrats disbanded but individual MPs continued to support the government. Fianna Fáil and the Green party held a majority until the 2011 elections, when Fine Gael and the Labour Party formed a coalition government.

The industrial relations system in Ireland has historically been fragmented, as is typical of liberal market economies. However, the economic crisis of 1980s lead to a pragmatic social partnership involving government, labour unions, and employer organizations, as well as community and volunteer sector later on. Six three/four year social pacts successfully agreed from 1987 until 2006. Seventh pact active when crisis hit (Doherty 2011).

Fiscal Policy and Welfare

In the lead up to the crisis, budgets generally resulted in modest surpluses, although given the strong state of the economy, the European institutions criticized authorities for being too expansionary (European Commission 2011a, 9).

The personal income tax was lowered slightly between 2000 and 2007, with the first marginal rate lowered from 22% to 20% and the second (top) marginal rate from 44% to 41% (OECD n.d.). From 2000 to 2007 the corporate income tax was nearly halved, going from 24% to 12.5% (OECD n.d.). The VAT remained at 21% from 2000 until crisis hit (OECD n.d.). Social security taxes on employers and employees lowered slightly (OECD n.d.).

"Between 1997 and 2009, social welfare rates more than doubled, and Child Benefit quadrupled, representing a real increase of 65 per cent to 70 per cent in the value of the State Pension (Contributory) and Jobseeker's Benefit, and a trebling of the value of Child Benefit in real terms (author's calculations)" (Hick 2014, 400).

2 Crisis

Housing and construction bubble burst in 2007. Unemployment increased and income tax revenue decreased rapidly. Furthermore, due to increasing reliance on various taxes related to construction activities, the crash of the housing market hit the government coffers doubly hard (Whelan 2014, 424).

Housing and construction activity relied heavily on open access to funding from banking sector. Furthermore, banks were increasingly funded by international bonds, which were a less stable source than traditional deposits. Collapse of Lehman Brothers precipitated increased suspicion of health of balance sheets of banking sector and funding dried up in September 2008 (Whelan 2014, 424). An economic recession, thus, became a full fledged financial crisis.

Real GDP contracted by 10 per cent over 2008 and 2009 (Whelan 2014, 424), while the unemployment rate increased from 4.6% in 2007 to 13.6% in 2010 (European Commission 2011b, 217).

The budget deficit increased rapidly: In 2007, the budget was nearly balanced (0.1% of GPD surplus), in 2008 the deficit was 7.3% and it increased to 14.2% in 2009 (European Commission 2011b, 223). Between 2007 and 2010, gross government debt increased from 25% to 95% of GDP (European Commission 2011b, 225).

Size of automatic stabilizers average compared to EU27, but due to the magnitude of the contraction in Ireland, they nonetheless generated a (automatic) fiscal stimulus of about 4% of GDP in 2008 and 2009 (Cameron 2012, 106)

3 Policy Response and Politics

September 2008

Fiscal → Blanked guarantee by government on all existing and future liabilities of the six domestic Irish banks. Provided for 2 years, such that any default on bank liabilities during that period covered by government (Whelan 2014, 424). This limited possible downstream actions of government considerably. During 2009 and 2010, an estimated 29% of GDP was injected into banking system by government (European Commission 2011a, 13)

October 2008

Fiscal → First post-crisis budget introduced on October 14. No radical measures to either consolidate the budget or stimulate the economy. Changes to tax policy estimated to increase revenues by 1 per cent of GDP (Barnes and Wren 2012, 289).

Taxation → Standard VAT rate increased by 0.5%, from 21 to 21.5 per cent.(ILO)

Taxation → New income levy introduced. Rate of 1% on gross income up to €100,100 per annum, and 2% in excess of that amount.(ILO)

Taxation → Capital gains tax increased from 20% to 22% (European Commission 2010).

Unemployment → *"Minimum number of of social insurance contributions required to quality for jobseekers benefit and for illness benefit doubled"*(Dukelow 2011, 423).

Unemployment → *"Maximum duration of entitlement to jobseekers benefit reduced from 15 to 12 months (and 9 months where the person has made less than 260 contributions"* (Dukelow 2011, 423).

Welfare → State pensions and other cash-transfer payments increased by 3.3 per cent. (ILO)

February 2009

Public sector → *"Introduction of a pension levy on public sector wages. New arrangement: first € 15 000 of earnings exempt, 5 % on next €5000 of earnings, 10 % on earnings between € 20 000 and € 60 000 and 10.5 % on earnings above € 60 000."* (European Commission 2009, 15)

March 2009

Politics → Breakdown of social partnership. Government reverts to unilaterally cutting spending, increasing taxes, and cutting wages and personnel in the public sector (Doherty 2011).

April 2009

Politics → *"Just six months after the 2009 Budget, the government was forced to announce another full Supplementary Budget. The bursting of the housing bubble deprived the exchequer of the revenues it had increasingly become dependent on, leaving a gaping hole in the public finances. In this Supplementary Budget of 2009, a series of harsh expenditure cuts and tax rises were announced"* (Hick 2014, 402). Ireland headed for annual deficits of about 20% (Whelan 2014, 424). Designed to save the exchequer €3.3 billion (revenue increases 55%, spending cuts 45%) (ILO).

Employment → Activation measures amounting to €128 million (~0.1% of GDP) announced. (ILO)

Family → *"Universal early child care supplement withdrawn and replaced with one year of free pre-school"* (Dukelow 2011, 423).

Family → *"Child benefit for those aged 18 years and over to be withdrawn on a phased basis"* (Dukelow 2011, 423).

Housing → *"Reduction in rent supplement"* (Dukelow 2011, 423).

Sickness → *"Minimum number of of social insurance contributions required to quality for jobseekers benefit and for illness benefit doubled"* (Dukelow 2011, 423).

Sickness → *"Entitlement to illness benefit limited to two years for new claimants"* (Dukelow 2011, 423).

Taxation → Rates of previously introduced income levy doubled and entry point of each rate lowered. (ILO)

Taxation → Capital gains tax increased from 22% to 25% (European Commission 2010)

Taxation → Ceiling on employee social security contributions raised by almost 50%, from €52000 to €75036. (European Commission 2009, 15)

Unemployment → *"Jobseeker's and supplementary welfare allowances cut by 51 per cent for new claimants aged under 20 who do not participate in a training programme"* (Dukelow 2011, 423).

Unemployment → *"Double social security payment made in December withdrawn – equivalent to 1.9 percent cut"* (Dukelow 2011, 423).

December 2009 (for budget year 2010)

Fiscal → Third contractionary budget in fourteen months introduced. Fiscal consolidation continues to be primarily on expenditure side, with 66% of savings coming from spending cuts and 34% from tax increases (OECD 2012, 160). *"...[T]he biggest revenue impact stems from the Carbon Tax ... The estimated revenue is € 330 million (including VAT) per year."* (European Commission 2014, 100).

Employment → Activation measures amounting to €136 million (~0.1% of GDP) announced. (ILO)

Family → *"Child benefit rates reduced by between 8.2 and 9.6 per cent"* (Dukelow 2011, 423).

Housing → *"Reduction in rent supplement"* (Dukelow 2011, 423).

Housing → Announced that mortgage interest relief will be faded out and abolished by end-2017 (European Commission 2014, 100).

Public sector → Tiered pay cuts for public employees. (5% on the first €30,000 of salary; 7.5% on the next €40,000 of salary and 10% on the next €55,000 of salary). (ILO)

Taxation → VAT standard rate reduced by 0.5%, back to 21%. (ILO)

Unemployment → *"Rate for jobseeker's allowance and supplementary welfare allowance reduced by 23% where job offers or activation measures refused by claimant"* (Dukelow 2011, 423).

Unemployment → *"Jobseeker's and supplementary welfare allowance reduced by 51 per cent for 18-21 year olds and by 23 per cent for 22-24 year olds"* (Dukelow 2011, 423).

Welfare → *"Weekly welfare payments to all working age adults reduced by between 3.5 and 4.2 per cent"* (Dukelow 2011, 423).

March 2010

Politics → Four year agreement between public sector unions and the Government (Croke Park Agreement). Government agreed that no further pay cuts would be enacted for the duration of the agreement (until 2014), while unions agreed that public sector employment would be reduced, by continuing the moratorium on recruitment and promotion; that it would be made easier to move public employees across and within sectors ('flexible redeployment'); and, that the design and delivery of public services would be subject to substantial reconfiguration (Doherty 2011)

November 2010

Politics → When two year government guarantee on banking sector liabilities came close to expiring, banks faced increasing difficulties in accessing funds. Given the situation, Irish authorities were forced to seek help from abroad (Armingeon and Baccaro 2012, 173). Bailout agreed with troika of European Commision, ECB, and IMF for a total of €85 billion. National Recovery Plan 2011-14 published with aims of achieving budgetary adjustments of €15 billion through increased taxation (1/3) and spending cuts (2/3). Spending cuts to welfare substantial, with a 13 per cent reduction from 2010 levels announced (Hick 2014, 398).

Employment → Minumum wages to by reduced by €1, to €7.65. (Government of Ireland 2010, 10).

Pension → Retirement age to be gradually increased to 68, from 65 (Armingeon and Baccaro 2012, 173).

Taxation → Standard VAT rate to increase from 21% to 22% in 2013, and to 23% in 2014.

December 2010 (for budget year 2011)

Fiscal → Budget introduced. Fiscal consolidation continues. *"The biggest contribution to the consolidation in 2011 in terms of revenue comes from the income tax with more than € 1.2 billion mainly through the reduction of tax credits (€ 435 million) and changes in the rate band (€ 395 million).*" (European Commission 2014, 100).

Family → *"Child benefit rates reduced by between 6.3 and 8.2 per cent"* (Dukelow 2011, 423).

Health → Spending cuts amounting to €750 million. Estimated to save 0.9% of GDP over 2011-14 period (OECD 2011, 134)

Taxation → Previously introduced income levy abolished, along with a special pre-existing health levy. Instead, a Universal social charge (USC) introduced. (European Commission 2014, 100). Revenue neutral for first year (distributional consequences?). The USC's marginal rate ranges from 2% to 7% (European Commission 2011c, 116)

Unemployment → *"Jobseeker's and supplementary welfare allowance for 22-24 year olds cut by 6 per cent"* (Dukelow 2011, 423).

Welfare → *"Weekly welfare payments to all working age adults reduced by between 3.8 and 5.1 per cent"* (Dukelow 2011, 423).

March 2011

Politics → Fine Gael and Labour party form a coalition government after February elections, replacing the Fianna Fáil and Green party coalition government. Pledge to maintain social welfare rates, which was generally understood as a commitment to not cut rates further (Hick 2014, 403). Fianna Fáil suffered historic defeat, losing 57 of their 77 seats in the lower chamber (Armingeon and Baccaro 2012, 174). Fine Gael and Labour party both made promises of renegotiating the financial package from the Troika and force banking creditors to take a "haircut", but little materialized of the promise after the elections (Armingeon and Baccaro 2012, 174).

December 2011 (for budget year 2012)

Fiscal → Budget introduced. Fiscal consolidation continues. *"While there are a number of tax increases, the Finance Bill 2012 also foresees increasing the lower exemption threshold of the Universal Social Charge, exempting around 330 000 people."* (European Commission 2014, 100).

Education → Cost of education allowance reduced by 40 per cent (Hick 2014, 409).

Family → Earnings disregard for one parent family payment reduced by 11 per cent, with further reductions in next four years planned (Hick 2014, 409).

Family → *"The temporary, half-rate payment when earnings rise above €425 to be discontinued [for new claimants of the one parent family payment]"* (Hick 2014, 409).

Family → Upper age limit of one parent family payment to be reduced from 18 in 2011 to 7 by 2015 (Hick 2014, 409).

Pension → *"Rate of payment for claimants with average of 20 weekly contributions per year reduced from 98% to 85% of full rate, with minimum entitlement at 10 average contributions reduced from 50% to 40% of the full rate"* (Hick 2014, 409).

Taxation → Standard VAT rate increased from 21% to 23% (European Commission 2014, 100).

Taxation → Standard rate on capital gains tax increased from 25% to 30% (European Commission

2014, 100).

December 2012 (for budget year 2013)
Fiscal → Budget introduced. Fiscal consolidation continues, with just under 60% of savings coming from spending cuts. *"The key revenue raising measures were widening of the social insurance tax base, a new property tax, increased excise duties on alcohol and cigarettes and increased rates of Vehicle Registration Tax and motor tax on all vehicles."* (European Commission 2014, 100).

Education → Cost of education allowance discontinued (Hick 2014, 409).

Unemployment → Maximum duration of entitlement to jobseekers benefit reduced from 12 to 9 months for those with over 260 contributions, and from 9 to 6 months for those with less than 260 contributions (Hick 2014, 409).

Family → Higher rate child benefit payments for third and subsequent children discontinued (Hick 2014, 409).

October 2013 (for budget year 2014)

Fiscal → Budget introduced. Fiscal consolidation continues, with two-thirds of savings coming from spending cuts. *"The key revenue raising measures were increased excise duties and various charges on the financial sector"* (European Commission 2014, 100).

Pension → *"State Pension (Transition) abolished (in practice, raises retirement age from 65 to 66)."* (Hick 2014, 409).

Taxation → *"The minimum income tax threshold will fall from EUR 18 300 to EUR 15 300 by 2014, reducing the proportion of workers paying no tax from 45% to 35%. Including the elimination of tax breaks, these initiatives provide EUR 1.9 billion in additional 2011-14 revenue. "* (OECD 2011, 134)

Unemployment → Jobseeker's allowance reduced for new claimants aged 25 and for all claimants 18-24 year old. Reductions do not apply for those in approved education or training schemes or for claimants with children (Hick 2014, 409).

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