

APPENDIX 1

THE IMPACT OF UNITE'S INVESTMENT STRATEGY

The Government has admitted their policy of cutting €14 billion out of the economy was a failure.

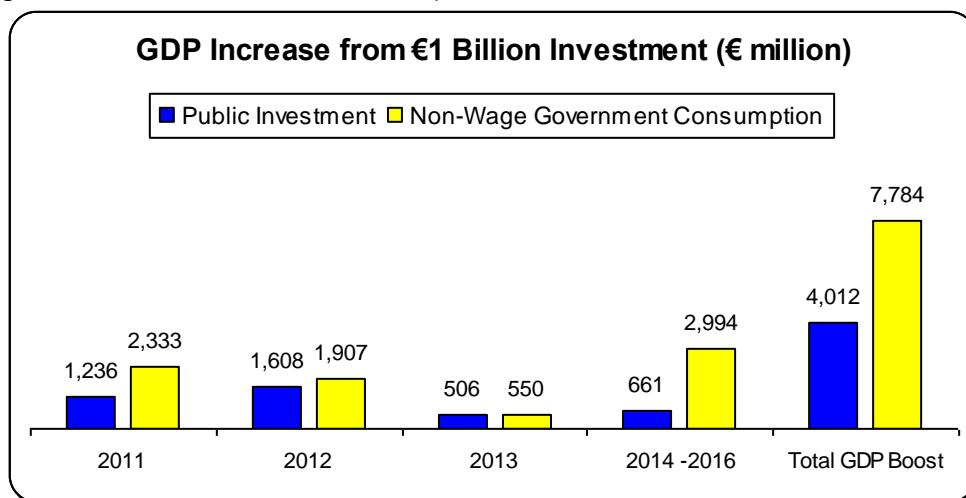
Now let's turn to an effective deficit-reduction strategy – one that understands that healthy public finances are inextricably intertwined with economic growth, job creation and rising living standards.

The following projections are provisional as the Government has announced they will publish new fiscal estimates following the release of the memorandum with the IMF/EU prior to the budget.

1. Investment – Growth, Jobs, and Deficit Reduction

We can assess the economic impact of our €15 billion investment programme¹. There are two ways to boost investment - through public investment or through public services (or non-wage government consumption). As seen, there is a considerable boost to GDP growth with non-wage consumption being the higher.

With respect to public investment, the table below only measures the 'demand-side' impact: this refers to the benefit that arises when the particular asset is being created or upgraded (e.g. the actual building of a next generation broadband network).



¹ The Lane-Benetrix multipliers: The Impact of Fiscal Shocks on the Irish Economy, Agustin Benetrix and Philip Lane, *The Economic and Social Review*, Vol. 40, No. 4,

In addition, there is the supply side impact: this measure the benefit of the asset created when the economy ‘uses’ it (e.g. the benefit of businesses and households actually availing of the asset). This is smaller but it becomes near permanent.

On this basis, we can measure the increase in taxation revenue. The Government uses a tax revenue ratio of approximately 31 percent of GDP (covering Exchequer, social insurance and local taxes). Therefore, we can estimate that for every €1 billion invested, the state will recoup over the next six years:

- Public Investment: €1.24 billion
- Public Services: €2.41 billion

From a small amount of investment, the state will receive the benefit of nearly €3.6 billion over six years. The reason for this substantial increase is due to employment: the Department of Finance estimates that every €1 billion in capital investment creates, on average, 10,000 jobs while the ESRI estimates that, in the medium-term 4,000 jobs will be created. The job content from public service investment is likely to be higher.

Of course, the actual amount of GDP boost and tax revenue will vary between different forms of investment – but the above is based on historical patterns.

2. Fiscal Consolidation through Taxation

The ESRI conducted two studies and found in both cases that increasing taxation has a less harmful effect on economic growth, consumer spending and employment which, in turn, provides a greater benefit to deficit reduction. We saw earlier that taxation measures realise higher ‘savings’ for the Exchequer. That’s because they are more ‘growth-friendly’. Here we measure the impact on GNP – the source of most of our tax revenue.

| 1st Year Impact on Growth from Budget Measures Equal to €1 billion | | | | | |
|--|----------------------------|----------------------------|------------------------------|--------------------------------|-------------------------------|
| | Increase Carbon Tax | Income Tax Increase | Increase Property Tax | Cut Public Sector Wages | Cut Public Sector Jobs |
| Impact on GNP | 1.0 | -0.2 | -0.3 | -0.4 | -1.0 |

Clearly, increasing taxation is less harmful to growth than spending cuts.

(a) Tax Increases after 2011

UNITE’s long-term strategy is to raise Government revenue to the European average – so that we can enjoy a European-level of public services and

economic investment. We fully endorse the ESRI's Professor John Fitzgerald's preference²:

Before we can determine the appropriate path of fiscal policy . . . we must first decide on what is the long run level of public services that we want. Then the tax level will have to be set at an appropriate level to fund that level of services. It is essentially a political question . . . My own preference would be to target a level of expenditure and revenue in the medium term equivalent to 45 per cent of GDP.

Therefore, it is crucial we start debating now how that will be achieved (though general taxation, social insurance, local taxation, etc.). During that transitional phase, it is important that consumer confidence and domestic demand be enhanced. Therefore, UNITE proposes general tax increases should only be introduced when wage growth resumes but just as crucially:

→ General taxation should be increased at a rate lower than that of wage growth.

We can see how this works through the example of a single average industrial wage earner:

| Average Wage Increase of 2.5 percent and a Personal Tax Increase of 1.25 percent starting in 2012 | | | | |
|--|-------------|-------------|-------------|-------------|
| | 2011 | 2012 | 2013 | 2014 |
| Disposable Income Increase (%) | - | 1.8 | 1.9 | 1.9 |
| Taxation as a % of Gross Income | 32.0 | 32.4 | 32.8 | 33.3 |

While the tax rate increases so does disposable income. This is how we can integrate rising taxation with wage growth while still maintaining domestic demand.

Raising taxation will provide more resources to the Exchequer with least damage to the economy. Prioritising high-income earners in the first year will allow recovery to set in so that general taxation can rise in 2012 in line with average wage growth. This is the progressive fiscal management the economy has, to date, been lacking.

3. REINVESTING SAVINGS TO GROWTH

Given that sending cuts are so economically damaging (cutting public sector employment by 17,000 employees raises only €330 million but cuts GNP by over €1 billion and reduces employment by over 20,000) there is little to be gained in cutting *overall* current spending levels. However, we can use any

² ESRI, Fiscal Policy For Recovery, October 2009

reductions achieved through efficiency gains, elimination of regressive spending programmes and falling unemployment costs to boost domestic demand. Here are some examples:

- An Bord Snip proposed reducing GMS payments to GPs to save €375 million³. If this were reinvested into rolling out a pre-primary/childcare network, the immediate economic benefit would be to increase employment by over 2,000, raise GDP by more than the amount 'saved' and reduce the deficit by 0.1 to 0.2 percent. This doesn't include the substantial social gains from early education or the considerable future supply-side boost that come from raising educational achievement.
- Let's assume that public sector efficiencies under the Croke Park Agreement would raise €450 million.⁴ Reinvesting this into restoring social welfare cuts would, at a minimum, increase consumer spending by a similar amount. As this expenditure worked its way through the economy, GDP would rise by over 0.3 percent while the deficit would fall by 0.1 percent. The gains could increase as enhanced consumer spending would disproportionately occur in low-income areas where multipliers would be higher.⁵
- UNITE's investment programme would create over 20,000 jobs directly in the first year with 40 percent of that being retained in the medium-term as a result of increased demand. This could create approximately €100 million in savings on unemployment and associated costs. If this were reinvested back into restoring pay cuts to low paid public sector workers, this would immediately raise €30 million in income tax/PRSI with the remainder largely increasing GDP through increased consumer spending.⁶

These are the real economic benefits of reinvesting to promote domestic demand while building up economic capital through stronger public services and protection.

For the purposes of this budget we will take a very conservative estimate of increasing savings of €500 million per year – from increased productivity, elimination of regressive programmes, and reduced unemployment costs.

³ It wouldn't actually 'save' this amount as more than half of this total would be lost through reduced tax revenue.

⁴ UNITE is sceptical about the alleged gains. The Government has no measurement to assess productivity gains. The Government's real agenda is to merely reduce public sector employment – one of the most deflationary and least fiscally-beneficial measures. That is not to say that a new Government might actually prioritise productivity rather than just down-sizing.

⁵ The impact would certainly be higher if the IMF study is to be believed. After capital investment, direct transfers to social welfare households ('hand to mouth households') have the most positive impact on the economy.

⁶ €100 million would restore approximately 40 percent of pay cuts to those earning below €35,000.

4. Sourcing the Investment

UNITE has written to the leaders of the opposition parties – Fine Gael, Labour and Sinn Fein – to ask them to repudiate the IMF/EU deal as it stands and to commit to re-opening negotiations if they enter Government. We have called on them to adopt two key principles:

- To refuse to be bound by the banking debt, and
- To ring-fence the cash and assets held by the National Pension Reserve Fund and the National Treasury Management Agency

Regarding the second principle, the current level of cash and assets available to the Government is approximately €34 billion (€14 billion held by the Pension Fund and €20 billion held by the NTMA). The Government has announced this will be used to subsidise the deficit and the debt. UNITE is opposed to this poor use of valuable resources – subsidising a plan that will fail to repair public finances.

→ **These resources should be used for investment during the next five years.**⁷

5. UNITE's Macro-economic Projections⁸

In bringing all the above elements together we assume the following:

- €12 billion temporary investment up to 2014
- €8 billion fiscal consolidation through taxation, though no taxes to be increased in 2011 on low-average incomes.

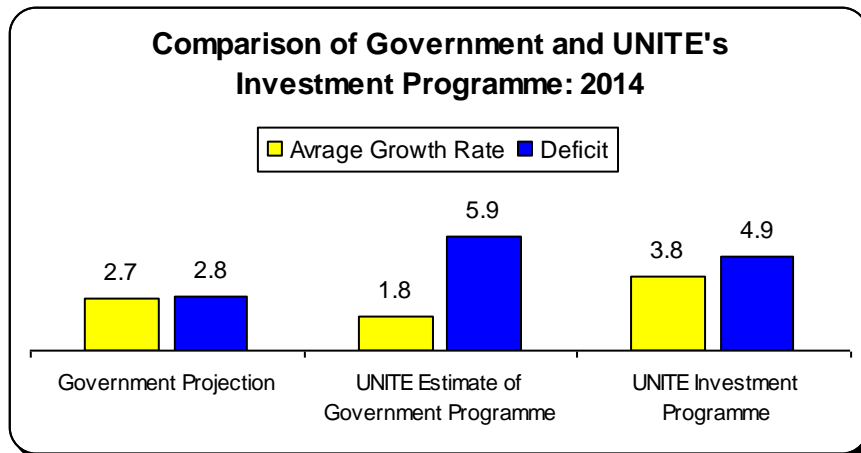
We stress these are provisional – we are awaiting new fiscal and economic data from the Government on foot of the IMF/EU bail-out. UNITE believes that the National Recovery Plan's underlying growth projections are too optimistic. They project that, before fiscal adjustments, the economy will grow by an average of 3.8 percent. On this basis the Government are projecting an average growth rate of 2.7 percent.

However, the day after the bail-out was agreed, the EU produced projections of 0.9 percent for the Irish economy next year – halving the Government's

⁷ The maintenance of the NTMA's cash balance costs, according to the ESRI, €800 million per year in recurring interest payments. An additional benefit of reducing this balance for the purposes of investment is to reduce interest payment costs by €120 million. This saving could be reinvested into either domestic demand or into investment.

⁸ UNITE's investment programme contains both temporary and permanent additions to public expenditure. It is envisaged that while in the Stabilisation Fund, the expenditure will be temporary and appear on the budget balance sheet as an 'extra-ordinary item'. While this may be technically counted as public spending by Eurostat, it does not require additional taxation or borrowing as this is spending from our savings. This line item will disappear once the temporary part of the programme ends. Integrating the remainder of the programme into permanent spending (e.g. capital expenditure) will depend on the pace of tax increases. However, there is sufficient savings to finance the entire investment from savings. This makes our 'stimulus' proposals different from what other countries had to do – borrowing further, necessitating cutbacks once their economies returned to growth.

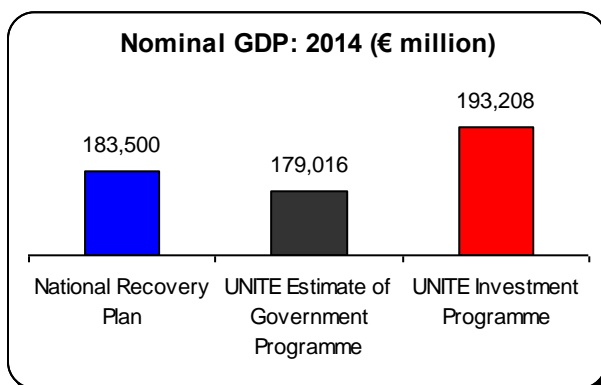
own projections. On this basis, it is difficult if not impossible to see how the Government can reach its growth targets contained in the National Recovery Programme.



UNITE is projecting that the Government's €15 billion programme (under the old Maastricht guideline target date of 2014) will manage a growth of less than 2 percent with the deficit sliding at over the twice the Government's estimate. It should be noted that the ESRI claims that under low-growth projections, the deficit will start to rise again in the latter half of the decade owing to growth falling away after the post-recession bounce.

UNITE's investment programme, however, boosts growth to 3.8 percent and sees the deficit falling to 4.9 percent.

The advantage from the UNITE programme going forward is that the demand-side impact of investment still has years to work its way through the economy. Almost 40 percent of our investment programme will impact on the economy after 2014. This is what is meant by embedding growth in the economy. As well, our projections do not factor in the supply-side benefit of investment – which will boost growth even further in the medium-term.



Therefore, by 2014 the economy, under UNITE's investment programme, will be much stronger.

Employment will be higher, there will be more enterprises working, tax revenue will be higher – and the deficit will be lower: that's what comes with growth.

UNITE will publish its full projections – estimating both the Government's new budgetary estimates and our own programme – following the publication of new fiscal and economic data.



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