SHOULD PEOPLE WHO HAVE VISIONS SEE A DOCTOR?

ANNUAL TASC LECTURE 2015 – DAVID BEGG

Amongst the most memorable phrases attributed to Helmut Schmidt, the former Social Democratic Chancellor of West Germany, who died last month was:

‘People with visions should go to the doctor’.

I beg to differ. As least I would add the qualification ‘unless it is evidence based’.

In fact I hope to persuade you that we do need a vision. We need to begin imagining a more sustainable kind of development model for Ireland, but one which is rooted in solid research.

As the country emerges from a prolonged recession and once again experiences strong economic growth there is a real danger that we would fail to learn from the near death experience of the last eight years. Moreover, we are left with significant infrastructural deficits, and a possible long term social scarring effect, which will require investment into the future.

Frank Cluskey, a former Labour Party leader, once remarked that ‘you don’t go through Hell for the practice’. But we are not that good at learning from experience in Ireland. The 2008 crisis was the fourth time since independence that we have looked into the abyss of economic and social desolation. It happened before in the 1930s, the 1950s and the 1980s.

I believe that there is a paradox at the heart of the independence project. Britain has so influenced our polity that we have intellectually shied away from considering alternatives to the liberal market economy model. To an extent we can see this reflected in the public discourse about 'Brexit'.

I intend to make the case that we should look to the small open economies of Northern Europe for our inspiration. It is a case based on evidence collected over many years of research.

But first let us return briefly to Helmut Schmidt. He was Germany's longest serving chancellor who saw politics as 'pragmatic action for social purposes'.

This emphasis on pragmatism is connected with a debate within German Social Democracy which went on for nearly fifty years. It concerned divisions between orthodox Marxism and revisionism epitomised respectively by Karl Kautsky and Eduard Bernstein. It was a debate which was only finally resolved in the Bad Godesberg Programme in the 1960s which resolved to reform capitalism rather than to destroy it. [1]

In the programme's well known phrase, it committed the SPD to promoting 'as much competition as possible, as much planning as necessary'.

Scandinavia was different. Socialist Parties largely did not get bogged down in an orthodox Marxism versus revisionism disputation. From the 1930's they adopted a people's party and reform agenda. They were able to outmanoeuvre the radial right and avoid the collapse of the left and democracy that led to the rise of fascism elsewhere in Europe.

This reached its apogee with the Rehn-Meidner Model in the 1950s. Gosta Rehn and Rudolph Meidner were economists working for the Swedish LO, The Trade Union Centre, and the essence of their model was to shift the definition of socialisation from common ownership of the means of production to increasing democratic influence over the economy.[2]

To a greater or lesser extent this model was adopted by the other Nordic countries. That region is today the most economically efficient and socially cohesive in the world.

For most of my working life I have been interested in the Nordic countries and what they have achieved. With the onset of the 2008 crisis I realised that the Irish case exhibited real serious questions of long term sustainability and I decided to look into how other small open economies managed the tensions between states, markets and society.

My starting point was a study of industrial policy in European small open economies by Peter Katzenstein in 1985, [3] and to a lesser extent a report into the Irish economy conducted for NESC by Lars Mjøset in 1992. [4]

Mjøset was asked to compare Ireland with other small open economies to find out why they were doing so well and why Ireland was lagging behind. Using a development theory approach he concluded that Ireland was beset by a series of vicious circles preventing the emergence of an auto centric national economy, principally the failure to develop a national system of innovation.

Mjøset's report failed to gain traction in policy making circles, perhaps because the economy began to exhibit signs of growth soon after its publication. Nevertheless it is worth recalling that MacSharry and White's account of the Celtic Tiger period mentions that in the early 1990s people were wondering whether Ireland was a viable economic entity at all. [5]

Katzenstein was writing for an American audience fixated on the economic threat posed by the emergence of Japan as a major exporting country and a perceived statist antidote to America's ideological celebration of market competition.

He identified three dominant forms of contemporary capitalism: liberalism in the United States and Britain; statism in Japan and France; and corporatism in the small European states and to a lesser extent, in Germany. He contended that the small European economies had no choice but to accept economic adjustments forced on them by markets while using a variety of social and economic policies to prevent the cost of change from causing political eruptions. In this they exhibited what Katzenstein described as 'The strength of the weak', a paradox in international relations terms.

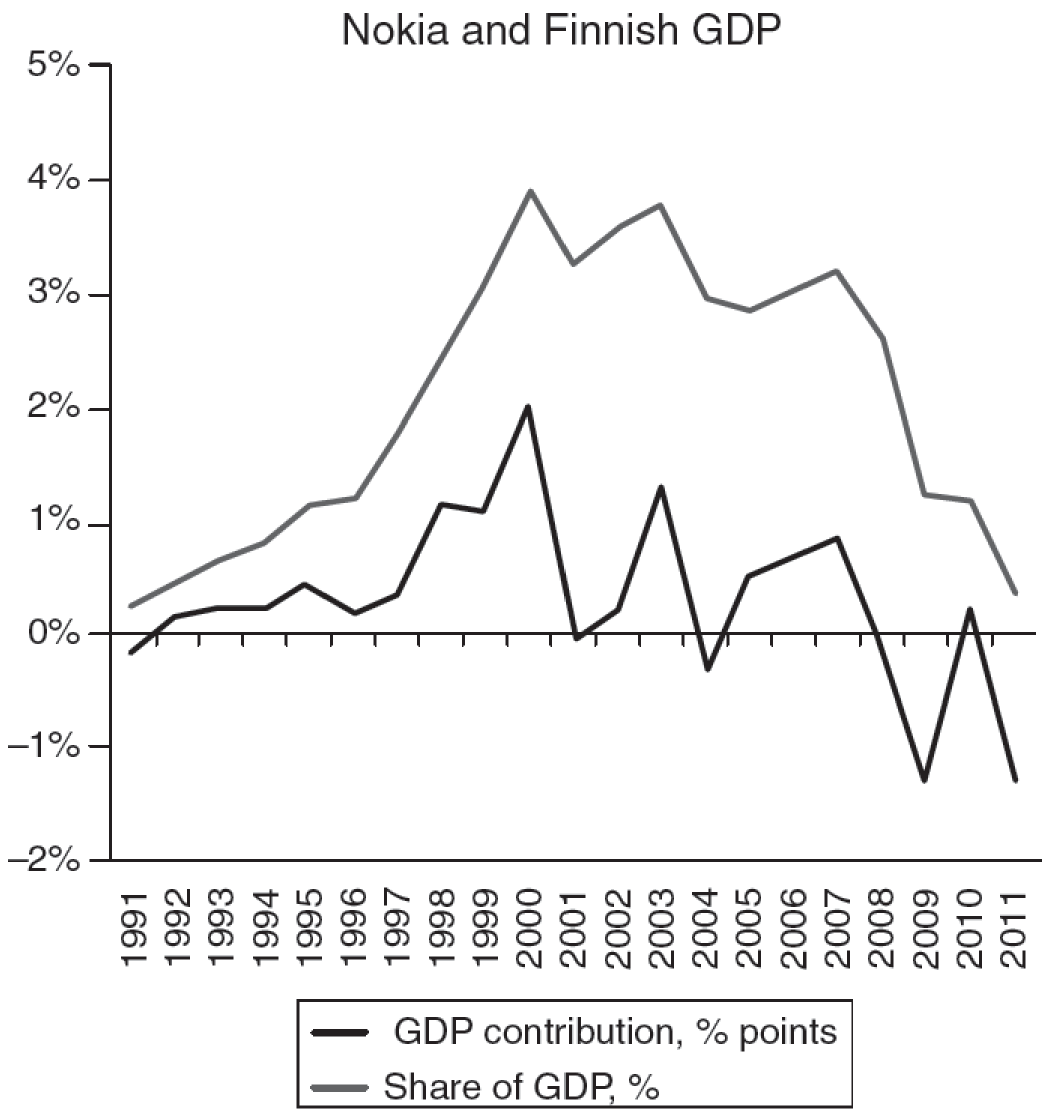
Katzenstein's research focused on seven countries; Sweden, Norway, Denmark, The Netherlands, Belgium, Austria and Switzerland, because, as he said, 'They were close to the apex of the international pyramid of success', yet little was known about how they managed their relations with the global economy.

Interestingly, he excluded both Finland and Ireland, largely because they were late industrialisers.

The purpose of my research was to establish whether Katzenstein's conclusions were still valid, and if they were, what lessons could it teach Ireland.

I specifically included Finland together with Denmark and the Netherlands as comparators for Ireland. The reason I choose these countries was:

Finland, a late industrialising country like Ireland but now widely regarded as a hi-tech success story. Unlike Ireland, however, this success is based on the extraordinary achievements of an indigenous company, Nokia. The type of financial and banking crisis which hit Ireland in 2008 was experienced by Finland in 1992/93 but it recovered quickly albeit with a long term scarring effect. Moreover, Finland lost a significant export market when the Soviet Union collapsed around the same time.



Source: Jyrki Ali-Yrkkö *(Ed) Nokia and Finland in a Sea of Change, updated, The Research Institute of the Finnish Economy*

Basically the Finns had to reinvent their economy and aim it at western markets. Finland joined the EU in 1995 and qualified for membership of the Eurozone, like Ireland, in 1999. It is the only Nordic member of the Eurozone.

Today it is at the heart of Europe and is one of the creditor countries taking a hard line on the need for fiscal consolidation.

Netherlands, an economic powerhouse at the heart of Europe but still a small open economy, albeit with a GDP four times the size of Ireland. It has a population of 16 million and the highest population density in Europe (493 people per sq.km). Dutch society traditionally has had deep religious cleavages and managing these differences, often referred to as pillarization, has been a focus of public policy. Consensus building is at the core of the polity. The Netherlands has been a key Actor in the European integration project from the beginning. With Belgium it convened the 1956 Messina conference which led to the Treaty of Rome two years later. The Netherlands is a close ally of Germany and its currency has been pegged to the Deutschmark since the 1970s. For the Netherlands EMU was a logical stage of European integration and its membership of the Eurozone was never in doubt. The Dutch shocked the European elite by voting against the EU Constitutional Treaty in 2005.

Denmark, Denmark has a population of 5.6m. Like the Netherlands it pegged its currency to the Deutschmark in 1982 but has never been able to convince its population to join EMU. Nevertheless, its polity is constructed as if it were a member and European integration requirements have been a key focus since the early 1990s. Denmark has a strong agricultural tradition and is often compared to Ireland for that reason. Industrially, however, it is the mirror image of Ireland with a strong indigenous SME industrial base and a relatively small amount of FDI.

It is an important sub supplier of German industry. Consensus building is a way of life in Denmark. All interest groups in society have some form of representation and it is often described as a 'negotiated economy'.

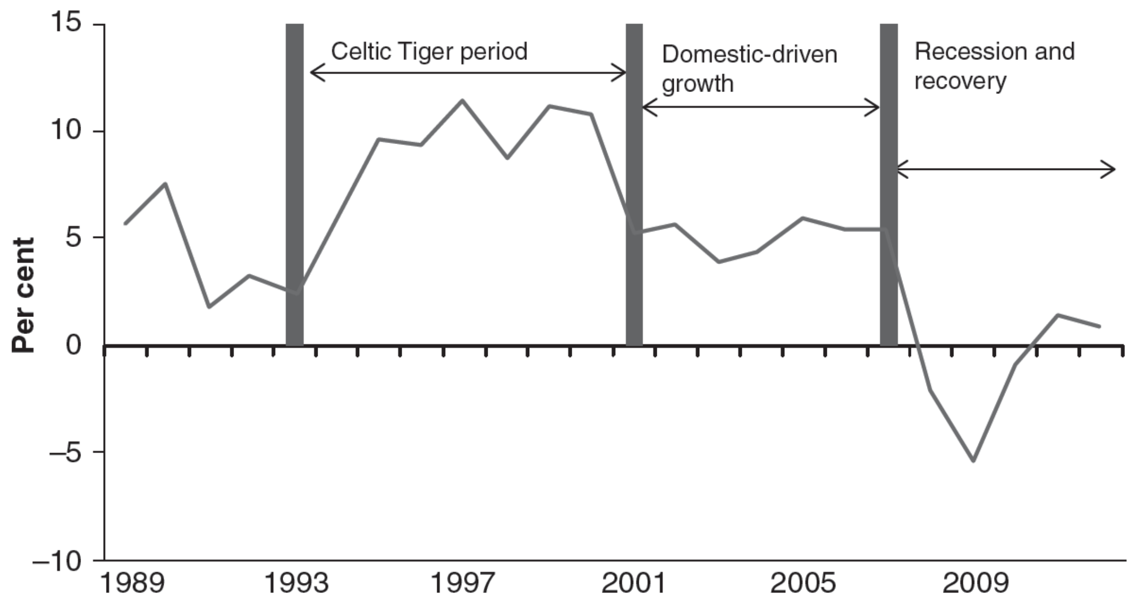
To sum up, what makes these countries appropriate for comparison with Ireland is that they are all small open economies. All three are social market economies and they are at the heart of Europe (even though Denmark is not formally a member of the Eurozone).

By comparison Ireland appears to be an outlier in Europe, and one of only three countries not part of the continental land mass. It was a late industrialiser and it missed out on the post-war 'golden age'. When it joined the EEC it had a long way to go to catch up and as late as 1994 its GDP per capita was only 60 per cent of the EU average.

While the other countries in the study are firmly within the German sphere of influence (In Finland's case this is a recent development) Ireland's single biggest trading partner and closest ally in Europe is Britain. Put another way, when Ireland joined EMU no other potential entrant had the same trade exposure to non-entrants as it had. Moreover, the Irish economy cycles out of phase with that of the core continental states of the Eurozone because of its heavy export and investment dependence on Britain and the United States and it has low levels of intra-industry Euro-area trade. This misalignment means Ireland's interest rate requirements are different and unlikely ever to be a priority for the ECB. Despite this unique risk exposure EMU membership never became a highly politicised issue among the mainstream political parties. [6]

As mentioned earlier, Ireland has displayed a susceptibility to boom and bust economic cycles.

Irish Economic Growth, 1989-2009



Source: Fitzgerald & Kearney (2013:5) ESRI

Tension between markets and society is an acute dilemma for small open economies. Coping strategies to deal with it have long been central to the polities of the Nordic countries in particular.

Soon after Katzenstein completed his study in comparative political economy in 1985 the tectonic plates began to shift in Europe. The Single European Act of 1986 effectively initiated The Single Market. The pace of European integration accelerated after the Maastricht Treaty was implemented in 1994. The Eurozone currencies were locked together in 1999 and The Single Currency became a reality in 2002.

The single biggest enlargement, involving the central and eastern European countries, took place in 2004 reflecting, to a large extent, geo-political imperatives arising from the collapse of the Soviet Union. These developments created pressures which, as we know from the experience of Ukraine, have yet to work their way out.

From a theoretical standpoint my research used a Polanyian framework. Karl Polanyi's seminal work *The Great Transformation* was published in 1944. [7] This was a very insightful critique of liberalism which has a particular value in helping us to understand the fault lines in contemporary capitalism.

Indeed, it is the very success of his theoretical opponents – Friedrich Hayek and Milton Friedman – in re-establishing the moral and political authority of free market doctrine that has made Polanyi's analysis even more relevant for understanding the present era.

Polanyi advanced three theses in *The Great Transformation*, viz:

- That land, labour and money are not commodities that can or should be traded within markets;
- That the economy should always be embedded in society and not the other way around;
- That people will always demand protection by the state from market forces oppressing them, what he called 'the double movement'.

Simply put, Polanyi believed that while markets were necessary and desirable, a market society was not. He believed that the maximum opportunity for real freedom can only come through expansive socioeconomic rights, which are firmly rooted in institutions. It is a vision of a moral social democracy supported by vigorous democratic participation from civil society. [8]

Thus I looked at the way the four countries coped with the exogenous pressures caused by deepening European integration over twenty-five years by examining how their institutions functioned.

Of course it was not possible to do this for every aspect of the European integration process so I concentrated on:

- The general policy approach of governments to integration;
- Economic and monetary union as the flagship project of integration;

And

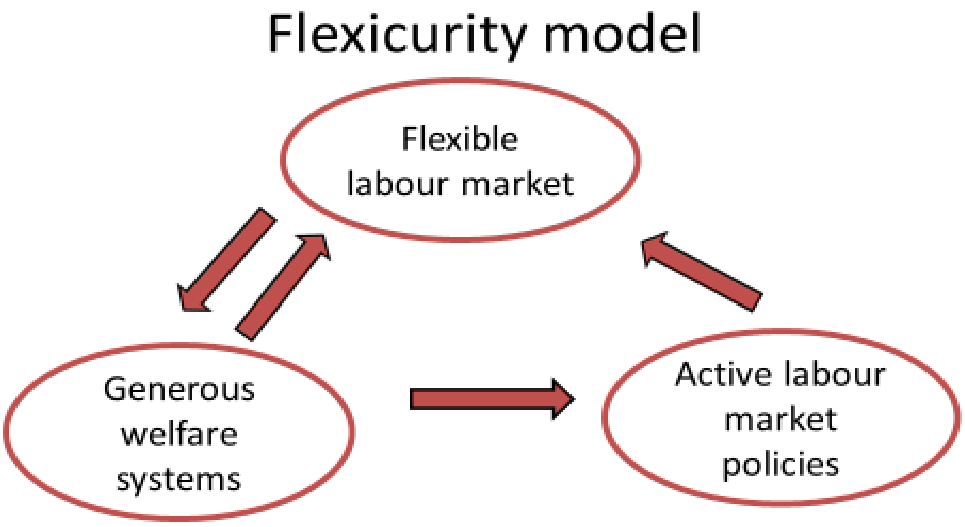
- Social policy and social pacts.

The 1980s was characterised in all four countries as a period of high unemployment and high welfare dependency. Goran Therborn, for example, described the 14 per cent unemployment rate in the Netherlands as, 'the most spectacular employment failure in the advanced capitalist world'. [9]

Finland had to re-orientate its economy towards the West following the collapse of the Soviet Union, while at the same time dealing with a major banking crisis which hit the country in 1992/1993.

High unemployment rates in Denmark propelled the Social Democrats, led by Poul Nyrup Rasmussen, to power in 1993. Like the Netherlands, Denmark had earlier pegged its currency to the Deutschmark thereby limiting the policy space for action on unemployment.

Nevertheless, the 1990s became the era of 'employment miracles' in all four countries. In Denmark this was achieved through a combination of active labour market policies and investment, the former embodied in the unique 'flexicurity ' model.



Source: Derived from Madsen (2006: 331)

The Netherlands focused on increased labour force participation by women via part-time work, the so called one and a half jobs per family strategy. Finland was an outlier for some of this period because of its twin trade and banking crisis, but devaluation and a developmentalist approach brought recovery towards the end of the decade.

In Irelands' case, 450,000 new jobs were created in the most sustained and sustainable period of economic expansion the country has known. It was a developmentalist phase which unfortunately was succeeded by a more speculative approach after 2001.

The principal preoccupation of all the comparators during the 1990s was meeting the criteria to qualify for membership of EMU. This imposed considerable discipline. To the extent that all four countries qualified – against expectations in Ireland's case – this was itself a benchmark of achievement. It is noteworthy too that change in the scale and pace of European integration had to be accommodated while simultaneously managing a transition from high-1980s levels of welfare expenditure and unemployment.

The period 2001-2008 saw an unwinding of some of the more progressive achievements of the social democratic governments, for example, a hollowing out of the flexicurity system in Denmark. The credibility of EMU was also undermined in that period by infringements of the Stability and Growth Pact by France and Germany and the impotence of the EU Commission to respond. In addition, the banking systems of the world were incubating a crisis, which when it broke in 2008, hit the small countries hard because their economies are so open.

In reflecting on the evolution of the development models we can first of all note that the Netherlands is now often categorised with the Nordic countries in the context of measures of re-distribution, equality and labour market regulation in a way that detaches it from the continental group of social market economy countries. We also note that in Finland, Denmark and the Netherlands, significant welfare reforms have taken place. But, politically the social reform agenda has been shaped by pragmatic considerations. These countries have bounced back from the crises of the 1980s and 1990s. Their reforms have maintained the principles of universalism and the core values of the welfare state. At the same time, these countries remain among the most economically strong, productive, competitive and socially cohesive countries in Europe if not the world.

What makes these countries better able to deal with crises is the strength of their tradition of accommodative politics which, as Katzenstein points out, dates back beyond the nineteenth century and facilitated the political re-orientation that took place in the 1930s and 1940s. The distinctive political structures and practices built on this tradition allow pragmatic bargains to be struck by a handful of political leaders. The fact that institutions are so deeply rooted affords them a protection from exogenous shocks. Thus, the depth of commitment to European integration must be understood in this context. It is a constant which influences policy in all aspects; a spine to the system that does not shift. This tradition is absent in Ireland. For a period during the 1990s, Ireland appeared to converge with the comparator countries, achieving as good or better employment and economic outcomes. The developmentalism driving the convergence was not sustained.

The research findings are summarised in this slide:

	BASELINE 1987-1994	REASON FOR JOINING EMU	EVOLUTION OF DEVELOPMENT MODEL
NETHERLANDS	• High unemployment • High welfare dependency • 'Most spectacular unemployment failure in advanced capitalist world' • Structural flaws – disability regime exploited for industrial restructuring • PvdA chooses welfare reform over relations with unions • But Wassenaar Agreement hugely influential	• Economic reasons • Logical extension of close links to German economy and 1970s peg to DM	• Preparation for EMU • Improving sustainability of welfare regime via increased labour force participation. • Unemployment problem solved via part-time work (1.5 jobs per family model) • Welfare/pensions reform • More limited role in welfare admin for labour market actors • But social pacts first default option in crisis
FINLAND	• Late industrialiser helped by war reparation requirements • Loss of Soviet market (estimated @ 20% of exports) • Banking/financial crisis compounded by liberalisation of capital markets	• Geo-political imperative to be at the heart of Europe • Sub-optimal experience of monetary policy as conducted by Bank of Finland	• Complete restructuring of economy and re-orientation towards West • Big focus on ICT-Nokia • Reversal of Cold-War policies e.g. neutrality • Return of centralised corporatist bargaining

DENMARK	• High unemployment as a result of two oil crises in 1970s • Compounded by peg to DM • Ameliorated through coordination of economy via market mechanisms embedded in collective agreements	• Not a member but tracks Euro	• Employment generated via public investment and strong labour market activation (flexicurity model) • Public sector reform to support export strategy • Strong focus on globalisation challenge • Exports influenced by innovation for domestic needs (e.g. Green Energy)
IRELAND	• Gradual recovery from mid-1980s crisis **but** • Still high unemployment and GDP/capita of only 60% of EU average • Early gains led to embedding of Social Partnership	• Independence from UK • Earlier experience of currency volatility • Expected benefit from low interest rates • Strong coalition in favour	• Sustainable economic expansion and job growth via productive investment to 2001 • Post 2001 construction boom fuelled by financialisation, low interest rates via EMU and perverse tax incentives • Pro-cyclical budgetary policies • Crisis and unwinding of Social Partnership

What conclusions can be drawn from the research?

First we can say that Katzenstein's thesis has held up over more than a quarter century since he published *Small States in World Markets: Industrial Policy in Europe.*

Finland, Denmark and the Netherlands still tend to top the world rankings in terms of economic efficiency, competitiveness and productivity. But they also come first in terms of social cohesion and equality. Finland, for example, has the best education system in the world.

For sure they have had, and still have problems. They have had to duck and weave to respond to markets. They have been hit by the 2008 financial crisis but were not overwhelmed by it in the way that Ireland was.

Social Democracy has been an influence on the polity of the Nordic countries in a way that it never was in Ireland. Specifically, the Nordic welfare state was constructed using three political ideals: the legacy of liberated peasants, the spirit of capitalism and the utopia of socialism. Equality, efficiency and solidarity, the essential principles of these three political ideals, merged into a consensus that enriched each other. [10]

Nationalism and the Civil War in the 1920s ensured that all major issues in Ireland have been conceptualised in terms of independence rather that class interest. In effect all governments, whatever their political orientation, have to govern within a social democratic polity in the Nordic countries.

Even when Social Democratic parties are not in government, the social democratic welfare state thrives. This is known as ‘the Svallfors Paradox’ after Stefan Svallfors, a Swedish Sociologist. [11]

That said, antipathy to immigration has seen the emergence of new social cleavages and extraordinary electoral gains for right wing parties.

Ireland’s future is highly contingent on Europe and Europe faces existential crises on many fronts. The sluggish pace of economic recovery risks inflicting permanent damage on a region drained of confidence and beset by low inflation. Terrorism and immigration combine to undermine confidence.

Greece is still in intensive care and, of special interest to Ireland, Britain is becoming increasingly semi-detached from The Integration Project.

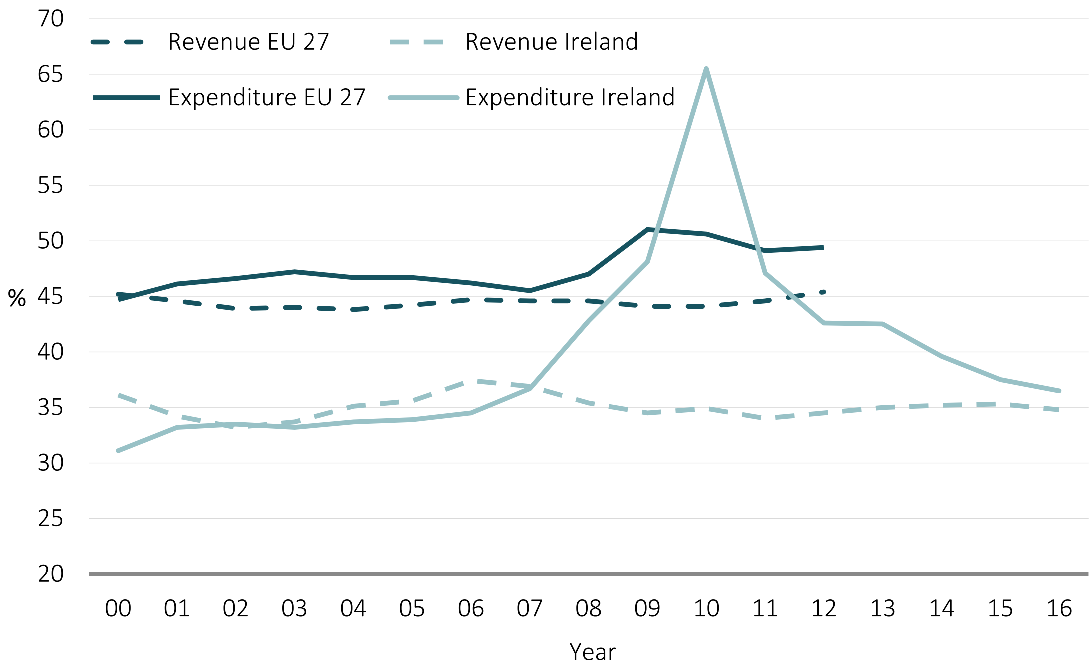
The EU is in danger of being overwhelmed by global and regional military conflicts, the co-ordination of macroeconomic policy and humanitarian emergencies.

Yet the lesson of the 2008 crisis must surely be that a monetary union without a fiscal and political union is not sustainable. The paradox is that the permissive consensus that attended the integration project for the last sixty years has evaporated.

It seems to me that a resolution of the paradox of European integration will not be found without some change in the remit of the ECB. It is too powerful, too independent and too preoccupied with narrow questions of sound money and price stability to serve as the motor for such an ambitious project. I believe the only way forward is to align the remit of the ECB with that of the US Federal Reserve Board, requiring it to also take account of social concerns such as unemployment.

If a way forward on integration is found Ireland will surely be under increasing pressure to converge with the taxation and spending norms of the rest of the group of social market economies. We are considerably adrift as this slide shows:

General government revenue and expenditure: Ireland and EU 27



Source: NERI Quarterly Economic Facts, December, 2013 [*www.nerinstitute.net*](http://www.nerinstitute.net)

Leaving aside these bigger issues of convergence within the Eurozone there are really serious consequences related to sustainability arising from our addiction to low taxes.   Let me give you one example.

It is a kind of political cliché to say that our future lies with our children.   What does that mean in practice though?

It is my privilege to be Chairman of Barnardos and the reality of our day-to-day experience is that one in six children is now living in a household experiencing food poverty and households with children are 89 per cent more likely to be in rent or mortgage arrears than those without. Where is the sustainability in that?

At the other end of the age spectrum an increasing cohort of people are facing into retirement without adequate pensions or the means to continue paying for health insurance. We know from the HSE's 2016 Service Plan that it will take an extra €720 Million just to stand still.

These demographic pressures alone will put heavy demands on our public spending, not to mention a debt to GDP ratio of 100 per cent.

And still people argue for the abolition of USC – which raises €4 Billion – and for flat taxes. If we wanted to be creative we could convert a portion of the USC to finance a mandatory second tier pension. That would be a sustainable approach to fiscal policy.

The question then is whither Ireland? Like it or lump it our future is in the Eurozone. There is no way a small country can deal with problems which are global in nature – climate change, for example – on its own. As we approach the centenary of the 1916 rebellion against Britain, if we are honest with ourselves, we have been obsessed with the idea of independence. It has informed our relationship with Europe since we joined the EEC. But we joined with Britain and we always wanted Britain beside us on our journey. That is no longer possible. An average of the last six Polls on Brexit shows the remain and leave sides finely balanced. We have reached the denouement of the independence debate. It is time to let go of our demons. Henceforth, we have to engage with the European Integration Project in a different way.

The clear outcome of this study in comparative political economy is that a gradual transition towards emulating the social market economy model of the comparator countries offers the best possibilities for long-run sustainability. Finland had to reinvent itself in the most adverse circumstances in the 1990s. As it recovers strongly from recession, and enjoys a growth and demographic advantage over the rest of Europe, Ireland is, by contrast, in a good position to act now to shape its future.

In effect Ireland is at a critical juncture and needs a Rehn-Meidner type model on the lines of that constructed by the Swedish LO economists in the 1950s and which subsequently shaped the acclaimed Nordic model. It will not be the same because times, values, cultures and the circumstances are different.

But at the very least, it may help to recapture the developmentalism of the 1990s and put the country on a trajectory towards a sustainable future. Without a political vision of where we should be headed, we become mere spectators of our own drift.

Finally, it is worthy of reflection that the 100 years Ireland has spent pondering its relationship with Britain might have been better spent thinking about an older conflict. A thousand years age, on 23 April 1014 to be precise, the Irish King, Brian Boru, defeated the Viking invaders at the Battle of Clontarf near Dublin. If the outcome had been different, Irish people might today be living in a prosperous and progressive social democracy. It is never too late to rectify a failure of public policy.

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