

A Time for Ambition

Ensuring prosperity through investment



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Executive Summary

The government's investment plan, *Building on Recovery: Infrastructure and Capital Investment, 2016-2021* (BoR), is extremely important but it is deeply disappointing in its lack of ambition.

In the first year of the plan, 2016, Exchequer investment of 1.7 percent of GDP will be lower than the 1.8 percent level in 2013 which was the lowest level to date. It only rises to peak at 2.05 percent in 2021.

Investment in infrastructure is important because it underpins economic and social development and ensures future progress. Investment collapsed after the crash of 2008 and public investment by the State in 2013 was at its lowest level since records began. A major cause of the collapse was financialisation, but adequate public investment is a crucial part of the way out.

This report shows that public investment can be difficult to get right both fiscally and because of various EU rules. Nevertheless it is essential and we need to develop new strategies to undertake public investment adequately and successfully. Some of these may seem akin to financialisation but with a strong emphasis on public return and equality we can deliver good public investment projects, which in turn will lead to increased private investment.

Infrastructural investment in Ireland is picking up, but from a very low base. It was also at the lowest level in all 28 Member States in the EU. While the BoR plan will see increased investment in cash terms, as a percentage of GDP it will actually fall in the first year.

The €27bn planned in Exchequer funding will be supplemented by €500m in PPPs and investment of €14.5bn by the State enterprises – which have not yet been privatised – as part of overall public investment. This low level of Exchequer funding at €27bn over the years from 2016 to 2021 will not be adequate for Ireland's future infrastructural needs.

The level of cuts in public investment should never have been as severe as they were in Ireland. We failed to learn from the losses on economic growth imposed by the 1980s infrastructural investment cuts. And this failure to learn from history was within one generation. New investment planning is suggested in this report to prevent recurrence and to provide certainty for infrastructural investors.

Why Investment is Important

The importance of investment in infrastructure is examined in Chapter Two. Investment is the first port of call in cutting spending during any downturn, which is a mistake.

The government must increase investment substantially because:

- Ireland desperately needs the assets – social and affordable housing, public transport, schools, clinics, as well as education and training.
- Interest rates are historically low.
- Investment costs less during a recession and, while it may be over, there is still an output gap and high unemployment, especially among construction workers.
- The lack of investment is reducing future economic growth and development.
- Investment leads to innovation which makes the economy more efficient.
- Governments never cut investment – they only postpone it.

The State did invest strongly for some years until recently and the evidence is there in our roads, many hospitals, schools and courts. But progress was cut off.

What Should Exchequer Investment Be?

In the government plan *Building on Recovery: Infrastructure and Capital Investment, 2016-2021* (BoR), of the total of €27bn directly from Exchequer, €3.8bn will be invested in 2016 and there will be a small increase annually to 2021. It is analysed in Chapter Three.

From 2003 to 2009 the Irish government invested an average of 3.9 percent of GDP but from 2013 to 2015 it only invested at half that level. The BoR proposes Exchequer investment of only 1.84 percent on average a year over the lifespan of the plan. This is lower than even the years after the crash (2009-2012) when it averaged 2.9 percent. Much more is now needed to ensure prosperity. The government recognises its own caution and proposes that it be revised upwards in a few years.

The level proposed in this report for investment is that it should rise to 2.25 percent of GDP or €5bn in 2016 (compared to under €4bn in the BoR) and then should rise progressively to 3.25 percent in 2020 and 2021. This would enable Ireland to catch up with leading EU states on public infrastructure, including housing and public transport, and to make up for Ireland's recent underinvestment. This would require Exchequer funding of almost €42bn in the years to 2021, substantially up on the proposed €27bn in the BoR six year plan. The government does say that its plan should be ratcheted upwards, in two years. However, it must be greatly increased immediately especially as growth is strong and is projected to be firm (provided there is no overheating of the economy).

The additional funds could be raised by increased taxation (from growth and other sources), by borrowing, and from the new sources outlined in the BoR and in this report. However, it is proposed here that most of this extra investment should be funded by part of the proceeds of the planned privatisation of the bank shares currently in public ownership.

In a time of great infrastructural need (and very low interest rates), these bank proceeds of €20bn (or perhaps as high as €29bn) coming on stream from 2016 onwards, should not all be used to repay national debt. Up to €15bn of these bank proceeds should be invested in Ireland's public infrastructure. The timing is fortuitous as the sales tranches come on stream from 2016, just as infrastructural investment is required. The State should also retain a substantial stake in one major retail bank (AIB) to ensure banking excesses do not occur again, and to retain one major bank in Ireland.

The need for such a substantial increase in Exchequer investment on top of that €27bn in the BoR are as follows: the low base; to make up some lost years; the housing, especially the social housing, crisis; the poor public transport systems; the need to catch up with Europe on public infrastructure generally; the growing population; and the contribution of such infrastructure to improved equality. The focus of this report is on why investment is important, the BoR plan, and why it should be more ambitious, and where the funds for such ambition lie.

New Sources of Finance

It is suggested in the BoR and in this report that if capital for investment cannot be borrowed because of EU rules, then some can be raised from other sources. These include pension funds; a special housing savings bond; taxing the highly profitable but under-taxed corporate sector; less tax cuts than promised; and from the sale of AIB and BOI shares worth a minimum of €20.7bn, using the Ireland Strategic Investment Fund and the €7.2bn invested in the National Pension Fund.

The BoR plan has a number of interesting proposals for new sources of funding such as other privatisation receipts, public private partnerships, EU funds, the remaining pension fund reserves and sources such as the Central Bank's surpluses.

The restrictive EU economic rules on funding investment have meant public policy makers were forced into inventing new packages of "off-balance sheet schemes" of financing. Most economists agree that states should mainly borrow to invest. In Ireland's case, the timing, the cost of borrowing, the returns, and the impact on the economy and society are excellent.

Borrowing is superior to complex off-balance sheet financing. However, borrowing would not be necessary to boost the BoR plan, if these bank proceeds were invested. The bank proceeds would add to direct investment, and with its simplicity, it would give speed and certainty to project managers, for those who will use the assets and indeed for the builders, who can focus on building and not financial instruments.

Housing

The government's housing strategy, unveiled finally in 2014 and amended since, is deeply disappointing, especially in a time of unprecedented crisis. Reflecting the BoR, it is lacking in ambition and overly reliant on private interests and on financialisation.

The large decline in local authority housing is a dramatic manifestation of the shift to the monetisation of social investment such as housing. This allowed the banks and mortgage brokers a slice of this vast new "market" of low income housing provision where the State had previously provided directly. It failed.

One-third of all housing was directly provided in the 1970s and 1980s and this fell to 10 percent in the mid-1990s. It collapsed to a mere 3.5 percent of all housing completions in 2012.

The withdrawal from direct provision and the granting of the array of tax breaks for property investors contributed to the economic collapse. The shift to a privatised and monetised housing policy created this current housing shortage.

The late 1990s early 2000s was a time when the Exchequer funds were overflowing with a surplus of over a billion a year for some years. All capital investment was funded by surpluses. Yet the government moved from direct provision to "off-balance sheet" and marketised social housing provision.

The annual €500m of taxpayers' current expenditure, which is given in subsidies to private landlords, should be capitalised by investing it into real physical publicly-owned homes. Instead "the State will take measures to enhance the capacity of the (private) sector to contribute in a more sustainable and cost effective way to social housing supports" (DECLG, 2014).

A worrying feature of current fiscal thinking is that it appears that few lessons were learned from recent history. Tax breaks are not free. They are the same as public spending, but with one key difference – we don't know how much they will ultimately cost. The demands for more and more tax breaks for student housing, for the homeless, for housing development etc, is of grave concern. It will cost more than direct spending, will have many unintended consequences, is bureaucratic and the outcomes are uncertain.

Providing Greater Certainty for Public Investment in Infrastructure

It is argued that in most countries public investment is poorly planned and executed. Certainty is vital for long term investment and the stop-go system in Ireland must end. The key reforms suggested in this report include the establishment of an Infrastructural Commission for Ireland, which would bring much needed long-term planning back into government policy. This Commission would plan 25-30 years ahead for Ireland's future needs and set clear priorities. This infrastructure assessment would be carried out every 10 years and include deep research and consultations with the public, local authorities, NGOs, regulators and others.

The EU and each Member State should also adopt a "Golden Rule" which would set out medium and long term plans and priorities for investment. The Infrastructural Commissions and Fiscal Councils in each Member State would encourage adherence to maintaining each Member State's infrastructural investment at a minimum level equal to depreciation plus inflation in times of recession.

Europe's Role in Investment

While there continues to be opposition from Europe to increased public spending (while other parts of the Commission call for increased investment) including investment in needed infrastructure, under its present – restrictive – rules, there are grounds for hope as some rules have been made more realistic.

The Irish 2015 and 2016 Budgets, the relaxation of some EU rules, and the Juncker investment plan for Europe are welcome, though there is room for radical reform of economic policy.

The government also needs to strengthen its demand, made to the EU Commission in March 2015, that it becomes more realistic on the need for investment and that it amends its rulings from gross national debt ratios to net debt under the Growth and Stability Pact.

With 23,000,000 unemployed in the EU28, there is a substantial lack of demand and economies are running at under-capacity. The EU has its €315bn investment plan, but it is too weak to provide sufficient stimulus.

With the admission by Ajai Chopra, formerly head of IMF in the Troika, that Ireland "was unfairly treated" and with the new EU rules on failing banks, the EU has to lighten up and allow Ireland to use the bank shares for investment rather than paying off creditors.

Chapter One – The Investment Crisis

Red Cow Disease

In order to ‘save money’ on Exchequer investment back in the 1980s, senior officials in the then Department of Local Government blocked local authority engineers from building a full, modern interchange at the Red Cow Inn on Dublin’s M50 motorway. It was a major error.

Many years later, and at a multiple of the original price of the proper interchange, it was eventually built. But it was at great cost in time and money to Irish commuters, business, and the economy.

The Red Cow Roundabout ‘solution’ demonstrated how narrow thinking, perhaps with the best of intentions in stretched times, can end up costing so much more in time, effort and money.

Governments do not cut infrastructural investment, they only postpone it. The Red Cow Disease is a manifestation of the classic but erroneous idea that governments are like households and should not spend more than they earn. The correct analogy is of a business – borrow, invest, expand, repay debt and prosper.

Why there is an investment crisis

Firstly, the ratio of Exchequer or government investment to GDP in Ireland was the lowest in the EU in 2013. Secondly, the level of public investment in 2013 was Ireland’s lowest in 50 years (when records began). Thirdly, the decline in Irish government investment spending was the largest fall across the EU since 2008.

Each year a country should increase its infrastructural investment to a level that will at least replace its depreciating assets and allow it to build new infrastructure in line with population and growth. However, when there is a crash or recession, the first cuts in public and of course private spending are in infrastructural investment. What can be done to counter this strong drive to cut investment severely during a downturn? Keynesian economics favours public sector “pump-priming” investment during and after recessions (IMF, 2015, Blinder and Zandi, 2010, Arestis & Pelagadis, 2010).

In this report, I will first examine the evidence of the collapse in infrastructural investment. It will be seen how investment is the first port of call for cuts when governments face stringent budgets. The required level of investment for a modern economy will be assessed against past trends and internationally. In Chapter Two, I will show why investment is important. In Chapter Three, the government investment programme *Building on Recovery: Infrastructure and Capital Investment, 2016-2021* (BoR) will be assessed to see if it meets Ireland’s needs for investment. It will be seen that the plan proposes to keep Exchequer investment close to the historically low levels of recent years.

An alternative programme of Exchequer infrastructural investment of far greater scale is proposed. In Chapter Four the new sources of funding suggested in BoR will be critically examined. A radical solution to the shortage of funds for investment is proposed, which provides capital for direct investment. In Chapter Five, I will examine a vital part of investment – housing. In Chapter Six, I will consider institutional and other ways to counter the policy failure of cutting or postponement in the future. In Chapter Seven, I will argue why the European dimension in investment – already important – has to be improved. In the conclusion, Chapter Eight, I will draw the analysis together

and show why much more needs to be invested in Ireland than is planned under the new investment programme, welcome though it is.

Building on Recovery: Infrastructure and Capital Investment 2016-2021 (BoR) is most welcome – but many have not realised how bad things had become. Some policy makers are aware of the importance of investment. One government advisory body, The National Competitiveness Council, stated in a recent report (2015) that it was worried about the collapse in investment. It “believes that there is now a need to increase public capital expenditure and that public investment in infrastructure is prioritised and targeted at those areas that can have the greatest positive impact upon Ireland’s competitiveness.” It also pointed out that capital expenditure is “not just about physical infrastructure. The development of the new Science Strategy and the development of a new National Skills Strategy” are important investment programmes.

In its Scorecard it found that “perceptions of (infrastructural) quality still lag behind OECD average and are well behind leading performers” (20015b, F41, p39).

Engineers Ireland and the Central Bank are also conscious of Ireland’s current investment collapse¹.

Investment Levels and Financialisation

For clarity, it is helpful to define two concepts used throughout this report. These are levels of investment and financialisation.

Three levels or types of “investment” are discussed. First, is the total investment in the economy, from all sources, public and private. The total level largely reflects the business cycle. It was 19.2 percent of GDP in 2012 up from 17.2 percent in 2011, (but down from the bubble surge of 31 percent in 2006). It is usually around 22 percent.

The second is the overall public investment. It has three components: i) Exchequer funding; ii) the state-owned sector (especially the commercial state companies); and iii) there are privately funded public investments, like PPPs, which are state sponsored. The three are also called the Public Capital Programme. The overall Public Capital Programme was 3.1 percent of GDP in 2015. The Exchequer investment was 1.8 percent of GDP in 2013 and 2 percent in 2014.

This report will cover all three levels, but the main focus will be on the role of Exchequer investment, because of its importance in funding public infrastructure.

The second definition is financialisation. A key point in this report is that financialisation, which has contributed much to the international economic collapse, is still dominant and is in danger of impairing the recovery.

Financialisation is defined as the growth of the financial sector since the 1980s. It is generally agreed that its size has risen to excessive levels. It is where profit-making is increasingly through finance rather than trade, production and useful services. Many of the instruments created during this period, including PPPs, complex forms of off-balance sheet financing, privatisation, derivatives and such do not add long term value, but are profitable to the excessive and overpaid executives in

¹ Irish Times 2 November 2015 p2 Business

financial services. Financialisation includes the 'shareholder value model' of corporate governance and economic policy.

Thomas Palley defined financialisation as "a process whereby financial markets, financial institutions and financial elites gain greater influence over economic policy and economic outcomes." US Economist Michael Hudson was even more critical describing financialisation as "a lapse back into the pre-industrial usury and rent economy of European feudalism"².

Public investment in advanced countries

Ireland is not the only country where there has been falling public investment in recent years. The situation is worse in some countries where it has been falling for decades. "In advanced economies, public investment has been on a gently downwards path for the past three decades. In the UK, public investment relative to GDP is a third of its level in 1970. There has been no deepening in the global capital stock for a generation. Given the role public investment has often played in the past in supporting private innovation, this is not an entirely comforting picture." (Haldane, 2015 A3 p170) The UK is no example for Ireland to follow, with total investment even lower than here (Eurostat 2015).

The crash accelerated what were declining rates of total investment in the Euro area. Investment as a component of real GDP fell from an average increase of 3.1 percent of GDP between 1997 and 2006 to minus -0.7 percent between 2007 and 2016. Even Germany, France and Italy saw a drop of investment as a component of real GDP of -10 percent in 2009, with Spain at -17 percent (IMF 2015, TA5, p170). The IMF also forecasts moderating growth to 2020 because "long-run potential output growth may have fallen broadly across economies," and it cites one contributing factor as "persistently low investment" (IMF, 2015, Pxiii).

The First Port of Call for Cuts

The first port of call for any government making cuts in public spending is to cut public investment. It is easy and provokes least resistance. A solution to this 'inevitable' policy reaction will be examined later.

The IMF (2015, p89) found that "For economies with clearly identified infrastructure needs and efficient public investment processes and where there is economic slack and monetary accommodation, there is a strong case for increasing public infrastructure investment." It also suggests that borrowing should be undertaken if need be, because those that are "debt financed would have larger output effects than an increase that is budget neutral." It concludes: "the increased public investment would provide a much-needed boost to demand in the short-term and would also help raise potential output in the long term."

Even the EU Commission (2014, p122-8) in a recent review of the 1980s said "such swingeing cuts to government investment are not optimal from a government finance policy perspective and left Ireland with a substantial infrastructure deficit when growth picked up in the 1990s." In a recent

² Thomas Palley <https://ideas.repec.org/p/uma/periwp/wp153.html> and Michael Hudson, 2003, <http://www.counterpunch.org/2003/08/29/who-benefited-from-the-tech-bubble-an-interview-with-michael-hudson/>

study the IMF (2014b, p82) found “that public investment shocks have statistically significant and long-lasting effects on output.” These surprising quotes are from two members of the Troika, which cut investment here.

In its review of the public capital programme, back in 2011, the Department of Public Expenditure and Reform (DPER) admitted that “It is clear that the Public Capital Programme must make a further contribution to budgetary consolidation.” Regrettably, these cuts in public investment were successfully made since then. The new BoR reverses this erroneous decision.

In an analysis of CSO data on investment between 2000 and 2009, the boom years, White (2010) found that the best investment was public investment. Much of the private investment had been in assets which turned out to be less than useful, for example housing in areas where nobody wanted to live (ghost estates) or similarly with retail and commercial property. There was not a great deal invested in innovation or in human capital.

Most of the increase in investment was in roads, other infrastructure with some by exporting Multinational Corporations (MNCs) and indigenous firms, and by the semi-state enterprises (some of which have now been privatised). There was little useful investment in the 2000s by the rest of the private sector. These years of high income growth did not translate into sound investment in our capital stock. Capital stock doubled but most of it was in private housing (e.g. ghost estates) and little investment was undertaken in other areas, except by the State. However, the one area the State did not invest much in was social housing. It did not simply leave it to the market, but also gave investors many subsidies.

Evidence of the investment collapse

There has been a dramatic collapse in infrastructural investment in Ireland in recent years to 2014. It followed on a large collapse in the 1980s recession (generated by bad economic policies following the 1977 election), demonstrating that governments do not always learn from history, even within the same generation.

Figure 1 illustrates the staggering reduction in total (cash) investment since the crash of 2008, even factoring in the bubble nature of the peak. The peak was in early 2007 but the key point is that total public and private investment in the economy fell from €12bn a year in Q1, 2007 to a low of €5.9 in Q1, 2012. This is a fall of 51 percent.

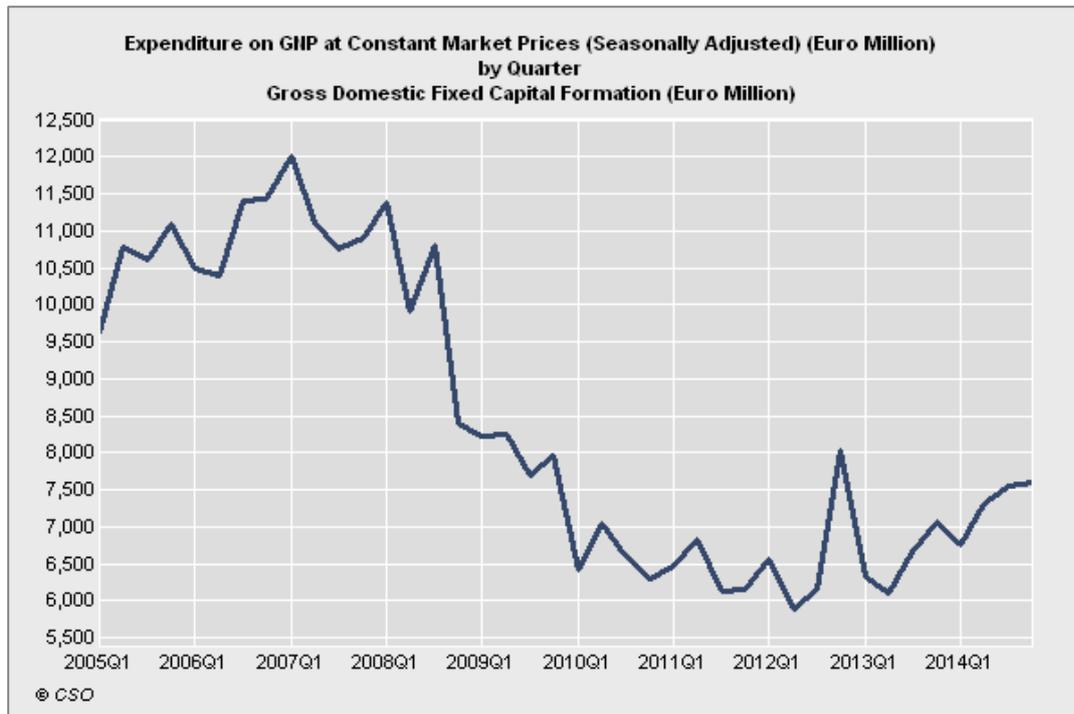


Figure 1: Total Investment (€m) by quarter (Source: CSO)

Total investment in the Irish economy was almost 20 percent of GDP in 2014, which is still slightly below the historical long-term rate which is 22 percent of GDP for Ireland. This is similar to most EU countries. Ireland needs to be slightly above the EU average to catch up.

Figure 2 shows a) the large falls in total investment in Ireland in the 1980s and since the crash; b) how it compares to the Euro area; c) how cyclical it is; and d) the historical average for Ireland at 22 percent of GDP (straight line).

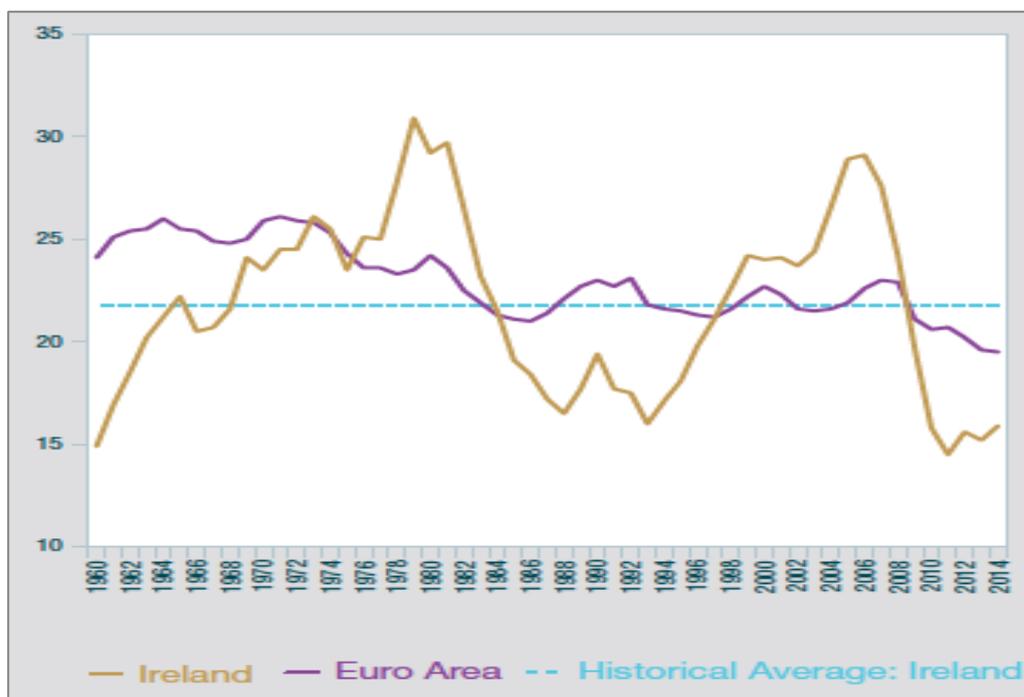


Figure 2: Investment Ratios as % of GDP, Ireland & Euro Area (Source: Central Bank)

The Central Bank points out that “Government investment has declined by two-thirds since 2008. As a result, the ratio of government investment to GDP in Ireland at 1.7 per cent in 2013 was the lowest ratio in the EU. Furthermore, the decline in government investment spending was the largest across the EU over the period since 2008.”³

The Central Bank’s Diarmaid Addison-Smith examined both investment and depreciation over a 50 year period in Ireland. The government’s level of investment reached a historically low level in 2013, turning negative for the first time since the data series began, which means public capital stock declined.

Addison-Smith also finds that “the Government’s net acquisition of nonfinancial assets turned negative in 2013 for the first time since the (CSO) data series began – pointing to a decline in the public capital stock.” In 2013, depreciation actually exceeded government investment by €800m (CSO, 2015c T4).

In short, this is a public investment crisis. He says we will return to close to normal levels in 2016, but the important point is that Ireland has had substantial under-investment in recent years.

According to Eurostat, total investment in Ireland fell to just 14.5 percent of GDP in 2012, and it also confirmed it to be the lowest in the European Union. The EU average was 21 percent with even Greece at 15.4 percent and Cyprus at 19 percent in that year. However, these figures were later revised up to 17.2 percent for Ireland for, 2012 – still one of the lowest in Europe (by Eurostat). By 2014, Ireland was at 19.1 per cent for total investment. Greece and Cyprus had plummeted to 11 percent.

³ Central Bank, Qterly, 2, 2015, p 12-15, note by Diarmaid Addison-Smyth

But European countries are under-investing and thus this average is lower than it might be. Indeed while Sweden, Belgium and Austria were investing at over 20 percent in 2014, the UK, Italy and Denmark were only investing in the high teens. The high level of aircraft leasing⁴ and R&D in Ireland may be inflating the investment levels.

With the need to catch-up on lost investment of recent years, we need to be above average for a number of years to come. NCC (2015b) and others have shown that infrastructural investment in Ireland is not at European standards and the housing crisis is much discussed. Some countries are much higher but as pointed out above, investment levels in the UK and US are below average.

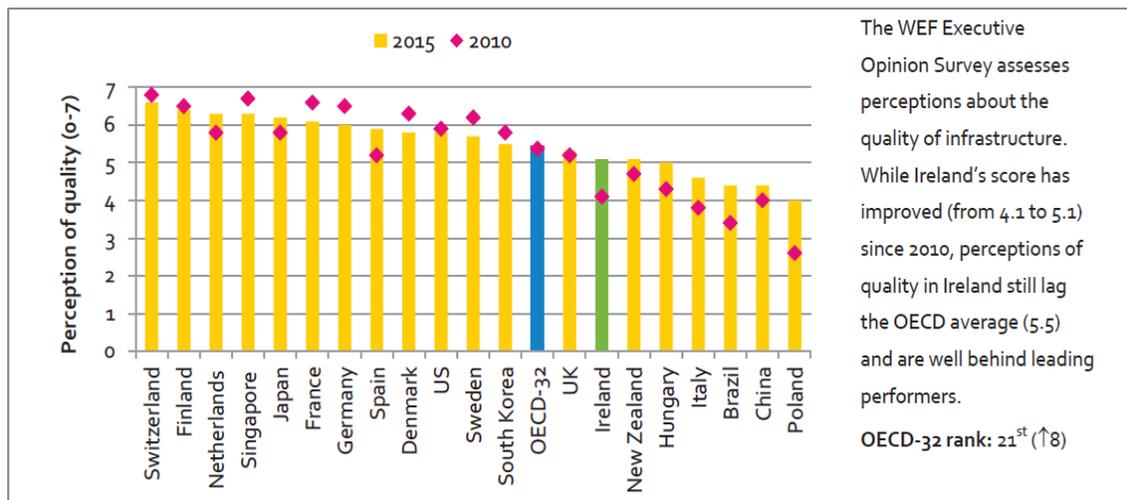


Figure 3: Perception of Quality of Overall Infrastructure, 2015 (Source: WEF, via NCC Ireland’s Competiveness Scorecard, 2015)

Figure 3 shows that whilst there was an improvement in Ireland’s score on infrastructure since 2010, it is still behind the average and well below the leaders.

Volatility is Difficult to Iron Out

A second important feature of Irish investment is how volatile it is compared to other countries (as was seen in Figure 2). Major peaks and deep troughs are not good for investors, citizens or anyone as they lead to uncertainty and asset price instability. There is always some volatility in private investment, reflecting economic cycles, and many economists argue that ideally it should be countered by the State stepping in to boost demand with investment in public infrastructure, which may be substantial at times.

However, Ireland as a small open economy, can be expected to be more volatile than other large, less trading nations. In fact, it suffers particular volatility in its private investment sector because of the disproportionate size of the multinational sector and especially the aircraft leasing industry (O’Brien, 2015). Even with an extremely active, and well-informed public investment programme to step in as a stabiliser, governments would still be unable to even-out such volatility.

⁴ Half of all aircraft owned or leased are based in Ireland. Thus the disproportionately large aircraft leasing industry inflates total investment. “All aircraft owned by Irish resident leasing companies are now considered part of the Irish capital stock, despite the fact that the vast majority of them will never actually be based out of Ireland.” (O’Brien, 2015)

Nonetheless, public policies on the public programmes in both the 1980s and since the crash of 2008 have been to exacerbate investment volatility through the severe cuts in public investment, rather than to mitigate it.

It can be argued that public infrastructural investment is never cut – it is only postponed. For most of it will have to be made up later... and usually at greater cost, when prices have risen.

Chapter Two – The Importance of Investment

In a recession investment falls, and it falls even more precipitously during a crash. Investment in Ireland has fallen substantially and total investment was at the lowest in the EU28 in 2013. Public investment had fallen to the lowest level in 50 years.

Investment in infrastructure is important because it provides the framework for the economy to grow. We have been under-investing, particularly as a result of the recession and our over-reliance on financialisation. It was financialisation that caused many of our economic ills but public investment is a crucial part of the way out.

The government's BoR plan points out how important investment is: "High-quality infrastructure is an important element of a modern society and economy. It strengthens economic growth through enhancing efficiency, productivity and competitiveness. It also underpins social cohesion through providing vital facilities for people in the form of schools, public transport, health care and housing" (BoR, 2015, p 6, repeated on p13).

However, it admits that "The scale and profile of the Exchequer component of the Capital Plan has been developed with reference to the Government's present medium term economic growth forecasts and is fully consistent with Ireland's fiscal targets over the coming years"(2015 p5). In short it is constrained by EU rules which will be examined later. However, it states that it will be "revised upwards" in the coming decade and there will be "a mid-term review" (p6).

It correctly points out that in determining the appropriate level of capital expenditure, "International comparisons can aid discussion but it is not straightforward to compare or benchmark the level of investment in one country with that in another. Geography, population densities, economic growth, and the scale of any infrastructural deficit are important variables but CSO shows a projected steady increase in our national population over the next three decades, rising above 5 million by 2025/26 and to over 5.6 million by 2046." It makes the case for greatly increased public investment.

The delay in public investment has five impacts. Firstly, investment would usually have cost less during a recession. Secondly, it has a bigger economic impact during a recession as its multipliers are higher in such times (the multiplier effect is the increase in final income from an increase in spending and the size of the impact depends on a number of factors). Thirdly, when projects are postponed employment is reduced (with important multiplier impacts lost too). Fourthly, it reduces future economic growth and development. As part of this impact, investment-related innovation makes the economy more efficient. Fifthly, there is the loss of the asset and the use of it. For example, the massive reduction in public housing has deeply impacted on a vast number of people, driven inefficiencies and costs, and pushed up rents.

In a discussion of the size of the public investment multiplier, Achim Truger (2015) found it was generally above one and thus somewhat larger than other spending categories. Thus public investment is the most effective short-run fiscal policy instrument. Some recent studies even come up with much larger (relative) estimates of the investment multiplier. Truger cited Auerbach and Gorodnichenko (2012) who found values larger than two with a maximum estimate of larger than four for some projects. In a panel regression for 15 European countries for the period 1980 to 2013 Hakhu et al. (2014) conclude that increases in the public capital expenditures to GDP ratio lead to

long-run decreases in the debt to GDP ratio. IMF (2014: 87-90) ran simulations with its DSGE model for advanced economies and found positive multipliers.

With such knowledge of the importance of public investment in the economy, it is a puzzle as to why it was cut back so fast during recession by governments. Public capital and infrastructure are closely related. The IMF (2014b, p79) says “a significant component of the public capital stock in most countries consists of infrastructure, and the public sector was and continues to be its main provider.”

When there is a recession/depression such as Ireland had, investment collapses and it is the private sector which responds most quickly as firms, individuals, banks, etc., cut back. The State is by far the biggest investor in most economies. It can and should counter – to some substantial degree – the natural fall in private investment during a recession. This did not happen in Ireland in the 1980s nor recently.

The size of public investment in any country is large, dominant and important for economic progress, particularly in boosting activity in a downturn.

In a study of the impact of the recession Ball (2014) found that Ireland’s potential output had fallen dramatically by 35 percent between end 2007 and 2015, as Figure 4 shows. The overall loss in the 23 OECD countries was over 8 percent. He said Ireland’s potential output was still weak in mid-2014.

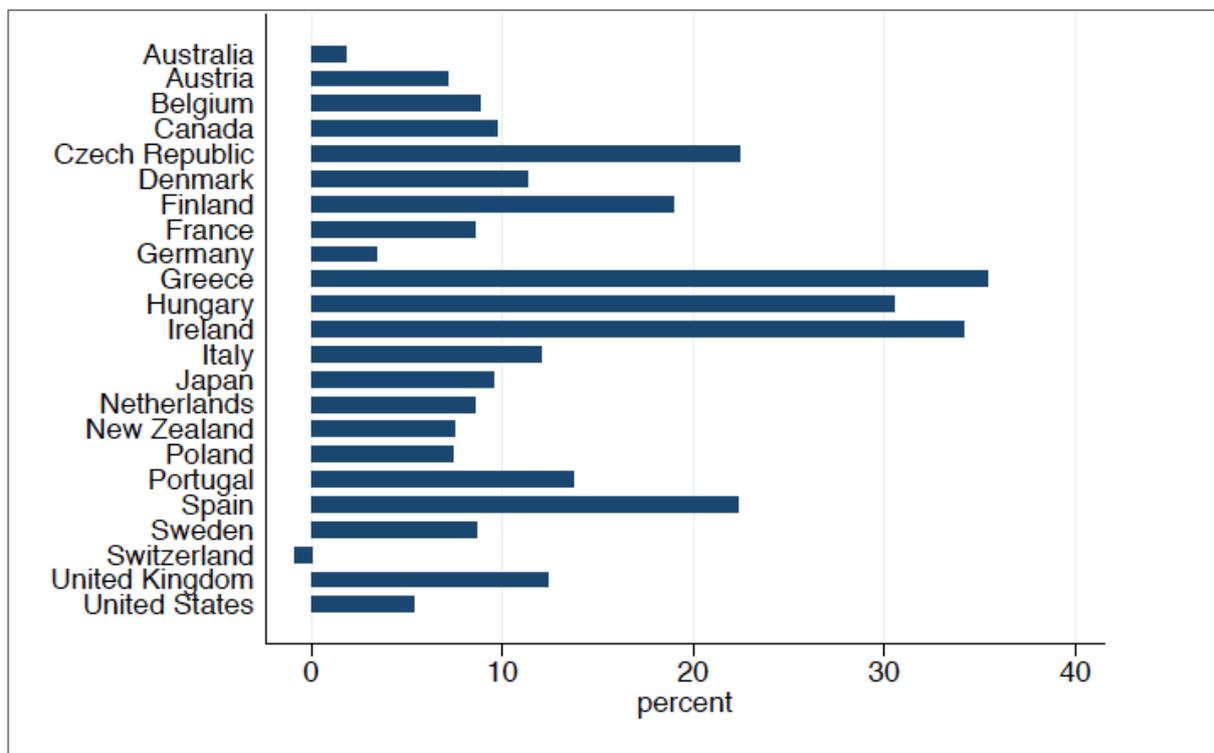


Figure 4: Loss of Potential Output 2007-2015 (Source: Ball, 2014)

However, as Ball based his figure for potential growth on the very rapid growth rates in Ireland in the past, which were inflated by the bubble, this overall figure at 35 percent for lost output is probably too high. Nonetheless, there was a substantial loss of potential output in Ireland and a large increase in public investment is one way to rapidly recover.

A further contributing reason for Ireland's current low investment is high unemployment, which peaked at 15 percent a few years ago and which is still 9 percent. Besides pushing down domestic demand (which fell dramatically for many years), unemployment also pushes down overall wages. With lower wages, employers hold on to workers and do not invest in machinery. This leads to reduced investment and lower productivity growth. It is not a virtuous circle.

Finally, the Irish economy badly needs public investment, according to no less an authority than the EU itself. At the same time as discussion of the first AIB repayment to the government was happening in November 2015, the Commission's report on Ireland, which forecast growth at 6 percent, one of the highest rates in the world, pointed out that "Supply constraints, for instance in housing or infrastructure, may become more pressing." It also warned that "Public investment (is) still well below the EU average" (European Commission 2015, p80). Thus there appears to be confusion in the Commission, but so much has changed (with strong growth, the exposition of the Troika's own errors, etc.) that it cannot but agree to the investment of some of the AIB privatisation proceeds in Ireland's "well below average Exchequer investment."

In its study of public infrastructural investment, IMF found (2014b) that "increased public infrastructure investment raises output in both the short and long term, particularly during periods of economic slack and when investment efficiency is high. This suggests that in countries with infrastructure needs, the time is right for an infrastructure push: borrowing costs are low and demand is weak in advanced economies."

The IMF also found that there has been "a substantial decline in public capital as a share of output over the past three decades" (2014b, p89).

The study found "evidence from advanced economies suggests that an increase in public investment that is debt financed would have larger output effects than an increase that is budget neutral, with both options delivering similar declines in the debt-to-GDP ratio." (IMF 2014b, p89) In short borrow and invest, though it warns this is not a blanket recommendation for all countries and it urges efficiencies in public investment too. Ireland does not need to borrow more as the bank proceeds will be coming on stream from 2016.

Finally, the results of the IMF simulation for advanced economies (which included Ireland) "suggest that a 1 percent of GDP permanent increase in public investment increases output by about 2 percent in the same year. (2014b, p87). In short, its model shows that each 1 percent increase in public investment will double economic output almost immediately.

Public investment beats quantitative easing

When the ECB launched its €1.1tn quantitative easing programme (printing money) in 2015, it expected that it would stimulate lending and that would in turn boost investment and jobs. This did not work. It helped somewhat, but the crisis is about more than monetary policy. Fiscal policy is essential too and the EU has pursued austerity.

Companies are not investing. Many have vast cash reserves which are being used to buy back shares or boost dividends rather than invest in production. Cash reserves of European non-financial companies are 40 percent higher than in 2008 at \$1.1tn, according to Moodys.

After the 2008 crash companies greatly reduced investment, paid off debts, and then built cash piles and bought their own shares. According to the Financial Times (7 Sept 2015) Standard & Poor's predicted that global capital expenditure would fall more than 10 per cent in 2015, largely due to contraction in energy and mining.

The fact is that companies will not invest simply because interest rates are low. They invest when they expect growth, when they see returns in profits but not when they have excess capacity. They have excess capacity because so many other companies are not investing because of lack of demand. It is a vicious circle. It is compounded by inequality as it is the rich and corporates who have so much more capital and income and will not spend nor invest it.

Indeed, the low cost of capital may be part of the problem rather than the solution. It has given a life-line to companies which may otherwise have collapsed, generating more competition for better companies.

In an article on quantitative easing in the Financial Times (7 Sept 2015) Mohamed El-Erian, chief economic adviser to Allianz, described the mistakes in world economics very accurately:

“There are four reasons why, acting on their own, central banks have not delivered high and inclusive growth.

- First, the west had invested in the wrong growth model, over-emphasising finance rather than real investment.
- Second, national and regional inequality matters as it drives a wedge between the ability and willingness to spend.
- Third, firms don't invest when there is excessive indebtedness.
- Fourth, if the architecture is incomplete — as it is in the Eurozone — this in itself undermines economic recovery and lift off.”

Thus it is back to the Keynesian view that the state initiates investment – the stimulus to pump prime the private sector. With 23,000,000,000 unemployed in the EU28, there is a lack of demand. This is exacerbated by the currently historically high level of inequality – too many have too little to boost demand sufficiently.

In part recognition, the EU has its €315bn investment plan over three years, but this is too weak to provide sufficient stimulus. It is too cautious because of the balanced budget fetishism within the EU elite. They know it – in September 2015 the ECB had to reduce its 2015 growth forecast for the Eurozone to 1.4 percent from 1.5 percent.

Thus, quantitative easing by central banks is insufficient. The weak Juncker investment plan is a step in the right direction but it is too modest. Each state must also be allowed to borrow to invest, now.

Public Investment can be an Economic Stabiliser

One of the great benefits of the modern economy is the work of automatic stabilisers – such as public spending which kicks in to replace the fall in the private sector activity in a recession. The largest of these automatic stabilisers is the welfare system, which was largely protected by the Irish government, and it contributed greatly to countering the huge fall in domestic demand in recent

times. The welfare system includes payments for those out of work (€2.6bn in 2015), for children (€2.4bn) and importantly the very large sums paid in public pensions (€6.7bn in 2015) to older people.

The other big stabiliser should be public investment, provided it is maintained during a recession. Public investment should have had a major influence in stabilising crisis economies and keeping up their long-term growth potential. However, in the recent crisis, investment shrank in Ireland dramatically, thanks to a) EU rules which are “hard wired into austerity,” b) neglect of investment by most advising economists, and c) poor awareness of the vital importance of investment by hard-pressed governments.

Chapter Three – Building on the Government’s Response to the Investment Crisis

The crisis led to a collapse in investment to the lowest levels in years. In recognition of this and the need to catch up, the government has published a public investment programme *Building on Recovery: Infrastructure and Capital Investment 2016-2021* (BoR).

This plan “sets out the Government’s commitment to Exchequer investment of €27 billion over the six-year period 2016-2021.” The Plan also announces the development of a new 3rd Phase of the Government’s PPP programme with about €500 million of PPP projects. “In addition, over the period of the Capital Plan, the wider State sector plans to invest €14.5 billion in capital projects. This will principally be undertaken by the commercial State-owned companies. These will lead to about €42 billion of State-backed investment in capital projects. Investment by the commercial State companies will be underpinned by funding from the Ireland Strategic Investment Fund, the National Asset Management Agency and other sources.”

The previous 2011 government plan *Infrastructure and Capital Investment, 2012-2016* made the mistake of setting out a deeply fiscally conservative approach. “Over the medium-term, there will be a lower level of resources available for capital investment. While not ideal, this is the reality of the fiscal challenge which the Government faces” (2011, piii).

The 2011 plan had claimed that “the Government has decided that the Public Capital Programme needs to contribute further to achieving fiscal consolidation, and is confident that this can be done without major negative consequences for economic activity.” This caution was to further delay much needed investment for four years.

This Plan is Too Cautious

There is a line between prudent and profligate, but in the light of Ireland’s infrastructural deficit, this thinking in 2011 and now in 2015 with the BoR, greatly errs on the cautionary side. There will be major consequences for future growth and prosperity with this weak level of spending. The BoR plan may replace depreciation in each future year, but with several years of under-investment to be made up, population growth and increased demands for modern European public infrastructure, such a cautious plan will undermine the economy and future prosperity.

While Exchequer investment will be expanded, the plan acknowledges that it will not be Keynesian-style State-led investment⁵. Its opening statement sets the tone this: “Economic recovery in Ireland will be enterprise-driven and export-led” (p1). Thus it aspires to be largely, if not fully, led by the private sector and by exports. In fact, the push for export and innovation from the private sector is unlikely to be as successful as its potential in the absence of significant public investment, which is required to underpin it (Mazzucato, 2013).

Many of the specific projects, like a modern children’s hospital, schools, Dublin LUAS extension etc. are welcome, but they are basic and overdue. The decision not to link Dublin’s public transport

⁵ The Keynesian view is that in the short run, particularly during recessions, economic output is strongly influenced by aggregate demand (total spending in the economy including investment). “Free” markets are not self-regulating and state intervention, including investment during downturns, is necessary to achieve full employment and price stability.

infrastructure with the DART underground but instead to build a scaled-down Metro North is a major mistake. It is due to the parsimony of the overall plan, dictated by Europe and the perceived and misguided need to be overly prudent. This decision will be a repeat of Red Cow Disease on a bigger scale. New stations will have to be installed in the future, existing ones enlarged and new links built, all at greater cost and inconvenience.

In an effort to boost the apparent size of the Exchequer programme, it stated that “In total, this State-backed investment package represents over 3.5 percent of GNP.” This package is what used to be called the Public Capital Programme (PCP). Indeed what was notable by its absence in the BoR was a discussion of the shrinking size of the PCP due to the policy of privatisation. The absence of any debate on the impact of privatisation on long-term public investment is disappointing. It will be discussed in the next chapter.

Exchequer investment or government fixed capital investment in Ireland was high until the crash. It was cut each year and by 2012, it was very low by Irish or international levels. The BoR plans increases in capital investment, but analysis of figures from Budget 2016 and the plan itself, show that Exchequer capital spending against GDP will fall to even lower levels than those in 2012-14, when it was at the lowest level in 50 years.

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Euro area	:	:	:	3.2	3.2	3.3	3.6	3.4	3.1	2.9	2.8	2.7
Ireland	3.6	3.5	3.5	3.7	4.6	5.2	3.7	3.3	2.4	2.1	1.8	2

Table 1: Government Fixed Investment (% GDP) (Source: Eurostat)

First, let’s examine historical levels of government investment. Table 1 shows the level of Exchequer investment over the past 12 years in Ireland and in Euro area of 19 countries (Eurostat data). Irish Exchequer or government investment was at high levels during the mid-2000s, peaking at a very high 5.2 percent of GDP in 2008, the year of the crash. But it declined each year and fell to the lowest levels both in Europe and in our history 2012-2014⁶. Adjusting to GNP would bring it up closer to Europe, but it still would be low. Further there is a public investment crisis in many advanced countries, which is dragging down the average.

Next, we examine the future planned investment. Under the BoR, the Exchequer investment falls to only 1.7 percent of GDP in 2016, lower than even the lowest year in Table 1 of 1.8 percent in 2013. It averages only 1.84 percent rising to peak at 2.05 percent in 2021.

There are a few caveats. Firstly, these estimates are based on the Department of Finance’s projections for GDP – if they are over-optimistic and the investment programme is adhered to, this ratio will rise. Secondly, there are some differences in long data series though these neutralise each other out. Thirdly, GDP is the international benchmark but there can be difficulties in using it for

⁶ GDP is the international comparator used, but even adjusting for the lower GNP, Ireland’s exchequer investment is still considerably below most EU states in the recent years 2012-2014. It is difficult to get comparable long term data, but what is called the “Exchequer Capital Envelope” projection in the BoR, p6 is the same as Gross Voted Capital Expenditure 2016-21 in T10, Budget 2016.

Ireland. It is much higher than GNP for Ireland and it is more volatile. However, as it is a consistent benchmark, it is fine for showing trends for Ireland. But comparisons with other states, which are used in Table 1 increase Ireland's Exchequer investment against the Euro area. Even if adjusted to GNP, Ireland would still be lower than the Euro area in the latter years.

The average for the next six years is projected at 1.83 percent of GDP. In contrast, in the years 2002 to 2009, Exchequer investment averaged 3.97 percent of GDP (Eurostat). A proportion was related to the construction bubble, particularly in the later years.

Figure 5 takes a longer perspective and it shows how much lower investment will be as a percentage of GDP for the period of the plan. It also shows that the absolute amount will rise (the columns) and it will eventually be higher than say 2003. But it still will be substantially lower as a percentage of GDP as the line shows.

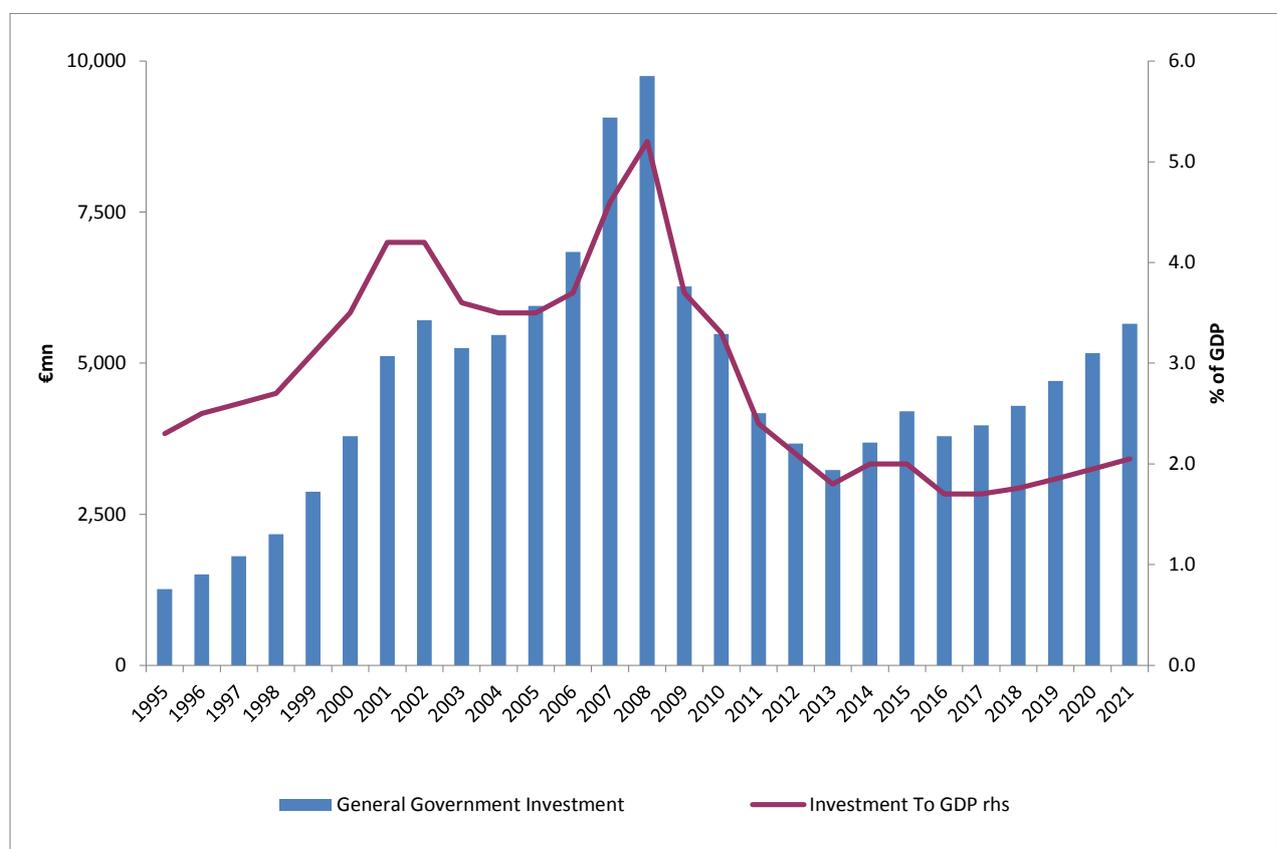


Figure 5: Exchequer investment (actual '95-'15, planned '16-'21) (Source: Building on Recovery)

The actual cash investment in billions is given from 2009 to 2021 in Appendix 1. It is clear that the new programme, BoR, is lacking in ambition. This is illustrated by examining historical investment patterns in Ireland, which was done in the graphs in Chapter 1 and by comparing Table 1 historical Exchequer investment against that proposed in the plan in Table 2 (see page 25). If the DoF growth projections used in Table 2 are correct, and they would seem to be on course for the first two years based on current trends, then this proposed investment is lower than even the lowest years in Table 1.

The overall larger Public Capital Programme had been cut from over €12bn at peak in 2008 to €6.5bn in 2015 (Dept. Finance).

There was a bubble in overall investment in Ireland in the 2000s, but less so in investment in public infrastructure. However, the bubble did add to the cost of such infrastructure – due to high construction costs. Therefore, the projected figures should be a lower figure than achieved in the past. Unlike Irish private sector bubble investment during the years to the Crash of 2008, most investment in public assets and buildings was useful (White, 2010) – the Exchequer investment was in substantial and necessary public assets like roads, trams, courthouses, schools and hospitals.

Keynesian economists have long argued that in recessions, the state should borrow to make up the shortfall in private investment. However, it was seen that the EU rules, governed by a deficit fetishism (the term coined by Simon Wren-Lewis), will not allow such borrowing. There has been some relaxing of these rules in recent times but it is insufficient.

What level of public investment should Ireland seek to attain?

Until the crash of 2008, Ireland has had a rate of total investment over time of 22 percent of GDP, which is a little above the EU average. Ireland has been catching up with the EU and while it now has higher than average national income by GDP (or GNP) per capita, the level of wealth in Ireland is still behind that in many EU states. This includes both private assets owned by individuals and public infrastructure owned by the State.

That is why we need to invest more to build EU standard public infrastructure in schools, crèches, hospitals, clinics, public transport etc. with Europe. Anyone who has been to EU cities will have seen the superior public transport systems in operation. Ireland was catching up, but the investment collapse has pushed us back. There was substantial progress in bridging the investment gap with Europe over the past, as cited in comment in Figure 3 but it was insufficient. Further, some investment, e.g. in housing was unproductive.

Thus it would be reasonable – to help catch up – to seek a figure of 2.25 percent of GDP from 2016, rising to 2.5 percent in 2017 and 2018 then 3.0 in 2019 and 3.25 for 2020 and 2021. While these figures are based on an assessment of past performance and current needs, they are suggested by the author. This is not exact and would require a detailed assessment of all investment needs nationally, including in human capital and of aspirations for improvements. This is not available and would be subject to much debate. For example, we have ideas about various urban transport plans for Dublin, but the costs depend on the level of ambition and on more detailed analysis and feasibility studies. What is clear is that the BoR plan (which will begin by cutting investment as a percentage of GDP) is grossly inadequate.

The BoR suggests an average Exchequer investment of only 1.84 percent of GDP a year to 2021. This is low. The suggested Exchequer investment here is of 2.25 percent of GDP rising to 3.25 percent (average 2.8 percent), which is well below the average achieved of 3.9 percent in the 6 years 2002 to 2007 but above the 1.84 percent proposed in the plan. In those six years Exchequer investment had totalled €38.2bn.

Proposed Exchequer Capital Envelope 2016-2021 €m

	2016	2017	2018	2019	2020	2021	Total 2016 - 2021
Planned (€m) (BOR)	3,800	3,970	4,230	4,600	5,000	5,400	27,000
% of GDP	1.70	1.70	1.76	1.85	1.95	2.05	
Proposed (€m)	5,018	5,825	6,100	7,600	8,613	8,938	42,094
% GDP	2.25	2.5	2.5	3.0	3.25	3.25	

Table 2: Proposed Exchequer Capital Envelope 2016-2021 (Sources: Building on Recovery, DoF Budget 2016 and own projections.)

The level proposed in this report is higher than the plan and it is more realistic as it is closer to long term investment trends and needs. It will meet Ireland's infrastructural needs and provide certainty. It is equivalent to €5bn in 2016 as in Table 2, €1.2bn above what is planned that year.

Thus an additional €15bn on the BoR's proposed €27bn is required, giving a total of €42bn. This Exchequer investment in public infrastructure between next year and 2021 is a near 56 percent increase on the BoR.

This may seem like a large increase, but studies indicate that it is not. Crafts (2014 p108) said that: "Ireland's GDP could quite possibly grow at 3 percent per year from the late 2010s to 2030." Indeed the government's own projection for GDP growth for the shorter period, from 2015 to 2021 is 3.74 percent. As Kamps (2005) has suggested that the optimal public investment to GDP is 3 percent for an economy with a trend growth rate of 3 percent, then the suggested increase in exchequer investment in this report of €42bn over six years, averaging 2.84 percent of GDP a year, (1 percent a year above the government plan) is in fact modest in light of the official projected growth rate in the period.

Where this money is to be found is now examined.

The caution in Exchequer investment reflects the proposed reductions in total public expenditure to 2021 outlined in Budget 2016 (T. A2:1). The government plans to reduce public expenditure from 38.2 percent of GDP in 2014 progressively each year to just 28.4 percent in 2021. Even with an adjustment upwards for Ireland by about 17 percent due the distortion in GDP for international comparisons, it is still low. It is a proposed 26 percent reduction in public spending in seven years. These major cuts in public expenditure are not re-assuring for citizens who want improvements in public services.

Commenting on the BoR plan, the OECD (2015 Nov) said: "The plan should focus on increasing the density of the metropolitan area, which will help to increase the viability of public transport and lower emissions of greenhouse gases." Sprawl is the hallmark of Dublin and it should be tackled in the revised plan. Climate change mitigation will need substantial State-led investment.

The IMF, one of the Troika which sought cuts in investment in Ireland for the bailout in the Memorandum of Understanding (2010) now also argues for increased investment. In its World Economic Outlook (2014), it “examines the macroeconomic effects of public investment in a large number of countries. The findings suggest that in countries with infrastructure needs, now is a good time for an infrastructure push.”

Chapter Four – New Sources of Finance

“The physical assets of a nation are financed by the wealth of its households. People talk about ‘new sources of finance’ when what they mean is new ways of channelling existing sources of finance” (Kay 2015, p147).

The Government plan (p viii) says “Department of Public Expenditure and Reform will step up engagement in these areas and explore all possible alternative funding streams.” “These areas” refers to alternatives to direct expenditure by the State. These alternatives may ultimately generate returns in excess of the cost but some may impose costs on the taxpayer.

In light of the negative contribution of financialisation of economies to the collapse, there is a much harder and critical view of off-balance sheet financing today. However, it is still worth examining these alternatives.

If capital to deal with the investment crisis cannot be borrowed, because of EU rules, then it can be raised from other sources, such as pension funds; a special housing savings bond; taxing the highly profitable but under-taxed corporate sector; and by giving less tax cuts than are being promised and other new ways. Many are suggested in the BoR.

It has been suggested above that the Exchequer investment programme be substantially increased to 2.25 percent of GDP a year from 2016 and rising to 3.25 percent in 2020 and 2021, which is a substantial increase on that proposed in the BoR. How should the extra funding be raised?

The Ireland Strategic Investment Fund (ISIF)

It is planned to use €7.5bn of the €22bn left in the National Pension Reserve Fund at end 2014 (its assets were then transferred to NTMA) for the Capital Programme (BoR, p45) through the new ISIF. It will also be used to leverage an additional €15bn in capital from private interests for public infrastructural investment through the ISIF.

The leveraging of private funds is reasonable if it is proven in advance that it will not be overly costly.

Capital Sources

A total of €400m from the privatisation of BGE (privatised close to the bottom of the market) is to be used “to set up an off-balance sheet financial vehicle” to help approved housing bodies to fund social housing (p.46).

There are two questions on this decision. Firstly, if the BGE capital can be used for investment rather than to repay national debt, why not also use the additional billions from the bank shares to fund investment directly, instead of using them to repay debt which is falling anyway? Secondly, why not use the BGE capital directly? Why is this new “financial vehicle,” the Strategic Housing Fund, needed instead of direct investment of this €400m? It is possible that it can leverage additional funds, but value for money must be factored in.

The ESB has paid large dividends of c. €1bn over the past decade to the Exchequer, including from special sales of assets during the crisis, but it is unlikely that it can be approached again in this way as the crisis is over and it is an independent company. Access to this €1bn during the crisis demonstrated the value of retaining good commercial State companies in public ownership. This is particularly pertinent in a small open economy where key sectors should be maintained in

indigenous control to counter the vagaries of predatory global capital. Its financial performance and service to the State is in stark contrast to the six private banks, all of which collapsed and cost the State dearly.

Other sources for boosting actual Exchequer investment in infrastructure include borrowing, especially given the falling rate of interest on the national debt, and the surpluses of the Central Bank (€1.6bn in 2016 and €1.7bn in 2015) (Exchequer receipts and expenditure 2016). In addition there is another €1.75bn, the NAMA Board having revised its projected terminal surplus up from €1bn to at least this figure (1 October 2015).

Privatisation – Shrinking the Public Capital Programme

In the BoR, the government highlighted the total public capital programme over the direct Exchequer-financed part of it. In effect a substantial part of the programme has been privatised, rendering it much less useful as a policy tool than it had been. There has been no public policy debate about this particular negative impact of privatisation for some reason.

The Public Capital Programme of, say, 1995, set out a proportionately far greater capital investment programme of State-owned commercial bodies than in 2016. Since then many have been privatised. This has greatly reduced the role of the State in many areas but also in wider public investment. Some of this investment is being made by the privatised companies. However, the largest single investing company in Ireland, Telecom Eireann, is now a pale shadow of its former self as an investor and in every other way as Eir. It was privatisation which permitted its numerous boards to cease investing heavily in broadband etc and instead it was asset-stripped by successive owners (Sweeney, 2004 and Palcic and Reeves, 2011). A fraction of its size when in public ownership, it is now investing again.

Commercial state owned enterprises privatised since 1995

1. Irish Steel – privatised in 1996, closed in 2001.
2. Eircom – privatised in 1996 and 1999; almost collapsed in 2009.
3. INPC – privatised in 2001. Now Phillips Petroleum.
4. ACC – sold to Rabobank in 2001.
5. ICC – sold to Bank of Scotland in 2001, now Lloyds.
6. TSB – 2001 privatised and sold to Bank of Scotland & rescued by UK govt.
7. IFI – 2002 closed.
8. Aer Lingus – largely privatised in 2006. Now part of IAG/BA.
9. BGE – 2014, part-privatised – British consortium including Centrica.
10. National Lottery – privatised 2014 sold to Camelot/An Post.

Privatisation reduces the public capital programme. Due to widespread privatisation, much of Britain's infrastructure is now owned by foreign firms, including, ironically, many state-owned firms like France's EDF. Besides the loss of public control of very key infrastructure like water, electricity and airports there are other issues with privatisation. "GCHQ, the electronic eavesdropping agency, is seeking special access to Chinese computer systems to allay security concerns over Beijing's growing stake in Britain's critical national infrastructure including Chinese participation in a £24bn new reactor at Hinkley Point in Somerset and two other plants which are to be built with EDF" (FT 16 October 2015).

The argument here is that key areas of the economy should not be privatised. The impact on the public capital programme might be replaced by private investment, but control is gone and in some cases private firms simply will not invest if it reduces short-term profits. It also leads to complex regulation necessary to prevent either excessive profits or eviscerated investment.

The corporatisation of Irish Water was mishandled. But much of the focus of the public's hostility was on the potential for future privatisation. It demonstrates the innate hostility of Irish people to such privatisations. People did learn from the Eircom debacle. Well-run State companies have a role in the modern economy. Indeed they play a significant role in Europe and are important in most emerging countries.

Public Private Partnerships – PPPs

The main advantage of PPPs is that the State gets infrastructure for which it could not afford to borrow during lean times and especially during the seven year crisis after the crash. The key question is whether there is really value for money or is it following "a financial fashion" from the UK which also let financial interests share in large State contracts. This can be productive, but in many cases is costly, according to UK studies.

There was no need for PPPs in Ireland when first introduced because surpluses were being generated in the mid-1990s. They were totally unnecessary as all current and capital spending was funded out of revenue during the late 1990s and early 2000s⁷. We were simply following the British fashion, an ideological idea, which was also very popular with private financial types who could get a slice of the action. After the crash of 2008, the case for PPPs was no longer simply ideological and had become necessary with the EU rules.

Chapter 4 of the BoR plan is devoted to finding new ways of off-balance sheet funding for public infrastructure. The plan says that since 1996 almost €6bn in financing from private interests has funded public infrastructure through PPPs.

The plan explains the benefits of PPPs:

"PPPs involve contractual arrangements between the public and private sector to deliver infrastructure or services that were traditionally provided directly by the public sector. Under the arrangements, infrastructure is delivered by a private sector firm and, following construction, the

⁷ Between 1977 and 2003 it was largely in balance, with surpluses in five years -being 3.9% or €3.2bn in 2000.

asset is made available for public use. The State pays an annual unitary payment to the PPP company over an extended period, typically 25-30 years.”

“At the end of the contract period, the asset comes into State ownership but in the meantime the PPP is regarded as ‘off balance sheet’ when calculating the deficit from the perspective of the Fiscal Rules and adhering to the Stability and Growth Pact. This means that the initial capital cost of the project does not impact on the public finances over the construction period, but rather its cost is spread over the lifetime of the project. Provided all other value for money requirements are met, this can make PPPs an attractive proposition, particularly given our fiscal constraints.”(p41)

It continues: “Looking beyond the 2021 horizon, the Exchequer will be committed to paying an average of over €360 million per annum (indexed for inflation) in PPP unitary payments between 2022 and 2035, followed by an average of about €280 million per annum from 2036 until 2042. It will be a further 10 years (2052) before all payments due under these PPP commitments are made in full. This is a considerable ongoing financial commitment that will absorb a significant amount of the Government’s discretionary capital” (p42).

In 2015 €496.8 million in PPPs is on the government balance sheet, and €5,375.6 million is counted as off-balance sheet. In total, this is €5.87 billion. With such a large sum it is clear why financial interests like them – assume 3 percent in fees which pays €180m.

Because of this ongoing and rising cost, the government finally decided to cap PPPs in 2015 at 10 percent of all Exchequer capital expenditure: “the aggregate level of annual expenditure on PPP unitary payments is to be capped relative to the Exchequer capital envelope, which will see the total cost of PPPs, including up-front direct Exchequer costs, being limited to 10 percent of total annual Exchequer capital spending” (p42).

€70m in loans from the ESFI, a European fund, is promised (p46) to fund half of the Department of Health’s PPP project involving 14 primary care centres in Ireland. Why this is not directly funded and in full is not addressed. Primary health centres are unlikely to be profitable enough to repay such loans. Thus it will fall on the taxpayer in fees and interest.

There are additional costs to PPPs over direct provision as the plan has set out above. In the UK, most of the 50 or so formal studies of PPPs and Private Finance Initiatives (PFIs) have been very critical. No major study has been made of the €6bn spend to date here. Here, the Comptroller and Auditor General’s office has done one study which was highly critical. It found that instead of saving taxpayers money, the Department of Education “should have concluded that adopting the PPP approach to the procurement was likely to be in the region of 13 percent to 19 percent more expensive than conventional procurement. The analysis also indicates that the deal involved relatively little transfer of risk to Jarvis (the bidder)” (C&AG, 2004).

Another Government report was critical of lack of information (which was to be addressed in a specific way by the Department of Finance and the Department of Public Expenditure and Reform). This report said also that “significant costs have been incurred on cancelled PPP projects. Some of this expenditure is sunk cost that has delivered no effective benefit.” The “appropriate sharing of project risks is a requirement if PPP projects are to deliver value for money” (C&AG, 2011).

Reeves (2015) welcomed the cap imposed in PPPs but called for a major independent study of them. He also pointed out that “despite claims that PPPs would guarantee ‘speedy delivery’ of projects, the reality has been a litany of delays and postponements. This is partly explained by the complex nature of procurement under PPP which results in lengthy tendering periods.”

In his book on financialisation, “Other Peoples’ Money”, John Kay finds: “There are many disadvantages to partnerships. In particular there are substantial costs in binding the government into a long-term arrangement whose details are largely ineffectually pre-specified. Complexity and inflexibility reached absurd lengths in the PPPs put in place to modernize London’s underground” (2015 p160).

He concludes by saying “instead of borrowing on spectacularly favourable terms, governments are aggressively buying back their long term debt and cutting their capital expenditure in the name of austerity. The common sense that sees the outcome as absurd contains more wisdom than technical explanations peppered with acronyms such as PPPs, PFI, QE and SIV” (2015, p160).

Similar critical arguments have been made by Reeves, (2011, 2013) Palcic (2011) and Sweeney (1990, 2004, 2015) of the use of PPPs and of privatisation in Ireland.

It is essential that the Government now undertakes a major study of existing PPPs to assess their true long term cost. We know that PPPs will cost the taxpayer €225m in 2016 and every year after for many decades. As a whole they have not been independently assessed which is surprising with promises of transparency and cost benefit studies and they have a cost to date of almost €6bn. There is at least the appearance of excessive cost to taxpayers to support extra gains to private investors.

Financialisation – Off Balance Sheet Financial Innovation

“When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.” JM Keynes, General Theory.

The BoR plan states: “Public Spending Code, which was launched by the Department of Public Expenditure and Reform in late 2013, is now in place to ensure a comprehensive and uniform approach is taken to project appraisal and evaluation by all State bodies that are charged with delivering projects under this Capital Plan” (p47). This is most welcome.

However, this State has not a good record of getting value for money. For years several NGOs and ICTU, in particular, sought all tax expenditures to be fully appraised in advance. This did not happen until it was too late. These tax breaks, which were regressive, fuelled the property bubble. Many of their recipients ultimately paid heavily as did the taxpayer, the poor and Ireland.

The overly restrictive EU rules on economic governance and its obsession with surveillance and the exercise of power of Member States are a good example of the power of vestigial ideas, particular on deficit rules and gross national debt.

However, in seeking “off balance sheet funding” public servants could be in danger of becoming like the financial “experts” who sold sub-prime mortgages wrapped up with other loans in “triple A” rated packages. Instead of simple borrowing, they are engaging in financial “whizkidery” which will cost more, has unintended consequences and is regressive. Nonetheless, thanks to EU rules – which

appear to be prudent but which are underpinned by anti-Keynesianism – they are being forced into seeking new forms of financing investment which are costly in the longer term.

It was seen that financialisation is the growth of the financial sector which has risen to excessive levels, where it has become an obstacle to development with the ‘shareholder value model’ of corporate governance, short-termism and distorted behaviour and economic policy.

There are funds which can be utilised for investment and the new plan suggests some, such as the Ireland Strategic Investment Fund which is investing €7.4 billion across industry sectors, regions and asset classes. There is around €13.6bn in assets in State companies which could be further leveraged to provide further investment funds, the BoR says.

But policy makers need to be highly critical of adhering to these economic fashions which have failed or which impose excessive long term costs.

An old source – borrowing

The cost of borrowing is at historically low rates. Ireland was not able to borrow a few years ago. In September 2015 it borrowed €1bn at a mere 1.8 percent (over 15 years). This was down from 2.8 percent average in 2014. This offer was almost three times oversubscribed. This is historically cheap funding.

Ireland has had no problem in getting cheap loans and it also has substantial cash borrowing reserves. It is borrowing at rates comparable with the best-rated countries. It is thus remarkable that it is not allowed to productively invest this money by EU rules and most of the cash reserves cannot be used for investment.

Reforms of public contracts

The BoR plan sets out a number of reforms to give better value for money for the taxpayer, to make the tendering process level and less costly, a register of building contracts etc. Indeed many private firms expend great effort and cost on tenders which are overly complex, sometimes due to the method of financing. On the other hand, some public contracts have gone to firms which are registered for tax in tax havens and some public contractors also have poor labour records.

It has been disappointing that the Irish State continues to award flawed contracts to tax-avoiding companies, registered in tax havens, and/or do not even have to recognise trade unions⁸. Unions are a proxy for good governance and reduce risk for the public by exposing corruption, short cuts, dangerous practices, tax evasion and avoidance.

Another government investment plan, *Construction 2020* (DECLG, 2014) complements the BoR. It sets out 75 points including social clauses to protect workers and in doing so, public investment. This is welcome as Ireland’s record of awarding contracts is well below acceptable European standards.

⁸ For example, according to the Irish Independent (13 July 2015) Greyhound which has the waste contract for Dublin is registered in Isle of Man, City Bin is an unlimited company is registered in Galway and in Jersey, Oxygen is unlimited and IoM, Panda Waste is unlimited and IoM, and Country Clean is unlimited. This is only a fraction of such disclosure avoidance and financial engineering by contractors which make money from public contracts.

For example, in Denmark, Irish firm Atlanco was sacked by Metroselskabet, the Copenhagen Metro, as it was found to be exploiting workers in 2014. Metroselskabet said it had abused the “social clause” between contractors and staff: “We make very clear demands that there should be proper conditions on the building sites and these demands are not flexible.”⁹

Public Procurement is a difficult and necessary process to ensure fairness for bidders and value for the taxpayer. But it is unnecessarily cumbersome and costly for bidders. It is delaying many projects particularly in the crisis area of housing. Urgent steps need to be taken to simplify it by increasing thresholds and improving processes. Until the housing crisis is eased, radical steps should be considered. Planning is still bureaucratic and must also be reformed to speed up development.

Public Procurement is worth €10bn annually in Ireland. It should be the leader in high standards of safety, labour standards, quality of work, good governance and impact on the domestic economy though multiplier maximisation. It should be “cowboy-free”. It is not.

Using bank shares

It was seen that there are many obstacles to borrowing money – even at today’s historically low interest rates – to invest in much needed infrastructure. A large number of initiatives for alternative funding are being taken by government – the National Pension fund, EIB and other sources. Another source is in increased taxation – an obvious option.

There is another clear source of finance for investment which will not break European rules and regulations. It is of sufficient scale that we could almost double the investment planned under the modest BoR programme. This is to use the proceeds from the privatisation of the rescued banks for investment.

Ireland retains stakes in three domestic banks, AIB (99.8percent), Bank of Ireland (13.9percent) and PTSB (74.9percent) which are valued in the region of €15 billion and it is stated government policy that these will be divested over the medium to long term (Budget 2016, Economic and Fiscal Outlook dated October 2015, pC29). The privatisation of AIB is likely to command a price of around 20 percent more than its book value, which was €11.229bn in mid-2015 and it was rising sharply. That would allow the State to recoup €3.5bn or more by the privatisation of just 25 percent of the bank.

On 12 January 2015 “Mr Noonan said he is confident that over time the State will get back all the money invested in the three banks”.¹⁰ The total sum invested was €29bn from three (AIB, BOI and PSTB) of the six banks, the bulk of which (€20.7bn) went to AIB. Thus it is possible – if Mr Noonan is correct – that the government could have €29bn additional funds to invest in Ireland without increasing taxes or borrowing more.

These banks had repaid €10bn of the €64bn of taxpayers’ funds by mid-2015 – made up of €4.3bn from the sales of Irish Life and parts of Bank of Ireland. €5.7bn of this which was paid to taxpayers by the bailed-out banks was actually in fees and penalty interest on rescue loans (DoF, August 2015). Unfortunately, Anglo Irish Bank and Irish Nationwide Building Society were bailed out at a cost of €34bn but will never repay that debt.

⁹ CHP On Line Post, Denmark, 19 Sept 2014

¹⁰ RTE 12 January 2015

Even if there was no debt repayment at all, based on the government's own projections for economic growth, the gross debt would fall to 74 percent of GDP by 2021 and to 64 percent of net debt as GDP rises. In late 2015, Ireland is in very favourable economic circumstances with low interest rates on this debt, rising taxes, low oil prices and a weak euro and no problem raising more borrowing at very low rates. It is wise to repay debt, but there is no need to do so in these benign circumstances.

When there is a choice between repaying some of this debt and the bank proceeds affording us to greatly increase what all are agreed are needed investments on our children's (and our own) future infrastructure, the choice is clear – invest.

It is expected that at least €4bn will be paid from AIB to the state in 2016. This is slightly more than the €3.8 the government plans to invest in infrastructure that year. This report advocates that €5bn be invested, or €1.2bn more. If the balance, €2.8bn was paid off the gross debt, it reduces it by just over 1 percent. Some of the bank proceeds might be used to pay off national debt, but most of it should be used to increase Exchequer capital investment. However, the bank shares are capital and none should be used for current expenditure.

Mr Noonan said as the money to rescue the private banks “was borrowed in the first instance,” it has to be paid back¹¹. But as the government did a deal on the promissory notes which reduced the rates but prolonged the debt repayment period, equally it can do another deal with Europe on the bank proceeds. Further, the economic situation is greatly improved.

The admission by Ajai Chopra, the International Monetary Fund's former mission chief to Ireland, that “Ireland was treated unfairly when its Eurozone partners prevented it from burning senior bondholders in its bust banks during the financial crisis,”¹² adds to Ireland's case for fairer and more reasonable treatment by Europe now on utilising some of the funds from these same banks for infrastructural investment.

Patrick Honohan, then Governor of the Irish Central Bank, also said “I think it's fair that European decision makers subsequently had misgivings about having blocked this bail-in”¹³ (of senior bondholders) and that they changed their minds on this later and it may have helped to be more reasonable. Chopra later told the European Parliament that: “ECB threats at the time to cut off funding to Irish banks if the country resisted signing up to the bailout were unnecessary,” and even went as far to say that, “as the Central Bank to countries including Ireland, the ECB should never have been part of the Troika.”

Chopra said: “The ECB initially pressed for swift deleveraging of Ireland's banking sector through front-loaded and large-scale asset sales to reduce quickly in its large exposure to Ireland. In doing so, it put protection of its own balance sheet before the cost to the Irish taxpayer. Later the ECB accepted that fire sales of assets would be counterproductive, but by then trust in the institution and its legitimacy had been damaged.”

¹¹ Irish Independent 7th November 2015

¹² Financial Times 20 December 2013 and Irish Independent, 13 November 2015

¹³ Irish Times 18th November 2015

While the ECB treated Ireland disgracefully, the Troika as a group – the ECB, Commission and IMF – did not handle Ireland’s bailout well either. They refused to allow senior bondholders of Irish bank debt to be burnt. However, later they did so for other countries and the cost of bank failures is written into EU legislation. They fought against increased aggregate demand, an important part of which is Exchequer funded investment. These mistakes, at the very least, require a new flexible approach from now on. The Troika acted less in solidarity with a sovereign state and more in imposing archaic economic rules.

To date, the Minister for Finance has a preference that the proceeds will be used to pay off the national debt. The Department of Finance also said that: “Cash raised from the sale of any part of AIB will be used to pay off some of the national debt, including loans from the Troika” (Irish Independent, 25 Sept 2015).

It is vital that Mr Noonan (or his successor) change their mind in the light of our investment needs and invests in infrastructure a proportion – say up to €12bn – of the €20bn to €29bn from the proceeds of the bank shares. There is an unanswerable case to use much of bank proceeds for investment in public infrastructure and not in debt repayment.

Move EU to accept net national debt

Another proposal is for the government to take a radical and challenging view of the EU rules on the deficit. The Tánaiste, Joan Burton, has argued that: “We should not be constrained from essential investment by a narrow or rigid interpretation of fiscal rules on the part of the European Commission.”¹⁴ It was reported last March that the government had set about a concerted lobbying campaign of the European Commission to exercise flexibility. There have been some moves in areas, but little of significance on investment. EU rules focus on gross general government debt (GGDebt)¹⁵ (as percentage of GDP) instead of net national debt, which is a better benchmark.

The GGDebt as a proportion of GDP rose from 24 percent in 2007 to a peak of 120 percent in 2012 and 2013. At end-2014, GGDebt was 108 percent of GDP and was under 100 percent at end 2015. In contrast net debt will be a much lower 80 per cent by end 2015. This is because Exchequer had cash and other financial assets totalling €17.9bn at end of June 2015 (NTMA, 2015). This lower figure gives greater flexibility to the government. The EU rules stipulated that gross debt should not exceed 60 percent. This target is an attempt to build resilience into the economic system, which is a worthwhile ambition, but it was poorly constructed, missing the key factor, net debt.

Some countries have few cash assets but others, including Ireland, have substantial cash assets and this means our net debt is considerably lower than our gross debt.

¹⁴ *Irish Times* 16 March 2015

¹⁵ General government debt (GGDebt), an internationally standardised measure of debt which all EU countries are legally obliged to use for their twice-yearly reporting of government deficit and debt under the Maastricht Treaty. The GGDebt is defined by EU regulations as the total gross debt at nominal value outstanding at year-end for the consolidated general government sector – that is, the total gross debt owed by all government bodies to third parties outside government.

Ireland had €22.1bn left in its National Pension Reserve Fund at end 2014. Of this, €7.2bn is to be invested in the Strategic Investment Bank as was seen, but there are other funds too totalling €15bn invested in shares and bonds, under the direction of the Minister for Finance.

Also some of the Government's new borrowings are invested in the ECB, earning a pittance, but waiting to pay off debts as they come due (e.g. those with higher interest rates). This not inconsiderable sum of cash on deposit should also be deducted from the gross debt¹⁶. This imprecise EU rule should be challenged by the Government again, both in increased lobbying, but also by action if necessary.

Thoughts on New Sources of Finance

In conclusion, more innovative forms of financing investment can and should play a role in investment. The BoR plan has proposed many excellent ideas, but the key suggestion in this report is to invest the proceeds of the bank shares directly in Ireland's infrastructure.

The bank shares in public ownership are worth €20bn and perhaps up to €29bn. They are to be sold off from 2016, just as we need to ramp up investment. It is proposed that up to €15bn capital realised from the sale of bank shares should be added to proposed Exchequer funds and other sources. €4bn is expected in 2016, which is €2.8bn over the additional investment suggested in this report for that year over the BoR figure.

The BoR concedes that a much larger sum than the €27bn Exchequer investment (€4.5bn pa) from 2016 to 2021 is needed. Thus, it should be substantially revised upwards to €42bn or €7bn a year. And the addition can be funded by the banks' proceeds. The State should also retain a substantial shareholding in one Irish retail bank, AIB. It is too important as a major bank to be allowed back to its old risk-taking ways without better governance and oversight. The taxpayer should share in its upside too.

John Kay (2015) points out that financialisation allowed the banks and financial sector to grow far too big and become unproductive. Thus many highly qualified, intelligent people are working hard, shifting money around in circles. The State should not be a facilitator of nor be used by financialisation. There is a role for new sources of finance, for PPPs and other methods, but the preference should be for direct financing of public investment, including borrowing, particularly as it is cheaper and more transparent.

¹⁶ Another point is that Irish resident holders of government bonds increased from only 17 percent at end-2009 to 50 percent at end 2015 which means that a substantial flow of interest on government debt is now within Ireland.

Chapter Five – Housing

The cuts in investment in housing have been far too deep and harmful. This policy error is impacting on many areas of the economy and society through high prices of homes, housing shortages, high rents, homelessness, deep debts, etc.

Exchequer funding for social housing fell from over €1.7bn in 2008 to just €597m in 2014. This is a 65 percentage drop. But by 2008, the provision of local authority housing had been cut radically as Table 4 below shows. The massive cuts in local authority housing direct provision – without a coherent alternative policy on affordable housing – has impacted on all areas of housing from top to bottom. It is not just those at the bottom of the pile who are affected, but of course, they feel it most.

However, in the BoR, almost €3bn in Exchequer funding will be allocated to housing, that is between €400-580m a year to 2021. In addition, rent supplement payments will continue to fund private rents for some years. The aim is social housing of 35,000 new homes to be built and 75,000 provided in rented and leased homes by 2021 (DoECLG, 2014, p1v). The social housing will be supplied directly, by housing associations and through PPPs. €400m from the privatisation of profitable BGE may be used as leverage to entice in more private interest investors to the provision of social housing too (BoR, p32).

Over €1bn of NAMA money has been invested in housing and a further €3bn is also to be invested in this important sector in Dublin (p46). While this is partly welcome, NAMA must keep State owned housing away from hedge funds and other financial predators and partner with serious, long-term investors.

The National Economic and Social Council (NESc) reported that in May 2013, there were almost 90,000 households on the waiting lists. Of these almost 67,000 are in private rented accommodation with 42,000 in receipt of rent supplement. This means that around 23,000 are living with parents, friends, in emergency accommodation (around 1,700) or in their own property (around 600) (Housing Agency 2013).

In addition there are the homeless; children living with adults; people with special needs; and Travellers, according to NESc.

NESc also argued that future demographic changes are predicted to increase demand further. A recent study (Housing Agency, 2014) estimates that 80,000 residential units would be required between 2014 and 2018, or 16,000 per year, almost half of which are required in Dublin and surrounding areas. The Agency later said that only 2,057 homes were built in Dublin by September 2015, but a higher number of units – 20,000 – are now needed a year to meet this 80,000 target (IT 24 Oct 2015).

The monetisation of local authority housing

A policy decision was taken by successive governments (and local authorities) that local authorities would withdraw from building local authority homes and people on low incomes would rely on a) buying their own homes, b) on housing associations, and c) the private rented sector.

The figures in Table 3 show this was implemented from the late 1990s on, with near full withdrawal in recent years from the direct provision of local authority housing, in comparison with the 1970s and 1980s. In those decades direct provision was as high as 33%.

	Local Authority	Total	Local as % total
1985	6523	23,948	28%
1995	2960	30,537	10%
2005	4209	80,957	5.2%
2010	1328	14,604	9.1%
2012	363	10,225	3.6%
2013	293	8,301	3.5%
2014	102	11,016	0.9%

Table 3: Local Authority Housing as a % of all houses constructed (Source: Depts of Finance and Environment and Local Government)

Table 3 shows the massive reduction of local authority housing provision, particularly as a percentage of the total. In addition there were some local authority acquisitions in recent years (for example, 202 homes were bought in 2012, 253 in 2013, and 183 in 2014).

The government plans “an off-balance sheet ‘Special Purpose Vehicle’ to stimulate private sector financing for the delivery of social housing.”¹⁷ This is because EU rules do not allow the government to increase its debts, even when it makes sense to do so. The State did not build in the boom years when it could well afford to, because it had been decided that the market would provide. Ironically, it is constrained from action today when interest rates are historically low and there is even greater need.

Direct funding is simpler, more predictable, faster and cheaper in the long run. There is, however, difficulty with EU rules, which are overly restrictive. These are driving governments into new forms of financing which ultimately may be costly.

Progress on Housing

There is some progress. In Budget 2015, the importance of social housing funding was finally recognised with finance increased in 2015 by €210m to €800m and a commitment to multi-annual funding for social housing to 2017 of €1.5bn in direct funding. This year, 2015, 2,386 units are to be built with a further 3,000 units to be provided out of current spending. It is unclear if they will be bought or rented as there is little data. It is planned to increase this substantially, with most being provided by a subsidised private sector.

It can be seen from the above Table 3 that this is well below what was provided in the past and from the data on needs, it is also well below what is required.

¹⁷ “Social Housing Strategy to 2020,” Dept Environment, Community & Local Govt Nov 2014

This housing strategy appears to err on the side of caution and financialisation over prudent economic management. It was the financialisation of housing which was one of the underlying reasons for the crash.

There has been a chorus of calls for increased subsidies to private interests for student accommodation and the homeless which, if conceded, would mean no addition to the stock of public housing but a lot of public subsidy to private landlords. As Dr Nat O'Connor (2015), an expert in housing, has said, "giving tax breaks to some taxpayers is just another way to spend public resources, only without the beneficial side effect of public ownership of assets."

Chapter Six – Providing Greater Certainty

What can be done to mitigate the fall in public investment? What steps can be taken to provide certainty to what are very long term plans for substantial investment? Infrastructural investment is so important that it is worth trying to protect it during a downturn, perhaps with institutional changes.

In the past there was a consensus that it was sound economics to borrow to invest. However, the European Union has set many complex and poorly understood rules (even by EU officials themselves) to govern the economic management in the Member States. These rules focus on gross budget deficits and types of spending, but as yet there are no rules on protecting investment. In fact, the other rules ensure that it is not protected.

However, is not unthinkable that such European Commission rules can be changed. In fact, Europe played a historically constructive role in investment in the past with the Structural Funds which were immensely important in boosting poorer Member State economic investment and progress. They boosted Ireland's investment greatly and helped it into its Celtic Tiger catch-up and take-off period. Indeed, EU rules governing the execution of such investment were excellent.

Infrastructural Commission and a 'Golden Rule'

It is well recognised that cutting investment is damaging during a recession and for the subsequent economic recovery. Thus, there is a case for two new institutional initiatives – an Infrastructural Commission, which would seek to protect such public capital investment; and a 'Golden Rule' on minimum infrastructural investment by government.

In the UK the Conservatives implemented the Labour Party initiative for a National Infrastructure Commission. Labour had set up the Armitage Review which called for "the establishment of an independent National Infrastructure Commission to identify the UK's long-term infrastructure needs and monitor the plans developed by governments to meet them." The Conservatives agreed and established this body in October 2015 under Lord Adonis (National Infrastructure Commission, 2015).

An Infrastructural Commission here could also consider how Ireland's future needs could be met in a targeted and efficient manner with value for money being a primary consideration. It could bring much needed long-termism into government policy. It would plan 25-30 years ahead for Ireland's future needs across all major national infrastructure and set clear priorities. This Infrastructural Assessment would be carried out every 10 years and include deep research and consultations with the public, local authorities, NGOs, regulators and others. The new Transport Infrastructure Ireland (TII) established by the government in late 2015 is confined to transport only. It should be expanded to include all major infrastructural planning, including financing needs and execution as the new Infrastructural Commission for Ireland.

There would be an Oireachtas vote on the evidence-based infrastructure priorities within six months of their publication, and government departments would have to form detailed 10 year Sector Plans of how they will deliver and fund work towards these priorities within say a year of that.

The Oireachtas would then vote on these 10 year plans and the permanent Infrastructural Commission would scrutinise the ability of these plans to meet the 25-30 year national priorities and report to parliament annually on their delivery.

In addition, there should also be an EU rule forbidding Member States from cutting investment to levels below replacement of depreciated assets plus inflation, within a set period of years. Such a rule was in place in some countries in the past. There would be a 'Golden Rule' on investment in the European Union. Then the EU would ensure that governments would maintain investment, particularly in recessions. This would counter the current rules where democratic governments are forced to adhere to the Growth and Stability Pact (GSP), even when it clearly hurts badly and, worse, when it is failing. This would mean changes in EU economic rules such as the 'Six-Pack', the 'Two-Pack' and the Treaty on Stability, Coordination and Governance.

Each Member State's investment should never be allowed to fall below replacement levels at the bare minimum. This 'Golden Rule' for investment in Europe would allow borrowing for investment to be excluded from the EU Growth and Stability pact rules, within certain parameters. Depreciation should also be allowable to be deducted from investment which would allow proper measurement of increases in capital formation.

In conclusion, an Infrastructural Commission should be established to plan and execute investment. The EU and each Member State should also adopt a 'Golden Rule' under the direction of this Infrastructural Commission which would set out medium and long term plans and priorities for investment. The Infrastructural Commission along with the Fiscal Councils in each Member State would encourage adherence to maintaining investment in times of recession.

Improving the management of public investment and assets

In most countries, public assets could be much better managed. There has been a substantial improvement in this area in Ireland in recent decades with the corporatisation of some public services and the high levels of efficiency in the commercial Irish State companies. These are amongst the best performing State companies in the world and indeed are also some of the best performing companies in Ireland. However, the vast stock of assets remaining in central government, local authority and other State bodies could be better managed.

There is a vast amount of publicly funded assets in the control of non-governmental bodies which should be on the government balance sheet because the taxpayer has funded them in full. These include hospitals, schools and nursing homes etc. which are run by the churches and so-called voluntary bodies.

According to Detter and Fölster in their recent book (2015) only the UK, New Zealand and Sweden produce national balance sheets of their public assets. In fact, the CSO is constructing a national balance sheet (CSO, 2015b) which will assist in better economic planning.

On the liabilities side there is endless debate about the national debt. Gross debt in borrowings is almost equal to national income or GDP, but it was seen that there are also substantial pension liabilities. The government has quantified the full liability for all future payments to current and preserved pensioners and their spouses, based on current pension rules – estimated at €98 billion at end of 2012. However, some would criticise the methodology of the current estimate. Pension

funding is a challenge, with aging populations. We also know the size of the national debt, at €200bn or 97 percent GDP at end of 2015, but we require an accurate valuation of most Irish public assets – roads, schools, public buildings etc., which is not based on estimates.

Knowing what a country is worth is a basic tool of economics. Similarly, it would be worth assessing the private wealth in each country as Piketty (2014) has suggested not by broad estimates but actually have Revenue fully assess it as it did (but only for wealthy people) back in the late 1970s when Ireland had a Wealth Tax. Such a survey of all individual assets and liabilities would help assess inequality levels and the potential for equitable taxes, but importantly would lead to a more accurate national balance sheet for economic planning.

Detter and Fölster (2015) set out three core principles in managing public assets. The first, transparency, is essential for accountability. The second is to set out clear objectives, and the third is that those State assets which are commercial must be shielded from political interference.

Thus on the first objective, in Ireland we have a broad idea of the State's balance sheet, but it needs to be greatly strengthened with a comprehensive valuation of all State assets and indeed all its liabilities. The high level of public assets, at market value, (if deemed to be the best method) when accurately calculated, may surprise people.

On the objectives, while Detter and Fölster (2015) do not favour privatisation over public ownership, they say the key objective should be value maximisation, or 'shareholder value.' They seem to be unaware that this is a discredited corporate strategy. Its founder/advocate Jack Welch of GE eventually conceded it was a "dumb idea". The short-term focus on value leads to perverse incentives.

On the third point, keeping political interference to a minimum, Ireland has relatively independent commercial State companies which perform well and do very well compared to many indigenous private firms (Sweeney 2004). Detter and Fölster say: "Most State-owned companies – such as the oil giant Petrobras in Brazil, State-owned banks in India, and State-owned enterprises in China – are reportedly wasteful and corrupt" (2014). This is not correct for Ireland, though it probably is in many of the emerging countries and to some extent in some developed ones.

However, Ireland stands with France and Norway as three countries where State companies are well run, productive and profitable (Sweeney 2004). In France they are seen by right and left as national champions, supported by the shareholders including the State, in expanding into other EU countries. It was seen that, ironically, an Irish State company paid the taxpayer over €1bn in dividends, some of which ultimately helped bail out the once mighty "shareholder value-driven" banks.

Detter and Fölster found that "central governments alone hold significantly more commercial assets than private equity firms, hedge funds, pension funds, sovereign wealth funds, or the super-rich. The value of public commercial assets is on the same order of magnitude as annual global GDP—and comfortably higher than global public debt" (2014). The National Pension Reserve Fund held over €30bn in such assets at one time.

Detter and Fölster say: “National Wealth Funds are the perfect compromise: they keep public assets under government ownership while simultaneously preventing undue government interference”. Ireland has NewEra which is the State holding company, but its role has been privatising and not developing and growing these companies and their assets.

Yet in Ireland, in spite of good performance and the debacle of the collapse of the highly profitable and heavily investing Eircom ten years after it was privatised, the agenda by several political parties is to sell most of them off. The Labour Party is reluctant. However, under the Troika over €3bn in State assets were privatised and part of the reason was to pay down (bank) debt during the crisis. This was 50 percent more than was set out in the Programme for Government, albeit written when the Troika set the agenda. It is not unreasonable to sell some State assets to help out in a crisis, but it is the worst time to do so and it should be part of an overall strategy to develop them.

The view that a small economy needs a dynamic indigenous sector, a key part of which is commercially State-owned or at least State-controlled, was held by most political parties in the past.

In recent decades, the main parties, Fianna Fáil and Fine Gael, both of which set up many commercial State companies, have followed the British financialisation fashion of privatisation. They also simultaneously ensured the greatly improved performance of Irish State companies since the early 1980s. Of course good performance made them easier to sell. Both parties have become advocates of privatisation despite the fact that in Ireland it has not improved the performance of State commercial companies. If anything, the opposite is true. And control or some influence is gone, as is the future earnings stream.

The shareholder-value driven publicly quoted company, the plc., briefly became the model for all companies. It was not just the State companies which were privatised but building societies, cooperatives, giant mutual insurance companies and more. Most did well at first and especially for the then current members, but then some collapsed.

It has been argued that many forms of ownership are preferable to the plc. and in a small open economy, State ownership of assets is a form of ownership which should be pursued especially when key areas of the economy should be subject to some form of public control.

Exchequer investment where certainty is underwritten will have many positive effects. Ending the uncertainty of the stop-start promises on roads, metros, hospitals and schools will not alone deliver such infrastructure more speedily, but it will retain a cadre of substantial expertise in Ireland by giving security to the 125,000 craft workers, labourers, engineers in construction, the 28,400 unemployed construction workers, and the tens of thousands in related supply sectors. Investment on the scale proposed here would have a dramatic impact on the rate of unemployment. To give this certainty a expenditure of adequate scale such as in this report is necessary.

Direct Exchequer funding eliminates the uncertainty surrounding PPPS and other ‘innovative’ forms of financing. They do have a role but direct and planned Exchequer funding gives certainty which is crucial especially for large, long-term projects. Such investment would be overseen by the Infrastructural Commission. It would also allow the building up of a cadre of competent professional and skilled expertise in sectors of construction which can and should be maintained in Ireland. Certainty on funding will underpin the retention of these skills.

Chapter Seven – The Role of Europe in Investment

It was seen that in the past Europe played a significantly positive role in investment for many states, not least for Ireland. The EU Structural Funds had a major impact on our prosperity, mitigating our own government's cutbacks in the 1980s with substantial transfer sums for Ireland (and also for Portugal and Spain) and the rules governing them improved our way of investing greatly.

At the end of 2015, Ireland exits the 'corrective arm' of the Stability and Growth Pact and fiscal policy then becomes subject to the provisions contained in the 'preventive arm' from 2016, which is an achievement. It has moved from a union of solidarity to a German style rules-based union. And they are rules which are inflexible and deeply orthodox, constraining economic growth and prosperity.

Europe has turned to much less generous economic and social transfers between states, with cohesion and transfer funds being greatly reduced possibly due to the size and relative poverty of the ten new Eastern states. The Commission has been largely taken over by neo-classical economic thinking.

It has been seen that the European Union has set rules to govern economic management in the Member States which may seem reasonable to some to ensure that governments do not spend or borrow too much. However, many economists have argued that these particular rules adopted and implemented with such vigour are too restrictive and that the level of austerity imposed has not worked. Rather it has prolonged a deep recession. The rules are also particularly constraining on investment.

However, the interpretation of the Stability and Growth Pact has been clarified with the aim of providing more fiscal leeway for Member States under adverse economic conditions and/or implementing structural reforms. There were some initiatives – such as the introduction of the so called 'investment clause' under the Stability and Growth Pact – to support and protect public investment but these are restrictive and too late for Ireland.

The Juncker Plan

The Juncker investment plan is a weak recognition of how bad things have become. It is a European Fund for Strategic Investments (EFSI) to finance investment on a large scale with European-wide total investment impact of €315bn from 2015 to 2017 (European Commission 2014). This is supposed to be reached without additional public debt on the national or European level.

However, there is general agreement among many European economists that the size of the plan is too small. Secondly it relies too much on private investment which would probably take place anyway if profitable. Thirdly, it will also take a long time to implement. Fourthly, the Juncker plan also relies too much on widely shifting EU-wide public funds to underpin and leverage private investment at a time when private sector business confidence is still low.

Treating Ireland Fairly

It was argued in Chapter Four that the Troika treated Ireland badly during the bailout. It was seen that Ajai Chopra, said: “Ireland was treated unfairly when its Eurozone partners prevented it from burning senior bondholders in its bust banks during the financial crisis.” This necessitates the case for fairer and more reasonable treatment of Ireland by Europe now on allowing us to use some of the funds from these same banks for infrastructural investment.

Chapter Eight – Conclusion

This report shows that investment in infrastructure is important because it underpins economic and social development and ensures future progress. Ireland has been under-investing in public infrastructure in recent years. Exchequer investment fell to its lowest level in 50 years in 2013. A major cause of the collapse was financialisation. Adequate public investment is a crucial part of the way out.

The Government's investment plan, *Building on Recovery: Infrastructure and Capital Investment, 2016-2021* (BoR), is extremely important but it is disappointing in its lack of ambition.

Infrastructural investment in Ireland is picking up, but from a very low base. It reached a trough in 2013 and was at the lowest level in all 28 Member States in the EU. The BoR plan will see an increase in Exchequer investment in cash terms but as a percentage of GDP, it will actually fall initially.

The government must increase investment substantially because we need the assets – social and affordable housing, public transport, schools, clinics, etc and importantly, education and training. Interest rates are historically low; investment costs less during a recession; and the lack of infrastructural investment is reducing future prosperity. Good infrastructure and investment in people also reduces inequality.

The level proposed in this report suggests Exchequer funding of €42bn in the years to 2021, substantially up on the proposed €27bn in the government's six year BoR plan. This suggested level is based on previous trends.

The suggested Exchequer investment here is of an annual average of 2.8 percent of GDP 2016-2021 which is well below the average achieved of 3.9 percent in the 6 years 2002 to 2007 but above the 1.8 percent average proposed in the government plan.

Exact investment needs are difficult to quantify and depend to a great degree on political choice. However, the government does agree that it has a plan which should be increased. But it must be greatly increased. And immediately.

This public investment would enable Ireland to catch up with leading EU states on public infrastructure, including housing and public transport and to make up for recent underinvestment.

It was seen that the simulation for returns on public investment by the IMF for advanced economies (which included Ireland) "suggest that a 1 percent of GDP permanent increase in public investment increases output by about 2 percent in the same year" (2014b, p87). It may seem high but the IMF study is saying that for every €1m invested there is a rapid return of €2m. Either way, when there is a high loss of potential output, the returns on infrastructural investment are high. The level of investment should be increased to be commensurate with the projected levels of economic growth to 2021.

The additional funds could be raised in several ways. However, it is proposed that most of this additional investment of €15bn over that proposed in the BoR plan should be funded by part of the proceeds of the privatisation of the bank shares currently in public ownership.

These bank proceeds of €20bn (or perhaps up to €29bn) are coming on stream from 2016 onwards. It is currently proposed that all of this capital be used to repay national debt. In a time of great infrastructural need, with low interest rates on a declining (as percentage GDP) debt level this is not just a mistake, it is a major policy blunder.

Between €10 and €12bn of these bank proceeds should be invested in Ireland's public infrastructure. The timing is fortuitous as the sales tranches come on stream from 2016, just as the additional infrastructural investment is required.

The State should also retain a substantial stake in one major retail bank (AIB) to ensure banking excesses do not occur again and to retain one major bank in Ireland with some public oversight.

However, the government may feel that it has to repay the national debt with these funds because that is what the EU and Troika want. However, times are different. The Irish economy is performing strongly, we are exceeding our targets on deficit reduction, the debt will fall anyway as a percentage of GDP and, most importantly, the moral authority of the Commission and Troika has been undermined. They have been seen to treat Ireland poorly. Anyway, it would be difficult to enforce if Ireland did proceed to use the bank proceeds for productive investment instead of paying off creditors now (who will be paid anyhow).

It was seen that the Troika did not handle Ireland's bailout well. Ajai Chopra, the initial leader of the Troika admitted that "Ireland was treated unfairly." The Troika would not allow senior bondholders of Irish bank debt to be burnt, but this is now allowed for other countries and also the cost of bank failures is covered in EU legislation. It was against increased aggregate demand, an important part of which is exchequer-funded investment while they now ironically call for increased investment.

The economic performance of the EU in building a European-wide recovery has been very poor and this is largely because of its inability to move from its obsession with overly-restrictive rules. However, it did renegotiate with the new government in 2011 on reversing the minimum wage cut, on the promissory notes and more. Thus it has to open up on investment and on the use of the bank capital for such investment.

While there continues to be opposition from Europe to increased public spending including investment in needed infrastructure, under its present – restrictive – rules, there are grounds for hope as some rules have been made more realistic. But, as stated above, Europe and the Troika have to get more realistic on investment and its funding.

It was seen that the government's housing strategy is also disappointing, especially in a time of unprecedented crisis. Reflecting the BoR, it is lacking in ambition and overly reliant on private interests and on financialisation.

The quickest way to solve the housing crisis is the direct provision of social housing under this revised public investment programme. This avoids all the delays of seeking off-balance sheet funding. Such a major housing drive will impact on the whole housing market, pulling down prices and rents and thus boosting competitiveness and equality.

The large decline in local authority housing is a dramatic manifestation of the shift to the monetisation of social investment such as housing. This allowed the banks and mortgage brokers a

slice off this vast new 'market' of low income housing provision where the State had previously provided directly. It has failed.

It was seen that a third of all housing was directly provided by the State in the 1970s and 1980s and this fell to 10 percent in the mid-1990s. It collapsed to a mere 3.5 percent in 2012. This report shows how a massive and urgent programme of social housing can be provided directly by the Exchequer. It cuts out the time wasting and other obstacles of off-balance sheet funding schemes. They will of course be built by private builders, who will not have to worry about money drying up.

Certainty is important for long-term investment and it must be put back into the process. The key reforms suggested in this report include the establishment of an Infrastructural Commission, which would bring much needed long-term planning back into government investment policy. Also the EU and each Member State should adopt a 'Golden Rule' under the direction of the Infrastructural Commission which would set out medium and long term plans and priorities for investment.

In this report, financialisation is repeatedly criticised because it contributed much to the biggest economic collapse since the Depression. Many of the instruments invented during this period, including complex forms of off-balance sheet financing, derivatives, PPPs and such do not add value in the long run.

The impact of the privatisation of many State commercial enterprises in the past twenty years on reducing the Public Capital Programme as a tool of government has not been discussed in the BoR or elsewhere. The ESB provided huge dividends during the crisis and the remaining firms are major investors. In contrast, the largest investing company in Ireland in the 1980s, privatised Telecom Eireann, is a pale shadow of its former self as Eir.

There was no single cause of the crash but the dominant economic model of "rational expectations" and "efficient markets" set the scene for the collapse. In spite of widespread realisation of the fatal flaws in this model, many of the ideas are still held by people in power. These people are still very influential in the banks, many companies and institutions internationally, including the EU and here. Financialisation has led to the monetisation of basic needs like housing and that thinking is still dominant – in spite of all that has happened.

This report shows that public investment can be difficult to get right both fiscally and because of various EU rules. Nevertheless it is essential and we need to develop new strategies to undertake public investment adequately and successfully. Some of these may seem akin to financialisation but with a strong emphasis on public return and equality we can deliver good public investment projects, which in turn will lead to increased private investment.

A final footnote in the run-up to the Irish general election in 2016. In the Canadian elections in late 2015, the leader of the left New Democracy, Tom Mulcair, was leading in the polls. He was set to be Prime Minister. He moved to the centre, promising to balance budgets.

Justin Trudeau of the Liberal Party outflanked him on the left, promising to invest substantially in affordable homes and other public infrastructure. "Why put off investing when we have an opportunity now?" Trudeau asked. He sided with those economists who are opposed to "secular stagnation."

The NDP did not win the election as the polls had predicted but lost more than half their seats. Trudeau had a historic victory and became Prime Minister, promising investment funded by borrowing if required.

Appendix 1

Actual and Planned Capital Investment 2009-2021

Table 4 shows the actual cash amounts of Exchequer investment from 2009 to 2015 and the projected figures for 2016-2021 (also in T2). It will be seen that the figures for 2016 onwards are much lower than after the crash in 2009 and 2010, though there was rapid winding down in the Exchequer investment programme.

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
7.3	6.1	4.7	4.3	3.4	3.3	3.8	3.8	4	4.2	4.6	5	5.4

Table 4: Actual and Planned Capital Investment (€billion) (Sources: Budget Documents 2010-2016 and BoR)

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