Sixth Troika Review Places More Emphasis on Growth

In a break from its predecessors, the sixth troika review of the Irish bailout explicitly emphasises a need to induce growth in domestic economic demand. The first and most obvious example of this is the decision to earmark up to half of the proceeds from the sale of state assets for reinvestment in employment-generating projects, while the remainder will be used to reduce the government debt burden. While it remains unclear exactly how much the government will raise from the privatisation of assets, an indicative target of €3 billion has been set, implying an investment budget of up to €1.5 billion.

Also contained in the review is an annex written by the government that outlines how they plan to meet the objectives of the bailout programme in terms of our banking policies, fiscal policies, and structural reforms. Previous reviews tended to look at structural reform solely through the lens of enhancing competitiveness, focusing on areas such as wage-setting arrangements and lowering costs in sheltered area such as medicine and law. When employment was mentioned, it was usually a reference to supply-side activation measures, which are essential for helping the unemployed find work but which do not in of themselves lead to large-scale job creation.

In the sixth review, the goals of increased competitiveness, better activation policies and fiscal sustainability remain, but they are placed alongside a "growth pillar" that aims to improve job creation and boost domestic demand. In particular, the European Investment Bank (EIB) is cited as a source of funding for growth-enhancing projects that the Irish government cannot afford to finance at present. Reference is also made to any unused funds in the EU Budget, which Ireland could be trusted to spend wisely given our history of prudent investment using EU Structural funds. The government wish to create a "Growth Fund" for investment in "job-rich" projects. Demand-side employment measures are also mentioned, including the 2011 Jobs Initiative and the 2012 Action Plan for Jobs.

The apparent switch in both the language used and the emphasis on policies proposed is partially a result of the progress already achieved in tackling competitiveness issues, but is also unsurprising given the recent developments in Europe. The election of President Hollande in France has modified the debate and has increased the use of pro-growth rhetoric. The economic situation in Europe, with the euro zone seemingly yet again on the brink of recession, has also reduced the likelihood of a trade-led recovery. Increased competitiveness will only lead to greater exports if there is demand abroad for Irish produce. Hence, measures to stimulate domestic demand are coming to the fore.

It should be noted, however, that we are still very much engaged in an austerity programme. The parameters of the next Budget are outlined in the review. There will be €3.5 billion worth of consolidation, €1.25 billion of which will be revenue measures including a property tax, a broadened base for income tax, increased rates of indirect taxes, and a restructuring of motor tax. The other €2.25 billion in savings will come from expenditure reductions including reductions in the amount spent on social welfare, the public sector wage and pension bill and capital expenditure. Further cuts of €3.1 billion and €2.0 billion are planned for 2014 and 2015 respectively. At best, the proposed Growth Fund will mitigate the impact of austerity on certain sectors while the broad thrust of government policy will remain contractionary.

How to Spend it?

Given the seriousness of the fiscal situation, it is crucial that careful consideration is given to how a Growth Fund could be spent. The troika criteria that projects invested in should be "*of a commercial nature, meet ex-ante cost benefit criteria, enhance employment and preserve long term fiscal sustainability*" is immensely sound advice.

As a tool for raising domestic demand in the short-run, capital expenditure is relatively ill-suited. Large projects can be expected to have long lead-in times to allow for careful planning and evaluation, so that by the time any additional employment is created the economic circumstances could be radically different. One possible response to this would be to re-consider projects that were in motion but have subsequently been shelved due to the fiscal consolidation. However, caution would be advised when considering restarting a project that was devised when the economy was forecast to grow in the region of 4-4.5% indefinitely. The new reality of a far smaller economy argues for a rethinking of investment plans and priorities.

The "cost" part of any cost-benefit analysis is not simply the monetary price of undertaking a project – there is also an opportunity cost of foregone alternatives on which money could be spent. An obvious alternative in our current condition would be reducing the debt burden and the state's interest bill. A proposed project needs not only to be worthwhile, but must generate a rate of return that beats the costs of incurring more debt.