Ireland: Government to impose draconian austerity measures with opposition support

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Ireland's prime minister (Taoiseach), Brian Cowen, has warned of more savage cuts than expected in the emergency budget scheduled for April 7.

Speaking to the Dail, or parliament, Cowen of Fianna Fail said that there had been a "serious deterioration in the public finances," with the Department of Finance estimating a deficit €4.5 billion. This is a rise in the deficit from a predicted 2 percent to as much as 6 or 6.5 percent.

A bleaker picture still was painted by Central Bank Governor John Hurley, who said that Ireland is experiencing "an unprecedented contraction" in output, which is set to continue for the next two years. The 6 percent decline in Ireland's GDP would lead to unemployment topping 11 percent.

The decline had begun in the property and construction sectors, but had now "broadened out into a marked weakening of domestic demand, which is being significantly amplified by the contraction in export demand as a result of the movement into recession of all our main trading partners," Hurley said.

"No one should be in any doubt about the seriousness of the global situation, which is not easing, and the seriousness of our own difficulties," he added. At the end of the two years, Hurley said that the economy would have declined by 10 percent.

The government's emergency budget will impose devastating cuts in public spending, while raising large additional amounts through taxes on working people. These cuts will be in addition to the €2 billion pay cut already levied on public service workers via the "pension levy," and the €2 billion cuts in spending already announced for the 2009 budget.

Cowen said the cuts were necessary because Ireland had to deal with the crisis "in a way which would be seen to be credible by international markets."

Announcing the proposal, Finance Minister Brian Lenihan made clear that the new taxes will be levied on the lowest-paying workers. Currently, 40 percent of the workforce earns wages below the tax threshold. But in future, according to Lenihan, "Everybody will have to pay something."

State finances are perilous. The Irish exchequer posted a budget deficit of €2 billion in the first two months of 2009, in comparison with only €125 million over the same period of 2008. Tax receipts over the same period fell from €7.5 billion to €5.7 billion. Property-related taxes fell most dramatically. Capital gains tax receipts fell 73 percent, while stamp duty on house sales fell 59 percent. Corporation tax takes, based on Ireland's already very low rate of 12.5 percent, fell 37 percent, while VAT, based largely on consumer spending fell 17 percent.

Income tax receipts fell by 7.4 percent, but this is expected to accelerate as unemployment, already standing at 10.4 percent of the workforce, continues to increase. Last month showed in increase of 26,700. The government anticipate unemployment will reach as high as 450,000 by the end of 2009. Currently, it stands at 353,000. Additional welfare spending because of rising unemployment has so far cost around €1 billion. State officials claimed that some €25 billion will have to be borrowed in 2009. The total state budget is around €55 billion.

The Irish government currently has to pay 1.7 percent higher interest than, say, the German government, on bonds issued to raise debt. Government officials told the opposition parties, "We need to convince the markets that Ireland is committed to restoring the public finances to sustainable positions."

The government is also seeking to remain within the limits it outlined to the European Commission, under which the budget deficit would be restricted to 9.5 percent of GDP. It has appealed to the opposition Fine Gael and Labour parties for support, with Lenihan telling parliament that the state faced a "moment of national crisis"

Both Fine Gael and Labour have indicated that they are in fundamental agreement with the Fianna Fail/Green coalition government.

Fine Gael leader Enda Kenny offered a "guarded welcome for the decision, belated as it is, by Brian Cowen to accept my call for a new budget." Labour's Joan Bruton criticised the government's "miserable failure in stabilising our finances," but expressed no disagreement with the general thrust of the proposals.

Kenny and Labour Party leader Eamon Gilmore told Cowen that the opposition parties should be briefed on the detailed figures available to government, if he wanted their support for the tough measures ahead.

The government is also seeking to re-open talks with the "social partners," the employers and trade unions.

Thus far, the unions, in the face of considerable protests from large numbers of workers against unemployment and the pension levy, have not agreed to the resumption of talks. A nationwide strike is planned in Ireland for March 30. The unions are fearful that too open support for the government at this stage would seriously undermine their ability to maintain control over the working class.

The budget proposal follows a devastating few weeks for the Irish economy. Last month, the government were forced to announce the recapitalisation of Allied Irish Banks (AIB) and Bank of Ireland. This means handing over state funds to the banks to cover their bad debts and allow them to perform normal banking functions. Both banks are to receive €3.5 billion of state funds, following the collapse of previous efforts to recapitalise them with just €2 billion, simultaneous with the nationalisation of Anglo Irish Bank in January this year.

The money will be taken directly from the National Pensions Reserve Fund, with €4 billion of current resources, nearly 25 percent of total assets, to be handed over. Another €3 billion is to be found by diverting state contributions to the pension fund for 2010 and 2011 straight into the banks.

Even so, financial commentators doubt the sums offered are sufficient. The combined exposure to toxic debts of the two banks amounts to €10 billion of a total of €36 billion in property and development loans. As the economic situation worsens, their level of debt exposures grows.

A "fragility index" prepared by RBS on the financial position of each eurozone country through measuring nine indicators such as debt, foreign funding and current account balances, found Ireland the most vulnerable in five of the nine areas. Over the next three years, debt worth more than 100 percent of Irish GDP will have to be refinanced on far more expensive terms than currently available. Part of this debt includes €60 billion of bank bonds maturing by 2011, with RBS stating that "this poses a material risk for the stability of the Irish financial system."

Former International Monetary Fund chief economist Simon Johnson warned, "The G7...need to focus on this problem during their discussions.... We need a plan of action for Ireland and we need it now. What we don't need is another Iceland-type situation."

Others noted that the offer in 2008 by the Irish government to guarantee all bank deposits in the aftermath of the collapse of Lehman Brothers may prove to be catastrophic. Writing in the *Irish Times,* economist Morgan Kelly wrote that the government had nationalised Anglo Irish and recapitalised AIB and Bank of Ireland without even being fully aware of the extent of their possible liabilities. "The ability of the State to continue funding itself ultimately depends on the size of these bad debts," he said. "If they are of the order of €10-€20 billion, we will survive. If they are of the order of €50-€60 billion, we are sunk."

"We could expect cuts of one-quarter to one-third in public sector wages and social welfare benefits, and draconian tax rises to bring the deficit back to around 5 percent of national income in two years."

However, "There is actually a worse scenario where international bond markets suffer a general panic, like 1998. Not only does Ireland get torpedoed, but also Portugal, Italy, Greece, Spain and Austria. The IMF and [European Union] simply would not have the resources to bail out so many economies and we would be entirely on our own."

"In circumstances where the government could not even pay public sector salaries, the bank guarantee would immediately become worthless and we would see an uncontrollable run on all the Irish banks."