

First Inter *Trade*Ireland Economic Forum

Global Outlook

Farmleigh House, Phoenix Park, Dublin

Thursday, 18th June 2009



For full coverage of the Economic Forum-Global
Outlook, please visit:

<http://www.intertradeireland.com/economicforum>

Overview

The broad objective for the Forum was to provide a consensus view from leading economic experts on the likely extent (depth and duration) of the current global downturn, the nature of any recovery and to consider government and private sector responses in terms of stimulus remedies and transformational opportunities within an island context.

The forum took the form of an opening address by Minister for Finance Brian Lenihan, followed by individual 30-minute presentations by five keynote speakers. The audience of over 100 delegates was composed largely of policymakers, business body representatives, economists and media commentators.

The speakers included:

- **Brian Lenihan TD** is Minister for Finance in the Irish Government.
- **Dr Adam S Posen** is deputy director of the Peterson Institute for International Economics, Washington DC
- **Dr Linda Yueh** is a fellow in economics at the University of Oxford and a visiting professor at London Business School
- **Dr Martin Weale** is director of the National Institute for Economic and Social Research in London
- **Professor Frances Ruane** is director of the Economic and Social Research Institute in Dublin
- **Professor Michael Smyth** is head of the school of economics at the University of Ulster

Opening and closing remarks were delivered by Dr David Dobbin CBE, chairman of *InterTradeIreland*. Adam Posen, Linda Yueh and Martin Weale were the speakers in Session One. They focused on the global economic environment (US, China and Britain/EU) and sketched it by way of its potential relevance to Ireland and Northern Ireland as small open economies.

After the interval, Frances Ruane and Michael Smyth analysed the situation facing the economies on the island of Ireland and examined its interaction with and connexion to the wider global economy.

The morning was rounded off with a 45-minute plenary session in which the panel addressed questions submitted both in written and verbal form by the delegates. This lively discussion was chaired by Dan O'Brien of the Economist Intelligence Unit.

Key messages which emerged from the presentations and discussions included:

- Lessons learnt from past recessions have meant that the broad policy response has been appropriate in terms of fiscal stimulus and quantitative easing. However, there is a degree of uncertainty over finding the right balance between pump priming the recovery and creating inflationary pressures.
- Flexible economies placed in a context of democracy and strong property rights are more able to manage the economic downturn and are more prone to growth.
- There are increasing signs that the recession is bottoming out but the path to future recovery remains subject to many uncertainties.
- The banking system crisis has been stabilised but not necessarily resolved.
- Unemployment will lag well into 2010.
- High manufacturing export-led economies have been more exposed to the recession.
- In Europe and in the US the recovery will depend, in some extent, on increased consumption levels, while in the UK consumption needs to decrease to more sustainable levels.
- Emerging economies are growing but this growth is not sufficient to stabilise the global imbalances because domestic consumption levels are not high enough.
- The level of government indebtedness leaves countries very exposed to future catastrophes.
- There has been little unwinding of the global supply chain, which could benefit Ireland if the opportunities of skilled labour force and global demand are seized.
- The opportunities for the island economy lie in re-establishing an international reputation for high governance standards, meeting environmental commitments, reaping the benefits of continued investment in education and R&D, and setting up new innovation-centred companies.
- Both jurisdictions on the island should look to co-operate in a shared market of six million people. Such all-island scale facilitates markets for energy, labour, retail and transport.
- There is a necessity for small economies to be open and collaborative. Ireland should benefit as a small global economy tapping into global capital flows.
- Several speakers commented on the need for better data and evidence in order to improve forecasting both of the recovery and of future economic prospects.

Irrational movements in stock market prices make it unreliable as an indicator of underlying trends.

- The island, North and South, need to continue to invest in the fundamentals, i.e. education and R&D.
- North/South co-operation could be strengthened by using the ‘New Commons’ approach as the economic rationale for co-operation. This approach identifies resources that have characteristics of both public goods and private property. They include knowledge, medical and health, infrastructure, cultural, markets and global commons.

In conclusion the Forum succeeded in:

- Exploring the scope of the global recession and identifying potential paths for recovery.
- Identifying and debating local policy options within a global context; and
- Putting North/South economic cooperation into a global context where the issues of optimising common resources to create economies of scale and scope that can improve competitiveness become paramount.

Opening Remarks (David Dobbin)



During the opening remarks, Dr David Dobbin, commented that the theme of this forum - 'Global Outlook'- has never been more relevant nor indeed uncertain. No country has been immune from the current economic downturn. However, -he stated- recovery will come, it may be a changed economic landscape but new economic opportunities will arise. For us to be prepared and ready to take advantage, it is vital that we in business and government are well informed about the latest global economic developments and when and how the current downturn is likely to end. We felt that it was important to bring the latest thinking from leading international experts to the economic challenges faced by our two economies.

Dr Dobbin, declared that with the recovery, new economic opportunities will arise and both economies on the island will need to be prepared and ready to make the most of it.

The Forum, he said, will serve as platform for the latest thinking from leading international experts on the economic challenges faced globally and in the island of Ireland.

According to Dr Dobbin, the Forum will focus on the question of economic recovery, the evidence for this and how durable it may be. In addition, he highlighted the importance of exploring the interaction between the two economies on the island and the potential for greater cross-border cooperation in order to restore the competitiveness of the island.

In words of InterTradeIreland's Chairman, "Providing a forum for analysis and debate is crucial to stimulate ideas which can create a strong foundation for economic renewal and growth"

David Dobbin, concluded the opening remarks by welcoming and introducing Minister Lenihan and the panel of speakers.

Quotes:

"No doubt that economics have moved to the centre stage ... Theme of the Forum has never been more relevant."

"In these circumstances what is needed by every business on this island...is that we are well informed on what is likely to happen next."

"We believe that it is important that the Forum...explores the interaction of our two economies and the potential for cross-border cooperation."

Minister for Finance Brian Lenihan

Launching the forum, Minister for Finance Brian Lenihan noted how economics has moved to centre stage in the world over the past year and said that there still appeared to be a great deal of denial about the economic problems facing Ireland.

He said that, “it is a huge task to bring the public with us... and ensure the economy takes a more benign course”.

The minister pointed out that not every country has had a housing bubble like Ireland’s and faces similar problems with exports. Indeed, a loss of net income of some 13% is projected for 2008-2012.

He said that both North and South are facing problems, including a fall-off in activity in their trading partners. However, “cross-border relations have never been better...The changed atmosphere is the most encouraging aspect of current life.”

Lenihan explained the key challenges are to stabilise public finances, address the banking crisis, and promote competitiveness and employment.

A dramatic decline in public finances has been caused by the fall in tax receipts occasioned by the burst housing bubble. This necessitated a number of budget adjustments in the last year.

The Minister said we must restore confidence and competitiveness by reducing our unit labour costs – this is essential if we are to be competitive on the world economy. While some firms have negotiated reductions of up to 30%, he put the average wage reduction at 6.9%.

He said that while the banking crisis was not generally well-understood, the root causes of it were very serious for the world economy. If the Government let banks fail, the consequence would be very serious. He said that if the National Asset Management Agency triggers further losses, the State would have to increase its stake.

He emphasised the importance of countries trading with each other and pointed out that there was a particular danger from a “growing partitionism” by banks liquidating assets overseas and concentrating on national markets.

Quotes

“After two decades of irrational exuberance, we have to restore confidence. [This] all requires a great deal of public understanding.”

“If you are to socialise the losses, you must socialise the gains.”

“The single island market offers greater opportunity for business and trade than a partitioned market... We must foster stronger trade as the basis of our wealth.”

Adam S Posen



While noting wryly that the Irish economy was out of its Celtic Tiger phase and into its “Bob the Builder” phase, Posen struck an essentially calm note with his assertion that the current recession was not so different from previous recessions.

While there was much debate as to the expected shape of the recovery (“V”, “L” or “W”), he believed that essentially the point is that economies were bouncing back but that the process would be bumpy.

He referred to the bursting of the Japanese property bubble at the start of the 1990s and said that this was a W-shaped recession. The current recession is worse and impacting globally, but he pointed out the policy response has been better, with a number of states becoming activists in trying to resolve it. He highlighted the importance of fiscal stimulus in the recovery, however he noted it cannot work indefinitely.

He distinguished two potential sources of growth in the US economy: housing construction and healthcare. In many US regions, there has been population increase and the construction rate has been lagging behind this since 2006. In terms of healthcare, the Obama administration has plans to expand and reform the health insurance system. Some 46 million people in the US do not have health insurance, which creates a pent-up demand for medical procedures and tests. Healthcare constitutes one-sixth of the economy and its expansion will create a step-jump in demand.

While unemployment may lag into 2010, growth will take place. The extent to which this is sustainable depends on the trend growth rate (down before the financial crisis) and wages and prices being set in line with it. The global nature of the fall suggests that the eventual rise will also be global.

Posen noted the low level of protectionism, despite the severity of the downfall. Countries such as Brazil and India are not engaging in import substitution and, as a result, the global risk is not triggering an unwinding of the global supply chain.

Quotes

“It takes a lot to keep an advanced economy with property rights down. The natural state of a free market economy is to come back.”

“I am not convinced the measures taken today in the US have fully resolved the banking crisis. They have stabilised the system... Extricating the government guarantees and money make for a bumpy ride... I hope that is not going to happen!”

“... Rainy day fund.. you don’t want to have to use it twice”

“If we have a world where countries are excessively reliant on US consumption and the only way they can recover is by the US returning to its mildly spendthrift ways, it’s not going to work.... Countries have to rely on domestic demand or not get as much growth.”

Linda Yueh



Yueh presented a view of the global crisis and the world's shifting economic structure. She portrayed China (now the world's third-largest economy) as a particular engine of international recovery and went on to analyse global imbalances.

The G7's share of the world economy is shrinking, while the share of the BRIC nations is increasing in importance. By 2015, they are forecast to contribute one-third of global GDP. While the emerging economies of Asia and elsewhere are the fastest-growing, they still exhibit low levels of consumption, which is one source of imbalance.

A graph revealed that in China last year, GDP per capita (PPP) ran at just one-ninth that of the US and about one-seventh that of the EU.

China has become the fastest-growing component of global GDP and accounts for about 13%. It is one of the twin engines of global growth along with the US. China's income is doubling every eight years. In the early 1990s, China, India and former communist countries shifted their focus outwards, doubling the global labour force to three billion.

Yueh noted that, following the dot.com bubble bursting in 2001, the US Federal Reserve cut interest rates. Savings fell in US, but increased in China. When countries are running surpluses and accumulating reserves, they buy US treasuries to stabilise their currencies.

The effect of the credit crunch was minimal on emerging market banking systems as they are not sophisticated capital markets, she explained. However, Lehman Bros took a slight toll on its creditors based in Asia. The worst-affected are indebted and export-led economies such as Singapore.

Yueh asked whether China had enough domestic demand to be the driver of a recovery. With a falling consumption to GDP ratio, does China have enough domestic demand to offset the decline in exports? The fall in exports has created 20 million unemployed migrant workers. Growth has slipped from 9% last year to 6.1% in the first quarter of 2009 and the challenge will be for government spending to increase to bear the brunt of falling exports. Some \$600 billion will be spent as a stimulus and \$125 billion on healthcare.

The IMF is predicting a global growth rate of about 2%. But given the population rise, the growth needs to be at least 3%. Developing nations are growing but not enough to lift us out of the slump, she said.

Quotes

“The World Bank has estimated that, since the 1990s, China is as important a driver of global growth as the US.”

“Ireland should benefit as a small global economy tapping into global capital flows.”

“Recovery will depend on consumption growing.”

“Social insecurity will lead to higher personal savings and this will depress domestic demand.”

Martin Weale



Weale remarked that the roots of the recession go back to a period when savings were too low in the Western economies. However, high savings has not saved countries from recession. Countries with high savings and a dependence on exports, like Japan and Germany, have fared worse than some countries with low savings, such as the UK and US. An economy's exposure to manufacturing exports has a direct link with its increased exposure to this recession.

He believes that if the banks hadn't been bailed out, the effects on the economy would have been much worse. Furthermore, world trade appears to be stabilising and in fact is starting to increase. This provides grounds to conclude at this moment that we have probably seen the worst elements of recession.

UK industrial production figures for April 2009 are less gloomy than the December-March period and indicate that a period of sharp contraction is coming to an end. The collapse in production is levelling off – there was a recovery in output. He made the point that we would be unlikely to find a recovery in production if the rest of the economy was still contracting.

There has been a 4.5% fall in output – which implies a similar fall in consumption. But to have a more sustainable economy UK consumption needs to be 7% lower than it is, as there is a problem with over-consumption and low savings rates.

Weale observed there is currently no good mechanism for forecasting what will happen to stock levels and hence economic forecasting has not done very well recently.

With specific reference to Ireland, he noted the high share of capital investment in GNP (30%) – this is just 17% in the UK and 20% in the Euro area. As a result, Ireland's economy is vulnerable to any downturn in such investment. And he cautioned that unless Ireland maintains a high rate of growth, the share of capital investment in the economy is too high. Nevertheless, he believes that savings level in Ireland of 14% of GDP indicates the situation is sustainable.

Quotes

“There is evidence that world trade is stabilising and rising slightly. This is one of the indicators to show that we probably are beyond the worst aspects of the recession at the moment.”

“There is a sense that the period of sharp contraction is over, although we run the risk of stagnation in UK.”

“As far as I can tell the recession is over as it looks like the fall in output is retreating.”

Frances Ruane



Prof Ruane provided an overview of GNP changes in the last few decades. She explained that GNP per capita has climbed steadily since 1976 except for a blip in the early 1980s which was mild compared to the current recession. However, GNP per capita has been falling since 2007 and will continue to fall until 2011. In 2010 Ireland will be back to where it was in 2001 on this basis “which was not a terrible place”. She believes we will not attain 2007 standards of living until 2013.

However, it all depends on Ireland doing the right things, in policy terms. And she notes that a mid-term view should be taken rather than just focusing narrowly on year-by-year figures.

Ruane argued that those laid off since the construction peak in 2007 will have to be absorbed by the traded sector. Meanwhile, there is and will continue to be unemployment. Under scenarios of both world recovery and a prolonged recession, unemployment is projected to rise to 17% in 2010. Real after-tax wage rates are falling and will not turn around until 2012.

Conducting a SWOT analysis of Ireland’s economy, she outlined the strengths as EU membership, a high participation in education, a relatively young and flexible workforce, a positive disposition to entrepreneurship and a modern economic structure.

Opportunities include re-establishing an international reputation for high governance standards, meeting environmental commitments, reaping the benefits of investment in education and research & development, and setting up new industries.

Among Ireland’s weakness, Ruane highlighted the blows to reputation dealt by banking scandals and the Lisbon Treaty rejection; a debt overhang and future interest rates patterns; unrealistic expectations; skills gaps, high rates of pay and the need for regulatory reform.

All these elements stand in the face of threats such as the world taking a protectionist stance, the erosion of Ireland’s English-speaking advantages, a delay in taking action and a failure to develop effective policies.

As a small open economy, Ireland must ensure that it regains competitiveness and exercises greater cost control. Ruane advocated the need to formulate and follow development policies to promote economic growth. Both sides of the Border should look to co-operate in a shared market of six million people. Such all-island scale facilitates markets for energy, labour, retail and transport. Together, North and South can strive towards greater competitiveness by assisting each other with policies on health and social services and all-island benchmarking of these; education and public services; and planning, regulation and taxation. Economies of scale can be enjoyed if rigorous policies are developed and implemented.

Quotes

“To understand where we are it is important to see where we have been.”

“On the island of Ireland there is a need to address the issue of greater cost control.”

“There are many benefits still to be drawn from an island market of six million people”

Michael Smyth



Smyth started with a portrayal of many of the economic woes of Northern Ireland. There was a two-thirds fall in new housing starts between a peak in 2006 and the end of 2008. Unemployment rose from 23,000 in 2007 to a current level of 48,000, much of it in construction and related activity. Retailing also saw major job losses.

House prices had been climbing at up to 50% per annum. They have now fallen by 35%. Itemising a value from cross-border shopping of up to £500 million, he calculated it as a windfall of some 2.5-3% of total consumption and described it as a significant boon to the North.

However, despite household and business confidence remaining very low, Smyth said the severity of the current recession has been exaggerated. Back in the 1980s, inflation reached 18%. In the same decade, the man-made fibre industry collapsed and “tore the heart out of Antrim and Carriockfergus”. While the North would not return to its 2007/2008 jobs peak until 2018, it was nevertheless currently the fourth-lowest unemployment region in the UK.

Negatives included unforeseen civil service back pay claims set to fall due soon. Also, he noted that the non-imposition of water charges was leading to a water company deficit of over £500 million. The capital charge on the company is likely to come back onto the North’s balance sheet and may amount to a crippling charge of £200 million per year.

Devolution of policing and justice has huge economic implications and Smyth believed there was a certain air of unreality in the Northern Executive as the British taxpayer continues to pick up the tab. In the longer term pressures on public finances in Northern Ireland are likely to intensify.

Smyth explained the North and South could benefit most through following a “new commons approach”. This is a policy whereby efficiencies are found by sharing resources. Market failure has been the main economic justification for greater intervention by the two administrations to promote greater levels of economic cooperation and hence economic welfare. Smyth argued that that the rationale can be strengthened further using the “new commons approach”.

Key among the resources that might be used more optimally would be healthcare; infrastructure; and the knowledge activities (education, intellectual property rights, internet system and access, etc). He concluded that there was no time more suitable than now for seeking the efficiencies of North/South cooperation.

Quotes

“We have been led to believe the current downturn is the worst in living memory and the North has fallen off a cliff. It is not.”

“The suggestion that unemployment [in Northern Ireland] will quadruple from now is daft.”

“This recession is a walk in the park compared to the 1980s.”

Plenary discussion

Written questions submitted by the delegates on the floor and presented by Dan O'Brien, as chair, were addressed by the panel. Some verbal questions were also taken in the course of the session.

On inflation (asked by Jamie Delargy):

Posen played down any fears. He said "Most occasions of serious inflation go with major foreign government breakdowns. But no economy is looking like Argentina right now... Fearful question about inflation are not a real element now."

On central banks (asked by John Simpson):

Weale said, "The Bank of England should have been lending money direct to the private sector where it was needed."

Posen said, "Central banks are not the most important thing in the world." He noted however that the European Central Bank was ahead of the US Fed.

On exchange rates and use of the dollar as a reserve currency (asked by Ian Talbot):

Yueh said, "Bric countries don't necessary want to fund western debt. If inflation were to take hold, it would devalue currency and depress the value of their foreign exchange holdings in dollars. The dollar is still the most secure and liquid exchange rate currency in the world. Alternatives such as special drawing rights are still 44% composed of the dollar. The emerging world will continue to be pegged to the dollar."

However, Ruane expressed the "notion of more than one reserve currency likely to emerge". She gave the localised example of Irish companies beginning to sell abroad doing so in sterling.

On euro and sterling and their influence on recovery (asked by Tom McCarthy):

Weale said, "The chances of the UK adopting the euro are zero... the US dollar is the primary reserve currency."

On why Posen was "so pessimistic" about the euro zone (asked by Jim O'Leary):

Posen replied that policy stimulus and the banking system are a drag on the economy, and on the trend rate of growth. "We think euro area banks have not written off as much as outside the euro area."

On whether the Doha round is dead (asked by Gerry Monks):

Posen said that, in its present form, people will not spend a lot of time resurrecting Doha. Frances Ruane referred to "speaking out of both sides of our mouths" on the issue of trade.

On financial nationalism (asked by David Gavaghan):

Yueh said financial nationalism involved banks consolidating their balance sheets and releasing funds to domestic businesses while withdrawing capital from foreign investments – “Looking ahead, it’s very complicated.”

Talk progressed to an investigation of the impact of financial nationalism on Ireland and whether euro zone membership was still a net benefit to Ireland.

On how well-served were European economies by the policymaking institutions of the EU (asked by Jim O’Leary):

Weale believed, “They have no money to spend to offer stimulus. The only significant policymaking institution is the ECB. There is a case to say it could have cut interest rates further than it has.”

He was of the opinion that Eastern Europe was more likely to benefit: “Where we may see the EU playing a role is in preventing a major collapse in Eastern Europe countries.” However, he pointed out that it was not the EU but rather the IMF that played a role in helping Latvia.

Yueh took up this point. “Sweden is playing a role in Latvia – and Sweden is backed up the ECB. Sweden’s currency is being defended by the ECB,” she explained.

Posen pointed out that, “If Ireland had not been in the EU and an adopter of the euro, the history of the last 15 years would have been much worse for Ireland.” He said that for Ireland as a small open economy, the benefits of a single currency were enormous. He concluded: “The EU system is not functioning efficiently enough because of the nationalism... We need more Europe.”

On the island of all-island cooperation (asked by Liam Clarke):

Mike Smyth referred to the institutional barriers to anything like an all-island labour market (qualifications, mutual recognition and differing social security systems). On corporation tax he believes that any incoming Conservative government in the UK may be more open to devolved tax rates. On the idea of a single currency Frances Ruane felt that there was no more chance of Ireland leaving the Euro as of the UK joining it.

Concluding remarks (David Dobbin)

In the course of the forum, we saw that clear signs of global economic recovery are there. Questions however remain about its strength and sustainability, whether it will be a “double dip” or a “cold shower”. But there was an agreement that globalisation has not unwound which augurs well for the future.

We may have spent all our rainy day money so we have twenty years to hope that we have no further wars or recessions – a challenge to us all.

We must doubt whether pre-recession consumption levels are sustainable. If we move to higher savings and lower consumption, will we see a lower growth rate in the future and will this be sufficient to counter population growth?

Moving to the local we heard how this is a construction-led recession which has hit assets hard. We need to improve our competitiveness and build our banking sector back up.

We then turned to the issue of cooperation and the benefits that may come out of this. We must drive the synergies of the North and South to their fullest extent, collaborating on public expenditure and in innovation, and cooperate to use the potential of our huge resources of young people.

We appear to be coming out of the first recessionary dip, although the bad news there may well be a second dip ahead. Overall, all the panellists agreed that while things are worse than they were, they are much better than they were in pre-boom years. In short, we are still enjoying relative prosperity and the opportunities are there as we move forward.