

OVERTAXATION BRINGS RECOVERY TO A GRINDING HALT

Like no other, Friday's growth figures are a stark reminder of the wrong direction we are heading in. And they don't yet capture the impact of a Euro zone recession about to happen. What they do tell is how the reverse Pauline conversion in – from the path of righteousness and back on to the path of error and failure – is ruining the economy. From 4.8 per cent annual growth in the third quarter of 2010, GNP was by the third quarter of this year falling by 4.2 per cent. Unlike more export driven GDP, GNP reflects far more domestic trends and events, budgets included. The courageous December 2009 budget finally began to cut public spending. In doing so it heralded the end of a series of failed and destructive tax increases that – like their antecedents of the mid-1980s – reduced tax revenues and demand. The positive response of relieved consumers, employers and investors took just 9 months to materialise. Twelve months later the reverse happened: As Friday's figures confirm, consumers, investors and employers have slunk back into pessimism as politically designed "line of least resistance" policies take precedence over proper cuts in spending. From cutting fat and leaving taxes alone, the December 2010 shifted to cutting muscle and bone, raising taxes and leaving fat untouched. Welfare benefits have been cut when they should have been means tested. jobs have been cut when pay, pensions and increments should have been benchmarked instead. And thanks to this – with an oncoming Euro zone recession still to take its toll – we are back in recession.

Superficially the construction sector could be blamed for the latest figures. Up to now, that sector was certainly a victims of its past excesses. But with any excess long flushed out of it, it is now suffering from external factors, namely a misguided procyclical regulatory policy that is well past its sell by date. If bank lending to the sector could be normalised, some confidence, stability and modest growth could return to the sector: Rising rents – plus the ongoing rise in the country's population – speak of latent demand waiting to be set free. But as long as the crunch continues, there is no hope of recovery.

Glimmers of light remain. One of them is the vital difference between Ireland on the one hand and Greece, Portugal, Italy and Spain on the other. At €850 million in the third quarter, our current account surplus is somewhat down on the same period of 2010, but still in healthy contrast with the chronic deficits in the other PIIGS. In trade if not in fiscal terms,

Ireland is paying its way. A brighter glimmer still is the ongoing gain in Ireland's competitiveness. The only EU country to see a fall in hourly labour costs, Ireland's labour costs fell by 1.1 per cent as average Euro area costs rose 2.7 per cent. Put together, that represents a welcome and badly needed competitiveness improvement of around 4 per cent. If that trend can continue for another year or two, we can make serious inroads into unemployment by 2016 as predicted by IBEC. But will it?

Price levels in the economy are a huge barrier to this: VAT hikes, imminent VHI premium hikes, excise duty hikes and a household charge are just some of the examples of a death of a cuts being inflicted on Irish workers in the form of price increases on an already overly expensive cost of living. The state driven nature of much of our economy – the lack of real competition - is the main reason for this. Tragically the trend is not towards more competition, but away from it. Together with the Croke Park deal, trends towards consolidation in key service sectors are pulling us back to the monopolistic stagnant economy of the 1980s where the state bleeds the private sector dry. Apart from totally distorting incentives in the Irish labour market - what talented person in their right mind will now want to work in the private sector when they can earn higher pay in more secure public sector employment? - the public private wage differential also pushes direct and indirect taxes up far higher than they need to be, killing demand, jobs and growth.

More destructive still is continuing dysfunction in banking sector. Externally, an excessively meek position in Europe has resulted in a failure to date to exact modest haircuts from bondholders. Internally, despite banks being now well capitalised with healthy ratios of Tier 1 capital – and despite Ireland having one of Europe's highest savings rates –billions of euro that should be circulating in the economy are locked in bank vaults. As disappointing exchequer returns for November show weak domestic demand is leading to a vicious fiscal spiral and given the almost total dependence of the last budget on a strategy of indirect taxation, government has every incentive to get the Regulator to adopt a counter-cyclical rather than a pro-cyclical approach.

But the most destructive aspect of official policy of all is fiscal policy. Raising tax rates when far greater savings can be made is particularly fatal. The household charge is a classic example: That the government intends to raise €160 million in a flawed household charge

when it could instead raise over three times this amount, €511million, merely by implementing reform recommendations contained in a reform that government itself commissioned – is just one of several example of how vested interests are pushing government towards destructive, demand and jobs destroying policies instead of growth and efficiency enhancing policies. The next few months will see the latest growth figures work themselves out in appalling exchequer returns. If these don't convince government to change strategy nothing – other than a “No” vote in a forthcoming Euro referendum – will.