Why is there a sudden need for an additional one billion cut in Irish public sector pay?

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While nominal labour unit costs in Germany rose by 5.9 %, and 8.1 % in the UK during the last three years, Irish labour unit costs fell by 12.2 % during the same period due to the imposition of wage cuts (especially in the public sector) and a significant increase of the productivity of Irish employees. Compared to the Irish, across the entire EU only Latvian workers faced a bigger labour unit cost losses (-15 %) according to official EU statistics (European Commission 2012: 24).

The Irish government implemented all austerity cutback demands set by the EU/ECB/IMF Troika without hesitation. In turn, Commission President Barroso (2013) celebrated Ireland at a recent conference of the Irish Business and Employers Confederation (IBEC) because the Irish case apparently "shows that the [Troika] programmes can work." In recognition of these efforts – we were told by the Government a few weeks ago – the EU and the ECB accepted a restructuring of the Anglo Irish Bank debt which reduced Ireland's short term liabilities by one billion euro.

So where is the sudden demand for an additional one billion euro cut of Irish public sector pay bill coming from? Why is the Government determined to break the Croke Park I agreement that was supposed to run until June 2014 and to take an additional billion out of the economy? The answer to this question is surprisingly simple. The Government and Troika underestimated the negative impact that austerity cutbacks have on the growth rate of the economy:

> According to Olivier Blanchard, the fund's [IMF's] top economist, the impact of fiscal consolidation is "large, negative, and significant". The size of this effect is bigger than the fund previously thought. "Fiscal multipliers"—the change in GDP growth that results from a change in the government's structural budget deficit—were thought until recently to be 0.5. New IMF research now suggests a multiplier effect of 0.9-1.7 is more likely. So deficit reduction of one percentage point could knock up to 1.7 percentage points off growth (The Economist 2012).

What are the implications of this IMF miscalculation for Ireland?

Ireland's general government debt currently stands at 106 % of its GDP, which is way above the EU threshold of 60 % (European Commission 2012: 24). In turn, the Irish Government agreed to a severe austerity programme that does not seem to have an end. Because the austerity cutbacks reduce our growth rate, it is in fact quite impossible to reduce our debt to GDP ratio by the imposition of additional austerity measures, such as the proposed pay cuts. Hence, the IMF "calculation error" very much confirms the judgement of those who have argued that the national economy is not working in the way private households work, as eloquently outlined in a recent piece in the *London Review of Books,* which assessed the implications of the IMF's "calculation error" for the UK:

> That other factor might well be the same as the one identified by the International Monetary Fund earlier in the year. It concerns a technical economic factor called the multiplier, and that in turn involves us in a discussion of what GDP is and how the economy works. Imagine for a moment that you come across an unexpected ten pounds. After making a mental note not to spend it all at once, you go out and spend it all at once, on, say, two pairs of woolly socks. The person from the sock shop then takes your tenner and spends it on wine, and the wine merchant spends it on tickets to see *The Bitter Tears of Petra von Kant*, and the owner of the cinema spends it on chocolate, and the sweet-shop owner spends it on a bus ticket, and the owner of the bus company deposits it in the bank. That initial ten pounds has been spent six times, and has generated £60 of economic activity. In a sense, no one is any better off; and yet, that movement of money makes everyone better off. To put it another way, that first tenner has contributed £60 to Britain's GDP. Seen in this way, GDP can be thought of as a measure not so much of size – how much money we have, how much money the economy contains – but of velocity. It measures the movement of money through and around the economy; it measures activity. If you had taken the same ten quid when it was first given to you and simply paid it into your bank account, the net position could be argued to be the same – except that the only contribution to GDP is that initial gift of £10, and if this behaviour were replicated across the whole economy, then the whole economy would grind to a halt. And that, broadly speaking, is what is happening right now. People are sitting on that first tenner.
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> The example of the hypothetical tenner is part of the reason why: governments need to keep money moving around. For a household, to deposit the money in a savings account might well be the most sensible course. Governments, on the other hand, need that velocity – they need GDP. In order to get it, they sometimes have to borrow that first tenner, which they can do in a range of ways not available to ordinary citizens (who can't, for example, just print the money). Once that first tenner is spent, the government's hope is that it will continue to be spent many more times (John Lanchester 2013).

Hence, the proposed additional one billion euro cut of the public sector pay bill is the result of the use of a failing economic model. Cutbacks take much more money out the economy than previously thought. According to the IMF's own new calculations, every tenner cut by the government will decrease the GDP by 17 euro. Last October, it seemed that this is the "time for a rethink" of the austerity agenda (The Economist 2012). But obviously this is not the case in Ireland.

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