

The role of macroeconomic policy in Euroland: a case study of Ireland

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Abstract: The economic crisis has impacted particularly adversely on eurozone countries, in addition to the USA. In this paper, it is argued that, even under the current, more relaxed, rules of the Stability and Growth Pact (SGP), those countries, such as Ireland, are being forced to adopt pro-cyclical fiscal policy in the short term which will prolong the recession. Even in the longer term, when private expenditure has recovered, the constraints on eurozone macroeconomic policy will prevent the achievement of sustained full employment across the member countries.

A careful cost benefit analysis should be undertaken to investigate whether Ireland should leave the eurozone. However, economic commentators appear to take Ireland's continued membership as a given. If Ireland were to restore its capacity to conduct independent monetary and fiscal policy, then the introduction of a Job Guarantee to achieve full employment and low inflation would be appropriate, as opposed to an indiscriminate Keynesian fiscal stimulus.

1. Introduction

The global financial crisis (GFC) has had a particularly strong impact on European countries and the USA. In 2008(3) Eurozone countries officially entered recession and the economic prospects remain very bleak (OECD, 2009). The slump provides a major medium term challenge to the operation of the Eurozone macroeconomic policy framework, notwithstanding the signs of a tentative recovery in August 2009. The economic and social costs of sustained unemployment will be substantial, with many citizens unable to participate fully in economic and social life indefinitely.

While the GFC provides a context for this paper,¹ its major focus is a critical assessment of the long term capacity of Eurozone macroeconomic policy to achieve and maintain full employment across member countries, with particular reference to the problems facing a small open economy such as Ireland.

There has been a systemic failure of macroeconomic policy in most developed economies, both inside and outside the Eurozone, which has its origins in the paradigm shift that occurred in response to the first oil shock in the early 1970s and was crystallised in the OECD *Jobs Study* (1994). This report emphasised the primacy of supply side reform and eschewed an active role for aggregate demand management.

This orthodox consensus has been codified within the policy framework of the European Monetary Union (EMU) through the deflationary bias imposed by its centralised 'one size fits all' monetary policy under the common currency and the imposition of budget constrained fiscal policy on individual member countries through the Stability and Growth Pact (SGP).

The persistent failure of European (and other) economies to achieve sustained low rates of labour underutilisation over the last 30 years is explained by insufficient aggregate demand, which can be addressed within an integrated policy framework. While prudent households recognise their budgetary constraints, fiscal policy by countries operating with their own fiat

currencies under flexible exchange rates is not budget constrained, in either the short or long term. The SGP imposes a totally inappropriate fetter on the conduct of fiscal policy by member countries.

Ireland suffered a massive real shock in the wake of the GFC with grim forecasts by the Economic and Social Research Institute (ESRI) for future output and employment, following the unemployment increase in 2008 (Bergin et al. 2009a). Despite both the major appreciation of the euro against the pound sterling since late 2007 and rising domestic costs, its trade balance has improved, in part due to the collapse of imports, but the prospects for domestic demand are bleak, given the contractionary budget in April 2009 and depressed consumption and investment expenditure (Burke, 2009).

Policymakers have limited scope for manoeuvre, given the constraints of EMU policy. Bergin et al (2009a) correctly argue that any domestic economic recovery is almost entirely dependent on the recovery of the world economy plus significant cost cutting (and/or favourable exchange rate movements). Many households already face reduced work hours and/or job loss, so reduced hourly wages will compound the difficulty of maintaining living standards, particularly given levels of indebtedness following the recent housing boom.

Thus serious consideration should be given to whether Ireland should remain in the Eurozone, which, under the current policy framework, precludes member countries from attaining and sustaining full employment. The restoration of an independent currency would provide Irish policy makers with the capacity to adopt relatively unfettered fiscal policy and with an exchange rate instrument providing extra flexibility in policy design, which is currently absent since Irish economic circumstances do not impact on the value of the euro.

This paper, however, rejects traditional Keynesian pump priming of the type being adopted by countries, including the UK, USA, Canada, New Zealand and Australia, to increase employment. Under a Job Guarantee (JG), government expenditure is perfectly calibrated to the prevailing level of unemployment, so the complexities of policy adjustment in view of uncertain changes to the macroeconomy are neutralised (Mitchell, 1998; Mitchell and Muysken, 2008). The JG also incorporates a counter-inflation policy.

We next briefly document the costs of persistent labour underutilisation. We then detail the emergence of the consensus policy framework, and how it influenced the development of Eurozone macroeconomic policy. A comprehensive critique of this policy model is outlined with particular reference to aggregate demand management. In Section 5 the policy critique is illustrated by reference to forecasts for the Irish economy and the policy initiatives advocated by local commentators. We then propose an alternative policy framework which is underpinned by functional finance principles and employs a JG to secure and maintain full employment. Concluding comments follow in the final section.

2. Economic and Social Costs of Labour Underutilisation

Full employment can be defined as when everyone who wants a job at the current wage is able to secure one. The economic benefits of sustained full employment are indisputable: the economy produces at maximum capacity and microeconomic efficiency is enhanced through more rapid structural adjustment. When hysteric effects, associated with skill atrophy and reduced capital investment, are considered, there are major long term economic costs of sustained unemployment.

The personal pecuniary costs of unemployment can be represented by replacement ratios based on different scenarios, but they ignore the long-term potential income loss from sustained unemployment and/or reduced long term capacity to secure employment due to

skill atrophy (Junankur and Kapuscinski, 1992). Benefits may only be available for a limited period. Also higher unemployment is associated with higher income inequality in most societies (Galbraith, 1998:133-149; Sen 1997:164).

There is a broad international consensus across disciplines, including economics, psychiatry and epidemiology that sustained unemployment is also associated with significant personal and social costs including:

- social exclusion and the loss of freedom;
- psychological harm;
- ill health and reduced life expectancy;
- loss of motivation;
- the undermining of personal relations and family and community life;
- racial and gender inequality; and
- loss of social values and responsibility (Allen et al, 2007).

Social and economic exclusion resulting from unemployment encourages anti-social behaviour and fosters the growth in illegal activity as a means of generating income (Burgess and Mitchell, 1998, Darity, 1999).

The recent loss of full-time employment has been partially offset by rising part-time employment in countries including Australia, the UK and Ireland, but at the cost of increased underemployment. Underemployment in the USA has deleterious consequences for health (Dooley and Prause, 2004).

Also, labour force participation tends to be pro-cyclical, so rising unemployment is accompanied by increased hidden unemployment. Thus, reliance on just the official unemployment rate provides a misleading picture of the extent of labour underutilisation. A rule of thumb is to double the official rate to obtain an hours based rate of underutilisation (CoffEE, 2009). The massive costs of labour underutilisation imply that full employment (as conventionally defined) and price stability should be the objectives of macroeconomic policy.

3. Contemporary Macroeconomic Policy

Introduction

The origins of contemporary macroeconomic policy in most developed countries lie in the policy responses to the first oil shock in the early 1970s. The role for active fiscal policy was steadily eroded and a preoccupation with low inflation subsumed low unemployment as the policy priority.

The traditional definition of full employment was reinterpreted in terms of the natural rate of unemployment, and later the NAIRU, a bargaining equilibrium representing a barrier to further economic expansion.

Economies were alleged to have strong equilibrating properties. Sustained falls in the unemployment rate could only be achieved by supply side reform. Most European economies which did not operate some form of employer of last resort scheme experienced relatively poor labour market outcomes (Ormerod, 1994:203). This shift in macroeconomic policy design was crystallised in recommendations developed in the *OECD Jobs Study* (1994).

The OECD report claimed that persistently high unemployment in Western economies in the late 1980s had resulted from their inability to adapt and innovate in response to change, specifically intensified international competition, globalisation and technological progress.

Thus unemployment was viewed as largely structural in origin, so policies were advocated to remove the supply side impediments to the smooth operation of national economies. The *Jobs Study* also supported the growing macroeconomic conservatism which emphasised the need to reduce structural budget deficits and public sector debt over the medium term and the pursuit of low inflation (Mitchell and Muysken, 2008).

The focus on supply side inflexibility redefined persistent unemployment as an individual problem arising from personal deficiencies, including inadequate education, skills and work experience and inappropriate attitudes to work, whereas in the post-war period it was viewed as a collective problem. Consequently full employment was redefined as full employability and became the objective of macroeconomic policy (Allen et al. 2007; Mitchell and Muysken, 2008). Activation policies to prepare the unemployed for employment were instigated in most Western countries, and were often accompanied by penalties for non-compliance.

EMU policy framework

The macroeconomic model underpinning the EMU policy framework shares its main assumptions with the supply side orientation of the *Jobs Study*. There is a short run, but no long run, trade-off between unemployment and inflation. Say's Law holds, so that the level of effective demand does not play an independent role in the (long run) determination of economic activity, but rather adjusts to underpin the supply determined level of output corresponding to the NAIRU (Arestis and Sawyer, 2003). Discretionary fiscal policy is typically eschewed. However the counter-cyclical role of fiscal policy as an automatic stabiliser is acknowledged, with fluctuations occurring around at worst a balanced budget over the cycle (ECB, 2003:37). By contrast, monetary policy (MP) is the main instrument of macroeconomic policy, since it can be adjusted quickly in response to shocks, to restrain inflation. The ECB sets interest rates in pursuit of the inflation objective and national central banks are responsible for regulation.

The original core elements of the SGP were: (a) achievement of a budget close to balance or in surplus; (b) submission of annual stability and convergence programmes by member states; and (c) monitoring of the implementation of these programmes. Member countries must formally borrow in order to finance budget deficits.

The SGP was designed to ensure 'sound public finances and hence fiscal discipline' in the Member States after the introduction of the euro (Diebalek et al, 2006:81-82). 'Achieving and sustaining sound positions in public finances is essential to raise output and employment in Europe. Low public debt and deficits help maintain low interest rates, facilitate the task of monetary authorities in keeping inflation under control and create a stable environment which fosters investment and growth ...' (European Commission, 2000:9).

Automatic stabilisers would provide a sufficient counter-cyclical impact during a slump, without breaching the 3 percent limit set on the deficit to GDP ratio (Arestis and Sawyer, 2003). Under monetary union, there was a need for rules-based fiscal policy because individual countries had the incentive to run deficits, since the adverse interest rate effects would be diluted across the entire EMU (Diebalek et al, 2006).

The SGP was reformed in 2005 in response to criticisms that, while it constrained behaviour, the rules were not enforced (Arestis and Sawyer, 2003; Alves and Afonso, 2006). The revised SGP provided countries with greater flexibility in responding to excessive deficits, and increased reliance on a 60 percent public debt to GDP criterion to assess fiscal sustainability, without undermining fiscal discipline (Alves and Afonso, 2006). The reformed SGP attracted considerable criticism, because it was more complex and less transparent so there was more

scope for disagreement about compliance, but it had more coherence within an orthodox economic logic (Diebalek et al, 2006).

4. Critique of Policy Consensus

Supply Side Reform

OECD claims about the primacy of supply side reform to reduce unemployment have been challenged by labour economists, including Baker *et al.* (2002:55) who found no correlation across nineteen OECD countries between levels of unemployment and six institutional variables which were most frequently analysed: the unemployment benefit replacement rate, unemployment benefit duration, employment protection laws, union density, bargaining coordination and tax incidence. There was no relationship between the extent to which countries pursued deregulation and the decline, if any, of structural unemployment, so that the alleged *inflexibility* of eurozone labour markets could not be the cause of high unemployment rates (Arestis and Sawyer, 2003).

OECD (2004:165) admitted that the evidence supporting their view that high real wages cause unemployment 'is somewhat fragile'. Also

- There was no significant correlation between unemployment and employment protection legislation;
- The level of the minimum wage had no major impact on unemployment; and
- Highly centralised wage bargaining was associated with lower unemployment (OECD, 2006a:209-216).

OECD (2006b) concedes that *market reliant* countries and those characterised by *coordinated collective bargaining* and *social dialogue* experienced similar employment rates with the latter exhibiting lower income inequality but at a higher budgetary cost. Also the removal of obstacles to participation and job creation was advocated through tax-benefit reforms, activation policies, workplace flexibility, lifelong learning and removing obstacles and providing incentives to participation of under-represented groups, including the disabled, women and older workers. Thus supply side reform remains central to the OECD agenda.

Aggregate Demand Management

OECD (2006b) reaffirmed the importance of the consensus macroeconomic model for all countries with the centerpiece being the NAIRU model. However a broad range of empirical evidence has challenged this perspective and reasserts the role of aggregate demand in the determination of employment.

Modigliani (2000) found a close relationship between movements in unemployment and variations in labour demand, measured by employment plus vacancies, for France, Germany and the UK over the period 1963-1998.

Mitchell (2001) analysed the cyclical movements of unemployment and vacancies using phase diagrams. He found attractor points for each along the 45° line signifying strong persistence, but the attractor points shifted at times which coincided with major cyclical events. The consistent explanation of this evidence is that demand constraints, as opposed to changes in labour market efficiency, influence relative levels of unemployment and vacancies,

Mitchell and Muysken (2008) find evidence of unemployment persistence in selected OECD economies over the period 1960-2006 which challenges the claim that departures from the NAIRU are temporary following shocks to aggregate demand. The NAIRU is also cyclically

sensitive, so the claim that the NAIRU is determined by long run supply factors (eg. Layard et al, 1991:18) is rejected. The rebuttal of the NAIRU model raises serious questions about the effectiveness of the EMU policy framework, to which we now turn.

EMU Policy Framework

Arestis and Sawyer (2003) outline major shortcomings of EMU monetary policy. First, tight monetary policy can address an inflation induced by a demand shock, albeit with an uncertain lag (Arestis and Sawyer, 2002), but is, at best, a crude mechanism for addressing the impact of supply shocks. Second, a common monetary policy under a single currency may suit the 'average' country, but not countries in general (see below).

Third, Bibow (2003:5), quoted by Arestis and Sawyer (2002), notes that, according to ECB (2003), monetary policy is never in conflict with economic growth, because restrained inflationary expectations sustain confidence in price stability, which stimulates economic activity. But ECB (2002) shows that monetary policy had strong real effects in the euro area.

Fourth, a 2 percent inflation target increases the likelihood of deflation. Moderate rates of inflation improve the relative position of low-income groups (Blinder, 1987; Forder, 2003). Fifth, Arestis and Sawyer (2003) question the effectiveness of monetary policy in responding both to recession, as well as controlling inflation.

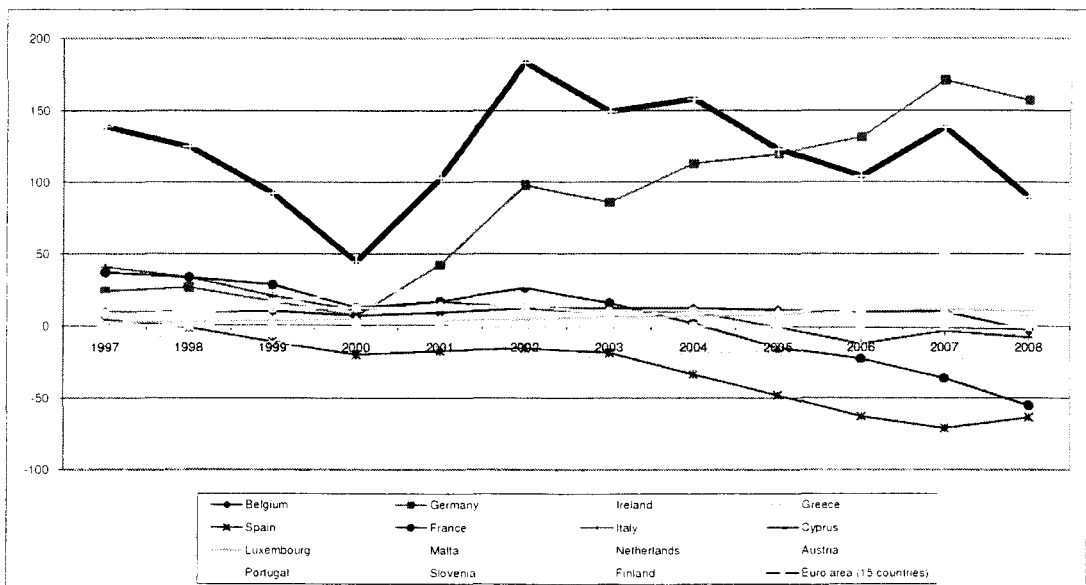
We now consider the SGP. First, the limitation of budget deficits to a maximum of 3 per cent is highly restrictive for many EMU countries (Arestis and Sawyer, 2003), which has been clearly demonstrated during the GFC, and has lead to a temporary relaxation of the rules.

Second, the sectoral flows accounting identity is:

$$(S - I) + (M - X) = (G - T) \quad (1)$$

where S,I,M,X,T,G denote Private Savings, Investment, Imports, Exports, Tax Revenue and Government Expenditure, respectively.

Figure 1: Eurozone annual net exports of goods & services at current prices (1996-2008)

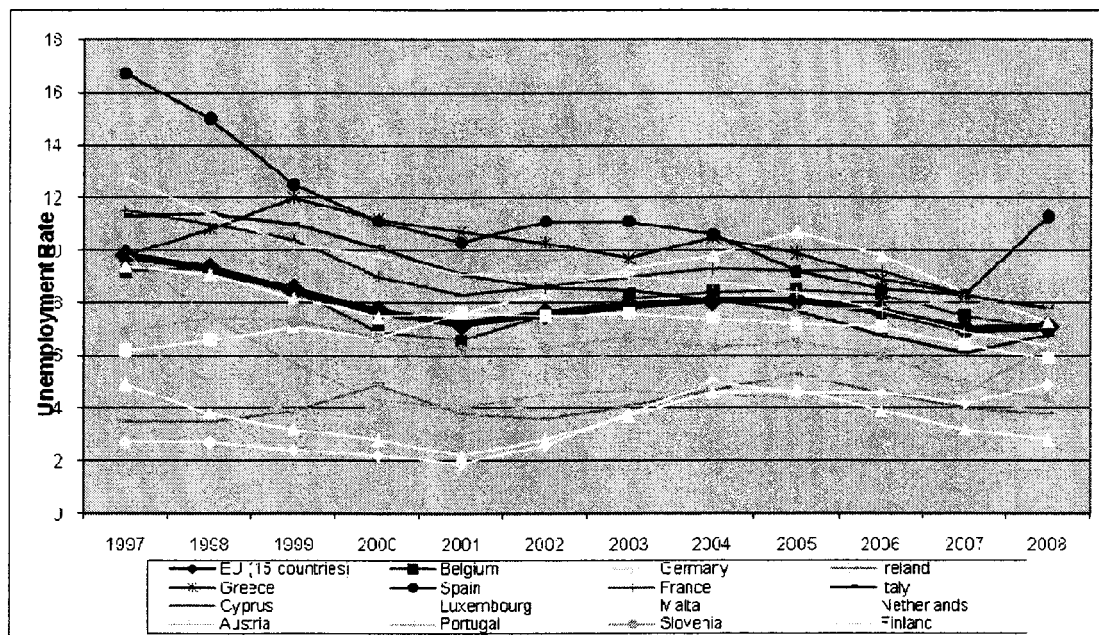


Source: European Commission (2009).

Eurozone countries operating under the SGP must achieve budget surpluses at full employment, given the requirement of (at worst) a balanced budget over the cycle. Sustained full employment would be possible, given a desire to net save ($S > I$) if the trade surplus was sufficient. On the other hand, a budget surplus accompanied by a low positive (or negative) trade balance means that the private sector in aggregate is dissaving. This could occur temporarily under full employment, but the private sector would become increasingly indebted. In time households and firms would cut their consumption and investment expenditures to restore their balance sheets, which would cause rising unemployment. Indeed this is precisely what has been occurring. Thus sustained full employment requires budget deficits (Arestis and Sawyer, 2003; Mitchell and Muysken, 2008).

The overall trade surplus for the 15 Euro countries is small, so there is no sign that they are each converging towards a trade surplus, let alone at a level sufficient to achieve sustained full employment. Since 2006, if Germany is excluded, the member countries had an overall trade deficit. The world trade balance is zero, so if prudent public sector management is viewed as running surpluses, the private sector worldwide will be net dissaving.

Figure 2: Eurozone annual unemployment rates (1996-2008)



Source: European Commission (2009).

Figure 2 illustrates the ongoing failure of Eurozone countries to achieve full employment, despite buoyant world growth over a sustained period. Spain, Finland and Ireland experienced significant declines in unemployment between 1996 and 2007. The average unemployment rate for member countries was 7 percent in 2007, before the onset of the GFC.

Thus the failure to secure full employment in Eurozone economies results from adopting principles of so-called sound public finance rather than running budget deficits to finance net saving by the private sector. We now examine the plight of Ireland which further illustrates the deficiencies of the EMU policy framework.

5. The Irish Macroeconomy

From the mid-1990s to the end of 2007, Ireland enjoyed rapid economic growth and falling unemployment. A number of factors are thought responsible, including the low relative rate of corporate taxation (10 to 12.5 percent throughout the late 1990s), the net transfer payments from EU members representing up to 4 percent of GNP which were used for physical and human capital investment; and the high level of state subsidies which, with relatively low wages in the 1990s, provided an incentive for foreign companies including Dell, Intel, and Microsoft, which wanted a Eurozone base to locate there. By 2006 employment in foreign owned companies exceeded 150 thousand. There was a high rate of immigration.

Over the period 2003-2007 annual real economic growth in Ireland averaged 5.3 percent, but became increasingly concentrated in the non-traded construction sector, which was fuelled by low nominal interest rates. Employment in construction more than doubled between 1997 and 2007. Property prices grew strongly.

Unemployment averaged 4.5 percent (2003-2007) and 290,000 net new jobs were created (Leddin and Walsh, 2008). Competitiveness has declined since 2002 (Honohan and Leddin, 2006), with inflation above the EMU average. Ireland's real effective exchange rate appreciated about 30% from January 2002 to December 2007 in contrast to below 20 percent for its European competitors and a real depreciation for the USA (IMF, 2009:4).

The construction sector collapsed in 2007/08. Since the beginning of 2007, Ireland's gross fixed capital formation has fallen by 42.6% (Burke, 2009), while consumption has dropped 13.7 percent, but exports have grown, particularly in manufacturing and chemicals, while imports, particularly of capital goods, declined (Burke, 2009).

Unemployment and underemployment rose sharply with unemployment reaching 12 percent in 2009(2). Between 2008(3) and 2009(2), the participation rate dropped from 64.2 to 62.5 percent (Central Statistics Office, 2009). Recalculation of the unemployment rate in 2009(2) with the higher participation rate adds more than percentage points. Employment cuts occurred in multi-national companies, including Dell. Between 2008(3) and 2009(2), total employment dropped approximately 180 thousand, yet part-time employment grew about 12 thousand. Thus the rate of labour underutilisation is inadequately measured by the official unemployment rate (CoffEE, 2009).

The supplementary budget of April 2009 was designed to reduce the deficit to 9.5 percent of GDP, as part of a multi-year strategy to restore the deficit to below 3 per cent by 2013, in line with SGP dictates. Thus fiscal policy has assumed a pro-cyclical role, which is typical of Eurozone countries (EC, 2006), despite the ongoing need for counter-cyclical fiscal policy (Honohan and Leddin, 2006).

Central Statistics Office (CSO) data revealed an unprecedented annual rate of deflation of 6.5 per cent to September 2009, mainly driven by falling mortgage interest costs. The ECB's main refinancing rate was set at 1.0 per cent in May. Survey evidence from Irish SMEs reveals widespread employment and/or wage cuts (Taylor, 2009).

In its analysis of recovery scenarios (Bergin et al, 2009a), ESRI forecast negative GDP growth rates of 8.2 percent (2009) and 1 percent (2010) and the unemployment rate peaking at 17 percent in 2010. Net emigration of 30,000 is projected in 2009.

Given Ireland's inability to either influence the value of the euro or implement expansionary fiscal policy, academic opinion, in particular Bergin et al (2009a), is clear that domestic economic recovery is largely reliant on a significant recovery of the world economy, accompanied by an improved level of international competitiveness.

Irish export growth is expected to resume in 2011, which will be enhanced by increased competitiveness with nominal wages having declined by 6.0 per cent over the period 2009-2011. A vigorous wage cutting campaign to achieve this may promote resentment and reduced productivity in the next upturn.

GDP growth is expected to average 5.6 percent in the recovery (2010-2015). The cumulative loss of output during the recession will exceed 10 percent, with ongoing losses from a cut in the potential growth rate from 3.6 to 3.0 percent (Bergin et al, 2009a:13). Despite cumulative net emigration of almost 116,000 between 2009 and 2015, the unemployment rate will still be 6.4 percent in 2015, falling to 6.3 percent by 2020 (Bergin et al, 2009a:46).

Following the April 2009 Budget no further fiscal policy interventions are assumed to occur. The National Asset Management Agency (NAMA) will purchase €77 billion worth of underperforming property loans mainly from Allied Irish Bank and the Bank of Ireland at a 30 percent discount, in exchange for NAMA bonds which the banks will be able to exchange for cash from the ECB. 'Even if the funding needs of the banking system were eventually largely repaid, the full resolution will take some considerable time.' (Bergin et al, 2009a:47).

OECD (2009) outlines stylised medium term scenarios for its member countries. Following fiscal consolidation from 2011, Ireland, and the overall Euro area will achieve an unemployment rate of 9.4 percent in 2017. The OECD assumes an extreme version of hysteresis, so that all unemployment becomes structural with output growing at its potential rate, and the problem of insufficient aggregate demand is excised.

6. An Alternative Perspective

Functional Finance

The principles of functional finance have been outlined in numerous publications (see, for example, Mitchell, 1998; Mitchell and Muysken, 2008) and will be summarised. An independent country with its own fiat currency which operates under a floating exchange rate is a monopoly supplier of its own currency. Government spending is not revenue constrained and is the source of the funds the private sector needs to pay its taxes and net save.

The cash position of the banking system is important for the central bank, which, in its operation of monetary policy, targets short-term interest rates. If there are excess reserves, say due to the government running a deficit, competition between the commercial banks to create better earning opportunities puts downward pressure on the cash rate. In the presence of a support rate below the target rate (possibly zero) which is paid on excess (overnight) reserves, there is an interest rate corridor which compromises the operation of monetary policy. If the central bank desires to maintain the target cash rate then it must drain this surplus liquidity by selling government debt. In other words, government debt functions as an interest rate support mechanism via maintenance of desired reserve levels in the commercial banking system and not as a source of funds to finance government spending.

However, the USA and Japan recently removed the margin between the support rate and the short term rate. Thus interbank competition is eliminated and the central bank can maintain a positive interest rate target without issuing interest-bearing debt because the excess reserves arising from daily budget deficits earn the market-return. Thus monetary policy is separated from the quantity of bank reserves, which is important in the recovery from a financial crisis, when the level of excess reserves is relatively high (Keister and McAndrews, 2009).

In summary, unlike the private sector, a national government is not budget constrained. If the private sector wishes to net save (taking into account the trade balance), the economy can

only achieve sustained full employment, if the government runs a large enough deficit. Thus, unemployment occurs when net government spending is too low to accommodate the private sector's need to pay taxes and the desire to net save (taking account of the trade balance).

Orthodox economic commentary, including OECD (2009), fails to differentiate between countries which operate with their own fiat currency and those which have limited fiscal policy options due to voluntary membership of the EMU. Under orthodoxy all countries are considered subject to the operation of a binding inter-temporal fiscal budget constraint in the pursuit of so-called fiscal sustainability, yet even within its own questionable logic what constitutes a sustainable debt to GDP ratio is unclear.

Job Guarantee

European Commission (2008) grudgingly accepts that fiscal policy can influence aggregate demand in the short term and, in principle expenditure and tax policies could stabilise temporary fluctuations of output. However the Commission argues that fiscal policy rarely operates to stabilise fluctuations which is probably due to i) an implementation lag; and ii) the political economy of fiscal policy, so that other factors influencing its settings.

Countries with their own fiat currencies, such as the USA, UK, Canada, Australia and New Zealand, have adopted traditional Keynesian pump priming in response to the GFC. Papers, including Mitchell (1998) and Mitchell and Muysken (2008), argue that in the imperfectly competitive macroeconomic framework in which modern governments operate, a better alternative is to utilise an *employed* buffer stock approach, namely a Job Guarantee (JG), whereby the public sector offers a fixed (minimum) wage job, to anyone willing and able to work. Given the space constraints, a brief summary is provided.

The buffer stock expands (declines) when private sector activity declines (expands). The JG thus minimise the real costs associated with the flux of the private sector. Full employment is maintained with a changing mix of private and public sector employment. Since the JG wage is open to everyone, it becomes the national minimum wage and does not disturb the private sector wage structure thereby ensuring that the JG is consistent with price stability.

The ratio of JG employment to total employment is defined as the Buffer Employment Ratio (BER) (Mitchell, 1998). This ratio conditions the overall rate of wage demands. When the BER is high, wage demands will be correspondingly lower. If inflation exceeds the government's target, tighter fiscal and monetary policy would be triggered to increase the BER, which entails workers transferring from the inflating sector to the fixed price JG sector. Ultimately this attenuates the inflation spiral. So instead of a buffer stock of unemployed being used to discipline the distributional struggle, this is achieved via compositional shifts in employment, with those workers transferred to the JG sector losing income, rather than jobs.

The JG wage could be adjusted in line with trend productivity growth plus the target inflation rate (McDonald, 2008; Watts, 2010) to avoid both changing real relativities and to promote static efficiency in low wage firms.

The introduction of a JG would mark a return to the post-Second World War full employment policies which ensured that all workers could earn wages and live free of welfare support.

The JG does not rely on the government spending at market prices and the exploitation of multipliers to achieve full employment which characterises Keynesian pump-priming. Some increase in government expenditure at market prices may be politically justified in the presence of ongoing unmet needs, such as aged care and transport (CoffEE, 2008).

Generalised demand expansion in isolation is unlikely to create jobs for the most disadvantaged, does not address spatial labour market disparities which are common across

OECD economies, and does not incorporate an explicit counter-inflation mechanism. Also, as noted, there are inevitably implementation lags, which create the prospect of either ongoing unemployment or an outbreak of demand pull inflation, which must be resolved by job loss, precisely because the government is hiring employees at market rather than minimum wages (Forstater, 2003). Thus a commitment to full employment based on pump priming relies on the sanction of unemployment as its counter-inflation mechanism, unless a successful incomes policy is implemented.

The JG is precisely calibrated to the number of unemployed workers. Thus debates over the timing of adjustments to stimulus packages in response to changed economic circumstances are redundant. Full employment under the JG is defined as loose. The reader is referred to Mitchell and Muysken (2008) for a more detailed exposition of the JG.

7. Conclusion

The lack of criticism of Ireland's membership of the EMU is curious since its economy is subject to arms length monetary policy and the compliance requirements of the SGP. The recent vote in support of the Lisbon Treaty reveals that the public has also been convinced about the virtues of continued membership. Local commentators exhibit a somewhat fatalistic attitude about the capacity of the economy to restore a low unemployment rate, let alone sustained full employment. ESRI's projections are rather more optimistic than those of the OECD, and are based on large and persistent trade surpluses, following the recovery of the world economy and a high income elasticity of demand for Irish exports, which at the end of 2008 were 50 percent of Irish GDP (Burke, 2009). Despite being a member of a trade bloc less than 50 percent of Irish exports go to Eurozone countries and about 24 percent of its imports originate in those countries.

Reduced confidence in the banking system, a weak inducement to invest, uncertainty over whether corporate tax rate differentials can be sustained, a lack of export diversity plus increased competition from lower wage Eastern European members of the EU would lead most economists to question whether large Irish trade surpluses are achievable and sustainable. Support for the SGP and thus rejection of discretionary fiscal policy appears to be premised on arguments about crowding out and the alleged consequences of issuing debt to finance deficits, which are fallacious for a country operating with its own fiat currency under flexible exchange rates.

Sustained labour underutilisation will impose enormous long term economic and social costs. Consequently a comprehensive cost benefit analysis of Ireland's membership of the Eurozone should be undertaken, so that the alleged benefits of being part of a trade bloc, but subject to a policy framework which is largely insensitive to Ireland's economic circumstances, can be carefully evaluated.

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¹ We do not present an analysis of the origins of the GFC. Juniper and Mitchell (2008) argue that the triggers included the US real estate boom and the involvement with risky segments of the market, through sub-prime loans, which for their viability relied on ongoing increases in real estate prices so potential defaulters could refinance their loans. Also trillions of dollars of credit-default swaps were written which were essentially unregulated insurance contracts and were supposed to provide the owner with protection against (mortgage) loan default. When households defaulted on their loans, some financial institutions that had issued the swaps could not honour their obligations.

'But the crisis became seriously disruptive to the real economy when the interbank market dried up. Banks struggled to fund their exposed positions. Investors, who in more normal times underwrote the capital of these financial institutions, became extremely risk-averse fearing that the sub-prime exposure was the tip of the iceberg. Once the credit markets became crippled, firms in the real economy started to struggle to finance their working capital.'