



SUBMISSION FROM THE IRISH HOTELS FEDERATION ON IMMEDIATE ECONOMIC STIMULUS PROPOSALS

EXECUTIVE SUMMARY

There is a national economic emergency and solutions must reflect the extreme seriousness and urgency of the situation.

The proposals reflect the view that economic confidence must be restored, clear leadership and example must be shown, the pain of adjustment must be shared and the public finances will take several years to be corrected

The immediate priorities are 1) confidence, 2) sustain current economic activity and employment and promote additional short term activity and 3) correct the public finances.

We recognise the conflict between wage moderation and reductions in public expenditure and the need to stimulate domestic demand. However, economic activity is also underpinned by competitiveness. A careful balancing of policies is needed. A critical determinant of weak confidence is the current and future state of the public finances.

The IHF proposes;

- An 8 year period for public financial adjustment
- Reduction in the cost of governance at the national, regional and local levels
- Reduction on a graduated basis of an average 25% in the public sector paybill through salary reductions rather than headcount reduction
- Freezing of social welfare payments for 3 years
- Substantial reduction in non- pay public expenditure
- Reduction of standard rate of VAT by 5 percentage points to stimulate local demand
- Increase in income tax for high income earners
- Pay increase proposals in current national agreement should be cancelled and reductions implemented
- Minimum wage and JLC rates reduced by 10% and frozen for three years
- House insulation programme for 100K dwellings supported by tax allowances on expenditure up to €10K per dwelling over next two years.
- Prohibition on all public sector price and charge increases for the next three years
- Range of measures to improve immediate flow of credit to enterprises to reduce the rate of business collapse
- Easing of regulatory rules for small and medium enterprises and VAT exemption level to be increased to €150K

INTRODUCTION

The Irish economy is in a terrible position. It is currently the worst performing economy in the developed world. Unemployment, with all its economic, social and personal hardship will grow throughout 2009 and is highly likely to exceed 15% by end 2009. Economic activity in 2009 will decline by at least 4%. The euro appreciation has decimated competitiveness relative to the UK. The public finances are in a particularly dismal state with very high and unsustainable borrowing. The scale of the public finances problem and the difficulty of dealing with it are draining economic confidence. The tourism and hotel industry are experiencing their worst economic environment in decades. There is no guarantee that the weak state of the economy is a short term phenomenon. Confidence of investors, enterprises and consumers are at historic lows. We have a national economic emergency and solutions must reflect the extreme seriousness and urgency of the situation.

UNDERLYING PRINCIPLES

The Irish Hotels Federation (IHF) proposals are governed by the following principles

- Confidence in the Irish economy and the public finances must be restored now
- An urgent and immediate comprehensive and integrated response is required
- The pain associated with the solutions must be shared by all sectors and groups in the economy
- There must be clear leadership through example from the top of Irish political and civil society
- The three immediate priorities must be to restore confidence, to preserve and promote economic activity on which all our social and personal progress is based and to design an approach to rebalancing the public finances
- Restoration of economic balance to the economy and to the public finances will require several years of appropriate policies

POLICY CONFLICTS

The economy is in the midst of a national and international economic recession which in normal circumstances would require a strong government fiscal stimulus through tax reductions and/or expenditure increases. Unfortunately the public finances are already in a very weak current and medium-term situation with a collapse of tax revenues and large levels of borrowing. The Irish recession is worse than the international situation due to the very large collapse in construction activity which has also worsened the tax revenue decline. Solutions to the public financial situation are directly in conflict with the need to stimulate domestic aggregate demand. Unfortunately, failure to deal with the public sector borrowing will reduce the already low investor and consumer confidence in the economy and lead to lower economic activity. Correction of the borrowing mainly through taxation increases is not an option. This would require very substantial increases in income tax and indirect tax rates which will reduce competitiveness (eg for tourism) and have undesirable effects on the labour market. In addition, they would reduce

domestic demand. It is undesirable to add to unemployment through reductions in the level of public sector employment in a period of rapidly rising unemployment. Nonetheless, the public sector paybill is an important determinant of overall public spending and must be brought into line with the efficient (economic activity promoting) tax revenue capacity of the economy. Interest rates through the efforts of the European Central Bank are already low and declining. Unfortunately the external value of the currency is now inappropriate for the Irish economy but as we are part of the single currency the policy instrument of devaluation or depreciation is not available. There is no alternative to internal adjustment of domestic costs to reflect the exchange rate change. To add to all of this, the past peak level of construction employment will not be recovered even when the recession is over. The same is also true for financial services employment. Future employment and economic growth will be more dependent on the export and internationally competing sector, including tourism, than has been the case over the past decade. Consequently competitiveness, labour cost, other cost components and non cost factors will be critical. Unfortunately, wages are a substantial source of domestic demand and this must be acknowledged in the strategy.

The task is to develop a short term strategy which is compatible with medium and long term requirements. The IHF recognises that calls for wage moderation or reductions give rise to the concern that only one sector of society is being asked to carry the burden. The national economic crisis is so severe that all sectors must contribute and share the pain. It should be acknowledged that many parts of the enterprise sector are already carrying an adjustment burden through reduced profits, losses, lower prices, closures and the wiping out of past entrepreneurial and financial investment. Private sector workers are already suffering reduced wages, reduced hours of work and unemployment unlike those in the public sector.

TERM AND STRUCTURE OF THE INTEGRATED ECONOMIC RESPONSE

There are three immediate tasks, to generate confidence in the future of the economy, to give a response to the current immediate economic situation and protect economic activity and to implement a public finances correction strategy. This should be done within the context of a longer term set of policies and solutions which focus on economic development requirements. The priority is to respond to the immediate situation in a one to two year scenario which will be linked to a longer term strategy and which will prevent larger levels of economic decline. For example, the October Budget talked of achieving a below 3% borrowing requirement in 2011. This was unlikely. Since then the Government has spoken of a much longer period to restore balance. The IHF recommends that the public finances should be restored over a period of 8 years.

The long term plan should be based on realistic (and probably low growth rates) and should have short term, medium term and long term perspectives. This, of course, creates its own problems in that the longer the period of high borrowing the higher is the national debt and the higher are annual interest payments which take resources away from the provision of public services.

LEADERSHIP FROM THE TOP

The IHF believes that the public service must be restructured and its costs reduced to reflect the new ongoing lower tax revenue capacity of the economy. The concern with public service reform has moved beyond the issues of efficiency and effectiveness to what the economy can afford on the basis of the “economic activity supporting” tax base. There is absolutely no point in raising taxation to levels which will reduce the incentive to innovate, to work, to set up businesses and to invest. The scale of the adjustment requires substantial sacrifice and pain from providers and users of services. This restructuring should begin at the top. The IHF proposes a rigorous review of the scale, nature and cost of the governance structures of the economy at national, regional and local levels with the aim of reducing the costs of governance.

ADJUSTING THE PUBLIC FINANCES

The adjustment of the public finances should be over an eight year period. Adjustment over a short time period would have undesirable economic and social effects. The adjustment mechanism must take account of spending cuts, taxation increases and phased borrowing. The IHF recognises the economic and social role of public expenditure particularly for the less well off sectors of society. The IHF believes that the return to public financial stability requires very substantial cuts in expenditure. It is unavoidable that the cost burden of the public sector on the overall economy must be reduced.

It is inappropriate and self-defeating that we would raise taxes to remove the borrowing. The pay bill is a substantial element of public expenditure and there must be reductions in this. The current paybill was based on the expectation of tax revenues which will now not be realised for several years into the future. The paybill can be reduced by staff reductions including both non renewal of contracts and voluntary and involuntary redundancies. The pay bill also can be reduced by salary reductions. In light of the deteriorating labour market situation IHF believes it is more desirable to reduce the cost base of the public sector through salary reductions than through employment reductions. IHF proposes that as part of the immediate response to the public financial crisis there should be a 25% reduction in the public service paybill and that this should be achieved by a graduated scale of salary reductions depending on salary level and that these new lower levels should be not increased for three years.

As part of this approach increased annual leave could be offered in part exchange. In the absence of salary reductions the adjustment will have to come through reductions in public sector employment.

The Government should immediately announce that the proposed medical consultant’s contract will not be proceeded with. Adjustments should be made to the current public sector pensions schemes to reduce its cost to the economy. In 2008 the public service pensions bill was over €1.8B

The public sector paybill (including pensions) excluding local authorities is just under €19.5B in 2009. A 25% gross reduction improves the public finances by about €5B on a recurring basis but income tax, PRSI and the VAT and excise associated with the

spending and multiplier effect will be lost giving a net improvement in the finances of about €3B. Clearly this is only a proportion of the adjustment that is needed over the next several years. It highlights both the severity of the problems and the urgent need to reduce costs. Hopefully a resumption of economic growth from 2010 onwards will generate revenue buoyancy. Other reductions in public expenditure must be sought to rebalance the public finances. IHF proposes that social welfare payments should be frozen for the next three years and all other aspects of expenditure should be immediately substantially reduced by at least 20%. The IHF proposes that priority should be given to expenditure reductions in programmes which do not support economic activity. The reductions in expenditure should include a substantial element of the state removing itself from specific activities and not focus on incremental and marginal changes in the same level of state activities.

TAX CHANGES IN THE IMMEDIATE STRATEGY

The immediate short term strategy should include a package of tax reductions to stimulate the economy and selective tax increases to support the rebalancing of the public finances. It is well recognised that high tax levels are a disincentive to enterprise and employment creation. Tax increases should be kept to a minimum and applied where there is lesser economic impact. Nonetheless, tax will have to make some contribution to the public finances correction but expenditure reductions should be the main solution. IHF proposes that the expenditure reduction/tax increase proportions of adjustment should be 75 % at least expenditure adjustment/25% at most./ tax increases

Indirect taxes, VAT and excise, are already high relative to other EU economies. There is no scope to increase most of these if domestic demand is to be supported. IHF proposes that the standard VAT rate should be reduced by 5 percentage points to stimulate domestic spending. This increase should be maintained for six months at which time it would be reviewed.

Profits tax is an important element in attracting FDI and should not be increased. EU regulations will not allow the Government to distinguish between different sectors as regards profits tax rates.

To assist in rebalancing the public finances and to ensure equity in the burden sharing a new higher rate of income tax should be applied to all personal incomes in excess of €250K per annum.

NATIONAL PAY AGREEMENT & MINIMUM WAGE/STATUTORY WAGES

The current national partnership pay proposals should be changed to reflect the likelihood of significant private sector wage reductions over the next two years and the need for a public sector reduction. Individual sectors and enterprises in the private sector are already negotiating or have already negotiated reductions in wages. The wage agreement should recognise the likely practice of wage reductions. Ideally wage reductions should be used instead of employment reductions. The current levels of the minimum wage and statutory wage rates such as the JLCs should be reduced by 10% and frozen at these lower levels for three years. Cost increasing provisions of JLC orders such as double time on Sundays should be removed.

MAINTENANCE OF EXISTING ECONOMIC ACTIVITY AND PROMOTION OF NEW SHORT TERM ACTIVITY

There should be a complete and full prohibition of all public sector price and charge increases for the next three years and public organisations should have to cope within that constraint and the tight budgetary constraint. There is little point in allowing the public sector to avoid necessary adjustment by imposing higher prices and charges on the private sector. The recent public transport price increase should be reversed.

There should be a commitment to lower energy prices by 10% in 2009 from current levels in addition to reductions which may arise from possible lower future oil and gas supply prices. If necessary this should be done by postponement of intended investment projects and should include substantial reductions in the domestic cost component of energy production and distribution.

This price freeze will complement the price reductions now being implemented by the private sector and the proposed wage changes and will contribute to increased competitiveness as recommended by the National Competitiveness Council. In the absence of significant decreases in cost and improvements in competitiveness and in the context of the very poor economic performance the ability of Ireland to stay part of the single currency will be in question. Competitiveness enhancement must be at the heart of Government decision making.

Wage moderation or reductions and public sector price controls will contribute to the maintenance of existing employment.

The recent Government Framework document referred to a scheme involving €30M to promote insulation of houses. IHF proposes a substantially larger scheme which will provide tax allowances for the incurred expenditure. Expenditure of a maximum of €10K per dwelling would be allowed with tight cost guidelines to ensure value for money. Allowance would be at the marginal tax rate and would be payable in the following tax year to the work taking place. This would be mainly new economic activity and the tax returns from the increased output would cover the cost of the tax foregone through the allowance for claims on the standard rate and most of the cost for claims on the higher rate. The target should be for at least 100,000 dwellings to be insulated over the next two years. This could generate an extra €1B in construction related expenditure and be associated with at least 5000 jobs. A wider scheme of home improvement and domestic green investment should also be considered for tax allowances.

Despite Government efforts to improve the operation of the banking sector through deposit guarantees and capitalisation there is still inadequate flows of credit to enterprises. This is putting at risk the sustainability of otherwise commercially viable enterprises and creating substantial short term uncertainty. The availability of credit should be a more important and urgent concern of Government and should be reflected in capitalisation terms and conditions and if necessary loan guarantee schemes. Easier access to credit will support existing levels of economic activity. In the hotel sector, for example, there is little point in forcing a lender to sell what was a €4M property (pre recession) to pay off a loan of €3M because the property may realise only €2M and the bank loses €1M. It is better to park the loan if the assessment of the business model is that in the medium term it can satisfy all obligations.

To deal with the immediate credit situation and as a result contribute to short term economic activity IHF makes the following proposals;

- The immediate establishment of an SME Credit Monitoring Committee including the financial regulator, central bank (1) relevant government departments (2), business sectors (3) and an independent chair(university sector) to provide monthly assessments of the availability of credit within two weeks of each month end.
- Financial regulator to ensure that rules and regulations concerning credit cost and conditions and lending criteria should support the enterprise sector
- Easing of tax payment requirements including commercial rates and revenue commissioner taxes to facilitate cash flow of enterprises and risk improvement for the lending agencies
- Risk sharing by Government and the banks for increased lending to hotels and guest-houses (loan guarantee scheme for fund required additional to 2007 levels for working capital requirements)
- Supportive approach by banks to serious cases of loan difficulty in the absence of adequate lending by banks, the establishment of direct lending or direct funding of lending by the Government.

REGULATORY ENVIRONMENT

Over the past several years there have been substantial increases in the cost of doing business because of new cost increasing regulations including labour regulations, health and safety and environmental matters. There should be no new regulations for the next three years and regulations introduced in the past two years should be removed. Specifically in labour regulations there should be an amnesty for hitherto non-compliance and implementation of certain provisions such as Sunday double time should be ended. Overall there must be a more supportive and small-enterprise friendly environment. Tax allowance measures and a supportive regulatory environment should be introduced to support new self employment and new micro enterprises including an exemption from VAT and other regulatory requirements for all enterprises with a sales revenue of up to €150K.