Assessment of the Impact of The Lisbon Treaty on the Irish Economy

A Survey of

The Views of Leading Independent Economists

in Ireland

Analysis of results by

Alan W. Gray

William H. Batt

Pat McCloughan

Derek Scully

For
Robert and Geoffrey

Acknowledgements

The main element in this research represents an analysis of a survey of leading independent non-government academic and research economists in Ireland. Indecon would like to acknowledge with thanks the valuable inputs provided by 66 individual economists responding to this survey. The authors would also like to thank other colleagues in Indecon particularly Greg Swinand, Conor O'Toole, Shane Garret, Carol Harold, Martina Hodacova, Niamh Kelly, Finola O'Riordan, Adrian Byrne and Sean Kennedy. Thanks are also due to a number of leading professors of economics who have submitted attributed comments to the analysis. The usual disclaimer applies.

Indecon Public Policy Series

The Indecon Public Policy Initiative includes the publication of books, articles and papers on leading policy issues. The research in this publication was undertaken by Indecon and was not commissioned by any external organisation. The cost of completing this research was met exclusively by Indecon with no outside funding obtained. The publication is part of the non-profit-making Indecon Public Policy Series. Indecon (Ireland) is the largest economic consultancy practice in Ireland and is part of the Indecon International Consultancy Group. All enquiries should be sent to Indecon (Ireland), Indecon House, Fitzwilliam Place, Dublin 2, email mailbox@indecon.ie; phone 01-6777144, fax 01-6777417.

Details re Authors of Analysis

Alan W. Gray is Managing Director of the Indecon International Consultancy Group and also Managing Partner of Indecon (Ireland). Alan holds primary and post-graduate degrees in economics from Trinity College. He has published extensively on economic policy issues and edited the book on International Perspectives on the Irish Economy, which includes contributions from some of the world's leading economists including US Nobel Prize Winners, Kenneth Arrow and Paul Krugman. He has undertaken major economic assignments in Ireland, the UK, Europe and North America. He is currently Chairman of London Economics and is also a Director of a number of companies including Tedcastle Holdings and Origin Enterprises Plc. Alan directed the review of tax incentives in October 2005 which recommended the abolition of a wide range of property based tax incentives and which was reflected in changes in the 2006 Budget.

William H. Batt is a Divisional Director with Indecon's Strategy and Policy practice. Prior to joining Indecon, William worked as international economist with Oxford Economics, where he provided sectoral consultancy advice to leading multinational firms and government departments. He was previously an economist with Cambridge Econometrics. He has extensive experience in advising on economic and policy issues in Ireland and internationally. William completed his undergraduate studies in economics at University College Dublin and his postgraduate studies at the University of Cambridge.

Pat McCloughan is a Divisional Director with Indecon. Dr McCloughan has almost 20 years' experience as an economist and joined Indecon from the University of Liverpool, where he was Director of Undergraduate Studies in the Department of Economics and Accounting. Pat's academic qualifications include first class honours MA in Economics (NUIG) and a PhD in Economics from the University of East Anglia (UEA), Norwich, UK. Pat has directed a number of Indecon sectoral review assignments and his wide policy-oriented consultancy expertise gained in Ireland and abroad includes the application of quantitative techniques to policy issues. Pat has published extensively on a wide range of economic issues.

Derek Scully is a Senior Economic Consultant with Indecon. Derek holds an undergraduate and a first class honors MA degree in economics from UCD. Prior to joining Indecon, Derek was a member of the Department of Economics at UCD where he lectured on a number of economic topics to students within the department and to postgraduate students in the Smurfit Graduate School of Business, UCD. Since joining Indecon, Derek has worked with Indecon's policy team on a number of projects in Ireland and in UK.

Introduction

This report represents an independent analysis of the economic impacts of Ireland's forthcoming decision in relation to the Lisbon Treaty. Specifically, it represents the views of leading independent, non-government academic and research economists in Ireland on the economic implications of Ireland's vote on the Lisbon Treaty. It is important to note that the main counterfactuals relate to the likely impacts arising from an acceptance or rejection by Ireland of the Lisbon Treaty. This may differ from the impact of a position whereby the Lisbon Treaty was never proposed. As a result, some economists believe that a 'Yes' vote might not dramatically improve the prospects for the Irish economy but as one Irish economist suggested to the survey, "a No vote would have very negative consequences compared to the status quo". It is also important to note that the views expressed in this document and in the survey are confined only to economic issues and do not deal with any issues which may or may not arise in other areas such as security, defence, human rights or other issues.

What Economists were Surveyed

The survey results represent the opinions of 66 leading economists who are engaged in research or academic work in nine of the main centres of independent economic analysis in Ireland. Specifically, economists in the economics departments of the following organisations were surveyed:

- Trinity College, University of Dublin
- University College Dublin
- The Economic and Social Research Institute
- Indecon Economic Consultants
- National University of Ireland, Galway
- University College Cork
- NUI, Maynooth
- Dublin City University
- University of Limerick

Economists Not Included in the Survey

Economists working in the media or in banks or other financial institutions were not included. Economists working in government departments or agencies or in employer or trade union organisations were also not included in the survey. While many excellent economists work in these organisations, it was felt useful on this occasion to outline the views of independent non-government research and academic economists.

Securing Ireland's Overall Economic Interests

The Lisbon Treaty involves a series of complex changes to the Treaty on European Union and the Treaty of Rome establishing the European Community. One issue of importance in any consideration of Ireland's vote on the Lisbon Treaty is what impact this is likely to have on Ireland's overall economic interests.

There are a range of factors relevant to this assessment including the following:

- Consequences, if any, of efforts by Ireland to expand and diversify its exports;
- Potential impact on foreign direct investment;
- Consequences for confidence in the Irish economy;
- Cost of Irish borrowing;
- Impact on Ireland's relationships within the EU;
- Reputation of Ireland as a committed member of the European Union;
- Impact of Lisbon Treaty on the delivery of solutions to the economic challenges facing Europe;
- Position of Ireland's corporate tax rate;
- Impact of the expansion of the scope of the Commission's commercial policy;
- Effectiveness of EU decision making; and
- EU agreement on decisions with budgetary implications.

In the table overleaf we outline the views of the leading economists surveyed on how Ireland's overall economic interests are likely to be affected by the vote on the Lisbon Treaty. The findings indicate that 91% of the economists surveyed believed that, taking all factors into account, Ireland's overall economic interests would be best served by a 'Yes' vote. The factors influencing this evaluation are discussed in subsequent sections.

Taking all factors into consideration, in your opinion, how are Ireland's overall economic interests likely to be best secured in the forthcoming referendum?

	Response Percent
Best secured by a 'Yes' vote	**90.8%**
Best secured by a 'No' vote	9.2%

Source: *Indecon analysis of the views of 66 leading independent non-government economists*

The potential significance of the Irish vote on the Lisbon Treaty for Irish economic prospects is an aspect on which the vast majority of the leading academic and research economists held strong views and this is reflected in the fact that over 90% of the economists surveyed were of the view that Ireland's best interests would be secured by a 'Yes' vote.

This view is illustrated by the comments from Professor John O'Hagan of Trinity College, as outlined in the box below.

"Ratification of the Lisbon Treaty is in my opinion critical to the well-being of the Irish economy and indeed the wider Irish society. Is it only by acting through the EU that we can influence so many things over which we have limited if any control, such as environmental damage, threats to supply of energy sources and raw materials, terrorism, illegal trade in goods and people and establishing the 'rules of the game' for orderly trade, international banking, and competition. The Lisbon Treaty in my opinion makes the EU more effective in this respect in three main ways. First, it will lead to a much more streamlined decision-making process on Pillar 1 issues. Second, it will greatly enhance the 'clout' and image of the EU on the World Stage. Last, it will partly address the democratic deficit issue by giving more powers to the European Parliament and more say to National Parliaments. All of this will lead to a stronger EU, from which Ireland can only benefit in my view, economically and otherwise. A ringing endorsement of the Treaty will ensure Ireland's commitment to this project and greatly enhance its reputation and influence in the international financial and investment community and in the corridors of political power in the EU".

Professor John O'Hagan, Trinity College, University of Dublin

Impact on Foreign Direct Investment

Foreign direct investment is particularly important for the Irish economy. As is indicated in the table, the value of sales of foreign-owned, agency-assisted manufacturing and internationally traded services companies amounted to €102.9 billion in 2007. Against this background, it is important to consider the likely impact of Ireland's vote on the Lisbon Treaty for foreign direct investment.

Sales in Foreign-Owned Manufacturing and Internationally Traded Services, 1990 – 2007

	2003 €k	2004 €k	2005 €k	2006 €k	2007 €k
Total – All Sectors	82,462,550	84,814,628	90,470,039	96,740,748	102,920,889
Manufacturing	59,339,868	60,441,591	63,885,624	67,592,251	71,657,479
Food/Drink/Tobacco	5,655,055	5,036,189	5,382,708	5,658,272	5,694,003
Chemicals/Pharmaceuticals	25,361,608	27,203,749	29,082,403	29,124,439	32,905,651
Electrical & Electronic Equipment	18,684,703	18,491,261	19,233,305	23,283,015	22,680,416
Medical Devices/Instruments	5,432,164	5,695,950	6,357,048	5,572,921	6,100,189
All Other Manufacturing	4,206,339	4,014,442	3,830,161	3,953,604	4,277,219
Internationally Traded Services	23,122,681	24,373,037	26,584,414	29,148,498	31,263,411
Software Development	15,595,189	16,949,925	17,716,870	19,761,038	20,727,142
All Other Services	7,527,492	7,423,112	8,867,544	9,387,459	10,536,269

Source: *Forfás Annual Business Survey of Economic Impact 2007*

The determinants of foreign direct investment are complex and influenced by factors such as access to markets, the availability of skills and the cost competitiveness of the Irish economy, and by Ireland's corporate tax rate. Decisions on investments are also influenced by investors' confidence in the Irish economy and this may in turn be influenced by Ireland's decision on the Lisbon Treaty. On the latter issue, a clear majority of independent economists surveyed are of the view that a 'Yes' vote would be likely to facilitate the attraction of FDI.

Please indicate your view on the likely impact of a 'Yes' vote for the Lisbon Treaty on Foreign Direct Investment in Ireland?

	Response Percent
Likely to Facilitate Attraction of FDI	65.2%
No Impact	**31.9%**
Likely to Hinder Attraction of FDI	2.9%

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Ireland is fighting to maintain its share of foreign investment in an increasingly difficult environment and a 'No' vote would be likely to damage Ireland's prospects.

"Ireland's productivity performance is a key determinant of its future economic success and is directly related to the country's success as a location for inward foreign investment, despite the geographic distance from major markets. This has been helped by the effective history of attracting investment and by changes in comparative advantages, including the reduction in the significance of transport costs. There are, however, a wide range of options open to companies in deciding on investment locations. Against this background a 'No' vote by Ireland could reinforce other concerns and would be likely to severely impact negatively on Ireland as an export platform for foreign investment."

Alan Gray, Chairman - London Economics

Expansion and Diversification of Ireland's Exports

As a small open economy, Ireland is one of the most export-dependent countries within the EU. Exports account for 89% of Ireland's GDP and the future success of the Irish economy will be significantly influenced by the performance of the country's internationally traded sector.

In this context, it is relevant to consider whether a 'Yes' vote for the Lisbon Treaty would impact on efforts by Ireland to expand and diversify its exports. There is uncertainty among the economic profession on what impact this would have on exports. Given this uncertainty, 51.5% of economists believe that on balance a 'Yes' vote would be likely not to impact on the expansion and diversification of Irish exports but 47.1% felt it would be likely to have a positive impact on this aspect of the Irish economy.

Please indicate your view on the impact of a 'Yes' vote for the Lisbon Treaty on efforts by Ireland to expand and diversify its exports?

	Response Percent
Likely to have a Positive Impact	47.1%
No Impact	**51.5%**
Likely to have a Negative Impact	1.5%

Source: *Indecon analysis of the views of 66 leading independent non-government economists*

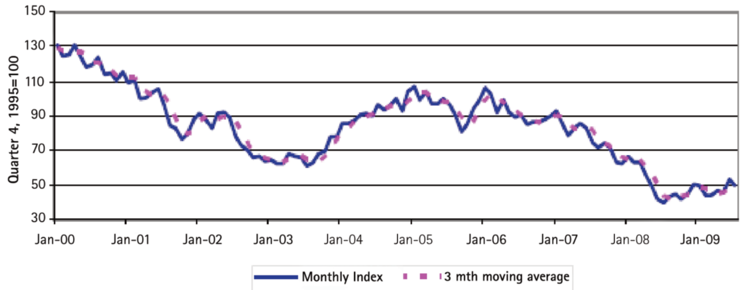
International Confidence in the Irish Economy

Confidence in the Irish economy is a difficult issue to measure and one where the precise impacts are hard to establish. There is, however, little doubt that international confidence in the Irish economy impacts to varying degrees on a range of issues including:

- Attitude to consideration of new foreign direct investment in the Irish economy;
- Cost of public sector borrowing;
- Indirect impact on consumer confidence and the implications for consumer expenditure;
- Perceptions on asset values.

Confidence in the Irish economy has been affected by the extent of the deterioration in the Irish economy and the associated negative international media coverage. This is also evident in consumer sentiment in Ireland. This is reflected in the KBC/ESRI consumer sentiment index. While the overall Irish Consumer Sentiment Index stood at 49.5 in July, compared to a figure for July 2008 of 39.6, the decline since 2000 is evident.

Consumer Sentiment Index



Source: *KBC Bank /ESRI Consumer Sentiment Index*

The views of economists in Ireland on the likely impact of passing the Lisbon Treaty on international confidence in the Irish economy are outlined below. This indicates that 82.1% of economists felt the passing of the Lisbon Treaty would be likely to help develop confidence in the Irish economy. No economist surveyed felt this would hinder confidence.

Please indicate your view on the likely impact of passing of the Lisbon Treaty in Ireland on international confidence in the Irish economy?

	Response Percent
Likely to Help Develop Confidence in the Irish Economy	**82.1%**
No Impact	17.9%
Likely to Hinder Development of Confidence in the Irish Economy	0.0%

Source: *Indecon analysis of the views of 66 leading independent non government economists*

The views of economists of the economic impact of the Lisbon vote on confidence in the Irish economy is, in part, a reflection of the changes resulting from economic and financial globalisation. This is illustrated by the views of Professor Philip Lane overleaf.

"Economic and financial globalisation has fundamentally altered the behaviour of national economies, with the fates of individual countries increasingly bound together. The prosperity promised by globalisation can only be equitably distributed and coupled with economic stability if the global economic and financial systems can be governed and regulated in an effective manner. This increasingly requires a coordinated European-wide approach to major economic policy issues. The Lisbon Treaty will improve the quality of economic governance by the European Union and enhance the democratic underpinnings of global economic governance. Since Ireland is to the forefront of economic globalisation, Ireland will gain disproportionately from these improvements. The current international financial crisis has dramatically illustrated the costs of a non-coordinated approach to economic governance".

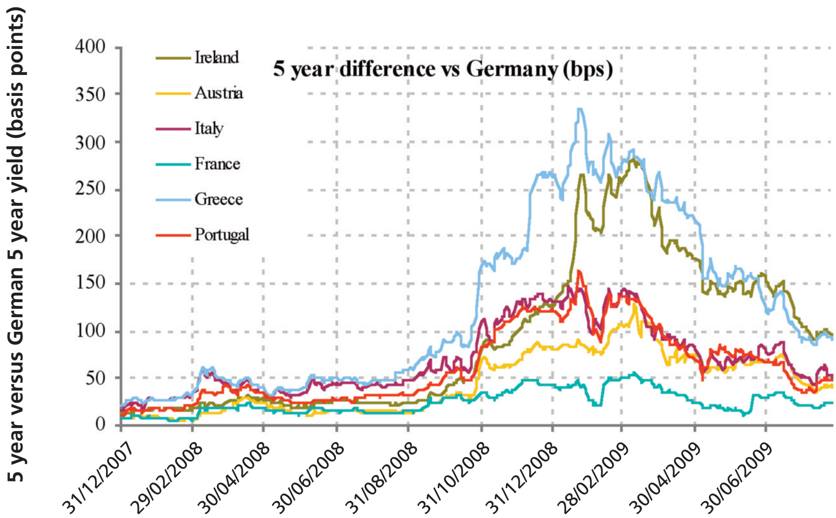
Professor Philip Lane, Trinity College, University of Dublin

Cost of Irish Borrowing

Ireland's general government deficit is expected to be in excess of €18 billion next year and possibly even larger than this. Gross debt is likely to rise to around 75% of GDP by 2010. The scale of Irish borrowing represents a very significant cost for Irish taxpayers and will result in either higher levels of taxation or lower levels of public service provision. In recent years confidence in the Irish economy had resulted in Ireland being able to secure a very competitive cost of borrowing, and Ireland's debt spread was similar to that in Germany.

However, with the economic and banking crisis in Ireland, the fall in international confidence in the Irish economy resulted in Ireland having exceptionally high borrowing costs. Since the onset of the international crisis the yield on 5 and 10 year government bonds in Ireland (relative to Germany) rose very significantly resulting in a higher cost of borrowing faced by the Irish government relative to Germany and some other economies. However, as can be seen from the chart overleaf, the cost of Irish borrowing compared to Germany has declined significantly since mid 2009.

Ireland's Debt Spread Compared to Other Countries
(Yield on Five and Ten Year Government Bonds)



10 year versus German 10 year yield (basis points)

01/01/2008 01/03/2008 01/05/2008 01/07/2008 01/09/2008 01/11/2008 01/01/2009 01/03/2009 01/05/2009 01/07/2009

Source: *Indecon analysis of Bloomberg data*

Ireland's debt spread is fundamentally influenced by medium and long term perceptions of how the Irish economy will perform. The views of leading economists surveyed on this issue are presented in the table below. The results suggest that a majority (53.0%) of economists surveyed believed that the impact of a 'Yes' vote on the Lisbon Treaty in Ireland would help narrow Ireland's debt spread. While 47.0% were of the view that the Lisbon vote would not impact on this issue, no economist felt a 'yes' vote would worsen Ireland's debt spread. A number of Irish economists are concerned about the potential impact of a 'No' vote on the cost of borrowing and of how sentiment towards the Irish economy can impact on this issue. For example, one economist indicated that *"I think the spreads issue is particularly important. I have been surprised by the number of international bond traders commenting to this effect. Given the amount of borrowing we're facing over the next several years, I think this is worth emphasising"*. Indeed the sensitivity of Ireland's debt spread to changes in sentiment is a remarkable feature of recent developments and highlights the vulnerability of the Irish economy to international perceptions.

Please indicate your view on the likely impact of Ireland's vote on the State's debt spread vis-à-vis other countries?

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Impact on Ireland’s Corporate Taxation

The competitiveness of different locations for investment will, in part, be influenced by the level of corporate taxation as this will impact on the net after tax cost of investment.

This will be determined by the rate of corporation tax and the tax rules applying in the home country of the investor. The Irish corporation tax rate is 12.5% for active income and 25% for passive income. Maintaining a competitive corporate tax rate is one element in Ireland’s comparative advantage for foreign investment.

In the previous 2008 referendum, there had been various media and public discussions on the impact, if any, of the Lisbon Treaty on Ireland’s corporate tax position. While those promoting the Treaty argued that the Lisbon Treaty would not impact in any way on Ireland’s corporate tax as setting of taxation levels was exclusively within the competence of individual Member States, there were views expressed to the contrary.

On 19 June 2009 the Heads of State or Government of the 27 Member States of the European Union provided legal guarantee that certain matters will be unaffected by the entry into force of the Lisbon Treaty.

Among those matters was taxation, and it was agreed that “Nothing in the Treaty of Lisbon makes any change of any kind, for any Member State, to the extent or operation of the competence of the European Union in relation to taxation”. This development is reflected in the views of economists where the results indicate that 87.5% indicated that ratification of the Lisbon Treaty would not result in imposed changes in Ireland’s corporate tax rate.

Please indicate your view on the likely impact of ratification of the Lisbon Treaty on Ireland's corporate tax rate

Source: *Indecon analysis of the views of 66 leading independent non government economists.*

Relationships Within the EU

Ireland's relationships with other EU Governments and other parties within the EU will undoubtedly have consequences for a range of policy and other decisions affecting Ireland. While it is of course a matter of judgement what impact a 'Yes' vote in the Lisbon Treaty will have on such relationship, most economists surveyed believe that it will significantly assist the management of Ireland's relationship within the EU.

Please indicate your view on the potential impact of a 'Yes' vote on the Lisbon Treaty for Ireland's relationship with other EU Governments and other parties within the EU. A 'Yes' vote would:

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Ireland's Reputation

Some of the available evidence suggests that Ireland's reputation as a committed member of the European Union has suffered in recent times as a result of Ireland's 'No' vote. It is also clear that Ireland's economic reputation has been impacted by the dramatic reversal of Ireland's economic growth, combined with the banking crisis and the deterioration of Ireland's public finances. While it would be a mistake to believe that Ireland's economic reputation will not be significantly influenced by the effectiveness of policy decisions and by the overall performance of the economy, one element of Ireland's international reputation is whether the country is perceived as a committed member of the European Union.

Most economists surveyed believe that a 'Yes' vote would significantly enhance Ireland's reputation as a committed member of the European Union.

Please indicate your view on the potential impact of a 'Yes' vote on Ireland's reputation as a committed member of the European Union?

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Delivery of Economic Solutions

The Lisbon Treaty represents a new Treaty which, if passed, would amend the Treaty on European Union. It was signed by the Heads of Government or Heads of State of the twenty-seven Member States of the European Union but requires ratification by all Member States.

Supporters of the Treaty have argued that it is designed to reform the working of the European Union to enable the Union to respond to current needs of the 27 Member States.

While few economists, if any, would suggest that the Lisbon Treaty on its own would be central to solving all the economic challenges, the issue is whether it would help or hinder the delivery of solutions to the economic challenges facing Europe.

While some economists surveyed felt it would not impact on the solutions, a majority, 58%, felt it could help deliver solutions.

Please indicate your view on the potential impact which the passing of the Lisbon Treaty would have on the delivery of solutions to the economic challenges facing Europe?

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Expansion of Common Commercial Policy

The Common Commercial Policy, which is the European Union's international trade policy, is one of the small number of areas of exclusive competence or responsibility for the European Commission. This is of key importance to the European Union's negotiations on international trade. One change arising from the Lisbon Treaty which has not been given much debate in Ireland concerns the expansion of the scope of the Common Commercial Policy to include explicit reference to outward foreign direct investment. Outward investment is increasingly important to European countries including Ireland.

It is, however, important to stress that the Lisbon Treaty requires the Commercial Policy to act unanimously in areas of trade in services, intellectual property and foreign direct investment where the negotiations cover issues for which unanimity is required internally.

A majority (63.9%) of economists surveyed felt that the expansion of the scope of the CCP would have a positive impact on EU trade and foreign investment.

Please indicate your view on the impact of the expansion of the scope of the Common Commercial Policy as a result of the Lisbon Treaty (which is the EU international trade policy) on EU trade and foreign investment

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Effectiveness of EU Decision Making

The Lisbon Treaty represents the combined views of EU governments on how to reform the management and operation of European Union in order to reflect the expansion of the Community to 27 Member States and the increasing economic and other complexities.

While not a specific Irish issue, an important factor influencing the economic consequences for Ireland of the Lisbon Treaty is whether it would improve decision making processes within the EU. Most of the Irish economists surveyed judged that the likely impact of changes in the Lisbon Treaty would be to improve decision making processes within the EU.

Please indicate your views on the likely impact of the changes in the Lisbon Treaty on the effectiveness of decision-making processes within the EU

Source: *Indecon analysis of the views of 66 leading independent non government economists*

The potential impact of the Lisbon Treaty on the efficiency of the European Union is highlighted in the views below from Professor Michael Cuddy.

> *"I believe the European Union has been good for Ireland in the past, both socially and economically, and will be central to our economic recovery and future prospects. I am convinced that Ireland should be at the very heart of the European Union project and not out on the periphery of its decision making. I am convinced that the Lisbon treaty is primarily a set of proposals, procedures and protocols, which will enable an extended European Union to work more efficiently in all of our interests".*
>
> **Professor Michael Cuddy**, National University of Ireland, Galway

EU Decisions with Budgetary Implications

The Lisbon Treaty included a number of innovations in relation to the European Union finances which are detailed in Article 312. Among the important changes are the provision for the first time in the Treaty of multi-annual financial planning, which gives a basis to existing practice.

The Treaty also sets out principles of financial planning including that there can be no agreement on new measures with significant budgetary implications unless funding is available within the limit of the Union's own resources and is in compliance with multi-annual financial framework. 63.3% of economists surveyed believed that this was likely to have a positive economic and financial impact.

Please indicate your view on the likely impact of the new principle in that there can be no EU agreement on new measures with significant budgetary implications unless funding is available within the limits of the European Union's own resources and is in compliance with multi-annual financial framework

Source: *Indecon analysis of the views of 66 leading independent non government economists*

Conclusion

The forthcoming decision of the Irish people in the referendum on the Lisbon Treaty will undoubtedly have economic implications for Ireland.

There is an overwhelming agreement among the leading independent non-government economists surveyed that taking all factors into consideration, Ireland's overall economic interests are likely to be best secured by a 'Yes' vote.

While the Lisbon Treaty may only have a minor impact on certain economic issues, it is believed that it would fundamentally impact on a range of key issues including the facilitation of foreign investment and international confidence in the economy. These are important requirements for a small open economy like Ireland's.