

A half a century of managing the Irish economy

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Introduction

- How policy has influenced events
 - Did policy make things better or worse?
 - Where policy failed:
 - Was it because the economics was faulty?
 - Was it because policy-makers were blind?
- Fiscal, monetary and supply side policy
- Lessons from past half century
- The path to recovery

Questions on Fiscal Policy

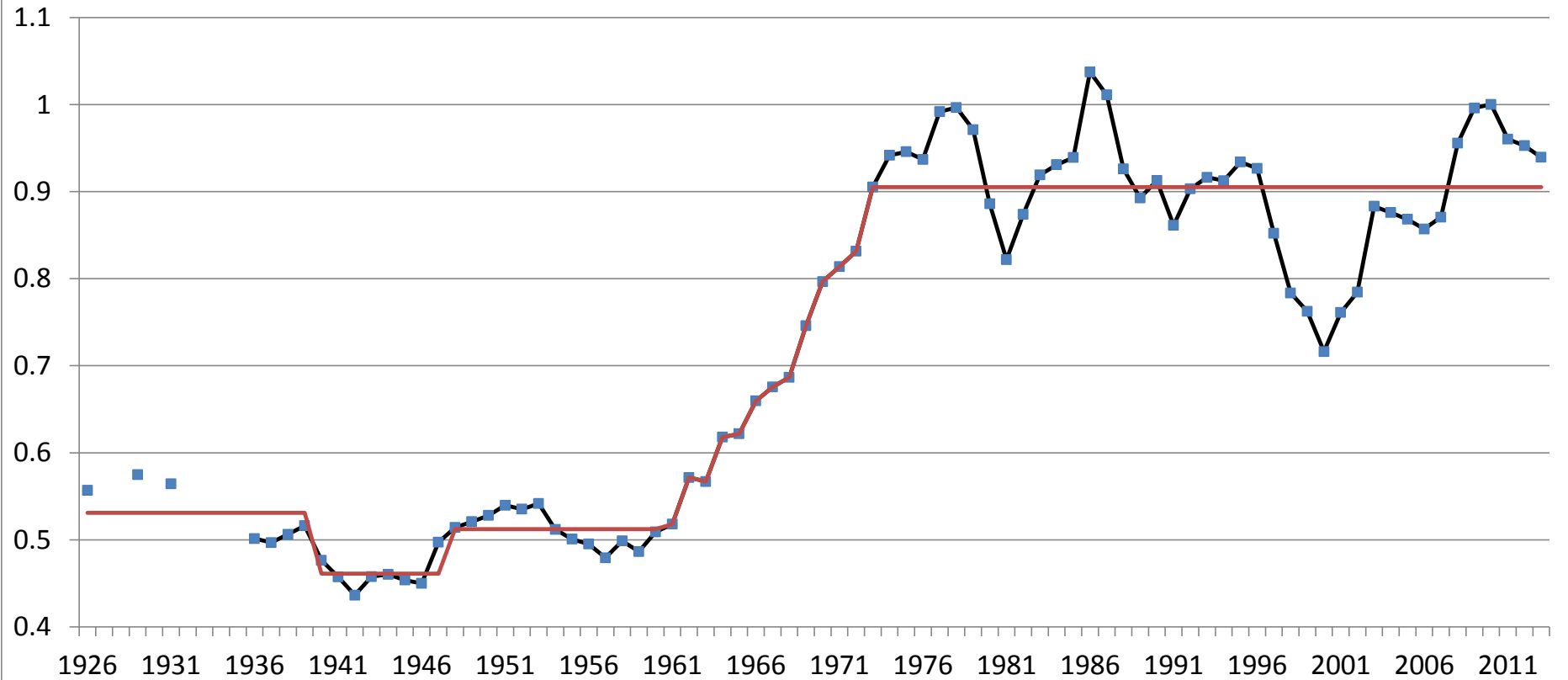
- Mistakes:
 - What was wrong?
 - Why was it wrong?
 - How much damage did it do?
- Fiscal Medicine
 - How much adjustment
 - How fast to adjust
 - Instruments to adjust

The Economic Story

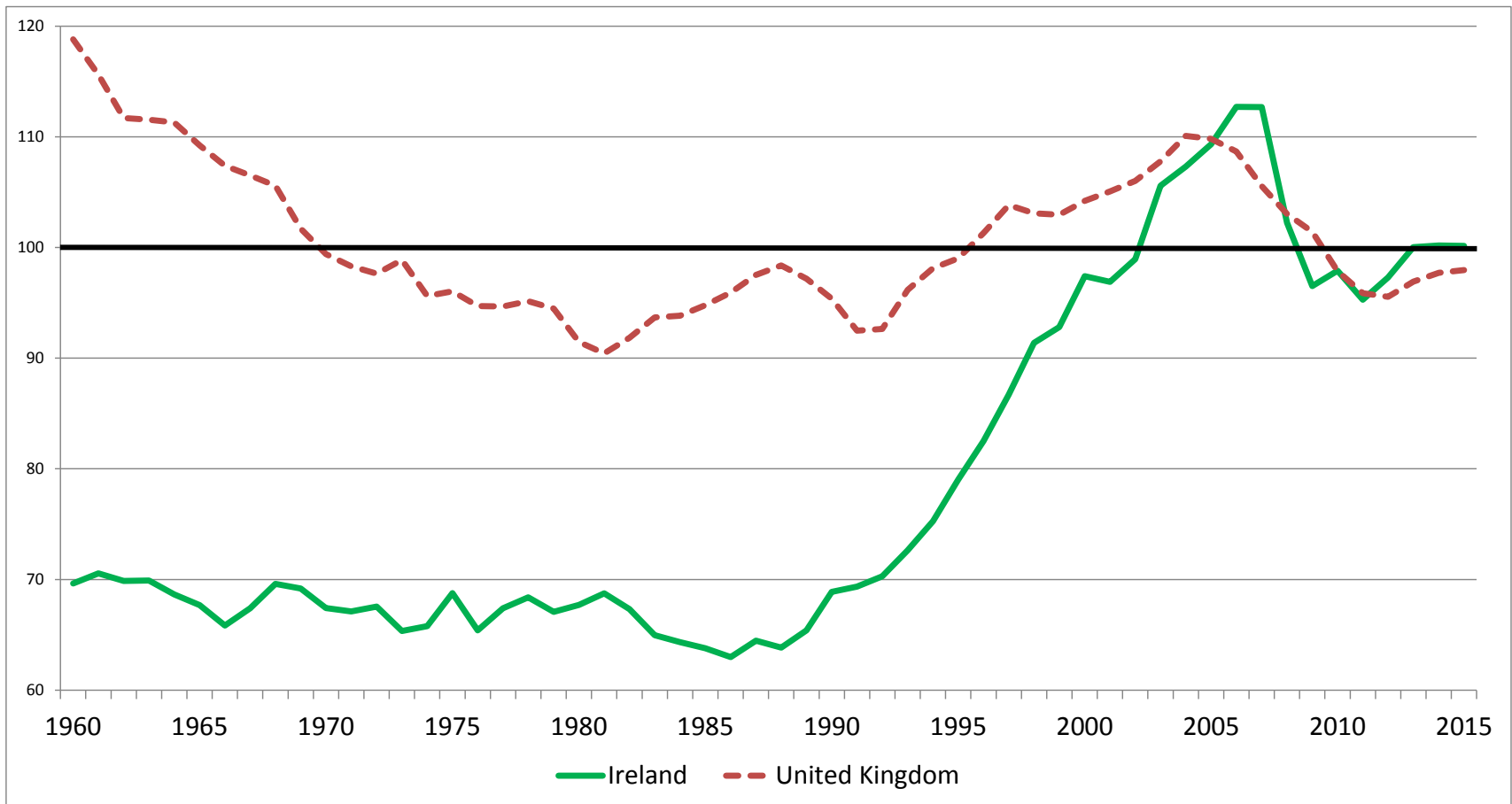
- How did Ireland manage to fail for so long
- Success only after 70 years of failure
- Consequences of failure took time to sink in
 - 1950s – Commission on Emigration
 - Economic Development, 1957
 - Investment in Education report - 1966
- Success based on EU membership
 - Developing an open economy
- Belated convergence in living standards

Ireland v UK, Wage Rates

Wage Rates, Manufacturing: Ireland relative to UK



GDP per head v EU 15



Ireland – GNP, GDP adjusted for PPS for others

Long-term Drivers of Convergence

- Demographic Change
- Structural Policies affecting supply side:
 - Free Trade
 - Investment in education
- Decades of failure before success

Economic Effects of EU Membership

- Sinn Féin: closed economy policy ended 1960
- Income effect 1972/3 – farming
- FDI – for an EU market
 - Denmark and Finland had a different model.
- Structural funds: a help, not the main story
- EU Single Market especially important
 - Platform for developing an open economy

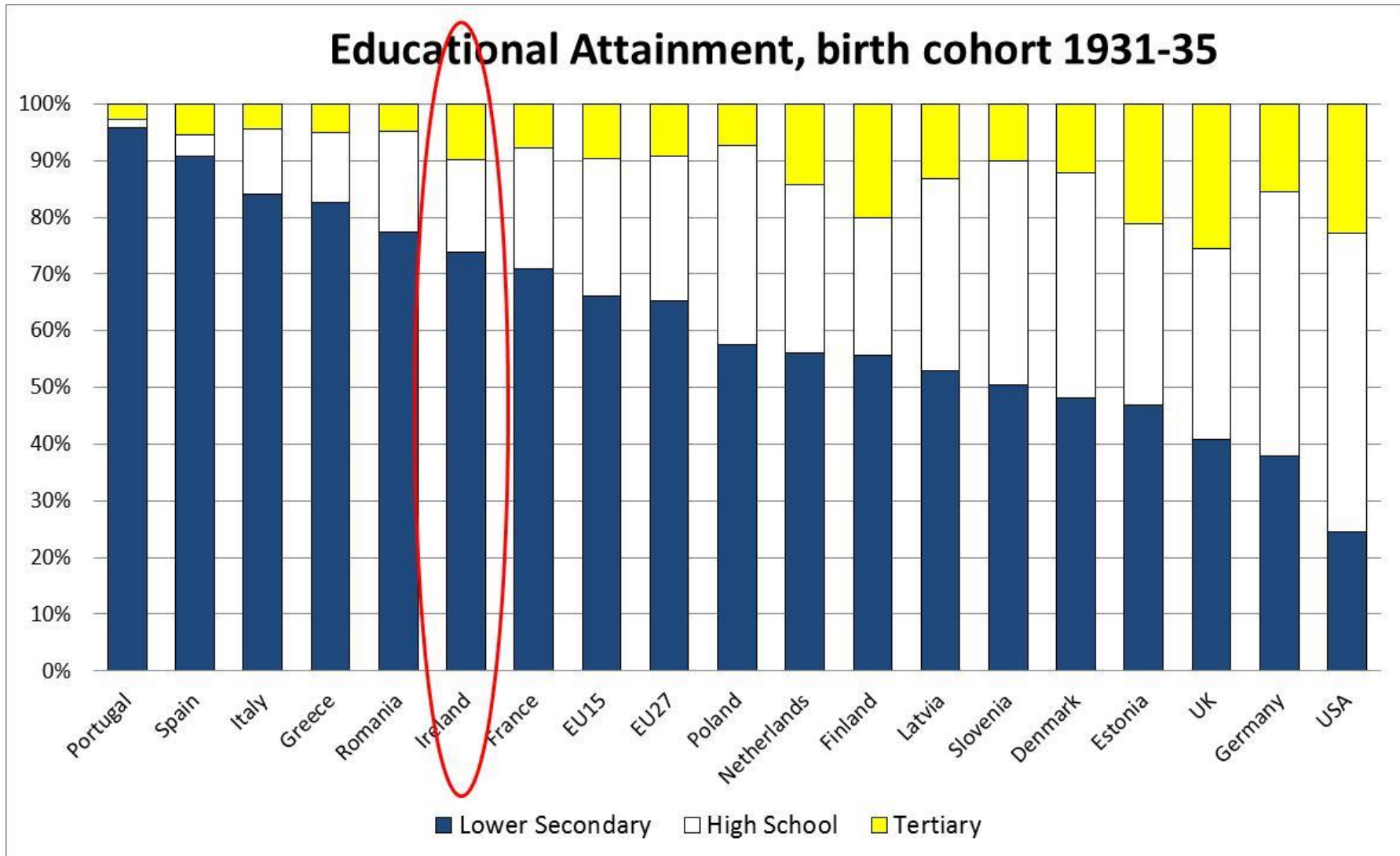
The EU Single Market

- Before 1992/3 some sectors did not prosper
- Single Market
 - Public procurement freed up
 - Single market in services
- Now:
 - medical devices, telecommunications equipment, pharmaceuticals, financial services etc.

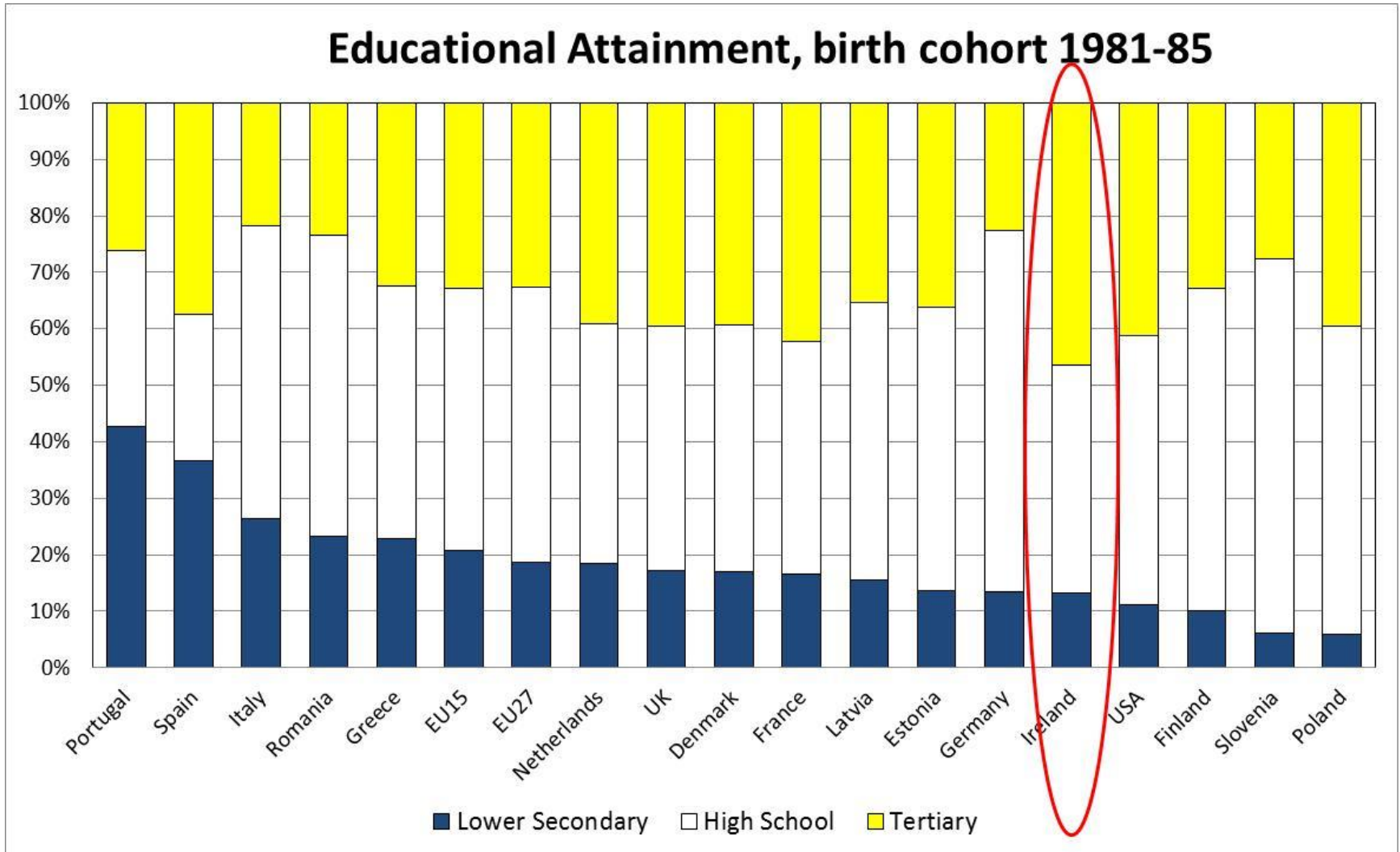
Education

- Affects economy through three channels:
 - Increases productivity: labour demand
 - Increases participation: labour supply
 - Increases employability & reduces unemployment
 - Durkan, Fitzgerald and Harmon, 1999
 - 20% of growth 1960-92
 - Bergin & Kearney, 2007

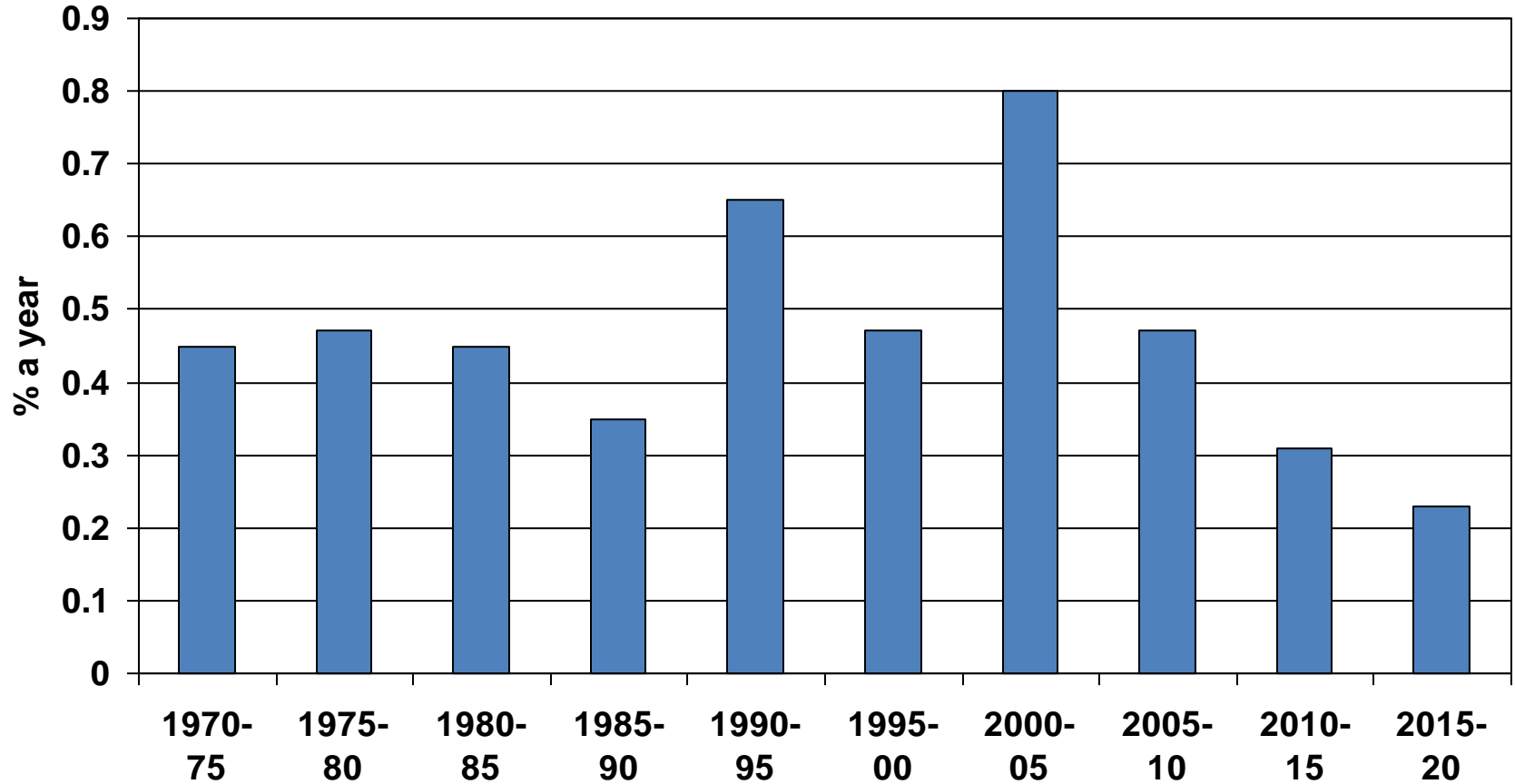
Education – cohort of 1931-5



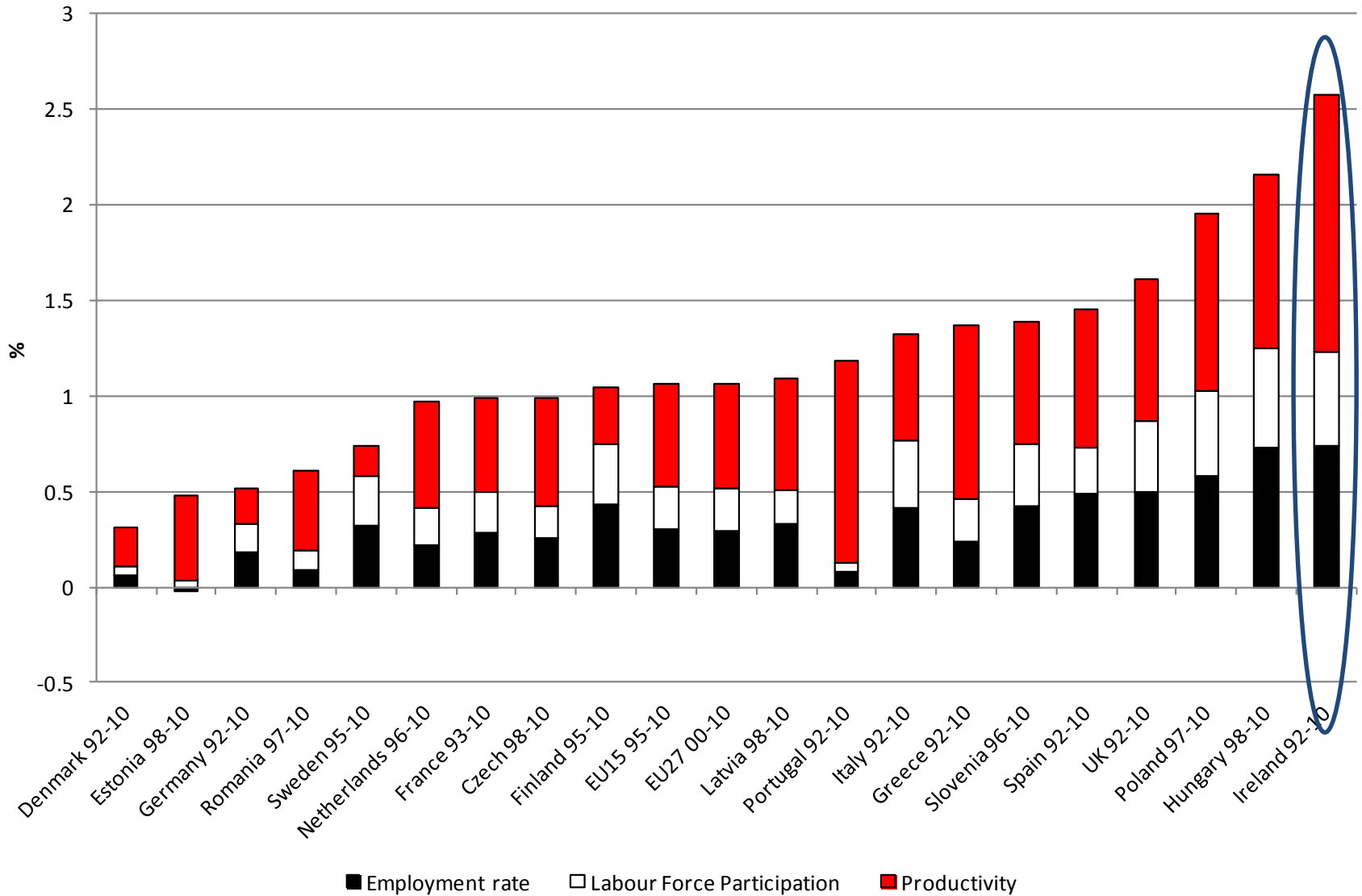
Education – cohort of 1981-5



Growth in Human Capital Index

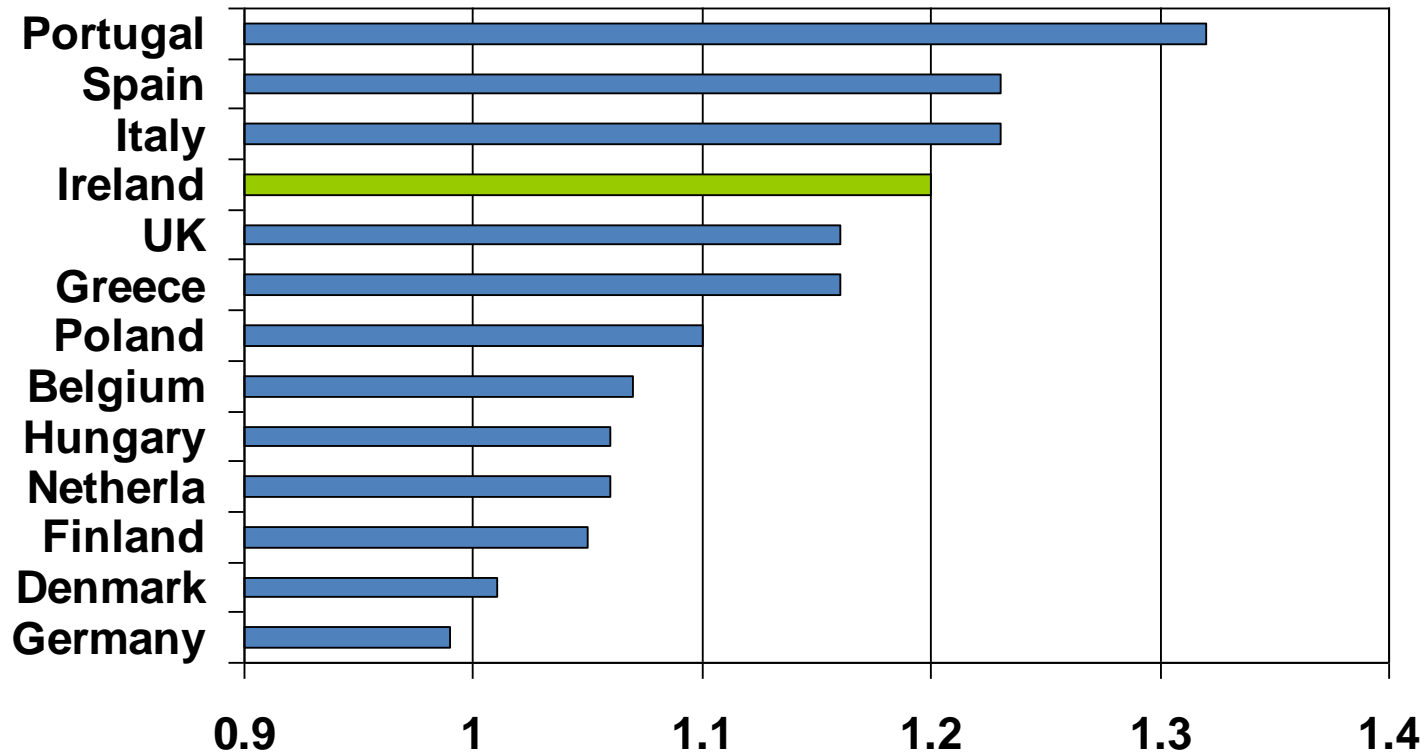


Contribution of Rising Educational Attainment to Growth, annual average



Investment in Human Capital

Ratio of Human Capital Index for 25-29s / 55-59s



Policy Failures & Successes

- 1970s Inflation
- 1977-81 Fiscal stimulus
- 1983-90 Fiscal adjustment
- 1990s Structural Funds
- Monetary policy and the economy 1986-92
- 2000-08 Uncontrolled boom
- 2009-13 Managing the bust
- 2014- Path to Recovery

The 1970s - Inflation

- 1974 White Paper
 - concentrated on controlling costs
 - Food subsidies 1975
- Research 1974-6
 - Highlights exchange rate
 - Decision to revalue against sterling 1976
 - Not implemented, but influenced future policy
 - EMS, EMU

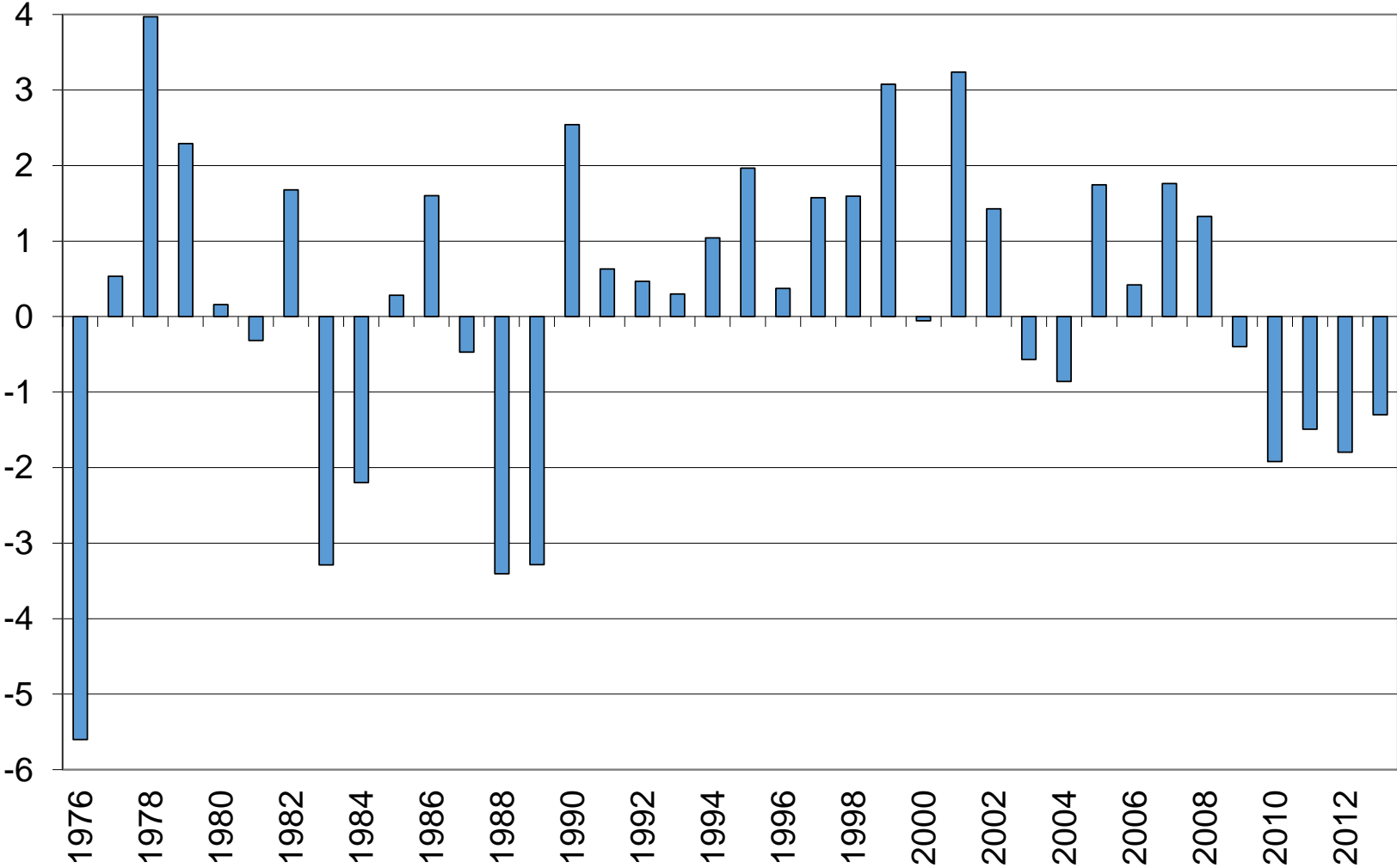


1977-1981 Fiscal Stimulus

- Election promises – major tax cuts
- Little media or independent assessment
- Economic comment 1978 identified danger
- Borrowing & debt rise but low interest rates
- There was a “black hole” which was not seen
 - Things were even worse than they looked
- Then....

Fiscal Policy

Incremental Measure of Fiscal Stance
(% of GNP +ve expansionary -ve contractionary)

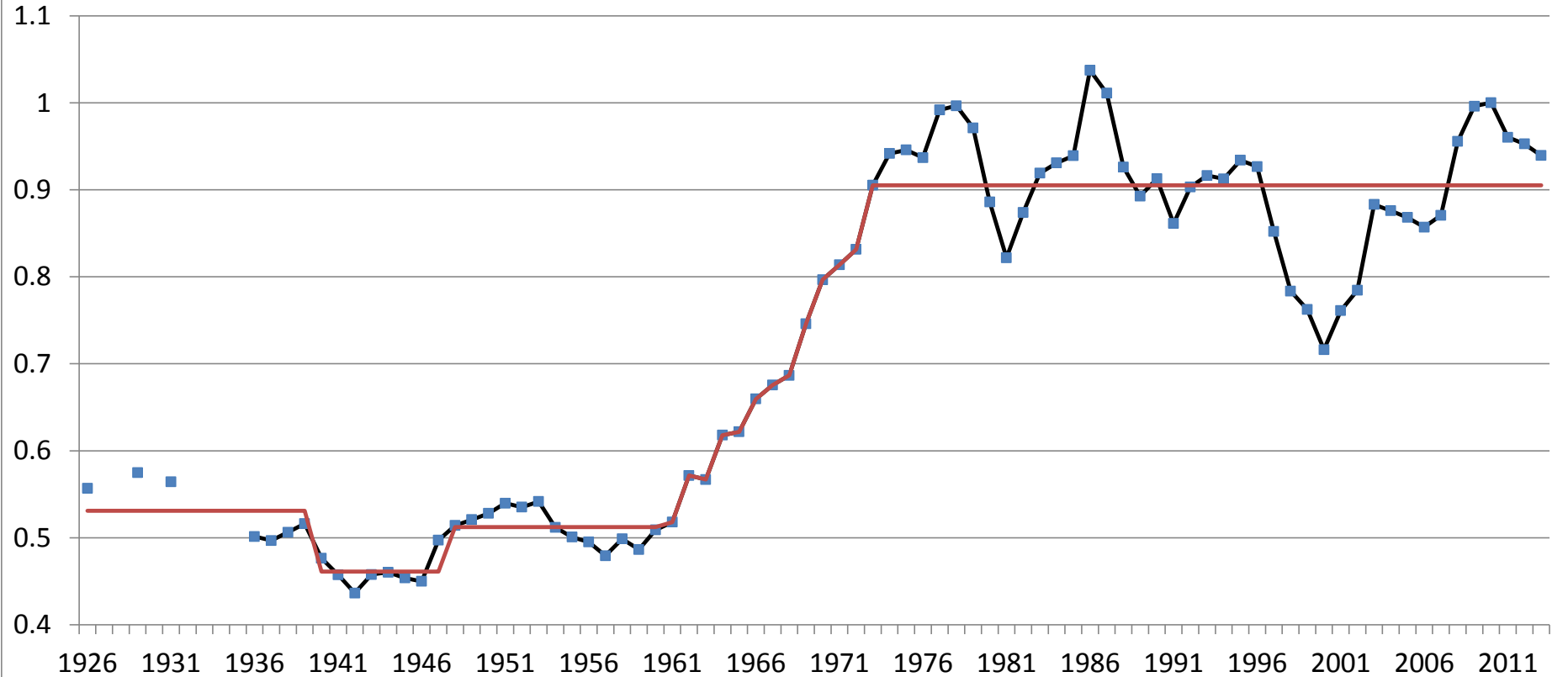


1980s Fiscal Adjustment

- Problems tackled 1983-4
 - Too much reliance on tax and not enough on cuts
 - Delayed adjustment
 - 1985-6 eased off – too early
- 1987-9 adjustment completed
 - More reliance on expenditure cuts
- Lessons?
 - Get it over with faster
 - More on expenditure than taxation
- German unification & German monetary policy
 - Delayed the Celtic Tiger which was purring 1989-90
- Left economy very competitive and ready to grow in 1990s

Ireland v UK, Wage Rates

Wage Rates, Manufacturing: Ireland relative to UK



1990s Structural Funds

- More emphasis on human capital
- Prioritisation of projects
- Not politicised: continuity across governments
- Reasonable value up to end of 1990s
- Initially targeted obstacles for business
 - E.g. roads and ports to export
- By end of 1990s obstacle: social infrastructure
 - Problems of commuting, housing etc.

EMU

- EMU was the right answer
 - A pity that certain flaws were not identified
 - A pity that government's did not understand it!
 - A pity about Irish government policy
- Also crises in US, UK, Estonia, Latvia etc.
- Comparing EMU and non-EMU countries
 - No difference in bad policies and bubbles
- Comparing EMU and non-EMU countries
 - Much more support for problem countries in EMU

Managing the 2000s boom

- From 2001 economy began to move too fast
 - Turning point probably 2003
- Monetary policy
 - Not able to manage property boom
- Fiscal policy – the answer
 - Run an increasing surplus to take steam out
 - Make housing more expensive to reduce demand
 - Irish housing supply squeezed rest of economy
- Banking regulation – non-existent
- Either or both fiscal policy or regulation could have worked
- Economic advice concentrated on fiscal policy.
- Lack of attention to financial economics and regulation

Restoring Order – 2009-2015

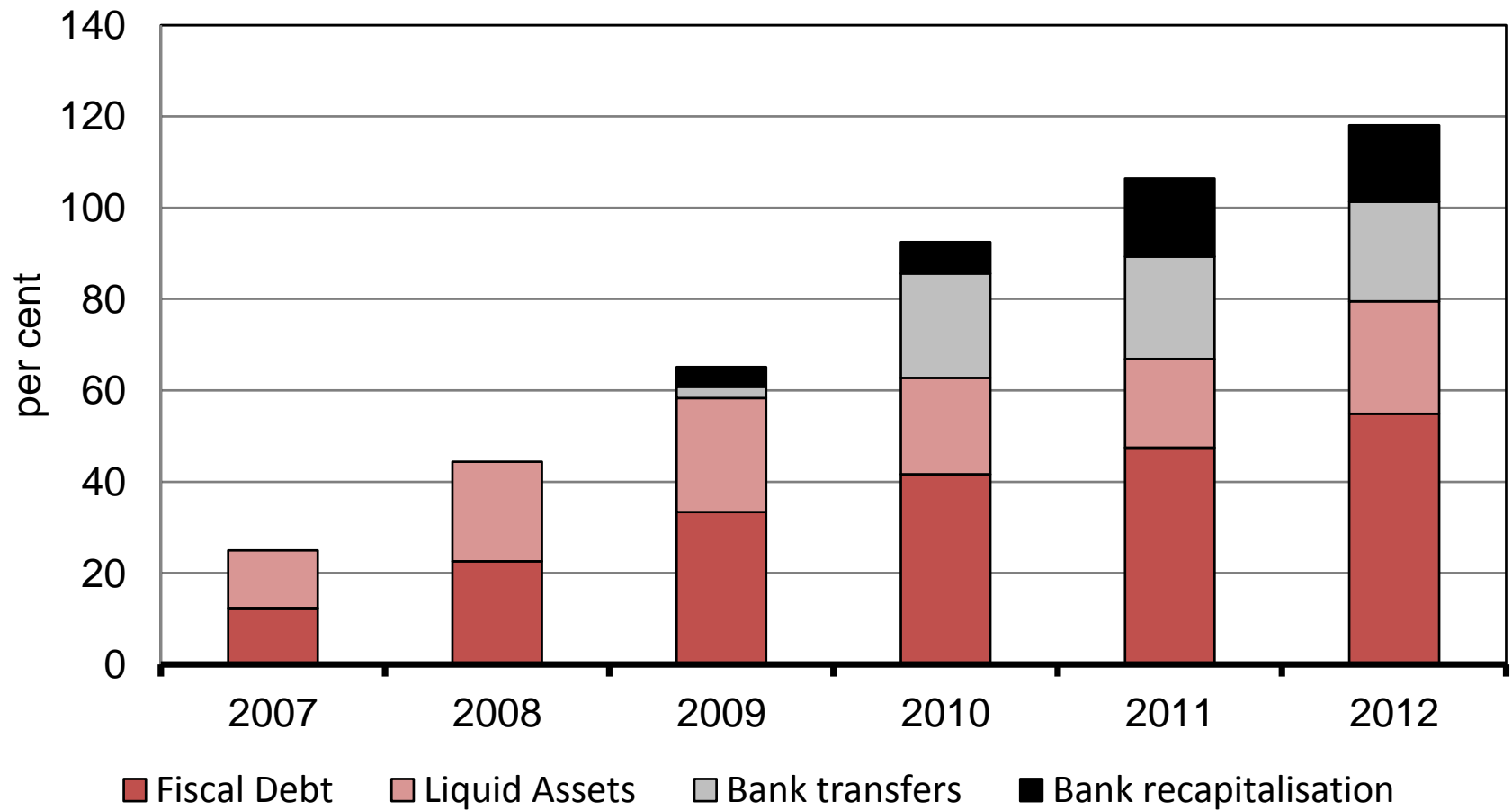
- Size of banking problem underestimated
 - Only clear from autumn 2010
- There was a huge hole in the public finances
 - Also a massive increase in welfare expenditure
- c. €30 billion of cuts
 - €9 billion to increase welfare expenditure
 - €1 billion to pay for interest on banking debt
 - €20 billion to plug the hole in the public finances

Government Transfers as % of GDP

									Change
	2007	2008	2009	2010	2011	2012	2013		2007-2011
Germany	16.0	15.8	17.4	16.7	15.7	15.6	15.7		-0.3
France	17.4	17.6	19.2	19.2	19.1	19.5	19.9		1.7
Netherlands	9.7	9.7	10.7	11.0	11.1	11.5	11.9		1.4
UK	12.1	12.6	14.3	14.2	14.2	14.6	14.5		2.1
Ireland	11.5	13.8	17.7	17.6	17.5	17.5	16.3		6.0
Greece	14.6	16.1	17.6	17.8	19.3	19.8	18.5		4.7
Spain	11.5	12.3	14.4	15.1	15.3	16.0	16.3		3.8
Portugal	14.1	14.6	16.4	16.4	17.0	17.5	18.4		2.9

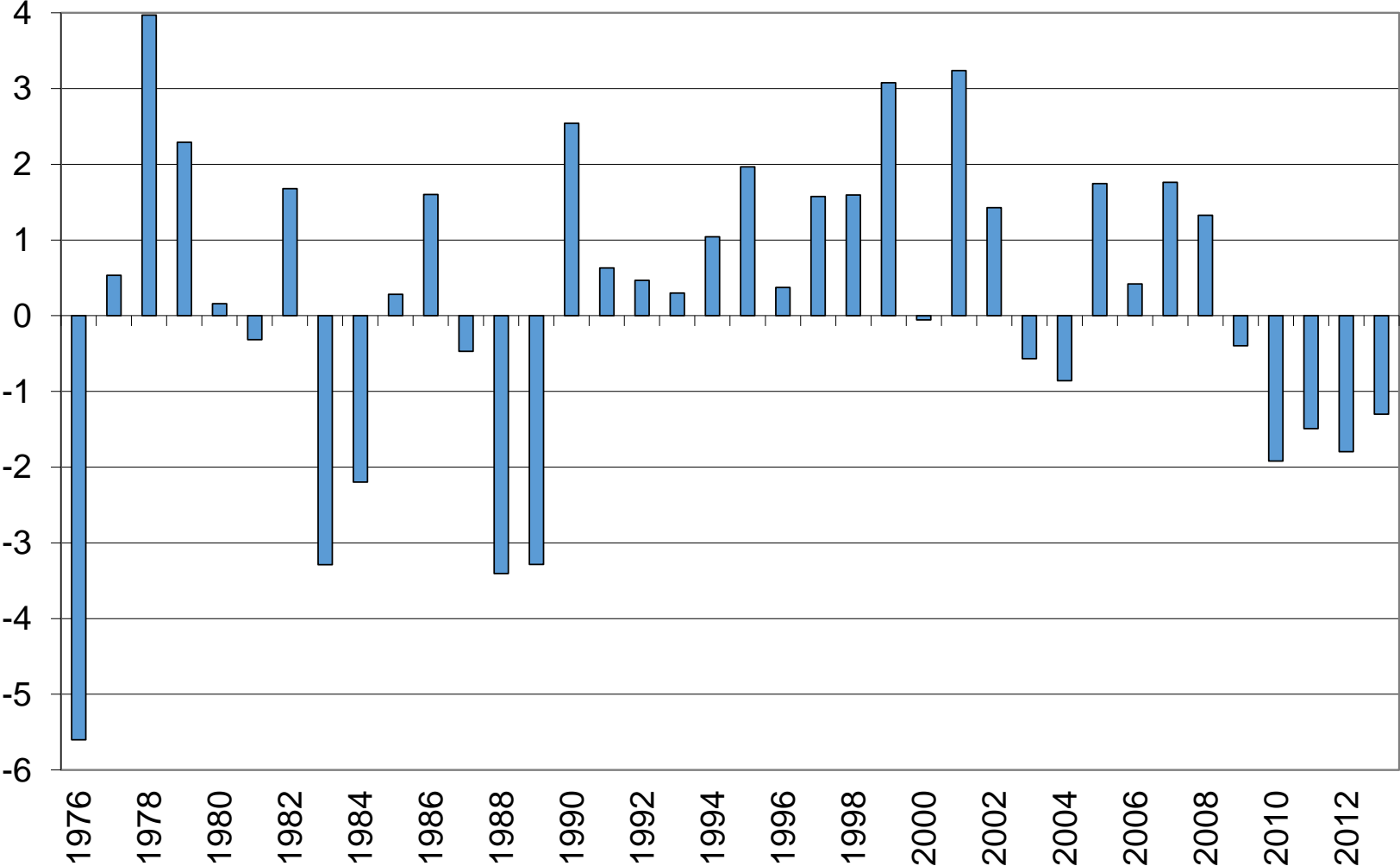
Source: EU AMECO database. GNP is used for Ireland, not GDP.

National Debt, Gross, % of GDP

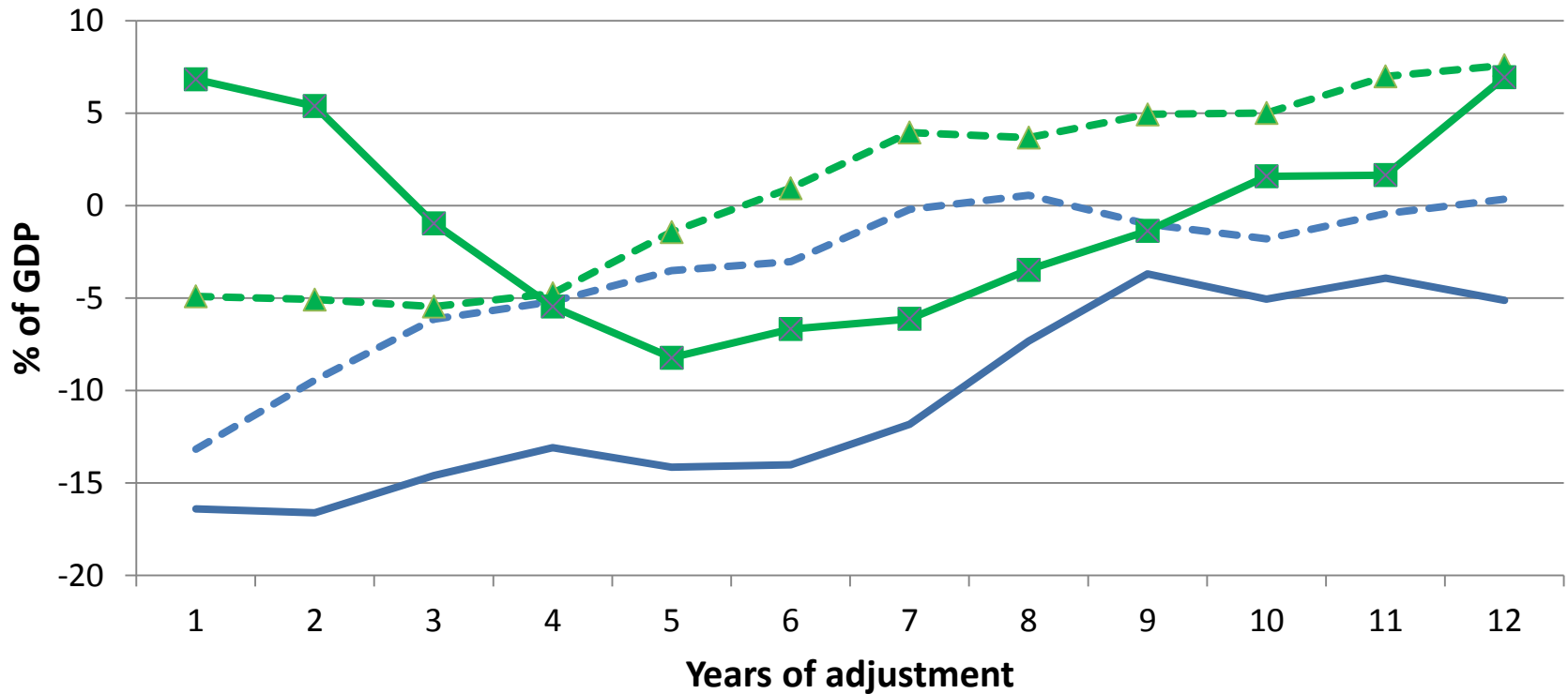


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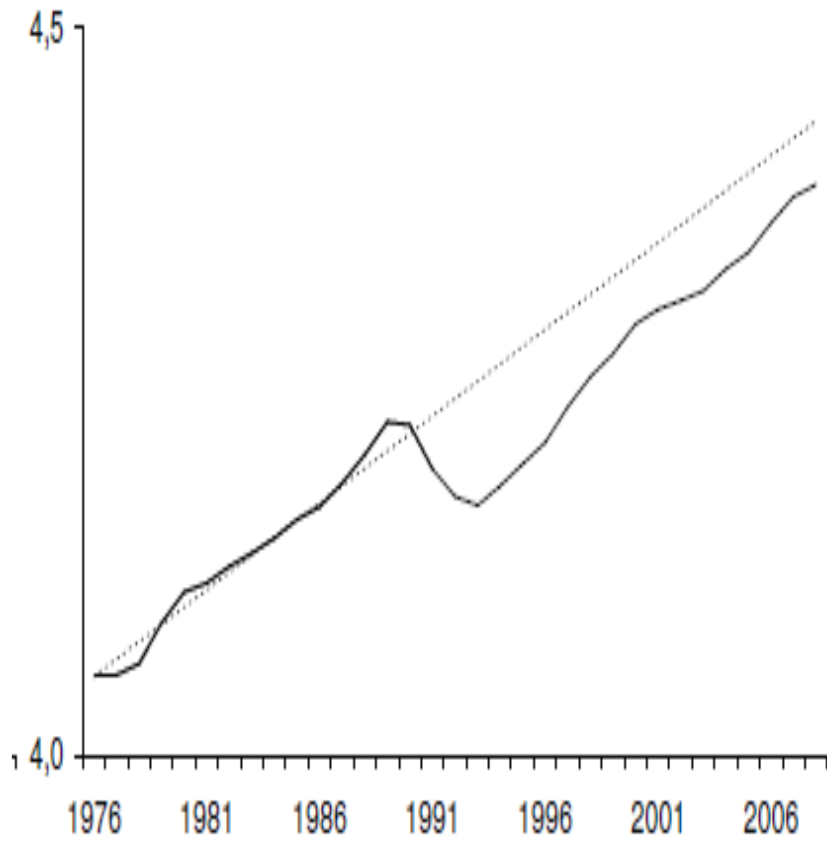
Ireland 1980s, Finland 1990s



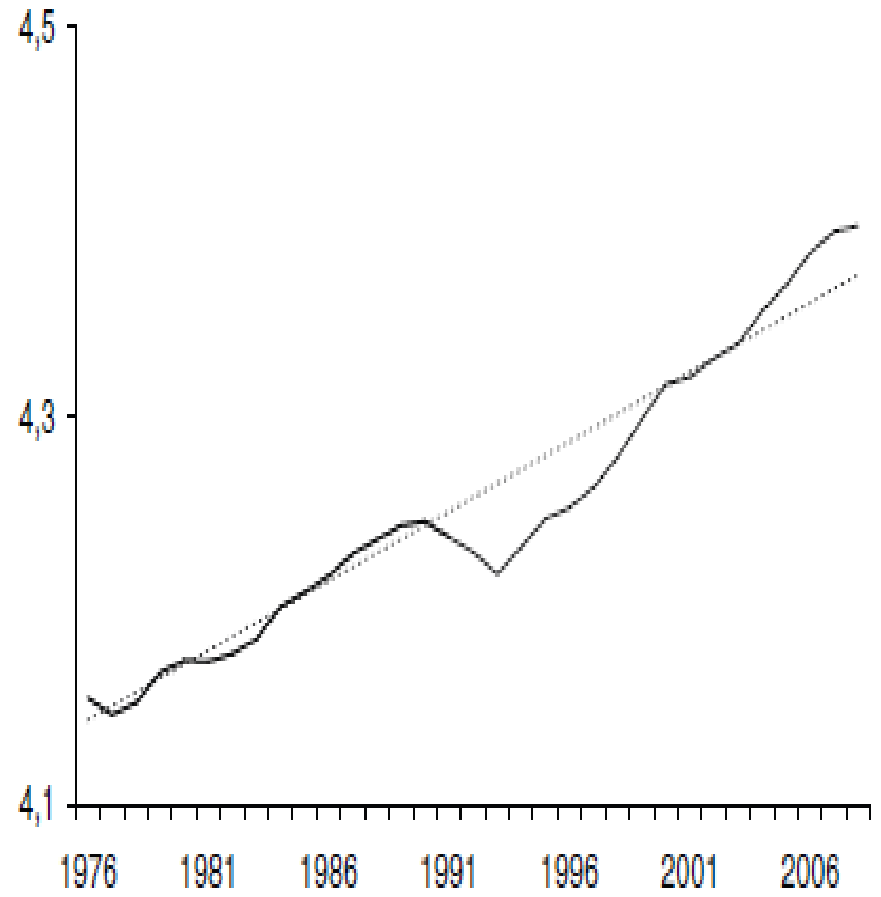
--- Ireland Current Account
-▲- Finland Current Account

— Ireland Government Borrowing
-■- Finland Government Borrowing

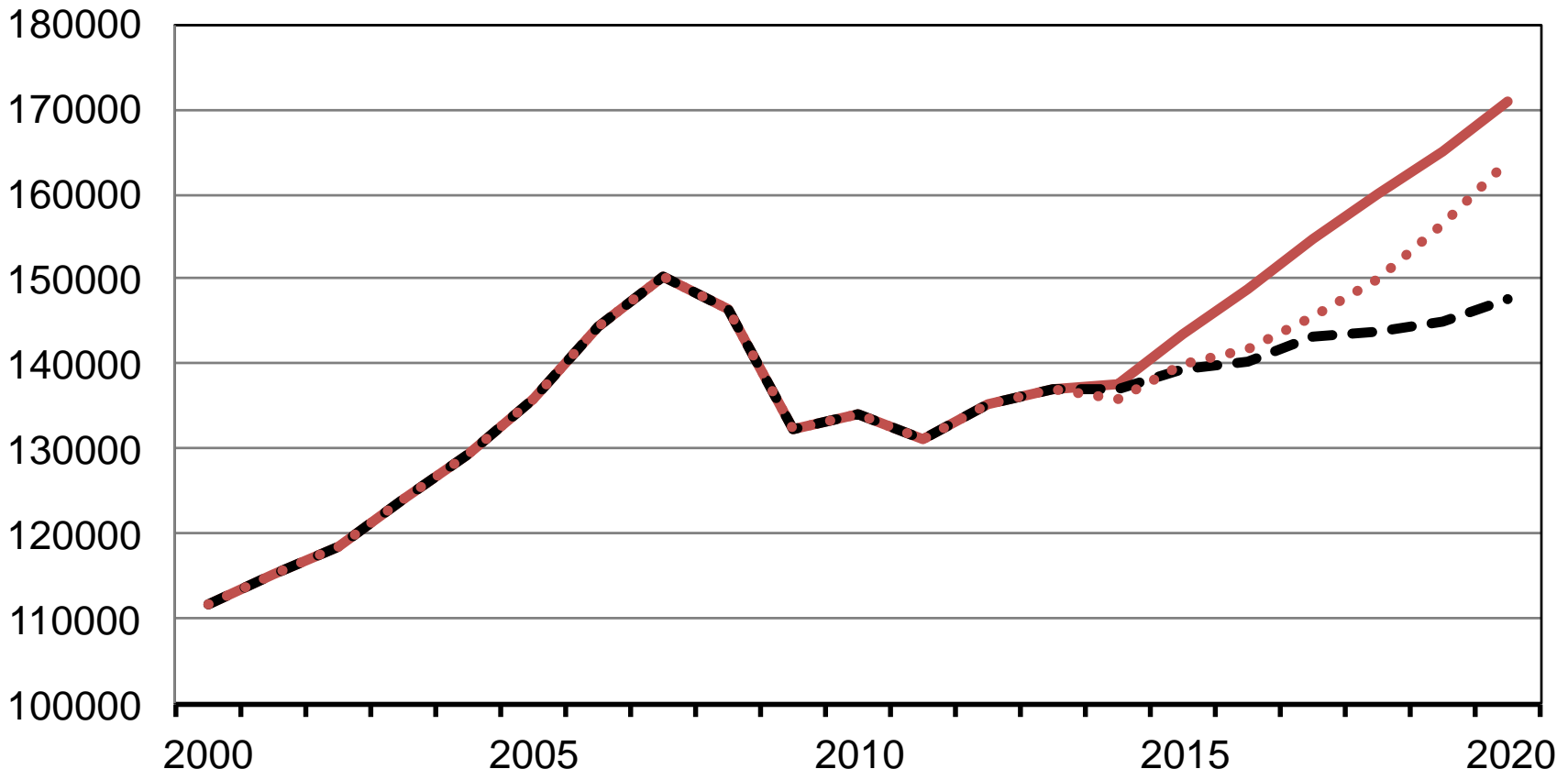
Finland



Sweden



GNP



— Recovery - - - Stagnation . . . Delayed Adjustment

Spanish v Irish Approach

	2010	2011	2012	2013
<hr/> Plan of: Spain <hr/>				
Spring 2010	9.8	7.5	5.3	3
Spring 2011	9.2	6	4.4	3
Spring 2012			5.3	3
Latest	9.4	9.4	10.3	6.8
<hr/> Plan of: Ireland <hr/>				
Winter 2009	11.6	10	7.2	4.9
Winter 2010		10.6	8.6	7.5
Latest	10.7	8.5	7.9	5.7

Lessons

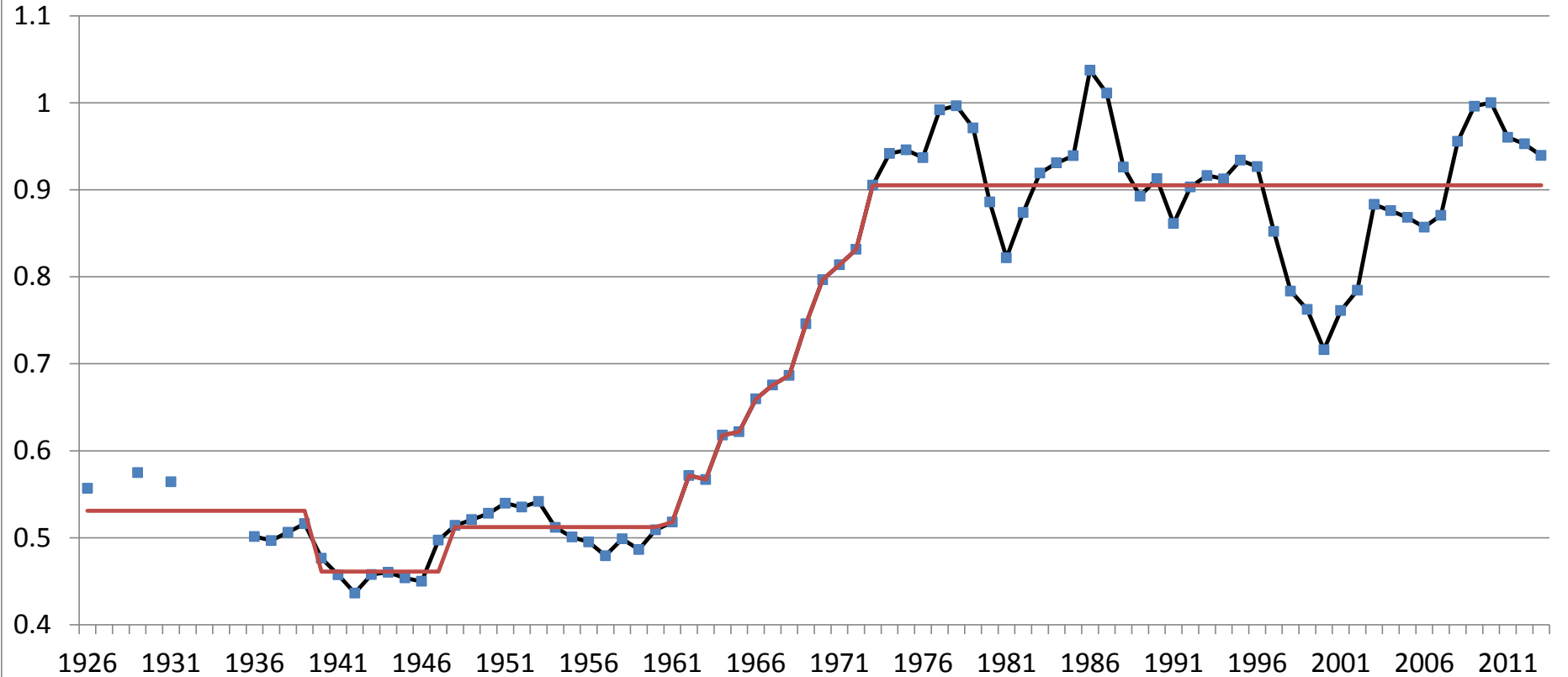
- Apart from avoiding a crisis!
 - Caution in fiscal policy important
 - Regulation – better safe than sorry
- Ireland - Tackling the Crisis
 - Under-promise and over-deliver
 - Adjustment should not be too long drawn out
 - Ireland's plan – not the Troika's
 - Over-capitalise the banks – if you can
 - If not, you need a bail-out
- For EU
 - Bail-outs worked (except Greece). The problem was liquidity
 - Need EU banking system: EU regulation – being delivered
 - Need an appropriate EU fiscal Policy – not happening

Path to Recovery

- Ireland re-priced itself and the tradable sector was not broken:
 - So far recovery driven by external demand
 - Irish firms as well as foreign
 - However, investment very low (housing)
 - Substantial current account surplus (BOP)
 - Scope for increase in domestic demand
 - Relatively high personal saving (deleveraging)
- Implies a few years of above trend growth
 - Make the most of it!

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Public Finances: Medium Term

- Festina lente!
- Possible target for 2016 – zero borrowing
- Over period 2016-2020 should run a surplus
 - Average 1%.
 - However, if recovery is vigorous, may need taming:
 - possibly substantial surpluses by 2018-19
 - Need to use fiscal policy to manage economy
 - Running a surplus not a contractionary policy
 - Debt repayment not an objective
 - Preparing for aging: will need financial assets
- Problem of EU approach to measuring fiscal policy

The National Debt

- The state has significant financial assets
 - Objective is to maximise price for these assets
 - Objective to halve cost of banking crisis
- With a continued recovery and a successful policy outcome on realising financial assets:
 - Debt/GDP ratio 2020 could be significantly < 70%
 - Lower than Germany, France and EU 15 average
 - With exceptionally low interest rates the debt burden is light

Risks

- EU
 - Failure of EMU – most unlikely
 - Zombie Europe – possible: EU Response?
 - Banking Union – essential: Cost of capital
 - UK Exit
- Possible domestic policy failures
 - Making banking sector fit for purpose – fast
 - Labour market?
 - Recalibration of industrial policy

Strategic Issues

- Evolving Ireland's competitive advantage
 - Developing new areas
 - Reduced dependence on taxation
- EU institutional change & Possible UK Exit
- Implications of population growth
- Ageing of the population