Ireland Julian Clarke ICRCC 7march2011
What Kind of Economy?

- Classic Small Open Economy
  - Small Domestic Market
    - Constitutes about 1% of the euro area
  - Large Reliance on Trade
    - Constitutes 190% of Output
    - Living standards depend on performance as an export base
  - Regional Economy within EMU
    - Limited macroeconomic control instruments

Celtic Tiger - Driving Forces

- Celtic Tiger from mid 1990s
- Europe's highest growth economy
- No single factor
  - Various elements came together at same time
- Primary Factors:

–Openness & EU Access

–Foreign Direct Investment (FDI)

–Human capital - Skilled Workforce

–Demography and Labour Market - Young

- Secondary Factors:

–EU Structural Funds

–Consensus Economic Strategy

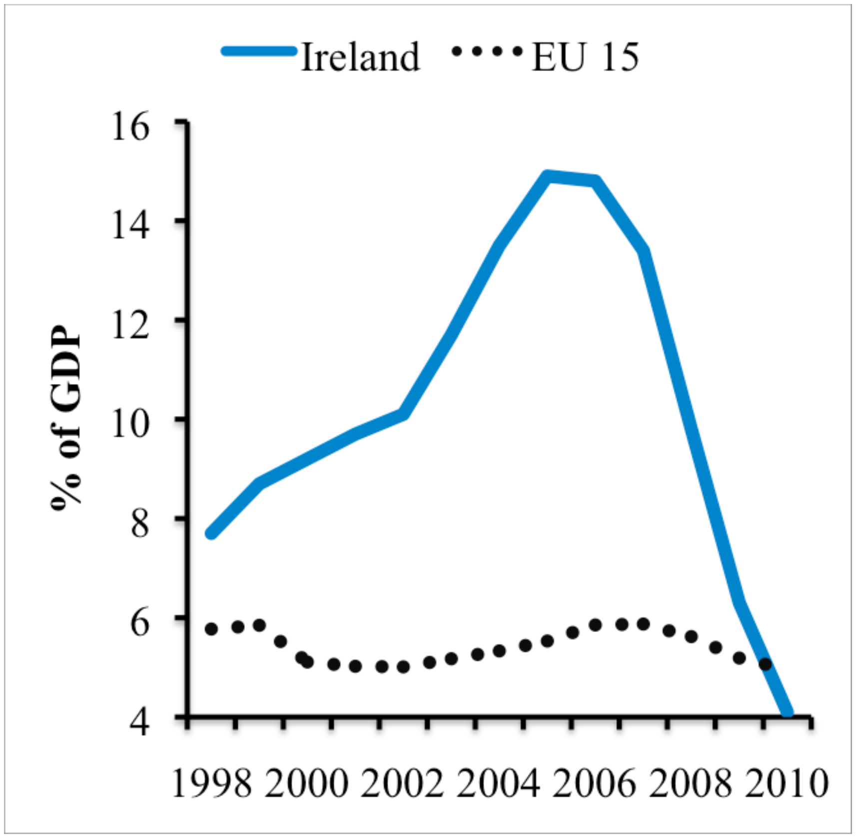
–Fiscal Reform

THE CRISIS Outline

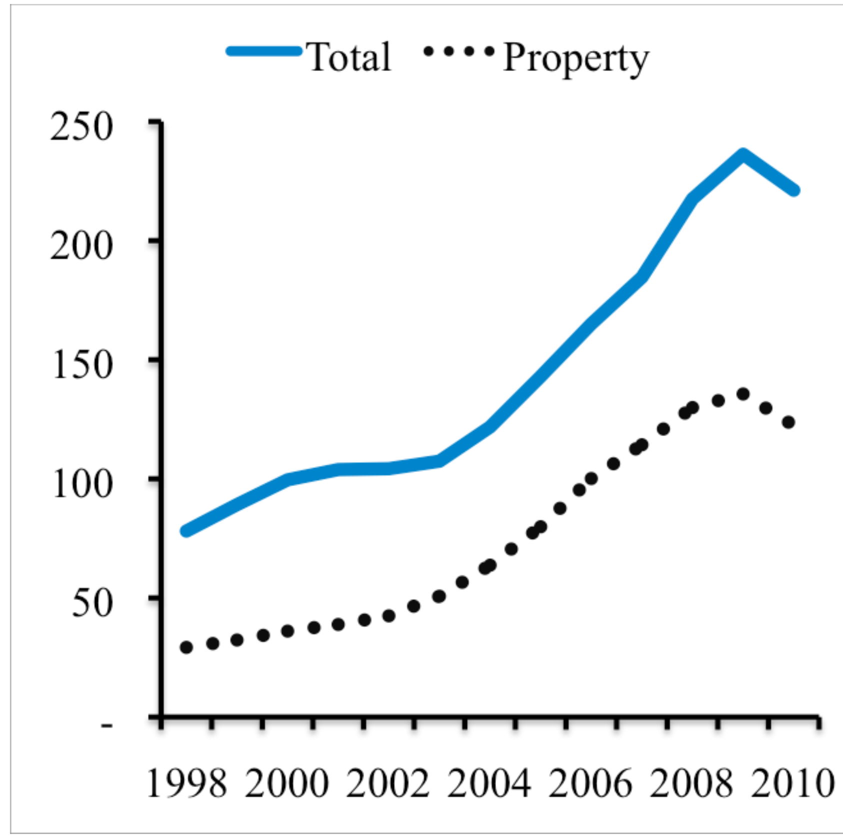
- Double Trouble - the housing bubble and credit bubble.
- The Aftermath – explosion in Irish government debt.
- The policy response – seven years of austerity budgets.
- The Labour Market – structural unemployment.
- Comparison with the 1980s.

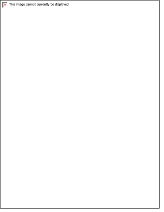
Double Trouble

Housing Investment

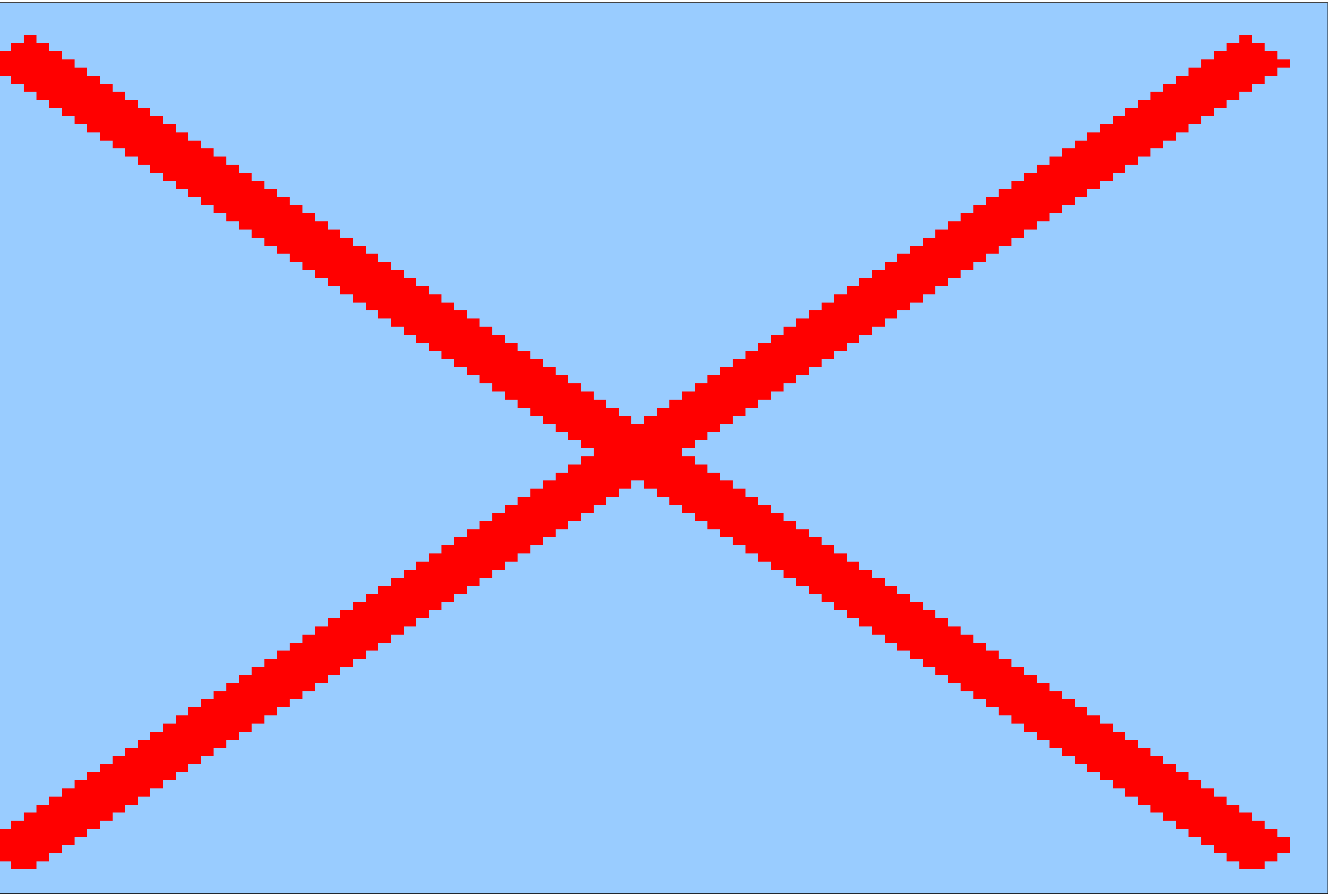


Private Sector Credit

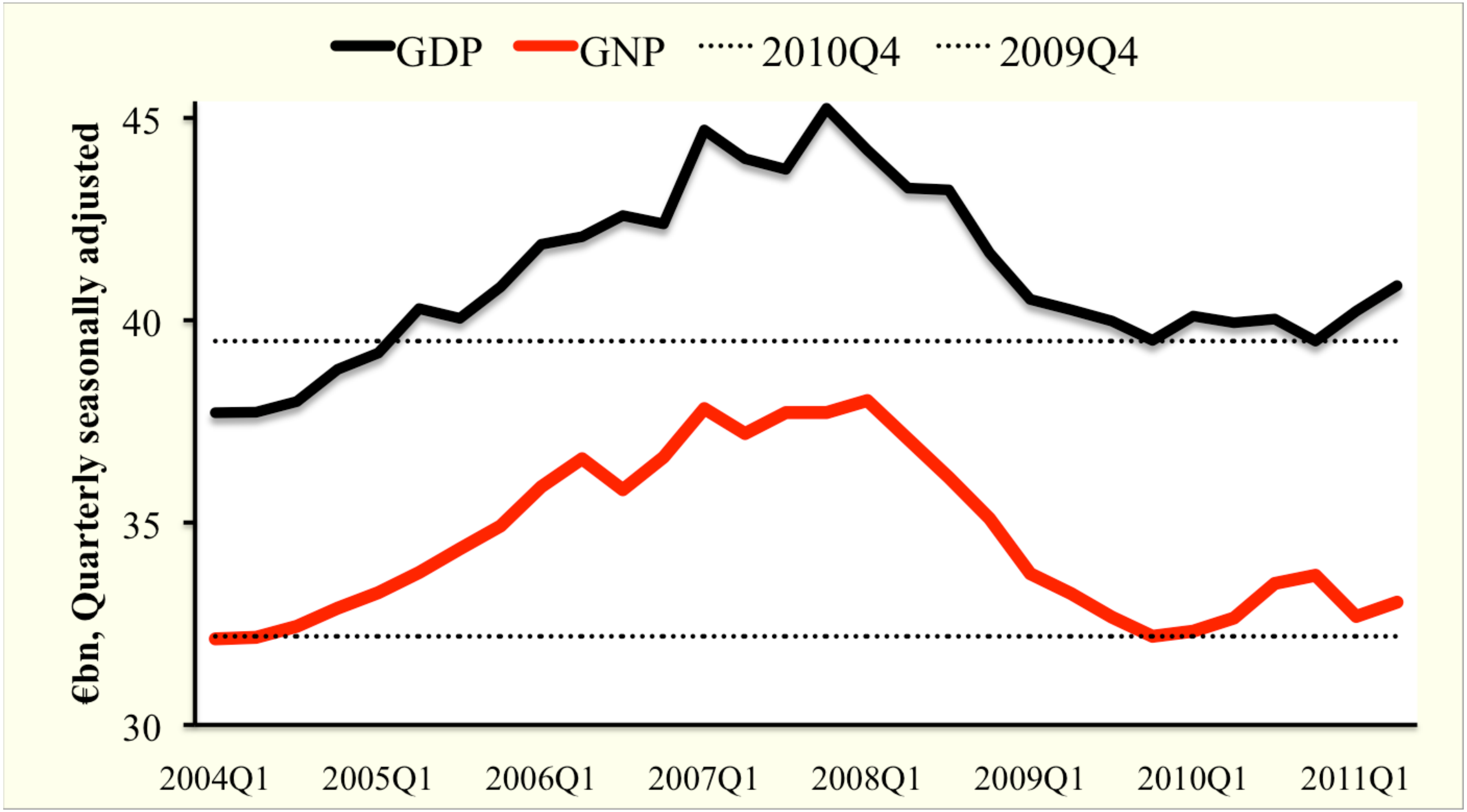




X Economic growth (GNP)

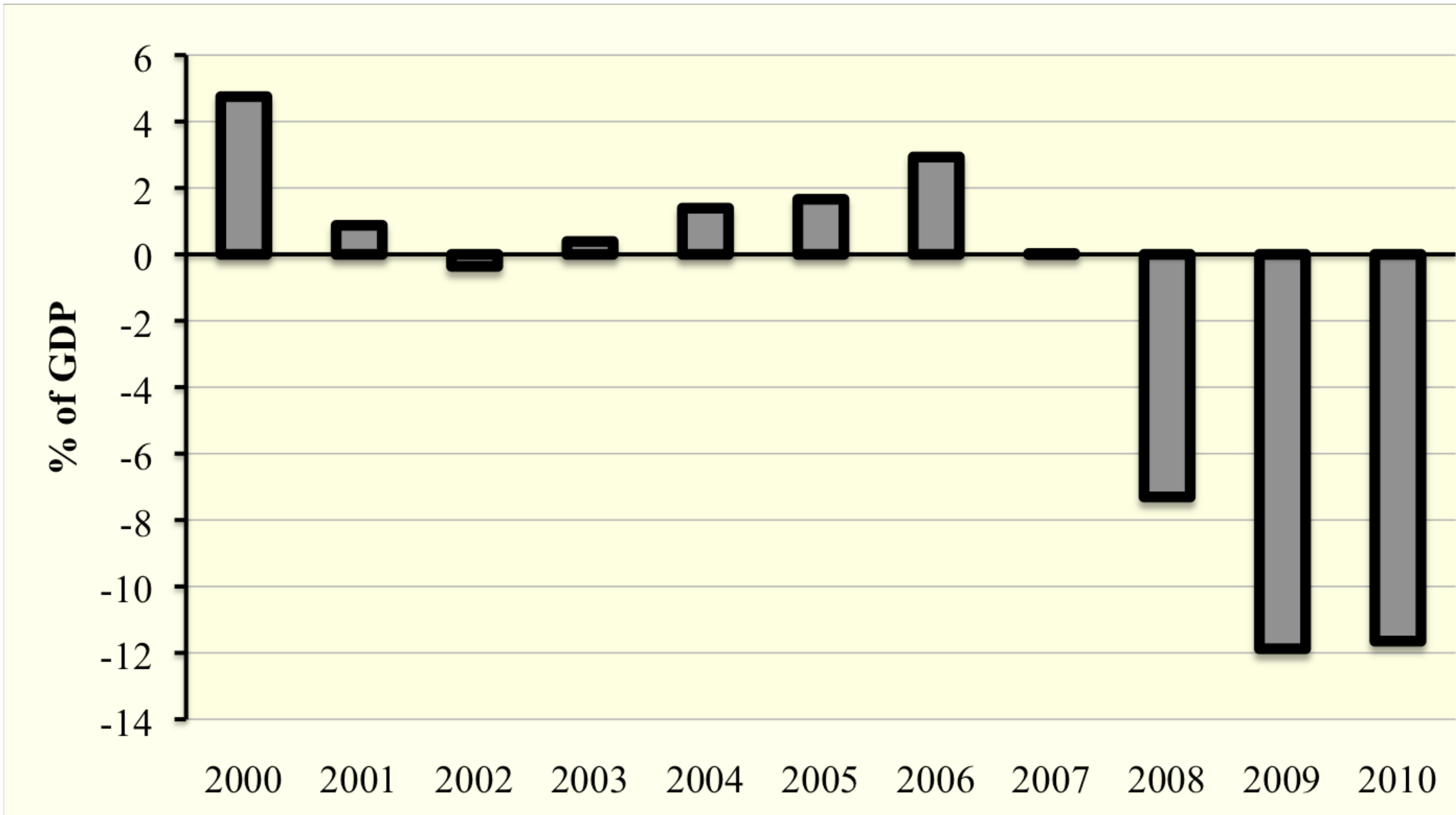


Recent GDP & GNP

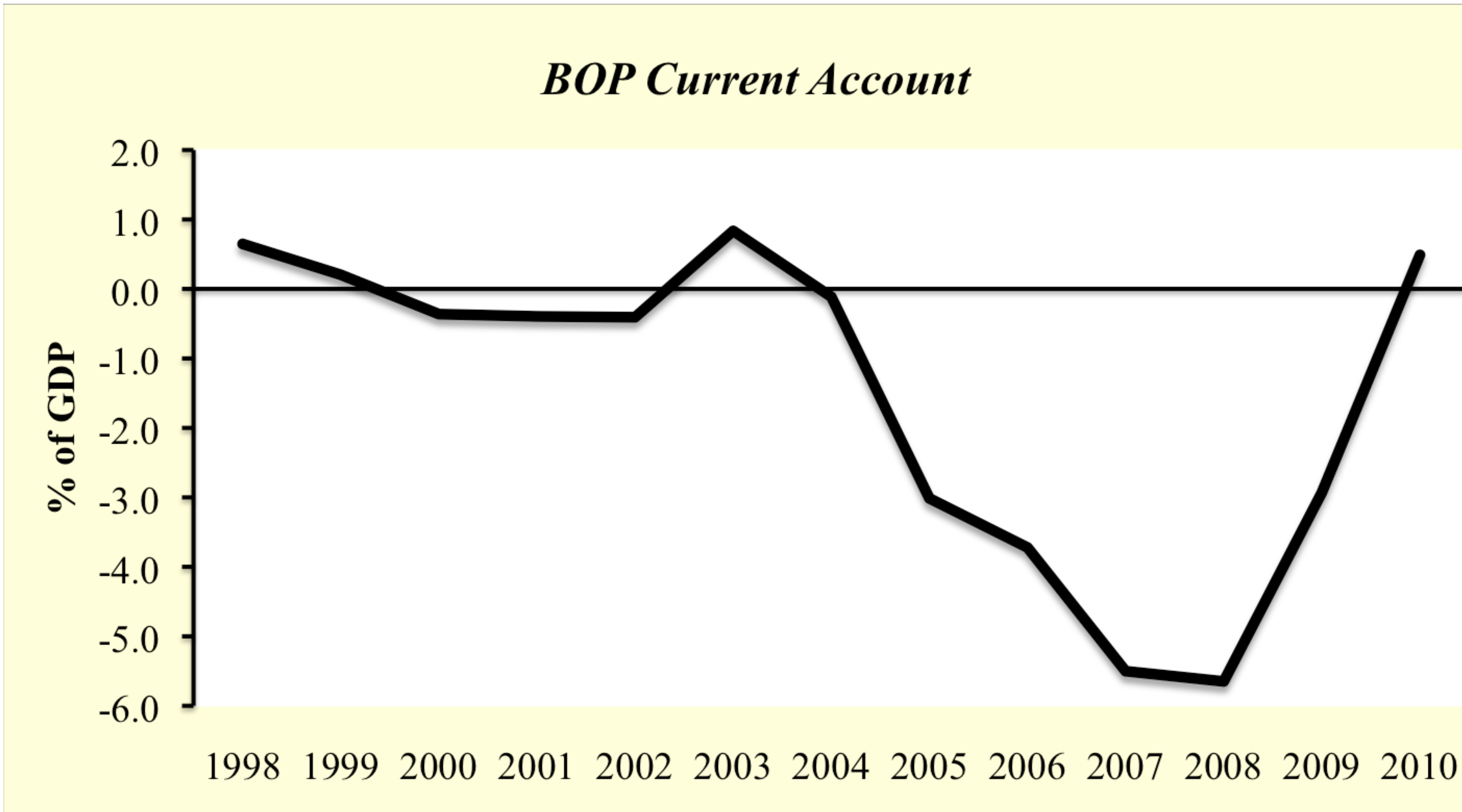


Budget returned to large deficits of 1980s – spending more than earning

Fiscal Balance – more recent "P&L A/c" (excl banks)



Early Warning Indicators were available



Crisis Aftermath

- Huge losses in banking system

- IMF/EU programme agreed in Nov 2010
  - €67.5bn in external financing

- Seven year austerity programme agreed
  - begun in 2008

- Pro-cyclical effects of this programme unavoidable
  - Debt interest payments almost €5 billion in 2010.
  - Likely to be €11 billion by 2015 (> 6% of GDP)

Pro Cyclical Mistakes

Pro-Cyclical: Govt putting money into economy at time already booming → overheating

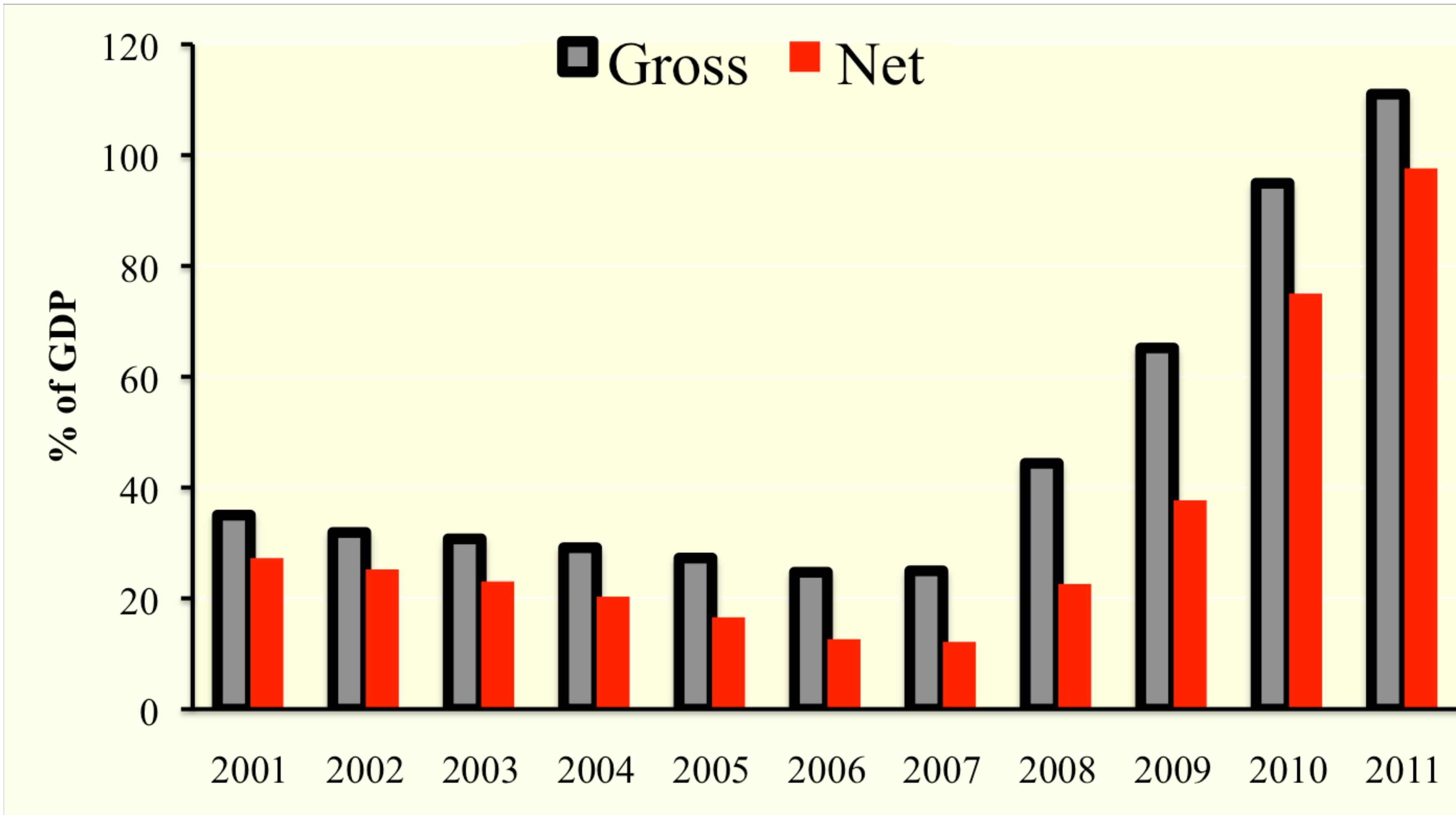
- Example: tax incentives to boost construction & housing at time house prices increasing rapidly and sector already operating close to full capacity

Counter Cyclical policy preferred by economists:

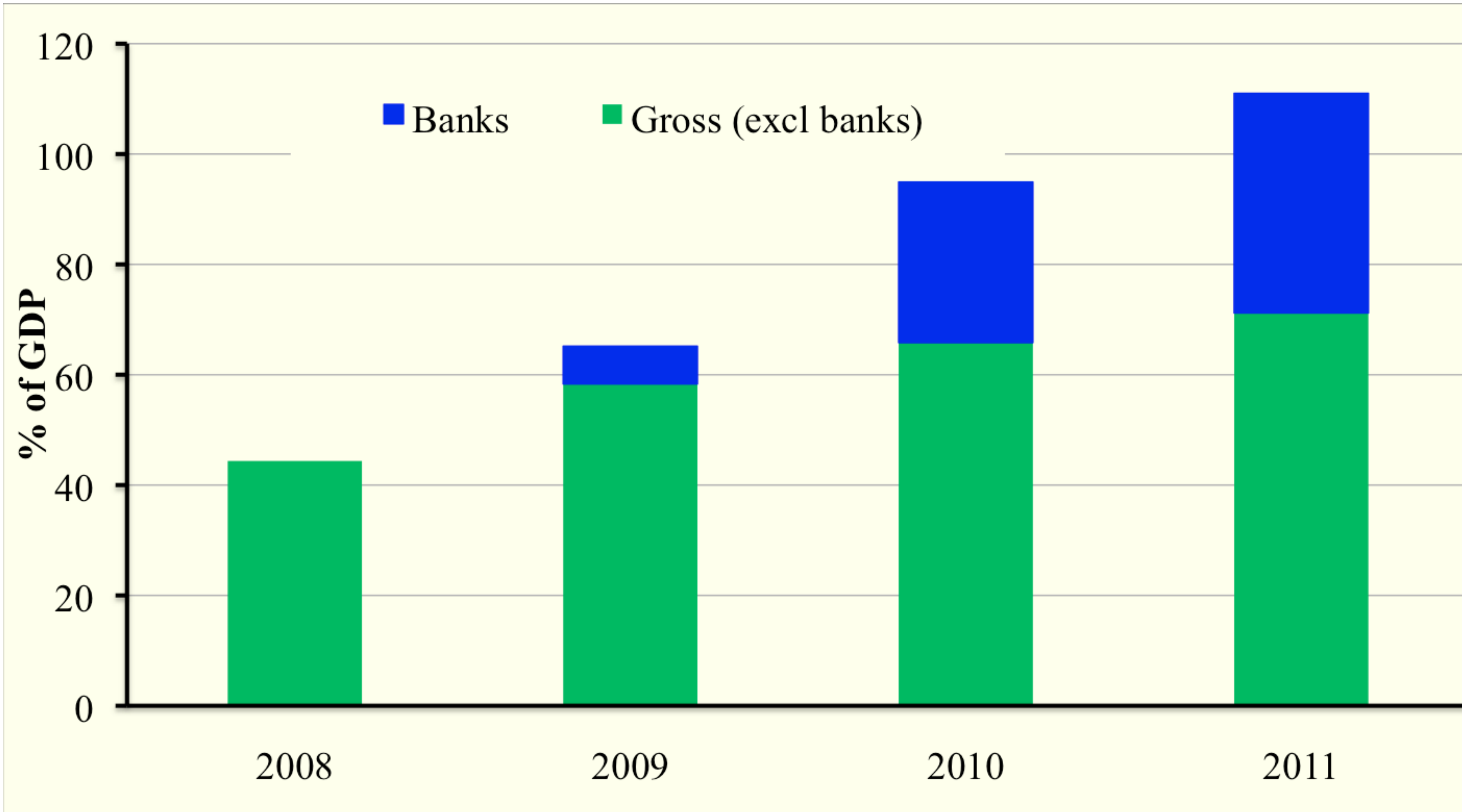
- Take money out of economy (run a higher surplus) when economy booming
- Put money into economy (run down surplus or run a deficit) when the economy is weak/contracting

Aim: *over the cycle* have a balanced budget

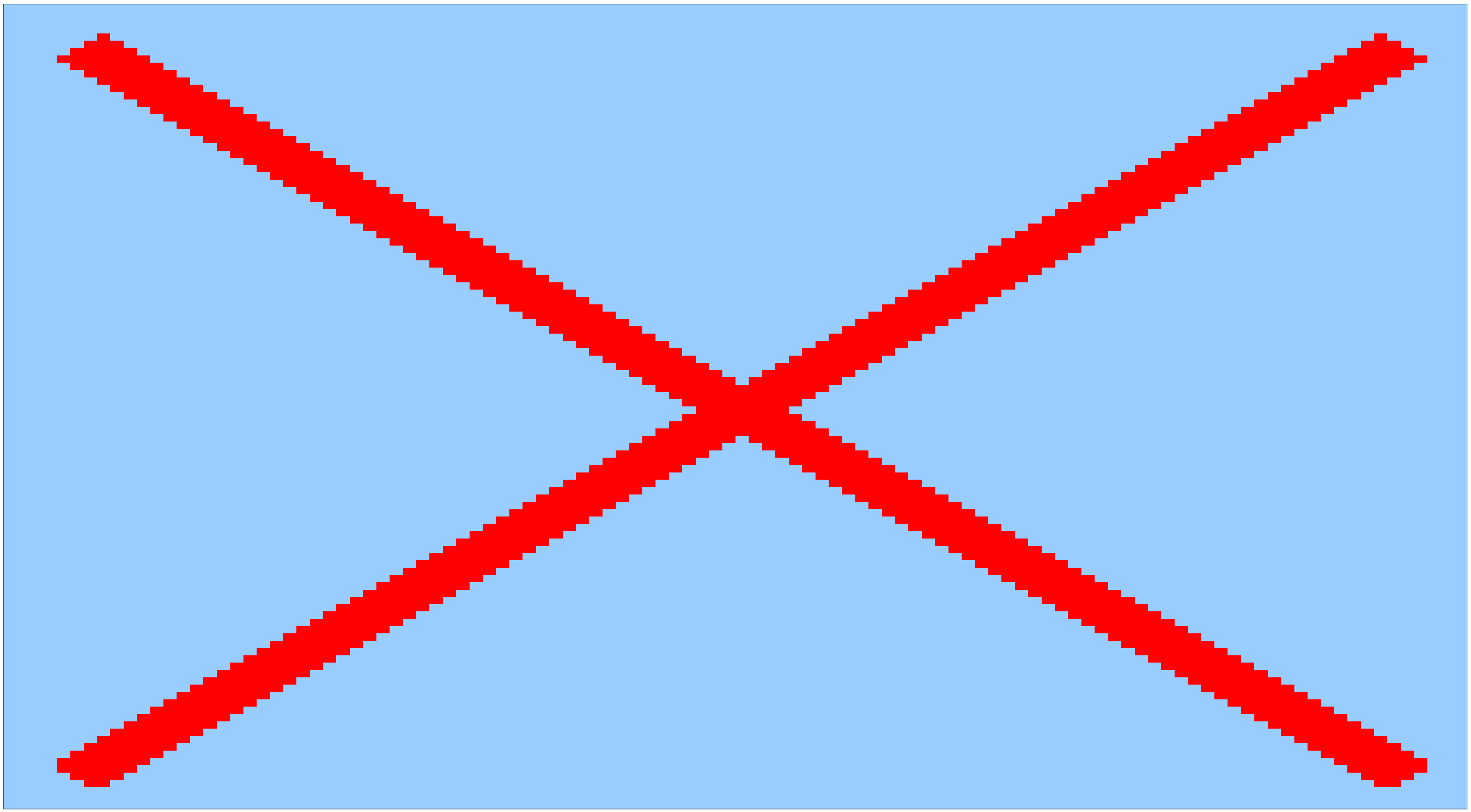
General Government Debt



Government Debt (excl banks)



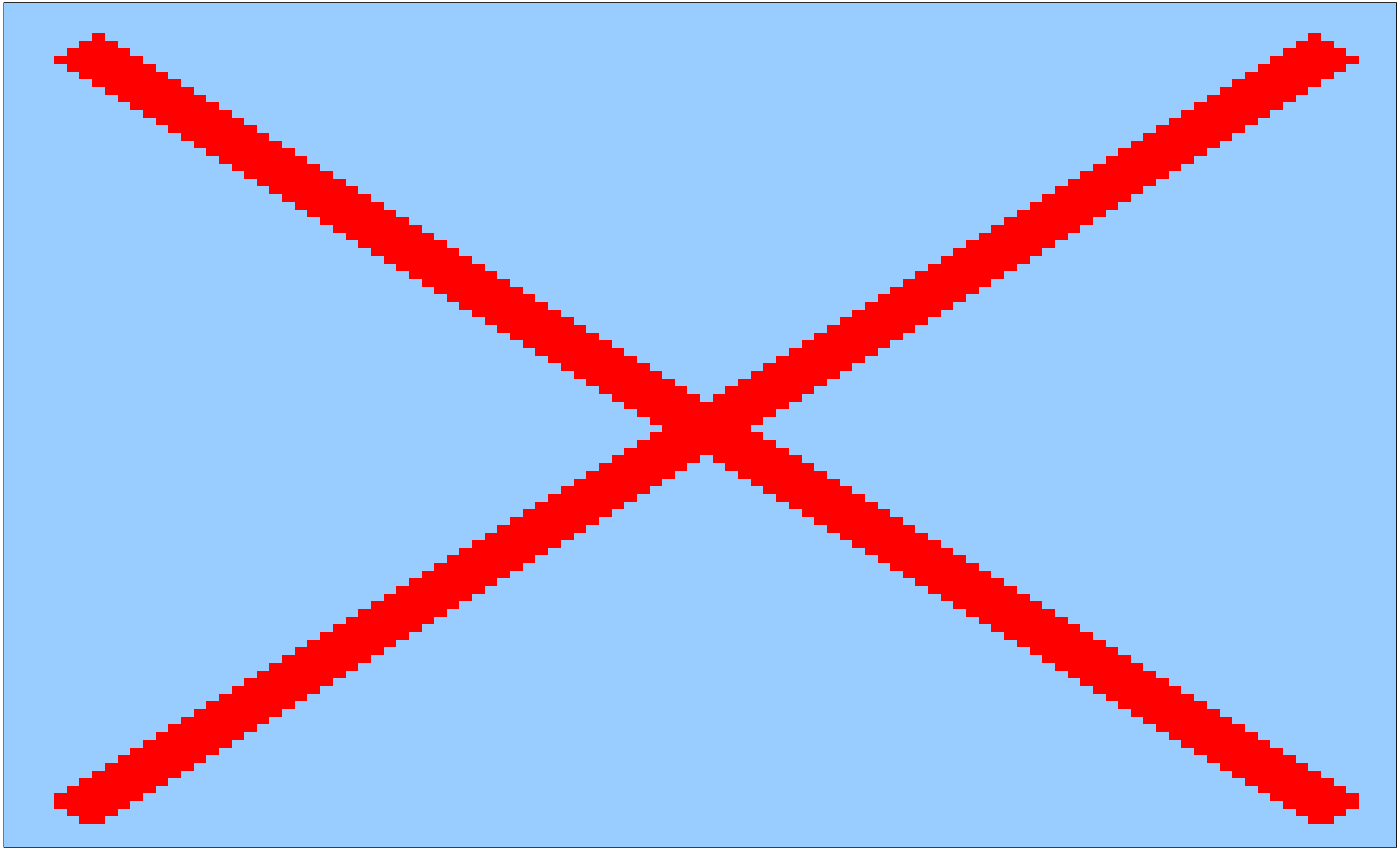
X Net Migration



Will the “Homing Pigeons” return again?

- Huge Emigration in 1950s
  - Perception of a failed economy
  - Leave, Never to Return
- Brain Drain in 1980s
- Net inflows began in the 1990s
- Now a resumption of net outflow
- “Homing Pigeons”
  - Enhances productivity
  - Increase productive potential of economy
  - Good for FDI – foreign direct investment

Unemployment rate



? The €30bn Austerity Package

Economy can return to growth

- Outcome will depend on:
  - World recovery – no stalling
  - Export sector responds to world demand & competitiveness as before
  - Labour market flexible and competitiveness restored
  - Banking system finally sorted out
  - No more shocks!
- If all conditions met – High Growth or more
- If none of these conditions met – Low Growth or worse

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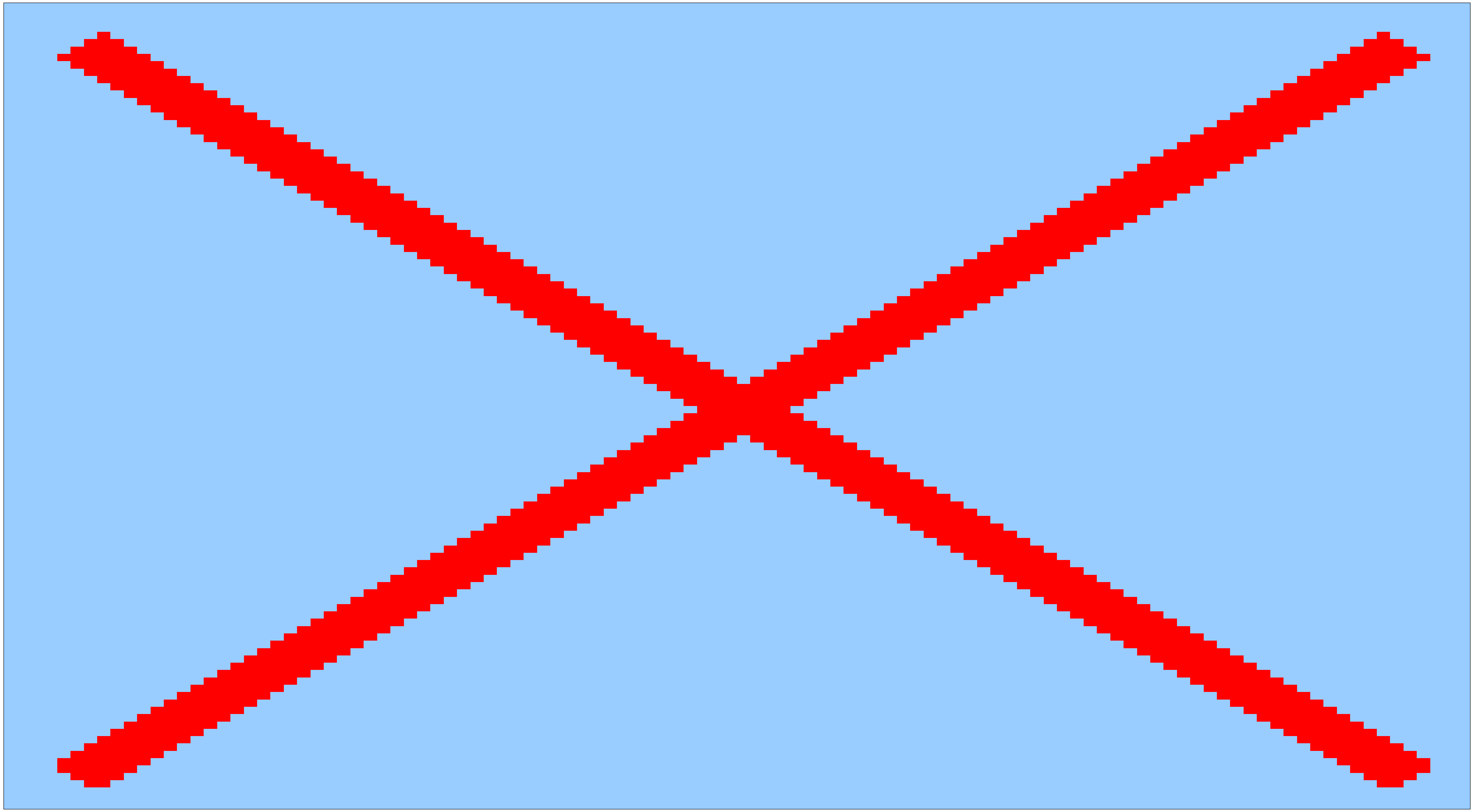
GDP growth rates



Path to Recovery

- Good performance in export sector
  - BUT financial crisis in Euro area is a threat
- BOP surplus emerging
- Savings rate high
  - households paying down debt
- Internal devaluation
  - fall in wages and prices

Lessons

- What goes up….economic cycles exist
- Consider views that are not the consensus
- Have a stable tax base – do not rely solely on cyclical factors
- Government fiscal policy needs to become counter-cyclical

Repeat previous transformation?
Obama : ***'Is Feidir Linn'***
'Yes We Can'

- 1980s: “Third world” type debt problems
- Late 1980s: Turnaround in economic fortunes following courageous action; opposition support not party politics
- 1990s: Rapid expansion; squandered
- Late 2000s: Severe recession