Ireland's Experience after an Adjustment Programme

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Good morning. It is a pleasure to be in Athens and to participate in this conference. My thanks to the Economic Chamber of Greece for inviting me here today.[1]

In my introductory remarks, I will focus on some select issues relating to Ireland's experience during and after our own EU-IMF adjustment programme which was agreed in December 2010 and was completed in December 2013. The total size of the Irish programme was €85 billion, of which €17.5 billion came from the Irish state. While the nature of the crisis that developed in Ireland was quite different from that in Greece, and indeed Portugal and Cyprus, I hope that some of the lessons we have learned are relevant for your discussions during the course of today.

Ireland's crisis, which broke in 2008, was primarily a banking/property crisis, caused by excessive, imprudent lending by banks to the property sector, financed in the main by unstable wholesale funding from abroad. This resulted in a significant property bubble, with inflated residential and commercial property prices, very high private sector indebtedness, an over-reliance of the public finances on property-related tax receipts, and a large current account deficit, which had deteriorated rapidly over the period 2003-2008. When the crisis hit, the building and construction sector collapsed, with spillover effects to the rest of the economy and the fiscal position. The massive exposure of the domestic banking system became very evident very quickly towards end-2008, and the Irish banks were no longer able to fund themselves, nor did they have remaining collateral eligible for normal ECB liquidity operations. A range of government supports for the banking system would be required, not least large-scale capital injections, and the rapidly widening fiscal deficit, combined with the commitment to backstop the large losses of the banking sector, pushed the government finances into an unsustainable position in the eyes of international investors and the need to enter an EU-IMF programme at end-2010.

In fact, the process of fiscal adjustment had started two years earlier in late 2008 with the first in a long series of contractionary budgets, and indeed much of the heavy lifting had already been achieved by the time the programme started. Furthermore, the programme finally agreed with the EU-IMF largely reflected the 4-year budgetary plan already published by the Government. Over the period 2008-2010, ex ante adjustment measures of the order of 9 per cent of GDP were introduced; over the period 2008 to 2014 this amounted to almost 17 per cent of GDP.[2] These were roughly two thirds on the expenditure side and one third on the revenue side, and included large cuts in public sector pay in addition to higher taxes, notably income taxes. As large as this adjustment was, it was much smaller than the fiscal contraction experienced in Greece and therefore the spillover effects to the Irish economy have not been as large.

The fiscal adjustment programme was credible and underpinned by a realistic set of macroeconomic assumptions and some significant improvements in the institutional framework for fiscal policy. This enabled the Government to deliver on the targets which had been set and indeed to over-deliver in some years. Establishing this track record of delivery was important in restoring market confidence.

[1] I thank Reamonn Lydon for his assistance in preparing these remarks.
[2] "Ireland's Recovery from Crisis", John Fitzgerald, CESifo Forum No.2 2014.

The modalities of the programme were also important. The EU-IMF loans offered to Ireland came initially with unfavourable terms, both in terms of the interest rate charged and the maturities of the loans. This was eventually recognised, and from the middle of 2011 Ireland benefitted from successive reductions in the interest rates on official loans and from extensions of the maturities.

An examination of the market yields on Irish Government bonds shows that this alleviation of the financial terms of the assistance was a turning point in achieving the restoration of market confidence. As a first step, treasury bills were issued in mid-2012. Access continued to improve, especially after ECB President Draghi announced Outright Monetary Transactions. Market access was confirmed through well-subscribed bond issues in January and March 2013 including a 10 year issue. These improvements, combined with close adherence to the budgetary targets allowed the government to take the decision to exit the programme on schedule at end-2013. Importantly, the national treasury agency (NTMA) had accumulated a large cash pile before we exited the Programme so there was also no immediate exposure to market risk. On exiting the programme, there was strong buy-in to recover from the crisis – so the Irish authorities recognised that continued sound policies were needed and immediately post-programme released a medium-term economic strategy to cover the period from 2014 to 2020.

Supports for the banking sector before and during the programme included an initial government guarantee of liabilities; establishment of the National Asset Management Agency (NAMA), which is a bad bank for commercial property loans; downsizing, through both deleveraging and restructuring; comprehensive stress tests and large-scale capital injections. Regulation and supervision, which were deficient in the run up to the crisis were revamped. Overall, the government injected over 40 per cent of GDP into the banks, which understates the amount since GDP figures for Ireland significantly overstate the value of national income. In addition to the massive fiscal outlay, shared among taxpayers, sizeable losses were incurred among bank shareholders and some subordinated debt holders. Rebuilding the banking system from the ashes of the financial crisis was undoubtedly one of the main challenges facing Ireland during and after the adjustment programme.

As in the case of Greece and all the countries represented on the panel this morning, Irish households have ultimately, in a variety of ways, borne a large share of the adjustment. Fiscal measures led to an 8 percentage point increase in the effective tax rate, rising from 17.5 per cent to 25 per cent for the average household. Income inequality did not change much during the recession, helped by both the progressivity of tax changes, and in no small way, automatic stabilisers.[3] As mentioned already, pay cuts were imposed on all public sector workers while welfare payments were also reduced. Public sector pay cuts were also progressive, with higher cuts for higher earners, and pension contributions also went up. In the private sector, firms that experienced a negative demand shock opted to reduce labour costs using a combination of layoffs, wage cuts, freezes and hours reductions.[4] The largest wage cuts were for new hires, with reductions

[3] For an in-depth review of distributional developments over this period, see "Income Distribution in Ireland: Through Recession, Towards Recovery", by Tim Callan, Mark Regan, Michael Savage and John R. Walsh. ESRI Budget Perspectives 2017, Paper 2.

[4] "Labour Cost Adjustment during the Crisis: Firm-level Evidence" Suzanne Linehan, Reamonn Lydon and John Scally. Central Bank of Ireland, Quarterly Bulletin Article, July 2015.

of 20 per cent on average between 2007 and 2012.[5] While the wage adjustments did not prevent large increases in unemployment – from 4 to 15 per cent between 2007 and 2012 – the 'internal devaluation' allowed Ireland to recover some of the competitiveness which had been eroded during the credit fuelled overheating of the early 2000s. Ireland's openness as an economy has meant that strong export growth has contributed significantly to the overall economic recovery and we have benefitted more than other countries from the recovery in external demand.

The last decade has also seen the Irish household sector pay down the debts built up during the credit bubble. From a peak of €200 billion (or 210 per cent of disposable income) in 2008, household debt has fallen to €140 billion (around 135 per cent of disposable income) – which is still incidentally high by international standards. Non-performing loans rose sharply in the years after the crisis hit, and even now there remains a large lump of very long term, non-performing mortgages, despite wide ranging reforms to bankruptcy laws, radical policy initiatives by the Central Bank, and a steep learning curve for lenders.[6]

Before I turn to current economic performance, let me briefly mention two aspects of the Irish economy which did not change during or after the crisis. The crisis has not led us as an economy to change our overall economic model, which is an export-oriented / FDI based model and which has served us well before, during and after the crisis. The strength and dynamism of the exporting sector boosted the resilience of the Irish economy during the downturn, and quickened its recovery, despite the weak external growth environment in 2011 and 2012 in particular. Nor were structural reforms a prominent feature of the adjustment programme in Ireland, which largely reflects the fact that Ireland began the programme with markets that were relatively flexible by European standards.

The Irish economy has recovered strongly over the past six years, with the turnaround starting around 2012/2013. The numbers in employment are up over 17 per cent. Unemployment which peaked at just over 15% in 2012 is expected to fall to below 5% next year. Underlying economic growth, abstracting from distortions from the multinational sector, is running at between 4 and 5 per cent per annum, and this has been both broad based across the economy and driven mainly by domestic demand. The general government balance has recorded primary surpluses in each of the past four years, and the headline position is projected to return to surplus in 2020. The public sector debt ratio is also following a favourable trend but is still much too high. This is a significant achievement when one considers the underlying deficit peaked at almost 12 per cent during the Crisis. The While it stands at around 70% of GDP, this is a meaningless measure for Ireland since GDP is inflated significantly by some multinational activities that have no connection to the domestic economy, and our preferred measures of debt to adjusted Gross National Income (or GNI*) is still just above 100%.

Employment and income levels are now close to where they were when the crisis hit a decade ago. While this constitutes a remarkable recovery in many ways, given that Ireland's collapse in the Great Recession was one of the deepest and longest of any country, some may also conclude that it

[5] "The flexibility of new hires' earnings during a recession", by Reamonn Lydon and Matija Lozej. [VOXEU, 02 October 2016.](https://voxeu.org)

[6] "Resolving Non-Performing Loans in Ireland: 2010 – 2018", Sharon Donnery, Trevor Fitzpatrick, Darren Greaney, Fergal McCann and Micheal O'Keefe, Central Bank of Ireland Quarterly Bulletin, No.2 2018.

constitutes a lost decade. However, in closing I would draw attention to some of the ways that Ireland 2018 differs from Ireland 2008.

First, output and employment are much better balanced now than a decade ago; for example, around 1 in 16 workers are now employed in construction compared to 1 in 9 before the crisis. Economic growth in recent years has also been driven by incomes, mainly due to higher employment rather than wages, and credit conditions remain subdued. Fiscal policy is also no longer reliant on construction sector revenues and indeed a key lesson from the crisis relates to the need to ensure the overall tax base is broad, stable and sustainable such that it can remain resilient in the face of any firm or sector specific shocks to more transient or unstable forms of tax revenue.

Second, there is currently a clear policy stance, with widespread political and public buy in, to mitigate cyclical economic risks by building resilience into fiscal policy and avoiding potential overheating in the economy. Prudential supervision and macroprudential policy tools are much better equipped to both monitor the build-up of systemic risk and build resilience among both borrowers and lenders.

My introductory remarks are necessarily high level and I look forward to elaborating further in the Q&A.