Debt and Austerity in Ireland

andy.storey@ucd.ie

Phases of Irish Growth: 1

- Pre-2001: based largely on foreign direct investment (FDI) and exports (multinationals account for 70% of Irish exports)

- Gross National Product (GNP) versus Gross Domestic Product (GDP) disparity. 2009: GNP 23% below GDP; first quarter of 2011: GDP grew by 1.3%, GNP fell by 4.3%

- Importance of 12.5% corporation profits tax rate? Most important to the International Financial Services Centre (IFSC)

IFSC

- Hedge funds, investment banks, structured investment vehicles (SIVs)…
- Outside traditional regulatory structures: ‘light touch’ (and Financial Regulator regarded his responsibility as only to ‘Irish’ banks)
- If documents submitted to the Financial Regulator before 3pm, a fund would be authorised to set up in the IFSC the next day

Phases of Irish Growth: 2

- Post 2001: Based largely on a property price bubble; investment in buildings 5% of GDP in 1995, 14%+ in 2008; by 2006/07, construction output was contributing 24% to GNP (Western Europe average was 12%), accounting (directly and indirectly) for 19% of employment (including high levels of migrant labour) and 18% of tax revenues (this last had fallen to less than 3% by 2010). By contrast, income tax as a proportion of total tax revenue fell from 37% in 1994 to 27% in 2006

Credit Growth

- Household debt: €57 billion in 2003, €157 in 2008
- Mortgage lending: €44 billion in 2003, €128 billion in 2008
- 6 main Irish banks borrowed €15 billion from abroad in 2003 – €100 billion by 2007 (and not just lending to buy property in Ireland)
- Household debt now 180% of household disposable income (40% in 1993)
- House prices quadrupled between 1996 and 2007; now down 40% from peak, and may have further to fall; ‘ghost estates’

Anglo Irish Bank (now nationalised)

- Loan book growing by 20% per annum, specialised in property development
- Chairman annually (and temporarily) moved around €87 million lent to him personally out of this bank so loans would not be spotted by shareholders in audit
- Cost to the state of this bank alone will be €43.5 billion (including interest) in ‘promissory notes’ to be paid out at a rate of €3.1 billion per annum

Whose Responsibility?

- Facilitated by liberalised lending practices, lax cross-border regulation and low interest rates (European Central Bank – ECB); ECB variable rate cut from 4.25% in August 2001 to 2% in June 2003

- Also facilitated by domestic tax incentives: 2004-2009, property-related tax breaks may have cost the exchequer €1.9 billion

Bank Guarantee

- 30th September 2008 – all depositers and senior bondholders guaranteed by the state
- “On 30 September 2008, the Irish people woke up to find that the… government had put up the entire Irish State as collateral for the crushing liabilities of six private banks. The country was now liable for approximately €400 billion [probably more] in leveraged loans in a recession, while sitting on top of a slowly deflating property bubble” (Conor McCabe)

The Price to Pay

- Total costs of bank bailout now estimated at €70 billion (plus National Assets Management Agency (NAMA) borrowing of €29 billion so far); also ‘contingent liabilities’; note that there is considerable confusion here…

- Government deficit of 32% of GDP in 2010: bank financing accounting for two-thirds of that

Costs

- GNP down 15.4% from its peak

- €20 billion+ in fiscal adjustment, "the equivalent of…€4,600 per person.. the largest budgetary adjustments seen anywhere in the advanced economic world in modern times" (Karl Whelan)

- €6 billion in further spending cuts and tax increases in 2011; average of €3 billion for each of next 3 years

International Underpinning of Austerity

- IMF-EU conditionality (December 2010) in return for loan of €58 billion at interest rate of 5.8%, as Ireland (allegedly) could not access private financial markets

- ‘The Geithner Mystery’? Role of ECB also; IMF, by contrast, prepared to countenance bondholder (creditor) discounts

The Reality of the ‘Bail Out’

- “a bailout of European investors foolish enough to lend to Anglo Irish Bank and other insolvent banks, courtesy of the Irish taxpayers. The markets having declined to finance this commitment on top of the Irish sovereign debt, our European friends have kindly provided ‘assistance’ in the form of loans at a mark-up of three per cent [so that money can be] routed from Irish taxpayers to European private creditors of Irish private banks. Indeed, a substantial portion has already been paid over, to be replaced with sovereign debt” (Colm McCarthy)

Is it Working? 1

- Unemployment at 14+% (446,800), over 40% long term
- Estimates of emigration: 70,000 in year ending April 2010 and 50,000 in year ending April 2011
- Economy still in recession, with investment down from €48+ billion in each of 2006 and 2007 to a little over €18 billion in 2010 (capital has gone on strike)
- Irish 10-year bonds as high as 12%
- Irish banks dependent on loans of €150 billion+ from ECB and Irish Central Bank, as bank deposits fall steadily (example of 'contingent liabilities')
- Debt-GDP ratio of 90% in 2010 (110% if NAMA counted), expected to rise to 120% in 2013 and perhaps 145% by 2014 (ratio was 25% in 2007); situation even worse when assessed against GNP (150%+)

The Size of the Debt

- “Irish insolvency is now less a matter of economics than of arithmetic… Ireland’s government debt will top €190 billion by 2014, with another €45 billion in Nama and €35 billion in bank recapitalisation, for a total of €270 billion, plus whatever losses the Irish Central Bank has made on its emergency lending. Subtracting off the likely value of the banks and Nama assets, [one source]… reckons our final debt will be about €220 billion, and I think it will be closer to €250 billion, but these differences are immaterial: either way we are talking of a Government debt that is more than €120,000 per worker, or 60 per cent larger than GNP” (Morgan Kelly)

Is it Working? 2

- Bondholders being paid off, debt being socialised in advance of a restructuring; for example, repayment of €750 million made by state-owned Anglo Irish Bank in January 2011 to an unidentified creditor not covered by the bank guarantee
- “Never let a serious crisis go to waste. What I mean by that is it’s an opportunity to do things you couldn’t do before” (White House Chief of Staff Rahm Emanuel, November 2008); ‘Shock Doctrine’: economy being restructured through, for example, attacks on rates of pay for the low paid and proposed privatisations

Reaction?

- Well attended protest marches
- But in 2009 only 0.1% of all Irish workers involved in industrial disputes

Why the Silence?

- Emigration
- Fear (including the ‘negative equity generation’: perhaps 1 in 5 households)
- Attitudes to EU
- Hopes pinned on February 2011 election; policies have continued, strictly minimal moves towards ‘burden sharing’ with bondholders
- Legacy of ‘social partnership’
- Media

Example of Media Role

- Irish Finance Minister met with Geithner in June 2011, and was then ‘interviewed’ by the Irish state TV’s Washington correspondent as follows: “His [Geithner’s] influence was discussed quite widely after an article saying that he intervened. We’ll put that aside, because we don’t know that he intervened. We haven’t got the evidence” – these are the ‘journalist’s’ words!

Hope for the Future?

- Election of sizeable number of left wing members of parliament and rise in electoral support for left-leaning Sinn Fein – Left vote in February election may have exceeded 20%

- ‘Enough’ campaign for a referendum on the ‘bail out’ and other initiatives, including local ‘burn the bondholders’ protests and initiation of a debt audit