The European Crisis and the Myth of the Irish Recovery: an Insight | *Marco Biagetti*
Revista de Economía y Estadística | Vol. LIV | N° 1 | 2016 | pp. 123-145 | ISSN 0034-8066 | e-ISSN 2451-7321
Instituto de Economía y Finanzas | Facultad de Ciencias Económicas | Universidad Nacional de Córdoba
http://www.revistas.unc.edu.ar/index.php/REyE

The European Crisis and the Myth of the Irish Recovery: an Insight*

La crisis europea y la leyenda de la recuperación irlandesa: un enfoque

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Abstract

In this paper I first review the main points of the European crisis, showing that the credibility of a time-infinite fixed exchange rate, together with the free movement of capitals in the EU determined overconfidence, an excessive fall in interest rates, and overborrowing that made the system collapse when the external–originated crisis struck, damaging public finances as the banking system had to be rescued by governments. Secondly, I scrutinize an apparent success story of austerity-linked recovery from the crisis: Ireland. I outline that the outgoing government in 2010 acted well in the midst of the financial crisis, regardless of the effectiveness and desirability of the austerity measures. But I also collect facts and figures evidencing that what appears to be a true recovery is only being obtained by means of some unavoidable accounting tricks depending on a new mandatory national accounting EU rule about the treatment of investments. Unfortunately all this produces inflated figures for the GDP and GNP, while the standards of living of Irish citizens continue to fall behind.

Keywords: Eurozone, banking crisis, austerity measures, interest rates, GDP, GNP.

JEL Classification: E65, F34, F45.

*. The views expressed in this paper are those of the author and do not necessarily reflect those of the Agency for Territorial Cohesion. The usual disclaimer applies.

RESUMEN

En este artículo en primer lugar examino los puntos principales de la crisis de la eurozona (UME), mostrando que la credibilidad de un tipo de cambio fijo, junto con la libre circulación de capitales en la UME determinó un exceso de confianza, una caída excesiva de las tasas de interés y superabudancia en la demanda de prestamos, lo que hizo colapsar el sistema cuando se produjo la nombrada crisis la cual tuvo origen en el exterior de la zona. Esa crisis dañó las finanzas públicas, pues que el sistema bancario tuvo que ser rescatado por los gobiernos. En segundo lugar, analizo una aparente historia de éxito de la recuperación de la crisis que parece debida a la austeridad: la de Irlanda. Resalto que el gobierno irlandés saliente en 2010 actuó bien en el medio de la crisis financiera, a pesar de la eficacia y conveniencia de las medidas de austeridad. Pero también recojo hechos y cifras sobre lo que sólo aparentemente parece ser una verdadera recuperación y que sin embargo se obtuvo mediante algunos trucos de contabilidad inevitables y dependientes de una nueva normativa obligatoria de contabilidad nacional tomada a nivel de la UE y relativa al tratamiento de las inversiones. Desafortunadamente todo esto produjo y todavía produce cifras infladas para el PIB y el PNB, mientras que los estándares de vida de los ciudadanos irlandeses siguen siendo no muy afectados.

Palabras clave: Eurozona, crisis bancaria, medidas de austeridad, tipos de interés, PIB, RNB.

Clasificación JEL: E65, F34, F45.

I. INTRODUCTION

The EU's debt crisis was initially triggered by events occurred in the American banking sector. When a slowdown in the US economy caused over-extended American homeowners to default on their mortgages, banks all over the world with investments linked to those mortgages started losing money. America's fourth largest investment bank, Lehman Brothers, collapsed under the weight of its bad investments, scaring other banks and investors with which it did business. The fear that more banks could fail caused investors and banks to take extreme precautions. Banks stopped lending to each other, pushing those reliant on such loans close to the edge.

European banks that had invested heavily in the American mortgage market were it hard. In an attempt to avoid the failure of some banks, governments came to the rescue in many EU countries like Germany, France, the UK, Ireland, Denmark, the Netherlands and Belgium. But the cost of bailing those banks out proved to be very high. In Ireland it almost bankrupted the government until fellow EU countries stepped in with financial assistance.

As the EU and Europe as a whole slipped into recession in late 2008, a problem that started in the banks began to affect governments more and more, as markets worried that some countries could not afford to rescue banks in trouble. Investors began to look more closely at the finances of governments. Greece came under particular scrutiny because its economy was in very bad shape and successive governments had racked up debts nearly twice the size of the economy (European Commission, 2014).

Furthermore, in late 2009, the then recently appointed Greek Prime Minister George Papandreou announced that Greek previous governments had failed to reveal the true size of the nation's deficit. Greece's debt were larger than what had been previously reported.[1] After this announcement, the Portuguese, Spanish and Italian public debts also started becoming a matter of concern no matter their ratio to GDP was.

II. What happened to countries' indebtedness

Thus, the European crisis was regarded as an external shock originating from the US subprime mortgage meltdown. The former EU Commission President José Manuel Barroso[2] stated that "the crisis originated in North America and much of our financial sector was contaminated by… unorthodox practices from some sectors of the financial market".[3]

However, at least Greece and Italy already had a high debt to GDP ratio long before the US financial crisis blew up. Why then, say, did Greece

1. Indeed, in 2004 Eurostat had already revealed that Greek statistics on budget deficit had been under-reported at the time Greece was accepted into the European Monetary Union. According to Eurostat, the 1999 deficit was 3.4% of GDP instead of the originally reported 1.8%.
2. While this paper is being written (early July 2016), former EC president Barroso has just been hired as Goldman Sachs International's chairman to help the Wall Street firm deal with the fallout from the UK's Brexit vote (*The Guardian*, July 8th 2016).
3. Available at http://theweek.com/articles/474464/did-cause-european-debt-crisis

keep on walking on the indebtedness path? The usual explanation is the following: German and French banks in particular had bought many Greek sovereigns because they assumed that Greek debt, like any other in the Eurozone was fundamentally risk-free. Because the monetary union made the commitment to low inflation more credible[4], the introduction of the Euro in 1998-2001, strengthened by the free movement of inputs like capital – a well known provision in the so called *acquis communtaire* - determined a bias in capital markets in that it caused an excessive reduction of interest rates from Athens to Helsinki, from Lisbon to Berlin. Thus, the unique currency caused interest rates to fall even where expectations of high inflation previously kept them high, i.e. it created a framework of adverse incentives to economic agents. Indeed, a time-infinite fixed exchange rate spurs governments to ease fiscal discipline, as it provides biased signals to financial markets, hiding devaluation or redenomination risks and boosting Member States' creditworthiness (Tornell and Velasco 1995). Bond buyers assumed that a bond issued in any country of the Eurozone was equally safe. This caused the spread between long term interest rates of Greek, Italian, Spanish or Portuguese bonds to fall versus the same long term interest rates of German Bunds. This second fact constituted a further reason to ease fiscal discipline: indeed, it is intuitive that if the cost of a resource (in the case of money the interest rate) is artificially reduced, it will be wasted more easily thus causing overborrowing as a normal free riding phenomenon (Ciżkowicz et al., 2015, Feldstein, 2005). Furthermore, the adoption of the Euro delayed rather than advanced, economic reforms in the Eurozone periphery and led to the deterioration of important institutions in these countries. The abandonment of the reform process and the institutional deterioration, in turn, not only reduced their growth prospects but also fed back into financial conditions, prolonging the credit boom and delaying the response to the bubble when the speculative nature of the cycle was already evident (Fernandez-Villaverde et al. 2013).

Furthermore, the Maastricht debt criterion (i.e. the limit of 60% in the debt to GDP ratio) was not respected also by Germany and France. Indeed, France has been suffering a cumulating wage inflation difference with respect to Germany very much like Spain (J. Sapir, 2012). Secondly, Italian, Belgian and, to a minor degree, Greek debts did not increase too much after 2000. Thirdly, in 2010 Spain's public debt to GDP ratio was 61% compared to a non Eurozone country like the UK whose ratio had reached 80%. But,

Footnote 4 (from previous page): The so called Euro convergence criteria (better known as the Maastricht criteria) must be met by an European Union Member State in order to be accepted in the more restricted Eurozone club so that it can adopt the Euro as its currency. Under Article 140 of the Treaty on the Functioning of the European Union (henceforth the Treaty), the criteria to be met are the following: i) 12 months average yearly rates of harmonized inflation consumer prices (HICP) shall not exceed the HICP reference value, which is computed by the end of the last month with available data as the unweighted arithmetic average of the HICP inflation rates of the 3 EU member states with the lowest HICP inflation plus 1.5 percentage points. However, EU member states with a HICP rate significantly below the Eurozone average cannot qualify as benchmark countries (in the last 6 years Greece, Bulgaria and Cyprus were such outliers); ii) the annual general government deficit to GDP ratio at market prices, must not exceed 3% at the end of preceding fiscal year and neither for any of the two subsequent years. Deficit being "slightly above the limit" will as a standard rule not be accepted, unless it can be established that either: "1) the deficit ratio has declined substantially and continuously before reaching the level close to the 3% limit or 2) the small deficit ratio excess above the 3% limit has been caused by exceptional circumstances and has a temporary nature." If a Member State is found by the European Commission to have breached the deficit criteria, they will recommend the Council of the European Union to open up a deficit-breached Excessive Deficit Procedure (EDP) against the State in accordance with Article 126(6) of the Treaty which will be abrogated again when the State simultaneously comply with both the deficit and debt criteria; iii) the ratio of gross government debt to GDP at market prices must not exceed 60% at the end of the preceding fiscal year. Or if the government debt to GDP ratio exceeds the 60% limit, the ratio shall at least be found to have "sufficiently diminished and must be approaching the reference value at a satisfactory pace." This satisfactory pace was defined by a specific formula, with the entry into force of the new debt reduction benchmark rule in December 2011, requiring the States in breach of the 60% limit to deliver – either for the backward or the forward-looking 3-year period – an annual government debt to GDP ratio decrease of at least 5% of the part of the benchmark exceeding the 60% limit. If both the 60% and "debt reduction benchmark rule" are breached, the European Commission will finally check if the breach has been caused only by certain special exempted causes (like capital payments to common financial stability mechanisms as the European Stability Mechanism). In this case the Commission will then rule an exempted compliance. If this is not the case, the Commission will recommend the Council of the European Union to open up an EDP against a Member State in accordance with the above mentioned Article 126(6) of the Treaty which will be abrogated again when the State simultaneously comply with both the deficit and debt criteria; iv) Applicant countries should not have devalued the central rate of their euro pegged currency during the previous two years and for the same period the currency stability shall be deemed to have been stable without "severe tensions". Furthermore, participation in the exchange-rate mechanism (ERM/ERM II) under the European Monetary System (EMS) for two consecutive years is expected, though according to the Commission "exchange rate stability during a period of non-participation before entering ERM II can be taken into account." For example, Italy was deemed to have converged within only 15 months as an ERM-member, while for Cyprus, Malta and Latvia their 18 months of membership were insufficient; v) the average yields for 10 year government bonds in the past year shall be no more than 2 pct points higher than the unweighted arithmetic average of the similar 10-year government bond yields in the 3 EU Member States with lowest HICP inflation. If any of the 3 EU Member States in concern are suffering from interest rates significantly higher than the "GDP-weighted Eurozone average interest rate", and at the same time by the end of the assessment period have no complete access to the financial lending markets, then such a country will not qualify as a benchmark for the relevance value; which then only will be computed upon data fewer than 3 EU Member States (this happened to Ireland in 2012 for example). As part of the EU treaty, all of the EU Member States are obliged to adhere to the Stability and Growth Pact (SGP), which has adopted identical limits for governments budget deficit and debt. Due to the fact that several countries did not exercise a sufficient level of fiscal responsibility during the first 10 years of the Eurozone lifetime, two major SGP reforms were introduced. The First reform was the Six Pack which was followed by the Fiscal Compact signed by 25 out of the then 27-EU Member States.

unfortunately for Spain, its debt was no better rated than those of Portugal or Italy, while the UK's was considered to be safe.

All this means that there are different cases to consider even though there is a common denominator: the imbalance between core and non-core countries that is inherent in the Euro economic model (Perez-Caldentey and Vernengo, 2012). These authors argue that it was the euro and its effects on external competitiveness, that triggered ever more mounting disequilibria and debt accumulation in non-core countries.

III. SPECIFICITIES OF THE EUROZONE PUBLIC DEBT

The Eurozone public debt is not purely domestic nor purely external. Most of it is denominated in euro and held by Eurozone residents. Yet, it is different from the domestic debt of countries owning their own currencies because more of it is held outside the issuing country and because the issuing country does not have full control over the currency in which the debt is denominated. Therefore, debt in the Eurozone can be considered to be both "foreign" and "domestic" (Gianviti et al. 2010). This means that it is not subject to the currency mismatch associated with the external debt: governments have to pay their debts in the same currency they collect their revenues but they cannot use inflation to get rid of an excessive debt burden, as might be the case of a domestic government debt.

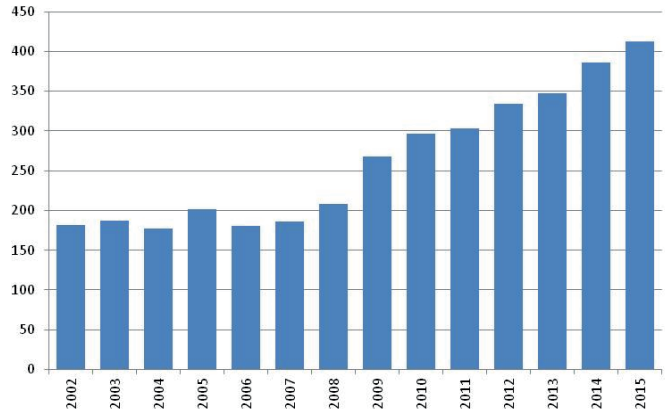
The Eurozone seemed to have no provision for sovereign debt crises and Article 125 of the Treaty on the Functioning of the European Union (TFEU) rules out the possibility of a bailout of an EU Member State by other Member States or by some EU institution. Therefore without inflation and bailout, a countries with excessive debt has 3 ways to escape the mess: 1) harmful fiscal retrenchment; 2) default inside the eurozone; 3) leaving the eurozone. Thus far, the first way has been chosen to the harm of populations.

IV. THE CASE OF IRELAND: THE ROARING YEARS AND THE CRISIS

The Irish economy enjoyed an exceptional period of sustained growth from 1994 up until 2007: in the earlier years, it was driven by the expansion of the world trade and a rapid increase in the world market share

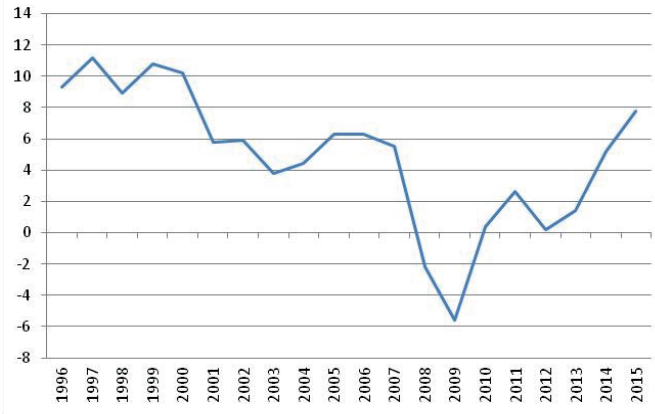
for Irish exports as a result of the competitive nature of the Irish tradable sector. This produced a strong approach to the full capacity output and a rapid increase in living standards (Bergin et al. 2011). Later, the process continued spurred particularly by Foreign Direct Investment encouraged by low corporate income tax rates (currently at 12.5%) and by the fact of being an English-speaking country (see Figure 1).

Figure 1: Irish FDI stock relative to GDP



Source: Eurostat

Figure 2: Growth in Ireland (1996-2015): yearly percentage change



Source: Eurostat

In figure 2 the Eurostat official Irish growth rates can be seen. Ever since the start of the available time series, Ireland has experienced a very

high growth with the exception of the 2008-2012 period. In the last two years high growth rates seem to have resumed their fast pace.

On account of this strong growth the Irish economy experienced a great increase in real estate prices that reached an all-time high in 2007. This was facilitated by Ireland's demographic structure that recorded an high (for a European nation) natural increase in the population in the 1990s. The largest cohort of the population in 2000 was aged 20-24. In addition, the number of retired people was low due to high emigration from the 1930s to the 1950s. Thus, Ireland entered the mid-1990s boom period under-endowed with infrastructure in the form of dwellings. The number of adults per dwelling was substantially higher than in the other EU Member States with the exception of Spain. In addition, the boom in the economy meant that many Irish emigrants returned and many immigrants came to work in Ireland, putting further pressure on public and private infrastructure. In other words, the upsurge in the building sector was a natural consequence with its pathological bubble firstly disclosing only in 2003. Of course, the bulk of the additional resources required to fuel the increase in output of the building sector had to come from other sectors of the economy, leading to a reallocation of resources within the economy (FitzGerald and Morgenroth, 2006). Wage rates were driven up across the economy by the rapid growth in labor demand in the building sector and, as a consequence, firms dependent on the export markets suffered. The building sector had started crowding out the rest of the economy.

House prices stabilized in 2008, beginning to decrease by 2008 Q3 (Environment, Heritage and Local Government, 2010).[5] As a matter of fact, by 2007, the Irish economy had already become too dangerously dependent on housing and real estate sector as a source of economic growth and tax revenue. A lightly regulated financial system fed on this process. In fact, the growing construction boom was led by the increasing reliance of Irish banks on wholesale external borrowing (particularly from Germany and

5. In 2008 the average price of a new house in Ireland was 305,269 euros, while in 2009 it had decreased to 242,033 euros, i.e. a decrease of 20.7% in a year. They had reached 313,678 euros in 2008 Q2 and had subsequently started falling by 2008 Q3 to 301,680 euros. In 2009 Q4 they had decreased to "only" 226,505 euros and stabilized in the first two quarters of 2010, hovering around 226K euros. Second-hand house prices fell as well from an all-time high reached in 2008 Q1 (359,277 euros) to 244,679 in 2009 Q4. Housing loans approved were more than halved in 2009 (by 52,1% falling to 12,585).

from 2003) at a time when international financial markets were awash with cheap investable funds sustained by the fall of nominal and real interest rates.[6] In other words, the Irish participation to the EMU and to the globalization of financial markets reduced the concern on the balance of payments disequilibria. Specific tax incentives boosted the overheated construction sector and more generally fostered non-tradable goods and services, while a tax on mortgage interest payments could have been used to raise the cost of borrowing for households, mirroring the effect of a rise in interest rates, thus controlling house prices more effectively (Barry and FitzGerald, 2001). Moreover, banks stimulated demand with loan-to-value mortgages up to 100%. The level of mortgage per capita credit increased over tenfold between 1995 and 2008 (Russell et al., 2011 Table 4.2), while the ratio of house prices to average earnings suggested clearly that mortgage levels had become unsustainable (Kelly, 2009).

When the real estate price bubble burst – very much like Spain's - the country experienced a deep banking crisis, increase in unemployment and a fall in net earnings generated from the labor market (-11.5% in the period between 2004 and 2011, see Watson and Maître 2013). The contraction in national output was unprecedented and this resulted in a fiscal crisis that obliged the country to accept a "bail out" from the EU and the IMF.

The rapid deterioration in the labor market, alongside stringent austerity measures implemented to plug the public finances had a widespread impact on peoples' lives. Public sector earnings fell significantly due to the introduction of a pension levy in 2009 and a wage cut between 3 and 15% in 2010 (O'Connell, 2012).

In the private sector, the adjustments were mostly made through job cuts rather than wage reductions. Increasing rates of largely involuntary part-time work for men and women in both the public and private sector had a depressing effect on weekly and labor market earnings (Russell et al. 2013). The mean equivalized income per individual at 2004 prices fell

6. According to the Bank for International Settlements the foreign borrowings of Irish banks had reached 110 billion euros in 2008. Much of this was borrowed on a three month rollover basis to fund building projects that would not be sold for several years. When all of those properties could not be sold anymore, a classic asset-liability mismatch followed. The banks were said to be illiquid but not insolvent by 4 billion euros, but this turned out to be a huge underestimation.

from 20,962 euros in 2008 to 19,003 euros (Callan et al. 2013, table 5).[7] Tax changes such as the introduction of the Universal Social Charge (USC) and changes to Pay-Related Social Insurance (PRSI) also reduced net earnings. During the first phase of the recession, social welfare payments were protected. The 2009 budget increased income support rates for social welfare recipients. However, the 2010 and 2011 budgets reduced the rates in most schemes for those in working age, although the payment in respect of child dependents was increased and the rates of payment for old age pensions had remained unchanged. Since 2009, the universal child benefit payment has been cut a number of times and the early childcare supplement –a cash grant of 1,000 euros payable for children under six years— was abolished in 2009. Payments to young unemployed people were cut substantially (Maître et al. 2014, p. 4). FitzGerald (2014, table 1) shows how the cumulated fiscal adjustment implemented in Ireland in the period 2008-2015 was about 19.5% of the ex ante GDP (31.8 billion euros). Overall, two thirds of this adjustment involved expenditure cuts and one third increased taxation.

Private debt problems played a more significant role than in previous recessions. Per capita credit card debt rose from 102 euros in 1996 to 707 euros in 2008 and the number of credit card issues increased dramatically during the boom period. The level of personal house indebtedness in Ireland also increased dramatically (Russell et al. 2011, Table 4.1). In 2013 Q2 (i.e. when the spread with the German bund had already started to substantially decrease, suggesting a significant reduction in country risk) 12.7% of mortgage holders were still in arrears for principle dwellings as were 20.4% of buy-to-let mortgage holders. The level of mortgage/rent arrears among Irish households was the highest in the EU at 11.6%. Only Greece came close to the level of housing arrears observed in the so-called Celtic Tiger (Irish Central Bank, 2013). Combining information on arrears in utility bills, hire purchase repayments and mortgage/rent, just less than 20% of Irish households were in arrears in at least one of these categories compared to an average 11.7% for the EU 28. Emigration – not only from foreign nationals but

7. For the sake of truth, the authors estimate that the impact of public policy would have played a mildly progressive role. The effects of changes in tax and welfare systems over the 2009-2014 period have reduced the incomes of the richest 10% of the population by 15.5%, while the decline in the incomes of the poorest 10% of the population was 12.5%. The population at risk of poverty in 2011 was 16%. Without reduced welfare transfers it would have been close to 50%. In the boom years it would have been under 30%. Of course, the resulting increase in welfare payments has contributed to the problems in the public finances.

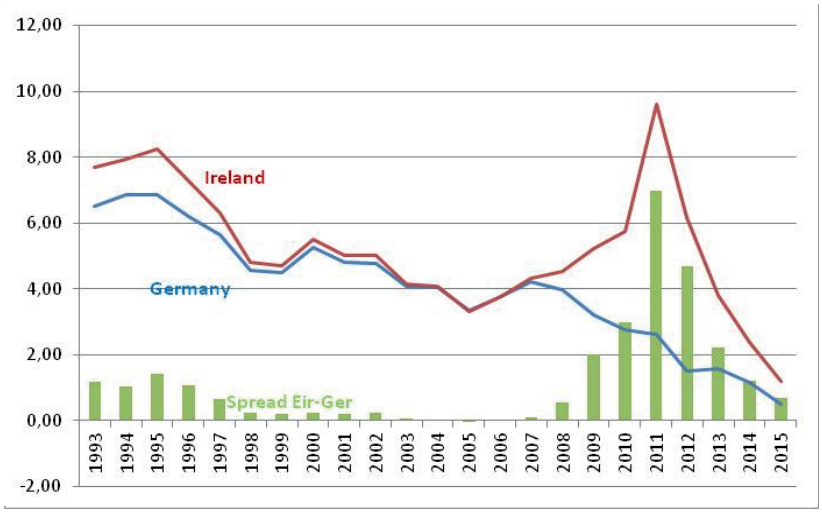
also of Irish highly skilled nationals – started increasing again. Interestingly, more people decided to go somewhere other than the US, the UK or the EU.[8]

There were also policy failures. A false sense of security lulled households and companies believing that the boom was sustainable and it also persuaded policymakers that a soft landing was likely.

The spread between the Irish and the German sovereign yields was virtually null between 1998 and 2007, a decade that can be defined the golden age of the Eurozone[9], but in 2008 they started growing again when the global economic recession struck. (see Figure 3).

This hubris was not confined to domestic policymakers: O'Leary (2010) shows that the European Commission and the IMF also failed to warn of the need for a change in domestic policy.

Figure 3: spread between Irish and German Sovereign yields (1993-2015, 10 years maturity)



Source: own calculations on IMF data

8. Emigration of skilled workers, proved long-term in nature, could have negative, permanent effects on an economy by lowering its TFP.

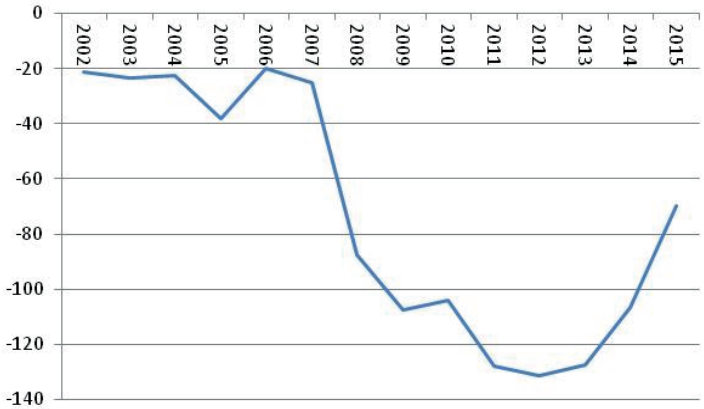
9. The Euro started circulating in 2002 but the exchange rates were fixed in late 1998.

Anyway, the policy stance by the last outgoing Irish government in drawing up the program in late 2010 was rather unusual because it aimed to under-promise only 3 months before an election (it is more usual for governments to over-promise in a run up to an election). But it also anticipated a disastrous election result and, instead of over-promising, facilitated the incoming government by putting an achievable set of fiscal targets. This approach of under-promising and over-delivering in Ireland contrasted with that of Spain. The adjustment in the Spanish public finances planned in 2010 was more ambitious than that of Ireland. The Spanish plan was aimed at reducing the deficit to 3% of GDP by 2013. In the spring of 2011, the outgoing government, raised the bar for the incoming government, committing to reduce the deficit even more rapidly in 2011 and 2012. However the latter government in spring 2012 found that this time path of adjustment was not realistic and it had to dramatically alter the plan. Because of a failure to meet more ambitious targets, the financial markets temporarily lost faith in the ability to deliver and Spanish bonds yields rose above the Irish. By contrast, in the case of Ireland, smaller but steady progress was rewarded with a steady fall in bond yields. Thus, the lesson that can be learned from these two examples is that it is better to under-promise and over-deliver.

Furthermore, the high FDIs had a worrying downside which started being evident when Ireland decided to be one of the original member of the Eurozone: the net international investment position strongly deteriorated and started improving only in the last two years (2014-2015) even though it is still well above the -35% of GDP threshold called for by the European Commission in the Macroeconomic Imbalance Procedure[10] (see Figure 4). The rapid improvement of the last two years may be also due to the fact that the BoP's current account usually gets better when there is a rapid fall in domestic investment (Ireland, Spain) as a consequence of a bubble burst than when there is a fall in domestic consumption (Greece, Portugal, Fitzgerald 2014).

10. The Macroeconomic Imbalance Procedure (MIP) aims to identify potential macroeconomic risks early on through a set of 14 indicators, prevent the emergence of harmful macroeconomic imbalances and correct the imbalances that are already in place. It is a system for monitoring economic policies and detecting potential harms to the proper functioning of the economy of a Member State, of the Economic and Monetary Union, and of the EU as a whole. The MIP scoreboard indicators cover: a) Internal imbalances from public and private indebtedness, financial and asset market developments including housing and private sector credit flow, unemployment rate; b) External imbalances and competitiveness, that may arise from the evolution of the current account and the net investment positions of the Member States, the real effective exchange rates, share of world exports and nominal unit labor cost; c) Employment indicators, like the activity rate, the long-term and youth unemployment rates.

Figure 4: Irish net international investment position on GDP (2002-2015)



Source: Eurostat

The mechanism is the following: when foreign capital enters a country, it finances its investments through two different channels: the former is indirect when an investment is carried out by a resident individual who borrows abroad; another is direct if it is implemented directly by a non resident entrepreneur through foreign savings. If a resident entrepreneur borrows abroad, his/her country gets indebted: the balance of payments records a positive capital inflow and negative interest and payments principal (the loan return) because the FDI has to be compensated. If a non resident entrepreneur decides to build a plant in the country, he surely creates income, jobs, and a profit for him/herself (quite high if the corporate income tax is low as it is the case for Ireland). This profit will be partly reinvested, partly spent in Ireland, partly returned to the entrepreneur's own country of origin. In the balance of payments, repatriated profits are passive incomes to be paid to remunerate FDI inflows. In the period 1992-2016, average capital income paid by Ireland to the rest of the world have been 32% of its GDP on average, while the other 11 founding members of the Eurozone only reached 6%, i.e. it was five times larger than the Eurozone 12 and six times larger than in the most relevant economies of the area (Germany, France, Italy). In the same period average growth rate of the Irish GDP reached 7% against an average 3% of the other members. But its income balance of payments was strongly negative (the situation worsened from 2000. Up until 1999 the Irish current account was slightly positive, see Bagnai 2012, Bergin et al. 2011 Figure 2), regardless of the strong growth, that had the debt to GDP ratio fallen impressively from 91% in 1991 to 25% in 2007.

Hence, one needs not to get insight only looking at (the worsened) public finances, even though some sort of fiscal tightness could have been carried out to slow the process in the first years of the 2000s (Barry and FitzGerald 2001).[11] As it has been showed, much of the income produced with trade went out to compensate foreign capital.

Indeed, when Ireland entered the Eurozone, its competitiveness crushed: up to 2008, the average T/T-3 change (one of the MIP indicator) in the real effective exchange rate was strongly positive (i.e. Ireland lost competitiveness) except in the year 2000 (see Figure 5).

Figure 5: Real Effective exchange Rate of Ireland 42 trading partners average T/T-3 change

Source: Eurostat

11. According to the authors, the bursting of the dotcom bubble in the early 2000s led to a slowdown of the world economy. Thus, to curb the negative effects on Irish growth, the government chose not to intervene prociclically. That slowdown was less severe than had initially expected and it effectively provided some breathing room for the Irish economy. Bergin et al. (2011) blame inappropriate fiscal policy action for the period 2001-2007 and the regulatory authority of the financial sector which did not move to defuse the growing crisis by imposing an appropriate regulatory framework on the domestic financial system. They estimate that over the period 2008-2011, the budgetary tightening, equivalent ex ante to 13% of the Irish GDP, had a cumulative ex post impact of 7.5% of GDP. While this is very severe, according to those estimates it was not as severe as the sum of the austerity budgets of 1983, 1988 and 1989 together at 10% of GDP. The reason for this is relatively straightforward, while the nominal cuts introduced in the 2008-2011 period may have well been unprecedented, in real terms their effect is more muted since prices and wages were also falling. By contrast, in the 1980s, relatively high rates of inflation meant that a nominal freeze in pay rates or welfare payments translated into a more severe real reduction.

As a matter of fact, when the crisis struck in 2007-2008, exports collapsed and foreign trade proceeds were not enough any longer to compensate foreign capital inflows: the country fell in the foreign private debt spiral above mentioned. Indeed, in the period 2000-2008 Irish REER appreciated about 40 percentage points , the trade balance fell by 13 percentage points and the current account reached the -5% threshold over GDP.

It has already said by how much property prices started collapsing and the severe losses in the domestically-owned Irish banking system owned that followed.[12] The rescue of this banking system proved to be extremely costly because when domestic banks have a high share of their business at home a collapse in a sector lead to the collapse in banks. This has proved to be an albatross around the neck to the economy.[13] A positive trade balance was regained only through a deep recession that made imports deeply fall.

5. The Irish recovery myth

But the so called Irish growth fairytale has to be more deeply scrutinized in order to understand what has happened and what is currently going on. Firstly, it started from 2013 and so far has experienced a strong decrease in the wage share (from 43% to 34% of GDP from 2008 to 2015), due to the decision of carrying out a huge internal devaluation.[14] The Central Statistical Office of Ireland (CSO, henceforth) has recently released data concerning the stunning growth of the last quarter of 2015 which outranked India and China's and ended up resulting in the best annual outturn since 2000. In mid-July 2016,

12. Two weeks after the Lehman Brothers announced it would file for Chapter 11 bankruptcy protection, the provision of a blanket system-wide state guarantee for Irish banks was announced. This measure was taken because of the drain of liquidity that had been affecting Irish banks and that had bought one important bank on the brink of failure. In April 2009, the Irish government established the National Asset Management Agency (NAMA), with the mandate to purchase at a steep average discount the universe of development-related loans from banks, above a certain value. This meant that banks required substantial upfront recapitalization programs - which could only be provided by the State - and led to a huge increase in gross government debt and deficit (Beker, 2013, Bagnai 2012). Finally, the Irish government had to request the assistance mentioned in the article from the EU and IMF in November 2010 to avoid default on its public debt which had increased in five years from 42.4% to 120% of its GDP.

13. The rapid recovery of Baltic countries can indeed be explained by the fact that their banking system is almost entirely foreign-owned.

14. The wage share of Hungary that did not join the Eurozone remained quite stable: in 2008 it was 44% of GDP, while in 2015 it was only two pp below (42%). In point of fact an external devaluation is helpful to net exports and does not negatively affect wages (Atish et al., IMF 2014).

it revised up growth for 2015 from 7.8 to 26.3% in front of a gobsmacked audience.[15] As The Economist puts it, in modern history only poor countries experiencing natural resource booms or the end of wars have grown faster.

Secondly, it did almost nothing to job creation (only 5,000 jobs were added) while employment is still 9 percentage points below the peak reached at the start of 2008. A total of 44,100 net new jobs were created in 2015, while the employment to population ratio still stands at less than 64%, ten points below the UK's. Some wage pressures are starting to emerge but only in some highly skilled segments of the market, where supply is strongly tight. Once again, construction remains the fastest growing sector of employment but still remains some 54 percentage points below its 2006 peak. The weird thing is that good exports were valued at 111 billion Euros based on customs data but 144 billion in the Balance of Payments data – a jump of 28%. Apart from adjustments for double counting, the bulk of the upsurge relates to the booking of foreign manufacturing, in Ireland for tax avoidance purposes – this activity called contract manufacturing.

The Chemicals plus Medical devices sector, which accounts for 58% of the 111 billion Euros total, added about 2,000 jobs in a ten year period (2005-2014) while in 2015, the indigenous-dominated Food and Beverages sector had a low single digit performance with a surplus rise of 4%, despite positive currency developments during much of the year, compared with the overall goods trade surplus rising from 43 to 65 billion Euros, a jump of 51%.

In terms of employment, the indigenous sector is much more job-intensive and of course much less export-oriented than the foreign sector. This simply means that the rise in the overall goods trade surplus is not a significant jobs engine for the Irish economy and provides a sort of "leprechaun's gold" for the typical Irish citizen which is reflected in an Irish per capita standard of living[16] below Italy's and a very high hidden underemployment (Henningan, 2015, IMF, 2013).

During the recession the rising headline data was useful in promoting confidence overseas as it gave an impression to journalists and investors that

15. Eurostat has not validated this data yet. Thus, Figure 2 graphs old 2015 data.

16. This is computed by Eurostat as actual individual consumption (AIC) expressed in Purchasing Power Standards (PPS).

Ireland had switched focus from property and was achieving rising real exports, particularly in computer service. But as independent think tanks show (among which Financial Facts of Ireland and William Fry Law) about half of the 250 billion Euros worth of exports are totally inexistent, comprising about 60 billion Euros related to the Double Irish tax dodge used by companies such as Google, Microsoft, Oracle, Facebook, the above mentioned contract manufacturing, the treatment of aircraft purchases by aircraft leasing companies based in Ireland, even though most of those airplanes never visit the country (FitzGerald, 2015) and the excess profits of foreign-owned manufacturers. But these phony figures cannot be avoided in a sense. The change stems from a Europe-wide shift in the way investment is treated in GDP statistics.[17] When a company executes a tax inversion, registering in Ireland to benefit from its low corporate tax rate, it and its intellectual property are now added to the country's capital stock, while returns are included in the GDP. Ireland's capital stock has indeed increased by one third in 2015, as American firms rushed to pull off tax inversion in anticipation of a likely crackdown.

It is well known, figures of GNP (value added accrued to resident factors) for Ireland are quite distant from those of GDP and about 20% lower. In 2015 the value of GNP was 85% of GDP. But the trend in recent years of those mainly large American companies moving their headquarters and tax residency to Ireland is negating the reliability of even the GNP as a metric while the Balance of Payments data are also polluted.[18] In point of fact, if the impact of aircraft purchases and redomiciled PLCs are taken into account, the recent jump in Irish trade surplus turns out to be a small deficit (0.3% of GNP) even in 2014 (CSO, 2015). Moreover, in 2015, two big US so-called tax inversions – Medtronic and the takeover of Botox-maker Allergan by Actavis – boosted Irish GNP but the CSO does not disclose the total impact of these tax avoidance moves on the national accounts. In 2016

17. The introduction of the European system of national and regional accounts (ESA 2010) has been a major event for the EU Member States. The most notable change to national accounts indicators was the treatment of expenditure on research and development which is now recorded as gross fixed capital formation rather than intermediate consumption (i.e it is capitalized). This change has revised EU-28 (UK included) 2010 GDP by 1.86%. The second most important change was the inclusion of the expenditure on weapon systems which accrued 0.17% to the 2010 EU-28 GDP. The Member States also took the opportunity to rebenchmark their national accounts, review their data sources and introduce new or improved once (see. Dunn, 2015).

18. This also messes up productivity data, unit labor costs, and distorts science and technology indicators.

Pfizer, the US drug giant, is likely to become Irish for tax purposes so that another boost in GNP is expected.

Finally, mergers and acquisitions (M&As) were vibrant in 2015, with a significant rise in deal values from 43.5 billion Euros in 2014 to 189 billion in 2015, although there was a drop in deal volume from 120 to 104. One national accountant can soon get the knack of M&As worth 189 billion with a GDP at 204 billion.

VI. WHAT CAN BE LEARNED FROM THE IRISH EXPERIENCE

Overall, the so called Irish fairytale has many weaknesses and fictions. Indeed it is not enough to take a glance at growth rate figures but it is always useful to understand why a country grows, because its capacity to fulfill its financial commitments is relevant. When growth is financed by foreign capital, it turns out to be intrinsically fragile. In my view the Irish story teaches us six more things:

1) It resembles the destiny of many other advanced and emerging countries which have collapsed due to an unsustainable foreign debt, at a time when public debt to GDP was often negligible (in the case of the Eurozone this is particularly true for Ireland and Spain).

2) FDIs are surely difficult to shut down or dislocate (the so called reversal with sudden stop is a typical feature of the portfolio investments) but they may be a weight for a country and for a long time due to mandatory compensation. Indeed the average 2002-2007 negative capital income that Ireland had to pay to remunerate FDIs reached -15% of its GDP. An enormous figure, exceeded only by that of the Democratic Republic of Congo (-23%).

3) A strong currency as the Euro is not always useful to an economy and does not prevent it from the possibility of fire sales of its firms because their value is given by their expected profits and if an overvalued currency restricts profits more than it does with costs, firms get devalued. In the last couple of years Ireland's figures have been helped by the new European statistical rules and by American enterprises becoming Irish but the divide between GDP and GNP from a side and the median Irish standard of living is evident.

4) Even though the outgoing government acted well back in 2010, the idea that a strong money can defend a nation (even if it is small, open and trades mostly outside the Eurozone as it is the case for Ireland) is a direct expression of a short-sighted nationalism just as that of Churchill when he defended the monetary fetish of one sterling for 4.86 dollars, doomed to fail anyway after blowing the British economy to pieces (Keynes, 1925).

5) Over borrowing contributed to push traditional low-TFP sectors like real estate in Ireland and rest of the periphery. From an efficiency point of view this is harmful for long term growth.

6) From a welfare point of view austerity measures are never successful for the people, with scars also hurting in the long term.

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