

For economics  
assignment



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Another incentive to attract this investment was the fact that Ireland was now part of the EC so therefore could act as a gateway into Europe. At that time Ireland had a young, well trained, English speaking workforce and a developing social partnership with the unions which would help to limit the possibility of industrial disputes (Featheriness, 2010). The growth levels that Ireland achieved were unprecedented during this period and Gross Domestic Product (GDP) increased on average by 7% each year and was the highest among in the European Union (EU) fifteen members at that time.

Ireland also increased its GDP business dealings by over 23.5% (COED, 2009). This growth was also supported by a growth in the population of just under 13% due to high net migration as a result of the return to Ireland of former emigrants and migrants from the new member states of the EU. (Central Statistics Office (CSO) 2007). The unemployment rate fell from 9.9% in 1997 to 4.6% in 2007. This in turn led to an increased demand for imports which rose from 10.3 billion in 1997 to over 54.3 billion in 2007 (COED, 2009). The balance of trade surplus which had stood at 226 million in 1997 was turned around and became a deficit of 10.3 billion in 2007 (CSO, 2009). With the relaxing of the banking regulations by the government, Ireland was seen as the perfect location to become the centre for international finance with a large number of jobs being created. This light touch was to be proved to be disastrous in the long run.

The momentum in the Irish economy slowed down in 2002, at the same time as the international downturn in the information technology sector which had a huge effect on Ireland. Economic growth did return in the years after 2002, but this was based on what is known now as unsustainable and questionable economic and political practices (Featheriness, 2010). Ireland became over dependent on the property sector. Initially, the investment in property was based on supply and demand, with the rise in the population and in employment, the demand for houses increased.

With the economy recovering from the dotcom bubble crash, a certain amount of speculation stole into the market and people underestimated the risks in wanting to own their own homes. Loans approved from the financial sector rose from 4.4 billion in 1997 to over 31.4 billion in 2006. To meet this

demand, the stock of house completions increased by over 430. 000 in six years, from 2001-2006. In 2006, the number of completions peaked at approximately 93, 000 houses, compared with 38, 000 in 1 997, the start of the boom.

Even with this large increase in house completion, prices soared. The average price of a house in 1997 was 1 02, 491 and increased to 350, 242 by the first quarter in 2007. There was a similar reaction to the price of an apartment, which saw an increase of 246% over the same period (Department of the Environment, Heritage and Local Government, 2009).

The property market was beginning to show the signs of an asset price bubble in 2004, with many analysts commenting on Ireland's over reliance on the property and construction sectors.

The Economist (2004) survey remarked that the Irish banking system was heavily exposed to a property sector shock, specially Allied Irish Bank (AIB) and the Bank of Ireland. These warnings would appear to have been ignored and the Irish governments monetary and public policies seem to justify this claim (Sullivan and Kennedy, 2010). Lane (2012) suggests that it was a missed opportunity on behalf of the Irish government not to tighten fiscal policy during 2003-2007 when it was a period in which the private sector was taking on more risk.

The credit and housing boom had created extra tax revenues since the high construction activity, rising asset prices and capital inflows boosted the take from asset transaction taxes, capital gains taxes and expenditure taxes. The low interest rates also meant that the servicing of debt was below historical

averages. Instead of tightening fiscal policies, the Irish government decided increases public spending and/or tax cuts. If they had taken a more forward-looking and prudential approach to risk management and accumulated buffers it might have helped when the boom ended in such a quick and disturbing manner.

In 2008 the Euro was ten years in existence. In considering how successful the first decade had been, the European Commission (SEC) produced a 350 page report (European Commission, 2008) and several research papers, to evaluate the European Monetary Union (EMU) performance over that period of time. After careful consideration the report concluded that the 'EMU is a resounding success'. The reservations of the one-size-fits-all monetary policy and the dangers of the uncoordinated fiscal policies seemed to have been over-looked.

The economic performances of Spain, Greece and Ireland were approved and any inflationary differentials were said to be a sign of competitiveness realignment doing its job. At the time, few disputed the findings of the report, over, when the full extent of the economic crisis emerged towards the end of 2009 and the beginning of 2010 and the four countries at the centre of the crisis (the three good performers plus Portugal) came under attack, the media and the markets, turned to the report, using it to attack the poor performance of the Euro.

Granted the Greek case was different in that they had misled the Commission regarding their public accounts, but this was not the case for the other three that had been widely praised for their economic

performances in the preceding years (Giovanni and Sparta, 2010). THE CRISIS When the recession in Ireland occurred in 2008, the then Irish government placed the blame on the current international crisis for the collapse. However, evidence suggests that the country was heading for a financial slump even without the international recession.

House prices had began to fall dramatically which led to the demand for new houses also to fall. This led to the housing market to come to a shuddering halt as people decided to wait for the prices to go back up before selling. The collapse in construction activity followed by a corresponding increase in unemployment led to huge shoes in income tax revenue coupled with a large increase in social welfare payments. Irish real GAP fell by ten percent, with nominal GAP falling from 190 billion to 161 billion in 2007.

Without fiscal adjustments, annual deficits were forecast to be as large as twenty percent of GAP annually (International Monetary Fund (MIF), 2010). With the fall of Lehmann Brothers in September 2008, it was evident the Irish banks were in a precarious position. Funding from banks worldwide had dried up overnight and the now faced crisis in both liquidity and solvency. The Irish government stepped in and guaranteed loans, obligations and deposits of the six Irish banks, totaling 400 billion, almost twice the size of the country's GAP (Lane, 2012).

WAS IT A CRISIS? The Economic and Social Research Institute (ESRI) Mid Term Report (2013) states that in the last five years, Ireland has experienced the worst economic crisis since the Second World War. The consequences of the crisis include an exceptionally high level of unemployment coupled with

a dramatic increase in indebtedness. Over the last century there have been different types of economic and financial stress periods in market economies such as currencies crises, sovereign debt crises, financial crises or combination Of all three.

In order to compare Ireland's experience, it is important to identify crises which have had the comparable features. This is problematic as although Ireland has experienced what could be classed as a traditional banking crisis, occurring after a credit and asset boom, it also occurred during a major global shock. In addition, the fact that Ireland is a member of the EMCEE, it did not endure a currency crisis. The Central Bank October Quarterly 2012) uses the severe economic and financial crises experienced by Sweden, Finland and Norway in the sass as a comparison to the position that Ireland was in.

In all three countries, financial deregulation, credit demand and strong economic activity created an asset and credit boom. The credit risk was focused in real estate as most Of the borrowing was for property related purposes. As in the Irish case, poor risk management, a slack approach to fiscal management and insufficient supervision was prevalent at that time. All three countries had to endure a rise in the German interest rate in 1992 as a exult of the Exchange Rate Mechanism (ERM) crisis that occurred at that time.

In a similar move taken by Ireland, both Sweden and Finland implemented blanket guarantees for depositors (Central Bank, 2012). In terms of real GAP, the cumulative fall in the Irish GAP exceeded that of both Sweden and

Norway. High unemployment may remain an issue in Ireland for the foreseeable future, although GAP could recover within a number of years. The difficulties faced by Ireland were as serious, if not worse than the issues that were dealt with by Sweden, Norway and Finland (Central Bank, 2012). IS THE CRISIS OVER?

In the Irish Advisory Council Pre-Budget Statement 2015 (2014) it was stated that in the past Ireland's fiscal policy had been shown to contribute greatly to the boom and bust economic cycles which caused extremely negative social consequences. This pattern has to be changed to remain on course in repairing the public finances even if the short-term indicators show improvements. The government has already implemented austerity measures amounting to almost 20 billion in the period 2008-2011 and further measures of 12 billion are expected in the period 2012-2015.

So far, 3% of these measures have been implemented, leaving 2 billion to be implemented in 2015. The council recommended that this stage of the austerity plan is completed. While the Exchequer returns for August 2014 showed a surplus of 1.1 billion ahead of predictions, this broad-based improvement should be viewed with caution and not deflect the government from the path they are on. If the government implements the full 12 billion adjustment as set out in the austerity package the general government balance would be -1.9% in 2015, which would be well inside the 3% target they were set to achieve.

There are risks associated with these estimates and the -1.9% figure would create a buffer that could soften any shocks that were likely to occur. While



meeting the 3% target has been the most important factor of fiscal policy in recent, it is not the only issue in the fiscal adjustment. The main objective has been to correct the maintainable gap between government spending and income and to reduce to debt level and to return to sustainable growth in output, incomes and employment in the economy.

Although the adjustment of 2 billion may not be needed to reach the 3% target in 2015, there is still a substantial gap, estimated to be 7 billion in 2014, between government spending and income which needs to be rectified. This would add to the already substantial debt that exists, estimated to be 215 billion, or 122% of GDP (Fiscal Advisory Council, 2014). The information announced in the budget depicted a recovery that was gaining momentum. Consumer spending, investments and exports are increasing which are assisting in the recovery.

Employment has increased for the last seven quarters, with 70,000 more people at work since the peak in 2012. The unemployment rate is still high, at 11.1%, but has fallen for the last twenty-seven months in a row. It is expected that unemployment will continue to fall to an average of 10% in 2015. It is forecast that over two million people will be employed in 2006. This growth has had a healthy effect on the public finances as the tax returns are expected to exceed the amount forecasted 41 billion, by 1 billion. The GDP growth is expected to reach 4.7% in 2014, with a growth of 3% expected in 2015. Growth in the years after that until 2018 is forecast to be above 3% each year, which is the steady economic growth required to continue the recovery. Improvements in the interest rates on the EX/MIFF loans will assist in minimizing the borrowing requirements and the

repayments due. The forecasted debt to GAP ratio has fallen to under 1 1 1 with the net debt forecast to be below 910/6. Although the debt is still high compared to other EX. members, the approach will ensure that the cost to the taxpayer will be reduced with regards to the interest payable on the national debt.

Due to the growth predicted in the public finances, the government did not implement the 2 billion austerity measures that were expected and in addition introduced tax reforms which re estimated to cost 585 million in 2014 (Budget 201 5, 2014). CONCLUSION After the highs of the ‘ Celtic Tiger’ and the excellent performances produced up to 2008, the Irish economy has suffered a severe setback due to circumstances that some experts would say were of their own making.

Relaxing the regulations on the financial institutions, coupled with slack supervision created a competitive atmosphere in the financial sector that got out of control. Not that all of the decisions taken by successive governments have been instrumental in the downfall. By taking steps to attract FED as a second best Option to having their own indigenous industry base, Ireland has built up a well respected reputation for a well trained and English speaking workforce capable of working in the high-tech industries. It was not just Ireland that disregarded the warnings about the credit and property bubbles that were growing.

The larger economies, such as the US and the UK were also culpable. Decisions taken at the time of the crisis have been criticized. The Irish finance ministers decision to guarantee the loans and deposits of the six Irish

banks the major one. What would have been the consequences if e had not done so? If the results of Iceland's default and present situation are examined, it could be said that the right decision had been made. Ireland is now on the road to recovery, with unemployment falling and GAP on the rise again.

This was an opportunity for the present government to continue with the last of the proposed austerity measures and create a buffer in case of any future shocks. The government failed to do so; instead they made small changes to the tax regime to alleviate the tax burden on the workers. Could it be there is one eye being kept on the general election which s due in 2016? The tax changes made have to be paid for and the only is by borrowing. Is this the type of politics that got Ireland into the boom and bust cycles criticized by the Advisory Council?