Ireland and Spain in the Crisis: the Tortoise and the Hare?

John FitzGerald
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www.esri.ie
Outline

- The Origins of the Crisis
  - Best indicator of danger: current account
- Past Experience of Adjustment
- Tackling the Crisis
  - The Tortoise and the Hare
- Resolution
Origins of Crisis

- Low cost of capital and housing “need”

Symptoms:
- Net foreign liabilities of banking system
- Current account deficits mounted

Compliant with SGP etc. – Surpluses
## Dwellings per 1000 Adults

<table>
<thead>
<tr>
<th>Country</th>
<th>All Dwellings</th>
<th>Occupied</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>620.8</td>
<td>594.6</td>
</tr>
<tr>
<td>France</td>
<td>633.6</td>
<td>525.6</td>
</tr>
<tr>
<td>Germany</td>
<td>598.5</td>
<td></td>
</tr>
<tr>
<td>Ireland 2001</td>
<td>525</td>
<td>464</td>
</tr>
<tr>
<td>Ireland 2006</td>
<td>574</td>
<td>478</td>
</tr>
<tr>
<td>Netherlands</td>
<td>534.0</td>
<td>534.0</td>
</tr>
<tr>
<td>Poland</td>
<td>453.5</td>
<td>421.2</td>
</tr>
<tr>
<td>Spain</td>
<td>655.1</td>
<td>443.6</td>
</tr>
<tr>
<td>UK</td>
<td>574.8</td>
<td>550.8</td>
</tr>
</tbody>
</table>
Housing Investment

% of GDP

- Ireland
- Spain
- EU 15

Years:
Net Foreign Liabilities of Banking System

- Ireland
- Spain
- Poland
Current Account Balance, % of GDP

Spain
Ireland

1995 1997 1999 2001 2003 2005 2007 2009 2011

-10.0 -8.0 -6.0 -4.0 -2.0 0.0 2.0 4.0 6.0

-10.0 -8.0 -6.0 -4.0 -2.0 0.0 2.0 4.0 6.0
Previous EU Current Account Crises

- No clear pattern
  - Mostly adjusted through higher exports
  - Exchange rate change helps, but not universal
- External environment important
  - Allows adjustment with growth
- Current account adjusts before government
  - Takes 4 to 6 years for quite large adjustments
- Current circumstances different
  - The external environment is universally bleak
Government and Current Account Adjust

Ireland Current Account

Finland Current Account

Ireland Government Borrowing

Finland Government Borrowing

Years of adjustment

% of GDP

Graph showing the comparison of Ireland and Finland's Current Account and Government Borrowing over a period of years.
## Current Crisis – Adjustment to date

<table>
<thead>
<tr>
<th>Country</th>
<th>Years</th>
<th>GDP</th>
<th>BOP</th>
<th>Investment share of GDP</th>
<th>Unemployment rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Growth</td>
<td>%</td>
<td>Initial</td>
<td>Initial</td>
</tr>
<tr>
<td>Ireland</td>
<td>2007-12</td>
<td>-6.0</td>
<td>-5.5</td>
<td>25.6</td>
<td>-15.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>2008-12</td>
<td>-5.6</td>
<td>-6.9</td>
<td>21.8</td>
<td>-4.6</td>
</tr>
<tr>
<td>Spain</td>
<td>2007-12</td>
<td>-4.2</td>
<td>-10.0</td>
<td>30.7</td>
<td>-11.6</td>
</tr>
<tr>
<td>Portugal</td>
<td>2008-12</td>
<td>-5.7</td>
<td>-12.6</td>
<td>22.2</td>
<td>-6.7</td>
</tr>
<tr>
<td>Romania</td>
<td>2007-12</td>
<td>2.0</td>
<td>-13.6</td>
<td>30.2</td>
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<tr>
<td>Lithuania</td>
<td>2007-12</td>
<td>-2.4</td>
<td>-15.0</td>
<td>28.1</td>
<td>-11.4</td>
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<tr>
<td>Estonia</td>
<td>2007-12</td>
<td>-4.9</td>
<td>-15.7</td>
<td>35.5</td>
<td>-10.6</td>
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<tr>
<td>Greece</td>
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<td>-20.1</td>
<td>-17.9</td>
<td>22.6</td>
<td>-9.4</td>
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<td>-22.4</td>
<td>34.1</td>
<td>-10.6</td>
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<td>3.4</td>
<td>-25.2</td>
<td>28.7</td>
<td>-7.3</td>
</tr>
</tbody>
</table>
## Current Crisis – Adjustment to date

<table>
<thead>
<tr>
<th>Country</th>
<th>Years</th>
<th>Exports</th>
<th>Change in current a/c as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ireland</td>
<td>2007-11</td>
<td>80.2</td>
<td>10.5</td>
</tr>
<tr>
<td>Hungary</td>
<td>2008-11</td>
<td>81.7</td>
<td>8.8</td>
</tr>
<tr>
<td>Spain</td>
<td>2007-11</td>
<td>26.9</td>
<td>9.1</td>
</tr>
<tr>
<td>Portugal</td>
<td>2008-11</td>
<td>32.4</td>
<td>10.7</td>
</tr>
<tr>
<td>Romania</td>
<td>2007-11</td>
<td>29.3</td>
<td>9.6</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2007-11</td>
<td>53.8</td>
<td>14.5</td>
</tr>
<tr>
<td>Estonia</td>
<td>2007-10</td>
<td>67.1</td>
<td>12.6</td>
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<tr>
<td>Greece</td>
<td>2008-11</td>
<td>24.1</td>
<td>12.3</td>
</tr>
<tr>
<td>Latvia</td>
<td>2007-11</td>
<td>42.5</td>
<td>20.7</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2007-11</td>
<td>59.5</td>
<td>24.2</td>
</tr>
</tbody>
</table>
Adjustment to date

- Current a/c adjustment through cutting imports
- Some countries: large investment share of GDP
  - Adjustment through a building bust: Ireland, Spain and Baltics
  - Accompanied by big falls in output – unemployment
  - Possible financial collapse
- Other countries reduction in current account:
  - Through cuts in consumption and imports
  - Very painful for wider population – adjustment not complete
- Fiscal tightening may reduce structural deficit
  - But initially reduces actual deficit by much less
## Banking Cost – Fiscal Effects

<table>
<thead>
<tr>
<th>Country</th>
<th>% of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>6.7</td>
</tr>
<tr>
<td>Germany</td>
<td>11.6</td>
</tr>
<tr>
<td>Greece</td>
<td>14.5</td>
</tr>
<tr>
<td>Ireland</td>
<td>38.0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>6.9</td>
</tr>
<tr>
<td>Spain</td>
<td>5.1</td>
</tr>
<tr>
<td>UK</td>
<td>5.4</td>
</tr>
</tbody>
</table>

EUROSTAT, IMF Fiscal Monitor and national sources
Banking Adjustment

- Initially: uncertain of magnitude
- Responsibility
  - Turning private sector debt into public sector debt
  - Government?
- Transparency or hide it?
  - Too big to hide but too burdensome to carry
  - Take action fast. If possible – overcapitalise BUT
  - Ireland forced to act fast – Spain delayed action
- Wider effects – end of the EU single market
Adjustment to date

- Conclusions
  - EMU membership not crucial – investment bubbles throughout EU
  - Don’t own your own banks: Ireland v Estonia!
  - Size of export sector matters for current a/c adjustment
  - Adjustment takes time – first the current account and THEN the public finances
Resolution

- Banking Union
  - Recreate the Single Market
- EU fiscal policy
- Domestic fiscal policy
  - Multipliers?
- Political Economy of Adjustment
- The labour market
- EU recovery crucial
Banking Union

● Bust national banks:
  ● Ireland and Spain

● Bust foreign Banks
  ● Estonia and Latvia

● Consequences:
  ● Renationalisation of banking: Ireland, Austria, Italy, UK
  ● Country specific cost of capital
  ● Consequences for growth in EU (Barrell, et al., 2012)

● An EU banking and financial system
  ● The single market
Euro Area Fiscal Policy

Impact on GDP

Source: Euroframe, 2013
## The Tortoise and the Hare

### Spanish v Irish Approach: Deficit as % of GDP

<table>
<thead>
<tr>
<th>Official Plans</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Plan of: Spain</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spring 2010</td>
<td>9.8</td>
<td>7.5</td>
<td>5.3</td>
<td>3.0</td>
</tr>
<tr>
<td>Spring 2011</td>
<td>9.2</td>
<td>6</td>
<td>4.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Spring 2012</td>
<td>9.2</td>
<td>8.5</td>
<td>5.3</td>
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</tr>
<tr>
<td>Latest</td>
<td>9.7</td>
<td>9.4</td>
<td>10.6</td>
<td>6.5</td>
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<tr>
<td><strong>Plan of: Ireland</strong></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Winter 2009</td>
<td>11.6</td>
<td>10</td>
<td>7.2</td>
<td>4.9</td>
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<td>Winter 2010</td>
<td>10.6</td>
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<td>10.8</td>
<td>9.0</td>
<td>7.5</td>
<td>7.1</td>
</tr>
</tbody>
</table>
Domestic Multipliers

- Openness matters
  - Export some of austerity, AND import effects too
- Affected by domestic risk premium
  - Reduced impact of tight fiscal policy
- Effects of deflation on labour market
  - Downward wage rigidity
  - Cannot pass through tax increase to employers
  - Reduced impact on competitiveness
- Deflation affects banks, which affects State
The Labour Market

- Legacy of high unemployment
  - Return to full employment – raise potential output
  - However, will the long-term unemployed get jobs?

- Elasticity of substitution of skilled for unskilled
  - If elasticity low, need to grow demand for aggregate labour or reduce supply of unskilled
EU 15, Labour Market, Lower Secondary Education

Labour supply

Employment
EU15, Tertiary Education

Thousands

Years: 1995 to 2010

- Labour supply
- Employment
Unemployment rate by level of education, 2010

- Lower secondary
- Upper secondary
- Tertiary education
Articles: