

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

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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

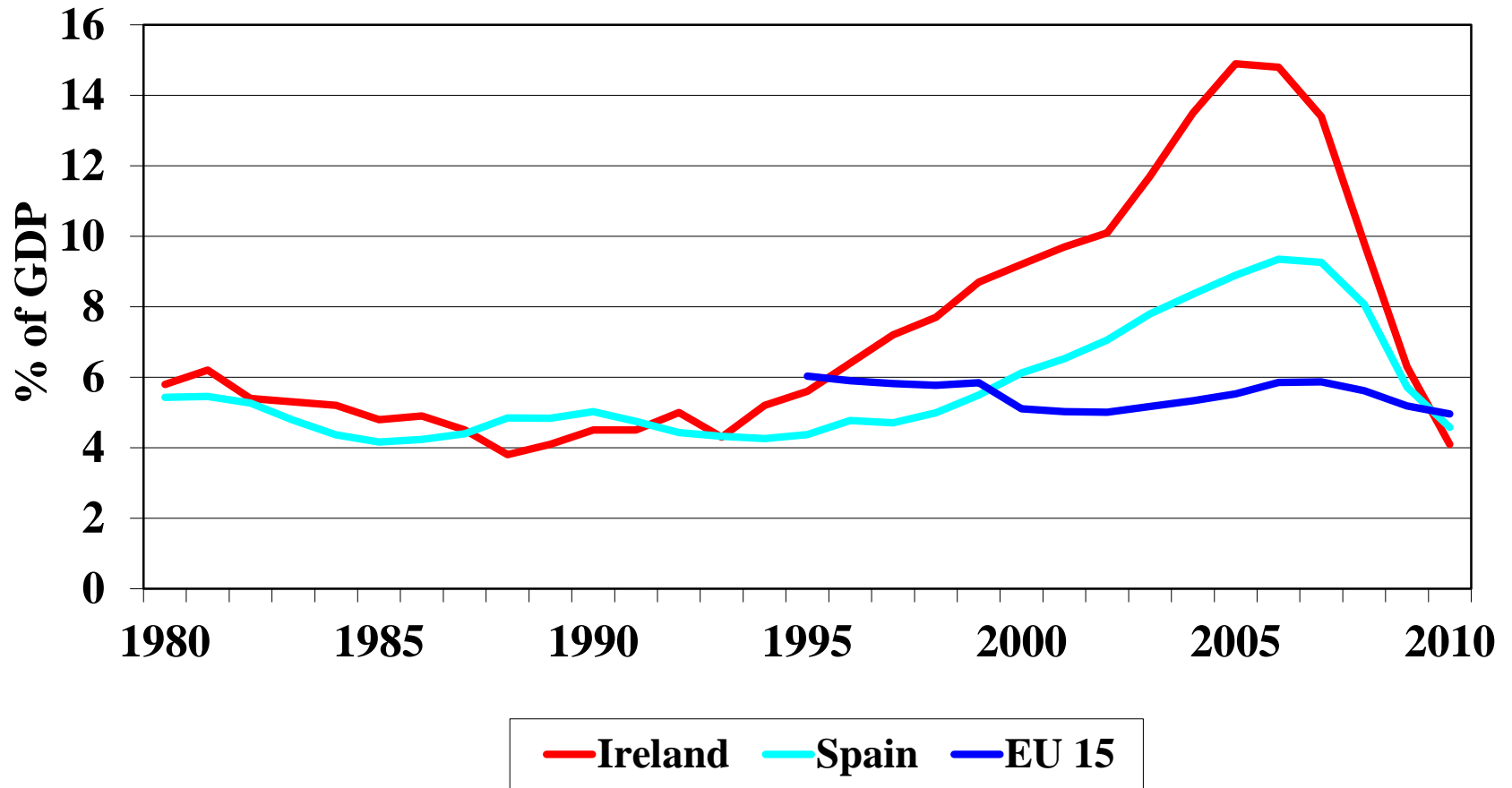
- Low cost of capital and housing “need”
- Symptoms:
 - Net foreign liabilities of banking system
 - Current account deficits mounted
- Compliant with SGP etc. – Surpluses

Dwellings per 1000 Adults

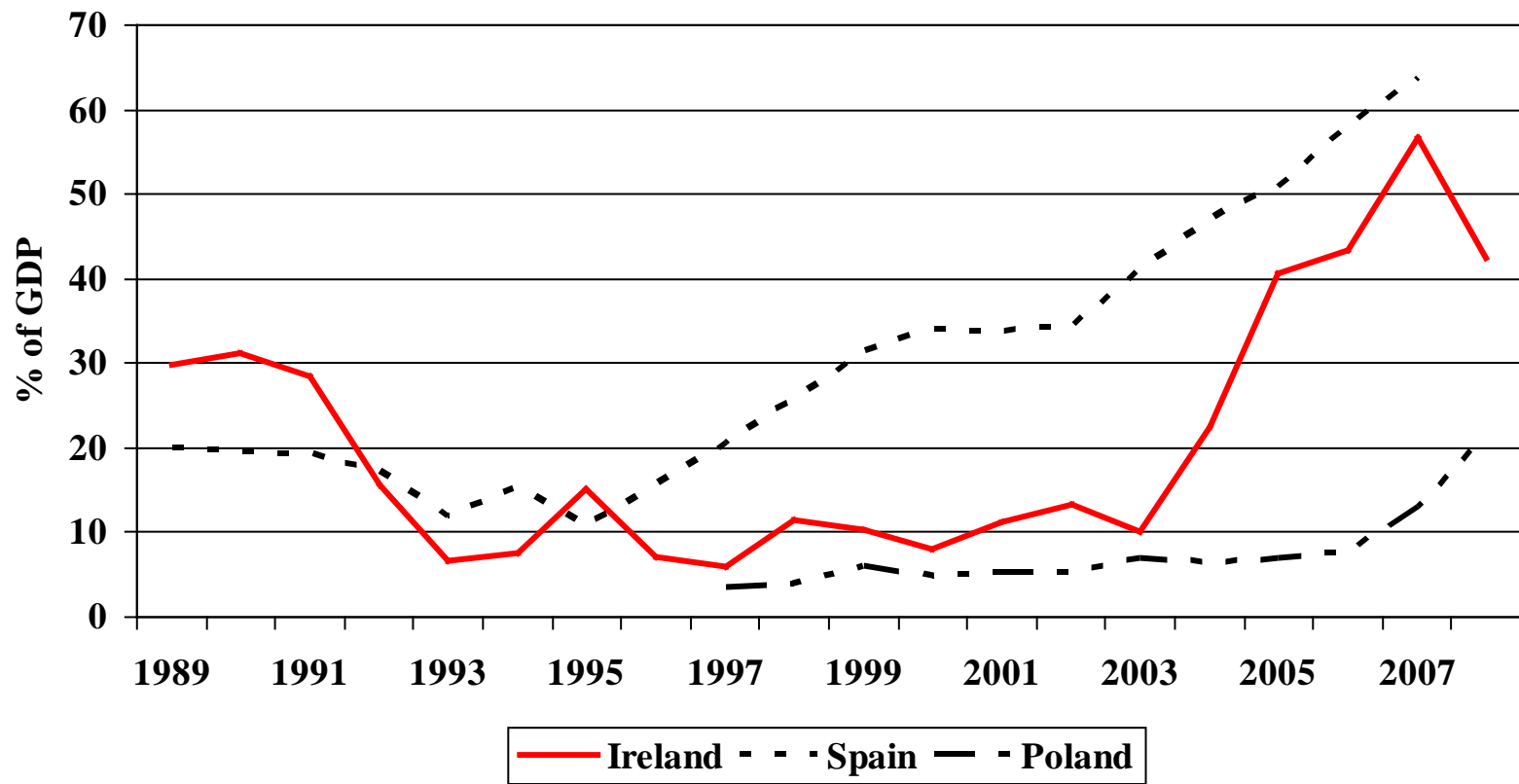


	All Dwellings	Occupied
Denmark	620.8	594.6
France	633.6	525.6
Germany	598.5	
Ireland 2001	525	464
Ireland 2006	574	478
Netherlands	534.0	534.0
Poland	453.5	421.2
Spain	655.1	443.6
UK	574.8	550.8

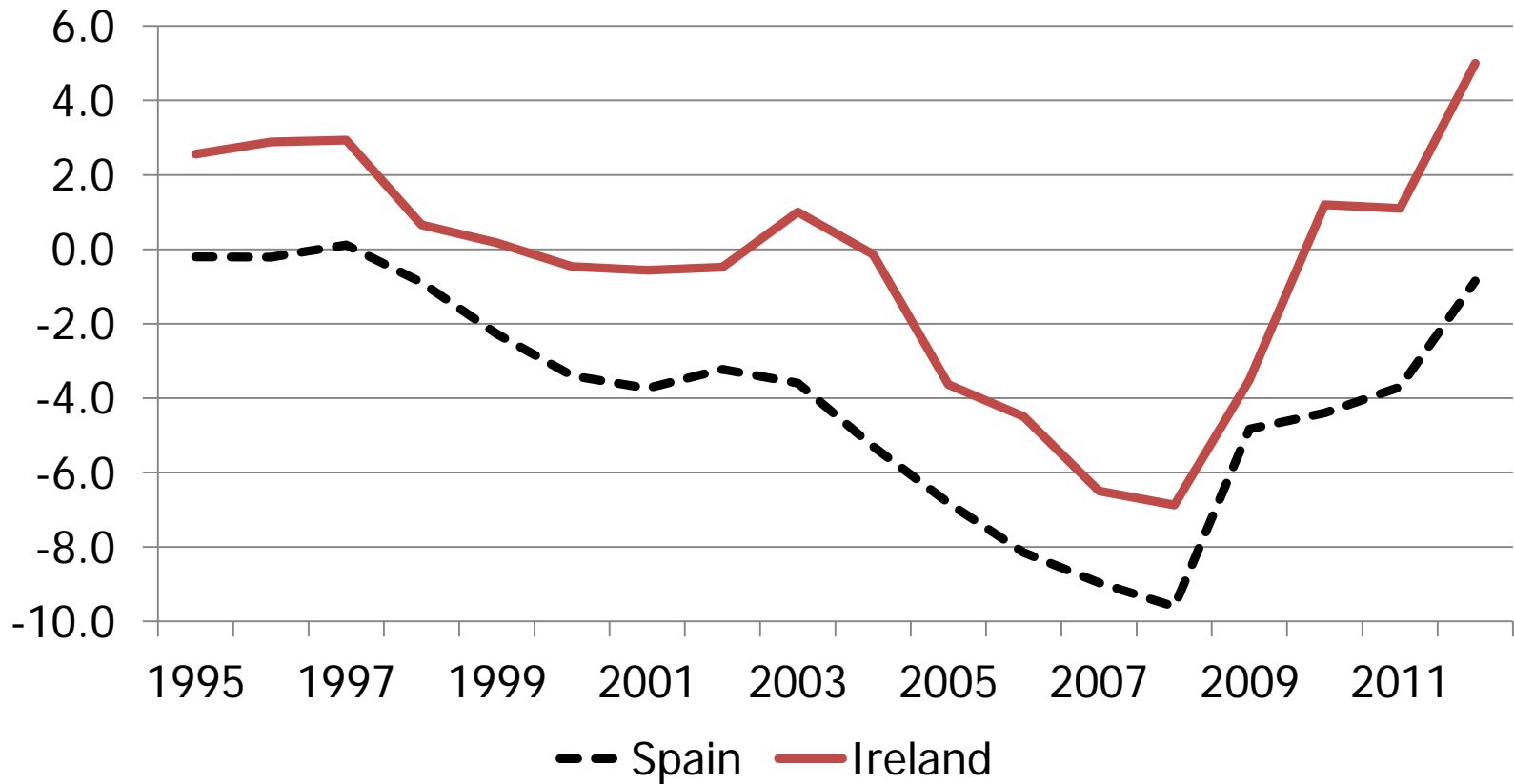
Housing Investment



Net Foreign Liabilities of Banking System



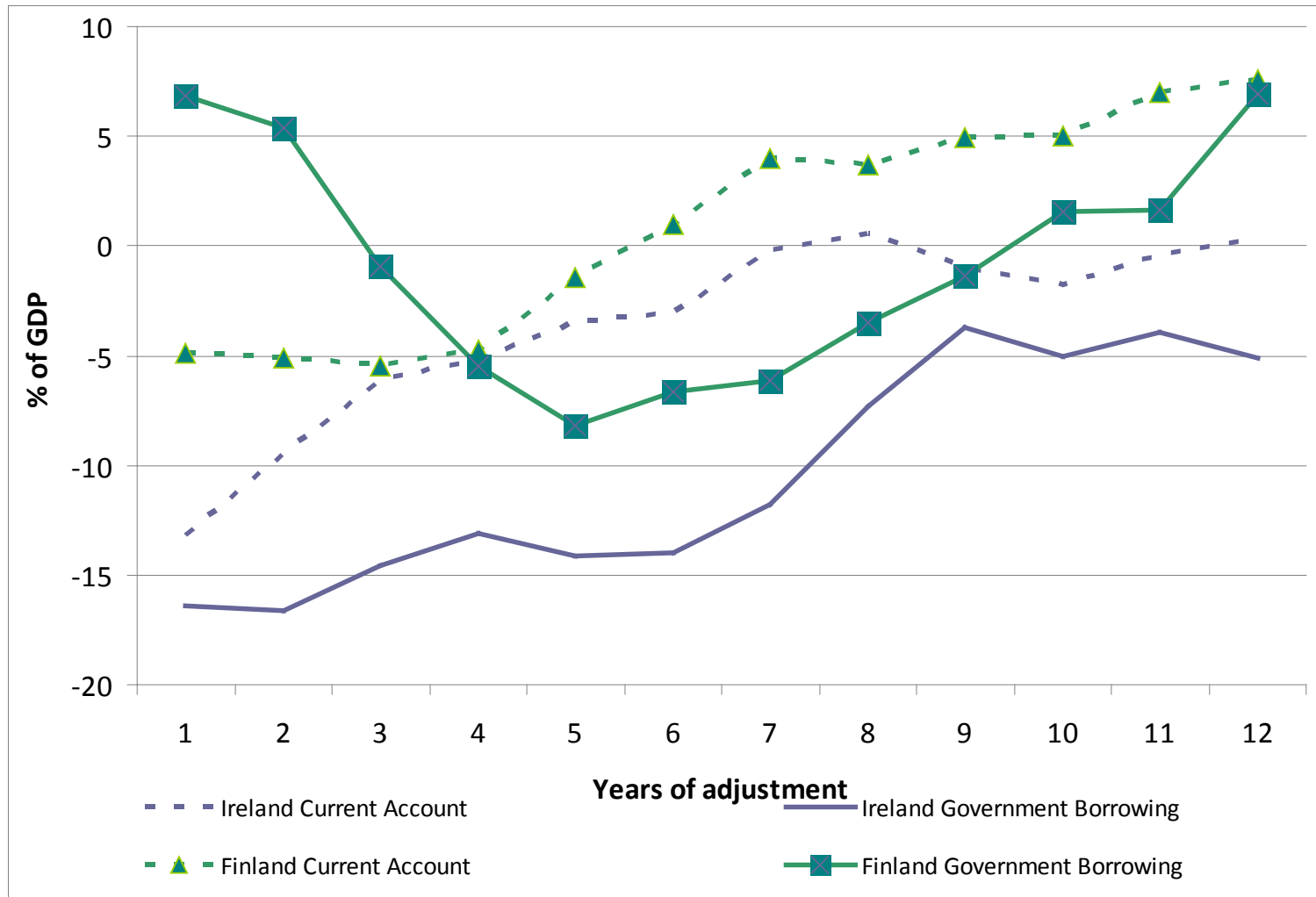
Current Account Balance, % of GDP



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



Current Crisis – Adjustment to date

		GDP	BOP	Investment share of GDP		Unemployment rate
		Growth	as % of GDP			
Country	Years	%	Initial	Initial	Change	change
Ireland	2007-12	-6.0	-5.5	25.6	-15.6	10.0
Hungary	2008-12	-5.6	-6.9	21.8	-4.6	3.1
Spain	2007-12	-4.2	-10.0	30.7	-11.6	16.7
Portugal	2008-12	-5.7	-12.6	22.2	-6.7	7.4
Romania	2007-12	2.0	-13.6	30.2	-3.5	0.6
Lithuania	2007-12	-2.4	-15.0	28.1	-11.4	9.5
Estonia	2007-12	-4.9	-15.7	35.5	-10.6	5.6
Greece	2008-12	-20.1	-17.9	22.6	-9.4	16.6
Latvia	2007-12	-12.2	-22.4	34.1	-10.6	8.4
Bulgaria	2007-12	3.4	-25.2	28.7	-7.3	5.4

Current Crisis – Adjustment to date

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

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

	% of GDP
Belgium	6.7
Germany	11.6
Greece	14.5
Ireland	38.0
Netherlands	6.9
Spain	5.1
UK	5.4

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

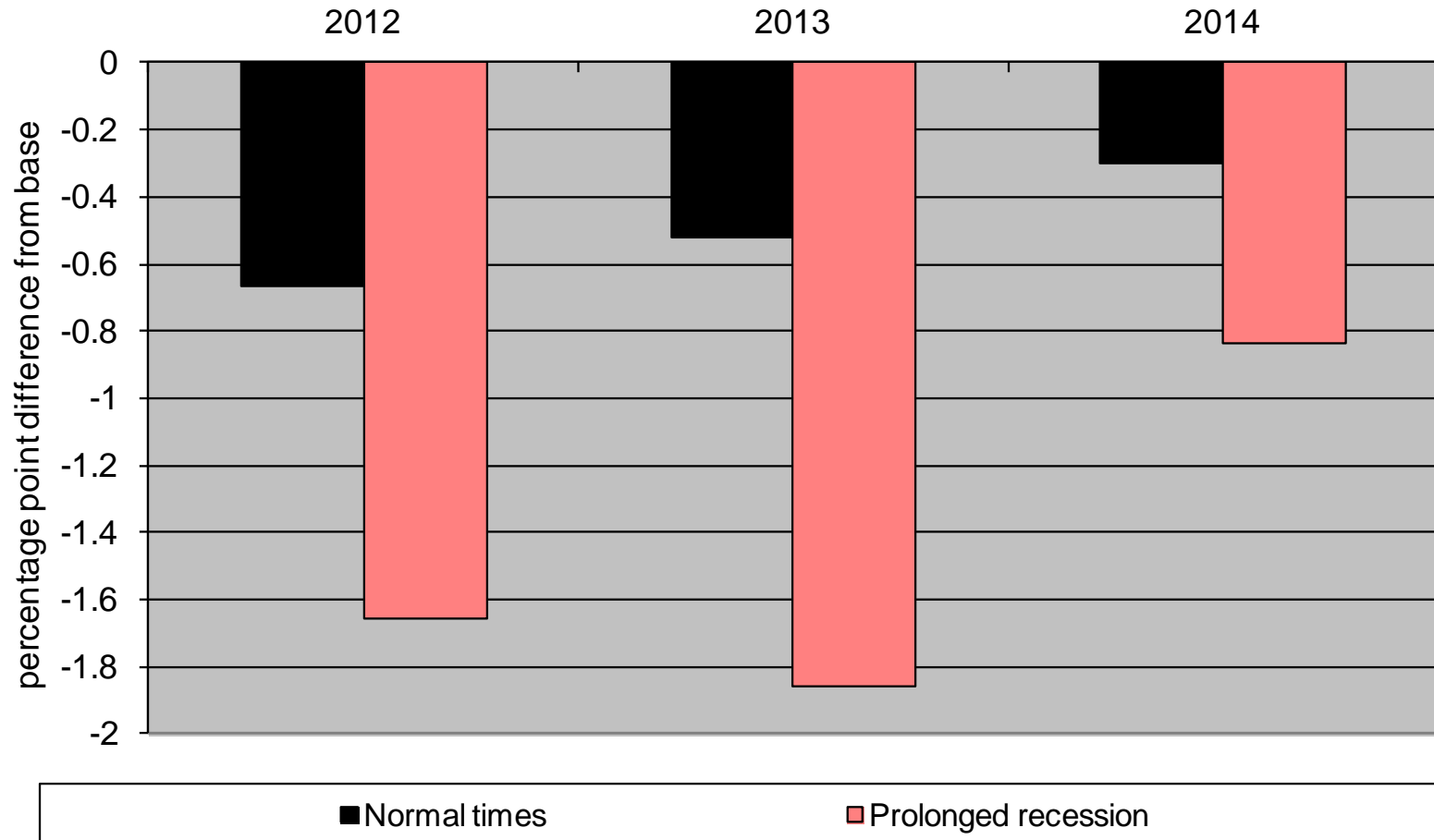
- Banking Union
 - Recreate the Single Market
- EU fiscal policy
- Domestic fiscal policy
 - Multipliers?
- Political Economy of Adjustment
- The labour market
- EU recovery crucial

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





The Tortoise and the Hare

Spanish v Irish Approach: Deficit as % of GDP

Official Plans	2010	2011	2012	2013
Plan of: Spain				
Spring 2010	9.8	7.5	5.3	3.0
Spring 2011	9.2	6	4.4	3.0
Spring 2012	9.2	8.5	5.3	3.0
Latest	9.7	9.4	10.6	6.5
Plan of: Ireland				
Winter 2009	11.6	10	7.2	4.9
Winter 2010		10.6	8.6	7.5
Latest	10.8	9.0	7.5	7.1

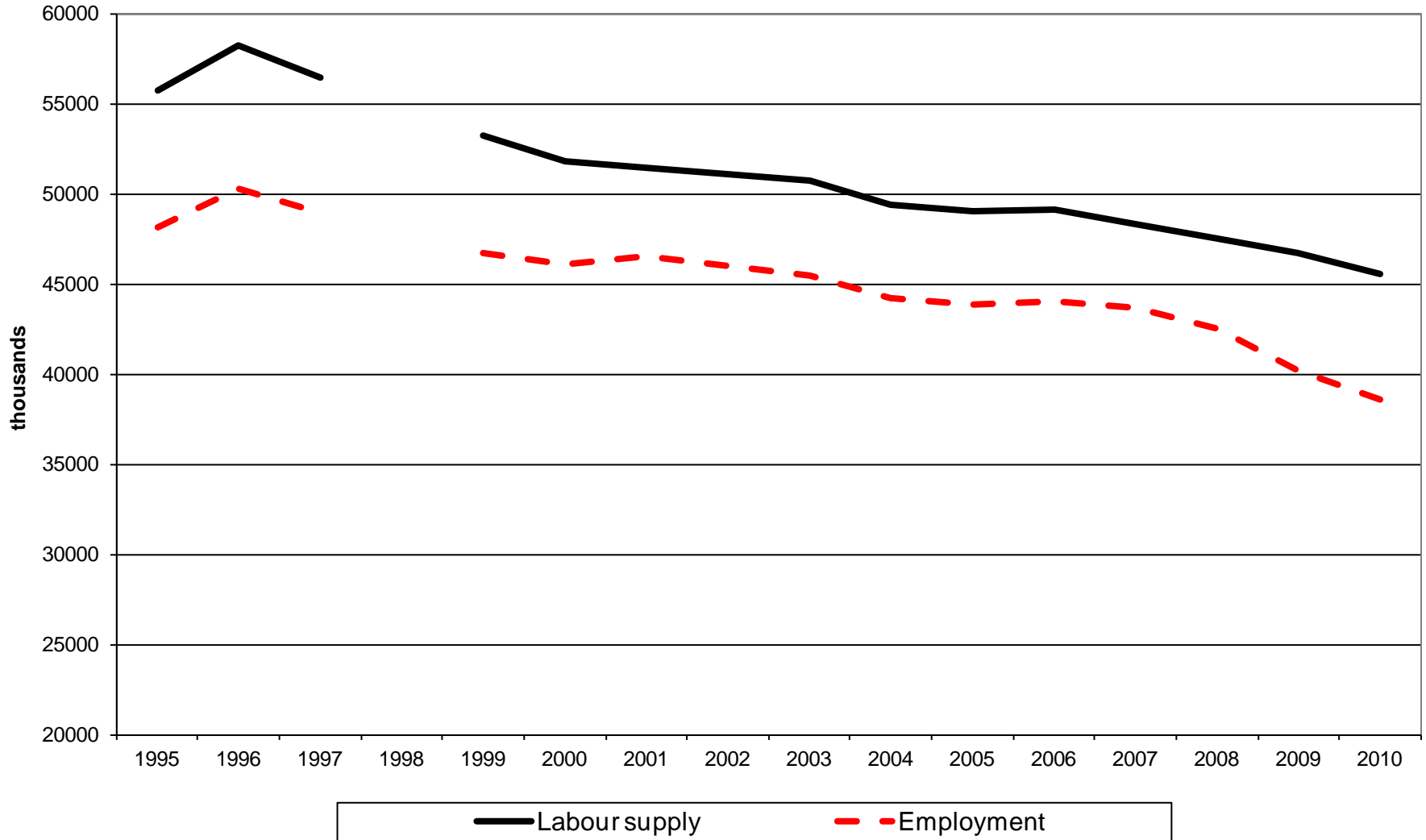
Domestic Multipliers

- 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

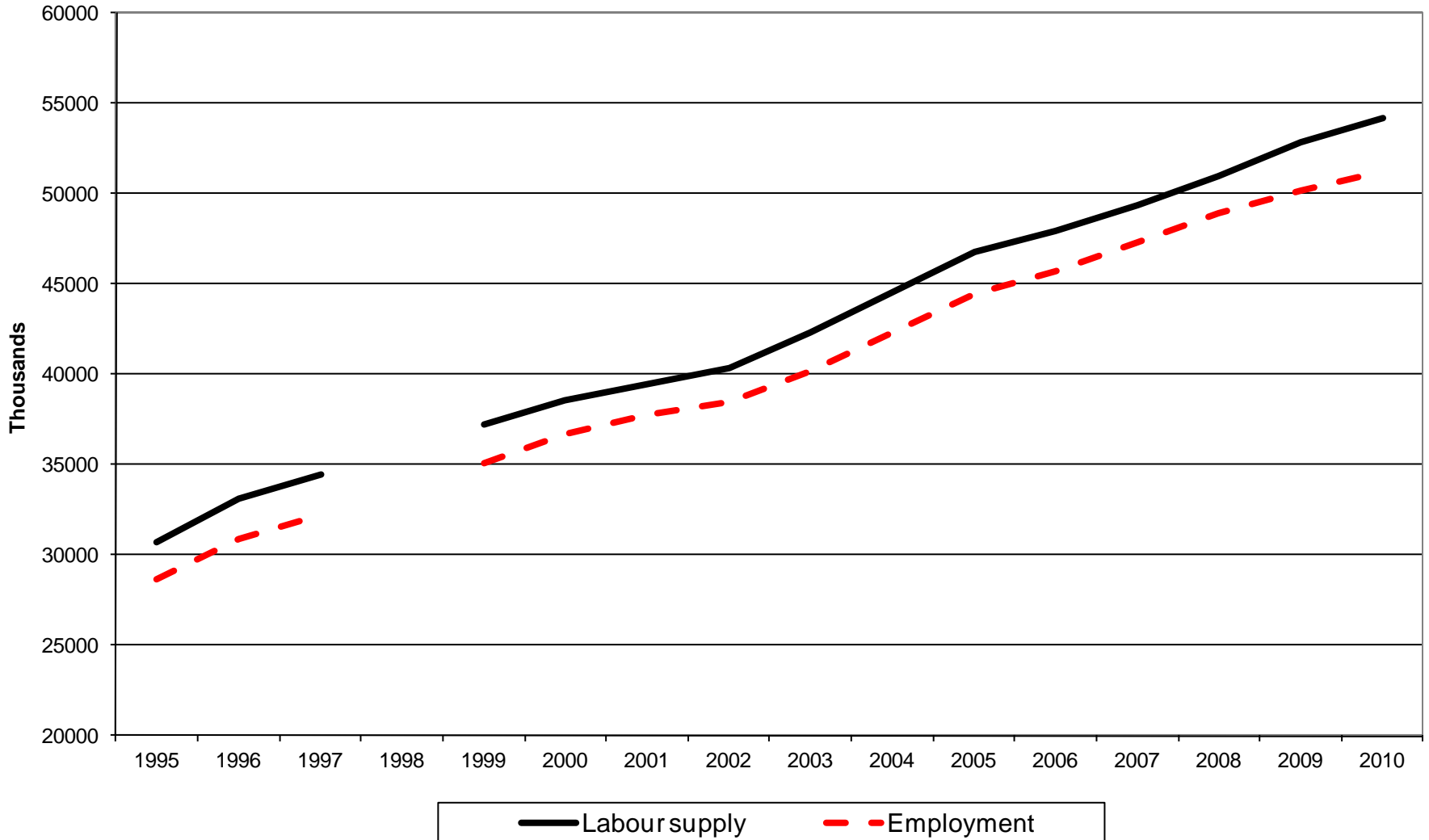
The Labour Market

- 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

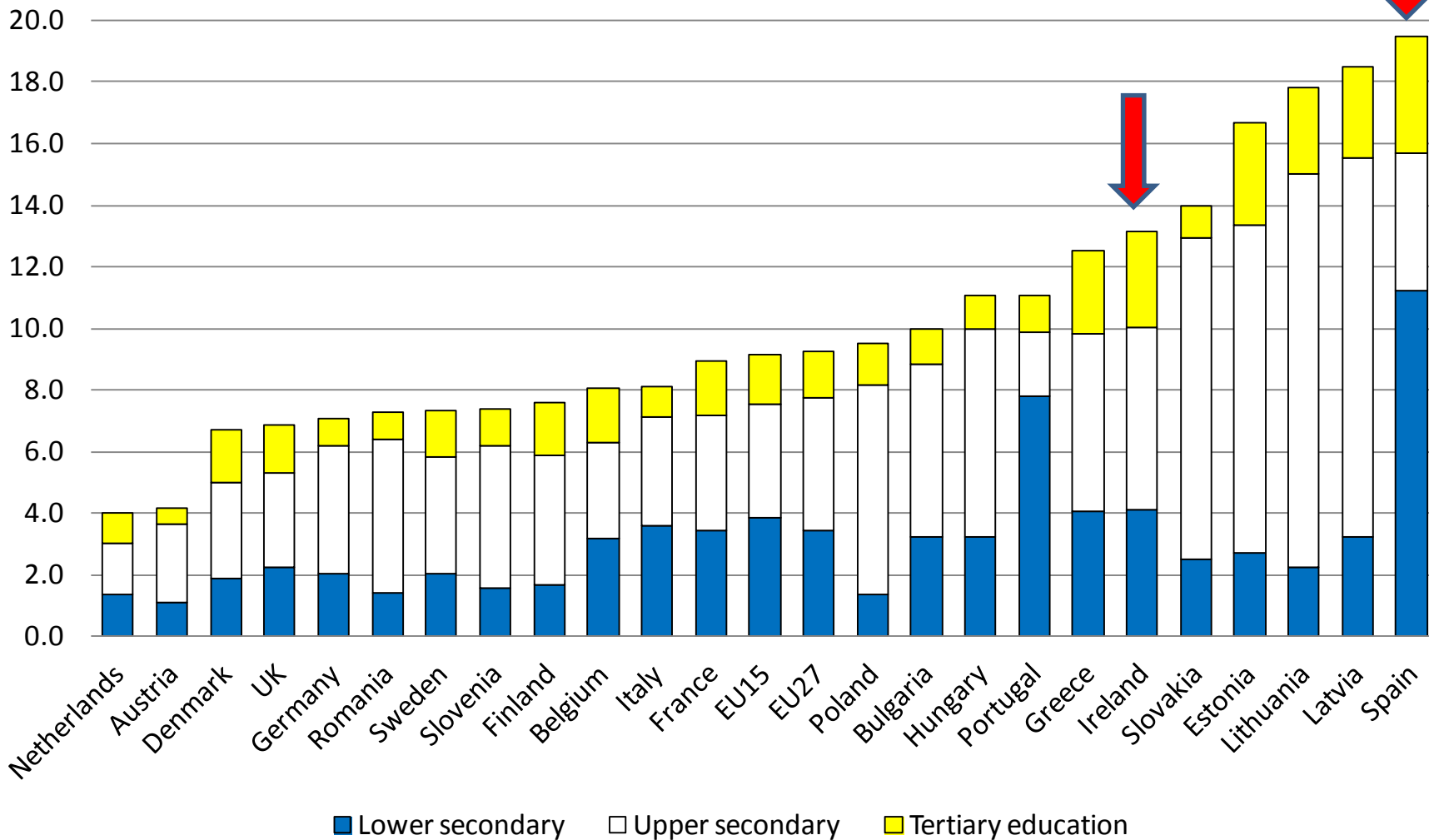
EU 15, Labour Market, Lower Secondary Education



EU15, Tertiary Education



Unemployment rate by level of education, 2010



Articles:

- Barrell, R., Fic, T., FitzGerald, J., Orazgani, A., Whitworth, R., 2011, "The Banking Sector and Recovery in the EU Economy" *National Institute Economic Review*, No. 216, April 2011, pp.R41-R52.
- FitzGerald, J., 2012, "Fiscal Policy for 2013 and Beyond", in T. Callan ed. *Budget Perspectives 2013*, Dublin: The Economic and Social Research Institute.
- FitzGerald, J., 2013 "Financial crisis, economic adjustment and a return to growth in the EU", *Revue de l'OFCE - Debates and policies*, No.127 pp. 277-302