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Ireland - Turning Back the Clock

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On June 10th 2011, Brian Lenihan, 52, died of cancer. As the ruling government's Finance Minister up until the general elections on the 25th of February of this year, when the Fianna Fail government was replaced with a coalition of Fine Gael and the Labour Party, his name has been interwoven with the Irish crisis and crisis management. Although early elections and the change in government were necessary due to broad social dissatisfaction stemming from the austerity measures, Lenihan actually succeeded in reaching an agreement with the opposition parties and the finance bill was passed in both houses of Parliament just prior to being dissolved. Mr. Lenihan's unfortunate early death offers an opportunity to reconsider the reasons for and consequences of the Irish crisis and to re-evaluate its management.

The first step of the Lenihan-led financial government of Ireland was a 440 billion Euro offer of guaranty to bank deposits right after the financial crisis became visible in the autumn of 2008. After this, 100 billion Euros were spent in subsequent steps on bank bailouts. As the newly elected government stated, the banks received a "blank check". Lenihan's view was that by "strengthening and improving" the funding position of the banks, more credit would be generated for businesses and households that would aid in the growth of the economy. This approach, however, was accepted with skepticism even by the IMF. Nevertheless the position of Ireland's financial leadership illustrates they thought the credit-default problem could be cured by more lending. *Hair of the dog*, (or, as the Hungarian proverb goes, 'curing a dog's bite with its fur').

The new government elected in February of 2011 has not changed anything in the basic therapy-mix. Thus far it has only attempted to renegotiate the EU/IMF rescue package the country received in November 2010 in order to decrease the 5.8 percent interest rate on the loan. This, however, is no more viable than Lenihan's concept of credit boom. In May, Angela Merkel stated explicitly that any concession should be matched by "further commitments and conditionality". She was obviously thinking about a potential increase in the Irish corporate tax (12.5 percent). Being the main attractive element of the Irish economy, Ireland cannot afford to increase this tax rate. With higher taxation of corporations, Ireland would lose its hope of being a top investment location for transnational corporations and hence of being able to export successfully. Ireland has a dual economy in which only the transnational sector performs well on the world market.

Although Ireland's economy is different from the other weak euro-countries, it has profound similarities with them. Just like the other three countries (Greece, Portugal and Spain), Ireland;

* is also a semi-peripheral economy connected to the globalized world market as a dependent actor,
* has suffered a loss in its relative competitiveness in the 2000's and
* has had to trade using a currency whose value is determined by other, stronger economies and which has become overvalued without the possibility of devaluation.

Historically, Ireland has long been a semi-peripheral, dependent economy. The era of the "Celtic Tiger" is also a result of this semi-peripheral position: a result of the local activity of foreign, above all American, transnational corporations that transplanted the effect of the American information-technology boom of the 1990's to Ireland. The devaluation of the national currency (the Irish Pound) in 1993 further helped the export offensive in the 90's. These elements have disappeared in the 2000's.

Ireland's euro-membership began at almost the same time (1999) as the 'soft landing' of the American information-technology boom (middle of 2000). Total FDI-stock was equal to approximately 60-80% of GDP in the 90's and 150% in 2002. But after that it fell suddenly: profit repatriation took place. The US tax amnesty law played an important role, as it made it worthwhile to repatriate profits, offering a 5.25% tax rate on profits in place of the previous 35% rate.

At the beginning of the 2000's, with the decrease of production, investments and the reinvestment of foreign company profits, capital that did not find satisfactory opportunities elsewhere in the real economy spilled out into the financial sphere, into lending, derivatives, unit-linked products, etc. The demand fuelled by these instruments either on the consumer or on the real estate/housing market created the illusion of an unbroken upsurge in the economy while also pushing up prices. In this situation, the redistribution of GDP in favor of labor was not the result of a regulation or governmental 'mistake', but rather the natural and inevitable consequence of market mechanisms and interest competition within society, as well as the governments' natural interest and goal of strengthening the social peace. Moreover, before this period, the trend was the opposite. Wages and tax exemptions increased while social benefits soared. Between 2000 and 2007 the combined share of labor's compensation and social benefits in GDP increased from 52.2 to 64.8 percent. This, however, was still far below the Euro zone average (76.2 percent).

The end of the information technology boom, rising profit repatriation and labor's increasing share of GDP resulted in a deterioration in the general economic equilibrium and, at least for Ireland, an effective appreciation of the Euro. Absent the option to devaluate the overvalued (appreciated) currency, the competitiveness of the Irish economy itself deteriorated, rendering crisis management more difficult.

Lenihan's heritage lives on. Irish governments, old *and* new, are placing their bets on foreign capital dependent exports and the restoration of cost competitiveness, i.e. the reduction of labor's share in GDP. This essentially means that Ireland, whose entry into the crisis was a consequence of its semi-peripheral position in a hierarchic world order, is attempting to rise out of the crisis by turning back the clock, i.e. by attempting to put the crisis-causing mechanisms back in place.

In light of this vicious circle it should not surprise that the likelihood of rising out of the debt trap is highly doubtful.

First, let's take exports! In the 90's, information technologies (mainly software and related services) driven primarily by the activities of American affiliates in Ireland, led Irish exports. Now the pharmaceutical industry plays this role.

In 2010, 60% of Ireland's total commodity export derived from chemicals and related products (SITC 5) and the net trade surplus of this group was equal to the total trade surplus. Within this group medicinal and pharmaceutical products (SITC 54) made up 46 percent and organic chemicals (SITC 51) which are linked to the first sub-group, made up 36.5 percent. However Ireland produces almost no pharmaceutical products on its own. The only Irish company in the ring is Elan, whose major operations are in the US. This structural change in exports adequately reflects the dependent path of the Irish economy mentioned above.

Second, let's take the redistribution of GDP at the expense of labor. Since 2008, about 22 billion Euros in budgetary adjustments have been put into effect, two-thirds of which were related to expenditure that directly or indirectly lowers wages and social benefits, i.e. labor costs. The national debt, however, will increase in the coming years, continuously increasing the debt service burden. Between 2011 and 2015, the share of interest payments to total government tax-revenue will rise from 15% to 21%, or, measured in terms of GDP, from 6.2% to 21%. In 2015, more than 9 billion Euros must be paid on interest. However, since austerity measures constrain internal demand, the only possible solution is a rise in exports. But in order for this to occur, internal devaluation (price and wage cuts) is (are) necessary. The circle is closed.

Till now, growth has been lower than expected. What is more, the bank stress-test made by the ECB in March 2011 points to the need for a 24 billion Euro bailout of Ireland's four crisis-banks. As a result, the forecast of the Stability Program Update (April 2011) had to be corrected. Now it is predicted the deficit will be reduced more slowly. Still, the goal remains for a government budget deficit of less than 3 percent and a massive (3.4 percent) surplus in the primary balance by 2015.

In order to reach a sustainable growth path, at least 4 percent growth in GDP is necessary. This however will not materialize until 2015. What is more even the Stability Program Update forecast, which places GDP-growth between 2.5 and 3%, seems unrealistic, in part because the strong members of the Euro zone hope to maintain a strong currency. The European Central Bank increased interest rates a few weeks ago, making the financing of private, national debt and company investments in Ireland more difficult. Indirectly, the appreciation of the Euro will contribute to the deterioration of the competitiveness of Irish exports. Financial market instability poses similar threats, as well as the increasing strength of the German economy or the growing competition from BRIC countries on the world market.

Budget restructuring requires 15 billion Euros in belt-tightening measures from wage, salary and social benefit earners. Although the bailing out of the banking sector has led to the increasing indebtedness of the state, servicing this debt weighs most heavily on wage, salary and social benefit earners. The price of reaching equilibrium—as unlikely as that may be— is a shrinking share in value-added from those who produce it.

The core question remains: where is the limit of social tolerance?

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