

Ireland Economy Cillian Ryan

Is the Euro to blame for Ireland's woes?

"Blame the banks and the Irish Government, not the Euro, for Ireland's woes..."

Professor Cillian Ryan, Jean Monnet Chair in European Economics

"Many commentators in the UK are pointing to Ireland's presence in the Euro for its current economic woes. This is somewhat misplaced. The 'Celtic Tiger' was founded on solid economic grounds. Ireland is an attractive location within the Eurozone for overseas firms due to its English speaking, well-educated, and relatively young workforce and low corporate tax rate. Without the Euro, it is arguable that the boom years may never have happened.

Its problems lie, rather, in the failure to adhere to the disciplines that membership of a currency zone demands. These aren't complex. Put simply, you just have to live within your means.

In Ireland the main high street banks responded to the economic boom by engaging in reckless lending to individuals and property developers. Their narrative for doing this was that failure to do so would result in Irish banks losing out to their larger and more powerful continental competitors. It is not clear to what extent mainland European banks did have their sights on little Ireland, but beyond misguided patriotism there is no economic justification for the Irish government's failure to regulate the excessive lending of its banks.

But the Government too was swept along by its own propaganda. Most countries report their level of annual income by a statistic called Gross Domestic Product (GDP). This is a measure of the economic activity within a country during the year. There is an alternative measure, known as Gross National Product (GNP), which measures economic activity by Irish nationals (and firms) whether in Ireland or abroad but which deducts from GDP economic activity by foreign firms and workers located in Ireland. For big countries like the UK and the US the difference between the two measures is tiny (of the order of 1-2%) but for a small country like Ireland, which serves as a base for large international companies, it is closer to 20%. So the government deficit as a fraction of Irish citizens' real annual income was 17.3 % and its debt was nearly 78% (compared to 14.3% and 64% on the GDP measure). Viewed from the perspective of GNP Ireland's economic progress was considerably more modest and its deficits and debts more substantial than the popular press might have had us believe. The true underlying economy was not in a position to justify the second highest minimum wage in Europe and public sector salaries which were significantly in excess of the UK.

Would opting out of the Euro have saved Ireland? Well that really would have been killing the goose that laid, if not the golden egg, at least a daily egg. Despite what we read, a devaluation is not a free good. The British Pound has depreciated almost 25% since 2007, that means that everyone in the UK, consumers and producers using imported raw materials, are paying 25% more for goods purchased abroad. In addition, the risks associated with a flexible currency means that potential foreign lenders look for higher returns which pushes up interest rates and exacerbates exchange rate movements. A depreciation is really a distortionary tax that effectively cross-subsidises exporters by imposing hardship on everyone else.

The Birmingham metropolitan area has a population and GDP in excess of Ireland but nobody is seriously arguing that it should have an independent currency. While some would argue that the world should adopt a single currency, currency stability is vital for small countries which is why before the Euro, Ireland was part of the ERM and before that it was tied 1 to 1 with the British Pound. True there were many devaluations during the ERM period, but these were caused by lax economic discipline, specifically monetary discipline. Ultimately, to paraphrase Milton Friedman, devaluations, like inflation, are always and everywhere a monetary phenomenon.

Nor has devaluation of the Britishpound since 2007 solved the UK's economic problems. With a deficit of 11.5% and a debt to GDP ratio of 68% there is much to be done to stabilise the UK Government's own finances. Ultimately, it isn't complex, it is the real economy which matters, not nominal exchange rates, and we all have to live within our limited means. That 's not a matter of sovereignty, that's reality.