Ireland's recovering economy: an EU perspective
THE CRISIS

The Irish economy experienced rapid economic growth beginning in the mid-1990s, but from the early 2000s onward growth was fuelled by a property bubble marked by an overreliance on construction and the rapid expansion of credit.

When the bubble burst in 2007-08, all parts of the Irish economy were affected. The rate of unemployment tripled in just one year. Tax revenues in the bubble period had become heavily reliant on property-related taxes, such as stamp duty. But these taxes collapsed when the bubble burst, while expenditure remained high. This exposed an underlying ‘structural deficit’ (meaning the deficit that would exist if you strip out the effect of the boom) in the public finances that had not been sufficiently recognised during the boom. Irish banks, which had engaged in risky property-related lending, faced substantial losses because borrowers could not repay their loans and the collateral dropped in value. In September 2008 the government decided to issue a blanket guarantee of banks’ liabilities – a decision that would have significant implications for Ireland’s banking system and public finances.
THE EU/IMF ADJUSTMENT PROGRAMME

By November 2010, doubts about the solvency of Irish banks were mounting again and the government found that it could not borrow on international bond markets to finance its own fiscal deficit except at very high interest rates.

Faced with this situation, the government decided to apply to the EU and the IMF for a programme of financial assistance. The financial assistance programme totalled €85 billion for the period 2010 to 2013 (including a contribution of €17.5 billion from Ireland’s National Pension Reserve Fund). If Ireland had not received this funding, the country would have faced a much more sudden correction to its budget to bridge the gap between receipts and expenditure, and essential public services would likely have been badly impacted.

Under the programme the Irish authorities agreed with the external partners in the so-called ‘Troika’ (the European Commission and the IMF, together with the European Central Bank) a series of over-arching policy commitments designed to help return the country to a path of sustainable growth, while protecting the most vulnerable in society. The choice of specific policy measures to achieve these objectives was left up to the government, provided that they were consistent with the overall programme objectives.

To achieve its goals, the programme contained policy commitments under three main areas:

1. The financial sector – The measures in this area were designed to help repair the banks’ balance sheets so that the financial sector could better support the economy through new lending to households and Small and Medium Sized Enterprises (SMEs).

2. Fiscal consolidation – The programme outlined an adjustment path designed to restore sustainability to public finances by increasing tax revenues whilst minimizing the impact of this adjustment on growth.

3. Structural reforms – Reforms in this area were designed to improve competitiveness in the Irish economy, and so support a return to growth and job creation. They include such measures as opening up sheltered sectors to more competition, strengthening the enforcement of competition policy and reforming sectorial wage agreements (which cover areas where unemployment tends to be highest) and strengthening the provision of services to help the unemployed.
EXITING THE PROGRAMME

Ireland successfully exited its programme at the end of 2013 and is now financing itself through its own efforts.

This is thanks to determined implementation of the programme policies and to the joint efforts of the Irish people, the Irish authorities as well as Ireland's partners.

The recent fall in unemployment, the pace of job creation and the ongoing recovery of Ireland’s banking sector send a strong signal that Ireland’s robust response to the crisis has delivered results.

Now out of the programme, Ireland has moved back to the normal governance procedures which apply to all euro area Member States.

THE WIDER EUROPEAN CONTEXT

Although much work has been done under the EU-IMF programme to address the deep imbalances that got Ireland into the crisis, the economy still faces key challenges. In many ways, these are challenges Ireland shares with its European partners.

- **Completing financial sector repair.**

  Europe’s banks – including Irish banks - are still in the process of repairing their balance sheets. This important task will be underpinned by a new financial supervision architecture at EU level, called the Single Supervisory Mechanism (SSM).

  A first step to setting up the SSM is to carry out an EU-wide stress test exercise in advance of the transfer of banking supervision to the European Central Bank. This is important because it will get rid of any remaining uncertainty around the health of the banks.

  Alongside supervision of banks at EU level, the European Commission is working with the Member States on new proposals for a Single Resolution Mechanism (SRM). This mechanism will harmonise the approach Member States take to dealing with failed banks. Together, these twin pillars of “Banking Union” will boost confidence in Europe’s financial institutions and protect the integrity of the internal market.

  In Ireland’s case, addressing the high level of mortgage arrears in a targeted, differentiated and fair way, is an additional challenge, which must be addressed in order to free up lending capacity to the economy and restore sustainability to household finances.
Banks need to find sustainable solutions for genuinely distressed borrowers, whilst restoring payment discipline in other arrears cases.

**Improving competitiveness.**

In Ireland as across the EU, labour costs play an important role in competitiveness. Keeping costs in line with productivity growth will help bring down the unacceptably high level of unemployment.

A particular concern is that some sectors of the economy, such as the legal professions, remain sheltered from competition. This can result in higher prices in those markets, which can hurt competitiveness across the wider economy.

Opening up sheltered sectors is therefore vital, even where this means confronting powerful, vested interests. Another important enabler of competitiveness gains is innovation.

Encouragingly, Ireland ranks among the best in the EU in terms of innovation output, but the challenge for all Member States is to harness the good ideas that are ‘Made in Europe’ and turn them into successful products and services.

**Promoting sustainable fiscal policies.**

Government Deficit and debt levels are still too high in many Member States, including in Ireland. Achieving a differentiated and credible fiscal consolidation is key to sustainable growth.

‘Differentiated’ means that each Member State faces a different ‘fiscal consolidation path’ (i.e. the plan to bring the deficit down over time), according to its starting position, its economic conditions and its ability to access funding from bond markets.

‘Credibility’ can be enhanced by having a rigorous budgetary framework that sets binding government spending ceilings for a number of years in advance.

Under the programme, Ireland has made appreciable efforts towards putting its public finances on a more sustainable footing. However, the fiscal deficit remains large, while the debt to Gross Domestic Product ratio is also high.

For this reason, it is important that Ireland continues the adjustment begun under the programme, to achieve its goals of medium term sustainability. This is particularly important in view of the fiscal challenges posed to Ireland by an ageing population, which will become more of an issue in coming years.
THE EUROPEAN SEMESTER

The EU stood by Ireland during the Financial Assistance Programme, providing policy guidance and support along with financial assistance. But though the programme has been successfully concluded, this does not mean the EU will step away from Ireland.

One of the instruments of policy coordination is the European Semester, an annual process for all Member States, including Ireland.

The Semester involves inputs from the Irish authorities, from the national parliaments, the European Parliament, and also the European Commission.

Taking all these inputs on board, the Commission will produce a set of recommendations for each country – called Country Specific Recommendations – that are in harmony with the policy priorities for the EU as a whole.

The Recommendations will address the specific challenges that the country faces and can include issues as wide ranging as public finances, labour market issues, the environment, or how to open up the economy to more competition.

The goal is to help guide good policy making that brings about growth and prosperity for Europe and its citizens.

GLOSSARY: AGS Annual Growth Survey (general economic priorities for the EU) - AMR Alert Mechanism Report (screening system for economic risks) - CSRs Country Specific Recommendations - EDP Excessive Deficit Procedure - IDR In-Depth Review - Economic Partnership Programme outline of key structural reforms needed for a durable correction of the deficit.
TACKLING THE UNEMPLOYMENT CHALLENGE

Perhaps the toughest challenge arising from the crisis for Ireland has been the rise of unemployment to unacceptably high levels. This is, in part, the legacy of a structural over-reliance on construction jobs during the bubble years.

Approximately half of the increase in unemployment in Ireland after the bursting of the bubble was due to the collapse of construction-related activities. Having peaked at close to 15% in 2011, the rate of unemployment has begun to decline since then.

Encouragingly, the labour market has also begun to expand again. However, these relatively modest improvements hide a worrying fact – a larger proportion of the unemployed have been without a job for over six months. Long Term Unemployment bears with it substantial economic and social costs.

Workers who are out of the job market will lack up-to-date skillsets and will be more difficult to place as new jobs become available. Just as important are the human costs – joblessness is the single biggest determinant of poverty risk in the EU.

Addressing this problem will require extensive policy actions such as labour activation measures and re-skilling.

Ireland has begun to reform the delivery of activation supports and further education and training, and its continuing efforts in this area will be vital in the years to come.
For Further Information

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