



Why Austerity?

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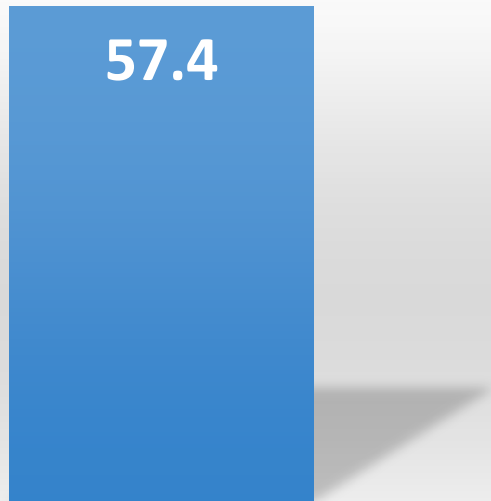
Why austerity?

- We've been through an extremely difficult fiscal adjustment
 - Huge negative impact on households and businesses
- Was it necessary?
- Understand the options by looking at data from the pre-crisis, crisis and post-crisis periods

Origins of the crisis

- Triple bubble → Crisis
 - Credit
 - House prices
 - Construction
- A “hidden bubble” in the public finances
- Cause of crisis not primarily fiscal
- But it became a fiscal crisis when the public finance bubble burst

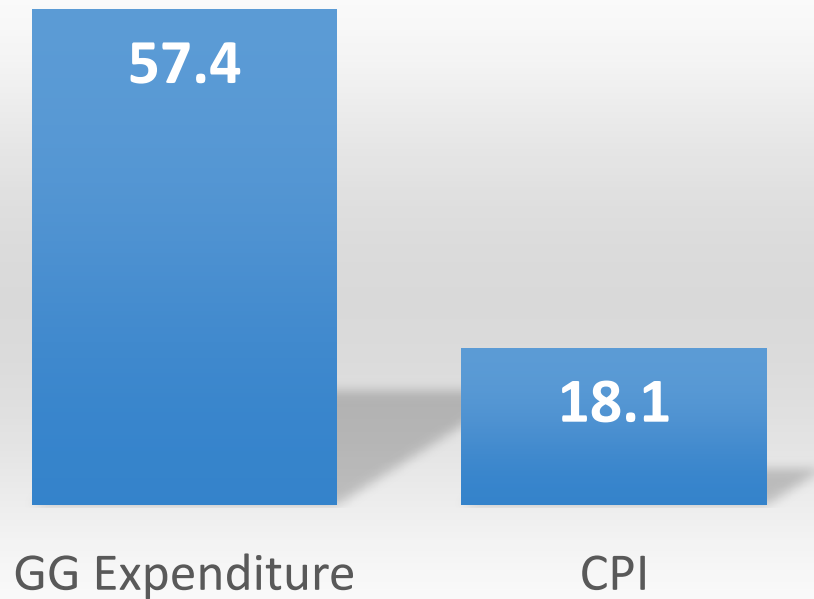
Growth in General Government Expenditure, Total Percentage Change, 2002-2007



GG Expenditure

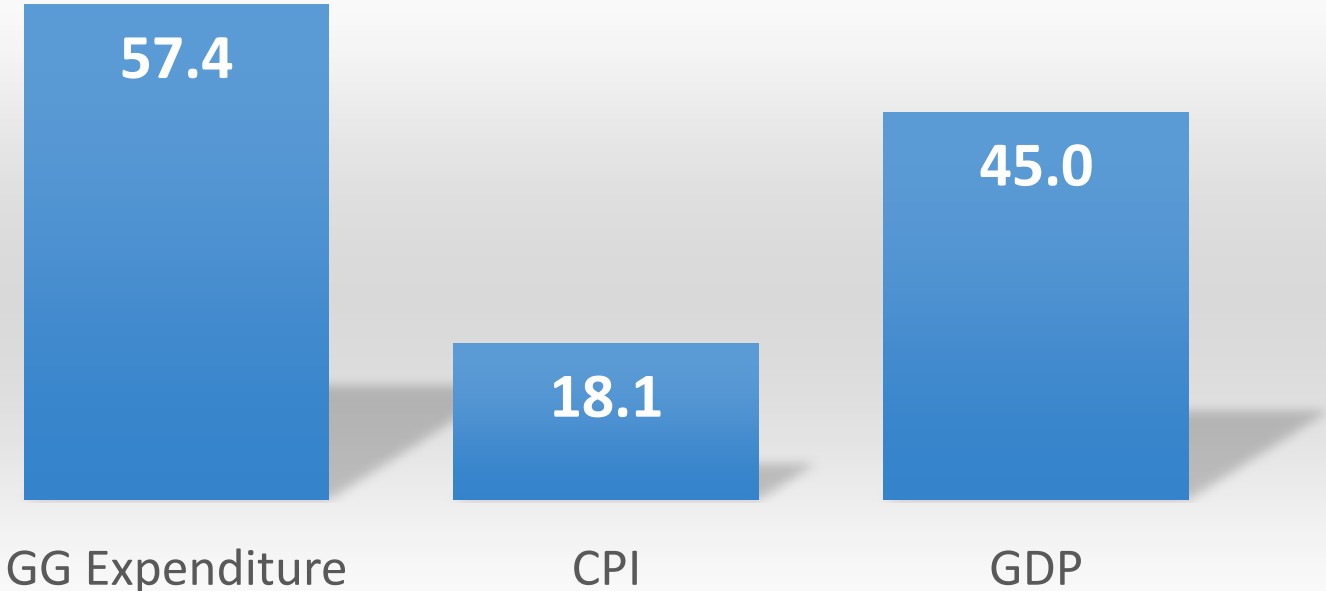
Source: CSO

Spending growth far outstripped inflation



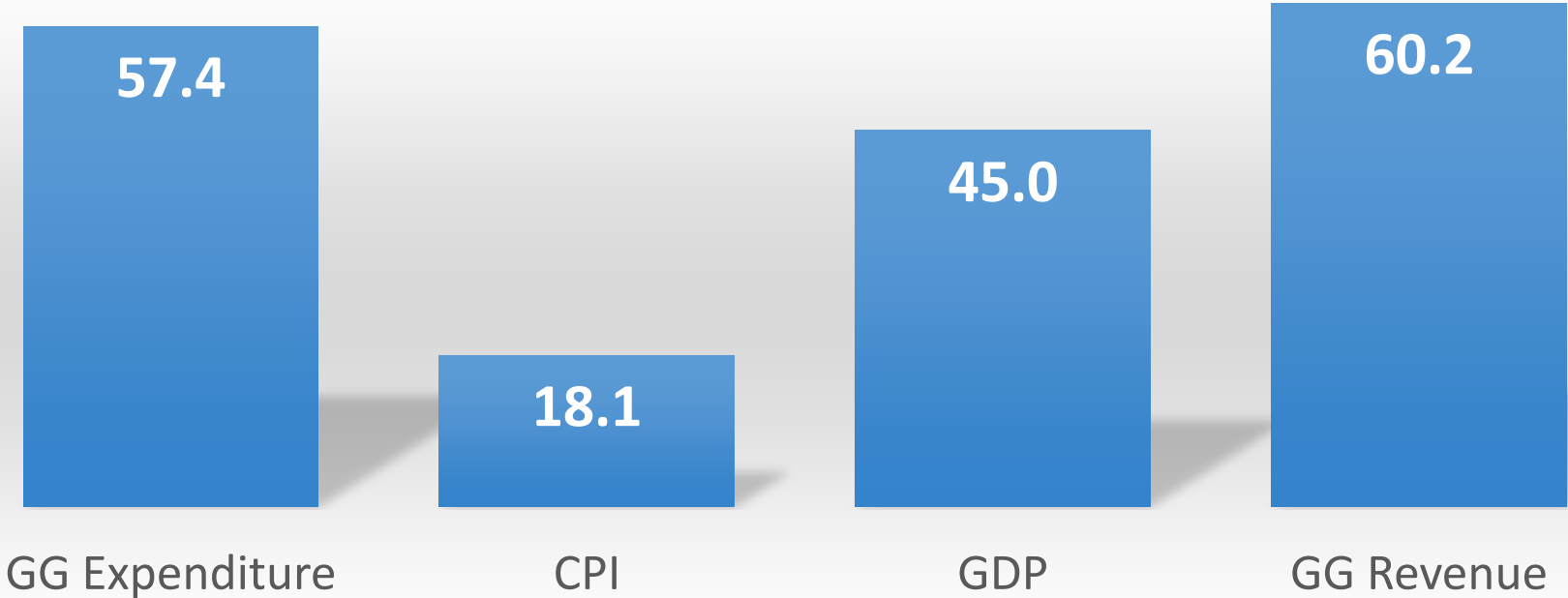
Source: CSO

But partially offset by strong economic growth



Source: CSO

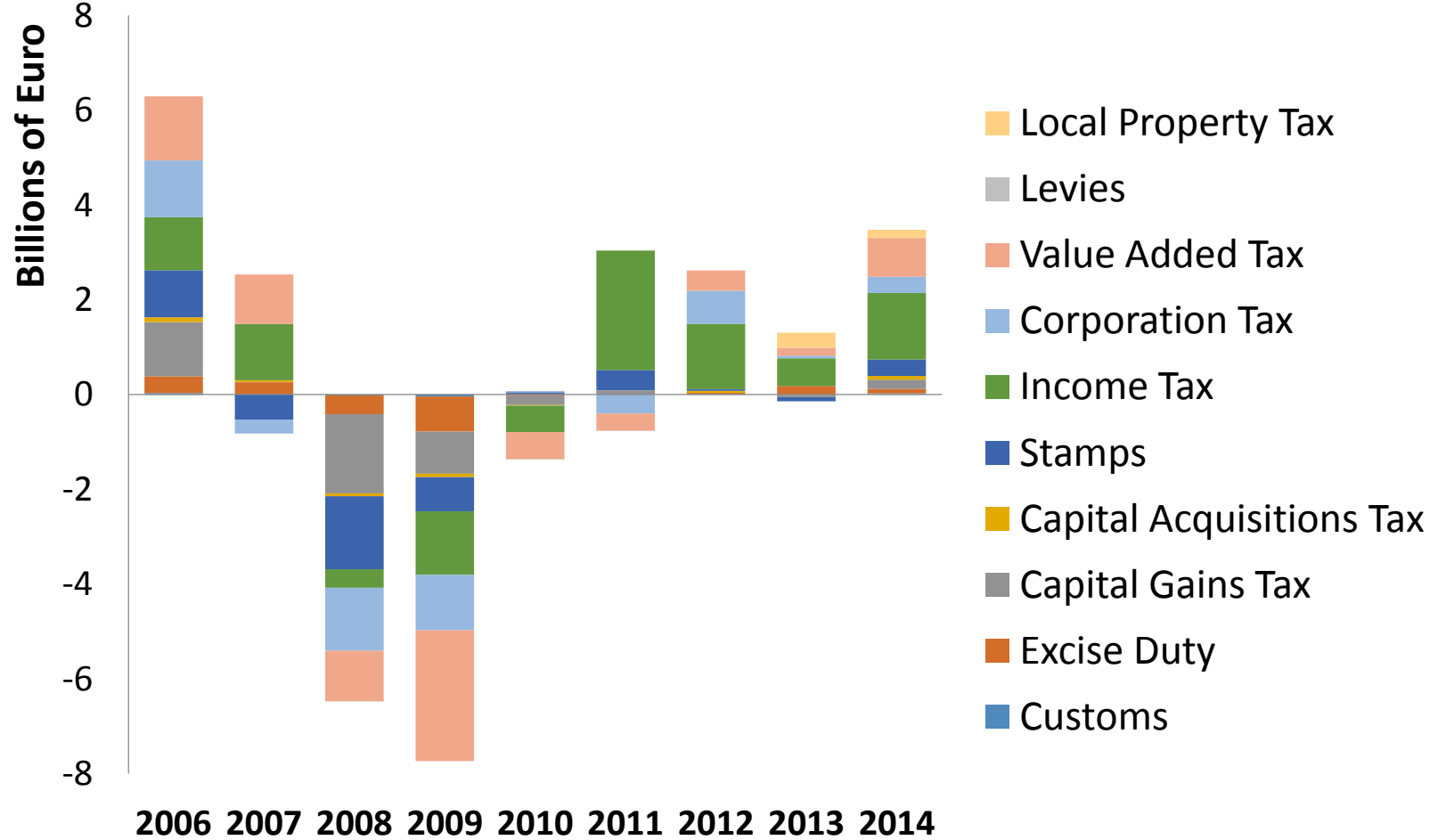
And revenue actually grew faster than spending – but not sustainable



Source: CSO

Bursting of the triple bubble led to a collapse in revenue

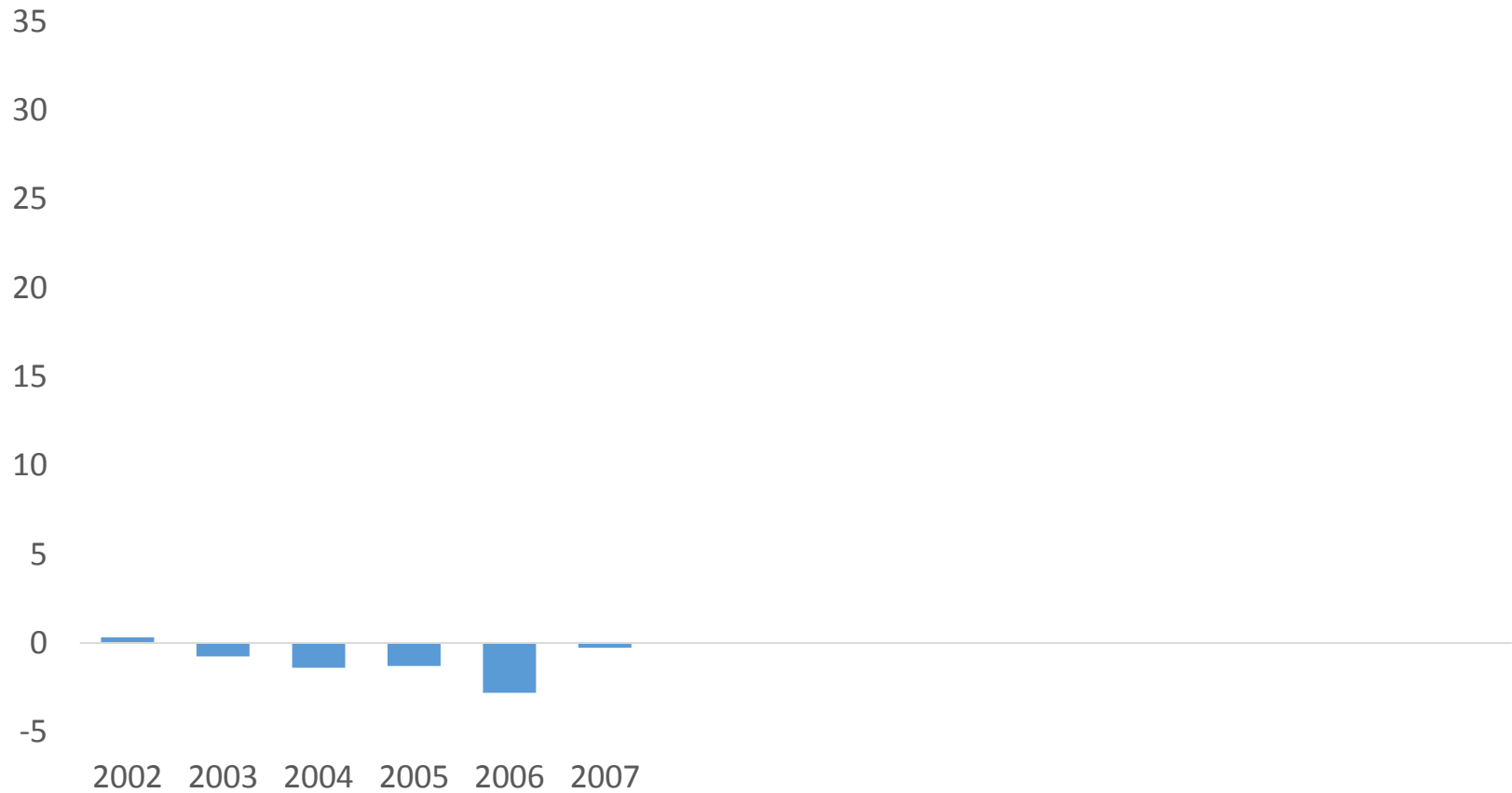
Year to Year Changes in Exchequer Revenue by Category



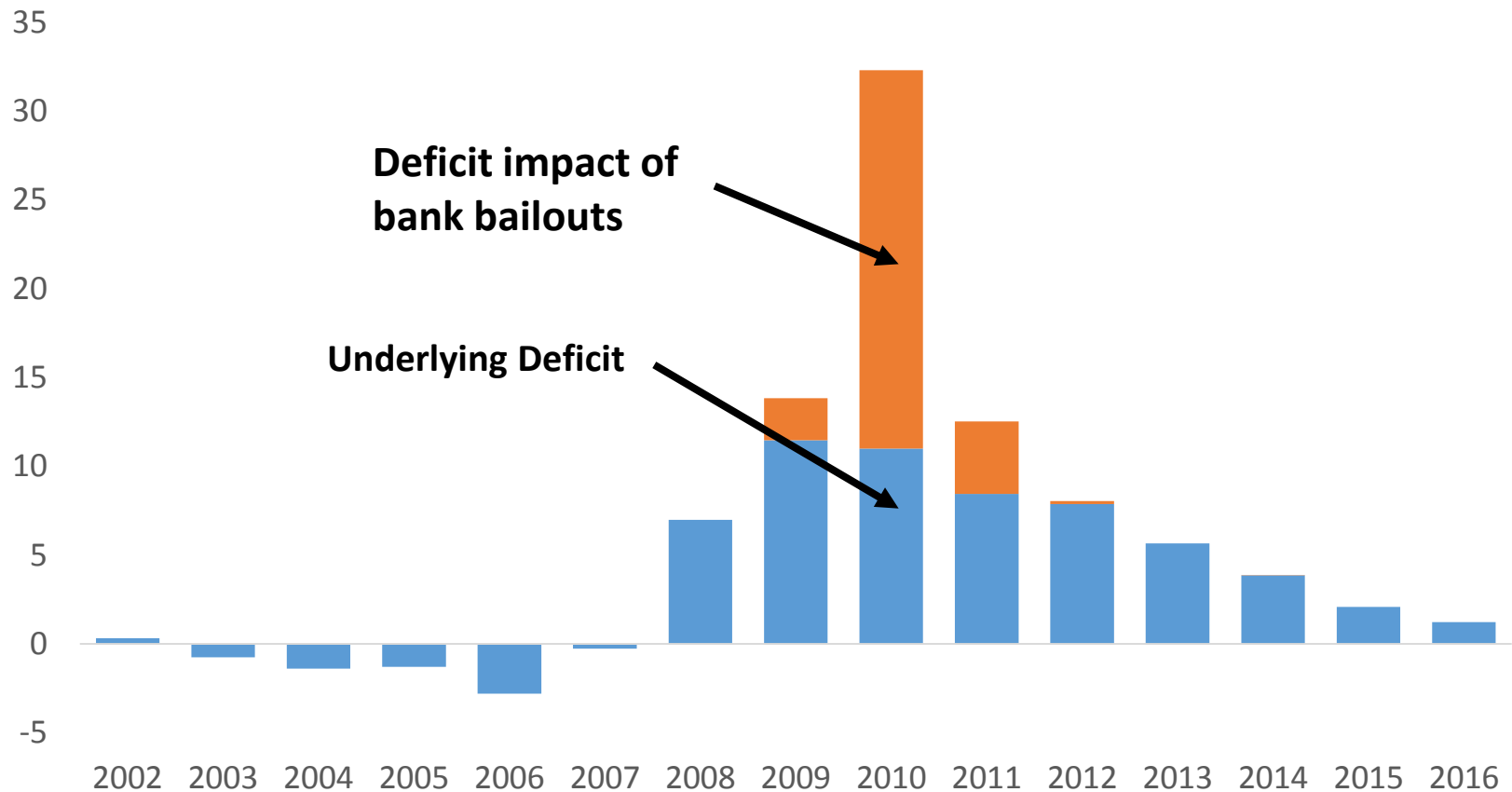
Source: Department of Finance

Had been running surpluses

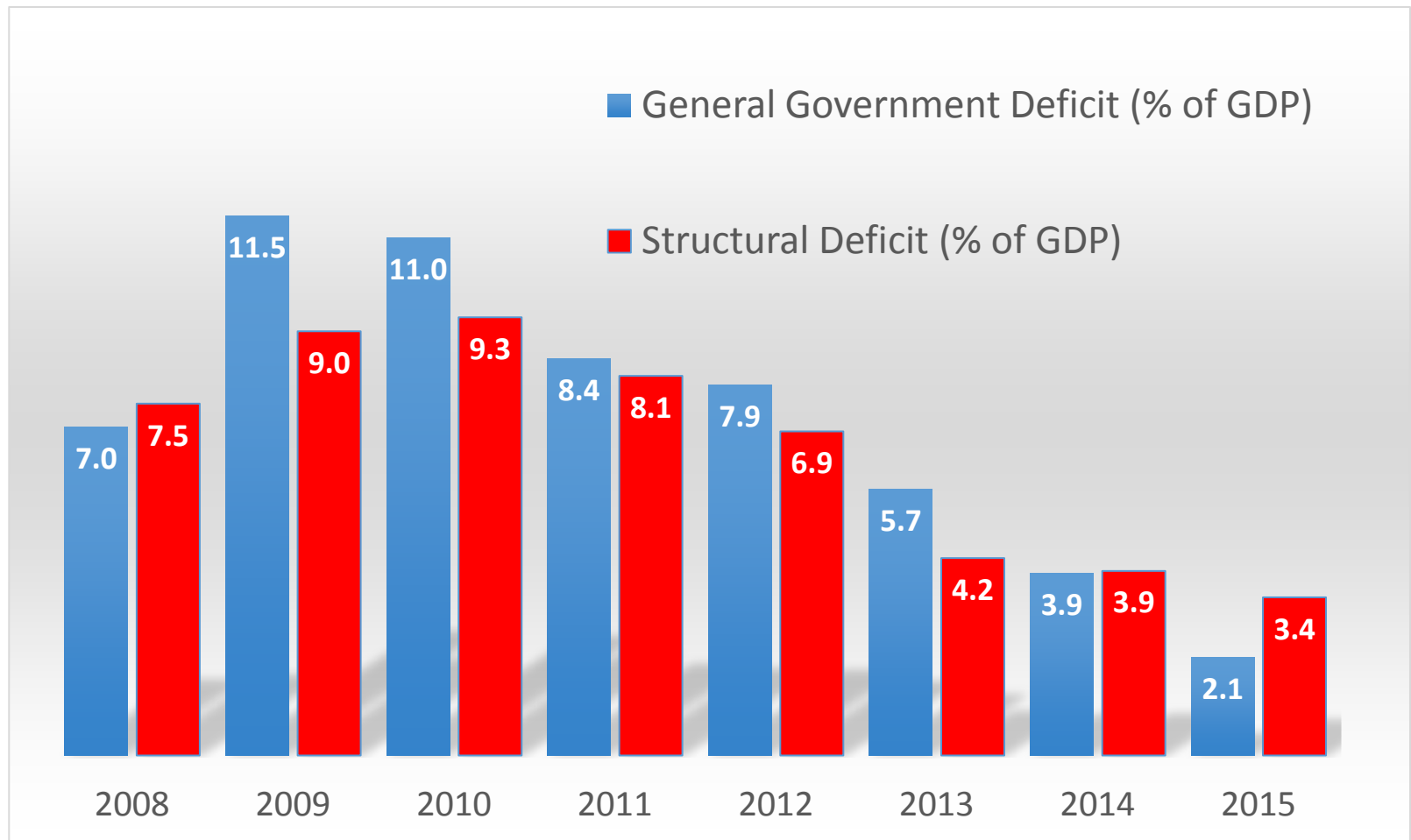
General Government Deficit, % of GDP



But deficit exploded due to recession and bank bailouts

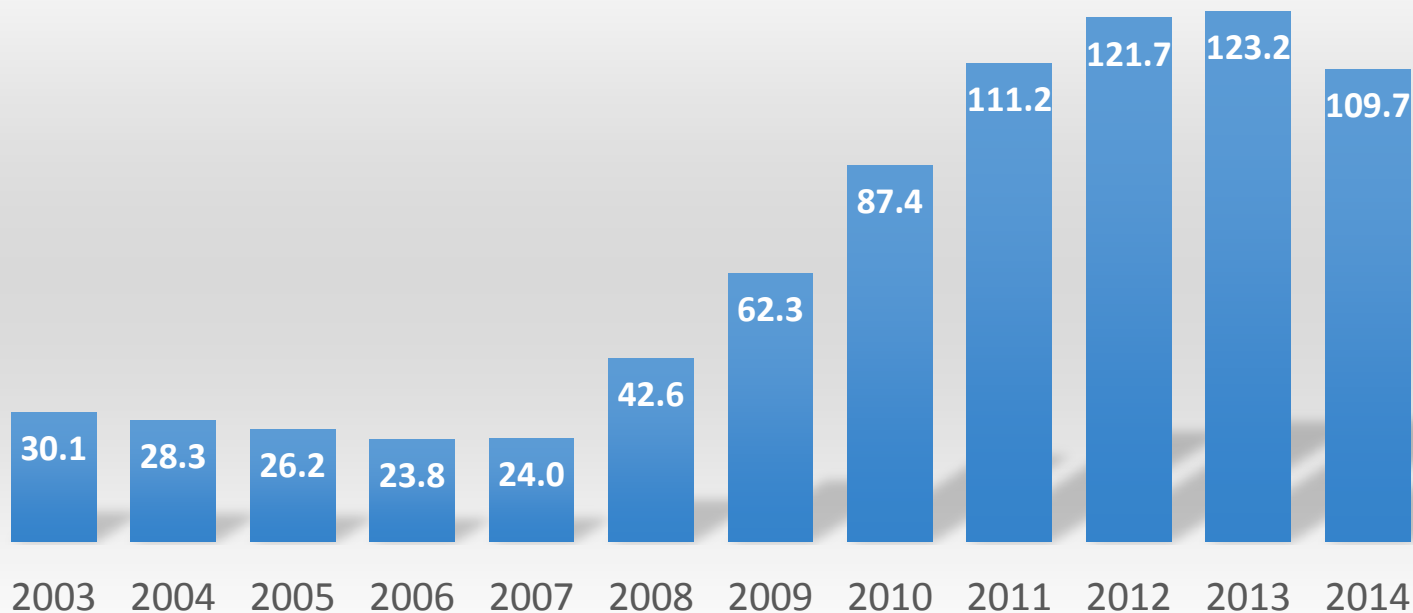


Underlying deficit considered to be primarily structural



Debt put on an unsustainable path

Percent of GDP



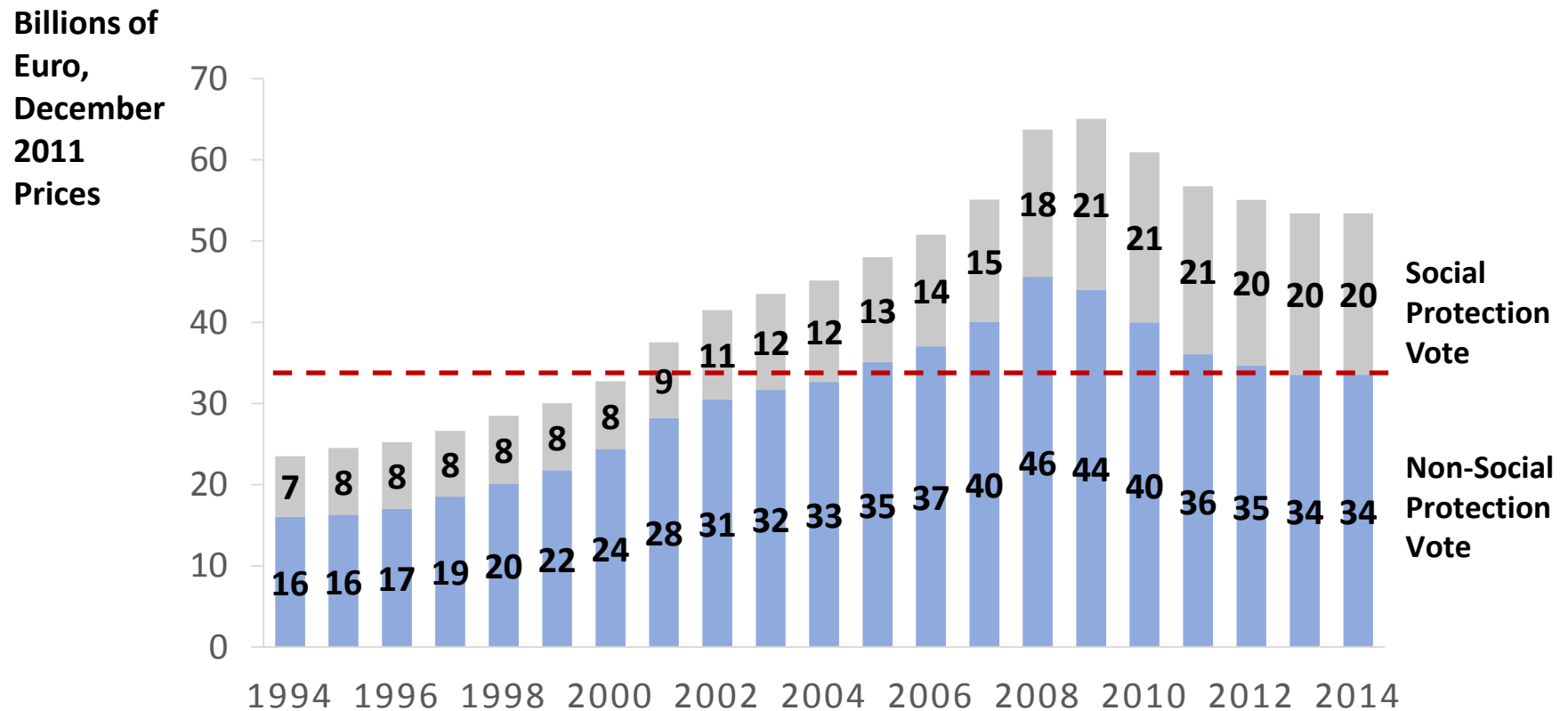
Source: Eurostat

**No choice but to significantly
lower the deficit to stabilise the
debt ratio and preserve access to
borrowing**

A large austerity programme was required

	Billions of Euro
July 2008 Expenditure adjustments	1.0
Budget 2009 (October 2008) Revenue raising measures	2.0
February 2009 Expenditure adjustments	2.1
Supplementary budget (April 2009) Revenue-raising & expenditure-reducing measures	5.4
Budget 2010 (December 2009) Revenue-raising & expenditure-reducing measures	4.1
Budget 2011 (December 2010) Revenue-raising & expenditure-reducing measures	6.0
Budget 2012 (December 2011) Revenue-raising & expenditure-reducing measures	3.5
Budget 2013 (December 2012) Revenue-raising & expenditure-reducing measures	3.5
Budget 2014 (October 2013) Revenue-raising & expenditure-reducing measures	2.5
<i>Total ex ante adjustment, 2008 - 2014</i>	30.1

Evolution of inflation-adjusted *Gross Voted Expenditure*, December 2011 prices, 1994-2014



Source: Department of Public Expenditure and Reform

**To what extent was the austerity
caused by the bailout of the
banking system?**

Roughly two-thirds of increase in debt due to collapse in the economy

	€bn
Gross Debt (end-2007)	47.1
Gross Debt (end-2014)	203.3
Change in Gross Debt	156.2
Contributions	
Underlying deficits	97.1
...of which primary	58.1
...of which interest	38.9
Gross debt increasing bank-related costs (capital transfers)	46.8
Change in EDP Debt Instrument Assets (incl. cash balances)	17.7
Other stock flow adjustments	-5.4
Memo Items:	
NPRF funding	20.7
Est. Value of Assets *	16 - 17
Recouped: Disposal of investments (July 2015) **	6.6
Recouped: Income, fees and bank levy (July 2015) ***	6.2
Net actual/imputed interest costs on financing (to 2014) ****	-4.6

Sources: CSO (bank-related costs using CSO April 2015 EDP data on impact of banking interventions); Department of Finance; internal IFAC calculations.

Notes: Gross debt increasing bank-related costs capture any capital injections recorded as deficit-increasing (capital transfers).

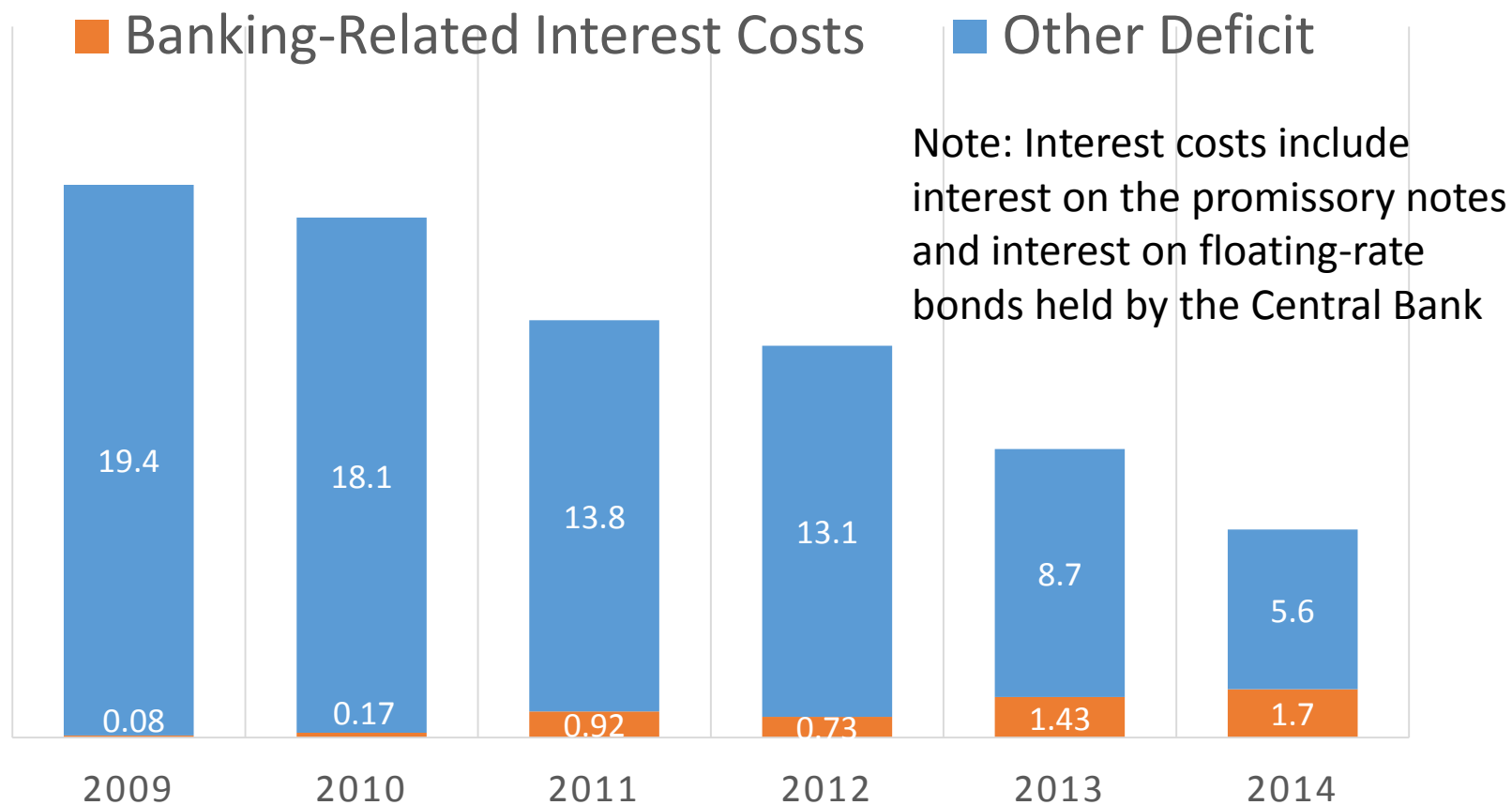
* EY valuation of NPRF AIB ordinary + preference shares at end-2014 (€11.7bn) + €1.6bn AIB CoCos; ISIF (30 June 2015) €1.6bn BoI ordinary shares (14%); and 75% of PTSB at recent share price.

** Estimates cover BOI, AIB and PTSB equity, CoCos and pref. share transactions including the sale of Irish Life. Details here: <https://www.kildarestreet.com/wrans/?id=2015-07-16a.619>

*** Estimates cover guarantee fees (CIFS/ELG + €0.5bn from IBRC), investment income and the Budget 2014 Bank levy. Details here: <https://www.kildarestreet.com/wrans/?id=2015-07-16a.619>

**** Net interest includes actual interest, where relevant, and imputed interest on financing Bank related costs using CSO April 2015 EDP data on impact of banking interventions.

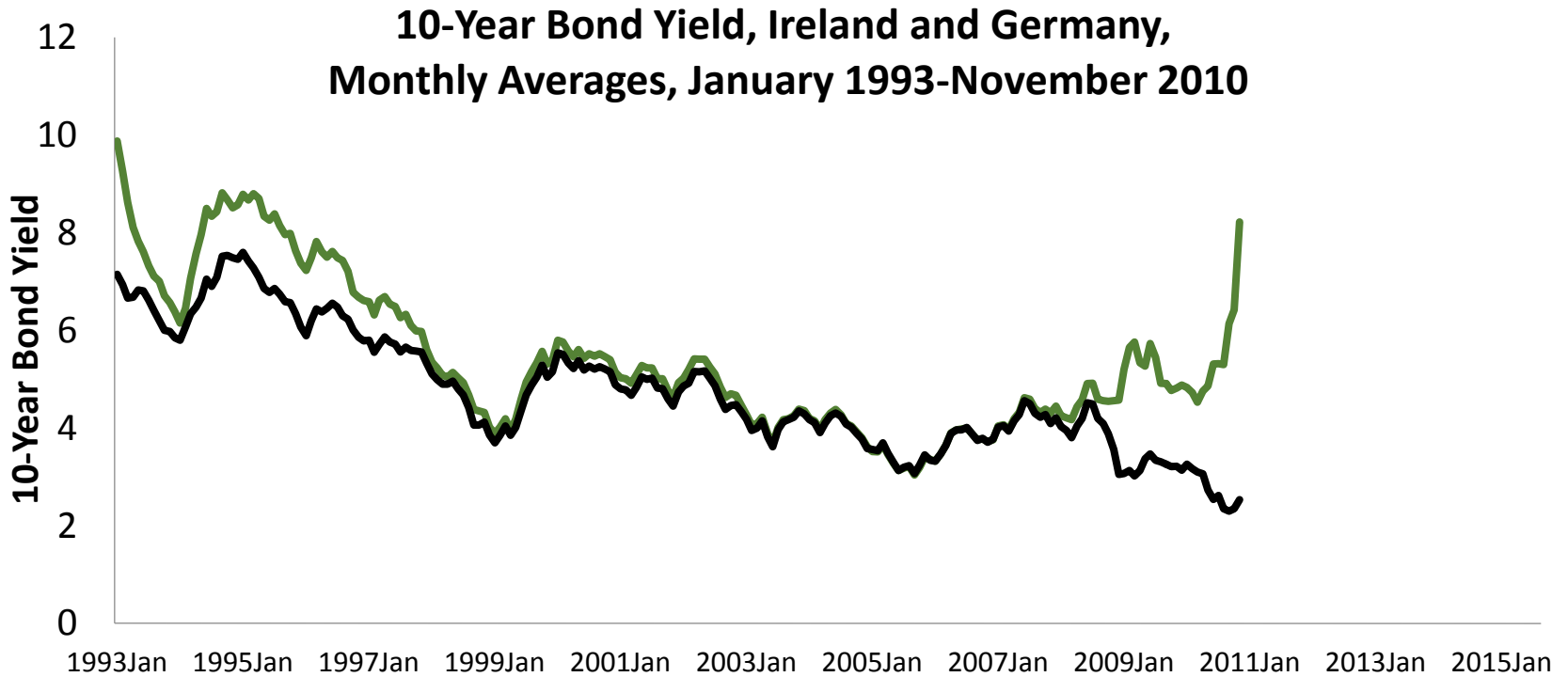
Contribution of banking-related interest costs to the deficit, billions of euro



Sources: Department of Finance; Comptroller and Auditor General

**Was the austerity caused by the
troika programme?**

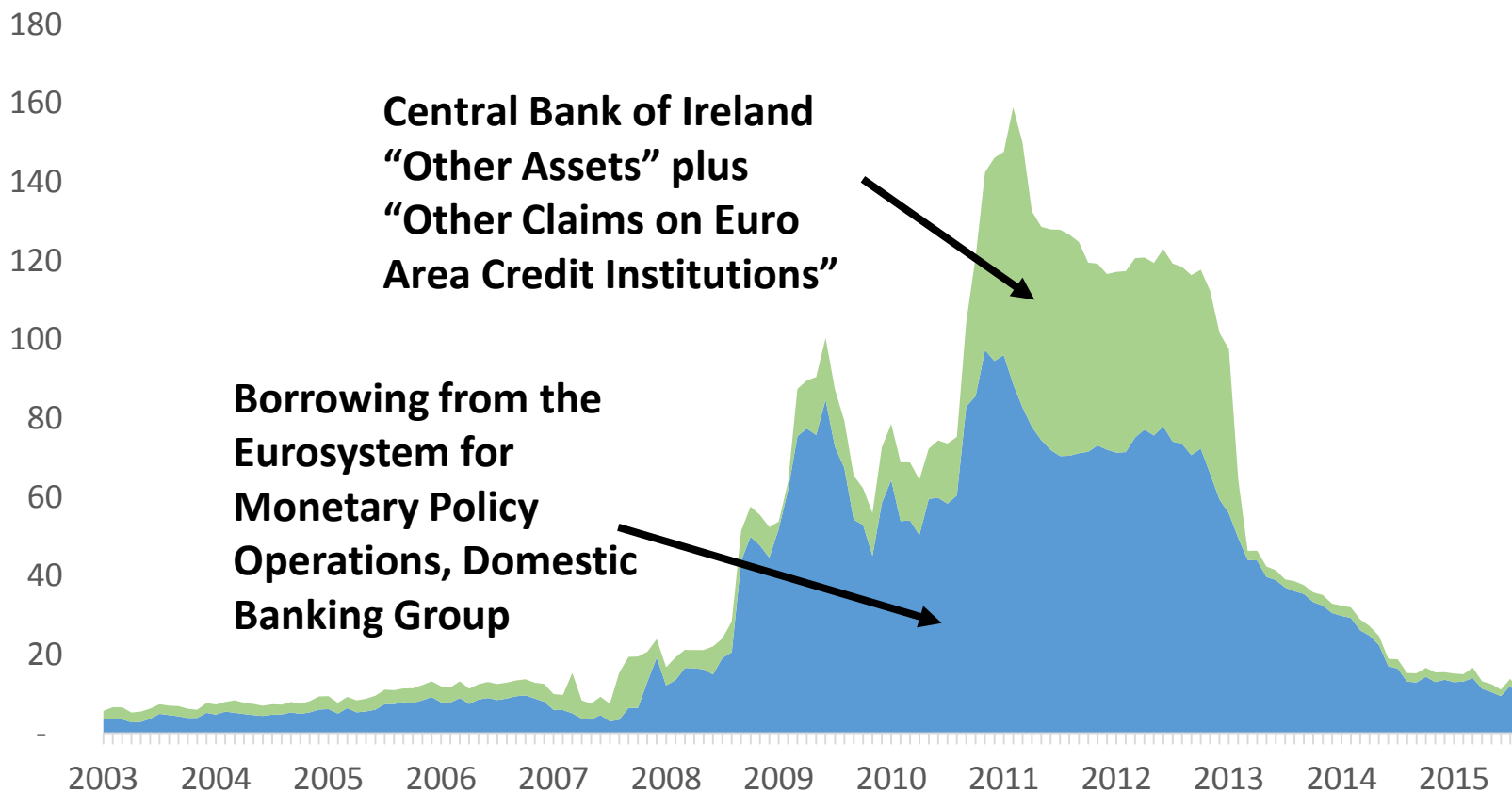
State lost its ability to borrow in the second half of 2010



Source: ECB

Run on the banking system → Large-scale borrowing from Eurosystem

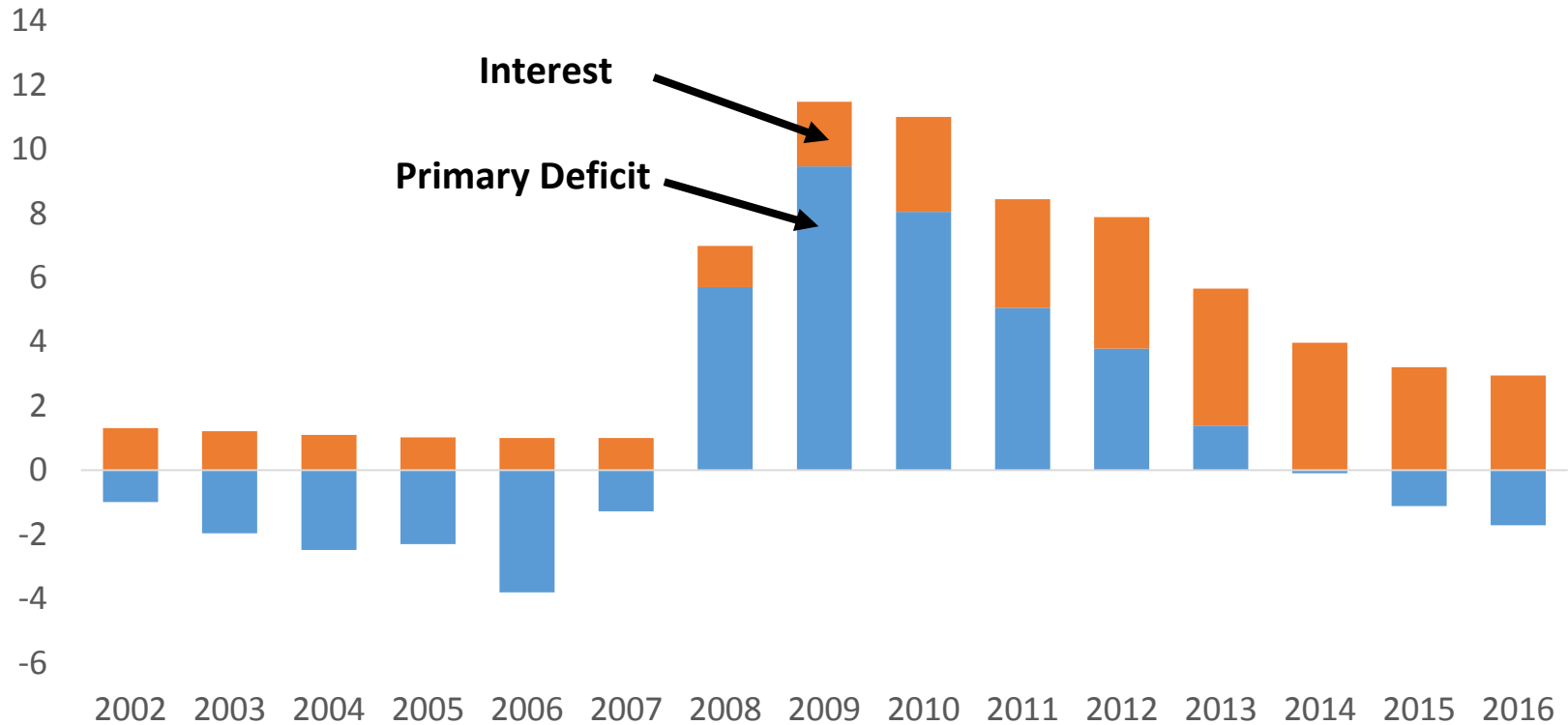
Billions of Euro



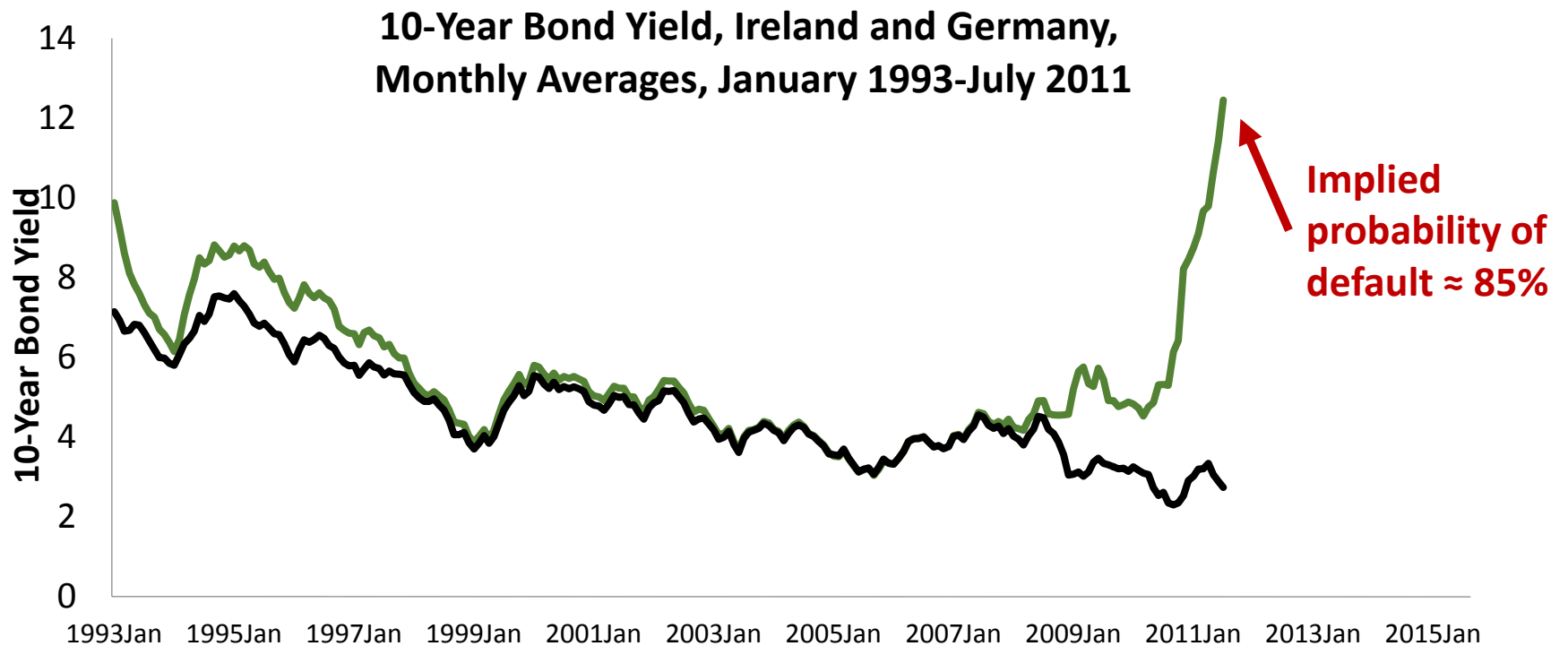
Source: Central Bank of Ireland

Large primary deficit implied massive required adjustment in the absence of assistance

Percent of GDP



Creditworthiness continued to erode in early months of the programme

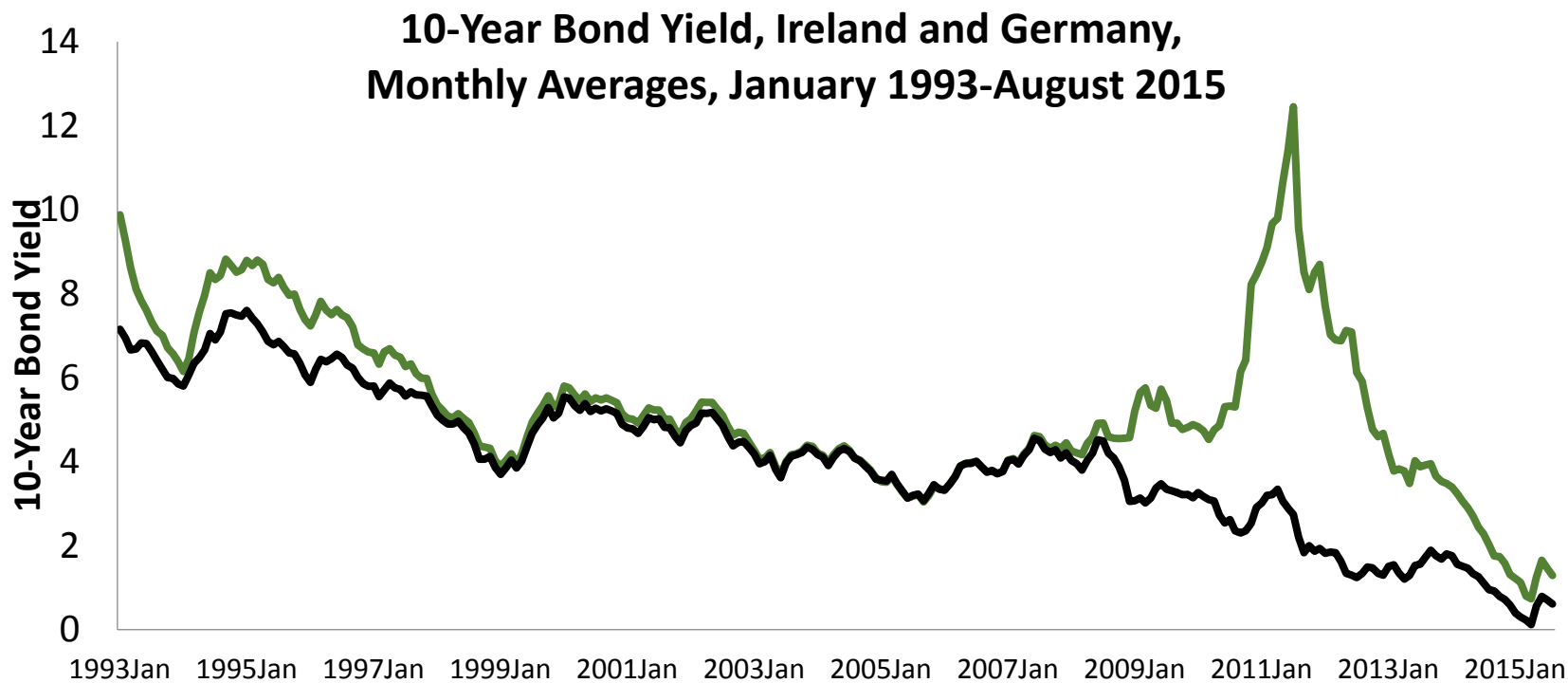


Source: ECB

Multiple uncertainties

- Uncertainty about growth prospects
- Uncertainty about the size of bank losses
- Uncertainty about the capacity of new centre-right/centre-left coalition to make the necessary adjustments
- Uncertainty about the evolution of European support policies

“Catalytic finance” strategy began to work from the second half of 2011



Source: ECB

Alternatives?

- Sovereign default
 - Hard ball
 - Debt restructuring
- Burden sharing with bank creditors

Reducing the cost of the bank bailout

- A guarantee was necessary, but September 2008 guarantee too broad, and limited subsequent burden-sharing options
- A resolution regime should have been put in place prior to the expiry of the blanket guarantee in September 2010
- Run on banking system by November 2010
 - Importance of retaining support of Eurosystem
 - Limited savings from “burning” senior unsecured unguaranteed Anglo bondholders

**Can we prevent it from
happening again?**

Some emerging lessons from the banking inquiry

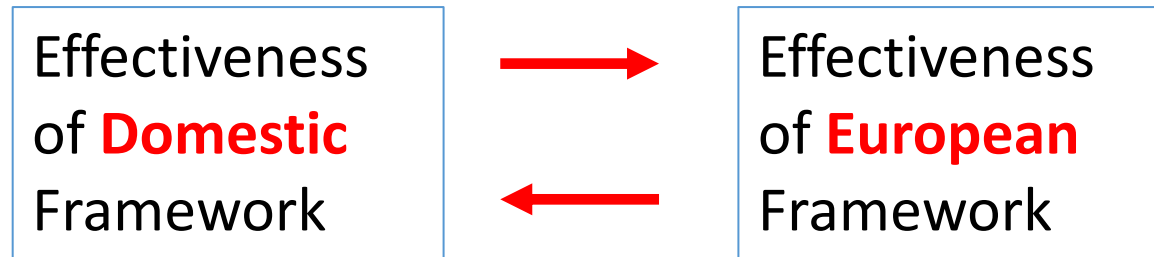
- Difficulty of avoiding pro-cyclical policies in times of strong economic growth
- Importance of risk management
 - Looking beyond central scenarios
- Significant crisis-induced institutional reforms
 - Banking
 - Fiscal

Rationale for a strong budgetary framework

- Avoid pro-cyclicality in good times
- Avoid large forced adjustments in bad times
 - Need to reduce debt to income ratios to safer levels

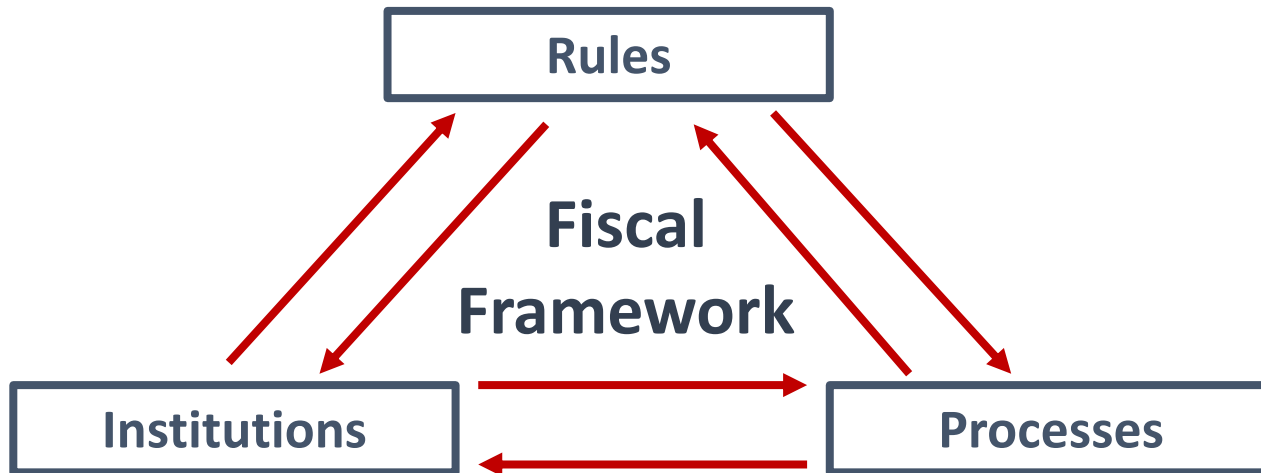
Complementary domestic and European elements

Domestic ownership adds legitimacy to the European rules



Monitoring, peer pressure and possible sanctions of the European framework enhances the effectiveness of the domestic framework

Synergies between rules, institutions and processes



Summing up

- Crisis caused by bursting of property/credit bubble
- Became a fiscal crisis
- Deficit reduction was unavoidable; failure to adjust would likely have caused much greater austerity
- Roles of bank bailout costs and troika programme need to be put in proper perspective
- Challenge now is not to let it happen again