

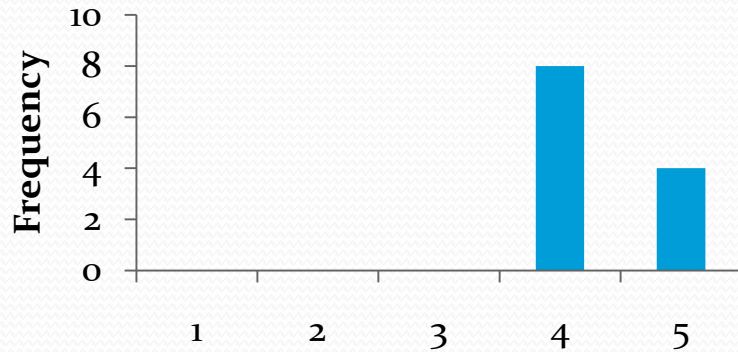
EC1800 ECONOMICS

Lectures 13-15

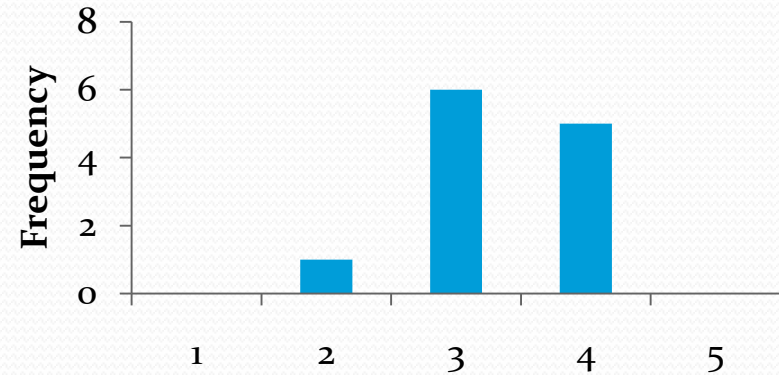
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Last Week's Feedback Form Results

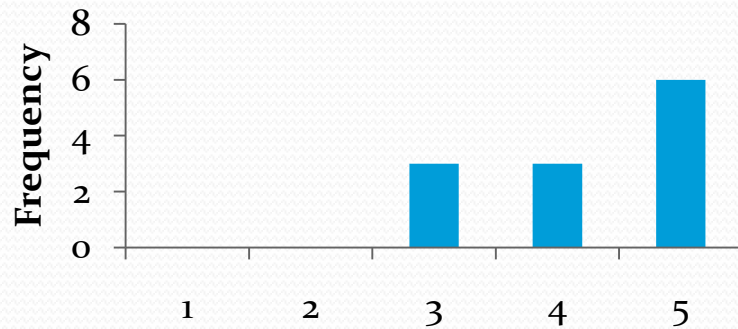
Boring/Interesting



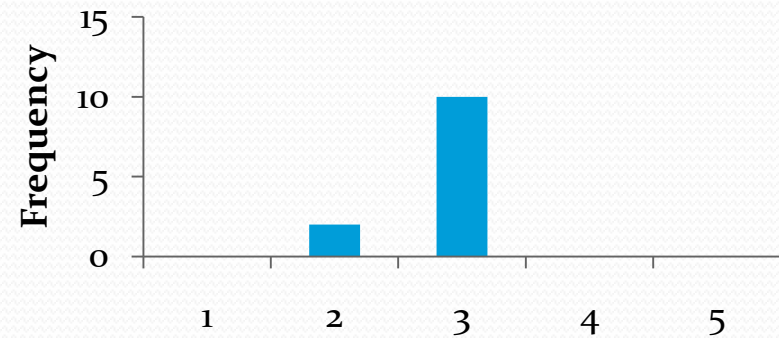
Slowly/Quickly



Confusing/Clear



Hard/Easy



Feedback So Far

Date	Boring/ Interesting	Slowly/ Quickly	Confusing/ Clear	Hard/ Easy	Average Hours Studied	Average Section 1 Mark	Average Section 2 Mark
11 th Nov	4.5	3.78	4.44	3.22	7.67	54.17%	58.30%
18 th Nov	4.5	3.75	4.08	2.92	4.1	79%	8%
25 th Nov	3.46	3.38	3.69	2.92	2.03		
2 nd Dec	4.33	3.33	4.25	2.83	3.06		

**So what did you think
about the Reading?**

What We Covered Last Week I

Week 1: Types of Wealth

Week 2: Sustainability of Wealth

Week 3: Stability of Wealth 1

Week 4: Stability of Wealth 2

This Lecture: Economic History of Ireland 2 (not 1!)

What We Covered Last Week II

- Economics sees:
 - A sudden drop in Demand = a Recession
 - A sudden rise in Demand = a Boom
 - If a rise in Demand outstrips Supply, you get *inflation*
- Inflation = a rise in the price level
 - Whenever prices start to rise rapidly in some industry
e.g. Housing, Tulips, Food, Oil etc
- Inflation is very, very bad so governments try to prevent inflation by raising interest rates in anticipation of a rise in inflation

What We Covered Last Week III

- Therefore governments try to predict the future
 - Sometimes this works, sometimes it doesn't
- When can we predict the future?
 - = when the recent past has been stable (e.g. Stable growth) because then we can infer future behaviour from past behaviour
- When can't we predict the future?
 - = when the recent past has been volatile
- Always, always, always at ANY stage the game can suddenly shift without warning (a *structural break*)

What We Covered Last Week IV

- Equilibrium
 - Within a certain range of conditions a system will tend towards equilibrium
 - A tiny change in those conditions may cause a system to suddenly try to leave equilibrium
 - What change this might be is often unpredictable. Just like the movie *Equilibrium* starring Christian Bale!
- Stability & Growth = the System ticking along well, not much change (the Rich get richer, the Poor get poorer)
- Volatility & Recession = Change (good for some, bad for others)

What We Covered Last Week V

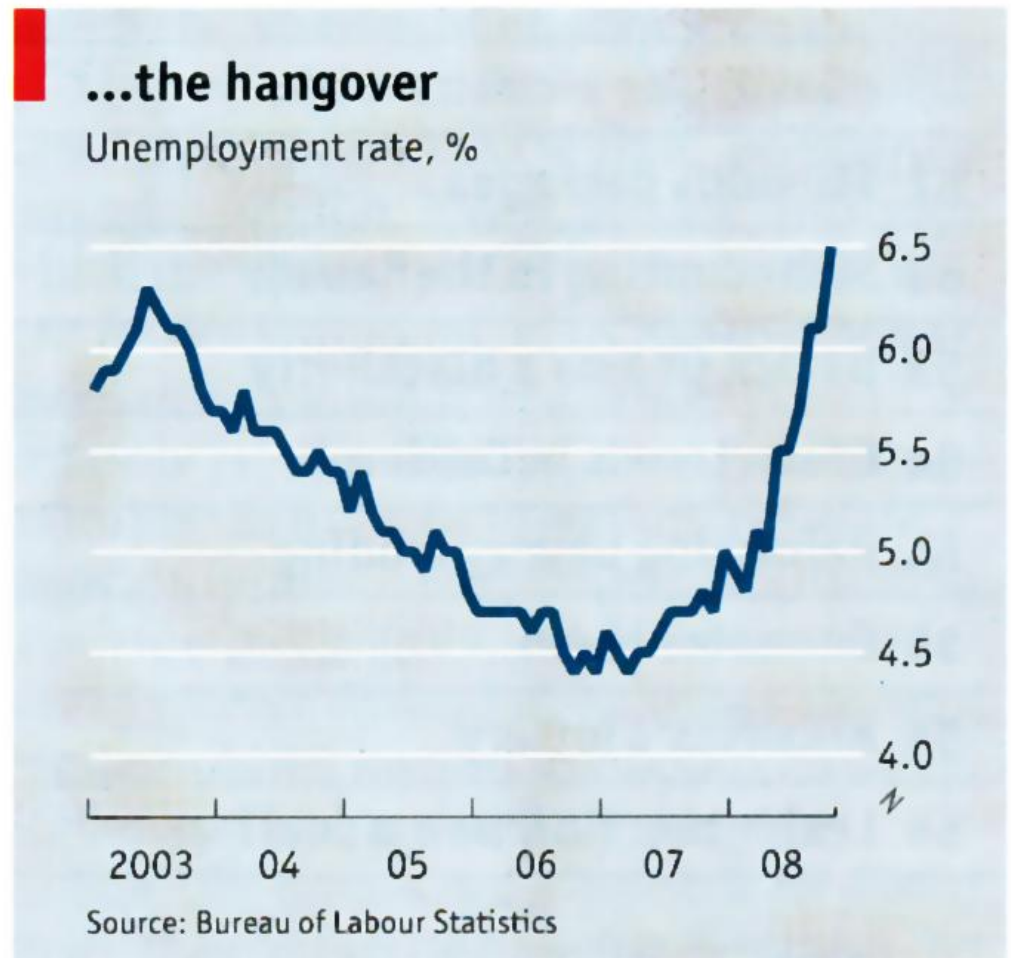
- Life is all about trying to fill in the gaps e.g. to draw lines between the dots
- Sometimes some sets of dots **do not mean the same** as other sets of dots even when they come from the same source (the technical term for this is *incommensurability*)
- Failure to get this right blows up Space Shuttles and ruins Economies
- But getting this right is hard, sometimes is completely impossible

What We Covered Last Week VI

- Chaos Theory: Equilibrium occurs when volatility is smoothed out, Disequilibrium occurs when volatility is amplified (this week's reading)
- Lastly, I performed a study of the Dow Jones stock market index and found that very, very rarely it breaks the Gaussian (Normal) Distribution
 - This is when the normal laws of Demand & Supply equalising completely break down
 - Whenever this happens, BIG change is coming across all of society

Some Bad Economic News This Week I

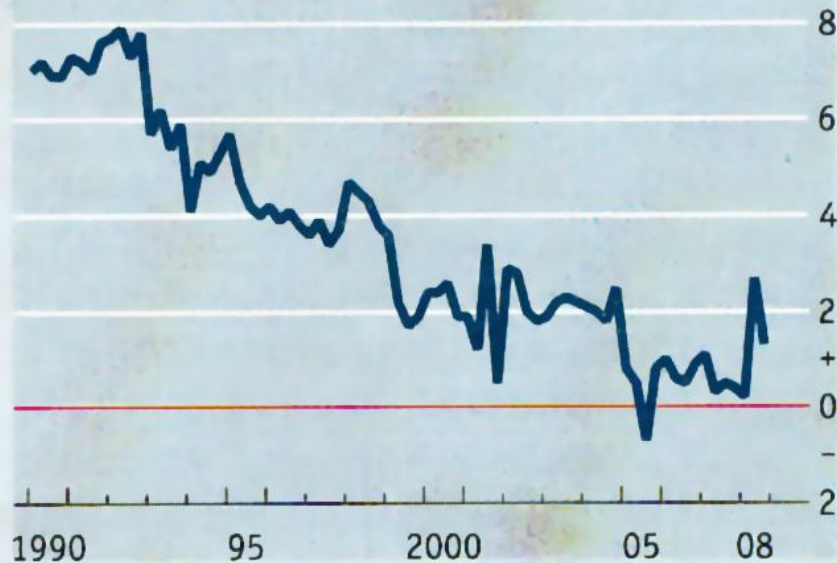
- This week released the US employment figures for November:
- Some 533,000 jobs lost in November alone
- 1.9m jobs lost in 2008



Some Bad Economic News This Week II

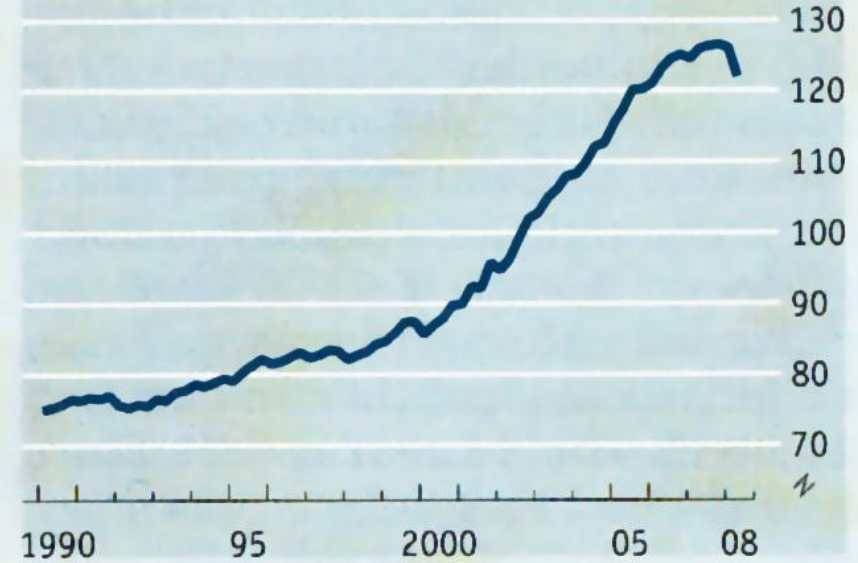
After the party...

Personal saving as % of disposable income



Sources: Federal Reserve; US Bureau of Economic Analysis

Household debt as % of disposable income*



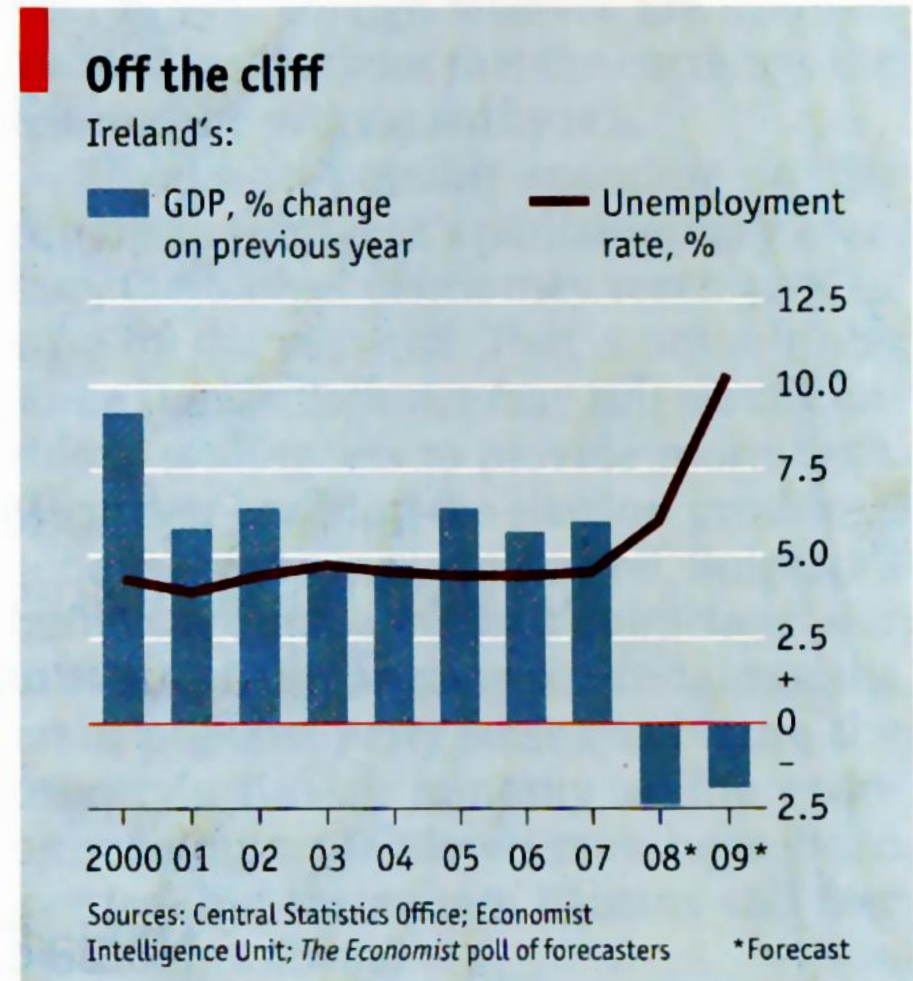
*Includes consumer credit and mortgage lending

**Why is bad Economic
News for the US bad for
Ireland?**

Even More Bad Economic News

This Week III

- The Irish government anticipates a deficit of up to €15bn in 2009 (€13.3bn has been quoted as the max)
- To be honest, the tax rises are nothing like severe enough
- We also need a severe reduction of public services



The Irish Economy I

- Around 31% of Irish GDP is taken as taxes
- However Ireland is very unusual: it is a small economy with lots of foreign corporations
- Adjusting GDP for the money these corporations push through Ireland to avoid tax, taxation takes 36% of the Irish economy
- Therefore, more than a third of our economy is the Government
- In a severe recession, this needs to shrink

The Irish Economy II

- Obviously, shrinking the public sector is risky for any politician
- A huge number of influential people in Ireland depend on the state for employment
- No politician likes being seen to close schools, hospitals or cut back people's "fun"
- However, it was letting people have "too much fun" which got us into this mess in the first place
- **How and why that happened is very closely aligned with the history of the Irish state**

What Happens Next?

- We have covered a LOT of theory in the last few classes
- This module is supposed to be related to Ireland, so for the remainder of the course I'm going to attempt to apply some or all of this theory to Ireland
- This is really tough because, as mentioned before, Ireland's economy is just plain weird:
 - It's small but has huge import & export flows
 - It has a very low density of population despite having a relatively large economy (unlike any other similar small European country, but similar to the USA)
 - This means spending patterns are more like the USA than Europe. Why?

What Happens Next?

- Like the USA, Ireland's population is concentrated together in "hot spots" which are very dense with huge sparsely populated gaps in between
- This means that the Irish like big houses & driving cars unlike the Europeans who prefer flats and public transport
- However, Ireland's culture is much more homogenous than Europe thanks to a highly integrated Education system
 - There is nothing like the cultural difference between regions as say a small European country like Belgium

What Happens Next?

- I'm going to do this “the wrong way round”, so I'm going to start this week with the Celtic Tiger (1995 onwards) and next week go earlier
- This is because the lectures for my Masters end this week so I'll have the time to do the research for next week's lecture, whereas this week I still have class tests and essays etc.
- The big problem is there is a total lack of information before 1995. Ireland wasn't important enough internationally

Irish Economic History

- In fact, because I know so little about this topic – and because most of you are much older than I am – we’re going to go for true class participative learning!
- Fill in the sheet with five “economically important” events and when you think they happened
- We’ll have a quick discussion about them, but I’ll take them away for researching the next lecture
- Next week’s lecture:
 1. My best attempt at Ireland’s Economic History
 2. Essay writing guidelines (handout)

Fill in the sheet with five
“economically important”
events and when you think
that they happened

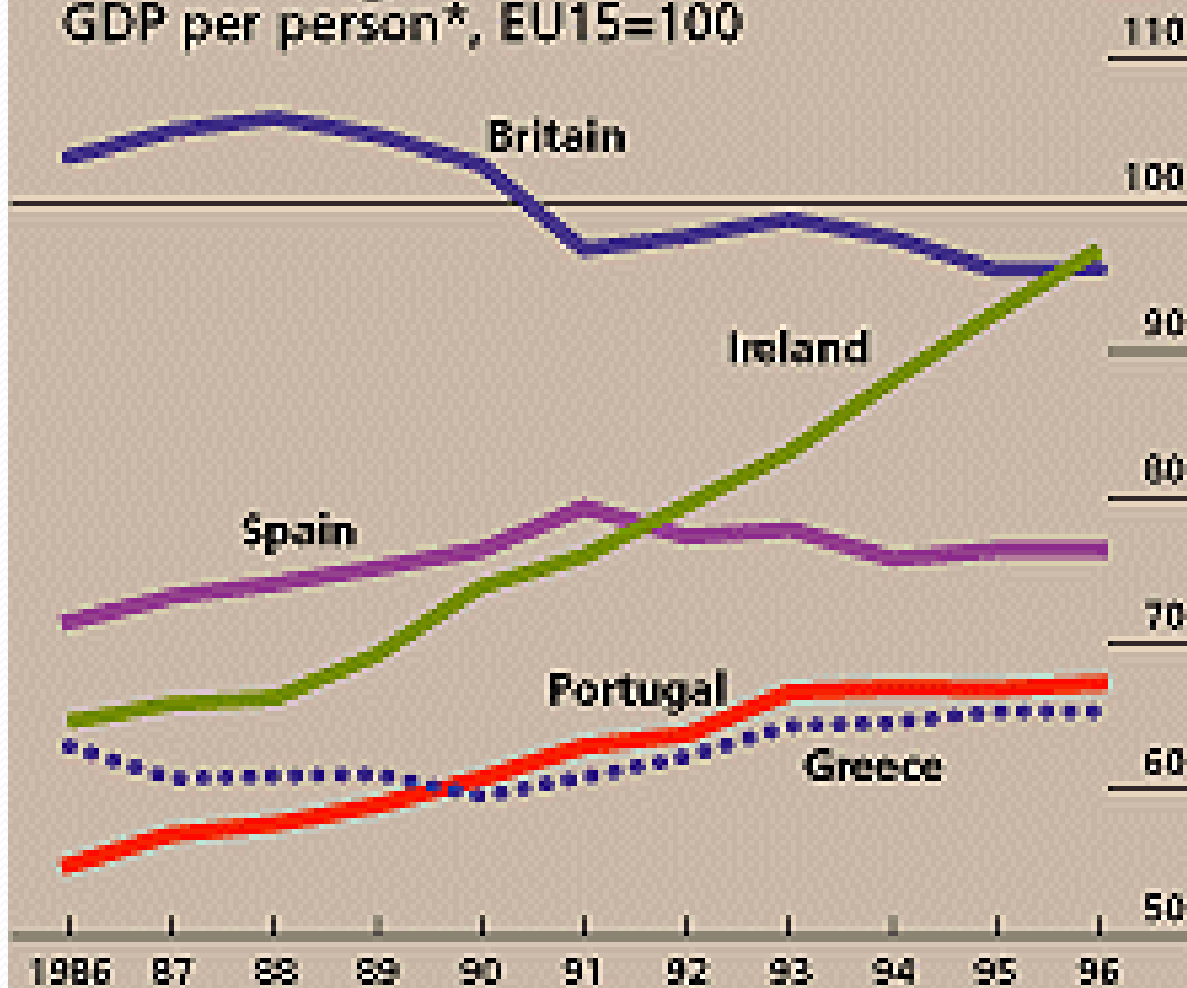
The Economic History of Ireland I

- Everything in here is straight off the internet – I know NOTHING about the Irish economy before 1995
- Why? Because no one in Economics cared about the Irish economy at all until the Celtic Tiger
- Ireland is too small and unimportant in the world Economy to merit much study
- Therefore, there is simply not much material available and what there is, isn't of a high quality

Amazing

GDP per person*, EU15=100

1



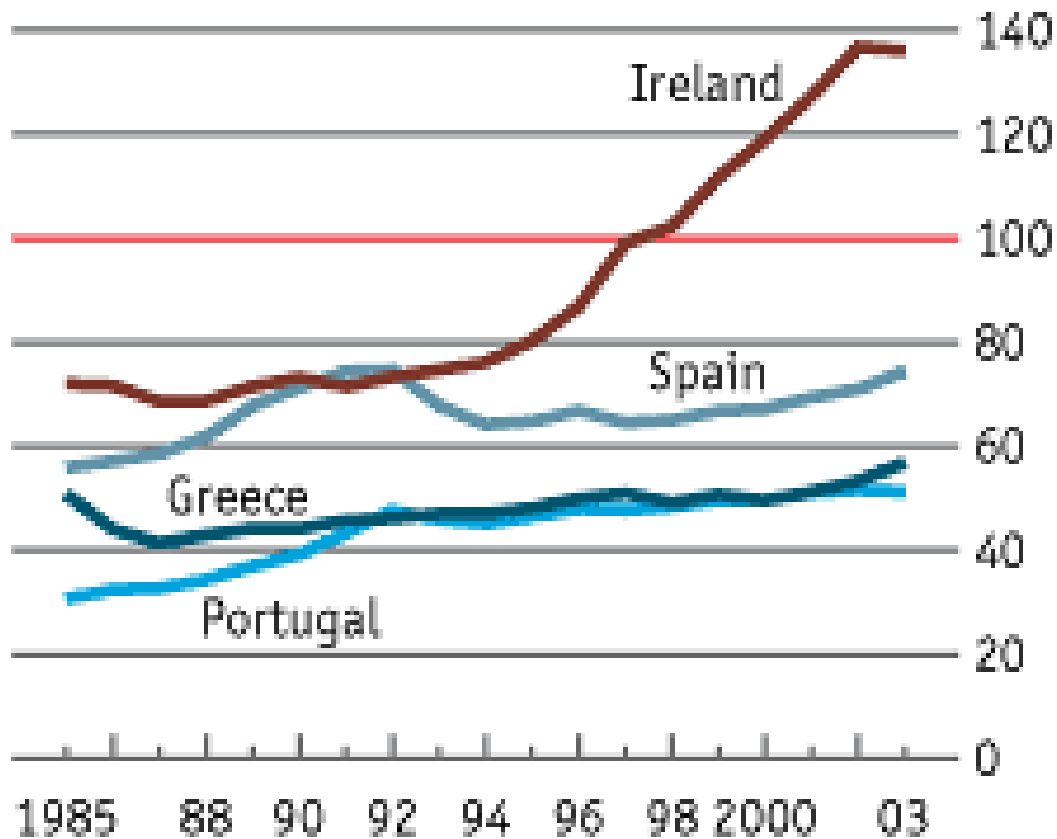
Source: OECD

*On a purchasing-power basis

Leader of the pack

1

GDP per head as % of EU15 average



Sources: OECD; Economist Intelligence Unit

In numbers:

- Between 1995 and 2004, Ireland's productivity rose by 35.9% and the numbers employed by 43.3%
- Together, these increased National Output by 95%!
- The top four contributors to this growth*:
 1. Chemicals (532.9)
 2. Pulp, Paper Printing and Publishing (168.3)
 3. Electrical & Optical Equipment (121.9)
 4. Food, Beverages & Tobacco (94.6)

* 'Productivity in Ireland: Trends and Issues' by Mark Cassidy
(2004)

How did the Celtic Tiger begin? I

- That is a very good question!
- The answer is that no one is quite sure, but it has something to do with these top seven causes (in reverse order of importance):

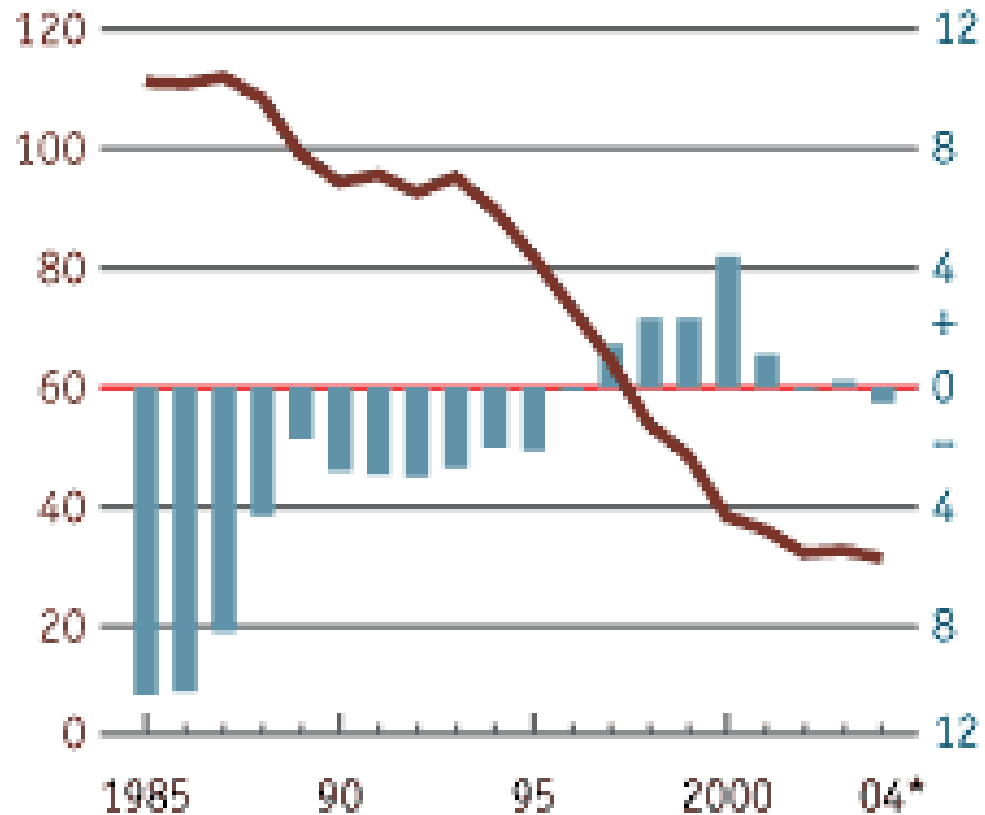
Number 7: We started to pay off our National Debt

Payback

2

*Gross government
debt as
% of GDP*

*Budget
deficit
% of GDP*



Source: OECD

* Forecast

Why was paying off the National Debt Important?

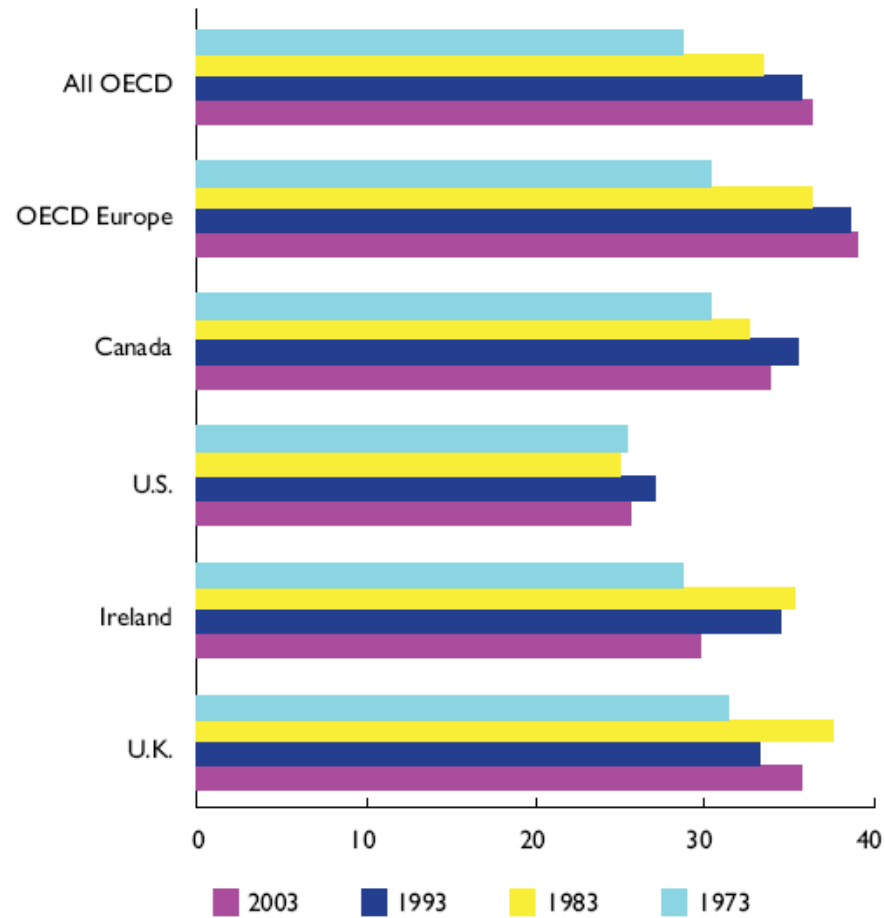
- Despite running a budget deficit, the Government started to pay off the National Debt which had risen ludicrously under Haughey in the 1980s
- This sent a message to the world that the Government were serious about balancing their budget no matter the political cost
- This inspired confidence in foreign investors that Ireland would be run competently in the future

How did the Celtic Tiger begin? II

Number 6: Wage Restraint

- In 1987 the Irish government entered a **Social Partnership** with Unions and Employers
- Why was this important?
 - This kept wages low and therefore kept labour costs competitive. This was done on the promise that if the Economy performed well, tax cuts would be given

Total Tax as a Percentage of GDP, 1973–2003



Source: Organisation for Economic Co-operation and Development, Revenue Statistics of OECD Member Countries, 1965–2004.

How did the Celtic Tiger begin? III

Number 5: EU Subsidies

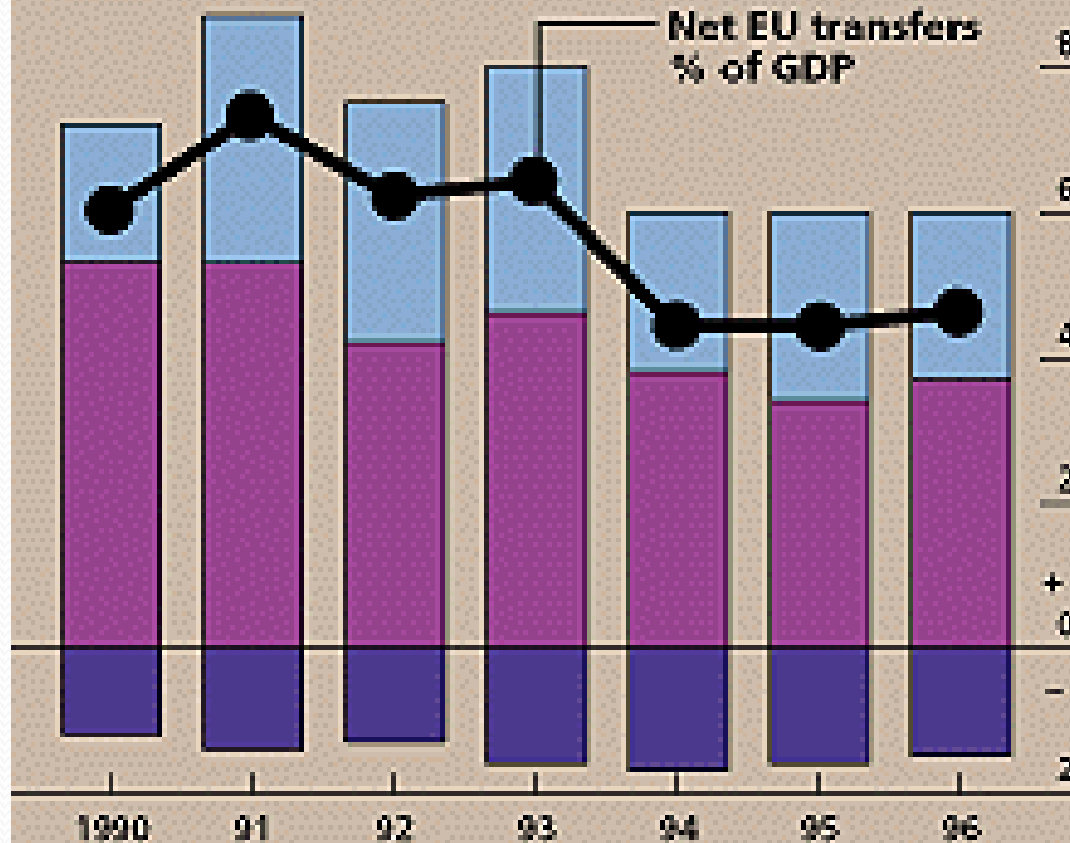
- When Ireland joined the EU, we had a mostly agricultural economy which benefited greatly from EU subsidies
- This brought a lot of money into the Irish economy

A friend in need

2

Ireland's net EU transfers, % of GDP

- Structural funds
- Common Agricultural Policy
- Contributions to EU



Source: IMF

How Important Were Subsidies?

- Despite what people think, EU subsidies were only important at the very beginning of EU membership
- Ireland's economy had actually been substantially improving anyway for twenty years before that
- Transfers never exceeded 5% of GDP
- Most Economists would say that subsidies only added 0.5% to GDP growth (which is not much compared to an average growth of 6.9%)
- They probably were far more important in bringing Ireland's **infrastructure** up to European standards

How did the Celtic Tiger begin? IV

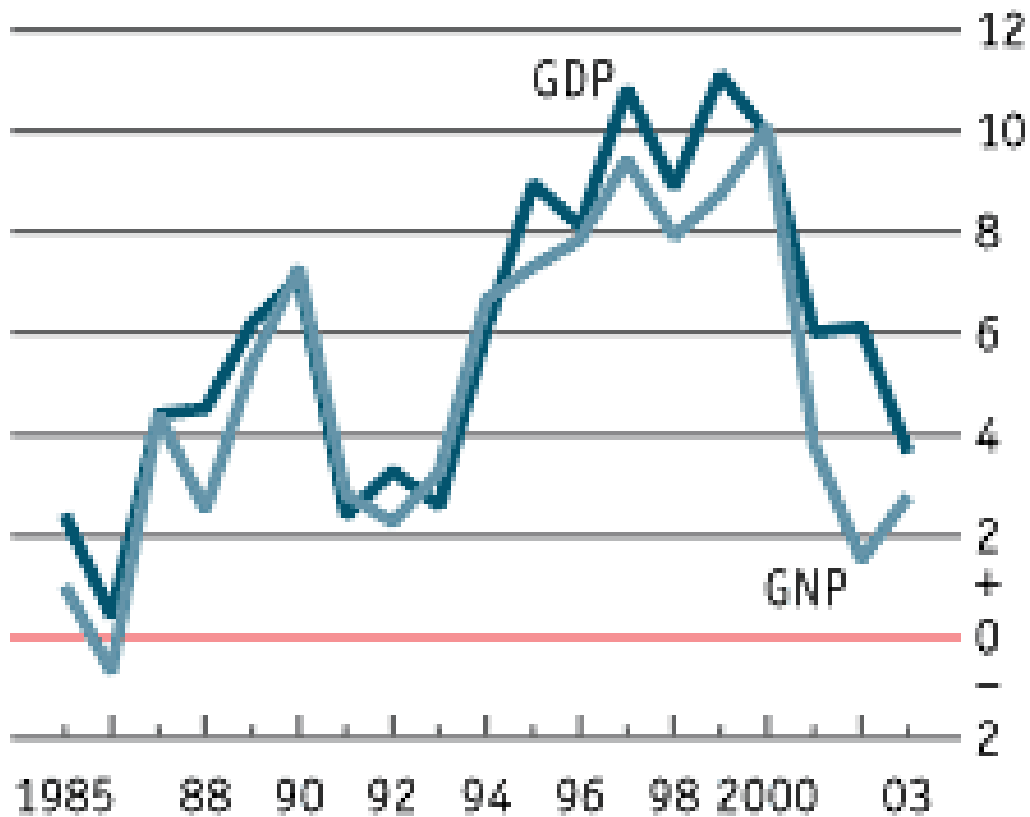
Number 4: Foreign Direct Investment (FDI)

- FDI is the amount invested annually into Ireland by non-Irish people
- Most of FDI came and still comes from the US
- Some of FDI is because Ireland has a skilled English speaking workforce
- However a lot of FDI, probably a majority, is to avoid taxation
- Therefore Ireland has been **leeching** from other Western nations

Widening gap

3

% change on a year earlier



Source: National accounts

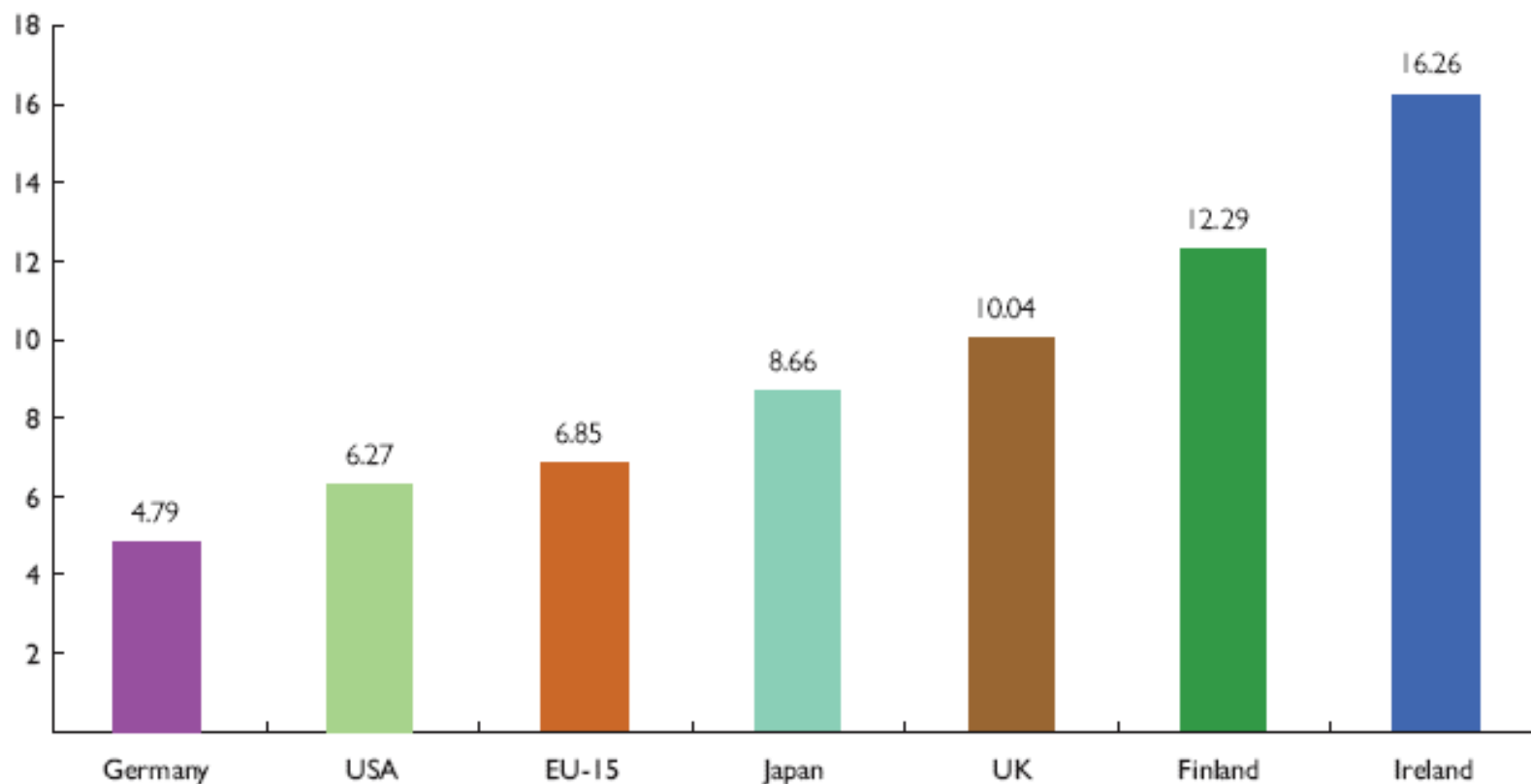
How did the Celtic Tiger begin? V

Number 3: Education

- Ireland has invested heavily into professional education, specifically managers, computers & medical (practical people e.g. **Engineers**)
- This has produced a highly skilled workforce which (IT & health care) multinational corporations like
- However, the investment is very disproportionate – some of the population are as ignorant as a century ago

Science and Engineering Graduates Age 20–34 in 2000

Graduates per 1,000 population



Source: European Commission, *Third European Report on Science & Technology Indicators, 2003*, March 2003, at europa.eu.int/comm/research/press/2003/pdf/indicators2003/reist_2003.pdf (February 15, 2006).

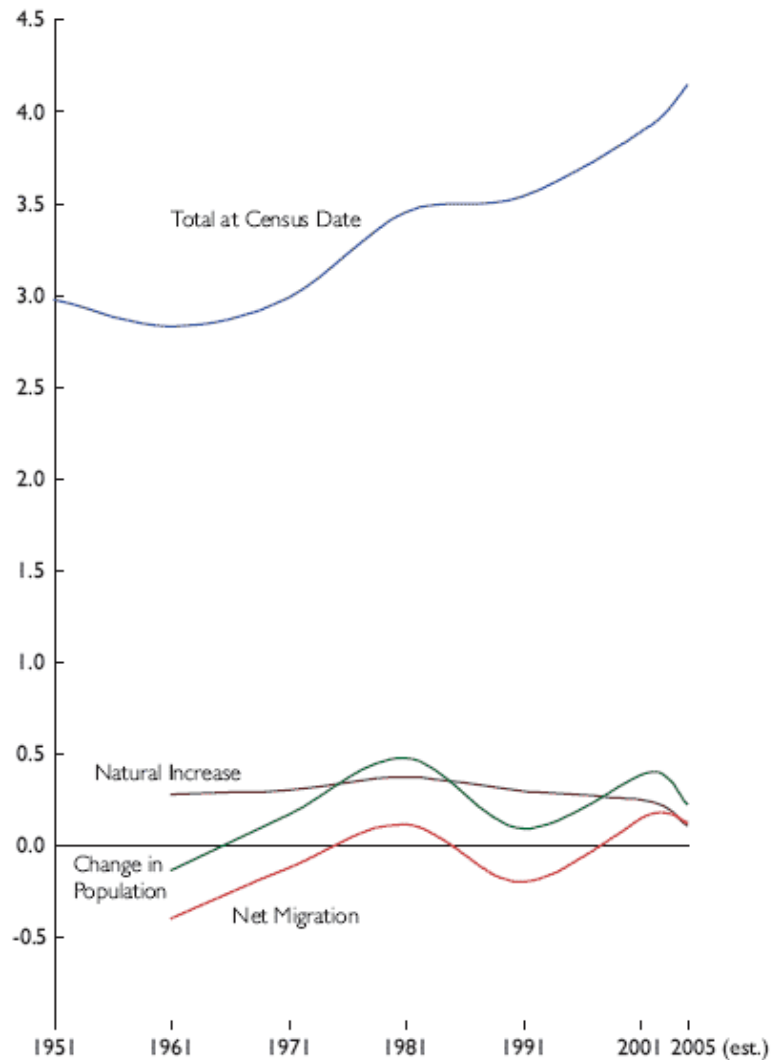
How did the Celtic Tiger begin? VI

Number 2: Demographics

- Thanks to de Valera, the Irish population kept having babies much later than the rest of Europe
 - Ireland's birth rate peaked in 1980, twenty years later than everyone else
 - Therefore we have a much more youthful population with a more modern skillset
- More people available to work means more Economic Activity

Population of Ireland, 1951–2005

Millions of People



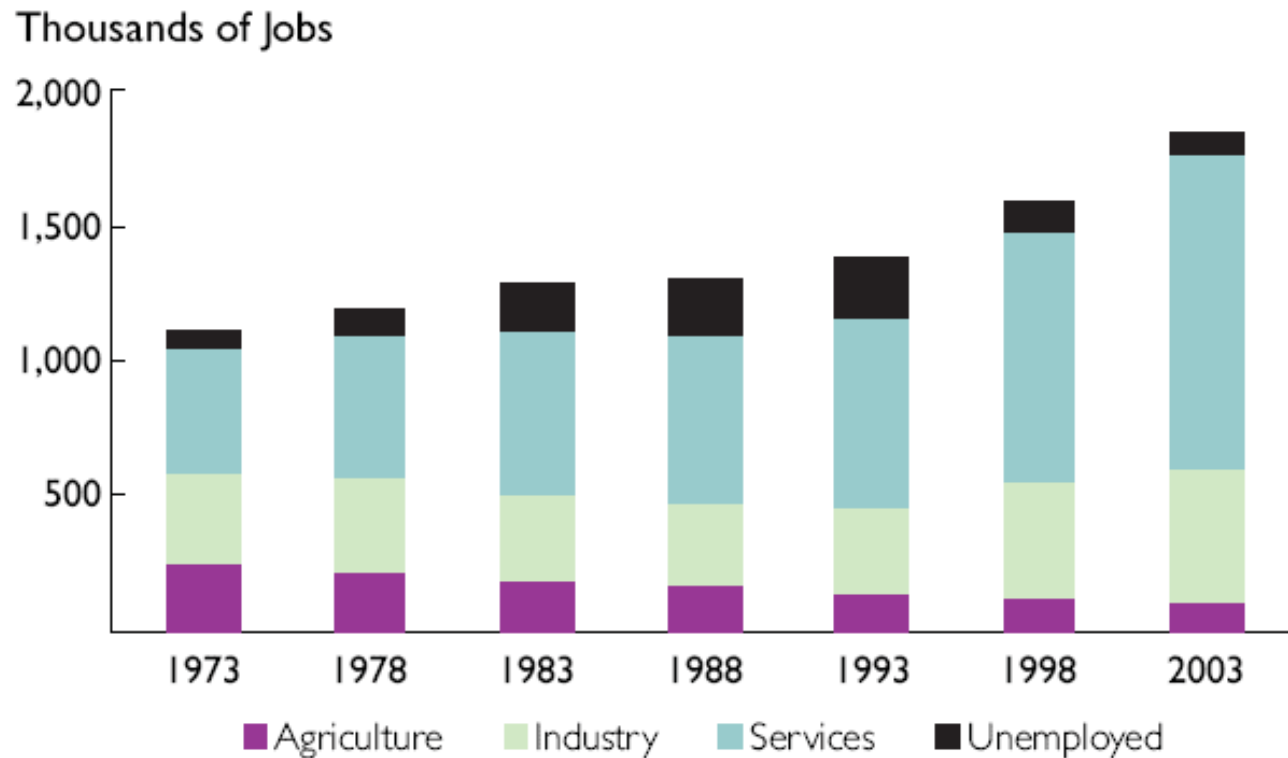
Source: Ireland Central Statistics Office.

How did the Celtic Tiger begin? VII

Number 1: Labour Force Participation (LFP)

- However the single biggest cause, according to Economists, has been a massive rise in the number of people working (especially women)
- The rise in LFP may account for **half** of the Celtic Tiger
 - In other words, most of the Celtic Tiger was simply Irish people starting to work as hard as the international average

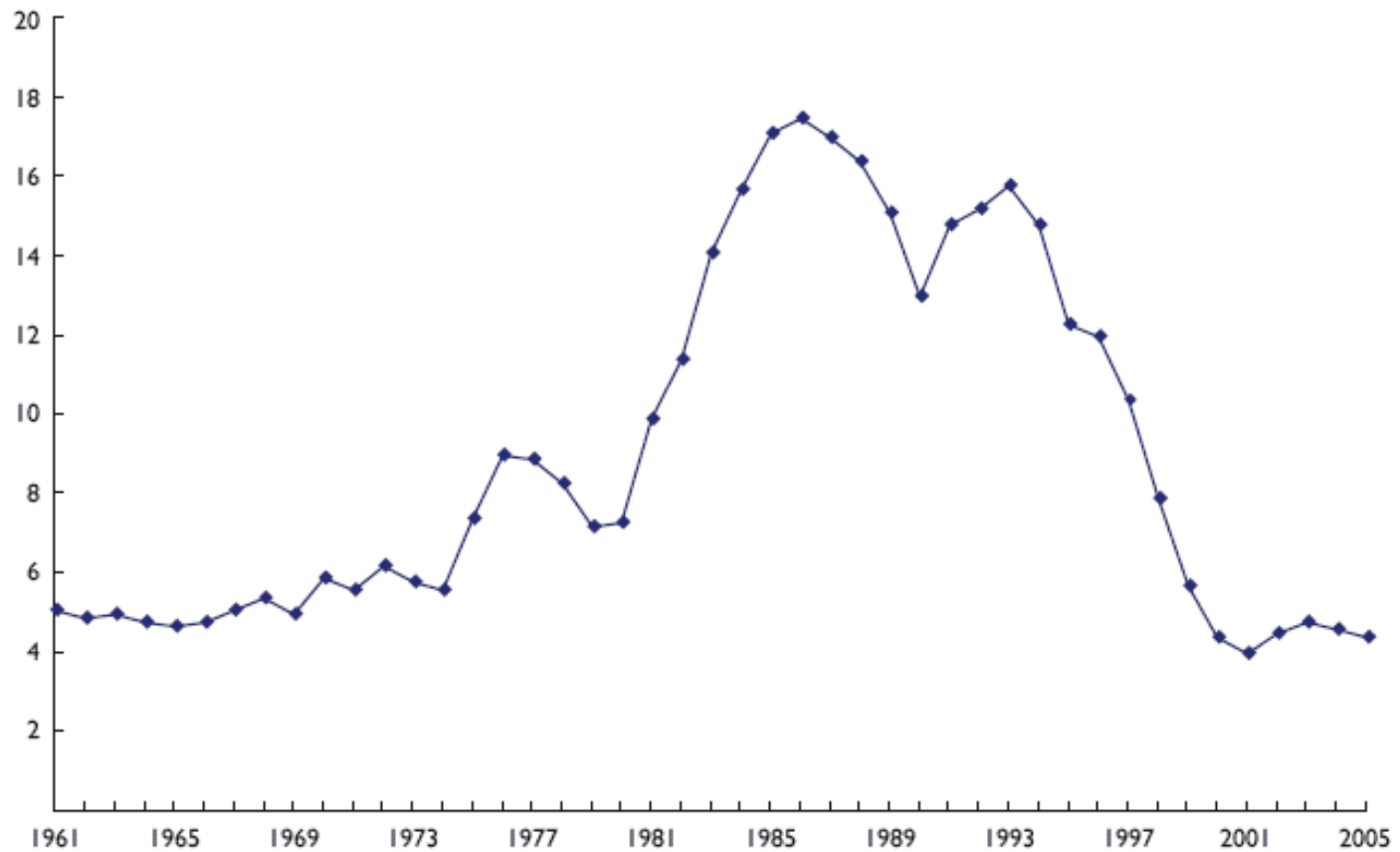
Employment by Sector and Unemployment, 1973–2003



Source: Ireland Central Statistics Office.

Unemployment Rate, 1961–2005

Unemployment Rate



Source: Ireland Central Statistics Office and U.N. International Labour Organization.

Summary of Causes of Celtic Tiger:

1. Labour Force Participation
2. Demographics
3. Education
4. Foreign Direct Investment (mostly from US)
5. EU Subsidies
6. Wage Restraint/Social Partnership
7. Paid off the National Debt (though now we have consumer debt instead!)

Doom & Gloom I

- Of those seven causes, the top two biggest contributors are gone forever
- FDI is heavily dependent on the US economy
 - Indeed one of Barack Obama's campaign pledges is to reduce US FDI abroad – if he does Ireland will suffer immensely => our GDP will approach GNP
- EU subsidies and the National Debt are gone
- This leaves just Education and Wage Restraint left!
(though we could do lots to reduce consumer debt)

A tale of two Economies

- The “leeching” effect is very important
- Without leeching via FDI, Ireland’s productivity growth would be less than **half** of what it is
- GDP would be around **30%** lower than it is
 - This would make Ireland about *average* in the EU, not super-rich
- Without FDI, Ireland’s economic growth shrank to an average of 1% annually since 2000
- In effect, we have imported a little slice of America and run it parallel to our native economy, averaging the numbers (and of course collecting taxes)

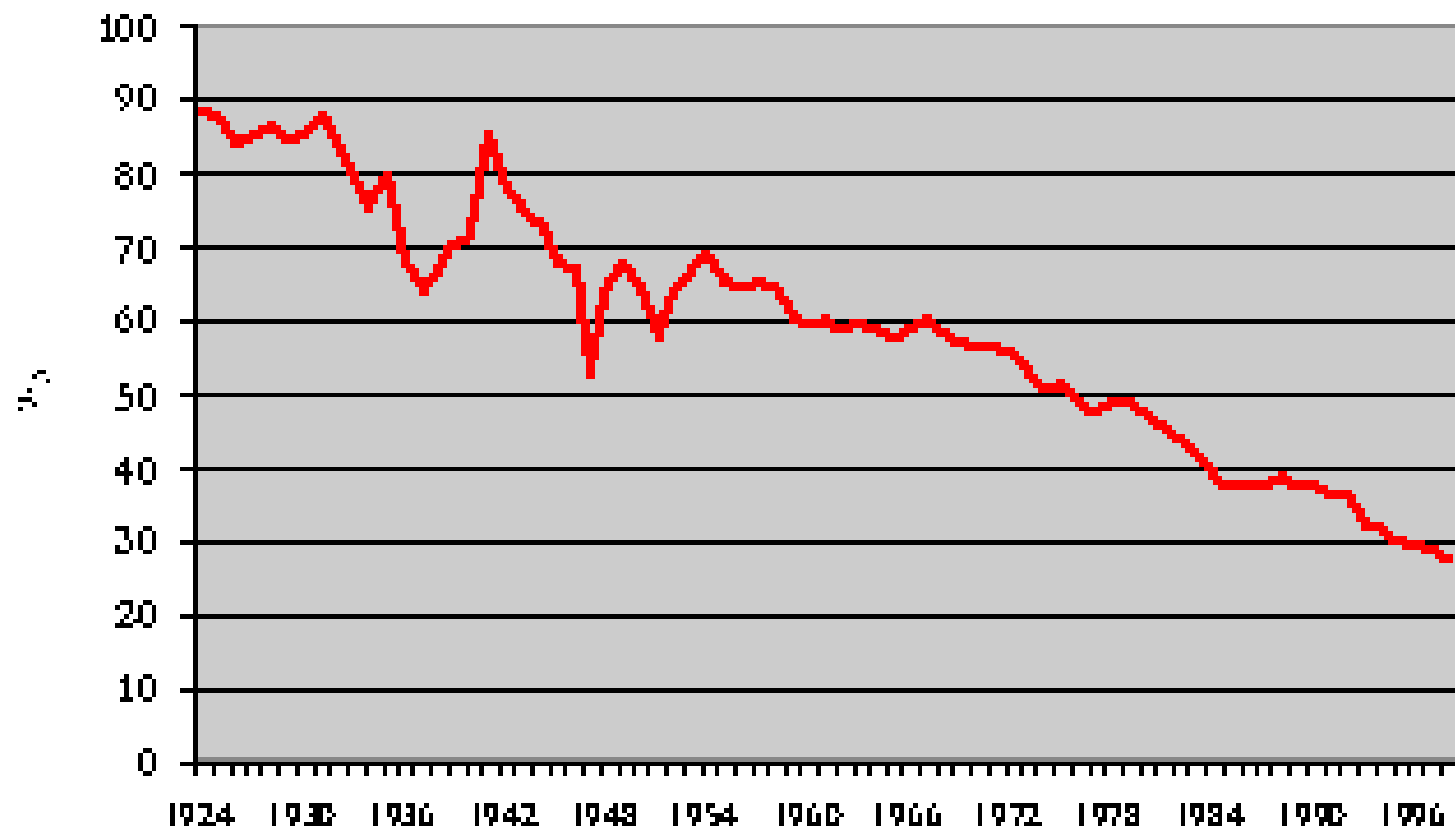
Doom & Gloom II

- Given all this, the chances are that Ireland's Economy will perform worst out of all EU countries in the next few years
- This is because Ireland's two biggest trading partners (US & UK) are facing their worst recessions since the 1970s
 - One Sterling pound is currently worth only €1.10!
- Both the US & Britain have the quadruple whammy of a real estate + financial meltdown, an unstable currency, rapidly declining oil reserves and a large & rapidly growing national debt. This is **very bad** indeed for Ireland

Doom & Gloom III

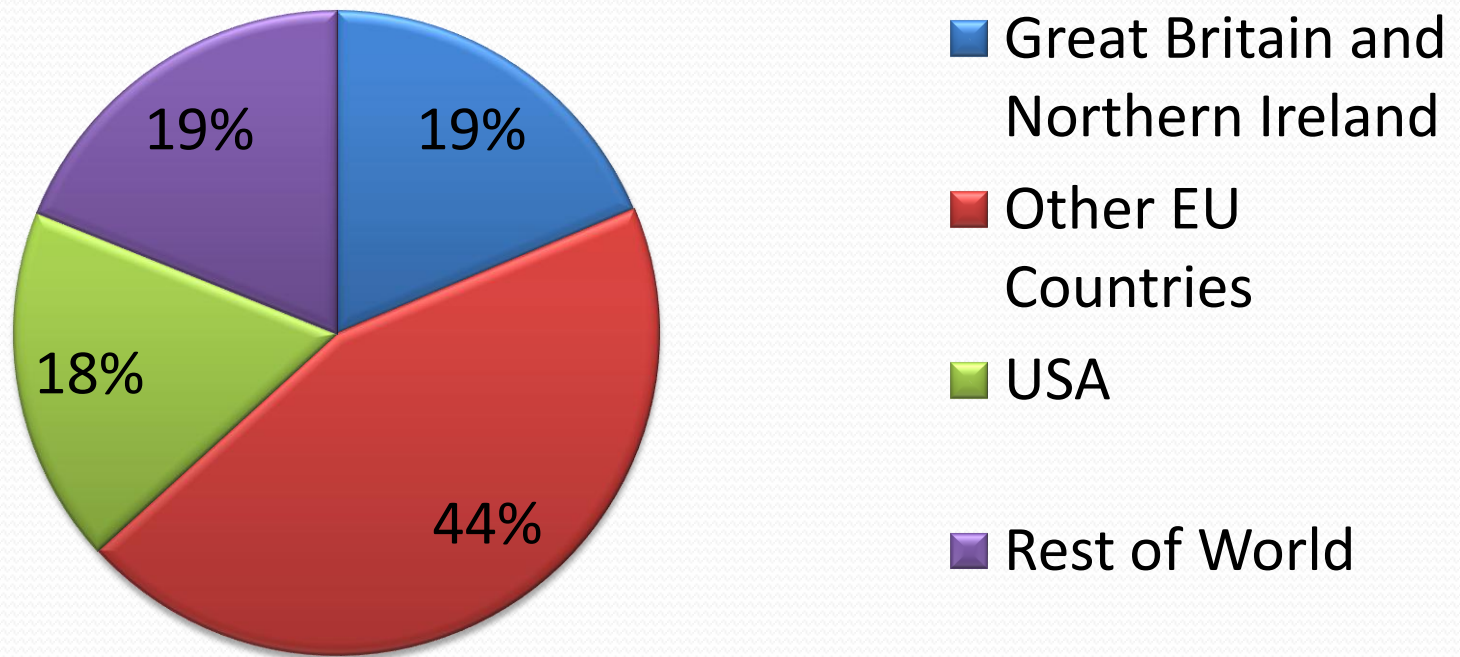
- Indeed, were Ireland not part of the Eurozone, our entire country would be bankrupt right now just like Iceland or an increasing number of Eastern European countries
- Thankfully, because we ARE part of the Eurozone, we won't be as badly off as Britain or the USA
- Also, it helps that the Irish economy no longer trades with Britain as much as once upon a time:

Figure 1: UK's share of Irish trade, 1924-98



Breakdown of Irish Exports

Irish Exports in 2007



Conclusion I

- Ireland has caught up with the rest of Europe but its GDP is artificially inflated
- Some even say that Ireland's "success" is merely an offshoot of the US economy – a "paper tiger"
 - This is because worker productivity for native companies is far below worker productivity for foreign companies
- There will be little further economic growth past other EU countries in the future
- So, what about wealthiness? Is Ireland wealthy?

Conclusion II

- Next week we will try to investigate Ireland's history before the Celtic Tiger. Because whatever one thinks about the Celtic Tiger, we have prospered while EU countries such as Portugal and Greece have not
- I'll give you lots of handouts from *The Economist* on Ireland for your Christmas reading
- And for the one lecture remaining after Christmas, we will try to integrate the theory with Ireland's history
- After that, it's all up to you in your essays!

See You Next Week!