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The Responses of Greece and Ireland to the Crisis

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Abstract

Starting in the U.S as a subprime mortgage crisis in the second half of 2007, the financial crisis gained a global character when Lehman Brothers went bankrupt in September 2008. Peripheral countries in the Eurozone especially were affected by the crisis since the global crisis turned into a sovereign debt crisis in those countries, particularly in Greece and Ireland. However, the reason why the crisis was felt so deeply in Greece and Ireland is that both countries already had problems resulting from country-specific factors.

The reason for analyzing Greece and Ireland in this study is that they are the two most severely affected countries in the European Union by the financial crisis of 2008. However, during the period from their Euro accession to the outbreak of the crisis, both of these countries had high growth rates. Despite the high growth rates achieved, why did these two economies experience big problems because of the global financial crisis? Both applied for EU/IMF funds in order to overcome the crisis but their processes of overcoming the crisis were different. What are the underlying reasons for this? Did adoption of the Euro make these countries more vulnerable to the global crisis or did being within the Eurozone facilitate their process of overcoming the crisis? These are the main questions to be answered in this study.

Key Words: *Sovereign debt crisis, Greece, Ireland*

Yunanistan ve İrlanda'nın Krize Tepkisi

Özet

2007 yılı ikinci yarısında ABD mortagage piyasalarında başlayan finansal kriz, 2008 Eylül ayında Lehman Brothers'ın iflası ile birlikte küresel bir nitelik kazanmıştır. Krizden özellikle Euro bölgesindeki çevre ülkeler etkilenmiştir. Çünkü küresel kriz başta Yunanistan ve İrlanda olmak üzere bu ülkelerde ülke borç krizine dönüşmüştür. Ancak küresel krizin Yunanistan ve İrlanda'da bu kadar derin hissedilmesinin nedeni her iki ülkenin de kendine has faktörlerden kaynaklanan sorunları içerisinde barındırmasıdır.

Bu çalışmada Yunanistan ve İrlanda'nın analiz edilmesinin amacı, Avrupa Birliği içerisinde 2008 küresel finans krizinden en çok etkilenen iki ülke olmalarıdır.

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Ancak her iki ülkede de Euro'ya geçişin ardından krize kadar olan dönemde yüksek büyüme oranları elde edilmiştir. Elde edilen bu yüksek büyüme oranlarına rağmen neden bu ekonomiler küresel finansal krizle birlikte büyük sorunlar yaşamıştır? Krizden çıkmak için her iki ülkede AB/IMF fonlarına başvurmuştur. Ancak krizden çıkış süreçleri farklı olmuştur. Bunun nedenleri nelerdir? Euro'ya geçiş bu ülkeleri küresel krize daha duyarlı hale mi getirmiştir yoksa Euro içerisinde olmak bu ülkelerin krizden çıkış süreçlerini mi kolaylaştırmıştır? Çalışmada bu sorulara cevap aranmaya çalışılacaktır.

Anahtar Kelimeler: *Ülke borç krizi, Yunanistan, İrlanda*

1. INTRODUCTION

During the period called "The Great Moderation", the world economy was characterized by high growth, low inflation, and long-term credit expansion resulting from abundant liquidity, low risk premiums and low interest rates[1]. In this period, there was a kind of consensus among countries on the implementation of the monetary policy, and short-term interest rates were used as policy measures. However, when the financial crisis starting in the U.S. in 2007 began to affect all the countries globally with the collapse of Lehman Brothers in September 2008, a need emerged to change monetary policies in effect. A number of central banks started to implement non-standard monetary policy measures along with the standard policy measures.

By 2010, a number of uncertainties started to emerge on financing public debts of some countries in the Eurozone. The challenge of sustaining public debts and credit rating downgrades resulting from the increase in risk premiums of countries were the factors leading to these uncertainties. As a result, the global financial crisis turned into a sovereign debt crisis, shaking Greece and Ireland most, in particular. In both countries, high growth rates were achieved over the period from the adoption of the Euro to the outbreak of the crisis. After joining the Euro, low interest rates were used to finance government expenditures in Greece and to promote investments made in construction sector by the banking sector in Ireland. The collapse of Lehman Brothers in September 2008 caused a difficulty for both countries in finding funds in the international capital markets.

This study focuses on the analysis of Greece and Ireland. The reason for choosing these two countries is based on some specific factors. First, both countries applied for the EU/IMF funds. Second, the factors leading to the crisis in both countries were different. But among other EU members, Greece and Ireland were the two most severely affected countries by the 2008 global financial crisis by late 2009. External and fiscal imbalances caused the crisis in Greece while the problems experienced in the banking sector resulted in the crisis in Ireland. The study will first focus on the measures taken by the European Central Bank against the

1 Klaus Ragling and Max Watson, 'A Preliminary Report on the Sources of the Ireland's Banking Crisis', (2009) http://www.bankinginquiry.gov.ie/Preliminary%20Report%20into%20Ireland's%20Banking%20Crisis%2031%20May%202010.pdf, (Access Date: February, 2, 2014).

global financial crisis, followed by the analysis of the internal and external factors causing the crisis in Greece. Then the stages of the crisis for the Irish economy will be examined. Finally, a comparative analysis of both countries will be presented.

2. HOW THE 2008 CRISIS AFFECTED THE EUROPE

Starting as a subprime mortgage crisis in the U.S. in August 2007, the crisis turned into a liquidity crisis soon and spread to all countries. Following Lane[2], Trichet[3] and Drudi et al[4], the phases of the crisis can be analyzed under three periods[5]. The first phase of the crisis covers the period from August 2007 to the collapse of Lehman Brothers. The mortgage crisis starting in the U.S affected the countries in the Eurozone as they invested in mortgage-backed securities via the banks operating there. Also, in an environment of uncertainties, banks substantially reduced providing funding to their counterparties in the interbank market. This led to a lack of liquidity in the interbank market[6]. Accordingly, the European Central Bank, like other central banks, provided banks with liquidity after August 2007. However, the size of the balance sheet was kept unchanged[7].

The second phase covers the period from the collapse of Lehman Brothers (September 2008) to May 2010. During this period, the European Central Bank used non-standard monetary policy measures along with the standard measures. The non-standard policy measures were adopted to support the standard monetary policy measures and ensure the transmission of the monetary policy to the economy[8]. Short-term interest rates, which are standard policy measures, were reduced by 325 basis points, from 4.25 percent in October 2008 to 1.00 percent

2 Philip R.Lane, 'The European Sovereign Debt Crisis', Journal of Economic Perspectives, 26(3), 2012, pp. 55-56.

3 Jean-Claude Trichet, 'Uncononventional Monetary Policy Measures: Principles-Conditions-Raison d'être' International Journal of Cenrtal Banking, 9(1), 2013, pp. 236-237.

4 Francesco Drudi, Alain Durré and Francesco Paolo Mongelli, 'The Interplay of Economic Reforms and Monetary Policy the Case of the Euro Area', Working Paper Series, No.1467, European Central Bank, (2012) http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1467.pdf, (Access Date: March, 3, 2014).

5 There are some studies preferring to use different classifications. For example, in the study by Cour-Thimann & Winkler (2013), the first phase of the crisis covers the period following the collapse of Lehman Brothers in September 2008; the second phase covers the sovereign debt crises in the Eurozone led by Greece; the third phase covers the period when the sovereign debt crises deepened again as of mid-2011.

6 Stephan Fahr, et al., 'A Monetary Policy Strategy in Good and Bad Times Lessons from the Recent Past' Working Paper Series, No.1336, European Central Bank, (2011), http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1336.pdf, (Access Date: March, 1, 2014), p. 26.

7 Puriya Abbassi and Tobias Linzert, 'The Effectiveness of Monetary Policy in Steering Money Market Rates During the Recent Financial Crisis' Working Paper Series, No.1328, European Central Bank, (2011), http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1328.pdf, (Access Date: January, 3, 2014), p. 8.

8 Domenico Giannone, et al., 'Non-Standart Monetary Policy Measures and Monetary Developments' Working Paper Series, No.1290, European Central Bank, (2011), http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1290.pdf, (Access Date: April, 5, 2014), p. 14.

in May 2009[9]. Enhanced credit support, which is consist of five elements, is the non-standard monetary policy measures implemented in addition to the standard monetary policy measures[10]. The specific features of the euro area required this policy to be implemented. When compared to the U.S among other developed countries, banks in the euro area have an important role in the financial system and are the primary source of financing[11]. This led the non-standard monetary policy measures implemented by the ECB to focus particularly on the banking system and aim at supporting bank funding and improving liquidity conditions[12].

The third phase was marked by sovereign debt crisis that broke out in early 2010. During the first two phases, the European Central Bank (ECB) faced difficulties similar to the ones experienced by the other central banks. However, the third phase of the global financial crisis, the euro area became the focal point. Following the collapse of Lehman Brothers, the countries in the euro area launched some incentives like state guarantees and capital injections in order to support their banking sectors[13]. But by 2010, some uncertainties started to emerge about financing the public debts of some countries in the euro area. The problem of sustaining the increasing public debts and the credit rating downgrades resulting from the increase in the sovereign risk premiums were the contributory factors. According to the investors, the credit risk was transferred from the private to the public sector with the bank rescue packages implemented by the countries in the euro area[14]. The bank rescue packages caused sovereign bond spreads to increase in the countries with weakening fiscal positions[15].

That the investors lost their appetite for risky financial assets directed their attention towards low-yielding but safer government assets. While assessing government bonds, the investors began to take cross-country differences in creditworthiness and bond market liquidity into consideration[16]. As a result, the highest

9 Puriya Abbassi and Tobias Linzert, p. 11.

10 Jean-Claude Trichet, 'The ECB's Enhanced Credit Support', Keynote address at the University of Munich/IFO symposium, (2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1500267, (Access Date: April, 5, 2014), p. 12.

11 ECB, 'The ECB'S Monetary Policy Stance During the Financial Crisis' Monthly Bulletin, January, (2010), p. 68.

12 Philippine Cour-Thimann and Bernhard Winkler, 'The ECB's Non-Standard Monetary Policy Measures the Role of Institutional Factors and Financial Structure', Working Paper Series, No.1528, European Central Bank, (2013), http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1528.pdf, (Access Date: March, 3, 2014), p. 11.

13 Francesco Drudi, Alain Durré and Francesco Paolo Mongelli, pp. 3-9.

14 In the study by Ejsing & Lemke (2009), bank and soverign credit risk premiums were analyzed in ten Euro area countries for the period January 2008- June 2010. It was stated that following the announcement of bank rescue packages by several governments in October 2008, there was a decrease in the risk premiums of banks while there was an increase in sovereign risks. This was associated with the fact that investors percieved this as a "credit risk transfer" from the private to the public sector.

15 ECB, 'How have Governments' Bank Rescue Packages Affected Investors' Perceptions of Credit Risk?, Monthly Bulletin, March, (2009), pp.35-37.

16 Maria Grazia Attinasi, Cristina Checherita and Christiane Nickel, 'Euro Area Fiscal Policies and the Crisis: The Reaction of Financial Markets', Ad van Riet (eds.) Euro Area Fiscal Policies and the Crisis, Working Paper Series, No.109, European Central Bank, (2010), http://www.ecb.int/pub/pdf/scpops/ecbocp109.pdf, (Access Date: January, 5, 2013), pp. 38-39.

increase in sovereign bond spreads was observed in countries entering the crisis with unfavorable fiscal positions[17]. During this period, The Securities Markets Program was announced by the European Central Bank in May 2010. The objective of the program was to restore the dysfunctional market segments and make the monetary transmission mechanism functional by providing liquidity to the debt market[18]. The monetary measures yielded effective results[19]. However, the countries in the euro area experienced the impacts of the financial crisis differently as they were different in terms of their macroeconomic structures. Greece and Ireland are the most remarkable examples of this difference.

3. ENDOGENOUS AND EXOGENOUS CAUSES OF THE GREEK CRISIS

Various endogenous and exogenous factors have led to the crisis that Greece has been experiencing since October 2009[20]. The first internal factor is the deteriorating fiscal structure of Greek economy. As a result of the economic policies implemented prior to the crisis in Greece, government revenues were not enough to cover the government expenditures. This led to an increase in the budget deficit[21]. After Greece joined the Euro, the budget deficit in Greece always remained above the Stability and Growth Pact's limit[22]. But, this did not cause any problems until 2009. The early elections in October 2009 resulted in the government change, with the victory of the socialist party led by Papandreu. The new government[23] announced that the budget deficit of the country was 12.7 percent of GDP for 2009[24]. This caused concerns among investors for two reasons. First, this figure was almost two times more than the one announced by the previous government. Second, the Greek government admitted that the previous budget deficit figures would be misleading[25].

17 ECB, 2009, p. 37.

18 Jean-Claude Trichet, 2013, p. 237.

19 See Puriya Abbassi and Tobias Linzert, 2011 ; Domenico Giannone, et al., 2011; Stephan Fahr, et al., 2011.

20 Georgios P. Kouretas and Prodromos Vlamis, 'The Greek Crisis: Causes and Implications, Panoeconomicus, 4, 2010, p. 394.

21 Dina Abdel Moneim Rady, 'Greece Debt Crisis: Causes, Implications and Policy Options', Academy of Accounting and Financial Studies Journal, 16, 2012, p. 90.

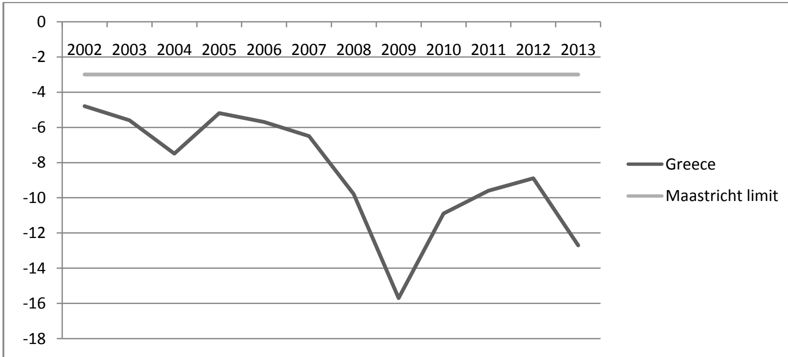
22 According to the Stability and Growth Pact, budget deficits should not be over 3 percent of GDP; government debt-to-GDP ratios should not exceed 60 percent of GDP.

23 The previous government announced that the budget deficit would not be higher than 6.5 percent for 2009 (Kouretas & Vlamis, 2010: 395). Then this figure was revised up to 15.6 percent (Provopoulos, 2013: 3).

24 Michael G. Arghyrou and John D. Tsoukalas, 'The Greek Debt Crisis: Likely Causes, Mechanics and Outcomes', The World Economy, 34(2), 2011, p. 174.

25 Oxford Economics, 'Is Greece Heading for Default?', (2010), http://www.oxfordeconomics.com/publication/download/214082, (Access Date: January, 1, 2013).

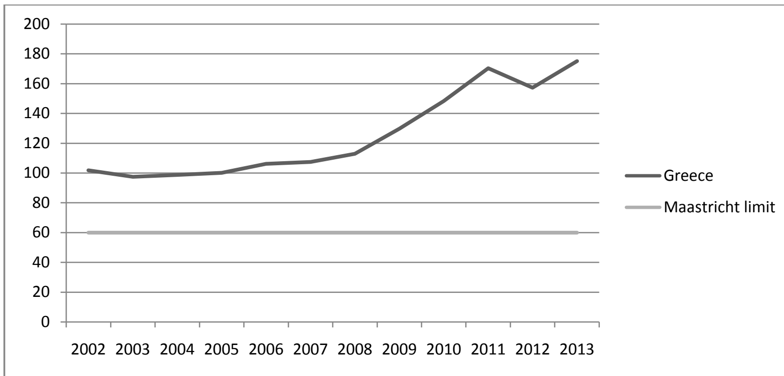
Figure 1: *Government Deficit/Surplus*



Source: Eurostat,http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=teina200, (access date: June, 30, 2014).

The increase in fiscal deficit in Greece led to an increase in government debts[26]. During this period, the ratio of government debt to GDP also increased. Although this ratio was already quite higher than the Stability and Growth Pact limit during the transition period to Euro (close to % 100), it did not show a remarkable increase until 2009[27]. This ratio has sharply increased since 2009, resulting from decreasing growth rates, increasing real interest rates and widening budget deficit[28].

Figure 2: *Government Debt (% GDP)*



Source: Eurostat,http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=teina225,(access date: July, 2, 2014).

26 It is important to know the difference between debt and deficit. When the government expenditures are more than its revenues, then the government has a deficit. The government borrows to meet the deficit. This generates the government debt (Meghir, et al. 2010: 4).

27 Heather D. Gibson, Stephen G. Hall and George S. Tavlas, 'Fundamentally Wrong: Market Pricing of Sovereigns and the Greek Financial Crisis', Journal of Macroeconomics, 30, 2013, pp.3-4.

28 IMF, 'Greece: Staff Report on Request for Stand-By Arrangement', (2010), http://www.imf.org/external/pubs/ft/scr/2010/cr10110.pdf, (Access Date: August, 8, 2013), p. 35.

Second, the trade policy in effect prior to the crisis of 2008 resulted in an increase in current account deficit. The current account deficit increased from 5 percent of GDP in 2001 to around 12 percent of GDP in 2009, which was a two times more increase[29]. Third, high wages and prices led Greece to lose its international competitiveness[30]. For the period 2001-2009, its competitiveness declined between by 20 percent to 25 percent, as measured by consumer prices, and unit labor cost respectively[31].

Regarding exogenous factors, Greece became a member of the Economic and Monetary Union (EMU) in 2001. From its entry into the Economic and Monetary Union to the outbreak of the crisis[32] (2001-2008), real GDP had an average increase of 3.9 percent per year and Greece became the second-highest growing economy after Ireland[33]. Greece's entry into the euro area helped increase investors confidence, thereby enabling Greece to borrow at low interest rates until the outbreak of 2008 crisis. Yet, the debts were used to increase the consumption, finance government expenditures, and offset low tax income rather than to make productive investments that would enhance its international competitiveness[34]. This became reversed with the collapse of Lehman Brothers in September 2008 and caused difficulty for countries dependent on the international capital market like Greece in finding funds. In a sense, the global financial crisis resulted in a process endangering the growth model of Greece[35].

4. HOME-MADE FACTORS OF THE IRISH CRISIS

The causing factor of the crisis in Ireland is thought to be the different growth strategy adopted before and after 2000. Although GDP growth in Ireland outperformed GDP growth in other EU states until 2007, it could not achieve its success in the 1990s[36]. This was because of the shift in the sources of economic growth in Ireland. Ireland adopted different growth strategies before and after 2000[37]. The

29 Oxford Economics, 2010.

30 Dina Abdel Moneim Rady, 2012, pp. 90-92.

31 Heather D. Gibson, Stephen G. Hall and George S. Tavlas, 'The Greek Financial Crisis: Growing Imbalances and Sovereign Spreads', Journal of International Money and Finance, 31, 2012, p.501.

32 This period (2001-2008) was called the "golden age" of Greek economy. During this period, growth rates increased; unemployment decreased; the inflation rate was kept down although it was above the Euro area average. Despite these improvements, a positive progress was not achieved in terms of overcoming the fiscal problems (Alogoskoufis, 2012: 11).

33 Heather D. Gibson, Stephen G. Hall and George S. Tavlas, 2012, p. 500.

34 Rebecca M. Nelson, Paul Belkin and Derek E. Mix, 'Greece's Debt Crisis: Overview, Policy Responses and Implications, Congressional Research Service, (2011), http://www.fas.org/sgp/crs/row/R41167.pdf, (Access Date: October, 3, 2013), p. 3 ; Nikolaos Karagiannis and Alexander G. Kondeas, 'The Greek financial crisis and a developmental path to recovery: Lessons and options', real-world economics review, 60, 2012, p. 59.

35 IMF, 'Greece: Ex Post Evaluation of Exceptional Access under the 2010 Stand-By Arrangement', IMF Country Report, No.13/156, Washington D.C.: IMF Publications, (2013a), https://www.imf.org/external/pubs/cat/longres.aspx?sk=40639.0, (Access Date: June, 5, 2014).

36 Klaus Ragling and Max Watson, 2009, p. 21.

37 Sean Ó Riain, 'The Crisis of Financialisation in Ireland', The Economic and Social Review, 43(4), 2012, p. 503.

Irish economy grew by 9.5 percent on average per year in the 1990s, particularly in the period 1994-2000 thanks to the export-oriented growth strategy[38]. The increase in foreign direct investments in Ireland helped achieve these high growth rates[39]. But the economic growth in the 2000s was attributed to the construction sector[40]. This shift in the growth strategy led to a crisis in both the banking sector and in public finances in Ireland[41]. The Irish crisis resulting from some factors specific to Ireland was also triggered by some international factors.

The economic growth in the 2000s was driven by the investments made in housing and property sector[42]. This caused the house prices to become overvalued, contributing to a housing balloon, which brought about two problems for the Irish economy. First, particularly because of the increasing demand for unqualified labor, wage rates were determined out of the productivity growth and led to a fall in the international competitiveness. Second, increasing government revenues depending on the increase in tax revenues gained from the construction sector sharply decreased when the construction sector entered into a recession[43].

Having become overvalued in early 2007, the house prices started to fall before the outbreak of the global crisis[44]. When the house prices started to fall, the demand for houses also dropped[45]. However, the economic collapse was triggered by the liquidity crunch in the international market resulting from the collapse of Lehman Brothers in September 2008[46], as investments in land and housing were mainly financed by the banking system via short term foreign funds, particularly after 2003[47]. The liquidity crunch in the international market caused difficulty for the banking system and made the financial sector more vulnerable[48]. Low interest rates were achieved and foreign exchange risk for foreign borrowings was re-

38 During this period, Ireland was named as "Celtic Tiger" (Honohan, 2010: 136).

39 İsmail Emre Bayram, 'Finans Odaklı Büyüme ve Avrupa'da Sosyal Refah Devletinin Geleceği: Kriz Sürecinde İsveç ve İrlanda Deneyimleri', içinde Fikret Şenses, Ziya Öniş ve Caner Bakır (der.), Ülke Deneyimleri Işığında Küresel Kriz ve Yeni Ekonomik Düzen, (2013) İstanbul: İletişim Yayınları, s. 162.

40 Sean Ó Riain, 2012, p. 503.

41 Patrick Honohan, 'What Went Wrong in Ireland?', (2009), http://homepage.eircom.net/~phonohan/What%20went%20wrong.pdf, (Access Date: June, 30, 2014), p. 1.

42 Philip R.Lane, 'The Irish Crisis', IIIS Discussion Paper No. 356, (2011), https://www.tcd.ie/iiis/documents/discussion/pdfs/iiisdp356.pdf, (Access Date: June, 10, 2013), p. 6.

43 Morgan Kelly, 'The Irish Credit Bubble', UCD Centre for Economic Research, Working Paper Series, WP09/32, (2009), http://www.ucd.ie/t4cms/wp09.32.pdf, (Access Date: December, 3, 2013). pp. 13-14.

44 Although the Irish government argued that the economic collapse was mainly caused by the global financial crisis, overvalued house prices in Ireland started to decline in early 2007 (Whelan, 2011: 5-6).

45 Karl Whelan, 'Ireland's Sovereign Debt Crisis', UCD Centre for Economic Research Working Paper Serises, WP11/09, (2011), http://www.ucd.ie/t4cms/WP11_09.pdf, (Access Date: December, 3, 2013), p. 5-6.

46 Different from the crisis in the U.S, the credit crisis in Ireland did not result from the problems in the mortgage market (Connor, et al., 2012).

47 Philip R.Lane, 2011, p. 8-11.

48 Patrick Honohan, 'Euro Membership and Bank Stability–Friends or Foes? Lessons from Ireland', Comparative Economic Studies, 52, 2010, p. 136.

moved, especially after Ireland joined the monetary union[49]. Both of these factors contributed to the housing boom in Ireland[50].

The shift in the sources of economic growth in Ireland between 2000 and 2007 had an impact on the shift that occurred in the composition of tax revenues[51]. Tax revenues shifted from stable sources of taxation such as personal income tax to tax revenues dependent on cyclical developments in the construction sector such as corporation tax, stamp duty and capital gains tax. However, this includes two interrelated problems. First, the increase in cyclical tax revenues makes it difficult to access to accurate information about the budget structure, inasmuch as tax revenues that increase during the economic growth sharply fall when a crisis emerges. This, secondly, makes budgets more vulnerable to a crisis[52]. As a matter of fact, this was the case for the Irish economy. As a result of the economic growth, income tax rates were continuously cut and expenditures were boosted. The ratio of income tax to tax revenues in total fell from 37 percent in 1994 to 27 percent in 2006. The increase in the tax revenue underpinned by the economic growth was mainly thanks to the taxes collected in the rapidly expanding construction sector. While the property related taxes comprised 4 percent of public revenues in 1995, they increased to 18 percent of revenue in 2006, which led to a budget surplus until 2007. Besides, tax base was contracted[53]. The collapse of construction activity led to a decline in tax revenues. After the world economy entered into a deep recession in September 2008, the economy contracted by -6,4 in 2009 and the budget surpluses gained throughout years turned into a budget deficit[54]. During the years 2003 – 2007, the budget had a surplus of 1.3 percent of GDP but in the period 2008-2013, it had a deficit of 13.3 percent of GDP. Budget deficit peaked to 30.6 percent of GDP in 2010.

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49 After becoming an EMU member, the interest rates in Ireland were below that suggested by the Taylor Rule (Gurdgiev & Lucey, 2011: 26)

50 Gregory Connor, Thomas Flavin and Brian O'Kelly, 'The U.S. and Irish Credit Crisis: Their Distinctive Differences and Common Features', Journal of International Money and Finance, 31, 2012, pp. 60-70.

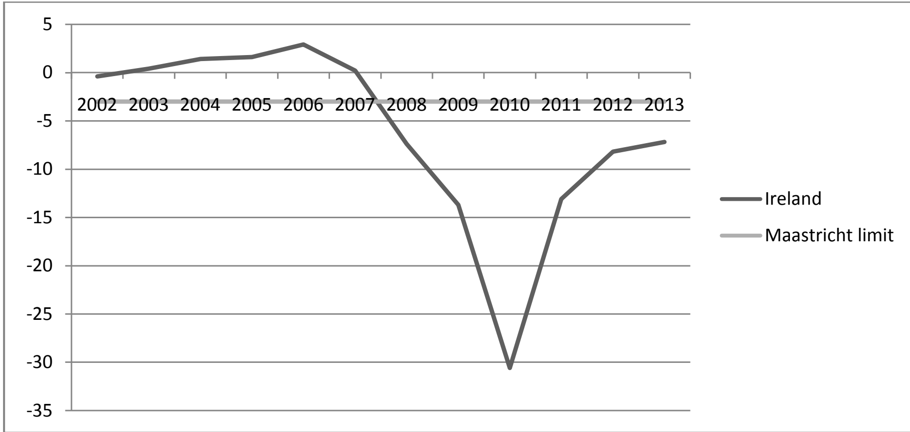
51 Jim O'Leary, 'External Surveillance of Irish Fiscal Policy During the Boom, Irish Economy Note No. 11, (2010), www.irisheconomy.ie/Notes/IrishEconomyNote11.pdf, (Access Date: December, 3, 2013), p. 4.

52 Klaus Ragling and Max Watson, 2009, pp. 26-27.

53 Karl Whelan, 'Policy Lessons from Ireland's Latest Depression', The Economic and Social Review, 41(2), 2010, pp. 231-240 ; Constantin Gurdgiev and Brian M. Lucey, 'The Irish Economy: Three Strikes and You're Out?', PANOECONOMICUS, 1, 2011, p. 23.

54 Karl Whelan, 2011, p. 7.

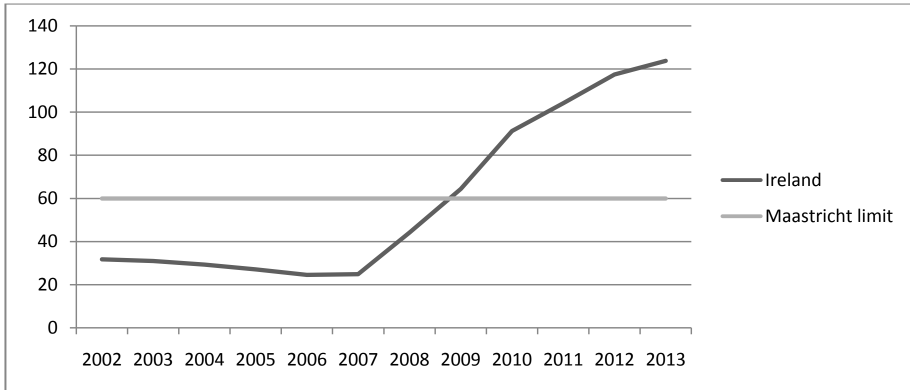
Figure 3: *Government Deficit/Surplus (% of GDP)*



Source: Eurostat,http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=teina200, (access date: June, 30, 2014).

In Ireland, the ratio of government debt stock to GDP was below that set by the Maastricht criteria until 2008. Between the years 2003-2007, the ratio of government debt stock to GDP was 27.4 on average, soaring to 90.8 during the years 2008-2013. The underlying reason for such an increase in government debt stock was the burden of restoring the banking system that collapsed[55].

Figure 4: *Government Debt (% GDP)*



Source: Eurostat,http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=teina225, (access date: July, 2, 2014).

55 İsmail Emre Bayram, 2013, s. 153.

5. THE COMPARISON OF THE TWO COUNTRIES

Starting as a subprime mortgage crisis in the U.S. in 2007, the crisis spread to the whole world following the collapse of Lehman Brothers in 2008. The crisis turned into a Greek sovereign debt crisis in late 2009, the first signs of which became apparent in the spread of Greek government bonds over comparable German government bonds[56]. What may be the underlying reasons for increasing spreads of Greek government bonds? Gibson et al.[57] associated this change with political uncertainties and sovereign downgrades. In an economy with high public debts, the concerns about the sustainability of debts lead to multiple equilibria. In such a case, expectations are of vital importance. Negative prospects for the economy may suddenly turn into a bad equilibrium[58]. As a matter of fact, this was what the Greek economy experienced. With the emergence of political uncertainties as well as the macroeconomic imbalances, credit rating agencies[59] (Fitch, Moody's and S&P) started to downgrade the credit ratings of Greece. Greek banks were also exposed to low credit ratings because of the government bonds in their portfolios. This made it difficult for Greek banks to provide liquidity to the economy and had an adverse impact on the economic growth. Credit rating agencies continued to downgrade sovereign credit ratings which led to a rise in spreads. The rise in spreads led to further sovereign downgrades, going on as a self-feeding process[60]. In 2012, Greece's exit from Euro was placed on the agenda[61]. The banking crisis caused Ireland to go through the debt crisis. Government debt stock that fundamentally increased because of the bank rescue packages introduced led to increasing concerns about Irish economy[62].

In fact, both countries had high growth rates during the period from entrance into the Euro to the outbreak of the crisis, which was particularly thanks to the decreasing interest rates achieved after adopting the Euro as the single currency. In the meanwhile, the Greek economy grew as the government support the economic activity which money borrowed from abroad into the economy via various channels (such as public infrastructure)[63]. In Ireland, banks borrowed from foreign

56 George Alogouskoufis, 'Greece's Sovereign Debt Crisis: Retrospect and Prospect', Hellenic Observatory European Institute, (2012), http://eprints.lse.ac.uk/42848/1/GreSE%20No54.pdf, (Access Date: April, 7, 2014), pp. 27-28.

57 Heather D. Gibson, Stephen G. Hall and George S. Tavlas, 2013.

58 Fatih Özatay, 'High Public Debt, Multiple Equilibria and Inflation Targeting in Turkey', Globalisation and monetary policy in emerging markets, 23, 2005, p. 276, from Bank for International Settlements.

59 First, its credit rating was downgraded from A- to BBB+ by Fitch in December 2009. Then it was downgraded six times by S&P, six times by Moody's, and seven times by Fitch until July 2011. This led Greece to be classified as very speculative (Ardagna & Caselli 2012: 3).

60 Heather D. Gibson, Stephen G. Hall and George S. Tavlas, 2013, p. 10 ; George A. Provopoulos, 'The Greek Economy and Banking System: Recent Developments and the way forward', Journal of Macroeconomics, 30, 2013, p. 5.

61 This was called as GREXIT by the markets (Provopoulos, 2013: 6).

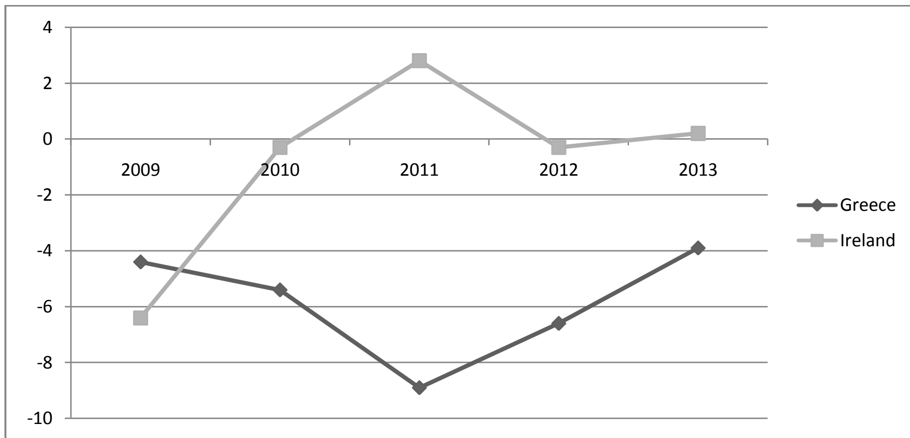
62 The sovereign spreads specific to Ireland particularly increased when the scope of the guarantees in the banking sector was expanded (Sgherri & Zoli, 2009: 8).

63 Costas Meghir, Dimitri Vayanos and Nikos Vettas, 'The economic crisis in Greece: a time of reform and opportunity', Discussion Paper. Greek Economists for Reform, 5 August, (2010), www.greekeconomistsforreform.com, (Access Date: October, 3, 2013), p. 22.

banks at low interest rates and used this money in a way leading the construction sector to outgrow. The main difference between these two countries in this regard was that the borrowing was done by the government sector in the former while it was done by the private sector in the latter.

After the global financial crisis turned into a sovereign debt crisis in Greece and Ireland, real GDP dropped in both countries. Irish economy shrank by -6.4 in 2009, which was more than that of Greece (-4.4) for the same year. Yet, the Irish economy recovered faster than the Greek economy did[64]. Ireland's faster recovery is thought to have resulted from its ability to convince the markets about its long-term commitment to the Euro by taking the necessary measures[65]. In Ireland, the economic growth was achieved in an environment where there was fiscal contraction and tight credit conditions for the households and companies, all of which led a decrease in domestic demand. This shows that the growth was an export-led growth[66].

Figure 5: *Real GDP Growth Rate*



Source: Eurostat,http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00115&plugin=1 (access date: July, 2, 2014).

Both countries were provided with rescue packages by the Troika formed by the EC (European Commission), ECB (European Central Bank) and IMF. A rescue package of 110 billion euros was announced for Greece. Of this amount, it was declared that 80 billion euros would be provided by the Eurozone countries

64 It is necessary to state that the recession in Ireland lasted longer than expected. In fact, the study by Woods & O'Connell (2012) on four advanced economies where the problems in the property market turned into a crisis indicated that the recovery in Ireland took place more slowly.

65 Michael G. Arghyrou and John D. Tsoukalas, 2011, p. 179.

66 Karl Whelan, 'Ireland's Economic Crisis: The Good, the Bad and the Ugly, Journal of Macroeconomics, 30, 2013, p.12 ; IMF, 'Ireland: Staff Report for the 2012 Article IV Consultation', (2012a), http://www.imf.org/external/pubs/ft/scr/2012/cr12264.pdf, (Access Date: August, 8, 2014), p. 15.

while the rest, 30 billion euros, would be provided by the IMF[67]. This program was made up of three pillars: to ensure the sustainability of the fiscal position of Greece; to enhance the competitiveness of Greek economy; to preserve financial stability[68]. In accordance with the first objective, Greece committed to lowering its fiscal deficit below 3 percent by 2014[69]. Accordingly, some tight fiscal measures were included into the program to keep fiscal deficits under control[70]. Nevertheless, the fiscal measures that mainly aimed at downsizing the public sector, cutting government expenditures, and reducing wages lead to an increase in unemployment and have an adverse impact on growth[71]. In line with the second objective, Greece committed to introducing reforms for health care and pension systems and tax administration that would increase the competitiveness of Greek economy[72]. After the announcement of the rescue package, spreads began to fall although it continued only for a short time by the autumn of 2010. When it became clear that it was no longer possible to follow the program[73], the spreads started to increase again[74]. This was driven by such factors as the difficulty in implementing structural reforms because of the political turmoil in the country, big demonstrations organized by the citizens, and the uncertainties about financing current account deficit and debt sustainability[75]. This process ended with the announcement of the second rescue package for Greece on February 21, 2012. The main objectives of the program were to ensure debt sustainability and boost competitiveness of the economy. Although the main objectives of the second program were similar to those in the first program, it focused more on reforms enhancing growth and loosened fiscal targets for 2012-2013[76].

A rescue package was announced for Ireland by the EC, ECB and IMF for the period 2010-2013. Providing a funding of 67.5 billion euros, the first priority of the program[77] was to restructure the banking system. It also included some commitments to implementing further fiscal consolidation and introducing structural

67 Rebecca M. Nelson, Paul Belkin and Derek E. Mix, 2011, p. 6.

68 IMF, 2013a, p. 10-11 ; George Alogouskoufis, 2012, p. 31.

69 Nikolaos Karagiannis and Alexander G. Kondeas, 2012, p. 61.

70 Richard Baldwin and Daniel Gros, 'Introduction: The Euro in Crisis: What to do?', Richard Baldwin, Daniel Gros and Luc Laeven (eds.) 'Completing the Eurozone Rescue: What More Needs to be Done?, 2010, London: Centre for Economic Policy Research, pp.14-15.

71 Antonio Garcia Pascual and Piero Ghezzi, 'The Greek Crisis: Causes and Consequences', CESifo Working Papers, No.3663, (2011), www.cesifo.org/wp, (Access Date: March, 5, 2013).

72 Nikolaos Karagiannis and Alexander G. Kondeas, 2012, p. 61 ; IMF, 2013a, p. 11.

73 Although the political leaders stated that the program would be effective, the reason for its being short-term is claimed to be the failure in convincing the market participants and calming down the market (Ardagna & Caselli 2012).

74 George A. Provopoulos, 2013, p. 6.

75 IMF, 'Greece: 2013 Article IV Consultation, IMF Country Report', No.13/154, WashingtonD.C.:IMFPublications, (2013b), http://www.imf.org/external/pubs/ft/scr/2013/cr13154.pdf, (Access Date: June, 5, 2014), p. 25.

76 European Commision, 'The Second Economic Adjustment Programme in Greece', European Economy: Occasional Papers, No.94, (2012), http://ec.europa.eu/economy_finance/publications/occasional_paper/2012/pdf/ocp94_en.pdf, (Access Date: July, 22, 2014), pp. 6-21.

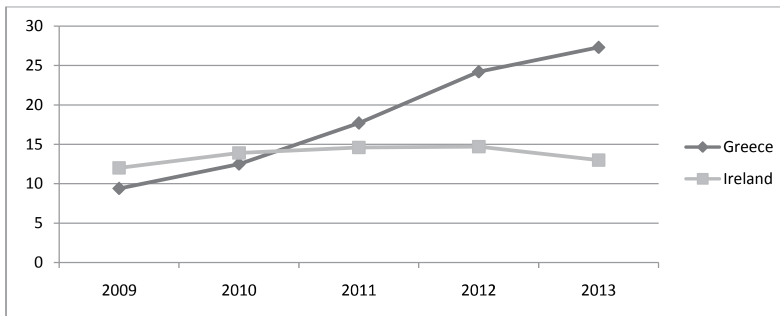
77 The Irish government provided an additional financial aid of 17.5 billion euros in order to recapitalize the banks. As a result, the total amount of funds provided to the economy reached 85 billion euros (Whelan, 2013: 10).

reforms[78]. The priority of these reforms was to enhance the operation of the labor market[79]. The program introduced for Ireland was completed in December 2013. This may be due to the fact that Greece, as the first country to be provided with financial assistance by the EU, ECB, and IMF, served as a template for Ireland[80]. But, the decisive factor was Ireland's highly favorable market conditions.

During the period 2000 – 2007, the unemployment rate was around 4 percent in Ireland. Starting to increase with the economic contraction as of 2008, the unemployment rate peaked at 14.7 percent in 2012 and then began to fall down[81]. But it was quite above the pre-crisis rate, which was caused by the sharp decrease in domestic demand, a gradual recovery and limited opportunities for creating new jobs[82]. As a matter of fact, a number of people were employed in the construction sector prior to the crisis. Following the collapse of the construction activity, male workers with low level of education, in particular, lost their jobs[83].

In Greece, unemployment rate was 9.4 and 12.5 percent in 2009 and 2010, respectively, which was below the rate in Ireland. Yet, it continued rising in the following years. Unemployment rate in Greece has not started a downward trend by reaching its peak, yet. The economic contraction in Greece was more than expected, thereby leading to an increase in unemployment. The program could not restore the growth. Poor implementation of structural reforms and political uncertainties contributed to this failure[84].

Figure 6: *Unemployment Rate*



Source: IMF, Greece IMF Country ReportNo.14/151,https://www.imf.org/external/pubs/ft/scr/2014/cr14151.pdf, Ireland IMF Country Report No.14/165, http://www.imf.org/external/pubs/ft/scr/2014/cr14165.pdf ,(access date: July, 2, 2014).

78 Karl Whelan, 2013, p. 10.

79 Philip R.Lane, 2011, p. 24.

80 Rebecca M. Nelson, Paul Belkin and Derek E. Mix, 2011, p. 12.

81 Maria Woods and Siobhán O'Connell, 'Ireland's Financial Crisis: A Comparative Context', Central Bank of Ireland, Quarterly Bulletin 04, 2012, p. 104.

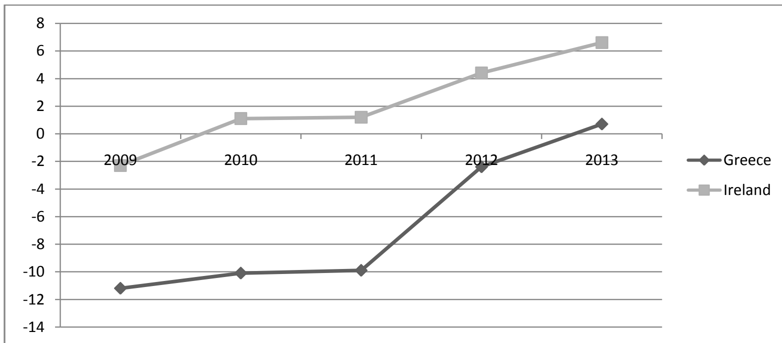
82 IMF, 'Ireland: Staff Report for the 2012 Article IV Consultation', (2012a), http://www.imf.org/external/pubs/ft/scr/2012/cr12264.pdf, (Access Date: August, 8, 2014), p. 13.

83 IMF, 'Ireland: Selected Issues', IMF Country Report, No.12/265, Washington D.C.: IMF Publication, (2012b), http://www.imf.org/external/pubs/ft/scr/2012/cr12265.pdf, (Access Date: August, 8, 2014), p. 60.

84 IMF, 2013a, pp. 32-33.

Ireland has started to restructuring its competitiveness that it lost during the period of construction-based growth. This led Ireland's current accounts to move into a surplus in 2010 and 2011. The decrease in import driven by the decline in the domestic demand was also a contributory factor[85]. But, in Greece the current account recorded a surplus only in 2013.

Figure 7: *Current Account*



Source: IMF, Greece IMF Country ReportNo.14/151,https://www.imf.org/external/pubs/ft/scr/2014/cr14151.pdf, Ireland IMF Country Report No.14/165, http://www.imf.org/external/pubs/ft/scr/2014/cr14165.pdf ,(access date: July, 2, 2014).

EMU membership helped Greece and Ireland overcome the global financial crisis. But for membership, funding problems for the banking system would have become much more severe. Firms and households would have borrowed more in foreign currency and their balance sheet risks would have been higher and also national central banks would have had coordination problems[86]. Ireland returned to the bond market on June 26, 2012. Successful implementation of the program and the financial assistance provided by the European partners are thought to have allowed this return[87].

6. CONCLUSION

Starting in the U.S as a subprime mortgage crisis in the second half of 2007, the crisis gained a global character following the collapse of Lehman Brothers in September 2008, shaking the peripheral countries in the Euro area, in particular. Out of them, already existing problems in Greece and Ireland made the impacts of the global crisis more severe, turning it into a sovereign debt crisis.

From adoption of the Euro to the outbreak of the crisis, Greece and Ireland were the two fastest growing economies in the Euro zone. The high growth rates were underpinned by the interest rates that decreased after their entry into the

85 IMF, 2012a, pp.29-40.

86 Klaus Ragling and Max Watson, 2009, p. 25.

87 IMF, 2012a, p. 10.

EMU. The Greek government and Irish banks took the advantage of high borrowing enabled by lower interest rates. The main difference between Greece and Ireland in this regard was that borrowing was done by the public sector in the former but by the private sector in the latter. That is why the crisis had a different direction for both countries. In Greece, sovereign debt crisis caused banking crisis while it was the opposite in Ireland.

Although borrowings at low interest rates allowed after joining the Euro became unsustainable with the global financial crisis, the problems specific to Greece and Ireland were the fundamental causes of the crisis. Greece faced a twin problem resulting from the high budget deficit and current account deficit. But, in Ireland the banking crisis and fiscal crisis were the main triggers. If they were not EMU members, they would have faced the same problems. Yet, some countries not in the Euro zone were more severely affected by the crisis. EMU membership, on contrary, helped Greece and Ireland survive the financial crisis better. But it should be noted that Ireland's process of overcoming the crisis was different from that of Greece. Managing to complete the program, having favorable market conditions, and succeeding in promoting its economic growth via a shift from outward-oriented to export-led growth are thought to be some contributory factors to Ireland's relative success.

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