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Monetary Challenges of European Integration: Ireland

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Abstract

The monetary realization of the European Union Treaty has brought economic success for the European countries. However certain issues of the process, including the development potential for future and uncovered financial challenges of the new regime for a national economy need to be examined. The case study of Ireland, one of the European most successful model, can provide new options for exploration of the transition of the national economic policy from 1973 (then country joined EEC) till the beginning of the XXI century of a European country, the change of the European periphery’s opportunities relative to the core area of the Union. The report poses several questions. The first one is why Ireland managed to reach the economic success - so called Celtic Tiger only in 1990-s, after over 20 years of the European Community’s membership, and how it correlates with the world monetary events. The comments on that include the overview of the outward factors, especially the American-European relation, the national Irish policy, the change of the “periphery” status within EC and a detailed analysis of the European monetary regulation. Since the success was achieved, the next step was to make it keep going. However, the world recession in the early 2000-s created new challenges. The second part of the report is devoted to the interaction of the elaboration of the State economic policy and the EU economic regulations. This will be illustrated first of all with the details of the well-heard story of the Irish Budget 2001. The way, how Ireland, a small economy, approaching the limits of the Stability & Growth Pact in 2001, was handled by the EC Institutions shows the contradictory nature of this interaction. Moreover, the different approach to the French and German, exceeding the regulation ceiling, in the European Commission could be treated as the “moment of truth” for the core and periphery status in EU, the consequence of the existence of informal interplay, the division of influence between the member states. The material indicated above must help to understand a more general question – how the membership in the international organization, namely the European Union, influences the State’s management of economy. The example of the Irish economy shows the transformation of the meaning of the participation in the economic integration - from the instrument to achieve the national social-economic goals to the economic axiom, though not all the time for the benefit of the national economy. The given statements are going to be illustrated by the analysis of the monetary policy of the EU, reports from IMF.
**Introduction**

For many years Ireland was a periphery country with quite limited possibilities to develop. The 1990-s have become a period completely contrast to the previous experience. The economy has provided high-speeded development. The success model was nick-named “the Celtic Tiger”, alluding to the Asian economic tigers. One of the drives for the Celtic tiger has been a participation in the European integration. Although the full analysis of the Celtic tiger demands the overview of many aspects of the economic policy and performance, one particular area – monetary policy provides a good example of how complicated are relations between the successful Irish economic model and the forces that are responsible for its emergence – the European integration.

The final stage of the European Monetary Union has been aimed at the introduction of a new currency and a common monetary policy. This has been a completely new, unprecedented experience, for this a lot of comments and forecasts were done before and after the euro-zone was created. In contrast, this paper is not to make any more forecasts, but to reconstruct the performance of the Irish economy at the beginning of the final stage of EMU. The main focus is the relation between the interests of the Irish national economy and the common supranational economic framework, search for the Irish status’s identification within EC, namely, for proves whether the Irish periphery status within EC has influenced that or not. However, we should start with the early period of the Irish economic history, previous to the accession to the European Community. This gives an opportunity to understand the main tasks that Ireland was trying to realize through the international cooperation.

The next two parts of the paper are devoted to the brief scope of the development of the European monetary cooperation and Celtic tiger’s basics. All that gives the material to better understand the gap between the European monetary policy and the Irish needs and possibilities for the national economic policy within EU. The last part details the astonishing precedent of the Irish budget, which was called by some journalists as a “quiete revolution”, the top moment revealing the contradiction between the common European policy and the demands of national monetary policy. All that material provides fertile soil for the reflection how the national policy could be designed in an integrated space.
Pre-Maastricht period (1970-1980s)

One of the youngest European States has been the Republic of Ireland, as it was officially named in 1949, before it was de jure independent the Free State or Saorstát Éireann. Exactly as the other European countries in the immediate after war period, Ireland stayed on the bilateral line. Since the very beginning of a new State, or ever for the previous centuries, Irish economy was going on orbiting the British one. So even when the Europe saw the revival of the multilateral trade, Ireland was bonded to Britain. The lagging in development, embodied in the uncompleted industrialization, could be explained by poverty in resources and the colonial policy. The strongly Conservative politics were also a warrant for a lack of radical reforming. The monetary policy of the period which preceded the entrance to the EEC was very cautious and limited.

Although the eternal political aim had been a complete independency, in the economic terms this was unreachable, while the economy was in a dependant state, 80% of the Irish export, which consisted mainly of agricultural products, was going to Britain. For the two thirds of the Irish society, who were involved in agricultural sector, the monetary policy was needed in term of parity with the English sterling, which should help to maintain the agricultural sales.

The brief outlook of the monetary policy of this period shows how dependant it was. Two significant steps were made the Central Bank Acts of 1942 and of 1971, laying out the basis for the Irish Central Bank. Before that Ireland had the Currency Commission to take note issues functions, thus ignoring the Resolution of the World Monetary and Economic Conference in 1933, which recommended to developed countries with no central bank institution to establish independent central banks with the requisite powers and freedom to carry out a currency and credit policy, and was one the latest countries to establish a Central Bank, contrasting to 23 countries who got independent central banks in a period of 1921-1936. Even then the Central Bank was established, it had a squeezed power. It had no authority to set requirements on the reserves for the commercial banks. These banks continued to keep reserves in the London money market and were independent from the Central Bank in terms of liquidity requirements.

It was only by the beginning of the 1970-s the Irish government recognized that an efficient monetary system in which the public have confidence is indispensable for successful

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1 Kennedy K.A., Giblin T., MacDonagh D.  P.68
economic and social development. The bank's legal tender note fund, the backing for the currency, which originally consisted almost entirely of sterling, began to hold gold, US dollars and US Federal Government securities, as well as assets representing the country's subscription to the International Monetary Fund and a balance in the General Fund of the Bank. Over the years the external reserves have been coming increasingly under the Central Bank's control. The foreign exchange assets of Departmental Funds and most of the sterling assets of the Associated Banks were transferred under the Central Bank’s control. In this way the country's external reserves were then controlled by the Central bank.

In 1965, it commenced the issue of guidelines to the Associated Banks on domestic credit creation. The format laid out by the economist J.Oslizlok was to control credit through the guidelines and thus influence the rate of growth of the domestic money supply.\(^2\)

In late 1969 the Parliament was aware of the creation of a money market. The bank accepted a wide range of short-term deposits from the banks and finance houses, for active dealings in short-dated Government securities and for the issue of Exchequer Bills to the banks at more frequent intervals. Money which was formerly placed in London was being placed at home and in the Irish money market the Irish Central bank started to play an important role. The Central Bank Act of 1971 confirmed the increase in the Central Bank’s power.

All the time, since the 1927 Currency Act there was a fixed one-for-one parity between the Irish pound and the pound sterling. The exchange value of the Irish pound, which was remaining the same as against sterling, automatically followed changes in the value of sterling vis-à-vis other currencies. The Irish Minister for Finance Mr.Colley recognized that it was contradictory to the IMF membership.

This position was not consistent with the obligations from the International Monetary Fund’s membership (Bretton Woods Agreement Act of 1957), as such obligations were set out in the Article IV of the Fund’s Articles of Agreement:

- (1) “The par value of the currency of each member shall be expressed in terms of gold...”
- (2) “A member shall not propose a change in the par value of its currency except to correct a fundamental disequilibrium”.
- (3) “A change in the par value of a member's currency may be made only on the proposal of the member and only after consultation with the Fund”\(^3\).

\(^3\) Dail Eireann Vol.251:Col.1465-6 16 February 1971
However, it was very important for the Irish government not to arise the question of devaluation of the currency in relation to sterling. The Government was going to remain the existing parity with sterling.

The parity of the Irish pound with the sterling had another consequence. The Irish price level was determined by the British, for the fixed exchanged rates between two currencies and no impediments to trade (this was certainly true, especially with the Trade Agreements of 1938, 1948 and the Anglo-Irish Free Trade Agreement of 1965), the prices in two markets were not divergent. However, since the British inflation was higher than the average European rates, it was not a positive feature. For example, in 1964-1978 Irish inflation was 5.7 per cent higher than the German one.

The decision to apply for EEC membership was a result from the dependency on the trade partner Britain and the will to overcome it. The Irish strategy was based on “survival”, in order not to lose the main partner, it was decided to follow Britain in the European Economic Community. Since Britain was negotiating the membership, Ireland had to do the same. Through visits to Brussels, meetings with top European officials the Irish were preparing the ground for the entrance. The main aim was “to avoid break of the trade with Great Britain”. For Ireland it was important not to get to be divided with Britain by the customs border, that’s why Ireland applied for the EEC membership along with Britain, Denmark and Norway in 1961, the Irish diplomats managed to get the Irish application coming first. The wished aim was achieved in 1973.

In terms of the monetary policy there were some expectations:

Indeed, we are looking forward to the prospect of membership of the European Economic Community in which, if present proposals materialize, there will be a progressive movement towards fixed parities between the currencies of all the member countries. I hope that no more need be said to dispel misapprehension on this score, particularly as financial confidence is so important a foundation for economic development.”

Then Ireland joined the European Community, the ideas of the European monetary cooperation were right in the process of development and implementation. In 1970-1 a plan of economic and monetary union was worked out by the Werner Group and accepted by Member States. In 1972 a “Snake” system, centered at the German currency and permitting exchange rates to fluctuate within limits, was created, in the following year the European Monetary Cooperation Fund was established. In 1979 European Monetary System along with

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4 Leddin A.,O’Leary J. P.181
5 Hillery P. P.21
ECU (European Currency Unit) and exchange rates mechanism (ERM) to reduce exchange rate variability and achieve monetary stability were adopted.

Certainly, to realize a common policy coordination was needed. So Ireland had, as “each Member State” to “pursue the economic policy needed to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency, while taking care to ensure a high level of employment and a stable level of prices’ (EEC Treaty Article 104) and had to coordinate national policy with the Community objectives (Article 105).

The joining EMS was even more serious concern, although the Irish were willing to let the European partners know that they supported cooperation within a Community, there was an anxiety and concern about the uniform monetary system; and they were worried about potential losses and situations, where they would not be able to cope. The special attention was done on the breaking the parity with the sterling. The most of the main priorities was agriculture, so the question of joining EMS was treated from that point, namely CAP:

“A point of particular importance to us is that monetary instability has had serious effects on the functioning of the common agricultural policy almost since we joined the Community. It has led to the development of the system of monetary compensatory amounts which has broken the unity of the market, impeded trade, penalized our exports and, worse, and created anomalies which have threatened serious adverse effects on employment here”\(^7\).

In reality, the adjustment process from the sterling linkage to the EMS was rather long and painful. The overvaluation of both the Irish pound and real exchange rates happened due to the links with UK, in turn, it led to the loss of price competitiveness, in comparison to some EEC members, it was 46.2% and it made significant contribution to the rise of the unemployment. Among the factors contributing A.Leddin and J.O’Leary put the oil crises, the world and UK recession, demographic features and “the Central Bank’s failure to communicate the new policy to all relevant parties”\(^8\).

The overview of the Irish monetary policy before joining the EEC and during the pre-Maastricht period proves that the policy itself was not active and developing at a slow pace, it was dominated by the dependency on the British economy and the stimulant and the tool to put into life any significant change was from outside, among them joining EEC was extremely important. Nonetheless, the adjustment process was too long as it was expected and the Irish expectations were not realize in full. The economic success was still in the future.

\(^6\) Dail Eireann Vol.215:Col.1466 16 February 1971
\(^7\) Dail Eireann Vol.308:Col.413 17 October 1978
The Treaty of Maastricht: New Perspectives

The Treaty of Maastricht, or the Treaty Union was a turning point in the European history, a new era of closer cooperation was to come. The Treaty was aimed to reach “economic and social progress”, by which it was meant the growth of the European economies, improving quality of life through building “the space without internal frontiers, through the strengthening of economic and social cohesion and through the establishment of economic and monetary union, ultimately including a single currency” (Article 2).

The Delors Committee, after the decision of the European Council in Madrid, in 1989 worked out a report that provided the scenario for the European economic and monetary union that was confirmed in the following EC documentation – The Treaty of Union and accompanying protocols. The way to the single economic and monetary policy was divided into three steps – the initial stage, the transitional to the final and the final one.

The first one was aimed at the complete removal of barriers, fiscal and technical. The deepening of the economic coordination by Ecofin (Council of Economic and Finance Ministers) and the Committee of the Central Bank Governors were defining common surveillance. Although the committee was expressing views, they were not obligatory. The second stage was continuing with strengthening convergence and consolidation of the single market program. At this stage ESCB was absorbing EMCF (European Monetary Cooperation Fund) and the Committee of Central Banks Governors. The third stage assumed the single currency policy, following after locking of exchange rates of the Member States and attribution of economic and monetary competences to the European institutions. For example, ESCB was the one to formulate monetary policy, exchange rate policy and manage official reserves. The calendar was that - the first period 1990-1994, the second one 1994-1997, as provided by the Treaty, but eventually prolonged until 1999, the third one was to begin from January 1st 1999.

The successful realization of the program demanded coordination and decision-making on a common institutions level, but not only on a national level. Thus, the European institutions were empowered to have more control and intervention in the economic policy of State-members. The article 103, paragraph 1 claims that the Member States treat the economic policy was a question of common concern and agree on it in the Council in accordance to the

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8 A.Leddin and J.O’Leary. P.196-7
Article 102 a, in other words, in the context of common orienting points. To ensure the close coordination of the economic policy and regular cohesion, the economic development of each country, the way how the Institutions’ regulations are fulfilled have been supervised. All members are within the regulated framework. The Protocol on the excessive deficit of budget set up limits: the maximum of deficit of budget, planned and real, in the market prices to relation of GNP as 3% and 60% as maximum for the State debt to GNP in the market prices” (Protocol on the excessive deficit procedure).

For those, who not following the orienting points, the sanctions would be applied. In 1997 the Pact for Stability and Growth was introduced. In accordance to the Pact the countries with the budget deficit in more than 3% were obliged to create non per cent deposits, valued in dependence of GNP and deficit, which then should be converted into fees if the budget is not correct in two years.

Ireland entered to the final stage of EMU in January 1999, and it was not an easy decision. At least four considerations were being observed – the profit that reduction of transaction costs and exchange rate uncertainty might bring to Ireland, perspectives of good economic environment with high growth and low inflation, the regional pattern of economic activity and the decision of UK keeping the sterling.

If not joining, few alternatives to the joining EMU were theoretically available for Ireland. One of them could be pegging on sterling and euro. The tool for maneuvering would be interest rates and intervention in the foreign exchange market. After 1993 Ireland was following this type of policy. But although the adjustable pegs help to avoid the risk of excessive foreign currency exposure, they are hard to maintain under the large financial flows\(^9\).

Another alternative would be the return to the sterling linkage, but this was certainly unrealistic.

Third variant could be free floating. However, for small open economies, at the few exceptions, it could lead the currency to sink due to lax monetary policy\(^10\).

The ESRI measured the benefits for Ireland of joining EMU if UK joins as well – they were for 1% of the real growth rate more than that in the situation of opting out.

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\(^9\) World Economic Outlook May 1998 A Survey by the Staff of the International Monetary Fund. P.7
\(^10\) Leddin A., Walsh B.M. P. 550
Table 1. Benefits to Ireland of UK membership in EMU

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<th>Sterling out</th>
<th>Sterling in</th>
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<tr>
<td><strong>Gains from:</strong></td>
<td></td>
<td></td>
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<tr>
<td>Reduced transactions cost</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Lower interest rates</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Competitiveness</td>
<td>-0.4</td>
<td>0.0</td>
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<tr>
<td>Risk of shocks</td>
<td>-1.0</td>
<td>-0.4</td>
</tr>
<tr>
<td><strong>Net effect</strong></td>
<td>0.4</td>
<td>1.4</td>
</tr>
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Source: ESRI, Economic Implications for Ireland of EMU P.345

In March 1998 the decision on the bilateral exchange rates at which the currencies of the countries participating were entering EMU would be locked was made. The upward realignment of the Irish pound to the central parity into line happened.

In 1998, due to divergences in the cyclical position, the Member States could be divided into two groups – the countries like UK, Netherlands, Denmark, Finland and Ireland (they are, apart from UK, “small countries”) with strong expansions and inflation subdued and a group of “big countries” consisting of Italy, France and Germany with moderate growth and higher inflation. Two groups had its own key points and risks, different from each other – for the first ones the main was to avoid overheating, while for the second ones - to stimulate growth. This would mean that a monetary policy was to satisfy all – countries with quite different economic situations. The IMF World Outlook was emphasizing at this potential difficult situation of the future euro zone:

As this convergence occurs, close coordination of monetary policy will be needed to ensure that an appropriate balance is struck between minimizing the risk of overheating in whose economies where expansions are mature and supporting recoveries where they are less advanced.\(^\text{11}\)

The questions related to this would embrace the assumptions concerning the suitability of the common monetary policy for Ireland, taking into account its small size. The question “Will small, less prosperous, countries be so anxious to prove their suitability for the single currency that they will lose any voice in the overall management of the system and, in
particular, find it impossible to object to a deflationary regime?” was risen by the ESRI experts in early 1990-s.\textsuperscript{12}

Some economists saw this process of the concentration of the coordination in the supra-national level as a loss of independency by ‘big countries’, but not by ‘small’ ones. In 1991 it was expected that the EMU would increase the concurrence and the shift to the center of the Union, but the perspective of exchange rate was seemed to be understood as unimportant for Ireland\textsuperscript{13}.

The measures that could have contributed to the stabilization of the currency and low inflation, were creating a climate, which could enable the shift towards a single currency. However, the loss of economic self-dependence, at least, a part, was to be painful. Not always the interests of a country meet the interests of a common economic policy. Certain losses were to be suffered in the way to a common goal. This also could reveal the bottom flows in the distribution of the influence among the European countries.

\textsuperscript{11} World Economic Outlook. May 1998 A survey by the Staff of the International Monetary Fund. P.14
\textsuperscript{12} Maastricht and Ireland. P.48
\textsuperscript{13} The Economy of Ireland. Policy and Performance, 1991. P.202
“The Celtic Tiger”

In 1980-s Ireland had one of the lowest rates among OECD countries. The maximum GDP was 6.1%, the national debt was 116% GDP and the unemployment accounted for 17.6%.

However, in the last decade of XX century dramatic changed occurred, in the second half of the decade the average growth of GDP was 9.3%.

Table 2. The dynamic of GDP in Ireland

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</thead>
<tbody>
<tr>
<td>GDP%</td>
<td>1.9</td>
<td>3.3</td>
<td>2.7</td>
<td>5.8</td>
<td>9.7</td>
<td>7.7</td>
<td>10.7</td>
<td>8.6</td>
<td>9.8</td>
<td>10.5</td>
</tr>
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GNP increased for 4.6% in the 1990-1998 period. In 1999 r. Ireland was ahead EC countries, USA and Japan for the GDP growth rates, domestic demand and hourly wages. The explanation for such brilliant performance should found outside. There were two major external factors contributing to the Irish growth – the emergence of the Single European market and the growth in the American economy in 1990-s.

The development of the American economy was accompanied with increase in investment, especially in IT sector. The competitiveness and weak dollar provided American companies with good positions in the international markets. In a period of 1988-1996 there was a significant rise in export. By 2000 the American economy reached the top of the cyclical upturn. There was an American venture capital. While in 1980-s the American venture capital was kept inside the country, in 1990-s it was exploring the foreign market. In 1990-s American investments abroad accounted for 802 bln.$, profiting from 23000 branch companies. Europe was a favorite destination, accounting for 55% of all foreign investment.

February 27th 1992 the Maastricht Treaty was signed, creating the single European market. The market was one of the biggest ones and was certainly lucrative for the world companies.

15 O’Hearn D. P. 174.
In the 1990-s these two factors, the American investment and the European Single market, coincided. At glance, it would be logical to imagine that the main investment would go to the core of EC, to the “golden triangle”, based on a line Paris-London-Amsterdam, while the periphery would be less covered. However, the Single market provided periphery countries with new opportunities. It has become possible to operate in any EC country having a single license and being based in another EC country. By 1990-s Ireland had relatively cheap but qualified labour resources.

Another Irish advantage was an attractive tax regime. The corporation tax was the lowest in Europe, a corporation tax for industry was 10% only.

By 1990-s such factors as natural resources have become less important, while the others, like telecommunication networks have gained attention. Ireland has one of the most developed telecommunication network valued in 3.5 bln.$\textsuperscript{18}.

These factors: qualified labour force, low corporation tax rate, made Ireland attractive for investment, and first of all, the one from USA. The American investment in the Irish industry in a 1992-1998 period has increased for a quarter, accounting for 16% of the Irish GDP. This indicator of the openness of the economy has been the highest in the world; even Singapore’s indicator has reached 9% only\textsuperscript{19}.

However, the main investment flowed into three industries: IT, engineering and pharmaceuticals. In 1990-s such MNCs opened factories in Ireland – Intel, Gateway, Dell, AST, Apple, Hewlett-Packard, Simens-Nixdorff, Microsoft, Lotus, Oracle, Intel, Fujitsu, Xilinx, Analog Device, Dell, Gateway, IBM, Digital.

Following the American investment the Irish export volume developed dramatically. In a period of 1993-1998 it increased for 23.072 mln.Irish pound, the trade balance reached 26.4% GNP. Ireland turned to be the second larger exporter of software, after the United States.

While the changes in the volume of export, also a shift in the destinations appeared. The growing export to America has faded the export to Britain, the main trade partner\textsuperscript{20}.

The corporation tax was giving quite good profits. Already in 1994 it brought 592 mln.Irish pound, while in 1999 this sum was 1432 mln. Irish pounds. The high tempus of the development have allowed Ireland to solve series of social-economic issues. The quality of

\textsuperscript{18} Nagle G., Spencer K. P. 138.
\textsuperscript{19} Foreign Affairs, Wash., 2001. May/June. P. 89.
life was improved a lot and has reached the European average. The unemployment was
decreased, as new venture companies mushrooming during the 1990-s were providing a lot of
working places. The national debt was reduced; the Irish annual balances were improving: In
the 1996 the budget deficit accounted for 0.4%, and in 1996 there was a proficiency in
1.8%. This was achieved with an adjustment following the realization of the EMU program,
but also with increased profits from foreign investment.

Also while adjusting to the Single market scheme, Ireland has received a lot of
European funding aid through the Structural Funds. That’s how the new infrastructure was
renovated.

In brief, such was a basis of the Celtic Tiger, which reached its top in late 1990-s. The
next step was to keep such performance going, to maintain growth. The next period was also a
beginning of the third stage of EMU and demanded more convergence and the switching off
some of the monetary instruments that could deteriorate the Irish economic miracle.

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What meant Single Currency for the Celtic Tiger?

The Union Treaty made the single currency a reality. The evident advantages of the single currency market was the inflation control, decrease of the gold reserve, allowing to use the excess in the investment, to low the price of credit, building the single judiciary space for money, credit and monetary regulation, optimizing the costs for service inside the Community, lowering risks.

The euro should have freed the European monetary system from the dependence on US dollar fluctuations, should have become an alternative to the American currency, dominant in the world market, which had a half world governments’ reserves. The euro-zone was to get as closer as possible to the optimal currency zone, referring to the American experience, the term introduced by the American economist R. Mundell in 1961. However, on the way to the goal the “asymmetric shocks”, or the unequal spreading inside the zone, were more than possible. Among the instruments to overcome the shocks are the mobility of labour force and salary flexibility. The euro-zone had much possibility to meet the shocks, as the price difference in eleven countries was higher than among the States in America. The level of labour mobility reached only one third of the same rate in USA. So in the early stage the conditions were not quite to favour the fulfillment of the goal and carried the potential risks.

Another important feature on the way to the single currency was the partial loss of self-dependence, the limited space for maneuver for the national monetary policy. In the meeting in Madrid in 1995 the European Council confirmed the transfer to the single currency from January 1st 1999. The European currency got its recent name – the euro. It was also admitted the necessity in fixed exchange rate between the euro and the national currencies. In May 1998 the European Central Bank and the European System of Central Banks came out with a guideline of a single monetary policy. The national currencies of the State-members, at exception of UK, Denmark and Sweden, stopped to be independently presented at the world market in relation to other currencies, their price was dependant on the euro rate, as the exchange rates were fixed and were not to be changed. The giving up the independent policy of exchange and interest rates which were converged was a

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serious matter. In the euro-zone a country can’t change the rates, as that is the privilege of the European Central Bank.

The loss of these functions was critically assumed by some economists. The possibility to refuse from euro and return to a previous currency was possible in a principle, but no working scheme existed. The resign from EMU was complicated, technically a country could reissue its old currency, but agreed exit rules were missing, as a result the countries within EMU would stay as “a leaving would be more painful. In a case of withdraw from the euro a monetary crisis is inevitable, in fact, the participation in the euro-zone is cemented.

In the situation of a recession, a state with its own currency could lower the rates, stimulating demand, lowering the credit costs, lower the price of the currency and push the export. The countries with the euro participation don’t have such adaptive mechanisms, as these functions are transferred to ECB.

The necessity to follow the rates, set up by ECB, created inequality for “big” and “small” countries:

“ECB’s job is to choose the repo rate of the euro so as to maintain low inflation, averaged over the eurozone, and it is unlikely to be persuaded to deviate from this objective by the government of a small member country that cannot pay its bills. But if the governments of one or more large eurozone countries were in budgetary straits with the possible results, there would be overwhelming pressure on the ECB to set the repo rate for the euro a little lower than is consistent with the inflation objective”. In the first days in the financial markets the euro rate fell 13% down in relation to US dollar. Then it fell down 7% more. The European banking credits with excessive deposits in euro was related to this. As the excessive amount appeared, the supply exceeded demand; the rate of the European currency fell.

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One of the EMU’s aims was anti-inflationary policy. The set by ECB the level of inflation was less than 2% per year, which was inadequate according to the experts from the Economists: “ECB was taking the instructions in word and was trying to get inflation at zero, not considering the consequences”\textsuperscript{28}.

By the end of 1999 the average level of inflation in EC was 3%. In Ireland, where it was initially expected that the participation in the euro-zone would smooth the level of inflation, featured to the majority of the EC economies, this process had a greater speed. If in 1999 the average rate was 1.5%, in 2000 this rate was 5.7%. The customer prices increased for a 62%\textsuperscript{29}. The inflation’s increase in Ireland was due to external forces. For example, in mid-2000 the world price for oil grew, reaching 30$ per barrel\textsuperscript{30}. However, the internal pressure on the economy also existed. As a result of growing export, the demand for labour resources was quite acute, the employees were demanding the increase salary, and this would excess the growth of efficiency. The contradiction was partly overcome by the Program for Prosperity and Fairness, and this would be mentioned in details below. The fall of the Irish inflation in 2001, with the serious fluctuations, reached over 3%, shows that the internal policy is quite important even under EMU.

Although the exchange rate of US dollar was higher than the euro’s one, this tendency was temporal. In opinion of B.Lynch, the euro’s growth was inevitable. In January 2002 euro was cashed. This activated demand. On January 1\textsuperscript{st} the Irish Central Bank passed more than 1500 transactions. A lot of people were trying to exchange more money than a set limit of 500 pounds.\textsuperscript{31} In its turn, the growth of euro in a background of fall of the dollar, which accounts for a one third of the world trade, made the Irish export more expensive, and less competitive.

The losses in the Irish trade under the strong euro are inevitable. There are two possible decisions. First one is to decrease interest rates of ECB, which would delay the growth of the currency rate. This is not under the control of the Irish officials. The second one is the fall in the Irish producers’ prices. This is the only alternative for the Irish businessmen, to “recognize as soon as possible that neither clients, nor themselves could survive under the Celtic tiger prices”\textsuperscript{32}.

\textsuperscript{29} Clinch P., Convery F., Walsh B. P. 84.
The budget 2001

In 2000 EC approved an aim for the following ten years to become the most competitive and dynamic science-based economy, able to grow and create better conditions for employment and social cohesion. The same year the Broad Economic Policy Guidelines, the deliberate macroeconomic strategy was adopted.

The main priorities and requirements were determined by the global surrounding. In summer 2000 the oil prices increased, a surprisingly dramatic downturn happened to the American and Japanese economies, the global equity market witnessed volatility. The Single market and the single currency were taken as a main framework for the growth strategies. The main course was to sustain economic growth in the context of less favourable outside conditions. The budget policy was to be designed in such a manner so to avoid excess demand and inflationary pressure\(^{33}\).

By 2001 the Irish inflation was twice high as the European average. One of the favourable conditions for the Celtic Tiger was relatively low labour costs and the lowest corporation tax in Europe, attracting many investors. Under huge investment flows the demand for labour was automatically growing, causing the rise of salaries and decreasing the competence of the Irish labour. In order to restrain inflation of salaries and keep the investment, the Irish government was an initiator of an agreement, known as Program for Prosperity and Fairness, which set the limits of the salaries growing; in return the government guaranteed the tax decrease. The Agreement was signed in 2000 between the State and the nineteen organizations from the social and commercial sectors. Among the participants were the government, the Irish Board of Trade, Business and Employers Confederation, Irish Congress of Trade Unions, Farmers Association.

The part concerning the industrial peace was providing that “no cost-increasing claims by trade unions or employees for improvements in pay or conditions of employment, other than those provided, were to be made”; industrial harmony was to be promoted and strikes or other form of industrial protest were precluded (Annex I). The government, in its turn, was taking social improvements in different fields of education, employment and social care. These improvements were rather expensive. The Social Economy Program was estimated as 41 mln. Irish pound per year.

Following that partnership, in December 2000 the budget for 2001, which decreased the income tax and increased the social expenses, was passed. The Budget Statement was presented to the Irish Dail on December 6\textsuperscript{th}, 2000, Minister for Finance Mr.McCreevy explained the taken measures. The increase in 2001 post-budget in net current spending was to be 6.6\%, including the PPF. The Government decision to have an increase beyond the target 4\% limit was taken to ensure more rapid progress in key social spending areas and to help secure industrial peace.

Anti-Inflation Package was to meet the challenge of increase of inflation. While the government was expecting inflation to fall in 2001, the Minister for Finance was determined to take some additional specific measures to cut the inflation rate. That package consisted of: first, direct tax measures to increase participation in the economy; second, cuts in indirect taxes to bring down the CPI and ease transport costs; and, third, measures to encourage consumers to save rather than to spend\textsuperscript{34}.

Outside EMU Ireland’s difficulties could be solved through interest policy, the government could have increased the interest rates to combat inflation. But the interest rates were set up by the ECB. So it was the other path to restrain the inflation of wages – PPF. In the words of Financial Times, Ireland suffered from the “one size fits all” principle\textsuperscript{35}. This directly refers the concerns, expressed already in the 1990-s.

In their understanding of the Irish budget for 2001 the economists divided into two camps. The observers of Financial Times supported the policy chosen by the Irish policy, saying:

Higher wages may seem an odd way of reducing demand, but in a fixed-exchange rate system they are the only way to reduce the super-competitiveness that fuels extra demand. The PPF has been remarkably successful in restraining wages and keeping Ireland competitive. It was the right policy when Ireland had abundant unemployment labour but has reached the end of its useful life.\textsuperscript{36}

\textsuperscript{34} Dail Eireann Vol.526:876 06 December 2000
\textsuperscript{35} Financial Times, London, 2001 January 24 P.
The chosen strategy was appreciated by the economists of University College Dublin again as the only right one:

“We’ve been very lucky, in that, in a full employment economy, we have followed an expansionary fiscal policy that could have been expected to lead to rising inflation in the price of services and associated wages, and a further overheating of the property market. Instead, like the dues ex machine that comes from the sky in Greek plays and solves the unresolved by divine intervention, an emerging recession and the Twin Towers cataclysm makes such a policy now seem well judged and appropriate. Domestic demand has been stimulated as global demand slows”.  

The contrary position was taken by the ECB and the European Commission. In particular, O.Blanchard claimed that the expectation that the decrease of income tax could raise the demand for labour and lower the inflation’s level was not real. In his words, “at best” the tax cut and wage moderation “will buy time”; and “sooner or later” a wage increase or/and a fiscal contraction would happen.

In the Commission’s official report it was stated that the Commission was pleased with the projections for the period 2000-03 of an average Irish surplus of 4.2 % and the debt ratio declining, however, as “the macroeconomic scenario underlying the projections assumed a gentle decline in real GDP growth and in inflation”, it was considered the stimulatory nature of the budget for 2001 to be a considerable risk “to the benign outlook in terms of growth and inflation portrayed in the updated program for 2000”. The budget, the main measures of which were direct and indirect tax cuts and substantial increases in current expenditure, was recognized not consistent with the broad economic policy guidelines (Bulletin EU 1/2 2001 1.3.7). On this basis, it was recommended to the Irish government to redress the inconsistency of the budget with the broad economic policy guidelines and take countervailing budgetary measures during the year (Bulletin EU 1/2 2001 1.3.8).

Interesting enough that the chosen form to make Ireland to follow the main line was rather informal – through “peer group pressure”. However, the Irish were not easy to give up. The budget 2001 caused much disputes among the Irish government and the European Commission. While in the Commission’s opinion, “the tax cuts and spending increases would fuel demand and worsen the overheating of the Irish economy”, “increase the economic risks”, in this way the budget policy of Ireland was inconsistent with the main guidelines, and the Commissioner P.Solbes was telling about the necessity to “discipline Ireland for its expansionary budget policy”, the Irish Commissioner David Byrne and the prime minister

37 Clinch P., Covenry F., Walsh B. P. 89-90.
38 Ibid. P. 84.
assistant Mary Harney joined the struggle for the budget. The reaction of Minister Charlie MacCreevy was quite categorical: “My defense is that policies pursued by Ireland have led to the economic success. Perhaps, when other countries in Europe have that sort of success, I will take more cognizance.”

The Irish precedent of discrepancy with the European guidelines received much attention from the Commission and media, highlighted by different TV channels like national Irish RTE and the international CNN.

One of the aspects of the debates was the Irish status quo as a small country of EC. P.Solbes was insisting on the following the guideline even despite the small size of Ireland. The European Commission had a fear, and thus, a reason for insisting, that the Irish case would become a precedent for big countries.

The other budget discrepancy happened in two years and received another welcome. In November 2002 the representatives of Germany and France announced that their countries would go beyond the limits of budget deficit for the three coming years. The majority of the European ministers of finance supported the temporal disaccord, which in other way would mean fees. The Declaration instructing the government of both countries to change the budget mechanism in 2005 was adopted. All that reaction was more quiet and supportive. Comparing two incidents a question arises if there is a difference in status of “big” and “small” countries, the core and the periphery. In 2002 the Italian GDP fell down drastically. It is worth mentioning that three of them Italy, Germany and France account for 75 % of the European GDP, while Ireland – just for one. Possibly these conditions led to such “soft”, loyal reaction on the French and German actions.

Certainly all countries have dividends from the smoothing economic discrepancies, the single market, however, during the overcoming of the crises the misalignment and the opting out of the criteria of convergence was more preferable. This makes the question of how efficient is the common economic policy of the Union is. Moreover, some economists suggest that the Pact of Stability and Growth prolong the economic recession of Europe.

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44 Ibid.
Conclusions

Through its history, since the gain of independence, Ireland had a different monetary experience – a monetary union with UK, meaning a fixed parity of the Irish pound with sterling, which was based on the strong trade links between two countries, but causing high inflation; the entrance to EMS, which was somehow a repetition to the participation in EMU, leading to the sterling’s parity break and a realignment to the DM, which helped to downturn inflation’s rates, but in longer terms than it was expected; and at the end, the final stage of EMU, participation in the euro-zone. In the early period till 1979 Ireland was providing a quite limited monetary policy, even delaying the effective acting of the Central Bank. Although, technically, the Irish could provide an active monetary policy, as they were not restricted by any agreement and could choose to devaluate against sterling, to address to inflation by the interest rates policy, they were not doing that. The reverse situation came in early 2000-s. The Irish economy was performing well and then it was the question of cooling, a desperate need in a elaborated monetary policy, but in that case, that was no longer available to them due to the binding to the rules of the European Monetary Union. Thus, Ireland had very few occasions to experience active, independent monetary policy. The European integration contributed to the Irish economic growth, though the monetary integration has presented several challenges that the Irish had to meet.

The introduction of euro meant the fixed exchange rates and converged interest rates, the unavailability of quite effective tools for the monetary policy in the advanced economies. The situation of 2000-2001 was tricky enough. To relieve economy, to save the Celtic tiger, the Irish would need to change the interest rates, but they are not longer in the competence of the national authority, but at the ECB’s disposal. While bigger members, like Germany, would influence ECB, Ireland as a small country had no means of pressure on the European Central Bank. As a result, the only left option would be a fiscal and the public agreement policy. For the Ireland’s luck, there has been an experience in wages agreements, Table 5. shows that. It was partly because the community used to be consolidated and for the small size as well.

However, even the Irish fiscal policy was attacked by the Community’s institutions’, as the budget 2001 was going to the limits of the Stability and Growth Pact. It is also significant that the way of how the European Institutions were trying to bring Ireland back to the guidelines was an informal peerage pressure. In contrast to the Irish budget’s incident, the bigger members – France, Germany was treated in the supporting way. All that reveals that
the informal pressure means exist. The two examples – the availability of the influence on ECB and possibility to escape from some provisions – shows the inequality of the status of ‘big’ and ‘small’ countries. Under the previous cooperation such inequality was less obvious and thus, such inequality could be attributed to a new currency regime.

The adoption of euro by Ireland tied the country to the supranational institutions’ authority, and the national monetary policy has stopped to be independent and hardly would be for the absence of the bailout clause. The high rates of inflation of 2000-1 coincided with the beginning of the euro-zone, and this may suggest the existence of the asymmetric shocks. Later on, as the statistics show, the inflation was cut down in 2003-2004.

Indeed, the Irish experience is very useful for the future economic strategy’s design for the small countries within the multinational monetary cooperation.
Table 3. The dynamic of the Irish inflation

![Graph showing inflation over time with data points for each year from 1989 to 2004.]


Table 4. Unemployment rates of Ireland

![Graph showing unemployment rate over time with data points for each year from 1990 to 2004.]

The source: ESRI, 2006

Table 5

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<tr>
<th>Program</th>
<th>Years</th>
<th>Terms</th>
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<tr>
<td>Program for National Recovery (PNR)</td>
<td>1987-1991</td>
<td>Average of 2.5% per annum wage increase</td>
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</table>
| Program for Economic and Social Progress (PESP)       | 1991-1994| Year 1 - 4% increase<br>
|                                                       |          | Year 2 - 3% increase (+ 3% local bargaining clause)<br>
|                                                       |          | Year 3 - 3.75%                                                      |
| Program for Competitiveness and Work (PCW)            | 1994-1997| Year 1 - 2.5% increase<br>
|                                                       |          | Year 2 - 2.5% increase<br>
|                                                       |          | Year 3 - 2.5% increase                                              |
| Partnership 2000 for Inclusion, Employment and Competitiveness | 1997-2000| Year 1 - 2.5% increase<br>
|                                                       |          | Year 2 - 2.25% increase (+ 2% local bargaining clause)<br>
|                                                       |          | Year 3 - 1.5% first 9 months + 1% in last 6 months                  |
| Program for Prosperity and Fairness (PPF)             | 2000-2003| Year 1 - 5.5% increase<br>
|                                                       |          | Year 2 - 5.5% increase<br>
|                                                       |          | Next 9 months - 4% increase                                         |
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