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Greece – Ireland
The useful practice of turning a sick man into a tiger

- In the past years Greece and Ireland have posted impressive economic growth in the wake of strategic decisions like EU and EMU membership and the implementation of significant structural reforms, yet they also face significant challenges during the current conjecture.

- Ireland, in which the public sector had to provide significant support to the domestic financial system, has experienced so far a much more forceful contraction than Greece, where the contraction seems to accelerate at a time that it appears to have past its peak in most other countries. Yet Ireland is facing the prospect of a gradual recovery in a setting of flexible and competitive markets and a friendly business environment, following the reforms of the late 80's, even though certain aspects of the functioning of markets related to network industries, professional services and the retail sector are still registered as relatively stringent by the OECD.

- Greece also went ahead with the deregulation of significant sectors, like telecommunications and financial services, in the 90's and the positive impact of these reforms was enhanced by the macroeconomic stabilization that followed the EMU accession of the country. At the same time though, important sectors like energy and road transport do not operate yet as open and competitive markets, the business environment is documented as not favorable largely because of the legislation that curtails competition in product markets and professional services and that also increases the administrative burden and invites corruption.

- Ireland, and even more so Greece, failed to restructure the public sector during the years of fast growth. As a result of the weakness of budgetary institutions, the built in increase in public expenditure led to a rapid deterioration of public finances once the rapid growth of GDP disappeared, leading to a significant shortfall of the projected revenues. Apart from the measures taken, initially only in Ireland but now also in Greece, to restrain the short term increase of public expenditure, mainly through the reduction of public servant pay, both countries still face the challenge of substantially restructuring their public sectors, increase its efficiency and its capacity to provide quality services to citizens and businesses. In Greece, it must be noted, these challenges appear to be more significant though, as Ireland has reaped significant benefits from the reforms it implemented in the public sector and the tax system in the late 80's. In addition, in Ireland the deterioration of the public finances is largely related with the initiative to rescue the domestic financial system.

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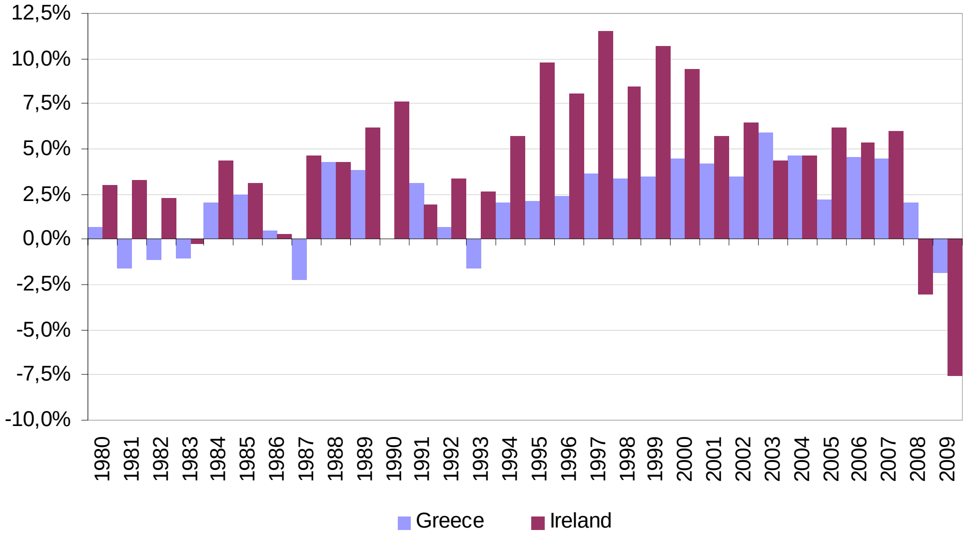
1. Macroeconomic Environment

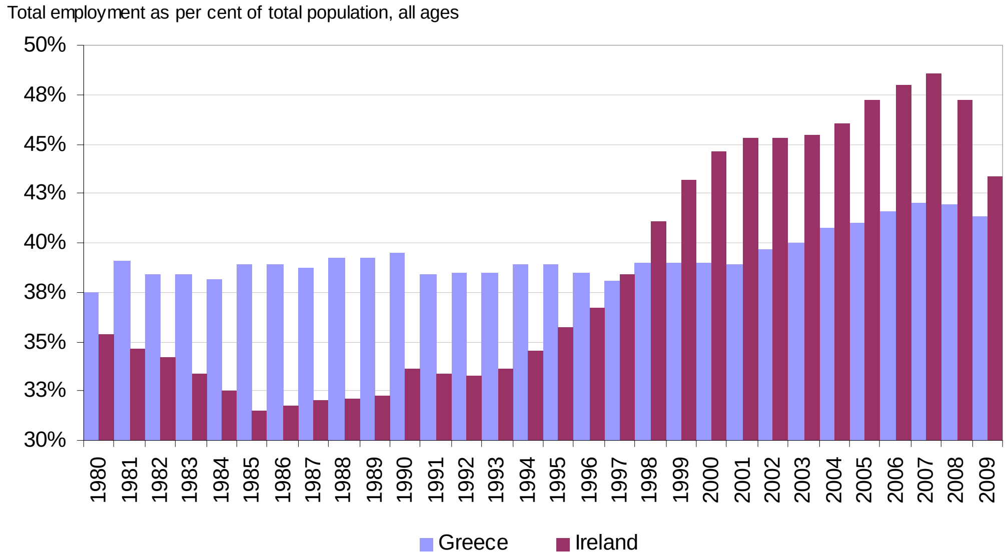
In the past years Greece and Ireland have posted impressive economic growth in the wake of strategic decisions like EU and EMU membership and the implementation of significant structural reforms. During these times in both countries employment increased, and in particular in Ireland, which also has suffered so far the larger fall in employment during the current conjecture. This pattern seems to affirm the experience of other countries with flexible markets that usually suffer more during abrupt downturns but then face quickly improving prospects.

Figure 1: Real GDP growth *(at 2000 market prices)*



Source: Ameco Database

Figure 2: Employment rate



Source: Use of data on Total population (National accounts) (NPTD) and Employment, persons: total economy (National accounts) (NETN) by AMECO

Table 1: Macroeconomic policy comparison

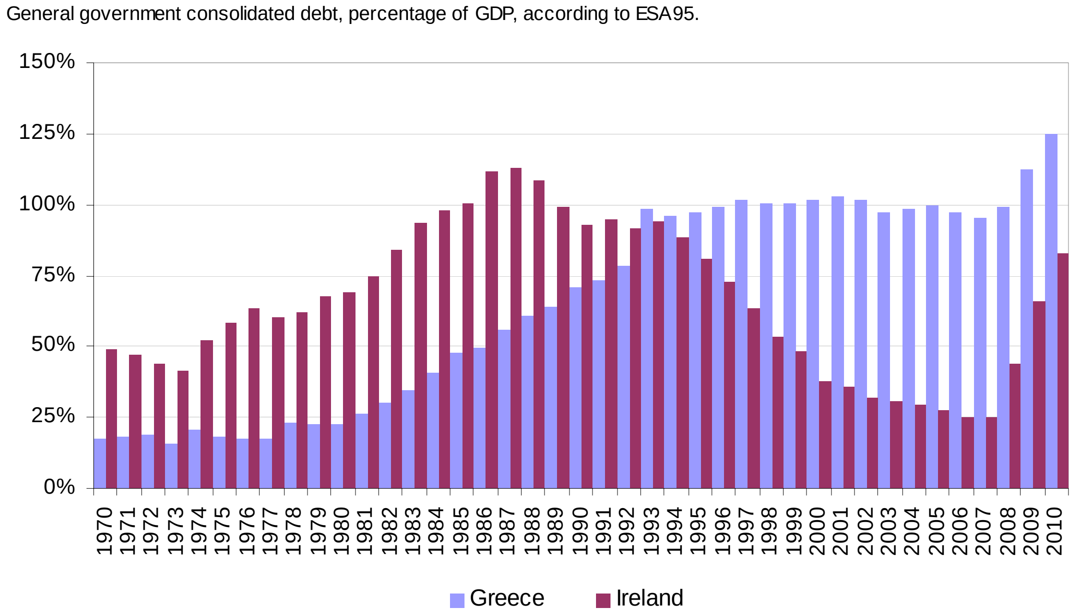
	Ireland	Greece
GDP	Strong growth after the 80's	Strong growth after 90's
Unemployment	After years of high unemployment, reforms in the late 80's led to a gradual but accelerating improvement of the job market. The current crisis has eliminated a large part of these gains though.	A weak improvement during the period of strong growth is followed for now by a moderate weakening. Yet future prospects remain unfavorable as long as a determined reform effort is not undertaken.
Government finances	Severe imbalances were wound down through reforms in the 90's. Now again put under strain by the crisis and the support given to the domestic financial system. There is still a need to increase public sector efficiency.	Deficits and high public debt with severe structural weaknesses persist since the 80's, with short exceptions, and still await a determined reform effort for their resolution.
Ageing	Moderate challenges prior to the crisis have become more pressing as the public debt increased, reducing the buffer that the low public debt provided previously.	Significant challenges from rapid population ageing are paired with challenging debt numbers and public finance prospects.

2. Public sector finances

The fiscal consolidation challenge for Ireland is severe, the underlying budget balance having moved abruptly from surplus to a large deficit. Consolidation has already begun to repair the deterioration in the public finances via a series of emergency budget interventions amounting to close to 5% of GDP in 2009, but the adjustment process will last several years. Debt levels have risen very substantially from initially low levels not only because of a fall in government revenue but also because of the extensive support provided to the faltering domestic financial system. Restoring the budget to a sustainable path will require both increases in revenues and cuts in public expenditure.

On the tax side, this involves correcting structural deficiencies that built up as revenues became over dependent on buoyant house prices and construction, which have collapsed, while the revenue-raising capacity of the income tax base became severely impaired. For Greece, the high fiscal deficit and recently rising public debt point to the urgency of improving the financial situation and efficiency of the public sector. The current deterioration threatens to loom heavily over any future recovery, especially as long as the impeding costs related with the ageing of the population are not dealt with swiftly and decisively.

Figure 3: General government consolidated debt



Source: Ameco Database

The need to deal with wider ranging reforms in public finances and the effectiveness of public expenditure has been matched so far, in both countries, with reductions in the pay of public sector employees. Nevertheless public sector pay had increased, according to Eurostat data, before the crisis to levels that were, when compared to the pay received by the private sector in both countries, much above the European average, as shown by Table 2.

It should be noted that in both countries government expenditure till the onset of the current crisis rose in line with the rapid GDP growth, but the improvement of budgetary institutions, the increase in the efficiency of the public sector and the rebalancing of public expenditure and the reform of the tax systems did not proceed at the required pace. This neglect meant that once the downturn occurred, it led to a fast deterioration of public finances as revenue fell but expenses kept rising in both countries.

Table 2: Pay in the private and public sector

Monthly gross salary, dependent employment 2006

	Public control	Private control	%difference
EU 27	2,261.88	2,210.42	2.33%
Euro Area 16	2,545.92	2,266.22	12.34%
Ireland	4,144.45	3,096.82	33.83%
Greece	**2,136.41**	**1,473.15**	**45.02%**

Source: Eurostat

The size of the challenges posed currently by the fiscal position is larger in Greece. Yet the fact that Ireland has dealt in the past effectively with similar challenges, when it embarked on a determined effort to wind down fiscal imbalances and support future growth in the late 80's, shows that a determined effort can deal with such challenges effectively. The legacy of the fiscal consolidation of Ireland that started in the late 80's should be used as a case study for Greece today, but it can also be used as an example to stress the future benefits that the current fiscal stabilization efforts promise for Ireland.

3. Structural reform and the Business Environment

Ireland is documented by the OECD and the World Bank to have regulation that allows for a much more competitive working of product and services markets and at the same time imposes on businesses a much lower administrative burden. Greece on the other hand scores much below the average of the other European countries on these aspects and often emerges as one of the weakest performers on these issues, in spite of the progress made in certain markets like communications and financial services during the 90's.

Both countries still face significant challenges with their effort to rationalize their public sectors, even though these challenges appear to be higher in Greece both because of the relatively worse situation of the public finances and because of the lower scores documented by OECD research regarding the effectiveness of public sector services, which range from health and education to the quality of infrastructure and the administrative environment.

Table 3: Flagship reform comparison

	Ireland	Greece
EU and EMU membership	Yes	Yes
Financial sector deregulation	Yes	Yes, from the 90's
Energy sector deregulation	Remaining obstacles are removed gradually according to the OECD	Not yet sufficient
Road freight sector deregulation	Deregulated	No
Telecommunications deregulation	Deregulated	Yes from the 90's. But with some backtracking in the licensing of mobile telecommunications infrastructure
Public sector and budget reform	Needed	Needed
Reduction in administrative burden	Is already at low levels	Lagging and remains at high levels
Quality of government regulation	RIA is applied	RIA is not effectively applied

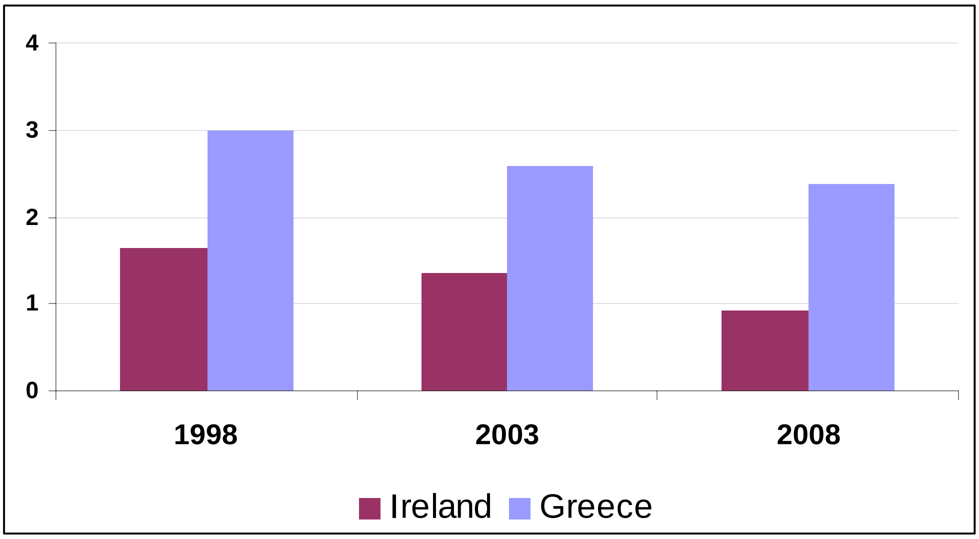
Regarding product market regulation, Ireland started out in 1998 at a favorable position relatively to other OECD countries, as a result of the reforms undertaken since the late 80's, and from there achieved some further improvement. Greece started out at a much more unfavorable position in 1998, and especially since 2003 has not achieved any further noteworthy improvement according to the OECD integrated product market regulation indexes (Figure 4).

The OECD data that starts in 1998 does not capture how Ireland before the 80's proceeded for many years with the establishment of state monopolies, the adoption of regulation that curtailed competition in markets and a fiscal policy based on high government spending and increasing tax rates. In the wake of the oil shocks, widespread tax evasion and increasing social unrest unemployment increased along with government debt in a setting of economic stagnation. A determined effort to deregulate markets, sell off public enterprises and reduce tax rates, which was assisted also by some other favorable circumstances and a successful drive to attract foreign investment, helped reverse this situation and turn the "sick man of Europe' from the 80's into the "Celtic tiger" of the 90's and lead Ireland to the favorable position recorded by the OECD for 1998.

It has to be stressed that as part of this effort Ireland not only embarked on a path of fiscal responsibility but at the same time actively championed to improve the business environment and transparency. As a result today Ireland faces the challenges of the current conjecture and the fallout from the excesses of its financial system with a much more favorable business environment than it had in the 1980's, which is not the case for Greece whose situation is closer to the situation that Ireland was facing in the late 80's.

Figure 4: Timing and intensity of product market reform

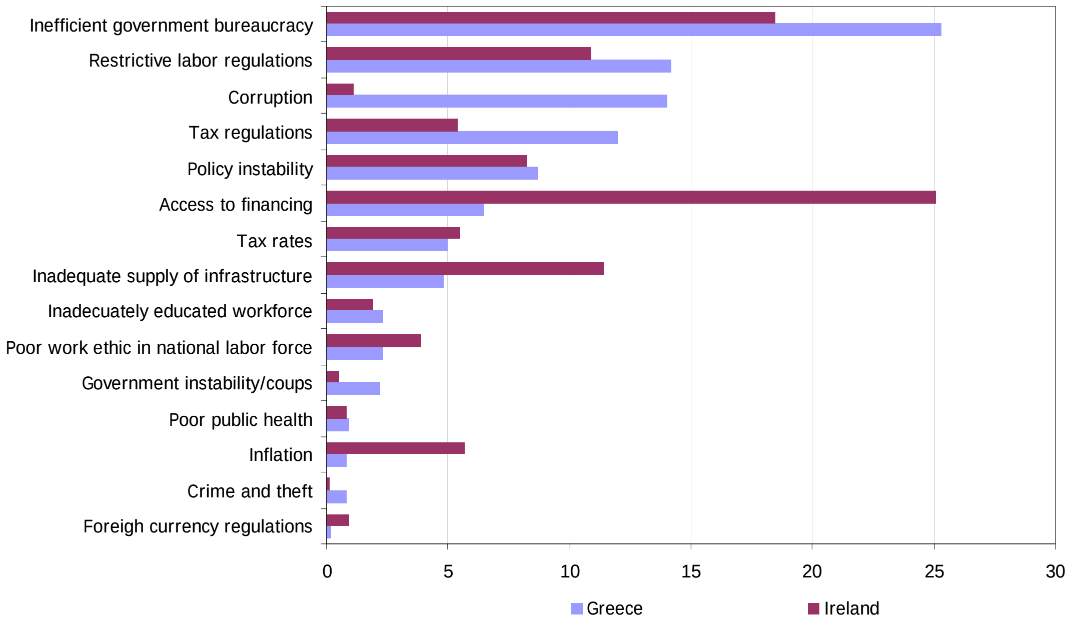
Product Market Regulation, 1998-2008 *(Value of indicator[1])*



[1] The product market indicator of regulations is measured as a simple average of regulation in 7 non-manufacturing sectors: Rail, road, airlines, gas, electricity, telecom and post. The indicators are normalised, ranging from 0 to 6, expressed as percent of maximum score across OECD countries, where 6 reflects relatively most regulated product markets.

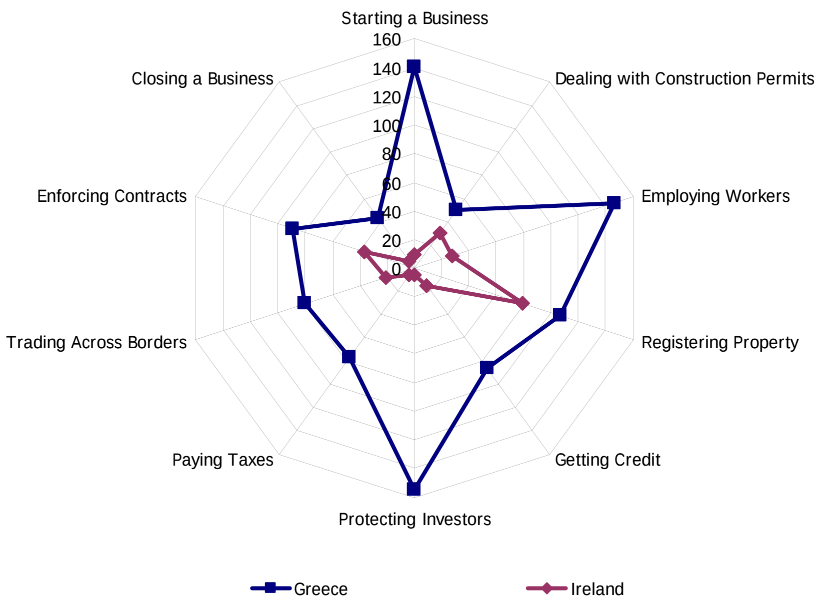
Source: OECD Indicators of Product Market Regulation for 1998, 2003 and 2008

Figure 5: The most problematic factors for doing business 2008 – 2009



Source: World Economic Forum, Global Competitiveness Report 2008 – 2009

Figure 6: Doing Business 2010 rankings



Source: World Bank, Doing Business 2010

In order to improve the terms at which it faces the current challenges Greece has to improve its business environment and take advantage of its strong points like the infrastructure that has been put in place during the past decades. To do that Greece has to minimize uncertainties, risks and costs that relate to the investment and entrepreneurial activity which stem from bureaucracy, useless processes and loss of time due to complex regulations and rigidities in the markets. Moreover, further action needs to be undertaken to allow the flexible and prompt adaptation of businesses to the developing circumstances, to reduce opaque tax burdens on entrepreneurial activity, to encourage investments and innovation, to promote the development of capabilities of human resources, in order to leave room for undertaking business risks with adequate remuneration. Indeed, the experience of the efforts Ireland undertook in the 80's is most relevant for Greece today.

4. Taxation

The current debate about tax reform in Greece becomes most relevant given the experience of Ireland in the 70's and at the beginning of the 80's. At the time successive Irish governments tried to balance the deteriorating public finances with increasing tax rates, a strategy that yielded few tangible results and that contributed to the stagnation of an uncompetitive and closed economy.

After the late 80's the reform agenda included not only reduced tax rates, but more importantly a process which meant that any changes in the tax laws were announced well in advance of its application and a determined effort to curb tax evasion. It is now generally accepted that this strategy helped the economy to grow fast and to attract significant investment from abroad, which in turn contributed gradually to an increase in employment. Today, even though the corporate Irish tax rates are much lower than in Greece as shown in Table 4, the revenue of the Irish government from corporate income tax as a percentage of GDP is exceeding the respective revenue of the Greek government, as shown in Table 6. Actually, this was also true in the past years when the corporate tax rate in Greece was even higher.

Table 4: Corporate income taxation

Corporate income taxation	Ireland	Greece
Small companies	12,50%	*
Baseline	12,50%	25,0%
Dividend taxation, upon distribution to individuals	20,00%	10,0%+

*For proprietor companies half the income is taxed at the corporate level with 20% and half the income is taxed as personal income of the proprietor, or the proprietors, according to the income bracket of each of them. +To be increased.

Source: Tax Database, European Commission

Furthermore, the highly progressive personal income tax system of Greece, as shown in Table 5, which essentially exempts more than half the households form any income tax and which aims to collect most personal income taxes from relatively few families that declare high incomes, secures lower revenue for the Greek government, when compared to the Irish government, of about 2,5% of GDP less as is shown again in Table 6. As a result the Irish approach after the late 80's, which educed tax rates and at the same time sought to reduce tax evasion, yields significant lessons for Greek policy makers, including of course the commitment to implement a predictable tax system and the usefulness of a simple tax system that is enforced in a way that minimizes tax evasion.

Table 5: Personal income taxation

Personal income taxation	
Ireland	▪ Tax credits. ▪ Low rate from 0 till 35.400 euro annual income of 20%. ▪ High rate of 41% over 35.400 euro annual income.
Greece	▪ Tax free income of 12.000 for salaried labour. ▪ 25% from 12.000 till 30.000. 35% from 30.000 till 75.000. 40 over 75.000 euro of annual income. Intention to make personal income taxation more progressive.

Table 6: Government revenue

	2003	2004	2005	2006	2007
Total Taxes (including SSC) as % of GDP					
Ireland	29.0	30.3	30.7	32.1	31.2
Greece	32.3	31.2	31.5	31.3	32.1
Total Taxes (excluding SSC) as % of GDP					
Ireland	24.6	25.6	26.0	27.3	26.3
Greece	20.5	20.1	20.4	20.3	20.4
Indirect Taxes as % of GDP: Total					
Ireland	12.6	13.2	13.7	14.2	13.5
Greece	12.5	11.9	11.8	12.3	12.3
Direct Taxes as % of GDP: Total					
Ireland	12.0	12.4	12.3	13.2	12.8
Greece	8.0	8.1	8.6	8.0	8.1
Direct Taxes as % of GDP: Personal income taxes					
Ireland	6.8	7.4	7.3	7.2	7.3
Greece	4.4	4.4	4.6	4.6	4.7
Direct Taxes as % of GDP: Corporate income tax					
Ireland	3.7	3.6	3.4	3.8	3.4
Greece	2.9	3.0	3.2	2.7	2.6

Source: Taxation trends in the European Union European Commission 2009 publication