SHOULD IRELAND STAY IN THE EURO?

Frank Keoghan

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When I was younger, Alan Dukes, now chairman of the notorious Anglo Irish Bank campaigning for a 'yes' to Maastricht, intoned that the principal advantage of Ireland's membership of the euro zone would be that we wouldn't have to bother about currency exchange when we went on holiday in, or traded with the other euro zone countries. But he conveniently ignored the major disadvantages, which are:

- firstly, that the rate of interest or cost of credit is decided for the benefit of the euro zone as a whole, not by the needs of our own economy,
- secondly, that the rate of exchange of the euro vis-a-vis other currencies is decided in a similar manner,
- and finally, as long as NI remains with sterling our continuing membership of the euro zone, especially if it were to move towards a fiscal as well as a monetary union, would add a profoundly new dimension to partition.

The euro zone is flawed for at least three main reasons:

1. It was set up as a political device to reconcile France to German reunification after 1989 and many economists do not regard the euro zone as an optimum currency area, able to sustain its own currency indefinitely.
2. The euro zone is incapable of maintaining one currency, interest rate policy and exchange rate policy for economies that have different levels of productivity and implicit economic competiveness, different resource endowments and different degrees of exposure to economic shocks. It has prevented euro zone deficit countries from protecting themselves against exports from the stronger euro zone economies by robbing them of the ability to devalue their currencies.

3. Finally, our recent history has shown that it puts countries like Ireland under the rule of the ECB whose policy it is to prevent insolvent private banks going bust anywhere in the euro zone and which insisted that we keep Anglo Irish afloat at horrendous cost to the people of this State.

So a political stance that advocates struggle to achieve an independent Irish state with an independent currency and, with that, control over the interest rate or exchange rate – the most fundamental tools of economic policy, is not a matter of sentimental nationalism but is economic common sense.

Joining the Economic and Monetary Union (EMU) deprived us of the ability to maintain our competitiveness by adopting an exchange rate or interest rate that would enable us to balance our payments and it fails to compensate us for that loss by the automatic transfer of resources from the centre.

The Treaties require all EU Member States to join the euro zone, except Britain and Denmark, which negotiated legal opt-outs under the Maastricht Treaty. The Swedish people rejected joining the single currency in 2003 by 56% to 42% and in 2010 Sweden's growth rate was the highest in the EU.

As Europe's biggest exporter of manufactured goods, Germany gains big economic advantages from EMU. Weaker EMU members can no longer use currency devaluation to defend themselves against German imports while its trade surpluses are largely recycled to the peripherals. Outside EMU the German mark would soar, while the peripheral countries' currencies would fall. But Germany, with its high rate of savings, relatively low wage rates and balance of payments surplus is unwilling to expand domestic demand to stimulate employment in the euro zone's deficit economies. In Europe the result of this situation is the sovereign debt crisis.

There are three ways out:

1. the debts are paid off out of real economic growth – an impossibility in the context of the austerity regimes which the EU insists on for the peripheral euro-zone countries;
2. the debts are inflated away by printing money;
3. or they could written down, through peripheral members leaving the euro zone.

The value of having one's own currency was shown for Ireland in the period 1993 to 1999 when the currency markets forced the Irish elite to abandon the fixed exchange rate that was part of the EU's Exchange Rate Mechanism (ERM).

This seven-year period was the only time in the history of the Irish state when it in effect floated its currency, giving the Irish economy a highly competitive exchange rate. This boosted Irish exports, inhibited competing imports and launched the country on over a decade of exceptional economic growth.

For over sixty years, the Irish pound was pegged at par with sterling, giving Ireland an implicitly over-valued currency which reduced competitiveness and inhibited economic growth and employment – as succinctly outlined in Conor McCabe's recent work, *Sins of the Fathers*.

In 1979 Ireland broke the link with sterling but tied its currency to the Deutsche mark in the (EMS) in preparation for EMU. When Britain devalued in September 1992, Ireland stayed with the Deutsche mark so that by January 1993 the Irish pound was worth 110 pence sterling.

But Ireland's over-valued currency was ruining its trade, which was mostly with Britain and the USA. This forced the Irish government to devalue the punt by 10% in January 1993. The Irish pound floated downward for the rest of the 1990s. It was at 90 pence sterling when Ireland adopted the euro in 1999.

And then there was banking! As late as the end of 1997, almost 90% of all Irish bank lending was financed by Irish deposits while

property-based lending made up less than a third of the loan books of the Irish banks.

Irish bank customers could borrow in foreign currency, but as the borrower carried the exchange rate risk such loans were expensive and rare. Our membership of the euro removed this de facto cap on Irish bank lending.

Irish banks could borrow from other euro zone banks without any exchange rate risk and the cost of borrowing halved as Irish interest rates converged on German rates during 1998. This combination of a massive increase in the availability of credit and a halving of interest rates was the harbinger of economic disaster.

By the end of 2007 – ten years later, Irish bank lending was almost seven times greater than it had been a decade earlier while deposits had 'only' tripled. This meant that the proportion of Irish bank lending financed by Irish bank deposits fell to less than 45%.

If we had opted to stay out of the euro in 1999 it is likely that the Irish pound would, like sterling and the dollar, have initially risen against the euro while our interest rates would also have stayed higher than those in the euro zone.

In 1999 the Republic did roughly one-third of its total trade with the euro zone, one third with the UK and one-third with the USA and the rest of the world. In 1973, the year Ireland joined the then EEC, 55% of total Irish exports went to the UK. In 2009, 53% of exports from Irish-owned firms went to the UK.

In 2008, the proportions for total trade were: euro zone 34%, UK 24%, rest of world 42%;

The 1993 devaluation gave Ireland a highly competitive exchange rate. Its growth rate almost doubled to 6% in 1993, the year of the devaluation, averaging 8-9% a year from then until 1999 when Ireland joined the euro zone.

Euro-zone interest rates were then low to suit Germany and France, which were in recession in the early 2000s. But Ireland was

experiencing a boom and needed higher interest rates to dampen demand. Instead, Ireland effectively halved its nominal interest rate in joining EMU.

This led to a borrowing binge which was concentrated on the property market and expanding domestic demand. Meanwhile, the sterling and dollar areas with which we do the greater part of our trade floated their currencies downward.

A sharp internal division has emerged between EU core and periphery, reflected in progressive loss of competitiveness by the periphery relative to the core which has benefited from extraordinary pressure on workers' wages. In Germany, this has meant practically stagnant real wages. Loss of competitiveness has entailed systematic current account deficits for the periphery, mirrored by equally systematic surpluses for Germany.

The alternative of exit from the euro zone is the great unmentionable in peripheral EU countries such as Ireland. There is no doubt that it would have severe consequences for us but it is notable that a number of influential economists continue to raise the issue in the media.

It is an indictment of our political system that there is no rational debate about possible default scenarios that could arise out of the present ongoing crisis – for example the effects of a default by Greece and its exit from the euro. There is a duty incumbent on democratic and progressive forces to be preparing for such an eventuality. Yet the silence from these quarters mirrors that of the mainstream.

During the recent difficulties there have been proposals to reintroduce the Greek drachma for domestic purposes – which would in practice result in devaluation – and a short holiday for Greece from the euro zone, returning at a lower exchange rate, has also been proposed.

The underlying logic of these proposals is clear: the problem originates in loss of competitiveness. Any discussion on this issue in

Ireland has been dominated by right-wing thinking and the government's intent, backed by the EU/ECB/IMF is to achieve a devaluation of wages across the economy in order to restore competitiveness. But where are the progressive voices making the obvious point that this objective can also be tackled through currency devaluation which would be much more equitable, as it would reduce living standards for everyone, not just workers or the vulnerable?

I will refer to these suggestions as 'conservative exit'. Conservative exit would operate as a complement to the IMF austerity package and the 'six pack' about to be imposed by the EU Commission, by allowing for devaluation which is currently impossible.

Devaluation would have costs for workers since real wages would fall to the degree to which imports entered the wage basket. But there would also be costs for sectors of capital, particularly those servicing debt abroad, including corporations and banks.

Cessation of payments and restructuring of international debt would have to be pursued. A lengthening of the present adjustment period beyond the target date of 2014 would be less likely to produce a deflationary shock, exacerbated by increased unemployment, as government expenditure would not be so severely curtailed.

But conservative exit would not by itself deal with the longer-term challenge of raising productivity growth and altering deficient economic structures. It would merely change the terms of trade, encouraging production of exports.

Whether or not Irish capital would be able to grasp this opportunity to restructure indigenous production, expand investment, and develop new fields of activity is open to question. The free market in Ireland would have to generate an uncharacteristic burst of productive dynamism!

The task is complicated because peripheral countries typically have productive structures of intermediate technology while, as in

Ireland, real wages are above those of competitors in Asia and elsewhere. There is a risk, therefore, that conservative exit coupled with liberalisation would lead to protracted stagnation accompanied by bouts of inflation, successive devaluations, and slow erosion of workers' incomes.

Central to the credo of Ireland's ruling elite, in common with the elites of other peripheral states, is remaining within the euro zone and shifting the costs onto working people. This leaves the option of 'progressive exit' – that is, an exit conditional on radical restructuring of the economy and society.

Default and exit from the euro zone have very serious implications but these must be weighed against the serious implications of continued recession and stagnation. One thing is clear: exit requires radical political and social alliances which do not exist in Ireland at present, other than in potential form. It would be far from easy to make them real, particularly as shifting the balance of power in favour of labour is predicated upon democratic organisation of the economy and society. But there is no reason to believe – if a credible political force proposed it – that it would be impossible for progressive exit to win broad support.

Restructuring of debt would be necessary. Debtor-led (Irish state) repudiation of the debt would mean unilateral suspension of payments – an implied threat of 100% burning of the bondholders. There would have to be an independent public audit of debt following suspension of payments and fair and transparent arbitration.

In November 2008, Ecuador became the first country to undertake an examination of the legitimacy and structure of its foreign debt. Ecuador's use of legitimacy as a legal argument for defaulting set a major precedent; indeed, the formation of a debt auditing commission sets a precedent in identifying illegitimate or odious debt. Subsequently, in June 2009, Ecuador reached an agreement with 91% of creditors to buy back its debt for 35 cents on the dollar.

Following progressive exit, access to international capital markets would become extremely difficult. Banks would come under heavy pressure, facing bankruptcy, but a sustainable path to growth could be achieved, provided there was serious economic and social transformation.

These measures would represent a challenge to the EU institutions but would also represent a challenge to workers organizations which have consistently espoused the rhetoric of 'social Europe' within Ireland and the EU.

Some strategic steps are clear:

Default and exit, would certainly create problems in public finances, but these would be ameliorated as recovery began after default. The government could also borrow from the state banking system as well as monetising the deficit to a certain extent by issuing government securities or notes; but clearly the government deficit would have to be addressed through strict spending targets, while preserving social priorities.

Repudiation of the debt would run the risk of precipitating a banking crisis, since substantial volumes of public debt are held by domestic banks. To protect the banking system it would be necessary to engage in nationalisation, creating a system of state banks.

Creating public banks would guarantee deposits, especially those of small savers. It would also facilitate the advance of credit on reasonable terms to small and medium enterprises, thus protecting employment. These banks would contribute to attaining sustained growth, as well as beginning to reverse the financialisation of the economy.

Capital controls would also be necessary, in the first instance to prevent the outflow of liquid funds and protect the banking system and to marshal national resources. Managing capital flows would also be necessary to avoid importing instability from abroad.

All state guarantees on interbank lending would have to be lifted, though the state could still guarantee deposits in the new currency. Investors who invested in Irish government bonds would be burned, being paid back in the new currency, which would find its own value.

As the Central Bank would do what the US, Britain, Canada and Sweden are doing now and print money, the liquidity trap that we are in would evaporate. Clearly, inflation would rise and the state would need to introduce CPI-linked bonds to refinance itself as Sweden and Finland have successfully done. Unemployment would fall rapidly as it has done in practically every country which has embarked on such a policy. The Asian 'tigers' collapse in 1997 is an example of this rapid re-employment phenomenon.

But there are other problems in terms of fairness. Young people with debts would benefit, middle-aged people with assets and pensioners would lose out. But as most of the value of these assets will be wiped out in the grinding recession the next few years will bring, over a five-year period there might be little net difference.

The combination of public banking and controls over the capital account would immediately pose the question of public ownership over other areas of the economy. Underlying competitive weaknesses already threaten the viability of entire areas of economic activity in Ireland.

Public ownership of specific sectors would be necessary to prevent collapse. Public utilities, transport, energy, and telecommunications would be prime candidates, at the very least, in order to support the rest of economic activity. With significant areas of economic activity under public ownership and control, the rest of the economy could be shifted onto a different growth path governed through the introduction of industrial policy.

Public institutions and mechanisms for promoting development, which have been steadily abolished in the years since the Maastricht Treaty, would be rebuilt on a new basis.

This is not a policy of isolationism. It would be necessary to maintain access to international trade, particularly within the EU just like it would also be necessary to seek technology transfer and capital from abroad.

There is growth potential in Ireland in areas of clean energy production and efficiencies as well as improved water quality/delivery, natural resource development and waste disposal. There is also scope for public investment in housing provision, urban planning, roads and railways. There is, finally, the more difficult task of improving technology as well as research and development, an area in which we are woefully deficient.

Structural change also requires transforming education by committing additional resources and expanding its reach to the poorest. Presently, Ireland ranks 30th out of thirty-four OECD countries in terms of education expenditure as a percentage of GDP.

It is apparent that structural change of this order could hardly be undertaken using the present inefficient and corrupt mechanisms of the Irish state. Broad political and social alliances are necessary to rebuild the structures of state on the basis of grass-roots control, transparency and accountability.

Support for real wages could be provided through a policy of income redistribution effected through a restructuring of the tax base. Pressure on workers would be reduced in the long term if food, rents, building costs, and services such as gas and electricity were subjected to price control.

Transfer payments would also be used directly to tackle inequality in peripheral areas and regions.

The Irish economy is resource-rich possessing rich farming land, extensive seas, oil, gas and a range of minerals and could become an immediate beneficiary from primary commodity exports if either resources were taken into state ownership or taxed realistically. No more licenses for resource exploration would be issued and a state exploration company could be set up.

Discoveries could then be exploited by the government on behalf of the people utilising what remains of the National Pension Reserve fund or in co-operation with countries possessing expertise. A land value tax should be introduced immediately and ring-fenced to sustain and improve the provision of public health services.

We should immediately begin negotiations with the other peripheral countries that are experiencing difficulties in order to explore the possibilities for joint coordinated action. In our natural hinterland, Britain, Denmark, Sweden and Norway are non-euro-zone members – and so a natural trading bloc and we should now concentrate on expanding our trade with these countries.

On the tax front, several of the highest earners in Ireland pay no tax whatsoever: we have over 19,000 millionaires, while 1,000 people with incomes above €100,000 a year pay less than 5% tax. And these aren't tax exiles – they live in Ireland. The only way to recover this money is through an assets tax which is common in several countries – France, Norway and Switzerland for example.

If the €320 billion in assets held by the top 5% attracted a 2% annual assets tax it would bring in €6 billion per year. To put this in context, as part of the deal negotiated with the 'troika' the government has committed to a combination of tax increases and public spending cuts presently totaling €3.6 billion in 2012.

Peripheral countries such as Ireland are currently confronted with stark choices because of the crisis and the structural weaknesses of the euro zone. The current crisis is being resolved through austerity measures that serve the interests of the social classes which created the disaster in the first place. It is inequitable, imposing huge costs on working people who are not to blame for the upheaval – all to save the euro!

There would be costs to any form of radical strategy; but unlike the option of austerity, radical change would have the potential to put the economy on a sustainable path of development that would

produce benefits for all. The choice belongs to society and, as always of course, depends on struggle.

So what are we to do? We could acquiesce in unending austerity, remaining within the euro zone and putting up with recession, or stagnation, for the indefinite future. If, austerity fails and EU creditor-led restructuring does not produce decisive results, the option of debtor-led default would emerge for Ireland but in the midst of social and economic chaos caused by failed austerity.

My answer is to leave the euro, reinstitute our own currency, allow it to fall to reflect the real competitive position of our ruined economy and start again. The vast majority of economists and commentators say this is not possible. But these same people believed the 'soft landing' mantra.

Leaving the euro would be radical and challenging but the consequences would have to be balanced against the decades of austerity promised by continued membership. Only last week the commission said that austerity will continue to be demanded into the foreseeable future and the recently agreed 'six pack' ensures that it will.

I don't know about you, but I'd prefer to live in a country that gives itself a chance, than in one where the current policies can only lead to slow strangulation. But there are no easy, painless answers to Ireland's crisis whichever way one looks at it. Nevertheless, I believe that, on balance, exit from the euro would be to our advantage and that we should begin the debate now and not leave the issue to be decided behind closed doors by a few people in the way the destructive bank bailout was decided – allegedly in somebody's kitchen.

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