

Rise & Fall

of the

Celtic Tiger

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Closure. At this moment, I feel it is vital for us all as individuals and as a nation to achieve it, all of our lives are being consumed by the discussions, reports and anecdotes of the 'Celtic Tiger' era . That is yesterday, we need to focus on tomorrow and find solutions to the issues. But without closure, this cannot happen. As our own Patrick Kavanagh said:

*“When Drake was winning seas for England
We sailed in puddles of the past
Chasing the ghost of Brendan’s mast”*

We cannot afford to go round in circles paying the blame game with each other while the rest of the world moves on. Otherwise we run the risk of being left behind.

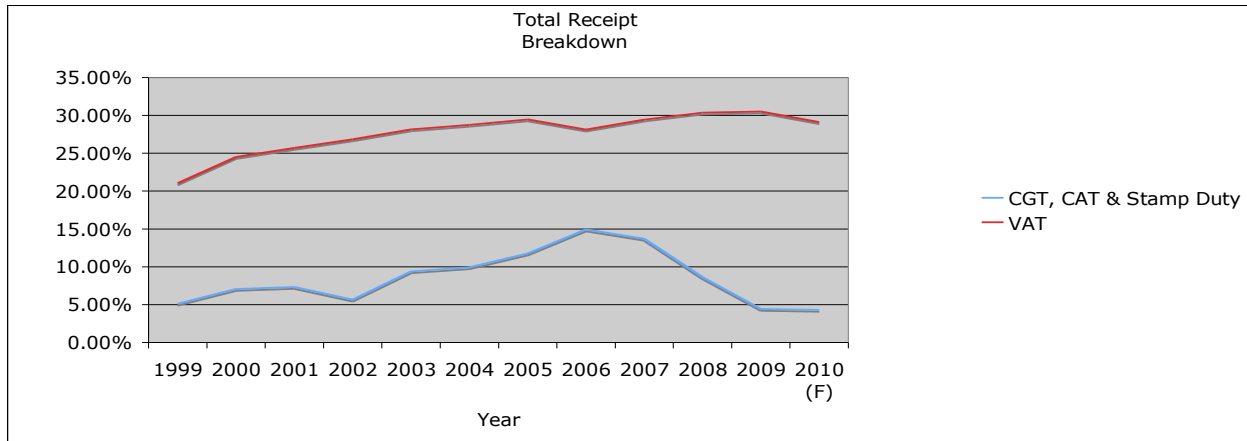
I think it is important not to dismiss the Celtic Tiger as an era of madness in which nothing was achieved. I want to give you my thoughts on how and why we got into this situation, and where I believe the future lies.

Who is to blame for the situation we are now faced with? Simple....everyone. Each group had a contributing factor...I stand up and take my blame, I look in the mirror and see the mistakes, poor decisions and bad judgement calls that were made as I and those around me, lost the run of ourselves. But, there is no single factor or person in which all blame can lie, without doubt, some elements were more pivotal than others...but everyone played a part in the final outcome which we find ourselves in today.

There is a culture of begrudgery and finger-pointing that seems inherent in Ireland, it was not prevalent during the boom as people tend to get on a lot better when they are being successful, but now that things have become difficult in Ireland, it has reared its ugly head. This attitude needs to change. The world keeps turning and the country continues to drown in indecision and petty argument over what sector, institution or individual deserves the most blame!. We should be helping one another, lifting each other up instead of pushing each other down.

Let me begin with the big one, Government. With the massive increase in tax receipts from the property boom, they grew fat and lazy. It was their policy that sparked the bubble, primarily through the use of tax breaks in a number of sectors. When demand then faltered, and their tax receipts were hit, they adjusted policy to try reignite the property sector. This shows a real lack of innovation on their part, refusing to get off the gravy train, even when it ran dry.

The graph below shows the increase in tax receipts to the government through VAT & Asset Taxes (CGT, CAT & Stamp Duty) from '99 to 2010. The Asset Taxes account for 15% of all receipts in 2006, up from 5% in '99. VAT accounting for 30% in 2009, up from 21% in '99.

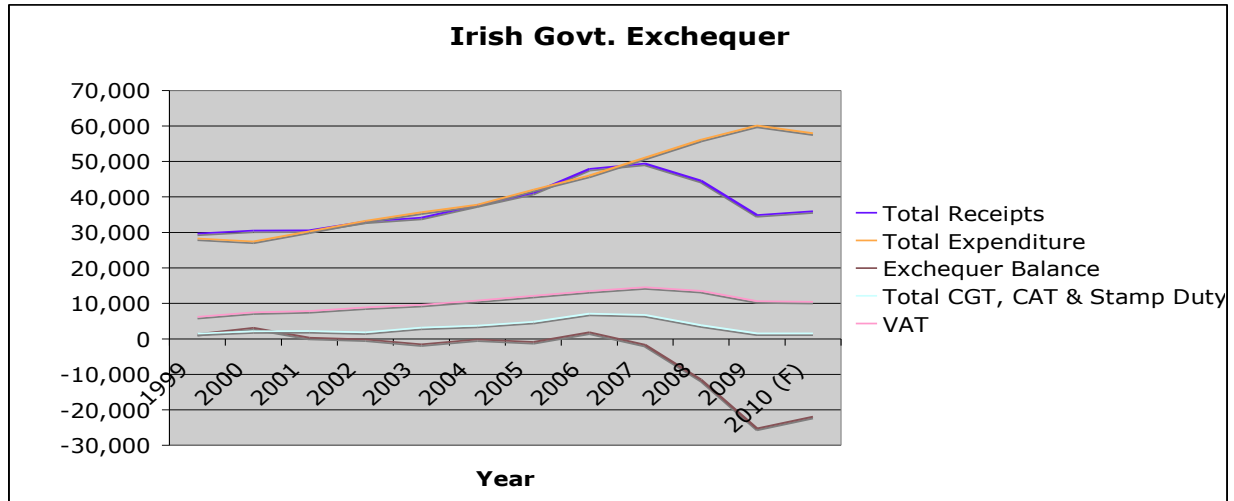


With this easy money coming into the government, they became overly reliant on these few sectors tied to property in order to fund their pet projects and a cut in taxes in order to keep themselves in power.

This blind reliance on a few closely linked sectors has caused massive damage to the country. Take the hotel sector, which I know very well, for example, through the tax incentivisation of hotel development, without any cap on the number allowed to be constructed, the country ended up with a total of 60,000 rooms. 10,000-15,000 of these now face closure or a change of use as demand is simply not there. It is simple economics that where the government decide to aim policy and direct the incentives, that is where the action will be. This incentivisation resulted in people doing the deals because they *could*, not because they *should*.

Government expenditure grew with the increase in receipts, allowing them make crazy, unsustainable decisions that, now the receipts have fallen, have led to the massive, €20bn+ deficit which we must deal with. With a population that has grown accustomed to the 'Tiger' lifestyle, and with a government that grew complacent with money that came too easily to them. We now find it very difficult to make the necessary cuts. The McCarthy report has shown the required changes which need to be made, but only *some* of the have been implemented. People fight the cuts at every turn, refusing to take the necessary medicine. People want someone else to feel the pinch of the cut, not understanding that we are all in this together.

The graph below shows how receipts and expenditure rose together through the boom, and when the receipts fall with the housing market collapse, the expenditure continues to rise out of control. Some action has been taken to bridge the gap, but there is a *lot* more to do.



On the note of government deficits, unlike most other nations, who's GNP & GDP are very closely matched, due to Ireland's reliance on US multi-nation companies, who locate in Ireland, but repatriate their profits, Irish GDP & GNP are two very different figures. GDP takes account all of the companies profits, even though the government only receives 12.5% of these profits through corporation tax. GNP does not take these profits into account, meaning it is the more correct figure we should be basing economic indicators off. In 2009, GNP was approximately 18% lower than GDP. The much publicised 14.3% deficit, which was the highest in Europe is actually closer to 17.6%!

And with continued 'investment' into the banks, which is now rightly identified as a current expenditure, the deficit will rise considerably this year. Most likely leaving us with the largest deficit in Europe. This cannot be dismissed as a mere technicality, we cannot buy into the government spin of 'underlying deficit' being what really matters. The markets take into account the whole picture, they do not care how the information is presented, they know what is there. That is why this 'technicality' will not change anything. The markets see through all the spin and will set the rate accordingly. This is why we pay more for money than the majority of countries in the Euro, even though we are all the same in theory.

One area that has not gotten enough attention is the income the government received from the building sector throughout the boom, but not just through direct property taxes which I have already touch on, I want to include the indirect taxation they received too. Looking only at the residential construction sector, according to the Construction Industry Federation (CIF). The total sale price of a new home, included 40+% of direct and indirect taxes the government accrued during the entire construction and sales process. Using 2007 new homes in Ireland as an example, the below model shows the income received by the government in that year. Essentially, Joe Public took on a 30 year loan which he stretched himself thin to afford at the time in order to pay the government its 40% which had been accumulating from the inception of the development. This money is now gone into failing banks and bloated, overpriced public services. Forcing us to rely on the ECB and markets for support.

Year	Total No. Units Built	Av. Selling Price
2007	93,000	300,000
Total House Sale Value -		27,900,000,000
Govt. Tax Income - 40%		11,160,000,000

This €11.1bn accounts for over 20% of total govt receipts in 2007.

With the initial increase in property values primarily led by the smaller more innovative banks, eg. Anglo, in the early part of the decade, there was a rush by the institutional banks, AIB & BoI and foreign banks, BOSI & Rabobank through ACC, to get a slice of the action. This massive increase in credit, roughly €150bn too much, allowed the market to reach crazy levels as banks continued to finance any deal.

The reward system within the bank had a big part to play in this, essentially rewarding the signing of a loan, not the completion of it. It is the same as me receiving a medal for crossing the starting line in a marathon, and never being asked if I was going to finish the race. They were not too concerned about the how the loan principal was to be pain down. With this system, the re-finance became a common strategy. The banks actively discouraged us from selling assets, throwing money at us for every deal, pushing for the maximum valuation so they could lend more money. And it made sense at the time. Why would we take on the big tax bill from selling an asset when you could re-finance, take out a comparable amount of equity and avoid all tax, but more importantly, keep ownership of the property that will continue to appreciate? People, ourselves included did not see this as increasing liability, we saw it as a way of milking the asset but also allowed us to stay involved so you could do the same thing in another couple years....Like the rest of the country, we convinced ourselves that Ireland had defied the cyclical nature of capitalism, and was on a never ending cycle of appreciation.

As you can see from the model below, with a similar amount of net cash going to the owners with the re-finance and the sale option, why would someone chose to pay the tax man and lose their stake in a property that was a 'sure thing' to continue appreciating?

			Value	Debt	Equity	Capital Gains Tax	Closing Fees	Net Cash to Owner
						20%	3%	
	<i>Initial Purchase</i>	2003	1,000,000	750,000	250,000			
2 Options	<i>Refinance</i>	2007	2,000,000	1,500,000	500,000			750,000
	<i>Sell</i>	2007	2,000,000	750,000	1,250,000	200,000	50,000	1,000,000
Sale	12%	of Gross (Value & Acquisition Cost) Value is Tax						
Re-Finance	0%	Tax. Allows you to keep ownership of property, which you assume will increase again in time.						

In addition to this, we have also learned of the questionable accounting and ethics that went on within all the banks and massive failure of the regulator to address any of the numerous issues going on within the banks.

The Developers, portrayed as a bunch of greedy, egotistical men. A lot of truth in this, but unfair to portray everyone in the sector like this. At the early stages of the boom, some fantastic developments in the country that helped create communities and uplift areas. Some beautiful developments took place in Ireland that we can be proud of and helped attract some of the big multi national US companies to our shores. At the early stage, the sector was filled with many good, integrity filled people...but as more and more people got involved, the quality of projects was compromised. Turning agricultural land into a development land or building housing developments in any and all part of the country was exceptionally profitable, so it became too attractive for people to resist. This led to a big increase in the number of people involved in the development sector and with banks very willing to lend money, even to people with little or no experience in the area, it allowed prices to be pushed up further yet again. In Ireland, business is very personal, successful developers took on a celebrity like status in the country, some believing their own hype and indulging in the media attention. Now, in the downturn, it is equally personal, with people trying to place blame for the entire demise of the 'Celtic Tiger' on the shoulders of few.

Then, at the end of the chain, you have the buyer, whether it's an owner/occupier or a speculator/investor... Us Irish have an amazing affinity to property, we seem to need it! The word 'rent' was taboo, only when you own can you be considered successful. Unlike Europe, where people happily rent for their entire lifetime, we have to own. A good job and a happy family was not enough, you were only a true success when you owned property.

I think it is fair to say that there was a certain element of "keeping up with the Joneses" throughout the country, it was very hard not to get involved with the 'easy' money if your neighbour was raking it in and driving flash new cars. A desperation then seeped into the market. People became desperate to own a home, or add to their portfolio, whether it was affordable or even made financial sense at the time. There was no gun to their heads, plenty of supply to rent from, but we, as a nation, had to own.

Now, when all this is said and done, I still feel that property was still one of the safest investments. Investment into the bank shares would leave you with close to nothing. In 2007, the Big 4 banks were capitalised at €55bn, by 2009, it had fallen to €4bn. Obviously massive losses in property, but not to this extreme, on top of this, property was tangible, you could use the asset.

But at the end of the day, I do not believe all the blame should lie in the investment made, whether it be stocks & shares or property. The real issue was the manor in which everyone invested...you walk a very fine line between massive profits and complete losses when you have a large amount of gearing on every asset. If you have an asset with 80% debt on it, it only takes a 20% drop to lose all your cash invested. But a 20% increase doubles your money. That is how fine the fine.

Historically, no gearing was allowed with shares, as the assumption was that they already were geared within the company you were investing, but this changed and people took on as much debt as possible in order to maximise returns. Property speculators, of all sizes took on as much gearing as possible, rarely ever putting money down, instead using supposed equity in other deals as the new equity. Owners occupiers would return from bank meetings giddily exclaiming that they put little or even no money down for a property. No one taking a step back from the herd and asking ‘What if prices fall?’ Investors losing all sight of value in their investments, only concerning themselves with the capital appreciation over time.

Look at the model below to show where the yields are for average homes in Ireland in Feb 2007, at the height of the boom, today and where prices need to get to in order to represent value.

	House Price	Monthly Rent	Net Yield
2007	300,000	1100	4.40%
2010	200,000	900	4.49%
Sustainable Value	150,000	900	7.20%

An investor should look for a 6-7% net yield on his investments. As you can see, we are not there yet... To get to this magic number, two things can happen:

One - Rent can increase. This is very unlikely, with deflation, high unemployment, wages falling, taxes rising and mass emigration all happening at the moment, we are doing well if rents stay where they are.

The other option is that prices fall further, somewhere close to 25%, assuming rents remain the same.

This would obviously not concern an occupier as they do not buy for the income, but it is an important indicator figure for the housing sector.

When it is so clear that we all played a part, I find it upsetting how the press feed the public appetite for blood. Business was always very personal in Ireland, and we must accept that with the good and the bad times. But that is no excuse for animosity...real businessmen who helped take this country out of the doldrums. Are now enemy No.1. Businessmen, accountant, lawyers, estate agents...who 5 years ago had nothing but massive admiration for these business man, now join the masses and have nothing but negative comments on them. Forgetting all good that was done at their hands. No doubt that they made questionable decision, but we must look at the boom and bust with balance, and not succumb to the media circus.

So what next? We let the few fall...and then nothing changes, the token heads have rolled, but are eagerly filled by their proteges who share the same ideas and principles, and ultimately lead Ireland down the same path. This cannot happen, there is a real need for change in this country. From the top down.

As I mentioned earlier, it is too easy to simply brush aside all achievements of the last 15 years as tainted, a period where We, the Irish finally got over our inferiority complex and started standing up in the world to be counted...Look at what we accomplished:

- Unemployment goes from 15% in the mid 90's to 4% in 2005 – we reached full employment and had a total of 1,000,000 extra people in the workforce.
- GNI increases at a rate of 7% per year from '94 - '00 and 3% per year from 2000 -'07.
- Human Development Index – essentially quality of life score taking into account numerous economic and social factors – goes from 0.81 in 1975 to .959 in 2005.
- Massive infrastructure improvements! The addition of the Luas, Port tunnel, improvement of existing road networks and the addition of new roads all around the country is a massive asset for us to now have.
- The addition of certain buildings and areas throughout the country will be a massive asset for us going forward. Take the North & South Docks in Dublin as an example. We cannot simply focus on the 'ghost estates.'
- With all of the extra money flowing around the country, the philanthropic side came out in a lot of people, both domestically and abroad, helping to fund some badly needed facilities and initiatives for the less fortunate.

So...Where to now for?

- Sustainable growth!! 3 or 4% per annum. For this to happen, we need REAL business to be created, ones that employs people, create good and services, and if possible, allow us to export them. These wealth generators need to be incentivised through tax breaks and other incentives.
- In order for us to export any goods or services, we need to get our competitiveness back. This was a big factor in Ireland attracting investment, and will be an even bigger factor when it comes to them deciding to stay or move to Eastern Europe, China or India. As we are in the safety of the 'ECB Ark' we have no flexibility with a currency, which would allow us devalue, a typical solution to this kind of crisis. But this 'Ark' has been vital to our survival for the last 18 months, without them we of surely been target by the markets, but his may still come to pass in the coming months...This instead means that we must deflate the prices and wages in order to get competitive again, this is what the Greeks are currently trying to achieve. For this everyone need to be on board, employers, employees, landlords. Everyone must accept that the cuts need to happen, whether they are wages, rents, government projects. Some people talk of how cheap life has gotten in Ireland...nonsense...it still has a long was to go before it is back to an appropriate level.
- Leadership – we need the government to step up and take charge. Feels like they are more concerned with conserving seats and saving face than dealing with the issues at hand. We need a new, fresh viewpoint from the government. Innovation and creativity is what we need. Not archaic, conservatives ideas that do not solve anything. Take the dole queues for example, today, 1 in 3 men under 25 are unemployed, 33% this is our future generation and we are allowing them to waste away. No one wants to be unemployed, people want to work and be productive. Social & Family affairs will account for over 30% of our total expenditure as a nation this year. It is vital that this issue is addressed, not only for their sakes, but for the country, if this continues it will bankrupt the state, and in addition, it will force a large portion of our future generation to emigrate. Some governments are being proactive on this, Belgium for example, currently exploring the possibility of subsidising new employees in certain sectors, paying a certain amount of their wages, this is a good, innovative solution, it allows people hungry for work, to work, businesses to survive by subsidising wages and finally allows the government to reduce their own social welfare cost, all at the same time.

- Bank Regulation – we need to step this up, hire a firm German to oversee the entire sector and keep everyone in line, we cannot allow us to make the same mistakes as before, if we take only a single piece of knowledge from the demise of the Celtic Tiger, it needs to be lessons in how to avoid it happening again. Take Canada for example, their banking system is well regulated, they tried to only lend out 85c for every \$1 they had on deposit. With this tight regulation, they avoided the depths of recession that we are currently in and are already growing as an economy again. In Ireland, we were lending, on average €1.60 for every €1 we had on deposit. Some institutions got to €2.6 for every €1 on deposit.
- Irish in the World – I strongly feel that there is now a need for all the Irish in the world to connect together. Ireland needs to be bigger than the island of Ireland. We are only 6m people in a world that contains over 80m of us. On the note of being in the world, I feel that selling the foreign portfolios of our Irish banks is a mistake, I feel that we need to be in the world. CRH today have over 95% of their business outside of Ireland. That is the model we should be following.