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POLICY PAPER

Averting Crisis? Commentary from the International Institutions on the Irish Property Sector in the Years Before the Crash

CIARÁN MICHAEL CASEY*
University of Oxford

To profit from good advice requires more wisdom than to give it.
Wilson Mizner

Abstract: Ireland has been particularly badly impacted by the current international crisis, with an unprecedented deterioration in government finances and unemployment reaching 14.9 per cent. In many ways, the economic roots of the Irish crisis are quite mundane; the country experienced a classic asset bubble. As early as the year 2000, commentators were pointing Irish policymakers to examples of dozens of property boom/bust cycles in the recent histories of developed economies.

What is certainly more controversial is how an advanced social democracy sleepwalked into a crisis that in retrospect seems to have been so apparent. In many ways, the Irish crisis can be considered as having stemmed from a failure of the variety of institutions that helped influence economic policy. This paper will examine what the large international institutions published about the Irish property and construction sectors from 2000 to 2006. It will show that the European Commission published comparatively little of relevance, while the International Monetary Fund in particular produced regular in-depth analysis that challenged prevailing policy. None of the institutions, however, came remotely close to anticipating a near-total collapse of construction activity, rendering inadequate many of their policy recommendations.

I INTRODUCTION

The objective of this paper is to establish what the large international institutions published about the Irish property sector during the period from 2000 to 2006. More specifically, it will examine what those organisations

* Email: ciaran.casey@history.ox.ac.uk

said about the factors that precipitated the crash. The paper will focus on the discourse on construction and property, rather than the attendant impacts of the boom on competitiveness, the financial sector, or fiscal policy. The key organisations that made formal assessments of the Irish economy were the Organisation for Economic Cooperation and Development (OECD); the International Monetary Fund (IMF); and the European Commission (EC). Significantly, Ireland was a member of all three organisations throughout the period, and contributed to the funding of each.

The most pertinent OECD publications about Ireland for our purposes are the *Economic Surveys*. These are very comprehensive (around 150 pages each), and were generally published every second year. As such, the 1999 report will be included to ensure that the entire period is contextualised and examined fully. The *Economic Outlooks* are published twice a year, and contain only a very brief examination of Irish economic fundamentals and perhaps a paragraph or two of analysis and policy advice. In many ways these can be regarded as the ideal counterbalance to the *Economic Surveys*, since their brevity forces the authors to give unequivocal opinions. A working paper on the housing boom in Ireland was published in 2006, most of which was also included in the Economic Survey for that year.

The primary relevant publications by the IMF from the period are the annually published *Staff Country Reports* (or Article IV consultations). These are considerably shorter than the OECD's *Economic Surveys*, at approximately fifty pages each. The reports were written by named professional economists who would visit Ireland to meet with officials, including government ministers, senior departmental officials, academic economists, and senior officials from the Irish Central Bank. The reports are the outcome of these discussions, and give an indication of the interplay between the staff giving policy advice and the authorities receiving it. This gives them a dimension beyond that of the other international reports, particularly since they were sometimes quite frank about disagreements between the IMF mission and Irish decision makers. In several of the years the *Staff Country Reports* were augmented by a report of similar length dealing with selected issues in greater detail. These "Selected Issues" papers are particularly relevant where they deal with the property boom in more detail than the core reports.

The European Commission published by far the least of the three organisations on the Irish economy. The annual *Public Finances in the EMU* and biannual *Economic Forecasts* reports contained about two pages for each country, and were in the main quite superficial. The Commission also published two *EcFin Country Focus* papers on Ireland during the period, which contain a little more detail at six pages each. While one could argue that the analysis made by the Commission was in keeping with its mandate, the limits of the breadth and depth of its surveillance are conspicuous relative to that of the other two organisations.

In a 2011 investigation into the IMF's staff (who are all professsional economists) performance in the run-up to the international crisis, the organisation's Independent Evaluation Office (IEO) suggested that the primary purpose of IMF surveillance was arguably to warn member countries about domestic vulnerabilities and threats to the international economy (2011, p. vii). It seems reasonable to assume that this was a core function of the publications of all three agencies and they should be evaluated on this basis. It is also worth considering that an unduly benign analysis was likely to have been damaging rather than useless. The reports by these international organisations were accorded significant cachet in the national discourse, and in some instances helped bolster the consensus view and induce complacency. Crucially, for example, Patrick Honohan has suggested that the IMF's conclusion that the Irish financial sector was fundamentally sound in 2006 would have assuaged internal doubts about its resilience (2010).

Michael Breen has suggested that IMF staff, all professional economists, did not suffer from the same skill-set shortages that were associated with the Irish Department of Finance at the time (2012, p. 434). This is interesting given the IMF's own subsequent contention that in large, advanced economies, missions were often slow to challenge the consensus held by large numbers of highly-qualified economists working in central banks, and were thus subject to a degree of "intellectual capture". One would assume that international specialists would have been less intimidated in speaking "truth to power" in their dealings with a smaller country like Ireland, and thus more objective. However, IMF staff subsequently surveyed maintained that the incentives facing them had not encouraged harsh criticism of the policies pursued by member countries, particularly since they could not rely on the support of their own executive board. Less than half of staff reported that they considered that their opinions had been listened to by national authorities. Furthermore, both staff and national authorities were very mindful of the fact that strong language from the IMF could precipitate increased borrowing costs, or even a crisis (IMF, 2011, pp. 17, 35).

The IEO has also pointed to the influence of "groupthink" by IMF staff, as well as general assumptions about the likelihood of a very significant crisis in the developed economies. It defines groupthink as being "… the tendency among homogenous, cohesive groups to consider issues only within a certain paradigm and not challenge its basic premises" (IMF, 2011, p. 17). Pete Lunn's examination of the decision-making biases that he maintains influenced Irish economic policy is useful in this context (2011). In this case, extrapolation bias, whereby more recent events are given undue weight in forecasting the future at the expense of earlier events, was clearly a feature. Furthermore, while these international analysts should have been further removed from Irish society, and thus less subject to confirmation bias than internal commentators, their heavy reliance on the research produced by domestic agents clearly exposed them to the dominant view of the Irish economy.

This paper is based on an examination of all of the relevant reports on the Irish economy that were published by the OECD, the IMF, and the European Commission between 2000 and 2006. The quotations used are representative of the key positions taken by the organisations over the period. The paper will first consider the main policy recommendations pertaining to the property sector, before turning briefly to the material published on property supply and the rental market. The attempts made to establish the fundamental value of Irish residential property and the examinations of pertinent historical comparisons are particularly important, and will be examined in detail. The associated macroeconomic and fiscal concerns that were raised by the international organisations will then be considered, before finally turning to some concluding comments.

II POLICY ADVICE

The international organisations were cognisant of the fact that house price increases were dramatically outpacing economic growth from the outset of the period. In 2001 the OECD observed that the average increase was an enormous 20 per cent annually (2001, pp. 16, 20). In 2006 it suggested that while prices had started from a very low base, at an average of €75,000 in 1995, they had more than trebled in the interim (2006, pp. 36, 43). There had been brief respite following the global downturn in 2001, when house price inflation eased to approximately 3 per cent. However, it rebounded strongly the following year, reaching 15 per cent in 2003 (IMF, 2004a, p. 7).

The IMF provided very robust analysis from the outset in this respect, and returned to the issue of house prices again and again throughout. While the OECD did pay some attention to the issue, it really only addressed property with comparable rigour in 2006. The European Commission examined the sector in very little detail until the end of the period. It is conspicuous that even from the IMF the main preoccupation was with house prices, with relatively little examination of commercial property or the importance and vulnerability of the construction industry itself. This discrepancy will be returned to at the end of the paper.

The agencies were quite vocal in their policy recommendations throughout the period. For example, in 1999 the OECD challenged the favourable policies towards home-ownership, arguing for the desirability "… either to phase out mortgage interest tax relief or tax the imputed rents on owner-occupier housing and to expose owners to higher holding costs through either the reintroduction of a residential property tax or through a restructured capital gains tax" (1999, p. 19). In 2003 the IMF rebuked the government for its frequent policy reversals around property, particularly the frequent changes to the stamp duty regime and the stimulating measures introduced in 2002, which it blamed for having incited the resurgence in prices. In their discussions with the Irish authorities the mission staff argued that these frequent volte-faces could distort the decision-making processes of market participants and exacerbate volatility. Crucially, the mission went on to contend that any measures introduced to postpone the adjustment of prices would increase the risk of a sharper decrease down the line (2003, p. 16).

In 2004 the key policy recommendation made by both IMF staff and the executive board was that "… the authorities should continue to communicate their views about potential overheating in the housing market to help achieve a soft landing, and look to removing the subsidies to housing over the medium-term to help moderate house-price cycles in the future". Given the general perception of the IMF as being strongly pro-market, the fact that it advocated for government intervention to suppress demand through dampening expectations is somewhat surprising, and was probably indicative of how concerned the organisation had become about what it viewed as the medium-term structural imbalances in the housing market (IMF, 2004a, p. 3).

In 2006 the OECD argued that rises in house prices were a zero-sum game, benefitting current homeowners at the expense of first-time buyers. The organisation was quite strident in pointing to the large capital gains achieved by some landowners as a result of rezoning and of major infrastructural investment by the State. It maintained that part of this windfall should have been taxed in order to help fund the infrastructure that had created the gains in the first place. The under-pricing of infrastructure in the property taxation system was identified as having been one of the factors fuelling demand and prices. The report advised the government to "… phase out the strong bias towards housing that is embedded in the tax system" and to introduce a property tax. The authors also pointed to the fact that since monetary policy was now the preserve of the European Central Bank (ECB), the Irish government had limited power to avoid a crash in the property market. On this basis it argued that addressing the bias towards home-ownership in the tax system was even more crucial. Significantly, the organisation found that the authorities had taken no action on its 2003 recommendation to reduce the tax incentives for speculative investment in property (2006, pp. 36, 43, 126-131).

The OECD was evidently concerned about the role played by large tax advantages in driving-up prices and urged the government to remove these tax incentives on a phased basis. The organisation suggested that there had been prolonged periods where the user cost for homeowners had been negative, taking into account interest rates; opportunity costs; depreciation; and the absence of property taxes, particularly in the late 1970s (after the abolition of rates) and from the mid-1990s. The untaxed capital gains on owner-occupied homes were singled out in particular as having been a potential "catalyst for the upward spiral". The tax regime for owner-occupiers was considered unique in the OECD, since it allowed households to deduct mortgage interest against income tax, while simultaneously not taxing property values, capital gains, or imputed rent (2006, pp. 119, 121).

A particularly relevant divergence of opinion between the IMF and the Irish authorities was the Fund's view that the propensity of the public to buy property was a strong argument against the state subsidising housing, through tax-deductibility on primary dwellings and the absence of a wealth tax, even on second homes. In a quote that perhaps explains much of the basis behind Irish housing policy in this period, the mission reported that "… the authorities noted the political, likely insurmountable, difficulties of removing interest-deductibility of mortgages or introducing taxation on property given the electorate's long history of strong attachment to, and preference for owning, property". In complete contradiction to the IMF recommendations, the public drive for property-ownership was actually used to justify the favourable tax regime (2004a, pp. 19, 20, 26). Again in 2006 the Fund advised broadening the tax base, by phasing out property-based incentives; introducing a property tax; or reducing mortgage interest relief. Crucially staff reported that "… officials acknowledged the economic desirability of broadening the tax-base, but pointed to popular opposition to increasing property-related taxes" (2006, pp. 3, 11-13).

In a very clear example of reliance by the international agencies on domestically-produced research, the "Bacon Reports" formed the basis for much of their analysis in the early years of the decade.[1] The 1999 OECD report went into extensive detail on the recommendations of the 1998 Bacon report, and subsequent government "Action on House Prices". In particular, Bacon's emphasis on the need to increase unit supply and reduce excessive investor demand framed much of the discussion. The OECD found that the second Bacon report (1999) had met with an immediate policy response from the government, and while these responses had been considered positive and

[1] A series of government-commissioned reports on the housing market from 1998-2000, led by consultant economist Peter Bacon.

timely, the report gave the impression that they had not gone far enough. The really politically-challenging issue of introducing extra charges had been left untouched: "… reintroducing a residential property tax and thereby increasing opportunity costs of inefficient land use would reinforce the incentives for landowners to use their land more effectively" (1999, pp. 104-106). The IMF agreed that it was "unfortunate" to see structurally-transformative items like a property tax and water and sewage charges left off the agenda (IMF, 2000a, p. 31).

By 2001 the OECD was of the opinion that the government actions on the back of the Bacon reports had started to take effect. However, it maintained that the government failure to fully charge homeowners for externalities and infrastructure had encouraged urban sprawl. A prime example of such an externality inadequately captured was the absence of an appropriately-high fuel tax to pass the costs of road-building and maintenance on to commuters. The organisation contended that this was exacerbated by the withdrawal of an anti-speculative property tax in March 2001, which had undermined efforts to develop denser rental housing (2001, pp. 11, 12). In 2006 the OECD neatly summarised what it viewed as the incoherence and "policy flip-flops" of the period since the first Bacon report:

> … A package of tax measures was introduced in 1998 in an attempt to deflate what appeared to be a housing bubble. Stamp duty on new houses that were not owner-occupied was increased, while stamp duty on second-hand houses was reduced; capital gains on disposals of qualified residential land was reduced; and tax breaks for rental income were removed. These were successful in stopping house price inflation – possibly too successful, as they were reversed in the 2002 Budget. Meanwhile, another package of measures was introduced in 2000 in order to discourage investors from buying rental property. This included a 9 per cent stamp duty on the purchase of property for rent. That also worked but had the predictable side effect of driving up rents, so it was abolished just a year later. Stamp duty was changed again in the 2005 Budget, this time lowering the tax for first-time buyers (2006, pp. 19, 121).

The IMF was noticeably less diplomatic in its criticism, observing that prices had decelerated sharply between 1998 and 2002, but rebounded after the Bacon measures were reversed. Staff explicitly blamed this reversal for the resurgence in price increases, after five months of consecutive falls from September 2001 and an apparent soft-landing in the housing market (2002a: Public Information Notice, 2). The Commission concurred that the rebound in completions was attributable to the incentivising measures introduced in the 2002 budget (2002, p. 59). Unusually, and in an indication of how critical the Fund was of the series of policy reversals, the 2004 *Selected Issues* paper quoted Charlie McCreevy's speech introducing the 1998 measures, presumably with a view to highlighting the inconsistency:

> ... the package of measures announced last Thursday will help restore balance to the housing market. It will also help to remove another significant factor that has been fuelling price escalation, namely the expectation or – depending on one's perspective – fear of further price increases (IMF, 2004b, pp. 32-33).

III SUPPLY AND THE RENTAL MARKET

The discourse around supply evolved rapidly through the period. The OECD attributed the moderation of price increases at the start of the decade to the increase of supply to 50,000 domestic units per annum, in part on the back of government action in the wake of the first Bacon report. However, the organisation saw a shortfall of supply as being a continued problem, based on Bacon's estimate that a supply of 54,000 units per annum was required to stabilise the market. In 2002 the IMF suggested that most analysts agreed that the annual flow of supply had met demand levels (2002a, pp. 14, 22). However, by 2006 the OECD observed that the rate of annual unit completion had rapidly increased to 79,000 units, well above the identified sustainable rate. Furthermore, the report emphasised that housing construction now accounted for some 14 per cent of GNP, and considered the key question as being whether the inevitable slowdown came gradually or suddenly. The authors suggested that the perceived scarcity of accommodation was partly down to resource misallocation, insofar as the increased stock of dwellings was absorbed by vacant or secondary houses. The report cited the finding by Fitzgerald *et al.* (2003) that the number of vacant dwellings had risen by 80,000 units nationally between 2000 and 2003, representing half of all the new units built in the period (OECD, 2006, pp. 36-8, 126-31). This factor was also examined by the IMF, which pointed to the fact that some 40 per cent of new houses were being purchased as second or investment properties. Both the completion rate per capita and the proportion of GDP invested in housing were found to have exceeded those of any other industrialised country between 1996 and 2001 (IMF, 2004a, 18-9, 22-8).

The relative narrowness of the rental market was considered problematic, with the OECD pointing to the 80 per cent owner-occupancy rate, compared to rates of 66 per cent in the United Kingdom, 64 per cent in the United States, and just 38 per cent in Germany (1999, pp. 104-105). In 2004 the IMF expressed concern at the fact that rental yields had actually fallen in tandem with the acceleration in construction and increase in prices. While the organisation did not labour the point, the natural implication was that the demand for houses significantly outweighed the demand to live in them. The international agencies were also mindful of the influence of quite a large cohort of fledgling property investors, with the Fund citing the findings of the Gunne/EBS 2003 report, suggesting that approximately 60 per cent of investors had been in the buy-to-let market for three years or less, and that 50 per cent of landlords had only one property. The Fund also pointed to the opinion of some analysts that investors had moved money out of equities and into property after the ICT downturn, citing the fact that some 90 per cent of residential property owners "… considered housing a preferred choice of investment vehicle, and about 70 percent of them said they were planning to increase their residential portfolio over the next five years" (IMF, 2004b, pp. 18-35). The OECD profiled many of these investors as baby-boomers investing in the buy-to-let market in order to provide for retirement (2006, p. 119). The Fund warned that the buy-to-let sector could be affecting prices significantly, particularly if new and inexperienced investors were entering the market based on unrealistic expectations of future price increases despite falling rents (2004b, pp. 18-32).

IV VALUATION AND INTERNATIONAL PRECEDENTS

The most fundamental concern for the international agencies in the period was whether or not Irish property was actually overvalued, and thus whether prices were likely to fall. In the early years of the decade, the OECD maintained that there was no speculative bubble, but did express concern over rapidly rising prices and the potential for overshooting in the future (2001, pp. 8, 34-5). Despite the resurgence of rapid increases in 2002, the organisation reaffirmed its view that there was "… no strong evidence to suggest that the current situation in the housing market should be characterised as a bubble" (2003a, pp. 24-26). The organisation emphasised that the dynamics of the housing market are not symmetric, in that prices rise quickly during a boom, but that often people will take properties off the market rather than sell at a loss. Hence it predicted that a small fall followed by several years of a flat market was more likely than a steeper fall. The report did acknowledge that if for any reason the fundamentals underpinning prices were to change then they could fall substantially, for example a drop in expected income growth rates. It also acknowledged that construction rates would have to return to sustainable levels and that this process was seldom smooth (2006, p. 127).

Notwithstanding its contention that fundamental drivers had justified most of the increases, the OECD conducted its first extensive assessment of whether prices were excessive in 2006. It reported that most of its approaches showed that prices had overshot their equilibrium, at least to some extent.[2] Somewhat evasively, the authors concluded that 80-90 per cent of the increases from 1995 had been justified by the fundamentals.[3] The remainder was memorably described as having been "speculative froth". In making international comparisons, the authors noted that house prices in Dublin were significantly more expensive than in "comparable" cities such as Paris and London. However, they found that the rental for city-centre apartments was comparatively normal. In terms of the relationships between prices-to-rents and to prices-to-disposable income the report found that in Ireland's case both ratios had far exceeded those seen in previous international cycles (OECD, 2006, pp. 123-125).

Using the "forward-looking present value" approach, the survey argued that predictions of permanently lower interest rates and strong growth rates in disposable income into the future justified higher prices on the basis of future fundamentals. The precariousness of basing current prices on forecasts aside, the authors still estimated an overvaluation of 20 per cent assuming "normal" interest rates. The report was quite dismissive of the usefulness of affordability indicators, though concluded that the average mortgage repayments burden actually represented a lower proportion of disposable income in 2005 than it had in 1991, when interest rates were much higher. Thus, assuming that interest rates remained low, affordability measures were not considered to suggest a significant overvaluation (2006, pp. 125-126). Notably, the authors did not account for the fact that the average mortgage length had increased significantly in the intervening period, thus allowing for a higher level of overall indebtedness with the same monthly repayment burden stretched over a longer schedule.

Perhaps the most significant analysis made by the OECD throughout the period was its one-page examination of the recent history of boom-bust cycles in international property markets, tellingly entitled: "Has residential

[2] These econometric calculations came from an OECD working paper published separately by David Rae and Paul van den Noord in the same year.

[3] Marc Coleman subsequently contended that staff within the Central Bank of Ireland encouraged the OECD to downplay its finding that property was overvalued by 15 per cent, with officials suggesting that "… numerical estimates of overvaluation should be presented only with extreme caution to avoid destabilising the market". (Marc Coleman (2006), 'Housing Market Overvalued but Stable – OECD' in *The Irish Times,* 3rd March 2006.)

construction ever had a soft landing?". The report found that between 1960 and 2004 there had been 49 residential construction booms in 23 countries for which data were available. The ensuing downturns were usually very rapid, with an average of 40 per cent of the trough to peak increase lost in the first year, and another 40 per cent lost in the second. In a remarkable paragraph that seems to fly completely in the face of the organisation's predictions of a likely soft landing, the report asked:

> How common are soft landings? If a soft landing is defined as a relatively small reduction in the investment rate, they are not especially common. There have only been four cases where the decline in per capita investment has been smaller than one-third of the increase that occurred during the boom years (these are the Netherlands after 1978, Belgium after 1990, the United Kingdom after 1998 and Finland after 2000). Soft landings are more common if they are defined as gradual declines, i.e. where it takes at least three years to hit the trough. There have been around 20 examples of these. But all of these were comparatively deep declines. If a soft landing is defined as something that is both mild and gradual, there has not been a single case out of the 49 boom-bust cycles (2006, p. 128).

The IMF took a distinctly harder line than the OECD, explicitly arguing that demand may have been driven in part by expectations of further price inflation from the outset of the period. The Fund observed that the usual method for assessing house prices is "… to relate historical price developments to a basket of observed fundamentals", and that beyond the influence of these fundamentals, "… sustained rapid price increases over several years may lead to self-fulfilling expectations-driven demand followed by price overshooting". By way of evidence, the 2000 report used historical examples from the United Kingdom, Sweden, and Norway in the late 1980s. While the authors acknowledged that such comparisons were by no means conclusive, they suggested that they were informative. They pointed to the fact that cumulative real estate prices in Ireland had exceeded those in the comparison countries. While they recognised that several Euro Area countries and US regions had sustained property booms in the 1990s without a downturn (Finland, Netherlands, Norway, Colorado, Oregon and Utah), they argued that none of these had seen increases on par with Ireland's: "... in fact, no industrial country in the last 20 years has experienced price increases on the scale of Ireland without suffering a subsequent fall" (2000a, pp. 4, 13, 16). The fact that this evidence was published at the outset of the period seems striking.

The *Selected Issues* paper of the same year went even further, giving perhaps the most comprehensive analysis of prices from the period. The report noted that increasing construction costs had only represented a fifth of the inflation of property prices from 1994, with the rest coming from rising land prices. While the authors acknowledged the per-capita housing stock at the outset of the boom had only been two-thirds that of the rest of Europe, they argued that several measures showed that prices in Ireland had already reached unsustainably high levels. For example, the ratio of house prices to disposable income had reached its highest level since the 1970s, and was substantially higher than that of the UK, both then, and during the UK's property boom of the late 1980s. Controlling for quality, house prices in Ireland were found to be some of the highest in Europe, with Dublin prices higher than those in Paris and Berlin, if substantially below those of London (2000b, pp. 9-12).

The authors also cited the finding by Bacon (2000) that affordability for first-time buyers had deteriorated to levels comparable to previous lows of the late 1980s at this juncture. Despite these affordability concerns for new entrants to the market, the average mortgage-repayment burden across all households was observed to have been low by international standards, at just over 20 per cent of disposable income. Nonetheless, the report stressed that modest overall levels of indebtedness did not imply appropriate house-price levels, since price increases left mortgage debt unchanged while increasing the net worth of existing homeowners. The authors also observed that average loan-to-value ratios had remained constant at 60 per cent, and that buyers now had to bring much higher deposits (2000b, pp. 12, 15). While not teased out explicitly, the implication seems to have been that prices were rising but not on the back of loosening credit conditions at the outset of the decade.

The Fund argued that coming to a firm conclusion as to whether or not prices were inappropriately high was difficult, given the dramatic change in the economic environment. While prices had outpaced growth in personal income, like the OECD the authors did accept the logic of further increases based on expected future personal income, given Ireland's high growth prospects. Furthermore, Economic and Monetary Union (EMU) entry was considered to have signified a fundamental change in the stability of interest rates. The authors also accepted that given the likelihood that the government would continue to promote inward-migration, potential buyers had a strong case for anticipating continued high demand, and thus moving forward their purchases. Nonetheless, the report maintained that even given strong fundamentals, sustained price growth itself becomes a concern. It identified the major challenge as being identifying the point at which the market had entered a cycle of self-fulfilling expectations of price increases stimulating demand, in turn fuelling further price increases (2000b, pp. 17, 19).

The paper made the astute point that by its nature residential property is more susceptible to boom-bust cycles than other asset markets. It emphasised that in an environment where home-ownership is the norm, the issue for potential entrants is not whether to buy but when. In the context of rising prices, potential buyers will move their purchase dates forward, increasing immediate demand. If this effect becomes widespread, the price increase expectations will become self-fulfilling and self-reinforcing insofar as if they affect the actions of other potential buyers. Furthermore, while investors will sell other financial assets if they consider the price to be in excess of the fundamentals, in the case of housing this rarely happens unless it is to buy another house. Given Ireland's undeveloped rental market, homeowners were considered even more unlikely to sell and rent with the intention of buying when prices had fallen. In essence, the poor rental market incentivised home-ownership, and fed into fears of being priced out of buying. The report also observed that the low levels of personal indebtedness actually enabled expectations-led demand by giving buyers scope to buy sooner rather than later (2000b, p. 18).

The Fund suggested that the US property booms provided good examples for Ireland, since they illustrated a variety of regional market experiences within a common currency area. Ireland was considered to have witnessed one of the highest rates of house-price inflation of almost forty episodes witnessed internationally in the preceding twenty years. The following extract should have resonated particularly with Irish policymakers:

> Comparing house price inflation during the boom with subsequent growth, it is clear that most high inflation episodes have been followed by price declines. There is a pronounced tendency for these declines to be larger the higher the growth during the boom. This is particularly true when ranking episodes by annual growth rates. Countries and regions experiencing booms comparable to Ireland's have all suffered sizable price declines; the most extreme case was Finland, where prices declined by 46 per cent in four years, but even excluding Finland, episodes characterised by real house price inflation of 14 per cent or more suffered on average a loss in the next four years of over 40 per cent of the cumulative price increase during the boom (2000b, p. 19).

Though the Fund acknowledged that several Eurozone and US property booms of the 1990s were still underway or had been followed by soft landings, it suggested that the rate of increase in Ireland was much more akin to that of the booms of the 1980s, nearly all of which had ended badly. The authors likened the Irish experience to those of Hong Kong and Singapore, where prices had more than trebled over the course of a decade and were followed by very significant falls, suggesting that this "… may not necessarily be a source of comfort regarding the prospects for a soft landing in the Irish housing market". Given sharp increases in prices over and above income growth, the authors concluded that "… if property prices in Ireland were to level off without a significant fall, it would be an event unprecedented in the last 20 years. Of the nearly forty episodes of high property price inflation examined here, there has not been a single experience of price inflation on the scale of Ireland's which did not end in prices falling" (2000b, pp. 23-27).

The Fund acknowledged that there was no inevitability about a fall, since Ireland's prospects may have shifted in ways not captured by the traditionally observed fundamentals. However, it countered that the key question was whether price inflation could be sustained over years without a speculative element emerging. Immigration, low interest rates, and low rates of personal indebtedness were considered to be double-edged swords, since they justified households in spending more than they otherwise would have. The authors presciently warned that the risk might arise not from a downturn at the time, but from the possibility that rapid price increases would continue and lead to a sharper decline in the future (2000b, p. 27).

The 2001 report attributed the slowdown in house price increases at the start of year to increased supply, a significant increase in the stamp duty rates on second homes, and a tightening of lending conditions by credit institutions. However, staff emphasised that the stamp duty measures had already been reversed. They were also clearly mindful of the fact that interest rates were still comparatively low (IMF, 2001, pp. 10-12). The following year the agency suggested that there was little risk of a price bubble re-emerging, conspicuously less hesitant in using the term after the danger had apparently passed (2002a, pp. 14, 22).

The 2003 report was noticeably guarded in making a definitive judgement on the basis that equilibrium prices could not be estimated reliably. Crucially, however, the mission did conclude that the risk of a significant overvaluation was substantial. In what could be perceived as an implied dig at other commentators, staff argued that while the fundamentals could be used to justify the rise in prices "qualitatively", coming to a conclusion quantitatively was considerably more difficult. Interestingly, the report found that while the ratio of prices-to-rents had reached a record level, the price-to-income ratio had only exceeded its long-run average by approximately 15 per cent. Staff calculations suggested that prices in 2002 exceeded their long-run equilibrium levels by 16.5 per cent, allowing for demographic and income changes.

However, if the long-run equilibrium level was calculated excluding the boom period, incorporating the years from 1976 to 1997, the implied deviation was found to be over 50 per cent. While the authors were keen to show both sides of the argument, they were clearly mindful of the risk and prepared to highlight it (2003, p. 28).

By 2004 the Fund and the Irish authorities were in broad agreement that house price increases continued to run at unsustainably high rates, and the longer the boom ran unabated the more likely the risk of a sharp correction. Predictably, the staff report did not specify which of the authorities it was referring to. The mission noted that while prices were rising across many countries, the scale and duration of the Irish boom was unique. Notably, and conceivably with a level of frustration, the mission reminded the authorities that they had provided evidence suggesting that prices had exceeded demand fundamentals in the 2003 consultation (IMF, 2004a, pp. 3-12). Particularly striking was the fact that rents had dropped over the previous two years, while prices had continued to rise. The price-to-earnings ratio of 29 in early 2004 was estimated to be over 100 per cent above its historical average (2004b, pp. 16-19, 22-8).

The Irish authorities were perceptibly defensive, countering that some commentators were justifying price levels by pointing to supply-side issues, such as the price of development land and high building costs. In a perfect example of a qualitative justification for prices, the authorities also pointed to the Irish predilection for home-ownership. Unsurprisingly, the mission was unconvinced, particularly in view of the now enormous levels of supply. While staff accepted the view that property valuation could reasonably be based on expected future increases in disposable income, they argued that price increases of 12-15 per cent far outstripped medium-term growth prospects of 4-5 per cent (2004a, pp. 18-19). The following year the Fund noted that the price-to-earnings ratio was double its historical average, and remarkably one-and a-half-times its 2002 level. The authorities half-heartedly countered that Ireland had a very low number of dwellings per capita by international standards (2005, p. 11).

The 2006 report was surprisingly frank in detailing the divergence of opinions made apparent during the discussions between the Fund and the Irish authorities. The IMF staff considered prices to be overvalued, Central Bank staff considered them to be becoming somewhat overvalued, and Department of Finance officials deemed them to be in line with fundamentals. All parties were of the view that given the small wealth effects of housing on consumption, a fall in construction activity rather than in property prices was the key risk. Interestingly the Fund also recognised that such a fall could occur without a downturn in house prices (2006, pp. 4, 8-9).

V MACROECONOMIC IMPLICATIONS

The agencies were mindful of the growing importance of property prices and construction activity to the wider economy, but clearly underestimated how fundamental and precarious the dependency had become. The OECD warned the government to run balanced budgets or surpluses on the basis of uncertainty in the property market, but even in 2006 was explicitly of the view that a soft landing, with a levelling out or slight decline in prices and a gradual fall-back in construction activity, was the most likely scenario. The apparent contradiction with the findings of its examination of the recent history of property booms in the same report is striking. Furthermore, the organisation maintained that even if a sharp contraction did happen it was unlikely to lead to recession. In its negative scenario, where "… house prices fall by a significant amount over the next few years either because the economy gets hit by a negative shock or because houses are more over-priced than commonly thought", the organisation was primarily concerned with the impact that this would have on domestic consumption levels, rather than the exposure of the construction or banking sectors. Tellingly, the negative scenario, including the effects of consequential fiscal tightening, was envisaged to impact on GNP by up to 3 per cent (2006, pp. 16, 36-8, 43).

The IMF was much more wary from the outset, and considered the property boom to be a risk both insofar as it contributed to inflation, and given its potentially destabilising influence "in its own right" (2000a, pp. 4, 13, 16). The 2004 mission was keen to emphasise the risk to the economy from a potential downturn in both the property market and construction sector. Interestingly, the Irish authorities expressed their concern to the mission that residential construction now represented some 12 per cent of GNP, compared to 5 per cent in the US and 3 per cent in the UK. While the authorities were particularly mindful of the potential employment losses (with construction accounting for 10 per cent of total employment), they were encouraged by what they perceived as the flexibility of the labour market. Interestingly, the mission was openly sceptical, and reported itself to have been more "agnostic" about the likelihood of a smooth transition of labour (2004a, pp. 4, 7, 12, 20-1, 26).

By 2006 both the mission and the executive board of the IMF were of the view that growth had become overly reliant on building investment, sharp increases in property prices, and on rapidly increasing credit (2006: Public Information Notice, 2). Again however, it is worth noting that the acknowledgement of the reliance on these factors for growth did not imply an understanding of the precariousness of the economy, even in the face of lost competitiveness. By this juncture the Commission predicted a tapering-off of construction towards sustainable levels for the coming years, though in the event of an external shock a sharp contraction was considered possible. Perversely, the fact that the impressive supply-increase had not put a brake on prices was considered to be indicative of solid demand (Čech, 2006, pp. 1-3).

VI CONCLUSION

In summary, the analysis on residential property prices by the IMF seems to have been very robust from the start of the decade. While the OECD only published a similar assessment at the end of the period, it too was commendably empirical and analytical in its approach. The studies of historical comparisons, by the IMF in 2000a and 2000b and the OECD in 2006, were particularly strong. In retrospect, it is remarkable that these assessments garnered so little public attention, particularly since they were so similar to Morgan Kelly's analysis (2007).[4] What is even more inexplicable is that after doing such an analysis, the OECD itself did not change its forecast. After concluding that none of the forty-nine examples used in its historical study had experienced a soft-landing, if one was to interpret such as a mild and gradual decline, the organisation remained adamant that a soft-landing was the most likely possibility for Ireland, even if it did refuse to rule out the possibility of a sharper contraction. While one could argue that the organisation did not necessarily intend for its use of the term "soft landing" to be imbued with the same meaning, the contradiction seems astonishing.

The IMF was notably less forthcoming in predicting how the boom would end, in stark contrast to its admirable candour in arguing that houses were overpriced from 2003. Possible explanations are either that it had no strong opinion, or that predicting a sharp correction would be both possibly self-precipitating and understandably unpopular with the Irish authorities who were required to sanction the publishing of the report. While it is impossible to know on the basis of the reports themselves, the latter does seem likely. On this basis it would seem very desirable for the international agencies to have produced a public report in tandem with a private appendix for the government, dealing with the sensitive concerns more forthrightly than would have been allowed for in the body text. It is also worth considering the relationship between the Irish state and these institutions. In each case Ireland was an elective member, and not subject to major sanctions beyond an

[4] Much of the media interest in Kelly's analysis came in the wake of the 2008 bank guarantee, and it garnered surprisingly little attention in the newspapers at the time. Perhaps unheeded warnings issued by an individual made for a more compelling narrative than concerns raised by large organisations.

EU fine. Analysts in these organisations likely felt that there was a limit to which they could criticise government policy, particularly if superficially the economy seemed to be thriving.

By contrast to their far less accurate evaluations of the financial sector, we should not underestimate the valuable analysis that was provided by these organisations on the property boom during the period, particularly their use of the historical evidence. The finding by the IMF in 2000a and 2000b that of forty episodes in the previous twenty years, not one country had experienced a property boom on the scale of Ireland's without a subsequent fall was remarkable (2000a, p. 16). The OECD's 2006 study provided further corroboration (2006, p. 128). The fact that both analyses found a significant correlation between the scale of the rises in a boom and the subsequent fall during the correction was crucial, particularly given the unique scale of the Irish boom and the finding that those falls were on average so precipitous. Debates over whether prices were justified by fundamentals seem to have missed the point in view of the apparent ubiquity of boom/bust cycles in modern economic history. A fall seems to have been highly likely on the basis of the boom alone.

In many cases the advice given seems to have been very sound. The beseeching of the Irish authorities to reform the bias towards home-ownership in the tax system was clearly a constant. The reversal of the post-Bacon 1998 measures, introduced to keep prices under control, clearly drew particular ire. It was a sign of how precarious IMF staff considered the housing boom to have been that they uncharacteristically advocated that the government actively intervene to downplay public expectations of further price increases in 2004.

There was a discernible lack of openness on the part of the Irish authorities to consider alternative interpretations of the boom proposed by IMF staff in the Article IV consultations. The arguments proposed by the Fund were nearly always empirically substantiated, while the counter-arguments made by the authorities often seemed feeble or dismissive by comparison. This was implicitly recognised in 2003, when the Fund suggested that it was much easier to use fundamentals to justify prices *qualitatively* than *quantitatively*, with both words italicised (2003, p. 28). While qualitative trends were often used to justify high prices, there was little evidence in the IMF reports of the Irish authorities making serious efforts to engage with the arithmetic of whether the specific price levels made sense. Breen provides an example of such a justification, from the then Tánaiste Mary Harney in 2006, using demographic and economic trends and third-party advice as proxies for explicit analysis to justify the government position:

> Recent preliminary census figures for population growth would tend to support the view that the demand for housing is in line with our young

population, income and employment growth, and that the consensus scenario for the housing market is a soft landing (2012, pp. 432, 437).

A vital consideration raised by the reports on the IMF consultation in 2006 was the acknowledgement by the authorities that a property tax was desirable, but their counter-argument that it would have been politically unpopular (2006, p. 13). In retrospect it is extraordinary that such statements were made so unguardedly to a third party and allowed to be published. The choice for the government thus lay in balancing the conflict between its duty to minimise the risk to the economy, and the presumably strong motivation to secure political popularity. In this context, it is very difficult to escape the conclusion than economic stability was potentially jeopardised for political gain. It is also worth considering the contention made by the authorities in 2004 that the political opposition to a property tax or removal of stamp-duty relief would likely have been "insurmountable" given the electorate's drive for home-ownership (2004a, p. 20). This raises the interesting question of whether the electorate had installed a government whose support was contingent on making the politically palatable choices, but that it did not trust to make unpopular decisions on the basis of what it determined to be the national good. In this respect, one could argue that there was a sense of determinism about the outcome of the boom, given the apparently highly restrictive mandate given to successive Ahern administrations.

It is particularly remarkable that so little was written about commercial property prices or the construction sector by any of the organisations. While both the OECD and the IMF were clearly cognisant of the rapid increases in the prices of commercial property, neither conducted analysis on it in the same way they did on the residential sector. More analysis on the increases in prices of retail and office buildings would have been welcome, particularly if international comparisons similar to those done with housing could have been made. This deficiency is particularly pertinent given how outlandish some flagship commercial developments became, and how much more readily developers defaulted on their debts than mortgage holders, leaving the liabilities squarely with the banks.

The collapse of the construction sector was perhaps the single most damaging blow to the Irish economy at the onset of the crisis. Although the international organisations did express concern about the extent of the reliance of the economy on the sector, clearly none anticipated the precipitousness of its fall. Again an historical examination of how construction activity had fared in the face of downturns in comparison countries would have been highly instructive. As a consequence of their failure to anticipate a near-total collapse of construction activity, the agencies correspondingly failed to consider the possible extent of the ramifications for employment, economic output, the banks, and the fiscal position that would emanate from such an event. This rendered much of their policy advice pertaining to these fundamental issues wildly inadequate. Rather than helping to "plug the gap" (OECD 2006, p. 20), the construction sector had temporarily masked a systemic crisis. The fact that the international organisations missed this trend so completely reflects a critical inadequacy in the quality of their surveillance in these years.

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