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School of Applied Social Studies,
University College Cork,
Ireland

From Bust to Boom to Bust Again: Trends in Irish Public Revenue and Expenditure from 1997 to 2012.

Helen Norris, BSoc Sc, MA in Management

Abstract

The focus of this article is Irish public revenue and expenditure trends over the past two decades. More specifically, the implications of recent trends in Irish public revenue and expenditure during the early years of the 'Celtic Tiger' boom in the late 1990s, during the latter years of the of the boom in the early 2000s, and during the radical economic crisis from 2007 onwards are examined. There is a focus in particular on 1997, 2003 and 2009 as exemplars of the above periods, as the sheer volume of revenue and expenditure statistics recorded means that it is not practical to examine every year. The primary aim of the research is to trace key trends in public spending and revenue during this period and, through comparison with trends in Iceland during the same period, highlight the structural weaknesses intensified by public policies of the early 2000s. Finally, an examination of how these trends contributed to the fiscal crisis, which led ultimately to the provision of an emergency loan by the International Monetary Fund and the EU in 2010, is undertaken.

Keywords: Public expenditure, Celtic Tiger, economic crisis, austerity

Introduction

Literature and key commentators alike have provided numerous and often opposing models to describe the state's role within society. However, it has been determined that a pragmatic model best describes the Irish state and its role in the delivery, promotion and eventual demise of the Celtic Tiger period; leading to the economic crash that endures to this day. Notwithstanding the state's prominent and recently adopted neo-liberalist agenda, Ireland remained throughout the boom period a 'small open economy' highly dependent on foreign direct investment and the global economy, most aligned to pragmatic thinking. The article also investigates issues of state legitimacy and the primary contributing factors for the sharp loss in public confidence that arose during the economic crisis. Key factors contributing to the state's economic failure are presented, namely the 2008 housing, construction and banking collapse, with commentary on the inherent structural weaknesses of these sectors.

Neo-Liberalism Irish Style and State Legitimation

The state is best described a set of institutions that govern a given society and hence, a state's 'raison d'être' is, in a modern sense, is the overseeing of public expenditure and taxation provision as a means of fulfilling core functions such as the redistribution of wealth, social control, defence, economic regulation and, ultimately, ensuring its own legitimacy. In Ireland, the state is as a dominant player in economic, administrative and social terms. However, this may have changes over the course of the previous decade. For instance, it is argued that the state is now a marginal figure within wider global structures. This is mainly due to its shared governance with, and reliance on, the European Union (EU), International Monetary Fund (IMF) and the European Central Bank (ECB), as these institutions now set the course for Ireland's economic and fiscal policies.

The development and subsequent collapse of the Irish economy in late 2008 has confirmed the Irish model to have a strong neo-liberal orientation, due to a high level of exposure to global trends. As Kirby (2010) has observed 'the Ireland of the Celtic Tiger [was a] highly market-friendly state with its subordinate relationship to global market forces, and the egalitarian social impact of this state-market relationship, constituted an Irish form of neo-liberalism' (Kirby, P., 2010: 147). Since the foundation of the state, the Irish government has played a key role in creating desirable conditions for private interests to flourish. Pragmatic in nature, the state readily altered its ideological stance in order to move with the wider political environment. Year on year taxes on capital and wealth were continually cut and social expenditure reduced. 'This was presented as if it would benefit the population due to the increase it would bring in terms of foreign direct investment; however evidence suggests that the majority did not in fact benefit' (Allen, K., 2000: 83). Recently such policies have been found to result in deepening inequality and social exclusion.

A distinctive feature of the Irish situation has been the importance attributed to foreign investment as the driver of Ireland's economic policy. The prime example of this policy's execution was the lowering of the Corporation Tax rate (taxation on a company's profits) to twelve and a half percent. Foreign capital and foreign direct investment increasingly became a means of generating employment (Kirby, P., 2010) and economic activity. This was ultimately as a result of the Corporation Tax policy. According to Kirby (2010) this is 'a model in which public authority favours market players […] and have actively used state power over the course of the Celtic Tiger boom to give ever greater freedom of action to these players, with disastrous consequences for sectors like construction and banking' (ibid: 164).

According to Habermas (1975) has observed, 'if governmental crisis management fails, it lags behind programmatic demands that it has placed on itself. The penalty for this failure is withdrawal of legitimation' (1975: 68). Advanced capitalist societies often fall into legitimation difficulties, even if state interference succeeds in increasing the productivity of labour and distributing gains. Growth takes place due to such interferences, which may further the wealth generating power of the state, but is not necessarily in interests or expectations of the population. During the onset of the Irish economic crash, a legitimation crisis took hold as the state created a highly profitable industrialised economy, without redistributing much of the benefits in the form of social welfare. Forgoing public expenditure allocated to, for instance, the improvement of social welfare services in order to save the country's failing banks, was key in the withdrawal of legitimation in the Irish case.

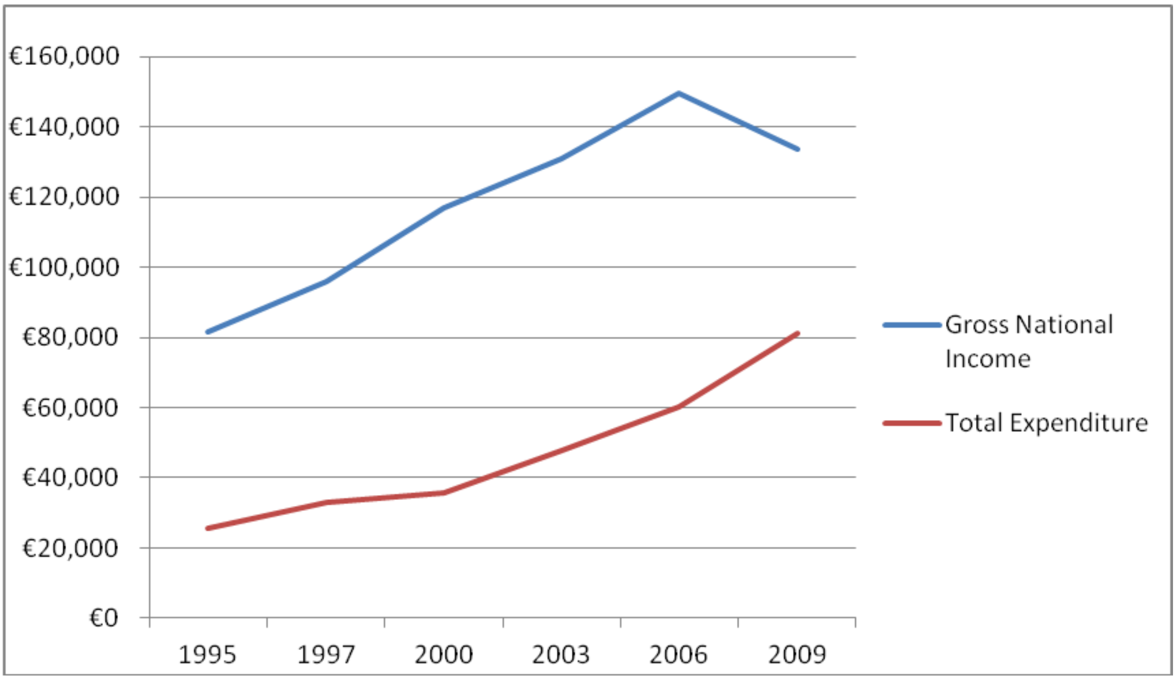
The Origins and Emergence of the 'Celtic Tiger'

In the latter years of the 1990s, the Irish economy entered its 'Celtic Tiger' phase. A high rate of foreign direct investment and low Corporation Tax rate coupled with a new Social

Partnership approach to industrial relations transformed the economy. As a result Ireland became the fastest growing economy in the OECD (Lee, J., 1989). According to Whelan (2011) 'this exceptional economic growth allowed [the] Irish government to achieve a holy grail that was the envy of politicians around the world' (2011: 5). Lowered tax rates and raised spending were possible year after year due to unprecedented. Economic growth averaged at over six percent per year between 1987 and 2007 (ibid, 2011). However, this would have never been possible if it were not for the Government's investment in education, the English-speaking workforce, infrastructure and EU membership.

By 2000 Ireland had become one of the world's wealthiest nations; unemployment fell to four percent, a level never seen before within the Irish economy (Allen, K., 2000). Radically increased levels of state revenue eventually surpassed those of other EU member states, trends that were envied by economies all over the globe. Ireland was heralded as a shining example of successful adaption to globalisation. During this period Income Taxes were cut and replaced with property related taxes and public spending grew, a factor motivated by the political desire to remain in popular standing with the electorate. Rising employment was commonplace primarily due to increased competitiveness and mass immigration, which compensated for labour shortages. The Republic was viewed as a 'prime tax haven' with the Corporation Tax rate residing at the lowest in Europe which was subject to considerable aversion from other EU member states. This, combined with substantial relief on Inheritance and Capital Gains Tax and the absence of meaningful Property Taxes, meant that pressures on PAYE workers was inevitable in order to recover losses in government revenue. (Allen, K., 2000)

Figure 2.3: Trends in Irish Public Revenue and Expenditure (€millions) 1995-2009



Historical National Income and Expenditure Tables 1995-2010

The Economic Crash

The economy collapsed in the late 2007 following a property market and banking collapse. This was characterised by a dramatic fall in tax returns, followed by cuts in public expenditure. Nonetheless, according to Whelan (2011: 5-6) 'evidence [suggested] that Ireland was heading for a rough landing even in the absence of an international recession'. While construction created mass employment, it was presided upon the availability of cheap money, ultimately provided by the banking sector. For the state, revenues were mostly raised from Income Tax, Stamp Duty and Corporation Tax. Fifteen percent of the national income came from house building and six percent from other forms of construction at the peak in 2006. This is compared to approximately six percent during the 1990s. As a result, these named cornerstones were seen to have played a considerable role in the economy's eventual demise.

After years of a very low debt-GDP ratio, the country appeared to be protected from any threat of an economic downturn. However, Ireland's heavily reliance on the health of the property sector and the revenue it produced eventually surfaced. The restructuring of the tax base during the latter years of the boom encouraged large tax revenue collection from construction and related industries. ‘When construction activity collapsed, this substantial source of government revenue disappeared almost overnight’ (Whelan, K., 2011: 7). The collapse in construction activity coupled with a jump in unemployment amounted to huge losses in tax revenues and increased social welfare payments. Real GDP declined by approximately four percent in 2008 and a further eight percent in 2009. Ireland was heading for deficits as large as twenty percent of GDP (Whelan, K., 2011), even before the effect of the bank bailout on the public finances. ‘The scale of these potential deficits meant, that despite the low starting level of debt, the Irish government realised there was no room for discretionary fiscal stimulus to ease the effects of the severe downturn’ (ibid, 2011: 8).

The Impact of the Economic Crash

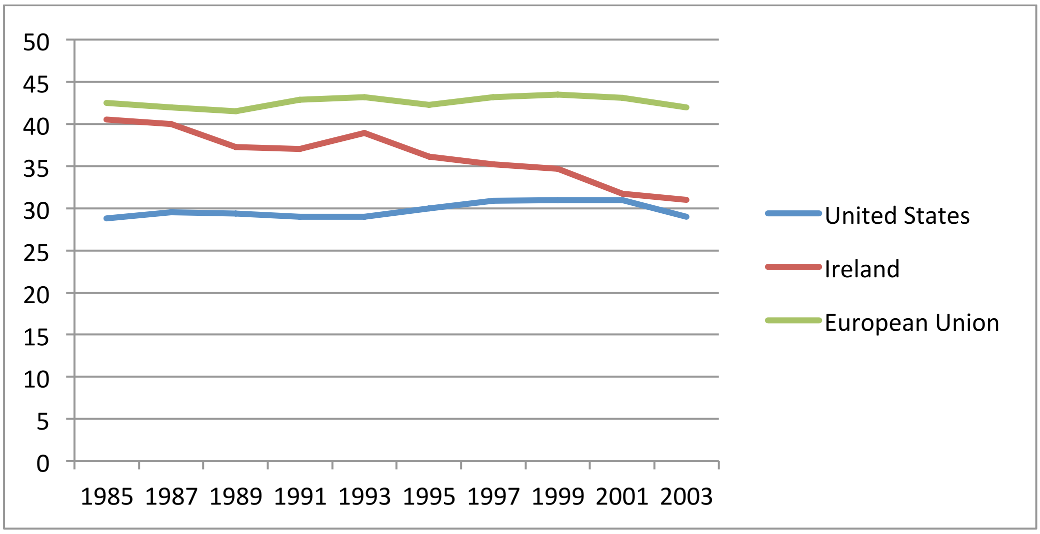
During the boom Ireland had one of the highest GDP and GNP rates in the EU; GNP expanded by seventy percent in ten years from 1987 onwards, whereas GNP expanded by twenty seven percent (Considine, M. & Dukelow, F., 2009. Thus, during the boom GDP rates were grossly inflated as much of this wealth did not stay in the country. Thus, when analysing economic growth and performance GNP is a much superior measure. The exceptional rates of GDP and GNP growth were attributed to the expansion of FDI and the attraction of multi-national corporations, enhanced through grants, incentives and tax reform. However, even though the above policies contributed largely to the boom, they were also a significant causal factor of the country’s downfall. Hence, the growth rate, using GNP, for the period between 2005 and 2010 stood at approximately minus one percent per year demonstrating the contraction of economic growth (CSO, 2010).

Inequalities in social service provision such existed before the economic crisis of 2008 as the state did not invest sufficient revenue to address them. This led to limited commitments to social services and a growing reliance on private sector provision, the mainstay of those in a position to pay. Thus social services are increasingly being privatised, while the losses of the financial sectore have been socialised. Thus, with the tightening economic outlook overshadowed by the punitive terms of the bailout programme these sectors remains driven by rigorous budgetary constraints; with continued attempts to reduce spending to enable tax cuts (Allen, K., 2010).

The Irish Taxation System

One of the most striking features of Irish tax policy over the past 50 years has been the low rate of tax paid on profits by multi-national corporations. As Fortin (2001: 4) has commented, 'Irish policy over the past 40 years has been very active in promoting economic growth through the creation of an incentivised low-taxation regime'. The extensive boom period which preceded 2008 gave the state and its political actors the freedom from the historically embedded fiscal constraints that characterized the Irish economy. This was as a result of the growth in government revenue, which allowed both tax decreases and increases in expenditure. A flexible labour market and a low taxation base was key in the promotion of Ireland as an ideal business environment, but was not without its critics – 'the model that from a distance seemed so successful, turned out to be much more ambiguous on closer examination' (Kirby, P., 2010: 3). The reliance of Irish government on volatile demonstrates how the Irish taxation system responded to the needs of corporate capital rather than to the needs of its own citizens. Thus, the Irish Model needs to be interpreted in a manner that takes into account the negative features that were central characteristics of a development model dependent on FDI and a low tax-base; implicating the deep collapse of the economy.

Figure 3.1: Government Tax & Non Tax Revenue Ireland, US & EU ($Billions)



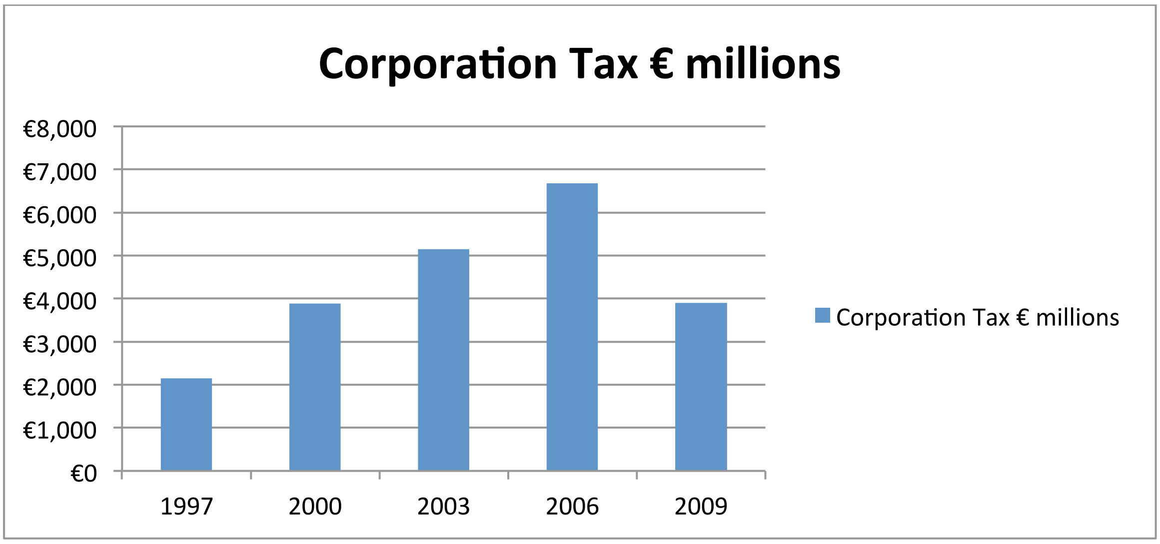
Source: CSO, National Income and Expenditure Accounts and European Economy.

Revenues Generated and Taxation

Corporation Tax: The Cornerstone of Irish Taxation Policy

According to Barry (2003), 'increased FDI inflows were one of the factors driving the boom. The country is the most FDI-reliant economy in the EU' (ibid., 2003:1). The protection of the low Corporation Tax policy ultimately had two detrimental effects. Firstly, an extremely low rate of corporation tax offers multinationals an incentive to engage in transfer pricing. According to the Black, J et al. (2009) it is achievable by using it to transfer a large amount of a corporations profits between different parts of the business. This is profitable when tax rates differ across countries. The practice of transfer pricing made Irish GDP appear higher than it actually was, making the economy seem more prosperous. Furthermore, large amounts of profits generated within the country were repatriated back to the multinationals country of origin, by and large the US. However, 'to speak against the low rate of corporation tax in Ireland is almost to speak treason' (CORI Justice Commission, 2004: 59) as even pressures from the EU have not yet changed political opinion on its harmonization.

Figure 3.7 (€millions)

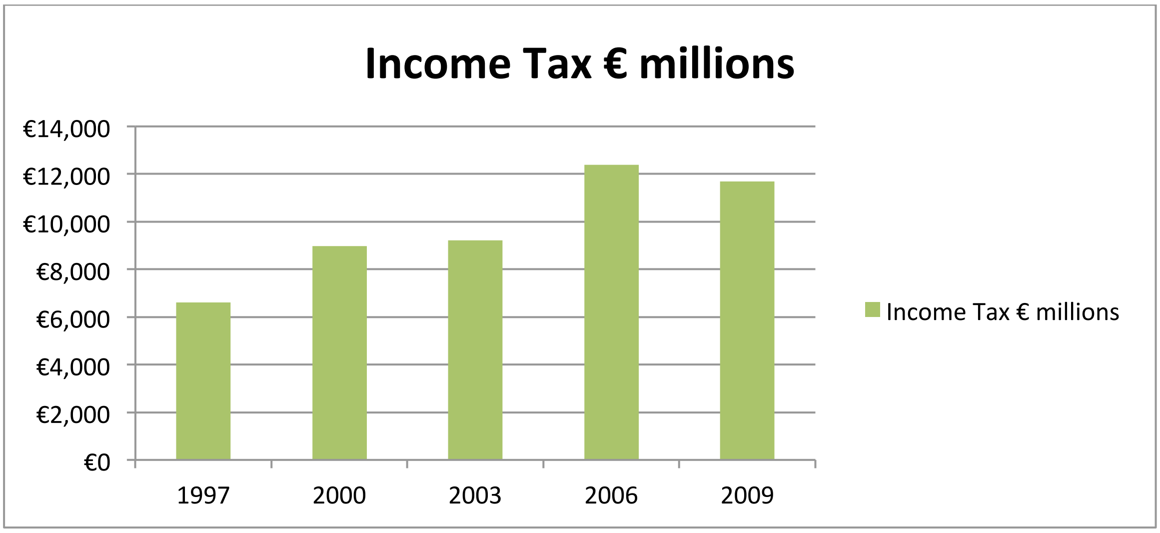


Source: National Income and Expenditure Tables 1995-2010

Income Tax

'Government spending and taxes vary in their aims and their impact on households. Whatever the aim of a particular measure, whether it be to provide an income during periods of unemployment or sickness or to raise tax revenue, the measure has re-distributional consequences' (Stanford, C. et al., 1980: 15). The main redistribute impact of the taxation system will always stem from Income Tax revenues. However, it is commonly held that the Fianna Fáil government of the boom simply reduced the Income Tax rate in order to maintain support from the electorate, eliminating its re-distributional purpose. Whatever the case may be, the returns generated through Income Tax during the boom were low in comparison to other European member states.

Figure 3.8 (€ millions)

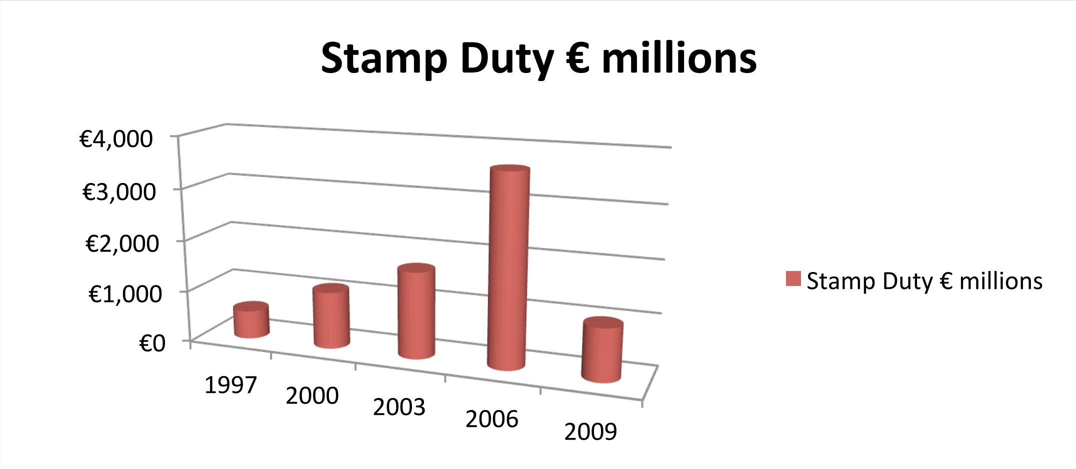


Source: National Income and Expenditure Tables 1995-2010

Stamp Duty and Value-Added Tax: the rise and fall of the housing bubble

Ireland's tax-base was altered during the latter years of the boom to collect more tax revenue from construction taxation. As the Irish State does not have a standard property the government alternatively levied Stamp Duty; a form of taxation that is paid in full when a house is purchased. Accordingly due to high levels of housing activity, larger returns were collected during the boom than in recent years. Nevertheless, 'when construction activity collapsed, this substantial source of government revenue disappeared almost overnight (Whelan, K., 2011: 8) as demonstrated by Figure 3.9 below. Consequently when the housing bubble finally burst revenue streams from Stamp Duty collapsed, leaving no sustainable property tax to take its place.

Figure 3.9 (€ millions)

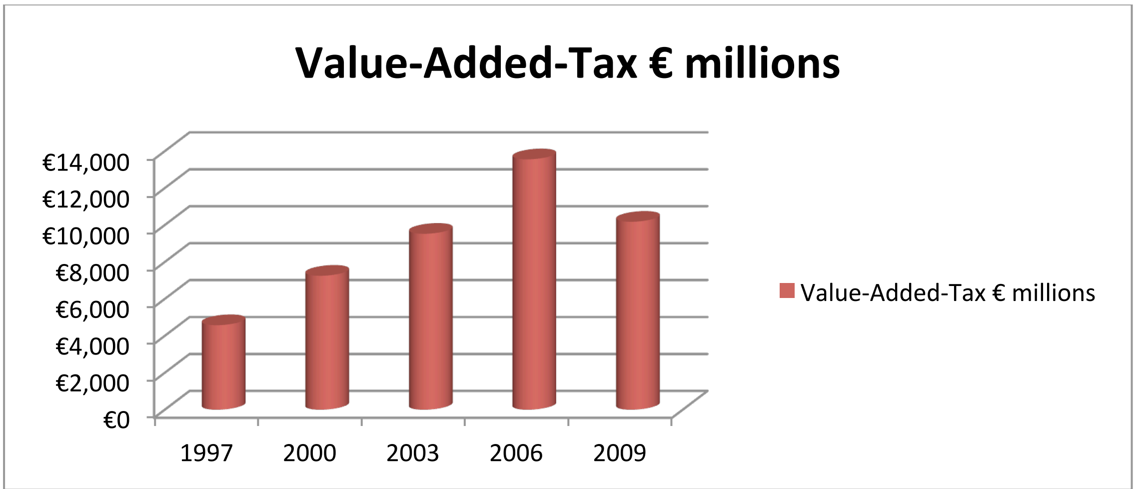


Source: National Historical Income and Expenditure Tables 1995-2009.

Value-Added-Tax

Throughout the period in question government subsidies funded the building sector; reckless banks lending to developers to purchase sites at grossly inflated prices was commonplace, at a cost which was passed onto buyers. Membership of the EU meant interest rates were kept low, ensuring the availability of cheap money. As inflation rose to grossly high levels, revenue from VAT ensured a significant return to the exchequer, illustrated by Figure 3.10 below. Nevertheless, once the construction and housing market collapsed, the government was left with an extraordinary shortfall in the public finances, which left the economy particularly vulnerable to the global economic crisis and the collapse of the property market.

Figure 3.10 (€ millions)



Source: National Historical Income and Expenditure Tables 1995-2009.

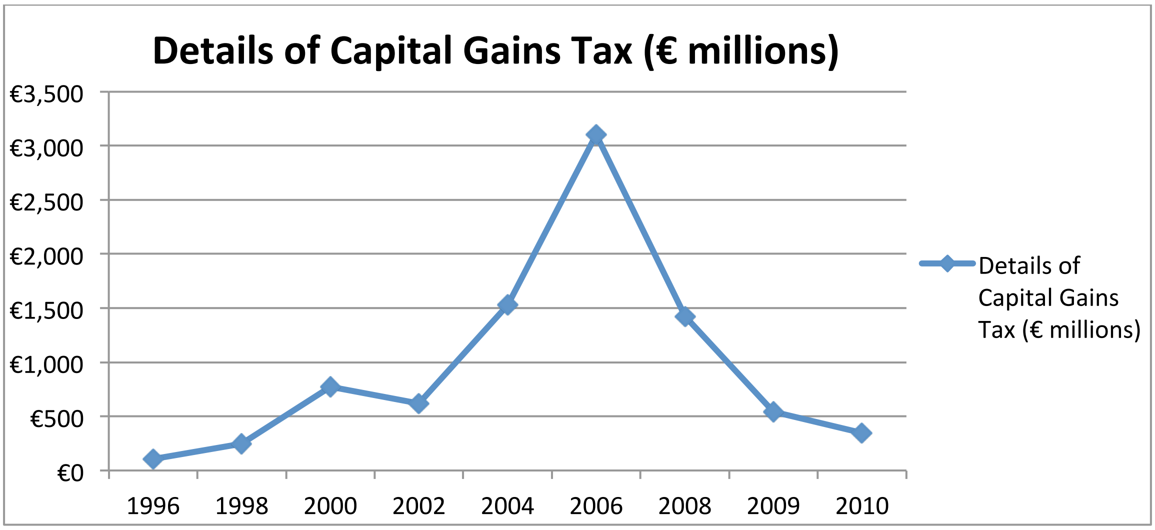
Residential Property Tax

As a result of their volatility and long-term unpredictability, the Revenue Commissioner has recommended 'a move away from a transaction-based tax on property towards introducing more stable revenue sources, including an annual tax on property' (Commission on Taxation, 2009: 5). An over-reliance on transaction taxes during the economic boom, has contributed to tax revenues dropping faster than GNP in the onset of the recession. A broadening of the existing tax base to provide a more stable and continuous source of revenue is necessary and it is recommended that this should be implemented as soon as is feasible (Commission on Taxation, 2009). If the Irish taxation system is to become equitable, the taxation base needs to be broadened. A move towards a Residential Property Tax could be the first step in achieving this goal, as taxes on less mobile assets will cause less economic and social distortions. Nonetheless, the timing of its implementation will always be a politically sensitive matter.

Capital Gains and Capital Acquisitions Tax

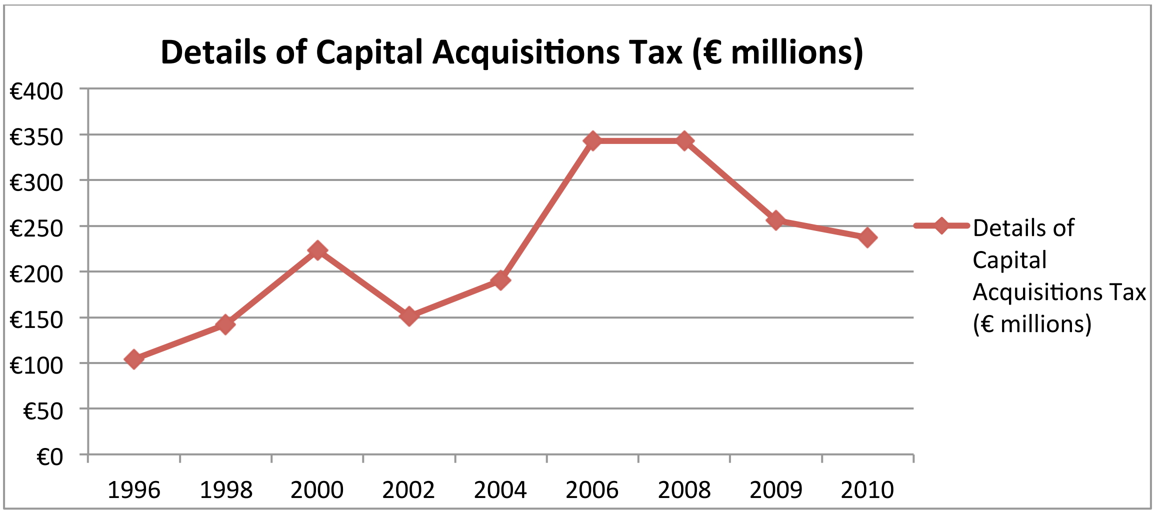
As it is evident 'income alone is rarely a complete test of ability to pay. Wealth confers advantages in its owner even when no income is derived from it. It also gives security. While wage […] income dies with the earner, capital and the income from capital endure and may be passed on to future generations' (Commission on Taxation, 2009: 124). Revenues collected from Capital Gains and Capital Acquisitions Tax approximately peaked between 2006 and 2008. Thus, if rates were modestly increased during the boom to collect revenues proportionate to those generated from Income Tax, Ireland would be closer to bridging the gap between the wealthy and the poor, as well as that of public revenue and expenditure. This would allow for increased streams of revenue for social services, re-distributional schemes and funding of the Welfare State.

Figure 3.11 (€millions)



Source: CSO, National Income and Expenditure Accounts 1995-2010.

Figure 3.12 (€millions)



Source: CSO, National Income and Expenditure Accounts 1995-2010.

Tax revenues which had been running to some extent ahead of expenditures for a number of years, suddenly slumped far behind. Total government revenue declined from €68 billion in 2007 to €60 billion in 2009 as revenue from Stamp Duty and Capital Gains dropped from €6.3 billion to €1.6 billion respectively. There is no doubt that the government underestimated the effect of the reliance on an unsustainable tax base. As the construction sector collapsed, the world recession took hold and multinationals began to pack up and look for better places to invest, tax revenue was hit hard, leaving the government no choice but to impost a series of harsh austerity measures once again on the taxpayer.

The Irish and the Icelandic Cases: a comparison

The Irish and the Icelandic cases can be said to have had similar characteristics during their booms of the 2000s. However in terms of their consequences and responses in dealing with the banking collapse both countries exerted clear distinctions. Iceland, on the one hand, allowed the banking sector to declare itself bankrupt, thus saving the taxpayer enormous amounts of revenue. However, the Irish government decided to provide a blanket bank guarantee scheme in 2008 and 2009, which continues to cost the exchequer sizable amounts of revenue. Consequently, Iceland has been 'slowly emerging from a deep recession following the collapse of its main banks' (OECD, 2011: 1) as economic growth has resumed. The economy stopped contracting in late 2010, due to consumption and business led-growth. The Icelandic-IMF programme was very successful and therefore Iceland was the first country to graduate from such a programme since the 2008 financial crisis. Furthermore, the government has begun to put the public finances once more on a stable path, merely four years after the economy entered recession. 'Total direct fiscal costs of the recent financial crisis amount to [approximately] twenty percent of GDP, which is higher than any other country except Ireland' (ibid: 2). However, according to the OECD, Iceland has been implementing a fiscal consolidation programme, reforms to address the shortcomings of the financial regulatory system, a series of austerity measures, while also injecting revenue into the economy to stimulate economic growth. Hence, it has been anticipated that Iceland's budget deficit will fall below three percent of GDP in 2012, with a small surplus projected for 2013 (OECD, 2011).

Although the Irish and the Icelandic cases are extremely comparable they differ significantly in term of the measures that were adopted in the aftermath. In Ireland the bank bailout and subsequent austerity measures impacted considerably more on its taxpayers. Radical changes in financial circumstances and reduced competitiveness have led to an unemployment rate of over fourteen percent, a lack of growth in the domestic economy and a huge reliance on export led growth restore prosperity. Irish government gross debt as a share of GDP has reached one of the highest levels in the OECD. Official financial support, from the IMF and

EU, remains crucial in the short term, particularly regarding the continuing recapitalization of the banking system.

Social Solidarity amidst Economic Recovery

Structural Weaknesses

The main structural gains of the Celtic Tiger primarily benefited the wealthier section of the Irish population. The use of social partnership to legitimise policies for retrenchment of the welfare state and development of a neo-liberal economic stance have worked to benefit the wealthy elites and transnational corporations as opposed to those most in need. Furthermore other structural weaknesses include- a low taxation base; failure of the government to develop a strong indigenous industrial sector; reliance on low cost foreign direct investment and a low rate of Corporation Tax; failure to invest in the welfare state and high knowledge sectors which would maintain employment. Nonetheless, the most prominent structural weakness concealed within an era of full employment was that most of the population did not encounter must of the prosperity of the Irish economic boom.

Moreover, while social partnership was an enormous advancement of this period, trade-unions and the Voluntary and Community sector hold relatively little power regarding the navigation of social policy. Social policy and welfare state reform only occurred when the government had the means to do so, and thus as a result of the recession these provisions have been cut. While the previous government opted for a low taxation regime and economic investment to attract investment, it did so at the expense of investing in the welfare state (Considine & Dukelow, 2010). Thus the Fianna Fáil/ Green Party government failed to solve the challenge of resolving the unemployment crisis that has been historically embedded in Irish society. The period of low employment between 1996 and 2007, concealed rather than resolved that long term structural weaknesses of the welfare state. As a result, 'the economic development policies pursued have paved the road to the major escalation in unemployment during the recession' (ibid: 2).

Conclusions and Recommendations

According to O'Connor (2010: 1), 'Irish Society during and after the Celtic Tiger continues to be characterised by fundamental structural problems in the welfare state, including its inability to provide sustainable employment, despite its newly found and now lost prosperity'. There is a need to introduce radically new employment and economic development policies, as current responses typically serve the sectional interests in Irish society. In learning lesson from the crisis the overriding conclusion the need for policy reform. New policies need to be implemented to reduce unemployment and put the economy on a more stable and sustainable path in order to ensure a sound recovery. Firstly, the taxation base needs to be restructured and, most importantly broadened, to incorporate fairer and progressive forms of taxation, in order to maintain an equitable welfare state. Currently Irish total tax revenue stands at a mere thirty per cent of GDP, the second lowest only to the USA out of the OECD countries. Irish public and social expenditure resides at the lowest in the OECD at sixteen per cent, which is only marginally lower than the USA at the present time (OECD, 2010). The above structural weaknesses arose out of the liberal pursuit of public policy. Thus income inequalities have remained persistent over the last ten years. The enormous quantity of wealth generation was not experienced by lower socio-economic groups, as relative poverty at the height of the boom stood at twenty per cent of the population, homelessness grew, and the numbers on the Local Authority waiting lists reached 53,000 (DoEHLG, 2008).

The structural problems arising from poor economic and employment policies have highlighted the state's inability to equip the workforce with adequate education and training to secure better paid and more sustainable employment. If this were made to be a priority during the boom, the government would have equipped it to provide their own welfare instead allowing the population to become overly reliant on an inadequate welfare state. These structural failures, arising from the states incompetence and the strong influence of the neo-liberal agenda have been present since the foundation of the state and must finally be addressed (ibid: 2010).

According to O'Connell (2010: 4) 'when the Celtic Tiger bubble burst, the structural failings […] along with other in the banking system which lay hidden […] resulted in unemployment more than doubling in two years'. It is recommended that the government focus on creating a welfare state that is equitable and fair, which should be financed by sustainable and progressive taxation. Although the IMF has recommended that the government reduce the deficit through expenditure cuts, focusing on social expenditure cutbacks is of little use given the deficit was principally created by unemployment, tax revenue decreases and private sector debt. It is also recommended that the government attempt to provide capital injections in order to generate growth, although this may prove difficult given the impending imposition of the EU Fiscal Consolidation Treaty. Nonetheless, lack of economic stimulus will mean unemployment will remain high and subsequently fall at a slow rate. Stimulating the economy could prevent a prolonged recession through economic growth and employment generation, prevent tax revenues from declining further and could also address some structural weaknesses. Solutions to unemployment, which focused on correcting the problems of the economic crisis, would also have a positive impact on other social challenges such as poverty, emigration, housing, and health problems. However, these issues require further recommendations in their own right, which would require further research into the specific area.

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