

Ireland: Lessons from Success and from Failure

In the wake of the global financial crisis and Ireland's self-inflicted economic woes, some commentators have leapt to the conclusion that its apparent success in the decade and a half to around 2005 was a mirage.

They have pronounced the Celtic Tiger dead, and added insult to injury by arguing that current austerity policies will make Ireland's predicament worse.

This analysis lacks all perspective.

In an editorial this month, the *Wall Street Journal* reviewed the "facts of [Irish] life" for the "historically challenged".

"Since 1995", it said, "even allowing for the recession, which knocked nearly 10% off economic output, GDP per capita has more than doubled in Ireland, to \$41,000 from less than \$18,000. Since 1983, GDP per capita has quintupled. Also since the early 1980s, Ireland's employment rate has gone from about 50% of the working age population to between 60% and 70%."

The editorial added, "Ireland's progress has been real and dramatic and remains a long way from being undone by the events of the past two years."

The essence of the Irish story in recent decades is easily told.

For years up to the late 1980s, Ireland was widely regarded as "the sick man of Europe". It shared with New Zealand a history of poor economic management which led to high levels of inflation, unemployment, budget deficits and public debt that brought it to the brink of an economic crisis.

Like New Zealand, it changed direction, opened up its economy, controlled inflation and public expenditure, pursued a programme of deregulation and privatisation and created a business-friendly environment. Government

expenditure, which was 52% of GDP in 1987, fell to 31% by 2000 and tax rates were substantially lowered.

Ireland's fortunes were transformed but there were always inconsistencies in Irish policies. Indeed *New Zealand Herald* columnist Brian Gaynor (wrongly) interpreted Ireland's success as due not to a generally orthodox stabilisation and liberalisation programme but to statist, 'picking winner' policies by the Industrial Development Agency, along with transfers from Brussels.

Ireland also retained a centralised wage-fixing system. (I was invited to Ireland in 1999 to speak on New Zealand's experience with freeing up the labour market.)

From the early 2000s, economic management in Ireland deteriorated. A recent inquiry into the banking crisis by the governor of Ireland's central bank noted that domestic macroeconomic imbalances built up during most of the decade.

"The government's procyclical fiscal policy stance, budgetary measures aimed at boosting the construction sector, and a relaxed approach to the growing reliance on construction-related and other insecure sources of tax revenue were significant factors contributing to the unsustainable structure of spending in the Irish economy."

The fiscal position deteriorated and government spending mushroomed to over 48% of GDP by 2009.

Membership of the eurozone benefited Ireland, but it also meant that monetary policy was not suited to Irish conditions and contributed to overheating and inflation. Bank borrowing at low interest rates stimulated the property bubble and bank regulation was lax, in part because of cronyism.

Ireland's fortunes turned pear-shaped with major bank failures that were exacerbated by the global financial crisis. Some banks had to be nationalised, the real estate market collapsed, some companies (like Dell) that were lured to Ireland by various inducements moved elsewhere, the

unemployment rate has hit 13.6%, and out-migration has resumed on a large scale.

However, of all the EU countries in crisis, Ireland has taken the strongest remedial medicine. The government has brought down three austerity budgets and another will be announced in December. Public spending is being reduced by around 7% of the annual budget and tax increases have been ruled out as a means of closing the budget deficit.

Cuts in wages and pensions have helped improve the badly eroded competitiveness of the export-dependent economy.

Ireland is not out of the woods yet as the costs of bank failure continue to grow but, unlike Greece, has not had to call on the eurozone bail-out fund.

The ruling party is likely to lose office at the next election. However, the popularity of the finance minister responsible for the austerity programme is astonishingly high, an indication that the Irish consensus around economic policy remains intact.

Former US president Bill Clinton may have struck the right note when he told an Irish audience last month, "I believe you'll get out of this, but not fast."

Ireland is not the first country to be seized upon as a failed model by anti-market economists – premature rites were pronounced during Chile's early 1980s recession.

Thanks to sounder bank regulation and an independent monetary policy (with an exchange rate that adjusted to the external shocks) New Zealand survived the GFC in better shape than Ireland.

But there are useful lessons for New Zealand both from Ireland's successes and its failures – just not the ones that some commentators have drawn.

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