the Atlantic

Is Irish Austerity Paying Dividends?

By Megan McArdle

Sep 22 2011

Last year, the failure of Irish austerity was on the lips of every left-wing wonk in America. Paul Krugman, the leader of this school of thought, has compared austerity to bloodletting and other such primitive medical quackery (a comparison he repeated a couple of days ago). He compared Ireland's embrace of austerity unfavorably to Spain's reluctance, and used Ireland as a sort of Keynesian object lesson:

Why not slash deficits immediately? Because tax increases and cuts in government spending would depress economies further, worsening unemployment. And cutting spending in a deeply depressed economy is largely self-defeating even in purely fiscal terms: any savings achieved at the front end are partly offset by lower revenue, as the economy shrinks.

. . . Just ask the Irish, whose government -- having taken on an unsustainable debt burden by trying to bail out runaway banks -- tried to reassure markets by imposing savage austerity measures on ordinary citizens. The same people urging spending cuts on America cheered. "Ireland offers an admirable lesson in fiscal responsibility," declared Alan Reynolds of the Cato Institute, who said that the spending cuts had removed fears over Irish solvency and predicted rapid economic recovery.

That was in June 2009. Since then, the interest rate on Irish debt has doubled; Ireland's unemployment rate now stands at 13.5 percent.

That was March 2011. Though Ireland's bonds spiked in the summer, their yields have now started falling:

Their yields are still higher than Spain's, but they had a much bigger banking crisis, for which the government has provided guarantees; the current improvement is rather remarkable.

Meanwhile, the Wall Street Journal reports that their economy has started growing again at a very respectable rate:

The national statistics office said Thursday gross domestic product in the three months to June was 1.6% higher than in the first quarter and 2.3% higher than in the same period of 2010.

That was the fastest year-to-year expansion since the last three months of 2007, after which Ireland's previously fast-growing economy was felled by the financial crisis and the collapse of a debt-fueled property boom.

The Central Statistics Office also raised its calculation of growth in the first quarter to 1.9% from the previously estimated 1.3%. The growth was broad-based, including manufacturing, agriculture, transport and communications.
Meanwhile, Spain struggled to stay in positive territory last quarter.

Does that mean that Ireland's experience vindicates austerity over stimulus? In your face, Mr. Fancypants Nobelprizewinner!

Umm, no. Ireland's economy is still frail, and it's recovery is export-led--a real danger with a euro crisis lurking on the horizon.

But I do think it vindicates--ahem!--what I wrote last year:

Related thoughts: whatever events unfold, a lot of pundits who insist on treating whatever has happened in the last five minutes as if they were the final events of the crisis, are going to look like idiots. If Spain ends up in the same place as Ireland, the virulent arguments over Irish austerity are going to look rather silly in retrospect; if Europe's banking system is badly compromised, the model of economic crisis that centers around American bank regulation and monetary policy will be severely compromised; and so forth. Pundits and regulators should both be playing the long game.
It's going to take the better part of a decade, at the very earliest, to untangle what has "worked" and what didn't in this crisis. Looking at a snapshot of what happens to be happening right now is not very useful.