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The Celtic Tiger Is Dead. Long Live The Celtic Tiger.

By: Ranjit Dighe – June 20, 2013

Northern Ireland was the perfect place for this week's G8 summit. These meetings are supposed to promote peace and prosperity, and Northern Ireland, since the Good Friday Accords of 1998, has been a textbook case of how the two go hand-in-hand. Despite two global recessions, its post-Troubles economy has enjoyed resurgent investment, immigration, and tourism. If peace can develop into true harmony, growth should accelerate, as the 99 "peace walls" separating Catholic and Protestant neighborhoods in Belfast come down and resources in Northern Ireland can flow freely to their best use. In keeping with the spirit of the summit, British PM David Cameron dangled the prospect of financial assistance to Northern Ireland as its tears down those walls.

Just 12 miles from the site of the summit, the Republic of Ireland offers economic lessons to Northern Ireland, as well as the rest of the world, both in what to do and in what not to do. Northern Ireland, for all its progress, remains a relative backwater in the United Kingdom, ranking tenth among the UK's twelve territorial units in per capita income. Its sibling to the south, by contrast, is one of the richest nations in Europe, richer than the UK or any of the European G8 powers. And practically no other country rose higher during the boom of the 2000s or fell farther in the worldwide financial crisis. Ireland had a double-dip crisis, following the worldwide crisis of 2008 with one of its own, marked by costly bank bailouts, a sovereign debt crisis, and an unemployment rate that still is over 13%.

Ireland did many things right in the past three decades. One does not have to be a Thatcherite to acknowledge the success of Ireland's market liberalization in the 1980s and 1990s: opening up to foreign imports, investment, and immigration; reducing its chronically high government budget deficits; and reducing its confiscatory top tax rates on personal and corporate income. In the last case, Ireland went so far as to become a tax haven, with a corporate tax rate of 12.5%, barely half of Britain's and less than a third of America's. Although America's effective corporate tax rate, net of all loopholes, is not much higher than Ireland's by some measures, the high statutory rate, together with the complexity of the tax code, put America at a disadvantage. Numerous American companies, from Apple to PepsiCo, have moved operations to Ireland. Economists on both the left and right tend to favor lowering the corporate tax rate while closing loopholes in the interest of efficiency and horizontal equity (why should some corporations pay full fare while others pay nothing?). Tax avoidance was a big issue at the G8 summit; countries like the US and UK could do much to preempt tax avoidance by cutting corporate tax rates.

Ireland's immigration policies have also been remarkable. For a country with an exceptionally homogeneous population and a long history of net emigration, Ireland reacted adroitly to the hordes of outside job seekers that its boom attracted. Beginning in 1996, more people came to Ireland than left. The country opened its borders to workers from EU countries and was liberal in its acceptance of non-EU work applicants, especially skilled workers. Study after study finds that skilled immigrants benefit their new economy, yet many countries, including the US and UK, make it overly difficult for skilled workers to enter. Ireland's new workers were easily absorbed, as unemployment fell to levels that seemed unimaginable a decade earlier. The labor market was one of the most flexible in the world, and employers praised the productive labor force of well-educated Irish and skilled immigrants. Even today, a 2013 World Economic Forum survey finds that the Irish are among the most welcoming people in the world to foreign visitors.

Today, however, Ireland's labor market is among the weakest. The unemployment rate is 13.5%, compared with 7.6% in the US, 7.8% in the UK, and 8.1% in Northern Ireland. While this is not much higher than the 12.2% jobless rate for the euro-using nations as a whole, it is still alarmingly high and would be much higher still if not for a mass exodus of foreign workers. Arguably, Ireland's mass unemployment is a greater calamity than the country's recent sovereign debt crisis and ECB bailout. What is at the root of it?

The short answer is that the collapse of the housing bubble turned Ireland's economy into a crater. Real GDP has not only failed to recover its 2007 peak, but it is also still short of its level in the crash year of 2008. Ireland's housing bubble was in a class by itself: it lasted twelve years, twice as long as the US bubble, and real property prices tripled, a feat unmatched by any other modern economy. When housing prices began to fall in 2007, property investment and other business investment plummeted. House prices kept on falling and may not have bottomed out yet. Irish households had borrowed to the hilt during the boom, and drastically cut back their spending when bad times hit. (The household debt to income ratio in Ireland is currently 200%, higher than in Greece, Italy, or Portugal.) Ireland's banks were deeper in property loans than their US counterparts, so insolvency ran deeper, credit was tighter, and the bailout was costlier. The big bailout came two years after the crash, in 2010, and caused such an explosion of the deficit and debt as to precipitate a sovereign debt crisis. The lesson here seems to be the usual one: manias happen, and they are hard to stop for several reasons. First, they can be hard to spot, as they are usually preceded by and even coincide with excellent economic performance based on fundamentals, such as high productivity growth and surging exports. Second, the prosperity they bring at the time often benefits a lot of people, who want to believe it's real. Third, politicians and their appointees want to ride this wave of prosperity as much as anyone else does. If a bubble can be tamped down, it requires tremendous courage and influence on the part of politicians and policymakers.

Finally, Ireland has a lesson about fiscal austerity: It's great during a boom, bad during a slump. Ireland in the mid-2000s was the rare country that followed the second part of John Maynard Keynes's fiscal prescription: run deficits during depressions, surpluses during booms. (Many countries choose instead to run deficits every year.) Ireland's government produced balanced budgets in the early 2000s and growing surpluses in the mid-2000s, and its debt-to-GDP ratio shrunk to an enviable 20%. But when the crash hit, the government actually reduced its spending, by about 20% from 2008 to 2013. So the Irish got the other part of Keynes's dictum wrong. This severe fiscal contraction

undoubtedly exacerbated an already-dismal economic situation. The deficit rose anyway, on account of reduced revenues and the bank bailout, and the debt/GDP ratio soared well above 110%. Even that might not have prompted a sovereign debt crisis but for investors' fears over the Greek debt crisis and the looming crises in Portugal, Italy, and Spain. Ireland's debt would still be manageable if not for the massive bank bailout, which again raises the point that unchecked manias are dangerous. (Granted, the bank bailout did not have to happen - economists as opposite as Paul Krugman and the Cato Institute's Alan Reynolds say it was a mistake, and Iceland said no to its banks in a similar situation - but bailouts are the usual rule in these situations.)

Ireland's economy has too much going for it to stay depressed indefinitely, and as one of the world's most open economies, its foreign investment and exports are sure to pick up when the world economy rebounds. When it does, I hope policymakers will find a way to keep on lid on the next Irish bubble.