

Share via  
Facebook

Get 4 FREE trial issues >>

Subscribe Student offers



Log in | Subscribe | Register | My account

Digital & mobile | Newsletters | RSS | Classifieds | Help

Monday December 20th 2010

Search

Home World politics Business & finance Economics Science & technology Culture Site index Print edition



Economics  
Free exchange

- Be the first to comment
- E-mail
- Print
- Recommend
- Share
- Permalink

## Sometimes, austerity makes sense

Dec 20th 2010, 15:50 by R.A. | WASHINGTON

PAUL KRUGMAN is on the [warpath](#) against the free-market fundamentalists who keep getting things wrong. He doesn't have a terrible case—American leaders who have warned that monetary and fiscal stimulus would lead to soaring bond yields and runaway inflation have been proven wrong, and then some. But this isn't the best supporting evidence for his piece:

*The free-market fundamentalists have been as wrong about events abroad as they have about events in America — and suffered equally few consequences. "Ireland," declared George Osborne in 2006, "stands as a shining example of the art of the possible in long-term economic policymaking." Whoops. But Mr. Osborne is now Britain's top economic official.*

*And in his new position, he's setting out to emulate the austerity policies Ireland implemented after its bubble burst. After all, conservatives on both sides of the Atlantic spent much of the past year hailing Irish austerity as a resounding success. "The Irish approach worked in 1987-89 — and it's working now," declared Alan Reynolds of the Cato Institute last June. Whoops, again.*

Was Irish economic policy prior to the crisis a disaster? It certainly wasn't a complete mess. As a small, open economy populated by well-educated English speakers, Ireland wisely determined that it could do well by attracting foreign direct investment, and through this process the Irish economy enjoyed stunning growth rates that helped turn its population from one of the poorest in Europe to one of the richest. Neither was this model the cause of the current economic woes (although we have learned that Ireland's narrow tax base did make the federal budget vulnerable to a sharp slowdown). Ireland's present woes stem from the reckless activities of its banks and from the inflation and collapse of a massive property bubble, coupled with the lack of an independent monetary policy.

Now, it is misleading for George Osborne to cite Ireland as a model that can easily be imported into Britain. But it's also a bad idea for Mr Krugman to conflate the FDI-oriented Irish model, which is generally quite successful, with the bubbly financial wreckage lying atop it. Ireland's financial woes don't indicate a rotten economic core any more than than America's financial troubles point to a flawed American economic model.

What about the austerity, then? It's difficult to imagine that Ireland would be in better shape had it not embraced early austerity. Ireland has a pretty substantial budget deficit (see [this](#)) that needs to be closed. Whatever you think the Irish government should have done with its banking problems, that fiscal gap would have been there. Indeed, absent the double-blow of growing bank losses and ill-timed German musings about sovereign debt restructuring, Irish austerity might have allowed the country to miss the crisis; it has a lot of cash in hand and little need to tap debt markets until late next year.

What has thrown everything off is the bank rescue. It's the bank rescue that pushes Ireland's debt ratio into truly uncomfortable territory. It's the bank rescue that makes deleveraging such a long and painful process. And it's the bank rescue (and its distributional impact) that has led markets to question Ireland's ability to make austerity stick, which has led to rising yields and crisis. Had Ireland opted to stick bank creditors with greater losses, it might not have lost credibility with markets.

Ireland's leaders probably expected better behaviour elsewhere in the euro zone, as well. Perhaps they believed other peripheral nations would follow their lead sooner, rather than waiting for crisis to force them into drastic cuts, thereby reducing the impact of contagion fears on Irish yields. They may have expected more fiscal assistance from stronger euro zone nations. They might have hoped for a monetary policy more in keeping with the median economic conditions within the single currency area. They surely expected a less stumbling response to crisis from the Germans.

But it's hard to see what great advantage Ireland would have gained from delaying austerity. Either markets would have attacked sooner, or Ireland would be facing bigger

### About Free exchange

In this blog, our correspondents consider the fluctuations in the world economy and the policies intended to produce more booms than busts.

RSS feed

Advertisement

Download a report on the 'Liveable Cities' conference and research here.

Economist Conferences Supported by Philips

With research conducted by Economist Intelligence Unit

### Economist blogs

- Americas view
- Asia view
- Babbage
- Bagehot's notebook
- Banyan's notebook
- Baobab
- Blighty
- Buttonwood's notebook
- Charlemagne's notebook
- Daily chart
- Democracy in America
- Eastern approaches
- Free exchange
- Gulliver
- Johnson
- Lexington's notebook
- Multimedia
- Newsbook
- Prospero
- Schumpeter's notebook
- The World in 2011: Cassandra
- Which MBA?

Most commented Most recommended

- China and the Nobel peace prize: The empty chair
- Germany and the euro: We don't want no transfer union
- Dealing with WikiLeaks: The right reaction
- China and the Nobel ceremony: Explain in vain
- Turkey and religious freedom: Wooing Christians
- Global power: The dangers of a rising China
- The state of Russia: Frost at the core

Share via

and more drastic cuts now. Mr Krugman likes to point out that Ireland is being attacked by the bond vigilantes despite its austerity. Well, other peripheral countries are in very serious economic trouble despite not embracing Ireland-like early austerity. It is far from clear that in five years we'll be praising Portugal's prudent handling of the crisis while condemning Ireland's foolish embrace of austerity.

Once again, it's misleading for Mr Osborne to cite Ireland as a model. Britain's fiscal gap is smaller and markets aren't yet demanding cuts. But it's not crazy to think that Ireland has, for the most part, made the best of an awful situation.

Recommend E-mail Share Print Permalink

Readers' comments

The Economist welcomes your views. Please stay on topic and be respectful of other readers.

[Review our comments policy.](#)

You must be logged in to post a comment. Please [login](#) or [sign up](#) for a free account.

Post your comment

cat institute Britain: An angry day in London, what next?

9. Saudi Arabia and China: Looking east

10. Science: The lonely 6%

Over the past five days

Advertisement

Latest blog posts - All times are GMT

Sometimes, austerity makes sense  
From **Free exchange** - 14 mins ago

Word pushers  
From **Johnson** - 2 hours 28 mins ago

Word Lens: not science fiction, but not exactly perfect either  
From **Johnson** - December 19th, 20:55

Bringing loaded guns on planes  
From **Gulliver** - December 19th, 18:27

Send a message to the future  
From **The World in 2011: Cassandra** - December 19th, 17:45

Loosen up  
From **Eastern approaches** - December 19th, 12:22

Word Lens: This changes everything  
From **Gulliver** - December 18th, 22:06

[More from our blogs >](#)

Products & events

Stay informed today and every day

Subscribe to *The Economist's* free e-mail newsletters and alerts.

[Get e-mail newsletters](#)

Subscribe to *The Economist's* latest article postings on Twitter

[Follow The Economist on Twitter](#)

See a selection of *The Economist's* articles, events, topical videos and debates on Facebook.

[Follow The Economist on Facebook](#)

Advertisement



Classified ads

