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Ireland’s economy

Getting boomier

The problem of a one-size-fits-all monetary policy in the euro area is back

THE swings in Ireland’s economic fortunes have been wilder than for most. Just look at the labels it has attracted. In 1988 it was dubbed the “poorest of the rich” by this newspaper. By the 1990s it had transformed itself into the Celtic Tiger, Europe’s answer to the fast-growing economies of emerging Asia. In the 2000s it was turbo-charged by the low interest rates that came with membership of the euro (some called it a “euro-bubble” economy). But by the end of 2010 it was a ward of the IMF, as its twin housing and credit booms turned to bust. Now its speedy recovery from the crash has earned Ireland a new title: the Celtic Phoenix (see article).
A hyper-globalised economy is one explanation for this whiplashing. Exports are 114% of GDP, and since the late 1980s Ireland has encouraged foreign direct investment, often from American firms. But another factor is the euro area’s one-size-fits-all monetary policy. Ireland is too small to affect the fortunes of the overall euro-zone economy, and thus the decisions of the European Central Bank (ECB). Low interest rates caused it trouble before; and, on its current trajectory, Ireland will soon once again be an economy ill-suited to the ECB’s monetary tailoring. Other small and open economies, such as the Baltic states, Cyprus and Malta may eventually face a similar problem. To stabilise their economies, all these countries will have to lean more heavily on other tools to regulate excessive credit, as well as on fiscal policy. Unfortunately, the early signs are that Ireland has only learned half that lesson.

One size fits none

Start with policies to curb credit growth. A first line of defence is the proper regulation of banks. In the bubble years, Ireland was a poster-child for what not to do. Most of its problems stemmed from one bank, Anglo Irish. Feeble regulators allowed its lending book to grow at a wildly imprudent rate, with loans heavily concentrated in commercial property. Today, Ireland has independent-minded economists at the helm of its central bank—Patrick Honohan, the current head, and Philip Lane, who takes over from him this month.

They are already showing mettle. The central bank has used macroprudential tools in response to a burst of house-price inflation, placing caps on the value of loans that banks can extend in relation to the value of homes and to borrowers’ income. The trouble is that these tools are largely untried and their efficacy unknown. In places such as Sweden, measures of this sort have failed to restrain soaring house prices.

Other tools are also needed, chief among them fiscal policy that leans against the business cycle by raising taxes or cutting spending in a boom. Charlie McCreevy, Ireland’s finance minister between 1997 and 2004, scorned that idea. “When I have the money, I spend it. When I don’t, I don’t,” he once said. Sadly, there are already signs that the McCreevy doctrine still holds sway in Ireland. The recent budget, the last before elections in the spring, diverts stronger-than-expected corporate-tax receipts into extra spending worth 0.7% of GDP this year, and allows a similarly sized boost from tax cuts and additional expenditure in 2016. That is a mistake. Policymakers should at least let the budget’s “automatic stabilisers”—the waxing and waning with the cycle of tax receipts and spending on unemployment benefits—operate freely.

Lax budgetary policy was not a prime cause of Ireland’s bubble economy in 2000-07. But the crash that followed the boom would have been less painful if Ireland had had more fiscal insurance to draw upon. Given the inherent limitations of the euro area’s single monetary policy, such insurance may well be needed again.