Reversing Murphy’s Law – does austerity work?

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Which is it? The luck of the Irish, or Murphy’s Law?

Today’s *Capital %26 Conflict* has an Irish theme. Looking at **Japan’s past helped us understand China** yesterday. So why is Ireland’s past important to you today?

If you live there, it’s important for obvious reasons. Then **there’s the Brexit story** and Prime Minister Theresa May’s negotiations to form government.

But there’s something else about Ireland

Its past is at the forefront of our own political debate in the UK. You might argue it’s the key political debate of our time: in a debt-drenched world, does austerity work?

“The end of austerity” and the “Age of austerity is nearly over” were the media lines in the wake of the election May lost by barely winning. Let’s ignore whether they’re right and ask a deeper question.

Do governments have to run sensible budgets? So many around the world don’t, but they seem to get away with it. Except in the eurozone. And South America.

But to repair a budget in the wake of profligacy, austerity seems dangerous. Just look at what it’s doing to Greece.

The posterchild of austerity working is of course Ireland. But the Irish economist Stephen Kinsella went on the Financial Times’ Alphachat to explain to listeners why Ireland is in fact not a good example of austerity working. Well, it is, but only because of unique aspects to Ireland.

Ireland recovered despite austerity, says Kinsella. Other countries should not look to Ireland for solutions. They’ll only be misled.

Kinsella’s arguments are excellent. But his conclusions contradict them. And support the views he opposes.

But first, what are these factors that Kinsella points to?

Is Ireland really that special?

The Irish economy is very open to the rest of the world’s investment and trade. Trade as a per cent of GDP is extraordinarily high. That helped the economy rebalance quickly and provided some support during the crisis. Ireland’s exports did just fine, while imports tumbled. This improved Ireland’s balance of trade. Investment from overseas counteracted the loss in local investment.

Migration is open too. Huge swathes of Irish emigrated during the crisis, which Kinsella says has had very unpleasant effects. I’m not sure what they are. The Irish I’ve met around the world seem rather pleased they left. But of course, losing one out of nine people over seven years is a remarkable change. It kept unemployment down during the crisis though, masking how bad the crisis was. That’s Kinsella’s point.

Let’s consider these two factors. They show that having a free market and open economy help you deal with a crisis. They show that allowing migration makes people better off. It’s a fantastic lesson for other countries in crises to learn from. If you’re in an economic crisis, rather than imposing trade restrictions, trying to prevent emigration and shutting out the world, you should do the opposite. You should become more free market, more open.

Kinsella also explains that Ireland went into the financial crisis with very little national debt, allowing it to deal with the crisis. That’s an argument in favour of austerity during the good times, as well as the bad. It’s a great lesson for other nations to learn from.

Debt is dangerous because it hampers you

One reason for Ireland faring well before and during the crisis is its huge tax base of multinational corporations. Ireland is a corporate tax haven that hosts gigantic multinationals, which is how I came to live there at the age of seven, just down the road from where Kinsella now works at the University of Limerick.

Kinsella seems to think that Ireland was magically gifted these multinational taxpayers rather than pointing out they're the result of clever tax policy. Again, that policy is driven by a free-market ideology. Ireland shows how being a low-tax country benefits you, another thing foreign countries can learn from. Rather than raising taxes to raise tax revenue, lower them enough to attract large multinationals.

But what about austerity during the crisis? Does it work or not? Kinsella didn't discuss this much during the interview. One example why austerity doesn't work, according to Kinsella, is that the Irish imposed austerity on themselves before the likes of the **International** Monetary Fund and the European Central Bank did. Hmmm.

Of course self-imposed austerity is preferable

But it's hardly an argument against austerity, imposed or not.

Even more odd, Kinsella argues that the social safety net and emigration allowed the Irish economy to grow during the crisis. This makes zero sense. An economy cannot grow from emigration, nor from having a social safety net. And it also doesn't fit the narrative of austerity at all either.

Kinsella claims "no in Ireland believes in the infallibility and primacy of the markets." I met many that do about a year ago. But the ones who do are often the ones who left in that emigration boom he mentions. Even if they don't acknowledge their understanding of the primacy of the free market, their actions certainly do. They understood that the free market requires them to make their own way rather than vote in Irish elections for whatever economic policy they want.

The free market is good at cutting through what people claim and focusing on what they do. Just think of how rich prominent socialists are. That's why a famous free-market economic treatise is called "Human Action" and not "A General Theory of …"

You've probably cottoned on that Kinsella's arguments are downright bizarre. They explain how austerity does work. They explain how open and free markets help you deal with an economic crisis. And they show why austerity before the financial crisis is important – it reduces your debt so you can weather a financial crisis.

Free market and open economy work

Kinsella seems to reach the conclusion that austerity doesn't work instead of realising that free markets and an open economy do work. In other words, the free market and running a sensible budget is a good idea. You can call it austerity, or fiscal consolidation as Kinsella puts it, or whatever you like. But claiming Ireland is unique and therefore austerity shouldn't be tried, rather than explaining how other nations can follow Ireland's good policies, is a disappointing way to think about it.

As the Alphachat presenter pointed out, "the austerity that was imposed did actually have the expected results that would be predicted…"

Kinsella adds one brilliant point in his interview though. Why didn't the Irish riot? Everywhere else around the world people rioted against austerity.

Firstly, the state maintained key parts of its social safety net. Taking this away from people is worse than making them reliant on it in the first place, so that's a good idea.

But there's another phenomenon that Kinsella and I both agree on. When I visited Limerick, the Irish finance minister at the time sat behind me in the pub while I ate scampi. There were no guards in sight. Supposedly, back in the financial crisis, this meant the politicians were subject to verbal abuse during their pints. That prevented the sort of stupid policies that American politicians get away with while hiding behind guards.

It's not just governments that are going broke

Eurozone governments and **American state governments can't print money**. For them, austerity is a simple mathematical problem. They don't have a choice. That's why they all end up imposing it in the end. The money-printers usually prefer trying inflation first though.

But it's not just governments that are in trouble. Companies can't print money either. And they can't even change laws to fudge the accounting in their favour.

In Japan, the pension obligations of the big firms threaten to cause big problems. But the phenomenon is moving to the US too. General Electric's woes hit the media recently. Bloomberg reported that GE's pension fund is US$31 billion short of what it needs, 33% of the total obligations. Even after spending a billion a year on pension contributions, the shortfall is growing.

The demographic change causing this worldwide phenomenon is only getting started. Our world will have to change dramatically as pensions come due in the government and corporate world. The current model won't work.

Until next time,

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