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## **The Future of the "Celtic Tiger" economic model.**

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Ireland is a lead indicator of the health of the Anglo-Saxon approach to globalization. For much of the past 10 years it has been heralded as an "economic model" for other countries. Wise men from nations as diverse as China, Israel and Chile have visited to study the miracle of the "Celtic Tiger." If anything this curiosity marked the peak in Ireland's economic performance.

Now, amid the intensity of the credit crisis, the Irish economy has become the first in Europe to drop into recession. Whether it becomes the first to climb out of recession is largely in the hands of its politicians and policy makers. The way in which they answer the challenges ahead will determine whether it really is an economic model worth following, with more to its recent success than easy credit and overconfidence.

Ireland potentially has a bright economic future, but to realize this it needs to allow its property bubble to unwind and once again focus on drivers of organic growth like education and innovation. It faces a series of broad problems in the interim: high debt levels, a large and contracting property/construction sector, declining competitiveness, and inflated expectations of wage and economic growth.

So far, the important debate on what to do and how to deal with the side effects of globalization has simply not taken place in Ireland. As with many other European countries, political glee at, for example, the effects of short-selling restrictions on hedge funds has masked a general failure to face up to the serious underlying economic and financial problems.

Again like many of their European counterparts, Irish policy makers need to show some of the "stand up and fight" attitude of U.S. Treasury Secretary Henry Paulson, and the policy innovation of Federal Reserve Chairman Ben Bernanke. In short, denial of the downturn needs to be broken quickly, and policy makers must move on to focus on what Ireland economy should look like 10 years, rather than 10 months, from now.

Among the specifics that need to be addressed are the shepherding of banks through phases of both deleveraging and refunding of balance sheets, and the managed deflation of the property market. The plan announced yesterday to guarantee bank debt and deposits, while still unclear in detail, suggests that policy makers now have a sense of how serious things could be. But there are questions as well, such as how the country can afford to guarantee €400 billion worth of assets when its GDP, at €190 billion, is less than half that total.

In the property sector, the government should avoid bailouts of any kind -- particularly for builders, who are keen to unload some of their debt and housing stock. The exception is at the lower end of the market, where a steep, prolonged fall in house prices could sow the seeds of future social problems. Infrastructure such as public transport and schools needs to

be built around new housing estates and conurbations, where developer's zeal has led planner's aptitude.

Ireland must also rediscover its competitiveness, which has deteriorated as the hubris in its property and construction sectors has helped inflate prices and expectations. In this regard, bringing down high public expectations of the kind of lifestyles, wages and economic growth people can enjoy is going to be a very difficult but critical test of political leadership.

Another Irish lesson for other countries is how the balance of power within the economy needs to be changed. At one stage, the property and construction sectors accounted for nearly 30% of Ireland's output, although the real-estate market is arguably more of a "casino" economy than a real and productive one. Ireland's economy needs to be weaned off this sector. And while remaining cognizant of the role of foreign multinationals as pistons of its economy, Ireland needs to focus on expanding the number of domestic industries that have relatively high organic growth. These include software and green-technology firms.

In this respect, one advantage for Ireland is its pragmatic and entrepreneurial business class and business-friendly investment climate. Yet Ireland needs to spend more money and intellectual energy on encouraging more innovative and research-intensive industries. At the same time, important segments of the economy such as the financial-services sector need to be pushed up the value chain to avoid the threat of competition from countries like India. Ireland should be attracting hedge-fund managers, for example, not back-office functions for hedge funds.

A final and very complicated challenge for Ireland is what to do about monetary policy -- or rather, the lack of it. Giving up monetary sovereignty in 1999, when Ireland joined the euro currency zone, provided the bonus of low real interest rates in the early part of this decade. But this arrangement has recently proved a straitjacket in the context of the sharp slowing of the Irish economy and the European Central Bank's inflation vigilantism. In short, Irish policy makers need to find innovative ways of using micro/fiscal policy to produce the kind of warming/cooling effects that could come from an independent monetary policy.

Many of these challenges may seem local, but they mirror the challenges facing other small countries, from Finland to the Czech Republic, Portugal and the Gulf states. The coming of age of Ireland's economy, and its success or not in moving up to the next tier of economic development over the next 10 years, is what will really mark it out as an economic model worth following.

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