# Patrick Honohan: Irish exceptionalism in the world economy

Address by Mr Patrick Honohan, Governor of the Central Bank of Ireland, at the Royal Irish Academy, Dublin, 10 March 2014.

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*Accompanying charts can be found at the end of the speech or on the Bank Ireland's website.*

For one hundred years after the Great Famine, the Irish economy was at the extreme end of the international spectrum in numerous demographic dimensions (population growth, family formation, fertility). For the past fifty years it has been characterised by an increasingly exceptional degree of internationalisation – not only in trade, but also and especially in the ownership of industry. The past thirty years have seen extreme swings in net international indebtedness and extreme sensitivity of net migration flows to employment conditions at home and abroad.

The *persistence* of distinctive characteristics illustrates the fact, nowadays often neglected, that national policy choices do have lasting effects and structural features of the national economy are not all necessarily washed away by forces of international economic convergence. The *swings* also suggest an adaptability of the Irish economy which has enabled the nation, through decisive policy action, to recover from situations of extreme macroeconomic imbalance.

National capacity to influence the type of economy we live in, and to recover from setbacks, means that there is scope for choice and innovation across a range of policy dimensions. Research based on global experience suggests that national success in generating sustainably high average living standards and employment levels does not pre-suppose a narrowly defined type of economic society. Albeit satisfying a vital shared institutional underpinning, successful economies, both within Europe and elsewhere, have displayed economic diversity in numerous dimensions, ranging from the type of financial system to the distribution of income and wealth across households.

Thus, although experience has taught us the importance of ensuring that the economic incentives built into our economies are not destructive, and that fiscal and monetary discipline is crucial to long-term prosperity, there is still room for important policy choices.

Of course countries differ because of their natural resources, or their geographical location. That is not what I have in mind; rather it is matters which are in principle subject to policy or collective action. I hope there will be indulgence for my succumbing to professional deformation by drawing somewhat disproportionately on finance for examples, but on this occasion I will not focus on day-to-day financial policy issues.

## The false new normal

There was a period some years ago, peaking around 1996–7, when it seemed that a new normative standard for national economic policy was coming into fashion worldwide. Economic growth was strong in what are called the advanced economies and in the emerging markets, and stable conditions had prevailed for several years in the international financial markets, allowing the expectation that – in what was soon to be dubbed the "Great Moderation" – economic conditions in most countries of the world would at last begin to converge to a satisfactorily high level.

In Ireland, the Celtic Tiger period was well under way, with its seemingly miraculous performance in delivering increasingly high employment, increasing living standards and a balanced budget.

And there *is* much to admire about economic performance in the mid-1990s. We should not forget, just because of what happened subsequently, the very substantial and sustained improvements in living standards in those years. And we should not forget that those improvements reflected the correction of previous policy errors which had resulted in the disruptive high inflation, unemployment and economic stagnation of the 1970s and 1980s.

By the mid-1990s, then, it was not unreasonable to ask whether there would soon be any point in studying the differences between economies. In our continent, with apparent consensus on a European way of conducting economic policy in a consistent and largely cooperative way, and in particular with the creation of the single currency, what future would there be for students of the Irish economy if the object of their analysis was blending into a broader European background as a merely regional economic entity?

As the millennium turned, everywhere deregulated financial firms seemed to be at the forefront, spearheading this era of prosperity with their support for investment backed by increasingly sophisticated risk management systems.

By now everyone understands that the exaggerated and over-reaching reliance on financialisation (see later) for generating prosperity was sowing the seeds of the global crisis. Indeed, just as a warm winter allows insects and disease to survive into spring, the prolonged period of stability itself had lulled many into a sense of false security, creating an environment that provided no warnings to those with growing risk appetite. In particular, the combination of stability and hubris lured Ireland into a disastrous extreme – exceeded only by Iceland – in this dimension.

One casualty of the crash should be the idea of inevitable convergence of national economic models. Some of the countries which most conformed to the conventional view of best-practice, and which had been held out as exemplars, have stumbled more heavily. True, the weaknesses that have been exposed are now easy to interpret in terms of crude failures of private and national housekeeping. It is crucial not to lose sight of those fundamental rules: the need to retain sufficient internal and external balance in order to ensure budgetary and financial stability. But that is not my focus today.

What I want to reflect upon instead is something that has also been in evidence during the boom and bust: the fact that national economies preserve long-lasting and persistent differences, one from the other, which can together affect the economy's ability to generate high levels of employment, productivity growth and resilience to shocks as well as affecting the distribution of income and wealth and the quality of life in other dimensions. Successful economies continue to differ in many ways and – I would argue – are likely to continue to do so. While departing from budgetary and financial discipline is never a successful strategy in anything other than the shortest of time horizons, the idea that economic structure differences must inevitably erode over time is unsupported by evidence.

It is not hard to illustrate ways in which the Irish economy has differed – in some respects quite sharply and measurably – from otherwise comparable countries. One dimension is demography, and that brings us back to the Great Famine.

## Faint echoes of pre-Famine in the recent bubble

I hope it will not be considered invidious or distasteful to draw some parallels between the Famine and more recent events. A million dead and a million emigrants – the traditional aphorism, now regarded by scholars as conservative (Ó Gráda, 2012) – are not to be compared in scale or nature with the consequences of what has happened in the recent crisis. But there is some similarity in the build-up of vulnerability and monoculture through early marriage, subdivision of land-holdings and reliance on a single nutritious but vulnerable foodstuff that preceded the Great Famine and the property bubble banking monoculture of the recent bubble.

True, even if there have been mistakes, it is surely the case that the Irish policy response has been less ideologically contaminated than that of the 1840s. But, as with many other episodes of economic downturn, international policy activism was stayed, not only by the constraints of infeasibility, but by censoriously excessive concerns about moral hazard.

The boomerang effects of a failure to recognise exceptional needs at exceptional times, on the part of those who could help more, but who are infected by such ideology, is something that continues to require the active efforts of scholars on the global and European stage to find the convincing arguments and evidence of the collective benefit of a more holistic approach to policy action. The need for Ireland to engage with partners in modelling the future macroeconomic policy for Europe and mapping out Ireland's position within that landscape is by now well understood.

## Demographic exceptionalism

One legacy of the Famine was Ireland's persistent exceptionalism in demographic statistics – a topic about which I inherited my father's fascination. As late as the 1950s, Ireland really stood out for its weak demographic dynamism.

Best-known here is the decline in the population of Ireland right up until 1961, when it reached a nadir at about half the pre-Famine level of well over a century before. This was quite exceptional (Figure 1).

Reviewing a worrying demographic situation in the early 1950s, the Government-sponsored *Commission on Emigration and Other Population Problems* still found Ireland at the extreme end of the spectrum in many dimensions, not only in regard to emigration, but especially related to family formation and childbirth. Thus, although the crude birth rate was exactly at the average of twenty comparator countries, this was the product of two outlying features with offsetting effects: an exceptionally high rate of fertility within marriage (fully 50 per cent above the average elsewhere) and very delayed marriage (with average age of women at marriage almost 2 years above the average along with the highest proportion of women remaining unmarried throughout their life) (Figure 2).[1] These distinctive features clearly pervasively influenced Irish family, politics and society generally, and not least its economic development.

As far as I know, long-conventional interpretations attributing these remarkable demographic anomalies to altered risk perceptions following the Great Famine remain largely unchallenged. The Great Famine had drastically changed the perception of risk and perhaps the risk aversion of the survivors of the Famine who stayed in Ireland and caused them to delay family formation, in many cases indefinitely.

Faced with such a persistent situation a modern-day development economist would look for alternative risk-pooling and risk-sharing mechanisms – such as crop insurance – as welfare-improving initiatives that could offset the impact of increased perceptions of risk. The 19th Century Irish financial system offered none of these, of course. Indeed, Ireland is generally considered to have been backward in the development of community-focused financial intermediaries. For a variety of reasons that are still debated by scholars,[2] the cooperative credit movement of Raiffeisen and his competitors on the continent did not at first take a strong hold in Ireland despite Horace Plunkett's effort to bring the credit dimension into the cooperative movement in the late 19th Century.[3]

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[1] Until the 1980s, the fraction of births to unmarried mothers was very small, averaging about 3 per cent, before jumping ten-fold by end-Century.

[2] A debate triggered by Guinnane (1994).

[3] The credit unions of today trace their origin only to the 1950s.

## Globalisation

Gradually in the 1960s and 1970s Irish demography began to normalise.[4] But in one demographic dimension Ireland remains extreme, namely in the extent to which migration continues to respond to economic incentives. The emigration story is an old one, but in improving times, such as we saw in the two decades before 2007, net immigration surged, bringing the share of foreign nationals in the population up to record levels for Ireland, and to an extent which is at the high end of the European scale. The openness is partly a consequence of policy decisions.

One remarkably persistent consequence of the Irish propensity for openness to migration is the way in which British unemployment rates still seem to exert a powerful influence on Irish rates. I first wrote about this thirty years ago, drawing on data between 1963 and 1983. Although the boom times made the idea seem obsolete, the past decade has shown that the relationship has not gone away. Much though I would like to give as much credit as possible to Irish policymakers for the way in which unemployment in Ireland has begun to turn down in the past couple of years, at a time of increases in the euro area, the chart shows that some of this must be attributed to the parallel improvements in the UK economy, which has managed in several respects, including unemployment, to survive the recession rather better than the euro area (cf. Lane 2012) (Figure 3).

The connection with foreign labour markets, enabling migration to swing rapidly in response to pressures and opportunities, is only one lasting and pervasive aspect of Ireland's deep embeddedness in the global economy.

The most conspicuous dimension here is the extent to which the business sector, especially the manufacturing and export services sector is dominated by foreign-owned firms. This story is well-known and does not require much rehearsing here. It is manifested in various statistical comparisons, some more directly and obviously connected with the presence of multi-national corporations (MNCs) than others.

Ireland shows up as one of the international outliers in the ratio of exports to GDP, for example: Ireland's ratio here of well over 100 per cent is matched or exceeded only by Luxembourg and a handful of entrepôts such as Singapore. Another indicator – the ratio of GNP to GDP – awards Ireland bottom ranking among any sizeable country (Figure 4).[5]

To be sure, it is easy to exaggerate the extent of MNC dominance, inasmuch as a sizeable fraction of the output and exports generated by that sector are not attributable to the inputs of domestic factors of production, but depend heavily on imported materials and services, and the value of foreign-produced patents. Nevertheless, less problematic indicators, such as the share of manufacturing employment accounted for by MNCs confirm the importance of the foreign-owned sector.

While the importance of foreign-owned firms can be traced back to pre-independence times, the present patterns of foreign ownership dominance have emerged as a clear consequence of Government policy from the 1950s on to encourage inward foreign direct investment. The

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[4] Age at marriage and at birth of child declined, fertility within marriage declined, though not to the low levels to which other European countries have reached. The Total Period Fertility Rate TPFR fell from over 4 in the mid-1960s to 1.85 by the mid-1990s, but (having slightly recovered since to just over 2) is still the highest in the EU (though – at not quite the replacement rate), though the children come later in life with the average age of mother at childbirth back up to 31.8 (well over a year older than the EU average). (Report on Vital Statistics 2011).

[5] Just 58 countries have a GDP of above US$ 100 billion. Ireland has the lowest ratio of GNP to GDP of these countries. The handful of smaller economies with lower ratios: Chad, Congo (Brazzaville), Luxembourg, Puerto Rico, Solomon Islands. The impact of MNCs on the interpretability of Irish macroeconomic data is extremely complicated and contains many very important traps for policy analysis. For example, see FitzGerald (2013).

efforts of the IDA and other agencies, combined of course with the tax structure, have played a powerful role. The model has been a significant driver of Ireland's success in achieving high average living standards, even if critics have long-noted the potential vulnerability associated with such heavy reliance on this segment of enterprise.

One hoped-for element of the policy of encouraging foreign-owned firms is the inward transfer of technology and business know-how including to locally controlled firms. As the decades passed, this transfer does seem to have happened to an increasing extent. But the reliance on foreign-owned firms has lasted a long time. Irish-owned companies have grown and prospered over the past half-century, and the most pessimistic of prognostications have not materialised. Nevertheless, this systemic dependence on foreign capital and know-how has skewed Irish development. In the interests of robust diversification, most Irish economists observers would hope for a greater convergence towards normality in this aspect of Irish economic development, with a stronger emergence of innovative Irish companies alongside those steered from abroad.

One side-effect of the heavy reliance on multinational corporations for driving employment and productivity growth has resulted from the fact that these companies generally bring most of their financing with them, thereby reducing the pressure on the local financial intermediaries and markets to innovate in the direction of designing and appraising financing packages for modern industry. While this did not discourage Irish banks from expansion, it likely contributed to their slide into a monoculture of property lending.

### Debt

That leads us to the third dimension of exceptionalism, namely indebtedness. Here Ireland's history once again displays some dramatic and exceptional evolutions. Unlike demography, debt was not a particularly prominent part of Ireland's economic history until the past forty years or so.

Indeed, rather the opposite was the case: Irish *banks* typically shipped a large segment of the funds mobilised through deposits into the London money market, where they remained relatively safe but yielding little (Figure 5).[6]

As far as *government* debt is concerned, it was not until the early 1970s that the conservative fiscal discipline maintained by all parties started to weaken. Even before the first oil crisis of 1973, the Government had abandoned its self-imposed rule of borrowing only for investment purposes. The global crisis that followed hard upon the heels of this slippage was associated with imported inflation, counter-cyclical Government spending and eventually a loss of fiscal control. By 1986 the Government's debt ratio had risen to an alarming level (Figure 6), prompting some distinguished commentators to forecast and even recommend (at that time) some form of debt restructuring or default. But the corner had been turned. The correction in the fiscal accounts that took hold and accelerated in the 1990s saw Ireland's public finances return to health extraordinarily quickly. Indeed, a recent IMF study identifies Ireland's fiscal turnaround after 1986 as quite exceptional and not replicable by other countries.[7] Especially

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6 This built on a familiar UK colonial pattern, whereby the issue of colonial banknotes was permitted, but only on condition of the issuing authority holding British Government securities as backing. Irish banks did the same, not just for their note issue (superseded by Irish government Currency Commission notes after 1927), but also for a large part of their deposits. The deposits in turn were fuelled by high wartime prices for agricultural exports. Note that definitional changes mean that the time series in Figure 5 has significant discontinuities, notably at 1966, 1982 and 1996.

7 This is how the IMF staff put it: "Among the recent episodes of substantial debt reduction, Ireland (1986) stands out. Starting from a relatively low level of GDP per capita, however, this remarkable decline was driven mainly by the very high growth rate resulting from the process of catching up with the other European economies. Ireland experienced a structural transformation in the late 1980s from an agriculture-based economy, which had already occurred earlier in many other advanced economies (see Honohan and Walsh,

noteworthy is the fact that this reduction in the debt ratio occurred without a surge of high inflation; rapid inflation and depreciation was part and parcel of the often-chaotic reductions in the real value of local-currency denominated debt issued by other over-indebted countries in the past.

The Irish banking sector was a sizeable financier, but ultimately not the main financier, of the Government's debt explosion in the late 1970s and early 1980s. The banks did draw down their net foreign assets and built up a limited net foreign liability position, but beyond a certain point it was for the Government to finance itself from abroad (cf. Barry et al., 2011). When the Government got its borrowing under control, its debt ratio began, as mentioned, to decline sharply. Without the Government as a source of lucrative lending opportunities, the banks began to look elsewhere for business opportunities.

For almost a decade up to 2007, even though public spending expanded sharply, Ireland's public debt ratio continued to decline even from the low levels which it had reached by the end of the millennium. This was because tax revenue from the property boom was so high.

But if public debt was under control, private debt was not. Returning to Figure 5 shows the rapid expansion in net foreign debt of the Irish banks. Recalling what I have said about the banks' earlier behaviour, the speed and scale of this accumulation was altogether new. The Irish banks were moving into unfamiliar deep waters, where they would soon get into difficulties and drown.

Growth in the new millennium relied increasingly heavily on bank-financed property-related revenues to support – directly or indirectly – employment, profits, dividends, wage and salary income levels, and tax revenue. The rapid reversal in the trend of public debt after 2007 has been quite explosive. It reflects both the injection by the Government of funds into the failed private banking system, as well as the emergence of a huge deficit on the rest of the Government's accounts, shorn as they now are of the boom-time tax revenues.[8] Once again, it seems that the Irish economy has shown a propensity for rapid changes of fortune. It is not to understate the severity of the debt challenge, public and private, currently facing the Irish economy to recognise this propensity, and to believe that it reflects in part a flexibility which will clearly be a very helpful ingredient in the recovery.[9]

Had it not been for the official funding from EU and IMF sources, the budgetary cutbacks would have had to be much more severe, and economic wellbeing would have been much more badly affected. Indeed, the collapse in incomes and the rise in unemployment in the crisis largely predates the arrival of the Troika. Unemployment at the end of the programme was lower than at the beginning. But now the legacy of debt, public and private (only some of which can be attributed to the famous bank guarantee) presents major challenges for government and for over-indebted households, firms and their bankers. For the Government, there has been the challenge of dealing with indebtedness.

Of course the early decision to socialise the risks of bank losses has turned out to be much more of an unnecessarily open-ended gamble than it can have seemed at the time to the decision-makers, blindsided as they were to the lack of well-quantified underpinning of the advice they were being given. From that point on, as more and more information emerged

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2002; and Perotti, 2012). We therefore have not included this episode in our case studies because it does not seem repeatable by countries currently dealing with high public debt." (IMF *World Economic Outlook*, October 2012)

8 Of the increase of some 85 percentage points in the ratio of net Government debt – that is net of the Government financial assets – to GDP, about half is attributable to the bank recapitalisations; rather less of the increase in the gross debt ratio is attributable to this cause, because some of the recapitalisation was paid for by cashing-in existing financial assets.

9 Full analysis of Ireland's international debt position, public and private, raises complicated data issues. See Lane (2013).

about the banks, and indeed as the extent to which tax revenues had become dependent on the now-vanished property boom, management of the rapidly accumulating official debt has become a central priority. It has included efforts to improve the terms of the debt (notably negotiating with European partners the lengthy debt maturities and reduced interest rates eventually secured on both the budgetary and bank-related debt), as well as phasing the adjustment in such a way as to protect firms and households from too sudden a contraction of aggregate demand while at the same time accomplishing the adjustment sufficiently quickly to help speed the restoration of confidence by local and foreign investors. So far the judgment of the markets and of official lenders is positive.

**An exceptional bubble**

Coinciding as it did with similar developments in other advanced economies, it is not straightforward to isolate what was truly exceptional about the Irish construction and property boom and bust. Certainly some elements were exceptional; others less so.

In particular, should we interpret the way in which Ireland allowed a truly exceptional property bubble to emerge in such an uncontrolled manner as reflecting some unique and inherent broad-based failures of the national psyche? After all, it is not only in Ireland, but in many countries around the world also, that bankers and regulators are – or should be – acutely conscious of the mistakes – sometimes breathtaking – that they too made. Over-confidence in the risk management capacity and self-regulating properties of modern finance were widespread. Hubris, and over-optimism, combined with greed, were by no means confined to the Irish economy. It was fatally easy in such an environment for Irish decision makers to buy in uncritically and unreflectively to naïve and to some extent ideological attitudes.[10]

The aggravating Irish ingredient was the fact that it had just experienced the employment miracle of the 1990s: against that background a continuation of double-digit growth rates did not feel as outrageously unsustainable as it should have. The earlier period – the true Celtic Tiger period – represented a solid and exceptionally fast catch-up to attainable living standards based on productivity and value for money (cf. Honohan and Walsh, 2002). But the catch-up was so fast as to encourage illusory expectations. The inflow of bank borrowing in the 2000s was turbocharged by the momentum of that period. It is the speed of Wile E. Coyote’s chase that brings him so far over the abyss before he realises his mistake. When the crash came, Ireland was further out than most of the others.

Yes, those in charge should have been more aware of the risks than a cartoon character, but before claiming world exclusive rights to this type of error, let us not forget the foreign banks from Britain, Denmark and the Netherlands who, in their enthusiasm not to miss out on the money to be made from the Irish boom, lost just as much of their book as did the Irish controlled banks.

This is not to question the value and importance of understanding in greater depth how these mistakes were made, thereby helping avoid such behavior in future. That promises to be a valuable function of the forthcoming Oireachtas hearings and inquiry.

The wrenching adjustment that followed the abrupt end to the Irish property and construction bubble (coinciding as it did with a sharp global recession) has presented exceptional challenges for Irish economic actors, both in respect of short-term crisis management, and in setting course for the longer-term future. As far as the short-term is concerned, output and employment in Ireland fell exceptionally sharply during 2008–9 by amounts matched by few others (Figure 7). Since then, after three years of little change, a more positive tone emerged in 2013 with employment in particular recovering almost to its end-2009 level – while still

10 Of course policy should not have relied on “feel” cf. Lunn and Ruane (2013).

over 11 per cent below the 2007 pre-crisis peak. Despite the need for further fiscal adjustment, all the signs are for a continued recovery, albeit slow.

### "Varieties of capitalism"

Nor, I think, is Ireland all that exceptional in the spectrum running from *liberal* and *coordinated* market economies, seen as a key distinction in the current literature in Economic Sociology and Political Economy examining what are termed the "varieties of capitalism". Even if I am not an adept of this method of comparatively analysing the economies of different countries, there is clearly something in this literature. It rightly exposes and emphasises that the characteristics of successful national economies can differ for extended periods: there is no ineluctable convergence to a single straitjacket determined by the logic of the market or of technology.

In recent decades, Ireland has oscillated between these varieties, having exhibited some features of each and at different times.

One dimension discussed in the literature on varieties of capitalism is the growth of "financialisation" in recent decades. Another – not unrelated – is the degree to which the varieties of capitalism may be correlated with levels and trend of inequality. Let me close by discussing these two dimensions.

### Financialisation and the future contribution of finance

The term "financialisation" evokes the growth in size, revenue and influence of the financial sector which was especially striking in the US, UK and some other so-called *liberal* economies, though noted also to a lesser extent across most of the world.

Let's not forget the extensive body of empirical literature finding that financial *deepening* (usually measured as a growth in the ratio of the assets of financial firms to the size of the economy) is clearly causal for more rapid growth in developing countries. There is no evidence that financial *deepening* has systematically worsened inequality in those countries; if anything rather the opposite. But neither proposition seems to hold for advanced economies. Beyond a certain point, greater "financialisation" is not unproblematic.

The symptoms of "financialisation" are evident in Ireland in the developments of the early years of the new millennium (Cf. Ó Riain, 2012). The total size of the financial assets located in the "IFSC" firms and funds places Ireland on the edge of some international comparisons as having a very large financial sector relative the size of the economy, and even globally significant in absolute terms (cf. Lane, 2013). But most of these assets are at most tangentially linked to the rest of the economy. Stripping away that international enclave business allows us to focus on what matters more.

As we have seen, the domestic Irish banking system was traditionally rather passive as an investor, stable, but contributing comparatively little to economic growth. From the early 2000s, though, massive growth in its activities and apparent profitability told a new story. It would be hard to deny that this was "financialisation" even if, as I would argue, on a smaller scale than in the US.[11, 12] Smaller because the exploitative predatory lending evidenced in

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[11] It is notable that most of the recorded profits of the banking sector were reinvested and not paid out in dividends: more so indeed in Anglo Irish Bank than in the other two large locally controlled banks. Top bankers were indeed well paid, but their remuneration seems to have accounted for a smaller proportion of the bank's revenue than the extraordinarily high figures for US investment banks. For instance the directors and top management (executive committee members) of Anglo Irish Bank were paid the sizeable total of €18 million in 2007, compared with €86 million paid in equity dividends, but also to be compared with the before tax profit recorded as €1.2 billion. (Note, though that such remuneration figures do not include loans, for example).

parts of the US sub-prime mortgage lending market spilled-over to Ireland to only a limited extent. Nor does it seem that, in contrast to the United States (Rajan, 2010), provision of easy mortgage credit was seen by the political establishment as an attractive way of meeting the living standard aspirations of lower income households.

Yet in the aggregate, the behaviour of the banks in fuelling the property bubble with their unrestrained lending both to developers and to final purchasers was hugely damaging to economic wellbeing. Their shallow credit analysis meant that the banks greatly underestimated the risk of both forms of lending. Fixing the banks along those dimensions should be a relatively uncontroversial and mundane task. Probably it is much more important in finance that fundamentals of soundness are restored than that any particular flavour of financial sector development is pursued in preference to others.

But we should envisage far more than avoidance of failure from this sector in the future.

Nobel laureate Robert Shiller, a perceptive critic of the US financial system and its excesses, is nevertheless an advocate of greater use of financial engineering in improving the performance of the economy, notably by devising and making available better instruments for risk-pooling and risk-sharing. (Shillerian finance might have come up with a risk-sharing instrument sufficient to ease the anxieties that generated that post-Famine deferral of family formation.) In credit, the value of soft information and local knowledge is being re-appreciated, leading to some reappraisal of the relationship model for SME lending. Community-based lenders can be key actors in this dimension.[13] And innovations in such areas as crowd-funding could also come to complement other forms of non-bank finance which are sure to grow in importance as banks repair their balance sheets and respond to regulatory demands. Not every financial innovation makes sense; finance attracts many crackpot schemes and is a happy hunting ground for populism. But it is clear that there are several different proven models of organising finance that are equally good in delivering growth outcomes,[14] and which can have different impacts in other dimensions.

### Income inequality

Returning to the question of income inequality, I would argue that Ireland is not exceptional in this dimension either. As far as the income share of the top 1 per cent is concerned, the last quarter of the 20th Century saw Ireland's figure growing midway between that of a group of "Anglo Saxon" countries and a group of "continental" countries (Alvaredo, Atkinson, Picketty and Saez, 2013).

Indeed, in Ireland, despite the substantial loss of national income in the bust, policy has gone some way towards limiting the rise in poverty in the downturn (Callan et al., 2013). This surely reflects a broad political consensus in Ireland; indeed some will argue that more should have been done. Actually the data suggest that the later years of the boom did allow relative poverty to decline in Ireland, at a time when the opposite was happening in many countries (Figure 8). And the corresponding data for 2010 and 2011 suggest that any reversal in this improvement has been small and mainly concentrated among young adults (the data for 2012 are not yet available). A similar story is shown by the Gini coefficient, another indicator of inequality. Of course, holding inequality or relative poverty constant at a

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[12] In line with standard international practice, the recorded profits of the banks contributed to measured GDP, whereas their loan losses have been treated as a capital item, and have not been subtracted from the GDP of any year.

[13] This is why I regard strengthening of the credit union movement both financially and institutionally – a task which has been conferred on the Credit Union Restructuring Board (REBO) as worthy of the substantial financial resources that have been earmarked for it.

[14] For instance the choice between relying mainly on stock markets or on universal banks for the financing of firms.

time of falling aggregate income still means a loss of purchasing power for those at the bottom of the income distribution who can least afford it. And these inequality data are probably not as reliable as some of the other more familiar macroeconomic data. But on this evidence the Irish record here seems better than in some of the adjusting countries in Europe. Here is an area where Ireland is not at an extreme: there is scope for policy to have a lasting impact.

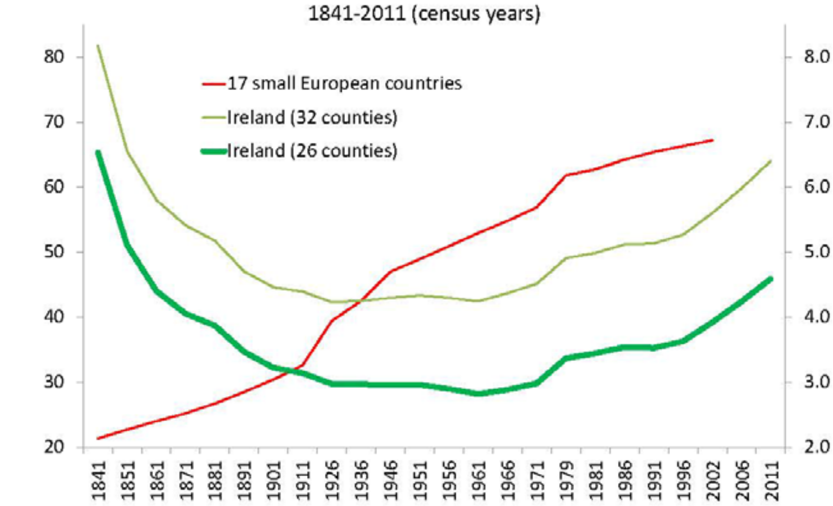
A long-argued issue in the economics of growth and development is whether greater equality of income is causally associated with more or less development – this is a topic that has been receiving a welcome degree of renewed interest internationally. What is clear is that countries at equally high levels of average living standards can exhibit very different internal income inequalities, reflecting different approaches to economic policy. "Growth is still good for the poor" is the self-explanatory title of a recent study by some of the leading experts in the field by which they mean that there is no systematic tendency for growth to worsen income inequality: economic growth is accompanied by growing inequality in some countries, and by growing equality in others. Conversely, recent research lends some support to the attractive proposition that a reduction from high levels of inequality can help drive faster growth in average living standards (cf. Dollar et al., 2013; Ostry et al., 2014).

## Conclusion

History shows us that, as a nation, Ireland does have a significant room for policy choices which can have a lasting impact on the quality of economic development. While there are important preconditions – common across countries and substantially defined in the acquis of the European Union – for successful national economic performance, economic policy is not simply a question of converging to a single normative standard. The European Union embraces considerable variety of style within the acquis, and this variety enriches and strengthens Europe. Such choices are political ones: we need to be aware that they exist.

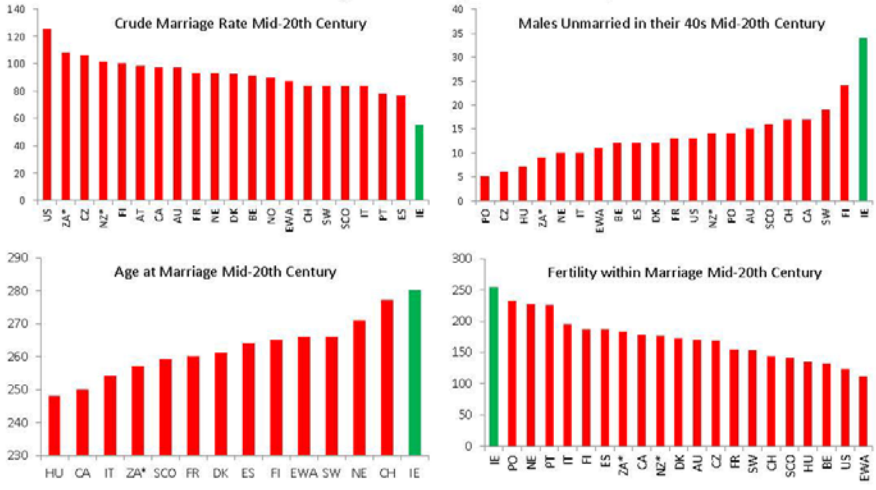
We should also be aware of the speed with which the conditions of macroeconomic imbalance can change quickly in Ireland, not least because of its exceptional openness. Seemingly intractable imbalances have been corrected surprisingly quickly; balanced conditions have suddenly slipped out of control. The policy message here is one of *optimism* that at least some elements of current conditions can be made to swing around more quickly than is often supposed; and of *vigilance* that slippage does not occur again.

**Fig 1: Population: Ireland and other small countries**
1841-2011 (census years)



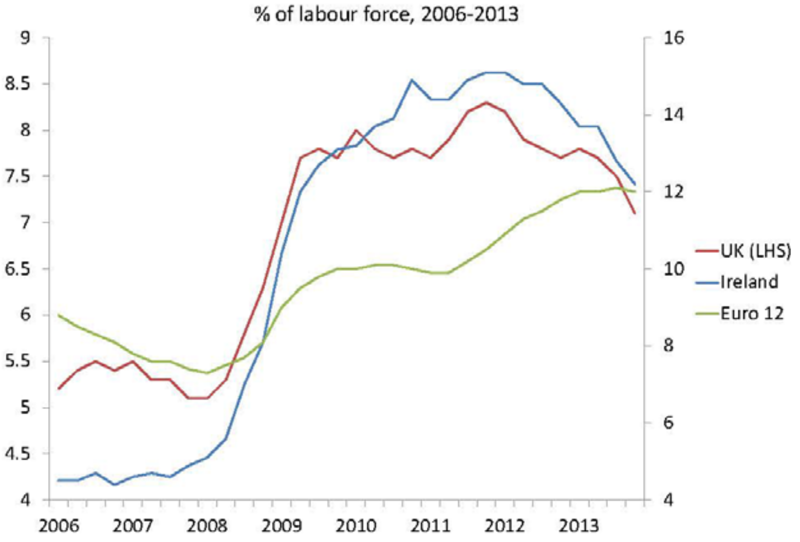

Source for other countries: Maddison (2003)

**Fig 2: Ireland the outlier:**
Marriage and Fertility, mid 20th Century



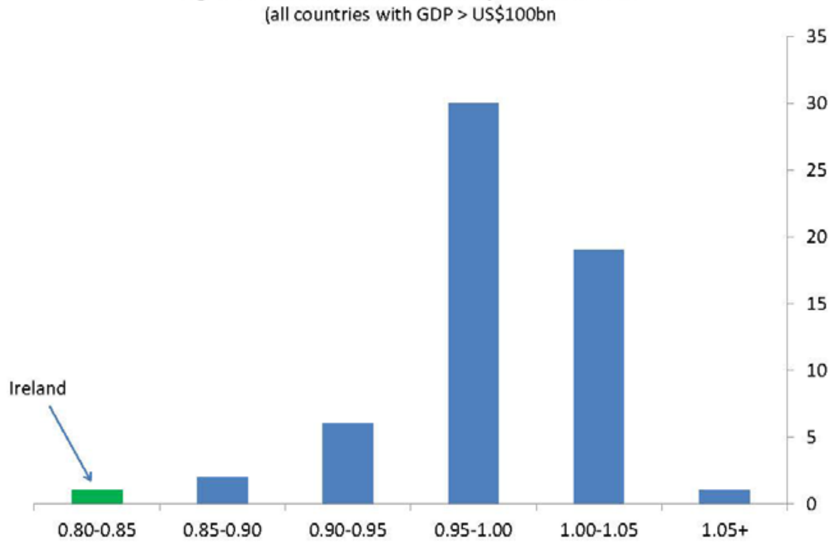

As reported in Commission on Emigration and other Population Problems (1955)

**Fig 3: Unemployment rates: Ireland and UK**
% of labour force, 2006-2013

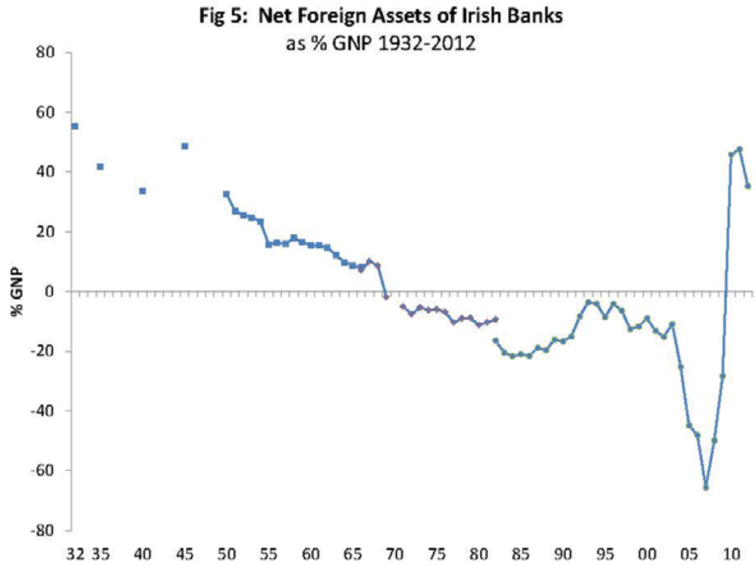



Source: Eurostat

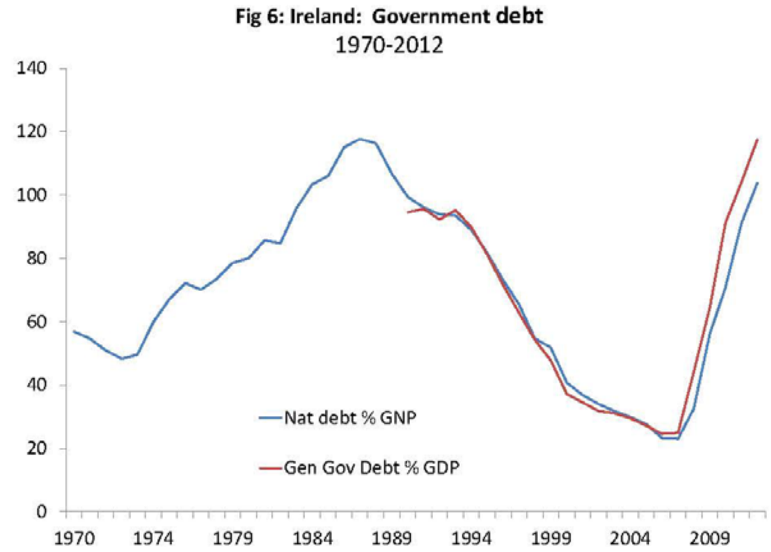
**Fig 4: Distribution of countries by GNP/GDP ratio**
(all countries with GDP > US$100bn




Source: World Bank WDI




NB: definitional changes imply several breaks in series




Source: NTMA

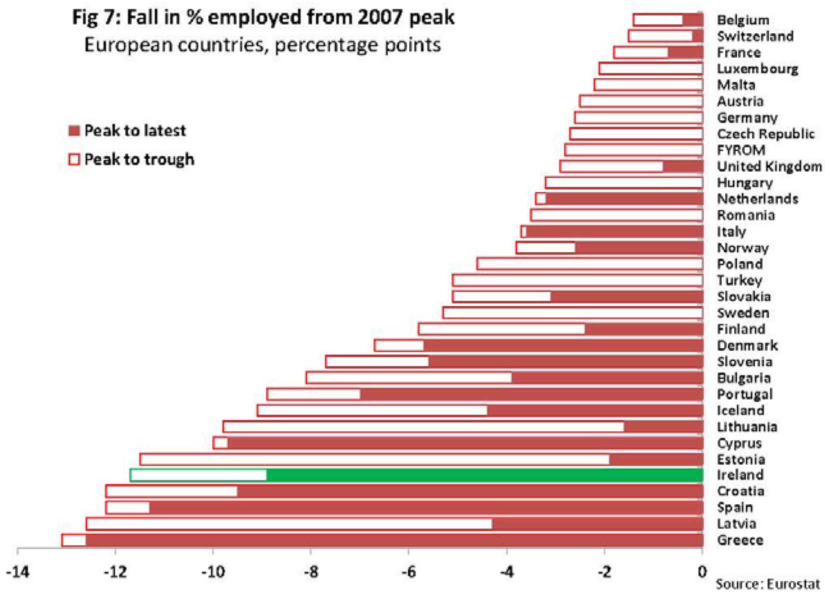


Fig 7: Fall in % employed from 2007 peak
European countries, percentage points
Peak to latest
Peak to trough
Belgium
Switzerland
France
Luxembourg
Malta
Austria
Germany
Czech Republic
FYROM
United Kingdom
Hungary
Netherlands
Romania
Italy
Norway
Poland
Turkey
Slovakia
Sweden
Finland
Denmark
Slovenia
Bulgaria
Portugal
Iceland
Lithuania
Cyprus
Estonia
Ireland
Croatia
Spain
Latvia
Greece
-14
-12
-10
-8
-6
-4
-2
0
Source: Eurostat

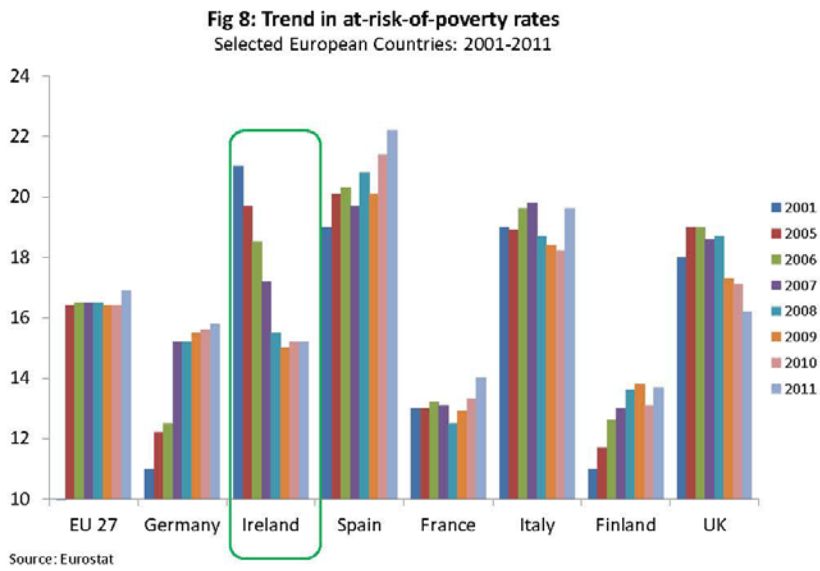


Fig 8: Trend in at-risk-of-poverty rates
Selected European Countries: 2001-2011
24
22
20
18
16
14
12
10
EU 27
Germany
Ireland
Spain
France
Italy
Finland
UK
2001
2005
2006
2007
2008
2009
2010
2011
Source: Eurostat

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