THE CONVERSATION

The lessons Europe forgot are the ones Australia will do well to remember

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The Irish have seen their booming economy implode. Is it a good lesson for Australia? AAP

When Treasurer Wayne Swan finger-wagged at the recent set of G20 events, scolding his European colleagues and telling them to get their act together, he had more of a point than perhaps the Australian media gave him credit for.

One the central tenets in economics is that that economic policy needs to be credible and politically feasible or it will be hijacked by any number of forces.

The inability of the Eurozone forces to put in place a "wall of money", as one Finance Minister put it, places Europe in the same position the precursor to the euro found in 1992 – except this time it is not just one speculator (George Soros) but rather the forces of the entire sovereign debt market that are finding every weak spot and going after it.

The critical problem is that the economic solution has not come forward and instead we have this bizarre dancing around solutions with multiple agency involvement, and political opportunism playing a not insignificant role.

IMF head, Christine Lagarde: no solution yet. AAP

The Irish lesson

People need to remember the real impacts of these shenanigans. The Irish vantage point remains an interesting one, and also an illustration of the sort of farce the concept of the united Europe has become.

From a period of strong growth fuelled by exports, foreign direct investment (FDI), favourable demographics, EU support and so on in the 1990s, a former basket case economy had become a star performer based largely on sound activity and fundamentals.

By 2002 the growth model had stalled and a new phase began where property investment began to drive growth in the Irish economy, and from 2004 to 2007 Ireland binged on cheap credit sourced from international markets and fed, via domestic banks, into property speculation. It horribly distorted the economy, leading to wage inflation in unsustainable sectors, public finance becoming heavily reliant on property revenue and our entire banking system totally exposed.

New Irish Prime Minister Enda Kenny. AAP

When the global financial crisis began, it became rapidly apparent that the game was up in Ireland. The government dealt with the crisis with a combination of stealth taxes, dramatic reductions in public expenditure including across the line cuts in nominal pay of public sector workers, and the creation of a bad bank which purchased property loans from the domestic banks at a discount. The extent of the losses suffered by the banks was such that a combination of nationalisation, capitalisation and closure resulted.

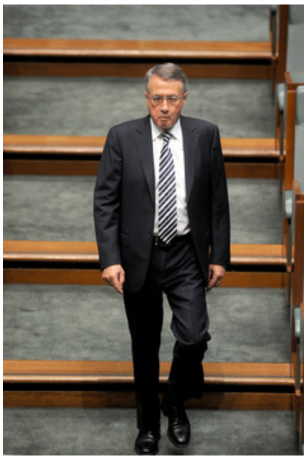
"Fateful decision"

A fateful decision to guarantee all the liabilities of the Irish banking system was initially greeted with enthusiasm as people welcomed the stemming of deposit flight. But the effective sovereign bond financing of the late property bubble coupled with the liability of general government activity led us to the bailout loan deal with the EU and IMF and heavy dependence on the ECB for banking liquidity support.

Currently, Ireland is continuing a rapid program of fiscal adjustment and on measures such as improved competitiveness, FDI, or exports is performing well. But the fragility of the European and global market means that there is little or no certainty on the path forwards. Unemployment has risen to 14%, higher among young people, low educated and men. Domestic demand is flattened by a combination of readjustment in the construction and ancillary labour markets, weakened bank credit lines and households rebalancing after a credit boom.

Europe's lost generation?

This is, therefore, not some abstract issue about the money markets. The internal adjustments – in Ireland, in Greece and so on – are extremely damaging. While most people are taking the austerity and simply getting on with things, it is clear that certain groups are being disproportionately hit. The youth labour market is particularly weak all across Europe. The concept of a "lost generation within a lost decade" has become ever more real.



Should Wayne Swan reappraise his approach? AAP

When Treasurer Swan had his pop at his G20 colleagues he perhaps should have gone further and told them what to do – swift, deep and decisive action that aims to turn this lost decade into more a painful chapter, with Europe acting as a coherent force.

In addition, be consistent. In Ireland's case, for what is perhaps the first time since the crisis evolved, public opinion is firming around the idea that we have been the good guys (amongst the bad guys) and have taken, and continue to take the medicine –but to no end, so why did we bother?

In particular the insistence of the European Central Bank (ECB) on the Irish government not "burning" private unguaranteed bank bondholders in our most toxic institution was seen widely as symptomatic of the paralysis of thought at the heart of the Eurozone problem.

As a recent blog post by Irish commentator Colm McCarthy eloquently puts it, "searching for a politically acceptable solution is fine if the set considered intersects with market-acceptable solutions."

Swan's approach

The chances of that happening are slim – and that ultimately leaves a Eurozone breakup as the current pathway. That won't be pretty, bringing us towards a global credit crunch that will could be as big as the peak of the GFC.

If the Treasurer wants to avoid his colleagues in the G20 in time retorting "who are you to talk?" he needs to reappraise what his objectives are in the context of what looks to be increasing economic uncertainty and ensure the firepower is there to keep Australia out of the mess.

While the direct exposure may be small, the indirect effects could be profound. For example, the breakup of the Eurozone will create an economic perturbation that will be the biggest push factor on migration in generations, and Australian Labor policy will need to be keenly aware of this.

Ireland
Global financial crisis
Sovereign debt
Global economic shakeout
Eurozone