Ireland needs its apocalypse now [1]

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The Republic of Ireland?s Minister for Finance announced [3] this morning that its bailout of Anglo Irish Bank will be €10bn more than anticipated, and that the Irish government is effectively nationalizing the country?s second biggest bank, Allied Irish Banks. The Irish budget deficit for this year will now be 32%, with the bank bailouts costing around 20% of GDP. This is a direct consequence of the Irish government?s bank deposit guarantee which I wrote about [4] on Wednesday, which assures 100% of deposits in an effort to avoid bank runs. But this guarantee assumes that the state itself will not become bankrupt, something which is now probably likely.

If Ireland does go bankrupt, the options will then be a sovereign default or calling in either the International Monetary Fund or the European bailout fund, the latter of which would likely impose punitive measures to punish Ireland for her low corporation tax rate. This would end Ireland?s chances of recovering to the days of the Celtic Tiger and, under EU management, would doom its economy for decades. The longer it takes for the Republic to be put out of its misery, the more leverage the EU will have. A collapse now seems inevitable ? the only question is when it will come.

Ireland should take three painful steps to end its purgatory and put itself on the road to recovery. Firstly, it should end its 100% bank deposit guarantee and stop protecting banks and savers from their own mistakes. This would remove a large part of the budgetary burden. Secondly, it should default on some or all of its debt and fix its budget deficit through cuts in current expenditure. A fire sale of capital building projects and the privatization of other state assets (the state-owned gas and electricity companies, for instance) would bring in some much-needed revenue and help with the private sector recovery by opening up the number of industries subject to competition. Finally, the government should withdraw from the eurozone immediately. This would allow for a currency revaluation that would end the trade stasis that the euro has locked Ireland into, with artificially high prices depressing Irish exports.

These steps would be painful, mirroring Iceland?s collapse last year. But to continue further without a currency revaluation and trying to prop up the banks through further deficit spending would make the eventual economic collapse significantly worse. Ireland needs to allow the collapse to occur now, rather than risking a generation-spanning catastrophe by postponing the inevitable.

Links:
[1] http://www.adamsmith.org/blog/international/ireland-needs-its-apocalypse-now
[2] http://www.adamsmith.org/taxonomy/term/5809

[3]
http://www.irishtimes.com/newspaper/breaking/2010/0930/breaking4.html?sms_ss=twitter&at_xt=4ca461ded45172cb,0
[4] http://www.adamsmith.org/blog/tax-and-economy/ireland-is-no-model-of-austerity/
[5] http://disqus.com/?ref_noscript
[6] http://disqus.com