

Who's afraid of 10 per cent growth?

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Former Taoiseach Garret FitzGerald last week added his voice to the gloomy chorus calling for a reduction in the rate of economic growth as a response to the build up of inflationary pressures.

Quite how one is meant to knock a few percentage points off the growth rate (apart from the trusty method of re-electing Garret) is not at all clear.

This fretful debate about whether renewed inflation signals an end to the economic boom is generally inconclusive. The substantive economic issues certainly seem complex in the face of limited information. More generally, we have trouble as a society in finding a coherent story to tell about the causes, extent and vulnerabilities of our economic renaissance.

Accustomed to systemic failure, we scarcely believe success and fear that our presumption of its continuation only invites its early demise—the laughter of the economic gods at our overweening pride. In the absence of a convincing account of where we are, the public mood is caught between grasping at unconvincing reassurances from on high, and half-believing the prophets of doom in the cheap seats.

The rise in inflation is naturally of concern but deserves a considered response. The puzzle up to now was that inflation had not risen sooner, given how fast the economy has been growing and for how long.

The worry is that we are seeing the much-predicted feeding through of house price inflation to general prices, on the back of an unhealthy credit boom.

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Yet we might also be partly confusing fairly natural rises in some particular prices (especially the price of skilled labour) with general inflation.

Furthermore, a reasonable medium to long-term expectation was that our membership of both a single market and a monetary union would lead to a convergence in our inflation rate with our eurozone partners.

This was precisely Ireland's inflation experience in our last monetary union—that with Britain until 1979. Might we be seeing merely the adjustment of the price level to a new plateau, which would be consistent with our higher level of income, rather than a sustained inflationary spiral?

It is widely understood that our membership of the eurozone precludes an independent monetary policy response, such as a rise in Irish interest rates. The implicit and incorrect corollaries are that there was once a period of independent and successful Irish monetary policy, and that such an alternative would be open to us outside the eurozone at an acceptable cost.

The usual alternative put forward as a policy response is a fiscal tightening. This is very problematic. One must doubt the extent to which our growth path can be reliably fine-tuned (even if we knew what growth target we were aiming for) by manipulating the budget surplus (even if we knew what budget surplus was appropriate). The uncertainties here are acute, especially when set against a rationale for more tax reform to unburden the labour market even further.

On the other side of the budget, sound microeconomic arguments and reasonable equity arguments for more public expenditure on human capital and infrastructure appear in conflict with concerns about macroeconomic stability, that is, inflation.

These dilemmas are manageable if we understand that the best public policy can do is to attempt to facilitate non-inflationary growth rather than imagining we can precisely direct inflation or growth—the conceits which led us astray before. In short, we are left with supply-side policies, which amount to freeing up the productive potential of markets to meet demand without a general rise in prices.

The widespread calls for action to extend labour market opportunities (including for economic migrants), to ensure a functioning housing market and to bring competitive pressures to bear on transportation, are essentially pro-growth, low inflation policies. We are all supply-siders now. President Rea-

gan would be pleased.

Even admitting that there are limits to the supply-side response and that we will one day reach them, the current tenor of the debate veers depressingly from the alarmist to the complacent.

Despite the commonplace rhetoric of rapid economic change and constant social challenges, we haven't absorbed in public policy terms the true meaning of our transition to a dynamic, market oriented economy.

In part it means that an intrinsic part of sustained economic success is many failures along the way. In particular, when markets work well, they do so not just by permitting new entrants and rewarding success, but crucially also by signalling failure and allowing exits from the market.

This is more than a needless weeding out of underperformers for cruelty's sake. Allowing for failure is the key market mechanism which ensures resources are freed up and diverted away from useless activities towards worthwhile ones. When those resources are people, society naturally has an interest in allowing the state to ease the transition but without undermining the essentially healthy process at work.

No economic crisis is without pain, but perhaps one of our problems in the 1980s was that we only belatedly allowed such a process to work. The depth of our dysfunction as an economy was obscured by the pursuit of a chimerical stability and led only to stagnation. By the same token, some of the emergent difficulties do not by themselves determine our medium-term prospects but are useful signals to which we can respond.

This is pertinent to the chatter about the prospects for a satisfyingly melodramatic economic crash after our presumably undeserved successes. (An economic crash would at least have the advantage of ending David McWilliams' continual predictions of same, but let us be dignified, and move on.)

In a sense, in a dynamic market economy, the crash never stops—and a good thing too. Eircom provides one case study. We see an organisation in the middle of restructuring in a volatile but important sector, taking a stock market beating because of difficulties in the sector and doubts about its own competitive prospects. We see the resulting discomfort of a market participant which must respond to the demands of its owners for a return on their hard-earned (sometimes borrowed) cash, pressures that were at best diffuse when it was owned by all of us. Now we know it is no longer a division

of the Department of Posts and Telegraphs. And so does Eircom. So long, and thanks for all the flotation receipts.

The contrast with the persistent uselessness of some market-immune organisations, such as CIE, is instructive. Its failure to meet its impossible mandate of being at once a social provider, residual employer and competitive player, is only now clarified by the urgency of the transport crisis. Public ownership, in other words, failed to provide the necessary, healthy mechanisms for CIE to raise and allocate resources and failed to provide the performance indicators, such as profit and loss, or a share price, which might have signalled that failure.

By the same token, the gyrations in market values for dotcoms is uncomfortable but innovation is classically understood to require such “waves of creative destruction”, as the economist Schumpeter termed them. Old behemoths fall aside, their places taken by upstarts—some of whom might even have a business plan. Eventually, the market overextends itself and withdraws, having winnowed and sorted, not just the enterprises, but investors as well.

If there is a systemic risk for us, it is that the one domain upon that such exit mechanisms have only barely intruded is that of electoral politics, which is remarkably peopled by Ireland’s past.

The continual generational change and wider dynamism which now characterises the activities of employees and employers in much of the public and private sectors is curiously absent from representative politics. Maybe that’s why so many of our politicians appear so . . . well, so 20th century. Another crisis, anyone?

http://www.aidankane.net/writingsetc/2000_kane_growth.html