

A No vote in Ireland's referendum on the Fiscal Treaty might contribute to the demise of the current mindset of austerity.

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Polling in the lead up to Ireland's vote on the Fiscal Stability Treaty has pointed to the endorsement of the Treaty. But will the Treaty be a positive force for Ireland, and for Europe? [Simon Wren-Lewis](#) argues that the Treaty is ultimately flawed as it treats the current crisis as stemming from massive public sector debts, whilst ignoring that these debts come from governments' bailouts of banks that were under threat due to unsustainable borrowing from the private sector.



Today Ireland votes on the [Fiscal Stability Treaty](#). Polls suggest the result will be yes. Will this be a solid endorsement for the clauses of the Treaty, and the vision that lies behind it? I doubt it very much. What may be much more decisive is a clause that only allows access to Europe's new bailout fund to states that ratify the treaty. Given Ireland's current situation, you could say that voters have very little choice but to vote yes. In addition, I have read quite a few posts over the past few weeks (e.g. John McHale [here](#)) suggesting that the Treaty does not impose any additional burdens to the austerity Ireland is already implementing. In that sense, there is no immediate cost in voting yes, if you think the current austerity is unavoidable.

If that is the immediate cost benefit calculus, what about the longer term? Philip Lane [writes](#) "My own take is that, if the Treaty is implemented in an intelligent, cyclically-sensitive manner (consistent with the flexible, holistic interpretation laid out in the "six pack" regulations), the new fiscal framework will be a positive force, helping Ireland and other European countries to gradually exit from high debt levels and avoid destabilising pro-cyclical fiscal policies in the future."

Unfortunately, I think you could also argue exactly the opposite. If the Treaty is implemented in an unintelligent manner, with an attempt to satisfy all its numerous rules and clauses without regard to macroeconomic context, the results could be disastrous. (If you want an example of how this can happen, [see](#) the

Netherlands.) As I have suggested [before](#), the Treaty is similar to the Stability and Growth Pact (SGP). True, compared to the original SGP, the emphasis on cyclically adjusted deficits gives formal acknowledgement of the importance of automatic stabilisers. More generally, whereas in the original Pact there were two main criteria for budget deficits, now there are many more (see [here](#), or [here](#)). That can be read as flexibility, or it can be interpreted as confusion, muddle and bad economics. Hence both optimistic views like Philip's and more pessimistic readings (see Karl Whelan [here](#) for example) are possible.

What I believe is clear is the overall vision that the Treaty represents. It sees the essential problem with the Eurozone as being public sector indulgence. This is a profound misreading of what happened before the recession. By far the bigger [problem](#) for most periphery countries was private sector indulgence fuelled by



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cheap borrowing. In Ireland, and now in Spain, this transforms itself into a public sector problem because banks are bailed out.

The fact that it was excess private sector borrowing that was the ultimate cause of the crisis does not mean that fiscal policy was appropriate. Far from it. Fiscal policy should have been much tighter than it was, because it needed to be countercyclical. However, the idea of countercyclical fiscal policy was nowhere to be found in the original SGP, and hardly figures in the Treaty. If the Treaty had been a realistic response to the current crisis, issues to do with macroeconomic stability (e.g. relative inflation rates, real exchange rate disequilibrium) would be at its centre, rather than as the vaguely worded single paragraph that is Article 9.

This failure in both the original SGP and the new Treaty to recognise how important countercyclical fiscal policy is to the viability of the Euro is a major, perhaps the major, design flaw. (I have written about this [before](#), but for a similar message see [here](#).) What is worse, the obsession with public sector profligacy has diverted Eurozone policymakers from understanding this, both before and during the crisis. It has also discouraged recognising the scale of the problems facing the banking sector, and indeed the obsession with austerity has [probably](#) made this problem worse.

One response to this argument is political. Yes, the Treaty is a distraction, but it is a pre-requisite for other important reforms of the euro system. In simple language, the Treaty is needed because without it there is no chance of persuading Germany to even think about Eurobonds and the like. But perhaps what has to change is this German (and Dutch, and Finnish) mindset. As long as the 'fiscal irresponsibility' story remains the dominant narrative, we will get either continuing policy inertia, or worse still [games](#) of chicken being played with national electorates. That road may lead to disaster, as Boone and Johnson argue [here](#). There needs to be a collective realisation that the causes of the crisis are not as originally advertised. There are solutions (e.g. Nick Stern [here](#)), but they require Germany and others to put Euro survival ahead of national self-interest. With the election of Hollande, there is a chance of this happening. In this context you could argue that an Irish yes vote does nothing to help change the austerity mindset, whereas a no vote might have contributed to the mindset's demise.

That is easy for me to write. It is also easy for me to conjecture from the other side of the Irish Sea that if Ireland voted no, this would make no difference to their ability to receive bail-out funds. Ireland has been the poster boy for the 'austerity' cure, and for this and many other reasons the Eurozone is not going to let the little matter of a popular referendum make them throw Ireland to the market wolves. However, I can quite understand that, given what Ireland has been through, it would not want to take that risk for what would, I admit, be little more than a gesture. It may also be that, ironically, Ireland's opportunity to argue that the Treaty is a dangerous distraction is greater if it votes yes. If the vote is yes, it must take that opportunity.

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Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.

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