Opportunities and Challenges of being a small open economy

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An uncertain macro environment
Policy uncertainty

Source: Bloomberg
The Business Cycle – still going

Expansion cycle now the second longest in history

*Note: Current expansion phase started in June 2009, length calculated till November 2018. Average expansion cycle excludes current ongoing cycle

Last data point: November 2018

Source: NBER
The risk is that trend growth resets lower

Source: Bloomberg
Five ‘Levelling’ themes

- Goodbye globalization, hello multipolar world
- Financialisation is like climate change, deal with it or we have a crisis
- Populism gives way to wisdom and then, to fiscal activism
- Geopolitics in flux – new rivals and new coalitions
- Hamilton project – what is new? And how are we positioned institutionally
Goodbye Globalization, hello multipolar world
Globalization is over

Global Trade (% of GDP)

Peak 2008 level: 61%

Source: World Bank
Implications

- Globalization gives way to a multipolar world
- Broad, macro risk of a trade shock that produces a recession.
- Small, open economies are even more so the ‘canaries in the coalmine’
- Trade flow and supply chain disruption will rise, but these can be an opportunity
- Ireland will increasingly have to choose sides, or position itself as an intermediary.
- Risk is that regulation, democracy, technology and other vectors become less universal and more multipolar
Financialisation is like climate change, deal with it or we have a crisis
Global indebtedness continues to rise

Debt (% of GDP)

Source: IMF
Implications

- Central banks are too dominant and have distorted the political economy

- Too much debt in EM, corporates and in large economies. Like climate change, the risk is to wait now and have a great crisis later.

- A solution would be to remake the international rules of finance – ‘Westphalia for Finance’.

- Euro-zone stress and consolidation a major theme. Opportunity for Ireland is in the ‘safe asset space’.

- Opportunities in finance in general – debt trading, the building of China’s financial infrastructure, impact investing.
Populism gives way to wisdom, and then, to fiscal activism
Levelling of politics
Rise of populism in Europe

Source: Eurasia Group
US wages weakest in 70 years, corporate profits high

Source: FRED Economic Data
Implications

- **Populism creates risks not solutions, eventually we get to an Agreement of the People**

- **Major trend towards fiscal activism to the benefit of households over corporations** - Green New Deal an incoherent example of where policy is headed

- **New parties, new issues (data, mental health)**

- **Investment spending may be local than international**

- **Search for a more balanced model of growth...small country secrets of success...intangible infrastructure. Idea of country strength becomes more important.**
Geopolitics – Hanseatic 2.0, QUAD, SCO...and the end of the WB, IMF and WTO
Small, advanced countries have the same problems and solutions

Canaries in the coalmine

Index value

Note: small countries include Ireland, Switzerland, Netherlands, Hong Kong, New Zealand, Sweden, Singapore

Last data point: October 2018, data for NZ as of August 2018

Source: Bloomberg
Implications

- Small countries clubbing together. Pro-growth, fiscally conservative group in Europe, Hanseatic League 2.0.

- New total wars, Thucydides, defense spending.

- Security and defence become much greater issues for the EU. EU Army.

- Old institutions like the WTO will fade...implications for the rules and regulations governing investment flows. SoftBank, ADB more important.
The Hamilton Project
Building China’s financial architecture, soft power

Yield to Worst

Source: Datastream
Implications

- New tech (AI, blockchain, genetics, robots etc) – need to decipher what matters for Ireland. Are they fads, bubbles? And are life cycles so short that it is not worth chasing them.

- Ireland may need to become a leader in legal and compliance infrastructure...i.e. it could host the Internet Police.

- Need to complete the building of the euro-zone, and to bring the EU back in touch with people. Ireland has examples to offer – Citizen’s Assembly.

- Risk is that Ireland’s institutions are suited for the 19th and 20th centuries, and continue to fragment under the strain of 21st century challenges.