Reinvention of Europe Project

Ireland: from interdependence to dependence

By Brigid Laffan

Since the fatal decision to bail out Irish banks in September 2008 and thus socialise bank debt, Ireland has found itself in the throes of multiple crises: banking, public finance, economic and reputational. Although the Irish Government began a programme of fiscal consolidation in 2008, the state was so overwhelmed by the gravity of its banking and public finance problems by November 2010 that it had to reluctantly accept a rescue package from the European Union and International Monetary Fund. Ireland, having exchanged dependence on the UK for interdependence within the EU, now found itself dependent for funding on an EU/IMF Programme of Financial Support. The troika became an integral part of the governance of the state with periodic visits to check on the performance of Ireland as a programme country. This is deeply traumatic in a country that, since its foundation in 1922, has been able to meet external obligations to financial markets even when poor. As Ireland strives to return to the bond markets, it does so in the context of a eurozone in crisis, a significant shift in the attitude of its nearest neighbour towards the EU and the prospect of a step change in integration as the euro member states complete the single currency. Although this brings the “f” word (federalism) onto the agenda, in Ireland the real “f” word is simply “fix” it. Ireland is far more preoccupied with the immediate crisis than with longer term developments in the eurozone, notwithstanding their significance.

From being a model small EU member (and Europe’s “shining light” according to The Economist), Ireland’s state and society went from boom to bust it a very short time frame. Almost overnight it became a debtor, unable to fund itself on bond markets. The causes were both domestic and external. The Irish boom had mutated into a bubble driven by over-reliance upon the construction industry, negligent financial regulation, an expansion of public expenditure, wage inflation with a consequent loss of competitiveness, and the emergence of a current account imbalance. The crisis, however, was not all home grown. The expansion in credit flows, both global and within the eurozone, fuelled pro-cyclical policies and gave the state, Irish banks and citizens access to too much cheap credit. When the fissures in the Irish banking system were exposed in September 2008, the absence of a eurozone bank resolution mechanism made it a very dangerous club to be part of. The decision to guarantee the vast bulk of the banks’ liabilities, without knowing what those liabilities were, proved catastrophic. The cost of the bank bailout (approximately €64 billion) makes it one of the most expensive bailouts in history. The ECB’s post-Lehmans determination that no bank would be allowed fail in the eurozone meant that Ireland’s taxpayers and society now carry the full burden of the reckless lending of Irish and non-Irish banks in the 2000s. The 1.6 million Irish households now

carry a far higher bank related debt burden relative to other euro and non-euro states. But by guaranteeing the liabilities of the banks, the Irish state rescued not only its own financial system but also the euro-wide financial system at a time of extreme vulnerability.

Responses

The cost of the bank bailout and the fiscal gap that opened up following the collapse of construction led to the €85 billion November 2010 rescue package (representing 54 percent of Ireland's 2010 GDP). This came with a high level of conditionality, including a commitment to fiscal consolidation of €15 billion between 2011 and 2014.

With the politics of austerity scheduled to continue well into the second decade of the 21st century the response from the Irish electorate has been swift and devastating. In the February 2011 election the incumbent Fianna Fáil (which has dominated Irish politics since the 1930s) lost 24 percent of its vote and 57 parliamentary seats (taking it down to 20 seats in the 166 seat Dáil Éireann). Its junior coalition partner, the Green Party, failed to win a seat. The FF/Green government was replaced by a coalition of Fine Gael (76 seats) and Labour (37 seats), labelled a *Government of National Recovery*. A new central bank governor and financial regulator were appointed, and both a Fiscal Council of independent experts and a new ministry for Public Expenditure and Public Sector Reform established. To give voters a say in political reform a constitutional convention began its deliberations on 1st December 2012.

Irish society responded to the crisis with a mixture of anger, resilience, passivity, and humour. Unlike in other peripheral countries, there have not been sustained mass demonstrations or strikes. There were two large demonstrations (in November 2010 when the troika arrived; and in November 2012 with the sixth successive austerity budget), and opposition has mobilised against specific measures such as the €100 household charge. Experiences of the crisis have varied. Young people have been badly hit by unemployment (in the third quarter of 2012 the overall rate was 14.8 percent), and many have emigrated (76,300 left in 2011). Unlike in most other crisis countries retirees have not faced significant cuts. The new government entered office with a threefold pledge not to increase income tax, reduce welfare rates, or renege on commitments to public sector unions (the "Croke Park Agreement", which trades extensive reforms for a guarantee of no further pay cuts beyond the 5-15 percent reductions in the 2010 budget). Notwithstanding four years of austerity and six austerity budgets, the Irish Government continues to command majority support (although opposition to austerity is growing). In May 2012 the Fiscal Treaty referendum was passed with 60.3 percent of the vote. The government's ability to persuade the electorate to vote for a European treaty at a time of crisis underlines the firm majority conviction that Ireland is better off anchored in the EU, although the preoccupation so far has been with dealing with considerable domestic challenges rather than fully engaging with how Europe might integrate further in the future.

Performance and interpretation

In keeping with the pragmatic Irish focus on “fixing” the country, there is a heated and highly politicised debate taking place in Ireland about how well they are coping with fiscal adjustment and austerity, and the assistance given by other eurozone members. In October 2012 the troika described Ireland’s reforms as a “well performing adjustment programme” characterised by “steadfast” implementation.[1] Ireland has consistently met its fiscal targets, leading in turn to Ireland being viewed as the model of how to implement an adjustment programme. Seen from outside, Ireland is a country that has managed to meet its adjustment commitments, returned to modest growth, regained some competitiveness and increased its exports. This image is promoted by the government as it attempts to rebuild Ireland’s reputation in the EU and beyond, and to engage the support of the Irish diaspora. Efforts to bring their expertise, resources, and experience to assist in Ireland’s recovery have led to an intensive global outreach effort, seeking investment and export opportunities well beyond Europe as part of the recovery strategy. In July 2012, Ireland began to re-enter the bond markets for the first time since the bailout programme began in 2010. The official line is that Ireland is on the mend and although still vulnerable, has the institutional and cultural capital to make it through the crisis.

There is an important eurozone dimension to Ireland’s crisis management, with successive governments trying to put the question of burden-sharing on the EU agenda. The present government has struggled to get its eurozone partners to acknowledge the scale and burden of the bank bailout. The June 2012 Euro Area statement which concluded that “We affirm that it is imperative to break the vicious cycle between banks and sovereigns” was regarded as a major breakthrough by the Government. [2] This statement also noted that “The Eurogroup will examine the situation of the Irish financial sector with the view of further improving the sustainability of the well-performing adjustment programme.”[3] The Irish government interpreted this as meaning that there would be some burden sharing on the bank bailout. But these hopes were dashed when it became clear that the “triple A” countries (Germany, the Netherlands and Finland) would not countenance using the ESM to deal with legacy debt.

The focus of government attention now appears to be on what are called the promissory notes, a mechanism worked out with the ECB to fund the winding down of a toxic bank and a toxic building society, Anglo Irish and Irish Nationwide, in a vehicle called the Irish Bank Resolution Corporation (IBRC). The Government is seeking to restructure the €30 billion associated with the promissory notes to make Ireland’s overall debt position more sustainable. The IMF is clearly of the view that the eurozone must live up to its June 2012 commitments on burden sharing, and is regarded in Dublin as more sympathetic than the EU elements of the troika. Referring to these commitments, the IMF argued that they “represent key stepping stones towards the mutually beneficial goals of ensuring Ireland’s economic recovery and its durable return to the bond market, thereby avoiding

1 See http://www.imf.org/external/np/sec/pr/2012/pr12398.htm

2 Euro Area Statement, 29th June 2012 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf

3 Ibid.

continuing dependence on official financing".[4] However it is proving very difficult for the Government to make a break through on burden sharing. The long term sustainability of Ireland's debt requires it, as does the need to maintain political acceptance of the burden that has been placed on a small country with only 1.6 million households. As a consequence, debt write-offs for Greece play badly in Ireland and add greatly to the pressure on the government as it strives to stick to the programme of fiscal consolidation.

Conclusions

Because of the nature and depth of the crisis facing Ireland, there is little official time and energy to focus on the broader impact of the crisis on the euro area and on the future shape of EU governance. There is a general welcome for the tentative beginnings of a banking union, although without a bank resolution mechanism such a union would be regarded as a "banking union lite". Further economic and fiscal integration is regarded as inevitable but the nature and extent of integration in these highly sensitive fields has yet to emerge. All Irish governments are attentive to the need to legitimise deeper integration because any major development in European integration will require the consent of the people in a referendum. There is also a concern about developments in the United Kingdom and the possibility that it may weaken its connections to the EU. Any Irish government would favour the UK's fullest possible engagement with the Union, but if a dynamic develops that leads the UK to the margins of the Union or even beyond, Ireland will not follow. This reflects Ireland's national interest; in 2011 only 17 percent of Irish exports went to the UK; 41 percent to the rest of the EU; 16 percent to the US; and 24 percent to the rest of the world. Thanks to the EU Ireland has broken free of its historic dependence on the UK, and if the choice was between being associated with the UK at the margins of the Union or being a part of an increasingly hard core, both the Irish state elite and electorate would opt for engagement with the core. That said, a disconnected UK would pose serious problems for Ireland given the shared border, and the Irish will strongly encourage the UK to remain a full member of the Union. As for Ireland, although it is experiencing its most difficult days in the EU since accession 40 years ago, the majority of the Irish people still see EU membership as central to how this small state engages with the world. But this does not mean that the Irish electorate is blind to the problems of integration and the challenges facing the Union as it struggles to retrofit the single currency regime.

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4 2012 Article IV Consultation with Ireland - Concluding Statement of the IMF Mission 18th July 2012, http://www.imf.org/external/np/ms/2012/071812.htm