When Banks Cannibalise a State:[1] Analysing Ireland's Financial Crisis (ARI)

Peadar Kirby [*]

Theme: Ireland's banking crisis was described by the IMF in early 2009 as matching 'episodes of the most severe economic distress in post-World War II history', yet measures taken since 2008 to overcome it have only served to worsen the crisis.

Summary: Hailed for over a decade as the 'Celtic Tiger', Ireland's economy collapsed in 2008 as falling property prices exposed huge liabilities in its banking system resulting from reckless lending to builders and developers. This paper describes the trajectory of Ireland's worsening banking crisis from 2008 up to the acceptance of an EU/ECB/IMF rescue package in November 2010 and a four-year austerity plan to reduce the budget deficit from 32% of GDP. The paper links the crisis to features of the development model that brought high economic growth from 1994 to 2007 and ends by examining the prospects for overcoming the current crisis.

Analysis: As Ireland faced its most severe budget ever in December 2010, the fourth austerity budget in a row, and having been forced into negotiations with the EU Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF) on a package of financial assistance, the scale and depth of the Irish financial crisis was causing worries for the future of the euro itself. With international markets demanding record interest rates touching 9% for Irish government bonds and with a deficit that was to reach 32% of GDP if the estimated cost of rescuing the Irish banks was included, political leaders and the media were united in seeing the budget as a vital element in regaining international credibility that Ireland could surmount its enormous problems. Details of a four-year austerity strategy published in late November detailing cuts in expenditure and tax rises designed to bring the deficit down to 3% of GNP by 2014 as demanded by the European Commission failed to calm market turmoil and even the normally cautious Economic and Social Research Institute (ESRI), Ireland's principal independent economic think-tank, voiced its doubts that this target was achievable.

[1] The reference is to a quote from a senior Labour Party deputy (member of the Irish Parliament) and former party leader, Pat Rabbitte, who in a debate in the chamber on Wednesday, 17 November 2010, said the following: 'Whatever emerges from the discussions with the IMF, the talks had better ensure that this is the last bailout, unless the Government is going to permit the banks to cannibalise the State' (full text available at http://www.kildarestreet.com/debates/?id=2010-11-17.471.0&s=speaker%3A282#g500.0, accessed 8/XII/2010).

[*] *Professor of International Politics and Public Policy at the Department of Politics and Public Administration and Director of the Institute for the Study of Knowledge in Society, University of Limerick.*

What makes the collapse of the Irish economy and financial system all the more surprising is that for the decade up to 2007, Ireland was being hailed as a 'Celtic Tiger', 'a showpiece of globalisation'[2] due to its high growth rates, low unemployment and substantial increases in living standards. Policy makers in Central and Eastern Europe, throughout Latin America and even in Canada were seeking to learn the lessons of the 'Irish model' and Ireland was being held up as the poster child of the EU, a sign of how EU transfers and policies could help latecomers to achieve success.[3] This paper therefore analyses Ireland's banking crisis against the backdrop of the Irish model, tracing the development of the crisis and linking it to features of the model that seemed to hold out such promise. The paper closes by examining the prospects for overcoming the current crisis.

Trajectory of the Irish Crisis

Since recession hit in mid-2008 and the government stepped in to save the banking system on 30 September of that year through a blanket guarantee covering customer deposits and banks' own borrowings to a total of €440 billion, the severity of Ireland's crisis has grown continuously worse. The first signs that Ireland's growth economy was faltering had come in 2007 as prices in the booming housing market began to contract but it was mid-2008 before the alarm bells began to sound that the economy was entering into a deep recession as domestic demand contracted and unemployment began to rise. Even then, however, most forecasters were predicting a return to growth in 2009 as an upswing in the global economy would increase the demand for Irish exports. Then the collapse of Lehman Brothers in mid-September 2008 exposed the vulnerability of the Irish banking sector as a gap of around €200 billion between what the banks had lent (largely to property developers) and deposits taken in had been bridged by borrowing in international markets, but access to these markets now began to dry up. The bank most exposed to the property market, Anglo Irish Bank, began to lose deposits of around €1 billion a day as international depositors withdrew their money, and within days it became clear that most other Irish banks were also in difficulties. At an all-night crisis meeting between the government and the heads of the largest Irish banks on 29 September it was decided that a blanket guarantee of the banks' liabilities was the best option to avoid what was feared would be the imminent collapse of at least Anglo Irish Bank. The Minister for Finance, Brian Lenihan, called it the cheapest banking bailout in history, words that were to come back to haunt him as the government's guarantee of the whole banking system, including international bondholders, effectively handed Irish taxpayers the bill for the reckless practices of the Irish banking sector during the economic boom, a bill that international markets increasingly feared was unpayable.

While the guarantee avoided the collapse of any Irish bank, neither did it resolve the banking crisis. Indeed, it has been described as a 'malignant colossus over the entire scene' which 'served to prop up the banks but it aligned the fortunes of the State with their fate'.[4] This had two main effects: (1) it made the banks more and more dependent on state support to survive; and (2) it made the Irish state's fiscal crisis severely worse. The period since September 2008 has witnessed a slow and painful revelation of just how

[2] Nicola Jo-Anne Smith (2005), *Showcasing Globalisation? The Political Economy of the Irish Republic*, Manchester University Press, Manchester, p. 2.
[3] See, for example, Eva Paus (2005), *Foreign Investment, Development and Globalization: Can Costa Rica become Ireland?*, Palgrave Macmillan, New York.
[4] Arthur Beesley (2010), 'Bank Guarantee Loomed Large in Two Years of Talks with Brussels', *The Irish Times*, 30/XI/2010, p. 10.

deep is the crisis of the Irish banks, which eventually sent the alarm bells ringing in Brussels and finally forced the Irish government to accept at the end of November what is widely seen as a humiliating bailout package from the EU, the ECB and the IMF. Throughout 2009 and 2010, the government was forced to inject more and more capital into the Irish banks; the more it did so the more did international markets lose confidence in Ireland, reflected by the steady reduction by the main rating agencies of both the country's credit rating and that of the main Irish banks. Exactly two years after the September 2008 guarantee, the Minister for Finance, Brian Lenihan, tried to calm the markets by announcing a final figure for what it would cost to save the Irish banks: the estimate was €45 billion, rising in a worst-case scenario to €50 billion. This, it was hoped, would inject some certainty into the situation and calm the markets. However, comments by the German Chancellor, Angela Merkel, that bondholders would have to carry some of the costs of bank bailouts in future further scared the markets and the costs of Irish borrowing continued to rise on the international markets over October and November. Irish officials and some politicians did not hide their anger at the German move.

The ECB was also growing alarmed at the growing dependence of the Irish banking sector on its support. Irish banks shed €109 billion in overseas deposits in the two years to September (this figure includes the subsidiaries of foreign banks in Ireland). According to the Irish central bank, the figure was made up of overseas deposits of €64 billion and €45 billion in debt securities held by overseas bondholders. This lost funding was replaced by the ECB, from which Irish banks had borrowed €130 billion by the end of October 2010, as well as a further €34 billion from the Irish central bank. In September 2010 the gap between their deposits and loans stood at €175 billion. During that month, €55 billion of bank bonds held mainly by UK, German and French banks matured and were repaid, mostly by borrowing from the ECB. By this stage, the state had been forced to nationalise three Irish banking institutions. By late November, the flight of deposits from the two largest Irish banks, Bank of Ireland and AIB, and their inability to access capital through the international financial markets, forced the state substantially to increase its shareholding in both. Only one Irish banking institution, Irish Life and Permanent, remained a viable commercial entity at this point. The government had been forced to inject €33 billion into the banking sector, most of it in promissory notes, spreading the payments over 10 to 15 years. Shares in the two largest Irish banks dropped, in the case of AIB from a peak of €23.95 in January 2007 to a low of 34 cents in November 2010 and, the case of Bank of Ireland, from a peak of €18.65 in February 2007 to a low of 27 cents. The three largest Irish banks have lost €35 billion in deposits in 2010, most of which flowed out since June. AIB has lost €13 billion in 2010, amounting to 17% of its deposits. Its reliance on central-bank funding trebled since June. Anglo-Irish Bank, whose reckless lending to property developers had placed it at the centre of the banking crisis, saw its deposits fall from €51 billion at the time of the bank guarantee in 2008 to around €16 billion by late November 2010, and its reliance on Irish central bank funding was estimated to have grown to more than €43 billion. In late November 2010, the government finally decided to close it, transferring its deposits into a viable bank.

Acknowledging the banks' extensive over-lending to the property sector, the state had established the National Asset Management Agency (NAMA) in April 2009 to manage the sector's non-performing loans. Altogether it expects to buy €73 billion worth of non-performing loans from the five banking institutions and for these to pay around half the original value of the debts. For example, in the first six months of 2010, it paid €8.4 billion for property loans with a nominal value of €16.4 billion, paying the banks bonds which they can exchange for cash with the European Central Bank. Through relieving the banks of their bad debts, it had been hoped that they could raise fresh capital and so begin lending again; however, the extent of the 'haircut' as the discount on the loans' value is called, has further damaged the balance sheets of the banks, especially Anglo Irish Bank, and some critics now accuse NAMA of making the banking crisis worse. In time, NAMA hopes to sell the property it has now acquired at a profit, though it is expected to have to simply knock down and return to vacant sites some of the unfinished 'ghost estates' it has acquired, particularly those in small towns where demand for housing has collapsed.

The ECB's growing awareness that Ireland, a country with about 1% of the EU's GDP, had ended up with more than 20% of the ECB's lending, opened the next phase in Ireland's deepening crisis. The Economics Professor Antoin Murphy has argued that the ECB's desire for a new mechanism to relieve it of some of the burden of its lender-of-last-resort function to the Irish banking system prompted a major change in its monetary policy in mid-November. As he wrote: 'As a result the Irish crisis, which has been initially a fiscal/funding crisis as highlighted by the bond markets, shifted to a full-scale crisis about the liquidity and solvency of the Irish banking system'.[5] It was its decision to discontinue lending to Irish banks and seek a new arrangement from the European Commission and the IMF to provide an alternative bailout strategy that forced the Irish government to negotiate an €85 billion package of financial assistance announced first in Brussels and then in Dublin on Sunday 28 November before the Asian markets opened. This is made up of €10 billion for recapitalisation of the banks, a €25 billion bank contingency fund and a €50 billion sum to support the state's borrowing requirements for the next three years. Of this, €22.5 billion comes from the IMF, €22.5 billion from the EU Commission, €17.5 billion from the European Financial Stability Fund and a total of €5 billion in bilateral loans from the UK, Sweden and Denmark. Controversially, the Irish state is also to contribute €17.5 billion, €12.5 billion of it from the National Pension Reserve Fund, effectively depleting this last financial reserve that the Irish state has had at its disposal. The average interest rate on these loans is 5.85%. The agreement endorses many of the measures contained in the Irish government's four-year austerity plan (see below), including the €1 cut to the hourly minimum wage, does not require any increase in Ireland's 12.5% corporation tax as had been mentioned by various European officials, and lengthens to 2015 the date for Ireland to reduce its budget deficit to 3% of GDP.

The package, which Irish politicians denied was needed right up until the last moment, has been severely criticised in Ireland. Attention has been focused on four aspects. The first is the interest rate that Ireland will pay for its borrowings, higher than the 5.2% being paid by Greece for its bailout package and than the average 4.8% being paid by Ireland for borrowing in the international market place up to recent months. Secondly, what has caused even more anger is the failure to force bondholders or indeed the ECB itself to share some of the costs. The banking analyst Peter Mathews argued that Irish negotiators 'had a duty to clearly demonstrate… that the ECB had been 50% culpable in its failure in regulation and supervision of Irish banks for four years up to 2007-2008' and knowingly advancing loans to the Irish banks when it was obvious that they were heading for insolvency. He concluded that the ECB should have given a write-down of €60 billion on the €130 billion they lent to Irish banks.[6] Thirdly, the contribution from Ireland's National Pensions Reserve Fund has horrified opposition leaders who had hoped to use some of

[5] Antoin Murphy (2010), 'ECB Shift from Lender of Last Resort Casts Doubt on Independence', *The Irish Times,* Business This Week supplement, 26/XI/2010, p. 3.
[6] Peter Mathews (2010), 'Lame Team Failed to Point Finger Back at ECB', *The Irish Times*, 30/XI/2010, p. 13.

this as a stimulus package for the economy if, as seems certain, they win power in the general election to take place in early 2011. Finally, observers were very surprised at the paucity of information in the package on what concrete steps are to be taken to restructure the Irish banking system apart from general comments on downsizing and reorganising the banking sector so that it is proportionate to the size of the economy. As the *Irish Times* columnist Fintan O'Toole wrote, referring to the Treaty of Versailles at the end of the First World War and the Marshall Plan after the Second, the 'bailout of broken and delinquent Ireland is much more Versailles than Marshall. There is no sharing of the burden. There is no evidence of a single thought for the consequences of mass unemployment, mass emigration and war on the most vulnerable. There is no European solidarity… The sadistic pleasures of punishment have trumped the sensible calculation that an Ireland enslaved by debt is not much use to anyone'.[7]

There has been less comment on the failure of European officials to force Ireland to increase its corporate tax rate since there is a widespread consensus that this is essential if the economy is to return to growth. However, two aspects merit comment. One is the failure to ask some of the most profitable multinational companies in the world to share in a small way the huge burden of increased taxes now being placed on low- and average-income taxpayers in Ireland. This is the moral argument on which there is total silence in Ireland. The second argument is an economic one: increasing the tax on corporations could help to wean the Irish economy off its excessive dependence on the foreign sector and, with enlightened state policies, help develop an innovative domestic industrial and services sector to act as a modern motor of growth replacing the property sector which has now crashed. A final comment on the EU/ECB/IMF package is that, judging by public comments, it may be undermining the widespread support for the EU among the Irish public and even some senior politicians as the insistence that Irish taxpayers bear all the pain of adjustment has greatly angered the public.

Alongside the banking crisis, a severe budgetary crisis has developed in the Irish state's finances, seen by some economists as a more serious threat to the solvency of the Irish state. The state's income through tax revenue severely deteriorated in 2008, due in part to the collapse in property prices since stamp duty, a tax on the purchase of property, had become a major source of state income during the boom. By the end of 2009 the budget deficit had widened to 14.6% of GDP but various measures to cut spending (including two cuts in the income of public servants) and some modest tax increases had reduced it to 11.9% by late 2010; however, once the full cost of supporting the banks is factored in, the deficit rises to 32% of GDP in 2010, widely regarded as the highest ever recorded in a developed country in peacetime. The Irish government sought to avoid having the costs of the banking crisis included in the budget deficit but this was refused by the EU. Meanwhile, the economy entered into a severe contraction, with GDP declining by 3.5% in 2008 and by a further 7.6% in 2009; GNP, regarded as a more accurate measure of Irish growth, since it excludes the profits of multinational companies taken out of the economy, contracted by 3.5% in 2008 and by a further 10.7% in 2009. Consumer spending in 2009 declined by 11.1% of GDP while government expenditure declined by 5.1%. The reduction in consumer spending reflects not just a reluctance on the part of consumers to spend but also the greater difficulty being encountered in borrowing from the banks.

[7] Fintan O'Toole (2010), 'Abysmal Deal Ransoms Us and Disgraces Europe', *The Irish Times*, 29/XI/2010, p. 11.

As international markets increasingly lost confidence in Ireland's ability to meet its huge debts, the government announced a four-year strategy to detail how it planned to return the budget deficit to 3% of GDP by 2014 as demanded by the EU Commission. In late November the austerity plan, entitled *The National Recovery Plan 2011-2014*, announced details of cuts in public spending totalling €10 billion and tax rises of €5 billion. Cuts are spread widely and include reducing the number of public servants by 25,000 from the current level of 307,000, cutting the pay of new entrants to the public service by 10%, cutting public service pensions by up to 12%, and cutting spending on health, education and social welfare. One controversial proposal is to cut the minimum wage by €1 an hour. On the tax side, most of the proposals will hit low- and average-income earners rather than high-income earners as the central proposal is to reduce the income levels at which people begin to pay tax from €18,300 to €15,300 by the end of the plan. Value Added Tax (VAT) is to rise from 21% to 23% in the final two years of the plan, a measure that will also hit lower-income households to a greater extent. A modest tax on housing and water charges is to be introduced for the first time. In contrast, very modest adjustments to capital gains tax and no increase in corporate tax are proposed. Apart from its distributional inequity, the lack of any stimulus package in the plan coupled with its silence on the cost of the banking crisis and its optimistic forecasts for economic growth led opposition leaders to promise they would change it if elected to power following a general election in early 2011; this has further undermined its credibility both at home and abroad.

A further element of uncertainty in the Irish situation concerns the extent of mortgage default by private homeowners over the coming years. An economics professor who was one of the few to predict accurately in advance the scale of the banking and housing crises, Morgan Kelly, caused panic in early November when he predicted mass mortgage defaults which would plunge the country into an even worse crisis.[8] A report by a government-appointed expert group a few days later estimated that 70,000 mortgages or 8.9% of the total are in arrears, an increase from just under 14,000 or 1.4% of the total in mid 2008, and recommended that stressed lenders be allowed to defer part of their payments for up to five years. The government has now acted on these recommendations. However, some observers are nervous that this problem could become a lot worse.

Causes of the Crisis

While Irish government Ministers have tended to ascribe the causes of the Irish banking collapse to the international financial crisis, a report commissioned by the Minister for Finance into the causes of the Irish crisis was unequivocal in clarifying where the principal blame lay: 'Ireland's banking crisis bears the clear imprint of global influences, yet it was in crucial ways "home-made".'[9] The report, written by two leading European banking experts, uncovers in forensic fashion the multiple governance and policy failures that led to the crisis.

In outlining the global influences that played some part in at least creating the conditions for the crisis, Regling & Watson ask: 'Was it a coincidence that Ireland's economic fundamentals began to deteriorate when Ireland joined the euro area?'.[10] They argue that

[8] Morgan Kelly (2010), 'If you Thought the Bank Bailout was Bad, Wait until the Mortgage Defaults Hit Home', *The Irish Times*, 8/XI/2010, p. 11.
[9] Klaus Regling & Max Watson (2010), 'A Preliminary Report on the Sources of Ireland's Banking Crisis', Government Publications, Dublin, p. 5.
[10] *Ibid*., p. 24.

certain aspects of EMU membership 'certainly reinforced vulnerabilities in the economy. Short-term interest rates fell by two thirds from the early and mid-1990s to the period 2002-07. Long-term interest rates halved and real interest rates were negative from 1999 to 2005 after having been strongly positive'.[11] This situation contributed to the credit boom in Ireland since low interest rates encouraged borrowing and the removal of exchange rate risk facilitated the banks in accessing foreign funding, ensuring the flow of credit could continue. In this situation, official policies and banking practices faced key challenges with 'scope to mitigate the risks of a boom/bust cycle through prudent fiscal and supervisory policies, as well as strong bank governance – thus raising the chances of a "soft landing" for the property market and for society at large. In the event, official policies and banking practices in some cases added fuel to the fire. Fiscal policy, bank governance and financial supervision left the economy vulnerable to a deep crisis, with costly and extended social fallout'.[12] Each will be examined in turn.

Regling & Watson examine both the expenditure and revenue sides of fiscal policy. On expenditure they find that current expenditure grew faster than nominal GDP in each year from 2001 to the onset of the crisis. On revenue, they chart the ways that the composition of tax revenue had shifted gradually from stable sources of taxation, like personal income tax and VAT/excise taxes, to cyclical taxes, such as corporation tax, stamp duty and capital gains tax. The share of these cyclical taxes reached 30% of tax revenue in 2006; in the late 1980s it had amounted to only 8%. This created two problems: it made it difficult to assess the underlying structural situation of the budget and it made the budget more vulnerable to a recession. The collapse in tax revenue in 2008 leading to the sharp increase in the fiscal deficit mentioned earlier resulted from this shift in the sources of taxation. On bank governance, the report states: 'Errors of judgement in bank management and governance contributed centrally to Ireland's financial crisis. It seems that there were key weaknesses in some banks' internal risk management in areas such as stress-testing; the assessment of credit risks; and in some cases major lapses in the documentation of loans – and that these were factors that allowed vulnerabilities to develop'.[13] The authors identify four indicators of exceptional financial exuberance: (1) a growth in credit whose rate of expansion and rise in asset and funding risks 'should have rung alarm bells'[14]; (2) the concentration of lending on assets in property, particularly commercial property, and on a limited number of key developers; (3) high loan-to-value ratios; and (4) a high exposure to funding risks which was system-wide. They speak of 'a collective governance failure, and in part it reflected an uncritical enthusiasm for property acquisition that became something of a national blind-spot'.[15] Finally, the report found the response of government supervisors 'was not hands-on or pre-emptive' and contrasted with the experience in some countries where supervisors 'acted to stem the tide' when faced with evident risks.[16] Four key problems are identified with government supervision:

(1) Supervisory culture was insufficiently intrusive, and staff resources were seriously inadequate for the more hands-on approach that was needed.
(2) Governance failures were not addressed sufficiently toughly.
(3) Macrofinancial vulnerabilities were underestimated.

[11] *Ibid*.
[12] *Ibid*., p. 5.
[13] *Ibid*., p. 29.
[14] *Ibid*.
[15] *Ibid*., p. 33-34.
[16] *Ibid*., p. 6.

(4) Key facts that should have been of central interest to supervisors were not available to policy-makers in a timely manner at the point where the crisis began to unroll.[17]

The report notes the absence of forceful warnings from the Central Bank of Ireland on marcofinancial risks 'in which financial stability analysis should have sounded the alarm bells loudly'. They add that, in reference to IMF, OECD and ECB reports on the Irish banking sector, 'in fairness external surveillance sources fared little better'.[18] Overall, they point to the fact that, unlike in other countries, bank regulators were not being asked to deal with technically complex problems. 'Ireland's banking exuberance indulged in few of the exotic constructs that caused problems elsewhere. This was a plain vanilla property bubble, compounded by exceptional concentrations of lending for purposes related to property'.[19] To this extent, Ireland's banking crisis is a very old-fashioned one.

The Banking Crisis and the Irish Model

In reading the Regling & Watson report, it is clear that these outside experts were puzzled at the reasons for some of the causal factors they identified. What explains the changing nature of the tax system making state revenues so vulnerable as growth declined? Why did state regulators not act more forcefully to rein in banks' risky practices? Why did banks put so much of their lending into property? The closest they get to an explanation is their comment about enthusiasm for property becoming a national blind-spot. To this comment, they add the following: 'It was in this sense at least a wide political and social phenomenon, and some of the underlying misjudgements about debt and property were so embedded in collective psychology that this can be imagined, perhaps, to mitigate institutional failures to some degree'.[20]

However accurate this is, it misses some of the wider features of the Irish model that became consolidated over the course of the Celtic Tiger boom from the mid 1990s. Three key features were identified by Kirby[21] that are crucial to explaining the factors mentioned by Regling & Watson. The first of these relates to the structure of the Irish economy, that became ever more reliant on high levels of foreign investment, particularly in targeted high-tech sectors of US industry and, later, services. Many commentators have drawn attention to the dualistic nature of the Irish economy, with the multinationals acting as the motor of growth through high-quality employment, much higher levels of exports and higher productivity per worker.[22] The domestic sector, by contrast, was less productive, had a weaker technological profile and exported mainly to the British market. The motor of growth in the Irish economy was foreign investment, and state policy continues to give priority to the foreign sector in both industry and services; this is the reason why Irish politicians so staunchly resist pressure to increase the low 12.5% tax on corporate profits that is seen as a key policy tool attracting multinationals to Ireland. The role that property development took on in the Irish growth model, therefore, needs to be understood as an illustration of the absence of other more entrepreneurial investment opportunities in the domestic sector when recession caused by the bursting of the dot.com bubble in the US

[17] *Ibid*., p. 36-42.
[18] *Ibid*., p. 6.
[19] *Ibid*.
[20] *Ibid*., p. 33-4.
[21] Peadar Kirby (2010), *Celtic Tiger in Collapse: Explaining the Weaknesses of the Irish Model*, Palgrave Macmillan, Basingstoke; Peadar Kirby (2002), *The Celtic Tiger in Distress: Growth with Inequality in Ireland*, Palgrave Macmillan, Basingstoke.
[22] See, for instance, Michael Casey (2010), *Ireland's Malaise: The Troubled Personality of the Irish Economy*, Liffey Press, Dublin.

(coupled with the effects of 9/11) forced a turn to more domestic factors to maintain growth. Property developers, encouraged by state tax breaks and subsidies, and with close personal ties to the main governing party, Fianna Fáil, drove domestic demand and profits which were enabled by cheap credit from the banking sector. Nothing could illustrate more the dualistic structure of the Irish productive economy.

The second feature of the Irish model as identified by Kirby relates to the weak relationship between the booming economy at the height of the Celtic Tiger and the relatively low levels of investment in social provision by European standards. The boom years were characterised by a weakening welfare effort and the Irish welfare state was described by Boyle as 'Europe's most anorexic welfare state' in 2005.[23] The former Taoiseach (Prime Minister), Garret FitzGerald, voiced the concerns of many when he asked: 'Why is it that, with a level of income higher than that of 22 of the 27 EU states, our public services fail to look after children in need or to care for the ill and the old; fail to make any serious attempt to rehabilitate our prisoners; and fail to ensure access to clean water – not to speak of failing to provide efficient competitive public transport, just to mention a few of our more obvious public service deficiencies'.[24] These illustrate some of the consequences of the low-tax road to development that Ireland adopted over the course of the boom, driven by an ideological commitment to what the former leader of the Progressive Democrat party, Mary Harney, described as a choice between Boston and Berlin with her preference being clearly for the former, a low-tax US model with weak social provision. The commitment to this development model, anchored in Ireland's dependence on attracting high levels of foreign investment and the policy makers' desire to offer an attractive low-tax environment to win this investment for Ireland, moulded a particularly market-friendly state which is the final feature of the Irish model identified by Kirby.[25] He traces how the Irish state moved from being a welfare state to being a competition state which gave priority to the needs of foreign investment over those of its own citizens, especially the most vulnerable. This extreme market-friendly state found expression in its light-touch regulatory system, deferring to market authorities and lacking the will to develop the intrusive forms of regulation that Regling & Watson found so lacking in the Irish state. These structural features of the Irish model therefore help explain why the property sector grew so large, why banks lent so heavily to it and why the state so deferred to the market and failed to regulate it in any robust way.

Conclusion: As is clear from this account, Ireland is faced with two severe crises, interlinked but distinct. One is a serious budget deficit and the other is a banking system that can only survive with large-scale state support. While a succession of austerity budgets have succeeded in bringing down the state's deficit as a percentage of GDP (when the additional costs of the banking crisis are not taken into account), they have done so at the cost of deepening the recession and postponing any possibility of an increase in internal demand boosting growth rates. There is nothing currently planned by the Irish government that holds the prospect of changing this situation over the course of the four-year austerity plan now being implemented until 2014. The one positive element

[23] Nigel Boyle (2005), *FÁS and Active Labour Market Policy 1985-2004*, The Policy Institute at Trinity College, Dublin, p. 115.
[24] Garret FitzGerald (2008), 'End of Asset Boom Reveals Foolishness of Tax Cuts', *The Irish Times*, 11/X/2008, p. 14.
[25] As O'Brien has written: 'The imperative of attracting and keeping foreign firms has soaked deep into every nook and cranny of the apparatus of the state in a way not to be observed elsewhere'. Quoted in Neil Collins *et al*. (2007), *Modernising Irish Government: The Politics of Administrative Reform*, Gill & Macmillan, Dublin, p. 118).

of economic activity is the growth in exports from the multinational sector of the Irish economy; while these are not now feeding through to the rest of the economy it is hoped that they will in time contribute to reducing unemployment and boosting growth. Meanwhile, the banking crisis has got continuously worse; measures taken have proven too little too late and the cost to Ireland's international reputation has been immense. The hope now rests on severely downsizing the banks.

The Governor of the Central Bank of Ireland, Professor Patrick Honohan, is proposing such measures as the disposal by the banks of some of their assets, the sale of sizeable blocks of residential mortgages to international investment funds, and the entry of foreign purchasers for some or all of the banks. He is also insisting that Irish banks will require much higher capital ratios in the future.[26] To this situation must now be added the funds that can be drawn down by Ireland as a result of the financial assistance package from the EU, the ECB and the IMF. These funds, together with what looks like a more determined effort by the Irish central bank to restructure the banking sector, may just put the sector on the road to recovery though this will take time. However, the high rates of interest to be paid on these borrowings and the lack of popular legitimacy in Ireland for this package may undermine its effectiveness and cripple the state with a severe problem of indebtedness for the foreseeable future, a burden that citizens are going to be less and less willing or able to carry. Furthermore, while a shift to the left is likely in next year's general election, the incoming government has its room for manoeuvre very severely curtained by the EU/ECB/IMF package, particularly as regards injecting a badly needed stimulus into the economy. The future is therefore far too uncertain to predict what is likely to happen. The most that can be said is that Ireland is passing through a crisis similar to that of a country defeated in war: not only is its economy in very deep recession but its economic and political elites have been severely discredited and the population is avid for a new beginning. What form this might take is all to play for.

Peadar Kirby
Professor of International Politics and Public Policy at the Department of Politics and Public Administration and Director of the Institute for the Study of Knowledge in Society, University of Limerick

[26] Patrick Honohan (2010), 'Financial Regulation: Risk and Reward', address by the Governor of the Central Bank of Ireland to an International Financial Services Summit, Dublin, 10/XI/2010.