

The Irish Crisis and the EU from a Distance ¹

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History is littered with banking crises, a fact that renders Ireland's 2008 crisis less than unique. What is special about the Irish case is that it was the first banking crisis in a country that is a member of the Eurozone. As a member of the Eurozone, Ireland, its government and central bank faced distinctive constraints when the crisis struck. The central bank could not expand its balance sheet at will – it could not print money to bail out the banks. It could provide Emergency Liquidity Assistance, but subject to assent of the European Central Bank, a body on whose governing council it had just one vote. As a member of an economic and monetary union characterized by a single financial market, Ireland came under pressure to minimize destabilizing spillovers to its European partners.

Conversely, the Irish economy and financial system were strongly affected – unusually strong affected by events, policies and decisions elsewhere in Europe. Here one might cite the onset of recession in other Eurozone countries, the policies of the European Central Bank, and the rescue package provided by the EU and the International Monetary Fund. Those strong effects then continued to be felt in the restructuring of the obligations to the European System of Central Banks that the country incurred in the course of resolving its crisis and in the implications for the country of the EU's efforts to construct a banking union, an initiative in which Ireland's own experience had no little influence.

This paper reviews the role of the EU and its institutions in the Irish crisis. The author is conscious that he likely to be seen as carrying coals to Newcastle, or in this case Dublin. Others in the room will be closer to the Irish case and better informed about its details. Still others will be better informed about the inner workings of the European Union. The goal of this paper therefore is not to provide a detailed account of the crisis and EU response, but rather to offer some reflections on how Ireland's status as a member of the EU and the Eurozone shaped its crisis in distinctive ways. Another caveat: it is not possible to discuss the role played by the European Commission and the European Central Bank without considering also the third member of the Troika, the IMF. Happily, the organization of this conference, of which the Fund is co-sponsor, signifies recognition of this fact.

1. Before the Crisis

It is tempting to argue that the structure and, indeed, the very existence of the European Union and the Eurozone helped set the stage for the crisis – that conditions in Ireland could not have developed as they did in the absence of these entities.

The situation in 2007-8, when claims on the Irish banking system peaked at some 400 per cent of GDP, was largely though not entirely unprecedented. This was an exceptionally large, highly leveraged banking system atop a small island. It grew out of the high mobility of financial capital within the single market. It reflected the freedom with which Irish banks were

¹ I thank Craig Beaumont, Stefan Gerlach, Philip Lane, Ashoka Mody and Karl Whelan for comments. The usual disclaimer obviously applies.

permitted to establish and acquire subsidiaries in other EU countries. It reflected the ease of accessing wholesale funding given the perception that the exchange risk that would have otherwise been associated with making local-currency loans to Irish banks was absent in a monetary union. It reflected the perception (more accurately, the misperception) that bank failures, like sovereign defaults, had been rendered a thing of the past.² This misapprehension was evident in the compression of credit default swap spreads on private nonfinancial sector debtors that accompanied the decline in sovereign bond spreads following the transition to monetary union. The crisis was further shaped by the absence of a banking union to accompany the monetary union. It reflected the absence of a single supervisor, allowing national supervision and regulation to proceed without due attention to their impact on neighboring banks and countries.

This said, other cases, like that of Iceland, point to the fact that it was possible to replicate these achievements, such as they were, outside the Eurozone. Iceland surpassed even Ireland in building a very large banking system atop a small island economy, allowing that banking system to grow dependent on flighty wholesale finance, and permitting the banks to become overcommitted to risky investments. Developments in Iceland were not entirely independent of the EU, of course. It was Iceland's membership in the European Economic Area that allowed it to set up subsidiaries in EU countries so readily, attract internet deposits so freely, and offer foreign retail investors deposit insurance so credibly. But Iceland is also a reminder that it is possible to have a banking crisis with Irish characteristics without being a member of the EU and its monetary union. It is a reminder that the connections between Ireland's crisis and its membership in the EU and the Eurozone are complex.³

The same caveat applies to the real-estate boom and the importance of risky exposures to the property market in the subsequent problems of the banks. While borrowing by property developers and aspiring homeowners was fueled by the decline in interest-rate spreads that flowed from the advent of the euro, the experience of other countries like the UK reminds us that property booms and the associated financial weaknesses could arise equally without help from the euro. In Ireland, the availability of financing at floating rates meant that interest-rate convergence reduced the cost of financing for new and old borrowers alike, which fueled the bubble. Public policy encouraged the view that everyone, including those most at risk of unemployment in the event of a recession, should become owner-occupiers. A poorly regulated rental market with a limited supply of well-maintained properties, dearth of professional investors and no security of tenure beyond 12 months gave potential renters ample incentive to seek mortgage finance for home purchases instead.

In hindsight, the weaknesses of the Irish banking system are blindingly clear. Loan-to-deposit ratios were high. Loan books were allowed to expand rapidly, which would not have been possible without declining lending standards. Large portfolio concentrations heightened the

² The basis for this conclusion was unclear at the time, and it remains unclear even now. Some argued that lower interest rates were justified because adopting the euro eliminated the possibility of money finance of budget deficits ruled out national bailouts of insolvent financial intermediaries. This last argument is especially ironic, of course, in the Irish case.

³ Other channels through which membership in the EU and its monetary union might have influenced the course of events in Ireland include growing international competition, which put pressure on bank margins and encouraged additional risk taking, and the introduction of new products (100 per cent mortgages, tracker mortgages etc.) by new entrants into the market.

sensitivity of bank balance sheets to the changing fortunes of the property market and, indeed, to those of individual property developers. Banks were led by a new generation of officers possessing little practical experience with risk management. Internal controls and accountability were lax. Loans were sometimes backed not by cash flow or collateral but by simple personal guarantees, and even where collateral was provided valuation could be an issue. Bank managers were allowed, even encouraged, to borrow from their own banks. In banks like Anglo-Irish, the credit committee provided little in the way of checks and balances. Not until the late stages of the boom were the minutes of Anglo's credit committee even taken.

While the Central Bank and Financial Regulator pointed to some of these problems, they took little in the way of corrective action.⁴ Ireland is not the first case where the relevant authority was tasked with promoting the national financial system as much as with regulating it. Capture is a classic problem for regulation. Moreover, there is a good reason to worry that regulatory capture is a particular problem in a small economy, where the same individuals interact (play golf) repeatedly.

In such a setting, independent assessments of the conduct of regulation and its consequences are especially important. Here Ireland was blessed by external surveillance of its financial regulation, and of its economic and financial policies generally, by the European Union and the IMF. Between 2004 and 2011 the Irish banking system was subject to the oversight of the Committee of European Banking Supervisors (what subsequently became the European Banking Authority). The responsibilities of the CEBS included monitoring the adherence of member states to EU standards for financial supervision and fostering supervisory cooperation so as to encourage national supervisors to internalize the cross-border spillovers of their policies. However, CEBS reports display a preoccupation with defining standards and best practices rather than examining the conformance of individual member states with those standards and practices.⁵ The excesses of banking practice in Ireland seem to have received little scrutiny.

Surveillance by the European Commission, for its part, focused on fiscal policy under the provisions of the Stability and Growth Pact. Ireland's budget surpluses thus freed it of serious criticism, although there was some mild chiding of the country for running declining surpluses in the late stages of the boom, which lent a modestly procyclical stance to policy.

Similarly, the record of IMF surveillance is at best mixed. The 2007 Article IV consultation with Ireland, concluded in September, pointed to rapid loan growth as a source of potential vulnerabilities. It flagged the high share of bank lending to construction and real estate firms and highlighted the banks' dependence on wholesale funding. These observations did nothing however to challenge the impression that the banking system was fundamentally sound. As the executive directors' conclusion put it, "Directors welcomed the indicators confirming the soundness of the Irish banking system, including the stress tests suggesting that cushions are adequate to cover a range of shocks even in the face of large exposures to the property market."⁶

⁴ Details may be found in Nyberg Committee (2011), formally the Commission of Investigation into the Banking Sector in Ireland.

⁵ Thus, its annual report for 2007 makes no mention of Ireland other than to identify the Central Bank as lead regulator.

⁶ Language that is taken directly from the staff report.

This assessment echoed the Financial Sector Stability Assessment undertaken in early 2006. Here the Fund was buying into, where it could have been challenging, the stress tests undertaken by the Central Bank of Ireland, using its in-house macroeconomic model, and by the financial institutions themselves.⁷ In particular, the cumulative two-year 22 per cent decline in house prices posited in the adverse scenario does not strike one, in hindsight, as especially stressful.⁸

The problems of connected lending and lax internal controls brought to light subsequently escaped the IMF's scrutiny. The staff report for the 2007 Article IV consultation praised the banks for their "relatively high degree of arm's length transactions....[and] high standards in areas such as bank competition, investor protection, and corporate transparency..."⁹ Staff praised the country for taking the recommendations of the earlier Financial Sector Assessment Program to heart. These are not the sort of statements that would call Irish regulators to task or have them alert the fire brigade.

2. The Crisis and the Guarantee

The banking crisis in late 2008 focused on two institutions, Anglo-Irish Bank and the Irish Nationwide Building Society, an ostensibly unrelated institution with which Anglo's CEO did personal business. From the start, there was uncertainty and lack of agreement about whether the problems of other Irish banks were remotely as severe. Anglo's high profile and earlier success had made it a business model for its competitors. Even if there was an absence of overt problems at other banks, there were still grounds for worrying that these might be lurking in their balance sheets. Under the circumstances, the prudent response for creditors – retail depositors and wholesale funders alike – was to limit their exposure.

This, then, was a classic case of contagion growing out of asymmetric information. The response of the authorities was to render that asymmetry irrelevant by issuing their blanket guarantee of the banks' liabilities. The circumstances surrounding their decision remain sketchy to outsiders like the present author, transcripts and recordings of the deliberations being incomplete. But from the perspective of the present paper, a few observations are in order.

First, it is important to recall that the guarantee, however ill devised and regrettable, came two weeks after the failure of Lehman Brothers. Financial markets and confidence were in an extremely fragile state. This context is important for understanding why the Irish authorities felt compelled to resort to drastic measures.

Second, it does not appear that the EU officials, whether at the Commission or the ECB, were implicated in the decision. Indeed it does not appear that they consulted.¹⁰ There are indications that, if anything, they were less than pleased, given that a generous guarantee might

⁷ Similar conclusions were then repeated in the Financial Stability Report issued by the Central Bank and Financial Regulator using data through September 2007 (Central Bank and Financial Services Authority of Ireland 2007). Writing a year later, the government's consultants, Price Waterhouse Coopers, did not better.

⁸ Hindsight is always 20/20, of course, but recall that home prices had risen by roughly 70 per cent in the five year through the end of 2006.

⁹ IMF (2007b), p.14.

¹⁰ The ECB and the Commission were informed of the government's decision early in the morning of September 30th, prior to public announcement (Honohan 2010, p.126).

draw divert deposits from other troubled EU countries. The Honohan Report makes the point that the absence of European-wide effort to help distressed financial institutions was regrettable. This allowed each national authority, in its wisdom, “to take whatever measures might prove necessary to deal with its own situation.”¹¹ The EU can absolve itself of guilt for the guarantee but not of responsibility for failing to anticipate the problem or to offer a coherent response.

Related is the fact that the ECB did not offer a clear alternative. To be sure, it was possible for the banks to apply for Emergency Lending Assistance (ELA) from the Central Bank of Ireland. This could have been obtained, in principle, even in the absence of ECB-eligible collateral, subject to the agreement (lack of objection) of the ECB governing council.

However, whether that agreement would have been forthcoming was uncertain. Although ELA was a bank obligation to the Irish central bank, not the ECB, the government was obliged to guarantee the Irish central bank’s claim. And whether the Irish sovereign had the capacity to stand behind it might become a question, not least in the minds of the ECB’s governing council. Resorting to ELA could thus activate the sovereign-bank doom loop and elicit a negative market reaction. Evidently, there were fears on the part of Irish policy makers that large-scale resort to ELA could dent confidence in the Irish banking system and in the sovereign’s finances, both, and that this might be every bit as much as being denied ELA. Thus, the absence of a liquidity facility free of stigma – and the absence of a mechanism for directly recapitalizing troubled banks like that eventually discussed in the context of banking union – was one factor that pushed Irish officials toward their guarantee.¹²

This is not to deny that more selective alternatives were available. Irish officials could have guaranteed deposits and new wholesale funding while applying haircuts to existing bank bondholders. They could have exempted other bond holders--beyond only holders of undated subordinated debt--from their guarantee. They could have guaranteed the liabilities of banks other than Anglo-Irish and Irish Nationwide while seizing, resolving and recapitalizing the two troubled institutions.¹³

But this would have required a judgment that Anglo and Irish Nationwide were insolvent whereas other banks were only illiquid. It seems clear that Irish policy makers themselves were operating under a severe asymmetry of information. Circa 2008 they took at face value the assurances of Anglo’s management that the problem was simply one of liquidity. And not having devised a resolution strategy ex ante, their lack of information extended to how best to respond to market pressures.

¹¹ Honohan (2010), p.121.

¹² See also footnote 15 below.

¹³ This refers to how they might have responded in September 2008. Anglo-Irish bank was of course nationalized later, on January 21, 2009. Prior to that it would have been possible to split Anglo into a good bank, deposits in which were secure, and a bad bank that would be put through liquidation, with losses for unguaranteed creditors. Note also that the 2008 guarantee did have certain exclusions, such as undated subordinated debt.

In throwing a blanket over the banking system rather than intervening more selectively, the Irish authorities were disregarding a large literature on the resolution of banking crises.¹⁴ This emphasized the importance of having a clear crisis resolution strategy in place before the fact. It emphasized the importance of marshaling the information needed to distinguish insolvency from illiquidity. It emphasized the importance of quickly resolving insolvent financial institutions rather than keeping them on life support. It emphasized the importance of bailing in uninsured creditors. And it emphasized the importance of transparency. Problems of asymmetric information in this case evidently extended to asymmetric information regarding best practice in responding to crises. That asymmetry may have reflected hubris. But it also resulted from the misguided belief that old-fashioned banking crises were no longer possible in Europe's newfangled monetary union. And it reflected the absence of strong guidance from the EU and IMF both before and at this critical juncture.

The initial guarantee, offered unilaterally by Irish authorities, extended for two years. Over its life, the banks came to rely on ECB credit (standard credit and ELA both), as wholesale funders worried about the impending expiry of the guarantee and, even if it was extended, about the ability of the Irish sovereign to make good on it.¹⁵ ELA borrowing effectively worked to bail out the bondholders, as maturing bonds were repaid. In this way the Irish sovereign paid off its maturing debt (more precisely, the maturing debt it guaranteed) and funded itself through the summer of 2011.

It is not surprising that the ECB was uncomfortable with this situation. ELA was designed to provide temporary liquidity assistance to individual banks, not to meet the funding needs of an entire national banking system and not to substitute for the capital shortfall of insolvent financial institutions. It is understandable, given this, that ECB officials were disquieted by Ireland's growing dependence on the facility.

But signs of their discomfort helped to fuel the wholesale funding runs on IBRC and other Irish financial institutions. Then there was ECB pressure for Ireland to negotiate a Troika program. Letters released by the ECB last November confirm that Trichet threatened Ireland with the termination of ELA, forcing it to apply for aid.¹⁶ Some commentators go further and suggest that Trichet insisted (telephonically) that the Irish authorities not bail in bank bondholders on the grounds that doing so would damage the big French and German banks holding Irish bank paper.¹⁷ Others dispute the claim. They point to the Irish authorities themselves, or at least some of them, as underestimating bank losses and resisting calls to haircut the bondholders.

¹⁴ Many examples could be cited, but an exceptionally clear distillation of the conventional wisdom on these matters is Hoggarth, Reidhill and Sinclair (2003).

¹⁵ Many of the bonds issued in extremis, in 2008, matured in September 2010, coincident with the expiry of the guarantee, something that only heightened the urgency of funding problems. The increase in borrowing from the Eurosystem was mainly through standard, collateral-eligible facilities before 2009 and through ELA starting in February of that year. ELA was initially extended only to Anglo Irish; eventually it was offered to all guaranteed banks. Borrowing through standard facilities, which remained the largest share of the total even in 2010, was a liability of the European System of Central Banks as a whole.

¹⁶ The relevant ECB webpage is <http://www.ecb.europa.eu/press/html/irish-letters.en.html>.

¹⁷ McSharry (2014) recounts conversations with Brian Lenihan where Lenihan characterized the situation this way.

Be that as it may, a key point is that the monetary union did not possess a mechanism for directly recapitalizing the insolvent banks of Eurozone members. This would come with the move to establish a banking union, complete with resolution fund and with the capacity of the European Stability Mechanism to directly recapitalize banks. But not in 2010.¹⁸ Its absence in 2010 reflects more general neglect, at that time pervasive, of the need for banking union to accompany monetary union.

Controversy then turns to the treatment of the banks' creditors in the Troika program. At the time, controversy centered on whether to impose losses on the holders of €19 billion of senior unsecured and unguaranteed debt. The IMF initially favored a haircut of roughly 50 per cent, a proposal which gained the Irish government's full support. But the ECB opposed this approach on the grounds that it might disrupt the flow of wholesale funding to other Eurozone banks. Again the ECB's position prevailed.¹⁹ That the ECB was involved in program design and monitoring, exceptionally and controversially, suggests that its opinions carried weight. That the IMF was out-maneuvered, or felt obliged to give way, raises questions about whether it should allow itself to participate in such programs as a "junior partner" (contributing only a minority of the finance) along with regional entities.

The decision contributed to understandable public outrage over the program. The banks' creditors, other than holders of its equity, were shielded from losses for the time being, while Irish taxpayers were saddled with an enormous bill. The absence of burden sharing undermined public support for the program. A better way of addressing the ECB's concerns would have been for it to reiterate its commitment to provide funding against collateral to banks elsewhere in the Eurozone. That this was not done may have reflected worries about how further expansion of the central bank's balance sheet would be perceived in other member states. If so, it is regrettable that such concerns were allowed to prevail.²⁰

3. The Promissory Note Deal

In the course of 2010 it became increasingly questionable whether the Irish sovereign would be able to borrow on financial markets to recapitalize the banks. As an alternative, the government provided the banks – or, more precisely, the Irish Bank Resolution Corporation (IBRC), which inherited the skeletons of Anglo Irish and Irish Nationwide – with a lump of money in the form of so-called promissory notes. The Irish government directly provided the IBRC with €31 of promissory notes that threw off roughly €3.1 billion annually (2 per cent of GDP) for the first 13 years and smaller amounts thereafter. With the government unable to borrow, the scheme relied on the ability of the Central Bank of Ireland to accept the promissory notes as collateral and provide cash in return, which it did in the familiar form of Emergency Liquidity Assistance. By injecting the promissory notes, the Irish government was effectively

¹⁸ Whether direct recapitalization using ESM resources backed jointly and severally by the members is now agreed to continues to be disputed; see below. In contrast, the ECB did move quickly, starting in 2008, to create other channels for meeting the liquidity needs of national banking systems, notably through the fixed-rate full allotment policy of October 15, 2008, under which "financially sound" counterparts have their bids fully satisfied, against "adequate collateral" (Gonzales-Paramo 2011).

¹⁹ As Pisani-Ferry, Sapir and Wolff (2013) note, some countries represented on the IMF's Executive Board, such as the United States, were not entirely unsympathetic to the ECB's concerns.

²⁰ The case of Cyprus in 2013 suggests that EU officials drew some lessons from Ireland's experience in 2010 and subsequently, although they would need to refine those lessons in the wake of their Cypriot adventure.

guaranteeing that the Central Bank of Ireland and, by implication, the Eurosystem would be repaid.

The scheme was designed to reassure the ECB's governing council whose approval was required for the extension of ELA. The extension of ELA is formally contingent on a national government guarantee to stand behind its national central bank, as noted above – consistent with the ECB's no-money-finance-of-deficits rule. This promissory-note mechanism was designed to indicate that the government was serious about the guarantee.

The corresponding problem was that the Irish government was required to come up with substantial amounts of money in a period of painful austerity. Paying out €3.1 billion in interest and principal reduction required the authorities in Dublin to cut an additional 2 per cent of GDP out of the budget or, once market access was restored, to repay ELA, whose cost is only marginally above the ECB's refinancing rate, by borrowing at considerably higher cost, thereby raising anew questions of debt sustainability.²¹ The first course, cutting spending further, was politically toxic, not least because of the public perception that fiscal adjustment was being undertaken to repay the ECB for losses made by a few bad banks and property developers; the second was economically destructive.

In February 2013, the government therefore restructured the promissory notes. In conjunction with the early liquidation of IBRC, instead of simply transferring the promissory notes to the account of the central bank the authorities converted them into long-term bonds with maturities of 27 to 40 years. This eliminated the need to make repayments of principal for the next 27 years, in turn obviating the need for yet more politically problematic austerity in the short run, as well as addressing longer-run concerns for debt sustainability. Back-loading the repayment of principal and extending maturities reduced the present value of the obligation by roughly 33 per cent.²²

There was an element of circularity in these payments, as Whelan (2013) notes. The central bank returns its surplus or profits to the government. Assuming that it otherwise had a surplus or profits, additional interest earnings on the new bonds, serviced by the government, would translate into additional surplus or profits for the central bank, which would then be returned to the government. A possible fly in this ointment was that as part of the deal the central bank agreed to sell off the bonds to the private sector as quickly as possible.²³ The government will then be paying interest to private investors, foreign as well as domestic, in order to repay the Irish central bank's Target 2 liability to the ECB. What the government pays out will no longer come back to it in the form of transfers of CBI profits.²⁴

²¹ The ECB's refinancing rate was close to zero, and ELA was provided at roughly 75 basis points above that rate. Even when Ireland was again able to access the bond market in March 2013, yields on its new ten-year bonds were on the order of 4 per cent.

²² By how much the present value was reduced depends, obviously, on the discount rate. The estimate in the text is based on Whelan (2013).

²³ More precisely, "as soon as possible, provided that conditions of financial stability permit."

²⁴ Of course, when the CBI sells the bonds, it will receive additional income in the form of the proceeds, adding to its profits and to immediate transfers to the government, other things equal. But there is then the worry that precipitous bond sales will depress their prices, imposing an additional drain on the public finances.

The ECB governing council was studiously silent about the deal, but its “non-objection” was presumably required for the Irish government to proceed. It has been speculated that the decision to sell the bonds on a specified schedule was intended to allow the ECB to claim that there was no violation of the prohibition of money financing. While the CBI hadn’t purchased the bonds directly in violation of Article 123 of the European Treaty, it had ended up with them anyway, which was presumably too close to the same thing for the comfort of those involved. Pre-committing to a schedule for selling off its holdings was a way for the CBI to signal that any stretching of Article 123 was purely temporary. The problem being that this comes at the price of some financial risk to the Irish sovereign.

Finally there is the question of whether the €25 billion of long-term bonds should remain an obligation of the Irish sovereign now that the European Union, by empowering the European Stability Mechanism to directly recapitalize banks, has opened the door to the possible mutualization of such obligations in the future. Pressure to allow direct recapitalization by the ESM reflects in no small part the lessons of Ireland’s experience, where a country that had previously displayed fiscal virtue found itself caught in the diabolic loop where banking problems create debt problems that aggravate those banking problems.²⁵ The Irish case was explicitly cited in the June 2012 euro area summit communique that committed to introducing direct ESM recapitalization.

Direct recapitalization will require evidence that the member state is unable to provide financial assistance to the troubled institutions without suffering “very adverse” consequences for debt sustainability.²⁶ The financial institutions in question must be systemically relevant for the euro area or its member states. The member state in question must have a sound fiscal and macroeconomic record.²⁷ There are no grounds for questioning that Ireland would have satisfied these conditions had the relevant guidelines been in place in 2010.

Whether this also opens the door to the ESM assuming some of the €25 billion of bank-related debt incurred by the Irish sovereign is more opaque. The June 2012 communique emphasized that “similar cases will be treated equally,” to the delight of Irish policy makers. Other European policy makers are more cautious: they interpret this to mean that similar cases will be treated similarly *when they occur in the future*. Advocates for Ireland point to the “encouragement” the country received in 2010 from the ECB to extend its guarantee. Others like the German, Dutch and Finnish governments insist that Ireland made its own bed and should now be made to sleep in it.

4. Other Issues

A comprehensive treatment of the impact of the EU on the Irish crisis would consider not just issues related to the banking crisis and its resolution but also other provisions of the Troika program, other EU and ECB policies, and the European recession itself. This paper makes no pretense of being comprehensive, but a few reflections on these issues are in order.

²⁵ The transfer of credit risk from the banks to the sovereign at the time of the bank rescue package is documented for Ireland by Attinasi, Cjecjerota and Nickel (2009).

²⁶ See European Stability Mechanism (2014).

²⁷ Whether even if these circumstances are met the ESM will assume meaningful amounts of credit risk directly remains to be seen.

The program for Ireland was based on overly optimistic assumptions about growth, both domestically and Eurozone wide. In 2011 the Eurozone grew at roughly the pace forecast by the IMF. In 2012 and 2013 growth was then sharply lower than forecast (Eurozone GDP shrank rather than expanding as anticipated in late 2010). By 2013 Eurozone GDP was more than 5 per cent lower than expected at the outset of the program. This obviously made it more difficult to boost exports and grow the Irish economy. Domestic demand also proved weaker than the IMF and its Troika partners initially forecast. Where the initial program anticipated that the Irish economy would grow by 5.4 per cent between 2010 and 2013, actual growth was just half that, 2.7 per cent according to the latest data.²⁸

The IMF has acknowledged that its excessive optimism about Eurozone growth reflected its underestimation of the relevant fiscal multipliers in an environment of near-zero interest rates where there was little scope for monetary policy to offset fiscal consolidation, and in circumstances where multiple European countries were consolidating simultaneously.²⁹ Hindsight suggests that a slower pace of fiscal consolidation, not just in Ireland but in its Eurozone partners, could have helped to moderate the loss of output and rise in unemployment while doing relatively little to slow the decline in the debt/GDP ratio.³⁰ It is relevant here that the Irish authorities were fully committed to the goal of rapid fiscal consolidation. As pointed out by Pisani-Ferry, Sapir and Wolff (2013), the Troika may in fact have exercised something of a moderating influence.³¹

Ireland was hit by financial shocks from the EU as well. Chancellor Merkel and President Sarkozy's Deauville declaration of 19 October 2010 that, in future crises, bondholders would be automatically bailed in caused a sharp increase in spreads on the debt of the Irish sovereign. Subsequent backtracking by EU officials, in the view of most, did not fully repair the damage. To be sure, the Irish crisis was already fully underway. But Deauville heightened the dependence of the Irish banking system on the CBI and ECB and left Irish policy makers even less time to prepare for what came next.³² Similarly, the Greek crisis and its management (including the long delay and associated uncertainty in moving to restructure debts to private creditors) had an adverse impact on Irish spreads.³³

More attention or at least verbiage was directed toward banking programs in Troika documents for Ireland than in the comparable documents for Portugal and Greece.³⁴ The Irish program anticipated that deleveraging of the banking system would be achieved in substantial part by asset sales.³⁵ The pace of these fire-sales has been criticized for depressing asset prices,

²⁸ Growth looks somewhat stronger if the depressing effect on the data of patent expiry in the pharmaceutical sector is excluded. Looking at GNP rather than GDP growth paints Irish growth experience in a somewhat more favorable light (GNP growth in 2010-13 was 3.6 per cent).

²⁹ See for example Blanchard and Leigh (2013).

³⁰ Somewhat slower fiscal consolidation might have been possible, as noted above, had the government not committed to make payments to the banks' bondholders.

³¹ Initial program negotiations led the government to agree to postpone by one year, to 2015, the goal of reducing the deficit to 3 per cent of GDP.

³² The point is disputed by Mody (2014).

³³ Evidence to this effect is provided by De Santis (2012).

³⁴ Verbiage here refers to frequency of banking-related terms per page of documentation, as reported by De Sousa et al. (2014).

³⁵ Other options, like raising additional deposits, not being possible under the circumstances.

ultimately at the cost of the Irish taxpayer.³⁶ If the front-loaded nature of asset sales reflected the desire of the ECB, as a Troika partner, to reduce its exposure to Ireland, this is regrettable. Even now, there are questions about the capital adequacy of the country's banks, given the large stock of nonperforming loans.³⁷ Not to beat a dead horse, but more rapid and comprehensive write-downs of debts to bank bondholders would have helped to address this problem.

Last there is the impact of the ECB's monetary and credit policies, something that has been a mixed bag for Ireland. The ECB's decisions to tighten in 2008 and 2011 were unhelpful from a growth standpoint, to put an understated gloss on the point. In contrast to their findings for Spain and Portugal, Godl and Kleinert (2014) do not find that announcement of the ECB's Securities Market Program and Long-Term Refinancing Operation had a favorable impact on Irish spreads. More important was President Draghi's "do whatever it takes" statement in 2012 in taking the specter of euro break-up off the table. It is hard to imagine that Ireland could have achieved its clean exit from its Troika program (as opposed to a messy exit from the euro) in the absence of this statement.

5. Conclusion

Financial crises leading to international rescues are never happy, and Ireland is no exception. Economic costs are large and distributed unevenly. Emergency lenders being concerned to be paid back, assistance comes with politically difficult, and often resented, conditions. Adjustment and recovery goals are difficult to meet. Crisis countries do not recall their experience fondly.

These observations are important for putting in context criticisms levied against the Troika for its actions in Ireland. That said, there is plenty to criticize. The EU can be criticized for failing to do more to anticipate a classic banking crisis, allowing supervision to be delegated to national authorities, and raising few cautions about the results. It may be too much to ask, paraphrasing the Queen of England, to expect them to have seen "it" coming. That said, financial surveillance could have been more systematic and effective. The EU has now acknowledged as much by creating a single supervisor as part of its banking union.

Although the fatal decision to respond to the banking crisis with a blanket guarantee was taken by the Irish authorities, they did not receive wise counsel from the EU. Ireland's policy that no bank would be allowed to fail was also the EU's policy, *de facto* if not *de jure*. Uncertainty surrounded the provision of ELA; the Irish authorities received no assurance that if they immediately put Anglo Irish and Irish Nationwide into receivership other banks would receive unlimited liquidity support. The absence of a mechanism for directly recapitalizing the two troubled banks allowed the sovereign-bank doom loop to come into operation. The ECB applied pressure for Ireland to request a Troika program in 2010, to refrain from administering haircuts to holders of senior unsecured and unguaranteed debt, to undertake sales of bank assets more quickly than Irish officials thought best, and to sell off the long-term bonds acquired by the Central Bank of Ireland at a pace that posed risks to the government's finances.

³⁶ Pisani-Ferry, Sapir and Wolff (2013), p.89.

³⁷ Central Bank of Ireland (2014), p.21.

Management of the Eurozone crisis did not help. Uncertainty surrounding Greece and its debt restructuring spilled over. Official talk about the possibility of exit or a “temporary holiday” from the euro, even if prompted by the problems of other countries, affected market sentiment toward Ireland. Inaccurate assumptions about fiscal multipliers, botched stress tests, and on-again-off-again progress toward banking union made things unnecessarily difficult.

That said, the EU and its institutions learned from the experience. The creation of a banking union with a single supervisor, harmonized deposit insurance, a resolution mechanism capable of directly recapitalizing troubled banks, and a dedicated resolution fund perhaps best symbolizes this fact. The idea is that taking supervision out of the hands of the national authorities, at least in part, will reduce problems of capture and strengthen surveillance next time around. A well-specified and adequately funded resolution mechanism will prevent national authorities in the future from feeling obliged to resort to an Irish-style guarantee. Stronger banks Eurozone wide will assuage fears of uncontrollable contagion and financial chaos flowing from isolated bank failures.

Making this progress not just symbolic but real will now require giving that single supervisor real teeth, fully funding that resolution fund, and allowing the ESM to assume meaningful amounts of credit risk. Will it happen? Stay tuned.

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