NEW DIRECTION
THE FOUNDATION FOR EUROPEAN REFORM



Journey Without Maps

Ireland and the Euro

Tom Gallagher
May 2012



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Executive Summary

The study, completed on 25 November 2011, argues that Ireland took the fateful decision to join the eurozone in 1999 despite its economy diverging cyclically and structurally from the rest of the European countries. The inability of its political leaders to foresee the likely huge disadvantages has resulted in surrendering some key levers of economic sovereignty that would have been vital to retain during this extended financial and economic crisis.

As in case of other eurozone members the euro gave Ireland access to credit at low interest rates which led Irish decision-makers to pursue a reckless expansionary policy. The EU offered regular praise for the Irish model instead of encouraging the European Central Bank to use its powers to rein in a speculative bubble, which burst in 2008 resulting in a rapid decline.

As the banking crisis intensified in Ireland, in 2008 and 2010, the EU took two decisions that have proved acutely damaging for the future development of Irish economy and prosperity:

- The EU fully backed the Irish government's decision to guarantee the deposits of the main Irish banks with tax-payers money. At the same time the debts were not restructured, in order to limit the liabilities faced by the state through a strategy of burden-sharing with bondholders.
- In 2010, the EU made Ireland to accept a financial bail-out. This step protected interests of private lenders and investors rather than tackling structural problems in the Irish economy so as to promote a return to growth.

The EU allowed a mountain of debt to be placed on the shoulders of Irish citizens rather than introduce modifications to the workings of the eurozone which could have enabled Ireland and other distressed members to work towards reviving their economic competitiveness.

Without taking necessary steps the future of Ireland is likely to be one of unrelieved economic decline marked by plunging living standards, mass unemployment and emigration. This study looks into what Ireland needs to do in the short and long term to revive economic growth and secure prosperity:

- Austerity policies should be spread more equitably between the public and private sectors as the commercial, small and medium business, are bearing the brunt of the prolonged downturn, while large financial and property institutions have been protected by state measures, and many public service employees with strong unions have faced little squeeze on their incomes.
- Proposals to restructure private debt arising from the collapse of house values need to be actively considered. For example reform of Irish bankruptcy laws and partial debt relief to certain grades of house-owners could increase the likelihood of a revival in the property market along with economic growth.
- The need for a managed re-structuring of debt, the current level of which it is beyond the capacity of Ireland's small population to meet. This would involve rolling over existing government debt and working with the ECB to find effective means of reducing the still high level of borrowing on private balance sheets.
- A tightening of the law on what constitutes bribery and corruption in order to reduce the hold of narrow economic and professional interests over public policy.

- Reforms to strengthen the oversight of parliament over the executive and a centralised and often inefficient system of public administration are overdue in order to increase the quality of political decision-making.
- The relationship between national EU members and EU institutions needs to be placed on a new basis in order to promote cooperation which enjoys democratic legitimacy.
- Such measures increase the likelihood that domestic investment and growth can recover and that a climate can emerge enabling Ireland to implement a broad range of structural reforms, essential for long-term recovery.





Introduction

Over the past three years, Ireland has experienced one of the most severe recessions and banking crises seen in any modern developed state. There are increasingly sharp disagreements about what the principal origins of this crisis are and what the pathway for Irish recovery is. The official position of the European Union has been to describe the crisis as domestic in origin. José Manuel Barroso, the President of the European Commission, has complained about uninspired domestic policy-making. Both he and the leaders of France and Germany have argued that the citizens of Ireland must repay a huge volume of private debts incurred by Irish banks – even if this means low growth and severe cuts long into the future.

A new Irish government obtained a large electoral mandate in February 2011, after having argued that an agreed debt restructuring schedule is a more sensible way ahead; numerous economic analysts agree with this assessment. It has been pointed out that Irish taxpayers were not parties either to the lending decisions or the borrowing decisions that they are now expected to take full responsibility for. Moreover, Ireland found it difficult to take corrective action, thanks to belonging to a currency union in which it no longer had the ability to adjust interest rates or devalue its currency in order to combat overheating in the economy.

The Irish public and their government leaders have recognised the need for major domestic austerity in order for Ireland to return to economic health. In 2008, the previous government admitted the scale of the banking crisis and took the step of guaranteeing bank deposits. Dublin heeded the warning from Europe that a failure to guarantee private bank debts could spark off a much wider crisis affecting major European banks – which had been the chief investors in the Irish boom. Ireland has published several detailed reports which contain stern criticisms of the state oversight of financial affairs. But at the top of the EU, an equivalent candour about the failings of the European Monetary Union is hard to detect.

The euro had been launched with a political goal very much in mind: that of merging national economies into a common European system, one that hopefully would become the basis for a post-national federal state. But the level of ideological enthusiasm was not accompanied by sufficient practical steps to accomplish such an audacious feat. The respective competences of the European Central Bank (created to manage the currency union) and the other EU pillars were never properly worked out (as the crisis from 2009 starkly revealed). Indeed, its management was an unhappy compromise meant to reconcile the contrasting approaches to banking supervision of its two chief national guardians, France and Germany. There was no shortage of warnings that the currency union could only thrive if the tax and budgetary arrangements of its members were to be subject to tight central oversight. But the curtailment of national sovereignty required for this was bound to generate Europe-wide resistance; besides, such a frontal assault was out of character with the EU tradition of draining power from national members by stealth and subterfuge.

Instead, it was hoped that the birth of the euro and the abandonment of national exchange rates and interest rates would begin a process of economic convergence. Intensifying economic activity in the 16 eurozone members did occur but not in ways that reinforced the federalist aspirations of its architects. The low interest rates designed to promote the return to growth of the eurozone's largest member (Germany) led to a frenetic lending spree. A surge in lending to peripheral eurozone members – by German and French financial institutions in particular – marked the euro's initial decade. High returns – usually unavailable at home – were sought in economies witnessing a property boom. These peripheral economies took advantage of the low interest rates to intensify borrowing, in order to prolong what turned out to be a perilous asset bubble. The disparities between eurozone states based around industrial production



(Germany, Netherlands, Austria in particular), and others – mainly on the periphery (Greece, Ireland, Portugal and Spain: the GIPS) – that were relying on low interest lending to fill the gap between tax receipts and spending, grew immensely. Similar reckless lending contributed to what became known as the sub-prime financial crisis in the USA after 2007. Warning signals were ignored by the ECB and EU about the steep disparities within the eurozone. The outlook of European institutions and major financial bodies at that time suggested that it was relatively unimportant if some countries massed large surpluses and others huge deficits, since they were on the same journey towards a common economic future.

Euro-enthusiasm collapsed when, in short succession, the ratings agencies downgraded the sovereign debt of Greece (2009), Ireland and Spain faced banking crises of different levels of intensity over a longer period, and Portugal confronted state bankruptcy (early 2011). But the crisis also affected the banking systems of core EU states and quickly turned into an institutional one. The suspension of critical judgment that accompanied the planning and early implementation of the currency zone was visible in the efforts to contain the crisis. It was assumed that delinquent members bore the sole responsibility for their difficulties and that the role of lenders from more powerful states and the framework of the currency union in which they operated, did not require searching examination. This attitude was incredibly slow to dislodge, even as it became clear that financial bail-outs, piling further loans onto distressed states, were not nursing them back to health.

Recapitalising insolvent banks was not based on any well-thought-out strategy but sprang from a desperate effort to preserve the Euro as a viable concern. The overall response to what had become a crisis of the eurozone by the middle of 2011 was also determined by the electoral timetables of the dominant figures on the European council, France and Germany. From within the structures of the EU, there was little desire to consider alternative steps to long-term debt repayment such as a structured default. Instead the only bold new departure was a demand for further financial federalism involving central control of national budgets and taxation policies, presumably with the same bureaucratic elites in charge that had presided over the debacle of the Euro.

There was not even the pretence of public consultation about using astronomical proportions of tax-payers' money to feed this financial leviathan; the European Parliament has little control over the workings of the ECB and has largely stayed on the side-lines throughout the escalation of this crisis. Nor was there any concern with adhering to the conditions of the Lisbon Treaty, which clearly disallowed the bailouts of 2010-11. Its rules, painstakingly drawn up to reinforce the legitimacy of the European Union, proved in a remarkable short space of time to be decorative and dispensable. How else is one to interpret the admission of France's finance minister Christine Lagarde in December 2010 that: 'we violated all the rules because we wanted to close ranks and really rescue the eurozone'?[1]

The European debt crisis stems from poorly-planned efforts to create a single economic zone from countries with vastly different economic conditions and needs, and it threatens to become a danger to global financial stability due to the glaring lack of competence shown in trying to confront it. All too often, decision-making occurs in secretive conclaves, and after deal-making involving senior states and EU mandarins, with others often complaining of having been left out.[2] The absence of democratic overlay or

[1] *Wall Street Journal*, 17 December 2010.

[2] An illustration was the informal meeting, in May 2011 of finance ministers from a number of the Eurogroup countries, a body over which the Luxembourg Prime Minister, Jean-Claude Juncker presides, to discuss the continuing Greek crisis. His spokesman denied the meeting was taking place. See 'Secret Euro Crisis Meeting in Luxembourg Today', EU observer, 7 May 2011.



transparency was shown during a critical turning-point in crisis talks between Ireland and the EU on 16th November 2010. Wolfgang Schäuble, Germany's finance minister, pressed his Irish counterpart Brian Lenihan to hold a press conference immediately after a meeting in Brussels to discuss a bail-out, to announce an application for aid without the matter even having been discussed at cabinet-level back in Ireland.[1]

The incompetent and often self-serving way that leading national players have confronted the crisis has increased the perception that the EU is now becoming a danger to global financial stability. At home, the leaders of France and Germany have presided over a collapse in support of their ruling parties (and, in the case of Germany, with mounting tensions between them and coalition partners and allies in academia and the media). The insistence on putting the blame on national decision-making, and on asserting that the solution must involve further centralisation and transfers of national wealth to EU institutions, threatens to unleash debilitating conflicts inside the EU.

During the recent Irish general election, top Eurocrats made clear that they were reluctant to have a re-think if Irish voters failed to endorse their deflationary approach to the crisis involving long-term austerity and the rescue of investors in Irish banks across Europe. They seem to have got their way. Michael Noonan, the new finance minister who previously had criticised the bail-out for being 'a downright obscenity', now described the EU approach, one hardly changed in any point of detail, as 'good for Ireland'.[2] The views of the electorate which had inflicted a crushing defeat on the previous government, in no small measure because of such policies, suddenly diminished in importance as a government with a sweeping majority contemplated four years in office. The electorate had previously behaved with calm and restraint, even as austerity measures ate into living standards. But it is unclear whether respect for democratic rules will continue if the solidarity and trust between government and the people – necessary for workable democracy – continues to be eroded.

It is becoming harder to recall that for nearly two decades, Ireland was the EU's star pupil. The fast growth rates enjoyed by what used to be a stagnant economy made it a model for other peripheral states experiencing the EU's gravitational pull. Attempts are already being made to rewrite history and dismiss Ireland as a deviant case in the story of European integration. But Ireland, with a lax approach to governance and key aspects of financial regulation, was far from being a maverick player. It reflected a wider malaise that is easily visible at the heart of the EU decision-making process. The EU has often been reluctant to encourage member-states to maintain capable state administrations, even though its own policy instruments are often feeble in practice. Irish governments in recent times have shared the EU's addiction to corporatism, where insiders have preferential access to resources and political power and its political institutions are decorative and mired by clientelistic practices. Lip-service is paid to subsidiarity (as in the case of Ireland), while strenuous efforts are made to centralise huge amounts of power in unaccountable bodies whose performance is not effectively monitored nor its office-holders properly held to account.

[1] Dan O'Brien, 'Banking on Europe: the true story behind Ireland's bailout', *Irish Times*, 23 April 2011.

[2] Fintan O'Toole, 'Time to remember all those promises', *Irish Times*, 5 April 2011.



Purpose

This report aims to show that a failure of statecraft at both national and European levels accounts for the severity of a financial crisis that now extends well beyond Ireland and Greece. It catalogues the policy failings in the Irish state's management of the economy, but argues that Ireland has been more open about these failings than the EU institutions have been about theirs. It seeks to show that no strategy has been provided that indicates how Ireland's recovery can occur via long-term debt repayment. Defenders of this approach have melted away outside of the ECB. Among academic analysts and serious media commentators, the case for an orderly restructuring of debt has grown, as the low-grade approach of the EU institutions has become harder to conceal. But what is still rarely heard is the need for a balance of power between EU institutions and national states, with greater power to be restored to the latter. The role that the EU allocates for Europe's nation-states in this crisis is a subordinate one. They are to oversee the measures of austerity that are to be imposed on the GIPS states, and must also provide huge amounts of funds (by now much bigger than the Commission's annual budget) for bids to solve the financial emergency.

The EU has had a dismal role in generating economic growth over the last two decades, even as it has amassed unprecedented power in the economic realm. This paper argues that the recovery will only occur if nation-states are intimately involved in the process. Central organisation of disparate economies by remote bureaucrats has been exposed as a failure and the EU must now allow nation-states the authority to devise solutions for the crisis that do not involve the mass alienation of their citizens. If economically stricken states collapse into deep acrimony and disorder, the EU has shown that it is far too weak to fill the vacuum.

Ireland is the focus of this report, a country whose level of debt (mainly acquired over the past three years) may be bigger in relation to its economy than the reparations Germany was instructed to pay at the end of the First World War.[1] This report believes that moves in Europe to compel Ireland to carry a massive burden of debt repayment will not work, and will threaten to both prolong and expand the crisis. A more equitable policy of burden-sharing is needed, along with a searching analysis of the range of alternatives to a currency union which in its present form has caused spectacular harm to individual countries, and also to Europe's standing in the world. Until now, EU leaders have been willing only to discuss greater financial centralisation, dismissing approaches that involve taking certain countries out of the eurozone or that divide it into a number of currency unions that match the conditions of their members. There has been a refusal to even recognise the case for overhauling failing institutions at the centre of the crisis, as opposed to a policy of subjecting national economies to perhaps decades of painful contraction.

The report aims to show that further refusal by the EU to consider an alternative (to a bail-out strategy that has yielded few successes) brings real danger to Europe. The signs of a fundamental crisis of legitimacy are not hard to see, due to the failure of the EU to work with nation-states as partners. If the poorly conceived policies foisted on Ireland are extended across much of the eurozone, it could mark the start of deepening crises, each threatening to undo much of the economic progress seen in Western Europe since 1945.

[1] Anatole Kaletsky, 'Like Iceland, Ireland can refuse to pay up', *London Times*, 13 April 2011.

1. The Celtic Tiger and the Eurozone

Ireland joined the European Union (EU) in 1973, fifty-two years after it had achieved its independence from Britain. Until then, it had been an introspective country absorbed with consolidating its statehood, mainly by reducing British influence over its affairs. The unification of the island was never accomplished, but by the eve of the Second World War the larger part of the state, ruled from Dublin, had, through agreement with London, established full sovereignty over what became the Republic of Ireland in 1949. Not only did Ireland remain neutral in the Second World War but it largely avoided the major ideological battles which convulsed continental Europe in the first half of the 20th century. The longstanding struggle for independence meant that its political culture continued to be shaped by a nationalist outlook. Europe-wide polls still usually show that Ireland ranks very highly among EU members in identification with national values.

On 12 June 1955, Eamon de Valera, arguably the chief architect of the Irish state, spoke in the Dail (the Irish Parliament) about the danger which the accelerating movement for European integration posed for Irish sovereignty. He had just returned from a meeting of the Council of Europe in Strasbourg where he encountered growing enthusiasm for a European constitution along federal lines complete with a European army. He told the Dail that Ireland had not struggled to put an end to direct British control only to find itself part of another sovereign realm where 'on matters that we would have regarded as of important interest to us … we would have been out-voted by 30 or 40 to one.' 'It would,' he declared, 'have been most unwise for our people to enter into a political federation which would mean that you had a European parliament deciding the economic circumstances, for example, of our life here.'[1]

Dismal economic results led Ireland to abandon a long-term strategy of promoting economic self-sufficiency and to welcome multi-national companies from the end of the 1950s. The greater economic success then enjoyed by the states in the European Economic Community led Ireland and Britain to submit applications for full membership and they joined in 1973. Ireland surrendered valuable north Atlantic fishing grounds and the main beneficiary of entry was the farming sector, thanks to the Common Agricultural Policy. By 1978 the per capita income of farmers was already more than double the 1970 level.[2] Despite the arrival of transfer funds from Brussels, Ireland's economy languished for the first fifteen years of EU membership. For most of the 1980s, it appeared overwhelmed by serious economic problems, reflected by a very high ratio of public debt to GDP and a steep renewal of emigration.[3]

In 1985, per capita GDP was less than two-thirds of the European Union average. But two decades later it stood at 130 per cent. The population grew between 1981 and 2006 from 3.4 million to 4.2 million, faster than anywhere else in Europe at that time.[4] In 1998, when Jacques Santer, then President of the European

[1] Bruce Arnold, 'History warns us about the risks of ceding power to EU', *Irish Independent*, 11 July 2009.

[2] Diarmaid Ferriter, *The Transformation of Ireland: 1900-2000*, London: Profile Books, 2005, pp. 682-83.

[3] Cormac Ó Gráda, *A rocky road: The Irish economy since the 1920s*, Manchester: Manchester University Press, 1997, p. 31.

[4] Cormac Ó Gráda, 'From Celtic Tiger to paper tiger?', *Inside Story*, (Australia), 15 April 2009.



Commission, addressed Irish parliamentarians, he noted how 'it is rare to find any period of such profound transformation which has been as successfully managed as here in Ireland.'[1]

The economic breakthrough which began around 1988 was admiringly dubbed the Celtic Tiger for emulating Asian countries in attracting prestigious companies, through which rapid export-led growth boomed. It was North American firms which dominated the new investors and the Irish economy would do far more business with Britain and the USA than with its continental EU partners for many years to come. A major advantage for most of the 1990s was the independent exchange rate policy that Ireland enjoyed from 1993 to 1999. Turbulence on the money markets led Ireland to float its currency. It obtained a highly competitive exchange rate, boosting Irish exports, and inhibiting competing imports.

Ireland's attractiveness as an investment destination derived from a number of broad factors: unimpeded access to EU markets, a low corporation tax; an undemanding regulatory environment; a labour force that was skilled, flexible, English-speaking and still relatively low-paid up to the early 2000s. Major foreign investments secured by the Irish Development Agency saw world-class technologies introduced to Ireland, along with management practices which led to a sustained increase in productivity and competitiveness (much of it centred on the high-tech sectors).[2] If Ireland could be said to have a model for development, it was a hybrid one. It combined elements of American neo-liberalism (minimal state, privatisation of public services, public-private partnerships, laissez-faire planning, low corporate and individual taxation, and limited regulation) and European social democracy (social partnership, welfare safety net, high indirect taxes, responsiveness to EU directives and obligations).[3]

It was no small achievement for Ireland to build a pharmaceutical, medical and software industry some distance from Europe's geographic core. Following the 2008 banking crisis, some analysts were quick to disparage the Irish miracle as a mirage driven by tax cuts followed by a huge credit boom that permitted real estate prices and construction to soar before their spectacular collapse.[4] But unwise decision-making only really became apparent after 2001. Charlie McCreevy, Finance Minister from 1997 to 2004, channelled hundreds of millions of euro in subsidies or tax incentives to the property sector.[5] It was assumed that Ireland could continue to boom thanks to a property-driven bubble based on the low interest rates of the eurozone. But until the end of the millennium, there was a solid basis to Irish achievements. The 'miracle' was predominantly driven by productivity gains, investment into education and technology and competitive wages. Unemployment plummeted from 16 per cent in 1994 to 4 per cent in 2000 – essentially full employment for the first time in modern history.[6] Ireland actually secured a competitive niche in a globalised economy, before poor governance sharply eroded previous success.

[1] Ray MacSharry and Padraic White, *The Making of the Celtic Tiger: The Inside Story of Ireland's Boom Economy*, Cork: Mercier Press, 2000, p. 154.

[2] *Economist Intelligence Unit, Ireland Country Profile, 2001*, London: The Economist 2001, pp. 37-38.

[3] 'Invisible ideology and the political middle-ground of Irish neoliberalism', *Ireland after NAMA*, 4 March 2010, http://Irelandafternama.wordpress.com.

[4] Peter Boone and Simon Johnson, 'Irish Miracle – or Mirage?', *New York Times*, 20 May 2010.

[5] Shane Ross, *The Bankers: How the Bankers Brought Ireland to its Knees*, Dublin: Penguin Ireland, 2009, pp. 123, 129.

[6] Patrick Honohan, *The Irish Banking Crisis, Regulatory and Financial Stability Policy 2003-2008*, Dublin: Irish Central Bank, 2010, p. 21.



Ireland's political culture and party system remained ossified even in the face of dramatic economic change. A clientelist political world was centred on the managing of local grievances and the brokering of influence within the state apparatus.[1] Low-grade political decision-making impaired long-term development. Little sustained debate about policy direction and the values that should shape the new Ireland emerged from the universities. The prestige of the traditional professions, law, medicine and accountancy, still outshone science and technology. The path to wealth and respectability still lay through property investment. Less than €200m was going into capital investment in Irish business annually after 2004 whereas overseas property investment was grabbing at least €10bn. Little attention was given to utilising Ireland's natural resources in order to respond to market opportunities. Thus, during the decade of 1999-2009, in areas of natural strength like food and drink, exports only rose from €6.6bn to €7.10bn whereas in Germany the increase was much higher, from €20bn to €40bn.[2]

Fianna Fail (Soldiers of Destiny), the dominant political force for the previous 75 years, switched from being a party expressing nationalist and Catholic values to one essentially bound up with Ireland's *nouveaux riche*. Broad formulation of policy was left to the unelected 'social partners' from the employers' organisations, tilted towards the banking sector, and public sector trade unions whose leaders were co-opted onto the boards of major state institutions (including the central bank).[3]

By 2008, it was not far-fetched to view Fianna Fail as the political wing of some of Ireland's most powerful property developers. Bertie Ahern, Ireland's Prime Minister from 1997 to that year, grew close to them. In June 2006, speaking in the Dail, he boasted about Ireland's achievement of building new homes at a rate five times faster than the rest of the EU.[4] Today many of these homes are to be found in 'ghost estates' destined for demolition due to the absence of buyers.

'Over-lending for land and property investment, much of it through heavy, short-term foreign borrowing' pushed Ireland towards financial disaster. This was the explanation contained in the 2010 report of Patrick Honohan, the new governor of the Irish Central Bank, about the origins of the crisis. It described 'an unusually deferential approach to the banking industry' which 'might have partly constituted what is described in the literature as "regulatory capture".'[5] Indeed, by the end of 2008, Ireland's three main banks had lent more than three times the country's national income. Ireland's banks ballooned in size by borrowing from other European banks, so the health of Europe's financial system became wrapped up in their fate.[6]

In 2007, Prime Minister Ahern had assailed those 'sitting on the sidelines … moaning … I don't know how people who engage in that don't commit suicide because frankly the only thing that motivates me is being able to actively change something.'[7] The Honohan report argued that there were powerful disincentives for

[1] Fintan O'Toole, *Ship of Fools*, London: Faber, 2009, pp. 33, 44.

[2] Michael Hennigan, 'The Very Bad Luck of the Irish', *The Irish Economy*, 20 May 2010, www.irisheconomy.ie.

[3] See Shane Ross, *The Bankers: How the Banks Brought Ireland to its Knees*, Dublin: Penguin Ireland, 2009, chapter 1.

[4] Martina Devlin: 'Why Bertie Ahern should stick to blowing bubbles', *Irish Independent*, 23 December 2010.

[5] Patrick Honohan, *The Irish Banking Crisis, Regulatory and Financial Stability Policy 2003-2008*, Dublin: Irish Central Bank, 2010, p. 9.

[6] Simon Johnson and Peter Boone 'Brady Bonds For the eurozone', *Project Syndicate*, 15 September 2010.

[7] 'Ahern sorry over suicide remarks', *BBC News*, 4 July 2007.



regulators 'rocking the boat' and being prepared to 'spoil the party'.[1] The bankers who had used their institutions as their own private finance houses and who were extremely casual towards established banking practice were the titans of the Irish establishment; a weak legislature was unable to act as a restraining force. After their fall, the Dail Committee on Economic Regulatory Affairs found it difficult even to compel leading bankers to give evidence before it, revealing the inability of the Irish parliament to call corporate and regulatory bodies to account.[2] Neither of the main opposition parties cried "stop!" during the boom years. Fine Gael, in some critical eyes, is viewed as a more prosaic version of Fianna Fail, while the Labour Party is closely linked with the public sector whose salaries soared ahead of those in the private sector after 2000.[3] When both of these parties formed a coalition in March 2011, their unwillingness to strengthen the powers of the Dail in relation to the government was immediately noticeable.

Domestic mishandling of a runaway property boom and what turned into casino banks was, in no small part, responsible for the financial shock of 2008. But even if had been under more prudent management, it would have been difficult to shield the Irish economy from danger.

2. Joining the Eurozone

In boom conditions, Ireland needed higher interest rates to prevent price bubbles. In theory, easy credit could have been curtailed by increasing taxes or cutting spending. But this would have required great self-restraint of a kind perhaps unusual in a country enjoying economic plenty for the first time in its national history. The normal way of restraining consumer demand would have been to raise interest rates, but this instrument was no longer available to the Irish Central Bank. When Ireland became a founder member of the European Monetary Union (or eurozone) in 1999, control of its own currency was ceded to the European Central Bank, which set one policy for all euro countries. Germany as the largest economy in the eurozone was able to use its leverage to maintain interest rates even below the eurozone equilibrium.[4]

Garret FitzGerald, Prime Minister from 1982 to 1987 – and until his death in 2011, Ireland's best-known exponent of the European federal project – publicly stated in early 2011 that 'entering the eurozone in the 1990s – unhappily without any political understanding of the implications of this for this State's economic and financial policy – thus contributed to financial collapse … we halved our interest rates on joining EMU [and] this gave huge impetus to the borrowing binge that followed between 2002 and 2007.'[5]

In an interview in early 1999, the first head of the ECB – Wim Duisenberg – had said that Ireland, together with Spain and Portugal, were already having difficulties with the interest rate cut based on their national

[1] Patrick Honohan, *The Irish Banking Crisis, Regulatory and Financial Stability Policy 2003-2008*, Dublin: Irish Central Bank, 2010, p.16.

[2] Constantin Gurdgiev, 'State of our Democracy', *True Economics*, 18 February 2009, http://trueeconomics.blogspot.com

[3] Sebastian Dellepiane Avellaneda and Niamh Hardiman, 'The European context of Ireland's Economic Crisis', *The Economic and Social Review*, Vol. 41, No 4, Winter 2010, p. 486.

[4] Ambrose Evans Pritchard, 'Flat earth European Central Bank misreads oil spike again', *Daily Telegraph*, 7 March 2011.

[5] *Irish Times*, 10 January 2011.



interests. The London *Economist* commented that such differences expose the difficulties of those Euro participants whose economic cycles were not synchronised with the core of the European economy – for which the ECB's monetary policy is tailored.[1]

Over the long-term, Duisenberg's candour was unusual. The American economist, Paul Krugman has claimed that, in the second half of the 1990s, the European Commission was reluctant to release information on the costs (as well as the benefits) of a single currency after officials had originally been asked to prepare such a broad analysis.[2]

In the early 2000s, Irish banks stopped using their deposits to underpin loans and started to borrow money extensively from foreign banks, and to offer easier forms of credit to home buyers. Prestigious parts of central London were bought up by successful Irish financiers. Membership of the eurozone has been seen as part of Ireland's larger strategy to assert itself in the face of Britain, its still-influential ex-colonial neighbour. But the bulk of trading continued to be carried out with Britain and the USA – which meant that the Irish economy diverged cyclically and structurally from the eurozone mean.[3]

The sterling and dollar areas, to which Ireland was still closely aligned, floated their currencies downward without Ireland being able to do likewise. They thereby had cheaper prices, which encouraged huge numbers of citizens to cross the border to do their shopping in Northern Ireland.[4]

A post-nationalist outlook among the political elite allowed the surrender of financial controls which had previously been hard-won expressions of sovereignty. The gravitational pull of Europe was strong, even though there was no shortage of economists who considered that the economic benefits of joining the eurozone were meagre.[5] High hopes that the Euro would create a more dynamic and integrated European economy were not met: productivity growth among EMU members slowed from an already sluggish 1.6% a year before the euro's 1999 launch to 0.8% a decade later.[6] The best estimates pointed to trade among eurozone members being only 10 to 15 per cent larger than it would otherwise have been.[7]

But ideological concerns resonated perhaps even more strongly among the European architects of the eurozone. A currency that could vie with the dollar had long been the dream of ardent believers in a common Europe that would supersede former nation-states. Before 2010, the eurozone produced the equivalent of 74% of the US total output, despite having a larger population.[8] The Deutschmark was the

[1] *Economist Intelligence Unit, Ireland, 1st Quarterly Report, 1999*, London: The Economist 1999, p.13.

[2] Paul Krugman, 'Can Europe be saved?', *New York Times,* 12 January 2011.

[3] Daniel Hannan, 'There is a way out for Ireland', *Daily Telegraph,* 17 November 2010, http://blogs.telegraph.co.uk.

[4] These and other long-term shortcomings for Ireland have been calculated by Anthony Coughlan in *Ireland: the Euro and the Economic Crisis*, Dublin: National Platform, December 2010.

[5] Colin Hay et al, 'Ireland: The Outlier Inside', in Kenneth Dyson (ed.), *The Euro At Ten,* Oxford: Oxford University Press, 2008, pp. 185, 187.

[6] 'The euro at ten: Demonstrably durable', *The Economist,* 30 December 2009.

[7] Paul Krugman, 'Can Europe be saved?', *New York Times,* 12 January 2011.

[8] Constantin Gurdgiev, 'A long term view of the currency markets', True Economics, 7 March 2010. http://trueeconomics.blogspot.com



obvious candidate for challenging U.S. monetary ascendancy. But, because of the short but destructive Nazi episode from 1933 to 1945, it had subsequently always been difficult for Germany to assert a powerful national role. After 1989, apprehension among important allies like France and Britain about German re-unification was allayed by the willingness of German elites to absorb the Deutschmark in the new pan-European currency.

For proponents of a post-national European entity, the arrival of the Euro was about far more than completely liberalising cross-border trade. Pierre Werner, the banker who led the government of Luxembourg for many years, had unfurled the Werner report in 1970. It called not only for a monetary union but for a transfer of economic policy to a centralised European authority within a decade.[1] In 2000, Joschka Fischer described European Monetary Union when he was German Vice-Chancellor as 'a quantum leap' creating an 'inexorable federal logic'.[2] But little hard thinking would occur about how to reduce the imbalances between members, ones that would increase due to irresponsible lending by the core to the periphery.

The 1992 Maastricht Treaty (signed on 7 February 1992) had approved the existence of the Euro. Germany's political system did not require a referendum in order for the treaty to become law. Nor did France's, but one was held and the treaty was only approved by French voters by a very slim margin in 1992. In a pre-vote television address, President François Mitterrand had assured the French public that, contrary to the explicit language of the treaty, European monetary policy would not be left to European central bankers but would be subject to important political oversight.[3] Fiscal and budgetary convergence – the pillars of a system of economic governance – were therefore not (explicitly at least) on the agenda.

While the European Central Bank controlled interest rates and the money supply, each country's fiscal surplus or deficit was determined by the tax and spending decisions of its sovereign government. Therefore, as the British financial analyst Liam Halligan observed, it was impossible to enforce collective fiscal discipline in a currency union of individual states.[4]

In Brussels and Frankfurt, there was no desire for any serious analysis of the effectiveness of the currency union, one that would involve the wider public. Hence the shocked surprise when, in 2010 Herman van Rompuy, the President of the European Council revealed that voters had actually been misled about the Euro by its architects. During the early phase of the deep financial crisis in Greece, which had become the 16th member of the EMU in 2001, he declared on 26 May: 'we are clearly confronted with a tension within the system, the dilemma of being a monetary union and not a fully-fledged economic and political union. The tension has been there since the single currency was created. However, the general public was not really made aware of it.' [5]

[1] Tom Gallagher, *Romania and the European Union*, Manchester: Manchester University Press, 2009, p. 56.

[2] Ambrose Evans-Pritchard, 'Has Germany finally killed off the dream of a European super-state', *Daily Telegraph*, 22 March 2010.

[3] Martin Feldstein, 'EMU and International Conflict', *Foreign Affairs*, November/December 1997.

[4] Liam Halligan, 'Herman and his Frankenstein euro have done enough damage already', *Sunday Telegraph*, 30 May 2010.

[5] Bruno Waterfield, 'Ordinary people were misled over the impact of the Euro', *Daily Telegraph*, 27 May 2010, http://blogs.telegraph.co.uk.



This admission shows that hard questions – about the sustainability of the Euro in the absence of the institutional engineering needed for full-blown economic federalism – were avoided. Instead, there was an implicit assumption that monetary union deserved to succeed because of its own transcendent virtues as shown by the contemptuous attitude towards economists who argued that ultimately the biggest victim of the US downturn of 2008 could be the single currency due to the structural flaws contained within it.[1]

There were restraints on the financial decisions taken by individual eurozone members. These started with the mutual surveillance of ministers of finance in the eurozone who were grouped together in ECOFIN. More substantially, the Stability and Growth Pact, 'a semi-formal protocol' had emerged out of the Maastricht Treaty in order to govern the eurozone and compel members to maintain their budget close to balance or in surplus over the medium term.[2] Stiff fines were to be imposed on members who breached a 3 per cent limit for budget deficits. Speaking in Dublin in May 2004, Jean-Claude Trichet, the longest-serving head of the European Central Bank, explained how such safeguards prevented 'the random behaviour of the different national fiscal policies of the member states' having a destabilising effect inside the currency union.[3] But already, in 2003, the Pact's enforcement capabilities were seen to be feeble when the ECOFIN accepted the European Commission's advice that France and Germany were in violation of it but that the imposition of sanctions was not necessary.[4] When the currency union plunged into crisis after 2009, these two countries played the lead role in seeking to resolve its difficulties and there were no shortage of commentators who argued that it was the current interests of their ruling elites which shaped their responses.

It would be the financial crisis that engulfed Greece from late 2009 onwards which exposed the design faults in the single currency. It became impossible to conceal the degree to which the public debt and budget deficit were careering out of control. A strong reaction from the bond markets pushed up the risk premiums on Greek borrowing to exorbitant levels. The EU's initial approach was unhurried. Even as Greece edged towards default in early 2010, Greek problems were described as manageable. Only as the truth dawned that, left to its own devices, Greece would quickly run out of money to fund basic services, did the main EU players reluctantly spring into action. On 11 April 2010, Greece was offered an emergency assistance package of €45 billion euros, one-third of which would come from the IMF. After the ratings agencies had shown their lack of confidence in this measure by reducing Greek bonds to junk status, the bail-out was enlarged to €110bn in May. New machinery was created to protect high deficit countries (and the Euro itself) from hostile markets, €750 billion being set aside in total. The Maastricht Treaty was categorical on the point that no bailout would be permitted for any member of the single currency. But increasingly, it appeared to be a self-amending treaty. In 2005, there had been no reaction from the EU when it emerged that Greece had concealed the extent of its budget deficit over a long period of years in order to join the eurozone in 2001, a clear treaty breach.[5] Nor were there any voices at the heart of the EU decision-making labyrinth of the EU prepared to argue that Greece should be assisted to carry out an

[1] Liam Halligan, 'Eurozone teeters on the verge of a "euroquake"', Sunday Telegraph, 2 October 2011.

[2] Henry Farrell and John Quiggin, 'Hard Keynesianism in the European Union', *Foreign Affairs*, May-June 2011.

[3] Frank Barry, 'Jean-Claude Trichet 2004: No design flaws in the euro project', *Irish Economy*, 15 May 2011, www.irisheconomy.ie

[4] See Iain Beg and Waltraud Schelke, 'The Pact is Dead: Long Live the Pact', *National Institute Economic Review*, No 189, July 2004, pp. 86, 88.

[5] Matthew Lynn, *Bust: Greece, the Euro, and the Sovereign Debt Crisis*, Hoboken, NJ, USA: John Wiley, 2011, pp. 118-19.



orderly default and leave the Euro 2010 because, however much it mended its ways, it simply lacked the ability to compete effectively with Germany in the same currency union.

3. Ireland's Financial Crisis Begins

By now, Ireland was already presenting a different but almost as formidable insolvency challenge. Unlike Greece, the state finances were in fairly good order, but the banking system faced deep crisis. The folly of allowing major banks to lend 2-3 times the country's national income was about to hit home. Those banks involved in reckless property gambles had seen their share value slashed on 17 March 2008, Anglo-Irish Bank losing 15% of its market value. The Irish drama was played out against a bigger financial crisis on Wall Street centred around underperforming sub-prime mortgages, one that would culminate in the US government allowing the giant investment bank Lehman Brothers to collapse the following September. By then, Ireland's main banks were in a grim position. They didn't have funds to lend to investors and businesses, nor did they have the means to pay back loans to international banks. A run on Irish banks became unavoidable. On 29 September 2008, the stocks of the three main Irish banks, Anglo Irish, A.I.B., and Bank of Ireland, fell between a fifth and a half in a single trading session. A run on Irish bank deposits started, one that has continued despite first national and later European efforts to guarantee their viability.[1]

The government was now led by Brian Cowen who had been minister of the finance from 2004 to 2008, just as the asset bubble soared. He had replaced Bertie Ahern as Prime Minister in the spring of 2008 after much of the public had lost confidence in him due to aspects of his personal finances arising from his close links with leading figures in the property business emerging in a tribunal of enquiry.[2] The new minister of finance, Brian Lenihan saw the crisis as a short-term liquidity problem. It was expected that a wide-ranging state guarantee would quickly enable the banks to re-attain access to credit in the markets; on this basis, the government authorised a state rescue of the banks. It involved Ireland guaranteeing deposits of the six main banks with taxpayers' money. The guarantee extended to foreign bondholders attracted by the high returns from Irish bank investments and even covered those holding any future bonds that were issued.[3] Ireland then sought and received a borrowing facility from the ECB.[4]

Confidence failed to be restored in the main banks as the true scale of their problems became evident. The problem they were confronted with was not a shortage of liquidity but outright insolvency in the case of several major banks.[5] In January 2009, the Irish government nationalised Anglo Irish and its losses, by then estimated at 34-billion-euro (and rising). In late 2009 a 'National Asset Management Agency' (NAMA), was

[1] See 'No let-up in flight of private sector deposits from Irish banks in July 2011', Namawinelake, 31 August 2011, www.namawinelake.wordpress.com.

[2] O'Toole, *Ship of Fools*, pp. 40-41.

[3] Constantin Gurdgiev et al, 'The Irish Economy: Three Strikes and You're Out'?, *Panoeconimicus*, Vol. 58, No 1, 2011.

[4] Robert Peston, 'The unbelievable truth about Ireland and its banks', *BBC News*, 31 March 2011, www.bbc.co.uk.

[5] Constantin Gurdgiev et al, 'The Irish Economy: Three Strikes and You're Out'?, *Panoeconimicus*, Vol. 58, No 1, 2011, p.12.



created which took over €90b in bank loans (making a loss of €1.1 billion in its first full year of operation).[1] The Irish government at the time was under no legal, economic, or arguably moral obligation to give this guarantee. It could have guaranteed domestic deposits and renegotiated the external bonds given that the main Irish banks were insolvent. Soon NAMA would hold more assets than any other publicly quoted company in the world. Nervous markets shunned Irish banks and Irish government bonds were issued to the banks to enable them to stay afloat. The decision amounted to the socialising of private risk, with Irish tax-payers paying for the losses incurred by mainly overseas investors.

The sum required for the recapitalisation of the banks and NAMA was estimated to be in the region of €100 billion – three or more years of tax revenue.[2] Soon it would emerge that the quality of the loan portfolios was much worse than what the government had been told by the banking sector on the eve of its fateful 2008 decision. The decisions made by Brian Lenihan and the Fianna Fail government became increasingly harder to defend as the systemic nature of the crisis in the Irish financial system became evident. Leading economists – several of whom (notably David McWilliams and Morgan Kelly) had issued dire warnings over a period of years about the government's mishandling of the state finances – declared that the government was on course to destroy the capital base of the Irish banking system 'by pouring even more money into a deflating bubble.'[3] Nevertheless, on 30 March 2010 the Dail gave its approval for yet more state rescue. Most opposition deputies feared that to allow toxic banks to fail might lead to a banking meltdown that would have a severe impact on day-to-day life and could leave Ireland isolated within the eurozone, perhaps soon outside it completely.

By 2010 it had long been clear that the European Commission and the ECB saw the crisis as domestic in origin, one whose resolution required long-term domestic austerity. In autumn 2008, it would have been inconceivable for Brian Lenihan to not have coordinated his response to the financial emergency with Brussels and Frankfurt. Thereafter, the Commission did not reject a single one of the government's banking interventions, involving a massive outlay of revenue to recapitalise stricken institutions.[4]

On 8 March 2011, Martin Wolf of the *Financial Times*, after warning that he found it hard 'to believe that debt restructuring would be avoided elsewhere', harshly criticised Dublin and the EU for their maladroit approach to the 2008 crisis: 'I find it unforgivable that the last Irish government guaranteed bank debt so insouciantly, and that the rest of the European Union has supported this decision. For a sovereign to destroy its own credit, to save the creditors of its banks, is plainly wrong. It does not make it better, but worse, that it is doing so largely to protect financial systems in other countries.'[5] By the third year of the

[1] Namawinelake, 28 July 2011, www.namawinelake.ie.

[2] Brian Lucey, 'Country's future staked on most volatile of markets', *Irish Times*, 1 April 2010.

[3] 'We warned you: critics of government proved right', *Sunday Tribune* (Dublin), 10 October 2010; see also 'Prime Time', Radio Telefis Eireann, 16 October 2003 in which David McWilliams warned of the dire consequences for young people of participating in a property boom that was not an expression of economic vitality but 'a vacuous confidence trick' perpetrated by the banks and landowners.

[4] Emmet Oliver, 'EU Commission must also take blame for Ireland's debt woes', *Irish Independent*, 25 November 2010.

[5] Martin Wolf, 'Why the eurozone will survive', *Financial Times*, 8 March 2011.



Irish financial crisis, such views enjoyed widespread adherence among economic and financial commentators well beyond Ireland.[1]

One of the premises that competitive capitalism is founded on is that investors accept the consequences of their actions. It is unlikely that many bondholders expected to be rescued by the Irish government. Michael Lewis, the author of the most extensive account in the international press of the Irish crisis, related having spoken to a former senior Merrill Lynch bond trader who, on September 29, 2008, 'owned a pile of bonds in one of the Irish banks. He'd already tried to sell them back to the bank for 50 cents on the dollar – that is, he'd offered to take a huge loss, just to get out of them. On the morning of September 30 he awakened to find his bonds worth 100 cents on the dollar. The Irish government had guaranteed them! He couldn't believe his luck. Across the financial markets this episode repeated itself. People who had made a private bet that went bad, and didn't expect to be repaid in full, were handed their money back – from the Irish taxpayer.'[2]

According to the Irish financial analyst Shane Ross – a fiscal conservative who was elected to the Dail as an Independent member by a landslide in February 2011 – 'just as Anglo was culpable, so too were the originators of the funds that Anglo passed on to Ireland's property developers: German, British, French, Dutch and other European financial institutions.[3] From an early stage of the crisis in Irish finances, there had been understandable concern about the health of banks in Germany (and to a lesser extent also France, Britain and the Netherlands) that had lent heavily to Irish banks before 2008, when generous returns appeared guaranteed. Germany's banks in particular were bound to fear any decision to 'burn bondholders', requiring them to cover their own losses. They had enjoyed extremely low returns for a very long time and, operating in such an environment, bankers had taken 'the logical decision to lend to sectors and countries where available returns were much higher'.[4] As the crisis escalated, Germany displayed an impressive level of opposition to using its funds to bail out countries on the periphery of the eurozone which were in severe difficulty. Germany's banks were not only well-connected in Berlin but also at the level of the German Länder, having worked closely with political leaders over a long period to shape economic priorities.[5]

In a succession of austerity budgets, the Irish government sought to sharply cut back public spending between 2008 and 2010. Opinion polls revealed a deep vein of popular scepticism concerning the justice of socialising private debts, and whether this risky crisis-busting measure would indeed enable Ireland to climb out of the deep economic hole it was in. But, perhaps due to the fact that the major trade-unions had influenced the direction of policy over preceding decades, no major protests ensued, unlike in Greece. Irish austerity and discipline elicited open praise from the ECB President, Jean-Claude Trichet in 2009 and 2010.[6] There was also praise from the top of the ECB for the results of the stress tests carried out into European

[1] Colm McCarthy, 'Terms of the bailout deal are not unfair – they are impractical', *Sunday Independent* (Dublin), 13 March 2011.

[2] Michael Lewis, 'When Irish Eyes are Crying', *Vanity Fair*, March 2011, pp. 127-28.

[3] Shane Ross, 'Bankers who peddled the poison', *Irish Independent,* 5 December 2010.

[4] Alan Posener, 'It's a bit rich for Germans to gripe about Ireland', *Guardian*, 17 November 2010.

[5] The vulnerability of the German *Landesbanken* was conveyed in Iain Hardie and David Howarth, '*Die Crise* but not *La Crise*', *Journal of Common Market Studies*, Vol. 47, No 5, 2009.

[6] *Evening Herald* (Dublin), 26 February 2009, www.politics.ie, 19 January 2010.



banks in the second quarter of 2010 by the Committee of European Banking Supervisors at the request of the EU's ECOFIN and the ECB. 84 out of the 91 banks tested got an 'A'. Bank of Ireland and AIB were deemed to be in good health, allowing Brian Lenihan to claim that the two main banks passed because of 'decisive and prompt action taken earlier this year'.[1] A statement released by the ECB on 23 July 2010 insisted that 'the stress-testing exercise is comprehensive and rigorous. It confirms the resilience of EU and Euro area banking systems to major economic and financial shocks ... The ECB welcomes the publication of EU-wide stress tests'.[2]

4. The EU's Unwanted Loan to Ireland

The health of the European financial system appeared closely bound up with the resolution of Ireland's banking crisis. Due to an absence of confidence in Ireland's recovery prospects, it was the ECB which was buying up Irish government bonds issued to ensure continuing liquidity in its banks. Despite being two-thirds smaller, by August 2010, Ireland had received more ECB financing than Greece – totalling 75% of Irish GNP.[3] In September and October, the Irish Central Bank would extend €20bn of exceptional liquidity to the Irish banks over and above the €130bn they had been lent by the European Central Bank, which itself was one-quarter of all ECB lending to eurozone banks.[4]

Concern at the top of the eurozone that temporary liquidity for Ireland was turning into long-term funding would not have been unexpected, even though the EU and ECB were the principal external supporters of the Irish approach to its banking crisis. The markets reacted badly when it was reported on 29 October 2010 that Angela Merkel had declared that bondholders would have to take losses as a condition of future rescue plans. It has been alleged that the German Chancellor had spoken out in order to court such an adverse market reaction and prepare the ground for the Irish bail-out.[5] Ireland's finance minister, Brian Lenihan later complained that damage was caused to Ireland's shaky financial position at this time by the readiness of certain ECB board members to brief newspapers in their own member states about the Irish position.[6] He further complained that, in the autumn of 2010, the ECB suddenly began to exert pressure on Ireland after a long period of limited engagement with the Irish authorities on addressing its problems. By contrast, after meeting Olli Rehn, the Commissioner for Financial Affairs, when he visited Dublin on 8 and 9 November, he believed that the European Commission wished to extend further time to Ireland to overcome its difficulties without a bail-out. But, at a meeting of ECOFIN ministers in Brussels on 16 November, Lenihan was told that the survival of the currency union depended on Ireland rapidly acceding to a bailout. He rebuffed Wolfgang

[1] *Irish Times*, 23 July 2010.

[2] European Central Bank, www.ecb.int, 23 July 2010.

[3] Simon Johnson and Peter Boone, 'Brady Bonds For the eurozone', *Project Syndicate*, 15 September 2009, Washington, DC.

[4] David Gardner, Tony Barber and Peter Spiegel, 'A Punt too far', *Irish Times*, 19 November 2010.

[5] A critical view of Merkel at this time is offered by the British Conservative MP John Redwood, 'The Euro crisis – phase 2', *John Redwood's Diary*, 16 November 2010, www.johnredwoodsdiary.com.

[6] Dan O'Brien, 'Banking on Europe: the true story behind Ireland's bailout', *Irish Times*, 23 April 2011. This is the source for Lenihan's assessment of the EU-ECB role in the November 2010 events as described in section 8.

Schäuble, Germany's finance minister when he pressed him to hold a press conference immediately after the meeting to announce an application for aid.

Lenihan's account of this period was challenged by Rehn in November 2011 when the European Commission claimed that from early September 2010 it had made clear to the Irish authorities that Irish borrowing costs were becoming unsustainable and that a coordinated 'rescue' looked increasingly unavoidable.[1] Little or no evidence has emerged of the discussion of alternatives to a policy described by Lenihan of 'stuff[ing] the banks with capital and see[ing if that] would that generate confidence in them'. Both the Commission and the International Monetary Fund – then headed by Dominique Strauss-Kahn, a committed advocate of full-scale European integration – were prepared to accept prescriptions from the ECB that were soon presented to the Irish government. Lenihan later criticised the ECB for presenting plans for the restructuring of the Irish banks that had not been 'fully thought-through' and appeared to show unfamiliarity with the banking situation. Matters had been brought to a head by the intervention of the US treasury secretary, Timothy Geitner. He pressed the EU to impose its will on Ireland in case a bank default there caused a chain reaction of bank failures across the EU. He also 'argued forcefully' against any losses being imposed on holders of senior bonds in Irish banks.[2] The Irish thus found themselves isolated and when the issue of default was raised by Irish officials negotiating with a team of IMF, EU Commission and ECB officials sent to Ireland to arrange a bail-out, 'the Europeans went completely mad,' according to a senior government source.[3]

On 21 November, there was an announcement of a loan to Ireland of €85 billion. The main portion – provided by the EU – was to be lent at 5.7 per cent, a higher rate of interest than that involved in the Greek bail-out (or the one agreed with Portugal in the spring of 2011). A spokesperson for the Commission said the 'profit' that the EU makes by lending to Ireland will be invested back into the EU budget and will be distributed to EU members at the end of each financial year.[4] Forceful ECB threats to withhold liquidity support available to all eurozone banks, resulted in one amazing concession: Ireland agreed to pay the liabilities of unsecured and unguaranteed bondholders, which had not even been part of the open-ended 2008 guarantee to the banks.[5] To raise the colossal sums needed, plans to sell off strategic state industries would be unveiled in the autumn of 2011 but already a large part of Ireland's own sovereign wealth fund, the National Pension Reserve Fund was to be used to fund over 17 per cent of payments on the loan.[6] It had been a rare measure of prudence by the government, designed to avert a pensions time-bomb. By 2010, it was seen as the only source of revenue that Ireland had left for strategic investment to rebuild the economy. At this humiliating point in the country's history, it was hard to avoid the conclusion that Ireland had been placed under a quasi-protectorate status under the supervision of an IMF-ECB-Commission troika. This perception was reinforced when, on 12 September 2011, Jürgen Stark, the departing German member on the ECB executive council , bluntly stated that the government was in no position to avoid repaying the latest segment of unsecured debt because it was not 'autonomous to take this decision ...'[7]

[1] Arthur Beesley, 'Irish bailout was resisted for months by Lenihan and Cowen', *Irish Times*, 19 November 2011.

[2] Ibidem.

[3] *Sunday Independent* (Dublin), 28 November 2011.

[4] Donal O'Donovan, 'EU to book a hefty profit on Irish bailout', *Irish Independent*, 6 January 2011.

[5] Colm McCarthy, 'We have fallen prey to a costly and failed policy', *Sunday Independent* (Dublin), 18 September 2011.

[6] *Financial Times*, 29 November 2010.

[7] Colm McCarthy, 'We have fallen prey to a costly and failed policy', *Sunday Independent* (Dublin), 18 September 2011.

5. Ireland: from Star Pupil in the EU to Pariah

Ireland, only a short time before the lead-model for how a once poor country could flourish under EU tutelage, was on its way to being characterised in Brussels as an irresponsible country which had frittered away important advantages provided by EU membership. The Fianna Fail party had been in power for nearly all the years of epic growth, but it had neglected playing an active role in European policy-making (for instance often having a poor attendance record at meetings of the EU Council of Ministers).[1] Awkward referendum defeats for important measures had taken place, in 1991 for the Single European Act and, far more seriously, for the Lisbon Treaty in 2008. Keen pro-EU figures such as Garret FitzGerald and Professor Brigid Laffan denounced the party as a poor steward of European interests, especially once boom turned into bust.[2] Fianna Fail wasn't actually hostile to the expansion of central EU power at the expense of state sovereignty, as shown by the vigour with which the party campaigned for the second referendum on the Lisbon Treaty, which Ireland was prevailed upon to hold in September 2009. Nor was it easy to characterise the Irish as harbouring deep scepticism about the European project.

In the 2008 referendum, a majority had responded to the effective campaign against the Lisbon treaty mounted by the businessman Declan Ganley, the founder of the Libertas movement. Far from campaigning to exit the EU, he wished to dilute the concentration of power in the hands of secretive and non-elected structures, enabling ordinary citizens to influence its affairs.[3] But arguably, the first referendum was lost due to the complacency of the government which mounted an unimpressive campaign on behalf of the Lisbon treaty; Brian Cowen even admitted in 2008 that he had neglected to read the document. Charlie McCreevy, by this time Ireland's EU commissioner, declared that 'no sane and sensible person' would attempt to read such 'an impenetrable' document.[4] There were times when Fianna Fail appeared an incongruous party of government. It could all too easily look like a parish movement of local fixers, recognisable to anyone with knowledge of the more impenetrable politics of parts of southern and central Europe. Glaringly absent was a strategic vision of what to do with the power it had exercised for most of the post-1922 history of the Irish state. Brian Cowen had even spent part of the weekend when the international troika was in Dublin negotiating the bail-out, campaigning in a by-election in the north-west of the country.

Fianna Fail lost the Donegal South-West by-election of 26 November 2010 to Sinn Fein which, within 3 months, would be only 6 seats behind Ireland's premier political force after a general election took place on 25 February 2011. While the Cowen government's credibility crashed in the eyes of both Irish voters and its European partners, public figures that enjoyed closer links to European power centres began to express concern about the EU's hardnosed approach to Ireland's plight. John Bruton, Ireland's Prime Minister from 1994 to 1997, when Fianna Fail was in opposition, was one of a diminishing number of influential EU figures who was strongly committed to viewing the USA as more of a partner than a rival. He had been the EU's

[1] *Irish Times*, 18 April 2011.

[2] *Irish Times*, 10 January 2011, Tony Barber and John Murray Brown, 'A Vote in a Void', *Financial Times*, 22 February 2011.

[3] Bruce Arnold, *The Fight For Democracy (A series of interviews with Declan Ganley)*, Dublin: Killynon House Books, 2009, p. 49.

[4] *Daily Mail* (London), 3 September 2009.



ambassador to Washington from 2004 to 2009 before becoming chairman of the International Financial Services Centre, the body spearheading the foreign investment, (much of it North American) that had poured into the country, attracted in large part by Ireland's low corporation tax.

On 7 March 2011, Bruton delivered a lecture at the London School of Economics in which he openly criticised the ECB for failing to rein in speculative bubbles in member countries. He argued that under the statutes of the European System of Central Banks, the ECB was indeed empowered to intervene to correct such problems. More controversially, he complained that a blind eye was turned to 'irresponsible lending' by German, French, Belgian and British banks.[1]

The European Commission was paying close attention to Ireland's economic performance during the Celtic Tiger years as the finances of its member states grew increasingly interconnected. But in Brussels, public criticisms of the direction Ireland was going in were in fact extremely rare before 2008. This was publicly stated by Klaus Regling, one of the few European officials to admit that the international bodies which had an oversight role over Ireland's economy had failed in their job. He had been head of the Commission's Directorate General for Economic Affairs (2001 to 2008) and was now the head of the European Financial Stability Facility (EFSF: the bail-out fund). Speaking in Dublin on 27 April 2011, he admitted that the frenetic policies of economic expansion being pursued In Ireland 'were not criticised really by outside bodies, who were in charge of doing this, of supervising the economy – the IMF, the OECD, the European Union, including me, myself in my job'.[2]

One analyst has found that the tone of 'Commission assessments and Council opinions published on Ireland between 2002 and 2007 … became less critical and more approving over time'.[3] In 2006, the Council and the Commission concurred that 'the fiscal position can be considered as sound and the budgetary strategy provides a good example of fiscal policies conducted in compliance with the [Stability] Pact'.

As for the IMF, in 2003, it expressed concern about 'the spectacular increase in house prices and credit to households over the past several years'.[4] But over the next four years, macroeconomic policy was described as 'sound' and fiscal policy as 'prudent'. In 2004, [IMF] Executive Directors commended the continued impressive economic performance of Ireland's economy, which is based on sound economic policies providing useful lessons for other countries'.[5]

Simon Johnson, former chief economist at the IMF, complained about 'the really bad decisions made by pan-European banks and their regulators over the last decade'. Writing just after the EU-IMF intervention in Ireland, he claimed that one of the reasons why 'Ireland's European partners' do not want to see Ireland

[1] Leigh Phillips, 'ECB turned blind eye to predatory lending', *EUobserver*.com, 8 March 2011.

[2] *Sunday Independent* (Dublin), 1 May 2011.

[3] Jim O'Leary, 'External Surveillance of Irish Fiscal Policy During the Boom', *Irish Economy Note*, No 11, July 2010, www.irisheconomy.ie/Notes/IrishEconomyNote11.pdf, p. 11.

[4] *2003 International Monetary Fund Country Report, No 03/242*, Washington DC: IMF, pp. 15, 17.

[5] Quoted by Jim O'Leary, 'External Surveillance of Irish Fiscal Policy During the Boom', *Irish Economy Note*, No 11, July 2010, www.irisheconomy.ie/Notes/IrishEconomyNote11.pdf, p. 14.



restructuring its subordinate debt, was because these failings would be exposed, contributing to 'potential fiscal risks in other eurozone countries'.[1]

6. Endemic Politicking and False Messiahs

Unifying objectives – behind which members of the eurozone and the wider EU could rally during an extended crisis – turned out to be elusive. Much of the appeal of the EU had previously rested on deepening inter-state cooperation designed to narrow economic disparities between member states. But the first decade of the currency union had seen Germany pull away from most of the other members. In particular, even deeper disparities than before had emerged between dynamic north European economies and much less competitive southern European ones. The large peripheral eurozone had acquired dangerously high current account deficits by borrowing too much at the cheap interest rates set by the ECB. They could no longer deflate their way out of trouble by devaluing their own currencies and raising interest rates.

Far from laying the foundations for a common European economy, the single currency had instead opened up ominous new centrifugal tendencies. Low interest rates encouraged a productivity gap in the eurozone, confirming Germany as the dominant industrial nation in Europe. It was able to export massively to the rest of the eurozone, receiving payment in borrowed money, much of which had emanated from Germany, or its frugal savers.

Changes in the EU's governance between the Maastricht and Lisbon Treaties had also seen more power accrue to France and Germany, in particular due to new weighted voting arrangements corresponding to the population sizes of member states. Both states dominated the ECB and they agreed on the paramount need to preserve the Euro intact and to contain the banking crisis through taxpayer relief in those crisis-ridden states carrying the main burden of debts. The EU at times appeared to be very much a Franco-German condominium. But the chemistry between Chancellor Merkel and President Sarkozy was often poor. They also faced acute but varying domestic difficulties and it was hard to avoid the conclusion that their approach to the crisis of the eurozone was often driven more by their own domestic political needs and less by commitments to preserving the momentum behind the European project. A slump in Sarkozy's popularity meant that much of his approach to governance derived from how to boost his chances of being re-elected in 2012. Merkel's Christian Democrats had also slumped to a post-war low in popularity. Both her Free Democrat coalition partner and state governments opposed debt restructuring. This was seen as turning the eurozone into a debt transfer union in which German trade surpluses were used to rescue crisis-ridden members.

After a decade, a monetary union envisioned as the key foundation stone for a durable economic union – one hopefully enabling the EU to compete as a top player in the globalised economy – had instead considerably widened existing national and regional economic differences. No meaningful convergence of disparate economies could be detected.[2] Instead, Germany found itself the spectacular beneficiary of the one-size-fits-all monetary policy. Analysts were to be found like Jim O'Neill from Goldman Sachs who argued that the German economy had decoupled from Europe, becoming the 'supplier in chief to China's

[1] Simon Johnson, 'Will Ireland Default? Ask Belgium', *New York Times*, 25 November 2010.

[2] Ambrose Evans Pritchard, 'Flat earth European Central Bank misreads oil spike again', *Daily Telegraph*, 7 March 2011.



industrial revolution' and an honorary member of what were known as the BRIC countries (India, Brazil, Russia and also China), distinguished by their high growth rates and access to coveted energy resources.[1]

The workings of a lop-sided monetary union had enabled Germany to expand its international economic role while most other eurozone economies enjoyed sluggish growth, mainly confined to the service sector. A monetary union lacking the powers to shape fiscal and budgetary policies among its members failed to be the progenitor of an economic union. The EU's inept handling of the crisis offers little evidence that a fiscal union would have given rise to the stubbornly elusive European economy. The powers the ECB had over interest rates, exchange rates and money growth were bound to benefit some members and not others and it is hard to imagine that the rules for a fiscal union would have altered that position.

As the crisis evolved into one of years and not months, there was a striking reluctance among the dominant state and institutional players in the EU to admit that there had been procedural and institutional deficiencies in the construction of the monetary union. Instead, the finger of blame was pointed at errant peripheral states. The very harmful precedent offered by France and Germany when they had defied the terms of the Stability and Growth pact, requiring fiscal discipline in order to maintain the stability of the EMU, was overlooked. [2] (Ireland and Spain were two members ensnared in crisis by 2011 which had never breached the deficit ceiling of the Stability Pact.) Romano Prodi, then the Commission's President, described the Stability and Growth pact as 'stupid'.[3] This remark well illustrates how the workings of the most ambitious of the EU's post-national initiatives have been shaped by informal actions, often by the stronger players. The senior EU members, in flouting budgetary restraint so early in the life of the Euro, were offering a disastrous example to junior members whose economies were weaker. This very point was noted in Dublin by the Dail's Joint Committee on European affairs in its 2010 report. Franco-German defiance of what were seen as inconvenient rules, ones actually designed to maintain monetary stability, were only likely to encourage weaker EMU states to fill the gap between tax receipts and spending by large-scale borrowing – and this is what happened. [4]

After the bail-out, Professor Brigid Laffan – who headed the 'Ireland for Europe' campaign during the 2009 re-run referendum on the Lisbon Treaty – criticised the ECB for failing to plan for the crisis.[5] But the higher up the EU hierarchy one looked, the less likelihood there was of finding any such candour. After 2008, there was reluctance to admit to Europe-wide failings in the management of the monetary union. Perhaps because of the skeletons in the EMU closet, there was also a determination on the part of relevant EU power-holders to limit the role of other major international players. A determination to avoid examining the tried and tested institutions and procedures in the USA (which had reached the end stage desired by many Europhiles for Europe – a federal system with its own single currency) had already long been evident. In the 1980s, after commercial banks in the United States had lent too much to Latin America, sovereign

[1] Ambrose Evans-Pritchard, 'Germany must choose EMU fusion or fission', *Daily Telegraph*, 20 February 2011.

[2] Gaby Umbach and Wolfgang Wessels, 'The Changing European Context of Monetary Union: "Deepening", "Widening" and Stability', in Kenneth Dyson (ed.), *The Euro At Ten,* Oxford: Oxford University Press, 2008, p. 65.

[3] David Howarth, 'Delegation and Commission Leadership – Economic and Monetary Union', in Jack Hayward (ed.), *Leaderless Europe*, Oxford: Oxford University Press, 2008, p. 41.

[4] Sebastian Dellepiane Avellaneda and Niamh Hardiman, 'The European context of Ireland's Economic Crisis', *The Economic and Social Review*, Vol. 41, No 4, Winter 2010, p. 247.

[5] John Murray Brown, 'Irish minister hits at ECB over bail-out', *Financial Times*, 1 December 2010.



debt was eventually restructured through the creation of "Brady bonds." These bonds enabled investors to 'swap their claims on (insolvent) Latin American countries into long-maturity, low-coupon bonds that were collateralised with US Treasuries'.[1] The issuing of Eurobonds, in different forms, has been under discussion by economists for several years. But the danger is that this crisis measure will primarily be used – by proponents of a fiscal union – as a device to promote tighter, centralised control over eurozone economies.

As leading EU institutions persevered with channelling astronomical amounts of tax-payers cash into crisis – ridden banks or national exchequers, the IMF was increasingly depicted as an alternative fount of wisdom. In the first quarter of 2011, the leading Irish economist Colm McCarthy believed he could see growing signs that 'the IMF wants to share bank losses with bank creditors and re-capitalise banks with EU-wide, and not just national, fiscal support'.[2] When Dominique Strauss-Kahn (DSK) resigned as head of the IMF on 19 May 2011, there was widespread regret over his departure. Joseph Stiglitz, the former head of the World Bank, viewed it as "Ireland's loss".[3] Martin Wolf praised him for his ability to persuade European leaders to focus on the crisis.[4] But his crisis role appears overrated even before any definitive verdict can be delivered about his tenure at the helm of the IMF. Until the Greek crisis entered a critical stage in the spring of 2010, the IMF was rebuffed because the EU 'feared a loss of control and because it could be interpreted as the sign that the eurozone was as badly run as countries that usually require IMF assistance'.[5] Later, DSK was prepared to publish an IMF report in January 2011 in which it was stated that 'a temporary set of measures' had been devised by the EU that 'will not solve the underlying problems.'[6] But at no point during the feverish discussions leading up to the bail-outs for Greece, Ireland and Portugal, is there evidence that he criticised the improvised approach of the EU, one that centred around heaping more debt on already insolvent countries in the hope that somehow a decisive corner would be turned. There is plenty of evidence, however, that he was focusing on his ambitions to run for President of France in 2012 against the current incumbent, Nicolas Sarkozy. The 'Financial Stability Update' issued by the IMF in January 2011 backed a corporatist pan-European approach to the crisis bound to appeal to the French Socialists whose candidate he was the clear favourite to become, until personal scandal brought his public career to a sudden halt. A key passage of the update stated: 'Euro area-wide resolution mechanisms need to be deployed and strengthened as needed. The introduction of a pan-European bank resolution framework with an EU-wide fiscal backstop would help decouple sovereign and banking risks.'[7]

DSK was the member of a proud and often ruthless national elite that 'behaves dismissively towards smaller countries'. The author of these words – the economics editor of the *Irish Times*, Dan O'Brien – briefly clashed with DSK when, over dinner, the Frenchman proclaimed that the EU needed to become an 'empire' (O'Brien pointing out to him that many smaller European countries had cause to be wary of such an

[1] Simon Johnson and Peter Boone, 'Brady Bonds For the eurozone', *Project Syndicate*, 15 September 2009, Washington, DC.

[2] *Sunday Independent* (Dublin), 13 March 2011.

[3] See David McWilliams, 'DSK's Downfall is Ireland's Loss', *David McWilliams blogspot*, 23 May 2011, www.davidmcwilliams.ie.

[4] Martin Wolf, 'The eurozone after Strauss-Kahn', *Financial Times*, 18 May 2011.

[5] Dan O'Brien, 'Bailout pledges would not be easy to keep', *Irish Times*, 1 February 2011.

[6] Colm McCarthy, 'Funding versus capital, The IMF on eurozone policy', *Irish Economics*, 25 January 2011.

[7] *Sunday Independent* (Dublin), 13 March 2011.



arrangement).[1] Lorenzo Bini-Smaghi, the Italian representative on the ECB board until late 2011, frequently championed unaccountable Euro-centralism in his media interviews. Justifying national austerity measures implemented by European central fiat, he declared in April 2011 that 'if taxpayers have the right to share in decision-making, they must also accept the consequences'.[2] Despite the Keynesian noises he was uttering before his planned return to full-time politics, there is no categorical evidence that DSK demurred from that view; nor from the one expressed by Olli Rehn, the EU Economics commissioner that 'the Euro is not just a technical monetary arrangement, but rather … is the core political project of the EU …'.[3]

7. Euro Ideology Invoked to Avoid Confronting the Crisis

As the lengthening crisis saw no long-term plans emerge from the EU that might provide the making of an exit strategy, fear was stoked in order to shore up its authority. On 10 November 2010, as the Irish banking crisis was reaching one of its peaks, the EU President, Herman Van Rompuy, warned that 'In every member state, there are people who believe their country can survive alone in the globalised world. It is more than an illusion: it is a lie ... The biggest enemy of Europe today is fear. Fear leads to egoism, egoism leads to nationalism, and nationalism leads to war'.[4]

His warning came as there was growing evidence that the Commission and the ECB were determined to force states in difficulties to accept wage cuts, a slashing of social provision, and even a fire-sale of national assets to raise funds for a rolling debt repayment programme. Moreover, popular sovereignty was increasingly painted as a dangerous force and, according to the UK Conservative MP Daniel Hannan, his speech was a sign that state sovereignty was to be decoupled from national interests which would be mediated by un-elected civil servants in European gatherings.[5]

Discussions were already occurring about altering the Lisbon Treaty (only ratified in 2009), so as to move on to a form of economic governance for the EU involving common fiscal and budgetary arrangements. The EU summit in Brussels on 16-17 December 2010 wrangled over a stability mechanism that would amount to a new permanent bail-out fund. But Germany preferred it to be a last resort-measure to be introduced 'if indispensable to the stability of the Euro area as a whole', since Berlin was already providing €162 billion of the €580 billion emergency assistance pledged in assistance mainly to Greece and Ireland since May 2010.[6]

[1] Dan O'Brien, 'Interplay of biggest powers pits self-interest against bailout rate', *Irish Times*, 28 May 2011.

[2] *Irish Times*, 15 April 2011. This assumes that the Irish electorate are responsible (as taxpayers) for the specific decisions that took place in private firms (banks as buyers and sellers of money). The secretary general of the European Commission, Catherine Day, an Irish citizen, declared in April 2011 that 'Nobody made us take the loans. We did it . . . The bottom line is that when you take out a loan, you take out a liability to pay it back, and that's part of the credibility of countries as well.' This led the well-known commentator Fintan O'Toole to ask: 'Who are this "us" and "we" of which she speaks? What Day seems to mean is that when anyone in a private Irish company takes out a loan, everyone who happens to be Irish acquires a liability to pay it back'. See Fintan O'Toole, 'Time to remember all those promises', *Irish Times*, 5 April 2011.

[3] Leigh Phillips, 'Rehn on eurozone rescue: 'Mission Accomplished'', *EU observer*, 15 April 2011.

[4] *Daily Telegraph*, 11 November 2010.

[5] *Daily Telegraph*, 11 November 2010.

[6] Ian Traynor, 'Year of bullying, bluff and bailouts leaves Euro fighting for its life', *Guardian*, 15 December 2010.



Already, at a summit of G20 countries in October 2010, a statement had been issued that any new stabilisation and assistance mechanism would not come into effect before mid-2013.[1] The delay was meant to calm the markets, but by the close of 2010 they were reacting negatively to the improvised measures being taken to prevent the crisis worsening.

The markets could see that Ireland had taken on a massive amount of EU and IMF debt in order to be able to clear the private debt that it had previously placed on the national balance sheet in October 2008. Six weeks after the EU-imposed bail-out, Irish debt suffered a hefty downgrade to 'baa1'. The market price for Ireland to borrow money over a ten year period rose to 8.7%, compared to 3.1% for Germany.[2] John Bruton, the ex-Irish Prime Minister, believed the adverse reaction on the markets stemmed from a realisation that the EU lacked a vision for how to restore economic growth and enable Ireland to generate a flow of funds that will contribute to its debts being repaid.[3] He implicitly criticised the improvisation surrounding the approach to the crisis and he urged (in vain) that the European Council should be recalled right after Christmas to work on a strategy for reviving the entire eurozone.

The public comments of leading EU personalities and government officials revealed other priorities: not only preserving the currency union as the main trophy of European integration but exploiting the crisis to speed up the transformation of Europe on post-national lines, became explicit objectives. Speaking in Brussels on 12 January 2011 to the Spinelli Group, a new network of prominent euro-federalists, Joschka Fischer, Germany's former foreign minister, called for an acceleration of European integration and an abandonment of decision-making based on inter-governmentalism: 'We need to hand over some budget prerogatives to the EU ... we need similar pension ages ... we are going to have to draw all the threads together ... [and] future integration steps need a political Europe'.[4]

François Fillon, the French Prime Minister, declared in January 2011 that 'Europe is at a historic turning point. The real question right now is whether to keep building on this adventure, or whether we leave it at that … We are going to move towards greater integration.'[5] Days later, at the annual Davos economic summit, Nicolas Sarkozy declared: 'Chancellor Merkel and myself will never – do you hear me, never – let the Euro fall. ... The Euro is Europe. And Europe spells 60 years of peace'.[6] Earlier Herman van Rompuy had warned that the EU itself could not survive the collapse of the Euro.[7]

So the doctrine of a deeper union remained a sacred cause for elite figures at the top of European institutions who have publicly squabbled over the handling of the crisis. Even former Chancellor Gerhard Schröder, who played the key role in admitting Greece to the eurozone despite already huge misgivings

[1] Bob Davis, 'Default gets another look amid Irish bailout', *Wall Street Journal*, 23 November 2010.

[2] John Redwood MP, 'Why bail outs are not working', John Redwood's Diary, 20 December 2010.

[3] *Irish Times*, 22 December 2010.

[4] Andrew Willis, 'European concerns about sovereignty loss are "almost amusing"', said former German foreign minister Joschka Fischer', *EU observer*, 12 January 2011.

[5] *Daily Telegraph*, 14 January 2011.

[6] 'Failure of the Euro would be cataclysmic', EU observer, 27 January 2011, www.euobserver.com.

[7] Leigh Phillips, 'President Van Rompuy: The EU is in a 'survival crisis'', *EU observer*, 16 November 2011.



about the state of its finances, was insisting in September 2011 on the need for an intensification of the drive towards 'a United States of Europe'.[1]

But the markets were unimpressed. Yields on both Greek and Irish bonds continued to rise well into 2011 as the bail-out strategies for these countries failed to convince the markets and the ratings agencies that defaults could be avoided. Klaus Regling, the official from Germany who manages the eurozone's main bailout fund, the €440 billion European Financial Stability Facility, had spent much of his seven months in charge visiting the bond and financial markets in the US and the Far East to assess investor reaction to the EU's measures to defend the Euro; at the start of 2011, the *Guardian*'s European editor, Ian Traynor, learned through senior officials that he was worried that key fund managers, especially in the US, did not rate the Euro's chances of survival very highly.[2] By August 2011, Alan Greenspan, former Federal Reserve chairman was prepared to openly state that 'the euro is breaking down'.[3]

Confidence in EU efforts to tackle its crisis might have been greater if its sheer scope had been acknowledged and steps were taken to address central failings as well as the crises on the periphery of the eurozone. Long-needed change to ensure proper supervision of the European banking system might have boosted the credibility of the single currency and indeed attracted people of ability to head its institutions. But at the EU summits of 2010 and the first half of 2011, the idea of banking reform or the creation of a single Euro-area bank regulator were avoided in political horse-trading between major national and institutional vested interests. Those parts of Germany's banking system which are highly leveraged and poorly capitalised, have no interest in falling under the scrutiny already directed at the eurozone peripherals, at least until hopefully the worst of the crisis has passed.[4] Serious 'problems with Germany's state-owned banks brought the country's financial system to the brink of collapse', it has been claimed by financial analysts writing in *Der Spiegel* in March 2011.[5]

Chancellor Merkel's words that Europe 'will do what it takes' to preserve the single currency have not been backed up by effective action.[6] Arguably, much of her caution stems from her own political vulnerability at home. Indeed, her fractious centre-right coalition has at times catered to populists sentiments on the eurozone crisis rather than pointing out that governments are rescuing the savings of their own citizens in the guise of rescuing peripheral states in the eurozone.[7] She has so far refrained from pointing out the link between the external surpluses of core states and the financial fragility on the periphery. Nor has she publicly indicated that the short-sightedness of German banks in investing in high-risk Irish banks was itself a powerful contribution to the crisis of the Euro. In May 2011, seven German regional banks threatened to

[1] 'Europe needs to wake up', (Interview with Gerhard Schröder), *Der Spiegel* (Online International), 5 September 2011.

[2] *Guardian*, 18 January 2011.

[3] Daniel Hannan, 'Meanwhile in the eurozone', *Daily Telegraph*, 24 August, 2011.

[4] Colm McCarthy, 'European banking system needs redesign to prevent another crisis', *Sunday Independent* (Dublin), 13 February 2011.

[5] Christoph Pauly and Anna Seith, 'Germany's banks still in dire straits', *Der Spiegel*, (English language edition), 15 March 2011.

[6] *Wall Street Journal*, 10 December 2010.

[7] Martin Wolf, 'The "grand bargain" is just a start', *Financial Times*, 30 March 2011.



boycott stress tests, something which (according to the Frankfurter Allgemeine Zeitung highlighted 'the acute fragility of Germany's banking system').[1]

There is little desire in Brussels and Frankfurt to face the facts and view this as a European banking crisis, one requiring an overhaul of the affairs of the Euro. The increasingly feverish deliberations between powerful leaders and the different bureaucratic and financial entities in the EU could proceed more smoothly for them if the crisis was depicted as one that chiefly affects the so-called eurozone periphery which in fact accounts for 35% of Euro-area GDP, 40.5% of its population, and 40% of the gross total government debt.[2] This became the chief article of faith of those at the helm of European affairs and it meant that crucial amounts of time were lost – by failing to recognise that the root of the problem lay in an ill-planned currency union with in-built dysfunctionality which had exposed many of the nations of Europe to catastrophic dangers.

8. The Decline of Solidarity and the Rise of Core Europe

In November 2010, with parliamentary elections fast approaching in Ireland, the EU Commissioner for Economic Affairs, Olli Rehn insisted that he did not want to involve himself in democratic politics in Ireland, but he immediately then warned about re-opening key parts of the EU package.[3] Opinion polls would soon be showing mounting opposition to the enforced loan and, not for the first time, such an intervention showed EU disdain for the views of national electorates.

The powers of smaller countries had been dwindling for a long time due to the sharp reduction of issues in which vetoes could be applied and the phased introduction of weighted voting according to population size. There were fears among second-tier members that in any push towards an economic union, it would be the fiscal approaches and even specific agendas of centrally-placed countries that would prevail.[4] Garret FitzGerald, Foreign Minister and later Prime Minister during Ireland's first fourteen years in the EU, expressed alarm at the threat to the decision-making system known as the 'community method'. It is supposed to preclude member states, regardless of their size and importance, from pushing their own interests by proposing new EU laws. He feared that the 'ill-prepared' inter-governmental approach of France and Germany on eurozone reform risked sweeping aside established principles of community decision-making and further side-lining the Commission.[5]

Almost alone in Europe, Germany's economy was forging ahead as recession threatened numerous other advanced economies. After growth of around 3.6% in 2010, it was expected to grow by at least 2.5% in 2011.[6] Germany's economic model – 'its productivity, its consensual labour relations, its focus on product

[1] *Frankfurter Allgemeine Zeitung*, 5 April 2011, quoted in *Eurointelligence*, 1 April 2010. www.eurontelligence.com.

[2] Constantin Gurdgiev, 'Eurostrich', *Village Magazine* (Dublin), June-August 2011.

[3] *RTÉ News*, 29 November 2010.

[4] Donal Donovan, 'Loss of fiscal sovereignty inevitable if euro to survive', *Irish Times*, 13 January 2011.

[5] *Irish Times*, 12 February 2011.

[6] *BBC News*, 12 January 2011.



quality, its penetration of emerging markets' – was certainly worthy of emulation.[1] But this striking achievement had its origins in expansionary policies designed to create solidarity among war-ravaged nations seeking to escape Soviet domination. Punitive policies of reparations imposed by the World War I victors had stifled German enterprise and creative energy, instead helping to plunge the country towards a disastrous form of political nihilism. By 2011, there were growing numbers of commentators who feared that the EU's own strategy of ensuring that it was citizens in crisis-ridden countries that bore the main debt burden was reminiscent more of the harsh Versailles peace than of the Marshall Plan.[2]

In February 2011, a charter for economic liberalism was issued by the European Commission. It was initially known as the Competitiveness pact, but was soon renamed as 'the Pact for the Euro' perhaps from a realisation that many of the most competitive economies in the EU in fact belonged to countries that had resolved to keep their own currencies. Its liberalising demands, included wage restraint across the eurozone, a reduction in public service spending, constitutional changes limiting government borrowing, and the raising of retirement ages.[3] A case could be made for restraining public spending and limiting aspects of state intervention in the economy. But no solutions were offered for the systemic problems that the post-2007 crisis had exposed in the European banking sector, such as the need to control the expansion of private credit. Perhaps not coincidentally, this sector was a favourite destination for Eurocrats who had risen to the top of the European Commission. The proposed economic measures would not be accompanied by any measures designed to reduce the concentration of power in non-elected EU structures (the opposite in fact with another treaty change in the offing). So it would be hard to sell them to a sceptical citizenry across the 27-member EU. Polls continued to show that the EU had a major problem of legitimacy. The more powers it had accumulated from Maastricht to Lisbon, the less impressive was the use that they were put to and the greater the fear and distrust shown towards ordinary Europeans by those at the centre of power in Brussels.

Although Germany was viewed as an economic model for eurozone laggards to emulate, hardly any desire was evident in that country for German economic prowess to metamorphosise into a German-led Europe. Between the eras of Chancellors Kohl and Merkel, closer links to resource rich or developing economies had blunted close ties with the USA and now the rest of the EU. If anything a retreat from European commitments was becoming hard to conceal in Germany. Its own political and state institutions (though declining in credibility) possessed accessibility and transparency which were lacking in the opaque and often secretive European structures.[4] The federal political system, more responsive than counterparts in the still centralised states of France and Britain, made it hard for politicians to ignore anger and bewilderment from different quarters about Germany having to subsidise eurozone countries at risk of bankruptcy. The western part of the country had channelled €1.7 trillion to the old DDR (East Germany) since reunification in 1990. It is still paying €60bn annually without visible convergence having been achieved.[5] If fiscal transfers are often awkward within nations, they can become deeply problematic between them. By early 2011, Chancellor Merkel was insisting that the price for mutual assistance was economic coordination along German lines. Between summits, more energy went into turf wars between the Commission and the

[1] Timothy Garton Ash, *Guardian*, 24 November 2010.

[2] See especially Gideon Rachman, 'Politics poison Europe's new debt deal', *Financial Times*, 15 March 2011.

[3] Leigh Phillips, 'Competitiveness Pact 'was never the blueprint people thought it was', *EU observer*, 14 March 2011.

[4] See the devastating indictment of Marta Andreasen, *Brussels Laid Bare*, London: St Edward's Press 2009.

[5] *Daily Telegraph*, 20 February 2011.



Franco-German originators of the competitiveness pact than into producing a scheme that enjoyed coherence and long-term feasibility.[1]

9. Ireland: Intensifying Crisis

It was tempting for some to view the excesses of Irish banks and the incompetence of political and financial regulators in Dublin as the failings of an entire people. But in 2008, the Irish government had been strikingly open about the nature of the failings in its financial sector and had been the first eurozone country to embark on tough austerity. Such candour has been lacking in other parts of the eurozone where according to a former chief analyst at the IMF, 'really bad decisions [have been] made by pan-European banks and their regulators over the past decade …'[2] Evidence has continued to emerge that the dysfunctionality of Ireland's banks is something that exists across the European banking sector. The stress tests undertaken by the EU into the eurozone banking sector in 2010-11 have been able to shed light on how deep and widespread the problem is that first emerged in Ireland due to a combination of factors in 2008. If Ireland stands out only due to the timing and perhaps intensity of the banking problem, then it becomes even harder to justify its citizens carrying the primary burden for reforming delinquent banks.

To prevent the Irish state drowning in its own debts, the annual rate of growth has to be significantly higher than the interest due on the national debt. David McWilliams is just the best-known of a large number of economists who, by 2010, were arguing that a debt-deflationary spiral could only be avoided if the Irish economy grew by 8-10 per cent annually. Yet, even before the shocks to the global economy caused by the seismic disaster in Japan and political upheavals across the Middle East, even the most optimistic government growth projections were just below 4 per cent.[3] The Irish national debt, which had been a manageable €38 billion in 2008 was due to rise to €165 billion in 2011 and was projected to reach €200 billion in 2014. Martin Wolf of the *Financial Times* believed that by 2012-13, the public debt ratio would be 125% of GDP. Long before then, Simon Johnson, formerly chief economist at the IMF, believed that the size of debt interest payments relative to the tax base would simply prove unsustainable.[4]

But further pressure from Ireland's European partners endangered what growth could be expected from Ireland's still vigorous high tech export sector. On 12 March 2011, at the end of the latest EU summit to grapple with the financial situation, Chancellor Merkel bluntly told journalists that 'it is simply fair to say we can only give our commitment when we get something in return …' She was referring to the need for Ireland to raise its corporation tax before a revision of what the *Financial Times* called 'the usurious' interest rate of 5.7 per cent placed on the EU loan could be relaxed.[5] On this sole issue, Ireland's new government, headed by Enda Kenny stood firm, knowing that this tax was responsible for luring North American companies to Ireland and building a high tech sector far from the economic heartlands of Europe. It had been President Sarkozy who had first raised the issue, declaring in January that Ireland cannot benefit

[1] Charlemagne, 'The divisiveness pact', *The Economist*, 10 March 2011.

[2] Simon Johnson, 'Will Ireland default? Ask Belgium'? *New York Times*, 25 November 2010.

[3] Carsten Volkery, 'Drastic cuts and punitive interest rates', *Der Spiegel*, 12 August 2010.

[4] *RTE* (Irish state radio), Prime Time programme, 14 March 2011.

[5] *Irish Times*, 14 March 2011; *Financial Times* 15 March 2011.



from the European Union's financial aid while maintaining its low corporate tax rate.[1] There were persistent claims that France's effective tax rate for corporates was just 8.2 per cent (when various hidden incentives were taken into account) below the Irish level of 11.8 per cent.[2] The transparency of Ireland's rate made it an easy target, especially for core EU governments, facing elections and who needed to mollify restive voters.

Alan Kelly, an Irish Labour Party MEP, argued that 'changes to our corporation tax regime would wipe out any economic progress Ireland has made and we would remain relying on the EU'.[3] Through March 2011, Irish politicians were united in insisting that taxation policy was a prerogative unambiguously reserved to the member states under the European treaties and had been the subject of an explicit commitment by leading Eurocrats when Ireland voted for a second time on the Lisbon treaty.[4]

It was hard to see any prospect of economic revival for Ireland under a long-term programme of extreme deflation. Unemployment in March 2011 reached 14.30%, the highest it had been since 1992.[5] By now, property prices have dropped in Ireland by around 50% leaving a large portion of young salary earners in negative equity. This personal debt trap prevents them taking advantage of opportunities abroad, or even those in another part of the country.[6] Ireland was well on the way to losing the equivalent of €41 billion, the amount of receipts it had received from the EU budget over the entire period from 1973 to 2009. Much of this money would be routed from Irish taxpayers to European private creditors of Irish private banks. Indeed, by the start of 2011, a substantial portion has already been paid over, to be replaced with sovereign debt.[7] At home, banks were being re-financed and those responsible for their near demise were receiving a large economic lifeline while small and medium-sized firms, especially in the retail sector, were being forced into liquidation due to punitive rents and collapsing sales. The financial sector had long enjoyed official protection in Ireland and the evidence that this continued regardless of its inglorious performance was striking. This was not an unfair reflection of the picture at the level of the European political economy increasingly influenced by the EU. An article in the *Financial Times* as the publication of EU-wide stress tests on banks drew nearer, pointed out that the bonus culture still – flourishing in many of Europe's banks – rewarded not only star performers but numerous mediocre ones as well.[8]

[1] *Irish Times*, 13 January 2011.

[2] Colm Keena, 'Corporation tax: unravelling the myths', *Irish Times*, 11 February 2011.

[3] *Irish Times*, 13 January 2011.

[4] *Sunday Independent* (Dublin), 16 January 2011.

[5] *Irish Times*, 16 March 2011.

[6] The claim of a comment on the Charlemagne blog, *The Economist*, 18 February 2011.

[7] Colm McCarthy, 'Sarkozy's grandstanding on our corporation tax misses the point', *Sunday Independent* (Dublin), 16 January 2011.

[8] Megan Murphy and Patrick Jenkins, 'Banking: ahead in the clouds' *Financial Times*, 14 March 2011.

10. European Neo-Imperialism Takes Shape

In recent decades, it is not hard to view Ireland as a faithful pupil of the EU in many of its political and financial arrangements. There was the same addiction to corporatism, ensuring that a decorative parliament had very little influence over key decision-making. Instead, powers were ceded to unelected and unaccountable public and private sector representatives to set wages, and influence public spending, taxation and investment policies.[1] Government allowed Ireland's 'Social partners' bold oversight over decision-making. They worked more closely with civil-servants than did a largely toothless Irish parliament. The side-lining of representative institutions was very much in line with core thinking at the apex of the EU. Indeed, there was close interaction between Ireland's corporate power-brokers and those in Brussels, especially between respective groups of civil servants. The switch of the centre of decision-making to Brussels in many key policy-making areas was welcomed by civil servants: it freed their actions from effective scrutiny by the Dail and greatly enhanced their own influence, undermining the separation of powers principle. Not surprisingly, the downside of corporatism, already familiar to EU watchers, in which mobilised groups have preferential access to resources, appointments and political power, became ingrained features of Irish public life.

But while Irish voters were able to inflict a crushing electoral defeat on the ruling Fianna Fail party on 25 February 2011, the main power holders in the decisional structures of the EU continue to remain beyond the reach of supposedly sovereign citizens. The European Parliament, based in Strasbourg, to which the ECB is nominally accountable, does not have the power to enact legislation to alter its structures or mandate. As demands for financial federalism intensify, the question of how such a powerful institution of economic governance can be made accountable to citizens who pay for it, remains completely absent from the discussion.

The evidence suggests that at the top of the EU there is a determination to continue with the deeply misguided policy of forcing more loans on Ireland, still at onerous terms. Three years after banking losses were placed on the state's balance sheets with the approval of the ECB, the country edges towards complete insolvency. However punitive the austerity regime imposed on Irish citizens, it is hard to see how shock therapy can generate the revenue capable of restoring solvency. Growth figures were adjusted downwards by the Irish Central Bank shortly before a prominent Irish minister, Leo Varadkar, was quoted in May 2011 by the media as saying that Ireland was 'very unlikely' to resume borrowing in 2012 and might need yet another bail-out.[2] The official line remained that Ireland was suffering from short-term liquidity problems.

The danger remains that a rigid deflationary policy will destroy remaining market confidence in the fundamentals of the Irish economy and the country will ultimately be forced to default on its sovereign debt in a disorderly manner. Through socialising private debt over the long-term, it is reckoned that the bill for Irish citizens will be €70 billion, €15,000 for each of the Irish state's 4.5 million residents.[3] Any surpluses generated by the economy will be used to clear debt rather than promote economic growth. In addition,

[1] Gurdgiev, 'Eurozone: The High Cost of [Corporatist] Complacency', 16 March 2009, http://trueeconomics.blogspot.com

[2] *Irish Times*, 1 June 2011.

[3] Andrew Willis, '€24bn needed to regain confidence in Irish banks', *EU observer*, 1 April 2011.



the high interest rate slapped on the loan to Ireland from the ECB and the IMF only serves to increase the debt burden. The interest rate is far greater than any growth rate Ireland can hope for. It precludes the Irish economy from creating the resources that can service this debt and enable the state to return to creditworthiness.[1]

Despite the impracticality of the bail-out strategy, there is no backing, at the heart of the EU, for an orderly Irish default – not least because the Franco-German holdings of Irish bank debt are so high. Ireland must endure an indefinite purgatory without being able to take the conventional measure of adjusting interest rates or devaluing the currency usually open to countries that face economic adversity. The paucity of options stemmed in no small part from the absence of statecraft which the *Financial Times* argued was in even shorter supply than funding across the whole eurozone.[2]

In Ireland, the leadership deficit led to the taking of a fatal step – the placing of a huge volume of private debts on the state balance-sheet. This open-ended guarantee to the banks and their bondholders on 30 September 2008, after years of injudicious and sometimes highly dubious financial decision-making, was described by Michael Noonan on 31 March 2011 as an event that will go down in history as the blackest day in Ireland since the Civil War (fought in 1922-23). The new Irish finance minister was announcing a further injection of €24 billion into the Irish banking system, the fifth bailout of the banks since 2008. This followed the completion of a fresh set of stress tests which revealed that the systemic failings created by a frenzy of expansion based on cheap imported credit were far worse than what had been revealed in the previous tests carried out in 2010. The EU had insisted on a rigorous check of the kind which has yet to be adopted by Spain where a portion of that country's banking system is thought to face not dissimilar problems. But the ECB also turned a deaf ear to calls made by Noonan and Prime Minster Kenny for burden-sharing in the period preceding the 31st March announcement. This could have taken the form of converting debt into equity in the re-launched banking system that is to be structured around two banks. But this would require a change in the mandate of the ECB which does not take stakes in banks.[3]

On 31st March 2011, there was not even an ECB announcement on a medium-term funding facility to Ireland. It had previously been leaked to the press, but Reuters reported that internal disagreements within the ECB's council had dashed it;[4] Axel Weber, the departing head of the Bundesbank declared, on the day that the latest plans for the Irish banking system were unveiled, that it was a big mistake for governments to make taxpayers liable for all bank risks.[5] His recommendation for burden-sharing however commanded no support in German governing circles.

Noonan, previously a fierce critic of the EU-IMF bail-out, seemed to bow to the prevailing European realities, saying after a month in office that 'Europe is very good to us' and 'the debate is over'. He insisted that the change the electors voted for was coming and that it centred round 'a major revamp of the banking

[1] Daniel Gros, 'Neither a borrower nor lender be', *CEPS Commentary*, Brussels: Centre for European Policy Studies, 18 March 2011.

[2] Editorial, 'Rescue politics', *Financial Times*, 1 June 2011.

[3] Emmet Oliver, 'Enda has to play his hand well in high-stakes poker', *Irish Independent*, 26 March 2011.

[4] 'No ECB funding facility for Ireland after stress tests due to political disagreements', *Eurointelligence*, 1 April 2010, www.eurontelligence.com.

[5] 'ECB's Weber – Ireland bank creditors should take losses', *Yahoo! News*, 31 March 2011.



system'.[1] But the Irish state continued to buy toxic bank assets while making plans to sell off state assets, destroying the balance-sheet in the eyes of one observer.[2] Another commentator was certain that by embracing such a strategy, Ireland would soon 'no longer [be] a nation but merely a bankrupt branch of the ECB'.[3] There is no sign of Ireland's defensive elite giving voters the opportunity to decide in a referendum who should carry the burden for the astronomical debts, one enjoyed by Iceland's citizens in 2009.

Enda Kenny, the head of government was disinclined to meet with top EU officials in the Commission or the ECB to discuss any alternative course beyond the debt deflationary one. So Ireland remained a spectator as the crisis assumed a critical level in mid-2011. Beforehand, intense discussions were initiated by the European Commission about creating a new system of fiscal overlordship, centred on a European Stability Mechanism (ESM) which would have powers exceeding those of the ECB.[4] But there was no room in these elite transactions for any democratic consultation and even the views of member-states are likely only to be taken account of in a perfunctory manner. Such disregard of popular sovereignty led to recurrent unrest in East-Central Europe during the decades of Soviet control and currently, the prestige of unelected power-holders is hardly much greater than that of Soviet apparatchiks and enforcers before 1989.

By the summer of 2011, the chief European political actors remained fixated by the need to shore up the banking sector but were incapable of agreeing on any crisis management strategy. The ECB raised interest rates for the second time in three months, intensifying pressure on a Spain struggling to remain afloat financially. On 4 July Wolfgang Schäuble claimed that preparations were quietly being made for a Greek default while Olli Rehn of the Commission insisted no such thing was happening. On 12 July, Greece's Prime Minister, George Papandreou, wrote to Jean-Claude Juncker, complaining that Greece was paying the price for EU's 'experimentation and confusion'. By 13 July, Spain's ten year yields had risen above 6% for the first time since 1999 while the Irish ones had reached another record by the 14th. Irish finance minister Noonan declared on the 14th that the spread [of the crisis] to the core is a game-changer: '... everyone around the table in ECOFIN is now seeing the problem as a European problem ...'[5] An EU crisis summit on 21 July took the decision to restructure a portion of Greek sovereign debt and lower the interest rates on its 2010 loan. This meant a second bail-out for Greece which left the EFSF rescue fund with around €100 billion left in its coffers, an insignificant amount in light of the €2,500 billion mountain of debt owed by Italy and Spain.[6] The €37 billion default on Greek bonds sanctioned by the troika of the EU-IMF and ECB was another huge retreat from the fiscal self-responsibility which was supposed to be a cornerstone of the eurozone. The leaders of the 17 countries issued a statement declaring that the Greek case was unique and they went on to 'solemnly reaffirm their inflexible determination to honour fully their own individual sovereign signature'.[7] It would have been odd to leave Ireland paying usurious interest rates on the 2010 loan and

[1] Fintan O'Toole, 'Time to remember all those promises', *Irish Times*, 5 April 2011.

[2] David McWilliams, 'We're being played for fools', *Sunday Business Post* (Dublin), 24 April 2011.

[3] Tom McGurk, 'Who will hoist the Jolly Roger?' *Sunday Business Post*, 17 April 2011.

[4] Christian Reiermann and Michael Sauga 'Enormous damage': Weber's exit highlights Merkel's euro problem', *Der Spiegel* (English language edition), 14 February 2011.

[5] The information in this paragraph is found in *Eurointelligence Daily Briefing*, a press review on the financial crisis, see daily_briefing@eurointelligence.com.

[6] Dan O'Brien, 'Welcome relief despite flaws in the rescue plan', *Irish Times*, 23 July 2011.

[7] *Irish Times*, 8 September 2008.



these were lowered by around 1%, amounting to savings of around €500 million to 1 billion across three years. The interest rates were lowered further in September, the lower rate was made retrospective on debt already paid in 2011, and the time required to settle the massive loans that had recently been incurred was extended to 30 years. This amounted to the partial orderly default which critics of the post-2008 Irish crisis strategy had long advocated only to be warned that it might lead to a closure of Ireland's ATMs as panic swept the banks. An EU Commission statement hailed the package for providing 'enhanced sustainability' to Ireland's crisis measures. Constantin Gurdgiev was left in no doubt that the debt reduction and maturity extensions was belated recognition that the astronomical scale of the debt forced upon Ireland made it impossible to envisage any return to normal economic conditions.[1]

A process of talking up Ireland's stabilisation efforts had already began which led to a *Financial Times* editorial on 2 September arguing that Ireland was on the road to recovery (the only evidence being offered was a slide in her debt yields). In four years, Ireland had gone from EU 'wunderkind' to serial delinquent and was now being hailed as a model pupil by Eurocrats desperate to identify a success, however vestigial, for its policy of safeguarding financial institutions and obliging citizens to pay for much of their recent excesses. But the fundamentals of the Irish economy remained weak and the July measures amounted to a fudge designed to buy time.[2] Mrs Merkel sought to invoke a summit which she had been reluctant to have with significance: 'What we are doing now is an example for deeper integration – handing over and transferring more competences to EU institutions. This is a historic day'.[3]

But it was widely assumed that only a limited amount of time had been bought: The only consistent message from those speaking for the EU structures was the desirability of further centralization without any need for democratic checks and balances. As long as national governments continued to function, it was plain that there would be huge divergences about what economic governance would entail. Even among creditor states in the eurozone these divergences were stark. The Netherlands objected angrily upon discovering a bilateral arrangement between Greece and Finland, relying on EU bail-out funds as collateral. The Dutch threatened to veto the second bail-out for Greece unless Finland retreated which it reluctantly did.[4] The German Bundestag voted, on 29 September, to increase the bail-out fund to €440 billion (much of which would come from Germany) but with deepening dissension among groups who warned that the EU was fast turning into a debt transfer union.

Huge falls in share prices occurred across Europe on 30 September. The improvised rescue-bid for Greece failed to engender any market confidence in its prospects for recovery and the flaws of the latest EU crisis response triggered a potentially much graver one. Italian and Spanish debt yields soared within four days of a supposedly 'historical' EU initiative, soon reaching the highest seen since the eurozone's formation. The new emergency was only contained after the intervention of the ECB on 6-7 August. Its executive board, after much wrangling, agreed to buy up Italian and Spanish debt and the €22 billion provided brought yields down to sustainable levels. It was the latest of the mainly German U-turns that marked a retreat from 'fiscal self-responsibility' to the dismay of the Bundesbank governor, Jens Weidmann and even the President of

[1] Constantin Gurdgiev, 'Ireland and Portugal are allowed to restructure some of their sovereign debts', *True Economics*, 14 September 2011.

[2] Dan O'Brien, 'Beware the economic paradox now emerging', *Irish Times*, 1 September 2011.

[3] *EUobserver*, 21 July 2011.

[4] *EUobserver*, 31 August 2011.



Germany, Christian Wulff.[1] On 24 August, Wulff accused the ECB of going 'far beyond' its mandate, disregarding article 123 of the Maastricht Treaty and shoring up insolvent states: 'I think the massive bond-buying program of the European Central Bank is politically and morally questionable'.[2] Merkel brushed aside such criticisms as well as others from her former mentor Helmut Kohl who in his 17 years as Chancellor made the creation of 'a European Germany' the foundation of his political strategy.[3] Under Chancellor Merkel, Germany has been forced to choose between two principles its elites have long held dear – the maintenance of a policy of sound money or fidelity to the goal of European integration. On 9 September, the abrupt departure of Jürgen Stark, the German representative on the ECB in protest at Trichet's willingness to buy French and Italian bonds, revealed the disorientation at the top of the ECB over its handling of the financial crisis.

Merkel lost any remaining inhibitions about embracing a firmly centralist vision for the 17-member eurozone, one at variance with longstanding practice in her own country. In early September, details began to emerge of a push towards creating a tight-knit alliance of eurozone members which would unify their fiscal, budgetary and social policies.[4] Mark Rutte, the Dutch Prime Minister, advocated a special EU commissioner to oversee the budget of the entire eurozone. The holder of the post would have the right to intervene fully in the running of countries. Errant states would be placed under 'guardianship' but those 'not willing to make themselves a ward, may choose to make use of the option to leave the eurozone', Rutte pointed out. As if to underline the seriousness of what was being proposed, this letter was co-signed by the finance, economy and foreign ministers and sent to the Dutch parliament.[5]

The emerging model for eurozone governance was in fact the one already tried out in Greece, Portugal and Ireland with distinctly mixed results. A telling innovation was the Fiscal Advisory Council which the EU and IMF had pressurised Ireland to set up in mid-2011. It was composed of 'fiscal referees' who offered authoritative advice that the Kenny government might not be in a position to easily refuse.[6] Pro-consuls from the troika exert pressure to ensure that Ireland paid a total of €4.3billion to investors in failed Irish banks in September 2011 while the government was preparing a budget that will seek to save broadly the same amount in cuts and tax rises.[7] The Dublin government continues to accept that citizens will have to bear the burden of mistakes made by finance institutions at home and abroad as well as regulators and politicians while diluting democratic oversight over fiscal policy. It seems to hope that by acting as a good pupil, it will obtain sympathetic treatment from EU institutions where informal approaches often override whatever the rules happen to be. So far, the responses of Brussels have been grudging ones, designed to prevent debt levels crippling the Irish economy while ensuring that the society continues to function as a debt-servicing machine long into the future. In June while in Washington, the finance minister, Michael

[1] *Daily Telegraph*, 24 July 2011.

[2] Ambrose Evans-Pritchard, 'German endgame for EMU draws ever nearer', *Daily Telegraph*, 5 September 2011.

[3] 'Merkel rejects predecessor Kohl's criticism of 'unreliable' Germany', *Deutsche Welle*, 25 August 2011.

[4] 'Divide and rescue: Berlin lays groundwork for a two-speed Europe', *Der Spiegel Online*, International edition, 5 September 2011.

[5] Leigh Phillips, 'Netherlands: Indebted states must be made 'wards' of the commission or leave euro', *EUobserver*, 7 September 2011.

[6] Cormac Lucey, 'People want to be deceived, therefore let them be deceived', *Irish Daily Mail*, 9 July 2011.

[7] Gene Kerrigan, 'Hooray! We're back on track – again', *Sunday Independent*, 11 September 2011.



Noonan, urged that senior bondholders should share the losses of the Anglo-Irish bank. But he retreated when an unnamed ECB official declared that 'we may have to come to the conclusion that it doesn't really make sense for the ECB to keep putting €100 billion into Irish banks. What we are doing is actually illegal. ... Maybe we might come to the conclusion that we should stop'.[1]

After receiving plaudits from a range of European bodies and figures as well as the IMF for its stoical and cooperative approach to paying off massive bank debts, Noonan tried again in September. He sought a meeting with Trichet to write down a €714 billion debt owed by Anglo Irish Bank which was due to be paid in November.[2] But the European Commission said there was no chance of bondholders being burned and also poured cold water on a potential mortgage relief fund designed to revive the property market and encourage renewed spending by consumers.[3] Ireland's citizens face the prospect of setting aside, long into the future, a massive part of their state's GDP to service a huge debt that was forced on them by bad political judgment in 2008 and an EU diktat in 2010. Foreign investment is bound to be discouraged, domestic business is certain to remain flat and the departure abroad of a large proportion of people often with valuable skills but who are unwilling to endure years of economic inactivity, appears guaranteed.

In the second week of November 2011 Ireland paid €706 million to unsecured bondholders in Anglo-Irish bank which had been closed at the behest of the ECB. Unlike the Greek Prime Minister, Andreas Papandreou, Enda Kenny played a marginal role at the EU summit in Brussels on 26-27 October which took decisions that further confirmed the disastrous way Ireland's economic problems had been handled by its overseers.

Further debt relief measures were announced for Greece with leading Eurocrats insisting that they did not amount to a default. Greek private debts, which fell disproportionately on French and German banks, would be covered by the EFSF whose assets were to be tripled to a figure around €1 trillion. The bail-out fund's head, Klaus Regling immediately set off for Beijing on the geopolitically momentous mission of seeking China's help in underwriting European sovereign debt as core countries edged towards insolvency. But it soon became clear that the 17 eurozone countries will have to make hefty contributions even if China thinks it has enough to gain from shoring up an unsustainable financial regime in Europe. The contributors will include Ireland despite it being unable to borrow on the money markets. Not only is deep recession a long-term prospect for the weakest eurozone states but the policy of keeping the EU's chief ideological flagship afloat at all costs, means that the EU as a whole is condemned to years of non-growth. In a dramatic confrontation in the European parliament on 19 January 2011, José Manuel Barroso had angrily rebuked an Irish MEP, Joe Higgins for the EU's record in Ireland during the crisis. He declared that 'it was not Europe that created this fiscally irresponsible situation and this financially irresponsible behaviour … It is important to know where the responsibility lies …'[4] By contrast, once the crisis was no longer confined to the European periphery and centred around the health of French and Germany banks, it was re-interpreted as a core emergency requiring a common European response ; it was agreed that €30 billion of European financial losses on Greek debt would be covered by the EFSF.

[1] *Sunday Times Ireland*, 19 June 2011.

[2] *Irish Times*, 8 September 2011.

[3] *Irish Independent*, 9 September 2011.

[4] *Irish Times*, 20 January 2011



Plans were unfurled for fiscal and budgetary convergence in the eurozone countries with Olli Rehn, the Commissioner for Economic Affairs being appointed Vice-President of the Commission. EU inspectors would be able to vet national budgets before they reached their respective parliaments. Decisions on tax and spending will be surrendered by state legislatures to the EU bureaucracy, depriving citizens of any real say in core functions of government. In Ireland such a seizure of power is likely to be challenged in the courts and could lead to a fresh referendum. But the lukewarm market reaction to another contrived plan hammered out after frantic negotiations, one meant to reconcile diverging French and German state interest, showed all the hallmarks of a steadily deepening crisis. The markets were even less impressed by the moves coordinated by the Franco-German pivot of the EU to engineer the removal first of Papandreou because of his sudden call on 31 October for a referendum to allow Greek voters to judge the latest EU-imposed austerity package followed by the departure of Italy's Silvio Berlusconi on 14 November. They were replaced by technocrats Lucas Papademos and Mario Monti, both closely linked with policies shaping the currency union in its first decade. The Italian and Greek parliaments reluctantly approved their governments with few parliamentarians wishing to be members because their legitimacy was widely seen as questionable; and the Greek and Italian positions on the markets worsened with widening bond yields the chief expression of their lack of confidence in the EU's clumsy intervention to promote a kind of Mediterranean regime change that would sustain its strategy of expecting the debtor states to be the ones to bear the brunt of measures meant to heal a broken currency system. On 20 November, Spain's voters decisively rejected the 8-year Socialist government and gave a clear majority to the main centre-right party. But Spain's deteriorating position on the markets accelerated as it and Italy found it difficult to raise money on the markets at acceptable rates. Sovereign default appeared unavoidable for these countries unless the EU came up with a rescue strategy that could convince the markets that the eurozone still had a future. The main ideas on the table 1) turning the ECB into the lender of last resort by guaranteeing fragile bank systems of the eurozone core and 2) the issuing of Eurobonds were ones that lacked decisive momentum. Opposition from Germany hampered both and there was a fast-disappearing pool of investors ready to risk betting on Europe's financial prospects.

The Kenny government in Ireland's confidence that the EU would ultimately be in a position to look after Ireland's interests now started to publicly fade given the disarray visible at the heart of EU decision-making. On 23 November, Finance minister Noonan strongly hinted that unless Ireland received debt relief as a recognition of the role it had played in upholding the integrity of the EU financial system, then it would be hard for the EU to obtain any Irish approval for any proposed treaty changes. He claimed that the public mood had turned very sour, perhaps a realisation that had sharpened due to the sharp electoral losses recently faced by his party.[1] One incident that had caused deep disquiet was the revelation that the European commission had shown details of the Irish budget to the Bundestag before Irish parliamentarians had a chance to glimpse them. The Irish government 'protested very strongly' to Brussels, a gesture of dissent denoting the declining credibility of the EU within the Europhile wing of the Irish elite.[2]

EU power-holders may still judge the stabilisation of the Irish front to be a success as the sovereign debt crisis worsens and threatens calamity in the heart of the eurozone. But the suffering that is expected of much of Ireland's population in order for them still to be considered 'good Europeans', will surely lead to a fundamental re-assessment of the value of a European integration project that has been pursued in recent decades chiefly for ideological purposes, ones that are at variance with the needs of most European citizens. It is hard to see Irish citizens colluding in the replacement of their democratic institutions with a

[1] Ambrose Evans-Pritchard, 'Ireland demands debt relief, warns on EU treaties', *Daily Telegraph*, 23 November 2011.

[2] *Irish Times*, 24 November 2011.

central command composed of unelected functionaries operating from the heart of the EU. Any attempt to abolish states and make them wards of unaccountable central institutions seems destined to reignite conflicts over self-determination in Europe which it had once been thought had been largely solved with the collapse of nearly all of the European dictatorships at the end of the 1980s.

11. Conclusion

The main EU bodies with a role in the crisis – the ECB, the Commission and the European Council – bitterly diverge over details but still there is an insistence on having one sole policy for the crisis of the eurozone. The road to recovery involves members of the eurozone periphery accumulating a mountain of debt, handing over key elements of national sovereignty, and resigning themselves to years of penury and non-growth. The crisis continues to be viewed as one whose main origins are to be found in specific countries rather than a European-wide financial failure stemming from the attempt to create an ill-designed currency union for members of the EU who had very different economic conditions and needs.

There is no evidence that the European Union has 'a Plan B' or is even analysing the impact of its deflationary strategy on the countries where it is being acted out. The adamant refusal to discuss policy alternatives, as spectacularly ill-conceived measures place growing strain on the economic and financial underpinnings of much of Europe, is astonishing and disturbing. The Euro has assumed the status of a dogma not that far apart from the medieval belief that the world is flat or, in our own age, the insistence of the Soviet Union that the absolute state domination of the economy is the only guarantor of human progress. As in the Soviet bloc, the rules have proven to be dispensable – with the Lisbon Treaty, enacted with great solemnity, then swiftly violated in order to allow massive quantities of citizens' earnings to be used to shore up the currency union. The only alternative countenanced appears to be more intensive financial federalism. As likely as not, this would involve the same set of bureaucratic elites who performed so badly in handling lesser roles, being given control of Europe-wide budgets and tax regimes.

The 'Holy Alliance' which insists that the progress of Europe is bound up with a common currency, consistently dismisses alternative proposals: such as a temporary leave of absence for distressed members like Greece, who then devalue in a bid to return to competitiveness; or a two-tier eurozone, in which the interest rates and exchange rates suit the needs of members currently locked into a deeply unsatisfactory core-periphery relationship. Different pan-European packages of debt-restructuring have also been advocated. Such approaches no doubt have real advantages and disadvantages, but the EU sticks limpet-like to one policy, piling more debt onto millions of European citizens, even though what appears to be an increasingly desperate strategy has failed to reveal any light at the end of the tunnel.

Ireland made a catastrophic mistake in 2008 when it placed a huge volume of private debts onto the state balance-sheet. But arguably, equal naivety was shown by the Irish government of Brian Cowen, and perhaps that of his successor too, by assuming that effective and disinterested advice and leadership could be supplied from the core of the EU. Unfortunately, the crisis has shown it to be noticeably absent due to the way that power is wielded within the power structures of the EU.

The Kenny government needs to change course and recognise that it is failing its citizens with an externally-imposed policy of paying a colossal debt. The undertaking is impossible to realise and will only plunge the country into a devastating recession. Ireland enjoyed the fastest growth of debt of any country in the world between 2008 and 2010 thanks to its rulers accepting an economic policy increasingly worked out by



Commission and ECB officials (in tandem with the IMF).[1] Austerity is unavoidable but policies should be spread more equitably between the public and private sectors. Proposals to restructure private debt arising from the collapse of house values need to be actively considered. The case has been made for a well-designed mortgage relief scheme which would target people who made house purchases in good faith that they can no longer afford.[2] The state, through tax-payers contributions and the state pension fund is already financing a debt-relief scheme for private investors in private banks to whom, arguably, it had little obligation. NAMA is a controversial debt management scheme meant to salvage the investments of major property holders. Household debt in Ireland was 147% of GDP in September 2007 and unless this level is reduced, consumption will continue to fall. The revival of the property market and the launching of new businesses can be ruled out for a lengthy period. Ireland has little alternative but to repudiate the unsecured debts of creditors in defunct banks if a recession of the magnitude forecast by many commentators is to be avoided. Iceland's recovery from a devastating economic crash in 2008 has occurred through similar measures. The IMF allowed Iceland important leeway in determining how it managed the crisis. Its insolvent banks were allowed to collapse. The loans of indebted homeowners were restructured in the knowledge that many could not otherwise be paid and their holders would emigrate. In June 2011 when Iceland returned to international debt markets, its bond offering was subscribed twice over.[3] Of course, Iceland was able to execute a revival in its fortunes because it had the range of policy options which were denied to Ireland through its membership of the eurozone. If Ireland is to have any hope of reviving its economic competitiveness, it needs to release the grip of the ECB on its decision-making. Towards this end, It should be working to gain acceptance for an orderly suspension of Ireland from the eurozone, or else a two-tier eurozone in which the interest rates and exchange rates suit the needs of members. The reaction of the United States and China indicates clearly that the EU is seen as a serious a danger to global financial stability, due to the lamentable stewardship of the crisis that has been provided from within the eurozone. The ECB has stepped into full daylight as 'the world's strangest central bank', under little oversight or restraint from any political entity and where directors make provocative statements that add to market jitters.[4] Its performance, and indeed that of the European Commission's financial directorate, may offer an alarming indication of what centralised economic government for Europe would be like. Another financial institution – the IMF – has witnessed an unseemly tussle to place another European in charge of its affairs because the European debt crisis is seen as dominating global financial affairs for the next two years at least.[5]

It is hard to envisage any single European nation-state plunging the affairs of Europe into such chaos, as the EU has done through aggressively pushing a supra-national approach to problems that require national solutions not often low-grade ones driven from the centre and devised by an unaccountable set of Euro elites. It is nation-states that will be forced to deal with the worst aspects of the crisis, involving human cost. National parliaments need to have real involvement in what will be an arduous recovery process if it is to have any democratic legitimacy. Nothing less than a halt to the EU strategy of marginalising its national

[1] The growth claim was made by Constantin Gurdgiev, on 'the Vincent Brown' Show, TV 3, Ireland, 27 September 2011.

[2] The main advocate is Morgan Kelly who was almost alone in predicting the scale of the financial crisis. See Genevieve Carberry, 'Kelly says cost of 'mortgage forgiveness' are not enormous', *Irish Times*, 19 August 2011.

[3] Paul Cullen, 'Iceland: from ruin to role model? *Irish Times*, 24 September 2011.

[4] Colm McCarthy, 'We must fight back to renegotiate the bail-out', *Independent on Sunday*, 29 May 2011.

[5] This is the view of the successful candidate, French finance minister, Christine Lagarde. See *Daily Telegraph*, 27 May 2007.



members and draining them of sovereign authority should occur if the cooperation and trust required to undo the excesses of Euro-centralism are to stand any real chance of success.

Imposing massive debt on citizens and draining their national institutions of any remaining authority appears to be a path to ruin for Europe. IMF projections show that eurozone economic growth is likely to average just 1.4 per cent in 2011-13 against 3.7 per cent for other advanced economies. Other projections suggest that the eurozone's share of world GDP will decline from 18.4 per cent to 12.72 between 2000 and 2015.[1] Pursuit of policies whose scarcely-concealed objective is to place nation-states under the control of architects of a failed strategy for growth is in real danger of condemning Europe to an era of backwardness and sharply escalating internal conflict.

In conclusion, the scale of this crisis makes it all too appropriate to recall the words of the German economist Wilhelm Röpke, written in 1956 as half-a-century of European empire building was about to unfold:

'Decentralism is the essence of the spirit of Europe. To try to organise Europe centrally, to subject the continent to a bureaucracy of economic planning, and to weld it into a block would be nothing less than a betrayal of Europe and the European patrimony. The betrayal would be the more perfidious for being perpetrated in the name of Europe and by an outrageous misuse of that name'.[2]

[1] For these figures see Constantin Gurdgiev, 'The insolvent household called Europe', *Presseurop*, 23 November 2011, www.presseurop.eu.

[2] Wilhelm Röpke, *A Humane Economy*: The Social Framework of the Free Market, ISI Books, 1998.



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