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Chuaigh Ár Lá – Debt of A Gaelsman: Ireland's Sovereign Debt Crisis, National and International Responses

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Chuaigh Ár Lá¹ – Debt of A Gaelsman: Ireland’s Sovereign Debt Crisis, National and International Responses

James Croke *

Abstract: How did a small island nation on the periphery of Europe go from the pauper of the European Union, to a paragon of a market economy, and back to fiscal ruin within the space of twenty years?

Ireland was the poorest nation in the European Economic Community (EEC) in 1988. In the late 1980’s and early 1990’s it undertook structural reforms to fundamentally reshape its economy, the result was a booming economy throughout the mid-to-late 1990’s and early 2000’s, primarily fueled by exports and foreign direct investment. Rather than continue on a sustained, but slower, growth path in the 2000’s, the Irish went on a credit binge that inflated domestic property prices to dizzying highs and resulted in a financial hangover, the likes of which had never been seen before in the Republic.

This credit bubble went unchecked by regulators and, in fact, was actively encouraged by successive governments. Although asset bubbles may be inevitable, Ireland could avoid future fiscal crises by running a more counter-cyclical tax policy and adopting a rules-based approach to banking regulation. From a Europe-wide perspective, the EU should put teeth into enforcing compliance with the fiscal spirit of Stability and Growth Pact and should create an independent regulator to monitor systemic risk in European Union (EU) financial institutions to ensure that kinds of problems that arose in Ireland do not appear elsewhere in the EU.

¹ Translates to “our day has passed.”

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I. INTRODUCTION

The recent global financial crisis, precipitated by the collapse of Lehman Brothers in September of 2008, has drastically altered the short-to-medium term economic prospects of most European nations, if not all developed economies. However, for several nations on the periphery of the European economic landscape, the crisis has exposed startling shortcomings in their public finances. The most severely affected of these countries are Portugal, Italy, Ireland, Greece, and Spain (PIIGS).²

Of the European countries in such dire fiscal straits, Ireland is perhaps both the most surprising and the most expected example of an economy in distress. Ireland’s situation is surprising because of the unprecedented growth its economy experienced from the mid-nineties until 2007.³ The Irish economy’s fall from grace was predictable for much the same reason as the United States’ economy; it had become overheated and overly reliant on a debt-fueled property boom.⁴

² Martin de Sa’Pinto, *Hedge Funds to Favor BRIC not PIIGS in 2010: Lipper*, REUTERS, Jan. 15, 2010, <http://www.reuters.com/article/2010/01/15/us-hedge-research-idUSTRE60E2OJ20100115>.

³ *The Irish Economy*, ECON. AND SOC. RES. INST., http://www.esri.ie/irish_economy/ (last visited Feb. 23, 2011).

⁴ Jim Landers, *Drowning in Debt: Ireland Faces a Tough Road to Economic Recovery*, DALL. MORNING NEWS, Sept. 26, 2010, <http://www.dallasnews.com/business/headlines/>

This Comment contends that although Ireland's economic downturn was inevitable, its fiscal crisis was, and continues to be, greatly exacerbated by ineffective regulation of the banking sector at the national level and poor supervision of Ireland's fiscal state at the European Union (EU) level.

As a relatively small economy on the edge of Europe, Ireland will always be exposed to the economic shocks of larger nations, particularly the United States and the United Kingdom. However, this is not to say that Ireland cannot mitigate the effects of future external economic crises and at least ensure that its fiscal plights are not the result of domestically created problems. With the proper regulatory structure in place and a conservative approach to banking regulation, Ireland can and should be able to weather future economic storms.

This Comment first traces the development of Ireland's economy since its accession to the EU in Section II and the causes of the recent fiscal crisis in Section III. The Comment will then shift its attention to the Irish government's response to the crisis in Section IV. Finally, in Section V, the Comment suggests measures for the Irish government to implement to head off future fiscal trouble and potential EU-wide coordination of banking regulation.

A. Background and Overview of the Effect of the Financial Crisis On Ireland

Since the beginning of the recent financial crisis, Ireland's fiscal situation has deteriorated dramatically. By December 2010, the national debt soared to €93.4 billion (\$129.6 billion),⁵ a 24% increase from 2009.⁶ By then end of September 2011, this figure had increased to €114.7 billion (\$159.1 billion).⁷ Likely as a reaction to the country's poor fiscal health, the yield on its 10-year bonds reached a record high of 8.7% on November 10, 2010.⁸ This yield was 6.2 percentage points above the yield on German Bunds.⁹ Although the Irish debt management agency raised €20 billion (\$27.7 billion) from the bond markets prior to the yield spike and funded its short-term obligations, the high yields made it unfeasible to finance long-

20100925-Drowning-in-Debt-Ireland-faces-3711.ece.

⁵ Conversions are based on exchange rate of one Euro for 1.3867 US Dollars as of October 14 2011 (10:52 a.m.).

⁶ Nat'l Treasury Mgmt Agency (Ireland), *General Government Debt*, <http://ntma.ie/GovernmentDebt/historicalData.php> (last visited Dec. 30, 2011).

⁷ Nat'l Treasury Mgmt Agency (Ireland), *Government Debt*, <http://www.ntma.ie/GovernmentDebt/GovernmentDebt.php> (last visited Dec. 30, 2011).

⁸ David Oakley et. al, *Irish Bond Yields Surge to Record*, FIN. TIMES, Nov. 10, 2010, <http://www.ft.com/cms/s/0/2a6f23d0-eca9-11df-88eb-00144feab49a.html#axzz1hgEWa5qr>.

⁹ Editorial, *Still Crazy After All These Yields*, ECONOMIST, Nov. 11th, 2010, www.economist.com/node/17465261.

term debt.¹⁰ As of November 14, 2010, Bloomberg reported that Germany was pressuring Ireland to avail itself of the European Financial Stability Facility (EFSF), a newly created fund to provide for troubled European economies, in order to quell market volatility.¹¹ Ireland later acceded to external pressure and accepted an emergency credit line totaling €85 billion (\$111 billion) from the International Monetary Fund (IMF) and the EU.¹²

As a result of these developments, it is unclear how much actual control Ireland will have in shaping its own financial regulations and determining its own fiscal policy in the future. The terms of the EU-IMF loan require that Ireland meet strict quarterly targets set by the EU-IMF to reduce its budget deficit.¹³ Further, Ireland will have to consult the EU-IMF before making any fiscal policy decisions that are “not consistent with the agreement.”¹⁴ Because of this uncertainty in the short term, this Comment will not focus on the immediate changes Ireland could make to improve its public finances and short-to-medium term growth. Rather, it will focus on long-term measures to head off future fiscal crises, like the one Ireland is currently experiencing.

II. DEVELOPMENT OF THE IRISH ECONOMY PRECEDING THE CRASH

Prior to joining the European Economic Community (EEC) in 1973, Ireland was among the economic underperformers of Western Europe.¹⁵ Much of Ireland’s underperformance prior to joining the EEC is attributable to protectionist policies pursued from the early 1930’s to the 1960’s as a means to build up domestic Irish industry in the wake of political separation with the UK.¹⁶ Most notable of these policies was the Control of

¹⁰ *Id.*

¹¹ Dara Doyle & Simon Kennedy, *Ireland Urged to Take Aid by Officials Amid Debt Crisis*, BLOOMBERG, Nov. 12, 2010, <http://www.bloomberg.com/news/2010-11-12/cowen-says-ireland-cooperating-with-eu-as-debt-crisis-threatens-region.html>.

¹² David Labanyi, *Ireland to receive €85 billion bailout at 5.8% interest rate*, IRISH TIMES, Nov. 11, 2010, <http://www.irishtimes.com/newspaper/breaking/2010/1128/breaking1.htm>.

¹³ Stephen Collins et al., *Memorandum sets out detailed conditions of EU-IMF loan deal*, IRISH TIMES, Dec. 12, 2010, <http://www.irishtimes.com/newspaper/frontpage/2010/1202/1224284574676.html>.

¹⁴ *Id.*

¹⁵ KLAUS REGLING & MAX WATSON, A PRELIMINARY REPORT ON THE SOURCES OF IRELAND’S BANKING CRISIS 21 (2010), available at <http://www.bankinginquiry.gov.ie/Preliminary%20Report%20into%20Ireland%27s%20Banking%20Crisis%2031%20May%202010.pdf>.

¹⁶ Rory O’Donnell, *Ireland’s Economic Transformation: Industrial Policy, European Integration and Social Partnership* 4, (U. Pitt. Cen. West Eur. Stud., Working Paper No. 2, 1998), available at <http://aei.pitt.edu/27/> (noting that the Irish economy was deindustrialized in the 19th century); see generally Frank Geary, *Deindustrialization in Ireland to 1851: Some Evidence from the Census*, 51 ECON. HISTORY REV. 512 (1998), available at

Manufactures Act,¹⁷ passed in 1933 and enforced until 1957, which prohibited foreign ownership of Irish industry by requiring that 51% of the voting shares of manufacturing companies be held by Irish citizens.¹⁸ These policies failed to encourage native industrial development and resulted in recession and emigration in the 1950's.¹⁹

Upon ascension to the EEC, Ireland was the poorest nation in the entire EEC group of countries.²⁰ Economic stagnation continued through the 1980's, a decade marked by high unemployment²¹ (reaching 17% in 1986²²), high levels of public debt (reaching 125% of GNP in 1987²³), and mass emigration to the United States and the United Kingdom.²⁴ As a country survey by The Economist magazine in 1988 rather harshly put it:

Take a tiny, open ex-peasant economy. Place it next door to a much larger one, from which it broke away with great bitterness barely a lifetime ago. Infuse it with a passionate desire to enjoy the same lifestyle as its former masters but without the same industrial heritage or natural resources. Inevitable result: extravagance, frustration, debt [. . .] Ireland is easily the poorest country in rich north-west Europe. Its gross domestic product is a mere 64% of the European Community average.²⁵

This dismal trend continued until the early 1990s, when through a series of structural and taxation reforms made in the late 1980s, the economy underwent an unprecedented period of growth commonly referred to as the "Celtic Tiger."²⁶ A heavily protectionist economy transformed into a very open-market economy.²⁷ Ireland's GDP grew by an average of

<http://www.onlinelibrary.wiley.com/doi/10.1111/1468-0289.00103/pdf>.

¹⁷ Control of Manufactures Act 1932 (Act No. 21/1932) (Ir.), available at <http://www.irishstatutebook.ie/1932/en/act/pub/0021/index.html>.

¹⁸ Antoin E. Murphy, *The 'Celtic Tiger'—An Analysis of Ireland's Economic Growth Performance* 7-8, (Eur. U. Inst., Robert Schuman Centre for Advanced Stud., Working Paper No. 16, 2000), available at http://www.eui.eu/RSCAS/WP-Texts/00_16.pdf.

¹⁹ O'Donnell, *supra* note 16.

²⁰ REGLING & WATSON, *supra* note 15.

²¹ David McKittrick, *More Migrants Quitting Ireland than any EU State*, INDEPENDENT (UK), July 29, 2010, <http://www.independent.co.uk/news/world/europe/more-migrants-quitting-ireland-than-any-eu-state-2038004.html>.

²² INTERNATIONAL MONETARY FUND [IMF], *World Economic Outlook: Sustaining the Recovery* (Oct. 1, 2009), available at www.indexmundi.com/ireland/unemployment_rate.html.

²³ Murphy, *supra* note 18, at 4.

²⁴ *Id.*

²⁵ Editorial, *Poorest of the Rich*, ECONOMIST, Jan. 16, 1988, at 3.

²⁶ See generally Patrick Honohan & Brendan Walsh, *Catching Up with the Leaders: The Irish Hare*, 2002 BROOKINGS PAPERS ON ECON. ACTIVITY 1, 28 (2002).

²⁷ See Peter Herrmann, *Tíogar Ceilteach—An Enlargement Country of the 1970s as Showcase?*, 38-40 (Eur. Soc. Org. Sci. Consultancy Inst. for Indep. Res., William Thompson

8.4% per annum between 1994 and 1999.²⁸ Irish unemployment fell dramatically, from 16% in 1985 to below 5% in 2001.²⁹

Although the commentators are not in agreement as to the precise cause or causes of this growth miracle, most agree that structural labor and tax reforms were necessary preconditions for Ireland's prosperity.³⁰ Ireland became an attractive destination for foreign direct investment due to its English-speaking population, relatively low wages, educated workforce, and low corporate taxes.³¹ Social partnership helped maintain wage moderation in spite of a booming economy, as did an increase in the number of women entering the workplace.³² Also contributing to growth was a massive influx of EU money that funded, among other things, modernization of Ireland's physical and technological infrastructure.³³ Development of infrastructure was essential in creating a framework upon which a high-tech and export driven economy, as Ireland aspired to be, could thrive.³⁴

As a result of this marked growth, the standard of living in Ireland improved, and by 2001, Irish workers' incomes exceeded the EU average. The wage moderation of the 1990's had seemingly been abandoned.³⁵ This surge continued unabated as compensation per employee rose at two to three times the European average rate from 1997 to 2008.³⁶ By 2007, Irish

Working Papers 7), available at <http://www.ucc.ie/en/socialpolicy/WilliamThompsonWorkingPapers/>.

²⁸ Murphy, *supra* note 18.

²⁹ Honohan & Walsh, *supra* note 26, at 28.

³⁰ Compare *id.* (arguing that Ireland's growth miracle of the 1990s was largely the result of catching-up with the rest of Western Europe), with Oliver Blanchard & Barry Bosworth, Response, *Comments and Discussion on Catching Up with the Leaders: The Irish Hare*, 2002 BROOKINGS PAPERS ON ECON. ACTIVITY 57 (2002) (focusing on wage moderation while increasing productivity as the proximate cause of the growth miracle).

³¹ See Irene Lynch Fannon, *The Luck of the Irish or Just Plain Old Tax and Regulatory Planning? The Success of Venture Capital in Ireland*, 1 ENTREPRENEURIAL BUS. L. J. 231, 236-42 (2007).

³² Lucio Baccaro & Marco Simoni, *The Irish Social Partnership and the "Celtic Tiger" Phenomenon* 5-7 (Int'l Inst. Lab. Stud., Discussion Paper No. 154, 2004), available at <http://www.ilo.org/public/english/bureau/inst/publications/discussion/dp15404.pdf>.

³³ See THE WORLD BANK, RESHAPING ECONOMIC GEOGRAPHY, WORLD DEVELOPMENT REPORT 237 (2009). Since its accession to the EU, Ireland has been a net recipient of EU funds amounting to €62 billion (\$86 billion) between 1973 and 2009. Pat Gallagher, *Balance of Payments Still in Ireland's Favour*, IRISH EXAMINER, Jul. 27, 2009, <http://archives.tcm.ie/irishexaminer/2009/07/27/story97318.asp>.

³⁴ See CEM GALIP ÖZENEN, DEP'T OF INFRASTRUCTURE AND SERV. (TURKEY), THE EFFECT OF STRUCTURAL FUNDS ON IRELAND'S DEVELOPMENT AND LESSONS FOR TURKEY 19-22 (2006), available at <http://ekutup.dpt.gov.tr/ab/ozenencg/irlanda.pdf>.

³⁵ REGLING & WATSON, *supra* note 15 (commenting that while the economy operated at full employment, the focus shifted from keeping wages competitive to increasing wages to reflect economic growth).

³⁶ *Id.* at 22 (noting that prior to 1996 compensation for Irish employees grew in line with

wages were the second highest in the EU after Luxembourg.³⁷ Wage inflation drastically decreased Ireland's competitiveness and deterred investment in exporting industries.³⁸ Further, massive wage increases in the public sector would later severely undermine government finances by keeping public expenditures high in spite of a drastic fall-off in tax revenues due to the recession.³⁹ The problem of high wages for government employees persists even after several rounds of cuts since 2008.⁴⁰

The EU's influence constitutes almost as important a factor as domestic reform in shaping Ireland's economy prior to the recent crash. Ireland has long been a supporter of moves toward increasing European market integration.⁴¹ It was entirely unsurprising that Ireland chose to join the European Monetary Union (EMU) in 1998 and that Ireland adopted the Euro as its currency in 1999.⁴² With the introduction of the Euro, Irish debtors and banks were able to borrow at comparatively lower interest rates for a sustained period of time.⁴³

other EU countries but that after 1997 Irish employees' compensation grew faster than the EU average and that after 2002 in particular this rate of growth increased dramatically).

³⁷ *Id.*

³⁸ Carol Newman, *Lost Competitiveness Must Be Tackled*, IRISH TIMES, Oct. 24, 2008, at 5.

³⁹ Parmy Olson, *Ireland: Fiscal Situation Bad But Not IMF-Bad*, FORBES, Jan. 1, 2009, http://www.forbes.com/2009/01/15/ireland-imf-update-markets-econ-cx_po_0115markets06.html.

⁴⁰ Ann-Marie Walsh, *Public Sector Wages Fall 4% but Pay Still Beats Private Sector*, IRISH INDEPENDENT, Oct. 22, 2010, <http://www.independent.ie/national-news/public-wages-drop-4pc-but-pay-still-beats-private-sector-2390351.html>.

⁴¹ This is not to say that Ireland has not had any reservations about greater European integration, most notably the initial rejection by referendum of the Nice and Lisbon treaties. Ambrose Evans-Pritchard, *Rejection by Ireland Fails to Modify Nice Treaty*, THE TELEGRAPH (LONDON), Jun. 12, 2001, <http://www.telegraph.co.uk/news/worldnews/1308884/Rejection-by-Ireland-fails-to-modify-Nice-Treaty.html>; Sarah Lyall and Stephen Castle, *Ireland Derails A Bid to Recast Europe's Rules*, NY TIMES, Jun. 14, 2008, <http://www.nytimes.com/2008/06/14/world/europe/14ireland.html?pagewanted=all>.

Ireland's Constitution, unlike most EU member nations, requires a national referendum whenever significant changes are made to existing EU treaties. *Crotty v. An Taoiseach*, [1987] I.R. 713 (Ir.). Irish concerns are motivated chiefly by a fear of losing its staunch neutrality in the international arena. See Henry McDonald, *Lisbon Treaty Hangs in Balance as Ireland Votes*, THE GUARDIAN (LONDON), Oct. 2, 2009, <http://www.guardian.co.uk/world/2009/oct/02/lisbon-treaty-ireland-votes-eu>.

⁴² See Amity Stauffer, *What is the European Monetary Union?*, THE UNIV. OF IOWA CTR. FOR INT'L FIN. AND DEV., <http://ebook.law.uiowa.edu/ebook/faqs/what-is-the-european-monetary-union> (last visited Nov. 10, 2011). The move to join the EMU was not solely economic, there was (and is) a strong political desire in Ireland to reduce trade dependence on the UK and strengthen cultural and economic ties with trading partners in continental Europe. See Jim Power, *The Debate is Good but is it Too Late?*, FIN. TIMES, Sept. 28, 2000, at 45.

⁴³ Sebastian Dellepiane Avellaneda & Niamh Hardiman, *European Economic Crisis: Ireland in Comparative Perspective 5*, (September 2, 2010) (Univ. Coll. Dublin, UCD Geary

As a prerequisite to joining the EMU, member states must pledge to adhere to the Stability and Growth Pact (SGP).⁴⁴ The SGP is designed to ensure that member states maintain budgetary discipline after the introduction of the Euro.⁴⁵ The SGP requires member countries to run current account deficits of no more than 3% of GDP and total public debt levels of a maximum of 60% GDP.⁴⁶ In spite of its disastrous fiscal situation, Ireland managed to stay within the bounds set by the SGP until 2008.⁴⁷ Moreover, Ireland no longer controls its own monetary policy, as this power was ceded to the European Central Bank (ECB) in Frankfurt when it adopted the Euro.⁴⁸

Although Ireland appeared to be the picture of economic health throughout the 2000s, all was not what it seemed. Years of budget surpluses masked deep structural problems in the budget.⁴⁹ Moreover, expansion of bank asset sheets and record profits hid lax regulatory oversight, poor corporate governance, and reckless lending.⁵⁰ Lehman Brothers's collapse ostensibly precipitated the financial crisis, however Ireland's economic condition was actually a house of cards vulnerable to any gust of wind.

III. CAUSES OF THE CRISIS IN IRELAND

Ireland, like almost all market economies, was deeply affected by the near total collapse of financial systems after the bankruptcy of Lehman Brothers in September 2008. Even though Irish banks did not themselves

Inst. Discussion Paper Series), available at www.ucd.ie/geary/static/publications/working_papers/gearywp201046.pdf.

⁴⁴ *Resolution of the European Council on the Stability and Growth Pact*, 1997 O.J. (C236).

⁴⁵ See Paulo Vila Maior, *The Stability and Growth Pact: Enforceable, Flexible or Dead?* 2–3 (UACES 33d Annual Conference and 8th Research Conference, 'The European Union: The First Ten Years, the Next Ten Years?', Univ. of Newcastle, Sept. 2003), available at <https://bdigital.ufp.pt/dspace/handle/10284/1417> (noting that the creation of the SGP was primarily motivated by German concerns that countries joining the EMU would behave well, fiscally speaking, in order to gain accession to the Euro but would revert back to profligate spending once accession was secured).

⁴⁶ Dellepiane & Hardiman, *supra* note 43, at 3.

⁴⁷ Jim O'Leary, *External Surveillance of Irish Fiscal Policy During the Boom*, (Nat'l Univ. of Ireland, Maynooth, Dep't of Econ., Fin. & Accounting, Working Paper Series N210-10, 2010), available at <http://eprints.nuim.ie/1991/1/N210-10.pdf> (noting that in the five years prior to the financial crisis Ireland was running an average budget surplus of 1.3% of GDP). In 2008 Ireland ran a deficit of €13.2 billion (\$18.3 billion) or 7.3% of GDP and fell outside the limits set by the SGP. BUDGETARY AND ECONOMIC STATISTICS, DEPT. OF FINANCE, (2011) (IR.), available at www.finance.gov.ie/documents/guidelines/BES_Sept2011.pdf.

⁴⁸ Stauffer, *supra* note 42.

⁴⁹ REGLING & WATSON, *supra* note 15, at 25–26.

⁵⁰ *Id.* at 19.

hold toxic assets, they were heavily exposed to global money markets and thus very vulnerable to the liquidity shocks that resulted from Lehman's bankruptcy.⁵¹ This exposure to the global marketplace, which was a contributing factor to growth during the period of rapid economic expansion in the late 1990's and 2000's, became an acute vulnerability during the financial crisis. Ireland boasted a very high trade-to-GDP ratio immediately prior to the financial crisis,⁵² with a particularly heavy reliance on foreign direct investment from the United States.⁵³ As the United States underwent its own financial crisis,⁵⁴ peripheral economies,⁵⁵ such as Ireland, suffered greatly.⁵⁶ A modification of the old phrase "when the United States sneezes the world catches a cold" is appropriate here, except that instead of a cold, Ireland caught something akin to tuberculosis.

Although the financial crisis emanated from the United States, it would be misguided to attribute the primary blame for the atrocious state of the public purse in Ireland on external factors. That blame should be placed squarely on domestic actors, both public and private.

A. Failure of State Actors

Perhaps the most glaring shortcoming of the Irish government of the past 10 years was a failure to responsibly manage budgetary surpluses during the period of rapid economic expansion. Throughout the 2000's, a series of Fianna Fáil-led⁵⁷ coalitions simultaneously increased public expenditures and cut income taxes.⁵⁸ By 2009, as a result of these policies, Ireland had among the lowest income tax burden of any Organization for Co-operation and Development (OECD) country.⁵⁹ Public expenditure

⁵¹ *Id.* at 16.

⁵² Herrmann, *supra* note 27, at 39.

⁵³ *Id.* at 40.

⁵⁴ I am referring specifically to the liquidity crisis that resulted from the collapse of Lehman Brothers in September 2008.

⁵⁵ "Peripheral economy" is a proxy for those countries on the outer edges of the European Union (Greece, Ireland, Italy, Portugal and Spain) that have undergone national debt crises since 2008. Editorial, *The Myth of the Periphery*, *ECONOMIST*, Mar. 25, 2010, at 59.

⁵⁶ Gregory Connor et al., *The U.S. and Irish Credit Crises: Their Distinctive Differences and Common Features* 4, (Irish Economy Note No. 10, Working Paper No. 10, 2010), available at <http://www.irisheconomy.ie/Notes/IrishEconomyNote10.pdf> (noting that with the seizure of the credit markets following Lehman's collapse Irish banks were unable to refinance their large foreign borrowings and that this problem was compounded by the rapid deterioration of their domestic loan portfolios essentially bringing the entire Irish banking system to its knees).

⁵⁷ Fianna Fáil is a center-right Irish political party.

⁵⁸ O'Leary, *supra* note 47, at 5.

⁵⁹ ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT [OECD], *TAXING WAGES* 21 (2009).

grew faster than GDP every year from 2001 until the onset of the crisis.⁶⁰ In the 2007 budget alone, the government increased social welfare spending by €973 million (\$1.35 billion) and cut taxes by €501 million (\$695 million).⁶¹ Not only did this combination of tax cuts and public spending increases leave the public fiscal health very susceptible to slowdowns in growth, but the Irish means of generating tax revenue also became more dependent on the business cycle.⁶²

Particularly problematic was the Irish government's shift in tax policy from reliable sources of taxation, like income and excise duties, to an increased reliance on cyclical taxes, like corporate tax, stamp duties,⁶³ and capital gains.⁶⁴ "The share of these cyclical taxes reached thirty percent of tax revenue in 2006; in the late 1980s it had amounted to only eight percent."⁶⁵ Although surpluses appeared to be quite large, once adjusted to the business cycle these surpluses were in reality quite small.⁶⁶ Others, including the IMF, estimate that instead of budgetary surpluses during 2005, 2006, and 2007, Ireland actually had structural deficits of 5.4%, 5.7%, and 8.7% respectively.⁶⁷

When a state's revenue source is so heavily dependent on transactional-type taxes, it leaves the country's fiscal situation in a very fragile state when fewer of the taxed transactions take place.⁶⁸ Inevitably, fewer property-related transactions did take place once credit dried up during the liquidity crisis, and state revenue suffered accordingly.⁶⁹

⁶⁰ REGLING & WATSON, *supra* note 15, at 25–27.

⁶¹ Senan Hogan, *Give-away Irish Budget Focuses on Families and First-time Home Buyers*, IRISH NEWS, Dec. 7, 2006, at 12. Particularly shortsighted was the government's decision to double the mortgage interest deduction for first-time homebuyers, thereby perpetuating over-investment in the already inflated residential property market. *Id.*

⁶² Dellepiane & Hardiman, *supra* note 43, at 7–8.

⁶³ A stamp duty applies to "any instrument that is executed in the State or, wherever executed, relates to any property situated in the State or any matter or thing to be done in the State . . ." Stamp Duties Consolidation Act 1999 (Act No.31/1999) §2(1)(b) (Ir.), available at <http://www.irishstatutebook.ie/1999/en/act/pub/0031/index.html>. This effectively means that a tax is levied whenever property is conveyed.

⁶⁴ REGLING & WATSON, *supra* note 15, at 26.

⁶⁵ *Id.*

⁶⁶ *Id.* at 25–27.

⁶⁷ See INT'L MONETARY FUND [IMF], IRELAND: 2009 ARTICLE IV CONSULTATION—STAFF REPORT; AND PUBLIC INFORMATION NOTICE ON THE EXECUTIVE BOARD DISCUSSION, 21–22 (Jun. 2009), available at <http://www.imf.org/external/pubs/ft/scr/2009/cr09195.pdf>.

⁶⁸ Patrick Honohan, *The Irish Banking Crisis Regulatory and Financial Stability Policy 2003–2008*, 29 (unpublished report to the Minister of Finance from the Governor of the Central Bank), available at <http://www.bankinginquiry.gov.ie/Background.aspx>.

⁶⁹ Revenues from stamp duties decreased from €1.65 billion (\$2.29 billion) to €930 million (\$1.29 billion) from 2008 to 2009, a 43.7% drop. DEP'T OF FINANCE (IR.), ANALYSIS OF TAXATION RECEIPTS (2009), available at <http://www.finance.gov.ie/documents/exchequerstatements/2009/taxreceiptdec2009.pdf>.

Ireland's financial situation was completely unsustainable, and the worry about over-dependence on stamp duty as a means of revenue was borne out when those sources of revenue began decline dramatically in 2007.⁷⁰

B. Over-Investment in the Property Market

Ireland, like other Anglo-Saxon economies,⁷¹ has long fostered very high levels of home ownership; 75% of all Irish homes were owner-occupied in 2007.⁷² It was precisely this inclination toward real estate investment that caused the collapse of the Irish economy.⁷³ Before 2001, Irish economic growth was primarily driven by competitive wages and an influx of foreign direct investment.⁷⁴ After 2001, as Ireland's wages began to rapidly outpace GDP growth, its former competitive advantages eroded, and unsurprisingly foreign direct investment correspondingly declined.⁷⁵ During the period between 2001 and 2007, foreign direct investment in Ireland declined dramatically from just under 15% of Eurozone FDI in 2001 to just over 5% in 2007.⁷⁶

During the period when foreign direct investment was falling deeply, the construction sector became an ever-increasing driver of growth in the Irish economy.⁷⁷ By 2007, the construction sector made up 20% of total GDP⁷⁸ and over 12% of the workforce.⁷⁹ Throughout the 2000's, Ireland experienced an asset bubble in property much like the one that occurred in the United States during the same time period.⁸⁰ However, unlike banks in the United States, Irish banks did not invest in exotic financial instruments

⁷⁰ O'Leary, *supra* note 47, at 8.

⁷¹ This term refers to English-speaking economies, whose variant of capitalism is typified by low taxes, minimal regulation and a weak social safety net. This category is thought to include the UK, the US, Australia, New Zealand, Canada and Ireland. *Anglo-Saxon Capitalism*, FIN. TIMES LEXICON, http://lexicon.ft.com/term.asp?t=Anglo_Saxon-capitalism (last visited Nov. 20, 2010).

⁷² CENT. STATISTICS OFFICE (IRELAND), CONSTRUCTION AND HOUSING IN IRELAND 2008 EDITION, 67 (Dec. 2008), available at <http://www.cso.ie/en/media/csoie/releasespublications/documents/construction/current/constructhousing.pdf>.

⁷³ See Morgan Kelly, *The Irish Credit Bubble* 1–2 (Univ. Coll. Dublin Ctr. for Econ. Res., Working Paper No. 32, 2009).

⁷⁴ Editorial, *Ireland's Economy, Threadbare*, ECONOMIST, Nov. 18, 2010, at 85.

⁷⁵ UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, WORLD INVESTMENT REPORT 83 (2005) available at http://www.unctad.org/en/docs/wir2005_en.pdf (FDI into Ireland decreased from \$26 billion to \$9.1 billion between 2003 and 2004).

⁷⁶ See INT'L MONETARY FUND, *supra* note 67, at 9–12.

⁷⁷ Kelly, *supra* note 73, at 13 (noting that between 2001 and 2007, 28% of Irish GNP growth came directly from the construction sector).

⁷⁸ INT'L MONETARY FUND, *supra* note 67, at 4.

⁷⁹ CENT. STATISTICS OFFICE (IRELAND), QUARTERLY NAT'L HOUSEHOLD SURVEY QUARTER 4 2007, at 7, available at http://www.cso.ie/en/media/csoie/releasespublications/documents/labourmarket/2007/qnhs_q42007.pdf.

⁸⁰ Kelly, *supra* note 73, at 11–12.

or engage in complex securitization of mortgage-backed securities, rather the problems lay in “plain vanilla property lending (especially to commercial real estate).”⁸¹

The primary driver in inflating the Irish real estate market was the combination of low interest rates and the availability of personal credit.⁸² This, in turn, was coupled with a tax deduction for mortgage interest and incentive schemes to the construction industry.⁸³ As a result, house-price inflation ensued.⁸⁴ Irish banks engaged in intensified lending in the real estate sector that contributed to the bubble.⁸⁵ Often, banks abandoned their traditional conservative lending ethos in favor of increasingly risky loans.⁸⁶ This can be seen in the emergence in the mid-2000’s of loans with loan-to-value ratios⁸⁷ of up to and over 95%,⁸⁸ which are in stark contrast to the average loan-to-value ratios of 60% in the mid-1990’s.⁸⁹

When it became clear that the Irish economy was overheating, raising interest rates might have been appropriate as a means to deal with the growing asset bubble in Irish real estate.⁹⁰ However, this was impossible due to the centralization of control over monetary policy at the ECB, where concern was directed toward larger economies in the EMU that benefitted from low interest rates.⁹¹ Consequently, Ireland had to manage loss of

⁸¹ REGLING & WATSON, *supra* note 15, at 29.

⁸² Dellepiane & Hardiman, *supra* note 43, at 6.

⁸³ Honohan, *supra* note 68, at 30-31 (noting that by 2006 Ireland was one of only four OECD countries that permitted a mortgage interest deduction without a property tax).

⁸⁴ Jānis Malzubris, *Ireland’s Housing Market: Bubble Trouble*, 5 ECFIN Country Focus Issue 9, Sept. 26, 2008, at 1, 2), available at http://ec.europa.eu/economy_finance/publications/publication13187_en.pdf (noting that between 1992 and 2006 new house prices increased by 300% in real terms and 340% in nominal terms).

⁸⁵ Dellepiane & Hardiman, *supra* note 43, at 6.

⁸⁶ Kelly, *supra* note 73, at 11–12.

⁸⁷ Loan-to-value ratio refers to the percentage of the property’s value that is mortgaged. The ratio is derived by dividing the amount of the mortgage by the value of the underlying property. Joe Wallace, *FHA Loans: What Does LTV Mean?*, FHA NEWS AND VIEWS, <http://www.fhanewsblog.com/2011/06/fha-loans-what-does-ltv-mean/> (last visited Dec. 26, 2011). High loan-to-value ratios are associated with a significant risk of default. See generally, Brent Ambrose & Anthony B. Sanders, *High LTV Loans and Credit Risk*, http://www.uky.edu/~ambrose/Ambrose_Sanders_High_LTV.pdf (last visited Dec. 26, 2011).

⁸⁸ REGLING & WATSON, *supra* note 15, at 32–33.

⁸⁹ David Duffy, *A Note on Measuring the Affordability of Homeownership*, The Econ. and Soc. Research Inst. Quarterly Econ. Commentary, Jun. 26, 2004, at 71–72, http://www.esri.ie/news_events/press_releases_archive/2004/a_note_on_measuring_the_a/index.xml.

⁹⁰ See Timothy A. Canova, *Financial Market Failure as A Crisis in the Rule of Law: From Market Fundamentalism to a New Keynesian Regulatory Model*, 3 HARV. L. & POL’Y REV. 369, 379–81 (2009) (discussing the debating schools of thought on using monetary policy as a means of combating asset bubbles).

⁹¹ Dellepiane & Hardiman, *supra* note 43, at 4–5.

exporting competitiveness through fiscal policy and wage-cost containment.⁹² Due to Ireland's unusually weak formal rules governing its budgetary procedures,⁹³ the Minister for Finance effectively had *carte blanche* when it came to crafting a budget.⁹⁴ The series of ministers in charge of the Department of Finance, from 2001 until the crisis began, displayed no political will to dampen the rapidly overheating property market.⁹⁵ Nothing exemplifies this more than the budgetary philosophy of Charlie McCreevy, Minister of Finance from 1997 until 2004, in his now infamous response when challenged on his large increases in public expenditures—"[w]hen I have it, I'll spend it."⁹⁶

C. Impact of the Fall

After reaching dizzying heights, property prices fell to earth with a thud.⁹⁷ In 2007, property prices nationally declined by 7.3% and by an additional 9.1% in 2008.⁹⁸ Prices fell in commuter counties of Dublin by 16.8%.⁹⁹ The fall in property prices heavily impacted Irish banks, whose domestic loan portfolios constituted as much as 61.2% of their balance sheets.¹⁰⁰ Shares of Anglo Irish Bank, at one time the nation's third largest lender, were trading at €18 (\$25) per share in May 2008. Eighteen months later, they were trading at 1% of that value.¹⁰¹ Unsurprisingly, Anglo Irish Bank was very exposed to the commercial property and construction

⁹² *Id.* at 6.

⁹³ Philip Lane, *A New Fiscal Framework for Ireland* 12–17 (Inst. for Int'l Integration Studies, Discussion Paper No. 315, 2010), available at <http://www.tcd.ie/iiis/documents/discussion/pdfs/iiisd315.pdf> (noting that Ireland has very few rules guiding the Minister for Finance's fiscal decisions, e.g. limits on expenditure growth or budget balance, and that Ireland's fiscal process is not checked by an independent fiscal agency).

⁹⁴ *Id.*

⁹⁵ Sarah Carey, *Ireland Spent the Money—Now It's Time to Pay*, THE TELEGRAPH (LONDON), Apr. 7, 2009, <http://www.telegraph.co.uk/comment/5121005/Ireland-spent-the-money-now-its-time-to-pay.html>.

⁹⁶ *Id.*

⁹⁷ To get a flavor of the effect of the boom, and then bust, in the property market, a home in Churchtown, Dublin was sold in 1997 for €700,000 (\$970,000), in 2006 for €10.5 million (\$14.6 million), and in 2010 was in receivership with an asking price of €3 million (\$4.2 million). Edel Morgan, *Fortunes of D14 House, from Boom to Bust*, IRISH TIMES, Nov. 18, 2010, <http://www.irishtimes.com/newspaper/property/2010/11/18/1224283610270.html>.

⁹⁸ PERMANENT tsb/ESRI HOUSE PRICE INDEX 1996-2011, THE ECON. & SOC. RESEARCH INST., http://www.esri.ie/irish_economy/permanent_tsb_esri_house_p/ (last visited Dec. 26, 2011) (follow link to spreadsheet above contact information).

⁹⁹ *Id.*

¹⁰⁰ INT'L MONETARY FUND, *supra* note 67, at 34 (showing figure representing percentage shares of total outstanding credit for the construction (5.2%), residential mortgage (34.8%) and real estate activity sectors (21.2%)).

¹⁰¹ Caroline Crawford, *Anglo Irish Shares Plummet to New Low of 15 Cent*, EVENING HERALD (IRELAND), Dec. 24, 2008, <http://www.herald.ie/news/anglo-irish-shares-plummet-to-new-low-of-15-cent-1584982.html> (last visited March 3, 2012).

industries, with over 70% of its total loan portfolio being dedicated to those areas.¹⁰²

As a result of the violent bursting of this asset bubble, Ireland's economy has suffered immensely. Ireland's GDP, which grew every year since 1993,¹⁰³ declined by 3.5% in 2008 and is expected to contract by approximately 13.5% from 2008 through 2010.¹⁰⁴ Any growth on the horizon is likely to be painfully slow. GDP in 2011 is only forecasted to increase by just over 1.0%.¹⁰⁵ Inextricably linked to this acute contraction of GDP has been the unemployment rate. The unemployment rate has skyrocketed from 5.6% at the end of the second quarter of 2008 to 14.2% at the end of the second quarter of 2011.¹⁰⁶

To go along with these dismal economic events has been the great human toll that the crisis has taken in Ireland. Emigration, a relic thought to be relegated to the history books, has returned to Ireland. Thirty-five thousand people left the country from January to April 2010 alone and a net 100,000 people are expected to leave the state by April 2012.¹⁰⁷ For a country of approximately 4.2 million,¹⁰⁸ this volume of emigration has a profound impact, both economically and emotionally. Economically, the

¹⁰² REGLING & WATSON, *supra* note 15, at 32.

¹⁰³ GDP Growth (Annual %) Data/Graph: Ireland, WORLD BANK, <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/IE?display=graph> (last visited December 26, 2011).

¹⁰⁴ INT'L MONETARY FUND, *supra* note 67, at 5. To get a concrete idea of this decline, it is estimated that average household wealth in Ireland has decreased by €100,000 (\$138,000) since the end of 2008. Cliff Taylor, *Household Wealth Down €140k Since Peak*, THE SUNDAY BUS. POST ONLINE (Ireland), Sept. 4, 2011, <http://www.sbpost.ie/news/ireland/household-wealth-down-140k-since-peak-58467.html>.

¹⁰⁵ Brian O'Mahoney, *Ernst & Young Cuts 2011 GDP Growth Forecast by 1.7%*, IRISH EXAMINER, Nov. 10, 2010, <http://www.irishexaminer.com/business/ernst-young-cuts-2011-gdp-growth-forecast-by-17-135954.html>.

¹⁰⁶ CENT. STATISTICS OFFICE (IRELAND), LIVE REGISTER NOVEMBER 2011 at 13, *available at* http://www.cso.ie/en/media/csoie/releasespublications/documents/labourmarket/2011/lreg_nov2011.pdf.

¹⁰⁷ Colm Heatley, *Irish Emigration is Forecast to Accelerate, Exceeding Worst Years of 1980s*, BLOOMBERG, Jan. 19, 2012, <http://www.bloomberg.com/news/2011-01-20/irish-emigration-is-forecast-to-accelerate-exceeding-worst-years-of-1980s.html>. Although many of the emigrants are not Irish nationals, but rather non-national immigrants who are leaving the country, since 2010 the majority of emigrants have been Irish nationals. CENT. STATISTICS OFFICE (IRELAND), POPULATION AND MIGRATION ESTIMATES APRIL 2011 at 4, *available at* <http://www.cso.ie/en/media/csoie/releasespublications/documents/population/current/Population%20and%20Migration%20Estimates%20April%202011.pdf>.

¹⁰⁸ CENT. STATISTICS OFFICE (IRELAND), POPULATION 1901-2006, *available at* http://www.cso.ie/Quicktables/GetQuickTables.aspx?FileName=CNA13.asp&TableName=Population+1901+-+2006&StatisticalProduct=DB_CN.

loss of the young, educated workforce impacts economic recovery.¹⁰⁹ Emotionally, it brings up the history of Irish emigration¹¹⁰ that is strongly linked with “national shame.”¹¹¹ Moreover, the Irish landscape is littered with over 2000 “ghost estates”—completed or partially completed planned residential estates that are mostly vacant—that serve as a very visual reminder of the country’s recent economic past.¹¹²

IV. THE IRISH RESPONSE TO THE FINANCIAL CRISIS

After the financial crisis hit in September 2008, Ireland, like most countries, acted quickly in an effort to stem further losses in a rapidly deteriorating situation. On October 2, 2008, the government raised deposit protection up to €100,000 (\$139,000) to shore up market confidence in Irish banks.¹¹³ Many of the measures undertaken by the government were adopted in haste and without the usual deliberation that attends massive changes in public spending and banking regulation because of the extreme stress placed on financial markets.¹¹⁴ It may be unfair to judge these measures in the harsh light of day because of the conditions under which they were made; however an assessment must be made of what the government has done to date in order to make provisions for the future. As the expression goes, if we do not understand history then we are doomed to repeat it.

A. Bank Guarantees and Implementation of NAMA

In a drastic move to shore up confidence in the banking sector, the Irish Government moved to guarantee all depositors in Irish banks in 2008.¹¹⁵ The assets covered by this guarantee amounted to approximately

¹⁰⁹ Although the data is preliminary, persons aged 15–24 make up almost half of Irish emigrants since 2008. CENT. STATISTICS OFFICE (IRELAND), POPULATION AND MIGRATION ESTIMATES APRIL 2011 at 6, *available at* http://www.cso.ie/en/media/csoie/releases_publications/documents/population/current/Population%20and%20Migration%20Estimates%20April%202011.pdf.

¹¹⁰ Guy Chazan, *Irish Remedy for Hard Times: Leaving*, WALL ST. J., Feb. 24, 2011, at A1, *available at* <http://online.wsj.com/article/SB10001424052748703803904576152422920009948.html> (noting that emigration is to the Irish as inflation is to the Germans—an historic economic trauma that is fixed in the national psyche).

¹¹¹ Editorial, *Ireland's Crash - After the Race*, ECONOMIST, Feb. 17, 2011, <http://www.economist.com/node/18176072>.

¹¹² Olivia Kelly, *Building Slowdown Stalls Attempt to Complete 2,000 'Ghost' Estates*, IRISH TIMES, Oct. 14, 2011, <http://www.irishtimes.com/newspaper/ireland/2011/1014/1224305756663.html>.

¹¹³ Killian Kehoe, *Ireland—Responses to the Financial Crisis*, 2009 EUR. ST. AID L. Q. 126, 126-27 (2009).

¹¹⁴ *Id.*

¹¹⁵ Neil Shah et al., *Ireland, France Aid Banks, As Jitters Go Global*, WALL ST. J., Oct. 1, 2008, at A1.

€365 billion (\$506 billion), several times the country's GDP.¹¹⁶ This measure was designed to help ease Irish banks' immediate short-term liquidity concerns stemming from the bankruptcy of Lehman Brothers.¹¹⁷ In spite of the government's explicit backing, market confidence in the banking sector continued to deteriorate throughout 2008.¹¹⁸ In December 2008, as losses continued to mount, the government agreed to inject €5.5 billion (\$7.6 billion) into Ireland's three largest banks, Bank of Ireland, Allied Irish Bank and Anglo Irish Bank.¹¹⁹ In return for this capital infusion, the state took a 25% stake in Bank of Ireland and Allied Irish Bank and a 75% controlling interest in Anglo Irish Bank.¹²⁰ In January 2009, the government outlined plans to nationalize Anglo Irish Bank, a particularly reckless commercial lender that was dubbed the "world's worst bank,"¹²¹ on the grounds that its failure would pose a systemic risk to the Irish financial system.¹²²

In an effort to clean up banks' balance sheets and reorganize the financial sector, the Irish government passed legislation to create the National Asset Management Agency (NAMA) in April 2009.¹²³ NAMA was designed to restructure the banking sector by buying up bad debt from six Irish financial institutions in exchange for Irish government bonds.¹²⁴ The Agency is authorized to buy property-development assets with a book value of up to €90 billion (\$124.8 billion).¹²⁵

Criticism for the plan has come from many quarters, including Joseph Stiglitz, prominent economist and Nobel Prize winner, who argues that NAMA squanders taxpayers' money by substantially overpaying for essentially worthless loans.¹²⁶ Underlying Stiglitz's criticism is the

¹¹⁶ Honohan, *supra* note 68, at 19.

¹¹⁷ *Id.*

¹¹⁸ Niamh Brennan, *Reputation of Ireland Inc is Under Spotlight After Resignations*, IRISH TIMES, Dec. 20, 2008, at 19.

¹¹⁹ *Review of the Year*, SUNDAY BUSINESS POST (IR.), Dec. 28, 2008.

¹²⁰ *Id.*

¹²¹ Michael Lewis, *When Irish Eyes Are Crying*, VANITY FAIR, Mar. 2011, at 174, available at <http://www.vanityfair.com/business/features/2011/03/michael-lewis-ireland-201103> (quoting Theo Phanos, a British hedge fund manager with interests in Ireland).

¹²² Colm Keena & Harry Magee, *Government Nationalises 'Fragile' Anglo Irish Bank*, THE IRISH TIMES, Jan. 16, 2009, at 1.

¹²³ National Asset Management Agency Act 2009, (Act No. 34/2009)(Ir.), available at <http://www.attorneygeneral.ie/eAct/2009/a3409.pdf>.

¹²⁴ Frank McDonald, *Bad Debt Agency May Be Scaffold for Property Developers*, THE IRISH TIMES, Apr. 4, 2009, at 6. The plan is quite similar to the original concept of the U.S. Troubled Asset Relief Program, which was initially conceived of as a means to remove toxic securities from U.S. banks' balance sheets. See Editorial, *The Tale of TARP*, WASH. POST, Oct. 3, 2010, at A18.

¹²⁵ INT'L MONETARY FUND, *supra* note 67, at 16.

¹²⁶ Louisa Fahy & Simone Meier, *Government 'Squandering' Money in Bank Bailout Plan*, IRISH INDEPENDENT, Oct. 7, 2009, <http://www.independent.ie/business/irish/>

difficult question of how to price these property-related assets for which there is not a liquid market. If NAMA overpays for the assets it will be at substantial cost to taxpayers. However, if the NAMA aggressively negotiates down the value of these assets banks may become insolvent once again, thereby undermining the purpose of the entire endeavor, namely, to ensure the soundness of bank balance sheets.¹²⁷ Even after NAMA had started buying up the “bad assets” from Irish banks, losses at these institutions have been larger than initially anticipated and the government may have to inject yet more capital directly into these banks.¹²⁸ In 2010, Anglo Irish Bank recorded a pretax loss of €17.6 billion (\$24 billion)—the largest corporate loss in Irish history.¹²⁹ Alan Dukes, a former minister for finance and current chairman of Anglo Irish Bank, claims that total losses in the Irish financial sector may amount to over €100 billion (\$139 billion) and require an additional €50 billion (\$69.5 billion) injection of capital to insure a stable banking core.¹³⁰

B. Austerity Measures

After expending massive state resources into failing banks and with its public finances in serious decline, it was not entirely surprising that Standard & Poor's downgraded Ireland's credit rating from AAA to AA+ in April, 2009.¹³¹ Utilizing a government stimulus as a means to jumpstart economic growth became unfeasible with Ireland's rising budget deficits.¹³² As a result, the Irish government was forced to undertake severe cuts in the public sector wages and to institute tax increases as the sole means of bringing public finances back in order and convincing the market that it was serious about tackling its debt issues.¹³³

The government announced an emergency budget in April 2009, in

government-Isquosquanderingsquo-money-in-bank-bailout-plan-1906787.html.

¹²⁷ See Kelly, *supra* note 73, at 13–20.

¹²⁸ Editorial, *The euro zone's trouble spots: The bottomless bail-out; Ireland counts the rising cost of rescuing its banks*, ECONOMIST, Sept. 30, 2010, at 79, <http://www.economist.com/node/17155947>.

¹²⁹ Joe Brennan, *Anglo Irish Expects 2010 Loss of 17.6 Billion Euros*, BLOOMBERG, Feb. 8, 2011, <http://www.bloomberg.com/news/2011-02-08/anglo-irish-bank-sees-2010-loss-of-24-billion-most-in-country-s-history.html>.

¹³⁰ *Id.*

¹³¹ Barry O'Halloran, 'Credible Framework' Needed to Tackle Crisis, IRISH TIMES, Apr. 1, 2009, at 18. Since April 2009 Standard & Poors has downgraded Ireland's debt several times, and as of August 2011 S&P rated Irish debt at 'BBB+/A-2' or just above junk bond status. *S&P Affirms Ireland's Rating*, IRISHTIMES.COM, Aug. 5, 2011, <http://www.irishtimes.com/newspaper/breaking/2011/0805/breaking18.html>.

¹³² Stephanie Flanders, *When Fiscal Stimulus Isn't Stimulating*, STEPHANOMICS (Apr. 7, 2009, 7:14 PM), http://www.bbc.co.uk/blogs/thereporters/stephanieflanders/2009/04/when_fiscal_stimulus_isnt_stim.html.

¹³³ Editorial, *The Party is Definitely Over: How Wage Cuts and Tax Rises Might Preserve the Gains of Ireland's Celtic Tiger Years*, ECONOMIST, Mar. 21, 2009, at 51.

which it cut €1.8 billion (\$2.5 billion) from the public budget and placed a 7% levy on pensions and an income levy on all tax brackets.¹³⁴ These measures were intensified in the year-end budget as public sector pay was cut by 5-8% for those making less than €125,000 (\$173,000) and up to 15% for those making more than €125,000 (\$173,000).¹³⁵ These cuts were unilaterally imposed on public sector workers without consultation with public sector trade unions. Unsurprisingly, these cuts were met with harsh criticism from trade unions that threatened widespread industrial action as a result of the proposed cuts.¹³⁶

The government, working in conjunction with trade union groups, eventually achieved a compromise in the “Croke Park Agreement,” with the government offering assurances that there would be no more pay cuts in return for active implementation of public sector reform measures.¹³⁷ Although an agreement was eventually reached, it is clear that the long-standing “Social Partnership”¹³⁸ agreements between trade unions, business leaders, and the Irish government had collapsed.¹³⁹ In spite of industrial strife, and in contrast to other European nations facing similar painful cuts and tax increases, Ireland did not experience large-scale violent protests like those seen in Greece in 2010.¹⁴⁰

V. SUGGESTED MEASURES TO IMPROVE IRELAND’S LONG-TERM FISCAL HEALTH

Ireland is in a dire fiscal condition, and there are no easy answers to remedy its current balance sheet problems and its issues with raising capital from the bond markets. Many of the immediate issues will likely be addressed by an emergency loan from the EFSF, the IMF, or some combination of the two.

Some commentators, most vocally David McWilliams, an Irish economist and social critic, have suggested that the best approach for Ireland to take would be to leave the EMU and return to floating its

¹³⁴ *Ireland Unveils Emergency Budget*, BBC NEWS, Apr. 7, 2009, <http://news.bbc.co.uk/2/hi/business/7986862.stm>.

¹³⁵ Editorial, *Ireland’s Budget: Hard Times*, ECONOMIST, Dec. 10, 2009, at 58.

¹³⁶ Padraic Halpin, *Irish Unions to Strike Against Budget Cuts*, REUTERS (UK) (Mar. 8, 2010, 5:48 PM) <http://uk.reuters.com/article/idUKTRE6273AI20100308?pageNumber=1>.

¹³⁷ Dellepiane & Hardiman, *supra* note 43, at 18.

¹³⁸ Begun in the mid-1980s, “Social Partnership” was a series of tripartite agreements between the “social partners,” namely the Irish Government, trade unions, and employers to stimulate the economy through wage moderation and lower taxation. *See generally* History of INOU in Social Partnership, THE IRISH NAT. ORG. OF THE UNEMPLOYED, <http://www.inou.ie/policy/partnership/historyofinouin.html>.

¹³⁹ Martin Wall, *End of Social Partnership Can Liberate Unions*, IRISH TIMES, Jan. 18, 2010, at 6.

¹⁴⁰ Dan Bilefsky, *3 Reported Killed in Greek Protests*, N.Y. TIMES, May 5, 2010, at A6.

currency independently.¹⁴¹ McWilliams' posits that if Ireland dropped the Euro, it would be able to devalue its own currency.¹⁴² These commentators contend that once its currency is devalued in relation to the currencies of its main trading partners, Ireland will be able to export its way back to economic growth.¹⁴³

This is certainly a drastic measure, and whatever its purported economic benefits, it would be very difficult to push through the political process. Any attempt to leave the EMU would likely require a national referendum, and thus require a majority of public support.¹⁴⁴ However, even after rejecting the Treaty of Lisbon in 2008,¹⁴⁵ the Irish public still had the second most positive view of the EU of all member states.¹⁴⁶ Ireland's abandonment of the EMU would be detrimental to the country's long-term economic health because it would risk marginalizing the country within Europe. Also, the debt that Ireland currently owes to external creditors is denominated in Euros. Thus, even if Ireland were to leave the EMU and devalue its own currency in an effort to kindle growth, the servicing of its Euro debt would become tremendously more expensive.¹⁴⁷

Leaving the Euro would likely harm Ireland's long-standing relationships with its European trading partners and weaken Ireland's

¹⁴¹ See David McWilliams, *Should We Divorce the Euro?*, THE DAILY BUSINESS POST, Jan. 10, 2010, <http://www.sbpost.ie/commentandanalysis/should-we-divorce-the-euro-46642.html> (arguing that Ireland was never a proper fit for a monetary union with the EU to begin with on the grounds that the currency union forced Ireland to attempt to be more competitive than Germany as an exporter, something that Ireland could not achieve). Note also that Ireland sends the majority of its exports, not to other Euro countries, but to the UK, the US, and the rest of the world. CENT. STATISTICS OFFICE (IRELAND), *Main Trading Partners 2010*, available at <http://www.cso.ie/en/statistics/externaltrade/maintradingpartners-2010m/>.

¹⁴² McWilliams, *supra* note 141.

¹⁴³ *Id.*

¹⁴⁴ See *Crotty v. An Taoiseach*, [1987] I.R. 713 (Ir.).

¹⁴⁵ See *Q&A: The Lisbon Treaty*, BBC NEWS (Jan. 17, 2011, 10:42AM), <http://news.bbc.co.uk/2/hi/europe/6901353.stm> (The Treaty of Lisbon is an amending treaty to the pre-existing EC treaties designed to streamline EU institutions after the ascension of 10 additional members in 2004); see also, Editorial, *Ireland and the Lisbon Treaty: Second Time Lucky?*, ECONOMIST, Oct. 2, 2009, <http://www.economist.com/node/14573513> (arguing that Ireland rejected the Treaty of Lisbon in 2008, due to concerns that the treaty could impinge Irish sovereignty on issues such as neutrality, internal taxation rates, and abortion; as well as Ireland's own proportional representation in EU institutions under the proposed Treaty).

¹⁴⁶ Colm Kelpie, *Ireland's EU Love Affair Feels Strain; Survey*, MIRROR (IRELAND), Feb. 18, 2009, at 14. Even though the Irish public's view of the EU remains favorable, there has been a marked uptick in the percentage of people who hold a negative view of the EU and its benefit to Ireland since the beginning of the financial crisis. *Id.*

¹⁴⁷ Bagehot's Notebook, *Tin-eared Tories*, ECONOMIST, (Nov. 22, 2010, 6:52 PM), http://www.economist.com/blogs/bagehot/2010/11/euro_crisis.

already shaky political standing in the EU.¹⁴⁸ Furthermore, there is a possibility that if Ireland leaves the Euro, other countries may follow.¹⁴⁹ Taking this line of reasoning to its logical extreme, it is possible that the entire Eurozone would collapse. This would wreak untold havoc on financial markets and could have a disastrously destabilizing effect on the global economy, potentially driving the world back into recession. This may seem improbable, but if we have learned anything from the turmoil in the financial markets in the past few years, it is to expect the unexpected and plan for the worst accordingly.

Changes in banking regulation and a major overhaul in tax policy are two areas where the Irish government can lessen the risk of future domestic crises. This, by itself, is not enough to ensure the future economic health of the EMU member states or the viability of the Euro itself. The EU should create a supranational structure designed to assess systemic risk and provide for checks when those risks arise. Moreover, integrated into this institution should be a mechanism to provide lines of credit for fiscally distressed member states.

A. Regulatory Reform of Banking

As pointed out above, Irish banks were at the heart and center of the crisis in Ireland.¹⁵⁰ It would be utterly fruitless to attempt to undertake any other reform measures without first addressing banking regulation. At least some of the failure of the Central Bank & Financial Services Authority of Ireland (CBFSAI), the regulator responsible for overseeing financial institutions in Ireland, can be attributed to its dual mandate as regulator and promoter of the financial services industry in Ireland.¹⁵¹ This dual role creates an inherent conflict of interest between ensuring that financial institutions are fundamentally sound, and shying away from attracting negative attention to the financial industry. A recent report commissioned by the Minister of Finance summarizes this awkward situation by pointing out that “[b]anks and building societies were seen as important institutions deserving appropriate respect and threats of action by the FR [Financial Regulator] in the absence of compliance were not typically part of the

¹⁴⁸ See Martin Feldstein, *Leaving the Eurozone*, WORLD FIN., Dec. 18, 2009, <http://www.worldfinance.com/news/contributors/feldstein>.

¹⁴⁹ There are signs that other EMU countries including Portugal, Greece, and Italy may be inclined or forced to leave the Eurozone. See Axel Bugge, *Minister Says Portugal Could be Push Out of Euro*, REUTERS (UK), Nov. 13, 2010, <http://uk.reuters.com/article/idUKTRE6AC1OD20101113>; Desmond Lachmond, *Why Greece Will Have to Leave the Eurozone*, FIN. TIMES, Jan. 11, 2010, <http://www.ft.com/cms/s/0/c1236fbc-f41e-11df-886b-00144feab49a.html#axzz15xYjosjN>.

¹⁵⁰ See *supra* Part III.

¹⁵¹ Honohan, *supra* note 68, at 44.

process.”¹⁵²

A key part of this compliance problem is the system of banking regulation that the CBFSAI operated under, namely the “principles-based” approach.¹⁵³ The potential for reckless abuse and the risks of regulatory capture would have been lessened had the CBFSAI been operating the less flexible “rules-based” system. Under the principles-based system, a regulator announces certain broad-based principles, which financial institutions must adhere to.¹⁵⁴ This is contrasted with a “rules-based” system where detailed rules set out clearly what must be done and what will happen in the event that rules are not followed.¹⁵⁵ These systems have their own individual merits and drawbacks. The principles-based approach gives more flexibility to regulators about when to pursue enforcement, and it encourages financial institutions and regulators to work to achieve a particular result.¹⁵⁶ The advantage under the rules-based approach is precisely the opposite of the principles-based approach. It removes discretion from a regulator to decide when rules have been breached and lessens the degree to which regulators and financial institutions work collaboratively.¹⁵⁷ The rules-based approach is appropriate when there is a fear that regulators will not diligently enforce stated principles.

The principles-based approach is entirely dependent on voluntary enforcement by the regulator, which works well when that institution creates a reputation for stringent enforcement of the stated principles. However, when such a vigilant approach is lacking, as it was in the CBFSAI, it signals to financial institutions that they have free reign to proceed as they wish, irrespective of the stated principles. Part of this laxness may be attributable to the familiarity between regulators and senior executives at financial institutions and a desire to avoid inflicting embarrassment on one’s acquaintances, which may be inevitable given Ireland’s size.¹⁵⁸

Due to the harm caused by this coziness between regulators and bank executives, it seems that a move to a more rules-based system would be the best approach to banking regulation in the future. If the discretion to enforce proper banking practice and discourage risky lending is removed

¹⁵² *Id.* at 55.

¹⁵³ *Id.* at 43.

¹⁵⁴ See FINANCIAL SERVICES AUTHORITY, PRINCIPLES BASED REGULATION: FOCUSING ON THE OUTCOMES THAT MATTER (2007), available at www.fsa.gov.uk/pubs/other/principles.pdf.

¹⁵⁵ See James Surowiecki, *Parsing Paulson*, THE NEW YORKER, Apr. 28, 2008, http://www.newyorker.com/talk/financial/2008/04/28/080428ta_talk_surowiecki.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ This attitude is borne out by a recent quote from an Irish business leader who stated, “[t]here is a culture of ‘I can’t slam people, because I know them’.” *Ireland’s Economy*, Threadbare, *supra* note 74.

from the regulator's control, those rules are more likely to be followed and enforced. Although there are drawbacks to a rule-based system, namely, that industries subject to the system expend substantial resources attempting to evade the rules,¹⁵⁹ the alternative is worse. Furthermore, the dual mandate of the CBFSAI should be eliminated, as there is an inherent conflict in responsibility to promote an industry and enforce regulations upon that same industry. If there is to be a state-sponsored champion for promotion of the Irish financial sector, this responsibility should be placed in a totally separate development agency, such as the Irish Industrial Development Authority or a wholly new independent agency created specifically for this purpose. As noted above, the alternative is what Ireland has seen in the last two years, where the close ties between the political and business elites ensure that banks do not fear regulators and take on a disproportionate amount of risk.

Although this comment will not go into detail as to the types of rules Ireland should enact, there is a broad consensus that requiring banks to maintain a high capital reserve-to-loan ratio encourages a more conservative lending ethos.¹⁶⁰ However, in order for such a requirement to be truly effective, it will be necessary to coordinate an EU-wide measure to raise capital reserves. If the measure is not EU-wide then there is a risk that banks will relocate to other European states to take advantage of looser capital requirements. Furthermore, having higher capital requirements in relation to other European states may discourage increasing competition for banking services in Ireland.

B. Readjustment of Tax Code in Favor of Counter-cyclical Revenue Sources

One of the primary reasons Ireland's fiscal health changed from large surpluses to extreme deficits so quickly is that the Irish government relied too heavily on cyclical revenue sources, stamp duties in particular.¹⁶¹ When those property transactions dried up, so did tax revenue. The state needs to shift its revenue base from a pro-business cycle approach to one that provides a more consistent source of revenue. An annually levied property tax would have the dual benefit of providing a dependable stream of tax revenue and dissuading future over-investment in property. Although such a move would undoubtedly be very unpopular with the Irish public, desperate times call for necessary measures. The Government can use the crisis as an opportunity to implement drastic changes. To quote Rahm

¹⁵⁹ Honohan, *supra* note 68, at 47 (noting the amount of human ingenuity poured into attempting to evade Canada's complex rules regarding capital gains taxation).

¹⁶⁰ See generally Patricia Jackson et al., *Capital Requirements and Bank Behaviour: The Impact of the Basle Accord* (Basle Comm. on Banking Supervision, Working Paper No.1, 1999).

¹⁶¹ O'Leary, *supra* note 47, at 18–19.

Emmanuel, “[n]ever allow a crisis go to waste.”¹⁶² When the economy eventually improves, the impetus to impose such a tax will likely evaporate.

Along similar lines, the existing mortgage interest deduction should be gradually phased out. Like the absence of a property tax, this deduction distorts the market by providing incentives to invest in property over other types of investment. The deduction also raises a horizontal fairness question, namely, why should the state subsidize homeowners over similarly situated groups like renters? Moreover, the deduction, like deductions generally, disproportionately benefits wealthier individuals.¹⁶³

C. Creation of an EU Institution Responsible for Systemic Risk

Throughout much of the sovereign debt crisis that has ravaged Europe since 2008, the EU has been notable not for its action but for its inactive and reactive approach.¹⁶⁴ The Euro was set up to centralize control of interest rates in the ECB, but the EMU left fiscal policy to the member states.¹⁶⁵ As a result, there was no supranational means of providing credit to struggling member states that were in extreme fiscal distress. This became very clear when Greece had to be bailed out in the spring of 2010.¹⁶⁶ The EU did eventually act, however its policies on the sovereign debt crisis were made on an ad hoc basis.¹⁶⁷

At its inception, the SGP only provided for a small range of policy measures to deal with member states' fiscal deficits.¹⁶⁸ Most of these measures did not apply to Ireland, however. In the years immediately preceding the crisis, Ireland's fiscal situation fell squarely within the constraints set by SGP. However, a probing analysis would have revealed that public finances were on shaky economic ground. As a result, Ireland's dangerous financial condition continued unchecked by the EU because it followed the letter of law—deficits within 3% of GDP¹⁶⁹—even though it ignored the spirit of the law by making public finances particularly vulnerable to changes in the business cycle.¹⁷⁰

¹⁶² Jeff Zeleny, *Obama Weighs Quick Undoing of Bush Policy*, N.Y. TIMES, Nov. 9, 2008, at A19.

¹⁶³ See Edward L. Glaeser & Jesse Shapiro, *The Benefits of the Home Mortgage Interest Deduction 2* (Harv. Inst. Econ. Res., Paper No. 1979, 2002), available at <http://www.economics.harvard.edu/pub/hier/2002/HIER1979.pdf>.

¹⁶⁴ Anne Seith, *EU Too Slow to Provide Answers in Financial Crisis*, DER SPIEGEL (INT'L), Oct. 6, 2008, <http://www.spiegel.de/international/europe/0,1518,582526,00.html>.

¹⁶⁵ Dellepiane & Hardiman, *supra* note 43, at 4–5.

¹⁶⁶ *Id.* at 19.

¹⁶⁷ *Id.*

¹⁶⁸ O'Leary, *supra* note 47, at 9.

¹⁶⁹ Jim O'Leary, *The Stability and Growth Pact: A Fiscal Framework Whose Time Has Come?*, Budget Perspectives 2011 at 18-20, (Econ. and Soc. Res. Inst., Research Series 18, 2010), available at <http://www.esri.ie/UserFiles/publications/RS18/RS18.pdf>.

¹⁷⁰ O'Leary, *supra* note 47, at 15–16.

Even the policies that the EU could implement to ward off fiscal irresponsibility were seldom used prior to 2008 even though member states like France and Germany routinely ran deficits in those years.¹⁷¹ The effectiveness of these “punishments” from the EU is unclear, given that violations of the SGP are ignored by Germany and France.¹⁷² As the Irish parliamentary committee on European affairs noted:

By late 2003 it became clear that their deficits were continuing to rise and that neither France nor Germany would meet their targets. Neither Member State faced sanction due to this non-compliance. These cases pointed to obvious credibility and enforcement problems for the SGP. If the two largest euro area economies fail to comply with the rules then why should smaller countries do so?¹⁷³

All this points to necessary changes in the enforcement of the SGP. When the EU decided that it wanted to create a single currency for Europe, it is clear that it did not envisage member states becoming insolvent. As a result, it did not provide measures to prevent or deal with a worst-case scenario, like a member state’s severe fiscal crisis requiring a bailout by the EU. Such measures could have prevented or at least mitigated the effects of the recent crisis.

The role of enforcing the SGP is currently held by the Economic and Financial Affairs Council (ECOFIN),¹⁷⁴ a subgroup of the Council of the European Union. The Council is made up of ministers of finance from the twenty-seven member states.¹⁷⁵ ECOFIN is the wrong entity to be responsible for imposing sanctions for violations of the SGP due its inherently political composition. As politicians, the ministers are unlikely to advocate for harsh sanctions or politically unpopular changes to other nations’ public finance. The EU should create an independent regulator responsible for enforcing the SGP and monitoring systemic risk among European financial institutions. This power could be rolled into the existing functions of the ECB, much like the Federal Reserve is set to become the regulator for systemic risk in the United States.¹⁷⁶ The ECB possesses experience and knowledge of international finance that make it the

¹⁷¹ *Id.*

¹⁷² *Id.* at 9–10.

¹⁷³ HOUSES OF THE OIREACHTAS, JOINT COMM. ON EUROPEAN AFFAIRS, EUROPEAN MONETARY UNION: CHALLENGES AND OPTIONS 6 (2010), available at <http://euaffairs.ie/>.

¹⁷⁴ O’Leary, *supra* note 47, at 9.

¹⁷⁵ Banque de France, The ECOFIN and the Informal ECOFIN Councils (2006), available at <http://www.banque-france.fr/gb/eurosys/telechar/europe/04-409ECOFIN-GB.pdf>.

¹⁷⁶ See MARC LABONTE, CONG. RESEARCH SERV., RL 41384, THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT: SYSTEMIC RISK AND THE FEDERAL RESERVE (2010), available at <http://www.llsdc.org/attachments/files/240/CRS-R41384.pdf>.

appropriate body to perform such a function.

As an ancillary function, this institution should also provide credit to member states that are undergoing severe fiscal stress. The advantage of having a permanent emergency credit institution is that the Eurozone will not run into the problems that it experienced with the Greek bailout. Such an institution could set conditions precedent to accessing credit and attach previously agreed-upon terms to accessing states. This would provide a more orderly and timely means to provide credit in emergency situations.

VI. CONCLUSION

If we have learned anything from the financial crisis that precipitated the Great Recession, it is that markets and policy makers have short memories. To counter this effect, proper institutional structures ought to be put into place to correct for irrational exuberance of the type witnessed in Ireland in the past decade. Ireland is an example of the disastrous consequences that may follow if corrections are not made. Although mass emigration may be a problem specific to Ireland, budget deficits, banking crises, and unsustainable public debt loads are not exclusive to Ireland.

Further, the EU needs to implement changes to its structure and enforcement of the SPG in order to provide for substantive preventive measures to avoid fiscal disaster by member states. It also needs to provide credit for member states in the event of budgetary crises. The current system is too political, as it ignores the discrepancies of larger member states and enforces sanctions in an uneven and unpredictable manner. It makes much more sense for the role of surveyor of member states' fiscal health to be occupied by an essentially apolitical body, like the ECB.

Ireland's recent travails present a learning opportunity for the global economy, especially emerging markets. Since its emergence in the mid-1990s, economists and policy makers have touted Ireland's economic model as a paragon of development and as a template for other small developing nations. Ireland is no longer the poster-child for developing nations; however, there is a risk of throwing the baby out with the bath water by focusing solely on Ireland's recent fiscal crisis. The past twenty years of Ireland's economic history can be broken down into two distinct phases: the late 1980s until approximately 2001, and from 2001 or so onward. The former phase represented real and sustained economic development based on fundamentally sound principles, whereas the latter stage was an attempt to continue rapid economic growth, even though most of the gains from structural economic reform had already been realized. The result should have been sustained, albeit slower, growth; however what emerged was a reckless property boom and bust.

In spite of its current position, Ireland still has better economic prospects than other debt-riddled EU countries like Greece and Portugal, precisely because of investments in the education of its populace and the

reforms undertaken in the first phase of the Celtic Tiger. In that sense, Ireland's rise and subsequent fall presents a more complete picture of economic development and a cautionary tale to policy makers in similarly situated nations.