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# Economic Crisis and the Politics of Austerity in Ireland

By Niamh Hardiman

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The countries of the Eurozone periphery – Greece, Ireland, Portugal, and Spain – tend to be grouped together because of the severity of the crisis they have experienced since 2008, and because the first three of these are now in EU-IMF loan programmes. All are now required to implement fiscal retrenchment to address their government deficits. While the Greek sovereign debt crisis dominates the news in summer 2011, what is often overlooked is that Ireland's is a very different kind of crisis, and that Spain and Portugal are rather more like Ireland than they are like Greece.

Despite its massive accumulated debt – which has grown from 25% of GDP in 2007 to a projected 120% of GDP in 2014 – Ireland's main problems at the moment do not stem primarily from poor management of the public finances (though many weaknesses can certainly be identified in hindsight), but rather from the collapse of the banking system (Dellepiane and Hardiman, 2011). It was the private rather than the public sector that engaged in a surge of borrowing in the wake of the low interest rate regime instituted by the Euro. This also meant that other European banks, especially German and French, are now very exposed to the fragile banking sectors of the peripheral economies, greatly increasing the interdependencies within the European financial system. The problem was greater in Ireland than elsewhere, where the so-called light touch regulatory regime to which Ireland was committed, along with Britain, turned out in effect to mean little or no regulation at all. In a small society in which personal connections were highly valued, close links developed between the banks, property developers, builders, and the dominant political party (Fianna Fáil) that had been in power since 1997. The massively over-extended Irish banks had very little involvement in the complex trading products that were the undoing of the major US financial institutions. As three official investigations have now confirmed, theirs was a 'plain vanilla' problem of over-lending on over-priced assets during a boom. Regulatory oversight

and risk assessment had been scaled back, by domestic as well as foreign-owned institutions. A form of group-think or herd mentality set in which allowed them to believe that property values could never fall and that irrational exuberance would end in a soft landing.

This is not to overlook the fact that there is also a sizeable deficit in the public finances in Ireland as well, and indeed public spending is estimated to exceed public revenues by about 40% in the current year. The collapse of the building industry and the dearth of credit in the economy choked off growth, and exposed the degree to which surging public spending commitments had been dependent on cyclical revenue sources. As in the other peripheral economies of the Eurozone experiencing asymmetric shock, revenues slowed while automatic stabilizers pushed spending up; just as one might expect, a gap opened up in the government's budget. But in Europe's monetary union, ongoing fiscal imbalances are not permitted. In October 2008, the European Commission launched excessive deficit procedures for Ireland, Greece, Spain, France, Latvia and Malta, under the Euro Stability and Convergence Programmes (SCPs). From a small surplus in 2007, the Irish deficit was estimated at 6.3% GDP in 2008, and was expected to widen to 9.5% in 2009; it was required to reduce this to below 3% by 2014. In 2010, Ireland's recorded fiscal deficit was 32%, mainly due to the obligation government had assumed to rescue the banks; but the public component was still over 12%. This is not due to any failure on the part of Irish government to engage fully with fiscal stabilization measures. From the outset, it accepted the imperative to reduce the deficit, and has engaged vigorously in adjustments that rely on spending cuts and revenue increases in a ratio of about two to one. Indeed, it has done this pre-emptively, and has been praised as a very model of government commitment to regaining market credibility. Ireland has already made very significant fiscal adjustments: between 2008 and 2014, on current projections, a total of €30bn will have been taken out of the economy, two-thirds through spending cuts. This is equivalent to about 18% of the total GDP of 2010, or 22% of GNP.

However, in current circumstances, the prevailing orthodoxies about how the politics of credibility works do not match the experiences of countries that have tried it. There is no crowding out of investment opportunities that needs to be curbed, and investor confidence is not at issue. Public spending cuts have even damaged the credibility of governments' borrowing capacity, as the ratings agencies have responded to cuts with downgraded credit ratings, arising from the probability that economic growth will be dampened. Growth in Ireland has been negative for three consecutive years. Government reported in Budget statements that the massive fiscal effort was stabilizing the deficit, but projections of the effort required to reduce it, and of the total debt accumulated as a result, continued to increase.

The dual experiences of an economic shock and a banking crisis would be difficult to manage for any government. The option of postponing retrenchment, let alone engaging in expansionary measures, is not only politically constrained, but has little credibility in Ireland in view of prior experiences in the 1970s and 1980s. The constraints on Irish government options come from another source, which is the tension between politics and markets not only nationally but internationally. The transnational consequences of monetary union escape effective regulation and management by national politics, but the international governance of monetary union is only partially institutionalized at European level (O'Rourke, 2011). Domestic decision-making must engage with what Vivien Schmidt has called the 'unfinished architecture' of European integration (Schmidt, 2010). European Union politics may be thought of as having a range of equilibrium points involving the assorted actors and institutions affected by the crisis. The politics of austerity in the European periphery is not necessarily the optimal strategy for resolving the various issues that need to be addressed. But it is the one that is politically possible at the European level at the moment (Dellepiane and Hardiman, 2010). What is not so clear is whether and for how long this new politics of austerity will be sustainable in Ireland.

The President of the European Central Bank, Jean-Claude Trichet, recently restated his views about how best the stability of the Euro is to be ensured: 'We emphasise the three pillars necessary for European governance, all three of which must be improved substantially: supervision of fiscal policies, supervision of competitiveness indicators, and structural reforms' (cited in the *irisheconomy.ie* blog, 10 June 2011). What is striking about this is what it does not say. It makes no mention of economic growth as a

priority. And it makes no mention of the fact that none of these three sets of measures – all entailing stringent compliance conditions in the countries in the EU-IMF loan programmes – has any direct bearing on the underlying problems of the European banking system. Sticking with these three targets provides an indirect means of preventing a wider banking crisis from emerging for the time being. The problem for Ireland is that it comes at a heavy cost.

Ireland's slide into the EU-IMF loan programme can only be understood in the context of developments at a European level. Fallout from the Greek crisis in May 2010 worsened the market assessment of Ireland's risk rating. The government, having undertaken a blanket guarantee of the banks in September 2008, believing this bailout would be 'the cheapest in the world', in the words of former Minister for Finance Brian Lenihan, found itself saddled with responsibility for their ever-mounting losses. The full scale of rescuing and recapitalizing the Irish banking sector rose from an estimated €5.5bn in September 2008, to €11 billion in the first half of 2009, to €35 billion in March 2010, to €46 billion in September 2010, to a total of about €70bn, in what was announced as the last and final upward revision of the cost of bailing out the Irish banks in March 2011. In an ironic though unintended reversal of Lenihan's earlier view, the Governor of the Central Bank Professor Patrick Honohan called this 'one of the costliest banking crises in history'. The hidden underside of this is that the ECB has been the guarantor of the liquidity of the Irish banking system, at very low interest rates (of about 1%), amounting to some €170bn by 2011, both directly and indirectly.

The EU-IMF loan programme did not require any more stringent adjustment conditions than the government was already committed to in the National Recovery Plan 2011-2014, which had been approved by the European Commission in November 2010, as the latest instalment of the stability programme. But other terms and conditions associated with the EU-IMF loan programme were more controversial. The European element of the loan contained an interest rate premium which the Fine Gael-Labour government, elected with a resounding majority in February 2011, had vowed to renegotiate, an issue with which it has had little evident success to date. But in addition, no review of 'burden-sharing' was to be permitted, that is, no write-down of the returns to bondholders which had become the responsibility of the Irish government. Brian Lenihan was reported to have been 'crestfallen' by the ECB's intransigence on this matter; the IMF was reported

to have been surprised at the ECB position; the Governor of the Central Bank confirmed that 'no political room was offered to him by the people' (that is, the official 'troika' who concluded the loan agreement). The reason behind this tough position on Ireland's banking system appears to be to ensure that other European banks, especially in Germany, do not suffer a write-down in their position, which could open further unwelcome scrutiny of the robustness of their funding. It is also reported that US Secretary of State Timothy Geithner insisted that Irish bank bondholders be repaid in full, lest 'contagion' spread to the entire European system, to which American-backed credit default swaps are exposed to the tune of €120bn. Some commentators have suggested that Ireland should exercise a stronger bargaining stance in seeking to relieve the Irish taxpayer of the crushing burden of liabilities they face. But since the public deficit is still very large, and since the medium-term continuation of credit to the Irish banking system is still subject to ongoing informal goodwill on the part of the ECB, it could well be countered that the Irish negotiating position is not particularly strong.

Ireland is therefore required to implement the politics of austerity in full measure. What the eventual outcome will be remains open to speculation. Ireland's best prospects for achieving renewed growth come from its long-standing commitment to a low corporation tax, which has been a core pillar of the FDI-led export-intensive development strategy; but French criticism of this policy has stalled negotiations on interest rate modification. The government position is that the Irish debt can and will be fully repaid and that no default can be contemplated; but many commentators express doubt, since there seems little prospect that Ireland will be able to return to the borrowing markets at end-2012 as projected, in which case it may find itself in the position Greece is in during 2011, needing a further

tranche of official lending. The domestic political management of Ireland's austerity programme has not as yet been deeply problematic. It caused the collapse of Fianna Fáil, one of the two main historical parties in Ireland, and since the incoming centrist Fine Gael-Labour coalition is also bound by the terms of the EU-IMF loan programme, this may leave political space open for a new kind of opposition politics that makes a more radical appeal to the politics of disaffection (Mair, 2009). The eventual outcome of the politics of austerity will be shaped by developments at European level, and by the challenge of building new coalitions of interest among European leaders to address the hidden problems of the European banking system that underlie the very visible issues of fiscal deficits.

**Niamh Hardiman** teaches in the School of Politics and International Relations at University College Dublin. She is currently engaged in collaborative research on the comparative political economy of the crisis in the European periphery. Her edited volume on Irish Governance in Crisis will shortly be published by Manchester University.

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