Area: Europa
ARI 79/2011
Date: 28/4/2011

Crisis and Change in Ireland (ARI)

*Raj Chari**

Theme[1]: The 2011 Irish election must be placed in the context of both the economic and the political crisis that preceded the vote in order to examine its results and consider Ireland's future in Europe.

Summary: After years of economic growth during the 'Celtic Tiger' boom, Ireland fell into economic decline as a result of its financial crisis in 2008. Ireland's fall can best be understood as home-made, fuelled by speculation and lax regulation of the financial sector. In the context of this economic and financial crisis, Ireland then suffered a political crisis in which the Fianna Fáil (FF) government coalition lost legitimacy, prompting an early election on 25 February 2011. Unsurprisingly perhaps, a new coalition government comprised of Fine Gael (FG) and Labour came into being as a result. A major issue to be addressed by the new government relates to the renegotiation of the interest rates on the EU/IMF bailout agreed in December 2010. However, what remains unclear is how much this new government's hands are already tied and whether or not the EU seeks to renegotiate the terms of the deal.

Analysis:

The Economic and Political Context

For almost a decade before 2008, the 'Celtic Tiger' gained the attention of the world: after being a laggard in the EU economy throughout much of the 70s and 80s, from the late 90s Ireland was one of the fastest-growing EU economies and represented a model for growth. Under the leadership of Bertie Ahern, who was elected for a third term as Taoiseach (Prime Minister), the centre-right Fianna Fáil (FF) won the 2007 elections. It subsequently governed in a three-party coalition government alongside the Greens and the Progressive Democrats. The coalition took office in June 2007 with a view to holding on to power for the next five years.

But the plans changed: amidst growing concern over his personal financial affairs, Ahern resigned in May 2008 and was replaced by his then Minister of Finance, Brian Cowen. While all seemed positive for Cowen when he took over as Prime Minister, months later a massive economic and financial crisis hit the Republic.

The economic downturn in Ireland that started in the autumn of 2008 has probably been more severe than in any other European country, with the possible exception of Iceland. To put it in an international comparative context, many countries, such as the UK, Germany, France and, to a relatively lesser extent, Spain, had to bailout domestic banks

* *Trinity College Dublin*

[1] The author thanks Gary Murphy and Ignacio Molina for raising excellent points during the course of this study and commenting on earlier drafts.

throughout the global economic and financial crisis. But the Irish situation under Cowen's government –which was a consequence of actions during the previous Ahern administration, of which Cowen was Finance Minister– was particularly dire. Pagoulatos & Triantopoulos' (2009, p. 47) data show that, at a total of €400 billion, the overall Irish bank support package is one of the largest in the EU in absolute terms; in relative terms, it is *the* highest in the EU as a percentage of GDP.

The collapse of the banking system became the iconic story of a country that went from bust to boom and to bust once again. It can be argued that the 'bust' unfolded in three main stages.

First, in the autumn of 2008, when the dismal situation of the banks was becoming apparent, the government implemented one of the main 'life-support' systems for banks: a bailout by tax-payers through the newly-created National Assets Management Agency (NAMA). The institution was to effectively act as a state-owned bank, with its main task being to absorb the bad loans made by Irish banks during the Celtic Tiger period, estimated at over €80 billion (*The Guardian*, 30/III/2010). In the government's words, on 29 September 2008 it 'put in place a guarantee arrangement to safeguard all deposits (retail, commercial, institutional and interbank), covered bonds, senior debt and dated subordinated debt (lower tier II)'[2] with all major Irish financial institutions. This remedy, as well as other injections of public money into the Bank of Ireland (BoI) and the Allied Irish Bank (AIB) in February 2009 and the nationalisation of the Anglo-Irish Bank the previous month, meant that the state literally had to find billions of euros to finance the deals (*New York Times*, 28/XII/2008 and 12/II/2009).

Secondly, with the Central Bank announcement of 30 September 2010 it was clear that Ireland's troubles were even worse than expected: the Anglo-Irish bail-out would cost up to an additional €34 billion to be added to the €23 billion injected before then; while the effectively nationalised AIB would need a further €3 billon in addition to the €7.4 billion already received (*Irish Times*, 30/IX/2010). As a result, state spending would need to be further decreased, including a 20% pay-cut for public service workers and a freeze on any promotions. Perhaps even more worrying was the siphoning-off of even more funds from the ailing education and health services.

Third, shortly before the December 2010 budget, which aimed to implement more social welfare and even pension cuts, the Irish state agreed that it could not weather the storm without a bail-out: a rescue package from the IMF and EU was agreed to the amount of €85 billion, of which €45 billion was loaned by the EU, €10 billion earmarked towards further bank recapitalisations and €50 billion for budgetary requirements over the following four years (*Irish Times*, 28/XI/2010). For 2011 alone, the total interest payment for the package was estimated at €5.6 billion.

So, what went wrong in Ireland? There are two dimensions to help understand the Irish 'bust'. First, during the good times of the Celtic Tiger, banks became involved in a large amount of speculative loans, thereby increasing their systemic risk. The Trinity College Dublin economist Patrick Honohan, who would later become Governor of the Irish Central Bank in 2009, argues that '… banks got caught up in the mass psychology of an unprecedented property bubble… (and) began to increase the share of their assets in property related lending from less than 40 percent before 2002 to over 60 percent from

[2] See http://www.ntma.ie/IrishEconomy/bankGuaranteeScheme.php.

2006' (Honohan, 2009, p. 209). Low interest rates in the EU helped spur demand, which subsequently saw an unsustainable housing price and construction boom (Glick & Lansing, 2010). The construction workforce alone had increased from 7% in the mid-90s to over 13% by 2007 (Honohan, 2009, p. 212).

The boom was effectively financed by large amounts of foreign borrowing by the banks, which had no intentions of 'tightening credit conditions as the prices rose' (Honohan, 2009, p. 212). Yet recourse to foreign funds quickly dried up in early 2007 when 'foreign investors started dumping Irish bank shares because of the banks' heavy exposure to a property sector that had all the hallmarks of a bubble' (Ross, 2009, p. 83).

Secondly, the Irish financial regulator simply did not do its job during the heyday of the economic boom: the Irish Financial Services Regulatory Authority (IFSRA), which was established in 2003 after having taken over regulation of the sector from the Central bank, did little to identify whether or not Irish banks were placing themselves at risk. For instance, the Irish regulators ignored simple but important warning signs of increased risk exposure, such as rapid balance-sheet growth.[3]

As Honohan suggests, is not clear that the regulator analysed to the loans provided to developers (Honohan, 2009, p. 219). The financial regulators apparently also overlooked strange loans from banks such as Anglo Irish. Connor *et al.* (2010, p. 15) contend that,

'…. the regulatory regime for domestic Irish banks during the pre-crisis period was extremely weak and ineffective… the only aggressive actions of the Irish Financial regulator seemed to be directed at media leaks; its relationship with the financial services sector was very accommodating and compliant. For example, for eight years, the board chairman and other Directors of Anglo Irish Bank hid very large personal loans by temporarily transferring them just prior to the accounting year-end to other banks complicit in the scheme and then by pre-agreement rolling the loans back into Anglo Irish immediately after the publication of the annual accounts. It is not yet clear whether the regulator approved, ignored or missed this subterfuge, but no regulatory action was taken.'

Well in to the crisis, by October 2008 it was apparent that the regulators had effectively done nothing to regulate the sector, even openly stating that it was up to the banks to regulate themselves (Neary, 2007). There were no 'dawn-raids' on banks and no fines were imposed for bad banking practises, such as overcharging clients (Ross, 2009, p. 81).

Paul Krugman explains that 'the people charged with keeping banks safe (in Ireland) didn't do their jobs... regulators looked the other way in part because the country was trying to attract foreign business, in part because of cronyism: bankers and property developers had close ties to the ruling party' (Krugman, 2010). This is something that is also echoed in a forthcoming study that analyses in more depth the concept of a 'symbiotic relationship' between the state apparatus (including the regulators as well as the FF party), bankers and developers (Chari & Bernhagen, 2011).

[3] For example, if an annual growth rate of 20% is a threshold, the Anglo Irish Bank crossed it at an average of 35% every year between 1998 and 2007 (Honohan, 2009, p. 217).

If the above helps indicate the dimensions of the *economic crisis* in Ireland since September 2008, then it is little surprise that this development led to a *political crisis* that became apparent in 2010 in three main stages. First, from early 2010 the government in power was continuously suffering in the polls. Secondly, with the central bank announcement in September 2010 on the magnitude of the banking crisis, the government lost any remaining credibility. Finally, in January 2011 the Green Party, which was in coalition with FF, withdrew its support for the government. This led to a series of internal conflicts within FF, the resignation of Brian Cowen and the call for an early election on 25 February 2011.

The Parties and their Leaders during the Campaign
With the resignation of Brian Cowen, Micheal Martin was elected by his fellow party members sitting in the lower House (Dáil) as the new FF leader. Having held significant ministerial posts during the FF governments over the previous decades –which included implementing the workplace smoking ban when he was Minister of Health– he was seen to be one of the most credible FF party members in terms of integrity, honesty and transparency in politics.

However, the damage done to the party during the previous three years meant that the two main opposition parties –particularly Fine Gael (FG) and Labour– were already seen to be leading the electoral race well before it began. Enda Kenny led FG, a centre-right party that many observers find difficult to distinguish ideologically from FF. However, FG's stance on some policy issues –such as healthcare– is more left than right, making it somewhat different. Although he had lost the 2007 election as leader of his party, Kenny had increased FG's seats from 31 in 2002 to 51 in 2007. Moreover, he led a unified party that backed him strongly from all parts of the country in the 2011 campaign. This was made evident by the failed leadership take-over bid of Richard Bruton a year earlier. Bruton, brother of the former Prime Minister John Bruton, was considered to be the main driver of FG's economic policy. His leadership bid failed because he had the full support of only FG's Dublin-based TDs (Members of Parliament) but not from the rural constituencies. Once Kenny held off his challenge he was quickly able to reunite the party.

The Labour party had Eamon Gilmore at the helm during the campaign. Early perceptions in the summer of 2010 when an election was imminent were that there was even a slight possibility that Labour might win the election, having around 32% support in the opinion polls (*The Guardian*, 23/II/2011).

The other smaller parties were seen before the race as being either in a position to increase their number of seats from the previous election (such as Sinn Fein, led by Gerry Adams) or to dramatically fall given their former association with the coalition government (as was the case with the Green Party, led by John Gormley.)

Issues During the Race
The biggest issue in the campaign related to the country's economic difficulties and which party would be the best to lead Ireland out the crisis. One major point related to the terms and conditions of the EU/IMF deal negotiated in December 2010. While FF contended that it was all but impossible to renegotiate, the other parties campaigned on renegotiating the interest rate (*The Wall Street Journal*, 1/III/2011). When the deal was signed by FF a 5.8% interest rate had been stipulated and considering that the amount to be received by the EU (through the European Financial Stability Facility, EFSF) amounted to €45 billion,

a 1% reduction would save approximately €450 million a year to the tax-payer. Wary of having to take the loan in the first place, many citizens welcomed any party that would be able to renegotiate the rate. Moreover, most voters felt that bondholders and banks –not taxpayers– should have accepted more responsibility for having lent to Irish banks that in turn lent foolishly.

In the shadow of this big issue, other issues also emerged, such as the future of the Irish banking system, which was effectively on life support. Clearly sell-offs and mergers are inevitable, but the details of the future plans were not fully spelled out by any party during the campaign, outflanked by the issue of a lower interest rate on the EFSF loan. With little hope in sight for future economic recovery, a related issue was the state of unemployment in the country and how to solve the increasing flight of businesses to other countries with more stable economic climates. Finally, the future restructuring of the civil service and third-level education, electoral reforms and the future of healthcare all formed part of the campaign. But it could be argued that despite being one of the most significant elections in the history of the Republic, the campaign remained a rather lacklustre affair, perhaps because the results were more or less known by pollsters well before the vote.

Opinion Polls During the Campaign
From the opinion polls during the campaign it was obvious right at the beginning of the race that FF was set for its worst election results ever. Michael Gallagher's data helps illustrate how FF started low and never managed to even reach over 20% of the intended vote, despite having attained close to 42% in the 2007 General Election.[4]

In more detail, and relying on evidence from Millward Brown and Red C polls in particular, it can be seen that when the first polls were published at the end of January, FF support was the lowest of the three major parties at around 16% of the vote, while FG led the way with around a third of the vote and Labour had well over 20%. By the middle of February, the FF vote was starting to slip to between 12% and 15%, FG was gaining slightly and Labour remained steady. According to polls shortly before the 25 February election, FF was at around 15%, FG 40% and Labour 18%. Sinn Fein support was steady throughout the campaign, hovering at around 10%.

Election Results
Table 1 summarises the election results and highlights the percentage of votes received in 2007 and 2011, the number of seats won in 2011 by each party of the 166 seats from 43 constituencies elected by means of the PR-STV (Single Transferable Vote) electoral system, and the difference in seats from the previous election in 2007.

Figure 1. Election Results, Irish General Election, 25/II/2011

Party	% Votes 2007	% Votes 2011	Seats 2011	Seat Change from Previous Election
Fine Gael	27	36.1	76	+25
Labour	10	19.4	37	+17
Fianna Fáil	42	17.4	20	-58
Sinn Fein	7	9.9	14	+10
Others (mostly independent candidates)	14	17.2	19	+13

Source: www.electionsireland.org and Gallagher (2011).

[4] See Gallagher (2011) under the section 'Opinion Polls'.

FG emerged as the clear winner, gaining 25 seats more than in the previous election. However, it did not attain a sufficient majority to rule single-handedly. Shortly after the election, FG negotiated with Labour –the party that gained the second-highest number of votes/seats– to form a coalition government. Kenny (FG) was elected Prime Minister in March and Gilmore (Labour) became his deputy (Tánaiste). While FG increased its vote by more than 10% from the previous election, Labour almost doubled its support. Sinn Fein increased its vote by over 3% from the previous election and gained 10 seats, becoming the fourth-largest party in the Dáil.

Perhaps the most interesting result of the election was not which party won, but how a governing party (and its coalition parties in this case) can be decimated. The results were FF's worst showing in 85 years, reflecting how unpopular the government had become as a consequence of the perceived mishandling of the economic and financial crisis, cronyism and lack of transparency when governing. Several key FF members who held ministerial posts in the previous administration were not re-elected. These include Mary Coughlan (Tánaiste and Minister of Education), John Curran (Government Chief Whip) and Mary Hanifan (Minister for Tourism, Culture, and Sport). The Green Party failed to have a single member elected –losing all six of its seats–, paying the price for having supported the unpopular FF when in government.

Another observation relates to the accuracy of the opinion polls throughout the campaign, as shown in Table 1, compared to the actual results, shown in Table 2. Although some of the pollsters got it right for some parties, some FF supporters seemed to have concealed their intention to vote for their party during the campaign, as discussed by observers such as O'Malley (2011) even before the vote. Gallagher notes that:

'The RTE exit Poll (done by Millward Brown) was very accurate: It estimated support precisely and was very close for SF, but slightly over-estimated Labour and Others while being more than 2 percentage points too low for FF. The last of these may suggest that there really were, as many had speculated, "secret" FF supporters who voted for the party while being reluctant to admit this to pollsters'.[5]

Conclusion

Future: Are the New Government's Hands Tied?
The 2011 election in Ireland shows that political change is inevitable, especially in the wake of an economic crisis that brings a country to its knees. The FF government had lost all of its credibility to continue in power and the results clearly show that the people wanted change. And the new government seems keen to add transparency to politics and to rid the country of the cronyism of the past.

But it remains unclear what exactly the new government can really do, especially with regard to renegotiating the terms of the EU/IMF bailout. Certainly, there are already indications that the new government is not receiving much support from other EU states. For example, Angela Merkel has clearly said that the new government has to stick to the terms that the previous government negotiated on the aid package. In her words: 'If the Irish government now has a problem with interest rates, our job is to figure out what we can do –or whether we can do anything–'.[6]

[5] See Gallagher (2011) under the Section 'Opinion Polls', post-election comment.
[6] http://www.independent.ie/national-news/kenny-bailout-blow-2563678.html.

Coupled with this, on the home-front are the related problems of continuing unemployment, growing emigration, increasing capital flight, fumbling banks that are not respectable targets for take-overs, weak projected economic growth and the inability to raise revenues to maintain international standards of primary, secondary and third-level education. Without a doubt, the new government will take on the fight in Europe. But its hands are tied, and it is hard to see on which leg the country is really standing.

Raj Chari
Trinity College Dublin

Bibliographical References

Chari Raj & Patrick Bernhagen (2011), 'Explaining the Sunset over the Celtic Tiger' *Irish Political Studies*, forthcoming, December.
Connor G., T. Flavin & B. O'Kelley (2010), 'Irish Economy Note No. 10 – The US and Irish Credit Crisis: Their Distinctive Differences and Common Features', http://www.irisheconomy.ie/Notes/IrishEconomyNote10.pdf, accessed March 2010.
Gallagher, Michael (2011), 'Irish Election 25 February 2011', http://www.tcd.ie/Political_Science/staff/michael_gallagher/Election2011.php.
Glick, R., & K. Lansing (2010), 'Global Household Leverage, House Prices and Consumption', *FRBSF Economic Letters*, 2010-01.
Honohan, P. (2009), 'Policy Paper: Resolving Ireland's Banking Crisis', *The Social and Economic Review*, vol. 40, nr 2, Summer, p. 207-31.
Honohan, P. (2010), *The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008: A Report to the Minister for Finance by the Governor of the Central Bank*, 31/V/2010, http://www.bankinginquiry.gov.ie.
Krugman, P. (2010), 'An Irish Mirror', *New York Times*, 8/III/2010.
MacDonald, Frank, & Kathy Sheridan (2009), *The Builders*, Penguin, Dublin.
Neary, P. (2007), 'A Principles Led Approach to Regulation – Striking the Right Balance while Regulating over 10,000 Firms in the Financial Sector', presented at the Public Affairs Ireland, Regulating Ireland Conference, 16/VII/2007, http://www.financialregulator.ie/press-area/speeches/Pages/AddressbyPatrickNearyChiefExecutiveFinancialRegulatorRegulatingIrelandConference.aspx.
O'Malley, Eoin (2011), 'Poll of Polls with Seat Projections: Is Fianna Fáil Support Underestimated?', http://politicalreform.ie/2011/02/20/poll-of-polls-with-seat-projections-is- fianna-fail-support-underestimated/, accessed 18/III/2011.
Pagoulatos, George, & Christos Triantopoulos (2009), 'The Return of the Greek Patient: Greece and the 2008 Global Financial Crisis', *South European Society and Politics*, vol. 14, nr 1, March.
Regling, K., & M Watson (2010), 'A Preliminary Report on the Sources of Ireland's Banking Crisis' 31/V/2010, http://www.bankinginquiry.gov.ie.
Ross, S. (2009), *The Bankers*, Penguin, Dublin.