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LETTER FROM DUBLIN

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By: Kevin O'Rourke

It is one thing to know that someone you love is terminally ill; their death still comes as a shock.

I certainly don't want to compare the arrival of the EU-IMF team in Dublin last week to a bereavement. But I was surprised at how upsetting I found it, given that it came as no surprise. It had been clear for a long time that the blanket guarantee given to the liabilities of Ireland's rotten banks, in September 2008, had saddled the State with a debt that was too big for it to handle. Ten successive quarters of declining real GNP, and one attempt too many to draw a line under the losses of our banks, made our exclusion from international capital markets inevitable. But to know something is one thing; to see it actually happen is something entirely different.

I am not alone in feeling this way, it seems. The economics editor of the Irish Times, Dan O'Brien, wrote that

"nothing quite symbolised this State's loss of sovereignty than the press conference at which the ECB man spoke along with two IMF men and a European Commission official. It was held in the Government press centre beneath the Taoiseach's office. I am a xenophile and cosmopolitan by nature, but to see foreign technocrats take over the very heart of the apparatus of this State to tell the media how the State will be run into the foreseeable future caused a sickening feeling in the pit of my stomach.

This is not to say that we would be happy to have our country's affairs managed by the current, disgraced, government. I yield to no-one in my loathing of the men and women who have done this to my country. What has been the intellectual low-point of the last couple of years? Was it the cash-for-clunkers stimulus package (Ireland does not produce any cars)? Or the statement by our Finance Minister that Ireland need not fear a bank run, since Ireland is an island? Or the biggest Irish joke of them all, which underpinned the bank guarantee in the first place: that if we wanted investors to retain confidence in the creditworthiness of the Irish *State*, we needed to make sure that nobody who invested in our (private sector) banks ever lost a penny?"

The latter decision is the one that sank the country. It was the last great act of hubris of the Celtic Bubble, and was immediately denounced by one of the heroes of the crisis, my old UCD colleague Morgan Kelly. On the night the guarantee was announced, Kelly pointed out that while it was the right policy if the Irish banks were facing a liquidity crisis, it was a terrible policy if they were insolvent, which was in fact the case. As they always do when confronted with someone smarter than them, the Dublin establishment circled the wagons, and Kelly was dismissed as an irresponsible young troublemaker of no consequence. He has been proved right, of course, but the establishment is still at it, making the

same fundamental mistake of thinking that a solvency crisis is just a liquidity crisis. Now, however, the establishment is European as well as Irish, and it is the State rather than the banking sector which is insolvent.

The week started on an optimistic note. The general reaction was one of relief – at last, the Indians had come to sort out the cowboys. (The Indian in question was Ajai Chopra, head of the IMF mission to Dublin; there are no prizes for guessing who were the cowboys.) But the atmosphere soon changed, as it became clear that a substantial portion of the bailout funds would be earmarked, not for vital public services, but for the black hole that is the Irish banking system. At one stage there seemed to be the prospect of some relief for Irish families: the Irish Times was reporting that the EU-IMF team would deliver the loss-sharing with bondholders that our own government had been too craven to insist on. This would have been a good-news story that could have transformed the mood of ordinary people, and proved that the European Union was on their side. That hope was dashed over the weekend.

The finger of blame was clearly pointed by the Minister of Finance, Brian Lenihan, and several of his colleagues: it was the European Central Bank and the Commission who had vetoed the proposal to force some of the bank losses back onto the bondholders. This interpretation is generally accepted in Dublin, although many observers also blame the Irish negotiating team for caving much too easily into pressure from Brussels and Frankfurt. The implication is that the IMF were the good guys: an unusual position for them to find themselves in, perhaps, and one with political implications in a country whose relationship with the European Union has been uneasy in recent years, and which has conserved close ties with the United States. On Monday night, an opposition spokesman made it clear that he would be much happier negotiating with the IMF, who are reasonable people, than with our European partners. The fallout from this will be toxic.

The reaction to the news that Irish taxpayers are to be squeezed while foreign bondholders escape scot-free has been one of outraged disbelief and anger. At the start of last week, it was possible to make the argument that 'burning the bondholders' was irresponsible, since it would inevitably lead to contagion, and the spread of the crisis to Iberia. That argument has at this stage lost all validity, since contagion has happened anyway. Besides, the correct response to the possibility of contagion was never to engage in make-believe, but to extend taxpayer protection to other Eurozone members as required. Swapping debt for equity in a coordinated fashion across Europe would show ordinary people that Europe is on their side; but like the PLO of old, the European Union never misses an opportunity to miss an opportunity. It could have provided a means of kick-starting a new post-crisis growth strategy based on investment in the infrastructures we will need in the future; instead it has transformed itself into a mechanism for forcing pro-cyclical adjustment onto countries that are already sinking. It could have led the way in reining in an out-of-control financial sector; instead it now embodies the discredited principle that banks must never, ever, default on their creditors, no matter how insolvent they may be.

To make matters worse, it is simultaneously preparing a new scheme which will be able to handle sovereign defaults within the Eurozone from 2013 onwards. Presumably Ireland will be one of the first clients of this new facility, assuming of course that default can be avoided before then. To shrug one's shoulders and accept that sovereign default down the road is preferable to private sector defaults now seems astonishing, but such are the depths of irresponsibility to which responsible opinion is now sinking.

Who knows what the political consequences of all of this will be? The southern Irish are a conservative lot, and dislike direct confrontation (we leave that to our Northern brethren). This means that political change in normal times is slow; but when it does come, it may come in a rush. If we had a national list system, a Labour-Sinn Fein coalition would be a possibility at this stage. However, our multi-seat constituency system makes it difficult for rising parties to translate support in opinion polls into seats in parliament. Even so, we are about to have a general election, and if Brussels thinks that this deal is not going to be the big issue in that election, then they are even more out of touch than we already think they are. It is no longer even certain that the budget will be passed in December. Brussels may not have a Plan B, but they had better prepare one nonetheless.

Irish citizens may bring down the bailout of foreign bank creditors by voting at the ballot box, but if they do not, they will bring about a default of some kind by voting with their feet. We now face a negative spiral in which austerity causes emigration, which increases the burden of the debt, which ultimately leads to more austerity. We need a game-changer to break the cycle, but what might it be? Since the fundamental problem is that Ireland is insolvent, the smart thing to do is to tackle our debt burden head-on, but the Europeans have vetoed this.

Changing our politics might help, by creating a shared sense of national purpose that people can buy into. Unfortunately, it is hard to see the prospect of a Fine Gael-Labour government encouraging young people to tighten their belts and stay home for the good of the country: at this stage, the country needs radical change that can give people a sense of hope. There is a huge desire for such change, but no coherent vehicle to translate that desire into action. One immediate focus should be constitutional reform that everyone can buy into, since people inevitably differ about the policies needed to bring about a recovery.

Iceland is an obvious model for us. In a referendum, her voters have already rejected a proposal to pay back their banks' creditors, who will take major losses. Now they have elected a constitutional assembly charged with drafting a new constitution. Ireland probably needs this more than does Iceland; I wish I were more confident that we will follow the latter's example.