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Private Bank Debts and Public Finances: Some Options for Ireland

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Summary

This paper explores the issue of banking debt and its relationship to public finances. The context is set by the huge and disproportionate weight of socialised private debt on Irish public finances together with the lack of progress in relation to the signals made in regard to Ireland's position from the EU summit in June 2012. The paper is organised around four questions:

1. What is the total amount of 'socialised' banking debt in Ireland and what are its components?
2. What options are technically and politically feasible for a re-structuring of banking debt?
3. What would an optimal or fair resolution look like?
4. How big difference could a deal on bank debt make to public finances in Ireland?

Progress is required in relation to adjustments to the total amount owed, the length of period over which repayments are made and the interest rate charged on borrowing to repay the debt. The paper argues that the option of suspending payment, pending satisfactory negotiated outcomes, on the next amount owed on 31st March should not be excluded at this point especially in the context of little apparent progress in relation to the matter.

Keywords: Banking, General Government Debt, Promissory Notes.

1 What is the total amount of ‘socialised’ banking debt in Ireland and what are its components?

> *Ireland holds the undesirable position of being the only country currently undergoing a banking crisis that features among the top-ten of costliest banking crises along all three dimensions [..fiscal cost, increase in debt and output loss..], making it the costliest banking crisis in advanced economies since at least the Great Depression. And the crisis in Ireland is still ongoing. (Laeven and Valencia, 2012: 19-20)*

The Irish economy experienced a sharp contraction in output and employment following the onset of recession in 2008. This was linked in a major way to international credit squeeze, a collapse in Irish property prices and a major crisis in banking in 2008. The banking system underwent a severe adjustment highlighted by the guarantee of deposits and bonds in the following six financial institutions: Allied Irish Banks, Bank of Ireland, Anglo-Irish Bank, Irish Nationwide Building Society, Educational Building Society and Irish Life and Permanent.

The genesis of the economic crisis is overwhelmingly in the private sector – bad corporate governance (and possibly criminal behaviour in some cases), excessive and inappropriate lending with the consequence that bank balance sheets became bloated and potentially unstable in many private financial institutions. These failures were facilitated by grossly inadequate public regulation and oversight. All of this is well documented elsewhere and does not necessitate elaboration here (see, for example, Honohan, 2010 and the Nyberg Report – Report of the Commission of Investigation into the Banking Sector in Ireland, Nyberg 2011).

The European and international context for these developments was a regime of light-touch regulation in many countries including Ireland as well as risky and highly complex securitisation in the finance markets. The regime of ‘one size fits all’ low interest rates across the Eurozone helped fuel the credit boom in Ireland – providing a pro-cyclical stimulus through low interest rates in Ireland, Spain and elsewhere. Added to this were tax policies which favoured speculative investment and helped inflate the property bubble even further. Credit was over-extended with reference to income and the underlying long-term value of the property. Large volumes of inter-bank lending as well as lending to households took place without due regard to the long-term viability of prices. By 2007 German, French and UK banks were hugely exposed to sudden or large downturn in property prices in a number of other EU Member States including Ireland[1].

The Irish property crash in 2008 together with the mounting instability in global financial markets from 2007 onwards triggered a credit freeze and funding crisis in the Irish banking system in the summer of 2008. What initially appeared to be a liquidity crisis was, in effect, a deep solvency crisis. Acting under pressure of events and fearing a run on deposits the Government decided to extend a guarantee against all deposits and most bank bonds in September 2008. In retrospect this decision had huge implications for public liability for private debts – many of which were incurred as a result of bad corporate practice and poor regulatory oversight. Even if corporate governance were not an issue the lack of any haircut for senior creditors who had lent to Irish banks has given rise to concerns of 'moral hazard'[2].

The role of the European Central Bank and European Commission at this time is unclear. However, the 'Nyberg' Report (Report of the Commission of Investigation into the Banking Sector in Ireland, 2011: 78) had the following to say:

> *In any event, by the evening of September 29, there was the immediate prospect that at least one Irish bank was facing likely default on its maturing obligations the following morning. There was no euro-wide framework in sight for dealing with emerging difficulties and clear indications had been given to the Irish authorities that it was their responsibility to address the problem. The Government had earlier concluded that it could not permit any Irish bank to fail (which the Commission understands was also the advice from the ECB), given the potentially very serious adverse effects on confidence in the banking system in Ireland and elsewhere. There was a fear that a default could set off a generalised "run on the [Irish] banks".*

Evidence suggests, however, that IMF officials were open to the option of haircuts for unsecured senior bondholders but were over-ruled by the ECB in 2010.

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[1] For example, data provided by the Bank of International Settlements in March of 2011 show that in Ireland, in the third quarter of 2010 (just prior to the bailout and in the same period as funds were flowing out of the Irish banks), total foreign bank exposure including banks in the IFSC was US$156.3 billion of which $57.8 billion related to German banks and $37.4 billion related to UK banks. Only in Spain did German banks have a higher exposure, at $85.8 billion, in the third quarter of 2010 (Bank of International Settlements, 2011). In the first quarter of 2012 total Germany bank exposure in Ireland had fallen to $18.2 billion while in Spain it was $45.9 billion.

[2] Information provided in a Parliamentary Question in January 2013 indicates that, over the five years ending 2012, a total of €11.7 billion was repaid in junior or subordinated bonds for the four (originally six) 'covered' financial institutions representing a 55% haircut on the nominal value of €25.7bn (PQ 1785/13 on 17 January).

The subsequent 'scenic' route to nationalisation of most of the main banks proved highly costly. A series of bank recapitalisations by the exchequer proved insufficient to save the banks. Anglo-Irish was the first to be nationalised in January 2009 following unsuccessful attempts to recapitalise that bank[3]. There followed a series of major capital injections into the banks covered by the September 2008 guarantee. For a small country, the amounts involved were enormous and became bigger as the full extent of bank insolvency and impaired bank assets became apparent. There were three vital and inter-linking developments that featured during the period from Autumn 2008 to Autumn 2010:

- Deposits and liabilities including most bonds were guaranteed by the Irish Government (the total, in 2008, came to €352 billion – double the level of GDP in Ireland in that year[4]).
- By the Autumn of 2010 five of the six covered banks were effectively nationalised.
- The vast bulk of bondholders[5] who were repaid (those who lent to the banks before and after 2008) did not see any 'haircut' or reduction in their repayment.

The direct cost of bailing out private banks by the Irish taxpayer – to date – is estimated to be €64 billion. This does not include the contingent liabilities associated with the NAMA experiment as well as the risks of further capital injections should new problems arise. Since December 2009 NAMA has acquired loans with a face value of €74 billion from financial institutions paying out €31.6 billion to the institutions involved. It is not clear if NAMA will break even, make a profit or a loss in the future. The exchequer is liable for any shortfalls in the future.

The components and details of what has been one of the largest European public bailouts of a broken and bankrupt private banking system are shown in Table 1 below.

3 The Minister for Finance announced, in December 2008, that three of the covered banks were to be recapitalised by the exchequer.
[4] Source: Eurostat.
[5] All 'senior' bondholders and many 'junior' or subordinated bondholders.

Table 1 The Cost of the Bailout as of January 2013 (€ billions)

Date Due	2009	2010	2011	2012	Total
Anglo-Irish Bank	4.0 E	25.3 P	0	0	**29.3**
Irish Nationwide Building Society (INBS)	0	5.3 P 0.1 S	0	0	**5.4**
Allied Irish Banks (AIB)	3.5 F	3.7 F	3.9 E 8.8 F	0	**19.9**
Education Building Society (EBS)	0	0.25 P 0.65 S	0	0	**0.9**
Bank of Ireland (BOI)	3.5 F	0	1.2 F	0	**4.7**
Irish Life and Permanent (ILP)	0	0	2.7 E	1.3 E	**4.0**
Total	**11.0**	**35.3**	**16.6**	**1.3**	**64.2**

Sources: Reply to Parliamentary Question 34630/12 (17 July 2012)

Notes on sources of funding:
E denotes Exchequer funds (€11.9bn)
P denotes Government Promissory Notes (€30.85bn)
F denotes National Pension Reserve Funds (€20.7bn)
S Special Investment Share (€0.75bn)

In summary, National Pension Reserve Fund (NPRF) funding came to €20.7 billion which was used for share capital/preference shares in Allied Irish Bank (€16 billion) and Bank of Ireland (€4.7 billion[6]). The NPRF now only has just over €5.2 billion left. The exchequer funding source was €11.9 billion and was used for share capital injection in Anglo-Irish Bank (€4.0 billion), AIB (€3.9 billion) and Irish Life & Permanent (€4.0 billion). The value of the Promissory Notes issued by the Government as assets for covered banks comes to €30.85 billion. The issued promissory notes were €25.3 billion to Anglo-Irish, €5.3 billion to INBS and €0.250 billion to EBS.

The total bill, at just €64 billion, is equivalent to approximately 40% of annual Gross Domestic Product in Ireland in 2012 – an estimate consistent with that by Laeven and Valencia (2012: 20). Although relative to total financial assets fiscal costs in Ireland were limited, relative to GDP they were huge. Laeven and Valencia (2012:19) have studied systemic banking crisis over many decades across the globe and conclude that[7]:

[6] €1.7 billion of this was converted to equity in June 2010. A total of €1 billion was sold off in January 2013 as 'CoCo' bonds - contingent convertible capital bonds.

[7] Laeven and Valencia (2012: 26) estimate fiscal costs as 'the component of gross fiscal outlays related to the restructuring of the financial sector. They include fiscal costs associated with bank recapitalizations but exclude asset purchases and direct liquidity assistance from the treasury.'

In terms of fiscal costs, the still ongoing banking crises in Iceland and Ireland already rank among the ten costliest crises. Fiscal costs have reached very high levels in Iceland and Ireland in part because of the relatively large size of the financial systems in these economies, amounting to multiples of GDP.

A number of qualifications or clarifications, however, are in order:

- Some of the cost of bailing out private banking was associated with a reduction in the National Pension Reserve Fund as noted above.
- The estimated total amount added to General Government Debt was in excess of €42.3 billion equivalent to 26% of GDP in 2012 or, very approximately, just under 22% of total estimated General Government Debt in 2012[8]
- It is not certain that the public will not be liable for further capital injections in the banks should their liquidity and solvency be further impaired beyond what has been foreseen in various recent capital stress tests.
- The total public 'contingent' liability for assets transferred to the National Asset Management Agency (NAMA) is a matter of concern given the uncertain future performance of NAMA assets.
- Some of the capital injections may yield a return in the long-run and some of the Government holdings of preference or ordinary shares may be redeemed if and when these are sold eventually.

In summary the total amount directly added to General Government Debt as a result of bailing out the banks is just over one fifth of the total stock of outstanding debt. However, given that a huge amount of the bailout money was sourced from the National Pension Reserve Fund (NPRF) it is important to acknowledge the total opportunity cost of the bailout in terms of net government debt when cash balances are deducted. The NPRF and cash balances could have been invested in productive economic activity. When this is taken into account the total amount of General Government Debt which results directly or indirectly from the bank bailout the proportion of banking debt in the overall total may be higher[9]. This still leaves a large

[8] Eurostat data sources show a total of €41 billion between 2009 and 2011 (http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/excessive_deficit/supplementary_tables_financial_turmoil) to which must be added €1.3 billion in 2012. Coffey (2013b) has estimated a figure of €47 billion which includes €42 billion of capital transfers and approximately another €5 billion which arose from additional borrowing.

[9] Indirect impacts of government intervention to assist the banks would have diverted resources from productive investment or domestic economic activity with adverse impacts on the general government deficit and thereby on General Government Debt. Estimating the overall impact of the bank intervention is more than an accounting exercise and involves dynamic interactions in the macro-economy and public finances – a reality often missed in much economic commentary.

sum of gross government debt which is accounted for by the cumulative impact of recessionary government deficits where revenue has fallen short of government spending for five consecutive years thus adding over €77.5 billion in this five year period.

It should be noted that some of the stock of gross government debt carried over before the recession in 2008 is included in today' stock. Of an estimated €192 billion in gross general government debt in 2012, €42 billion is accounted directly as a result of bank bailouts and an estimated €77.5 billion is accounted for by cumulative general government deficits since 2008. This leaves just under €72.5 billion due to other factors including estimated stock/flow adjustments as well as a carry-over of €47 billion gross general government debt in 2007 (See Coffey, 2013a, for further details). Some of the cumulative recessionary impacts on public finances are linked to the banking crisis to the lack of bank lending to small and medium sized enterprises. The opportunity cost of diverting scarce public funds to bank recapitalisation is bigger than the explicit and direct bank bailout costs to date.

The original bank guarantee of September 2008 was for two years. The largest amount of the banks' bond funding was scheduled to mature at the end of September 2010, in advance of the expiration of the guarantee. A wall of cash was due to be rolled over, equivalent to €30 billion of government-guaranteed bank debt. Critically, however, the banks were unable to obtain new funding on the market and became almost totally reliant on the willingness of the European Central Bank (ECB) and the Irish Central Bank to provide liquidity. This in turn damaged the market perception of Ireland, and the sovereign temporarily withdrew from the bond markets as bond spreads worsened. As confidence was impacted non-resident corporate and household deposits were withdrawn from the Irish banking system.

The cost of bailing out the banks has had a major impact on public finances:

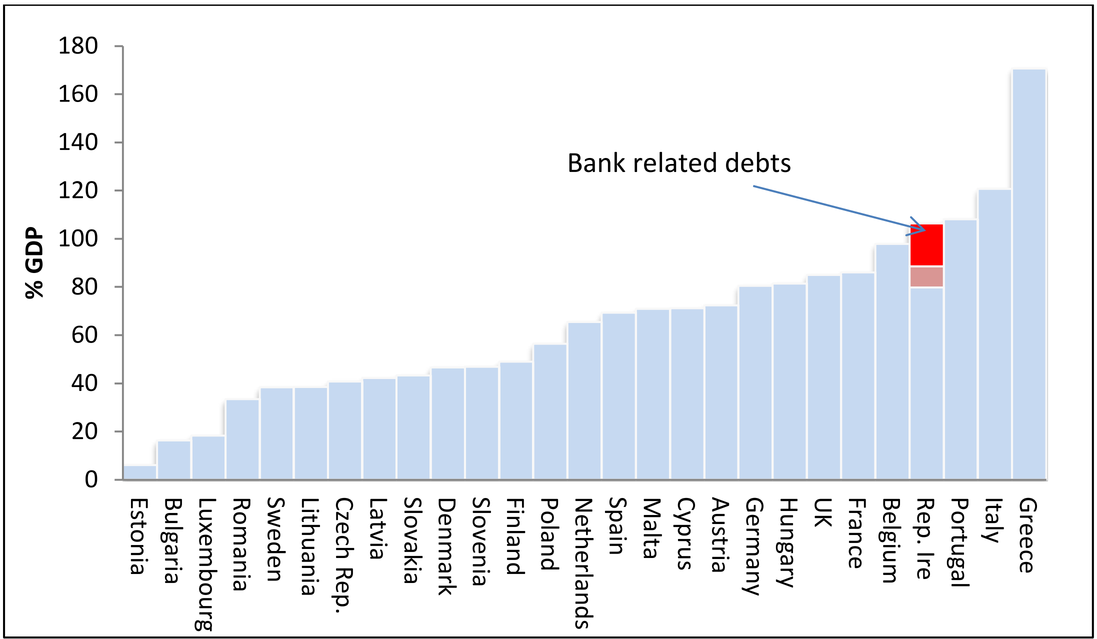
- By socialising huge amounts of private debt and adding these to the General Government Debt in 2010 (€34 billion or just under 20% of GDP in one single year[10]) international market confidence was seriously impaired leading to an escalation in government borrowing costs in 2010 and the subsequent 'Troika' bailout in November of that year.

[10] Given a large gap between GDP and GNI the estimate of bank debt and General Government Debt as percentages of total national income or output would be higher still if GNI were used as the comparator.

– The cost of servicing government debts has risen in line with the huge increase in General Government Debt (from 1% of GDP in 2007 to a projected 5.6% in 2013).

– There is a continuing burden of debt stretching into the longterm – not least in regard to the debts incurred as a result of rescuing Anglo-Irish bank/INBS.

Chart 1 General Government Debt as a Percentage of GDP in 2011 (and financial institution related debts in Ireland)



Source: Eurostat
Note: Of the total of 106.4 for Ireland in 2011 17.8 percentage points is accounted for by the IBRC Promissory Notes (=€28.36 billion) and 8.8 percentage points by other bank related debt (= €13.9 billion). The latter number does not include the impact of reductions in cash balances and NPFR assets on net general government debt.

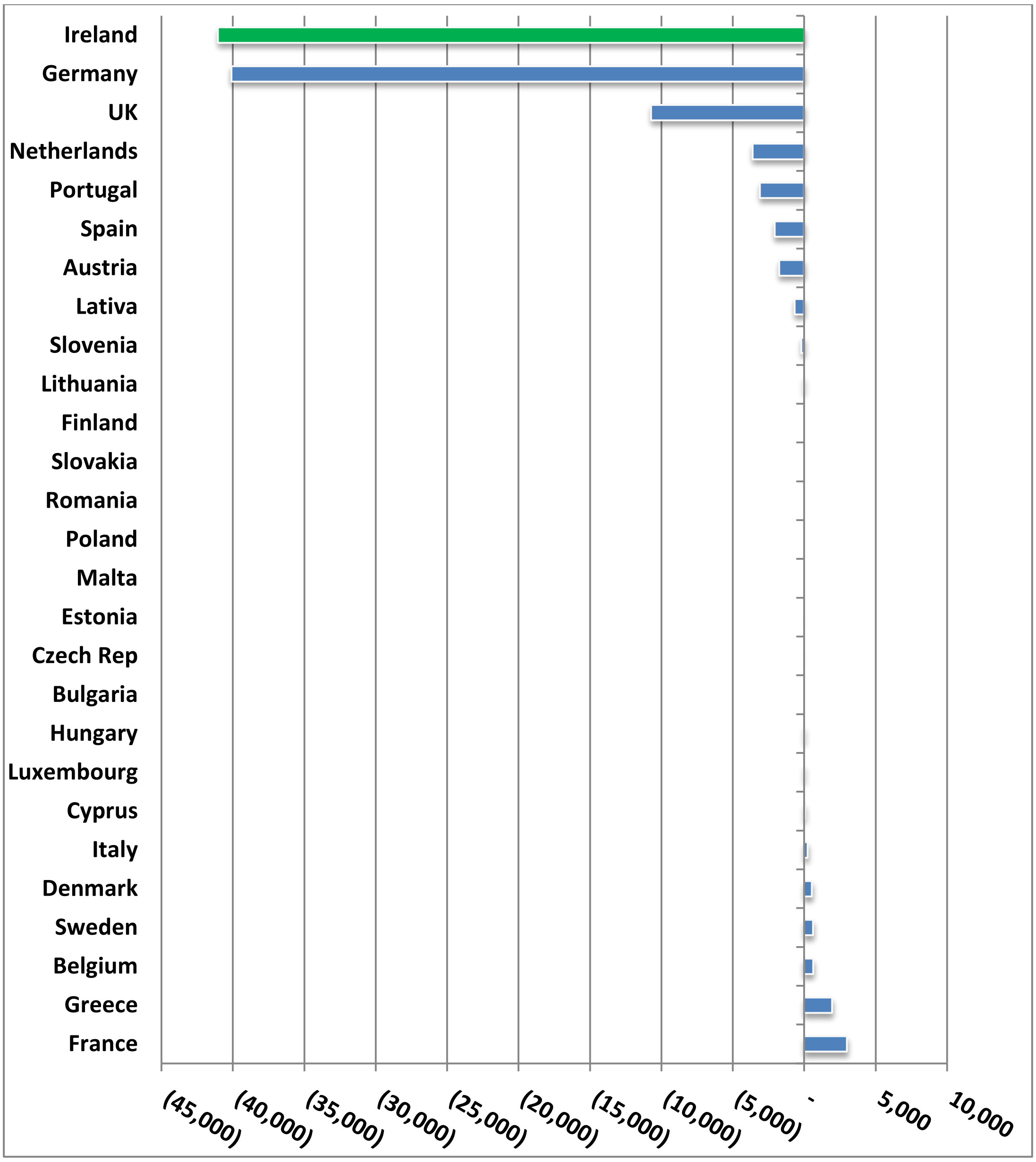
Some idea of the total cost, to date, of bailing out the Irish banks has been discussed elsewhere (Taft, 2013). Using the same Eurostat data sources as in Taft (2013) it is possible to report the total net cost in millions of euro added to the General Government Deficit over a 5-year period (Chart 2). Total net cost is measured as the sum of Government expenditures (mainly accrued interest payable on loans and capital injections both arising from financing of government interventions) less Government revenues (guarantee fees, interest and dividends received by Government). As Coffey (2013b) has noted the cost in terms of deficit-increasing interventions may under-state the total cost to the taxpayer. This is certainly the case in Ireland where, in addition to deficit-raising interventions by Government, cash balances and the reserves in the NPRF were used even though these did not impact directly on the deficit – as measured by Eurostat – or on General Government Debt as measured by Eurostat. Coffey (2013b) estimates that €41.4 billion of public bailout costs was in the form of 'capital transfers' and thus added to the General Government Deficit in various years between 2009 and 2012. Capital transfers are classified as 'lost money' with no prospect of a return in the future. Separately, €23.8 billion was in the form of capital transactions which were not counted by Eurostat as additions to the Deficit. These include payments for ordinary shares, preference share and contingent capital notes in the cases of AIB, BOI and Permanent TSB. Capital transactions are classified as commercial transactions which may involve a return or a realisation of dividends in the future.

The total direct fiscal cost, as measured by Eurostat, in the case of Ireland was €41 billion (shown as a minus sign in Chart 2). This sum does not include the additional cost to Irish taxpayers of reducing cash balances as well as equity investments under the National Pension Reserve Fund. This is the highest absolute amount for any EU Member State over this period. It represents 42.6% of the total net cost across all 27 EU Member States (€41.0 billion out of €96.2 billion) over the period 2007-2011. Coffey (2013b) queries the extent to which the total cost to taxpayers is under-stated by reference to Eurostat data of the impact on government deficits only. He writes:

> *So has Ireland carried 42% of the total EU cost of the banking crisis? Impossible to say. We do know that Ireland has incurred 42% of the deficit-impacting measures introduced in response to the crisis. But that is not the same thing as the total cost.*

Given that some capital transactions – which are not measured by Eurostat as adding to the Government Deficit – may attract a long-term pay back to the Government is it accurate to say that they are fully part of the public cost of bailing out private banks? Only time will tell. Capital transfers provide a more reliable and sure measure of the immediate cost to the taxpayer and on this measure used by Eurostat Ireland is very much in a unique position in terms of the scale of the public cost especially when measured as a proportion of GDP or per capita of population.

Chart 2 The Total Net Cost of Bank Capital Transfers (Government Deficit) not including capital transactions - € millions.



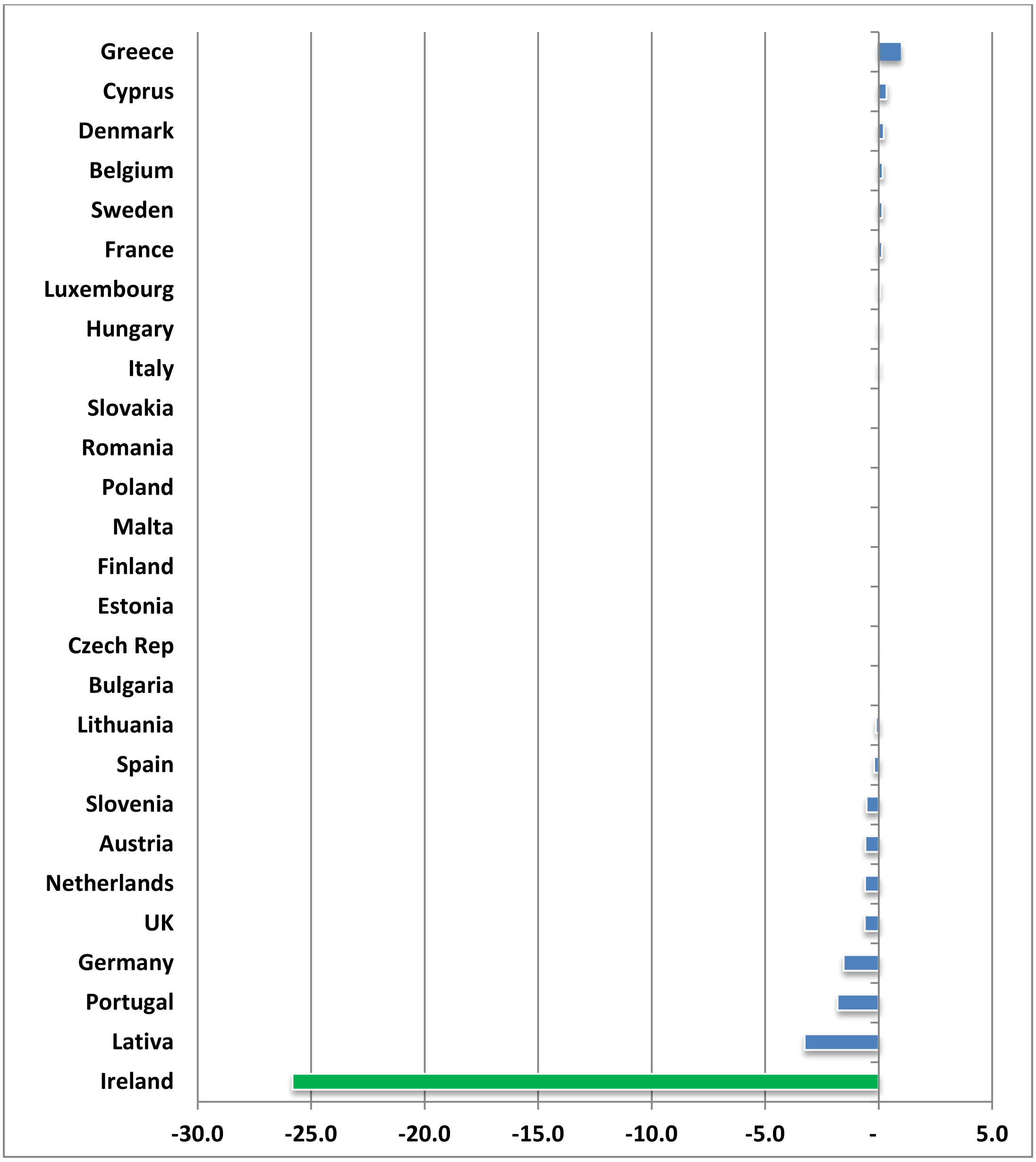
Source: Eurostat 2012.

Considering the small size of the Irish economy relative to the total EU economy the figure of €41 billion is huge. When the cost of bailing out financial institutions as reflected in the public deficit is expressed as a percentage of annual GDP (in 2011) the cost is a staggering 25.8% for Ireland (Chart 3). The next highest percentage is for

Latvia (at -3.3% of GDP). The total cost to the taxpayer, as distinct from the cost in terms of additional government deficit, could be higher still in Ireland. Coffey (2013b) points that this may be significantly higher in other countries. However, judging by the nature of interventions in other countries and using the IMF database cited in Laeven and Valencia (2012) it is possible to conclude that Ireland is in the top 10 countries in terms of the combined cost (fiscal, public debt and output) and second only to Iceland in Europe[11]. No European Union member state, apart from Cyprus, comes anywhere near Ireland in terms of the fiscal cost.

[11] Although Ireland is likely to be overtaken by Cyprus in 2013.

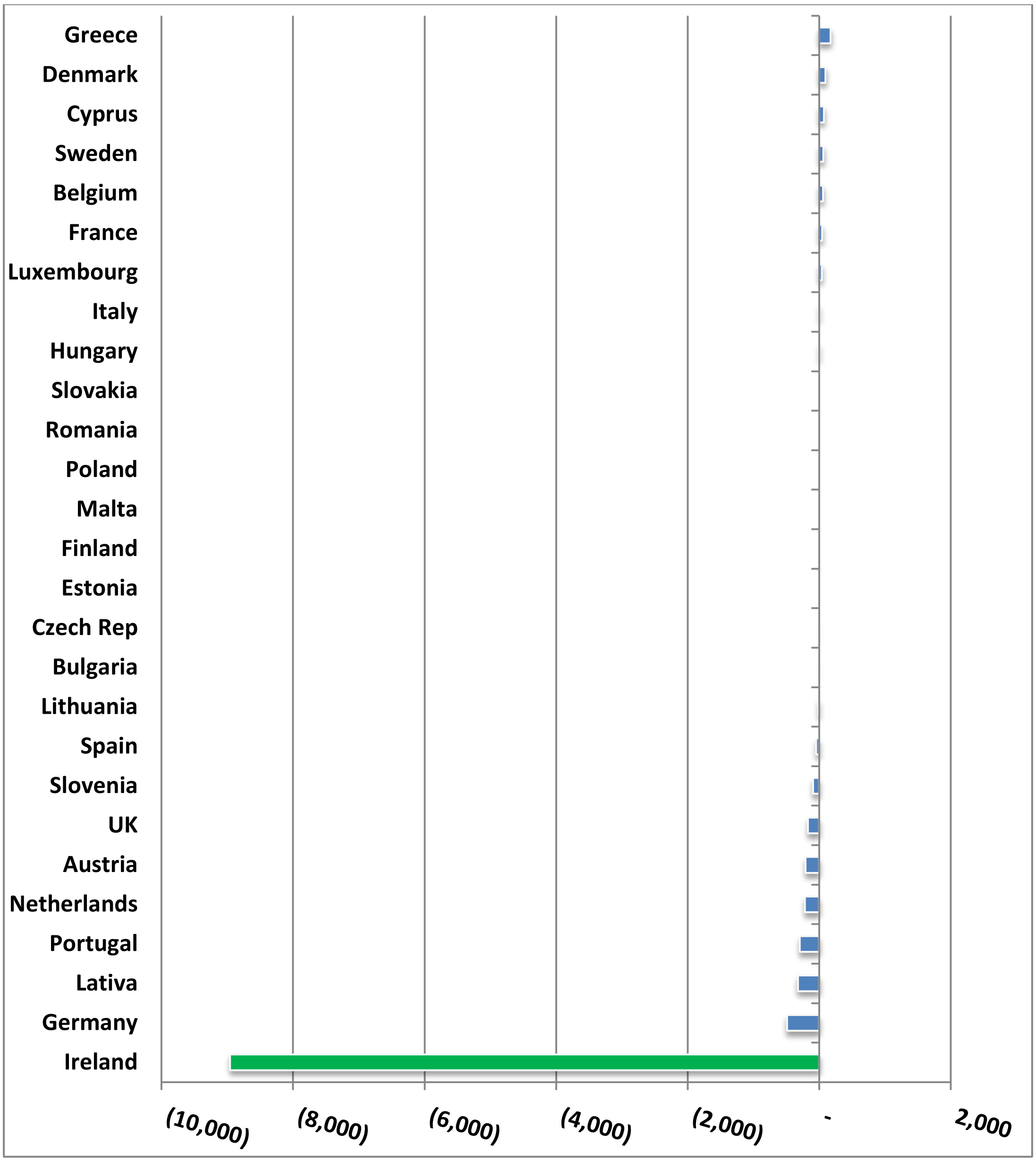
Chart 3 The Total Net Cost of Bank Capital Transfers (Government Deficit) not including capital transactions – percentage of GDP in 2011.



Source: Eurostat 2012.

Finally, if account is taken of the fiscal impact on the population of Ireland which is small relative to total EU population, Chart 4 shows the total cost in Euro per capita in each EU Member State. The cost is €8,956 for Ireland compared to €191 per capita for the EU as a whole.

Chart 4 The Total Net Cost of Bank Capital Transfers (Government Deficit) not including capital transactions – per head of population in 2011 (€ per capita).



The societal costs associated with continuing fiscal austerity over five years are all too apparent to communities, families and enterprises. There is a widely held belief in Ireland that the burden of private banking debt has been, unjustly, transferred to the general population but especially those on low pay, the young, the poor and the vulnerable – in other words those who did not cause the property and banking crash in the first place.

2 What options are technically and politically feasible?

To address the question of debt relief it is important to distinguish between two parts of the overall social bill – to date – for bailing out private banks:

A. The cost of bailing out AIB, EBS, Bank of Ireland, Anglo-Irish and ILP through direct cash injections (from the exchequer or from the NPRF) – estimated at €32.5 billion;

B. The cost of writing 'Promissory Notes' to cover the cost of recapitalising what were Anglo-Irish Bank and Irish Nationwide Building Society (and have now been merged into the Irish Bank Resolution Corporation, IBRC) – estimated at €31.6 billion.

Before discussing the issue of 'Promissory Notes' (B) which accounts for slightly less than half of the total estimated public bill of bailing out the banks, it is necessary to consider the implications of that portion of debt which is accounted for under A above.

2A the cost other than that arising from Promissory Notes

Direct cash injections into the banks, including € 4 billion for Anglo-Irish at the beginning of 2009, were used for a number of purposes including offsets to the significant holes in bank balance sheets arising from impaired loans as well as the flight of deposits in the latter half of 2010. Capital reserves of these banks were also required in the context of paying off bank debts including the repayment of bondholders who had lent to these banks. The repayment of these loans has been the subject of controversy since late 2008. It is believed by some and disputed by others that the repayment, in full, of most of these bondholders was due to some external political pressure on the Irish authorities for a number of reasons related to the stability of the European banking system as well as the exposed position of large funders who had taken a risk on investment in Irish banks. The full extent of any such pressure is difficult to establish due to a lack of transparency surrounding the various communications between European institutions and the Irish authorities stretching from the Autumn of 2008 to 2010 and beyond.

Linked to these concerns is the problem that the treatment of 'moral hazard' in relation to any investment or loan which bears a risk premium has not been the same in relation to mortgage holders and other borrowers. It can be argued that if senior bondholders have not taken a hit – so far – then it could be asked why some mortgage holders (for example) who genuinely cannot pay have to take a hit in terms of losing their homes or part of their ownership of the home? These concerns and questions are not unreasonable since there is a direct link between the assets side of a bank's balance sheet and the liabilities side.

On the other hand if Irish taxpayers have paid significant amounts to recapitalize the banks such as to cover write-downs on the mortgages in the case of those who 'genuinely cannot pay' then the issues of bondholder haircuts and mortgage payer forgiveness can be separated. However, it is not certain that further recourse to taxpayer bailout of the banks will not occur. The outstanding balance on private dwelling houses accounts in arrears of more than 90 days was €16.8 billion at end-September, equivalent to 15.1 per cent of the total outstanding balance on all such mortgage holders[12]. Currently, over 86,000 or 11% of mortgage accounts are in arrears of more than 90 days.

In the event that loan losses are greater than those envisaged in the worst-case scenario in Blackrock's 2011 PCAR assessment (Central Bank, 2011) for whatever reason including a possible further deterioration in domestic demand and disposable income then the issue of haircuts in the case of remaining some bondholders may have to be revisited.

One way of addressing the problem of bank associated public debt under this heading is through sale of equity stakes in the 'pillar banks' (Bank of Ireland and AIB) to the European Stability Mechanism (ESM). Estimate vary, but it is widely believed that it might be possible for the Irish Government to raise €5 and €15 billion through this approach and use the proceeds to make a modest reduction in General Government Debt or bring forward the liquidation of IBRC. However, it is not clear that such an approach – which is likely to happen in practice – is in Ireland's best long-term interests. Having at least one state-owned Irish bank competing on Irish and European retail and capital investment markets should be considered.

Whatever the merits of a unilateral or negotiated write-down on senior bondholders it must be borne in mind that the majority of bondholders in the covered banks have been repaid at this point in time (early 2013). Some bonds are outstanding and it is not

[12] Source: Central Bank of Ireland (2012) Residential Mortgage Arrears and Repossessions Statistics: Q3 2012, 13 December 2012.

clear that a unilateral or negotiated write-down in debt for these lenders is feasible or desirable.

It could be possible for the Irish government to ensure that institutions under its effective control (in particular AIB) would not pay the full amount owed on outstanding bonds. In the case of IBRC it is claimed that the total amount of unsecured and unguaranteed senior bonds is not more than €1 billion (Whelan, 2012: 656). It is worth noting that the total amount of bonds outstanding at Anglo-Irish on 29th September 2008 was €10.8 billion for senior bondholders, €4.8 billion for 'subordinated' bondholders and €1.5 billion for UK government covered bonds. All of the senior and UK covered bonds were covered by the blanket government guarantee of September 2008. €2.1 billion of the subordinated debt was covered. In the next two years up to September 2010 most of these debts were repaid.

At this point in time, it is not clear that a unilateral policy of systematic bond write-downs would be beneficial to Ireland's interests given the impact of any unilateral action on:

- interest rates on other loans to Ireland in the money markets where Ireland might hope to borrow more and more in the future; and
- reputational damage on the political and commercial levels where Ireland is seeking to regain both credibility and attractiveness as a place to invest.

Any amounts saved in such partial defaults might very well be more than cancelled out by unknown and difficult to quantify negative impacts. On the other hand, as noted above, the issue of repaying these loans in full on the liabilities side of the banks' balance sheets is related to the problem of distressed assets or mortgage loans held by Irish financial institutions.

2B the case of the 'Promissory Notes'

Promissory Notes were written by the Irish Government in the course of 2010 to enable Anglo-Irish Bank and INBS to repay their bondholders and depositors and continue functioning legally as a commercial entity. To enable Anglo-Irish to continue as a functioning commercial entity it was decided to issue loans to Anglo-Irish from the Irish Central Bank. These loans to Anglo-Irish are called Emergency Lending Assistance (ELA). The ELA loans have been used over a period of two years to make bond repayments as they come due and to replace deposits.

The ELA loans to Anglo/INBS were backed by 'Promissory Notes'. The promissory notes were issued to Anglo/INBS by the Irish Government and are assets which Anglo/INBS could use as collateral for ELA funding and which outlined a schedule of annual payments from the Irish government (to whom they are a liability) to Anglo/INBS. The Promissory Notes are akin to a mortgage in so far as the notes involve repayments over a long period of time, up to 20 years in the case of these Notes, and the repayments are composed of interest on the remaining loan and reduction of the principal owed. Since the Government did not have adequate funds to make these repayments it was necessary for Government to borrow on international markets to make these repayments. The first annual promissory note payment of €3.1 to Anglo/INBS took place in March 2011.

Due to a complex arrangement in March 2012 the Government avoided paying the €3.1 billion due in 2012 from its cash reserves. However, the Government is liable for that amount as it was converted into a short-term loan taken out on NAMA assets and channelled through the Bank of Ireland. The details of this are explained by Whelan (2012:666-7) as follows:

> *IBRC made its €3.06 billion ELA repayment as scheduled and as insisted by the ECB. There was an adjustment to how this payment was made. IBRC were provided with a 13-year government bond. It then entered into a repurchase agreement with the state-controlled National Asset Management Agency (NAMA) in which NAMA provided IBRC with €3.06 billion in return for temporary ownership of the 13-year government bond. So the money to make the ELA payment came from the Irish state. The IBRC subsequently swapped the bond with Bank of Ireland. Specifically, Bank of Ireland purchased the bond for €3.06 billion and is pledging the bond as collateral with the ECB in return for an estimated €2.87 billion. In return, IBRC is loaning Bank of Ireland the ECB "margin" of €190 million and providing them with a fee of €39 million. So, on net, IBRC is receiving €2.83 billion from this operation, to be repaid in one year. After the Bank of Ireland agreement was concluded, IBRC repaid NAMA, adding an additional €229 million from its own funds.*

In simple terms the cost was delayed and transferred through a complicated set of channels with no reduction in the long-term burden imposed by the Promissory Notes. Neither did this temporary arrangement achieve any change in the way the General Government Deficit is measured for the purposes of compliance with the Troika fiscal parameters. In 2013 over € 6 billion for 2012 and 2013 remains payable as a direct result of the Promissory Note arrangement.

When the Irish Central Bank is repaid the annual sum of €3.1 billion required each year under the IBRC repayment schedule, this money is taken out of circulation. What happens is that the total value of the Central Bank assets and of liabilities are reduced simultaneously when its ELA lending is repaid. The repayments due by the exchequer are shown in column B of Table 2 below. An annual amount equal to €3.1 billion is to be paid to the IBRC on the 31st March each year beginning in 2011. After 13 annual payments of €3.1 billion, the annual repayments begin to fall, from €2.1 billion in 2024, eventually reaching zero by 2032. The total repayment over a period of 21 years comes to €47.9 billion. This latter figure is made of two components:

- A total interest bill payable by the exchequer to IBRC over the 21 year period of €16.8 billion; and
- €30.6 billion which is exactly equal to the total amount of money put into Anglo-Irish and INBS in 2010 by the Irish taxpayer.

The calculation of the interest payable is based on interest rates applicable in 2010 when the Promissory Notes were initially written up. An interest payment 'holiday' was granted for 2012 and part of 2011 in the original design of the scheme. The full impact of interest payments is due to kick in from 2013 when €1.9 billion is due on the Notes in March of this year. Whelan (2012:664) estimates that the interest rate applicable from 2014 onwards is approximately 8% per annum. As the principal sum is gradually wound down over the years the annual interest payments are reduced accordingly. As discussed later, a portion of this interest is recycled through IBRC and on to the Irish Central Bank and remitted to the exchequer by way of Irish Central Bank profits.

Table 2 Promissory Note Payment Schedule (€ billions)

Date Due	Total Interest	Repayments	Capital Reduction	Total Amount Outstanding
	A	B	C	D
31/3/2011	0.6	3.1	2.5	28.1
31/3/2012	-	3.1	3.1	25.0
31/3/2013	0.5	3.1	2.6	22.4
31/3/2014	1.8	3.1	1.2	21.2
31/3/2015	1.7	3.1	1.3	19.9
31/3/2016	1.7	3.1	1.4	18.5
31/3/2017	1.5	3.1	1.5	17.0
31/3/2018	1.4	3.1	1.6	15.4
31/3/2019	1.3	3.1	1.7	13.7
31/3/2020	1.2	3.1	1.9	11.8
31/03/2021	1.1	3.1	2.0	9.8
31/03/2022	0.9	3.1	2.2	7.6
31/03/2023	0.7	3.1	2.3	5.3
31/03/2024	0.6	2.1	1.5	3.8
31/03/2025	0.4	0.9	0.5	3.3
31/03/2026	0.4	0.9	0.5	2.8
31/03/2027	0.3	0.9	0.6	2.2
31/03/2028	0.3	0.9	0.6	1.6
31/03/2029	0.2	0.9	0.7	0.9
31/03/2030	0.1	0.9	0.8	0.1
31/03/2031	0.0	0.1	0.0	0.0
Cumulative total	16.8	47.9	30.6	

Whelan has pointed out that a large proportion of the amount of projected interest payments by the exchequer (column A of Table 2) simply represents transfers of money between different arms of the Irish Government (the IBRC, the Central Bank and the Exchequer). On the assumption that IBRC assets are used to pay off IBRC liabilities including ELA funds extended by the Central Bank of Ireland and assuming an estimated interest rate of 3.0% per annum rising to 4.5% per annum on funds lent by the Central Bank to IBRC, Whelan estimates that it will be possible for IBRC to pay off all of its debts as early as 2021 at which point, he suggests, the Government could wind up IBRC and cancel the remaining payments. If this were to happen the total interest bill might come to €6 billion instead of the much higher estimate of €16.8 billion.

Whelan further suggests that most of the estimated interest bill of €6 billion would be returned to the State in the long-run in the form of profits to the Central Bank of

Ireland. However, he concedes that interest payments in the short-run do matter for government accounting because these payments are counted as part of the cost of servicing General Government Debt on a year to year basis. The full extent of recapitalisation of Anglo-Irish and INBS in 2010 by the Irish government was counted by Eurostat – the European statistical agency – as a one-off increase in the total stock of debt. Once interest payments start to kick in from 2013 the annual interest bill is counted as a cost to the Irish government in each year. It is these payments of interest €1.9 billion in 2013, €1.8 billion in 2014 and €1.7 billion in 2015 – which cost the Irish taxpayer since they effectively raise government current spending by these amounts with the result that the Irish government is expected to find savings in other areas of spending and/or increases in revenue by an offsetting amount.

In addition, because the Irish Government does not have the money to pay interest paid to IBRC it has to borrow additional funds – at approximately 4% per annum – in order to be able to pay back money to IBRC each year. This cost is difficult to estimate but is significant and it not included in most estimates of the cost of the Promissory Notes.

Based on 2011 accounts of IBRC once IBRC debts to the Irish Central Bank are excluded (the value of ELAs), IBRC assets appear to be adequate to repay all other IBRC debts including the remaining bondholders. ECB loans to IBRC have been largely, if not entirely, repaid at this point. Hence, the Irish Central Bank remains to be repaid by IBRC. In effect the Irish taxpayer, who ultimately owns the Central Bank and IBRC is paying IBRC to pay the Central Bank, which in turn, 'destroys' the money by taking it out of circulation. Total assets and liabilities are reduced by this amount by the Irish Central Bank. At the same time outstanding ELA loans from the ECB are reduced by the same amount.

ECB concerns about changes to the Promissory Note payment arrangement are primarily to do with the setting of precedent (through what is termed monetary financing) rather than any material concern about liquidity flows back from Ireland to ECB which are relatively small in terms of the overall size of financial assets. However, it is important to consider the wider political and banking aspects of any 'unilateral' action by the Irish Central Bank which is, after all, a constituent part of a European banking system bound by legal rules and mutual agreement. It is clear that for Ireland to continue to stay within the Eurozone and the emerging institutional arrangements for European banking it must seek agreement of its European partners. However, in seeking agreement in a way that respects European solidarity must have, as a starting point, a strong negotiating position – one that does not expose Ireland to further crippling debt burdens on a future generation as well as one that does not open up a risk to the delicate process of full re-entry to international capital markets in the future. The risk of retaliatory action by the ECB in response to any unilateral default or temporary suspension of repayments is a serious concern. This would be most unlikely to entail withdrawal of ELA given the risks of contagion and instability in the wider European banking system. The ECB could use the risk management framework to increase the rate of interest on funds lent to Ireland as well as take a different view in relation to the quality of existing Government bonds as collateral.

It is important to weigh up the costs and benefits of any given negotiating stance. Such an analysis goes beyond the scope of this current paper. However, it should be recalled that there are historical precedents for a change or evolution in the policies of the ECB since the onset of the current financial crisis. Ultimately, a cost to one link in the chain of European economic inter-dependence is a cost to all as the experience in Greece has (tragically) illustrated.

It is clear that, as of early 2013, there is some political momentum behind a 'deal' on bank debt associated with the IBRC Promissory Notes. This has been facilitated by the 29th June 2012 EU Summit statement which hinted that Ireland might be viewed as a special case in the context of future banking provisions[13].

While it is not clear which options are under discussion it would seem that a partial debt relief could take a number of forms including:

[13] ' We affirm that it is imperative to break the vicious circle between banks and sovereigns. The Commission will present Proposals on the basis of Article 127(6) for a single supervisory mechanism shortly. We ask the Council to consider these Proposals as a matter of urgency by the end of 2012. When an effective single supervisory mechanism is established, involving the ECB, for banks in the euro area the ESM could, following a regular decision, have the possibility to recapitalize banks directly. This would rely on appropriate conditionality, including compliance with state aid rules, which should be institution specific, sector-specific or economy-wide and would be formalised in a Memorandum of Understanding. The Eurogroup will examine the situation of the Irish financial sector with the view of further improving the sustainability of the well-performing adjustment programme. Similar cases will be treated equally. 'http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/131359.pdf

- A write down in the nominal value of the total principal (€28.1 billion remaining);
- A moratorium on repayments of the principal for an agreed period;
- A stretching of the maturity of the 'loan' from 10 years to a longer period; and
- Some adjustments to the measured interest payment schedule in a way that provides up front relief for hard pressed public finances.

It is not possible to speculate on which of the above options are likely and what extent of relief is likely. Some recent indications as of January 2013 have not been encouraging. A number of crucial questions are likely to arise following any announcement:

- To what extent is the nominal value of the debt 'locked in' officially whether by means of Irish Government or European bonds or otherwise for present and future generations?
- To what extent will the timing of repayments be adjusted to allow for immediate up-front relief on the fiscal front while spreading the payments over a longer period when, hopefully, a combination of real economic growth and price inflation will lower the ratio of debt (and its servicing) to GDP?
- How might any relief in terms of debt-servicing or repayment of principal by the Irish exchequer be used to redirect efforts into writing down other portions of government debt or investing in job-productive investment?
- Would a deal on banking debt come with 'terms and conditions' in other areas of public policy including, for example, further sale of state assets or commitments in relation to corporate taxation?

3 What would an optimum or fair resolution look like?

An equitable solution needs to be found to the problem of sovereign debt. It is not right that the entire burden of adjustment is placed on Irish taxpayers, workers and businesses enduring the effects of recession any more than on European taxpayers. The growth in public debt and the burden of servicing this debt on the accounts of government constitute a major constraint on return to economic growth and sustainable public finances in the medium-term. Much damage has already been done and the lack of burden-sharing in relation to private debts already repaid is seen as undermining the principles of social cohesion and European solidarity. Governments across Europe and the institutions of the European Union including the European Central Bank have a responsibility to find a solution to the inter-linked problems of debt, recession and public sector deficits in member states.

It has to be acknowledged that the responsibility for the current crisis in banking and in public finances in many European countries is a joint responsibility. It is not correct to place all of the responsibility on one partner to this situation.

Previous analysis of the background and immediate causes of the Irish banking crisis identifies many actors including key domestic policy makers and analysts who ignored the warning signs and, when confronted with a growing systemic crisis in the summer of 2008 took inappropriate steps based on a poor understanding of the underlying problems. Overlaying domestic failure was a gathering international crisis and heightened anxieties in the Eurozone which increased in the course of the following four years. While it is not correct to apportion all of the blame on domestic policy and banking practice, neither is it appropriate to apportion all of the blame on international circumstances. The role of former Anglo-Irish Bank is particularly noteworthy. The 2011 Nyberg report (Report of the Commission of Investigation into the Banking Sector in Ireland, 2011:ii) comments as follows

> *Anglo in particular was widely admired domestically and abroad, and lauded (by many investors, consultants, analysts, rating agencies and the media) as a role model for other Irish banks to emulate.*

It is necessary to find a solution to the triple lock of:

- High and unsustainable levels of general government debt which now come to an estimated 117% of Gross Domestic Product in 2012 (and likely to rise to over 120% in 2013).
- High and escalating costs of servicing this debt through interest payments year after year (reaching a maximum of 5.5% of GDP in 2014).
- The particular problem of repaying debts incurred by Anglo-Irish / INBS under the heading of Promissory Notes.

In this section the focus is on Promissory Notes' since

- these constitute a huge proportion of the public cost to date;
- they are the subject of intense debate in early 2013;
- they appear to be the subject of negotiation and possible agreement between the Irish authorities and the European Central Bank and European Commission.

Prior to the General Election of February 2011 expectations were high among many commentators and voters that a new, incoming government would not pay some of the private debt that had been socialised – particularly that associated with dead banks such as Anglo-Irish. At the very least there was an expectation that the new government would adopt a very tough bargaining position with the international agencies especially the ECB. As late as the summer of 2011 certain bonds in the 'pillar banks' were trading well below face value in the expectation of a 'write-down' in the repayment. In the event these bonds were repaid months later in full yielding a handsome profit to investors whose corporate identity will never be known. One T.D. prior to the 2011 General Election was quoted as saying:

> *All I can say to the Irish people – some of whom may be watching tonight – is that if things go our way there will be a new government in six week time and the banks aren't getting another cent," he said at the time. Anglo Irish Bank is not getting another cent of our money and any bank coming to us looking for more money is going to have to show how they're going to impose losses on their junior bondholders, on their senior bondholders and their other creditors before they come looking to us for any more money. Not another cent*[14]*.*

[14] http://www.thejournal.ie/kenny-says-well-pay-our-dues-a-year-after-varadkar-said-not-another-cent-350805-Feb2012/

A ‘technical’ option involving a speedy wind-up of IBRC and liquidation of all its remaining assets to repay up to €10 billion in ELA funding would be possible. Whelan (2012:668-9) has argued that an agreement involving the Irish Government, the Irish Central Bank and IBRC could be done in such a way that it ‘was not opposed by the ECB Governing Council’. It could be argued that the arrangement is not in harmony with European Treaties[15] since it involved monetary financing by a European Central Bank – the Irish Central Bank.

In the immediate weeks before the Guarantee of 29th September 2008, the ‘Honohan Report’ comments about the use of Emergency Lending Assistance (ELA) in general (this was prior to the creation of the Promissory Note arrangement in 2010) as an option for assisting banks in difficulties:

> *While this [E L A] would have had to be notified to the ECB, and any significant amounts would have required prior agreement (strictly speaking: no objection) by the ECB Governing Council there is no reason to believe that this would not have been forthcoming (Honohan, 2010: 122).*

In an earlier section the Honohan Report notes:

> *In the Eurosystem, this form of financial assistance may be used in the case of a solvent but illiquid credit institution which does not have sufficient collateral with the required characteristics for use in normal ECB lending operations. Such assistance can only be given on the basis of adequate alternative collateral and the associated credit risk is assumed by the national central bank and not the Eurosystem as a whole. Honohan, 2010: 116).*

A number of unresolved questions arise in relation to the introduction of Promissory Notes in 2010:

- What views, if any, were sought from, and given by, the European Central Bank in relation to the decision to write these Notes?
- Given that Anglo-Irish was insolvent as soon as late 2008 was the use of financial assistance via ELA and the subsequent use of Promissory Notes legal?
- What other communications took place between the Irish authorities, the European institutions, other Governments and commercial interests with a stake or lending exposure in Irish banks in the period of 2008-2009?

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[15] And possibly the Irish constitution pending the outcome of a legal challenge which is underway in January 2013.

A resolution to the specific problem of the Promissory Notes in the case of Ireland is now accepted. The details remain to be determined. A deal might involve:

- A significant up front relief to public finances where most or all of the costs of servicing this debt are removed;
- Agreement to postpone the repayment of interest and/or principal by a very significant period of time to allow space for economic recovery.
- Agreement to write-down, transfer or 'freeze' the total debt value of the Promissory Notes.

'Freezing' the total debt on these Notes might involve no repayment for a long period of time. 'Transferring' the debt might mean rolling the principal into a European Union bond issued by the European Stability Mechanism. Such an approach might involve the introduction of EFSF or ESM long-term bonds enabling the Irish Government (or the ESM if it were agreed to fully transfer the liability to a new EU banking union) to repay the debt over a much longer period during which the EFSF/ESM would provide the collateral to the ECB. It is not clear that such an approach would be readily accepted in Europe and even it were the Irish Government would be exposed to continuing high levels of public debt and continuing costs of debt servicing (albeit at a lower level than otherwise would be the case) in the case where the bonds were ultimately to be repaid by Ireland.

Writing down some of the debt might be an 'Irish solution to an Irish problem' entailing liquidation of all remaining IBRC debts and repayment of outstanding lenders from disposal of all IBRC assets with the Central Bank taking any remaining losses (if any) with the agreement of the ECB. However, the problem raised by 'legacy bank debts' and the setting of precedents for other Member States (not least Spain) weighs on the ECB.

At a political level discussions seem to be focussed not at all on a debt write-down but on some type of 're-structuring' of the debt where 're-structuring' will involve a longer time to pay back the debt and lower interest rate bills in the short-term. It is unfortunate that a debt write-down seems to have been ruled out as a starting point in the negotiations. Clearly, the ECB and certain EU Member States are anxious that a precedent is not set – even if it could be plausibly argued that IBRC and its predecessors had ceased to be functioning commercial banks or financial institutions over 2 years ago. On the other hand the burden on Ireland – occasioned by a series of international events and pressures in 2010 – is seen to be unjust and intolerable. Some commentators see it as an obstacle to full re-entry to the bond market by Ireland in 2014 given the short-term repayment schedule demand in the Promissory Notes arrangement.

In a restructuring of the debt, the total nominal amount of debt would remain the same – it might be repayable over a longer period of time thus giving breathing space to Ireland or it might involve lower interest payments thus lowering the total long-term cost of the loan to Ireland. Any delay in repayments of interest or principal involves a change to what analysts refer to as 'Net Present Value' (NPV). NPV is the value of a future stream of payments (net of receipts such as profits earned by the Central Bank and returned to the exchequer) discounted back to the present time. In other words the value of a payment of, say, €3 billion paid in 30 years time is not equivalent to €3 billion paid today. This is almost certainly the case for at least two reasons:

- Prices will increase over time thus eroding the 'real' value of any given amount;
- Real growth in GDP – in the long-run – will reduce the real economic value of output or expenditure forgone as a result of making a payment in 30 years time instead of today.

A discount rate to reflect the impact of price inflation and real growth is used to estimate today's value of a future liability. There is no agreement on what the value of such a discount rate should be. However, most economists would use a rate of between 4 and 6% - made up of an assumed long-term average rate of price inflation and real growth in the economy. It should be recalled that following the Second World War national debt in many countries was at an extremely high level and interest repayments constituted a drain on scarce public resources. However, a combination of factors including real economic growth and long-term price inflation eroded the real value of much public debt and, when expressed as a percentage of GDP or national income, high debt levels, initially, did not lead to a crippling of post-war economic recovery or did not prevent the expansion of social protection and services to citizens. It should be recalled that a large write-down in World War I debt for Germany was agreed in 1953.

A number of agreement scenarios may be postulated:

a) A complete write-down of the debt and closure of IBRC and discharging of all remaining IBRC debts from available IBRC assets other than the Promissory Notes.
b) An extension of the maturity of the Promissory Note debt from its current period of 10 years to a much longer period (15 has been cited as possible option).
c) Use of a 40 year bond and an 'interest-only' repayment schedule for a long period of time after which the debt is repaid in full and in one go.
d) A new interest payment 'holiday' or reduced interest payment schedule for a further 3 years (for example) and/or a cap of €2 billion on the annual repayments to IBRC. and
e) No change to the current repayment schedule.

Further analysis will be required to elaborate on the impact of any new arrangement on (i) General Government debt service in the immediate three-year period ahead and (ii) the Net Present Value (NPV) of all future payments/receipts compared to the alternative of no change to the current repayment schedule. Given a projected repayment by the Exchequer of €44.7 billion up to 2027 (extrapolating from information in Table 2 above but factoring in the €3.09 deferred payment of 2012 and excluding the 2011 payment) and using a 5% annual discount rate the net present value as of January 2013 of this future payment flow is €29.1 billion. However, if future borrowings are included to fund the annual repayments the NPV could be very significantly higher than this.

Alternatively, if there were to be a cap of €2 billion annual repayments the total bill with a consequent stretching out of the repayment period over which the entire sum of €28 billion is repaid the total bill would come to €36.8 billion and the NPV would be €20.5 billion – not accounting for the cost of borrowing to pay the annual sum of €2 billion.

The above two scenarios would see only a very gradual fall in the level of General Government Debt over a 15 year period. There would be, however, an immediate impact on the headline General Government Balance (or deficit) with an estimated accrued interest payment of only €760 million in most years in the case of a 15 year bond or a slightly higher amount in the case of a re-structured arrangement and a cap of €2 billion payment per annum from the exchequer to IBRC.

Alternatively, a complete write-down in the debt including the outstanding value of the 2012 Bank of Ireland bond used to settle the promissory note obligation in 2012 would see reduction of just under 18 percentage points in the General Government Debt and a removal of €1.85 billion from public expenditure in 2014.

The choice of discount rate is very important to the determination of NPV for any given maturity or assumed structure of repayments. By assuming a relatively low discount rate (for example 3%) it is possible for the NPV to be higher under an extended repayment schedule compared to the current arrangement.

A key policy concern is the immediate cost in terms of servicing debt and how this is measured in General Government finances according to present Eurostat rules. The focus on what is paid by General Government to IBRC may provide a very misleading picture of the long-term liability of General Government for the debt in question. Some reconsideration of this matter by Eurostat seems warranted especially considering the central role of Eurostat-measured deficits and debt in determining compliance with Maastricht and fiscal compact budgetary criteria.

If the transfer of Anglo-Irish debts to the public was carried out under some undue international pressure without regard to the ability to pay of the Irish government and with consequent damage to Ireland's reputation and its capacity to recover its economic position as a result of burdensome austerity policies then there is a need to address the problem in a comprehensive, fair and effective way. The best outcome would be an agreed solution that provides significant upfront as well as long-term relief, that recognises the economic and moral imperatives of not putting the entire burden on Irish taxpayers.

Pending such a successful agreement it is important that a strong negotiating position is adopted. The following should be considered:

- Suspend Promissory Note payments due in March 2013 pending successful and satisfactory negotiations for all concerned; and
- Focus these negotiations on three issues in the following order:
    - reducing the value of the principal
    - extending the maturity of the loan

- and lowering or re-scheduling interest payments on borrowings by Ireland to repay the debt

By the far the fairest and most financially sure solution is for a partial or complete write-down in the principal of the debt associated with the Promissory Notes. Such an outcome would take account of the unique circumstances in which this part of private banking debt was imposed on the taxpayer when the bank in question was already known to be insolvent. As direct consequence of this imposition on sovereign debt there was a considerable further loss in market confidence in Irish government bonds in late 2010 thus precipitating the 2010 bailout. Moreover, such a write-down would remove an estimated 17 percentage points of GDP from the total stock of General Government Debt bringing Ireland back close to a public debt/GDP ratio of 100% instead of a likely figure of 120% next year.

Allied to a strong negotiating strategy is the option of taking legal recourse through the European Court of Justice. Such a strategy would have the advantage of compelling witnesses, discovering relevant documents and communications as well as probing the legal status of various actions in the light of European Treaties.

Finally, the prospect of conceding policy changes in regard to financial transaction taxes in exchange for debt relief should be explored. As Stewart (2012:13) Ireland needs to wrestle with the choice of being part or a UK/London sphere of influence or moving towards 'greater integration within the Eurozone with all that implies in terms of a Financial Transactions Tax, greater harmonisation of regulation and taxation'.

4 How big a difference could a deal on bank debt make to public finances in Ireland?

In the previous section, three options for reducing debt burden on the Promissory Notes were mentioned. A reduction in the nominal value of the principal would be, by far, the most beneficial to Ireland but the most contentious given ECB concerns about setting a precedent even though a large debt write down has already occurred recently in Greece in 2011[16]. Stretching out the loan period could ease the burden of repayment but, depending on assumptions made with regards to inflation, growth and the appropriate 'discount' rate applicable could simply shift the debt burden – unfairly – to the younger generations who have already taken a heavy hit in terms of income, pay, employment and personal debt.

Adjusting the 'interest rate' needs to be clarified – changes to the interest rate charged by IBRC to the Government or by the Central Bank to the IBRC is largely irrelevant in the long-run given the circularity of cash flows among government owned bodies. However, the interest charged to Ireland in a situation where the ESM (for example) takes charge of the debt would be relevant. It should be noted that the interest paid by the Irish Government on general borrowings that go towards repaying IBRC are determined by international and European market trends.

Any write-down or any 'Europeanisation' of the Anglo-Irish debt component of General Government Debt (equivalent now to just over 17% of Irish GDP) would help Ireland meet its long-term 'debt brake' target of 60% by means of a more gradual adjustment. Proposals have been made by many economists to share the burden of bank debt – possibly through a conversion of a portion up to a limit of 60% of GDP into European bonds. McDonnell (2012) has considered the options for a stronger regulation of banking and pooling of risk within the European Unions allied to a social compact. McCarthy (2012) recommends careful design of capital adequacy rules, bank resolution procedures and the funding of a common European deposit insurance

[16] The previous default in Western Europe had occurred in Germany in 1953 when a large amount of its debt inherited from the Versailles Treaty period was written down. The last of this debt was paid off in 2010 – 92 years after the end of World War 1 and following write-downs in 1948 and in 1953. European and German history might have been different if a debt cancellation was undertaken prior to 1932. The future of the European project could be different if there is greater flexibility on government deficits and debt than has been shown to date while stimulating the European economy and strengthening a commitment to a social Europe.

scheme. He does not see a need for significant fiscal union if proper controls and procedures are in place where no bank is not too big to fail.

Any relief on interest payments could make an upfront difference in terms of the government deficit. Any relief by way of €1.9 billion and €1.8 billion in interest payments in 2013 and 2014, respectively would be helpful. The 'repayment' of the principal sum within the total amount of €3.06 billion due in March of this year and later years is treated under the Exchequer account and not under General Government. The 'demonetisation' of that debt by the Central Bank on receipt of a payment from IBRC which in turn is paid by the Exchequer represents a real deflationary shock to the economy because of the forgone positive contribution to domestic demand resulting from repeated contractions in government spending year by year. There is a real opportunity cost in the 'burning' of money by the Central Bank when it reduces the total value of its assets and liabilities by the amount paid to it by IBRC each year. This is where the greatest impact needs to be made.

In conclusion the following taken from an article written by Ashoka Mody in the Irish Times on 14th November 2010[17] in which he argues that perpetual austerity seems destined to fail and makes the case for spreading the debt burden across the Euro Zone members or 'asking private lenders to share the pain' is relevant:

> *… if holding the taxpayers of the debtor nations liable remains the centrepiece of the debt-reduction strategy, growth will remain throttled and debt ratios will remain high. The ECB will be sucked further into burden-sharing.*

[17] http://www.irishtimes.com/newspaper/opinion/2012/1114/1224326574017.html

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