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JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 21 Eanáir 2015

Wednesday, 21 January 2015

The Committee met at 9.30 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D’Arcy,
Deputy Michael McGrath,	Senator Susan O’Keeffe,
Deputy Eoghan Murphy,	Senator Marc MacSharry.
Deputy Kieran O’Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Mr. Klaus Regling: Ireland and the euro area as a whole have already done a lot by deciding on new policy co-ordination mechanisms. We have now - I mentioned it earlier - the so-called excessive imbalance procedures. This looks at macroeconomic imbalances that can lead to a crisis like excessive divergence in competitiveness, current account imbalances and credit bubbles. All this is now done in a systematic way. It did not exist before the crisis. We always had a Stability and Growth Pact but not these other elements. The Stability and Growth Pact has been strengthened. There is less room for political interference now. The Commission proposals will normally become European law. We have done things on banking union, including transferring the supervision of important systemic banks to the single supervisory mechanism, SSM. That is important. We have the European financial stability facility, EFSF, and as a permanent crisis mechanism, the European Stability Mechanism, ESM, which did not exist before the crisis. There are many different elements where we have tried to draw the conclusion.

Let me mention also the European Systemic Risk Board, ESRB, which is not well known by the broader public. It is a very important innovation because it has this mandate of looking at macro-prudential risks. No one did that at the European level before 2008 and, let me say again, the same in the US and the UK. So, not only a European phenomenon. One clear lesson of the crisis is that these macro-prudential aspects can become very important. Supervisors in the past only looked at the micro aspect. They went into a bank - maybe not assertively enough - and looked at the loan book, loan by loan, and decided whether it was a good loan or a bad loan, whether the provisions were enough. However, there was no one to add it all up, which is the macro-prudential side, to come to a judgement on whether, overall, from a macroeconomic perspective, what banks were doing in a country was excessive or not. So, we have learned lessons in many different areas here in Ireland, but also in the euro area as a whole.

Chairman: I thank Mr. Regling again on behalf of the committee for his participation today and his engagement with the committee. It has been a very informative and valuable meeting in understanding the factors leading to the banking crisis in Ireland. Once again, we extend our sympathies to the family of Mr. Watson on his recent passing. I propose we suspend until 11.45 a.m., at which time we will resume with the next session of the meeting when we will be dealing with Professor Lane.

Sitting suspended at 11.30 a.m. and resumed at 11.45 a.m.

Professor Philip Lane

Chairman: The Joint Committee of Inquiry into the Banking Crisis is resuming in public session. Next on the agenda is our discussion with Professor Philip Lane from Trinity College Dublin. Our guest is a professor of international macroeconomics and director of the Institute of International Integration Studies at Trinity. He received a doctorate in economics from Harvard University in 1995 and was an assistant professor of economics and international affairs at Colombia University between 1995 and 1997 before moving to Trinity College in that year. He is a research fellow of the Centre of Economic Policy Research and has been a visiting scholar at the International Monetary Fund and the Federal Reserve Bank in New York, and a consultant to the European Commission.

His research interests include international macro-economics, economic growth, European monetary union and Irish economic performance. He is a managing editor of the *Economic and Social Review* and is also on the editorial boards of the *Journal of the European Economic*

Association, the *International Journal of Central Banking*, *Open Economies Review* and *Economics and Politics*.

Professor Lane has been invited here today to discuss the Irish banking crisis, and economic and monetary union.

Before we begin, I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If they are directed by the Chairman to cease giving evidence in relation to a particular matter and continue to do so, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings be given. The witness has been informed previously that the committee asks witnesses to refrain from discussing named individuals in this phase of the inquiry.

Members are reminded of the long-standing ruling of the Chair to the effect that members should not comment upon, criticise or make charges against a person outside the House or an official by name, or in such a way as to make him or her identifiable.

I now invite Professor Lane to make his opening remarks.

Professor Philip Lane: Thank you, Chairman. I am glad to have the opportunity to speak to the committee today and to take questions about the role of the euro in what went on. Since the mid-1990s this has been one of my main research areas. The idea of monetary union was in the air since the early 1990s and there was a lot of discussion about what might happen once the euro was formed. Of course, now we have seen all that has gone on in the first 15 years.

I will make four points in this opening statement, so it will be an overview of the more detailed written statement I have provided. The first point is to talk about the global context. Europe, in the end, is a relatively small part of the world economy. We have to remember that the euro area lives in a global economic and financial system.

Second, I will talk about the impact of the euro in its first decade until the crisis. My third point is about the role of national macro and financial policies under the euro. My fourth point will be about how the euro has affected crisis management since 2007-2008.

In terms of the global context, since the late 1990s the creation of the euro was not the only major event in the world economy. In the background, for example, the rise of China had a big effect. China was growing so quickly that it was important in the late 1990s, but by the mid-2000s it was very important. That had trading effects, although maybe less so here. For example, the economies of Portugal, Greece, Italy and so on were quite affected by the rise of cheap imports from China. Financially, the surpluses coming out of China were essentially flowing into the US financial system. Low interest rates in the US prompted, for example, the rise of securitisation in US financial markets and European banks were active in the US system. Therefore, there was a deep connection between what was going on in the US in the mid-2000s and what was going on in Europe. A lot of that was being intermediated through banks. European banks were important in linking the US financial system to the European financial system.

That meant that by the mid-2000s we had this global liquidity situation where interest rates were quite low globally, while capital was flowing and trying to find extra yield. There was a lot of interest in innovative products like asset-backed securities. There was a lot of availability of non-deposit funding. What we saw were lots of countries starting to run much larger imbalances. That was true in the euro area but also outside it. We saw the Baltic economies and Ice-

land running large deficits. Within the euro area, Ireland was running a current account deficit, but it looked smaller than what was happening in Spain, Portugal and Greece for example.

Let me now turn to the direct effect of the euro itself, which was interacting with those global factors. It is important to split the time period into sub-parts. First of all, from 1997 to 2001, there is an entry phase. The fact that EMU was going to happen already led to a decline in interest rates in the periphery of Europe. It led to a lot of optimism that now interest rates and inflation would be lower. It created a situation where there was more temptation to invest, consume more and save less.

I would emphasise, however, that period really came to an end with the recession in 2001. The US recession and the European recession in 2001, even though relatively brief, did break that initial phase. If one went back and asked people in 2002 and early 2003 what happened next, they would say essentially that the exciting phase was over. Essentially, one might think at that time that the world would settle down to more normal behaviour. At that point, however, from 2003 to 2007, the import from the US of low interest rates, innovative financial products - and global banking corporations looking to invest through the interbank market and bond market in national banking systems across Europe - all of these credit events were happening then.

I would emphasise that at that time the fundamentals in Europe were looking less good. The interaction of credit supply was becoming more available, but in fact the story in Europe was becoming less positive. In a number of economies demographic factors were turning more negative. Oil prices were going up, which was a negative for importing countries in Europe. The dollar depreciated quite a bit. From 1999 to 2001 the dollar appreciated a lot, which has boosted Ireland in particular. From a low in late 2000, when €1 bought only $0.82 cents, by 2008, €1 bought $1.57. That was a pretty massive dollar depreciation against the euro.

In countries like Ireland and Spain, one saw that the business model of building export markets was replaced by an emphasis on local activity, especially construction. The quality of economic activity from a long-term sustainability point of view declined in that period. Essentially, there was a credit supply shock with all of this global liquidity being available, but in fact there were fewer productive opportunities in Europe at that time.

I will come back to the crisis period after 2007. Let me turn to my third point about what the role of national policies inside a monetary union is, especially in the context of this kind of credit shock. I will come back to interest rate policy in a minute. The other levers of policy include credit policies, thus using financial regulation to ensure that banks do not over lend. Today, we are talking in Ireland about loan-to-value ratios and loan-to-income ratios. The Central Bank of Ireland could have used those tools in the mid-2000s. Other countries did use them to a much larger extent than here.

This morning, Mr. Regling talked about the fact that these were out of fashion a little bit at that time. I think one can find examples where they were used more extensively than here. That is the first line of defence. When the source of the instability is global credit, the more direct way to deal with that is through regulation of credit politics here in Ireland.

The second line of defence is fiscal. At a micro level concerning the role of taxes and subsidies that might have encouraged investment in housing, those policies could have been changed. At a macro level, the narrative is that under monetary union the scale of fiscal surpluses one needs to run when one is in an all out boom situation, is much larger than was achieved. It is the case that the fiscal balance was in surplus for a long time but fiscal surpluses of 1% or 2% of

GDP were basically not enough. There are counter examples. I wrote in the report that in 2007 countries like Finland and Sweden had surpluses of more like 5% of GDP. Again if we roll back the clock, would that have been something that was seen as politically viable in the Irish situation - running surpluses in the mid-single digits? In the report I describe also the possible role of a rainy day fund. Essentially, given how difficult it is to manage surplus situations, it might have been a way to communicate to the population that some of this tax revenue was a windfall, so the capital gains taxes, the stamp duties and so on might be seen as ring-fenced. They were not going to be long-term revenues at the level that they were and those revenues could have been diverted into a secure fund, which then could have been released when the downturn came. I wrote about this in the late 1990s before the EMU pointing to this perhaps being one of the innovations we need. Regarding going into the euro, there was enough evidence that one needs to run fiscal policy on a more prudential basis than was achieved. It is important to say that it is not the case that the Irish system failed to deliver surpluses. There were surpluses and public debt came down to a relatively low level but this was of a different order - the scale of it that was needed to stabilise the system was much greater than was politically discussed at the time.

I will turn to interest rate policy, the one that we do not have under the euro but could have had outside the euro. One thing we could have taken before joining the euro was to revalue the Irish pound, so in terms of the lock-in exchange rates, we could have done more. There was a small revaluation in early 2008 - it was around 3%. The Irish economy was rocketing in 1998 and 1999. It could have been anticipated that a much bigger revaluation could have been a good way to start in the move to the euro because that would have relieved inflationary pressures that built up. In terms of interest rate policy, in the period 1999 to 2002 it is clear that we would have chosen much higher interest rates if we had been outside the euro. The economy was really strong, inflation was quite high and way above the European average. We would have seen much higher interest rates here. It is not super clear after that. From 2003 to 2005 inflation here has come down and in 2004 and 2005 we were pretty close to the European average. It is not clear to me that the Irish Central Bank at that time would necessarily have picked much higher interest rates. In 2006 and 2007 we were back to a situation where the economy started to overheat again and we would have picked higher interest rates. I think the interest rate sequence we would have seen would have been different but I also would emphasise that carries its own problems.

When a country has a small economy with its own currency and it raises interest rates in the heated situation we were in, there will be offsets. One is that it will look very attractive to global investors. If one is offering a 5% interest rate when France is offering 3%, one will have a lot of capital flowing in. It could have brought in foreign capital to look for gains here. The currency would have appreciated. The interest rates we would have needed to cool down the housing market might have been the interest rates that would have had severe consequences for the export sector. Switzerland is seeing that now. There is a trade-off between the currency position and the interest rate position we want for financial stability versus what is desirable for the real economy. That is the conundrum, there is no way around it, which is why, essentially, there is the current debate. Interest rates cannot do everything. We need the credit policies - the macro-prudential policies - as well.

Iceland had a floating currency. If one mixes a floating currency with poor regulation, one can get perverse outcomes because the krona in the mid-2000s was quite strong. What that meant was that an Icelandic risk-taker could say to an international bank that in euro terms he or she was worth €1 billion because of this currency appreciation effect and therefore he or she

could offer it better collateral and could borrow more. Again, with a well-regulated banking system that effect goes away but one has to think about the interaction of interest rate policy, regulatory policy and fiscal policy together.

My final point is about the crisis. In the first period of the crisis from August 2007 onwards, there was a fairly positive view of European Union membership because it must be remembered that with the euro we had access to European Central Bank, ECB, liquidity whereas if countries outside Europe like Iceland, Latvia and so on had foreign debts and if they did not have liquidity to help service those debts, the scale of the problem was going to get bigger. One could say there is a little bit of inoculation but there is a down side to inoculation which means resolution is postponed. It must be remembered that a big part of liquidity provision is allowing foreign investors to escape, that the foreign depositors could leave the Irish banking system and be replaced by ECB liquidity. It is important to emphasise again that a major beneficiary of liquidity is not necessarily local but the fact that foreign bondholders can get out of their positions in a smooth and easy way. ECB liquidity is a double edged sword. It is a big benefit of being part of the euro system but there are some down sides in that some crisis resolution options are avoided through that mechanism. I would say that the ECB delayed too long in coming up with an outright monetary transactions, OMT, type structure. In 2011 and 2012 there was unnecessary prolongation and a deepening of the crisis through the debate about whether the ECB has a role in eliminating redemonination risk.

If we had not been in the euro we can imagine the scenario where we had borrowed a lot but were outside the euro. That scenario would have been a much deeper crisis but maybe faster recovery. The crisis would have been deeper because if we owed dollars or other foreign currencies, there would have been a lot of bankruptcies. On the other hand, the foreign creditors might have come up with deals. They might have shown forbearance. They might have offered debt restructuring and so on. On the alternative of being outside the euro, the initial crisis would have been deeper because we would have had to face up very quickly to many bankruptcy situations. Living standards would have dropped a lot because one of the consequences of devaluation is that imports become very expensive and since so much of what we consume here are imports, we would have seen a very sharp decline in living standards. That is what happened in Iceland. When the krona devalued in Iceland it helped recovery because Icelandic firms have become more competitive over time but the impact effect is a lot of financial distress and a big decline in consumption. I do not think there is one answer to the question of which is better - a very devastating shock crisis but quicker recovery or having a more stable, gradual approach, which is what we have had.

Chairman: I thank Professor Lane. To summarise some of the points touched on in his opening statement, he seems to suggest that even in the context of the eurozone the authorities in Ireland could have done much to stem the rising boom via prudent fiscal policy, a credit policy through the Central Bank and the Irish Financial Services Regulatory Authority and the suggestion of a rainy day fund. Following on from our engagement with Mr. Regling this morning and Professor Lane's opening comments, what is Professor Lane's view of the relationship between the Central Bank and the regulatory authority and the banks during the lead up to the crisis period?

Professor Philip Lane: I do not have any direct knowledge of that relationship beyond reading the Honohan and Regling-Watson reports and so on. The issue here is that the role of the Central Bank is quite distinct from the individual banks in the sense that the Central Bank is there to be at arm's length so that it is not bound up with the banks and it has a good deal of

knowledge. It is not bound up with the banks. It has a lot of knowledge. The individual banks might be concerned with market share. They only see an incomplete picture of what is going on, whereas the regulator's office, in principle, should see everything because it has the books of all the banks. It can look at the aggregate data. It can take a systemic view. The regulator and the Central Bank really have the core responsibility here. Individual banks might decide to take certain risks. It is up to the regulator to say "Listen, you cannot all do this - if you all make the same lending decisions, if you all lend into property, if you all lend to the same guys, clearly there is going to be a collective problem". The solution to that is a regulator who is prepared to prioritise stability and to say "Listen, you may want to lend at that rate, but it is collectively too risky - we need to intervene".

Chairman: I would like to ask a question before I call Senator D'Arcy. Professor Lane suggested in his paper that if Ireland had not joined the eurozone, the potential would still have existed for a credit boom to happen in Ireland. Maybe he can expand on that.

Professor Philip Lane: My first observation is that we saw pretty significant credit booms in other parts of Europe outside the euro area. Second, I tried to indicate when I spoke about interest rate policy that the global financial system can overwhelm individual economies, including those with their own currencies. The interest rate tool is a double-edged sword, whereas macroprudential domestic credit policies are much more direct. A simple refusal to allow the banks to lend too much can do a great deal to stabilise the local system.

Chairman: I thank Professor Lane.

Senator Michael D'Arcy: I welcome Professor Lane and thank him for coming. I would like to refer to the significant credit flows that came in, not immediately after we joined the euro but a couple of years afterwards. There was a slight slowdown or recession when the dotcom bubble burst. What were the significant factors underlying the major increase in the banks' balance sheets in the era that was mentioned by Professor Lane - late 2002, 2003, 2004 and 2005?

Professor Philip Lane: We have to look at why the banks wanted to raise so much funding and why the world was willing to lend to them. It is important to look at that from both sides. I will look at why they were willing to lend to Ireland from a global point of view. There was a fundamental lag in perceptions. Ireland had grown so much for the previous decade. The late 1990s were really spectacular here. A trader or analyst in a global bank might have argued that Ireland had a pretty good story to tell. It is understandable why it started. It is understandable that this happened in 2003 and 2004, when the global conditions were so liquid. I looked at this last week. At that time, Irish banks had historically not been major issuers of bonds, for example. An argument in favour of buying some of them could have been made by those who did not have much by way of bond exposure to the Irish banking system. I think there was an appetite in 2003 and 2004. It was felt that Ireland might be under-weighted in global investment portfolios. In all of these things, there is a reason it starts. I think the bigger issue is that over time, it grew too quickly and it went on for too long. I do not necessarily have a big issue with the fact that this thing started. The issue is that there was too much delay in recognising that it had gone too far and was going on for too long.

Senator Michael D'Arcy: Would I be correct in saying Professor Lane's view is that the improvement in our weightless economy prior to 2002 was a genuine national increase of abilities and an increase in our GDP?

Professor Philip Lane: Sure. For example, one indicator is that throughout that period,

Ireland ran current account surpluses pretty much most of the time. In net terms, we were lending to the world - we were not borrowing from the world. That changed around 2003 or 2004. The really rapid expansion in the late 1990s was sustainable in the sense that it was not being driven by borrowing from the rest of the world. That is an indicator. In the mid-2000s, we were growing but the liabilities to the rest of the world were also growing at the same time.

Senator Michael D'Arcy: Professor Lane made the point in his initial piece that non-EU areas or non-eurozone jurisdictions also went through a property increase, in effect. I would like to ask about the ability of the Irish banks to raise additional funds. I am not just thinking about bonds. I am thinking specifically about bank properties that were sold to pension funds before being rented back. How would Professor Lane term that practice, which occurred during this era?

Professor Philip Lane: That was done by AIB. I am pretty sure it was pretty small in terms of its overall balance sheet. I can see how it would have made sense from an organisational point of view. That sounds okay to me if a bank wants to concentrate on lending, rather than managing its own properties. The sale of their buildings by the banks is probably a pretty small part of the overall story. It might also indicate their private view of whether the property market was overvalued. That might also come into it. Maybe they were selling because they took the view that if they were going to be lending to the Irish property market, they did not want to be holding an Irish property as an asset as well.

Senator Michael D'Arcy: Does Professor Lane think that deep down, the banks knew the market had overheated?

Professor Philip Lane: I do not think it is a question of knowledge - it is a question of risk management.

Senator Michael D'Arcy: Some 190 people or corporate entities had approximately €30 billion of loans on the commercial loan book. How would Professor Lane class that scale, involving such a small number of people or corporate entities, in terms of risk management?

Professor Philip Lane: This goes back again to the role of the regulator. Last week, Patrick Honohan mentioned the absence of a central credit register. When the committee gets to talk to individual bankers, maybe they will be able to say more. Maybe each individual bank was insufficiently clear about the total indebtedness of these individuals. These individuals might say to one bank "here is my situation". If they are simultaneously borrowing from many different banks, maybe the collective risk exposure is bigger than what was visible to each individual bank.

Senator Michael D'Arcy: Governor Honohan attended and gave evidence last week. Part of his evidence related to his discussions with the former Minister for Finance, Brian Lenihan. He had hoped to get to the weekend following the bank guarantee if emergency liquidity assistance could have been made available. Why does Professor Lane think such assistance was not available at that stage? It would have allowed the authorities to buy a little time to get to the weekend. Rather than having to deal with the matter in a number of hours, they would have had a few days when the markets were closed.

Professor Philip Lane: I do not think I have anything to say that is different from what Patrick Honohan said. I suppose the way I would phrase it is that the euro was a very young monetary system. It had only been around for the good times between 1999 and 2007. The

playbook was not there to show how a national banking system should respond when its banks get into trouble. This goes back to the issue of whether they might have been overly cautious. Perhaps they decided not to try emergency liquidity assistance because they thought it might not be appropriate. The alternative could have been to raise the issue, explore it, discuss it with the ECB and say "Listen, here is what we are thinking and here is the situation". Rather than assume it was not feasible, for whatever reason, it is something I would have hoped could be explored more.

Senator Michael D'Arcy: Remarkably, subsequent to that week in 2008, the amount of ELA went from a very small level to about €90 billion, and then there was an additional amount of tens of millions of euro from other EU funding. The relatively small amount of ELA in that period would have been a fraction of what subsequently went in. Can Professor Lane explain? I am baffled as to why a small amount was not considered to get to the weekend, when there would have been more time, and subsequently tens-----

Professor Philip Lane: We must remember that the regular liquidity facilities of the euro system were already being tapped. That was providing support. ELA was coming into play because the amount of collateral that could be put in with the euro system had run out. There was a need to do something of a more emergency or exceptional nature. I think this is a question that the committee will definitely have to raise with the relevant authorities when it gets to speak with them. From the outside, it is not clear why that was not pursued. I do not really have any good explanation.

Senator Michael D'Arcy: In regard to the funding cliff that appeared subsequent to that when the guarantee was concluded, did that have an influence on the eventual State bailout?

Professor Philip Lane: This again goes back to the issue of the Central Bank and what one would expect a central bank to do in a multi-country monetary union. It is probably fair to say that the attitude of the euro system to Ireland had to be constrained by the issue of what this would mean for the behaviour of other countries in the system, whereas, if we had our own national central bank which only had our own national interests to think about, it would have been different. However, there are pros and cons to that. It must be remembered that because of the euro system, this was a massive net inflow to Ireland. If we just had our own national central bank, all we could do would be, essentially, to move funding from the Central Bank to the bank balance sheets. It would not be a way to draw net resources into Ireland. Because we are members of the euro system, however, there was a big net inflow into Ireland. As I tried to point out earlier, we were not the only beneficiaries of that, because the net inflow from the euro system allowed a net outflow of private investors, so that depositors and bondholders could escape. Who benefits from having lots of liquidity? Partly, there is a benefit here because we did not have to do the kinds of things that would have been necessary without that funding, but, partly, the benefit goes elsewhere.

Senator Michael D'Arcy: In relation to the subsequent bailout and the deals prepared by the ECB, the IMF and the Commission, the rates and the terms and conditions were so penal that they were akin to the national penal laws. In Professor Lane's paper dated February 2011 he made the point that the UK and Denmark made funds available to non-EU countries at much lower rates. Why or how, in the period of solidarity, was this nation being charged an awful lot more than what other countries were establishing with bilateral rates?

Professor Philip Lane: I would have to return to that particular piece of paper, which I have not looked recently, to recall that. It was fairly simple at the time. The logic was that this

was essentially an IMF-plus bailout, so we would use the IMF funding rules, which were set to charge us a pretty stiff premium.

Senator Michael D'Arcy: But the European Commission rates were higher than the IMF rates.

Professor Philip Lane: There are different ways of phrasing it. They were in the same ballpark as those of the IMF, which included a big risk premium - or not so much a risk premium as a penalty clause, under which, in order to make sure countries do not look for bailouts until they really have to, the financing has to be at a penal rate. That is a long-standing tradition. But what that did not allow for was that we were in it together. If we are all in the common euro area, that is not the right analogy. The IMF analogy of a global membership helping an individual member country did not suit Europe, and eventually it moved to say it would essentially be at the cost of firms, more or less.

Senator Michael D'Arcy: As a matter of information, a December 2010 agreement between Iceland and the UK and Dutch Governments on the Icesave debt had an interest rate of 3.2%.

Professor Lane's paper, which he presented us with prior to this morning's meeting, seems to indicate that he was critical of NAMA. It states that in the absence of medium-term liquidity support, forced deleveraging over a short timescale can be self-defeating by driving down property values in a fire sale process. I am taking that as a comment on NAMA.

Professor Philip Lane: No. It goes back to ELA and euro system liquidity and so on. One view of liquidity is that where a bank has a one-week problem, liquidity has to be provided for a week, but when a central banking system has made many long-term property loans, essentially a liquidity crisis could last for years. If one tries to get the banks to sell off those loans quickly, there will be a big decline in asset prices and, therefore, it would be self-defeating, turning a big problem into a massive problem. When there is a property-based banking crisis, liquidity needs to be extended for years, which is what has happened, and NAMA has been part of that. NAMA has the NAMA bonds, has provided liquidity to the system and has been gradually selling its portfolio. Ireland has been able to make a case that liquidity support is a years-long issue, not a months-long issue. It must be remembered that in the bailout discussions in November 2010, some of the troika were essentially arguing for a pretty quick disposal of assets by the banks, and over the next few months the Irish authorities were able to convince them that this would be self-defeating. My point there was that dealing with the liquidity problem, as it turned out, was going to be a process that took years. Liquidity was needed for years and years. It was not something that would take just a few months.

Senator Michael D'Arcy: I just want to explore this a little further-----

Chairman: The Senator is out of time.

Deputy Joe Higgins: In his introduction, Professor Lane set the discussion and processes in the euro area within a global economic and monetary system. I would like to dwell a little on that. He said in the written statement with which we were furnished that it was vital to understand that there were several structural changes in the international economy and the international financial system from the mid-1990s, so the creation of a single currency could not be viewed as the sole or even the primary factor behind the extraordinary growth in national financial flows during the pre-crisis period. If I pushed Professor Lane to say what was the

primary factor in the explosion of credit worldwide from the mid-1990s, could he outline one, or maybe two?

Professor Philip Lane: First of all it is a sort of ongoing research. Essentially if one thinks about the world economy and where it is now compared to 1995, what fraction of world GDP is coming out of emerging Asia is a great deal higher. Asia had its crisis in 1997-98 and one of the consequences of that was that Asia essentially decided to take a cautious approach that they would be a big net saver, they would grow quickly but they would spend less and the surpluses out of Asia were a major reason interest rates in the US went down quite a bit. The low interest rate environment in the US was the source of a lot of funding for Europe. The big narrative for me is the financial implications of the rise of emerging Asia.

Deputy Joe Higgins: Is Professor Lane not overstating the sovereign states in a sense that Oxfam said that in 2007, at the beginning of the crash, the 80 richest billionaires had $1.5 trillion in the markets at that time. No doubt Professor Lane is familiar with the work of Professor David Harvey, professor of anthropology at the City University of New York. Professor Lane echoes in his opening remarks the words of Professor Harvey who spoke about strange new markets arose which pioneered with what became know as the shadow banking system, permitting investment in credit swaps, currency derivatives, even future markets, pollution rights and betting on the weather. He states that this massive global funding grew from virtually nothing in 1990 to $250 trillion in 2005, at a time when global output was only $45 trillion. To the year 2008, it grew to an astonishing figure of $600 trillion. Was it inevitable that with funds of that magnitude sloshing around the financial markets, extraordinary speculative developments would manifest themselves as these funds competed for profits?

Professor Philip Lane: That is definitely a big part of the mechanics of what went on. Let us remember that the reason that the frenetic innovation was taking place was that interest rates were so low that many investors in order for them to be able to offer a reasonable return had to do something different. The reason that interest rates were so low was that essentially one had a great deal of global saving being released out of Asia. The money coming out of Asia was concentrated on low risk products. They were not interested in taking global risk. The low risk end of the market became not very attractive for everybody else because there was so much demand for low risk products from Asia. All of these new types of products were being driven by a “search for yield”. How in this environment can investment make a bit extra? The ideal is to find something that makes a bit extra but looks safe. This is the reason for securitisations - trying to come up with AAA, which was not safe.

With regard to billionaires, the first point is that there are different types of billionaires in the world. Some are probably contributing to the global savings glut. Remember that a great many billionaires are essentially aggressive risk takers. They also borrow a lot. They may be quite rich but they would be part of the risk taking side.

Deputy Joe Higgins: I will return to Professor Lane’s point on the “search for yield”. In the 1970s by common consent we had a massive increase in petrodollars by sheiks and oil tycoons and that led to huge lending in the developing world which in turn led to an incredible debt crisis in Africa and Latin America, causing significant suffering of course for millions of people. Does Professor Lane see a similarity between that and what developed up to the crash in the mid-1990s?

Professor Philip Lane: That is a reasonable analogy. When one has a big shock in the world, whether it is the big increase in oil prices in the mid-1970s or the entry of China into the

global economic system, that can give rise to large asymmetry. Some parts of the world want to be a net lender but where does that money end up? What is the role of the international financial system in funnelling that money to end users and from the point of view of the end user, just because somebody wants to throw a lot of money at one, is one wise to take it? One has to consider whether those contracts are fair. There was hope in the 2000s because so much of the funding was not sitting on bank balance sheets. In the 1980s various US banks were in trouble because they had lent so much money to Latin America, whereas by and large in the 2000s there was not so much bank lending as securitised bonds and so on. The hope was that the risk would be spread across many investors. Of course, in the end it did not turn out like that.

Deputy Joe Higgins: On page 2 of the written report furnished by Professor Lane which deals with the search for yield, he refers to synthetic higher risk assets that offered higher interest rates. He states, "Alternative investment products that offered the promise of higher returns also grew rapidly (hedge funds, private equity), with these entities taking on high debt loads in view of the low interest rate environment and the high risk tolerance on the part of investors." Was all of this developing into a situation where what might be seen as investment in staid entities, these funds were chasing higher yields by taking higher risks?

Professor Philip Lane: The reason that billionaires would now be investing in the hedge funds, would be that perhaps these smart guys could find returns that are not available from putting money in a regular deposit fund or regular investment vehicles. That is very much part of the same general dynamic when interest rates are so low that if one wants to make a bit extra what can one do? One can take on more risk explicitly and I think those hedge funds and private equity funds would say that they are good at working in risky environment. Even more damaging was where the risk was hidden, where mortgages got chopped up into safe and less safe components. When what looked safe was not safe, there was mispricing of risk.

Deputy Joe Higgins: I have one more question before I move on to the next point, whether what we have been talking about has a particular relevance to what happened in Ireland. Oxfam stated that the 80 richest people owned about 48% of world wealth in 2007, when the crash happened. Oxfam states that since 1990 income from labour has made up a declining share of gross domestic product across low, middle and high income countries. It states, "Around the world, ordinary workers are taking home an ever-dwindling slice of the pie, while those at the top take more and more." With that increasing share to profit, interest and rent and less for working people, does Professor Lane see that as a background to working people being forced to borrow more to buy the products that they could not afford from their ordinary wages and then on the other hand these funds that we have been talking about lending to them to try to boost their profits?

Professor Philip Lane: I think that is a really important part of what went on. That is one consequence of the decline in the labour share. One of the puzzles since the late 1990s is that profits have been relatively high but firms have not invested so much. Increasingly firms sit on a great deal of cash. Like the Asian sovereigns, the corporations typically do not want to take on investment risk. They put the cash on deposit or they buy short-term net products. So it is another source of cash looking for safety and, in turn, driving down the risk-free rate and encouraging the search for yield. On the other side of that is the fact that labour incomes in many countries were stagnating. I am less familiar with studies that have been carried out in Europe. In the US, however, the high increase in household debt was, at least in part, being driven by the stagnation of wages. That definitely is a part of what went on.

Deputy Joe Higgins: The key question relates to the Europe, the euro area and Ireland.

Why were countless billions of euro and dollars cascading around the financial markets in this way and why were so many exotic products developed? Why was the money in question not invested in manufacturing, for example, particularly in view of the fact that 25 million people in the European Union were unemployed? Why were billions poured into property speculation in Ireland at a time when, by common consent, broadband infrastructure and water infrastructure were in desperate need of investment?

Professor Philip Lane: There is a global issue here. Investment rates, in terms of the real or productive economy, have been low in Asia and in the advanced economies. Some of the stories people tell essentially revolve around competition. With the rise of new competitors from the emerging world, it is not super-clear what is the right investment strategy for many corporations. In addition, many activities need less by way of investment because of IT developments. In the context of cloud computing, for example, the cost of establishing a new IT company is a lot less than used to be the case because it is possible to rent storage space in the cloud and so on. There are many different stories with regard to why investment rates have come down. I agree that the fact so much was invested in property reflects some kind of distortion in how the world economy works.

Deputy Joe Higgins: Would Professor Lane agree that the international financial markets as a phenomenon were simply becoming more parasitic? Against the background of the credit explosion, speculation and deregulation internationally, was it inevitable that the regulatory system was going to collapse? In an article which appeared in *The New York Times* in 2005, it was claimed that Ireland had become known as the wild west of European finance. Is Professor Lane of the view that there was truth to this claim?

I apologise to Professor Lane for cramming in my final question at this point but time is against me. A debt equating to 100% of gross domestic product has been placed around the necks of the Irish people. Ordinary citizens would like to know where the many billions of euro that were moving around during the property bubble ended up. We know that some of this money was paid out in the form of wages, etc. However, what happened to the massive amounts that were paid for land and the huge profits that were made? The Irish people are in an extremely indebted position as a result of political and economic decisions which were made, but which we are not allowed to discuss just now, and austerity policies that were put in place.

Professor Philip Lane: I would be more optimistic in that I do not believe there is anything inevitable about the policy framework. There was a regulatory choice. It is important to say that there are these kinds of global factors, but policies still make a great deal of difference. You can see that some countries around the world have mechanisms which did protect their banking systems. There is nothing inevitable about the regulator getting caught up in it. In the Irish case, it is very important to distinguish between the regulation of the local banking system versus the regulation of the IFSC. If you like, the regulation of the IFSC is also part of a global issue relating to international finance versus national systems. Essentially, there is a lot of global effort along the lines of: "How can I structure my global portfolio to avoid regulatory intrusion?" I will set up a contract which runs through the Cayman Islands, which lands in Ireland for a bit, which goes on to Switzerland and so on. We know the world needs to deal with offshore finance and Ireland is part of the debate with regard to what is the role of offshore centres of different types in the global system.

On the last question of who are the net losers and winners from this, it would be an important project to generate a full answer. Part of it was waste. We do have a great deal of wasted capital in the context of all of the effort to build houses where no one wanted them and so on.

Part of it is that the money just went down the drain in terms of waste. We pay for things which are useless. Let me go back to the issue of who was involved in 2007 and where are they now. Of course, the way the system was, a lot of these debt contracts were paid off. Essentially, we replaced the banking liabilities with sovereign liabilities through recapitalising Anglo and so on. The question, of course, is whether we could have managed an alternative way to resolve that or whether we could have managed to place more of the losses on foreign investors. This inquiry will address that matter with different layers of analysis in the coming months. I think that, yes, more could have been put onto foreign investors in different ways but it is equally not so clear that there is any easy answer. I hope this inquiry can reveal what were plausible alternative possibilities.

Chairman: I wish to pursue two of the matters Deputy Higgins raised. The first relates to the growing sophistication, complication and diversification of the range of products available within the financial services sector. Did the availability of such products have an impact on the regulatory framework that was in place and increase the pressure on it?

Professor Philip Lane: Yes and no. The IFSC is involved with all sorts of sophisticated financial products but that is pretty much quite separate to the regulation of local banks. All the narratives would state that what when on with the local banks was plain vanilla and involved regular property lending. They were not getting into trouble because of-----

Chairman: The second matter is securitisation, which Professor Lane mentioned in both his opening comments and in a couple of his engagements with members. Will he explain what constitutes securitisation and indicate how banks develop and sell securitised products? What was the rate in Ireland compared with the US in this regard? Was it lower or higher and what was the level of concentration in the area of commercial property? If there had been more or less of this, would it have had a positive or more negative impact on Ireland? Will Professor Lane first outline what securitisation involves?

Professor Philip Lane: Traditionally, banks would have gathered deposits and made loans. Those loans would be a source of income because they would receive the interest payments from the debtor. That is how a bank would earn income. However, an alternative strategy came to be developed as follows. Let us say I have 10,000 mortgages. I will write a contract which says that I will issue a bond where the pooled income from those mortgages will form the basis for making the interest payments on that bond. If you issue that bond, you no longer worry about those 10,000 mortgages because-----

Chairman: Does the bank still own the mortgages when it issues the bond?

Professor Philip Lane: There are different layers in that regard. In most cases there is a residual element because you want the bank to remain interested in those loans. However, if a lot of the risk is transferred to the bond investors, the bank can then release funding and look for new opportunities.

There was a certain amount of issuance of mortgage-backed securities by the Irish banks, but I do not think it was a massive part of what was going on. It was more the case that the global banks - the massive international banks - were moving away from direct lending to buying bonds. Sometimes the bonds were backed by US securities but, quite often, all they would need was a good rating. Irish banks were pretty highly rated so they could buy A-rated bonds, and they might have bought a B-rated bond at more risk. Essentially, the global banks were moving from making direct loans to being bond investors.

Senator Susan O'Keeffe: I thank Professor Lane. Given all the changes that occurred in the world, or global financial system, over the 1990s and into the 2000s, were bankers reckless, opportunistic or greedy, or was it just good business to take the chances that were taken?

Professor Philip Lane: The population of bankers probably includes extreme versions of greedy, reckless and all of that. From reading the three reports, the Nyberg, Honohan and Regling-Watson reports, one would see examples of where it seemed to make sense to the bankers. They bought the narrative that the world was safer than it used to be. There had not been too many recessions in the preceding decades. Where there was a recession, it was pretty brief. None lasted more than a few months. Even with the currency crisis of 1990 to 1993, recovery from it was reasonably rapid. An individual bankers might have misperceived the collective risk. This is why I am going back to the role of the regulator. Each individual bank might think what it is doing is acceptable but when they are all making the same decisions, one gets a systemic problem. If they are all lending into property and to the same guys and if they are all lending to particular models, then the collective system becomes too risky. The only entity that has the collective view is the regulator. Ultimately, if banks are reckless and so on, so be it, but essentially they can be constrained by regulatory intervention.

Senator Susan O'Keeffe: I suppose it is easy to buy into the narrative if one is actually making money out of it. In light of the existence of global banking corporations, and the fact that banks are bigger and do more than they used to do 100 years ago, is there now an imbalance of power between a central bank and the banking corporations, the centres of profit? Is that a serious problem for any country, particularly Ireland?

Professor Philip Lane: Globally, that is an issue. The global banks are big relative to any individual country. However, the banks here that caused the problem for us were the local banks. They were definitely under the control of the local system.

Senator Susan O'Keeffe: Do they effectively have more power than the Central Bank because they are profit centres and because of the way they operate? Perhaps "clout" is a better word than "power".

Professor Philip Lane: The Central Bank works indirectly in the sense that it works by controlling or restricting the behaviour of the individual banks. As individuals, we deal with the individual banks. In the end, the banks are regulated and know that if they do not have a licence from the Central Bank, they will not be able to raise-----

Senator Susan O'Keeffe: However, the regulation failed.

Professor Philip Lane: The regulation was not done.

Chairman: The Senator made a statement. Is she asking a question?

Senator Susan O'Keeffe: In fairness, some of the evidence that others have stated-----

Chairman: In fairness, the Senator cannot make a statement and ask a witness to agree with it. The Senator should ask a question.

Senator Susan O'Keeffe: Others have observed that regulation failed so I am saying-----

Professor Philip Lane: I would not phrase it like that. That would imply regulators did the best they could and yet it was not enough. The situation here is that regulation was not done to the degree necessary. They could have adopted alternatives, as we are seeing this week with

the debate about low loan-to-value ratios and other restrictions. Of course, all of that would have been very difficult politically. Can you imagine in 2004 or 2005 a central bank coming in big-time to say, "This has gone on too long and has gone too far and we are really going to stamp this out"?

Senator Susan O'Keeffe: There is a suggestion there that the Central Bank could not act by itself and that there was a political inclination.

Professor Philip Lane: Again the Senator will have to ask the people involved. It was true, and is still true, that the Central Bank operates within a wider system. This is why it is independent. One gives it the independence and one delegates saying: "You are free to do that; it is under your authority." It did have that independence. I would say it is reasonable for the political system to delegate decisions to the regulator. In the end, it is with the regulator.

Chairman: I remind committee members that it would be more to the purpose and beneficial to ask questions based on the paper and any information that Professor Lane has submitted to the committee today rather than moving into subjective areas on which he may or may not have an opinion. On a number of occasions, he has stated a question might be better answered by other witnesses coming before the committee. There was a paper presented to this committee and I encourage members to address that in their questioning.

Senator Susan O'Keeffe: Professor Lane says that at a microeconomic level the property boom could have been countered through reforms that reduced the tax incentives offered to developers and householders. He says that on page 6. Mr. Klaus Regling and Mr. Max Watson report that by 2005, according to the OECD, the cost of tax expenditure had become larger than the remaining income tax receipts. It appears to be extraordinary that the cost of tax expenditure was larger than the remaining income tax receipts. There is obviously a big imbalance. What was going on that had us arrive at a point where those reforms were such that the property boom was not being countered in the way Professor Lane suggests it could have happened?

Professor Philip Lane: Again, that is something I do not cover in great detail. It is a fact that there were many tax breaks and allowances. Again, it is not just at the level of the developer. The fact is that mortgage interest relief and other tax breaks existed. Perhaps a more generous interpretation is that some of the tax breaks might have made sense at a particular time, but the fact that they were prolonged and not eliminated must be borne in mind. Around the world, that is an issue. Historically, tax breaks, even when temporary, tend to get rolled over and are continued. Perhaps having a system with a much tougher approach to the renewal of tax breaks could have been part of what could have happened.

Senator Susan O'Keeffe: Can I finish by asking about offshore centres, to which Professor Lane referred? Clearly, financial products have changed over the years. I believe Professor Lane said they become more "innovative". Equally, offshore banking and that whole system has become more innovative. Is there any evidence that financial institutions themselves used those offshore centres to funnel their own profit away and, therefore, leave a worst-case scenario for the taxpayer to address?

Professor Philip Lane: I have not really looked at that. In the Irish case, I would not say so. Globally, there may be elements of that. An interesting point is that when Ireland unified the tax rate for corporations, the tax rate on banks came down as part of the overall reduction in tax rates for corporations. That element may also be part of the wider story here.

Deputy John Paul Phelan: I welcome Professor Lane. Before and during the crisis, was he approached by anybody from the Government for his advice on what was taking place seeing as it was a major part of areas he has researched in his academic career?

Professor Philip Lane: Professor Honohan mentioned last week that he met Mr. Brian Lenihan. I was in a meeting in June 2008 where there was a discussion on fiscal matters. I wrote a paper in 2007 and a couple of co-ed pieces, which said the economy was slowing down and we needed to have an adjustment to our fiscal strategy. I had another meeting with Brian Lenihan around that time and I also met him in mid-September 2008 to talk about the fiscal situation. In January 2009, Professor Honohan and I met him again. There was no agenda and the meetings involved very casual conversations.

In 2010 I wrote a report for an Oireachtas committee on the fiscal framework, how to set up a fiscal council and fiscal rules. In that structured way I was involved in that element, but apart from that the answer is “No”.

Deputy John Paul Phelan: Did Professor Lane feel that in any of those casual meetings with no agenda anything he said was reflected in decisions which were subsequently made?

Professor Philip Lane: They were-----

Chairman: Be mindful of where we are going, Deputy.

Professor Philip Lane: No, they were at the super-casual end of the scale.

Deputy John Paul Phelan: That is fair enough. Senator O’Keeffe and Deputy Higgins posed the question earlier of why such investment was directed towards property when he was talking about the amount of money invested in the country. In his answer to Senator O’Keeffe, Professor Lane touched on tax incentives in the property sector. At what stage does he believe those incentives ceased to have a positive impact? Were they ever required, in terms of boosting activity in property development?

Professor Philip Lane: They definitely did have a role to play, descriptively. I do not know whether they had a dominant role to play. At a micro level, there is the question of why the property boom was more intense in some regions and districts than others. In other words, in terms of the geography of where investment took place, the incentives, I am sure, had a bigger effect in terms of the overall picture. From the reports written, we know property booms have happened time and again. It is a classic boom-and-bust cycle that can take place. There is no great mystery about the dynamics of property booms. Professor Honohan used the phrase, “A plain vanilla boom-bust cycle”, and that is what we had. To return to tax incentives, my guess is that they probably had more effect in terms of what particular locations were affected rather than the overall scale.

Deputy John Paul Phelan: In regard to the wider profession of economics, there were some voices which expressed, perhaps late in the day, criticism of fiscal policy. The term “groupthink” is often used regarding politicians, the media, bankers, property developers, and what went on in Ireland in the lead-up to the banking crisis. Was Professor Lane’s profession part of the groupthink that went on?

Professor Philip Lane: Yes, there were various levels of that. Globally, there was insufficient weight put on the downside risks of financial innovation. The benefits were overstated and the costs understated. The Deputy mentioned fiscal policy, but there are more general is-

sues such as the credit boom, the housing boom and so on. I would have said there is probably a fairly generic consensus that fiscal policy was too loose. Going back to the mid 1990s, people would have said that if a country was going into a monetary union, fiscal policy would need to be a lot more prudent.

I have a lot of sympathy for the political system. Once one goes into surplus, going from a small surplus to 5% or 6% will be very difficult to do. That is why having institutional reforms, such as a rainy day fund, might have helped. Insufficient attention was paid to the rise of stamp duty and capital gains tax.

On the wider issue of the credit boom, the house price boom and so on, individuals such as Professor Morgan Kelly, David McWilliams, Alan Ahearne and various people in the media who contributed-----

Deputy John Paul Phelan: Some of those voices were very late in the day.

Professor Philip Lane: This is a big issue. It comes back to the regulator. The data we see as academics come with a lag. The unfortunate thing about the crisis was that the boom was relatively short. My broad narrative is that in 2002 and 2003, the start of it could have been tolerated. In 2004, things were maybe still okay. The question is when in 2005, which is the key year, does one call stop? There is a mix. People started talking about this in 2006. Even if the credit boom was towards its peak, there was a lot of time in 2006 and 2007 to say we were in trouble and to ask how we could get out of it at the least cost.

Deputy Pearse Doherty: I want to begin by referring briefly to the point Professor Lane made in response to the Chair regarding mortgage securitisation. He mentioned it was not a major part of what went on. I want him to elaborate on that, with particular attention to the Central Bank's bulletin in July 2011, when it indicated that at the end of 2007, 12% of mortgages were securitised and were off balance sheet, and this accounted for €17 billion in loans which had moved off the balance sheets of the larger credit institutions. Time and again in the documents presented to us by Professor Lane, the point is emphasised that it was obvious there was a slowdown in the property market and issues in terms of bank funding. What was the reason behind the fact we had 12% of our mortgage book off balance sheet? What role would that have played?

Professor Philip Lane: That sounds about right. It is important, but not massive in terms of the overall balance sheet. In terms of the bond market and the way the banks were issuing bonds in the mid 2000s, they were doing all sorts of things. There were dollar, sterling, senior and subordinated bonds. This may go beyond the scope of what members can do in this inquiry, given the amount of time they have.

The treasurers of the banks, in terms of the mechanics in a given period, may have chosen to do a mortgage-backed security issuance or a straightforward unsecured bond. They, in turn, would have been interacting with the global banks who would have been the advisers and would have outlined the cheapest ways to raise funding in a month or year. Others can answer questions better than I can on that level of mechanical detail on how banks design and raise funding. Broadly speaking, one category in which people were interested was asset-backed securities. There are many different elements to how banks raise funding. Did the Deputy's information refer to the covered banks or did it also include what went on with Ulster Bank and so on?

Deputy Pearse Doherty: The report referred to up to 12% at the end of 2007, at which

time just under €17 billion worth of loans had moved off the balance sheets of the larger credit institutions. The key is that they moved off the balance sheets. It is not a case of mortgage securitisation because some of them remained on the balance sheet.

Professor Philip Lane: Right.

Deputy Pearse Doherty: These were off the balance sheets. That is fine. I am mindful that I am limited in terms of time. In the opening statement Professor Lane presented to the inquiry he stated: "it is possible that the lack of precedents and the untested nature of the ELA framework ... may have deterred the Central Bank ... from deploying ELA to buy some time in managing the severe liquidity squeeze on Anglo Irish Bank". Is that his assumption and opinion or is this based on any conversations he had with anybody who may be involved?

Professor Philip Lane: This is me looking at the fact that they did not do it. There may be a couple of lines in the Honohan report to this effect as well, that they were reluctant to pursue it. As someone said earlier, the fact that emergency liquidity assistance was used big-time later on reveals that if one makes the case for it, it can happen. I do not know the individuals involved. In the euro system, the ECB is the central bank for all member countries. We could ask if our national Central Bank had been able to step in at that time, what would we have done? If there had been a funding problem at home, the national Central Bank would have stepped in and provided substantial liquidity to the local banks, but a national central bank cannot provide foreign currency liquidity. To the extent that these were funding from overseas, there would have been a problem.

Deputy Pearse Doherty: I asked that question because Professor Lane offered his opinion at that time, but at exactly that point central banks were providing liquidity to other financial institutions that were in danger in other member states. In this regard I reference Fortis Bank, which was rescued by three European member states, France, Belgium and the Netherlands. On 26 September 2008, Fortis Bank was offered €5.4 billion in a marginal lending facility which had to be approved by the ECB governing council. On the morning of 29 September, the ELA was formally sanctioned for that bank and by 3 October, a number of days later, it rose to €51 billion. The reason I ask about this, and it was mentioned by Professor Lane and others, is that this was not unique. In terms of the ELA, it was not only provided by Belgium, it was provided by-----

Professor Philip Lane: The Netherlands.

Deputy Pearse Doherty: -----the Dutch Central Bank at exactly the same time.

Professor Philip Lane: That is a good counter-example and a good question to raise with the people involved in that decision.

Deputy Pearse Doherty: I may be straying into other areas that Professor Lane may not want to answer, but given that this was happening and the Governor of the Central Bank was a board member on the governing council of the ECB, would it be understandable that he would be familiar with what was happening in Fortis Bank at that time?

Professor Philip Lane: In respect of the example the Deputy gave of the ELA being provided on 26 September and, as he said, being improved pretty quickly if it was approved on the 29th, that would be an interesting question to ask the Governor of the time.

Deputy Pearse Doherty: Okay. Thank you.

Chairman: To cap off on a point Deputy Doherty raised with Professor Lane, if we look at ELA as a defibrillator or a life support machine, in his opening statement Professor Lane stated that it is possible there was a lack of precedent or the untested nature of the ELA framework and that was one of the reasons. Was it the case that they had the equipment but never read the instruction book and they then never actually engaged the machine?

Professor Philip Lane: I doubt they did not understand what the rule book was. I am pretty sure they did, but there is the issue of under what circumstances ELA is appropriate. The traditional view of ELA was that it was something extremely temporary and also one had to be assured of solvency. One had to be assured that the bank was solvent.

Chairman: That brings me on to my next question. ELA is only available on the basis that the bank is in need of liquidity. If the bank is insolvent, it is prohibited from getting ELA. That is correct, is it not?

Professor Philip Lane: Yes.

Chairman: Therefore, in Professor Lane's view, should the ECB have approved such enormous loans to banks such as Anglo Irish Bank and the Irish Nationwide Building Society during the period 2008 and 2010?

Professor Philip Lane: This was essentially on the understanding that the Irish Government was going to stand behind those banks.

Chairman: Does Professor Lane think that the ECB should have approved such loans?

Professor Philip Lane: I have not thought enough about that direct question to give any kind of interesting answer.

Chairman: I will give Professor Lane a few moments if he needs to think about it.

Professor Philip Lane: The Chairman is asking about Anglo and Irish Nationwide.

Chairman: Yes. Basically, in Professor Lane's view, should the ECB have approved such enormous loans to banks such as Anglo Irish Bank and the Irish Nationwide Building Society during the period 2008 and 2010?

Professor Philip Lane: If the Irish Government was standing behind them - tracing this out and noting the counter-factors - and if the ECB said that it did not think our sovereign could withstand it and it did not want to make ELA available to these banks because the essential guarantor of solvency, which is the Irish sovereign, would be compromised by that - there is the matter of whether that was for the ECB to decide - we should remember that in 2008 the Irish Government still had relatively little debt. If we think about the evolution of sovereigns spread in 2009 and so on, it is only in 2010 that the sovereign bank loop got much more intense. Going back to 2008 and 2009, it was probably not the ECB's call. The ECB has a veto but the-----

Chairman: The ECB was signing the cheques. I am sorry to press Professor Lane on this but he seems to be struggling with the answer.

Professor Philip Lane: If the Irish Government was standing behind those banks, essentially that in the end was a matter for the Irish-----

Chairman: The Irish Government was standing behind it, but the ECB was signing the

cheques.

Professor Philip Lane: On the basis of a guarantee-----

Chairman: The issue is regarding the ECB's behaviour, not the Irish Government's behaviour. Was the ECB right to fund those banks during 2008 to 2010?

Professor Philip Lane: On the basis that they were being guaranteed by the Irish Government, yes.

Chairman: Okay. Was that on the basis that they needed liquidity or on the basis that they were solvent?

Professor Philip Lane: On the basis they were solvent because solvency was guaranteed by the Irish State.

Chairman: Thank you. I call Deputy Kieran O'Donnell.

Deputy Kieran O'Donnell: To take up that point that was just made, in the context of the type of guarantee that was put in place, which was a two-year guarantee that brought about a funding cliff for the banks two years afterwards in September 2010, Professor Lane said that the Government ensured solvency. I would not agree with that statement because the fact is that the banks themselves are either solvent or insolvent. That is not determined by the Irish Government standing behind them. That is determined by the balance sheets of the banks. Was there a duty of care on the part of the ECB to ensure that if it was extending ELA funding through the Irish Central Bank, Anglo Irish Bank and the Irish Nationwide Building Society, in particular, were solvent at the time?

Professor Philip Lane: The solvency of those banks was entirely because the Irish Government was prepared to recapitalise them and provide that support. Therefore, in the absence of the public recapitalisation-----

Deputy Kieran O'Donnell: With due respect, Professor Lane, we clearly now know-----

Chairman: I would advise the Deputy not to make his own judgment.

Deputy Kieran O'Donnell: I am sorry.

Chairman: I would advise the Deputy to put a question.

Deputy Kieran O'Donnell: With hindsight, is it a fair comment to make that at the time of the guarantee being put in place, both Anglo Irish Bank and the Irish Nationwide Building Society were insolvent?

Professor Philip Lane: In September 2008, some numbers seemed to be floating about as to them possibly being insolvent. Relative to GDP, the scale of insolvency at that point was maybe within what the Irish Government felt it could handle in a worst-case scenario, but of course those estimates were way off once the property prices and GDP cratered in the rest of 2008 and throughout 2009. Solvency calculations in September 2008 were going to be very different from solvency calculations in September 2009, for example.

Deputy Kieran O'Donnell: The point I am making is that one of Professor Lane's areas of expertise is in European monetary union policy. Is it a fact that the ECB was sending funding directly to the banks? It was not extending funding to the Irish Government, but to the banks.

Was there not a duty of care on the ECB? As Professor Lane is probably well aware, ELA funding cannot be extended if the banks are insolvent.

Professor Philip Lane: To me, this sounds a little bit semantic in the sense that the solvency owed to the Irish Government recapitalising these banks. The ELA was going through the national Central Bank. The ECB in Frankfurt, now with the single supervisor mechanism, has direct oversight of bank regulation. At that time-----

Chairman: I will just come in on Deputy O'Donnell's question. Was it the view of the ECB between 2008 and 2010, based on the information that was presented to it, that these banks were solvent?

Professor Philip Lane: If the Chairman could somehow communicate that question to the ECB and get an answer from it, that would of course be the way to-----

Chairman: Professor Lane has an understanding of EU monetary policy. He would be of the view that, to get the money, the banks had to be solvent.

Professor Philip Lane: Sure, but from a solvency point of view, the fact that they were being recapitalised and also had the guarantee of liabilities from the Irish Government was sufficient.

Chairman: Regardless of whether there was a guarantee or whether the guarantee was two blanket guarantees, the banks had to be solvent to qualify for ELA.

Professor Philip Lane: Right, but one source of solvency was State recapitalisation.

Deputy Kieran O'Donnell: Professor Lane's area of expertise is European monetary policy.

Professor Philip Lane: Right.

Deputy Kieran O'Donnell: So, if the ECB was extending ELA funding-----

Professor Philip Lane: Again, the national Central Bank extends the ELA with the supervision-----

Deputy Kieran O'Donnell: It extends that funding under the umbrella of the European Central Bank.

Professor Philip Lane: Sure.

Deputy Kieran O'Donnell: In Professor Lane's opinion as an expert in this area, if we were applying standards to the Irish Central Bank in terms of regulation of the banks, would the ECB under its governance rules have been required to do due diligence and check that the banks were solvent before, in effect, agreeing to ELA funding being put into them?

Chairman: We will move on after this because Professor Lane has answered many questions.

Professor Philip Lane: My sense is that there would be a level of due diligence, but if the answer is that these banks are only solvent because the Irish sovereign is choosing to recapitalise them, that is sufficient for the ECB.

Deputy Kieran O'Donnell: I have just one final question.

Chairman: That is okay if the Deputy moves to another area.

Deputy Kieran O'Donnell: Let us go back. As a committee, it is obviously of interest that Brian Lenihan is no longer with us. Professor Lane was party to discussions with Brian Lenihan and the current Governor, Professor Honohan, in the summer and December of 2008. Am I correct in that?

Professor Philip Lane: I do not recall December 2008. I know that in January 2009, Professor Honohan and I had a joint meeting. He stated last week that he had a meeting with Brian Lenihan in December 2008, but I was not at that meeting.

Deputy Kieran O'Donnell: Going back to Professor Lane's June 2008 meeting-----

Chairman: Could the Deputy move back towards what we are talking about, please?

Deputy Kieran O'Donnell: I will be brief. At that meeting, what was the subject of discussion?

Professor Philip Lane: I will try to recall.

Deputy Kieran O'Donnell: Who looked for the meeting?

Professor Philip Lane: At the time, it was not so consequential.

Deputy Kieran O'Donnell: Did the former Minister look for the meeting with Professors Lane and Honohan-----

Professor Philip Lane: Yes.

Deputy Kieran O'Donnell: -----or did they look for it? He looked for the meeting with them.

Professor Philip Lane: Right. It was in the context of him being new in the job and trying to read into the brief and that, around that time, I had written an op-ed about the slowdown and what were the fiscal issues to do with it. Partly, if we think that there is a new phase and that property revenues are going away, we need to adjust spending levels and come up with other sources of revenue. Partly, there was the difficult issue of not doing the fiscal crunch too quickly, because that could be-----

Deputy Kieran O'Donnell: Was banking discussed at all?

Chairman: I am sorry, but the Deputy is out of time. I call Senator Barrett. I encourage members again to return to Professor Lane's paper and to focus upon many of the issues that we have discussed here to inform the committee with the specific purpose of Professor Lane being before the inquiry this morning.

Senator Sean D. Barrett: I welcome Professor Lane, a long-standing colleague of mine. The italicised part of his paper on page 8 reads: "The capacity of the euro area to respond to such a financial crisis is as yet untested." He warned of that in 2006. Is that not right?

Professor Philip Lane: Right.

Senator Sean D. Barrett: He was one of the people who saw this happening. As he knows,

people like Professor Barry Eichengreen saw the euro as being designed for France, Germany and some northern European countries. He actually said that he was quite surprised that "Ireland, Spain, and other countries at the periphery of the European Union were among the founding members of the euro area". In the scenario that Professor Lane draws, his final remark at the end of page 12 reads: "A central bank that is not bound by a fixed exchange rate commitment can forestall such unnecessary crises by acting as a 'lender of last resort'." Was it a problem in September 2008 that there were design faults in the euro, that we had not really thought out the consequences of membership and that, reverting to Deputy O'Donnell's question on ELA, we were totally unprepared because we had not worked out the implications, as Professor Lane warned in 2006 and other economists warned when we joined the euro?

Professor Philip Lane: There is a two-level answer there. One is, if we had our own national Central Bank, that could have made it easier to deal with local funding because the Irish Central Bank could have printed as many Irish pounds as it had wanted, but it could not print dollars, sterling or whatever. If we had the same kind of credit boom that included a lot of foreign funding, that foreign funding would have been in foreign currency. In the same way that Iceland could not stabilise its banks in terms of its foreign funding and in the same way as in emerging market crises, when one has foreign currency debt, the fact that one has a local central bank does not get one that far. There is a mix. The general issue is "Yes".

Also in my report, I pointed out that, in the 1990s, we had the Scandinavian banking crisis, we had the east Asian crisis, we had the Mexican crisis and we had the Russian crisis. Going into the euro, there had been all sorts of financial crisis in recent history, in part reflecting the fear that, with more and more cross-border finance, maybe more accidents would happen. There is a history of the euro by Professor Harold James, about the committee meetings in the 1980s and 1990s up to the point of the euro. The fact that those committee meetings decided not to deal with having a common crisis mechanism was a euro system design flaw. The fact that the euro system did not have a crisis mechanism meant that, from word go, the responsibility was at home. If there was not a European crisis mechanism, we needed a national level crisis mechanism, a rainy day fund and so on. There was also a question of under what conditions we could use ELA. That is a question to engage on with the regulator.

Senator Sean D. Barrett: As we plot the future, have we something to learn from Canada, for example?

Professor Philip Lane: Canada is obviously a much larger economy. It is the case that it had a tougher level of regulation. The fact that one can find plenty of examples where there was no banking crisis says that it was not just down to global factors. It was, in that sense, avoidable. That is absolutely true. Learning about good ways to regulate and what risks not to take is definitely a good idea.

Senator Sean D. Barrett: Some commentators seem to think that Europe will still not meet the Basel III standards whereas Canada, Australia and Singapore will. Would that concern Professor Lane, that we might do all of this all over again?

Professor Philip Lane: Generally speaking, there is an ongoing issue about the best way to regulate banks and what is the appropriate level of bank capital. One might say all these fancy regulations are secondary to, first, making sure the banks have enough capital and, second, making sure they do not borrow too much. Simple rules can go a long way.

Deputy Eoghan Murphy: I want to examine the idea of the rainy day fund which you,

Professor Lane, have mentioned a few times this morning. Your point is essentially that because we moved from a taxation base that was pro-cyclical – I think Mr. Regling's report refers to going from 12% to 30% - that money should have been ring-fenced for a rainy day fund, for future difficulties.

Professor Philip Lane: Yes.

Deputy Eoghan Murphy: We were running budget surpluses at the time but you also make the point that they were not big enough. In one of your papers you stated that underneath it all there was a structural deficit. Mr. Regling said this morning that we are still not good at working out that structural imbalance under the economy.

Professor Philip Lane: There are different levels. There is one which is abstract but core to the fiscal compact, that is a question of whether GDP is at potential. For most of what is called a structural balance it is a question of where in the GDP cycle we are. There is also the concept of the financial cycle, when credit is growing quickly and construction activity is very high. That is so visible and obvious in the Irish data it is not a small issue of whether Ireland can grow at 3% or 4%. When capital gains tax, stamp duty and so on grow at such a rapid rate under no circumstances could one say those revenues will be there every year forever. If they will not be there every year forever one could say these are windfall revenues. One saves a windfall for the rainy day, one does not ramp up current spending or make tax cuts to get rid of it. In the scale of the revenue boom we had at that time it would have been possible to come up with fairly simple decision criteria that would have allocated a fair chunk of revenue to a rainy day fund.

Deputy Eoghan Murphy: So our true structural imbalance is something we can see only after the fact.

Professor Philip Lane: That is true but even in that situation the fact that the true balance is known only after the fact means that, first, one proceeds on a prudential basis and, second, as time moves on one can release funding from the rainy day fund if one is too pessimistic or can have some mechanism to replenish it if one is too optimistic. There are ways to get around that.

Deputy Eoghan Murphy: When talking about a rainy day fund, what place does the National Pension Reserve Fund, NPRF, have?

Professor Philip Lane: That is interesting because there was an element of that in setting up the NPRF but the logic of that was more long term. It was to deal with the increase in pension commitments that we will face after 2025. In line with that long-term goal, the portfolio was extremely equity focused. It was not liquid and we had to sell so much of these equities at the bottom of the market. The fact that our crisis happened at the same time as the global financial crisis meant we had to liquidate a lot of the assets in the fund to recapitalise the banks. If we look back at what happened to those equity shares since then it was very badly timed.

Deputy Eoghan Murphy: We pursued the wrong investment strategy with the NPRF.

Professor Philip Lane: Not if it is a national pension reserve fund.

Deputy Eoghan Murphy: From the point of view of this crisis we did.

Professor Philip Lane: What should have happened was that, while on its own terms the NPRF was a good idea, one could have set up a second fund. A lot of countries such as Chile have several stabilisation funds to cope with the long term, the cycle and so on. One can have

a long-term fund to deal with these long-term aging issues and a cyclical fund to deal with the rainy day.

Deputy Eoghan Murphy: Was it a mistake to divest the NPRF when we did and invest that in the banks, regardless of where the money went in the banks? Was the timing of the divestment a mistake?

Professor Philip Lane: When your back is to the wall financially you are going to gather funding where you can. The fact of that funding being available was important to limit the amount we needed to borrow from the rest of the world. In accounting for the crisis it is important to keep in mind that its impact is not just the increase in debt but the fact that we had to run down that fund. That should be definitely included in the overall financial cost. The rainy day fund would have existed on top of that.

Senator Marc MacSharry: With entry to the EMU by Ireland do you, Professor Lane, think the Central Bank here went on autopilot?

Professor Philip Lane: No. First, my understanding is that national central banks had a lot of responsibility in the euro area. There are lots of committees so the Irish Central Bank staff had many more duties at a euro area level because there would have been all sorts of committees where each member country would have been sending staff. The level of activity probably went up. It is true to say that it is more orientated towards euro area policies and not so much the local issue.

Senator Marc MacSharry: Exactly.

Professor Philip Lane: In the mid-2000s, when the scale of the boom was becoming obvious I do not know because I have not looked at what they were up to in detail, but I am guessing they were definitely paying attention and they did have financial stability reports and so on. The issue was the reluctance to make big decisions. Their analysis might have shown that risks were going up in the mid-2000s but they were too slow and too reluctant. They made some decisions. There was an increase in the capital charge on high loan to value mortgages and so on but it was not sufficient. I do not think it was an analytical issue of not understanding what was going on, it was basically a question of whether they were prepared to pull the trigger to cool it down.

Senator Marc MacSharry: So the Central Bank was not on auto pilot-----

Chairman: I have to ask the Senator to be more measured in his language. “Auto pilot” presumes a judgment on his part. If the question is have the powers increased, lessened or diminished or whatever that is fair enough. I reckon that is what he is implying.

Senator Marc MacSharry: It is not a case of what the Chairman reckons I am implying.

Chairman: Can the Senator clarify his question?

Senator Marc MacSharry: Auto pilot.

Chairman: Is the Senator making the judgment that the Central Bank was on auto pilot?

Senator Marc MacSharry: I asked the question of the witness. I am going to clarify it now. Professor Lane, you are saying it was not on auto pilot but certainly the focus for the Central Bank, which was busier because of the all the new committees in which it had to participate,

was on serving the ECB mission rather than on the national one. Would it be fair to say that?

Professor Philip Lane: I would say that is a big part of it but if you look at financial stability reports from the mid-2000s, they were diagnosing that risks were accumulating here. The issue is moving from diagnosis towards action so the big issue is why they did not decide to be more interventionist to manage those risks by restricting credit growth through various mechanisms.

Senator Marc MacSharry: Does the structure of the responsibility, and to use a phrase I used earlier with other witnesses, the fiduciary duties of the members of the governing council of the ECB, where the governors of the central banks had to be committed to the overall mission of the ECB, compromise the role of governors of central banks in their responsibilities to their mother central bank, nation or people?

Professor Philip Lane: Professor Honohan talked about this last week. I do not think I have a different view to his.

Senator Marc MacSharry: I was not aware he gave a clear answer.

Professor Philip Lane: Let me give my version of what I thought I heard and my understanding of the role of the governor. When they make a QE decision tomorrow, maybe, or when they make an interest rate decision, they essentially focus on the euro aggregate. They do not talk about how the interest rate will affect Ireland or they do not talk about how the interest rate will affect France because they are there to set the policy for the euro area.

When it comes to financial stability issues, when essentially one has national financial systems, then the Governor would have the role of explaining to the euro council - the governing council - "Here's what's going on." The Governor is appointed by the Irish Government. So I would be fairly sure they would, within the rules of the euro system, advocate as far as possible what is in the national interest of Ireland, subject to the rules of the euro system.

On the question of lobbying, should the rules of the euro system be different? That is more indirect through the political systems of Europe about what the mandate of the ECB should be.

Senator Marc MacSharry: I will continue to ask that question of others. The previous witness used the word "incomplete". Professor Lane referred to the youth of the EMU and that, in his words, it had known only good times. In many ways the Irish people were the guinea pigs as the bigger European players minimised their losses while trying to come up the curve in the context of the international financial crisis.

Professor Philip Lane: Yes. I think even on Monday at the conference here in Dublin Benoît Cœuré spoke about it; essentially attitudes have evolved over time. The diagnosis of the financial crisis has evolved over time. In the report I stated that essentially financial stability is really a common responsibility. To the extent of the common responsibility, it is deeply unfortunate that essentially so much happened at a national level. The fact that the guarantee was issued at a national level without, it looks like, too much negotiation in advance with the rest of Europe-----

Senator Marc MacSharry: We do not know that.

Professor Philip Lane: That is my understanding; I have not heard anything different from that. When it comes to the unguaranteed bonds in 2010, it seems clear that if the euro system decides they do not want bondholders to be burnt, then that should be paid for at a European

level; it should not fall on an individual country to protect the financial stability of Europe. However, essentially the mechanisms were not in place at that time to deliver on that.

Chairman: I ask the Senator to be brief as we are out of time.

Senator Marc MacSharry: With the vision that is outlined now by the Commission in terms of the capital markets union and the level of integration that is mooted in that regard, will that serve Ireland well or will it expose us more as a small nation within the eurozone?

Professor Philip Lane: I think the phrasing of capital markets union will be important. Essentially too much capital flows through banks which therefore puts depositors at risk and therefore puts governments at risk in order to protect depositors, whereas if one has much more funding going through capital markets essentially it is much more transparent about who bears the risk. It protects, basically, regular savers, who deal with regular banks, from risk. I think it is a positive for Ireland. If there is an alternative for banks, there is more by way of bond markets and more by way of equity funding - all of those things which have been traditionally limited are possible at a European scale with commitment to make that happen. I think that is important for the future of Europe.

Part of the tragedy of what has happened is Europe was too dependent on banks and therefore there has been basically so much effort to save the banks and that has been so expensive.

Deputy Michael McGrath: I welcome Professor Lane who is the last speaker. I have a few questions on the role of the euro and monetary union which he addressed in some detail in his paper. In the round considering the factors that led to the crisis and then the management of the crisis within the confines of monetary union, would Ireland have been better or worse to have been out of the euro?

Professor Philip Lane: I do not think there is a single answer on that. The way I phrased it in the report - I think in the opening statement - is outside the euro the crisis would have been different. One would have had, I think, a deeper crisis initially because the currency would have collapsed in value. There would have been very large increases in interest rates because to protect the currency interest rates would have gone up. What would have been the consequences? One would have had a lot of bankruptcies just as, say, in Iceland one saw the banks going bankrupt. So in part there is a benefit to that because the foreign creditors would have taken a hit. So some of the losses would have been transferred outward.

On the other hand there would have been a lot of financial distress here. With devaluation there is a big distributional effect because with import prices going up, consumers would have taken a big hit initially. On the other hand with the weaker currency maybe after two or three years, recovery would have kicked in more quickly. So one has a very unstable short term, but maybe a faster recovery. On the weighting of stability versus other factors, people will have different opinions. It is an interesting-----

Deputy Michael McGrath: Is Professor Lane an advocate of Ireland's membership of the euro?

Professor Philip Lane: I wrote earlier in my career - it is included in the material I sent the committee - a couple of pieces in 1997-98 where I essentially point out the risk factors. My view is that the risk factors could have been managed through a financial regulator that is more proactive and through a fiscal policy that basically put more aside for the rainy day.

On the euro for Europe, can the Deputy imagine the history of Europe for the past 15 years with 19 more currencies or 18 more currencies - whatever the number is today? During the 1992-93 currency crisis we all had individual currencies. There was a reason the euro was created in the sense that there were a lot of inefficiencies and problems with having a set of independent currencies. So I suppose my view is the euro could have worked and can be made to work so long as the rest of the policy set-up is in line with that.

Deputy Michael McGrath: Does Professor Lane think Ireland is better in than out?

Professor Philip Lane: So long as the euro exists, yes, definitely.

Deputy Michael McGrath: On page 6 of his paper, Professor Lane makes criticism of fiscal policy in stating that during the good years the budget surplus should have been bigger and put into what he called a fiscal reserve fund. Have we matured as a country and dealt with the apparent conflict between fiscal prudence and winning elections? What is his view on the journey through which we have come and how we now regard fiscal management? Have we taken the right steps or is there still a risk on that front?

Professor Philip Lane: We now have at national and European level a framework with the fiscal rules and the independent fiscal council that is intended to make life easier. Let us imagine we are back in a boom situation and revenues are high, essentially the purpose of the fiscal rules and the fiscal council is to increase the political cost of excessive generosity. So now, if one likes, it is a restraint. I think those restraints are not fool proof.

If a government really wants to ignore the fiscal council and ignore the fiscal rules, it probably can get away with that for quite a bit. It depends on the political system buying into that rules-based framework. That is for the members, as politicians, to work out. It is that kind of framework where they are constrained in what they can do. It is important to say that across the world there is an understanding that essentially this does not end the political debate because one can have a high-spending government yet still running surpluses if it is prepared to raise taxation. It is not about how much a country should spend or how much it should tax. It is saying that if it spends a lot over a cycle, it needs to raise enough revenue to match that.

Deputy Michael McGrath: I have a final question. Professor Lane spoke earlier about the issue of a central credit register and the fact that one was lacking. First, if we had had a central credit register what role could it have played in terms of improving the bank's ability to make proper lending decisions and also protecting borrowers in cases during the period when losses were being built up in the system? Second, does it surprise Professor Lane that six years out from the epicentre of the crisis we still do not have a central credit register?

Professor Philip Lane: My view on this comes out of the Honohan report. It does seem as if individual banks had incomplete information. At least some of the decisions they were making were on the basis of not having the full picture of the debts of individual borrowers, and we have seen that in some cases. It is important that the credit register is in place before the credit situation normalises. When there was very little lending for the past six years perhaps it was not the first order of business but as the banking system normalises, having that in place will be important.

Deputy Michael McGrath: Thank you.

Chairman: To conclude, at the start of his engagement this morning Professor Lane listed a number of policy instruments within the power of the State, whether with the Central Bank,

Government or whomever, that could have lessened the exposure that was happening in Ireland. Could he rank for us in order some of those policy instruments that would have actually reduced the risk?

Professor Philip Lane: First and foremost is tougher regulation, which would have slowed down the credit boom. The second is fiscal policy. It is important that there were surpluses, and it is important to state that public debt did come down but the fiscal mindset was not sufficiently altered by Economic and Monetary Union, EMU, membership. If we had been running a fiscal surplus of 5% or 6% in the mid-2000s, that would have enabled us to absorb the hit of the crisis much easier.

The other element is in terms of crisis management. A more narrow guarantee and an earlier shutting down of Anglo Irish Bank would have helped to narrow the losses. On that I do not have anything different to say from what Professor Patrick Honohan said.

Chairman: I thank Professor Lane for his participation today. It has been an informative and valuable meeting which has added to our understanding of the factors involved in the banking crisis in Ireland. I will now bring the meeting to a conclusion. The witness is excused. The committee is adjourned until 9.30 a.m. tomorrow.

The joint committee adjourned at 1.55 p.m. until 9.30 a.m. on Thursday, 22 January 2015.