HOUSES OF THE OIREACHTAS

Volume 1 **No. 11**

AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 4 Márta 2015

Wednesday, 4 March 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 Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Context Phase

Dr. Peter Bacon

Chairman: The committee of the inquiry into the banking crisis is now in public session. Good morning and I would like to welcome you to the joint public hearing of the Joint Committee of Inquiry into the Banking Crisis. Later this morning we will hear from Professor Alan Ahearne but in our first session of this morning's discussion we will hear from Dr. Peter Bacon on the Bacon report on the housing market in Ireland and the development of the proposals to establish NAMA.

Dr. Peter Bacon is a well-known economist. He holds primary and postgraduate qualifications in economics including a PhD from Trinity College Dublin. Since September 1994 he has built and developed an economic consultancy practice. During his career Dr. Bacon has held a wide range of positions in Ireland and overseas. He has worked in the public and private sectors in Ireland, for some years as a stockbroker. In the public sector he has worked as an executive and as a ministerial adviser. Dr. Bacon's overseas experience includes working in developing economies with the Organisation for Economic Co-operation and Development (OECD), Paris, and working in developing and transitioning economies with the World Bank, Washington DC, and the EU TACIS programme. His main areas of interest are in macro-economic and financial policy issues and evaluations of policies and projects at sector level. He has published widely over the years in these areas. Dr. Bacon, you are very welcome before the inquiry this morning.

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 they continue to so do, 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 is to be given. As you have been informed previously, the committee is asking 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 they should not comment on, 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.

Dr. Peter Bacon: Thank you, Chairman. I make this statement on foot of your invitation to attend this morning, to assist you in your deliberations. You have requested that I address all or some of the following matters in my evidence: the development of the proposal to establish NAMA, including the options assessed and the conclusions reached; tax policy towards housing and property development; planning and development during the boom; Ireland's housing market in the late 1990s; debate about housing policy prior to the crisis; Ireland's housing market in the international context; and recommendations made by me in respect of the residential property market in Ireland and their implementation.

I am happy to endeavour to assist you and the committee in relation to these issues on the basis of certain consultancy assignments carried out by me and which have been published or placed in the public domain as follows: An Economic Assessment of Recent House Price Developments, a report submitted to the Minister for Housing and Urban Renewal (April 1998); The Housing Market: An Economic Review and Assessment, a report submitted to the Minister for Housing and Urban Renewal (March 1999); The Housing Market in Ireland: An Economic Evaluation of Trends and Prospects, a report submitted to the Minister for Housing and Urban Renewal (June 2000); and Evaluation of Options for Resolving Property Loan Impairments and Associated Capital Adequacy of Irish Credit Institutions: Proposal for a National Asset Management Agency (NAMA), Abridged Summary of Report (8 April 2009).

I will start with the housing market. Developments in Ireland's housing market in the late 1990s, in the Dublin region in particular, were symptomatic of fundamental change in housing patterns. House price inflation, especially in Dublin, began accelerating from 1993, reaching 14% per annum in the four years to 1997 and 25% in 1997.

These trends were the result of favourable macro-economic developments in Ireland including lowering interest rates, reinforced by demographic factors and changing social patterns. For example, gross immigration was occurring at an annual rate of 44,000 and concentrated in household formation ages, almost half being aged between 25 and 44 years. By contrast, emigration was concentrated in the younger age of 15 to 25 years, about 62% being of that age. Changing social patterns were reflected in a rise of one and two person households from 41.9% of the total in 1988 to 46.8% in 1997. While housing output increased 80% between 1993 and 1997, the share of completions in Dublin fell.

The recommended policy response contained in the reports considered that, to be effective, a policy response would need to: achieve a better balance between demand and supply in the short term; improve the potential supply of housing in the short to medium term; engage in infrastructure developments; and improve medium and long term planning of development of the east region. The April 1998 report proposed specific policy initiatives under each of these headings, although most debate and commentary focused on the fiscal measures which comprised the following: the repeal of section 23 relief from investment in residential property; the removal of deductibility of interest on borrowings undertaken for investment in residential property against personal income for taxation purposes; and the reforms to the stamp duty code and changes to capital gains tax as it applied to serviced zoned land.

The two subsequent reports of March 1999 and June 2000 contained more detailed proposals directed mainly at improving the supply side response. These latter recommendations were framed in the context of achieving credibility, clarity and certainty. In support of these criteria specific recommendations were made to: achieve higher residential densities; carry out key strategic infrastructure investments to overcome bottlenecks such as the northern fringe interceptor sewer; accelerate the process of securing required planning consents on significant sites in Dublin city and county through the use of strategic development zones (SDZs); improve the deployment of existing planning resources; increase the resources available to the planning system; impose fiscal penalties for non-realisation of potential of SDZs; propose revisions to the stamp duty regime; establish an anti-speculation property tax; establish measures to secure improvements in the quality and availability of rented accommodation; and to strengthen the institutional framework for securing a more effective housing response in the greater Dublin area.

I will turn now to the outcome. Rates of increase in prices of new and existing houses in Dublin and nationally slowed sharply from the middle of 1998. The peak rate of inflation in the new house market was 24.6% in the first quarter of 1998 countrywide and 33.8% in the first quarter of 1998 in Dublin. By the first quarter of 2000, these rates had halved to 12.9% and 16.2% respectively. In the existing house market the peak rate was 36.9% in the third quarter of 1998 country wide and 41.7% in the third quarter of 1998 in Dublin. These rates too more than halved to 17.4% and 20% respectively in the first quarter of 2000. At the same time, the annual rate of new house completions increased about 10%, to approximately 46,500 units, the highest annual rate of completions ever recorded to that time. However, in 2001 the measure to exclude interest deductibility was reversed. Thereafter prices re-accelerated, despite a supply response rising to almost 90,000 units annually, as speculative forces gathered increasing momentum.

I will move now to the development of the proposal to establish NAMA. At the heart of the banking crisis was a concern of capital markets with regard to the adequacy of banks' capital to meet future loan impairments and institutions' capacity to obtain additional capital externally. Future impairments were of concern because for the previous decade Ireland had experienced rapid inflation in property values and lending to the property sector had become an increasingly important component in credit institutions' lending. In addition, there was heightened international concern about the health of the financial sector.

Irish banks were facing an extremely unstable outlook in respect of international wholesale deposits, upon which they had become significantly dependent in the previous decade to fund expansion of their assets or lending. They were experiencing major withdrawals of these deposits, a shortening of the average duration of deposits and substantial recourse to the Central Bank for short-term liquidity support. This was not a sustainable trend. In addition, the initiatives taken by Government to that date were considered to be insufficient to achieve rates of capital adequacy that would encourage investors to hold and invest further equity in Irish credit institutions when prospective impairments were considered. As long as this remained the case, it could be expected that share values would remain depressed and deposit liabilities would be likely to experience continued attrition and foreshortening in duration. Such a prospect would hinder economic recovery, complicate further the required adjustment of the public finances and leave Ireland's international credit rating subject to downward pressures and speculative attacks. Therefore, it was concluded that additional and far reaching measures needed to be undertaken as soon as possible to place the banking system on a sound footing.

Deterioration in the Government debt to GDP ratio was under way as the general Government deficit widened. A significant part of this deterioration arose from the effects of cyclical downturn. Moreover, discretionary budgetary adjustments to curtail the widening deficit would be partially undone by the deflationary impact of the discretionary measures themselves. To some degree, in the absence of international recovery and-or gains in competitiveness and productivity in Ireland, the domestic fiscal adjustment process had the characteristics of a vicious spiral comprising weakening economic activity leading to widening of the Government deficit and indebtedness leading to discretionary adjustments leading to further erosion of economic activity and so on.

The deterioration in Ireland's credit terms associated with a worsening fiscal position was compounded by the additional contingent liabilities assumed by Government by virtue of the guarantee of the deposits of credit institutions from the previous September. Capital markets were uncertain how to value the additional liability of the Government on foot of the guarantee and the resulting confusion was causing Irish bond spreads to widen unfavourably. Against this backdrop, it was considered imperative that initiatives should be undertaken that would lead to stability in banks' deposits and term debt liabilities and eliminate the need for a renewal of the guarantee in place at the time. To achieve this required removing all doubts about capital adequacy of the credit institutions and their capacity to deal with prospective loan impairments.

There are a number of broad approaches, which are not mutually exclusive, to bank capital support schemes. These revolve around recapitalisation programmes involving stress testing against expected losses, asset guarantee schemes and asset management arrangements. The key features of recapitalisation programmes are future capital shortage is anticipated by testing adequacy of current capital in stress scenarios; the adequacy of capital to absorb losses is assessed; and the regulatory authority may then require more capital, which may be raised from the market, for example, by way of a rights issue or attraction of new shareholders, which may be either private or State. This approach needs to take account of implications of market conditions for cost of capital to bank, dilutive implications for existing shareholders and protection of State capital if the external shareholder is the Government. There have been many recapitalisation programmes put in place in the US and the EU in the current crisis, including in Ireland.

The key characteristics of the asset guaranteed or risks insured by the State approach are troubled assets remain on the balance sheet of the banking system; troubled assets are not subject to upfront mark-to-market write-downs; the bank usually is liable to a relatively small first loss tranche and the State covers elevated losses for a fee; equity capital is not affected as assets do not have to be sold at the current marked-down levels; no initial outlay is required from the State and a fee, premium or compensation arrangement is paid for the guarantee; compensation to the State in the form of convertible preferred shares or warrants is dilutive, of existing shareholders; and such schemes have been implemented at ING, Citigroup, Bank of America and RBS.

The key features of the asset management arrangements approach are troubled assets are transferred from the balance sheet of the banks at an agreed price; mandatory participation is required; the banks take the impairment loss to profit and loss account now; the bank is cleansed of troubled assets making valuation of the remaining part of the bank less complicated; the removal of impaired loans reduces the risk weighted assets of the bank and releases capital or reduces the shortfall in capital required; a discounted sale of assets may result in a significant reduction in the equity of the seller; and significant financing may be required from the State for the asset management company, impacting negatively on the fiscal position. Examples at the time included UBS and Securum-Nordbanken in the Swedish crisis of the 1990s.

Nationalisation was explicitly considered in the context of the report. Where a bank's net worth has already been wiped out or would be by future impending losses or where Government are or will become dominant shareholders as a result of recapitalisation or other initiatives, nationalisation may be the most effective means of protecting the interests of all of the stakeholders – Government, equity and bondholders, depositors and the business franchise owned by the bank – and carrying out the required restructuring to enable the bank to stabilise its business in support of the wider economy in the future. For example, nationalisation could be used to facilitate mergers of operations and improve efficiencies of scale in accessing wholesale credit markets so as to bring about required strengthening of management or corporate governance. In effect where taxpayers are liable for guaranteeing the deposit liabilities of banks and also guaranteeing the bank against losses in the value of assets, in whole or substantial part, by any arrangement, such as those described above, nationalisation may be considered necessary to overcome issues of moral hazard. These situations are mostly likely to arise with respect to shareholders, who may be seen to be bailed out or gifted as a result of initiatives to support bank capital. Another such concern may be the additional cost to the taxpayer in terms of deteriorations of the market's rating of sovereign debt instruments and the premium paid to bondholders in respect of this.

A number of nationalisations were made in the course of the current crisis in the UK, notably Northern Rock and Bradford & Bingley, and of course here in Ireland Anglo Irish Bank Corporation was nationalised in January 2009. A summary comparison of the general attributes of these approaches is contained in a table. I do not propose to go through the table because the committee has it.

The very features which make the asset guarantee approach intuitively attractive - no money up-front from Government and no write-down in banks' balance sheet assets - contain also inherent fundamental weaknesses, namely, that a contingent liability is created in the balance sheet of the Exchequer. The situation would have significant parallels with the bank guarantee of the six credit institutions. It too was adopted on the basis that it involved no up-front outlay on the part of the Exchequer and on the basis that it would not be "called" and therefore the premium payments by banks would be a net receipt to the Exchequer. In the event, capital markets did not grapple well with the contingent liability created by the deposit guarantee. The tendency was to price Irish sovereign debt unfavourably, reflecting a view that more issuance of Government debt would be required. Indeed, an argument developed that if any part of the guarantee came to be called, in effect all would be called and that would lead to extreme problems for the Exchequer. The point of relevance here is that contingent liabilities are inherently uncertain in nature, are often evaluated in an ill-informed way with resulting errors and the potential for further adverse speculation against Ireland. As a result of the decision to guarantee the debt liabilities of Irish credit institutions the credit rating of sovereign, Ireland became inextricably bound up with the issue of Irish banks' capital adequacy. A further guarantee approach, this time in respect of banks' property-related loan assets, would create a further layer of uncertainty through the creation of another contingent liability on the Exchequer. This would further entwine the sovereign rating with Irish banks' capital adequacy problems without actually providing any clarity as to how capital adequacy would be achieved, other than through a calling of the contingent liability.

By contrast, the asset sales approach, while involving the recognition of "pain" at the outset contained the merit of certainty and clarity, provided of course the projection of the extent of impairment was accurate in the first place. In the particular circumstances prevailing it was considered that there was much to be said for recognising and crystallising prospective property-related loan losses explicitly, rather than allowing them to remain on banks' balance sheets with a concomitant additional contingent liability on the Exchequer.

A feature of the guarantee approach is that assets remain on the balance sheets where they have been created. Another side to this is that they continue to be managed by the officers and executives of banks which created the problem assets in the first place. In the case where assets are complex financial instruments, such as many of the assets acquired by banks that were originated in the US and based on sub-prime borrowers, their valuation and resolution may best be undertaken in the banks which acquired them and which have the financial skills appropriate to this task. The nature of impaired property loan assets simply was not of this character. They were loans created and secured by property assets, development land, work in progress, completed but unsold residential stock and under-performing property investments, which are now worth significantly less than was envisaged by the loan. There is not a great deal banking skills can do to resolve this dilemma. Moreover, the property development companies involved in these transactions are almost entirely privately owned, championed by entrepreneurial characters and mostly without equity or recourse to equity markets, and in many cases do not have the depth of management skills to engage in the kind of portfolio sales and work-outs which ultimately are required to resolve the impairment issue.

Asset management companies, AMCs, offer prospects for avoiding many of the shortcomings associated with a continuation of the existing bank-property developer relationship. Potential advantages include: economies of scale in administering work-outs and in forming and selling portfolios of assets; benefits from the granting of special powers to the government agency to expedite loan resolution; and the interposing of a disinterested third party between bankers and clients, which might break connections that otherwise could impede efficient transfers of assets from powerful enterprises.

Sweden's AMCs provide examples of some of these potential advantages, but other countries have found it difficult to realise them. First, government agents may lack the information and skills of private market participants. Second, government agencies do not operate in a vacuum. They, too, are creatures of the societies that create them, and government agents must negotiate, rather than dictate, solutions, just as private market participants must do. In negotiations with government agencies and private participants alike, the strength of one's position depends on one's "threat point", the ability to credibly threaten adverse consequences for one's bargaining opponent, if agreement is not reached.

Notwithstanding these shortcomings, it was considered that AMCs, by virtue of the potential advantages they contain, that I have noted, have the potential to bring about better economic resolution of the impaired loans of Irish property developers than relying on existing bank management and banker, developer relations, which brought about the problems in the first place.

The point I am about to make is one I made extensively at the time. It was never picked up and I considered at the time and still consider that it is one of the most important points. A further important consideration relates to the future financing requirement of impaired assets. Many of the impaired assets will be capable of achieving higher values if they can be worked out rather than disposed of. A key issue for successful work-out will be access to additional capital, equity and debt required for the work-out. It is extremely difficult to see how existing property developers will be able to access capital markets effectively for such equity and banks' capacity to extend credit will be limited by the absence of collateral available from most of them. Potentially the amounts involved are large and a feature of Irish property developers is they are not publicly quoted companies and have not had a history of recourse to equity markets for their funding. I made the point when the crash occurred that the first thing that happened in the London market was that British Land, Land Securities and Hammerson, and some others, went straight to the market and raised capital to bolster their balance sheets because they were quoted companies. There was not a single one in Ireland then or now. Instead, they have relied on retained earnings for equity and bank lending for the balance. This shortcoming cannot be put right now and it represents a significant impediment looking forward to resolution of the impairment issue, at least cost. There has been a development in the past two years in the sense that there are now three publicly quoted real estate investment trusts, which is certainly a welcome development to absorb very fine commercial property assets from the resolution process.

An AMC, however, does have the potential to at least mitigate this issue in two respects. First, it has the potential to achieve scale and overview of developments and projects. Banks will be concerned about the security they hold and how that can be maximised and realised. In many instances more than one bank will be involved in the security and their individual interests may not correspond. An AMC would be able to achieve project oversight. Second, if properly structured and resourced with relevant property-related skills, such an entity would have the potential to attract long-term capital in a manner that individual development companies would not.

In conclusion, it appeared to me that the asset management approach had the potential to offer greater assistance in achieving resolution of the impairment issue upfront and maximising taxpayer returns, over the long term.

Chairman: Thank you, Dr. Bacon, for your opening comments. You wrote three reports, in 1998, 1999 and 2000. In the 2000 report you noted house prices were rising rapidly despite a strong response of housing supply, the law of supply and demand. The report recommended new measures including further proposals to discourage investors and another reform of stamp duty. Maybe you could outline these measures to the committee, how many of the key recommendations were implemented by the Government and what impact they had on the housing market.

Dr. Peter Bacon: The easy part of the question relates to the tax measures because it is an event. There is a finance Bill or supplementary finance Bill. There is a piece of legislation and the event either happens or it does not. All the tax and fiscal recommendations that were made in the reports were implemented. I highlighted one of them being reversed in 2000 or 2001. With regard to the supply-side enhancement measures, the 1999 and 2000 reports contained sections which assess the extent to which measures proposed in the previous report were implemented and what the impact was under four headings. Those headings were price and price stability, affordability and supply-side response. In the latter two reports, there was consideration of impact on the rented sector, which was something not considered at all in the first report.

In trying to answer the question of whether those supply measures were implemented, I point out that these were not an event. They form a process. The principal recommendation on the supply side related to the policies relating to residential densities. Members are either Deputies or Senators, and they will know from constituency work that densities are not an easy subject. It is easy for economists and planners to make recommendations but there are major issues with that topic. What I can state factually is there was a tendency over the period and subsequently for residential densities to rise. Did they rise enough and could they have risen more? Did they rise fast enough? These are judgments and some of these issues are still ongoing.

Chairman: At the core of the position, would it be accurate to state in considering the housing market between 2001 and 2002, prices started stabilising and maybe even calmed a bit?

Dr. Peter Bacon: Yes. As I stated, the rate of price increase halved between 1998 and 2000.

Chairman: Would that effect in the market be related to the implementation of your recommendations?

Dr. Peter Bacon: You can relate that slowdown directly to the fiscal measures.

Chairman: That brings me to my next question, before I bring in Deputy Higgins. In 2001, the Government reversed a number of measures that Dr. Bacon suggested and were introduced. Stamp duty for investors was cut, tax on second homes was eliminated and interest relief was restored as a deductible expense when calculating tax on residential income. What was your view on the reversal of the recommendations implemented on foot of your report?

Dr. Peter Bacon: I think they were too early.

Chairman: Were you consulted about that?

Dr. Peter Bacon: No.

Chairman: There was no-----

Dr. Peter Bacon: Let us be clear. My job is as a paid economic consultant. I get terms of reference, I write and submit a report and I get paid, if I am lucky.

Chairman: The record is that your recommendations were implemented and by your account this morning, that had a measurable impact on the housing market. We saw a stabilisation and maybe even a drop in prices as a result of your recommendations. Your recommendations were then reversed and what happened to the market? Did the prices start increasing again or-----

Dr. Peter Bacon: Yes.

Chairman: -----did they stay stabilised?

Dr. Peter Bacon: It did. To be fair to the record, you must point out that supply did respond to the supply-enhancing measures. The rate of house completions effectively doubled from 25,000 to 50,000 by the mid-2000s.

Chairman: For the record again, you were not consulted on any of those reversals of the measures outlined in your report.

Deputy Joe Higgins: A briefing paper from the researchers to the committee indicates the following, “The increasing role of investors and speculators in the residential property market was a source of concern to the Irish Government when it commissioned Bacon’s first report.” Was that Dr. Bacon’s understanding of why the Government commissioned his succession of three reports? He has just told us of his belief that the recommendations put into effect from the first report had a significant impact on house prices. Which measures specifically does he think were effective in reducing house prices?

Dr. Peter Bacon: The Deputy has two questions. The terms of reference to the first report did not contain or express, in my memory, any concern about speculation. We are talking about late 1997 for these terms of reference for the report. The terms of reference were about concerns that prices were accelerating. The concern of the Department of the Environment and Local Government at the time was to get a handle on why this was happening. People did not know. I do not think there was a preconceived view or belief at that time that speculative forces were strong. At the time, I do not think they were. From 1998 onwards, during the course of this work and as noted explicitly in the second and third reports, the significance of speculative demand was rising and ultimately driving the market. On the question of specific measures, it is very difficult to isolate one measure. Certainly, in the short term and in the sense of bringing down the rate of increase in prices, the measure that bit hardest was the tax deductibility of interest.

Deputy Joe Higgins: That was for investors.

Dr. Peter Bacon: Yes. It was the ability to offset interest costs against revenue.

Deputy Joe Higgins: Yes. Although the rate of increase did reduce in 2001, for second-hand houses, for example, prices still increased at approximately two thirds of the average industrial wage in that year alone. An ordinary person would see that as an inordinate increase. Would Dr. Bacon’s proposed measures have been enough to have an ongoing effect in bringing the prices down to much lower levels than this?

Dr. Peter Bacon: I think they would but there would have been adverse side-effects, the impact of which would probably have become intolerable for any Government. Mainly, this would relate to a shortage of accommodation in the rented sector. The first report was about house prices and there was no part of the terms of reference regarding the rental sector. The report was on why house prices were accelerating and raising headlines. That is basically the content of the terms of reference. They also asked for recommendations to stabilise the issue. That is what the report contained. I have always acknowledged that a side consequence of curtailing investment demand, as the measures did and which led to a levelling of prices, is to reduce the supply of rented accommodation. That is what happened.

Deputy Joe Higgins: An article in *The Irish Times* from 6 December 2001 by Mr. Colm Keena suggests that the decision made by the then Minister for Finance, Mr. Charlie McCreevy, to reverse a high rate of stamp duty for investors "was done against official advice and after intensive lobbying by interested parties." The briefing note from the researchers to the committee makes the following assertion, "There appears to have been an intense lobbying campaign from property and construction sector interests to remove the curbs on investors." Was Dr. Bacon aware of lobbying or the extent of lobbying by vested interests at that time?

Dr. Peter Bacon: No, not other than what was contained in media reports. I was not confronted with representations in any formal part of the research that was going on. However, I do not think anyone in Ireland was unaware that there was a lot of pain. The measures I proposed and that the Government implemented hurt people.

Deputy Joe Higgins: Which people?

Dr. Peter Bacon: The investors. If an investor goes from a situation where he can offset interest costs against rental income to a situation where he cannot, he is feeling it where it hurts: in his pocket. Many people within the industry were pointing to the side consequence of the measure, namely, that the rental sector was becoming tighter and that rents were increasing.

Deputy Joe Higgins: What is Dr. Bacon's understanding of the nature of these investors? Did they have political clout? Did that affect Dr. Bacon?

Dr. Peter Bacon: I am not going there. I have no idea.

Deputy Joe Higgins: I wish to explore the issue of affordability of homes with Dr. Bacon. My interpretation, which Dr. Bacon can correct if I am wrong, is that he saw affordability more for the ability to pay a mortgage. One of Dr. Bacon's recommendations was to increase the length of mortgage time. I think he may have put out a figure of 35 years on one occasion.

I am keen to explore with Dr. Bacon a different take, as it were, on affordability and ask for his opinion. Dr. Conor McCabe, from the UCD school of social justice, in an article, Irish Housing and Wages, 1977 to 2006: Portrait of a Scam, published on 8 June 2010 stated:

> Best practise has house prices at 2.5 to 4 times the average industrial wage...apart from the recession years of the mid-1980s, housing in Ireland has been overpriced for the past 33 years...The figures belie the current myth of the 'Good' Celtic Tiger which ran up to around 2002, and the 'Bad' Celtic tiger which ran from 2002 to 2007...In 1997, house prices once again breached 5.0, and just kept on climbing...By the time the 'Good' Tiger ended in 2002, the affordability ratio stood at 8.17.

Why did Dr. Bacon not measure affordability in regard to the absolute cost of a house, rather than projecting a period of 35 or 40 years for repayment?

Dr. Peter Bacon: There are two reasons. The average industrial wage is not representative of the average wage within the economy. Most people in Ireland now work in the services sector. I am sure Deputy Higgins has a better handle on it than me. The proportion of the labour force which earns the average industrial wage is very small. In respect of the proportion of the labour force engaged in industry, as measured by the average industrial wage, a figure of 25% or 30% sticks in my mind, although I stand to be corrected on that number. The use of the term "average industrial wage" is always, to my mind, a misleading term. It is an official term but it is misleading in the sense of providing a measure of average incomes of would-be house purchasers. I am sure the numbers that Deputy Higgins quoted are arithmetically correct but they are the result of the fact that a significant number of people earn more than the average industrial wage.

The second question Deputy Higgins asked me was why I measured the analysis in terms of mortgages. That is how most people and most first-time buyers finance the purchase of homes. It is the element most relevant to them.

Deputy Joe Higgins: Our researchers have suggested that in a number of years during the housing boom the increase in the value of the average home was larger than the amount of money a worker on the average industrial wage would take home over the whole year. In fact, from 1996 to 2006, they maintain that the price of an average home increased 400%, an average each year of equivalent or greater than the average industrial wage. The result was that the increase in house prices created significant opportunities for investors to make large profits in housing development. Does the range of what were massive price increases by any standards indicate a serious level of profiteering and speculation in the housing market?

Dr. Peter Bacon: I cannot comment on profiteering. It is not a defined term. People will make a profit if they sell a house or if they buy it at one price and sell it at another price. As to the extent to which it is profiteering in the sense that I think Deputy Higgins means, that is to say, as being excessive profit, I do not know.

Deputy Joe Higgins: Anecdotally, it was said of new housing developments that every second house represented a profit for developers in some cases. Would Dr. Bacon consider that profiteering?

Dr. Peter Bacon: I would.

Deputy Joe Higgins: That did happen, did it?

Dr. Peter Bacon: I do not know.

Deputy Joe Higgins: I will move on to NAMA briefly. Dr. Bacon preferred the NAMA set-up rather than nationalisation. What is Dr. Bacon's view of the Comptroller and Auditor General's observation that the Bank of Ireland was given approximately €1 billion above the real market value of its impaired loans? In preparing his report did Dr. Bacon underestimate, perhaps, the level of impairment in loans?

Dr. Peter Bacon: First of all, I would not comment on any remarks of the Comptroller and Auditor General because I am not familiar with his work. I am not going to comment on that.

Deputy Joe Higgins: In essence he said that state aid of €1 billion was given to Bank of Ireland.

Dr. Peter Bacon: I am aware of that but I am not in a position to comment on it. I cannot second-guess his numbers. I take them at face value.

The second question Deputy Higgins asked me was whether the bank-----

Deputy Joe Higgins: When Dr. Bacon prepared his report-----

Dr. Peter Bacon: The question was whether I underestimated-----

Deputy Joe Higgins: It was about the level of impairment, as would seem to be evidenced by what the-----

Dr. Peter Bacon: I will answer that question. The level of impairment that I estimated was not done on a loan-by-loan basis. It was done at an aggregate level. I was working from published data. Certainly, NAMA was acquiring loans from financial institutions and the level of write-downs seemed to me on average to be greater. However, one would expect when one gets into the guts of something for it to be either greater or smaller. If Deputy Higgins is asking whether I underestimated it, the answer is that I did not try to estimate it in the first place. I gave an indication at a macro level for the system as a whole of what the degree of impairment would be. Certainly, the anecdotal material, which is all I have seen, the same as Deputy Higgins, has reported that the prices paid by NAMA for loans were greater than that.

Deputy Joe Higgins: The two major pillar banks were worth perhaps €500 million between them around that time. Would Dr. Bacon consider that perhaps the nationalisation of the banks, with a return to profitability, as of now, accruing to the taxpayer, might have been a better option than NAMA?

Dr. Peter Bacon: No, and the reason I do not is that I do not think there would have been the hollowing out of the banks' balance sheet of those bad loans unless there was, as I put it in my remarks and in my report, the disinterested third party of NAMA, the performance of which rested on getting an accurate valuation of what the worth of the assets it was taking on would be. I think the result would have been fudge. It would have been administrative fudge compounded by political fudge.

Deputy John Paul Phelan: In relation to Dr. Bacon's three reports on the housing market, how was he appointed to conduct those reports? Was there a tendering process?

Dr. Peter Bacon: There was. There was an advertisement in the back of one of the newspapers from the Department of the Environment, Community and Local Government. The Deputy can guess which one. I put together a consortium. We bid for the job. We were interviewed and we got the job.

Deputy John Paul Phelan: Was it advertised each time?

Dr. Peter Bacon: No, it was not. It was advertised in the first instance and I think the subsequent contracts were awarded as follow-on contracts.

Deputy John Paul Phelan: When Dr. Bacon was conducting those reports, did he have private clients who were property developers, be they commercial, residential or financial institutions?

Dr. Peter Bacon: No.

Deputy John Paul Phelan: Has Dr. Bacon ever served in any capacity with a property development company or a financial institution?

Dr. Peter Bacon: Yes, but subsequent to this work.

Deputy John Paul Phelan: Will Dr. Bacon outline what that was?

Dr. Peter Bacon: I have carried out consultancy work for Ballymore Properties, Treasury Holdings, Bovale Developments, and there is another one. I think it may have been called Shannon but I am not sure. There were at least four.

Deputy John Paul Phelan: That was subsequent to conducting the reports.

Dr. Peter Bacon: Yes, subsequent to the three reports on the housing sector. I served as a director in one of them.

Deputy John Paul Phelan: Which one?

Dr. Peter Bacon: Ballymore.

Deputy John Paul Phelan: I have a couple of questions about NAMA. Will Dr. Bacon give a brief outline to the committee about the events that preceded his report which I think was commissioned by the National Treasury Management Agency at the time? How did Dr. Bacon come to conduct that particular report?

Dr. Peter Bacon: It was actually commissioned by the Minister for Finance through the agency of the NTMA but I think the contract was a contract between the Minister and myself. If I am wrong about that, it was a contract between the NTMA, as agent of the Minister, and myself.

Deputy John Paul Phelan: Was that a public tender process?

Dr. Peter Bacon: Not that I am aware of. It was by the Minister.

Deputy John Paul Phelan: The Minister at the time, being the late Deputy Brian Lenihan.

Dr. Peter Bacon: Correct.

Deputy John Paul Phelan: Where and when did the Minister approach Dr. Bacon?

Dr. Peter Bacon: There were two approaches. Through a mutual acquaintance he asked if I would meet him for a chat about the situation. I think that was in November or December 2008. I met him in Government Buildings; he was present with a second secretary. The meeting happened. The meeting ended. I walked away scratching my head and I got a phone call in late January inviting me to have another chat. It was a chat about: “You know, look, the situation is deteriorating; I am canvassing views about what ought to be done, what needs to be done, what the options are.” I met him again and I felt that it was a similar discussion to the previous one but he did at the end of it say to me: “You seem to have developed your thoughts significantly more than the last time we spoke. Would you do some work? Would you commit these thoughts to paper and carry out some work?” That was what happened.

Deputy John Paul Phelan: Dr. Bacon is an economic consultant. I do not want to ask a leading question.

Dr. Peter Bacon: I am used to them. I can tell when they are coming.

Chairman: Dr. Bacon will not get used to them here.

Deputy John Paul Phelan: Would it have been commonplace that a Government contract like that or a commission to do a report for the Government would have been done through private conversations rather than through the usual channels of tendering?

Dr. Peter Bacon: I honestly think in the circumstances it would not have been done through tendering. How would it be advertised? A tender such as: "Help us with a crisis." When I was sitting there I think there was already in place an international investment bank which was opining and giving advice on the same subject. That was Merrill Lynch. I do not remember seeing the advertisement for that one either.

Deputy John Paul Phelan: We might get an opportunity to ask that question as well later. At the time that Dr. Bacon was conducting that particular report prior to the establishment of NAMA, did he have any commitments to financial institutions or property companies?

Dr. Peter Bacon: No.

Deputy John Paul Phelan: I want to put a quote to Dr. Bacon from the first page of his report prior to the establishment of NAMA: "As regards their property loan portfolios, the six guaranteed credit institutions face cumulative economic impairment on their land and development loan exposures and associated property investment loans of around €34 billion on loans outstanding of €80 billion to €90 billion." Will Dr. Bacon comment on the difference between his estimate and the final figure for impairment on those particular loans? I acknowledge that it was an estimated figure when he was conducting the report.

Dr. Peter Bacon: I am working from aggregate financial data. As the Deputy will be aware NAMA did not move loans lock, stock, and barrel. What it did was it subjected each and every loan to rigorous scrutiny. I would not have been party, at an individual level, to knowing what the security behind those loans was or what they were worth. There would have been all kinds of cross-guarantees at an individual level, which, working from macro data, one would not have had access to or knowledge of.

Deputy John Paul Phelan: How did Dr. Bacon arrive at the estimated figure which was on page one of his report?

Dr. Peter Bacon: From published data. From what was available in the public domain at the time.

Deputy John Paul Phelan: In more recent times Dr. Bacon seems to have changed his opinion on NAMA. I think in 2012 he said that it was not reaching its potential and that maybe a different course of action should be taken

Dr. Peter Bacon: I do not think I said a different course of action should have been taken; not a different approach.

Deputy John Paul Phelan: Will Dr. Bacon outline what caused him to change his view?

Dr. Peter Bacon: What caused me to change my opinion is that NAMA has the biggest property portfolio, I think, under one roof, certainly in Europe, and it has acquired that at rock bottom prices. We all know what is happening at the moment in the property market. It goes through cycles. Ireland went through a particularly vicious one. I think the criticisms that I have made of NAMA have not been about the general approach. It is more about the ethos. My personal opinion, based on what I see - no greater than that - is that it has acted more as a debt collection agency than as a property value maximising entity.

Deputy John Paul Phelan: Dr. Bacon used the word "ethos". What does he mean by that?

Dr. Peter Bacon: I will again make the point. If one asks me from an economic point of view what is wrong with the Irish property sector and where it looks funny compared with property sectors in other jurisdictions, I would say it is the capital structure. They do not have access to long-term funds, which is equity. The property sector, more than any other sector, requires long-term capital. NAMA has brought some of that to bear, but there is no quoted entity collecting equity investment from investors to develop residential or commercial property in Ireland.

Deputy John Paul Phelan: This is my final question on NAMA. It was widely said in 2009 that it would provide banks with additional collateral that could be used to borrow from the ECB. Given that excessive borrowing from the ECB played a key role in triggering Ireland's bailout, what is Dr. Bacon's assessment of the 2009 solution, which related to liquidity problems as opposed to assessing the size of the solvency problems?

Dr. Peter Bacon: It is a good question. The fundamental problem was a solvency problem. It was masked for some considerable time to some people who were looking at it as a liquidity problem, but there was a liquidity issue. I do not think there was anything wrong. The Irish banking system, not unlike some other European banking systems at the moment which are subject to notice, did need liquidity. I do not think there is any difficulty with that, provided that one did not confuse that with the underlying problem of insolvency. It was not misdiagnosed in the end.

Deputy John Paul Phelan: My last couple of questions are on the guarantee. Dr. Bacon is on record - in the *The Sunday Tribune* of 23 January 2011 - as stating that he recommended to the Minister for Finance in March 2009 that there should be an early review of the bank guarantee. I ask him to outline the nature of that recommendation.

Dr. Peter Bacon: It was simply to get rid of it as soon as we could. There was a contingent liability sitting on it and NAMA was there with the express purpose of removing the uncertainties that surrounded that contingency. No more than that.

Deputy John Paul Phelan: If Dr. Bacon's advice had been adhered to, how could the guarantee-----

Dr. Peter Bacon: In what respect?

Deputy John Paul Phelan: In regard to the need for an early review-----

Dr. Peter Bacon: It did.

Deputy John Paul Phelan: What impact did that have?

Dr. Peter Bacon: I delivered the report after that. I was not involved in the evaluation.

Deputy John Paul Phelan: Fair enough, but Dr. Bacon is a keen observer of everything.

Dr. Peter Bacon: They got rid of it. I do not think that was a controversial point. It was a monkey on the back of Government and it wanted rid of it. It did not need me to tell it to get rid of it.

Chairman: Can I come back to one matter Deputy Phelan was dealing with to get clarity for the committee from Dr. Bacon? Deputy Phelan referenced the first page of the NAMA report, which states:

> As regards their property loan portfolios the six guaranteed credit institutions face cumulative economic impairment on their land and development loan exposures and associated property investment loans of around €**X**Bn [Figure deleted. Market sensitive] on loans outstanding of about €80-90Bn.

An X has been inserted, as the figure was considered too market-sensitive to be put into the public domain at the time. It refers to loans outstanding of around €80 billion to €90 billion. Is that figure still market-sensitive?

Dr. Peter Bacon: I do not think it is market sensitive.

Chairman: Okay. Can you tell the inquiry what you consider that figure to be?

Dr. Peter Bacon: No, because it is not my call. The intellectual property of the report is in the ownership of the Minister for Finance and I am bound by the Official Secrets Act. I have no difficulty with the figure being put in the public domain, but I am not going to be the one to do it.

Chairman: That may happen at this morning's inquiry later on. In regard to your reflection on what you considered figure X to be back then, is it still your view that figure X stands the test of time and is accurate?

Dr. Peter Bacon: I think the figure was the best estimate that could have been made at the time. Subsequent events and evaluations would have shown it to be light.

Chairman: That it was underestimated?

Dr. Peter Bacon: Yes.

Chairman: Thank you very much.

Deputy Pearse Doherty: Cuirim fáilte roimh an tUasal Bacon. To pick on the comments of the Chairman on the abridged version of Dr. Bacon's report, which has been quoted, I am not sure if he is aware that his entire report was released to me through a freedom of information request, which revealed the X figure. Can he clarify that the X figure on page one, paragraph three of his report is €34 billion?

Dr. Peter Bacon: I am not going to comment. I do not doubt that the Deputy has been given that figure. I am not going to comment. If he got the figure, he got the figure, and good luck to him. Do not ask me to confirm or deny it. As far as I am concerned, I am still bound by the Official Secrets Act.

Chairman: Deputy Doherty is putting the figure on the record from the report being released to him as being how much?

Deputy Pearse Doherty: Some €34 billion.

Chairman: Thank you.

Deputy Pearse Doherty: As I said, the abridged version was the version that was in the public domain for quite a while. The full report is now in the public domain. In the abridged version, as was mentioned by previous Deputies, it is stated that the X figure was based on outstanding loans of €80 billion to €90 billion. The actual report states that this is based on the total value of property loans outstanding in September 2008 of €158 billion. This paragraph is one of the main conclusions of the report. Can Dr. Bacon explain to the committee why the abridged version which was in the public domain for many years contained a loan amount of €90 billion and the actual full report suggests it was higher, at €158 billion?

Dr. Peter Bacon: The higher figure related to all of the institutions, including Anglo Irish Bank. The figure in the abridged version was excluding Anglo Irish Bank. My memory-----

Deputy Pearse Doherty: Can I stop Dr. Bacon there? I will give him the full quote, which is:

> As regards their property loan portfolios the six guaranteed credit institutions face cumulative economic impairment on their land and development loan exposures and associated property investment loans of around €**X**Bn [Figure deleted. Market sensitive] on loans outstanding of about €80-90Bn.

That is the abridged version, which specifically referred to the six institutions. The first line of the official report states: "As regards their property loan portfolios, looking forward to 2011 the six guaranteed credit institutions...", so we are talking about the exact same six institutions.

Dr. Peter Bacon: Okay. Well then, it is the difference between the development loans and the development and investment loans. The investment loans were-----

Deputy Pearse Doherty: The abridged version does contain development loan exposures and associated property investment loans.

Dr. Peter Bacon: Yes, but there is a separate category. It is associated investments. I mentioned in passing that there was a question about cross-guaranteeing. NAMA was only taking on the development loans and associated investments - that is to say, investments that were associated with the development loans. There was another tranche of loans called investment loans which were not included. That is the difference.

Deputy Pearse Doherty: I will move on, because I am restricted in terms of time. Paragraph 13 of the full version of the report suggests that the €34 billion of losses in the six institutions would require further capital injections of €9.2 billion in core tier 1 capital ratios in certain institutions. Has that figure stood the test of time? What was the actual capital requirement?

Dr. Peter Bacon: I think it was greater. There is a question of legal requirement and adequacy from the point of view of the markets. I do not know what the final figure was as I stopped looking at this when I stopped getting paid for it. It was, however, of that order of magnitude or greater and I believe it was greater.

Deputy Pearse Doherty: The record shows that Anglo Irish Bank required a large portion of the total amount. Dr. Bacon's report came out on 20 March 2009, just a number of months after the guarantee was brought in. Paragraph 26 deals with revising the credit guarantee. It states:

> A restructuring of the guarantee consistent with the introduction of the NAMA initiative should be seen as an integral element of a comprehensive strategy. In summary, the aim should be to enhance the credibility of the guarantee by simultaneously reducing the contingent liability under it and by extending its temporal scope in relation to the sort of long-term bond issuance which is critical to ensuring the covered institutions' survival.

How could the guarantee, which had a legal underpinning, be restructured at that time, just a number of months after the guarantee was introduced?

Dr. Peter Bacon: It could not be.

Deputy Pearse Doherty: Why does Dr. Bacon suggest that a restructuring of the guarantee consistent with the introduction of the NAMA initiative should be seen as an integral element of a comprehensive strategy?

Dr. Peter Bacon: If it had been possible it would have been desirable to reduce the contingent liability.

Deputy Pearse Doherty: Did Dr. Bacon put something into this paragraph that he knew could never be done?

Dr. Peter Bacon: No, I did not know it could not be done. I felt it was worth exploring whether it could be done. Why was the guarantee there? It was because people did not believe the institutions had adequate capital to cover the impairments. If NAMA was put in place and the impairments removed, would we have removed the uncertainty surrounding the institutions in question to the extent that they would not then need the guarantee?

Deputy Pearse Doherty: Paragraph 29 asks a number of questions on bond issuance relating to the recapitalisation of the banks. Dr. Bacon states:

> Another key factor relates to the underlying public finance position and current efforts towards stabilising the deficit which is widening beyond expectations. Then there is the question of the impact of such expansion on the debt and the capacity to service the debt. Ireland has the capacity to absorb additional debt service costs if these were to come about.

How wise or unwise was that statement?

Dr. Peter Bacon: I hope it was wise.

Deputy Pearse Doherty: Does Dr. Bacon still believe Ireland had the ability to take on additional debt at that time, in the context of bank recapitalisation and a report that suggests that the banks were going to lose €34 billion on property loans?

Dr. Peter Bacon: I was talking about debt, not the contingent liability. The debt service costs would obviously rise but we had the capacity.

Senator Sean D. Barrett: When Dr. Bacon was engaged in work on this subject in the 1998-2000 period, were things like loan-to-value or loan-to-income part of his deliberations or did he concern himself mostly with supply-side issues?

Dr. Peter Bacon: They were part of my deliberations. They are contained in my first report, which differed from the subsequent two reports in containing the results of an extensive consultation with the stakeholders of the sector, including the financial institutions who provided the lending. On the question of how to judge what size mortgage to give, the answer was consistently two and a half to three times plus one. In other words, the rule of thumb was two and a half to three times the income of the principal household earner and one times the income of a second earner.

Senator Sean D. Barrett: What about loan-to-value?

Dr. Peter Bacon: Loan-to-value was less. I think between 80% and 90% would have been regarded as normal. It was, of course, more than 15 years ago but I recall it seemed to me at the time that the main issue was an ability to service the debt rather than loan-to-value and the greater focus was on the income multiple.

Senator Sean D. Barrett: The graph of house prices shows that events arising from Dr. Bacon's report caused the market to go down but then we just resumed and it kept on increasing at the same rate until the collapse.

Dr. Peter Bacon: It actually accelerated.

Senator Sean D. Barrett: Were there financial forces and practices, such as weak regulation, which meant that whatever what we did the 2008 collapse was inevitable?

Dr. Peter Bacon: Absolutely.

Senator Sean D. Barrett: Can Dr. Bacon expand?

Dr. Peter Bacon: I am glad the Senator asked me that question. We must remember the circumstances of the time. It was 1998-99 and a time of Ireland's near-term accession to the euro. Markets were anticipating that, upon Ireland joining the euro, there would be no currency risk between the Irish punt and the euro. This meant that Irish interest rates would converge to euro rates, by which was meant German interest rates. That assumed there would then be capital inflows and arbitrages, which there were. There was increased competition between financial institutions to gain a share of the housing market and, with the undoubted slippage in the application of income criteria, there was a reversal of the slamming of the brakes on investment demand and when that occurred Ireland was in the euro. There was no exchange risk, there were European banks with surplus funds and Irish banks with an opportunity to lend funds. Guess what happened? The brake on speculative and genuine investment demand was removed.

Senator Sean D. Barrett: What should the Central Bank have been doing at that period?

Dr. Peter Bacon: To be honest, I am unclear about what legal force the Central Bank could apply in determining what the criteria for banks for mortgage lending should have been. I am aware, as is the Senator, of what it is saying at the moment but at that time two and a half to three plus one was not being adhered to in all cases and as competitive pressure on the banks intensified the tendency to move outside those criteria increased. It was a one-way bet. There was no exchange rate risk and, in effect, quantitative easing was taking place in an Irish economy that was expanding rapidly, meaning we got a bubble.

Senator Sean D. Barrett: Given where we are now, what should the Bacon report No. 4 contain?

Dr. Peter Bacon: There will not be one. I do not think there was anything wrong with the original assessment. I do not think in the present circumstances there is a basis of a bubble in the Irish market. For one thing one does not yet have a normally functioning banking sector in relation to mortgage finance. If there were a Bacon report, what would it be focusing on at the moment? It would be saying, “Why in heaven’s name, seven or eight years after the collapse, are we still dealing with a mortgage arrears problem?”

To be fair to the Government, it took a calculated risk with NAMA. The principle had been applied, but never on the scale on which NAMA was done. So that problem was removed and I think wisely so because on the basis of the way in which the arrears problem has failed to get resolved, what would have happened if one had left all of the stuff that went to NAMA with the banks to resolve?

So there was a residual left with the banks to resolve themselves. They have not resolved it. A result of that is that the supply of housing to the second-hand market in the current circumstances is constrained.

Senator Michael D’Arcy: Dr. Bacon is very welcome. In terms of the figure X that Deputy Pearse Doherty has just put on the record - that is €34 billion - there is some confusion whether the amount was €34 billion out of €80 billion or €90 billion, or €158 billion.

Dr. Peter Bacon: It was not €158 billion.

Senator Michael D’Arcy: We will say it was €34 billion out of €80 billion or €90 billion. Dr. Bacon’s figure was remarkably close to the conclusive figure, which was a little bit less than €32 billion. His analysis was concluded in March or April 2009. Is that correct?

Dr. Peter Bacon: April. As Deputy Doherty has pointed out the report was submitted on 20 March.

Senator Michael D’Arcy: Did Dr. Bacon have sight of the PwC report that was conducted on behalf of the Minister for Finance, subsequent to the bank guarantee? He did not. The fieldwork on that was concluded in December 2008, four months before Dr. Bacon’s analysis was concluded. That report stated that the banks were solvent. I ask Dr. Bacon to outline his review of that report.

Dr. Peter Bacon: I am not familiar with the report. I have not seen it, so I am not going to comment on it.

Senator Michael D’Arcy: Okay. From what Dr. Bacon saw in the period prior to his concluding his report, were the banks solvent at that stage?

Dr. Peter Bacon: To give the honest answer, I think it appeared to me there was a serious risk to their solvency. Solvency itself is not a “Yes” or “No”. I will answer the question in a different way. The conclusion I drew was that the problem that had to be confronted was much more in the nature of resolving a solvency problem than in resolving a liquidity problem.

Senator Michael D’Arcy: I will ask a leading question. When Dr. Bacon concluded his report, were the banks solvent or not in his opinion?

Dr. Peter Bacon: They needed recapitalisation. I cannot give the Senator a “Yes” or “No” answer on that, but I mean-----

Senator Michael D’Arcy: May I ask the question a little bit differently then?

Dr. Peter Bacon: Okay.

Senator Michael D'Arcy: Would the quantum of funds required have wiped out the banks' capital ratios?

Dr. Peter Bacon: Yes.

Senator Michael D'Arcy: Does Dr. Bacon have any knowledge on the subsequent NAMA pricing model?

Dr. Peter Bacon: None whatsoever, I am pleased to say.

Senator Michael D'Arcy: So Dr. Bacon has no information on that, along with everybody else.

Point 32 on page 8 of Dr. Bacon's submission states, "In conclusion, it appears that the Asset Management approach has the potential to offer greater assistance to achieving resolution of the impairment issue upfront and maximising taxpayer returns, over the longer term." Has NAMA been run in an appropriate way to maximise taxpayer returns over the longer term?

Dr. Peter Bacon: I am in no position to evaluate NAMA and I have not evaluated NAMA. The only remark I would make is that I think one significant development, it appears to me, subsequent to my work and subsequent to the establishment of NAMA was, of course, the negotiated programme, the bailout and the troika. I think there was a decision on foot of the troika recommendation to accelerate NAMA receipts. That certainly would have infringed on any effort to achieve a long-term maximisation.

Senator Michael D'Arcy: I ask about Dr. Bacon's third report, which was implemented.

Dr. Peter Bacon: The housing report.

Senator Michael D'Arcy: Yes. The implementation of the recommendations that had the effect of cooling the property market-----

Dr. Peter Bacon: The first report.

Senator Michael D'Arcy: Sorry, the first report in 2001. Subsequently those recommendations were removed. Does Dr. Bacon believe that the then upcoming general election had any influence?

Chairman: I thank Senator D'Arcy.

Deputy Eoghan Murphy: I ask Dr. Bacon to clarify an issue that came up earlier. When he was designing the March 2009 report for NAMA, did he hold any positions or directorships that might have been in conflict with his designing that report?

Dr. Peter Bacon: No.

Deputy Eoghan Murphy: The report states that it is the report of the special adviser at the NTMA. Is that just-----

Dr. Peter Bacon: At the NTMA.

Deputy Eoghan Murphy: Yes, I know. That was just a formal title that was given to Dr. Bacon on the basis of conducting for the Minister-----

Dr. Peter Bacon: Absolutely.

Deputy Eoghan Murphy: Where did the recommendation to house NAMA in the NTMA come from?

Dr. Peter Bacon: Me. Why? Because the capital market skills are down there. It was the only part of the public service where I would think there are high-quality capital-market skills. I think I dealt with that. Maybe Deputy Doherty would be able to fill the Deputy in. It was certainly, I think, in the main report - the why and wherefore.

Deputy Eoghan Murphy: Dr. Bacon goes through a couple of reasons in the main report, but it was unusual to house NAMA in the NTMA.

Dr. Peter Bacon: Why?

Deputy Eoghan Murphy: Dr. Bacon gave a couple of specific reasons. What I am curious about is that he subsequently talked about the ethos in NAMA and it being a debt-collection agency.

Dr. Peter Bacon: Yes. That is my impression. I can only give the committee my impression.

Deputy Eoghan Murphy: Was Dr. Bacon surprised at that outcome given that it was housed in the NTMA?

Dr. Peter Bacon: Somewhat, but that is the function of the legislation. They get a report on 20 March, they implement, they make the announcement on, whatever it was, 9 April, and then there is a whole statute that grows for, I think, 18 months or two years. In the end what one finishes up with is a statutory agency implementing a statute.

Deputy Eoghan Murphy: Did it end up as Dr. Bacon intended it to end up?

Dr. Peter Bacon: Yes, in principle. The only question that I would have is the focus on debt recovery. To my mind there can be a conflict between short-term debt recovery and the realisation of long-term value to the taxpayer.

Deputy Eoghan Murphy: Dr. Bacon talked about this focus on debt collection and he said it was difficult to know why it was being implemented in this way and that a possible reason was that it would not be possible to find the expertise to run that kind of operation in Ireland.

Dr. Peter Bacon: Yes.

Deputy Eoghan Murphy: I ask Dr. Bacon to elaborate on that. Did Dr. Bacon feel NAMA had the required expertise to do its job as he had intended it?

Dr. Peter Bacon: NAMA is a major, major property portfolio. The number of people in the world who have headed up that kind of operation is quite small. It is very specialist - think of Blackstone, BlackRock and people who have bought assets from NAMA. I would think the skill set did not exist in Ireland to take on the management of that portfolio.

Deputy Eoghan Murphy: The skill set did not exist in Ireland to take on the management of that portfolio. Despite that, the NTMA was the best place.

Dr. Peter Bacon: Hold on. The executives within the NTMA in terms of capital markets expertise, debt issuance, managing portfolios - there is no doubt that is there. The skills I would question are the property skills - the property development and investment skills.

Deputy Eoghan Murphy: Dr. Bacon mentioned the time it took from his designing NAMA to it coming into effect and then the transference of loans took some time as well. Two previous witnesses have criticised that delay.

Dr. Peter Bacon: Yes, it is easy to criticise it. I would criticise it but, equally, one has to turn around and say that legislation does take time to put into place. One cannot go off taking loans and assets off banks' balance sheets without having the legal authority to do so.

Deputy Eoghan Murphy: Would there have been a benefit to anyone in that delay?

Dr. Peter Bacon: I do not know.

Deputy Eoghan Murphy: Okay.

Dr. Peter Bacon: There was certainly a cost. The sooner one tackles the problem and gets it off banks' balance sheets, the better. I mean, what were the banks doing? One had a situation where there was going to be a major interface between the Irish banking system and a new agency, and both sides had to wait until legislation was in place before they could take their tracksuits off.

Deputy Eoghan Murphy: My final question is this. The legislation is in place and they get to work. Dr. Bacon has criticised the pace at which it has done its work.

Dr. Peter Bacon: Not the pace that it has done its work. The only thing I have criticised, I think, is the ethos, which is an impression.

Deputy Eoghan Murphy: "I think it would help the market if assets were sold quicker. I think the pace of sales to date has only been forestalling recovery".

Chairman: Who is the Deputy quoting from?

Deputy Eoghan Murphy: An interview with Dr. Bacon in the *Irish Independent* in October 2010.

Dr. Peter Bacon: The context was that I think there are some assets - I think they are still there in NAMA - that had no value, have no value and will have no value. They could have been got rid of straight away.

Deputy Kieran O'Donnell: I want to deal with two items. First, I want to clarify a few points regarding NAMA. Am I correct in saying Dr. Bacon presented his report to the then Minister for Finance, Mr. Brian Lenihan, on 20 March?

Dr. Peter Bacon: In 2009.

Deputy Kieran O'Donnell: And the actual report was published on 8 April 2009.

Dr. Peter Bacon: The abridged summary report was presented at a press conference on 8 or 9 April.

Deputy Kieran O'Donnell: I think it was 8 April.

Dr. Peter Bacon: Yes, it was presented on the 8 April and there was a budget on the 9 April.

Deputy Kieran O'Donnell: Does Dr. Bacon stand over his report of 20 March?

Dr. Peter Bacon: Yes.

Deputy Kieran O'Donnell: Does he think it differed in any way from the abridged report that was published on 8 April?

Dr. Peter Bacon: No, the abridged report was an extract from the main report.

Deputy Kieran O'Donnell: The report that Deputy Doherty got under freedom of information, which is available on the website, shows that Dr. Bacon was looking at a discount of approximately 22% on all the loans. Is that correct?

Dr. Peter Bacon: When the Deputy says "all the loans", what-----

Deputy Kieran O'Donnell: On average. I can quote the figures for each of the institutions. Dr. Bacon was looking at around 22% for AIB, 21% for Anglo and 21% for Bank of Ireland.

Dr. Peter Bacon: That is on loans for development and investment but NAMA was being established to take only loans for development and associated investments, not all investments.

Deputy Kieran O'Donnell: However, when NAMA was actually implemented, the scale of the write downs was, on average, 57%. That is a big leap from an average of 22%. The question is how we got to that point. Dr. Bacon's report that was presented to Government on 20 March 2009 is a very detailed report that specifically goes down through each bank and Dr. Bacon specifically indicates how the €158 billion of loans is made up for each of the individual banks. That gave rise to a write-off of the order of €34.4 billion, which was a 22% average discount. We then come to a situation where, when the abridged version was published on 8 April, Dr. Bacon was looking at €74 billion of loans with a write-off of €42.2 billion, which is about 57% of a discount. When Dr. Bacon was writing his report for 20 March, if he had known that the discounts were going to be of the order of nearly 60%, would he have recommended the establishment of NAMA?

Dr. Peter Bacon: Yes. To be honest, one would have recommended its establishment *a fortiori* because the implications of doing something else and leaving the loans-----

Deputy Kieran O'Donnell: But-----

Dr. Peter Bacon: Sorry, let me finish the point.

Deputy Kieran O'Donnell: In the limited time I have-----

Chairman: You spent a lot of time asking the question. I have to allow the witness a respectable period of time to respond.

Dr. Peter Bacon: I will try and make the answer as brief as I can. One would have been leaving behind a greater part. What was revealing about the final loan discounts that NAMA instituted or imposed was how large they were-----

Deputy Kieran O'Donnell: Did Dr. Bacon know when the abridged report was published on 8 April 2009 that the discounts were going to be of the order that they were?

Dr. Peter Bacon: I put down, on the basis of macroeconomic data that was there, what I thought.

Deputy Kieran O'Donnell: Dr. Bacon has agreed with Deputy Doherty that the €34 billion was in regard to loans of the order of €80 billion, which is very close.

Dr. Peter Bacon: Some €90 billion.

Deputy Kieran O'Donnell: Clearly, Dr. Bacon must have known when the abridged report was published on 8 April-----

Chairman: The Deputy is over time.

Deputy Kieran O'Donnell: Surely, Dr. Bacon must have known that the discount was going to be of the order of 60%.

Chairman: You cannot make suggestions like that. You can ask the question.

Deputy Kieran O'Donnell: How can Dr. Bacon reconcile the position he gave to Deputy Doherty, where he said €34 billion was in regard to loans of €80 billion, with the position that, when the report was published on 8 April, he did not know the discounts were going to be that high?

Chairman: Dr. Bacon can answer.

Deputy Kieran O'Donnell: The banks were not solvent.

Chairman: I have to allow the witness to respond.

Dr. Peter Bacon: I am not sure what the Deputy's question is.

Deputy Kieran O'Donnell: My point is that the report Dr. Bacon provided to Government on 20 March is fundamentally different to the report that was published on 8 April.

Dr. Peter Bacon: There is no inconsistency between the two. On the numbers that are being quoted, the denominator in one case is loans for development and associated investments, that is €80 billion to €90 billion. The other figure is loans for development and all property investments. That is the only difference. The €34 billion is the €34 billion, not the estimate that I came up with.

Senator Marc MacSharry: I thank Dr. Bacon for taking the time to be with us today. With regard to the Central Bank, Dr. Bacon said in his testimony that it was "unclear what legal force the Central Bank can apply to determine what mortgage lending should be". Can he expand on that? Does he feel the Central Bank had any power at the time to determine how banks acted? What is his sense of that?

Dr. Peter Bacon: My sense is that it was unclear, as I said.

Senator Marc MacSharry: That is very clear. In the context of the financial crisis, Dr. Bacon has stated:

> Ireland was not hit by a sudden shock in mid to late 2008 that no-one could have foreseen, as has been often contended. The fact is that the stock markets could see what was coming-----

Chairman: Is the Senator referring to Dr. Bacon's opening statement?

Senator Marc MacSharry: No, I am quoting from the report, A Contribution to the Debate on National Economic Recovery. Why is Dr. Bacon of the view that everyone - with the exception of Morgan Kelly and David McWilliams - did not get it and failed to read what was happening in the stock markets? I refer in this regard to the Government, the IMF, the EU Commission, the Central Bank, the regulator and the ESRI.

Dr. Peter Bacon: I do not know.

Senator Marc MacSharry: Did Dr. Bacon foresee what was going to happen?

Dr. Peter Bacon: I indicated in my reports in 1999 and 2000 that the speculative force gathering behind the demand for residential property was growing and posed a threat. Subsequent developments in the market and in the policy response reinforced that.

Senator Marc MacSharry: In terms of his testimony today, Dr. Bacon has clearly indicated his belief in the correct nature of the establishment of NAMA. He suggested that short-term debt recovery versus the realisation of the long-term value to the taxpayer may be debated. Is he of the view that if more capital had been available to NAMA in respect of work-outs rather than disposals, it could have given rise to better results for the taxpayer? Does he feel that the accelerated winding down of NAMA is in the best interests of the taxpayer? Should disposals and work-outs have been staggered and should there have been a focus on obtaining a better return for the taxpayer? Have the optimum results been achieved?

Dr. Peter Bacon: The short answer in respect of the Senator's final question is that, all other things being equal, it is not optimal that realisations have been accelerated to a greater degree. To be fair, however, I was careful to use the phrase "all other things being equal". The truth is that they were not equal. One went to the bailout programme and that programme contained the requirement to accelerate disposals. Ireland needed that bailout programme so it is not a question of what was best for the taxpayer. It would have been a bad decision to say "Look, we are not going to go for this bailout programme because there is this requirement in it and we need to work out NAMA for longer". Other things being equal, the difference between a good investment and a bad investment is often time.

Chairman: The Senator has two minutes remaining.

Senator Marc MacSharry: In A Contribution to the Debate on National Economic Recovery, Dr. Bacon refers to the potential for NAMA to be part privatised to an international private equity investor.

Dr. Peter Bacon: Yes.

Senator Marc MacSharry: Does he remain of the view that this could be done?

Dr. Peter Bacon: Yes, and I think it is happening but probably in a different way. I mentioned that one had the welcome emergence of residential quoted real investment trusts. In effect, that is resulting in a privatisation of NAMA assets.

Senator Marc MacSharry: Again, in A Contribution to the Debate on National Economic Recovery, Dr. Bacon refers to how cautious the EU response was to the crisis here. Did the EU response benefit or adversely affect the Irish taxpayer?

Dr. Peter Bacon: It benefited the taxpayer in the sense that without the support of the ECB, that liquidity issue facing the banking sector in Ireland would have led us to look an awful lot more like some other European countries at the moment.

Chairman: Final question.

Senator Marc MacSharry: With the benefit of hindsight and his expertise as an economist, will Dr. Bacon give us a sense of his view on the Irish response to the crisis?

Dr. Peter Bacon: Whose response?

Senator Marc MacSharry: That of the Irish Government. I refer to the response here in Ireland to the crisis. With the benefit of hindsight and his expertise as an economist, will Dr. Bacon provide his assessment in that regard?

Dr. Peter Bacon: It is easy to be critical and you guys have party-political agendas as well as other agendas.

Senator Marc MacSharry: Not in this room.

Dr. Peter Bacon: Point taken. I would say this, if one did not have the response of the Irish Government, the Irish economy would today look an awful lot more like that of one other European economy of which I can think.

Senator Marc MacSharry: I thank Dr. Bacon.

Senator Susan O'Keeffe: Did anybody in authority, either formally or informally, seek Dr. Bacon's advice about the bank guarantee?

Dr. Peter Bacon: No.

Senator Susan O'Keeffe: Between his housing report in 2000 and his report to NAMA in 2009, was Dr. Bacon involved in compiling any other reports for Departments, semi-State agencies or similar entities?

Dr. Peter Bacon: That is how I make my living.

Senator Susan O'Keeffe: I appreciate that is how Dr. Bacon makes his living. However, I am specifically asking whether he compiled any other reports for Departments or whether his work during the period related to the private sector.

Dr. Peter Bacon: No. The workflow varies between the private and public sectors.

Senator Susan O'Keeffe: So it was a mix.

Dr. Peter Bacon: Yes, there is always a mix.

Senator Susan O'Keeffe: When did Dr. Bacon work as an adviser to Bertie Ahern?

Dr. Peter Bacon: That was 1991.

Senator Susan O'Keeffe: What kind of an adviser was Dr. Bacon to Mr. Ahern?

Dr. Peter Bacon: Economic adviser.

Senator Susan O'Keeffe: How did that come about. Was Dr. Bacon a member of the party?

Dr. Peter Bacon: No.

Senator Susan O'Keeffe: So how did it come about that Dr. Bacon worked with him?

Dr. Peter Bacon: I think he was looking for an economic adviser and he approached me. I had left employment in Goodbody Stockbrokers and set up my consultancy practice. I think it was a year or two in existence when he approached me and asked me to be his economic adviser. I did it for a very short while - three months, I think, or maybe four. I do not think it was any longer than that. I held the position for a short duration.

Senator Susan O'Keeffe: At the turn of the previous decade, Dr. Bacon made a number of recommendations in respect of how to calm the housing market. Variously, those recommendations were subsequently overturned, ignored or abandoned.

Dr. Peter Bacon: Some.

Senator Susan O'Keeffe: At some point thereafter, Dr. Bacon started working for a number of developers and, as he indicated earlier, that is his job. Ultimately, how would he describe himself? Would it be as an economist or a developer?

Dr. Peter Bacon: I am certainly not a developer. I would describe myself as an economist.

Senator Susan O'Keeffe: But Dr. Bacon was a director of Ballymore Properties.

Dr. Peter Bacon: Correct.

Senator Susan O'Keeffe: What was his relationship with that company if he was a director rather than a developer?

Dr. Peter Bacon: It mainly involved giving advice in relation to economic matters as a board member.

Senator Susan O'Keeffe: Yes, but Dr. Bacon was also a director of the business.

Dr. Peter Bacon: Yes.

Senator Susan O'Keeffe: Dr. Bacon obviously identified the fact that problems were arising in the 1990s. He had concerns and he made recommendations. At what point did he realise that everything was going south and become concerned about what was happening?

Dr. Peter Bacon: I expressed my concerns from 2000 to the effect that there was an accelerating trend. I expressed those concerns in my reports.

Senator Susan O'Keeffe: Yes, and after that did Dr. Bacon express them to anybody else?

Dr. Peter Bacon: Subsequently, to anybody who asked.

Senator Susan O'Keeffe: Did anybody in particular ask about Dr. Bacon's concerns as opposed to those who might have listened to them originally?

Dr. Peter Bacon: No.

Senator Susan O'Keeffe: If we move on from Dr. Bacon's 2000 report, he was obviously still working as an economist and he had private clients and Government clients. At what point did he think "Things are getting worse. Things are very serious."?

Dr. Peter Bacon: To be honest, as an economic consultant one does the job and one moves on to the next one. I think the next one might have been in the area of pensions reform. One keeps in touch in the sense that one reads the daily newspapers and monitors the situation. As I have indicated, I did carry out individual projects for property developers. They know more about property development, I do not. They use my skills in relation to economics and I am happy to provide that service.

Senator Susan O'Keeffe: But they hired Dr. Bacon for his skills and they knew about his work previously.

Dr. Peter Bacon: That is how they did.

Senator Susan O'Keeffe: David McWilliams said when he was here that "...ghost estates are indicative of how supply does not respond." He was talking about the housing market. What is Dr. Bacon's response to that?

Dr. Peter Bacon: I think it shows that demand does not respond. If one builds houses in places the market is not looking for or not willing to live, for the price one offers, or if one offers a style of house or quality of development which the market does not want, then ghost estates prove that the market penalises.

Senator Susan O'Keeffe: What did Dr. Bacon think of section 23? It was in existence when he was in the Department, so did he have an observation about section 23 when he was in the Department as an adviser, as opposed to when he wrote the reports beyond that?

Dr. Peter Bacon: Unnecessary.

Senator Susan O'Keeffe: But they kept going?

Dr. Peter Bacon: Yes.

Senator Susan O'Keeffe: Why were they unnecessary?

Dr. Peter Bacon: Because of the market, look at the strength of demand. One does not need to incentivise an activity that is buoyant.

Senator Susan O'Keeffe: So why were they there?

Dr. Peter Bacon: I do not know. They were not repealed.

Senator Susan O'Keeffe: Did Dr. Bacon specify to the Minister at the time that they were unnecessary?

Dr. Peter Bacon: Yes.

Senator Susan O'Keeffe: And what did he say?

Dr. Peter Bacon: I write a report, it is not an interactive approach.

Senator Susan O'Keeffe: I meant when the witness was an adviser to the Minister.

Dr. Peter Bacon: Sorry, I mistook what was said. In 1991 the economy was flat on its back, I misunderstood.

Senator Susan O'Keeffe: There was a confusion there.

Chairman: There is no confusion, I am moving on, Deputy Michael McGrath.

Senator Susan O'Keeffe: For the record, I was trying to clarify.

Chairman: Quickly and succinctly.

Senator Susan O'Keeffe: I am not asking a question, I just want to make sure that I have not misled Dr. Bacon. Is Dr. Bacon happy that he has clarified that?

Dr. Peter Bacon: Yes.

Senator Susan O'Keeffe: Thank you.

Deputy Michael McGrath: Thank you Chair, and I welcome Dr. Bacon. Can I make sure that we are connecting the numbers correctly here? Many numbers have been thrown around during the course of different questioning? NAMA paid €31.8 billion for loans with a book value of €74 billion, an overall impairment of about €42 billion. Are we correct in relating that back to the broad estimates, made by Dr. Bacon on a macro basis, of €34 billion potential impairment facing the banks? When Dr. Bacon was preparing the report in 2009 which informed the establishment of NAMA, he said to Senator D'Arcy that he did not have access to the PricewaterhouseCoopers' reports compiled at that time. Was Dr. Bacon aware that they existed or were being prepared?

Dr. Peter Bacon: No. The work I did on the proposal for a national asset management agency was delivered on Friday, 20 March 2009. I am trying to think when it commenced, I know I met the Minister in late January, so it was shortly after that. It was the most intensive piece of work I have done in a 40 year career. It was done within the National Treasury Management Agency building - they kindly provided me with a room and coffee. Both were required. In terms of what was available to me, effectively that was Central Bank bulletins.

Deputy Michael McGrath: I put it to Dr. Bacon that the task he was given was to evaluate the options for resolving property loan impairments and associated capital adequacy of Irish credit institutions. For a number of months, PwC was actually in the banks examining those very issues. PwC gave a report to the Minister for Finance on Friday, 20 February 2009, a month before Dr. Bacon's report. It comprised a detailed loan review of Anglo Irish Bank's top 70 land and development exposures, which accounted for 63% of the bank's total land and development loan book. Was Dr. Bacon not aware of that or given access to any of those records or documents?

Dr. Peter Bacon: No.

Deputy Michael McGrath: Even though he was examining matters which were very much related?

Dr. Peter Bacon: Yes, but at a different level. I work at a policy level, evaluating different approaches. I am not the same kind of animal as PwC. I am a one-man band who sits down and works it out, at a conceptual level and with data. From what the Deputy tells me about the PwC report, it was in the banks looking at loans or lending, that is not my bailiwick.

Deputy Michael McGrath: Yes, but Dr. Bacon was making ultimate recommendations around the issue of capital adequacy and the impairment of loans. There was a lot of detail there in the system which, according to evidence, was not made available to him.

Dr. Peter Bacon: It was not made available, but I do not believe there was a conscious effort made to either make it available or deny availability of it. The terms of reference I was working within were to evaluate the problem and to make policy recommendations and that is what I did.

Deputy Michael McGrath: That PwC report made the point that even under the adverse scenario, Anglo was projected to meet the minimum capital requirements at the end of September 2010. That conclusion was there a month before Dr. Bacon's report was completed.

Dr. Peter Bacon: I presume that both reports were considered by the Department of Finance in coming to the decision it came to.

Deputy Michael McGrath: When Dr. Bacon was doing his work in 2009 did he ever envisage that €64 billion would ultimately have to be injected into the Irish banking system?

Dr. Peter Bacon: No.

Deputy Michael McGrath: Did he not believe the problem was on that scale?

Dr. Peter Bacon: I am sorry I laugh, but I remember the response when I presented the figures in my report. There was a standing committee, chaired by the Minister, comprising the suspects one would expect - finance, Central Bank and NTMA. I was invited to attend one of those and the Minister asked how my work was going and had I any numbers. I gave the meeting a work in progress account. I suppose that surprise was my memory of that meeting. Surprise from people at the numbers that were coming out.

Deputy Michael McGrath: Beyond his reports which relate to 1998, 1999 and 2000 in terms of the property market, what in Dr. Bacon's view were the main drivers or ingredients of the rapid increases in residential property prices seen during 2004, 2005 and 2006?

Dr. Peter Bacon: The main ingredients were: the relaxation of the interest deductibility measure; the low interest rates - excessively low for the Irish economy which was growing strongly; and the unlimited supply of finance from international banks to Irish banks, a result of the removal of euro exchange risk. They were the ingredients which increasingly fed speculative demand. There are very few laws in economics, but demand and supply is one of them. If supply goes up and prices go up then something funny is going on. That was happening in the Irish housing market. Supply was accelerating, there is no doubt - in one year 90,000 houses were built - yet prices were accelerating. One looks at the population dynamics, that is a bubble. Supply was accelerating - there is no doubt about that. There was one year in which we built 90,000 houses, yet prices were accelerating. When one looks at the population dynamics, that is a bubble.

Chairman: I invite Deputies Joe Higgins and John Paul Phelan to ask some brief supplementary questions before concluding proceedings.

Deputy Joe Higgins: As I have only three minutes for questions and answers, I will quickly put three questions.

Dr. Peter Bacon: If the Deputy puts his questions, I will also try to be brief.

Deputy Joe Higgins: Dr. Bacon described real estate investment trusts as a positive development. I will put an alternative view that has been expressed to me by a mortgage holder who is having a loan transferred to one of these trusts. It was put to me that these trusts are vulture capitalists and these transfers make the mortgage holders position very vulnerable. Will Dr.

Bacon comment on that alternative view?

I asked Dr. Bacon a question on the affordability of homes in which I noted that the price of a home increased in each year in the ten-year period from 1996 to 2006 by an amount equivalent to the average industrial wage. Dr. Bacon appeared to minimise the apparent severity of these increases by stating that many people earned more than the average industrial wage. While that is true, in 2006, when the average industrial wage was €30,000, two thirds of all incomes were less than €30,000 and the median annual income was €25,000 per annum. In light of these figures, will Dr. Bacon reconsider his view on whether these price increases were inordinate?

In the mid-2000s, it was reported in *The Irish Times* and many other newspapers that 11 acres of residential development land in Stillorgan had been bought in 2000 for €32 million and sold four years later for €85 million before any building had taken place. Given that permission had been granted for 478 apartments on the site, the speculative gain in this transaction would have added €100,000 to the price of each apartment. As a long-time consultant on property issues, does Dr. Bacon consider it was moral or immoral to allow this level of profit-taking - some might describe it as profiteering - in land for what is a basic human need of a home?

Dr. Peter Bacon: On the first question about the real estate investment trust, this is a quoted vehicle on the Irish Stock Exchange, with investors. As to what are the characteristics of these investors, they could include the Deputy, me or an institution. I do not think there is a particular type of investor - a "vulture", to use the Deputy's word - involved in real estate investment trusts. There is a diversity of investors. The attraction of the real estate investment trust - or the benefit, as I see it - is that it is a quoted vehicle that enables anyone to invest in its shares.

Will the Deputy briefly remind me of his second question?

Deputy Joe Higgins: It related to affordability.

Dr. Peter Bacon: The Deputy is quite right. The second and third reports recognised what was happening was at the bottom of the market. The market had raced away and there was a yawning gap for people on lower incomes trying to get on to the first step of the ladder. The reports contained specific measures to try to address that, such as shared ownership schemes and partial equity. There were specific measures contained in both the second and third reports to try to deal with that.

On the Deputy's third point, I can remember being asked by a commentator in an RTE programme, which I believe was broadcast on 9 April, how I could morally stand over something. The reason I remember the answer I gave at the time was that I got an awful lot of stick for it. I answered that I was an economist, not a moralist. I cannot give an answer on a moral issue and the morality of something; I can only deal with the economics of it.

Deputy John Paul Phelan: I have three brief follow-up questions.

I want to get something straight on the figure of €34 billion. Dr. Bacon stated he had access to information that was in the public domain and in Central Bank bulletins. Did he have access to any information from the Financial Regulator or Department of Finance?

Dr. Peter Bacon: No.

Deputy John Paul Phelan: On the National Asset Management Agency, in answer to a question from Deputy Eoghan Murphy, Dr. Bacon stated, perhaps jocosely, that he stopped having a serious interest in NAMA when he was no longer paid to have an interest in it. Several members, including me, have quoted media reports from 2010, 2011 and 2012 in which Dr. Bacon gave strong opinions and comments on the workings of NAMA. If he no longer had such an interest in the agency, on what did he base his comments? Did Dr. Bacon work for property development companies in the post-2009 period?

Dr. Peter Bacon: To deal with the last question, the answer is “No”. To deal with the question before that, I think I said that any of the comments I have made about NAMA have largely been in relation to the point that I have re-emphasised here, namely, ethos and debt collection. That is the only point I have made and it is based purely on impression.

Deputy John Paul Phelan: In response to a question from Deputy Michael McGrath, Dr. Bacon spoke about a meeting chaired by the late Minister for Finance, Deputy Brian Lenihan, and attended by the usual suspects. Who were the members of the committee?

Chairman: He said they were the usual members, not the usual suspects.

Deputy John Paul Phelan: That is fair enough. Where and when did the meeting take place and why was Dr. Bacon present?

Dr. Peter Bacon: I was present because I was asked to attend. From memory, I think it took place shortly before St. Patrick’s Day. It was before my report was finalised and maybe the Minister wanted to get a sense of that.

The Deputy asked who was present. There were representatives from the Central Bank, the NTMA, the regulator, the Department of Finance, a firm of legal solicitors and Merrill Lynch. I think that was it. As to what it was, it seemed to me to be a monitoring committee. I attended it-----

Deputy John Paul Phelan: Dr. Bacon stated that it was a standing committee.

Dr. Peter Bacon: Sorry; I may have been mistaken about that. It seemed to be a working committee that met. It was clear that it was not the first time it had met and I doubt it was the last time.

Chairman: There were a number of committees around that time, one of which was the domestic standing group.

Dr. Peter Bacon: No; I am not sure if this one had a name.

Chairman: I propose to wrap up with a couple of issues. To return to a number of responses Dr. Bacon gave to Deputies Joe Higgins, Michael McGrath and other speakers, his reports focused extensively on the need to increase supply in the housing market to dampen house prices. Is that a fair conclusion? They did not really examine the commercial and retail property sector but were focused strictly on residential and investment property.

Dr. Peter Bacon: Absolutely.

Chairman: Housing supply increased substantially in the years prior to 2008, as noted by Dr. Bacon and others, and this did not appear to restrain house price inflation at the time. Loan-to-value rules were not properly implemented and, by Dr. Bacon’s own terms, income ratios began to drift out of sync. In addition, in the buy-to-let sector, 100% mortgages, interest-only payments and so forth were provided. Mortgages terms were also extended to 35 years. This is a summary of the behaviour in the residential property sector at the time. Are housing markets somewhat different from other markets in that normal rules of supply and demand often do not explain how they work? David McWilliams, in his testimony to the inquiry last week, stated that the crisis was very much credit-fuelled and was not an issue of supply and demand.

Dr. Peter Bacon: I think it was credit-fuelled but I think what the credit was fuelling was demand. The housing market is different from buying a banana. The stock is effectively fixed and adjustments to the stock take place very slowly. That is in the nature of it, and land acquisition, planning and all the rest can take five or six years. Once speculative forces start to take off in the housing market, it is a pretty safe bet that the trend will not be reversed.

Chairman: The Central Bank is encouraging banks to revert to 20-year mortgage loans, which are the traditional mortgage schedule. In terms of Dr. Bacon's recommendation to extend the schedule to 35 years, would such a measure enhance access to credit for purchasers?

Dr. Peter Bacon: No. It would enhance the type of credit that is available to the purchaser. Going back to Deputy Higgins's point, with a 35-year mortgage one is going to pay more over the lifetime of the mortgage than with a 20-year mortgage, but in the early years for a low-income householder, one enables them possibly to get on to the ladder.

Chairman: In July 2009, the Central Bank came out with a series of recommendations about income ratios - not setting off rooms in the house for letting purposes so that could be looked at. It was very strident on the issue of pulling back from the 35-year schedule, which would certainly be in conflict with Dr. Bacon's recommendation for 35 years. Does he still stand over the 35-year recommendation?

Dr. Peter Bacon: Recommendations are made in the context of the time and the problems of the time.

Chairman: That brings me to the present. Would Dr. Bacon still recommend 35-year mortgages in today's market?

Dr. Peter Bacon: I do not think there is anything wrong with consumers being able to face a suite of duration over which they repay their loans so, no, I do not think it is wrong that a 35-year mortgage is there.

Chairman: I thank Dr. Bacon for appearing before the inquiry. The objective of the inquiry is not just to look at the past and learn the lessons, but going into the future to ensure that the type of crisis that was visited on the Irish nation is not rested upon people's shoulders once more. Does Dr. Bacon have any advice or recommendations for this inquiry in a forward-looking sense?

Dr. Peter Bacon: No, other than to wish it well.

Chairman: I thank Dr. Bacon for his participation today. It has been a very informative and valuable meeting, which has added to our understanding of the factors that led to the banking crisis in Ireland.

I propose that we suspend for 15 minutes and return at 11.55 a.m.

Sitting suspended at 11.42 a.m. and resumed at noon.