

HOUSES OF THE OIREACHTAS

Volume 1

Number 13

AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉI- REACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 11 Márta 2015

Wednesday, 11 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

Chairman: I thank Professor Farrell for his participation today. It has been a very informative and valuable meeting which has added to our understanding of the factors leading to the banking crisis in Ireland.

Sitting suspended at 11.30 a.m. and resumed at 11.50 a.m.

Professor Niamh Hardiman

Chairman: I now call the committee back into public session. Is that agreed? Agreed. We will now commence with session 2 of this morning's hearings, which is a discussion with Professor Niamh Hardiman, UCD, on systems of governance. At our sessions this morning, we are focusing on the theme of relationships between State authorities, political parties, elected representatives, supervisory authorities, banking institutions and the property sector.

For our next session, I would like to welcome to the meeting Professor Niamh Hardiman to discuss the issue of systems of governance. Professor Hardiman is associate professor of political science and public policy. She has studied at UCD and Nuffield College, Oxford, and worked for a time at the Economic and Social Research Institute in Dublin. For several years, she was a fellow of Somerville College, Oxford, where she was the tutor in politics before moving to the school of politics and international relations in UCD, where she is director of graduate studies and director of the interdisciplinary public policy programme. Her research interests centre on the political economy and public policy. She is interested in the politics underlying policy outcomes, the politics of how public policy priorities are formed and implemented, the implications of institutional design for good governance and the political economy of growth, distribution and redistribution. Among her recent papers are work on comparative fiscal responses to crises, methodological challenges arising from analysis of fiscal policy choices, the political economy of housing bubbles, new approaches to thinking about the European periphery, the effects of crisis on State structures, the implications of State structures for vulnerability to crisis and the fiscal foundations of the State. Professor Hardiman is very welcome to the inquiry this morning.

Before I 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 Professor Hardiman is directed by the Chairman to cease giving evidence on a particular matter and continues to do so, she is entitled thereafter only to qualified privilege in respect of her evidence. She is directed that only evidence connected with the subject matter of these proceedings is to be given. As she has 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 Houses or an official by name or in such a way as to make him or her identifiable. I call on Professor Hardiman to make her opening remarks.

Professor Niamh Hardiman: I thank the Chairman. I have been invited to talk about governance practice in Ireland. I think that the broad outlines of the banking crisis are familiar enough. We know that the banks borrowed too much, they made too many risky loans and too little heed was taken of the growing property price bubble. So, from a political science perspective, some of the key weaknesses that stand out for me are, first, there was too little oversight and accountability going on in the Irish political system. The banks, we now know, were too

lightly regulated, but in political life, too, the powers of Parliament to scrutinise policy were, in my view, too limited. There was not enough accountability for things that go wrong, so it was often hard to learn the right lessons for the next time, or even better so there would not be a next time.

Second, politicians and key public officials in some respects may have had too little distance from powerful private sector interests. Third, there was too much consensus over policy priorities and critical views were marginalised. There was too little specialised knowledge in the public service and there was a resistance to using expertise effectively. Each of these features of the political system is in conflict with principles of good governance. I would like to sketch in some of the institutional weaknesses that made these kinds of problem possible.

For a political scientist, institutions are important because institutions that work well are crucial for good political outcomes. They create the framework for people's interactions with one another. That is what an institution is. However, even good institutions can end up being run badly or operating badly, so there is always a need to have appropriate incentives to keep good standards of conduct going.

When we are thinking about good governance, there is not actually any single agreed definition. It is always something that is under debate, but there is an influential contribution to this debate developed by the Quality of Government Institute at the University of Gothenburg in Sweden, which says that good governance depends on what it calls the impartiality of institutions that exercise government authority. In this sense, there are two aspects of impartiality in the way that the State relates to its citizens. One concerns what I might say is the input side of things, that is, who gets access to public authority. The principle here is that privileged groups should not be able to gain preferential access to decision making in ways that would distort considerations of public interest. The other side of things is what I might call the output side of things, the outputs of political decision making, that is, the way political authority is exercised. This means that procedural rules and guidelines should always be respected and no individual or group should be either favoured or discriminated against.

So far, so good. We might say "relatively uncontroversial", because these formal principles are well represented in Irish public life, but if we think about the Irish experience, we can see that there are a number of weaknesses in institutional design and in actual political practices. I want to identify three areas that correspond with the three sets of problem that I mentioned just a moment ago. These are about, first of all, political oversight and accountability; second, the relationships between political actors and private interests; and, third, the contestation of ideas.

First, thinking about political oversight and accountability, governments have to manage public affairs, but policy also needs to be challenged and government needs to be held to account. We have a power dimension, one might say, of the exercise of public power and also a legitimacy dimension. It is more difficult in Ireland than elsewhere to scrutinise and amend legislative proposals and more difficult to hold the Government to account. I believe this was the subject of discussions the committee held with Professor David Farrell in the last session. His, and other research, indicates that the Irish Legislature is still a bit of an outlier in comparative perspective on these indicators. Accountability within the public service is also a problem. We are not always good at learning from mistakes when things go wrong in the public service. Too often we are inclined to say that the system is to blame and we leave it at that. All this is in the process of change at the moment. The Civil Service renewal plans are aimed at reforming the ways the Civil Service functions and includes procedures to improve and strengthen accountability. This is all very much a work in progress.

CONTEXT PHASE

My second point is about privileged access to decision making. There should be distance in the relationship between private interests and public authority in both input and output. We know there were close relationships between banks, builders, developers and political leaders during the years of the boom. This is potentially a problem on the input side of things. It may present a problem for Government's ability to take a measured view of its policy options or to establish enough distance and aggregate all the preferences it is exposed to in a public interest perspective. We have legislation on standards in public office, regulation of political donations and freedom of information legislation, all of which really do help to reduce the incidence of inappropriate access and influence - but poor practices may be harder to control or eliminate. Our ethics legislation dates from 1995 and 2001 and I do not think many people would suggest there were no problems at all in the years that followed. Making sure that legislation has the desired effect may not be quite so straightforward.

One way of having strong accountability in other European countries involves the strong role of parliamentary committees, but this is an area where there have been some weaknesses. When we think of regulation in the financial sector there is also a gap between what the formal rules say and the way informal practices actually play out. The powers that were available to the Financial Regulator before the crash were, as I understand, not excessively weak, but enforcing an effective regulatory regime is another matter. The Irish form of light-touch regulation was never going to get full disclosure of risks and liabilities on the part of the financial institutions. Ireland was not the only country to commit taxpayers' money to providing guarantees to the financial sector, but there are a couple of things that stand out about the Irish experience. Policymakers had fairly limited access to any kind of accurate information about the true state of the banks before the guarantee was extended. This is a problem which goes back well beyond 2008. It is a clear failure of the regulatory regime.

Although large guarantees were extended in other countries, they did not necessarily have to put them into practice. The difference lies in the organisation of the banking sector itself and the links they had with each other. Denmark for example committed 259% of GDP to guaranteeing its banks and Ireland committed 232% - similar orders of magnitude. While the Danish taxpayers were eventually liable for something like 1% of GDP, in 2012 it was estimated that the direct cost of the guarantee to the State was around €64 billion, which is 41% of GDP. It seems that the government in Denmark was able to negotiate a sector wide rescue scheme which involved a lot of participation by the financial industry itself.

I am not saying that the Danish experience is directly translatable to Ireland, there are many problems in trying to translate practices from one country to another, but what it does illuminate is that the Government seemed to have very little insight into what was going on until it was too late. As one analyst said it was "torn between denial and panic" when it was too late to do anything other than step into the breach with large guarantees. One might well think that in a small country like Ireland it is quite difficult to maintain appropriate distance between the Regulator and those who are regulated, or between the powerful, wealthy business interests and the politicians. Many of these people come from similar backgrounds. They went to the same schools and may even be related to one another. All of this plays a role in lowering the boundaries between the personal and the official political roles. However, Denmark is also very small and socially interlinked. Institutions need to be well designed and appropriate incentives and sanctions should encourage good practices to try to avoid the worst happening in the first place. This involves informal practices as well as the formal rules and sanctions.

My third point is about groupthink and critical evaluation, groupthink meaning when criti-

cal judgment is not properly exercised. Peoples' opinions converge on what is perceived as general wisdom without subjecting it to too much criticism. Many people have commented on the scale of groupthink during the boom and this was clearly a problem, not just in the case of bank risk, but in macroeconomic policy more generally. Ireland was far from unique in this naive faith in the self regulating market and the ideas that property prices were going to rise forever, there was going to be a soft landing and that this time is different. This time is never different. However, at the same time there were dissenting voices - people sounding the necessary warnings. There were those who were uneasy about bank risk and the sustainability of the property boom. Sometimes these people may have lacked the confidence to speak out too loudly, but there were enough who raised their doubts and their warnings. For the most part they were criticised or even ridiculed. The question now is how to create a space for those people who offer an alternative point of view, even though it is unpopular, so they get taken seriously and that countervailing opinion gets factored into the discussions, perspectives and anticipations?

Among the safeguards against groupthink in public life there has to be: high quality information available; a public service that can use the information well; practices such as having open environment for debate; critical engagement with different points of view in different fora; and encouragement of contestation over ideas in the policy process. Open debate is the basis for informed analysis and good policy formation. Developing the policy capacity of the public service was not very high on the list of political priorities during the boom. Indeed, during those years there was a proliferation of new agencies. Why were they created? It was because often it was easier to do new things by adding on new skills outside the existing public bureaucracy. We now have a lot of State agencies and there is a clear rationale for many of them. Agencies which operate at arm's length from Government can serve a valuable purpose. In other cases one might have expected these new positions to be created inside Departments themselves but instead we have this agency proliferation. In 2008 the OECD commented, not favourably, on what it called the "organisational zoo" of Irish State agencies.

Good policy making also needs access to good technical skills of all sorts and these are improving now. We have the Irish Government Economic and Evaluation Service, but there are other areas where there are skills and competence deficits. There have been questions, for example, about the management skills of the senior civil service. Reform is under way in these areas, but it is still very much a work in progress. We want the public service to act as a guardian of the public interest. To do this it needs to maintain a culture of independence from political influence. In formal terms that is well established in Ireland, but we sometimes hear it said that some senior civil servants may be less willing now than in the past to challenge Government ministers' points of view. There may be a number of reasons for this. In other countries, when a government is in power for a long period of time, civil servants may be more likely to align themselves with Government preferences. The way we organise career promotions may encourage anticipatory adjustments. It may be that civil servants are under a lot of day-to-day pressure to protect their Minister from criticism and from bad publicity in what is an intensely media saturated policy process. Until quite recently, if individuals wanted to expose things that have gone wrong they could expect very little protection. We now have The Protected Disclosures Act 2014. That goes a good way towards remedying this, both in the private and the in the public sectors. Here again if we want the legislation to have the effect that we want more is likely to be needed. There has to be a culture of encouraging critical engagement. The most effective way of doing this is to develop an environment in which debate and disagreement is normal, where discussion is not shut down too quickly in the interests of getting a decision, where people do not feel that their right to speak out is determined by their place in the hierarchy.

CONTEXT PHASE

Critical analysis is exactly what universities do. We engage in information, research, evidence and so on. Some progress has been made in engaging the universities in critical debate about public policy and public sector reform, but I think more could usefully be done. We can also think about the role that civil society organisations may play, an active role as watchdogs over the public interest, over regulatory and other bodies.

Inside the banks themselves we can now see that there were weaknesses in corporate governance to do with this phenomenon of group think. Banks engaged in very risky lending practices not least because their own shareholders put pressure on the directors to match the performance of the most profitable institutions, which were also the most risky. No bank can grow its profits at the extraordinary rates that we saw during the boom, in a safe manner. The brakes were off inside the high street banks too in terms of internal vigilance. It might be useful in this regard to think about the differences in the governance of the Irish and the Canadian banking sectors. The Canadian banks did not suffer systemic crisis this time around. One contrast between the two systems is the fact that the Canadian financial regulator played a very strong role. Bank directors expected rigorous and even painful scrutiny by the regulator and they internalised that expectation in the way that they conducted their own directorial responsibilities.

Inside the banks, the way the banks functioned also shows some interesting differences. As I understand it, directors can influence board decisions and bank outcomes through very much the same sort of practice that I mentioned a moment ago, good information, good preparation, an ability to ask hard and unexpected questions, a willingness to be critical and challenging towards management and to hold them to account effectively. In Canada, some of the corporate practices provided a stronger framework than may have been in existence in Ireland for encouraging these behaviours. For example, Canadian directors often, it seems, hold *in camera* sessions without management present. This lets them test ideas and build support among colleagues. This seems to have helped the non-executive directors to avoid excessive deference towards managers and it strengthened the independent and challenging voices on corporate boards.

In conclusion and in summary, I think what I have been focusing on is this feature of good governance centring on the idea of impartiality. Good institutional design is vital, but so too are the practices that make institutions work effectively. In the Irish case, this has implications in three areas that I have outlined. My first point was about political accountability. I noticed a relatively weak capacity to subject the Executive to scrutiny. Improving accountability is still in its early stages. The second point is about the relationship between private interests and public office holders and this needs to be constantly monitored. My third point is about the risk of group think and this persists as long as there is too little respect for informed critical opinion, too little willingness to look for high quality information and too little openness to debating and contesting ideas.

Chairman: I thank Professor Hardiman for her opening statement. I will deal with two matters before I open up the questions to members. The first matter is political oversight. Which countries does Professor Hardiman consider to be more effective than the Republic of Ireland in their political oversight and how do they differ from the Irish political system? Further to that, to what extent are political institutions and the electoral systems in which they operate important in determining these types of differences?

Professor Niamh Hardiman: There are some indicators of the strength of the executive *vis-à-vis* the legislature in different countries. Ireland and Britain stand out as having particularly weakly developed powers available to the legislature. This is usually measured in terms of

the powers and competences available to parliamentary committees, powers of compellability of witnesses, powers to command papers, but also agenda setting of the work of the parliament itself, the time-tabling within committees, the ability to get amendments accepted inside committees, the degree to which committees work along party political lines, the ending of debate and the guillotining of debates in committees. All those indicators suggest that in Ireland and Britain the parliamentary committees have a weaker scope of powers available to them. Many continental European countries have stronger powers. The strongest of all are in Scandinavian countries, it seems, and in the Netherlands where committees have extensive powers to set agendas and so on.

To what degree is this influenced by the electoral system? There is extensive debate about the Irish electoral system and electoral system reform is the first answer whenever anything goes wrong. I am not so convinced. Practices and expectations might not necessarily be changed by having, for example, a list PR system. One of the things that is encouraged in continental European systems by having a list system, is the ability to prioritise getting people elected on account of their policy competence but there is a price to be paid for that and that is that they get onto party lists without necessarily having to have a very close association with their constituency base, with their electorate. I do not have to tell that to people here. You are all elected politicians. You know much better than I do what it takes to get elected. The very strong features of the Irish electoral system are that it enables a strong connection with the local electoral base and to have a strong sense of responsiveness to civil society. These are very important things that I do not think we would want to lose from the current electoral system.

Chairman: That issue was addressed with Professor Farrell this morning.

Professor Niamh Hardiman: I would imagine so.

Chairman: The question that was put to him was how would he rate the level of connection between the public and the public representatives in Ireland compared with other jurisdictions. Does Professor Hardiman have a view on this also?

Professor Niamh Hardiman: Yes, I am sure I agree with Professor Farrell. The point that the Chair has asked about was about the powers of the Legislature. It may be that parliamentary committees could be encouraged and supported to work more actively.

Chairman: The statement that madness is doing the same thing over and over and expecting different results has been attributed to many people, from Sigmund Freud to Roy Keane. With regard to Professor Hardiman's statement that Ireland has been very poor at ensuring that the appropriate lessons are learnt when things go wrong in the public service, can she provide examples of specific failures from which we have not learnt lessons or maybe have learnt lessons? What lessons would she say need to be drawn from the banking crisis?

Professor Niamh Hardiman: The particular things that I was asked to think about in connection with engaging with the committee have to do with the banking crisis. There are other areas where sometimes the easiest response to a policy mistake is to move on and to press on with new kinds of practices and arrangements, ensuring that people who have occupied positions of responsibility are maybe moved aside, but really probing what went wrong can be problematic. In the context of the banking crisis things did go wrong in the banking sector before. There was a financial sector collapse in 1984 and I wonder if the right sort of lessons were learnt about risk that can happen inside financial institutions and the sort of oversight that may be required at that point. We know, for example, that Pat Gallagher was subject to crimi-

nal proceedings in Northern Ireland and many commentators have asked why that was or why these were not pursued in the Republic. I do not know the answer to that question. There were questions about the financial sector in the past and questions were raised during the 2000s. The Comptroller and Auditor General raised questions about the functioning of the regulator's office during that period. German financial regulators suggested more vigilant oversight might have been desirable in the mid-2000s, but somehow these warnings and lessons were not taken on board or absorbed into a type of critical reflective practice in order that, in anticipation of things happening, measures might have been put in place ahead of time.

Deputy Kieran O'Donnell: I welcome Professor Hardiman. I will focus on the area on which she was asked to contribute - the contribution of the system of governance pertaining to the circumstances that gave rise to the banking crisis in Ireland - as well as the second and third points she mentioned - privileged access to decision makers and groupthink. She said politicians and key public officials had too little distance from powerful private sector interests, resulting in what is sometimes termed "cronyism" or "crony capitalism". She also spoke about groupthink. How big a factor were the two features of crony capitalism and groupthink in contributing to the banking crisis that unfolded in 2008?

Professor Niamh Hardiman: Both were very important. If we look at what happened to the growth model Ireland was following in the 2000s, the emphasis shifted a little from the 1990s. Economists tell us that the Celtic tiger economy had two phases. During the 1990s growth in productivity and adding new resources to the economy were generating a strong export performance and a strong performance in traded services. After 2000 there was a shift towards investment in capital stock, most of which was going into construction, especially housing. There are many reasons for this. The Irish population was growing and there was a housing shortage; perhaps the early indicators of the housing bubble that were first explored in the late 1990s did not necessarily see the full magnitude of what was coming along. The context had changed a great deal, of course. By 1999-2000 we were living in the eurozone and very cheap credit was available. We now see the fiscal incentives to facilitate additional economic activity in the area of construction were misplaced in terms of generating a long-term sustainable growth model. They were also unwise in a context where it was becoming very much cheaper to borrow and use money in the banking sector. There were tax breaks for construction and incentivised building supports for quite a long time. It was well into 2005 and 2006 before these started to be withdrawn.

Deputy Kieran O'Donnell: How did the crony capitalism manifest itself in the groupthink? What were the examples of it? How did it manifest itself practically in that period?

Professor Niamh Hardiman: We have evidence of a great deal of personal interaction between politicians and some of the key actors. We know that some of the political donations and so forth contributed to some of this personal closeness. That is not necessarily problematic in itself, but it is problematic where it might encourage too strong a commitment of public policy to policies that are very favourable to these sectors. There is a type of win all around. It is very favourable and attractive for politicians to be able to generate more economic activity at a time, as in the early 2000s, with the dotcom crash there were problems in attracting new inward investment. With elections coming there is always a bias in the electoral cycle towards generating growth, making sure people have more money in their pockets and having more people at work. This type of self-reinforcing bias towards policies-----

Deputy Kieran O'Donnell: What institutional forms could have been put in place at the time that would have provided stability in helping to prevent the banking crisis from taking

place?

Professor Niamh Hardiman: One thing that was very much in evidence during the 2000s was the particularly strong bias in fiscal policy towards pro-fiscal commitments. We know that this is a recurring problem in Irish political life. There are very strong political and electoral pressures to commit to increased public spending in the good times and when the bad times come, there is no fiscal headroom. As there is very little scope for evening out the economic cycle, corrective measures are introduced at a time when they are most difficult. One of the corrective measures is the type of thing that has been put in place in recent years in the form of the Fiscal Advisory Council, to have an independent advisory body to provide information and expert and informed commentary on Government spending plans. It would not stop the Government. Irish Ministers for Finance have a tremendous amount of discretion when it comes to devising and implementing fiscal policy. The good side of that is that when a quick turn around in policy is needed, as we saw in response to the crisis, Irish Governments, in the context that they have good networked governance in the wider society, which we can discuss as well, have the capacity to make policy and implement it quite well through a very effective public administration system. They can turn around quite quickly. The balance side of it is that if disadvantageous or perhaps unwise fiscal policy is being pursued, there is very little friction in the system. There are very few institutional breaks. Again, this comes back to parliamentary scrutiny.

Deputy Kieran O'Donnell: In her paper Professor Hardiman speaks about the proliferation of the organisational zoo, with the growth of State agencies. One of those involved the separation of the Central Bank and the Financial Regulator, which happened at the time. How much of a factor was this organisational zoo of the various animals of Government and State organisations? How much did it contribute to institutional designed dysfunctionality? How big a factor was it?

Professor Niamh Hardiman: I would make a distinction between the mode of regulation specifically in the financial sector and in State agencies more generally. The design of the regulatory system in the financial sector is not that important - whether we had one regulator or the two-headed regulation system - but it could have been made to work better. Professor Patrick Honohan's report suggested lines of accountability were not always clear and that some oversight issues might have fallen through the cracks between the two bodies. If true, that would be a problem, but the real problem was the manner in which financial regulation was implemented. I see this as separate from the growth in new agencies and the creation of an ever greater number of new agencies during the 2000s, especially in the second half of that decade. I led a research project in UCD that gave rise to the Irish State administration database, which is an interesting and very useful research tool. We document every State agency created since the foundation of the State, categorised according to multiple criteria, and can show when and where different agencies were created.

Deputy Kieran O'Donnell: Where was the high concentration? Where was the exponential increase?

Professor Niamh Hardiman: Quite a few were in regulatory areas, but many of them were in service delivery and advisory bodies.

Deputy Kieran O'Donnell: In what period was the exponential increase in numbers?

Professor Niamh Hardiman: It was during the 2000s, especially the mid to late 2000s. It

is not that these agencies are doing a bad job in what they are asked to do. The problem is really about policy co-ordination. We have made it more difficult than we might really have to for ourselves to have good, coherent policy and to aggregate all the activities we can see going on in the different agencies. Some agencies have to be stand-alone and at arm's length from the Government. We have to have arm's-length regulatory agencies. It has worked out very well for Ireland to have, for example, a great deal of autonomy accorded to IDA Ireland. We need a lot of agencies but the problems of policy co-ordination can be problematic.

Deputy Kieran O'Donnell: Professor Hardiman referred in her briefing paper to Denmark's banking crisis. She said that, according to various analyses, differences lie in the relationships between the banks and government. When she compared Denmark and Ireland, what differences did she find in the relationship?

Professor Niamh Hardiman: Denmark has had a very different kind of banking system. For a start, there are very many banks, and they are all quite small. Second, they tend to be quite highly networked with one another. They have good habits — if one wants to put it like that — of sorting out problems together.

Deputy Kieran O'Donnell: Could Professor Hardiman deal specifically with the relationships between the banks and government?

Professor Niamh Hardiman: The Irish Government had more segmented relationships with the banks. It tended to deal with them one at a time. It did not have the corporate interlinkages that have existed in Denmark. That was a problem in respect of the flow of information between the Government and banks. I refer not only to the flow of information between the banks and the regulator. The Government did not necessarily understand what was going on inside the banks. There was a moment when some kind of networked solution looked like it might be getting off the ground in Ireland. Bank of Ireland and Allied Irish Banks, for example, might have become involved in offering some assistance or support to Anglo Irish Bank. It did not happen, as I understand it, because it was thought to be unnecessary at the time, again because of a dearth of information. When it did become necessary, it was effectively too late for everyone. Therefore, there was a drift to a point of no return. The real problems I am interested in trying to identify lie further back, in governance relationships. Weaknesses might have arisen that made problems-----

Deputy Kieran O'Donnell: With regard to good governance, what are the key elements in the Irish context? First, what were the weaknesses in terms of practical key elements? Has progress been made in that area? What would Professor Hardiman like to see?

Professor Niamh Hardiman: In general or in particular policy areas?

Deputy Kieran O'Donnell: We are here to deal with the banking crisis. What does Professor Hardiman believe has been taking place since the crisis that is positive? What more needs to take place?

Professor Niamh Hardiman: We are learning the lesson the very hard way this time. Many changes have been taking place that are very valuable. Certainly, the restructuring of the pillar banks, the intensification of oversight on the part of the Central Bank, the vigilance and due diligence are immensely more valuable.

My thoughts are partly about formal institutional reform and partly about being attentive to the way institutions work in practice. We thought we had a financial regulation regime but

the way it was being implemented was highly influenced by inappropriate expectations about the way the economy worked, based on the idea that markets would be self-regulating and that banks would not take unnecessary or excessive risks on behalf of their depositors, shareholders and so on. These assumptions turned out to be inappropriate. This time, we are correcting the mistakes of last time, but we do not know what the mistakes the next time will be. My point is really that although we are now busy correcting the mistakes that we learned about, we must also try to make sure we have institutions that are themselves adaptive, resilient and capable of policy learning and policy anticipation.

Deputy Kieran O'Donnell: In summary, in terms of the work of the inquiry, what further institutional reforms does Professor Hardiman believe need to take place to prepare us for another banking crisis that may arise down the road?

Professor Niamh Hardiman: I am not an expert in banking regulation; I am not really equipped to speak on that. More generally, the points I am raising have to do with our capacity to ensure accountability and democratic legitimacy, insight and oversight. All the points I have been making about having really informed and engaged parliamentary debate are important. Another important point to which I am drawing attention is that, in all our institutions, there is a need to develop the capacity for critical reflection and the encouragement of engagement. Professor Patrick Hohohan's report mentions the culture of hierarchy and authority inside the Central Bank and Financial Services Authority of Ireland. That is the enemy of critical debate, critical inspection and good governance.

Chairman: I will let Deputy O'Donnell in again. Deputy Michael McGrath has 15 minutes.

Deputy Michael McGrath: Professor Hardiman is very welcome. I thank her for her time. Could she clarify a reference in page 31 of the paper she wrote in 2012 with Professor Clarke? It states: "Career mobility between the boards of the Central Bank and the commercial banks was not uncommon, and indeed directors of both AIB and Bank of Ireland held simultaneous appointments on the board of the Central Bank". Could she clarify what she is referring to without naming any individuals?

Professor Niamh Hardiman: It would be inappropriate for me to comment on issues that are currently under discussion elsewhere in the political system and that may be under review elsewhere. That comment came directly from somebody else's research. My understanding of good governance is that there should be separation in the appointments people hold. In so far as this may have been true, there might have been questions to raise about people having conflicted interests and preferences.

Deputy Michael McGrath: Is Professor Hardiman saying there were individuals serving on the board of a commercial bank at the same time as serving on the board of the Central Bank?

Professor Niamh Hardiman: As I said, that is not original research that Professor Clarke and I undertook. The comment is attributed to another source. I refer to that source.

Deputy Michael McGrath: Is it not established as a fact on the public record?

Professor Niamh Hardiman: To be honest, I would have to look again at that paper. I am not exactly sure what the Deputy is referring to so I could not endorse or comment further on it.

Deputy Michael McGrath: Could the professor characterise the corporate governance arrangements that would have applied within the Irish banks during the 2000s, or from 2002 or

2003 onwards? What are her thoughts and observations on the corporate governance arrangements that applied at board level in terms of important sub-committees, such as credit committees and risk and compliance committees?

Professor Niamh Hardiman: I am not an expert on corporate governance; I have to say that from the outset. Therefore, my knowledge is second hand and I am not sure how valuable specific comments would be. I have read reports, including a PhD thesis by a student of mine who has investigated the activities of non-executive directors. I reference that in my paper. The student suggested there is room for non-executive directors to change some aspects of their practices. She suggested that, quite apart from exercising risk and compliance functions within banks, non-executive directors could exercise a greater voice and challenge usefully. Preparation and information are very important, as are challenge and debate, and opportunities to facilitate these inside banks are important also. I have made mention of the *in camera* sessions apparently held in Canadian banks. These are practices that seem to have worked well for the Canadian banks. As I understand it, they do not seem to have been common in Irish banks.

There are codes of practice for directors of banks. A lot of the professional reflection is now being guided by developments in Britain including, for example, the common code recommendations in the Walker review of 2009, where some of the advice for directors is very much along the lines of developing information, engaging with challenging behaviour and engaging in the type of critical debate I am characterising as the enemy of groupthink.

Deputy Michael McGrath: To clarify, Professor Hardiman did not look specifically at the governance arrangements within individual financial institutions?

Professor Niamh Hardiman: No, that is not my area.

Deputy Michael McGrath: Professor Hardiman made reference in her opening remarks to the comparison between the Irish and Canadian banking sectors. She spoke about the role of the regulator in Canada and highlighted one particular difference in terms of the *in camera* sessions. The regulatory environment is one aspect, and a very important one, but in terms of how the banks were run and the arrangements internally, does she have any other examples of key differences between what was being done in Canadian banks versus Irish banks during the years in question?

Professor Niamh Hardiman: Corporate governance of Canadian banks is even less an area of expertise for me than corporate governance of Irish banks. However, it should be noted that what were then the two large Canadian banks had a major collapse in 1984. On foot of that, the banks themselves got a terrible fright and adopted a conservative business model thereafter. As a result, they were a little bit more resistant to the temptations of ready credit and financialisation than were many of the American banks and others in the English-speaking world.

Deputy Michael McGrath: On page 31 of the 2012 paper she wrote with Professor Blaind Clarke on the crisis in the Irish banking system, Professor Hardiman makes the point that from the establishment of the Office of the Financial Regulator in 2003 to October 2008, not a single Irish bank was fined as a result of an inspection. She makes a contrast in this regard with the situation in the UK. What does the professor think this tells us, if anything, about the regulatory regime and the conduct of the institutions?

Professor Niamh Hardiman: I do not know if any Irish banks deserved to be fined during that period. That is the first thing to say. The second thing to say is that knowing now what hap-

pened, it does seem there may well have been, at a minimum, questions to be asked. We were pushed back to asking about the vigour of the regulatory regime that was in practice. There were many reasons that Ireland wanted to adopt a light-touch regulatory regime. It was the norm in Britain as well and Irish expectations about what financial regulation would do were very much shaped by the fact that we really wanted to have an IFSC in Ireland. We wanted to encourage investment by traded financial services, and it has been very valuable to the Irish economy to have that. The real question is how light is light enough? Those are the sorts of questions the committee is concerned to investigate now.

Deputy Michael McGrath: On page 18 of the 2012 paper, there is reference to an initiative by the Central Bank in 2005 to introduce a corporate governance code for credit institutions and insurance undertakings. The bank engaged in pre-consultation in 2005 and 2006, but decided to delay the code until early 2007. The point is made in the paper that this delay was unfortunate as the introduction of the code, even at that late stage, might have shone light on the serious corporate governance deficiencies in some of the institutions prior to the Government's decision in September 2008 to guarantee the banks. Will the professor expand on what difference it might have made if those new corporate governance code arrangements had been introduced at an earlier date?

Professor Niamh Hardiman: It is very difficult to speculate about what might have happened and it would be quite inappropriate for me to do so. What we are looking at is a rather late introduction of more exacting compliance requirements and practices.

Deputy Michael McGrath: By describing the delay as unfortunate, Professor Hardiman is speculating that things might have been different if it was done earlier.

Professor Niamh Hardiman: I am speculating to the extent that we might also say, for example, that tighter restrictions on lending between 2003 and 2007 might have prevented the banks from being exposed to such a large degree of liabilities. These are issues about which it is easy to speculate in hindsight, but I do not have any special expertise to allow me to comment further than that.

Deputy Michael McGrath: The professor noted in her opening remarks before the committee today that the powers available to the Financial Regulator prior to the crash were "not excessively weak". Will she expand on that and indicate the basis on which she arrived at this conclusion?

Professor Niamh Hardiman: Again, there are people who have greater expertise than I do in financial regulation and the legal arrangements around that, but my understanding is that the powers available to the Financial Regulator would have permitted a more vigorous oversight regime than was actually implemented. There is a report by the Comptroller and Auditor General which states that the Financial Regulator might have asked for more resources but did not do so. I mentioned this in the context of noting that there can be a distinction drawn between formal institutions, rules and laws on the one hand and, on the other hand, the ways they are put into practice, the informal practices that develop and how these things are actually lived out. One can have lots of appropriate strong rules and so on in place but whether they actually have bite in terms of really regulating practices may be another matter. There are all sorts of aspects to how conduct actually goes on that we also want to know about and understand. That is a matter as much of trying to contribute to changing culture, changing expectations, and changing the norms, values and mutual understandings people have about how institutions need to work as it is about designing the institutions in the first place. This comes back to my point about critical

engagement and antipathy to groupthink.

Deputy Michael McGrath: On page 4 of her opening statement, Professor Hardiman makes reference to a dearth of accurate information available to policy makers about the true state of the banks prior to extending the guarantee, which she describes as a clear failure of the regulatory regime. Is she relying on the work of others in making that statement or what is her basis for saying it?

Professor Niamh Hardiman: Most commentators would have expected that in a robust regulatory regime, there would have been more information about the degree of exposure of the Irish banks. That is exactly what my comment refers to.

Deputy Michael McGrath: The professor referred to privileged access to decision making. Is there one clear example of where that type of access was used successfully to influence a decision by policy makers or influence the approach of the Central Bank or regulator to conducting their functions? Is she talking in the round and in generalities or does she have specific instances to back that up?

Professor Niamh Hardiman: What I am trying to sketch is a pattern of economic governance. On the specific issue of relationships between private interests and political decision makers, we could look to, for example, tribunals of inquiry for evidence of instances where payments to politicians occurred, where words like “corruption” have been used and so on. It is not really my concern to delve into those sorts of issues here. I understand Dr. Elaine Byrne will appear before the committee; she is the expert on this.

Deputy Michael McGrath: I am asking this question in the context of the banking crisis.

Professor Niamh Hardiman: In a banking context I have no observations at all to make directly on that. What I would say is that it really is the structured set of relationships that is important. It does not even necessarily have to be the case that banks lobby to get their interests attended to by Government for them to be very important players in the political process. It is these structured relationships between different interests that I want to flag and I am suggesting government needs to have the capacity to establish a distance in policy formation processes from powerful social interests. That involves scrutiny and deliberation of competing policy proposals and a critical analysis or evaluation of the priorities being followed in economic policy. I have mentioned previously what we now see to be inappropriate fiscal incentives and as an inappropriately loose stance in allowing a great deal of credit to be built up in the Irish economy, but these were policy decisions Governments took. We do not have to look for and it would probably be impossible to find any instance of specific lobbying that resulted in these policy decisions being taken. It is the policy structure that is the problem and we really want to try to understand how we can do better.

Senator Marc MacSharry: I thank Professor Hardiman for coming. On pages 3 and 4 of her presentation she refers to the close relationships which developed between “banks, builders, developers and political leaders.” There is also a reference to Ireland’s poor ranking in the global competitiveness index of the World Economic Forum in 2014. Among the poorest ratings for Ireland was “favouritism in decisions of government officials”. If the Professor is familiar with this, will she give us some examples of such favouritism?

Professor Niamh Hardiman: I cannot; the Senator will have to ask the World Economic Forum for them. What I was reporting was that there was a perception that whatever the mea-

ures the World Economic Forum-----

Senator Marc MacSharry: Does Professor Hardiman know what metrics the forum uses to measure such things? On what are such statements based?

Professor Niamh Hardiman: I could look it up and find out for the Senator, but I cannot respond to the question immediately.

Senator Marc MacSharry: That would be useful. It would be interesting to get an insight into it. Does Professor Hardiman have any specific comment to make on the relationship between the regulator and the banks? Is there an economic forum that can focus on this?

Professor Niamh Hardiman: I do not know of comparative metrics used. Among the principles of good regulation are two essentials, the first of which is expertise. It is important to ensure the regulatory system has strong expertise in the area it is trying to oversee because regulators are there to stop people from doing things they want to do. When people want to do things, they will try to find ways around the rules. Recently in the *Financial Times*, for example, Ms Gillian Tett commented on the fact that the stress tests for American banks were possibly too lenient even still because the regulatory system was imposing stress tests that were too predictable. The financial institutions and their professional advisers are organising their reporting systems to match the tests that they know are going to be used for them. Therefore, knowledge of the systems in order that regulation can be tough, unpredictable and not pre-arranged is very important.

The second essential is relational distance. Analysts of regulation have suggested relational distance is very important, that there should not be close personal or professional relationships between the regulator and those regulated. Relational distance must be maintained, but expertise has to be prioritised. That is difficult to pull off. The Irish-----

Senator Marc MacSharry: What are the metrics we can use? What prevents regulator A and banker B from being pitched against each other in the winter league at the golf club, for example?

Professor Niamh Hardiman: That is a real problem and part of what I am flagging. We have a much tougher financial regulatory apparatus and regime now, but we can never be complacent about how well institutions, rules and laws are operating because there is no way of controlling the myriad ways around the rules, including informal social interactions. What is every bit as important is cultivating a changed insight into and an understanding of how institutions ought to behave. Institutions are not just, as I have said before, formal apparatuses; they are also underpinned by ethics, an ethos, norms, values and ideas, including the ideas people carry around in their heads about appropriate behaviour.

Senator Marc MacSharry: Would Professor Hardiman describe these norms, ethics or practices as very low, acceptable or high?

Professor Niamh Hardiman: I have no metric against which to pitch it.

Senator Marc MacSharry: Other than Professor Hardiman's own experience.

Professor Niamh Hardiman: What I am suggesting is that the Irish record on how regulators were appointed and the skills they had available to them was not optimal in terms of meeting the criteria I suggested, that is, the combination of expertise and relational distance.

CONTEXT PHASE

Senator Marc MacSharry: Should there be criteria or codes of conduct for determining how social interaction should be handled between politicians, civil servants, bankers, regulators and so forth?

Professor Niamh Hardiman: I think all sorts of guidelines on appropriate conduct are desirable. We have had new legislation on compliance, ethics in public office, scrutiny and oversight of donations to political parties with a view to trying to control and eliminate-----

Senator Marc MacSharry: Is it sufficient?

Professor Niamh Hardiman: That is my point. Rules-based enforcement of conduct can only ever go so far. What is every bit as important is building cultures based on the ethos one would like to see developed. This is based on interpersonal expectations about what is appropriate in exchanges and relationships that are often unspoken. Codes of conduct can codify these things and in so far as they help to entrench norms and diffuse people's expectations about what is appropriate, they are very important. Again, it is only through talking, debate, criticism, exposition and critiques that we can keep these to the fore in everybody's mind.

Senator Marc MacSharry: Is it codes of conduct that we require?

Chairman: I am sorry, but the Senator is out of time.

Professor Niamh Hardiman: Codes of conduct can help, but they are not the end of the story.

Deputy Pearse Doherty: Professor Hardiman made reference to groupthink in the run-up to the crisis. Has she identified traces of groupthink currently within our parliamentary system?

Professor Niamh Hardiman: I have not had occasion to explore areas of groupthink that would be relevant to this inquiry.

Deputy Pearse Doherty: Does Professor Hardiman believe it is a thing of the past or not? Has it been confined to the immediate post-crisis period? She talked about three areas, but does she think it is just a post-crisis issue or is it still an issue today?

Professor Niamh Hardiman: My point is that we never really know until it is too late. It is easy to identify with hindsight. What I am suggesting is that we need to be vigilant against the danger that we might be becoming too complacent, with everyone thinking things are fine and sharing the same world view about how policy works. We should always be wary about a comfortable consensus and willing to listen to critical voices when they emerge, with a view to making space for them and assessing the validity of what they have to say. It is too easy to exclude critical voices when they are uncomfortable, but they may be the harbingers of future dangers about which we do not know from within our cosy consensus.

Deputy Pearse Doherty: On page 2 of her statement Professor Hardiman argues that "privileged groups should not be able to gain preferential access to decision-making in ways that would distort considerations of public interest." I ask her to enlighten the committee on how to define this; how the public would know and how we can protect ourselves in that type of scenario, that is, where there is privileged access to decision-making? There have been well-documented instances from the past where the Taoiseach of the country met with senior directors of banks and the regulator and sought their opinions on budgetary matters but it was claimed that banking matters were not discussed. How can we define whether that was an ap-

propriate meeting? Alternatively, was it a case of, as Professor Hardiman suggests, privileged groups being able to have preferential access to decision making?

Professor Niamh Hardiman: I did not pin that particular phrase on to any particular episode. What I want to highlight is that there are two dimensions to governing in a democratic political system. One is the exercise of power and responsibility. Governments must be able to exercise discretion, manage the economy, respond all the time to all the hard challenges that come their way and look for advice. The other dimension is legitimation and accountability. We know the Eurobarometer report suggests that Irish people have unusually low levels of confidence in our public institutions at the moment. They have been in decline for a number of years, which is very worrying because people are seeing that the levels of accountability have been weak and the mechanisms for getting that accountability have been weak. Inquiries such as this are the kind of thing I am talking about - the capacity to find out things that went wrong.

We also want these sort of processes on an ongoing basis. To come back to the points I made at the outset about parliamentary committees in other systems, it relates to this vigorous debate about ongoing policy and policy proposals and asking hard questions of the Government. It is very hard to ask hard questions of the Government in our system. A couple of times, Opposition questioners have been told that they did not ask the right question so they could not get the answers they were looking for. It relates to control of information by the Executive and the difficulties the Parliament has in gaining access. By “Parliament”, I mean both the governing party backbenchers and the Opposition parties, not just on party lines.

Deputy Pearse Doherty: Professor Hardiman quoted the World Economic Forum report of 2014 which highlighted “favouritism in decisions of Government officials”. Could she explain what this phrase means? Has she any evidence to back up this statement?

Professor Niamh Hardiman: This is very similar to the question asked by Senator MacSharry. The World Economic Forum is picking up on the experiences of economies in preceding years. I do not have the precise metric according to which it developed its comparative rankings of countries on these indicators. I flagged the fact that it thought that there was something problematic. I have been indicating that the structure and the patterns of decision making and policy formation have been problematic and have favoured some interests over others in ways that did not prove to yield a sustainable growth model and that were problematic when it came to avoiding the accumulation of risk. That is what I was pointing to.

Deputy Eoghan Murphy: We know from the pre-crisis period that there was extraordinary access on the part of the banks to senior political figures. When we look at that context, does access necessarily mean influence in policy decision making? If we think it does, are we talking about limiting access or just monitoring it?

Professor Niamh Hardiman: Access may or may not involve influence and influence may or may not be appropriate. There is no general answer to that. One thing to remember is that people who want Government to do something like to have access and access is not evenly distributed among different groups and interests in our society. Having exceptionally easy access could be a problem in a context where we are trying think about the balance of consultation and the interests that gain access. That is the concern there.

Deputy Eoghan Murphy: Would good design mean limiting access or just monitoring it more effectively?

Professor Niamh Hardiman: I think our recent moves to have a register of lobbyists are very helpful in that regard. Again, it is part of tightening up our rule base monitoring and trying to introduce more oversight and regulation of how interests gain voice in political access and representations. That is very helpful. The point I keep coming back to is that this is never enough by itself. We also need to think about the way in which we might open out deliberation about policy and expose the kind of engagements that Governments have with different kinds of interests to scrutiny and inspection. It is partly Government in the sunlight. Whenever something is secret, we may want to know why. Is there something we should know about here?

Deputy Eoghan Murphy: In respect of the lobbying Bill, does Professor Hardiman think it is important that where an informal contact is made, there is a requirement that this be noted and published? It is coming back to this idea of a small society and people bumping into people, people knowing each other, meeting someone at the golf course and something getting raised in that context.

Professor Niamh Hardiman: The problem in a small society is where one stops. If I accidentally bump into the Minister for Finance at Charles de Gaulle Airport, do I report that? Where does one stop? Trying to pin down every single instance of contact in rules, trying to enforce things and reporting on everything is the high road to disaster in terms of monitoring and respect for the rules. That is probably not the way to go but there may be ways of requiring more vigorous compliance with structured and unstructured engagements that I do not know about. I am not in a position to comment how lobbying legislation is to be implemented.

Deputy Eoghan Murphy: In respect of the idea of creating an environment for competition among ideas, is the Irish Fiscal Advisory Council, which Professor Hardiman mentioned previously, an example of how one creates that environment or could it be seen as an example of creating another agency or voice that may or may not be listened to?

Professor Niamh Hardiman: Most of all, it is about developing a culture. Developing a culture is a challenge. I have some specific thoughts about ways in which these sorts of priorities can be supported. I suggested involving universities and other people who have expertise in particular kinds of policy areas in policy debates. There are innovations inside some Departments at the moment. For example, the Department of the Taoiseach has been organising open seminars on key issues like risk assessment. The Department of Public Expenditure and Reform has been very involved in reaching out and engaging with lots of different areas of expertise as well as building up the Irish Government Economic and Evaluation Service. If I can make a small institutional plug, UCD is keen on thinking about ways in which it can develop these kinds of academic practitioner engagements. I recently organised a round table involving people from the public service which was attended by about 20 or 30 people, including people from the Departments of Finance and Public Expenditure and Reform and academics. We had a very good discussion about international trends in public sector reform which is helpful and informative for all concerned. Those kinds of practices can only be a good thing.

Deputy Eoghan Murphy: Coming back to the idea of institutional design and looking back to the pre-crisis years, does Professor Hardiman think that the Oireachtas was designed in a way that meant it could effectively oversee Government action or did it merely come down to the way it was used?

Professor Niamh Hardiman: We have a fully functional, fully constitutional and fully democratic political system with a Constitution that says that the Executive is accountable to the Legislature so in formal and constitutional terms, we are right up there. There is nothing

wrong with our formal democratic structures. I am talking about giving them effect. We have a very typical Westminster-type parliamentary system. As the Government is fully formed from the Legislature, it means that the practice of party discipline to control majorities in the Legislature means preferential access to use of power and the power to get legislation through and to curtail debate if the Government wants to do so. This is built into Westminster systems; it is how they work, and we are very like the British Parliament in this regard.

The British Parliament has changed in some of its practices. In Ireland, we have been developing parliamentary committees since the 1980s, but Britain has gone further. House of Commons committees are, frankly, scary for those who must appear before them. Their reports are debated in Parliament and get a lot of public attention. I would like to see a situation where Oireachtas reports, and there are many excellent reports, really feature as an agenda item in public debates and where the substance of policy and learning which happens through having vigorous debates in the Oireachtas would push issues through to a legislative agenda, and certainly help create the type of environment and expectations I have been speaking about with regard to a normative reappraisal of how we do business. Often when we do business as usual it is hard to see outside the parameters.

Deputy John Paul Phelan: Following Deputy Murphy's question on whether access is influence, Professor Hardiman spoke about exceptionally easy access for certain groups. Is it not the case then that access is an example of the political system we have in Ireland? Professor Hardiman and Professor Farrell outlined strong support for the method of election, and different interests have exceptionally easy access, to use the phrase Professor Hardiman used in answer to Deputy Murphy's question.

Professor Niamh Hardiman: On the electoral system, I am not saying it is not worth looking at other electoral systems. I am not so completely wedded to PR-STV that I would say it is the best of all possible systems we could ever have. I am just saying it is not necessarily the source of all the problems people attribute to it. When we think about access we think about a number of different things. The access of individual citizens to their representative is one thing and the access of powerful interests to the wider policy-shaping agenda is something different. In Irish politics people value the fact they can get to see their representative easily, but there is a downside to this. Who am I to say, because the members know this better than I do, but my understanding is very often what people want is help with negotiating a bureaucracy which can seem very unresponsive, help with finding out rights and entitlements they have and should be able to access easily but somehow cannot, or help with problems for which a policy solution may be available to them of which they are not aware. Helping people to negotiate a system which is a bit opaque suggests not only there is a good connection between people and their representatives, but also there are things we need to look at again regarding the opacity or difficulty of negotiating our wider public services.

Deputy John Paul Phelan: Professor Hardiman outlined in a number of answers that in her opinion too much consensus existed in the political system, and perhaps in other institutions and between institutions, in the lead up to the financial crisis. Professor Farrell emphasised in many of his answers the need to move towards what he described as a more consensus form of politics, and that we did not have enough of a consensus form of politics. Perhaps I am missing something, but potentially there seems to be a direct contradiction between Professor Farrell's view on the type of politics that existed in Ireland before the financial collapse and how we needed to move to a European model of consensus, and Professor Hardiman's view that too much consensus existed. Can Professor Hardiman square this circle?

Professor Niamh Hardiman: Obviously I do not know exactly what Professor Farrell said. I was not able to see him because I was on my way here. I suspect what he may have had in mind is the tendency in Westminster-type parliaments to have a very adversarial style of politics whereby the Government sees it as its business to defend its preferences to the hilt and the Opposition sees it as its business to embarrass the Government at every point. What I am speaking about, in terms of contestation, is in the sphere of ideas, policy debates and the engagement of ideas, not simply barracking and point scoring in a party political manner but a gauged evaluation of policy and bringing to bear different critical perspectives with a view to trying to tease out the politics of feasibility. I am not saying there is a technical solution to everything. Sometimes choices are irreducibly political and it comes to a matter of the preferences, priorities, ideology and value priorities the Government may have which will lead it in one direction rather than another.

I suspect when Professor Farrell spoke on consensus he may have been speaking about a capacity to engage more constructively, through debate, negotiation and the contestation of ideas, and aggregate different points of view to find common perspectives where these might be possible or desirable. I am thinking about things like, for example, really evaluating the parameters of what is fiscally possible in an economy and what the wisdom is of engaging in expansion or contraction, or what amount of fiscal headroom would be desirable to have at a particular time.

Deputy John Paul Phelan: In her presentation Professor Hardiman emphasised the role of groupthink in the difficulties in Ireland, and she also mentioned the Nyberg report. Has she found examples of groupthink to the same level, or any level, in other EU countries which experienced a financial crisis at the same time as that which hit Ireland? Has she studied this?

Professor Niamh Hardiman: It would be hard to say. Ireland is not the only country which experienced a crisis, of course. The prevalence of belief in self-regulating markets was what did for us all. The economics profession is engaging in a lot of heart searching about the way it formulated its ideas, taught students about risk, and downplayed all the issues which were very much on the political agenda in the wake of the great depression when regulation and the separation of interests between high street banks and other financial institutions were introduced. There is great literature now on the lack of vigilance, how risky markets are and how dangerous it is to rely on markets in a world where we have new, hard to understand, complex and risky financial products, capital mobility and enormous financial corporations.

Senator Susan O’Keeffe: I welcome Professor Hardiman. On page 6 she refers to the culture of independence needing to be maintained in the public service so it can function as a guardian of the public interest. To be clear, is she saying, therefore, there is a culture of independence already? Is that the implication of the word “maintained”? Does she mean there needs to be one because there is not one?

Professor Niamh Hardiman: Formally there is. Irish institutions score very well on all the comparative metrics of democratic performance. We have a very incorrupt public service. We have a public service that has been commended by the IMF on its capacity to learn. It has a very high implementing capacity and very high effectiveness capabilities. What I am flagging is the need we have for a public service that continues to be non-political, which is its role in our Whitehall-type system, and to be the guardians of the public interest and public interest considerations. Again, it is about senior civil servants being willing to offer challenge to Ministers. At the end of the day, it is the Government which has the electoral mandate. What Government Ministers want to do should not be countermanded by civil servants. That is not what I am saying. However, they should feel free to give advice which would not necessarily reflect what a

Minister had suggested in the first instance or which might not be what he or she might wish to hear. We do not always know how these relationships play out because they are subject to privilege and secrecy. One of the reforms that some people have suggested would be helpful in understanding how those relationships work and in facilitating the Civil Service in maintaining its role as the guardian of the public interest is that which would allow senior civil servants to testify to parliamentary committees. I understand they are not able to do this at present.

Senator Susan O’Keeffe: They are permitted to do so under the new legislation.

Professor Niamh Hardiman: But they would not have been able to do so in the past.

Senator Susan O’Keeffe: That is correct. If we consider the period between 2000 and 2007, it is obvious that power was vested in Government and in the Parliament. Was power vested in the Civil Service or would one even refer to it as power?

Professor Niamh Hardiman: It depends on the theoretical perspective one adopts. I am not sure whether it would be described as power. Power to do what?

Senator Susan O’Keeffe: To make decisions, to introduce policy, to change a Minister’s mind or offer proposals for legislation. There are all sorts of ways in which power can be potentially manifested. I am just asking Professor Hardiman, as a political scientist, where the Civil Service fits into the power structure that exists in this country. One could examine the position in other countries but we are interested only in what happens here.

Professor Niamh Hardiman: The Civil Service must be very much at the disposal of the State in the context of the implementation of public policy. That is its purpose. Having a good, effective and efficient Civil Service is terribly important. Both the efficient and distributive institutions of the public service can work well or they can work badly.

The Civil Service has a responsibility to be able to draw on expertise in order to be in a position to support the development of good policy. One of the areas that has come under scrutiny in recent years is the dearth of technical economic expertise in the Department of Finance. There were many hugely competent individuals within the Department who had a great deal of such expertise but the kind of structured professional training required was not in good supply. We need to ensure we cultivate the necessary skills and specific competences as well as encouraging appropriate relationships - that we think of as being reflective of good public sector practice - in the context of co-operation with and distance from Ministers.

Senator Susan O’Keeffe: When Professor Edward Kane gave evidence before the committee, he described the financial system - in the way it interacts with the political system - as being elitist as a result of the fact that bankers are treated as high priests of a sort because they make the elites happy.

Chairman: Final question.

Senator Susan O’Keeffe: It is my final question. Professor Hardiman refers to “the dearth of accurate information about the true state of the banks that was available to policy-makers prior to extending the guarantee – a clear failure of the regulatory regime”. If Professor Hardiman agrees with Professor Kane that those to whom I refer are high priests and regardless of the amount of information available, is it not the case that the same decision would have been made? Does Professor Hardiman have a view on that matter? What Professor Kane stated was quite serious in nature and Professor Hardiman may harbour a different opinion.

Professor Niamh Hardiman: This is the first time I have heard that quote. It sounds as if what is being characterised there is excessive and inappropriate deference to people who should have been carrying out a professional function.

Senator Susan O’Keeffe: What is the position if there is that deference?

Professor Niamh Hardiman: The questions I have been raising all along relate to where we accord deference and the circumstances in which it is inappropriate to do so. Questioning the bases of authority is always useful. If authority is based on knowledge and competences, then people would be willing to accept it. If, however, it is simply an assertion of right or entitlement or of entitlement due to position, then it is a problem because we are not really able to discover that which we need to know. In such circumstances, there is a risk of information which should come into the public domain not doing so. I would certainly see that as a problem.

Senator Sean D. Barrett: I welcome Professor Hardiman. I am interested in her quote from Mary Halton’s thesis regarding the conduct of non-executive directors in Canada, who held meetings without management being present “as the primary tool through which to test ideas and build support among colleagues. This arguably helped to avoid excessive deference on the part of non-executive directors and to strengthen independent and challenging voices on corporate boards.” Professor Edward Kane, to whom Senator O’Keeffe just referred, sees directors as trustees for society as a whole and not as members of a forelock-touching old boys’ club. Is there much literature available in respect of the new kinds of director to whom Mary Halton, Professor Hardiman and Professor Kane refer preventing the tendency to engage in groupthink?

Professor Niamh Hardiman: As I said before, I am not an expert in corporate governance but I am sure there must be literature on directors. There is certainly a great deal of reflection on the kind of role directors can, and perhaps should, be playing. Taking seriously their role as trustees is very much part of that. I referred to the Walker review of corporate practices in financial services and the banking sector in Britain, which is developing codes of practice in this area. We are always willing to learn from systems which have lessons to teach us. Among those lessons is advice of a sort, which seems to have been adopted long ago by Canadian directors, to the effect that directors should have that combination of expertise and distance to which I have been referring.

Senator Sean D. Barrett: Unfortunately, we do not like whistleblowers. Is it not the case that there is evidence that the careers of whistleblowers are ruined by their actions? In many cases organisations never institute reforms, rather they just gang up on the contrarians involved.

Professor Niamh Hardiman: Yes. We have to learn to love our whistleblowers.

Senator Sean D. Barrett: The deference we are discussing applies, particularly in this Parliament, to European matters. Professor Hardiman provided additional information to us on EMU and what it means. Did we understand what we were doing when we joined EMU? Were there contrarians who spoke up when Denmark, Sweden and the United Kingdom did not join? If so, did anyone think to follow their advice and reconsider this matter or was it a case of just touching the forelock and continuing on?

Professor Niamh Hardiman: The decision to go into EMU dates back to the late 1980s and early 1990s. In 1992 Ireland was in a bit of a tricky situation. There were many economists who stated that the architecture of EMU did not look good and that it did not constitute an op-

timial currency union. They were of the view that, in the absence of a transfer union, a banking union, debt resolution and all of the things we have now learned as so important, it would prove somewhat problematic. Maintaining an independent exchange rate regime was very challenging for Ireland at the time. On the whole, compliance with the requirements to join EMU worked well for Irish economic performance in terms of the policy process. In the early stages, most people expected that upside would be very strong and that integration with the wider European economy would be facilitated by the single currency, that trade would improve, that our export links with other eurozone countries would be intensified and so on. Adaptation to the new policy regime, whereby there was no control over exchange rates and monetary policy, was probably slow in coming because it attached new importance to the domestic capacity to manage by using just cost-containing mechanisms, fiscal policy, etc. What people did not realise was all the perverse incentives that would spill out from having such low interest rates. That was a shock that was genuinely hard to manage.

Senator Sean D. Barrett: The new, ethical and open complex that the professor has described to us sounds most interesting. The “big four” accountancy firms dominate accounting at the banks. With regulatory capture, the way regulatory institutions are set up and even finding that one bank gave €41 million in loans to its own directors, how does one promote the much better system described by the professor? How can one extend it into areas so we never get a recurrence?

Professor Niamh Hardiman: With instruments on every front, I think. Formal regulatory regimes are terribly important and so also are codes of conduct by professional bodies so that banks do self-regulation and self-monitoring.

In so far as regulators get captured by those whom they were supposed to regulate, accountability to Parliament can help as well as scrutiny, opening things to question and assessing how well the regulators are doing. Civil society bodies have a role in this as well. I am referring to non-governmental organisations and civil society groups that can exercise an adequacy role and watchdog role which would alert us all to problems or shortcomings. Journalism and journalists can also play a part in this by, for example, uncovering stories that are unsavoury, need more investigation or show us where our institutions or practices are failing. It is all about democratic accountability and legitimacy that has many strands which I have tried to elaborate.

Senator Michael D’Arcy: I thank the professor for attending. I refer to the paper written jointly by herself and Professor Blánaid Clarke. On page 31, it states that “directors of both AIB and Bank of Ireland held simultaneous appointments on the board of the Central Bank.” Did that happen in Canada? Professor Hardiman has given Canada as an example of a good regulatory regime.

Professor Niamh Hardiman: I cannot comment on that definitively because I am afraid I do not know. If the Senator wishes, I could find out.

Senator Michael D’Arcy: The discussion paper continued:

In September 2008, against the backdrop of this deliberate policy of light-touch regulation that the regulator insisted that Anglo was not insolvent and that it had enough assets to cover its debts. There is no evidence to suggest Anglo is insolvent on a going-concern basis. It is simply unable to continue on a current basis from a liquidity point of view, he told the Taoiseach.

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Can the professor comment on the subsequent analysis by PwC for which it was paid €5 million?

Chairman: I do not know if the witness has the skillset to answer that question.

Senator Michael D’Arcy: I am quoting what the witness has stated.

Chairman: All right.

Senator Michael D’Arcy: My question is relevant.

Chairman: We give a notification when it comes to reports. I shall allow the witness respond and shall take guidance from there.

Senator Michael D’Arcy: PwC was subsequently paid €5 million to carry out an analysis of the banks covered by the bank guarantee. It subsequently discovered, when the report was published, or the analysis was, that the banks were solvent.

Professor Niamh Hardiman: What is the Senator’s question?

Senator Michael D’Arcy: The professor made the point that light touch regulation led to the Financial Regulator making the statement to the Taoiseach that the banks were solvent. In light of PwC being paid €5 million to analyse direct-----

Chairman: Is this the Senator’s commentary or is it contained in the report?

Senator Michael D’Arcy: It is in this report here. I ask the professor to comment on her statement in her paper on the Financial Regulator making a statement to the Taoiseach that the banks were solvent.

Professor Niamh Hardiman: There are two things I would like to say about that. First, we now know, in hindsight, there was a dearth of information all round and that the Financial Regulator did not have access to all the information. This is what we seem to have learned. I am not in a position to comment as to the veracity of any of those claims.

Second, in regard to any particular institution about which there are ongoing discussions in the public domain, I am not at liberty to comment I am afraid.

Chairman: All right. I call Deputy Joe Higgins.

Deputy Joe Higgins: Professor Hardiman stated on page 1 of her written introduction, under the title of privileged access to decision-making, that, “politicians, and key public officials had too little distance from powerful private sector interests, resulting in what is sometimes termed as “cronyism” or even “crony capitalism.” In the letter the professor received from the banking committee she was asked to cover the following:

The key features of an effective system of governance, i.e. standards to which relationships in institutions, within a democratic structure should operate, and an understanding of good governance in the context of a healthy public and political life.

Did crony capitalism affect good governance during the bubble-inflation period? Is there a contradiction or not, in her view, between crony capitalism and “good governance in the context of a healthy public and political life”?

Professor Niamh Hardiman: What I have sketched out is a policy regime during the 2000s which involved Government in prioritising a certain way of supporting economic growth and job creation. It turned out to be hard to sustain, because it was built on short-term construction interests which adds very little value or long-term value to the economy. It also encouraged and allowed risk to develop in the financial system because it depended on the ongoing availability of credit for property. This way of arranging policy and prioritising some kinds of economic activities in policy incentives, in the early to mid-2000s, is what I designated as problematic.

We can now see, in hindsight, the scale of the property bubble that developed. In future we want to try to make sure we have balanced capabilities for really assessing the viability, durability and good foundations for any particular growth regime supported by specific kinds of fiscal incentives. Opening these out to critical scrutiny and accountability, in different political and public fora, is really what I want to stress.

Deputy Joe Higgins: The professor referred to critics and contrary views to those prevailing, by common consent, in the inflation of the bubble period, being ignored. Yesterday, Mr. Simon Carswell, who is a correspondent for *The Irish Times*, said the following about banks, Government, builders and regulators in his written evidence on page 2:

For these parties, it was too comfortable - and indeed self-serving for some - to stay in the crowd and stick with the consensus, particularly when so many people were making so much money. The result of this was that contrarians were ridiculed, silenced or ignored to ensure the credit-fuelled boom continued for years as their past warnings did not come true.

In Professor Hardiman's view there were more than just those four parties that ignored or contradicted the so-called contrarians. In her view, why were they ignored?

Professor Niamh Hardiman: A lot of people have commented on this matter. When the economy is booming nobody wants to hear that it is hurtling towards the edge of a precipice. There is a wider problem for democratic societies in general. Governments have time inconsistent preferences. Governments are faced with genuinely difficult problems of trying to compete for power and win power in the next election.

Chairman: I am sorry to interrupt the professor but I call for order in the room.

Professor Niamh Hardiman: Issues that have a longer time horizon than the next election are difficult to factor fully into the Government's calculations. Between 2004 and 2007, the Government, having attempted to correct some of the fiscal exuberance in the run-up to the preceding election and the European elections, was correcting the exposure with a view to the next election. It is always difficult to hear unwelcome news but my point is that we should attune ourselves to the need not to get too comfortable inside the expectation that nothing will ever go wrong.

Deputy Joe Higgins: In the course of her address Professor Hardiman stated: "Banks engaged in very risky lending practices not least because their own shareholders put pressure on the directors to match the performance of the most profitable institutions, which were also the most risky." If there is no legal restriction on profiteering, for example, in the home building industry, and profit is a key driver of private banks and developers and those who run them, how fair is good governance in that situation? Does profit maximisation drive out good governance?

Professor Niamh Hardiman: My argument is that there is a different sort of balance to be struck. At the time I am speaking about, some banks were growing profits at a rate that most

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expert commentators would have thought to be unwise. There would have been a question about the riskiness of the business model they had been pursuing. If there was nothing illegal about what they were doing and if they were not constrained by regulation from what they were doing, there was nothing in essence to stop them other than what their own internal audit or risk management might have suggested.

My observation is about the pressure this puts on other financial institutions that are also responsive to their own shareholders. When an economy is in this exuberant state, people expect their investments to yield a good return. My comment is that people should be sceptical about the durability of the business model that their money is tied up in. The economist, Hyman Minsky, is often cited nowadays because a long time ago he developed a model whereby he predicted that crashes were inevitable, that financial crises will recur and will happen for different reasons next time, but they will happen. They can be worse or less damaging, but they will be driven by the acceleration of expectations that there is money to be made. People pile in to try to make money while they can and the people who are slowest in getting out are the ones who will be caught most severely. The Minsky moment comes when panic sets in and exuberance evaporates and there is no more money to be made. People start to exit that apparently profit-making sector very rapidly, causing a sudden crash.

It is a monetary note to shareholders too, to be sceptical, to ask questions and to be challenging.

Chairman: I wish to wrap up with a number of matters before Professor Hardiman goes. Arising from the point Deputy Higgins has made, is it possible to introduce legislation to force the banks to implement better patterns of corporate governance? Do we need legislation in this area and would she indicate what type of legislation is necessary?

Professor Niamh Hardiman: As I have already said, I am not willing to comment on what should be in legislation on corporate governance because it is not my area of expertise. There are very special competences involved in that. Legislation on many aspects is always a possibility.

Chairman: I do not want a generalisation. If Professor Hardiman does not have specifics I will move on. Am I correct Professor Hardiman, that you have written on political funding and donations?

Professor Niamh Hardiman: No, I have not written on this area.

Chairman: Does Professor Hardiman wish to add anything further? The inquiry is not just about examining the past but also about considering the future to ensure that the mistakes of the past are not revisited on the public and the nation again.

Professor Niamh Hardiman: I think I have had a good opportunity to bring out the themes that I really wanted, and these include the suggestion that we need more fora for democratic scrutiny of policy if we are to hold Government accountable and we need both rules, procedures and practices and expectations of vigorous questioning of policy consensus in every forum imaginable.

Chairman: I thank Professor Hardiman for her participation in the inquiry. It has been a very informative and a valuable meeting which has added to our understanding of the factors leading to the banking crisis. I think it should be noted that the appearance of Professor Hardiman is the first time a woman has come before the inquiry.

I propose that we suspend until 3.30 p.m., at which time we will meet Professor Honohan

Sitting suspended at 1.45 p.m. and resumed at 3.30 p.m.

Professor Patrick Honohan

Chairman: We will resume in public session. The Joint Committee of Inquiry into the Banking Crisis is now in public session for session 3, which is a public hearing with Professor Patrick Honohan to clarify oral evidence previously given to the committee.

I welcome Professor Honohan, Governor of the Central Bank, to this session. Following his appearance before the committee on 15 January to discuss the Honohan report, he subsequently wrote to the committee on 13 February to provide some additional information and clarifying some of his evidence. In the circumstances, the committee felt it appropriate to invite Professor Honohan back to discuss the issues raised in his correspondence. This letter is available on the banking inquiry website.

Before he begins, I wish to advise him 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 the committee. If he is directed by the Chairman to cease giving evidence on a particular matter and he continues to do so, he is entitled thereafter only to qualified privilege in respect of his evidence. He is directed that only evidence connected with the subject matter of these proceedings is to be given. As 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 Houses or an official by name or in such a way as to make him or her identifiable. Today's proceedings are specifically in regard to the Governor's correspondence to the committee. Other matters in regard to this inquiry that may be relevant to him will be dealt with at later stages. I invite Professor Honohan to make his opening remarks.

Professor Patrick Honohan: Thank you very much, a Chathaoirligh. In my letter of 12 February, I sought to clarify parts of my evidence to the inquiry on 15 January. I have prepared these short introductory remarks on the presumption that the inquiry has invited me back on this occasion to amplify my views on the alternative courses of action that might have been taken by the Government at the end of September 2008. Perhaps I should recall explicitly that I myself had no involvement in the guarantee decision, so my views are based on what I learnt from preparing my May 2010 Report on Regulatory and Financial Stability Policy, as well as on many conversations with other experts and on my general knowledge of banking crises in other countries.

I will start with a critique of the decisions of end-September 2008. There are several features of the decisions at end-September that can be criticised even allowing for the limited information then available to the decision makers. The first was the guaranteeing of some of the subordinated debt. Providing an explicit guarantee to subordinated debt holders is not only potentially costly to the State, but undermines the rationale for allowing banks to meet part of their regulatory capital with subordinated debt. This was a definite design flaw in my opinion. True, thanks to steps subsequently taken, the payout to subordinated debt holders of Anglo in the end was a small proportion of the total fiscal cost; however, that payout was not negligible.