Statement to the Oireachtas Committee of Inquiry into the Banking Crisis in Ireland

Elaine Byrne

In the invitation to appear before the committee I was asked to address:

- Narrative on how the property sector and banking sector interacted with government, elected representatives and the State during the period prior to the banking crisis in Ireland;
- Narrative on the nature of the relationships between the property sector, banking, government, elected representatives and the State;
- What, if any, controls or structures exist to regulate any such relationships;
- Whether being a small country is a factor, or not, in terms of any such relationships.

1. Historical Context – Culture of Deference Firmly Established before the Boom:

I will address these issues by focusing on political donations. At the heart of the four corruption Tribunals in Ireland over the past three decades (Hamilton, McCracken, Moriarty, Mahon) were serious concerns about how political action was funded. These Tribunals, particularly McCracken and Moriarty, exposed a deferential culture by regulatory authorities toward the banking sector between the 1970s and 1990s. It also identified a deferential culture by banks toward politics and vice versa. An absence of political will to enforce regulatory compliance was a recurring theme within the Tribunals. I will give just two examples of this.

1. Central Bank Inspectors examined the Guinness & Mahon (G&M) loan book in 1976 and 1978. The Inspectors expressed concern that 'Guinness & Mahon was facilitating a tax avoidance scheme... [which] was tantamount to facilitating tax evasion.'[1] The Central Banks Inspectors discovered that one of its own directors had a loan of IR£416,000 which was secured by an IR£230,000 offshore deposit in the Caymans. The response by the Central Bank was to trust a promise made by the (de facto) G&M chief executive who promised that the bank would wind down its loan business to Irish residents which was backed by offshore deposits. This promise was not kept.

   Twenty years later, the McCracken Tribunal discovered the consequences of this deference. Ansbacher was the largest incidence of tax evasion in the history of the state. Revenue subsequently yielded over €112 million in unpaid taxes and penalties from 200 Ansbacher accounts. This tax evasion was enabled by non-action by the Central Bank, Revenue Commissioners, company law regulators and prosecuting authorities. Although the *Finance Act, 1986* empowered Revenue to inspect non-residence declarations held by financial institutions, it did not do so, for instance.

2. Charles J. Haughey's indebtedness to AIB spiralled from IR£188,844 to IR£1,143,839 between 1975 and 1979. The Moriarty Tribunal noted that AIB

'exhibited a marked deference in its attitude' towards the leader of Fianna Fáil.[2] On his election as Taoiseach in December 1979, Mr Haughey's personal overdraft was seventy-seven times his IR£14,717 gross annual salary. Mr Haughey's financial advisor negotiated an IR£393,000 write down of the Taoiseach's debt. The Tribunal described this 'somewhat unorthodox' bank discount, which amounted to a third of Mr Haughey's overall arrears, as conferring 'a substantial benefit on Mr Haughey in circumstances referable to his political office' and as 'an indirect payment.'[3] Moreover, the Moriarty Tribunal estimated that Mr Haughey received at least IR£9,106,369 in donations between 1979 and 1996.[4] The McCracken and Moriarty Tribunals revealed a distinctive overlap between prominent financial donors of Mr Haughey and individuals within the banking and property sectors.

The purpose of these two brief history lessons from the Tribunals is to illustrate that a culture of deference between State authorities, political parties, elected representatives, supervisory authorities, banking institutions and the property sector was already well established by the 1990s. This culture of deference operated in a context where political parties and individual politicians were especially financially vulnerable.

2. Disclosed Political Donations to Political Individuals and Political Parties: 1997, 2002 and 2007 Elections:

What follows is a short explanation of political funding legislation as a means of describing the nature of the relationship between politics and the property and banking sectors. The purpose of which is to demonstrate that it is impossible to present a complete picture of how political parties financed their 1997, 2002 and 2007 election campaigns. Not all donations were legally required to be disclosed. The disclosed donations do nonetheless infer a pattern, as illustrated in the appendix.

The Electoral Act, 1997 was established in response to controversy arising from unorthodox political donations which came to public attention during the course of the Hamilton (Beef) Tribunal. It emerged that some political individuals and political parties were reliant on donations from the beef industry in the late 1980s and early 1990s. This relationship between the beef industry and politics created the public perception that a quid pro quo existed. In other words, that political donations facilitated policy decisions which benefited the beef sector.

The 1997 Act established new rules for the disclosure of political donations. For the first time in the history of the Irish State, political donations, over a certain limit, were required to be disclosed. The threshold for disclosure of donations to political individuals (including candidates to Dáil, Seanad, Presidential and European elections) was €634.87. The threshold for disclosure of donations to political parties was €5,078.95. There was no limit as to how much could be donated.

The Electoral (Amendment) Act, 2001 maintained the disclosure limits under the 1997 Act but introduced a limit as to how much could be donated. The threshold for disclosure of donations to political individuals remained at €634. However, donations must not exceed €2,539 in any given year by the same donor. The threshold for disclosure of donations to political parties remained at €5,078. However, donations must not exceed €6,349 in any given year by the same donor. Also of significance was the prohibition of foreign donations in circumstances where the donor was not an Irish citizen. *The Electoral Act, 1997* and the *Electoral (Amendment) Act, 2001* required that political individuals (including candidates) and political parties must submit an annual statement of donations and elections expenditure to the Standards in Public Office Commission. I complied this data from the Standards Commission to construct the three graphs in the appendix.[5]

2.1 Disclosed Donations to Political Individuals:

Figure 1 represents all disclosed donations to political individuals between 1997 and 2009. The period includes the 1997, 2002 and 2007 general elections. In doing so, it must be clearly acknowledged that this figure represents <u>disclosed donations</u> as opposed to <u>undisclosed donations</u>, i.e. donations under the €634.87 threshold. There are a number of observations that can be extrapolated from this data:

- Disclosed donations to political individuals significantly increased in election years.
- Fianna Fáil representatives attracted almost twice as many disclosed donations as all other parties combined during the 2002 and 2007 general elections.
- That Fianna Fáil candidates were the beneficiary of more disclosed donations than candidates from other parties is not surprising because proportionate to other parties, Fianna Fáil traditionally runs more candidates. Of the 466 candidates that ran in the 2002 election, 22 per cent were from Fianna Fáil. Nonetheless, during that election year, Fianna Fáil received two-thirds of all the funding disclosed which means that candidates from that party were in receipt of seven times more disclosed donations than a non-Fianna Fáil candidate.
- It is not possible to breakdown the sources of the disclosed donations (as is the case for party donations) as donations tend to be from individuals without reference to business addresses.
- Political individuals attract significantly more disclosed political donations than political parties, notwithstanding the 2001 amended rules which introduced a higher donation limit to political parties (€6,349) compared to political individuals (€2,539).
- Disclosed donations to political individuals in 2007 amounted to €855,995. Excluding subscriptions from the salaries of elected representatives to their parties, disclosed donations to political parties in 2007 amounted to just €43,693. It appears that it was more attractive to donate to political representatives than political parties.

2.3 Disclosed Donations to Political Parties:

Figure 2 represents all disclosed donations to political parties between 1997 and 2009. There are a number of observations that can be extrapolated from this data:

- Since the introduction of the *Electoral (Amendment) Act, 2001* – which introduced a limit on the value of donations to be disclosed – a pattern emerged whereby all political parties disclosed under the limit.
- The disclosed donations by all political parties amounted to €753,523 in 2001, the year before the 2002 election. In contrast, disclosed donations by all political parties amounted to €17,000 in 2006, the year before the 2007 election. These figures exclude politicians donating to their political parties.
- There appears to be a deliberate policy by political parties of soliciting donations below the disclosure thresholds. This is perhaps due to the relatively small difference in the maximum donation that can be accepted by a political party (€6,349) and the amount that must be disclosed (€5,078).
- Fine Gael returned a nil disclosure to the Standards Commission from 2001-09. Fianna Fáil, Fine Gael and Labour disclosed a zero return in disclosed donations for 2009, the year all three parties ran substantial local, European, by-election campaigns and a Lisbon Treaty referendum.

It is impossible to present a complete picture of how political parties were financed. Of the €10.1 million spent by parties and candidates in the 2007 general elections, €1.3 million was disclosed with no information available as to the origin of the remaining €8.8 million. The €10.1 figure does not encompass all that was spent at the 2007 election.

The legislation requires that election expenditure is only accountable for the period between the dissolution of the Dáil to polling day, usually three to five weeks. Electioneering prior to this period is not accounted for. Election campaigning for the 2007 election was well underway before May 2007. For instance, the pre-election statement of intent between Fine Gael and Labour, known as the "Mullingar Accord," was inaugurated in 2004 and accompanied by a billboard campaign.

2.3 Disclosed Donations to Fianna Fáil by Sector:

Figure 3 represents all disclosed donations to Fianna Fáil (excluding donations to political individuals) between 1997 and 2007. This amounted to €1,819,210. Eighty per cent of this figure was donated between 1997 and 2001. Subsequent to the 2001 Act, the maximum donation a party could receive was limited to €6,349. As already outlined, this is an incomplete picture of how Fianna Fáil was funded because there was no statutory obligation to disclose donations below the legal threshold of €5,078. Nonetheless, the figures do infer trends regarding the sources of political donations.

- **35 per cent (€635,970)** of Fianna Fáil's disclosed donations were from property and construction interests. Fianna Fáil received substantial donations in 1998 for the specific and stated purpose of campaigning on the 1998 Good Friday Agreement referendum. When these are excluded, disclosed donations from property and construction interests amount to 39 per cent (€545,818).[6] A list of property companies and developers who donated to Fianna Fáil can be accessed on the Standards Commission website.
- **20 per cent (€367,109)** were from business interests.
- **13 per cent (€245,801)** were from individuals.
- **9 per cent (€160, 239)** were from hotels and catering.
- **7 per cent (€122, 688)** were from the motor sector.
- **7 per cent (€126, 240)** were from the food and drink industry.
- **5 per cent (€90,190)** were from banks and financial services. This figure does not include donations by individuals who were donating in a personal capacity and who were associated with the banking sector.
- **4 per cent (€70,972)** were from professional services such as solicitors firms and auctioneers.

- **34 per cent (€89,162**) **of the Progressive Democrats** €262,241 disclosed donations came from the property sector.

It appears that the Property Barons of the 1990s and 2000s replaced the Beef Barons of the 1980s. The Opposition did not disclose any donations from property interests. Fine Gael disclosed €197,914 in donations between 1997 and 2000 from a variety of businesses and individuals but <u>did not disclose donations above the legal threshold from 2001-09.</u> Almost two thirds of the Labour party's €392,255 disclosed donations came from the trade union movement. Sinn Féin were in receipt of €1,299,608 in disclosed donations in this period – much of it from the salaries of elected representatives (North and South) and organisations such as "Friends of Sinn Féin Australia" and "Friends of Sinn Féin America."

3. Policy:

Irish legislation was criticised by the Council of Europe Group of States Against Corruption (GRECO) in 2009 for failing to account for 'behaviour of those persons who are close to power and who try to obtain advantages from their situation by influencing the decision-maker.'[7] Reliance on political donations from a particular sector may facilitate a perception of undue influence by donors over policy making. This undue, but not illegal, influence by vested interests over regulation and policy-making arises where elites have access to insider information, which they utilise, for their private benefit. This informal misuse of power occurs where personal relationships, patronage, lobbying, political favours and political donations unduly influence the decision-making process even if no laws are broken.

Did donors from the property sector have a vested interest in the formulation of policy? Was the decision-making capacity of political parties eroded by a conflict of interest? Were key political decisions insulated from critical debate because they were executed within a closed and cartelised system that facilitated regulatory capture?[8]

What did Honohan, Regling and Watson, Nyberg and Wright have to say?

The Honohan, Regling and Watson, Nyberg and Wright reports offered limited analysis into policymaking process outside of the financial sector. The Honohan report dedicated six paragraphs to tax incentives aimed at the construction sector. Regling and Watson briefly described the problems of policy analysis, design and implementation as "unusually severe," pointing in particular to weaknesses in tax policy. Nyberg had five paragraphs on "Advice on Economic Policy."

Honohan found that the 'significant factors contributing to the unsustainable structure of spending in the Irish economy, 'were due to the 'Government's procyclical fiscal policy stance, budgetary measures aimed at boosting the construction sector, and a relaxed approach to the growing reliance on construction-related and other insecure sources of tax revenue.'[9] Tax reliefs, incentives schemes and income tax exemptions for developers and investors included:

> multi-storey car parks, student accommodation, buildings used for third-level educational purposes, hotels and holiday camps, holiday cottages, rural and urban renewal, park-and-ride facilities, living over the shop, nursing homes, private hospitals and convalescent facilities, sports injury clinics and childcare facilities.[10]

Regling and Watson noted that such tax reliefs, 'directed to the property sector, often in particular regions of the country… contributed to a more general misallocation of resources as some of the tax concessions seem to have been granted on an ad-hoc basis in a not fully transparent way.'[11]

These incentives were not necessarily bad; they brought much needed investment to specific areas of the country. The problem was that they went on too long. As Wright has acknowledged in his testimony to the Banking Inquiry, these policies should have been "grandfathered" or ended earlier. Why were reliefs extended twice over the period of their implementation?

For instance, the *Finance Act, 1994* and Chapter 1, Part 9 of the *Taxes Consolidation Act, (TCA) 1997* provided for accelerated capital allowances for hotels. Although this special provision for hotels was terminated in Budget 2003, the *Finance Act, 2003* included transitional arrangements that allowed for the continued availability of 100 per cent write off over 7 years provided certain conditions were met. This arrangement was further extended in the Finance Acts 2004 and 2005. The *Finance Act, 2006* effectively extended the transitional period by introducing a phase-out period. A report by Peter Bacon for the Irish Hotels Federation has asserted 'the tax allowance scheme allowed hotels to access both equity and debt finance easier than would be the case otherwise…. the total value of tax allowance related to hotels that have not been open 7 years at end 2009 would be just over €1.5 billion.'[12]

Other incentives of note include the 2000-07 Special Incentive Tax Rate for developers. This sought to free up land for development by taxing proceeds from the sale of land at 20 per cent instead of the higher rate of up to 42 per cent. Moreover, in 2002, Part V of the *Planning and Development Act, 2000* was amended to allow developers to negotiate their way out of providing 20 per cent social and affordable housing in any development through a land swap, payment to the council or building equivalent social and affordable housing elsewhere.

It would be helpful if the Banking Inquiry considered the following:

- A list of the tax reliefs and incentives granted by the Government to developers and investors between 1997 and 2007.
- What was the cost of these reliefs and incentives?
- Why were these tax incentives extended beyond their natural life span?
- Did the structure of local government funding facilitate a financial dependency on development levies? Did this reliance on such levies (worth nearly €600 million in 2005 and €700 million in 2006) influence erroneous planning decisions?
- How many politicians, or their close associates, received interest-free loans or mortgages on favourable terms or loans received outside of normal lending practices?

4. Eight Reforms to Regulate such Relationships:

1. Independent audit of the capacity and operational ability of oversight agencies - CAB, ODCE, GBFI, Central Bank, Revenue, Competition Authority and other agencies charged with the prevention, detection, investigation and prosecution of white-collar crime. This approach was taken by the UK Attorney General. The 2008 De Grazia Review appraised the Serious Fraud Office (SFO) in relation to two US agencies: the US Attorney's Office for the Southern District of New York and the Manhattan District of Attorney's Office, two well-established bodies prosecuting serious and complex economic crime. The 34 recommendations focused on operations, capability, governance and external relationships;

2. Introduce monetary awards for whistleblowers. In the US, the *Dodd Frank Act, 2010* established the Office of the Whistleblower. The Act expanded powers first introduced under the *Sarbanes-Oxley Act, 2002*. The Securities and Exchange Commission is authorised by the US Congress to provide monetary awards ranging between 10 and 30 per cent of the money collected in cases where high-quality original whistleblower information leads to a Commission enforcement action of over $1 million in sanctions;

3. Introduce a register of liabilities. Australia, Finland, New Zealand, Poland, Spain and Canada require politicians to publicly disclose any debts they may have. Ireland only has a register of assets;

4. The Standards Commission Annual Report 2013 contains twenty recommendations on reforming the Ethics and Electoral Acts. I submitted an additional six recommendations on the Draft Guidelines on Party Finance in my submission to the Standards Commission in 2013;

5. Political parties to publish accounts under the Guidelines on Party Finance in advance of the 2016 general election. The delay by government in introducing these guidelines means that parties are not obliged to publish accounts under these new guidelines until after the 2016 election;

6. The establishment of an independent commission to decide how political activity in Ireland is funded. The principle that politicians should not regulate themselves is well established - political actors do not decide constituency boundaries. Ireland's rules on political funding disproportionately favours incumbents and political parties;

7. Introduction of a web-based centralised information platform to coordinate consultations with individuals, stakeholders and lobby groups. This would serve to report on input received on policy and detail how decisions were made. It would improve the openness and transparency of engagement in policy making by all actors. Stakeholder and lobbying interaction is recorded by Health Canada within the Consultation and Stakeholder Information Management System (CMIMS): http://www.hc-sc.gc.ca/home-accueil/rto-tor/index-eng.php

8. Stop blaming our small population or geographical size for bad governance.

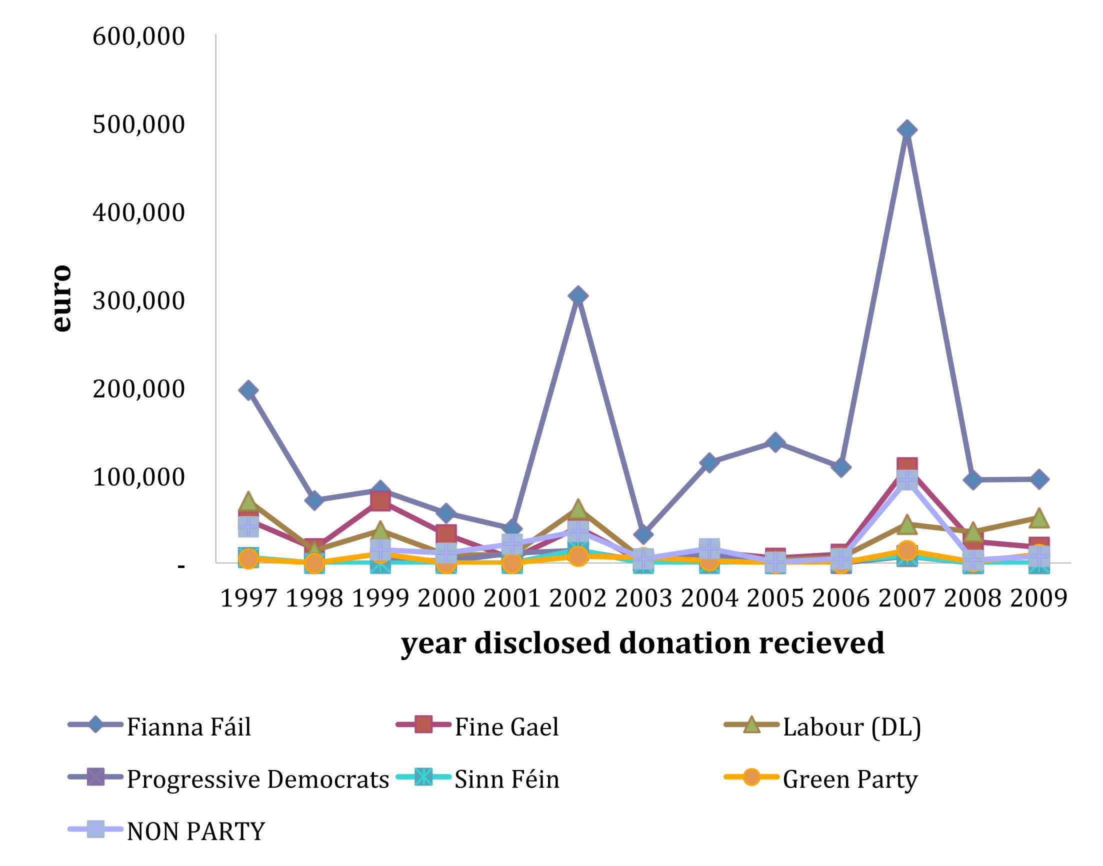
5. Whether being a small country is a factor, or not, in terms of any such relationships:

The population size of a country is not a determining factor in measuring governance effectiveness. Academic research shows that poor governance is correlated with the quality of institutions, lower levels of investment and growth, inequality, education, democratization, colonial heritage, religion and an absence of legislative controls. In Ireland's case, substantial levels of regulation combined with a high degree of state ownership enabled considerable political discretion.[13] These conditions were at the heart of the majority of governance scandals since the foundation of the state.

Table 1 ranks the governance score of seventeen selected countries in 2008. The Transparency International Corruption Perception Index (CPI) is a compilation of corruption scores which ranks countries from least corrupt (1) to most corrupt (166). The World Bank measures good governance using six different indicators. Four are presented here. The best possible rank for good governance is 100. Although Transparency International and the World Bank use different aggregation methods, they are highly correlated. The population size of the 17 countries is also provided. This is a crude exercise but it demonstrates that countries with a smaller or larger population size rank both higher and lower than Ireland in the good governance stakes. Indeed, the table suggests that countries with a smaller population tend to have better governance than countries with larger populations. "Being a small country" is a bogeyman argument – a lazy explanation - as to whether a country will have poor governance. Lots of small countries escaped the economic collapse unscathed. Lots of big countries did not.

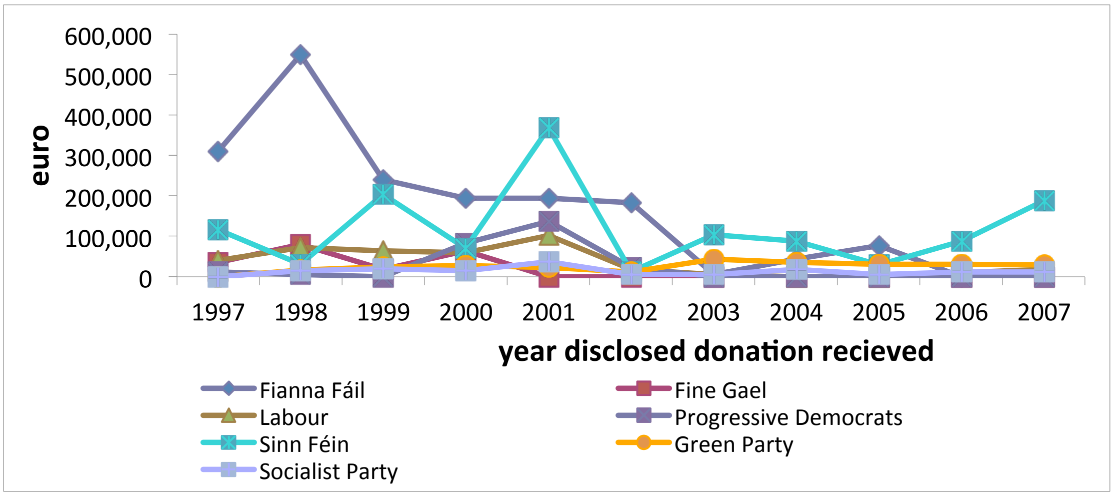
6. Appendix

Figure 1: Disclosed Donations by Political Individuals 1997-2009



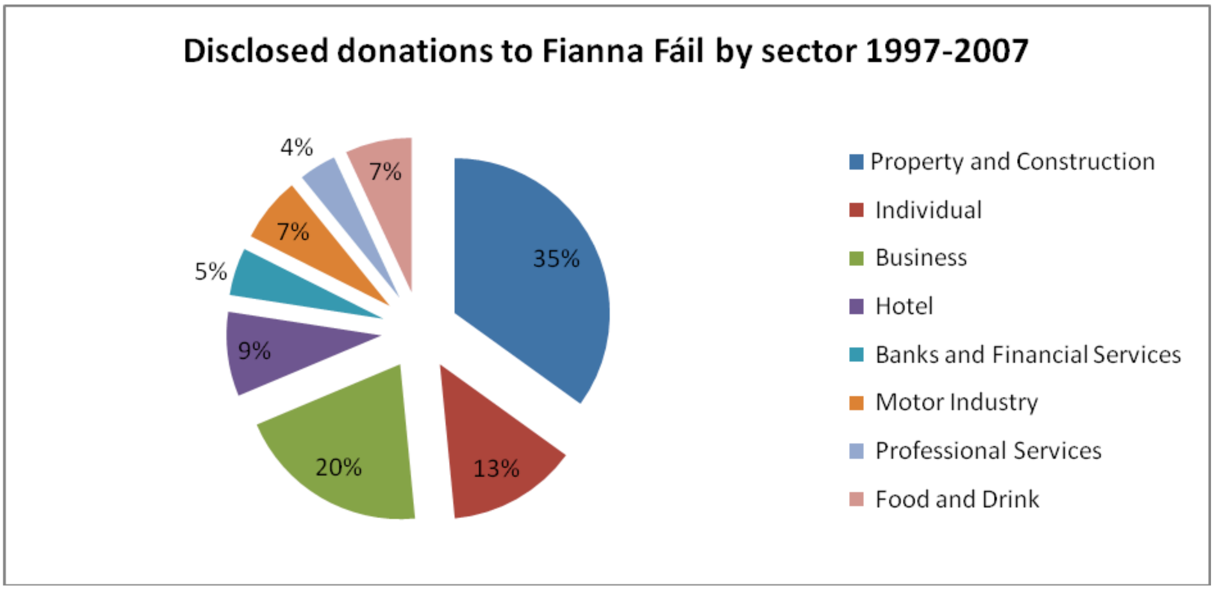
Source: Author's analyses from Public Offices Commission Annual Reports 1998-2001 and Standards in Public Office Commission Annual Reports 2002-10.
Notes: Total Figures rounded to the nearest euro. 1998-2000 figures converted from punt to euro. DL merged with Labour in 1999.

Figure 2: Disclosed Donations by Political Party 1997-2007



Source: Author's analyses from Public Offices Commission Annual Reports 1998-2001 and Standards in Public Offices Commission Annual Reports 2002-08.
Notes: Total Figures rounded to the nearest euro. 1998-2000 figures converted from punt to euro. Australian and US dollars also converted to euro. Converted on the first of January of the year of disclosure using currency converter: www.wolsink.com/currencyconv.php. Total figures exclude monies a) returned to donors and b) returned because monies exceeded disclosure limit. Labour figures include small number of Democratic Left (DL) donations. DL merged with Labour in 1999. Donations received during 1998 were given on foot of the Good Friday Peace Agreement outlined in endnotes.

Figure 3: Disclosed Donations to Fianna Fáil by Sector 1997-2007



Source: Author's analyses from Public Offices Commission Annual Reports 1998-2001 and Standards in Public Office Commission Annual Reports 2002-08.

Table 1: The Small Country Bogeyman Argument

Country	CPI Rank 2008	WB Control of Corruption Rank 2008	WB Rule of Law Rank 2008	WB Government Effectiveness Rank 2008	WB Voice and Accountability Rank 2008	Population size / million
Denmark	1	100	99.5	99.5	100	5.5
New Zealand	1	98.5	97	93.7	97	4.2
Sweden	1	97.6	98.5	98	98.5	9.2
Singapore	4	98	92.3	100	37	4.8
Finland	5	99	98	99	96.6	5.3
Switzerland	5	97	96.6	98.5	99	7.6
Germany	14	92.7	94.3	88.8	93.7	82.1
Norway	14	93.7	100	97	99.5	4.7
Ireland	**16**	**93.2**	**93.3**	**88.8**	**95.7**	**4.5**
United Kingdom	16	92.2	92.8	93.2	91.8	61.8
Belgium	18	86.9	89.4	87.9	93.3	10.7
Italy	55	64.6	63	64.5	81.2	58.8
Greece	57	61.1	75.5	71.8	73.5	11.1
Lithuania	58	60.2	70.7	72.8	71.6	3.1
Poland	58	67	65.9	67.5	74.5	38.1
Romania	70	55.3	53.8	45.6	62	20.5
Bulgaria	72	47	50.5	52.9	64.9	7.5

[1] Moriarty, Mr. Justice Michael, *The Moriarty Tribunal Report. Report of the Tribunal of Inquiry into Payments to Politicians and Related Matters. Part 1* (Dublin: Stationery Office, 2006), p.612.
[2] *Ibid*, p.550
[3] *Ibid,* pp. 29; 551.
[4] *Ibid,* 2006: pp. 544-5.
[5] E. Byrne, *Political Corruption in Ireland 1922-2010: A Crooked Harp?* (Manchester University Press, 2012).
[6] When donations for specific purpose of GFA are excluded: €545,818 from property; €220,406 from individuals; €166,490 from business; €84,055 from hotels; €90,190 from banks; €122,688 from motor industry; €70,972 from professional services; €81,800 from food and drink. TOTAL: €1,382,419
[7] GRECO, *Third Evaluation Round Evaluation Report on Ireland Transparency of Party Funding (Theme II)* (Strasbourg: Council of Europe, September 2009). Accessed on www.coe.int., p.16.
[8] F. Barry, *Politics and Economic Policymaking in Ireland* (Trinity College Dublin: working paper, October 2009).
[9] Honohan, P. *The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, A Report to the Minister for Finance by the Governor of the Central Bank* (Government Publications Office, 2010), p. 6.
[10] Honohan, p. 31.
[11] Klaus Regling and Max Watson, *A Preliminary Report on The Sources of Ireland's Banking Crisis* (Government Publications Office, 2010), p. 27.
[12] P. Bacon, *Over-Capacity in the Irish Hotel Industry and Required Elements of a Recovery Programme* (Irish Hotel Industry, November 2009), p. 39, 41.
[13] Byrne, *Political Corruption*.