Tithe an Oireachtais
Houses of the Oireachtas

Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Brian Cowen

02 July 2015

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[1] *See s.37 of the Houses of the Oireachtas (Inquiries, Privileges and Procedures) Act 2013*

STATEMENT OF BRIAN COWEN
Minister for Finance, 2004-2008

I was appointed Minister for Finance on 29 September 2004 and remained in this position until 7 May 2008, when I became An Taoiseach. In submitting this statement, I am adhering to the format outlined by the Inquiry and address each of the themes and lines of inquiry as contained in the Direction issued. My replies are as follows:

I. Effectiveness of ECOFIN and the Domestic Standing Group (DSG) (Central Bank, Financial Regulator and Department of Finance)

C1a. Inter-departmental contact and the Memorandum of Understanding (MOU) with other EU states on the issue of banking.

1. The Economic and Financial Affairs Council (ECOFIN) is responsible for economic policy, taxation issues and the regulation of financial services across all EU member states.

2. The DSG was set up following an EU Directive aimed at better coordinating any emerging financial situation at a national level through greater cooperation and coordination between the Central Bank, the Financial Regulator and the Department of Finance.

3. As Minister for Finance, I attended the monthly meetings of ECOFIN, accompanied by Department of Finance senior officials.

4. On the evening before each ECOFIN meeting there was a meeting of the EuroGroup. This was attended by Finance Ministers of the Member States in the Euro area, the relevant EU Commissioner and Mr Trichet from the ECB.

5. While the rules of the Stability and Growth Pact were reviewed during my time as Minister, the central rule remained that all Member States were to move towards a debt/GDP ratio of 60% and annual deficits not exceeding 3% of GDP. Throughout my time as Minister, Ireland comfortably met these central criteria.

6. Throughout this period, there was no indication of significant problems on the horizon until the autumn of 2007.

7. In 2007, issues started to emerge regarding the US subprime mortgage crisis whereby triple ‘A’ rated loans had been bundled by US banks and sold into the global banking system, including European banks. Doubts about the credit worthiness of these loans began to manifest itself in the markets. This had the effect of dramatically reducing liquidity within and between banks throughout the euro zone area.

8. It was the settled view that Irish banks had not purchased any of these toxic assets and did not therefore risk exposures on that front.

9. When these market trends emerged, the ECB triggered supplementary Long Term Refinancing Operations (LTROs). This mechanism was the ECB's primary policy response measure aimed at keeping liquidity in the system and was created as a direct response to the US subprime issue as it affected European banks. Up until this time there had been no problem with liquidity at all in the system. What had materialised is that the ECB found itself having to provide supplementary liquidity to the system where the markets previously provided same without any problem.

10. The DSG was monitoring and continued to analyse the liquidity issue right up until the crisis in September 2008. There was a view across the board that Ireland's banks were well capitalised and this view was shared with me as Minister for Finance throughout this period 2007- 2008.

11. During October and November 2007, there were further announcements by the ECB to extend and allocate more liquidity into the system. These measures by the ECB were reinforcing the view among policy makers in Ireland that the issue to be dealt with related to liquidity only.

12. In January 2008, the DSG prepared a scoping paper on financial stability issues, including the impact of Emergency Liquidity Assistance (ELA) on the confidence of a financial institution. They analysed the Northern Rock scenario whereby the announcement of the initial provision of ELA to the bank resulted in a run on bank deposits, culminating in a guarantee on deposits being provided by the Chancellor of the Exchequer.

13. It was clear that throughout this period the focus of the work of the DSG remained firmly on liquidity. Various contingency planning was undertaken by the DSG, covering both procedure and policy. That work was ongoing when I left the Department of Finance for the office of An Taoiseach in May 2008.

14. My understanding of the MoU (which was originally signed in 2003 with revisions in 2005 and June 2008) was that it was agreed that there would be greater cooperation between the ECB and domestic authorities including Central Banks, Financial Regulators and Departments of Finance across all 27 EU member states.

15. The DSG arranged for the operation of the MOU at a national level.

16. The evolution of the MOU was based on the desire to share information between authorities in different countries to enable the early detection of a crisis, guidelines for minimising cross border financial contagion between banks and other providers in the financial services sector.

17. National or institutional responsibilities did not change under the MoU.

18. Given the enormity of the financial crisis which emerged across Europe in September 2008 each Member State became focused on national stabilisation measures.

II. Role and effectiveness of the policy appraisal regime before and during the crash

C2b. Role of Advisors in analysing the crisis (to include crisis management options)

19. During my time as Minister for Finance, in particular from August 2007 onwards when the liquidity concern arose, DSG officials worked on issues arising. All analysis done by Government during this time was conducted by the DSG.

20. The work undertaken by the DSG during my time as Minister related to updating their existing arrangements for coordination and communication in the event of a bank getting into difficulty.

21. The DSG also considered the position regarding the availability of ELA from the Central Bank, if deemed necessary. In the Euro System this form of financial assistance may be used where a solvent but illiquid credit institution does not have sufficient collateral with the required characteristics for use in normal ECB lending operations.

22. The assistance can only be given by the national central bank on the basis of adequate alternative collateral and the associated credit risk is assumed by the national central bank and not the Euro system as a whole.

23. A Liquidity Group chaired by a Central Bank official was established in early 2008 to obtain and disseminate information on liquidity developments from the main credit institutions and to identify any potential problems.

24. At no point during my time as Minister was it thought by the authorities that any of the banks were facing imminent underlying solvency risks.

III. Effectiveness of the regulatory, supervisory and governmental regime structure

R1b. Effectiveness and appropriateness of the supervision policy and powers

25. In looking at the reports already done on the banking crisis, there is no evidence that the Financial Regulator did not have adequate powers to deal with the emerging situation if it had been analysed and identified properly at the time.

26. The reports referred to a deferential approach having been adopted with the lending institutions where processes were checked but outcomes and risks that the banks' behaviour was causing were not identified and corrected.

27. The Central Bank and the Financial Regulator's office had significant resources in dealing with the supervision and regulation of the lending institutions.

28. The Department of Finance's Banking Division was small and saw its role primarily as one of preparing and sponsoring any legislative changes that the Central Bank or Financial Regulator might seek.

29. The Department of Finance did not see its role as second guessing the work and assessments of the Central Bank and Financial Regulator's office who had specific day-to-day statutory responsibility in this area.

R1c. Appropriateness of the macroeconomic and prudential policy

<u>Macroeconomic Policy</u>

30. The budgets that I presented were built on what appeared to be conservative economic projections, targeting very modest deficits and an ongoing decline in the debt burden.

31. At the time, many of those assumptions proved to be overly conservative with the actual fiscal out turn being better than projected on budget day in a number of instances. Those outcomes were targeted at the same time that the Government was putting aside 1% of our national income every year for investment in the National Pension Reserve Fund (NPRF).

32. In my first budget, I targeted a general Government deficit of 0.8% of GDP; in my second, 0.6% of GDP; in my third budget, I targeted a general Government surplus of 1.2% of GDP and in my final budget, a deficit of 0.9% of GDP.

33. These were responsible fiscal targets at the time which appropriately balanced the resources at hand and the demands for better services and infrastructure.

34. As Minister, public investment was a major priority. This country had suffered from decades of underinvestment in our physical and social infrastructure and I was determined to use the resources at my disposal to put that right. Our rate of public investment at around 5% of GNP was approximately twice the European average. This was a correct level of public investment in my view as we sought to close the infrastructure deficit, to underpin competitiveness and to improve the lives of all citizens, young and old.

35. I also took the opportunity presented by our economic growth to transform the funding for services for the disabled, to support childcare, particularly in the early years, to improve the lives of our elderly citizens and to make the tax system fairer.

36. While the rate of growth in public expenditure was, with the benefit of hindsight, high, I do not recall that any public representative ever argued that I was providing too much for the old age pension, welfare payments, childcare supports or improved services. In fact, there were demands for greater spending coming from every sectional interest in the State, much of which could not be met.

37. I do regret that current spending growth was not lower during my time as Minister for Finance. However, even a slower, more modest rate of growth in spending on health, education and welfare would not have eliminated the need for the painful fiscal adjustments we saw from 2008. That adjustment was driven by the global financial crisis and the collapse in economic activity, a collapse which was more pronounced in our country because of the high level of construction activity taking place in Ireland at the time.

38. When I was Minister for Finance, I shared the positive view of our prospects which was held by all the main research and international agencies. But contrary to what some are now trying to suggest, I was concerned about the potential vulnerabilities and risks arising from the rapid escalation in property prices which was a recurring theme in risk assessments.

39. It has since been alleged that no action was taken by our Government to deal with these risks. This seems to be based on a view in some quarters it seems that I was in some way beholden to property market interests. This is simply not true. The facts are that prior to any signs of an emerging international crisis, there were four important actions taken to attempt to minimise the potential vulnerabilities in the banking sector related to the dependence on highly valued property.

40. The four actions taken were:

(i) The decision in December 2005 to abolish a very wide range of property based tax incentives.

(ii) The refusal by the Government to abolish or dramatically reduce stamp duty.

(iii) The decision of the Financial Regulator in early 2007 to increase the capital requirements on banks for speculative property lending from 100% to 150%.

(iv) The decision by the Government to allocate 1 per cent of GNP every year into a National Pensions Reserve Fund.

41. These key actions taken prior to the crisis were significant and reduced the risks and vulnerabilities of the Irish economy. Without these actions the crisis in the Irish economy would have been far worse.

42. The world changed forever in 2008 following the crisis in the international financial sector and the failure of Lehman Brothers. The resultant extent of the economic depression meant that the actions taken prior to the crisis were in no way adequate.

43. However without these actions being taken, the situation would have been considerably worse.

44. In order to refute the suggestion that no action was taken to minimise vulnerabilities, it is worth considering the significance at the time of each of the four main actions cited above. It is important to reflect on some of the opposition to these actions which if heeded, would have left Ireland in a more detrimental position.

Abolition of Property Based Tax Incentives

45. As Minister for Finance, I was concerned about the Irish property market and the cost and role of related tax incentives. In my first Budget in December 2004, I decided to direct the Department of Finance and the Revenue Commissioners to undertake a full review of all property based tax incentives. I also highlighted my preference for a complete and comprehensive reform of the system rather than a piecemeal approach. Outside Consultants were also employed to work on this exercise. I made it clear that I would take appropriate action in the 2006 Budget.

46. In presenting the 2006 Budget in December 2005, I decided to immediately restrict the ability of the use of property based tax incentives by those on high incomes. I introduced for the first time in the Finance Bill a measure to ensure that such taxpayers were no longer able to use property tax incentives or other measures to reduce their tax bill in any year below a certain level. In Budget 2006, I also decided to undertake a fundamental dismantling of the property-based and area-based tax incentives which had developed over 20 years.

47. I did this because I was concerned that these incentives were contributing to an overvaluation of property with resultant vulnerabilities. This decision did not gain favour with many interested parties in the property market. It also represented a decisive policy shift because over a long period, successive governments had added more new property incentives rather than engage in wholesale abolition of existing incentives.

48. Those who suggest I did nothing to curb the property spiral specifically ignore the fact that in presenting my 2006 Budget, I announced the most radical abolition of property based tax incentives made by any recent Minister for Finance.

49. In particular I announced the discontinuation of the following property based tax incentives:

Abolition of Urban Renewal Scheme
Abolition of Rural Renewal Scheme
Abolition of Tourism Renewal Scheme
Abolition of Special Property based relief for hotels
Abolition of Property reliefs for holiday cottages
Abolition of Property relief for student accommodation
Ending of relief for multi-storey car parks
Abolition of reliefs for third-level educational buildings
Abolition of sports injury clinics property incentives
Abolition of reliefs for property developments associated with park and ride facilities.

50. The property based incentives for the general rental refurbishment scheme were also abolished. Similarly, the tax relief which was available for interest on loans taken out to acquire an interest in property rental companies was abolished for all new loans taken out after 7 December 2005.

51. I took these and other measures to reduce the vulnerabilities of the Irish economy to the escalation in property prices, to secure a greater return for the exchequer, to enhance equity and to do so in a way that reflected the fact that there were over 250,000 jobs in the sector. I took these measures to reduce the vulnerabilities arising from the dependence on the property sector.

52. Transitional arrangements were put in place for projects that were at that stage up and running or being completed. No new projects were eligible under any of those schemes from the date I announced their abolition in December 2005.

53. Both sets of external consultants dealt with the transitional issue and both recommended an extension of relief for such pipeline cases. One recommended a simple extension of 100 per cent relief for 17 months beyond 31 July 2006. The other recommended an extension of 5 years but at only 50 per cent relief.

54. I chose a middle course, which was decided upon with my officials. For pipeline cases, we only allowed 100 per cent relief if completed before the end of December 2006. Thereafter where 15 per cent of the relevant expenditure cost was incurred by that date, July 2006, the relief applied to only 75 per cent of the expenditure incurred in 2007, and to 50 per cent for expenditure incurred up to the end of July 2008, when no relief would apply beyond that date and would thus end.

55. A further protection before any future proposal of this type could be brought forward was the provision that a cost benefit analysis showing the economic benefit that would accrue from any such introduction and that there would be an automatic 3 year review after it became law.

56. If such a provision had been in place when this type of tax relief was first introduced in 1985, the achievement of the economic objectives for which the schemes were initially devised could have become apparent much sooner. In any event, in hindsight, these schemes could have been terminated much earlier.

Resistance to Calls to Abolish Stamp Duty

57. In late 2006 and up to the General Election in June 2007, I was also the subject of sustained criticism for my decision as Minister for Finance to resist widespread demands to abolish or dramatically reduce stamp duty on property.

58. At that time, I accepted that the levels of stamp duty in Ireland were among the highest in the world and that this meant real consequences for people buying houses. While I agreed that some adjustments were appropriate, I realised that the high levels of stamp duty were a break on the escalation of property prices and acted as a disincentive to greater property speculation.

59. I felt that calls for the abolition or serious reduction of stamp duty were simply irresponsible in a context of rapid property price growth. I therefore strongly resisted such demands.

60. There is no doubt abolishing/reducing stamp duty at that time would have been politically popular. But it also would have increased the vulnerabilities of the banking system and the Irish economy to overvalued property. I therefore refused to go down this route. I was subject to much criticism for this. It is hardly surprising today that the cheerleaders for the abolition of stamp duty, or its radical reduction, are now silent on what would have been the impact on property prices or the resultant impact on the scale of banking crisis had I heeded their calls.

Increase in Capital Requirements on Speculative Property

61. The decision of the Financial Regulator at the start of 2007 to increase the capital requirements on banks for speculative property lending to 150% from 100% was a decision which I strongly supported. I accepted that this brought the capital requirements on Irish banks for speculative property lending to one of the highest in the developed countries but I believed it was totally appropriate given the vulnerabilities of Irish banks to property prices.

62. This was taken at a time when international agencies and others were still benign on the prospects for the Irish banks. We now know that given what happened since, this action should have been taken at the start of the period of lending growth by banks but it was a significant initiative.

Allocation of 1% of GNP to National Pension Reserve Fund

63. The final action taken to reduce vulnerabilities of the Irish economy was to allocate 1% of GNP every year into a National Pension Fund. This was despite calls from the political opposition from time to time to use that fund for more capital expenditure in Ireland. This would have increased further the Government spend into the economy.

64. The tax revenues from the economic growth were used to engage in unprecedented capital investment to provide key infrastructure such as roads, public transport projects, schools, third-level research facilities, energy and communications. This infrastructure has greatly increased our productive capacity and will be essential in returning the economy to a sustainable growth rate as global conditions improve.

65. The economy was operating at or close to its potential over this period. During this time, the economy was enjoying conditions of full employment with an unemployment rate at 4.5%. With full employment, the labour market got much tighter which reflected in further price and wage pressures and inevitably a loss in competitiveness.

66. Large public investment in infrastructure to deal with development bottlenecks arising as a result of the economy being at full tilt could not totally compensate for that, certainly within the same period. In my view, this investment was necessary and appropriate to continue to expand the productive capacity of a growing economy.

67. While headline indicators suggested that fiscal policy was on an appropriate track over the period, more attention could have been paid to the underlying fiscal position and stance which was pro-cyclical. However it must be acknowledged that few independent observers of the policy making process – either domestic or external – highlighted this as a major concern.

68. There was a failure to adopt policy to reflect the realities of membership of the euro. With monetary policy conditions set with regard to euro area conditions as a whole and the exchange rate no longer available as a macroeconomic adjustment tool, fiscal and other policies (e.g. incomes) needed to play a greater role in macroeconomic stabilisation and adjustment. However such conditions do not appear to have received adequate attention over the period 2000 to 2006.

69. Opposition parties criticised Government during growth years for spending too little. Their new revised criticism, to fit changed times and circumstances, is that during these years we actually spent too much. Yet the facts are we recorded budget surpluses in 10 of the 11 budgets up to when I left office as Finance Minister. We used the period of sustained economic growth to more than halve the General Government Debt as a percentage of GDP, from 64% in 1997 to 25% in 2008. If the assets of the National Pension Reserve Fund are taken into account, the net debt position at the time I finished being Minister for Finance was about 14% of GDP. This undoubtedly slowed the Irish economy from the rate which would have applied if an additional percent of GNP each year was allocated for more spend at the time. This subsequently gave the Government vital headroom to borrow to help us through the crisis when large deficits had to be funded even after serious annual adjustments were made to start closing the gap that then emerged between expenditure and revenue.

Prudential Policy

70. The role of the Department of Finance was to promote financial stability by developing financial services legislation where required which was implemented by the Central Bank and the Financial Regulator. The former was charged with formulating macro prudential policy with the latter managing micro prudential policy with individual financial institutions.

71. The entire regulatory system under the guidance of the Central Bank and the Financial Regulator was established on the continuing principle of being independent of the Department of Finance. All of the quarterly reports prepared by the Central Bank were independent. The Financial Stability Reports were drawn up by the Central Bank in consultation with the Financial Regulator. Briefings were provided to me as Minister based on these findings. I had and was given no reason to doubt the economic and financial stability projections contained in these.

72. By summer 2007, the Central Bank’s report noted that growth in credit had started to abate as did house prices. This was viewed as being evidence of an incremental steadying of the market.

73. The establishment of the DSG no doubt assisted in bringing the Central Bank, Financial Regulator and the Department of Finance closer together is terms of improved coordination and monitoring of the developing liquidity situation.

74. Throughout 2007 and up to the summer of 2008, third party domestic and international independent economic reports suggested a slight slowdown in economic activity. The analysis from the Central Bank was that there would be a soft landing regarding the property market.

75. I agree with the conclusions of the Regling and Watson Report which stated that banking practices, governance failings and financial supervision seriously exacerbated Ireland’s credit and property boom which left the economy vulnerable to a deep crisis and depleted its fiscal and banking buffers when the crisis struck.

76. I believe that had there been more robust, independent work and scenario planning undertaken by both the Central Bank and the Financial Regulator regarding the banking system, this would have informed the silently evolving risk scenario and enabled the Central Bank, the Financial Regulator and the Department of Finance to develop timely, strategic interventionist policies and strategies.

77. There was a lack of analysis by both the Central Bank and Financial Regulator in challenging the over concentration of risk in property. The emphasis seemed to have been more on the residential housing market than on the commercial property sector and that was a mistake.

78. There was clearly a culture of deference in operation between the Financial Regulator and the financial institutions it was regulating.

79. I agree with the findings of the Nyberg Report which asserts that the policy apparatus was complacent. As Minister, I should also have been more doubting, more questioning by challenging the broad consensus of opinion that had developed on these matters.

80. There is no doubt that while international factors were a critical component in the crisis, it would be wrong not to accept that the crisis was made worse for Ireland because of internal factors.

81. There were vulnerabilities built up within the banks: property prices were overvalued and there had been a gradual loss of competitiveness in the Irish economy.

82. These domestic vulnerabilities interacted with the global crisis and that lead to the protracted downturn. I believe that if the unprecedented global financial collapse had not happened, there would have been a softer landing for the Irish economy but the overvaluation of properties and related vulnerabilities within banks put Ireland in a weaker position when we had to face the global crisis. I accept that ongoing actions would have been required to address these vulnerabilities even in the absence of the global crisis.

83. The views on the prospects for the Irish economy in 2007 from the OECD, European Union, IMF, Moodys, ESRI and many other commentators were positive. The Central Bank produced a financial stability report for 2007 which stated that “notwithstanding the international financial market turbulence, the Irish banking system continues to be well placed to withstand adverse economic and sectoral developments in the short to medium term”.

84. The advice at the time was that the balance of evidence suggested that the banks had sufficient capital to absorb the likely losses but that there were vulnerabilities and risks. With hindsight this proved to be fundamentally wrong. However those were the views expressed at the time. We know now that grave mistakes were made in the judgment of the capital adequacy of the Irish banks and the assessment of future loan losses. It is, however, important to note that no one in the independent authorities ever advised the Government that the capital adequacy was not sufficient or that higher capital adequacy ratios should be imposed.

85. I believe the key factors which are relevant regarding the mistakes made in the lead up to the banking crisis were:

(i) Fundamental errors were made within the management of individual banks which led to excessive risk taking. As Professor Honohan stated, the primary responsibility for the crisis in the banks rests with the institutions themselves and the lending practices they pursued in the search to maintain or increase market share.

(ii) Banks became too dependent on wholesale funding. As a result, when the international credit market unexpectedly froze, the banks were vulnerable and in need of Government guarantees.

(iii) Inadequate financial regulatory controls were implemented in Ireland and in other international economies based on a mistaken view of governance within banks.

(iv) There were property tax incentives in place over the period from the mid-1990s which, with the benefit of hindsight now, should have been terminated many years prior to my decision in December 2005 to abolish these incentives.

(v) Individuals were left in dominant positions within individual financial institutions for too long a period. There were stunning failures of corporate governance and not enough turn-around in management personnel in those institutions.

(vi) There was a failure to impose international stability risk assessments and protection systems which took account of the interaction of global financial systems. This was not a peculiarly Irish problem.

(vii) There was a failure to implement more intensive compliance regulation of those financial institutions which were too big to fail. I believe that auditors, regulators and Government all share part of this responsibility.

(viii) The higher capital requirements on speculative property loans in Irish banks which were introduced at the start of 2007 should have been imposed many years earlier.

86. These lessons have now been fully taken on board and policies implemented to ensure that a banking crisis can never happen again in Ireland. While Government shares responsibility for its role in these mistakes, it is noteworthy that many of the strongest critics of the Government were silent on these issues prior to the crisis and indeed were proposing measures such as the radical reduction or abolition of stamp duty which would have made the position much worse.

IV. Effectiveness of the supervisory practice (Central Bank, Financial Regulator and Department of Finance)

R2c. Adequacy of the assessment and communication of both solvency and liquidity risks in the banking institutions and banking sector

87. When we joined the euro, Irish banks got access to a new source of wholesale funding at low rates of interest and with no exchange risk. Integrating the Irish financial system within the Euro area was always viewed as positive.

88. The more integration that took place, including financial integration, the better it was deemed to be for us. The question of access to this liquidity being cut off completely was never seen as a realistic prospect in any foreseeable circumstances.

89. When problems with liquidity arose, being part of the Euro system and having access to ECB policy responses was again seen as a strength for Ireland.

90. Regarding solvency of the banks, the message from the authorities was that the banking system was adequately capitalised given their level of profitability, they appeared to be in good financial health.

91. While concerns were expressed when overall financial stability was being assessed, there was no suggestion that downside risks would transform into such a critical situation for Ireland.

92. The external surveillance mechanisms, including the OCED, IMF and European Union, together with the ESRI, were forecasting a continuation of strong economic growth in Ireland compared to our EU counterparts. Credit rating agencies looked favourably on Irish banks.

93. During my time as Minister for Finance, there was no consensus that we were heading for what ultimately happened.

94. It cannot be said that the supervisory practice was effective since the analysis concentrated on liquidity being the problem without adequately preparing for a situation where the whole financial system was at risk.

95. The change which saw the banks accessing increasing amounts of wholesale funding did not prompt a review by the authorities as to what wider effects a property downturn would have on the capital adequacy of the banks and there was insufficient first hand evidence available about the deterioration in the banks' risk management policies.

96. Worst case scenarios were not worked out because of the general regulatory approach which relied too heavily on trusting the governance mechanisms within the banks themselves.

V. Clarity and effectiveness of the nexus of institutional roles and relationships

R3a. Awareness and clarity of roles and accountability amongst the regulatory and supervisory institutions of the state

R3b. Nature and appropriateness of the relationship between the Central Bank (including the Financial Regulator), Department of Finance and the banking institutions

R3c. Effectiveness of the communication between the Central Bank and Department of Finance

97. The Central Bank was responsible for overall financial stability assessment. The Financial Regulator was responsible for day-to-day supervision of the lending institutions themselves.

98. I was aware that when financial stability reports were being compiled, that the Central Bank and the Financial Regulator interacted on that exercise.

99. The Central Bank issued quarterly bulletins and financial stability reports to the Department of Finance. The Governor would call to update me, usually around the time of quarterly bulletins being issued, and before Budget time when he would also formally issue a pre-Budget letter setting out the overall stance of the Central Bank on the economic and budgetary situation.

100. There was contact between the Financial Regulator and the Department of Finance at official level as one would expect. During my tenure as Minister, I met with the Chairman of IFSRA in the Department on three occasions to discuss IFSRA business at the time.

101. The Governor would make a personal call to meet the Minister in the Department from time to time, five or six times a year. The Governor would have been with the Secretary General of the Department before meeting me, while the meetings were informal, the Governor would communicate his overall assessment of the economy and the Central Bank's written assessments on the economy at the time. In overall terms, the briefings were broadly positive.

VI. Appropriateness and effective utilisation of the expert advice

R4a. Appropriateness of the expert advice sought, quality of analysis of the advice and how effectively this advice was used.

102. The expert advice received in the normal course of events from a range of multilateral institutions over the years including the OECD, European Commission and IMF, were in overall terms positively disposed towards Ireland's economic and financial situation

103. The question of expert advice being obtained beyond what the DSG was considering itself took place after my time as Minister and during my time as Taoiseach.

R4c. Analysis and consideration of the response to contrarian views (internal and external)

104. I was not aware of contrarian views within the Department of Finance which differed in substance from the Department's overall assessment.

105. Regarding external contrarian views, the most notable was a research paper by Professor Morgan Kelly of UCD which was published by the ESRI when it launched the ESRI Summer Quarterly Economic Commentary Review of the Irish economy in July 2007.

106. In an interview on publication of the review, ESRI economist, Dr Alan Barrett made it clear that the ESRI did not share Professor Kelly's prognosis that house prices in Ireland over the following 8 years could drop between 40% and 60% in value.

107. Whilst the ESRI thought that house prices were overvalued by 15%-20%, it did not believe there was going to be a sharp fall in house prices. It was forecasting a house price decrease of 3% for 2007 with it stabilising the following year. The ESRI view was that economic growth would be 4.9% in 2007 moderating to 3.7% in 2008, a growth rate which they said was consistent with a degree in stability in house prices in 2008.

108. The main stream view remained amongst most commentators that house price increases had been underpinned by many factors including a strong economy, increases in employment and earnings, reductions in taxation and lower interest rates resulting from participation in monetary union.

109. Professor Kelly's more pessimistic view proved to be more accurate as we now know although in his paper he saw the main macroeconomic effect of this as being higher unemployment due to reduced house building activity as prices fell over the period in question. He states in the paper that he remained of the view that Irish banks were well capitalised at the time.

VII. Clarity and effectiveness of the Government and Oireachtas oversight and role

R5a. Effectiveness of the Oireachtas in scrutinising public policy on the banking sector and the economy

110. Throughout my period as Minister for Finance, the critique from the political opposition was that we were not addressing economic issues quickly enough. There were constant demands for more spending. Practically all economic private members motions which allowed the opposition debate issues of their choice in the Dáil, involved demands for more public spending in the areas of health, education, transport etc.

111. On other occasions the opposition was calling for more money to be returned to taxpayers.

112. They were predicting continued economic growth and were proposing looser fiscal policies than Government during the 2007 General Election Campaign.

113. Very few parliamentary questions were put down on banking issues generally let alone suggestions that the banking system and the economy were facing ruin. There were parliamentary questions on subprime lending which was a very small part of the overall Irish residential mortgage market. The capital adequacy or otherwise of banks was not to my knowledge ever raised as a priority issue.

114. I was in favour of improving opportunities for better Dáil oversight of the annual budgetary process as Minister for Finance.

115. I introduced new arrangements whereby from January 2006, I met with the Committee on Finance and the Public Service to discuss the economic and fiscal background to the 2006 and the two subsequent budgets .The following autumn, the Department of Finance would update these three year economic and fiscal projections and publish them in place of the then existing Economic Review and Outlook, which dealt with only the current year up to that time.

116. From 2007, individual Ministers would publish an Annual Statement on the outputs and objectives of their Departments, and from 2008 the actual out turns. These Statements were then presented to the relevant Oireachtas Committee along with the Department's Annual Estimates.

117. After these individual examinations, the Oireachtas Committee on Finance and the Public Service would co-ordinate the preparation of a Report to the Dáil on the outcome of these deliberations. I instituted those changes to meet the desire on all sides of the House for better debate, better scrutiny and better results from the raising of tax and the spending of public money in the State.

118. This laid the groundwork for a new unified Budget procedure for Budget day 2008, which was presented to the Dáil on 5th December 2007. All policy initiatives involving an increase in public spending beyond the 'existing level of service'(ELS) figures, together with Social Welfare increases and tax changes were all dealt with on Budget day.

119. The Pre-Budget Outlook (PBO) set out the ELS figures in October before the Budget, and also the economic and fiscal outlook for the following three years. I was responding to the Dáil Public Accounts Committee that asked for a clear distinction between the pre-Budget and post- Budget allocations in its October 2005 Report on Estimates Reform.

120. From time from time I also went before the Oireachtas Committee on Finance to discuss current economic matters and hear Members' views in a question and answer format.

R5b. Appropriateness of the advice from the Department of Finance to Government and the use thereof by Government

121. During my time at the Department of Finance, there was a recognition that keeping tax levels low generated economic growth which in turn produced tax revenues to fund public expenditure. Despite the obvious and international risks, the outlook was broadly positive and budgetary strategy allowed for significant policy initiatives.

122. The Department were advising that spending growth should not exceed growth in revenues. There was room for substantial sustained infrastructural investment consistent with projected levels of economic growth but at the same time keeping the burden of taxation and debt at reasonable levels. The Department was expressing caution regarding the economy and the need to keep the budget balanced at a level which could cope with any slowdown in growth that may occur over the period ahead at that time.

123. Department views, with Ministerial sign off, were submitted to Cabinet in the annual June memo on budget strategy. After Cabinet discussion on it, and subsequent bilateral discussions on the departmental estimates, spending and tax relief outlined in December budgets were above that advocated in June.

R5c. Analysis of the key drivers for budget policy

124. Programmes for Government and the social partnership processes which included spending and tax expenditure commitments were drivers of Government policy.

125. The enlargement of the EU in 2004 led to increased net immigration significantly to Ireland in the following years. At the same time our own population was also increasing. This required expansion of day-to-day public services and capital investment needs in housing, education and transport.

126. All this left us more vulnerable than would otherwise be the case to deal with the current economic challenges.

127. However there was a limited amount of formal analysis and advice on fiscal risks outside of the June memo to Cabinet.

R5d. Appropriateness of the relationships between Government, the Oireachtas, the banking sector and the property sector

128. The relationship of the Department of Finance with the banking sector and the property sector was primarily through their federations: the Irish Banking Federation (IBF) and the Construction Industry Federation (CIF).

129. Individual banks dealt with the Department through contact with the relevant officials. My own interaction with banks was seldom and infrequent.

130. Every year the Minister for Finance would receive many pre-budget submissions in writing from economic and social actors including the IBF and CIF. The main groups would be met every year by the Minister for Finance at meetings attended by officials where oral presentations would amplify the written submissions put forward.

131. The incumbent Minister for Finance would always be a guest speaker at IBF annual dinners or an industry awards ceremony.

132. In my time as Minister for Finance, I regarded my relationships with these two sectors as being appropriate. Their access to the Department was in no way different from how other organisations of economic importance were dealt with.

Brian Cowen
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