Statement of John Moran, Secretary General (2012-2014)

Dear Members of the Committee

I joined the Central Bank only in July 2010 to restore credibility to Ireland's supervision of wholesale banks, becoming more centrally involved only in 2011 when appointed Head of Banking Policy and Restructuring and later (2012) Secretary General of the Department. For that reason, I confine my observations to matters arising after 2010.

I have been directed to make a written submission on nearly 20 diverse topics of inquiry. It would not have been possible given the restrictive word count to do justice to each. So, rather than provide short (and probably not so instructive) text for each topic, I have taken the liberty to make more general observations pertinent to the range of items.

My observations are presented under the following headings:-

- Ireland's crisis was not just a banking problem but very much a fiscal one
- Burning the bond-holders - not the silver bullet solution
- The civil service and the political process
- The Department's relationships with the NTMA and the Central Bank
- Other changes made in the Department during my three years there.

A Our crisis was not just a banking problem but very much a fiscal one

Some people like watching thriller TV programmes or movies, accustomed to plots with high-suspense and goodies or baddies. They might wish for the drama of Ireland's economic collapse to be couched in terms of irresponsible over-paid bankers, reckless developers, the night of the bank guarantee, and the burning of these faceless bondholders. It makes good TV as they say!

A simplistic rhetoric has therefore been entertained that if we had not had a collapse of Lehman Brothers and the Irish banks and had burned the bondholders, we would have had no issues.

True, our property price collapse led to awful widespread destruction of personal wealth and unemployment.

But the sad reality is that an acute lack of fiscal capacity at Governmental level removed flexibility in easing the impact of those problems. The fiscal rectitude we are experiencing since, was a necessary result of the terrible and perilous structure of Ireland's fiscal profit and loss (or if you like taxes and spending). That P&L collapsed causing recurring deficits to be painfully funded by piling yet more debt onto the back of future generations. As we come out of this crisis, this debt will end up being be more than twice the net debt expected from the bailout of the banks.

This all should not be forgotten.

Annual current spending (sadly, recurring) and reductions (again, recurring) in the annual taxation burden had been set at levels out of all appropriate relationship with the quantum of sustainable revenues of the state in the early years of the 21st Century.

Budgetary spending decisions had been funded in the years leading up to the crisis from what were very fragile revenue sources, built on the quicksand of an economic performance overly concentrated on one over-blown sector - property. The country was then building perhaps 50,000-60,000 houses surplus to its medium term annual requirement. Spending had been increased assuming that this excess activity was not just justified at that time, but worse, would continue into the future. No one was planning for what might happen to stamp duty, PAYE revenues and social welfare payments or even to spending or wages in the economy and people's standards of living if construction were to resize to 25,000 units of output, a more sustainable quantum – even if we had managed a soft landing on property prices.

Second order impacts arising from excessive public sector wage levels and unsustainable property prices had also in turn led to excessive wage demands in the private sector and excessive costs in the real economy. Even parts of the economy which should have been doing well in a then growing global economy were in fact losing market share and had become uncompetitive.

It is true that it is important to understand why the government, the civil service, the regulator or even the banks themselves had not done more to restrict the excessive growth of the property market and prevent the dramatic collapse of the economy and the banks.

It is important to know why and how the government took decisions around the bank collapse which added further pressure on the State's funding capacity.

But I believe it is equally important, and perhaps even more important, that we understand for future proofing our state what was it in the structure, operation, and DNA of the organs of our state, the political system, the civil service, the broader public sector that allowed this precarious fiscal situation to develop. Looking at decision processes related to the collapse of the banks will be informative for that more general question too.

Had we not had to fund large fiscal deficits for 2010 and for the foreseeable future thereafter, the State's negotiating power either with the international markets or indeed with the European and IMF backstop funders would have been very different. It might have helped to avoid being shut out of markets and to have avoided a troika bailout entirely.

But that was not to be. A situation had been allowed to develop in the years running up to the crisis such that, without external funding from some source, the lights would have had to be turned out, not just in the banks who should have been able to rely anyway on the support of the ECB as liquidity provider of last resort, but in the public services of the country. This scenario is being re-enacted by Greece as I write this submission.

Why had we not structured our tax system more sustainably? Why had non-recurring stamp duty not been sensibly converted into annuity tax revenues like property tax or water charges? Why had unusually high stamp duties and PAYE taxes from an overblown property sector not been put into a rainy day fund for unemployment payments when things would not be so rosy? Why were the windfall gains spent to throw oil on the fire itself?

Had these alternative routes been taken, how much less painful might the last couple of years have been when the rug was taken out from under our fragile structure by the rapid withdrawal of international wholesale funding in 2008?

Where was the debate recommending these alternatives, which might not have been so politically popular? How did the decisions get made? Why did no political party manifesto contain proposals for the introduction of property taxes, charges for the consumption of water, more appropriate burdens of sustainable taxes to pay for necessary public services, the reductions of public sector pay back to long term sustainable levels? And when we say the Irish public were blameless, ask would we have voted for such a Government in the 2007 election?

These type of questions could form a helpful backdrop to the inquiry's assessment of the robustness of our governance structures, looking forward.

B Burning Bondholders – not a Silver Bullet Solution

There are many reasons to justify why senior and not just junior creditors might have borne more of the cost of the collapse witnessed in the Irish economy and banking system. There are others which justify the longer game plan of keeping the EU and IMF authorities on side supporting the recovery.

But in rushing to over emphasis the import of this decision, let's not lose sight of a simple fact much over-looked in ill-founded public debate.

Producing a 3 billion reduction of current deficits (otherwise required to be funded by yet more annual borrowings) requires austerity measures with repeating annual impact. The reduction is not avoided by a once off decision to not repay say 3 billion to Anglo senior bondholders. Also, that decision does not generate cash income to pay excessive government expenditure as would by comparison a 3 billion dividend from Bord Gais. The decision just means our loss would be 3 billion less in the future. Not paying it would simply have meant we would have had 3 billion of borrowing not 6 billion in that first year. As the deficit continued, we would still have had additional new borrowings of 3 billion each year thereafter.

Indeed, a very unfortunate coincidence of numbers helped fuel the ill-founded public debate since the amount to be repaid on the promissory note was almost equal to the amount of the recurring saving needed to be achieved for that year's budget. Refinancing the promissory note payment with longer dated borrowing, did not prevent the state borrowing more money to make 3 billion of social welfare payments. Conversely, not repaying the promissory note would not have generated cash income to pay for that 3 billion of payments and avoided borrowing to do so.

Furthermore, when bondholders were repaid, they were repaid essentially from funds borrowed by the banks themselves. Indebtedness at the level of state owned banks was generally replaced by new bank borrowing by those banks (typically from the ECB), to be repaid in time from the activities of the bank, not tax revenues.

Only when the bank had to take capital from the state and there was no likelihood of recovering that money could one really say that the state (i.e., we taxpayers) had really funded the payback of the bondholders.

Put another way, burning bondholders might have simply generated a smaller ongoing debt number. Paying them with borrowed state funds, only increased the annual fiscal effort during recent years by the amount of the interest payable on the debt incurred for related bank capitalisation.

In the extreme, not paying 30 billion of capital to IBRC and reneging on the promissory note would not as is sometime suggested have generated a current day windfall which could have been distributed to the population in 2013 to ease austerity. It would merely have meant that we would not have the burden of the long term low cost borrowing which replaced it but allows us to absorb this loss economically over a longer period into the future.

Would, however, a state which had defaulted on its commitments be now able to borrow at the historically low rates available to Ireland for new borrowing? Recall that a one percent reduction in average interest rates saves around 2 billion per annum to our budget.

I fear that much of the public debate around this issue has been misplaced and the inquiry would do well, to clarify this matter once and for all when it assesses the cost of the crisis and sharing of the impact.

C The Civil Service and the Political Process

I wish also to raise some system-wide issues which struck me during my tenure as Secretary General.

I am not the first to identify these issues but I do so to share my somewhat unique perspective as a recent "outside" holder of a Secretary General position.

These items may merit consideration by the Inquiry as it examines broader issues:-

- Firstly, I found it surprising in 2011, how little debate on strategic issues for Ireland was, or could be, led publicly by civil servants. I was very fortunate to have a Minister willing to let me engage in that type of debate but it seems other Ministers might even have openly discouraged this in the past. Did they fear a loss of their own public air time?

  Officials have been criticised for not engaging more outside their own departments but when they do venture out into public debate, are they supported by the public and their public representatives or are they instead criticised and attacked almost as political targets especially when they are expressing uncomfortable truths? Thought should be given to what is in Ireland's best interests.

  My own experience was to suffer (what I still consider to be) unacceptable interference by the media into my personal life when I dared to stimulate discussion on key choices facing our urban planners and to be subjected to inaccurate public criticism by some even then current politicians for stating facts in a neutral but truthful way about repossession statistics in the country. Unless the system robustly defends (not attack) civil servants acting in good faith, is it fair to expect them to be more vocal and point out the alternatives, however unpopular, to the political choices or to protest loudly when perhaps a wrong decision is being contemplated?

- It was surprising too to me how little <u>proactive</u> debate about strategic longer term choices for Ireland was taking place even in private within the corridors of power in ways that involved the full broader leadership team of all of the government departments.

  Should our political system encourage this more or permit the time to be crowded out by an agenda dictated on short termism? Do we really have the right structures as a state to encourage wide ranging cross disciplinary debate about future spending priorities or infrastructural needs or the structures of our economy?

  When spending is broken up rigidly using departmental expenditure headings based on last year's spend and holistic spending choices are hosted in a different department than that where analogous tax expenditure decisions are made, do we have the right structure to identify weaknesses or for reformative decisions permitting reallocation of resources to new or longer term or less visible priorities? The housing sector issues we faced in 2006-2007 and those we have again in 2015 show how root and branch cross-departmental action and resource reallocation from some budgets may need to be involved to avoid significant negative impacts for other budgets like social welfare. Does our system permit this?

- Elected representatives have a nature and role different to those employed in public administration, whether for a fixed term or for their entire career. I observed though in some quarters a surprising lack of equilibrium between the perception of relative positions of the political decision makers and the public service (especially the civil service). I suggest that it is important for the inquiry to question if we have achieved an unqualified environment of mutual respect to encourage truly free debate across the system.

- I suspect few of the citizens of Ireland have taken the time to discover how our Cabinet really works in practice. Yet, this is the primary hub of decision making, where not just the decision about the bank guarantee took place but indeed all major government decisions.

Is it the right choice in 2015 that civil servants from relevant departments are excluded from the debates at Cabinet? What if during the debate someone raises a novel but detailed point not addressed in the supporting papers? Should those armed with the background technical detail to address that be typically excluded? Should Ministers well-versed in one department's activities be expected without the presence of some of their own civil servants who might have broader experience to be held responsible collectively for all decisions? Should exceptions be made if the government memo cannot be circulated to all other departments a couple of weeks beforehand for comment? Naturally, this becomes less critical as a particular Cabinet matures and develops greater experience, but how well can it really work in the first couple of weeks of each new Government?

When I came to the Department in 2011, I had no reason to imagine it to be so.   It seemed natural that I was asked to lead over two nights a seminar to brief those cabinet members with questions on detailed technical issues related to the fundamental and complex bank restructuring and the recapitalisation decisions of March 2011. I thought it was always like that but it seemed not so. My early surprise instead was that I was not expected to present the material officially the following day at Cabinet and participate and help any debate. Instead I was asked to wait outside while the debate took place.

Each system has its own merits. I just mention this as it was in stark contrast to how some other high level decision fora operate, for example, the Central Bank Commission. There, for the same issues in 2011, key staff were involved in the prior evening's seminar and also the discussion at the Commission for that agenda item, even if they might not be present when the actual "go" "no-go" decision takes place after the debate.

Is it right to retain in 2015 traditions developed when perhaps the world was less complicated, fast and inter-connected?

- Another interesting aspect of the operation of Cabinet and the sub-committees of Cabinet is how status updates of the deteriorating economic and banking system health were coming to and being discussed or not by the cabinet ministers and their respective officials in 2007 and 2008.

When the final critical time sensitive decisions had to be taken, were the Ministers already well informed about all of the background, even if the exact tactical decision and precise supporting facts might not be available along the way?

Were periodic health checks of the Irish economy, of the world economy, reaching the government ministers and being debated together even if no specific decision needed to be made?

Did the absence of a state-wide risk assessment framework, a system wide risk register and risk committee, of course, mean that it was unlikely to have a government memorandum to trigger this discussion formally at Cabinet?

Are things better now in terms of a Cabinet spending time on periodic reviews of the performance of the system? Or is debate only triggered by a memorandum to require specific political action/decision, where a specific piece of legislation is coming for approval or where some report into the latest political issue has been published or needs to be commissioned?

Certainly, the quarterly review of the troika process and the periodic reviews of the Action Plan for Jobs are examples of a good practice. How much cross Cabinet debate takes place though when the annual reports of departments are presented (notably, in the absence of the relevant Secretary General), to sign off on the output of those departments and their priorities for the upcoming years? How well do Cabinet colleagues point out to a Minister gaps in his planned work-scope to make sure nothing important falls between the cracks? Do the Cabinet debate together the Quarterly Financial Stability Reports, for example, from the Central Bank, reports from the OECD, from the IMF when they are published?

- Another surprise was to discover that former governments seemed, at least so the story goes, to have discouraged (even banned) the idea of meetings of secretary generals as a group to discuss policy unless their Ministers were present.

I had expected to find much more robust debate among the civil service team as a leadership group of the issues facing the country. I would have expected to equally see fora for the civil service leadership to debate the same issues I had just mentioned above, the IMF or OECD and other reports on Ireland, the Central Bank or Department of Finance's views of the state's finances, the Department of Public Expenditures views of priorities for spending to future proof the country for the future and so on.

Is it happening at the Cabinet table for a period beyond the next election? If it is not happening there nor at Secretary General level, where could it happen? Is it appropriate if the vacuum is being filled by cross Ministerial political advisor discussions only? What about only by less structured reactive bilateral, perhaps tri-lateral, departmental discussions?

The troika process meant I did not notice this vacuum quite as quickly as I might in my earlier years as there was already a driver to help encourage more system-wide thinking of priorities. After the exit from the bailout though, those macro discussions seemed replaced by a lesser level of engagement, perhaps more like what I understand seems to have existed beforehand.

For example, I am left to wonder when was the last time the Taoiseach of Ireland, all of the key Ministers and their Secretary Generals and perhaps the advisors stepped out together for a senior management one or two day offsite to discuss together the priorities they see facing the country? It may be interesting for you in the Inquiry to ask similar questions as you analyse what was happening or not happening when the country really found itself in a mess in 2007 and 2008.

- I arrived as the Department of Finance was being restructured into two separate departments. Maybe this also accentuated the gap. Perhaps in the past with a Department of Finance responsible for the civil service, for policy advice on broad economic direction as well as for distribution of spending among departments, this absence was less critical. Also, in a somewhat closed system or recruitment, there was always the fall back that a long time civil servant always seemed to "know who to ask" or "know someone who knows the right person to get that done" from having worked with people over the years. But in the system now set up to encourage integration of people at all levels from diverse backgrounds and even from other countries, the existence of a more formalised robust system to encourage cross-disciplinary debate, thinking and action is even more critical. Large multinational companies, with ever transient work forces have spent much time trying to perfect the ways to encourage this. Perhaps there is learning there.

- Oireachtas committees might also help by acting as a forum in which technical civil servant experts together with public representatives may discuss matters freely and publicly.

But some committees prefer interrogative styles rather than debate among equals. Also, they are often done department by department rather than involving officials from across the system relevant to a subject matter. Does the adversarial nature of some Oireachtas committees encourage the type of informed cross party political debate which might serve the country well into the future?

Why, for example, would those posing the questions not simply always provide at least their preliminary questions or areas of inquiry in advance with precision? Would that not facilitate better preparation for the discussion? We all know how much better our answers were when the lecturers gave us hints as to the exam questions in school.

This is not an exam to catch out the civil servant or department with surprise questions but should rather be a public debate of the issues to inform. What is important should not be just a soundbite to get exposure on the 6pm news or in newspapers but rather the substance of the matter. From a department's perspective, success seems to be measured by having nothing reported about the discussion at all as that suggests no problems were identified. Is this the right way to encourage good debate and highlight important issues to the public?

If I might be bold, I might suggest R5a (which was not a specific area of inquiry for me) might allow interrogation of what system of Committee operation ensures the important but often boring subjects are not squeezed out by the search for sound-bites or desire to cover the very recent topical matter.

Those still wondering what I mean by this, should look to see how much I was not questioned at my last PAC appearance on the important matters of governance I raised in my opening address, which I had distributed in advance. I had thought of it as an opportunity to focus on longer term challenges facing the department, how we were working to be more efficient in use of resources and public money and how we had been working to address the structural issues identified in earlier reports on the Department. These are now similar questions to those before the inquiry.

If the political process and public interest value the importance of these governance issues before the problem arises, then they should also encourage time be spent to understand and debate them even if the news at 6pm will be less enthusiastic about covering them.

It is not my intention to be critical of one side or the other. Each part of the system has obvious strengths. I have hoped simply to raise aspects of the operation of the system which appeared to me at least (an outsider to the existing system) to be areas where perhaps the system operating in 2011-2014 remains based on traditions, many emanating from the establishment of the state or even older Whitehall days, which are not quite the same elsewhere. Our system might still be correct but in the aftermath of yet another major failure to protect the citizens of the country, I would suggest at least a re-evaluation of suitability is in order.

D The Department's Relationships with the NTMA and the Central Bank

(a) 2011 banking policy governance changes

My early observation to the Minister in 2011, after I moved to the Department, was that it had been complicated to move decisively and cohesively on the bank restructuring as there were essentially three different actors of Government, (i) the Minister and the Department's banking policy unit, (ii) the NTMA's shareholder management unit, and (iii) the Central Bank team supervising the banks and coming up with resolution strategies.

In early 2011, the Central Bank alone had engaged the necessary (but not inexpensive) advisors of the quality required to manage the key PCAR process but the Minister (or NPRF) was the shareholder of the banks. Additionally, the CBI was the only institution which had in earnest begun the recruitment of the necessary extra staff to handle the extent of the crisis.

Better cooperation and communication was I believe an outcome of my own move from the Central Bank team to the Department and by our decision to move the NTMA team physically and from a governance point of view into the Department. Michael Torpey, as head of that team, sat not just on the management structure of the NTMA but now equally on the Department's management team. In this way, he was able to embed key officials of the former Department's banking unit into his team and create an integrated team of both experienced corporate finance professionals and experienced civil servants to assist me and the Minister in a complex job at hand. Closer cooperation with the PCAR banks also meant finally that the investor public regained confidence that Ireland was operating to a single coherent plan of action.

Certainly, the process of tapping into the best advice for the tough decisions was made much more seamless with officials from this banking unit readily participating also in discussions around the Economic Management Council table. The experts were readily available to and directly embedded in the Department's process of advising the Minister rather than have their advice transferred from the NTMA to the Minister by other Department officials or memorandum. I would suggest that these changes helped the better evolution of decision making about, for example, the removal of the guarantee or the restructuring of the promissory notes.

(b) Governance of the NTMA and the role of the Department

There are a number of observations I might also proffer about the way in which the NTMA had been operating in early 2011.

- The original structure set up for the NTMA seemed intended not to prioritise strong flows of two way information between the agency and the Department in ways to encourage the expression of views by Department officials on activities within the remit of the NTMA and vice versa. The CEO of the NTMA regularly reported directly to the Minister and sought permission to take various funding decisions, but most typically not in the presence of officials of the Department whose views could only be solicited often after the fact.
- Additionally, since the Department Secretary General was merely a participant on the CEO of the NTMA's *advisory council* (not a board with a binding authority as a matter of governance) the oversight role of the Secretary General and his or her role in day to day NTMA activities was also very limited.
- No one from the NTMA attended the Department's management meetings.
- The relationship *de facto* worked well but much of this could be put down to good inter personal relationships not *de jure* protections. Had that former element broken down, the structure had few of the checks and balances one might like to see to deal with a concentration of very considerable power in the role of the CEO of the NTMA. This was even more important with the expanding role being suggested with the development of New Era and the Strategic Investment Fund.

As a result, during my tenure as Secretary General and with the strong support of John Corrigan

- a new "Financing the State" unit in Merrion Street reporting directly to me and staffed by another very experienced financing practitioner (seconded to the Department from the NTMA) helped break down barriers and improve Departmental analysis, and
- very important governance changes were introduced by statute:-
    - A board appointed by the Minister would henceforth manage the NTMA and the CEO would be answerable to the board.
    - There would be a Chairman who would also be appointed by and available also to the Minister.
    - There would be a statutory position for the Secretary Generals of both the Department of Finance and the Department of Public Expenditure and Reform on the board, and *ergo* a role for both in the management of the Agency.
    - An independent investment committee would be responsible for the investment decisions of the SIF.

(c) Communications between the Department, the Central Bank and the NTMA

The Secretary General of the Department serves on the Commission of the Central Bank, a role which has caused much annoyance to the officials of the IMF when asked to opine on the required independence of the Central Bank from political interference.

In the absence of other alternatives, this bridges the discussions between the Central Bank management and those of the Department on key strategic matters. Informal discussions between the Governor and the Minister or between officials of both institutions must not be the only channel.

At least during the crisis (I do not know the provenance of this structure), a body referred to as the Principals Group, involving key officials from the Central Bank, the NTMA and the Department also met (sometimes weekly or even more frequently) to deal especially with operational issues associated with the bank restructuring and the bailout negotiations.

The challenge was to move the agenda of this meeting away from operational issues and into the realm of financial stability of the economy, of the financial sector and of the state's funding, seen perhaps by some as areas of their own exclusive competencies. Many other countries have relied on such a tri-partite forum as a real discussion forum to test expectations of the future and the robustness of a state's responses to challenges arising from those expectations. The Inquiry may have seen the correspondence between the agencies as to changes which might be made to the operation of the committee to make it more strategic in focus and have views thereon.

E Changes made to the Department

As already mentioned, I set out in detail for the PAC measures we had taken to reform the operation of the Department in the years I was Secretary General.

I cannot improve the description by restating it in new words here. I would therefore commend the members of the Inquiry to the full text of that opening statement.

CLOSING REMARKS

By way of closing context, you might say a form of disclaimer, I would add:-

- I only joined the Department of Finance in March 2011, after many of the decisions the subject of the inquiry had been taken. I therefore had to make decisions and recommendations based on the reality of these decisions. Speculation as to what might have happened had they been otherwise was never going to be a productive use of valuable time while we were fighting the crisis;
- I was not involved at the Central Bank in any of the discussions leading up to the bailout announcement nor the negotiations on the original bailout terms;
- In helping the inquiry, I have to be conscious not just of my obligations under the Official Secrets Act 1963 Act but also the obligations of Section 33ak of the Central Bank Act, 1942;
- I have not engaged a team of people to help me reanalyse history and files in detail (which anyway are not in my possession) and therefore the above observations are based largely on recollection which I hope is not incomplete or coloured with the passage of time and subsequent events;
- I would however refer the members of the Inquiry to the more detailed Annual Reports of 2012 and 2013 published by the Department during my tenure. These present a more comprehensive description of matters I have not had the space to elaborate on here as fully as I would have liked.
- I am sure that my successor has made further refinements beyond those described and perhaps modified the approach I have set out. I understand he will be appearing separately before the Committee and my content should therefore be read accordingly.

- As I mentioned at the outset, covering 20 items in such a short submission was never likely to do justice to the importance of each of the items and I welcome the opportunity to be able to elaborate more on the 18th June.