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Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

Bertie Ahern

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Witness Statement of Mr. Bertie Ahern

to

Oireachtas Committee of Inquiry into

the Banking Crisis

Chairman, I make this statement on foot of your request to assist you and your colleagues in your deliberations inquiring into the banking crisis. You have requested that I address certain issues from my position of Taoiseach during the Dáileanna 28th, 29th and 30th. For the record my tenure as Taoiseach over this time extended over three Governments from 16 June 1997 - 6 June 2002, 6 June 2002 - 14 June 2007 and 14 June 2007 – 7 May 2008.

You have requested that I address a number of specific topics in my evidence which are of interest to the Inquiry, including:

- The nature and effectiveness of the operational implementation of macro-economic and prudential policy;

- The Appropriateness of the expert advice sought, quality of analysis of advice and the effectiveness with which it was used and what consideration was given to contrarian views;

- The effectiveness of the Oireachtas in scrutinising public policy on the banking sector and the economy; the appropriateness of the advice of the Department of Finance to Government and the use thereof and the analysis of the key drivers for budgetary policy; and the relationship between government, the Oireachtas the banking sector and the property sector.

- Addressing the formulation and reaction to crisis simulation exercises; including the role responsibilities and objectives of the Domestic Standing Group (DSG), the adequacy of that process - including a consideration of the bank resolution legislation.

I will turn now to these matters in turn first before making some wider contextual remarks which I hope the Committee may find useful.

Nature and effectiveness of the operational implementation of macro-economic and prudential policy

The available evidence supports a strongly positive conclusion under this heading. The main economic problems facing Ireland in the mid-1990s were high unemployment, net emigration, relatively low incomes and the need for increased productivity. A decade later these problems were substantially solved. GDP growth in real terms averaged about 7.25% in the decade or so to 2006 and the corresponding rate of growth in GNP was nearly 6.4%. Such rates of growth were substantially above those experienced in other EU Member states and indeed throughout the OECD area at that time. The 2005 Annual Report of the National Competitiveness Council reported that Ireland's rate of growth in this period was more than double that of the US and triple the average rate achieved by other Eurozone countries. They also noted that labour productivity had been growing by 5% per annum and that the taxation and regulatory systems had developed to become ‘key competitive strengths’ of the economy. Furthermore, with Government investment in infrastructure being ‘significantly higher’ than in other developed countries a previously important and long standing weaknesses was being addressed.

As a result of these developments, employment in Ireland increased from 1.38 million in 1997 to over 2 million by 2006 and the unemployment rate declined from 10.3% to 4.3%. Net inward migration accelerated from 19,000 per annum in 1997 to 70,000 per annum a decade later. A key indicator of the progress that was achieved in this period was that by 2007 the National Competitiveness Council could report that Ireland was ranked fourth in the world in the UN’s Human Development Index based on strong improvements in income per capita, life expectancy and education levels.

These achievements were made against an international background of a slowdown in growth in Ireland’s main export markets from 2001-2003 and ongoing fears of a steep decline developing in the USA. Furthermore, at home the aggregate fiscal position was managed in a highly conservative and prudential way. Thus, Total Government Expenditure as a percentage of GNP actually declined from 39.8% in 1997 to 39.2% in 2007. Government Gross Current Expenditure as a percentage of GNP fell from over 36% to under 33%, facilitating an expansion in Capital spending from 3.6% to 6.3% of GNP in that decade. The overall government balance rose to a surplus of over 6 per cent of GNP, from 1.3 per cent a decade earlier in 1997. Finally, to seal this point in relation to prudential financial management it should be emphasised that the Exchequer Debt/GDP ratio fell from 63.6% in 1997 to 25.1% in 2006.

Budgetary Policy was successful also in addressing social inequality. For example, in its *Quarterly Economic Commentary* of December 2004 the ESRI concluded:

> "In terms of income redistribution, Budget 2005 has been strongly progressive in terms of the direction of tax measures, social welfare payments, and the absence of indirect tax increases. As regards the Budget's overall fiscal stance, the most appropriate indicator of the budget position is the General Government Balance (GGB), which we forecast to move from a surplus of 1.1 per cent of GDP this year to a deficit of 0.6 per cent in 2005. This expansionary fiscal stance may not be inappropriate given that there are potential downside risks to our forecasts over the next few years." (ESRI, QEC, Dec. 2004, p1).

A year later writing in the QEC of December 2005, in an article entitled Future Irish Growth: Opportunities, Catalysts Constraints, Prof. Frank Barry of UCD concluded as follows:

> "It is suggested here that if Ireland can continue to attract substantial FDI and the labour pool necessary to man it, further convergence on US income per head – which remains well above that of the EU 15 – should be available" (ESRI, QEC, Dec. 2005, p54).

And clearly Ireland has been extremely effective at attracting FDI. At the heart of this success is the operational effectiveness of IDA Ireland, the agency with responsibility for implementing Government policy in this area. For example, the *IMD World Competitiveness Yearbook 2008* ranks Direct Foreign Investment flows to Ireland at 10.79$billion and 4.22% GDP as the two most significant improvements in competitiveness of Ireland in that year.

Appropriateness of Expert Advice etc.

When it comes to expert advice and high quality economic analysis, the Government have a wide range of sources available. International organisations - including the European Commission, the IMF, the OECD and financial ratings agencies like Standard & Poor's and Moody's – each carry out independent assessments of macro-economic and financial conditions in Ireland. For the most part these are undertaken about annually and usually highlight what in their view are the prospects facing the economy and the policy initiatives that require to be prioritised to optimise economic performance on a sustainable basis. These organisations have the advantage of having international perspectives and the insights they provide are especially valuable when considering economic conditions and prospects in a comparative context. In other words they enable us to judge performance relative to countries with whom we compete. This comparative perspective is obviously very useful from the point of view of assessing if Government policy is on the right track.

At national level there are several organisations (funded or part funded by the exchequer) such as the ESRI, the NESC, Forfas, and the Central Bank which, through their regular publications and studies on particular aspects of the economy, provide valuable and continual monitoring of economic performance at macro and sector level and with respect to individual policy initiatives undertaken or proposed by Government.

Increasingly, in recent times, domestic financial and professional services providers have also devoted increased resources to economic analysis, policy evaluation, commentary and economic forecasts. While the research of these organisations is focused primarily for the benefit of their own client bases it can provide useful insights for policy development and evaluation in public policy terms.

I would also mention under this heading (I will go into it in some more detail under the heading key drivers of budgetary policy below) the elaborate annual process of soliciting and evaluating pre-budget submissions from interested parties and individuals, by the Department of Finance. This process provides a broad platform from which Government can elicit ideas, potential initiatives and amendments to existing schemes to improve budgetary formation.

In addition, it is always open to Ministers, on the advice of their departments, to solicit interest from external consultants with respect to particular issues or problems which are foreseen developing. Furthermore, there is a well-developed public tendering process in place to facilitate the public service in procuring the most appropriate level of expertise at fair value for tax-payers.

In overall terms, therefore, I hope the Committee of Inquiry can see from my remarks that aside from economic advice available from the permanent civil service and in particular the Department of Finance, there is a very wide range of sources of advice both from an international and domestic focus which allows government to draw a synthesis, which one hopes of course is balanced and gives due consideration to the very wide range of views that is inevitably brought forward in such a process.

Obviously I am not going to present a comprehensive review of the policy decisions that were made in this period nor the inputs to those decisions. However, I think it is important that the Committee takes due recognition of the information that was available when the decisions were being made to counteract the retrospective narrative that has developed, with the benefit of hindsight, over the years since the crisis first began to manifest in 2008. To this end, the table below summarises IMF forecasts and results for real GDP percentage growth in Ireland as published in the *World Economic Outlook* over the period 2004-2009. (The WEO is published in Spring and Autumn). Data from successive publications are shown.

	2004	2005	2006	2007	2008	2009
Spring 04	3.6	4.7	5.0	4.8	4.7	4.7
Autumn 04	4.7	5.0	4.5	4.5	4.6	4.6
Spring 05	5.1	4.8	4.6	4.5	4.6	4.6
Autumn 05	4.5	5.0	4.9	4.7	4.5	4.5
Spring 06	4.5	4.7	5.0	5.2	4.7	4.5
Autumn 06	4.3	5.5	5.8	5.6	4.9	4.4
Spring 07	-	5.5	6.0	5.0	3.7	3.8
Autumn 07	-	5.9	5.7	4.6	3.0	3.8
Spring 08	-	-	5.7	5.3	1.8	3.0
Autumn 08	-	-	5.7	6.0	-1.8	-0.6
Spring 09	-	-	-	6.0	-2.3	-8.0

It can be readily seen that the crash was not foreseen by the IMF who only revised their outlook when the slowdown was well and truly at hand. For example, as late as Autumn 2007, the IMF was forecasting that the Irish economy would grow at 3% in 2008 after inflation is deducted. Even when it became clear that there was a severe global downturn the IMF forecast in late 2008 was that there would be no more than a marginal fall of 0.6% in real GDP in Ireland in 2009.

These data indicate the information that was available to decision makers at this time and the conclusions are clear: even an organisation such as the IMF remained convinced that Ireland's economic expansion was sustainable.

Inevitably, of course, there were stresses and strains associated with rapid expansion in economic activity. The most noted and commented upon at the time was the growing importance of the construction sector in the Irish economy. At some stage this growth would inevitably ease. For example, the ESRI *Medium Term Review of 2003* noted that:

> "At some stage over the coming decade, when the demand for housing has been largely met, it is likely that prices will fall to levels closer to the EU average and this will be the signal for a winding down of capacity in the sector………The inevitable process of adjustment to lower demand for building and construction output which is still some way off will prove painful for the sector."

In other words, market forces, which had driven up prices, had led to increased economic activity. However, as supply rose some of the increase in prices and activity would be expected to be reversed. This was expected to occur at some stage during the years 2003 to 2013.

In its subsequent MTR in 2005, the ESRI noted that no slowdown was seen and that 'there is a growing aura of invincibility about the Irish economy' with consumers showing 'a high degree of certainty about the future'. While with the benefit of hindsight this can be interpreted as unwarranted complacency, the ESRI went on to conclude that 'the fundamental factors driving the Irish economy ... remain quite favourable' (p. I). A note of caution was sounded but the subsequent analysis, which comprised a high growth and a low growth scenario, was based on alternative assumptions regarding the impact on Ireland of what were described as 'global economic imbalances' which could lead to the US economy slowing considerably and experiencing 'a painful adjustment'. To an extent this is what subsequently transpired. The forecast based on this scenario was that Irish growth would slow to 3.5% per annum in 2005-10 and 3.1% in 2010-15. Unemployment would rise to about 7% in the early years of the slowdown before falling back to the 2005 level of 4% while the public finances would remain broadly in balance. Of course, if the US economy did not suffer this painful adjustment then Irish growth rates were forecast to be higher. The implication is that no home grown crisis was foreseen and even an imported one would have relatively mild effects due to the fundamentally sound nature of the Irish economy.

These examples are provided here simply to illustrate what was available to policy makers and it is not my purpose to critique these organisations. However, the research and conclusions of these organisations constitutes a major input to policy decisions. Of course, having this research available does not mean that the most appropriate course for policy was always clear. Some divergences of opinions are to be expected and indeed contrasting views and opinions were encountered. This range of views was always taken into account in reaching policy decisions during my time in office but the synthesis of opinions leading to policy decisions inevitably reflects the conclusions of the vast majority of the research. I believe that this is the correct basis on which decisions should be made. In this respect, it must be noted that the overwhelming and virtual consensus during this time was that Irish policy was moving the economy in the right direction, that the economy was on a sustainable growth path that could be expected to slow somewhat in response to changes in fundamental drivers, that the main risks could be traced to developments in external economies and that the dangers posed by domestic factors represented challenges to be managed rather than the first indicators of a crises such as subsequently developed.

Effectiveness of Oireachtas in Scrutinizing Public Policy and Associated Issues

In overall terms, Chairman, I think the effectiveness of the Oireachtas in scrutinizing public policy on the banking sector and the economy is good and compares favourably with that of other countries with democratically elected parliaments.

As this Committee will be well aware, economic debate in the Dail Chamber is extensive, focused, often sharp and when required can be conducted expeditiously, especially when matters of urgent legislative provision is required.

Aside from debate in the Chamber of course I believe that the specialised Committee system which advises now on a wide range of economic, financial and other matters has resulted in Deputies and Senators having additional opportunities to participate to an even greater extent in specialised parliamentary work in their areas of interest and/or expertise, where they can take evidence from interest groups, meet witnesses or invite key Departmental Officials in on specific matters of interest. The fact that Committees usually meet in public and publish reports gives further strength to the democratic parliamentary process. I think that between the Joint Committees on Finance, Public Expenditure and Reform; Jobs Enterprise and Innovation and the Committee of Public Accounts there is very considerable scope for cross Party scrutiny of matters of public policy in the areas of economics, finance, banking and related matters.

Turning to the issue of the Department of Finance and the appropriateness of its advice, I find myself in broad agreement with the conclusions of the report of Mr Rob Wright commissioned by the late Mr Brian Lenihan, TD, Minister for Finance in 2010 and entitled *Strengthening the Capacity of the Department of Finance*. I believe the recommendations made under various headings in the report such as budgetary and other processes; Economic and Fiscal Forecasting; Advice over the budget cycle and so on, if implemented would result in a more effective Department in terms of guiding Government policy making.

The establishment in 2006 of the *Central Expenditure Evaluation Unit* within the Department to promote best Value for Money practice in public expenditure programmes and projects, and its subsequent evolution to provide analytical support marked an important step in recognising the need for a more analytical approach to policy formation with respect to spending. Its successful implementation provides an encouraging marker of progress which can be built upon more widely in the Department.

The key drivers of budgetary policy during my tenure as Taoiseach rested on ensuring that budgetary policy supported and encouraged growth in a sustainable way, while ensuring that inequality was reduced and social protection was enhanced. At times these various objectives can be in conflict but I think that over the period we are speaking of there was considerable progress achieved by combining budgetary policy with reforms through the social partnership process which resulted in enhance competitiveness and growth leading to substantial improvements in the living standards of those most in need.

Regarding the relationship between the Oireachtas, the Banks and the Construction sector, I believe it is correct that channels of communication should be open between policy makers and key sectors of the economy. For many years this was reflected in Social Partnership which provided a broad range of sector representatives with a direct mechanism to contribute to the policy making process. This continues today in various forms through delegations, budgetary submissions, meetings between officials and economic interests and a range of other mechanisms. Such structured mechanisms are required for two reasons. First, in a relatively small country such as Ireland it is inevitable that that there will be a relatively small circle of key influencers. It is important therefore that access is provided to a broad range rather than an elite. Second, I have always believed that Government should not be distanced from the governed. Instead it must be able to interact to listen and respond to views, proposals and criticisms. I always sought during my period in office to maintain contacts to ensure that this could be achieved.

Formulation and Reaction to Crisis Simulation Exercises and the Role of the DSG

There has been considerable criticism of the performance of the Financial Regulatory Authority leading up to the crisis. In 2006, in line with new EU-wide procedures, an inter-agency financial committee, the Domestic Standing Group ("the DSG"), was established to deal, *inter alia*, with crisis management issues and financial stability. The DSG involved the Central Bank, the Financial Regulator and the Department of Finance. The parties entered into a Memorandum of Understanding which came into force in July 2007.

The DSG was intended as a framework to help manage financial stability issues, including potential systemic crises. The chair was to be rotated among the three parties on an annual basis. It comprised of high-level representatives of the Department, the Bank and the Financial Regulator.

At the outset, the work program of the DSG included:

- exchanging information on market and regulatory issues;
- overseeing the updating of the crisis management manuals of the CB, FR and D/Finance;
- participating in crisis simulation exercises;
- developing principles for the resolution of financial crises, taking account of work being done at the EU level;
- policy and procedural issues relating to deposit insurance; and

- examining the impact of company law provisions on insolvency in crisis situations.

The DSG was the principal mechanism for the exchange of information relevant to the discharge of the parties' respective responsibilities in relation to financial stability. The membership of the DSG could be augmented with representatives from other public authorities as appropriate to take account of the nature of a particular event occurring or issue arising or the need for specific information on any relevant issue.

The DSG met quarterly to consider matters of significance to its role in relation to financial stability on the basis of an agreed annual work plan. Additional meetings could be called by any of the parties if it was considered that an issue needed to be examined in advance of the next scheduled meeting of the DSG. The parties communicated routinely between meetings on matters of financial stability that arose in the course of day-to-day business. Each party agreed to nominate a representative who could be contacted, at short notice if required, with a view to activating a meeting of the group.

Through the DSG, the parties were to develop a framework aimed at managing potential systemic crises by overseeing the preparation of contingency plans and conducting simulation exercises and stress tests, as well as by participating as appropriate in these exercises and reviewing the outcomes. The DSG was to develop general principles to guide the resolution of financial crises, taking account of EU work in this area. The DSG could establish sub-groups to consider particular issues, such as responding to operational disruption of the financial system and business continuity arrangements for the financial system. In a crisis situation the DSG was to facilitate each party in fulfilling its responsibility to inform and advise the parties' principals.

The outturn of events indicates that criticisms of the regulatory system have validity. In practice the DSG was in existence for only a year at the end of my tenure as Taoiseach and it would not be reasonable to make an evaluation of its effectiveness after such a short period. However, it is my opinion that the severity and unprecedented nature of the events that unfolded meant that such shortcomings as existed in regulatory capacity could not have been overcome by the kind of co-ordinating and information exchange role envisaged for the DSG. As such, the reintegration of the regulatory role into the Central Bank means that co-ordination is now a matter of internal management for the Central Bank and this may provide a stronger mechanism.

Context of Budgetary Policy

In terms of wider budgetary policy and also maybe to give proper context to the issues under discussion, I think it is worthwhile to emphasise that during my period as Taoiseach Ireland finally caught up with and then surpassed average EU living standards. It was a sizeable national achievement to raise our living standards from a historically low base of two-thirds of the EU average.

The downturn did have a very hard impact on individuals and families, especially those who lost their jobs, and of course that saddened me and I wish the recession did not happen. However, it is disingenuous to suggest that all the gains this country made have been wiped out. Between 1997 and 2008, this country thrived and not only did Ireland enjoy record economic growth, but Irish living standards were raised across the board, and this drove social progress. This rising tide was essential in lifting hundreds of thousands of our people out of poverty, to reversing forced emigration, to significantly increasing pensions and child benefit, to modernising schools, health facilities, roads and communications infrastructure around our country, and in creating well paid jobs for our young people at home.

This represented positive change in the lives of many people and, despite the recession, a lot of this progress is still there, benefitting thousands of our citizens. I am glad that government allocated huge amounts of money in this period into regenerating traditional areas of poverty such as Ballymun, Fatima Mansions in Rialto, and parts of Limerick, Cork, Waterford and other cities. I am glad we put money into the islands, improving the electricity supply, the sewage system, and building new piers. Throughout the country, people now drive on better and safer roads. The motorway network that Government supported during my tenure has cut journey times and is a vital economic and social artery for our people. People also travel on better trains. Our schools and hospitals have more staff working in better buildings. All the time, as Taoiseach, what I wanted to do with budgets was to improve the quality of life for ordinary people and to provide services that our country did not have before.

Those who say we squandered the boom forget that in my time as Taoiseach we actually recorded budget surpluses in 10 of our 11 budgets. We balanced sustained increases in spending with the need to reduce our national debt. As a result, Ireland paid over a billion euro less every year in interest payments.

I want to remind younger members of the Oireachtas that when I first came into this House in 1977 and for right through the 1980s, our national debt was an unsustainable millstone around the neck of taxpayers. It was a barrier to national progress as huge sums of revenue had to service interest payments. In 1997, the year I became Taoiseach, 20 per cent of all taxes raised in the State were used to service the National Debt. In 2007, my last full year as Taoiseach, that figure stood as low as 4.3 per cent. During my time as Taoiseach, we continued to pay into the National Pension Fund so that when the downturn came we had €20 billion saved, which provided some protection when the recession came.

There is zero credibility in suggesting that an open economy like ours could withstand a global recession and the collapse of the global investment banking system. This was not just an Irish experience. It was a worldwide recession that affected America, Japan, Britain, China and most of the developed economies in the world.

In 2007, the International Monetary Fund maintained that Ireland's economic growth would be strong over the medium term. The IMF Directors said our economic performance was robust and was supported by 'sound economic policies'.

When I left office a year later, the IMF and other international organisations such as the OECD, along with national ones such as the ESRI, were all predicting growth in the Irish economy in the region of 3 per cent for 2009. In June 2009, little more than a year on from my resignation, they were predicting a contraction of between 8 per cent and 10 per cent. That illustrates how unprecedented and unforeseen this global crisis has been and how quickly it took root.

It is true that we had some warnings about over-reliance on property. But it is important to be clear about the record. In October 2004, the IMF alluded to a possible overheating in the housing market even though, subsequently, they themselves and other economic commentators implied there was no bubble. In the Budget two months later, Brian Cowen, as Minister for Finance, announced a review of tax incentive schemes. In the next Budget, we announced a termination date for all existing property-related tax incentive schemes with the exception of private hospitals, registered nursing homes and childcare facilities. Our stamp duty was already the largest transaction tax on property in the EU. Despite a concerted campaign by some to get rid of that tax, or to reduce it substantially, I refused to go down this route. If I had listened to these calls, this would have added fuel to the housing market and we would have experienced far greater difficulties than we ultimately experienced.

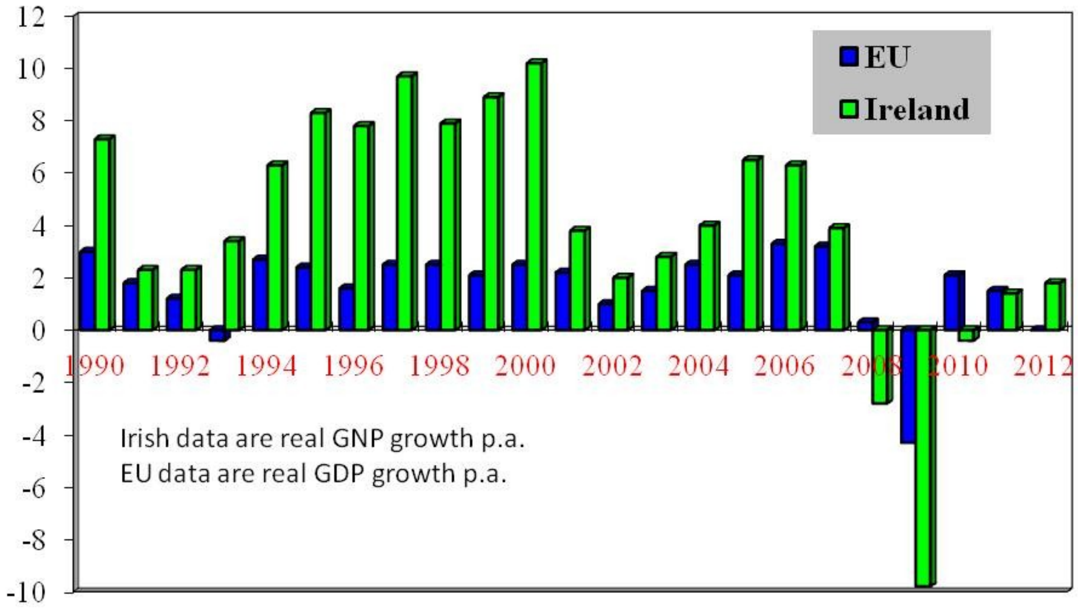
We were able gradually to remove incentives from the property market, but membership of the euro meant we were unable to raise interest rates. According to the IMF report in the summer of 2009, the housing boom was caused mainly by cheap credit due to low interest rates, along with rising incomes and a strong demand for housing. There is no doubt that this created a structural weakness in the economy and the international downturn ensured this has turned from a soft landing into a very hard one. I wish this didn't happen and with hindsight, of course, I would have done things differently.

I did make mistakes, I admit that but so does everyone who governs. I know that during my time as Taoiseach, while I did not get everything right, I can honestly put my hand on my heart and say I did try my very best to do the right thing by the Irish people. Of course, I apologise for my mistakes, but I am also pleased that I did get a lot of things right.

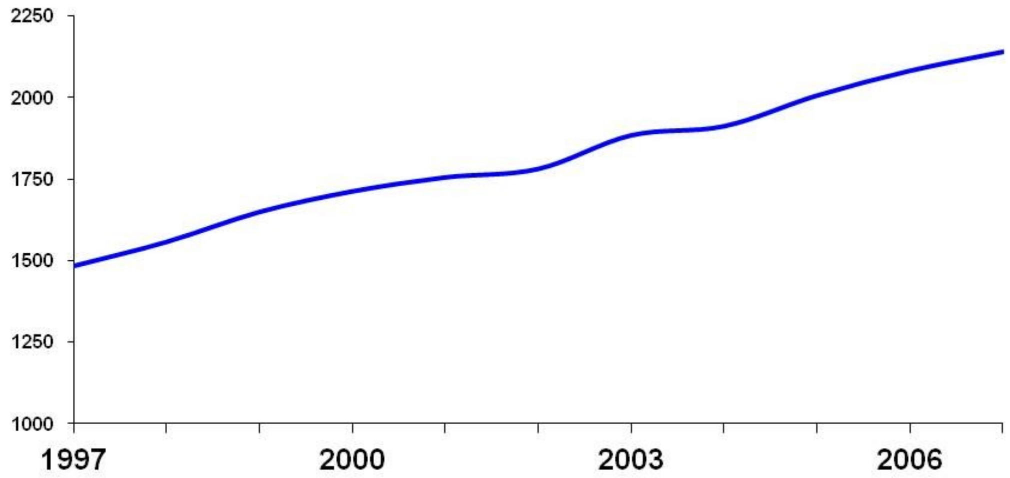
The winds of the greatest international recession since 1929 did batter our country after my departure. But now as that storm abates, it will become increasingly clear that a lot of the progress the Irish people made in the first decade of the twenty-first century, such as in modernising our infrastructure, investing in our roads, our schools and our hospitals, have not been washed away.

I make these points not to take away from the fact that Government has had to do Trojan work in recent times and that the Irish people have endured many sacrifices in a national battle for our economic and social stability. I want to conclude by saying I respect the work done by my successor Brian Cowen and the late Brian Lenihan. I also admire the efforts of the current Government and I think the Taoiseach, Minister Noonan and Minister Howlin have shown a lot of commitment and courage in tackling the financial crisis. I think one of the lessons we should all take from this crisis is that maybe our politics needs to be less partisan and that as a small island, we should all pull together. The last few years have been extremely tough on many ordinary families and that breaks my heart, but the work of our democratic political system must prevail and the problems we faced on a massive scale of unemployment, emigration and the banking crisis, are on track to being resolved.

Ireland's Economic Growth



Total Employment in Ireland, 1997-2007 (000s)



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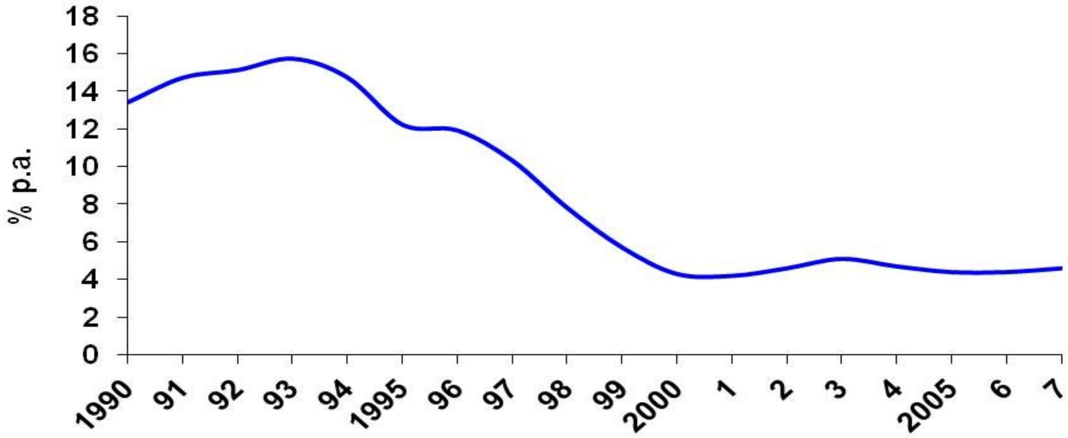
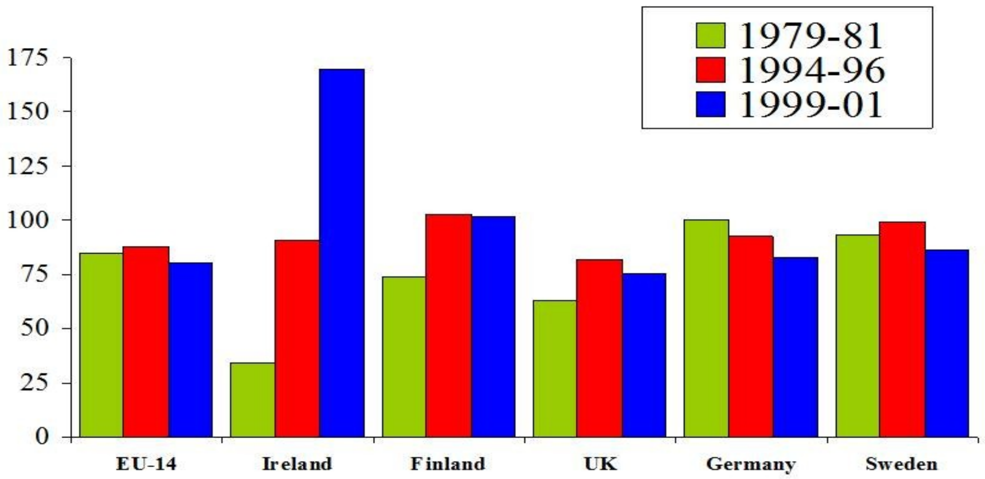
Unemployment in Ireland, 1990-2007

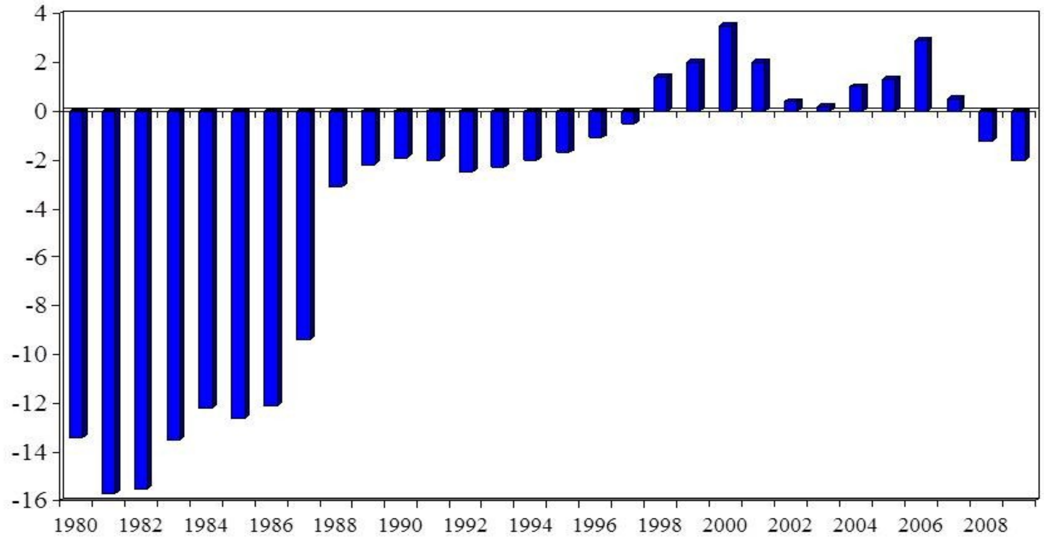


Labour Productivity Levels in Manufacturing Relative to US



Irish Government Balance

(% of GNP)



Ireland's National Debt-GNP Ratio

(% of GNP)