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Joint Committee of Inquiry into the Banking Crisis

Witness Statement of

David Begg

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Joint Committee of Inquiry into the Banking Crisis

Statement of David Begg

Introduction

In the direction to attend this committee which I received I am asked to give evidence in relation to my role(s) as General Secretary of the Irish Congress of Trade Unions and Non-Execution Director of Central Bank of Ireland from 1995 – 2002 and CBFSAI from 2002 – 2010. For the avoidance of misunderstanding at the outset I should make it clear that these roles were quite separate.

I was appointed initially as a Non-Executive Director of the Central Bank in 1995 and re-appointed in 2000. However, I did not become General Secretary of the ICTU until 2001. In other words I was not a representative of ICTU on the Board of the Bank.

Notwithstanding this I am happy to outline my views as General Secretary of ICTU but I will do so separately in Part 2 of this statement. Part 1 will deal with the themes and specific questions you have asked me to respond to.

With the enactment of the Central Bank and Financial Services Authority of Ireland Act in 2003, I was re-appointed to the board of the Central Bank but not to the Authority. Thus I had no further involvement in supervision or regulation of the Banks.

PART 1

Theme R1: Effectiveness of the Regulatory, Supervisory and Governmental Regime Structure

(a) Appropriateness of the Regulatory Regime

German policy makers and bankers had urged Europe towards financial integration since the 1950s. The course of this trajectory took an upward swing in June 1988, when the European Council agreed to liberalise all capital movements. In effect this was formal financial integration, which was copper fastened by the Maastricht Treaty which came into force in 1994. Its effect was to elevate capital to the same legal status as goods, services and people which had enjoyed free movement within the borders of the EEC for forty years.

The European Central Bank (ECB) subsequently became the premier institution of Economic and Monetary Union (EMU) under the terms of the Maastricht Treaty. The single currency came into being ten years later. EMU did not, however, involve any institutions for fiscal or banking union which were later revealed as serious deficits. Indeed, with hindsight, the Eurozone can hardly be described as an optimum currency area. The ECB received the singular mandate to maintain price stability. A Stability and Growth Pact (SGP) and Excessive Deficit Procedure (EDP) were intended to control fiscal sustainability, with the Maastricht Treaty explicitly proscribing bail-outs of imprudent members.

These rules were believed to be sufficient to foster real economic convergence. As Donovan and Murphy (2013: Chapter 2) point out, thinking within the ECB and mainstream economics generally, is strongly influenced by ideas associated with New Classical Macro Economics (NCM) and Efficient Market Hypothesis (EMH). These ideas emphasise the rationality of economic behaviour and the efficiency of financial markets, with the corollary that asset bubbles are unlikely to arise and that financial markets require relatively little regulation. NCM combined with EMH led over time to several changes of emphasis in Macro Economic policy thinking including, inter alia, an emphasis on light touch financial regulation. As Martin Wolf (2014: xvii) described it; 'The insouciance encouraged by the rational-expectations and efficient market hypothesis made regulators and investors careless'. This thinking, along with the deeply embedded German aversion to inflation, strongly influenced the architecture of EMU.

One consequence of the liberalisation of capital markets was that large financial flows looking for investment outlets contributed to keeping real interest rates low worldwide. The abundance of liquidity and low interest rates encouraged financial institutions and asset holders to try to increase the rate of return on their portfolios by increased leverage at the cost of higher risks. The global financial crisis emanated from the conjunction of widespread financial fragility and a lopsided globalisation process, proceeding rapidly amidst large financial imbalances. A principles based regulatory system was unsuitable for these circumstances and the problem was compounded in the Irish case by competitive pressures associated with the presence of foreign banks regulated from outside the jurisdiction (Gyfason et al, 2010).

(b) Effectiveness and Appropriateness of the Supervision Policy and Powers

Writing in the *Financial Times* on 23rd September 2008, the then Managing Director of the IMF, Mr. Dominique Strauss-Kahn said:

"This crisis is the result of regulatory failure to guard against excessive risk-taking in the financial system, especially in the US"

It is manifestly the case now that supervision was neither effective nor appropriate but principles based (or light touch) regulation was not exclusively an Irish phenomenon. It was derived from the ideas governing regulation generally in Europe and indeed internationally. Almost certainly the regulator subscribed to those ideas but did not originate them. It is worth recalling that in 2007 the IMF ranked Ireland's regulatory system highest in a study of accountability and independence in 32 countries (IMF Working Paper WP/07//25 published on 1st February 2007).

The truth is that, notwithstanding the shortcomings of the Irish approach, regulatory policy was located in an international context that was deeply flawed. Regulatory Rules are promulgated by the Basel Committee on Banking Supervision

(c) Appropriateness of the Macro Economic and Prudential Policy

Here again policy followed an International best practice model the weakness of which was exposed by the 2008 crisis.

Adair Turner, Chairman of the UK Financial Services Authority in a 2009 review of regulation states that:

> '*At the core of (assumptions guiding pre-crisis regulation) has been the theory of efficient and rational markets. Five propositions with implications for the regulatory approach have followed:*
>
> *(i) Market prices are good indicators of rationally evaluated economic value.*
> *(ii) The development of securitised credit, since based on the creation of new and more liquid markets, has improved both allocative efficiency and financial stability.*
> *(iii) The risk characteristics of financial markets can be inferred from mathematical analysis, delivering robust quantitative measures of trading risk.*

(iv) *Market discipline can be used as an effective tool in constraining harmful risk taking.*

(v) *Financial innovation can be assumed to be beneficial, since market competition would winnow out any innovations which did not deliver value added.*

Each of these assumptions is now subject to challenge on both theoretical and empirical grounds, with potential implications for the appropriate design of regulation and of the role of regulatory authorities'.

The problem of assuming that self-interest – Adam Smith's invisible hand – would make people do the right thing was that it was not correct. This is the 'flaw' to which Alan Greenspan referred to when he recanted his view about efficient markets before a US Congressman Committee in October 2008. He accepted that the pursuit of self-interest, however beneficial in the economy as a whole, does not necessarily lead to financial stability.

Unfortunately, Greenspan's conversion came too late. Regulators elsewhere who followed the same set of beliefs as the world's best known regulator had for too long taken a benign view of banks and the risks they were taking.

In Ireland's case this was reflected back to assessments of Macro Economic stability by the Central Bank. Financial Stability Reports did identify major vulnerabilities building up in the financial system leading to credit growth and indebtedness, house prices and increasing repayment burdens to the household sector. But these were located in a context where the banks were assessed to be generally sound.

These assessments were also made in the context of the Eurozone stability and growth pact. The SGP failed in a number of ways to prevent deficit and debt (public and private) problems within the Euro area. It was overly focused on current budget balances and not enough on the sustainability of Member States' public finances or underlying economic conditions. In the case of Ireland and Spain the criteria specified in the pact were consistently met even though the property markets were booming (NESC, 2010: 92).

The OECD (2006) review of the Irish economy identified housing as the key domestic risk facing the economy. But it said nothing about the banking related aspect and anyway considered that a 'soft landing' was the most likely outcome. The IMF (2007) overview of the Irish economy found that:

> 'Fiscal policy has been prudent, with a medium term fiscal objective of close to balance or surplus, in line with fund advice. In the past couple of years, windfall property related revenues were saved and the fiscal stance was not pro-cyclical, in line with fund advice (IMF, 2007: 3)'.

While both the OECD and IMF identified risks facing the Irish economy, neither identified the extent to which the public finances were reliant on property related transaction taxes.

In summary, the likelihood of a gradual adjustment dominated official thinking. The soft landing hypothesis might have been possible up to the Lehman Brothers collapse but not afterwards. We were seriously exposed in the banking sector and we didn't know it. The risks to the economy were identified in the Financial Stability Reports but they were qualified by assurances about the fundamental strength of the banks which were wrong.

Theme R2: Effectiveness of the supervisory practice (Central Bank, Financial Regulator and Department of Finance)

(a) Effectiveness of the use of supervisory powers

In 2009, in the aftermath of the onset of the crisis the EU established a high level group on financial supervision, chaired by Jacques De Larosiere, to review financial supervision in the European Union. The group concluded that there had been real and important regulatory failures. It recommended giving more powers to make financial stability reports more effective rather than relying on 'Moral Suasion '. At a European level it recommended the establishment of a European Systemic Risk Council under the chairmanship of the President of the ECB. The group also recommended setting up an integrated network of European Financial Supervisors.

(b) Nature and Effectiveness of the Operational Implementation of the Macro Economic and Prudential Policy

This is an area of significant institutional failure in Ireland. The regulatory regime was altered radically as a result of the Central Bank and Financial Services Authority of Ireland Act, 2003 which amended the original Central Bank Act of 1942. It established the Irish Financial Services Regulatory Authority (The Regulator) as an autonomous entity and it was given responsibility for prudential regulation. The powers formerly held by the Central Bank for the regulation and supervision of the financial institutions were transferred to the Regulatory Authority under sections 33c of the new Act. The Central Bank was left with residual responsibility for stability of the financial system and various functions related to the European system of Central Banks. Henceforth the Regulator was accountable to the Oireachtas and communicated directly with the Department of Finance. The Regulator also published a separate Annual Report.

The impetus for a new body with two independent pillars came from the Mc Dowell report but as Mr. Patterson has told the committee in his evidence, it was also influenced by the radical de-regulation of financial services under President Reagan in the US during the 1980s and the 'Big Bang' de- regulation in the UK in 1986. As the Tánaiste said at the time:

"We are responding to changes in the Market place, changes in consumers' needs and changes in financial regulation in Europe and globally……… This is a new chapter for financial regulation in Ireland, with a new culture and a new structure for the 21st century' (Press Statement, 20th February 2001)".

The Central Bank was opposed to the changes as they would essentially interdict the line of sight between financial stability and the soundness of the Banks. My personal view supported this evaluation and I also felt that the change was, to some extent at least, motivated by ideological considerations. I was involved with the Governor and other Board members in making representations to the Minister for Finance about it. Clearly the 2008 crisis exposed the institutional flaws in this structure and it was reversed.

Theme R3: Clarity and Effectiveness of the Nexus of Institutional Roles and Relationships

(a) Awareness and Clarity of Roles and Accountability amongst the Regulatory and Supervisory Institutions.

The 2003 Act was fairly specific about the respective roles of the Regulator and the Central Bank. The Regulator was autonomous in its powers and responsibilities. The only areas of joint engagement was in relation to sign off on Financial Stability Reports and shared services such as IT and HR.

(b) Nature and Appropriateness of the Relationship between the Central Bank, (including the Financial Regulator) Department of Finance and the Banking Institutions.

As far as I could observe, executives of the Central Bank and the Regulator put a lot of effort into making the new structure work. The relationship between the Central Bank and the banking institutions became less frequent as a result of a transfer of supervision and regulation to the Regulator. At least that is the way it seemed, Board members were never involved in the interface with the banks under either the pre or post 2003 models. The Secretary General of the Department of Finance was always a Board member so that channel of communication could hardly be improved upon.

Theme R4: Appropriateness and Effective Utilisation of Expert Advice

(a) Appropriateness of the Expert Advice sought, quality of Analysis of the Advice and how effectively this Advice was used.

In the autumn of 2008 when the crisis was building toward its climax, Price Waterhouse Cooper (PWC) was commissioned to assess the state of the Bank loan books. The report concluded that the Banks were sound. Specifically, it said that the analysis performed by PWC showed that all of the institutions reviewed were in excess of the minimum Irish Regulatory Requirements as at 30th September 2008. Overall regulatory capital ratios stood at between 8 per cent and 12 per cent, reflecting capital of over €44 Billion. However, in informing the Minister of the outcome of this review the Board and the Authority recommended urgent steps to strengthen the capital positions of the covered institutions.

Theme R5: Clarity and Effectiveness of the Government and Oireachtas Oversight and Role

(d)Appropriateness of the Relationship between Government, The Oireachtas, the Banking Sector and the Property Sector.

Apart from what is in the public domain, I have no special insights to offer relating to this line of enquiry.

Theme R6: Relationship with and oversight by International Stakeholders

In the years when the crisis was incubating all the international agencies – IMF, OECD and ECB – took a positive view of the performance of the Irish economy. Earlier, in or around 2003, the European Commission disagreed with the Minister for Finance about budgetary policy but their case was undermined by the fact that Ireland was fully compliant with the Stability and Growth Pact (SGP) while Germany and France were not. Otherwise Ireland was regarded as a Poster Child for globalisation by the EU and presented to Greece, for example, as a role model (Antoniades, 2010: 74). The role played by Mr. Trichet, during the critical stages of the crisis is, I understand, being investigated by the Committee of Inquiry but I have no special insights to offer on this point.

Donovan and Murphy (2013: 6) correctly draw attention to the failures of the EU and ECB in the run up to and during the crisis. Amongst these failures were:

- The inability of the SGP procedures to prevent the emergence of underlying budget deficits such as those of Ireland;
- The implications of low interest rates;
- The delegation of responsibility for regulation to national level with consequence for policy co-ordination;
- The role of the ECB in the 2008 Bank Guarantee;
- The ECB's position regarding the treatment of banking debt incurred by the taxpayer as a result of the Bank Guarantee.

In the years following the bailout, I had many meetings with the EU/ECB/IMF Troika in my capacity as General Secretary of ICTU. This was a very bad experience which I have detailed elsewhere in my statement.

Theme R7: Effectiveness of the Policy and Institutional Response Post Crisis

(a) Assessment of what has been done, work –in- progress and what remains outstanding from the recommendations of previous reports.

As I retired from the board of the Central Bank over five years ago, I cannot comment on this.

Theme C4: Appropriateness and Effectiveness of the Domestic Policy Response

(e) Cost of the Crisis and Sharing of the Impact.

It is clear from the evidence given to the inquiry by Mr. Considine that both the ECB and the US Secretary of the Treasury refused to allow any part of the burden to be shared with senior bondholders. Instead, in the absence of a capability to devalue the currency, the burden of adjustment was borne by citizens via an internal devaluation. This hit labour markets, welfare recipients and public services. The long term scaring effect of this adjustment may only be fully revealed in the years ahead.

Theme C6: Appropriateness and Effectiveness of other EU-wide Policy Responses

(d) Role and influence of ECB.

There are clearly significant institutional deficits in EMU. The crisis has revealed that it is impossible to operate a currency union with a fiscal, economic and political union as well (Hemerijck, 2013). For the last fifty years European integration has proceeded on the basis of a permissive consensus which probably no longer exists. The integration project is stuck.

The problem with the ECB is that it has a singular mandate of 'Price Stability', which combined with its independence, means that there is no effective counterbalance by any other European institution. It is a technocratic body with no political accountability and yet it can influence the lives of 500 million Europeans. In my opinion this construct is politically unsustainable in the long run. It amounts to too much of a democratic deficit.

On the other hand it is highly unlikely that institutions with a social remit can be established to balance the ECB. The reason is that social policy is largely a national competence and member states, particularly I would say in the Nordic Social Market economies, are unlikely to surrender that competence to a central institution. Moreover, welfare regimes among the twenty eight member states are so diversified that it would be difficult to agree on one welfare state model.

Accordingly, the only solution I can see is for the remit of the ECB to be aligned with that of the United States Federal Reserve (FED). Under the Humphrey Hawkins Act of 1978, the FED is required to take on board Government economic goals including achieving economic growth near potential combined with 'reasonable price stability'.

<u>Theme C7:</u> Impact of the Crisis on Bank Creditors

(a) Options for Burden Sharing during the Period 2008-2013

It appears from the evidence already given to the inquiry that both the ECB and Timothy Geitner, the US Treasury Secretary, refused to allow Ireland to burn the senior Bondholders.

<u>Part 2</u> – Perspectives of the Irish Congress of Trade Unions

In his statement to the Committee Mr. Con Horan, Prudential Director of IFSRA, called attention to 'The Great Moderation' as the paradigm within which pre-crisis regulation was conducted. The Great Moderation described the long period of Macro Economic calm which pre-dated the crisis. It held that, through policy alone, Central Banks had managed to create stable conditions of strong growth and low inflation. The Great Moderation was constructed on three pillars, viz:

- The disinflationary influence of cheap Chinese manufactured exports;
- A cheap credit model;

<u>**And**</u>

- A change in the balance of power between capital and labour consequent upon the growth of the global labour force by 1.5 Billion following the demise of the Soviet Union and the decision of China to become capitalist by decree.

The thinking was that cheaper goods would increase purchasing power. The decline in Labour's share of national income due to a weakened collective bargaining position would exert a downward pressure on inflation and could be compensated for by the ready availability of cheap credit (Mason, 2009). Francis Fukuyama (1992) in his book ***The End of History and Last Man*** advanced the thesis that liberal capitalism had reached its apotheosis and would embrace the entire world as a single economic system.

This trajectory had its origins in the 1980s which saw the end of the post-war 'Golden Age' of social democracy. The two oil crises of the 1970s gave rise to 'stagflation' – a combination of economic stagnation and high inflation – which precipitated a kind of counter revolution against Keynesian economics. Margaret Thatcher in Britain and Ronald Reagan in the United States were the leading political – as distinct from intellectual – proponents of the new ideology. They respectively took on the miners in Britain and Air Traffic Controllers in the United States and defeated them thus delineating very clear battle lines based on class interest.

Generally speaking this neoliberal approach did not produce widespread conflict in Europe but its intellectual underpinning gained huge influence. From the 1970s on New Classical Macro Economics became the dominant paradigm widely taught in universities. NCMs' rejection of stimulatory Macro Economics policies on the grounds that they did not work implied that monetary policy should be removed from political control into independent Central Banks. The Efficient Markets Hypothesis (EMH) ideologically complemented NCM with its belief in the efficiency of financial markets. The combination of NCM and EMH led to major changes in Macro Economic thinking including, inter alia, an emphasis on light touch financial regulation. It was all part of an international intellectual revolution which, as a number of witness statements have said, was fully embraced in Ireland following the establishment of an autonomous regulatory authority under the 2003 Act.

This paradigm was opposed by a European (and Irish) Trade Union movement which broadly remained committed to social democratic ideas in politics and neo Keynesian ideas in economics. It was only to be expected that these competing paradigms would cause a degree of creative tension between me and some colleagues on the Central Bank board from time to time. An example of this would be in relation to inflation. The ECB remit to keep inflation close to or at 2 per cent is also more or less an international standard of great concern to the Bank over the years. Inflation of 3-4 per cent would not trouble me if it meant full employment. It now turns out that deflation is a much more troublesome phenomenon to deal with.

Also, in my opinion, the Bank was obsessed with evaluating competitiveness from the singular metric of wage growth. From my perspective, Labour's share of national income was falling and I felt that the Bank's emphasis was misplaced. Given my role as titular head of the Irish Trade Union Movement, none of this could be unexpected. I must make it clear, however, that I enjoyed good personal relations with my fellow Board members and I never saw them act other than in the public interest as they saw it.

Looking back over the period of my time on the board of the Central Bank, it is possible to discern two distinct periods of economic development.

By the early 1990s there was a concern that Ireland had not recovered from the mid- 1980s recession. The National Economic and Social Council (NESC) commissioned a Norwegian academic, Lars Mjoset, to research the question of why Ireland was not performing as well as certain other small open economies in Northern Europe. Mjoset (1992) found that Ireland suffered from a series of self- reinforcing vicious circles involving underdevelopment. In the event the economy began to grow strongly in 1994. By the end of the 1990s Ireland had closed the income gap with the rest of Europe. It was a period of good co-operation and sustainable productive investment. The develop mentalism that characterised this period was not replicated in the period between 2001 and 2008. Instead investment moved more towards property and the achievements of the 1994-2001 period were not consolidated.

By 2004 it became clear to me as General Secretary of Congress that we were heading in the wrong direction. Our pre-budget submission of that year called for the removal of all property based tax incentives. By the following year (2005) our pre-budget submission voiced concern about overheating in the economy suggesting that:

> *"Future economic policy should consider focusing on optimising economic growth rather than continuing the relentless pursuit of 'growth for growths sake' which has both economic and social downsides"*

Following the accession of ten Central and Eastern European countries to the EU in 2004 the government, without any consultation with Congress, followed the lead of Britain and Sweden and opened the Irish labour market from day one. Not surprisingly this caused an increase in immigration and indirectly contributed to some difficult industrial disputes. It also gave an impetus to the housing market. I was reminded recently by a fellow board member that I said to the Board at that time that this was unsustainable because Irish people were investing in buy to let houses, built by immigrants who were renting the same houses. It was a potentially huge vulnerability in my view. We were recreating Mjoset's vicious circles.

In this regard I wish now to respond to a letter I received from the Committee of Enquiry on 26th May, 2015, drawing my attention to the fact that another witness, Mr. Tom O'Connell, in his statement ' names or otherwise makes comment on you'. I assume this refers to a passage at the end of Page 3 of his statement, relating to the Financial Stability Reports (FSRs) wherein he recalls that:

> *"In fact, I should say that one member of the Board did have grave doubts about what was happening; his words ring in my ears to the effect that "It was all a house of cards and would end in tears".* However, his views appear not to have had any impact on policy making in the Bank'.

I cannot say for sure whether I made that comment. Certainly it accords with my views and my style of language but, in my opinion, it could have come from any one of the three Directors.

In May 2005 Congress made a detailed submission to the Department of Finance arguing the case for the abolition of property based tax schemes (Appendix 1)

On 4th October 2005 I was invited to give the keynote address to a social policy conference organised by CORI in UCD. A copy of that speech, wherein I set out my views on a wide range of economic and social issues of the time, is attached at Appendix 2. I wish to draw the attention of the committee to Pages 8 and 9 which included the following passage:

> *"We need also to take a more considered look at our economic policy. Since the 1980s our national priority has been jobs, which rightly required us to focus on maximising economic growth. But it is worth asking whether growth at all costs, and almost as a mantra, is appropriate to our current circumstances. To continue to grow at five per cent per annum is only possible with immigration of 50,000 – 60,000 people per annum. And that assumes that all the people who come will stay. If there is a replacement factor the gross immigration will be higher. Indeed we could be faced with a situation of jobs being lost to Irish workers due to outsourcing while immigration increases. This could lead to social tensions and the issue of race or nationality being exploited by unscrupulous elements. In addition, it must be borne in mind that people who come here also require houses, hospitals and schools. Given our obvious failures to provide these for our citizens to date, the question must be asked: do the relevant authorities have a coherent plan and strategy on this issue? Would it not perhaps be wiser to have a target rate of growth of say twice the EU average? It might take us a couple of years longer to reach the same level of GNP. But national GNP growth anyway is not the same as GNP per capita. Reaching the same target over a longer timeframe might actually increase GNP per capita and thus wellbeing.*
>
> *The emphasis must surely be on sustainable growth. We have a finite land mass – we cannot cover the island in concrete. Why are we knocking down hotels and putting people out of work in Dublin to build apartments? Is this good planning? We need an intelligent land use management strategy. We should try to maximise indigenous labour force growth including supporting more women to work and reskilling of workers in tandem with sustainable levels of immigration"*

These sentiments were repeated at many fora including the Central Bank, NESC and, indeed, directly to the Minister for Finance by the President of Congress and myself.

Not everything in that speech turned out to be right but a lot of it did. Quite frankly, I had no expectation that the crisis would manifest itself as it did. I had no independent line of sight on the soundness or otherwise of the Irish banks nor did I know or suspect that the mathematical approach to the evaluation of risk which caused Lehmans to collapse was flawed. Intuitively I did suspect the possibility of a global correction but for completely different reasons. Economic history points to cycles which last for prolonged periods but eventually become unstuck. For example the period between 1870 and 1914 was one of globalisation and the gold standard not too dissimilar to today, but it all collapsed into the misery of the First World War. After the war it was impossible to recreate the economic conditions that preceded it and Woodrow Wilson's efforts at creating new institutions largely failed (except for the ILO). The growth of fascism precipitated World War 11 and it was followed by the Bretton Wood's settlement and the institutions of the New Deal. The neoliberal era had also lasted thirty years and I suspected that the hubris in Fukuyama's (1992) analysis might also be misplaced. I expected something to happen but for the wrong reasons.

When the crisis hit in 2008 it is important to note that, whatever other mistakes were made, international action did prevent a repeat of the 1930s crash. For the first year or so policy reverted to Keynesian stimulus. But unexpectedly that changed to austerity except in the United States.

Congress opposed austerity. We feared it would lead to deflation and a Japanese style slump. We knew that fiscal consolidation would have to happen but we wanted it to be spread over a longer period (to 2017) and back loaded , not front loaded, to try to keep up domestic demand and let growth do some of the heavy lifting of adjustment . We also wanted the consolidation to be more focused on tax measures than public service cuts. We campaigned for this approach under the banner of 'The Better Fairer Way'. Would this have been better? We don't know the counterfactual.

In February 2009 I said publicly that I thought the banks would be nationalised. The Department of Finance and the Central Bank were very unhappy about this and I had to go to some lengths to make clear in the media that this was a personal view and not the view of the Central Bank (Appendix 3).

During the period when Ireland was a programme country my colleagues and I met quarterly with the EU/ECB/IMF Troika. It was a dispiriting experience and utterly valueless. My impression of the Troika was of an uncaring technocracy of neoliberal zealots devoid of empathy. I exclude the IMF from this description. They were more reasonable, which was a surprise to me because I had first-hand experience of IMF structural adjustment programmes in the Developing world during the 1990s. We were able to establish a useful separate bilateral relationship with the IMF.

The most significant learning for me out of this experience relates to how EMU worked in practice. I did not expect that, in the event of an exogenous shock, and absent the facility to devalue the currency, the whole burden of adjustment would fall on labour markets. The Finns were better prepared as a Labour movement than we were. They used their national collective agreement to negotiate buffer funds to cushion the impact of adjustment. Then again such funds might have been raided to bail out the banks as the National Pensions Reserve Fund was raided.

It is clear to me also that there is no social institution to balance the independence and power of the ECB. An institution with the sole remit of price stability is not concerned with 26 million out of work. The remit of the ECB should be changed to reflect the same range of social and economic responsibilities as the Federal Reserve (FED) in the United States.

Conclusion

In my opinion there were two crucial policy errors which made the impact of the 2008 global financial crisis on Ireland much more than it needed to be.

The first was the enactment of the 2003 Act which created a dual pillar structure within the CBFSAI. The second was the decision to embrace principles based (light touch) regulation. Both were domestic policy choices.

That said, both decisions were in resonance with the zeitgeist of the times internationally. The orthodoxy concerning how financial markets were supposed to work was largely unquestioned. This was 'Group Think' on a massive scale. The fact that the stability and growth pact monitored the wrong indicators meant that there are no effective external oversight that might have prevented the Banking failure here. The Financial Stability Reports, grounded in the SGP, identified the risks correctly but assumed too much about the soundness of the Banks as the Central Bank no longer had a direct line of sight on what was happening in the banking sector. It relied on the Regulator for that information. The crisis exposed other deficiencies in EMU apart from the SGP. The absence of any kind of fiscal or monetary solidarity – as, for example, with Euro Bonds – meant that the burden of adjustment was borne via internal devaluations. Finland endured a crisis similar to Ireland in the 1990s but its recovery was much quicker, not least because it was able to devalue the Markka by 30 per cent.

The so called 'Great Moderation', upon which so many incorrect assumptions about markets were based, turned out to be a chimera. In his seminal work*, The General Theory*, Keynes wrote about the differences between risk and uncertainty. Risk can be quantified and therefor mitigated, uncertainty cannot be. Regulation in future must be aimed at minimising risk in the knowledge that uncertainty will always be with us.

I confirm that the documents attached to this statement are true and correct and are in the public domain.

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