Banks, Governments & Citizens

NERI *InBrief* Research

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1 What is the total amount of 'socialised' banking debt in Ireland and what are its components?

Following the collapse in property prices and associated disruption in banking in 2008 the Irish economy experienced a sharp contraction in output and employment in 2008-2009.

The genesis of the economic crisis is overwhelmingly in the private sector – bad corporate governance, excessive and inappropriate lending with the consequence that bank balance sheets became bloated and potentially unstable in many private financial institutions. These failures were facilitated by grossly inadequate public regulation and oversight.

The total cost of bailing out private banks by the Irish taxpayer – to date – is estimated to be €64 billion. The components and details of what has been one of the largest public bailouts of a broken and bankrupt private banking system are shown in the Table below.

The Cost of the Bailout as of January 2013 (€ billions)

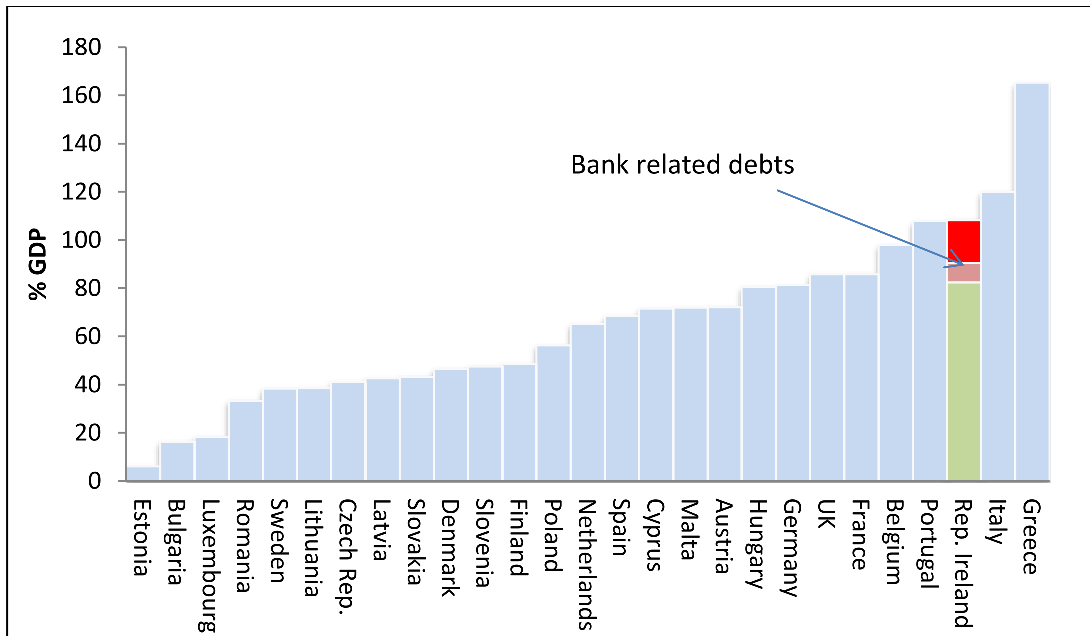
Date Due	2009	2010	2011	2012	Total
Anglo-Irish	4.0 E	25.3 P	0	0	**29.3**
Irish Nationwide Building Society (INBS)	0	5.4 P	0	0	**5.4**
Allied Irish Banks	3.5 F	3.7 F	3.9 E 8.6 F	0	**19.7**
Education Building Society	0	0	0.9 P	0	**0.9**
Bank of Ireland	3.5 F	0	1.2 F	0	**4.7**
Irish Life and Permanent	0	0	2.7 E	1.3 E	**4.0**
Total	**11.0**	**34.4**	**17.3**	**1.3**	**64.0**

Sources: Reply to Parliamentary Question 34630/12.

Notes on sources of funding:
E denotes Exchequer funds (€11.9bn)
P denotes Government Promissory Notes (€31.6bn)
F denotes National Pension Reserve Funds (€20.7bn)

The total bill, at €64 billion, is equivalent to approximately 40% of annual GDP. Total Government debt includes only some of this cost (€41 billion). Chart 1, below, shows that Ireland's Government debt is very high and banking related costs are part of these debts. This sum does not include the additional cost to Irish taxpayers of reducing cash balances as well as equity investments under the National Pension Reserve Fund.

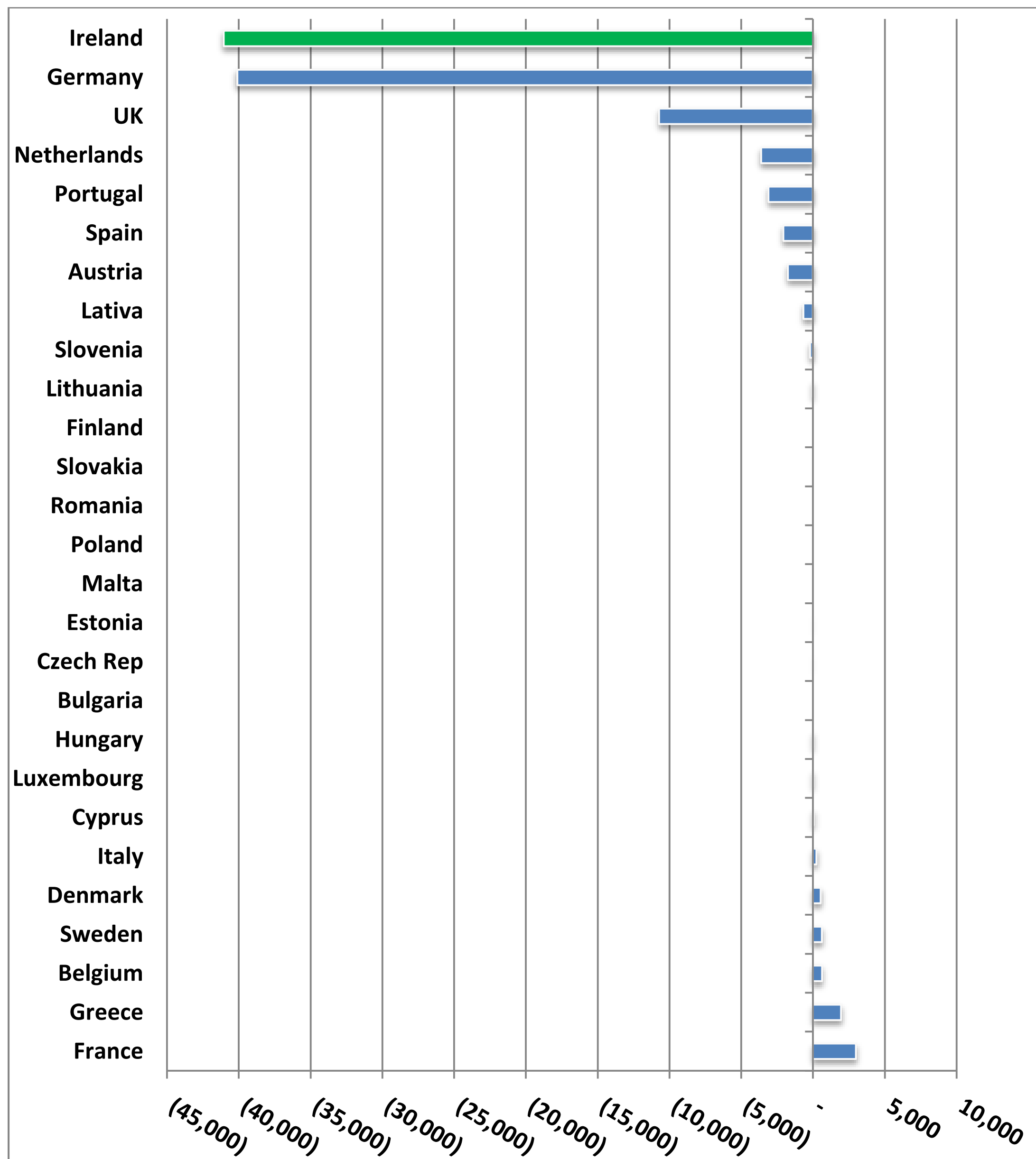
Chart 1 General Government Debt as a Percentage of GDP in 2011 (and financial institution related debts in Ireland)



Source: Eurostat

The debt burden arising from the bank bailouts and its direct impact on Government deficits is the highest absolute amount for any EU Member State over the period 2007-2011 (Chart 2). It represents 42.6% of the total net cost across all 27 EU Member States.

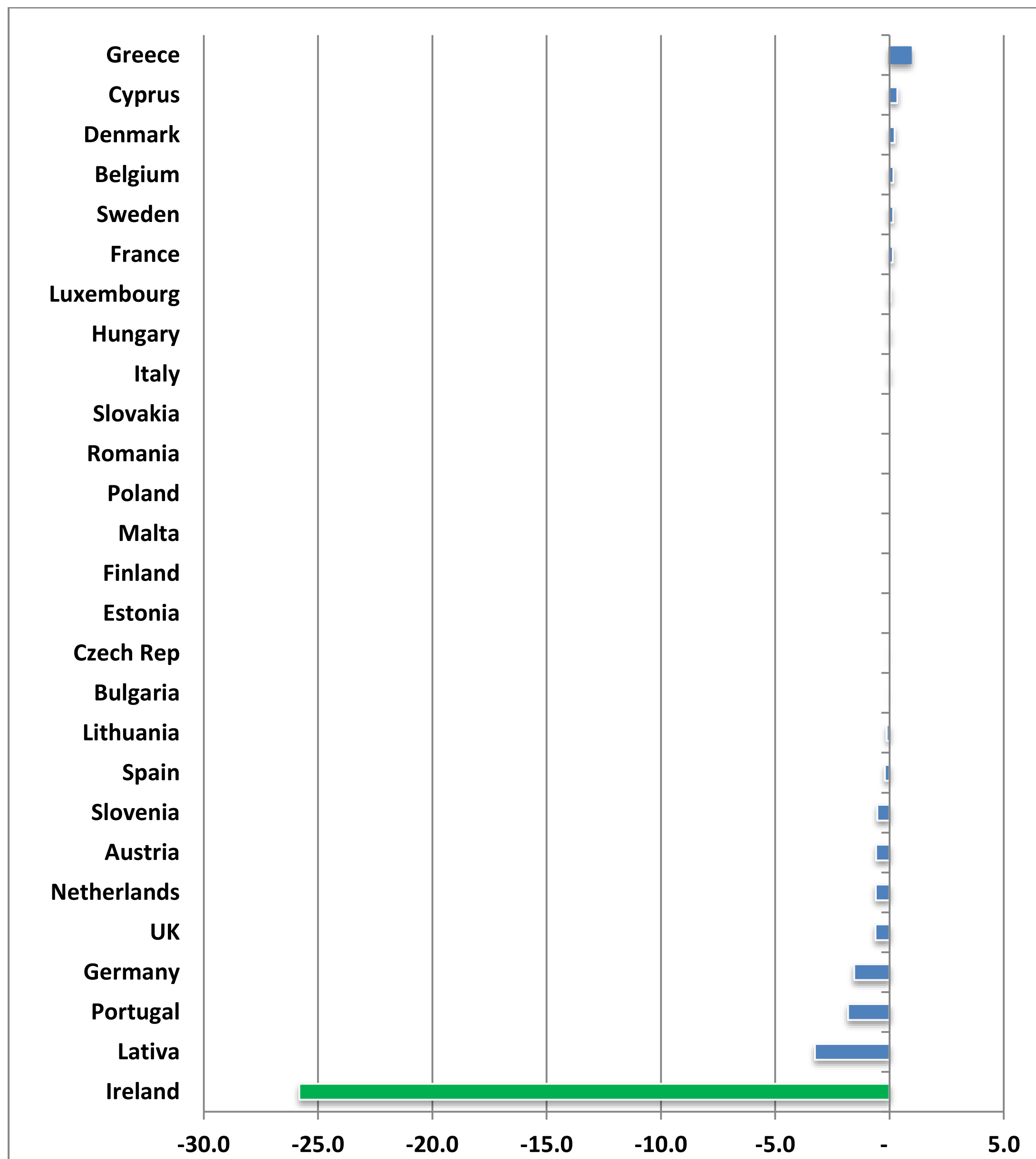
Chart 2 The Total Net Cost of Bank Capital Transfers (Government Deficit) - € billions.



Source: Eurostat 2012.

Considering the small size of the Irish economy relative to the total EU economy the figure of €41 billion is huge. When the cost of bailing out financial institutions is expressed as a percentage of annual GDP (in 2011) the cost is a staggering 25.8% for Ireland (Chart 3).

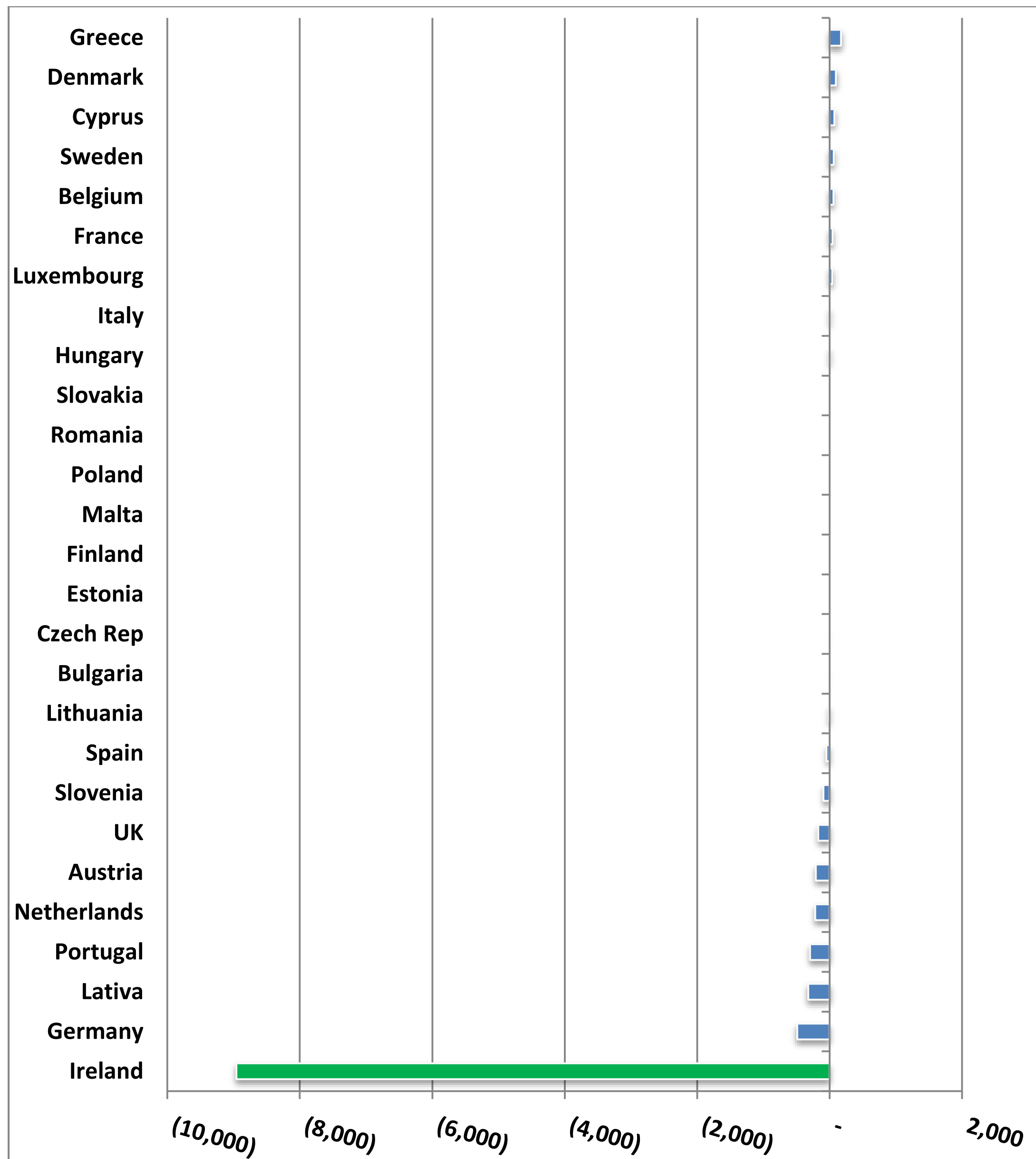
Chart 3 The Total Net Cost of Bank Capital Transfers (Government Deficit) – percentage of GDP in 2011.



Source: Eurostat 2012.

Finally, if account is taken of the fiscal impact on the population of Ireland which is small relative to total EU population, Chart 4 shows the total cost in Euro per capita in each EU Member State. The cost is €8,956 for Ireland compared to €191 per capita for the EU as a whole.

Chart 4 The Total Net Cost of Bank Capital Transfers (Government Deficit) – per head of population in 2011 (€ per capita).



The societal costs associated with continuing fiscal austerity over five years are all too apparent to communities, families and enterprises. There is a widely held belief in Ireland that the burden of private banking debt has been, unjustly, transferred to the general population but especially those on low pay, the young, the poor and the vulnerable – in other words those who did not cause the property and banking crash in the first place.

2 What options are technically and politically feasible?

To address the question of debt relief it is important to distinguish between two parts of the overall social bill – to date – for bailing out private banks:

- The cost of bailing out AIB, EBS, Bank of Ireland, Anglo-Irish and ILP through direct cash injections (from the exchequer or from the NPRF) – estimated at €32.5 billion;
- The cost of writing 'Promissory Notes' to cover recapitalisation of what were Anglo-Irish Bank and Irish Nationwide Building Society (and have now been merged into the Irish Bank Resolution Corporation, IBRC) – estimated at €31.6 billion.

2A the cost other than that arising from Promissory Notes

It could be possible for the Irish government to ensure that institutions under its effective control (in particular AIB) would not pay the full amount owed on outstanding bonds.

At this point in time, it is not clear that a unilateral policy of systematic bond write-downs would be beneficial to Ireland's interests given the impact of any unilateral action on:

- interest rates on other loans to Ireland in the money markets where Ireland might hope to borrow more and more in the future; and
- reputational damage on the political and commercial levels where Ireland is seeking to regain both credibility and attractiveness as a place to invest.

2B the case of the 'Promissory Notes'

Promissory Notes were written by the Irish Government in the course of 2010 to enable Anglo-Irish Bank to repay its bondholders and depositors and continue functioning legally as a commercial entity. To enable Anglo-Irish to continue as a functioning commercial entity it was decided to issue loans to Anglo-Irish from the Central Bank. These loans to Anglo-Irish are referred to as Emergency Lending Assistance (ELA). The ELA loans have been used over a period of two years to pay back bondholders and depositors.

The total repayments over a period of 21 years comes to an estimated €47.9 billion. This latter figure is made of two components:

- A total interest bill over the 21 year period of €16.8 billion some of which will be remitted to the Irish Government in the long-run; and
- €30.6 billion which is exactly equal to the total amount of money put into Anglo-Irish and INBS in 2010 by the Irish taxpayer.

Because the Irish Government does not have the money to pay interest paid to IBRC it will have to borrow additional funds over the coming decades – at approximately 4% per annum – in order to be able to pay back money to IBRC each year. This cost is difficult to estimate but is significant and it not included in most estimates of the cost of the Promissory Notes.

3 What would an optimum and fair resolution look like?

A deal might involve

- A significant up front relief to public finances where most or all of the costs of servicing this debt are removed;
- Agreement to postpone the repayment of interest and/or principal by a very significant period of time to allow space for economic recovery.
- Agreement to write-down, transfer or 'freeze' the total debt value of the Promissory Notes.

At a political level discussions seem to be focussed not at all on a debt write-down but on some type of 're-structuring' of the debt where 're-structuring' will involve a longer time to pay back the debt and lower interest rate bills in the short-term. Clearly, the ECB and certain EU Member States are anxious that a precedent is not set – even if could be plausibly argued that IBRC and its predecessors had ceased to be functioning commercial banks or financial institutions over 2 years ago. On the other hand the burden on Ireland – occasioned by a series of international events and pressures in 2010 – is unjust and intolerable. Some commentators see it as an obstacle to full re-entry to the bond market by Ireland in 2014 given the short-term repayment schedule demand in the Promissory Notes arrangement.

A strong negotiating position is needed at this time. The following should be considered:

- Suspend Promissory Note payments due in March 2013 pending successful and satisfactory negotiations for all concerned; and
- Focus these negotiations on three issues in the following order:
    - reducing the value of the principal
    - extending the maturity of the loan
    - and lowering or re-scheduling interest payments on borrowings by Ireland to repay the debt

4 What difference could a deal on bank debt make to public finances in Ireland?

Any write-down or any 'Europeanisation' of the Anglo-Irish debt component of General Government Debt (equivalent now to just over 17% of Irish GDP) would help Ireland meet its long-term 'debt brake' target of 60% by means of a more gradual adjustment. Proposals have been made by many economists to share the burden of bank debt – possibly through a conversion of a portion up to a limit of 60% of GDP into European bonds.

Any relief on interest payments could make an upfront difference in terms of the government deficit. Any relief by way of €1.9 billion and €1.8 billion in interest payments in 2013 and 2014, respectively would be helpful. The 'repayment' of the principal sum within total amount of €3.1 billion due in March of this year and later years is treated under the Exchequer account and not under General Government. The 'demonetisation' of that debt by the Central Bank on receipt of a payment from IBRC which in turn is paid by the Exchequer represents a real deflationary shock to the economy because of the forgone positive contribution to domestic demand resulting from repeated contractions in government spending year by year. There is a real opportunity cost in the 'burning' of money by the Central Bank when it reduces the total value of its assets and liabilities by the amount paid to it by IBRC each year. This is where the greatest change needs to be made.