Comments by Karl Whelan (UCD) on "Distinctive Features of the Irish Banking Crisis" by Patrick Honohan, delivered at the Statistical and Social Inquiry Society of Ireland on October 26, 2023.

I want to thank Patrick for writing and presenting this paper. The Irish banking crisis generated a lot of controversy at the time but it is now long enough ago that a calm and dispassionate analysis of events can be undertaken. Patrick is a great man for providing calm and dispassionate analysis. I am perhaps less well known for these qualities, so my comments will perhaps be a bit less charitable to some of the participants than Patrick has been.

From today's perspective, I think it is important to understand what we learned from how Ireland's public service and political leadership responded to this crisis. Patrick is, in general, relatively forgiving in his assessment of the policy response. I would characterise his assessment as that mistakes were made in responding to the crisis once it emerged but that the outcome would have been pretty bad even in a best-case policy response, thus limiting the real impact of these mistakes. I think this is perhaps a bit generous.

From my reading of Patrick's paper, a key theme that emerges is that, rather than attempting a substantive analysis of the problems in the banking sector, Ireland's leaders preferred to engage in magical thinking and a belief that bluster was an effective response to all problems.

Patrick writes "*The authorities should have realized that these banks were deeply insolvent, but they did not.*" This was not a small failing. There were plenty of reasons to be very concerned about the solvency of the banks. It didn't require much knowledge of international banking history to know that commercial property busts had often driven bank insolvencies and the possibility that this might be the case here should have been considered. Share prices are not a perfect yardstick of the value of a bank's equity capital but the collapse in the prices of Irish bank shares months prior to September 2008 showed a belief among investors that these banks had lost their capital. Ghost estates were already prominent around the country. The day after the guarantee, Morgan Kelly said on RTE's Prime Time that "*All the ghost estates you see can see around the place, that is the capital of the Irish banks*."

Patrick's paper gave me a better sense than I previously had about the sequence of events that ended up with the September 2008 guarantee. The Central Bank were unwilling to admit the scale of the impending insolvency problem because this would have required admitting a catastrophic supervisory failure on their part. The idea of introducing bank resolution legislation was considered and rejected because passing it would have suggested that at least some of the banks were in bad shape and this ran counter to the messaging that the banks were fine. An alternative to a guarantee was that the Central Bank could have extended Emergency Liquidity Assistance (ELA) to the banks, giving the government breathing space to work out a potentially less costly response to the crisis. Patrick tells us this was considered but rejected because Northern Rock had received ELA and the authorities didn't want people to think any Irish banks were as bad as Northern Rock (in reality, they were considerably worse).

Even with these other options ruled out, the extent of the guarantee had the downside of maximising the potential cost to the taxpayer with the perceived upside being that it maxed out on the bluster strategy: We would show the world how much faith we had in these banks by backing them to the hilt.

After the guarantee, with options to reduce the cost to the taxpayer eliminated, the bluster strategy was continued. Admitting the government had put the taxpayer on the hook for enormous losses was not politically feasible at first, so denial and obfuscation continued long after this strategy had failed to convince markets and depositors. For example, tons of political capital was expended insisting that the Irish banks couldn't be nationalised because this was somehow unthinkable when in the end, this was precisely what happened. Bondholders losing money they had loaned to Irish banks was raised as a spectre that would ruin the country's reputation: Today, bondholders in failed banks losing money is official EU policy.

One can also question whether the Irish government would have been better off to request an EU-IMF programme far earlier than it did, perhaps prior the full-scale bank run that took place during Summer and Autumn 2010 which was financed via an explosion in the (at one point unthinkable) ELA financing from the Central Bank. Again, I think national pride and magical "something might turn up" thinking played a role in an unwillingness to explore this option at an earlier point.

From today's perspective, the question I would ask is whether our policy-making structures are better placed now to avoid magical groupthink in response to major crises. I am somewhat optimistic that Patrick's period as Central Bank Governor introduced an important change in culture in that organisation towards a culture of greater scepticism when dealing with financial institutions and towards more honest exchanges of opinion within the organisation. I am less optimistic that the policy-making structures in our civil service, government and politics have substantially changed since the crisis.

I would like to also say a few words about the role of the ECB. The ECB's role is mentioned in Patrick's paper but not as prominently as I had expected given that their key role in how Ireland's crisis evolved and in the timing of the EU-IMF programme.

The ELA that was provided by the Central Bank of Ireland to the Irish banks required regular approval by the ECB Governing Council, which could decide via a two-thirds majority to discontinue ELA if it deemed such a programme to run counter to its monetary policy goals. From early 2010 onwards, as international depositors lost faith in the Irish banks, signals began to emerge from Frankfurt that various officials were unhappy with Irish banks becoming reliant on large amounts of ELA.

Patrick's paper characterises the timing of Ireland's EU-IMF programme as being the "Irish authorities realising" that this "was now the best option for Ireland." My recollection is that the ECB decided to make the continued provision of ELA reliant on Ireland entering an EU-IMF programme involving not just banking sector restructuring but also "fiscal consolidation" and "structural reforms". The famous letter from Jean-Claude Trichet of November 19, 2010 was dated after it was clear that Ireland would be entering a programme but the message it contained had been delivered a few weeks earlier. To paraphrase Don Corleone, Ireland's decision to enter a programme was based an offer from the ECB that Ireland could not refuse.

The result of this was that the ECB's role in Ireland's crisis became highly politicised, not least because of their subsequent preferences about repayments of bank creditors and the design of the adjustment programme all being publicised and being highly unpopular. To this day, IMF officials are amazed they walked away from an adjustment programme as "the good guys". I am still unclear as to what part of the ECB's legal mandate requires it to make lender of last resort loans to banks contingent on fiscal consolidation and structural reforms.

And Ireland wasn't the ECB's last rodeo. Similar drama surrounding the withdrawal of ELA occurred again after elections bringing in new governments in Cyprus in 2013 and in Greece in 2015. Despite being an organisation that ostensibly strives to be independent from politics, the ECB ended up remarkably entangled in a series of politicised controversies.

Could this happen again? Perhaps. The ECB's cumbersome and opaque ELA procedures remain in place. But the hope for avoiding these kinds of problems lies in the use of the resolution tools established by the EU's Bank Recovery and Resolution Directive (BRRD), passed in 2015, to deal with failing banks before they become reliant on large amounts of ELA. Patrick notes that each of the Irish banks in 2008 met the BRRD criteria for "failing or likely to fail". The Irish government's 2008 approach to dealing with failing banks would be illegal today and these banks would be put through some sort of resolution process which would inflict losses on bank creditors and be less expensive for taxpayers.

My concern, however, is that while BRRD's tools are fine for showing up on a Friday afternoon at individual institutions, wholesale wiping out of creditors may be considered too destabilising during a future multi-country systemic banking crisis and the BRRD rulebook may go out the window. In this case, the issues around extending (and eventually ending) ELA may be back on the ECB's agenda.