

# Crisis and Bailout in Ireland: Bank and Financial Regulation Deficiencies

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The financial subprime crisis, which started in 2007 in the mortgage area of the United States, and had a wide global spreading effect in 2008, had among its multiple consequences the disclosure of unsustainable economic situations in Europe. It is a dominoes-like projection where highly sensible financial markets react with fear and strength to facts which exacerbate the perception of economic risk in various forms.

Ireland's bailout, agreed on Sunday, November 28<sup>th</sup>, occurred after the Greek one. Currently, Portugal is in a very weak situation and Spain has serious internal deficits.

The precarious situations of all these economies had been already recognized as weak long ago, which perhaps explains the creation of the European Stabilization Fund, with headquarters in Luxemburg, of approximately 500 millions Euros, in conjunction with the European Union and the Monetary Fund, which is on standby for new victims and is also a sort of dissuasive element of fears or attack attempts, facing weak economies. It has already been suggested to increase this sovereign rescue fund to 750 thousand millions Euros.

The question is why were the actions taken not enough to strengthen these economies, anticipating the market pressures which would end up leading them to an unavoidable bailout?

On the other hand, almost all financially weakened economies (due to excessive generalized expenditure, high fiscal deficit, high public debt or an overexpanded financial system with plentiful arrears) have shown that both the macroeconomic projections and the corrective goals are frequently

excessively optimistic, and that the corrective goals of economic adjustment are insufficient. Until finally, we end up with lack of credibility and panic, and the dynamic of elevated and increasing interest rates for the increasing risk primes and the contraction of the resources availability to renew debts, lead to an exhaustion of the capacity to fulfill the financial commitments, and to bailout.

With no debt rescheduling although with lower interest rates, bailout can be, once again, just a delay of debt rescheduling with some discounts or “haircuts”, which is certainly very costly, painful and embarrassing.

These economic adjustment processes are in the hands of the political authorities of the countries, who intent to do as minimum as possible, by trying to have the lowest political cost to buy time and reach a temporary calm in the financial markets, which are difficult to deceive. Experience has demonstrated that its level of realism and its financial analysis capacity tends to be greater than that of politicians or government authorities.

The situation described above has been happening for quite a long time in Ireland, Greece, Portugal, Spain, and maybe other Central European countries. However, in the United Kingdom, we have the impression that the new government of David Cameron has reacted anticipating the spread risk with very strong measures in the public sector and the bank sector, in order to generate an adjustment which aims at achieving economic stability and sustainability, by gaining trust among investors and consumers, so as to allow economy to grow again and enter a recovery cycle which enables them to reduce the deficit and the debt.

Ireland started, in 1974, when it entered the European Economic Community, and prepared itself to participate in the Monetary Union with a unique currency (the Euro), a process of rapid growth which led its economy to a developed country level, with a high per capita income of nearly US\$46,000 in 2009.

Due to their effective and discreet public policies, Ireland became a paradigm for the emerging economies. The country appeared in the rankings of economic freedom, competitiveness and *Doing Business* of the World Bank, in advantageous places.

Unlike other European economies, it was neither the excess of public spending nor the over-dimensioned social welfare system which deteriorated the economy, but rather the overexpanded bank system which financed the housing bubble and collapsed the banking system, which had already been nationalized. The public sector, which had surplus and a moderate debt, when underwriting the banks to avoid their bankruptcy and the immediate bankruptcy of thousands of companies, acquired

considerable liabilities which, finally, generated a fiscal deficit estimated in more the 30% this year, and a debt of 64% of the GDP, before the deficit adjustment to 32%.

Therefore, the origin of the crisis were deficiencies in the financial and bank regulation, which allowed the overexpansion of the banking system and the creation of a huge housing bubble, without taking preventive and timely measures.

It is highly reasonable to believe that after the bailout, with resources close to 85 thousand millions Euros, Ireland will stabilize for a while, but in the mid-term, 2 to 3 years, it will probably have to reschedule its debt in order to accelerate its adjustment and economic growth.

The crisis and bailout of Ireland has created a great volatility in the financial markets, which may be temporary and also a strong contagious element for Portugal and Spain, where, unlike Ireland, the origin of the economic weakness is related, in the public sector, to excessive public spending and the costly expansion measures of the social welfare system.

In all these European economies, productivity has dropped, thus hampering the adjustment which already presents obstacles in the rigidities existing mainly in the labor market.

The unique currency monetary system has suffered a serious failure in its current condition. Monetary Union is not consistent with fiscal plurality. It is necessary to have greater discipline and future fiscal homogeneity, with adequate supervision controls and strict penalties for those who do not comply with the established rules and generate great negative externalities.

Ireland has a pretty flexible economy and an efficient economic management capacity; therefore, it has advantages to recuperate faster than other European economies with a small capacity to establish quality public policies and discipline in public spending.

The consequence derived from this recent episode for the small and open emerging economies, is that they must watch fiscal discipline and solvency, and regulation and supervision of the banking system. The risks and subsequent social costs are high when living with strong imbalances in a demanding and vigilant international scenario.