HOUSES OF THE OIREACHTAS

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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Déardaoin, 26 Feabhra 2015

Thursday, 26 February 2015

The Committee met at 9.00 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D'Arcy,
Deputy Michael McGrath,	Senator Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Context Phase

Mr. David McWilliams

Chairman: In commencing this morning's proceedings I welcome everyone to the 11th public hearing of the Joint Committee of Inquiry into the Banking Crisis. At our first session this morning we will hear from Mr. David McWilliams on issues related to early warnings, divergent and contrarian views in the context of the banking crisis in Ireland. David McWilliams is an economist, writer, broadcaster and journalist. He worked initially as an economist with the Central Bank of Ireland, the Union Bank of Switzerland and Banque Nationale de Paribas. Since 1999 he has been a broadcaster, writer, economic commentator and documentary maker. He has written four books, writes two weekly economic columns and he has made various documentaries. He has brought a one man economic stand-up show to the stage at the Abbey Theatre. David McWilliams is credited with being one of the first economists to predict a boom in Ireland's economy and for his predictions of an Irish property bubble building from 2000 to 2007 which would ultimately burst. He was the first to coin the phrase "ghost estates". In January 2007, David McWilliams was selected as one of 250 young global leaders by the World Economic Forum and he is a regular speaker on the international circuit. I welcome Mr. McWilliams.

I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If the witness is directed by the Chairman to cease giving evidence in relation to a particular matter, and continues to do so, the witness is entitled thereafter only to a qualified privilege in respect of the evidence. The witness is directed that only evidence connected with the subject matter of these proceedings is to be given. The witness has been informed previously that the committee is asking witnesses to refrain from discussing named individuals in this phase of the inquiry. Members are reminded of the long-standing ruling of the Chair to the effect that Members should not comment on, criticise or make charges against a person outside of the House or an official by name, or in such a way as to make him or her identifiable. Can I invite Mr. McWilliams to make his opening remarks to the inquiry please.

Mr. David McWilliams: Thank you very much, Chairman. It is a pleasure to be here. I just want to make some opening remarks about the period in question, starting with 2000 and going up to 2008 and beyond. It is my opinion that the Irish banking system, and by extension the rest of the Irish economy, was set up to fail. I saw this earlier than anybody else and I made this opinion and these ideas available as widely as possibly. In fact, I probably spent the best part of a decade trying to warn as many people as possible on as many platforms as possible that our property market was going to crash and that when it did, our banking system would be in a situation where money would fly out of the system and lead to a banking crisis. I did this in hundreds of thousands of words; not thousands, but hundreds of thousands of words, in dozens of articles, two a week in the *Irish Independent*, the biggest selling newspaper in the country, and in *The Sunday Business Post*.

I made documentaries about this. I had my own TV show on TV3, which was watched by tens of thousands of people. I warned people at every juncture that our housing market was a credit bubble and credit bubbles bust and it is not a matter of if they bust but when they bust. The documentaries of *The Pope's Children* book, which I wrote, were watched by 36% of the Irish watching audience; that is a lot of people. *The Pope's Children*, and I do not say this for any other reason than to make the point, was disseminated extremely widely and was the best-selling non-fiction book, not of the year, but of the decade, and it was published in 2005. So these ideas were out there, disseminated widely, in the most accessible way. When I hear the view that nobody saw this coming or that this was in some way a shock or we were taken by surprise, I do not believe that is the case. I think the Irish property crash and the banking crash were both incredibly predictable and absolutely preventable.

This testimony will be a little bit different in the sense that it will not be about what should have or could have happened, and if we had seen that, if we did not see that, and my God I cannot believe we missed that. This testimony will be taken from contemporaneous articles, pieces of work that show thinking at the time. This was not isolated thinking. In fact, I believe, and my experience through the period from 2000 onwards was, that many thousands of ordinary Irish people could see what was happening. The difference is that I was an economic commentator and an economist and I had the platform of the media to deploy these ideas. I cannot tell you the number of times I went into bars and pubs and chatted to people and they said, "Hold on a second, this doesn't seem right; what is going on here?" So it is not as if a significant part of the population was not already worried. I want to make that point that this was preventable and predictable, and that these views were widely disseminated. There were not a huge coterie of individuals doing this but it was certainly out there.

One could probably ask oneself why did this guy, who is a former Central Bank economist, an investment bank economist, why did he not just come home to Ireland, keep his mouth shut, play the game and get on with business. The reason is I felt that if one has a specialty, if one understands something, one has something like a patriotic duty or a moral imperative to say that the policy or numbers of policies that we have together will lead our country into catastrophe. I think it was a patriotic thing to do. It certainly was not a worthwhile thing to do and it certainly was not fashionable and it certainly did not make me popular. The interesting thing is that all through this period I was accused of being unpatriotic when I believe in actual fact it was something that was essential to do if one had the education and the experience to do so. I remember people saying that I was unpatriotic for talking down the economy. The committee might remember that expression, "Talking down the economy". I think that was maybe a reaction on the part of certain parts of the establishment to somebody saying, "Hold on a second, this thing will not last."

It seems to me from a political perspective that on every big economic issue, Ireland tends to split between insiders and outsiders. The insiders are people with "pull", the old fashioned word, with access to power, and the outsiders are people who are actually on the outside. In the case of the property market and the associated banking and credit explosion, the insiders were the bankers themselves, estate agents, people who were doing well out of the property market, parts of the professional classes who were doing very well, and senior Government officials who were looking the other way or were not necessarily taking on board what was clear. These are the people on the inside who were actually doing well. Then, of course, political parties, because if there is a property boom there will be a tax boom. If there is a tax boom then there will be lots of goodies to give out, lots of sweeties to give out. So I think they are the insiders and in the situation of a housing boom where house prices are rising well above what the average person can afford, the outsiders are simply the people on the outside who are forced to play a game in which the dice is loaded against them from the start. I think that is important; there is a political context in this.

I suppose I devoted such enormous energies to trying to warn about this for two main reasons. The first reason was because I believed that hundreds of thousands of ordinary Irish people would end up in negative equity and would end up in debt and would end up in a situation where their lives would be destroyed by the debt associated with the housing market and they would end up being the people who paid. That is a social reason. The second reason, and this is very important for the context of this, is that I had worked both inside the Central Bank in Ireland in a crisis but, more crucially, I had also worked outside in investment banking. What I see and what I saw were panics in investment banks, panics in financial markets, and I could see that every single day we avoided taking responsibility for this mess. Every single day we said, "It will be grand," or, "There will be a soft landing," or, "Don't worry about it, it is the markets." We were therefore condemning ourselves to run out of options when the crisis happened. The more we ignored, the more desperate we became and therefore the more we ignored the more likely we were to end up, which we did when the crash came, in a situation where our choices were not between good and bad but between bad and worse.

The crash was inevitable. Now why was it inevitable? This is the key. It was inevitable because of the way in which the banks were financing themselves. Again I wrote all of this at the time. I was writing this in 2000 and 2001. This is not me thinking back and looking with hindsight. This was obvious to anybody who was trained. It was obvious. This is not the sort of thing that anybody who is trained could not see. This panic did not have to happen. The panic of September 2008 did not have to happen. It was not anything that was pre-ordained. It could have been fixed very early. The problem is if there is no housing boom there will be no banking boom. If there is no banking boom there will be no banking crisis. If there is no banking crisis there will be no interventions, such as the guarantee, and there will be no bailout. All of these things are the consequence of bad economic policy, not the cause. They are the consequence. What happens in banks when they get out of control is that they all end in bank runs. A bank run is when people take their money out. A bank run is called a run because it happens quickly; it is not a bank amble or a bank stroll or a bank stroll around the park with a dog. It is a run because people panic. That panic will be more extreme if there is what is called hot money, if there is international money financing the banks. When I saw this in 2004 that was when I realised we had a serious problem.

The Irish banking crisis began in 2000, not in 2008 as is sometimes suggested. It began in 2000. The great English economist John Stuart Mill, speaking about the railway crash that happened in Ireland during the Famine, said that crashes do not destroy the wealth of a nation, they merely evidence the extent to which wealth has already been destroyed by stupid decisions taken in the boom. So the destruction of the Irish balance sheet did not happen after 2008; it actually happened before. That is the nub of the issue, because prevention is always better than cure; we know that. There is a direct link therefore between not heeding the warnings and vilifying those who warn. There is a direct link between this and the subsequent panic which need not have happened and the decisions that were taken.

The best way to look at this credit banking panic is through the prism of a forest fire. Let us imagine a forest fire in a small place; the pyromaniacs start the fire which, in this case, are the banks and the forest is the general economy. The people who are supposed to be the firemen, the regulators and the monetary authorities, look the other way and say "Don't worry about the fire". Some people would have said we have had them before and they have been quite nasty but this one will be different. The firemen say "Don't worry, we'll be grand, it will blow itself out." Then the fire engulfs, not only the forest, but is about to engulf the entire village beside it. The village leaders, the politicians, are faced with the choice - does one let the thing blow and see what happens because one never knows maybe a house will remain, or does one put it out? At that stage one has to put out the fire with every single method possible. Why? Because it is already engulfing the entire place. If one looks at the situation in that way one can see the way in which I, who wrote this a long time ago, think about these situations.

Who started the fire? I wrote many years ago that property markets can only increase with credit. Property markets do not increase as a result of supply and demand. That was a big canard. It does not happen that way. It is credit. Who gave the credit? The banks. Worse, what happened? When the banks ran out of our deposits - normally the bank would say to itself I have a deposit here that will allow me to lend - they borrowed other people's money to give to us to buy houses that we were buying and selling to each other at expensive prices and calling it a miracle. Whose money did they borrow? They borrowed from the Germans, French, British, etc. There was hot money coming in. For example, one of the largest banks took 100 years to build up a balance sheet of €60 billion but it doubled that in three years. Let us think about that. Why? Because it had all this money coming in.

What was the regulation called? It was called light touch regulation. Light touch regulation means one guarantees, almost makes certain, that the banking system is going to implode because hot money always leaves. When hot money leaves then the rest of the money leaves too. We actually set the entire thing up and this is crucial to a fail.

The interesting thing is a lot of people said: "Don't worry. The free market will discipline the banks." That does not happen. Let me explain what happens in the free markets. On the way up the free markets do not discipline the banks but do the opposite and allow the banks to do what they want. As a consequence we have an extraordinary situation where one joins the EMU, which was an unusual decision we might talk about later but it had a material impact on the economy, most of which in my opinion is negative. We have light touch regulation, we get this flood of money into the banks which facilitates over-lending and then the over-lending facilitates over-borrowing. All of this sounds familiar now but back in 2003 nobody was discussing it or those who did were vilified. I shall play the committee a little 40-second clip of me on "Prime Time" in October 2003 which was watched by 400,000 people. This is important and I said:

> The Irish housing market is a scam. It is an enormous financial swindle that could potentially confine an entire generation of young Irish workers to years of bad debt. Far from being a reflection of economic vitality and fundamental demand the housing bubble is, in the main, a vacuous financial confidence trick that has been foisted upon us by an alliance of banks and the landowners.
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> Today, in Ireland, the price of the average house is close to ten times the average wage. This represents an economic failure on a monumental scale. Behind this nonsense is excessive and irresponsible lending from our financial institutions. The situation would be laughable if it were not so serious.

That clip dates from October 2003. I said: "The Irish housing market is a scam." That is what it was and that is what I want to come back to. It was financed by over-lending not demand.

A lot of people have asked me what made me think like that while other economists did not. I will wrap up but I want to make the following point about what happens when house prices rise. Economics tells us that when the price rises the demand falls, that is what we teach kids in school. In Ireland the opposite happens with house prices. When the price rises the demand rises because people get panicked. One hears that all the time. People say: “Jesus, prices are going up by 10%. I’d better get on the ladder now because if I don’t I’ll have to pay another 10% next year.” A very active rise in prices, once it is allowed, creates a dynamic in people’s heads to buy more, not less. This is why economists could do with common sense, which is what I have always felt. I urge them to talk to people. I suggest they forget the models, talk to people, ask them what they think and then think about supply. Economists will say “Oh, when the price rises the supply goes up”.

The main houses we have in Ireland are a stock of housing. The houses are already built. Someone like my Mum would trade down from a family house, she would move on and some other family would have the home. Let us think about what happens when house prices rise. My mother would say, and it is natural, “I won’t sell that now if they are going up by 20%. Wouldn’t I be mad to sell so I shall sell next year”. That would be a totally rational decision for my mother. Not only does the price not work, it amplifies the problem. It ends up that supply eventually adjusts but it adjusts far too late. We end up building houses in the wrong place for the wrong people at the wrong price. That is why I coined the expression “ghost estates”.

In 2006, I was travelling back from Westport having visited Allergan, a factory which produces Botox, not for my own use. I visited for a piece of research I was doing about who made Botox. While I drove back from Mayo to Dublin I saw that every little town had a huge big estate and was reminded of a conversation I had had the night before. I was thinking, because I had talked to a local guy the night before about the famine in Mayo, about how extraordinary it was and how unbelievably catastrophic it was. He talked about the famine villages around Delphi and that neck of the woods. He said they were like ghost villages and were kind of creepy. When I saw the estates on my drive back home I thought they were exactly the same and that they were ghost estates. It is funny because when one comes up with a term one does not realise that it will drop into the lexicon so quickly. Obviously the “breakfast roll man” was building the “ghost estates”. All these things happened but the ghost estates are indicative of how supply does not respond.

One wonders why people behave like this. I want the committee to understand, at the very beginning, why the economy behaves like this. People behave like this because we are all impacted by each other. Economists think we are all rational. We are not. We are highly irrational. Has anyone every met a more irrational animal than us? We fall in love, we follow stupid football teams - all the things that make no sense. The reason is that everything we do is impacted by other people.

A couple of months I was in the Aviva stadium with my son. In Dublin, there are two types of people. There are those people who buy their own tickets to the Aviva and there those people who get paid to go to the Aviva. I fall into the former camp. I remember Ireland scored three tries against Australia in the first 18 minutes. Even though I had really good seats with my 12-year old I saw none of the tries. Why? Every time the Irish team did well everyone seated in front of us stood up. Then I had to stand up and my kid had to stand up and get on my shoulders. Then the people behind me had to stand up and that continued for all the people behind them. That is exactly how the economy works too. The fellas who stood up first had no idea they were sending a signal to me to stand up because I was behind them. I had no idea that I was impairing the view of the people behind me. We had all paid to sit in the Aviva but we ended up standing. That is how is the economy behaves. When people see house prices rising in Ireland they buy houses, if they can, not because they want them but because other people are buying them. That type of herd behaviour is essential to understand why a property boom in a country like ours, if it is not controlled, gets totally and utterly out of hand unless of course one is lending to this property boom in which case one is making money so does not care. The question is, why did the banks not see this? Why did they not see that their own balance sheets were being impaired? I believe it is because banks' balance sheets play tricks on them. Every time a chunk of money goes in to the economy, house prices rise. That means the banks' collateral rises so they feel safe. Every time the collateral rises they feel safer and safer and ultimately they lend more and more and more. Then, if your bonus is related to your share price you have a greater interest in lending more because lending more makes you rich and gives you profits.

Chairman: Move towards a wrap up now Mr. McWilliams because we also have to ask you some questions.

Mr. David McWilliams: I am trying to get to the point of why this economy works as it does and why we need to have a set of views of the economy which reflect what actually happens in reality and not in some dream world of academia. I am saying the banks' balance sheets play tricks on them and they ultimately go bust. Why is that? Because they are allowed to borrow yet more. They keep borrowing and the balance sheets look fine. Then they realise the more they borrow, the worse the balance sheet is, but they don't see it.

Why did the interest rate not rise? Because we are in the EU. We have this crazy situation in that we have decided we are Germans. What is that all about? Ireland does most of its trade with Britain and the US, yet we have a currency attached to Germany. Somebody else may elucidate as to why that is. When German interest rates fall, our interest rates fall too. When our interest rates fall there is no warning sign from outside. That is hugely important because it is material to the next ten years, not just the last ten years.

We also have an issue with groupthink. Why did nobody, or very few, speak out? I believe groupthink is something that happens in many aspects. I believe that if you have ideas in Ireland which are beyond the mainstream, those ideas go through three phases. The first phase is open ridicule, the second phase is violent opposition and both of these happened to me. The third phase is where we are now which is that everybody pretends they were on your side all the time. This is what happens. Groupthink shifts because it is a conventional wisdom. We can talk about this during the questions.

Chairman: I will ask that you wrap up please Mr. McWilliams. Much of what you gave the Committee in your opening statement will be also be addressed in the questions this morning.

Mr. David McWilliams: This is all about 2006. During 2007 and 2008 I became very worried. My articles became extremely agitated. I could see the smart money leaving the country. One could see this in repo rates and credit default swops. In The Pope's Children and in the accompanying TV series, I said that certain well known Dublin banks were then little more than out of control hedge funds, leveraging themselves and their clients' money into property. I said that these outfits usually went belly-up. I worried, but not because I had any contact with the banks. I was so toxic at that stage that I had never been in any of the banks. I may have bumped into one or two of them at economic conferences but that was the height of my contact. I had no insider knowledge or data. This was simply an economist working in the banking system, on his own and at his own desk, who could see what was going on.

Chairman: Mr. McWilliams I have afforded you more time than any other witnesses that have come before the committee. You are now on 25 minutes. Usually the limit is 15 minutes so I will have to ask you to wrap up.

Mr. David McWilliams: We can wrap it there.

Chairman: I am moving to questions. The lead questioners today will be Deputy John Paul Phelan and Deputy Pearse Doherty with 20 minutes each. Other questioners will have eight minutes after that. I will set the scene. Mr. McWilliams, you mentioned the housing price bubble in your opening address this morning. Given that you were warning for such an extensive period of time, was there any point prior to 2007 when you thought that your warnings may have been mistaken?

Mr. David McWilliams: No. I became increasingly certain because the evidence was all over the place, from the hard economic numbers to the anecdotal evidence and conversations. When you see house prices going completely out of kilter, you realise there is a serious problem. One of my best leading indicators was a piece in the Irish Times called Take Five, a part of its property section which offers city by city house price comparisons. The article showed readers the difference between a two-up two-down house in Dublin city for €500,000 and a 17 bedroom chateau outside Paris with a direct RER rail link to Place de l'Opéra, for the same price. As the property-credit-borrowing binge became worse, it struck me that there was no way we could avoid a banking crisis. It became a matter of when, not if.

Chairman: You mentioned in your book The Pope's Children that a property crash was on the way. You based this on the Minsky Kindleberger credit cycle analysis. Can you please outline to the Committee what that theory means?

Can you also inform the inquiry if any person in authority contacted you in regard to the concerns you were raising at that time?

Mr. David McWilliams: It is an interesting question. The book The Pope's Children was so widely read that these ideas were in the ether. This was not an academic book that nobody read, it was the biggest selling non-fiction book of the decade. This has all happened before, all over the world. We can go back to the Romans or even the Bible. Deuteronomy and Leviticus, two books in the Old Testament, deal with debt forgiveness after booms. We are not talking about something new, we are talking about something that is deep in our culture.

Most mainstream economists in Ireland believe in classical economic theory and I do not. I never have. I will give an example of what happens in peoples' heads when prices rise. There are two stand out American economists I learned about after I left postgraduate studies and university in Ireland; Charles Kindleberger and Hyman Minsky. They understood that once credit was put into the mix, it profoundly changes the way people behave. Members will know this from talking to their constituencies. Kindleberger outlined the various stages of the cycle. There are seven stages.

One is when something material happens or actually changes. In our case we joined the European Monetary Union and our interest rates in the long term went from a real interest rate of about 6% down to almost zero. Our interest rates fell which changed the landscape profoundly. House prices begin to rise in this first stage of Kindleberg's model. The second stage is euphoria. People begin to think it is because of themselves that their house price is rising. They think they are clever. House prices continue to rise. The third phase is gearing, which is when the banks get involved with the idea that one can remortgage a house to buy two gaffs in the Algarve. Gearing means that the whole thing starts to get a little bit crazy. The fourth phase is the mania phase when people become manic. People actually flew to Bulgaria to buy houses, financed by their houses in Ireland. Banks are now pushing the money. The fifth phase is the bubble phase. We all lived through it and know what it is. The sixth phase in the Kindleberger cycle is the phase of distress. This is when people start to dislike the smell of the situation. Early people get out and start selling. The seventh phase of the Kindleberger Minsky cycle is called *torschlusspanik,* a German phrase from when it happened in Germany and Austria in the 19th century. It translates as shut door panic, when everybody jumps and runs for the door and tries to sell. The whole thing collapses. This happens in assets all the time and I could see this.

There are three phases which happen next. The first is the Minsky moment. This is crucial because our banks had a Minsky moment in September 2008. A Minsky moment is when a bank realises it does not have any money and must sell good assets to pay for the losses on bad assets, because those assets are entirely bought on margin. Once one buys something on margin, one is in the lap of the gods. So we had Kindleberger's seven stages, then we had a crash and then came the Minsky moment where we had bank collapses. Again, this is all in the book. At that stage only massive state intervention can help. It is described as requiring a hegemon, that is, a big country or large institution, a central bank or the ECB, say, to come in and right the situation. That is because they, like me, do not believe in classical economics. The economy will not right itself after this type of boom and there must be an intervention.

Chairman: That leads me to my last question. I ask Mr. McWilliams to be as succinct as possible in all his responses as we have another witness attending later. He referred to that big moment and the big intervention that is required-----

Mr. David McWilliams: I apologise for interrupting the Chairman. I did not answer his last question, which was whether anybody in authority contacted me, at any stage, to discuss my concerns. The answer is "No". Categorically, not one adviser, not one Minister, not one civil servant, not one member of the regulator contacted me. Nobody did. In actual fact, I would have been toxic to all of them and they probably would have avoided me like the plague. All of this was going on and never once was I asked my opinion on anything by anybody, informally or formally.

Chairman: To come back to the Minsky moment, Mr. McWilliams spoke about how the big intervention might manifest itself. In the Irish situation, it was in the form of the banking guarantee. Did the design and implementation of the guarantee have any relationship to Ireland's entering a bailout programme two years and two months later?

Mr. David McWilliams: Yes, I believe it definitely had. As I said at the start, the guarantee, the bailout, all of these issues are the consequence of the pathetic policy from 2000 to 2008. The outcome was foreseen and certain. It was simply a matter of how bad it was going to be. That was really the question that was revealed over the course of the subsequent few years.

Deputy John Paul Phelan: I welcome Mr. McWilliams. As a pope's child myself, my first question relates to his book, *The Pope's Children*, published in 2005. It was this book, in many respects, which brought Mr. McWilliams to national prominence. One reference in that book particularly struck me when I reread it recently, namely, the statement that the decline of Germany had changed Irish psychology and was central to Ireland's success. Will Mr. McWilliams outline briefly what he meant by that?

Mr. David McWilliams: There is a chapter in the book called Vorsprung Durch Credit, which was a play on an Audi advertisement slogan. One has to come up with these things, and it seemed to work at the time.

Deputy Kieran O'Donnell: Its called marketing.

Mr. David McWilliams: Yes, it seemed a good chapter heading. What I was trying to explain, which had not really been explained before and certainly had not been explained to the Irish people by the policy makers, was that once one joins a monetary union, what one is effectively doing, if there is no regulation of one's banks, is getting the PIN number to the ATM card of the richest person in the room. Of course, the richest person in the EU's room was Germany. It was rich and it was in decline. After reunification in the early 1990s, the united country swallowed up the former East Germany and it cost it a fortune to do so. Germany's economy then began to stagger under the weight of those repayments and as a result of the cultural and demographic shift. The country started to go into decline in the period from 1995 to 2005. For Ireland, this meant our interest rates, which were really set for the Germans, went to levels that were totally inappropriate for the boom we were having. It meant that the normal way in which one warns people that things are out of kilter, which is by setting higher interest rates, not only did not happen but we actually got lower interest rates.

I was trying to explain in the book where the money was coming from. I remember going to pubs and people asking, "Where is all this bloody money coming from?". I recall a builder friend of mine who worked with me years ago in Boston saying to me that the difference in Ireland at that time, compared with the past, was there was now no problem getting money. For the 2005 book, I invented a German character whom I named Udo Lindenberg after a German crooner. This guy was sort of the German version of France's Johnny Hallyday - not a great gig to attend, I suspect. I invented the character and named him for this singer I had heard of. Udo represented the old, parsimonious German saver. Banks hate savings because they do not make any money on them. In fact, they pay out for savings. In that situation, they asked themselves who they could give them to in order to make money on Udo's savings, and over here was Ireland.

Deputy John Paul Phelan: I will bring Mr. McWilliams forward now to the very early part of September 2008. In a radio interview on RTE's "Saturday View", he stated that a crisis was imminent in the Irish banking system and that at least one Irish bank would be closed before Christmas. He said in his 2009 book, *Follow the Money*, that he received a number of telephone calls from bankers in the wake of that interview who accused him of causing panic. Will he indicate how many calls he received and what was said during those conversations?

Mr. David McWilliams: I received two telephone calls, neither of them from persons who would have been household names. This goes back to a very important point. In Ireland, we have an inability to accept reality. It is a national issue we have. In a crisis, the most important thing is to define one's reality not as one would like the world to be but as it actually is. Once one has defined that reality and got the facts, then one can do something about it. Once something has been done about it, one can then face into the crisis. It struck me that in Ireland, all the way through 2007 and 2008, the official policy was to delay and pray. It was a case of we will say everything is grand and pray the cavalry will come over the hill and save us.

Deputy John Paul Phelan: To clarify, what was the nature of Mr. McWilliams's telephone conversations with those bankers?

Mr. David McWilliams: They said they had heard me on the radio and both referred to "dangerous talk" and warned about frightening the horses. The problem with that is that I knew, not from talking to bankers but from looking at what are called repo spreads and credit default swaps, that all the hot money, this significant investor money, was leaving. Whose money gets called after that? Your mum's money and my mum's money gets called. It falls to depositors, in other words. What struck me as really strange was the more they spoke about "dangerous talk", the more they imperilled the deposits of the little guy, because the big guy always gets out first. The context is this idea of delay and pray and not being honest with ourselves. The more they denied it, the more terrified I became because it either meant they did not understand the significance of what was happening, they did not have any facts at their disposal or they actually did not care.

Deputy John Paul Phelan: I have another question about Mr. McWilliams's radio interview in September 2008.

Mr. David McWilliams: I have the transcript here.

Deputy John Paul Phelan: Was the former Minister for Finance, the late Brian Lenihan, on the same panel or did Mr. McWilliams meet him that day in another part of the building?

Mr. David McWilliams: I had never met the late Brian Lenihan before that day. I was on a panel with him; Brendan Keenan, my colleague and economics editor at the *Irish Independent*; and then member of the Opposition, Deputy Richard Bruton. I had written an article the night before for *The Sunday Business Post* in which I said exactly what I have just outlined, namely, that the banks were not being truthful. Either they did not know what was happening, which is unforgivable, or they would not admit what was happening, which is another issue. My recollection was, now that I have the transcript, that the first about half an hour was spent talking about the public sector. I think Brian Lenihan was involved in a partnership negotiation. We talked about the public sector, and there were budget cuts coming. I interjected and said, "We can talk about this all we like - I can read the echo verbatim, but we will put it into the record - but the problem is the banks and that the Irish banks risk going bust in the next couple of months". I cited the Swedish example and I said what was happening in Ireland was exactly what happened in Sweden and in Japan.

Deputy John Paul Phelan: Did he, at that time, invite Mr. McWilliams to make further contact?

Mr. David McWilliams: I have the quote here from the Minister, and again I can absolutely understand why a Minister for Finance in a country does not want to precipitate, or has no interest in precipitating, any further panic than is already there. The Minister replied to me and said, "That is dangerous talk". I think when we get to a situation where telling the truth is regarded as dangerous, the Deputy knows that we are in the last resort saloon. We came out of the RTE interview and there was chitchat and pleasantries and Brian Lenihan said to me, "You seem to know what's going on". He said to me, "You got all this right in the last couple of years" and he laughed. He said, "Why don't you come in and advise me because everybody else is in advising me?" That was the actual quote. He said, "Here is my number" and he scribbled it down. I scribbled it down, I think, on the back of one of the books I had taken in with me. That was the first time I met Brian Lenihan, so I took his number.

Deputy John Paul Phelan: About 11 days later on Wednesday, 17 September, Mr. McWilliams made a phone call to the Minister.

Mr. David McWilliams: I thought to myself that pray and delay could be a tactic but that there has to be a strategy. I was really fully expecting a strategy to come out, that this is what we were going to do, that we have a bank resolution mechanism and we know how to deal with this. At every juncture during those two weeks, nothing was coming. It was still the same thing, that the banks are well capitalised and that the Irish banks have been stress tested. One will remember all that sort of stuff. The crucial point to appreciate is that the rich guys get their money out; it was a poor average person who gets burned in a bank run. That is what happens.

Chairman: The diary that you are working-----

Mr. David McWilliams: At this stage, it was already on Joe Duffy, which I think as a leading indicator would suggest that if it is on Joe Duffy, it is real. You can quote me on that.

Deputy John Paul Phelan: What was the nature of that phone call on Wednesday, 17 September, and what did Mr. McWilliams say?

Mr. David McWilliams: I went on "Prime Time". Now just think of what happened. Lehman's had gone bust and the Americans had tried to let a bank go bust and ring-fence it - this idea that one can amputate the leg - but what had actually happened was the opposite. Not only did it not stop the crisis-----

Chairman: The Deputy is asking you about a sequence of meetings you had with Brian Lenihan. We can fill in the historical parts ourselves.

Mr. David McWilliams: After "Prime Time", I realised-----

Deputy John Paul Phelan: In the phone call on 17 September that Mr. McWilliams made-----

Mr. David McWilliams: Yes. That is why I called him. I realised-----

Deputy John Paul Phelan: What was said?

Mr. David McWilliams: He said, "I'm busy now, I will call you back". That was fine. I was sitting at home and the phone rang. My expectation was that he would say, "Listen why don't you come in and talk to ourselves in the Department". He asked where I lived and I said Killiney. He said he would be out to me in an hour. That was the meeting.

Deputy John Paul Phelan: The famous meeting took place, I think from reading the book again, between 10.15 p.m. and 2 a.m., so it was a four hour meeting.

Mr. David McWilliams: No. I think the book said two. It was well after midnight. It could have been 2 a.m. or 1.30 a.m. It was around that.

Deputy John Paul Phelan: Before he arrived, was Mr. McWilliams preparing any thoughts or views as to what he might say to him?

Mr. David McWilliams: No. It is a funny thing. It might not feel strange for members as they are politicians, so they meet each other all the time, but I have never had a politician in our house. I certainly never had a Minister in our house. We had a little panic and my wife said that I had better go and buy some biscuits, so I found myself in Centra in Ballybrack buying digestive biscuits and milk. I am just giving a sense of-----

Chairman: I need to move to the substantive part of this engagement, please.

Mr. David McWilliams: Had I got anything prepared------

Chairman: I am looking forward to the coffee break later this morning but we need to deal with the issue.

Mr. David McWilliams: The good thing was that I had an article that I was sketching out that night in my head. It was published subsequently in *The Sunday Business Post* and was called "The State must act as a safeguard". What this sketch was doing was that it was looking at the options available to the country and seeing what could work.

Deputy John Paul Phelan: So Mr. McWilliams was preparing himself for his-----

Mr. David McWilliams: In preparation for this, I realised that I have written over 1.2 million words of economics which have been published in this country, so it is a lot. These articles are sketches but it is a good contemporaneous note on the thinking.

Deputy John Paul Phelan: On that very point, did Mr. McWilliams take a note of the meeting or after-----

Mr. David McWilliams: I published-----

Deputy John Paul Phelan: I understand but after he left that night, did-----

Mr. David McWilliams: No. I did not take notes but I was very well aware of what the conversation had been about. I suspect that this article is as close to a contemporaneous note, and that was published. It was published on the Sunday but was written on the Friday.

Deputy John Paul Phelan: Further on in the book, I think on page 16, Mr. McWilliams says he got the impression that the Minister was quite isolated from his officials and sceptical of the advice he was getting. Briefly, why did he come away with that impression?

Mr. David McWilliams: The most important thing in all these crises is to establish the facts. I said to him, "Do you know the facts?" and "Do you absolutely know what is going on?". He said "No, I am getting different numbers all the time". I said to him, "Okay, so you don't know the facts, so what you have to do is do something temporary to buy yourself time until you find out the facts".

Deputy John Paul Phelan: That leads me to my next question. Again, on page 16, it says the Minister asked Mr. McWilliams what he would do. I want the witness to briefly outline what his response was.

Mr. David McWilliams: We went through - I can go through it here in this article - why a variety of other ideas would not work. Does the Deputy want me to go through that?

Deputy John Paul Phelan: Yes, please.

Mr. David McWilliams: The first idea after Lehman's was that a country could let a bank go and that would insulate the system. If the United States could not let Lehman's go, with the deepest financial market, with the best central bank in terms of ability, with its own currency and with its own monetary policy, we could not do that because it did not work in the States. The second day after Lehman's failed, the Americans did what would be called the nationalisation route. They nationalised AIG, the massive insurance company. Nationalising would not have stopped the bank run in Ireland because the bank run was systemic in the sense that people were taking money out of all the banks, so you nationalise one but it just means that people will say, "Who is next?". That is exactly what happened in America.

The next day Merrill Lynch went bust. I did mention to the Minister that I found it ironic that his lead advisers were Merrill Lynch, people who could not even keep their own bank solvent, let alone advise others. At the time, he was aware.

The third option was that one of the big Irish banks would buy one of the small Irish banks, the idea being if you have a big balance sheet, you can actually take over a smaller balance sheet but I said to him at the time that all the Irish balance sheets were bust because we all knew they were doing the same thing. So even without the figures, you knew that they were all bust. I remember saying to him that I thought "two bad balance sheets does not make a good one".

Then he said, "What about the idea of giving a €100,000 guarantee to depositors?". I said, "That could work but you cannot really be half pregnant, Minister" and I remember he kind of smiled at this. I said that if until yesterday you said the banks are well capitalised and then tomorrow morning you say, "Do you know what, not only are they not well capitalised, they are going to bust but we will protect some people". When the hot money is owned by people in trading floors, that does not cut it. In fact, that proved to be the case. A limited €100,000 guarantee was introduced on the Friday after that and it did not work as money continued to flow out. Just as I had been thinking, once you admit that you have a problem, having denied it all the way up, it opens the floodgates, which it did.

Finally, I said, "There is one other option," and he said, "Well, we are working on that other option." The Merrill Lynch options show that the Department was working on what was called the blanket guarantee. Blanket guarantees have been used in 14 out of 42 bank crises. They are not unusual, but the Irish one was followed in Denmark and Germany a week later. It is only as a last resort and I remember saying to the Minister, "I don't know; I don't have the facts, but I think we are at the last resort. What you have got to do [this is very important for the record and it is written down in black and white in all of my documents] is you have got to introduce a holding guarantee which buys you the time to allow your auditors and your civil servants to go in and find out the facts. You cannot do something permanent when you are not in possession of the facts and if you are not in possession of the facts and that is the case right now, you need to do something temporary with a time limit. That time limit you have got to figure out."

Deputy John Paul Phelan: What time limit did Mr. McWilliams have in mind?

Mr. David McWilliams: In the article I said up to two years and it is written in black and white: "The Government could do this for a limited period. This is absolutely crucial. This is a holding guarantee. Let us say two years."

Deputy John Paul Phelan: On page 22 of *Follow the Money*, Mr. McWilliams said that because the Irish banks' funding had become unstable, if their funding as well as their deposits were not guaranteed, they would come crashing down and that they would have to come up with the money immediately for people's deposits. When he spoke to the Minister about this, did he include subordinated debt in the guarantee, as well as-----

Mr. David McWilliams: No, subordinated debt is strange. There are 14 other instances around the world of last resort guarantees, given when time is running out and confidence is shattered and the state has to step in or the alternative is a bank run and a total collapse of the banking system. We know from the Great Depression that this is not what you want. This causes recessions to turn into depressions. However, in all cases, there is a distinction between debt and equity for corporate finance receiverships. Equity like instruments are never included and subordinated or junior debt is subordinate to or underneath and at no stage did I ever imagine that such debt would be included and the reason is that it is known that in all corporate finance receiverships subordinated debt is an equity like instrument. It comes at the very, very last and has many more of the characteristics of a share than a bond. You get paid more to hold the subordinated debt, so you are being paid for the risk. If you are being paid for the risk over and above everybody else, when the risk materialises, you cannot expect to be paid in full.

Deputy Pearse Doherty: Cuirim fáilte roimh Mr. McWilliams to the committee. I will follow on from Deputy Phelan's questioning.

Mr. McWilliams has put on record his engagement with the Minister for Finance on that Wednesday night and we can read about it in his book, *Follow the Money*. The committee is gathering evidence and he will be the only person who can give us evidence on the other interactions he had with the late Minister. Will he clarify the number of telephone calls between him and the then Minister from 17 September onwards? It appears from his book that there may have been 12 telephone calls and two face to face meetings.

Mr. David McWilliams: That is right. When I say 12, it could have been 13 or 14. I was in China during all of this period.

Deputy Pearse Doherty: We will come to the detail in that respect.

Mr. David McWilliams: Then I had two face to face meetings with Brian Lenihan. The final one was on 4 October 2008 and I never saw him or met him again. It shows a very intense period of discussion and after that, I never met Brian Lenihan again. I met him once at a meeting of about 60 to 70-----

Deputy Pearse Doherty: If Mr. McWilliams will allow me, I will get into that because the Chair will keep me tight to my time.

Mr. David McWilliams: Okay, go for it.

Deputy Pearse Doherty: Mr. McWilliams referred in his book to the call on Friday, 19 September saying that when the then Minister rang to say they were contemplating a partial guarantee, he indicated that his view was that such a guarantee would just alert the world. Did the Minister explain what they were thinking about in respect of a partial guarantee?

Mr. David McWilliams: I would like to say of the then Minister that he was very discreet when he met me. He was very professional. He never gave me indications that anything was being decided. He more or less wanted to use me as a sounding board rather than anything else. He did not have to explain a partial guarantee. What it means is that if it is €50,000 or €100,000, the state will be behind it. I said to him that that was all very well if the bank run was Irish people going to ATMs, but the bank run would be the billions of euro of hot money being traded on international financial markets. What they would look at in the context of a partial guarantee was if all of the denials up until then had been wrong and that would spook them even more. I have worked on financial markets and seen how they work.

Deputy Pearse Doherty: I appreciate that. I just wanted to know what the then Minister was saying.

Mr. David McWilliams: He said they were going for that. I said, "Go for this and see does it work."

Deputy Pearse Doherty: Mr. McWilliams said there were telephone calls on a daily basis. One of his comments regarding the calls was that the then Minister said his officials in the Department were dead set against a full guarantee. What did he say to Mr. McWilliams about the officials' opinion on such a guarantee?

Mr. David McWilliams: I said to him, "You can be dead set against a full guarantee but a temporary one, if you know the facts ... up until now the officials had consistently understated the extent of the problem, so a full guarantee should only be introduced temporarily to attain the facts if the banking system was imploding." What I thought he was saying about the officials was they still felt the banking system was not going to implode.

Deputy Pearse Doherty: Can I clarify this because we are taking evidence? Did the then Minister for Finance say to Mr. McWilliams that his officials were dead set against a full guarantee?

Mr. David McWilliams: Because they did not realise the extent. They believed a partial guarantee could work. Hours after the partial guarantee had been introduced on the Monday, it was very clear it had not worked. This is the whole point. It had not worked and, therefore, they had to realise that. Their hope was things were not as bad as they seemed and this is consistent with an entire orchestra of underestimating the problem. The partial guarantee was introduced. Had it worked, it would have been fantastic, but it did not. Then you are into a totally different reality.

Deputy Pearse Doherty: Did Mr. McWilliams have any other conversation with other members of the Cabinet during this period?

Mr. David McWilliams: I had one telephone call from John Gormley towards the end of the week I was in China and he asked me what was going on. I said, "You should tell me because I am actually in Beijing. I have no idea what is going on." He had read the article in *The Sunday Business Post*. Again, it was more of a sounding board discussion. Apart from those two, I had no conversations with anyone.

Deputy Pearse Doherty: Did Mr. McWilliams have any conversation with John Gormley about a full guarantee?

Mr. David McWilliams: No. I told him to read what I had written and buzz me back, but he did not. They were pretty busy at that stage.

Deputy Pearse Doherty: With regard to nationalisation and conversations with the late Brian Lenihan, did Mr. McWilliams discuss the option of nationalisation? Can he inform us what Mr. Lenihan was saying about that issue if it was discussed?

Mr. David McWilliams: He asked whether nationalisation of one of the smaller banks could work. I said that it could but that it would not stop a bank run. We must be very clear about what we were trying to do. We were trying to prevent a national run on the banking system. What signal does it send by nationalising a small bank? It sends a signal that the bank is problematic. In a panic, does it say that people should not worry and that the rest of them are fine, or does it make a depositor wonder what will happen if one bank has been nationalised and is about to go under? I informed Brian Lenihan that exactly this tactic was taken by the IMF in 1998 in Asia. There was a crisis in Thailand with the baht, followed by crises in Malaysia and then Indonesia. The IMF came in and said the countries should nationalise the bad banks, which they did. People thought that this was the organisation that did not see anything coming and was now telling us that it was limited to a certain bank. It created an accelerated bank run.

The second thing is that by nationalising a bank in the middle of a crisis, we take on all of the liabilities so we do not give ourselves the temporary idea to find the facts. This involves crystallising losses today.

Deputy Pearse Doherty: I appreciate that.

Mr. David McWilliams: This means not achieving what we were trying to achieve, to stop a bank run, and ending up with a large bill straightaway because people did not know the facts.

Deputy Pearse Doherty: I am not getting the merits of nationalisation as opposed to not nationalising. It is more the thinking of the then Minister for Finance. Mr. McWilliams seems to have had a large amount of contact with the second most powerful politician in the State at a time of major financial crisis. During that contact, did the Minister indicate any time that he was in support of nationalisation, particularly coming to the final point?

Mr. David McWilliams: No, as I said, Brian Lenihan was always incredibly discreet and professional and never indicated at any stage that he had any preference. This is as I would have expected. He listened and I suspect he had his own opinions. At no stage did he give an indication of where he was going. He was talking to a lot of people around this period. I felt very sorry for him because it struck me that it would be a bit like me being elevated to the Attorney General in the middle of the biggest constitutional crisis the country has ever faced and having to make a decision. Against that background, I probably would have called around to prominent lawyers and asked them what they think of this.

Deputy Pearse Doherty: The Governor of the Central Bank, Professor Honohan, gave evidence to the inquiry that Brian Lenihan "agreed with the idea of an overall guarantee but he also thought that INBS and Anglo should be nationalised there and then". Was that expressed to Mr. McWilliams?

Mr. David McWilliams: That was never communicated to me, certainly not from Brian Lenihan. I said to him that if he did not know the facts, how do we know that the next problem will not be in one of the bigger banks. This is what subsequently ended up being the case. He never communicated to me any overall preference. He was always in listening mode.

Deputy Pearse Doherty: There was daily contact and Mr. McWilliams gave advice on the first day. What was the reason for coming back for advice on a daily basis and phoning Mr. McWilliams when he was abroad?

Mr. David McWilliams: He wanted to know what was going on in the international community. I was going to a World Economic Forum event like the one in Davos but in China. He was asking all the time what foreigners were saying. He was asking what people outside Ireland, looking in, were saying and I was keeping him up to date on the conversations I was hearing. There were loads of sessions on the banking system. The purpose for him calling me when I was in China was to see what people on the outside were saying. I told him at one stage that one of the deflating things about being an Irish person is that others do not think that much about us at all. We think that they think hugely about us but they do not. To the extent that I was listening to them, they were saying that all the European banks have problems, that the

European Union must come in and that Ireland was in the eye of the storm. They were all sure that there would be some pan-European solution.

Deputy Pearse Doherty: Mr. McWilliams says that he was very discreet in his contact but also that Mr. Lenihan doubted the regulator and the Governor of the Central Bank.

Mr. David McWilliams: I do not think one needs to be the Minister for Finance to doubt the regulator at that stage. Let us think about what has happened. The bank regulator has not seen the biggest bank catastrophe in a western democracy in a long time. Did Deputy Pearse Doherty doubt him? Brian Lenihan was saying that he was not too sure. A lot of people could not see how someone could miss this. It was more that he was incredulous.

Deputy Pearse Doherty: In the opening statement sent to us, although not in his oral presentation of it, Mr. Williams mentioned that in March 2009 he wrote articles that "the guarantee should be rescinded". This is something that has been repeated time and time again. Can Mr. McWilliams inform the committee when he formed the view that the guarantee should be rescinded?

Mr. David McWilliams: The first part was that when I wrote these articles, my idea for the guarantee was a holding guarantee to figure out the problem and move on. The question is whether that should be in one year or two years. The time horizon is important. I remember saying to the Minister that if people are worried their money will not be in the bank when they go to get it out, and a two-month or three-month guarantee is given, that is not long enough to assuage the average punter that their money is safe. People must be given time sufficiently far out that they think they will be grand. Two or three months would have taken us to Christmas and was not that far. On the other hand, I said to him that auditors need to find out the facts about the maturity obligations of all the loans of the banks so that we did not cover too much.

Deputy Pearse Doherty: I appreciate that. Mr. McWilliams has provided that in evidence over numerous articles but the question is when Mr. McWilliams formed the opinion that it should be rescinded. The Chairman will cut me off and I also want to come to Mr. McWilliams's contrarian views.

Mr. David McWilliams: During October, I wrote extensively that I was beginning to get worried about the nature of this. The first was about the inclusion of subordinate junior bonds and the second was the way of tying the weaker banks into other banks. I became worried that what I thought was an emergency measure to protect depositors was going to end up being used as a cloak to protect bank creditors.

Deputy Pearse Doherty: The banks signed the deed of guarantee on 24 October. Is it Mr. McWilliams's position that the guarantee should have been rescinded after the banks signed up, or before?

Mr. David McWilliams: Absolutely. After meeting Brian Lenihan on 4 October, I found myself back on the outside, where I had been since 2000. Contact became sporadic and then there was nothing at all. I thought this was simply the way he was moving away from my thinking. My thinking was to be as flexible as possible and to try, as much as possible, to buy oneself time. His thinking, and the Department's thinking, became harder and harder and then the migration towards we are going to pay everything became almost obvious to those of us who were worried about it. I began to write constantly warning people that this was being used as a way for full payment, in the case of a bankruptcy, which was never the objective.

I argued that we should move to what is called the savings and loans model in the United States. That model came about as a result of a big collapse there in the 1980s and 1990s where eventually they realised the cost of bank bailouts was going to be too much. They decided that what they were going to do was force the bondholders - the debtholders - to take equity which made them shareholders in the banks which, in a way, allied the banks and shareholders in the same place. That was increasingly my thinking and then the following became so obvious to me after NAMA. What NAMA did with the guarantee was it ensured that this country would end up selling our assets at a discount and buying our liabilities at a premium. That is morally wrong but is also a financial disaster. At that point we had created the ELA or emergency liquidity assistance. That meant the banks' liquidity was solid so one could have rescinded the guarantee, kept NAMA in place and nothing would have happened because the ECB was back in there and the Central Bank was back in. That was the idea by-----

Deputy Pearse Doherty: I am sure some of my colleagues will also pick up on that point.

Mr. David McWilliams: Yes.

Deputy Pearse Doherty: In an article published in *The Sunday Business Post* on 20 January 2008 Mr. McWilliams wrote:

> A few years ago, one of Ireland's best known bankers indicated to me just how important it was that the Irish banks remained Irish-run in a downtown. His nightmare scenario was an Irish property market slump, coincident with a change of management in Ireland's major banks. In a crisis, he envisaged a response that was almost a type of financial war-cabinet, where bankers would have a direct line to the governor of the central bank and the Minister for Finance.

Without mentioning names, is this the same conversation Mr. McWilliams referred to in chapter 10 of his book *Follow the Money*, on page 129?

Mr. David McWilliams: It is the same conversation.

Deputy Pearse Doherty: Is it reasonable or not to say that the elements of the scenario that were outlined by the banker in 2005 to Mr. McWilliams appeared in the response in 2008?

Mr. David McWilliams: No, I do not think so. I think this was a conference that I was chairing. Because it was 2005 and because nobody at that stage was talking about property busts and our banking problems, and I was the chairman, so I said "Hold on a second. It is all very well to say that the economy is flying along. What happens not if, but when, this implodes?" I said what was likely to happen was that Irish banks would be bought by some other banks, Wilbur Ross-type characters or whatever it happened to be in the case. I then got the response that it would be better if Irish executive remained at the helm.

Deputy Pearse Doherty: The banker suggested, at that time, that there would be "a type of financial war-cabinet, where bankers would have a direct line to the Minister for Finance."

Mr. David McWilliams: That is what happened at the end. I remember writing, I think around December, that we had experienced, and I recall this, a financial coup d'état-----

Deputy Pearse Doherty: Yes.

Mr. David McWilliams: -----where the banks are running the show and the citizens are miles behind. That is what really happened in the period.

Deputy Pearse Doherty: I shall ask a final question but I will get a chance to comment later. Mr. McWilliams has provided the committee with extensive evidence in the form of documentaries and written material that he had written from the period 2008 which foretold the financial crisis. If it was as obvious as he has said, why was it ignored by what he called the insiders?

Mr. David McWilliams: That is a huge question. In a small country one gets significant vested interested. When a small country experiences a banking and property boom many people will make a lot of what looks like very easy money. That cohort of people have a clear incentive to vilify the maverick.

With respect to my own profession of economics, it amazed me at the time that so few, in any positions of power, did anything or said anything. I have found it amazing that people were swanning around with titles like bank expert and international bank expert. I said "Well, hold on a second. You were living in the country that had the most catastrophic bank crisis and you didn't open your beak." People watching this are entitled to ask that question.

There is a thing in Ireland which I refer to as conventional wisdom. When conventional wisdom sets in it is repeated by serious people. People say "He is not a serious person but I am a serious person because the guy beside me is a serious person." Then he repeats the mantra and then mantras replace hard thinking. Once mantras replace hard thinking then every serious person buys into them. J.K. Galbraith said something very interesting about changing one's mind. It is very hard to change one's mind if one is a serious person. He said that when faced with the choice of changing one's mind or finding the proof that indicates one does not have to, the vast majority gets busy finding the proof. Let us consider that thought in the context of this country. People like me were regarded with the view that it could not possibly be right, what this guy is saying, because the vista is too apocalyptic. One of the views was "Ah but he spent too much time abroad."

I feel, and this is worrying for subsequent future years, that when this society coalesces around what I would call a simple truth, such as there will be a soft landing or the banks are well capitalised, it is an extraordinarily dangerous place to be. It means that, like lemmings, we all go over the cliff together.

As I have always thought, if one thinks of a quadrant of maverick, consensus, right and wrong, which applies to politics as well, if one is in that consensus and one is wrong then people adopt the view that we are all wrong together and sure that is grand. People think "We are all a bit stupid but we are all stupid together". If one is in the consensus and one is right people think "Sure, we are all geniuses, that is great. Jesus, you are smarter than me. Oh my God, you are outrageously smart." If one is a maverick and one is wrong then one is a maverick that is wrong. In that case one is incredibly isolated, laughed at, sneered at and regarded as being somebody who is not serious.

Chairman: Please conclude.

Mr. David McWilliams: Let me make this very important point. If one is a maverick and one ends up being right then one is a very uncomfortable person to be around.

Chairman: I want to round off this session by asking a simple question. I hope Mr. McWilliams gives me a short answer and then I shall call Deputy Higgins.

At the time of the guarantee, and in Mr. McWilliams's engagements with Mr. Lenihan during that period, was it his view that the banks were in need of liquidity or were they insolvent?

Mr. David McWilliams: That is a very good question.

Chairman: Can Mr. McWilliams answer my question?

Mr. David McWilliams: I can try. Illiquidity leads to insolvency. This is the distinction I hear all the time "Oh, they were just illiquid and they were not insolvent." This is a very important thing to look at bank crises.

Chairman: Is it Mr. McWilliam's view? Mr. McWilliams wrote extensively about this matter at the time.

Mr. David McWilliams: If the bank is illiquid it will go insolvent. That is the key. If one thinks it is illiquid then one has to prevent it from being illiquid because if it is illiquid it will go insolvent in a panic. It does not matter if one thinks the banks might necessarily be solvent. They will become insolvent when liquidity dries up so one has no choice.

Chairman: In 2008, Mr. McWilliams, in his book *Follow the Money*, wrote the following:

> The question for the state is whether we are looking at a situation of illiquidity or insolvency. Pessimists say the banks are insolvent; optimists argue they are simply liquid. If it is insolvency, which is unlikely, then there are the normal longer-term measures to deal with bad debts.

In September 2008, in an article published in *The Sunday Business Post* , he wrote, "In contrast, a full guarantee would have meant full protection with creditors." I am still trying to establish his assessment. Is it his view that the banks were in need of liquidity or were they insolvent which in layman's terms means they were bust?

Mr. David McWilliams: If one did not inject liquidity they would go bust, definitely.

Chairman: I thank Mr. McWilliams and call Deputy Joe Higgins.

Deputy Joe Higgins: On 10 June 2001, Mr. McWilliams wrote on his website:

> A property boom transfers huge wealth from wage earners to landowners with the banks sitting in the middle facilitating the trade. Wage earners become relatively poor ... Periods of speculative excess also lead, in every country, to extraordinary disparities of wealth. The "new rich" typically have their counterpart in a "new poor". In Ireland, the property bubble has created an entire demographic section of highly indebted commuter-workers in tandem with a booming private client business for the banks and brokers.

Does Mr. McWilliams still hold to that analysis?

Mr. David McWilliams: Absolutely.

Deputy Joe Higgins: In an article dated 11 February 2001, Mr. McWilliams summarised how cheap credit flowing into a country can destroy it with illusions of wealth. He colourfully referred to the Spanish conquest of Latin America and the ransom which the Incas paid for their unfortunate emperor. In one week, he wrote, "the Spaniards plundered more gold [from there] than the entire continent of Europe produced in a year". He continued, "A monumental mass of gold and silver crossed the Atlantic between 1540 and 1580 - Gold robbed from Latin America paid for everything". He concluded:

There was hardly any lasting positive effect on the Spanish economy. How did Spain manage to waste one of the biggest financial windfalls in human history? And are there any lessons for modern Europe and Ireland in the history of the Spanish gold rush?

In Ireland, were there any equivalents of the indigenous peoples of Latin America who were robbed? If so, who were they? Were there individuals or institutions that were the equivalent of the Conquistadors? Were there individuals or institutions that were the equivalent of the Spanish aristocracy who Mr. McWilliams said in his article benefited hugely? How did Ireland manage to waste the biggest windfall in the history of the State?

Mr. David McWilliams: I have always liked using history to explain matters. The interesting thing about human nature is that it never changes. All these things happen again and again. At the time, what really struck me as fascinating from an economic historian's perspective was how Spain went from being the richest and most aggressive colonialist country in Europe in the 16th century to the poorest in the 17th century. How did that happen? There are many theories but one in particular struck me. What actually happened was that when they plundered all the gold from Latin America, it became easier not to work. Huge swathes of the Spanish manufacturing and agricultural sectors stopped because the Spaniards did not bother working. The people who actually got the most benefit from the Spanish plunder of the Inca gold were not the Spanish but the Dutch and the British who actually made the nails, the hammers, the guns and other products they sold to the Spaniards. That always struck me as interesting.

What the Spaniards had was a massive monetary stimulus, like in the context of Ireland. They woke up one morning and had all the money in the world. We woke up one morning and through the banks had all the money in the world. As had happened in Spain, when one has all the money in the world, prices and inflation rise and one abandons manufacturing. Why should we make stuff when we can actually sell a site down the road?

Deputy Joe Higgins: That is the question.

Chairman: As we have three minutes left, we need to move into the 21st century.

Deputy Joe Higgins: Why would the financial markets plough money into land and speculation rather than, in Mr. McWilliams's words, into science, technology and innovation, especially when the European Union had between 20 million to 25 million unemployed?

Mr. David McWilliams: It is less risky at the time. If the Deputy thinks about it, if one puts money into land in Ireland, how many tax breaks does one get? Loads. How much cheap capital does one get? Loads. Why does one get cheap capital? It is because the banks say they know what land smells and feels like. However, take someone like Apple's founders. They tell the banks they are going to build the most amazing computers out of a garage and will need X millions of euro to do so but have no guarantees or collateral, just that it is all in their head. The banks will not give someone like that money.

What I was trying to explain in the historical context was that one part of our economy would become bloated with capital while another part would become totally starved. That is where we have to got to in Ireland. We have a massively efficient multinational sector but very little domestic industry. I believe this is because of the way in which Irish capital was given out in the boom, namely, that it always favoured land. At the very top of the boom, 88% of every single loan given out by an Irish bank in this country was to a property or property-related investment. When one allows the banks be the sole arbiter of the distribution of capital, one will get endemic short-termism. Why? It is because it drives up their share prices and bankers' bonuses are paid by share prices.

Chairman: The Deputy has one minute left.

Deputy Joe Higgins: I had better fast forward.

Mr. David McWilliams: That is the problem with starting with Pizarro.

Deputy Joe Higgins: In his written statement, Mr. McWilliams stated when one speaks against mainstream views, there are three phases, first, the open ridicule phase, second, the violent opposition phase and, third, everyone pretends they were on your side all the time phase. It reminds one that, apparently, 15 years after the Easter Rising, it would have taken Croke Park to accommodate everyone who claimed they were in the General Post Office that Easter.

Mr. David McWilliams: It is a bit like all those who were at the first U2 gig in the Dandelion Market.

Deputy Joe Higgins: In his written statement Mr. McWilliams stated, "Had the warnings been listened to and acted on, rather than dismissed and ridiculed, it would have been possible to avoid a banking crisis". Mr. McWilliams was a media commentator and had a media platform. What role does he believe sections of the mainstream media played in the generation of the property bubble? Was the media an impartial observer, vested interest or neither?

Mr. David McWilliams: I can only answer in the context of myself. Never once was anything I ever said muzzled by any editor. I have written for *The Sunday Business Post* all the way through. It is the newspaper of the economic, financial and political class. I went through three editors at that newspaper. Nobody ever telephoned me or censored my articles. I have also worked for the *Irish Independent* for many years. It is the largest newspaper in the country and, again, never once has anything I ever said been spiked or questioned by an editor. I am bit of a gypsy because I have worked for TV3, RTE and Newstalk, the main television and radio stations. Never once has anything I have written or suggested been interfered with.

It is not that there was a corporate line for people like me. Maybe I was like an exotic creature in the zoo in that they always have to have one of us. What is quite funny is the number of people who wrote about the boom saying it would all be grand and it was fantastic but are now saying they all saw it coming. I have never been muzzled or interfered with by anyone.

Deputy Joe Higgins: What about the media in general?

Mr. David McWilliams: As for the general attitude, I must admit I think it really is down to the specific journalists, writers, opinion writers and commentators. I really think that and do not think there was a general feeling. That said, if one picks up a newspaper and one has 1,000 words by David McWilliams stuck in the middle saying watch this, and one has 20 pages of glossy advertising in the supplement then clearly, there is a bias in there.

Chairman: I call on Senator MacSharry.

Senator Marc MacSharry: I thank Mr. McWilliams for his attendance. I have three and a half questions and so will move quickly. I will start in this century and will take all the books as read. Bearing that in mind, Mr. McWilliams mentioned the forest fire and so on. Going back to the era, for politicians specifically as opposed to economists, what to Mr. McWilliams indicated most strongly that not all was right with the regulator or the Central Bank in respect of advice they were giving?

Mr. David McWilliams: I do not know. Where does Senator MacSharry want to start? Politicians-----

Senator Marc MacSharry: Let us say that I am Brian Lenihan. What would have stated clearly to me that the Central Bank and the regulator may not be what they needed to be in respect of what I was getting from them?

Mr. David McWilliams: On the most important thing, has the Senator ever played schoolboy soccer?

Senator Marc MacSharry: No.

Mr. David McWilliams: Schoolboy Gaelic?

Senator Marc MacSharry: No.

Mr. David McWilliams: No sport. What sort of a man is the Senator at all? Does everyone know the expression “the banger” in football? Sometimes, were one to play schoolboy soccer, one would turn out for the under-12s and a lad with a beard who looked about 22 would turn up for the other bunch.

Senator Marc MacSharry: We would call him a ringer.

Mr. David McWilliams: Okay, so it is a banger in Dublin. If a banger turns up on a team and scores five goals against one, one knows there is something wrong. The young fellows are tiny and he is a big lad. Banks can be bangers too, by which I mean that if a bank emerges out of nowhere and begins to record profits that are extraordinary and way out of sync with what traditionally had been the case, either the people are geniuses or there is something going on. If one thinks about banking, it is a very simple business. One lends 2% or 3%.

Senator Marc MacSharry: Okay I get it.

Mr. David McWilliams: This is important. If I were a politician, I always would be hyper-sceptical of hyper-success because I would wish to know what actually was going on in there.

Senator Marc MacSharry: Mr. McWilliams believes the absence of the regulator and the Central Bank stating that this is a bank that took 100 years to get to €60 billion, as he stated earlier-----

Mr. David McWilliams: And doubled it in three.

Senator Marc MacSharry: Yes. The fact that the regulator and the Central Bank might not have been saying that was a big issue and should have been ringing alarms-----

Mr. David McWilliams: It is an enormous issue. I mean-----

Senator Marc MacSharry: I am not trying to lead but-----

Mr. David McWilliams: It is an enormous issue. However, what is much more important is to say it at the time and not to say it now, when everyone knows. I mean having the balls to say it when it was not popular and was not what everyone was saying. I mean saying “Hold on a second, I do not mean to rain on your parade but I feel this is wrong”. The regulator should scare the daylights out of bankers. The regulator is the Elliot Ness of the gig and should swagger in. The regulator should be able to say “Come in lads and lock the door; I am worried about this”. Once one gets a situation where they perhaps are all a bit too cosy, the institutions - I am not talking about individuals - become part of the problem.

Senator Marc MacSharry: So they all went native. Is that it?

Chairman: That is a matter for the committee to decide. Senator, that is a leading question.

Mr. David McWilliams: Okay, but in terms of politicians-----

Senator Marc MacSharry: How wrong would the statement “they all went native” be? Is it right, is it wrong or is it a fair assessment?

Mr. David McWilliams: The Chairman-----

Chairman: If Mr. McWilliams will permit me for a moment, I will ask the-----

Senator Marc MacSharry: I was giving a number of options.

Chairman: The Senator’s option still is wrong. I ask him to reframe his question and not to use a leading question.

Senator Marc MacSharry: To ask the question again and a good few minutes have elapsed, in Mr. McWilliams’s mind, what act should have indicated most to the political leaders of the day that the regulator and the Central Bank were not interpreting the facts?

Mr. David McWilliams: The amazing thing is the Senator is looking for one act. There is an entire cornucopia of evidence.

Senator Marc MacSharry: The first act.

Mr. David McWilliams: For example, I recall writing extensively. I appeared on John Bowman’s “Questions and Answers” television programme in or around 2004 and alluded to the fact that all the commentary about Ireland was about a budgetary expansion at the time of approximately €3 billion. There was the whole budget thing and the Minister for Finance of the day was on the panel. I said the most important thing was not that €3 billion has been injected into the economy by the Government but that €23 billion has been borrowed in the same period by the private sector. The private sector was borrowing and injecting into the country eight times more than the budget surplus. In my mind, that would have been a moment.

Senator Marc MacSharry: As that was only one question and I have eight minutes, we must work better at this.

Chairman: Apologies, the Senator has a bit more time. He has two more minutes.

Senator Marc MacSharry: Four minutes.

Mr. David McWilliams: Does this go on every day? Is it like this all the time?

Senator Marc MacSharry: Yes it is.

Chairman: Be quick.

Mr. David McWilliams: Is there something I should know about?

Senator Marc MacSharry: Mr. McWilliams said he was "slapped down by [his] own profession and the establishment". Did he mean journalists or economists?

Mr. David McWilliams: Economists.

Senator Marc MacSharry: Would Mr. McWilliams say economists therefore were largely complicit in pushing the "Let's party" agenda?

Mr. David McWilliams: While I do not think one could say that, I can say what amazes me. It seems to me that the single most explicit profession that almost made certain that one missed this was to be called an economist.

Senator Marc MacSharry: To move on from that and similar to what Deputy Higgins may have been asking Mr. McWilliams, does he think that other than himself, were the media largely complicit in pushing?

Chairman: I would withdraw the word "complicit". I ask the Senator perhaps to ask Mr. McWilliams's view on the behaviour of the media during the time.

Senator Marc MacSharry: Would Mr. McWilliams say-----

Mr. David McWilliams: Senator, I answered the question.

Senator Marc MacSharry: He gets the message anyway.

Mr. David McWilliams: I get the message and answered the question. In my case, and one is talking about making big documentaries for RTE, I was never ever-----

Senator Marc MacSharry: The joint committee knows that Mr. McWilliams was not. However, I am interested in his view of others and of the industry. Was there a herd mentality in the industry that drove the partying?

Mr. David McWilliams: Yes, there undoubtedly was a herd mentality.

Senator Marc MacSharry: That is good.

Chairman: A final question.

Senator Marc MacSharry: With regard to Economic and Monetary Union, EMU, I do not have the time to get into it now but perhaps other questioners will follow on.

Mr. David McWilliams: That is a shame.

Senator Marc MacSharry: It was where I would have liked to have focused more. In any event, should Ireland have joined the euro?

Mr. David McWilliams: Not at all. There is no shred of economic, financial or monetary persuasive evidence to suggest that. We are a country that trades overwhelmingly with the English-speaking world, with America, Britain and Canada, where our kids go. Where do Irish kids go when they look for work? I do not see them rocking up to Bordeaux. They go to the English-speaking world. There is no scintilla of economic evidence that suggests anything other than a prejudice. EMU is a continental system; we are an Atlantic race and an Atlantic economy. It makes no sense and it has been disastrous for this country.

Senator Sean D. Barrett: I welcome Mr. McWilliams, with whom I have had many previous meetings on these topics. During what years was Mr. McWilliams at the Central Bank?

Mr. David McWilliams: It was from 1990 to December 1993.

Senator Sean D. Barrett: In what section was Mr. McWilliams?

Mr. David McWilliams: The international economic affairs section, which at the time was dealing with the post-Maastricht build-up to EMU. That was my first job.

Senator Sean D. Barrett: Were issues of the prudential regulation of banks discussed when Mr. McWilliams's group got together in the Central Bank?

Mr. David McWilliams: The first time I worried about the way Ireland's economy might deal with a crisis was during the currency crisis in the Central Bank in 1992. I was working as an economist in the department that was dealing with the European Union and the putative European Central Bank, as it became. I was always amazed at the extent to which the people on the inside denied reality. The beauty about Ireland is that if a currency is overvalued, one can see it not in outflows of money but in the length of the queues of Toyota Corollas at Sainsbury's in Newry to buy cheap Harp for Christmas. Deputy Doherty will know this as someone from Letterkenny. If the Irish currency is overvalued relative to sterling, the currency of our major trading partner, Irish people go across the Border to buy stuff. We have a living economic experiment in Dundalk, Letterkenny and Lifford. During the currency crisis I pointed out to one of our bosses who was claiming there would be no crisis or devaluation that the *Irish Independent* was reporting on these queues of punters, although they were probably driving Ford Escorts rather than Toyota Corollas at the time. I got the impression that sometimes when one was inside, one was being dictated to by the tyranny of one's own peer group. If one's peer group consists of the fellows one meets in Brussels, conversations might not reflect the country one is supposed to be discussing. I refer to that psychology in a book called *The Good Room*.

Senator Sean D. Barrett: We were asking about the prudential regulation of banks. Did Mr. McWilliams ever come across the people who were in charge of that?

Mr. David McWilliams: No, it was a very stratified organisation. To tell the truth, I cannot recall who would have occupied that role.

Senator Sean D. Barrett: There was criticism in the Honohan report of the fact that approximately 15 out of 1,200 staff were working on prudential regulation of banks.

Mr. David McWilliams: Is the Senator asking what the other 1,185 were doing?

Senator Sean D. Barrett: That did not seem to indicate that it was much of a priority. I take it Mr. McWilliams did not meet the people who had the job of ensuring banks were solvent.

Mr. David McWilliams: I was 24 years old at the time. I had just completed a master's degree and it was my first job. What stuck with me, however, was the level of group think in the place.

Senator Sean D. Barrett: It argued very strongly against the McDowell report. It wanted to regulate the banks. Could Mr. McWilliams see it carrying out that task?

Mr. David McWilliams: The evidence when I was writing about this suggested that not only was it not carrying out its regulatory function but that it was also facilitating a type of irregulation which would lead to this crisis.

Senator Sean D. Barrett: When we joined the euro, against the advice of Mr. McWilliams and others, could we have regulated the flow of capital to keep it out of property and mortgages?

Mr. David McWilliams: The first quote on this was in an article in 2000, where I stated we could create a simple rule which would make sure the banks did not over-lend. At the moment, if an individual's house price increases, the bank can loan more against it. That is a built-in inflationary mechanism. In 2000 I came up with a backward looking house price index whereby the last house price increase was divided by the average of the index and then multiplied by the loan-to-value ratio, which means that the increase in prices reduces the amount of money that can be lent. It would be a dynamic system which could regulate itself. That is how one should do it. It is a simple statistical rule and it would be unbelievably easy to put in place. It would strangle house price inflation because house price inflation would limit the amount of money that could be lent. That is the sort of regulation we need.

Senator Sean D. Barrett: What could we have done about commercial property? We have heard evidence that commercial property was even more toxic.

Mr. David McWilliams: The most important thing for me in the Irish banking system was that we were running liability and asset risk, which is a terrible cocktail. The liability risk was the hot money coming in seeking a higher yield and financing commercial property. One stops commercial property prices rising by managing liability risk, that is, both sides of the balance sheet. If, for example, the regulator saw that a bank had just issued a short-term liquidity instrument of €500 million, which was happening all the time, it could have said, "Hold on a second, you cannot do that." The regulator would manage the bank's liabilities, which are the source of its delinquency, and as a consequence the bank would not be able to lend for commercial property. That is what we have to do in an open economy. Instead, however, we were looking at the asset side of the balance sheet and praying it would be okay but then panicking.

Senator Sean D. Barrett: Mr. McWilliams liked Sweden and Switzerland. I ask him to tell us what they did.

Mr. David McWilliams: Sweden did exactly the same as we did at the beginning. I told the then Minister that he had reached the last resort. Sweden had reached the last resort in 1992. When it had a similar boom-bust cycle, it introduced a blanket guarantee of all deposits, excluding subordinated debt, and by this means it stopped a bank run. Our objective was similarly to stop a bank run. Sweden quickly realised it would have to set up a bad bank and it did so extremely quickly. It wrote down the assets very quickly and minimised the cost. However, it also devalued its currency by 40%. Once a country devalues its currency, it is back to life. What happened in Ireland's banking crisis was that, amazingly, not only did we not devalue our currency, but it actually increased in value between 2008 and 2010. Sweden cut its interest rates to zero, but our interest rates went up after the crisis. We had an extraordinary set of policies that even a student taking leaving certificate economics would know was wrong.

Senator Sean D. Barrett: I would still like to ask Mr. McWilliams about Switzerland.

Deputy Michael McGrath: I thank Mr. McWilliams for coming before us. The warnings he gave from 2000 onwards have been well ventilated. I would like to discuss further his thoughts about the crisis period of autumn 2008. Irrespective of what he believes should have been done subsequently, does he believe the decision taken at the end of September 2008 to guarantee the banks was the right one?

Mr. David McWilliams: Yes, not only was it the right decision, it was the only decision that could have stopped a bank run. Over the last five years an amazing number of scenarios have been painted about what could have been done if, could, must, blah blah. Hindsight is a great luxury. At the time we had a banking system that had been set up to fail. It was not a matter of "if", it was a matter of "when". The combination of hot money and a bank run is the most vicious and contagious financial episode one can imagine. It is the financial equivalent of Ebola. One needs to come in with all possible interventions to reduce the perceived risk in the minds of people that their money will not be there when they go to the bank tomorrow. That is crucial. Much of my testimony has been about how, in God's name, did we let it get to that situation. Once one is in that situation, however, one has to ask whether one knows the facts and, if one does not, whether one should take the risk that not knowing the facts might imperil the banking system. There is absolutely no way one can do that. It is in black and white in all my writing that the guarantee needed to be temporary in order to give us time to get into the banks to investigate the situation.

Deputy Michael McGrath: Mr. McWilliams referred to a period of two years.

Mr. David McWilliams: I said: "Let us say two years." The phrase "let us say" is hardly a scientific formula. I told the then Minister that the period had to be sufficiently long to assuage the fears of Irish depositors but sufficiently short not to encompass everything. I said to the Minister it has to be sufficiently long to assuage the fears of Irish depositors but sufficiently short not to encompass everything. I said to him that is what auditors and civil servants do, they make those decisions.

Deputy Michael McGrath: Can I tease out your train of thought at the time and what you believed should have happened but maybe did not happen? On 28 September you said the only option is to guarantee 100% of all depositors, creditors in the banking system. After the guarantee on 1 October you described it as a masterstroke, a practical blueprint for the new financial architecture that will emerge from this global crisis but 18 days later you were critical of the Government's approach. Why? What changed in the interim given that at that stage PwC was already in the banks assessing the balance sheets of the loan books? What did not happen in that 18 days that you believe should have happened?

Mr. David McWilliams: It is a very fair question. If the objective was to stop a bank run and that was achieved, that was a very important achievement. Had it not been done and had the Government gone down the road of allowing banks to go bust where would that have left us? That is a risk I do not believe any government can take.

The second idea is that the bank run had been stopped and the Government was beginning to take its own hands off its throat and breathe again to the extent that it had some calm. PwC was in the banking system. I do not think it is speaking out of school to say its report was not really worth much. It said the banks were quite okay.

Deputy Michael McGrath: They had not reported from 19 October.

Mr. David McWilliams: In that three week period, I had come through seven years of being ignored, seven days of being listened to and starting seven years of being ignored again. I was back on the outside for whatever reason. When I heard about the subordinated debt I thought this does not sound right.

Deputy Michael McGrath: You had earlier written about 100% of creditors being guaranteed.

Mr. David McWilliams: I said shareholders do not get covered. In any receivership subordinated debt is regarded as equity. That is absolutely clear from what I said. It is an equity style instrument, not a debt instrument.

Deputy Michael McGrath: Approximately 1 billion of those were repaid during the guarantee. That is €1 billion.

Mr. David McWilliams: It is important because it shows a way of thinking. I write from my desk in my office. It struck me that we were moving towards using the guarantee not as an emergency measure but as a full payment mechanism in the event of bankruptcies.

Deputy Michael McGrath: In practical terms what did you expect to happen over those two or three weeks that did not happen?

Mr. David McWilliams: I expected the Government to make the guarantee more conditional. Brian Lenihan told me he liked speaking to me sometimes because I spoke English not economics and "economicese". I told him to regard it as being like writing an insurance policy. If one writes an insurance policy for a young fellow to drive there will be small print to the effect that if he is drunk or taking drugs, etc., the policy is null and void. I told him to put in conditions to protect himself because we were still buying time. Everything was calm, amazingly, given what had gone before.

Deputy Michael McGrath: For a while, yes.

Mr. David McWilliams: I told him to use this to make sure he had enough wriggle room because that would give him the chance to do something permanent once he had the facts.

Deputy Michael McGrath: Absolutely. Do you believe that at that time, in September 2008, the value of the liabilities in the Irish banking system exceeded the real value of the assets?

Mr. David McWilliams: That the bank capital was gone?

Deputy Michael McGrath: That the banks were insolvent.

Mr. David McWilliams: They were definitely illiquid and were moving towards insolvency.

Deputy Michael McGrath: The guarantee resolved the liquidity issue in the short term at least but one could argue, and it is a fact, the banks were still insolvent.

Mr. David McWilliams: It is a fact, and we not only had the guarantee but also ELA. At the time of the guarantee the collateral in the banks was not regarded as worthy of collateral by the ECB. The Government could not go to the ECB and say it had a parcel of land in Westmeath which it reckoned was worth €10 million and ask for €10 million in cash because the ECB would not take it. There had to be negotiations with the ECB to say the Government needed emergency liquidity. It then began to emerge that the black hole in Anglo Irish Bank was enormous.

Deputy Michael McGrath: Do you believe with the benefit of hindsight that the banks were insolvent at the end of September 2008?

Mr. David McWilliams: I think some of the banks were insolvent. I discussed with Brian Lenihan the possibility that they could be. I said they would definitely be insolvent if he did not give them liquidity.

Deputy Michael McGrath: They got that and they were still insolvent.

Mr. David McWilliams: The interesting thing is they were all insolvent. All Irish banks needed a Government bailout in some shape or form.

Deputy Michael McGrath: They were all insolvent.

Mr. David McWilliams: They all needed help. None of them could survive on their own.

Deputy Michael McGrath: I know but insolvency is a very particular term with a particular meaning.

Mr. David McWilliams: Now we know that certainly the two smaller banks were insolvent. That became apparent-----

Deputy Michael McGrath: Can you name them for the record?

Mr. David McWilliams: This is why I said to the Minister he should have this savings and loan option, the debt for equity swap.

Deputy Michael McGrath: To clarify, for the record of the inquiry, who do you believe was insolvent at that time?

Mr. David McWilliams: It is obvious now that Anglo Irish Bank was insolvent.

Deputy Kieran O'Donnell: I want to deal with an area you can shed light on. Much of what we have dealt with to date is already in the public domain. I want to refer to your book, *Follow the Money*, where on page 17 you write the first encounter prompted a series of events in which the Minister began by peeling garlic and drinking tea in your kitchen and ended with the announcement of the bank guarantee less than two weeks later. I want clarification on several issues in that intense two week period. How many times did you meet Mr. Lenihan?

Mr. David McWilliams: I met Brian Lenihan twice in my life.

Deputy Kieran O'Donnell: You met him on 17 September.

Mr. David McWilliams: Yes and I met him on 4 October, which was a Saturday. I had been in China for seven or eight days.

Deputy Kieran O'Donnell: You had not met him-----

Mr. David McWilliams: I had never met him before and I never met him since.

Deputy Kieran O'Donnell: Between 17 September and 4 October how many telephone discussions did you have with him?

Mr. David McWilliams: As I told Deputy Doherty, I would say ten.

Deputy Kieran O'Donnell: In those conversations over that two week period what did you discuss? You were speaking to him daily.

Chairman: In the interests of time management if there is new information that has not already been given in the testimony this morning or if you have nothing further to say please let us know because then we can move on.

Deputy Kieran O'Donnell: I have a line of questioning and I ask the Chairman to allow me-----

Chairman: My job is to ensure there is no repetition.

Deputy Kieran O'Donnell: I want to get the chronology of the events and discussions.

Mr. David McWilliams: As I told Deputy Doherty when I was in China I had no idea what was really going on here. There was an eleven hour time difference.

Deputy Kieran O'Donnell: That was from the 23 September. Give me an idea of the telephone calls you would have had.

Mr. David McWilliams: He was asking me, particularly when I was away, what were international financiers, economists and bankers saying about Ireland because this was part of the international financial crisis. I tried to tell him what I was hearing but on many occasions I had to tell him that with the collapse of the American financial system we were not that high on their radar screen.

Deputy Kieran O'Donnell: Mr. McWilliams wrote two defining articles. In the article of 21 September he wrote about guaranteeing deposits and made reference to a complete blanket guarantee for two years. Then on 28 September his article appears to be almost a carbon copy of the actual guarantee that was announced a few days later. When did Mr. McWilliams write that article of the 28 September?

Mr. David McWilliams: I wrote that one when I was in China.

Deputy Kieran O'Donnell: It is almost identical to what was in the guarantee.

Mr. David McWilliams: This is the very interesting thing. At no stage was I an adviser to the Irish Government. At no stage was I a senior civil servant. At no stage was I a central banker advising. At no stage was I in the regulator's office. I was one individual writing from my desk about what I saw going on. I have to be very clear about this. There were dozens of paid advisers deep in the system writing reports and advising. What struck me as interesting was that despite having dozens of advisers they missed the whole thing. I was writing on my own, as I had been since 2000, about what I felt was going on in the economy, and I still write on my own about what I think goes on in the economy.

Deputy Kieran O'Donnell: On page 26, the Minister asked Mr. McWilliams, "Are you sure about this, David?". This was only a few days before Mr. McWilliams's article of 28 September; when this article was being written was he aware of the direction the Minister for Finance was taking?

Mr. David McWilliams: No, at no stage did the Minister give any indication that he was thinking one way or the other, and this is what I would fully expect. He was emphatic about that. If the Deputy reads on from that note, the Minister said, "Are you sure about this?" What did I say? Will the Deputy read on?

Deputy Kieran O'Donnell: Mr. McWilliams said: "No, Brian, I am not sure it will work but I am sure of one thing, we have no alternative."

Mr. David McWilliams: And that is exactly what I felt, that we had allowed a banking crisis to engulf the State because we had not listened to the warnings that people like me gave at various stages. We had no reason to be in that situation at all but we got there.

Deputy Kieran O'Donnell: How does Mr. McWilliams reconcile that position with a blanket guarantee when his view, which he articulated over a long period of time, was effectively to burn the bondholders?

Mr. David McWilliams: There is absolutely no inconsistency. It is an important question to answer. What is written everywhere is that a temporary guarantee should be introduced to give Government, civil servants and monetary authorities time to find out the facts. Nothing permanent can ever be done without the facts.

Deputy Kieran O'Donnell: I know that.

Mr. David McWilliams: Does the Deputy believe that the Irish guarantee is long or short?

Deputy Kieran O'Donnell: Mr. McWilliams gave a two year guarantee.

Mr. David McWilliams: Let us be very clear.

Deputy Kieran O'Donnell: Mr. McWilliams articulated a two year guarantee.

Mr. David McWilliams: Let us be very clear. I did not give any guarantee to anybody.

Chairman: I will allow Deputy O'Donnell back with a final question but he should allow Mr. McWilliams to answer.

Deputy Kieran O'Donnell: No, but Mr. McWilliams articulated a two year guarantee.

Mr. David McWilliams: I will read out what the history of guarantees is to the Deputy. It is quite interesting.

Deputy Kieran O'Donnell: I have limited time. I am asking a very specific question.

Chairman: Mr. McWilliams spoke about a two year guarantee in his article and the guarantee itself worked out to be two years; Deputy O'Donnell is asking Mr. McWilliams what the correlation is between that.

Deputy Kieran O'Donnell: My question is a more specific one. Mr. McWilliams always articulated in the past that bondholders in a free market are risky capital. The blanket guarantee that was put in place guaranteed risky capital and subordinated debt. He articulated this in his article of the 28th of September and in his book at page 22, where, speaking to the Minister, he said, "However, I argued because the Irish banks funding has become so unstable, if we did not guarantee the funding as well as deposits the banks would come crashing down." That is at variance with his previous articulation. Did the blanket guarantee cover bondholders?

Mr. David McWilliams: The Deputy has really mixed things up. I will tell him how. He is talking about the difference between a panic in a financial market and a period of calm. The whole point of a temporary guarantee is to make sure that everything is calmed right down by doing what has to be done, because the banks are going to go to wall, for no other reason than the fact that people will take their money out. That is the first thing.

The second thing is that during the period of calm when the liquidity issue has been addressed the Government must establish what is in the best interests of the State. Is it in the best interest of this State to pay out into perpetuity every single creditor of insolvent banks or is it in the best interests of this State to do what I said, which is to introduce a temporary guarantee and then move against the creditors?

Deputy Kieran O'Donnell: Two years is not a temporary guarantee. What happened at the meeting between Mr. McWilliams and the Minister on 4 October that caused the relationship to go sour?

Chairman: Mr. McWilliams should deal with the second question please.

Mr. David McWilliams: There are 14 examples of blanket guarantees given in bank crises around the world. The Irish guarantee is the third shortest. Can I explain that to the Deputy again? It is the third shortest. So it is as close to the minimum that has ever been given in the OECD and that involves Denmark, Ecuador, Finland, Germany, Honduras, Iceland, Ireland, Indonesia, Japan, Malaysia, Mexico, Nicaragua, Sweden, Thailand, and Turkey. That is the first thing.

The second thing is what happened to our relationship. Nothing. Brian Lenihan and I always got on quite well. What happened was I kept saying to him:

> Make it conditional. Make it conditional. Don't be open ended. Make it conditional. You are in the driving seat now. You own them. You are the boss. Make it conditional so that we are not in a situation where we end up paying off risk capital. You have to stop the crisis, which is absolutely essential. Once you have done that you are in the driving seat. You do what you want.

That was what the opportunity was. We could have done what we wanted. Napoleon said, "to govern is to choose". A Government has to make choices.

Chairman: We are now going back into another century. We will stay with the crisis period.

Senator Susan O'Keeffe: What happened? Did the Minister not take Mr. McWilliams's advice to make the guarantee conditional?

Mr. David McWilliams: Yes.

Senator Susan O'Keeffe: How did Mr. McWilliams feel about that?

Mr. David McWilliams: Was I surprised? It was terrifying. The articles that I was writing in the weeks afterwards were all warning "hold on a second, we have to make this conditional, we have to make this temporary, this has to be holding, it is doing its job in the sense that my Mum is not taking her money out of her bank account". We have that period of calm. Thereafter I suspect that there was almost a sort of a banking *coup d'état* in policy. It seemed to me that the interests, not so much of the banks but the bank owners, the creditors, were being elevated, and I had been told that the ECB had said that no bank can go under. I believe the inquiry has different information now.

Chairman: The best way to describe it is as assembling information.

Mr. David McWilliams: I had been told at the time that the ECB was saying that no European bank could go under at any stage. I wrote at the time that if that was the ECB's directive, it should pay for the consequences of this policy. If one thinks about it, in the case of a bank going under, only four groups or institutions can pay for it: the taxpayers of Ireland, the taxpayers of Europe, the ECB itself, by injecting a promissory note-type instrument, or the creditors. We had the choice and we did not seem to negotiate. I have no idea why. I think this is the European element, which I am sure the committee is coming up to, as to what the ECB involvement in all this was.

Senator Susan O'Keeffe: In the years that Mr. McWilliams was writing all his warnings, did anyone ever come up to him at a conference, on the street, in the pub, or anywhere at all? Did they write to him or telephone him and tell him he did not know the half of it, or something similar? He says he was the outsider and that he wrote 1 million words, that he was issuing warnings and nobody came to him or called him-----

Mr. David McWilliams: No, that was-----

Senator Susan O'Keeffe: -----in the official arena. I am asking whether there were people who said to him quietly that he was right.

Mr. David McWilliams: No. It is still gratifying when I am in a pub and so many people come up to me and say, "Thanks. We were going to buy this house but we watched one of your programmes and we didn't". The public and the establishment had totally different views. The members of the public thought I was saying things they thought in their gut was right. I never had any conversations with anybody in the political process, the big banks, the regulator or the Central Bank. In 2005, Deputy Enda Kenny asked me to address the Fine Gael parliamentary party in Portlaoise. Were any of the Fine Gael committee members there?

Chairman: We do not need to know who was there, we just need to know what was said.

Mr. David McWilliams: I am on tricky business with this language. I talked about a concept I have come up with, "deckland", which was this part of Ireland that was emerging. Deputy Enda Kenny said it was interesting. That was the only time. Deputy Higgins invited me in to have a discussion with him and his party in the Teachers' Club in Parnell Square in 2006 or around then. Only the extreme right and the extreme left consulted with me.

Senator Susan O'Keeffe: When the Minister left Mr. McWilliams's house that night, having had the garlic and the tea, how would Mr. McWilliams describe what he was feeling on a scale on one to ten, if one was very concerned and ten was very comforted?

Mr. David McWilliams: That is a very interesting question. It was very strange for me, because having been ignored for seven years, suddenly your man was in our kitchen. That was a very strange feeling. I have always said that I felt incredibly sorry for Brian Lenihan the individual, because I felt that here was a good man in the middle of an enormous financial storm, having been put into the job in recent months. He was really trying to get on top of things and he was really open. That was the interesting thing. He never closed himself off. He was always saying, "That could work, that might work". How did I feel? I felt that if something was not done in order for him to appraise himself of the facts, we would have a monumental crisis.

Senator Susan O'Keeffe: Is Mr. McWilliams saying that there was still a significant shortage of facts available to the former Minister?

Mr. David McWilliams: It was total. When one goes to find out what is going on, one needs facts. One needs the hard numbers. Is it 1 million or 10 million? The impression I got was that he and the people around him - the paid advisers and all these people - were not in possession of the facts at all. Therefore, they could not do anything permanent. They had to do something temporary because they had to calm it down in order to find the facts. As a former investigative journalist, Senator O'Keeffe knows that one needs to dig.

Senator Susan O'Keeffe: Mr. McWilliams talks about reading and watching credit swaps, repo spreads, figures and facts, I suspect, to say that he was not just saying these things, he knew them. Is he saying that he was the only one doing that? Were other people doing that exercise, or was he just pursuing and digging?

Mr. David McWilliams: All these things are online. If one wants to see the prices that AIB is paying investors to borrow money from it-----

Senator Susan O'Keeffe: One has to look .

Mr. David McWilliams: Yes. One goes online. There is a thing called Bloomberg, which is a sort of financial market survey. It was there all the time. The price of Irish credit default swaps - for example, if one wanted to buy Bank of Ireland shares and bought insurance to protect against the risk that Bank of Ireland would go bust - was going through the roof, so people were thinking that this bank was in trouble.

Senator Susan O'Keeffe: Most people were not looking at that.

Mr. David McWilliams: They did not seem to be. This is public information.

Senator Michael D'Arcy: Is Mr. McWilliams satisfied that the Minister was on top of his brief when he was discussing those matters with him in early September?

Mr. David McWilliams: He was on top of the brief he was given. This is an important distinction. At a time of crisis, there is a massive move for institutional self-preservation. It is a general rule. It is human nature. If there is a recurring theme in this process, it is that reality was denied at every stage. People did not want to look into the vista and admit that it could be that bad. This may be the pinnacle of that process.

Senator Michael D'Arcy: Can I ask Mr. McWilliams about the telephone call he received from John Gormley? When was that? Was Mr. McWilliams in China at that stage?

Mr. David McWilliams: I was in China. I did not know John Gormley particularly well. The thought that went through my mind at one stage was, "Why didn't they ring their own bloody advisors? Why are they ringing me?" I never got paid a cent for all this. If I had actually billed out all this, I would be a reasonably wealthy man. John Gormley called me and asked what I thought. I told him I was in Tianjin, which is a city in China that I had never heard of, but Senator D'Arcy said it has 11 million people in it. There was a sense of "I think this is happening, I'm not too sure". What struck me was why they had to telephone a bloke in China to find out what was going on right under their noses.

Senator Michael D'Arcy: Did Mr. McWilliams ask him?

Mr. David McWilliams: I did, jokingly.

Senator Michael D'Arcy: What was his response?

Mr. David McWilliams: The response was that up until now, everything they had been told had been wrong. That is true. They were told there would be a soft landing. That was wrong. They were told the banks were well-capitalised. That was wrong. They had been told prior to that that the Irish economic boom was based on fundamentals and that was wrong too. Eventually, if one consistently gets advice that is wrong, one says, “There is one dude over there who is writing all the time. He seems to have a fairly good handle on it. We’ll ring him”.

Senator Michael D’Arcy: Did Mr. McWilliams get the impression from his conversations with two Ministers at a crucial time that there was an inability within-----

Chairman: Question the ability, not the inability.

Senator Michael D’Arcy: Was the ability available within the Department of Finance, the Central Bank, the Regulator’s office-----

Mr. David McWilliams: I do not think the Senator needs me to answer a question whose answer is so self-evident.

Senator Michael D’Arcy: We touched briefly on the PwC analysis carried out on behalf of the Department of Finance. Did Mr. McWilliams have sight of any reports?

Mr. David McWilliams: No. I must reiterate that during the period from 2000 right up to now, I did not have sight of any data. As I told Senator O’Keeffe, what I was doing was looking at what was publicly available.

Senator Michael D’Arcy: So it was Mr. McWilliams’s analysis-----

Mr. David McWilliams: It is not always analysis. In Ireland we have what I term the “nose-tipping” approach to conversation, whereby someone says “Ah, you wouldn’t know now what I know”.

Senator Michael D’Arcy: Is it instinct?

Mr. David McWilliams: It is not instinct, it is knowledge. There is nothing instinctive about this. It is about having worked in the system, understanding the system, looking back at the academic literature - Senator Barrett would be aware of the historic aspects - or going back as far as the bloody Incas if we have to in order to find repetitive cycles.

Senator Michael D’Arcy: What is Mr. McWilliams’s view on the PwC report, which was published early in 2009 following the completion of the fieldwork relating to it in December 2008? How does he tally what it contains with what happened when NAMA was established some 13 months later with a 50% writedown?

Mr. David McWilliams: I cannot tally the two of them. Can the Senator?

Senator Michael D’Arcy: I am asking Mr. McWilliams.

Mr. David McWilliams: No, I cannot.

Chairman: Next question.

Senator Michael D’Arcy: Mr. McWilliams is a very experienced broadcaster and commentator. He does not give away much by his body language but I did detect some dissatisfaction on his part regarding the use of the term “unpatriotic” in respect of him and other contrarian commentators. What is his view on the put downs that were placed in the public domain regarding him and others?

Mr. David McWilliams: It is very hurtful. It is designed to hurt.

Senator Michael D'Arcy: Intentionally?

Mr. David McWilliams: We are all adults. It was difficult for my wife and other people around me, particularly my mother. Irish mammies read all that stuff. Really nasty things were written all the way through with regard to ability, motives, etc. Sometimes people write things they do not really mean. If one looks back at some of the comments, they were very personal and quite nasty. However, I am the sort of person who becomes emboldened by that kind of carry on. Maybe it is something deep in my psyche. There is the really nasty stuff and then everyone pretends that they are on one's side all the time. The put downs and all those quite slanderous articles were difficult to take but we are big boys and that is the cut and thrust of life.

Senator Michael D'Arcy: Mr. McWilliams clearly has analysis based upon the 14 blanket guarantees that were extended internationally at various times. How does the Irish blanket guarantee rate in terms of its expense in the context of GDP?

Mr. David McWilliams: It is an interesting question and I have the hard data relating to it here. The average fiscal cost for the whole thing in Turkey, Thailand, Sweden, Nicaragua, Mexico, Malaysia, Korea, Jamaica, Indonesia, Finland and Ecuador was 26.8% of GDP. Those countries range from the highly developed, namely, Sweden and Finland, to the underdeveloped, namely, Indonesia. When all the numbers are done and when NAMA is closed down, I think the Irish case will be somewhere around there.

Chairman: It will reflect that average, yes?

Mr. David McWilliams: It seems that way.

Deputy Eoghan Murphy: I thank Mr. McWilliams for attending. One area the inquiry is obliged to examine is the relationship between developers and politicians. In Mr. McWilliams's view, is there a relationship between political donations and political decision making?

Mr. David McWilliams: Is there a relationship? I cannot imagine that one would give money to anyone and not expect something back. Let us consider the position of children. When one gives money, sweets or a present to somebody, does one now expect to get something back?

Chairman: I must advise the witness and the questioner that we are moving into generalities. We could have a conversation about how someone thinks something happens over a cup of tea. We must discuss specific matters.

Mr. David McWilliams: That is fair enough.

Deputy Eoghan Murphy: Mr. McWilliams touched upon this matter quite a few times in his book, *Follow the Money*, and stated that politicians could not make decisions that might inconvenience builders and bankers. He proceeded to relate two stories, one about Bertie Ahern and the second about a golf classic hosted by Brian Cowen. Was he making an implication when he made that statement and followed it up by relating those two stories?

Mr. David McWilliams: As far as I know, I did not think we are in the business of mentioning names here. So I think it is impossible for me to answer that specific question.

Deputy Eoghan Murphy: In his book Mr. McWilliams stated that, in the context of the 2007 general election, 71% of donations to political parties came from people involved in property development.

Mr. David McWilliams: Yes. I was making a Galway tent connection between a political party and a very significant industry. I do not think that anybody will refute the fact that proximity of a political party - or of many political parties - to certain parts of industry probably means they are going to be treated differently. This is not exclusive to Fianna Fáil. I did a one-man show in the Abbey Theatre and I was always intrigued as to how the former leader of Fine Gael, for example, got gambling or speculative debts written off by AIB-----

Chairman: Mr. McWilliams should not stray into the area of identifying individuals. I already pulled him up in that regard.

Mr. David McWilliams: It always seems to me that maybe this stuff goes on. My point is that I think one is right to get windy when one sees donations coming from one sector. However, I really cannot elaborate on this because of what the Chairman has said.

Deputy Eoghan Murphy: This matter is interesting, particularly in terms of the idea for a guarantee that Mr. McWilliams was promoting and the fact that the actual guarantee that was implemented was different to that.

Mr. David McWilliams: Yes, it was extremely different.

Deputy Eoghan Murphy: Professor Edward Kane, who came before us previously, has indicated:

> A government's willingness to rescue different firms lies on a continuum and is influenced by several variables. In particular, a firm's access to political elites grows with its interconnectedness, geographic footprint, and the number of employees and creditors that can be persuaded to contribute on its behalf to re-election campaigns.

He was making a statement about the American situation.

Mr. David McWilliams: Yes and that is a fair point. The committee has one of the very few guys, namely, me, who spent nearly ten years issuing warnings about all of this, including the nexus between bankers and developers and how this was sucking away the resources of the country. Although I made all of those connections, my major concern, as an economist and a commentator, lay in the fact that if one sees all that stuff emerging, it only reinforces the need to have really strong, independent regulation. People do what people do and this constantly underscores the need for strong, independent, highly vigilant regulators. The most important point about regulation is that one can have the best regulation in the world but if one does not police it, it is not worth the paper on which it is written. As such it is better to have fewer points of regulation which are well policed rather than to have pages and pages of unpoliced regulations. What the Deputy has painted is a picture which underscores absolutely the need for strong, independent, unimpaired, almost loner-type figures. There is no problem with being a loner and not having a gang to hang out with in order to police what the Deputy speaks of.

Deputy Eoghan Murphy: Does what Professor Kane talks about in terms of rescuing different firms bear any relationship to how Mr. McWilliams's proposal for a guarantee evolved?

Mr. David McWilliams: What the Deputy is suggesting is that the guy who was most against the bankers ends up in a situation where a consequence of what he thought absolutely necessary was that certain banks would be saved. If the Deputy looks at my writings-----

Deputy Eoghan Murphy: No, sorry. Mr. McWilliams had an idea which was not implemented in the way he thought it would be.

Mr. David McWilliams: Yes. I would have thought - and I said it in all my writings - that the normal rules of corporate finance should apply in the case of insolvency. Therefore, the guarantee would have been rescinded as the liquidity problem was already plugged. Then one would have lined up all the creditors in a room and had a bank resolution mechanism as that is the system whereby we as a society deal with bad banks. At the very top, one would have what I call “trust creditors”. They are creditors in trust, which is to say depositors. When my mum goes to put her savings into the bank, she does not realise that technically she is lending money to the bank. In her head, it is a nest egg, something for grandchildren and what she has put away for a rainy day. She does not have any realisation that technically in the event of a bankruptcy, she is a lender. Therefore, my solution, as I wrote at the time, was that as simple depositors trust the system, they should be regarded as trust creditors and encircled. Under that, one then has the normal hierarchy of creditors which everybody understands. It happens every single day in this country in receiverships. That is the system we could still have. That answers the Deputy’s question. If there were massive insolvencies, they would have been dealt with in the normal way.

Deputy Eoghan Murphy: I come then to resolution measures. In his writings, Mr. McWilliams makes implications around some of the resolution measures that followed the guarantee, for example the design of NAMA.

Mr. David McWilliams: I was very in favour of the Swedish approach as it looked like a good blueprint from a country that does not get much wrong. Over the years, the Swedes seem to be very good at public administration. What they did was to write down their loans incredibly quickly, which had the effect of allowing the banks that were good to begin to lend again very quickly. This materialised rapidly in the significant growth of the Swedish economy in the 18 months after their banking crisis. My feeling was and to a degree still is that the NAMA process was so slow in writing down and it never freed up the banks that had got the stuff off their balance sheets to begin the process of lending. We remained in what Keynes would have described in a traditional liquidity trap for a long time. Irrespective of how low the interest rate was, people had too much existing debt and did not want to borrow any more while the banks had too much bad debt and did not want to lend.

Chairman: I need to move towards wrap up. This is way over time.

Deputy John Paul Phelan: Deputy McGrath asked questions earlier about insolvency versus liquidity and Mr. McWilliams indicated that on the night of the meeting on 17 to 18 September, he did not have any evidence that there were insolvency issues within some of the------

Mr. David McWilliams: I did not have any evidence, but I said that if one let them go illiquid, they would become insolvent. The interesting thing is that the best banks, if they are margin driven and have heavily exposed one side of their balance sheets to short-term debts, will go insolvent if one lets them be illiquid.

Deputy John Paul Phelan: I put a quote to Mr. McWilliams from *Follow the Money*. It states: “The Minister indicated that the problem was more acute. The most revealing thing about our conversation was that it was AIB not Anglo Irish that had the most severe funding problems".

Mr. David McWilliams: That is the one that put the wind up me. I was asking if it was just Anglo Irish Bank and he mentioned all the banks. I will explain what happens when things are going well. Let us say I am good for my money and Deputy Phelan gives me €100 and I say I will give it back in 100 days. Deputy Phelan will say that is fine. If he then hears that I have given €80 of that €100 to someone to whom I owe money and that fellow has given money to someone he owes, he will say he is only giving me the money for a week.

Deputy John Paul Phelan: What I want to ask is whether it raised the fact that there were solvency issues rather than a liquidity issue in AIB. He has said it did.

Mr. David McWilliams: No. What the Minister was saying was that one of the bigger banks had a short-term liability profile which would have made it illiquid. The Deputy should think about the bank he is talking about. It was the biggest bank in the country.

Deputy John Paul Phelan: I understand. My final question relates to an article I have just found from the *Irish Examiner* on Monday, 2 November 2009, which was written by Seán Connolly, the political correspondent. The article was on a war of words that erupted between Mr. McWilliams and the late Minister, Brian Lenihan. It was a year and a bit after the guarantee. I refer to a specific quote from the late Brian Lenihan who said, "He contacted me through my brother, Conor, and said he wanted to meet me and I happened to be meeting another friend in that part of the city that evening who lived further up the road". That is a direct contradiction of the outline of the initial contact Mr. McWilliams had.

Mr. David McWilliams: On the contrary, it is not a contradiction at all. Brian Lenihan scribbled down a number to me. I went to look for it that night. I looked for it but could not find it. I had his brother's number because I had been the breakfast presenter at Newstalk and the brother had been a regular on the show. I telephoned the brother and said "Listen, your brother gave me his number. I have not got it. Can you give it to me?" and he said "Yes".

Deputy John Paul Phelan: He indicated furthermore that he really did not go out specifically to meet Mr. McWilliams and said he happened to be in that part of the city.

Mr. David McWilliams: Come here. If someone rocks up in your kitchen, he wants to meet you. I did not rock up in his kitchen.

Chairman: I note to Deputy Phelan and Mr. McWilliams that the entry of late information into an inquiry towards the close of a session is not usually how we go about our business. We usually inform witnesses before coming in. I would not expect Mr. McWilliams to deal in detail with documentation presented at the end of a hearing.

Deputy Pearse Doherty: Mr. McWilliams mentioned that this was obvious to anybody that was trained, which is important. I want to take Mr. McWilliams through 28 January 2008. His former employer, UBS, had issued a recommendation at that time. It issued a sell recommendation on AIB and Anglo Irish Bank as a result of mounting fears that they might suffer a rise in bad debts due to their exposure to falling commercial property markets. UBS estimated a 30% possible decrease with rents remaining the same.

Chairman: That needs to be supported.

Deputy Pearse Doherty: It is the factual note. Ian Keogh reported on 24 February that within two hours of this call being made, 34% of the value of the Irish banks was stripped away. Mr. McWilliams said that this was obvious to anyone who was trained. What information did UBS have to be able to make such a strong recommendation on AIB and Anglo Irish Bank that the Department of Finance, the Regulator, the Governor or politicians could not see?

Mr. David McWilliams: That is a very good question. A bank like UBS will have a bank analyst whose job is to look at banks all the time. The analyst would have been able to see the complexion of the loans given out by the Irish banks; how much was for tracker mortgages and how much was for commercial property, etc. The person at UBS was doing what I had been doing for years previously, namely, trying to value the commercial property for which these banks were lending enormous amounts of money. One values such an asset by estimating the stream of income that will come from it and multiplying it by a multiple. UBS probably saw that the stream of income coming from Irish commercial property was falling because much of it was empty, similar to the ghost estate situation. UBS was saying if the stream of income from the commercial property goes to zero, the loan goes bad immediately. The only way the loan can be made good is if one continues to lend money against it, which is what happened in Ireland. This is the type of analysis UBS would have come up with and it would have said a chunk of the balance sheet could go bust. UBS would have asked what the share price of the company was and realised it was very high. Given UBS was not being paid to take such a risk, it would sell it.

Deputy Pearse Doherty: Mr. McWilliams said it was obvious to the trained eye.

Mr. David McWilliams: It is totally obvious.

Deputy Pearse Doherty: Even at this stage, could any excuses be made for those in the institutions and the Department who were trained but who did not find it obvious and did not see it?

Mr. David McWilliams: It is very difficult to suggest. If a medic or immunologist misses a plague, what would people suggest about his or her competence?

Deputy Pearse Doherty: In an article of 25 May 2008, Mr. McWilliams wrote:

> The boom in Ireland was little more than a scam. Ireland was the victim of a financial *coup d'etat* whereby a cabal of the banks and developers, with the blessing of the Government and cheer-led by various vested interests who were getting their grubby cut, took over our economy.

Does Mr. McWilliams stand by this statement and, if so, how can he back up the statement that it was done with the support of the Government of the day?

Mr. David McWilliams: I will play a recording of comments I made during a debate in 2003:

(The joint committee heard an audio recording)

> The Irish housing market is a scam. It is an enormous financial swindle that could potentially confine an entire generation of young Irish workers to years of bad debt. Far from being a reflection of economic vitality and fundamental demand, the housing bubble is, in the main, a vacuous financial confidence trick that has been foisted upon us by an alliance of banks and landowners. Today in Ireland, the price of the average house is close to ten times

the average wage. This represents an economic failure on a monumental scale. Behind this nonsense is excessive and irresponsible lending from our financial institutions. The situation would be laughable-----

Deputy Pearse Doherty: My specific question was how Mr. McWilliams can say definitively that the Irish Government supported this financial *coup d'etat* by the bankers and developers. What is the evidence to back up the statement?

Mr. David McWilliams: Because there was no evidence of a push back from a way of managing our economy which was happy, at the top of the boom, for 88% of every loan, €88 of every €100 given out, to go to property. One cannot run a modern economy or a democracy like that.

Chairman: I return to the issue of the guarantee. In a newspaper article of 28 September 2008, entitled State guarantees can avert depression, Mr. McWilliams discussed the costs of various options that could be taken regarding nationalising banks and stated:

> There is another reason for not nationalising, and it is taxpayers' money. Once you start using taxpayers' money, you have to be careful. The lesson from the US in the past week is that using taxpayers' money is unsuccessful and deeply unfair. The beauty of guaranteeing deposits is that you use no money – not a penny.

With the benefit of hindsight, do you believe these comments underestimated the potential cost of the State guarantee?

Mr. David McWilliams: The comments were about the immediate cost. At the time, the options before the State were to incur many billions of euro of costs immediately with the notion of crystallising losses. The article explicitly said it would not cost a penny at that moment. The idea was to buy time by doing it temporarily. No banking crisis can be dealt with without cost. At the time, major discussions were taking place about budget deficits-----

Chairman: While I do not believe in pushing people to "Yes" or "No" answers, with the benefit of hindsight, do you think your comments underestimated the potential cost of the State guarantee?

Mr. David McWilliams: No, because they were about the immediate cost of a guarantee. The idea of a temporary holding guarantee was to prevent a bank run which would destroy people's savings. When one is in government, one can do these things, it is one's decision for one's country. The Government could have minimised the cost.

Chairman: In your opening statement, you said you had published 2.5 million words.

Mr. David McWilliams: I have published 1.2 million words, and I have read nearly all of them during the past three weeks.

Chairman: Excellent, because I have a question on them. Did you ever get it wrong?

Mr. David McWilliams: We all get lots of things wrong.

Chairman: What did you get wrong?

Mr. David McWilliams: Wow. This is a trick question.

Chairman: It is not.

Mr. David McWilliams: While we all get lots of things wrong, I do not think I got anything wrong during the period we are discussing. I am an economic commentator. I am an independent economist and have never been paid by the State for advice.

Chairman: I had many professions before I came here and I have got things wrong in those professions. It is not just politics.

Mr. David McWilliams: Of course one gets things wrong.

Chairman: Give us an example of something you got wrong in 1.2 million words.

Mr. David McWilliams: I get things wrong every day.

Chairman: Give us an example. In the 1.2 million words you have written about the economic crisis in this country, did you get anything wrong?

Mr. David McWilliams: It is an unfair question. One gets things wrong every day and one hopes to learn from them.

Chairman: In terms of getting things right for the future, what is your assessment of the Irish Government's level of preparation for the banking problems that emerged in September 2008? How well was the State prepared? Are Irish policy making authorities better prepared today, particularly regarding the regulation of the property and banking sectors?

Mr. David McWilliams: We were totally unprepared in 2008 because we had not listened to any of the warnings. I am not sure I see anything now that would prepare us again for such an eventuality. The most important thing is to be hyper vigilant on a sector which, if managed well, can serve the needs of the economy very well but, if managed badly, can lead to a financial catastrophe.

Chairman: Is there anything else you would like to add before we conclude?

Mr. David McWilliams: No.

Chairman: I thank Mr. McWilliams for his participation today. It has been a very informative and valuable meeting which has added to our understanding of the factors.

Sitting suspended at noon and resumed at 12.15 p.m.

Professor Terrence McDonough

Chairman: I welcome Professor Terrence McDonough and apologise for the late commencement of session B, which is to discuss issues relating to the international, EU and domestic policy contexts to the banking crisis in Ireland. Professor McDonough is professor of economics at NUI Galway and has a PhD in economics from the University of Massachusetts at Amherst. Before joining NUI Galway in 1995, he held posts at the Institute of Industry Studies at Cornell University, Canisius College, Buffalo, and Dublin City University. He has published numerous books and academic articles, was on the editorial board of the Review of Radical Political Economics and is currently on the editorial board of the International Journal of Pluralism and Economics Education. His current interests include globalisation, American and Irish economic history, political economy, the history of economic thought, and economics education for labour and community groups.

Before we begin, I advise Professor McDonough that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to the committee. However, if they are directed by the committee to cease giving evidence on a particular matter and they continue to so do, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and, as they were previously informed, the committee is asking witnesses to refrain from discussing named individuals in this phase of the inquiry.

Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside the House or an official either by name or in such a way as to make him or her identifiable.

I invite Professor McDonough to make his opening statement.

Professor Terrence McDonough: I thank the committee for inviting me to testify before it today. Along with the rest of the nation, I am looking forward to learning about many of the specific events and decisions leading up to the Irish banking crisis. In contrast, however, I will concentrate on addressing today's brief, which concerns the international, European and Irish policy context of the banking crisis. In doing so, I will be presenting a macroeconomic analysis of the overall crisis which still faces the world's peoples today, at least seven years after its inauguration.

It is important to understand that the situation affecting Ireland at the time of the banking guarantee cannot be characterised only as a financial crisis. Instead, Ireland at this time was caught up in a perfect storm, one whose great winds have periodically abated only to blow up again. It is popular in some quarters to refer to Ireland's crisis as homegrown, and it is certainly true that one storm front blew up within the borders of Ireland. However, 2008 saw the tragic convergence of this front with two other influences, one the global storm of the international crisis of global neoliberalism. This blew Ireland against the other influence, namely, the unforgiving shores of the euro system. We do not have to go all the way back to the proverbial butterfly flapping its wings to find the origins of this maelstrom. The global crisis, the European crisis and the Irish crisis all find their origins in the same basic institutions of the age. All are rooted in the four institutions of globalisation, neoliberalism, repression of labour and financialisation.

What are these institutions? Globalisation is the disintegration of production processes into their component parts and the location of each of these components in that area of the world most congenial to making profits. The production process is then reintegrated through free trade across borders. This process brings employers and workers face to face across the globe. Neoliberalism is a complex phenomenon. It can perhaps be most succinctly described as market fundamentalism, a belief that important social decisions about production and income distribution are almost always and everywhere best left to be determined in markets. This idea manifests itself in institutions like the World Trade Organisation, policies like deregulation and privatisation and ideologies like free market economics. The repression of labour involves the erosion of the power of labour to defend its organisations, working conditions and standard of living. It is most dramatically evidenced in the decline in union density. Financialisation, according to the American economist Jerry Epstein, "refers to the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions, both at the national and international level".

All these institutions date from the early 1980s. Their beginnings are marked by the political victories of Ronald Reagan in the United States and Margaret Thatcher in the United Kingdom. These new institutions can be collectively labelled the era of global neoliberalism. This new stage of capitalism at first led to recovery. In the 1970s, capitalism was in a period which has come to be known as the Great Stagflation, a condition of simultaneous high unemployment and high inflation which was unpredicted by the Keynesian economics of the time. Together, globalisation, financialisation, neoliberalism and the loss of labour influence led to a period known in some quarters as the Great Moderation. Profit rates, which had been falling from the late 1960s, bottomed out in the early 1980s and over time returned to their previous levels. Growth recovered, although it did not reach the standards of the earlier post-Second World War period. Employment rose and inflation fell and remained low.

However, this economic recovery is only one side of the story. The same set of institutions which led to the global neoliberal recovery from stagflation would eventually create the most serious economic crisis since the Great Depression. Problems became evident almost immediately. Globalisation led to the unification of previously separate national markets for goods and services. Competition within this new larger market led to the emergence of excess capacity in many industries. Labour's loss of bargaining power led to the stagnation of real median family income in the United States. This wage stagnation occurred despite the continual increase in the productive capacity of labour. These two factors, excess capacity and stagnant wages, led to a rate of investment which, while positive, was relatively sluggish by historical standards. This relatively sluggish investment was accompanied by restored profitability. If the restored profits were not being invested in productive plant and equipment, where could they go? Financialisation made it increasingly easy to fund the purchase of various categories of assets, driving up their prices and creating capital gains, which could only encourage further speculation in asset prices. Borrowing on the basis of rising asset prices temporarily sustained demand in the face of sluggish investment and stagnant wages. When the asset bubble burst, however, the full force of listless investment and low wages was felt in the emergence of what was, in Keynesian terms, a crisis of inadequate demand. For the ordinary household, it was a crisis of unemployment.

That is the global context and, naturally, we are much more concerned with the specific situation of Ireland. A close look at the origins of the Celtic tiger, however, reveals that it was a creature of these same four institutions of global neoliberalism, namely, globalisation, neoliberalism, the repression of labour and financialisation. As is often the case in Ireland, we had to wait a few years for the advent of global neoliberalism - Irish style. For Ireland, the key date is 1987. A neoliberal approach to government in Ireland began when a minority Fianna Fáil Government came to power in 1987. Minority status led to seeking a consensus economic strategy which could attract the support of other parties. It was supported by Fine Gael's adoption of the Tallaght strategy under the leadership of Alan Dukes. Two years later the neoliberal Progressive Democrats entered coalition with Fianna Fáil. O'Riain and O'Connell summarise the turnaround in public spending:

> Restoring order to the public finances was achieved by severe cutbacks in public expenditure in 1987-1990. Total current spending fell by over ten percentage points in real terms between 1987 and 1989. Total current spending fell from 57% of gross national product in 1985 to 42% in 1990.

The fall in expenditure created room for tax cuts. The top rate of income tax fell from 60% to 48% over five years. Basic corporate income tax rates also fell.

In addition to embarking on a new macroeconomic strategy, the new Fianna Fáil Government also convened the first of a series of tripartite industrial negotiations leading to a national partnership agreement, the Programme for National Recovery, PNR. For the unions' part, they could sense a rightward shift in the political system and feared the Government might be capable of importing the Thatcherite strategy of a massive attack on the unions aimed at negating their economic, social and political influence. The PNR established a neoliberal pattern of achieving wage moderation through the promise of future tax cuts. Frank Barry calculates these tax cuts accounted for about one third of the increases in take-home pay to 2004. Such moderation under social partnership led to a falling wage share. The wage share was 71 % of gross domestic product in 1986 and fell to 54% in 2001. Days lost through industrial disputes dropped off drastically beginning in 1987. Accordingly, the repression of labour in Ireland led not to wage stagnation, as in the United States, but to wage moderation under social partnership.

The social partnership process was careful not to jeopardise Ireland's traditional internationalisation strategy. Teague and Donaghey conclude that social partnership operated "hand-in-glove with the wider policy of economic openness". The Single European Act came into effect in 1987 and was approved by referendum in the same year. The implementation of the Single Market coincides with a boom in foreign employment in Ireland, with such jobs growing by 50% between 1987 and 2000. The Single European Act was accompanied by plans to expand Structural Funds spending. Structural Funds were doubled in 1988 and again in 1993. A new Industrial Development Agency, IDA, strategic plan was unveiled in 1983. The new strategy would concentrate on technologically advanced firms with high potential for market growth. These developments copperfastened globalisation as an essential element of Ireland's growth strategy.

The year 1987 also saw the investment hunting capacity of the IDA applied in a new realm. It was decided by the incoming Government to target investment in international financial services through the establishment of the International Financial Services Centre, IFSC. By 1999, attracted by light touch regulation, 66% of all FDI, foreign direct investment, inflows were accounted for by the IFSC. It was the source of 24% of all services exports. The IFSC would be an important conduit for foreign capital flows and was central to Ireland's participation in transnational financialisation.

Irish participation in the global neoliberal social order was no longer in doubt and this institutional framework underpinned the advent of the famous Celtic tiger. Of course, the tiger is also now infamous because, as was the case at the global level, the elements of global neoliberalism would not only set the conditions for Ireland's rise but also its spectacular fall from grace. Under Ireland's peculiar labour institutions, wages rose but the level of inequality rose much faster. The fear of Thatcherism had fed into the formation of social partnership. As noted before, wage moderation was traded for tax cuts. This tendency was strongly reinforced by the perceived need to compete globally through low taxes and a neoliberal policy preference for minimising the capacity of the State.

The economic momentum of the Celtic tiger eventually fed into blowing up the real estate market. Financialisation provided the wind beneath the wings of the Irish asset bubble. Rising levels of inequality created an aspiration for levels of consumption which for many could not be supported from current income. Rising house prices provided an expensive asset of expanding value for those in the housing market and collateral for borrowing by those who already owned their own homes. Household debt rose from less than 120% of disposable income in 2003 to 220% in 2009. The bubble in the property market provided an alternative source of government income through stamp duty and construction-related VAT, compensating to some extent for the overall low tax regime.

Ireland was now poised for crisis. We had a property bubble which could be traced back to financialisation. We had high levels of household debt which could be traced to the property bubble and rising inequality. We had a low tax regime which could be traced back to the repression of labour, globalisation and neoliberalism. The property bubble burst in 2007, endangering the banking system. The global crisis hit in 2008, intensifying Irish problems. The collapse of banking, construction and the tax regime produced a fiscal crisis. The financial crisis, the fiscal crisis and unsustainable household debt then created an unemployment crisis. It was at this point that the global storm front and the Irish turbulence combined ran up against the sea cliffs of the inflexible euro system. This euro system was also rooted in global neoliberalism, a global neoliberalism - euro style. The drive for globalisation led to the Single European Market. Globalisation linked with financialisation to create the euro currency. The Single European Market and the euro led to trade surpluses in some countries that were recycled into blowing up asset bubbles and trade deficits in other countries which weakened their fiscal positions. Financialisation, linked with a strong dose of neoliberal ideology, led to a fiercely independent European Central Bank aggressively limiting its responsibility to inflation control. Neoliberal ideas of small government and limited intervention in private markets, with the declining influence of labour, led to a monetary union without any fiscal capacity to address problems through increased government spending at European level. Together the Single European Market, the euro, the European Central Bank and limited fiscal capacity can be said to constitute the euro system.

When the turbulence hit, the euro system made sure Ireland could find no haven through devaluing its currency, conducting an independent monetary policy or receive help through fiscal stimulus. The euro rules have forced Ireland to cut spending and raise taxes in the teeth of a depression. Instead of a port in the storm, the backwash from the euro cliff intensified the maelstrom. On 29 September 2008, in the dead of night, Ireland desperately tried to signal for help, but the cannon broke loose and holed the ship of State below the waterline.

How could this catastrophe have been avoided? The only path was to have seen the storm coming and been prepared for it. This is not a question, as some have recommended, of hiring more economists in the Department of Finance. In fact, professional politicians and professional economists in the lead up to these events all saw the world in much the same way. To avoid the storm, both would have had to see the world differently. I have lived for 20 years in Galway. It is said of the weather in Galway that it is either raining or about to rain. Similarly, in the mainstream economic view, the economy is either calm or rapidly becoming calmer. This theory may barely pass muster in good times, but to prepare for a storm you have to see the economy as potentially tempestuous and riven with conflict and contradictions. A view of the capitalist economy which ignores its historical dynamics, which sees it as a haven of harmonious give and take, a peaceful equilibrium of supply and demand, which works best when interfered with least, will inevitably lead to foundering on hidden shoals amidst unexpected turbulence. This is where Ireland still finds itself today.

Chairman: Thank you Professor McDonough. In your opening statement you make strong reference to a neoliberal policy programme that has been in place since 1987 up to the present. Can you define what you mean by neoliberalism?

Professor Terrence McDonough: It would probably be helpful to talk more specifically about what would constitute neoliberal policies which persisted pretty much from the 1987 breaking point up to the current day. The first point is the relatively low level that public expenditure takes up in relation to Irish GDP. This is somewhere around 30%, whereas the EU average would be around 40%. This has been consistent throughout this entire period. It is similar to the situation of the tax take, which came down subsequent to 1987 and has not come back much.

The question of openness and free trade and the strategy of internationalisation and running export surpluses would be very consistent across all the governments, in this case since 1957, certainly from 1987 to the present. We have also engaged in very light touch regulation which has persisted since 1987 and the foundation of the Irish Financial Services Centre, IFSC. While these policies might not have been defended enthusiastically by any given Administration they have remained constant.

Chairman: I am sure you will be familiar with the budgetary process, that education, social welfare and health costs as a proportion of the budget make up the lion's share of the overall sum. Would you see that level of expenditure in the annual budget as consistent with the theory you are proposing?

Professor Terrence McDonough: Yes I would in the sense that neoliberalism is always relative. It is relative to the levels of expenditure which would have been achieved under other policy regimes. While those levels of expenditure are substantial and not negligible they would be smaller than those of our European partners. They compare favourably with those in the United States and Britain but those countries would be examples of heavily neoliberal influenced regimes.

Senator Michael D'Arcy: I welcome Professor McDonough and thank him for coming here. He states:

> The global crisis, the European crisis, and the Irish crisis all find their origins in the same basic institutions of the age. All are rooted in the four institutions of globalisation, neoliberalism, repression of labour, and yes, financialisation.

Which of these does he believe was the most important in causing the Irish banking crisis?

Professor Terrence McDonough: The Irish banking crisis can be most easily traced to a combination of financialisation on the one hand and neo-liberalism on the other. The linking of Ireland to the global financial markets was extraordinarily strong. There was quite a bit of money available which consequently was brought into the country and transferred to domestic activity. The low level of regulation and the high level of openness to financial movements would probably be where I would lay the most emphasis. This is also closely related to the whole goal of globalisation and the establishment of the IFSC was part of our globalisation strategy.

Senator Michael D'Arcy: Professor McDonough also states, "A neoliberal approach to government in Ireland began when a minority Fianna Fáil government came to power in 1987". Could he name non neoliberal Governments prior to 1987?

Professor Terrence McDonough: Yes, I certainly think the Administrations immediately previous to that one would not be considered neoliberal in that they had very high levels of expenditure and were associated with high levels of tax. The tax levels were not high enough to cover the expenditure. Previous to 1987 the Irish regime was a more typically Keynesian one rather than a neoliberal one. That would be true across the board in North America and Europe as well.

Senator Michael D'Arcy: What about the Fine Gael-Labour coalition Government prior to 1987?

Professor Terrence McDonough: It would not be considered neoliberal.

Senator Michael D'Arcy: What about the Fianna Fáil Government under Charlie Haughey immediately prior to that?

Professor Terrence McDonough: Charlie Haughey has prominence in having led the most non neoliberal and then the most neoliberal governments.

Chairman: Professor McDonough should speak of the Administrations rather than the individuals.

Professor Terrence McDonough: I am sorry, I did not mean to single anyone out.

Senator Michael D'Arcy: Would Professor MdDonough describe most of the Governments since 1987 as neoliberal?

Professor Terrence McDonough: Yes, to differing degrees but neoliberalism is a set of policies and preconceptions, tendencies etc., all of which can be said to have played a role to a greater or lesser degree in each of the Administrations since 1987. This would also be true in Great Britain on one side of our country and the United States on the other. There were transitions between Democratic and Republican Administrations in the United States but the basic orientation of each Administration, when considered at this abstract level, was the same.

Senator Michael D'Arcy: Is that irrespective of which party was in government?

Professor Terrence McDonough: Irrespective of which party. The Blair regime in the UK could also be characterised as a neoliberal regime.

Senator Michael D'Arcy: How did neoliberalism and globalisation affect the Irish bank guarantee?

Professor Terrence McDonough: The neo-liberal approach sees the economy as fundamentally sound, with basically free markets. If you see the economy as fundamentally sound and you have basically free markets you have a theory called the efficient markets hypothesis. It argues that markets consistently use the maximum amount of the best information to come to valuations which reflect the best information at the time. This could therefore always be trusted to form the basis of further action. Governments could not really compete with markets in gathering this information and felt themselves to be at a disadvantage. Governments felt the best thing to do was reinforce wherever the markets were going.

When the banks came to the Government and explained they did not have a solvency crisis but simply a temporary liquidity crisis which could be addressed through a guarantee to get over the hump, I believe the Government can be partially forgiven for believing this. Not because it was correct, clearly it was not, but that was the conventional wisdom of the time. The conventional wisdom of the time led us to the depressed situation still facing us today. The conventional wisdom of the time needs not to be reinstated but broken with.

Senator Michael D'Arcy: In his opening address, Professor McDonough states, "Ireland at this time was caught up in a perfect storm, one whose great winds have periodically abated only to blow up again". What period is he talking about, this era of the perfect storm?

Professor Terrence McDonough: I believe that storm begins in 2007 but is not quite evident until 2008. I believe we are still in it now. So, from 2008 until the present.

Senator Michael D'Arcy: Can I ask the witness what, in his opinion, are the ingredients of the perfect financial storm?

Professor Terrence McDonough: I believe the ingredients of the perfect storm are not simply limited to financial questions. This is one of the larger points I want to make in the context of this hearing today. While there is much emphasis placed on the financial troubles that faced Ireland, Europe and the larger global capitalist system, this should not blind us to the fact that there were other deeply rooted institutional factors. These factors contributed to the inauguration of the crisis in 2008, but also seriously contributed to the failure to address that crisis in subsequent years. These factors particularly relate to stagnant wages; the falling power of labour to defend its working conditions; low levels of investment closely related to high levels of excess capacity associated with globalisation on international markets; the inability of governments at local Irish level, at larger European level and at the global level to find a way to intervene to compensate for the financial chaos we faced; very low levels of private investment and the increasing inability of the ordinary person to prop up consumption in the economy because of falling wages and falling standards of living.

The crisis is broad but at the same time much deeper. It goes to the basic institutions of the era in which my students have grown up, which began in 1987 in the international context and in subsequent years in the Irish context.

Senator Michael D'Arcy: The era of stagnant wages was mentioned as from 2007 until now, is this correct?

Professor Terrence McDonough: I should make the distinction that I am talking about stagnant wages in the global context. The Irish context did not experience wage stagnation to the same degree, in fact Irish wages and income probably doubled in the period between 1987 and 2005.

Senator Michael D'Arcy: Regarding the low interest rates from the crisis era, would they have contributed?

Professor Terrence McDonough: Certainly the low interest rates did contribute to the problem. These are probably often dropped out of explicit consideration because interest rates in the European single currency market are determined by European policy. The interest rates were probably much more suited to Germany which was trying to come to terms with the reunification with East Germany and the economic problems created by that. The rates were certainly inappropriate to an Irish economy facing in to a serious housing bubble.

Senator Michael D'Arcy: Professor McDonough states that we had a low-tax regime traceable to the repression of labour globalisation and neoliberalism. The property bubble burst in 2007. Did we have a low tax regime or did we have a too narrow tax base?

Professor Terrence McDonough: That is a good question. I believe both are true. On the one hand we had a set of social partnership agreements which were trading wage moderation for cuts in income tax. I believe that resulted, along with our internationalisation strategy, in tax rates which were lower than they should have been. They were certainly lower than comparable continental countries. The Government was also making up for these low income tax rates by taxing the property bubble in various ways. Taxing a property bubble is a way of narrowing the tax base because a property bubble cannot continue forever.

Senator Michael D'Arcy: Can I ask the professor his view on taxation. He says that the tax base was reduced from 60% to 48% and subsequently the marginal rate is now 40%. Does he think we should go back to the 60% rate? I would also like his opinion about the establishment of the International Financial Services Centre which many consider a success story. I refer to the film "The Commitments" which was my memory of the docks in the early 1990s.

Professor Terrence McDonough: The artistic reference is interesting. In *The Irish Times* this morning, Yanis Varoufakis, the Greek finance Minister, makes reference to Beckett's play, "Happy Days". If the question is posed on whether we wanted a derelict dockland or an Irish financial services centre one can certainly see the argument for establishing the IFSC. The point I keep coming back to is that all of these things have their impact and work their impact out in a dynamic way over the course of time and that things which are initially positive in their impact can ultimately contribute to very serious negative outcomes as that dynamic works itself out.

The establishment of economic activity in the Dublin docklands was a very good thing. The total lack of regulation of that economic activity, especially in light of its financial character, turned out to be not such a good thing and the impact of that on the remaining portion of that neighbourhood in the docklands now is substantially negative.

As regards the tax question, I think that we can do with higher tax rates on upper income levels; we can do with taxing wealth in addition to income; we can do with a policy which raises the incomes of people at the lower end of the economic scale and which then provides an opportunity to increase taxation there as well.

I am not a supporter of this process whereby more and more people are taken completely out of the tax net and are then no longer seen as contributing to the collective services which the society should be providing, primarily for people at the lower end of the scale. I think we need to collect more taxes in general.

Deputy Michael McGrath: Professor McDonough is very welcome. Are we pronouncing your name right?

Professor Terrence McDonough: Yes.

Deputy Michael McGrath: Very good. I thank him for his attendance and participation. I will start by maybe developing a better understanding of his economic outlook and philosophy, which is shaping his opinions, and will put a few questions to him in that context. He referred to the Single European Market. Is he in favour of the Single European Market and of the European Union project, for example? Could he give us his view on that?

Professor Terrence McDonough: That is an excellent question and a difficult one. In general, I would have been quite sympathetic to a process of political unification across Europe but I would have always been supportive of basing that process of political unification, at the very minimum, on traditional European social democratic values. I think that in the current period, especially in terms of the negotiations which have taken place between the Greek Government and the European Union institutions over the past two weeks, a line has been drawn under the traditional social Europe model. What has developed in the era of monetary union is very difficult to defend not only philosophically, but also economically.

Basically taking exchange rate policy out of the hands of local governments has proven to be extraordinarily damaging. The separation of local governments from the ability to conduct their own monitoring policy has been extraordinarily damaging. Setting governments in competition with one another within the EU around the questions of tax policy and expenditure, without creating a more federal capacity to spend and address problems when they arise, has been extraordinarily problematic. I think a militantly independent central bank, insulated from democratic control, is not defensible.

Beyond that, the European Union has unfortunately participated in a general tendency to separate economic decision-making from democratic and representative bodies and rest that decision-making in what were initially faceless bureaucracies but they have now, more or less, acquired a bit of a face. We can now talk about these personalities. People know who Wolfgang Schäuble and Mario Draghi are but that is problematic in itself. These people should not be as important as they are and I think that calls, as Michael Noonan would have said, the practice of the European-----

Deputy Michael McGrath: To move on, Professor McDonough has spoken somewhat positively about the notion of political integration and political unity but what I am hearing from him on all of the other economic pillars and on the monetary union is negative. Is he in favour of free trade within the European Union and the free movement of people and, for example, of capital pillars of the European projects?

Professor Terrence McDonough: What has happened in terms of the free movement of capital relative, to some extent, to the free movement of labour, is that one of the sources of the problems which I identified, which is wage stagnation in much of the world and increasing inequality in this corner of the world, particularly, has been the radical change in the bargaining power of capital relative to labour and the free movement of capital is the conditioning of that-----

Deputy Michael McGrath: They are not very clear answers. I am getting an analysis but not any answers.

Professor Terrence McDonough: I am not an enthusiast of the free movement of capital but on the other hand I am not an enthusiast in trying to prevent the free movement of labour.

Deputy Michael McGrath: It is kind of on the one hand and on the other hand. Is Professor McDonough in favour of the euro?

Professor Terrence McDonough: I have to say that at the moment, I am not. There are two different questions. Was the euro a good idea? Absolutely not. Is it extraordinarily difficult to think about how one might approach that and move to the other side of the problems which that has created, that is, should we leave the euro? We need to be thinking about that. I would not say we should leave the euro as definitively as I would say that entering the euro was a mistake.

Deputy Michael McGrath: Is there an economy somewhere on the globe that the professor would hold out as the role model?

Professor Terrence McDonough: No. I think what Ireland needs to do is find a way to build the society it wants to be and then find a way to put that society before the world and invite participation from other countries, corporations and things like that.

Deputy Michael McGrath: Is Professor McDonough prepared to name a country that comes closest to his ideology in terms of an economic model?

Professor Terrence McDonough: No.

Deputy Michael McGrath: Is there any?

Professor Terrence McDonough: No.

Deputy Michael McGrath: On the issue of the nexus of the four institutions to which the professor referred - Senator D'Arcy took him through a number of those - could better regulation domestically by the Irish Central Bank and the Irish Financial Regulator have been an effective counterweight to the nexus of those four institutions? Could proper and effective regulation in his view have offset what he might regard as the negatives from these four institutions?

Professor Terrence McDonough: I think proper and effective regulation would have gone some way to preventing the problems we were in. The 40 pieces of legislation which were passed over the period of time from 1987 to the early 2000s, basically the liberalising of the financial markets and making it easier to engage in these kinds of activities, were quite clearly a mistake.

Deputy Michael McGrath: Professor McDonough identified a point in our economic history and political history, 1987, as somewhat of a turning point, in his view, when these types of policies began to be pursued. Is he, therefore, of the opinion that what went immediately prior to that was better and more sustainable from an economic point of view?

Professor Terrence McDonough: Clearly not. Ireland was very much in crisis in 1980, in 1985 and in the late 1970s. I would not put the Irish crisis in the 1980s as the model for dealing with the Irish crisis in the 2000s.

Deputy Michael McGrath: As for one to be holding out 1987 as a negative turning point, many commentators would argue it was a positive turning point in dealing with the crisis we had, would Professor McDonough give us his view?

Professor Terrence McDonough: It is certainly true that we did deal with the crisis we had. As primarily an economic historian, my work has been involved with observing that the resolution to one crisis is often, as history unfolds, the basis for the outbreak of the next. That is very much what happened in Ireland. We resolved the 1980s crisis in a certain way and the way in which we resolved it formed the basis for continuing social change and continuing social struggle. The upshot of those very institutions which resolved the crisis was ultimately, many years later, to set the stage for the crisis we face today. That is one of the contradictions of history.

Deputy Michael McGrath: One of the four institutions, the primary drivers of the economic model, Professor McDonough cites is what he terms "the repression of labour", which, he states, "involves the erosion of the power of labour to defend its organizations, its working conditions and its standard of living". I am curious as to how he can reconcile that with his criticism of the social partnership agreements, which, many would argue, gave the labour movement far greater power and greater influence in the running of the country. Can Professor McDonough reconcile those two points?

Professor Terrence McDonough: We could probably deal with this fundamentally by looking at the outcome in terms of labour's share in national income. I suppose what we could do is contrast it, on the one hand, with the fact that Irish wages did not stagnate in the same way that they did in the United States. On the other hand, if one looks at labour's share of national income, labour's share of national income around 1980 was about 71%, that is, of everything produced in Ireland, 71% of it went to the working class or those represented by the labour movement. By 2002, that figure was down to around 45%. While labour succeeded in preventing an outright stagnation of wages, labour's relative weight in the economy, especially in terms of its income, declined quite drastically. If one looks at labour density, that is, what percentage of the workforce is represented by unions, that dropped rather precipitously. It has been halved, essentially, over the course of social partnership.

Deputy Michael McGrath: In page 9 of his opening remarks, Professor McDonough states:

> Instead of a port in the storm, the backwash from the Eurocliff intensified the maelstrom. On the 29th of September, 2008, in the dead of night, Ireland desperately tried to signal for help, but the canon broke loose and holed the ship of state below the waterline.

Can he elaborate on what he means by "Ireland desperately tried to signal for help"?

Professor Terrence McDonough: To some extent there I am getting caught up in my metaphors. The metaphor is appropriate in that the bank guarantee was intended to be a signal to the private financial markets that they could safely continue to invest in, lend to and capitalise the Irish banking system. In that sense, basically, it was a call for private financial help.

Deputy Michael McGrath: Was Professor McDonough referring to any efforts on the part of the Government or the authorities to reach out internationally in those critical 24 hours or whatever?

Professor Terrence McDonough: No. That was reaching out to the private markets. In fact, I am sure Deputy Michael McGrath will be aware our European partners were initially rather unhappy with it.

Deputy Michael McGrath: Okay. I will leave it at that.

Chairman: Senator Sean Barrett has six minutes.

Senator Sean D. Barrett: I welcome Professor McDonough. This is the third member of the Galway troika. Professor John McHale comes in quite a lot and Professor Alan Ahearne does as well.

Professor McDonough, on page 8, states, "This is not a question, as some have recommended, of hiring more economists in the Department of Finance". What did he mean by that?

Professor Terrence McDonough: I was particularly struck by that recommendation and the promulgation of the statistic that among the employees of the Department of Finance, only 17% have economics degrees. If one were to go back to some earlier testimony, that of Professor John FitzGerald from the ESRI and Dr. Donal Donovan from the IMF, one would discover that it was not the lack of economists in the IMF which caused the failure to call the crisis in a sense in that there is no shortage of economists in the ESRI-----

Senator Sean D. Barrett: It was not the IMF, but the Department of Finance, about which Professor McDonough wrote.

Professor Terrence McDonough: My point is simply there is no shortage of economists in the IMF and those economists were describing the Irish situation as "rosy". If the Department of Finance were to hire the same economists that the IMF did, they would have been telling the same story.

Senator Sean D. Barrett: The IMF only paid flying visits. I refer to the staff who were there all the time in the Department of Finance. The evidence we heard from Mr. Wright was that they represented 7% of the total staff complement in the core of Finance, compared to 60% in Canada and 40% in the Netherlands. Why would Professor McDonough keep it at 7%?

Professor Terrence McDonough: I certainly would not want to be accused of damaging the employment prospects of members of my profession at the Department of Finance or, for that matter, my graduate students. My contention is simply that the economics profession, as it is currently constituted, works with models of the economy which are closed, that is, they assume a closed system. It is a bit like pouring water into a bowl. What happens to the water in the bowl? It reaches its own level and is, thereafter, calm. If one disturbs it, it returns to its previous level. It is not a very good basis for talking about the real world, which is an open system in which water is subject to tides, wind, waves and, occasionally, the mother of all storms. If that is one's model, one will not predict a storm.

Senator Sean D. Barrett: If one retains the number of qualified economists at only 7%, would that not lead to the professor's other problem of light-touch regulation? If one is to regulate a sector, one had better have qualified staff there to do it.

Professor Terrence McDonough: I will take that comment on board, yes. If we were to increase regulation, one would have to increase the expertise of Departments such as the Department of Finance.

Senator Sean D. Barrett: We had the large capital inflow that Professor McDonough criticised earlier. It happened. One was outvoted, if one had wanted not to join the euro. What would Professor McDonough have done, if he were the Governor of the Central Bank and he saw this significant capital inflow coming into Ireland in 2003? How would he have responded?

Professor Terrence McDonough: That is an interesting question. I would certainly have prevented it from all flowing into the housing market and at the cost of having it flow elsewhere. Certainly, high levels of capital inflow that would have been invested in increasing productive capacity in the Irish economy would have been more than welcome. High levels of capital inflow, that perhaps flowed back out again and could be to some extent taxed along the way, would have been, maybe, not to the benefit of our trading partners but could have been to the benefit of the Irish Exchequer. High levels of capital inflow which then flowed into simply increasing the price of assets, most prominently, commercial and residential property, were not constructive. I think we confused rising asset prices with rising health in the economy.

Senator Sean D. Barrett: How should banks be regulated in that context?

Professor Terrence McDonough: My feeling is that bank regulation cannot be too intrusive. I think the lesson of the banking crisis is that the private banking system cannot be trusted with all that money. My view would be that the financial system, the banking system, should be primarily publicly owned. I was asked earlier whether I would point to a model which I would endorse; I would not point to a whole model but I think that the South Korean public ownership of its financial system is really rather well run.

Senator Sean D. Barrett: In the Irish system what proportion of bank funding does Professor McDonough believe should be in equity?

Professor Terrence McDonough: I think if we had a public banking system that would not arise. I would hesitate to give the Senator a specific figure but given our current banking system unreconstructed, I would double it.

Deputy Eoghan Murphy: Is it Professor McDonough's view that social partnership contributed to or played a role in Ireland's financial crisis?

Professor Terrence McDonough: Yes, specifically the deals that were struck around the question of wage moderation. Again I would emphasise that Irish wages did not stagnate like they did in the United States and to a certain extent in Britain. The wage moderation in exchange for eroding the tax base was a poor decision and it was a poor decision which I believe was reached collectively. There were tripartite negotiations between the representatives of the employers associations, the main union federations, and the Government. I think the Government, the employers, and the unions all participated in that decision and I think we have come to regret it.

Deputy Eoghan Murphy: I got the impression from Professor McDonough's opening statement that he felt that the unions had a choice in engaging in social partnership.

Professor Terrence McDonough: That is something that I think the historians of Irish labour will debate. I think the unions did make a choice and that choice was made in light of what was going on across the water and in light of a fear of Thatcherism.

Deputy Eoghan Murphy: Is Professor McDonough's opinion based on some of the historical work that he has already done?

Professor Terrence McDonough: It is based on some of the historical literature and also some of the personal contact I have had with the labour movement over the years.

Deputy Eoghan Murphy: Could Professor McDonough expand upon the point he made on the lack of democracy in the ECB and central banks generally?

Professor Terrence McDonough: Certainly. This is very much a trend internationally. We have been moving further and further away from democratic influence on economic decisions. The model, in a certain sense, is the independence of the American Federal Reserve. The American Federal Reserve has a double mandate. Its mandate is, on the one hand, to control inflation, but also to address the problems of unemployment when they arise. Our central bank, which is the ECB, is not mandated to address the problem of low levels of economic activity throwing people out of work. It is explicitly left out of its charter. It is solely responsible for maintaining stable prices. In that sense I think we have an ultra-monetarist central bank, much more monetarist than one would find in the United States.

Deputy Eoghan Murphy: Does Professor McDonough regard that as a design flaw?

Professor Terrence McDonough: It is very definitely a design flaw.

Deputy Eoghan Murphy: Does Professor McDonough believe that increased democracy can be brought into a central bank without bringing in political interference?

Professor Terrence McDonough: I would not want to define democracy as political interference. I think that if we were to democratise economic decision-making at that level, that is at the high level of central banking, we would need to reform our democratic institutions all the way down to make sure that what we were seeing was the expression of popular will rather than the interference by politicians or vested interests. That said, I think that the performance of the Central Bank in the absence of political supervision has been extraordinarily poor. There has just been quantitative easing in Ireland seven years after it was first engaged in rather successfully by the Federal Reserve Bank in the United States.

Deputy Eoghan Murphy: Thank you.

Deputy Joe Higgins: Professor McDonough relates the origins of the property bubble and the crash to the four institutions that he outlined - globalisation; neoliberalism; repression of labour, which he explains is a reduction in the bargaining power of workers; and financialisation. He gives his definitions of those. He also refers to falling profitability from the 1960s onwards as a feature of international capitalism at that time. Were these institutions, globalisation, neoliberalism, financialisation and reduction of labour power, instruments that were coincidental at this time or were they designed to restore the profitability of capital internationally?

Professor Terrence McDonough: Where did these institutions come from? In general, these kinds of institutional transformation come from the conflicts and initiatives which break out in the context of the previous crisis. In this case we are talking about the stagflationary crisis which we had here in Ireland in spades but which was also evident across the globe. I think that in a certain sense, and this is not always the case historically, what has to happen for this kind of crisis to be temporarily resolved is either some kind of class compromise, which is how one might characterise the New Deal system after the Second World War in the United States, or there has to be a victory by one side or the other. I think the era of global neoliberalism could be characterised as a victory for capital, as a victory for business, and as a restoration of the profit level on the back of the repression of the other major candidate for income in society.

Deputy Joe Higgins: Professor McDonough provided figures which show that the percentage of GDP that was going to workers fell substantially; is this related?

Professor Terrence McDonough: Yes, I believe that that drop in Ireland was the sharpest drop of anywhere; if profitability is raised, the share of labour in GDP will be lowered.

Deputy Joe Higgins: Professor McDonough cited the American economist, Gerald Epstein, who has examined the increasing importance of financial markets, financial motives, financial institutions and financial elites in the operation of the economy and its governing institutions at national and international levels. Why were there such significant levels of financialisation and such massive funds sloshing around the financial markets rather than those funds going into productive investment, infrastructure and job creation in a context of mass unemployment in many parts of the world?

Professor Terrence McDonough: That is relevant to one of the things I have been emphasising, namely, our current problems are related to what has happened in the financial sector and the financial crash. The other factors have to be taken into account precisely to explain why all of this money has flowed into finance, as opposed to its traditional destination as investments in productive capacity. That is substantially due to the other problems that have been manifest in the global neoliberal era, including the stagnation of demand due to repression of wages. If people cannot buy what is produced, there will not be investment in production. If businesses are not interested in buying investment goods because of excess capacity in global markets, people are not going to produce these goods and what are they going to do instead? They are going to funnel their money into financial instruments and to the extent that the money funnels into financial instruments, the prices rise and it looks like a good deal. Of course, it is not sustainable.

Deputy Joe Higgins: The financial markets as Professor McDonough describes them involve international financial institutions, huge banks and hedge funds. Do financial markets operate as a socially progressive factor, a factor that enhances democracy, a kind of economic dictatorship or one, more or none of the above? He described market fundamentalism as a belief that important social decisions about production and income distribution are almost always and everywhere left to be determined in the markets. Was the bailout of banks and bondholders as seen in Ireland consistent with neoliberalism and, if not, why not?

Chairman: We have to give Professor McDonough time to respond.

Professor Terrence McDonough: Once the economic crisis hit, the question arose of who was going to pay the piper. The decision was made that bondholders were not going to pay and that governments would pay. Ultimately, the taxpayers paid and, as the Deputy pointed out, the majority of taxpayers are ordinary working men and women. The decision on who was going to pay came down on one side of the question or the other.

In regard to the dominance of financial markets, it is true that if one has a capitalist economy one has to start with money. Capitalist profit making starts and ends with money. One starts with a certain amount of money and ends up with more money. The real question is where that additional money comes from. Financial institutions provide the starting money. The problem arises when the financial sector of the economy becomes so large that it interferes with the provision of resources for the real economy. I would not characterise it as a dictatorship of the financial sector. If we were to go back to the last financially dominated post-Second World War social order, we would find that different elite interests exercised influence in the political arena.

Deputy John Paul Phelan: I refer to Deputy Michael McGrath's questions about Professor McDonough's economic thesis. Professor McDonough identified South Korea as an example of a banking sector that worked. There must have been a successful society or country at some stage in history on which he is basing his arguments. Most financial theories are based on an example that worked. I am not asking him to identify one specific society but where is the basis?

Professor Terrence McDonough: If we consider the entirety of my academic work on the current period and the basis for it - I have also done work on the 19th century in Ireland which is less relevant - my concern has been to understand the historic dynamics specifically of capitalist systems. In my work I have identified what I think is a useful characterisation of the long-term dynamics, which is that we have periods of relative calm and relatively successful capitalist growth, during which recessions are shallow and the expansions are long, but we also have periods of capitalist crisis. We can find the periodic arrival of these crises in the revolutions of 1848, the long depression of the late 19th century, the great depression of the 1930s, the great stagflation of the 1970s and, now, the great recession of the early 21st century.

Deputy John Paul Phelan: Does Professor McDonough have examples-----

Professor Terrence McDonough: I am not really that interested in identifying which of those periods in any particular country would be a model for the others. In fact, the conclusion is that when one is faced with a crisis, one must do something different. Do not look for past models.

Deputy John Paul Phelan: That is a fair point. To be clear, I was asking Professor Mc-

Donough whether he could provide examples of where the alternative to the criticisms he made in his presentation actually worked. He has not pointed to any alternative, bar the banking sector in South Korea.

Professor Terrence McDonough: We cannot solve a global neoliberal crisis with more global neoliberalism. Similarly, I do not think we can solve it by looking to the past. We need a creative approach.

Deputy John Paul Phelan: I will ask a completely different question regarding the Irish crisis and financial collapse. Does Professor McDonough think our narrow tax base and, in particular, the absence of a property tax played a role in what happened in Ireland?

Professor Terrence McDonough: I certainly do think so, and I am fond of making the point that if we were to have a property tax, we ought to tax all property not simply the property that the ordinary Irish man or woman might own. The property tax as it stands only applies to the family home. Why discriminate against the family home as a form of property? Let us tax property across the board.

Deputy John Paul Phelan: As somebody who was very young in 1987, I cannot say I have instant recollection of everything from that period. Professor McDonough and Deputy Eoghan Murphy referred to the formation of social partnership. I want to dig deeper into Professor McDonough's comments about the threat of Thatcherism being introduced in Ireland. He implied that the unions felt they had to enter into social partnership to avoid Thatcherism. I have never heard of this before and I would like to know the basis on which he makes this assertion.

Professor Terrence McDonough: As the Deputy was speaking I was trying to remember where I was in 1987. I think I was teaching economics in Buffalo, New York. I remember, quite vividly, some friends of mine in an industrial union trying to leaflet a windscreen wiper plant in the city which was threatened with being moved to Mexico at the time of the maquiladora investment programme. As they tried to hand out leaflets people ran from them as they did not want to be seen accepting the leaflets, believing they would be the ones to be laid off when the plant moved most of its operations to Mexico. In this period there was a sharp decrease in the bargaining power of labour and that was expressed in the policy which the Thatcher Administration pursued. This policy was watched extraordinarily closely here and there would have been a dereliction of duty had it not been.

Deputy John Paul Phelan: Does Professor McDonough have any Irish example of the threat of Thatcherism?

Chairman: The Deputy is out of time.

Senator Marc MacSharry: I thank Professor McDonough for coming along. What alternative to social partnership would he have used?

Professor Terrence McDonough: That is a difficult question to answer. Ireland's labour leadership in that period faced difficult times and made a decision to enter into the social partnership arena. I am not necessarily critical of the arena itself as it was just another forum for negotiation. However, I would be critical of the result, although this result unfolded over a long period of time.

Senator Marc MacSharry: What are the professor's thoughts on the relationship between the union leadership of the time and its membership?

Professor Terrence McDonough: There needs to be a much closer relationship between the membership and the leadership, for good or ill. This is a general point and not specific to Irish trade unions. Social partnership was, at the end of the day, inimical to that. Trade union leaders were in closed rooms negotiating with employers and Government representatives rather than in touch with their membership and that is a problem with social partnership.

Senator Marc MacSharry: I do not hear an alternative though. If negotiation is not the way, what would the alternative be?

Professor Terrence McDonough: Things would have been better with more of a wage-led growth strategy. That would have necessitated a more militant approach to bargaining rather than trading a moderate approach to bargaining for income tax cuts.

Senator Marc MacSharry: Would that mean disputes, protests, lost days etc?

Professor Terrence McDonough: Yes. That is the price of a conflictual system.

Senator Marc MacSharry: Professor McDonough said that on 29 September 2008, in the dead of night, Ireland desperately tried to signal for help but a cannon broke loose the ship and holed the ship of state below the water line. Can he expand on this? What could or should have been done when Ireland signalled for help on that night?

Professor Terrence McDonough: I have a strong opinion on what should have been done with the banks. I am a little hesitant to bring it up lest I be accused of, to use an American term, "Monday morning quarterbacking". I suppose the closest Irish phrase is "hurling on the ditch". The Government should have nationalised the good part of the banks and left the bad part of the banks in private hands. It should have taken over the deposits, which are not assets but liabilities. It should have taken a corresponding amount of assets, which would have included the buildings, office, equipment and general management structure of the banks, and left the bad loans to be worked out in a very capitalist and very private way.

Senator Marc MacSharry: Professor McDonough said earlier that he favoured higher taxation and talked about the reduction from 60% to 48%. If tax reductions were to be offered now, would he see this as a repeat of the mistakes of the past?

Professor Terrence McDonough: Yes. I do not favour the current trend of taking advantage of the small upturn in the economy to cut taxation, and certainly not the top rate of taxation.

Deputy Pearse Doherty: Professor Edward Kane gave evidence to this inquiry earlier in the year. He had said in a 2004 paper that, while policy making during a crisis may be of the seat-of-the-pants variety, the policy itself is informed by a political and economic struggle over who pays for the losses. What is Professor McDonough's opinion of that statement? Does he agree or disagree with his assessment of crisis policy making as a political and economic struggle?

Professor Terrence McDonough: I think it is fundamentally accurate. The question facing policy makers here, working in the context of the European Union and other global institutions, is basically one of who is going to pay for the crisis. The banking solution which I just proposed is simply one in which bondholders and lenders should have paid. To the extent that they were not going to pay, the question should have been transferred to the people who had the money. The people who had the money is the European Central Bank.

Deputy Pearse Doherty: What were the political and economic power blocs at play in the context of the Irish crisis?

Professor Terrence McDonough: I am not a political sociologist but the very close relationship between political parties, Government Departments, the construction sector and the banking sector was not helpful.

Deputy Pearse Doherty: In an article of 2010 entitled "The Irish Crash in Global Context" Professor McDonough stated that financialisation was facilitated by the neoliberal push for deregulation. This committee has heard evidence relating to the deregulation of the banks and the impact that had on the banking crisis. Can he explain why, in his view, there was a push for deregulation? What purpose does deregulation serve?

Professor Terrence McDonough: In the context of the Irish situation deregulation was very much in service of a strategy of internationalisation. This strategy had been seen to be successful and it was the basis on which policy makers were thinking about economic policy in the future. It was transferred directly to the financial sector with the push for the IFSC and then people asked what they could do to attract investment into this sector of the global economy in Ireland. The basic thing to do was to offer them a free hand and that is what I think was done.

Deputy Pearse Doherty: We have discussed light-touch regulation and deregulation in the past and Professor McDonough has given testimony on the subject of the amounts of money going through the IFSC. Do we have light-touch regulation of the IFSC now or is it a thing of the past?

Professor Terrence McDonough: I have not seen the kind of efforts to regulate finance in Ireland that would be obvious and sensible in light of the severity of the crisis that was created. There seems still to be a very close relationship between the IFSC and Government Departments.

Deputy Pearse Doherty: In the context of the IFSC, are the ingredients of the perfect storm, to which Professor McDonough referred earlier, still there or have they disappeared?

Professor Terrence McDonough: One would have to ask whether some of the immediate contributors to the storm had been dealt with. High levels of inequality and debt persist. We have been very slow to take aggressive actions to reduce debt levels. In this morning's newspaper the EU is reported as raising the issue, although it is somewhat ironic in that some of the debt is due to EU policy. We have moved from a low-tax regime and have not been able to restore productive investment, rather than financial activity, in the Irish economy.

Deputy Pearse Doherty: Yesterday, Professor Gregory Connor came before the committee and he said:

> ...a misunderstanding of the big risk of systemic liquidity problems in the banking sector. That was also missed. As such, the economists share some blame.

Would Professor McDonough agree or disagree with Professor Connor's statement that there was a misunderstanding of systemic liquidity problems and, if so, why did the misunderstanding occur?

Professor Terrence McDonough: The second part of the question is the relevant one. Clearly, there was a misunderstanding, and we need to ask why. It goes to the basic world view shared by economists, Irish policy makers and many political parties and other influential people, that the world is such that markets are efficient. The world is not that place.

Senator Susan O'Keeffe: When Professor Ed Kane came before the inquiry he said there was a tendency to regard bankers as high priests. Does Professor McDonough have an opinion on this?

Professor Terrence McDonough: Interestingly, this came up as one of the main topics of discussion some years back when I was interviewing a politician for a magazine article, which is not something I do every day. People such as Michael Fingleton and Sean Quinn were seen as gods somehow, and they were the "go to" people for economic advice.

Senator Susan O'Keeffe: Was that a tendency at the time?

Professor Terrence McDonough: Certainly, yes.

Senator Susan O'Keeffe: The medium-term review published by the ESRI in 2008 stated, among other things, "the fundamentals of the Irish economy are sound". From Professor John FitzGerald's evidence to this inquiry we know the ESRI had done no research on the financial sector for a number of years. Can an economist ever say the fundamentals of an economy are sound without examining the financial sector?

Professor Terrence McDonough: No, and the real question is why you people keep inviting the ESRI back. Its record is terrible.

Senator Susan O'Keeffe: Could Professor McDonough expand on that?

Professor Terrence McDonough: It did not call the crisis and it has not called the recovery from the crisis. What good is it?

Senator Susan O'Keeffe: On that note, if one were to examine any economy, would one, as best practice, include the financial sector as part of the activity?

Professor Terrence McDonough: Absolutely. To be fair to my colleagues, there is a trend to be more serious about the financial sector. The models used to model the Irish economy did not include the financial sector because it was thought that money was simply a veil and not a very important institution and, as an institution, a source of instability.

Senator Susan O'Keeffe: Was the ESRI alone in thinking the financial sector did not matter?

Professor Terrence McDonough: Not at all. It was the conventional wisdom. The ESRI was not alone.

Senator Susan O'Keeffe: On page six of Professor McDonough's statement, he described the IFSC as "an important conduit for foreign capital flows". Is he saying the existence of the IFSC was what allowed the flow of foreign capital and had it not existed, there could not have been such a flood?

Professor Terrence McDonough: There is a famous controversy in the economic history of the US as to whether railroads were key to the development of the interior of the country. The argument is that had the railroads not been there, people would have dug canals, therefore railroads were not key. One cannot make such an argument very convincingly. While it is probably true that other conduits would have been found for bringing finance into the Irish economy, the IFSC was a very important conduit for it in practice.

Senator Susan O'Keeffe: When Professor Gregory Connor gave evidence he said 88% of GDP was coming in as hidden borrowing through the banking system, and we are on the hook for it. How did we arrive at such a position?

Professor Terrence McDonough: Because we were not watching the domestic banking system and because our partners in Europe were not watching their banking systems very effectively. There were two players in the drama.

Deputy Kieran O'Donnell: This is a banking inquiry and we are speaking about neoliberalism in terms of what Professor McDonough feels were the policies pursued since 1987. Can he condense his philosophy and the economic and social model he would espouse and like to see? He referred to a creative process. Could he define it in a word?

Professor Terrence McDonough: No, I certainly would not define it in a word. In terms of addressing this economic situation, I would examine the origins of the problem and the solution that might be achievable. In the short to medium term, we would need to replace stagnant wages with rising wages, sluggish private investment with increased public investment, a hollowed out neoliberal State with a more active State, and unregulated private finance with public banking. The euro without a transfer union needs to be a euro with a transfer union or we need to find a way of mutually exiting this particular straitjacket. We have a dysfunctional ECB and we need a functional one. In Ireland we need redistribution, a debt write-down and higher tax take.

Deputy Kieran O'Donnell: How would Professor McDonough finance this?

Professor Terrence McDonough: We are under-taxed. We need continental levels of taxation. That is one way I would finance it.

Deputy Kieran O'Donnell: Define that in terms of rates and the tax base?

Professor Terrence McDonough: I certainly would not give the committee an entire breakdown of rates, but we need to move from the low 30% into the high 40% in terms of the percentage of GDP we take in through tax.

Deputy Kieran O'Donnell: We are talking about all across the range - income tax, corporation tax-----

Professor Terrence McDonough: I would be talking largely about income tax.

Deputy Kieran O'Donnell: Would Professor McDonough be talking about wealth tax?

Professor Terrence McDonough: It should play a role. The French model in that respect is a starting point, at least.

Deputy Kieran O'Donnell: I have two more quick questions. How could the type of model Professor McDonough has articulated and espoused have prevented the banking crisis? What measures would he like to see put in place now, which he feels would prevent a future bank crisis?

Professor Terrence McDonough: The proposals I am making are very much in the context of the current period. Something similar would have had positive effects on the banking crisis. The banking crisis was not felt uniformly across the world. The South American nations with strong capital controls were relatively unscathed. Nations with strong banking regulation, like Canada, experienced less of a problem. Therefore, I think something like this would have been better than what we had. If, for instance, we had a much larger public banking sector - as they have in North Dakota, for example, strangely enough - we would have been able to weather this a good deal better.

Deputy Kieran O'Donnell: Professor McDonough spoke earlier about controls over the flow of credit. In practical terms, how could the Government of the time and the Central Bank have done that? What impact would higher taxes have on employment growth?

Professor Terrence McDonough: It is interesting. We have forgotten that in the post-Second World War period, almost all countries had rather tight restrictions on capital flow. This was one of the bases for the rapid growth in standards of living. Controlling capital flows is not inconsistent with economic growth. Regarding the impact of higher taxation on employment, it is not so much the level of taxation as the level of organisation, innovation, participation and democratic commitment to the productive activities in society that determine the level of employment growth. Higher wages would lead to higher demand and more employment.

Chairman: When Peter Nyberg was before the committee, one of the comments he referred to related to the social partnership model and how expenditure grew in public sector wages. Is Professor McDonough familiar with that part of the Nyberg report and would he like to make a comment on it?

Professor Terrence McDonough: Specifically, he would have been critical of the level of public sector wages.

Chairman: Yes.

Professor Terrence McDonough: The problem is not so much the level of public sector wages as that the level of wages in the private sector did not follow those in the public sector. That is, we needed a wage-led regime. It would have been better. Public sector wages establish a benchmark, although I hesitate to use that word, for the private sector. I do not think we should be benchmarking the public sector on the private sector, but we should be benchmarking the private sector on the traditional labour protections that public sector unions have been able to achieve for their members.

Chairman: That is a standards in employment issue. In terms of a wage issue, which is also an equality issue, the benchmarking that took place was the public measured against the private. Does Professor McDonough have a view on that?

Professor Terrence McDonough: Generally, good public services are preferable to very high wages. The question of public sector wages is not a single question-----

Chairman: Specifically on the Nyberg report, does Professor McDonough agree with the-----

Professor Terrence McDonough: If one looks at the higher reaches of the public sector, yes. The higher reaches of the public sector are overpaid. If one looks at the lower reaches of the public sector, one finds that they are a little better paid than similar jobs in the private sector, but this is because the public sector does not discriminate against women to the same extent that the private sector does in those lower-paid jobs.

Chairman: To finish up, two economists were in the Oireachtas recently. It was not with this committee, but with the social protection committee. One of them was Professor John FitzGerald and the other was Dr. Dónal de Buitléir. Professor FitzGerald said, "The overall impact of Government policy on expenditure and taxation of successive Governments has had a progressive impact." Dr. Dónal de Buitléir stated, "The fact is that we have the most progressive tax and transfer system in the OECD both absolutely and proportionately." Would Professor McDonough have a view on those two statements?

Professor Terrence McDonough: I think those two statements are quite literally true. This was the finding of the recent TASC report. What we have to start with is the most unequal market distribution of income in the developed world and after taxes and transfers, we end up with something much closer to the average.

Chairman: Is there anything else Professor McDonough would like to add before we come to a conclusion?

Professor Terrence McDonough: No, I think I have been talking a lot.

Chairman: With that said, I thank Professor McDonough for his participation. It has been a very informative and valuable meeting, which has added to our understanding of the factors leading to the banking crisis in Ireland.

Sitting suspended at 2.10 p.m. The joint committee resumed in private session at 2.25 p.m. and adjourned at 4.15 p.m. until Wednesday, 4 March 2015.