Irish banks bailed out as economy unravels

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Statements by finance ministers that banks are "well capitalised and meet the regulatory capital requirements" have come to mean that a country's banks are near insolvent, tax payers will be presented with an enormous bill to bail them out and workers will face major assaults on their jobs, wages and pensions.

So it is in Ireland, already severely impacted by the global economic crisis. On December 16 Finance Minister Brian Lenihan, announced that up to €10 billion would be necessary to help recapitalise three of Ireland's banks.

Allied Irish Bank (AIB), Bank of Ireland and the Anglo Irish Bank have all suffered damaging losses. Indicating that a major banking collapse was imminent, Lenihan stated that these banks "are embedded in our economy in terms of their borrowing, in terms of their deposits that they're of systemic importance."

Lenihan initially hoped that cash for the banks could be raised on international markets, but by December 21 the government conceded that €5.5 billion of state finance would be made available. Some €2 billion worth of shares would be purchased in both Bank of Ireland and AIB, in return for 25 percent of voting rights in both companies. Anglo Irish, the weakest, would be effectively nationalised, with the government taking a 75 percent stake in the company for just €1.5 billion.

The move comes after the Irish government's dramatic offer, in early October, to guarantee all bank deposits to a potential cost of over €400 billion. Intended as a move to prop up the Irish banks and prevent large depositors taking flight, the decision sparked an initial flood of deposits into Irish banks before finance ministries worldwide responded with similar measures. Eleven weeks later and the banks are again on the brink, the promises of early October a distant memory.

The Anglo Irish Bank is effectively worthless. Founded in 1964, it claims on its website a "long established reputation, built on relationship management, service quality and professionalism." Its shares are currently worth between 15 and 25 cents. A year ago they were each worth around €16.50 with a peak of over €17. The bank, once worth €12.9 billion is now worth between €114 million and €189 million.

According to Credit Suisse, the bank needs up to €3 billion in immediate capital to re-assure investors alarmed over the extent of its exposure to bad debts. Other estimates are much higher. The bank's total loans amount to €73 billion.

A year ago, Anglo Irish directors were boasting that the bank had no exposure to toxic US mortgage securities. Its base rather, was in the Irish commercial market. But now the Irish property market has collapsed with prices down 10 percent over the year, and even the most optimistic forecasts do not expect a revival before 2010. Anglo Irish exposure to local property is unclear and the source of much speculation. Some figures suggest up to 80 percent of its loans are on commercial property in Britain and Ireland.

In addition to the collapsing balance sheets, confidence in Anglo Irish and other Irish banks has been undermined by revelations surrounding the activities of the Anglo Irish board. It has emerged that Sean Fitzpatrick, the bank's chairman, had personally taken out €87 million in loans from the bank and deposited the cash, temporarily, in Irish Nationwide. Total loans to directors amounted to €150 million, almost as much as the bank is currently worth. Fitzpatrick, along with fellow director Lars Bradshaw, and chief executive David Drumm, have been forced to resign. The practice appears to have been habitual since 2001.

The loans are currently under investigation by the Irish Institute of Chartered Accountants, while PIBA, the country's largest broking group, told the press that it was "not certain that the appalling practices at Anglo Irish were not illegal."

The Financial Regulator, Patrick Neary, a man whose position is also under threat, claimed that the practice was not illegal. However, the *Sunday Business Post*, Ireland's financial newspaper, aghast at the consequences for Ireland's financial reputation, fulminated in an editorial: "How on earth could it ever be appropriate for a bank chairman to have a loan of €87 million from his own institution? And how could other executives stand by as the transaction to move the loan off the bank's books and back onto them was performed every year."

The paper also noted that the board of Irish Nationwide must have been aware of the loans for years, while the regulator himself appears to have sat on the information for months. The implication is that Fitzpatrick's practices were common knowledge among the financial elite and unlikely to be unique. Fitzpatrick has been replaced by Donal O'Connor, chair of the Dublin Docklands Development Corporation.

AIB, Bank of Ireland and the entire sector are not in much better shape, although share prices recovered somewhat on news of the bailout, unlike Anglo Irish which fell even further. According to Bloomberg, the ISEF index of Irish financial shares has fallen 72 percent since the October deposit guarantee. The six leading finance institutions between them are estimated by the financial regulator to hold some €39 billion in speculative property loans.

For its part AIB, in addition to accepting government cash, is seeking to prop up its position. The group's Polish subsidiary, Bank Zachodni, which employs 10,000 workers in Poland, has implemented a pay and recruitment freeze. Standard and Poors, the credit rating agency, has downgraded its view of both banks, noting of the Bank of Ireland, established in 1793, that it faced "deteriorating asset quality."

In the 1990s and early 2000s the Irish economy, dubbed the Celtic Tiger, grew by as much as 10 percent annually based on US corporate investment directed towards production for European markets. When the investment boom slowed, the economy was maintained by the property boom. Ireland now faces the rapid collapse of both.

The same week as the banking bailout, Dell Computers announced that it intended to close its Irish based laptop production operation. Despite pleading from Deputy Prime Minister Mary Coughlan, Dell intends to cut up to 2,000 workers from its Limerick site as it relocates production to Eastern Europe or China. The company opened a factory in Poland in January 2008, while 43 percent of its global purchasing is from China, a proportion that is expected to increase. Flextronics, who manufacture computer components, immediately announced that 118 jobs would go from its Limerick operation. Banta Global Turnkey, which also supplies Dell, intends to shed 65 workers.

According to the Irish Development Agency, green field investment projects fell by 22 percent in 2007, following a 25 percent drop in 2006, before the impact of the deepening world recession. Another survey from the same organisation suggested that 45 percent of corporate chiefs, who had chosen to invest in Ireland, now regretted the decision. The survey cited high labour costs, poor transport and network infrastructure.

Currency fluctuations are also causing serious problems. According to the Irish Small and Medium Enterprise Association, (ISME) up to 95,000 jobs are in danger. The group's head of research, Jim Curran, noted that the collapse of the British pound against the euro (Ireland is in the euro-zone) was having devastating consequences for Irish based companies, often food and agriculture related, exporting to Britain. Curran told the *Sunday Business Post* "when the old Irish pound hit £1.10 against Sterling in 1992, it was deemed a national crisis by the government. Now we are approaching the equivalent on £1.25, which is a national disaster."

An ISME report noted that 45 percent of companies reported a fall in exports, against 28 percent reporting an increase. Some €16 billion of Irish exports are intended for Britain.

Both Curran and Liam Shanahan, of the Irish Exporters Association, demanded the bailouts extended to the banks to be made available to smaller businesses. Both demanded pay cuts for workers and railed bitterly against the terms of a recent national pay agreement, "Towards 2016 Social Partnership" which, they claim, offered workers 6.5 percent increases.

In fact, the draft agreement, drawn up before the financial crisis really erupted, nominally offered workers 6 percent over 21 months. The agreement, reached between employers, government and the trade unions, opened with a three month pay freeze in the private sector and an 11 month freeze in the public sector. Moreover, the agreement offers employers an, "inability to pay" escape clause from the wage increases, and makes clear that the increases must be locally negotiated. In any case, the agreement is voluntary and cannot be enforced on employers.

The deteriorating economy is producing panic amongst business commentators. Writing in *Finfacts*, Michael Hennigan complained, "With the death of the Celtic Tiger and a grim outlook for the year ahead and beyond, the country is in dire need of an effort that could be termed the moral equivalent of war."

Hennigan denounced the government, and "crony capitalism, laziness, short-term political self-interest and a political system that produces politicians who are simply incompetent to hold ministerial office." But his main target was public sector workers, who he complained "earn between 10 percent and 30 percent more than comparable counterparts in the private sector." He concluded by calling for the Green Party to "exercise the one power it has" and bring down the government to force a general election on tax and spending.