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Ireland creates “bad bank” to rescue finance and property speculators

Steve James
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Ireland’s “bad bank,” the proposed National Assets Management Agency (NAMA), is an instrument to channel huge amounts of state spending into the hands of the very banks and property developers whose reckless and criminal speculation has brought the Irish economy to the brink of ruin.

Outlined in the Fianna Fail/Green government’s emergency budget in April, NAMA is intended to supervise billions of euros of bad loans mostly made to a narrow circle of property developers.

The full cost of the loans, which are now non-returning and will now be NAMA’s responsibility, is not known. It is not clear whether NAMA is conceived as an alternative to, or part of, a nationalisation of Ireland’s remaining banks. Anglo-Irish Bank has already been fully nationalised, while AIB and the Bank of Ireland have both been recipients of large government hand-outs but are not, at this point, fully owned by the government.

Should it emerge as an agency to own, rather then merely supervise, the debts, then it has not yet been specified at what price NAMA will buy the banks’ bad loans. Many loans are likely to be purchased by the Irish government at a price far above their real current value.

The NAMA proposal emerged as one component of the Fianna Fail-Green coalition’s response to the collapse of Ireland’s major financial institutions. The onset of world recession has intensified already well-advanced tendencies within the Irish economy, and brought the Celtic Tiger investment-led boom period of the last two decades to an abrupt halt.

By producing goods at relatively low costs and very low tax rates for the European markets, and with receipt of European Union funds, Ireland attracted investment from the United States, Europe and Japan. During the late 1990s and early 2000s, it had one of the fastest expanding economies in the world. However, the cheap labour platforms offered by China, and particularly eastern Europe, undermined Ireland’s ability to remain internationally competitive. Growth rates prior to the world financial crash became dependent on a speculative property bubble and building boom, largely around the capital Dublin.

The bubble was already bursting before the collapse of Lehman Brothers, and subsequent developments have left Irish financial institutions with huge books of loans, mostly bad, mostly to property developers.

Led by the building sector and intensified by a more general falling off in production, the Republic of Ireland is now in a depression. According to Ernst & Young’s “Economic Eye” report, GDP is expected to collapse by 8.9 percent in 2009 alone. Unemployment is increasingly rapidly.

Over the last few months, the government has aggressively slashed public spending, imposed pay cuts in the form of various tax and pension “levies” on all sections of workers. On the other hand, it has moved to preserve the financial elite by guaranteeing all deposits and loans in Irish banks to a potential €440 billion, and has nationalised the most exposed Anglo-Irish Bank.

NAMA is another in this series of desperate measures. It is also intended to rescue Ireland’s fiscal reputation, much damaged by the exposure of the incestuous relations between the government, leading bank officials, regulators and the property speculators.

The new institution will take responsibility for property-related loans held by the major banks, the book value of which is a huge €90 billion.

A letter from 20 leading academic economists shortly after NAMA’s announcement in April warned of the ruinous consequences for public finances of buying the loans. It stated, “With €90 billion in loans to be purchased, the consequences to the taxpayer of overpaying for bad assets by 10 to 30 percent are truly appalling.”

A report from the Dublin-based Economic and Social Research Institute (ESRI) suggested that the government would pay €50 billion for the debts, which would entail injecting an additional €20 billion into the banks beyond cash that had already been allocated. This level of support

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would result in around 75 percent of the Allied Irish Bank (AIB) ending up in government control, and a lesser share of the Bank of Ireland.

The head of the National Treasury Management Agency (NTMA), Dr. Michael Somers, told the Dail (parliament) Committee of Public Accounts in mid-May that he was “aghast” at the scale of the loans. The NTMA is to oversee NAMA’s establishment. Somers also told the committee that he did not know how NAMA would operate, whether it would take control of the loans directly, or whether they would remain on the books of the respective banks.

Currently some 3,000 to 5,000 employees are maintaining the “impaired” loans at the banks. Somers’s own preference was for the loans to remain with the banks, with NAMA having only a core supervisory staff. He warned of a lawyers’ bonanza as “the implications of this are enormous and the legislation will be very complex.”

If the loans are transferred to NAMA, then the agency could itself emerge as a giant landowner and property management company with assets consisting of land, development projects in various stages of completion, and finished and occupied buildings. It would have to remain a landowner for a long time, because, according to a former property director of Irish Life, “If traditional normal market related valuation principles are applied, then even existing values will vaporise in a fire sale environment.”

Put another way, the loans held by the banks are currently worthless, and attempts to recoup losses by selling the developments for which the loans were taken out will only recover a fraction of their value, while bankrupting large numbers of developers. Therefore, the loans will be handed over to NAMA, bought at a hugely inflated price by government, managed and massaged for over a decade, then sold back to those who created the crisis in the first place.

While developers will technically be liable for all the money they have borrowed, NAMA is expected to work with them to get projects moving, and will even make further funds and new loans available. Even then, the industry is lobbying to ensure it extracts the most from the government. A Construction Industry Federation (CIF) meeting held mid-May complained that the time being taken to establish NAMA was prolonging the unstable economic environment. The federation promised to “pursue every avenue” in making its case to the Department of Finance.

Despite the confusion, plans are moving ahead. Legislation is expected to go through in September, with the first transfer of assets expected in November. The tendering period for NAMA functions has already been completed. On May 26, the six main banks submitted details of their property portfolios to the government. One report suggested that the Bank of Ireland was intending to transfer some €12.2 billion of debts and €8 billion of related loans within weeks of NAMA’s establishment.

In a closely related development, the government announced last month that the Anglo Irish Bank would be handed an additional emergency sum of €4 billion following its first set of financial results after nationalisation. Finance Minister Brian Lenihan made clear that no effort would be spared to save the bank, which lost the €4 billion in the first three months of this year.

The losses were entirely due to bad loans and compared with a mere €33 million set aside for bad loans last year. Lenihan said that without new funds the bank could not continue trading. Were this to happen, its €64 billion of loans would be imperilled, which contained a “systemic” risk to the entire Irish banking system.

Further loan losses of at least €3.4 billion were anticipated. Every 10 percent slump in the value of property deepened its loan losses by €1.5 billion. Since 2006, Irish property prices have fallen by as much as 40 percent. Other figures suggested the bank now holds €10.7 billion in ‘impaired’ loans, up from €1.6 billion nine months ago. Some €2.5 billion of these loans have not had any repayments for 90 days. Customer deposits have fallen from €34 billion, down from €51 billion in September, requiring bending of regulatory rules to allow it to keep functioning.

In the midst of general financial mayhem, the bank wrote off some €308 million previously lent to “long standing clients” to buy shares in the bank itself. Another €31 million was written off to “former directors.” Investigations are continuing into €8 billion in short-term deposits from Irish Life and Permanent to prop up Anglo Irish’s annual accounts, just before the bank’s share price collapsed last year.

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