European Central Bank presses Irish government for more social cuts

Steve James
23 September 2010

The Irish government raised €1.5 billion on the sale of government bonds this week, completing its target of raising €20 billion this year. It was able to do so only by promising yet more austerity measures on top of successive cuts imposed since 2008.

The government raised sufficient funds to continue functioning into next year. In the end, the bond offer to the financial markets on September 21 was over-subscribed, as international investors raced to take advantage of the extraordinarily high yields being offered on eight-year and four-year bonds.

High interest rates on government bonds are yet another means through which the vast cost of the Irish bank bailouts, which have already been imposed on the public purse, will be passed on to the working class. The bonds will be repaid at the expense of future social spending.

The successful sale followed a few hysterical hours last Friday, during which two-year bond prices leapt half a percentage point following the publication of a Barclays Capital report suggesting that Ireland's growing debt crisis would ultimately require European Union (EU) or International Monetary Fund (IMF) emergency funding.

The Barclay's report stated that, although short-term funding would not be a problem, "the colossal fiscal effort which will be required to stabilise the public debt over the medium term leaves little fiscal space to deal with any further unexpected financial sector losses".

The report supported the brutal austerity measures already imposed by the Irish government, but added, "The problem is that, despite these policy efforts, the government has very few options left of its own".

Driven by fear that bonds ultimately might not be fully repaid, the interest rate on two-year bonds rose to 3.54 percent, while the rate for 10-year bonds reached 6.3 percent—the highest since the adoption of the euro on its launch in 1999. Facing similar pressures, yields on Portuguese bonds also rose for the third successive day. Irish 10-year yields rose again Monday to 6.5 percent.

In the midst of the panic, the European Central Bank (ECB) intervened with only a tiny amount—some tens of millions of euros—while the IMF stated that it did not envisage Ireland requiring assistance. An unconvinced euro trader told the *Financial Times,* "There are just no buyers out there for Ireland because of worries over its banks and economy. Ireland and also Portugal are very much the worry for investors".

Underlying such fears is the scale of the Irish public sector deficit and the ongoing uncertainty over the condition of the country's banks. Ireland is currently borrowing more than it can raise in revenue to the tune of 14.3 percent of gross domestic product (GDP). This is the highest figure in the European Union, including Greece.

Despite the recent decision to wind up the *Anglo Irish Bank* over the coming decade, the final cost of the debt burden solely due to Anglo Irish remains unclear. Current best guesses are €30 billion, while the remainder of the banking system also requires huge sums. Total Irish GDP is only €172 billion.

Irish Times economics editor Dan O'Brien expressed the sense of panic. He wrote, "This cannot go on much longer. Ever rising bond yields and a rapidly growing debt stock are like nitrates and glycerine—let them mingle and agitate together and sooner or later they explode".

O’Brien expressed astonishment at the small scale of the ECB intervention: “I struggle to comprehend this. And not from an Irish point of view, but from the perspective of Europe’s interests”.

He went on, “Think of the May bailout as a dyke around the currency. It is big enough to hold back an inundation caused by Ireland, Greece and Spain failing. If all three countries need help, the water will be lapping over the top of the dyke and the pressure on it will be enormous.

“As a bailout may well be the euro’s last line of defence, bond-buying by the ECB essentially protects that line of defence”.

The ECB’s miserly response is conditioned by the view that the working class in Ireland, not the major European powers and particularly Germany, should pay the entire cost of the Irish financial system’s debts. At the same time, the ECB is seeking to end the cheap loans through which a number of the weakest banks, many of them Irish, have been propped up since 2008.

ECB council member and president of the German Bundesbank, Axel Weber, stated Friday, “The financial crisis is still with us—we are not in year one after the crisis, we are in year four of the crisis…. Moral hazard is in the financial system. I want to get to a situation where the term ‘too big to fail’ does not exist”.

EU Economic and Monetary Affairs Commissioner Olli Rehn of Finland laid down the law to Dublin. “I have full confidence on Ireland and its capacity to deal with determination to complete the financial repair and necessary restructuring of the banking and financial sector”.

In response, the Irish political and financial establishment promised yet more austerity. The governor of the Central Bank, Patrick Honohan, stated that reprogramming of the state budget was “clearly necessary soon” to allow Ireland to reduce its debts. Honohan claimed that reducing the rate of interests paid on debts clearly “more than offsets any short-term adverse impact on domestic demand from lower net public spending”.

Ciaran O’Hagan of Société Générale demanded an increase in the retirement age and a property tax.

The government have already stated their intention of cutting a further €3 billion from state spending in the next budget, due in December. The cuts were first proposed as part of a series of annual spending cuts recommended by economist Colm McCarthy and accepted by the government in 2009. But over the last weeks, Finance Minister Brian Lenihan has indicated that the proposed €3 billion was the “minimum” level of cuts that would be expected, while Taoiseach Brian Cowen insisted it was “imperative” that the required level of cuts were implemented.

The Irish government has already imposed among the most savage spending cuts in Europe, with public sector workers having suffered on average a 15 percent pay cut, while all areas of welfare benefit and social spending have been slashed.

Likely further measures include a cut in pension tax relief, which will impact 90 percent of working people, other forms of indirect taxation, a “workfare” scheme, and further reductions in capital spending. Unemployment is already standing at 13.8 percent, at nearly 228,000, and is expected to reach 14.5 percent, while the Live Register, which includes part-time workers, stands at 455,000. Homelessness in Dublin, which has impacted particularly on foreign workers once attracted by boom-time conditions, is up 20 percent in one year.

Private employers are taking their cue from the government. The Construction Industry Federation recently attempted to reduce building workers’ wages by a full 20 percent, while the government’s Labour Court, backed by the unions, recommended a 7.5 percent cut.