Leading to Crisis: Decision-Making in Ireland's Celtic Tiger

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Abstract

The meteoric rise and catastrophic fall of Ireland's economy between 1997 and 2010 is a compelling story. The so-called Celtic Tiger disappeared and Ireland turned to international partners for financial assistance. This research seeks to understand the causes of the economic crash in Ireland, and - more specifically - to better understand one of the regularly cited causes: poor economic decision-making.

The puzzle for this research is to reveal which factors influenced policy-makers in Ireland and how those factors impacted decision-making. This includes better understanding the presence and impact of *irrationality* in policy-making. The research seeks to determine (i) whether evidence of active, impactful irrationality among key decision-makers in the period before Ireland's crash is detectable using a quantitative method, and linked to this (ii) what role did *interests*, *institutions*, and *ideology* play in poor decision-making.

The research proposes that leaders in Ireland fell victim to higher relative levels of a particular form of decision-making bias, behavioural convergence, and that this can be tested using the leadership traits *conceptual complexity* and *in-group bias* as a proxy, employing the *Leadership Trait Analysis* technique. Contrary to the hypothesis, the research finds that Irish leaders in the run up to the crisis had higher rather than lower scores for conceptual complexity, and lower rather than higher in-group-bias, relative to other leaders. The thesis finds that personality trait scores vary considerably over time, that the position that the leader holds, and that the decision-making context can have a significant impact on leaders' trait scores. Further, the nature of the content analysed (ad libbed versus pre-prepared text) can also have a significant impact on scores.

Next, process tracing a decision case-study finds evidence of interests, institutions, and ideology impacting on decision-outcomes. However, it is the combination of ideological and institutional factors that have the clearest negative impact. The research brings these learnings together to help inform better decision-making, and indicates scope for further research arising from this thesis.

PART I

Chapter 1: The Economic Crisis in Ireland

1.1 Introduction

The meteoric rise and catastrophic fall of Ireland's economy between 1997 and 2010 is a compelling story. Since the Irish State was founded in 1922 its economy suffered some highs but many more lows. From the stabilising policies of the 1920s, to the economic nationalism of the 1930s and 1940s, the stagnation and emigration in the 1950s, the outward looking revival of the 1960s, through the economic crises of the 1970s and 1980s, Ireland had spent seventy years seeking out a sustainable economic model that would foster growth and employment, and reverse decades of population loss to emigration.

By the end of the 1990s it was thought that Ireland had arrived at such a model as the 'Celtic Tiger' emerged. In 1996 there were 250,000 more people living in Ireland than in 1986, 216,000 more people at work, and the Irish economy moved from being "among the poorest in Europe", to being dubbed "the region's star" (The Economist, May 15th 1997). The Celtic Tiger moniker was earned by virtue of an economy growing at East Asian rather than West European rates. Ireland's Gross Domestic Product (GDP) grew by 10 per cent in 1995 and by 7 per cent in 1996.

From the beginning of the next decade things began to change. Ireland's competitiveness decreased sharply as labour costs rose in real and absolute terms, public expenditure growth exceeded economic growth (including public sector pay and numbers), current account surpluses became deficits, household debt climbed, bank lending increased strongly, Ireland's share of international trade fell, and - perhaps most critically - the tax base became unstable (Regling and Watson, 2010: 26). Yet, in 2007 Ireland's economy appeared in relatively rude health. Economic growth was running at 5 per cent. The unemployment rate was 4.5 per cent. Employment was growing by over 70,000 jobs per year. Gross current spending was to increase by 11.5 per cent, and gross capital spending by 13 per cent. Ireland's gross debt to GDP ratio was under 25 per cent, one of the lowest in Europe.

Within two years, Ireland had entered what has been described as a crisis of five overlapping elements: a banking crisis, a public finance crisis, an economic crisis, a social crisis, and a reputational crisis (NESC, 2009). Strong economic growth had turned into a 7 per cent contraction. In four budgets between July 2008 and December 2009, government spending was cut by €9 billion. Another year later and Ireland was, in the words of the government, facing an economic crisis without parallel in its recent history. GDP had fallen by nearly 15 per cent from its height in 2007. Over 320,000 jobs had been lost since employment peaked in 2007. The gross debt to GDP ratio was 80 per cent. In 2010 Ireland turned to international partners for financial assistance. That assistance included financial support from the European Union (EU), International Monetary Fund (IMF), and bilateral loans from the United Kingdom, Sweden and Denmark, and was on the on the basis of specified conditions.

It is decision-making by Ireland's leaders over the period from the end of the sustainable growth to the onset of the crash that is of interest to this research. More specifically, the research seeks to explain why policy-makers acted the way they did, and better explain the disastrous decisions they took in the decade before the crisis.

1.2 The Puzzle: Why Decision-Makers Acted as They Did

The purpose of the thesis is to seek to understand the causes of the economic crash in Ireland, and, more specifically, to better understand one of the regularly cited causes: poor economic decision-making. The poor economic policy pursued in Ireland emerged despite advice which if acted upon may have mitigated the subsequent crisis (e.g. action to address declining national competitiveness). The over-heated property market occurred in a time of unprecedented economic expansion, encouraged by pro-cyclical fiscal policies, individuals' investment errors, banking and regulatory errors, and poor political decisions. The thesis seeks to explain those decisions.

The scale of the Irish economic disaster makes it an important and interesting case for official investigations and academic studies, and many have been undertaken since the crash. Official investigations include those by the Honohan (2010), Wright (2010), Regling and Watson 2010), Nyberg (2011), and by the Houses of the Oireachtas (2016). Other relevant works include those by Allen (2009), Kinsella and Leddin (2010), Kirby (2010), Whelan (2010), Drudy and Collins (2011), McCabe (2011), and Woods and O'Connell (2012). Analysis of the wider crisis can be found in Buti (2009) and Esposito (2014). It is now accepted that Ireland's policy-makers did received advice from international organisations that if heeded would probably have helped bolster the economy against the global crisis which emerged in 2007, but also that this advice was not delivered forcefully and unequivocally enough (O'Leary, 2010; Wright, 2010; Nyberg, 2011; Houses of the

Oireachtas, 2016). Domestically, warnings on Ireland's deteriorating national competitiveness were also sounded (see Appendix A).

The puzzle for this research is to reveal the factors influencing policy-makers in Ireland and how those factors impacted the decision-making process, to in turn explain the failure of government to respond to policy advice. In short, what caused these bad decisions? Based on analysis to date, the causes of poor policy-making in Ireland are so well-known and (now) so obvious as to warrant little further exposition: key decision-makers believed that the basis for growth was robust, that market regulation and supervision was satisfactory, financial institutions were sound, and that the boom would continue and/or there would be a soft-landing. These decision-makers were caught-up in, and benefiting from, a cheap credit-fuelled property and construction bubble to such an extent that any suggestion of significant policy change, which in hindsight may have head-off or mitigated the crash by protecting competitiveness, was ignored (e.g. moderating public expenditure, stabilising the taxation base, cooling the property market). This disastrous consensus was in turn the result of a naïve belief in the efficiency of financial markets, supported by *irrational forces* (Nyberg, 2011). Nyberg acknowledged the powerful, negative influence of the paradigm of efficient financial markets i.e. the assumption that developments in financial markets, almost by definition, could not be seriously flawed from a systemic point of view, and that regulation of the financial markets would reduce innovation and efficiency without improving stability. But his investigation identified another overarching, causal issue:

> "It is the belief of the Commission that stronger, irrational forces were also present. The widespread consensus as well as the confidence, until the very last moment in late 2008, that everything would end relatively well points to the existence of a national speculative mania in Ireland during the Period, centred on the sale and acquisition of property. Warning signs were ignored as continuing economic stability was confidently assumed. Traditional values and practices were seen as less relevant in the new financial order. When the mania ended, participants had difficulty in accepting blame for their own part in it since everything had seemed so normal and acceptable at the time" – *Nyberg, 2011: 94*

Whereas the role of the markets in the crisis and the failure of financial market regulation specifically, are well understood as a result of the aforementioned research, the concept of irrational forces and when and how they impacted economic decision-making in Ireland is less well developed. Nyberg identified two specific irrational forces, *groupthink* and *herding*, and Lunn (2013) developed this approach further, concluding that one likely contributor to the non-progression of ostensibly sound economic policy was the impact of a number of empirically-established behavioural biases held by decision-makers, of which groupthink and herding were just two examples. Behavioural biases (Nyberg's *irrational forces*) are systematic errors in judgements and choices which are influenced by emotions. A behavioural economics approach focussing on the impact of behavioural biases, including groupthink has been a feature of analysis of Ireland's economic crash. As one witness told the official Inquiry:

> "The various players, including politicians, builders, bankers and regulators, displayed 'behaviour exhibiting bandwagon effects both between institutions (herding) and within them (groupthink") - *Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 54*

The witness, a journalist and author on Ireland's crash agreed with Nyberg's conclusion that various institutions in the run-up to the Irish crisis fell victim to irrational forces, exhibited groupthink and herding, hindrance of critical thinking and overall risk assessment, widespread consensus, and confidence until the very last moment in late 2008 that everything would end relatively well (Nyberg, 2011: 7, 48, 49, 94 and 95).

The almost unanimous acceptance of what proved to be disastrous views within public policy and discourse was, according to Nyberg and others, at the heart of what went wrong in Ireland. There was a stubborn confidence in a persistent era of economic stability, and asset-wealth growth. Given the scale of the crisis and its implications for an entire economy and society, it is natural to seek to get to the heart of what went wrong in Ireland, not just for the sake of the Irish but to inform policy approaches in other economies. The 2011 investigation was based on an in-depth examination of the role of the banks and auditors in Ireland's crash as you would expect. Interestingly from a political science point of view, Nyberg also examined the role of public institutions including Regulators and Government Departments. The investigation's contention that "groupthink could easily exist in public institutions, with a publicly mandated and thus strongly empowered leader gradually eliminating independent critical analysis among staff" Nyberg, 2011: 9) is important; it was not only banks, stock traders, investors, or property developers/purchasers alone who were victims of groupthink.

The use of the words irrational forces is, of course, both interesting and central to this research. Recent studies of Ireland's economic crisis highlight the presence and impact of behavioural factors.

> “Regling and Watson refer to ‘euphoric conditions’, a ‘national blind-spot’ and behaviour ‘embedded in collective psychology’. The now Governor of the Central Bank, Patrick Honohan, describes ‘mass psychology’; a ‘construction frenzy’ and ‘hysterical’ financial markets. Whelan blames ‘over-optimism’, especially in relation to the continuation of Ireland’s abnormally high economic growth. In addition to invoking herding and groupthink, Nyberg refers to national ‘mania’; FitzGerald even calls it ‘madness’” – *Lunn, 2013: 565.*

These references to behavioural biases in analysis of the crisis in Ireland, albeit often in what he calls a ‘folk-psychology’ manner, prompted Lunn (2013) to apply a behavioural economics approach and assess whether known biases in decision-making were instrumental in the development and severity of the crisis. Lunn sought evidence that key decision-makers, including politicians, were influenced by specific behavioural bias phenomena and which have been identified previously via experiments and field studies.

In short, Lunn picks up where Nyberg finished and expanded upon the idea of irrational forces. He suggests policy-makers in Ireland may have ignored policy advice that now seems indisputable, because they, for example, predicted future outcomes based on the past (extrapolation bias), placed greater weight on existing beliefs (confirmation bias), predicted outcomes too positively and overestimated the accuracy of those predictions (overconfidence bias), were adverse to uncertainty (ambiguity aversion), conformed to majority views (behavioural convergence), were drawn toward immediate rewards (time inconsistency), or gave inordinate weight to losses or gains (loss/gain asymmetry) (Lunn, 2013: 566). These biases, and an emphasis on irrationality as an explanation for Ireland’s crisis, have been a feature of many studies of the crash. In fact the broad approach to governance in the years preceding the crash has been described as “the politics of hubris”, where Ireland was a “hotbed of consensus politics”, and external warnings to government were summarily dismissed (Murphy, 2016: 103-128). Whelan (2010) reviews Ireland’s economic performance of the preceding two decades, from the early days of the so-called Celtic Tiger, through to the housing boom, and the crash, and then attempts to draw some lessons. Whelan refers to the apparent consensus among economists that economic growth was likely to continue at a healthy pace, adding:

> “It was hardly surprising that Fianna Fáil was re-elected to government in 2007 on the basis of an election manifesto whose underlying assumption was that growth over the following five years would average 4.5 per cent per year. Rather than challenge these assumptions, the opposition political parties largely agreed with this assessment. This over-optimism was, I believe, the fundamental source of a range of different policy

mistakes which left Ireland badly placed for coping with the economic slowdown to come" – *Whelan, 20 : 238*

In this one synopsis alone one can detect extrapolation and overconfidence biases which feature on Lunn's list of established behavioural decision-making biases. Whelan says that the over-optimism (as opposed to overconfidence bias) about economic growth that prevailed during the period leading up to 2007 was responsible for a number of serious policy errors. In his 2014 study, Mercille points to impact of irrationality in an examination of Irish mainstream media coverage of Ireland's housing bubble that burst in 2007. Mercille states that because the boom was advantageous to key sectors of the Irish corporate and political establishment (e.g. builders and developers, banks, the government and property firms), it was never seriously challenged, despite it being "possible to identify bubbles with a reasonable degree of confidence before they burst" (Mercille, 2014: 286 and 287). The work goes on to show that media performance in Ireland fits the description Nyberg gave to finance industry where there was a large amount of herd behaviour and groupthink (i.e. behavioural convergence bias) "pointing to an uncritical acceptance and following of the dominant trends and decisions that sustained the boom and led to the bust" (Mercille, 2014: 287).

Getting more specific of the role of leaders in the lead up to Ireland's economic collapse, Brennan and Conroy (2013) analyse the CEO letters to shareholders of a bank over ten years for evidence of CEO personality traits, including narcissism (a contributor to hubris), hubris, overconfidence and CEO-attribution. This followed newspaper speculation that the banking crisis of 2008 was partly caused by CEO hubris. In addition, following predictions that hubris increases the longer individuals occupy positions of power, the authors examine whether hubristic characteristics intensify over time.

Not unlike this research, Brennan and Conroy analyse whether there is evidence of bias (hubris) by means of content analysis to gain insights into the personality of the person making the utterances, using proxies for the bias; in this case the content is bank CEO letters to shareholders. This is based on the authors' belief that content analysis has the potential to reveal how the mind-sets of the individuals being studied function, citing Craig and Amernic's (2011) suggestion that analysis of corporate communication has the potential to reveal linguistic traces of personality. Using discourse analysis, they study destructive narcissism as revealed in the CEO letters of Enron, Starbucks and General Motors. Craig and Amernic analyse CEOs' public language, which mediates the interactions of their companies and organisational audiences for those corporate disclosures (Brennan and Conroy, 2013: 180). As discussed later, this research is based on the argument that that analysis of communication by political leaders in parliament also has the potential to reveal traces of personality. Revealing these traits is important for Brennan and Conroy as, again in a similar vein to this research, their work is based on the assumption that "cognitive biases can have a potentially detrimental effect on corporate performance if the executives exhibiting such behaviours are left unchecked" (Brennan and Conroy, 2013: 188). Their content analysis of CEO utterances does point to hubris syndrome in the character of the CEO, concluding that "these symptoms might act as a warning to boards of directors in relation to the character traits they look for when recruiting CEOs" (Brennan and Conroy, 2013: 190).

Another study of decision-makers in the lead up to Ireland's economic woes has been undertaken by Dowling and Lucey (2014). By taking a behavioural economics approach to their analysis of the role of Boards of Directors in Irish banks' risk management, and exploring the likely presence of behavioural biases among senior executives, they find the Irish context provides a pertinent case study of what can happen when hubris and associated behavioural biases take control of a bank's risk management strategy (Dowling and Lucey, 2014: 1). Similar to this research, Dowling and Lucey ask why catastrophic events came to pass, how did established external processes not prevent or slow down activity that precipitated disaster. They explore the role of Bank Boards in their control and oversight function of risk and particularly highlight some of the behavioural perspectives. Their starting point is the view that "[e]xisting studies of risk governance by Board of Directors generally ignore this role of behavioural characteristics of directors, both individually and as a group, despite significant recent evidence that these behavioural characteristics can play an important part in determining firm risk attitudes and carrying out of the risk oversight function." (Dowling and Lucey, 2014: 3 and 4).

This research has a similar starting point, but rather than examining Boards of Directors, focusses on political decision-makers in government. Interestingly, the authors also employ Lunn's categories of established biases (2013), and claim that at "a national or aggregate level in Ireland all these biases were demonstrably present" (Dowling and Lucey, 2014: 7). This claim is based on (i) a general consensus in the national elections of 2002 and 2007 that the economic circumstances would continue to be benign, (ii) demonstrations that macroeconomic forecasts for Ireland were consistently overoptimistic, (iii) central bank and stability reports showing no major concern with the housing bubble, and (iv) lack of willingness to challenge the consensus and change economic course. The paper focuses on the banking system and finds evidence of pervasive bias in the fact that the short-term liquidity issues of the banks in 2008 dominated the long-term questions on solvency, and that "banks and policy makers continued to pour money into manifestly insolvent banks and banks likewise poured money into insolvent borrowers rather than take the embedded losses" (Dowling and Lucey, 2014: 7 and 8).

While Dowling and Lucey's analysis presents evidence of how biases played out among decision-makers within the banks, they do not broaden out this out to an examination of decision-makers in government, which is the purpose of this research. Rather they argue that senior decision-makers in Irish banks were subject to considerable behavioural biases affecting their approach to risk taking, which along with Brennan and Conroy's work, and Mercille's examination of the media, is an important element in our overall understanding of decision-making in the years preceding Ireland's economic crash.

Notwithstanding all of these contributions, a number of gaps remain. First, evidence of the presence of behavioural biases specifically among key political decision-makers in Ireland is absent. The studies on Ireland referenced above do deal with biases directly but do not assess the political leaders involved. International studies have assessed political leaders but not through the prism of behavioural bias (van Esch, 2015). Testing for the presence of impactful irrationality among decision-makers in government is at the heart of this research. It is analysis of this kind which can best inform processes to reduce the likelihood of disastrous decision-making occurring again.

Second, Lunn's analysis notes that the circumstances of Irish decision-makers during the crisis closely parallel contexts that are known empirically to produce these biases. This research unlike any previous analyses seeks evidence of irrationality among political decision-makers using material from the time the decisions were being taken. This will allow a more precise examination of any claim that Ireland's decision-makers fell victim to irrational forces at the moment a poor decision was being made.

Third, evidence that biases were more prevalent in Ireland versus elsewhere is also absent, would be novel and is worthy of empirical analysis. In attempting to explain why did the crisis happen in Ireland, Lunn's answers include the suggestion that behavioural biases may have been fomented by the length and extent of the so-called Celtic Tiger, which was extraordinary by international standards meaning that biases hypothesised were likely to be magnified by the extraordinary scale of Ireland's boom (Lunn, 2013: 584). Thus, some method of assessing the strength of irrationality in Ireland relative to levels amongst decision-makers in other economies would be most useful in developing the explanatory power of behavioural biases with regard to the causes of Ireland's crisis.

Finally, irrationality is part of the human condition, ever-present and predictable (Ariely, 2008; Kahneman, 2011). Yet previous analysis suggests it was particularly impactful in the years immediately preceding the crash, compared to other periods of time. This raises a number of questions. Why was irrationality more prevalent and impactful at this time? Was it activated by other factors? Were such activating factors the root cause of the problem, rather than irrationality? McCarty, Poole, and Rosenthal (2013) posit that *interests, institutions,* and *ideology* 'lurk behind' poor policy decisions. For example, interests influence decision-makers by mobilising constituencies, via direct expenditure on electoral campaigns, and by the production and provision of information. In addition, institutional arrangements can have a significant bearing on information flows, and levels of expertise. Finally, ideology can justify erroneous action or inaction, despite events and information suggesting a particular course of action (McCarty, Poole, and Rosenthal, 2013: 15, 72, 73, and 112-114). This research investigates the role played by these three factors in activating irrationality and/or the extent to which they in and of themselves explain poor decision-making.

To paraphrase Vennessen, although it can be argued that the phenomena of interest here (irrationality, behavioural bias, groupthink, interests, institutions, and ideology) are obviously impactful, and can be deemed so by common-sense intuition, the implications of previous studies, or deductive reasoning, this research is based on a belief that if and how they impact decision-makers is an empirical question, and only painstaking empirical investigation can uncover them fully (Vennessen 2008: 233). Thus, notwithstanding the extensive analysis to date, two important questions about the genesis of Ireland's economic crisis remain:

1. Is evidence of active, impactful irrationality among key decision-makers in the period before Ireland's crash detectable using a quantitative method?
2. What role did interests, institutions, and ideology play in poor decision-making?

The first question is borne out of the need to test assertions made about the role played by irrationality in the economic crisis, and an optimism that perhaps policy-makers need not wait to employ painful hindsight to confirm the presence of levels of irrationality which damage economic policy-making. The second question is posed with the broader objective of informing responses to counteract any negative link detected between can interests, institutions, and ideology, and suboptimal policy decisions more generally.

1.3 Thesis Structure

In Part I, Chapter 2 sets out how the learnings from behavioural economics can enhance our understanding of how an economic crisis such as the one experienced in Ireland arises. Using a framework that more accurately reflects how decisions are really made, reveals new considerations for those seeking to understand how decision outcomes are arrived at. Far from being fully rational and utility-maximising, decision-makers are impacted by emotions, are limited by bounded rationality, and are subject to empirically established biases (irrational forces). One of these biases in particular, behavioural convergence bias (groupthink / herding), is believed to have played an important and negative role in many debacles, including Ireland's crash. This leads to a hypothesis that leaders in Ireland fell victim to higher relative levels of this form of decision-making bias, and that this hypothesis can be tested using the leadership traits *conceptual complexity* and *in-group bias* as a proxy for behavioural convergence bias. The purpose of Chapter 3 is to set out the theoretical approach to the case study, specifically to explain how interests, institutions, and ideology impact on decision-making, and how they interact to influence irrational or rational decision-making.

Part II of the thesis investigates if we can establish whether there is evidence of active irrationality in the period before Ireland's crash using the quantitative method *Leadership Trait Analysis* (LTA). Opening Part II, Chapter 4 sets out the research design employed to assess the levels of conceptual complexity and in-group bias of leaders, and to do so at a distance. The objective is to test the hypothesis that decision-makers in Ireland in the years preceding the economic crash had lower relative levels of conceptual complexity compared to decision-makers in comparable economies, and higher levels of in-group bias. The Chapter presents a research design to detect the presence of impactful decision-making biases 'in real time' as opposed to in painful hindsight, to inform crisis prevention and mitigation strategies. Employing the LTA technique, the research design provides a comparative content analysis of political leaders in Ireland and those in a group of western democracies in the years leading up to the most recent global economic crisis. Chapter 5 reports the results of the application of the content analysis research design to the utterances by eight Irish leaders in parliament. The results do not provide evidence to support the hypothesis that Irish leaders in the run up to the crisis had lower scores for conceptual complexity and higher levels of in-group bias, relative to the mean of a norming group of other Western leaders. This prompts the question as to whether these leaders were not in fact victim to irrational forces, or whether the LTA method is not suitable for detecting these forces. The Chapter closes with a preliminary investigation of this issue.

In light of the findings reported, Chapter 6 starts by offering a review of the LTA technique and the ongoing discussions concerning its validity and reliability. In an effort to contribute answers to some of the remaining questions in this matter, the Chapter proceeds with conducting an empirical analysis of all seven LTA leadership traits of British Prime Minister Gordon Brown and Irish Taoiseach (prime minister) Brian Cowen. Finally, on the basis of this and previous methodological analyses of the LTA, the Chapter draws conclusions and offers some guidance on more appropriate use of the method.

In moving from Part II to III, the thesis moves from the general to the specific and from a quantitative to a qualitative approach. In Part III, a 'most-likely' case is used to investigate the role interests, institutions, and ideology play in shaping decision outcomes. The research moves to a specific case of economic decision-making and the qualitative process tracing of a case-study of one such decision; the decision of the State in 2005 not to intervene to prohibit or limit the availability of 100 per cent loan-to-value (LTV) mortgages. This 'most-likely' case is selected to investigate the role of certain factors (interests, institutions, and ideology) in shaping a decision outcome.

Chapter 7 describes the research design to determine if and how the three factors impact on decision-making. This includes setting out the process tracing approach employed, the approach to case-selection, summarising why the selected case is suitable, and setting out the case study analysis framework that will be applied. The Chapter proposes a new framework for decision-making analysis which links the three factors of interests to the outcome of the decision.

The decision-making case study is set in and shaped by a particular decision-making environment. Chapter 8 identifies the main actors in the case (State/Government, Regulator, and banks), describes how they interact with each other, each with their own roles and objectives, and within a loose hierarchical structure. Chapter 9 then recounts the relevant events in Ireland leading up to the decision by the Government in November 2005 not to intervene to prohibit or limit the widespread availability of 100 per cent LTV mortgages.

These are the events to which the research design described in Chapter 7 is applied to reveal the extent to which interests, institutions, and ideology impacted on that decision, and to provide evidence of irrational decision-making.

Chapter 10 then reports the outcome of the application of the process tracing research design to the detailed case study. This augments the quantitative content analysis research into government decision-making in the run up to Ireland's recent economic crisis reported in Part II of this thesis. The final Chapter provides a discussion of the findings of the research as a whole and expands on how the learnings can help explain why decision-makers acted the way they did in the years leading up to the crisis. It also examines the prospects of developing a real-time method of detecting active irrationality among decision-makers with a view to improving crisis-prevention or mitigation strategies. The Chapter will also discuss how the learnings from behavioural economics, and what we have learned about how interests, institutions, and ideology impact decisions, can improve policy-making more generally (e.g. use of heuristics), and how the proposed framework of decision-making can improve outcomes.

1.4 Summary of Findings

The literature posited that leaders in Ireland fell victim to higher relative levels of irrationality, and particular forms of decision-making biases - behavioural convergence -, and that this can be tested using the leadership traits *conceptual complexity* and *in-group bias* as a proxy using the LTA technique. Contrary to the hypothesis, Irish leaders in the run up to the crisis had higher rather than lower scores for conceptual complexity, and exhibited lower rather than higher in-group bias relative to other leaders. This finding prompted the question as to whether the analysed decision-makers were not victims to irrational forces, or whether the method employed is not suitable for detecting these forces.

Several previous studies had explored the validity of LTA and this thesis added analysis to reveal whether the trait scores vary over time, and whether trait scores vary over time due to a change in the position that the leader holds (role), or the specific decision-making context the leader finds themselves in (state), or the nature of the content analysed to assess trait scores (source). The thesis finds that trait scores vary considerably over time, that role and state can have a significant impact on trait scores, and that the nature of the source (ad libbed versus prepared content) can also have a significant impact on scores. In addition, as the comparator reference group was based on a variety of sources, the research found that these groups may actually not be suited to assess leaders' scores in certain circumstances. Therefore, it is likely that the failure to uncover evidence of irrationality amongst Irish leaders before the crash is a consequence of the method employed. Every practical step possible was taken to eliminate alternative explanations for the failure to uncover evidence (role, state, and source) but these could not be ruled out. However, making the suggested amendments to the research design may make it possible for evidence of active, impactful irrationality among key decision-makers in the period before Ireland's crash to be detected using this quantitative method. This answers the first key question posed in this research.

Next, the role of interests, institutions, and ideology play in poor decision-making was investigated. A framework of decision-making analysis was proposed which linked the three factors of interests (interests, institutions, and ideology) to decision outcomes. This model is applied using a process tracing technique to a bad-decision case study, and the decision on 100 per cent LTV mortgages in 2005 provides evidence that the three factors all influenced the decision outcome. However, it was the combination of ideological and institutional factors that had the greatest negative impact. The dominant market ideology of the time, combined with the relative institutional standing of decision-makers, contributed to the poor decision outcome. That free market ideology raised the threshold to be met before intervention by the State was seriously considered, and coupled with the relatively low standing of the primary proponent of such intervention, meant a sub-optimal outcome was reached. Further, the process tracing evidence suggests that irrationality cannot be described as the primary cause of the poor outcome. The detailed information considered and discussed by decision-makers in the case, over a period of months, argues against impactful behavioural convergence or groupthink. Though many of the symptoms of such irrationality were present (selective bias in processing information at hand, poor information search, incomplete survey of alternatives) *within* institutional actors, *between* them there was detailed information exchange and deliberation.

The final Chapter brings all of these learnings together to help inform better policy-making and decision-making, and indicates scope for further research arising from this thesis.

Chapter 2: Decision-Making and Irrationality

2.1 The Behavioural Economics Approach

When decisions - and decisions on economic matters more specifically - go wrong, the factors shaping a leader's choice come under scrutiny. Nyberg (2010) zoned in on the beliefs of individual decision-makers who were in a position to take national policy steps to shape Ireland's economic fortunes. Nyberg concludes that *irrational forces* were one of the reasons those decision-makers in Ireland made poor choices (Nyberg, 2011: 94). Much of decision-making theory, indeed neo-classical economics as a field of study, is based on the notion of rational actors taking rational decisions to deliver the perceived optimal outcome for them ('expected utility'; see Bernoulli, 1738/1954). The behavioural economics approach arises from an examination the application of the 'rational actor / expected utility' theory in the real world and finds it to be an inadequate descriptive model. As Rick and Lowenstein put it:

> "Fortunately, many economists would view the [rational actor model] as outdated. This is largely attributable to the advent of "behavioral economics," a subdiscipline of economics that incorporates more psychologically realistic assumptions to increase the explanatory and predictive power of economic theory. The field first achieved prominence in the 1980s and has been gaining influence since then. And much of the thrust of behavioral economics has involved, or at least could be construed as involving, an enhanced understanding of emotions" - *Rick and Lowenstein, 2008: 139*

That is not to say that traditional or neo-classical economics is unaware of, or ignores the limits to rational human behaviour or the role of emotions in decision-making. It is a question of the weight given to the impact or influence of bounded rationality on decisions, despite being a theme which features in economic and political thought across centuries. For example, though most remembered for his work *The Wealth of Nations* published in 1776, Adam Smith's first book *The Theory of Moral Sentiments* (1759) proposed a theory that seems closer to behavioural economics than classical economics, where behaviour is the outcome of the struggle between what Smith termed the 'passions' and the 'impartial spectator'; in short "Adam Smith's world is not inhabited by dispassionate rational purely self-interested agents, but rather by multidimensional and realistic human beings" (Ashraf, Camerer, and Loewenstein, 2005: 131, 145). In 1848, John Stuart Mill warned of irrational behaviour in politics and his belief that individuals "lose some of their capacity for well-informed, thorough reasoning upon entering the political sphere" (Schnellenbach and Schubert, 2014: 3). Right through to Keynes in the 1930s, who wrote of ephemeral factors influencing markets, the impact of irrationality and human limitations were a feature of economics. In the 1940s Schumpeter wrote that an individual expends "less disciplined effort on mastering a political problem than he expends on a game of bridge ... Thus, the typical citizen drops down to a lower level of mental performance as soon as he enters the political field" (Schumpeter, 1942: 261-62; Schnellenbach and Schubert, 2014: 4) In this respect, Schumpeter foreshadowed Daniel Kahneman's work on attention and effort (2011). It was the work of Paul Samuelson from the late 1940s on that marked the rise to dominance by the rational actor model in economic thinking. The behavioural economics approach proposes an alternative account of decision-making, viewing Samuelson's neo-classical economics to be a useful normative model, but a poor descriptive one. The behavioural approach is based on the *bounded rationality* of the actor as they are subject to the irrational forces of behavioural biases. This term was first used by Herbert Simon in 1957.

> "The alternative approach employed in these papers is based on what I shall call the principle of bounded rationality: The capacity of the human mind for formulating and solving complex problems is very small compared with the size of the problems whose solution is required for objectively rational behavior in the real world — or even for a reasonable approximation to such objective rationality" - *Simon, 1957: 198*

Put simply, human emotions limit our ability to make purely rational decisions. In *Judgement Under Uncertainty* (1974), *Prospect Theory: An Analysis of Decision under Risk* (1979) and *Choices, Values and Frames* (1984), Kahneman and Tversky demonstrate the presence, impact and – most importantly - the predictability of irrational forces or decision-making biases. The consequence is poor decision-making in almost every area of life, from our failure to save or provide an adequate retirement pension (present bias), to our inclination to only heed advice which accords with our own (confirmation bias), to our tendency to put a higher value on our possessions than we would be willing to pay for them (endowment effect). A purely rational, actor would save more, provide for an adequate pension, would assess all advice equally on its merits, and would see no additional intrinsic value in the fact that an item is currently theirs.

Kahneman and Tversky examined these phenomena and what determines peoples' beliefs, and how, in circumstances of uncertainty, they rely on a limited number of *heuristic principles* (mental 'short cuts' or 'rules of thumb') to assess probability of outcomes, reducing complex tasks to simpler judgemental operations. When people are asked to assess the frequency of a class or the probability of an event, they do so by the ease with which instances or occurrences can be brought to mind. Reliance on these heuristics causes cognitive or behavioural biases in laymen and experts, and is not attributable to motivational effects such as wishful thinking, or the expectation of payoff or penalty. Kahneman and Tversky analysed decision-making in risky scenarios, demonstrating how their *prospect theory* (as opposed to utility theory) accounts for observed attitudes toward risk. Central to this are the *biases* of loss/risk aversion and loss/gain asymmetry where losses loom larger than gains and people experiences of losing an amount of a good appear to be greater than the pleasure associated with gaining the same amount. These theories are further extended in their later studies which demonstrated how decisions "can be described or *framed* in multiple ways that give rise to different preferences, contrary to the invariance criterion of rational choice" (Kahneman and Tversky, 1984: 341). In summary:

- **Heuristics** (mental short-cuts): Such as the availability heuristic where a decision-maker estimates probability based on the ease of which an instance comes to mind. For example, the length and extent of an economic bubble may make it more difficult for decision-makers (government, regulators, investors, borrowers/lenders etc.) to conceive of a crisis scenario.
- **Loss/gain asymmetry** (losses loom larger than gains): Where a decision-maker places more weight on a loss than on a gain of equivalent size. For example, during the emergence of an economic bubble, decision-makers may pursue increasingly risky financial practices to stave off, recoup, or delay losses.
- **Framing effects** (seemingly inconsequential variation in the presentation of choice impacts on preferences): For example, periods of rapid economic growth in a bubble provide benchmarks for data-comparison which impact on a decision-maker's expectations and perceptions of 'normality', risk and opportunity.

The attachment of significant weight to irrational forces in economic decision-making presents a challenge to the dominant utilitarian, rational choice perspective on economic behaviour, whereby an economic actor balances the costs against benefits of a choice and pursues the action to maximize advantage. Whereas the rational choice/utilitarian approach ignores the motivation for choice, the behavioural approach is very much concerned with why and how the actor estimates the cost and benefits, and the cognitive process that precedes the choice. The emergence of the behavioural approach has also contributed to challenges to economic syllabi and teaching in higher education particularly in the aftermath of the crash in 2008 (for example see the report of Post-Crash Economics Society at Manchester University, 2014). In regard to political decision-making, Simon was strident:

"the principle of rationality, unless accompanied by extensive empirical research to identify the correct auxiliary assumptions, has little power to make valid predictions about political phenomena" (Simon, 1985: 293).

The behavioural approach has been of increasing influence since the 1980s, particularly in the areas of behavioural finance (Barberis and Thaler, 2003) and so-called nudging approaches to policy (Thaler and Sunstein, 2008), with the list of empirically established behavioural biases growing over time (see Table below). The concept of irrationality and the impact of behavioural biases have been considered outside of the often abstract, though revealing scenarios of Kahneman and Tversky's ground-breaking analyses.

Bias	**Definition**
Extrapolation bias (Projection bias, Overinference)	When predicting future outcomes based on the past, placing more weight on the most recent events
Confirmation bias (Myside bias)	The inclination to place greater weight on and to actively seek information consistent with prior beliefs
Overconfidence bias (Over-optimism bias, miscalibration)	A tendency to predict outcomes too positively and to overestimate the accuracy of predictions
Ambiguity aversion (Aversion to Knightian uncertainty, Illusion of explanatory depth)	Greater willingness to take risks in contexts where people feel able to quantify the risk, or where people feel relatively competent in assessing the risk.
Behavioural convergence (Bandwagon effects, Herding, Information cascades, Conformity, Groupthink)	The tendency to copy similar decisions made by others, or conform to majority views
Time inconsistency (Present bias, hyperbolic discounting)	Systematic changes in individual preferences over time, whereby more immediate rewards become disproportionately attractive
Loss/gain asymmetry (Loss aversion, endowment effect)	Giving greater weight to losses than to equivalent gains, including willingness to take risks to avoid or recover losses

Table 2.1: Examples of established decision-making biases (from Lunn, 2013)

These concepts have generated popular best-seller publications such as Ariely's *Predictably Irrational* (2008) and *The Upside of Irrationality* (2010), which focus on how bounded rationality impacts everyday decision-making for individuals. Notwithstanding the focus of this research on the decision-making of a small number of political leaders, understanding how the irrational decision-making of individuals aggregates up to irrational markets is important. The lessons from Kahneman and Tversky's approach, and the concept of bounded rationality has led to a better understanding of market behaviour especially in explaining the emergence of market bubbles i.e. instances where expectations contribute to asset prices departing strongly and unsustainably from historical levels (McCarty, Poole, and Rosenthal, 2013: 14). The notion of individual irrationality aggregated to irrational markets has been used to explain assets bubbles going back as far as the "tulipmania" of 17th century Amsterdam which saw the reported prices of several breeds of tulip bulbs rise to above the value of a furnished luxury house (Thompson, 2006: 100). Irrationality has become linked to market bubbles to such an extent that Shiller (2005) recounts how the mere use of the words 'irrational exuberance' by former Chairman of the US Federal Reserve Alan Greenspan in a televised speech in 1996 precipitated sharp declines in stock markets across the globe (Shiller, 2005: 1).

1. The Dutch Tulip Bulb Bubble 1636
2. The South Sea Bubble 1720
3. The Mississippi Bubble 1720
4. The late 1920s stock price bubble 1927–1929
5. The surge in bank loans to Mexico and other developing countries in the 1970s
6. The bubble in real estate and stocks in Japan 1985–1989
7. The 1985–1989 bubble in real estate and stocks in Finland, Norway and Sweden
8. The bubble in real estate and stocks in Thailand, Malaysia, Indonesia and several other Asian countries 1992–1997
9. The surge in foreign investment in Mexico 1990–1993
10. The bubble in over-the-counter stocks in the United States 1995–2000

Table 2.2: The "big ten financial bubbles" (Kindleberger and Aliber, 2005: 9)

Regarding political decision-making, the behavioural economics approach has been applied most notably in the sphere of international relations. Herbert Simon, for one, linked the argument that 'leaders matter' to the fact that they do not necessarily act rationally (Hermann, 2010). Writing in 1985 on human nature in politics and the link between psychology and political science, Simon notes that the limitations of knowledge and computing power of decision-makers may make them incapable of making objectively optimal choices. To deduce the boundedly rational choice in a situation, we must know the decision-maker's goals, the information and conceptualisation he or she has of the situation, and their abilities to draw inferences from the information they possesses (Simon, 1985: 294). Simon's experimental studies of political decision-making indicated that rationality is bounded by how the people involved process information, what they want, the ways in which they represent the problem, their experiences, and their beliefs:

> "In effect, decision-makers do not have unlimited time, resources, and information to make choices that maximize their movement toward their goals. They satisfice, settling for the first acceptable option rather than pushing for ever more information and a more optimal choice. People are, at best, rational in terms of what they are aware of, but they can be aware of only tiny, disjointed facets of reality" - *Hermann, 2010: 2.*

Successive studies indicate that a leader's personal characteristics may have significant effects on political decision-making (Hermann, 1980a; Kaarbo and Hermann, 1998; Dyson, 2006; Schafer and Walker, 2006; Hermann and Dayton, 2009; Keller and Foster, 2012). Hermann recalls the contention of Snyder et al. that it is policy-makers who perceive and interpret events, and whose preferences become aggregated in the decision-making process that shape what governments and institutions do (Hermann, 2010: 1). Furthermore, when the people in governments change, a difference in perspective often occurs in parallel. Resonant with this research, analysis shows that there is a contraction of authority to those most accountable for policy in crisis situations (Hermann and Kegley, 1995; Boin et al., 2005). Preston (2001) and Beer, Healy, and Bourne (2004) illustrate that experience also appears to count as an important influence on how policy-makers interpret events, while policy-makers feel more comfortable and confident dealing with domains in which they have some expertise (Stewart and Stasser, 1995). Kowert (1996) takes issue with the assumption that personality theory has little to offer, an assumption which can lead political psychologists to direct their attention elsewhere.

> "Personality theory does allow for generalizable propositions based on variations in personality types. Such a statement may seem patently obvious to many psychologists, but it is not sufficiently appreciated with a few notable exceptions among political scientists" - *Kowert, 1996: 422*

The knowledge that leaders' personalities matter, that rationality is bounded and that decision-making is impacted by a leaders' conceptualisation and processing of information is central to this research. Of interest here is how the approach has enhanced the study of political decision-making. The rational actor theory of international relations has been challenged since the early 1970s with the publication of Allison's *Essence of Decision: Explaining the Cuban Missile Crisis* (1971). The influence of Kahneman and Tversky's analysis on political science is notable, and by elevating the presence and of impact of heuristics, loss aversion and framing effects on decision-making, behavioural economics has prompted more sophisticated understanding of how policy-actors behave. Kahneman and Tversky (1981) demonstrated how seemingly inconsequential changes in presentation (framing) of choice problems caused significant shifts in the preference of the decision-maker. In developing the *punctuated equilibrium* model of policy-change (see Chapter 7 also), Baumgartner and Jones (2009) have illustrated the importance of framing effects on political decision-making.

Perhaps most famous account of the impact of bounded rationality and the behavioural approach in the sphere of international relations is Irving Janis' exploration of the decision-making process in the run up to the 1961 Bay of Pigs incident. In his ground-breaking 1972 work, Janis revealed "a mode of thinking that people engage in when concurrence-seeking becomes so dominant in a cohesive in-group that it tends to override realistic appraisal of alternative courses of action" (Janis, 1982: 9) – in other words *groupthink*. A systematic treatment the phenomenon can be found in the second edition of Janis's book (1982), which "extends and above all systematizes the earlier formulation" (t' Hart, 1991: 256). Groupthink is the tendency of individuals when in groups to adopt the viewpoint of that group rather than to form an intellectually independent assessment, and is similar to *herding*, the more general tendency to follow other decision-makers. As Lunn states "herding and groupthink belong to a category of phenomena collectively termed 'behavioural convergence" (Lunn, 2013: 564, 567). This classification will be important later. Returning to the Bay of Pigs scenario, the Kennedy administration converged on one course of action, which proved disastrous. Janis termed the Bay of Pigs the "perfect failure" and in his second edition produced evidence of groupthink in additional international relations settings (wars in North Korea and Vietnam, and the attack on Pearl Harbour, and a case study of the Watergate controversy). In addition to these "cases studies of major fiascoes resulting from poor decisions" he provided two counter-point cases (Cuban Missile Crisis, the Marshall Plan), as examples of "well worked out decisions made by similar groups" (Janis, 1982: viii).

The groupthink concept has been employed to help explain fiascoes beyond politics and economics, such as the Challenger space shuttle disaster (Esser and Lindoerfer, 1989) and, more recently, the Fukushima nuclear power plant disaster (Reb, Iinuma, and Joshi, 2012). Groupthink has also become synonymous with other debacles such as the collapse of Swiss Air in 2001. However it is important to note that despite the widespread use of Janis' groupthink concept within and outside academic research it is not without its critics. Criticisms include the absence of a robust theoretical framework or precise causal sequence (rather it provides a set of antecedent conditions or symptoms), the difficulty capturing meanings of conditions (e.g. trust, anxiety), the challenge of assessment in real-life scenarios, the risk of hindsight bias from focussing on fiascoes, and the absence of a spectrum of case-studies groupthink decision outcomes (from success to disaster, and in between). See Park (2000) for empirical tests, and Baptist (2015) for a summary of criticisms.

2.2 Behavioural Convergence, Conceptual Complexity and In-group Bias

The preceding sections have set out the theoretical underpinnings for the contention that leaders and their decisions matter, that the learnings from behavioural economics can improve our understanding of how decisions are made and the impact of bounded rationality, and that these learnings have been applied to international cases. At this point, attention starts to turn to if and how groupthink can be measured in a useful way. Before dealing with the 'how' in Chapter 4, the remainder of this Chapter will deal with the 'if'.

Tetlock looked back at the diverse theoretical approaches taken from the early 1970s to "the problem of how psychological factors influence political decision-making" (Tetlock, 1979: 1314). From the study of unresolved psychological conflicts (Glad, 1973), the need for achievement and power (Winter, 1973), to the impact of cognitive consistency (Jervis, 1976), there has been an acceptance that political personal traits and predispositions can be measured. However, Tetlock noted that relatively few of the approaches to assessing personality traits considered exactly how interaction among policy-makers can influence decision-making. The one exception was Janis' groupthink approach, which argued that intense social pressures toward uniformity and in-group loyalty within decision-making groups can build to the point where they seriously interfere with both cognitive efficiency and judgement (Tetlock, 1979: 1316). This linkage between the group situation, social pressure, and an impact on cognitive information processing and judgment is an important element of the groupthink concept. This is because detecting and measuring behavioural biases in general is not a straightforward task, and the usual methods are unsuitable for the purposes of this research.

Typically, behavioural bias is detected in economic laboratory settings where groups of subjects are asked to make decisions in controlled and variable conditions to reveal the choices made and offer an explanation for these. Most of the biases listed in Table 2.1 were initially identified in economic laboratory experiments observing individuals in deliberately contrived, decision-making scenarios. For example, the earlier section referred to one of the criticisms of the groupthink concept being the challenge of assessing such behavioural conformity in real-life scenarios. This is apart from the theoretical and hindsight challenges.

The now famous experiments conducted by Solomon Asch (1951) to test for conformity behaviour involved a group of college students, some of whom are instructed to deceive others during an experiment in visual judgment, comparing the lengths of lines on cards. A more modern version of this assessment technique used functional Magnetic Resonance Imaging (fMRI) to investigate the neural basis of conformity, again in the face of erroneous information (Berns, 2005). While these are extreme examples, they do illustrate some of the challenges of assessing the presence or impact of decision-making biases. This is particularly true for this research as many of the actors of interest (decision-makers) can be well-known figures (nationally and internationally) who held positions of significant authority and esteem, and are thus unlikely to participate in typical experiments to assess conformity and behavioural convergence bias (e.g. card games with actors; fMRI examination). Further, typical experimental approaches are overt, where a covert approach is preferred, and are usually conducted 'after-the-fact', when assessment at the time of parallel consequential decisions are being taken is preferred here. To assemble psychological assessments for individuals who cannot be accessed directly, we require effective and efficient techniques, and because key decision-makers are often inaccessible to researchers, specific content analysis schemes have been developed (Young and Schafer, 1998: 86). This issue of how to assess at a distance will be explored in Chapter 4. For now the issue is what would be measured, were a suitable technique be available, given the difficulties set out above.

Preceding the rise of behavioural economics, a tradition in psychology of experimental studies to reveal, measure and categorise individual differences in cognitive tasks and information processing began in the 1950s (see Kozhevnikov, 2007 and Suedfeld, 2010 for summary). The rise of authoritarianism during and after World War II increased academic interest in 'how' as opposed to 'what' people think, in pursuit of explanations for such overtly rigid views. As Suedfeld notes:

> "'Ways of thinking' have long been considered as stable personality characteristics, although not always labelled that clearly. Intelligence, for example, is to a large extent a matter of thinking style, and it has hallmarks of many personality traits: it is quite stable across time and situations, affects behavior in a variety of ways, and has a strong innate component. The classic concept of authoritarianism, although based on the psychoanalytic theory of child development, clearly has cognitive implications. The thinking of people high in authoritarianism is characterized by rigidly held ideas, black-or-white evaluations, and a reluctance to consider alternative beliefs as legitimate. Other personality systems, some more and some less clear in their cognitive foundations, include dogmatism, field independence, personal constructs, explanatory style, need for cognition, and need for closure" – *Suedfeld, 2010: 1670*

As discussed earlier, Simon (1985) found that if we take into account the limitations of knowledge and computing power of decision-makers then we may find them incapable of making objectively optimal choices, and much will depend on the information available and conceptualisation of the decision-maker, along with their ability to draw inferences from the information they possess. Suedfeld states that in the course of the cognitive revolution in psychology during the 1960s, theory focused on 'complexity', "generally thought of as a combination of flexibility, high levels of information search, and tolerance for ambiguity, uncertainty, and lack of closure" (Suedfeld, 2010: 1670). As a result, the construct *conceptual complexity* emerged (Schroder, Driver, and Streufert, 1966). Tetlock's finding that the group situation and social pressure associated with groupthink had a direct impact on cognitive information processing and judgment is important here. Conceptual complexity is a construct proposed by Schroder et al. in 1966 to explain and measure how individuals behave and make decisions in various situations. Central to this approach is the assumption that it is not only *what* information is available to individuals when making decisions that is important, but *how* that available information is processed by the individual. For example, how does the individual perceive the different dimensions of the information and its alternatives, and the connections and trade-offs between them. Conceptual complexity is this "degree of differentiation which an individual shows in describing or discussing other people, places, policies, ideas, or things. The more conceptually complex individual can see varying reasons for a particular position, is willing to entertain the possibility that there is ambiguity in the environment, and is flexible in reacting to objects or ideas" (Hermann in Schafer, 2000: 521).

Young and Schafer (1998) outlined and assessed the "methodological arsenal" available to researchers attempting to assess decision-makers at a distance: *operational code*, *cognitive mapping, image theory,* and finally, *trait analysis*, which is the preferred approach for this research. Young and Schafer assessed each of these on the basis of the associated underlining theory, how the method makes inferences, and correspondence with observed behaviour. In summary, trait analysis to assess conceptual complexity and in-group bias is the preferred assessment method in this research because, as Young and Schafer note, it was developed to explain success in complex decision environments and it is a trait that differentiates among people as well as a variable that reflects changes in a person's situation, e.g. from stressful to less stressful. Given that the interest here is in the presence and effect of behavioural convergence bias, groupthink and herding, conceptual complexity trait analysis is particularly useful in that the more conceptually complex person will "see the world in more nuanced terms and...not react to any situation without gathering and processing contextual information" (Young and Schafer, 1998: 84). The opposite is true for a decision-maker displaying lower conceptual complexity at a point in time. Speaking of the findings of conceptual complexity studies in the sphere of international affairs, Young and Schafer state:

> "[C]onceptually complex leaders wanted to check with politically powerful others, to seek further information about the information at hand, and to consider a range of alternatives before taking action" - *Young and Schafer 1998: 85*

The corollary resonates with the findings of Nyberg in a national policy setting, and whether leaders in Ireland before the crash did not want to check with others, or seek additional information about information on the economy, and did not adequately consider the range of alternatives, options and contingencies before making decisions. Thus, the conceptual complexity construct is akin to the impact of groupthink in that it is related to the characteristic of the decision environment and considers the ability of an individual to process information (i.e. the information processing complexity exhibited by the individual) as a trait that can vary, and is impactful on decision-making. Unlike groupthink however, conceptual complexity can be more readily assessed. This makes conceptual complexity a valuable construct when attempting to assess the presence and impact of groupthink or behavioural convergence bias.

Low Conceptual Complexity	Symptoms of Groupthink
• Low desire to seek multiple sources of information concerning issues and policy options • Less readily able to change views on an issue in light of new evidence • Unable to see varying reasons for a particular position • Not willing to entertain the possibility that there is ambiguity in the environment	• Incomplete survey of alternatives and objectives • Failure to examine risks of preferred choice • Failure to reappraise initially rejected alternatives • Poor information search • Selective bias in processing information at hand • Failure to work out contingency plans

Table 2.3: Conceptual Complexity and Groupthink (Based on Hermann 1999, Dyson 2004, and Janis, 1982)

It is important to note that there are two components to the complexity construct. Conceptual Complexity (CC), used in this research, is a stable *trait* while Integrative Complexity (IC) is the *state* component which changes over time. See Suedfeld (2010) for more detail. Implications of the use of trait analysis in general, and the trait/state debate are discussed at length in Chapter 6. In addition to the theoretical linkages, conceptual complexity as a proxy for behavioural convergence bias offers and important practical advantage in that it allows psychological assessment of individuals who cannot be subjected to typical experimental techniques. Measurement of conceptual complexity moved from paragraph scoring using a 1-7 scale (Suedfeld and Rank, 1976), to guided interviews using a 25-point scale (Streufert and Nogami, 1989), to remote and automated techniques (Hermann, 1999).

Irrational Force →	Decision-making Bias →	Behavioural Convergence →	Groupthink →	Conceptual Complexity / In-group Bias

Table 2.4: Linkage between irrational forces, biases and traits

Ultimately, having a sense of a political leaders' level of conceptual complexity is only useful if helps explains the outcomes of decisions taken in that psychological context. To this end Schafer states:

> “Conceptual complexity has proven to have explanatory power for some state behaviors. Most notably, Hermann has demonstrated that lower conceptual complexity scores by leaders tend to correlate with more conflictual state behavior. In addition, low complexity correlates with higher risk propensities by the state, less reliance on diplomacy, and quicker commitments of state resources to a conflict. Others have argued that conceptual complexity correlates with the process of decision-making: More complex leaders will establish better and more open information processing during decision-making” - *Schafer, 2000: 522*

Again applying the opposite, that less complex leaders will establish suboptimal and less open information processing during decision-making, suggests a strong premise for conceptual complexity as a proxy for the symptoms of groupthink: incomplete analysis of alternatives and objectives, poor information search, failure to examine risks of preferred choice, failure to reappraise initially rejected alternatives, selective bias in processing information at hand, and a failure to work out contingency plans.

Finally a second leadership trait, *in-group bias*, has been developed to assess the degree to which a leader feels connected to their political, economic, social, cultural group, and how protective they are of their own in-group (Hermann, 1999). Decision-makers who display strong in-group bias are prone to only perceive the positive aspects of their group and to downplay weaknesses, and this can reasonably be assumed to be associated with behavioural convergence, groupthink and herding.

2.3 Hypothesis

Having established that theoretical link between groupthink, behavioural convergence, and leadership traits (conceptual complexity and in-group bias), it is now possible to describe how this helps address a central question: why did leaders in Ireland take the decisions they did, and to what extent was irrationality a contributing factor?

Many examinations of Ireland’s crash suggest that policy-makers in Ireland made poor choices, and that irrational forces were one, important cause. Based on the behavioural economics literature, it is clear that bounded rationality and behavioural biases offer a more accurate explanation for poor decisions by leaders in the years preceding Ireland’s crash, and that behavioural convergence bias manifested as groupthink and herding behaviour in particular, was present and impactful. It has also been argued above that in the face of the challenges of detecting bias in general and groupthink in particular, in a way useful to this research, the trait ‘conceptual complexity’ can proxy for behavioural convergence bias for assessment purposes. This assessment can be augmented by also looking at the extent to which a leader demonstrates in-group bias. Armed with a research design which illustrates the potential for content analysis to reveal levels of complexity and in-group bias (Chapter 4):

The hypothesis is that decision-makers in Ireland will have:

- *H1: lower relative levels of conceptual complexity compared to decision-makers in comparable economies, in the years preceding the economic crash, and*
- *H2: higher relative levels of in-group bias compared to decision-makers in comparable economies, in the years preceding the economic crash.*

The first of the two key questions for this research is whether evidence of active, impactful irrationality among key decision-makers in the period before Ireland's crash can be detected. The literature provides a firm basis for expecting such irrationality to be present, and for expecting the conceptual complexity and in-group bias traits to provide signals of this. Further, the literature prompts an expectation that these signals will be stronger when analysing leaders in Ireland, compared to results for other economies. In terms of fiscal cost, output losses, and increase in debt, Ireland's crash was the costliest crisis in advanced economies since the Great Depression (Laeven and Valencia, 2012: 20). Official and academic investigations of the cause of the crisis point to irrational consensus, hubris and groupthink. Part II of this thesis will provide a quantitative test of this, and the subsequent Chapters will examine the role of interests, institutions, and ideology in poor decision-making.

Chapter 3: Decision-Making, Ideology, Interests, and Institutions

3.1 The Role of Interests, Institutions, and Ideology

It is axiomatic that interests, institutions and beliefs matter in in shaping political decisions and outcomes. The sizeable empirical literature (see de Figueiredo and Richter, 2014 for an excellent summary) shows that *interest* group lobbying is pervasive, that the number or interest groups is positively correlated with macroeconomic activity, that politicians targeted by interests tend to be powerful allied agenda setters, that "who you know" matters, and that issue expertise may also matter to targeting. Tsebelis (1995) notes that while there is general agreement that political *institutions* matter, the consensus breaks down when it comes to the outcomes of specific institutional structures. Institutional structures impact on the likelihood of a certain regime types (e.g. democratic, authoritarian) arising in the first instance, or on the clarity of choice for the electorate, or on the distribution of political power (Tsebelis, 1995: 289-290). Even within authoritarian regimes institutions may matter, and there are strong arguments to support the view that party system structure, electoral rules, and the type of executive system have important consequences (Gandhi, 2008). The impacts of interests and institutions are linked to the presence, or otherwise, of a pervasive ideology.

As Feldman and Johnston (2014) note, the default operationalisation of *ideology* in scholarly research is as a continuum, ranging from socially liberal to socially conservative, or from the economic left to the economic right. Given the focus of this research on economic policy, the concept of ideology used here refers to the latter, with the left referring to an abstract belief in State action, intervention in the economy/markets and higher levels of government spending and taxation, and the right referring to a contrasting abstract belief in a laissez-faire policy approach, non-intervention by the State in economic affairs, and lower levels of government expenditure and taxation. The two important aspects of ideology are, first, that it is an action-related set of ideas, and second, that it leads to action which disregards circumstances. Ideology as a force which can lead to suboptimal policy decision outcomes, such as policy bubbles, emerges because these "abstract beliefs…constrain specific policy preferences" (Feldman and Johnston, 2014: 339). Importantly for decision-making, ideologies are the framework for how people interpret (new) data. An ideologically-driven policy actor may, for reasons of that ideology – including reference to poorly interpreted data – take action that proves detrimental to the wider group, or fail to take action which proves beneficial to that group.

Given the complexity of, and pace of change in, modern policy-making environments in which political decision-makers and interests sit, it is not surprising that long-established academic perspectives of decision-making and public administration (e.g. the bureaucratic-model; the top-down authority perspective) have been described as stale and apparently irrelevant to those they claim to study (Rhodes et. al, 2011: 1). To reinvigorate the field, new approaches to analysis of decision-making in the public service have emerged and these point to the influence of interests, institutions, and ideology, to varying degrees.

Kingdon's *multiple streams framework* (1984) considered decision-making with an emphasis on why some issues are processed by the governmental system, while others are not. The activity of interests is one explanation as agenda setting may involve the transfer of issues from a non-governmental agenda to a formal, governmental agenda (Kingdon, 2014: 16, 45-70). Alternatively, decision-making maybe impacted by a change in ideological balances on foot of an election. Finally, institutional factors such as the role of officials in the executive branch of government have been shown to be important for agenda setting (Kingdon, 2014: 30).

While accepting that the decision-making environment is both complex in terms of the multiplicity and non-linearity of actions, and is capable of learning from previous decisions and adapting behaviour, *complex adaptive systems* (CAS) theory also notes the influence of the factors important to this research. For example, reform of public administration in the last thirty years has resulted in a plethora of actors and interests with heterogeneous motives interacting in policy and decision-making, leading to highly variable results and a limited ability to hold any one organisation to account (Rhodes, 2013: 332). In terms of the rules of the game and Ireland's public policy decision-making environment, CAS theory also recognises how rules emerge from the interaction of those interests or "system stakeholders" (Meek and Rhodes, 2014: 25).

In explaining their *punctuated equilibrium* model of policy-making, Baumgartner and Jones (2009) give central importance to the role of institutions which, when in place for extended periods, structure participation and give the illusion of equilibrium. They link institutions and interests closely noting that this equilibrium helps create policy-monopolies and a political and economic system which appears to provide continuing benefits to the same group of interests.

> "Institutional rules inevitably have policy consequences, which is why seemingly arcane decisions… so often become the subject of intense debate. Changing the procedures of decision-making often has unintended consequences however; policy-makers are therefore generally conservative in altering them" – *Baumgartner and Jones, 2009: 14*

This final point is exemplified in the Irish context in the design of regulatory institutional structures (see Chapter 8). Overall, for Baumgartner and Jones the policy-making environment can be explained with reference to the impact of *institutions* ('venues") and *interests* ('policy communities'), in parallel with *irrationality* (framing). Chapter 2 outlined how framing, along with the use of heuristics and the prevalence of loss/gain asymmetry, can impact on preferences and decisions. In the punctuated equilibrium model, the urgency and mobilisation that precedes a sudden policy-shift is linked by Baumgartner and Jones to bounded rationality and framing effects. In these cases, information which was previously available may be redefined or reinterpreted and thus contribute to policy-change.

Analysis of Ireland's public policy system specifically, has noted the impact of interests, institutions and beliefs/ideology on decision-outcomes (Murphy, 2010 and 2016). In terms of interests, Rhodes and Boyle (2012) refer to the importance of the *elite perceptions* in shaping public service activity and reform. With the declining influence of the church in Ireland, a new group of business elites with access to the highest levels of government emerged, joining the construction industry which had long been a feature of Irish governance. Finally, the institutionalisation of interests in the social partnership process gave significant power to labour interests (Rhodes and Boyle, 2012: 42).

In terms of policy failures, analysis over decades has highlighted the impact of interests, institutions and beliefs/ideology in shaping policy outcomes. In his examination of decision-making in democratic politics, Jones refers to how governments respond to interests noting that "the actual range of policies is far narrower than the variability of preferences or interests in society" (Jones, 1994: 20). Jones states that the pervasive nature of satisfying interests is evident from, for example, studies of legislative representation where the policy decisions of leaders are compared to the preference or attitudes of interests on issues of the day. In parallel, institutions play a crucial role. In an effort to address the mismatch between policy complexity and limited evaluative resources, "institutions may be designed to achieve but one aim, and when they confront the contradictory demands that are part and parcel of governance, they may fail" (Jones, 1994: 20). In another analysis, Nutt includes interests – in the form of unmanaged social and political forces – as one of the seven "traps" which lead to decision failure:

> "Successful implementation calls for the understanding and careful management of peoples' interests. If these interests can be uncovered and understood, the social and political forces that the interests stir up are usually manageable" – *Nutt, 2002: 87*

Turning to the role of the three selected factors on bubbles and crashes, Grossman's analysis of nine policy "disasters", including the most recent economic crisis, finds that the related policy mistakes "had one thing in common: they were based on ideology rather than sound economic analysis" (Grossman, 2013: xvii). In his analysis, this results in decision-makers clinging to one "key idea" as their only guide to economic policy. Grossman, in one example, points to the ideologically-driven, (self-)interest driven tax-reduction policy pursued in the US in 2001 as signalling the start of the business cycle expansion that led to the global crash in 2007/08. This was followed by a fiscal stimulus provided via a doubling in military spending to $595 billion, supporting ideologically-driven military action in Iraq and Afghanistan (Grossman, 2013: 141-142).

McCarty, Poole, and Rosenthal (2013) present the most succinct framework, arguing that it is the impact of interests, institutions, and ideology specifically, that sees successive governments facilitate dangerous policy and market bubbles. First, the role of interests in policy-making and bubbles goes beyond the 'few bad apples' theory which politicians must stick to in public, and into "legally and ethically dubious behaviour in generating…crises" (McCarty, Poole, and Rosenthal, 2013: 72, 73). Interest groups influence decision-makers by mobilising constituencies, direct expenditure on electoral campaigns, and the production and provision of information. For elected decision-makers, constituent mobilisation is a constant consideration, and whether out of their interests or out of self-interest in being re-elected, a policy-maker may make poor decisions.

For political leaders, voter preference is key and in the US, for example, workers in the financial sector, compared to a general population of survey respondents, are more likely to vote, are more likely to try to influence other voters, are more likely to attend an electoral campaign event, and more likely to work on an electoral campaign (University of Michigan, 2004). While it is arguably a more important consideration in the US, there is little doubt that the campaign funding boosts interest group influence among policy-makers (McCarty, Poole, and Rosenthal, 2013: 81).

Perhaps of greater concern is the point regarding information and lobbying, and the impact on the decision-making process. Similar to the impact of institutional policy-delegation (see below), “most of the time [decision-makers] depend on outside lobbyists and interest groups for information about the consequences of policy choices” (McCarty, Poole, and Rosenthal, 2013: 85). This information asymmetry is exploited by interest groups, who have little incentive to suggest or support policies which can contribute to the medium-term benefit of the economy or society, but rather focus on their short-term advantage.

In Ireland, one of the most prominent, and ultimately damaging, examples of linkages between decision-making and sectoral interests was the move to so-called “relationship banking”. The Nyberg Commission noted the reliance on relationship banking for growth by Anglo Irish Bank and Irish Nationwide Building Society. These financial institutions provided loans to a limited number of entrepreneurs operating in the riskier parts of the property market, found it difficult to decline a loan to any of its top customers, and allowed loans that were not supported by strong or sufficient cash flows or collateral to be frequently reinforced by personal guarantees, which were either unsupported by assets free of debt, or supported by equity in other property (Nyberg, 2011: ii and 32). The banks were dependent on a small number of interests, the Central Bank was dependent on those same banks for information, regulators were dependent on information from the Central Bank, and government decision-makers were dependent on information from the regulators. In addition, “the pattern of tax cuts left revenues increasingly fragile [and] dependent on taxes driven by the property sector” (Nyberg, 2011: 5), leaving government budgetary policy dependent to a large extent on a small number of interests.

Second, the problems arising from the impact of interests (and ideology) are compounded by decision-makers having to “create policies within institutions that are resistant to policy change” (McCarty, Poole, and Rosenthal, 2013: 90-116). Obviously, sound policy-making in general and bubble-avoidance in particular, requires policy change and institutions that facilitate such change. In the case of the US, the suggested institutional arrangements which hinder rather than facilitate positive decision-making and policy outcomes include fragmented political power, frequency of national elections, small, single-member electoral districts, and parliamentary procedures. In addition, McCarty, Poole, and Rosenthal point to the impact of levels institutional knowledge on decision-making. It is a truism that the greater the extent to which a leader, government and parliament lacks information or expertise on critical issues, the greater the probability of poor decision outcomes. Institutional arrangements can have a significant bearing on information flows, and levels of expertise. For example, where the nuts and bolts of policy are delegated to regulators, it is harder for governments to distinguish between bad policies and poor implementation (McCarty, Poole, and Rosenthal, 2013: 112-114).

In Ireland, both the institutional set-up (the Social Partnership model) and the information/expertise deficit arising from institutional and regulatory arrangements (the relationship between the Financial Regulator, Central Bank of Ireland, and the Department of Finance) all contributed to Ireland's crisis. The Irish government's budgetary process was "completely overwhelmed" by the Social Partnership model (Wright, 2010: 5), while "key facts which should have been of central interest to supervisors (e.g., on bank governance) were not available to policy-makers in a timely manner at the point where the crisis began to unroll" (Regling and Watson, 2010: 40).

Third and finally, for McCarty, Poole, and Rosenthal's framework, the final seven words of the Oxford English Dictionary's definition of ideology are particularly telling; ideology is defined as a "systematic scheme of ideas, usually relating to politics or society, or to the conduct of a class or group and regarded as justifying actions, especially one that is held implicitly or adopted as a whole and *maintained regardless of the course of events*" (2013: 15; emphasis added). In other words, despite events and information suggesting a particular course of action, one which may be optimal, ideology can justify alternative, erroneous action or inaction. Ideology can be viewed as one of many heuristics through which irrational human beings try to make sense of the world, and it has been argued that this appears to be more prevalent among relatively well-informed elites, who are trying to make sense of more information: "To blame a regulator's ideology for a regulatory mistake is merely to emphasize that regulators, like entrepreneurs, depend on theories to guide their actions. Ideologies provide them" (Friedman, 2009: 157). Further, the ideological identity and brand of the group or party of which a decision-maker is a member may be so strong that taking a decision which runs contrary to that ideology may be politically harmful to that decision-maker.

For McCarty and colleagues, ideology is synonymous with irrationality but under the model employed here, they are variables independent of each other either or both of which can impact on the decision-outcome (dependent) variable. Ideology, as defined earlier, is a systematic scheme of ideas regarded as justifying actions that is held implicitly or adopted as a whole, and maintained regardless of the course of events. This is in contrast to irrationality, which is not something one voluntarily holds or adopts, but rather is a consequence of our human make-up. Being human makes us, to use Ariely's famous phrase, predictably irrational but it does not make us ideological.

For McCarty, Poole, and Rosenthal, ideology played a central role in the political bubble which surrounded the recent crash in the US; it is "a basic set of beliefs about how the world works and about what is right or wrong" (McCarty, Poole, and Rosenthal, 2013: 38). For example, if the onset of the financial crisis prompted a government to move towards increased regulation, the legislature would immediately amend appropriate laws and structures. Ideology, however, limits the force of this channel of action. The abstract example they provide to explain the impact of ideology on economic policy is remarkably relevant to the actual events in Ireland in the decade preceding the crash there:

> "In certain contexts, pragmatists and ideologues alike might agree that lowering tax rates is a good idea. But a pragmatist would want assurances that lowering tax rates is a good idea…The pragmatist would also understand that context matters. Lowering taxes when taxes are high is quite different form lowering taxes when taxes are low…Conversely, an ideologue may want to lower taxes because she believes that lowering taxes is inherently a good thing to do….The fifth tax cut is just as valuable as the first four" - *McCarty, Poole, and Rosenthal, 2013: 39*

Tax reductions are a telling example of how ideology can contribute to a policy bubble. The changing structure of the tax system in Ireland from the 1990's to 2007 presents an instructive example of dynamic policy-making, where a policy-shift on taxation originally occurred to influence economic behaviour and outcomes, grew in response to positive feedback through the 2000s and burst in 2007, some four years after its instrumental value, and four years after, moved from being a strength to being a weakness.

As the later section illustrates, an underlying issue in the period up to Ireland's crash in 2008 was the development of an imbalance in the fiscal policy strategy: "the Government made policy decisions which directly contributed to erosion of the tax base" (Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 162). Between 1994 and 2007, the share of income tax as a proportion of total tax revenues fell from 39 per cent to below 30 per cent. These tax reductions were driven in part by an ideological shift in policy, manifest in the electoral success of the Progressive Democrats and their participation in successive coalition governments. The tax cuts were made possible by gains in other, transient/transactional sources of revenue (Stamp Duty, CGT and VAT). Over this period the Government's finances and consequently, their entire macroeconomic tax and expenditure model became increasingly dependent on, and vulnerable to, maintaining stability in the construction and property sectors, leaving itself open to increased vested interest activity.

The official investigations into the crash also flagged up the role interests, institutions, and ideology in Ireland's case. One investigation highlighted the impact of interests and institutions in its conclusion that effective policy in the potential bubble was lacking as a consequence of the "deference and diffidence" displayed by policy-makers (Honohan, 2010: 12). Another pointed to the impact of firmly held ideological beliefs when it found that the crisis emerged from a naïve belief in "paradigm of efficient financial markets" amongst decision-makers (Nyberg, 2011: 94 and 95). It would not be correct, of course, to claim that interests, institutions, and ideology were the only contributory factors in Ireland's (or perhaps any) political and economic babble. Casey (2010) places an emphasis on the cultural context in which decisions are made, concluding that this was important in precipitating what he terms "Ireland's malaise".

3.2 Economic and Political Bubbles: An Example from Ireland's Tax Policy

In 2016, the official parliamentary inquiry into the crash noted the significant powers conferred on political leaders by the Constitution, to make far-reaching decisions without any prior engagement with the Oireachtas and that prior to the crash, Government made policy decisions not always accepting the advice given to them (Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 13). Poor economic policy emerged despite advice which if acted upon may have mitigated the subsequent crisis (e.g. action to address declining national competitiveness). Ireland's bubble and over-heated property market occurred in a time of unprecedented economic expansion, encouraged by pro-cyclical fiscal policies, individuals' investment errors, banking and regulatory errors, and poor political decisions. That bubble was both economic and political.

The familiar boom-bust cycles occur when "business cycles – the periodic, normally moderate swings in economic activity – become exaggerated, leading to excessive economic expansion followed by a dramatic collapse" (Grossman, 2013: xix). An economic bubble is a generic term for the unsustainable increases in asset prices in the "mania phase" of this economic cycle (Kindleberger and Aliber, 2005: 12) and there are many notable examples in history (see Table 2.2). A political bubble is the range of policy decisions that promote and exacerbate bubbles in economic markets and precipitate economic crises such as Ireland's in 2007/08. Both economic and political bubbles have a pro-cyclical character. A political bubble is "a real and/or perceived policy overreaction that is reinforced by positive feedback over an extended period of time" (Maor, 2014: 469). Economic and political bubbles are linked, have "marked similarities" and coincide for three reasons: both are fuelled by the greed of interests, both are strongly influenced by the rules of the game, and both rely on specific sets of beliefs (McCarty, Poole, and Rosenthal, 2013: 14-17).

Ireland's taxation regime from 1987 to the crash twenty years later provides an example of the link between policy and economic bubbles. The key reasons behind the emergence of Ireland as the so-called Celtic Tiger have been the subject of much study (Nolan, O'Connell and Whelan 2000; Barry 2003). Accession to the European Union (EU) in 1973 or even earlier events, such as the end to protectionist economic policies in the 1950s, can be cited in such analysis as marking a turning point. But, as Barry notes, "Ireland did not deviate much from around 60 per cent of the level of national income per head in the UK (the country's single most important trading partner) between 1913 and 1985" (Barry, 2003: 1).

In the decade up to 1987 the Irish government's broad macroeconomic policy approach gave primacy to the "one-sector small open economy" perspective which held that all sectors of the economy produced goods and services that Ireland could export in unlimited quantities at given world prices (Honohan, 1988). The consequence was the belief by government that balancing the budget could as easily be achieved by raising the taxes paid by individuals as by the more politically-difficult method of cutting spending, that any necessary financial adjustment could be achieved without negatively impacting on unemployment, that public sector job losses could be avoided, and that the impact of taxation on wages and the cost of doing business was not of great importance (Barry, 2003: 7). As a result levels of taxation rose sharply to service the government debt resulting from unchecked spending. To illustrate the heavy burden on individuals, Walsh notes that by the late 1980s a worker in a company that was paying less than 10 per cent tax on its profits was herself paying tax (including social security) at a 75 per cent rate, along with very high rates of VAT and excise duties (Walsh, 2010: 670). Public debt hit crippling levels (133 per cent of GDP in the early 1980s) and by 1985 personal income tax made up 31 percent of tax revenue, up from 18 per cent in 1965 and 25 per cent in 1975 (O'Connell and Rottman, 1992: 227). This policy approach failed. By 1987 the unemployment rate soared to 17 per cent even though emigration exceeded 40,000 people.

A number of events aligned in 1987 which signal that period as a turning point in Ireland's economic fortunes. These include the impact of improved flows of foreign direct investment in preparation for the Single European market, the devaluation of the currency in 1986 making exports cheaper and imports more expensive, positive working-age demographics, the supply of relatively low cost labour, a boost of exports to the UK as a result of a shift in economic approach there (lower taxes, higher consumption), the onset of the more corporatist approach to policy making with social partners, the impact of deregulation in the aviation sector on visitor numbers, and the prospect of significant transfers via structural funds from the EU (valued at as much as 3 per cent of GDP per annum).

Another important event was the adoption of a new fiscal strategy of cuts to both spending and taxation, in 1987, a strategy pursued by a minority government with the support of the main political opposition and in the context of the aforementioned social partnership model. Spending cuts hit State capital investment, public service pay and numbers, and current expenditure by State bodies, all of which provided the resources for changes in taxation. Economic theory links changes in taxation to growth through their influence on the decisions of economic agents. Taxation – in theory - changes economic decisions and can thereby affect economic growth through its impact on disposable incomes, public consumption of goods and services, and the demand for (and hence supply of) infrastructure, all of which impacts positively on the demand for labour and boosts government revenues. Moderating labour costs via reduced income taxes places downward pressure the cost of doing business which makes goods and services more competitive for export, and Ireland more desirable as a location for mobile investment. In addition, allowing workers to keep more of what they earn boosts productivity, with high personal income taxes empirically shown to be more detrimental to growth than consumption, environment and property taxes (OECD, 2009; Prammer, 2011). As Whelan puts it, at a time of deep crisis, Ireland was in fact "primed for growth" with its workers were becoming increasingly productive, yet the population as whole was significantly under-employed (Whelan, 2013: 3). In a bid to exploit this, a new approach was set in train.

The government's *Programme for National Recovery*, published in 1987, said that Ireland would "rapidly reach the stage where two-thirds of taxpayers pay tax only at the standard rate", placing the strategy firmly in the context of economic growth, stating that after four years of high taxation, high unemployment and high emigration, Ireland needed better management of the economy and the burden of taxation must be reduced. In the first year of this new fiscal strategy fresh measures saw 93,000 taxpayers who would otherwise be liable at the 48 per cent rate pay tax at 35 per cent. In addition, 55,000 taxpayers who would otherwise be on the top rate of 58 per cent would now have a marginal rate of 48 per cent. Sixteen thousand taxpayers were taken out of the tax net altogether, while a further 5,000 became entitled to marginal relief. Taken together, the approach meant that nearly 63 per cent of taxpayers would be paying tax at the standard rate in the first income tax year following the adoption of the new fiscal strategy. The taxation policy bubble of interest thus formed in Ireland 1987 to positively influence economic behaviour and outcomes in the face of the dire economic circumstances outlined above. The government saw economic growth as a precondition for employment growth and an improvement in living standards in Ireland.

The impact of the new fiscal strategy adopted in 1987, with tax changes at its core, generated great cause for optimism and confidence, and the supply of this policy increased in response to positive feedback through the 1990s. Gross National Product rose from €24 billion in 1986 to almost €34 billion in 1991, personal consumption of goods and services increased from €17 billion to €23 billion over the same period, and the interest on national debt finally levelled off in 1990 after soaring over the previous fifteen years[1]. By 1989 the deficit had dropped below 3 per cent of GDP, never to breach this level again until 2008, and the debt ratio had fallen below 100 per cent (O'Leary, 2010, 3).

[1] Author's calculations based on data from the Central Statistics Office.

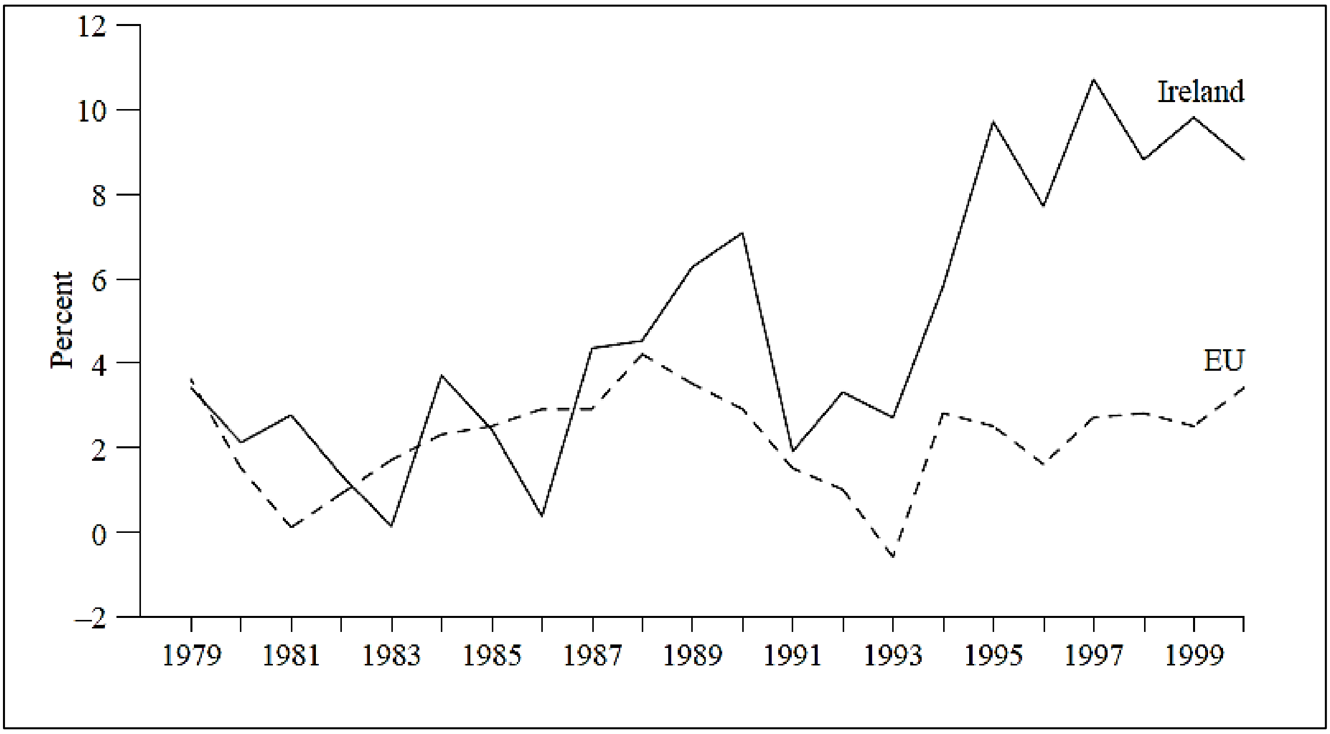

Figure 3.1: GDP Growth Rates, Ireland and EU, 1979 – 1999 (Walsh, 2010: 661)

Walsh correctly views 1989 as significant for Ireland with, as illustrated above, the country clearly outperforming the rest of Europe from this point on (Walsh, 2010: 660). The positive feedback emerged not only from the economic data but from the polling booths also. Fianna Fáil, the incumbent minority government which adopted the new fiscal strategy in 1987, was re-elected to government as part of a coalition in 1989, and in all was returned as the largest party in government from 1987 to 2011 bar a short period from 1995 to 1997. The bubble-inflating feedback from the electorate was unsurprising given that the fiscal strategy and policy supply it produced allowed successive Fianna Fáil-led governments to institute income tax cuts accounting for about one-third of the rise in real take-home pay between 1987 and 2003 (Barry, 2003: 13).

In 1989, the new government continued with its approach to tax policy in pursuit of growth committing to reduce the standard rate of income tax to 25 per cent by 1993 and move towards a single higher rate of tax. In 1993, the next government made a priority of removing the low paid, especially families out of the tax net altogether, to broaden the standard tax band so that only relatively high earners pay the higher rate of tax, and to further reduce rates, especially the standard rate.

In their analysis of the crisis on behalf of the Irish Government, Regling and Watson found that despite the consequences being clear in the second half of the 1990s, policy instruments such as fiscal and income policies were not used to offset the well-known expansionary effects of European Monetary Union membership on the macroeconomic environment, and in fact, tax policies "fuelled the fire" (Regling and Watson, 2010: 24). In its programme for the years following an election in 1997, the government stated that it recognised the need to reduce the burden of personal taxation in order to reward effort and give people an incentive to take up work, committing to reduce the basic rate of income tax to 20 per cent and the higher rate to 42 per cent over the next five years. If economic circumstances permit, the objective was to reduce the higher rate to 40 per cent by 2002. Basic allowances were to be increased, and rise by at least the rate of inflation at each Budget.

The perceived gains from this supply of a low personal taxation policy continued through the 1990s and into the 2000s. As O'Connor notes (citing Kirby and O'Connell and Russell), "Ireland became a blueprint economic miracle held up to other countries as a model to emulate. This was based on the rapid level of economic development achieved since the mid-1990s. Ireland's average GDP growth from 1990 to 2004 was a stunning 6.37 per cent per annum. In 2003, Ireland's GDP per capita stood at 133 per cent of the EU25 average. There was also a staggering increase in employment. From 1993 to 2004, employment levels jumped from approximately 1.18 to 1.84 million, an increase of over 650,000 at work in slightly over ten years" (O'Connor, 13: 2010).

Upon election in 2002, the new government pointed to the dramatic reductions in taxation in the preceding years, yet committed to sustaining economic growth and maintaining full employment by *inter alia* keeping down personal and business taxes in order to strengthen and maintain the competitive position of the Irish economy in the period leading up to 2007. Their stated priorities with regard to personal taxation were to achieve a position where all those on the national minimum wage were removed from the tax net, and to ensure that 80 per cent of all earners paid tax only at the standard rate. In addition, if the economic resources permitted, the government would use the potential of the tax credit system to effectively target changes and to pursue further improvements in the income tax regime.

Average economic growth in Ireland exceeded 6 per cent between 1987 and 2007, the numbers at work almost doubled from 1.1 million in 1987 to 2.1 million in 2007, and the unemployment rate plummeted from 17 per cent to 4.5 per cent over the same period (Commission on Taxation: 2009, 71). The nature of employment growth also signalled something of a simultaneous societal shift with non-agricultural employment jumping from 33 per cent of workers in 1993, 41 per cent in 2000, and 46 per cent by 2007 (Honohan, 2010: 21). It is true that establishing cause and effect vis-à-vis the government's programme of tax reduction and economic growth is challenging, and the subsequent boom cannot be described as having been caused by tax cuts alone. However, there is a coincidence on the timing of an adoption of this new fiscal strategy and an inflection point in economic progress.

Ireland was demonstrating all of the attributes to modernity, convergence and affluence and the positive feedback created the ideal conditions in which a policy bubble can grow. The initial optimism and confidence spawned by the new fiscal policy from 1987 turned into something more dangerous in the new millennium. As Maor notes, "for a policy bubble to grow, over-optimism and overconfidence should propel the process of positive feedback. Overconfidence and optimism of policy-makers may trickle down from policy-makers to the general public (or vice versa), whose appetite for risk and high expectations may lead to a gradual inflation of the bubble" (Maor, 2014: 476).

The notion of the policy bubble implies a tipping point where policy moves from being accurately valued and supplied at appropriate levels, to being over valued and over-supplied, leading to overreaction. O'Leary (2010: 4) speaks of "two phases of the long Irish boom... roughly divided by the millennium year". Identifying the precise year of the tipping point in the case of Ireland's taxation policy is perhaps futile and certainly challenging. Nevertheless, it is possible to estimate at what stage tax changes ceased to yield sustainable gains to the Irish economy and started to present a risk to the public finances. A proposed estimate here is that tipping point to have arrived just prior to, or in, 2003. The centrality of this policy bubble and overreaction in terms of tax policies to the later crisis in Ireland is clear from one of the official reports:

> "Much of the reason for the revenue collapse lies in the systematic shift over the previous two decades away from stable and reliable sources such as personal income tax, VAT and excises towards cyclically sensitive taxes. Revenue became increasingly dependent on corporation tax, stamp duties and capital gains tax (in that order); the contribution of these taxes to total tax revenues rose steadily from about 8 per cent in 1987 to 30 per cent in 2006 before falling to 27 per cent in 2007 and just 20 per cent in 2008. The steady growth in revenue from the above ―fair weather taxes during the two decades from 1988 – with only two brief hesitations in 1993 and 2001-02 – created a false sense of security as to their sustainability and induced policy makers to take advantage by narrowing the base of the personal income tax and lowering rates. The latter did help buy wage restraint but left the budget seriously

> exposed to a downturn. Had the tax structure been less cyclically sensitive, the fall in revenue in 2008 would have been much lower" - *Honohan, 2010: 29*

While today the size and broad distribution of the tax burden across tax types in Ireland is not greatly out of step with other EU countries (O'Connor, 2013: 538), this was not the case in the early 2000s. As the policy overreaction took hold and continued to be over-supplied in response to the positive feedback, historical tax revenue data shows the trend of increased reliance on taxes on capital with a reduced reliance on taxes on income and spending (Commission on Taxation, 2009: 74). The data points to 2003 as the time, the tipping point, whereby the contribution of income tax to overall revenues became too low relative to other components such that continuing to supply the policy placed the economy in jeopardy, as opposed to bolstering or propelling growth. From 1999 to 2002, Ireland reduced the total tax burden across the board from 32 per cent to 28 per cent of GDP, though in a context of expanding GDP.

It is worth highlighting a point O'Leary makes about this period in Ireland: "there is a widespread perception that the period from 2000 to 2007 was one during which taxes were greatly reduced in Ireland. Actually, this is not the case. It is true that some taxes were reduced, but the overall tax burden remained unchanged. What defines the period rather better is the big shifts that occurred in the *composition* of tax revenue and the extent to which the *income tax* base shrank" (O'Leary, 2010, 5, original emphasis). By 2001, the new fiscal strategy had been in place for fourteen years and budget of that year implemented a package of tax cuts equivalent to 1.4 per cent of GDP. This was followed by two budgets in which taxes were raised: by the equivalent of 0.5 per cent of GDP and 0.7 per cent of GDP respectively.

Nevertheless, by 2003 the proportion of the Irish State's tax revenue coming from personal income tax (expressed as a percentage of GDP) fell to 7.7 per cent. It had been 9.4 per cent in 2000. By 2003, as Honohan puts it, the reliance on taxes that could only generate sufficient revenue in a boom, had made public finances highly vulnerable to a downturn. (Honohan, 2010: 20).

The taxation of individuals fell steadily from 1998 to 2002, from over 12 per cent of GDP to 7.4 per cent, at a time when GDP was rising rapidly. Although it rises slightly, taxation of individuals was at 8 per cent when the crisis broke and only rose sharply in response to the crash. This was the result of a process that began in 1987 and by the mid

1990s really took hold. The top personal income tax rate in Ireland went from 48 per cent in 1995, to 46 per cent in 1998, to 44 per cent in 2000, to 42 per cent in 2001, and to 41 per cent in 2007. As O'Leary finds "just as there was a more or less secular increase in the share of capital taxes and stamp duties in total revenue from the mid-1990s, so there was a secular decline in the share of income tax in the total. It fell by about 10 percentage points over this period" (O'Leary, 2010: 6).

Yet, in 2005 the government introduced another tax-cutting package which reduced taxes by the equivalent of 0.4 per cent of GDP, another in 2006 which did likewise, and yet another in 2007, cutting taxes by a net 0.6 per cent of GDP in the year preceding the boom. Whereas across the EU in 2007 over 45 per cent of tax on average came from taxing labour, in Ireland it was 34 per cent (Commission on Taxation, 2009: 75).

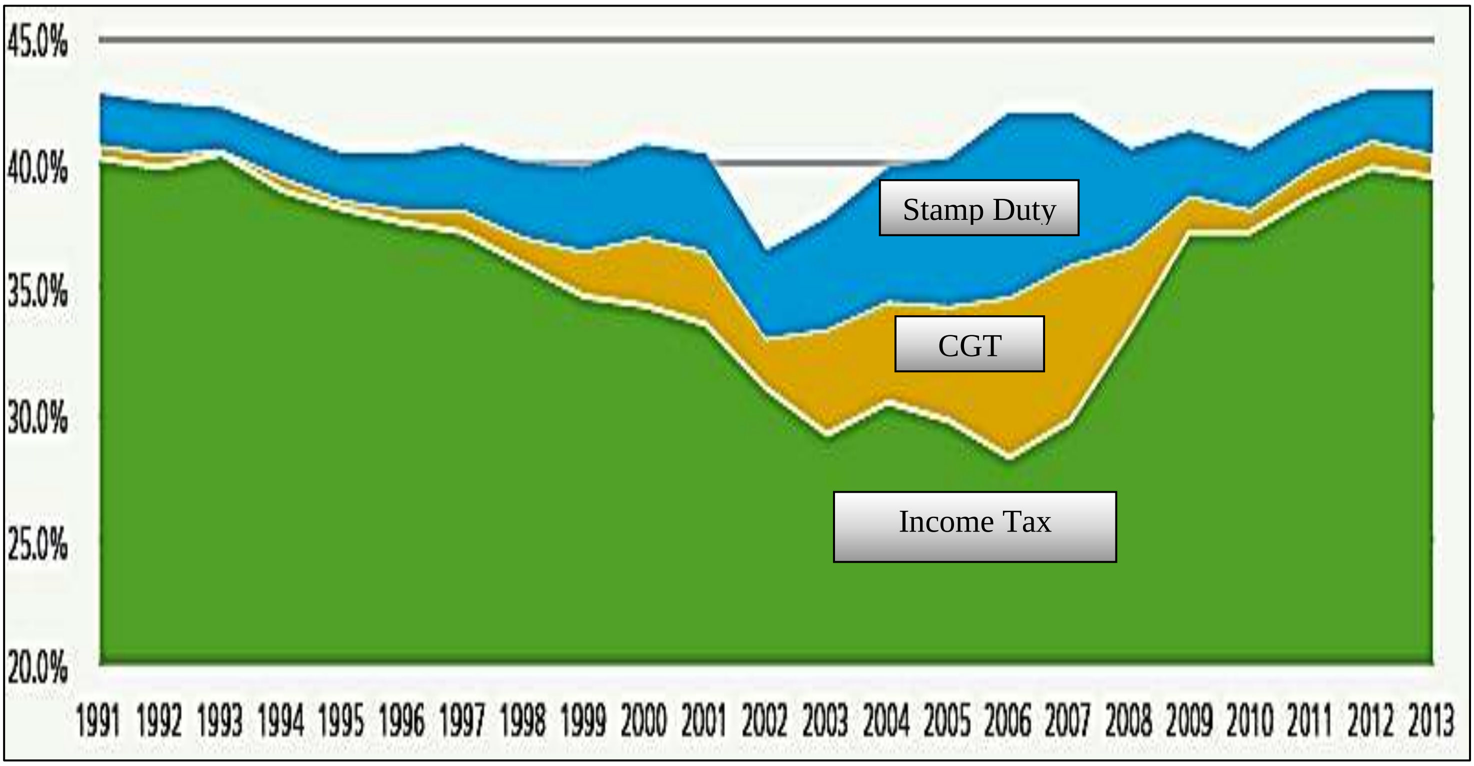

Figure 3.2: Tax Base Erosion in Ireland: Source as a Percentage of GDP, 1991 - 2013[2]

As Regling and Watson describe, the government repeatedly offered income tax cuts, inflating the policy overreaction bubble, which seemed sensible at the time as revenue was booming. The problem was that "over time, this approach narrowed the tax base and made it

[2] *Report of the Joint Committee of Inquiry into the Banking Crisis Volume 1*, Houses of the Oireachtas, January 2016, p. 176

more fragile because the "booming" part of tax revenue turned out to be a transitional phenomenon" (Regling and Watson, 2010: 27). This approach was possible because between 2002 and 2006 the total tax ratio increased every year, reaching 32 per cent in 2006, driven by the flood of VAT receipts, capital gains tax and stamp duties associated with property market transactions. The consequence was a difficulty to assessing the underlying, structural situation of the budget and the fiscal stance because the cyclical taxes grew rapidly in the run-up to the crisis, and increasing the vulnerability to a recession, because the cyclical taxes reversed rapidly in the downturn. Overall, between 2000 and 2007 the proportion of income earners legitimately not paying any income tax increased from 28 per cent to 40 per cent (O'Leary, 2010: 6).

The Irish government's pursuit of a new fiscal strategy policy was in a context of advice to the contrary at the time the policy was enacted. Two studies in particular summarise the relevant international reports on the Irish economy (Wright, 2010), and assess the external surveillance of Irish fiscal policy during the boom years (O'Leary, 2010). These analyses include examples which show that the Ireland's fiscal policy was in a context of warnings at the time this tax strategy policy was pursued. It is important that there is evidence that the overreaction was wrongly adopted in the presence of external prompts to deviate or desist. That said, the Wright report into the crisis in Ireland itself concluded - similar to O'Leary - that these occasional warnings from international commentators took a benign attitude towards the risks that were building up, and there was general view was that there were no serious implications for the Exchequer or the economy generally.

The inflated bubble of taxation policy supply burst at the end of 2007, some four years after its instrumental value, and four years after it moved from being strength to being a weakness. Although 2007 was a record year for tax receipts the economic environment changed rapidly and Ireland quickly fell into recession. It is not surprising that the State's tax receipts fell by more than a quarter over the years 2008 and 2009, greatly exceeding the 14 per cent contraction of nominal GDP between 2007 and 2009. The consequences of this particular policy bubble are clear from the conclusions of the Irish government's commissioned study of the crisis:

> "The main reason for the sharp increase in the fiscal deficit in 2008-09 was the collapse in tax revenue. This was possible because the structure of tax revenue had changed dramatically from the 1990s to 2006-07. The composition of tax revenue had shifted gradually from stable sources of taxation, like personal income tax and

> VAT/excise taxes, to cyclical taxes, such as corporation tax, stamp duty and capital gains tax. The share of these cyclical taxes reached 30 percent of tax revenue in 2006; in the late 1980s it had amounted to only 8 per cent" - *Regling and Watson, 2010: 26*

The remarkably high sensitivity of tax receipts to economic activity was a result of the policy overreaction in the preceding four years. Armed with the power of hindsight, an investigation into the lead up to the crisis pointed out that fiscal policy needs to build in sufficient allowance for temporary revenues, that the tax base should not be eroded, that independent institutional sources for economic and fiscal projections would be useful, and finally that it would be worth exploring the use fiscal rules, such as a medium-term expenditure ceiling (Regling and Watson, 2010: 43).

In July 2011, the Irish Fiscal Advisory Council was established as an independent statutory body tasked with providing an independent assessment of official budgetary forecasts and proposed fiscal policy objectives. This was part of the wider *Fiscal Responsibility Act* passed by the government which includes a structural balance rule and a debt rule. Finally, Ireland passed the EU Fiscal Treaty referendum in July 2012. All of these can be considered measures to prevent, if not outlaw, oversupply or overreaction on this policy front in the future, in response to the painful recent past which saw a government collapse, rocketing personal and sovereign debt, a rapid unemployment and emigration crisis, and loss of economic sovereignty via a request for international financial assistance.

What is clear is that the decision to adopt a new fiscal strategy in 1987, which changed structure of the tax system in Ireland through the boom, is a telling example of dynamic policy making, where a bubble forms, grows in response to positive feedback, and bursts years after it moved from being strength to being a weakness. This policy overreaction in pursuit of short-run benefits ultimately delivered massive societal costs despite warnings to the contrary. The reasons for this likely go beyond bounded rationality and consensus, and include interests, institutions, and ideology as important drivers of this harmful policy and economic bubble. Overall, this research employs the framework presented by McCarty, Poole, and Rosenthal, and argues that these three factors impact on the decision outcome though they are not mutually exclusive, or even competing. Rather, together they explain key decisions in Irish policy-making.

3.3 Theoretical Framework of Decision-Making

While interests, institutions, and ideology may or may not be impacting on any particular decision-making process, bounded rationality is ever-present in human decision-making (see Chapter 2), yet humans do not always make irrational decisions. Irrationality can vary, depending on the extent to which it is activated. Part II of the thesis investigates whether there is evidence of particularly active irrationality in the period before Ireland's crash using a quantitative method of Leadership Trait Analysis. Part III uses a most-likely case to verify if and how interests, institutions, and ideology play a role shaping a decision outcome, and also to seek evidence of irrationality in decision-making.

One perhaps unintended consequence of Nyberg's analysis of Ireland's crisis is that, by identifying the causes to be a combination of a naïve belief in efficient markets and irrational forces, he downplayed rational decisions that nonetheless had poor outcomes. Not all rational decisions are good or irrational ones bad. Schumpeter (1939) noted the example of 'hog cycles', whereby a producer of a good may respond rationally to a shortage of a product and consequent high prices by investing in increasing output. However, the time-lag in arrival of the good on the market (e.g. production of crops, animals) sees other producers respond similarly and a surplus supply arises which could ruin the first producer's business. Alternatively, Klein (1999) uses the example of 'firefighter's intuition', whereby a firefighter makes a good decision to leave a burning building prior to a collapse, absent any obvious rationale. It is entirely possible that poor decisions were taken by Irish policy-makers out of rational self-interest, such as the interest in short-term electoral success. Added to this, bounded rationality is ever-present, yet rational decisions are taken regularly suggesting that Nyberg's harmful irrational forces are sometimes more active than others. Chapter 2 outlined some of the lessons from behavioural economics and how it challenges the rational actor / utility maximising assumptions of neo-classical economics. Central to this debate are decision-makers' preferences, and assumptions about their knowing what they want, doing what they want, and why they want what they do. Congdon, Kling, and Mullainathan (2011: 10) summarise how the results of behavioural economics prompt deviation from the standard assumptions about preferences in rational-choice economics.

Imperfect optimisation: The classical model assumes that individuals are capable maximizers of their own utility- that is they know what they want and what will make them happy and that their choices and preferences are consistent. Behavioural economics, however, finds that individuals are imperfect in their ability to maximise their own welfare and that their choices are often inconsistent- that is that individuals have more difficulty knowing what they want than the standard model assumes.

Bounded self-control: Even when individuals accurately perceive their own interests, they can have difficulty realising their intentions. The classical model allows for no such difficulty, and it assumes time consistency in preferences. Behavioural economics recognises forces such as temptation and procrastination as real and meaningful phenomena- that is that individuals have more difficulty doing what they want than the standard model assumes.

Non-standard preferences: Finally, the standard model also makes some weak assumptions about the shape of individual preferences. Behavioural economics finds two important cases in which those assumptions appear in accurate first preferences appear inaccurate: first, preferences appear to be set over changes in status rather than over end states. Second, the assumption of pure self-interest is often a bad assumption, in that individuals routinely hold preferences that are other-regarding- that is, that what people want is different from what we usually assume.

Figure 3.3: Behavioural Economics and Assumptions about Preferences, from Congdon, Kling, and Mullainathan, 2011

As Jones argues, decision-makers value or weight preferences depending on the context in which they are evoked (Jones, 1994: 6) and attempting to identify whether a suboptimal decision was arrived at as a result of rational or irrational forces is less than straightforward. It is possible that a policy-maker might make a perfectly rational or totally irrational suboptimal decision. For example, they may make a rational decision to support ultimately-damaging tax policies because it is so closely linked ideologically to their political party that not doing so could harm their electoral prospects. This would be a rational response to powerful incentives. Or the same policy-maker may on another occasion make an irrational decision to support ultimately-damaging tax policies as (irrational) confirmation bias leads them to place greater weight on the benefits of the policy, than on the downsides. That is irrational decision-making. Knowing that interests, institutions, and ideology play a role in generating and sustaining economic and political bubbles, and that rational and irrational decision outcomes can be arrived at, prompts the framework proposed here.

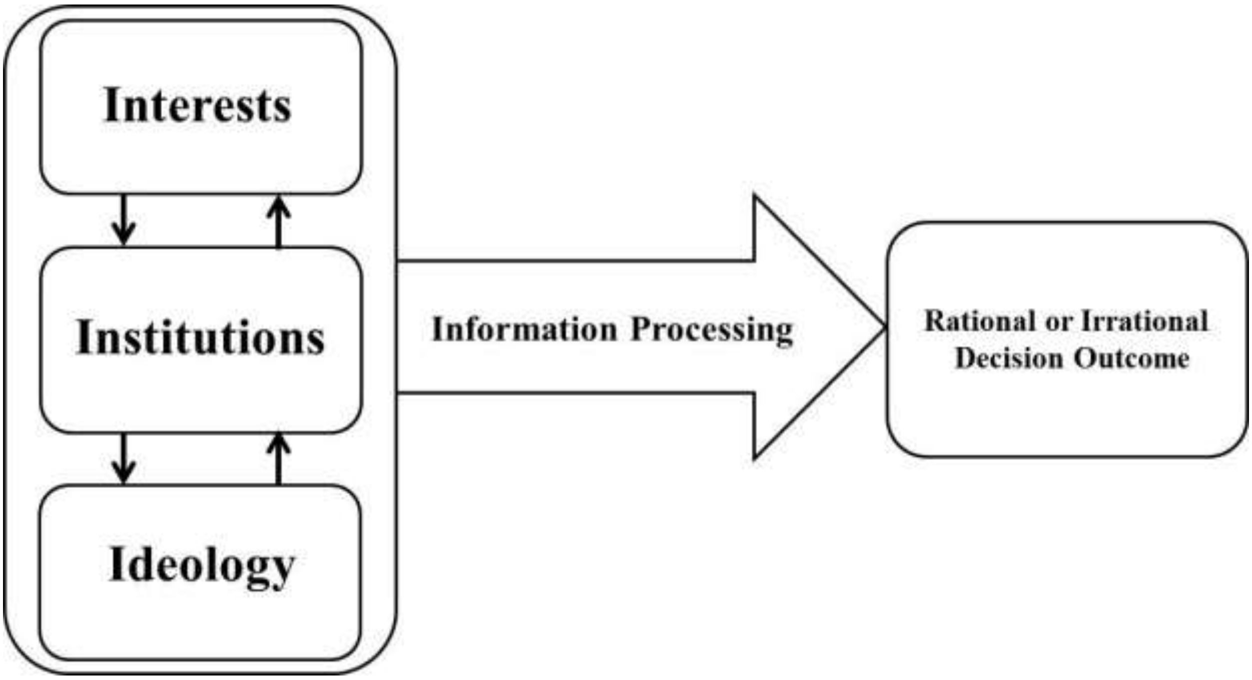

Figure 3.4: Proposed Framework of Decision-Making

The above is a framework (rather than explanatory theory) with which to analyse the role and interaction of the three factors on a decision outcome, which may be rational or irrational, or optimal or sub-optimal. For example, the policy-maker chooses an option because it is the preferred option of a powerful external interest group. The group may be in a position to mobilise an important constituency (of voters), direct expenditure on electoral campaigns, or produce and provide information important to the policy-maker. In this case, it is rational for the political decision-maker to support those interests' views. This can also be aligned to the self-interest of a politician to be re-elected. Ireland has seen examples of planning decisions being influenced by the interests of property developers (Final Report of the Tribunal of Inquiry into Certain Planning Matters and Payments, 2012). Slow progress on reform of sheltered sectors of the Irish economy, such as the legal services, are also linked to the power of external interests, while the decision in 2003 to decentralise certain government department functions is also considered to have been taken to serve constituency interests.

The policy-maker may also rationally choose an option because of the external institutional framework which may be resistant to alternatives, or in which power and knowledge is distributed in such a way as to militate against alternative options. Authority and access to information can be distributed across government; in Departments, Agencies, and Regulators. A policy-maker in a government Department may be overly or totally reliant on information from a Regulator and may thus make a poor but rational decision. This was a key feature of the Irish crisis where the Financial Regulator relied on information provided by the banks, there was poor information sharing and definition of responsibilities between the Financial Regulator and the Central Bank, and poor information sharing and definition of responsibilities between both of these and the Department of Finance (Honohan, 2010). In such a scenario it is plausible that a policy-maker could make a poor, but rational, decision in response to powerful incentives arising from the institutional framework.

Alternatively, a policy-maker may select an option as a consequence of a rigid ideological belief held by them, their party, or which dominates political thinking. An elected decision-maker who is a member of a party with a strong ideological brand (e.g. Tea Party Republicans in the US) whether conservative/right or socialist/left might rationally choose an option because to do otherwise would be politically damaging to them or their party. A decision which runs contrary to stated ideological position (e.g. a tax increase by a representative on the economic right or a spending cut by a representative on the economic left) can be used against the decision-maker by those within and without their own grouping. In Ireland, ideology has been highlighted as a contributing factor in shaping income tax policy from to 2003 on, after which the contribution of income tax to overall revenues became too low relative to other components such that continuing reduce tax placed the economy in jeopardy, as opposed to bolstering or propelling growth.

A policy-maker may also arrive at an irrational decision because the relevant information and messaging is controlled by others with a strong interest in the outcome, which in turn activates irrationality. In pre-crisis Ireland regular property market assessments by the two biggest banks, reports published by two large Dublin stockbrokers, research by the independent (but State-funded) Economic and Social Research Institute, and annual reports published by the Central Bank and Financial Services Authority of Ireland reveals evidence of extrapolation bias and that expectations of continued house price increases were not confined to households (Lunn, 2013). Lunn also notes that the persistence of beliefs about the prospect of a soft-landing for the property market and the financial soundness of the banks is a theme of the official report into the performance of the Central Bank and the Regulator which points to confirmation bias and “highlights lack of scepticism and selective reading of evidence” (Lunn, 2013: 576). (At a broader level, ratings agencies have also been criticised for their naïve reliance on historical patterns; see Friedman, 2009: 134)

In addition, the irrational choice preferred by the decision-maker may come about as a consequence of the institutional framework in which they work. Nyberg found that a "silo" organisational structure strengthened the effect of lack of critical discussion, groupthink", and modest or absent serious consideration of alternatives among Irish public authorities (Nyberg, 2011: iv). Further, poor decision outcomes are more likely where key institutions have certain characteristics e.g. where financial institutions and supervisors tend to act in a herding manner, groupthink and conformism is present within these institutions, and the media and the political system take a supportive rather than a challenging role (Nyberg, 2011: 9). It is reasonable to expect that an institutional scenario where the Regulator is dependent on the banks for information, the Central Bank is dependent on the Regulator, and the Department of Finance is dependent on the Central Bank and the Regulator for information, increases the likelihood of groupthink or herding.

Lastly, a decision-maker may choose an irrational option because the rigid ideological belief they hold precludes consideration of important information. The ideological polarisation of politics makes policy-making resistant to the incorporation of new information (McCarty, Poole, and Rosenthal, 2013: 90). Where it would be rational to seek out new information to inform a decision, ideologues may only seek or process information which confirms or is unambiguously supportive of their ideology. This may extend to only including those with a similar ideology to their own in decisions. In Ireland's case, this ideological barrier to rational decision-making manifested itself in an assumption that developments in the financial markets could not be seriously flawed, that regulation of the financial markets would reduce innovation and efficiency without improving stability, and that less and lighter regulation was therefore better (Nyberg, 2011: 94). Nyberg concludes that the widespread ideological belief in the efficiency of markets makes the international nature of the financial crisis, as well as the general unpreparedness of Irish banks and authorities, easier to understand: "To the extent that this paradigm, in its naïve version, had become widely trusted among Irish financial professionals in private and public institutions, such an assumption may have been made both across institutions and within institutions (strengthened through groupthink)".

It is important to note that the forces of interests, institutions, and ideology at play are decision-specific. The process outlined here does not expect these three factors to be fixed, as the interests, institutions, and ideology impacting on a decision on, say, environmental regulation can be expected to be very different to those at play in a decision on financial regulation. Finally, these three elements can be expected to interact with each other. For example, political institutions may put certain decision-makers at the heart of the political system. By putting elected politicians - who all share the same electoral incentives - in control, it makes it more likely that their short-term electoral self-interest may lead to sub-optimal decisions. Further, the cabinet system may put the same types of people in a collective decision-making role, usually with the same ideologies which could encourage sub-optimal decisions. Similarly, the ideological position of a policy-maker may influence whose interests are heard in the decision process (for example proponents of State intervention versus market players).

Overall, the quantitative content analysis research in Part II attempts to reveal the presence of irrationality amongst decision-makers by seeking evidence of behavioural biases, using the leadership traits conceptual complexity and in-group bias as a proxy. To probe the issue further, the second element of the research employs qualitative case study analysis to reveal the influence of the three explanatory forces amongst decision-makers, namely ideology, institutions and interests, and reveal the rational or irrational nature of the decision-process. The starting point for the entire research was Nyberg finding that public policy in Ireland seems to have almost unanimously accepted and encouraged views and practices that later proved disastrous, and that irrational forces were a key contributor or facilitator of this disastrous decision-making by government. (Nyberg, 2011: 94-97). So, up to this point irrationality has been the variable of interest. The hypothesis for the case study research is that there are three factors which alone or together may impact information processing, and contribute to the creation and sustaining of policy bubbles. The decisions may be rational or irrational, but the information processing element is key.

The impact of ideology, institutions and interests on information processing, and hence on decision outcomes, is the link between Parts II and III of this thesis. These three factors impact on information flow and on those decision-makers processing that information. It is these decision-makers that are assessed (in terms of leadership traits) in Part II of this research. How the interests, institutions, and ideology shape the flow of information is examined in detail in Part III. The resulting decision may be irrational in terms of the extent to which it was impacted by established decision-making biases (see Table 2.1). The analysis of utterances in Part II, and the process tracing in Part III are informed by a subjective assessment, in hindsight, that certain decisions were poor. As stated in section 1.1, the objective of this research to better understand poor decisions made by policy-makers in pre-crisis Ireland, with an emphasis on factors contributing to poor or irrational decisions. This is, in part, to inform processes or systems which could mitigate the impact of such factors.

The case study approach is being pursued to supplement the quantitative content analysis technique used in this research and because case studies are "generally strong precisely where statistical methods and formal models are weak" (George and Bennett, 2005: 19). The case study will help us further understand why economic advice offered between 1997 and 2007 did not translate into policy action that would have mitigated the likelihood or severity of the economic crisis in Ireland from 2008, and to what extent and how each of the three factors contributed to this. The case study is targeted to help reveal irrationality, as well as the other factors that can help explain poor decision-making.

PART II

Chapter 4: A Research Design to Assess Irrationality

4.1 Assessing Behavioural Biases At a Distance

It is clear that irrational forces (behavioural convergence bias, groupthink, herding) are at the heart of *ex post* explanations as to why the crisis in Ireland unfolded in the way it did. One question this prompts is whether it is possible to reveal these irrational forces *as they were happening* so that action is conceivable which could mitigate, if not avert, future crises. Typically, behavioural bias is detected in economic laboratory settings where groups of subjects are asked to make decisions in controlled and variable conditions to reveal the choices made and offer an explanation for these (see discussion in Chapter 2). Many if not all of the biases thought to have been impactful in Ireland's crisis were initially identified in economic laboratory experiments, but evidence of the presence and impact of decision-making bias would be more persuasive if gathered in an environment more like the one of decision-makers before the crash. The laboratory/experimental approach is unsuitable for the nationally and internationally known decision-makers of interest here. To perform psychological assessment of such individuals, effective and efficient at a distance techniques are necessary. Because key decision-makers are often inaccessible to researchers (they may in fact be deceased), specific content analysis schemes have been developed (Young and Schafer, 1998: 86). These at a distance techniques allow researchers to perform assessments and derive measurements using material that is available without gaining direct access to the decision-makers of interest, and are based on the central premise that:

> "...what people say and how they say things can tell us much about what they think and who they are. For instance, we all know the adage that an optimist refers to the glass as half full, while a pessimist calls the same glass half empty. By specifying that specific traits or beliefs are associated with the usage of particular words, phrases or speech patterns, and then looking for these patterns in a subject's verbal material, we can assess many different psychological traits and characteristics. For instance...someone who uses more black-and-white terms such as absolutely, definitely and always as opposed to more gray terms such as possibly, maybe and perhaps is presumed to be lower in conceptual complexity" - *Schafer and Crichlow 2010: 47*

This premise has been shown to hold true for complexity and bias traits, which this research employs as a proxy for the behavioural convergence bias behind the groupthink which is thought to have contributed to Ireland's crisis. For example, Tetlock performed content analysis on archival records of public statements of decision-makers in five American foreign policy crises. All the material (once topically restricted) was coded using two content analysis techniques which showed that public statements of leaders could reveal groupthink as posited earlier by Janis (Tetlock, 1979). Tetlock noted that the material upon which Janis relied in developing his groupthink theory (observer accounts of private conversations and participant memoirs) “were susceptible to serious retrospective distortion” (Tetlock, 1979: 1316). Of the two behavioural methods open to researchers to test Janis’ theory- laboratory simulation and content analysis of archival material – Tetlock chose the latter, employing an assessment of conceptual complexity as previous studies had shown it to be sensitive to shifts in the complexity of processing caused by situation, and because it can be applied to documents as letters, essays, speeches, and diplomatic communications. Using content analysis to assess the presence and effect of groupthink via conceptual complexity, Tetlock found that public statements of decision-makers in groupthink crises were characterised by significantly lower levels of complexity and evaluated political groups with which they identified, more positively (Tetlock, 1979: 1322). Tetlock used the state component of conceptual complexity (integrative complexity), but that Tetlock successfully detected groupthink/behavioural convergence (i) using the conceptual complexity construct and, (ii) employing a content analysis technique, supports the approach taken in this research. Tetlock added a note of caution however, stating that the research evidence does not rule out alternative explanations, adding that “a decisive test...will probably elude us for a long time” (Tetlock, 1979: 1323). This note of caution and pessimism remains today.

4.2 The Leadership Trait Analysis Technique

Personality traits are part of the psychological make-up that informs the way individuals act and think. Researchers have distinguished a wide variety of different traits and have used several different methods to determine them (Winter et al. 1991; Judge et al. 2002; Suedfeld, 2010). As it is highly unlikely that political leaders are willing to undergo more invasive psychological tests, these at a distance techniques have resorted to analysing speech-acts as a proxy for leaders’ personal dispositions (Schafer and Walker, 2000; Suedfeld, 2010). The conceptual complexity construct allows psychological assessment of leaders at a distance using such a content analysis approach. The Leadership Trait Analysis or LTA technique developed by Margaret Hermann is one of the most prominent techniques for studying personality traits of leaders and with this technique, seven different personality traits, including conceptual complexity and in-group bias, can be determined.

Leadership Trait	Description
Conceptual complexity	The intricacy of the cognitive structure of a leader's belief system. Cognitively complex individuals have a desire to seek multiple sources of information concerning issues and policy options, are able to see varying reasons for a particular position, and are willing to entertain the possibility that there is ambiguity in the environment
In-group bias	The degree to which a leader praises his own political, economic, social, cultural group and how patriotic and protective they are of their in-group
Belief in one's ability to control events	The amount of control leaders feel they have over the situations they encounter
Need for power or influence	The concern for establishing, maintaining, or restoring one's power of influence / have an impact on other people
Self-confidence	The leaders' sense of self-importance and sense of one's self
Task orientation	The extent leaders are focussed on completing their task and solving problems or on building and nurturing human relationships by maintaining group spirit and morale
Distrust of others	The level of trust a leader has in other actors and whether they see them as trustworthy

Table 4.1: Leadership Trait Analysis: Traits and Meanings

This research employs the first two of these listed seven traits, conceptual complexity and in-group bias. The LTA technique is grounded in the assumption that frequent use of certain words and phrases indicates the presence of certain personality traits. Hermann first set out the LTA content analysis approach in her 1999 paper, and it is summarised by Dyson as follows:

> "The scheme is a theoretically-driven content analysis of a leader's verbal output. More specifically, an assumption is made that the more frequently leaders use certain words and phrases in their interview responses (and other verbal behavior) the more salient such content is to them.
>
> At issue is what percentage of the time when leaders could exhibit particular words and phrases they are, indeed, used. This procedure consists of an identification of opportunities within a leaders text for exhibiting verbal behavior associated with the

> trait variables, recording whether this opportunity was taken and whether the words used are indicative of a positive or negative score on that trait based on the coding dictionary developed with the technique, and the summing of all such instances within the piece of text. Finally, a ratio trait score (0-100) for that leader is calculated" - *Dyson, 2004: 50*

A high level of conceptual complexity is indicated by the more frequent appearance of words such as 'possibly', and 'approximately' in the content for an individual, while a lower level is indicated by such words as 'certainly' and 'absolutely' (Suedfeld, 2010: Conceptual complexity is scored based on the percentage of frequency of words related to either high complexity (i.e. approximately, possibility, trend) or low complexity (i.e. absolutely, certainly, irreversible) complexity. This assesses the capability of decision-makers to discern different dimensions of the environment when describing actors, places, ideas and situations.

In-group bias is scored on the percentage of times a reference to the group is favourable, shows strength, or a need to maintain group identity. Of interest is ascertaining when the decision-makers references his or her own group are the modifiers used favourable (i.e. great, progressive, successful, prosperous), do they suggest strength (i.e. powerful, capable, made great advances), or do they indicate the need to maintain group honour and identity (i.e. must maintain our own interpretation, decide our own policies). Decision-makers high in in-group bias are prone to only perceive the good aspects of their group and to deny or rationalise away any weaknesses, which can reasonably be assumed to be associated with behavioural convergence bias.

As noted in a previous Chapter, measurement of conceptual complexity moved from paragraph scoring using a 1-7 scale (Suedfeld and Rank, 1976), to guided interviews using a 25-point scale (Streufert and Nogami, 1989). In Smith (1991), Baker-Brown et al. provided a scoring manual for conceptual complexity which "can be used with any connected verbal discourse to which the researcher has access" (Baker-Brown et al., 1991: 403). Winter describes it as a method that has been "applied to archival material and personal documents in many studies, offering both real-world confirmations of laboratory results and also psychological explanations of important social and political processes" (Winter, 1991: 119). However, one significant drawback of employing content analysis to assess conceptual complexity in the past was that:

> "[C]oding is difficult, in large part because it does not reply simple content counting rules of the sort that other content analytical approaches employ. Assessing...complexity requires the judgement of trained coders, who have to make subtle inferences about the intended meanings of authors. Coders often make difficult

judgements concerning whether differentiation or integration exists in particular statements." - *Baker-Brown et al., 1991: 402*

Thies (2009) summarises Margaret Hermann's work on conceptual complexity as one of the main approaches to complexity assessment at a distance, with one of the "distinct advantages of Hermann's approach is that it can be machine coded, thus increasing the reliability of the measure and allowing conceptual complexity to be studied in a greater number of actors over time" (Thies, 2009: 452). Addressing Baker-Brown's concerns, a computer program, *Profiler Plus*, has been developed that will automatically code for all LTA traits. The software detects conceptual complexity and in-group bias through content analysis scoring, reporting frequency of words related to either high complexity (i.e. approximately, possibility, trend) or low complexity (i.e. absolutely, certainly, irreversible). Thies point is borne out by the number of political leaders whose conceptual complexity has been assessed and reported in recent years to help understand their decision-making and its outcomes. These include:

- Ronald Regan and George Bush (Dille, 2000)
- Jimmy Carter and Bill Clinton (Dille and Schafer, 2000)
- Dwight Eisenhower, John F. Kennedy, Lyndon Johnson, and George Bush (Preston, 2001)
- George Bush, Bill Clinton, Lyndon Johnson and Harry Truman (Mahdasian, 2002)
- Saddam Hussein and Bill Clinton (Post ed. 2003), Tony Blair (Dyson, 2006)
- Thirteen UK Prime Ministers between 1945-2008 (Dyson, 2008)
- Asian Central Bankers in the late 1990s (Thies, 2009)
- Margaret Thatcher (Dyson, 2009)
- Hermann van Rompuy (Van Assche, 2009)
- Brian Cowen, Angela Merkel, Nicolas Sarkozy and José Zapatero (van Esch, 2015)

While the aforementioned works are based on the same theoretical underpinnings as this research, this work is novel in that it links personality trait to the presence and impact of behavioural biases.

Regarding validity of LTA and its power to explain leaders' behaviour, firstly, aside from the continuing use and perceived value of the method, it is important to note Hermann's assessment of its accuracy in capturing the styles that leaders actually exhibit. Hermann (1999: 40) developed profiles on 21 leaders using the procedure proposed here and the subsequent ratings were compared with those "made by journalists and former government personnel who had had the opportunity to observe or interact with the particular leaders". The correlations between the two sets of ratings averaged 0.84 across the set of leaders suggesting that the profiles derived from this at a distance technique provided researchers with similar types of information on which to judge behaviour as had the other raters' experiences with the actual figures (Hermann, 1999: 41).

In his discussion on validity, Dyson (2008), states that in addition to face validity, finds that more detailed research on leaders "seeking to process trace the linkages between complexity and policy outcomes has also provided support" (Dyson, 2008: 14). He adds that more can be done, suggesting that case study analysis comparing leaders in similar situations but with differing levels of complexity "are perhaps the most direct tests of the behavioural hypotheses associated with information processing style", and that approach forms part of this research.

We have already seen Schafer's account that personalities traits have been proven to have explanatory power for leader behaviours, but what of LTA, of which conceptual complexity and in-group bias, are but elements? While research has demonstrated that higher or lower trait scores by leaders tend to correlate with behaviours, how useful, for example, have the aforementioned assessments of leaders been in explaining their decisions?

> "The preceding studies are evidence of two critical concerns for the study of foreign policy analysis. First, we can identify specific personality traits for individual leaders and they are distinguishable from one another on the basis of those traits. Second, the traits analyzed by Leadership Trait Analysis have been found to correlate with the political behavior of the states or organizations those leaders represent. In short, leaders do matter and Leadership Trait Analysis can both explain past behavior and predict future outcomes based on the hypotheses associated with the method" - *Mahdasian, 2002: 37*

The test employed here is the application of the LTA technique to provide a comparative content analysis of political leaders in Ireland and those in a group of western democracies in the years leading up to the most recent global economic crisis. The results will provide evidence to support (or not) the hypothesis that Irish leaders in the run up to the crisis had lower scores for conceptual complexity and higher for in-group bias, relative to the mean of a norming group of other Western leaders.

The next Chapter offers a review of the LTA technique and the ongoing discussions concerning its validity and reliability. In an effort to contribute answers to some of the remaining questions in this matter, it proceeds with conducting an empirical analysis of all seven LTA leadership traits. On the basis of this and previous methodological analyses of the LTA, it draws conclusions and offers some guidance on more appropriate use of the method.

Ultimately, validity concerns arise when the hypothesis posed here is tested and the results analysed.

4.3 Profiler Plus Software

Content for Irish leaders will be analysed using automated software to generate scores for each individual decision-maker (0-1) for conceptual complexity and in-group bias to be compared to those for over 50 political leaders from around the world. A computer program, *Profiler Plus*, has been developed by Social Science Automation (see https://socialscience.net) that will automatically code for the traits of interest here. Assessments of Bill Clinton and Saddam Hussein (Hermann, 2003) and twelve British Prime Ministers (Dyson, 2008), and many other have been made using this combined LTA technique and this particular software. As Dyson notes, "recent advances in the power of desktop computers and software design have made possible the automation of this content analysis scheme" (Dyson, 2004: 45). Dyson presents the argument that "new methodological techniques of computer assisted textual analysis can be applied to the available public domain source materials in order to generate reliable data on the individual characteristics" of decision-makers (Dyson, 2004: 48).

One downside to using Profiler Plus is that it is commercially developed and much of the information about how it and the dictionaries work, is proprietary. A licence for academic use was applied for and granted for this research. What is known is that the LTA Profiler Plus coding scheme involves seeking specific content (words and phrases) that signify either the absence or presence of the seven LTA traits. Where the identified content indicates that a trait is present, then a score of one is assigned to that content. Alternatively, the absence of the trait means that a score of zero is assigned to that content. The scores within the totality of the content are averaged to present a score from zero to one. The scores for an individual decision-maker (0-1) on the traits of interest, conceptual complexity and in-group bias, can be compared to those of other political leaders. As Hermann sets out, through such comparisons the researcher can determine whether the particular decision-maker is high or low on a trait.

The developers of the combined LTA / Profiler Plus approach were contacted directly as part of this research to seek the greatest possible clarity about the process by which the software generates the scores, and the possibility of comparing sample phrases with LTA dictionaries. This was born out of a concern the system appears to be something of a 'black-box', the internal workings of which are a hidden from the user, but in which much faith is placed. It was put to the developers that, ideally, the software would display some examples of the researcher’s text which scored highly/lowly on certain traits, for example. The developers were asked if there were any studies that describe what exact process Profiler Plus embarks on once it begins. In reply, the developers stated that, they understood the perception of the software as a black-box, adding that “to some extent, that is true”.

> “The analysis is based on the theoretical framework of LTA. The specific dictionaries are not released since they are proprietary ~ otherwise others could remake the program. So unfortunately [we] cannot help you any further with this question, except note that the literature justifies the method (Hermann, Dyson). Generally speaking, those articles serve as the justification for the method” – *Derksen, 2013: Personal communication*

Correspondence with the developers did yield some further information. Unfortunately a non-compressed version of the coding schemes (dictionaries) for the version of the software used in this research was not obtainable; “although the schemes are technically recoverable, that is more effort than it's worth to us, barring a requirement for a funded project” (Young, 2013: Personal communication). It was possible to receive the names of the 53 leaders analysed for the ‘norming group’, to confirm that both speeches and interviews were used to generate scores, but not obtain the scores over time for these leaders (see section 4.5).

In an article by Young and Hermann (2014), some more detail of how Profiler Plus works became available. Writing about version 7 (version 5.8.4 was used in this research), the authors state that the software is multi-pass, word-and-phrase counting system looking for words and phrases that match entries in one or more lists or dictionaries. If a word or phrase in the text matches a dictionary entry, it is coded, which means a category count is incremented and the system moves on. Information from one pass is carried over from one pass to another. Multiple-pass systems are able to ‘remember’ information from one pass by storing information associated with each word (Young and Hermann, 2014: 636). For example, tables 4.1 and 4.2 illustrate Profiler Plus analysis for the sentence ‘*We debated who won the television debate*’.

Profiler Plus - code documents - Sandbox/master,,

Initial state of:
We debated who won the television debate.

Index	Class	Lemma	Modif...	Pos	Text
1	BOD	(bod)			
2	BOP	(bop)			
3	BOS	(bos)			
4		we		pronoun-personal	We
5		debate	ed		debated
6		who		pronoun-interrogative	who
7		win			won
8		the		dt	the
9		television			television
10		debate			debate
11		.		punc	.
12	EOS	(eos)			
13	EOP	(eop)			
14	EOD	(eod)			

Figure 4.1: The initial state of "We debated who won the television debate" after loading into Profiler Plus (second "debate" not coded)

Profiler Plus - code documents - Sandbox/master,,

Step after applying Tagging59,3.4,:
We debated who won the television debate.

Index	Class	Lemma	Pos	Tense	Text
1	BOD	(bod)			
2	BOP	(bop)			
3	BOS	(bos)			
4		we	pronoun-personal		We
5		debate	verb	past	debated
6		who	pronoun-interrogative		who
7		win	verb	past	won
8		the	dt		the
9		television	noun		television
10		debate	noun		debate
11		.	punc		.
12	EOS	(eos)			
13	EOP	(eop)			
14	EOD	(eod)			

Figure 4.2: The state of "We debated who won the television debate" after part-of-speech tagging (second "debate" tagged as a noun)

According to the article, the words ‘television debate’ can be problematic for systems attempting to code for complexity because, although debate between two alternatives may indicate complexity, the phrase ‘television debate’ does not. Profiler Plus as a multiple-pass system first tags each word with its part of speech (Table 4.1), and then counting as complex only those instances of ‘debate’ that are verbs (Table 4.2). The coding is accomplished using a rule that triggers when the word “debate” is found in the text, but it only counts the word as an indicator of complexity if the value… is “verb.” Notwithstanding this additional insight much about the operation of the technique and software is unknown, and this leads to some of the methodological issues explored in Chapter 6.

4.4 Leaders of Interest, Period of Analysis and Retrieval of Leader’s Utterances

This research is interested in if and how decision-makers in Ireland were influenced by their beliefs about the economy and its competitiveness in the decade before the crash. But who are the decision-makers of interest here? As set out by O’Malley and Martin (2010), the Irish Prime Minister, the Taoiseach, is considered to be one of the strongest of all heads of government, with one of the highest degrees of influence within their system of government, and potentially more powerful that any of their European counterparts, save the British Prime Minister. According to the Department of the Taoiseach’s website, “the Taoiseach is Ireland's Head of Government. He is Party Leader, Government Chairman and Chief Policy Maker” (www.taoiseach.gov.ie). Unsurprisingly then, the utterances of the Taoiseach will be subject to analysis in this research.

Connolly and O’Halpin (2004) state that “there is a clear ranking in the perceived importance of Ministerial portfolios, with Finance generally accepted as the most important (after the Taoiseach, of course) because of its responsibility for economic management and for public expenditure” (Connolly and O’Halpin, 2004: 253). Again, the relevant public statements made by the holder of the position of Minister for Finance are of specific interest to this research. Finally, although the title of the Ministry/Department has varied over the years, the issue of competitiveness has been a central concern of Ireland’s serving Minister for Enterprise. This is not surprising given the link between macroeconomic stability, national competiveness, firm performance and Ireland’s attractiveness as a location for foreign direct investment, all of which is the responsibility of that Minister. Therefore, statements made by the holder of the “enterprise” portfolio in government will also be examined in this study. (The institutional arrangements are expanded upon in Chapter 8).

OFFICE	HOLDER	TENURE
Taoiseach	John Bruton	1995 - 1997
	Bertie Ahern	1997 - 2008
Minister for Finance	Rúairí Quinn	1995 - 1997
	Charlie McCreevy	1997 - 2004
	Brian Cowen	2004 - 2008
Minister for Enterprise	Richard Bruton	1995 - 1997
	Mary Harney	1997 - 2004
	Micheál Martin	2004 - 2008

Table 4.2: Ireland's Pre-Crisis Leaders to be Subject of Trait Analysis

A starting-year of 1997 for the analysis would be appropriate for two reasons. First, a general election was held in June 1997, following which there was a change of government. Fianna Fáil and the Progressive Democrats formed a coalition with Bertie Ahern as Taoiseach. Ahern remained Taoiseach following subsequent general elections in 2002 and 2007, the end-year chosen for this analysis and the final year before the crash in 2008. Therefore, 1997 is a starting point for the decade in the lead-up to the crisis with the constant of Fianna Fáil-led governments with Ahern as Taoiseach throughout. Second, the National Competitiveness Council (NCC) was established in 1997 to report on key competitiveness issues facing the Irish economy and offer recommendations on policy actions required to enhance Ireland's competitive position. This provides a reference point from which the State and others, via the social partnership agreement of that year, can reasonably be seen to have been concerned with maintaining Ireland's competitiveness in a context of very strong economic growth, employment growth, falling unemployment, low inflation, and government deficit/debt reduction. To add some sense of comparison, the utterances of the Taoiseach, Minister for Finance and Minister for Enterprise in the previous short-lived government (1995-1997) will also be analysed.

In assessing decision-makers at a distance the researcher must take a number of factors into consideration when settling on which content will be subject to scrutiny. Dyson (2008) summarises three key points, some of which have been touched upon in sections above as follows:

> “The focus here is text analysis, which, in the form of content analysis of the speeches, interviews, and verbal communications of political leaders, is now an exciting avenue of research in political psychology. Text analysis offers potential solutions to several of the major problems that have traditionally beset psychological studies of political leaders.
>
> First, the ready availability of large volumes of text produced by leaders, and the increasing ease with which text can be accessed online, substantially mitigates the traditional problems of access as a barrier to generating useful empirical insight on elites.
>
> Second, the discipline necessary to construct content analysis schemes that achieve high levels of reliability has imposed a clarity of conceptualization that has not always been present in studies of the psychological characteristics of political leaders.
>
> Finally, the increasing extent to which these content analysis schemes have been automated, with analysis performed solely by computer, has drastically reduced the labor-intensive processes associated with manual content analysis, allowing for the processing of large samples of text and the grounding of studies in a solid base of empiricism” *– Dyson, 2008: 8*

Hermann finds that in the course of completing profiles of the leadership styles of political leaders, “it has become evident that the analyst can develop an adequate assessment of leadership style based on 50 interview responses of one hundred words or more in length. Confidence in one’s profile, of course, increases the more interview responses the analyst can assess but any profile will suffer if it is determined on less than 50 responses” (Hermann, 1999: 3). Taking all of this into account (and the validity of the LTA technique discussed above), for this research the universe of decision-makers’ responses to oral parliamentary questions (PQs), available through the official record on the Houses of the Oireachtas website, will be collected and analysed using the LTA technique discussed earlier. Though responses to parliamentary questions contain some scripted elements, they also provide adlibbed content as supplementary questions are asked and answered. Renshon (2009) provides results which strongly indicate that public or the private data generate the same results using content analysis, and thus providing tentative confirmation of the validity of using public speeches.

In his 2008 study Dyson applies Hermann’s LTA technique to post-1945 British Prime Ministers, utilising responses to Parliamentary foreign policy questions in order to generate data on their individual characteristics, stating that these “data provide a basis for empirical study of the impact of the Prime Minister on decision-making” (Dyson, 2008: 21).

Dyson states that responses to questions in [parliament] are appropriate materials for the generation of trait scores because (i) they are from a single source, eliminating differential audience effects which might bias estimates, and (ii) they are relatively spontaneous, reducing the risk that they are entirely pre-prepared and thus more indicative of the trait orientation of an aide or speechwriter than the subject in whom we are interested (Dyson, 2008: 52).

The website of the Houses of the Oireachtas (Ireland's parliament) provides an accessible online source for text, suitable to the scale of this research. Following Dyson (2008) and unlike studies prior to his, a sampling procedure for selecting texts was not used- this provides greater confidence in the reliability of the trait data, which rests on analysis of over three million words spoken by the relevant Irish leaders, and constitutes population, rather than sample data (Dyson, 2008: 52). One issue to be overcome is the precise retrieval of that content to make the analysis feasible within available resources.

The Dáil records for January 28th 1998 are used here to illustrate the process which might was automated. One way to read what was said in the Dáil by, say, the Taoiseach on this day is to enter the search requirements using the online search function. This returns 23 records and clicking on the first result allows you to read the written answer given by the Taoiseach to a question asked by a member of the Dáil regarding commemorative events (Figure 4.3).

This approach returns written replies as well as oral replies to parliamentary questions' (PQs). Crucially for the purposes of this research, it is replies to oral PQs rather than written PQs that are of interest. This is to maximize the likelihood that responses are those of the leaders, and not of a civil servant, aide, or advisor. Helpfully, Dáil oral PQ exchanges are labelled "ceisteanna" ("questions" in Gaelic) within the search results, and thus can be selected via an additional search including this term. This additional search reduces the number of records returned from 23 to 3, and selecting, for example, the third result allows you to read the oral PQ answer given by the Taoiseach to an oral PQ asked by a member of the Dáil regarding basic income (Figure 4.4).

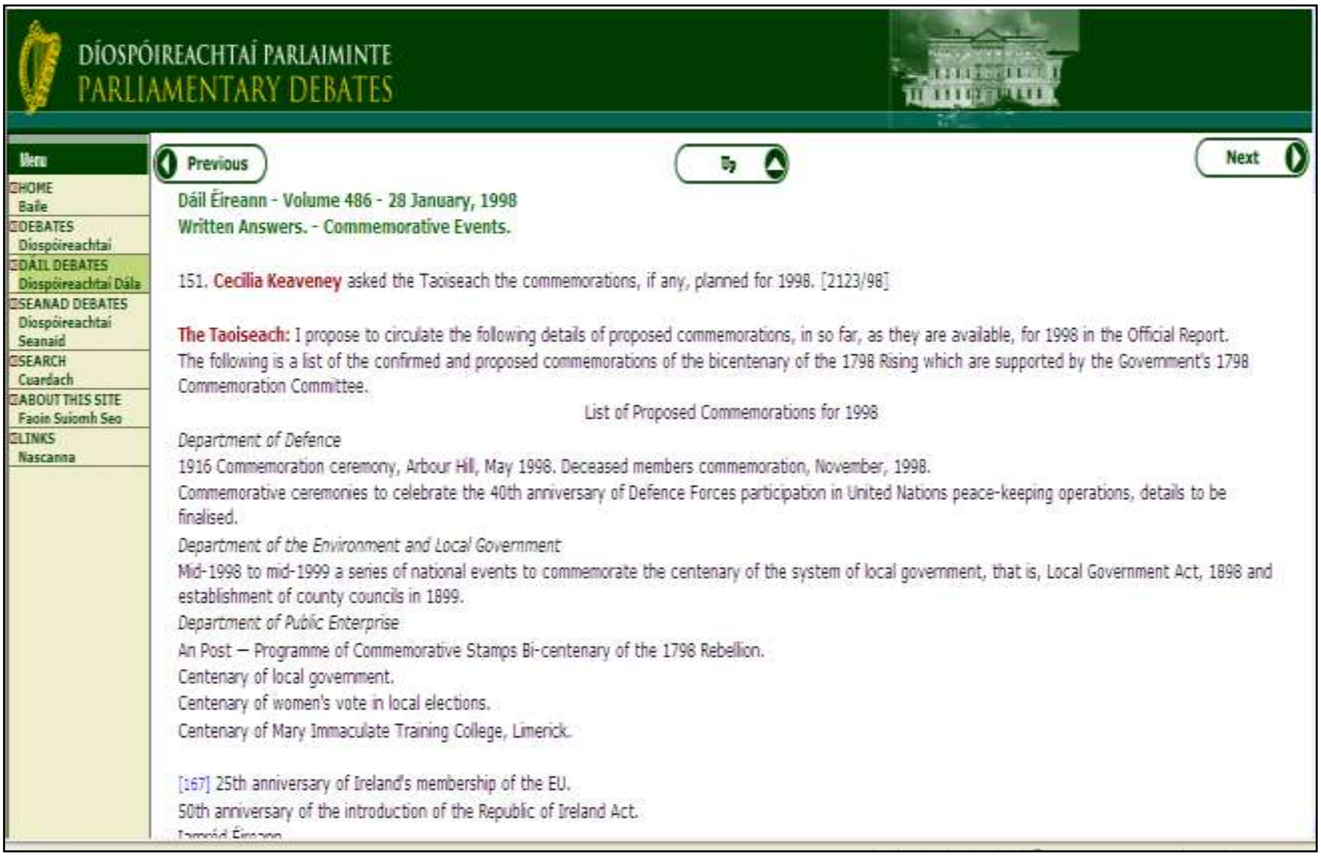

Figure 4.3: Returned Record using Manual Search Option

Figure 4.4: Returned Record Using "Ceisteanna" Field with Manual Search Option

Because this is an oral PQ, the record contains the full exchange between the questioner **and** the respondent (Deputy Sargent and the Taoiseach respectively, in this case), and any others who interjected. Extracting *the utterances by a particular person only* from these oral PQ exchanges, over a decade or more, would be prohibitively resource-intensive. Having firstly searched and located the exchanges of interest on a particular day by a particular person, a researcher then has to:

- Manually select the record
- Copy and paste the entire exchange
- Remove any text in the record that is not actually spoken (e.g. speaker's name)
- Remove the words not spoken during the exchange by persons other than the person of interest
- Further tidy up the text (e.g. remove the embedded paragraph marker numbers).

This multi-step process would have to be repeated for every day, for every speaker. As there are hundreds of Dáil sitting days of interest (December 15th 1994 – June 14th 2007), and eight persons of interest who will answer a number of oral PQs on any particular sitting day, this process would be labourious to the point of making the research impossible given the resources available.

To overcome this problem, an automated process was designed, based on a number of factors. First, the daily Dáil record is not only held as readable text on the internet, it is recorded in *Extensible Mark-up Language (*XML) format. XML is a mark-up language that defines a set of rules for encoding documents in a format that is both human-readable and machine-readable. So, returning to our January 28th 1998 example, the Dáil debates page reads as per Figure 4.5, whereas the XML format of this debate is also available and appears as per Figure 4.6.

Mr. Sargent: asked the Taoiseach the steps, if any, his Department has taken to establish the task force promised under An Action Programme for the Millennium to investigate the introduction of a basic income scheme. [22736/97]

The Taoiseach: In An Action Programme for the Millennium the Government is committed to producing a Green Paper on the issue of basic income within two years. The social partners are also committed in Partnership 2000 to carrying out an independent appraisal of the concept and the full implications of introducing a basic income payment for all citizens, taking into account the work of the ESRI, CORI and the expert group on the integration of tax and social welfare.

In line with these commitments a working group on basic income has been established under the auspices of my Department to examine how the issue should be dealt with. The working group, having reviewed the material available on basic income, has developed terms of reference for a study whose findings will assist the group in progressing its work. The study, to be undertaken by independent consultants, will commence shortly and it is envisaged it will be completed by the autumn.

Mr. Sargent: Fáilte romhat ar ais tar éis na Nollag. The commitment in the programme for Government to examine the concept of a guaranteed basic income is welcome. I stress the urgency of consideration of that matter. How many times has the task force met? Will the report which the Taoiseach said will be published in the autumn deal with the labour force implications as well as the fiscal implications of a basic income, two aspects of the remit of the task force?

The Taoiseach: The task force has met five times and has held a seminar and a number of open days...

Figure 4.5: Standard Rendering of Online Dáil Record

<MainHeading Type="OA" LHead="Ceisteanna—Questions." RHead="- Basic Income">

<Title>Ceisteanna—Questions. - Basic Income.</Title>

- <Speaker pid="TrevorSargent" hpid="Mr. Sargent Mr. Sargent">

<NameTxt>Mr. Sargent</NameTxt>

<P Just="Left">asked the Taoiseach the steps, if any, his Department has taken to establish the task force promised under An Action Programme for the Millennium to investigate the introduction of a basic income scheme. [22736/97]</P>

</Speaker>

- <Speaker pid="Bertie" hpid="The Taoiseach Bertie Ahern">

<NameTxt>The Taoiseach:</NameTxt>

<P Just="Left">In An Action Programme for the Millennium the Government is committed to producing a Green Paper on the issue of basic income within two years. The social partners are also committed in Partnership 2000 to carrying out an independent appraisal of the concept and the full implications of introducing a basic income payment for all citizens, taking into account the work of the ESRI, CORI and the expert group on the integration of tax and social welfare.</P>

<P Just="Left">In line with these commitments a working group on basic income has been established under the auspices of my Department to examine how the issue should be dealt with. The working group, having reviewed the material available on basic income, has developed terms of reference for a study whose findings will assist the group in progressing its work. The study, to be undertaken by independent consultants, will commence shortly and it is envisaged it will be completed by the autumn.</P>

</Speaker> <Speaker pid="TrevorSargent" hpid="Mr. Sargent Mr. Sargent">

<NameTxt>Mr. Sargent:</NameTxt>

<P Just="Left">Fáilte romhat ar ais tar éis na Nollag. The commitment in the programme for Government to examine the concept of a guaranteed basic income is welcome. I stress the urgency of consideration of that matter. How many times has the task force met? Will the report which the Taoiseach said will be published in the autumn deal with the labour force implications as well as the fiscal implications of a basic income, two aspects of the remit of the task force?</P>

</Speaker> <Speaker pid="Bertie" hpid="The Taoiseach Bertie Ahern">

<NameTxt>The Taoiseach:</NameTxt> - <P Just="Left"> The task force has met five times and has held a seminar and a number of open days...

Figure 4.6: XML Rendering of Online Dáil Record

Thus, the initial rationale for the expectation that this process could be automated was that the records of interest are freely available in machine-readable format. The record is machine-readable because the text is tagged. Discussions with those responsible in the Oireachtas for these Dáil debates suggested that extracting the data of interest for this research (just the utterances by a particular person from oral PQ exchanges) was theoretically possible because the record is tagged in terms of the speaker and the type of exchange. So, taking the XML extract in Table 4.6 as an example, the exchange has the tag *MainHeading Type="OA"*, indicating it is an oral PQ answer, and the Taoiseach's utterances have the tag *Speaker pid="Bertie"*.

The second prompt for the expectation that an automated process could be developed was that a not altogether dissimilar approach was used in previous research (Elgie, Quinn, and Stapleton, 2006). As part of that research, the results of an internet search similar were processed through to a Java computer programme, which is particularly suited for the purpose of examining 'strings' of text, determining their content and acting on this information. In that case, the programme was modified until it could reproduce control results, and used to search through a file containing hundreds of results, count how many days each particular types of exchanges occurred and sort them into appropriate files, all in a matter of seconds. The programme employed by Elgie, Quinn, and Stapleton, served a different purpose to that of this research. While they used Java to interrogate, sort and count the universe of records returned from a search of Dáil debates, here the programme would either have to (i) interrogate a subset of records returned from a search of Dáil debates (i.e. 'ceisteanna'), or (ii) interrogate a raw XML file. Following (i) or (ii) the programme would then have to retrieve the text spoken only by a certain individual. A commitment to some minimal support by the Oireachtas was secured and the next step was to engage the programming expertise required to either amend the programme used in the 2006 research or write a new programme capable of interrogating records returned from a search of Dáil debates or interrogating the raw XML data.

To retrieve the required content, the School of Computing in Dublin City University (DCU) was engaged to provide computer programming assistance. Postgraduate students were encouraged to participate as a means of demonstrating their ICT and project management skills by developing a programme capable of interrogating Dáil records to retrieve contributions made by senior policy makers. Crucially the programme had to be capable of retrieving the text spoken by the individual of interest. Once that was achieved, the output of the programme could be tested against a sample of manually extracted days and, finally, be subjected to LTA content analysis. A short piece of code was written in the Python scripting language which was capable of interrogating the raw XML files, retrieving the utterances spoken only by a specified individual, and output the results to a plain text file.

To ensure that the automated method could reliably return content for analysis (i.e. text identical to that which would be retrieved manually from the Oireachtas website), a short comparison test was run. A sample day for each of the eight leaders of interest was chosen using no other criteria other than ensuring the leader answered oral PQs on the day. The relevant text was retrieved automatically and manually. The output of both techniques was saved into sixteen electronic documents (two files of text, one automatically retrieved, on manually retrieved, for each leader).

The pairs of files for each leader were then compared using the ‘compare documents’ function in Microsoft Word. In the case of Bertie Ahern, the comparison of automatically and manually retrieved text for January 28th 1998 showed that the automated programme could retrieve identical text to the manual process, except that the word “Tánaiste” uttered by Bertie Ahern and recorded as such on the Oireachtas website, was returned as “T‡naiste” by the automated programme. As requested in the programme design, the automated retrieval had not returned the numerical marker “[13]” from the website version and thus was shown to be able to return clean text in this regard.

A similar test was run for Brian Cowen for November 8th 2006, a day on which he answered Leader’s Questions as Minister for Finance. The only differences noted here between the automatically and manually retrieved text were that the automated retrieval did not retrieve the “€“ symbol, “Bus Átha Cliath” became “Bus tha Cliath”, “blasé” became “blas”, while “Dún Laoghaire” became “Dn Laoghaire”. Again, unwanted markers were missing from the material returned by the automated programme, as required. The same test was run for the other leaders of interest: Charlie McCreevy (sample from October 8th 1997), John Bruton (sample from February 6th 1996), Mary Harney (sample from May 8th 2003), Mícheál Martin (sample from February 7th 2006), Richard Bruton (sample from April 22nd 1997), and Rúairí Quinn (sample from June 5th 1996). In all cases the automated method reliably retrieved text that was almost identical to the manual method where each daily record from the Oireachtas internet page was examined and text retrieved line by line, save for the text errors above. The automated method also had the advantage of not returning the unwanted text markers.

The only other difference was that the automated process did not recognise or report non-English words. Examples include the Irish words Dáil, Fianna Fáil, Sinn Féin, Pleanála, FÁS and Forfás, and phrases such as *vis-à-vis*, *inter alia*, *communiqué*, *fait accompli*, *raison d'être* and *in loco*. The only problematic term identified in the test was where the note "Additional information not given on the floor of the House" was correctly not returned in one instance by the automated programme, but not in another instance. Overall, these text errors, the non-recognition of non-English terms or phrases such as the preceding is not a concern for this analysis as these words and terms are assumed to occur randomly and in relatively small numbers across the text. In any event the Irish words would not have been recognised or processed by the content analysis software package that will be applied to text.

This automated approach yielded in excess of three million words spoken by eight Irish leaders for analysis. As shown in Table 4.3, the annual word counts vary from 6,800 for Mary Harney in 2004 to 325,000 for Bertie Ahern in 2006, all of which exceed the required word count for Hermann's LTA technique.

Who	Year	Word Count
John Bruton	1995/96	80,120
John Bruton	1997	59,617
Rúairí Quinn	1995/96	30,965
Rúairí Quinn	1997	21,775
Richard Bruton	95/96	23,210
Richard Bruton	1997	12,864
Bertie Ahern	1997	64,559
Bertie Ahern	1998	172,430
Bertie Ahern	1999	186,541
Bertie Ahern	2000	185,412
Bertie Ahern	2001	193,680
Bertie Ahern	2002	169,897
Bertie Ahern	2003	283,055
Bertie Ahern	2004	259,754
Bertie Ahern	2005	266,397
Bertie Ahern	2006	325,175
Bertie Ahern	2007	107,995
Charlie McCreevy	1997	9,704
Charlie McCreevy	1998	36,210
Charlie McCreevy	1999	45,789
Charlie McCreevy	2000	42,965
Charlie McCreevy	2001	41,678
Charlie McCreevy	2002	25,816
Charlie McCreevy	2003	33,637
Charlie McCreevy	2004	18,095
Brian Cowen	2004	11,008
Brian Cowen	2005	51,491
Brian Cowen	2006	44,863
Brian Cowen	2007	14,026
Mary Harney	1997	12,086
Mary Harney	1998	29,865
Mary Harney	1999	31,629
Mary Harney	2000	18,250
Mary Harney	2001	17,800
Mary Harney	2002	17,629
Mary Harney	2003	27,664
Mary Harney	2004	6,802
Mícheál Martin	2004	12,074
Mícheál Martin	2005	34,508
Mícheál Martin	2006	30,328
Mícheál Martin	2007	20,854
Total		**3,078,217**

Table 4.3: Word counts analysed for Leaders

4.5 The Norming Group and Reporting Results

The crux of this research is that, based on the literature, decision-makers in Ireland had lower relative levels of conceptual complexity and higher levels of in-group bias, and examining what they say will reveal that they trusted their intuition, were willing to go with the option which presented first, and deemed action preferable to information seeking. One of the additional benefits of LTA is that once the leaders' speech content has been analysed and individual scores calculated for each of the traits, it is possible to put the scores into perspective by determining how they compare with those of other leaders; "without doing such a comparison, there is little basis on which to judge if the particular leader's traits are unusually high or low or about average" (Hermann, 1999: 32).

Region	Control over Events	Need for Power	Conceptual Complexity	Self-Confidence	Task Orientation	Distrust of Others	In-Group Bias
World Leaders (N=284)	Mn=.35 SD=.05	Mn=.26 SD=.05	Mn=.59 SD=.06	Mn=.36 SD=.10	Mn=.63 SD=.07	Mn=.13 SD=.06	Mn=.15 SD=.05
Western Europe (N=53)	Mn=.33 SD=.07	Mn=.26 SD=.05	Mn=.57 SD=.06	Mn=.32 SD=.13	Mn=.64 SD=.09	Mn=.09 SD=.06	Mn=.17 SD=.05
Eastern Europe (N=78)	Mn=.34 Sd=.05	Mn=.24 SD=.05	Mn=.59 SD=.05	Mn=.39 SD=.10	Mn=.68 SD=.07	Mn=.10 SD=.05	Mn=.14 SD=.06
Middle East & Northern Africa (N=46)	Mn=.33 Sd=.06	Mn=.27 SD=.06	Mn=.56 SD=.08	Mn=.31 SD=.13	Mn=.58 SD=.06	Mn=.16 SD=.07	Mn=.15 SD=.06
Pacific Rim (N=79)	Mn=.34 Sd=.06	Mn=.27 SD=.06	Mn=.59 SD=.08	Mn=.32 SD=.12	Mn=.62 SD=.08	Mn=.14 SD=.08	Mn=.16 SD=.05
Anglo-America (N=15)	Mn=.36 SD=.04	Mn=.24 SD=.04	Mn=.60 SD=.05	Mn=.45 SD=.08	Mn=.62 SD=.06	Mn=.12 SD=.03	Mn=.13 SD=.03
Latin America (N=13)	Mn=.37 SD=.03	Mn=.25 SD=.02	Mn=.60 SD=.05	Mn=.34 SD=.05	Mn=.65 SD=.06	Mn=.19 SD=.06	Mn=.15 SD=.03

Table 4.4: Leadership Trait Analysis Scores (Means and Standard Deviations)

Trait scores (including conceptual complexity and in-group bias) for a heterogeneous group of political decision-makers from many different countries, called the "norming" group, are available for the period of interest and when put alongside the data gathered here for Ireland's leaders will help reveal whether behavioural convergence was more prevalent there versus comparable economies. (The absence of wide variation of scores for the various LTA traits is notable, and this point will be investigated in Chapter 6.)

Adami, Eddie Fenech	Kohl, Helmut
Ahern, Bertie	Kok, Wim
Alema, Massimo D'	Leterme, Yves
Amato, Giuliano	Lipponen, Paavo
Ásgrímsson, Halldór	Lopes, Pedro Santana
Aznar (López), José María	Merkel, Angela
Balkenende, Jan-Peter	Oddsson, Davíð
Barroso, José Manuel Durão	Papadopoulos, Tassos
Berlusconi, Silvio #1	Persson, Göran
Berlusconi, Silvio #2	Prodi, Romano #1
Blair, Tony	Prodi, Romano #2
Bondevik, Kjell Magne #1	Rasmussen, Fogh Anders
Bondevik, Kjell Magne #2	Rasmussen, Lars Løkke
Brown, Gordon	Rasmussen, Poul Nyrup
Cameron, David	Reinfeldt, Fredrik
Chirac, Jacques	Sarkozy, Nicolas
Christofias, Demetris	Schüssel, Wolfgang
Clerides, Glafcos	Schröder, Gerhard
Cowen, Brian	Sigurðardóttir, Jóhanna
Jäätteenmäki, Anneli	Simitis, Kostas
Gonzi, Lawrence	Sócrates, José
Gusenbauer, Alfred	Stoltenberg, Jens #1
Guterres, António	Stoltenberg, Jens #2
Haarde, Geir	Verhanen, Matti
Juncker, Jean-Claude	Verhofstadt, Guy
Karamanlis, Kostas	Zapatero, José Luis Rodríguez
Klima, Viktor	

Table 4.5: Leaders in 'Western Europe' Norming Group

In this research, the norming group, means and standard deviations referenced are those for the group of 53 western leaders (see Table 4.5), given the focus on Ireland. On the advice of the developers of the method, data for Ireland's leaders were included in the norming group (Derksen, 2013: Personal communication).

In a context where bandwagon effects, herding, information cascades, conformity, and (above all) groupthink were thought to have significantly contributed to Ireland's crisis, varying levels of conceptual complexity and in-group bias among individuals will help reveal a particular disposition, willingness to entertain the possibility that there is ambiguity in the environment, and flexibility in reacting to alternative ideas. This is the basis of the hypothesis tested in the next Chapter.

Chapter 5: Evidence of Elevated Irrationality in Pre-Crisis Ireland

5.1 Hypothesis Assessment and Results

Investigations into the economic crisis in Ireland found that decision-makers made poor choices, and according to one official report irrational forces were one, important cause (Nyberg, 2011). A reading of behavioural economics literature reveals that bounded rationality and behavioural biases offer a more precise and useful explanation for the suboptimal decision-outcomes in the pre-crash in Ireland. Behavioural convergence bias manifested itself as groupthink and herding behaviour in particular. Previous sections of this thesis have argued that in the face of the challenges of assessing biases in general and groupthink and herding specifically, in a useful way, the conceptual complexity and in-group bias traits can reveal behavioural convergence bias. This content retrieval process set out earlier produced in over of three million words spoken by these eight leaders for analysis. For this research, norming group means and standard deviations (Table 4.4) for a group of 53 Western leaders are used as follows:

- Irish leaders in the run up to the crisis will have lower relative levels of conceptual complexity compared to decision-makers in comparable economies
- Western leaders conceptual complexity trait score mean is 0.57; standard deviation is 0.06; scale 0-1

- Decision-makers in Ireland will have higher relative levels of in-group bias compared to decision-makers in comparable economies, in the years preceding the economic crash
- Western leaders in-group bias trait score mean is 0.17; standard deviation is 0.05; scale 0-1

- If a leader's score is one standard deviation above/below the population mean or more, they are considered high/low for the trait

Table 5.1: Hypothesis and Scores for Assessment

If the hypothesis holds, the eight Irish leaders analysed will (i) have a score for conceptual complexity below 0.57, on a scale of 0 to 1, preferably 0.51 or lower, one standard deviation below the norming group mean, and (ii) have a score for in-group bias above 0.17, preferably 0.22 or higher, one standard deviation above the comparator group mean.

As reported in table 5.2, the results of analysis on all of the content for the eight leaders refute the hypothesis. Each and every leader had a level of conceptual complexity above the mean of 0.57 for comparable Western leaders. The lowest score was for Taoiseach

John Bruton at 0.65, which is more than one standard deviation higher than the norming group mean. Three leaders, Quinn, McCreevy, and Harney had scores of 0.71, well above the mean for Western Leaders. Regarding in-group bias, all Irish leaders analysed had a level of in-group bias which was lower than the mean of 0.17 for comparable decision-makers. The highest score was for Richard Bruton at 0.12, a result which was one-standard deviation below the benchmark mean.

Irish Leader	Word Count	Conceptual Complexity	In-group Bias
John Bruton	139,737	0.65	0.10
Rúairí Quinn	52,740	0.71	0.09
Richard Bruton	36,074	0.69	0.12
Bertie Ahern	2,214,895	0.66	0.10
Charlie McCreevy	253,894	0.71	0.10
Brian Cowen	121,388	0.68	0.11
Mary Harney	161,725	0.71	0.09
Mícheál Martin	97,764	0.69	0.11
Norming Group Mean		***0.57***	***0.17***
Norming Group Standard Deviation		***0.06***	***0.05***
Hypothesised score		***<=0.51***	***>=0.22***

Table 5.2: Trait Analysis Results for Irish Leaders

These results do not support the hypothesis. Irish leaders in the run up to the crisis had higher (rather than lower) trait scores for conceptual complexity relative to the mean of other Western leaders, and they had lower (rather than higher) scores for in-group bias. These results challenge the literature on Ireland's crisis. Firstly, they suggest that Irish decision-makers, to a greater extent than leaders elsewhere, had the desire to seek multiple sources of information concerning issues and policy options, were readily able to change views on an issue in light of new evidence, were able to see varying reasons for a particular position, and were willing to entertain the possibility that there was ambiguity in the environment. Secondly, the results suggest that policy-makers in Ireland referenced their group favourably, showed the need to maintain group identity, perceived only the good aspects of their group, and denied any weaknesses, to a lesser extent than leaders in other comparable countries. This runs contrary to claims of irrational behavioural convergence and groupthink.

5.2 Preliminary Interrogation of Results

It is important that the basis for any rejection of the hypothesis is clear: is it because Irish leaders were not in fact victim to irrational forces (groupthink) to a greater extent than anywhere else, or is the method not valid for detecting these forces. These issues are probed in the remainder of this Chapter using the content already retrieved for Irish leaders, and additional content retrieved from media reportage. A deeper methodological view employing additional content, and a conclusion on this question, is provided in Chapter 6.

Before this, some insight can be gained employing the data already gathered. In the previous Chapter it was noted an adequate assessment of traits can be based on 50 interview responses of one hundred words or more in length. Confidence in the results, of course, should increase the more content used (Hermann, 1999: 3). Rather than the 5,000-word requirement for analysis suggested by Hermann, the results reported in table 5.2 above were generated using multiples of this for each of the Irish leaders; from 36,000 for Richard Bruton, to 2,200,000 for Bertie Ahern. The analysis also examined traits over long time periods: two years for Bruton, and eleven years for Ahern. This raises the potential that such large word counts and wide time-spans mask important variation in levels of conceptual complexity and in-group bias at particular points in time. If a leader was the victim of a consequential fall in conceptual complexity, or rise in in-group bias at the time an important decision was being taken, the research approach used here could not detect it.

Thus it is important and interesting to see how a trait measured using LTA and Profiler Plus, behaves over time. To do so, the 2.2 million words of content retrieved from Ahern's responses to oral PQs in Dáil Éireann were split into 436 blocks of text, with a mean word count of 5,080 words in each block. The blocks of content were extracted in strict sequence, where no regard was given to the date on which the content was uttered, though sentences were not left incomplete. The text was then analysed to determine the level of conceptual complexity evident in each block. Figure 5.1 shows that, despite some variation in scores and slight downward trend over time, in the main the trait value remains above the mean for the norming group. Figure 5.3 displays box plots, where the dark and grey boxes are the 25th and 75th percentile respectively and the line represents the median/50th percentile. The results show that there is little significant variation across time. This suggests that the analysis of single blocks with large word-counts over longer time-periods is not responsible for any rejection of the hypothesis.

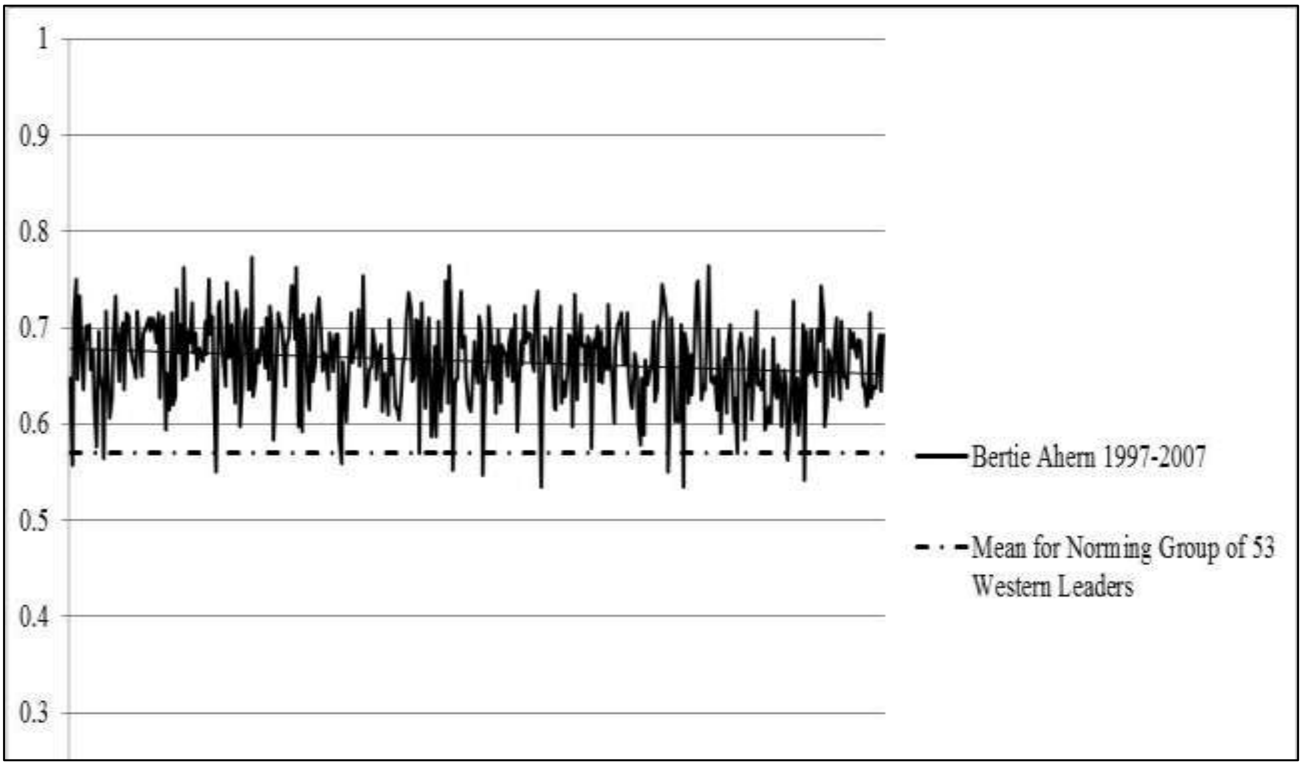

Figure 5.1: Ahern's Conceptual Complexity, 1997 - 2007

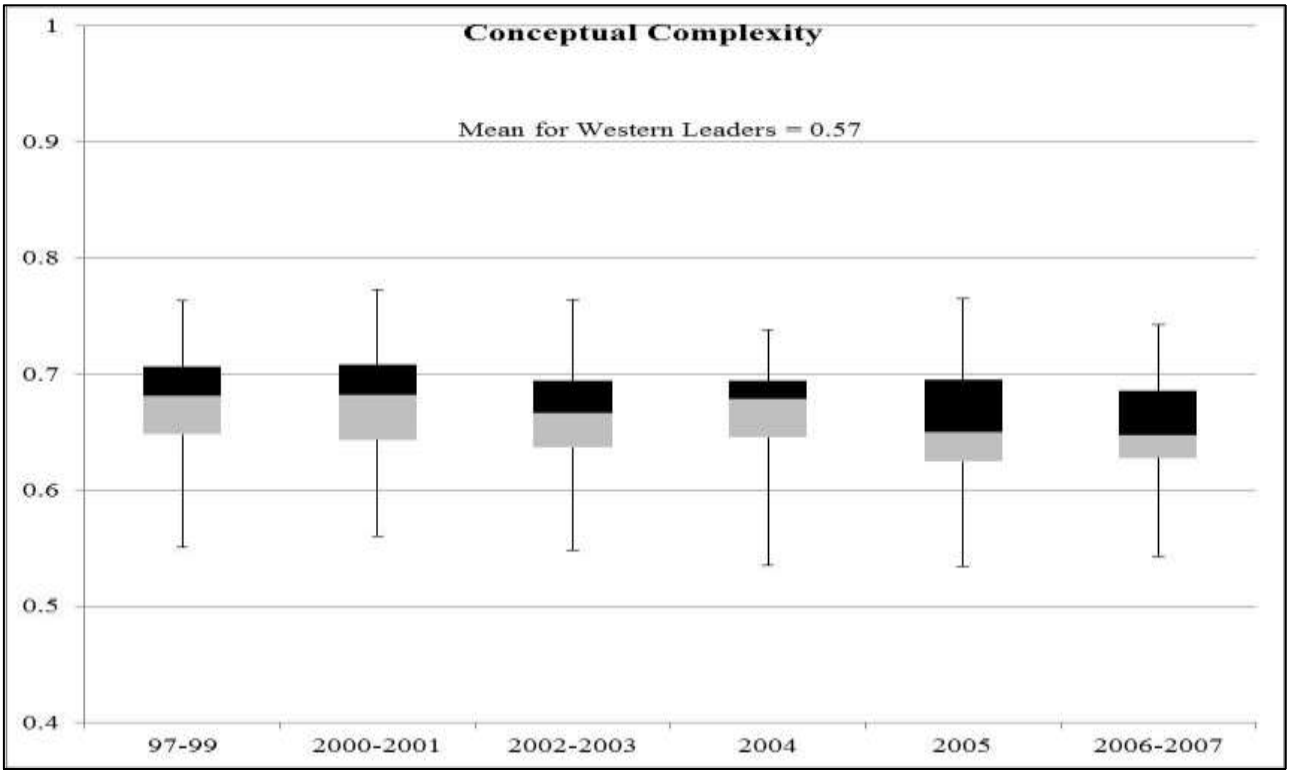

Figure 5.2: Ahern's Conceptual Complexity, 1997 – 2007 (grouped)

Alternatively, the results reported thus far may conceal the fact that trait scores are shifting within the aggregate depending on the topic being discussed. This would fit with Mahdasian's finding that "[i]f a researcher is interested in how a leader will behave in economic negotiations with a trading partner, the average value of trait scores derived solely from economic topics will likely be a more appropriate measure of how the leader will behave than the average of their mean scores produced through analysis of responses on political and conflict/security topics" (Mahdasian, 2002: 137). The next piece of analysis tests an assumption that Ahern's scores for leadership traits (e.g. conceptual complexity) measured using the LTA technique will vary depending upon the topic he is talking about.

This follows Mahdasian, and *prima facia* evidence that Ahern's handling of economic matters varied from his approach to, say, Northern Ireland or European Affairs. Bertie Ahern's record of success/failure on economic matters is at variance to his record on other matters, especially the Northern Ireland peace process. In Ahern's autobiography he states that, reflecting on his broader legacy, the "most significant contribution" he made was in the peace process (Ahern, 2009: 349). One commentator states that while the realisations about the economy would destroy Ahern's reputation, the "success of his Northern Ireland policy stands unblemished" (Whelan, 2011: 333). While another assessment notes that there is no question that the crisis in the Irish economy has prompted some revision of his legacy of presiding over the greatest boom in the history of the state, the general view of his handling of other issues (bar his personal finances) appears positive (Clifford and Coleman, 2009: 375).

All of Bertie Ahern's utterances in the Dáil in response to oral parliamentary questions (PQs) were split out into five themes as per Table 5.3. The content was split into these themes by reading all 2.2 million words and determining which of the five topics the utterances related to. In the case of the economy, Europe, and Northern Ireland, identifying the topic was straightforward, though there was some inevitable overlap. For example, many of the Dáil discussions of Europe were in relation to economic matters (e.g. discussions at ECOFIN of EU-wide tax harmonisation or duty-free treatment of goods).

Given that the overarching concern of this research is the economic crisis in Ireland, unless the content was specific to Ireland's (as opposed to Europe's) economy, the utterance were categorised as being about Europe. Inevitably, some of the content did not relate to any of the main categories of interest and this was split into an "Other" category which included discussions of non-EU international affairs and visits, the United Nations, elements of the national Programme(s) for Government not directly related to the economy etc., the functioning of the Department of the Taoiseach, the role of the Communications section and political advisors, the operation of National Economic and Social Council/Forum, freedom of information requests, the national archives, and the *eCabinet* system, for example. Finally, given the critical role that standards in public office (SIPO) issues played in Bertie Ahern's career, particularly his stepping down as Taoiseach, content on this topic is split out.

Year / Topic	**Northern Ireland**	**Economy**	**Europe**	**Standards**	**Other**	***TOTAL***
1997	22,411	10,055	8,302	2,101	21,690	***64,559***
1998	54,184	32,084	35,722	0	46,701	***168, 691***
1999	56,677	21,714	37,576	13,379	57,195	***186,541***
2000	49,000	38,737	26,042	554	71,078	***185,411***
2001	50,384	44,532	43,232	1,015	54,517	***193,680***
2002	36,615	47,214	26,401	1,945	57,721	***169,896***
2003	46,551	57,840	26,433	8,931	143,299	***283, 054***
2004	44,338	44,820	25,112	2,485	142,976	***259,731***
2005	43,447	48,064	16,886	8,470	149,524	***266,391***
2006	52,022	56,469	18,862	12,795	185,026	***325,174***
2007	8,908	16,260	5,825	1,806	75,196	***107,995***
TOTAL	464,537	417,789	270,393	53,481	1,004,923	***2,211,123***

Table 5.3: Content Word Count by Topic - Bertie Ahern 1997-2007

Examining that content over time shows that (while in absolute terms steady) the proportion of content dealing with Northern Ireland declines over time, the proportion dealing with the economy is relatively stable, while the discussion of "Other" matters rises sharply from 2001. This is due to the inclusion of non-EU international affairs in this category, and the sharp increase in discussion of international events in the aftermath of the September 11th attacks in the United States in 2001.

Topic / Trait	Conceptual Complexity	In-Group Bias	Control over Events	Need for Power	Self-Confidence	Task Orientation	Distrust of Others
Economy	0.68	0.10	0.36	0.25	0.35	0.85	0.06
Europe	0.69	0.10	0.38	0.24	0.32	0.81	0.03
Northern Ireland	0.63	0.09	0.39	0.25	0.37	0.76	0.12
Other	0.68	0.10	0.38	0.25	0.31	0.79	0.07
Standards	0.66	0.10	0.36	0.20	0.33	0.77	0.05
Norming Group	***0.57 SD=.06***	***0.17 SD=.05***	***0.33 SD=.07***	***0.26 SD=.05***	***0.32 SD=.13***	***0.64 SD=.09***	***0.09 SD=.06***

Table 5.4: Trait Mean Scores by Topic - Bertie Ahern 1997-2007

	Economy	**Europe**	**Northern Ireland**	**Norming Group**
1997	0.67	0.67	0.64	0.57
1998	0.69	0.72	0.62	0.57
1999	0.69	0.71	0.63	0.57
2000	0.69	0.71	0.65	0.57
2001	0.67	0.68	0.64	0.57
2002	0.68	0.66	0.64	0.57
2003	0.67	0.73	0.63	0.57
2004	0.68	0.68	0.64	0.57
2005	0.68	0.67	0.60	0.57
2006	0.65	0.68	0.62	0.57
2007	0.67	0.66	0.62	0.57
Mean	***0.68***	***0.69***	***0.63***	***0.57 SD 0.06***

Table 5.5: Ahern's Conceptual Complexity score by topic

The results show that, based on his responses to oral PQs, there is some variation in the trait scores for Bertie Ahern depending on the topic he is discussing. In terms of conceptual complexity, the higher score when discussing economic matters goes against the assumption that it would be lower. The difference in conceptual complexity scores for 'economy' versus 'Northern Ireland' was significant in 1998, 1999, and 2005 (difference was equal to or greater than one standard deviation). With a score of 0.68, Ahern's level of conceptual complexity when discussing the economy was similar to that revealed when he was discussing European issues (0.69) and Other topics (0.68). Interestingly, Ahern scored 0.63 for conceptual complexity when discussing Northern Ireland. This runs contrary to expectation that Ahern would display greater rather than lesser complexity in dealing with the peace process. Regardless of topic, Ahern's scores for conceptual complexity were significantly higher than for the comparator group of Western leaders (0.57). Whether discussing the economy or Northern Ireland, Ahern's levels of in-group bias remained well below the mean for Western leaders. Turning to trait stability over time, Ahern's scores per trait per topic remained remarkably steady. The detection of different scores for the same trait depending on topic does support the use of the LTA approach. Ahern's conceptual complexity scores stay above the norming group mean for all topics. Overall, the aggregation of topics in the original scores (Table 5.2) does not explain a rejection of the hypothesis.

Another explanation for why the analysis did not reveal the hypothesised conceptual complexity and in-group bias scores, is that the *role* individuals hold in Ireland (compared to leaders in other Western democracies) is impacting the comparison in some way. To look at this more closely, firstly the PQ replies for one individual – Brian Cowen as Minister for Finance (2004 to 2007) and as Taoiseach (2008) - were analysed. The analysis compared 120,000 and 180,000 of his words from each role respectively, and the additional content for Cowen's time as Taoiseach was retrieved in an identical manner as the rest of the content. Secondly, the research compared complexity scores for a role held consecutively by two individuals. The late Seamus Brennan was Minister for Transport from 2002 to 2004 and he was succeeded in this portfolio by Martin Cullen, up to 2007.

Cowen's Role	**Conceptual Complexity**
Minister for Finance	0.68
Taoiseach	0.65
Norming Group Mean	***0.68***

Table 5.6: Leader's Conceptual Complexity Score, by Role

Minister for Transport	**Conceptual Complexity**
Seamus Brennan	0.63
Martin Cullen	0.67
Norming Group Mean	***0.68***

Table 5.7: Role's Conceptual Complexity Score, by Leader

Given that the content and context are as identical as can be reasonably found, Cowen's trait scores as Minister and as Taoiseach should be identical, if role does not matter. On the other hand, given that the content, context and portfolio are the same and Brennan and Cullen are different individuals, the LTA analysis should detect and report different trait scores. As shown in Table 5.6, though Cowen's scores should theoretically be identical, they are not. At the same time, the difference is small, probably insignificant, meaning one could argue that in Cowen's case role did not have a significant effect on his complexity score, assessed in this way. Table 5.7 shows Brennan's and Cullen's scores to be different, as expected, but not significantly different. Again, Irish decision-makers in the run up to the crisis have trait score which differ from hypothesised levels, relative to leaders elsewhere. Given the inconclusive nature of this preliminary examination of the impact of role on trait scores, further more and more in-depth analysis of the impact of role (and state and source of content) is undertaken and reported in the next Chapter.

Despite some initial analysis, it appears that a rejection of the hypothesis that Irish leaders in the run up to the crisis would have different trait scores relative to the mean of other Western leaders cannot explained by (i) the large size of the word-counts of the blocks of content analysed, (ii) the aggregation of topics within that content or (iii), the role of the leader at the time of the analysis. Therefore and finally in this Chapter, analysis of additional content was undertaken to determine if expected trait signals can be revealed there using the LTA and Profiler Plus method.

5.3 Seeking LTA Trait Signals in Media Reportage

Given the difficulty in finding the hypothesised trait signals in the material from parliamentary debates, attention turned to identifying another source of material where evidence of irrationality or groupthink was likely to be present. The role of the media in supporting or contributing to the property bubble in Ireland has been flagged as an issue of concern and consequently the official Oireachtas Inquiry in 2015 heard evidence from academic commentators and media professionals under the theme of "the role of the media during the property boom" (Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 96). In its report the Committee recounted the testimony of one witness:

> "Print and broadcast media in Ireland played a difficult-to-measure but almost certainly significant role in the inflation of the property bubble and the legitimisation

of risky behaviour by the financial services sector in the lead up to the crisis of 2007 and 2008" – *Harry Browne, School of Media, Dublin Institute of Technology Evidence to the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 96*

The Inquiry concluded that it is clear that property advertisers did attempt to put pressure on the media, with a previous editor of the *Irish Times* newspaper telling the Inquiry that "she was aware that many telephone calls were made to [the] Managing Director of the newspaper, by the property sector about coverage in not just the property supplement, but the main newspaper also. As Editor, she was aware of statements made by some in the property sector that the *Irish Times* would never get an advertisement again after the publication of an article … which predicted a drop in property prices" – (Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 97). Mercille's analysis (2014) concluded that the media in Ireland ran stories which were "often dismissive of so-called 'doomsayers' or remained vague and ambivalent about the existence of a bubble. Just like the Irish government, it is only once property prices had started falling that the media acknowledged that the market was on a downward trajectory" (Mercille, 2014: 297). Consequently, media reportage in the years preceding the crisis presents itself as likely location for the pursuit of a strong trait signal using the LTA technique.

This element of the research analyses the content of the *Irish Times* newspaper. According to the Joint National Readership Survey, that newspaper had a typical daily readership of over 300,000 in 2000s. Content was retrieved from the paper via the *Lexis Nexis* system, using a query which returned all articles containing the words "Ireland" and "economy" in editions of the paper published on any Wednesday in the years 2000, 2005, 2006, 2007, 2008 and 2009 (311 editions in total). Content was analysed for the year 2000 to provide a baseline from a year preceding the headiest days of the so-called Celtic Tiger, for 2005, 2006 and 2007 to capture those heady days, and 2008 and 2009 to cover content during the immediate aftermath of the crash.

Based on the literature the levels of the two traits most likely to proxy for groupthink - conceptual complexity and in-group-bias - can be expected to be significantly lower and higher respectively in the years 2005, 2006 and 2007, than they were in 2000, and the reverse in 2008 and 2009. In line with the many references to hubris in the literature on Ireland (Brennan and Conroy, 2013; Dowling and Lucey, 2014; Murphy, 2016), the levels of the self-confidence trait detectable in the content can also be expected to be higher in the years 2005, 2006 and 2007, than they were in 2000, and may fall in 2008 and 2009.

None of the results produced the expected significant difference in signals. Regarding conceptual complexity (Figure 5.3), though all of the subsequent years were lower than the baseline score, none were significantly so. The 2008 and 2009 scores were lower than the baseline of 2000, and cannot be described as being dramatically higher post-crisis. The narrow range of the results (0.66 to 0.70) is similar to the results for Irish leaders' utterances reported above. There was little or no variation in the levels of in-group bias detected (Figure 5.4), though these was a spike in the level in 2006. In terms of self-confidence (Figure 5.5), a baseline of 0.38 was recorded for the year 2000. Contrary to expectation, the level of the self-confidence trait detectable in the content was lower in the years 2005 and 2007, than in 2000. The level was three points higher in 2006 (a ten point jump on the previous year) which is notable. While the levels in 2008 and 2009 were below the 2000 baseline level, it cannot be said that they dropped significantly from previous years, bar 2006.

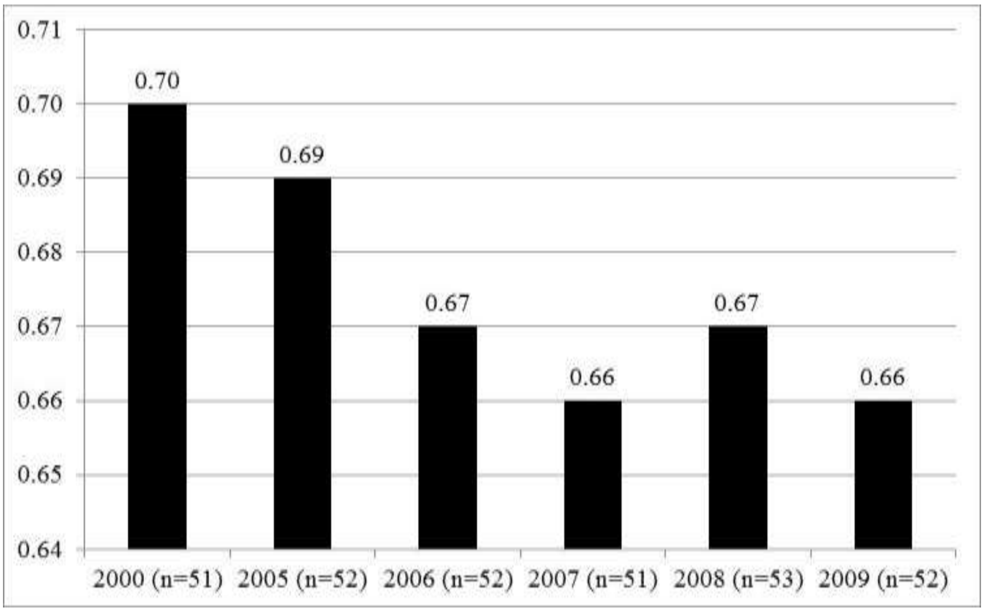

Figure 5.3: Level of Conceptual Complexity detected in selected Irish Times editions

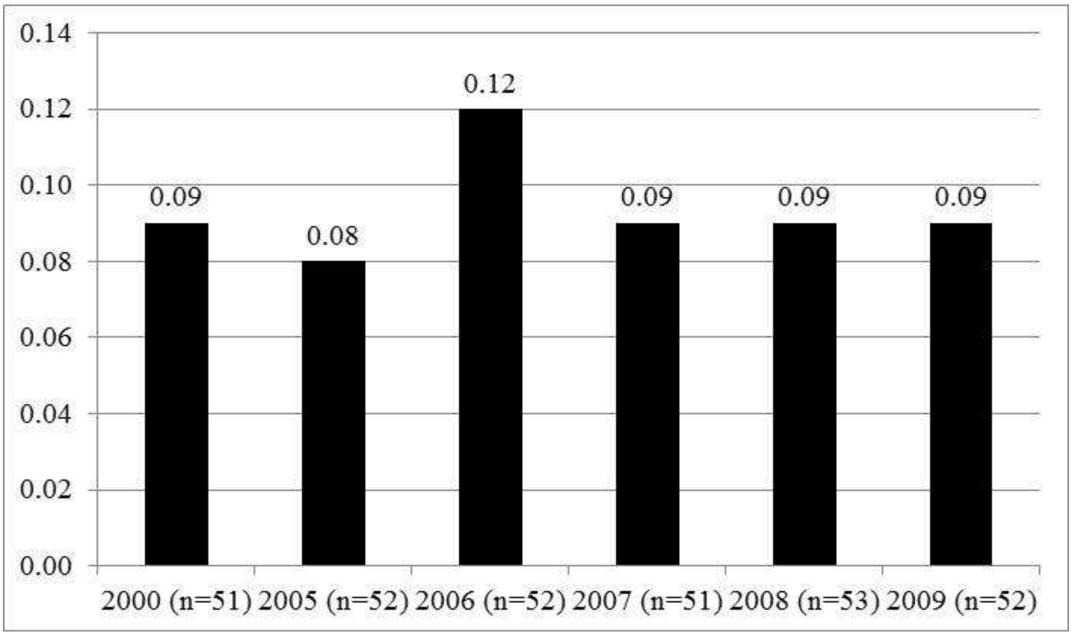

Figure 5.4: Level of In-group Bias detected in selected Irish Times editions

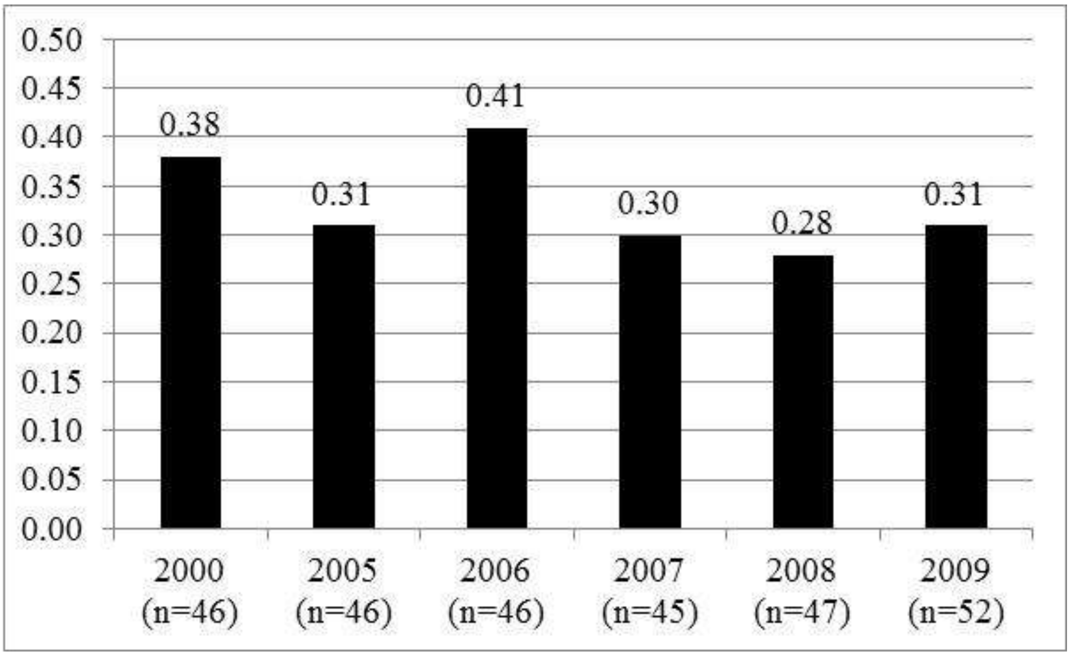

Figure 5.5: Level of Self-Confidence detected in selected Irish Times editions

The results in this section do not resolve the question of the basis for any rejection of the hypothesis for Ireland's decision-makers. The pervasive view is that institutions, including the media, and individuals were gripped by a variety of behavioural biases which contributed to their making disastrous choices which negatively impacted on their economic well-being. The related, expected signals did not materialise, meaning that if the Irish media (in this case represented by the *Irish Times*) were seized of groupthink and over-confidence, it is not revealed in the pattern one could reasonably expect. This could be for a number of reasons: the LTA technique is not useful for detecting bias, or is not useful when analysing articles from the printed press. Finally, it may be that the media did hold and reflect these biases in their reportage, but that this simply was not evident from the articles chosen for this analysis.

5.4 Conclusion

Contrary to the hypothesis, Irish leaders in the run up to the crisis had higher rather than lower scores for conceptual complexity, and lower rather than higher scores for in-group bias - relative to other leaders. The hypothesis could be rejected because irrationality in the form of groupthink was not an important factor in decision-making, or because the methodology was invalid. Breaking down the content into smaller blocks of analysis did not provide a definitive answer, though it did reveal sizeable trait score variation suggesting that the timing of any particular decision of interest should be considered carefully. Examination of ‘leader by topic’ suggests the technique does allow detection of some variation depending on the issue being discussed by the decision-maker, and examination of ‘leader by role’ suggests that portfolio may matter. The use of alternative content for LTA analysis, media reportage, did not resolve the issue. The expected trait signals based on the literature, again, was not revealed.

Overall, evidence to support Nyberg’s claims of impactful irrational groupthink and herding were not unearthed using this particular technique. While the automation of the LTA method has tackled the basic issues of reliability involved in the coding of large amounts of data, validity issues have proven harder to settle. Is the hypothesis rejected because conceptual complexity and in-group bias cannot proxy for convergence bias? If they are a proxy, is the LTA method not sensitive enough to reveal variation in levels among and between leaders? Does the role of Irish leaders make a comparison with other Western leaders unsuitable? What constitutes significant change, or difference, when comparing one leader over time, or one leader to another/group of leaders? The trait/state debate is important for the LTA method. If LTA truly measures a leader’s traits a researcher may draw upon sources at any time available. If LTA actually measures a leader’s state at a given moment, a researcher must be more selective and only gather sources for analysis that is of right period, and understand, assess and take into account a leader’s circumstances and any significant impact it has on results and conclusions. Previous research has suggested a variety of conditions under which traits may change such as learning and time in office and different political contexts, and it is plausible to assume that major events and crises, and different institutional or political roles, could impact on a leader so as to impact on assessment.

The next issue to be addressed is which sources are suitable to use when constructing a leadership trait profile. The issue of 'strategic' use of speech-acts (often called *impression management*), and whether leaders display different personal dispositions in private versus in public is an important issue that speaks to the validity of all measuring at a distance techniques. Impression management refers to the behavioural strategies people use to create desired social images or identities (Tetlock and Manstead, 1985: 59.) As Tetlock and Manstead argue, establishing the precise extent to which impression management complicates or even invalidates research findings in this area is challenging. Researchers must be aware of, acknowledge and report the fact that impression management is a factor, and where practical, take mitigating steps.

Before the hypothesis can be rejected on the basis that irrational groupthink was not an impacting factor on decision-making in Ireland, these validity issues must be explored, and this is the subject of the next Chapter.

Chapter 6: Exploring the Methodological Challenges of Leadership Trait Analysis[3]

6.1 Leadership Trait Analysis: Methodological Challenges

Given the scale and widespread impact of the global financial crisis since 2008, it is understandable that questions are asked of those who took important relevant decisions. It has been claimed that political scientists have not adequately explained why policy-makers in liberal democracies acted the way they did in the years before the economic crisis (Bernhagen and Chari, 2011: 456), and that analysis of the economic crash in Ireland concluded that - up to that point - discussion of economic governance had been largely missing in the Irish debate, and that this needed to rectified (Kirby, 2010: 55). This research aims to address this gap on the basis that economic governance, personality traits, and the decisions made by political leaders, actually matter. In addition, once a crisis emerges the issue of political leadership becomes more salient. Decision-making is delegated to a small group of leaders ('t Hart et al., 1993; Hermann et al., 2001) and the uncertainty associated with large-scale upheaval increases public demand for leadership, vision, and decisive action.

The public and scholars alike wonder how their leaders' personality traits and leadership style influence their crisis response (Thies, 2004; 2009; Basham and Roland, 2014; Van Esch, 2015; Van Esch, and Swinkels 2015; Boin, 't Hart, and Van Esch, 2012). To provide this answer, a valid and reliable method is needed to establish leaders' personal characteristics across cases. In other words, preceding the larger theoretical and empirical question of how the personalities and leadership styles of political leaders matter, lies the basic but complex methodological question of how to establish political leaders' personality in a consistent and reliable fashion. While this issue may seem somewhat more mundane than the big theoretical question, answering it constitutes a vital step in advancing our understanding of the role of leadership in politics. The preceding Chapters illustrate the importance of this issue: if policy-responses are to be devised to help avert or mitigate crisis events, valid and reliable assessment methods must be available to ensure that causes are isolated and addressed. The application of one leadership analysis technique in this research has failed to do so.

Important methodological ground-work has been done and several techniques to study the personal characteristics of political leaders exist. One of these techniques and the one chosen for this research, Leadership Trait Analysis (LTA, see Chapter 4), focuses explicitly

[3] This chapter is based on collaborative research undertaken by the author and Dr. Femke van Esch, Associate Professor, Utrecht University School of Governance. Consent for use of this research here has been granted.

on measuring the personality traits of political leaders, and this has given rise to a vibrant and flourishing research program. LTA has several advantages over other techniques: it encompasses a broad range of traits, and the automation of the coding process makes it time-efficient and reliable. Moreover, while the quantitative nature of the technique has the definite drawback of losing some of the depth and intuitive validity that comes with small-n case-study research (Post, 2014), it does enable researchers to systematically study trends in occurrence and variability of traits as well as establish correlations between leaders' traits, its causes, and consequences (Dyson 2008; Schafer 2000; Thies 2004; Van Esch and Swinkels 2015).

Over the years, an active research program has emerged exploring whether leaders' personality traits as measured by LTA matter for political processes and outcomes. The questions examined include leaders' use of advisory systems, foreign policy behaviour, negotiation, sense-making and belief-change, and policy outcomes (Dyson 2006; Hermann 1980a; Hermann and Dayton 2009; Kaarbo and Hermann 1998; Keller and Foster 2012; Mahdasian 2002; Schafer and Walker 2006; Van Esch 2015; Van Esch and Swinkels 2015). This research is focused on decision-making. Nevertheless, there are disadvantages to employing automated methods and they must be applied with care and with close consideration of research-specific validation.

Grimmer and Stewart (2013) surveyed a number of automated methods to provide advice on how to validate the outputs, and clarify "misconceptions and errors in the literature", arguing that "for automated text methods to become a standard tool for political scientists, methodologists must contribute new methods and new methods of validation" (Grimmer and Stewart, 2013: 267). LTA falls into the category of 'dictionary methods' they reviewed, as it uses the rate at which key words appear in a text to classify it into particular categories (traits). The authors offer this advice:

> "When applying dictionaries, scholars should directly establish that word lists created in other contexts are applicable to a particular domain, or create a problem-specific dictionary. In either instance, scholars must validate their results. But measures from dictionaries are rarely validated. Rather, standard practice in using dictionaries is to assume the measures created from a dictionary are correct and then apply them to the problem" - *Grimmer and Stewart, 2013: 275*

The authors discourage the use of many commercial tools for quantitative text analysis as these programmes simply provide the researcher with output, but it is "often difficult, and sometimes impossible, to validate the output" (Grimmer and Stewart, 2013: 271). This issue arose and was discussed in Chapter 4.

6.2 LTA Validity and Trait Stability

The automation of the LTA method has tackled the basic issues of (intercoder) reliability involved in the coding of large amounts of data. However, the above-mentioned validity issues have proven harder to settle. While most authors that have applied the LTA framework have used it to answer substantive questions, several authors have also addressed its validity issues. A review of these methodological studies shows that tentative agreement exists on certain core questions.

- Firstly, several studies have explored the construct validity of LTA traits by comparing whether the scores correspond with existing scholarly accounts of the leaders' disposition and behaviour (Dyson, 2008; Kesgin, 2012; 2013; cf. Hermann, 2002). These studies conclude unanimously that the outcome of <u>leadership trait analysis shows significant correspondence to qualitative assessments of leaders personal characteristics and behaviour</u>.
- Secondly, a range of studies find that the <u>LTA is able to differentiate meaningfully between the personalities of different leaders</u> (leader-effect, Dille, 2000; Dille and Young, 2000; Dyson, 2008; Kesgin, 2013; Mahdasian, 2002).[4]
- Finally, Mahdasian (2002) finds that <u>the topic of the speech-acts on which the LTA is based may give rise to significantly different scores</u>, but no significant differences are revealed between original or translated version of particular speech-acts (cf. Herman, 2002).

However, important issues remain. An overarching question is whether LTA measures *trait* - psychological dispositions that remain relatively stable throughout leaders' lives - or *state* – characteristics that may evolve over time and in response to external circumstances. Authors that have addressed this question have come up with ambiguous results with some leaders being more stable over time than others, and on some traits more than others (Dille and Young, 2000; Dyson, 2008; Mahdasian, 2002). As a result, different authors hold different positions on the trait/state issue (Schafer, 2014).

[4] Mahdasian (2002) finds that LTA does not differentiate significantly between leaders for In-group Bias.

Over time, Hermann has come to believe that traits are variable rather than stable. Dyson (2008) notes the considerable variation in trait scores for individual leaders, but refrains from drawing any theoretical conclusions from his findings, while Thies (2004) takes an explicitly ambiguous position. However, finding a more cohesive and settled position is important. For example, if LTA measures stable personality traits a researcher may draw upon any statement made by a leader at any time. If LTA measures leaders' personal disposition at a specific moment in time, researchers are well-advised to be more selective and only use statements made during the same period in which the behaviour was displayed (or decision was made) that they are seeking to explain.

Moreover, some studies have suggested that there may be an underlying pattern to the stability and change found in empirical studies, and propose a variety of conditions that may induce changes in leaders' personal trait scores and that therefore should be taken into account by researchers using the LTA. There is, however, no consensus as to what factors may significantly affect leaders' LTA scores. Mahdasian (2002) has suggested that time in office may affect leaders' personal dispositions, while Dille (2000) has studied whether cooperative international relations may be relevant, but neither finds evidence for these propositions in their studies of US presidents.

In the literature, several other factors are identified that may affect leaders' personality trait scores, in particular the leaders' different institutional or political positions (*role*), the decision-making context the leader finds themselves such that these generate stimuli, such as stress, which may alter behaviour (*state*), and finally, the content-material analysed to generate the trait scores using LTA and Profiler Plus (*source*). The following section will set out why these three factors could impact on the scores for seven LTA traits. To recap, these traits are:

Leadership Trait	**Description**	**LTA Trait Code**
Conceptual complexity	The intricacy of the cognitive structure of a leader's belief system. Cognitively complex individuals have a desire to seek multiple sources of information concerning issues and policy options, are able to see varying reasons for a particular position, and are willing to entertain the possibility that there is ambiguity in the environment	CC
Belief in one's ability to control events	The amount of control leaders feel they have over the situations they encounter	BACE

Need for power or influence	The concern for establishing, maintaining, or restoring one's power of influence / have an impact on other people	PWR
Self-confidence	The leaders' sense of self-importance and sense of one's self	SC
Task orientation	The extent leaders are focussed on completing their task and solving problems or on building and nurturing human relationships by maintaining group spirit and morale	
Distrust of others	The level of trust a leader has in other actors and whether they see them as trustworthy	DIS
In-group bias	The degree to which a leader praises his own political, economic, social, cultural group and how patriotic and protective they are of their in-group	IGB

Table 6.1: Leadership Trait Analysis: Traits, Meanings, and Code

Table 6.2 shows the mean scores for a norming group of 53 Western leaders for the period 1998 to 2008 analysed using the same methods that will be applied in this chapter (Hermann, 1999; Derksen, 2012).

Western Leaders	**BACE**	**PWR**	**CC**	**SC**	**TASK**	**DIS**	**IGB**
High (equal to or greater than)	0.40	0.31	0.63	0.45	0.73	0.15	0.22
Norming Group Mean (53 Western Leaders)	**0.33**	**0.26**	**0.57**	**0.32**	**0.64**	**0.09**	**0.17**
Low (equal to or lower than)	0.26	0.21	0.51	0.19	0.55	0.03	0.12
Standard Deviation	0.07	0.05	0.06	0.13	0.09	0.06	0.05

Table 6.2: Norming Group Mean Scores and Designation Scheme for Western Leaders

6.3 Expectations of the Impact of Role, State, and Source

With regard to institutional role, the difference between the heads of government – in the Irish and British case the Prime Minister – and their ministers, stands out. For even if Prime Ministers are the 'first among equals', the position brings both different demands as well as different personal and institutional power resources (Heffernan, 2003). In the case of the UK and in Ireland, Prime Ministers typically emerge from fierce leadership competitions in their parties, and general elections, successes which will understandably boost their self-confidence. Moreover, their predominance can be expected to somewhat sate a previously held need for power, while simultaneously boosting their belief that they can control events. Whether the power of the role is exercised by exploiting resources within policy networks, through agenda-setting, or by structuring the choices of cabinet and parliament via the selective releasing and withholding of information, the Prime Ministerial role can be expected to increase self-belief and decrease the craving for power (O'Malley, 2007; Toye, 2011).

Certainly, these impacts can be expected in relation to both of the leaders assessed in this Chapter (Gordon Brown and Brian Cowen) following their long waits for the opportunity to become Prime Minister, ten and eleven years respectively. As Tony Blair's likely heir apparent, Brown's wait in particular can been characterised as frustrated and impatient (Heffernan, 2005: 614; Peston, 2005; Bower, 2004; Rawnsley, 2001). Altogether, this leads to expectation that: Leaders' belief that they can control events and their level of self-confidence will be lower as Minister than as Prime Minister, while a leader's need for power will be higher as Minister than as Prime Minister.

Crisis and leadership are closely intertwined phenomena as crises are episodes of threat and uncertainty likely to harm leaders' confidence and reduce a sense of control. Moreover, today's crises will increasingly test the conceptual complexity of leaders as, they are often the product of processes like globalisation, deregulation, technological advances which "promote a close-knit world that is nonetheless susceptible to infestation by a single crisis. Comparatively slight mishaps within these massive and intricate infrastructures can rapidly escalate in unforeseen ways" (Boin and 't Hart, 2003: 545).

These forces were certainly at play in the global economic crises faced by Cowen and Brown in 2008, and in the case of Cowen in particular, are viewed as sapping him of self-confidence (Irish Times, January 17th, 2011). Crisis events drive up a leader's need for power as policy responses emerge via multi-actor coordination where consultation, negotiation, and outright confrontation is necessary ('t Hart, Rosenthal, and Kouzmin, 1993; Flin, 1996). Commenting after the crisis, Cowen described it as akin to multiple plane crashes, with multiple causes, all occurring at the same time (Cowen, 2012).

Finally, crises can erode a leader's trust in others. Crises are accompanied by increasingly assertive and tenacious media coverage, and leaders pressured by "streams of informal investigations, proactive journalism, insurance claims, and juridical (including criminal) proceedings against them" (Boin and 't Hart, 2003: 545). This leads to the expectation that leaders' need for power, conceptual complexity, and distrust of others will be higher after the onset of a crisis as opposed to before, while their belief he can control events and his self-confidence will be higher before the crisis, than after.

In addition to the effect of contextual factors on leaders' LTA scores, another issue central to the methodological discussions surrounding the LTA framework is that of the most appropriate source-material. In this regard, the issue of *impression management* is important. Impression management refers to the behavioural strategies people use to create desired social images or identities (Tetlock and Manstead, 1985: 59). What people say and do frequently represent attempts to create desired impressions on others, and people are "highly sensitive to the social significance of their conduct and are motivated to create desired identities" (Tetlock and Mansfield, 1985: 60). For political leaders and for those generally whose office depends on the votes or support of others, such impression management is especially salient. Most studies devoted to this issue and using a variety of methods focus on difference between leaders' public and private speech-acts and find that despite being fraught with potential hazards, the studied leaders' messages were remarkably similar across public and the private statements, providing some empirical confirmation of the validity of using public speech-acts to assess leaders dispositions (Renshon, 2009: 658; Dyson and Raleigh. 2014; cf. Marfleet 2000;).

Researchers only very rarely have access to private sources (cf. Dyson and Raleigh, 2014 for private source availability). When this is the case, the choice is easy: researchers would always prefer to use them over public sources. However, at a distance techniques were developed precisely because studies usually do not have direct access to private sources, but still want to answer important research questions. Therefore an alternative is needed and the most immediate question is therefore what public sources are best used to derive trait scores using LTA: prepared speeches, responses to parliamentary questions (used in this research), or ad libbed speech-acts.

Originally, Hermann advises use of ad libbed remarks and responses to questions, however (as the research confirms) these are relatively rare and not easily sourced. Having to rely on these will limit the total amount of data available and thereby the opportunity to control for other factors. This is why research has relied on less spontaneous sources such as replies to parliamentary questions (Kaarbo and Hermann 1998; Dyson 2008) or even fully prepared speeches (Winter et al., 1991; Mahdasian, 2002; Thies, 2004). It is, however, unclear whether these more prepared speech-acts return similar results as ad libbed speech. Prepared speeches offer a better opportunity to manage created identities than spontaneous, ad libbed speech acts, with greater knowledge of topic, audience and greater time to prepare conferring advantage. Research shows that "[w]ithout question, people often seek culturally valued identities", and certain leadership traits are more valued than others (Tetlock and Mansfield, 1985: 61). For example, depending on the specific event, utterances can be designed in advance to improve leaders' image by creating or amplifying the impression that they believe they can control events, are ambitious, or favour one group over another.

Evidence of this can be found in Mahdasian's analysis (2002) where the scores for these three associated traits (control of events, need for power, and in-group bias) were consistently lower when speech-acts are more spontaneous. Interestingly and contrary to intuition perhaps, there is little evidence of leaders managing-up the impression of the intricacy or complexity of their belief system, or the variety of their beliefs in prepared material. Scores for the conceptual complexity trait were found to be higher rather than lower in ad libbed speech acts (Dille and Young, 2000; Mahdasian, 2002; Dyson and Raleigh, 2014). Similarly, there is some evidence that when speaking spontaneously, leaders can portray greater levels of self-confidence and task orientation (Mahdasian, 2002: 79). Though this might appear contrary to what one might expect of impression management strategies, it is equally possible that a leader would be more confident, assertive and focussed using his owns words rather than that of a speech-writer. This leads to the expectation that leaders' scores for the belief in their ability to control events, need for power, and in-group bias will be higher in prepared speech content, compared to ad libbed utterances. The empirical analysis section of this Chapter will further explore all of these remaining questions.

Firstly, it will examine whether the seven trait scores vary over time. Then, the Chapter will study whether trait scores vary over time due to a change in *role* (e.g. Minister / Prime Minister), or a change in *state* (e.g. pre-crisis / crisis period). Finally, a comparison is provided of trait scores using two different *sources* (prepared and ad libbed) speech-acts. Each of these analyses is unique in including all seven LTA traits (cf. Mahdasian, 2002).

6.4 Testing LTA: Research Design Choices

To further explore the methodological questions set out above, LTA scores for two European leaders, Gordon Brown and Brian Cowen, were generated. Gordon Brown was the British Chancellor of the Exchequer from 1997 to 2007, and Prime Minister from 2007 to 2011. Brian Cowen was the Irish Minister for Finance from 2004 to 2008 and Taoiseach from 2008 to 2011. Selecting Brown and Cowen is interesting in that both leaders went directly from having the role of Finance Minister to role of Prime Minister. Secondly, after a period of economic boom, they were both faced with the 2008 financial crisis. Third, as turbulent times also stimulate leaders to engage with the public and other political actors, there was a high probability that both prepared and spontaneously ad libbed content could be located. Overall, Brown and Cowen thus offer the variation sought to address our research questions, in terms of role, state and source. At the same time, they display similarities that allow us to assign any changes or differences we find to these three variables more confidently. They are both English-speaking, removing any possibility of translation bias, and while the Irish and UK political systems differ somewhat (though within a European Union supranational context) their respective executive roles are remarkably similar (O'Malley and Martin, 2010). There is also an attraction in keeping the topics of speech-acts as similar as possible as research shows this to be important (Mahdasian, 2002), and both leaders had to deal with saving banks and responding to the resulting sovereign debt crisis. Finally, both were rather unsuccessful as leaders in the end, having presided over a period of growth that proved unsustainable, and providing their nations' initial response to the 2008 market crash in a manner that ended with electoral defeat, and a personal exit from politics.

To establish their LTA scores, both ad libbed speech acts and prepared / semi-ad libbed responses to parliamentary question were selected for both leaders from their instalment as Chancellor of the Exchequer, throughout their time as Prime Minister, to their eventual demise. For the purposes of this research, July 2008 is chosen as the moment when both Brown and Cowen moved into crisis mode.

At that time, Brown was dealing with what a prominent publication called "Britain's sinking economy" (*The Economist*, July 3rd, 2008) involving "a punishing slowdown with a recession looking likelier by the day, sharp decline in home-building, soaring costs of food and fuel, and consumer confidence is at an 18-year low"[5]. By the end of the month the economic circumstances were irrefutably revealed to be having a political impact on Brown. On July 24th Brown's Labour Party lost a by-election in Scotland, with the media stating that Gordon Brown's premiership had been dealt a "potentially fatal blow as Labour lost one of its safest seats in one of the biggest by-election shocks ever" (*The Telegraph*).[6]

The circumstances and timeline for Cowen were not greatly different. For example, on July 8th 2008, the Irish government issued a statement on foot of exchequer returns which confirmed that the State was facing a shortfall of €3 billion in tax revenue for the year, that expenditure was running at 11 per cent ahead of the same period in 2007, and that there were

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[5] http://www.economist.com/node/11670314 retrieved November 5th 2014.

[6] http://www.telegraph.co.uk/news/uknews/scotland/2457021/Glasgow-East-by-election-Humiliation-for-Gordon-Brown-as-Labour-loses-to-SNP.html retrieved November 5th 2014

now a number of new spending pressures arising from the spike in unemployment (Department of Finance, 2008)[7].

The ad libbed speech-acts were sourced via a structured search on the internet and major international, Irish and British news-media (via Lexis-Nexis). All fragments that were found were included irrespective of their length (cf. Mahdasian, 2002). Given that ad libbed speech acts were most difficult to source, this content availability and timeframe was used as the benchmark to match the word count and timing of parliamentary sources.

Analysis Groups	Sample Size (n)
Cowen (Analysed by Month)	11
Cowen (Analysed by Year)	5
Brown (Analysed by Month)	20
Brown (Analysed by Year)	8
Cowen and Brown (Analysed by Month)	31
Cowen and Brown (Analysed by Year)	13

Table 6.3: How Text is Grouped for Analysis, and Sample Sizes

Content for Gordon Brown (from 1998, 2001, 2003, 2006, 2007, 2008, 2009 and 2010) totalled over 69,000 words of both ad libbed and more prepared content from parliament. This can be broken into ad libbed and prepared content for when he was Chancellor of the Exchequer (29,979 and 30,153 words respectively), for when he was Prime Minister (39,462 and 39,409 words), and for the pre-crisis (47,565 and 47,791) and crisis periods (21,876 and 21,771).

For Brian Cowen, 28,000 words of both ad libbed and prepared content (from 2006, 2007, 2008, 2009 and 2010) were sourced, within which sits ad libbed and prepared content for when he was Minister for Finance (4,699 and 4,785 words), for when he served as Taoiseach of Ireland (23,845 and 24,136 words), and for the pre-crisis (12,333 and 13,282 words) and crisis periods (15,667 and14,718 words).

The review will include all seven LTA traits, and the scores produced by the LTA process are subjected to a quantitative analysis to determine whether significant differences exist between trait scores on the basis of role, state, and source. Any significant findings will further be explored qualitatively. The empirical analysis will start, however, with a review of how stable the LTA scores of Cowen and Brown's actually are.

[7] http://www.finance.gov.ie/news-centre/speeches/former-ministers/statement-brian-lenihan-td-minister-finance-0 retrieved November 5th 2014.

6.5 Trait Stability: Do Role, State, and Source Matter?

As indicated in Figure 6.1, both leaders show a wide variety in trait scores. The dots above/between/below the lines indicate a respective high/average/low score relative to the comparator norming group. However, like in previous studies, the extent to which scores vary differs significantly by leader and by trait (Dyson, 2008). In terms of range, Brown's scores on belief in ability to control events and self-confidence are most volatile. Brown's belief in his ability to control events, for instance, ranges from a high of 0.61 in June 2003, to a low of 0.18 in March 2009 and the range of scores on self-confidence is even wider.

Taking into account the lower number of data points, the scores for Brian Cowen fall within an even wider range. This is especially the case for self-confidence and distrust in others. In terms of their designation (see Table 6.2 above), a considerable amount of Brown's scores on belief in ability to control events, need for power, conceptual complexity, distrust of others and in-group bias fall within both the high and the low category. In the case of Cowen, several scores on need for power, conceptual complexity, self-confidence and distrust of others are located in both the low and high category. These results are based on the leaders' speech acts aggregated per month, which is a relatively limited time-frame. When aggregated per year, most scores fall either in the average-high or average-low range, and thus show more consistency. Still, the scores of Brown and Cowen seem to provide support for the view that the LTA reveals the temporary state of mind of leaders rather than stable personality traits. This has important implications for the application of the technique and researchers should be careful in selecting their sources as close as possible to the behaviour they aim to explain. Moreover, it raises the question whether there is an underlying pattern to this volatility.

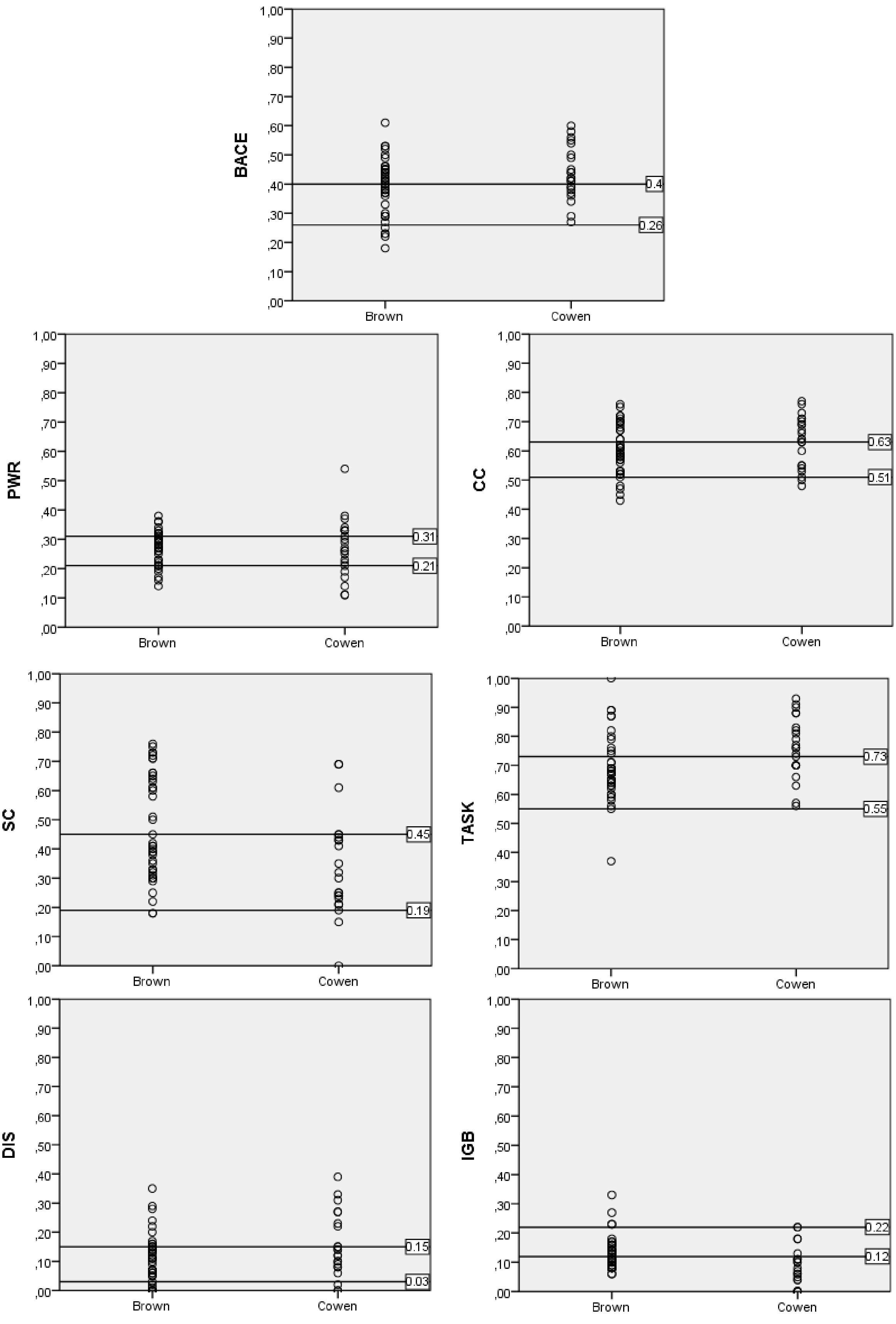


Figure 6.1: Range of Brown and Cowen's Monthly Leadership Trait Scores

6.6 The Impact of Role

One of the factors potentially causing the variability in score over time is the leader's political role. Research such as Mahdasian's (2002) or Dyson's (2008) which compares either U.S. Presidents or British Prime Ministers (2002), removes the necessity to take this factor into account. However if one intends to compare leaders who hold different roles, perhaps in different countries as is the case with the overall research here, then the issue of role emerges as a consideration. For is it appropriate to compare the trait scores of a British Prime Minister, with those of an Irish Taoiseach or a German Chancellor, or a cabinet Minister to a President? Or will their specific roles impact on the leaders' trait scores by constraining or stimulating particular natural leadership traits?

To answer this question, an independent samples t-test was performed on the Brown and Cowen's speech-acts (prepared and ad libbed) at the time they were Minister of Finance, and while they were Prime Minister. When reviewing both leaders collectively, only distrust in others is significantly affected by role, with leaders becoming more distrustful when they are Prime Minister. When assessing the leaders separately, the analysis reveals that role does not significantly impact Brown and Cowen's need for power or influence, conceptual complexity, task orientation, or in-group bias. It does, however, affect their belief in their ability to control events, self-confidence, and distrust of others (see Table 6.4).

More specifically, role has a significant and large effect on Cowen's belief in his own ability to control events (measured on a monthly and annual basis), and his belief self-confidence when measured on a yearly basis. The results show that Cowen had a higher belief in his own ability to control events, but lower self-confidence when he was Prime Minister compared to when he was Minister for Finance. This is a puzzling combination, worthy of future examination. Gordon Brown's political role only mattered significantly for his distrust in others, which increased when serving as Prime Minister compared to when he was Chancellor of the Exchequer.

Leader (Analysis Period)	Mean (Minister)	Mean (Prime Minister)	Trait	t-value	P
Cowen (Analysed by Month)	0.325	0.461	Belief in Ability to Control Events	-3.307	*0.004
Cowen (Analysed by Month)	0.208	0.284	Need for Power	-1.428	0.169
Cowen (Analysed by Month)	0.703	0.616	Conceptual Complexity	1.915	0.07
Cowen (Analysed by Month)	0.408	0.328	Self-Confidence	0.819	0.422
Cowen (Analysed by Month)	0.795	0.753	Task Orientation	0.721	0.479
Cowen (Analysed by Month)	0.190	0.145	Distrust of Others	0.744	0.465
Cowen (Analysed by Month)	0.058	0.091	In-group Bias	-0.854	0.403
Cowen (Analysed by Year)	0.280	0.415	Belief in Ability to Control Events	-3.333	*0.01
Cowen (Analysed by Year)	0.220	0.253	Need for Power	-0.622	0.551
Cowen (Analysed by Year)	0.720	0.626	Conceptual Complexity	1.836	0.104
Cowen (Analysed by Year)	0.565	0.319	Self-Confidence	2.741	*0.025
Cowen (Analysed by Year)	0.895	0.745	Task Orientation	2.279	0.052
Cowen (Analysed by Year)	0.155	0.151	Distrust of Others	0.054	0.958
Cowen (Analysed by Year)	0.040	0.091	In-group Bias	-1.844	0.102
Brown (Analysed by Month)	0.394	0.391	Belief in Ability to Control Events	0.096	0.924
Brown (Analysed by Month)	0.260	0.282	Need for Power	-1.231	0.226
Brown (Analysed by Month)	0.601	0.610	Conceptual Complexity	-0.357	0.723
Brown (Analysed by Month)	0.470	0.482	Self-Confidence	-0.2	0.842
Brown (Analysed by Month)	0.719	0.665	Task Orientation	1.541	0.132
Brown (Analysed by Month)	0.078	0.145	Distrust of Others	-2.714	*0.01
Brown (Analysed by Month)	0.126	0.138	In-group Bias	-0.644	0.523
Brown (Analysed by Year)	0.393	0.390	Belief in Ability to Control Events	0.086	0.932
Brown (Analysed by Year)	0.273	0.270	Need for Power	0.158	0.876
Brown (Analysed by Year)	0.603	0.592	Conceptual Complexity	0.365	0.721
Brown (Analysed by Year)	0.479	0.465	Self-Confidence	0.179	0.861
Brown (Analysed by Year)	0.696	0.650	Task Orientation	2.123	0.052
Brown (Analysed by Year)	0.095	0.150	Distrust of Others	-2.117	0.053
Brown (Analysed by Year)	0.121	0.120	In-group Bias	0.08	0.938

Cowen and Brown (Analysed by Month)	0.383	0.424	Belief in Ability to Control Events	-1.683	0.098
Cowen and Brown (Analysed by Month)	0.251	0.283	Need for Power	-1.676	0.099
Cowen and Brown (Analysed by Month)	0.618	0.613	Conceptual Complexity	0.218	0.828
Cowen and Brown (Analysed by Month)	0.460	0.409	Self-Confidence	1.039	0.303
Cowen and Brown (Analysed by Month)	0.731	0.706	Task Orientation	0.836	0.406
Cowen and Brown (Analysed by Month)	0.096	0.145	Distrust of Others	-2.015	*0.048
Cowen and Brown (Analysed by Month)	0.115	0.115	In-group Bias	-0.04	0.968
Cowen and Brown (Analysed by Year)	0.374	0.404	Belief in Ability to Control Events	-1.143	0.264
Cowen and Brown (Analysed by Year)	0.264	0.260	Need for Power	0.213	0.833
Cowen and Brown (Analysed by Year)	0.623	0.611	Conceptual Complexity	0.414	0.683
Cowen and Brown (Analysed by Year)	0.493	0.381	Self-Confidence	1.695	0.107
Cowen and Brown (Analysed by Year)	0.729	0.704	Task Orientation	0.736	0.469
Cowen and Brown (Analysed by Year)	0.105	0.151	Distrust of Others	-1.767	0.09
Cowen and Brown (Analysed by Year)	0.108	0.104	In-group Bias	0.274	0.787

Table 6.4: Impact of Role on Trait Scores

(t-test, two tailed $p < 0.05$)

However, many studies do not use absolute scores to assess traits, but rather rely on Hermann's method of categorising scores as high, average, or low (see Table 6.2 above). The use of the designations reduces dampens the apparent effect of role on the trait score. For example, when analysed in terms of low, average or high scores, Cowen's belief in the ability to control events is the only trait that was significantly dependent on political role.

Expectations • A leaders' belief that they can control events and their level of self-confidence will be lower as Minister than as Prime Minister • A leader's need for power will be higher as Minister than as Prime Minister Findings • Analysing leaders together did reveal an impact of role • Both leaders' scores for distrust of others were higher when serving as Prime Minister than when a Minister (no expectation regarding this trait) • Cowen had a higher belief in his own ability to control events when he was Prime Minister than when he was Minister (matches expectation) • Cowen had lower self-confidence when he was Prime Minister than when he was Minister (opposite to expectation) • Brown had a higher level of distrust in others when serving as Prime Minister than when he was Chancellor (no expectation regarding this trait) Conclusion of t-test analysis • Role can have a significant impact on leaders' trait scores

Table 6.5: Summary of the Impact of Role

Although further work is necessary, overall the results of this study indicate that role may have a significant impact on an individual leaders' belief in their ability to control events, self-confidence, and distrust of others. Other traits may not be impacted significantly by the role of the leader. These outcomes partly match the expectations. In the case of Cowen, the extent to which he believed he could control events was higher when he was Prime Minister than when he was a Minister. This lends some credence to theories around Prime Ministerial predominance and increased access to information and resources. However, contrary to one of the hypotheses, Cowen displayed higher self-confidence when he was Minister as opposed to when he led the country. Brown's distrust of others was significantly higher when he was Prime Minister rather than Chancellor. This is consistent with research which shows that backbench dissent in the House of Commons during the government of Brown was "higher than that seen in any previous post-war Parliament, along with showing the degree to which the government were forced to negotiate with, and concede to, their backbenchers in order to prevent rebellion reaching even higher levels" (Cowley and Stuart, 2014: 1). Finally, the results did not provide evidence that either leader's need for power was significantly higher as Minister suggesting perhaps that this trait does not subside on accession to the most senior Cabinet position.

6.7 The Impact of 'State'

The second factor that may impact on leaders' personal disposition and trait scores is the particular set of circumstances they face (cf. Dille, 2000). The t-test shows that having to deal with the crisis does not have a significant effect on any of the leadership traits when the scores for Brown and Cowen are aggregated. When the scores of the leaders are separated, however, the results indicate that the outbreak of the crisis had a significant impact on Cowen's need for power (measured on a monthly and annual basis). Cowen became considerably more power oriented when dealing with the crisis. Cowen's belief that he could control events also increased in the crisis (measured by year). In contrast, the crisis affected Gordon Brown's task-orientation (when measured by month and by year). Interestingly, rather than becoming more task oriented, Brown becomes less task-oriented with the outbreak of the crisis. None of the other traits showed significant effects. Again, assessing the effect of circumstance on leadership traits using Hermann's designation (high, average or low) renders very different results.

Leader (Analysis Period)	Mean (Pre-Crisis)	Mean (Crisis)	Trait	t-value	P
Cowen (Analysed by Month)	0.395	0.460	Belief in Ability to Control Events	-1.693	0.106
Cowen (Analysed by Month)	0.213	0.303	Need for Power	-2.246	*0.036
Cowen (Analysed by Month)	0.664	0.613	Conceptual Complexity	1.342	0.195
Cowen (Analysed by Month)	0.354	0.336	Self-Confidence	0.22	0.828
Cowen (Analysed by Month)	0.754	0.764	Task Orientation	-0.222	0.827
Cowen (Analysed by Month)	0.155	0.152	Distrust of Others	0.058	0.954
Cowen (Analysed by Month)	0.085	0.084	In-group Bias	0.023	0.982
Cowen (Analysed by Year)	0.340	0.460	Belief in Ability to Control Events	-4.21	*0.003
Cowen (Analysed by Year)	0.210	0.300	Need for Power	-3.007	*0.017
Cowen (Analysed by Year)	0.677	0.598	Conceptual Complexity	1.927	0.09
Cowen (Analysed by Year)	0.390	0.335	Self-Confidence	0.548	0.598
Cowen (Analysed by Year)	0.778	0.770	Task Orientation	0.148	0.887
Cowen (Analysed by Year)	0.158	0.143	Distrust of Others	0.279	0.787
Cowen (Analysed by Year)	0.077	0.088	In-group Bias	-0.404	0.697
Brown (Analysed by Month)	0.399	0.378	Belief in Ability to Control Events	0.598	0.553
Brown (Analysed by Month)	0.273	0.265	Need for Power	0.396	0.694
Brown (Analysed by Month)	0.619	0.574	Conceptual Complexity	1.577	0.123
Brown (Analysed by Month)	0.476	0.474	Self-Confidence	0.036	0.971
Brown (Analysed by Month)	0.718	0.631	Task Orientation	2.354	*0.024
Brown (Analysed by Month)	0.098	0.143	Distrust of Others	-1.597	0.119
Brown (Analysed by Month)	0.134	0.126	In-group Bias	0.433	0.668
Brown (Analysed by Year)	0.395	0.383	Belief in Ability to Control Events	0.323	0.751
Brown (Analysed by Year)	0.278	0.255	Need for Power	1.108	0.287
Brown (Analysed by Year)	0.608	0.573	Conceptual Complexity	1.041	0.316
Brown (Analysed by Year)	0.485	0.440	Self-Confidence	0.694	0.499
Brown (Analysed by Year)	0.693	0.635	Task Orientation	2.528	*0.024
Brown (Analysed by Year)	0.106	0.145	Distrust of Others	-1.236	0.237
Brown (Analysed by Year)	0.119	0.125	In-group Bias	-0.418	0.683

Cowen and Brown (Analysed by Month	0.398	0.422	Belief in Ability to Control Events	-0.988	0.327
Cowen and Brown (Analysed by Month	0.259	0.285	Need for Power	-1.375	0.174
Cowen and Brown (Analysed by Month	0.629	0.595	Conceptual Complexity	1.557	0.125
Cowen and Brown (Analysed by Month	0.449	0.400	Self-Confidence	1.022	0.311
Cowen and Brown (Analysed by Month	0.726	0.703	Task Orientation	0.776	0.441
Cowen and Brown (Analysed by Month	0.110	0.148	Distrust of Others	-1.563	0.123
Cowen and Brown (Analysed by Month	0.123	0.104	In-group Bias	1.197	0.236
Cowen and Brown (Analysed by Year)	0.377	0.421	Belief in Ability to Control Events	-1.606	0.121
Cowen and Brown (Analysed by Year)	0.255	0.278	Need for Power	-1.088	0.287
Cowen and Brown (Analysed by Year)	0.631	0.585	Conceptual Complexity	1.658	0.11
Cowen and Brown (Analysed by Year)	0.453	0.388	Self-Confidence	1.16	0.258
Cowen and Brown (Analysed by Year)	0.722	0.703	Task Orientation	0.522	0.606
Cowen and Brown (Analysed by Year)	0.123	0.144	Distrust of Others	-0.694	0.494
Cowen and Brown (Analysed by Year)	0.105	0.106	In-group Bias	-0.081	0.936

Table 6.6: Impact of State on Trait Scores

(t-test, two tailed p< 0.05)

All in all, the analysis does not support the contention that a leader's conceptual complexity or distrust of others would be higher after the onset of a crisis as opposed to before, nor that his self-confidence will be higher before the crisis. However in the case of Cowen, there is evidence that a crisis situation can make a leader more power-oriented, congruent with crisis theories of necessary multi-actor policy responses. Though only appearing in the analysis of annual scores, Cowen did display greater belief in his ability to control events in the crisis, which is surprising. While there was no *a priori* expectation that crisis would impact significantly on task-orientation, results for Brown did suggest this, albeit not in the direction one might assume. Due to the close coincidence of the onset of the crisis state with ascension to role as Prime Minister, for both leaders, further research is desirable particularly as the traits significantly impacted by the role and state are not identical. The "Belief in Ability to Control Events" trait is impacted significantly, and similarly by both variables.

Expectations • A leader's need for power, conceptual complexity, and distrust of others will be higher after the onset of a crisis as opposed to before • A leader's belief they can control events and his self-confidence, will be higher before the crisis, than after Findings • Analysing leaders together revealed no impact of state • Cowen had higher need for power when dealing with the crisis (matches expectation) • Cowen had greater belief in his ability to control events in the crisis (opposite to expectation) • Brown had lower task-orientation following the outbreak of the crisis (no expectation regarding this trait) Conclusion of t-test analysis • State can have a significant impact on an individual leader's trait scores

Table 6.7: Summary of the Impact of State

6.8 The Impact of Source

Finally, there is the question whether one can reliably mix ad libbed interview responses and semi-prepared parliamentary responses, or whether 'impression management' effects will distort the results. To address this question, again a t-test was performed comparing the scores for both sources split by month and by year. The analysis shows that for Cowen and Brown using ad libbed or parliamentary sources makes a significant difference for belief in ability to control events, self-confidence and distrust of others for monthly scores. Annual scores for belief in ability to control events and self-confidence only, are impacted by source.

For both leaders their scores on belief in ability to control events are generally higher when speaking before parliament than in their ad libbed speech, while their distrust of others is lower when speaking before parliament. Moreover, as Table 6.8 indicates, source has a particular strong effect on Cowen and Brown's self-confidence which is typically higher when they engage in ad libbed speech-acts than when they are addressing parliament. For some traits, source impacts in the same way on both leaders. Looking at their individual scores, distrust of others is higher for both leaders in ad libbed speech, belief in ability to control events is lower in ad libbed speech for both men, and self-confidence is higher using ad libbed material to assess the trait for both Brown and Cowen.

Leader (Analysis Period)	Mean (Parliament)	Mean (Ad Libbed)	Trait	t-value	P
Cowen (Analysed by Month)	0.446	0.427	Belief in Ability to Control Events	0.463	0.648
Cowen (Analysed by Month)	0.293	0.247	Need for Power	1.079	0.293
Cowen (Analysed by Month)	0.659	0.604	Conceptual Complexity	1.539	0.139
Cowen (Analysed by Month)	0.272	0.414	Self-Confidence	-2.061	0.053
Cowen (Analysed by Month)	0.797	0.724	Task Orientation	1.724	0.1
Cowen (Analysed by Month)	0.098	0.208	Distrust of Others	-2.724	*0.013
Cowen (Analysed by Month)	0.086	0.836	In-group Bias	0.06	0.953
Cowen (Analysed by Year)	0.392	0.384	Belief in Ability to Control Events	0.16	0.887
Cowen (Analysed by Year)	0.270	0.222	Need for Power	1.222	0.257
Cowen (Analysed by Year)	0.688	0.602	Conceptual Complexity	2.26	0.054
Cowen (Analysed by Year)	0.288	0.448	Self-Confidence	-1.938	0.089
Cowen (Analysed by Year)	0.818	0.732	Task Orientation	1.424	0.192
Cowen (Analysed by Year)	0.126	0.178	Distrust of Others	-0.986	0.353
Cowen (Analysed by Year)	0.080	0.082	In-group Bias	-0.075	0.942
Brown (Analysed by Month)	0.430	0.355	Belief in Ability to Control Events	2.614	*0.013
Brown (Analysed by Month)	0.277	0.265	Need for Power	0.662	0.512
Brown (Analysed by Month)	0.563	0.648	Conceptual Complexity	-3.698	*0.001
Brown (Analysed by Month)	0.353	0.599	Self-Confidence	-5.987	*<0.001
Brown (Analysed by Month)	0.687	0.696	Task Orientation	-0.249	0.804
Brown (Analysed by Month)	0.085	0.138	Distrust of Others	-2.077	*0.045
Brown (Analysed by Month)	0.133	0.131	In-group Bias	0.139	0.89
Brown (Analysed by Year)	0.436	0.348	Belief in Ability to Control Events	3.728	*0.005
Brown (Analysed by Year)	0.281	0.263	Need for Power	1.063	0.306
Brown (Analysed by Year)	0.569	0.629	Conceptual Complexity	-2.341	*0.035
Brown (Analysed by Year)	0.330	0.618	Self-Confidence	-6.436	*<0.001
Brown (Analysed by Year)	0.670	0.688	Task Orientation	-0.74	0.472
Brown (Analysed by Year)	0.090	0.141	Distrust of Others	-2.013	0.064
Brown	0.124	0.118	In-group Bias	0.518	0.612

(Analysed by Year)					
Cowen and Brown (Analysed by Month)	0.436	0.381	Belief in Ability to Control Events	2.316	*0.024
Cowen and Brown (Analysed by Month)	0.282	0.258	Need for Power	1.279	0.206
Cowen and Brown (Analysed by Month)	0.597	0.632	Conceptual Complexity	-1.639	0.106
Cowen and Brown (Analysed by Month)	0.324	0.533	Self-Confidence	-5.293	*<0.001
Cowen and Brown (Analysed by Month)	0.726	0.706	Task Orientation	0.698	0.488
Cowen and Brown (Analysed by Month)	0.089	0.163	Distrust of Others	-3.28	*0.002
Cowen and Brown (Analysed by Month)	0.116	0.114	In-group Bias	0.136	0.892
Cowen and Brown (Analysed by Year)	0.419	0.362	Belief in Ability to Control Events	2.377	*0.026
Cowen and Brown (Analysed by Year)	0.277	0.247	Need for Power	1.616	0.119
Cowen and Brown (Analysed by Year)	0.615	0.619	Conceptual Complexity	-0.144	0.887
Cowen and Brown (Analysed by Year)	0.314	0.552	Self-Confidence	-5.093	*<0.001
Cowen and Brown (Analysed by Year)	0.727	0.705	Task Orientation	0.661	0.515
Cowen and Brown (Analysed by Year)	0.104	0.155	Distrust of Others	-2.035	0.053
Cowen and Brown (Analysed by Year)	0.107	0.104	In-group Bias	0.215	0.832

Table 6.8: Impact of Source on Trait Scores

(t-test, two tailed $p < 0.05$)

Different sources do not produce significantly different scores for both leaders' need for power, task orientation or in-group bias. Scores for conceptual complexity reveals a nuanced picture. While there is no effect of source-type on Cowen's conceptual complexity, a pattern does seem to emerge for Gordon Brown (see Figure 6.2). A t-test reveals a significant effect of source type on Brown's conceptual complexity (measured both by month and annually) such that his ad libbed speech-acts show higher conceptual complexity than those generated by the more prepared speech-acts before parliament. The difference is most prominent in his years as Prime Minister.

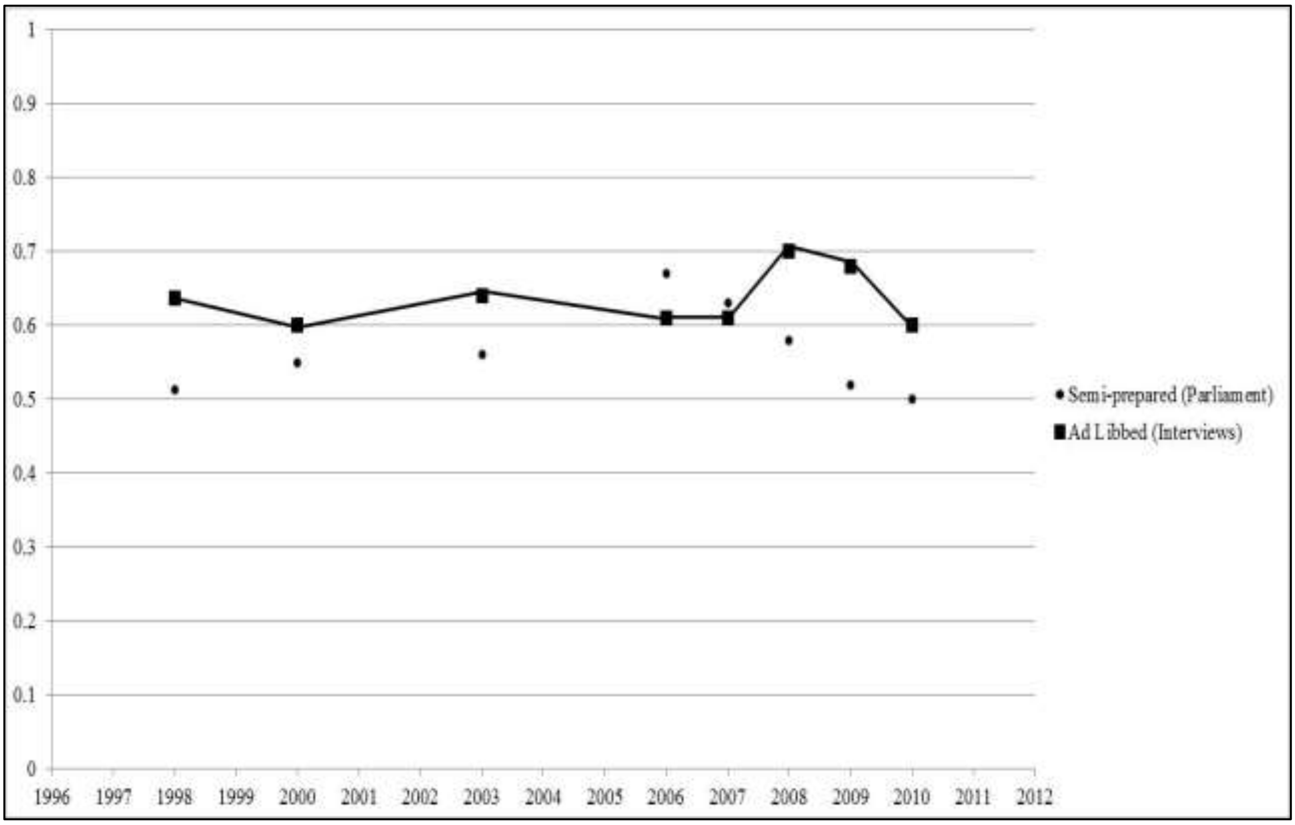


Figure 6.2: Brown's Conceptual Complexity by Source, per year

Expectations • A leader's scores for the belief in their ability to control events, need for power, and in-group bias will be higher in prepared speech content, compared to ad libbed utterances Findings • Analysing leaders together did reveal an impact of source • Both leaders' scores for belief in ability to control events were higher when speaking before parliament than in their ad libbed speech (matches expectation) • Both leaders' distrust of others was lower when speaking before parliament (no expectation regarding this trait) • Both leaders' self-confidence is higher when they engage in ad libbed speech-acts than when they have to face parliament (no expectation regarding this trait) • Brown's score for conceptual complexity is higher for ad libbed speech-acts than those generated by the more prepared speech-acts before parliament (no expectation regarding this trait) Conclusion of t-test analysis • Source can have a significant impact on leaders' trait scores

Table 6.9: Summary of the Impact of Source

The expectation that leaders' scores for belief in their own ability to control events would be higher in prepared material is supported by the results. Set piece situations such as parliamentary question time offer an enhanced opportunity for impression management and, for this trait at least, that opportunity appears to be availed of. However, further research is required to help understand why this is not the case for LTA scores for the need for power and in-group bias traits. Perhaps the ability to control events is a consistently valued identity trait in a way that need for power or in-group bias are not.

The higher traits scores for conceptual complexity (for Brown) and self-confidence in ad libbed utterances was not expected *a priori*, but are consistent with previous research, and add weight to the argument that a leader's confidence, assertiveness and focus can be more evident from their own ad libbed words rather than those prepared in advance and/or with input from others (Dyson and Raleigh, 2014; Mahdasian, 2002).

6.9 Consequences of findings for the study of Leaders At a Distance

The first issue that was raised concerned the question whether LTA measures stable traits, or the variable state leaders are in. In congruence with previous studies (Dille and Young, 2000; Dyson, 2008; Mahdasian, 2002) the analysis of Cowen and Brown finds evidence that LTA scores may vary considerably over time although the extent to which may vary between leaders and across traits. As LTA has been shown to discriminate between different leaders, this may not pose a problem as long as scholars treat the LTA framework as a tool to capture leaders' variable state of mind rather than any fixed personality state and adjust their methodological choices accordingly. As is shown in this Chapter, this is especially important when working with traits like belief in ability to control events and distrust of others. Only in-group bias and task orientation appear to be relatively stable over time and under varying circumstances.

When LTA scores are seen as a measure of state rather than trait, the question emerges whether there is a logic underlying the variability in scores. For both leaders distrust in others is significantly affected by role as they become more distrustful when they become Prime Minister. Cowen shows a significantly higher belief in ability to control events (per month and annually) and lower self-confidence (per year) during the time he was Prime Minister than when he was Minister for Finance. For Gordon Brown the precise political role he played only mattered significantly for his distrust in others (per month) whereby he showed a higher level of distrust when serving as Prime Minister. These effects, however, largely disappear when the LTA norming group framework is used as advised by Hermann and the trait-scores are reported in designations (high, average, low). The only remaining effect using this assessment model was on Cowen's belief in ability to control events, which was higher when he served as Prime Minister (per month). Of the hypothesised impacts of role on LTA, this was the only one which found support from this analysis, creating questions around the extent to which accession to Prime Ministerial role does in fact sate a craving for power, or instil a level of confidence which is robust to external challenges. Since no previous study has studied the effect of role, further research is needed to see whether this is a more general pattern and whether researchers may confidently use LTA to compare different leaders exercising different roles.

In addition, the effects of the outbreak of the financial crisis were explored. Previous studies suggest that salient external events may account for differences in LTA scores over time (Mahdasian, 2002), but the only study that has tested this hypothesis to date and which focussed solely on conceptual complexity, found no significant context effect (Dille, 2000). Again, the results in this Chapter largely confirm this earlier finding with regard to conceptual complexity. In terms of the other six traits, the effects are also limited. In absolute scores, Cowen is shown to become considerably more power-oriented when dealing with the crisis, while Brown became slightly less task oriented. Using Herrmann's designation scheme produces a different outcome, showing only Cowen's belief in ability to control events to be significantly higher after the onset of the crisis (all monthly scores). It may be that a domestic versus a global crisis, or a natural versus an economic disaster, would have prompted the hypothesised increase in the leader's conceptual complexity or distrust of others, or the expected lowering in his belief he can control events and self-confidence, but further research will be necessary in this regard. Overall, even a very salient economic and political event like the global financial crisis seems to have only a limited explanatory value for variation in LTA scores.

Further, although researchers are advised to use ad libbed sources, practical considerations of availability have forced several of them to use (semi-)prepared sources or mixed sources. Like some earlier studies, this analysis of Brown and Cowen suggests that the type of source material matters for the outcomes and researchers must be careful to consider the consequences of their choices. In fact, source effects are the most robust cause of variation in traits. In line with several previous studies, Cowen and Brown's belief in ability to control events, distrust of others, self-confidence and conceptual complexity scores vary significantly whether ad libbed or semi-prepared sources are used. However as the impression management thesis suggests, the scores vary in a predictable manner. In congruence with earlier studies, Cowen and Brown's scores on belief in ability to control events are significantly lower when their speech-acts are more ad libbed then when they engage in semi-prepared speech-acts. Moreover, conceptual complexity and self-confidence is higher when engaging in ad libbed speech (cf. Dille and Young, 2000; Dyson and Raleigh, 2014; Mahdasian, 2002). In contrast to the four US Presidents in Mahdasian's study however, Cowen and Brown's need for power, task orientation and in-group bias scores do not differ significantly over source types. The expectation that impression management would see a leader attempt to maximise perceptions of ability to control events were borne out, but this was not the case for need for power and in-group bias traits, posing questions around whether some traits are more consistently or predictably valued. Similarly, further analysis might help reveal the extent to which confidence, assertiveness and focus are revealed to a greater extent in ad libbed versus prepared utterances. While these results caution researchers not to mix different source-types or compare studies using different sources, the predictable patterns may offer opportunities to use semi-prepared sources when ad libbed sources are hard to come by when done in an informed fashion. Corrected for their respective tendency to increase (belief in ability to control events) or decrease (conceptual complexity, self-confidence) scores, semi-prepared sources may adequately reflect leaders' spontaneously professed state of mind.

This analysis has shown that using Herman's designations of scores as low, average and high may be problematic. Firstly, in several instances during the analysis the use of designations seem to both obscure meaningful differences in scores while at other instances the designations over amplify non-significant differences. This is the direct result of the categorisations as an increase of, for instance, 0.10 on a low average score may have no effect on the designation while an increase of 0.03 on a high average score may be enough to change the designation. Moreover, using one standard deviation, the range denoting high, average or low score may vary considerably. In case of belief in ability to control events, for instance, a score that sits between 0 and 0.26 is categorised as low while high scores lie anywhere between 0.4 and 1, a range more than twice as large. By using such unequal scales, significant variance between 'high' and 'super-high' (or alternatively 'low' and 'super-low') is obscured. This may hide the actual or contextual factors on the scores. More fundamentally, the designations are highly dependent on the composition of the norming group of leaders and their average scores. Current norming groups take into account some relevant cultural differences but include leaders with very different roles, in different contexts/states, and are based on a variety of sources. As this research has revealed some evidence that role, state and source-type influence leaders' scores, these norming groups may actually not be suited to categorise leaders' scores with.

6.10 Consequences of Findings on Study of Irish Leaders Before the Crisis

Chapter 5 reported results which did not support the hypothesis that leaders in Ireland in the lead up to the crisis would have lower trait scores for conceptual complexity, and higher for in-group bias, relative to the mean of a norming group of other Western leaders. The question was posed as to whether the analysed decision-makers were not victims to irrational forces, or whether the LTA method employed is not suitable for detecting these forces.

Several previous studies had explored the validity of LTA and found that its results showed significant correspondence to qualitative assessments of leaders personal characteristics and behaviour, that LTA is able to differentiate meaningfully between the personalities of different leaders, and that the topic of the speech-acts on which the LTA is based may give rise to significantly different scores. This Chapter added analysis to reveal whether the seven trait scores vary over time, and whether trait scores vary over time due to a change in role , state or source.

The first finding - that trait scores vary considerably over time - suggests that the research design set out in Chapter 4 could be enhanced by reflecting a greater need to see trait scores assessed at the precise time-period when a particular decision of consequence is being taken. The research looked at a broad time-period and was not concentrated on any one particular decision or set of decisions. These issues are dealt with further in Part III. The second finding - that role can have a significant impact on leaders' trait scores – was not considered to any great extent in the overall research design, though three roles were analysed (Taoiseach, Minister for Finance and Minister for Enterprise). It is possible that role did impact on the results but not to such an extent to explain the consistently higher conceptual complexity scores returned for Irish leaders. A more likely explanation for the results in Chapter 5 were the findings that source can have a significant impact on leaders trait scores, coupled with the finding that, as the reference norming groups are based on a variety of sources, these norming groups may actually not be suited to categorise leaders' scores with. Regarding conceptual complexity specifically, while there was no effect of source-type on Cowen's scores, a pattern did seem to emerge for Gordon Brown such that his ad libbed speech-acts show higher conceptual complexity than those generated by the more prepared speech-acts before parliament. Source can impact significantly on conceptual complexity scores, though the pattern seen with Brown would not itself alone explain why Irish leaders had a higher score than expected, as it was the material from parliament for Gordon Brown which had lower scores. Nevertheless, the research design could be enhanced by seeking to correct for the potential of semi-prepared to impact trait scores, particularly belief in ability to control events, conceptual complexity, and self-confidence scores. The possibility remains that semi-prepared sources can adequately reflect leaders' spontaneously professed state of mind if further research can continually enhance design. In-group bias was not significantly impacted by any of the variables.

Perhaps the most impactful finding from this Chapter in terms of the testing of the original hypothesis emerges from the overarching point about use of the norming group. The hypothesis rested almost entirely on Irish decision-makers having significantly different trait scores than the comparator norming group of Western leaders. However as found in this Chapter, though the norming groups take into account some relevant cultural differences, they include leaders with very different roles, in different contexts/states, and are based on a variety of sources. This Chapter has revealed some evidence that role, state and source-type influence leaders' scores, meaning the norming group employed to test the hypothesis may actually not have been suitable. Another issue is that it is possible that norming group scores do not represent ideal scores or a benchmark of good performance i.e. it is possible that the norming group mean for conceptual complexity is low.

The original hypothesis-test must be assessed on the basis of these results. It is likely that the failure to find evidence of irrational groupthink amongst Irish leaders before the crisis is a result of the method employed. Every step possible was taken to eliminate alternative explanations for the failure to uncover evidence (role, state, and source) but these could not be ruled out. However, making the suggested amendments to the research design may make it possible for evidence of active, impactful convergence bias among key decision-makers in the period before Ireland's crash to be detected using this quantitative method. Further research is required to provide a method of assessing behavioural biases at a distance, and to deliver a reliable proxy for detecting harmful groupthink and herding at the time of important decision-making.

PART III

Chapter 7: Assessing Ideology, Interests, and Institutions in Action

7.1 Process Tracing a Most-Likely Case

Chapter 3 set out the theoretical approach to the case study, specifically to explain why interests, institutions, and ideology influence decision-making, and how they contribute to irrational or rational outcomes. The purpose of this Chapter is to describe the research design to determine if and how interests, institutions, and ideology impact on decision-making. Among the conclusions reported in Part II of this thesis was that leadership trait scores vary considerably over time and that the research design set out in Chapter 4 could be improved by reflecting a greater need to analyse the exact time-period when a certain decision of interest is being taken. The preceding research examined a broad time-period (1995-2007) and was not concentrated on any one particular decision or set of decisions. This suggests that further investigation of the forces impacting on decision-making should zoom in on one decision taken over a confined time-span. Case studies employing a process tracing method offer maximum opportunity for learning and for generalising beyond a chosen case (Hall, 2003; George and Bennett, 2005; Bennett and Elman, 2006).

In this instance a most-likely case is sought; a subjectively bad decision where it is most likely that the theory-derived independent variables set out in Chapter 3 (interests, institutions, and ideology) will be present and impactful. The results set out in earlier Chapters have shown that the forces of interest to this research in the decision-making process can be difficult to locate and measure. In that case, it was the presence and impact of irrationality (decision-making biases). The same is true of interests, institutions, and ideology. According to Gerring, a central learning from Karl Popper's work is that it is easier to disconfirm an inference than to confirm that same inference (Gerring, 2007: 120). A most-likely case offers the potential to disconfirm the expectation that interests, institutions, and ideology influence the decision outcome. Further, a most-likely case makes it possible to evaluate instances in terms of "their degree of crucialness", and when disconfirming the argument that interests, institutions, and ideology are impacting decision-makers, it does not matter how other factors impact the decision. This most-likely case may provide evidence that the expectation is true, or needs to be reframed and "one may quibble over what it means to disconfirm a theory", but the point is that the most-likely case provides an important updating of a theoretical prior (Gerring, 2007: 121).

Consequently, a carefully considered, devised and executed framework for the case study analysis is crucial. The process tracing analytical approach will follow that set out by Gerring (2007). The chosen case study will rely heavily on contextual evidence and deductive logic to reconstruct causality due to the absence of temporal (pre/post-test) or spatial variation (treatment/control test). Process tracing is the chosen technique because the evidence pertaining to the variables of interest (interests, institutions, and ideology) and the bad decision outcome on mortgage policy is known in advance to be difficult to understand. The technique will see "multiple types of evidence…employed for the verification of a single inference – bits and pieces of evidence that embody different units of analysis" (Gerring, 2007: 173). Individual observations will, as Gerring notes, be non-comparable and the case studies will involve long causal chains, and in this sense the case studies will be akin to detective work:

> "The maid said this; the butler said that and the suspect was seen at the scene of the crime on Tuesday, just prior to the murder. Each of these facts is relevant to the central hypothesis – that Jones killed Smith – but they are not directly comparable to one another. And just because they cannot be directly compared, they cannot be analysed in a unified sample. The maid's testimony is empirical, and it is certainly relevant, but it cannot be reduced to standard dataset observations, and it is not meaningfully understood within a formal research design…Process tracing evidence is, almost by definition, difficult to verify, for it extends to evidence that is non-experimental and cannot be analysed in a sample-based format by virtue of the incommensurability if the individual bits of evidence" - *Gerring, 2007: 173, 184*

Lunn points to the value of evidence in documentation or personal testimony which can to some extent reveal whether particular forces are influencing decision-making, though adding an important word of caution about subjectivity (Lunn, 2013: 568). In Chapter 2, Janis' work on groupthink (1982) was summarised as an example of where case studies and fiascoes in particular, are employed to reveal the forces shaping decision-making (cf. Baumgartner and Jones, 2009: 40). Explaining his rationale for selecting fifteen fiascoes for close examination, Nutt states that debacles "offer insights into how a decision can go wrong, why it went wrong, and what changes in decision-making practices could improve the chance of success" (Nutt, 2002 :8). This rationale informs the focus on a most-likely, bad-decision case study here. Bennett and Elman state "it is appropriate to study a case in which the outcome is known if the purpose is to determine whether a purported necessary cause is operating" and also to "look within a case for the observable implications of a wide range of alternative explanations, to give these explanations a fair shake vis-à-vis the evidence, and to develop sufficiently diverse, detailed, and probative evidence to elevate one explanation (which may derive from a single theory or a combination of theories) over all others" (Bennett and Elman, 2005: 460). The framework employed here achieves these objectives (see section 7.4).

This is an empirical enquiry employing within-case observations, and at its centre the document evaluation and interview elements of the research will attempt to identify the steps in a causal process leading to an outcome, in this case, the bad decision not to intervene to prohibit or limit the use of 100 per cent loan-to-value (LTV) mortgages in Ireland in 2005. Process tracing is employed because it allows assessment of a theory by identifying the causal chain that links the independent variables (interests, institutions, ideology), and the dependent variable (rational / irrational decision outcome) and uncover relations between the possible causes and outcome (information processing). As described in George and Bennett (2005) process tracing is used to investigate and explain the decision process by which initial conditions are translated into outcomes so as to uncover what stimuli the actors attended to. It is more than a historical narrative and will deliver an analytical causal explanation, though "moving up the ladder of abstraction" by constructing an explanation (George and Bennett, 2005: 211).

Employing process tracing (exhaustive examination of sequential data) allows the research to establish and evaluate the link between the three factors of interest and the decision outcome by using archival documents, interviews and other sources to check whether the causal process of the theories can be observed in the sequence, and values of the intervening variables (Vennessen, 2008: 232). The subject of the research, decision-making, and the theories of interests, institutions, and ideology operate in "a world marked by multiple interaction effects, where it is difficult to explain outcomes in terms of two or three dependent variables – precisely the world that more and more political scientists believe we confront" – a world that Hall concludes makes process tracing a well-suited methodology for theory testing (George and Bennett, 2005: 206). Process tracing is a form of within-case analysis where at least parts of the case-study narrative are accompanied with causal hypotheses specific to the case. Process tracing can identify interacting variables, can be adapted to the phenomenon under study, help decide whether certain causes can or cannot be ruled out, can help uncover equifinality, and most importantly, assess theories (George and Bennett, 2005: 212-216).

In this case, the document analysis and interviews will uncover the foundations of individual behaviour that connect interests, institutions, and ideology and decision outcomes.

The design reflects the known limitations of the technique (the need for an uninterrupted causal chain, employing appropriate levels of analysis absence of a control, assumption of stable equilibria, feedback effects, causal versus intervening variables, and small-n sampling) by employing systematic process analysis (George and Bennett, 2005: 222; Hall, 2003). Documents are examined to see whether the causal processes which the framework outlined in Chapter 3 implies is in fact evident in the sequence in this case. Specifically, following Hall, the design is based on predictions derived from theories of interests, institutions, and ideology about the patterns that should be observed if the analysis framework is valid. Other relevant observations, as many and diverse as possible, will be made. Purposive sampling of interviewees is employed and given the limited set of actors involved in the case considered in this research, sampling of any kind may not be strictly necessary, as it may be possible to interview almost the total population of relevant elites (Tansey, 2007); see section7.6.

Following Bennett and Elman, the proposed in-depth case study offers separate inferential advantages, complementary to the quantitative approach and which are capable of producing verifiable, and in some instances, generalisable scientific explanations of decision-making in Ireland in advance of the economic crash. Further, the case study provides an account that runs from a suitably chosen beginning to the end of the story, has few (and preferably no) noteworthy breaks in the causal story, will suggest evidence that should be found if the account is true (i.e. evidence of erroneous decision-making), and provides evidence of observable implications that are inconsistent with alternative explanations. There is the openness from the start to find a deviant case in which the outcome is unexpectedly wrong: "a powerful, deductive, internally consistent theory can be seriously undermined . . . by even one wildly discordant observation" (George and Bennett, 2005: 114).

Further, Gerring suggests that good (convincing) process tracing analysis involves clarifying the argument preferably with the aid or a visual diagram (Gerring, 2007: 184). The diagram below depicts a framework (rather than an explanatory theory) with which to analyse the role and interaction of the three factors on a decision outcome, which may be rational or irrational (see section 3.3 for a full description of the framework). In this most-likely case the decision outcome is sub-optimal. As is often the case, process tracing is used here as an adjunct form of analysis, as a complement to the earlier quantitative content analysis work, and can be considered a cross-check or a triangulation: it is not intended to bear the entire burden of the full empirical study but to offer supporting evidence. The most-likely case study may rest upon contextual assumptions about how processes work, but "insofar as there is a comfortable fit between the evidence and assumptions…that account should pass muster” (Gerring, 2007: 185). That said, care will be taken to ensure that sufficient documentation is included in the account of the case study research such that verification is achievable. Having established the factors to be investigated via a case study approach, attention now turns to selecting the most-likely case for such an examination.

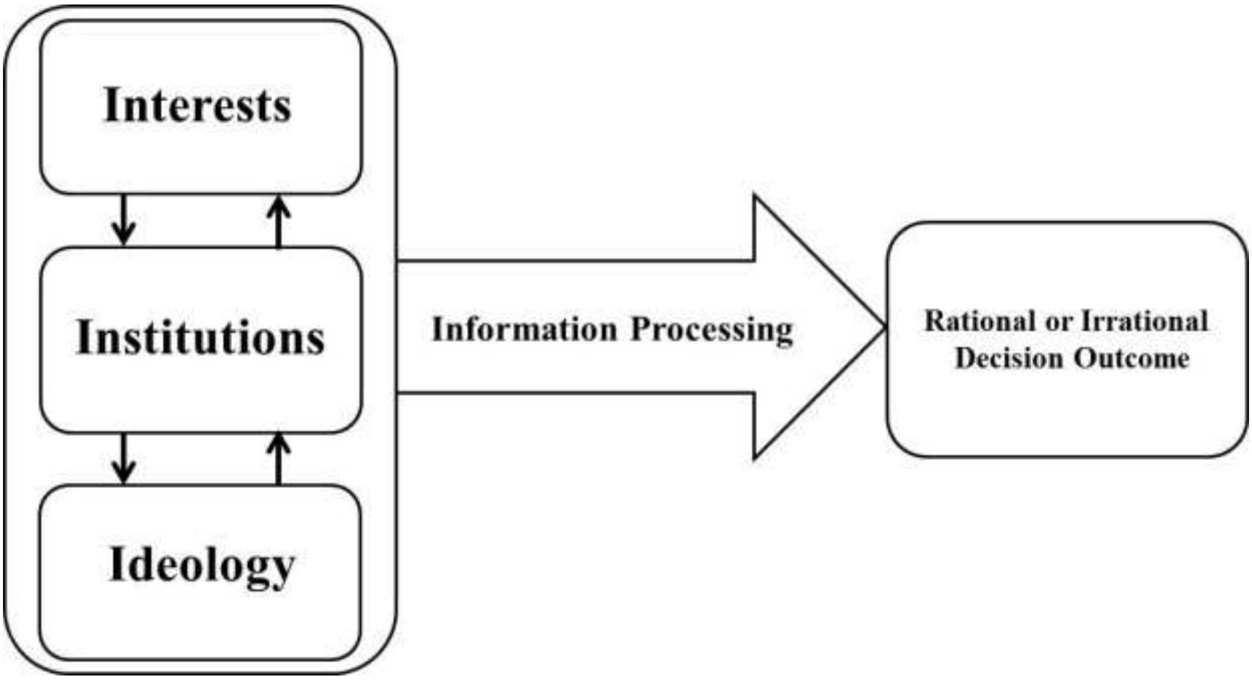


Figure 7.1: Proposed Framework of Decision-Making (see section 3.3 also)

7.2 Identifying the Most-Likely Case

Case selection involves purposive sampling as testing the hypothesis (that interests, institutions, and ideology interact to negatively impact on the decision-outcome) requires selection based on the dependent variable (see earlier discussion). In other words, a most-likely, bad decision case. The case is selected purposively according to criteria specified in advance: (i) a case is sought with known outcome i.e. bad decision, and (ii) the choice of case is shaped by continuing theory development, to examine if, when and how the three factors impact on the outcome. The rationale for the selection is that the impact of the variables of interests, institutions, and ideology, will be observable.

The case is not directly representative of diverse populations of decisions and the findings of the case studies are applicable to other decisions only in contingent ways. Nevertheless, the application of the detailed analysis framework (see below) will maximise the extent to which the case can uncover or refine a theories about interests, institutions, and ideology, and ultimately if and how these factors contributed to the recent economic crisis in Ireland (and perhaps elsewhere). It is reasonable to assume that the three factors examined are factors which are present and impactful in many if not all modern economies.

The unit of interest here is a 'Government decision', either as a formal decision taken by the Government at a formal Cabinet meeting or as a substantial policy decision taken by the lead Department in a policy area (See Article 28 of the Irish Constitution). The decision should relate to a policy area that can be reasonably assumed to have impacted on Ireland's economic fortunes. The approach is to identify a case, where the Government took a bad decision (in terms of protecting the economy) and examine it in depth. Such in depth analysis will include examination of contemporary State documents, media reportage, academic work, and interviews will relevant persons. As mentioned, this qualitative approach will complement and build on a quantitative content analysis already undertaken.

To identify a most-likely case for the process tracing exercise, a universe of government decisions was assessed, bearing in mind the period of interest and the constraints of Freedom of Information legislation. All 3,425 decisions taken at formal Cabinet meetings for the years 2001-2004 were assessed (see Appendix B). By examining these it was possible to identify via two iterations, two policy areas (and over sixty instances) where ostensibly bad decisions were taken: national competitiveness policy, and finance policy. However, given the broad scope of both policy areas, it was necessary to identify specific elements within each that could be subjected to in-depth, process tracing analysis.

This was done with reference to the four official investigations carried out into the crisis in Ireland i.e. Honohan (2010), Regling and Watson (2010), Wright (2010), and Nyberg (2011) reports. These documents were analysed to purposely seek out instances of where poor decisions with regard to national competitiveness and/or financial policy were likely to have been taken in the face of advice suggesting alternative action, which we now know with hindsight to have been the correct or more appropriate action. The most-likely case of a specific poor decision outcome which emerged from this analysis was the provision of 100 per cent LTV mortgages in 2005.

In their discussion of the role that financial policies played in triggering the banking crisis in Ireland, Regling and Watson refer to 100 per cent LTV mortgages originally being viewed by the authorities overwhelmingly in terms of "a benign shift to a modernised and competitive market – one that was in tune with developments in the UK and US" (Regling and Watson, 2010: 29). Of course, hindsight reveals that the introduction of such loans had a far from benign impact on the economy. Nyberg describes 100 per cent LTV mortgages as a "potentially high-risk retail product" (Nyberg, 2011: ii). The Nyberg Commission concluded that availability 100 per cent LTV mortgages "posed new risks" for the Irish economy, specifically for both the borrower and the lender (Nyberg, 2011: 21). Nyberg states that discouraging high LTV mortgages was one policy decision that could have had "a significant impact" with regard to crisis prevention or mitigation (Nyberg, 2011: 64). The Wright Review of the Department of Finance points to the introduction of 100 per cent LTV as "an opportunity lost", in terms of policy advice and a subsequent policy decision to avert or mitigate economic risk (Wright, 2010: 31). Wright does state that the Department of Finance would "have had a hard time" fighting 100 per cent LTV mortgages given the Government's strong concern about home affordability for first-time buyers, but once the Financial Regulator, declared himself to be fully satisfied with their introduction, "the Department stopped considering the issue" (Wright, 2010: 31). Nyberg's report references communication between the Department of the Environment, Heritage and Local Government and the Department of Finance in 2005, regarding the implication of 100 per cent LTV mortgages on house price inflation and household indebtedness. The Department of Finance, "after consulting with the Financial Regulator, responded that while borrowers and lenders should exercise caution, it did not see any particular need to take action" (Nyberg, 2011: 71).

A most-likely case is a subjectively chosen case where the theoretically-derived independent variables are most-likely to be operating, and impacting on the dependent variable. The case is to disconfirm their impact. The 100 per cent LTV mortgages case is a subjectively bad decision where it is most likely that interests, institutions, and ideology will be present and impacting on information processing and the decision-outcome. As will be shown in later sections, the decision not to intervene to limit or prohibit the product was an objectively bad decision based on the official reports, based on the data, and based on the hindsight testimony of banks at the Oireachtas Committee inquiry in 2015. The official reports describe the decision as being "high-risk", an "opportunity lost", and a "new risk". The data below will show, *inter alia*, that half of all mortgages in arrears in 2011 (70,000) extended in 2006 under the 100 per cent regime. The decision not to intervene to limit or prohibit 100 per cent LTV was a case where interests, institutions, and ideology are likely to be present and impacting. Official investigations suggest *a priori* that (i) the interests communicated by the Department of the Environment during the case will be important, (ii) issues of institutional power (between the Department of Finance and the Financial Regulator) will arise, (iii) ideology in the form of a shift to a competitive market feature in the case, and (iv) that irrationality in the form of mortgage product developments being an extrapolation of what was happening in the United Kingdom and the United States.

Finally, to get some validation of the decision on high LTV mortgages as a most-likely case, a now-retired senior Department of Finance official was interviewed. The official was given an overview of the research, the findings of the quantitative work to date, and approach to case study analysis. The clearly stated purpose of the interview was to ask the former official about government decisions that would make suitable case studies of poor decisions affecting the economy, contrary to Departmental or other advice, in the period before Ireland's economic crash. The bad-decision case study (100 per cent LTV mortgages), potential alternatives, and the approach to analysis were summarised for the official. The former official stated that the 100 per cent LTV mortgages case study appeared suitable, and when he reverted a short time after the interview did not suggest additional or alternative cases (Former Senior Official, D/Finance: Interview, July 1st 2014).

As will be described in the next section, the decision not to prevent 100 per cent LTV mortgages was a poor one, and presents a most-likely case. The case centres on an ideology-linked decision to intervene or not in a banking market made up of highly competitive interests, and where institutions debated and implemented the outcome. It is also a case conducive to process tracing, as it is time-bound and involved a small number of known actors. This case also presents an example of the complex decision-making environment posited by complexity theory, with non-linear processes and a variety of actors all adapting in response to events (see section 3.1). Finally it is an important case. As described below, the decision had significant negative direct and demonstration effects on the property market, which itself was at the heart of Ireland's crisis.

In light of all of the above, the most-likely case study on mortgage policy was the subject of a formal request for official State documents related to the decision under the Freedom of Information (FOI) Act 1997.

7.3 The Selected Case: 100 Per Cent Loan-To-Value Mortgage Policy

> "The property bubble that ended in 2007 showed the damage to financial stability that can be caused by too lax mortgage credit standards. Such an approach can fuel housing demand in a way that drives prices up beyond what can be sustained. This can result in a wave of defaults and insolvencies that destabilises the whole economy"
> – *Central Bank of Ireland, 2014: 2*

In October 2014 the Central Bank of Ireland published a consultation paper on macro-prudential policy for residential mortgage lending in Ireland i.e. the rules for banks on mortgage LTV (and loan-to-income) ratios. By opening that paper with the words recounted above, the Central Bank was framing the consultation in the context of Ireland's economic crash. To mitigate the likelihood of an economic crash, the Central Bank proposed (and later implemented) mortgage lending rules to ensure a greater degree of safety around the mortgage business and greater prudence around lending to households for the purpose of purchasing property. Key to such safety and prudence was the rule to be applied to the Loan-To-Value (LTV) ratio of mortgages. Of course this is some seven years after the crisis developed in Ireland.

The LTV ratio is important because research suggests a positive relationship between the LTV ratio and subsequent mortgage default, with higher ratios associated with higher defaults (Central Bank of Ireland, 2014: 8). Higher LTV ratios allow more people to enter the housing market because the deposit amount they have to save in advance of securing a mortgage is lower. However, higher LTV ratios leave the borrower exposed to a low housing equity buffer in the event that the value of the house falls. Research finds that LTV (and debt-to-income) limits are associated with a decline in house price appreciation and transaction activity, and that such the limits alter expectations, which play a key role in bubble dynamics (Freidman, 2009: 139; Igan and Kang, 2011: 1). More recent research indicates that rapid growth in high-LTV loans can be signs of a build-up in systemic risk and that LTV limits can be effective in reducing loan-growth and improving debt-servicing performances of borrowers, though not always curbing house price growth (Jácome and Mitra, 2015: 1).

Research by the international ratings agency Standard and Poors has found that 40 per cent of Irish mortgage borrowers remained in negative equity in 2016, that home loans originating in 2007, just before the crash, had the highest degree of negative equity at 59 per cent, and that mortgages issued between 2006 and 2008 were deepest in negative equity as they were issued at higher original LTVs and the initial loan was bigger (Irish Times, April 6th 2016).

In the early 2000s, high LTV mortgage ratios were not a long-standing issue in Ireland. An increased prevalence of higher LTV ratios from 2005 on was a consequence of Ireland's membership of the euro, the arrival of foreign banks to the Irish market, access to cheap international credit by domestic banks, and excessive competition between those banks for the mortgage market. In this context, new entrants and incumbents began competing aggressively, stimulating demand with innovations such as 100 per cent LTV mortgages, increasingly offered to middle-income borrowers, including first-time buyers**.** With painful hindsight the supervisory authorities in Ireland recognised the danger posed by these developments:

> "If there had been an effective LTV cap in place in the early 2000s it is likely that the costs of the crisis would have been very greatly reduced. For one thing, binding ceilings on LTV ratios would have reduced the effective demand for housing, very likely lowering prices. Furthermore, faced with weaker demand and a smaller flow of profits, it is likely that developers would have built fewer houses, and would have been left with a smaller stock of unsold properties when the crash came" – *Central Bank of Ireland, 2014: 9*

The failure of decision-makers to intervene in 2005 to prohibit the introduction of widely-available 100 per cent LTV mortgages to first-time buyers resulted in the distribution of mortgages with LTV ratios under 80 per cent falling, the proportion of new loans issued at over 90 per cent LTV growing rapidly, and the proportion of outstanding mortgages with LTV ratios of over 94 per cent also growing strongly. As was the experience in Ireland, when property values decline rapidly, individuals can very quickly find themselves owning properties valued at amounts significantly lower than the amount outstanding on the associated mortgage, a problem which would have been less severe had the LTV ratio been lower. An additional consequence of higher LTV ratios is the reduced options for the bank that issued the mortgage to show forbearance should the mortgage-holder fall into arrears distress. Research shows that borrowers with high LTV ratios more likely to fall into arrears distress, with conjecture in the research that the lack of significant equity in property impacts the decision to default by "borrowers with little or no equity being also likely to have been the most stretched at the time of the boom, with fewer lifetime resources, such as accrued savings, to draw on when harder times hit" (Lydon and McCarthy, 2011: 2 and 15). Imposing lower limits on the LTV ratio can mitigate risk by dampening the property market as they tighten the liquidity constraints of targeted borrowers and hence limit demand for housing.

As Chapter 9 recounts in detail, the Department of Finance was approached by the Department of the Environment in July 2005 who had concerns about an announcement by banks in Ireland that they were to make 100 per cent LTV mortgage products widely available. Having considered the matter, in consultation with the Financial Regulator, the Department of Finance decided not to intervene to prohibit or limit the products, and that decision not to intervene to limit the prevalence of those particular mortgages certainly impacted negatively on the country's economic fortunes.

Before looking at the bad decision in depth, it is worth considering what a good decision would have looked like. A good decision outcome in 2005 would have been tough measures, such as the government banning or disapproving publicly of 100 per cent LTV mortgages (Honohan, 2010: 12). The Nyberg investigation concluded the Regulator could have attached conditions to the banking licenses of certain institutions or withdrawn those licenses altogether.

Indeed, even a clear threat to do so if the banks did not change their lending behaviour might have had an effect. The measures taken by the Regulator in 2006 to increase capital requirements (after much discussion and debate) are widely accepted to have been a move in the right direction and had the desired impact on residential mortgage lending growth (though it is difficult to separate the impact from other developments such as interest rate increases in 2006).

Speaking in 2015, the Chairman of the Regulator from 2003 to 2008 agreed with Nyberg when he said that the Regulator "could have imposed additional, even more capital requirements than we did, although that would have run into some issues, like the anti-competitiveness issue and so on. But we could have imposed more stringent capital requirements; we could perhaps have gone at it through the consumer code that it was inappropriate to be selling these 100 per cent mortgages, to certain classes of people. We could have attached conditions to banking licences… which effectively would have banned them" (Brian Patterson, Evidence to the Inquiry into the Banking Crisis, June 11th 2015).

As the Central Bank of Ireland has stated, it is difficult to accurately estimate to what extent risky lending and borrowing behaviour would have altered, had a good decision been taken. Even if prices did not moderate as a result of the government banning or disapproving publicly of 100 per cent LTV mortgages, LTV caps would have reduced losses in the crisis. For example, the Central Bank's loan loss forecasting models suggest that an 80 per cent LTV cap would have lowered credit losses on residential property of the banks by at least 17 per cent, even if it is assumed that the same number of loans was made and that housing prices were the same as actually prevailed (Central Bank of Ireland, 2014: 9).

It might be argued that a good decision in 2005 would have been too late. One expert claims though it is impossible to identify when the bubble became irreversible and a collapse became inevitable, with the benefit of hindsight, 2006 probably represented the last chance to stop the build-up in debts (FitzGerald, 2015: 4). Research shows that the largest number of mortgage loans (just over 70,000) was extended in 2006, when house prices were close to their peak, and that by 2011 the largest proportion of mortgages in arrears originated in the years 2006 and 2007, accounting for over half of all accounts in such distress (Lydon and McCarthy, 2011: 3 and 8). In addition, in terms of affordability of mortgages the European Central Bank began to "hike interest rates in December 2005, and within eighteen months the ECB's policy rate had doubled" (Ahearne, 2015; 2). Thus a good decision on mortgage LTV in 2005 could have helped to halt the build-up of debts, helped to minimise later mortgage distress, and minimised the negative impact of the interest rate hikes that were to follow soon after. In all, the Wright Review of the Department of Finance points to inaction on 100 per cent LTV ratio mortgages in 2005 as "an opportunity lost", in terms of policy advice and a subsequent policy decision to avert or mitigate economic risk (Wright, 2010: 31).

It is also important to note that some action was ultimately taken in relation to high LTV mortgages in 2006. From the beginning of May there was an increase in capital requirements for new high LTV mortgages (above 80 per cent LTV). This involved "a sliding scale which, by progressively increasing the risk-weighting of mortgages from 50 to 60 per cent depending on the LTV rate resulted in a 2.4 per cent Tier 1 capital requirement for 100 per cent mortgages, compared with 2 per cent before" (Honohan, 2010: 100). It is now known that the Regulator consulted with the banks before introducing the measure, and the measure is viewed as being a weak response. What is of interest here is why necessary, firmer action was not taken in mid-to-late 2005, when similar if not identical information and concerns were present and expressed, and the extent to which interests, institutions, and ideology shifted policy-makers away from a good (in this case more timely) decision, and whether these is evidence of irrational decision-making.

7.4 Case Study Framework

The analysis framework used is a structured and focused comparison whereby general questions that reflect the research objective are asked to guide and standardise data collection, thereby making systematic comparison and culmination of the findings possible. The method deals only with certain aspects of the historical case examined, in other words the three factors of interest (interests, institutions, and ideology). The research objective of the application of the framework to the case study is to reveal the extent to which interests, institutions, and ideology were present and can explain the decision outcome. Thus the dependent variable to be explained is “decision outcome” (bad) and the independent variables which comprise the theoretical framework are interests, institutions, and ideology. These variables are expected to vary rather than being held constant to provide comparison. The material analysed via the framework comprises historical records: government documents, parliamentary records, media reportage, interviews, and other documents deemed relevant.

A key task of this element of the research is the method employed to assess the material. How will the presence and impact of the independent variables of interest be detected in the analysed case study text material? It is assumed that actors in the case studies especially publically elected politicians will employ the ‘strategic’ use of speech-acts (often called impression management), and that decision-makers display different personal dispositions in private versus in public. Impression management refers to the behavioural strategies people use to create desired social images or identities (Tetlock and Manstead, 1985, 59.) As Tetlock and Manstead argue, establishing the precise extent to which impression management complicates or even invalidates research findings in this area is challenging. Researchers must be aware of, acknowledge and report the fact that impression management is a factor, and where practical, take mitigating steps. One such mitigating step here is to source quasi-private official documents, attainable under Freedom of Information legislation and which can be expected to be less impacted by any impression management, than the public utterances used in the quantitative element of the research.

<u>The general question posed for interests is</u>: to what extent does the material provide evidence that strong self-interest or relevant interested party activity was present and impactful in the period preceding the decision? Who interests won out in the decision not to

limit 100 per cent LTV mortgages? Interest group activity refers to the extent to which a group (bank, Government Department, Financial Regulator, others) was lobbying specifically on the issue of mortgage policy. Lobbying is the transfer of information between interest groups and politicians, their staffs, and agents (de Figueiredo and Richter, 2014: 164). Information in practice may take many forms: "statistics, facts, arguments, messages, forecasts, threats, commitments, signals, or some combination thereof. Interest groups have budgets for and spend money on these activities, but that money is not transferred explicitly to politicians" (de Figueiredo and Richter, 2014: 164). Pursuing one's own interests or lobbying should not be considered inherently negative as it is an important and valuable aspect of policy-making, with interest groups providing vital information, legitimacy, and support to the decision-maker (Klűver, 2011). Neither should it be confused with corruption whereby decision-makers are offered and accept direct, often financial, rewards for selecting a decision outcome because it directly favours the paying interest.

Notwithstanding the "extraordinarily challenging" question of understanding and quantifying how interests are in obtaining policy or other outcomes, it is important to set out the structural context and organisational details, and this will be the case (de Figueiredo and Richter, 2014: 168, 175). This is provided in Chapter 8. The 100 per cent LTV mortgage case study narrative illustrates how the bad-decision outcome aligns with the interests those active in the lead-up to the decision being taken. This will help make the counterfactual obvious from the beginning. The documentation and testimony is examined to reveal the information transferred to the decision-maker, the Department of Finance, (directly or indirectly) by the each interested parties. Next, the examination will seek instances of where the decision-maker employs that information. Such instances may be obvious, sometimes less so.

It is assumed *a priori* that there will be instances where the decision-making actor (Department of Finance) simultaneously employs the information, attributes it to the interest as the source, and it is objectively clear that the information was a central consideration in shaping the final decision. However, it is also reasonable to assume that there will be other instances where the decision-maker employs the information less overtly meaning extremely close examination will be required. For example, where a decision-maker repeats the information provided by the interest verbatim, or close to it, but does not attribute it to that source. The approach will provide an understanding of variation and the counterfactual, help identify and explain how interested parties shape the decision outcome, and place this in the context of the other factors. In short, the material analysed as part of the case will allow detection of evidence that self-interest and interest was present and important in the time leading up to decisions on mortgage policy in 2005. The main players in that decision can be expected to reveal strong interests and self-interests, whether it is banks seeking to maximise market share, the Regulator's consumer, prudential and industry promotion roles, the Department of Finance's economic and political concerns, or Department of the Environment's housing function and political concerns (see Chapter 8).

The general question posed for institutions is: to what extent does the material provide evidence that institutional arrangements, mandates and expertise were impactful in the period preceding the decision? As set out in Chapter 3, institutional arrangements and knowledge impact on decision-making. In Ireland's case both contributed to the crisis via the Social Partnership process, and the 'knowledge interdependence' of banks, property developers, the Central Bank, the Financial Regulator, and policy-makers. Detecting evidence of institutions impacting in the case study will mean seeking and revealing in the material admissions or evidence of reliance on individuals and bodies external to the Department of Finance for information critical to the decision case. It might also present as a demonstrable inability of the policy-makers in the Department of Finance to take action which would have been beneficial, due to a lack of expertise. While strict quantitative approaches to estimating external influence through analysis of large volumes of text have been undertaken in other research (see Klűver, 2009), here a qualitative close reading of the material associated with each case is employed. The lack of institutional expertise and its most severe consequences are evident in Regling and Watson's analysis of financial regulation in Ireland before the crash:

> "Supervisors relied almost entirely on the central bank for economic inputs. By mid-decade, the financial and property boom in Ireland presented features – both macro- and microeconomic – in which financial stability analysis should have sounded alarm bells loudly. Domestic financial stability reporting by the central bank failed in this regard. It noted worrying features; but it failed to trace their interactions vividly or to warn how severe were the emerging risks to bank soundness and, ultimately, to the living standards of the ordinary citizen" - *Regling and Watson, 2010: 6*

The supervisory approach, information asymmetry, and dependence on external expertise which contributed to bad decision outcomes in Ireland reflected to some degree global developments and a move to reliance on markets' own assessments (see the discussion of principles-based regulation in Chapter 8). But there may be more local factors at play also. In their 2013 report, the Convention on the Constitution recount a number of phenomena which support the idea that institutional expertise is an impactful issue in policy and decision-making in Ireland:

> "There is little incentive for Irish politicians to have or to develop specialist skills in particular policy areas. Ministers are appointed from among elected politicians, and typically move between departments in the course of a career, learning as they go. This is very unusual in European terms. In most countries, including Britain, ministers can be appointed to government from outside parliament because they have specialized skills, while still being fully accountable to the legislature… The Irish civil service recruits people for their general skills, and people are expected to learn on the job. Ireland has fallen behind developments in the British system, on which our civil service is based, in areas such as graduate recruitment, specialist training, and construction of expert skills services" – *Convention on the Constitution, 2013: 17*

That Regling and Watson and others have found evidence of institutions impacting on the quality of decision-making via in-depth review of material, interviews etc. lends confidence to the approach employed here. Whether the cause is global or domestic is of secondary importance for this research. What is central is that the material analysed in the case can expose evidence that institutional expertise impacted on decision-making in relation to mortgage credit policy.

The general question posed for the ideology variable is: to what extent does the material provide evidence that ideological considerations were present and impactful in the period preceding the decision in November 2005? Ireland has often been cited as an almost unique modern society in that it is and has been without the meaningful impact of ideologies since the State was formed in 1922: a political system 'without social bases', as it were (Whyte, 1974). While it can be argued that Ireland's main political parties do not occupy a vast ideological, left/right spectrum, it would not to be correct to state that they are or were ideologically identical.

Benoit and Laver (2005) demonstrated the ability to reveal ideological positions of political parties by content analysis, and ordered Irish political parties on a left-right scale as follows: Labour, Fine Gael, Fianna Fáil, and the Progressive Democrats, using an expert survey; and Labour, Fianna Fáil, Fine Gael, and the Progressive Democrats using a content analysis of party manifestos (Benoit and Laver, 2005: 37). Further, they found that for Ireland the left-right scale is more about economic than social policy positions. Components of the left category include Market Regulation, Economic Planning, Protectionism: positive, Controlled Economy, and Welfare State Expansion. In contrast, the components of the 'right' category include Free Enterprise, Incentives, Protectionism: negative, Economic Orthodoxy, and Welfare State Limitation (Benoit and Laver, 2005: 35). The Labour Party, Fianna Fáil, Fine Gael, and the Progressive Democrats accounted for 82 per cent of the vote in the 2007 general election, and all but sixteen of the 166 seats in the Dáil. Nevertheless, it would be incorrect to believe that the ideological position of the main political parties was unimportant to them in terms of defining what they stood for, or that their ideological position was of no relevance when it came to decision-making. Remember, given the focus of this research on economic policy, the concept of ideology used here refers to the economic left/right as opposed to social liberal/conservative cleavages, with the left referring to an abstract belief in State action, intervention in the economy/markets and higher levels of government spending and taxation, and the right referring to a contrasting abstract belief in a laissez-faire policy approach, non-intervention by the State in economic affairs, and lower levels of government expenditure and taxation. In this context, the case study on possible intervention in the mortgage/banking market will be an instructive one.

For example, in their 2007 general election manifesto the Labour party employs language of the left, focusing on "society" as opposed to "economy", equality of outcome as opposed to equality of opportunity, to socialism, and the interventionist role of the State:

> "Ireland has a successful economy, but a society under strain… We cannot take our economic success for granted, but neither can we be content with economic success alone. We must measure ourselves too by the quality of our civilisation – by the kind of Ireland we create and bequeath to our children. We must seize the opportunity … to build an Ireland that [we] call the Fair Society… It is through the development of…potential that we individually and collectively flourish… To be a socialist is to recognise in each of us, the common humanity that binds all of us… Labour is the authentic Irish expression of the great European socialist and social democratic movement… We believe in government as a powerful agent for change" - *The Labour Party, 2007: ii*

The Progressive Democrats - in contrast - in their 2007 general election manifesto employ language of the right, making note of the new economic paradigm from the 1990s, personal initiative, enterprise, competitiveness, competition, and public finance control, and even include a side-swipe at parties of the left:

> "This country is unrecognisable from the failed economic wreck of the mid-1980s… The initiative and enterprise that brought about this dramatic change was unleashed by the policies of low taxes, competition, and investment in innovation and enterprise… The fundamental issues for…Ireland are sound public finances and progressive taxation policy [and] pro-enterprise, pro-competition polices and reforms… full employment will not be achieved by anti-growth…anti-development

policies…[or] by electing to government parties who are either indifferent or openly hostile to enterprise, initiative and progress" - *The Progressive Democrats, 2007: 4*

From even these few short passages it is possible to detect, despite close proximity on a left/right spectrum, the difference in ideas, and apparent importance of ideology to political decision-makers at the time in Ireland. Crucially, it is possible to detect the force of ideology and variation in ideological position from this text. The material analysed as part of the cases study will similarly seek such evidence that ideological considerations were present and impactful in the period preceding the decisions on widely available 100 per cent mortgages in 2005.

Based on the above, it is unsurprising that the basic coding frame will consist of the three categories arising from the theory and literature outlined above i.e. interests, institutions, and ideology. The case study analysis includes examination of primarily extant rather than elicited texts- contemporary State documents, media reportage, and academic work, supplemented by interviews with relevant persons, and these will be identified under these categories. In this way, the approach is not essentially based on grounded theory, as the core categories are not constructed from the data, but rather from logically deduced hypotheses (Charmaz, 2006: 6). That said, identification will involve some characteristics of grounded theory in that each step of data collection and analysis will allow for the possibility (perhaps probability) that the core categories can be elaborated on, their properties better defined, and the relationships between categories considered.

- ***Interests***: does the text indicate that the concerns and/or preferences of self or external interests were influencing with negative consequence, the decision process.
- ***Institutions***: does the text indicate that institutional arrangements and/or expertise were impacting with negative consequence on the decision process.
- ***Ideology***: does the text indicate that ideological considerations were present and influencing with negative consequence, the decision process.

Table 7.1: Definitions of the Three Core Categories for Identification

7.5 Evidence of Irrationality

The process tracing analysis presents an additional opportunity to qualitatively identify whether the bad decision was arrived at as a result of irrational forces, following the (unsuccessful) quantitative method employed in Part II. As described in Chapter 3, it is possible that a decision-maker chooses a perfectly rational or totally irrational suboptimal option. Having identified whether interests, institutions, and ideology are playing a role in generating the poor decision outcome on 100 per cent LTV mortgages, the texts will be analysed to determine whether irrationality was a result. For example, the earlier discussion on irrationality included the suggestion (based on Lunn, 2013) that bounded rationality amongst decision-makers could take the form of a number of different empirically established behavioural biases. Irrationality will be assessed with reference to evidence in the text of those empirically established behavioural biases specified by Lunn as likely to have been important in pre-crisis Ireland. More specifically, in taking the bad decision on 100 per cent LTV mortgages, did the policy-makers display evidence of predicting future outcomes based on the past (extrapolation bias), placing greater weight on existing beliefs (confirmation bias), predicting outcomes too positively and overestimated the accuracy of those predictions (overconfidence bias), being adverse to uncertainty (ambiguity aversion), conforming to majority views (behavioural convergence), being drawn toward immediate rewards (time inconsistency), or giving inordinate weight to losses or gains (loss/gain asymmetry) – see Lunn, 2013: 566.

Thus irrationality may be revealed using the second type of evidence outlined by Lunn i.e. documentation or personal testimony relating to the 100 per cent LTV mortgages case itself, which can to some extent reveal whether behaviour was consistent with the model. As Lunn notes this is, of course, partly subjective and "there may be other plausible interpretations of what was written, said and done. Illustrative quotations are selective and their representativeness dependent on… judgement. Moreover, as this exercise explicitly seeks indications that particular biases were involved, there is a danger of over-weighting positive instances" (Lunn, 2013: 567).

This approach has been used previously to detect the presence or absence of irrational forces in the period preceding decisions in the case of Australian finance executives in the lead-up to the crisis (Coleman and Pinder, 2010) and bankers, authorities, commentators etc. (Lunn, 2013) see examples in Table 7.2. As shown, evidence of irrationality in the documentation or testimony can come via data or direct quotations. The historical records, government documents, parliamentary records, media reportage, interviews, and other relevant documents employed in the case study will be examined specifically to reveal variation and report evidence.

Irrationality	**Examples of Evidence / Text**
Extrapolation Bias	• Of five economic commentaries, four forecast price increases in the year to come in the range 3–6 per cent; the fifth forecast a 7 per cent rise over the following 5 years. All of these professional commentaries made explicit quantitative reference to the most recent trends as their primary guide • "Between December 2005 and October 2006, new house prices rose by 8.8 per cent. We expect that the impact of current and anticipated interest rate increases should contribute to a moderation in inflation relative to recent months. We therefore assume that new house prices will increase by a rate of 10 per cent in 2006 and 6 per cent in 2007" – Economic Report
Confirmation Bias	• "It's not rubber stamping . . . If management's done their job properly then you shouldn't have situations that the board's knocking you back: if you don't know you're going to get it approved then don't put it up" - CFO of a Mining Company • "In any assessment of the dangers for financial stability coming from the housing market, the concept of the fundamental house price is key" – Economic Report • "All institutions confirmed to the inspectors that they have no concerns with the current or future repayment capacity of any of the borrowers" – Financial Regulator
Overconfidence Bias	• "Our view is that we are in a generation of industrialization that is going to go on for at least another couple of decades" – CFO of a Mining Company • "We take the view that we don't want to hedge our commodity price exposures at all. The shareholders are paying us for our exposure to copper price, or gold price or commodity price . . .We fundamentally have the view that we don't hedge" – CFO of a Mining Company • "I was huge into people . . . The difference between Anglo and, say, AIB was not the product – in other words money. It was the people and the way they dealt with the customer base. That was the difference. That might have been the big mistake we made, but that was the difference" – CEO of a Bank

Ambiguity Aversion	• "Funding: we don't even think about it, don't worry about it . . . I'm not a big fan of getting too smart or overly complicated with big structures. It's just money at the end of the day" – CFO of a Mining Company • "We operate in greater Ireland. London is eastern Ireland, Boston is western Ireland, and then there's mainland Ireland. Culturally, they are very similar regions; it would terrify us to lend money in France, for example." – Finance Director of a Bank
Behavioural Convergence	• "The Board would normally rely on what management is saying" - Treasurer of a Construction firm • Anglo had increased its market share from 3 to 18 per cent over a decade when domestic competition increased and foreign-owned banks entered the market. Executives and boards feared that failing to match Anglo's expansion might result in loss of customers, declining bank value, potential takeover and loss of professional respect. Remuneration schemes linked to market share or short-term share price may have exaggerated the threat • Bankers and those working for the authorities holding private doubts about the riskiness of lending or threats building up in the banking system feared sanctions or loss of influence if they followed-up troubling arguments or expressed professional concerns
Time Inconsistency	Various decisions required individuals to weigh up the lure of immediate rewards (or the avoidance of immediate aggravation) against longer-term risks. This decision structure applied to: • Loan officers or mortgage salespeople whose short-term remuneration and advancement were linked to the number of deals they made • Executives whose remuneration was linked to market share or share price • Board members and supervisors for whom questioning bank strategy or demanding changes entailed immediate costs (or risks) to reputation and perhaps prospects, when current profits and incomes were rising strongly
Loss/Gain Asymmetry	• ". . . foolishly we pursued our money. That was the mistake we made. We should have taken our burning." – Business Leader and Large Bank Shareholder

Table 7.2: Examples of Evidence of Irrationality in Testimony or Historical Documentation

(Modified from Coleman and Pinder, 2010 and Lunn, 2013)

As well as understanding how interests, institutions, and ideology impact the decision, the relationships between the factors are also worthy of consideration. Where the issue of institutional expertise is one category of interest as set out earlier, "there is some evidence that issue expertise may also matter to targeting [by interests]. However, the precise magnitude of this fact and the mechanism underlying it, are not well understood" (de Figueiredo and Richter, 2014: 169). Thus, the issue of decision-maker expertise may straddle two core identification categories, and the examination of the most-likely case might help add some understanding to the poorly understood processes underlying this particular targeting.

It will be clear from Chapter 3 and the above identification summaries that interests, institutions, and ideology are less discrete, and interact with each other to a greater extent than might first be assumed. Ideology works with institutional arrangements, which are impacted by interest group activity, and which in turn target often irrational decision-makers. The research fully takes into account that decision-makers will have multiple reasons for taking certain actions. It posits that interests, institutions, and ideology, are three factors and that they likely act simultaneously.

7.6 Interviews

To confirm that the documentary evidence accurately reflected the decision-making process and to maximise insight (conscious of hindsight effects), three in-depth interviews were undertaken in January and February 2016; one each with senior officials close to the 2005 decision in the Department of the Environment, in the Department of Finance, and in the Financial Regulator. The interviewees were selected on the basis of the official documentation from the time, relevant organisation charts, and testimony to the Oireachtas Joint Committee of Inquiry into the Banking Crisis. It was not possible to arrange interviews with the relevant Ministers or Ministers of State. The interviews were conducted in accordance with the guidelines provided by Dublin City University including informed consent and plain language statements. They were conducted face-to-face and began with a re-statement of the purpose of the interview and an offer to refresh the interviewee of relevant events from 2005 (see section 9.1).

An interview guide was used, though not verbatim and was supplemented with institution-specific questions based on the documentation. The interview material is used in a format agreed with the interviewees in advance under confidentiality arrangements i.e.

anonymously and with no direct quotations. These three interviews were in addition to the one described in section 7.2 undertaken to validate the case selection.

The interviews reflected elements of grounded theory as they were carried out using a few broad, open-ended questions which invite detailed discussion of topic. Such open-ended, non-judgmental questions were designed to encourage unanticipated statements and stories to emerge. The combination of the questions and conduct of the interview concentrated on achieving a balance between making the interview open-ended whilst focusing on significant statements related to the independent variables (interests, institutions, and ideology), and probing issues of irrational information processing (Charmaz, 2006: 26).

By process tracing this most-likely case, the objective is to look at the existence, impact and interaction of all factors within a single case of a bad decision. Taken together, this analysis proposes an instructive framework for analysis with these independent variables – interests, institutions, and ideology - explaining suboptimal decision-making as the dependent variable. The analysis framework offers a sound basis for confidence that such an approach can supplement the earlier quantitative content analysis research into government decision-making in the run up to Ireland's recent economic crisis. The 100 per cent LTV mortgage case study will further our understanding of why advice on the Irish economy offered between 1997 and 2007 did not result in policy action that would have mitigated the likelihood or severity of the subsequent crisis and to what extent each interests, institutions, and ideology contributed to this.

Motivation / interests

1. When you heard that First Active were issuing 100% mortgages in July 2005, what were your initial feelings?
2. What were the driving interests here? Own? House-buyers? Banks? Political? Wider government?
3. Who's interests do you think won out in the decision not to limit or prohibit 100 per cent LTV products?

Institutions

4. What role did your institution see itself as having vis-à-vis the other main players (Departments, Regulator, Banks)?
5. Who had the most power in this set up?
6. Who held the information?
7. Do you think there was information available to others to support your view but which was not readily available to you?
8. How would you describe the relationship between institutions?
9. Do you think a reasonable expectation was put in place regarding 'proving' that 100 per cent LTVs were bad?
10. Do you think that the institutional arrangements contributed to the decision not to intervene? Who was the decision-maker? Who had the power?
11. Do you think that the institutional arrangements contributed to groupthink or herding? Who had the information?
12. Was fear of breaking the consensus a factor?
13. Do you think it mattered that the Dáil was not in session / Minister / Government not around?

Ideology

14. How did your institution view its or the government's approach to stepping in to intervene in the banking market?
15. According to one view, it was important to 'trust the market'. What was your view of that approach?
16. Do you think that intervention (by the Government) would have been popular?
17. Do you think that thinking was flexible enough at the time to consider all outcomes of 100 per cent mortgages, or was there a rigidity linked to ideology?

Irrationality

18. Do you think that the decision was influenced by:
    a. Predicting future outcomes based on the past? (extrapolation bias)
    b. Placing greater weight on existing beliefs? (confirmation bias)
    c. Predicting outcomes too positively and overestimating the accuracy of those predictions? (overconfidence bias)
    d. Being averse to uncertainty? (ambiguity aversion)
    e. Conforming to majority views? (behavioural convergence)
    f. Being drawn toward immediate rewards? (time inconsistency)
    g. Giving inordinate weight to losses or gains? (loss/gain asymmetry)

Table 7.3: Interview Guide

Chapter 8: The Decision-Making Environment in Ireland in 2005

8.1 The Oireachtas, Government, Departments, and Social Partnership

The decision-making case study in the next Chapter is set in and shaped by a particular decision-making environment. The main actors in the case (State/Government, Regulator, and banks) interacted with each other, each with their own roles and objectives and within a loose hierarchical structure.

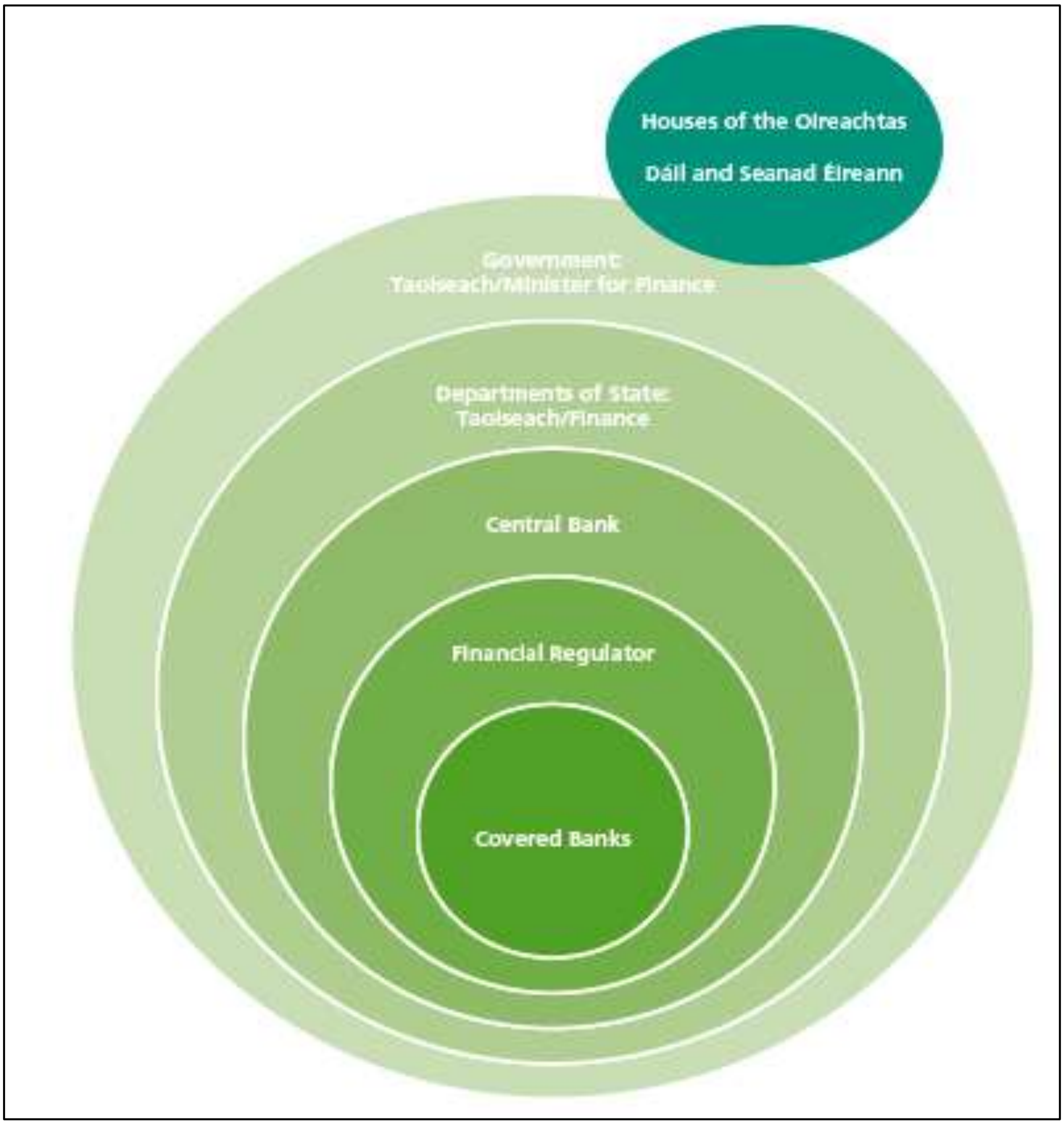


Figure 8.1: Key Roles 2000 - 2013: State, Regulators, Banks[8]

[8] *Report of the Joint Committee of Inquiry into the Banking Crisis Volume 1*, Houses of the Oireachtas, January 2016, p. 415

As illustrated by the official Inquiry into the Banking Crisis (Figure 8.1), the constitutional, institutional, regulatory and legislative arrangements suggested – in simple terms - that banks operating in Ireland were answerable to the Financial Regulator, who in turn was worked within the Central Bank Structure, which was answerable to the Department of Finance and the Department of the Taoiseach, which in turn were answerable to the Government, who ultimately were answerable to parliament. Before outlining the case of widely-available 100 per cent Loan-to-Value mortgages in detail, it is worth outlining in a little detail this policy environment and how it operated in 2005.

In common with many modern societies, the practical relationship between the parliament and the executive branch of government in Ireland has been a disappointing one in terms of delivering the directly elected assembly as *the* key decision-maker. The main chamber of the Oireachtas, the Dáil has been described as supine, woefully inadequate, and puny (Ward, 1974; Dinan, 1986; Chubb, 1992). Although dependent on it for support, the government of the day trumps the Dáil (and Seanad) in all meaningful ways. The government sees "virtually all" of its bills passed, takes on board opposition amendments "only as it sees fit", while "hardly any" of the opposition's own legislative proposals become law (Gallagher, 1999: 203). The party and whip system which are the bedrock of the parliamentary system in Ireland make the Oireachtas little more than a location for debate and nothing like a locus of power.

One role that the Oireachtas has continued to play however is that as a forum to turn issues of *public* concern into issues of *political* concern via mechanisms such as Leader's Questions, Order of Business debates, and opposition Private Member's time. The consequence of the foregoing for this case study research, and arguably in more general terms, is that – while it is not irrelevant - one cannot look to the Oireachtas as being the key holder of information, central decision-maker, or being primarily responsible for the outcome of policy decisions. For that, we must look to the Government, comprised of individual Departments and agencies of the State.

The lower House elects the Taoiseach and approves the Minister he/she chooses. The Fianna Fáil/Progressive Democrats coalition Government of the 29th Dáil, elected following the general election in May 2002 was constituted with fifteen Departments. These Departments and respective Ministers as of 2005 are set out in Table 8.1. Insofar as there is a hierarchy the two most important of these are the Taoiseach's and Finance Departments.

Government Department	Office Holder
Department of the Taoiseach	Bertie Ahern (Taoiseach)
Department of Health and Children	Mary Harney (Tánaiste)
Department of Agriculture and Food	Mary Coughlan
Department of Arts, Sport and Tourism	John O'Donoghue
Department of Communications, Marine and Natural Resources	Noel Ahern
Department of Community, Rural and Gaeltacht Affairs	Éamon Ó Cuív
Department of Defence	Willie O'Dea
Department of Education and Science	Mary Hanafin
Department of Enterprise, Trade and Employment	Micheál Martin
Department of Finance	Brian Cowen
Department of Environment, Heritage and Local Government	Dick Roche
Department of Foreign Affairs	Dermot Ahern
Department of Justice, Equality and Law Reform	Michael McDowell
Department of Social and Family Affairs	Séamus Brennan
Department of Transport	Martin Cullen

Table 8.1: Government Department Structure in Ireland, 2005

As set out in Chapter 4, the Taoiseach is considered to be one of the strongest of all heads of government, with one of the highest degrees of influence within their system of government, and potentially more powerful that any of their European counterparts, save the British Prime Minister (Elgie, 2004: 238-239). Connolly and O'Halpin state that "there is a clear ranking in the perceived importance of Ministerial portfolios, with Finance generally accepted as the most important (after the Taoiseach, of course) because of its responsibility for economic management and for public expenditure" (1999: 253).

The Taoiseach's Department is important not just because it is home to the head of the government but also - at that time under scrutiny - because of the increasingly important role played by the social partnership process which was run out of that Department. Governments interact extensively with interest groups, and in Ireland interest groups became institutionalised to a large extent through the social partnership process which began in 1987. This has been described as a system that aims to keep all the major interest groups reasonably happy by giving them a role within the broad economic approach of the State (Murphy, 1999: 275). Social partnership started out as a process of basic centralised wage bargaining but then expanded in terms of scope, structure and participation to consider issues such as housing costs, insurance costs, migration, and childcare policy (Hughes et al., 2007). Unions, employer and farming groups, and the community/voluntary sector (from 1996) agreed a series of eight national agreements- for example, the *Programme for National Recovery* (1987), the *Programme for Prosperity and Fairness* (2000), *Sustaining Progress* (2003) and *Towards 2016: Ten Year Framework Social Partnership Agreement* (2006). By 1999, 78 per cent of poll respondents stated that the social partnership model, hosted and chaired in the Department of the Taoiseach, was important for Ireland's economic success (Fitzgerald and Girvin, 2000). This broadening of scope and increasing importance had an impact on the roles and relative power of the Departments of the Taoiseach and Finance. Social partnership has been described as overwhelming the Department of Finance's budgetary process (Wright, 2010: 23), and any analysis of policy and decision-making in Ireland in period of interest must be mindful of the dominant role played by the Department of the Taoiseach and the social partnership process.

Of all Departments it is the performance of the Department of Finance which has come under the greatest scrutiny following the economic collapse. This is unsurprising. According to the official Inquiry into the Banking Crisis, the Department had a critically important role in relation to economic analysis, interaction with the Central Bank and Financial Regulator, and advising the Minister for Finance on *inter alia* the domestic economy, the macroeconomic situation, and financial stability. It also had a role in advising the Minister on the views of external, domestic and international economic forecasting authorities on the domestic and international economic situation. Most importantly for the following case study, in 2005 "the Department had the ability to advise the Minister on policy options to counter or offset the conditions that could lead to a crisis" (Houses of the Oireachtas, 2016: 148). These strategic roles sat alongside what could be considered to be the core functions of such a ministry: the day-to-day management of the State's finances, and public expenditure and revenue raising measures. The Department was also responsible for public service management and development. These core functions, and role in managing public sector performance and numbers, lead to constant interaction with the other fourteen line Departments.

The Department of Finance's breadth of activity was not without consequence, with the 2010 review of the Department of Finance stating that many other Departments expressed frustration with Finance observing that the Department lacked a critical mass, or interest in a strategic interface with line Departments" (Wright, 2010: 36). The nature and importance of interaction between the Department of Finance and one such line Department (Environment, Heritage and Local Government) will be explored in the next Chapter. In 2005, "Housing" was one of the Departments of the Environment's five main functional areas - alongside 'Environment and Natural Heritage', 'Built Heritage and Planning', 'Local Government', and 'Supporting the Provision of Infrastructure and Local Services' - and it had a stated objective to "oversee and seek to maintain an efficient housing market" (Department of the Environment, Heritage and Local Government, 2005: 23 and 44).

8.2 Financial Regulation

Already one can see the complex decision-making environment which existed in 2005. An ineffective Oireachtas looked on at as the Government dictated the policy and legislative agenda. Within Government, the Department of the Taoiseach played a dominant role, managing the "overwhelming" social partnership process. At the same time, in terms of economic policy and decision-making, the Department of Finance was 'in the driving seat' in theory if not in practice, as concluded by the Wright review. However, this decision-making environment was made even more complex following what has been termed "the most significant change to the formal institutions of Irish governance" over decade to 2007: the establishment of independent regulatory agencies such as the regulator for financial services (Westrup, 2007: 1). The root cause of Ireland's crash was the practices of the banks and the failure of the new financial regulator to effectively supervise them (O'Sullivan and Kennedy, 2010). The institutional arrangements and role of the regulatory authorities were a matter of controversy even before being formally established.

There is a link between the social partnership process and the development of the regulatory system in Ireland. According Westrup, up to the 1990s, policy outcomes reflected the interests of producers rather than consumers and this was in contradiction with the objectives of social partnership. The establishment of independent regulators like the regulator for financial services reflected the absence of an explicit role for the interests of consumers within social partnership, and the difficulty social partnership had experienced in challenging entrenched interests in firms (Westrup, 2007: 9). This was the broad context, but for financial services in Ireland there were additional motivating factors. By 1998 there was a "background of public concern over a number of tax evasion and overcharging issues related to banking" (Honohan, 2010: 34). These concerns arose most notably from the findings of an official inquiry that banks had encouraged customers to use concealed deposit accounts to avoid taxes due, and reports that banks had increased interest rates on overdrafts or loans without informing customers. In addition, the UK government had established its financial regulator, the Financial Services Authority, in 1997. The following year the Irish Government decided in principle to consolidate prudential and consumer protection regulation of almost all types of financial firms in a single regulatory authority. One important point to note in regard to the regulation of financial services is that unlike other newly regulated sectors (e.g. aviation, electricity, telecoms, accounting, pharmaceuticals, taxis etc.), there already existed a number of regulatory actors, most importantly, the Central Bank of Ireland.

> "A key milestone for reform arrived with the publication of a report by the Oireachtas Joint Committee on Finance and the Public Service in July 1998. The report recommended establishment of a new Single Regulatory Authority (SRA) to oversee financial regulation, enforcement, and consumer protection. This proposal would have removed responsibility for banking regulation from the Central Bank with the creation of an independent "greenfield" structure. The alternative was to consolidate all financial regulation and consumer protection matters within the Central Bank" - *Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 112*

A working party - the Implementation Advisory Group on the establishment of a Single Regulatory Authority for the Financial Services Sector - chaired by Michael McDowell was established to consider and progress this recommendation. That Group concluded that a financial regulator that was completely separate from the Central Bank should be established. The rationale was that sufficient accountability to the political system could not be guaranteed given the Central Bank's monetary policy independence. A minority of the Group preferred to locate the regulator within a restructured Central Bank (McDowell Working Group, 1999). However, as Westrup describes, this recommendation "set off a clamour" from the banks and other financial services firms arguing for the retention of the Central Bank as regulator:

> "What is clear is that neither the key state nor private actors wanted a change in the Central Bank's regulatory role. The close relationship between the Department of Finance and the Central Bank was typified by the almost automatic appointment of the First Secretary of the Department to be Governor of the Bank. The result was reluctance by these key state actors for a regulator to be created that was outside their control. The aggressive lobbying by the banks and the financial firms… confirmed their resistance to change in the regulatory status quo" – *Westrup, 2007: 14 and 15*

The result was the Central Bank and Financial Services Authority of Ireland Act (CBFSAI) 2003, which reflected the Government's choice to implement a compromise based on the minority recommendation. The compromise established the regulator as a new division within a restructured Central Bank. The regulator would have specified statutory functions and would report to the Governor of the Central Bank only in respect of organisational issues (e.g. staffing, finance) (Honohan, 2010: 37). One argument made for the compromise was that it would simultaneously allow for continuity and accountability, and preserve what was working well. According to the Joint Committee of Inquiry into the Banking Crisis, that compromise was "crafted by Dermot McCarthy, then Assistant Secretary in the Department of the Taoiseach" (Houses of the Oireachtas, 2016: 113).

Subsequent investigations have found this compromise organisational structure to be a contributor the economic crash in Ireland insofar as it did not allow for adequate supervision and regulation of banks. The fact that it was a compromise impacted on the new Regulator's credibility from the off, and the structure was seen as placing an emphasis on competition and resulting (perceived) consumer benefits, over macroprudential action. Above all, the structure created confusion about who had ultimate responsibility for stability of the economy, the stability of the banking system, and the stability of individual banks. Summarised by the official Inquiry, the chosen institutional arrangements were "unnecessarily complex and led to a real or perceived ambiguity in the respective roles of the Central Bank and Financial Regulator. Once the new structure, which represented a material change in the delivery of financial supervision in Ireland, was in place, the Government should have carried out an independent review and assessment of its effectiveness and the delivery of its functions" (Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 158). However, it would not be true to say that these frailties were universally known or expected at the time:

> "The twin-headed bank regulatory framework in Ireland from 2003 onwards was a hybrid, by global standards. However, this structure was at times viewed as an interesting experiment (like the different, but also original, approach in the Netherlands). Indeed, the IMF's assessment of Ireland's regulatory framework, at its inception, was positive: a key question across countries was how to keep non-supervising central banks linked in to macroprudential issues, and the IMF saw Ireland's framework as offering scope to do this" – *Regling and Watson, 2010: 36*

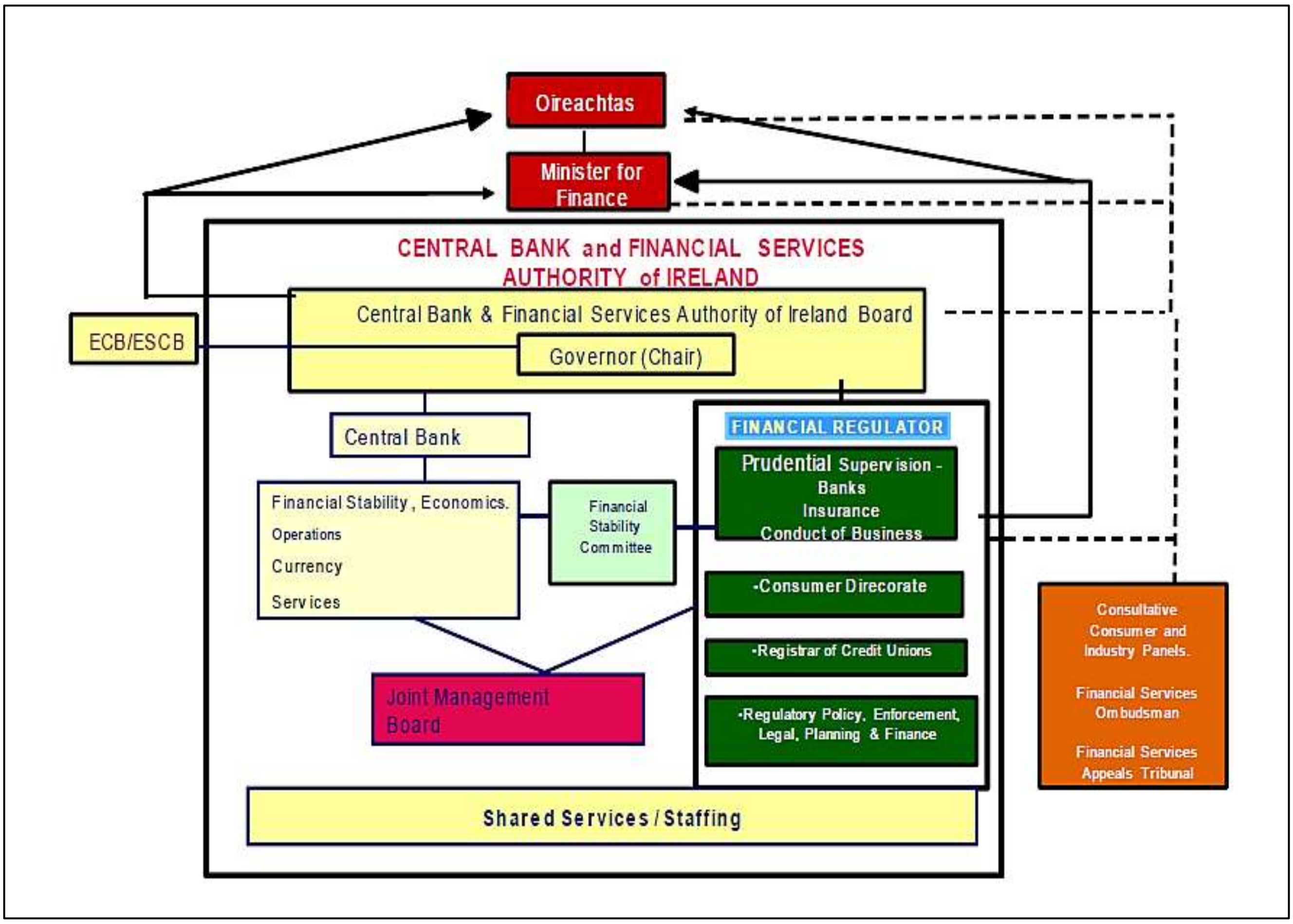


Figure 8.2: Complexity of Institutional Regulatory Structure, (Honohan, 2010)

Notwithstanding the new legislative arrangements, the Central Bank Act of 1942 still impacted on the day-to-day operation of the regulatory system. For this research, one particular section (S33AK) is of particular note. Section 33AK imposes obligations of professional secrecy on officers of the Central Bank and the Regulator with regard to confidential information they come across in the course of their duties and limits, for example, the extent to which Regulator staff could share information or views with the Department of Finance.

Another complicating factor was the potential for tension between the consumer protection and regulatory/supervisory roles of the Regulator. As referenced above, the Regulator was established against the backdrop of background of public concern over overcharging issues in banks and reports that banks had increased interest rates on overdrafts or loans without informing customers. The perception, if not the reality, that consumer issues trumped prudential issues was there from the start.

Speaking of early consideration of the regulatory structure in 1999, Honohan notes that the "newly-assigned importance of the consumer protection function was underlined by the proposed creation of the statutory position of Consumer Director within the Authority, whereas no corresponding position was proposed for prudential regulation (Honohan, 2010: 35).

In July 2005, the Regulator made the decision that the resources for administrative sanctions were to be primarily deployed towards consumer protection issues, and in 2006, the IMF proposed that the Prudential Director should be appointed to the authority so the position would be on a par with the Consumer Director (Con Horan, Evidence to Oireachtas Banking Inquiry, May 27th 2005). Honohan does state however that it would be wrong to assume that the Regulator devoted most of its time to consumer protection issues (Honohan, 2010: 41). Overall, it is important to note that the Financial Regulator's interests included those of the consumer issues, as well as having interest in the functioning of the banks from a supervisory point of view.

The regulatory framework was further complicated by the inclusion of a 'dual mandate' clause in the 2003 legislation establishing the regulatory system (Figure 8.3). Section 5A – (1) (b) of the Act states that the Central Bank (of which the Regulator was part) had a function to promote Ireland's financial services industry though not in such a way so as affect its supervisory role. This was in the context of Dublin's thriving International Financial Services Centre (IFSC) which was established in 1987 and was home to variety of internationally traded financial services, including banking. Within three years, employment at the IFSC had reached 14,000 people. In 2006, total corporation tax paid by firms operating in the IFSC amounted to €1.1 billion. Today there are over 38,000 people working at the IFSC and an estimated €1 billion goes to the Exchequer in payroll taxes each year (IFSC.ie / Revenue Commissioners[9]). Notwithstanding the obvious dual mandate, there was no consensus at the Oireachtas Inquiry that it contributed to the harmful, deferential approach taken by the regulator in the lead-up to the crash. That said, the 2010 Central Bank Reform Act removed the promotion of financial services as one of the Bank's objectives, as *inter alia* the Governor believed that promotion of financial services was incompatible with financial regulation and ensuring financial stability (Houses of the Oireachtas, 2016: 143-144).

[9] See http://www.ifsc.ie/page.aspx?idpage=6

5.—The Principal Act is amended by substituting the following sections for section 5A (as inserted by section 4 of the Central Bank Act 1998): Substitution of section 5A of the Principal Act.

"General functions and powers of the Bank.

5A.—(1) The Bank has the following functions:

(*a*) to carry out the efficient and effective co-ordination of—

(i) the activities of the constituent parts of the Bank, and

(ii) activities undertaken by any of those parts with persons who provide services to, or receive services from, the Bank, and

(iii) the exchange of information among those parts and between any of those parts and any of those persons;

(*b*) to promote the development within the State of the financial services industry (but in such a way as not to affect the objective of the Bank in contributing to the stability of the State's financial system);

Figure 8.3: Central Bank and Financial Services Authority of Ireland Act, 2003 (excerpt)

One point on which consensus does appear to have been reached is that this structure did have the potential to work, had implementation of regulation been approached properly. For example, the Oireachtas Inquiry found that it was the *execution* of the Regulator/Central Bank's mandates and the absence of interventions that directly contributed to the crisis (p. 158). Regling and Watson also reported that organisational questions should not have stood in the way of firm and proactive supervision, and that the issue was implementation (p. 37). The error in approach was the choice of a principles-based regime ('spirit of the law') over a rules-based one ('letter of the law'). This approach was consistent with the European approach, where the EU had adopted the principles-based approach based on minimum harmonisation, and financial stability risks were mainly treated as relating to individual banks, and not the economy as a whole (Houses of the Oireachtas, 2016: 421). One might question the why anything other than a rules-based approach to regulation would be adopted by any Financial Regulator anywhere, but as Regling and Watson put it:

> "From the early 1990s onwards, there was a debate in academic and policy circles about the ways in which regulatory structures and styles of supervision should be adjusted in the face of more complex financial institutions, more complicated financial products, and highly adaptive markets – markets which tended to find ways around any given set of rules. This debate was not conclusive… Some countries shifted towards principles-based regulation – which de-emphasized specific rules that could be side-stepped. Some countries adopted less intrusive approaches, sometimes described as light touch supervision" - *Regling and Watson, 2010: 17*

An example of the impact of this choice emerges from the case study in Chapter 9, with Honohan finding that "tough measures, such as banning (or disapproving of publicly) 100 per cent LTV mortgages, or setting and enforcing sectoral lending limits were not considered seriously as they were felt to be out of tune with the principles-based approach and with current international regulatory fashion" (Honohan, 2010: 12).

Notwithstanding the structural issues it faced since inception and the principles-based approach adopted by it, it is important to recall that the Regulator had "sufficient powers to deliver their prudential supervision of the banking sector in a more intrusive manner through, for example, imposing conditions on banking licences, revoking a licence, suspension of banking business and (after late 2005) administrative sanctions for breaches, including lending limits" (Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 159).

Ultimately the decision-making and regulatory structure put in place from 2003 on had serious, negative consequences for the link between citizens and the State. Westrup argues that there is an assumption that in most cases "citizens must delegate responsibility to elected politicians to create and enact policies, and that if citizens do not like them, they can choose to vote their elected representatives out of office. The creation of agencies that are, to some degree, outside the control of politicians but responsible for important decisions, obviously serves to weaken further the direct link of delegation" (Westrup, 2007: 7). Such a weakness is now evident, and the decision-making environment in Ireland in 2005 described in the section above paints a complex picture.

In light of this complexity, clarity of advice on key aspects of economic developments is of increased importance. Thus there is an inherent assumption that Irish decision-makers received advice on property market, mortgage credit availability, and house prices in the years before 2005 which would have encouraged them to take mitigating action. Examples of such advice are drawn from two sources: international advice offered by the International Monetary Fund (IMF) and domestic advice from Ireland's Economic, Social and Research Institute (ESRI).

Before setting out the detail, it is worth noting that there is now broad agreement that international and domestic advice was not delivered as precisely or strongly as the ensuing crisis warranted (Regling and Watson, 2010: 41 and 42; Honohan, 2010: 84; Nyberg, 2011: 70; Wright, 2010: 6 and 23). The testimony of a former IMF official to Ireland's official parliamentary committee enquiry into the banking crisis sums this point up as follows:

> "I think it is widely accepted that the IMF's surveillance process failed in Ireland. Although, as discussed below, some vulnerabilities were noted, the assessments by the IMF staff gave no inkling that a major disaster could be in the making. Adjectives such as "exceptional", remarkable", "highly impressive" were used throughout the first seven years of the decade to describe Ireland's overall economic performance. Such overly positive assessments by the IMF were not confined to the case of Ireland and there is no doubt that the organization did not see warning Such overly positive assessments by the IMF were not confined to the case of Ireland and there is no doubt that the organization did not see warning signs in many industrial countries in the build up to the global crisis. However, the extent to which a country's economic and financial situation deteriorated so sharply and dramatically - with minimal prior anticipation by the IMF - was, to my knowledge, probably unprecedented in the history of IMF surveillance" – *Donal Donovan, former IMF Official, February 18th, 2015*

A similarly damning appraisal was offered to the same enquiry by a former ESRI official regarding that organisation's advice where he stated that the ESRI "did not draw the connection between the growth of a property market bubble and the risks to the financial system" (FitzGerald, 2015: 1).

8.3 Examples of Economic Advice[10]

That both the international and domestic advice was not delivered as warranted is not disputed here. The purpose is to set out examples of information and advice that decision-makers can reasonably be expected to have been aware of which would have informed a decision that would have had a more positive outcome for the Irish economy than the decision which was ultimately taken. This is not an analysis of the quality or nature of advice

[10] See Appendix A for a discussion of advice specifically on national competitiveness.

(timeliness is relevant as decision-makers must be allowed some time to assimilate such information after it is first made available), rather it is an analysis of the existence of high-profile advice, or not.

Warnings and advice from the IMF, specifically dealing with the housing market and price inflation, can be found in their annual “Article IV” country report for Ireland published in November 2004, the year preceding the bad decision. The consultation discussions for that report were held in Dublin in July 2004, when the IMF met with the Irish Minister for Finance, the Governor of the Central Bank, other senior officials, the employers’ federation, trade unions, and members of the financial and academic communities (IMF, 2004: 1). At the conclusion of the previous consultation in August 2003, the IMF had “cautioned there was a significant risk that house prices could be overvalued”. One year on, the IMF found that house-price inflation was running well above sustainable rates and the longer it took for them to moderate the greater the risk of a “disorderly correction”. The IMF noted that, following a significant slowing in late 2001, the rate of house price increases rose to around 15 per cent in 2003 and was running just below that at the time of the consultations in 2004.

As a result the IMF recommended that Irish policy-makers should communicate their views about potential overheating in the housing market to help achieve a soft landing, and look to removing the subsidies to housing over the medium-term and “help moderate house price cycles in the future” (IMF, 2004: 3). Following his analysis of IMF surveillance of Ireland, Breen (2012) says threats to Ireland’s economy were identified in 2004 and 2005, including cautioning that “if the housing boom were suddenly to unwind, it might have a substantial impact on employment and private consumption. To address the housing market boom, it suggested Ireland strengthen its financial system with better supervision, stress-testing and higher regulatory standards, the idea being that it was only a matter of time before prices adjusted, and that the financial system should be prepared for the adjustment” (Breen, 2012: 435 and 436). Thus by the end of 2004 Irish decision-makers had, following discussions at the highest level, advice from a respected international observer that the housing market was overheating and that they should take steps to see house prices moderate.

One year earlier, decision-makers received cautionary advice from closer to home from the ESRI, an institute established in 1960 to provide an independent source of research evidence for policy in Ireland, whilst being funded by the State. One of its key publications is its Medium Term Review (MTR), published every two to three years. In July 2003, the ERSI published its ninth MTR which argued that “even if Icarus has singed his wings, the prospects remain reasonably bright for a soft landing. Provided that the world economy, and especially the European economy, finds its way back to its normal growth path by 2005, the factors that gave rise to the very rapid growth in the last decade are not yet exhausted, and the Irish economy still has the potential to grow at 5 per cent a year for another five years to the end of the current decade” (ESRI, 2003: vii).

However, alongside this optimistic macroeconomic scenario, the MTR contained advice on the property market. The Review noted that one of the consequences of booming house prices was that it had “increased the Irish economy’s exposure to a house price shock”, and identified affordability as a very important factor, as it determined “whether young adults set up independent households or remain at home” (ESRI, 2003: 59). As explained earlier, higher LTV ratio mortgages play an important role in making houses more affordable. The ERSI review pointed to the rise in personal debt finance for investment over the preceding decade or so, stating:

> “As is evident the level of debt remained broadly stable until 1993, but over the period of strong economic growth there has been a sharp rise in the level of personal indebtedness. The strength of the rise suggests that growth in personal debt has outpaced income growth over the period. The vast majority of this increase has been in borrowings for housing purposes. House mortgage finance and other housing finance amounted to just over 29 per cent of personal disposable income in 1990. By 2002 this had risen to 60 per cent. In contrast, other personal debt (finance for investment and other advances) has risen from nearly 13.5 per cent of personal disposable income in 1990 to 17.5 per cent in 2002. The rapid rise in the ratio of personal debt to income suggests that the exposure of households to an economic shock has increased. As much of the increase is the result of borrowing for housing purposes this suggests that the Irish economy is exposed to a shock affecting the housing market” – *ESRI, 2003: 57*

In this context, the following advice was offered by the ESRI in the same publication:

> “Fiscal policy has generally not been used actively in Ireland to reduce demand for housing. However, fiscal policy could have a significant effect on the domestic housing market through changing household disposable income, and especially through changing the cost of capital for homeowners. Against the background of a deflationary shock from the recent change in exchange rates, if inflation in the housing market were to continue, it might be prudent to take fiscal action to halt the rise. When the pressures ease, such fiscal action could be unwound, providing support to a market where prices might have begun to fall” - *ESRI, 2003: 85*

Thus by the end of 2003 Irish decision-makers had advice from the county’s preeminent national observer that the economy and households were exposed to an economic shock, that mortgages debt was a key risk factor, and advising that policy action to change the cost of capital would be prudent, and could halt the rise in house prices.

It is worth noting that in addition to external advice, the policy-system itself was demonstrating concern. In October 2004, the Irish Central Bank published a technical paper which, despite expressing the views of the authors rather than the Bank itself, went beyond comment on the housing market, and referred to high LTV ratios specifically. That paper found that greater levels of credit meant mortgage-holders have outstanding loans higher than what they otherwise would have been if availability had been curtailed, adding that if an increasing proportion of banks' loan were to borrowers with higher loan-to-value ratios, then they will have less of a comfort margin in the event of a decline in residential property prices (Fitzpatrick and McQuinn, 2004: 18).

While Nyberg believes that individuals in a position to make decisions "are and must be ultimately responsible for them *regardless* of what advice or suggestions they have received" (Nyberg, 2011: 6, emphasis added), the position here is slightly different in that decision-makers are deemed ultimately responsible for bad decisions *because* of the advice or suggestions they received. Successive investigations have shown that individuals in a position to make decisions did receive warnings and advice that, if heeded, would have mitigated the crisis.

On the face of it, a citizen in Ireland in 2005 might have believed that the sustainability of the economic, financial and banking system was being closely monitored and effectively managed, in a hands-on manner by the Financial Regulator and the Central Bank, with a clear line of responsibility and accountability from them through the Minister and Department of Finance, to the highest level of government in the Department of the Taoiseach, and ultimately on to an overseeing Oireachtas. The reality was different and the inadequate relationships between the Oireachtas, Government, Opposition, Ministers, Departments, the Central Bank, and the Regulator are summed up well among the findings of the Banking Inquiry:

> "The oversight, challenge and effective scrutiny by the **Oireachtas** of the Government and its policy decisions in relation to fiscal policy, financial stability and the system of financial regulation was inadequate in the pre-crisis years.
>
> The Constitution allows significant decision-making powers by Cabinet to make far-reaching decisions without any prior engagement with the Oireachtas. Members of the

> Oireachtas, including the **Opposition** are constrained, with the added issue of limited resources, in their ability to influence the decision-making process.
>
> Government, including individual **Ministers**, made policy decisions, based on a range of considerations, including having regard to, but not always accepting the advice of the Department of Finance, Central Bank and International organisations, and ultimately accepted overall responsibility for decisions made.
>
> The **Department of Finance** relied on the Central Bank Financial Stability Reports as the basis for assessing risks or threats arising from the banks. The Department relied on the overall assessment in the reports rather than responding to the specific risks identified in the reports.
>
> The Department did not carry out adequate independent analysis of the risks.
>
> There was poor assessment by the **Central Bank** of the build up of micro prudential systemic risk and they continued to believe and report that the banks and overall sector could withstand and manage the building risks in the system
>
> The Department of Finance was too reliant on external agencies such as the IMF, OECD and European Commission (who all in turn relied, to some extent, on information sourced from the Department of Finance and Central Bank) for economic forecasting and did not do sufficient analysis to successfully challenge or form an independent review on some of the key risks identified in these reports. This included, in some instances, editing and reducing the risks highlighted in the international reports and in speaking notes for the Minister.
>
> In the years leading up to the crisis, the **Financial Regulator** did not identify the systemic risk that was building up in the banking sector, did not identify the emerging risk to the financial stability of the overall system and, therefore, did not escalate these issues to the Central Bank" - *Report of the Joint Committee of Inquiry into the Banking Crisis Vol. 1, Houses of the Oireachtas, 2016: 194 and 15. Emphasis added.*

It was in this decision-making environment in Ireland that the banks could pursue strategies which not only put their own institutions at risk but also put the Irish economy at risk, given the scale and concentration of their lending to the property sector. The main players in the bad-decision case study had strong interests and self-interests, whether it is banks seeking to maximise market share, the Regulator's consumer, prudential and industry promotion roles, the Department of Finance's economic and political concerns, or the Department of the Environment's housing function and political concerns. The next Chapter examines an illustrative case involving a strategy not without significant risks, and a decision by banks and the State institutions discussed above.

Chapter 9: Mortgages Policy in Ireland: A Case Study in Decision--Making

9.1 Summary Chronology of Events

The purpose of this Chapter is to recount the relevant events in Ireland leading up to the decision by the Government in November 2005 not to intervene to prohibit or limit the widespread availability of 100 per cent loan-to-value (LTV) mortgages. These are the events to which the research design described in Chapter 7 will be applied to reveal the extent to which interests, institutions, and ideology impacted on that decision, and the extent to which irrationality was a result. The case study covers the period from July to November 2005 and involves a number of key events and actors. The following chronology of events serves as summary to reference as the detail is developed over the Chapter.

- April 19th: House price inflation is discussed as subject of a Private Members Motion in Dáil Éireann
- July 12th: The Governor of Central Bank publically warns of the growth of mortgage credit and private sector indebtedness
- July 13th: First Active launch the first widely available 100 per cent loan-to-value (LTV) mortgage for first-time buyers on the Irish market
- July 14th: The Department of the Environment contact First Active and Ulster Bank asking for details and criteria attached to 100 per cent mortgages
- July 25th: The Minister for Housing publically describes banks who offer the products as 'reckless'
- July 27th: The Secretary General of the Department of Finance tells an Oireachtas Committee that individuals and financial institutions have a particular responsibility to ensure that debt levels are sustainable
- August 4th: Permanent TSB, Ulster Bank, Bank of Ireland and its subsidiary ICS Building Society have all begun offering 100 per cent LTV mortgage products
- August 5th: The Department of the Environment emails the Department of Finance seeking a meeting to consider developments in the mortgage market, noting their concern over 100 per cent LTV products, and asking if there are ways to restrict their issuance
- August 9th: The Minister for Housing writes to banks outlining his concerns at the presence of 100 per cent mortgages on the Irish market, and urging caution in relation to them

- August 10th: A meeting is held between the Department of the Environment and the Department of Finance to discuss a response to 100 per cent LTV mortgages
- August 12th: The Head of Banking Supervision in the Financial Regulator prepares a memo suggesting new measures aimed at limiting high LTV residential mortgages
- August 12th: The Department of the Environment formally writes to the Department of Finance outlining its concerns
- August 17th: The Department of Finance prepares a series of actions internally to inform a response to the Department of the Environment, and contacts the Regulator seeking a meeting on the topic
- August 18th: Banks reply to the Minister for Housing defending the issuing of the mortgages
- September 1st: The Department of Finance complete and communicate internally its economic assessment of the impact of 100 per cent LTV products
- September 2nd: The Department of Finance writes to the Department of the Environment outlining the results of their preliminary analysis and inviting them to a meeting of the two Departments and the Regulator
- November 1st: The Central Bank publishes the *Financial Stability Review 2005*, which includes analysis suggesting that economic fundamentals (e.g. disposable incomes, low unemployment, interest rates, pent-up demand, demographics) can account for the vast bulk of the increase in mortgage indebtedness in Ireland
- November 1st: A meeting is held between the Department of the Environment, the Department of Finance, and the Financial Regulator to discuss 100 per cent LTV mortgages
- November 16th: The Minister for Housing tells Dáil Éireann that financial institutions have caused problems by offering 100 per cent mortgages, that he has serious concerns, and urging banks to be more measured in their actions
- November 16th: The Department of Finance consult with the Regulator on a draft, formal written response to the Department of the Environment
- November 25th: The Department of Finance sends a formal written response to the Department of the Environment indicating that no intervention to prohibit, limit, or discourage the issuing of 100 per cent mortgages will be made

Department of Finance

Minister for Finance: Brian Cowen

Secretary General: Tom Considine (also a member of the Board of the CBFSAI)

Assistant Secretary: William Beausang (Banking Finance and International Division)

Administrative Officer: Brendan O'Leary: (Banking Finance and International Division)

Assistant Secretary: Derek Moran (Budget and Economic Division)

Principal: David Hegarty (Budget and Economic Division)

Assistant Principal: Marie Mackle (Budget and Economic Division)

Assistant Principal: Gary Tobin (Public Expenditure Division)

Banks

Bank of Ireland: Brian Goggin, Group Chief Executive

Bank of Ireland: Joe Larkin, Managing Director (Mortgages)

Permanent TSB: Denis Casey, Chief Executive

Ulster Bank Group (*First Active* and *Ulster Bank* brands): Kevin Gallen, Head of Corporate Affairs

Allied Irish Bank: Dermot Gleeson, Chairman

Department of the Environment, Heritage and Local Government

Minister: Dick Roche

Minister of State with Responsibility for Housing: Noel Ahern

Secretary General: Niall Callan

Assistant Secretary: Des Dowling (Housing Division)

Principal: Denis Conlon (Housing Division)

Administrative Officer: Sinead Smyth (Housing Division)

Central Bank and Financial Services Authority of Ireland

Governor: John Hurley (Central Bank)

Director General: Liam Barron (Central Bank)

Head of Monetary Policy and Financial Stability: Frank Browne (Central Bank)

Chairman: Brian Patterson (Financial Regulator)

Chief Executive: Liam O’Reilly (Financial Regulator)

Consumer Director: Mary O’Dea (Financial Regulator)

Head of Consumer Information: Bernard Sheridan (Financial Regulator)

Prudential Director: Patrick Neary (Financial Regulator)

Head of Banking Supervision: Con Horan (Financial Regulator)

Figure 9.1: Relevant Persons in 100 Per Cent LTV Mortgages Decision Case Study, 2005

9.2 Housing Affordability Concerns in 2005

In 2005, Ireland was coming off another year of exceptional economic performance, with the second highest GDP per capita for 2004 in the European Union (EU), an employment rate up from 55 per cent in 1996 to 67 per cent in 2005, the lowest unemployment rate in the EU (4.2 per cent), and population growth of 13.9 per cent to over 4.1 million in the period 1996-2005, the second highest rate of increase in the EU (CSO, 2005: 14 and 15). The economy was already booming, but negative wholesale bank interest rates combined with a growing population, growing incomes and lower actual and prospective mortgage interest rates together "triggered the housing price surge" (Honohan, 2010: 22). Between 1995 and 2007 residential property prices rose by more than 180 per cent, and the maximum sustainable annual level of house construction (which was based on continued economic growth and immigration) estimated in 2005 to be in the region of 70,000 units was exceeded in 2004 for the first time (Nyberg, 2010: 18). The banks were fuelling this bubble via loan book expansion, which only intensified on foot of the increased competition in the mortgage market with the arrival of new entrants such as Bank of Scotland in 1999.

The simultaneous growth in employment and implementation of social partnership agreements which delivered wage increases and tax cuts saw the willingness and ability to pay for housing rise sharply. As Honohan puts it, "property prices developed their own momentum and overshot equilibrium levels. In effect, purchasers increasingly built in an expected continuation in the increase of the relative price of housing" (Honohan, 2010: 22). The increased ability to pay for housing was one consequence of low wholesale interest rates and fierce competition in the mortgage market as banks introduced new products, including high loan-to-value ratio mortgages.

By March 2005, three banks in Ireland – Ulster Bank, First Active, and Bank of Ireland – had begun marketing conditional 100 per cent LTV mortgages. The main condition was the occupation of the mortgage applicant when seeking the loan i.e. be a lawyer, doctor, accountant, dentist, vet, pharmacist, or similar stable profession of the time considered to have particularly strong incomes and job security. In addition, the most that could be drawn down under these mortgages was €400,000, "enough to buy a small family home in Dublin and a more roomy abode in most other places", while applicants were also expected to be of a certain age and to earn a certain minimum (23 years old and earn €32,000 per annum, in the case of Ulster Bank) before they could qualify (Irish Times, March 3rd 2005: 28).

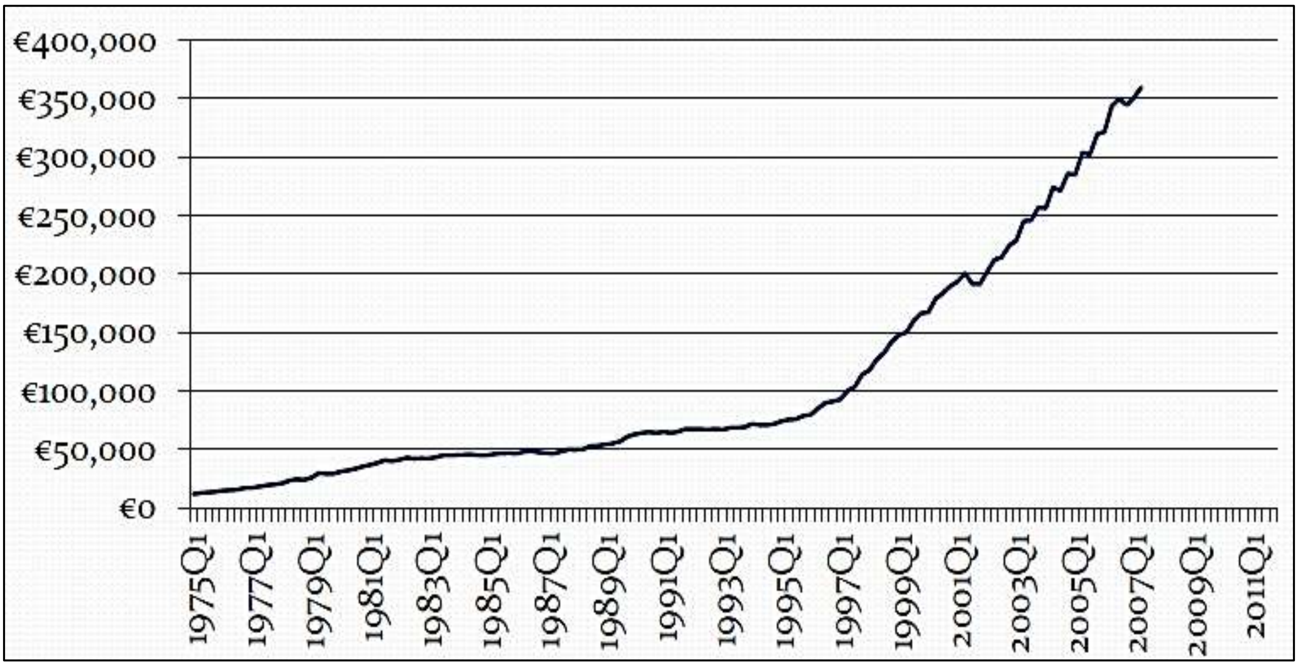


Figure 9.2: Average House Price in Ireland, 1975 – 2007[11]

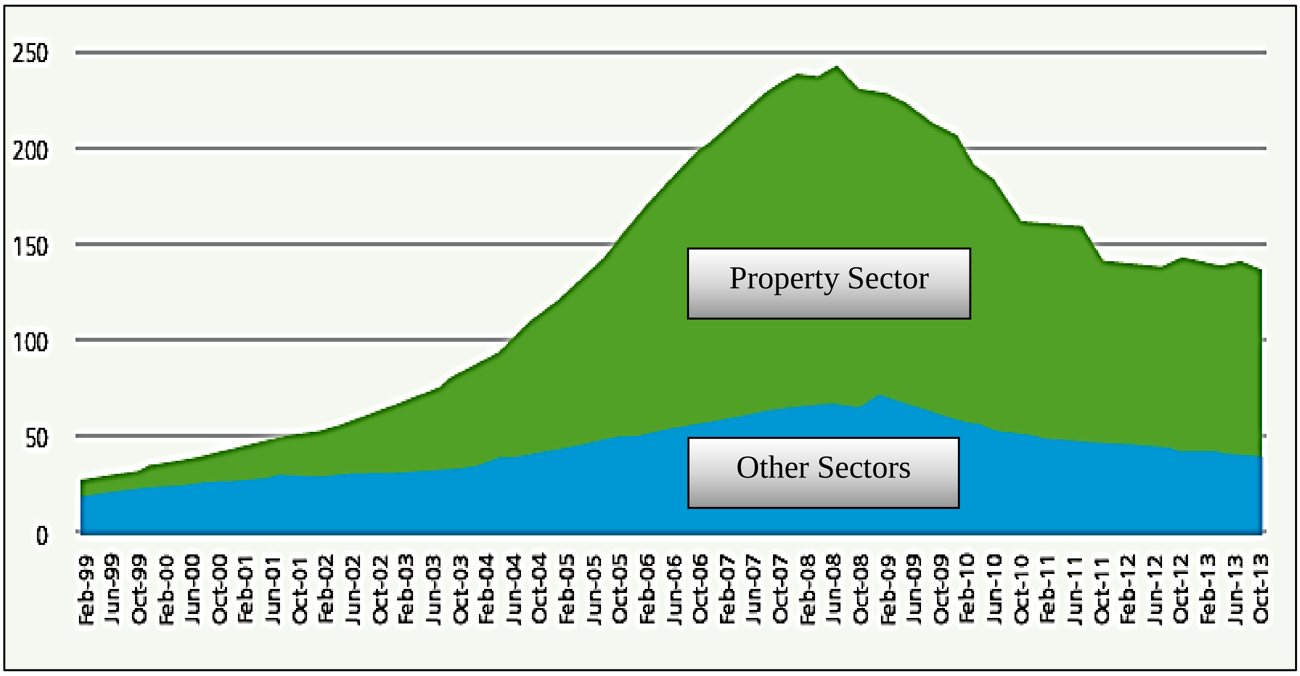


Figure 9.3: Sectoral Lending Volumes (€ billions), 1999 – 2013[12]

[11] *Challenges Facing the Irish Economy European Commission Conference*, Ronan Lyons, Galway, March 24th 2012.
[12] *Report of the Joint Committee of Inquiry into the Banking Crisis Volume 1*, Houses of the Oireachtas, January 2016, p. 133.

At the same time, the knock-on impact of house price inflation and loosening credit standards were becoming a more prominent political issue. In March 2005 the then Minister for Finance, Brian Cowen, was asked by the opposition his views on whether there is cause for concern at the figures on consumer debt, which showed a higher ratio of debt to income than ever before. The Minister replied that he was aware of the concerns expressed by a number of commentators in relation to the continued strong growth in credit, particularly to the household sector and the possible effects of increasing indebtedness upon borrowers, making three noteworthy points.

First, he was quick to distance himself and his Department from a direct role in response to those concerns, placing the issue squarely with the Central Bank and the Financial Regulator (Minister for Finance, Dáil Éireann, *Written Answers – Consumer Debt*, March 3rd 2005). Notably, the Minister uses the word "reckless" in relation to borrowing but not in relation to lending or credit extension/growth. In his reply, Cowen refers to "inappropriate" lending being potentially damaging to the economy.

Second, the Minister placed concerns over indebtedness in the context of ostensibly positive developments, stating that he had been advised by the Financial Regulator that the increase in personal indebtedness could be viewed against a background of record house-building and personal liabilities are backed by real assets.

Third, Cowen put an emphasis on the obligation on the banks to provide borrowers with adequate information so they could make an informed and appropriate decision, as opposed to any obligation on the banks to avoid reckless lending. Next, in terms of direction to the banks, the Minister reports that mortgage lenders had been (i) requested to review their practices in relation to customer income verification and the funding of mortgage balances so as to ensure that not only were loans properly secured but also that borrowers would be able to fully repay them, and (ii) advised of the need to stress test every would-be borrower's ability to meet their credit obligations, in the event of more challenging times. The focus is on income verification and testing the impact of a rise in interest rates, rather than the impact of very high or 100 per cent LTV ratios and the removal of the need for a deposit, on house prices in the short term, or market sustainability in the medium term.

The following month, the Minister of State at the Department of the Environment, Heritage and Local Government, Noel Ahern (**hereafter "the Minister for Housing"**) was asked a question specifically on house prices in Dáil Éireann. Again, certain points of emphasis are notable in his reply.

First, house price growth is explained as a consequence of unprecedented housing demand arising from sustained economic growth and demographic change, rather than a rapid extension of credit. Second, the Minister states that Government policy was focused on achieving an appropriate supply response and using targeted measures to provide access to housing and accommodation for lower income groups. There is no reference to measures to address demand or the role credit extension plays in this. Indeed there is a singular focus on supply with the Minister stating that "[n]o one simple solution to this issue exists without increased supply, which is why we have been working on that aspect for some years". The evidence of success for the Government's policy was, in the words of the Minister, that "2004 was the tenth year of record overall house completions with almost 77,000" (Minister of State at the Department of Environment, Heritage and Local Government, Dáil Éireann, *Priority Questions – House Prices*, April 13th 2005).

Although not referenced by name, the notion of very high or 100 per cent mortgages surfaces in this exchange in April 2005, with the Minister for Housing stating that the problem facing first-time home buyers at that time was "obtaining an initial deposit rather than a mortgage". The main opposition political party claims that finding a deposit is "the core problem for those trying to get on the housing ladder" and asks: "Does the Minister of State intend to bring firm proposals to Government to help such people whom Deputies encounter at every constituency clinic? It would be helpful to take meaningful action in this regard." In hindsight it is remarkable to see very high or 100 per cent mortgages suggested as a possible remedy to rapid house price inflation, if indeed that was what was in the mind of the opposition. Even if it was not, it is clear that there is an emphasis here on government action to help borrowers reach the growing asking prices rather than action to moderate prices beyond increasing supply.

On the other hand, the government had been encouraging – and in fact providing – high LTV loans for particular house purchasers for a number of years. The Affordable Housing Scheme was launched in March 1999 to help lower income households to purchase homes. According to the National Economic and Social Forum (NESF), under this Scheme Local Authorities provided additional new houses on land available to them in or near urban centres where house prices have created an affordability gap for lower income buyers. The houses were offered to eligible buyers at cost price and, accordingly, at a significant discount from the market value of comparable houses in the area. Purchasers were offered mortgage finance at favourable interest rates and a significant feature of the Scheme was that a new housing unit was constructed in each case (NESF, 2000: 24). Buyers could obtain a loan of up to 97 per cent of the cost of a house. Until 2005, the State provided all loans for affordable housing but had then concluded a deal with the Bank of Ireland under which it would offer up to 97 per cent of the value of houses available as part of four schemes. The Minister for Housing told the Dáil that he believed “other financial institutions will follow the bank’s lead and enter the market”. It is possible that one unintended consequence of this deal was an implicit signal by government in 2005 that the provision of high LTV loans by banks was desirable in the property market at that time, even for buyers with affordability problems.

House price inflation and affordability issues, particularly for first-time buyers, were moving ever higher on the political agenda and it was doing so on the basis of genuine concern among citizens as opposed to being a politically contrived issue or one exaggerated by the opposition. As one politician put it, “nothing takes up so much of our time as getting people into houses — whether by loans, planning applications, social and council housing or whatever — at our constituency clinics”. In mid-April 2005 the main opposition party tabled a Private Members Motion Dáil Éireann (Brian Hayes T.D. Dáil Éireann, *Social and Affordable Housing: Motion*, April 19th 2005), which began by noting that, *in alia*:

- The average house price in Ireland stood at €255,776, an increase of €18,000 in one year
- The price of an average house had increased from an average of €75,000 in 1996
- 42,500 people aged over 30 lived with their parents according to *Census 2002*
- Over 100,000 individuals were on local authority housing waiting lists

Again, the debate focussed to a large extent on “young people who want to buy their own home but who cannot afford to do so because, while their income can sustain the mortgage, they cannot provide the large deposit” / “the need to enable people to assemble a deposit is the critical measure that needs to be taken to free up people who cannot get into the house purchase market”, a problem for which high LTV mortgages can be seen as a solution.

The opposition urged government action on this issue stating that the “greatest problem facing young people is the complete and utter failure of the Government to get to grips with the housing crisis. Its *laissez-faire* approach to rocketing house prices has made Opposition Members sick as we witness the knock-on effects of its right wing policies”. As before, there was an emphasis on chasing rising prices in the first instance, rather than tempering them. The opposition’s first element of a three-point proposal was a savings scheme under which first-time buyers would receive €1 for every €3 they save provided those savings are used for a deposit on a house[13]. (The other two elements were the proposed abolition of stamp duty on second-hand homes valued at up to €400,000 bought by first-time buyers, and the front-loading of mortgage interest relief for first-time buyers on the first seven years of the life of a mortgage). As is the custom in the Irish parliament, the Government's response was to move a counter motion replacing the wording in the opposition's criticism with more positive, self-congratulatory text which, unsurprisingly focussed on the increased supply of housing rather than any mention to tempering demand or price growth via restrictions on credit. The emphasising of supply and the consequential construction boom was in fact used to goad the opposition (Noel Ahern, T.D., Minister for Housing, Dáil Éireann, April 19th 2005).

In his response to the opposition's criticism, the Minister for Housing again referred to the Government sponsored legislation of 2004, to facilitate lending institutions in providing high LTV (97 per cent) mortgages for affordable housing clients. He stated that he was pleased to hear that the first product had been announced by Bank of Ireland and would be extended through its branch network shortly. The Government expected other financial institutions to follow suit. There was no reference to the need to limit such activity, nor the dangers of its proliferation. In addition, by again taunting the opposition with recent statistics which indicated that house prices were moderating ("Perhaps it was unfortunate from the Opposition's point of view that the statistics which were published today showed there was a 1 per cent increase in house prices in three months"), the Minister and Government were demonstrating that they believed a cooling of house prices to be a good thing, something to be encouraged, and this would be crucial to the decision made in subsequent months.

A key player in the lending market is the Irish League of Credit Unions. In 2005, of the 29 per cent of adults in Ireland who had a loan of any type, 54 per cent of those loans (by number, not value) were provided via the approximately 450 credit unions across the country (O'Loughlin, 2006: 12, 13). In April 2005 the Minister for Finance was asked if he intended to request the Financial Regulator to investigate the continuing rise in personal credit along the lines proposed by the Irish League of Credit Unions, take action to prevent the debt-income ratio from continuing to rise, or to bring in further regulations to prevent financial institutions from granting excessive personal credit (Minister for Finance, Dáil Éireann, *Written Answers – Financial Services Regulation*, April 26th 2005).

[13] The proposed scheme was similar to the Special Savings Incentive Account (SSIA) scheme already in operation in Ireland at that time but which would not see savings and bonuses realised for another two years.

Unlike the similar question asked a month earlier of the Minister (see above), in this case a link was made to concerns about credit extension emanating from the central player in the Irish lending market. The Minister replied by first stating that he was aware of the concerns expressed by a number of commentators on the continued increase in credit growth, particularly to the household sector, and the possible effects of increasing indebtedness upon borrowers.

As before, the Minister for Finance was then quick to outline the institutional arrangements and the consequences for the allocation of policy responsibility, stating that the growth of credit and the associated increase in indebtedness was a matter for the Financial Regulator. The Minister outlined the steps the Financial Regulator was taking on foot of this responsibility i.e. highlighting the need for care amongst borrowers, requesting lenders to stress-test loans, and promoting greater information and awareness "to assist borrowers in making the most appropriate credit decisions given their circumstances". At this point, there is no evidence of concern or move toward action on the part of government to stem the rapidly rising levels of credit extension or personal indebtedness. It would be another four months before that would emerge.

9.3 The Arrival of Widely-Available 100 per cent LTV mortgages

It was in the summer of 2005 that the issue narrowed from lending practices and high levels of mortgage debt, to high LTV mortgages specifically. On July 12th the Governor of the Central Bank issued a statement on the publication of their 2004 Annual Report, and their concern regarding mortgage debt was clear. Driving this was data showing that total private sector credit was growing at an annual rate of about 25 per cent, that the private sector was highly indebted by international standards, and this level would very soon match the levels recorded in Europe's most indebted economies. The institution which, as repeatedly stated by the Minister for Finance, had responsibility for policy the growth of credit and the associated increase in indebtedness, was publicly and unequivocally stating its concern about the level of household indebtedness and the future sustainability of mortgage debt.

> Mortgage credit and, indeed, non-mortgage credit continued to grow very strongly last year with both aggregates increasing by more than 25 per cent. A continuation of these rates of increase would give rise to serious problems before too long. The substantial easing of house price increases that has occurred should, with a lag, lead to some slowdown in the growth of mortgage credit. Nevertheless, the ratio of debt to disposable income of the household sector, having increased substantially in recent years, is now in excess of 120 per cent. While most borrowers seem to be coping well with servicing this increased debt, an increase in interest rates from their current cyclically low levels could pose problems for new, more highly indebted borrowers.

> The risk of an unanticipated and sudden fall in residential property prices, accompanied by an increase in the default rate among mortgage holders, who may have been too willing to take on ever higher levels of indebtedness at the bottom of an interest rate cycle, is the risk that poses the greatest threat to the health of the banking system.'

Figure 9.4: Excerpts from Central Bank *Annual Report 2004*, pages 11 and 34

On July 13th 2005, the day following this cautionary note by the Central Bank, a bank in Ireland launched the first mortgage that "covers the full price of a property" widely available beyond certain stable professions (Irish Times, July 14th 2005: 1). The bank in question was First Active, part of the Royal Bank of Scotland group. The product was launched because the bank's mortgage market share was coming under pressure, and it followed market research, customer feedback, "rigorous risk assessment", and notification to the Financial Regulator of their intention (Cormac McCarthy, former Head of Finance and Chief Executive, First Active, Evidence to the Inquiry into the Banking Crisis, May 6th 2015).

Later that month the first indication of the Department of Finance's position on these developments was given at a parliamentary committee. The Secretary General of the Department, Tom Considine, who was also a member of the Central Bank's board told the committee that if a shock were to occur to the system from something happening outside the economy, for example, concerns would arise, adding that there was no sign of something like this happening at that moment. He went on to say that although 100 per cent LTV mortgages were now being marketed, it was anticipated that the take-up would be low as more stringent criteria would be required for the higher ratio, and noted the "onus on the Regulator to continue advising people of the risks and highlight the pertinent issues" (Tom Considine, Secretary General of the Department of Finance, *Joint Committee on Finance and the Public Service Debate on Department of Finance Strategy Statement 2005-07*, July 27th 2005).

In August, Ulster Bank, the owner of the first bank in Ireland to start offering 100 per cent mortgages to first-time buyers (First Active), reported a 15 per cent increase in total income in the first half of the year, buoyed by a strong mortgage and lending market. Commenting on the results, the bank's Chief Executive said that they saw nothing in their business that would lead them to have concerns adding that if anything, he expected the bank's mortgage take-up to increase, helped by the introduction of the 100 per cent mortgage (Irish Times, August 5th 2005: 1).

Within one month of First Active offering the first widely available 100 per cent LTV ratio mortgage, there were five mortgage lenders providing the product: "Permanent TSB, Ulster Bank, Bank of Ireland and its subsidiary ICS Building Society have all followed First Active's move to waive the traditional requirement for a deposit equivalent to 8 or 10 per cent of the purchase price of the property" (Irish Times, August 5th 2005: 7). The headline on the article read: "Lenders queue up to offer 100 per cent first-time buyers' mortgages".

9.4 The Concerns of the Department of the Environment

Although the parliament had adjourned for the summer recess, the arrival of 100 per cent LTV mortgages was causing concern amongst some policy-makers. According to emails secured under Freedom of Information (FOI) legislation, the Department of the Environment (**hereafter "D/Env"**) was in contact with banks from as early as July 14th 2005 regarding 100 per cent LTV mortgages (Email, Dept. of the Environment, Scan 1, July 14th 2005). On July 25th the Minister for Housing launched the bulletin of housing statistics for the first quarter of 2005. Despite the statistics showing that the rate of house price growth had slowed down, according to a media report of the launch the Minister feared that the wide availability of 100 per cent mortgages could reverse that slowdown. Regarding banks offering 100 per cent mortgages to first-time buyers, the Minister was quoted as stating:

> "That is bordering on the irresponsible and I'm very concerned that this trend might start where financial institutions are basically being reckless in handing out money" – *Noel Ahern T.D., Minister for Housing, July 25th 2005.*[14]

On July 27th D/Env requested information from Ulster Bank asking about the maximum LTV, terms, and conditions (see Figure 9.5). As that correspondence left D/Env, Ulster Bank was writing to the Department in response to the Minister's remarks quoted above. Addressing the Minister, Ulster Bank's Head of Group Corporate Affairs, wrote:

> "In particular I note your concerns about the possibility of financial institutions being 'reckless in handing out money' to first time buyers… As lenders we regularly see the frustration of many first time buyers… I can assure you that both First Active and Ulster Bank will continue to act as responsible lenders" – *Kevin Gallen, Head of Group Corporate Affairs, Ulster Bank, July 28th 2005.*

[14] BreakingNews.ie; retrieved November 27th 2015. http://www.breakingnews.ie/ireland/cwkfmhcwsncw/

> Sent: 27 July 2005 15:10
> To: Kevin.Gallen@UlsterBank.com
> Subject: Re: Ulster Bank 100% Mortgage
>
> Hello Kevin,
>
> Many thanks for the attached press release re. the above. Would it be
> possible to obtain the following additional information re. this product?:
> Max. LTV
> Max. term
> Available for investment properties or just primary residences?
> Available for all property types, e.g. one-bed/studios?
> Stress test
> Guarantors?
> Site purchase
> etc...
>
> I would appreciate any information that you could email me re. conditions
> applying to this new mortgage product.
>
> Thank you very much again for your help.
>
> Kind Regards, Sinéad.
>
> ***
> Sinéad Smyth
> Private Housing Sector
> Department of the Environment, Heritage & Local Government
> Custom House
> Dublin 1
>
> Phone: (01) 888 2309
> Fax: (01) 888 2012
> Email: sinead_smyth@environ.ie
> ***

Figure 9.5: Email from Dept. of the Environment to Ulster Bank, July 27th 2005

From: "Gallen, Kevin" <Kevin.Gallen@UlsterBank.com>
To: 'Sinead Smyth' <sinead_smyth@environ.ie>
Date: 27/07/2005 17:52:36
Subject: RE: Ulster Bank 100% Mortgage

Dear Sinead,

I summarise the information as follows:

Max. LTV - 100%
Max. term - 30 Years
Available for investment properties or just primary residences? - Just owner occupied residences
Available for all property types, e.g. one-bed/studios? - Not available on one beds/studios, or direct labour builds
Stress test currently at 5.5% (2% above our standard variable rate of 3.5%)
Guarantors? Not allowed
Site purchase Not allowed

Other Criteria
* Only First Time Buyers - Applicants must not own or share another property
* Must have > 3 years Employment history
* Maximum Debt Service Ratio is 40% (defined as Level of Total Financial Commitments as % of Net Monthly Income)
* No interest only option available
* Minimum mortgage - €85,000
* No investment properties
* No agricultural properties
* No business premises
* No flats (on any level) in multi storey type property exceeding five storeys, unless the property is pre-dominantly in private ownership
* No multiple type dwellings (i.e. bedsits with shared front door access)

Again, do not hesitate to revert if I can assist further. Kind regards.

Kevin.

Figure 9.6: Email to Dept. of the Environment from Ulster Bank, July 27th 2005

Ulster Bank

28 July 2005

Group Corporate Affairs and Legal Services
Ulster Bank Group Centre
George's Quay
Dublin 2

Telephone: 01 608 4573
Facsimile: 01 608 4015

www.ulsterbank.com

Noel Ahern TD
Minister for State
Department of Environment, Heritage
& Local Government
Custom House
Dublin 1

Re: 100% Mortgages

Dear Minister,

I refer to your recent comments about 100% mortgages at the publication of the Housing Statistics Bulletin for the first quarter of 2005. In particular I note your concerns about the possibility of financial institutions being "reckless in handing out money" to first time buyers.

Ulster Bank Group (through its First Active and Ulster Bank brands) recently launched 100% mortgages for first time buyers.

As lenders, we frequently see the frustration of many first time buyers, who have the financial capacity to repay a mortgage on the full cost of a home, but are caught in a "rental trap" – where large part of their disposable income is being used to rent a home, which otherwise could be applied to service a mortgage. The 100% mortgage offers a solution to this problem for qualifying borrowers.

I can assure you that both First Active and Ulster Bank will continue to act as responsible lenders. We have and will apply rigorous approval processes to ensure that the level of credit advanced is entirely appropriate to a borrower's circumstances. As an indication of this we have structured the offering to first time buyers with a maximum debt service ratio of 40% of disposable income and stipulated that applicants must have at least three years employment history. In addition, these mortgages are available for owner occupied residences only; site purchase, direct labour builds and one bedroom/studio apartments are excluded and, importantly, repayment capacity is stressed tested.

Our objective is that the availability of 100% mortgages for first time buyers will turn the aspiration of home ownership into a reality for qualifying applications, who would otherwise remain caught in the rental trap.

I hope that this provides you with assurance as far as the Ulster Bank Group is involved in the provision of such mortgages to first time buyers.

With kind regards.

Yours sincerely,

Kevin Gallen

Kevin Gallen
Head of Group Corporate Affairs

2 JUL 2005

Figure 9.7: Letter to Dept. of the Environment from Ulster Bank, July 28th 2005

Between August 2nd and August 9th 2005 the Minister wrote to Ulster Banks' Kevin Gallen, to Bank of Ireland's Group Chief Executive Brian Goggin, and to Permanent TSB's Chief Executive Denis Casey. Although the three letters differ slightly, the core messages are the same in each (See Figure 9.8 as an example). In short, the Minister for Housing was saying to the banks that his concerns were not his alone, and that despite the rationale expressed by the intuitions for 100 per cent LTV ratio mortgages, they should change their policy by limiting the issuance of high LTV mortgages to helping lower income households purchase homes under Government schemes. He also issues a veiled threat to intervene, having considered "what might be done".

Ref: 7127

July 2005

Mr Kevin Gallen,
Head of Corporate Affairs,
Group Corporate Affairs and Legal Services,
Ulster Bank Group Centre,
George's Quay,
Dublin 2.

Pat Martin,
Private Secretary,
confirmed that
this letter was signed
2/8/05.
S Smyth.
2/8/05

Dear Mr Gallen,

Thank you for your letter of 28 July regarding 100% mortgages and for the assurances given in relation to the approval process for such loans. However, these amount to just one element of the issue.

The Government have been concerned to address the needs of first time buyers and the focus on increasing housing supply has been directed at enhancing the availability of housing with particular regard to the first time buyer. The development of a range of affordable housing schemes specifically targeted across a range of different income categories has also sought to assist this element of the market.

In a situation where the challenge has been to increase supply to meet the very high levels of demand, it must remain a priority to minimise any inflationary pressures. A point you do not address is how 100% mortgages can be deployed in a way that will not add to such inflationary pressures. I am aware that similar concern has been expressed by a number of commentators, including some prominent economic analysts and consumer representatives.

I recognise the difficulties of many people who find it difficult to accumulate the necessary deposit while paying rent. However, the needs of such people, and the many other categories of first time buyer, will not in the longer term be well served by the prospect of additional house price inflation.

I am conscious that prudent lending practice has typically had regard to a range of criteria including two very important ones - the ability to repay the loan and risks in that regard, and the loan to value ratio. Moving to a 100% mortgage norm for first time buyers could be viewed as involving an effective abandonment of the second criterion or else, an assumption of significant ongoing house price inflation.

It would be most unfortunate if a general upward shift in lending levels for first time buyers were to cause a reversal in the recent trend of moderation in the rate of house price increases. Any consequential instability in the housing market could have serious consequences on a wide level, but especially for 100% borrowers. While, I appreciate that competitive dynamics can prompt lending institutions to promote new "products", I would urge Ulster Bank Group, even at this stage, to reflect on the approach to higher mortgage levels for first time buyers with a wider perspective than that reflected in your letter.

It will be necessary for me to consider what might be done to minimise the risk of adverse impact on the housing market, as well as pointing out the dangers involved. The Government's concentration on a policy of supporting increased supply allied to a range of specific affordable housing schemes has sought to help first time buyers in a way that is positive in its overall market effects. Most importantly, these schemes are not inflationary because they are delivering an increased supply of housing at a price that is below the general market level. In tandem with these, we have also co-operated in the development of mortgage products designed specifically for purchasers of affordable housing, offering qualifying first-time buyers loans of up to 97% of the discounted price of their home.

Now that Ulster Bank Group is prepared to go beyond the traditional loan to value ratio for first time buyers, perhaps it would consider focussing this additional lending specifically on purchases under the affordable housing schemes. This would help to avoid fuelling prices in the market and ensure that the resources are directed at securing home ownership for households that might otherwise be excluded. My Department would be glad to discuss such an approach.

Yours sincerely,

Noel Ahern, T. D.,
Minister for Housing and Urban Renewal.

Figure 9.8: Letter from Dept. of the Environment to Ulster Bank, August 2nd 2005

In parallel to this direct approach to the banks urging them to change their mortgage lending policy, the Minister's Department approached the Department of Finance (**hereafter "D/Fin"**) to discuss whether intervention was warranted and/or possible. On August 5th 2005 an official from D/Env (where the Minister for Housing was based) emailed a colleague in the D/Fin (see Figure 9.9) seeking a meeting "to consider the position in light of recent developments in the mortgage market". For the meeting, the D/Env official proposes focussing on "the implications for the housing market of the move by a number of lending institutions to offer 100% mortgages to first time buyers".

From: Denis Conlan
To: Gary Tobin
Subject: mortgage market

Dear Gary,

Our recent conversations regarding a meeting to consider the position in light of recent developments in the mortgage market refers. As regards an agenda, while related issues such as housing affordability and the level of indebtedness would, no doubt, arise, we would envisage focussing largely on the implications for the housing market of the move by a number of lending institutions to offer 100% mortgages to first time buyers generally. Within this theme a number of specific issues suggest themselves, for example:

1. To what extent is there cause for concern about the potential implications of higher levels of mortgage lending to first time buyers generally, in terms of:
- implications for house price escalation;
- implications for future stability of the housing market;
- potential wider economic implications.

2. If it were considered desirable to try to restrict the level of lending to first time buyers, what scope if any is there to do so, for example, in areas such as:
- possible raising of capital ratio requirements for lenders (the Prudential Director of the Financial Regulator was recently reported as saying this would not be ruled out if it is felt a lender's credit risk was reaching unacceptable levels);
- possibility of prohibiting lending over a particular percentage;
- scope for more unambiguous and forthright comments by the Regulator;
- possible scope for action by the Director for Consumer Affairs under the Consumer Credit Act e.g. additional/stronger warnings to accompany advertising of mortgages.

3. Possible scope for other forms of action to minimise negative potential of higher lending to first time buyers generally, for example:
- Minister for Housing and Urban Renewal has written to Ulster Bank Group regarding concerns in relation to 100% mortgages and suggesting that any higher levels of lending be channelled towards affordable housing schemes and similar approaches are likely to be made to other lenders offering 100% loans;
- Minister has also made a number of media statements voicing concern and urging caution;
- consider if there is scope for any other action to discourage 100% (or higher) borrowing.

I am attaching a copy of a response issued by the Minister for Housing and Urban Renewal to the Ulster Bank Group in response to a letter from them (which I will forward to you in hard copy). Attached also is information available to us regarding terms and conditions for 100% mortgages. Finally, I am also attaching a copy of an article in today's Irish Times which, I think, gives quite a good flavour of the sort of concerns that have been voiced, in quite a measured way, by some commentators.

I will confirm arrangements for a meeting with you early next week when I have spoken to John Callinan. The most suitable times for us would seem to be next Tuesday pm or Wednesday am or pm. As I suggested, we could meet in Des Dowling's office here in the Custom House. In the meantime perhaps you could consider possible attendance from your Department.

Yours Sincerely,

Denis Conlan,
Private Housing Sector.
5 August 2005.

CC: Des Dowling; Sinead Smyth

Figure 9.9: Email, Dept. of the Environment to Dept. of Finance, August 5th 2005

The official from D/Env also attached several documents to his email including a copy of the aforementioned Minister's letter to Ulster Bank, information from the banks on the terms and conditions associated with the newly available 100 per cent LTV mortgage products, and an *Irish Times* article of the same date, entitled "Building Confidence in the Housing Market", which the official describes as giving "a good flavour of the sort of concerns that have been voiced, in quite a measured way, by some commentators". That article states that compared with the UK, there was less that policy-makers in Ireland could do to stabilise the property market, yet "there are mistakes that, provided a spirit of prudence and foresight prevails, can be avoided by the private sector". Specific mention is made of the Central Bank warnings about strong growth in personal debt, and the recent introduction of 100 per cent mortgages by First Active placing "pressure on other banks to follow suit" (Irish Times, Business Section, August 5th 2005: 4). In alerting his manager of his correspondence to D/Fin, the D/Env official attached a memo noting the difference in D/Fin's initial and later response.

Des

We discussed arranging a meeting with Finance and Taoiseach's Dept re 100% lending. Both George Bourke and John Callinan are away but the latter will be back on Monday. I spoke to Gary Tobin, Finance who in turn contacted the Banking (William Beausang) and Economic sides. They will be happy to attend but would like to have some sort of agenda and any relevant papers. I would propose forwarding the attached. Can you let me know your likely availability next week before I contact John Callinan? I will put together some material.

Incidentally Gary Tobin was very interested when I contacted him first but in a subsequent conversation he seemed to down play the issue e.g. comments about the fact that many first time buyers are already getting 100% funding from a combination of sources. This probably reflects some reticence on the part of Finance (especially the banking side one would suspect) to get involved. The fact that the idea of a deposit saving scheme or bond has been mentioned in the media recently may also be a factor (I have not mentioned the NESC proposal in this context).

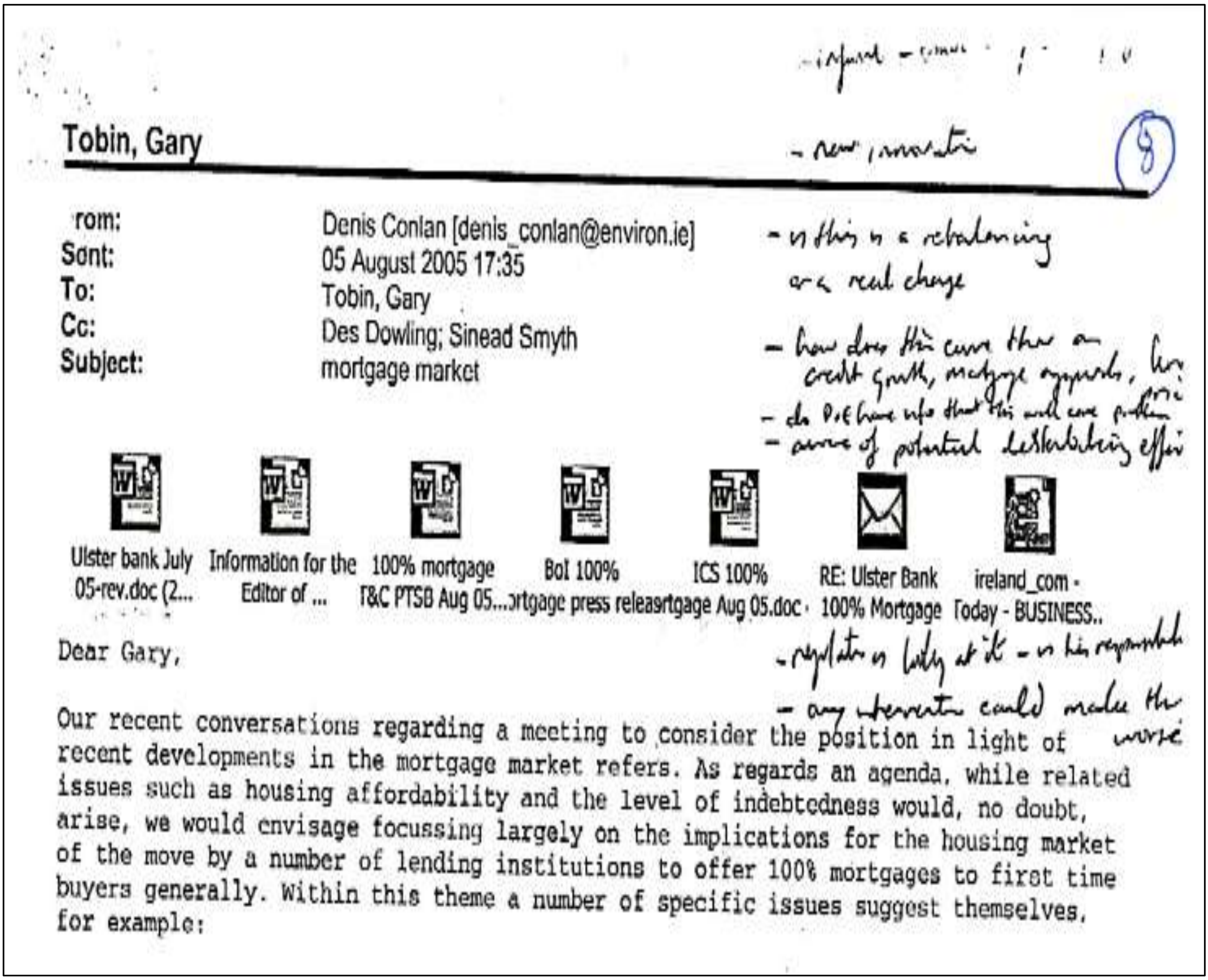
You might like also to see attached extract from today's Independent containing comments by MOS (I had not been aware of these).

Figure 9.10: Internal Memo, Dept. of the Environment, August 5th 2005

This is a critical point is this case study. The context, some evidence, and potential solutions are available to decision-makers to take a good decision, a decision which relates to a policy area that can be reasonably assumed to have impacted on Ireland’s economy. It is at this point that the three factors of interest (interests, institutions, and ideology) may impact to deliver the bad decision outcome which materialises via a formal letter from the Department of Finance to the Department of the Environment in November 2005.

9.5 The Initial Response of the Department of Finance

That crucial August 5th email from D/Env to D/Fin which spelled out both the risks associated 100 per vent LTV mortgages, and solutions which we now know could have mitigated the crisis, had eight bulleted notes written on it by a D/Fin official and they offer an indication of D/Fin's initial response to D/Env's concerns.



- informal - [illegible]

- new innovation

(8)

Tobin, Gary

rom: Denis Conlan [denis_conlan@environ.ie]
Sent: 05 August 2005 17:35
To: Tobin, Gary
Cc: Des Dowling; Sinead Smyth
Subject: mortgage market

- is this a rebalancing or a real change
- how does this come then on credit growth, mortgage approvals, house price
- do D/Env have info that this will cause problem
- aware of potential destabilising effect

Ulster bank July 05-rev.doc (2... | Information for the Editor of ... | 100% mortgage T&C PTSB Aug 05... | BoI 100% ...ortgage press release | ICS 100% ...rtgage Aug 05.doc | RE: Ulster Bank 100% Mortgage | ireland_com - Today - BUSINESS..

Dear Gary,

- regulator is likely at it - is his responsibility
- any intervention could make the worse

Our recent conversations regarding a meeting to consider the position in light of recent developments in the mortgage market refers. As regards an agenda, while related issues such as housing affordability and the level of indebtedness would, no doubt, arise, we would envisage focussing largely on the implications for the housing market of the move by a number of lending institutions to offer 100% mortgages to first time buyers generally. Within this theme a number of specific issues suggest themselves, for example:

Figure 9.11: Dept. of Finance copy of email from Dept. of the Environment, August 5th 2005 (excerpt)

As can be best made out, the legible notes in order read as follows:

- "informal (followed by two illegible words)
- new innovation
- is this a rebalancing or a real change
- how does this come thru on credit growth, mortgage approvals, (illegible word, possibly "house") price
- do DoE have info that this will cause problem
- aware of potential destabilising effect
- regulator is looking at it – is his responsibility
- any intervention could make this worse"

Figure 9.12: Dept. of Finance Hand-Written Notes on email from Dept. of the Environment, August 5th 2005 (excerpt)

On August 7th 2005, a national Sunday newspaper ran an article based on a recently published survey of first-time buyers for one of the banks (Permanent TSB), by the Economic and Social Research Institute (Sunday Tribune, August 7th 2005: 2). The article included the following:

- "Four out of five first time buyers say they save for considerable deposits of up to €24,000 over four years
- Hello? Says one recent professional buyer. "All my friends have just bought their first house and not one of them saved for four years. You borrow everything you can and then go to the credit union and, after approval, borrow to the limit of your credit cards. That's the way you live nowadays."
- The arrival of the 100% mortgage, despite the protestations of the financial institutions that they will apply only to a small 5% of high earners, will only serve to make more money available.
- Nine years ago, some 96% of all houses cost under €150,000 – a price that's little more than a folk memory to Dubliners now forking out close to €1m for a pretty standard four-bed semi-d in a decent location.
- Now, 41% of properties across the country cost between €240,000 and €400,000 with one in 10 priced at more than €400,000."

On August 10th, five days after D/Env sent their original email outlining concerns regarding 100 per cent LTV mortgages and potential interventions, three officials each from the D/Fin and D/Fin met to discuss the issue. The delegations were led at Assistant Secretary-level. From both Departments' respective notes, they agreed on the purpose of the meeting i.e. to discuss the potential impact of 100 per cent LTV mortgages on the housing market and house prices. The key issues for D/Env are evident from the lengthy internal briefing document they prepared in advance for their use at the meeting (Briefing note, Dept. of Environment, Scan 8, August 10th 2005).

The document *inter alia* says a "key concern is that if higher lending has the effect of pushing up prices, any short-term benefits to some first time buyers will be negative for others going forward who will end up paying higher prices, borrowing more to fund this, having to make higher repayments and being more exposed in the event of any deterioration in their own circumstances or in the market generally", a scenario which ultimately came to pass. The internal D/Env briefing also states that "100% lending is necessarily predicated on expectation of further significant price increases in the near future. This must give rise to concern because it is a factor not based on economic fundamentals. It amounts to pumping a market bubble". This unequivocal statement of a belief that further significant increases in Irish house prices would not be based on economic fundamentals will be important later in the case, as it is at odds with a key plank of the D/Fin's formal response in November which did not recommend intervention.

D/Env's note also shows an awareness of, and answers to, likely responses to their concerns. First, it says, "a point that some people will make [is] that the move will make little difference because many first time buyers are already borrowing 100%... via credit unions, parents etc.", (so-called secondary borrowing). The Department rejects this point stating (i) that research showed that such borrowers were a minority with 80 per cent saving an average of €23,000 and saving for a four-year period, (ii) that 100 per cent LTV mortgages leave people who would have been in a position to borrow with more cash available to them, and bring forward purchases, all of which "bids up" house process, and (iii) that secondary borrowing would not necessarily stop as a result of the wide availability of 100 per cent LTV products. Second, the note recognises that it could be argued that "the numbers getting 100% mortgages may be so few that there is minimal cause for concern". Again, the Department of the Environment rebut this position believing that such a view in turn "undermines the rationale for the change while still leaving potential for damage in terms of price expectations and the fact that those already in a position to buy may now have more money for this”.

For D/Env “the bottom line is that there will be significantly more liquidity in the housing market”. Again, this position is in direct contrast with the view that intervention could have negative consequences for the market. Rather it implies the precise opposite. Intervention is needed and the note expands on this where it adds: “the likelihood that the mortgage market is to some extent being driven by addiction to indefinite high growth rates increases the need for some sort of intervention to dampen things down”. Although D/Env believed that 100 per cent LTV mortgages had already caused damage in the short time they had been available they held that the fact that other banks were not offering the product “gives ground for hope that damage limitation is achievable”. Tellingly, D/Env’s note on 100 per cent LTV mortgages states:

> “While the main concern in the short-term is that higher lending without corresponding increases in supply will push up prices higher than would otherwise be the case, looking further ahead, there may be a risk that this could make the stability of the housing market more fragile in the event of any significant change in the factors that have underpinned growth such as low interest rates, growth in net incomes, high inward migration and strong investment demand (due to factors such as lack of alternatives and robust price expectations, as well as low interest rates).
>
> While comments about over-valuation of Irish property are somewhat tentative and difficult to substantiate, it might be foolish to ignore them (e.g. IMF) entirely. It is conceivable that any inflationary effect of increased lending levels can be absorbed by continuing strong housing output. However, that can also be looked at another way i.e. that a scenario might develop whereby unsustainably high output might be artificially prolonged by 100% (or higher) lending, increasing the risk of future instability… The bottom line seems to be that 100% or higher lending could make achievement of the much-desired soft-landing in the housing market more difficult…” - *Briefing note, Dept. of Environment, Scan 8, August 10th 2005*

The respective notes of that August 10th meeting between the Departments have been obtained under an FOI request (Note of Meeting with Dept. of Finance, Dept. of Environment, Scan 8, August 11th 2005; Note of Meeting with Dept. of Environment, Dept. of Finance, Scan 9, August 11th 2005). The most senior D/Env official at the meeting, an Assistant Secretary, opened the meeting outlining their concerns and the points summarised in the paragraphs above. He added a number of important points. First he stated that there was a “wide political view that this intervention was not helpful”. He added that while D/Env “didn’t see it’s role as interventionist it had previously intervened to discourage the uptake of endowment mortgages”.

These statements are recorded differently in D/Fin's note which simply states that D/Env was "generally reluctant in the housing market but that they had concerns regarding the possible implications of the new 100% mortgage products". The D/Fin note made no reference to political views or the fact that intervention in the mortgage market had been made previously.

According to their note, D/Env told D/Fin that "there may be a danger of bubble activity as lenders who traditionally looked for headroom in loan to value ratio may now be relying on anticipated price increases". The added that "[the] IMF have already warned that the Irish property market is overvalued". There is no mention of this in the D/Fin note, though they do record D/Env's view that 100 per cent LTV mortgages "were not helpful to the psychology of the housing market in terms of dampening house price expectations. These products – unlike the Government backed Affordable Housing Schemes – were demand side measures with no corresponding supply side counterweight".

Note of Meeting between Department of the Environment, Heritage and Local Government and the Department of Finance to discuss 100% Mortgages – 10 August 2005

Attendees - D/Finance: William Beausang; David Hegarty; Gary Tobin; D/Environment: Des Dowling; Denis Conlon; Ruth Murray.

The meeting was requested by the Department of the Environment in order to have an exploratory discussion of the potential impact on the housing market of new 100% mortgage products recently offered by a number of financial institutions to first time buyers.

D/Environment stated that:

- They were generally reluctant to intervene in the housing market but that they had concerns regarding the possible implications of the new 100% mortgage products.
- Would these new products help sustain an unsustainable level of output and/or lead to increased prices?
- Did 100% mortgages pose a threat to the 'soft landing' scenario for the housing sector?
- Would people bring forward house purchase decisions?
- Were financial institutions factoring in capital appreciation into lending decisions?
- Perhaps most importantly, was the traditional 'loan to value' criterion being abandoned or downplayed by financial institutions?
- Based on the latest available D/Environment housing statistics, house price increases are not moderating as quickly as the wider media might suggest. In some parts of the market, prices have been quite sticky. Indeed, Sherry Fitzgerald is predicting significant price increases this year.
- These new mortgage products were not helpful to the psychology of the housing market in terms of dampening price expectations. These products – unlike the Government backed Affordable Housing Schemes - were demand side measures with no corresponding supply side counterweight.

In response, the Department of Finance stated that:

- In a competitive market it is important to trust the market though there was of course a need to carefully consider prudential issues and implications for the wider economy.
- The Housing market is a domestic risk factor for the Irish economy. The market is delicately poised and any Government intervention could make matters worse.
- But the most likely scenario is for a soft landing.
- It is difficult to be certain at this time as to whether 100% mortgages will have a significant effect.
- Certain professionals were already receiving 100% mortgages before these new products became available. That said it is important not to be complacent. A watching brief needs to be kept on developments in this area over the coming months.
- IFSRA has two roles: prudential supervision and consumer protection. IFSRA have stated their preliminary view on this issue. No mortgage product will be allowed beyond 100%. IFSRA will be reporting on this issue to its Board at their next meeting.

Next Steps: Following on from the discussion, it was agreed that the Department of the Environment would formally write to the Department of Finance on this matter and that the Department of Finance would bring the matter to the attention of the Regulator for consideration.

Gary Tobin
15 August 2005

Figure 9.13: Dept. of Finance note of meeting with Dept. of the Environment, August 10th 2005

D/Fin's note of the meeting is the first official record of their views on the matter (as opposed to surmising from the eight hand-written bullet points on the crucial August 5th email). This record is in stark contrast to D/Env's note of the same meeting which reports that they posed only one question ("Will the higher level of demand result in a higher level of output than what might sustainable in the long term?"), whereas they state that D/ Fin posed multiple questions at the meeting:

- "Will this initiative de-stabilize the market?
- Does 100% mortgage pose a threat to strategy?
- What is our capacity to analyse the impact?
- Is this initiative just formalising a practice that was already in place?
- If we believe that 100% mortgages will impact on house prices- it will be necessary to show how this happens separated from all other drivers of prices.
- Are we confident that trying to restrict credit to FTBs is the right way to go and could it have significant consequences?
- Would we take the same view if a lender arrived in the market with very low interest rates?"

According to D/Env's meeting note, the next steps included bringing the Financial Regulator ("IFSRA") into the deliberative process.

Next steps

- DEHLG will write to the Department of Finance formally conveying the letter Minister of State sent to Ulster Bank and other Financial Institutions offering 100% mortgages.
- The letter should also set out the issues which the Department/Minister is concerned about in relation to the mortgages which he wishes the Department of Finance to consider.
- Department of Finance will write to IFSRA with a view to setting up a meeting to discuss the 100% mortgages.

Figure 9.14: Dept. of Environment note of meeting with Dept. of Finance, August 10th 2005 (excerpt)

For their part, D/Fin stated that the next steps would be for the Department of the Environment to "formally write" to them on the issues and the Department of Finance would "bring the matter to the attention of the Regulator for consideration". At this point in the decision process, it was clear that the Regulator was the next key player to be consulted.

In their meeting note, D/Env report D/Fin as stating that a formal approach to the Financial Regulator required “caution [and] clear questions/points on impacts”, though no explanation for why caution should be exercised is given. One explanation is that D/Fin held that a formal approach by a Government Department to the Financial Regulator on an issue was a significant intervention in its own right. In that case, it would be difficult for them or any Government Department to argue that they were in some way powerless, inconsequential or unimportant actors in this policy area.

Two days later, D/Env did as agreed and wrote to D/Fin, enclosing the letters from the Minister for Housing to the banks, and some background material “in order to assist further consideration of the matter”. This letter is the first and perhaps only formal articulation communicated from one element of the policy system to another, of the dangers posed by the widespread availability of 100 per cent LTV mortgages (see Figure 9.15).

Mr Hegarty } Pl. see letter + appendix c together with letters issued
Mr Tobin } credit institutions). Analysis of (A) by DED is central
cc Mr O'Gorman to our overall assessment of this. We will follow-up re (B) with IFSRA. I'm not entirely clear what is envisaged by (C). Once you have had a chance to review letter we should meet to discuss response.
WB 17/8

AN ROINN COMHSHAOIL, OIDHREACHTA AGUS RIALTAIS ÁITIÚIL
DEPARTMENT OF THE ENVIRONMENT, HERITAGE AND LOCAL GOVERNMENT

12 August 2005.

Mr William Beausang,
Assistant Secretary,
Department of Finance,
Upper Merrion Street,
Dublin 2.

10

AN ROINN COMHSHAOIL,
OIDHREACHTA AGUS
RIALTAIS ÁITIÚIL
DEPARTMENT OF THE
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TEACH AN CHUSTAIM
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Tel No: +353 1-888 2000
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Dear William,

Further to our exploratory discussion on Wednesday regarding possible implications of new 100% mortgage "products" for first time buyers announced by some lending institutions, I am enclosing, as agreed, copies of letters issued to the relevant institutions by the Minister for Housing and Urban Renewal in order to assist further consideration of the matter.

We are conscious of the view that availability of 100% mortgages might be regarded as a means of overcoming problems of access to home ownership for some people with ability to meet mortgage repayments but unable to secure a deposit. We are also very mindful of the difficulty in assessing the nature and extent of the likely impact of developments in the housing market and of the need to avoid any interventions that might either be unwarranted or have unintended effects. However, we have also noted that some economic commentators and others such as representatives of consumer interests and MABS have voiced concern about the possible effect of 100% mortgages on the market and on the level of indebtedness.

(A) From our consideration of the position, the main potential issue would appear to be the likelihood that a general increase in first time buyer mortgage lending levels would exert upward pressure on house prices. Factors giving rise to such pressure would include increased demand, unlinked to additional housing supply, arising from increase in liquidity and numbers of prospective buyers, and increased expectation of house price inflation. Depending on the extent of price increase, the net effect could be to offset any short-term benefit of increased accessibility to house purchase by leaving future buyers facing higher prices, higher mortgages and repayments than would otherwise be the case. There may also be a consequential issue related to the potential effect of any additional fuelling of prices and expectations in that regard on the long-term stability of the housing market, which most commentators appear to envisage achieving a "soft landing" in the context of general moderation in the rates of price increase over the past year or more.

(B) A particular issue that seems to emerge with the provision of 100% mortgages is that this would suggest effective abandonment of one of the two traditional core lending criteria viz, loan to value ratio. It would seem desirable to explore the reasons for such a change at this particular time and what the implications might be. The fact that the ability to pay criterion is being retained is a separate matter, given that both criteria had independently applied in the normal course. The only alternative interpretation to abandonment of the loan to value ratio would be that the lenders concerned are now consciously factoring expectation of significant on-going house price inflation into their lending policies which, if it were the case, would seem to give grounds for concern.

The foregoing and related issues are set out in a little more detail in the appendix to this letter. I hope that this material will be helpful in your consideration of the issue, both from the banking perspective in conjunction with the Financial Regulator and in the context of possible macro economic implications. While there seems to be a significant amount of prima facie evidence of the inflationary potential of this change in lending practice, it is, of course, very difficult to assess the likely extent of any impact in practice. In this regard it would also seem necessary not just to consider in isolation the potential impact of the move to 100% mortgages per se, but also the potential significance of this in tandem with other relevant developments and factors in the housing market, including the extent of house price inflation which as already occurred in recent years, the level of housing output, and views expressed by some commentators that Irish residential property may be relatively highly valued. Any grounds for concern in the latter regard would, of course, assume particular significance in the context of any possible future cyclical change, for example, in relation to interest rates or economic performance.

If it is concluded that the potential impact is such as to give rise to concern, this will raise the question of what action, if any, it may be appropriate for Government to contemplate. Without prejudice to your consideration of the issue and the views of the Regulator, it seems questionable whether direct restraint of lending would be feasible. Moreover, from the housing market perspective it would c

appear that the most productive approach might lie in attempting to direct any additional lending in a non-inflationary way and seeking to provide less inflationary ways of addressing the issue of access to deposit funding. The Minister's suggestion to the lending agencies regarding funding of affordable housing is directed towards the first of these elements. The second point may merit further consideration by both our Departments.

Yours sincerely,

Des Dowling,
Assistant Secretary,
Housing Division.

Figure 9.15: Dept. of Finance annotated copy of letter to them from Dept. of the Environment, August 12th 2005

Appendix – specific issues for consideration in relation to 100% mortgages

- While 100% mortgages have already been available on a limited basis (e.g. for "professionals") they have not been a norm in the market generally.
- Since there appears to be a general consensus that housing demand is well underpinned by economic and demographic factors, the need for an additional stimulus to demand at this point is not evident.
- There may be a risk that the measure will further fuel price expectations, particularly as a justification proffered for 100% mortgages is that, by enabling people to buy without having to save a deposit, a 100% mortgage will protect them from future price escalation. This approach previously gave rise to an element of "panic buying" which appears to have largely receded and a resumption of which would be very unwelcome. It is noted that the latest IMF report appears to place significance on the Government's success in dampening price expectations. The effect on price expectation is potentially damaging even if the number who succeed in obtaining 100% mortgages transpires to be relatively limited.
- There may be a danger that an upward shift in lending levels could artificially retard what is generally considered to be a necessary easing of housing output to a more unsustainable long-term level.
- Secondary borrowing (e.g. from parents, credit unions) will arguably continue in addition to 100% mortgages. Meanwhile those who may have purchased without secondary borrowing will have access to additional credit. Recent survey results indicate that the vast majority of house buyers achieve quite significant savings. Any reduction in this arising from availability of higher lending would seem likely to have an inflationary effect. Moreover, while the bringing forward of house purchases might be seen as a once-off phenomenon, insofar as it has an effect on house prices this is likely to be permanent.
- While the potential impact is initially on first time buyers, increased purchasing power in that group is likely to impact on other parts of the housing market. In any event, first time buyers represent a significant element of the housing market in their own right and are generally regarded as underpinning the market since all owner-occupier purchases must ultimately knock back to a first time buyer at the end of the transactions chain. Moreover, first time buyers are, of course, the group of main concern from a housing policy perspective.
- While provision of 100% mortgages might be interpreted in one sense as indicating a vote of confidence in the future strength of the Irish housing market by the financial sector, if the development is based largely on competitive dynamics, there is likely to be less substance to this view.
- There are some indications, anecdotally and from auctioneers that first time buyer prices have inflated as a result of the stamp duty changes. Increased lending levels could worsen any trends in that regard. The fact that stamp duty reductions were confined to first time buyers is likely to have increased demand from the latter without any incentive to increased availability of second hand houses which updating of stamp duty for owner occupiers could have provided.

Figure 9.16: Appendix to Dept. of the Environment Letter, August 12th 2005

It is clear that D/Env have noted three of the main points made by D/Fin at the meeting i.e. (i) that the availability of 100 per cent mortgages might be regarded as a means of overcoming problems of access to home ownership for some people with ability to meet mortgage repayments but unable to secure a deposit, (ii) that assessing the nature and extent of the likely impact of developments in the housing market might be difficult, and (iii) that it is important to avoid any interventions that might either be unwarranted or have unintended effects. By opening with an acknowledgement of this points, adding a "however", and continuing to outline their concerns, D/Env were implying that they did not view these three arguments to be of such strength as to dissuade them from mentioning possible interventions including "direct restraint of lending", albeit accompanied by a questioning of the feasibility of such an intervention.

On August 17th, the recipient D/Env's letter reviewed its contents and made hand-written notes on it. Firstly, the D/Fin official (who was the senior official from that Department at the August 10th meeting), highlighted three sections of D/Env's text and labelled them A, B and C (See Figure 9.15 above). The categorised sections of text were as follows:

> "A: exert upward pressure on house prices
>
> B: A particular issue that seems to emerge with the provision of 100% mortgages is that this would suggest effective abandonment of one of the two traditional core lending criteria viz, loan to value ratio.
>
> C: provide less inflationary ways of addressing the issue of access to deposit funding."

Figure 9.17: Dept. of Finance Hand-Written Notes on Letter from Dept. of the Environment, August 12th 2005 (excerpt)

At the top of the letter, the senior D/Fin official wrote the following in respect of A, B and C, and forwarded the letter with the notes to three colleagues:

> "Pls see letter + appendix together with letters to credit institutions. Analysis of A by BED is central to our overall assessment of this. We will follow-up re B with IFSRA. I'm not entirely clear what is envisaged by C. Once you have had a chance to review we should meet to discuss response"

It is assumed that BED refers to the Budget and Economic Division of D/Fin. Thus, a central action at this point was analysis by D/Fin of the potential for 100 per cent mortgages to contribute to house price inflation. In addition, D/Fin was to follow up with the Regulator regarding the extent to which these mortgages products represented an abandonment of the LTV criteria for such lending.

Finally, D/Fin is not certain what D/Env meant by "less inflationary ways of addressing the issue of access to deposit funding", though D/Env say in their letter it was something that may merit further consideration by both Departments. The Secretary General of D/Fin was a government nominee on the National Economic and Social Council (NESC), and – as discussed earlier – NESC had in in November 2004 recommended that "Government should explore possible ways of providing support to those who need assistance in achieving a deposit for owner-occupied housing. Such support could take the form of tax relief on saving for a deposit or a loan from the state to cover the deposit" (NESC, 2004: 6). D/Env, whose Secretary General was also a member of the Council, were aware of and noted that a deposit saving scheme had been mentioned in the media "recently", and in fact believed that it was one explanation for D/Fin's reticence to intervene on the issue of 100 per cent LTV mortgages (Internal memo, Dept. of Environment, Scan 5, August 5th 2005). In addition, the main opposition political party were proposing a deposit scheme and discussion of same featured strongly in the parliamentary debate on housing held in April 2005 (see section 9.2).

As interesting perhaps, are the elements of the text apparently ignored by D/Fin in pursuing this response, including the reference to possible interventions included in D/Env's letter i.e. direct restraint of lending and/or directing any additional lending in a non-inflationary way (e.g. the Minister for Housing's suggestion to the lending agencies regarding funding of affordable housing). There is no highlighting of any the text included on D/ Env's appended additional information, titled "specific issues for consideration in relation to 100% mortgages", despite the strident views contained therein.

9.6 Early Consideration by the Financial Regulator

The primacy of the Financial Regulator's role in this policy area in the eyes of the D/Fin is evident from the foregoing, but understanding their internal activity and decisions is difficult. In his 2010 report on the crisis, Honohan stated that the Regulator "was not passive in responding to the renewed system-wide expansion of property-related credit", and refers to an internal memo within the Regulator's office of August 12th 2005, two days after the meeting between the D/Env and D/Fin (Honohan, 2010: 100)[15].

The memo proposed an increase in capital requirements for new high LTV mortgages, rather than prohibiting their availability or discouraging their use, based on the idea of a capital surcharge on the "riskier property-related loans". According to Honohan, internal Regulator documentation pointed to a recognition of: (i) the unprecedented demand for housing credit, (ii) the IMF opinion that Irish property prices were overvalued by more than in other countries, (iii) high household debt/income ratios by international standards, (iv) increasing competition between lenders resulting in lowering of credit standards, notably the spread of 100 per cent mortgages, (v) the move to IFRS provisioning standards which reduced the general provisioning available in the banking sector to protect against increased defaults, and (vi) the prospect of slower property price growth (Honohan, 2010: 100).

Accordingly, the internal memo proposed what, according to Honohan, "now seems a very modest" increase in capital requirements for new high LTV mortgages (above 80 per cent LTV). The memo called for a sliding scale which, by progressively increasing the risk-weighting of mortgages from 50 to 60 per cent depending on the LTV rate resulted in a 2.4 per cent Tier 1 capital requirement for 100 per cent mortgages, compared with 2 per cent before). Honohan says there was some delay before this proposal was brought to the Authority, reflecting hesitation as to its advisability, despite the imposition "as noted in the documentation of more stringent national requirements by the regulatory authorities in Australia, Canada and Germany" (Honohan, 2010: 100). The proposal was finally approved by the Authority at end March 2006 and became effective from May 2006, but Honohan's official report did not state why the proposal was not accepted and implemented in mid-2005.

[15] A copy of this memo was requested from the Central Bank but they denied that request, stating that due to the confidential nature of the memo they were not in a position to release it.

Speaking in 2015, the proposer (Con Horan), who was Head of Banking Supervision at the Financial Regulator in 2005, told the Oireachtas Inquiry into the Banking Crisis, of his understanding of why the Financial Regulator did not make an intervention in 2005. In short, senior management within both the Financial Regulator and the Central Bank had considered the matter but did not believe the action was necessary because analysis on mortgage growth suggested that developments could be explained by economic fundamentals, there was concern that such intervention would jeopardise the stability of the Irish financial system, and would be inconsistent with the principles-based approach. The rejection of the proposal in August 2005 reflected the "majority view at the time was that the property market was going to have a soft landing as interest rates increased" (Con Horan, Evidence to the Oireachtas Inquiry into the Banking Crisis, May 27th 2015).

The Prudential Director at the Regulatory Authority in 2005 (and Con Horan's superior), Pat Neary confirmed Horan's account of events, in 2015. He indicated that it was the then Chief Executive of the Regulator (Liam O'Reilly) and the then Director General of the Central Bank (Liam Barron) who rejected the proposal, and that it was not considered by the Board of the Regulator (Patrick Neary, Evidence to the Oireachtas Inquiry into the Banking Crisis, May 28th 2015).

This evidence confirms that senior staff within the Regulator were aware of the risks posed by the widespread availability of 100 per cent LTV mortgages, and that intervention was possible and advisable. Instead of increasing the risk-weighting for 100 per cent LTV mortgages in 2005 as a disincentive to their provision, or effectively banning them by attaching conditions to banking licences, the Regulator relied upon moral suasion which Liam O'Reilly later admitted "was a mistake" (Liam O'Reilly, Evidence to the Inquiry into the Banking Crisis, June 11th 2015). Brian Patterson, the Chairman of Financial Regulatory Authority in 2005 later said that they feared foreign banks beyond their supervisory reach could have gained advantage over competitor Irish banks. Further, he said that the Regulator did not want to get involved in individual products, but that they could have tackled "inappropriate selling" of 100 per cent LTV mortgages by attaching conditions to banking licences which "effectively would have banned them (Brian Patterson, Evidence to the Inquiry into the Banking Crisis, June 11th 2015).

9.7 The View of the Banks

Around this time, mid-August 2005, responses from banks to the letters from the Minister for Housing on 100 per cent LTV mortgage products, were received by the D/Env. First, Bank of Ireland replied stating that the bank shared the Minister's concern over house price inflation. The bank added that there was "widespread consensus" that the Irish housing market was "entering a period of near equilibrium" (see Figure 9.18). Regarding 100 per cent LTV mortgages the letter went on, "[a]gainst this background, we are not of the opinion that our product is in itself going to cause a noticeable increase in house price inflation". Of course this view ran contrary to the belief of media, commentators and D/Env, and stating that the provision of 100 per cent LTV mortgages was not "in itself" likely to cause a noticeable increase in house price inflation was a straw man argument, as the Minister had not claimed that they would. Stating that these mortgages were not suitable for "every" first time buyer is another example of straw man argumentation.

Despite the bank stating that these products were not suitable for them, the content of the aforementioned ESRI survey and the views of the mortgage brokerage cited earlier demonstrated the expectation amongst first time buyers that the availability of 100 per cent LTV mortgages served to make more money available, and that half of all first time buyers could get on the property ladder without savings of their own, and expectation in a housing market is fundamental to price levels. As Nyberg put it, "readily available liquidity and perceived/expected demand for property can artificially inflate its value and create additional equity above existing loans. When the perceived demand and liquidity disappear, so does the supposed equity" (Nyberg, 2011: 36).

Bank of Ireland
Mortgages

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Of... of the Minister ... State
1 9 AUG 2005

18th August, 2005

Mr. Noel Ahern T.D.
Minister of State Department of the Environment, Heritage and Local Government
Department of Environment, Heritage and Local Government
Custom House
Dublin 1.

Ref 7127

Dear Minister Ahern,

I refer to your letter of August 9th and as you are aware, the Group Chief Executive, Mr. Brian Goggin has asked me to respond to the matters raised therein.

Thank you for your kind comments with regard to the Bank of Ireland initiative in the development of mortgage products specifically to support purchasers under the affordable housing schemes. We were very happy to work with the Department of Environment and Local Government in customising a mortgage product to meet the needs of the borrowers and we are continuing to work with the Department to further enhance the product availability.

The Bank shares your overall concern with regard to house price inflation as has occurred over the past number of years and we welcome the current moderation in this inflation. There is widespread consensus that the Irish housing market is entering a period of near equilibrium. Supply is running at record levels (completions in 2004 were 77,000; with 74,000 forecast for 2005). House prices are finally responding to this scale of supply and are forecast to increase by approximately 5% in 2005, a far more modest increase relative to house price inflation over the past decade.

Against this background, we are not of the opinion that our product is in itself going to cause a noticeable increase in house price inflation. Our product, by its nature and design is not suitable for every First Time Buyer and entry criteria has been set to target the product selectively and to those who are best positioned to afford a loan at this Loan to Value level. In addition, we are retaining our very strong focus on borrowers ability to repay and are, as you will be aware, one of the lenders in the market who stress test repayments at a rate of 2% above our standard variable rate. Several other key risk mitigants are in place, particularly with regard to property valuations. We have ensured that our business channels are fully aware of the product criteria and all credit decisions can only occur in our central underwriting function within Bank of Ireland Mortgage Bank.

Prior to the announcement of this product, it was our view that the mortgage market was well served with the vast majority of house purchasers being facilitated with traditional mortgages or our recently announced Breakthrough mortgage for the affordable housing sector. However, when our major competitors moved with an increased Loan to Value product for First Time Buyers, we were left with little option but to ensure that there was no product innovation gap in our portfolio in order to protect our franchise. The product will be kept under close review by us with regard to its suitability and appropriateness against prevailing market conditions.

We would welcome working with your Department particularly in the course of our further development of our Affordable Housing product.

Yours sincerely,

Joe Larkin
Director
Bank of Ireland Mortgage Bank.

Figure 9.18: Letter, Bank of Ireland to Dept. of the Environment, August 18th 2005

The reply from Bank of Ireland also touched on, rather than directly dealing with, the point made by the Minister for Housing that making 100 per cent LTV mortgages available saw the “effective abandonment” of one of two key, traditional criteria for securing a sustainable mortgage. These two criteria were ability to repay based on a loan-to-income multiplier, and a lower LTV ratio. In their letter Bank of Ireland say that “entry criteria has been set to target the product selectively and those who are positioned to afford a loan at this Loan to Value level” and they are “retaining [their] very strong focus on ability to repay and are… one of the lenders in the market who stress test repayments at a rate of 2% above [their] standard variable rate”. Finally, Bank of Ireland set out the motivation for introducing their 100 per cent LTV product: despite their view that the mortgage market was already well served, once major competitors began selling 100 per cent LTV mortgages they were left with little option but to ensure that there was “no product innovation gap” in their portfolio in order to protect their franchise.

Second, Permanent TSB replied to the letter from the Minister for Housing on August 19th. Again, the bank stated that it shared the Minister’s concerns regarding house price inflation, adding that the significant media exposure given to 100 per cent LTV mortgages focussed on their availability rather than the “strict criteria” applied to applications. (Letter from Permanent TSB, Dept. of the Environment, Scan 12, August 19th 2005). Pointing to the moderation in house prices at that time, the bank state that they “do not believe that the introduction of 100% mortgages should have any impact on this trend of moderation or in any way contribute to house price inflation”, and believe “it is important product option to have available… and one which can help alleviate the otherwise difficult plight of many people trying to make their first step onto the property ladder” (Figure 9.19). Unlike the letter from Bank of Ireland, there is no mention of the competitive market forces prompting Permanent TSB’s entry into this market or undertaking to monitor their use carefully. There is the claim that 100 per cent LTV mortgages should not have “*any*” impact on house prices, contrary to the belief of many observers. Perhaps even more striking was the omission from PTSB’s letter to the Minister that they had contacted the Regulator privately on at least two occasions in the previous month, asking the Regulator to intervene (Figure 9.20).

Minister
Copy forwarded to D Conlon
on 23/08/05 for his Info
AS.

Returned from MoS
on 31/08/05.

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Minister Noel Ahern TD
Minister for Housing and Urban Renewal
Department of the Environment,
Heritage and Local Government
Custom House
Dublin 1

Office
23 AUG 2005

19th August 2005.

Dear Minister,

I refer to your letter of the 9th August in respect of 100% mortgages for First Time Buyers (FTBs).

I can assure you that **permanent tsb** shares the Government's concerns about the needs of first-time buyers in general and the need to minimise inflationary pressures in the housing market in particular.

We are extremely sensitive to trends in the housing market in general. Our position as one of the largest providers of residential mortgage finance in Ireland over the past 50 years gives us a very clear understanding of the Irish housing market. This is reinforced through significant investment in detailed research such as the monthly **permanent tsb** House Price Index (undertaken in conjunction with the Economic and Social Research Institute). This investment is extended into other areas too. Most recently and again in conjunction with the Economic and Social Research Institute, we published what we believe is the most extensive research ever undertaken into the First Time Buyer market in Ireland. This has received extensive media coverage and I enclose a copy of the report for your information.

It is against this background that **permanent tsb** bank examines options for product development that will facilitate the needs of different categories of house buyers and which most recently has led to the launch of our 100% mortgage for First Time Buyers.

This product – and similar products launched by other companies before and after our own – have received significant media exposure. However most of that exposure has focussed on the availability in principle of 100% mortgages and relatively little on the strict criteria which we and others apply when considering applications for such mortgages.

The reality is that these mortgages are designed for a specific category of customer; one who can clearly demonstrate their ability to meet the loan repayments (including the stress testing of such repayments at interest rates of 2% higher than currently apply). Other conditions include restricting the availability of such loans for specific dwelling types.

In our research into First Time Buyers we identified that while the vast majority of such people are able to save relatively large sums of money to use as a deposit on their house purchase, there are many customers – particularly those currently paying significant rents – which can not make those savings while paying high rents but who could comfortably afford to repay the mortgage on a property should they be able to purchase one. We believe that the new mortgage will appeal to these customers in particular.

As you point out in your letter and as is being revealed in the **permanent tsb**/ESRI House Price Index, the rate of house price growth is now moderating across the country. We do not believe that the introduction of 100% mortgages should have any impact on this trend of moderation or in any way contribute to house price inflation and therefore we believe it is an important product option to have available for our customers and one which can help alleviate the otherwise difficult plight of many people trying to make their first step onto the property ladder.

I trust this clarifies our position on the matter.

Yours sincerely

Denis Casey
Chief Executive

Figure 9.19: Letter, Permanent TSB to Dept. of the Environment, August 19th 2005

FILE NOTE

Subject: **IFSRA/100% mortgages**

After an Irish Times Board meeting yesterday Brian Patterson, Chairman of IFSRA, asked me about the 100% mortgage situation. He was aware that I had spoken to Pat Neary and expressed reservations about the introduction of this product to the market, bringing with it as it did a no moral hazzard mortgage as well as introducing the concept which had not previously been seen in the market of significant potential competition around credit standards. Pat had told me that they were " a principles based regulator" and therefore that they had reacted as we had seen. I told him that I thought that in some way it was a pity that somebody from the Regulator had not made it perhaps clearer in private to First Active that they would not welcome this development and that in the circumstances as one of the leading residential mortgage providers we were left with no option but to introduce a similar product. I also told him that I hoped that the principles based regulation theory would apply in the consumer area.

Brian was aware of this conversation but told me that at the press conference following the publication of IFSRA's Annual Report there was a very significant amount of discussion on this topic. I told him that at this stage it seemed to me that the horse had bolted and that it was a pity that the Regulator had not made any negative views known at the time that the product was first being discussed. While clearly the Regulator has no legal powers to prohibit particular products, they do have general prudential powers, including the threat of the imposition of incremental capital, and I said that I thought that most institutions would think long and hard before introducing something about which the Regulator had indicated a fundamental unhappiness. I said that I thought that it was now pretty late in the day and what IFSRA needed to do was to have the courage of their convictions on any particular issue.

Brian said that he fully understood our position.

DAVID WENT
27 July 2005

Copy: Non Executive Directors, Denis Casey, Frank McGowan, Peter Fitzpatrick

CL

Figure 9.20: Internal File Note, Permanent TSB, July 27th 2005

9.8 Analysis by the Department of Finance

D/Fin's response to D/Env's letter, proposed by the senior official on August 17th, was (a) analysis by D/Fin of the impact of 100 per cent LTV mortgages on house prices, and (b) a follow-up with the Financial Regulator on traditional core lending criteria and LTV ratios. There is little documented evidence of extensive activity. The Wright Review of the Department of Finance later described this response as an example of D/Fin not organising a strategic response to the problem, or identifying a full range of options to moderate activity in the sector. It also demonstrated D/Fin's lack of coherence across its divisions in dealing with the issue (Wright, 2010: 31).

The only record of internal D/Fin analysis of the issue comes in the form of a two page document (entitled "Analysis of Possible Effect of 100% Mortgages") and an accompanying media article on plans by the Regulator to introduce a sliding scale of higher capital reserves for 100 per cent LTV mortgages, which it did eight months later. The official who prepared the analysis sent it to her superior on September 1st, and copied more senior officials in the Department on the email. When questioned at the Banking inquiry in 2015 about the Department's conclusions on 100 per cent mortgages, one of those senior officials copied on the analysis testified that he "wasn't involved in preparing that response" and was not able to cast any light on it. The analysis concludes that 100 per cent LTV mortgages would be inflationary, though the extent of that inflationary pressure was unclear. There are only two bolded sentences in the analysis. The first reads: "econometric studies demonstrate that relaxation of liquidity or increases in credit do exert a positive impact on prices"; and the second reads "at this stage it is impossible to tell the precise impact" (See Figure 9.21).

Tobin, Gary

From: Mackle, Marie

Sent: 01 September 2005 09:58

To: Beausang, William; Daly, Sharon; Hegarty, David; McCarthy, John; Moran, Derek; O'Sullivan, Loretta; Tobin, Gary

Subject: Regulator tightens capital rules on 100pc home loans Irish Independent 1.9.05

Text reproduced below.

ONLY 36 of the much-hyped 100pc mortgages were sold in the first two months of their existence, out of a total of 7,000 home loans drawn down during the period.

And the Financial Regulator is set to make the controversial new mortgages less attractive to banks by increasing the amount of capital they have to set aside to cover all mortgages.

The Regulator's chief executive, Liam O'Reilly, said yesterday that he would be very concerned if 100pc home loans became widespread.

"I don't think they should be advertised as suitable for the mass market," he said.

Latest figures show that less than 2pc of mortgages approved in the last two months, but not yet paid out, were for 100pc loans. The Regulator believes they should remain as a small minority.

"If we saw that they were becoming widespread, we would go into the institutions to make sure they had not reduced their affordability rules or were selling them to the wrong customers," Mr O'Reilly said.

But proposals to increase the banks' capital reserves on mortgages may have the biggest impact. At present, banks must cover half the mortgage.

With an 8pc reserve ratio, this means putting 4pc of the value of the loan into reserves.

Mortgages above 100pc of the value of the property have to be fully reserved, with 8pc of the value.

Mr O'Reilly plans to introduce a sliding scale which would mean higher reserves on most mortgages. The new 100pc loans would have to be fully covered, but even 80pc mortgages would have to carry more than the current 4pc reserve.

The move could prove controversial, since it may reduce the amount the banks are willing to lend.

But easier credit risks are pushing up house prices, with estate agents Douglas Newman Good reporting this week that even the prospect of 100pc loans for first-time buyers is driving up house prices in Dublin.

"We have to be concerned about a number of factors - what is going to happen to people's incomes, to inflation, to interest rates?" Mr O'Reilly said.

"We also have to ask if people are borrowing on the basis that their house will soon be worth 20pc more."

With the banks engaging in more populist advertising, Mr O'Reilly said they would take swift action over any "mis-selling" of mortgages.

"We now have the power to impose administrative sanctions. We have told the banks that if we find mis-selling, or collusion with customers who are giving false information, we will apply sanctions, preferably in public."

Brendan Keenan

Analysis of possible effect of 100% mortgages

Summary – take up low, impact inflationary but extent unclear.

- **Take up as of yet low, based on informal contact with some institutions.**
    - Irish Permanent informally advised that take up as of yet low. However it is a new product and it takes about a month and a half for approvals to be made. By year end they anticipate business to grow to 4 to 5% in this sector. (Unclear if referring to FTBs generally or to 100% mortgages specifcially). EBS only introduced product last week. ICS quite stringent about qualifying income when contacted as a potential customer. Apparently they have been receiving a lot of enquiries. Given time constraints other private sector institutions not contacted yet. Finance division has also been in touch with the Financial regulator. Data is only starting to be collected there and in DOELG too.
- **Impact inflationary, extent unknown:**
    - The Irish Permanent advise orally that in their view, impact on price likely to be moderate if any at all. However, **econometric studies demonstrate that relaxation of liquidity or increases in credit do exert a positive impact on price.** The impact may perhaps be felt as a short term "blip" with possibly little long run impact but it is really too early to say.
    - While no econometric or other studies of the impact of 100% mortgages specifically have been carried out in Ireland, econometric study of impact of credit[1] on house prices (Kieron McQuinn, Central Bank technical paper no 5 2004 November 2004) indicates an elasticity of about 0.6 with respect to the impact of a change in credit to price. Coefficients published in an earlier study in the Bank's Financial Stability Report Summer 2004 were also positive at 0.359 in respect of the impact on price of changes in current year credit and 0.55 for changes in the previous year's credit[2]. Studies on the impact of credit are currently being updated by the Central Bank for the next Financial Stability Report but that is not due out until November.
    - Initial feedback from informal consultation with non-private sector economists confirms that **at this stage its impossible to tell the precise impact** – observations are required possibly up to as long as a year before the impact on prices can be objectively established. Most non-private sector economists talked to do see a positive impact on price. However, none are sure as to the effect, with one unsure about the overall impact on house prices given the presence of other factors which are helping to ease the rate of price growth. Another consulted more recently sees little impact on price as it is in the interests of financial institutions themselves to behave prudently.
    - One institution contacted not offering the 100 per cent mortgages. Again, tentative off the record informal feedback suggests that as they see prices stabilising the introduction of 100% mortgages offers little prudential upside.

---

[1] Average mortgage approved. Credit represented by the letter C in this paper.

[2] Table 2 House price equation (2) page 82 Financial Stability Report 2004 available on the Central Bank's website http://www.centralbank.ie. Credit is represented by the letter G.

The product is perceived as a means to compete for market share. If they see a loss in share they will be forced to review the situation but as of yet no plans.

- At this stage only speculation is possible and it would not be fair to attribute any view to any organisation or individual given this. Since the consultations above however, some additional written comments have emerged. The first, from Goodbody Economic Consultants states "The first time buyer market is also likely to receive further momentum with the widespread promotion of 100% Loan-To-Value mortgages. We feel that this represents an unnecessary boost for a market which is currently settling into more sustainable rates of inflation".[3]
- Both the Irish Times and Independent of 31.8.05 carry articles on Dublin second hand house prices based on a survey by Douglas Newman Good. The Independent points out "One in two second homes in the capital are being bought by first time buyers, who have seen entry-level houses rise by 10.5pc in six months. The rise was attributed to the abolition of stamp duty on second hand houses for these buyers, with further increases expected due to the availability of the controversial 100pc mortgages".[4]
- One could speculate that house price growth might continue to decelerate but that the rate at which deceleration occurs might be delayed. For example if house prices were to decelerate to say 4% by year end that might be delayed to say 5% at year end. But no one knows of course.

- The presence of these mortgage in the UK has been cited frequently in the media. However, the UK is atypical in this regard. Data from the IMF shows that the UK and Ireland have had the highest loan to value ratios in a number of countries surveyed. (IMF November 2004 Selected Issues report). Furthermore, the UK has a monetary policy instrument with which to control house prices, and cannot be used as a guide as to future developments here.
- An interesting insight into possible factors underpinning the introduction of these mortgages might be gleaned from the latest Bank of Ireland review of the property market. It points out that investors have investment opportunities abroad and that the FTB share of the Irish market has declined in either 2003 or 2004.
- Lastly, the general view has been that interest rates are likely to remain flat in the short run. However more recently, in August, the Ulster Bank projected an increase in interest rates in Q3 05[5]. In February 2005 a survey of consumer expectations about the market revealed that expectations were that interest rates would remain low. Some highly geared individuals who have become used to persistently low interest rates may not be able to make repayments in the event of interest rate rises.

<u>Summary</u>
Despite the uncertainties, the most common view received so far is that this development is inflationary, though the extent and duration is unclear, as is the impact on the overall rate of house price growth.

[3] Goodbody Economic Consultants "Irish economic commentary Q3 2005 – The house is still in order" page 28
[4] (Irish Permanent TSB data shows a general moderation apart from Dublin and first time buyer segments).
[5] http://www.ulsterbank.com/ulster/shared_group_content/Economy/downloads/outlook.pdf page 10/18. See also page 7/18 for their comments on exposure to interest rates.

Figure 9.21: Analysis by Dept. of Finance, September 1st 2005

The analysis shows that D/Fin had informal contacts with the banks regarding the new products. Permanent TSB indicated to them that take-up was, at that stage, low adding that it takes around six weeks for approvals to be made. EBS had only introduced the product in the previous week, while ICS had received “a lot of enquiries”. The analysis states that “[g]iven time constraints other private sector intuitions not contacted yet”, meaning conclusions on product take-up were based on just three providers (Permanent TSB, EBS and ICS), none of whom had firm data.

The analysis goes on to say: “While no econometric or other studies of the impact of 100% mortgages specifically have been carried out in Ireland, econometric study of impact of credit on house prices (Kieron McQuinn, Central Bank Technical paper No. 5 2004 November 2004) indicates an elasticity of about 0.6 with respect to the impact of a change in credit to price”. The reference to the 2004 paper is notable here. While that paper does examine the link between credit and house prices in a technical manner, it is the non-technical conclusions arrived at on foot of that technical work that is perhaps more important in the context of the D/Fin’s investigation into the likely impact of 100 per cent LTV mortgages:

> “**Adopting different time-series econometric approaches, we find fairly conclusive evidence of a mutually reinforcing long run-relationship between house prices and credit levels**. This contrasts with other recent work which generally finds that this long run relationship operates in one direction or another.
>
> We argue that this result is probably due to the coming together of a group of country-specific factors in Ireland such as the recent economic boom, net migration and rigidities in housing supply. Based on the long-run estimation, we augment an existing model of the Irish property sector to examine the dynamics within the system.
>
> In the short-run **we find that the contemporaneous value of credit growth has a positive and significant effect on house price growth**. However, house prices do not appear to influence credit contemporaneously in the short run.
>
> **It would appear that the provision of greater levels of credit (in terms of loan to income ratio) over the past few years has also contributed to the rate of growth**. **Thus, while fundamental factors continue to experience favourable conditions (low interest rates, steady income growth rates etc.), the housing market is likely to continue to experience some price growth.**
>
> **However, in an equilibrium context, if the market is subject to, say, a significant income and/or interest rate shock and credit institutions, consequently, revise their credit income ratios downwards this would result in any initial price declines being exacerbated.**

On the basis of this work, what are the implications for the stability of the domestic financial sector? A greater level of credit availability means that, *ceterus paribus*, mortgage holders have outstanding loans that are greater than what they otherwise would have been if availability had been curtailed.

At the moment, banks have a 'haircut' on the market value of the housing assets through the loan to value ratio and the fact that this lending is collateralised. However, **if an increasing proportion of their loans are to borrowers with higher loan to value ratios, then they will have less of a comfort margin in the event of a decline in residential property prices**" – *Fitzpatrick and McQuinn, 2004: 17-18, emphasis added*

Parallel to carrying out its analysis, D/Fin contacted the Regulator on August 17th (record not available), and on September 2nd the Regulator replied nominating their Consumer Director (rather than their Prudential Director) to set up a meeting on the topic of recent developments in the mortgage market (see Figure 9.22).

On foot of their analysis and this reply from the Regulator, D/Fin replied D/Env (see Figure 9.23). The letter captures well the conclusions of the cursory and (as now seems the case) incomplete analysis undertaken within D/Fin, notwithstanding the adequacy or otherwise of that analysis. The letter concludes with an invitation to a meeting and it would be another two months, in November, before the Departments of Finance, Environment, and the Regulator would hold the relevant meeting on the issue.

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Liam O'Reilly
Chief Executive

Mr William Beausang WB 5/9
Assistant Secretary
Department of Finance
Upper Merrion Street
Dublin 2
Ireland

2 September 2005

Re: Recent Developments in the Mortgage Market

Dear William

Thank you for your letter of 17 August 2005. I have asked Mary O'Dea to contact you to set up a meeting on this issue.

Yours sincerely

Irish Financial Services Regulatory Authority

Figure 9.22: Letter from Regulator to Dept. of Finance, September 2nd 2005

September 2005

Mr Des Dowling,
Assistant Secretary General,
Department of the Environment, Heritage and Local Government,
Custom House,
Dublin 1.

Re: 100% Mortgage Products

Dear Des,

Further to your letter of 12 August 2005, I am writing to you concerning the issues you have raised regarding the new 100% mortgage products now being offered to first time buyers.

Given the importance of the housing market to the wider Irish economy, this Department would of course be concerned, for example, regarding any potentially inflationary effects on house prices.

Initial feedback from informal consultation with certain lenders suggests that to date take up of these new products has been limited.

It is our view that observations may be required possibly up to as long as a year before the impact on prices can be objectively established.

Nonetheless based on a preliminary in-house assessment, on balance, it appears likely that these products will be inflationary, though the extent and duration is unclear, as is the impact on the overall rate of house price growth.

Following on from our recent explanatory meeting, I have written to Mr Liam O'Reilly, Chief Executive of the Irish Financial Services Regulatory Authority (IFSRA) and he has proposed a meeting with Ms Mary O'Dea, the Consumer Director of IFSRA, to discuss the issue further. Given the role of your Department as regards housing policy, I would like to invite you to attend this meeting. In this regard, I would appreciate it if you could inform me of your availability over the coming days in order that I can arrange a mutually convenient date and time for the meeting.

Yours sincerely,

William Beausang
Assistant Secretary

Figure 9.23: Letter from Dept. of Finance to Dept. of Environment, September 2005

9.9 The Immediate Media and Political Backdrop

Over those intervening months, the issue continued to get attention in the media. On August 29th 2005 Davy Stockbrokers (who were part of Bank of Ireland Group and acted as stockbroker to Anglo Irish Bank, Bank of Ireland and Irish Life and Permanent at the time) published a 40-page research note which, inter alia, examined the impact of 100 per cent LTV mortgages being more widely available on affordability. The research cannot be described as obscure given that it was the subject of an article in *The Irish Times* headed "Testing times for 100% mortgages" (Irish Times, Property Section, September 1st 2005: 28), and was published on the same day as the alternative article from the *Irish Independent* which the D/Fin official attached to their in-house assessment of the issue (see above). Relying on the newspaper article alone it would be clear that a study of the impact of 100 per cent LTV mortgages specifically had been carried out in Ireland, and that there was cause for concern. Had this summary of the research prompted the reader to consult the full research they would have read, amongst other findings, the following:

- "If we take a look at the mortgage market where we have the most data, loan to value ratios (LTVs) have largely remained well behaved, until now that is.
- With FTB's finding it increasingly difficult to put together a deposit, First Active recently broke ranks and is now offering a 100% LTV product aimed at first time buyers.
- The product was described by one mortgage broker as the 'biggest development in the Irish mortgage market in years' and First Active admit that it will add to house price inflation in the short term.
- Ulster Bank (First Active's sister company), Permanent TSB and Bank of Ireland have all followed the move (i.e. over half the market by stock and flow) and even if the rest do not with their "off the shelf" offerings, it will up the ante in the market and encourage banks to offer 95–100% LTV's more frequently.
- The initial indications are that the product has been very popular
- The analyst posed as a first-time buyer couple with a joint income of €60,000 and, based on a 100 per cent LTV loan, was offered a mortgage of up to €360,000 over 35 years. Such an offer, at six-times the borrower's income, would require and repayments of 37 per cent of disposable income which is very high for such earners.
- Credit growth needs to slow from its current stellar pace.
- The findings do not surprise us and confirm our suspicion that the bank's willingness to lend may be as big a driver of the mortgage market right now as any of the other factors we tend to point to i.e. demographics, rising disposal incomes etc. and it is a trend we would prefer not to see".

August 29th 2005

Davy Equity Research

Davy

Irish banks

Irish banks party on…

but is a hangover likely?

- Over the past ten years, private sector credit in Ireland has increased more than six-fold and is still growing at over 26%. Given that Ireland's "catch up" phase is supposed to be over, we ask what is going on and should we be worried?
- Measured against GNP, Ireland now ranks as one of the most indebted countries in the eurozone, but such statistics do not tell the whole story. Personal debt/disposable income is heading for 140%, but household net assets have gone from €88bn to over €470bn in ten years, while low interest rates have supported affordability.
- However, looking at mortgage credit criteria, we think there are signs of some weakening. Three banks are now offering a 100% LTV product, while posing as a FTB couple with an income of €60k, we were offered a mortgage of up to €360k (repayments 37% of NDI over 30 years).
- So is this rising debt affordable? With interest rates and unemployment expected to remain low, we think the answer is yes, for most people, though credit growth needs to slow from its current stellar pace.

Figure 9.24: Example of Research Urging Caution Pre Decision (excerpt), August 2005

On September 8th, *The Irish Times* ran an article with the headline “Prepare your battle lines for fight ahead” warning that “if the economy fluttered and house prices fell even a tiny bit, consumers holding [100 per cent LTV mortgages] would be sitting in the very precarious position known as negative equity” (Irish Times, Property Section, September 8th 2005: 40). A week later, the headline was more direct: “Beware before banking on a 100% mortgage”. This article reports new research by the Irish Mortgage Corporation, stating” research tells us that first-timers are now less likely to save for their house purchases than ever before” (Irish Times, Property Section, September 15th 2005: 46). On October 8th, the Sunday newspapers ran stories by economist Alan Ahearne headed, “We are on our own if the bubble bursts” (Sunday Business Post, October 8th 2005) and “What goes up often comes down- with a big bang” (Sunday Independent, October 8th 2005).

Perhaps the most remarkable media story published in the run up to the meeting between the D/Fin, D/Env, and the Financial Regulator was published on October 14th 2005. Headed “Watchdog sanguine on property boom”, the opinion piece authored by Michael Casey is notable for a number reasons. Firstly, it was written by someone who had held a senior position within the Central Bank, where Casey had been Assistant Director General. In addition, the piece was openly critical of the Financial Regulator stating that despite the Regulatory authority expressing concerns about property prices, it seemed to be “more concerned about the prudential implications of property price increases rather than any inflationary consequences” (Irish Times, Finance Section, October 14th 2005: 5). Finally, the piece was remarkable in its direction towards policy-makers (as opposed to banks or borrowers), with the subhead reading: “policy-makers must put national interest before that of financial institutions”. The article stated that banking is an unusual industry in the sense that competition based on mortgage products could become "a race to the bottom". Casey argues that there was a role for the Regulator to act “as a ringmaster”

Why does it not rule out 100 per cent mortgages - and for that matter 120 per cent ones? The answers may include concern that intervention of this kind would smack of "moral suasion" which theoretically is out of fashion.

Fear of disintermediation is obviously a factor- foreign banks might take over some of the business of Irish banks. (If foreign institutions did take over some of the riskier business the domestic regulators should of course be happy.)

The financial regulator could also increase the capital adequacy requirements that banks must observe, and/or require banks to increase the risk weightings on property lending, forcing banks to allocate more of their capital to their propert loan books.

Again, the fear of disintermediation probably explains, in part, why this is not done. In addition, there would be an understandable reluctance to draw attention to a potential problem and run the risk of weakening the share values of financial institutions.

All policy actions have adverse side-effects. The challenge for the policy-maker is to find where the balance of advantage lies. In doing this, admittedly difficult, calculation, the national interest must be put before that of financial institutions.

The fact that none of the actions mentioned above has been implemented can only mean that the financial regulator doe not believe the property boom has been, or will become, a significant threat to the Irish economy or to financial institutions.

Figure 9.25: Excerpt from "Watchdog Sanguine on Property Boom",

by Michael Casey, *The Irish Times*, Finance Section, October 14th 2005

On the political front, it must be noted that these deliberations were taking place whilst the Oireachtas (parliament) was on summer recess which has begun on July 1st 2005. Although the Dáil and Seanad had returned on September 28th, there was no discussion on 100 per cent LTV mortgages until November 9th, and even then it was brief. During a session of parliamentary questions to the Minister for Finance, an opposition member had warned of the impact of future interest rate increases "for example, in the case of couples with 100% mortgages costing €600,000" (Dáil Éireann, *Other Questions – Official Engagements*, November 9th 2005). Rather than deal with the availability of high LTV products. Minister Cowen focussed on interest rate policy stating that it was "exclusively a matter for the Governor of the European Central Bank. I do not speculate on such issues, for obvious reasons". This reply is similar in approach to those offered in response to questions on credit extension and personal indebtedness, where the Minister highlighted the Central Bank and/or Regulator's role, as opposed to his or his Department's. Nevertheless, as will be shown later, it is important to have a reliable record of the issue of 100 per cent LTV mortgages being raised directly with the Minister for Finance in advance of the decision not to intervene, which would follow later in that month.

The ongoing nature and level of concerns regarding house prices is evidenced by the Government setting aside time on November 16th 2005 in the Dáil to discuss housing policy (Dáil Éireann, *Housing Policy – Statements*, November 16th 2005). The session opened with a statement from the senior Minister at D/Env, Dick Roche, and contributions were made from all sides of the House. Minister Roche used his statement to focus policy measures to address supply and quality. In terms of affordability, the Minister's emphasis was on State schemes for low-income households such as the shared ownership scheme, the 1999 affordable housing scheme, and the Part V housing initiative, and the forecasted 12,000 units of output to be delivered from all the affordable schemes between 2005 and 2007. The word "mortgage" did not feature in the Minister's statement. In contrast, the main opposition speaker raised the issue of mortgage debt early in his contribution:

> "People are now obtaining mortgages they will never be able to pay back. They are borrowing in a climate in which interest rates are about to increase. One might believe an increase of 1% is not very much, but one should remember it is not so long ago since mortgage interest rates were 15% or 16%. The Minister and I remember this. The reality is that there are unacceptable developments in the economy. The Minister's policy is not working and the pricing of houses has gone out of control" – *Fergus O'Dowd T.D., Dáil Éireann, November 16th 2005*

Another opposition member was more specific, and prescient, in his contribution:

> "It has reached the point where 110% mortgages for houses are available in some circumstances and while the current Celtic Tiger economy might allow for that, the fact is that economic downturns do and will happen. The Celtic Tiger economy is no more the product of the efforts of this Government or those of any other Government except on a macroeconomic scale, but I will concede that when the downturn occurs, it will not necessarily be the fault of Fianna Fáil. It is a cycle, however. It will happen and unless we prepare for it, and this is where the Government is responsible, many couples will face interest rate hikes and a situation will arise similar to that in London in the 1980s. We do not want that to happen" - *Paul Gogarty T.D., Dáil Éireann, November 16th 2005*

Unsurprisingly perhaps, given his engagement and public utterances on the topic in the preceding months, the Minister for Housing did use his statement to highlight his dissatisfaction with the banks:

> "I will not defend developers and some of them have been extremely greedy. Of late, however, financial institutions have caused problems. At present, they can be seen offering 100% mortgages and interest-only mortgages. They have so much money that they compete for market share and appear to be lending money to people who may not realise what they are getting into. I have serious concerns in that regard and I wish the financial institutions were somewhat more measured in their actions" - *Noel Ahern, Minister with Responsibility for Housing, Dáil Éireann, November 16th 2005*

Here the Minister points to the pursuit of market share by the banks, rather than a clamour amongst borrowers for the product, as the impetus behind the arrival of 100 per cent LTV mortgages on to the market, a view which echoes the response to him by Bank of Ireland. Nevertheless, the overall message from the Minister's contribution was that the Government was doing a good job because it was succeeding in its main objective of "delivering" record levels of housing output alongside investment in social and affordable housing.

The beginning of November saw another important development, with the publication by the Central Bank of its annual *Financial Stability Report* (Central Bank of Ireland, 2005), known as the FSR. The FSR is important, firstly as it "monitored and provided analysis of the key risks to the financial system and financial stability" (Houses of the Oireachtas, 2016: 10). Secondly, FSR 2005 contained a dedicated Chapter entitled "The Growth in Mortgage Indebtedness in Ireland", which employed econometric analysis to explain the increasing household mortgage indebtedness in Ireland at that time. Thirdly, it would subsequently be concluded that D/Fin relied on the FSRs as the basis for assessing risks or threats arising from the banks, and D/Fin "relied on the overall assessment in the reports rather than responding to the specific risks identified in the reports. The Department did not carry out adequate independent analysis of the risks" (Houses of the Oireachtas, 2016: 11). The Oireachtas Inquiry also heard that the Financial Regulator had never disputed the findings of the FSRs either. The FSR played a role in shaping thinking right at the top of D/Fin, with the Minister in 2005, Brian Cowen speaking in 2015 saying he met with the Central Bank when FSRs were produced, adding that briefings he received "from the Governor of the Central Bank and through the Financial Stability Reports were overall conclusively positive" (Houses of the Oireachtas, 2016: 188).

In this regard, the FSRs have been identified as one of the primary contributors to consensus that a so-called soft landing was the most likely outcome for the property market. The Director General of the Central Bank in 2005, Liam Barron speaking a decade later in 2015 said that the FSRs were "by far the most important means employed by the [Central]

Bank to convey its views on matters relating to financial stability", and linked them to the consensus:

3. There were extensive analyses of the soft landing scenario in the Bank's FSRs over the years. The first major study of residential property prices was contained in the FSR of 2004. The body of the Report had a section on fundamental and non fundamental influences on house prices. The model based on fundamentals did not provide evidence of overvaluation, while the non fundamental models gave very mixed results and showed overvaluations of 0% to 63%. The 2004 FSR also contained an article that assessed the housing sector from a financial stability perspective. With some qualifications, that study concluded that house prices were in line with long run equilibrium values.

Figure 9.26: Written Statement by former Director General of the Central Bank to the Oireachtas Banking Inquiry, September 2015 (excerpt)

In addition to influencing the top echelons of D/Fin, the FSRs were referenced by officials when considering individual economic issues. Specific reference is made to FSR 2005 in D/Fin's letter to D/Env later that month communication their decision not to intervene on 100 per cent mortgages.

As outlined by the Financial Regulator at the meeting, the overall assessment of the FSR is that the banking system is in a good state of health and is currently reasonably well placed to cope with adverse developments in the short to medium term. A central element of the FSR which is relevant to the issues raised in your letter is that a number of fundamental economic factors can go a long way in explaining the pattern in mortgage credit growth and the pattern of increased indebtedness in recent years.

Figure 9.27: Dept. of Finance letter to Dept. of Environment, November 2005 (excerpt)

This final statement is a reference to the aforementioned Chapter of FSR 2005 presenting the results of an apparently in-depth econometric analysis of increasing mortgage indebtedness in Ireland. That research has subsequently been the subject of some controversy at the 2015 Oireachtas inquiry into the crisis.

On the one hand, the Head of Monetary Policy and Financial Stability in the Central Bank in 2005, and author of the Chapter on mortgage indebtedness - Frank Browne - has made strong comments on that work. Browne gave evidence to the Oireachtas Inquiry in 2015 that the research reflected the position of the Central Bank as opposed to his personal contribution, that it was prepared under severe time constraints over the summer of 2005, that he was asked to avoid any implication that LTV data would signal that banks were behaving irresponsibly, that the research exercise overall was not conducive to a technical measure or empirical benchmarking, and that a lack of data or appropriate benchmarks hindered conclusions (Browne, 2015: 29-30). This is important for this research into the bad decision taken on 100 per cent LTV mortgages not least because that FSR Chapter - which was released in the weeks just before, and is referred to in that decision, includes the following passage:

> A demand-side manifestation of this wave of liberalisation and financial innovation affecting the loan market in Ireland is increasing loan-to-value ratios. The loan-to-value ratio is assumed to capture the gradual relaxation of liquidity constraints facing borrowers in the loan market as agents availed of the more liberal conditions in the loan market to build up to their target levels of indebtedness. Starting from a situation in the mid-1990s in which there is likely to have been substantial pent-up demand for mortgages, financial market liberalisation would have allowed households to give vent to that demand. The loan-to-value ratio is used as a proxy for the effect of this liberalisation on the demand side of the market. It should therefore have a positive effect on the mortgage loan stock.

Figure 9.28: Central Bank of Ireland's *Financial Stability Report,* November 2005, (excerpt, p.66)

On the other hand, the former Director General of the Central Bank provided the following evidence to the 2015 Oireachtas inquiry into the crisis:

11. I totally disagree with the manner in which Frank Browne deals with his study on **Mortgage Indebtedness** (at page 46 to page 49 of his submission). It was the most important study in the pre-crisis period and it provided one of the most important foundation stones for the Bank's view that there was no property bubble (this was the mainstream view, both domestically and internationally). In effect, Frank Browne now seeks to disown his own ideas on mortgage te to the postThere is no question that it was Frank Browne's position, based on a solid analytical foundation, that the growth in total indebtedness and mortgage indebtedness over the previous decades could be largely accounted for by fundamentals. The following extract

Figure 9.29: Section 24 Statement by former Director General of the Central Bank to the Oireachtas Banking Inquiry, November 2015 (excerpt)

The publication of FRS 2005 is central to this case study because:

- it monitored and provided analysis of the key risks to the financial system and financial stability
- FSRs were relied upon by the Finance Minister and his Department
- FSR 2005 contained a Chapter outlining the results of research into residential mortgage indebtedness which concluded that rapid growth could be explained by economic fundaments
- the Director General of the Central Bank believed that Chapter to be the most important study of the pre-crisis period, and he along with the then Chief Executive of the Regulator were the officials which rejected the internal Regulator proposal to intervene on 100 per cent LTV mortgages
- D/Fin would name FSR 2005 as informing its bad decision not to intervene to prohibit or limit 100 per cent LTV mortgages

On the same day as FSR 2005 was published, the most important meeting of this case study was held.

9.10 The Meeting Between Departments and the Regulator

On November 1st 2005, D/Fin and D/Env met with representatives from the Financial Regulator. It is notable that one of the representatives from the Regulators' office was the official (Con Horan) who had, three months earlier, prepared background data in a memo and proposal in response to his concerns over the impact of 100 LTV mortgages to senior colleagues. Horan had proposed an intervention by the Regulator, a proposal which was rejected internally. Four records related to this meeting have been sourced under Freedom of Information legislation:

1. A briefing note prepared in advance of the meeting by the Department of the Environment, for use at the meeting (Figures 9.30 and 9.31),
2. A note taken by a Department of Finance official at the meeting (Figure 9.32),
3. A note of the meeting composed by a Department of Environment official after the meeting, and
4. A memo on the meeting prepared by a Department of Environment official for the Minister for Housing.

Taking the four documents in order, it is clear that the objective for D/Env (for whom the meeting has been arranged) was to convey to the others that the Minister for Housing was "very concerned at the continuing level of house price increases and price expectations… and the likelihood that lending is a significant factor in this" (Note for Meeting with D/Finance and Regulator, Department of the Environment, November 2005, Scan 13)[16]. They noted recent articles by commentators not "attached to banks" raising concern, and wanted to hear the views of *both* D/Fin and the Regulator. D/Env wished to use the meeting as an opportunity to raise four critical points, each of which was subsequently found to be a real and valid concern:

[16] It is assumed that the Department of the Environment communicated the points set out in this note. They state in their note subsequent to the interaction, that the meeting "provided a valuable exchange of information and views on various issues and developments relating to the housing market and an opportunity to ensure that Finance and the Regulator are fully briefed on a range of relevant issues such as house prices, affordability and lending including various points in the attached personal briefing note".

- What are Finance and CB views on the market generally?
- Our view is that economic performance is likely to be the key factor in determining how things develop – possibly more so than demographics per se, which some commentators seem to rely mainly on – particularly as much of the demographic effect in terms of immigration is directly related to economic performance. Are there some question marks in relation to the economic underpinning of the housing market e.g.:
  - Elements of circular causation – extent to which economic growth is now influenced by construction sector and the fact that a key element of housing demand is immigration which in turn is a function of economic growth, and so on.
  - Global factors – both in terms of factors affecting the global economy such as oil prices and state debt in some cases and also concerns about global property over valuation e.g. recent comments by Alan Greenspan.
  - Questions about the robustness of current economic performance having regard to factors such as productivity, competitiveness, industrial output and exports. Suggestions (e.g. Jim O'Leary article) that current economic performance may not be as soundly based as pre-2001.
- In the event of any economic slowdown or significant interest rate increase does the level to which house prices have risen and current rates of increase leave the housing market vulnerable? Hence the critical importance of preventing any avoidable factors, however small, that could fuel further increases – including lending practices.

Figure 9.30: Dept. of the Environment Note for Meeting with Dept. of Finance, November 1st 2005 (excerpt 1)

D/Env brought their specific concerns regarding a move away from traditional LTV criteria to the meeting:

> "Doesn't its abandonment mean higher loans available to all who qualify on income criterion (as well as those who might have previously qualified on income but lacked deposit)? Isn't this bound to have an inflationary effect?
>
> Doesn't 100% mortgage build in expectation of price increase? Since lenders traditionally required headroom between loan and value – unless this is no longer needed they must now be regarding it as likely to be provided through price increase.
>
> There is concern that 100% lending will add to the psychology of house price inflation especially given the latter point. Price expectations are seen by many commentators as a significant factor influencing the market" – *Note for Meeting with D/Finance and Regulator, Department of the Environment, November 2005, Scan 13*

At their meeting in August, D/Env had been told by D/Fin that if D/Env believes that 100 per cent mortgages would impact on house prices it would be "necessary to show how this happens separated from all other drivers of prices". Notwithstanding the challenging nature of that task, the Department of the Environment did bring a response to the meeting.

> • In summary there are 4 potentially inflationary effects: 1. those who would have got 90/92% loans may borrow more. 2. those who would not have got loans because of LTV limit will borrow at up to 100%, including some who will bring forward borrowing and house purchase. 3. additional spending at FTB end of the market will filter up through the market. 4. expectations of price increases will be raised prompting more investment, more acceleration of purchases and less price resistance.

Figure 9.31: Dept. of the Environment Note for Meeting with Dept. of Finance, November 1st 2005 (excerpt 2)

Also included in D/Env's briefing note for use at the meeting are lengthy extracts from Michael Casey's opinion piece in the *Irish Times* (see section 9.9), indicating that they gave some credence to the points he made including: the need to put national interest before that of banks, that banking is an unusual market in terms of the need for intervention, asking why the regulator does not rule out 100 per cent LTV mortgages, and the inference that the Regulator does not view the property boom as a significant threat to the banks and the wider economy.

D/Env's briefing note also refers to media reports some weeks previous that the Regulator was proposing to impose higher capital reserve ratios for higher loan to value mortgages and asking whether there had been any further developments in this regard. (It is possible, if not likely, that they are referring to the same Irish Independent article of September 1st circulated by D/Fin official along with their in-house assessment).

While a similar pre-meeting note is not available for D/Fin, a copy of their hand-written notes from the meeting is available. These eleven pages can be broken into two sections: four pages of meeting notes and seven pages of a draft letter setting conclusions arrived at, a letter which was sent by D/Fin to D/Env three weeks later.

Meeting (Intro)

MEETING –
DIFIN FIN REG
DE & LG.

CONCERN D/FIN

100% mortgages being forward
hse purchase.

15

FIN /Reg ⇒ will analyse data.

L to Value Ratio abandoned.

Is LTV ratio removal removed.
FIN Reg ⇒ Competition in banking
Sector.

Banks looking at econ data
→ IMF etc perspectives see afford
ability to be maintained

Potential about Releasing K into
the mkt following Basle

Int competition → Danske Bank
will do so at Danish Rates.

[50% → 35%]

Basle II Requirements Directive

no. of countries will implement this regime

Capital weighting requirements

Response of Regulators

1) Called in CEOs of all Irish banks to highlight concerns C.B + Fin Reg.

2) Collecting data.

3) Auditors to ensure risks are being monitored.

4) Watching default stats – no trend coming through.

100 - 100% mortgage

Formal Responses - Diff to see 100%
is driving price rises.

But upward shift in lending levels
is not welcome. C.B. instruments
may be disproportionate.

[Dept Envt]
View in S.T. 100% mortgage is ok
but in L.T. ↑ mortgage lending
is not sustainable or response to
affordability

Since EMU ⇒ Irish banks can
borrow easily at low levels, no
risk premium by capital markets.

Reflect Regulators vv

- no compelling evidence that 100%
mortgage has driven prices. But no
need to be complacent

Core point is what happens to prices.

Maybe Q2 is an abberation but if it continues problems.

Immigration maybe affecting hse demand

Output 77/78,000 p.a.

Suggest a meeting towards the end of the year

M.O.S Ahern will have another go at the Lenders.

Q2. 44% up in 2004.

DoE affordability index.

Figure 9.32: Dept. of Finance Note of Meeting with Dept. of Environment and Financial Regulator, November 1st 2005 (excerpt)

Given the sparse nature of the note it is not possible to draw too many conclusions regarding D/Fin's interpretation of the discussion. At most, it can be said that this record did not reflect the same seriousness or concern evident from the briefing note D/Env, and presumably communicated, to the meeting. From the note it appears that the D/Fin's view of the best response was to keep a watching brief and meet again before the end of the year. It is interesting that the note states that there is an absence of "compelling evidence that 100% mortgage *has driven* prices" (emphasis added) as opposed to evidence that 100% mortgage *will drive* prices, in light of the compelling case that they indeed would do so included in D/Env's note, and views elsewhere. For example, D/Fin's own in-house assessment from two months earlier concluded that "it appears that these products will be inflationary", a conclusion they communicated to D/Env in writing in September. The 2004 technical paper by the Central Bank (cited by D/Fin) and the research by Davy's outlined above, also provided important evidence.

In contrast to D/Fin, D/Env drafted an extensive formal note of the meeting (Note of meeting with Department Finance and Central Bank / Regulator, Department of the Environment, November 2005, Scan 15). The key issue from their point of view was that "while the Department of Finance and the Regulator acknowledge that increased lending levels have potential to contribute to house price increases and the Regulator has concerns about 100% mortgages (which seem to involve the effective dropping of the loan to value criterion) there does not seem to be evidence currently available that would justify action by the Regulator to prohibit or restrict 100% mortgages but the position will be kept under close review". In other words, D/Env had failed to convince those with responsibility that intervention was warranted, with the evidence they had access to. According to D/Env's note, this was a result of:

(i) A determination by D/Fin and the Regulator that intervention "would appear likely to be a disproportionately severe response… which could provoke doubts about the sector, and the fact that it is not possible to isolate the effects of 100% mortgages, although it was agreed that more relaxed lending has potential to promote price increase" and,

(ii) D/Fin being "very conscious of the significant implications for the overall economy of a possible downturn in the construction sector and the fact that housing demand is now partly underpinned by immigrants many of whom are, in turn, employed in the construction sector".

In addition, D/Fin's note captures the difference between the privately expressed concerns of the Regulator (call in the banks, collect data, role of auditors, watch default rates) versus the formal, public response (difficult to see if 100 per cent LTVs driving price rises). Finally, there is a marked difference between the D/Env's record of the Regulator's response and D/Fin's, the former noting "concern", the latter not so.

9.11 Communicating the Decision

A fortnight after this meeting of the two Departments and the Regulator, D/Fin sent a draft of a reply to the Regulator to review and asking for any observations they may have in advance of it being sent to D/Env (see Figure 9.33). A hand-written and typed version of this draft were made available under FOI legislation but given the poor quality of the reproduction of the hand-written version, only the typed version is analysed here. The typed draft was reviewed by two officials in the Regulators office and although the final reply transmitted to D/Env differs to a significant extent, the correspondence received under FOI only allows one edit to be assigned to the Regulator, and it was a minor one.

November 2005

Mr Denis Dowling
Assistant Secretary - Housing Division
Department of the Environment, Heritage and Local Government
Custom House,
Dublin 1

Dear Denis,

I refer to our meeting held on 1 November 2005, which was also attended by representatives of the Financial Regulator, in response to the issues raised in your Department's letter of 1st August. These were in relation to the launch of the 100% mortgage products for first-time buyers by certain lending institutions. The meeting provided an opportunity to review with representatives of the Financial Regulator the range of issues highlighted in your letter, which as you will recall we had discussed with you bi-laterally last August. While I regret the delay in the meeting taking place, it ensured that the discussion would be fully informed by information regarding the take-up of these products and the detailed assessment of trends in mortgage credit growth and indebtedness examined in the Central Banks Financial Stability Review (FSR) which was also published on 1st November last.

As you will be aware, the overall assessment of the FSR is that the banking system is in a good state of health and based on all prudential measures, is currently reasonably well placed to cope with short to medium term credit developments. Credit growth and debt levels are identified as the main vulnerabilities to financial stability in Ireland. A central element contained in the FSR, relevant to the issues raised in your letter, is that a number of fundamental factors impacting upon supply and demand dynamics can go a long way in explaining the pattern in mortgage credit growth and the pattern of increased indebtedness in recent years. It also highlights a moderation in house price growth which suggests that while the risk identified in last years FSR of a sharp fall in prices cannot be dismissed, this risk may have receded somewhat. However, the FSR goes on to say that evaluative evidence suggests this moderation may not have persisted to the extent that was anticipated some months ago. This is also evidenced by your own Department's house price statistics as discussed at the meeting. As highlighted by the Central Bank, if house price growth were to re-accelerate, this would have important implications for the expectations of gradual moderation in house prices to an equilibrium rate.

At this stage it is hard to discern the wider impact of the availability of 100% mortgages. On initial consideration it would seem the 100% mortgage product is now regularising a situation where some first-time-buyers previously had access to additional borrowed funds from a variety of sources. The Financial Regulator emphasised at the meeting the relatively low level of uptake of the 100% mortgages. Hence, it appears unlikely that the availability of 100% mortgages products in itself could be exerting significant upward pressure on house prices. This is not to discount the prospective impact of an easing in credit constraints on house prices generally. Clearly this factor will need to be closely monitored by the Financial Regulator on an ongoing basis. It is obviously difficult to identify with precision, a single contributing cause to house price inflation, owing to the difficulty of distinguishing between a number of contributing factors.

The Financial Regulator also provided the meeting with an overview of aspects of the operational and policy context in which they operate. A relevant consideration to the issues you raise is the impact of competition in the banking sector in contributing to an easing of credit constraints. Much of the stimulus for this competition is the entry of foreign banks into the Irish market. The recent Competition Authority report on the Banking Sector pointed to a high degree of competition in residential mortgage lending and highlights the benefits of cheaper finance. The Financial Regulator also pointed to the potential impact of the pending Basle II bank capital regulations which will change banks capital requirements and increase the availability of funding for future lending purposes.

The Central Bank and the Financial Regulator have sought to raise the level of awareness of both borrowers and lenders of the importance of prudent borrowing and responsible lending. The Financial Regulator has already drawn attention to the need for consumers to choose the right type of loan for their needs. Separately, mortgage lenders were requested to review their practices and to stress test every would-be borrower's ability to meet their credit obligations in the event of more challenging times.

The issue which you raised in your letter concerning the disregarding of traditional lending criteria was discussed at the meeting with the Financial Regulator. They agreed there is a trend towards higher loan-to-value ratios but further mortgage product innovations will be closely monitored by them as part of their prudential regulatory function. The Financial Regulator stressed it is important that borrowers act sensibly, taking into account the prospect that interest rates will be higher in the medium term and the need for prudence on the part of the lending institutions.

It is proposed as agreed at the meeting to hold a further meeting later this year to review any further developments which may have arisen with regard to this issue.

Yours Sincerely

William Beausang
Assistant Secretary – Banking, Financial and International Division

Figure 9.33: Dept. of Finance draft letter to Dept. of Environment; version sent for proofing by Financial Regulator, November 2005

One of the officials from the Regulator's office asked that a paragraph be altered very slightly. The original paragraph reads:

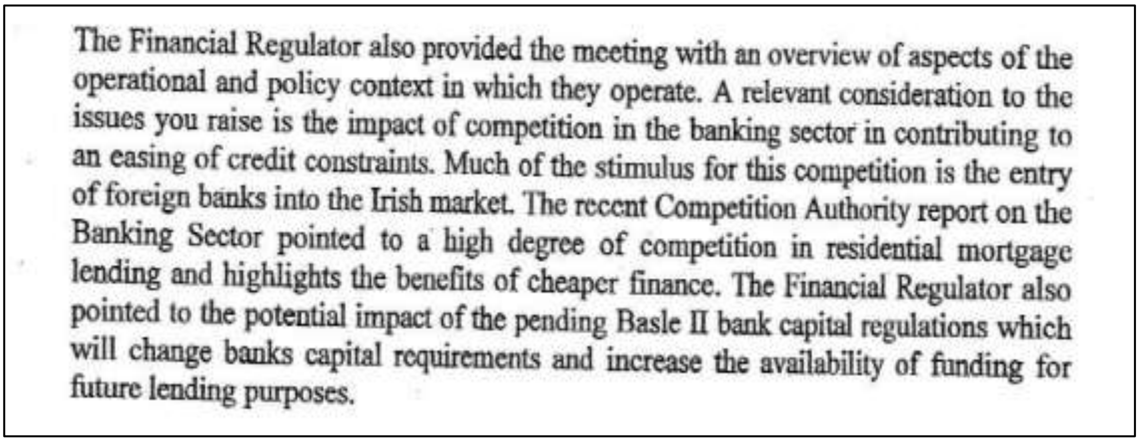
The Financial Regulator also provided the meeting with an overview of aspects of the operational and policy context in which they operate. A relevant consideration to the issues you raise is the impact of competition in the banking sector in contributing to an easing of credit constraints. Much of the stimulus for this competition is the entry of foreign banks into the Irish market. The recent Competition Authority report on the Banking Sector pointed to a high degree of competition in residential mortgage lending and highlights the benefits of cheaper finance. The Financial Regulator also pointed to the potential impact of the pending Basle II bank capital regulations which will change banks capital requirements and increase the availability of funding for future lending purposes.

Figure 9.34: Dept. of Finance draft letter to Dept. of Environment; version sent for proofing by Financial Regulator, November 2005 (excerpt)

Having reviewed the letter, the Regulator replied to D/Fin (see Figure 9.35). Although the Regulator only suggested a change which cannot be described as altering greatly the import of the message, it is evidence of the institutional relationship between the D/Fin and the Regulator. In the final version, all of the text in the paragraph, following the words "residential mortgage lending", was removed.

O'Leary, Brendan

From: Horan Con [con.horan@financialregulator.ie]

Sent: 18 November 2005 13:55

To: O'Leary, Brendan

Subject: RE: Reply to Dept of Environment

Brendan

Only one comment. In the fourth last paragraph I would propose changing the final sentence to ".....and increase the availability of funding.." to "...and is likely to increase the availability of funding..". The CRD will affect different institutions in different ways. The reduction in risk weights will reduce the capital required for mortgages but if a firm has a broad portfolio of assets, its capital could increase because of changes in other risk weights.

Con Horan

-----Original Message-----
From: O'Leary, Brendan [mailto:Brendan.O'Leary@finance.gov.ie]
Sent: 16 November 2005 12:17
To: Horan Con; bernard.sheridan@finanancialregulator.ie
Subject: Reply to Dept of Environment

Con / Bernard,

By way of follow-up from the meeting you attended on 1 November with representatives of Dept of Environment / Dept of Finance concerning mortgage credit issues, could you please review the draft letter attached for any obs etc you might have.

I would appreciate it if you could let me know if you have any comments by lunchtime this Friday 18th.

Regards

Brendan O'Leary
Banking, Finance and International Division
Department of Finance, Dublin 2
Ph:- + 353 1 604 5563
Fax:- + 353 1 631 8065
Email:- brendan.o'leary@finance.gov.ie

Figure 9.35: Emails between Dept. of Finance and Financial Regulator, November 2005

An Roinn Airgeadais
Department of Finance

Sráid Mhuirfean Uacht., Baile Átha Cliath 2, Éire.
Upper Merrion Street, Dublin 2, Ireland.
Telephone: 353-1 676 7!
Facsimile: 353-1 678 9!
LoCall: 1890 66 10 1
VPN: 8109
http://www.irlgov.ie/finar

25 November 2005

Mr Des Dowling
Assistant Secretary
Department of the Environment, Heritage and Local Government
Custom House,
Dublin 1

Dear Des,

I refer to the meeting held in this Department on 1 November 2005 in response to the issues raised in your letter of 1 August, regarding the launch of the 100% mortgage products for first-time buyers by certain lending institutions, which you will recall we had discussed bi-laterally last August. As you will be aware this meeting was attended by representatives of the Financial Regulator i.e. Con Horan Prudential side and Bernard Sheridan Consumer Protection and Mr Denis Conlon of your Department.

While the delay in the meeting taking place is regretted, it did ensure that the discussion would be fully informed by information regarding the take-up of these products since they were launched and the detailed assessment of trends in mortgage credit growth and indebtedness examined in the Central Banks Financial Stability Review (FSR) - which was also published on 1 November 2005.

As outlined by the Financial Regulator at the meeting, the overall assessment of the FSR is that the banking system is in a good state of health and is currently reasonably well placed to cope with adverse developments in the short to medium term. A central element of the FSR which is relevant to the issues raised in your letter is that a number of fundamental economic factors can go a long way in explaining the pattern in mortgage credit growth and the pattern of increased indebtedness in recent years.

The meeting concluded that at this stage it is hard to discern any wider impact of the availability of 100% mortgages. On initial consideration it would seem the 100% mortgage product is now regularising a situation where some first-time-buyers previously had access to additional borrowed funds from a variety of sources. The Financial Regulator emphasised at the meeting the relatively low level of uptake of the 100% mortgages. Hence, it appears unlikely that the availability of 100% mortgages products in itself could be exerting significant upward pressure on house prices. However, this is not to discount the potential impact of any attenuation in credit constraints on house prices generally. This factor is being closely monitored by the Financial Regulator on an ongoing basis.

The Financial Regulator also provided the meeting with an overview of aspects of the operational and policy context in which they operate. A relevant consideration to the issues you raise is the impact of competition in the banking sector in contributing to increased credit availability. The recent Competition Authority report on the Banking Sector pointed to a high degree of competition in residential mortgage lending.

In relation to consumer protection, both the Central Bank and the Financial Regulator have sought to raise the level of awareness of both borrowers and lenders of the importance of prudent borrowing and responsible lending. The Financial Regulator has already drawn attention to the need for consumers to choose the right type of loan for their needs. Separately, mortgage lenders are required to review their practices on a regular basis and to stress test every would-be borrower's ability to meet their credit obligations in the event of more challenging times.

As far as the question of changes in lending criteria are concerned, the Financial Regulator agreed that there is a trend towards higher loan-to-value ratios but further mortgage product innovations will be closely monitored by them as part of their prudential regulatory function. The Financial Regulator also stressed it is important that borrowers act sensibly, taking into account the prospect that interest rates will be higher in the medium term and the need for prudence on the part of the lending institutions.

Yours Sincerely

W. Miam Beausang

William Beausang
Assistant Secretary

cc MR D Conlon, D/EHLG
MR C Horn
MR B Sheridan } Financial Regulator

Figure 9.36: Dept. of Finance letter to Dept. of Environment, November 2005

Once the letter was agreed by the Regulator, it was reviewed by (at least) two officials within the Department of Finance and then transmitted to the Department of the Environment on November 25th, and copied to the Regulator (see Figure 9.36). This formal letter from D/Fin to D/Env, having been cleared with the Regulator, is the manifestation of what Wright called D/Fin's failure to organise a strategic response to the problems in the property sector, or identify a full range of options to moderate activity: "the Department's response to concerns elsewhere in Government, and in some areas of the banking sector, about the introduction of 100 percent mortgages…was an opportunity lost" (Wright, 2010, 31). The model proposed here identifies interests, institutions, and ideology contributing to rational / irrational outcomes as an explanation for this lost opportunity.

Overall, the purpose of this Chapter was to recount the relevant events in Ireland leading up to the decision by the Government in September 2005 not to intervene to prohibit or limit the widespread availability of 100 per cent LTV mortgages. It has provided a walk-through of the story from the economic backdrop to the conclusion, identifying milestones such as the arrival of the first 100 per cent LTV mortgage, D/Env's flagging of concerns with the banks and D/Fin, the views of the banks, the consideration (internally) by the Regulator, and the tri-party meeting. The account has run from the suitably chosen beginning in early 2005, through to the end of the story. It has no noteworthy breaks in the causal story and suggests evidence of erroneous decision-making. This process tracing allows the research to, as Bennett and Elman posit, determine whether the purported factors are operating and also to look within the case for the observable implications of alternative explanations. Further, the case has been set out such that the evidence can elevate one explanation, derived from the theory specified in Chapter 6, over all others (Bennett and Elman, 2005: 460).

Having set out the chain of events leading up to the November decision, the research design described in Chapter 3 can now be applied to outline the extent to which interests, institutions, and ideology impacted on that decision, and to reveal evidence of irrationality. The results of the analysis of the most-likely, bad decision case will be reported in the next Chapter.

Chapter 10: Case Study Evidence of Influences on Decision-Making

10.1 Recap on Approach

The purpose of this Chapter is to report the outcome of applying the process tracing research design set out in Chapter 7, to the detailed case study recounted in the preceding Chapter. By process tracing that most-likely case, the existence, impact and interaction of interests, institutions, and ideology can help explain the suboptimal decision-making outcome on 100 per cent loan-to-value (LTV) mortgages. This will supplement the quantitative content analysis research into government decision-making in the run up to Ireland's recent economic crisis reported in Part II of this thesis. The previous Chapter provided the detailed story from the economic backdrop in 2005 to the decision by Government in November 2005 not to intervene to prohibit or limit the widespread availability of 100 per cent LTV products. This Chapter will set out if and how interests, institutions, and ideology influenced the suboptimal decision on high LTV mortgages, and report evidence of irrational decision-making.

10.2 Evidence of Interests Impacting the Decision

The case-study shows that banks were against the widespread introduction of 100 per cent LTV mortgages, and sought intervention to prevent it. Evidence did emerge of the banks seeking to maximise market share, of the Central Bank and Regulator pursuing consumer, prudential and industry promotion interests, and of D/Fin giving primacy to economic and political concerns. There is also evidence of D/Env prioritising its housing function and political concerns including its stated interest to oversee and seek to maintain an efficient housing market. The interests of property developers are also discussed below.

The available documentary evidence from 2005 of the interests of the banks consists of Permanent TSB's internal file note (Figure 9.20), the letters from Joe Larkin of Bank of Ireland to the Minister for Housing on August 18th, and a letter from Denis Casey of Permanent TSB (PTSB) on August 19th (see Figures 9.18 and 9.19). Bank of Ireland only introduced the high LTV mortgage because a competitor had done so, and the motivation was to protect their franchise, *not* because there was a gap in the market or because it was an inherently 'good' product. By Bank of Ireland stating that the high LTV mortgages would be kept under close review by the bank, there is an implication that it had some concern with regard to the suitability and appropriateness of 100 per cent LTV mortgages. Despite the Minister for Housing issuing something of veiled threat when he stated in his letter that it would be necessary for him "to consider what might be done to minimise the risk of adverse impact on the housing market, as well as pointing out the dangers involved", Bank of Ireland's overall response was that the Bank itself would monitor the use of the product, in a context where it had admitted that the rationale for introducing the product was protecting its business. For their part, PTSB's letter differs from Bank of Ireland's, in that there is no reference to competitive market forces inciting PTSB's decision to issue 100 per cent LTV mortgages. There is a stated belief that the mortgages should not have "any" impact on house prices, contrary to the views of many observers and D/Env. PTSB's internal file note from July also suggests that they were not supportive of the products and had spoken to the Regulator on two occasions to make the case for intervention. From this evidence, it could be argued that the bad decision was not taken in the interests of the banks, at least Bank of Ireland (or AIB who were not marketing 100 per cent LTV products), as prohibiting or limiting their use would not have hindered their competitive position, assuming the intervention applied to all banks operating in the market.

The Oireachtas Committee of Inquiry into the Banking Crisis in 2015 shed further light on the views of the banks in 2005 with regard to 100 per cent LTV mortgages, though they were at this stage views framed with the benefit of hindsight. The evidence of the former CEO of Bank of Ireland aligns with the 2005 letter:

> "Bank of Ireland came into the 100% home owner market after the practice had been established and we were losing market share. The pioneers of 100% mortgages were Ulster Bank through First Active. And when the concept of providing 100% mortgages was first raised at a group risk policy committee, my recollection is it was declined and by the time we came to providing 100% mortgages, we were very much as a reluctant follower. It was to protect our franchise and, initially, the offering was to professionals. It was then broadened out to first-time buyers and, by definition, as things transpired; it was going to be a higher risk segment. That's why we didn't want to be in 100% mortgages" – *Brian Goggin, Evidence to the Inquiry into the Banking Crisis, April 30th 2015*

When asked whether, in hindsight, Bank of Ireland should have entered the 100 per cent LTV mortgage market, the former CEO replied, "no".

PTSB's evidence to the Inquiry in 2015 differed greatly from that set out in the aforementioned letter to the Minister. PTSB advised the Minister for Housing in 2005 that 100 per cent LTV would have no impact on the market or house price inflation, yet speaking in 2015 said that they privately told the Regulator that they "thought this was a bad product, a bad idea" and that in their view the Regulator "should seek to forbid the product" (see Figure

9.20 and David Went, PTSB, Evidence to the Inquiry into the Banking Crisis, September 3rd 2015). Despite this difference, there is some evidence that at least three banks (Bank of Ireland, AIB, and PTSB) were against the move to widely available 100 per cent LTV mortgages. Allied Irish Banks (AIB) did not enter this market in a significant way. Speaking in 2015, the AIB Chairman in 2005 (Dermot Gleeson) said that the introduction of 100 per cent LTVs was part of the RBS Group's Irish operations (First Active/Ulster Bank) aim "to become the largest bank in Ireland", adding that "AIB would sometimes grant 100% mortgage in the face perhaps of a threat to take a range of business elsewhere, but it never advertised 100% mortgages and never made them part of its marketing" (Allied Irish Bank, Evidence to the Inquiry into the Banking Crisis, March 26th 2015).

That leaves just one bank group, First Active / Ulster Bank, whose interests could be seen to have been served by the bad decision. First Active, along with Ulster Bank, was part of the RBS group and the bank that launched the first widely available 100 per cent LTV mortgage in Ireland, as recounted in the previous Chapter. Speaking in 2015, the former head of finance and chief executive at the First Active in 2005 explained the background to the launch of the product:

> "In 2004 the First Active mortgage market share was coming under pressure in the first-time buyer segment, where mortgage brokers in particular were gaining increased traction.
>
> Following market research and customer feedback, two things became clear to us. Firstly, whilst dated market maximum loans to value were already at 92%, some of our competitors were increasingly prepared to stretch LTVs to 100% or more to secure first-time buyers' business.
>
> Secondly, our customers were increasingly having to rely on expensive short-term debt, through credit cards and personal loans, to fund the excess between the maximum LTV and the house purchase price.
>
> We already had a 100% mortgage product in existence for some years for professionals on which our experience had been very good. Given this experience, together with factors to which I already referred and the positive economic and demographic backdrop, we decided to recognise the market reality through publicly introducing 100% mortgages in what we judged to be a controlled and restricted way – no exceptions policy, reduction in maximum term. Before launching it, we put the mortgage through a rigorous risk assessment program in RBS and we notified the regulator of our intention" – *Cormac McCarthy, former Head of Finance and Chief Executive, First Active, Evidence to the Inquiry into the Banking Crisis, May 6th 2015*

Taking this evidence together, it can be argued that that the primacy of interests of the banks can be ruled out as the main factor motivating the bad decision. It appears that Bank of Ireland, AIB, and PTSB were not seeking to introduce these products, save for in response to the actions of First Active/Ulster Bank. On the other hand, First Active itself admitted that falling market share was its motivation, and the interests of First Active/Ulster Bank were served by the decision not to intervene to prohibit or limit 100 per cent LTV mortgages. This evidence must be weighed against the interests of the other parties involved, such as the Department of Finance, as well as the relative importance of institutional and ideological forces.

There is evidence within the documentation that D/Fin placed significant weight on the economic (if not political) concerns, which were among its interests. This was in the context of what Honohan called the Government‘s pro-cyclical fiscal policy stance and "relaxed approach to the growing reliance on construction-related and other insecure sources of tax revenue" (Honohan, 2010: 6). After all, the revenue being generated by the property market to a large extent allowed Government spending to double in real terms between 1995 and 2007. It is clear from the Department of Finance's note of their August meeting that they saw the housing market as a domestic risk factor for the Irish economy, that the market was delicately poised, and that "any Government intervention could make matters worse" (Note of Meeting with Dept. of Environment, Dept. of Finance, Scan 9, August 11th 2005). The main economic Ministry or Department of any country would have an acute interest in maintaining the stability of their economy, and by arguing for a response (non-intervention) which in their mind kept the delicately poised economy going, they could serve their own short-term self-interest. It has been estimated that for every 10,000 houses built during the boom, one billion euro was generated for the Exchequer, 30,000 jobs were sustained and economic growth was boosted by one percentage point: "… it was a massive cash cow, everyone thought it was brilliant, but clearly, it wasn't" (Tom Parlon, Director General, Construction Industry Federation, Evidence to the Oireachtas Inquiry into the Banking Crisis, May 13th 2015).

That is not to say that D/Fin was unclear on the risks to the Exchequer of a downturn in the property market, or did not provide clear advice on the dangers of relying on associated tax revenues. However, D/Fin did not undertake "analysis or advice on the broader risk to the tax system from a more general downturn in economic activity from levels created in part by pro-cyclical fiscal policy…and this lack of policy initiative is …disappointing" (Wright, 2010: 32) . The Wright review of D/Fin concluded that there was no market for departmental advice on the suitability of policy commitments, but such analysis should have been provided and "communicated forcefully to the Minister for Finance and the Government". Taking the example of the in-house analysis undertaken on 100 per cent LTV mortgages at the end of August 2005, it is difficult to understand at this remove why it was prepared as it was (See Figure 9.21).

Firstly, the Central Bank's technical analysis published in 2004, known to D/Fin and examined (and cited) by them when trying to assess the impact of 100 per cent LTV mortgages, found that:

- Credit growth had a significant effect on house price growth
- Higher loan ratios have contributed to house price growth
- The housing market is likely to experience continued price inflation
- A significant shock will result in exacerbated price declines
- Greater credit availability means mortgage holders have outstanding loans that are greater than if lending had been curtailed
- If an increasing proportion of bank loans are to borrowers with higher LTVs then they will have less of a comfort margin in the event of a decline in property prices.

D/Fin deemed the most pertinent conclusion of this technical work by Central Bank staff to be the elasticity co-efficient of a change in credit to price, rather than the points above. There is no reference in D/Fin's analysis paper to any of these conclusions, which were based on "fairly conclusive evidence" (Fitzpatrick and McQuinn, 2004: 17). Instead D/Fin's analysis goes on to cite "informal consultations with non-private sector economists", which indicated that it was impossible to tell the precise impact of the widespread availability of 100 per cent LTV mortgages, and that up to one year's worth of data may be needed to objectively establish price effects. This was despite the Central Bank paper concluding that credit growth had a significant effect on house price growth, higher ratios contributed to house price growth, and higher LTVs presenting a real risk in the event of a fall in property prices, all based on historic data, and not relying on new/future data. As a consequence, D/Fin's analysis concludes that "only speculation is possible" regarding the consequences of not intervening as suggested by the Department of the Environment. After references to practice in the UK, investor opportunity abroad, and interest forecasts, the analysis concludes with the following summary:

> "Despite the uncertainties, the most common view received so far is that this development is inflationary, though the extent and duration is unclear, as is the overall

> impact on house price growth" – *Internal email and attachment, Department of Finance, September 1st 2005, Scan 12*

Secondly, there is the issue of the data which prompted an official within the Regulator to consider intervention on 100 per cent LTV mortgages earlier that month (August 12th), and outlined in the previous Chapter. The proposer of that intervention told the Banking Inquiry that his concerns were supported by research of international banking crises and, in particular, what had happened in Scandinavia in the 1990s. Specifically, the concern and proposal emerged from research which suggested that credit growth rates in excess of 20 per cent were indicative of a bubble, when levels in Ireland in 2005 "were growing higher than 20 per cent, 25 per cent, and 30 per cent" (Con Horan, Evidence to the Inquiry into the Banking Crisis, May 27th 2015). An important question here is whether the data which prompted the concern and proposal within the Regulator was available to D/Fin when undertaking their analysis in August, or was it available only to or within the Regulator? Interviewed as part of this research in 2016, a senior Regulator official close to this decision in 2005 provided some insight on this. Data which prompted the concern and proposal within the Regulator in August 2005 was publicly available, and from well-known sources. An example is the OECD's *Economic Outlook* (No. 78) which was published in 2005 and which contained a chapter investigating what was underlying house price growth (including in Ireland), and whether or not prices are in line with fundamentals. That OECD analysis reported, *inter alia*, that house prices had grown for 50 consecutive quarters in Ireland between Q3 1992 and Q1 2005, and had grown by 243 per cent over that time, by far the greatest upturn of all of the benchmarked countries (OECD, 2005: 146). Such data was enough to prompt some within the Regulator to suggest intervention on 100 per cent LTV mortgages, and lends weight to suggestions that D/Fin could have known what a good decision would have been (Senior Official, Financial Regulator in 2005: Interview, February 13th 2016).

That said, it is difficult to assess the adequacy of D/Fin's in-house analysis without falling victim to hindsight bias, and there are a number of explanations for why the analysis was carried out the way it was and reached the conclusions it did. For example, the Wright review has already found that there were "major shortcomings in the Department's capacity [and] the Department had neither the time nor the resources to conduct in-depth investigation of issues. This reflected shortages of skills in the requisite disciplines…" (Wright, 2010: 33). That said, this analysis was requested by the Banking Finance and International Division of its colleagues in the Budget and Economic Division in pre-crisis times (2005), before the crash and the "extraordinary pace of activity [which] exposed some major shortcomings" (Wright, 2010: 33). Thus, resources or time-constraints are not a likely explanation.

Alternatively D/Fin may have placed significant weight on the economic concerns which were among its interests, as discussed above. Interviewed as part of this research in 2016, a senior D/Fin official close to this decision in 2005 provided some insight on this. The fact that the concerns of D/Env were being handled by the Banking Finance and International Division as opposed to the Budget and Economic Division was significant. The Banking Finance and International Division was not required to make a call on any wider macroeconomic issues when working through the 100 per cent LTV mortgages case, despite these issues making up a key element of D/Env's concerns. The equivocal findings of the in-house analysis suited the Banking Finance and International Division who were co-ordinating the response within D/Fin, and that analysis provided reasons as to why D/Fin could rationalise 100 per cent LTV mortgages to be a relatively benign issue. Had that analysis produced empirical evidence or validated the concerns expressed by D/Env, D/Fin would have had a problem (Senior Official, D/Finance in 2005: Interview, January 11th 2016).

The inference here is that the interests or self-interest of D/Fin were served by an analysis that did not support D/Env's concerns and which rationalised developments in the property market. This suggests that the bad decision not to intervene on 100 per cent LTV mortgages might have served the interests of D/Fin, or elements of it. It can be confidently assumed that the alternative, an analysis which backed D/Env's concerns and which suggested that developments in the property market were a cause of concern, would have posed a real challenge for D/Fin, and the Banking Finance and International Division in particular, in terms of formulating a response that would not undermine wider policy. This fear of evidence which would have made an intervention necessary, re-emerges in the discussion on institutional factors.

There is further evidence of D/Fin's interests influencing the decision-making process later in the case. A comparison of the draft reply to D/Env in November 2005 (Figure 9.34) and the final version (Figure 9.36) in the previous Chapter, suggests a playing down of information which gave weight to D/Env's concerns and which suggested that developments in the property should prompt concern and intervention. Officials within D/Fin deleted the words underlined below from the draft reply to D/Env.

> "The recent Competition Authority report on the banking Sector pointed to a high degree of competition in residential mortgage lending and highlights the benefits of cheaper finance. The Financial Regulator also pointed to the potential impact of Basel II bank capital regulations which will change banks capital requirements and increase the availability of funding for future lending purposes".

Other notable deletions by the D/Fin from the original draft of the letter include:

- "Credit growth and debt levels are identified [in the Central Bank's Financial Stability Review (FSR)] as the main vulnerabilities to financial stability in Ireland.
- [The FSR] also highlights a moderation in house price growth which suggests that while the risk identified in last year's FSR of a sharp fall in prices cannot be dismissed, this risk may have receded somewhat. However, the FSR goes on to say that evaluative evidence suggests this moderation may not have persisted to the extent that was anticipated some months ago. This is also evidenced by your own Department's house price statistics as discussed at the meeting. As highlighted by the Central Bank, if house price growth were to re-accelerate, this would have important implications for the expectations of gradual moderation in house process to an equilibrium rate.
- Clearly [an easing in credit constraints] will need to be monitored by the Financial Regulator on an ongoing basis. It is obviously difficult to identify with precision, a single contributing cause to house price inflation, owing to the difficulty of distinguishing between a number of contributing factors."

Thus D/Fin removed text which brought to the attention of D/Env impending changes which would increase the availability of credit, highlighted credit growth and indebtedness as key vulnerabilities, stated that price moderation may not have persisted to the extent previously anticipated, noted that accelerated house price would have important implications for the expectations of a soft-landing, stated that banks' lending criteria must be watched carefully, and a recognition that the complexity of property price inflation made identification of key contributing factors difficult. This may have been done to help draw a line under the issue, as opposed to eliciting a future response from an already-concerned D/Env regarding even-further credit extension, market vulnerability, threats to the soft-landing thesis, and the possibility that high LTV mortgages were in fact a single contributing cause of house price inflation. As was the case with the in-house analysis, the alternative would have created a problem for D/Fin, and the Banking Finance and International Division specifically, with regard to formulating a response that would not undermine wider policy.

Interviewed as part of this research in 2016, a senior D/Fin official close to this decision in 2005 provided some insight on this. While there was a desire within D/Fin to ensure that the length of the reply was comparable to the length of the original correspondence from D/Env, text was removed from the original draft. For example, the text that Basel II bank capital regulations would increase the availability of funding for future lending purposes – though accurate – was removed because it was inconsistent with the message D/Fin wished to send D/Env, and was text that could galvanise D/Env's concerns (Senior Official, D/Finance in 2005: Interview, January 11th 2016).

Ultimately, the letter was drafted to present a collection of points, none of them entirely compelling or persuasive even in D/Fin view, to send a message from D/Fin that nothing was going to happen in response to D/Env's stated concerns, bar keeping the door open for further meetings and continuing the monitoring of the situation.

The interests of the Central Bank and the Regulator are a function of complex institutional arrangements described in detail in Chapter 8. In so far as their interests can be summarised, the Oireachtas Banking Inquiry describes the Central Bank (via the Governor) as being concerned with European System of Central Bank (ESCB) tasks, including financial stability, the Regulator's interests were the prudential and consumer regulation of financial service providers and, finally, the Central Bank and Financial Services Authority of Ireland (CBFSAI) Board, chaired by the Governor of the Central Bank was to the decision-making body for all remaining tasks, including the efficient co-ordination of the organisation as a whole (Houses of the Oireachtas, 2016: 133). There was also the 'dual mandate' clause in the 2003 legislation establishing the regulatory system which stated that the Central Bank and Regulator had an interest in promoting Ireland's financial services industry. Finally, as to whether the Regulator pursued its interests prudential and consumer regulation equally was also subject to debate as discussed in the earlier Chapter. While the Central Bank and Regulator became subject to Freedom of Information rules from April 2015, the rules only apply to records created from April 2008, meaning no documentation from them relating to the bad decision in 2005 can form part of this process tracing research.

To help overcome this, interviews were conducted as part of this research in 2016 with senior Regulator, D/Fin and D/Env officials close to this decision in 2005. According to them (and noting the dangers of hindsight), it was the short-term interests of consumers of banking services and house-buyers that primarily were being served by the decision in 2005 not to prohibit or limit 100 per cent LTV mortgages. This issue went beyond the availability of high LTV mortgages, and was as much to do with choice and competition in the banking market generally. These mortgage products would facilitate more first-time buyers purchasing homes, which was viewed at the time as being good from both a social and economic perspective, but the issue was as much about having many players active in the banking market Senior Official, D/Env. in 2005: Interview, January 8th 2016; Senior Official, D/Finance in 2005: Interview, January 11th 2016). In 2005, the Competition Authority pointed to the personal current account market in Ireland being highly concentrated, with AIB and Bank of Ireland sharing in excess of 70 per cent of the market, and this was as indicator of a lack of competition (Competition Authority, 2005: vii). The Authority concluded that banks in Ireland "do not compete aggressively for customers".

The focus on consumer interests was aligned with the interests of the Regulator at that time, and along with the view by those close to the decision that the consumer was the 'winner' in their discussions, suggests that the interests of the Regulator were a strong influence on the bad decision. As detailed in previous Chapters, the importance of the consumer interest function was evident in the Regulator with the presence of the Consumer Director on the Authority, though no corresponding position for the Prudential Director. Further, when D/Fin contacted the Regulator on August 17th 2005 regarding D/Env's concerns, the Chief Executive of the Regulator nominated the Consumer Director to respond to and meet D/Fin (see Figure 9.22). The interview conducted as part of this research in 2016 with a senior Regulator official close to this decision in 2005, shed light on another aspect.

The decision not to intervene was also aligned with the Central Bank and Regulator's interests with regard to their function under legislation to promote Ireland's financial services industry. It was believed by senior management within both the Regulator and the Central Bank that intervention on 100 per cent LTV mortgages, no matter how narrow the issue or targeted the measure, would draw unwanted attention to the Irish market and the nature of regulation here (Senior Official, Financial Regulator in 2005: Interview, February 13th 2016). This view is consistent with evidence heard at the Oireachtas Banking Inquiry when senior management considered intervention in August 2005 there was concern that such action would jeopardise the stability of the Irish financial system, and would be inconsistent with the principles-based approach (Con Horan, Evidence to the Oireachtas Inquiry into the Banking Crisis, May 27th 2015). All of this indicates that the Regulator's interests in the consumer-focused regulation of financial service providers, and the combined regulatory systems interests in promoting the financial services industry in Ireland, were an important factor in this decision-making process.

Discerning the interests of D/Env in this case is more straightforward given the number of documents accessible from the time and the extent to which D/Env stated their interests internally and to external bodies in those documents. Overall, it is clear that D/Env pursued the objective outlined in their Statement of Strategy, to “oversee and seek to maintain an efficient housing market” (Department of the Environment, Heritage and Local Government, 2005: 23 and 44). The Minister for Housing’s letters to the banks, D/Env’s initial email to D/Fin, their interventions at the two meetings on the topic, their formal letter to D/Fin, and their internal notes, all illustrate that D/Env’s interests were in maintaining a stable housing market, avoiding inflationary policies, and protecting against wider, negative economic impacts (see previous Chapter for documents). Even D/Fin’s note of the August 10th meeting records D/Env linking 100 per cent LTV mortgages to “the soft-landing scenario for the housing market” (see Figure 9.13). While D/Env’s interests were a factor in the decision, they did not win out as no intervention was made to prohibit or limit the high LTV mortgages in 2005. It was the interests of others (D/Fin, Regulator, consumers) which trumped those of D/Env and when these were combined with institutional and ideological factors (see below).

Finally, one group closely associated with activities which helped precipitate the crisis in Ireland were the property developers, and they were not dis-interested parties in this decision, while inactive parties in it. A feature of the bubble was the concentration of lending to a limited number of property developers (Regling and Watson, 2010: 31), and as that lending to property developers soared, much of it “turned out to be unrecoverable thus proving to be the major weakness of the banks” (Honohan, 2010: 26). The demand for lending by developers was spurred on by the supply of credit to mortgage borrowers, and that mortgage credit was the developers’ income. In this regard property developers would have had something to gain from a relaxation in lending standards and you might expect them to have been supportive of their introduction, or silent in response to criticism of their arrival on the Irish market. There is no evidence in the documents examined in this research of developers seeking to influence the decision in November 2005. Although speaking with hindsight, a decade after the event, the evidence of the developers’ representative organisation of the Oireachtas Banking Inquiry offers one explanation as to why this is so:

> "[H]aving thought about it long and hard, and the Construction Industry Federation, whatever the impression might have been, they're a very impressive, serious organisation with people that have been there for 20 and 30 years, a lot of experience, and a lot of integrity involved in the people. We look at that in terms ourselves and say, "What could we have done?"
>
> It would have been bloody difficult to stop it, at that time, but clearly, you know, a company that's reliant on your customers having 100% mortgages, and we not knowing where the financing was coming, and a banking system that was reliant on a massive lot of short-term credit and giving long-term loans was a recipe for disaster, but I didn't have the scope to see that, I'm sorry to say, at the time" – *Tom Parlon, Director General, Construction Industry Federation, Evidence to the Inquiry into the Banking Crisis, May 13th 2015*

In short, the developers do not appear to have been concerned enough, if at all, about where home-buyers sourced the credit to purchase the homes they were building or the terms of that credit, to intervene one way or another to pursue their interests on the issue of 100 per cent LTV mortgages.

Finally, this decision-making case progressed in a particular social and political context. As described in the previous Chapter, the knock-on impact of house price inflation and loosening credit standards were becoming an increasingly prominent political issue. Therefore any decision which could determine whether first-time buyers would have to save a deposit before purchasing a house was bound to have some social and political ramifications. Interviewed as part of this research in 2016, a senior D/Env official close to the decision in 2005 provided some insight on this. There was no sense in the summer of 2005 that intervening to limit 100 per cent mortgages would pay any political or electoral dividend. On the contrary, the products were viewed as socially and politically popular, suggesting that the decision not to intervene could have also served political interests Senior Official, D/Env. in 2005: Interview, January 8th 2016). There was no evidence of this from either the documentation of the time or from information gathered subsequently.

10.3 Evidence of Institutions Impacting the Decision

As set out in the research design in Chapter 7, evidence was sought of institutional arrangements and/or expertise impacting with negative consequence on the decision process. The extant documentary evidence does reveal institutions, and the relationships within and between D/Fin, the Central Bank, the Regulator, the D/Env, and the banks to be a telling factor which shaped the bad-decision outcome in November 2005. Institutions prompted the type of decision taken, prioritised certain interests, and promoted some information over alternatives. As the communicator of the decision, D/Fin will be placed at the centre of these relationships for the purposes of describing what the evidence reveals. This will be followed with some discussion of internal relationships within the Central Bank, between the banks and the Regulator, and the role played by Ministers.

The Department of Finance and the Department of the Environment

As two government Departments, led by Ministers from the same political party, subject to many of the same external economic, political, media and civic pressures, operating under the same civil service rules, the difference in D/Fin and D/Env's approach to this case is remarkable. The impact of interests detailed above explains some of this difference. The institutional arrangements and relationship are also important. On the face of it, D/Fin adopted to a large extent the views of the Regulator whereas D/Env appears to have displayed more independence when considering the evidence and arriving at conclusions. There was a marked difference in the weight given by D/Fin to input into the decision made by D/Env, and that made by the Regulator. That was a function of the relationship D/Fin had with both organisations.

In their formal approach to D/Fin on August 12th2005, D/Env states that it makes its points without prejudice to consideration of the issue by D/Fin and the views of the Regulator. Despite the Minister for - and Department of - Finance giving primacy to the role of the Regulator in a myriad of parliamentary questions, D/Env clearly still hold that D/Fin has the central role in dealing with their concerns about 100 per vent LTV mortgages. Interviewed as part of this research in 2016, senior D/Fin and D/Env officials close to this decision in 2005 provided some insight on this. There was recognition within D/Env that its activity and influence in housing policy had waned over preceding years. Whereas D/Env had been central to national housing policy via their steering of the three so-called 'Bacon Reports' in 1998, 1999, and 2000, this was not the case in 2005. The Minister and Department of the Environment were central to the preparation, publication, and implementation of these reports which assessed the housing market, evaluated the trends and prospects, and shaped housing policy in the early 2000s. D/Env also had a key role in mortgage policy up to 1989 from which point building societies (who were major players in the mortgage market) could legally demutualise, become public companies and operate as banks. Once they had done so, building societies were supervised by the Regulator in common with other financial institutions and D/Env ceased to have policy responsibility for them. All of this was despite the Minister for Housing, a 'Minister of State' / junior ministerial position, residing within D/Env. The consequence of developments was that D/Env's role in 2005 was essentially limited to social and affordable housing policy, urban renewal, and publishing housing statistics. Thus D/Env viewed D/Fin as the key institutional actor for them in responding to what they saw as a negative development in the mortgage market (Senior Official, D/Env. in 2005: Interview, January 8th 2016).

In 2005 D/Env still had a stated objective to oversee and seek to maintain an efficient housing market and this contributed to D/Fin perceiving D/Env's contacting them in July as a case of 'shifting responsibility' to D/Fin. There was a general sense in D/Fin that D/Env had abdicated its responsibilities around housing policy. For D/Fin, the 100 per cent LTV mortgages issue was one of *housing* policy, while for D/Env the issue was one of *banking* policy. When D/Fin and its Banking Finance and International Division took on the responsibility for D/Env's concerns as a banking policy issue this appears to have had a profound impact on the decision-making process. For reasons which will be discussed below, D/Fin treated the views of various institutions on banking policy differently, meaning that the concerns expressed by D/Env on banking policy issues were not given the same weight by D/Fin as, say, concerns expressed by banks or the Regulator. In short, the concerns expressed by D/Env did not constitute a red-flag for D/Fin, but the same concerns expressed by the banks or the Regulator to D/Fin would have been dealt with as a red-flag and may have been handled with a different level of seriousness and urgency by D/Fin. This was compounded by uncertainty within D/Fin as to whether the concerns about 100 per cent LTV mortgages reflected the organisational view of D/Env or were the concerns of the Minister for Housing, who was seen to be particularly active on this topic (Senior Official, D/Finance in 2005: Interview, January 11th 2016).

In the discussion on the impact of interests (above), there was evidence of a fear within D/Fin of data which would have made an intervention necessary, and this hierarchical approach to how concerns were treated further complicates the decision-making process. Analysis which suggested that developments in the property market were a cause of concern, would have created a significant challenge for D/Fin, and the Banking Finance and International Division in particular, in terms of formulating a response that would not undermine wider policy. This is particularly true if such analysis came from the banks or the Regulator. As it was, in July 2005, the institutional relationship between D/Fin and D/Env impacted on the decision not to intervene on 100 per cent LTV mortgages and militated against a good outcome: D/Fin did not rank D/Env's concerns are highly as those of the Regulator or banks, and felt D/Env were abdicating their responsibility on what was a housing, rather than a banking issue. That is not to say that this issue 'fell between two stools', as D/Fin and the Regulator were well connected and debated the issue.

The Department of Finance and the Regulator

On the face of it, the institutional relationship between D/Fin and the Regulator insofar as it impacts on this decision case, is straightforward and is well set out in the following evidence given to the Oireachtas Banking Inquiry:

> "In terms of the role of the Department of Finance on the banking regulation side, we had no role in raising issues/concerns around the stability of the banks with the Central Bank because that was their job and they were an independent Central Bank.
>
> Once you get into a space where the Department is encroaching on the independence of a Central Bank, or the independence of the supervisor, you're getting into, sort of, potentially quite difficult territory so, I mean, the responsibilities are defined in legislation…
>
> The Department's involvement then, on my area of the Department, in looking at the banks specifically, is actually very specific and looking at the regulatory structures itself, the responsibility for the legislation that we have, but it's also then the planning for a difficulty but we don't have a role and we didn't have the information and we would have been precluded from getting the information that would have allowed us to make any independent assessment…
>
> [The] Central Bank would certainly have given the Department short shrift, if it had arrived at its door asking or requesting to get involved in financial stability analysis" – *William Beausang, Evidence to the Oireachtas Banking Inquiry, June 24th 2015.*

There is consistent evidence throughout the contemporary documents of the primacy given to the Regulator by D/Fin in dealing with the 100 per cent LTV mortgages issue. Despite believing that this was a matter of housing policy, once D/Fin had accepted that they had to respond to D/Env, they deferred to the Regulator from start to finish, though they performed some in-house analysis. On receipt of D/Env first communication on this (see Figure 9.11) D/Fin highlighted the role of the Regulator, writing "regulator is looking at it – is his responsibility" on the correspondence. In their note of the meeting on August 10th, D/Env report D/Fin as stating that a formal approach to the Regulator required "caution [and] clear questions/points on impacts", though no explanation for why caution should be exercised is given.

D/Fin's official response to D/Env's concerns in November clearly reveals the institutional influence on the decision-making process. There are seven paragraphs in the letter, and the deferring of D/Fin to the Regulator/Central bank is evident in each (see Figure 9.36). First, D/Fin reminds the D/Env that there were representatives from the Regulator and Central Bank at their key meeting on November 1st. Second, D/Fin point to the data and findings on mortgages and indebtedness reported by the Central Bank in the controversial chapter in FSR 2005 (see Chapter 9). Third, D/Fin notes the Regulator's view of the health of the banking system and the extent to which fundamental economic factors can explain mortgage growth and debt levels. Next, D/Fin recounts the Regulator's view on the take up of 100 per event mortgage products. Fifth, they cite the Regulator's overview of the competitive nature of the banking market. Then D/Fin remind D/Env of the role and actions of the Regulator in regard to raising awareness among consumers of the need to borrow prudently, and for banks to lend responsibly. In the final paragraph, D/Fin reports the Regulator's view that higher LTV products are becoming more prevalent, and that borrowers and lenders must take into account the potential impact of higher interest rates. The cumulative effect of this presentation of the arguments by D/Fin is that there is very little of their voice in the communication.

The concerns raised by D/Env were communicated to D/Fin and there is no record of D/Env contacting the Regulator directly. In their letter to D/Fin (August 12th), they stated that if it was concluded that the potential impact of 100 per cent LTV mortgages give rise to concern, this would raise the question of what action may be appropriate for "the Government" to contemplate, not the Regulator (see Figure 9.15, paragraph six). What is apparent is that, despite the Regulator and D/Fin being formally independent *de jure* under legislation, the views held by D/Fin were *de facto* the views of the Regulator. This synchronisation in decision-making is most evident in the drafting of the formal reply to the D/Env (see Figure 9.33).

The formal separation of D/Fin and the Regulator, perhaps ironically, resulted in identical decision-making processes and conclusions.

> "The concept of supervisory independence was also central to the design of the EU framework for financial regulation. The authoritative expert consensus at the time was that banking supervisors should benefit from the same high degree of independence as central bankers. It was therefore integral to my area of the Department's relationship with the Financial Regulator that we should not take any significant action or step which could interfere or encroach on that strict supervisory independence.

> This was essential to rule out any scope for any perception of political interference in financial regulation and supervision, given the major conflicts of interest that might potentially arise. Any perceived breach of that principle would certainly have given rise to major concerns at regulatory authority level, given the authority's statutory mandate" – *William Beausang, Senior Department of Finance official, Evidence to the Inquiry into the Banking Crisis, June 11th 2015*

Far from ensuring that one institution was not influenced by another, the institutional arrangement resulted in one of them accepting entirely the views of the other. When asked a decade later specifically about D/Fin's response to the introduction by Irish banks of 100 per cent LTV mortgages, the responsible official in 2005 in the Department replied:

> "Well, I mean, there's, I think, papers in the public domain reflecting ... and a freedom of information request, which deal with that issue at some length. I mean, the issue was raised by the Minister of Housing at the time with the Minister for Finance. We examined the issue on the banking side in consultation with our colleagues on the ... on the economic side. We consulted with the Financial Regulator and we ... we responded and we met with the Department of the Environment and we ultimately responded to the Department of Environment on the basis of the analysis that the Financial Regulator communicated to us at that time around that issue. So, I mean, that's ... you know, that's an issue that we were involved in, yes, certainly, and it was an issue that we ... we assessed on the basis of the advice that we got from the Financial Regulator. I mean, you'll recall that the Financial Regulator, that ... we wrote out in November 2005 back to the Department of the Environment but I think in March 2006, the Financial Regulator introduced a higher risk weighting on mortgage lending with LTVs of 100%" – *William Beausang, Senior Department of Finance official, Evidence to the Inquiry into the Banking Crisis, June 11th 2015*

Speaking at the same inquiry, the Minister for Finance in 2005 also conveyed the dependence of D/Fin on the Regulator when it came to reacting to 100 per cent LTV mortgage products:

> "[T]he other point is on the regulatory side, I agree, you know, looking back now, there was certainly reason for the regulator to ... to intervene rather than simply adopt statements saying we'd be better ... you know, "Watch yourself getting a 100% mortgage" and all this stuff. We needed a more interventionist approach and we didn't get it. Now, that's where that ended up, and obviously it ... it contributed to some of the problem as well. So I ... I ... I mean these are the ... these are what we know now. I ... I just felt supply ... increased supply is the best way of dealing with moderating house prices" - *Brian Cowen, former Minister for Finance, Evidence to the Inquiry into the Banking Crisis, July 2nd 2015*

In the case of 100 per cent LTV mortgages at least, there is no evidence of some alternative view in D/Fin, and they did have access to D/Env's alternative view and access to identical data that had prompted a leading official in the Regulator to propose intervention in August 2005. However, D/Fin's own analysis did not produce strong arguments for an alternative course of action. Interviewed as part of this research in 2016, senior D/Fin and Regulator officials close to this decision in 2005 provided some insight on this.

First, D/Fin and the Regulator appear to have differing views, in hindsight, as to who was the key decision-maker on the 100 per cent LTV mortgage issue in 2005. Contrary to the belief in D/Fin, the Regulator believed that, while the meeting between them, D/Fin and D/Env did not constitute a decision-making forum, the Regulator was the lesser of D/Fin in decision-making terms, and the Regulator answered to them. Though the Regulator was independent of D/Fin and was responsible for *regulation*, D/Fin (in the Regulator's view) set the *policy*, and the discussion in 2005 on 100 per cent LTV mortgages was a matter of policy (Senior Official, Financial Regulator in 2005: Interview, February 13th 2016). The relevant legislation (Central Bank and Financial Services Authority of Ireland Act, 2003) does state that the Minister for Finance may, from time to time, request the Governor, the Board or the Regulatory Authority to consult with the Minister, in relation to their respective functions, as regards the performance by the Bank of any function of the Bank (other than one imposed on it by European obligations). The legislation also states that if the Minister for Finance has in writing notified the Regulator of any requirements with respect to the form in which its strategic plan is to be prepared, the plan must comply with those requirements. Legislative expertise would be required to decide whether these provisions did in reality mean that D/Fin set the policy on the mortgage market, but this point may be moot if it is what the representative from the Regulator at the meeting perceived to be the case.

Second, the institutional arrangement, and Central Bank/Regulator secrecy in particular, impacted on the decision-making process at this time. As discussed above, relevant legislation imposed obligations of professional secrecy on officers of the Central Bank and the Regulator and limited the extent to which Regulator staff could share information or views with D/Fin. An earlier section also recounted how the concerns expressed by D/Env did not equate to a red-flag for D/Fin, but the same concerns expressed by the Regulator to D/Fin would have been dealt with as a red-flag and might have been handled with a different level of seriousness by them. Though it emerged subsequently that there were those within the Regulator who felt strongly enough in 2005 to propose intervention on 100 per cent LTV mortgages, D/Fin had no sense of this during their engagement in 2005. The Oireachtas Banking Inquiry was told that both the Regulator's Head of Banking Supervision (Con Horan, who made the proposal), and the Prudential Director (Pat Neary) supported intervention in 2005 (Evidence to the Oireachtas Inquiry, May 27th and 28th 2015). Mr. Horan was the Regulator's representative at the meeting between them, D/Fin and D/Env on November 1st 2005. Had D/Fin known that the Prudential Director believed the situation on 100 per cent LTV mortgages to be such that intervention was warranted, that would be a major issue and would constitute a 'red flag' for D/Fin. The explanation emerging from the interviews undertaken for this research in 2016 with senior D/Fin and Regulator officials is that this crucial non-exchange of this information was a result of a combination of factors: a strong organisational line within the public service and the Regulator, the institutional secrecy within the Regulator (S33AK), a 'wanting to believe' / confirmation bias within D/Fin who were seeking re-assurance, an awareness of the political reality of the pressure on home-buyers, and the impact of recent analysis- specifically the Chapter on mortgage indebtedness in FSR 2005 (see Chapter 9). The impact of institutional factors on this particular decision were summed up in hindsight by a feeling within D/Fin that not only were confidential matters within the Regulator secret, everything was secret (Senior Official, D/Finance in 2005: Interview, January 11th 2016); and a belief within the Regulator that D/Fin were not seeking the views of the *representatives* of the Regulator (whom we know now held concerns) but were seeking the views of the *institution* of the Regulator as an entity in its own right (Senior Official, Financial Regulator in 2005: Interview, February 13th 2016).

Third, D/Fin's institutional standing within the policy system had been damaged by successive years of inaccurate forecasting on the economy and fiscal projections. In many instances growth often exceeded what D/Fin had expected, hurting their credibility and reducing their confidence in terms of recommending strong policy interventions. The simultaneous rise in influence of the Department of the Taoiseach and the Social Partnership process also denuded D/Fin of some of its traditional institutional power. The establishment of the Financial Services Clearing House in the Department of the Taoiseach, where D/Fin would have to report monthly to them and to the industry on the job they were doing, was further evidence of a loss of institutional power.

Overall, it is clear that the institutional relationship between the Regulator and D/Fin contributed to the poor decision outcome on 100 per cent LTV mortgages in 2005. Had D/Fin and the Regulator agreed with each other, and with D/Env about who was the ultimate decision-maker that could have impacted on the outcome, as could better information exchange around the level of concern within the Regulator about the products.

The Banks, and the Regulator / Government Departments

There is no record of communication between any banks and D/Fin on the 100 per cent LTV issue in 2005. This suggests that the banks, at least one of whom was in active engagement with the Regulator, did not believe it necessary and/or appropriate to contact D/Fin. This is telling given the view by D/Fin that a statement of concern from a bank to them on 100 per cent LTV mortgages would have constituted a 'red flag' (in a way D/Env's concerns did not), and begs the question as to whether the decision outcome would have been any different if, for example, D/Fin had received the messages contained in PTSB's file note from July (see Figure 9.20). In a sense, on this issue there was too little lobbying of D/Fin by the banks.

The banks were in contact with D/Env in the summer of 2005 (see Figures 9.6, 9.7, 9.18 and 9.19). First Active/Ulster Bank's letter was in response to the Minister for Housing's comments that banks were pursuing reckless lending policies, and the reply did not reflect any sense that these banks were overly concerned with D/Env's reservations about 100 per cent mortgages. For example, there is no offer to meet with the Minister or his officials to provide further re-assurance, nor any commitment to provide further updates or data. Bank of Ireland replied to the Minister for Housing's letter in which he clearly expressed concern. As discussed earlier, that bank expressed their shared concern and belief that they had no choice but to launch the product once a competitor had. They offer to work with D/Env on the affordable housing mortgage scheme, but again there is no sense that the bank sees D/Env as an important actor in, for example, working with them to get the Regulator to intervene. Permanent TSB also replied to the Minister for Housing's letter and it is noticeable they do not even inform the Minister that they had contacted the Regulator to say that 100 per cent LTV mortgages were "a bad product" and that "the Regulator should seek to forbid the product", assuming that this contact had already taken place (see Figure 9.20 and David Went, PTSB, Evidence to the Inquiry into the Banking Crisis, September 3rd 2015). In none of the correspondence between the banks and D/Env is there a sense that they view that Department as an important actor on the issue of mortgage policy. This is consistent with the discussion earlier about institutional power and the extent to which D/Env influence on housing policy had waned.

There is also evidence of the response politicians in general would have received from banks if they raised concerns about mortgage lending in 2005/2006, including a plea to trust the market. Speaking to the Oireachtas Inquiry in 2015, the former Green Party leader said the following:

> "On the question of banking, the Green Party was to the fore in directly criticising the lending practices of the banks. Our then Finance spokesperson, Dan Boyle, recalls in a book he published on our time in government, a meeting with the Irish Banking Federation in 2006. He attended this meeting, along with the current leader of the party, Eamon Ryan and I'd like to quote directly:
>
> 'We brought up the question of the efficacy and economic sanity of issuing 110% mortgages, and the general lack of sustainability that seemed to exist in the property market; a market the banks seemed intent on inflating further. The response to our concerns was both arrogant and condescending. We didn't understand banking, we were told, besides which the market would correct itself in a relatively painless manner'" - *John Gormley, Evidence to the Inquiry into the Banking Crisis, July 29th 2015*

This reveals something about institutional power, as representatives of the banks dismissed elected representatives of the citizens with (perceived) arrogance and condescension.

As was the case with interests, disentangling the banks' relationship with the Regulator is complicated by the fact that there does not appear to have been a singular view from 'banks' as to whether 100 per cent LTV mortgages were a bad idea. In one sense, the media coverage of the launch of the products exposed the nature of the relationship between the Regulator and the banks, stating that the "launch of the 100 per cent mortgage comes in a week in which the Central Bank welcomed the slowdown in house price inflation and signalled concern about high and growing levels of household debt" (Irish Times, July 14th 2005: 1). First Active bank either did not believe or did not care about the view of the regulatory institutions, and the Central Bank and/or the Regulator were not willing to take corrective action despite its own concerns and those further afield. As more banks entered the 100 per cent mortgage product market, they too were openly ignoring the Central Bank.

At the Oireachtas Banking Inquiry, the Chief Executive at the Regulator in 2005 was asked if the banks simply ignored warnings, to which he replied: "I think it goes back to the euphoria. We failed, I suppose, to convince the banks that there was an issue" (Liam O'Reilly, June 11th 2015). This is puzzling and perhaps self-serving. The correspondence from Bank of Ireland and the testimony by PTSB to the same Inquiry suggests that it was the banks who failed to convince the Regulator that there was an issue with 100 per cent LTV mortgages. From the evidence available, the best explanation for any failure here lies in the principles-based approach taken by the Regulator to the banks (see Chapter 8). This in turn reflects the influence of the third and remaining factor of interest in this research, ideology (see below).

One final institutional issue which may have negatively influenced this decision is the phenomenon of institutional memory. Institutions' memories of the past are thought to be particularly acute when tackling economic and financial policy problems (Haldane, 2013: 8).

> "Central banks have institutional memory, embedding past knowledge of the costs of inflationary excess. For example, the Bundesbank's inflation-aversion is deeply rooted in Germany's hyperinflationary past. This memory of the past is crucial for preserving the value of money in the future" - *Haldane, 2013 :9*

Senior management within both the Regulator and the Central Bank had held senior positions in these (or similar institutions) for a number of years. For example, Liam O'Reilly was Chief Executive of the Regulator at the time of the bad decision in 2005. He was assistant director general of the Central Bank of Ireland from 1998, had been responsible for all of the Central Bank's financial supervision functions, and was appointed interim Chief Executive of the Regulator in November 2002, and Chief Executive in May 2003. This form of continuity of service is not without consequence.

The Honohan report described the presence of what he called the "crying wolf" problem in the Central Bank in the years before the crisis. The Central Bank had "warned in the preceding decade of a possible housing market collapse which had not, in fact, occurred" (Honohan, 2010: 95). Interviewed as part of this research in 2016, a senior Regulator official close to this decision in 2005 provided some insight on this. When the Regulator, upon whom D/Fin were relying for guidance, was giving consideration to intervention on 100 per cent LTV mortgages in 2005, it was likely that senior management were influenced by institutional memory and feared "crying wolf" once more about the mortgage and property market, and this may have impacted negatively on the decision outcome (Senior Official, Financial Regulator in 2005: Interview, February 13th 2016). Concerns about the mortgage market within the Regulator's office and a recommendation to intervene would have been adjudicated on by individuals who were susceptible to Honohan's "crying wolf" problem. An example of the consequences is evident in this case: in January 2006 the Chief Executive of the Regulator retired (Liam O'Reilly), the Prudential Director became Chief Executive (Pat Neary), and the Head of Banking Supervision became Prudential Director (Con Horan). Almost immediately there was intervention on 100 per cent LTV mortgages. This suggests that the removal of the institutional memory of crying wolf helped a good decision to be made. Institutional memory can impact at very micro, individual levels as well as shaping the general institutional relationship between a relatively new Regulator and a longer-established Central Bank.

The Ministers

The detailed case set out in Chapter 9 demonstrates clearly the activity and involvement of a number of key actors including the Minister of State with Responsibility for Housing Noel Ahern, senior officials in D/Fin and D/Env, and senior people within the Regulator. There is no evidence of the involvement of the two senior Ministers: Brian Cowen at D/Fin and Dick Roche in D/Env. All three of Cowen, Roche and Ahern were members of the Fianna Fáil party so Ahern's activity cannot be deemed to have been a 'crusade' on behalf of a junior coalition political party. Interviewed as part of this research in 2016, senior D/Fin and D/Env officials close to this decision in 2005 provided some insight on this.

In the case of D/Env the explanation appears straightforward: the senior Minister, Dick Roche, typically left matters of housing policy to the Minister of State with Responsibility for Housing, Noel Ahern (Senior Official, D/Env. in 2005: Interview, January 8th 2016). The process in D/Fin is less clear, though the view in D/Fin on the issue of 100 per cent LTV mortgages in 2005 was that the concerns of D/Env expressed at official level (Assistant Secretary-to-Assistant Secretary) were treated no less seriously than had there been direct Minister/Minister of State-to-Minister correspondence. There is an issue of signalling here as there is a view that the correspondence was more comprehensive and the level of engagement was higher *because* the concerns of D/Env were expressed at official level. Ministers do not tend to exchange letters as lengthy, comprehensive and questioning as those exchanged between the two Assistant Secretaries in this case. Had the Minister for Housing Ahern written to Minister for Finance Cowen, it is possible there would not have been as much activity as it would have been treated as a standard political representation. In that case, the co-ordinating Division with D/Fin would have sought views from within the Department and from the Regulator, collated these into one response and returned a response. Whatever about the efficacy of the decision-making process that unfolded between July and November 2005, it is clear that the level of engagement, including two meetings on the topic, was greater than a typical political representation would generate. Also, had Ahern written to Cowen, a likely first question asked by the Minister for Finance would be 'do I have a role here' to which his officials would have replied 'no, this is a matter for the Regulator' (Senior

Official, D/Finance in 2005: Interview, January 11th 2016). There is no evidence of D/Fin officials bringing D/Env's detailed concerns to the attention of Minister Cowen.

The Minister for Finance would have been aware of the broad issues, if not the 100 per cent mortgage item specifically. For example, the Economic and Social Research Institute's Quarterly Economic Commentaries and Medium-Term Reviews regularly examined the interaction between the construction sector and the real economy and "briefings were provided to the Minister [for Finance] based on their findings. In briefing for the Minister on the 2005-2010 MTR, the Minister was informed that the continued rise in house prices posed a serious threat (Nyberg, 2011: 71). It is possible that the Minister for Finance was made aware of the issue by the Minister for Housing at another forum. For example, an earlier section recounted the warning of an opposition TD to Minister Cowen in the Dáil on November 9th. Further, speaking on national radio in 2015, a leading political journalist stated the following:

> "The [Minister with responsibility for Housing] railed against the 100 per cent mortgages and the property bubble…. He's never been given full credit for this… he bitterly opposed the hundred per cent mortgages. I know he was at a meeting of the Fianna Fáil parliamentary party one night and he raised it with the Fianna Fáil parliamentary party and he says "this is going to end in tears", and somebody who was there said [the Taoiseach] looked into the middle distance" – *Michael O'Regan, Parliamentary Correspondent of The Irish Times, speaking on The Marian Finucane Show, RTE Radio 1, June 14th 2015*

The Minister for Finance was a senior member of Fianna Fáil's parliamentary party at the time and may have been present to hear the Minister of State's concerns. Regarding the reported response of the Taoiseach, the Minister for Housing has contradicted the report above, saying that he "never raised his concerns about the property bubble with… the then Taoiseach Bertie Ahern". In a media interview in 2015, Noel Ahern is quoted as saying he did raise concerns with other agencies, such as the Central Bank and the Department of Finance, but when he met the Taoiseach they tended to "talk about other things" (*Sunday Independent*, August 23rd 2015). According to the newspaper, the Minister for Housing had "serious concerns over the proliferation of 100 per cent mortgages and the impact they had on the market". He is reported to have said:

> "[T]here was some official concern over 100pc mortgages. Many did not want to know… There was concern, we certainly had concerns about 100pc mortgages and we fought a battle on that with the banks and with the Central Bank, the Regulator and the Department of Finance alright…

> There was a bit of an attitude from them that 'it was only a promotional thing from a building society' and 'it will go away, it's only an advertising thing' and 'where's your evidence?' that sort of thing… Six months after they were accepting that, all of the other banks moved to follow First Active… It defied logic, but we were very much concerned about the 100pc mortgages, because they were dodgy… They assumed the market would continue to increase and people would be protected by those increases…
>
> We did want that and my own mantra was 'supply, supply, supply', which was prudent in the early years. The thinking was that if you increased supply, you meet the demand and you take the sting out of the thing… For the five years I was there, that was the policy. That was a success and we were hitting completion numbers not seen before. And then it took off again, which defied logic [after the 100pc mortgages were introduced”] – *Noel Ahern, former Minister for Housing, Sunday Independent, August 23rd 2015*

By describing his “battle” as being against “the banks and with the Central Bank, the Regulator and the Department of Finance”, he hints at an institutional coherence or policy unity amongst those four actors. The contemporary evidence detailed earlier suggests that this was not entirely the case, as most banks were not enthusiastic about the products.

10.4 Evidence of Ideology Impacting the Decision

The recollection of the Minister for Housing also suggests some ideological influence on certain decision-makers, as they “assumed the market would continue to increase and people would be protected by those increases” i.e. trust in the market to protect consumers. The detailed case recounted in the previous Chapter provides similar evidence. To recap, given the focus of this research on economic policy, the concept of ideology employed refers to the economic left/right as opposed to social liberal/conservative cleavages, with the left referring to an abstract belief in State action, intervention in the economy and higher levels of government spending and taxation, and the right referring to a contrasting abstract belief in a laissez-faire policy approach, non-intervention by the State in economic affairs, and lower levels of government expenditure and taxation.

From the first documentary evidence of D/Fin’s response to D/Env’s concerns, their hand-written notes on the initial email (see Figure 9.11), there is some hint of an ideological influence. D/Fin make the point that any intervention by the State could make matters worse. While this is ambiguous in terms of ideology, the statement to D/Env at their meeting on August 10th 2005 that it was important to “trust the market” is less so. This is followed up with the point that “a watching brief must be kept on developments”. The phrases indicate that ideological considerations were present and influencing with consequence, the decision-making process. In their note of the same meeting, D/Env state that the first point made by D/Fin in response to their concerns was that the Government "needs a strong basis to intervene in the market" (Note of Meeting with Dept. of Finance, Dept. of Environment, Scan 8, August 11th 2005).

There are also sections of D/Env's note of the meeting on November 1st that point to the both the influence of a free market competition ideology on the Regulator's thinking:

> "Although not proposing action at this time the Regulator is keeping the option of increase in mortgage lending capital requirements under review as a possible option. This would be considered a severe measure. The fact that a relaxation of capital requirements (from coverage of 50% of loan amounts to 35%) internationally under the Basel Capital Accord is due to come into effect on 1 January 2007 would put Ireland in an unusual position if we were to increase capital requirements. While there is some national discretion under the Basel Accord, there would probably need to be substantial evidence that the Irish market was some unusual in some significant respect to warrant departure…
>
> The Regulator is also conscious of a risk that any intervention in the mortgage market could affect competition, which has been largely beneficial for consumers. However, it was acknowledged that there is probably a degree of discomfort even within the sector about being compelled to provide 100% mortgages by competitive pressures" - *Note of meeting with Department Finance and Central Bank / Regulator, Department of the Environment, November 2005, Scan 15*

The statement by D/Env that the Regulator considered an increase in mortgage lending capital requirements to be a "severe measure" is at odds with the Honohan investigation findings in 2010. According to Honohan, there appears to have been a consensus among Regulator and Central Bank staff that "the capital requirements measures – which in addition to being very modest in size only came into effect close to the tail end of the boom – were viewed as a shot across the bows of the credit institutions, rather than an attempt to try to make high LTV transactions prohibitively costly" (Honohan, 2010: 103). Honohan also found evidence of this consensus in the minutes of the Regulators' board meeting for February 2006 when, in discussing the risk weighting of residential mortgages, reference is made to the fact that "the proposed change is not designed to interfere in the operation of the market or to reduce the level of mortgage lending, but to signal the determination of the Financial Regulator to ensure that there is appropriate capital provision. The Department of the Environment's description of the response by the Regulator to concerns over 100 per cent LTV mortgages in the note also points to this deference and diffidence (as identified by Honohan, 2010) which resulted from a free market competition ideology:

> "[A]ction taken by the Regulator includes: calling in chief executives of the lending institutions to discuss issues and concerns in relation to the market; close monitoring of data; ensuring rigorous examination of lending by internal auditors" - *Note of meeting with Department Finance and Central Bank / Regulator, Department of the Environment, November 2005, Scan 15*

Such weak intervention fits with Honohan's view that there was an unresolved anxiety in the Regulator's office that the necessary, aggressive intervention would lead to a loss of market share by Irish banks and/or trigger a collapse in confidence in the property market.

In the November letter (Figure 9.36), D/Fin reminds D/Env of the "operational and policy context" in which the banks and the Regulator operate, the "impact of competition in the banking sector", and "the high degree of competition in residential mortgage lending". They then reference a Competition Authority report on the Banking Sector. The first line of that Report states "Banks in Ireland do not compete aggressively" (The Competition Authority, 2005: vii), and the objective if the recommendations therein are to "make the banking industry more competitive", thereby extolling the virtues of free-market ideology. On mortgage lending specifically, the Report states:

> "Competition works well in banking when rival banks vigorously seek and win one another's customers with innovative products, lower prices, and better service. This is more likely to be the case when other banks and financial institutions can enter financial markets exhibiting above normal profits. Evidence of the benefits of competition can be seen in sectors of the financial services industry where competition has taken hold, in particular, residential mortgages. The entry of Bank of Scotland (Ireland) into the residential mortgage market in 1999, for example, led to an increase in competition, effectively leading to a fall of one percentage point in mortgage rates for customers" – *The Competition Authority, 2005*

D/Fin is telling D/Env - in the context of a letter on 100 per cent LTV mortgages - that competition in the residential mortgage market is a good thing because it provides customers with innovative products, lower prices, and better service. This echoes D/Fin's suggestion to the D/Env at their meeting in August, that they should "trust the market". This portion of the letter provides evidence of ideological concerns impacting on the decision-making process, with D/Fin evoking a free-market rationale to D/Env to justify non-intervention on high LTV residential mortgages.

Overall, an ideological position reflecting a laissez-faire policy approach, and non-intervention by the State is detectable from phrases such as "trust the market", "any Government intervention could make matters worse", and a "watching brief needs to be kept on developments”. However it has been shown that D/Fin were to a significant extent reflecting the view of the regulator rather than their own views so caution must be if suggesting this ideological influence applied to all of the decision-makers to an equal extent. Interviews undertaken as part of this research in 2016 with senior D/Fin, D/Env and Regulator officials illustrate the nuanced way in which ideology influenced the case.

For D/Env, market intervention was to be approached with caution and policy should be focussed on stability rather than change, which may have unintended consequences. This was especially true in the housing market due to the long-lead time for the full effects of policy change to emerge. That said D/Env believed a threshold had been reached on 100 per cent LTV mortgages - in terms of the data available and the likelihood of risk – such that intervention was needed. House-price escalation was continuing at such a pace and for such a long period, driven to a significant extent by excessive lending, that D/Env believed that action should be taken. They also looked to what the Central Bank would have done in the circumstances had they still had control over interest rate policy, and concluded that they would have intervened and increased rates. They could not prescribe what should be done but D/Env felt it incumbent on them to put the questions to those who could decide and could act (Senior Official, D/Env. in 2005: Interview, January 8th 2016).

D/Fin believed that the Government’s broad policy-approach was non-interventionist. This was especially true for the housing market where, interestingly, they looked at D/Env’s three ‘Bacon Report’ processes (discussed above) as an example of interference, perhaps politically driven. There was some recognition of the change in political thinking nationally with the electoral success of the right-leaning Progressive Democrats, and the appointment of Charlie McCreevy as Minister for Finance (1997-2004) who was seen as pro-market, which played to D/Fin’s own instincts. D/Fin also saw something of an osmosis of what was happening internationally influencing policy in Ireland. For example, the fall of the Berlin Wall, the presumed victory of capitalism, and institutions such as the EU Commission emphasising the creation of a ‘brave new world’ of market-driven integration with deep and liquid capital markets. D/Fin was aware of international research of the time which linked financial market development with productivity gains and how this was well received in Ireland in light of declining national competitiveness. The impact was hubris about the market model from 2000, and a belief that it was not a civil servant’s role to second-guess the market. In the sense that an efficient market was a conduit for information to flow in a way that it would not otherwise, this belief made sense from an economic ministry's perspective (Senior Official, D/Finance in 2005: Interview, January 11th 2016).

As mentioned earlier, this was at a time when D/Fin's institutional credibility and confidence had been damaged due to inaccurate economic and fiscal forecasts. The creation of the Financial Services Clearing House in the Department of the Taoiseach, where D/Fin would have to report monthly to the financial services industry, was also evidence of deference to the markets. The overall consequence is that D/Fin placed great significance on the markets and the banks having confidence in product-development. While a Department would not be strongly ideological, the dominance of the market ideology generally raised the threshold of what information or signals were necessary before intervention was to be recommended. This is significant in light of the earlier discussion whereby the concerns of D/Env did not constitute a red-flag to D/Fin, whereas similar concerns from a bank or the Regulator may have reached the necessary threshold for D/Fin to consider a more interventionist response contrary to the dominant ideology.

For the final key decision-maker in this case – the Regulator – ideology was an overtly influential factor. Interviews undertaken as part of this research in 2016 with senior D/Fin, D/Env and Regulator officials confirm this. Chapter 8 discussed some of the contributing factors: the choice of regulatory structure in 2003 placing an emphasis on competition and the resulting (perceived) consumer benefits, over macro-prudential action; the creation of the statutory position of Consumer Director on the Board of the Regulator; the legislative 'dual mandate' stating that the Central Bank / Regulator had a function to promote Ireland's financial services industry; and the choice of a principles-based regulatory regime ('spirit of the law') over a rules-based one ('letter of the law'). This last point was in the context of developments referenced above (the fall of the Berlin Wall, the victory of capitalism, the success of the Progressive Democrats, the appointment of Charlie McCreevy as Minister for Finance) and an international emphasis on market-driven integration and innovation (Senior Official, Financial Regulator in 2005: Interview, February 13th 2016). Additional evidence that market ideology raised the threshold of what signals were necessary before intervention was to be recommended was found in how Ireland's breaching of levels credit growth which signalled a bubble in Scandinavia, was treated by senior management in the Regulator and Central Bank.

The faith in markets was most clearly manifested in 2004 with the Basel II accord. Basel II is important in the 100 per cent LTV mortgages case because the accord saw responsibility for risk shift from the regulatory authorities to the banks (see Friedman, 2009). Basel II was a "continuation the deregulation of the industry which had been happening for more than a decade" following the period known as the great moderation- a decade or more of stable interest rates, stable inflation, and stable banking (Con Horan, Evidence to the Oireachtas Inquiry into the Banking Crisis, May 27th 2015). As the Regulator was responsible for making the accord a reality in Ireland and for generating (if not communicating) the substance of the response to D/Env's concerns about 100 per cent LTV mortgages, it was understandable that it influenced the decision. Notwithstanding the privately communicated concerns by banks to the Regulator, as far as those representing D/Fin and the Regulator during discussions were concerned, once the banks had decided that 100 per cent LTV mortgages were appropriate, that was it.

> "The system of regulation that was put in place by the [Regulator] failed. There is no denying that, it's a fact. In its defence, I would say it was the same system that was used throughout Europe and it is clear now that that whole system, throughout Europe, also failed. Now, you have to put it in the context as well of… the Basel II structure. I mean, the way in which that was evolving was to, if you like, rubber stamp the whole approach, principles-led regulatory approach going forward in Europe, whereby further responsibility was being transferred away from regulators to the boards and management of banks" - *Patrick Neary, Financial Regulator, Evidence to the Inquiry into the Banking Crisis, May 28th 2015*

> "Basel II accord provided what proved to be entirely unwarranted reassurance to the Department [of Finance] that the supervisory, prudential and financial stability systems in the [Central Bank and Regulator] were operating effectively" – *William Beausang, Senior Department of Finance official, Evidence to the Inquiry into the Banking Crisis, June 11th 2015*

The discussion on the impact of interests on the bad decision illustrated the importance of market forces to the banks and this section on ideology shows that none of the key players in the decision (D/Fin, Regulator, or D/Env) provided an ideological counterweight. D/Env, while cautious on intervention, did believe action was warranted in the summer of 2005. For D/Fin, ideology created a higher threshold for intervention in the market that they did not believe had been met. For the Regulator, the entire regulatory approach which was based on the market ideology argued against intervention on 100 per cent LTV mortgages in 2005.

Chapter 3 described *inter alia* McCarty, Poole, and Rosenthal's succinct approach which argues that it is the impact of the "three I's" – *interests, institutions, and ideology* - that sees successive governments facilitate dangerous policy and market bubbles. The process tracing of the bad-decision case study in Chapter 9, followed by the analysis in the sections above lends support to that framework. The decision on 100 per cent LTV mortgages in 2005 provides evidence that interests, institutions, and ideology all influenced the outcome negatively. The task remains to examine whether these three factors impact information processing to shapes a rational or irrational decision outcome. Before undertaking that task it is worth summarising the findings thus far on how interests, institutions, and ideology influenced the case in question.

Interests

Process tracing the most-likely case has revealed evidence that:

- The interests of D/Fin (Banking Finance and International Division) were served as, despite seeing the property sector as a risk-factor, the bad decision left the economic model untouched, and meant they had no difficult choice to make on a financial services market intervention.
- The interests (as opposed to the ideology) of the Central Bank and Regulator were served by the bad decision as it did not complicate their legislative duty to promote the financial services industry in Ireland.
- The interests of the banks were served only in so far as the bad decision allowed them to compete for market share once the first institution had entered the market.
- The interests of D/Env were not served by the bad decision as it did not contribute to maintaining an efficient housing market.
- The interests of elected politicians or property developers were not actively or overtly pursued in the case but the bad-decision would likely have served their short-run interests.

Institutions

Process tracing the most-likely case has revealed evidence that:

- The lower relative institutional standing of D/Env vis-à-vis the banks and Regulator in the eyes of D/Fin contributed to the bad decision.
- The dependence of D/Fin on the Regulator for information was a negative influence on the decision process.
- The lack of clarity about which institution (D/Fin or Regulator) was the *de facto* decision-maker in the case influenced the decision-making process negatively.
- The institutional secrecy of the Central Bank / Regulator in its dealings with D/Fin, and to a lesser extent D/Env, contributed to the bad decision.
- The decline in D/Fin's institutional confidence and credibility was a negative influence on the outcome.
- The lower relative institutional standing of government Departments vis-à-vis the Regulator in the eyes of the banks contributed to the bad decision.
- The institutional memory of the Central Bank was a negative influence on the decision process.

Ideology

Process tracing the most-likely case has revealed evidence that:

- The dominant market ideology of the time (combined with the relative institutional standing of D/Env) contributed to the poor decision outcome by raising the threshold to be reached for intervention to be seriously considered.
- The ideological instincts of D/Fin and probably the wider government-system at the time were served by the bad decision, and this hindered the process.
- The available evidence was sufficient for D/Env to conclude that intervention was necessary, and thus it trumped any ideological instinct, but this did not lead to a good decision overall.
- The ideologically-driven approach to regulation impacted negatively on the decision.

Of course these three factors interact, and this will be discussed below. Following the framework in Chapter 7, the next step is establishing a better understanding of the role of irrationality on the outcome. It is possible that a decision-maker chooses a perfectly rational or totally irrational suboptimal option, as information processing is impacted by one, two, or all three factors. Having now identified that interests, institutions, and ideology were playing a role in shaping how information was processed and the poor decision outcome on 100 per cent LTV mortgages, the evidence is analysed to identify the extent to which rationality or irrationality was the result.

10.5 Information Processing: Rationality and Irrationality

A bad decision can arise as a result of rational self-interest or the presence and actions of one or more powerful groups for whom it yields a greater return than an alternative. In this case, D/Fin and the Banking Finance and International Division acted out of rational self-interest as the bad decision meant they avoided the possibility of having to devise a significant and, in their eyes, risky financial services market intervention. It suited them that the in-house analysis (or other available data) did not conclude that D/Env were correct to be as concerned as they were, 100 per cent LTV mortgages were risky, or inflationary, or would contribute to an already overheating, property market bubble. D/Fin also acted out of rational self-interest when tailoring the communication of the outcome of deliberations such that no further oxygen was given to D/Env's concerns. The decision also suited the Central Bank and Regulator from a rational self-interest perspective as it was perfectly aligned with their pursuit of increased consumer choice, and an aggressive, competitive banking market. Though there was no evidence of activity by them in the decision case, it would have been perfectly rational for elected politicians or property developers to support the suboptimal outcome to serve their short-term interests in the form of votes, continued property related revenues for the Exchequer, or sustained housing demand.

The proposed framework for analysis allows for institutions to prompt a rational, poor choice by creating an information processing context which is resistant to alternatives, or which distributes power and knowledge in such a way as to militate against alternatives. The in-built independence of D/Fin and the Regulator was rational in terms of preventing inappropriate influence, but it also created the dependence of D/Fin on the Regulator for information. D/Fin's role in economic policy was much broader than the Regulator's but the case demonstrates that there was little or no independent, rigorous analysis of the impact of

100 per cent LTV mortgages on those broader policy spheres. The institutional framework also made it possible for two actors (D/Fin and the Regulator) to rationally conclude the other as being the *de facto* decision-maker in the case. In addition, the perfectly rational institutional secrecy provisions of the Central Bank / Regulator in its dealings with D/Fin, and to a lesser extent D/Env, limited information flow with disastrous consequences. D/Fin believes in hindsight, that had they been aware of the detail of the Regulator's internal data, concerns, and proposal in August 2005 that an alternative and positive decision-outcome was possible if not likely. Further, according to D/Env, D/Fin stated at their first meeting that if D/Env believed that 100 per cent mortgages would impact on house prices it would be necessary to show how this happens separated from all other drivers of prices. This is institutional bargaining power impacting on the decision, and D/Fin was making an unreasonable demand, one they could not meet themselves. Finally, while it was rational for actors to respond as they did to D/Fin's declining institutional confidence and credibility, it did mean crucial information (e.g. the content Permanent TSB's file note) did not flow in such a way as to increase the likelihood of a positive outcome. Even D/Fin's rational response to its own declining institutional confidence and credibility was a negative influence on the decision-making process, limiting their likelihood to take necessary action.

Finally, the proposed framework suggests that an ultimately poor choice might be preferred as a result of rigid abstract beliefs held by the decision-maker, their party, or which dominate political thinking, and which constrain alternative policy preferences. This is most evident in this case from the D/Fin's rational view that their ideological instincts and preferences of the wider government-system at the time were aligned with the ultimate decision outcome. It was not that case that the dominant abstract ideological beliefs resisted new information flows (see below), rather they helped rationalise the decision outcome.

Irrationality can emerge as a result an external groups' control of information and messaging activating one or more empirically-established behavioural biases. In this case, banks who believed 100 per cent LTV products to be appropriate (First Active) and those who believed them to be dangerous (Bank of Ireland, PTSB), issued the products in order to compete for market share. In doing so, the banks contributed to the activation of wider irrationality. This is similar to Lunn's findings that property market assessments by banks and others contributed to extrapolation and confirmation bias, expectations of continued house price increases, and the prospect of a soft-landing for the property market (Lunn, 2013: 576).

The first mention of 100 per cent LTV mortgage products in the Oireachtas is evidence of this effect.

> "We must consider the current confidence in the economy. One leading institution pointed out in recent days that 100% mortgages are available for house developments. I might not agree with 100% mortgages, but when a lending organisation gives out that kind of money it shows confidence in the economy" – *Ned O'Keeffe T.D., July 20th 2005*

Once the Regulator, Central Bank and D/Fin did not intervene soon after the introduction of the product, and banks marketed aggressively, the process cascades and the benign approach to the product reflected in Deputy O'Keeffe's comments stimulates irrationality in the form of behavioural convergence, herding and groupthink (Sunstein, 2015: 63-73). This may be the clearest example from this case of the evidence of elevated irrationality in Ireland suggested by Nyberg (2011), but which was not revealed by the quantitative analysis in Part II of this thesis.

A similar mechanism may have been at play when the decision not to intervene on 100 per cent LTV products aligned with the interests of the Central Bank and Regulator who were promoting Ireland's financial services industry under their dual mandate. For example, the evidence of the case shows that Pat Neary (then Prudential Director) supported Con Horan's proposal to intervene on 100 per cent mortgages in August 2005, but he did not get senior management to agree. The crash did not arrive for another two years and in that time the Central Bank and Regulator were able to assess their regulatory approach in the belief that it was working (placing greater weight on existing beliefs i.e. confirmation bias), and predicting a positive outcomes while overestimating the accuracy of those predictions (overconfidence bias). This irrational dissonance helped the Regulator to pursue its dual mandate. For example, Patrick Neary accompanied Taoiseach Bertie Ahern on a visit to New York in March 2007, where Ahern made a speech at a breakfast meeting with the US financial services industry. During the event Ahern sought increased investment in Ireland and said that Ireland was very lightly regulated compared to most of its European colleagues (Houses of the Oireachtas, 2016: 144).

The case recalled how First Active put its interests first and either did not believe or did not care about the view of the Central Bank and/or the Regulator. The Regulator later explained the ignoring of them by the banks as a consequence of irrational "euphoria".

Explaining these events with reference to “euphoria” points to the irrationality posited in the literature to explain how poor decision-making can arise (Lunn, 2013: 583).

The framework proposed in this research suggests that a poor decision can be arrived at due to the institutional framework similarly activating empirically-established behavioural biases such as groupthink or herding. The framework expects that the case can reveal organisational structures which facilitated a lack of critical discussion and groupthink, institutions and supervisors acting in a herding manner, and conformism to be present. In short, the political system would take a supportive rather than a challenging role (Nyberg, 2011: iv and 9). Before process tracing the case, there was some expectation the D/Fin would be dependent on the Central Bank and the Regulator for information, increasing the likelihood of groupthink or herding. The analysis starkly revealed the dependence of D/Fin on the Regulator for information on the appropriateness of 100 per cent LTV mortgages and that this was a negative influence on the decision process. Though parts of the political system (D/Env) took a challenging role in respect of the bank/Regulator’s stance, others adopted a more supportive role (D/Fin). The irrational institutional memory of the Central Bank also prompted both confirmation bias, and loss aversion with regard to reputation, and was another negative influence on the decision process.

Finally, the proposed framework suggests that a poor, irrational outcome choice can emerge due to the policy-maker’s rigid, abstract beliefs resisting new information flow, activating empirically-established behavioural biases. Nyberg concluded that the widespread ideological belief in the efficiency of markets became widely trusted among Irish financial professionals in private and public institutions, and prompted assumptions across institutions and within institutions, strengthened through groupthink (Nyberg, 2011: 94). In the case investigated here it is clear that the dominant market ideology of the time raised the threshold to be reached for intervention to be seriously considered by D/Fin. The information underpinning D/Env’s concerns did not reach the threshold demanded by the ideology, for market intervention. Further, the ideologically-driven approach to regulation faced a challenge in this case as evidenced by the fear about the message that intervention would communicate in terms of financial markets in Ireland.

The challenge of linking an influencing factor (interests, institutions, ideology) exclusively to either rational or irrational information processing is clear from this analysis. This can be explained by the proposed framework’s expectation that the three factors will be operating simultaneously and interacting with each other. The case showed how D/Fin's interests (seeking to avoid intervention) interacted with the institutional factors (D/Env's concerns were not given the same weight as those of others) and the ideological context (a high threshold for intervention). The case demonstrated how the interests of the Central Bank and Regulator were served by the bad decision as (i) it did not complicate their duty to promote the financial services industry in Ireland, and (ii) because the decision was seen as pro-consumer choice. Remember, the Central Bank and the Regulator were worried that even the smallest intervention could threaten a delicately poised market. It could be argued that promoting an industry model which they privately feared would collapse, is irrational. But if they believed that the alternative to a collapse was likely and in sight (e.g. precipitated by rising interest rates which would arrive), promoting the industry was entirely rational.

10.6 Conclusion

Overall, information processing was impacted by the interacting influences of interests, institutions, and ideology, and a poor decision-outcome was the result. However, it would not be accurate to say that the decision-making process was entirely irrational. Many errors were made for rational reasons, often in an actor's self-interests. Between institutions there was information sharing and debate, and the information necessary for a good decision was available to the Regulator, in particular. The Department of Finance may have been too deferential to the Regulator and not deferential enough to the Department of the Environment. As noted earlier, for D/Fin the 100 per cent LTV mortgages issue was one of *housing* policy, while for D/Env the issue was one of *banking* policy. Although the Department of Finance communicated the decision, it appears that the Regulator was the institution with the power to intervene to prohibit or limit the product. In that sense, the wrong institution made the formal decision. It is clear that the banks, on the whole, were not pressing for these products, ruling out their interests as a primary factor. Once one bank issued the 100 per cent mortgages, it was in other financial institutions' interests to allow competition but banks' interests were not the driving force. Ideology, framed as manifesting itself as principles-based regulation, is a ready defence, explanation or excuse for the bad decision but the process was more complex. It was the combination of ideological and institutional factors that had the greatest negative impact. The dominant market ideology of the time, combined with the relative institutional standing of decision-makers, contributed most to the poor decision outcome. That free market ideology raised the threshold to be met before intervention by the State was seriously considered, and coupled with the relatively low standing of the primary proponent of such intervention, meant a sub-optimal outcome was reached.

Finally, the process tracing evidence suggests irrationality cannot be described as the primary cause of the poor outcome. The detailed information considered and discussed by decision-makers in the case, over a period of months, argues against impactful behavioural convergence or groupthink. Many of the symptoms of such irrationality were present (selective bias in processing information at hand, poor information search, incomplete survey of alternatives) *within* institutional actors, however *between* them there was detailed information exchange and deliberation. Interests, institutions, and ideology interacted to prompt the poor rational and irrational information processing, which led to the bad result. Policy-makers arrived at these decisions for rational and irrational reasons; out of rational self-interest to avoid difficult action, as a result of rational institutional separation, or as a consequence of a rational assessment that the decision aligns with ideological instincts. But also as result of irrationality prompted by the actions of interests, as a consequence of groupthink and herding which was supported by institutional arrangements, and because a dominant ideology limited information flow.

Chapter 11: Discussion and Lessons

11.1 Introduction

Looking back at the original motivation for the research, what has been learned about why decision-makers acted the way they did? Despite possessing evidence-based advice that if implemented would have helped protect competitiveness and bolster the economy, the policy system did not respond adequately. At a general level the reasons for this are self-evident: decision-makers benefitting from the economic bubble bought into a soft-landing consensus which resisted suggestions of significantly altering policy. Underlying this, interests, institutions, and ideology interacted, and were a negative influence in the decision-making process, and contributed to a consensus. Not all of the mis-steps were irrational, and rational self-interest was an important element. At the same time, empirically established behavioural biases were active to an extent in Ireland and contributed to an ensuing bubble of a scale that it's bursting destroyed the economy. The social consequences were extensive and included significant unemployment, emigration, cuts to public services, tax rises, and political turmoil.

The behavioural economics literature created some optimism that decision-makers need not wait for painful hindsight to confirm that irrationality is present and impacting to an extent that it is damaging economic policy. Further, political theory suggested interests, institutions, and ideology as contributing factors to the poor decision-making that lead to the economic bubble. A worthy broader objective must be devising responses to counteract any negative link detected between these factors, irrational information processing, and bad decision outcomes. Thus, this research sought to answer two important questions:

1. Is evidence of active, impactful irrationality among key decision-makers in the period before Ireland's crash detectable using a quantitative method?
2. What role did interests, institutions, and ideology play in poor decision-making?

The preceding Chapters have endeavoured to answer these questions, and taken together can help add to our understanding of why policy-makers in Ireland before the crash acted the way they did, and did not respond adequately to advice.

11.2 What we learned in Part I

Part I developed the linkage between leaders' personal characteristics and decision-making. Policy-makers perceive and interpret what is happening around them, and it is their aggregated preferences that shape what governments and institutions do. In Ireland's case those preferences are believed to have been negatively influenced by irrational forces;

systematic errors in judgements and choices which were influenced by emotions. This phenomenon is the focus of the field of behavioural economics which, since the 1970s in particular, has been challenging the neo-classical notion of rational actors taking rational decisions to deliver the perceived optimal outcome for them. It is based on Simon's concept of bounded rationality, which recognises the small capacity of the human mind for formulating and solving complex problems, relative to the scale of the problems faced. Behavioural economics revealed the impact of heuristics, loss/gain asymmetry, and framing effects on our choices. These help explain why, in economic bubbles, decision-makers find it difficult to conceive of the possibility of a crisis scenario, why they pursue increasingly risky financial practices to stave off or delay losses, and why they have erroneous expectations and perceptions of 'normality', risk and opportunity.

Away from economics, the application of this behavioural approach has enhanced studies of international relations, most notably with the emergence the concept of groupthink. Research has demonstrated situations where people engage in consensus-seeking within a cohesive group to such an extent that it overwhelms assessment of what the optimal decision or action is. This behavioural convergence is thought to have been active during Ireland's boom, where decision-makers displayed behaviour exhibiting bandwagon effects both between institutions (herding) and within them (groupthink). Post-crisis research has identified behavioural biases impacting in media coverage of the boom and at the highest levels in banks. However, evidence of the presence of behavioural biases specifically among key political decision-makers in Ireland, and examining whether biases were more prevalent in Ireland versus elsewhere, was absent.

Part I also discussed the challenges to be overcome when attempting to detect impactful irrationality in real-time, especially as those who hold/held positions of significant authority and esteem, and are unlikely to participate in typical experiments to assess behavioural convergence bias. Helpfully, a 'methodological arsenal' is available to researchers attempting to assess decision-makers at a distance, including *conceptual complexity* and *in-group bias* trait analysis, the preferred approach for this research. The theory suggested that less conceptually complex leaders, highly committed to their own group, could be expected to establish suboptimal and less open information processing during decision-making, to undertake incomplete analysis of alternatives and objectives, perform poor information search, fail to examine risks of preferred choice, fail to reappraise initially rejected alternatives, to demonstrate selective bias in processing information at hand, and fail to work out contingency plans. Thus, conceptual complexity and in-group bias provided a potential proxy for behavioural convergence bias, to allow detection in a covert manner. This underpinned the statement of the hypothesis, that decision-makers in Ireland would have:

- *lower relative levels of conceptual complexity compared to decision-makers in comparable economies, in the years preceding the economic crash, and*
- *higher relative levels of in-group bias compared to decision-makers in comparable economies, in the years preceding the economic crash.*

Away from the concept of irrationality, a review of the literature further explained how economic and political bubbles emerge, and we learned that given that long-established academic perspectives of decision-making and public administration have been described as out of touch, new approaches to analysis of decision-making in the public service have emerged. These approaches (e.g. multiple streams framework; complex adaptive systems; punctuated equilibrium) have noted the rise in the number of actors with heterogeneous interests interacting in policy and decision-making, leading to highly variable results. They highlight the role of institutions which, when in place for extended periods, structure participation and give the illusion of policy stability. Interests and institutions are closely linked in these new approaches, as institutions create policy-monopolies and a political system which appears to convey benefits to the same interests. Turning to ideology, this factor has been singled out in previous research as the common factor in a range of economic booms and busts. This is because ideology results in decision-makers clinging to one 'key idea' as their only guide to economic policy. Official investigations into Ireland's crash have pointed to interests, institutions, and ideology as contributing factors in one way or another, describing them in a variety of ways; "deference and diffidence" or the "paradigm of efficient financial markets".

Part I detailed McCarty, Poole, and Rosenthal's analysis of decision-making, which informed the development of the proposed framework of decision-making analysis employed in the thesis. This section set out how interests influence decision-makers by mobilising constituencies, direct expenditure on electoral campaigns, and the production and provision of information. This problem is compounded by decision-makers having to operate within institutions resistant to policy change, and an institutional framework which have a significant impact on information flows and levels of expertise. Suboptimal decision outcomes are further encouraged when ideology justifies erroneous action or inaction despite events and information suggesting a particular course of action. The thesis recounted the case of Ireland’s taxation regime from 1987 to the crash twenty years later as an example of the link between policy bubbles and economic bubbles. The decision to adopt a new fiscal strategy, which changed the structure of the tax system in Ireland through the boom, provided an illustrative case of dynamic policy-making, where a bubble forms, grows in response to positive feedback, and bursts years after it moved from being strength to being a weakness. This policy overreaction in pursuit of short-run benefits delivered massive societal costs, despite warnings to the contrary. This example demonstrated how the causes of a bubble go beyond irrational forces, behavioural convergence and groupthink, and include interests, institutions, and ideology as important drivers of harmful policy and economic bubbles.

The proposed framework for analysis considers the impact of interests, institutions, and ideology on information processing, and the consequences for rational or irrational outcomes. We learned that one (probably unintended) consequence of previous analysis of Ireland’s crisis is that, by identifying the causes to be a combination of a naïve belief in efficient markets and irrational forces, research has downplayed rational decisions that nonetheless had poor outcomes. Not all rational decisions are ‘good’ or irrational ones ‘bad’. The literature suggested that decision-makers value or weight preferences depending on the context in which they are evoked, and efforts to pin-point whether a suboptimal outcome was arrived at as a result of a rational or irrational decision are not straightforward.

11.3 What we learned in Part II

Part II began by outlining a method to test the hypothesis that decision-makers in Ireland in the years preceding the economic crash had lower relative levels of conceptual complexity, and higher levels of in-group bias, compared to decision-makers in similar countries. The selection of leaders for analysis and period of interest were also set out. The Leadership Trait Analysis (LTA) technique is one of the most prominent techniques for studying personality traits of leaders and with this technique, seven different personality traits including conceptual complexity and in-group bias, can be assessed. Additional benefits of LTA include the availability of automated content analysis software and that, once the leaders’ content has been analysed and individual scores calculated for each of the traits, it is possible to put the scores into perspective by determining how they compare with those of other leaders. In the course of Part II we also learned that it is possible to efficiently extract specific content (responses to oral parliamentary questions) for specific Irish leaders from the online record of parliament.

Part II then tested the hypothesis that Irish leaders in the run up to the crisis would have a lower trait score for conceptual complexity, and higher scores for in-group bias, relative to the mean of other western leaders in a comparator ‘norming’ group. The results of analysis on all of the content for the eight leaders refuted the hypothesis. Each and every leader had a level of conceptual complexity above the mean of comparable Western leaders, and lower levels of in-group bias. Part II then reported preliminary tests to determine whether the hypothesis should be rejected on the grounds that irrationality was not an important impacting force in Ireland’s bubble, or whether there were methodological grounds. This analysis suggested that the analysis of single blocks with large word-counts was not responsible for a rejection of the hypothesis, and that there is some variation in the trait scores for a leader depending on the topic he or she is discussing. Next, LTA analysis of additional content from a leading daily newspaper placed further doubts on the methodology as the results did not produce the expected signals.

Part II thus reported that evidence to support claims of irrational forces impacting on decisions in Ireland before the crash was not unearthed in this stage of the research. The possibility remained that there could be issues with the method, with role, the state/context of the leader, and/or with the content used. Given the incredibly negative economic and social fallout from the economic crisis, real-time detection of impactful and harmful decision-making biases is worth seeking, and this lead to the research reported in the final Chapter of Part II.

That element of the research offered a review of the LTA technique and the ongoing discussions concerning its validity and reliability. In an effort to contribute answers to some of the remaining questions in this matter, the thesis conducted an empirical analysis of all seven leadership traits of a British Prime Minister and Irish Taoiseach. The research explained why it is that the role and contextual state of leaders, along with the content used to analyse them, might impact on LTA trait scores. We learned that leaders show a wide variation in trait scores, and that the extent to which scores vary differs significantly by leader, and by trait. The statistical tests then revealed that role can have a significant impact on leaders’ trait scores, their state (crisis/non-crisis) can have a significant impact on an individual leader’s trait scores, and finally that of all of the factors that may explain the variance in LTA scores that this thesis has explored, source type impacts to the greatest extent on LTA results.

In general terms we learned that when attempting to detect irrationality using an at a distance technique, the research design must be mindful of (i) the need to analyse content from a period close to or at the time the decision of interest was taken, (ii) the impact that the role the leader holds on results, especially if comparing leaders across countries, (iii) the consequences for their results of the environment in which the decision was taken, and (iv) the need to carefully select which content (ad libbed / prepared) will be analysed and the impact of that choice on results.

In terms of the original question of active irrationality, behavioural convergence bias, and resulting conceptual complexity and in-group bias among Irish leaders before the crash, the methodological research provided some answers. First, we learned that the research could be enhanced by assessing their personality traits at the precise time-period when a particular decision of consequence is being taken.

Second, we learned that comparing the scores for Irish leaders with leaders from abroad, whose roles may be very different, is likely to have impacted the results. Third, we learned that source can impact significantly on conceptual complexity scores, though the pattern seen would not itself alone explain why Irish leaders had a higher score than expected, as it was the material from parliament which had *lower* scores. Nevertheless, the research design's ability to detect irrationality among Irish leaders could be enhanced by seeking to correct for the potential of semi-prepared content to impact trait scores, particularly the traits 'belief in ability to control events', 'conceptual complexity', and 'self-confidence'.

Fourth and finally, perhaps the most impactful learning in terms of the testing of the original hypothesis emerges from the overarching point about use of the norming group. The hypothesis rested almost entirely on Irish decision-makers having lower conceptual complexity / higher in-group bias scores than the comparator norming group of Western leaders. However as found in this thesis, though the norming groups take into account some relevant cultural differences, they include leaders with very different roles, in different contexts/states, and are based on a variety of sources.

Therefore, it is likely that the failure to uncover evidence of irrational groupthink amongst Irish leaders before the crash is a consequence of the method employed. Every step possible was taken to eliminate alternative explanations for the failure to uncover evidence (role, state, and source) but these could not be ruled out.

Nevertheless the research findings do make a significant contribution to this area of study in terms of theory and methods, and the results of the application of the LTA analysis and the subsequent probing of validity issues are important. By connecting empirically established cognitive biases, leadership traits, and decision-making in public-policy, the thesis develops an avenue of theory worthy of further exposition. The analysis focussed on just one manifestation of irrationality (behavioural convergence bias / groupthink / herding) but many others have been suggested as contributing to poor decision-making in the years preceding the crash. Future research could consider and develop proxies to aid real-time assessment of loss/gain asymmetry or extrapolation bias, for example.

While an unequivocal statement on the relative levels of irrationality in the form of behavioural convergence bias among decision-makers in Ireland in the Celtic Tiger era was not possible, this arose from questions over the impact of specific factors (role, state and source), the norming group used for comparison, and the black-box nature of the software employed. Yet, the thesis does provide an empirical analysis of irrationality among decision-makers in Ireland, something absent from previous analyses including the official investigations. By linking cognitive biases to leadership traits, and setting out a content analysis approach to assessment, using automated software, this research had contributed to methodological considerations. Further, the thesis provides key considerations for researchers and software developers when testing the validity of quantitative trait analysis techniques.

11.4 What we learned in Part III

Part III of the thesis was designed to contribute to a broader objective to devise responses to counteract any negative link detected these between interests, institutions, and ideology, and irrationality, and bad decision outcomes. Specifically, these Chapters investigated the extent to which these three factors impact on information processing by decision-makers, and the rationality or otherwise of the outcome.

Part III went on to test the proposed analysis framework by process tracing a most-likely case (a subjectively bad decision where it is most-likely that three factors will be present and impactful) which was identified following an extensive case-selection process. The case study supplements the quantitative content analysis research in Part II. The case study helped us further understand why economic advice offered between 1997 and 2007 did not translate into policy action that would have mitigated the likelihood or severity of the economic crisis in Ireland from 2008, and to what extent and how each of the three factors contributed to this. The thesis explained that the chosen most-likely case study concentrates on the three variables within the causal process for bad decision-making, in the knowledge of the limitations of such an approach. Even though the case was chosen on the dependent variable, it served the purpose of identifying the potential causal paths and variables leading to the outcomes.

In the course of setting out the case-selection approach, we learned about the challenge facing researchers when it comes to isolating specific bad (or good) decisions when presented with the universe of formal decisions taken by a Government. We learned that despite applying a logical, two-stage iterative case identification process, the full universe of 3,425 formal decisions taken by the Irish Government from 2001 to 2004 could not reveal a suitable single most-likely case to be analysed. Four official investigations in to Ireland's crash – Honohan (2010), Regling and Watson (2010), Wright (2010), and Nyberg (2011) reports – and consultation with a former senior government official, led to identification of a suitable case: the decision by the Government in 2005 not to intervene to prohibit or limit the use of 100 per cent loan-to-value (LTV) residential mortgages.

The thesis then explained how the selected case met the necessary criteria for the process tracing approach, as well as setting out what a 'good' decision would have looked like in this case. We then learned how documentary and interview data can be analysed to reveal the influence of interests, institutions, and ideology on the decision outcome. The detailed definitions of the three core categories for identification were provided and taken together, the thesis proposed an instructive framework with these variables – interests, institutions, and ideology – linked to information processing and suboptimal decision-outcomes.

We then learned about the decision-making environment that existed in Ireland in 2005, with specific attention paid to the institutional relationships within and between the Oireachtas, Government Departments, and Social Partnership, and a detailed description of the structures for (and constraints on) the regulation of financial services, which are all critical to the case study. We learned how the nature of the structure of the Financial Services Regulator ('Regulator') within the Central Bank, their specific secrecy protocols, and dual-mandate to promote the industry, all impacted on the decision-making environment. The thesis also summarised the advice to Government about the overheating of Ireland's property market, and the short-comings of that advice, which provided the backdrop to the bad-decision case. Overall, in this element of the thesis we learned that citizens in Ireland in 2005 were wrong to have believed that the sustainability of the economic, financial and banking system was being closely monitored and effectively managed, in a hands-on manner by the Financial Regulator and the Central Bank, with a clear line of responsibility and accountability from them through the Minister and Department of Finance, to the highest level of government in the Department of the Taoiseach, and ultimately on to an overseeing Oireachtas. The thesis set out the reality where relationships between the Oireachtas, Government, Opposition, Ministers, Departments, the Central Bank, and the Regulator were inadequate.

Next, Part III set out in minute detail the events leading up to the bad decision on 100 per cent LTV mortgages, beginning in early 2005 and ending with communication of the decision in November that year. This extensive section of the thesis detailed the economic and political backdrop to the case, and circumstances surrounding the arrival of widely-available 100 per cent LTV mortgages. We then learned about the concerns expressed by one arm of Government (the Department of the Environment), the response of another (the Department of Finance), and early consideration of the issue by the Regulator. The documentation secured under Freedom of Information legislation and from other sources allowed us to learn about the views of the banks and the nature of the in-house analysis by the Department of Finance of concerns about 100 per cent LTV mortgages. Next, the thesis described the important media and political backdrop immediately preceding the decision and, using primary sources, recounted the details of the key meeting between Government Departments and the Regulator. Overall, we learned of the detail and nature of the interaction between Government Departments, Agencies and banks at a critical time before the crash, and this provided the evidence on which to undertake the detailed analysis which followed.

At this point the thesis could report that the process tracing method had revealed evidence which confirmed that interests, institutions, and ideology were interacting to influence information processing and the decision outcome. We learned that the interests of part of the Department of Finance were served by the poor decision as despite seeing the property sector as a risk-factor, the decision left the economic model untouched, and meant they had no difficult choice to make on a financial services market intervention. The interests of the Central Bank and the Regulator were served by the poor outcome as it did not complicate their legislative duty to promote the financial services industry in Ireland. Interestingly, the interests of the banks were served only in so far as the outcome allowed them to compete for market share once the first institution had entered the market. The interests of the Department of the Environment were not served as the decision did not contribute to maintaining an efficient housing market. Finally, we learned that the interests of elected politicians or property developers were not actively or overtly pursued in the case but that the bad decision would likely have served their short-run interests.

With regard to the influence of institutions on the most-likely bad decision case, the thesis confirmed that the lower relative institutional standing of the Department of the Environment vis-à-vis the banks and Regulator in the eyes of the Department of Finance contributed to the bad decision. The dependence of the Department of Finance on the Regulator for information was also a negative influence on the decision process. In addition, the lack of clarity about which institution (the Department of Finance or Regulator) was the *de facto* decision-maker in the case influenced the decision-making process negatively. We learned that the institutional secrecy of the Central Bank / Regulator in its dealings with the Department of Finance, and to a lesser extent the Department of the Environment, contributed to the bad decision. The thesis revealed that the decline in the Department of Finance's institutional confidence and credibility was a negative influence on the outcome. Further, the lower relative institutional standing of government Departments vis-à-vis the Regulator in the eyes of the banks contributed to the bad decision. Finally, we learned that the institutional memory of the Central Bank was a negative influence on the process.

Turning to the influence of ideology on decision-making, the thesis found that the ideological instincts of the Department of Finance and likely the wider government-system at the time were served by the bad decision, and that this hindered the process. The available evidence was sufficient for the Department of the Environment to conclude that intervention was necessary, and thus it trumped any ideological instinct, but this did not lead to a good decision overall. We learned that the dominant market ideology of the time (combined with the relative institutional standing of the Department of the Environment) contributed to the poor decision outcome by raising the threshold to be reached for intervention to be seriously considered.

Also in Part III, we learned that interests, institutions, and ideology interact and can be linked to irrationality. For example, the interests of the banks who issued 100 per cent LTV products activated wider irrationality, precipitated extrapolation and confirmation bias, built expectations of continued house price increases, and contributed to consensus view that the property market would experience a soft-landing. Also, we learned how the institutional arrangements activated groupthink and herding in decision-making in Ireland before the crash. The Department of Finance was entirely dependent on the Regulator for a position, while the Department of the Environment who had no such dependence, arrived at an alternative (and ultimately correct) position. We learned how ideology activated irrationality by raising the information-threshold which had to be breached before market intervention was considered seriously by the Department of Finance.

What could be described as an 'absence of politics' is also noticeable in the case. Though the Minister for Housing (who was a Minister for State) was active in seeking a policy response to the introduction of 100 per cent LTV mortgages, senior Ministers were not. There is no evidence of similar activity by the Minister for the Environment, Dick Roche, or consideration of the matter by the Minister for Finance, Brian Cowen. The case shows civil servants acting to represent their Ministers and Departments in the decision-making process, and officials from the Regulator representing the institutional view. This presents the possibility that the propensity to act impacted on the decision, with elected politicians being more inclined to be seen to act on issues than civil servants.

As described in Chapter 8, a citizen may have had an expectation that Ministers would manage key economic decisions in a hands-on manner. The case-selection process outlined in Chapter 7 shows that while there are many formal decisions taken by Government at meetings of the Cabinet, many decisions with significant consequences for the economy and society are taken elsewhere. In this case, the crucial decision to not intervene was not taken by Government or by elected politicians, and was taken via an informal process which is shaped as much by institutional relationships as it is by the formal institutional framework, making it a process more difficult to structure or reform. The public policy environment was shown to be complex and decision-makers engage in give-and-take with other actors in a continuous process of adaptation as the situation develops. The case study is a detailed account of this complex scenario, focusing on three factors which theory posits to be important influencers of decision-making.

Finally, the process tracing evidence suggests that irrationality cannot be described as the primary cause of the poor outcome. The detailed information considered and discussed by decision-makers in the case, over a period of months, argues against impactful behavioural convergence or groupthink. In fact, there may have been an overabundance of information (see Friedman, 2009: 169). Many of the symptoms of such irrational groupthink were present (selective bias in processing information at hand, poor information search, incomplete survey of alternatives) within institutional actors, but between them there was detailed information exchange and deliberation.

11.5 Scope for further research arising out of this thesis

Despite the valuable lessons provided by this research there remains scope for further research to help provide definitive answers to the two overarching research questions.

Firstly, there is the question of detecting active, impactful irrationality using a quantitative method, before a crisis emerges. In section 4.4 a new process was developed whereby text from leaders could be efficiently and reliably retrieved from online sources. Section 4.3 described how a software package, Profiler Plus, has been developed which can automatically subject text to Leadership Trait Analysis (LTA) to detect the levels of seven personality traits. In sections 6.8 to 6.10 there was a discussion on how different sources (ad libbed / semi-prepared) can impact on LTA trait scores and the possibility of correcting for this. Section 6.10 revealed the importance of performing LTA at a moment close to when a decision of consequence – and which may be impacted by personality – is being made.

These particular conclusions from this thesis offer the basis for interesting, rich, and important future research. Such research would involve computing as well as leadership studies expertise, and would have the objective of delivering a system for detecting active, impactful irrationality using a quantitative method, in real-time. The computing expertise would be necessary to link the automated retrieval of semi-prepared utterances by leaders from online sources, such as the Dáil record, with the automated LTA Profile Plus software. Given the increasing levels of computing power and the declining cost of data storage, a unified system would have the potential to allow utterances of leaders to be analysed on a near-constant basis. The system would allow any of the members of the Dáil (or indeed the Seanad), or those appearing at Oireachtas Committees (these transcripts are online also) to be analysed. Researchers could analyse political parties or groupings in aggregates, determine the extent to which traits vary by topic, by time of day, by day of week, by chamber of the

Oireachtas, by how far into a government's term the debate took place, or by Left-Right grouping. For example, and linked to Part II of this thesis, new research reports that assessments of conceptual complexity call into question the typical interpretation that conservatives are less complex than liberals (Conway et. al, forthcoming). The impact on an individual of moving between opposition and government could also be assessed.

The impact of significant national or international events on personality traits could also be more easily investigated. This would include the impact of historic events on the trait scores of leaders who are no longer in office, or even who are deceased. For example, research has shown that exposure to dramatic news stories significantly decreases individuals' recall of information in the stories and reduced the complexity with which individuals thought about the events reported (Milburn and McGrail, 2013). Of course, use of the system would not be limited to Ireland and it could be employed in any jurisdiction where parliamentary utterances are recorded, XML-tagged and accessible.

The leadership studies expertise is required to examine other forms of irrationality (beyond behavioural convergence bias / groupthink / herding). As noted earlier, many other biases have been suggested as contributing to suboptimal decision-making in the decade before the crisis. Additional research could seek proxies to assist assessment of loss/gain asymmetry or extrapolation bias, for example. Leadership studies expertise would also help overcome the methodological issues revealed in Chapter 6 of this thesis. Most significant of these would be the adjustments required to correct for the semi-prepared nature of the content from the Oireachtas. Depending on the resources available, researchers could view the delivery of the particular content and use only that judged to have been 'off-script'. Short of that, the thesis showed that employing ad libbed or parliamentary sources makes a significant difference for certain trait scores (belief in ability to control events, self-confidence, and distrust of others). Further research is needed to ensure the validity of the system is maximised.

In all of this it would be important to be conscious of the role of the speaker and to perhaps limit such assessments of speakers to comparing TDs to TDs, and Ministers to Ministers. If the research is interested in the trait behaviour of an individual over time, role is not an issue unless they change portfolio. Finally, given the findings regarding the value of the pre-prepared norming groups, it is advisable at this stage to limit the research such that there is no necessity to reference these. If a fully automated system were developed, researchers could investigate the possibility of generating new, bespoke norming groups. For example, a norming group of all the leaders of a particular party going back to the beginning of Dáil records (January 1919) would make for interesting analysis of present-day leaders. Most importantly, such an automated system has the potential to deliver a real-time detection of active irrationality, which has been identified as a significant contributory factor in the precipitation of the economic crisis. Given the economic, social and political fall-out of the crisis, future research along the lines set out above, are worthy of consideration.

Secondly, there is the question of interests, institutions, and ideology negatively impacting information processing and contributing to active irrationality among decision-makers, and strategies to mitigate their negative influence. This thesis and its proposed framework of decision-making analysis has reinforced the notion of the complex environment facing policy-makers (section 3.3), and also highlighted importance of the lessons from behavioural economics for policy-making (section 2.1). Complex policy environments increase the need for efficient information flow, and much of the negative influence of interests, institutions, and ideology revealed in the thesis arises from their impact on such flows. The thesis also demonstrated the link between irrational groupthink and the conceptual complexity / in-group bias of decision-makers (section 2.2). Chapters 9 and 10 presented a number of critical instances in the case-study where information did not flow correctly, and how this impacted negatively on the decision outcome. In this way the thesis has informed future research into mitigation strategies, and how the can be targeted.

For example, the data that prompted a senior official in the Regulator to propose intervention in 2005 included growth rates of bank loans households for house purchase. In this instance, the official noted that mortgage credit growth rates in excess of 20 per cent were indicative of a previous bubble in Scandinavia. Similar to later events in Ireland and elsewhere, Scandinavia suffered a bubble and bust in the early 1990s following *inter alia* financial market deregulation and the rapid increase of new lending from financial institutions. For example in Sweden, bank lending growth of 11 per cent per year in the early 1980s jumped to 20 per cent in 1986 (Englund, 1999: 84). The crash came in 1989 with an asset price collapse (property and stocks) and a sharp rise in interest rates, and in the following years with credit markets drying up, investment collapsing, GDP contracting sharply, and bank liabilities being guaranteed by the State. Similar events occurred in Ireland.

The fact that mortgage credit growth rates in excess of 20 per cent triggered concern within the Regulator in Ireland about a bubble in Irish property market is interesting. At the beginning of 2005 year-on-year mortgage credit growth rates in Ireland had hit 30 per cent, and stood at 28 per cent when the proposal for intervention was made in August 2005 (Central Bank of Ireland, 2016: 1). The eventual implementation of the proposal from May 2006 – coupled with interest rate rises – saw the level of growth decline, falling below 25 per cent within nine months. In hindsight, a notional limit of 20 per cent mortgage credit growth would have been a useful heuristic to mandate further investigation. In his famous speech in 2012, the then Executive Director of Financial Stability at the Bank of England, Andrew Haldane, argued that the type of complex financial regulation developed before the crash might not just be costly and cumbersome but sub-optimal for crisis control, and that in financial regulation, "less may be more" (Haldane, 2012: 1).

Haldane draws on lessons from behavioural economics (Simon, Kahneman and Tversky) as this thesis has, and similarly focusses in on the ability of decision-makers to manage complexity. In contrast to the discussion of heuristics in Chapter 2, Haldane combines the research of Gigerenzer (2007, 2010), with the financial regulators' experience of regulation post Basel II (see Chapter 8) to demonstrate that heuristics may in fact be an optimal response to the complex regulatory environment. In summary, the research found that heuristics or simple rules can be suitable decision-making techniques in the face of complexity because:

- Collecting and processing the information necessary for complex decision-making is costly
- Disregarding information can make not only for cheaper but also for better decisions
- In an uncertain environment, where probabilities are unknown, statistical weighting approaches to decision-making may no longer be suitable
- Other things equal, the smaller the sample, the greater the model uncertainty and the better the performance of simple, heuristic strategies
- Complex rules may cause people to manage to the rules, for fear of falling foul of them. (Haldane, 2012: 3-5)

Gigerenzer argues for the use of "fast and frugal" heuristics whose underlying reasons we are not fully aware of, yet which are strong enough to act upon, and which hit at the most important information while ignoring the rest (Gigerenzer, 2007: 16, 18). As mentioned, Haldane coupled this research with the experience of regulator's before the crash. Where the Basel I regulatory regime of 1988 was only thirty pages in length, Basel II was 347 pages long, and the exponential increase in length and complexity made it more difficult, rather than easier, for regulators to assess financial institutions. Haldane concludes:

> "Modern finance is complex, perhaps too complex. Regulation of modern finance is complex, almost certainly too complex. That configuration spells trouble. As you do not fight fire with fire, you do not fight complexity with complexity. Because complexity generates uncertainty, not risk, it requires a regulatory response grounded in simplicity, not complexity" – *Haldane, 2012: 19*

Returning to the need for strategies to improve information flow in complex environments, where interests, institutions, and ideology are influencing negatively, the work of Gigerenzer, Hertwig, and Pachur (2011) suggests an approach worthy of further research. Haldane's suggestion that fast and frugal heuristics are suitable for certain aspects of decision-making within financial regulation follows Gigerenzer, Hertwig, and Pachur's *ecological rationality* guidance principle: there should be a match between the mind and the environment, such that a heuristic function wells. By 'functioning well' the authors mean that the heuristic predicts faster, with less information, or more accurately than a competing strategy (Gigerenzer, Hertwig, and Pachur, 2011: xix). This is important; in process tracing the case of 100 per cent LTV mortgages, D/Fin referred to a short-list of indicators suggested by international observers as signalling a bubble which included less suitable metrics, such as those which would only have been impacted after the bubble had burst (e.g. unemployment, economic growth). The ecological rationality and the match between a heuristic and the policy-environment can be tested using computer simulation and mathematical analysis.

Future research employing these principles and techniques should investigate whether fast and frugal heuristics are suitable for certain aspects of decision-making within economic governance and policy on national competitiveness. This thesis has demonstrated how interests, institutions, and ideology negatively impacted information flow, including when data and related proposals from within the Regulator in 2005, which would have been positive, were rejected. For example, that decision process – in hindsight – would have unquestionably benefitted from a notional limit of *X* per cent mortgage credit growth as a useful heuristic to mandate further investigation by policy-makers. This thesis suggests there may be scope for future research to investigate if and how a suite of heuristics can be devised that will aid policy-makers with bounded rationality, subject to the impacts of interests, institutions, and ideology, can make better decisions in the face of complexity. These heuristics could apply across a range of policy areas from economics to competitiveness, to environmental and regulatory policy. The Irish Government has made a start in this area with the decision in 2015, based on the work of this author, to investigate the use of heuristics to provide early-warning signals for further action with regard to the sustainability of employment across sectors of the economy (Department of Jobs, Enterprise and Innovation, 2015: 243-246). In addition to the benefits of such heuristics spelled out by Gigerenzer, Hertwig, and Pachur, and by Haldane, they carry the potential advantage of being more resistant to the impacts of interests, institutions, and ideology, if carefully designed, agreed in advance and with some independent input.

Finally, future research on the impact of gender on macroeconomic decision-making may also be worth pursuing. Figure 9.1 listed the main actors in the case study on mortgage policy. Of the 29 people mentioned, only three are female. It is reasonable to assume that the same group of actors or at least a group with the same gender imbalance, decided upon a wide variety of economic and regulatory polices impacting on Ireland's fortunes. The gender imbalance is important because of the link made in behavioural economics between the gender of the decision-maker, and the assessment of risk (and risk/loss aversion). Empirical research shows that across a variety of scenarios, males engage in more risky behaviours than do females (see Byrnes, Miller, and Schafer, 1999 for meta-analysis; cf. Fehr-Duda, de Gennaro, and Schubert, 2006). In gambling, health, recreation, and social activity, females demonstrate a lower propensity toward risky choices as a result of the greater perceived likelihood of negative outcomes and lesser expectation of enjoyment (Harris, Jenkins, and Glaser; 2006). Research also suggests that level of stress in the decision-making setting amplifies gender differences in strategies used during risky decisions, as males take more risk and females take less risk under stress (Mather and Lighthall, 2012). Turning to financial decisions specifically, Dowling and Aribi (2013) show that the presence, and proportion, of female directors are strongly related to the propensity of a firm to engage in the risky activity (make large acquisitions), drawing on the psychological and decision-making research which shows females to be less overconfident in their decision-making. In the case study in this thesis, the decision-makers could be described as demonstrating risky behaviour by not responding to the concerns of the Department of the Environment and elsewhere, and not to intervening in the market. Of course, those decision-makers may describe the proposed intervention as a higher risk. In any event, the impact of gender (and gender imbalance) on macroeconomic decision-making by elected leaders and senior civil servants specifically, appears to hold potential for fruitful investigation.

11.6 Policy Implications

The learnings from this thesis are new and important but to what extent do they deliver a solution to the original puzzle? First, must policy-makers or advisory bodies still wait for painful hindsight to confirm that irrationality is present and impacting to an extent that it is harming economic policy? For now, yes. However, the method developed in this thesis which links irrationality, behavioural bias, leadership traits, conceptual complexity, and in-group bias represents good progress. It has opened up the possibility of assessment at a distance, and crucially, assessment in real-time. There is cause for continued optimism that the real-time detection of active irrationality among key decision-makers is possible. The new automated text retrieval process devised for this thesis, when coupled with the automated LTA/Profiler Plus system, opens great potential for researchers interested in leadership and decision-making. Further, though the hypothesis was not supported by the results, the subsequent in-depth investigation of the LTA methodology has produced important lessons for those designing approaches to assessment at a distance.

Second, the puzzle presented the challenge of devising responses to counteract any negative link detected between interests, institutions, and ideology, and poor outcomes. The development and testing of a new framework for analysis in this thesis which revealed the linkages with rational/irrational decision-making is valuable progress. Before this research was undertaken there were 'islands of knowledge': international research pointing to the role of interests, institutions, and ideology; research into Ireland's crisis highlighting the impact of interests and institutions, or ideology and irrationality. There were some linkages made of course, but the model developed for this thesis makes these linkages explicit and suggests processes which can explain variation in 'levels' of irrationality. This represents important progress as mitigation strategies can now be far more targeted as they are informed by a better of understanding of how of interests, institutions, and ideology can negatively impact on decision-making (in rational and irrational ways). For example, information which prompts concerns and suggests intervention should be assessed on its merits, unimpeded by the dominant ideology (or irrationality) of the day. It should not be the case that ideology raises the threshold for signal levels necessary before intervention is to be recommended, and strategies, including the targeted use of heuristics, can assist here.

Overall then, the thesis has succeeded in improving our understanding of why policy-makers in Ireland before the crash acted the way they did, and did not respond adequately to advice. Despite the results, the notion that irrationality was an important factor stands. The failure to detect the expected signal (lower relative conceptual complexity; higher in-group bias) was a function of the methodology. Further, the thesis provides an improved understanding of how interests, institutions, and ideology influenced policy-makers in Ireland to act the way they did, and ignore advice the way they did. They did so for rational and irrational reasons; out of rational self-interest to avoid difficult action, as a result of rational institutional separation, or as a consequence of a rational assessment that the decision aligns with ideological instincts. But also as result of irrationality prompted by the actions of interests, as a consequence of groupthink and herding which was supported by institutional arrangements, or because a dominant ideology limited information flow.

At a thematic level, the thesis has reinforced the sense of the complexity of the decision-making environment and a recognition of how important the learnings from behavioural economics are for policy-making. A recurring point has been how information flow is influenced by external factors and is processed by individual decision-makers, or decision-makers in groups. Although dealing with the impact of groupthink specifically, Sunstein and Hasties's prescription (2015) for better decision-making seems broadly applicable here. After all, a central challenge to be addressed is decision-makers failing to get important information, whether as a direct result of interests or institutions or ideology on actors acting rationally, or via linked irrationality. The remedy proposed by Sunstein and Hastie looks like it would have had a reasonable chance of improving the decision-making outcome in the case detailed here. That is (i) ensuring that options are not closed down too early, by preparing a comprehensive list of solutions ahead of selecting a solution, (ii) challenging any notion of the inherent 'wisdom of the crowd', by actively seeking dissent and ensuring diversity of opinion within the group of decision-makers, and guarding against 'happy-talk' dominating the discussions, (iii) avoiding 'chasing an expert', by consulting a number of experts as opposed to the one who appears best placed to inform a decision, and (iv) broadening information search by exploiting technology and web-based information sources, and employing creative idea-generation techniques. These immediate policy-lessons have, on the face of it, a good chance of improving decision-making on a case-by-case basis and, in the aggregate, guarding against broad policy failure. The longer term lessons with regard to developing efficient real-time detection of active and harmful irrationality, and devising suitable heuristics to help policy-makers overcome bounded rationality and complexity, can also contribute to strategies to mitigate against disasters such as the economic crisis in Ireland from 2008.

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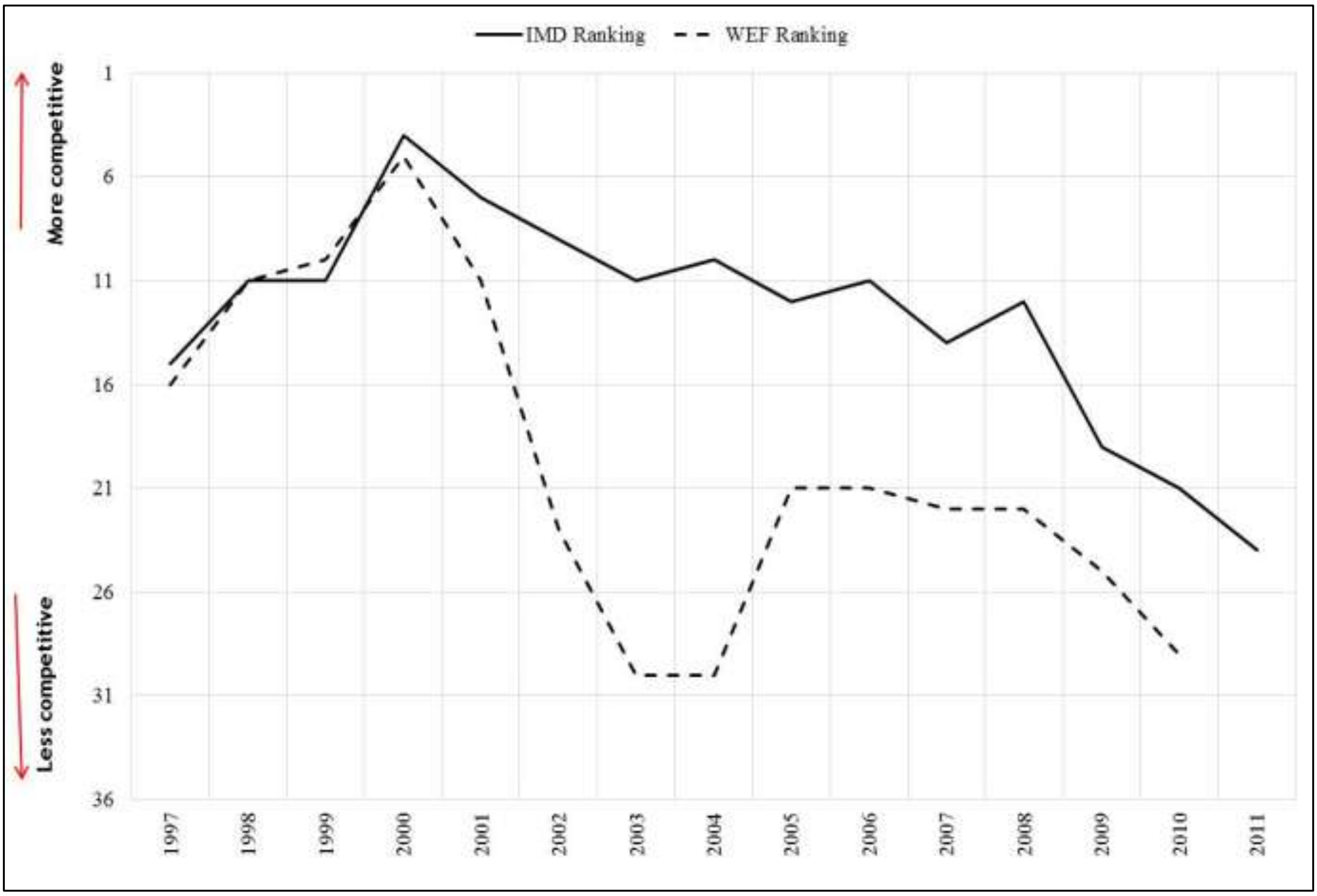
APPENDIX A

Advice from the National Competitiveness Council, 1997 – 2006

The National Competitiveness Council (NCC) was established in 1997 by the Government to report to the Taoiseach on key competitiveness issues facing the Irish economy and offer recommendations on actions necessary to improve Ireland's competitive position. The fact that the NCC was established in the first place should provide some encouragement that decision-makers viewed national competitiveness as important to the well-being of the economy (and the State as a whole), and that its advice on how to ensure a competitive economy would be acted upon. In fact, decision-makers presided over a steady decline in Ireland's competitiveness which made the economic crash more severe and recovery more difficult (NCC, 2009).



Ireland's International Competitiveness Rankings, 1997 – 2011[17]

[17] IMD ranking is taken from the International Institute for Management Development's *World Competitiveness Yearbook*; WEF ranking is sourced from the World Economic Forum's *Global Competitiveness Report*. Note that there were adjustments in the WEF methodology between 2002 and 2005 which may account for shifts.

Within a year of establishment, the NCC was warning that Ireland's competitive position - while outstandingly strong in recent years - was "not yet based on solid foundations and needs to be kept under constant review if recent danger signs such as skills shortages, infrastructural bottlenecks, lack of investment in telecommunications and the growing gap between multinationals and indigenous companies are not to undermine it" (NCC, 1998: 1). This warning was accompanied by policy advice on how to remedy the situation, in this case dealing with social insurance, personal tax rates corporation tax for small firms and the skill requirements of the economy.

The annual cycle of 'diagnosis and prescription' on Ireland's faltering national competitiveness continued over the period of the boom. Looking at their annual reports[18] shows, for example, in 2001, the NCC was highlighting the need for regulatory reform to increase competition in locally traded sectors. In 2003, they warned that the rapid growth in costs was not accompanied by higher efficiency and productivity. When these inefficiencies are passed onto the rest of the economy, the NCC warned that Ireland's international competitiveness would deteriorate and jobs in the exposed internationally trading sectors of the economy would be lost.

In 2004, they warned government to broaden its revenue base. In 2005, they warned of the need to strike the right balance between competitive taxes and the adequate provision of public goods. In 2006, the NCC highlighted the need to ensure the sustainability of the tax regime. They said government should continue to shift tax incentives away from investments in property and broaden the revenue base that finances public spending. The proposed next round of benchmarking the pay of public service employees vis-à-vis the private sector should be fully evidence-based and transparent in its analysis, and should continue to incentivise public sector efficiency they said, while urging government to gain better control over current expenditure.

These warnings were accompanied by recommended policy actions, directed at government to guard against downside risk. In some cases the government took on board recommendations related to improving Ireland competitiveness, took decisions and implemented policy changes (e.g. maintaining a competitive tax wedge, prioritisation of education and R&D investment, more integrated approach to planning and delivery of capital

[18] NCC publications can be found at www.competitiveness.ie/publication/nccSearch.jsp

projects). In others cases, recommendations were not acted upon (e.g. tackling the high cost base, competition in the domestic economy, advanced broadband infrastructure and services).

This was despite NCC recommendations often being included in political party manifestoes and even Programmes for Government. The 2007 government programme commits *inter alia* to ensuring that competition thrives and that costs are kept to a minimum, driving down the cost of waste management charges to business, upgrading national infrastructure with positive consequences for business costs and productivity, and taking action where people contend that their legal bill is excessive and includes wasted costs (Department of the Taoiseach, 2007). In short, warnings were communicated to decision-makers to inform them of negative developments in Ireland’s national competitiveness, accompanied by policy advice on how to remedy the situation but as shown by the data from international bodies (IMD and WEF), Ireland’s competitive position continued to deteriorate despite the annual diagnoses and prescriptions. The consequences of the failure to respond to advice on national competitiveness should not be underestimated, and its impact on the crisis is best summarised by Regling and Watson, who reference the competitiveness factors on which the NCC advised:

> “While global and domestic factors...interacted in mutually reinforcing ways, it is feasible to disentangle the main ‘home-made’ elements in the debacle.
>
> Fiscal policy heightened the vulnerability of the economy. At the macroeconomic level, [government] should have done more to dampen the powerful monetary and liquidity impulses that were stimulating the economy. Budgets that were strongly counter-cyclical could have helped to moderate the boom, and would also have created fiscal space to cushion the recession when it came.
>
> But budgetary policy veered more toward spending money while revenues came in. In addition, the pattern of tax cuts left revenues increasingly fragile, since they were dependent on taxes driven by the property sector and by high consumer spending. Ireland was also unusual in having tax deductibility for mortgages, and significant and distortive subsidies for commercial real estate development, yet no property tax...
>
> Wage settlements accelerated markedly from the late 90s, in absolute and in relative terms... Ireland had also the highest price level in the euro area according to Eurostat statistics.
>
> Competitiveness deteriorated significantly. From 1999 to 2008, Ireland's real effective exchange rate increased more than that of any other country in the euro area. Of course, some loss of competitiveness is the natural mechanism through which growth is slowed in a euro area economy that is overheating. In Ireland, however, an imprudent expansion of bank lending, accompanied by an unwise policy on tax exemptions, resulted in this natural economic cycle becoming much more extreme than should have ever have been the case” - *Regling and Watson, 2010: 21*

APPENDIX B

Case Study Selection from the Universe of Government Decisions

To identify a case for the process tracing exercise, first a universe of relevant government decisions was assessed, bearing in mind the period of interest and the constraints of legislation. The period of interest is from 2001 on, when the Irish economy moved from its sustainable growth phase to its unsustainable boom phase. Under the relevant legislation in force at the time of the research, access to papers was subject to a ten-year rule meaning that the final year which could be assessed was 2004.

A list of all Government decisions taken at formal Cabinet meetings for the four years, 2001, 2002, 2003 and 2004 was provided by the Department of the Taoiseach. The universe of formal decisions taken in these four years was 3,425 (868, 870, 852 and 835 in each year respectively). Selecting decisions which relate to a policy area that can be reasonably assumed to have impacted on the Ireland's economy is a subjective exercise. In addition, such a selection must be made based on how each decision is described in the list provided.

The list of 3,425 government decisions contains the title of the decision, not the detail of the decision itself. In some cases, the title of the decision strongly indicated that its substance impacted on the economy e.g. *Budget 2002*, *Economic and Budgetary Outlook 2003-2005*, or *Five Year Multi-Annual Framework for Capital Expenditure 2004-2008*. In other cases, the title strongly indicates the opposite e.g. *Chester Beatty Library: Report of the Board of Trustees, 2001*, or *Judge of The High Court: Appointment of One Ordinary Judge*. Unsurprisingly, a large number of the decision titles required a subjective judgement call when selecting them as being impactful on the national economy or otherwise: knowing what we know now, was this a decision that was likely to have contributed to the onset or mitigation of the economic crisis? Again, as Bennett and Elman note, although the dependent variable is known (bad decision), selection bias is to be avoided; "it is appropriate to study a case in which the outcome is known if the purpose is to determine whether a purported necessary cause is operating" (Bennett and Elman, 2006: 462).

Taking this together, and accepting that further informative documentation on each decision would be requested, 343 (10 per cent) of the universe 3,425 decisions taken in the four years from 2001 to 2004 could be described as on the face of it impacting on the national economy as understood in this research. Of the 868 formal decisions taken by Government at Cabinet in 2001, 86 (ten per cent) can be described as impacting the economy. For 2002, of the 870 formal decisions taken by Government at Cabinet in 2002, the number is 81 (nine per cent); in 2003 of the 852 formal decisions, 94 (eleven per cent) can be described as being of particular interest; finally in 2004, of the 835 formal decisions, 82 (10 per cent) can be described as being of real interest when considering the fortunes of Ireland's economy in the following years.

In selecting cases, it is important to be mindful of resource constraints. For example, examination of additional information provided by the Department of the Taoiseach revealed that there are 57 Cabinet documents associated with the Budget 2003 decision alone. Therefore, having reduced a universe of 3,425 possible decisions to 343 economy-related formal Government decisions as understood for this research, the case study selection process required a second run, to settle on a smaller and more practical number of potential cases.

To reduce the first decision-subset from 343 to, say, about five bad decisions for which official records would be sought, it was important to consider again the original purpose of the inquiry. It is widely accepted that lost national competitiveness over the period of the boom was a key element of how the crisis developed into a bust, and this aspect of economic policy is a central aspect of this research. Decisions which in hindsight were self-evidently incorrect are likely to be revealed in relation to the consideration of and response to the NCC's Competitiveness Challenge reports between 2001 and 2004 and the consideration of and response to the reports on expenditure trends and plans, and subsequent Budgets.

By examining the full universe of formal decision taken by Government at Cabinet during government meetings in 2001, 2002, 2003 and 2004, it was possible to identify via two iterations, two policy areas and over sixty instances where ostensibly bad decisions were taken, namely national competitiveness reports and public finance stability.

	Cabinet Meeting Date	**Decision Topic**
1	04/12/2001	'The Competitiveness Challenge 2001': Publication
2	19/11/2002	The Competitiveness Challenge 2002: Publication
3	25/11/2003	Competitiveness Challenge 2003 And The Annual Competitiveness Report 2003: Publication
4	05/10/2004	Competitiveness Challenge 2004 And The Annual Competitiveness Report 2004: Publication

Decisions on Competitiveness Reports 2001-2004

	Cabinet Meeting Date	**Decision Topic**
1	30/01/2001	Budget 2001: Update
2	06/02/2001	Ireland's Budgetary Policy: Commission Recommendation
3	20/02/2001	Government Policy On Public Expenditure In 2001
4	06/03/2001	Estimates 2001: Savings To Eliminate Overrun On Budget Spending Levels
5	27/03/2001	"No-Policy Change" Expenditure Projections For 2002-2003: Approval
6	15/05/2001	Expenditure Position In 2001
7	12/06/2001	2002-2004 No Policy Change Expenditure Projections
8	26/06/2001	Expenditure Review Process
9	27/07/2001	Economic And Budgetary Strategy 2002-2004
10	12/09/2001	Public Expenditure In 2001 And 2002
11	02/10/2001	Estimates 2002
12	23/10/2001	Estimates 2002
13	31/10/2001	Estimates 2002
14	06/11/2001	Estimates 2002
15	27/11/2001	"No Policy Change" Expenditure Projections For 2003 And 2004
16	27/11/2001	Estimates Of Receipts And Expenditure For The Year Ending 31 December, 2002 (White Paper)
17	05/12/2001	Budget 2002
18	30/01/2002	Budget 2002: EU Commission Assessment
19	12/02/2002	Revised Estimates For Public Services 2002 And Public Capital Programme 2002
20	26/02/2002	Estimates
21	26/03/2002	2003 Estimates/Budget Process
22	17/04/2002	Estimates
23	08/05/2002	Expenditure Review Process
24	02/07/2002	End June Exchequer Position And Approach To Expenditure Adjustments Agreed By Government

25	02/07/2002	Economic And Budgetary Strategy 2003-2005
26	26/07/2002	Estimates 2003: Expenditure Review Mechanism
27	22/10/2002	Economic And Budgetary Outlook 2003-2005
28	30/10/2002	Estimates 2003
29	05/11/2002	Estimates 2003
30	12/11/2002	Estimates 2003
31	20/11/2002	Estimates 2003
32	26/11/2002	Estimates Of Receipts And Expenditure For Year Ending 31 December 2003 (White Paper)
33	03/12/2002	NESC Report No. 109: Achieving Quality Outcomes - Management Of Public Expenditure
34	04/12/2002	Budget 2003
35	11/02/2003	Revised Estimates For Public Services 2003 And Public Capital Programme 2003
36	04/03/2003	2003 Service Plans And Expenditure Level
37	04/03/2003	2004 Estimates/Budget Process
38	23/07/2003	Expenditure Trends In 2003: Position At End May 2003
39	23/07/2003	Economic And Budgetary Strategy 2004-2006
40	16/09/2003	Expenditure Estimates 2004
41	22/10/2003	Expenditure Estimates 2004
42	04/11/2003	Estimates 2004
43	18/11/2003	Five Year Multi-Annual Framework For Capital Expenditure 2004-2008
44	22/11/2003	Five Year Multi-Annual Framework For Capital Expenditure 2004-2008
45	25/11/2003	Estimates Of Receipts And Expenditure For Year Ending 31 December 2004 (White Paper)
46	02/12/2003	Budget 2004
47	03/12/2003	Budget 2004
48	08/06/2004	Report On Expenditure Trends In 2004
49	14/07/2004	Expenditure Trends In 2004: Report
50	14/07/2004	Control And Management Of Expenditure: Report To End June 2004
51	14/07/2004	Economic And Budgetary Strategy 2005-2007

52	21/09/2004	Appraisal And Management Of Capital Expenditure
53	16/11/2004	Report On Expenditure Trends In 2004
54	23/11/2004	Estimates Of Receipts And Expenditure For Year Ending 31 December 2005
55	03/02/2004	Revised Estimates 2004 And Public Capital Programme 2004
56	27/10/2004	Estimates 2005
57	09/11/2004	Estimates 2005
58	23/11/2004	Estimates Of Receipts And Expenditure For Year Ending 31 December 2005
59	30/11/2004	Budget 2005
60	14/12/2004	E.U. Future Financial Perspectives: Policy Changes And Budgetary Means Of The Enlarged Union, 2007-2013

Decisions on Public Finances 2001-2004

However, given the broad scope of both policy areas, it was necessary to identify specific decision within each that could be subjected to in-depth, process tracing analysis. This was done with reference to the four official investigations carried out into the crisis in Ireland i.e. Honohan (2010), Regling and Watson (2010), Wright (2010), and Nyberg (2011) reports. That process is described in Chapter 7.