CENTRE FOR EUROPEAN REFORM
briefing note

Ireland's fiscal treaty referendum: (More) fear and loathing in the eurozone?

By Hugo Brady

On May 31st, Ireland will hold a referendum on the EU's 'fiscal compact'. Among other things, the new treaty obliges eurozone countries to introduce balanced-budget amendments into national law. Many observers expect a Yes vote, because the Irish economy is ailing and its government is reliant on a multi-billion euro loan administered by the EU and the IMF. But popular support for the governing coalition is in sharp decline. Voters are angry after three years of economic austerity and the No side is gaining support as public awareness of the poll increases. The balance of probability points to a close Yes, but – as opposition to austerity grows across the eurozone – an upset cannot be ruled out.

Why it may have to be Yes

Ireland will hold the only popular vote on the fiscal compact. It requires countries that use the euro to introduce balanced-budget amendments into national law or face fines from the EU's Court of Justice. The European Commission will act as policeman, ensuring that countries keep to the euro area's basic fiscal rules, which require governments to keep national debt to below 60 per cent of GDP and run very small or no public deficits.[1] These criteria appeared in previous EU treaties but were never enforced. Germany and the European Central Bank think that more credible rules on debt, along with a drastic reduction in public spending across the single currency area, will help end the euro crisis.

1 The compact was signed by all EU countries, except Britain and the Czech Republic, on March 2nd. It is formally known as the 'Treaty on stability, co-ordination and governance in the Economic and Monetary Union'.

Irish voters have rejected European treaties on the first attempt before, namely the Nice treaty in 2001 and Lisbon treaty in 2008. But they may yet pass this referendum if only because Ireland's economic situation is so dire. It is financially dependent on an €85 billion bail-out programme co-financed by the eurozone, IMF, Britain, Denmark and Sweden. The programme has paid the country's bills since 2010 when the then Irish government lost access to bond markets after assuming the colossal debts of its banks. (Anglo-Irish Bank, the worst culprit, lost over €45 billion following the collapse of the Irish property market.)

Generally, referendums tend to favour the status quo because voters fear taking risks. To win, either side needs to convince the Irish population that voting Yes or No will best secure Ireland's future prosperity. The coalition government – made up of Fine Gael (a Christian democratic party) and the Labour Party – is campaigning for a Yes. So too is the main opposition party, Fianna Fáil, along with IBEC, the largest business and employers' organisation.[2] Recent polls suggest that voters currently agree with them: 47 per cent are estimated to be in favour of the fiscal compact, 35 per cent are against, and 18 per cent are undecided.[3]

2 Fianna Fáil, a moderate conservative and nationalist party, led the government for over a decade before 2011 and remains deeply unpopular.

3 Red C poll, The Sunday Business Post, April 28th 2012. Later polls are likely to show a higher percentage of Nos.

If Ireland votes No, it can still draw on the €85 billion bail-out, scheduled to run out at the end of 2013. But its government would be denied access to its successor, the European Stability Mechanism (ESM), set up to lend up to €500 billion to euro countries in financial trouble. And Ireland may well need more

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financial help after 2013. The export sector has grown strongly since 2010. However, the domestic economy continues to shrink, partly due to the deflating property bubble, but also because of the impact of deep cuts in public spending demanded by the EU and IMF in return for the bail-out. Ireland's return to the financial markets is therefore dependent on strong demand for its exports. Irish ministers say it would be a foolish gamble to cut off the ESM life-line: they estimate that the country will need to raise at least €12 billion on the markets to meet the state's funding needs in 2014.

Aside from this fear factor, the coalition argues that it has successfully convinced international investors to treat Ireland as the 'best of the worst' amongst the troubled eurozone economies. In January 2011, investors took up an Irish government offer of a €3.5 billion 'bond swap', effectively agreeing to extend the life-time of some existing bonds. Optimistic observers have greeted the swap as a tentative first step back to economic sovereignty.[4] Yes campaigners will warn that the international opprobrium following a No vote would destroy such fragile confidence and risk a further downgrade to Ireland's already poor credit-rating. They may add the pragmatic point that – whatever the treaty's actual merits – a rejection would hardly put Ireland in a better position to demand concessions from its eurozone creditors. Unlike previous EU treaties, the treaty will enter into force in January 2013 so long as twelve euro countries ratify the text.

4 Simon Carswell, 'Fitch says Irish bond swap good news but risks loom', The Irish Times, January 28th 2012.

The Yes campaign has other advantages, too. First, the fiscal compact addresses only one area: economic policy. That makes it much less likely that the debate over ratification will be hijacked by unrelated issues such as abortion or the fear of conscription into a European army, two mainstays of popular paranoia that derailed the ratification of the Nice and Lisbon treaties respectively. Second, the compact rules will not fully apply to Ireland for many years. Under its terms, the troubled eurozone economies have until around 2035 to get their debt levels down to 60 per cent of GDP. Hence Greece and Portugal, the other two euro countries in bail-out programmes, have ratified the treaty through their national parliaments already without much fuss.

But anger needs an outlet

Nonetheless, the fiscal compact is a tough sell to voters and this will become more obvious as the campaign grinds on. First, the Irish public has suffered nearly four years of painful austerity, higher taxes, emigration and high unemployment, which stands at 15 per cent. As a result, the current government is haemorrhaging support, recording only 23 per cent backing in a poll published in April.[5] This is almost as low as the previous Fianna Fáil-led government which oversaw the initial bail-out negotiations. By contrast, Sinn Féin, a hard-line nationalist and eurosceptic party, polled 21 per cent, with its support increasing, mainly among working class voters.[6] Sinn Féin is leading the No campaign along with an assorted 'alliance' of fringe socialist groups. None of these enjoys great credibility with the public on economic issues, but this matters less in a referendum than it would in electoral politics.

5 'Tough decisions blamed for poll', The Irish Times, April 20th 2012.

6 The Irish Congress of Trades Unions has declined to take a position on the treaty, but three of its main constituent unions are openly calling for a No vote.

Second, voters are still smarting from Ireland's treatment at the hands of EU officials since 2010 when the bail-out was urged on a dazed Irish government at punitive rates of interest.[7] (EU leaders subsequently lowered the rates to around 4 per cent in mid-2011.) This resentment flared up in early 2012 after many households refused to pay a new property tax, specifically required by the bail-out agreement. Conditions are therefore set for a protest vote – particularly as it is not clear that those voters who have turned out to support EU referendums in the past are in favour of this particular treaty. Political pundits in Ireland currently predict a turn-out of below 50 per cent.

7 Hugo Brady, 'Ireland's election and the EU: From poster child to enfant terrible?', CER insight, January 28th 2011.

Ireland's referendum law makes matters even more difficult. The government is forbidden to use public money to campaign for a Yes vote, and equal amounts of public broadcasting time must be given to both sides of the argument. This means that the No campaigners are benefitting from ample media coverage, despite representing a very small number of seats in Ireland's parliament. Their main arguments are that the 'austerity treaty' will condemn Ireland to 20 years of cut-backs in public services and that the eurozone cannot afford to let the country go bust for fear of exacerbating the crisis. Therefore, they maintain, even with a No vote Ireland would still be able to borrow from the ESM. And even if other eurozone countries refused to help, the No campaigners say Ireland could still turn to the IMF without having to cede more powers to Brussels.

These arguments are simple to communicate. When trying to refute them, Yes campaigners may tie themselves in knots attempting to explain the nuances of European politics. This is because the compact changes little of substance aside from its new rule on balanced budgets. (Some officials quip that – if seriously enforced – the treaty would "make Keynes illegal".) But Germany and other North European countries want it to reassure voters who are worried about having to support further bail-outs for their allegedly profligate neighbours.

As polling day nears, eurozone leaders who worry about a No are likely to make statements that Irish voters find both threatening and condescending. (This has happened ahead of Ireland's failed referendum on the Lisbon treaty in 2008: France's foreign minister remarked that the Irish would be the "first victim" of a No vote.) This will not help the Yes side. Furthermore, another key moment will come on May 30th, when the European Commission begins using its new powers to monitor eurozone government budgets and to impose financial sanctions on those countries running 'excessive deficits'. Leaders have already ceded these new powers to the Commission, under the EU's so-called 'six-pack' or laws governing fiscal surveillance in the eurozone. They are merely re-stated in the treaty. Nonetheless, the No side is likely to point to this as a further example of Ireland's diminishing economic sovereignty.

What happens if Ireland votes No

If Ireland votes Yes, it will be a major morale boost for Angela Merkel, Germany's chancellor, after a series of political upsets. In particular, the 17 per cent of the vote won by the Radical Left Coalition (Syriza) in Greece – which opposes the country's bail-out agreement – has injected fresh uncertainty into her plans to stabilise the single currency.

But a No vote would be the popular equivalent of a 'credit event' in the politics of the eurozone crisis. France's new president, François Hollande, believes that the euro cannot be saved solely by a mix of spending cuts and tax increases, and has criticised the fiscal compact for being too one-sided. He would seize on a No vote to push harder for a new political settlement that includes a commitment to tackling unemployment and boosting business confidence by stepping up public investment in infrastructure. Simultaneously, a No vote would inflame opposition against austerity in Greece, Italy and Spain and may trigger calls for referendums to be held on the treaty in other countries.

President Hollande will not antagonise Merkel, a key ally, by openly calling for a No vote. But unless he makes his position on the fiscal compact unequivocally clear, the No side will be able to convince many Irish voters that a re-negotiation of its terms is possible. In any case, Hollande has to maintain some of the anti-austerity rhetoric he used on the campaign trail while his Socialist Party campaigns for elections to the French national assembly on June 10th and 17th.

Merkel would be dismayed at an Irish rejection of the fiscal compact but is likely to assert that it is politically untenable for a recipient of bail-out assistance not to sign up to greater fiscal discipline. (As with previous treaties, Ireland may even be asked to vote again.) She will continue to oppose calls for a move towards some form of debt mutualisation (also known as 'eurobonds') or a re-interpretation of the role of the ECB so that it can act as a lender of last resort to eurozone governments. The German chancellor has her own political and legal constraints at home: it is not certain that even the ESM will pass muster with Germany's constitutional court when judges rule on the measure later this year.

In the short term, the financial markets will interpret this as meaning that the EU has no politically viable plan to save the single currency. Until recently, many international investors had hoped that the combination of spending cuts, the creation of an ESM and cheap loans to banks from the European Central Bank (ECB) were part of an evolving political game that would eventually stabilise the eurozone. An Irish No vote would exacerbate the resurgent fear that this is not the case, bringing borrowing costs in Italy and Spain to even more unsustainable levels. (Interest rates for Spain are rising to this point already and Italy is not far behind.) The crisis would return to where it was in November 2011 – before the fiscal compact was agreed – when some felt European leaders had only ten days to save the eurozone.[8]

[8] *David Gow and Tania Brannigan, 'Save the euro in ten days or see the euro disintegrate, ministers are warned', The Guardian, November 30th 2011.*

A second battle of the Boyne?

The eurozone crisis is a dialogue of the deaf between two rival schools of thought. On one side, the ECB, Germany and other North European countries, say that the future of the single currency can only be secured by restoring business and consumer confidence through the cleansing effect of fiscal discipline. The other –

opponents of austerity in southern European and elsewhere, the IMF and most respected economists – think the euro is structurally flawed and, worse, that the public spending cuts intended to stabilise it are pushing Europe into an economic depression.

The former might derisively be called 'monetarist-liquidationists' by opponents; the latter, 'neo-Keynesians'. International investors, whose main object is to make money, are on no specific side but will react negatively to any political uncertainty that endangers their investment in government bonds. All sides have a stake in Ireland's referendum on the fiscal compact, especially the liquidationists: the point of the treaty is largely to reassure their own voters rather than to overhaul how the eurozone works.

Nonetheless, a No vote would more likely harden national positions across the continent rather than nudge EU leaders to come up with a more balanced approach to saving the euro. Meanwhile, the crisis would move to a new, more dangerous level unless political solutions could be arrived at quickly. Most proponents of a Yes vote would agree that the compact does not directly address the euro's structural flaws nor the need to get the eurozone economy growing again.[9] But the hope is that the compact will buy Merkel and others political capital to come up with solutions that are more likely to work. This will be easier if there first exists a clear, common set of fiscal rules to which all euro countries are solemnly committed.

[9] Ronan Lyons, 'The fiscal compact - vote yes to silliness (it's all about the cash)', March 13th 2012, http://www.ronanlyons.com.

Ireland has played host to key international contests before in its history. In 1690, it was the scene of the battle of the Boyne, where William of Orange defeated James II, an event that helped shape the future of Europe. In a way, the same may be true of its referendum on the fiscal compact. The only question remaining is whether fear trumps anger – or vice versa – in Ireland on May 31st.

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