Small States, Nationalism and Institutional Capacities: An Explanation of the Difference in Response of Ireland and Denmark to the Financial Crisis

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Abstract

This paper uses theories of small states (e.g. Katzenstein) and nationalism (e.g. Gellner) to explain why Denmark and Ireland responded to the 2008 financial crisis in different ways. In Denmark, a coordinated market economy with considerable corporatism and state intervention, the private sector shouldered much of the financial burden for rescuing the banking sector. In Ireland, a liberal market economy without much corporatism or state intervention, the state shouldered the burden. The difference stems in large part from the fact that Denmark had comparatively thick institutions and a strong sense of nationalism whereas Ireland did not. Lessons for the theories of small states and nationalism are explored.

Keywords: Capacities; Denmark; Ireland; Financial Crisis.

THis paper is about how two small, culturally homogeneous nation-states—Denmark and Ireland—responded very differently to the 2008 financial crisis.¹ In Denmark, often described as a coordinated market economy with considerable corporatism and state intervention, the private sector shouldered much of the financial burden for rescuing the banking sector. But in Ireland, often described as a liberal market economy without much corporatism or state intervention, the state shouldered the burden. Why would a coordinated country take a market-based solution and a liberal country take a statist solution? After all, liberal market economies allow market

¹ In terms of arable land mass and population, Denmark and Ireland are among the smallest countries in the OECD. They are also among the most ethnically, religiously, and linguistically homogeneous (Patsiurko et al. 2013, 2012).
actors to fend for themselves more than in coordinated market economies where they often receive assistance in times of difficulty (Hall and Soskice 2001; Soskice 2007; see also Albert 1993; Shonfield 1965). The answer lies to a considerable degree in each country’s different institutional capacities. However, understanding these capacities and how they developed and operated requires that we turn to two theories in comparative political economy that rarely speak to each other—Peter Katzenstein’s theory of small states and Ernest Gellner’s theory of nationalism. These theories allow us to specify the relationships between small states, nationalism, and institutional capacities that shaped each country’s response to the crisis.

Katzenstein (1985) argued that small states are vulnerable because of their dependence on international trade and their need to navigate geopolitical seas dominated by larger states (see also Cameron 1978; Garrett 1998; Jones 2008). Fear associated with vulnerability concentrates minds whilst small size allows close linkages among decision makers and other elites. In his view this situation led to corporatism—defined as (1) a centralized system of interest groups, (2) decision-making through continuous political bargaining between business, labor, the state, and political parties, and (3) a national ideology of social partnership. Much has been written about the first two points (e.g. Becker and Schwartz 2005; Hemerijck et al. 2000; Ó Riain 2004; Schwartz 1994, 2001), but little about the ideology of social partnership.

This brings us to the theory of nationalism. Nations, by which we mean groups with a common cultural heritage, are also often vulnerable, with dense linkages due to a shared sense of belonging (Gellner 1983; Hall 2010). So cultural homogeneity can be a useful resource for a modern society because it too allows those engaged in bargaining to understand each other without the sorts of religious, ethnic, racial or linguistic cleavages that might otherwise undermine cooperation (see also Bates 2008; Laitin 2007; Posner 2005). Put differently, cultural homogeneity breeds the national solidarity that can serve small states well, and many culturally homogeneous nation-states have been highly successful (Alesina et al. 1997, 2003; Patsiurko et al. 2013, 2012).

Our explanation for why Denmark and Ireland managed the financial crisis in such different ways can be highlighted immediately. Each country experienced the difficulties of scale and nation in different ways. This led to the development of rather particular institutional capacities for political decision-making. Denmark’s institutional capacities were much “thicker” than Ireland’s, as we
shall explain. When the financial crisis hit, institutional capacities shaped each country’s policy response. So we argue that institutions are the proximate causal factors whose antecedents are each country’s experience with small state vulnerability and nationalism.

Denmark fits the pattern as predicted by the small states and nationalism literatures. A long history of small state vulnerability led to the development of corporatist institutions, a well-developed state apparatus, and a robust, competitive political party system. Vulnerability also led to a strong sense of national solidarity, as did Denmark’s experience of becoming a culturally homogeneous nation. Hence, when crisis struck, Denmark had strong regulatory oversight, input from experts and interested groups, and inclusive and consensus-oriented decision-making. It also had a stronger sense of doing what was right for the nation as a whole. As a result, Danish crisis management was geared toward protecting the interests of the people (i.e., taxpayers) and the public budget rather than the individual banks and their investors. As a result, the banks paid for the bailouts.

In contrast, as a member of the British Empire until 1922, Ireland did not experience such a long history of small state vulnerability. Rather than developing corporatism and deepening the state apparatus, Irish politics was marked by a fragmented civil society and a state staffed more on the basis of tradition than merit. Moreover, nationalist disputes—both over the North and relations with Britain—undercut the potentially unifying effects of cultural homogeneity and spilled over into party politics, thereby ensuring a near hegemonic grip by the nationalist party, Fianna Fáil, in ways that both subverted competitive party politics and exacerbated cronyism. So when the crisis hit, Ireland had weak regulatory institutions, a dearth of economic expertise, and a decision-making process that involved much opaque backroom deal-making that favored the interests of individual banks over the interests of the nation as a whole. As a result, Ireland decided to protect the troubled banks with a massive, publicly-financed state guarantee at enormous expense to taxpayers and the public budget.

The theoretical implications of this are threefold. First, the beneficial effects of small size may be diminished if the small state exists within the protective realm of a larger one that shields it from vulnerability and thereby undermines the development of institutions fostering the cooperation, self-sacrifice and flexibility that the small states literature deems important. This was the Irish case because it
had been subject to colonial dependency; it lacked the long history of autonomy enjoyed by Denmark. Second, the effect of cultural homogeneity is not inevitably beneficial. It depends on how the nationalism that arises from it is expressed and institutionalized in political terms. In Ireland nationalism was distorted in detrimental ways because the founding nationalist party gained a hegemonic position that fostered corruption. This was not the situation in Denmark where nationalist sentiment led to more power-sharing among political parties. Third, and perhaps most fundamentally, the experience of nationalism and small state vulnerability are important determinants of how thick or thin the institutions are that affect how policymakers handle a crises when it occurs.

Our argument is not about the causes of the banking crises in Denmark and Ireland but rather the immediate responses to it. As it happens, the causes were similar. Domestic credit provided by each country’s banking sector as a percentage of its GDP was higher than in any other European country except Iceland and Cyprus (Hardiman 2013). The collapse of domestic housing bubbles triggered crises in both countries. The scale of both crises appeared to be overwhelming to those involved. Analysts today might see things differently with the benefit of hindsight. But Mario Draghi, the current European Central Bank President, when asked about how the crisis was handled in Ireland, reminded us that it “is a very big mistake to look at past events with today’s eyes. You should go back and consider what was the situation at the time” (Boland and Spiegel 2014). Still, no two countries experience a crisis in the same way and differences are to be found here (Gourevitch 1986). On the one hand, the assets of Ireland’s financial industry were three times as large as GDP; in contrast, the Danish industry’s assets were only twice as large (Woll 2014). On the other hand, Denmark’s real estate market was more overvalued and its funding was more susceptible to volatility. Overall, it is hard to say whether Denmark or Ireland was at the greatest risk when the crisis hit. Researchers who have examined financial crises in several countries—not only Denmark and Ireland—have concluded that there is little in the way of differences in domestic exposure to the financial industry and real estate markets that explains the very dissimilar responses in these countries to the financial crisis (Grossman and Woll 2012; Kluth and Lynggaard 2013; Woll 2014).

In this article, we begin by drawing a contrast between thick and thin institutions. Second, we review in more detail the Danish and Irish responses to the financial crisis. Third, we discuss each country’s
unique institutional portfolio—the background against which crisis management occurred. Denmark had thick institutions while Ireland had relatively thin ones. We describe how these differences stemmed from each country’s unique experiences with small state vulnerability and nationalism. Fourth, we explain how these institutions shaped each country’s response to the financial crisis. We begin our conclusion by considering and largely refuting an alternative argument according to which it was the presence or absence of pressure from the European Central Bank (ECB) rather than domestic institutions that explains the difference between the Danish and Irish cases. Final thoughts contrast our institutional argument with others in the field, before offering reflections on size and nation.

Our analysis is based on documents, secondary literature, and 21 in-depth interviews we conducted in 2012-2013 in Ireland and Denmark with politicians, regulators, bankers, journalists, and academics involved in, or knowledgeable about, the events in question. The interviews were especially helpful insofar as much is known about the policies each country pursued in coping with its financial crisis, but little is known about the decision-making processes involved (e.g. Kluth and Lynggaard 2013; Woll 2014). The interviews shed considerable light on these processes. We conducted the interviews following an open-ended semi-structured questionnaire designed to reveal the political processes involved. On average, the interviews took approximately about 75 minutes and were recorded digitally and then professionally transcribed. As we rely a good deal on information obtained in these interviews we refer to them in footnotes according to the name of the person interviewed regardless of whether or not we quote that person. To conserve space we only footnote their institutional affiliation in the first citation.

Ours is a small N study based on two national cases. Each case discusses the historical development of institutions and national identity, so as then to show how they influenced subsequent policy decisions. Given the small number of cases, our approach does not offer the benefits of generalizability. However, small N studies like this are well suited for testing causal arguments and discovering new hypotheses (Rueschemeyer 2003). This is certainly true here. In this case these theories and hypotheses are those associated with the literatures on small states and nationalism, which to our knowledge have never been brought together in order to explain how countries responded to the financial crisis.
This paper concerns institutional capacity broadly construed. Following Michael Mann (1984), infrastructural power is taken as developed administrative institutions that allow states to penetrate their societies effectively, not least so as to foster economic success. Scholars generally agree that a basic set of sound state institutions, such as the rule of law, clear and enforceable property rights, and a well-developed, professionally-oriented bureaucracy, are necessary to promote prolonged economic growth and social stability (Barzel 1989; Evans and Rauch 1999; North 1990; Weiss 1998).

But states also need transmission belts linking them to society in order for this to take place. Civil society must have well institutionalized organizations representing group interests capable of engaging in what Richard Samuels (1987) called the politics of reciprocal consent with their states. For instance, research on the benefits of corporatism in Western Europe and strong states in Asia showed that without well-organized interests in civil society—that can keep states apprised of the condition of the economy and the needs of economic and social actors—states have great difficulty in formulating policies that will facilitate growth and prosperity (e.g. Berger 1981; Evans 1995). Nevertheless, it is necessary to find the right balance. States must not be so close to organized interests as to be captured by them and succumb to corruption, nor must they be so far removed from these interests as to be cut off from the vital information they can provide. In the words of Peter Evans (1995), states should enjoy embedded autonomy.

Let us be clear. Institutions are formal and informal rules, including monitoring and enforcement mechanisms, and systems of meaning, including identities that define the context within which individuals and organizations operate and interact with each other (Campbell 2004: 1). The importance of formal and informal rules was emphasized by Katzenstein. The importance of systems of meaning and identity was emphasized by Gellner.

Of course, institutional capacities are variable and multidimensional. To capture this we distinguish between “thick” and “thin” institutions along three interrelated dimensions. First, thick institutions are similar to Weber’s notion of legalistic and professional bureaucracy. Crucially, bureaucrats are recruited on the basis of expertise rather than of tradition or cronyism. This is important so that policy—particularly policy that involves technically complex issues like
banking and finance—is made with input from people who are able to judge effectively and in a relatively objective manner the likely effects of various policy options. It should be remembered that institutions in both the public and private spheres can be characterized as thick and thin.

One clarification is necessary. The notion of institutional thinness should not be equated with cronyism, by which we mean corruption, bribery, and influence peddling (Kang 2002). Our concept of thin institutions goes beyond that and includes the institutional traditions and infrastructure that impedes the cultivation and recruitment of experts and prevents expertise from being available to policymakers; the relative institutional disorganization of civil society, as experienced by countries without corporatism or other forms of interest intermediation; and the institutions that undermine transparency in the policymaking process. In other words, thin institutions give rise to cronyism but should not be reduced to it.

Second, the thick institutions with which we are concerned are oriented toward the goals of the nation as a whole, rather than particular interests within it. As Katzenstein noted, this is one reason why corporatism was a successful form of political economy—it facilitated the sort of dialogue that led to a common understanding of the national interest and the political fortitude to pursue it through public policy. Orienting institutions toward national goals was also important for Gellner insofar as it was a way to bring about social peace and consensus.

Third, thick institutions are those that have developed over a long enough period of time to allow them to gain legitimacy in society. Thin institutions are less developed and less taken-for-granted—indeed some question their legitimacy, hoping that they can be changed. If institutions are viewed as serving the interests of the few rather than the nation as a whole, the possibility of a failure of legitimacy increases and the policies emanating from these institutions may be suspect and called into question (Habermas 1973). Again balance is paramount. Policymaking that is either excessively technocratic or excessively open to the interests of particular social groups can suffer from a deficit in legitimacy (Collins and Evans 2007).

This last point is as true of systems of meaning as it is of the formal institutions of state and civil society. In this regard it is worth remembering the words of George Bernard Shaw (1907: xxxiv-xxxv) in his discussion of nationalism:
A healthy nation is as unconscious of its nationality as a healthy man of his bones [...] But if you break a nation's nationality it will think of nothing else but getting it set again. It will listen to no reformer, to no philosopher, to no preacher, until the demand of the Nationalist is granted.

Thus when nationalism is buried and consensual—that is, when nation-building has taken place—it can help small states cope with the challenges of vulnerability. But if nationalism is closer to the surface and contested, it can have such nasty consequences as political division, acrimony and corruption.

Our conceptual point is that the relative thickness of institutions determined to a considerable degree the policy responses taken in Denmark and Ireland to the financial crisis. These institutional differences are the critical independent variables in question—variables that are the manifestation of each country’s experience with small state vulnerability and nationalism and that have been largely ignored in previous treatments of the crisis. As such, rather than being simply a general comparative institutional history, we take a sociocultural approach to what is typically seen as simply an economic phenomenon.

The crisis responses in brief

This section describes each country’s response to its banking crisis. In effect, this section presents the dependent variable for our two cases. Subsequent sections explain the variation in crisis responses that we delineate here.

Denmark's bank packages

Denmark’s response to the crisis was state-led but largely privately financed. Nationalization of banks was not an option but imposing haircuts (i.e. losses) on bank debt holders, recapitalizing and consolidating banks, and financing much of this privately most certainly was. All of this was worked out over four years in the form of five “Bank Packages” agreed to in the Folketing (parliament) (Bjerre-Nielsen and Lang 2011; Danske Bank 2012; Woll 2014).

The first package, in place from October 2008 through September 2010, involved an unlimited state guarantee for depositors and senior unsecured debt to all banks belonging to the Private Contingency...
Association (pca)—a banking industry organization for dealing with distressed banks. It was financed with DKK 35 billion (€4.5 billion) from the banking sector to the pca. Only if these funds ran out would the state guarantee become liable. Further, the government and pca established the Financial Stability Company tasked with winding down financial institutions that had become insolvent. It was designed to avoid a run on the banks that would undermine the stability of the Danish currency. It is important to highlight the fact that its efforts were geared primarily toward national rather than private interests.

The second package, established in February 2009, was a recapitalization scheme whereby banks were given the option of selling bonds to the government, which could eventually be paid back. If they were not paid back, they could be converted into equity shares. The state could then sell these to private investors thus insuring against serious losses, indeed perhaps even making a profit. Fifty banks and mortgage lenders applied for capital contributions for a total of DKK 63 billion (€8.2 billion) by the closing date.

However, in order not to overburden taxpayers the idea of the third package, introduced in March 2010, was to replace the state guarantee in the first bank package, which was scheduled to expire later that year. Distressed banks would now be closed temporarily, all unsecured and uninsured creditors would be subjected to haircuts, and depositors with deposits over DKK 750,000 (€97,500) would be exposed to losses. As it turned out two banks—Amagerbanken and Fjordbank Mors—went bankrupt in 2011 and haircuts were imposed on senior creditors. Denmark was the first country to impose haircuts on senior creditors in the wake of the global financial crisis.

The fourth bank package, launched in September 2011, was a response to the negative reaction of the financial markets to the haircuts imposed during the previous package. The fourth package sought to facilitate the consolidation of small and medium-sized banks into larger entities. In short, under this plan a healthy bank would take over a distressed one. The Financial Stability Company and the Guarantee Fund for Depositors and Investors—similar to the FDIC in

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2 The state eventually took over the activities of seven distressed banks. 132 of 138 banks applied for the government guarantee and thus had to contribute to the pca. When the Stability Package expired, the state had lost approximately DKK 12 billion (€1.6 billion) but covered this loss with funds drawn from the pca and associated pledges and guarantees from the banks (Bjerre-Nielsen and Lang 2011: 2-4).
3 Peter Straarup, former CEO Danske Bank.
4 Peter Straarup.
the United States—would provide guarantees and compensation to private firms willing to take over a distressed bank or its risky assets. In effect, they provided a dowry to private companies willing to take over a troubled bank. But haircuts could still be imposed on those holding debt in the distressed bank. The Financial Stability Company took over or wound down twelve banks by the summer of 2012.

The final bank package of March 2012 afforded banks the possibility of transferring commercial real estate to the Financial Stability Company. Overall, then, the costs of handling the Danish crisis would be borne largely by the banks and investors and not by the state.

**Ireland’s guarantee and bailout**

Things were simpler in Ireland. When the global financial crisis hit, the Anglo Irish Bank revealed in private that it would default without government support. Both the Bank of Ireland and the Allied Irish Bank (AIB) admitted that without help they would also be in trouble. The Cabinet met on 29 September 2008, and decided that night to issue a complete state guarantee to Irish banks, potentially involving a commitment of over €400 billion with no plans for haircuts or private financing.

The National Asset Management Agency (NAMA) was set up in 2009 to repair the balance sheets of key financial institutions that had made major bad loans in the housing and property development markets. Five banks joined: Anglo Irish, AIB, Bank of Ireland, Irish Nationwide Building Society, and EBS Building Society. The banks began turning over loans to NAMA in 2010 in exchange for government-guaranteed securities. The first phase of transfer involved €71 billion in outstanding loans. Haircuts were not imposed. Thus, the state agreed to recapitalize these banks although it ended up borrowing from the European Central Bank (ECB) to do so.

As the state gave more and more money to the banks, a liquidity/solvency crisis was transformed into a state fiscal catastrophe. In 2010 Ireland was forced to apply to the European Union for bailout funds. With mounting concern that Ireland would go bankrupt, ECB President, Jean-Claude Trichet, brought pressure to bear, insisting that a full bailout was necessary to ensure the stability of the Irish financial system and in turn prevent a contagion that would compromise the Eurozone itself (Boland and Spiegel 2014). A €67 billion bailout from the ECB was taken, again without haircuts being imposed
on bondholders—many of whom were German and French.\(^5\) Taxpayers suffered while bondholders lost nothing.

In sum, the corporatist state in Denmark made the banks pay while the liberal state in Ireland guaranteed them. In order to explain how these decisions were made we first need to understand the different institutional settings in which decision-making occurred.

**Institutional surroundings**

**Denmark: nationalist unity and thick institutions**

Denmark has been a sovereign state for centuries, for a long period possessing a medium sized empire with a heterogeneous mix of people from various religious, linguistic and ethnic backgrounds. However, the realm suffered a series of humiliating defeats and territorial forfeitures culminating in the loss to Germany of Schleswig and Holstein in 1864, leaving behind a culturally homogeneous rump state populated wholly by Danish ethnics. The result was a strong sense of vulnerability and national identity that was heightened further by Nazi occupation nearly 80 years later and that has persisted ever since (Ostergaard 2006; Korsgaard 2006).

Nonetheless, the country’s history of absolutism and empire building left behind a powerful state apparatus. Further, Denmark has a significant history of constitutional democracy. In 1849 a liberal democratic constitution was introduced finalizing the shift away from absolutism. Since then politics has come to be marked by truly competitive political parties across a wide ideological spectrum but often sharing power.

Following the 1864 debacle there was general realization of vulnerability insofar as another military defeat could eliminate the Danish state from the map (Kaspersen 2013, chap. 2). In consequence, institution building was initiated—from below as much as from above, from folk high schools to advanced welfare provisions—designed to further unify the Danes as a people. National identity is now secure and unquestioned, and this strand of institutional life is thick. Today Denmark is often described as a coordinated market economy in which all participants embrace the notion that they are

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\(^5\) Philip Lane, Trinity College Dublin.
part of a “community of fate” that must act in concert for the good of the nation (Pedersen 2006).

Such nationalism engendered a strong propensity for negotiation and consensus that was then institutionalized politically. It is rare that a government can be formed without at least one coalition partner. Further, the rules of parliamentary procedure encourage the consultation of opposition parties as a matter of course. Moreover, legislative rules are such that the executive branch does not overwhelmingly dominate the legislative branch; the two must work together to get things done. The importance of seeking consensus is still reinforced by the taken-for-granted belief that people need to pull together in a small country like Denmark in order to cope with major international pressures.6

Finally, Denmark has developed impressive institutional capacities for expert economic analysis (for a very detailed account see Campbell and Pedersen 2014, chap. 5). The use of independent expert advisory commissions is common and their recommendations often constitute the basis of legislative proposals in parliament. There are several reasons for the centrality of such expertise to policymaking. The economics departments at the University of Copenhagen and Arhus University have well-established graduate programs in quantitative economics. State bureaucrats working on economic policy generally graduate from these departments.7 Most importantly, however, in the wake of stagflation and the fiscal crises of the 1970s the political parties began to set aside ideological arguments in favor of those based more on sound economic analysis. They realized that this was necessary not only to resolve these crises but also to bolster Danish competitiveness in increasingly global markets. This depoliticization of economic policymaking was the direct result of nationalist considerations and, as such, an extension of the 19th century legacy of bolstering the Danish nation in the face of small state vulnerability.8

Overall, then, due to a series of responses to its nationalist and small state heritage, Denmark was characterized in the early 2000s by a number of thick institutions that facilitated negotiation, consensus making, and social partnership. These included extensive institutional capacities for expert analysis in economic matters. As we were told in one interview, the institutional capacities for cooperation, consensus making, and expert analysis are very much taken for granted—that is,

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6 Mogens Lykketoft, Danish Parliament.
7 Henrik Bach Mortensen, Danish Employers Association; senior official, Danish National Bank; senior official, Danish Bankers Association.
8 Senior official, Danish National Bank; Henrik Bach Mortensen.
legitimate—and rooted deeply in a common national identity; the Danes have learned that they live in a small vulnerable state and therefore must pull together.\(^9\)

**Ireland: nationalist division and thin institutions**

While Demark was once a medium sized empire with a developed state apparatus of its own, Ireland suffered from a long history of colonial repression, which stunted the development of its economy and state apparatus (Kirby 2010). Denmark was unified as a culturally homogeneous nation by the early 20\(^{th}\) century while Ireland was torn apart until very recently by nationalist conflict over its relationship both to the North and to Britain. And while Denmark was exposed and vulnerable to international forces for centuries, Ireland was protected by Britain until it won its independence in 1922. As one respondent put it, “We’re still a very young state, still learning how to manage the shop while the parents are away”.\(^10\) As a result, Ireland’s institutional capacities were much thinner than Denmark’s.

The national question remained unresolved far longer in Ireland than in Denmark. Even after Irish independence, partition between the North and South meant that there would be an open wound within the new state. Some wanted to unify the island but others accepted the division. In 1922 this dispute led to a short but brutal civil war. The Free State slowly lost its Protestant population, through accommodation and exit, thereby becoming more homogeneous in ethnic and religious terms. But the country remained deeply fractured with the identities of the two main political parties—Fianna Fáil and Fine Gael—thereafter based on the civil war divisions. The former was far more anti-British than the latter, but in policy terms both belonged to the center-right of the political spectrum. In further contrast to the way in which small state vulnerability had served to unite Danes as a nation, a measure of continued protection from England after independence, notably in military matters, enabled nationalist divisions to continue festering in Ireland.

A measure of accommodation was achieved in 1932 when Fianna Fáil formed a government, thereby allowing the entire population to participate in national developments. But even this did not end the fracture at the heart of the state. Fianna Fáil “defined itself very early on not as a party but as a national movement”, which helped ensure its

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9 Senior economist, Danish Bankers Association.
10 Ruairi Quinn, Minister for Education and Skills.
hegemonic position for decades to come. The party had the character of a Southern European populist affair: politics backed by constant appeals to a particular version of nationalism rooted in its insistence that the North needed to be reclaimed.\textsuperscript{11} But there is another factor that helps explain its hegemony. The Irish proportional representation system is largely based on multi-member constituencies that encourage local engagement and cronyism at the expense of forward thinking expertise—a condition whose legitimacy was criticized in several interviews including by one person who was so disillusioned with this system that he left politics altogether.\textsuperscript{12}

The institutional character of the Irish electoral system differs greatly from that of Denmark because of Ireland’s historical relationship with Britain. The political system was based on that prevalent in Westminster. The executive branch very much dominated the legislative branch thanks to the Westminster style of the party system, which had fewer checks and balances than the Danish one. Nor was there a committee structure in place in parliament which would have created consensus (Hardiman 2012: 217-220). Similarly, the Irish cabinet system, also modeled on Britain’s, was less inclined toward exercising real collective responsibility than the Danish system. This was not a world based on continual consultation with the other parties but rather a case of winner-take-all politics. It was a world whose institutional character was shaped by the country’s unique past as a small state under the protection of a powerful neighbor.

Insofar as civil society was concerned, Ireland only flirted with corporatism thanks to its liberal heritage from Britain. Experiments with corporatism occurred since the 1960s but they broke down in the late 1990s.\textsuperscript{13} Moreover, the trade association for the construction industry, which represented a large proportion of the Irish economy, never belonged to the Irish Business and Employers Confederation (IBEC), the peak association representing most other industries. And the multinational sector had greater access to the state than other sectors.\textsuperscript{14} In sum, neither the business community nor labor was nearly as well organized collectively as they were in Denmark. This created further opportunities for individual rather than national interests to influence policy makers.

\textsuperscript{11} Rory O’Donnell, Director, National Economic and Social Council. Its hegemony was also reinforced by the absence of a serious labor or social democratic party challenge.

\textsuperscript{12} Dan O’Brien, \textit{The Irish Times}; George Lee, RTÉ and former Fine Gael parliamentarian.

\textsuperscript{13} Rory O’Donnell; Tony Donohoe, Irish Business and Employers Confederation.

\textsuperscript{14} David Begg, Irish Congress of Trade Unions, and Central Bank board member.
Compared to Denmark, Irish regulatory institutions were also thin, especially regarding the multinational sector (Ó Riain 2014). State agencies were modeled on the British example: “the philosophy is British nineteenth century [liberalism]”.¹⁵ Very much related to this, the necessary economic expertise was in comparatively short supply within the state (Donovan and Murphy 2013: 88). This was again due in large measure to Ireland’s historical relationship with Britain and its nationalist heritage. First, the Irish education system, having been modeled on that of 19th century Britain, favored economic theory rather than quantitative economics. Second, the Catholic Church, whose seminal role in the development of Irish nationalism is well known, rode roughshod over education, especially in the countryside, and concentrated on teaching the humanities and religion at the expense of economics and science. The purpose was in effect to fortify the nation by cultivating future generations of good Catholic citizens. Third, Irish families pushed their children to pursue high-status careers in medicine or law rather than in economics or other less prestigious fields if they scored highly on national tests.¹⁶ Fourth, key regulatory appointments had little to do with economic expertise. For instance, the Governor of the Central Bank traditionally came from within the civil service; its Board of Governors lacked economists and according to tradition included lawyers, union representatives, and people from the arts and humanities; and the Financial Regulator at the time of the crisis had served in the civil service since he was seventeen.¹⁷ Many other appointments to both the Central Bank and Department of Finance were based on patronage rather than qualifications—a long-standing practice in Irish politics. Fifth, the Irish state was much less reliant on expert advisory boards than Denmark (Hardiman 2012: 217-20). Finally, the Official Secrets Act—another British bequest—restricted the degree to which people inside the state could discuss policy with experts outside the state.

In sum, Ireland’s thin institutions emerged from and reflected its rather different history of small state vulnerability and nationalism. Thanks in part to Fianna Fáil’s hegemonic position, rooted in on-going nationalist disputes, there was much less collective negotiation or consensus-oriented policymaking than in Denmark. Combined with its unique political institutions this meant that policymakers were

¹⁵ John Fitzgerald, Economic and Social Research Institute.
¹⁶ Cormac O’Grada, University College Dublin.
¹⁷ Philip Lane. The Central Bank Governor in 2008 had a legal background.
more responsive to individual rather than unified national interests. They also had less access to professional expertise than in Denmark. Finally, the legitimacy of these institutions was questionable in the minds of many people. The next section explains how institutions shaped each country’s response to the financial crisis.

*Explaining responses to the crisis*

**Thick institutions and Danish resilience**

From the 1990s onwards there was a booming housing market in Denmark. But things began to sour badly in late 2007 with a sudden drop in housing prices that was among the sharpest in industrialized countries and even worse than in Ireland (OECD 2009: 18). As prices fell some small and medium-size banks began experiencing difficulty in raising capital due to their aggressive lending policies and heavy exposure in the building sector. Bank Trelleborg became insolvent. Roskilde Bank, Denmark’s eighth largest, went bankrupt and, in 2008, the National Bank put it up for sale. Moreover, Danske Bank, Denmark’s largest, was so deeply invested in the Irish and Baltic banking sector that investors were unsure how sound was its balance sheet (Woll 2014). With the onset of the international financial crisis in 2008, the international capital markets froze and Danish banks suffered severe liquidity problems.

This was not the first time Danish financial firms had run into trouble. Several had done so when the Nordic countries were hit by a financial crisis in the late 1980s and early 1990s. Three consequences contributed to institutional thickening. First, in 1994 the public Guarantee Fund was established to help distressed financial institutions cover their liabilities and if necessary the costs of winding them down. But when this was deemed contrary to EU rules, the industry set up a private alternative in 2007, the PCA for distressed banks. This eventually became the backbone of the Danish bailout program (Woll 2014). Reflecting Denmark’s corporatist heritage, virtually all banks are members of the PCA (Kluth and Lynggaard 2013). Second, legislation was passed that removed the right of shareholders to veto the transfer of distressed bank assets to other

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18 Kent Petersen, Union of Financial Sector Employees; Henrik Bach Mortensen.
19 Senior official, Danish National Bank.
firms rather than go into bankruptcy. Under the law, the bank’s board had strong powers to transfer troubled assets to another bank if it was facing solvency problems. Why? “The interest of financial stability requires that shareholders [...] will just have to be wiped out if that’s necessary”.20 Put differently, the national interest trumped the interests of individual investors—a precedent that carried significant weight going forward, as we shall see. Third, in 2007 the Financial Supervisory Authority (fsa) joined forces with the Danish National Bank and the Ministry of Economic and Business Affairs to consider ways of bailing out banks in the event of a crisis. The Financial Stability Company came together with representatives from each organization to discuss the issue and run simulations as to how to handle a bank failure. Based on their analyses they fashioned a rudimentary set of crisis guidelines just in case they ever needed to bail out an individual bank in the future.21 This resulted in the further institutionalization of experts and professional economists in helping to manage Danish economic policy. In addition to Denmark’s already thick institutional legacy these three institutional changes proved to be important when the financial crisis hit.

To begin with, the decision to impose haircuts on bank creditors and avoid the state shouldering the financial responsibility for rescuing the troubled banks was rooted in the legacy of the banking problems of the 1990s where, “everybody just said this is how it should be: If you supply risk capital to private firms, you should be losing money if the bank goes into trouble [...] this was not a sort of point of debate [...] This was the accepted norm that this is how it should be”.22 In particular, the Financial Stability Company believed that “the consistent principle is that shareholders or the investors should pay in line with the principles of bankruptcy”. By 2008 these expert-supported views were taken for granted by almost everyone and, as a result, helped set the stage for the haircuts and privately funded bailouts imposed by the bank packages.23 Few wanted taxpayers to shoulder the financial burden of bailouts. They wanted to protect the national interest, not the interests of individual banks or investors.

Negotiation, consensus and experts played a major role in managing the crisis. Echoing long-standing corporatist traditions the Danish

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20 Henrik Bjerre-Nielsen, Financial Stability Company.
21 Henrik Bjerre-Nielsen; senior official, Financial Supervisory Authority; senior official, Danish National Bank.
22 Senior official, Financial Supervisory Authority.
23 Henrik Bjerre-Nielsen.
National Bank, the Danish Bankers Association, and the Ministry of Economic and Business Affairs took the lead in negotiating the first bank package, including forcing the banks to pay for it by contributing to the pca. Throughout the negotiations over the bank packages, the Bankers Association was in close contact with its members, easily able to garner their support for its ideas. The FSA and the Financial Stability Company were also involved. Labor, as represented by the Union of Financial Sector Employees, was not represented but agreed with much of what was decided. So did all the political parties, except the Socialist People’s Party on the far left.

There were several reasons for such agreement. First, there was general consensus at the time that great danger loomed for this small and vulnerable state: the national interest was at stake. The Danish banking sector—above all, Danske Bank—faced a major liquidity problem following the failure of Lehman Brothers. It was feared that something needed to be done very quickly or the banking sector would collapse. This is why it was agreed in the first bank package that the government would simply issue a blanket guarantee to depositors of all banks—albeit a guarantee backed by private funds.

Second, the National Bank and the FSA had considerable information about the condition of the banks to help guide them in crisis management. In fact, they were the only ones with access to all the banks’ balance sheets. The state’s thick institutional capacity in this regard was quite clear during negotiations about the bank packages. People tended to defer to the National Bank by virtue of the fact that its information was the best available.

Third, there was general recognition that the very technical issues involved required experts and professionals who knew what they were doing. Politicians lacked such expertise and were reluctant to get too involved for fear of messing it up. So the National Bank, the Ministry, and the Bankers Association with the assistance of the FSA and Financial Stability Company developed this together (Finansforbundet 2009: 8). Once they were done, they presented the package to the political parties and banks; their plan was accepted without fuss and passed into law. In fact, all the bank packages were formulated without much formal input from anyone else,
including the labor unions or business peak associations, with the exception of the Bankers Association. There were, however, informal backchannel communications with them.\textsuperscript{29} The political parties were formally involved only late in the process when they had to approve the packages in parliament.\textsuperscript{30} This was in keeping with Denmark’s sense of small state vulnerability, inclusive decision-making, and the trend since the 1970s toward less ideological and more expert-oriented negotiation and policymaking in economic matters—that is, toward further institutional thickening.

The fact that economic experts were central to crafting the bank packages was crucial for consensus making and, as we shall see, represented a major difference from the Irish case. To begin with, the Bankers Association had a team of five economists modeling the likely impact of the bank package scenarios. They were in close contact with their representatives at the negotiating table, as were the National Bank and the Ministry of Economic and Business Affairs. There was considerable agreement among the expert analysts, and this was conveyed to those involved in the negotiations. This is not surprising. After all, the analysts were using data from \textit{Statistics Danmark} in their models and received similar training at Copenhagen or Arhus University. And there was considerable informal communication among experts across these organizations.\textsuperscript{31} We also learned off the record that representatives from the National Bank consulted frequently with experts on Wall Street as well as others in the United States regarding possible courses of action.

The principals involved in the negotiations produced papers describing various rescue models. Discussions occurred, politicians and banks were consulted, and plans were revised accordingly. When we asked whether this sort of cooperation was typical we were often told that it was totally normal—that is, well-institutionalized. As a result, the bank packages were assembled and passed within a very consensus-oriented process.\textsuperscript{32}

This is not to say that everyone agreed automatically on everything. For one thing, the Social Democratic Party wanted the government

\textsuperscript{29} We were told in one interview that Danish Industry, the peak association representing Danish industries, was “very involved” informally (Henrik Bach Mortensen).

\textsuperscript{30} Senior officials, Financial Supervisory Authority and Danish National Bank; Peter Straarup; and Peter Schütze.

\textsuperscript{31} Senior economist, Danish Bankers Association. The Union of Financial Sector Employees as well as other unions and labor peak associations may not have been involved in the negotiations due partly to their lack of economic expertise in such matters. In this regard, the president of the union told us that since the crisis began his organization has tried to hire more economic advisors, “to try to get more influence on […] the situation about the crisis”.

\textsuperscript{32} Peter Schütze.
to take shares in the failing banks, that is, to push though partial nationalization. The National Bank was also in favor of this. But they only succeeded in obtaining agreement that investors in banks would receive haircuts. There were several reasons for this. First, was the desire to minimize the risks of moral hazard that might crop up if the government provided too much relief to the banks. Second, people wanted to ensure that taxpayers did not foot the bill for bailouts. Third, those negotiating the bank packages also knew that Nordea, a large Swedish-based bank with extensive Danish operations, would not accept any form of nationalization. So neither the government nor the Bankers Association was willing to accept nationalization. For another thing, some of the healthy banks were unhappy about being punished in the first two bank packages for the sins of others, as funds were taken from the bailout fund. They nevertheless agreed. Similarly, the Bankers Association was unhappy with the idea that emerged in the third bank package that banks and investors would have to take haircuts. However they also ultimately acquiesced.

Compromise and consensus was necessary because the banks had not violated any regulations. The banks went along with it all because they recognized the severity of the situation, accepting that steps were necessary not only for the financial services community but also for the country. According to Peter Schütze, who was CEO of Nordea as well as head of the Danish Bankers Association at the time, ever since the 1864 defeat by Prussia the financial, business and political elites have been aware of Denmark’s position as a small, vulnerable country—something he and others understood fully when they negotiated the bank packages. The commitment to national unity continued to reverberate over a century later!

We heard frequently that throughout this process things were made easier because the ministers, representatives from FSA and the Financial Stability Company, and the politicians knew each

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33 Senior officials, Financial Supervisory Authority and Danish National Bank; Peter Straarup.
34 Senior official, Danish National Bank.
35 Senior official, Financial Supervisory Authority.
36 Peter Straarup.
37 Peter Schütze.
other—thanks to Denmark being such a small country. But in contrast to the cronyism that such small state intimacy engendered historically in Ireland, the Danish state enjoyed a certain amount of autonomy from the banking industry. Indeed, the Banker’s Association was not in the driver’s seat at the negotiations, as noted, and therefore had to accept policies that it did not like. The former CEO of Danske Bank, explained: “You know you lose authority when you have issues, and I suppose in hindsight the banks have to accept the fact that this has been a situation where they gradually have lost authority in the legislative process, because losses have been material”. Moreover, there was an explicit institutional division of labor. The FSA determined which banks were in trouble. The Financial Stability Company then figured out how to wind down the troubled banks once they had been identified by FSA. Finally, the Ministry and the National Bank decided which banks would receive capital injections. On balance, this institutional arrangement was well suited to guarding against the sweetheart deals we found in Ireland.

In sum, Denmark’s thick institutional capacities rooted in a long history of small state vulnerability, facilitated an inclusive, consensus-oriented, and expert-based crisis management process. Nationalist legacies were also important. On the one hand, decision makers adhered to the belief that taxpayers—that is, the nation—should not be on the financial hook for the mistakes of individual banks. On the other hand, the banks accepted that they were culpable and should pay for their own mistakes by accepting haircuts and covering the losses of their fellow bankers through the PCA, accepting as it were that they were part of a community of fate and should thus take responsibility collectively for their actions in the national interest. Such nationally focused cooperation has long been typical of Danish policymaking, particularly in times of crisis (Pedersens 2006).

Thin Institutions and Irish Misery

The financial crisis in Ireland, like that of Denmark, was rooted in a housing bubble. When house prices began to fall in 2007 the great hope was that there would be a soft landing for the economy. Instead, a disastrous situation resulted.

The fateful decision of September 2008—that the state would guarantee the banks—was taken behind closed doors with little economic expertise on hand. The Finance Minister, Brian Lenihan, 38 Senior official, Financial Supervisory Authority. 39 Peter Straarup.
had little economic expertise and was closeted for most of the time with members of the threatened banks and with politicians from the government rather than with economic experts. In fact, there was only one economist in the room—an environmental economist not versed in banking and finance, present only because the Green Party was part of the government. So this was a decision taken by a very small group of politicians and bankers, not experts. There is a simple conjectural reason for this. The Financial Regulator and Central Bank had been thoroughly discredited because they had not anticipated the advent of such a crisis, perhaps not surprisingly as they lacked the necessary expert economists on staff. (Recall that the Danish experts had at least made preliminary plans by 2007 for another bank crisis.) This is why many of the Central Bank’s top employees were soon replaced with people who had such expertise. Patrick Honohan, an expert on banking crises, became the new Governor in September 2009. Many of the replacements were foreigners because few in Ireland were deemed to be sufficiently qualified. Similarly, the Department of Finance lacked the necessary technical skills and was out of touch with the broader economic community (Donovan and Murphy 2013, chaps. 5 and 6). Put differently, these organizations suffered serious problems of legitimacy, which compounded the problem of institutional thinness associated with the lack of sufficient expertise at the crucial moment.

That lack of expertise is so important that it requires some elaboration. First, the argument is not that there were no economists in these organizations but that they were often not the right sort of economists—that is, economists who specialized in “macro-prudential” analysis, which involves examining how bank lending and borrowing might affect the stability of the financial system as a whole and the economy in general. Second, as noted earlier, the supervisory boards of the Financial Regulator, Department of Finance, and the Central Bank lacked much economic expertise. At the Central Bank, whatever necessary expertise there was resided in isolated silos at lower levels in the organization—and even there the expertise was typically more in accounting than finance and macro-prudential analysis. Third, the banks themselves often lacked the appropriate expertise in risk management and auditing to be able to understand their own situations. Fourth, prior to the crisis, the lack of expertise was of no particular concern—at least among firms in the financial services industry and their regulators—because all of these organizations subscribed to neoliberalism and the so-called Efficient Market Hypothesis. That hypothesis was
pervasive in academic economics, arguing that competition and the discipline of the market could be relied on to avoid reckless financial behavior. Hence, only a very light regulatory touch was required—a view that facilitated groupthink and shut out any naysayers that might raise concerns (Donovan and Murphy 2013, chaps. 4, 5 and 8). Finally, the Secrecy Act ensured that civil servants and politicians were not allowed to consult freely with independent economists, such as Honohan, outside the state as the Danish National Bank did, for instance, with fellow experts as far away as the United States. So there were institutional barriers that prevented economic advice from getting to policymakers when they needed it most.\(^\text{40}\) In sharp contrast to Denmark, then, Ireland’s institutions were particularly thin regarding expertise.

The closed nature of the crisis deliberations between politicians and bankers was another manifestation of the institutional thinness that characterized Irish politics due to the country’s unique history as a small state. Although independent boards controlled the Financial Regulator and the Central Bank, a majority of the Regulator’s board, including its Chairman and Chief Executive, also sat on the Central Bank’s board. Nowhere was there the sort of extensive formal and informal consultation with people and organizations we saw in the Danish case (Donovan and Murphy 2013: 83). There were many complaints, not least in our interviews, about such highly insulated and seemingly corrupt political arrangements. In this sense the thin nature of Irish institutions was again evident in their lack of legitimacy.

When the crisis hit in Denmark there was much open debate about how to handle it; in contrast, there was little room for argument and innovation in Ireland. One source stressed “an absence of an infrastructure of dissent” by which he meant that unions, academics, experts, business associations, and other stakeholders were never consulted either formally or informally. Again, this was due partly to the fact that corporatist institutions were poorly developed in Ireland.\(^\text{41}\) As one minister told us, corporatism “was on the back burner” by the time the crisis hit.\(^\text{42}\) Others put it differently: the organization of civil society—the lack of corporatism—created an institutional space conducive to the growth of cronyism in the first place (Ó Riain 2014; Woll 2014). Indeed, institutions in civil society were perceived as being so thin that at one point Robert Putnam was invited to Ireland to advise on how to bolster them and create more social solidarity.\(^\text{43}\)

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\(^{40}\) Philip Lane.  
\(^{41}\) Tony Donohoe.  
\(^{42}\) Ruairí Quinn.  
\(^{43}\) Tony Donohoe.
Of course, many have noted that Ireland was a victim of crony capitalism. There is certainly some truth to this insofar as the housing bubble was largely the result of sweetheart deals, often laced with bribes, between developers and politicians (O’Toole 2010). Moreover, the government negotiated individually with each bank regarding the conditions they would accept for their own recapitalization and rescue (Woll 2014: 146; Grossman and Woll 2012). But several further points are important, all of which show that Irish institutional thinness should not be simply equated with cronyism. Why?

First, as noted earlier, institutions relying on expertise and facilitating open debate and consensus making were clearly lacking when it came to crisis management, which is one reason why Anglo Irish was able to hide its liabilities from the regulatory authorities (Woll 2014: 154). This is also one reason why decision makers mistook a solvency crisis for a liquidity crisis: they presumed that the troubled banks possessed real assets, and this illusion made it possible to imagine an orderly winding down of troubled assets during the two years of the guarantee. Second, appointments to leadership positions in the Central Bank and its Board of Governors were based on prior membership of the civil service, or a previous career in the law, arts, sciences and other fields. This had everything to do with long-standing institutionalized traditions and little to do with cronyism. Third, the Secrecy Act, which was inherited from Westminster, was an important reason why crucial outside experts were not consulted during the crisis. Fourth, the national educational system historically shied away from the sort of training necessary to cultivate a substantial cadre of experts up to the task of handling the crisis. This was reinforced by English traditions of pushing young people into medicine, law and religion rather than economics. None of this had much to do with cronyism either. As one respondent put it when dismissing the argument that everything boiled down to cronyism, the institutions “were not up to it”.

Much of this was compounded by the absence of adequate checks and balances in the political system—an artifact of Britain’s historical influence on this small state. There is considerable difference in parliamentary systems between Ireland’s Dail and Denmark’s Folketing. The former differs from the latter in being weak vis-à-vis the executive branch and the Prime Minister, and in having a rudimentary committee

44 George Lee. 45 Philip Lane. 46 Philip Lane. 47 David Begg; Alan Dukes; John Fitzgerald. 48 John Fitzgerald.
system. The party whipping system in the Dail is extraordinarily harsh: failure to toe the party line can lead not only to the forfeiting of one’s committee seat but even to expulsion from the party.⁴⁹ Within the executive branch the cabinet is weak; the real power is held by a very small, tight group of people including the Taoiseach (Prime Minister), the Minister of Finance, and very few others. Again the thinness of Irish institutions is clear. For these and other reasons one person in Ireland told us that Denmark was the “mirror image” of Ireland.⁵₀

Several of our interviewees stressed the role played by nationalism in the Irish case. On the one hand, Ireland recognized since the 1950s that it needed to catch up with the rest of Europe in terms of economic development. The developmental push since then was bound up with the urge to become an independent nation. Once the Celtic Tiger was unleashed people believed that it was due to Irish policy—that is, it was of their own doing—rather than the influx of foreign direct investment from abroad and structural funds from the EU. This contributed further to hubris, groupthink, and fears of not rocking the boat by speaking out against current development practices, particularly as they concerned real estate and housing. In other words, national pride, which was swelling after decades of underdevelopment thanks to British rule, blinded most people to the reality of the situation.⁵¹ On the other hand, because everyone had bought into this mindset, nobody knew what to do when the crisis hit. This is another reason why a solvency crisis was mistaken for a liquidity crisis—people could not believe that the banks, which had fostered such growth, were in such terrible shape.⁵²

Conclusion

Our first task is to consider an objection that suggests an alternative explanation. Our analysis has concentrated on domestic institutional factors in order to explain the different policy responses of Denmark and Ireland to the financial crisis. Consideration of the external environment is also necessary above all because the situation of the two countries was so different in one crucial aspect as to suggest an alternative explanation to our argument. While Ireland belonged to

⁴⁹ While we were in Dublin members of parliament were threatened with expulsion from their party if they voted against an abortion bill currently under consideration. ⁵⁰ David Begg. ⁵¹ Dan O’Brien; Jamie Smyth, The Financial Times. ⁵² George Lee; Rory O’Donnell.
the Eurozone, Denmark did not. Might it be that Denmark was able to impose haircuts whereas Ireland was pressured by the ECB to take a bailout without haircuts so as to avoid a policy that might have led to financial contagion in the Eurozone? Of note in this regard was the extreme reluctance of the ECB and Germany to impose haircuts in Greece—something that was nonetheless done because the Greek state was bankrupt and discredited. In contrast, the Irish state had been in surplus and its reputation was strong. Might it then be that haircuts in Ireland were ruled out less because of the thinness of its domestic institutions and more because of pressure from the ECB?

There can be no dispute about the fact that the ECB did rule out haircuts in 2010: a letter saying precisely this was sent by Jean-Claude Trichet to the Irish authorities on 19 November 2010 and has recently been released (Boland and Spiegel 2014). Hence any complete account of these years does need to involve the international dimension. However, this does not mean that the argument of this paper is erroneous.

What matters is timing. First, let us go back to the blanket guarantee of the banks in September 2008. What is most noticeable about that decision is that it was taken completely in the dark, even though warnings of impending crisis had been available for some time—not least from Jean-Claude Trichet when he visited Ireland in 2007. No discussions were held at the outbreak of the crisis with the European Union or the ECB (Woll 2014: 145). We learned in one interview that a different policy was conceivable: a guarantee for depositors with potential haircuts for the senior bondholders. Had this been presented to the ECB and had they been opposed to it, their view would have been expressed in writing—making them responsible thereafter for helping to deal with the problem. But no such policy went forward. Second, haircuts were not imposed at that time for a reason that had nothing to do with the ECB or concerns with contagion in the Eurozone. As is well known, the Irish economy had been booming since the early 1990s because it had attracted huge amounts of international investment. According to one of our interviews, Finance Minister Lenihan did consider haircuts at the onset of the crisis. However, it is likely that he was told not to impose them by Brian Cowan, the Taoiseach, so as to save the international reputation of Ireland’s political-economic model and with it the foreign direct investment upon which it depended so heavily.

53 Philip Lane.

54 Philip Lane.
Crucially consider the many months between September 2008 and November 2010. During these months Denmark—which had also issued a blanket guarantee—passed three bank packages, one of which included haircuts; Ireland did nothing. One reason was that pressure to avoid haircuts in Ireland was fierce at the domestic level but not at the international level that at time. Remember too that Anglo Irish fought against haircuts in part by refusing to divulge the seriousness of the situation in which they found themselves. More importantly, the state found it difficult to respond because of its limited capacities and the thinness of its institutional development: Irish regulators did not have full access to the banks’ books as did their Danish counterparts, which is why they were tricked into believing that the banks were more solvent than they actually were. The state therefore, barely knew what was happening.

To this lack of knowledge was added the failure to consult dissenting voices—precisely because they were excluded from the state. Many Irish economists called from 2008 for a variety of alternative measures to cope with the crisis. These included both the imposition of haircuts and the printing of Euros (which any Euro-zone country can do within limits) to deal with the lack of liquid funds that so hurt the economy from 2008 onwards. But, again, they had no voice within the state for the institutional reasons that we have described. There is no indication in our interviews or anywhere else as far as we know that the ECB leaned on Irish policymakers to abstain from such alternative measures in the initial months of the crisis. In this regard let us propose a counterfactual. Suppose a better developed, institutionally thicker Irish political-economic system had developed a coherent alternative plan—something along the lines of Denmark’s bank packages. Is it really likely that Jean-Claude Trichet would have vetoed it? Why would he have done so? The international markets wanted to see solutions and—with the exception of Germany—the ECB would surely have accepted an Irish proposal that was sensible and well crafted even if it had involved haircuts. After all, the Euro crisis went on and on precisely because markets did not believe that increasing indebtedness and austerity would lead to the restoration of prosperity. The Irish state was not up to the crisis it faced.

It is worth contrasting our account with other scholars equally concerned with state institutions (e.g. Grossman and Woll 2012; Kluth and Lynggaard 2013; Woll 2014). Attention needs to be drawn to four factors. First, they have ignored how small state vulnerability and nationalism were important antecedents of the story in
each country. As we have explained, the way these things played out influenced how institutions were created in the first place and how they operated during the crisis. Moreover, one cannot fully appreciate why the state took steps in Denmark to protect the general public interest (i.e. taxpayers and the public budget) while in Ireland it did not without understanding how different small state and nationalist experiences led to more inclusive, nationally-oriented decision-making institutions in the former and less inclusive, less nationally-oriented ones in the latter. Second, on the Danish side, other researchers tend to exaggerate the role of corporatism in the decision-making process. It is true that Danish decision makers were in touch with various corporatist groups as well as the political parties during their deliberations. However, compared to conventional Danish economic policymaking, crisis management was a more insulated affair. Perhaps, most notably, the politicians essentially abdicated responsibility to the regulators, the Bankers Association, and the Central Bank. Third, Grossman and Woll (2012) attribute the different responses in Denmark and Ireland largely to the political organization of the banking sector. Certainly the Danish authorities negotiated with the Bankers Association while the Irish authorities negotiated with individual banks. But one cannot understand this difference without appreciating the different institutional conditions that prevailed at the time, together with different perceptions of national identity, which as we have shown stemmed from each country’s unique national histories. More recently, Woll (2014: 157) argued that the Irish outcome was the result of a “complex mix of inappropriate regulation prior to the crisis, incomplete oversight, misjudged risk, deception and flawed crisis management”. We concur. But we have explained where this toxic mix came from in the first place while she did not. Finally, other researchers have neglected important variation in the degree to which decision-making in these countries involved experts—and how this was institutionally determined. In Denmark, the experts played the key role. And there was no hesitation in seeking the advice of experts outside the formal decision-making institutions and even outside the country. In Ireland, this was not the case.

Finally, let us highlight what we have added to literatures on small states and nationalism. To begin with, the small states literature fails to appreciate that it is not small size per se that brings vulnerability but rather the relationship that small states have to their neighbors that matters for institution building and national solidarity. It matters
whether the small state is independent and exposed to the international political economy or buffered from it by a powerful neighbor either through colonial domination, as in Ireland, or in some other way. Of course, buffering can be a double-edged sword. Because Ireland was later a protected member of the European Monetary Union it was initially able to draw on funds from the ECB to help finance its bank recapitalization scheme. But its dependence on these funds eventually made Ireland susceptible to pressure from the ECB, the European Commission, and the IMF to impose harsh austerity policies on its citizens in order to solve its sovereign debt crisis.

While not all small states are equally vulnerable, nor are all culturally homogeneous ones equally equipped with a unifying nationalist sentiment. Both Denmark and Ireland are culturally homogeneous. Each is predominantly of one religion, ethnicity, and language. Yet for reasons explained above Denmark enjoyed strong national sentiments that forged a common identity and willingness to work together for the common good during the crisis. Irish nationalism brought contention rather than unity. Nationalism can have either positive or negative effects depending on whether it is secure or contested, and depending on how it developed and was institutionalized in the first place (Posner 2005).

It is also important to understand the relationship between small size and nationalism. Without understanding Denmark’s long history of vulnerability, for instance, one cannot fully understand why corporatism and state institutions have such thickness. Ireland, long under the protective umbrella of Britain, had no such impetus for institution building. Something similar holds for nationalism. Denmark rallied in unity around the flag and built institutions to solidify that unity particularly after 1864 and again after the 1970s when ideology was largely set aside in favor of expert-oriented policymaking. When the banking crisis hit in 2008, stabilizing the national currency and financial system was the top priority. In Ireland, however, there had not been nearly as much time to develop national unity because of civil war, partition, and continuing disagreements over the country’s relationship with Britain. During the banking crisis, whatever concerns there may have been for Irish national interests were tempered by cronyism and special deals to save the banks—deals in which at least one of the banks, Anglo Irish, and perhaps others, were not forthcoming with full disclosure about the status of their liabilities. The banks put their own interests ahead of those of the nation.
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Résumé

Cet article mobilise les théories des petits États (ex. Katzenstein) et du Nationalisme (ex. Gellner) pour rendre compte des différences de réaction à la crise financière de 2008 entre le Danemark et l’Irlande. Bien que le Danemark possède une économie de marché coordonnée et fortement marquée par le corporatisme et l’interventionnisme d’État, c’est le secteur privé qui a assumé une grande partie de la charge financière liée au sauvetage du secteur bancaire. Inversement, alors que l’Irlande dispose d’une économie de marché libérale faiblement marquée par le corporatisme et l’interventionnisme d’État, c’est pourtant l’État qui a assumé une grande partie de cette charge financière. L’article montre que cette différence provient en grande partie du fait que le Danemark, au contraire de l’Irlande, est doté d’institutions solides et d’un sens élevé du nationalisme. L’article explore les leçons à tirer de ces deux cas pour les théories des petits États et du Nationalisme.

Mots-clés : Capacités ; Danemark ; Irlande ; Crise financière.

Zusammenfassung


Schlüsselwörter : Kapazitäten; Dänemark; Irland; Finanzkrise.