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Lund Papers in
Economic History

No. 166, 2017 *General Issues*

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Lund Papers in Economic History
ISRN LUSADG-SAEH-P--17/166--SE+34

Orders of printed single back issues (no. 1-65)
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Telefax: +46 46 131585

Full-text electronic issues (no. 58, 60, 61, 66--)
www.ekh.lu.se

Lund Papers in Economic History are published by the Department of Economic History, Lund University, Sweden. This series replaces the former series under the title *Meddelande från ekonomisk-historiska institutionen, Lunds universitet*. The change of name reflects the orientation of the series towards an international readership. The series is multilingual, but the majority of the working papers appear in English.

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Financial Implications of the Divorce of the Irish Free State from the UK, 1922-6

John FitzGerald and Seán Kenny[1]

Abstract

In this paper, we discuss the unresolved apportionment of national debt when Ireland exited the UK in 1922. Using archival sources and contemporary accounts, we estimate that the British claim on Ireland in 1925 amounted to between 80 and 100 per cent of GNP at a time when the political stability of Ireland was already fragile. We describe the process of how this contingent liability, arising from the Anglo-Irish Treaty of 1921, was ultimately waived in a Financial Agreement in 1925 at the expense of an unchanged border with Northern Ireland. The Irish government also sought, but failed, to secure protection against discrimination for Catholics in Northern Ireland as part of the agreement. While for the Irish Government, this settlement may have represented a political failure, the economic outcome of the agreement transformed the economic position of the new Irish State from one of potential insolvency into one of viability.

JEL: E62, F50, H60, H77, N00.

Keywords: Contingent liability, public debt, secession, independence, Ireland, United Kingdom, Financial Agreement, political economy, border.

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1. Introduction

In the aftermath of the 'Brexit' referendum result, with the UK's contingent monetary liabilities as a result of leaving the European Union (EU) to be resolved, the potential economic effects of Brexit on the island of Ireland and the political implications for the border between Northern Ireland and Ireland has formed a centrepiece of debate. There are parallels with Ireland's exit from the then United Kingdom of Great Britain and Ireland, which took place in 1922. The Treaty that established the Irish Free State[2], signed in 1921, addressed both issues: the border with Northern Ireland and the apportionment of the liabilities of the United Kingdom of Great Britain and Ireland between the smaller United Kingdom of Great Britain and Northern Ireland (UK) and Ireland. However, the Treaty left the details of the financial settlement and the final shape of the border to be finalised at a later date, casting uncertainty over the economic viability of the newly independent state. The status of the Irish border was a crucial issue for both parties to the settlement, and in 1925 it was the lever in arriving at a financial agreement that temporarily suited both the UK and Ireland. The largely unstudied aspects of how Irish exit from the UK were finalised in a new agreement in December 1925 form the centrepiece of this study.[3]

The post-World War I era saw many other such breakups resulting in a dramatic restructuring of the boundaries of the European continent. While some fragmentations occurred in an unstructured manner without any formal agreements between parties or adversaries, such as the Polish and Finnish exits from the Russian Empire, the Irish divorce, which we address, was formalised with an agreement signed by both parties on December 6th 1921. This type of more orderly breakup was mirrored in a number of later cases that include the Alma-Ata Protocol in 1991, which saw the dissolution of the Soviet Union, and the agreement reached in 1992 which lead to the breakup of Czechoslovakia in 1993. Such consensual divorces have, to a greater or lesser extent, also dealt with the economic consequences of the dissolution of states or unions by allocating assets and liabilities between the new political units.

In the case of the Treaty establishing Ireland in December 1921, Article V provided for the final determination of Ireland's share of UK Government Debt. The division of the debt would ultimately become linked with Article XII, which stipulated that a Boundary Commission would, based upon the "wishes of the inhabitants," re-draw a border for 'Northern Ireland,' a political entity which had been established by the Government of Ireland Act of 1920. The lack of discussion on the financial liability amongst contemporaries reflected the fact that the decision by Ireland to seek independence from the UK was driven by political considerations. It also probably reflected a much more limited understanding among the key players of how modern economies worked and of the potential long-term importance of a high debt level. Through the use of a number of primary and contemporary sources, this paper documents the political economy of events which resulted in the final settlement and provides analysis of the potential debt burden of independent Ireland in the event of "no deal" for Ireland in 1925, in today's parlance.

[2] Now called Ireland.
[3] See Barry,'The First Irexit' for a parallel with present.

The contingent liability was very large under Article V and would have placed doubt over the solvency of independent Ireland. However, the eventual settlement, which saw the vast bulk of this liability written down in December 1925, was unplanned by either side. It emerged as part of a broader agreement which settled the border of the new state by revoking Article XII. Section 2 of this paper looks at the broad context in which the final settlement of 1925 was reached. Crucial to the final outcome was the evolving story of the Boundary Commission. Section 3 describes the negotiations between all three governments in November and December 1925, which resulted in a new agreement. Section 4 examines the economic significance of the deal on the national debt by reconstructing the counterfactual and comparing with the post Agreement outcome. With the benefit of hindsight, its impact on the economic prospects of the new Irish state was quite profound as Ireland may have ended 1925 with debt to GNP of 90 to 110 per cent instead of the ratio of 10 to 15 per cent which was the actual outcome. However, for the wider public and for the financial markets, it seems to have been treated as a more limited development. Conclusions are set out in Section 5.

2. Context

The Anglo-Irish treaty was signed on the 6th of December, 1921 between representatives of the Irish Free State (henceforth 'Ireland') and the government of the United Kingdom.[4] It is associated with the end of the Irish war of independence, the beginning of political independence of what were the southern 26 counties of the island and the 'permanent' partition of Northern Ireland, which remained a part of the United Kingdom.

The terms of the Treaty were the immediate cause of the subsequent Irish civil war in 1922-3, which was primarily fought within Ireland between Irish government forces and anti-treaty rebels, who were opposed to the Irish parliamentary Oath of Allegiance to the British Crown (Article IV) and the partition of Ireland which was bound to result from its ratification (Articles XI, XII). While other research has addressed the later 1938 Financial Settlement in detail, little attention has been afforded to the contingent public debt which comprised part of the Treaty.[5] These Articles "never sparked the same passions" as those dealing with sovereignty, but the potential consequences of the financial Articles were very significant.[6]

2.1 Unfinished Business of the Anglo-Irish Treaty 1921

The Treaty's text contained a number of unresolved issues relating both to public finance and the boundary line which would divide Northern Ireland and Ireland. A contemporary, Lord Buckmaster, described it as "full of grave and dangerous ambiguity"[7].

Article V confirmed that Ireland would assume liability for the service of a share of the Public Debt of the United Kingdom and War Pension payments, as existing on 6th December, 1921. The liability was to be calculated at an unspecified future point in time and "in such proportion as may be fair and equitable.

[4] See Appendix 1b.
[5] O'Rourke, 'Burn Everything'; Ó Gráda, *Ireland* ,pp. 412-6 ; Fanning, *Irish Department of Finance*, c. 4.
[6] Matthews, 'Irish Boundary Crisis,' p. 407.
[7] Hansard, H.L. Deb 22 March 1922, vol. 49 cc. 709-829.

The second unresolved financial issue was that Ireland agreed to pay fair compensation to public officials who were directly affected by the new change of government such as judges and public servants (Article X). The issue of compensation was to be dealt with by the Compensation (Ireland) Commission, a body which would apportion liabilities between Great Britain and Ireland for damages, but was not mentioned in the Treaty.[8]

However, the most politically sensitive unresolved item was contained in Article XII, which allowed 'Northern Ireland,' originally created by the Government of Ireland Act of 1920, to exit the Irish Free State within one month. It did so on the 8th of December, 1922 petitioning "that the powers of the Parliament and Government of the Irish Free State shall no longer extend to Northern Ireland."[9] As a consequence of this predictable unionist rejection of an all-Ireland settlement, a Boundary Commission, consisting of three representatives appointed by the governments of Ireland, Northern Ireland and the UK, was to be established.[10] Its Report, which the Commission was under statutory obligation to produce, was to determine the new boundary by considering "the wishes of the inhabitants, so far as may be compatible with economic and geographic conditions."[11]

2.2 The Boundary Question 1920-2

The government of Northern Ireland, under the unionist leadership of Prime Minister James Craig, refused to appoint a Commissioner. They had not been party to the Treaty of 1921 and claimed legitimacy from the Government of Ireland Act of 1920, which had originally drawn a border along county lines rather than considering demographic factors. The 1920 Act had established a Northern parliament with jurisdiction over six out of nine counties of Ulster.[12] When the Treaty was signed in 1921, the acting Irish Minister for Finance and signatory Michael Collins, believed that "the decision of the Boundary Commission, provided for in Clause XII, would be certain to deprive 'Ulster' of Fermanagh and Tyrone" which had nationalist majorities.[13] A consensus view emerged amongst the southern press of an eventual one-directional set of transfers into Ireland, reflected by one newspaper claiming that "the treaty was an alleviation of partition and not the creation of it and in Clause 12 was provided the machinery of alleviation."[14] According to Lee, even in the event of such a reduction, the Protestant heartlands of Belfast, North Down, North Armagh and South Antrim did not need the periphery to survive economically.[15] The northern boycott of the Commission confirmed the view of the southern government that unionists feared substantial losses.[16]

In 1921, the British government ostensibly exhibited similar expectations. On the day after the Treaty, Lord Birkenhead stated that the new border would be designed to prevent any further political oppression of northern County Councils with nationalist members "which were

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[8] Compensation was dealt with by subsequent agreements which were superseded by the Financial Settlement, to which we restrict our focus.
[9] Gwynn, *History of Partition,* p. 219.
[10] See Murray, *Irish Boundary Commission* and Matthews, *Irish Boundary Crisis*.
for a detailed history.
[11] See Appendix 1b, Article XII
[12] Section 1, Subsection (2), Government of Ireland Act, 1920: 10 & 11 Geo V. See Appendix 1a.
[13] R.I.A. Foreign Policy Document, No. 240 NAI DT S1801A, 'Extract'; Collins, *Path to Freedom,* p. 95.
[14] *Irish Independent,* November 13, 1925.
[15] Lee, *Ireland,* p. 148-9.
[16] K. O'Higgins, 29th November, Chequers, DTaoiseach S4720A

excluded from their habitations by representatives of the Northern Parliament."[17] Prime Minister Lloyd George stated to Irish signatories that a Northern refusal to recognise the Treaty (Commission) would ultimately "save" those nationalist majority counties of Fermanagh and Tyrone.[18] He publicly expressed this belief saying that the majority of the people of those two counties "prefer to be with their southern neighbours" and that Northern Ireland could "only by means of coercion keep them".[19] Publicly, the British cabinet continued to share the view of the Irish press that the eventual publication of the Report would "be very favourable to the South."[20]

2.3 The Boundary Commission, 1923-5

The interlude between the signature of the Anglo-Irish Treaty in 1921 and the first meeting of the Boundary Commission three years later was a considerably longer period than anticipated, giving the temporary boundary a feature of permanence. A number of factors had intervened to prolong the process of implementing Article XII. The Irish civil war, which lasted until May 1923, had the effect of postponing progress and the existence of the Irish State came under threat.

Another factor in the delay was a period of exceptional political instability in the UK epitomised by the collapse of the Lloyd George government and the uneasy coalition which followed it.[21] There were political reasons for postponing implementation of Article XII on the part of the new British government. Outgoing Prime Minister Bonar Law warned in June, 1923 that the Boundary Commission "was a very dangerous topic."[22] The War Cabinet Secretariat agreed that "we ought to play for its indefinite postponement," while recognising that the Irish President of the Executive Council[23], W.T. Cosgrave, would have to raise it in view of autumn elections to counter republicans' criticisms of his government's neglect of Catholics in Northern Ireland.[24]

The election of the 1922-3 Conservative administration and the first ever Labour government in 1924 meant that the application of all outstanding questions in the Treaty no longer rested with the original British signatories.[25] Furthermore, the latter administration held less influence over the unionists at this crucial juncture.[26] Of the Irish signatories, Arthur Griffith, first President of the Executive Council, had died of heart failure on 12th August 1922 and Michael Collins, Griffith's successor, was killed in an ambush ten days later. With domestic pressures mounting, the Irish government put the onus on the British government by appointing Eoin MacNeill as their Boundary Commissioner in July 1923.[27]

The Northern government's refusal to appoint a representative to the Boundary Commission in May 1924 was referred to a Judicial Committee of the Privy Council by the UK

[17] HC Deb 01 October, 1924, vol. 177 cc. 241-242, recited.
[18] Gwynn, *History of Partition,* p. 213.
[19] HC Deb 14 December, 1921, vol. 149 cc. 39-40
[20] *Jones' Diary,* p. 235.
[21] Hand, *Report,* vii.
[22] *Jones' Diary,* p. 221.
[23] Now referred to as Taoiseach.
[24] *Jones' Diary,* p. 221.
[25] Gwynn, *History of Partition*, p. 222.
[26] Hand, 'MacNeill,' p. 214.
[27] Hand, *Report,* vii. Professor MacNeill was Minister for Education, an Ulster Catholic and a scholar of Celtic Studies.

government.[28] It found that royal prerogative did not extend to the government appointing a Commissioner for Northern Ireland and legislation was passed which enabled the external appointment of a Commissioner (J.R. Fisher) on their behalf by the British Cabinet.[29] From then until November 1925, politicians and newspapers in Northern Ireland generally refused to recognise the Commission as fears grew in Unionist circles of the likely outcome of its Report. Such anxiety caused Northern Ireland's Prime Minister, James Craig, to threaten in October 1925 that if the boundary was unfavourable to "Ulster", he would resign and take all steps necessary to defend any territory that he thought had been unfairly wrested from them.[30]

Together with the Chairman appointed by the British government, Justice R. Feetham, the Commission met for the first time on the 6th of November, 1924 agreeing to complete secrecy while they continued working through the next year on gathering information before publishing the report.[31] The new boundary line would become legally binding instantly upon its publication, as Article XII stated that its form "shall be such as may be determined by such Commission".[32]

2.4 Public Finances, 1922-5

The Free State faced an immediate threat to its existence from the civil war of 1922-3. Throughout this period, the government had to balance the financial needs of domestic security and its need to finance other basic services, without being perceived publicly to rely on external assistance from the British government. Both at civil service and at ministerial level, the relationship between the Irish and British governments was close and cordial in those matters where both sides believed their individual interests to be identical.[33]

Financial transfers from Ireland to Britain totaled almost £5 million in 1925, which included land annuity payments, pension payments to members of the Royal Irish Constabulary living outside Ireland and local loan fund payments (Table 1).[34] The size of these payments is one explanation for why the British government desired a fiscally solvent and politically stable Ireland.[35] From an Irish perspective, while comprising only 6 per cent of outflows on the current account of the balance of payments, they accounted for more than half of the deficit on the current account. There is early evidence of private conversations between the Colonial Office and the Free State regarding the security of these payments, such as arrears which occurred during the civil war.[36]

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[28] *Report of the Judicial Committee of the Privy Council: Irish Boundary Question, August 1924.*
[29] Hand, *Report,* ix. J.R. Fisher was an Ulster unionist, a believer in Northern partition, editor of the *Northern Whig* and a close ally of Craig.
[30] Ervine, *Craigavon,* p. 502.
[31] *Jones' Diary,* p. 235. Justice Feetham had been Legal Adviser to the High Commissioner in South Africa and was subsequently appointed as a Supreme Court judge there.
[32] See Appendix 1b, Article XII.
[33] Fanning, *Irish Department of Finance*, p. 129; Drea, 'Bank of England'.
[34] The police force before independence.
[35] Prime Minister Baldwin and Colonel Gretton, HC Deb 4 December, 1925, vol. 188 cc. 314-316, 334-5; President Cosgrave, Treasury, Dec 1, DTaoiseach S4720A.
[36] *Jones' Diary,* p. 220.

Table 1: The Balance of Payments of the Irish Free State, 1925

Inward or Credit Movements	£ 000	£ 000	Outward or Debit Movements
Exports	48,838	66,992	Imports
Income from Investments	11,000	3,340	Profits on Foreign Investment
Emigrants' Remittances	2,250	2,664	Payment of Land Annuities
Pensions	2,347	1,332	Pensions Paid to Members of the RIC
Adjustment of Post Office Balances	1,338	798	Payments from Local Loans fund
Compensation from British Government	584	520	Other Debits
Interest on Banks' loans to London Money Mkt.	250		
Net Export of Specie	231		
Deficit	8,808		
	75,646	**75,646**	

Sources: The Irish Trade Journal, 1926, p. 112.

Constant dialogue through "back channels" played a crucial role in the financial relationship between the Irish and UK governments. In 1923, Lionel Curtis, who was responsible for Irish policy at the Colonial Office, worried that Ireland might "soon not be able to pay its troops and might lose the civil war by default," urged the British Treasury to be helpful with loan guarantees and "begged [Cosgrave] that if he saw a real danger of not being able to find cash to meet awards in the immediate future that he would not fail to let me [Curtis] know."[37]

After the civil war, the first mention of the contingent liability was linked to the pending boundary question through such a channel. In June 1923, Kevin O'Shiel, on business with the Irish government in London, reported a conversation with Alfred Cope, a key British figure in Dublin Castle during the Truce, in which the latter advised on the financial relationship between the two countries.[38] He stated that the Irish government "should not stir hand or foot in the matter for many a day as yet- certainly not until after the Boundary Commission".[39] The Irish government remained silent on the boundary issue, which caused resentment among the army and Catholics in the North.[40]

In September 1923, a unionist newspaper named the *Morning Post* published a story claiming that setting the boundary clause off against some financial aspects of the Treaty was "exactly the line President Cosgrave would like to take."[41] It is remarkable, if indicative of domestic security concerns, that this article was never publicly mentioned until December 1925 as a "good prophecy".[42] Nonetheless, it is important to note that both Irish and British actors had made links between the boundary resolution (Article XII) and the Irish public debt liability (Article V) in private diplomatic circles.

However, as the ultimate border of Ireland was yet to be determined, the southern claim was that no "just" financial apportionment could be calculated until the Boundary Commission reported. The official line taken by the Irish Minister for Finance was "that pending the

[37] W.T. Cosgrave was President of the Executive Council, today referred to as Taoiseach or Prime Minister; *Jones' Diary,* p.220, 222.
[38] O'Shiel was the director of the North-East Boundary Bureau of the Free State Government in the period before the Boundary Commission was established.
[39] Fanning, *Irish Department of Finance*, p. 129.
[40] *Jones' Diary,* p. 223.
[41] *Morning Post*, 14 September, 1923
[42] Dáil Debates, 15 Dec, 1925

completion of the steps contemplated by Article XII, the matter could not be discussed."[43] On the day following the 1925 Financial Agreement, British Prime Minister Baldwin admitted that none of the signatories of the original Treaty "ever assumed that Article V could be given effect to until Article XII had been determined….as the one depended on the other."[44]

The Department of Finance files to 1925 do not include detailed consideration of the size of the contingent liability. This was partly due to contemporary sensitivities associated with the fact that in Irish eyes, the question of Ireland's contribution to the public debt hinged on considerations of historical justice, the ramifications of which were much more political than financial.[45] Because of British Treasury guarantees, no records of the talks of the interim agreement of 1923, which temporarily settled matters relating to compensation and land purchases survive, and the terms were not subsequently published in light of Irish political sensitivities.[46] As late as September 1925, the Accountant General to the Revenue Department in Dublin Castle recommended Finance to "avoid figures as much as possible" in discussions with the British government.[47]

3. The Negotiations

3.1 November 1925 and the "Leak" from the Morning Post

The 1925 agreement was catalysed by a controversial "leak" by the *Morning Post* newspaper on Saturday, the 7th of November, 1925. It predicted accurately the ultimate shape of the border which the Boundary Commission, supposedly operating under strict confidentiality, was due to award in the subsequent weeks.

In contrast to public expectations, the leaked map proposed to incorporate areas of the south into Northern Ireland. One northern newspaper reported that "the districts of East Donegal going to Northern Ireland are admittedly rich" while the southern newspapers lamented that transfers to the south were mostly "wild country" containing "no town of any importance."[48] To the vulnerable Irish government, the political embarrassment of the situation was made worse by reignited fears of the resumption of civil war.

In Northern Ireland, the unionist mood changed to one of relief; a notable shift in sentiment in the press and by the political class can be observed in their attitudes towards the pending report. For instance, one northern MP had "no reason to be pessimistic about the Boundary Commission."[49] The *Belfast Newsletter* now publicly criticised northern nationalists for their alleged repudiation of the Treaty (which unionists had always rejected) by their making deputations to the Dublin parliament to gain assurances that no such boundary outcome under Article XII would be accepted.[50] It also stressed that the northern government was not bound by the Commission's award unlike the situation facing the south, which must either accept the

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[43] Dáil Debates, 08 Dec, 1925.
[44] HC Deb 4 December, 1925, vol. 188 cc. 323.
[45] Fanning, *Irish Department of Finance*, p. 163.
[46] Fanning, *Irish Department of Finance*, p. 136.
[47] Fanning, *Irish Department of Finance*, p. 163.
[48] *Belfast Newsletter*, November 10, 1925; *Irish Independent*, November 9, 1925
[49] *Irish Independent*, November 21, 1925.
[50] *Belfast Newsletter*, November 12, 1925.

report or repudiate the Treaty, in which case it was forfeiting its very "right to exist" as a political entity.[51]

Parliamentary questions in Dublin were successfully avoided by President Cosgrave on the 11th of November but resumed on the 19th as pressure mounted to confirm that "the wishes of the inhabitants" had been considered by the Commission. Suspicion arose as to why politicians in Northern Ireland had received assurances from a confidential Commission that its award would be satisfactory to unionists.[52] For instance in September 1925, a northern nationalist who correctly anticipated the tenor of the report claimed that "everything taking place…is in the Unionist camp. [Commissioner] Fisher keeps them well informed. We can get no news."[53] Cosgrave's response placed responsibility solely on Commissioner MacNeill, with the statement that the alleged "leaked" boundary "fulfils none of the conditions called for by the clearly-expressed language of Article 12."[54] MacNeill resigned the following evening, confirming the worst fears that the "leak" was in fact accurate.[55] This political emergency initiated urgent talks between Irish and British representatives.

3.2 The London Talks- The Border and the Partition of Debt

Much of the anxiety felt by the Irish government can be explained by the fact that "once the three appointments had been made, a majority would rule" rendering MacNeill's resignation irrelevant, as was recognised by northern, southern and British newspapers.[56] Cosgrave sought an urgent meeting with British Prime Minister, Stanley Baldwin, which took place on the 26th November in Downing Street. Cosgrave was accompanied by Kevin O'Higgins[57] who throughout the subsequent 6 days of negotiations played a key role in the discussions (Table 2).[58]

Table 2: Meetings between Irish and UK Governments, November-December 1925

Date	UK Lead	Irish Lead	Location
26/11	Baldwin, S. (Prime Minister)	Cosgrave, W.T. (President)	Downing Street
28/11	Baldwin, S. (Prime Minister)	O'Higgins, K. (Vice President)	Chequers
29/11	Baldwin, S. (Prime Minister)	O'Higgins, K. (Vice President)	Chequers
01/12	Churchill, W. (Chancellor of Exchequer)	Cosgrave, W.T. (President)	Treasury
02/12	Churchill, W. (Chancellor of Exchequer)	Cosgrave, W.T. (President)	Treasury
03/12	Churchill, W. (Chancellor of Exchequer)	Cosgrave, W.T. (President)	Treasury
03/12	Baldwin, S. (Prime Minister)	Cosgrave, W.T. (President)	House of Commons

Sources: Jones' Diary; DTaoiseach S4720A. Note: 'President' and 'Vice President' of the Executive Council of the Irish Free State equates with Prime Minister and Deputy Prime Minister.

The Irish delegation stressed that the Commission's report, if published, would bring about the collapse of the Irish government because of its adherence to the Treaty. Cosgrave's major complaint was that the spirit of Article XII had been ignored as the predominantly Catholic

[51] *Belfast Newsletter*, November 20, 1925.
[52] Dáil Debates, 19 November, 1925.
[53] Lee *Ireland* , p. 147.
[54] Dáil Debates, 19 November, 1925.
[55] In private talks on November 26th with the British, Cosgrave stated that had MacNeill "been in touch with border or Free State feeling, he could scarcely have been party to that agreement," Whitehall, DTaoiseach S4720A.
[56] *Report of the Judicial Committee of the Privy Council*, p.5.
[57] Minister for Justice And Cosgrave's deputy.
[58] Detailed minutes of these meetings are published in the RIA Documents on Irish Foreign Policy, Volume 2. The minutes were agreed by both parties. It is unclear whether they were shared on a daily basis.

town of Newry, which was seen as the "acid test" of whether the Commission "followed their terms of reference," was to remain within Northern Ireland.[59] Baldwin agreed to postpone the publication, intimating the hope that an agreement might be reached with Northern Prime Minister Craig in the meanwhile, as the British could not offer one.[60]

The Irish delegates, led by O'Higgins, persistently argued for the protection of Catholics in Northern Ireland in return for an unchanged border. The key issues were gerrymandering of voting boundaries, which were "faked to deprive [nationalists] of representation," the removal of proportional representation from local government elections, the "special" police force, which was viewed as an instrument of sectarian oppression, and discrimination in employment.[61] Irish delegates claimed that if political recognition of these "hardships" was forthcoming with concessions for northern Catholics, this might allow Dublin to politically "carry" the status quo border politically.[62]

However, British Home Secretary Joynson-Hicks predicted the tone of unionist resistance, which would never "consent" to "outsiders" changing local electoral boundaries and other matters.[63] It was clear that Craig would not make any significant concessions and there was no expectation that the UK government would make him change his mind on all of these issues. While at Chequers, O'Higgins and Craig met bilaterally on the 29th November. After the meeting, Craig indicated to the Prime Minister that O'Higgins had raised the issue of Article V of the treaty that covered Ireland's responsibility for a share of UK debt.[64] This is the first reference to this issue in the meetings between the two governments and was an important development as subsequent negotiations moved to the Treasury on 1st December. This new option, which reduced the pressure on Craig to make unionist concessions, also was of significance from the Irish side, though O'Higgins consistently emphasised that he would greatly prefer concessions for Northern nationalists.[65] Craig instead promised "to help you all I can to get as much as you can out of these fellows [UK Government]."[66]

Table 3 summarises the first adjusted estimates of the Irish liability of UK debt made by Brennan, Secretary of the Department of Finance on the 30th November in Dublin, the day after the issue was first raised at Chequers. They correspond closely to the sum in the post-agreement announcement of the Minister for Finance of "£157¾ million pounds" and this approximated the figure that Churchill claimed an arbitrator "might reasonably be expected to award the British government".[67] They are based upon an Irish tax yield of 1.5 per cent of the total UK revenue.

[59] 29th November, Chequers, DTaoiseach S4720A.
[60] 26th November, Whitehall, DTaoiseach S4720A.
[61] 1st December, Whitehall, DTaoiseach S4720A.
[62] 28th November, Chequers, DTaoiseach S4720A; *Jones' Diary,* p. 240.
[63] 29th November, Chequers, DTaoiseach S4720A; 26th November, Whitehall, DTaoiseach S4720A.
[64] *Jones' Diary,* p. 242.
[65] Matthews, 'Irish Boundary Crisis,' p. 412.
[66] Ervine, *Craigavon,* p. 502.
[67] Dáil Debates, 8 December, 1925; 1st December, Whitehall, DTaoiseach S4720A.

Table 3: Irish Department of Finance Estimates of the British claim on the Irish Free State

		£
UK Total 1921	Capital Amount of Public Debt	7 840 000 000
	Capital Amount of War Pensions	850 000 000
Irish Free State, 6th December, 1921	Share of Debt (1.5 per cent)	117 600 000
	Share of Pensions (1.5 per cent)	12 750 000
	Net British Claim on Ireland	130 350 000
1922-25	Interest compounded at 5 per cent	27 462 454
Potential Irish Free State share of UK Debt, December 1925		**157 812 454**

Sources: Brennan Memo in Documents on Irish Foreign Policy, No. 358 NAI DT S4730. Note: Authors' calculations as crosscheck on Brennan's approximate estimates. 1925 rate of interest calculated for 11 months. No counterclaim considered in calculation.

Churchill also mentioned that some of the debt was owed to the US and that, as a result, the debt interest would flow out of the UK economy, increasing the burden. In response Cosgrave, as briefed by Brennan, pointed out that around £2000 million of the UK debt of £8600 million[68] was due to the UK from the Dominions and the UK's allies.[69] The Irish side did not raise the question of UK assets such as embassies abroad or the Bank of England and the subsequent agreement of March 1926 stipulated that the Free State could not in the future proceed with a counterclaim on UK assets.[70] The Irish Minister for External Affairs later admitted that when faced with the British claim, "we had no tangible assets against it."[71] When after consultation, the following day Churchill dropped the UK claim, the Irish side responded by offering two alternatives in return for Ireland accepting the status quo border.[72]

1. Ireland would agree a figure for the debt of £6 million, with payment spread over an agreed period.

2. The U.K. could waive Article V, but the Free State would agree to largely take responsibility for compensation payments, which the British government had paid since 1921, and add 10 per cent in compensation awards made by the Courts during and after the civil war.[73]

Option two was clearly preferred by Cosgrave and he specifically suggested paying £250,000 over sixty years, which is the form the subsequent agreement took.[74] After the Irish delegation left so that Churchill could consult the British cabinet, the agreed minutes record that Lord Birkenhead called "attention to the unfortunate economic situation of the Free State and to the undesirability of fixing payments which they could not possibly hope to discharge."[75] Whether the Irish delegation saw this minute before the agreement was finalised is not clear. However,

[68] Including war pensions
[69] The Irish side acknowledged that the Soviet Union was unlikely to repay the Russian debt to the UK.
[70] Appendix 1d, Article 10
[71] Dáil Debates, 8 December, 1925, D. Fitzgerald.
[72] 2nd December, Whitehall, DTaoiseach S4720A
[73] These payments were made to Irish unionists and employees of the UK government in Ireland through the Compensation (Ireland) Commission called the Wood Renton Commission.
[74] 2nd December, Whitehall, DTaoiseach S4720A.
[75] 2nd December, Whitehall, DTaoiseach S4720A.

the sentiment may have been widely shared, and was later expressed by unionist and conservative MPs at Westminster. [76]

Unlike the Government of Ireland Act of 1920 or the Anglo Irish Treaty of 1921, the agreement signed on the evening of 3rd of December was approved by representatives of all three governments and is presented in full in Appendix 1c.[77] Article XII on the Boundary Commission was revoked and Article V was waived, which released Ireland from its debt obligations under the Anglo-Irish Treaty. In return, Ireland assumed all liabilities undertaken by the British government in respect of malicious damages done between the beginning of the war of independence in January 1919 and the cessation of the civil war in 1923, retroactively increasing compensation to victims for the latter conflict by 10 per cent. A supplementary agreement formalised how this liability, with a capitalised value of £5 million, was to be discharged in annuities of £250,000 for a period of sixty years, with an initial payment of £150,000.[78] The remaining payments were waived by a further agreement between the two governments in February 1969.[79]

Northern Ireland's financial gain was insignificant. It had been contributing towards the cost of imperial services based on the decisions of the Joint Exchequer Board established by the Government of Ireland Act, 1920.[80] While it was suggested that Northern Ireland contributed almost £18 million since then, Churchill implied that on balance it was closer to £1 million annually as "every year" Craig's government's extraordinary requests for "security" expenditure had been granted.[81] Finally, it received £1.2 million as a grant-in-aid to meet expenditure in demobilising its security force, but continued to receive comparatively generous social service provisions from the British exchequer.[82] This factor was overlooked by the southern press who hoped that because Northern Ireland was still liable for the imperial contribution towards UK public debt, they might yet be enticed into an all-Ireland arrangement.[83]

Instead, Craig's gain was primarily a political one. Against public expectations Unionists had achieved an unchanged border and the Council of Ireland was effectively abolished.[84] As Craig promised, not "an inch" of territory was conceded and he provided no concessions to the minority of Catholics in Northern Ireland. Predictably, the settlement did not give long term security to unionists as the Catholic minority was neither small enough to be absorbed nor large enough to force the Belfast government to deal with it on equal terms.[85]

The UK was sympathetic to the Irish case, perhaps influenced by the security of £5 million in annuities and pensions which flowed to Britain every year.[86]In a speech following the signature of the agreement, Prime Minister Baldwin summarised the advantages of a fiscally solvent

[76] HC Deb 4 December, 1925, vol. 188 cc. 329, 348.
[77] F37-10-26 .
[78] F200/75/25; See Appendix 2c for calculations.
[79] *Irish Times*, 1 March, 1969
[80] See Mitchell, 'Undignified and Inefficient'.
[81] HC Deb 04 December 1925 vol 188 c 354, c361.
[82] HC Deb 4 December, 1925, vol. 188 cc. 317-318; *Irish Independent*, November 6, 1925; Matthews, 'Irish Boundary Crisis,' p. 440.
[83] *Irish Independent*, 4 December, 1925.
[84] See Appendix 1c.
[85] Matthews, 'Irish Boundary Crisis,' p. 440-1.
[86] *Jones' Diary,* p. 245, DTaoiseach S4720A, HC Deb 4 December, 1925, vol. 188 cc. 314-316.

Ireland. It would provide a reliable market for British manufacturers and relieve an economically weak Britain of a continuous flow "of immigration of a poor class of people."[87] From a political standpoint, British politicians became aware that imposing a solution on Ireland from outside was bound to fail and presented with a scenario where both north and south could forge a temporary agreement, they were quick to seize the opportunity.[88] The settlement left 2 per cent of the UK debt stock on its balance sheets which had never been removed.[89]

It had become public knowledge that both Northern Ireland and Ireland expected the British treasury to bear part of the costs in the event of potential transfers caused by a boundary commission award.[90] Furthermore, another civil war in Ireland, taking on a distinctively sectarian nature, would have exposed the UK to a new undefined liability and security commitment.

4. The Potential Debt Burden

The Government of Ireland Act partitioned the most advanced part of the economy of the island of Ireland within Northern Ireland.[91] With major production of linen and shipbuilding, it possessed a comparatively developed manufacturing sector.

As shown in Table 4, the structures of the two Irish economies differed considerably from each other and Great Britain (GB). The Northern economy had a similar share of employment within industry to the GB, but a much higher share of the labour force was employed in agriculture. The structure of employment in Ireland was completely different, where agriculture employed over half of the work force, selling to Britain with its "large industrial population to absorb [Ireland's] surplus produce."[92] However, during the post war slump Irish agricultural prices fell by 44 per cent between 1920 and 1924, placing considerable pressure on the terms of trade of a country that, as late as 193,1 was still exporting more than 75 per cent of its total in agricultural products.[93] Ireland was exceptionally dependent upon manufacturing imports from Britain as it had "few important lucrative industries", reflected in the low share of employment engaged in that sector. [94] sa Ireland's foreign trade was almost exclusively conducted with the UK, the logic of maintaining the sterling link was compelling.[95]

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[87] HC Deb 4 December, 1925, vol. 188 cc. 314-316.
[88] HC Deb 4 December, 1925, vol. 188 cc. 322-3.
[89] Author's calculations from DTaoiseach S4720A; Mitchell, *British Historical Statistics,* p. 602.
[90] *Irish Independent*, December 03, 1925.
[91] This act granted self-government to Northern Ireland within the UK and was also referred to as the 'Partition Act'. It also provided the same opportunity for the rest of the island of Ireland but the majority of political representatives sought full independence. See Appendix 1a.
[92] MacNeill, 'Ten Years'.
[93] Daniel, 'Griffith.'
[94] Churchill, HC Deb 4 December, 1925, vol. 188 cc. 358.
[95] Ó Gráda, 'Money'.

Table 4: Structure of Employment, 1926, per cent of total

	Northern Ireland	Ireland	Great Britain
Agriculture	26	53	8
Industry	40	13	37
Services	29	27	52
Public Administration	5	6	3

Source: *Census of Northern Ireland and Census of Ireland*, 1926, Mitchell, *Historical Statistics*, p.106.

This structural difference was reflected in living standard differences between Ireland and the UK. Official figures on GDP or GNP are not available for Ireland for the 1920s to allow a detailed comparison of income per head between Ireland and Great Britain. However, recent research on regional GDP has put Ireland's per capita GDP at 52 and 56 per cent of the UK's in 1911 and 1931 respectively.[96] The average wage in manufacturing in Ireland was around 70 per cent of that in Britain in 1926.[97] Though these are crude measures, they show a lower standard of living in independent Ireland, which reflected a weaker capacity to absorb the cost of a major increase in the national debt. In 1931, it was noted that while other states were finding difficulty in maintaining highly developed and organised economies in a "debt-ridden" setting, "Ireland's problem [was] to build up a normal economy from a lower plane."[98]

The civil war greatly added to the new state's financial problems. As Table 5 demonstrates, the cost of conflict to the state was considerable. The fiscal deficit quadrupled and this revenue gap was largely funded by the First National Loan in 1923, which was intended to cover the costs of destruction of the civil war.[99]Almost all of the deterioration in the deficit can be explained by the increase in "Army" and compensation for "Property Losses", which absorbed almost three quarters of government revenue in 1924 and 14 per cent of estimated (1926) GNP.

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[96] Geary and Stark, '150 Years'.
[97] Census of Industrial Production (Ireland) for 1926.; Department of Employment: British Labour Statistics; Historical Abstract, HMSO, 1971, p.53.
[98] MacNeill, 'Ten Years'.
[99] Gwynn, *Irish Free State*, p. 252.

Table 5: Decomposing the Deficit during the Civil War 1923-4

		1923	1924	Increase
Total Deficit (funded by borrowing)	£ Million	3.5	14.2	10.7
	% of GNP	2,3	9.2	6.9
Total revenue	£ Million	27.7	28.2	0.5
	% of GNP	18.0	18.3	0.3
Total Expenditure	£ Million	31.2	42.4	11.2
	% of GNP	20.2	27.5	7.3
Army	£ Million	7.5	10.6	3.1
Property Losses Compensation	£ Million	1.0	10.4	9.4
Total 'Cost of Conflict'	£ Million	8.5	21.0	12.5
	% of GNP	5.5	13.6	8.1
	% of Revenue	30.7	74.5	43.8
GNP (1926)	£ Million	154.1		

Source: Government Finance Accounts, 1922-4; Duncan (1940). Note: Expenditure categories above do not include indirect items which might also be considered reparatory costs under "Supply Services". Financial Year end is 31st March.

Without these exceptional "war time" costs the government would have recorded a budget surplus. Because of such expenditure, the government was highly constrained in its early years in the resources that it could deploy to tackle the multiple social and economic problems that the state faced.

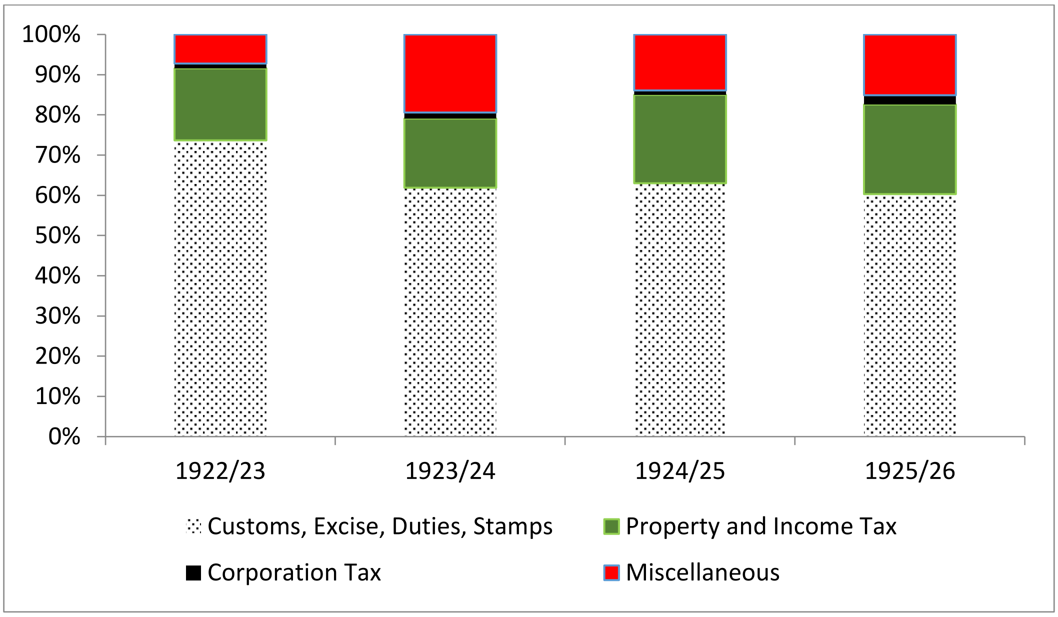
Demographically, the situation was not promising for servicing large increases in debt. The population of the Irish Free State had declined from 6.5 million in 1841 to 2.9 million by 1926.[100] This persistent trend, aside from producing the "inevitable effects in the mind of those who directed operations of business and the flow of capital," led additionally to pressures on the fiscal capacity of the state.[101] The disproportionate numbers of very young and old residing in the state (38 per cent of population) could not contribute significant tax revenue.[102] Furthermore, it was politically impossible to provide lower pension and other social welfare benefits than those which were offered within the UK. As an unusually large component of the population were classified for tax purposes as self-employed, raising revenue via income tax was historically difficult where incomes were generally low.

While income tax rates were purposefully kept below the British level to win approval of the middle classes, increasing regressive taxes (customs and excise duties), which tended to increase inequality, was the chosen policy (Figure 1). Due to the configuration of the economy, it has been claimed that this direction was largely "forced upon the Free State government," which regrettably tended to favour the mass of people who had *not* been strong supporters of independence at the expense of the mass of people who had. While these taxation choices

[100] MacNeill, 'Ten Years.'
[101] MacNeill, 'Ten Years'.
[102] Kennedy, *Productivity*, p. 8.

reflected "pragmatism over dogma," they should similarly highlight the vulnerable political position of the new administration in the event of a successful British claim.[103]

Figure 1: The Sources of Irish Exchequer Revenue, 1922-26 (% of Total)



Source: Government Finance Accounts, 1922/3-1925/26. Note: 'Customs and Excise' category above includes Motor Vehicle Duties, Estate Duties and Stamps; 'Miscellaneous' includes Post Office Revenue and Fees. Financial Year end is 31st March.

One significant difference between the UK and Ireland that might have been expected to affect the negotiations was the difference in the debt burden of the two countries. In the UK the debt was approximately 163 per cent of GDP in 1925 which compares to Ireland's ratio of around 10 per cent.[104] As a result, there was a large difference in the share of national resources pre-empted by debt service: out of exchequer revenues for the UK and Ireland, debt servicing accounted for 37 per cent and 0.4 per cent respectively.[105] It was against this background that the negotiations on the allocation of a share of the UK national debt to Ireland must be considered.

An addition to the Irish debt stock of £155.75 million, initially sought by Churchill, would have amounted to an increase of around 100 per cent of estimated National Income[106] or 80 per cent of estimated GNP[107] in 1926. Instead, after the agreement the debt to GNP ratio was just over 10 per cent.[108] At the current bond yield in 1925 of 5 per cent, such an increase would have resulted in additional annual debt interest payments of almost £8 million. This would have added over 5 percentage points of national income to the government's borrowing requirement posing a huge burden on the state, significantly raising the risk premium so that the increase in interest payments would, in all probability, have been significantly greater.[109] This level of debt

[103] The two paragraphs summarise Daniel, 'Griffith'.
[104] Crafts, 'Reducing High Public Debt'; *Finance Accounts*, 1924/5; Duncan, 'The Social Income'.
[105] *Finance Accounts* and Mitchell, *British Historical Statistics* , p. 590, 602.
[106] Duncan, 'The Social Income'.
[107] FitzGerald and Kenny, 'Managing a Century of Debt'
[108] GDP at factor cost from Kennedy, *Productivity*, p. 10.
[109] Duncan, 'The Social Income'.

was not reached in Ireland until the fiscal crisis of the 1980s in the context of a relatively stable, consolidated independent state.[110]

Recent research has shown that debt episodes of over 90 per cent of GDP not only tend to subtract almost one percentage point of growth on an annual basis but, if they remain above the threshold for five years and turn into "overhangs," they are likely to last another decade if no default event occurs.[111] Given the already poor investment climate, debt legacy was likely to aggravate sluggish economic performance. The burden of the additional interest payments would have been worsened by the fact that the size of the potential debt would have meant that it would have had to be financed by borrowing outside Ireland. As mentioned, Churchill underlined that the interest burden of the UK debt was aggravated by the fact that a substantial portion of the UK debt interest payments went to US lenders.

To finance the payment of debt interest, there would have had to have been a corresponding increase in the surplus (reduction in the deficit) on the Irish current account. This would have implied a permanent negative impact on the standard of living, with the terms of trade already deteriorating. The primary reason why Ireland had not yet experienced a "chronic balance of payments" problem with its persistent trade deficit was due to invisible annual earnings of £8.5 million on overseas assets of approximately £200 million and migrant remittances. The crucial role played by these flows may have been an important influence on the open economic policy and the close links maintained with the British money market by the new administration. However, it made the danger of "a disastrous flight of capital" very real in the event of political turmoil as the owners of such assets were typically ex-unionist capitalists or the rentier class.[112]

With hindsight, the formula for allocating the Irish liability might have been considered to be quite favourable to Ireland. The basis for the British estimate of 1.5 per cent may understate the Irish tax yield, as when taking the Free State ratio of revenue receipts to the total (pre 1922) area of the UK for the fiscal years 1922/23, 1923/24 and 1924/25, the average Irish yield is 3.3 per cent of the UK total.[113]

In spite of its very high debt burden the UK did not default on any of its debts after both the Napoleonic and Great Wars. As a result, the UK was still able to borrow at reasonably competitive rates in the mid-1920s: the yield on UK long-dated bonds was around 4.5% over the 1920s. Another important factor affecting bond yields is political stability. With the civil war in Ireland 1922-3 and the related destruction and dislocation, it was far from stable and must have appeared a risky investment. In addition, the contingent liability for a share of the UK debt, possibly amounting to over 100% of Irish GNP, would have increased that risk.

[110] FitzGerald and Kenny, 'Managing a Century of Debt'
[111] Reinhart et. al., 'Public Debt'; Reinhart and Rogoff, 'Growth'.
[112] Daniel, 'Griffith'.
[113] *Finance Accounts* ; Mitchell, *British Historical Statistics*, p. 584.

Table 6: Long-term Bond Yields

	Ireland	UK	Difference
1922	-	4.4	
1923	-	4.3	
1924	5.5	4.4	1.1
1925	5.3	4.4	0.9
1926	5.2	4.6	0.6
1927	5.2	4.6	0.6
1928	5.1	4.5	0.7
1929	5.0	4.6	0.4
1930	4.7	4.5	0.3

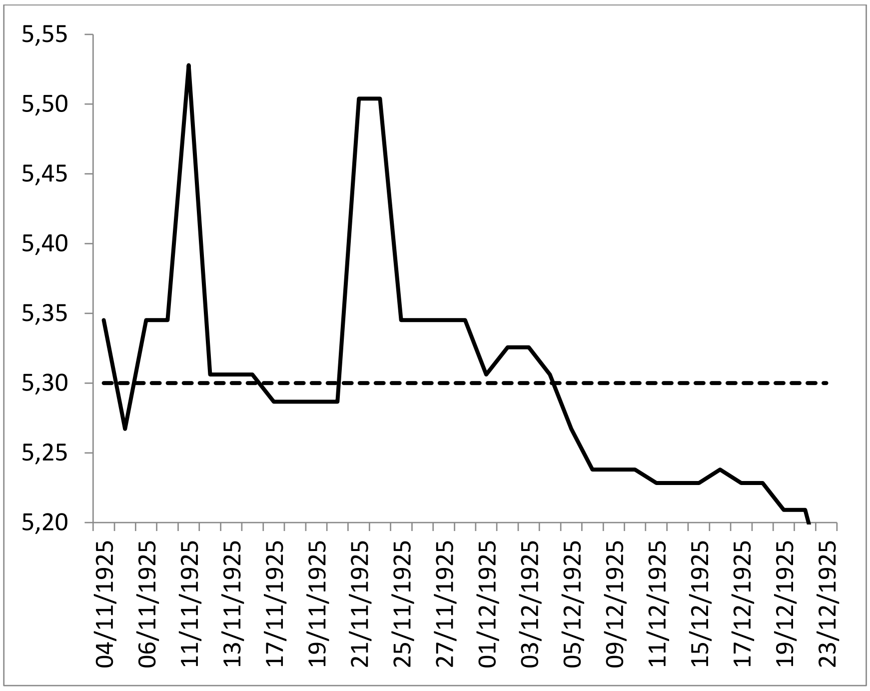
Sources: Finance Accounts; FitzGerald and Kenny, 'A Century of Irish Debt'; Mitchell, British Historical Statistics, p. 678.

As shown in Table 6, the Irish risk premium relative to UK bond yields was just over 1 percentage point in 1924, the year after the civil war ended. By today's standards this was a very low premium. It is made all the more puzzling by the fact that a number of opponents of the Treaty had already stated that the National Loan would be repudiated if they came to power.[114] The Irish risk premium fell slightly in 1925, even before the agreement was reached on the debt. In 1926, it fell further to 0.6 percentage points. While this fall could have been due to the removal of the very large contingent liability hanging over the state, it could also have been due to the normalisation of government in Ireland as the civil war was gradually relegated to history.

Some further light on how financial markets viewed the results of the agreement of December 1925 can be obtained from the daily market price data for Irish debt immediately before and immediately after the agreement of 3rd December 1925.[115] Figure 2 shows the daily yield relative to the 1925 average.[116] There was a significant spike in the yield after the first embarrassing leak on the outcome of the Boundary Commission upon Saturday the 7th of November. It raised fears of a possible collapse in the Dublin government. On the previous Friday, a smaller increase in the yield had occurred amid rumours that only "detailed adjustments" to the existing boundary were being considered and that no large transfers south were likely. The sharp rise in the yield reflected the political uncertainty facing the nascent state upon the release of this delicate news and was not affected by any prospective change in the debt burden.

[114] Meenan, *Irish Economy,* p. 252.
[115] See Foley-Fisher and McLaughlin, 'Sovereign Debt Guarantees' also.
[116] See Appendix 2d for details of calculations

Figure 2: Daily Yields of the First National Loan on the Dublin Stock Exchange, Nov-Dec 1925.



Source: Belfast Newsletter. Note: Dotted Line represents 1925 Average taken from FitzGerald and Kenny,'A Century of Debt'. See Appendix 2d for details.

The temporary fall in the yield later that week may be partly explained by the response of southern politicians, the press and officials in the immediate aftermath of the report. The *Cork Examiner*, for instance, ignored the speculation, claiming that the eventual official outcome would inevitably give dissatisfaction to both sides and that this knowledge had "cooled the passions" formerly associated with the problem.[117] More significantly, it was generally doubted that the Irish Boundary Commissioner, Eoin MacNeill, would sign such a report and the forecast was dismissed officially as pure speculation without justification by the secretary to the Irish Boundary Commission.[118] A second major spike in the yield however, was precipitated by MacNeill's resignation on the evening of the 20th November, confirming the worst fears of the Free State that the "leak" was in fact accurate.[119] As discussed above this triggered urgent talks between the Irish and British governments.

After the agreement was signed on 3rd December, providing increased political certainty and relieving Ireland of a very large contingent debt liability, the price of Irish bonds gradually rose above where it had been earlier in the year and the yield fell below the annual average. Financial equities fell by 9 per cent at the end of November but increased by over 20 per cent the following month on the signature of the deal.[120] The behaviour of both markets suggests that they did factor in some effect from the improved economic viability of Ireland as a result of the agreement. However, the size of the improvement in the national loan yield and the related

[117] *Cork Examiner*, Nov 10, 1925.
[118] *Irish Independent*, November 9, 1925.
[119] Later in private talks with the British, Cosgrave stated that had MacNeill "been in touch with border or Free State feeling, he could scarcely have been party to that agreement" - 26th November, Whitehall, DTaoiseach S4720A.
[120] Grossman et al.,'Monthly Stock Exchange.'

reduction in the risk premium was relatively small, reflecting the fact that, even before the agreement, financial markets had not seen the contingent liability as a huge risk factor. Political instability, as reflected by uncertainty about the outcome of the Boundary Commission, appears to have had a bigger influence on financial markets. The Chancellor of the Exchequer later admitted that the British delegation would have "had to review the whole situation in light of Ireland's capacity to pay. That is only what we do with every other debtor."[121] By December 1926 the First National Loan was trading at par and for the remainder of the decade, national loans traded mainly at premium.[122]

5. Conclusions

This paper has reviewed the financial aspects of the divorce between Ireland and the UK and its political economy. Though the separation was upon a consensual basis, the existence of unresolved financial liabilities combined with an unresolved political border posed a threat to political and economic stability. As we document, the crisis of November 1925 on the Boundary Commission Report forced a situation which resulted in the Financial Settlement being signed by the three governments.

As we document with the help of primary sources, the pending decision of the Commission was totally unexpected and the Irish Government had not considered what they might seek in return for accepting the current border: no plan had been developed on how the rights of Catholics in Northern Ireland could be protected and no consideration had been given in the Department of Finance to Ireland's contingent liability for a share of the UK debt. The Irish delegation was forced to react in an impromptu fashion during the discussions with the UK government. It is clear that, having failed in the early meetings to secure a more favourable delineation of the border, their next priority was protection for the rights of Catholics in Northern Ireland. When this policy was rejected by Craig, the link between Ireland's public debt (Article V) and the Border (Article XII) was revisited.

From the Irish point of view at the time of the agreement the outcome was a major political failure. They had achieved neither of their objectives – a favourable alteration of the border or equal civic rights for Northern Catholics. The agreement on the debt was seen as just sufficient to save face domestically. Nonetheless, as we show, had the full British claim been successfully pursued it would have had very serious economic consequences for Ireland. According to the Irish Minister for External Affairs, "even if we had striven our utmost to pay, it would result probably in bankruptcy."[123] By many contemporary debt vulnerability thresholds, Ireland's fiscal solvency would have been threatened.[124]

From the point of view of the UK government, the outcome of the negotiations was successful. They finally achieved a tri-partite agreement on the existing border. This removed the risk of further potential conflict between Ireland, Northern Ireland and the UK at a cost of 2 per cent of national debt, which they had never removed from their balance sheet to begin with.

[121] HC Deb 4 December, 1925, vol. 188 cc. 357.
[122] Meenan, *The Irish Economy,* p. 252; McLaughlin ' Economic Impact'.
[123] Dáil Debates, 8 December, 1925
[124] IMF, 'The Joint World Bank-IMF Debt Sustainability Framework'; IMF, 'Debt and Reserve-Related Indicators '.

However, while the separation of Ireland and the UK may have been driven by politics, the Financial Agreement only considered economic outcomes at the expense of political considerations. The failure of the UK government to make Craig provide guarantees for the rights of the Catholic minority in Northern Ireland did not have any negative consequences for the UK government at the time but in 1969, the same year that the original Boundary Report was released after decades of suppression, this changed with the outbreak of the civil rights movement and a campaign of violence.

From the point of view of the Northern Ireland government, the outcome of the talks was very satisfactory. Craig had consolidated the existing border through the agreement which also allowed him to evade concessions on the rights of the Catholic minority in Northern Ireland. His contribution on November 29, helping move the discussion onto the financial issue, proved very wise from his point of view, ensuring that the final agreement had no negative implications for Northern Ireland, albeit involving some financial cost for the UK.

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Appendix 1- The Agreements

a. **Below are listed the relevant articles of the *Government of Ireland Act, 1920* which are referred to in the main text.**

Section 1 (1) On and after the appointed day there shall be established for Southern Ireland a Parliament to be called the Parliament of Southern Ireland consisting of His Majesty, the Senate of Southern Ireland, and the House of Commons of Southern Ireland, and there shall be established for Northern Ireland a Parliament to be called the Parliament of Northern Ireland consisting of His Majesty, the Senate of Northern Ireland, and the House of Commons of Northern Ireland.

Section 1 (2)

For the purposes of this Act, Northern Ireland shall consist of the parliamentary counties of Antrim, Armagh, Down, Fermanagh, Londonderry and Tyrone, and the parliamentary boroughs of Belfast and Londonderry, and Southern Ireland shall consist of so much of Ireland as is not comprised within the said parliamentary counties and boroughs.

Section 2 (1)

With a view to the eventual establishment of a Parliament for the whole of Ireland, and to bringing about harmonious action between the parliaments and governments of Southern Ireland and Northern Ireland, and to the promotion. of mutual intercourse and uniformity in relation to matters affecting the whole of Ireland, and to providing for the administration of services which the two parliaments mutually agree should be administered uniformly throughout the whole of Ireland, or which by virtue of this Act are to be so administered, there shall be constituted, as soon as may be after the appointed day, a Council to be called the Council of Ireland.

b. **Below are listed the relevant articles of the *Anglo Irish Treaty, 1921*, which are referred to in the main text.**

Article IV

The oath to be taken by Members of the Parliament of the Irish Free State shall be in the following form:- I do solemnly swear true faith and allegiance to the Constitution of the Irish Free State as by law established and that I will be faithful to H.M. King George V., his heirs and successors by law, in virtue of the common citizenship of Ireland with Great Britain and her adherence to and membership of the group of nations forming the British Commonwealth of Nations.

Article V

The Irish Free State shall assume liability for the service of the Public Debt of the United Kingdom as existing at the date hereof and towards the payment of War Pensions as existing at that date in such proportion as may be fair and equitable, having regard to any just claim on the part of Ireland by way of set-off or counter-claim, the amount of such sums being determined in default of agreement by the arbitration of one or more independent persons being citizens of the British Empire

Article X

The Government of the Irish Free State agrees to pay fair compensation on terms not less favourable than those accorded by the Act of 1920 to judges, officials, members of Police Forces and other Public Servants who are discharged by it or who retire in consequence of the change of government effected in pursuance hereof. Provided that this agreement shall not apply to members of the Auxiliary Police Force or to persons recruited in Great Britain for the Royal Irish Constabulary during the two years next preceding the date hereof. The British Government will assume responsibility for such compensation or pensions as may be payable to any of these excepted persons.

Article XI

Until the expiration of one month from the passing of the Act of Parliament for the ratification of this instrument, the powers of the Parliament and the Government of the Irish Free State shall not be exercisable as respects Northern Ireland, and the provisions of the Government of Ireland Act 1920, shall, so far as they relate to Northern Ireland, remain of full force and effect, and no election shall be held for the return of members to serve in the Parliament of the Irish Free State for constituencies in Northern Ireland, unless a resolution is passed by both Houses of the Parliament of Northern Ireland in favour of the holding of such elections before the end of the said month.

Article XII

If before the expiration of the said month, an address is presented to His Majesty by both Houses of the Parliament of Northern Ireland to that effect, the powers of the Parliament and the Government of the Irish Free State shall no longer extend to Northern Ireland, and the provisions of the Government of Ireland Act, 1920, (including those relating to the Council of Ireland) shall so far as they relate to Northern Ireland, continue to be of full force and effect, and this instrument shall have effect subject to the necessary modifications. Provided that if such an address is so presented a Commission consisting of three persons, one to be appointed by the Government of the Irish Free State, one to be appointed by the Government of Northern Ireland, and one who shall be Chairman to be appointed by the British Government shall determine in accordance with the wishes of the inhabitants, so far as may be compatible with economic and geographic conditions, the boundaries between Northern Ireland and the rest of Ireland, and for the purposes of the Government of Ireland Act, 1920, and of this instrument, the boundary of Northern Ireland shall be such as may be determined by such Commission.

Article XIV

After the expiration of the said month, if no such address as is mentioned in Article 12 hereof is presented, the Parliament and Government of Northern Ireland shall continue to exercise as respects Northern Ireland the powers conferred on them by the Government of Ireland Act, 1920, but the Parliament and Government of the Irish Free State shall in Northern Ireland have in relation to matters in respect of which the Parliament of Northern Ireland has not power to make laws under the Act (including matters which under the said Act are within the jurisdiction of the Council of Ireland) the same powers as in the rest of Ireland, subject to such other provisions as may be agreed in manner hereinafter appearing.

c. **Below the December 1925 Agreement is presented in entirety with signatories from the three governments, which was passed in the Free State as The Treaty (Confirmation of Amending Agreement) Act 1925.**

(AGREEMENT AMENDING AND SUPPLEMENTING THE ARTICLES OF AGREEMENT FOR A TREATY BETWEEN GREAT BRITAIN AND IRELAND TO WHICH THE FORCE OF LAW WAS GIVEN BY THE IRISH FREE STATE (AGREEMENT) ACT, 1922, AND BY THE CONSTITUTION OF THE IRISH FREE STATE (SAORSTÁT EIREANN) ACT, 1922 .)

WHEREAS on the 6th day of December, Nineteen hundred and twenty-one, Articles of Agreement for a Treaty between Great Britain and Ireland were entered into:

AND WHEREAS the said Articles of Agreement were duly ratified and given the force of law by the Irish Free State (Agreement) Act, 1922, and by the Constitution of the Irish Free State (Saorstát Eireann) Act, 1922 :

AND WHEREAS the progress of events and the improved relations now subsisting between the British Government, the Government of the Irish Free State and the Government of Northern Ireland and their respective peoples make it desirable to amend and supplement the said Articles of Agreement, so as to avoid any causes of friction which might mar or retard the further growth of friendly relations between the said Governments and peoples:

AND WHEREAS the British Government and the Government of the Irish Free State being united in amity in this undertaking with the Government of Northern Ireland, and being resolved mutually to aid one another in a spirit of neighbourly comradeship, hereby agree as follows:—

1.—The powers conferred by the proviso to Article 12 of the said Articles of Agreement on the Commission therein mentioned are hereby revoked, and the extent of Northern Ireland for the purposes of the Government of Ireland Act, 1920, and of the said Articles of Agreement shall be such as was fixed by sub-section (2) of section one of that Act.

2.—The Irish Free State is hereby released from the obligation under Article 5 of the said Articles of Agreement to assume the liability therein mentioned.

3.—The Irish Free State hereby assumes all liability undertaken by the British Government in respect of malicious damage done since the Twenty-first day of January, Nineteen hundred and nineteen to property in the area now under the jurisdiction of the Parliament and Government of the Irish Free State, and the Government of the Irish Free State shall repay to the British Government at such time or times and in such manner as may be agreed upon moneys already paid by the British Government in respect of such damage or liable to be so paid under obligations already incurred.

4.—The Government of the Irish Free State hereby agrees to promote legislation increasing by Ten per cent. the measure of compensation under the Damage to Property (Compensation) Act, 1923, in respect of malicious damage to property done in the area now under the jurisdiction of the Parliament and Government of the Irish Free State between the Eleventh day of July, Nineteen hundred and twenty-one and the Twelfth day of May, Nineteen hundred and twenty-three, and providing for the payment of such additional compensation by the issue of Five per cent. Compensation Stock or Bonds.

5.—The powers in relation to Northern Ireland which by the Government of Ireland Act, 1920, are made powers of the Council of Ireland shall be and are hereby transferred to and shall become powers of the Parliament and the Government of Northern Ireland; and the Governments of the Irish Free State and of Northern Ireland shall meet together as and when necessary for the purpose of considering matters of common interest arising out of or connected with the exercise and administration of the said powers.

6.—This Agreement is subject to confirmation by the British Parliament and by the Oireachtas of the Irish Free State, and the Act of the British Parliament confirming this Agreement shall fix the date as from which the transfer of the powers of the Council of Ireland under this Agreement is to take effect.

Dated this 3rd day of December, 1925.

Signed on behalf of the British Government:

STANLEY BALDWIN.

WINSTON S. CHURCHILL.

W. JOYNSON-HICKS.

BIRKENHEAD.

L. S. AMERY.

Signed on behalf of the Government of the Irish Free State:

LIAM T. MAC COSGAIR.

KEVIN O'HIGGINS.

EARNÁN DE BLAGHD.

Signed on behalf of the Government of Northern Ireland:

JAMES CRAIG.

CHARLES H. BLACKMORE,

Secretary to the Cabinet of Northern Ireland.

d. **Below are listed the relevant articles of the *Heads of the Ultimate Financial Settlement between the British Government and the government of the Irish Free State (March 1926)* which are referred to in the main text.**

1.The Government of the Irish Free State undertake to pay to the British Government at agreed intervals the full amount of the annuities accruing due from time to time under the Irish Land Acts, 1891-1909, without any deduction whatsoever whether on account of Income Tax or otherwise

3. The British Government accept liability for the provision out of monies provided by Parliament of the cost of the interest and sinking fund on bonus and excess stock under the above-mentioned Acts subject to a contribution by the Irish Free State Government of the sum of £160,000 in the year 1926-27 and at the rate of £134,500 per annum thereafter.

5. The Irish Free State Government agree to discharge their liability outstanding on 1st April, 1926, in respect of the Local Loans Fund by the payment of an annuity payable half-yearly of £600,000 to the Fund for a period of 20 years payable on the 1st January and the 1st July in each year, the first half-yearly payment being payable on the 1st July, 1926.

8. The British Government waive all claims against the Government of the Irish Free State for the refund of any portion of the sums paid by them under Section 1 of the Irish Railways (Settlement of Claims) Act, 1921.

10. The Irish Free State Government agree to make no claim in respect of any of the assets of the Consolidated Fund of the United Kingdom including inter alia the Civil Contingency Fund and receipts on account of Reparations and Inter-Allied Debts.

Appendix 2. Data and Calculations

a. <u>The National Income of Ireland, 1926.</u>

As stated in the main text, official estimates of National Income are not available and we therefore apply the estimate of Duncan (1940) for 1926 GNP throughout. Where we refer to GDP, we refer to Kennedy's (1971, p. 10) estimate of GDP at factor prices (GDP less depreciation and indirect taxes). These estimates are likely to understate Irish national income, as when Duncan's estimate for 1938 is compared with official estimates, the former's are considerably lower.[125] While these estimates are not without their criticisms, they are the only published estimates to date and we use them bearing this caveat in mind.

As a crosscheck, recent work by Geary and Stark (2017) has shown that Ireland's national income in 1931 was 3.6 per cent of the UK total which varied by only 0.3 per cent of its share in 1911. Taking the recent estimate for the UK in 1926 of £4,255 million of Thomas and Dimsdale (2017) and assuming an unchanged share, this places Ireland at £153,180,000 which is closer to Duncan's figure GNP at factor cost below.

The benchmark figures are presented in Table A1.

Table A1: Published Estimates of Irish National Income, 1926 (Millions £)

	1926	**Sources**
GNP	£154.1	Duncan (1940)
GDP	£141.8	Kennedy (1971, p. 10)

b. <u>Debt Dynamics Compared</u>

In the text, reference is made to differences in the servicing of the British and Irish debt between the two entities. Bearing the limitations of the data pertaining to Ireland in mind, the steady state condition of public debt could be calculated as follows.

$$b^* = (i - \pi - g)d$$

Where $b*$ is the required primary budget balance to keep debt stationary, d is the public debt ratio, g is the real rate of economic growth, i is the nominal rate of interest and π refers to inflation. The UK figures are taken directly from Crafts (2016).

The Irish figures are less reliable, not least because of issues with national income estimates described above. For instance, taking the nominal rate of interest on the First National Loan is unlikely to be representative of the counterfactual, as interest rates were likely to increase dramatically in the event of a large increase in the debt burden (and political instability) which would have made the necessary effort in foreign borrowing extremely difficult. The growth figure in Table A2, which presents the comparative figures, is similarly questionable as it is taken from Maddison's (1996) interpolation between the existing estimates. Differences in various estimates and their reliability have been compared by Ó Gráda and O'Rourke (1996).

[125] See 'National Income and Expenditure Tables, 1938-44' and Fitzgerald (2017).

It is for these reasons, that we do not stress this finding in the main text, but consider it a useful exercise in the counterfactual nonetheless.

Table A2: The Steady State Condition of Irish and UK Debt (% of GDP)

	b	***i***	***π***	***g***	***d***	***b****
UK	6.1	4.8	-1.4	-4.6	1.7	**18.6**
Ireland (No Deal)	0.3	5.0	-2.6	-0.5	1.2	**9.2**
Ireland (Post Agreement)	0.3	5.0	-2.6	-0.5	0.1	**1.0**

Sources: Brennan Memorandum; Finance Accounts of Saorstát Éireann; FitzGerald and Kenny, 'Managing a Century of Debt'; Crafts, 'Reducing High Public Debt Ratios;' Kennedy, *Productivity and Industrial Growth,* p. 10; *Maddison, 'Monitoring the World Economy'; Central Statistics Office- Table CPA 04.*

c. Arriving at the Capital Value of the Debt during the Anglo Irish Financial Agreement

We take the accepted contemporary view that the capitalized debt of £5 million is the final Irish liability. While Article 3 of the subsequent 1926 Agreement specified that other annuities of £134,500 would be paid over a period of twenty years, these were not considered debt as they were payments relating to original loans taken on the Land Acts which covered fluctuations in prices and were based upon private flows from borrowers to the Commission. Indeed, when the capital value of the debt of the agreement was included in the National Debt for the first time in the Finance Accounts of 1943/44, it similarly referred only to the compensation annuity repayments.

It is worth reviewing the manner in which this was calculated from sixty annuities of £250,000.

$$P = \frac{r\ (PV)}{1-(1+r)^{-n}}$$

Using the standard present value calculation, where P is the annuity, r is the rate per period and n as the number of periods, we can arrive at the present capitalised value PV of the sum total of the annuities. At a rate of 3.5%, considered by the British Treasury as appropriate, over a sixty year period of annual payments of £250,000, the present capital value of the total liability was £6,236,138.[126] Though this sum was meant to cover British compensation payments already made to Ireland on account of damaged properties in Ireland, the latter reached only £4,868,800 and therefore a shortfall of £1.5 million remained.[127]
The British delegation suggested that the Free State should be deemed to have undertaken to repay a second moiety of £1.5 million compensation to the Irish Railways from a previous agreement, which was not linked to public debt.[128]

[126] This was crosschecked with the rough estimate provided on December 3, 1925 at Downing Street, DTaoiseach S4720A.
[127] DTaoiseach S4720A.
[128] These contested claims were ultimately waived in the Ultimate Financial Settlement of March 1926 which was a supplementary "tidying-up operation," Fanning, *The Irish Department of Finance*, p. 174; Appendix 1d, Clause 8.

Cosgrave preferred instead that Ireland should have been regarded as having already assumed liability for repayment of the British compensation liability above together with interest of 5 per cent on amounts already paid by the British government, which was calculated at £268,174, making a total of £5.1 million.[129] This was politically favourable to Cosgrave's government, as such sums were to be discharged to Irish resident loyalists who were "our own people".[130] Resisting pressure to pay a more expensive lump capital sum instead of the flat rate increase of 10 per cent on all compensation awards, Cosgrave instead offered an immediate payment of £150,000 and the subsequent sixty repayments of £250,000 at an interest rate of "approximately" 4.75 per cent in order to arrive, by construction, at the figure "approximately equivalent to the capital liability referred to".[131] This arrangement was formalised in a supplementary agreement.[132] Using the formula above indeed yields £5.09 million.[133]

d. Calculating Daily Bond Yields

The daily yields on the First National Loan were calculated from prices reported in the *Belfast Newletter*. As the prices were listed on the following morning's publication, they have been readjusted to match the previous day's activity.

The simplified formula used is:

$$Y = \frac{C + \frac{F - P}{n}}{\frac{F + P}{2}}$$

Where:

Y	=	Yield to maturity
C	=	Interest payable on the bonds
F	=	Nominal value of bonds purchased
P	=	Amount paid for the bond
n	=	Years to maturity

The nominal value of bonds purchased could only be taken on an annual basis from the sinking fund in the Finance Accounts which gave the nominal value of bonds bought back and market value (amount paid). The daily price "paid" in our equation was the daily price multiplied by the nominal value.

The full bond's life was twenty years as its maturity date was 1945.[134]

The interest was calculated by multiplying the nominal interest rate (5 per cent) by the nominal value purchased.

[129] Approximate Estimates from Treasury, DTaoiseach S4720A.
[130] Dáil Debates, 7 December, 1925
[131] December 3, 1925 at Downing Street, DTaoiseach S4720A.
[132] F200/75/25
[133] Includes the £150,000 downpayment.
[134] See FitzGerald and Kenny (2017) for a discussion on the maturity profiles of Irish national bonds since independence.

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