“Till Debt Do Us Part”: Financial implications of the divorce of the Irish Free State from the United Kingdom, 1922–1926.

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In this paper, we discuss the apportionment of national debt when Ireland exited the UK in 1922. We estimate that the claim on Ireland amounted to 80 percent of Irish Gross National Product (G.N.P.) and describe how it was ultimately waived at the expense of an unchanged land border with Northern Ireland. While this represents the largest debt relief episode in the twentieth century, the political cost of the agreement exceeded the financial gain in the long run. We find that domestic markets reacted more to political uncertainty than the pending liability, despite the financial stability which resulted from the debt write-down.

1. Introduction

As a result of Brexit, the Irish land border with the UK has once again been placed at the centre of the political and economic discourse.1 For the UK, the financial and economic implications of leaving the European Union have been key concerns. Yet, due to a previous political commitment on the status of the Irish border, leaving the union has proven more complex than most had anticipated. This paper revisits the last time that the border played a pivotal role in exiting an economic union. Specifically, it addresses the exit of Irish Free State (I.F.S.) from the UK in 1922 and analyses the apportionment of UK public debt in conjunction with the ultimate shape of the boundary, which was not finalised until the December 1925 Financial Agreement.

As part of the Anglo Irish Treaty of 1921, the I.F.S. had accepted both an undefined share of the UK public debt and the redrawing of the Irish boundary by an independent Boundary Commission. The Financial Agreement of 1925 resulted in a debt write-down of 80 percent of I.F.S. G.N.P., the largest relief settlement of the twentieth century. The unprecedented scale of the debt reduction reflected an attempt by the UK government to compensate the I.F.S. for (1) failing to deliver a redrawn border with Northern Ireland (N.I.) which adequately reflected “the wishes of the inhabitants” and (2) N.I.’s refusal to guarantee equal civic status for Catholics within the new N.I. state. It is likely that the UK delegation was conscious of the potential ramifications of the political shortcomings inherent in the agreement. Politically, the 1925 Anglo Irish Financial Agreement was a very costly one to all parties over the longer term horizon.

1 See McGuinness and Bergin (2019)
This paper revisits this settlement in its entirety and conducts a fresh analysis in light of the recent literature on debt relief episodes. Our paper essentially builds on the relevant but limited section on the 1925 Agreement in Fanning’s (1978, pp. 65–68) classic historical account of the Irish Department of Finance, 1922–1958. Specifically, we focus upon (1) the manner in which the liability was calculated, (2) the potential I.F.S. debt burden and its wider economic implications, (3) the international debt context and the negotiating position of the UK, and (4) the financial markets’ reaction to the key events of 1925. Furthermore, Fanning’s account relies heavily on political ex-post commentary of the signatories, both sides attempting to shore up support in their respective parliaments. From the UK side, it was important to stress that the I.F.S. had neither the capacity nor the political will to ever have paid, and thus they argued that the Agreement was “another Locarno-type” peace treaty. From the I.F.S. signatories’ point of view, it was important to claim that the potential debt burden would not only have been enforceable, but would have resulted in national “bankruptcy.”

In what follows, we draw on a range of primary sources and government documents to consider these issues. We find that the manner in which the UK calculated the I.F.S. liability was quite favourable to the I.F.S. and suggest that Treasury Officials attempted to set a lower figure that was financially feasible. Further, though the potential I.F.S. debt burden would have risen substantially, it would nonetheless have remained well below some of Europe’s most indebted nations.

We also review the market reaction to the 1925 Agreement and find that markets reacted frequently to negative political news, but did not react significantly to the undefined contingent debt. We suggest that shorter term market reactions can be explained by investor fears of repudiation on newly issued I.F.S. debt in the event of anti-treaty political success. Over the longer horizon, we show a downward path of the yields on I.F.S. debt through the entire 1920s and an associated falling risk premium over UK consols. As contemporaries recognised, this trend was mainly associated with growing political stability. However, another likely factor was the comparative financial stability of the I.F.S. when viewed against the backdrop of growing payment problems throughout Europe during the early 1920s to the 1930s.

The paper begins by presenting the context of the major elements of the story, namely the link between the undefined I.F.S. debt and the shape of the boundary and the negotiating positions of each side. We subsequently summarize the talks and the ultimate Financial Agreement of 1925.

The second part of the paper analyses the international context and addresses the potential debt burden. Finally, we assess the reaction of the Irish government bond market to key events of 1925 and beyond. We conclude with a summary.

2. Unfinished business of the Anglo Irish Treaty 1921

The Anglo–Irish treaty was signed on 6 December 1921 between representatives of what would become the I.F.S. and the UK government. N.I.’s Parliament never recognised the Treaty, as it had been granted its own political status as a region within the UK under the Government of Ireland Act of 1920. Consequently, the I.F.S. and N.I. administrations derived their legitimacy from exclusive individual arrangements with the UK government.

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2 H.C. Deb 04/12/1925, vol 188 c. 321.
3 Dáil Deb 08/12/1925.
4 See Appendix 1b.
5 See Appendix 1a.
The Treaty saw the end of the Irish war of independence, the beginning of political independence of 26 southern counties and southern recognition of a “permanent” partition of Ireland between the I.F.S. and N.I. However, the terms of the Treaty were the immediate cause of the subsequent Irish civil war in 1922–1923, which was primarily fought within the I.F.S. between government forces and anti-treaty rebels. The anti-treaty forces opposed the 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). Additionally, the Treaty’s text contained a number of unresolved issues relating both to public debt (Article V) and the ultimate boundary line to be decided by an independent Boundary Commission which would formally divide the island between N.I. and the I.F.S. (Article XII). A contemporary, Lord Buckmaster, described the document as “full of grave and dangerous ambiguity.”

2.1. The unresolved liability of Article V

Article V confirmed that the I.F.S. would assume liability for the service of a share of the Public Debt of the UK and War Pension payments, as existing on 6 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.” At the time of the Treaty, UK debt stood at 160 percent of GDP, the highest since the end of the Napoleonic Wars (figure 1).

6 H.L. Deb 22/03/1922, vol. 49 cc. 709–829.
7 Thomas and Dimsdale (2017).
Table 1. Decomposing the deficit during the civil war, 1923–1924

|                                | 1923  | 1924  | Increase |
|--------------------------------|-------|-------|----------|
| Total deficit (funded by borrowing) £ Million | 3.5   | 14.2  | 10.7     |
| % of National Income            | 2.3   | 9.2   | 6.9      |
| Total revenue £ Million         | 27.7  | 28.2  | 0.5      |
| % of National Income            | 18.0  | 18.3  | 0.3      |
| Total expenditure £ Million     | 31.2  | 42.4  | 11.2     |
| % of National Income            | 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 National Income            | 5.5   | 13.6  | 8.1      |
| % of Revenue                    | 30.7  | 74.5  | 43.8     |
| G.N.P. (1926)                   | 154.1 |       |          |

Source: Finance Accounts, 1922–1924; Duncan (1940). Note: Expenditure categories above do not include indirect items which might also be considered reparatory costs under “Supply Services”. The end of Financial Year is 31 March.

When the I.F.S. came into existence in 1922, it was granted full fiscal autonomy. The new state operated in the knowledge that an unresolved liability was yet to be agreed with the UK. The public finances of the I.F.S. were immediately tested throughout the civil war (1922–1923) during which the fiscal deficit quadrupled (Table 1). The deficit was largely funded by the First National Loan, which was raised at the end of 1923 and floated on the Dublin Stock Exchange on 7 January 1924.8 Anti-treaty partisans initially declared that the loan would be repudiated were they to attain power.9 As reported in Table 1, almost all of the deterioration in the fiscal deficit can be explained by the increase in “Army” and compensation for “Property Losses”, which absorbed almost three quarters of tax revenue in 1924.

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. As the ultimate geographic area of the I.F.S. was yet unknown pending a Boundary Commission Report (Article XII), the share of UK debt that the I.F.S. would assume under Article V became inexorably linked with the boundary question, to which we now turn.

2.2. The boundary question 1922–1925

The most politically sensitive unresolved item was contained in Article XII, which allowed N.I., originally created by the Government of Ireland Act of 1920, to exit the I.F.S. within 1 month and to remain within the UK.10 It did so on 8 December 1922.11 As a consequence of this predictable unionist rejection of an all-Ireland settlement, a Boundary Commission was to be established, consisting of three representatives, each appointed by the governments

8 Gwynn (1928, p. 252). Belfast Newsletter (08/01/1924).
9 Meenan (1970, p. 252).
10 See Appendix 1b.
11 Gwynn (1950, p. 219).
of I.F.S., N.I., and the UK. Its report would determine the new boundary by considering “the wishes of the inhabitants, so far as may be compatible with economic and geographic conditions.”

When the Treaty was signed in 1921 between the future I.F.S. and UK governments, the wording of Article XII convinced one I.F.S. signatory that “the decision of the Boundary Commission would be certain to deprive [N.I.] of Fermanagh and Tyrone” which had nationalist [Catholic] majorities. In 1921, UK Prime Minister Lloyd George stated to Irish signatories that an N.I. refusal to recognise the Treaty (Commission) would ultimately “save” those nationalist majority counties of Fermanagh and Tyrone. Ostensibly, the British cabinet continued to hold the view that the eventual publication of the Report would “be very favourable to the South.”

However, the Boundary Commission did not assemble until 3 years later due to the Irish civil war (1922–1923), the collapse of the Lloyd George government, the uneasy coalition which followed it, and the election of the Labour administration in 1924. A first attempt at convening the Commission collapsed in April 1924, when N.I., refusing to recognise the Treaty of 1921, declined to appoint a commissioner. This exposed the vulnerability of the I.F.S. government, as it had derived its legitimacy on the promise of the Commission delivering further territorial gains. The breakdown of the meeting strengthened support for anti-treaty suspicions that the Treaty (Article XII) could not succeed in delivering on “the wishes of the inhabitants.” Emergency legislation was passed at Westminster which enabled the external appointment of an N.I. Commissioner (J.R. Fisher) by the British Cabinet. The Commission met for the first time on 6 November 1924 and agreed to complete secrecy while they continued working through the next year on gathering information before publishing the report. The new boundary line was to become legally binding upon its publication.

2.3. The negotiating positions of the I.F.S. and UK

This section analyses the political economy of the Financial Agreement of December 1925 in an attempt to discern the economic positions, expectations and challenges facing each side before the settlement. Specifically, we draw on a range of primary sources prior to the London talks in an attempt to reduce the bias of ex-post political declarations in the aftermath of the agreement.

After the agreement was signed, the need to ensure its acceptance in the two parliaments saw the deployment of new arguments which were not advanced during the negotiations. For instance, for the I.F.S. government, it was necessary to convey that inevitable national bankruptcy had been avoided as it faced criticisms regarding the unchanged border. In

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12 See Appendix 1b.
13 See Appendix 1b.
14 R.I.A. Foreign Policy Document, No. 240 NAI DT S1801A, ‘Extract’; Collins (1922, p. 95).
15 Gwynn (1950, p. 213).
16 Jones’ Diary, p. 235.
17 Hand (1969, vii); Gwynn (1950, p. 222).
18 For a more complete account of the Boundary Commission, see O’Callaghan (2000) and Murray (2011).
19 Hand (1969, ix). J.R. Fisher was an Ulster unionist, a believer in Northern partition, editor of the Northern Whig, and a close ally of Craig.
20 Jones’ Diary, p. 235. Justice Feetham, who was chair of the Commission, had been Legal Adviser to the High Commissioner in South Africa and was subsequently appointed as a Supreme Court judge there.
21 See Appendix 1b.
London, the signatories stressed that a just peace had been achieved and downplayed Ireland’s capacity and willingness to pay the claim, in order to rebuke accusations of “an immense financial surrender.”

In 1925, I.F.S. official government debt servicing absorbed as little as 3 percent of tax revenue. However, in demographic terms, the disproportionate numbers of old and young residing in the I.F.S. (38 percent of population), which could not contribute significant tax revenue, placed a lower limit on debt servicing capabilities. The contingent public debt liability under Article V was not considered in the files of the I.F.S. Department of Finance and it operated in its first years of existence via the collection of taxes raised within its new political boundaries.

As early as June 1923, the I.F.S had received advice that it “should not stir hand or foot in the matter [Article V] for many a day as yet- certainly not until after the Boundary Commission.” Indeed, against the backdrop of this obstructionism, the UK Treasury sent a reminder of the pending debt issue in April 1925, though this official claim went unanswered in Dublin until 23 October when the Irish Department of Finance replied that it needed more time to consider a counterclaim. As late as September 1925, the I.F.S. Accountant General recommended Finance to “avoid figures as much as possible” in discussions with the UK government.

In addition to awaiting the ultimate outcome of the Boundary Commission’s decision, the reluctance of the I.F.S. government to consider the ultimate liability [Article V] was likely due to concerns about providing the anti-treaty opposition with political capital. The latter had refused to recognise Ireland’s share of the UK debt (as part of the Treaty) and had already threatened to repudiate the First National Loan of the I.F.S. in 1924, raised in large part to pay for the civil war. The I.F.S. government had less scope for manoeuvre as it had accepted the pending liability by its signature and ratification of the Treaty.

Attitudes within the I.F.S towards the repayment of UK debt in the aftermath of the war of independence were typically hostile. Newspaper reporting propagated the popular view that “expenditure by Britain upon wars never bestowed any advantage upon Ireland” and that in any final reckoning, it would be “considered how much the British Treasury has, since the Act of Union [1800], abstracted from Ireland in excessive taxation ... ‘more than an Empire’s ransom.’” The implicit suggestion is that much of the debt for which the I.F.S. was liable was odious in nature.

Writing in the latter half of the 1920s, Alexander Nahum Sack (1927, p. 157) outlined three characteristics which constituted “odious debt for the population of the entire state.” According to Sack, to qualify as “odious,” such debt has been issued without the population’s consent and without the intention of meeting “the requirements nor the best interest of the state, but to strengthen the status quo and to suppress any popular revolt.” Finally, the lender must have had prior knowledge of the intention of the loan. The bulk of the contingent liability comprised issues to finance the war effort [1914–1918] of the UK which had included

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22 H.C. Deb. 04/12/1925 vol. 188, c. 351.
23 Finance Accounts 1924/25.
24 Kennedy (1971, p. 8).
25 Fanning (1978, p. 129).
26 T160/239.
27 Fanning (1978, p. 163).
28 Meenan (1970, p. 252).
29 Irish Independent (16/02/1922).
Ireland in its entirety. Indeed, Irish MPs on both sides of the political divide took their seats at Westminster throughout the war and were well aware of the financial efforts required to fund it. It is obvious that the purpose of such loans was apparent to the lenders, as most were appropriately classified as “War Loans.” Furthermore, as Treasury officials recognised, a considerably higher share of the I.F.S.’s population had participated in World War 1 (within the UK) for which the debt was raised, than in the subsequent War of Independence. Consequently, the course chosen by the I.F.S. signatories of the Treaty was to secure the smallest liability possibly achievable.

The original claim, which had been forwarded by the UK, amounted to £155.75 million, producing an annuity of £6.25 million over a period of 60 years at the rate of 3.5 percent.31 This addition to the I.F.S. debt stock was the equivalent of between 80 and 100 percent of I.F.S. G.D.P.32 An annuity of this size would have equalled 24 percent of 1925 tax receipts in the I.F.S. From the minutes of the subsequent negotiations, it was pointed out to I.F.S. delegates that no state in Europe was paying less than 10 percent of its budget in the service of public debt. The Chancellor of the UK Exchequer, Winston Churchill, pointed to the recent debt agreements of France and Italy and suggested that Ireland could not fail to be sensible of the advantages to their credit that would follow a debt settlement.33 With the exception of Germany (which had been granted temporary relief) every state in Table 2, including neutrals such as Sweden, was paying more than 10 percent in tax revenues to service public debt in 1925, while the I.F.S. was paying 3 percent.

The UK’s debt position was “substantially different” from that of other allied countries such as Belgium, France, and Italy, as Germany’s repayments to the UK fell short of the latter’s transfers to the USA by $240 million. In contrast, the other three allied debtors recorded a surplus as their receipts from Germany exceeded their transatlantic obligations.34

Of the external debts acquired under the UK War Loans Act 1914–1919, 83 percent was

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Table 2. The cost of servicing European debt in 1925 (various countries), percent.

| State   | Share of tax revenue | Share of expenditure |
|---------|----------------------|---------------------|
| France  | 52.7                 | 45.9                |
| Italy   | 41.3                 | 32.4                |
| Sweden  | 16.8                 | 11.8                |
| Germany | 4.6                  | 4.3                 |
| Belgium | 57.4                 | 29.6                |
| Austria | 14.8                 | 13.6                |
| Finland | 10.3                 | 7.6                 |
| Romania | 21.9                 | 19.7                |
| UK      | 51.8                 | 47.8                |
| I.F.S.  | 3.2                  | 2.7                 |

Source: League of Nations Statistical Yearbook, 1926. Notes: Author’s calculations. Debt service costs equal amortization plus interest rates. Italy debt service includes “military pensions only”. Finance Accounts of 1925 used for Ireland.

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30 T160/430/12303.
31 T160/239.
32 FitzGerald and Kenny (2019); Duncan (1940).
33 D'Taioiseach S4720A.
34 Moulton and Pasvolsky (1932, p. 299).
due on the American government loan, on which interest was payable. The American component of the debt thus featured heavily in the subsequent negotiations with the I.F.S. and it was stressed that “if the attitude of the United States were to become less rigid, it would place us [UK] in a position to deal more generously.”

In 1925, the UK public debt ratio was 173 percent of GDP which compares to the I.F.S. ratio of around 8 percent. When the talks took place in late 1925, as much as 23 percent of outstanding UK government bond debt was due for redemption within 5 years, not including allied war debt. As Table 2 displays, over half of UK tax revenue was absorbed by debt servicing. The vast majority of UK debt holders were the voting public which placed additional political pressure on their delegation.

The commercial banking system held 19 percent of the UK debt, the Bank of England held 6 percent, non-residents held 5 percent, with the remaining stock all held by other domestic non-bank holders. In terms of institutions, particularly exposed were the non-bank financial institutions where over 54 percent of assets were invested in Government (and government guaranteed) securities. The Trustee Savings banks, though a small component of the system, had 76 percent of all assets invested in government securities and insurance companies were the next most exposed at 30 percent of their total portfolios.

The UK government was also aware that relief on the I.F.S. liability was likely to “strengthen the move in Ulster to reduce or abolish the N.I. contribution” and payments from other dominions at a time when “retrenchments were being pressed in education, health services, unemployment allowances and the armed forces.” In sum, the UK government was not in a favourable position to grant debt concessions to the I.F.S.

2.4. Calculating the I.F.S. debt

As both historical and modern contemporaries have recognised, there is no unique mechanism to apportion debts in the case of state secession. As Oosterlinck (2013) outlines, debts have been divided according to (1) population (Great Columbia in 1831; Federal Republic of Central America in 1841), (2) fiscal revenues (Austro-Hungarian and Ottoman Empires after World War I), (3) to GDP (Central African Federation in 1963) and (4) a combination of population and GDP (Czechoslovakia 1993). Additionally, there have been cases where one country has (5) assumed the whole debt burden (Pakistan in 1971 following the secession of Bangladesh). The evolution of the I.F.S. liability does not fit squarely into a single category, as the story of its liability straddles cases (2), (3), and (4) while in the end the UK assumed the entire debt burden (5).

The starting point for calculating the debt was the share of fiscal revenues Ireland generated within the UK. Specifically, two voluminous reports were published by a Royal Commission in 1895 and 1896, the terms of reference of which were to obtain information on the “relative taxable capacity” of Great Britain and Ireland (P.P. 1895, p. 3). It calculated that, though Irish

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35 Calculated from Pember and Boyle (1950, p. 335).
36 DTaoiseach S4720A.
37 Thomas and Dimsdale (2017); Finance Accounts, 1924/5; FitzGerald and Kenny (2019).
38 Calculated from Pember and Boyle (1950, p. 407).
39 Abbas et al. (2014).
40 Sheppard (1971, p. 31).
41 DTaoiseachS4720A.
42 H.C. Deb. 04/12/1925 vol. 188, c. 355.
taxes were about one eleventh of the UK, “the relative taxable capacity is very much smaller and not estimated by any of us as exceeding one twentieth” (P.P. 1896, p. 2). These estimates formed an essential backdrop to the calculation of the I.F.S.’s debt liability.

However, in 1924, the Treasury privately revisited that report and, accounting for adjustments, statistical errors, estimations of national income, and wage differentials, produced an all-Ireland tax yield of 3.7 percent of the UK total. The memo stressed that this must be considered a lower bound as it did not include all income under £150 “and such incomes form a far larger proportion in the poorer country than in the richer.” Almost 30 years after the first Reports (P.P. 1895; P.P. 1896), considerations of national income and income distribution had entered the UK Treasury’s calculations on debt apportionment. The memo also stated that the recent decline in the I.F.S. tax yield was only temporary, due to “the disturbances” and “price falls” and that “under normal circumstances the revenue will be sufficient to cover expenditure with some margin.”

In hindsight, the Treasury formula for allocating the I.F.S. liability could be considered to be relatively favourable. The basis for the UK claim on the I.F.S. was 1.5 percent of the total UK tax yield. However, this reckoning understated the I.F.S. 1925 yield, as total I.F.S. tax revenue was equivalent to 3.3 percent of the 1925 UK total, though the income tax yield comprised less at 1.7 percent. Therefore, the official UK claim was less than the lower of the two available estimates of a fiscal year that was already recognized as having produced a comparatively poor yield. Further, it was materially lower than the all-Ireland yield of 3.7 percent, considered a lower bound in 1924.

A question arises as to why a lower yield might have been considered. The Chancellor of the Exchequer [Churchill] later claimed 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.” He was privately advised that the official figure was indeed “a moderate estimate of their claim and one which they could rely on carrying before an impartial arbitrator.”

An alternative claim on the I.F.S. was considered, in which it would share half of the scheduled increase in interest on American War debt from 1933, at which time, under the Dawes Plan of 1924, the rate was to increase by one half percent terminating in 1984. The first annual I.F.S. charge would have amounted to £2,250,000 in 1933 and the capital value in 1925 at 3.5 percent interest was approximately £35 million. This claim, which represented only one fifth of the ultimate claim, was never shown to the Irish delegation and has not featured in subsequent scholarship on the potential debt burden.

3. The settlement

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 7 November 1925. It accurately predicted the shape of the border which the Boundary

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43 T208/101.
44 T208/101.
45 T208/101.
46 "Finance Accounts; Mitchell (1988, p. 584)."
47 H.C. Deb. 04/12/1925, vol. 188 cc. 35.
48 T160/239.
49 T160/239.
50 Fanning (1978).
Table 3. *Meetings between I.F.S. and UK governments, November to December 1925.*

| Date  | UK lead                          | I.F.S. 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     |
| 01/12 | Churchill, W. (Chancellor of Exchequer) | O’Higgins, K. (Vice President) | Chequers     |
| 02/12 | Churchill, W. (Chancellor of Exchequer) | Cosgrave, W.T. (President)  | Treasury     |
| 03/12 | Churchsell, 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 I.F.S. equates with Prime Minister and Deputy Prime Minister.

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 prosperous areas of the I.F.S. into N.I. and poorer regions in the opposite direction.  

Among N.I. unionists, a notable shift in sentiment in the press and by the political class can be observed in attitudes towards the pending report. The *Belfast Newsletter* even underlined that the I.F.S. must either accept the report or repudiate the Treaty, in which case it was forfeiting it’s very “right to exist” as a political entity.

To the I.F.S. government, political embarrassment was made worse by reignited fears of civil war. Parliamentary questions in Dublin concentrated on whether “the wishes of the inhabitants” had been properly considered by the Commission. I.F.S. President of the Executive Council, W.T. Cosgrave, responded with the statement that the alleged “leaked” boundary “fulfils none of the conditions called for by the clearly-expressed language of Article 12.” Commissioner MacNeill resigned the following evening, confirming the worst fears that the “leak” was in fact accurate.

### 3.2. The London talks

This political emergency initiated urgent talks between I.F.S. and UK representatives in London (Table 3). Much of the anxiety felt by the I.F.S. government can be explained by the fact that “once the three appointments had been made [to the Boundary Commission], a majority would rule” rendering MacNeill’s resignation irrelevant, as was recognised by northern, southern and British newspapers.

The I.F.S. delegation, headed by Cosgrave, went to London for 6 days of negotiations with the UK government beginning on 26 November 1925. Initially, the I.F.S. representatives stressed that, if published, the Commission’s report would bring about the collapse of the Dublin government which had honoured the Treaty. Cosgrave’s major complaint was that

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51 *Belfast Newsletter*, 10/11/1925; *Irish Independent*, 09/11/1925.
52 *Belfast Newsletter*, 20/11/1925.
53 Dáil Deb. 19/11/1925.
54 Dáil Deb. 19/11/1925.
55 Report of the Judicial Committee of the Privy Council (1924, p.5).
Table 4. The UK claim on the I.F.S.

|                                | £                  |
|--------------------------------|--------------------|
| **UK Total 1921**              |                    |
| Capital amount of public debt  | 7,840,000,000      |
| Capital amount of war pensions | 850,000,000        |
| **I.F.S., 6 December 1921**    |                    |
| Share of debt (1.5 percent)    | 117,600,000        |
| Share of pensions (1.5 percent)| 12,750,000         |
| Net British claim on Ireland  | 130,350,000        |
| Interest compounded at 5 percent | 27,462,454        |
| **1922–1925**                  |                    |
| Net British claim on Ireland  |                    |
| Interest compounded at 5 percent | 27,462,454        |
| **Potential I.F.S. 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.

The spirit of Article XII had been ignored and he rejected the idea that the Commission “followed their terms of reference”. UK Prime Minister Stanley Baldwin temporarily agreed to postpone the publication. The I.F.S. delegates persistently argued for the protection of Catholics in N.I. (against gerrymandering of constituencies, sectarian policing, and discrimination) in return for an unchanged border and desperately wished to suppress the publication of the new report. However, British Home Secretary Joynson-Hicks accurately predicted the tone of N.I. unionist resistance, which would never “consent” to “outsiders” changing local electoral boundaries and other matters.

Subsequently, Kevin O’Higgins and N.I. Prime Minister James Craig met bilaterally on 29 November, having received an ultimatum from Baldwin that “between them . . . they must discuss together the situation that confronted them.” After the meeting, Craig indicated to Baldwin that O’Higgins had raised the issue of Article V of the treaty that covered I.F.S. responsibility for a share of UK debt. Subsequent negotiations were moved to the Treasury on 1 December signifying the importance of this development.

Table 4 summarises the first adjusted estimates of the I.F.S. portion of UK debt made by Joseph Brennan, Secretary of the I.F.S. Department of Finance on 30 November in Dublin, the day after the issue was first raised at Chequers. This estimate corresponds closely to the sum in the post-agreement announcement of the I.F.S. Minister for Finance of “£157.75 million” though it actually exceeded by £2 million the official figure claimed by Churchill (£155.75 million). As stated, the claim was based upon an I.F.S. tax yield of 1.5 percent of total UK revenue and the UK Treasury had calculated that, based upon the latter figure, an annuity of £6.25 million per year was due for 60 years at a rate of 3.5 percent. The rate
of 5 percent was also mentioned in the negotiations as an upper bound, which would have produced an annuity of £8.25 million.  

It was later claimed that, when faced with the British claim, “we [the I.F.S.] had no tangible assets against it.” Nonetheless, in the internal files of the Treasury it was observed that claims were made by the I.F.S. against the local loans fund and the civil contingencies fund, which should be “dropped in any general settlement.” The supplementary agreement of March 1926 stipulated that the I.F.S. could never proceed with a counterclaim. 

Late on 1 December, O’Higgins stated that the I.F.S. government could only survive if one of two conditions was secured: a marked improvement of the situation of N.I. Catholics or a waiving by the UK of its rights under Article V. The following day, when “Craig would not meet them with adequate concessions,” Cosgrave met Churchill in private and offered to accept the status quo border in return for major financial concessions. Churchill, realizing that no agreement could be reached between N.I. and the I.F.S., conveyed to his cabinet that the collapse of the I.F.S. to anti-Treaty forces would imply losses, in addition to the claims under Article V, of the pension payments and annuities amounting to approximately £4.8 million annually. These arguments triumphed and it was privately agreed that the agreement would have to be promoted as another “Locarno [Treaty]” in the Commons.

3.3. The Financial Agreement of 1925

The agreement signed on 3 December 1925 was approved by representatives of all three governments and is presented in full in Appendix 1c. Article XII on the Boundary Commission was revoked and Article V was waived, which released the I.F.S. from its debt obligations. In return, the I.F.S. assumed all liabilities undertaken by the British government in respect of malicious [military] damages done between January 1919 and the cessation of the civil war in 1923, retroactively increasing compensation to victims for the latter conflict by 10 percent.

A supplementary agreement formalised how this liability, estimated at a capital value of £5 million, was to be discharged in annuities of £250,000 for a period of 60 years, with an initial payment of £150,000. The remaining payments were waived by a further agreement between the two governments in February 1969.

Craig’s gain was primarily a political one in the form of an unexpectedly unchanged border. Predictably, the settlement did not give long term security to N.I. unionists as the Catholic minority was neither small enough to be absorbed nor large enough to force the Belfast

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64 DTaoiseachS4720A.
65 Dáil Deb, 08/12/1925.
66 T160/239.
67 Appendix 1d; F37–10–26.
68 DTaoiseachS4720A.
69 DTaoiseachS4720A.
70 After the Irish side had left the meeting on 2 December, the 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.” This statement is at odds with the internal treasury documents and may simply reflect the preparation of a justification for waiving the debt for posterity, as the agreement was signed off the following day.
71 H.C. Deb. 04/12/1925, vol 188 c 321.
72 F200/75/25; See Appendix 2a for details on calculations.
73 Irish Times, 01/03/1969.
government to deal with it on equal terms.\textsuperscript{74} N.I.’s financial gain might seem insignificant, though it continued to receive comparatively generous social service provisions from the British exchequer.\textsuperscript{75} 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.\textsuperscript{76} While it was suggested that N.I. had contributed almost £18 million since 1920, Churchill claimed that on balance it was closer to £1 million annually.\textsuperscript{77} By 1930, concerns were raised inside the Treasury that if it became public knowledge that “we now subsidize N.I. to the tune of £1 million a year,” I.F.S. opponents of the land annuity repayments would claim that “the North had been better treated than the South.”\textsuperscript{78}

The settlement left 2 percent of the UK debt stock on its balance sheets, which might have been removed in the absence of the agreement.\textsuperscript{79}

We now turn to reflect on the scale of the debt write-down in an international context and consider the potential debt burden of the I.F.S that was waived as a result of the agreement.

4. The 1925 Agreement in perspective

4.1. The international context of the settlement

The Financial Agreement of 1925 removed a dormant UK claim on the I.F.S. of £155.75 million, amounting to 80–100 percent of G.N.P., depending on the denominator.\textsuperscript{80} After, the agreement, the I.F.S. government debt stood at 8 percent of G.N.P. However, in the aftermath of World War I, the I.F.S. joined a long list of European states which had experienced newly drawn political borders and which were navigating through the financial implications of secession. It is therefore appropriate to consider the 1925 Agreement in an international context.

A recent exhaustive study by Reinhart and Trebesch (2016) reviews the record on sovereign debt relief over the twentieth century. By adjusting their data from the post Hoover Moratorium era, it is possible to add the case of the I.F.S. to assess how unique the 1925 Agreement was. As Table 5 shows, even when we use the most conservative estimate of the debt ratio, the 1925 write-down is unparalleled (as a share of debtor national income) over the interwar period, representing the third highest case of relief expressed as creditor (UK) income, after France and Italy.\textsuperscript{81}

While these episodes reflect official sector debt and debt relief, it would also be informative to examine the pre-war experience when the bulk of UK creditors were private concerns. Because no consistent series exists on this, we collected data from the annual reports of the Council of the Corporation of Foreign Bondholders, combine the total nominal debt in default each year (1885–1929) and normalise it with UK G.D.P. Figure 2 presents the results. The

\textsuperscript{74} Matthews (2000, p. 440–1).
\textsuperscript{75} H.C. Deb. 04/12/1925, vol. 188 cc. 317–318; Irish Independent, 06/11/1925; Matthews (2000, p. 440).
\textsuperscript{76} Mitchell (2006).
\textsuperscript{77} H.C. Deb 04/12/1925, vol. 188 c.354, c.361.
\textsuperscript{78} T160/430/12303.
\textsuperscript{79} Author’s calculations from D’Taioiseach S4720A; Mitchell, (1988, p. 602).
\textsuperscript{80} FitzGerald and Kenny (2019); Duncan (1940). We rely upon the more conservative debt to G.N.P. ratio throughout of 80 per cent.
\textsuperscript{81} In Ireland’s case, GNP figures are more appropriate than GDP, as the latter refers to all output, including income generated which flows or is earned abroad. The total income remaining with Irish residents is the GNP and it differs from GDP by the net amount of incomes sent to or received from abroad. In general, over the periods covered in this paper, Irish GNP is comparable with international GDP.
Table 5. Defaults on debt owed to UK from the official sector, 1934.

| Default on UK (% UK GDP) | Debt relief (% of debtor GDP) |
|--------------------------|------------------------------|
| France                   | 17.4                         | 52.2                          |
| Italy                    | 5.8                          | 36.4                          |
| Belgium                  | 0.3                          | 4.1                           |
| Poland                   | 0.1                          |                               |
| Yugoslavia               | 0.8                          |                               |
| Romania                  | 0.7                          |                               |
| Greece                   | 0.5                          | 43.4                          |
| Estonia                  | 0.0                          | 1.7                           |
| Latvia                   | 0.0                          |                               |
| Australia                | 1.8                          | 6.2                           |
| New Zealand              | 0.6                          | 10.5                          |
| Portugal                 | 0.5                          | 10.3                          |
| I.F.S. 1925              | 3.5                          | 80                            |

Sources: For the I.F.S., see text. Reinhart and Trebesch (2016) for debt relief percentage. Authors’ Calculations on individual defaults derived from Reinhart and Trebesch (2016).

Figure 2. Previous defaults to UK creditors (private) as percent of UK G.D.P. Source: Annual Reports of the Council of the Corporation of Foreign Bondholders (1885-1929) for nominal value of principal in default and Thomas and Dimsdale (2017) for U.K. GDP. Note: Authors’ calculations from summing values of all new loans in default (national and provincial) from each annual report. Does not included Mexican default of 1866 or Russian default of 1917, as these primarily concerned French creditors.
Table 6. Comparing I.F.S. debt relief with later restructurings.

| Debtor                        | Period    | Relief as percent of external debt | Relief as percent of GDP |
|-------------------------------|-----------|------------------------------------|--------------------------|
| Latin American Debt Crises    |           |                                    |                          |
| Argentina                     | 1982–1993 | 80                                 | 24                       |
| Mexico                        | 1982–1990 | 105                                | 36                       |
| Venezuela                     | 1983–1990 | 106                                | 42                       |
| Soviet satellites             |           |                                    |                          |
| Bulgaria                      | 1990–1994 | 36                                 | 56                       |
| Poland                        | 1982–1994 |                                    | 15                       |
| Former Yugoslavia             |           |                                    |                          |
| Bosnia Herzegovnia            | 1992–1997 | n.a.                               | 22                       |
| Serbia and Montenegro         | 2003–2004 | 23                                 | 8                        |
| I.F.S.                        | 1922–1925 | 94                                 | 80                       |

Source: For the I.F.S., see text. Reinhart and Trebesch (2016) for other countries in sample. Note: Group 1 comprises emerging markets on fixed exchange rates, experiencing debt crises. Group 2 comprises Soviet satellite break away states. Group 3 comprises a sample of secessionist states of the former Yugoslav republic following conflict.

extent of the write-down of I.F.S. debt exceeds the size of all loans in default to UK creditors since 1840 (as a share of UK national income) at 3.5 percent.

Finally, we consider the Financial Agreement of 1925 in relation to other twentieth century debt relief agreements, irrespective of creditor location or status. Table 6 reports a selected sample of debt relief agreements from the Reinhart and Trebesch (2016) population. Bulgaria received the largest debt relief in the total population of countries in their study, at 56 percent of G.D.P. The I.F.S. Agreement exceeds all episodes by a large margin, even when using the most conservative estimate of I.F.S. debt to G.N.P. Indeed, external sovereign debt relief averaged 21 percent of GDP in the turbulent 1930s across the Reinhart and Trebesch (2016) sample.

How unique was the 1925 Financial Agreement in terms of its structure? In one way, the debt write-down was typical of the period. During the 1920s, a plethora of agreements were made where the terms were favourable to debtor countries, projected repayment periods were long (often exceeding 50 years) and the nominal interest rates charged were typically at or below 3.5 percent of principal outstanding.82

However, in almost all historical cases the settlement had been a protracted process.83 Indeed, while Reinhart and Trebesch (2016) study the overhang of World War I debt as outstanding in 1934, they show that rescheduling and payment irregularities on these debts began in the early 1920s. Therefore, the Financial Agreement of 1925 stands as an outlier in both the speed at which it was delivered and the size of the write-down. This was key in promoting recovery as the negative effects associated with the typically prolonged debt negotiations was apparent during the 1980s for example, where uncertainty over the shape of any ultimate settlement was found to be a “major force depressing capital formation throughout the Third World.”84

82 Reinhart and Trebesch (2016).
83 Oosterlinck (2013).
84 Lindert and Morton (1989, p. 234).
The major outcome of the 1925 Financial Agreement was a large write-down of the principal component of I.F.S. debt. Recent research has found that economic activity picks up following a debt relief operation if the deal involves face value debt reductions, while rescheduling operations with maturity extensions and interest reductions were not followed by an improvement in economic growth.\textsuperscript{85} Specifically, G.D.P. per capita increases of 11 and 20 percent were observed 5 years after debt relief episodes in advanced economies and emerging markets respectively.\textsuperscript{86} The unprecedented scale of the write-down is indicative of awareness on the part of the UK government on the increased likelihood of another civil war, due to the maintenance of the status quo border. The I.F.S. administration needed a political victory to take back to the public to mitigate the resentment regarding the failure to secure a boundary which reflected “the wishes of the inhabitants”. The UK government did not force the hand of the N.I. Unionists into political concessions for the Northern minority, choosing instead to use debt in diplomacy, which was a marked departure from its usual modus operandi.\textsuperscript{87}

4.2. The potential debt burden

Given the unprecedented scale of such debt relief, the counterfactual alternative might be considered. While impossible to state with any certainty, we can imagine some effects of a worse-case scenario materialising where the full liability was assumed by the I.F.S. At the current bond yield in 1925 of 5 percent, such an increase would have resulted in additional annual debt interest payments of almost £8 million. The more favourable proposal by the UK Treasury of an annual annuity, based on a 3.5% rate of interest, would have resulted in an annual payment of £6.25 million. Depending on the way the annuity was derived, it would have added between 3 and 5 percentage points of national income to the government’s borrowing requirement, posing a huge burden on the state.\textsuperscript{88}

Because such additional debt interest would have been paid to holders of debt abroad, it would have represented a major negative shock to the economy. Generally, the more closed an economy, the larger the multiplier effects from such a shock. In more recent times, the multiplier for a cut in public expenditure on goods and services was around 1.3—a cut in public expenditure in Ireland of €1 billion in 2013 would have reduced G.N.P. by almost €1.3 billion (Bergin, \textit{et al.}, 2013). In 1926, with much lower import intensity and very much lower marginal tax rates, the multiplier was considerably higher. Thus, the shock of having to pay for a share of the UK debt would have reduced national product in 1926 by a minimum of 5 percent, as a conservative estimate.

Because all of the annuity payments of £6.25 million would have gone to the UK it would have posed major problems for the balance of payments. To restore equilibrium would have demanded a very large increase in exports or a reduction in imports. The fact that the I.F.S. was “exceptionally dependent on imports” and that three quarters of its exports consisted of agricultural produce, did not bode well for its ability to service a large increase in the debt burden.\textsuperscript{89} The nature of the agricultural sector meant that there would have been a weak supply response, even to a devaluation of the currency, so that the bulk of the adjustment

\textsuperscript{85} Reinhart and Trebesch (2016).
\textsuperscript{86} Reinhart and Trebesch (2016).
\textsuperscript{87} Oosterlinck (2013).
\textsuperscript{88} Duncan (1940); FitzGerald and Kenny (2019).
\textsuperscript{89} Daniel (1976).
would have to have come from reducing imports. To close the gap of an outflow of 4–5 percent of GDP would have required cutting imports by around 10 percent or through an increase in exports of around 15 percent.⁹⁰

A reduction in imports was likely to have devastating effects on the economy as almost 60 percent of the total could be considered inputs to industry and agricultural productivity within the I.F.S.⁹¹ Such reductions would have warranted draconian increases in taxation or cuts in expenditure needed to close the budget deficit arising from the higher interest payments. The level of debt servicing that would have resulted from the I.F.S. accepting a share of the UK debt was not reached in the I.F.S. until the fiscal crisis of the 1980s, in the context of a comparatively stable, consolidated republic.⁹²

Another counterfactual could be imagined which involved the League of Nations. Indeed, during the 1925 negotiations, with the threat of renewed political violence overshadowing the I.F.S. delegation, their UK counterparts were informed that “any government in the Free State trying to restrain the people would be forced to consider whether any way out of their difficulties lay through their membership of the League of Nations.”⁹³ Recent research has shown that loans received from the League’s Economic and Financial Organisation largely accomplished their task, in that they provided much needed capital to countries in “dire financial straits” when international capital flows dried up completely.⁹⁴ While most of these loans were intended for reconstruction and currency stabilization, some were allocated to meet political crises, such as resettling the mass migration of refugees in Greece. First time issuers included Poland and Estonia who, similar to the I.F.S., faced political instability and high current account deficits. The league’s role as an external multilateral agent solved the credibility problem of borrowing countries, while it monitored the distressed countries’ reconstruction plans and ensured compliance of debtors with its programmes. Perhaps unrealistically, this scenario assumes that political stability remains intact in spite of the worst case outcome.

While it is impossible to estimate the counterfactual political fallout from both a perceived loss of territory and a dramatic increase in the public debt, the Agreement resulted in political and economic stability and prevented the counterfactual of capital flight, dramatic adjustment and dramatic declines in G.N.P., which may themselves have been aggravated by a renewal of violence and uncertainty. Importantly, a considerably large fiscal contraction was avoided in the period leading up to the Great Depression.

### 5. The market reaction

We now consider in detail the market’s reaction to the events surrounding the leaking of the Boundary report and the subsequent financial agreement. We use market price data for the National Loan to calculate approximate daily yield to maturity immediately before and after
the agreement of 3 December 1925 (Figure 3).95 There was a significant spike following the embarrassing leak on the outcome of the Boundary Commission upon 7 November. It raised fears of a possible collapse in the Dublin government. On the previous Friday, the yield had increased amid rumours that merely “detailed adjustments” to the existing boundary were being considered.96 The sharp rise in the yield reflected the political uncertainty facing the nascent state upon the release of this delicate news and it was not affected by any prospective change in the debt burden.

The temporary fall in the yield later that week may be 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.97 Further, it was generally doubted that I.F.S. Boundary Commissioner MacNeill would sign such a report and the forecast was dismissed officially as speculation by the secretary to the Irish Boundary Commission.98 A second major spike in the yield was precipitated by MacNeill’s resignation on the evening of 20 November, confirming the worst fears in the I.F.S. that the “leak” was in fact accurate. As discussed, this development triggered urgent talks between the I.F.S. and British governments.

After the agreement was signed on 3 December, providing increased political certainty and relieving I.F.S. of a very large contingent debt liability, the yield fell. Financial sector equities [stocks] fell by 9 percent at the end of November but increased by over 20 percent

95 Belfast Newsletter, 06/11/1925.
97 Cork Examiner, 10/11/1925.
98 Irish Independent, 09/11/1925.
the following month after the signature of the deal. The behaviour of both bond and stock markets suggests that they did factor in some effect from the improved economic viability of the I.F.S. as a result of the agreement. However, the positive market reaction to the deal may simply represent the resumption of a downward trend of the yield in 1925. The National Loan is therefore better considered against an alternative market instrument using a different comparative measure. figure 4 displays the cumulative abnormal bond return (CABR) on holding the First National Loan against British Consols. Despite the fact that this measure is related to the yield, it effectively measures the cumulative capital return on holding one instrument against another by tracking the difference in price change over a given sample period. The CABR on I.F.S. bonds over Consols grew rapidly from 3 December to the end of the year, showing a distinctly positive market reaction to the Agreement.

While the markets tended to react negatively to what were perceived as events engendering political uncertainty, such as the re-emergence of anti-treaty element and the prospect of a renewal of civil war, they did not seem to be concerned with the contingent liability for a share of the UK debt. This is similarly borne out by daily price data on the First National Loan throughout the 1920s. It is apparent from figure 5 that the value of government stock began increasing from its trough in September 1924, more than a year before the outcome of the Financial Agreement.

Two large contractions are visible in the market value of the government stock during the 1920s. The first decline of almost 10 percent between March and September 1924 coincides with the Army Mutiny crisis in March and the collapse of the first Boundary Commission
talks at the end of April. The Army Mutiny Crisis was the result of mass demobilisation following the civil war which caused resentment and spilled over into a temporary minor revolt within a faction of the military against the government. The collapse of the boundary talks in April 1924 strained the credibility of the 1921 Treaty amongst less committed supporters, whilst simultaneously strengthening the legitimacy of the suspicions of the anti-treaty group.

The second major decline of 7 percent broadly mirrors political developments in 1927. The results of the June 1927 election removed Cumann na nGaedheal’s working majority within the Dáil when Fianna Fáil, a newly formed anti-treaty party which had made electoral gains, took their seats for the first time on 12 August 1927.¹⁰⁰ The suspension of the Dublin parliament followed on 25 August and another general election was called on 15 September, which established a return of the ruling government, albeit as a minority administration. No interruption of the upward trend is apparent prior to this and the sustained rise in the value of the First National Loan through 1925–1926 offers little evidence to suggest market fear of a large contingent liability being realised, nor one of relief for its removal.

¹⁰⁰ Cumann na nGaedheal is the name of the political party which governed the I.F.S. since independence. Fianna Fáil was formed in 1926 as an anti-treaty party which chose to take its seats in Dáil Éireann if elected, in contrast to the remaining anti-treaty wing of Sinn Fein who did not recognise it.
Table 7. Major price movements and events, 1924–1930.

| Event                          | Period          | Price change | Decline in basis points | Std. dev. from mean (σ) |
|-------------------------------|-----------------|--------------|-------------------------|------------------------|
| The Army Mutiny               | 6 March 1924    | −1.1%        | 112                     | 2                      |
| The Collapse of the First     | 28 April 1924   | −3.4%        | 325                     | 3                      |
| Boundary Talks                |                 |              |                        |                        |
| Stock Market Depression       | August 1924     | −1.6%        | 150                     | 2                      |
| UK Election                   | 29 October 1924 | −2.9%        | 275                     | 3                      |
| Leak of Boundary Report       | 7 November 1925 | −2.1%        | 200                     | 3                      |
| Resignation of MacNeill       | 20 November 1925| −2.6%        | 250                     | 3                      |
| Fianna Fáil Enter Dáil        | 11 August 1927  | −1.4%        | 137                     | 2                      |
| Wallstreet Crash              | 24 October 1929 | −2.4%        | 237                     | 3                      |

Source: First National Loan prices from Belfast Newsletter and Foley-Fisher and McLaughlin (2016). Note: Authors’ calculations on price changes over two-day intervals.

However, this broader overview says nothing about shorter-term market reactions to contemporary news. Table 7 presents some of the most significant price declines (yield increases) linked to big events throughout the period. Of these eight largest price declines, five were due to perceived threats to political stability, associated with growing support for anti-treaty forces, whose earlier threat of repudiation still lingered. This view finds support in Irish history from other research showing negative reactions of the stock market as the perception of political instability grew out of the Irish Home Rule movement from the 1880s.101 Both the leaking of the Boundary report and MacNeill’s resignation moved the price by three standard deviations, as the threat of civil war or a collapse of the I.F.S. government increased.

Finally, the entry into the Dáil in August 1927 of Fianna Fáil was a perceived threat to the security of the National Loan. Politicians and press reports did little to allay investor fears. The Minister for Agriculture stated that “if the republicans were in tomorrow; the National Loan would go down to about 50” and another newspaper added that under such an election outcome “everyone who had a shilling in the National Loan would take it out.”102

However, even with the benefits of higher frequency price data, many market days passed without any price change and a major concern with Irish debt, even today, is illiquidity. To address this concern we present the annual yield to maturity, using sinking fund data from the I.F.S. government’s Finance Accounts throughout the 1920s. These are purchases by the Irish exchequer to retire debt from the secondary market and represent substantial transactions, which would move and test the market, in contrast to the dealings of smaller holders.

Table 8 reports a continuous fall in the annual yield and risk premium on I.F.S. debt which can be observed throughout the decade. Indeed, the market gyrations associated with short-term political crises observed in Table 7, appear as temporary phenomena. The civil war had placed “a premium on re-establishing stability” and the growing political stability of the new state might be one reason for the decline in risk premia.103 This at least, is the reason cited by one contemporary newspaper in 1927: “the efficiency with which the government had created order and security out of chaos was in no place so clearly reflected in the National

101 Hickson and Turner (2005).
102 Irish Independent, 03/05/1927; Connacht Tribune, 30/04/1927.
103 Kennedy, Giblin and McHugh (1988, p. 35).
Loan . . . our credit was practically as high as theirs [UK] and the effect of this was that Ireland could borrow money at a cheaper rate that any country in the world outside England.” 104 Nonetheless, newspaper reports such as these may simply reflect political bias, though the pattern is more puzzling in the context of other studies of the period, which showed that commercial banks demanded significant risk premia in lending to countries without a history of borrowing. 105 However, the I.F.S. was still a member of the sterling block/commonwealth area and it has been found that membership of the British Empire was associated with lower risk premia (more than 150 basis points) and facilitated lower borrowing costs during the troubled interwar period. 106

What other potential factors might explain the relatively muted market reaction to the removal of such a large contingent liability in the middle of the decade? Investor optimism throughout most of 1925 may reflect the fact that markets never believed in the I.F.S. assuming any amount of debt, as the I.F.S. administration had taken care not to leave any trace that they were considering such an eventuality. Alternatively, the muted reaction of the government bond markets might simply reflect the tendency that events which were considered important by ex-post observers of history were often of minor importance to contemporaneous financial markets and vice versa. 107 However, such views ignore the fact that established political figures such as John Dillon, the leader of the old Irish Parliamentary Party (until 1918) publicly estimated an annuity of £5 million in January 1925. At the annual dinner of the Chartered Accountants the following day, the Minister for Finance could only counter that this figure would need consideration of a counterclaim. 108

Significantly, in the case of the First National Loan, investors were primarily government supporters and the loan was floated upon the Dublin Stock Exchange, in spite of the joint stock banks’ reluctance to lend to the nascent state. As Fanning noted (1978, p. 97), “the Irish public clearly had confidence in the credit and financial stability of the state even if their banks did not.” Therefore, the majority of the holders of the National Loan may have been largely unconcerned with any potential “external” contingent liability due to the UK as long

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104 *Drogheda Independent*, 23/04/1927.
105 Oosterlinck (2013).
106 Ferguson and Schularick (2006).
107 Frey and Kucher (2000, 2001); Frey and Waldenström (2004).
108 *Irish Independent*, 11/01/1925; *Evening Herald*, 04/12/1925.
Table 9. *Timeline of major debt re-scheduling to creditors (USA and UK) 1922–1929.*

| Year | USA | UK |
|------|-----|----|
| 1923 | Finland, UK | |
| 1924 | Hungary, Poland, Lithuania | |
| 1925 | Belgium, Estonia, Italy, Romania, Latvia | Belgium, Romania |
| 1926 | France, Yugoslavia, Portugal | France, Italy |
| 1927 | | Greece, Yugoslavia |
| 1928 | | |
| 1929 | France | France |

Source: Based on Reinhart and Trebesch (2016). Note: Does not include the Dawes Plan (1924) rescheduling plan for Germany.

as the security of their own domestic investment was not in doubt. As shown in Table 7, five of the eight major price declines were associated with perceived threats to the domestic political status quo; the perception that anti-treaty factions would repudiate the loan lingered.

On mainland Europe, the 1920s were an especially difficult time in terms of sovereign debt service (Table 9). A cascade of sovereign debt defaults in the form of war reparations and rescheduling may have desensitized markets. An extreme instance occurred after the Soviet repudiation, “which neither halted trading in Russian bonds, nor did their price experience a sharp decline” (Lindert and Morton’s (1989, pp. 231-232) study of the period found that the majority of defaulters “escaped punishment during global crises: creditors were indiscriminate,” as adverse selection problems grew.

### 6. Conclusion

This paper revisits the sole previous occasion during which the economic and financial consequences of leaving a larger union (UK) became inextricably linked with the status of the Irish border. It focuses specifically on the circumstances around and the outcome of the Financial Settlement of 1925 between the I.F.S. and the UK.

First, we find that the debt relief received by the I.F.S. at 80 percent of G.N.P. is unparalleled in the twentieth century. The scale of the write-down was an attempt by the UK government to compensate the I.F.S. for failing to achieve a border which reflected “the wishes of the inhabitants” and for the former’s failure to bring the N.I. administration to grant equal civil rights to the Northern Catholic minority.

Second, we show that investors in the First National Loan of the I.F.S. were less concerned about the contingent UK liability as markets reacted in the short term to political instability and the lingering perception of the threat of repudiation associated with anti-treaty gains. Temporary economic and political stability were achieved as a result of the 1925 Agreement in the I.F.S., as reflected by the trend of falling yields and risk premia in the 1920s. However, the political costs of allotting N.I. greater leverage in the negotiations, became painfully apparent in later decades.

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109 Oosterlinck and Landon Lane (2006).
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