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Debt-relief and the Irish referendum

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In the recent history of European treaty making, Ireland has emerged as something of a roadblock in the path to deeper integration. Ireland's electorate initially rejected both the Lisbon and the Nice treaties. In each case, a second referendum was needed, offering concessions to public concerns, before the agreement could be ratified.

It is therefore little wonder that last week's decision by Enda Kenny, the Irish Taoiseach, that Ireland will hold a referendum on the European Union's "fiscal compact" has caused some turmoil. An Irish "no" – some commentators claim – would plunge the EU back in the very chaos from which it is struggling to escape.

Dublin's rejection of the treaty would be more than an embarrassment for the EU. While Ireland's economic travails are far from over, its booming exports and falling bond yields have earned the country the label of "poster-boy for austerity". Coming from such a virtuous source, a "no" to the fiscal compact would be a hard slap in Europe's face.

However, while an Irish rejection would be tricky to manage, its consequences need not be disastrous. Unlike the Nice and Lisbon treaties, the "fiscal compact" only needs to be ratified by 12 out of 17 eurozone members. Anyway, much of its substance is already enshrined in EU legislation.

Conversely, a no vote would have direct consequences for Ireland. When the European Stability Mechanism comes into existence in 2013, it will give loans only to countries that have ratified the treaty. Were Dublin to need support from the ESM at that date, it would have to sign or go without.

This lack of political leverage undermines the case of those who have argued that Ireland should use the referendum to extract concessions from the EU on the current debt-relief programme. It was therefore wise of Mr Kenny to state that he will not tie the two issues together. That would risk irritating his European partners, and undermine his efforts to re-negotiate other aspects of the programme.

Mr Kenny is seeking to restructure €31bn-worth of "promissory notes". These were issued by Dublin in 2010 to pay back loans from Ireland's central bank to Anglo-Irish Bank and Irish Nationwide Building Society, both at the centre of Ireland's financial crisis. The first payment on the notes falls at the end of March, while the last may not occur until 2031.

There are sound reasons why the government must honour its guarantees. The money provided to AIB and INBS was created by the central bank. To simply write off the debt would constitute a dangerous precedent, as every eurozone country could then claim the right to bail out insolvent banks by printing money. Unsurprisingly, it would also contravene the law that gives the European Central Bank control over the power to create euros.

There is a separate question, however, regarding the date when the money ought to be paid back. The current repayment schedule imposes a significant burden on the Irish economy at a time when it is still struggling to recover. A much better strategy would be to defer the repayment of the notes until the economy has resumed growing at a sustained rate. Alternatively, Dublin should be allowed to swap the existing notes for others with a longer maturity and a lower interest rate.

A restructuring would also make sense politically. Dublin has made significant progress in reducing its deficit and it would be foolish for Brussels not to reward this progress. And while Irish politicians share some of the blame for the blanket guarantee offered by Dublin to its stricken banks, it was the EU that strong-armed them in that position. Regardless of the referendum battle, it is only fair that the Union seeks to mitigate the impact of a wrong-headed decision.