Tithe an Oireachtais

An Coiste um Fhormhaoirsiú Buiséid

Réamh-Bhuiséid 2018: Tuarascáil ar Sheasamh Maicreacnamaíochta agus Fioscach Comhiomlána

Meán Fómhair 2017

Houses of the Oireachtas

Committee on Budgetary Oversight

Pre-Budget 2018: Report on Macro-economic and Aggregate Fiscal Positions

September 2017

32CBO003

Contents

Foreword

I welcome the publication of the Committee's *Pre-Budget 2018 Report on the Macroeconomic and Aggregate Fiscal Position*.

The Committee on Budgetary Oversight was established on 21st July, 2016 to enhance the Houses of the Oireachtas role in budget scrutiny with a particular focus on ex-ante Budget Scrutiny.

Between January and June 2017, the Committee conducted its ex-ante scrutiny on the macro-economic and fiscal position through a range of meetings with expert witnesses. This culminated in a meeting with the Minister for Finance and Minister for Public Expenditure and Reform, Paschal Donohoe T.D. on the 20th of July 2017.

This report offers a summary of the evidence heard by the Committee in the last six months, and its recommendations on Ireland's macroeconomic and fiscal position.

This report presages and will link in with the Committee's pre-Budget 2018 report, which is due to be published in early October.

I want to thank all witnesses who gave evidence to the Committee, the Members of the Committee and finally to the Financial Scrutiny Team for their support to Committee Members in drafting this report.

I commend this Report to the Dáil.

Josepha Madigan

_____

Josepha Madigan TD
Chairperson

Introduction

The Committee on Budgetary Oversight (the Committee) was established by order of the Dáil on 21st July, 2016. Its terms of reference are set out in Dáil Éireann Standing Orders Relative to Public Business (S.O. 186A – see Appendix A). Its remit includes the need to examine, and where it considers it appropriate, to report to the Dáil on the overall fiscal position, including:

> (i) the aggregated position on revenue and expenditure and the General Government Balance, including structural targets;
>
> (ii) medium-term projections for the public finances;
>
> (iii) macroeconomic forecasts and developments; and
>
> (iv) general fiscal governance including the application of fiscal rules and risks to the fiscal position;

Based on the evidence and material considered by the Committee between January and July 2017, this report outlines the Committee's view of:

- the macroeconomic position that will underpin decisions in Budget 2018 and the risks to this position.
- the fiscal position in 2017,
- the likely fiscal space in 2018, and
- some related matters.

The Committee will use the period from mid-September and October to focus on more specific issues on taxation and expenditure with a view to making pre-Budget recommendations on them.

1. Conclusions

1.1 Macroeconomic position

The Committee notes that the Irish Fiscal Advisory Council has endorsed "as within the range of appropriate forecasts" the set of macroeconomic projections prepared by the Department of Finance for SPU 2017.

The Committee is of the view that:

- Analysis of the public finances, public debt and their sustainability using alternative measures, including Modified Gross National Income (GNI*), is warranted.
- There is merit in considering reframing (domestic) fiscal targets as shares of GNI*.
- The Central Statistics Office (CSO) should explore with other statistical agencies if GNI* can be produced for other countries (even on a one-off basis) to allow more meaningful comparison of levels of tax and expenditure as a share of economic activity.

Based on the evidence of various witnesses at hearings held between January and July 2017, the Committee is of the view that the following macroeconomic risks need to be considered, in addition to risks already identified by Government:

- Capacity constraints in the construction sector and the potential of the construction sector contributing to the overheating of the economy;
- Low productivity in the indigenous industrial sector and other domestically orientated sectors.
- Legacy debt issues in domestic financial institutions;
- Under-investment in public infrastructure and a lack of coherent spatial planning;
- Issues around pay and its impact on the economy;
- Changes to the international tax system.

1.2 Fiscal Position 2017

The Committee notes that the aggregate deficit, as set out in Budget 2017, is still expected to be achieved, notwithstanding subsequent developments.

The Irish Fiscal Advisory Council (FAC) stated to the Committee regarding the fiscal rules "[a] breach was observed in 2016 and further breaches are planned for 2017." The Committee is concerned that the fiscal rules may be breached in 2017 as identified by IFAC.

The Committee notes that minimal compliance with the fiscal rules leaves little room to manoeuvre if there are unexpected events.

The Committee recommends that the Department of Finance and the Department of Public Expenditure & Reform continues to monitor and refine its methodologies to estimate income tax, Universal Social Charge (USC) and other taxes. The Committee on Budgetary Oversight should be informed when methodological updates materially impact on projected end-year revenue out-turns.

The Committee notes the overall below-profile expenditure as at end-June.

The Committee notes that the Government has made commitments for additional expenditure throughout the year (e.g. water charge refunds, public sector pay), and has stated that these commitments are to be paid for from existing resources.

The Committee recommends that, in future, when the Government announces significant expenditure not budgeted for, it provides an explicit statement to the Committee on Budgetary Oversight as to how such expenditure is to be funded, and its impact, if any, on adherence to the fiscal rules.

If such expenditure is to be funded from within existing resources, as voted on by the Dáil, it should be also stated which programmes will be affected.

1.3 Fiscal Position 2018 and beyond

1.3.1 Fiscal Space

The Committee welcomes the Government's commitment to ensure that the structural deficit target is met in 2018 as this increases fiscal space for 2019 and beyond.

The Committee notes the estimate of the net fiscal space for 2018 available from the Summer Economic Statement (SES) of €1.3 billion, allowing a nominal budget package of €1.5 billion.[1]

The Committee notes that pre-commitments on expenditure and revenue, notably carry-over from Budget 2017, reduce that amount to approximately €530 million after various adjustments to comply with the fiscal rules.

The Committee notes that, based on the figures produced in the Summer Economic Statement, the amount allowed for new current expenditure measures is less than the amount that the new Public Services Pay Agreement will cost.

The Committee recommends that any revisions of the fiscal space before the Budget are generally communicated to the Committee as soon as possible.

1.3.2 Fiscal Rules

The Committee re-iterates its position with regard to the fiscal rules and capital expenditure. In its *Report on Building on Recovery: Infrastructure & Capital Investment 2016 – 2021*, the Committee suggested the following as appropriate changes:

- Within the budgetary framework & fiscal rules, separate Capital and Current expenditure with different rules for each, for example the Golden Rule [2]adopted in the UK. This may involve a change in government accounting policies and techniques.
- Increasing the 4 year smoothing period currently in place. In this regard, in the non-government sector, major capital investments can be amortised over the lifetime of the asset. This should be factored into the way the State plans and finances such investment. This should also be factored into the fiscal rules.

[1] Data is based on best information available to the Committee in early September, and is subject to change following completion of the Committee's pre-Budget hearings.
[2] General government borrowing only allowed for investment, not to fund current spending.

- A relaxation of the fiscal rule that funding from the sale of state assets may not be used for capital investment especially post 2020.
- A relaxation of the fiscal rules for capital projects that are co-funded by the European Investment Bank (EIB).
- It should be noted, however, that in order to ensure the sustainability of public finances a cap on the level of the deficit should remain in place.

The Minister for Finance and Public Expenditure & Reform should continue to put forward a special case for Ireland to the EU regarding a relaxation of the fiscal rules.

As highlighted in the Committee on Budgetary Oversight's July 2017 Report on Capital Spending, current low levels of investment are impeding economic growth, and there is an urgent need for increased capital spending in the areas of housing and transport.

The Committee notes the Department of Finance's commitment to produce an alternative measure of the output gap, and looks forward to considering this measure and its implications for the fiscal position in due course.

1.3.3 Rainy day fund

The Committee notes IFAC's endorsement of the Rainy Day Fund, which it states "could make a useful contribution to more sustainable growth and to prudent management of the public finances".

The Committee notes the reduction in the amount set aside for the Rainy Day Fund, and the corresponding increase in capital expenditure that this will bring. This is consistent with the Committee's recommendations, in its July 2017 report on the Capital Plan, for increased capital investment.

The Committee also recommends that, as part of Budget 2018, the Government publishes a proposal on how the Rainy Day Fund will operate.

1.3.4 Debt Sustainability

The Committee recommends that the Government clarifies its timetable for the domestic targets for the debt-to-GDP ratio.

Now that the CSO has published GNI*, the Committee recommends that consideration be given to reframing this target as a share of GNI*.

1.3.5 Fiscal position in the medium term

The Committee notes the anticipated improvement in the budget position with a surplus likely in the medium term. It further notes that the debt-to-GDP ratio will continue to improve.

The Committee reiterates the principles it set out in its Pre-Budget 2017 Report, namely the need for a broad and stable tax base, and that budgetary changes should be progressive and should address strategic needs while recognising the fiscal rules.

The Committee recommends:

- More ex-ante analysis of proposed tax measures including their cost;
- Sustainability analysis of the main tax heads;

- Continued evaluation of existing tax expenditures (e.g. the VAT reduction in the hospitality sector).

The Committee welcomes the Expenditure Review and the renewed focus on achieving value-for-money from total Government expenditure.

1.3.6 Ex-ante Engagement with the Budget process

The Committee recommends that in future years, the Summer Economic Statement be published no later than mid-June and the Mid-Year Expenditure Report within a week of end-June.

1. Macroeconomic position

2.1 Economic growth

As the latest *CSO National Accounts* data show, the economy grew rapidly in 2016. The final figures for 2016 published on 14th July show a Gross Domestic Product (GDP) growth rate of 5.1%, with Gross national Product (GNP) growth of 9.6%. However, in Q1 2016 quarterly GDP growth was -2.6% and quarterly GNP growth was -7.1%. The latest quarterly results highlight the volatile nature of Ireland's economic growth statistics.

The Government projects GDP growth outlined in the *Stability Programme Update 2017* of 4.3% in 2017 and 3.7% in 2018. These are in general in line with other forecasts for the Irish economy (see table 1).

Table 1: Latest GDP forecasts for Ireland by institution (%)

Institution	Forecast made	2017	2018
Central Bank of Ireland	Jul 2017	4.5	3.6
European Commission	May 2017	4.0	3.6
ESRI	Jun 2017	3.8	3.6
IMF	Jun 2017	3.9	3.3
OECD	Jun 2017	3.7	2.5

Source: Department of Finance (2017) Monthly Economic Bulletin July 2017.

The Committee notes that the Irish Fiscal Advisory Council has endorsed "as within the range of appropriate forecasts the set of macroeconomic projections prepared by the Department of Finance for SPU 2017".

2.2 Use of new measure of domestic economic activity

The Committee notes the concerns relating to the use of GDP and GNP/ Gross National Income (GNI) as a measure of Ireland economic output. The Committee has heard evidence from numerous experts and stakeholders that the activities of multinational companies make the interpretation of GDP difficult.

From a budgetary perspective, there may be tension between using GDP as the basis of fiscal rules while basing decisions on taxation and expenditure on a more nuanced view of the level of economic activity in Ireland.

The recent National Accounts published the first estimates of GNI* as recommended by the Economic Statistics Review Group. It showed that in 2016 GNI* was 31.3% below the level of GDP and 16.9% below the level of GNI. The CSO in a separate note also showed that Gross Government debt was 72.8% of GDP and 106% of GNI*.

The Committee is of the view that:

- Analysis of the public finances and their sustainability using alternative measures including GNI* is warranted.
- There is merit in considering re-framing (domestic) fiscal targets as shares of GNI*.
- The CSO should explore with other statistical agencies if GNI* can be produced for other countries (even on a one-off basis) to allow more meaningful comparison of the levels of tax and expenditure as a share of economic activity.

2.3 Risks to economic growth

The *Stability Programme Update 2017* outlines a number of risks to the economic forecasts and notes that these risks to the baseline forecast remains tilted to the downside. The main risks identified in the *Stability Programme Update 2017* included, amongst others:

- A "hard Brexit" and related exchange rate realignment.
- External demand shocks including those specifically caused by geopolitical factors and trade protectionism.
- Policy uncertainty in the United States of America.
- Loss of competitiveness.
- Housing supply pressures.

The Committee has heard evidence throughout the year from various witnesses which confirm the above risks.

The Committee, following the evidence of various witnesses, is of the view that the following macro-economic risks need also to be considered in addition to the risks identified by the Government:

- Capacity constraints in the construction sector and the potential of the construction sector contributing to the overheating of the economy.
- Low productivity in the indigenous industrial sector and other domestically orientated sectors.
- Legacy debt issues domestic financial institutions.
- Under-investment in public infrastructure and a lack of coherent spatial planning.
- Pay pressures in the economy.
- Changes to the international tax system.

2. Fiscal Position 2017

3.1 Overview

Recent years have seen significant fiscal consolidation to control the deficit and associated debt levels. The General Government Deficit in 2016 was €1.5 billion or 0.6% of GDP in sharp contrast to the 9% of GDP deficit (excluding measures to support financial institutions) in 2011. The Gross Government Debt was €200.6 billion at the end of 2016 or 72.8% of GDP.

Budget 2017 projected a budget deficit of €1.2 billion or 0.4% of GDP in 2017. The update from the *Stability Programme Update 2017* did not change the 2017 projections of the overall deficit significantly. Gross Government Debt in the *Stability Programme Update 2017* was projected to be €204.6 billion by end 2017. However, this does not take into account of the effect of the AIB share sale in June (which raised approximately €3.4 billion or 1.2% of GDP).

The structural balance for 2017 was projected to be -1.1% of potential GDP in Budget 2017, this was revised to -1.2% in the *Stability Programme Update 2017*. Ireland's target is a structural balance of -0.5% of potential GDP or movement towards this target at 0.6 percentage points per annum.

IFAC gave evidence to the Committee on 20 June 2017. It stated that:

- So far, Ireland has shown a minimalist approach to compliance with the fiscal rules.
- A breach was observed in 2016 and further breaches are planned for 2017.
- The breach in 2016 is not deemed to be significant, though if the pattern of breaches continues there is potential that the public finances will be in a more vulnerable position than they would have been.

The Committee notes that the aggregate deficit as set out in Budget 2017 is still expected to be achieved, notwithstanding developments in the intervening period.

IFAC stated to the Committee regarding the fiscal rules "[a] breach was observed in 2016 and further breaches are planned for 2017." The Committee is concerned that the fiscal rules may be breached in 2017 as identified by the IFAC.

The Committee notes that minimal compliance with the fiscal rules leaves little room to manoeuvre if there are unexpected events.

3.2 First Half 2017 Figures

The Fiscal Monitor for end-June 2017 was published on 4th July 2017. It showed an Exchequer surplus of €2.485 billion, though excluding the AIB share revenue there would have been an Exchequer deficit of €500.5 million. The underlying year–on-year improvement in the Exchequer Balance was €642 million.

3.3 Tax

Tax revenue overall is €110 million under the end-June profile with shortfalls in income tax (-€214 million), Excise duties (-€84 million) and Stamp duties (-€64 million) offset to some degree by higher than expected V.A.T. receipts of €202 million and some other tax heads above profile. While tax revenue at end-June is 0.5% below profile, it is up 4.0% year-on-year.

The Committee heard evidence from the Department of Finance (on 5th April 2017) that the shortfall in income tax is in part due to the Universal Social Charge (USC). Based on the available evidence, it is likely that much of this shortfall in USC is due to an over-estimation of projected USC revenue due to the then methodology employed rather than an issue with the underlying economy.

The Committee recommends that the Department of Finance continue to monitor and refine its methodologies on estimating income tax and USC and other taxes. The Committee should be informed when methodological updates materially impact on projected end-year revenue out-turns.

3.4 Overall Expenditure

On the expenditure side, overall expenditure is €632 million or 1.9% below profile for the first half of 2017,[3] though up €940 million or 3.0% year-on-year. In broad terms:

- Gross Voted Current Expenditure was €265 million (or 1%) below profile.
- Non-Voted Current Expenditure (excluding debt interest) was €224 million (or 14.5%) below profile.
- Gross Voted Capital Expenditure was €57 million (or 3.6%) below profile.
- Interest on the National Debt was €86 million (or 2.3%) below profile.

3.5 Expenditure Issues 2017

The Committee has identified a number of expenditure pressures not accounted for in the 2017 budget figures. These include:

- The bringing forward of the public sector pay agreement;
- The payment of social protection Christmas bonus;
- The refund of water charges;
- Garda pay.

The Minister for Finance and Public Expenditure & Reform, Mr Paschal Donohoe T.D., confirmed to the Committee on the 20th July that a social protection Christmas Bonus would be paid this year, though did not indicate the level of the bonus.

The Minister also stated that the water charge refund would cost approximately €178 million and in January informed the Committee that the bringing forward of the public sector pay agreement would cost €120 million. He informed the Committee that it was the Government's

[3] Note these figures are based on Appendix IV of the Fiscal Monitor (incorporating the Exchequer Statement) June 2017.

intention that these latter expenditures would be paid through under-spends in other Exchequer expenditure and would not impact on the overall deficit target for 2017.

It is unclear at this stage if there will be sufficient savings to cover all these pressures.

The Committee notes the current overall below-profile expenditure at end-June.

The Committee notes that the Government has made commitments for additional expenditure throughout the year (e.g. water charge refunds, public sector pay) and has stated these commitments are to be paid for from existing resources.

The Committee recommends that in future, when the Government announces significant expenditure not budgeted for, it is explicated stated how this expenditure is to be funded and its impact, if any, on adherence to the fiscal rules.

If such expenditure is to be funded from within existing resources, as voted on by the Dáil, it should be stated which programmes will be affected.

3. Fiscal Situation - 2018 and beyond

4.1 Extra Resources Available for 2018 - "Fiscal Space 2018"

The Stability Programme Update (SPU) showed that total General Government Expenditure in 2018 is expected to be €78.38 billion, an increase of approximately €2 billion from €76.4 billion in 2017. General Government Revenue is expected to be €78.02 billion leaving a General Government deficit of €355 million or -0.1% of GDP in 2018. These figures incorporate the unallocated expenditure of €610 million.

Total Gross Voted Expenditure (i.e. expenditure directly approved by Dáil Éireann through the Estimates process) in 2018 is expected to be €60.1 billion, up from €58.1 billion (an increase of €2 billion or 3.4%). Before any additional Budget 2018 policy decisions have been taken, gross current voted expenditure is expected to increase by €1.2 billion or 2.3% in 2018 with gross capital expenditure increasing by approximately €800 million or 16.6%. The General Government Balance is expected to be -0.1% of GDP with a Structural Balance of 0-5% of potential GDP. Hence, in 2018, Ireland is expected to meet its Medium Term Objective under the EU fiscal rules.

The Minister for Finance and Public Expenditure & Reform, Mr Paschal Donohoe T.D., when addressing the Committee on the 20th July, emphasised the need to focus, not just on the additional fiscal space or additional expenditure, but also the totality of expenditure (approximately €60 billion voted and €78.4 billion in total). He stated that the Government is committed to reviewing 1/3 of expenditure each year to ensure "we are spending that money in the best possible way".

The Summer Economic Statement (SES) updated the estimate of available fiscal space for 2018 and beyond. Fiscal Space is calculated as the total amount of new tax and expenditure measures

that the government is able to introduce, while still being in compliance with the Expenditure Benchmark rule.

The SES estimates that the gross Fiscal Space in 2018 will be €1.7 billion. However, given certain pre-commitments of €0.8 billion (for demographic pressures and the original Lansdowne Road agreement) in spending offset to some extent by the non-indexation of taxation of €0.5 billion, the revised net fiscal space available for 2018 is €1.3 billion.

This figure needs to be further adjusted for commitments on capital expenditure and the related capital smoothing allowable under the fiscal rules and the need for a margin of compliance of €150 million under the Expenditure Benchmark to ensure that the structural deficit rule is complied with. When such adjustments are made, the (nominal) budget package allowed in 2018 is €1.5 billion.

However, this does not include the carry-over effect of Budget 2017, which used up resources that could have otherwise be used in 2018, or funding announced for the Action Plan for Housing. When these are taken off this leaves approximately €530 million of fiscal space uncommitted. This is currently divided between unallocated current expenditure measures (€140 million), revenue measures (€220 million) and capital expenditure (€180 million).

The extension of the Lansdowne Road agreement (estimated at €180 million for 2018) is not included in the figures and would exceed the amount set aside for new current expenditure measures.

The Committee welcomes the Government's commitment to ensure that the structural deficit target is met in 2018 as this increases fiscal space for 2019 and beyond.

The Committee notes the estimate of the net fiscal space for 2018 available from the Summer Economic Statement of €1.3 billion allowing a nominal budget package of €1.5 billion.

The Committee notes that pre-commitments on expenditure and revenue, notably carry-over from Budget 2017, reduce that amount to approximately €530 million after various adjustments to comply with the fiscal rules.

The Committee notes that under the figures produced in the Summer Economic Statement the amount allowed for new current expenditure measures is less than the amount that the new Public Services Pay Agreement will cost.

4.2 Revisions to Fiscal Space

The Committee notes that the estimate of the fiscal space was revised in the week before Budget 2017 *without* informing this Committee.

The Committee notes that the reasons for this revision in fiscal space was (a) revision of data by the CSO (b) a new estimate of the GDP deflator and (c) a revision in the carryover effect of the previous Budget. While revision due to a change in the GDP deflator is no longer an issue, due to a methodological change in the way the rules are operated, other revisions are still possible.

The Committee recommends that any revisions of the fiscal space between the Summer Economic Statement and the Budget are communicated to the Committee as soon as possible.

4.3 Fiscal Rules

The Committee in its Pre-budget 2017 report and in its more recent Report on Building on Recovery: Infrastructure & Capital Investment 2016 – 2021 has advanced the case that greater flexibility is needed with regard to the fiscal rules and borrowing for productive capital investment.

The Committee reiterates its position with regard to the fiscal rules and capital expenditure. In its *Report on Building on Recovery: Infrastructure & Capital Investment 2016 – 2021*, the Committee having reviewed the positon suggested the following as appropriate changes:

- Within the budgetary framework & fiscal rules, separate Capital and Current expenditure with different rules for each, for example the Golden Rule adopted in the UK. This may involve a change in government accounting policies and techniques.
- Increasing the 4 year smoothing period currently in place. In this regard, in the non-government sector, major capital investments can be amortised over the lifetime of asset and this should be factored into the way the State plans and finances such investment. This should also be factored into the fiscal rules.
- A relaxation of the fiscal rule that funding from the sale of state assets may not be used for capital investment especially post 2020.
- A relaxation of the fiscal rules for capital projects that are co-funded by the EIB.
- It should be noted, however, that in order to ensure the sustainability of public finances a cap on the level of the deficit should remain in place.
- The Minister for Finance and Public Expenditure & Reform should continue to put forward a special case for Ireland to the EU regarding a relaxation of the fiscal rules. The current low levels of investment are impeding economic growth and there is an urgent need for increased capital spending in the areas of housing and transport.

In late 2016 the Committee heard evidence from the then Chair of the Irish Fiscal Advisory Council, John McHale, that the EU's commonly agreed methodology to calculate the output gap was showing a positive output gap for Ireland (which was likely wrong) and that this in turn has implications for the calculation of the structural balance. Mr. McHale stated that the implication of such mismeasurement was that, under a more appropriate methodology, Ireland may have reached its MTO in 2017 and thus would not have to add the convergence margin for the Expenditure Benchmark in 2018. This would expand the fiscal space available for 2018. The Department of Finance and Expenditure and Reform acknowledges (in the Stability programme Update and elsewhere) that the commonly agreed methodology is not always suitable in an Irish context. The Department is working on alternative estimates of the output gap to be published alongside the Estimates produced using the commonly agreed methodology.

The Committee notes the Department of Finance's commitment to produce an alternative measure of the output gap and looks forward to considering this measure and its implications

for the fiscal position in due course.

4.4 Rainy Day Fund

Minister Noonan announced a Rainy Day Fund in Budget 2017. This would set aside €1 billion a year from 2019 onwards of the fiscal space as a buffer against unexpected shocks. The exact nature of the Fund and how it will operate are still unknown. The SES announced a change in Government policy regarding the prospective Fund and reduced the amount set aside for the fund by €500 million each year from 2019 to 2021. This reduction in the prospective Fund would allow an additional €500 million per annum for capital expenditure.

The Committee notes the increase in capital expenditure that reducing the amount set aside for the Rainy Day Fund will bring. This is in line with the Committee's recommendations for additional capital expenditure in its recent report on the Capital plan.

The Committee also supports the recommendation in IFAC's pre-Budget report that as part of Budget 2018, the Government publish a proposal on how the Rainy Day Fund will operate.

4.5 Debt Sustainability

The Gross Government Debt at approximately €200 billion in 2016 and 2017, and projected to rise to over €210 billion in 2020, is high. A number of witnesses (including the National Treasury management Agency (NTMA), IFAC and Department of Finance) outlined issues with relying on GDP as a measure of Ireland's economic output for debt sustainability analysis. Alternative measures such as per-capita nominal debt and the debt-to-income ratio were suggested. The Committee notes that such analysis is included in the *Stability Programme Update 2017* and IFAC's *Fiscal Assessment Report June 2017*.

NTMA has stated that "Debt-to-GNI* (106%), Debt-to-General Government Revenue (274%), interest cost as a share of revenue (8.5%) and the average interest rate on Ireland's debt (3.1%) are superior measures for comparison with other sovereigns (2016 figures)." On these measures (with the exception of Debt to GNI* for which no comparison data exists), Ireland's debt ratios compare unfavourably. The core issue is the size of the debt leaves little scope to absorb future fiscal shocks regardless of how it is measured.

The Committee heard evidence from NTMA and the Minister that the re-financing of €48 billion of Irish government bonds over the period 2017-2020 (42.3% of outstanding Irish government bonds) is not expected to be a cause of concern and should not affect the fiscal resources available.

The previous Minister for Finance, Mr Michael Noonan, T.D., announced in Budget 2017 a new target for the Gross Government Debt to GDP ratio of 45% for the mid-2020s. The Summer Economic Statement revised this target to 55% of GDP. The additional resources available due to this change are to be used to boost "potential output through increasing expenditure on capital formation". The SES stated that the 60% debt-to-GDP threshold will still be achieved in

2022 and that the 45%-to-GDP ratio would become a target "once major capital projects have been completed".

A 45% of GDP target is currently equivalent to a 67% of GNI* target, whereas a 55% of GDP target is currently equivalent to approximately 82% of GNI*.

The Committee recommends that the Government clarifies its timetable for the domestic targets for the debt-to-GDP ratio.

The Committee recommends that, now that the CSO has published GNI*, consideration should be given to re-framing this target as a share of GNI*.

4.6 Fiscal Position in the Medium Term

There are numerous pressures on the public finances at present, including the need to increase capital expenditure.

As discussed above, net fiscal space will be limited in 2018 without discretionary revenue measures or expenditure cuts or savings, which would increase the amount of fiscal space available. However, from 2019 onwards, assuming that Ireland meets its structural deficit target, the amount of fiscal space increases dramatically. The SES indicates that between 2019 and 2021 the total tax and expenditure packages could average €2.9 billion per annum. This would be lowered by the carry-over effect of Budget 2018's (and subsequent budgets') new policy measures.

The Committee has heard evidence from the Department of Finance and the Revenue Commissioners on the sustainability of the recent rise in corporation tax revenue. The increase in revenue from this source may be volatile and dependant on international factors beyond Ireland's control.

The Committee notes the recent publication of the Coffey report on this issue. The Committee discussed the issue in greater detail with Mr. Coffey during its pre-Budget hearings, and will report on this issue in more detail for its pre-Budget report.

The Committee considered a number of reports by external economic experts and evidence, comment and advice in relation to Ireland's public finances. The comment and advice received by the Committee on capital expenditure is detailed in the Committee's *Report on Building on Recovery: Infrastructure & Capital Investment 2016 – 2021.*

A non-exhaustive list of this comment and advice from various stakeholders is summarised below:

- The resilience of public finances to economic fluctuations and adverse shocks could be strengthened by broadening the tax base. (European Commission, National Competitiveness Council).
- Taxes should be shifted towards more sustainable and growth-friendly sources of revenue (i.e. property and environmental taxes). (European Commission, National Competitiveness Council (NCC)).

- High marginal income tax rates on relatively low incomes was a problem for the economy (Ibec). The tax system should support and reward employment and work. (NCC).
- The complexity of the tax system needs to be addressed. (NCC).
- Additional funding is needed in education and training (NCC, Irish Congress of Trade Unions (ICTU)), water and wastewater infrastructure (NCC), Housing (ICTU), Childcare (ICTU), Community Health Services (ICTU).
- There has been little evaluation of the effectiveness and efficiency of expenditure programmes and this ultimately weakens multiannual spending planning. (EU Commission).
- The Government is through the Expenditure Review process evaluating 1/3 of expenditure each year over the next 3 years with a view to ensuring value for money. (Minister for Finance and Public Expenditure & Reform).
- The growth in corporate tax receipts as a proportion of government revenue increases Ireland's exposure to changes in international tax regimes and basing permanent increases in current expenditure on such tax increase is a concern. (EU Commission, IFAC).
- Corporation tax revenue is highly concentrated and relatively volatile (Revenue Commissioners, IFAC).
- Evaluating tax reliefs such as the reduced V.A.T. for the hospitality sector (which is estimated to cost €626 million) is important. (EU Commission).
- The cost-effectiveness and sustainability of the healthcare system continues to pose challenges. (EU Commission).
- The planned "rainy day fund" and the announced 45% (now 55%) government debt to GDP ratio target go in the right direction. (EU Commission, IFAC).
- GDP is not the best measure of the domestic economy. Consequently, the resources available to the Government in terms of its ability to tax are not as great as GDP would suggest. (Governor of the Central Bank).
- Approximately a quarter of current debt (€52 billion) has to be re-financed between October 2017 and October 2020 (NTMA). The interest rate risk is now asymmetric – the risk of interest rates rising is greater than them falling. (NTMA).
- Increasing spending in line with the economy's sustainable growth rate is a sensible way to manage the economy and public finances. Following the fiscal rules would ensure that government debt falls and expenditure rises in line with sustainable growth. (IFAC).
- Increasing housing production will have implications for the fiscal position which will need to be carefully managed in the future. (IFAC).

The Committee notes the anticipated improvement in the budget position with a surplus likely in the medium term. It further notes that the debt-to-GDP ratio will continue to improve.

The Committee reiterates the principles it set out in its Pre-Budget 2017 Report, namely: the need for a broad and stable tax base, that budgetary changes should be progressive and should address strategic needs while recognising the fiscal rules.

The Committee recommends:

- More ex-ante analysis of proposed tax measures including their cost,
- Sustainability analysis of the main tax heads,
- Continued evaluation of existing tax expenditures (e.g. the VAT reduction in the hospitality sector).
- The Committee welcomes the Expenditure Review and the renewed focus on achieving value-for-money from all of Government expenditure.

4. Ex-ante Engagement with the Budget process

The Committee notes the timing of the publication of important pre-budget documents including the Summer Economic Statement (12th July), the Mid-Year Expenditure Report and associated papers (the afternoon of 20th July) and the Tax Strategy Group papers (31st July).

In order for the Committee to carry out meaningful ex-ante Budget scrutiny, such documents need to be published in sufficient time for consideration. The timing of the publication of the Summer Economic Statement and the Mid-Year Expenditure Report was not ideal in this regard. For example, the Mid-Year Expenditure Report and associated documents were published immediately after the Committee meeting with the Minister to consider the Summer Economic Statement. Therefore, there was no opportunity to discuss the issues arising from the Report with the Minister at that stage.

The Committee recommends that in future years that the Summer Economic Statement be published no later than mid-June and the Mid-Year Expenditure Report within a week of end-June.

5. Appendix

6.1 Terms of Reference

Standing Order 186A: Committee on Budgetary Oversight.

186A. (1) There shall stand established as soon as may be, following the reassembly of the Dáil subsequent to a General Election, a Standing Committee, to be known as the Committee on Budgetary Oversight, to examine and, where it considers it appropriate, report to the Dáil on—

(a) the overall fiscal position, including—

(i) the aggregated position on revenue and expenditure and the General Government Balance, including structural targets;

(ii) medium-term projections for the public finances;

(iii) macro-economic forecasts and developments; and

(iv) general fiscal governance including the application of fiscal rules and risks to the fiscal position;

(b) public expenditure policy, including—

(i) the expenditure position having regard to the Government Expenditure Ceiling and the expenditure benchmark under the Stability and Growth Pact; and

(ii) Ministerial Expenditure Ceilings applying to individual Estimates or groups of Estimates for the Public Services where significant variations from the expenditure profile could potentially impact on the overall fiscal position;

(c) Exchequer receipts policy.

(2) The Committee may consider a matter of public policy with significant impact on the budgetary position or on the overall fiscal position: Provided that prior to the commencement of such consideration, the Chairman of the Committee shall consult with the relevant sectoral Committee established pursuant to Standing Order 84A.

(3) The Committee may also consider the overall framework for parliamentary engagement throughout the course of the budgetary cycle and may make recommendations thereon to the sub-Committee on Dáil Reform for that Committee's consideration under Standing Order 107(1)(*b*): Provided that, in so doing, the Committee shall consult with—

(a) the Committees established pursuant to Standing Order 84A on any recommendations which, in the opinion of the Committee, impact on their role or remit; and

(b) the relevant Minister or Ministers on any recommendations which, in the opinion of the Committee, impact on the role or remit of a Department or Departments,

and shall notify the results of such consultations to the sub-Committee on Dáil Reform.

(4) The Committee shall have the following powers:

(a) power to send for persons, papers and records as defined in Standing Orders 85(2A) and 88;

(b) power to take oral and written evidence and submissions as defined in Standing Order 85(1) and (2);

(c) power to appoint sub-Committees as defined in Standing Order 85(3);

(d) power to engage consultants as defined in Standing Order 85(8);

(e) power to travel as defined in Standing Order 85(9).

(5) Every report which the Committee proposes to make shall, on adoption by the Committee, be laid before the Dáil forthwith, whereupon the Committee shall be empowered to print and publish such report, together with such related documents it thinks fit.

(6) The Committee shall consist of fifteen members, none of whom shall be a member of the Government or a Minister of State, and four of whom shall constitute a quorum: Provided that—

(a) the Committee and any sub-Committees which it may appoint shall be constituted so as to be impartially representative of the Dáil; and

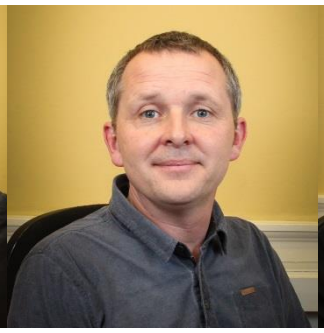
(b) the provisions of Standing Order 95 shall apply to the Committee.

(7) Until further notice in the 32nd Dáil, the Select Committee on Budgetary Oversight, established by Order of the Dáil of 21st July, 2016, shall continue in being as the Standing Committee on Budgetary Oversight, and accordingly, the current membership, Chairman, papers and work programme of the Select Committee shall be those of the Standing Committee.

6.2 Membership of the Committee

Seán Barrett TD

Fine Gael



Richard Boyd-Barrett TD

Solidarity – People Before Profit

Colm Brophy TD

Fine Gael

Thomas P. Broughan TD

Independents 4 Change

Joan Burton TD

Labour

Dara Calleary TD

Fianna Fáil

Lisa Chambers TD

Fianna Fáil

David Cullinane TD

Sinn Féin

Pearse Doherty TD

Sinn Féin

Stephen Donnelly TD

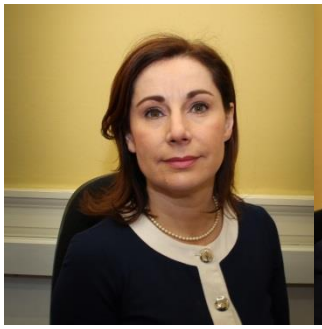
Fianna Fáil

Martin Heydon TD

Fine Gael

John Lahart TD

Fianna Fáil



Josepha Madigan TD

Fine Gael

Michael McGrath TD

Fianna Fáil

Eamon Ryan TD

Green Party

6.3 Links to Transcripts

Macro-Economic Outlook: IBEC 8 February, 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017020800001?opendocument

Competitiveness and Economic Growth: National Competitiveness Council: 14 February 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017021400001?opendocument

Fiscal Outlook, Competitiveness and Labour Market Developments: 22 February 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017022200001?opendocument

Report on the Revised Macroeconomic Indicators: 28 February 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017022800002?opendocument#D00100

Review of Capital Plan: Construction Industry Federation: *28 March 2017*

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017032800002?opendocument#B00100

Engagement on Overall Fiscal Position: *5 April 2017*

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017040500002?opendocument#B00100

Stability Programme update: Minister for Finance: *13 April 2017*
http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017041300001?opendocument

Capital Investment Plan 2016-2021: Dublin Chamber of Commerce: 9 May 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017050900001?opendocument

Pre-Budget Submission: Age Action Ireland: 17 May 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017051700001?opendocument

Capital Investment Plan (Resumed): Irish Exporters Association: 23 May 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017052300001?opendocument

Pre-Budget Submissions (Resumed): The Environmental Pillar: 31 May 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017053100001?opendocument

Corporation Tax Receipts: Department of Finance and Revenue Commissioners: 14 June 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017061400001?opendocument

Irish Fiscal Advisory Council: 20 June 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017062000001?opendocument

Capital Investment: European Investment Bank: 29 June 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017062900001?opendocument

Development and Reform of the Budget Process: Irish Human Rights and Equality Commission

Equality Budgeting: Discussion with the National Women's Council of Ireland: 12 July 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017071200001?opendocument

Summer Economic Statement: Min. for Finance & Public Expenditure and Reform. 20 July 2017

http://oireachtasdebates.oireachtas.ie/debates%20authoring/DebatesWebPack.nsf/committeetakes/CBO2017072000001?opendocument