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Committee on Budgetary Oversight

Report of the Committee Pre-Budget 2018

October 2017

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1 Executive Summary & Key Recommendations

Approach to Budget 2018

Given the limited amount of time that the Committee had to produce its pre-budget report following publication of the Summer Economic Statement, it was agreed to focus on a small number of key budgetary themes. In this way, there was scope to cover these topics in greater detail.

The key themes were chosen based on analysis of pre-budget documents, such as the Summer Economic Statement (SES), the Mid-Year Expenditure Review (MYER) and the Tax Strategy Group Papers (TSG). Themes were divided into revenue-raising and expenditure considerations. This was to ensure the Committee gained an overview of the budget as a whole, and how any expenditure proposals should be considered alongside how they will be financed. Analysis was carried out with assistance of DKM Economic Consultants. During August and comprehensive briefing material was provided to the Committee at the beginning of September. The Committee also received briefings from the newly-established Parliamentary Budget Office, which helped to inform its work. The Committee's approach to Budget 2018 is set out in detail in Chapter 4.

Fiscal Space

Underpinning all of the budget areas examined was the fact that new government spending is restricted by the size of the fiscal space. Approximately €650m is available in Budget 2018 for new policies. In meeting the Committee, both NERI and ICTU stated that this amount is not enough to address social housing requirements, for example, or the need for increased capital investment in infrastructure.

The issue of fiscal space, assumptions behind its calculation and how it could possibly be expanded, were discussed during the Committee's public sessions. In particular the issue of how the calculation of fiscal space could potentially expand it was highlighted in evidence received both from IBEC and NERI. Policy considerations concerning fiscal space are dealt with in Chapter 6 of the report.

Brexit

The Committee identified Brexit as a significant strategic issue. The ESRI in its evidence estimated that a "hard" Brexit could potentially reduce GDP by as much as 4%. The Committee also heard from Ibec and Chambers Ireland who stated that Ireland's SME sector was not prepared for its full impact. Both Ibec and Chambers Ireland urged the government to increase investment in capital projects such as upgrading public transport, improving connectivity to the ports and airports, rolling out the National Broadband Programme and encouraging diversification into other markets beyond the UK.

Revenue raising themes

Corporation tax: The Committee heard from the Irish Tax Institute (ITI), Ibec and Chambers Ireland that the 12.5% corporation tax rate was one of the most important aspects of Ireland's tax policy and that it was an essential part of a successful FDI strategy for a small open economy like Ireland.

However, the Committee notes that, in 2016, 37% of net corporation tax receipts were paid by just ten companies. The volatility of corporation tax receipts and the fact that this revenue source is highly concentrated underscores the importance, over the long-term, of also growing the indigenous enterprise sector.

In order to achieve this, the Irish Taxation Institute (ITI) stressed the importance of developing a comprehensive strategy for the indigenous sector, similar to that for FDI. Both ITI and Ibec suggested budget measures such as cutting Capital Gains Tax rates and increasing entrepreneur relief. This issue is discussed in detail in Chapter 12.

Income tax: Several issues around Ireland's income tax system were discussed, having been addressed in the Summer Economic Statement and the Tax Strategy papers. Issues included Ireland's narrow tax base and claims that workers face a high marginal tax rate at a relatively low entry point.

The government indicated that it favours proposed changes such as broadening the standard rate band, lowering the marginal tax rate and merging USC with PRSI. The Committee notes that both ESRI and IFAC maintain that introducing any tax cuts would not be prudent in the current economic climate. Alan Barrett (ESRI) stated that, while merging the USC with PRSI is a better option than abolishing the USC, it would still be quite costly to implement and that the best option is to leave the USC as it stands.

NERI also stated that it would not be prudent to introduce tax cuts or changes to marginal rates, as Ireland's income tax system is already one of the most generous in the EU. Neri contends that these cuts would not address the issue of low labour market participation or the income tax wedge. The Committee also notes that NERI and IBEC stated that addressing prohibitive childcare costs and the housing shortage would represent a better use of fiscal space. Income tax related discussions are covered in Chapter 13

Tax expenditures: Current tax expenditure policies include the R&D tax credit, health and housing expenditures, and tax relief on pension contributions. It should be remembered in amounts given out as tax credits and reliefs represent a loss of revenue to the Exchequer.

Debate also arose around the case study on the R&D tax credit. A recent government review of the R&D tax credit shows that between 2009 and 2014, 40% of R&D activity by companies is deadweight, and would have occurred regardless of a tax credit.

ITI and Ibec stated that the R&D tax credit forms an essential part of the corporation tax strategy, but stressed ways in which the credit could be tailored more towards SMEs. NERI stated that more direct subsidies could be introduced to encourage R&D by public bodies. This issue is covered in full in Chapter 23.

ESRI, IFAC, NERI and ICTU all advised that every tax relief/credit should have a specified sunset clause built into them and should be reviewed at regular intervals e.g. every 3 years. This would ensure the elimination of inefficiencies and greater value for money. Issues regarding tax expenditures are dealt with in Chapter 14.

Expenditure themes

Demographic Pressures: The CSO has projected that the make-up of the Irish population will change significantly in the coming years. Ireland still has a young population in comparison with other European countries; however, the dependency ratio is forecast to increase while the working age population percentage is estimated to drop from 60% at present to 50% by 2050.

Future demographic pressures will pose significant budgetary challenges for all areas of government policy, especially in relation to social welfare, education and healthcare costs. Therefore, proper budget provisioning must take account of anticipated expenditure increases,

On this issue ESRI, NERI and Ibec were questioned on how to prepare for future expenditure increases and whether the current budgetary provisions for demographic change were sufficient. The detail of these discussions is laid out in Chapter 8.

Alternative Sources of Capital Expenditure Funding: The Committee previously heard from numerous stakeholders that the welcome capital funding increase is not enough to address emerging infrastructure bottlenecks. This view was repeated during pre-budget hearings with ICTU, Ibec and Chambers Ireland. Both Chambers Ireland and Ibec stated that Ireland was at risk from becoming uncompetitive as a result of insufficient infrastructure.

Witness groups at pre-budget hearings urged that any available fiscal space should be channelled into improving, childcare facilities, housing supply and upgrading public transport infrastructure. The issue of capital expenditure funding is dealt with in Chapter 9.[1]

Expenditure Pressures and Savings: The government recently indicated that it plans to implement a regular spending review process to assess the efficiency and effectiveness of expenditure policies. Given the restricted fiscal space, it is important to identify any inefficiency to free up much needed funding. The Committee may revisit this area as part of its post-Budget review.

NERI pointed to OECD research, which shows Ireland's income tax system to be among the most generous in the OECD. Ibec, ICTU and Chambers Ireland stated that reducing income tax would be an inefficient use of fiscal space and argued that all available funding should be used to tackle barriers to labour market participation, such as childcare and housing costs. .

In its evidence, IFAC stated that Ireland had already breached its expenditure benchmark as set out in the fiscal rules in 2017 and that it was likely to breach it again in 2018. IFAC argued for a balanced budget rather than introducing tax cuts. While IFAC and the ESRI recognised the need for investment in capital infrastructure this investment needs to be targeted and prudent. Further detail is contained in Chapter 10.

[1] See also: http://www.oireachtas.ie/parliament/media/committees/budgetaryoversight/Committee-on-Budgetary-Oversight---Capital-Plan---Laid-report-260717.pdf

Themes spanning both revenue and expenditure

Climate Change: The Committee heard that it is likely that Ireland will not reach its carbon emissions targets by the 2020 deadline. From a budgetary perspective, fines associated with breaching these targets are quite onerous given Ireland's constrained resources. The Committee noted that the (IIEA) estimate that these fines could amount to €610m in 2020 increasing to between €3.7bn and €5.3bn by 2020, and these costs do not include the significant costs of tackling future extreme weather events, and climate mitigation costs.

All the witness groups highlighted the need to address this issue possibly by bringing in some form of carbon tax. However, the Committee notes that most stakeholders had not considered the budgetary impact of climate change issues to date. Climate change is dealt with in greater detail in Chapter 16.

Labour Market Participation: It is forecast that Ireland will reach full employment in the latter half of 2018; however labour market participation rates are comparatively low. NERI, ICTU, Ibec and ESRI all argued that the cost of childcare was one of the biggest barriers to labour market participation. This has an adverse effect on the provision of public services, and female participation in the labour market.

Childcare costs in Ireland are among the highest in the EU. NERI and ICTU suggested that one solution was to expand the public school system to include pre-primary care. The issue of labour market participation is covered in Chapter 17.

Shortages in the Housing Market: The Committee heard evidence from stakeholders maintaining that budgetary measures such as the Help-to-Buy scheme failed to stimulate the supply of houses, however, others have said it is too early to make a determination on the effectiveness of this scheme. All witness groups supported further evaluation of the decision making process for budgetary measures in the housing area.

Both NERI and ICTU argued that the State needed to step in and invest where the private sector has failed to provide social housing units. ICTU went as far to say that at least 10,000 social housing units should be built a year by the end of 2018. Ibec confirmed that employers are having difficulties in attracting and retaining staff, as housing in Dublin is too costly and employees want to live close to where they work in order to avoid long commuting times. The debate on housing and budget issues is covered in Chapter 18.

Other issues arising from pre-budget hearings

Second reduced VAT rate (9%) for Hospitality Sector: A lot of debate arose on the advantages and disadvantages of increasing the 9% VAT rate for the hospitality sector. ICTU argued that the reduction in VAT rates was only a temporary measure and that instead of resulting in a reduction in prices for consumers it resulted in a loss of €2.2bn in lost revenue.

Ibec and Chambers Ireland gave the opposing view that for the hospitality sector the reduced VAT rate has been a lifeline, particularly for small operators located along the Western seaboard. Such areas have seen a reduction in tourists from Britain and they argued that, if the higher VAT rate were introduced, many operations could go out of business.

ITI suggested that a smaller increase could be applied; for example, instead of re-introducing the 13.5% rate, a 10% rate could be introduced. ITI also suggested that the the list of services included for reduced VAT could be usefully re-assessed. The full debate on this issue is covered in Chapter 19.

Basic Income

The Committee recommends that the Department of Finance considers initiating a detailed study of a move to a basic income system for all citizens.

Rainy Day Fund

The government is committed to increasing capital expenditure by diverting €500m from the rainy day fund on an annual basis over the next 3 years. This measure is aimed at addressing the lack of capital spending over the last decade due to the financial crisis.

Ibec questioned the need for a Rainy Day Fund explaining that the NTMA already acted as a financial buffer against macro-economic shocks. According to Ibec and ICTU money in the Rainy Day Fund should be spent now on targeting investment in childcare and housing areas. Ibec went as far to say that all available fiscal space should be prioritised to address these two issues.

Conclusion

While time constraints have made this report somewhat limited in scope it contains detailed analysis of a small number of key budget themes, upon which the Committee has based its recommendations.

This pre-budget report, together with the Committee's previous reports, represents a further step towards the Committee's long term goal to promote meaningful and transparent scrutiny of budgetary decisions.

Key Recommendations

Fiscal Stance

Recommendations:

The Committee notes that the calculation of fiscal space available to Government depends on the EU methodology used to calculate the structural position in the economy, in addition to a range of other assumptions.

The Committee notes evidence presented to the Committee by IBEC, IFAC and ICTU, to suggest that:

- The fiscal space could potentially be expanded if the 2015 GDP growth figure of 26% was included in calculation of fiscal space.
- Government's application of the margin of convergence further reduces the amount of available fiscal space by approximately €150m.

Recommendations 1: (See P28 of report)

- The Committee recommends that:

  - The Minister and the Department of Finance should engage with the European Union in order to change the Common Agreed Methodology in order to produce a more meaningful measure of the output gap for Ireland.
  - Further analysis into the determination of the expenditure benchmark should be carried out (and consequently the reference rate) given the varying expert opinions.
  - That extensive engagement around the determinants of fiscal space for the coming year(s) should begin far in advance of the annual budget in future.
  - That the Committee should be provided with information regarding internal calculations of fiscal space for Budget 2017 by the Department in a timely manner after the Budget's publication, so as to fulfil its scrutiny role effectively.

Approach to future budgets

Recommendations 2:

The Committee notes that it has a very short time in which to carry out its pre-budget hearings and produce a report for submission to the Minister. In order to carry out effective ex-ante scrutiny for future budgets, the Committee should follow the budget cycle more closely, in line with OECD recommendations. It should begin its ex-ante budget scrutiny in January of each year with a view to submitting its pre-budget report to the Minister well in advance of budget day.

Demographic pressures

Recommendations 3: (See P30 of report)

- The Irish population remains comparatively young, but it is also ageing. Budgetary challenges and opportunities must be taken account of by Government as part of its medium term fiscal planning. The Committee recommends that:
- Budgetary planners give demographic pressures ever-increasing consideration so as to avoid future fiscal burdens
- Having regard to the absence of a uniform, cross-departmental approach to the analysis of the costs of demographic changes, a minimum time horizon in forecasting future demographic costs should be established to better inform fiscal planning.

International Budget risk

Recommendations 4:

The Committee notes with concern evidence from Ibec and Chambers Ireland which suggests that Irish SMEs are not sufficiently prepared for the impact of Brexit. The Committee also noted that ESRI in its evidence suggested that Brexit could possible reduce GDP growth by as much as 4%.

The Committee also notes evidence given by Seamus Coffey in which he stated that he saw changes to international tax policy such as CCCTB as a bigger threat, if implemented, to Ireland than Brexit.

In relation to protecting the Irish economy from risks such as Brexit and CCCTB, the Committee recommends that:

- Sufficient investment should be made in upgrading public transport, housing and broadband to improve connectivity.
- The Department of Finance should continue to protect the 12.5% corporation tax rate.
- The Government should engage with the Committee before end of Q2 2018 on the steps it is taking to Brexit proof its 2019 Budget.
- The Government should engage with the Committee in advance of budget 2019 on the evaluations it has carried out regarding the potential impact of CCCTB

Corporation Tax

Recommendations 5: (See P38 of report)

The Committee heard from Seamus Coffey of IFAC who stated that the possible implementation of the CCCTB posed a greater potential threat to Ireland than Brexit. The Committee also heard evidence from the ITI and Ibec that the risk posed by the Corporation Tax dependence could be mitigated by strategic investment in the indigenous sector.

The Committee recommends that:

- Ireland's 12.5% CT rate should be protected, and the potential impact to subsequent tax yields of international policy changes such as the CCCTB should be fully evaluated to the greatest extent possible, given available data.
- The Department of Finance should assess how best to spend or save corporation tax yields so as to mitigate the potential effects of revenue shocks, should external policy decisions be introduced.

Climate Change

Recommendations 6: (See P45 of report)

The Committee notes that possible climate change fines could have a significant budgetary impact in the medium term. Compliance costs do not include the additional ongoing cost of dealing with climate change events, or mitigation costs. The Committee notes the limited evidence of consideration given to climate change issues in budget planning to date.

The Committee recommends that:

- Government should takes steps to climate-proof future budgets by examining the possibility of introducing tax measures to encourage a reduction in emissions, using a similar approach to the sugar tax.
- Government should engage with the Committee before Budget 2019 on the steps it is taking to climate proof its budget proposals**,** including on decisions in relation to, for example, the equalisation of diesel and petrol.
- Current tax policies that give rise to fossil fuel subsidies (e.g. the electricity tax exemption for domestic users, reduced rates of VAT applied to energy, diesel rebate scheme, marked gas oil) should be reviewed, to include a public consultation.
- The Committee recommends that the Government examine the potential use of public tendering to make progress towards a low carbon economy and should ensure that state bodies are also actively implementing green procurement practices.
- Any tax incentives to reduce emissions or using renewables should only be used when complemented by viable, cleaner alternatives. Any new tax expenditures on Electric Vehicles or other climate change actions must be fully costed in Budget 2018 subject to regular Dáil review and approval.
- The Government should give consideration to updating and commencing (BIK) provisions in the Finance Act 2008 to allow for lower tax rates on BIK for EVs. This would follow moves by a number of other countries, such as the UK, France and Germany, which currently give EVs favourable BIK treatment.[2]
- Budget 2019 should include a statement assessing the climate change impact of the budget.

[2] TSG, op.cit.

Tax Expenditures

Recommendations 7: (See P43 of report)

The Committee notes the lack of adequate data and evidence relating to tax expenditure to support budgetary decisions. An example is the Help to Buy scheme.

Recommendations:

- Gaps in data relating to tax expenditures should be addressed, to allow acceptable efficiency levels to be established.
- Decisions regarding tax expenditure policy should be taken with a greater level of evaluation.
- There should be a greater level of oversight of the costs and benefits of tax expenditures with a view to achieving efficiency savings or confirmation of the policy's merits.
- Due to concerns that the Committee has about the increasing cost and concentration of the R&D tax relief, Revenue should engage with the Committee in examining these issues as part of its post-budget work programme.
- An assessment should be carried out by the Department of Finance to identify bodies not utilising the National Shared Services Office (NSSO), but which could take advantage of it in future.

Rainy Day Fund

Recommendations 8:

- 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 July 2017 report on the Capital Plan which calls for increased capital investment.
- That, as part of Budget 2018, the Government should publish a proposal on how the Rainy Day Fund will operate.

Childcare Costs

Recommendations 9:

- During its pre-budget hearings, the Committee identified Childcare Costs as one of the most significant barriers to labour market participation, and constraints on economic growth.
- The Committee recommends:

- While recognising the constrained fiscal space available in Budget 2018, that any available fiscal space be used to help prioritise investment to alleviate childcare costs, particularly for second earners.
- Current childcare cost relief measures and other barriers to labour market participation should be re-examined with a view to increasing participation rates.
- The Government should carry out a cost benefit analysis of the possibility of expanding the primary school system to include pre-primary care and education.

Gender budgeting

Recommendations 10:

The Committee heard from several witnesses in the lead up to its pre-budget hearings, including the National Women's Council of Ireland (NWCI), of the importance of assessing and where possible alleviating the gender impact of budgetary measures.

- The Committee will engage with the NWCI during its post-budget review to assess the gender impact of budget 2018 with a view to ensuring the gender proofing of future budgets
- The Department of Public Expenditure and Reform should work with the NWCI towards including a gender budgeting statement in Budget 2019.

Housing

Recommendations 11: (See P49 of report)

During its pre-budget hearings, the Committee identified housing as one of the most significant barriers to labour market participation, and constraints on economic growth. The Committee also notes that all stakeholders were supportive of the early introduction of a vacant site tax.

The Committee recommends that:

- A vacant site tax should be implemented, with higher rates on sites that can be easily built on and have the necessary infrastructure in place.
- The Minister should give consideration to early introduction as part of Budget 2018.
- There should be a significant increase in investment in social housing through a multi-annual response within the boundaries of fiscal space
- Priority could be given to expenditure on housing, if there are limitations on the total amount of capital expenditure available.
- The Committee encourages the construction of housing in a stable and environmentally sustainable fashion and that, if off-setting measures to balance potential overheating are required, these could be implemented in the medium-term.

Capital Expenditure

Recommendations 12:

- That the use of PPPs in capital expenditure should be re-examined
- The Committee supports efforts to leverage EIB funding for the funding in investment projects and encourages Government Department to engage closely with the EIB to achieve this goal.
- The Committee recognises ISIF's mandate to achieve both an economic impact and an investment return. The Committee recommends that infrastructure projects that can address key bottlenecks should be considered by ISIF for funding.

VAT on Tourism

Recommendations 13: (See P53 of report)

- The Committee notes with concern that there is limited evidence that large urban hotels are passing on the benefits of the VAT reduction to its customers, which goes against the original intent of this measure.
- The Committee also notes the discrepancy between the comparatively high cost of hotel rooms in some areas of the country coupled with one of the lowest VAT rates and this may indicate that the VAT rate could be subsidising areas in little need of a subsidy.
- The Committee recommends that Department of Finance review the available evidence that the VAT reduction measure has led to job creation.
- As recommended by the Irish Tax Institute, the Committee also recommends that the Department assess the different components of the VAT measure, possibly with a view to removing some categories from the tax subsidy.

Levels of Engagement

Recommendations 14:

Given the Committee's goal to develop a more effective system of budget scrutiny, the Committee recommends:

- That the Minister should commit to ongoing engagement and dialogue with the Committee, so that it can carry out pre-budget scrutiny well in advance of Budget 2019. In this regard, the Committee welcomed the level of engagement and assistance by the Minister for Budget 2018.
- That the Department of Finance should publish the Summer Economic Statement no later than the start of June 2018.

- That the Department of Finance and DPER should furnish the Committee with all budget-related documents at the earliest opportunity, to facilitate discussion and more effective scrutiny.
- The Committee acknowledges that the Minister is conscious that announcing budgetary decisions in advance of the Budget Day could impact the economic decisions of citizens and businesses.
- The Committee acknowledges the sensitivity around discussing individual tax policies in great detail ahead of potential budget changes, however, the Committee does expect that the Minister and his officials will engage in a constructive dialogue regarding issues around tax policy.
- The Committee will continue to engage with the Parliamentary Budget Office to enhance the budget scrutiny process.

2 Foreword

I welcome the publication of the Committee's Pre-Budget 2018 report.

The Committee on Budgetary Oversight was established on 21st July 2016 to enhance the level of participation by parliament on the budgetary process.

Budget Scrutiny

Budgets affect us all. Decisions made during the budget impact on the lives of citizens, the future of plans for business, and they determine how we can fund essential public services. Parliament plays an important role in holding government to account around budget decisions. Internationally, many parliaments are considering questions about how they can improve the budget scrutiny process, and develop committee capacity to monitor government spending plans.

The recent international financial crisis highlighted weaknesses in oversight of budget decisions by the Oireachtas, and underlined the need for parliament to develop its budget scrutiny role.

In this context, parliamentary reforms include the establishment of this Committee and in particular, a new Parliamentary Budget Office (PBO). Both are innovations that I hope will, over time; help enhance parliamentary scrutiny of the budget.

I welcome the recent appointment of Ms. Annette Connolly as Director of the Office, and look forward to working with the newly-established PBO, to develop the capacity of the Committee to carry out more detailed analysis in future and to bring a greater focus to budget scrutiny.

Pre-Budget Scrutiny

The Committee has conducted its pre-Budget (ex-ante) scrutiny of the budget through a desktop review of budget-related material and meetings with national stakeholders, including two meetings with the Minister for Finance and Public Expenditure and Reform.

The Committee also received briefings from DKM Economists, and briefings from the Parliamentary Budget office.

This report offers a summary of common themes emerging from the Committee's meetings with stakeholders, and recommendations on areas where there was consensus among Members. Where the Committee could not agree on a Committee position, the specific policy area is highlighted in the text, without an agreed recommendation.

The timeframe for examination of revenue raising and expenditure proposals was necessarily limited due to the timing of the publication of relevant budget documents.

This is an issue that is highlighted in greater detail in the report. However, rather than a one-off set piece, this report should be seen as a first step in developing a process for *"ongoing engagement by the Houses of the Oireachtas and its committees throughout the course of the budget cycle"* (OECD, 2016, 68).

Following on from this report, the Committee will build on progress already achieved by carry out ex-post analysis of the Budget, including equality budgeting, gender budgeting and a review of tax expenditures, before commencing it's out ex-ante scrutiny of Budget 2019 in early 2019.

Acknowledgements

I want to thank each of the stakeholder groups and witnesses who attended the Committee meetings: NWCI, IHREC, IFAC, ESRI, NERI, ICTU, Ibec, Irish Tax Institute and Chambers Ireland.; Daragh McGreal, Kathy Stout and Stephanie Bruce-Smith of DKM Economic Consultants; Ms. Annette Connolly, Mr. Barry Comerford and Mr. Níall Ó Cléirigh, from the Parliamentary Budget Office for their assistance.

I also want to thank the Members of the Committee for their time and participation during the pre-budget hearings and to Deputy John Lahart for his commitment as Vice-Chair during the course of the hearings; and to the Committee Secretariat for their support.

I also wish to acknowledge the Minister for Finance and Public Expenditure and Reform, Pascal Donohoe, TD and his officials for engaging with the Committee, and for assisting the Committee with relevant documentation.

I commend this Report to the Dáil.

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Josepha Madigan TD
Chairperson

3 Introduction

Introduction

The Committee for Budgetary Oversight was established in July 2016 on foot of an OECD review of Ireland's system of parliamentary engagement in budgeting. This review found that the level of engagement with the budget process by the Houses of the Oireachtas was under-developed (OECD, 2016). Since 2016 the Committee has begun, albeit in a limited form, to enhance the budget oversight function carried out by the Oireachtas.

The Committee produced a pre-budget 2017 report; however, only limited scrutiny was carried out due to the timing of the establishment of the Committee. Since then,, the Committee has produced a review of the Government's Capital Plan and a Macroeconomic and Fiscal Report.

These reports have each built on the progress made by its predecessor and contain some meaningful and ex ante scrutiny of Government expenditure and investment choices. For example, it is noted that the Committee's review of the capital plan and its recommendations it made were referenced in the Government's own review of the Capital Plan, published in August 2017.

Reform of the Budget Process

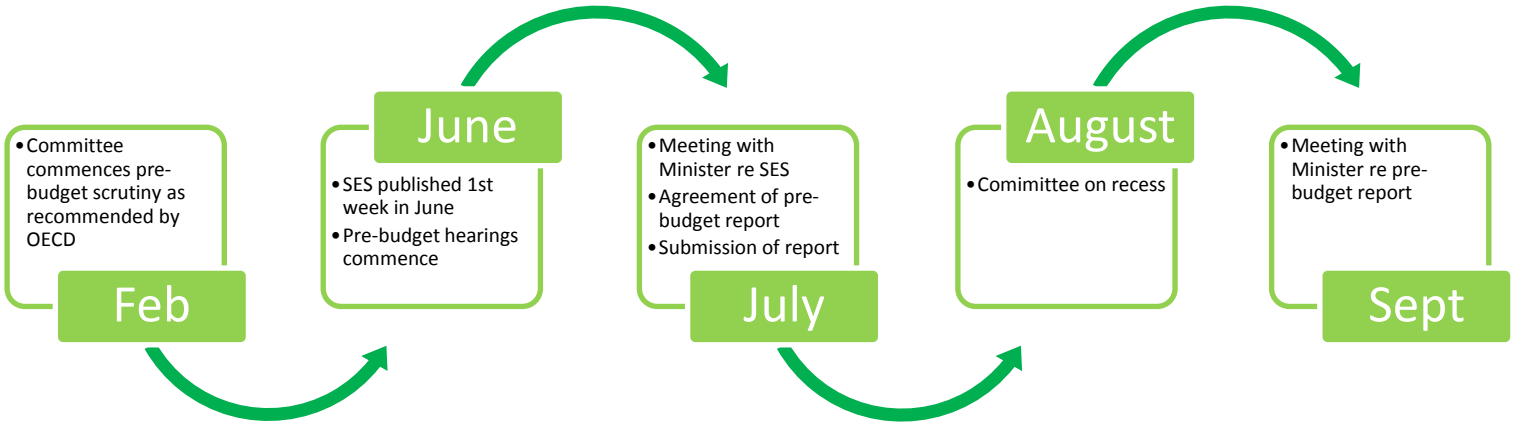
In relation to Budget 2018 the time-frame allotted for pre-budget scrutiny to be carried out by the Committee was also very tight; as a result the scope of this report is limited in its scrutiny of budgetary issues and decisions. However, together with the Committee's previous publications, it marks a first step towards developing an effective oversight function.

The Committee acknowledges that the existing approach to budget scrutiny is, to some extent, a disconnected series of set pieces. Over time and in line with best practice there is a need for a move towards a more joined up approach that encompasses the budget cycle as a whole. In order to achieve this, in 2018, the Committee needs to follow the budget timeline more closely and begin its scrutiny process earlier in the year.

The Budget Timeline & Post-budget Review

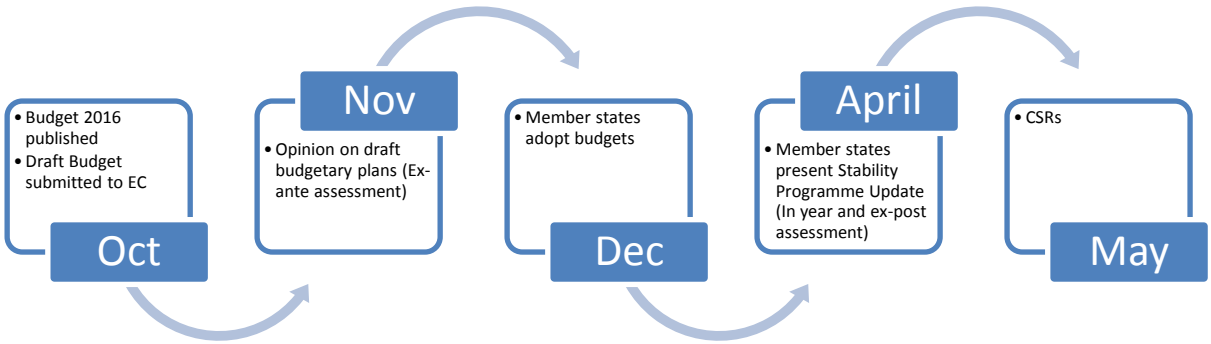
The Budgetary Oversight Committee is not a sectoral committee; it has a different agenda and strategic outlook. As such, it may need to consider following the budget timeline rather than the parliamentary calendar. By way of illustration, a chart of the timeline of the run up to the budget which the Committee could follow is shown below (Graph 1).

Graph 1: Example of Possible Pre-Budget Timeline



In addition, the chart below highlights the EU Semester timetable which the Committee should be monitoring.

Graph 2: EU Semester timeline



Implementing this change to the Committee's calendar would allow it to carry out more effective budget scrutiny and would make its outputs more impactful.

As part of the move towards a more effective oversight function the Committee intends setting out a longer-term post-budget review programme. This should provide a good jumping off point for Budget 2019 and will help to maintain the Committee's focus on its objective of meaningful ex- ante scrutiny and oversight.

The Parliamentary Budget Office

Another important part of enhancing the Committee's oversight function is the establishment of the Parliamentary Budget Office (PBO). In August 2017, Annette Connolly was appointed as Director of the PBO. Once this office is fully established, it will be able to assist the Committee in carrying its role by providing impartial analysis on budgetary, fiscal and macro-economic topics.

4 The Committee's Approach to Budget 2018

In advance of the Committee's pre-budget hearings, the Secretariat – with assistance from DKM – carried out an analysis of publications and data that would inform the Committee's work during the pre-Budget phase: documents from Government,[3] the Department of Finance,[4] the Department of Public Expenditure and Reform,[5] international bodies,[6] and pre-Budget submissions from a range of stakeholders.

This analysis was intended to identify a range of budgetary themes in light of Budget 2018. Many of these themes are widely recognised as presenting challenges or opportunities from a budgetary perspective. They were broken up into Revenue raising themes and Expenditure themes. This enabled the Committee to get a full picture of the budget as a whole and to see the links between revenue and expenditure.

Revenue

- Corporation Tax: Concentration, Dependence, and Sustainability
- Income Taxation: Base, Progressivity, and Rates
- Tax Expenditures: Budgetary Effects and Efficiency

Expenditure

- Demographic Changes: Forecasts, Costs, and Opportunities
- Capital Expenditure: Alternative Sources of Funding
- Expenditure Pressures & Efficiency Savings

Revenue & Expenditure

- Climate Change: Targets, Costs, and Taxation
- Labour Market Participation: Barriers, Costs, and Opportunities
- Shortages in the Housing Market: Expenditure & Taxation Options

The Committee invited a number of witnesses to provide evidence around general budgetary issues as well as specific input in relation to the identified themes. Witnesses who attended before the Committee represented a balance of institutions and bodies with insights into the budgetary process: IFAC, ESRI, NERI, ICTU, IBEC, Chambers Ireland, and the Irish Tax Institute.

[3] Programme for a Partnership Government
[4] The Fiscal Monitor; the Summer Economic Statement; Tax Strategy Papers; Tax Expenditure Reports; National Economic Dialogue; Stability Programme Update
[5] the Mid-Year Expenditure Report; Comprehensive Expenditure Review; Budgetary Impact of Changing Demographics 2017-2027 (IGEES paper)
[6] European Council Country Specific Recommendations; IMF Article IV.

On 27 September, the Minister for Finance and Public Expenditure and Reform attended the Committee to inform it of his and the Government's perspectives around Budget 2018. The Committee hopes that the Minister will take into consideration the issues raised by the Committee during the discussion, and set out in this report.

5 Macro-Economic Context

The Summer Economic Statement (SES), published in July 2017, set out the Government's short and medium-term economic and fiscal plans, a key aim of which is to achieve a balanced budget in structural terms in 2018. The Department of Finance forecasts continued growth over the coming years, a fall in unemployment, an increase in tax revenue, and an increase in expenditure.

The Statement indicates that the Government's policy objectives include developing the recovery, improving competitiveness, boosting productivity, enhancing the economy's resilience, broadening the benefits of growth, and improving public services.

The SES is an important document for the Committee as it is one of the first pre-budget documents to be published by the Department of Finance and is the basis of the Committee's pre-budget analysis.

Although the government's over-arching fiscal strategy was set out in the economic statement it did not contain many indicators regarding budgetary strategy. The SES highlighted potential external risks such as Brexit and possible changes to international tax policy.

The SES stated the need to respond to these risks by establishing a contingency or buffer against external shocks. A "Rainy Day Fund" will be implemented, once the Medium Term Objective is achieved in 2018 and approximately €1bn will be retained within the Exchequer. This figure has since been reduced to €500m with the remaining €500m to be invested in capital projects.

Macro-Economic Indicators

	2017f (%)	2018f (%)	2019f (%)
Real GDP	4.3	3.7	3.1
Real GNP	4.2	3.5	2.8
Unemployment Rate	6.4	5.6	5.5
CPI Inflation (HICP)	0.6	1.2	1.8
Debt-to-GDP Ratio	70.8	67.2	x

Source: Department of Finance, *Summer Economic Statement & Stability Programme Update*

In spite of the positive economic indicators shown above, key external and internal challenges facing the economy include:

- the nature of the future trading relationship between the EU and the United Kingdom;
- changes to the economic policies of the United States;
- addressing the country's infrastructural bottlenecks; and
- The capacity of indigenous economy policies to adapt to these dynamics.

A more detailed outline of the Committee's views on the macroeconomic and fiscal context in which Budget 2018 is framed contained in the Committee's Report *Pre-Budget 2018: Report on Macro-economic and Aggregate Fiscal Positions* (September 2017).

Level of Engagement

This year the Committee's examination of and discussions around the SES were delayed due to its late publication in July 2017. The SES, in order to be a meaningful and effective document, should not be published any later than early June.

The issue of the timing of its publication was raised at the Committee's meeting with the Minister on 20th July 2017. Committee members felt that its late publication impacted on the work programme. The fact that important pre-budget documents were published after the meeting, was also noted by the Committee.

In order to fulfil its remit of meaningful and effective ex ante scrutiny the Committee wishes to have constructive and meaningful engagement with the Minister and the Departments of Finance and Public Expenditure and Reform. The Committee views this meeting with the Minister as a solid base on which to build a good level of engagement with the Minister and his Departments.

On 27 September 2017 the Minister for Finance and for Public Expenditure and Reform again attended a pre-Budget Committee meeting. Key points raised by the Minister were as follows:

- In response to a query regarding the Local Property Tax, the Minister stated that it is his intention to proceed with a re-evaluation of LPT rates in 2019.
- The Minister indicated that the Irish income tax system is highly progressive and that it is Government's intention to maintain the progressivity of the system.
- Year-to-date anomalies between the profile of income tax revenue and the outturn for income tax revenue, in the context of falling unemployment, are expected to be corrected by the end of the year.
- The Government will initiate a consultation on the structure of the Rainy Day Fund in the coming months.
- On the question of differing estimations of the convergence margin between the Budget 2017 document and the Summer Economic Statement, Department of Finance officials advised the Committee that the variance is explained by updated and higher economic growth rates in the latter document than in the former.
- The Minister stated that it is his intention to award a Christmas Bonus this year (2017), although its value has not yet been determined.
- On the issue of the Coffey Report, the Minister advised the Committee that a decision has not yet been made whether to proceed with a consultation process regarding the Report's recommendations.
- When asked whether the forthcoming Budget would be Brexit-proofed, the Minister indicated that it would be, although he did not indicate any specific policies that would be included in the budgetary package.
- In relation to the reduced VAT rate for the hospitality sector, the Minister told the Committee that he believed the rate was beneficial to tourism in the context of the economic climate in which it was implemented.

The Committee acknowledges the sensitivity around discussing individual tax policies in great detail ahead of potential budget changes, however, the Committee does expect that the Minister and his officials will engage in a constructive dialogue regarding issues around tax policy.

The Committee will continue to engage with the Parliamentary Budget Office to enhance the budget scrutiny process.

6 Fiscal Space

The calculation of the fiscal space available to the Government each year is a factor of a methodology developed by the European Commission. The methodology takes account of Member State's historic and potential growth rate and its fiscal position in an effort to manage growth over the medium term, and to ensure that expenditure growth is not supported by unsustainable revenues.

The rules, as explained below, determine the level of allowable real expenditure growth in a given year, based on an average of potential GDP growth over a ten-year period: over the five years prior to the current year, the potential growth for the current year, and the growth forecasts for the four years hence.

Issues of interpretation have resulted in varying estimates of what the rate should be, particularly, as the 26% GDP growth rate initially determined for 2015 was discounted from the average.[7] It is expected that the reference rate will see upward growth over the coming years as the recessionary years fall out of the calculation.

The gross fiscal space is first calculated by the European Commission and subsequently the net fiscal space is determined after taking Irish policy choices into consideration. One of the issues the Committee explored with the Minister is the reasoning behind these policy decisions historically and going forward, the possibility of avoiding unnecessary constraints.

[7] IFAC, Analytical Note 7. The EU Expenditure Benchmark: Operational Issues for Ireland in 2016, p3; 'Ireland's estimated potential GDP growth rates for the crisis years are extremely low such that the averaging formula leads to an estimated potential growth rate that is much lower than current estimates. This means that the expenditure benchmark is far more constraining on the fiscal stance than is required based on an updated estimate of the reference rate and the change in the structural balance rule.'

Methodology to Calculate Fiscal Space

Gross Fiscal Space

1. **Reference Rate**: Ireland's potential GDP growth rate, or *Reference Rate*, for 2018 is 3.5%. This is the upper limit on allowable expenditure growth as set out under the EU's *Expenditure Benchmark*, and equates to a €2.4bn expansion in Fiscal Space. Such an increase is represented by the first green bar in chart 3 (below).
2. **Inflation**: Taking into account inflation in the Irish economy, a *GDP Price Deflator* is also applied, further increasing the available fiscal space. The GDP Price Deflator for 2018 is 1.3% of the 2017 Expenditure Aggregate. This equates to €900m as represented by the second green bar. The cumulative of the first two green bars amounts to an allowable expansion in expenditure of 4.8% or €3.3bn in 2018.
3. **Convergence Margin**: as Ireland has not yet reached its MTO of a structural deficit of 0.5% of GDP, its fiscal space for 2018 is reduced. A *Convergence Margin* of 2.3 percentage points is taken off the cumulative 4.8% allowable expansion outlined above. This 2.3 percentage point decrease reduces the available Fiscal Space for 2018 by €1.6bn. In total, once the relevant EU rules are accounted for, the gross fiscal space available in 2018 is €1.7bn.

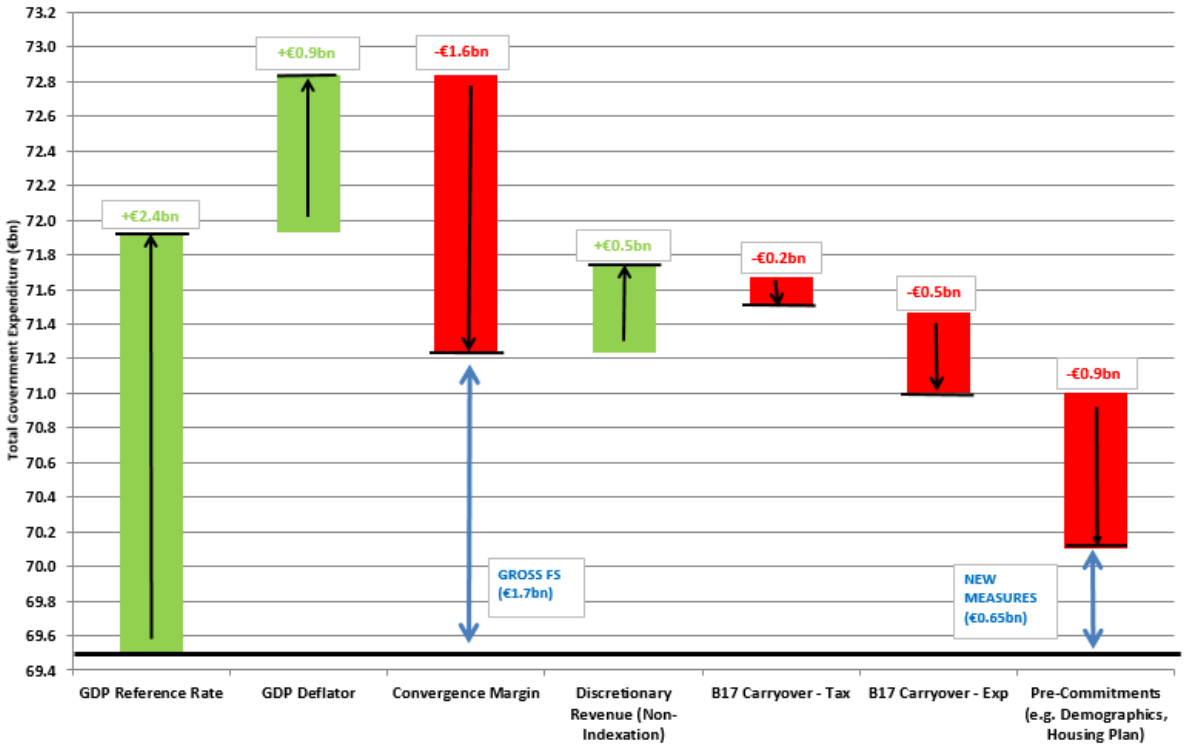
Net Fiscal Space

- **Non-Indexation**: From this gross amount, an additional €500m is available due to the policy choice of not indexing tax bands and rates. This expands the available resources for Budget 2018 to €2.2bn.
- **Carryover**: Measures from Budget 2017 that have full year carry-over effects in 2018 must also be accounted for in estimating the actual level of resources available on Budget Day. This amounts to approximately €170m and €470m in tax and expenditure measures, respectively.
- **Pre-Commitments**: The cost of pre-committed expenditure (approximately €900m in 2018) is also subtracted from the gross fiscal space.

Having taken all of these drivers into account, approximately €650m is available in Budget 2018 for new policies. This falls further, to approximately €470 million, when the public sector pay deal amounting to €180 million is taken into account.

Graph 3 below depicts the calculation of available fiscal space in 2018. The black horizontal line represents the 2017 Government Expenditure aggregate of €69.5bn. Each green bar represents an expansion in the available fiscal space for 2018, whereas each red bar represents a reduction in the available Fiscal Space.

Graph 3: Calculation of Available Fiscal Space for Budget 2018



Sources: Summer Economic Statement 2017 (July 2017); IFAC Pre-Budget Statement (September 2017); Note: Figures may not sum due to rounding; note: figures are estimates based on best available information as of September 2017.

Evidence

1. IFAC informed the Committee that Government should limit its budgetary choices to the €1.7 billion in available gross fiscal space and that '*If additional priorities are to be addressed, these should be funded by additional tax increases or through reallocations of existing spending*'. IFAC also informed the Committee that the Government breached the expenditure benchmark through its budgetary policies for 2017.
2. The ESRI noted '*Brexit could impact on the fiscal space because it impacts on the potential output of the economy, which is the key metric that determines the fiscal space*'.
3. NERI questioned the Commission's methodology for calculating fiscal space, arguing that the Commission's view that the Irish economy is overheating is incorrect and that the Commission's '*model is not designed for Ireland at all. It is essentially taking some of our fiscal space away from us*'.
4. The Department of Finance's decision to apply a margin of compliance of €150 million in 2018 was debated by the Committee. IFAC noted that the margin of compliance was not required to meet the fiscal rules, however, they stated that 'the reason it has introduced that is to ensure the MTO is hit in 2018'. Seamus Coffey stated that '*Our calculation is based on an improvement in the structural balance of 0.6 percentages point of gross domestic product, GDP. The Department's calculation is based on hitting the medium-term objective, MTO, in 2018, but the rules set out that what is required is to stay on the adjustment path to the MTO and that requires a adjustment of 0.6 percentage points of GDP*'.NERI had a

conflicting opinion and stated that in their view, ' *'it would be safe to use the €150 million. Such are the pressures on child care and housing that it would be foolish not to do so. Given the losses in terms of forgoing reduced interest costs versus the gains in terms of child care, education and so on, it speaks to using that money'.*

5. In calculating the available fiscal space for 2018 and beyond, the Department of Finance excludes the 2015 GDP growth rate of 26% and instead uses a growth rate of 5.5% for that year. This decision significantly reduces the GDP reference rate and therefore the permissable increase in public expediture. It was IBEC's view that '*maintaining the decision to forgo this additional fiscal space by excluding the 2015 GDP figure from the fiscal space calculations is a mistake*' and that '*an additional €7 billion in potential investment capacity between 2018 and 2021 if we were to apply the fiscal rules in their correct form*.'

Recommendations

The Committee recommends that:

1. The Minister and the Department of Finance engage with the European Union in order to change the Common Agreed Methodology in order to produce a more meaningful measure of the output gap for Ireland.
2. Further analysis into the determination of the expenditure benchmark be carried out (and consequently the reference rate) given the varying expert opinions.
3. As per OECD recommendations, that extensive engagement around the determinants of fiscal space for the coming year(s) far in advance of the annual budget in future be entered into.
4. That the Committee be provided with information regarding internal calculations of fiscal space for Budget 2019 by the Department of Finance in a timely manner after the Budget's publication, so as to fulfil its scrutiny role effectively.

7 Expenditure themes
7.1 Funding Demographic Pressures & Costs

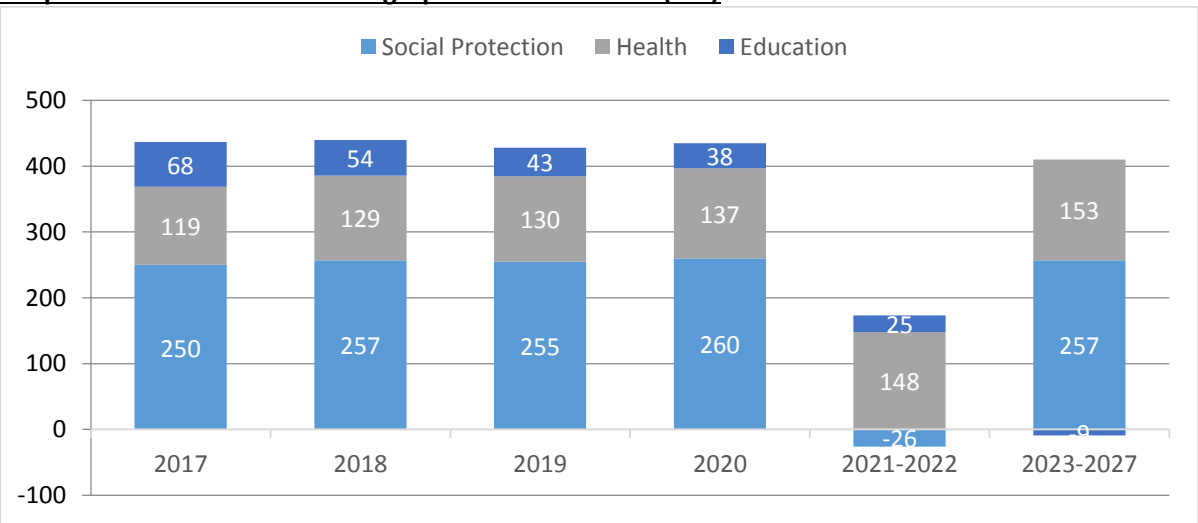
Overview

Demographic changes in the Irish population have a direct bearing on budgets as a portion of public expenditure must be ring-fenced to respond to changing demand for public services and social transfers. Effective budgetary oversight can support planning for such changes by examining whether Government has considered their whole-of-Government effects.

1. It is forecast that €120 million will be allocated to the health and education sectors for 2018 to finance additional staffing requirements.
2. In the years 2017 to 2020, costs in these sections are forecast to range between €428m and €440m. In the years 2021-2022 costs will decrease significantly (to circa €148m) due to a change in the retirement age, before increasing again (to €401m) in the years 2023-2027.
3. In the long term, the SPU states that *'the share of the working age population is expected to fall from approximately 60 per cent in 2013 to 50 per cent in 2050 contributing to a significant rise in the old-age dependency ratio'*.[8]

The forecast cumulative costs of responding to demographic changes out to 2027 are shown in Graph 4 below.

Graph 4: Annual Sectoral Demographic Cost Pressures (€m)



Source: IGEES Paper

[8] Department of Finance, *Stability Programme Update*, p.39.

Key issues

- A number of inter-linked issues were identified between demographic changes and public expenditure.

1. **Services**: An ageing population requires future public services which are distinct from those provided today. The future costs of cannot be fully estimated at this stage.
2. **Pensions**: Increasing or decreasing the value of social transfers in year X must be done while recognising the future costs of these changes due to demographic changes: a progressively greater number of eligible recipients could increase costs exponentially.
3. **Spending Reviews**: IFAC noted that spending reviews are a necessary means of assessing expenditure pressures caused by demographic changes.[9] Government could use longer term analysis of anticipated demographic changes to better evaluate the impact of policy options into the future.
4. **Immigration**: Whilst the effects of Brexit are not yet known, the UK's exit from the single market could increase emigration from the EU27 into Ireland, as it will remain the only English-speaking Member State. Additionally, the recovering Irish economy could be expected to incentivise Irish emigrants to return to Ireland.

Evidence

The Committee heard evidence from a number of witnesses about effects of demographic changes on the economic and fiscal position. Broadly, witnesses highlighted opportunities in the short term and risks in the long term.

1. The ESRI highlighted research that indicates that across Europe, policy responses to the ageing population are likely to include '*a mix of increased pension contributions, delayed payments, and extended working lives, and there is a value in thinking now about how these components might be best achieved*'.
2. In the short term, the ESRI told the Committee that the ageing population is '*having an impact on the growth prospects of the European area right now'*. NERI noted that the composition of the Irish population '*means the Irish economy has a higher growth potential than that of the EU*'.
3. The ESRI informed the Committee that a growing population could result in 'a *lot of opportunities from a business and State point of view in terms of the growth of the productive side of the economy and the working population*'.

Recommendations

The Irish population remains comparatively young, but it is also ageing. Budgetary challenges and opportunities must be taken account of by Government as part of its medium term fiscal planning. The Committee recommends that:

- Budgetary planners give demographic pressures ever-increasing consideration so as to avoid future fiscal burdens.

[9] IFAC, *Fiscal Assessment Report* (June 2017), p.67.

The Committee notes the absence of a uniform, cross-departmental approach to the analysis of the costs of demographic changes. The Committee recommends the establishment of a minimum time horizon in forecasting future demographic costs to better inform fiscal planning.

7.2 Non-Exchequer Funding of Infrastructure

Overview

The Stability & Growth Pact (SGP) allows for some flexibility around expenditure financed through public-private partnerships (PPPs), investment funds like the European Investment Bank (EIB), and domestic investment funds like the Irish Strategic Investment Fund (ISIF). The Committee hopes to re-examine the issues regarding PPPs as part of its post-budget work programme.

1. The Capital Plan assigns €113 million (2.5%) of capital expenditure allocation for the use of PPPs over the period 2017-2021.
2. The SES indicates that the estimated value of all Irish PPPs as at end-2016 was €500 million on the government balance sheet, and €4.3 billion off-balance sheet: a total of €4.8 billion.[10]
3. At end-June 2017, the total size of ISIF's investment fund amounted to €19.7 billion, split between a discretionary portfolio of €8.5 billion and a directed portfolio of €11.2 billion.

Key Issues

Whilst non-Exchequer funding options are open to Government, the Committee is of the view that these options are not being fully utilised. The Committee hopes to re-examine the issues regarding PPPs as part of its post-budget work programme.

1. **PPPs**: The Capital Plan's Investment Policy Framework for PPPs limits annual expenditure on PPP unitary payments so as to guard '*against committing an undue level of future Exchequer funds to pay for assets in use now*'.[11]
2. **EIB**: The establishment of an EIB Office in Dublin now provides Government officials with a greater level of access to EIB officials, events, and leverage around accessing finance over the coming period.
3. **ISIF**: The Summer Economic Statement indicates that the Government will re-examine ISIF's role in supporting capital investment in light of more readily available private finance since ISIF's launch.[12] The Statement also notes that ISIF investments could be '*reoriented towards complementing the role of the rainy day fund*'.[13]

Evidence

A number of witnesses who gave evidence to the Committee discussed opportunities for increasing capital expenditure through non-Exchequer means.

1. IBEC informed the Committee that IBEC believes '*that there is a resistance to the use of public private partnerships, PPPs, in our public capital programme*' and suggested that the

[10] Department of Finance, *Summer Economic Statement* (June 2017), p33
[11] Ibid., p.14.
[12] Department of Finance, *Summer Economic Statement* (June 2017), p.2.
[13] Ibid., p.2

cap placed on the proportion of the capital expenditure that is funded through PPPs is '*an arbitrary cap*'.

2. IBEC believes that there is insufficient focus afforded to the use of EIB resources and private resources in funding the delivery of capital projects.

Recommendations

In the Committee's *Report on Building on Recovery: Infrastructure & Capital Investment 2016 - 2021* (July 2017), a range of recommendations relating to increasing capital expenditure are laid out. In addition to these, funding infrastructure investment through non-Exchequer sources must also be considered. The Committee recommends:

- That the Government re-examines use of PPPs in capital expenditure. The Committee will also examine this issue.
- The Committee supports efforts to leverage EIB funding for the funding in investment projects and encourages Government Departments to engage closely with the EIB to achieve this goal.
- The Committee recognises ISIF's mandate to achieve both an economic impact and an investment return. The Committee recommends that infrastructure projects that can address key bottlenecks should be considered by ISIF for funding.

7.3 Expenditure Pressures & Savings

Overview

1. The Comprehensive Review of Expenditure process, which took place in 2012 to 2017, has been replaced by a new Spending Review process, which will examine the efficiency and effectiveness of specific programmes and policies rather than the totality of public expenditure.[14]
2. In June, IFAC highlighted the benefit of identifying '*both areas of expenditure pressure and areas for potential savings*'.[15]
3. The SES indicates that the spending review process '*will ensure that the principles of value-for-money, effectiveness and sustainability are central considerations*' in making allocations of available resources to current and capital expenditure, in light of competing demands.[16]

Key Issues

- Budget scrutiny of public expenditure should focus on the responsiveness and adaptability of that expenditure. There are a number of factors which act as drivers for government expenditure.

1. **Demand-led Services**: Achieving efficiencies and/or monetary savings across the public service can be limited if the demand for these services is high.[17]
2. **Pay**: Where pay accounts for a sizeable proportion of a department's total expenditure, the composition of the workforce will be a key driver of the latter's sustainability: grade composition, salary bands, age profile and length of service all impact the pay bill. The issue of the funding of future expansion of public services was also raised in discussions with the PBO.
3. Savings: Savings on expenditure on pharmaceuticals have been made in recent years in the Department of Health, although expenditure in other areas has been increasing.

Evidence

The Committee heard evidence relating to pressures on public expenditure and how these pressures can be alleviated.

IFAC informed that Committee that "*for 2017, additional within-year spending measures would not be advisable*", stating that any increase in expenditure this year would need to be offset by savings and/or increased taxation in other areas.

[14] *National Reform Programme*, p14
[15] IFAC, *Fiscal Assessment Report* (June 2017), p.26.
[16] Department of Finance, *Summer Economic Statement* (June 2017), p.ii
[17] DPER, Spending Review: Tracking Trends in Public Spending (July 2017), p.5.

Recommendations

Given the current level of fiscal space, it is prudent to identify any inefficiencies, as this could help to relieve expenditure pressures. The Committee recommends that:

- An ongoing rigorous assessment of all expenditure be carried in an effort to clearly identify areas of expenditure pressures and potential savings.
- That an assessment could be carried out by the Department of Finance to identify bodies not utilising the National Shared Services Office (NSSO), but which could take advantage of it in order to provide a more efficient public service in the future.

The Committee also notes that a review of the Public Spending Code is ongoing.[18]

[18] DPER, *Public Spending Code*, <http://publicspendingcode.per.gov.ie/>

8 Revenue themes
8.1 Corporation Tax

Overview

In its 2014 report on corporation tax,[19] the Department of Finance noted that the three main objectives of Ireland's corporation tax policy are to: 1) encourage economic growth; 2) support jobs; and, 3) fund public services.

In an effort to meet these policy objectives, Government should be (a) cautious not to over-emphasise the reliability of corporation tax as a revenue stream; (b) conscious that tax deductions lower the effective rate of tax paid; and c) aware of international competition and efforts to reform corporation tax policy at the European level.

1. In 2016, 37 per cent of net corporation tax receipts, or €2.75 billion, was paid by ten companies,[20] accounting for 5.7 per cent of total net tax receipts.
2. Data from the CSO and Revenue Commissioners was found to provide the best estimates of the effective tax rate – 10.9% and 10.7% respectively – when averaged over 2003-2013. Ireland has the third lowest corporation rate amongst OECD countries, behind only Hungary and Switzerland with 9% and 8.5% respectively.[21]
3. IFAC has stated that the concentration of corporation tax receipts is a reason for concern,[22] particularly as it relates to budget planning.
4. In recent year corporation tax forecasts have been the most inaccurate estimations in comparison with all other tax forecasts.[23] Out-turn has ranged from 30 per cent below and 50 per cent above target, impacting on budgetary planning.
5. Contrary to previous years, corporation tax receipt forecasts set out in Budget 2017 were not inaccurate (at end-August 2017 receipts are under profile by €14 million (-0.4%))[24].

Key issues

Given the importance of corporation tax to Ireland's tax base, a number of key issues were considered by the Committee.

1. **Dependence:** The European Commission, in its 2017 Country Report on Ireland raised the use of increased corporation tax receipts to fund current spending as an issue of concern.

[19] Department of Finance, '*Economic Impact Assessment of Ireland's Corporation Tax Policy: Summary Research Findings and Policy Conclusions'* (October 2014).
[20] Revenue Commissioners, Corporation Tax Receipts 2016 and Payments 2015. April 2017
[21] OECD, *Public Sector, Taxation, and Market Regulation*; Taxation Table II.2 Statutory Corporate Income Tax Rate. Available at; https://stats.oecd.org/index.aspx?DataSetCode=Table_II1
[22] IFAC, Note 10.
[23] IFAC, Analytical Note No. 10: Challenges Forecasting Irish Corporation Tax. Sept 2016
[24] IFAC, Pre-Budget Statement. Sept 2018

2. **Forecasting:** Bodies such as IFAC and the ESRI also voice concerns regarding the risks of this policy. Inaccuracies in forecasts and the high concentration ratio of taxpayers to receipts must be accounted for as part of prudent budgetary planning.
3. **MNCs:** Over the medium to long term, there is a risk of a shock to receipts if MNCs within the top 10 alter the nature or intensity of their activity in Ireland
4. **External Risks:** International developments such as Brexit, or changes to U.S. tax policy may also impact receipts in Ireland. The most pressing threat according to IFAC[25], if implemented, is the Common Consolidated Corporate Tax Band (CCCTB) as proposed by the European Commission.

Evidence

Witnesses broadly agreed that Ireland's corporation tax rate of 12.5% provides a competitive advantage over many OECD counterparts.[26] This competitive advantage could be hindered by weaknesses in the tax head's reliability and base.

1. Corporation tax, as has been confirmed by IFAC and the ESRI, is always highly volatile in comparison with all other tax heads. Forecasting challenges make it difficult to fully insulate against any potential shock reductions in corporation tax receipts.
2. IFAC informed the Committee that '*in 2015 corporation tax outperformed by €2.3 billion and gross voted expenditure was subsequently increased by €1 billion on the back of that. In 2016 there was a shock of €0.7 billion and gross voted expenditure rose by €0.7 billion, almost exactly in line with the shock. Rather than spend it immediately, its sustainability should be assessed before a decision is made*.' IFAC suggested that unforeseen corporation tax increases should be saved in the short-term as opposed to spending it immediately.
3. IFAC highlighted to the Committee that a structurally balanced budget would have been achieved two years earlier than currently projected if unexpected CT receipts and interest savings were used for debt reduction as opposed to within year spending in 2015 and 2016.
4. The European Commission has emphasised its intention to implement the CCCTB, but IFAC informed the Committee that implementation is less likely than Brexit. From a budgetary perspective, awareness around the potential detrimental effects of the CCCTB is important. The Committee heard from Seamus Coffey that, in his opinion, the potential implementation of the CCCTB poses a greater threat to corporation tax yields than Brexit.

[25] Mr Seamus Coffey, Presentation to Joint Oireachtas Committee on Finance, Public Expenditure and Reform and Taoiseach on the CCCTB. Dec 2016

[26] A 25% rate is charged on non-trading income and income from an excepted trade, as it is defined in the Taxes Consolidation Act

Recommendations

High quality analysis of corporation tax policy has been produced in recent years. The Committee hopes to see this trend continue so that sustainable policies are undertaken. The Committee recommends:

- That Ireland's 12.5% CT rate should be protected, and the potential impact to subsequent tax yields of international policy changes such as the CCCTB be fully evaluated to the greatest extent possible, given available data.
- The Department of Finance should assess how best to spend or save corporation tax yields so as to mitigate the potential effects of revenue shocks, should external policy decisions be introduced.

The Committee heard evidence from the ITI and Ibec that the risk posed by the Corporation Tax dependence could be mitigated by strategic investment in the indigenous sector.

The Review of Ireland's Corporation Tax Code (Seamus Coffey Report).

The Committee acknowledges that the Minister for Finance published the Coffey report in advance of the Budget, and this facilitated the Committee's pre-budget scrutiny process. With regard to the Coffey report, the Committee notes the findings of Seamus Coffey's recent report on the sustainability of corporation tax in Ireland. The Committee intends to examine the findings in further detail as part of its post-budget work programme.

8.2 Income Taxation

Overview

Income taxation (Income Tax, PRSI, and USC) receives a considerable amount of attention during the preparation of the Government's annual budgets.

1. The Department of Finance forecasts that €20.2bn will be raised through income tax (€16.5bn) and the USC (€3.7bn) in 2017, accounting for 40% of the total tax take.[27]
2. Income Tax receipts of €1,497 million were collected in August, in-line with profile (down €13 million). This represents a €88 million (6.3%) increase compared to August 2016.
3. Year-to-date receipts are €12,217 million, which are 1.8% (€221 million) below profile, but up €518 million (4.4%) in year-on-year terms.[28]
4. The European Commission finds that the Irish income tax system is highly progressive, when comparing the tax wedge at 167% of average income (€62,755) with the tax wedge at 67% of average income (€25,180). However, the income tax base is also found to be narrow. In 2017:
5. Comparative evidence shows that single earners in Ireland face among the highest marginal tax rates in the EU and that Irish workers compare favourably in relation to their effective income tax wedge at most income levels. At the same time, marginal income tax rates are high in Ireland when compared to rates in other countries.

Table 1 below shows the average income tax rate and marginal tax rate for a range of family types, as well as the ranking for each 'type' when compared across OECD Member countries. In the ranking columns, the lower the number the higher the rank. For example, 1 means that the country has the highest average/marginal rate in the OECD, 35 means that the country has the lowest. 16-19 means the country is about average.

Table 1: Average Income Tax Rate and Marginal Income Tax Rate for Various Family Types

Status	Children	Earners	Earnings (v Average)	Earnings (€)	Ave. IT Rate* (%)	OECD Rank (/35)	Marginal IT Rate (%)	OECD Rank (/35)
Single	0	1	167%	59,450	27.4	10	49.5	9
	0	1	100%	35,600	15.3	19	49.5	4
	0	1	67%	23,850	8.7	22	29.5	21
	2	1	67%	23,850	2.6	19	63.8	2
Married	2	1	100%	35,600	6.8	21	29.5	24
	2	2	100%-33%	47,350	8.7	18	29.5	26
	2	2	100%-67%	59,450	12.0	17	29.5	27
	0	2	100%-33%	47,350	8.7	23	29.5	27

Source: OECD Taxing Wages 2017; **Note: The average income tax rate includes USC (at its various rates) and excludes employee PRSI of 4%.*

[27] Tax Strategy Group , *TSG 17/02 – Income Tax and USC*, p.3.
[28] Or 5.2% on an underlying basis (i.e. excluding one-offs in the corresponding period in 2016); Department of Finance, *Fiscal Monitor July 2017*, p.3.

Key Issues

The quantum of income tax revenue collected through the income tax system is dependent, to a large extent, on the income distribution of taxpayers, progressivity and concentration.

1. **Income Distribution:** Pre-tax income is unevenly distributed in Ireland. A large proportion of workers earn less than the average industrial wage and a small cohort of earners earn a very high level of income. This income inequality is partially corrected through a progressive tax system.
2. **Marginal Rates**: Setting what could be considered excessive marginal tax rates could create a disincentive effect for higher earners, as highlighted by the Tax Strategy Group.[29]
3. **Effective Rates**: Reductions to marginal rates, which are comparatively high, lead to reductions to effective rates, which are comparatively low. Balancing these dynamics is a budgetary challenge.
4. **Exemptions**: Excluding a large proportion of low-income workers from income taxation could disincentivise their employers from providing higher wages or wage increases, since a small income tax wedge is an effective wage inflator.
5. **Universal Social Charge:** Removing or reforming the USC will be a challenge given the income distribution, the structure of the USC, and the structure of income tax, especially in light of the quantum of revenue collected through the USC.

Evidence

Witnesses who provided evidence to Committee outlined a range of perspective in relation to income taxation.

IBEC advised the Committee that although there may be social objectives to reducing the USC, IBEC is of the view that "*from an economic perspective it is not the best use of our resources*". IBEC also pointed out that reducing the USC would not address the disincentive effect of a high marginal tax rate and that when the marginal rate and childcare costs are taken into consideration, the effective income tax rate for a woman returning to work following childbirth could be as high as 80% or 90%.

NERI told the Committee that the tax wedge for a single person '*is the lowest in the EU 15 and less than half that of Belgium and Germany*'.

The ITI suggested to the Committee that '*there is huge movement in and out of the country by a very mobile labour market*' and that '*there has not been enough research carried out on what is the right income tax policy for a very small open economy*'.

[29] Tax Strategy Group, *TSG 17/02 Income Tax and USC*, p.13

Recommendations

The Committee recommends that:

- The Government initiates an econometric study on the nature of any potential incentive or disincentive effects of the Irish marginal income tax rate. The Revenue Commissioners should undertake more detailed analysis in order to provide granular data on policy choices that may affect individual taxpayers rather than taxpayer units in order to allow greater policy debate.
- The Department of Finance should examine the drivers of anomalies between the amount of revenue that is forecasts to be collected through income tax or the USC and the amount of revenue that is actually collected. The Committee expects full transparency regarding the data and information used in determining any income tax policy changes made in Budget 2018 when undertaking ex post scrutiny.
- Any impact analysis of income tax changes should include analysis of the gender impact of such changes.

8.3 Tax Expenditures

Overview

Over recent years there has been an increased level of attention given to the analysis of tax expenditures as policy choices and their related costs and benefits. The IMF has recommended a review of current tax expenditure policy in Ireland,[30] while the European Commission recommends narrowing their scope.

1. The Revenue Commissioners' most recent estimate of the annual costs of the State's 116 tax expenditures is €5.3 billion for 2016.[31] The accuracy of this figure must be questioned given gaps in the data that should contribute to their estimation.
2. Of specific tax expenditures, the Committee engaged with witnesses in relation to the R&D tax credit, which is estimated to have cost the Exchequer €639 million in 2015.[32]
3. In 2016 the Revenue Commissioners estimated that of those claiming the R&D Tax Credit from 2009 to 2015, 60% was a direct result of the credit being available, and 40% would have been undertaken regardless of the tax incentives.

Key Issues

In examining the relationship between tax expenditures and budgetary policy, the Committee was mindful of a range of considerations.

1. **Benefits:** Benefits of tax expenditures include lower administration costs than through direct expenditure policies and the solving of market failures without directly subsidising a particular industry or group.
2. **Evaluation**: There is potential to relieve pressure on the fiscal space by identifying tax expenditures that cost the Exchequer more in financial terms than their ultimate economic and/or social benefits.
3. **Data:** A lack of accessible data results in less dependable estimations, and causes problems in determining the efficiency of individual policies. This in turn makes it less probable that effective decisions will be taken in the continuation or discontinuation of tax expenditure policies that may cost more than the social or financial benefits they are set out to achieve.
4. **Efficiency:** Deriving the efficiency of tax expenditures can be challenge, particularly when some benefits are non-monetary, or have spill-over effects that are difficult to quantify. An absence of data available regarding the total benefits of a given tax policy makes it both costly and time consuming to analyse each measure on a regular basis.

Evidence

Tax expenditures raise contrasting opinions across the board given subjectivity around valuing their benefits, as evidenced through the contributions of witnesses who attended before the Committee.

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[30] IMF, *Country Report No. 17/172, 'Ireland, Selected Issues'*, June 2017.
[31] Tax Strategy Group, Tax Expenditures Review, 17/13. July 2017.
[32] Revenue Commissioners, Corporation Tax Receipts 2016 and Payments 2015. April 2017

1. Conducting regular review of the effectiveness of the various tax expenditure measures at addressing market failures was widely proposed by witnesses.
2. Dr Martina Lawless of IFAC and the ESRI noted that '*it is very much the Fiscal Advisory Council's view that all tax expenditures and rebates should be reviewed on an ongoing basis to make sure that the rationale for introducing them in the first place continues to exist*'.
3. Alan Barrett of the ESRI informed the Committee that '*there is an argument that tax expenditures in the pension area are not so much a tax break but deferred taxation*'.
4. Citing OECD research, Dr Tom McDonnell of NERI informed the Committee that '*among the issues it noted was that public research and development expenditure in Ireland is extremely low, as is research and development expenditure at national level, that is, public and private expenditure combined. It also noted that research and development tax expenditure is very costly and recommended that the direction of fiscal reform in this area be moved towards subsidies*'.

Recommendations

Through further scrutiny of tax expenditure policy, efficiency savings can be determined. Therefore the Committee recommends that:

- Gaps in data relating to tax expenditures should be addressed, to allow acceptable efficiency levels to be established.
- All tax expenditures should have systems for review and evaluation.
- That decisions regarding tax expenditure policy be taken with a greater level of evaluation with research provided to proving the benefits of such budgetary policies where possible.
- A greater level of oversight of the costs and benefits of tax expenditures could result in efficiency savings or confirmation of the policy's merits and necessity in spite of its expense.
- Ex ante, estimating likely deadweight loss is researched and implemented, with the view to making ex post analysis more effective. Outlining predetermined acceptable outcomes facilitates more prudent budgetary planning.
- Due to concerns that the Committee has about the increasing cost and concentration of the R&D tax relief, Revenue should engage with the Committee in examining these issues as part of its post-budget work programme.
- The Committee recommends an assessment of measures such as capital gains tax and entrepreneur relief with a view to stimulating the indigenous sector.
- The Committee also recommends a review of the current employment investment incentive to assess whether a seed investment programme, similar to that in the UK, could be implemented.
- The Department of Finance assess the cost of implementing a share option scheme for small businesses to stimulate the SME sector. The model used in the UK was put forward as an example of good practice.

9.Themes Spanning Revenue and Expenditure
9.1 Climate Change

Overview

A number of Government and Departmental publications outline the State's plans to address climate change, through sector-specific policies and programmes.

1. Ireland's 2020 binding targets include a 20% reduction on 2005 levels of non-Emission Trading Scheme (non ETS) sector emissions (i.e. the portion of emissions for which government is responsible). Ireland must also source 16% of its energy from renewable sources by 2020 (Renewable Energy Share (RES) target).
2. Currently, Ireland is projected to achieve a 4%-6% reduction in emissions on 2005 levels[33] and to source 13.2% of its energy from renewables by 2020 based on current progress.[34]
3. A failure to meet EU 2020 and 2030 carbon emissions targets will result in costs to the Exchequer through purchasing compliance or direct fines. Such costs would limit the fiscal space that will be available for day-to-day expenditure over the coming decades.
   In 2016, the compliance costs of missing the non-ETS target were estimated to be in the region of €60 - €120 million.[35] The cost of missing the RES target was estimated to be c. €140 million for every 1% shortfall.[36] This led to a 2016 estimate of exchequer costs of between €230 million and €610 million by 2020 and costs of between €3 billion and €6 billion by 2030.[37]

Key Issues

A range pressing short- and medium-term budgetary questions relating to climate change include:

1. **Fines:** The costs to the State of failing to meet its EU 2020 emissions targets will impact budgetary planning from 2020 on.
2. **Expenditure:** Climate change could lead to increased expenditure in mitigating and responding extreme weather events and other impacts.
3. **Taxation:** The use of tax system as a means of achieving climate goals has been emphasised by the Tax Strategy Group. Such tax-related mitigation measures have not been set out in Government publications, or the Summer Economic Statement.

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[33] Environmental Protection Agency, *Emission Projections Summary Report*, (April 2017) http://www.epa.ie/pubs/reports/air/airemissions/ghgprojections/EPA_2017_GHG_Emission_Projections_Summary_Report.pdf Ireland is expected to exceed is non-ETS target 13.7 Mt of CO_2 eq over the period 2013-2020 under the *With Existing Measures* scenario and to cumulatively exceed its obligations by 11.5 Mt of CO_2eq over the period 2013-2020 under the *With Additional Measures* scenario.

[34] Ibid.

[35] This is the estimated cost of purchasing unused entitlements from other Member States. See Joseph Curtin, *How much of Ireland's "fiscal space" will climate inaction consume?* IIEA Blog, 2016. http://www.iiea.com/blogosphere/how-much-of-irelands-fiscal-space-will-climate-inaction-consume In 2014, the IGEES put this figure at c. €90 million. IGEES, *Future Expenditure Risks associated with Climate Change/Climate Finance,* 2014 http://igees.gov.ie/wp-content/uploads/2013/10/Future-Expenditure-Risks-associated-with-Climate-Change-Climate-Finance1.pdf

[36] IGEES, 2014, op.cit.

[37] Curtin, 2016, op.cit.

4. **Competitiveness: taxation measures to mitigate climate change should** be used to complement other measures instead of bluntly distorting the competitiveness of the overall economy through cost increases without providing viable, cleaner alternatives.

Evidence

The Committee discussed economic and fiscal risks associated with climate change and policy options to address these.

1. The ESRI highlighted the financial risks that stem from a failure to meet climate targets arguing that the impacts from the signal this behaviour sends *"collectively or on a planetary level [...] have the potential to be much greater than the combined impacts of Brexit and any tax changes."*[38]
2. Chambers Ireland suggested measures such as a funding to incentivise the uptake of Electric Vehicles, such as free use of road and bridge tolls, as well as the electrification of Ireland's public transport fleet. They also argued that Government should examine the potential for greater use of green procurement by state bodies.

Recommendations

EU fines and the direct costs of climate change events have the potential to put immense pressure on future budgets. , The Committee recommends:

- That any tax incentives to reduce emissions or using renewables should only be used when complemented by viable, cleaner alternatives.
- That the Department of Finance engages with the Committee before Q2 in 2018 to discuss steps it is taking to climate proof Budget 2019.
- A review of current tax policies that give rise to fossil fuel subsidies (e.g. the electricity tax exemption for domestic users, reduced rates of VAT applied to energy, the diesel rebate scheme, marked gas oil).
- The Government give consideration to updating and commencing (BIK) provisions in the Finance Act 2008 to allow for lower tax rates on BIK for EVs. This would follow moves by a number of other countries, such as the UK, France and Germany, which currently give EVs favourable BIK treatment.[39]
- Include a statement in Budget 2019 assessing the climate change impact of the budget.
- Any new tax expenditures on EVs or other climate change actions must be fully costed in Budget 2018 and subject to regular Dáil review and approval.

[38] *Ex-ante Scrutiny of Budget 2018,* 13 September 2017, op.cit.
[39] TSG, op.cit.

9.2 Labour Market Participation

Overview

At 60%, the labour participation rate in Ireland is comparatively low, whilst full employment is forecast to be reached in late 2018. Ireland now faces the challenge of needing to increase labour market participation in order to support economic growth beyond the near term.

1. Labour market participation is related to, among other factors, the structure of income taxation and the rates leveraged at lower levels of income.
2. In May the European Council recommended that the Government enhance Ireland's social infrastructure, including in the areas of childcare and labour market activation, especially in relation to policies that support low-skilled workers and which address low work intensity.[40]
3. As a percentage of wages, net childcare costs in Ireland are among the highest in the EU. The availability and cost of quality fulltime childcare present barriers to female labour market participation and hinder efforts to reduce child poverty.[41]

The number of jobless households in Ireland is an economic, social, and budgetary risk: 11.6% of adults (aged 18-59 years) and 13.4% of children are in jobless households.

Key Issues

Labour market participation rates have a direct effect on the level of revenue collected and on the level of services provided by public bodies. This results in challenges to effective budgetary planning, especially with regard to the capacity of expenditure to support non-participants and the fiscal opportunity cost of untaxed earnings in the labour market.

1. **Expenditure:** Measures to increase labour market participation could include the level of support provided in the area of childcare, expenditure on job activation measures, and welfare measures to support re-entering the workforce.
2. **Taxation:** The 2016 Income Tax Reform Plan states that labour market participation increases as a result of reducing average labour taxes and that hours worked increases as a result of lowering marginal rates of tax.[42]
3. **Gender:** Earnings and workforce participation data indicate that males are more likely to be the higher earners in households and therefore the assessable spouse. Policy measures targeted at the secondary earner of a jointly assessed couple could be expected to have a more significant impact on females.[43]
4. **Disability:** The Make Work Pay Interdepartmental Group has identified key disincentives for people with disabilities to work, considered options to tackle these, and developed recommendations to tackle the main barriers that make work pay for people with disabilities. The Group's report is due to be released shortly.[44]

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[40] Ibid., p.8.
[41] *Council Recommendation* (May 2017), p.5.
[42] Department of Finance, *Income Tax Reform Plan,* p.21.
[43] Ibid.
[44] *National Reform Programme*, p.24.

Evidence

1. The ESRI informed the Committee that '*there would still appear to be some spare capacity in the labour market, especially if we consider the migration channel and credit growth in the economy is still somewhat limited*'.
2. IBEC considers the low female labour market participation rate '*as one of the great lost opportunities for our economy*' and that childcare costs '*act as a significant deterrent*' to labour market entry.
3. NESRI advised the Committee that '*what is more important is effective tax rates at the bottom of the income distribution where there is a choice about labour market entry at all*'.

Recommendations

As full employment is expected to be reached in the near term, activating labour that is currently outside the participation rate is an important endeavour. The Committee further notes the lack of data to measure the effectiveness of the existing range of employment supports.

The Committee recommends that:

- the Government gives consideration to addressing these information gaps with a view to increasing participation rates. It would also allow for a greater level of oversight of expenditure, which would in turn improve the budgetary process.
- Investment in childcare and housing areas would help to address barriers to participation, and are covered elsewhere.
- Elimination of all barriers to entry of labour market activation schemes for all workers returning to the workforce should end in Budget 2018.

9.3 Shortages in the Housing Market

Overview

Developments in the housing market are inter-linked with demand for, and functioning of, private housing, social housing, and housing supports.

1. The Committee notes that a number of causes have been attributed to the lack of supply such as a lack of finance for developers with viable projects,[45] the planning system,[46] a lack of infrastructure needed to support development[47] and the high cost of construction.[48] Increasing house prices, which have risen each year since 2013, has not led to a greater supply.[49]
2. For 2017, total Exchequer expenditure allocated in the area of housing is €1.46 billion. Inclusive of Local Authority funding, expenditure rises to €1.56 billion.[50]
3. As of end-August, capital expenditure in the Department of Housing, Planning, Community and Local Government totalled €415 million, €125 million (42.9%) ahead of target.[51]

Key Issues

1. Given the high level of public expenditure in housing programmes, it is important to ensure that proposed solutions are based on evidence that they will produce desired outcome. **Capital Expenditure**: A key budgetary challenge is the need to increase the capital expenditure on housing in the context of fiscal constraints. Avoiding overheating is a related concern.
2. **Current Expenditure:** Expenditure on housing supports provides individuals with rental accommodation through the private market, meaning public expenditure is – to an extent – influenced by rental price changes in the broader market.
3. **Taxation**: Tax incentives can encourage construction and/or the entry of landlords into the rental market, while taxation of construction and/or landlords can lead to revenue for the Exchequer.

Evidence

The Committee heard evidence from several witnesses on the budgetary and economic context to Ireland's housing market. In particular, evidence was provided around risks of overheating, the provision of social housing, tax incentives, and tax measures.

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[45] ESRI submission to the Dept of Finance, https://www.esri.ie/publications/tax-breaks-and-the-residential-property-market/

[46] ESRI submission, op.cit; John Fitzgerald, cited in Irish Times https://www.irishtimes.com/business/construction/dublin-councils-accused-of-preventing-housing-development-1.3093730

[47] ESRI submission, op.cit.

[48] *Daft House Price Report Q2 2017* https://www.daft.ie/report/2017-Q2-houseprice-daft-report.pdf

[49] Morgenrath, E., '*Housing Supply and House Price Trends: a County Level Analysis*', ESRI Research Note (2016). https://www.esri.ie/pubs/RN20160101.pdf

[50] IGEES, op.cit.

[51] Department of Finance, *Fiscal Monitor* (August 2017) http://www.finance.gov.ie/wp-content/uploads/2017/09/170904-Fiscal-Monitor-August-2017.pdf

IFAC advised the Committee that *"were a sharper than expected recovery in housing to take hold and overshoot regular annual requirements for housing completions [...] overheating could materialise in future years"*. IFAC also noted to the Committee that if Ireland wants to *"do more on the investment side, we should possibly do less on the consumption side [...]*', and advised that *"if off-setting measures are required, we should be willing to consider introducing them."*

ESRI noted that a multi-annual response that lives within the parameters of the fiscal rules was required. They highlighted research carried out on behalf of the Department of Finance that cautions against tax incentives to encourage construction.

Moreover, the committee was informed that ESRI research argues that *"apart from a site tax, Government measures aimed at housing markets across countries have had mixed fortunes in terms of achieving the desired outcomes."*

IBEC suggested making better use of resources, such as achieving better housing utilisation and ensuring better density in urban areas.

The ESRI noted that evidence exists which shows the scheme has not pushed up prices but that the basic aim of the policy to generate greater levels of affordability ultimately *"leads to greater levels of demand and higher house prices when supply is fixed."*

Recommendations

The role of budgetary policy in addressing the housing shortage is a contentious one, with some experts suggesting non-budgetary policy is of equal if not greater importance. It is therefore important that budgetary responses are adequately researched. The Committee recommends the following:

- The implementation of a vacant site tax, with higher rates on sites that can be easily built on and have the necessary infrastructure in place.
- The Committee also notes that all stakeholders were supportive of the early introduction of a vacant site tax, and Committee recommends that the Minister gives consideration to the early introduction as part of Budget 2018.
- The Committee recommends a significant increase in investment in social housing through a multi-annual response that stays within the boundaries set by the fiscal rules.
- The Committee endorses the recommendations of the report of the Committee on Housing and Homelessness, which calls for 50,000 social houses to be delivered over the next 5 years and that the necessary resources should follow.
- The Committee recommends that if there are limitations on the total amount of capital expenditure available, priority could be given to expenditure on housing.

- The Committee encourages that the construction of housing is undertaken in a stable and sustainable fashion and that, if off-setting measures to balance potential overheating are required, these could be implemented in the medium-term.
- The Committee recommends an increase in the budget for the Department of Education and Skills to provide apprenticeship programmes in the construction sector to cater for increased demand in this sector.

9.4 Other Themes

LOCAL PROPERTY TAX (LPT)

Overview

The local property tax was introduced in 2013 and replaced the household charge. In 2015, the then Minister for Finance took the decision to postpone a re-valuation of the local property tax (LPT) from 2016 until 2019. Therefore, the process for implementing the new (and first) revaluation of local property tax (LPT) is due to take place before the 2019 budget. Given that increases in housing prices are unevenly distributed across the country, some areas will face substantial increases in their property tax when the revaluation will take place, with the respective local authorities incurring windfall revenue gains. Other areas, however, will have their property taxes unchanged.

Key Issues

Given that the issues faced surrounding the LPT in 2015 and the issues faced today with a revaluation pending in 2019 are similar, the Committee decided to question witnesses on the merits of the current LPT structure and how best to reform it.

1. **Stability**: A pre-budget review of the LPT in 2015 concluded that there are shortcomings in the current system notably that it does not offer relative stability to taxpayers, local authorities or central government.[52]
2. **Minimum Yield**: The 2015 report by Don Thornhill recommended a new system of local taxation whereby a minimum yield of LPT for each area would be determined by Government. The Department of Finance and Revenue, using the LPT tax base data and other relevant information, would then estimate the property tax rates to be applied in each local authority area in order to raise this minimum yield...[53]

Evidence

1. Chambers Ireland suggested the bands and rates of taxation applied could be adapted to make the tax liabilities more acceptable to ordinary taxpayers.
2. He also recommended that in the long term the Government should consider the development of a land tax based on the value of a parcel of land as a replacement for LPT. This would mean that as the value of a piece of land increases, the rate of tax increases. He noted that such an approach to land management would encourage improved use of land and not penalise home improvements in the way LPT does

[52] Thornhill, Don, 'Review of the Local Property Tax (LPT)', July 2015 http://www.budget.gov.ie/Budgets/2016/Documents/Review_of_Local_Property_Tax_pub.pdf
[53] Thornhill, Don, 'Review of the Local Property Tax (LPT)', July 2015 http://www.budget.gov.ie/Budgets/2016/Documents/Review_of_Local_Property_Tax_pub.pdf

Recommendations

The Committee recommends that:

- From a scrutiny perspective, the Committee is generally of the view that Ministers should in future make a presentation to this Committee if it chooses not to follow the advice and/or recommendations of independent experts commissioned by Government, who have conducted reviews or analyses on budget policies.
- The Revenue Commissioners and Department of Finance officials meet with the Committee in late 2017/early 2018 to discuss the LPT revaluation process.

THE SLÁINTECARE REPORT

The Committee recommends that the Minister for Finance and Public Expenditure and Reform takes into consideration the Sláintecare report agreed by the all-party Oireachtas Committee on the Future of Healthcare in advance of the budget, and welcomes future engagement on any budgetary implications.

THE REDUCED VAT RATE (9%)

Overview

The Government introduced a second reduced VAT rate of 9% to apply in respect of certain goods and services, initially for the period 1 July 2011 to 31 December 2013.

1. The 9% rate applies to certain goods and services previously liable at the 13.5% rate, most of which relate to the hospitality sector.[54].
2. In Budget 2014 and Budget 2016, the Minister decided to extend the reduced 9% VAT rate.
3. It is worth noting that under EU rules Ireland is allowed to have only two lower VAT rates, thus while a 9% VAT rate could be changed to a 10% rate, a 10% rate cannot coexist with a 9% rate and a 13.5% rate.

Key Issues

1. **Foregone Revenue**: The estimated cost to the Exchequer of the reduced 9% VAT rate, since its introduction in 2011 to end 2016 is €2.2billion.[55] Revenue's most recent estimate for reverting the reduced 9% VAT rate back to 13.5% is that it would bring in extra revenue of €491 million.
2. **Breadth: As t**he reduced VAT rate is applied to wide range of goods and services, it might not be appropriately targeting the subject of its objective: tourism.

[54] Including restaurant and catering services; hotel and holiday accommodation; admissions to cinemas, theatres, certain musical performances, museums and art gallery exhibitions; fairgrounds or amusement park services; the use of sporting facilities; hairdressing services; printed matter such as brochures, maps, programmes, leaflets, catalogues and newspapers.
[55] TSG 17/06 VAT Issues

3. **Job Creation**: A key justification for the introduction of the reduced rate in Budget 2014 was to support job creation.[56] Whether the number of job created justifies the quantum of foregone revenue is an important budgetary consideration.

Evidence

The Committee chose to question witnesses on the rationale behind the continuation of the 9% VAT rate or on the reasons why it has been continued for many budgets when its effect on the hospitality prices for consumers is questionable.

1. ICTU stated that the reduced rate is *"a de facto subsidy that has already cost the State €2.2 billion in taxes forgone"* arguing that there is "*no justification for this ongoing subsidy to a highly profitable and predominantly low wage sector.*" Mr Berney informed the committee that there is no evidence of any significant new job creation or that the consumer has benefited in any way.
2. The Irish Tax Institute highlighted that there are a number of ways of amending the 9% VAT rate, noting that one could change one part of the list of items covered by the rate and not change another. She also highlighted that Ireland does not have to change the 9% VAT rate back to 13.5% but go for something in between, and possibly something the Committee may wish to explore.
3. Chambers Ireland emphasised the competitiveness aspect to the debate, remarking that some 17 out of 19 Eurozone countries have tourism VAT rates of 10% or less. He argued that increasing the rate to 13.5% "*would be detrimental to the sector*" and the retention of the 9% rate is "*important to retain jobs particularly in regional and rural areas*".

Recommendations

- The Committee recommends that the Department of Finance and CSO review the available evidence that the VAT reduction measure has led to job creation in all sectors and regions.
- As recommended by the Irish Tax Institute, the Committee also recommends that the Department assess the different components of the VAT measure, possibly with a view to removing some categories from the tax subsidy.
- The Committee also notes the discrepancy between the comparatively high cost of hotel rooms in some areas of the country coupled with one of the lowest VAT rates and this may indicate that the VAT rate could be subsidising areas in little need of a subsidy.

[56] http://www.merrionstreet.ie/en/news-room/releases/9-vat-rate-in-budget-a-further-boost-for-tourism-varadkar-ring.html

10. Appendix

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11.Terms of Reference

Go ndéanfar, de réir mholadh an Fhochoiste ar Athleasú na Dála faoi Bhuan Ordú 107(1)(*a*), Buan-Orduithe Dháil Éireann i dtaobh Gnó Phoiblí a leasú tríd an mBuan-Ordú seo a leanas a ghlacadh:

'186A. (1) Beidh arna bhunú, a luaithe is féidir i ndiaidh ationól na Dála tar éis Olltoghcháin, Buanchoiste, dá ngairfear an Coiste um Fhormhaoirsiú Buiséid, chun scrúdú a dhéanamh agus, más cuí leis é, chun tuarascáil a thabhairt don Dáil—

(*a*) ar an staid fhioscach fhoriomlán, lena n áirítear—

(i) an staid chomhiomlánaithe maidir le hioncam agus caiteachas agus Iarmhéid Ginearálta an Rialtais, lena n-áirítear spriocanna struchtúracha;

(ii) réamh-mheastacháin mheántéarma don airgeadas poiblí;

(iii) réamhaisnéisí agus forbairtí maicreacnamaíocha; agus

(iv) rialachas fioscach ginearálta, lena n-áirítear rialacha agus priacail fhioscacha a fheidhmiú maidir leis an staid fhioscach;

(*b*) ar an mbeartas maidir le caiteachas poiblí, lena n-áirítear—

(i) an staid chaiteachais ag féachaint don Uasteorainn Caiteachais Rialtais agus don tslat tomhais chaiteachais faoin gComhaontú Cobhsaíochta agus Fáis; agus

(ii) na hUasteorainneacha Caiteachais Aireachta a bhfuil feidhm acu maidir le Meastacháin ar leith nó grúpaí Meastachán i gcomhair Seirbhísí Poiblí i gcás go

That, in accordance with the recommendation of the sub-Committee on Dáil Reform under Standing Order 107(1)(*a*), the Standing Orders of Dáil Éireann relative to Public Business be amended by the adoption of the following Standing Order:

'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

bhféadfadh athruithe suntasacha ar an bpróifíl chaiteachais tionchar a bheith acu ar an staid fhioscach fhoriomlán;

(*c*) ar an mbeartas maidir le fáltais an Státchiste.

(2) Féadfaidh an Coiste breithniú a dhéanamh ar ní a bhaineann le beartas poiblí agus a bhfuil tionchar suntasach aige ar an staid bhuiséid nó ar an staid fhioscach fhoriomlán: Ar choinníoll go rachaidh Cathaoirleach an Choiste, roimh thosach an bhreithnithe sin, i gcomhairle leis an gCoiste earnála iomchuí arna bhunú de bhun Bhuan-Ordú 84A.

(3) Féadfaidh an Coiste freisin breithniú a dhéanamh ar an gcreat foriomlán do rannpháirtíocht pharlaiminte le linn an timthrialla buiséid agus féadfaidh sé moltaí i ndáil leis an gcéanna a dhéanamh don Fhochoiste ar Athleasú na Dála, is moltaí a bheidh le breithniú ag an gCoiste sin faoi Bhuan-Ordú 107(1)(*b*): Ar choinníoll, le linn dó é sin a dhéanamh, go rachaidh an Coiste i gcomhairle—

(*a*) leis na Coistí arna mbunú de bhun Bhuan-Ordú 84A maidir le haon mholtaí a bhfuil tionchar acu, i dtuairim an Choiste, ar ról nó ar chúram na gCoistí sin; agus

(*b*) leis an Aire nó leis na hAirí iomchuí maidir le haon mholtaí a bhfuil tionchar acu, i dtuairim an Choiste, ar ról nó ar chúram Roinne nó Ranna,

agus tabharfaidh sé fógra i dtaobh thorthaí na gcomhairliúchán sin don Fhochoiste ar Athleasú na Dála.

(4) Beidh na cumhachtaí seo a leanas ag an gCoiste:

(*a*) an chumhacht chun fios a chur ar dhaoine, ar pháipéir agus ar thaifid mar a mhínítear i mBuan-Orduithe 85(2A) agus 88;

(*b*) an chumhacht chun fianaise béil agus fianaise scríofa a ghlacadh agus chun

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

aighneachtaí a ghlacadh mar a mhínítear i mBuan-Ordú 85(1) agus (2);

(*c*) an chumhacht chun Fochoistí a cheapadh mar a mhínítear i mBuan-Ordú 85(3);

(*d*) an chumhacht chun sainchomhairleoirí a fhostú mar a mhínítear i mBuan-Ordú 85(8);

(*e*) an chumhacht chun taisteal mar a mhínítear i mBuan-Ordú 85(9).

(5) Déanfar gach tuarascáil a bheartóidh an Coiste a thabhairt, arna glacadh ag an gCoiste, a leagan faoi bhráid na Dála láithreach agus as a aithle sin beidh cumhacht ag an gCoiste an tuarascáil sin, mar aon le cibé doiciméid ghaolmhara is cuí leis, a chlóbhualadh agus a fhoilsiú.

(6) Maidir leis an gCoiste cúig Chomhalta dhéag a bheidh air, nach comhalta den Rialtas ná Aire Stáit aon duine acu, agus ceathrar acu sin is córam dó: Ar choinníol—

(*a*) go mbeidh an Coiste agus aon Fhochoistí a cheapfaidh sé comhdhéanta ar chuma go ndéanfaidh sé nó siad ionadaíocht chothrom don Dáil; agus

(*b*) go mbeidh feidhm ag forálacha Bhuan Ordú 95 maidir leis an gCoiste.

(7) Go dtí go gcuirfear a mhalairt in iúl sa 32ú Dáil, leanfaidh an Roghchoiste um Fhormhaoirsiú Buiséid, a bunaíodh le hOrdú an 21 Iúil 2016 ón Dáil, ar marthain mar an Buanchoiste um Fhormhaoirsiú Buiséid, agus dá réir sin, bainfidh comhaltas reatha, Cathaoirleach, páipéir agus clár oibre an Roghchoiste leis an mBuanchoiste.'

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.'.

—Ríona Uí Dhochartaigh, Aire Stáit ag Roinn an Taoisigh

12.Links to Transcript

13th September 2017 - Irish Fiscal Advisory Council (IFAC)

Transcript

13th September 2017 - The Economic and Social Research Institute (ESRI)

Transcript

19th September 2017 - Irish Business and Employers Confederation (Ibec)

Transcript

20th September 2017 -Nevin Economic Research Institute (NERI)

Transcript

20th September 2017 -Irish Congress of Trade Unions (ICTU)

Transcript

20th September - Irish Tax Institute

Transcript

20th September - Chambers Ireland

Transcript

13.Glossary

The Budgetary Rule falls under the preventive arm of the Stability and Growth Pact (SGP) and limits government annual budget deficits to 3% of GDP. Failure to comply with this Rule results in Member States transferring to the corrective arm of the SGP, also known as the Excessive Deficit Procedure (EDP).

CCCTB: The Common Consolidated Corporate Tax Base is a proposal in the European Commission to implement a single set of rules for calculating taxable corporate profits in the EU. Taxable profits are determined at an EU level, and then apportioned amongst countries (to be taxed at their own rate) based on the company's capital, labour and sales activity in each country.

Convergence Margin is applied to the Reference Rate for Member States that have not reached their Medium-Term Budgetary Objective (MTO), and reduces the amount of resources available for additional Government expenditure and/or tax reductions by that Member State.

The Debt Rule falls under the preventive arm of the SGP and limits public debt levels to 60% of GDP. If in excess of 60%, public debt must reduce by 1/20th annually (on average over three years). Failure to comply with this Rule results in Member States transferring to the corrective arm of the SGP, also known as the Excessive Deficit Procedure (EDP).

Dependency Ratio: The ratio of citizens under the age of 15, and 65 years or older, to those between the age of 15 and 64.

Economic Shocks: An economic shock is an unpredictable event, either positive or negative, that affects the economy. In the context of budgetary oversight, a shock can include an increase or decrease in tax revenue that was not forecasted prior.

EDP: Excessive Deficit Procedure is the corrective arm of the SGP. Member States in the EDP are subject to more stringent fiscal rules to move towards a 3% deficit to GDP and/or a 60% public debt to GDP ratio.

Effective Tax Rate: The effective tax rate is the average rate of tax to which an individual or company is liable on their earned income, once all income and deductions are accounted for.

EIB: European Investment Back is the EU's not-for-profit, long term lending institution and operates under the aim of boosting jobs and growth in member states.

Expenditure Benchmark limits government budgetary expansions to the medium term potential rate of GDP growth (Reference Rate). This can only be exceeded if the excess is matched by discretionary revenue measures.

Fiscal Space refers to the projected amount of resources available for additional Government expenditure and/or tax reductions (after having taken account of discretionary revenue measures), while ensuring compliance with the Expenditure Benchmark.

Full Employment: The point at which all members of society who are both willing and able to work have employment. This figure is almost never zero owing to a number of factors, such as the time delays employees may face in moving between employment.

GDP: Gross Domestic Product which is measured by the total value of consumption, investment, government expenditure, and net exports (value of exports minus imports) in the national economy over a given time period.

GNI: Gross National Income is GNP plus net receipts from abroad of wages and salaries and of property income, plus net taxes and subsidies receivable from abroad (i.e. EU contributions and receipts).

Government Expenditure Ceiling translates the EU's Expenditure Benchmark into the Irish budgetary system, but is narrower in definition in only including Central Government expenditure (as opposed to expenditure by all bodies that constitute the government sector). It is then broken down into individual Ministerial Expenditure Ceilings, which cannot be exceeded.

Gross Fixed Capital Formation consists of public and private investment, deducting disposals, in fixed assets retained for own use.

ISIF: The Irish Strategic Investment Fund is an €8.0 billion sovereign development fund operated by the National Treasury Management Agency (NTMA). The purpose of the fund is to support economic activity and employment in Ireland through commercial investing.

Labour Force: The total number of people, of working-age, that are able to work. This includes those in employment or unemployed and seeking work.

Labour Force Participation Rate: The participation rate is calculated as the labour force participation rate divided by the total working-age population. It differs from the labour force figure as it does no exclude citizens who are unable to work.

Marginal Tax Rate: The tax rate an individual or company would pay for one additional euro of income.

MTO: Medium-Term Budgetary Objective is a budgetary target for Member States to reduce structural deficits at a rate of 0.5% of GDP per annum. MTOs are updated every three years. Annual targets on the way towards the MTO are set, and the expected path of debt to GDP ratios is forecasted.

PBO: The Parliamentary Budget Office is an independent specialist unit within the House of the Oireachtas that provides financial and budgetary scrutiny and research. Establishment of the Office was recommended by the OECD in its review of budgetary oversight by parliament in Ireland in 2016.

PPPs: Public Private Partnerships are arrangements between the public and private sectors on the shared provision of public infrastructure or services that would have otherwise been supplied through traditional public sector procurement.

Rainy Day Fund is a contingency reserve designed to support activity and employment should the economic situation deteriorate, and is planned commence with projected contributions of €1 billion per annum once the State's MTO is reached. It was committed to unilaterally by the Irish government in 2016 in accordance with the Programme for a Partnership Government (PfPG).

Reference Rate is the maximum allowable rate of budget expansion for a given year under the Expenditure Benchmark. It excludes interest expenditure, EU funding and cyclical unemployment expenditure, but includes gross fixed capital formation by the public sector (averaged over a four year period).

SES: The Summer Economic Statement, released in July, outlines the Government's economic and fiscal objectives and plans over the medium term.

SGP: The Stability and Growth Pact is a set of EU rules used to ensure member states pursue sound public finances and coordinate fiscal policies.

SPU: Stability Programme Updates lay out each EU Member State's fiscal plans for the next three years, and are produced every April.

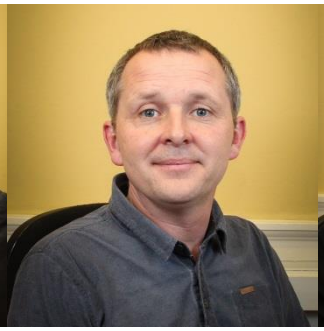
Structural Budget Balance is, in simplified terms, the cyclically adjusted budget balance less one-offs and temporary budgetary measures. It arises from an underlying imbalance in government revenues and expenditures.

TSG Papers: Tax Strategy Group Papers published by the Department of Finance, most recently in July 2017, look at a number of tax and social protection issues in advance of the Budget. They provide various options for future tax policy and highlight current concerns.

14.Committee Membership

Seán Barrett TD

Fine Gael



Richard Boyd-Barrett TD

Solidarity – People Before Profit

Colm Brophy TD

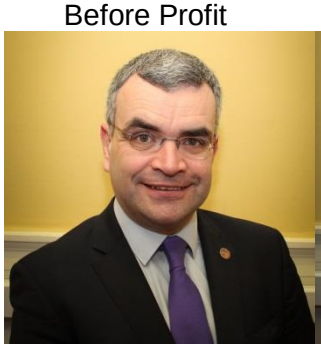
Fine Gael

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

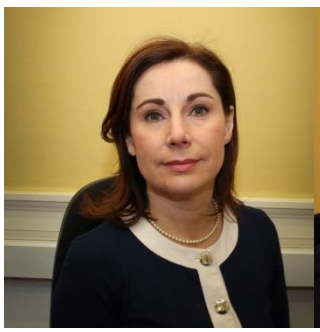
Fianna Fáil

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