Houses of the Oireachtas
Select Committee on Budgetary Oversight
Interim Pre-Budget Report, 2020
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Foreword

Throughout 2019, the Select Committee on Budgetary Oversight sought to enhance the level of debate and transparency around the budget process. The Committee’s approach has been to identify key budget themes based on advice from economic specialists, submissions received from stakeholders, and evidence-based research.

In April, the Committee issued an open call for pre-budget submissions. In addition to the witnesses who attended Committee hearings, the Committee is grateful for the quality of submissions received from the following stakeholders: the National Women’s Council Ireland; IBEC; Social Justice Ireland; the National Off-Licence Association; ITMAC; CPL Fuels Ireland; the Nevin Economic Research Institute; TASC; the Drinks Industry Group of Ireland; the Federation of Irish Sport; the ESRI; Chambers Ireland; the Irish Hotels Federation; the Irish Duty Free Alliance; Retailers against Smuggling; JTI Ireland Limited; Mr. Colm McCarthy; Dr. Stephen Kinsella;

The Committee began its ex-ante scrutiny of Budget 2020 on February 27th 2019, when it met with the Central Bank of Ireland to discuss the economic risks posed by Brexit. This was followed by a range of informative meetings with a representative selection of business organisations, trade unions, community and voluntary organisations, university academics and research institutes.

The Committee also benefited from engagement with representatives from the European Commission, the Irish Fiscal Advisory Council, the Parliamentary Budget Office, the Revenue Commissioners and the Local Property Tax Review Group.

A number of common themes emerged from the Committee hearings, which are reflected in the Committee’s Interim Report. These include: Brexit and its impact on Budget 2020 and fiscal policy; the quality of budget information; domestic and international risks to the economy; costings and budget information in relation to the National Broadband Plan.

Following the Committee’s scrutiny hearings, and consideration of evidence from stakeholders, the Committee then engaged with the Minister of Finance and Public Expenditure and Reform to consider key budget documents including the Stability Programme Update and the Summer Economic Statement.
It is clear that the budget planning process for Budget 2020 presents very particular challenges for Government. On behalf of the Committee, I would like to acknowledge the commitment of the Minister and his officials to the budget scrutiny process, and to participate in focused Committee scrutiny hearings.

I would also like to acknowledge the Secretariat for assistance with the preparation of this report.

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Colm Brophy T.D.
Chair
Section 1 – Introduction Section on Budget Scrutiny

This section briefly considers the role that parliament can play in the budget scrutiny process. According to the OECD, this budget scrutiny role is essential, because:

“Effective scrutiny by the legislative is a fundamentally important national concern, lying at the heart of issues such as transparency, inclusiveness, and democratic accountability…”¹,²

The OECD further argues that:

“…national parliament has a fundamental role in authorising budget decisions and in holding governments to account.”³

Over recent years, there has been a growing international trend to strengthen parliament’s role and capacity to carry out budget scrutiny. This is evidenced by different initiatives to enhance parliamentary institutional roles, and also by the increased number of independent fiscal institutions now set up in OECD countries to provide analysis and independent advice on budget and fiscal matters. As a result, many OECD parliaments have access to specialist advice, and have set up dedicated committees to scrutinise expenditure plans before the budget has been agreed.

What is Budget Scrutiny?

Although the practice varies across parliamentary institutions, in general terms, budget scrutiny involves the examination of government spending plans (annual spending plans and in-year spending) before it takes place. Pre-budget scrutiny by parliament also generally involves a consultation process with stakeholders to examine and to make proposals well in advance of budget day.

Traditionally, Westminster-style parliaments have strong traditions of ex-post scrutiny of expenditure, with close committee scrutiny of expenditure that has already occurred;

¹ http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/procedure-committee/should-there-be-a-commons-budget-committee/written/92179.pdf
² Written submission from Organisation for Co-operation and Development (OECD), CBC-05
³ Written submission from Organisation for Co-operation and Development (OECD), CBC-05
however, cultures of ex-ante scrutiny of budget plans are far less developed (Wehner 2011; OECD submission to Westminster inquiry). Wehner points out that most parliaments have a finance, budget or appropriations committee which considers the Executive’s spending proposals:

“The UK Parliament is unique among the OECD for not involving specialised committees in a systematic way during the process of approving the annual expenditure plans of the executive… this affects the quality of scrutiny of the spending framework and its implementation…”  

The House of Commons Procedures’ Committee recently held an inquiry to examine the role of parliament in budget scrutiny, and the merits of setting up a new Budgets Committee. In his submission, Wehner argues that a Budget Committee could improve the process by carrying out scrutiny of “periodic spending reviews, consider annual spending plans and their consistency with spending reviews and track spending in-year.”

In addition to monitoring annual budget planning, he emphasises the need for a specialised committee to focus on strategic issues which influence public spending decisions, including macro-economic developments and demographic factors.

**International Practice**

The OECD defines the practice of budget scrutiny as follows:

"Ex-ante parliamentary engagement allows parliamentarians’ views on issues of fiscal and budgetary policy to inform the budget formulation process. In this way, the executive’s budget proposal can reflect the input and priorities of the legislature, which is particularly relevant for countries where the parliament lacks significant powers to amend the draft budget.”

In its evidence to the House of Commons Procedures’ Committee, the OECD offers two examples of best practice in budget scrutiny in Canada and Scotland:

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Canada

In the Canadian example, Parliament has an Estimates Committee which holds a pre-budget consultation exercise to seek views from stakeholders and citizens on the Government’s Budget proposals.

Following the consultation process, the Estimates Committee can “…provide a series of recommendations to Government, which the Government can take on board when it presents its Budget proposal to Parliament later...Through that dialogue, wherein the Committee has a role at different stages of the Budget process, there is able to be a conversation between the Parliament and the Government about the extent to which the Budget is actually fit for purpose”.6

Scotland

In the case of Scotland, a pre-Budget report is also prepared:

“That pre-budget report presented its recommendations on what the Parliament would like to see in the Budget proposal. The Scottish Government, as part of its draft Budget, responded to the parliamentary pre-Budget report and wrote letters to the Committees about how they were addressing their recommendations. It is that sort of dialogue that really creates a Budget that is for everybody.”7

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6 http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/procedure-committee/should-there-be-a-commons-budget-committee/oral/94830.html
Budget Scrutiny in an Irish Context

In the Irish case, the OECD published a report in November 2015 highlighting the relatively weak role of the Oireachtas in ex-ante scrutiny of government expenditure. The OECD made a number of key recommendations to reform the budget process, stating that:

“the annual and multi-annual budget cycle should be structured around, and predicated upon, active and critical engagement with the Houses of the Oireachtas and its committees, so that parliamentarians can influence and critique budget allocations and priorities, making budgetary debate and discussion in Ireland more realistic, informed and effective.”

Arising from consideration of the report’s recommendations, Dáil Éireann established the Committee on Budgetary Oversight on 21 July 2016. The Committee’s remit was defined under Dáil Standing Order 186 (1); its role can be summarised as:

- Providing a well-defined role for the Committee itself to carry out budget scrutiny, and
- Taking a lead role in developing the overall budget scrutiny framework for parliament.

The Committee seeks to discharge its role by:

- Carrying out ex-ante scrutiny of revenue and expenditure options each year before the Budget
- Holding pre-budget consultation hearings with key national stakeholders
- Aligning its scrutiny hearings with the European Semester process, where, for example, it engages with the European Commission on the Country Report and holds scrutiny hearings with the Minister for Finance and Public Expenditure and Reform on the Stability Programme Update and the Summer Economic Statement
- With the support of the PBO, monitoring macro-economic developments and fiscal risks throughout the year ahead of the budget
- Carrying out ex-post scrutiny to evaluate budget measures or to assess how budgeted spend or revenue projections compare with outturns
- Engaging with the Irish Fiscal Advisory Council (IFAC) to scrutinise its regular Fiscal Assessment Reports

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• Preparing a pre-budget report each year and other scrutiny reports as it considers necessary. For example, a key theme of the Committee’s 2018 work programme was equality budgeting, and the Committee produced a report on Gender Budgeting.
• The Committee also has powers to make recommendations to the Dáil on how to reform the budget scrutiny framework, including the Estimates process.

However, in its initial developmental phase, the Committee has mainly confined its work programme to enhancing the pre-budget consultation process. The Committee has yet to turn to consider additional reform measures to improve parliaments’ overall framework to scrutinise Government’s financial decisions.

**Engagement on Budget Scrutiny**

The Committee welcomes the Minister for Finance and Public Expenditure and Reform’s willingness to engage with the Committee at key points in the annual budgetary cycle. The Minister’s engagement with the Committee has significantly enhanced the ex-ante budget scrutiny process and presents the Committee with a greater opportunity to develop a robust and sustainable budgetary scrutiny framework.

However, the Committee also wishes to draw attention to the fact that officials from the Department of Finance and Department of Public Expenditure and Reform are accountable to the Select Committee on Budgetary Oversight, and that engagement by officials, particularly on technical matters, is essential to assist the Committee in its scrutiny work.

**Evolution of Oireachtas Budget Scrutiny**

Since its establishment in 2016, the Committee has become an integral part of the national framework for budget scrutiny. The Committee has submitted interim and pre-budget reports, and post-budget reports. The Committee’s work is grounded in evidence submitted by witnesses that include technical experts, such as IFAC, PBO and research from institutions such as the ESRI and the Central Bank, and also sectoral stakeholders. In addition, the Committee has delivered a number of reports on specific areas, such as tax expenditures, local property tax and the EU budget and multiannual financial framework. Further, the Committee has worked to establish cross-party consensus on contentious fiscal issues.
However, the Committee notes that its remit is wider than the activities that are outlined above. Under Dáil Standing Order 186 (1), the Committee is also tasked with improving the Oireachtas budget scrutiny framework:

“Taking a lead role in developing the overall budget scrutiny framework.”

To this end, the Committee acknowledges that it should review its role in budgetary scrutiny with a view to increasing its linkages with Sectoral Committees and their scrutiny of respective Vote Groups.

The Committee also recognises, as highlighted by IFAC, the importance of developing a medium term strategy for the public finances. The Committee will examine whether there is scope for it to bring greater oversight to bear on the development and implementation of this medium term strategy.

**Recommendation:** Over the coming months, the Committee will review its current budget scrutiny framework, in particular against the recommendations of the OECD’s 2015 report *Review of Budget Oversight by Parliament: Ireland.* This review will assess how the Committee’s work programme can be expanded to better incorporate the findings of the OECD report.

The Committee also notes recommendations made by other stakeholders regarding how the Committee can further execute its remit. Dr. Stephen Kinsella recommended that the Committee should commission studies around the budget cycle on, for example, fiscal stress tests, to be carried out by the PBO; he also highlighted the value in having a Committee which can offer a strategic view on fiscal policy. He stated that:

“*We are at the budget preparation stage. However, I would like to see this committee sponsor far more analysis around the budget cycle… We still do not have, for example, dynamic scoring. It is not possible for a political party to propose introducing a wealth tax and be able to know how much it will cost; these things are not done yet.*

*In particular, we do not have a study that shows if corporation tax yield drops by 5% how much it would cost and where will we get the money to fund overruns in education and health…*

*“For example, if half the country wakes up tomorrow, and decides not to pay their property tax, it will have no impact on the budgetary surplus of the State because it*
amounts to less than €1 billion. If half of the corporations wake up tomorrow and decide not to pay corporation tax, we will not be able to afford to run the health system. It matters which taxes do not get paid and where the volatility is. Fiscal stress tests should be part of what this committee reports on. They are not difficult to do and the Parliamentary Budget Office, PBO, can do them…The IMF has developed methodology that is not difficult and that can be done with an Excel spreadsheet.”

These suggestions will be incorporated in the aforementioned review.
This section provides an overview of evidence received by the Committee in relation to macro-economic developments, and fiscal policy in the context of Budget 2020.

Economic Outlook

Headline economic growth, as measured by Gross Domestic Product (GDP), remained strong in 2018, and was ahead of target. Real GDP (adjusted for inflation) grew at 6.7% in 2018, which is the ninth consecutive year of positive growth, while Gross National Product (GNP) also performed strongly (5.9% growth).

Figure 1: Growth in GDP/GNP (at constant market prices) 2004 - 2018

While the Committee acknowledges the imperfections attached to using both GDP and GNP as measures of economic performance, the Committee welcomes indications that factors underlying GDP growth, which are less susceptible to distortion, also showed continued signs of health.

The Committee notes that Investment grew strongly in 2018, even when data for intangible assets, such as the aircraft leasing sector and other R&D imports, is omitted.

Source: Central Statistics Office (CSO), Quarterly National Accounts

Available at: https://www.cso.ie/pixeirestat/Statire/SelectVarVal/Define.asp?maintable=NQQ36&PLanguage=0
The Central Statistics Office (CSO) Labour Force Survey Q1 results show that the number of people at work has increased by 3.7% (81,200) in the twelve months to end of Q1 2019.\textsuperscript{12} The quarter-on-quarter (Q-o-Q) growth stood at 35,200. The Committee welcomes this continued increase in employment as evidence of strong economic growth.

The Committee notes that this robust economic performance fed into a reduction in the seasonally adjusted unemployment rate, which now stands at 5% or a total of 120,300 people currently unemployed, 35.7% of whom are classified as ‘long-term unemployed’ (unemployed for longer than 12 months).

Figure 2: Indexed change in employment/unemployment (2011 Q3 =100)

![Graph showing indexed change in employment/unemployment](https://www.cso.ie/en/releasesandpublications/er/lfs/labourforcesurveyquarter12019/)

Source: Committee Analysis of CSO Quarterly National Household Survey/ Labour Force Survey

The Committee notes that, with regard to regional and sectoral performance, all eight regions are experiencing growth year-on-year, and 12 of 14 sectors are in positive territory (agriculture, forestry and fishing, and “other” being the two in contraction) over the same time period.

\textsuperscript{11} These factors are generally seen to distort national investment statistics.

\textsuperscript{12} [https://www.cso.ie/en/releasesandpublications/er/lfs/labourforcesurveyquarter12019/](https://www.cso.ie/en/releasesandpublications/er/lfs/labourforcesurveyquarter12019/)
Forecasts

The Committee notes that the Stability Programme Update (SPU), published in April 2019, reduced Ireland’s growth forecast from 4.2% at the time of Budget 2019 to 3.9%. In evidence to the Committee, the Minister for Finance and Public Expenditure & Reform attributed the downward revision to anticipated slowdowns in key export markets, primarily the United Kingdom and the Euro area. Over the medium term, reasonably strong growth rates are projected to persist, albeit moderating to 3.3% in 2020 and reducing further to 2.4% in 2021.

The Committee notes that these forecasts were endorsed by the IFAC, however it also pointed out that they are predicated upon a central Brexit scenario of an ‘orderly exit’ by the United Kingdom.

Fiscal Position

The Committee notes that a small surplus was recorded in the General Government Balance in 2018, and that a further surplus of 0.2% of GDP is expected to be recorded this year. However, the Committee notes that there is a strong cyclical component underpinning this indicator, and that the 2019 Structural Government Balance, as measured by the differing methodologies of the Department of Finance and the Stability and Growth Pact, will be weaker, 0.1% and -1.1% of GDP, respectively.

Debt

Evidence to the Committee from a range of stakeholders including the ESRI, the PBO and IFAC has consistently highlighted the fact that government debt remains high. Reductions in the debt-to-GDP ratio have been aided by substantial GDP growth in recent years, although this is not an accurate reflection of underlying economic activity. The Committee also notes that reductions in gross debt have ceased in recent years.

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13 Stability Programme Update (2019), Department of Finance:
https://assets.gov.ie/8305/88ffede238074f2cb88fc996854a12b3.pdf


15 IFAC, FAR June 2019.
The Committee notes that the SPU does not outline any plans to further reduce the nominal debt level in the medium term, and that previous targets to reduce the debt-to-GDP ratio to 60% are now omitted from SPU 2019.

On the basis of evidence received by the Committee in its hearings, it appears to the Committee that continued growth in GDP will be relied on to further reduce the debt-to-GDP level, and to comply with the sub-60% ratio required by the Stability and Growth Pact.

The Committee also notes that, General Government Debt to GNI*, a more accurate reflection of Ireland's debt to economic activity, also remains high at 107%\textsuperscript{16}.

Figure 3: Ireland’s Gross Debt and Debt/GDP ratio 2011 - 2023

Source: Historical data from CSO Government Finance Statistics\textsuperscript{17} and National Quarterly Accounts\textsuperscript{18}. Forecasts from SPU 2019.

\textsuperscript{16} Department of Finance, Stability Programme Update 2019.
\textsuperscript{17} CSO Annual Population Estimates. Available at: https://www.cso.ie/pk/pxeirestat/Statire/SelectVarVal/saveselections.asp
\textsuperscript{18} Available at: https://www.cso.ie/pk/pxeirestat/Statire/SelectVarVal/Define.asp?maintable=NQQ36&PLanguage=0
Risks

A number of internal and external threats to the State’s economic performance were highlighted by stakeholders in ex-ante scrutiny hearings. Appendix 3 of this report includes IFAC’s risk matrix heat map, which is presented in an accessible format which the Committee can use to monitor fiscal and budgetary risks.

Internal Risks

Domestically, the Committee is extremely conscious of the risks of overheating in the economy, exacerbated by a tightening in the labour market. The Committee acknowledges the potential implications of the economy overheating, particularly in relation to maintaining recent competitiveness gains.

The National Competitiveness Council, in a meeting with the Committee, categorised the Irish economy as “high cost, slowly increasing”. However, the Council did also highlight that, at 0.7% growth, Ireland experienced the slowest rate of price increases in the EU in 2018. Nonetheless, as employment increases, and the supply of labour available to new and expanding enterprises decreases, employees could potentially command higher remuneration, increasing the cost of doing business. Labour costs grew by 2.9% in 2018, four times the rate of inflation. The NCC also highlighted steady increases in the price of commercial property and high interest rates which are also underpinning upward price pressures. The Committee also discussed rising inflation and its impact on small businesses.

The Committee recognises that in order to offset the impacts of rising business costs, it is important that there are productivity gains. The concentration of productivity growth among a small number of predominantly multi-national firms is also of concern to the Committee.

The Committee notes that, despite the internal risks highlighted above, the indications are that the Irish economy remains competitive, with Ireland being placed 7th in the 2019 IMD Competitiveness Rankings. This is a considerable improvement on 2018, when Ireland was ranked 12th.

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21 IMD World Competitiveness Centre. [https://www.imd.org/contentassets/6b85960f0d1b42a0a07ba59c49e828fb/one-year-change-vertical.pdf](https://www.imd.org/contentassets/6b85960f0d1b42a0a07ba59c49e828fb/one-year-change-vertical.pdf)
External Risks

Brexit remains a key challenge to the Irish economy, and has been raised in hearings and submissions by numerous stakeholders. In order to develop a more comprehensive understanding of the potential impacts of Brexit on Ireland, the Committee met the Economic and Social Research Institute (ESRI) to discuss its publication *Ireland and Brexit: Modelling the Impact of Deal and No-Deal Scenarios*.

The Committee also had robust discussions on potential implications with IFAC\(^{22}\) and the Central Bank of Ireland (CBI). The Committee recognises the severity of the potential economic and budgetary impact that may arise from a disorderly Brexit, but it is also aware that any form of a UK exit will have significant implications for Ireland.\(^{23}\)

In evidence to the Committee, following the publication of the SPU 2019,\(^{24}\) Minister Donohue referenced the impact that slowdowns in key global economies could have on the Irish economy. The Committee acknowledges that as a small, open economy, Ireland has a higher sensitivity to economic downturns elsewhere, particularly in the context of Ireland’s reliance on exports and FDI.

The Committee is monitoring developments in other global economies on a regular basis. As shown in Q1 GDP growth data displayed in Table 1 (below), the Eurozone, UK, US and Germany have all grown modestly by between 0.4% and 0.8%, relative to Q4 2018. Year-on-year, all four economies have grown, albeit Germany at a slower pace (0.7%). While, the US economy continues to grow strongly, the increasing protectionist measures adopted by the US and other nations are also a threat to the global economy.\(^{25}\)

With regard to the Euro area, Italy’s increasing borrowing costs on the bond market has been raised to the Committee, in particular by Mr. Colm McCarthy\(^{26}\). Given Ireland’s high

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debt level, the Committee is of the view that some vigilance is required. While Ireland is currently able to borrow at record low interest rates,27 this can change quickly, and the Committee notes that existing debt will need to be rolled over in the coming years.

Table 1: Growth in selected trading economies at Q1 2019

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<th>Q-o-Q</th>
<th>Y-o-Y</th>
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<tr>
<td>Eurozone</td>
<td>0.4%</td>
<td>1.18%</td>
</tr>
<tr>
<td>UK</td>
<td>0.5%</td>
<td>1.83%</td>
</tr>
<tr>
<td>Germany</td>
<td>0.42%</td>
<td>0.69%</td>
</tr>
<tr>
<td>US</td>
<td>0.76%</td>
<td>3.1%</td>
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Source: European data from Eurostat Quarterly National Account data28. US data from US Bureau of Economic Analysis29

The Committee notes that employment figures for the UK were also released during May, with the three-month average unemployment rate to March dropping to 3.8%,30 a 45 year low. Q-o-Q, the US economy expanded by 0.8% during Q1 2019, with a corresponding Y-o-Y increase of 3.2%.

Trends in Irish Public Expenditure

The Committee notes that total gross voted expenditure for 2019,31 including both current and capital, is profiled at €66.6 billion. To the end of May, total outturn expenditure was €26.1 billion, comprising €24.2 billion in current and €1.9 billion in capital expenditure. In aggregate, total gross voted expenditure is currently €145 million (0.6%) below profile. However, the Committee also notes that year-on-year, total gross voted expenditure is 8.2% (€1.97 billion) higher than at the same point in 2018.

27 https://tradingeconomics.com/ireland/government-bond-yield
29 Available at: https://www.bea.gov/data/gdp/gross-domestic-product
31 A concise overview for May 2019 of the aggregate amount and a breakdown by Vote Group is available in PBO publication 29 of 2019, Gross Voted Expenditure: January to May 2019.
Voted expenditure as of 31 May 2019 is €1.97 billion (8.2%) higher than it was at the same point in 2018. This has been primarily driven by increases in expenditure in relation to Housing, Planning and Local Government (+52.7%), Health (+10.1%) and Education (+7.3%). Combined, the increases in these three areas total €1.31 billion.

The Committee acknowledges the usefulness of the Fiscal Monitor in allowing for a detailed analysis of in-year income and expenditure on a monthly basis. The reasons for this increased expenditure will be subject to further scrutiny by the Committee before it prepares its final pre-budget report in September.

Revenue Trends

According to the latest available data from the Fiscal Monitor, total tax revenue for 2019 is forecast to be €57.9 billion. The largest tax head is forecast to be income tax (40% of total tax revenue), followed by VAT (26%) and Corporation Tax (14%).
The Committee notes that, as of the end of May, total tax receipts were €253 million (1.2%) below target, largely accounted for by the fact that Corporation Tax is behind profile by €223m. Given this, and the fact that Corporation Tax receipts are also 13% lower than at the same point in 2018, the Committee will be monitoring the performance of this tax head closely throughout the remainder of the year.

However, all the other major tax heads have increased year-on-year. The Committee notes that although Income Tax has grown year-on-year, it is marginally behind target.
Figure 6: 2019 Cumulative Tax Receipts compared to Profile

Source: Secretariat analysis of May Fiscal Monitor, Department of Finance
Every year, starting in November with the Annual Growth Survey, the European Commission (EC) monitors the budget process in each Member State. This process is known as the “European Semester”. The Committee on Budgetary Oversight aligns its work programme to the European Semester, so that it can effectively scrutinise the interaction between the Government and EC on key budget and fiscal issues, including adherence to EU fiscal rules.

The EC 2019 Country Report for Ireland\textsuperscript{32} was published on the February 27\textsuperscript{th} 2019. As part of its engagement in the EU Semester process, the Committee subsequently met with EC Director General Mr. Carlos Martínez Mongay on March 13\textsuperscript{th} 2019. The Committee notes that the EC expects Ireland, along with the EU economy, to continue to grow in 2019, but expects that the “pace of growth will moderate and the outlook is subject to major uncertainty”.\textsuperscript{33} This is mainly related to external factors such as “the UK’s withdrawal from the EU, and changes to the international taxation and trade environment”.

The Committee further notes that the Country Report highlights macro-economic imbalances faced by Ireland, largely due to the outstanding large stock of public and private debt. While public debt as a share of GDP is decreasing, the EC believes that Ireland remains potentially vulnerable to negative shocks, particularly given the potential volatility of tax revenues and the year-on-year increases in recurring expenditure on healthcare.

Nonetheless, the Committee welcomes one of the Country Report’s main conclusions, namely, that Ireland’s vulnerability with regard to the financial sector is declining.

\textsuperscript{33}Transcript of meeting of Select Committee on Budgetary Oversight, March 13\textsuperscript{th} 2019.
European Commission Draft Country Specific Recommendations

The EC’s Country Specific Recommendations for all EU member states were published on the 5th of June 2019. In Ireland’s case, the recommendations were as follows:

- Achieve the medium-term budgetary objective in 2020. Use windfall gains to accelerate the reduction of the general government debt ratio. Limit the scope and number of tax expenditures, and broaden the tax base. Continue to address features of the tax system that may facilitate aggressive tax planning, and focus in particular on outbound payments. Address the expected increase in age related expenditure by making the healthcare system more cost-effective and by fully implementing pension reform plans.
- Provide personalised active integration support and facilitate upskilling, in particular for vulnerable groups and people living in households with low work intensity. Increase access to affordable and quality childcare.
- Focus investment-related economic policy on low carbon and energy transition, the reduction of greenhouse gas emissions, sustainable transport, water, digital infrastructure and affordable and social housing, taking into account regional disparities. Implement measures, including those in the Future Jobs strategy, to diversify the economy and improve the productivity of Irish firms – small and medium enterprises in particular - by using more direct funding instruments to stimulate research and innovation and by reducing regulatory barriers to entrepreneurship.

Engagement with European Commission: Conclusion

The Committee is of the view that the European Commission’s annual engagement with the Committee greatly assists the Committee in monitoring key European budget documents and in identifying some key strategic themes for pre-budget scrutiny.

The Committee’s pre-budget hearings also featured detailed discussions with stakeholders on most of the themes outlined in the CSRs, which demonstrates their continued relevance to political considerations of domestic budget issues.

Stability Programme Update: Summary Economic Position

The Stability Programme Update (SPU)\textsuperscript{35}, published by the Government in April of each year, is a key milestone in the budgetary process, outlining Ireland’s national medium-term fiscal plan. The 2019 SPU outlines the Department of Finance’s updated economic and fiscal forecasts out to 2023. Following the publication of the Draft SPU 2019, the Minister for Finance and Public Expenditure and Reform appeared before the Committee on April 18\textsuperscript{th} 2019.

Table 2: Summary of main Economic and Fiscal Variables (%GDP)

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>6.7</td>
<td>3.9</td>
<td>3.3</td>
<td>2.4</td>
<td>2.5</td>
<td>2.6</td>
</tr>
<tr>
<td>Real GNP</td>
<td>5.9</td>
<td>3.7</td>
<td>3.1</td>
<td>2.2</td>
<td>2.3</td>
<td>2.4</td>
</tr>
<tr>
<td>GG Balance</td>
<td>0</td>
<td>0.2</td>
<td>0.4</td>
<td>0.7</td>
<td>1</td>
<td>1.3</td>
</tr>
<tr>
<td>Structural Balance (DoF)</td>
<td>0.4</td>
<td>0.1</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Structural Balance (SGP)</td>
<td>1.6</td>
<td>-1.1</td>
<td>-0.4</td>
<td>0.2</td>
<td>0.7</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Source: Parliamentary Budget Office, Preliminary Analysis of the Stability Programme Update 2019\textsuperscript{36}

The Committee notes that, in the period since the publication of the Economic and Fiscal Outlook with Budget 2019, the Department of Finance has revised some of the main economic indicators. Real GDP for 2018 was revised downwards from 7.5% to 6.7%, while projections for 2019 were also downgraded from 4.2% to 3.9%. Despite this, real GNP for 2018 was revised upwards from 4.4% to 5.9%.

\textsuperscript{35} Department of Finance, Stability Programme Update 2019: incorporating the Department of Finance’s Spring Forecast. (April 2019). \texttt{https://assets.gov.ie/8305/88ffe0e238074f2cb88f9c996854a12b3.pdf}

A small surplus was recorded in the General Government Balance in 2018, a better than expected outturn compared to the 0.1% deficit projected at Budget time in 2018. Expectations for a budget surplus have also increased to 0.2% of GDP for this year.

With regard to the underlying Structural Balance\textsuperscript{37}, the SPU is projecting a deficit of -1.1% in 2019, as opposed to -0.7% projected in Budget 2019. The Structural Balance provides an estimate of the Government’s underlying fiscal position: it adjusts the General Government Balance for the impact of cyclical or temporary tax receipts and expenditure, and one-off measures such as bank recapitalisations. The SPU also projects that Ireland will achieve its Medium Term Budgetary Objective, a Structural Balance not worse than -0.5%, in 2020. However, according to the Department of Finance’s own measurements, a structural balance of 0.4% was achieved last year and the structural balance will also remain balanced in 2019.\textsuperscript{38}

\textbf{Revenue and Expenditure Forecasts}

The Committee notes that according to the Department of Finance, General Government Revenue is anticipated to increase from €82 billion in 2018 to €86 billion (+4.8%) in 2019, and further to €100.4 billion (+22.4%) by 2023. The majority of the increase in 2019 is forecast to be offset by increased expenditure, but according to SPU projections, a surplus of €610m will be recorded in the general government balance. According to the SPU, this budget surplus is anticipated to grow year-on-year to 2023, at which point it is forecast to total €5.4 billion.

\textsuperscript{37} As measured by the EC’s Common Agreed Methodology.

\textsuperscript{38} Stability Programme Update (April 2019).
However, the Committee has questioned the robustness of these forecasts. The revenue and expenditure projections contained in the SPU were revised downwards from Budget 2019. Table 3 (below) presents deviations from original projections at the time of Budget 2019:

**Table 3: Change from Budget 2019 to SPU 2019 (€million)**

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Govt Revenue</td>
<td>€1,205</td>
<td>€720</td>
<td>-€65</td>
<td>-€365</td>
<td>-€580</td>
<td>-€315</td>
</tr>
<tr>
<td>Corporation Tax</td>
<td>€780</td>
<td>€500</td>
<td>€475</td>
<td>€45</td>
<td>€435</td>
<td>€435</td>
</tr>
<tr>
<td>General Govt Expenditure</td>
<td>€840</td>
<td>€35</td>
<td>-€240</td>
<td>-€1,285</td>
<td>-€200</td>
<td>€150</td>
</tr>
<tr>
<td>Exchequer Balance</td>
<td>€735</td>
<td>-€155</td>
<td>€1,115</td>
<td>-€195</td>
<td>-€55</td>
<td>-€105</td>
</tr>
<tr>
<td>General Govt Balance</td>
<td>€360</td>
<td>€685</td>
<td>€170</td>
<td>€915</td>
<td>-€380</td>
<td>-€460</td>
</tr>
</tbody>
</table>

**Source:** Parliamentary Budget Office, Preliminary Analysis of the Stability Programme Update 2019

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The SPU presents updated forecasts to reflect fiscal developments since the publication of the Economic and Fiscal Outlook alongside Budget 2019. The Committee notes the significant variance in revenue and expenditure projections over the intervening period.

Total government revenue for 2018 was €1.2 billion greater than predicted at budget time, underpinned by Corporation Tax receipts that were €780 million higher than anticipated. However, general government expenditure was also €840 million higher than anticipated. For 2019, forecasted general government revenue is now €720 million higher than previously anticipated, again supported by greater than expected Corporation Tax receipts.


The IFAC Fiscal Assessment Report (FAR)\textsuperscript{40} assesses the Government’s macro-economic and budgetary forecasts, the appropriateness of the fiscal stance and compliance with the budgetary rule. On June 11\textsuperscript{th} 2019, the Committee met with the IFAC to consider its FAR report, which was published on the same date.

Although the Committee notes that the report shows that the economy continues to grow strongly, as observed through all the key economic variables such as GDP, GNP, and employment, IFAC was nevertheless critical of a number of aspects of Government fiscal strategy.

The Committee notes evidence presented by IFAC, that Ireland is balancing overheating risks on one side, while also facing the possibility of a severe fiscal adjustment should a hard Brexit occur.

The Committee also notes that IFAC was critical of the Department of Finance’s medium term expenditure forecasts, which it argues “imply an implausible slowdown in spending growth based on technical assumptions, which do not reflect either likely future policies or the future cost of meeting existing commitments”.

The Committee notes with concern the prevalence of in-year expenditure increases, particularly those recorded in 2018, which IFAC identifies as being the result of “anticipated underspends in non-health areas not having materialised and higher than estimated social payments including the health service, housing assistance and other social protection schemes”.

The Committee notes IFAC’s recommendation that expenditure in Budget 2020 should not exceed what has already been allowed for in SPU 2019.

The FAR also highlighted Ireland’s high debt burden and an over-reliance on Corporation Tax to support permanent increases in current expenditure. The Committee notes IFAC’s recommendation that a ‘prudence account’ should be established and that it should be used to divert higher than anticipated corporation tax receipts, for use in an unexpected economic downturn.

The Committee also acknowledges that, despite strong revenue growth being recorded, public spending rose at a faster rate than income in 2018. As a result, the primary balance as a share of GNI* has flat-lined, as has been the case, since 2015.

**Recommendation:** The Committee recommends that the Minister for Finance and Public Expenditure and Reform commits to publishing a formal and detailed response to the bi-annual IFAC Fiscal Assessment Report in order to address significant issues raised in the report.
Section 4 - Risks

Overheating Pressures

Throughout its ex-ante budget scrutiny meetings, the Committee have been cautioned by numerous witnesses on the cyclical position of, and the risk of potential overheating in, the Irish economy. These witnesses, including the CBI, also advised the Committee that the risk of overheating is increased by the continued tightening in the labour market. Further, with regard to public capital investment, CBI stressed the importance of preventing public investment from crowding out the private sector by contributing to capacity constraints and “pushing up prices and wages”.

This message was reinforced by the European Commission who told the Committee on March 13th 2019 that:

“As the labour market tightens, however, skills shortages are becoming increasingly apparent in fast growing sectors, most notably for information and communication technology and highly skilled professionals in the construction and property sectors. Against this background, wage growth is picking up. This could be a sign of an economy operating at its potential. This is the reason we have indicated that the Irish economy could show some signs of overheating.”

On a similar theme, the Committee notes IFAC’s warning that there is potential for the economy to overheat if “housing construction expands at a faster pace than is expected, or if migration flows and credit growth rates follow more typical patterns for a mature phase of expansion in the Irish economy”.

Challenges Measuring the Economic Cycle

The Committee also acknowledges the challenges associated with calculating the output gap (OG) of the Irish economy. The OG is the difference between actual economic output and potential output, given the resources available in the economy. The OG, then, estimates

how close the economy is to potentially overheating, and the cyclical position of an economy.

Using the EC’s Commonly Agreed Methodology (CAM), Ireland’s output gap for 2018 was estimated at +1.6%, and is projected to be +1.3% in 2019. When the OG becomes positive, the economy is in danger of overheating as it is above capacity.

However, in 2018, IFAC carried out impactful research which showed that estimates of the Irish OG have been subject to significant ex-post revisions over time, larger than the OG itself.

More recent PBO research confirms that the average absolute revision to the Irish OG over the period 2004-2015 was 2.7 percentage points of potential GDP.

In order to address difficulties identified by IFAC in calculating the OG, and in response to the theory that the CAM is not suited to the Irish Economy, the Department of Finance has produced its own alternative methodology. Using this method, the Irish Economy looks to have been operating below capacity in 2018 (-0.5), but that it will be at considerable risk of overheating in 2019 and 2020.

This view (that the economy is not yet overheating) of Ireland’s cyclical position was broadly supported by the Central Bank when it met the Committee, and also by NERI who stated in their pre-budget submission that:

“Overall, there is little evidence that the economy was overheating in 2018. In our view the structural balance was marginally in surplus in 2018 with a feasible range of 0.0% to 1% of potential output.”

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44 https://assets.gov.ie/8305/88ffede238074f2cb88fc996854a12b3.pdf
**Recommendation:** Considering the inaccuracy of real time OG measurements, there is a possibility that the Irish economy may already be over-heating. In consideration of this, the Committee recommends that the government be particularly mindful of this risk in preparing Budget 2020.

**Figure 8: Output gap as measured by EC Commonly Agreed Methodology and Department of Finance**

The Committee also notes stakeholder evidence which emphasises the reduced public capital stock due to under-investment over the past decade, and consequently, it is important that any threat of overheating, or conversely a fiscal correction following Brexit, does not result in decreased capital expenditure. Particularly in the case of overheating, the Committee is of the view that increased taxation or reduced current expenditure should be used to take some pressure out of the economy, and therefore rebalancing resources towards the overheating sector.

**Recommendation:** Given the deficit of public capital investment since the economic recession a decade ago, the Committee recommends that the committed capital infrastructure projects, as set out in the National Development Plan, should proceed on
budget and on time, and subject to rigorous cost management measures and detailed fiscal assessments.

**Brexit**

Throughout the pre-Budget meetings with stakeholders, much discussion has been had regarding the fiscal impact of Brexit, particularly in the case of a disorderly UK exit. The Committee notes that the scale of the impact will be determined by the type of arrangement in place between the UK and EU post-departure.

In particular, the Committee notes the detailed economic modelling and analysis that has been undertaken by the Central Bank of Ireland (CBI), the ESRI/Department of Finance and IFAC.

According to the CBI, a hard Brexit would see:

> “very significant adverse effects, particularly in the first two years after a no-deal Brexit. They point to growth being around 4% lower in the first year than in our main forecast and a further 2% lower in the second year”.

However, if a deal is reached, which includes a transition period in the immediate aftermath of the UK’s exit, CBI forecast that output will be 1.7% lower than under a scenario in which Brexit had not taken place, and that there would be around 19,000 fewer persons in employment than in a no-Brexit scenario.

Similarly, the ESRI, in meeting the Committee, outlined:

> “the macroeconomic effects of Brexit are significant and negative for the economy. We find that GDP in the long term could be approximately 2.6% lower in a deal scenario, 4.8% lower in a no deal scenario and 5% lower in a disorderly no deal scenario”.

On the 11th June 2019, during its meeting with the Committee, IFAC outlined their analysis of Brexit. The Committee notes that IFAC have used the CBI and the ESRI/Department of Finance estimates of the implications of Brexit on economic output to assess the potential implications of Brexit on the public finances. These results are displayed in Table 4 below:
Table 4: Fiscal outlooks in Brexit scenarios (%GNI*)

<table>
<thead>
<tr>
<th></th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BUDGET BALANCE</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>0.3</td>
<td>0.6</td>
<td>1.2</td>
<td>1.7</td>
<td>2.3</td>
</tr>
<tr>
<td>Hard Brexit (ESRI/DoF)</td>
<td>-1.9</td>
<td>-2.3</td>
<td>-1.4</td>
<td>-0.4</td>
<td>0.5</td>
</tr>
<tr>
<td>Hard Brexit (CBI)</td>
<td>-3.2</td>
<td>-4.7</td>
<td>-3.8</td>
<td>-2.8</td>
<td>-2.1</td>
</tr>
<tr>
<td><strong>GROSS DEBT RATIO</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>101.7</td>
<td>93</td>
<td>92.7</td>
<td>89.2</td>
<td>86.7</td>
</tr>
<tr>
<td>Hard Brexit (ESRI/DoF)</td>
<td>106.4</td>
<td>101.1</td>
<td>102.6</td>
<td>100.3</td>
<td>98.9</td>
</tr>
<tr>
<td>Hard Brexit (CBI)</td>
<td>109.1</td>
<td>107.1</td>
<td>110</td>
<td>110.8</td>
<td>111.5</td>
</tr>
<tr>
<td><strong>FUNDING REQUIREMENTS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>7.2</td>
<td>9.9</td>
<td>1.2</td>
<td>5.8</td>
<td>3.8</td>
</tr>
<tr>
<td>Hard Brexit (ESRI/DoF)</td>
<td>9.6</td>
<td>13.2</td>
<td>3.8</td>
<td>8</td>
<td>5.7</td>
</tr>
<tr>
<td>Hard Brexit (CBI)</td>
<td>11.8</td>
<td>15.8</td>
<td>6.2</td>
<td>10.6</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: IFAC FAR June 2019.48

The Committee also notes with concern the warning from IFAC that a one year budgetary adjustment in the order of €4 billion may be required in the event of a hard Brexit. As detailed above, this would have a detrimental impact on the general government balance and could see the opening up of a significant deficit in the medium term. If this deficit was to be closed without borrowing, it would mean a tightening of fiscal policy at a time that support policies would be needed.

The Committee acknowledges the high level of engagement with institutions such as the ESRI, CBI and IFAC to discuss their research findings. The detailed analysis provided to the Committee has greatly enhanced the budget scrutiny process and contributed a strong evidence base to the pre-budget debate. The Committee notes the advices of the above institutions, which have all highlighted the potentially severe economic and budgetary impact on Ireland, particularly in the case of a hard Brexit. This would occur firstly through the

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48 Funding requirements are estimated as the Exchequer borrowing requirement + maturing debt+ anticipated buybacks of floating rate bonds.
activation of automatic stabilisers. In an economic downturn, automatic stabilisers adjust to provide support to the economy. Examples of these stabilisers include increased expenditure on unemployment benefits and reduced tax receipts. However, the Committee also recognises the requirement for targeted transition measures to assist economic adjustment, for example including to develop new trade routes and to fund sector specific supports. This view has been supported in particular by Dr. Stephen Kinsella, who told the Committee that he would prefer if Brexit contingency plans were:

“more specific in terms of the sectors that will be bailed out”.

The Committee acknowledges the difficulties that Brexit uncertainty, and the anticipated UK departure date of 31st October 2019, presents to the Minister for Finance and Public Expenditure and Reform, and to budget planners. While meeting the Committee on April 18th 2019, Minister Donohoe stated that:

“Reflection will be required if we find ourselves moving into October with no clarity on where Brexit stands, especially in the context of putting together a budget a few weeks beforehand. I wish to flag to the Committee that such a situation would require a lot of thought from me and from the Government, and a lot of engagement with the Oireachtas.

It is one thing to put together a Budget, as we did last year, where the central case scenario was that an orderly agreement would be reached. It is pretty likely that this will continue to be the central case scenario in that we know that we will go all the way up to at least October with the current trading conditions and political relationships continuing. However, finding ourselves in October with the UK due to leave that month will require work and a great deal of effort in terms of dealing with it.”

Further to this, the Committee notes from the 2019 Summer Economic Statement that two alternative budgets are being prepared, depending on the likely Brexit outcome. In order to maximize the value of the budget scrutiny process it is important that the Committee is made aware of the 2020 budget strategy at the earliest opportunity.

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49 Transcript of meeting of the Select Committee on Budgetary Oversight, April 18th 2019: https://www.oireachtas.ie/en/debates/debate/committee_on_budgetary_oversight/2019-04-18/3/
**Recommendation:** The Committee recommends that, no later than September 13th 2019, the Minister for Finance and Public Expenditure & Reform provides a detailed update on the Budget strategy being pursued for 2020 and in doing so allows sufficient time for this to be incorporated into the Committee’s Final Pre-Budget Report in September 2019.

This report previously referred to the targeted measures that will be required to support the sectors most affected by Brexit. The Committee notes PBO publication 31 of 2019 *Tracing Brexit Related Exchequer Expenditure – Budget 2019*\(^\text{50}\), and in particular the difficulties in accurately tracking the total level of Brexit related expenditure. Considering this, while the Committee believes that contingency planning is a prudent policy response, as the level of contingency expenditure increases, it is important that it occurs in a transparent and consistent manner.

**Recommendation:** The Committee fully acknowledges the importance of Brexit preparedness and the need to implement prudent precautionary measures. Nonetheless, the Committee recommends that the Government provides detailed costings regarding the cost of Brexit support measures to date, and provides further clarity on costs to be incurred in the medium term.

The Committee fully endorses the views expressed by a number of stakeholders that sector specific Brexit support measures should be identified and prepared for implementation prior to any UK withdrawal.

Section 5 – Fiscal Resilience

The Committee acknowledges that building up fiscal buffers and monitoring government debt are important in ensuring that the public finances are resilient to potential future negative shocks.

Compliance with Fiscal Rules

The Committee notes that using the EC’s CAM, Ireland achieved a structural balance of -1.6% of GDP for 2018 (-1.1% forecast for 2019),\(^\text{51}\) breaching the MTO of -.5%. Further, as the MTO was not reached in 2018, the Expenditure Benchmark was also technically breached. However, as pointed out by a number of witnesses, the Committee also acknowledges that this methodology is not a robust estimate of Ireland’s compliance with the fiscal rules.

In light of the above, the Committee welcomes the work that has been undertaken by the Department of Finance and IFAC to develop more appropriate measurements of Ireland’s compliance with the fiscal rules. IFAC has estimated, using a new ‘principles-based approach’, a structural balance of 0.2% of GDP in 2018.\(^\text{52}\)

The Committee notes that under these measurements, Ireland has achieved its MTO in 2018 and 2019. However, the Committee is also aware that the structural balance deteriorated significantly between 2017 and 2018 (1.2 percentage point reduction) and will deteriorate marginally again in 2019.

The Committee also acknowledges advice from the Minister for Finance and Public Expenditure & Reform, to the effect that the EC is currently carrying out an assessment of the CAM and its applicability to Ireland. The Committee supports this work and recognises the importance of developing robust and appropriate methodologies to measure the underlying fiscal position of the Irish economy.

Recommendation: The Committee recommends that under a baseline scenario of an orderly UK withdrawal from the EU, the structural balance should not deteriorate any further in 2019 and 2020, particularly in light of the threats potentially facing the Irish economy.

\(^\text{51}\) https://assets.gov.ie/8305/88ffede238074f2cb88fc996854a12b3.pdf
National Debt

The Committee notes that Ireland’s debt level is high, particularly as a share of GNI* (107.3% for 2018), and that while the Government has been successful in reducing this ratio, of late this success is mainly due to strong economic growth, rather than nominal debt reduction. While debt-to-GDP is a common international benchmark of government debt levels, the Committee acknowledges that in the Irish case, debt-to-GNI* provides a better reflection of Government debt relative to underlying economic activity, as highlighted by IFAC. The Committee also notes that the SPU 2019 states:

“while debt remains manageable in Ireland, it is crucial that the burden of debt is reduced further”.

Figure 9: Debt-to-GDP ratios in select EU countries (Ireland’s debt-to-GNI* ratio included)

Numerous stakeholders have cautioned the Committee about the debt levels, and some have suggested ways in which the debt burden could be decreased. In correspondence

circulated to the Committee, CBI highlighted research they have undertaken which examines scenarios where revenue windfall gains are saved to build up a fiscal buffer, compared to when such revenues are used to fund a temporary increase in government expenditure. In this instance, the research contrasts doing so when the economy is overheating against when there are no capacity constraints. The Central Bank also examined the resilience of the economy to a negative government expenditure shock when the windfall is used to build a fiscal buffer, compared to when it is not.

The Committee notes the findings of the study which show that increasing government spending, funded by a fiscal windfall, when the economy is operating at full capacity, could have negative implications in the long run.\textsuperscript{54} The evidence suggests that the stimulus impact of such expenditure could put upward pressure on wages and potentially lead to a loss of competitiveness and a reduction in export activity.

The Committee also acknowledges that the analysis points to several possible advantages of using revenue windfalls to build fiscal buffers. The research suggests that this approach could help to reduce Ireland’s high public debt and lessen the exposure of the public finances to negative shocks. Moreover, in the event of a negative shock, the research suggests that the presence of a buffer could help to avoid the need for dramatic pro-cyclical fiscal tightening in future. This could act to mitigate against the loss of output, and employment, during a future downturn.

This evidence is broadly supported by IFAC, who also cautioned the Committee about the high levels of outstanding debt, and recommended that managing the debt-ratio should be a key component of the Government’s medium term fiscal strategy:

“First, the Government’s debt ratio target should be revisited. It should be lower to reflect Ireland’s volatile growth rates, should be restated as a percentage of modified GNI*, should be clarified as either a ceiling or target and should have clear staging posts.”\textsuperscript{55}

The Committee also notes that high debt levels make Ireland’s creditworthiness vulnerable to rapid changes. Appearing before the Committee, IFAC highlighted that this may be


\textsuperscript{55} IFAC, Fiscal Assessment Report, June 2019.
problematic should the government be required to increase borrowing to mitigate the exchequer impacts of a hard Brexit:

“If our debt ratios began to start to rise and they were to start to look a bit closer at debt to GNI* not debt to GDP, where the former was heading for 100% and continuing to rise, the benign borrowing conditions of the last number of years could reverse quickly. Not only do we have a large debt to refinance, a hard Brexit could mean a large deficit to finance and the current benign financial conditions would no longer prevail.”

A similar view was also communicated to the Committee by Mr. McCarthy. In particular, when citing Ireland’s high debt levels, Mr. McCarthy raised awareness of the fact that access to bond-markets can reduce rapidly in the event of a negative shock. Both Mr. McCarthy and Dr. Kinsella also commended the performance of the National Treasury Management Agency at refinancing Irish debt at low interest rates, debt will have to be ‘rolled-over’ in the coming years, requiring bond market access.56

**Recommendation:** The Committee endorses the recommendation of IFAC that the target debt ratio should be re-stated as a percentage of GNI*, with a clear timeframe for meeting said target.

**Corporation Tax (CT)**

CT receipts have increased by 125% since 2014 and have been important in facilitating expenditure increases during the subsequent period. However, numerous stakeholders, including IFAC, NERI, IBEC, Mr. McCarthy and Dr. Kinsella have pointed to the risks of relying on a volatile revenue source, and raised the possibility that the current level of CT revenue being generated (€10.4bn in 2018) may be temporary, and is potentially liable to decrease in the medium term.

The Committee notes the research undertaken by IFAC which estimates the potential scale of over-inflation in CT receipts. The Committee is concerned to note the Council’s estimates that between €3 billion - €6 billion of 2018 receipts may not be sustainable in the medium to long term.57

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The Committee also notes that, while the cause of a decrease cannot be predicted, there has been consensus amongst stakeholders that there will be a CT receipt adjustment in future. According to the Central Bank:

“Uncertainty is the key element. A decline could come about as a result of either firm or sector-specific circumstances. It could come about because of deterioration in the global trading environment or because of a change in the international taxation environment.”

Given the uncertainty around the sustainability of these additional windfall receipts, the Committee agrees that using these revenues to support permanent increases in public expenditure is not a prudent approach to fiscal policy. The Committee notes IBEC analysis which is critical of the approach taken to public expenditure to date:

“Of the €14.3 billion we got in the surprise, €11.5 billion of that went on Supplementary Estimates in just four and a half years. Almost all of it went to day-to-day spending.”

The Committee also notes the significant concentration of CT liabilities amongst a small number of multi-national companies. However, the Committee has been advised by IFAC that the composition of these companies changes each year; this makes analysing the factors contributing to inflated CT receipts difficult. Given the essential role that CT has played in supporting public expenditure in recent years, the Committee believes that it is imperative that the government garners a better understanding of CT, and the threats to its long-term stability as a revenue source.

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Figure 11: Concentration of CT Receipts (2018)

The Committee notes that the Department of Finance is working with the Revenue Commissioners to carry out a study on the sustainability of CT receipts. While the Committee has the highest regard for the expertise and independence of Department of Finance officials in carrying out this work, it has previously called for this review to be independent. The Committee continues to believe that the expert external input would greatly benefit the study.

Recommendation: The Committee recommends that the Department of Finance engage with them in relation to the internal review of Corporation Tax receipts, and that this review should be concluded as soon as possible.

Business cycle effects aside, the Committee has also discussed the medium and long-term implications of international Corporate Tax reforms, in particular the OECD’s Base Erosion and Profit Sharing (BEPS) project and the Common Consolidated Corporate Tax Base. The threat to Government revenue from these reforms has been highlighted by IFAC, NERI and IBEC, the latter of whom referred to this as “unprecedented change”.

While NERI does not believe that the impact of these reforms will be as considerable as mapped out by IFAC, they have recommended that “potential losses should be baked into fiscal policy.”

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The Committee is keen that the Department of Finance should provide a greater level of detail on the level of risk that this international tax policy change may pose to medium and long-term finances.

When meeting the Committee to discuss the 2019 SPU, the Minister for Finance and Public Expenditure and Reform highlighted plans to examine the sustainability of CT receipts:

“\textit{I want the Department of Finance to have ownership of the process because corporation tax is such a key variable in what will happen in future. I am reflecting on how we might do that as corporation tax changes so often. If we see things changing before our eyes, I want to have an ability to understand the changes to be anchored in the Department of Finance. I hope to present a proposal on how we will do that in the Summer Economic Statement.}\textsuperscript{63}

In the Summer Economic Statement, the Minister outlined that:

\textit{“My Department will undertake and publish an assessment of the sustainability of receipts, in light of future multilateral policy changes in this area. This sustainability analysis will be published by March next year.}\textsuperscript{64}\textsuperscript{a} (Summer Economic Statement 2019, P.ii)

\textbf{Recommendation:} Given volatility of CT receipts, and the role they have played in facilitating increased current expenditure in recent years, the Committee believes that this study should be brought forward and published in advance of Budget 2020. This will allow for its findings to be incorporated into the Budget, reducing the likelihood of unsustainable expenditure increases based on temporarily inflated CT revenue.

During its pre-Budget submissions, the Committee discussed the use of ‘windfall’ CT receipts with a broad range of stakeholders and found no clear consensus amongst stakeholders as to how they should be treated. One of the key recommendations of the FAR, discussed with the Committee, was a proposal that the government establish a “prudence account” within which CT receipts over-and-above those anticipated would be lodged in-year. These monies, IFAC suggested, could subsequently be transferred into the rainy day fund or, alternatively, used for the purpose of paying down debt.

\textsuperscript{63} https://data.oireachtas.ie/ie/oireachtas/debateRecord/committee_on_budgetary_oversight/2019-04-18/debate/mul@/main.pdf
\textsuperscript{64} https://assets.gov.ie/10498/79569b9ea87b4be5bd077bb622c2d1f.pdf
In contrast, many stakeholders, including IBEC, recommended that CT receipts over and above forecast should be invested in strategic infrastructure projects. However, the Committee also notes that there was almost unanimous agreement amongst witnesses with the principle that unexpected CT receipts should not be used to meet current expenditure budgetary pressures or in-year supplementary estimates.

**Recommendation:** The Committee notes the view expressed to the Committee by independent experts that above profile Corporation Tax receipts should not be used to meet current expenditure needs. The Committee recommends that the government provides it with an analysis as to its view on how the Corporation Tax receipts revenue can best be used.

The Committee also held broader discussions with other stakeholders relating to how CT can be reformed to widen the tax base. In particular, Social Justice Ireland recommended to the Committee that a minimum effective CT rate of 6% should be implemented, and that a cap should be imposed on losses carried forward at ten years, and an end to CT tax breaks for banks. However, as highlighted by NERI, the Committee appreciates the need to avoid sudden changes to tax expenditures, and also notes the difficulty of implementing a minimum effective rate due to the absence of a common consolidated base at a European level.
Labour Market Pressures (Costs and Shortages)

In May 2019, the Committee met with the National Competitiveness Council to discuss its Cost of Doing Business 2019 report. The NCC explained to the Committee that while at present, Ireland is in a reasonably favourable competitive position, emerging pressures such as increasing wages and labour costs, will continue to erode Ireland’s competitiveness. The NCC stated that;

“The report identifies a number of emerging pressure points in our economy which have the potential to significantly erode our competitiveness further. The major cost factors for Irish businesses are labour costs, the rental price of commercial property, interest rates, and the continued increase in insurance costs”\textsuperscript{65}.

Recently released data that unemployment is already at 4.4\%\textsuperscript{66} and while the Committee welcomes these developments, it also acknowledges that this tightening of the labour market has begun to exert upward pressure on labour costs.

\textbf{Figure 12: Unemployment Rate 2011 – 2019}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{unemployment_rate_graph.png}
\caption{Unemployment Rate 2011 – 2019}
\end{figure}

\textit{Source: CSO Labour Force Survey Quarterly Series}

\textsuperscript{65} Committee meeting 8\textsuperscript{th} May 2019, NCC Opening Statement

In 2018, after a considerable period of moderate growth, labour costs in Ireland grew by 2.9%. This pace of growth is four times faster than the rate of inflation. The graph below charts the growth in Ireland’s nominal labour costs from 2012 to 2018 in comparison with that of other European countries and the UK.

The Committee notes that, while the graph shows that labour costs in Ireland have been lower than Europe and the UK, as the labour market tightens and unemployment moves below 5%, these pressures will become more acute.

**Figure 13: Nominal labour cost growth 2012 – 2018 (2012=100)**

![Graph showing nominal labour cost growth from 2012 to 2018](source: Eurostat Labour Cost Index)

The Committee also heard evidence from the CBI which suggests that labour costs are rising. Representatives from the CBI explained that:

“In our central forecast, growth in employment, while moderating, will continue to be relatively broad-based. In light of the outlook for employment, we also expect a further pick up in wages which, combined with expectations of modest inflation, should translate into higher real incomes and purchasing power for households. We are forecasting the average increase in compensation per employee to increase from 2.8% last year to 3.4% this year and 3.6% in 2020”.

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Transcript of meeting of Select Committee on Budgetary Oversight, February 27th 2019.  
In addition to increasing labour costs, a tightening labour market can also result in skills shortages in certain sectors. In its meeting regarding the publication of the Country Report Ireland 2019, Deputy-Director General of the European Commission’s Economic and Financial Affairs Directorate, Mr. Carlos Martinez Mongay stated that:

“labour market outcomes remain favourable, with the unemployment rate approaching pre-crisis levels. As the labour market tightens, however, skills shortages are becoming increasingly apparent in fast growing sectors, most notably for information and communication technology and highly skilled professionals in the construction and property sectors”.

Following on from the Country Report Ireland 2019, the CSRs include a recommendation to invest in upskilling the workforce, particularly in digital skills and to better align education and training to labour market needs. In relation to CSR 2 paragraph 13 states that:

“The tightening labour market and the emerging skills shortages and mismatches in certain sectors call for efforts to reach out to inactive groups of potential workers and to invest in under-tapped human capital”.

This issue has also been highlighted by the NCC in its Competitiveness Challenge 2018 Report and by Chambers Ireland in its pre-budget submission. In particular the NCC emphasised that skills gaps are emerging as a result of Brexit.

One channel, through which labour force pressures can be eased, is by growing the labour force or increasing participation rate. In pre-budget submissions to the Committee, both Chambers Ireland and TASC highlight concerns regarding labour force participation rates in Ireland. Although the Irish economy is approaching full employment, labour force participation, at 61.5% in 2018, remains below its pre-crisis peak of 64% with persistently high rates of long-term unemployment and inactivity. While the Committee notes that the labour force grew by 62,600 year on year, it also acknowledges that more should be done to increase the participation rate.

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69 Country Specific Recommendations Ireland 2019
70 Active Labour Market Policies, PBO Briefing Paper 10 of 2018
This issue has also been highlighted by the European Commission which included recommendations to decrease the level of inactivity and jobless households in the Country Specific Recommendations (CSRs) for Ireland in 2018. The CSRs state that:

“Almost three quarters of people not working in Ireland are inactive. Both the overall and child at-risk-of-poverty-or-social-exclusion rates fell slightly in 2016 but remain higher than the EU average. As a result, Ireland needs to complete the implementation of its Action Plan for Jobless Households, including by improving the integrated support to people furthest from the labour market”\(^{72}\).

In particular, low female labour force participation rates are a persistent issue for Ireland and other European countries. In Q2 of 2018 the female labour participation rate was 55.7% while the rate for male participation was 68.4%. One of the main barriers to female labour participation is access to affordable childcare. The NCC has estimated that gross full-time childcare fees for two children amounts to 39% of the average wage for a couple.\(^{73}\) In its pre-budget submission, TASC recommended that childcare spending increase from the projected level of 0.3% of GNI\(^*\) in 2019 to 0.5% for 2020.

**Recommendation:** The Committee recommends that the cost and quality of childcare be examined by the Government, with a view towards reducing costs for working families, increasing the labour force participation rate and easing the skills shortage.

Greater flexibility around working hours and working arrangements and making workplaces more accessible were also highlighted, by Chambers Ireland and the Disability Federation of Ireland, as ways to encourage labour force participation by both women and people with disabilities.

**Recommendation:** The Committee recommends that the Government assess options with regards to how workplaces can be made more accessible and disability-friendly in order to increase the labour force participation rate.

\(^{72}\) [Country Specific Recommendations 2018, European Commission](https://ec.europa.eu/growth/tools-databases/country-specific-recommendations_en)

Other Costs

In April 2019 the National Competitiveness Council (NCC) published its Cost of Doing Business in Ireland 2019 report. The Committee met with representatives of the NCC in May 2019 to discuss this report and its implications for Budget 2020. The report is a statistical review of business costs in Ireland, benchmarking them against Ireland’s key competitors. The report stated that:

“The cost profile of Ireland can be described as ‘high cost, slowly increasing’ and in this regard, Ireland finds itself in the company of countries like Iceland, Denmark and Sweden. The slow growth in costs – and particularly the fact that it is well below comparator countries - is welcome from a cost competitiveness perspective”.

(Cost of Doing Business in Ireland 2019, NCC)

Figure 14: HICP Inflation/ Price Increases in Selected European Countries

Source: PPP (2018)/ HICP (2018), Eurostat
The Committee was advised by the NCC that while Ireland is maintaining a cost competitive position, the strong headline figures for economic growth may be masking growing risks and vulnerabilities in the economy. In particular the NCC identified emerging cost pressure points such as;

“The rental price of Irish commercial property continues to increase at a steady pace, and Irish businesses face higher costs when accessing credit relative to the euro area and for accessing electricity compared to the EU average. Interest rates (3.3%) in Ireland are considerably higher than rates in the euro area (2%) meaning that an Irish business, looking to borrow money to futureproof its operations, faces costs that are on average 65% higher than their EU counterparties” (Cost of Doing Business in Ireland 2019).

In relation to insurance costs, Professor Clinch highlighted the lack of available data and encouraged the Committee to add its voice to the call for the CSO to produce better data on insurance and legal services. The NCC also highlighted to the Committee the fact that there are hidden costs emerging in the Irish economy such as traffic congestion, costs of planning processes, and recruitment costs in a tightening labour market.

The NCC, in its meeting with the Committee, also acknowledged actions being progressed in the Government’s Future Jobs Ireland initiative, to improve Ireland’s cost competitiveness by trying to improve productivity.

**Productivity**

The Committee notes that productivity growth is vital in order to ensure that increasing employee compensation and other business costs do not erode competitiveness in the economy. The National Competitiveness Council explained the importance of productivity growth stating that;

“*In the medium term productivity improvement will be the primary driver of competitiveness, employment, wages, living standards and the financing of public services*.”

In its Competitiveness Challenge 2018 Report, the NCC explains that although on a GNI* basis, Ireland’s labour productivity is below Germany and the US, on average Ireland’s

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74 Committee meeting 8th May 2019, Transcript
75 Committee meeting 8th May 2019, NCC Opening Statement
productivity rate from 2006-2016 has been well above most countries in the OECD and the Euro area\textsuperscript{76}.

However, the NCC suggests that this headline productivity performance is built upon a narrow base of highly productive, mainly foreign dominated sectors such as pharmaceuticals and ICT, and is heavily influenced by the activity of a small cohort of multinational “frontier” firms. The research suggests that the performance of these highly productive sectors and enterprises is masking the underperformance of many indigenous enterprises where productivity is stagnant or falling. However, this divergence across industry sectors is not uncommon in OECD countries.

These findings reflect the extent to which the Irish economy is concentrated on a small number of firms. The NCC in its meeting with the Committee stated that:

\begin{quote}
“The top 100 traders account for 80\% of exports value, with 10\% of firms accounting for 90\% of productivity. As I stated, we are flying on one big engine and must work strongly on the smaller engine”\textsuperscript{77}.
\end{quote}

\textbf{Figure 15: Productivity increases in foreign and domestic/other sectors 2011 – 2016 (2000=100)}

The issue of Ireland’s “productivity gap” and the need to support and develop Ireland’s indigenous industry was also highlighted in the Committee’s meeting with Ibec and the

\textsuperscript{76} Ireland’s Competitiveness Challenge 2018
\textsuperscript{77} Committee meeting 8\textsuperscript{th} May 2019, Transcript
Construction Industry Federation in June 2019. Fergal O’Brien, Ibec’s Director of Public and Policy Affairs stated that:

“Starting in Budget 2020 we will have no choice but to follow through on the promises of previous decades and finally make a concrete effort to grow our indigenous enterprise base. This includes an intense focus on productivity, innovation, skills and exporting early”.

Ibec went on to advise the Committee that one way in which SMEs could be supported and developed is to encourage more SMEs to avail of the R&D tax credit. Ibec explained to the Committee that at present, the uptake of the R&D tax credit within the SME sector is low due to the complexity of the R&D application process and the high administrative burden that this places on small domestic firms.

In discussions with EC, the Committee heard how properly directed investment could not only address the productivity divergence, but could also assist in addressing regional imbalances, one of Ireland’s CSRs:

“more investment in research and development, skills and digitalisation would address the lagging productivity of domestic firms. It could also address the sizeable regional differences in competitiveness, productivity and skilled labour that exist in Ireland.”

**Recommendation:** The Department of Finance include options and recommendations within the Tax Strategy Group Papers for Budget 2020, to adjust or amend the R&D tax credit in order to remove the administrative burden for SMEs and incentivise greater use of this tax credit within the indigenous SME sector. This will work to close the productivity gap between frontier and laggard firms.

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78 Committee meeting 19th June 2019, Opening statement from Ibec
Section 7 - Revenue

Carbon Pricing

The Committee acknowledges the significant challenge that climate change poses for society, and within that, the potential fiscal and budgetary issues that it will pose. Reflecting this, the Committee held a dedicated session with the ESRI, the Department of Communications, Climate Action and Environment (DCCAE) and the Climate Change Advisory Committee (CCAC).

The Committee engaged in a robust debate regarding the merits of increasing the price of carbon, the effectiveness of carbon taxes, and how best the revenue generated can be recycled to mitigate any potential regressive impacts.

The Committee notes from the evidence of the DCCAE that, for every €5 per tonne increase in the price of carbon, the yield to the Exchequer will be approximately €100 million. The Committee also acknowledges the views of the CCAC and the ESRI who pointed to a consensus in economic research which supports the effectiveness of carbon tax increases in decreasing carbon emissions. Measures to increase carbon tax were also supported in submissions made to the Committee by TASC and NERI.

The Committee also acknowledges the submission of CPL Fuels, who propose that no further carbon tax measures should be introduced as they suggest that it may lead to an increase in demand for illicit fuels not subject to carbon tax.

The Committee also acknowledges that an increase in carbon tax will have a disproportionate effect on households with lower incomes, who spend a larger portion of their income on fuel. In addition, Professor John Fitzgerald and the ESRI highlighted to the Committee that rural households will be more adversely impacted, primarily due to the higher prevalence of long distance commuting in these areas. Having considered these issues, the Committee is of the view that it is important that more vulnerable households are not made worse off by increasing the price of carbon.

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**Recommendation:** The Committee recommends that the Government should provide clarity on the direction it intends to take with regard to carbon tax, so allowing for it to be incorporated into medium term projections.

The Committee notes that the detailed work on this issue will be undertaken by the Oireachtas Joint Committee on Climate Action and recommends that said Committee should write to the Committee on Budgetary Oversight with regard to their recommendations.

**Recommendation:** Given the advice received from numerous stakeholders that there is a requirement for the tax base to be widened, the Committee recommends that a portion of the yield from the increase in carbon tax be ring-fenced for specific climate action investment that will be required in the medium term.

The Committee also notes that while there will be a yield from carbon tax, albeit temporarily, this will be at least partially offset by a reduction in excise duty. The Committee also acknowledges that excise duty on petrol and diesel generated €2.06 billion. Should the carbon tax be successful, this revenue stream will erode significantly over time, having a significant budgetary impact.

**Recommendation:** The Committee requests that the Department of Finance, and other relevant bodies, provide a detailed analysis of the total revenue implications of climate change activity, including the implications for other fuel based revenue sources. Details should also be provided with regard to how the Government will replace the depletion of other revenue streams.

**Tax Expenditures**

The issue of tax expenditures was raised with the Committee in its meeting with Social Justice Ireland (SJI), NERI and the Irish Congress of Trade Unions (ICTU) in June 2019. The stakeholders broadly echoed the views and recommendations contained within the Committee’s report on tax expenditures.  

SJI pointed out that during budget discussions, much focus is placed on income tax, tax revenues and social insurance payments, while there is little scrutiny of tax expenditures. Dr. Healy highlighted the need to regularly review and evaluate tax expenditures.

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[82](https://data.oireachtas.ie/ie/oireachtas/committee/dail/32/committee_on_budgetary_oversight/reports/2019/2019-04-08_tax-expenditures_en.pdf)
"We would strongly view that tax expenditures need to be consistently under review. We need to keep pace with changes in the economy. We should review on an annual basis. We should have a sunset clause on every single tax expenditure."\textsuperscript{83}

In its report on tax expenditures (April 2009), the Committee had put forward similar recommendations, which stated that:

- The Committee recommends, in relation to the information provided to the Committee on tax expenditure measures that have never had a review\textsuperscript{84}, that the Department of Finance carry out the following actions:
  - Provide a response to the Committee setting out the reasons why no review has been carried out to date on these measures.
  - Set out for the Committee, the Department’s view as to whether these measures need to be reviewed.
- In relation to the tax expenditure measures on the Department’s list where sunset clauses are not in place, the Committee recommends that the Department of Finance prepares a report giving detailed reasons as to why sunset clauses were not attached to these tax expenditures\textsuperscript{85}.

In its work on tax expenditures, the Committee acknowledges the engagement and proactive work of the Department of Finance in providing the Committee with additional information regarding tax expenditures.

On foot of its report, the Committee agreed to make the examination and scrutiny of tax expenditures part of its annual work programme. In order to make further progress in this area, the Committee will focus its work on scrutinising the tax expenditure review and evaluation processes carried out by the Department of Finance. The Committee is of the view that the establishment of a Standing Commission on Taxation would greatly assist in its work on tax expenditures\textsuperscript{86}.

\textsuperscript{83} Transcript, Committee meeting Wed 19\textsuperscript{th} June 2019
\textsuperscript{85} Committee Report on Tax Expenditures
\textsuperscript{86} Transcript, meeting of Select Committee, June 19\textsuperscript{th} 2019. \url{https://www.oireachtas.ie/en/debates/debate/committee_on_budgetary_oversight/2019-06-19/}
Recommendation: The Minister for Finance and Public Expenditure and Reform should consider establishing a standing Commission on Taxation to review and evaluate tax expenditure measures on a regular basis. The Commission should report to the Committee on an annual basis.

Local Property Tax

Subsequent to the publication of the Local Property Tax Review Group’s report on Local Property Tax (LPT), the Committee has had a number of meetings on this matter. Post-recess, the Committee will be submitting a report on the LPT revaluation. The Committee acknowledges that there is not a unanimous view on the Local Property Tax.

The Committee acknowledges the engagement of Minister and the senior officials from the Review Group with the Committee to discuss its report. The technical briefing provided by the senior officials allowed the Committee to gain a better understanding of the complexities of the revaluation process, and the difficulties in ensuring the new system is equitable, without making the administrative burden overly-cumbersome.

The Committee notes the report of the Review Group and recognises the importance of widening the tax base and providing stable revenue streams. While the Committee also acknowledges that any change to the LPT system will result in winners and losers amongst households, it is important that LPT remains equitable. Further, the administrative burden and complexity of the tax should not be complicated.

Recommendation: The Committee is in agreement that the current situation, whereby homes built in 2013 are exempt from LPT, while homes built subsequently are outside the net altogether, is inequitable and should not continue as part of the planned reform of the Local Property Tax. However, the Committee recommends that other exemptions currently in the LPT code such as, for example, those relating to properties with pyrite damage, and those owned by a charity or public body, should be retained.

Futureproofing the LPT system is important, particularly if the target revenue yield is to be protected. The Committee acknowledges that it is important that consideration is given to future movements in property prices, and fact that if a target yield is fixed, LPT as a share of total revenue is likely to decrease over time.
**Recommendation:** The Committee recommends that due consideration be given to the LPT options proposed by the Review Group to ensure that they are future proofed and will not result in revaluation or deferrals etc. in the future.
Section 8 - Expenditure

Capital Expenditure

The Committee acknowledges the importance of infrastructure delivery in maintaining, and improving, competitiveness. Numerous stakeholders have highlighted the under-investment in infrastructure over the past decade, with CBI highlighting that:

“Overall, public capital investment fell extremely sharply after the crisis, by around 60%. As a result, there was a significant depletion of the overall public capital stock, which remains very low.”

One of the flagship capital projects included in the NDP is the National Broadband Plan (NBP). The Committee held a dedicated session with the Minister for Finance and Public Expenditure and Reform on the increase in the projected costs of delivery of said project.

The Committee notes that, although the Minister informed the Committee that the greatest annual costs to deliver the NBP would coincide with periods during which considerable budget surpluses would be recorded, a subsequent meeting with IFAC called these medium term budget forecasts into question.

On this basis, and in order to carry out its budget scrutiny function, the Committee requires a greater level of detail on the sources of funding for the additional capital required to deliver the NBP.

The Committee is of the view that, if required, a portion of the windfall gains arising from higher than anticipated corporation tax receipts could be used to consolidate the delivery of the NDP.

However, these receipts should not be seen as a safety net against further cost overruns in future years. Numerous stakeholders, including SJI, NERI and Ibec, have cautioned against using CT receipts for this purpose. The Committee also notes that during its discussions, various stakeholders held diverging views on how to prioritise the allocation of future investment in infrastructure. For example, while SJI have highlighted investment in social

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housing, water, public transport and broadband, Ibec has emphasised the need to prioritise investment in skills, innovation and infrastructure as priority.

**Recommendation:** The Department of Public Expenditure and Reform should publish an updated list of NDP projects for the next five years, outlining the annual budgeted expenditure alongside the most up to date required funding, should be published alongside Budget 2020.

**Recommendation:** In an instance where the cost of a specific capital projects increases, such as in the case of the National Children’s Hospital and the NBP, the source of the additional funding should be clearly stated.

Notwithstanding the requirement for sustainable capital investment, the Committee is also conscious of inflationary pressures in the construction sector. With unemployment now at 4.4%, there is an acute shortage of labour in the economy, and this appears to also be the case in the construction sector. When meeting the Committee, the Construction Industry Federation highlighted their concerns on this:

“In mid-2016, SOLAS forecast that the industry would require about 100,000 additional workers over three years to replace those retiring or emigrating and to meet the targets set out for housing in Rebuilding Ireland and in the public capital programme, as it was known. Since then, we have been hiring an additional 1,000 people per month into the industry, coming to around 35,000.”

On the same theme, Mr. McCarthy pointed out to the Committee that, even if the financial capacity were available to dramatically increase capital investment, the economy does not have the resources available to meet it. Increasing investment in a sector when it is already at capacity, it will result in an increase in cost, and a reduction in competitiveness.

Allied to capacity issues referenced above, the Committee notes the importance of containing construction cost inflation in order to maximise the return from capital investment and to ensure value for money. The Committee was informed by the Minister for Finance

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and Public Expenditure & Reform that productivity levels in the Irish construction sector are 24% below the European average\textsuperscript{90}.

While poor productivity growth is a problem for almost all indigenous sectors, the Committee recognises that improving productivity levels in the construction sector will be vital to ensuring the delivery of the National Development Plan.

**Recommendation:** The Committee notes that a programme of work examining innovation in the construction sector is being undertaken by the Department of Public Expenditure and Reform in partnership with the Construction Sector Group. The Committee recommends that it meets with members of the Group to discuss the findings of the study in due course.

**Climate Action Expenditure**

The Committee acknowledges that the expenditure cost to the state of reducing carbon emissions will be significant in the medium to long term. The Committee welcomes the All of Government Climate Action Plan, launched on the 17\textsuperscript{th} of June 2019. Post launch, the Committee met the DCCAE and discussed the plan. The Committee was disappointed by the absence of timelines and costings contained in the plan and felt, from a budgetary oversight perspective, it made scrutiny difficult.

**Recommendation:** The Committee recommends that further clarity is provided regarding the Exchequer expenditure requirements of implementing the All of Government Climate Action Plan.

The Committee welcomes evidence provided by the DCCAE that Ireland is not likely to be subject to fines for missing its EU 2020 targets, but also acknowledges the challenge that meeting 2030 targets will present. However, there will be a cost to the Exchequer for the purchase of ETS credits, estimates of which vary. While there is considerable ambiguity around the ultimate annual cost, there is a possibility that it not will be a negligible cost.

**Recommendations:** The Committee recommends that DCCAE and the Department of Finance produce a robust estimate of the annual cost of ETS credits, which will allow for them to be prudently incorporated in medium term expenditure projections.

\textsuperscript{90} [https://data.oireachtas.ie/ie/oireachtas/debateRecord/committee_on_budgetary_oversight/2019-04-18/debate/mul@/main.pdf](https://data.oireachtas.ie/ie/oireachtas/debateRecord/committee_on_budgetary_oversight/2019-04-18/debate/mul@/main.pdf)
Use of Fiscal Space

With regard to how any available resources should be allocated, NERI have cautioned against tax cuts and cited international benchmarks in stating that Ireland is not a high-tax economy with regard to labour.

“When you have an economy on the verge of overheating, the literature would suggest that the last thing you would do is cut taxes at that point because all that would do is stimulate it even more. In any event other than a disastrous Brexit, you wouldn’t consider tax cuts of any kind.

“The implicit tax rate, which is tax revenue over the tax base, for labour is actually lower in the European Union than it is in Ireland”.91

SJI also argued against introducing tax cuts, stating that of the seven options for cuts in income tax and USC, only two would be viewed as fair. In relation to increasing income tax bands SJI explained to the Committee that:

“Increasing the band is not an effective or fair measure. Any changes to income tax should be made to tax credits not increasing tax bands. Bringing in refundable tax credits would benefit people on low incomes”.92

Rather than reducing taxation, SJI believe available resources should be invested in areas such as social housing, water, public transport and broadband. Also, it could be used to increase expenditure in services such as education and childcare.

This call, for a moratorium on tax cuts and a non-expansionary budget, was echoed by Mr. McCarthy and Dr. Stephen Kinsella in their meeting with the Committee on 25th June 2019. Colm McCarthy stated that:

“There should be no giveaways at all in this Budget”93.

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91 Transcript, meeting of the Select Committee on Budgetary Oversight, June 19th 2019. 
92 Transcript, meeting of the Select Committee on Budgetary Oversight, June 19th 2019. 
However, the Committee is very aware of the extremely challenging task involved in preparing a national budget at the critical juncture at which the economy finds itself, balancing overheating risks on one side, with a significant negative shock to economic activity possible, depending on the form of Brexit that occurs.

It is important that the Government has sufficient scope to react to any potential Brexit scenario, and has the resources available to implement any specific sectoral support initiatives, as previously discussed. While the Committee acknowledges that it is possible to run an increased budget deficit to do this, it is also aware, as highlighted by Mr. McCarthy, that the State “must have the balance sheet to sustain it”.

**Recommendation:** At this point, the Committee recommends that a prudent approach is taken to Budget 2020 that will allow sufficient scope for the Government to implement targeted support policies in the case of a hard Brexit, while also taking account of the possible call on resources arising from automatic stabilisers being triggered.

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93 Transcript, meeting of the Select Committee on Budgetary Oversight, June 25th 2019.  
Performance Budgeting

The Committee welcomes the Public Service Performance Report (PSPR) 2018, and also thanks the officials of the Department of Public Expenditure and Reform for meeting the Committee to discuss the Report. While the Committee acknowledges that there is a vast quantity of metrics included in the report and that it offers a first step in the right direction, it agrees with the PBO assessment to the effect that that:

“without improving the presentation of targets and output indicators and the level of financial information, it will not substantially assist them in scrutinising Government performance.”

In particular, the absence of financial information at programme level under the Department of Health is disappointing, particularly given the significant supplementary estimate that was required under the Vote in-year during 2018 and its overall impact on the budget.

Recommendation: The Committee would welcome further linkage between the performance metrics provided in the PSPR and the budgetary allowance for said activity.

Climate Proofing the Budget

The Committee is aware of the importance of prioritising climate action measures that will help to move Ireland towards a zero carbon economy. The fiscal and budgetary implications of not meeting the 2030 and 2050 emissions targets have been highlighted to the Committee by a number of witnesses, including, the ESRI, the PBO and Professor John Fitzgerald of the Climate Action Advisory Council.

The Committee also recognises the need to assess the impact of budget policy proposals from a number of perspectives including, climate, gender and equality. In February 2018 the Committee requested the PBO to carry out a study assessing how the budget process could be “climate proofed”. Similar to equality budgeting, the purpose of this study was to assess how climate action issues could be incorporated into the annual budget process.

In September 2018 the PBO published its report “An Approach to Better Incorporate Climate related Considerations into the Budget Process,” and presented its main findings to the Committee.

The report stated that;

“There is an economic rationale for strengthening the budget process to address climate change more effectively. Individuals are generally present-biased (i.e. they focus more on the present) and tend to perceive climate change as a long-term risk whose costs are unlikely to affect them in the short-term. As a result, climate change is rarely prioritised in budget decisions”.

The study analysed the approach to climate-related issues for a number of countries and put forward four possible options that could help to integrate climate proofing processes into the annual budget process.

- **Option A**: Having a section in the annual budget statement
- **Option B**: Publishing a supplementary report alongside the Budget
- **Option C**: Strengthening the performance-based Budgeting Framework
- **Option D**: Use of public expenditure reviews.

Taking the work of the PBO into account, the Committee made the following recommendations in its Final Budget 2019 report:

- The Committee welcomes the work on climate proofing carried out by the PBO and recommends that a Supplementary Climate Change report be published alongside the budget, addressing issues such as identification of the main budget allocations and tax measures that will have a significant impact on climate change targets and quantifying the impact of these measures on greenhouse gas emissions.
- The Committee also recommends incorporating papers addressing climate change issues into the Spending Review.

In its meeting with the DCCAE, the ESRI and Professor John Fitzgerald regarding the budgetary implications of climate action measures, the Committee raised the issue of the

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need to climate proof Budget 2020 and future budgets. Professor John Fitzgerald, Chair of the Climate Change Advisory Council stated that:

“In terms of climate proofing the budget, it sounds like a good idea to check what will be the effect of that”.

Officials from the DCCAE also supported the principle of introducing climate proofing processes into the Budget process, and explained to the Committee the work that is currently being undertaken by both the DCCAE and the Department of Finance to achieve this. In response to the Committee the officials stated that:

“The Deputy spoke about climate-proofing of the budget. I already mentioned that the plan contains a new commitment on carbon-proofing Government memoranda and individual investment appraisals. That should be strengthened as part of the public spending code the Department of Public Expenditure and Reform is preparing at the moment.

“Separately, I believe in last year’s Budget Statement the Minister for Finance gave an undertaking to developing green budgeting as part of the budgetary framework into the future. This year’s Revised Estimates Volume contains an appendix relating to the individual subheads across Departments that are specifically related to climate action. I understand the Department intends to develop that further in due course”.

Recommendation: That a Supplementary Climate Change report be published alongside the budget, addressing issues such as identification of the main budget allocations and tax measures that will have a significant impact on climate change targets and quantifying the impact of these measures on greenhouse gas emissions.

Recommendation: The Tax Strategy Group papers include in-depth analysis on the climate impact of proposed tax measures.

Recommendation: The performance-based budgeting framework be strengthened and improved, in particular to address data gaps in climate-related data currently apparent in the REV.

97 Transcript, meeting of the Select Committee on Budgetary Oversight, June 18th 2019.
Equality Budgeting

The Committee welcomed the fact that the Minister for Finance has voiced his recognition of the need for an Equality Budget Statement and the reference to its report made by the Minister for Finance on Budget day. However the Committee was disappointed that the Minister did not take the opportunity to issue and read out an Equality Budget Statement for Budget 2019.

The Committee is hopeful that, given that the Equality Budgeting Pilot Programme has gone through a full budget cycle, that more data and capacity will be available to the Department of Finance to allow the publication of an Equality Budget Statement to be read out by the Minister on budget day 2020.

In March 2019 the Committee wrote to the Department of Public Expenditure and Reform requesting an update on the progress of the Equality Budgeting Pilot Programme. In its response the Department explained that the pilot programme had been expanded and improved in a number of areas including the following:

- The number of participating Departments has been increased from six to nine. The three additional departments are;
  - Communications, Climate Action and Environment
  - Employment Affairs and Social Protection
  - Justice and Equality
- The scope of the programme has been expanded to include other dimensions of equality such as poverty, socioeconomic equality and disability.
- Eight additional equality budgeting objectives and performance indicators were identified and published in the Revised Estimates Volume 2019.
- An Equality Budgeting Expert Advisory Group was established in September to provide expert knowledge and support to the DPER and participating departments in their work to advance Equality Budgeting policy. The group first met in September and meets approximately every two months. The group members include NWCI, IHREC, ESRI, CSO, NESC, Departments of Social Protection, Finance, Justice and Equality and also Maynooth University.
- The REV 2019 now contains an Equality Budgeting Appendix which sets out a framework for Equality Budgeting under 9 themes.
On 14th May 2019, the Committee met with officials from the DPER and the Disability Federation of Ireland to discuss the Public Service Performance Report 2019 and the update on the Equality Budgeting pilot programme.

The Committee acknowledges and commends the work of the DPER and the participating Departments in expanding the scope of the pilot programme and developing the gender equality objectives and indicators.

The Committee also welcomes the establishment of the expert advisory group and the inclusion of an Equality Budgeting appendix in the Public Service Performance Report 2019.

However the Committee also recognises the need for further work to be done by the DPER and the participating departments to improve and refine the gender equality objectives and indicators.

As a result, the Committee reiterating some of the recommendations put forward in its Gender Budgeting Report to ensure that the DPER Equality Budgeting Programme moves beyond its pilot phase. The Committee will continue to monitor the progress of this programme.

**Recommendation:** The Committee recommends that an annual Equality Budget Statement (EBS) be prepared by the Department of Finance, and read by the Minister for Finance and Public Expenditure and Reform alongside the Budget Statement. The EBS should set out broad and ambitious strategic gender equality goals. These strategic goals should be linked to the gender equality performance indicators, objectives and targets chosen by Government Departments for inclusion in the Equality Budgeting Initiative. This would advance the integration of gender (and in due course other aspects of equality budgeting) into the annual budget process and the delivery of public services.

**Recommendation:** The Committee recommends that the Department of Finance utilise the SWITCH model to carry out ex-ante gender impact assessments of budget options for inclusion in the Tax Strategy Group Papers which will inform budget decisions in Budget 2020.

**Recommendation:** The Committee recommends that the Department of Public Expenditure and Reform (DPER) provide it with the ex-ante analysis that was carried out by the participating Departments which informed decisions to select specific spending programmes,
indicators (or metrics), targets and high level goals for the pilot. This information would help the Committee to evaluate the pilot and to assess its usefulness in gender budgeting.

**Recommendation:** While the Committee welcomes the improvements that have been made to the presentation of the Equality Budgeting themes and high level goals within the Public Service Performance Report and the REV 2019, it recognises that further works needs to be carried out to enhance and refine the key high level metrics and indicators. The Committee recommends that the Parliamentary Budget Office’s (PBO) analysis of the Equality Budgeting Pilot Programme (PBO Briefing Paper 4 of 2018), and constructive feedback contained therein, be taken into account by the Department of Public Expenditure and Reform (and the nine Departments involved in the pilot).

**Recommendation:** The Committee recommends that DPER commissions a research paper on the role and contribution of women in the Irish economy, similar to that commissioned by the Scottish government. This research would aid the various Departments in choosing and refining gender equality indicators and objectives, and would progress the collection of disaggregated data. Such a report, if commissioned, should be published by the end of 2020.
Appendix One: References


Department of Finance, *Response to Committee request for information*, March 2019. Available here


Eurostat, *GDP and main components (output, expenditure and income)*, June 2019. Available here


European Commission, *Recommendation for a council recommendation on the 2018 National Reform Programme of Ireland and delivering a Council opinion on the 2018 Stability Programme of Ireland* Available here


Parliamentary Budget Office (PBO), *Active Labour Market Policies Briefing 10 of 2018,* August 2018. Available here


Appendix Two: Links to Transcripts

27th February 2019 – Central Bank
Transcript

13th March 2019 – European Commission
Transcript

18th April 2019 – Minister for Finance Public Expenditure and Reform
Transcript

8th May 2019 – National Competitiveness Council
Transcript

11th June 2019 – Irish Fiscal Advisory Council (IFAC) and Minister for Finance Public Expenditure and Reform
Transcript

18th June 2018 – Climate Change Advisory Council, Department of Communications, Climate Action and Environment and Economic and Social Research Institute (ESRI)
Transcript

19th June 2019 – Nevin Economic Research Institute (NERI), Irish Congress of Trade Unions (ICTU), Social Justice Ireland (SJI), Ibec and Construction Industry Federation (CIF)
Transcript

25th June 2019 – Dr Stephen Kinsella, Associate Professor of Economics, University of Limerick and Mr Colm McCarthy, Economist, University College Dublin
Transcript
Appendix Three: Links to Heat map for monitoring potential imbalances in the economy

Appendix 3: IFAC Heat map for monitoring potential imbalances in the Irish economy

(Source: IFAC FAR June 2019)
New mortgage lending (% GNI*)
Credit to private sector Ex FI (% GNI*)
Adjusted private sector credit (% GNI*)
Adjusted private sector credit gap (% GNI*)
New SME credit (% GNI*)

Sources: CSO; Central Bank of Ireland; Department of Finance (Budget 2019 forecasts); Department of Environment, Heritage and Local Government; ESRI/PTSB; European Commission (AMECO and CIRCABC); Residential Tenancies Board; and internal IFAC calculations.

Notes: To provide a more meaningful analysis of sustainable wage growth rates, the sample periods for wage inflation, real wage inflation, relative hourly wage growth (Ireland / Euro Area), and change in wage inflation have been restricted to begin in 2003. This removes the latter years of Ireland’s convergence-growth period, where hourly wages grew by up to 10 per cent annually. For other calculation details, see Timoney and Casey (2018).
Appendix Four: Committee Membership

Maria Bailey 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

Barry Cowen TD
Fianna Fáil

Lisa Chambers TD
Fianna Fáil

Pearse Doherty TD
Sinn Féin

Declan Breathnach TD
Fianna Fáil

Martin Heydon TD
Fine Gael

John Lahart TD
Fianna Fáil

Michael McGrath TD
Fianna Fáil

Jonathan O’Brien TD
Sinn Féin

Eamon Ryan TD
Green Party
Notes:

1. Committee established by order of the Dáil of 21 July 2016
3. Deputy Marc Mac Sharry was discharged from the Committee and Deputy John Lahart was appointed to Committee in replacement for him by order of the Dáil on 31 January 2017.
4. Deputy Kate O’Connell was discharged from the Committee and Deputy Pat Deering was appointed to Committee in replacement for her by order of the Dáil on 9 February 2017.
5. Deputy John Paul Phelan was discharged from the Committee and Deputy Josepha Madigan was appointed to the Committee in replacement for him by order of the Dáil on 11 July 2017.
6. Deputy Pat Deering was discharged from the Committee and Deputy Martin Heydon was appointed to the Committee in replacement for him by order of the Dáil on 13 July 2017.
7. Deputy David Cullinane was discharged from the Committee and Deputy Jonathan O’Brien was appointed to the Committee in replacement for him by order of the Dáil on 3 October 2017.
8. Deputy Josepha Madigan was discharged from the Committee and Deputy Colm Brophy was appointed as Chairman of the Committee by order of the Dáil on 12 December 2017.
9. Deputy Dara Calleary was discharged from the Committee and Deputy Barry Cowen was appointed to the Committee in replacement for him by order of the Dáil on 17 April 2018.
10. Deputies Seán Barrett and Stephen Donnelly were discharged from the Committee and Deputies Maria Bailey and Declan Breathnach were appointed to the Committee in replacement of them by order of the Dáil on 1 May 2018.