DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 13 Meán Fómhair 2016

Tuesday, 13 September 2016

The Select Committee met at 1.05 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Deputy Pearse Doherty,
Deputy Colm Brophy,	Deputy Stephen S. Donnelly,
Deputy Thomas P. Broughan,	Deputy Michael McGrath,
Deputy Lisa Chambers,	Deputy Kate O'Connell,
Deputy David Cullinane,	Deputy Eamon Ryan.

DEPUTY JOHN PAUL PHELAN IN THE CHAIR

The select committee met in private session until 2 p.m.

Pre-Budget Statement: Irish Fiscal Advisory Council

Chairman: Apologies have been received from Deputy Calleary who cannot be in attendance. I welcome members and staff of the Fiscal Advisory Council, Professor John McHale, Mr. Seamus Coffey, Mr. Michael Tutty and Dr. Thomas Conefrey. The IFAC is here today to discuss its pre-budget statement, which was published last week.

Before we begin, I remind members and witnesses to turn off their mobile phones as the interference affects sound quality and transmission. I also want to bring to the attention of the witnesses that they are protected by absolute privilege in respect of the evidence they give to the committee. However, if they are directed to cease giving evidence on a particular matter and they continue to so do, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person or persons or an entity by name or in such a way as to make him or her identifiable. Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person either inside or outside the House or an official either by name or in such a way as to make him or her identifiable.

I ask Professor McHale to make his opening statement.

Professor John McHale: On behalf of the council, I thank the committee for the invitation to appear before it today. The council views the enhanced role for the Oireachtas in providing greater scrutiny of the budgetary process as a positive step and we wish the committee well in its work. With me this afternoon are council members, Mr. Seamus Coffey and Mr. Michael Tutty, and the council secretariat is also present.

In my opening remarks, I will focus mainly on the key messages from the council's pre-budget statement, published on Thursday last. While we are limited in what we can say as a council by our well-defined statutory mandate, we will, as always, endeavour to be as forthcoming to the committee as possible, making clear in responses to questions where we are giving personal rather than council opinions.

Three developments have created a challenging backdrop to the assessment of the appropriate fiscal stance for budget 2017: the CSO's revised national accounts data showing 26% growth in 2015; uncertainty over the impact of Brexit; and questions over the sustainability of corporation tax receipts. The revised CSO data mean that measures of growth based on headline aggregates, such as GDP and GNP, are detached from underlying developments in the Irish economy that determine the employment and incomes of Irish residents. Moreover, fiscal ratios based on these measures are not reliable indicators of the health of the public finances. This creates challenges for the council in respect of all elements of its mandate. These challenges will be addressed in detail in the council's November report by which time some additional data may be available from the CSO. In advance of budget 2017, an immediate issue is the assessment of the macroeconomic-fiscal position and the appropriate fiscal stance for 2017. In the current circumstances, it is necessary to look beyond the standard national accounts aggregates and to use alternative indicators when assessing the pace of growth of the economy. Based on an estimate of growth in domestic demand, real growth in 2015 measured approximately 5% and this pick-up is also reflected in other aggregates, such as employment and consumption.

The fast pace of recent growth has implications for the cyclical position of the economy. The output gap measures the difference between the actual level of output in the economy and what it could sustainably produce if all resources – human and capital – were being fully utilised. A range of formal estimates of the output gap reported in the council's June 2016 Fiscal Assessment Report suggested that the economy is operating close to potential in 2016. Recent strong growth in domestic demand and employment along with the return to net inward migration in the year to April 2016 are all consistent with the demand shortfall in the economy being reduced rapidly. While there are no major signs of overheating in the economy at present, it is important to note that there is significant uncertainty around this assessment and the position could change over the next number of years. Understanding the cyclical position of the economy and avoiding potential overheating will be important considerations in framing fiscal policy post-budget 2017.

Turning to an assessment of the fiscal position, the problems with the official estimates of GDP and GNP mean that the headline debt-to-GDP ratio underestimates the size of the debt burden and overstates its rate of improvement last year. As a result, alternative fiscal ratios must be used. In this report the council has found it more useful to focus directly on fiscal ratios expressed as a percentage of actual general Government revenue.

The council's adjusted debt ratio improves from 105% in 2014 to 97% in 2015, a fall of eight percentage points compared to the 27 percentage point fall in the unadjusted debt to GDP ratio. Thus the adjusted data point to a continuing gradual reduction in the State's debt burden, although the overall level of debt remains high by historic and international standards.

Turning to the council's assessment of the fiscal stance, the Government's planned stance for budget 2017 is more expansionary than implied by the intended use of the €1 billion of fiscal space for 2017 outlined in the summer economic statement. Previously announced new spending commitments for 2016 and 2017 of €0.5 billion and €0.9 billion, respectively, give a combined package of measures of €2.4 billion.

As the demand shortfall in the economy is likely to be small and is disappearing quickly, the economic case for a more expansionary stance than already planned by the Government through the €2.4 billion package is weak. Regarding debt sustainability considerations, the Government debt level when measured relative to Government revenue remains high. Although the current interest rate environment is favourable, the experience of recent years has demonstrated how quickly market sentiment can change. The State's high debt level means the overall fiscal position is still fragile and an adverse shock could cause the debt ratio and deficit to start rising again.

Moreover, in the wake of Brexit the risks facing the Irish economy have heightened since the publication of the council's last assessment in June. While it is possible that the eventual impact of Brexit on the Irish economy and public finances will be modest, there is much uncertainty and a more severe outcome is also possible.

There is also particular uncertainty related to the sustainability of the recent surges in corporation tax. Although the latest national accounts data give some insight into the reasons for the out-performance, its relationship to the asset and tax management decisions of a small number of multinational corporations gives reason to be cautious about its sustainability. Moreover, when underlying revenues are volatile, prudent budgetary management suggests that buffers should be built up to protect against potential reversals, especially where it is costly to reverse expenditure increases and tax cuts.

Weighing up these considerations, the council assesses that the Government's current plans for a €1 billion package in budget 2017, on top of the pre-committed expenditure increases for 2016 and 2017, is at the limit of the range of prudent policies. Any further relaxation of the fiscal stance in 2016 or 2017 beyond the current plans would not be appropriate given the strong pace of underlying economic activity, falling unemployment and the need to bolster the resilience of the public finances to adverse shocks. While an anomaly in the fiscal rules related to the AIB preference share transaction in 2015 could allow additional expansion in 2016, a further relaxation of the stance, as occurred in last year's budget through late supplementary expenditure estimates, would not be appropriate. The Government should take advantage of the current relatively strong growth in revenue to eliminate the remaining budget deficit and accelerate the reduction in the debt ratio.

The pre-budget statement also analysed the possible implications of Brexit for the Irish economy. Given the uncertainty around the eventual impact of Brexit on the UK economy and on Ireland, the council examined two possible scenarios. In a relatively benign baseline scenario using the most recent post-Brexit forecasts for the UK economy from the National Institute for Economic and Social Research, NIESR, in the UK, estimates suggest that Irish growth could be lowered by approximately three quarters of a percentage point in 2017 with more limited effects thereafter. In this case, the estimated fiscal space out to 2021 would not be significantly reduced compared to the summer economic statement.

A more severe outcome than these relatively benign short-run effects is also possible. Such a scenario could transpire if the UK's potential output growth is reduced by Brexit with knock-on consequences for the Irish economy. The exercise is not intended as a forecast of the possible impact of Brexit but rather is designed to illustrate how fiscal space could dissipate if the economy performs significantly worse than currently forecast in the years ahead.

For illustrative purposes, assuming a reduction in Ireland's potential growth rate of half a percentage point per annum, fiscal space could be reduced by approximately a quarter to €8.5 billion if attainment of Ireland's medium-term objective was also delayed by a year. Drawing on the council's stand-still expenditure estimate, allowing for increases in expenditure in line with projected inflation and demographic pressures would absorb over half of the reduced fiscal space in the illustrative adverse scenario. Finally, while much of the current focus for the upcoming budget is on short-term considerations related to 2017, as in previous reports, the council would like to highlight the importance of ensuring that annual budgetary decisions are anchored to realistic medium-term forecasts for the public finances. Without a realistic medium-term anchor, there is a risk of a return to the type of *ad hoc* year-to-year budgeting that served Ireland poorly in the past.

To sum up, amid the unusual uncertainty that prevails in advance of budget 2017, a few fundamental facts about the economy and public finances should not be lost. The economy has made an impressive recovery from the economic and financial crisis and good progress has been achieved in repairing the public finances. However, government debt remains high leaving the public finances exposed in the face of numerous risks and potential negative shocks. The Government should take advantage of the current strong growth in the economy to reduce the debt to safer levels. This would leave policy makers with more scope to offset the effect of future negative growth shocks and to protect the employment and living standards of Irish residents.

I thank the committee again for the invitation to appear today and we look forward to your questions.

Chairman: Thank you Professor McHale. Deputy Chambers is first with questions.

Deputy Lisa Chambers: I thank Professor McHale for the comprehensive review. There has been much discussion at recent meetings of this committee about capital investment or the lack thereof in recent years. We have also discussed the low interest rates currently available on borrowing. Does the IFAC have a view on whether there should be leeway given within the fiscal rules for capital investment? What would the council consider to be the priorities for capital investment? Should there be some leeway allowed to enable us to take advantage of the cheap money that is currently available?

Professor John McHale: I thank the Deputy for those questions. This is one place where we have to be careful to respect our mandate, in that it does not really allow us to get into giving advice or making suggestions for the composition of spending increases or tax cuts. My remarks, therefore, will have to be a bit more general rather than making specific recommendations on capital spending.

One thing we have observed and on which we have produced an analytical note is that currently public investment or public capital spending is low by our own historic standards as well as by international standards. Even though recent increases in planned capital spending have improved the situation somewhat, public capital spending is still just about keeping up with the depreciation of existing capital stock. There is some positive net investment but it is not very large. That is the background.

One of the issues that has come up a lot and which is implicit in the Deputy's question is whether the existing fiscal rules overly constrain capital spending. I wish to say a few words about the fiscal rules themselves first because they have come under a lot of attack. One of the reasons countries have these fiscal rules is that often the democratic process can create a tendency towards a deficit bias, which is not surprising in the sense that politicians have to get re-elected and their time horizons are thus that bit shorter than those of a body like the IFAC. Fiscal rules serve the function of pulling countries back, when the deficit is getting too large or the debt levels too high, to something more appropriate to the economy for the long term.

In the Irish case, the deficit bias problem is not too serious. There is a real understanding of the damage that excessive deficits and debts can do and so there is a natural tendency anyway, within the political process, to pull that back. However, a key problem in Ireland in the past has been that in good times when we had revenue surges, often when we were running budget surpluses rather than deficits, we introduced tax cuts and increases in spending which were very difficult to reverse once the revenue surges reversed. We saw that during the property bubble and there is a danger that it might occur again with the recent surge in corporation tax. One aspect of the fiscal rules that is very beneficial in stopping it from happening is the expenditure benchmark because it constrains overall expenditure growth, net of discretionary tax changes, to be in line with the underlying growth in the economy. That is a positive aspect of the rules. On the other hand, if the rules are at odds with what we might consider optimal fiscal policy then we should be concerned about the rules.

I know that many are concerned that the rules might be taking us away from optimal fiscal policy. It is true that if we were following optimal fiscal policy, we would want to undertake investments which have a positive net financial return. One could argue that the ideal rules would actually exclude net investment from the overall calculation of the deficit target and there have been developments at a European level to look into possible modifications of the rules to exclude at least certain categories of net investment. That is a positive development. That said, there is one other question that we need to ask. Even if we were concerned that the rules were not most effectively designed and that they should be making more of a distinction between current and capital spending, we still have to ask if the overall deficit target that we are aiming at is correct. In this, we must take into account that we still have a very high debt and need to bring it down. The only way we can really bring that debt down is by bringing the deficit down towards a balanced budget position. We also have to recognise that there are strong, underlying demographic pressures that will be going on for a number of years to come. Professor John Fitzgerald in an article published last week pointed out that there is annual growth of 3.5% in the number of pensioners, just to take one example of those underlying demographic pressures. Therefore, even though we might be concerned that the rules should be making more of a distinction between current and capital spending, given the need to bring the debt down and given the demographic pressures, we probably should be running a reasonably sizeable current budget surplus and an overall budget that is reasonably close to balanced is probably not inappropriate in the current circumstances. This means that we have difficult decisions to make. We certainly do not want to squeeze capital spending but we must take into account the demographic pressures and the need to bring the debt down, while still aiming for something close to a balanced budget, which the current fiscal rules do. It is a somewhat long-winded answer but I am saying that while people have raised issues about the fiscal rules, where we end up in terms of the overall deficit target seems to be broadly appropriate.

Deputy Lisa Chambers: I thank Professor McHale for what was quite an extensive answer. He made reference to a positive net financial return from investment. Is there any leeway for us there if we can show that the investment will bring money back into the Exchequer over time? It is a concern that we are only just keeping up with the depreciation of the national capital stock. I feel that my question has not really been answered in terms of assisting this committee in drafting its report and doing its job. One of the key issues we have discussed at length is capital investment and the need to stimulate the economy. In the context of current low interest rates, would we be foolish not to capitalise on that? I appreciate that Professor McHale may not be in a position to answer that.

Professor John McHale: I was trying to get at the issue. The rules are constraining at the moment in terms of the investment that we can undertake. What we have is an overall deficit target that includes both capital and current expenditure. I can see that with the backlog of investment projects - a lot of investment was postponed during the crisis - and the current low interest rate environment, one might ask why we are not undertaking those investments. There is a strong logic to that. However, if one is going to do it on-balance sheet in the general Government accounts, one faces these overall deficit targets. What I was trying to do was to recognise the power of the argument the Deputy is making, because there is much economic logic to it, but it would be a positive development to develop the rules to make more of a distinction between current and capital so one does not face these types of constraints. However, even after recognising that, the point I was making is that one must still look at the overall deficit. There are also other factors, including the fact that we have this very high debt and the demographic pressures. Ultimately, the deficit we are aiming at is still appropriate notwithstanding the correctness of the argument the Deputy is making, that there should be more of a distinction in the rules.

Deputy Lisa Chambers: That is a job for us to work on into the future at European level.

Professor John McHale: Yes.

Deputy Lisa Chambers: That brings me to my final question. There is a theme throughout Professor McHale's document. He says that the Government should take advantage of the current relatively strong growth in revenue to eliminate the remaining budget deficit and accelerate the reduction in debt ratio, and that it should take also advantage of the current strong growth in the economy to reduce the debt to safer levels. Earlier in the document, Professor McHale says that the council assesses that the Government's current plans for a €1 billion package in budget 2017, on top of the pre-committed expenditure increases for 2016 and 2017, is at the limit of the range of prudent policies. There appears to be a cautionary tone in that. The Central Bank told us last week that it proposes that we should go further than the 60% target and reduce it past that. Does Professor McHale agree with that assertion? Second, does he agree with the budget package we are putting in place? Are we going a little too far or would he be more cautious in his approach this year?

Professor John McHale: In terms of the debt target, that is somewhat down the road because it will take some time to bring the debt ratio down. It is useful to remember that in 2007 we had a debt-to-GDP ratio of 25%. That was not enough to avoid the crisis and we ended up losing our access to market borrowing, even though we went into the crisis with a very low debt-to-GDP ratio. However, it probably was essential to us avoiding default. We could have had a much more serious crisis if the State had been forced to default. One can see that even with a debt-to-GDP ratio of 25% to begin with one can still get into trouble. Currently, we estimate that if one makes an adjustment to GDP which we do based on revenue - we can get into the technical details of that if the Deputy wishes - the debt-to-GDP ratio last year we estimate at 97% of GDP. It is a very different situation from the one with which we went into the crisis. That is an unsafe debt level. We are not forecasting that a crisis is going to occur in the near term, but one can think of many things that could go wrong, ranging from a new crisis in the eurozone and the effects of Brexit being much more serious to a long list of risks to which one can point.

What we want to do is bring that debt ratio down in a phased way, and first down in the direction of 60% of GDP. It is worth noting that under the rules that currently exist, we have a medium-term budgetary objective to get the deficit, adjusted for cyclical factors, down to 0.5% of GDP. Once one goes below 60% of GDP one is allowed to run a deficit of 1% of GDP. If one kept at that and there was a nominal growth rate in the economy of 5%, one would eventually converge down to a debt-to-GDP ratio of just 20% of GDP, which is a little below what we had when we went into the crisis. Even under the current rules we are on a path to bring the debt down to much lower and safer levels. Whether it is necessary to have a supplementary target for the debt beyond that, as below 60% of GDP, it might be helpful, but already we are on a path, if we stick with the rules, to a debt-to-GDP ratio that would be in very safe territory. It is still a long way away to get there, but the important thing is that we bring it down in a phased way so that we reduce the risk the economy faces.

We note in the report that the size of the package is more than the €1 billion. There is €900 million of spending already committed for demographics, the Lansdowne Road agreement and some capital spending. There is also the €540 million that was announced for this year in June, so the overall package, taking together the new measures taken in 2016 and planned for 2017, is €2.4 billion. From an economic point of view, we still see that as a slightly contractionary stance. It is lower than what could be possible, given the underlying growth in the economy, but that is necessary, given that we are still in the process of bringing the deficit down towards the medium-term objective of 0.5% of GDP. We need to do that if we are going to have that further improvement in the deficit. Our view is that that is still a prudent policy in terms of what is being planned, but it is now at the limit. Our concern is that we basically said the same thing last year based on the planned use of the €1.5 billion of fiscal space, but the overall package turned out to be twice that, given the increases in spending announced through the Supplementary Estimates process. We would not like to see a repeat of that. That is why we are drawing attention to it. However, if the Government were to stick to that, we would see that as being consistent with a prudent policy and with the policy of bringing the deficit down and putting the debt on that phased path towards safer levels.

Deputy Lisa Chambers: That is a really important point that Professor McHale has just made - that we are at the upper limit of prudent policy, in his opinion, and that Supplementary Estimates throughout the year might bring us past a prudent position.

Deputy Michael McGrath: I thank Professor McHale and his colleagues. Picking up on Deputy Chambers's theme of the overall package and the €2.4 billion, of which €1 billion is the headline, as has been much discussed, his words are very carefully chosen, as they always are, when he talks about it being at the limit of the range of prudent policy. Is that another way of saying it is just about acceptable - that if it were anything beyond that, it would not be acceptable, but he would rather it be lower than, let us say, the €1 billion of new measures? It is that the thrust of what he is saying?

Professor John McHale: We would be happy to see it somewhat lower but - I do not want to make too many qualifications to my remarks - we do see it as a prudent policy. Our concern is that it might go beyond €2.4 billion. We do not see any scope for going in any way significantly beyond that without getting into territory where we would see it as not a prudent policy in terms of the overall objectives of the cyclical management and risk management of the economy in bringing the deficit and debt down.

Deputy Michael McGrath: I wish to ask Professor McHale about the issue of demographic pressures, about which he has written before. There seems to be a significant difference between the analysis of IFAC and that of the Departments of Finance and Public Expenditure and Reform as to the accurate estimates of what demographic pressures mean. Certainly, it seems to me that the pressures and demands are very strong. When one considers areas such as those about which Professor McHale spoke - for example, the number of pensioners, school places and home care supports for elderly people - the figure pencilled in for next year is €400 million. Is it still the view of the Fiscal Advisory Council that for next year and the next number of years the estimate provided by the Department is not sufficient to meet the actual demographic pressures?

Mr. Michael Tutty: I will take that question. Yes, we are trying to narrow the differences between us and the Department so that we can get a fix on what the real demographic pressures are, but our estimates are still somewhat ahead of the Department's. They are not way above them - there may be €100 million in the difference - but, as I said, I think we have worked out in the area of health what the pressures are and are pretty well in agreement on that. I think our difference would concern more the question of what to do about inflation in making forecasts than the demographics. The gap between us is bigger in that area. We feel that one cannot look into the medium term and say this is the amount of room we have for fiscal space, while ignoring the fact that inflation will take up quite a considerable part of that space. One does not have to talk about the indexation of social benefits or that sort of thing, but one must take account of the fact that there are inevitable pressures from inflation that will add to the costs of social welfare and other things over the medium term. If one assumes that will not happen, it is not a good basis for planning.

In the recent medium-term expenditure review published by the Department, there was an interesting sentence which seemed to say that it is moving in that direction to some extent. It refers to work being under way to develop a framework for modelling Government expenditure that goes beyond demographic drivers and that separately modelled the evaluation of volume and demand and price impacts. In terms of looking at the price impacts on public expenditure, the Department states that is what it is now doing. That is exactly what we want the Department to do so that can be taken into account in setting the medium-term forecasts.

Deputy Michael McGrath: I refer to the overall envelope of fiscal space estimated by the Department between now and 2021 of €11.3 billion net. How much of that does the council estimate is accounted for through the fact that indexation is not built into the system and not accounting for inflation?

Mr. Michael Tutty: Our estimate is that if inflation was fully taken into account it would add €4.1 billion to the expenditure projections. As I said, that does not have to take place. If, however, one is going to take measures to avoid the effects of inflation through achieving greater efficiencies or not increasing benefits in line with inflation, one has to take action to avoid that. If those actions are not taken, €4.1 billion is our estimate of what inflation will add to the costs-----

Deputy Michael McGrath: That would reduce the overall fiscal space to approximately €7.2 billion between now and 2021. There is some divergence - but much less - on the demographic side. Will that amount to a few hundred million euro between now and 2021? Mr. Tutty referred to a figure of €100 million for next year.

Mr. Michael Tutty: The figure is approximately €600 million in total.

Deputy Michael McGrath: That brings the figure down to about €6.5 billion, from €11.3 billion.

I have some final questions. There has been some weakness in Exchequer returns. VAT and income tax receipts are now running behind profile - I understand VAT receipts are in the region of €270 million, or €280 million behind profile. Is that a cause for concern or is it too early to say? How is that accounted for? Are there any reasons why it is happening?

Mr. Seamus Coffey: We have been looking at that and analysing the patterns in the Exchequer returns. In terms of the relative weaknesses in the profiles, if we compare the figures year on year, most receipts are still showing significant growth. Clearly, the projection was that the growth in tax revenues would be greater, particularly in the case of VAT, which is currently approximately €250 million behind profile. That will have an impact on the budget outcomes in terms of the projected deficits, etc.

In terms of weakness, given the extent thus far, we would not say that revenues, in overall terms, will come in below profile. Although some tax heads are showing below profile receipts for the past couple of months, others are above profile.

There may be timing issues in regard to excise duty. There are suggestions that when plain packaging was introduced many packaged cigarettes were purchased which led to an increase in excise duties in the early part of the year. That money will not be collected in the later part of the year. Corporation tax receipts remain significantly above profile. In overall terms, we do not see weakness.

For those areas that are showing certain weaknesses, such as VAT or income tax being below profile, at this stage it is still too early to say whether that is a result of timing effects that could be washed out before the year is over. It does not seem to be reflective of an underlying weakness in the economy. We still have employment and expenditure growth. It is something on which we will keep an eye, but at this stage we would not say that there is weakness there.

Deputy Michael McGrath: I have a final question. The council referred to reducing debt levels to safer levels. Does it mean achieving that through GDP growth in a meaningful way and underlining GDP growth so that the debt to GDP ratio is falling or is it suggesting that nominal debt be paid down if and when resources become available?

Professor John McHale: Under the rules, the plan is to get close to a balanced budget with a small deficit. That means the heavy lifting in terms of reducing the debt ratio would be done through growth. If there are any signs that the economy is overheating, there might be a case to go a bit beyond that deficit target and run small surpluses. It is only when one runs surpluses that one brings down nominal debt. That may be appropriate in the years ahead. If we follow the fiscal rules, growth will do the heavy lifting in bringing down the debt to GDP ratio.

Deputy Pearse Doherty: I want to pick up on an issue we touched on a number of times when the council appeared before the committee on previous occasions, namely, the difference between it and the Department of Finance. Mr. Tutty answered some of the questions. I want to go deeper into the figures he provided. He mentioned that €4.1 billion is what the council believes would need to be factored into the fiscal space to deal with inflationary pressures. Can Professor McHale inform the committee whether inflationary pressures on social welfare and pension payments and public service wages are included as part of the analysis, along with the inflationary pressures in regard to the non-wage elements of our expenditure on health and other areas? Is the council able to strip away those two components?

Professor John McHale: We have quite a disaggregated breakdown. It includes all of the price and wage pressures Deputy Doherty mentioned, except for the Lansdowne Road agreement which is already figured into the Government's figures. We have a full allowance for the price pressures that exist, and we do that for the various sub-components of expenditure.

Deputy Pearse Doherty: I asked previously for that information to be provided to the committee. The council has made these points in the media and elsewhere. It would be helpful to members of this committee to have a breakdown of the components. We will hear from the Government that it is a Government decision to increase public sector wages or pension payments for senior citizens but some elements are unavoidable such as the pressures on our health and education systems and the non-pay components that will increase. If we were able to identify those areas from the point of view of the council, it would be helpful for us in terms of teasing out those issues. I ask the council to furnish us with whatever information it has.

Professor John McHale: We can provide that to the committee. It has been a work in progress. A major amount of work goes into developing these estimates and we have been a little bit slow to release the detailed breakdown until we felt we could stand over all of the detail.

While it will always be a work in progress, we are happy to release the relevant information to the committee.

Deputy Pearse Doherty: I thank Professor McHale; that will be very helpful. I understand that there has to be a point in time when the council knows the data is robust.

We are in a bit of a mess. The council has been helpful in developing a new way of measuring our debt-to-GDP ratio but it does not mean anything apart from it being the way the council has now decided to calculate the ratio. It has no international standing and nobody else recognises the manner in which the council is calculating the ratio. Its task is to ensure that we comply with the fiscal rules but they do not mean anything unless one wants to believe that we reduced our debt-to-GDP ratio by 27% last year. That is what we are measuring the fiscal rules against and that is why we have been labelled with the term "leprechaun economics". How will we sort this out?

The council's job is to ensure that we are complying with rules that are meaningless because they are measured against GDP. Despite its best efforts to come up with a new way of calculating it, the European Commission does not measure our debt-to-GDP levels based on taxation revenue. Rather, it will measure it against GDP. What is the long-term solution for this, or is there a solution for it?

Professor John McHale: The first thing we need to do is understand what is happening in the Irish economy and where it stands. Putting aside any issues of international comparisons, we need to know what the situation is here. Between 2014 and 2015, by the measured numbers the ratio fell from 105% of GDP to 78% of GDP. This massively exaggerated the improvement and underestimated the extent of the debt we have. The first thing to do is get a better understanding of how things are changing over time, and the level of debt relative to the output of the economy. When we look at the debt-to-GDP ratio we are trying to compare the debt to the revenue potential of the economy, and GDP could be taken as a measure of the revenue the economy could generate. Given that GDP is problematic and inflates the true measure of activity in the economy, we go directly to examining the debt-to-revenue ratio. This is an unfamiliar number, so we scale it to make it comparable to the type of debt-to-GDP numbers with which people are familiar. There we take advantage of the fact that the revenue-to-GDP ratio was constant between 2011 and 2014, at approximately one third. We rescale revenue using the ratio for 2014 and this gives us a way to see the true improvement. By this measure, rather than going from 105% to 78%, it goes from 105% to 97%, with further improvements taking place this year. This shows there is improvement, but it is nothing as dramatic as we see with the headline numbers. It underlines the fact it is still very high and unsafe. Again, we are not forecasting a crisis, but with a debt ratio this high there is always a risk that something can go wrong. It underlines the need to continue the progress to decrease it.

Deputy Pearse Doherty: I hear that, and it is welcome the Irish Fiscal Advisory Council has come up with a new measurement for debt to GDP. It tells politicians and others to stop fooling themselves if they believe debt is decreasing to sustainable levels and that they should not swallow their own propaganda and state the country is doing well, because debt did not fall but increased in recent times. However, measured against GDP, it seems to have taken a dramatic drop.

My party's position was not to support the rules in the first place. Some of those who argued for them are now arguing that we should be able to spend capital, which we cannot because of the rules, and they wonder whether there is a way around them. We have gone through this in recent years. The problem is that we have binding rules that involve measuring against a factor that nobody in the room believes is credible, unless any of the witnesses want to state they do. We have rules that lack credibility. One may believe the idea behind the rules was prudent, but we have a serious problem with the measurement against GDP. Is this a problem that other European countries face or is it unique to Ireland?

Professor John McHale: The revisions to GDP which occurred here are unique to us. Other countries have measurement issues associated with the rules, particularly measurement of the structural balance which depends on estimates of the output gap and the potential output growth of the economy. Everybody is struggling with these issues. Deputy Doherty has raised a very important point, which perhaps has not received enough attention. With regard to applying the fiscal rules, much of the focus has been on coming up with alternative measures to GDP, but from the point of view of the rules what really matters is how the estimates of the potential output of the economy, and therefore the output gap, will change as a result of the revisions. Our view is that these revisions took place, but we do not see any additional evidence that the economy is overheating or underheating relative to what we thought it was before, so, at least to a first approximation, there really should not be any change in the measurement of the output gap as a result of these revisions. It would be very important, in terms of what the Department of Finance and the European Commission do, that whatever new estimates are made for potential output, and therefore the output gap that feeds into the rules, particularly through the measurement of the structural balance, do not change significantly, because that could really distort the application of the rules.

Deputy Pearse Doherty: That is very helpful. Professor McHale is showing his teeth less as time goes on. I am not sure whether it is about being longer in the position. I will come to this in a minute. The report, which is almost 30 pages long, has no reference bar a footnote to the improvement in the structural balance. The Irish Fiscal Advisory Council got into hot water regarding a "Morning Ireland" interview whereby the Commission had not informed it that the structural balance target for 2016 was 0.6%. Will we achieve this 0.6%? Is clear from the earlier documentation the Department put in the public domain that we will not achieve it. When I asked the Minister, Deputy Noonan, about this earlier he spoke about the two complementary pillars, which are the expenditure benchmark, referred to over and over in the report, and the improvement in the structural balance. He stated that the Irish Fiscal Advisory Council's view was that the over-performance of tax revenue in 2016 would secure compliance with this rule. Is the view of the Irish Fiscal Advisory Council that we will comply with the structural balance rule?

Professor John McHale: This partly back goes back to the answer to the previous question. Measurement of the structural balance is so up in the air as a result of the revisions to GDP that the issues are massively bigger than speaking about 0.4%, 0.5% or 0.6%. There is no point in speaking about meeting the structural balance target until we know what the revisions to the output gap are. We will get this information as part of the endorsement process, as one of our functions is to endorse the macroeconomic forecasts underlying the budget, and the committee will get this information shortly after we do. It will be very important to look at how these revisions have changed these measures of the output gap and therefore, by implication, the improvement in the structural balance.

Deputy Pearse Doherty: Before the revision of our GDP took place, the Department estimated in its spring statement that we would not achieve the structural improvement of 0.6% required. It suggested an improvement of 0.4%. In Professor McHale's view, given the revision of our GDP figures, is this likely to make the situation worse? My understanding is-----

Professor John McHale: We do not know-----

Deputy Pearse Doherty: My understanding is that what is now being sought is Commission approval to suggest this was a once-off, which would allow it to ignore the rule this year. Given that it is a pillar of the fiscal rules, which is the Irish Fiscal Advisory Council's primary job, I am surprised there is no reference to it in the report.

Professor John McHale: The Deputy's criticism is valid regarding our previous report. It would not have made sense to speak about it in this report, given the revisions. In the summer economic statement the projected improvement in the structural balance for this year was 0.5%. It was required to be 0.6%. It is possibly something we should be screaming about, if we thought even 0.5% was optimistic. However, we looked very closely at the revenue forecasts and thought they were on the conservative side. We saw it as quite likely that revenue would come in higher than projected at that point. If there was something about which we were concerned, we still have sharp teeth and are willing to use them but at the same time, there is no point in picking battles about a minor issue.

There is an area on which I would agree with the Deputy. It concerned us that the Government still set out targets that were not meeting the rules. It was a very small issue, and we did not make a big deal of it, but we believed it thought it would make it because it probably knew that its own revenue forecasts were quite conservative. We would like to see forecasts set out that at least show that the plan is to meet the rules.

Deputy Pearse Doherty: I will make two final points. Professor McHale said that the budgetary package is still prudent at the limits, despite the fact that in the period since he last spoke about this here, the Government decided to spend another €0.5 billion. I am not criticising it for doing that. It got lucky in terms of an AIB transaction that it tried to fight the Commission on and lost, and it was able to spend additional money. However, if it spent €1 billion, would Professor McHale still be calling it prudent policy? We had the same scenario last year where it was still considered prudent policy despite the fact that it spent over €1 billion. Professor McHale was advising that the Government would not go beyond what it was saying after the spring economic statement. It went beyond that and it was still considered prudent policy. I have disagreed with some of the analysis. Professor McHale is constrained in what he has to apply himself to in terms of the rules but I value a strong opinion, whether I think it is right or wrong.

Professor John McHale: The Deputy is being a little unfair to us on that. Last year, we came out and said in our pre-budget statement that the Government's plan for a package of €1.5 billion was appropriate and prudent policy. The actual package was twice that. We would not usually come out directly after a budget. We like to come out when we produce the reports but that was such a deviation from what we had said was prudent and what we expected. I did an interview the morning after the budget and stated clearly that we saw this as a deviation from prudent policy. Where we see those deviations, we are not afraid to express those opinions strongly. We got quite a lot of flak for coming out on it but we felt it was necessary. We had said something was appropriate, which was based on what the Government said it was planning to do, and then something very different happened. We will be willing to draw attention wherever we believe there are deviations from what we see as the appropriate course.

Deputy Pearse Doherty: The point is that all of that €1.5 billion, on which Professor

McHale came out on radio the week after and stated that it was beyond what he believed was appropriate, has gone into the expenditure base for this year, along with the other €500 million, and he still believes that is prudent policy. Either the view was incorrect at that time or he should be arguing that we should not be spending as much because the Government spent another €1.5 billion last year, which is now in the expenditure base for budget 2017.

Professor John McHale: That is a fair point. We look at matters cumulatively but one of our functions is to look at the fiscal stance, which is defined in the Fiscal Responsibility Act, in terms of a change in the structural primary balance. It is done on a year to year basis. When we assess the fiscal stance, we are looking at what has been done in the particular year, taking into account the cumulative effects but trying to provide an assessment budget by budget.

Deputy Pearse Doherty: My last question is on this budget. The language Professor McHale used in his report was interesting in terms of not relying on corporation tax, which may be volatile, and the fact that 41% of corporation tax is paid by ten companies, a statistic I have raised time and again. He also makes the point that it should not be used in the expenditure that is not easily reversed. I presume that is code for saying that the Government should be investing in capital infrastructure. Despite the restrictions in the fiscal rules, we have €1 billion that we can decide to spend in whatever way we want. We can put it into current expenditure, cut taxes for individuals or invest in capital. Is it correct that the Irish Fiscal Advisory Council is stating that capital investment is the most appropriate use of some of the fiscal space in this year's budget, as opposed to permanent increases or decreases, which it stated would be costly to reverse?

Professor John McHale: It would be reading too much into what we are stating there. We are making a general statement that once one increases spending, even the level of capital spending, it can be hard to bring that annual capital spend down as well. I take the Deputy's point that it is easier to reverse than make an increase in current spending into the health or education sectors. Tax cuts are also difficult to reverse. There is no hidden statement that we were making a case for capital spending.

Deputy Pearse Doherty: What is the council saying then? This is the problem with some of these documents. I can read into this that the council is saying it is not prudent to abolish the universal social charge, USC, or start the process because it has made the point about surplus corporation taxes in the hands of a small number of corporations. Someone else or other parties who want to abolish or partially abolish the USC will take a completely different reading because the language is couched in a way that does not want to interfere with the political debate as to what should happen. If the Government was to use all its fiscal space to cut taxes, would the fiscal advisory council still say it was nothing to do with it? Is there a point where it will give us more indication as to what it believes is prudent? There is a language there that is coded and satisfies everyone in the room.

Professor John McHale: We do have to stick to our mandate. Depending on what we say, if we deviate and start saying things about particular taxes or spending, then whoever disagrees with that position would come down very heavy on us claiming we were not following our mandate.

For instance, one aspect of our mandate is that we assess the budgetary forecasts. In assessing them, one of the factors we take into account is the kind of underlying spending pressures, including the price related pressures to which Mr. Michael Tutty referred. One of the messages we are giving, which I hope is not coded in any way, is that in making plans for tax cuts, there is a need to recognise that these spending pressures are there and to recognise the amount of fiscal space. There are choices to be made. Some may not be continued or inflation may not be kept up with fully for benefits. These are political choices. At least there is a recognition before commitments are made that these pressures will use up much fiscal space and that that space may not turn out to be there if there is a desire to maintain the existing level of services and benefits. That comes in under our mandate but we have to be careful about being specific about particular types of taxes and spending.

Deputy Pearse Doherty: I agree.

Chairman: Thank you, Deputy. I call Deputy David Cullinane.

Deputy David Cullinane: I welcome our witnesses. On the measurement of economic activity and gross domestic product, GDP, as the previous speaker said we are in a bit of a mess in that regard. The Central Statistics Office is speaking about using two sets of figures. I do not believe there is anything wrong with giving us the genuine debt and the real economic activity figures. It is not legal, however. EUROSTAT accepts certain measurements can be used, meaning we can have different sets of figures. How helpful are these, however? Last week, the chief economist from the Central Bank told the committee about a uniquely Irish bespoke set of economic indicators which would strip out aircraft leasing and intangibles and that would be the way to measure GDP. We can then go to Europe and elsewhere to sell this as a new way of measurement. How realistic is that, particularly given the headline figures that went around the world as a consequence of the distorted figures? It seems that we are blaming the fire alarm for the fire rather than addressing the fire in the first place. Part of the explanation is that we have a restructuring of company assets and we had capital flows as a consequence of the ending of the double Irish, which is to be phased out by 2020. Will that continue for the next number of years? Will we see more restructuring and capital flows and will this further distort the figures? This is a real problem for us because that is how we measure and apply the fiscal rules such as debt to GDP so we need to have a real hard look at it. We can come up with all sorts of different figures. The Irish Fiscal Advisory Council can have its figures, the CSO can have a different set of figures and the Central Bank can have its view but I am concerned about, and we should be concerned about, how they are interpreted in Europe and internationally and how they apply to the actual fiscal rules and the budgetary process. What is the witnesses' response to how we deal with that mess?

Mr. Seamus Coffey: There is no doubt that the revised national accounts were completely unexpected and the impact of some of these changes was not expected. In respect of how we react to that, the CSO says that there is an ongoing process to look at this and what the solution might be. I do not think we will end up with a situation with a bespoke Irish measure of national income. In respect of the process of coming up with methods of national accounting, by international standards, it takes years to come up with these approaches. The manuals run, not to hundreds of pages, but thousands. I do not think the best response we could come up would be an Irish solution to an Irish problem. The Central Bank has tried to strip out some of the things with its measure of domestic demand, which is a measure we also use. It involves stripping out the effective intangibles and aircraft leasing. It is not perfect but it does provide what might be called a measure of underlying growth relating to the impact if we can ignore these effects.

In respect of the 2015 figures, it is expected that it is a level shift so, primarily, it should happen once and one should return to more normal growth rates, whatever they might be in the Irish case. It is not really expected that something of this scale will happen again. The Deputy mentioned the impact of company restructurings and the abolition of the double Irish but, as he said, that is not happening until 2020 so it is not clear that companies would respond now to something that would not really have an impact until 2020 or 2021. There are various other distortions relating to US companies and their views on inversions where they wish to escape their US incorporation and merge with a smaller foreign entity. Many of them are choosing Irish companies to merge with and the US has moved to try to restrict that, but we are still not sure whether that will fully affect it. It did stop one major pharmaceutical company from inverting with an Irish company that itself had become Irish as a result of an inversion. I do not think we expect to see something of this nature happening again but we simply do not know.

We will have the 2015 figure that will show a massive jump - a big step effect - and from then on, we should return to more normal levels of growth but given the state of the Irish figures, that is quite hard to say. In terms of how we react and how they feed into the fiscal arithmetic, 2015 will remain an issue and as has been mentioned previously, steps are in play to smooth it out involving looking at happened in 2014 and what one expect to happen in 2016 and possibly taking a step in 2015 rather than including it. I do not think the CSO will say that this is a new denominator that we should use for fiscal rules. These rules are in legislation. They must have international comparability.

Our view concerns what the improvement is, particularly given the adjusted debt ratio. We are not saying that the debt ratio is 97% of GDP. We are saying that if we take it as being 105% in 2014 and one makes an adjustment for how much revenue the Government is bringing in, adjusted measure would be that it improved by eight percentage points so it is improving. It is not a measure that other countries use so one cannot ask what it is in terms of France or Germany but I get the point that our debt remains high.

In terms of the EUROSTAT figures, there was an increase in output in Ireland. We are not disputing that the figures are wrong but the key issue is who are the beneficiaries of that output. Given the huge role of multinationals in the Irish economy, if they have significant profits, we are getting perhaps a corporation tax cut of that, but if those profits go to foreign shareholders, they are not improving the Government's ability to service its debt. That is the key message we are trying to get across.

Deputy David Cullinane: My final question is in two parts. I will return to the sustainability of our tax base and the relationship between that and the budget. From responses to the previous question, I understand the IFAC's mandate and the limitations it has. The witnesses do not want to get into specifics but they mention the sustainability of the corporation tax rates and revenues from corporation taxes. We had a spike this year and last year in that. Are the witnesses concerned about the sustainability of those figures?

Regardless of what tax it might be, if we were to phase out or abolish taxes that are billions of euro, it is of a huge scale. There must be some opinion on that and on making budgetary decisions that are based on corporation tax rates where there was a spike and on the basis of eventually phasing out taxes or eroding the tax base to the extent that might happen over the next number of years. What are the witnesses' views on that?

It is very interesting to hear some of the voices that shouted loudest in support of the fiscal rules now looking for flexibility and talking about the rules being a strait jacket. IBEC is one of those. It is welcome that we are trying to get more investment in terms of capital investment but IBEC talks about taking the fight to Brussels to allow the investment strait jacket to be loosened. It then makes an argument that we should only pay down the interest on our debt and not on the capital. It was a unique and novel suggestion from IBEC. How tenable is it?

While the witnesses are limited to discussing capital investments, IFAC published a very significant document, which I have here, on capital investments in which it talks about very depressed levels of capital investment. The European Commission is on side. IBEC, trade unions and almost all the groups that have come in have said that we have had a capital investment strike and we need to invest more. Rather than asking how much, I am more interested in what areas the witnesses believe we need to increase capital investment.

Mr. Seamus Coffey: I will take the first question on the sustainability of corporation tax. One issue is that it jumped up so quickly. We are not predicting that it will fall but if it can rise so quickly, there clearly is the potential for it to fall again. We have assessed the volatility and predictions and forecasting of various tax heads. Corporation tax is the one that shows one of the highest levels of volatility and has the greatest difficulty in forecasting it. The revenue is coming in, and coming in quite strongly. If one considers what happened last year with supplementary spending, if that is being done on the basis of corporation tax receipts that are volatile, one can put in those changes in spending but can one be sure the funds will be there in the future? There is nothing there to say there is a major downturn in corporation tax receipts likely but caution should be practised when looking at it, particularly as to how concentrated it has been as was mentioned. Ireland does not appear to be unique. It is something we have looked at. Other countries seem to have a reasonably similar concentration of corporation tax but they do not seem to have the volatility in the receipts. It seems to be an issue we should take greater care of. It is highly volatile and the sustainability issue is because this year we are seeing it rise, yet next year it could fall. Should we be basing spending, as one would expect to do on a weekly, monthly, and annual basis, on something that is as volatile as that?

Mr. Michael Tutty: On investment, we talked earlier about the fiscal rules and investment and the fact there is a clamour in many countries at the moment to say, particularly with interest rates so low, that we should be investing more and not be limited by the fiscal rules. There is some flexibility there in the fiscal rules on investment. It is very limited and it applies only where one is making a major investment that is equivalent to a structural reform, namely, reforming an area through capital investment and it will bring returns to the Government over the future years. It is very limited; it only applies to 0.5% of GDP on a once-off basis so it is not really relevant. The real difficulty in trying to exclude investment is that there are many items that are regarded as investment which may not be bringing much of a return and then other things that are classified as current expenditure, for example, in the education area, that really do have a return. Trying to do it on a general basis and defining what should and should not be allowed in would always be a difficult matter. In my days in the Department of Finance many years ago, there was always a difficulty of trying to look at the rate of return on investment. John FitzGerald and the ESRI were doing a lot of work in this area for us on Structural Funds and trying to identify rates of return etc., so it is possible. One would get back to what John McHale was saying earlier that even if one looks for some flexibility, one would still have to look at the overall deficit in the country and determine whether that level of deficit was appropriate. It may be appropriate to do a little bit more on investment and increase the deficit but one certainly could not say that any amount of investment, no matter how much or what it is being spent on, should be added to the existing deficit. We are required and need to get our deficit down. Once we have achieved balance or close to balance, we will have much more flexibility for investment and other things.

Deputy Stephen S. Donnelly: I thank all the witnesses for their time today. I will start with one observation. The macro numbers are all over the place. It would be very useful to have a comparative analysis with *per capita* as the denominator. We use GDP, GNP or hybrids or whatever it is, but *per capita* or purchasing power parity, PPP, adjusted *per capita*, where that is more appropriate, would be very useful because our public debt levels are much scarier than the graphs that are being used show. There is a level of public investment and infrastructure investment. We have graphs here from some advisers to the committee which show it is one of the lowest in the OECD but that is using GDP as a denominator. When *per capita* is used as the denominator, I imagine it is even worse. My sense is that we are more of an outlier than the figures show. That is just an observation. It would be very useful to have that. It would show, in a comparative sense, that we are further outliers in a range of things including public debt and investment in public capital. We are further from the centre than we think. That is just an observation.

Professor McHale makes a very good point in his statement where he says the proposed expansion between 2016 and 2017 is not €1 billion. It is not the fiscal space of €1 billion we are talking about; it is actually €2.4 billion. It is the €1 billion we are talking about in the fiscal space, the €500 million we voted through for health in about an hour before the summer recess without any proper analysis whatsoever and another €900 million which was previously announced for 2017. Will Professor McHale explain to the committee what the big ticket items in the €900 million are?

Professor John McHale: Dr. Thomas Conefrey has some *per capita* data with him anticipating that the committee might ask for some alternative indicators so he will talk about that. He might as well take the other question on the €900 million.

Dr. Thomas Conefrey: On the *per capita* items first, we looked previously at debt *per capita* and it may be a ratio we use in the next report depending on whether we have new or improved macro data at that point. Some of the macro indicators that we looked at in the report were underlying domestic demand, excluding planes and intangibles, and consumption and net national income. In terms of the latter two, consumption *per capita* and net national income *per capita*, it is interesting that if one looks at those measures in real terms, the level of consumption per head and the level of net national income per head are both still slightly below their 2007 peak as of 2015. That is obviously showing a different picture from what one gets using GDP or GNP based on the revised data. It is certainly something that is useful. In terms of an international comparison-----

Deputy Stephen S. Donnelly: Can I just go back on the point Dr. Conefrey has just made? Is our per person consumption now or for whenever the latest data are available - 2015 - more or less what it was at the peak of the bubble?

Dr. Thomas Conefrey: It is still slightly below that.

Deputy Stephen S. Donnelly: It is in the region. Is the point Dr. Conefrey is making that it is quite close?

Dr. Thomas Conefrey: It is still below. There is still some ground to be made up whereas if one looked at GDP or GNP, they would suggest we regained our 2007 peak a year or 18 months ago.

Deputy Stephen S. Donnelly: I thank Dr. Conefrey.

Dr. Thomas Conefrey: On the composition of the €900 million, it is mainly the pre-commitments for the Lansdowne Road agreement. It is €400 million for demographics, about €300 million for the Lansdowne Road agreement and €200 million of pre-committed capital spending.

Deputy Stephen S. Donnelly: My next question is on the quantum. I know Professor McHale does not want to be pulled into policy issues such as whether we do things with USC. On the total quantum of revenue coming in, the comparative data I have seen suggests that if we just put aside PAYE versus whatever the basket of taxes are, by OECD levels we are a low-tax economy. We are materially below the average in terms of OECD levels if one uses it as percentage of GNP, GDP, or *per capita*. Without prejudice to what one would do with individual taxes, is it the case that if we look at Ireland's total quantum - the stuff we can bank on - and strip out the nonsense stuff that is due to foreign companies relocating their intellectual property, IP, here, is it the council's view that we are materially below the OECD average? Does Professor McHale believe it is prudent to erode the tax base in the upcoming budget, either through USC, PAYE, knowledge boxes or whatever it is? Does he believe that some of the €1 billion should be used for tax cuts or would he prefer to see the quantum left alone even if there were switches between different tax takes?

Professor John McHale: On the Deputy's first question, Mr. Seamus Coffey has done a lot of work on these international comparisons so I think he is best positioned to answer the question, if that is okay.

Mr. Seamus Coffey: I will take the first question. The Deputy is correct that if one can make an international comparison, although there are massive difficulties in terms of getting a common denominator to compare across countries, Government revenue in Ireland is substantially below the OECD average. The question becomes why Government revenue is below the OECD average. In the main it comes down to social insurance contributions. If one looks at income tax, sales taxes like VAT, corporation tax, which is now above the OECD average, and other taxes, we are close to the average for most of them. There might be differences in how we collect the money. With income tax, we are close to the OECD average for the amount of money collected but we collect it in a much different manner from other countries.

The big issue with social insurance is how we run our pension system. We are a much lower Government revenue raising country than other OECD countries but equally we are a much lower Government spending country, particularly on pensions. We tend to have a flat-rate pension system where one makes contributions and benefits are flat-rated based on the number and length of contributions, whereas in most other countries they have contribution-based systems where a person who puts in more money gets more money back. Our system is much more redistributive. Those on higher earnings make much greater contributions and those on lower incomes make a smaller contribution but everybody gets the same pension. One of the key drivers of the difference, which is quite substantial, is down to social insurance and how we run our pension system. There is ongoing debate in Ireland about how we should change it. If it were to change, it may end up with people actually giving more money to the Government, but equally then they just get it back. It would be a form of a long-term saving scheme. We do not have substantially less revenue for providing Government services in health and education.

Deputy Stephen S. Donnelly: If the pension contributions and benefits a person gets are stripped out, in comparison with other OECD countries Mr. Coffey is saying we are-----

Mr. Seamus Coffey: We are pretty much close to the average.

Deputy Stephen S. Donnelly: Okay, close to the average.

Mr. Seamus Coffey: Almost all of the difference would be about right. That is because of the scale of the difference involved. Consider France, which spends 14% of its GDP annually on public pensions. That is a huge sum of money washing through their government system. Whereas in Ireland, even if one takes the pre-revision figures, we spend 4%. If Ireland moved to the French pension system, it would involve spending 10% of GDP and would lead to €20 billion extra per just going through that one system, namely, our pensions system. France has a completely different pension system to Ireland. Almost all of the French pensions run through the state. While we are lower in government revenue, it is primarily driven by the fact that we have very low social insurance contributions and we do not have the benefits to match. When one makes the comparison, that is the big one that jumps out.

Deputy Stephen S. Donnelly: I thank the Mr. Coffey for that. On a related question, does the council have a view, regardless of what the fiscal space is, on whether the tax base should be eroded in the upcoming budget and future budgets?

Professor John McHale: I am afraid I am going to have to frustrate the Deputy on that one. It would not be appropriate for us to start making recommendations on the actual composition of the budget. I will, however, use it to make a more general point. One of the things-----

Deputy Stephen S. Donnelly: May I come back in on that? If the witness is not going to have an opinion on the matter, then obviously the committee cannot force him to. For what it is worth, I disagree with his view. I understand that he needs to be safe in his responses. Perhaps "safe" is not the word but I understand the council has many stakeholders and that the witness is treading a fine line. However, part of the Professor McHale's job, as I understand it, is to advise on prudent fiscal management of the State. I certainly believe that a view on whether the tax base - the revenue base for next year and future years - should be maintained, eroded or increased would fall very comfortably within fiscal advice to Parliament and the Executive.

Professor John McHale: The council reads the legislation more narrowly than that because we are asked to talk about the prudence of the fiscal stance, which is really around the overall size of the deficit. It does get to the more general point that I want to make. It is very important to the Irish Fiscal Advisory Council that it is not seen as partisan or ideological. Fiscal responsibility is not a partisan or ideological issue. The more one believes in government, the more one should believe in fiscal responsibility. There is the idea that fiscal hawks also want to shrink government but that is not what we are about. If we start getting into a situation where we are recommending tax cuts over spending changes, we are immediately into that political space, whichever way we go. It would undermine the council's ability to do the things where it can add the most value which is to really be a voice for fiscal responsibility. Hopefully, that is something all parties can share. There is a big advantage, given its particular mandate, to the council refraining from getting into a space that goes beyond its remit and the role that people want it to play.

Deputy Stephen S. Donnelly: To be continued. I have two final, technical questions. The fiscal space available is narrowed because the convergence margin is being applied. It is being applied because the Commission believes that the economy is overheating. It is my understanding that the council believes it is neither overheating and that we are more or less there. Would it be the professor's view that the convergence margin should not be applied, which would increase the fiscal space a certain amount?

Professor John McHale: The convergence margin is applied when the medium-term objective has not been met. The convergence margin applies to the expenditure benchmark and reduces the allowable rate of expenditure growth. The structural balance must be reducing by 0.6% of GDP until the medium-term objective is hit. Then that adjustment path condition and the convergence margin no longer apply. It is true that if the Commission did not see Ireland as currently running a positive output gap, we would be closer to that medium-term objective but we would still not be at it. Dr. Conefrey would have a better sense of the numbers. We would still be adjusting, but we would get there somewhat sooner. As the Deputy has pointed out, the Commission's methodology indicates there is a positive outward gap. Looking at the economy and various measures of overheating and alternative measures of the output gap, the council does not see signs of the economy overheating at present. However, we are probably getting close to a potential zero output gap. In answer to Deputy Donnelly's question, we would still be on the adjustment path even if the adjustments for the output gap were made.

Deputy Stephen S. Donnelly: I thank the Professor. I have a final question. On page four of the council's pre-budget submission, capital stock shows a huge spike for 2015. It references the fact that this is down to a small number of corporates, but because of confidentiality we cannot talk about them. I was taken by, and agreed with, Dr. Conefrey's analysis. When one runs the numbers, it is hard not to conclude that the corporate is Apple. It is Apple, not being able to pay tax anywhere anymore, re-domiciling its IP or whatever and its non-domiciled headquarters here. It is not really to do with inversions and it is not much to do with aircraft leasing. The major part of this 2015 massive jump in GDP and capital stock is basically Apple. Is that the view of the council? Can the witnesses comment on that?

Mr. Seamus Coffey: We do not have the information to assess the number of companies involved or whether it is a particular company. There is no doubt that the scale of the increase in the capital stock is huge and there are not many companies, even if one were to add them together, that would give that size of growth. Our capital stock grew by €300 billion and we know that most of that was intangible because Ireland simply does not have €300 billion of factories, roads or houses. It had to be a huge increase of intangible assets. Even if one considers other large sectors in Ireland, for example, the pharmaceutical industry with its intangible assets such as patents, one would have to go across quite a large number of companies moving a large amount of assets to Ireland in a very co-ordinated fashion at a particular point in time for it to have that impact. It does clearly point to a small number of companies. I am not sure how small is that number and we cannot be certain whether it is one particular company. It does, however, point to a very big shift of assets to Ireland.

Deputy Stephen S. Donnelly: I thank Mr. Coffey.

Deputy Richard Boyd Barrett: I thank the Irish Fiscal Advisory Council representatives. Anybody looking at this committee would be somewhat baffled by some of the discussion. Would it be a fair summary of the witnesses' comments, particularly in light of the EU ruling on Apple - I certainly agree with them - that the tax dodging activities of multinationals have now significantly distorted the real picture of the Irish economy to the point that the well-being of the economy is exaggerated significantly and that if we were to strip out all of that, the economic position would be far less rosy? Would it also be fair to say that it is imprudent, to use the witnesses' word, to rely on this stuff for any expenditure plans the Government may have? The council is saying that in so far as the Government has expenditure plans, they are on the outer limit of leaning on what may be a very unreliable source of income. I get that, but perhaps the witnesses could confirm that is what they are saying. Is it fair to say that, against that background, there would be nothing imprudent at all about spending the €13 billion that the EU believes is money in the bank already, money Ireland should have received in tax? It is not about the volatility of future corporate tax receipts linked to the tax dodging activities of a small group of multinationals. The money they have said is owed is money in the bank so it would be perfectly prudent to spend that money. I speak in fiscal terms and with a view to maintaining a sensible fiscal stance.

Mr. Michael Tutty: We will not start by talking about tax dodging on the part of multinationals but the operations of multinationals here have distorted-----

Deputy Richard Boyd Barrett: What does Mr. Tutty believe constitutes tax dodging?

Mr. Michael Tutty: The Deputy may use those words but we would not. The operations of multinationals have certainly distorted the economic statistics and that is why we are looking at the underlying position. We want to see what is happening in the real economy as opposed to the multinational end. There has been a jump in corporation tax revenues and we would like to see that continue into the future before we rely on them as a firm basis for further expenditures or tax reliefs. If the Apple money were firmly in the Exchequer as receipts, then we could depend on the Government to spend it but whether it should all be spent in one year would depend on the economic situation at the time and an assessment of the dangers of overheating the economy. In reality, though, those moneys are not yet ours and it will take a number of years before they will come to us. The question of how or whether we spend them is not a question for this budget.

Deputy Richard Boyd Barrett: I take that point but we spoke about prudence. If the EU ruling stands and the money was money that was owed to us, there would be nothing imprudent in our spending the money. It is money we should have had all along. Is that not the fact?

Mr. Michael Tutty: Yes. However, whether one spends it all at once-----

Deputy Richard Boyd Barrett: I did not say we had to spend it all in one go.

Mr. Michael Tutty: -----or spends it on things that will continue well into the future will have to be considered at the appropriate time. It is not a matter, however, for this coming budget so I am not sure what value there is in discussing it here, other than to say that if it becomes a receipt at some stage in the future, we can then spend it.

Deputy Richard Boyd Barrett: I have a question on the general corporation tax head. There has been a gross distortion of the growth figures because of what we believe is probably the relocation of intellectual property assets by Apple. Mr. Coffey outlined the figures in question relating to deductions on the part of Apple and a few other companies. The figures jumped massively from 2007 onwards and were part of what I believe is a tax avoidance apparatus. As far as I know, the figures we have go up to 2014 but is there any way of us knowing what is now happening in that area? Could we have a more detailed understanding of it? We have spoken about potential volatility in this area so it would help us make a judgment if we actually had the information. We do not have an up-to-date picture of the figures on corporate tax, on income, on profits and allowed deductions or allowable tax write-offs. Does Mr. Coffey think that is a problem? I certainly think it is a problem. There has been much talk about closing off the double Irish but do we actually know that the double Irish has been closed off? These companies can still avail of it and have done so in the past couple of years.

Mr. Seamus Coffey: I would love it if additional numbers were available to analyse. It would put us in a much stronger position. On the question of timing, one issue is the question of when the numbers become available to those who produce them. Companies have to submit their final corporation tax returns nine months after their year end so if a company has a year end of 31 December, it is not due to submit its final tax return until the following September. Companies have not even submitted their final returns for December 2015 yet so Revenue cannot collate the data.

Deputy Richard Boyd Barrett: Are there not provisional figures? We get announcements on those.

Mr. Seamus Coffey: The tax for 2015 is, by and large, paid so Revenue can give those figures and companies will have made a provisional return. They expect their tax bill to be a certain amount and they will have paid their money. The actual details and breakdown of revenue, and other items which produce the amount of tax they eventually have to pay, have not yet been submitted.

Deputy Richard Boyd Barrett: Would Mr. Coffey not want to ask, as I do, for information that is as up-to-date as possible in the form of provisional figures? We could then have some picture of what is going on. This is a huge distortion in our economy, which has spawned the term "leprechaun economics" and made us the laughing stock of the world. Would it not be helpful for us to have a more detailed picture, if not the final figures? Would it not be helpful to have the provisional figures available to us so that we could work out what is happening here? I would like to know if the double Irish is still operating in reality. It is available until 2020 so are they using it or not?

Mr. Seamus Coffey: When the CSO produced the first round of GDP figures and national accounts for 2015, they were based on provisional information but a couple of months later it had a better picture of what happened and the figures changed dramatically. Providing preliminary figures might be useful but unless they actually reflect what is happening, they might not be entirely helpful. Revenue only has figures for the tax paid when preliminary tax returns come in. It might be able to infer profits from that but cannot, for example, infer the trade charges, the figure for which has grown substantially over the past number of years. The trade charges figure is not relevant to the European investigation because it relates to expenditure - it relates to companies buying a service. If a technology is developed somewhere else, companies have to pay for it. In the case of Apple, there are not separate entities so it is not comparable to most companies in this respect. It is comparable in how it operates, however, and the question is not whether the double Irish is still operating. The question is whether companies in Ireland are still paying for technologies developed elsewhere and the answer to that is "yes".

Deputy Richard Boyd Barrett: This is very important and I accept what the witnesses say about disentangling the double Irish from trade charges. The jump from 2007 onwards, however, is spectacular. The deductions were allowed go from €6 billion to €19 billion and then to €21 billion. Can Mr. Coffey confirm that these were deductions that were allowed in advance? Mr. Coffey's paper refers to advance tax rulings and said the companies allowed a certain amount for the year. It then goes on to state that the companies used most of it, a fact which, presumably, is established later. We would therefore have a figure for what was allowed for 2015 and 2016, albeit that some of the figures will be provisional. Those figures should be furnished to us.

Mr. Seamus Coffey: There are two separate deductions at play. One is the trade charges which, by and large, are costs a company incurs such as interest on a loan or a royalty to use a patent or intellectual property. They have grown hugely over the past number of years in line with some of the revenues and costs of some of the multinationals operating here. Capital allowances are predictable as they are based on capital spending. If a company has acquired an asset, it does not just offset the cost in one year but spreads it out over a number of years by means of an allowance based on what it spent. Once the company pays the money, the allowance it can claim is a fixed amount every year. Revenue could possibly provide more up-to-date information on capital allowances but even then, once companies acquire new assets, and a lot of new assets have been acquired in Ireland recently, the figure will change. These allowances are not unique to Ireland but what is unique to Ireland is their scale relative to the size of the economy. Measures that allow companies to offset the cost of assets, or the cost of technology they are using, are standard throughout the world. It is simply that in Ireland the figures are vast relative to our economy.

Deputy Richard Boyd Barrett: They are, certainly, but my point is that they jumped extraordinarily. The scale of the jump is so vast. If I was in the Revenue Commissioners, I would be looking at whether this is an abuse of the allowances in place. If an allowance goes from €6 billion to €19 billion in a couple of years and then goes up to €21 billion, I would be asking whether the allowance is being abused on a massive scale. If it is, the potential loss of revenue to the State is simply staggering.

Mr. Seamus Coffey: Deputy Boyd Barrett is correct. A key issue is whether these prices are being set appropriately and, if a company in Ireland is using this technology, whether it is paying the right price.

Deputy Richard Boyd Barrett: The companies are setting their own prices.

Mr. Seamus Coffey: They would be separate entities or companies.

Chairman: They will be before the committee next week.

Mr. Seamus Coffey: If it was within the same companies, we would not have these flows. It is between separate companies. The question is whether the price is being set appropriately. In Ireland we now have transfer pricing legislation, so they should be set appropriately. The reason they have increased is simply that these companies have got bigger and bigger and more online advertising is being sold. We can track them not only in the accounts of the Revenue Commissioners but in the national accounts as well, where we can see the money flowing in and the patent royalties flowing out. Whether the prices are appropriate is a question the committee should be addressing to the Revenue Commissioners, but in terms of what they are, they are standard features of corporation tax. It is simply that in the context of Ireland the figures are enormous.

Deputy Richard Boyd Barrett: These are quick-fire questions. First, the council representatives said that the Government was at the outer limits of prudence. Would it be fair to say that our view about how we could and should raise extra money for spending, current and capital, from wealth taxes or higher taxes on those with higher incomes is far more prudent because it is about gaining extra revenue from relatively stable sources rather than basing it on sources that, the council maintains, are volatile?

Second, is it part of the remit of the council to warn against imprudence? We have mentioned the €300 billion figure for intellectual property. Another figure, which is the same, coincidentally, is the €300 billion worth of NAMA assets that have been disposed of, mostly to a small number of vulture funds. Is it part of the council remit to warn that this might be somewhat imprudent? Do the council representatives consider that movement of assets into a small number of hands imprudent?

Finally, we know the 26% jump in GDP is a fantasy. To what extent was that fantasy, perhaps on a smaller scale, present before the jump? How might that have affected the money we had to pay out to the European Union in the past ten years? Could we quantify that in a rough calculation? Given our population by comparison with other countries, was our contribution to the EU disproportionate? Does the council agree with that proposition?

Professor John McHale: I will set out some quick answers. When we talk about the overall package of €2.4 billion, we are looking at it as a combined package and its impact on the deficit. If people want to propose balanced-budget changes to that, whereby they raise certain taxes and increase spending, we have no issues with that, given our mandate.

Deputy Richard Boyd Barrett: That is because it is prudent. We are very prudent, in other words.

Professor John McHale: Yes, if it is balanced-budget, it is very prudent. That would be fine by us.

Chairman: It is the new politics.

Professor John McHale: I am afraid the question on the NAMA assets does go beyond our mandate.

The final question was about whether the distortions we saw in 2015 might have been there in other years. To some extent, possibly, yes, but it would have been much smaller. However, one difference between 2015 and what went before was that we saw not only that GDP became a very unreliable measure of what was really going on in terms of domestic activity, but so did GNP. Mr. Coffey has written a good deal about this. It revolves very much around a huge jump in depreciation, which also distorted the GNP number.

There was a question about the contribution to the European budget. That is based on something called gross national income, GNI, which is closely related to GNP. To the extent that pre-2015 GNP and GNI figures were not seriously distorted, it is a reasonable conclusion, even if we had some concerns about GDP, to suggest that there is little reason to worry that because of distortions to these national accounts aggregates, we would have been making essentially excess contributions to the budget. Some of my colleagues may wish to weigh in on that.

Mr. Seamus Coffey: I wish to follow up on the point we were discussing previously. The depreciation Professor McHale mentioned will feed into the capital allowance figure we have discussed. The committee may be interested in following up on something that might have changed significantly in 2015, even though we do not have the final figures yet, given the increase in depreciation in the national accounts of €30 billion. It is likely that the capital allowances in the corporation tax calculations will have jumped by a significant amount. I cannot give the committee the exact figure but it will be quite large. Again, it is related to the size of the assets.

I will offer one final point on the trade charges and capital allowances. They are deductions, not tax credits. Therefore, even though the amounts might be running to €20 billion, it is an expense.

Deputy Richard Boyd Barrett: That is a matter of opinion.

Mr. Seamus Coffey: Therefore, any impact on the tax would be at 12.5%. Let us suppose the trade charges or capital allowances were X billion. The question of how much more tax we would collect would be based on 12.5% of that amount.

Deputy Thomas P. Broughan: Page 10 of the council report states that the economy is operating close to potential in 2016. How does the council come up with that conclusion? The recent Department of Finance report indicates that we are still building fewer than 1,000 houses per month. We have extraordinary infrastructural deficits. For example, Dublin Airport must be one of the few airports with 25 or 30 million passengers that does not have a railway. We have major towns that are not well connected to Dublin. All of that is without even considering deficiencies in health, disability services and a range of infrastructural gaps. How can the council say that it is operating in that way? Where is the council getting that figure from?

Professor John McHale: We certainly would not say that there are no deficiencies in the economy.

Deputy Thomas P. Broughan: There are deficiencies. We have a dysfunctional construction industry and market. Ten of thousands of people are effectively homeless, yet the council maintains we are operating at close to potential. That is nonsense.

Chairman: Let him answer.

Professor John McHale: Let us think back to the boom years before the crisis. There were numerous deficiencies in the economy that we could have pointed to then as well. However, at the same time the economy was growing at greater than its sustainable rate and eventually we had a very sharp correction and a very deep recession. Economies can be in an unsustainable position where imbalances build up. Ultimately, this leads to a sharp downturn, even when we can identify serious deficiencies of the kind that Deputy Broughan has just described. They are separate concepts.

We look at a range of indicators for signs of overheating as well as competitiveness indicators, various housing indicators and credit growth indicators. We are continually monitoring for indicators that the economy might be overheating. We also have more statistical measures based on alternative measures to the output gap that the European Commission produces.

Is there a perfect measure? No. That is why we examine many different indicators. We have actually come to the conclusion that the economy is not overheating, or at least we do not see signs of it, even though the official measure used by the Department of Finance and the European Commission indicates that it is overheating. For example, although the unemployment rate has gone up a little to 8.2%, that level of unemployment would indicate some degree of excess capacity in the economy and is, again, another sign that the economy is not overheating.

Deputy Thomas P. Broughan: This committee, at very short notice, must make some contribution towards the 2017 budget. Many of the agencies that have appeared before us have said that there are good times ahead, possibly in 2018 or 2019, but it seems that 2017 will be another tight year, as has been the case for the last seven years. Are we, for example, exaggerating the potential impact of Brexit? In the context of Norway, Switzerland or even Iceland over the last few years, should we be more relaxed about Brexit and not allow it to hang over our budgetary programme for 2017 like a sword of Damocles? Should we not be prepared to put our best foot forward?

Professor John McHale: It has become a bit of a cliché to talk about the uncertainties surrounding the Brexit. What we have tried to do in our recent report is consider a number of different scenarios. We looked at a baseline scenario, which is probably not too far from the best guess and in that context, the impact of Brexit, at least in terms of its implication for budgetary policy, is quite limited. Under that baseline scenario, we lose around 1% of growth over a two year period but that has a fairly minimal impact on the fiscal space and, therefore, on what one can do in terms of budgetary policy. However, the point about Brexit is that we really do not know what will happen. One can imagine much worse outcomes so we also looked at a more adverse scenario - even worse scenarios are possible - under which there is a persistent loss of 0.5% of growth over a decade or more. That eats into the fiscal space and would have implications for budgetary policy. We tried to give some idea of how Brexit might have implications for budgetary policy.

Deputy Thomas P. Broughan: To follow up on a point made by Deputy Boyd Barrett and others, were the revisions of 2015 not known unknowns? We all knew this was happening, to some extent. We knew that strange things were happening in the multinational sector. We have known about transfer pricing, for example, for approximately 30 years. This affects how we evaluate the last few years. Are there other issues of which we are aware but for which we do not have the statistics that could affect us in the future? How is that the IFAC and other bodies like the ESRI were not able to give us some figures on this before now?

Professor John McHale: I will admit it did come as a surprise. There is no getting away from that. We were aware of the structure of the economy and the importance of multinationals. That has been showing up for a long time in, for instance, the huge gap between GDP and GNP. That was well understood. There were some puzzles that maybe, in retrospect, should have clued us into the fact that something odd was going on. One of those puzzles was the huge surge in corporation tax that we saw last year. There are still some uncertainties about all of the causes of that surge but it does seem that the on-shoring of assets, which was also behind the big rise in GDP, was a contributing factor. Mr. Coffey told me before we started that I should be more cautious than I have been in saying that on-shoring of assets was the real driving force but I think we all know that it certainly was a driving force. Whether there are other factors at work is something we still have to find out. Maybe that should have clued us in a little bit more because we were really puzzled by that. It is consistent with what we saw in terms of this huge on-shoring of assets which also led to a huge spike in GDP.

There is no getting away from the fact that everybody was surprised by the size of that revision and we cannot rule out other surprises. In an economy that is highly globalised with a very significant multinational sector, one is going to get these surprises more often than would be the case in a more sedate, less globalised type of economy.

Chairman: Deputy Ryan is next.

Deputy Eamon Ryan: Ladies first. I am happy for Deputy O’Connell to go next.

Chairman: That is very chivalrous of Deputy Ryan.

Deputy Eamon Ryan: I am still trying to work out what I am going to say.

Chairman: A less chivalrous explanation.

Deputy Kate O’Connell: I thank my constituency colleague. I hope I do not repeat anything that has been said already but I wish to return to the issue of the 26% growth rate. I am assuming that a unique or bespoke Irish calculation is necessary so that we as a country can have accurate data with which to plan our future. In terms of the surprise element of it, was any consideration given to the fact that something might happen and what was the gap between what the IFAC thought might happen and what actually happened? Did we think anything would happen when the base erosion project started and the double Irish loophole was closed off and, if so, what did we expect?

To follow on from a question posed by Deputy Cullinane, is there any data to suggest that it will take a number of years to wash out of the system? When we are creating a new bespoke calculation, will consideration be given to the limitations of the new sum, so to speak? What sort of issues might the new sum give rise to in the future? Has that been considered?

It was suggested earlier today that the 25% GDP ratio that pertained at the time of the crash may have stopped a default and I ask the witnesses to explain why. If the figure was 17%, for instance, would we have defaulted?

Regarding the multinationals, reference was made to shareholder profits going abroad or the fact that the shareholders are not resident here. Do we have any data on the multinational shareholder spread, in terms of where these people live or is that commercially sensitive information to which we have no access? Do we know, for example, that for every €10 of multinational shareholder profits, €7 goes abroad? Do we have that information?

I have raised at previous committee meetings the recent reductions in VAT and income tax receipts. I asked whether it could be attributed to Brexit and the answer I was given was that the data related to the months prior to Brexit. However, it seems coincidental to me. Perhaps some companies were very well prepared for Brexit and the data might be an indication of that preparedness. Is that a null argument?

Professor John McHale: Maybe I can take the first two questions very quickly and let my colleagues answer the others. In terms of a new measure of the economy that would complement GDP, it really is, at least initially, if not for the longer term, for our own use. We need to understand the level of domestic activity in the economy. That said, it is not easy. Both Dr. Conefrey and Mr. Coffey are on the new committee that is working with the CSO to consider alternatives. On the one hand, one can argue that there are now elements within GDP that are not part of Irish economic activity - much of what is known as contract manufacturing, for example, which does not affect Irish employment or Irish incomes. In some senses, it is a contaminant in there that is leading to a distorted measure of domestic activity. The challenge is to come up with measures that do not have those contaminants while not cutting out a bunch of stuff that we are actually interested in. In this report we have come up with a number of alternative measures, but they all cut stuff out that we might be interested in. When one looks at domestic demand, for example, one is cutting out net exports. When one looks at gross value added, excluding industry, one is getting rid of the stuff that is distorting things but one is also getting rid of all of the rest of industry and one does not want to do that. No matter what measure one looks at, it is a trade off between getting rid of the stuff that is distorting things and maybe getting rid of other stuff that one really does want to measure. These guys face the challenge of using the data as it exists at the moment to try to identify measures that really give one a better sense of the activity that is taking place in the Irish economy.

In respect of the 25%, I also mentioned that our debt to GDP ratio, appropriately measured as we see it, is probably around 100% of GDP. If the crisis had started off with a debt to GDP ratio of 100% of GDP, we would almost certainly have defaulted. Remember we went from 25% of GDP to 120% of GDP and lost access to markets but we avoided default, taking advantage of some outside assistance. If we had gone from 100% of GDP to 220% of GDP, there is no way we would have got through it without defaulting. We would have had a far more serious crisis that we might still be in rather than the recovery mode we are currently in. That gets back to the need over time to get to a safer level so that if some negative event should affect us again, we are in a stronger position to deal with it.

Mr. Michael Tutty: I am going to reply on the VAT question. I find it difficult to see how VAT receipts can have been affected by Brexit at this stage. Coming up to Brexit and searching exchange rate movements that may have affected what was going on in the economy, the main effect of Brexit is the uncertainty created for investment for the future because Brexit has not happened. It is not going to happen for quite some time so it should not have an immediate effect on consumer behaviour or business generally apart from its investment. I do not think we should be looking at Brexit as the reason for the VAT receipt shortfall any more than the income tax shortfall that is also behind profile. We must wait and see. The underlying consumption figures - the consumer expenditure figures - seem to be quite good so it is difficult to understand that shortfall. Hopefully, it is just a timing thing in terms of receipts. We are putting too much emphasis on Brexit. In respect of the UK economy and figures that went up after Brexit during August, it has been said that these figures show that Brexit did not have any effect but in the short term, I cannot see why Brexit should have a significant effect on behaviour that leads to VAT receipts.

Professor John McHale: There is one question we have not answered so Mr. Coffey might address it.

Mr. Seamus Coffey: On the issue of the shareholders, the simple answer is that for the multinational operating in Ireland, all the shareholders are foreign. The multinationals have subsidiaries here so their shareholders would be the parent companies. When the profits are made in Ireland, they would all be classed as essentially accruing to a foreign resident so all the profits would be accounted in the balance of payments as leaving. The parent company collects the money. People who buy shares in the parent company may collect a dividend. That would be counted on the way in so we could see dividend flows coming in but we simply would not know what companies they are coming from. An Irish person might have shares in a company. We cannot disentangle whether they have shares in a company that has an operation in Ireland. We see all the money flowing out and dividends coming in but we cannot tell whether they are getting the dividends from the parent companies that have subsidiaries in Ireland. In terms of the profits that are earned by the subsidiaries, it is all counted as going out because the parent company owns them.

Deputy Eamon Ryan: I thank the witnesses for their amazingly wide-ranging responses. It must have been a terrible summer to be a macroeconomist. It has shattered and the shards are on the ground. We spent years thinking that GDP growth figures were gospel and now we suddenly realise that E = mc2 is E = mc3 in physics terms. It must be very difficult. Perhaps there is an opportunity in it.

I apologise for looking at my phone. I take the Chairman's comments earlier about paying attention to the meeting but there is a quote from the Taoiseach, who I do not often quote, that I wanted to get. In his nomination speech after he was elected on 10 May, he said, "While on the international stage, the official record of the life of Ireland is one of exceptional growth and recovery, it is in the lived experience, the personal experience that the national life is revealed." He went on to say, "... I am anxious that the national record of the life of the time, be it the surge in tax receipts or the headlines on growth, must be more in tune and aligned with the personal record, the lived experience of the people". I thought that was a really good summary of the fact that this gospel economics must change.

I was also looking at the council's assessment of its mandate. I looked at the wording, which I am sure was chosen very carefully. It involves an independent assessment of the macroeconomic and budgetary forecasts published by the Department in the stability programme update and in the budget. In this process during which we are trying to reconsider our budgetary analysis and in light of whatever we must do for the European fiscal rules, could we not use it as an opportunity to develop economic metrics that follow the instructions from the Taoiseach, which are that they are in tune with the lived experience of the people? In response to Deputy O'Connell's point, Professor McHale said that the council was looking for metrics. Why not be ambitious and take the sustainable development goals and apply them to quality of life indicators? I know this is a difficult thing to do but it may give us exactly what the Taoiseach is looking for, namely, a form of economics that is more in tune with, or more useful for assessing, the lived experience of people than just bald GDP growth or inflation figures. It is a very broad philosophical question but it is right at the moment because we have seen that, in respect of simple adherence to growth figures on their own, they are not necessarily gospel.

The Secretary General of the Department of Public Expenditure and Reform is another person I would not usually quote as my first source of wisdom but he got it absolutely right when he asked in the national economic dialogue whether in respect of assessing our budgetary process we can get away from just assessing if it should be €1 billion or €1.2 billion and look at the lump sum of our expenditure and come up with answers as to whether we should stop spending in certain areas. Is the council unable to give us an independent assessment of this? Could we look at the productivity of our expenditure within the public expenditure area as one of the ways of assessing our progress or success rather than just looking at the headline quantum? As one example, could we do this to try to assess the productivity output of the public service, the money we are spending? This is particularly important at the moment because unless we have a baseline indicator of productivity, however we might want to measure that, how are we going to assess the next phase of our economic public service issues around, for example, pay issues after the Lansdowne Road agreement? Connecting pay increases to productivity increases that are real is surely the lesson from the crash. The benchmarking process was not capable of delivering that assessment. In response to an earlier question, Mr. Tutty said that the Department of Finance is looking at different metrics of performance measurement and so on. Can the council get involved in this, especially in assessing how innovative our public service is and what sort of output improvements we will get? Can we take that into account as part of a revised assessment of economic performance? It is tough but if we do not do that, economics is not connected to the real-life experience of our public servants as well as our people.

Professor John McHale: I am delighted to see that Deputy Ryan is so ambitious for us because these are certainly big tasks. On the Deputy's first question on the measurement issue, there is no doubt that gross domestic product, GDP, even if there were no problems of the sort we have been dealing with this summer, is an extremely limited measure of what matters in a society or even in an economy and it needs to be supplemented by many other measures that would give better measures of well-being that take into account environmental and income distribution issues. I agree with the Deputy on the broader measurement challenge and considerable work is being done to come up with better measures. The Deputy is probably familiar with Stiglitz's and Sen's committee work on alternatives to GDP. However, we also need something like GDP to the extent that it measures the economic output of a country. We tell our students that GDP is a measure of the goods and services produced in a country in a period of time. However, because of various changes to the measurement and the fact that elements such as contract manufacturing have come in - the Central Statistics Office, CSO, follows the rules precisely, so this is no criticism of it - GDP is not measuring the economic activity in the way we need to underpin economic and budgetary policy. In a sense there are two separate issues. We need to go much further in terms of those broader measurement issues but we also need to have measures of domestic economic activity, and if GDP is not going to do it, we need complementary measures.

With respect to Deputy Ryan's second question, this is a theme that has come up through the meeting with respect to the council's mandate. A mandate was given to us. We did not decide it. It was set down in legislation. We try to respect it. It has four elements to it, namely, assessing the macroeconomic forecasts, assessing the budgetary forecasts, assessing compliance with fiscal rules and assessing the fiscal stance as measured around the deficit, but it does not get into questions such as the issue the Deputy raised about the productivity of expenditure. There are other bodies that get into that space. The ESRI does work that certainly relates to that. A good deal of work is going on within Government on assessments and evaluations of particular programmes. Perhaps there is scope to expand the mandate of the Irish Fiscal Advisory Council, IFAC, in the future but for the moment we respect the mandate we have been given. We go into some issues in terms of the overall planning and control of expenditure and there is a section in the pre-budget statement indicating that we will continue in ongoing dialogue with the Department of Public Expenditure and Reform on the way expenditure is planned and controlled, but I will not go into the details of that here. That goes into the areas that we consider to be within our mandate, but on the broader issues of examining the productivity of public expenditure, we see that as going beyond our mandate. I take it as encouraging that the Deputy considers the council would have valuable things to say on that. I am sure councils in the future would be very open to potential expansions in terms of what the council is required to do.

Deputy Eamon Ryan: Mr. Tutty is itching to speak.

Mr. Michael Tutty: When the proposal for a parliamentary budget office was brought up last year, a question arose as to whether the IFAC should be incorporated into it or should be that budget office. We certainly believed that it went way beyond our mandate and that it would change the whole ethos of the council. The few people seated behind me would not be in a position to do all the current work and that work as well. It is a question that can be discussed as to whether our mandate should be wider, but we would have to see what the parliamentary budget office is in place for. Is that the body that should be advising parliamentarians on issues like that as opposed to the Irish Fiscal Advisory Council? There are plenty of options. We could start with Colm McCarthy bringing back an bord snip 3 if the members want to try that one.

Chairman: No.

Mr. Michael Tutty: That would be more apocalyptic than anything in the Book of Revelations.

Deputy Eamon Ryan: No. I would like to see the Irish Fiscal Advisory Council spread its wings and broaden the interpretation of the implementation of its mandate. We had an election that was defined by the relatively narrow issue as to what the fiscal space is. This budget debate will be defined largely around narrow figures of €1 billion one way or the other, which sounds flippant and is the marginal issue, while the big issue is whether we are providing space for people to express themselves, to work in the public service with real efficiency and innovation and, as a result, improve the daily lives of our people. Being good at that and being strategic in the State is what we need to debate but, for some reason, we get stuck in what I see as a very out-of-date, old fashioned, narrow economic argument around fiscal measures, which are important as we have to avoid the economy overheating, but avoiding that will come from greater productivity and assessment of the risks facing us.

Taking into account the council's mandate to comment on the stability programme update, which I imagine includes risk assessment such as its assessment of Brexit today, the stability programme update rightly identifies for the first time that the fiscal risk of us failing completely to meet our climate targets is of major risk to this State. A member of the climate advisory committee to the State published data this week estimating a fiscal risk to the State of the order of €5.5 billion from our current trajectory in terms of failure to make emissions reductions along the lines we would expect. The council delegates did not mention that in their assessment but would they agree with the Department of Finance's risk assessment of it being a major fiscal risk to the State as well as a risk to the wider environment?

Mr. Michael Tutty: Certainly on the basis of the level of fines that might be applied at European level, even taking it from that basic point of view, it is a risk from the fiscal point of view. Obviously, it is a risk for Ireland generally that if we have signed up to climate change targets, we should be achieving them and not be relying on others to achieve them. We need to do our bit, but I am not sure what the fiscal advisory council can do specifically on that.

Deputy Eamon Ryan: It could refer to it, in the same way as the council brought up Brexit as being a valid risk to the future of the State. It would be no harm for it to do that. The council recognising it as a risk would in itself be useful.

Professor John McHale: In linking it to the fiscal risk of fines, it was not, at least for me, properly on my radar. I thank the Deputy for raising it. It is something we should be thinking about. We were looking a little shorter-term but even from a fiscal perspective the Deputy is right. We will certainly give that some thought.

Chairman: Thank you.

Deputy Richard Boyd Barrett: I have a further question.

Chairman: I ask the Deputy to be brief.

Deputy Richard Boyd Barrett: I put this question to the ESRI as well. We have had a discussion about possibly making a case to Europe or there was reference to discussions in Europe about distinguishing between capital and current expenditure, particularly where there might be a return and so on. Is it the council's understanding that currently there is provision for us to make that distinction which therefore would allow us to borrow in particular areas without it being considered to be breaching the rules? I have not got a definitive answer on that. Alan - is it Alan Bennett?

Chairman: Barrett.

Deputy Richard Boyd Barrett: Alan Barrett seemed to indicate there might be circumstances, and people have argued for this in some cases. Is it true, for example, that if money is spent during flood emergencies, such expenditure is different? Does the council know exactly what the rules are on this? Is there any flexibility or is it a matter of us making a political case for a change? I am thinking of housing in particular and if we can say we have to do this, that there is a guaranteed return if we do it and we can make a case for it, is there any flexibility for that or is it a hard and fast rule?

Mr. Michael Tutty: Apart from the flexibility, I mentioned the major reforms, which are akin to structural reforms, and this applying only on a very limited basis. The rules do not distinguish between current and capital at all. There are rumblings among many countries that would like to see such a distinction brought in. The President of the Commission recently spoke about trying to make some amendments to allow education expenditure and some other forms of expenditure to be treated differently. There is nothing in the rules at the moment that we can draw on to say we can go beyond the rules just because we have a housing shortage. We cannot spend money on housing without it being counted as part of our budget expenditure.

Chairman: I thank Mr. Tutty and all the witnesses for attending this long but informative meeting. Everyone got to ask what he or she wanted. I am sure we will get back to the witnesses if we have any more questions for them. This year's process has been a little truncated. I am sure it will be different in years to come. I thank everyone for their attendance at the committee today. I remind members that we will be back next Tuesday at 10 a.m. for a long day's session.

The select committee adjourned at 4.35 p.m. until 10 a.m. on Tuesday, 20 September 2016.