DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 13 Nollaig 2016

Tuesday, 13 December 2016

The Joint Committee met at 5 p.m.

MEMBERS PRESENT:

Deputy Seán Barrett,	Deputy Pearse Doherty,
Deputy Colm Brophy,	Deputy Stephen S. Donnelly,
Deputy Thomas P. Broughan,	Deputy Michael McGrath,
Deputy Joan Burton,	Deputy Kate O'Connell,
Deputy Dara Calleary,	Deputy Eamon Ryan.
Deputy David Cullinane,	

DEPUTY JOHN PAUL PHELAN IN THE CHAIR

The select committee met in private session until 5.05 p.m.

Fiscal Assessment Report: Irish Fiscal Advisory Council

Chairman: I welcome members and staff of the Irish Fiscal Advisory Council, Professor John McHale, Mr. Seamus Coffey, Mr. Sebastian Barnes, Dr. Íde Kearney, Mr. Michael Tutty and Dr. Thomas Conefrey. The Irish Fiscal Advisory Council is here today to discuss its fiscal assessment report.

Before we begin, I remind members and witnesses to turn off their mobile telephones 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 invite Professor John McHale to make his opening statement.

Professor John McHale: On behalf of the Irish Fiscal Advisory Council, I thank the committee for the opportunity to discuss our recent assessment published on Wednesday, 30 November. We view our appearance before the committee as integral to the fulfilment of the council's mandate and important in fostering greater public awareness and debate around macroeconomic and budgetary issues. I am accompanied by council members, Mr. Sebastian Barnes, Mr. Seamus Coffey, Dr. Íde Kearney and Mr. Michael Tutty. The council secretariat is also present. The council would like to thank the staff of the Oireachtas for their ongoing and useful co-operation.

On a personal note, as this is my last appearance before the committee as chair of the council, I thank committee members for their interest in the council's work over the past five and a half years. Our engagements with the Oireachtas in my time as chair have given me first-hand experience of the commitment, hard work and talent of our parliamentarians, although, needless to say, we have not always agreed.

Today, I will cover our 11th fiscal assessment report. The report was written in line with the mandate of the council set out in the Fiscal Responsibility Act. The report assesses the macroeconomic and fiscal projections set out by the Government in budget 2017.

Before getting into the detail of our assessment of budget 2017, it is worth reflecting on some of the positive developments in the public finances and in the broader economy over recent years. The public finances have improved considerably with the underlying general government deficit falling from over 11% of GDP in 2009 to an expected deficit of less than 1% in 2016. Although still at a high level, the debt-to-GDP ratio has been put on a downward path. The Government's adherence to a credible fiscal adjustment programme, along with initiatives at a European level such as the European Central Bank's bond buying programme, have seen the Government's cost of borrowing fall dramatically from the highs recorded in 2011.

Importantly, the progress in repairing the public finances has been mirrored in other areas. As a result of the strong recovery in the economy since 2012, the number at work has increased by 195,000 and the unemployment rate has halved from its peak of 15%. The available data for 2016 present some mixed signals but the weight of evidence from a range of indicators shows that the economy continues to grow at a solid rate. The Department of Finance's central projection is for further steady real GDP growth of around 3.5% in 2017 and an average of around 3% from 2018 to 2021.

Notwithstanding the progress that has been made, an important reality behind much of the council's analysis is that, six years on from Ireland's entry into the EU-IMF programme, the legacy problems from the crisis have not been fully alleviated. Moreover, with a high debt level and tangible risks to growth from external sources such as Brexit, in addition to domestic risks, the economy and public finances remain susceptible to potential adverse shocks. As an example of this, a GDP growth rate just half a percentage point lower than currently forecast each year would mean the public finances would remain in deficit out to 2021.

In this context, an important achievement of recent years has been the putting in place of a new budgetary framework containing both domestic and European elements. The framework consists of sets of rules, processes and institutions, including, importantly, the role of this committee. The key components of the framework are consistent with principles of sound budgetary management. In an uncertain economic environment, full implementation of the framework can help achieve a phased reduction in the debt to safer levels and ensure that there is sufficient fiscal credibility to avoid forced austerity in bad times. However, as outlined in our recent Fiscal Assessment Report, incomplete implementation of the new framework leaves the economy and public finances more exposed to severe shocks, such as Brexit.

Turning to the council's assessment of the fiscal stance in 2016 and 2017, the projections in budget 2017 show that progress in improving the public finances largely stalled. Despite continued revenue growth and savings from falling unemployment and debt interest costs, the projected improvement in the general Government balance, stripping out financial sector measures, is just 0.1 percentage point of GDP in 2016, while the primary balance, that is, the balance excluding interest spending, is forecast to deteriorate in 2016, the first worsening since 2009.

The absence of significant improvement in the public finances in 2016 is in part due to within-year increases in expenditure that absorb most of the better-than-expected tax revenue. In June, the Government revised up its forecast of tax revenue for 2016 by €1 billion, with €900 million of this expected to come from corporation tax. With spending revised up by close to the same amount, this additional tax revenue will not contribute to a significant improvement in the deficit in 2016. This repeats what occurred in 2015 when the Government announced a €1.5 billion increase in spending for 2015 in line with an upward revision to corporation tax of close to the same amount.

The council is concerned over the use of positive revenue surprises to fund permanent spending increases, especially when the revenue surprise is largely due to a single, and relatively uncertain, revenue stream - in this case corporation tax. Instead of using the additional corporation tax revenue for permanent expenditure, a more appropriate policy would have been to use this revenue to reduce the deficit. As the sustainability of recent corporation tax increases is not yet assured, this would have left the public finances less exposed in the event of a reversal in corporation tax receipts in the coming years.

The slowdown in the rate of improvement in the public finances in 2016 is reflected in the failure to fully comply with the fiscal rules. The expected improvement in the structural balance in 2016 of 0.3 percentage points of GDP falls short of the 0.6 percentage points of GDP improvement required. The expenditure benchmark is complied with in 2016, but only with the inclusion of a technical one-off transaction involving AIB in 2015. Excluding the AIB transaction, the spending limit set by the expenditure benchmark would also have been exceeded in 2016. As 2016 is the first year the Stability and Growth Pact preventive arm and domestic budgetary rules apply following the closing of the excessive deficit procedure, the failure to fully comply with all rules is a source of concern.

Potential compliance issues are also signalled in the Government's projections for 2017. The budget 2017 forecasts show compliance with the structural balance rule; however, the forecasts indicate a breach of the expenditure benchmark. It is important for the credibility of the budgetary process that the Government's fiscal plans show full compliance with the domestic and EU fiscal rules based on the Department of Finance's own estimates of the structural improvement.

Putting these different elements together, the combined €3 billion package, or €3.7 billion in a full year, of tax reductions and expenditure increases announced in 2016 by the Government for 2016 and 2017 goes beyond the limit considered prudent by the council. Compared to the plan outlined in the July 2016 SES, the fiscal stance in budget 2017 leaves the public finances more exposed to risks than would have been the case if earlier plans had been adhered to. Viewed in isolation, the deviation from what could be considered a prudent stance in budget 2017 is not large but a repeat of the approach to budgetary management evident in 2015 and 2016 over several years would not be conducive to prudent economic and budgetary management.

From 2017 onwards, the Government's projected fiscal stance and intention to comply with the EU fiscal rules is consistent with the deficit and debt remaining on a downward path. Provided the economy is growing at a sustainable rate, the use of the available fiscal space as envisaged in the current forecasts would be consistent with prudent policy.

I would now like to make a number of remarks in regard to the planned fiscal stance in 2017 and over the medium term. First, for 2017, the available fiscal space under the rules has already been allocated in budget 2017 for tax cuts and expenditure increases. As a consequence, based on the current projections, any new increases in expenditure, such as to fund higher public sector pay, imply lower spending in other areas unless offset by compensatory tax changes. In 2018, €0.7 billion will be required to meet the carry-over cost of tax cuts and expenditure increases introduced in budget 2017. On current estimates, this absorbs over half of the fiscal space for 2018, implying very limited scope for new initiatives in the absence of offsetting savings or new revenue-raising measures.

The Fiscal Assessment Report also updates the council's stand-still expenditure analysis contained in previous reports. It is important to reiterate that this exercise is not intended as a forecast or recommendation for automatic indexation, but rather as a means of informing decision makers of the portion of available fiscal space that would be required to maintain the existing provision of public services and preserve the purchasing power of social protection benefits. The results of the analysis in this report indicate that accommodating estimated demographic pressures and the cost of maintaining real public services and benefits would absorb almost the full amount budgeted for current expenditure increases from 2017 to 2021.

An issue that has raised considerable debate in recent years, not least in view of historically low global interest rates, is the treatment of investment under the fiscal rules and the question of whether the fiscal rules are too constraining on capital investment. It is important to note that a key reason for the relatively constrained budgetary position in the near term is that Ireland still has a budget deficit that needs to be brought down towards a balanced budget position to ensure that the high debt to GDP ratio is reduced. This requires that spending growth, net of discretionary revenue measures, be kept below the potential growth of the economy. Once the medium-term objective is achieved - a structural deficit of less than 0.5% of GDP is reached - spending growth is allowed under the rules to grow at the underlying potential growth rate of the economy. This will allow more resources to be available for both current and capital spending and to meet important societal needs. Moreover, in both the near term and longer term, there is no restriction on faster spending growth provided that the necessary additional revenues are raised.

In the meantime, even if the rules were to make more of a distinction between current and capital spending, it would be necessary to ask whether a higher overall deficit path than currently being projected in budget 2017 to accommodate higher investment would be appropriate, even taking into account potential long-run benefits for potential output. Ireland already has a very high gross debt which needs to be brought down to safer levels. In the short run, a key step in moving the debt to a safer position is to lower the deficit towards a balanced budget, in line with the current Department of Finance projections. Therefore, although there may be concerns that the rules overly constrain capital spending, the current forecasts for the overall budget balance are likely to be close to what should be targeted in the coming years, given the need to bring the debt down and to make provision for future demographic pressures.

To address the concern that capital spending could be squeezed in the process of achieving the objectives for the overall budget balance, one possible solution is to supplement the main fiscal rule with a separate target for public investment. For example, the Government could aim to achieve an overall level of public investment equal to a certain percentage of economic output. A separate target for public investment could help ensure that viable public investment projects with positive long-term effects are undertaken, while preserving the advantages of the current fiscal rules in helping to avoid deficit bias and procyclicality in setting budgetary policy.

Summing up, the economy has made an impressive recovery from a deep economic and financial crisis, but fragilities remain. Looking to the future, it is important that the hard-won achievements of recent years are protected and built on to improve the resilience of the public finances in the face of numerous risks and to lay the foundations for sustainable growth in living standards. The risks facing the economy are tangible, with uncertainty around the long-term growth prospects of Ireland's three key trading partners, the UK, US and euro area. Avoiding a repeat of past fiscal policy mistakes made in Ireland during relatively good times, such as reliance on transient revenues to fund permanent spending, will be essential to ensure the economy and public finances have the capacity to withstand potential negative shocks in the coming years.

Deputy Pearse Doherty: I welcome Professor McHale and his colleagues to the meeting. I note this is his last appearance before the committee and I wish him well. He may be able to speak more freely in the future instead of having to represent the strict mandate under the terms of the Irish Fiscal Advisory Council.

I welcome his comprehensive and detailed report. He mentioned that using unexpected tax revenue is risky, the primary balance is not decreasing but is forecast to deteriorate and the expenditure benchmark will not be met in 2017, saying it is beyond prudent in respect of what the Government has done. It appears, however, that the council has endorsed the budget although that was something different. What is the council's overall stance on the budget? After five years I imagine the Minister for Finance and his officials could have predicted the council's critique of the budget. Many patterns are repeated, for example, using corporation tax in terms of permanent expenditure. During Charlie McCreevy's time tax reductions and expenditure increases were tied to stamp duty. Professor McHale says that year on year there have been upward revisions of previously published ceilings which happened before. He says one of the potential risks is a monetary policy in Europe that would not be conducive to the type of policy we have. This seems to mirror the past. The Department and Minister should have been conscious that the council would have criticised these elements in its budget yet they went ahead with it. What is Professor McHale's view of the fact that they have ignored what the council said?

Professor John McHale: It might be useful to say initially what we endorse. The endorsement function is limited to the macroeconomic forecast underlying the budget and we do a similar endorsement exercise for the stability programme. I thank the Deputy for the opportunity to clarify that point.

We made several substantive critiques, which the Deputy listed, in terms of the stalling in improvement in the budget balance. He mentioned the primary balance which deteriorated in 2016 after several years of improvement and that when there was an upward revision of approximately €1 billion in tax revenues there was an almost equal upward revision in spending within the year. He also said the fiscal rules were not fully complied with in 2016 based on current projections and will not be fully complied with in 2017. He is right that the Government was probably not surprised that we highlighted these factors. His main point is that it went ahead and did it anyway and whether that indicates that we are not having an impact.

This Government, like any government, is under huge pressures from all sorts of directions to spend more money and to cut taxes. Facing those pressures the deficit can be used potentially as a political release valve. Most people do not obsess about that but we think about it a lot because we have been given a particular role, largely as a voice for the future. When items are funded by greater deficit spending they are not free but the cost is being pushed to the future. That does not mean there are not times when running deficits is a sensible policy in a major recession or where there are major spikes in spending, good economic policy is to run deficits because overall one wants to have a policy that is closer to a balanced budget position and to keep debt at safe levels. We do not want the kind of risks we may have run before, and the very deep crisis we experienced. I see the council as providing some balance because these costs will be borne down the line. Just because the Government pursues policies that it could have predicted we might disagree with does not mean the countervailing voice is not present.

Deputy Pearse Doherty: The council says that the Government is taking risks with the Irish economy in certain areas, breaching the rules it championed. I have no love for those rules, as Professor McHale knows. We campaigned against them but we are very satisfied that every party in the Houses wants the rules changed in one way or another. Now, however, there is a false debate because nobody wants to comply with these rules. Everybody says they need to be changed. When they are breached it is no longer an issue. It is like a road where the natural speed of 60km/h is changed to 20km/h. It makes no sense. My view is that it is not a big issue that the Government is breaching these rules. There is a question about the teeth the council has, if that is the narrative. How does Professor McHale explain the European Commission's approach to the budget, that it is broadly compliant?

Professor John McHale: I disagree quite strongly that the budgetary framework put in place and the rules that are part of that are not quite advantageous and positive for the Irish economy. The rules will bring us close to a balanced budget position and will allow our debt to come down to safer levels over time to minimise the risks the Deputy refers to. When there are surges in tax revenues, particularly with the expenditure benchmark, it is harder to make the kind of mistakes we made before when we ramped up expenditures to match those revenues. The key reason for pursuing these rules is not that the European Commission tells us to do it but because it is good for the Irish economy and will keep it safe. It was always likely that as time passed after the crisis what the Deputy described was going to happen. People were going to begin to forget and say, "We do not need this framework; we can move back in the direction of the policies we had previously". Making it part of the national framework and putting in place a committee like this and an institution like ours helps to institutionalise that memory in order that we do not easily forget. It is easy to think that we do not face these risks. If we are hit by adverse shocks, having a strong budgetary framework at any debt level will become a huge asset because it will give credibility that the country will be able to get through them without defaulting, which will allow Ministers to do the borrowing that would be necessary to avoid austerity in the context of a deep crisis. That is one of the advantages to a strong framework but I ask the committee not to forget and to carry that memory of the pain we had to go through because of mistakes made in the past and to see that this framework that can, hopefully, help us avoid making them again.

Deputy Pearse Doherty: The report points out that along with the Government announcing budget 2017, it announced half of budget 2018 by eating into more than half of the fiscal space for 2018. This has left the Government with approximately €530 million, according to its calculations. Since his previous appearance before us, Professor McHale has provided us with difference in the council's assessment of demographic pressures and where the Government stands on this. In 2017, the council disputes the Government's figure by €176 million and the remainder of the current Vote by €359 million. Will he explain the remainder of the current Vote? Does that include wage inflation in the public service that may not materialise or does it relate to the cost of goods and services?

Professor John McHale: Dr. Conefrey is closer to the detail and I will let him answer that.

Dr. Thomas Conefrey: We have an updated version of the calculation in this report. For 2018, we identified an extra €600 million in pressures on top of what the Government parties have allowed for to fully accommodate demographics and prices. The vast majority is to accommodate price pressures. Given that half of the €1.2 billion is eaten up by the carryover costs of the measures in budget 2017, that leaves approximately €600 million and we estimate that all of that will be required to keep pace with inflation.

Deputy Pearse Doherty: That is not related to the old debate about non-indexation of tax rates, which is a discretionary Government policy, or increases in social welfare payments or public sector wages. These are unavoidable demographic and price pressures in the council's view. Am I correct that this is inflation kicking in?

Dr. Thomas Conefrey: On the wages side, we used the assumptions in the Lansdowne Road agreement for 2018 and, therefore, we have the same figures as the Department. In terms of whether these pressures are avoidable, the Government could bring in policies to increase spending below what would be needed to keep in line with inflation. It could bring in non-pay costs in the Department of Health and bring in measures or identify efficiencies that result in spending increases below the rate of inflation.

Deputy Pearse Doherty: I understand. I am trying to draw the distinction with a discretionary policy which the council has put forward previously. To maintain purchasing power, social welfare rates and wages would have to increase. This relates to non-wage pressures or price pressures.

Professor John McHale: Our work on this has been portrayed as advocating automatic indexation, which was never our intention. This exercise is about identifying how much extra spending would be required to provide the current level of services and benefits given those demographic and price pressures. Of course, it is a policy choice about whether you try to maintain those services or maintain the real value of benefits. We are trying to give the information to decision makers, including the committee. When we see the estimates for fiscal space, the next question should be: how much of that is required to do what we are doing as an input into the decision-making process? That is what the standstill scenario is all about. It was never meant to be a proposal for automatic indexation, which, unfortunately, is the way it was taken up.

Deputy Pearse Doherty: I appreciate that. The starting point of any discussion needs to be where we would be standing still this time next year and then deciding from there what needs to be done in terms of what is available. While the Government says there will be €530 million in fiscal space, the council has argued it is miscounting and there is a discrepancy of approximately €600 million, which means there will be no fiscal space. If we want to just stand still this time next year, it will be negative. There are pressures in the economy without the Government having to find another €59 million for water charges when they are abolished or €40 million for gardaí or whatever comes out of a wage agreement with the public sector or the fact we have a homelessness and housing crisis. Professor McHale argued for prudent fiscal management. How are we supposed to address any of those challenges if no fiscal space is available to the Government this time next year?

Professor John McHale: If it is believed that more spending is required, there is nothing under the rules that would stop the Government if it raised the necessary revenues. It cannot use deficit spending and push the cost of that spending into the future to achieve increased spending.

We are still in a tight period of fiscal policy because we are still adjusting towards the balanced budget position, which the Commission refers to as our medium-term objective, MTO. Once we achieve that - and that is projected to be achieved in 2018 - spending can be allowed to grow along with the underlying growth of the economy, which seems to be a sensible way to proceed as a long-run approach. As more resources become available because of economic growth, there can be more spending to allow Government spending to keep up with the growth of the economy. At that point, even without tax increases, more resources will be available to meet the needs the Deputy referred to. There are two parts. The Government can always have more spending if it is willing to fund it other than through deficit spending and once that objective is reached, more resources will be available even without tax increases to meet those important needs.

Deputy Dara Calleary: I thank the delegation and I wish Professor McHale well. I would like to explore the council's proposals for capital spending. The flexibilities suggested may not be flexibilities judging by Professor McHale's exchange with Deputy Doherty. The council proposes a new limit for such spending. Capital spending is becoming a major constraint on the growth of the economy and the current capital plan is not sufficient to deliver the infrastructure the country needs. How would the council's proposal work? Would more investment capital be released? Would it result in a greater capacity to borrow?

Professor John McHale: I would not necessarily put it as a proposal. The Deputy is correct that capital spending is low in the economy based on historic international norms. In recent years public capital investment has barely kept up with the depreciation of the existing capital stock. There were recent announcements of greater public investment. Public investment will now grow from €4.2 billion in 2016 to €7.3 billion in 2021. There were announcements of what I believe are fairly significant increases in capital spending but the Deputy's point is well taken, that even allowing for that, public capital investment as its share of the economy remains low. Also, as many people have pointed out, as a result of postponing many investments during the crisis and the low interest rates there are now many opportunities for public investment. We certainly understand the argument people make for using deficit financing to fund those investments. However, the point we emphasise in this report is that we have to take account of the overall level of debt. The fact that the debt might be accumulated for investment purposes does not mean we are still not carrying forward this high level of debt which creates these vulnerabilities, particularly in a very volatile global economic environment. The reason for getting down the deficit close to balance is that it puts that debt on a strong downward path.

I might use the analogy of a small business. Small businesses can often have good investment opportunities but one thing I have learned from talking to small business owners is that they are obsessed with cash and liquidity management, which means they can often be reluctant to undertake debt even when they have good investment opportunities because they are very concerned about their ability to roll over that debt in the future. They have to look at their overall level of debt, therefore, and not just the investment opportunities. I suppose we are making a similar point. I would not push the analogy of a nation state with a small business too far, but given the experience we have gone through where we lost our ability to access capital markets to roll over that debt for a period of time shows that we can be exposed to similar types of risks.

We are saying that the overall plans in terms of reducing the deficit and putting the debt on a downward path broadly makes sense but the Deputy is right that a problem can be that public capital investment gets squeezed out in the process when we have to meet these tough deficit targets. Capital spending is often the easiest element to cut. We were suggesting that, in addition to the existing fiscal rules and the deficit targets, we would also have a target for public investment, and to some extent it is already there, but would make it a robust target and put a good deal of focus on it to make sure that we do not squeeze that public capital investment in the process of trying to hit those deficit targets. It not a new proposal, it just draws attention to the fact that there is a risk that public investment gets squeezed in that process of trying to meet those deficit targets.

Deputy Dara Calleary: The expenditure ceilings and so on would remain the same but this would be a separate heading, as it were.

Professor John McHale: The ceilings are largely at departmental level and within those ceilings it would mean making sure that there was sufficient allocation to the capital side of the budget as well as the current side of it, having that overall target subdivided among the different Departments but overall making sure that capital investment does not get squeezed.

Deputy Dara Calleary: The authorisation and the transition in the Irish Fiscal Advisory Council, IFAC, coincides with the transition in the US. There is a tradition for US presidents to leave a note on the desk of their successor with some worldly advice. Will Professor McHale be leaving a note and what will be in it?

Professor John McHale: No. We just had our final meeting and we will have dinner later so we will have a general chat about it. I will not be leaving any notes. We have achieved a great deal over the past five and half years, a huge amount of it due to the excellent secretariat we put in place. We have led to there being a greater understanding of the budgetary framework that has been put in place and why it is of value to us as a country. I hope my successor will continue to communicate the message of the need to continue to do good fiscal analysis to understand that framework and its value. We play our part to make sure that we do not make the mistakes that were made previously, which was essentially the reason the council was put in place.

Deputy Dara Calleary: Dr. Conefrey instanced the health budget and the way we could squeeze for expenditure efficiencies. As he said what I was thinking of, does he not think we have tried to do that? His health efficiencies are somebody else's essential service. I could find efficiencies in academia that would be holy grails to academics. That may capture the constraints we have as public representatives in trying to represent citizens who have had eight years of very tough austerity cuts to services and higher tax bills, if they are lucky enough to be in employment, yet the council wants to put the brakes on us trying to bring people with us. Was Professor McHale ever able to square that circle between the role played by IFAC and the role played by public representatives during his time, or is his mandate so precise that this circle will never be squared?

Professor John McHale: My answer to that is very similar to the one I gave Deputy Doherty. I understand the pressures public representatives are under and, more important, the importance of this spending to people's lives. There is a temptation to borrow the money to do the spending. That is what greater deficit spending means, but that puts the costs to the future. Even if we never repay the debt, we carry it in perpetuity and we carry higher interest payments in perpetuity. If we run larger deficits now, we will have to run larger surpluses in the future. In addition to that, we increase the risks that the economy faces because if some adverse international event occurs, if Brexit turns out to be worse than we had thought or something happens in the US and there are problems in the eurozone, the higher the debt level we would go into that crisis with, the more vulnerable we would be. I made the point to Deputy Doherty that this voice tends not to be too prevalent in the debate because of the pressures coming from all sorts of directions and not denigrating that, health spending, as he said, is incredibly important to people's lives. Spending will be important three, four or five years down the road when we would be carrying this interest bill, which would be crowding out the room for that spending so we would only be postponing it. I have always thought that fiscal responsibility should be believed in most strongly by people who believe in Government and the positive role it can play in people's lives. As we saw in the crisis, it is when the Government could not fund itself, when it could not access the finance to cover the deficit that inevitably opens up in a crisis, it is the Government that suffers to a large extent because spending gets caught and has negative effects on people's lives.

I hope in recent years we have succeeded - I am not sure if we have achieved this - in trying to avoid making fiscal responsibility in any way an ideological issue. It tends to get associated with those on the right but that is not where we are coming from. We are very much in the middle in having a range of views across the council. As I said, the more one believes in Government the more one should believe in what we are doing and it should not be allowed to become an ideological issue. It in no way means that we do not believe in the importance of Government spending when we do the analysis and make assessments of the kind that we have made in this report.

Deputy David Cullinane: I welcome Professor McHale and his team, and I wish him well in whatever new role he takes up.

I will follow up on the earlier conversation Professor McHale had with an Teachta Pearse Doherty about the potential for increased spending in 2018. Professor McHale outlined the overrun or carryover cost of the tax cuts and expenditure increases from budget 2017 and budget 2018 which would be in the region of €700 million, and then there are the demographic pressures and the standing-still pressures that will come into play as well. Essentially, there may not be much money in the pot at all to spend in 2018. I am somewhat conscious of the council's mandate here and of what Professor McHale can and cannot say. One of the options mentioned in his opening speech, which he reiterated in response to an Teachta Doherty, is that "in the absence of offsetting savings or new revenue raising measures", then there is no money in the pot. Is he essentially saying that we must look at revenue-raising measures, spending savings, or both? Current Government policy, as Professor McHale will be aware, is to carry on and increase or accelerate tax cuts, including phasing out the universal social charge. How does that sit with what Professor McHale is telling us in terms of the limited wriggle room with fiscal space? Government policy is to cut taxes even more.

I will marry that with something Professor McHale stated in response to the critique of the fiscal rules. Professor McHale is somewhat isolated on this because it is the case that ever more commentators are saying that these are a constraint. It is not just politicians. IBEC has been quite critical of the lack of flexibility in capital investment. The Minister for Finance made a speech in Brussels recently about the need for greater flexibility in relation to the fiscal rules. Professor McHale talked about the current fiscal framework being advantageous. I suppose commentators would have a different view. Are they advantageous, for example, to those who are victims of the housing crisis? We do not have the ability to build houses because of these fiscal rules because we cannot borrow money to invest in capital infrastructure, which is, in part, why we have a housing crisis and why we have rising rents, which are symptoms of that as well. It is the same with health, etc. We have pressure points across public services. How will we resolve those through a system that Professor McHale states is advantageous? My point is that if there is pressure building in relation to the fiscal rules, not only politically but outside of the political system, what is the council's position on that? Second, Professor McHale might comment further if he can on a policy of tax cuts on the one hand and a position where we had limited fiscal space which is being downsized almost all of the time on the other.

My third question is, how can there be such a difference between the Fiscal Advisory Council and the Government on demographic pressures? The difference is in the region of €600 million. Surely, this should be more black and white than that. The council is either right or it is wrong. It cannot be so subjective. It is incredible that we have that level of divergence between the Department of Finance and the Fiscal Advisory Council in this area. It is something that has been a common difference between them for some time but it strikes me as odd that there can be such a divergence of views in monetary terms when it seems it should be something that is much more black and white, and much more grounded in facts because we are dealing with money and obvious pressures. Those are my three opening questions.

Professor John McHale: If it is okay, Mr. Coffey will answer the first one.

Chairman: Of course.

Mr. Seamus Coffey: I will take the part about the overall amount of money that may or may not be available. The fiscal rules have been in place for a number of years. For the past two years, we have seen measures introduced each year of €3 billion or maybe even a little more even though the rules were in place. In 2015, it was a different part of the rules - the excessive deficit procedure. We have been under the rules this year for the first time and, because of some technical reclassification, there was a total of over €3 billion.

In terms of 2018 and the amount available for the budget to be announced next year, which Deputy Cullinane is looking at, it would not necessarily be the case that there is no money available. The Government spends close on €60 billion every year. If one wants to make a reallocation, there is plenty of money within that that can be changed around. Equally, we are not saying that there will be no increase in spending. The total - there are different measures - gross fiscal space for 2018 would be approximately €1.8 billion. It is merely in terms of where that is allocated. The Government itself has already allocated €600 million for existing pre-commitments such as the Lansdowne Road agreement and its estimation of demographic pressures. Because of budget 2017, a further €600 million goes because some of the spending measures that were introduced in the budget will now be over 12 months rather than nine months. Some of the increases in social welfare, which begin in March, must be paid in 2018 over a full year. That is extra spending into the economy that has been announced this year but it will be additional spending in 2018. Finally, our estimation is that to stand still - to do what we are doing now - and to maintain social welfare in line with expected inflation and maintain the real level of services across different sectors will absorb a further €600 million. It is not the case that there is no money there. In a sense, it is just how it is allocated. There is €1.8 million of spending, either through existing pre-commitments, through standing still or paying for the measures announced in this year's budget. Equally, if the Government wishes to spend more, it can introduce its own discretionary tax measures and then there would be additional funds available.

In terms of the rules limiting spending, the rules intend to limit spending in the sense of the impact it has on the deficit. The fiscal rules apply for all countries of the eurozone and most countries of the EU, and they have various different levels of Government spending, from those high-tax high-spending countries - perhaps in Scandinavia - to lower tax low-spending countries. In rough terms the limits are, by and large, a choice but it is about ensuring that one does not get this push for additional deficits that can lead to problems.

Dr. Conefrey will take the question of why the €600 million difference arises.

Dr. Thomas Conefrey: We should not overstate it. It is €600 million over a five-year period and in terms of the size of the overall budget, these are relatively small differences. We have been working with the Department of Public Expenditure and Reform to identify where we diverge.

As the committee can imagine, over that kind of medium-term horizon some of the assumptions that one uses in these calculations can change and commentators can have different views. We have our own demographic model that we use to produce forecasts of the population by relevant age group over that period and some of the difference could lie there. Also, some of the individual categories - when one thinks about the drivers of demographic pressures, for example, in health and education - involve fairly complex and detailed work, and it is not surprising that one can get differences. Over that period, a difference of that size is actually quite small. It is something we are working on with the Department, and the Department published a helpful paper of its own along with the budget documentation explaining the demographic drivers in health and education. We place more of the emphasis on the other side of the calculation where the real difference is, that is, on the prices side. That is really where the gap over the full five-year period opens up between us. On the demographics, the differences are really quite modest over that length of time.

Deputy David Cullinane: I have a supplementary point to Mr. Coffey. Mr. Coffey stated in response to the question on the fiscal rules and whatever additional space might be there in 2018 that there is overall expenditure of €60 billion and there can be a reallocation within that expenditure that can deal with some of the pressures that we have. That is not a fair answer because much of the low-lying fruit in terms of whatever changes can be made have been dealt with quite harshly over the past six or seven years. I do not see much room within overall current expenditure where we can do much reallocating. It is not about reallocating. It is about additionality. The additionality that was identified in the stability programme update in terms of the fiscal space for the next number of years is being revised downwards. Even leaving that aside, we then have the carryover from this budget and the differences in terms of the standing-still money. That does not leave us with many options. If that is the case and if Government policy is to cut taxes further, one can see the difficulties facing us at a time when we have patients on trolleys.

We have major problems in housing and in hospitals and I do not see how we can square those two. As such, can the witnesses come back on that? I do not have a difficulty with balancing budgets in terms of day-to-day spending, but there is an obsession with it. The Tea Party in the USA, which is seen as an outlier politically, talks about balanced budgets. There is a difference between balancing budgets for day-to-day spending and borrowing for capital spending. That is one of the pressures we face. Everybody in the room has to borrow at times to provide the capital to build a home and for big infrastructural projects. That is what we do and the same should apply to the State. Professor McHale referred earlier to learning from the mistakes of the past and remembering the harsh lessons of the economic crash. However, we have gone from an extreme of reckless spending to an extreme of very limited spending and restricting ourselves in terms of investing in capital infrastructure funding for hospitals, schools, housing, flood prevention and all the other issues with which we have to deal.

My first question, very specifically, is on that difference between reallocation and additionality and my second is on whether the witnesses see a distinction between balancing budgets and not borrowing for day-to-day spending and borrowing for capital spending, which is where the debate is located. Also, what are their views on additional tax-raising measures?

Mr. Seamus Coffey: The discussion on whether there are resources available relates back to the discussion between Deputy Calleary and Professor McHale. It is a conflict that legislators face in terms of actually making choices. From our perspective, we tend to be a bit agnostic on the choices made and look instead at the overall package. The idea that there are no resources available is simply not something with which we would agree. Within the fiscal rules, there is scope. Over the past two years, between 2015 and 2016, measures totalling over €6 billion were introduced. If there are priorities there that should be addressed, one notes that there was scope to do so. However, choices have to be made and there is no disputing that. The line has to be drawn somewhere. No matter where it is drawn, somebody will always point out the things that are just beyond the limit and say "We could have done that" or "We could have done the other". That is simply a fact of having limited resources. When it comes to the overall issue of addressing the problems, it is true that the fiscal rules place constraints on what can be done in terms of deficits. If, however, we want additional resources, we can either look at existing spending - the point has been made that there is limited scope for reallocation - or we can raise additional tax revenue. The rules do not stop us doing that.

Deputy David Cullinane: What about the distinction between borrowing for capital and current spending?

Professor John McHale: To a significant extent, the Deputy has a point. There is an argument that comes from economics that if an investment yields a positive financial return, it should be undertaken. There is quite an amount of discussion going on at European level on possible changes to the rules to create a greater distinction between current and capital spending. That is an important conversation to have. The point I was making earlier is that one cannot make too much of a distinction in the sense that they both lead to higher borrowing and, ultimately, higher debt. There could be investments that yield such a high financial return that they pay for themselves but debt often has to be rolled over in a very short period. The fact that it initially funded some good capital investment may not be particularly helpful when that debt has to be rolled over. As such, one must look at the overall level of debt as well. In our judgment, the path of debt reduction we are on, which is very much associated with bringing the deficit close to balance, is a sensible and prudent policy for the Irish economy in light of the fact that we are starting at a very high debt level and that there will be a lot of fiscal pressure from future demographics. To bring that debt down, given the volatility of the international environment we face, is important. As such, there is a distinction to be made and it is an important conversation that will take place over the next year or so. I expect that some changes in the rules will come from Europe. However, one should not lose sight of the other objective, which is to get the debt to safer levels so that we are not so vulnerable in a very uncertain world.

Deputy Stephen S. Donnelly: I thank the witnesses and congratulate Professor McHale on his term as chair. No doubt, he will enjoy his dinner tonight. I thank him personally. I have been sitting across from him for six years now and I thank him very much for everything he has done and wish him the very best.

I have been reading through the council's report and it is worth noting that the materials we got from the secretariat were superb. Whoever did that should be thanked on the record. In reading the report, I would be reasonably happy were I the chief executive of a multibillion euro organisation of some description. I would be quite happy about how things had gone at a macro level - notwithstanding some of the things that have happened - but I would be very nervous about the future. I will go into the detail but I start by asking whether we are now beginning to repeat the budgetary mistakes of the past. We can go into all of the detail, but is it the council's sense at a high level that we are now locking in permanent spending commitments based on what may be quite transient corporation tax returns and so on? Is the council concerned that we are back to a pre-crash era and setting ourselves up for a fall, with the caveat that there are no safety valves this time? There is no further public debt to be borrowed and there are no public sector pay cuts or other cutbacks for companies or households. The airbag is gone, the ABS brakes are gone and we are running on bald tyres as matters stand. Even a small correction would cause the State a great deal more damage because all the shock absorbers are, more or less, gone. Is it the council's sense that we are now beginning to repeat the mistakes of the past and setting ourselves up for the next fall?

Professor John McHale: I might put it a little differently in that we came out of the crisis, as we came out of previous crises, and made significant changes that had the potential to make us safer. A great deal was done on the banking side, with a new system of banking supervision and regulation, and a great deal was done on the fiscal side, including a great deal at national level. I point again to this committee and the council as examples of that having regard to the Fiscal Responsibility Act. We have put this framework in place, which also has complementary European elements, and if we are serious about it, then it has the potential to make us safer - albeit there are no guarantees. Certainly, it will allow the debt to come down in a phased way and prevent us from making the mistakes of the past because if one really follows these rules, it is very difficult to use windfalls of tax revenue to fund permanent increases in spending. One really has to wait for that spending to be based on the underlying growth of the economy. While we have a framework that can keep us safe - and we are not saying disaster is imminent - the signs are that we are not taking the matter all that seriously. That point has come up a few times.

Deputy Stephen S. Donnelly: I appreciate that.

Professor John McHale: It is the slippage and the fact that, if this is the path we are on, the framework will not be there when we really need it. However, I am not saying it is going to happen next year and it may not happen in five years. If we are forgetting the lesson this quickly and starting to slowly abandon the framework, it could happen again.

Deputy Stephen S. Donnelly: I will take that as a qualified "Yes". I thank Professor McHale. Should we pay down any of the debt?

Professor John McHale: Paying down the debt is equivalent to running budget surpluses. While I am sorry about the technical jargon, there is this objective to get the structural deficit down to 0.5% of GDP. If we can do that, we will be following the framework and we will have a fairly fast rate of reduction in the debt-to-GDP ratio. If we were to follow the framework over a long period of time, we would get our debt-to-GDP ratio down to 20% of GDP. It would take us a long time to get there. That would be done without ever running a budget surplus. I think that would be fine in normal circumstances, although my colleagues might disagree with me. We do not need to pay down the nominal debt and we do not need to run budget surpluses. I would like to make one qualification to that. If there are signs that growth is strong and the economy is overheating - let us hope in a way that this happens - it may be necessary for cyclical management purposes to run budget surpluses. That is how I interpret the Minister for Finance's proposal for a rainy day fund. His approach seems to be that if there are signs that the economy is overheating, he will run budget surpluses and put the money away into a rainy day fund so that it can be used for cyclical management purposes in the event of an economic downturn. While it may be necessary to run budgetary surpluses, this would be done for cyclical management purposes. If we follow the framework and get close to a balanced budget, it should be sufficient to let the debt-to-GDP ratio fall, largely through growth. That should get us to quite a safe place.

Deputy Stephen S. Donnelly: So the answer to the question is "No".

Professor John McHale: Yes.

Deputy Stephen S. Donnelly: I thank Professor McHale.

Professor John McHale: My answers should be shorter.

Deputy Dara Calleary: You can take the man out of lecturing-----

Deputy Stephen S. Donnelly: One potential way to square the circle by meeting the need for investment while running a tight ship without repeating the mistakes of the past is to meet the target that avoids this convergence margin. The council made the point in its report that on the current trajectory, we will miss our structural balance targets for next year and, in fact, we may be missing them this year. Is that not correct?

Professor John McHale: The Deputy is correct in respect of this year, but the projection is that the targets will be met next year.

Deputy Stephen S. Donnelly: Is it the case we will miss it because it is being calculated using the so-called commonly agreed methodology? Are we missing the structural deficit target under the commonly agreed methodology?

Professor John McHale: That is a very good question. To get the structural balance, an adjustment is made based on the output gap. If the economy is considered to have a positive output gap - to be overheating, to all intents and purposes - essentially, an amount would be added on to the deficit to get the structural deficit. Under this commonly agreed methodology, there is an output gap of almost 2% at the moment. It is increasing the structural deficit. If Ireland was above its target of 0.5% of GDP, it would have to bring the structural deficit down by 0.6 percentage points of GDP per annum anyway. We think the commonly agreed methodology overstates the size of the output gap. Based on our analysis, we are probably close to an output gap of zero, if not a slightly negative output gap. It is closing rapidly.

I will set out the implications of the mismeasurement, to the extent that there has been a mismeasurement. It will take us a further year to reach our medium-term objective than would otherwise be the case. If we had a zero output gap at the moment, we could take the general Government balance as being equal to the structural balance. The projection for next year is that the general Government balance will be 0.4% of GDP, which would be below the medium-term objective. The convergence margin would not apply in such circumstances. This means that the extra adjustment is going on for a year longer than would otherwise be the case. It would be better if this was not happening. In an ideal world, the output gap would be measured properly.

Deputy Stephen S. Donnelly: It will apply to next year. Is that not the case?

Professor John McHale: It would be applying to next year anyway.

Deputy Stephen S. Donnelly: If we were using-----

Professor John McHale: If one had an output gap measure of zero, one would still be facing the same policy for next year.

Deputy Stephen S. Donnelly: One would still be using it.

Professor John McHale: In such circumstances, the medium-term would be achieved the following year. Less adjustment would be required and there would be more fiscal space in 2018.

Deputy Stephen S. Donnelly: I want to ask about the increase in corporation tax receipts because there is a fear that corporation tax is the stamp duty of this decade. We do not know whether this is the case. The figures suggest to me that the unexpected increase of 50% in corporation tax in 2015 was caused by Apple moving its intellectual property onshore. A few other bits and pieces may have contributed, but the increase can basically be attributed to Apple bringing its intellectual property to Ireland and therefore paying more tax. Those figures more or less work. My question relates to the transience of the current position. I appreciate that this is hypothetical, but I suggest it is probably more relevant in the context of a more protectionist United States under the incoming US Administration.

In 2015, corporation tax receipts unexpectedly increased by approximately 50%, which was huge. I think approximately €3.5 billion in unexpected revenues were received. This money on its own basically allowed budgets to continue. If that had not happened, we would have had a very different last 24 months in the Dáil. Those revenues have been put in the book as steady-state continuous revenues. If Apple were to decide tomorrow to redomicile its intellectual property to Delaware, our revenue would fall in a day. My question is not really about Apple. I have mentioned it as an example of a company where there has been a sizeable shift. Given that these receipts have been steady for the past year and half since the unexpected 50% increase, is the council concerned that they could decrease again just as quickly?

Professor John McHale: We are concerned, but we are not forecasting such a reduction. We have looked at the variance in overall tax revenues and the contribution of corporation tax to the volatility in revenues. Although corporation tax accounts for just 14% of total tax revenues, it disproportionately contributes to volatility and to forecasting errors when it comes to tax revenues. We know that 40% of corporate tax revenue comes from ten company groups. We understand, partly from what was said when representatives of the Revenue Commissioners appeared before this committee in advance of the budget, that although a significant part of the overall increase in corporate tax revenue in 2015 came from a small number of companies, it was more broadly based. Based on what we know, it is not really just-----

Deputy Stephen S. Donnelly: I am exaggerating for effect.

Professor John McHale: Yes. There are big risk factors. As the Deputy has rightly pointed out, it is possible in the current international political environment that there will be fairly substantial changes to US tax law. It is very hard to predict that, but it is certainly a risk that is out there. Putting all of that together, one would have to be concerned that there is as much of a chance of a substantial decrease as there is of a substantial increase.

Deputy Stephen S. Donnelly: Yes.

Professor John McHale: The existence of that risk has to be recognised. It is dangerous to introduce spending increases or other tax cuts that are very hard to reverse on the basis of a revenue stream that is itself quite reversible. I feel wrong talking about corporation tax when Mr. Seamus Coffey is sitting beside me. He knows more about corporation tax than anybody else I know. Perhaps he would like to contribute to the discussion at this stage.

Mr. Seamus Coffey: There is no doubt that the receipts are concentrated in Ireland. I do not think there is a suggestion that the huge increase in corporation tax which took place in 2015 can be attributed to a single player. As the Deputy mentioned, it increased from €4.6 billion in 2014 to €6.9 billion in 2015. It looks like it will be €7.5 billion, or perhaps slightly more, in 2016. If one looks at the statistics that have been produced by Revenue, which include data by sector, one will see that there has been a fairly broad-based increase in the receipts across a number of sectors. The receipts are dominated by the manufacturing, financial services and information and communications sectors. All three of those sectors grew but I am not sure whether one could place any one company in all three sectors to say that it caused the receipts to rise. It does look as though the increase is more broad but I still think it is probably concentrated in a small number of companies but the number is probably more than one. Perhaps the opportunity will arise for a committee of the Oireachtas to question a company on how much tax it paid in 2015.

Deputy Stephen S. Donnelly: I thank Mr. Coffey. I have been told by the Chair that I have one question remaining. I wish to clarify the position on the fiscal space for next year. We have been told it will be €1.8 billion and that €0.6 billion will be spent on the Lansdowne agreement and other prior commitments, another €0.6 billion on carryover from the recent budget and a further €0.6 billion on demographics and inflation. I thought I heard Dr. Conefrey say that the €0.6 billion for inflation and demographics is over several years. The notes I have indicate that it is €1.8 billion split in thirds on the areas I have outlined but I am not sure. Is that correct?

Dr. Thomas Conefrey: Yes, that is correct.

Deputy Stephen S. Donnelly: So it is €0.6 billion for next year?

Dr. Thomas Conefrey: Yes, for 2018.

Deputy Stephen S. Donnelly: I am sorry. Yes, of course.

Professor John McHale: The €0.6 billion figure came up twice in that it was also the difference between our estimate of the demographics over the full five years but we are using it in two completely different contexts.

Deputy Stephen S. Donnelly: I thank Professor McHale. Deputy Pearse Doherty asked a similar question. The sum of €0.6 billion relates to demographics and it is price inflation to the State because things become more expensive to buy. Does it also include inflation increases for social protection payments?

Dr. Thomas Conefrey: Yes, it does.

Deputy Stephen S. Donnelly: Does Dr. Conefrey know how much of the €0.6 billion is involved in that regard, because that is the discretionary bit to which Deputy Doherty referred?

Dr. Thomas Conefrey: In terms of pure price effects on social protection in 2018, we estimate that to be approximately €300 million.

Deputy Stephen S. Donnelly: So half of that - €300 million - is to allow the Government to increase social protection payments.

Dr. Thomas Conefrey: That is correct.

Deputy Stephen S. Donnelly: I thank the witnesses.

Deputy Eamon Ryan: I join in the best wishes and thanks everyone has given to Professor McHale. He has done a really good job with his council and it is very much appreciated. I am slightly scared that we are back in a whole range of different ways to some of the conditions that created the economic difficulty. I really like what he said earlier about it not being left or right but whatever one's political view, if one believes in government it behoves all to be involved. It is easy sometimes to characterise fiscal prudence as a conservative right-wing mantra but if one believes in government, I suppose it also makes sense.

I wish to ask some very simple questions because there is so much information here one could be overloaded. I found the document very interesting. Figure 2.8 refers to the labour share as a percentage of GNP and I thought that was interesting. This is a big broad question. One of the characteristics of what is happening around the world in the past five to ten years is that this graph is borne out in reality across most western developed economies. The share of income to labour has fallen across the board and has remained low for a long period, beyond any historical context. I cannot remember the figures historically but typically it is up around 45% to 50%. That is a projection forward to set it at 38%. My understanding is that is what has happened in most western developed economies in the past five years at least. That is a very big macroeconomic question, but it relates to some of the questions we have around pay, which must be part of the debate. Did the overall western world economic model get something wrong in terms of what it is allowing? Even the German recovery, whose economy is ahead of us, had a very difficult time in incorporating the former East Germany and one of the things it seems to have done is retained capital to corporations as the big economic approach. Do the witnesses have any thoughts on that in terms of the share of labour in terms of the GNP figure? Am I correct in saying that is uncharted economic territory in the big wide historic sense?

Professor John McHale: This is something we spent a lot of time thinking about at the OECD in doing these international comparisons so if Deputy Ryan does not mind I will invite Mr. Barnes to respond as he is very close to that work.

Mr. Sebastian Barnes: It is actually quite complicated. It is true in many countries but it is not true in every country. The level and the trend in labour shares differ quite a lot by country as well. What Deputy Ryan said is a basic characterisation of it but if one steps back from the labour share as a measure, there are a couple of things going on and this partly relates to political pressures as well. First, the growth of GDP is lower, which is bad for everyone. Second, it is true that in many countries labour share has been on a declining trend and has been weak since the crisis. The development of labour has been quite interesting since the crisis. On the upside, one of the few things that has surprised in many OECD countries is that employment has held up or recovered a bit more strongly than we would have expected given the growth in GDP, which of course pushes up the labour share a bit, but what has been exceptionally weak is wages. That really reflects a combination of two things, depending on where it is, but in general there has been a big weakness in productivity growth and when that happens people do not get wage increases and that may partly be linked to the resilience of labour. The other thing is that there probably are some pressures in the labour market which means it would be very hard to push up wages. Something we see across many OECD countries is an absence of wage pressure. Even in places like the US, it is taking a very long time to get any evidence at all that wages are pushing up. Even though the economy has been unspectacular, it has actually been there for a quite a long time and usually normal economic relationships tell us that there should have been much more wage pressure than there was. A number of things are going on, not all of which are well understood, but they fit together to make a whole.

Deputy Eamon Ryan: We have an interest in that because some of the political consequences of what is happening in the United States and due to Brexit are due to the level of wages paid for rural American industrial jobs.

My second question is related and is based on figure 2.7 on page 42. To be perfectly honest, I could not understand the graph. I wondered why it was going back on itself. I am interested in productivity growth and where it was said that real wage growth is forecast to be slightly below productivity growth from 2018 to 2021. Where is our measure of productivity growth? How does one measure that? The figures for 2018 to 2021 are based on projections but where do they come from? How is our productivity growth occurring? I ask because I remember a line from someone in the middle of the crisis to the effect that if only we had tucked in behind Germany and had the same productivity growth it had and we were not losing competitiveness in that sense we would have been fine in the euro. People blamed the euro but it was because we lost our productivity and competitiveness. If we are to learn the lessons, then we must avoid the conditions being recreated whereby the euro environment might be out of step again with Irish economic circumstances. To a certain extent, as long as we can maintain productivity and competitiveness compared to Germany in particular - our biggest currency partner - we are okay. I always find it difficult to find out the productivity statistics and who measures them. How certain are we about productivity?

Professor John McHale: The standard measure of productivity is where total output is measured by GDP divided by the number of workers so it is GDP per worker. One can have different measures of productivity at sectoral levels but that is the standard national measure of productivity. The projected growth for the Irish economy is reasonably strong and we will also have growth in the number of workers, but still the most likely scenario for productivity growth is reasonably encouraging. The point that we have been making is that even though the central scenario is reasonably encouraging there are huge risks around that given the uncertainties that exist in the world. In terms of this particular graph, it is complicated, but if one sees those red dots flattening out as the unemployment rate falls, that is looking at the Government's projections for wage growth. Even as the unemployment rate falls, one is not seeing faster growth in wages. What one really should be expecting moving up along the black line is that as the unemployment rate falls, pressures in the labour market build and wage growth increases. This is part of our assessment of the projections for wage growth in the economy. We believe they are too weak. We would expect that as the unemployment rate falls - we certainly hope that continues - wage growth in the economy will be faster than is currently projected by the Department of Finance. That is what the graph is getting at.

Deputy Eamon Ryan: I have a question on the capital side.

Mr. Seamus Coffey: I wish to make a brief point. It follows from the point just made. The emphasis of the graph depicting the labour share in figure 2.8 is not necessarily the historical pattern. It is more to do with the projections from 2016 to 2021, when we anticipate that the labour share will remain flat, perhaps with the additional wage pressures that might be in the economy. We would expect that to rise rather than remain flat.

There is an important point with regard to the labour share in these aggregate statistics for the Irish economy. It is important to make a distinction between the two Irish economies, in other words, the labour share in domestic companies as against the labour share in foreign-owned companies. Ireland's labour share in domestic companies for gross value-added is approximately 80%, the second highest in the European Union. Only French domestic companies allocate a greater share of value added to labour than Irish companies. However, Ireland's labour share for foreign companies is by far the lowest in the EU. Up to 2014, the figure was 25%. After what happened to the data in 2015, I imagine the figure is now far lower than 25%. Let us consider the graph again. There is a significant downward step in 2015. That does not necessarily represent a reduction in wages. It represents a massive step-change in the value of output created primarily in the foreign-owned sector.

The data on labour share in Ireland gives a differing picture of the domestic economy, where it seems reasonable, although I am unsure of the trend. The trend could be down. However, there is a singularly distorted picture because of the foreign-owned sector.

Mr. Sebastian Barnes: This illustrates the work we do on the endorsement side of the forecast. The point of this section is to illustrate some areas where we believe there are alternatives to the assumptions or scenarios of the Department of Finance. This could have a major implication. For example, the wage implication is important for consumption and Government spending, especially if Government spending is going to have to follow these increases.

Deputy Eamon Ryan: What we will face in the coming year on the capital side will be interesting. We have to carry out a review of the capital plan. Since we were expected to get back to being in the good boys book, to use the technical term, we were supposed to get some freedom. The idea was that in 2019, 2020 and 2021 the fiscal space would open up for capital expenditure. That was my understanding. That may be at risk now if some of the indicators before us prove to be correct.

It takes some years to ramp up capital spending. Perhaps the job of this Parliament is to assess the options and come up with the priorities on capital spending. That is what we do in housing, transport, energy, broadband and so on. There is no shortage of it. These factors are affecting the productivity of the State in a real way now. Transport at this stage has reached gridlock. That means productivity loss. It is certain; it is a question of physics or mathematics. If there is gridlock, we are goosed. Therefore, we must spend in the short term but we do not have the money for it under the current capital plan.

I did not understand the trick in the speech from Professor McHale. It is in the fiscal assessment report as well. The idea is that if we put it into a separate box, it may give us the ability to account for it in a different way or to protect it if we get into a crunch. Can Professor McHale explain that mechanism?

Professor John McHale: Yes, that is why I baulked when Deputy Calleary referred to it as a proposal. Really, it is something rather minor. Given that we have an overall target for the deficit, capital spending can often get squeezed. It fell to a low level as a share of the economy. The figure has been below 2% in recent years. The suggestion is that we put more focus on public investment as a share of the economy or as a share of total spending. We should have a clear target for the figures in order that capital spending does not get squeezed.

I imagine politicians have a better sense than I do of how, when spending cuts have to take place, it is easier to quietly shelve a capital plan than cut health spending or fire teachers.

Deputy Thomas P. Broughan: Is that in a scenario whereby the growth rate falls? We are discussing the way public investment is linked to growth.

Professor John McHale: There is no doubt that public investment is linked to growth. These are the trade-offs we face. There is value to current spending and value to capital spending. They have to be traded off. Often, the effects of cutting capital spending are more long term but they affect growth. However, they are the more likely cuts than those which result in pain being felt more in the short term - these are more often on the current spending side.

We need to think about ways in which we can avoid that. We need to ensure that we do not have too low a level of capital spending, given its importance to long-term growth. That is behind the proposal to focus on the public investment ratio, although we are also facing an overall deficit target.

I would not term it a proposal or a trick. It is simply that we need to focus on that question.

Deputy Eamon Ryan: It is a question of emphasis. Is that correct?

Figure 1.1 of the report depicts the changes in several economic indicators. Let us consider graphs B, C and D. We have reason to be somewhat concerned. Perhaps I am naturally too cautious or conservative. One can understand the traditional industrial production figures going down because of Brexit, currency risks, agricultural food industries and so on. However, for domestic demand and personal consumption it is somewhat different. In some ways, it might not be a bad thing because one of the characteristics that got us into trouble was our domestic demand. Personal consumption went completely out of kilter with the economic reality.

How up-to-date are the council's statistics? Some of the figures are internal Irish Fiscal Advisory Council calculations.

Professor John McHale: We have more up-to-date figures as a result of the recent quarterly national accounts. Dr. Conefrey can give the committee the updated figures, or else we can pass them on afterwards.

Deputy Eamon Ryan: I would not mind if there was a slight tempering of growth because I worry about over-heating. If it came down to 3%, that would be fine by me. However, if it came down to 1% it would not be fine.

Dr. Thomas Conefrey: We do not have any cause for major alarm now. Certainly, it is not the case that there is any evidence for any signs for a big slow-down in growth. Apart from the industrial production chart, we are seeing continued growth in the other indicators, especially employment. Even in domestic demand and consumption, the figures are still growing. We made the point in the November report that the rate of growth in some of these indicators had slowed compared to what we saw in 2015. However, there was still continued respectable growth.

The take-away message from our side is that we will be watching these things closely. In particular, we will be watching the traditional sector of industrial production. That is a concern. Many of the firms in that sector are dependent on the UK market. The exchange rate movements are almost certain to have had a negative effect on that sector. Whether, more broadly, there is a slow-down is another matter. There is no great evidence of a slow-down more generally, but we will be keeping an eye on some of these indicators. They are growing at a slightly slower pace than we saw in 2015.

Deputy Thomas P. Broughan: My question follows from that point. At times, it seems to many of us that we are on the cusp or beginning of moving into a completely different economic era with the uncertainty of Brexit, the Trump presidency and the changes to quantitative easing. Does the Irish Fiscal Advisory Council try to build any of those uncertainties into the figures for domestic demand, investment and growth? The council is taking a far more conservative view of activity than the Department of Finance.

Dr. Thomas Conefrey: In our pre-budget statement we included some analysis of the possible effects of Brexit on Irish growth. Numerous studies have been carried out by the Central Bank and the ESRI. In most of the studies, the key effect they take account of is the conventional trade impact. For example, if there was a reduction in growth in the UK, then it would reduce demand for Irish exports. That is the main channel they take account of when looking at the possible effect of something like Brexit. In that analysis, we also took into account the possible effect of uncertainty on Irish growth. It is also the case that on top of the negative trade effect, growth in Ireland could be reduced because of Brexit and due to the effect of uncertainty on business investment and consumer confidence. That gave us a slightly higher impact than some of the other studies I mentioned with regard to what it may do to GDP growth. The effect for 2017 would be to knock about 0.75 percentage points off growth and around 0.3 or 0.4 percentage points thereafter, which is a little higher than some of the other estimates that were around at the time, mainly due to the fact that we have tried to take account of some of factors that Deputy Ryan mentioned. It is the case that there is much uncertainty around the possible magnitude of those factors. The reason the studies focus on elements such as the trade effect is that one can come up with some sort of reasonable estimate of what the effect on exports might be. The effect of higher uncertainty in the UK on consumer spending in Ireland or on business investment is, obviously, much more difficult to capture, but it remains a likely important effect.

Deputy Thomas P. Broughan: Overall, is the Irish Fiscal Advisory Council disappointed with the performance of the Government in 2016 for the 2017 outturn, because obviously there has been this slippage? Do the witnesses feel that is a very fundamental move away from the commitments the council made?

Professor John McHale: I would say it is a move away from the commitments we have made but at this point I would not exaggerate it. One could imagine the situation being an awful lot worse but that is why we refer to it as a slippage and an incomplete implementation of the framework. There are reasons to be concerned. We really believe this framework is something that can protect the State and when we see its incomplete implementation, it raises certain concerns. Again, however, I would not exaggerate it at this stage.

Deputy Thomas P. Broughan: Reference was made to revenue surprises but they are not really surprises are they? We would have known there were certain assets - even after the disaster of the banking crash - that would possibly be used in the coming years. Are these one-off surprises ever really total surprises? Obviously, the GDP measurements were a terrible shock to many people, and perhaps to the Irish Fiscal Advisory Council, but are the other revenue surprises really surprises? I note the point being made, and it is made well, but I had this discussion with the Minister for Public Expenditure and Reform last week in the House. I sent the Minister a balanced budget in the run-up to the Budget. My budget involved significant additional taxation on some of the more wealthy sections of society but it was very nicely balanced. The Minister said it was almost a neo-liberal budget because there were surpluses and so on. Are there some other positives surprises we may be able to take from the kitty in the years to come?

Professor John McHale: I would say that the 50% growth in corporation tax revenue in 2015 really was a surprise. It was not predicted. When one has something that was not anticipated in advance, there can be difficulty even understanding when it has taken place. We are, however, getting a better, but limited, handle on it and then we will have the ability to be reasonably confident that those revenues will remain there in the future. The thing about surprises is that they can come from lots of different sources. We certainly see a world with many potential downside risks, whether that risk comes from the US with its new Administration or from the eurozone where there is always the possibility of events taking a bad turn, be it led from events in Italy or elsewhere. At the moment some of the signs of the form Brexit will take are not particularly encouraging. It could, however, be something completely different. We live in this very uncertain world and we are still in quite a vulnerable place. I know there is a sense that the bad times are behind us and why is the Irish Fiscal Advisory Council going on about the crisis and the vulnerabilities, but they are really still there. We still carry a lot of debt forward with us from that crisis period. Although things have recently taken a reasonable turn for the better, they could again take a turn for the worse. It is not just a case of specific risks that we could confidently identify as adverse events that will happen; the more general point is to be ready and to be in a strong position to be able to sustain Government spending if such an adverse event were to occur.

Deputy Thomas P. Broughan: With regard to the Minister's comments on the rainy day fund and the 45% debt target - this may have been raised earlier - does the Irish Fiscal Advisory Council see the comments as just rhetoric in the sense that the State has such an infrastructural deficit, or is it a target we could be realistic about?

Professor John McHale: This point came up when we appeared before the committee previously and it partly came up earlier also. Even if we follow the existing framework, and that does not require getting into budget surpluses, even if we get to a deficit of about 0.5% of GDP, once we get the debt to below 60% of GDP we are allowed to run a deficit at 1% of GDP. If we were to stay at that level and had around 5% nominal growth, 3% real growth and 2% inflation, the debt-to-GDP ratio would fall to 20% of GDP over time. I do not see much value in coming up with another target of 45% which would be an intermediate target along the way, given the framework we already have in place and which does not require us to run budget surpluses. The 45% target does not do much harm but I do not see it as adding a huge amount of value either. Will the Deputy remind me of his other question?

Deputy Thomas P. Broughan: It was about the rainy day fund.

Professor John McHale: The rainy day fund, again, was discussed earlier. I feel I have monopolised the debate. Does my colleague, Mr. Tutty, want to speak on the rainy day fund?

Mr. Michael Tutty: The rainy day fund is a good idea if we want to put aside money for bad times. It is something we should do in good times, not spending it automatically because when the bad times come we will not have room for manoeuvre to up our expenditure. We would be back in to the bad times of having to reduce expenditure and increase taxes at the wrong time from an economic aspect. There are issues about how a rainy day fund can be used within the fiscal rules. If we just put money into a fund, it is not real expenditure from the general Government point of view, but when it is taken out and we spend it, the money becomes expenditure from a general Government point of view. How it will fit in with the fiscal rules has to be looked at but, in principle, the rainy day fund is a good idea to put aside money in good times and have more available in bad times. Otherwise, we just find our tax revenue reducing and the budget deficit starting to increase rapidly and there are no reserves to use. In principle, it is good but the modality of it certainly has to be looked at in how it fits in with fiscal rules.

Deputy Thomas P. Broughan: Does it also depend of the performance of the economy like other sovereign wealth funds and so on?

Mr. Michael Tutty: Yes. Ireland was putting money into the National Pensions Reserve Fund in good days, and we were lucky to have that available when the crash came. The rainy day fund would be a similar type of operation. It is always easy, however, to talk about a rainy day fund in the future. Putting it in place at the present time is always more difficult as there are always so many other good things that the Government can do with available funds.

Deputy Thomas P. Broughan: I thank Professor McHale for his service to the State in the past five and a half years with the Irish Fiscal Advisory Council. I wish him well.

Chairman: Deputy Broughan never told the committee how he felt about being called a neo-liberal.

Deputy Thomas P. Broughan: I reject it.

Chairman: The comrade recovered. I too thank the members and staff of the IFAC, who are present. I think there are nine in total. I will not detain them much longer. I thank Professor McHale, who had a difficult role at certain times in the past six years. He has engaged with the committee since we were established and other Oireachtas committees. I speak on behalf of all the members and Members of the Oireachtas to wish him well in the future.

I thank everybody else for their attendance.

Is Deputy Doherty indicating that he wishes to speak?

Deputy Pearse Doherty: I am sorry Chairman, I have a question. I know the Chairman was doing the long goodbye.

I wish to raise a minor issue. We did not touch on the bond bubble, and although quantitative easing has been extended at the same time it has been signalled that it will be turning off and the fact the State is likely to reach the limit early next year. We have seen movement in bond yields in the past number of weeks, some significant movement in the century bonds - reducing by about 40%. I know Professor McHale spoke earlier about debt and the importance of reducing the debt levels because they have to be refinanced. In the council's view, is it bigger than that? Are we seeing a bond bubble that is about to collapse both in Europe and further afield?

Professor John McHale: When it comes to identifying bubbles, that is really difficult. It certainly is a source of risk, that interest rates that have been, as Deputy Doherty states, at very low levels and giving huge support to the budgetary position. If the interest rates were to rise, we would have very different debt dynamics.

On the other hand, at the moment, it does not seem that the markets are predicting very substantial interest rate increases during the next ten years or so. One can see that by looking at the yield of the bonds, the fact that yield on Irish ten-year bonds has increased to above 1%; I think they came back down and I am not quite sure where they finished today. However, a ten-year bond yield gives members some idea of the average interest rates that are expected over the next ten years on shorter-term bonds, essentially it is average interest plus a risk premium. The market's assessment is still quite sanguine in terms of how low interest rates will be in the next number of years. If it is a bubble, the fact that those yields are so low and the prices are so high is indicating a bubble. That could be the case, it could burst and could change very quickly. There is risk there, but at least the market assessment is still that interest rates are going to stay low for a protracted period.

I had not been aware of the century bonds which the Deputy mentioned, which shows that the market's longer-term expectations of interest rates have taken a jump upwards but given one is not seeing it in terms of the ten-year bonds, it is outside that ten-year window. It is certainly a risk but it does not seem that there has been a huge change in market sentiment thus far, though certainly some change

Deputy Pearse Doherty: We will hold Professor McHale to that as his parting thought.

I wish to be associated with the Chairman's remarks on the service Professor McHale rendered to the State and to this committee during his leadership of the Irish Fiscal Advisory Council over the past five and a half years. I wish him well.

Professor John McHale: I appreciate that and thank the Deputy.

The select committee adjourned at 6.55 p.m. until 4 p.m. on Tuesday, 17 January 2017.