DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 20 Meitheamh 2017

Tuesday, 20 June 2017

The Select Committee met at 4 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Deputy Lisa Chambers,
Deputy Colm Brophy,	Deputy Pearse Doherty,
Deputy Thomas P. Broughan,	Deputy Michael McGrath,
Deputy Joan Burton,	Deputy Eamon Ryan.

DEPUTY JOHN LAHART IN THE CHAIR.

Business of Select Committee

Vice Chairman: Apologies have been received from Deputies Dara Calleary, Pat Deering and John Paul Phelan. On behalf of the committee I send our congratulations to Deputy John Paul Phelan on his appointment as Minister of State at the Department of Housing, Planning and Local Government.

No. 1 on the agenda is the minutes of the meeting of 14 June. Are they agreed? Agreed. Are there any matters arising from those minutes?

Deputy Thomas P. Broughan: I wish to raise section 39 health organisations. This is still a critical issue. Is it the case that we will meet the not-for-profit organisation about this, that it will make the full presentation to us on the restoration of funding and that we can consider it in the context of the Budget Statement in 2018?

Vice Chairman: That is agreed.

Deputy Thomas P. Broughan: That is the situation.

Vice Chairman: We will do it before the budget. It will probably be in September.

Deputy Lisa Chambers: Chairman, do we have more scope to invite other groups to appear before us to provide evidence to us? What time is available for us to hear from other groups?

Vice Chairman: I am told we have some time in September. Does the Deputy have an interest in hearing from a group?

Deputy Lisa Chambers: I think it would be prudent to hear from groups on Brexit and on the terrorist attacks in the UK in recent weeks in order that as a budget committee we would discuss our defence budget. In that context, it would be prudent to hear from one of the Army representative associations or both, that is, RACO and PDFORRA, and they could present to the committee. We have one of the lowest spends in terms of defence capabilities in the European Union. We are now dealing with a new scenario in terms of Brexit. Clearly, events in the UK and in Waterford have highlighted the need to discuss our current budget spending on defence. Members may feel it is adequate but I do not. As a committee, we need to have that conversation. I would be eager to have that conversation in advance of our report for this year.

Vice Chairman: We will take that suggestion on board and come back to the Deputy on it.

Deputy Lisa Chambers: I thank the Chair.

Vice Chairman: No. 2 is our work programme. An updated work programme has been circulated to members. It is possible that a meeting will be held on Tuesday, 18 July to review the summer economic statement and the mid-year expenditure report. We await confirmation of the publication of these reports by the Department of Finance. I ask any member who has suggestions for changes to the programme to contact the clerk to the committee.

With regard to the National Economic Dialogue, I remind members that we are scheduled to attend the NED on Wednesday 28 June and our meeting with the European Investment Bank is scheduled for Thursday 29 June. Will members please confirm their attendance at NED to Ted, our clerk to the committee?

Before we return to public session with witnesses, is there any other business that members wish to raise?

Deputy Lisa Chambers: I have a further proposal on the defence issue. If it is not appropriate or not considered necessary to hear from the representative associations, in the alternative might we hear from the Minister of State with special responsibility for defence, Deputy Paul Kehoe? Perhaps he would brief the committee on his Department's work in that regard.

Vice Chairman: We will consider that. Are there any further views on that? No. We will invite in our witnesses.

Irish Fiscal Advisory Council: Discussion

Vice Chairman: I would like to introduce the witnesses. I welcome members of the Irish Fiscal Advisory Council, IFAC. They are very welcome to the Committee on Budgetary Oversight. I welcome Mr. Seamus Coffey. I believe it is his first appearance before this committee in his capacity as chairman of the Irish Fiscal Advisory Council. I will also take this opportunity to thank Mr. Coffey's predecessor, Professor John McHale. I also welcome to the committee IFAC members Dr. Martina Lawless, Mr. Michael Tutty and Mr. Eddie Casey who is the chief economist with IFAC and head of the secretariat. We are to discuss the fiscal assessment report. Before I begin I advise members of the committee and witnesses to turn off their mobile phones as they interfere with the sound quality and transmission of the meeting.

I bring to the delegates' attention that witnesses are protected by absolute privilege in respect of the evidence they are to give to the committee. However, if you are directed by the committee to cease giving evidence on a particular matter and you continue to do so, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given and you are asked to respect parliamentary practice to the effect that where possible you should not criticise or make charges against any persons or entity by name or in such a way as to make him, her or it identifiable.

Members are reminded of the long-standing parliamentary practice to the effect that members should not comment on, criticise or make charges against a person outside the Houses or an official either by name or in such a way as to make him or her identifiable.

I invite Mr. Coffey to make his opening statement.

Mr. Seamus Coffey: On behalf of the Irish Fiscal Advisory Council, IFAC, I thank the committee for allowing us to attend and to discuss our recent fiscal assessment report, which was published a few weeks' ago. Joining me today are fellow council members Mr. Michael Tutty, and Dr. Martina Lawless. Unfortunately Mr. Sebastian Barnes and Dr. Íde Kearney cannot attend. The council secretariat Mr. Eddie Casey who is the IFAC head of the secretariat and chief economist is also present as are Mr. Niall Conroy, Ms Kate Ivory and Mr. Kevin Timoney.

At the outset I acknowledge to the committee the work of the council's previous chairman, Professor John McHale, whose efforts made a huge contribution to the establishment and development of the council over the last years. It is a tough task, but I hope to maintain the standards set during Professor McHale's tenure.

The council's work has been helped by interacting with this committee. Our previous chairman valued these engagements, as do my fellow council members and I. We hope we can continue to interact meaningfully with the committee and I would also like to acknowledge the ongoing interaction between the secretariat and the Oireachtas staff to support these meetings.

The IFAC published its 12th assessment report on the 7 of June. The report covers all aspects of the council's mandate, as set out in the Fiscal Responsibility Acts 2012 and 2013. The report assesses: the macroeconomic and budgetary forecasts in the Government's 2017 stability programme update; compliance with Irish and EU fiscal rules; and the appropriateness of the broader fiscal stance.

I will now turn to the fiscal position. It is worth noting the significant progress that has been achieved in resolving Ireland's fiscal crisis. Ireland's underlying deficit was brought below 3% of GDP in 2015 from a peak of 11.5% of GDP in 2009. This achievement reflected a sustained effort at consolidating the public finances by successive governments. The efforts made since 2008 have helped to finally put debt levels on a declining path. While debt is expected to rise in euro terms over the coming years, it is expected to decline steadily as a percentage of total government revenue. Strong economic growth, record low interest rates, and the move toward a balanced budget help underpin this turnaround. In turn, this has helped to restore the State's capacity to borrow independently but significant challenges remain both from a macroeconomic and fiscal perspective. On the fiscal side, high debt levels limit our room for manoeuvre. Net debt, which strips out the government's cash and liquid asset holdings, increased from €26 billion at the end of 2006 to more than €175 billion at the end of 2016 and this continues to rise, albeit much more slowly.

Measuring Ireland's debt against GDP has become increasingly meaningless, given recent distortions. Current debt levels are equivalent to 2.4 times the total annual revenue of the Government, whereas pre-crisis levels were equivalent to just 0.4 times total revenue and the current EU average is 1.5. Ireland's net debt-to-revenue ratio remains the fourth highest in Europe, behind Greece, Portugal and Cyprus.

On the macroeconomic front, there are risks in the short-run that the recent cyclical recovery in employment and output could continue more strongly than is envisaged in the latest forecasts. This could even lead to overheating, for example, if the property market were to respond more rapidly to persistent supply shortfalls. The latest Department of Finance macro-forecasts imply that the number of new houses completed each year would steadily increase by around 3,000 units until annual completions reach 30,000 in 2021 - but it might increase much faster. The IFAC would welcome a recovery in housing supply, but notes that higher than normal levels of new house completions might be required for some time to address a large backlog or pent-up demand. Put simply, if we need 30,000 to 35,000 housing units each year, as the ESRI suggest is consistent with structural demand, then we might need to produce more than this until any backlog is sufficiently dealt with. Producing more housing units would lead to faster growth and faster tax revenues but would not be expected to last forever. Instead, high levels of output might only be expected to last until such time as the backlog is addressed before eventually returning to more normal levels. Previous research by the ESRI suggests that an additional 10,000 new house completions would add one percentage point to GNP growth and this would likely be tax-rich in nature. We need to consider how we would deal with any faster than normal, and likely transient, growth in revenues.

An appropriate way to deal with cyclical risks like those potentially arising from housing would be to allow supply to recover and even exceed normal levels, while recognising that the associated revenues would be transient. Looking through short-run developments and increasing spending in line with the economy's sustainable growth rate would be a sensible way to manage the economy and public finances. To manage the public finances prudently, we need to think carefully about what growth rates - and by extension, government revenues - might be considered sustainable. Looking further ahead, the IFAC sees risks that trend growth rates for Ireland might be weaker than was previously thought. This could happen if a harder than expected Brexit occurs, or if risks related to US economic and tax policy were to materialise. Productivity, which is the key driver of growth in the long run, has important links to trade but Brexit could decrease trade, and exporters face significant challenges in diversifying into other markets.

Having achieved a general government deficit of less than 3% of GDP in 2015, Ireland entered the domestic budgetary rule and graduated from the corrective part of the EU's Stability and Growth Pact to its preventive arm. The rules help prevent governments repeating policy mistakes that contributed to crises in recent decades. The new framework can help us to withstand future shocks, and help to prevent overheating. The rules help us to avoid using cyclical or transitory revenues to fund permanent spending increases, while allowing faster spending growth if it is funded by sustainable revenues. So far, Ireland has shown a minimalist approach to compliance with the fiscal rules. This is the first two years in which the new budgetary framework operates. A breach was observed in 2016 and further breaches are planned for 2017. Such breaches can result in levels of spending that are permanently higher than would have been the case if the rules were complied with. If repeated, we could end up with spending levels that outstrip the pace at which Government revenues can sustainably grow.

Strengthening Ireland's fiscal framework is an important, positive legacy of the economic crisis and one which the Government has committed to respecting. The Oireachtas, the Council and the wider public have roles in monitoring and enforcing the national rules. The framework should help to make future boom-bust cycles less severe, guide Government debt to safer levels and underpin borrowing capacity during a period when high debt levels will leave Ireland vulnerable to shocks.

It is important to remember that constraints imposed by the rules are likely to be less severe than the constraints that can also be imposed by debt markets. As experienced by Ireland in 2010, debt markets can be even more demanding in terms of the fiscal policies viewed as consistent with access to funding to cover deficits and roll-over debts. A credible commitment to a framework that ensures debt sustainability can also allow Ireland to expand rather than narrow the room for fiscal manoeuvre.

Our assessment is that plans should remain consistent with this new framework beyond 2018. At that time, the rules will allow us to expand budgetary policy more in line with the economy's sustainable pace of growth, while steadily reducing debt levels sticking to the spending rule - the expenditure benchmark - after that would be a sensible guide for fiscal policy. While not a formal requirement, this position would go some way towards avoiding a fiscal policy that aggravates the boom-bust cycle.

To conclude, I thank the committee for again providing us with an opportunity to attend today. We look forward to taking questions and hearing the views of members.

Vice Chairman: I thank Mr. Coffey. I call Deputy Chambers as she was the first to indicate a wish to speak.

Deputy Lisa Chambers: I thank Mr. Coffey for his presentation.

I recall that on the last occasion, when IFAC made a presentation to us in the run up to the Budget 2017, the fiscal space, as we knew it then, in terms of the money that was available to spend, IFAC advised the committee that the fiscal space was at the upper limits of prudent spending in terms of protecting the economy. Following that presentation, the Government managed to find additional funds and spent an additional €200 million. I am interested in hearing the views of the witnesses on that matter given that prior to the additional spend IFAC felt we had already reached the limit. What is Mr. Coffey's view on the additional spend? Did it have a negative impact on protecting our economy and servicing the debt? Was the Government's decision to spend the extra money prudent?

I have a few questions on Brexit. To what extent does Mr. Coffey believe that Ireland can benefit from inward investment following Brexit? Did IFAC factor Brexit into its own forecast? If so, in what way?

Mr. Coffey touched on compliance with the budget rule in his opening statement. He said that we have breached the rules. Can he outline the breaches? What impact will they have?

Mr. Coffey made an interesting comment on housing. He said that if we respond too quickly to the housing problem and build houses too fast that we could overheat the property market. I would like to hear his views on the current Rebuilding Ireland plan. Should it be revised? Will IFAC contribute to the current review of the plan in light of what he has said here today?

Vice Chairman: The Deputy has asked questions on the four topics of Budget 2017, Brexit, the financial rules and housing.

Mr. Seamus Coffey: I thank Deputy Chambers for her questions.

We assessed the figures for budget 2017 in our November 2016 fiscal assessment report. She is correct to say that prior to that we had said it would be prudent to increase fiscal space to between €1 billion to €1.2 billion for the budget. Yes, the budget went beyond that. In November 2016 we said that expenditure went beyond what was prudent and was inappropriate for the economy both from a fiscal perspective, managing the public finances, and from an economic perspective.

In terms of public finances, one might say that the impacts are small. The breach of the expenditure benchmark was €200 million. The additional €200 million in a sense is baked in and occurs each year. If one gets repeated breaches of the fiscal rules - as we are getting - there will be a build-up of spending and maybe tax cuts above what would sustainably be allowed. It is not simply a case of small breaches. Once one adds them up one gets to a significant position. We have only been in this part of the fiscal framework for two years. It looks like we have breached the rules for 2016 and are set to breach them for 2017. If those patterns continue there is a potential that public finances will be in a more vulnerable position than they would have been if we had adhered to the fiscal framework.

The Deputy asked what impact Brexit will have on the fiscal framework. One impact of not adhering to it is that we would not be in as strong a fiscal position to deal with the impact of Brexit as we might otherwise be. She spoke about the benefits of Brexit. At the moment much of the focus is on how much Brexit will cost the Irish economy. If it does bring costs, we would like to be in a position to deal with them and absorb them. When one wants additional fiscal effort to deal with such problems then one wants to have it available. If we have already used the additional fiscal effort then it will not be available. Ireland has a history spanning 50 years of using fiscal resources when they were not needed and not having them available when they were needed. That is the cycle that we want to break. It is unclear whether we have moved far enough away from the old patterns to allow that to happen.

In terms of the benefits of Brexit, a hard Brexit has been built into the current macroeconomic forecasts. One could say there is an upside if Brexit does not turn out as hard as envisaged. Let us consider the growth forecast produced by the Department of Finance. It has already knocked half a percentage point off the GDP growth rates for most years out to 2021. Depending on the outcome of the negotiations, maybe Brexit will not be as hard as that.

It is not the Irish Fiscal Advisory Council's role to judge whether Brexit is beneficial. If the UK leaves the customs union and the Single Market there is potential for Ireland to benefit but it is very difficult to say what form that will take. There has been some focus on the financial world and whether financial companies would move. From an Irish perspective, I am sure we are interested in employment. It is unclear how Ireland could benefit from companies moving their head office or the licensing part of their operations. The key issue for us is the potential impact Brexit could have on trade out of Ireland. If there is a hard Brexit and trade barriers imposed then Ireland's potential growth rate would be lower. Irish companies must find different markets and are well used to dealing with the UK market. From a food perspective, both countries have similar tastes. We make products that we consume and they consume but it may not be as easy to enter other markets.

In terms of the breaches of the fiscal rules in the past number of years, the breach in 2016 was primarily in terms of the structural benchmark or deficit. In terms of the continued improvement we must make in our deficit, we brought it below 3% of GDP but it was still a deficit. There is a requirement to move to what is called a balanced budget in structural terms. A balanced budget is deemed to be -0.5% of GDP, to which we must make steady improvements. The requirement is to improve by 0.6% percentage points of GDP each year. There was a 0.3% improvement in GDP in the outturn for 20016. That means we were 0.3% short.

The expenditure benchmark is the other rule. Ireland, under the rules that applied at the time, did not breach the expenditure benchmark in 2016. That was primarily due to a technical adjustment that was not made. There was an AIB transaction in 2015 that allowed additional spending. We did not breach the expenditure benchmark.

It looks like both rules will be breached in 2017 and, thus, we would not have the required improvement in the structural balance. We are supposed to improve it by 0.6 percentage points of GDP. We are not getting there fast enough. Again, a breach of the expenditure benchmark has been planned for.

Reference was made to the principle that sets the amount of fiscal space or how much one can increase expenditure. Given what has been done in revenue, and we have had some revenue reducing measures that limits expenditure, yet we have increased expenditure above the expenditure benchmark, and it is planned to breach that in 2017. One could say that the breaches that took place in the two years were minor but they do start to accumulate.

The final topic that the Deputy raised was housing and overheating the property market. One of the problems that we see at the moment is that the housing supply is so low and, thus, problems are building up. It is pretty clear that housing output is below the equilibrium level. The longer that situation persists the greater the chance of pent-up or unmet demand. When housing output does begin to increase, not alone will we have the equilibrium level of output that we want to have to meet ongoing demand, we will have the legacy problem of five years of reduced output. Output could ramp-up pretty quickly, not necessarily from the public sector but, equally, from the private sector. The latter has the potential to increase much faster. There is a concern how that situation will impact on the economy. The employment rate has hit 6% and growth remains quite strong. The economy will probably grow by between 5% and 6%, which is above it long-run equilibrium growth rate. There is difficulty in measuring that but it is probably somewhere between 3% and 4%. The economy is growing above that at present. If we were to ramp up housing output, and if it does ramp up, where are the workers going to come from if the unemployment rate is dropping? Are we going to lose workers from other sectors? Are people going to transfer to construction? Will this lead to wage pressures as there is competition for workers? Perhaps workers could be imported through net inward migration but they would require housing. We would be bringing in workers to solve a problem that they are adding to. The issue is whether there is the space in the economy, both the fiscal space to fund additional public spending on housing and the resource space is available. At present we see no overheating in the economy. The unemployment rate is low, but at 6% there is still some capacity in the labour market. We are not seeing a large increase in credit, which would be an issue in respect of an economy that could potentially be overheating. What we would like to get is a much clearer picture on our external position. Are we borrowing money from abroad? Are we living within our means? At present our external position is hugely influenced by the impact of the multinationals. It shows Ireland having a huge balance of payments surplus in that there is far more money coming into the Irish economy than leaving. If that is accruing to multinational companies, it is not necessarily giving us a true position of where the underlying position of the Irish economy is. The CSO has promised to give us an improved measure over the next couple of weeks. If we look at an indicator of where an economy is going, the current account, the flow of money in and out of a country is a very important indicator. We do not have that at present. Across the range of indicators we have looked at, we do not see overheating pressures but we see the potential to move in that direction.

Deputy Joan Burton: I welcome the members of the Irish Fiscal Advisory Council. Following Mr. Coffey's fairly extensive answer, I wish to raise two points. In regard to the calculation, Mr. Coffey said fairly trenchantly that measuring Ireland's debt against GDP has become increasingly meaningless, given recent distortions and so on. The proposals being discussed by the CSO and other bodies about recalculating that in respect of GNI* has also led to a situation where at this committee last week, one of the assistant secretaries in the Department of Finance spoke a debt to GDP target of 45% into the long run. I would like to know whether the Irish Fiscal Advisory Council shares the view that Ireland needs a very significant infrastructure investment in order to modernise the economy and to keep the economy competitive pre-Brexit and post-Brexit, in particular in areas such as public transport and finishing off the roads network, which is incomplete, especially in large sections of the west coast and the connections between the major cities of Cork and Limerick. Are the two aspirations inconsistent - in other words, the suggestion has been made but there has been no detailed work that I am aware of that PPPs could replace direct Government spending on infrastructure. However, from what I know of EUROSTAT, and the witnesses probably know a great deal more of its inner working, EUROSTAT increasingly is looking unfavourably on PPPs, as being rather much the same as direct infrastructure projects because if one builds a public hospital or a public road, even if the financing is done by private means or through private mechanisms, essentially the State carries the risk, because it cannot close down a public hospital, a public road or a public courthouse built by a PPP. That is not going to happen. We have several examples from the UK, including Scotland, and from different parts of Europe that PPPs are a particular construct. Mr. Coffey commented on the measurement of the debt to GDP ratio being largely meaningless, does he share the approach in developing this GNI*? If so, could he give us an explanation in simple English of what it means? We feel we have stars in our eyes in relation to GNI*, not being mathematicians. I am very concerned about the very hardline stance of the Department of Finance. Last year when it came to the budget, this committee was told by the Department of Finance that it was all signed off but on budget day, it was very significantly different. That was pretty much on the day before the budget; it was not months or weeks in arrears. Will Mr. Coffey give us his thoughts on this? We are preparing for the scrutiny of this year's budget and we have a stand by the Department of Finance of working to a debt level of 45% of GDP. We also have an infrastructural deficit - I do not know if the IFAC shares that view - which needs to be addressed. How do we reconcile these two apparently irreconcilables?

Vice Chairman: There are two issues, one on the GNI* and an explanation of it and the measuring and calculation of debt and infrastructural investments.

Mr. Michael Tutty: I will let Mr. Coffey speak about GNI* because he is the nerd in that area rather than me.

Let me address the debt level, at EU level the requirement is still to get to 60% of GDP but GDP is becoming increasingly distorted from our point of view and that is why the previous Minister for Finance decided we should be aiming at 45% rather than 60%, taking account of the 26% increase in our GDP in 2015. From a practical point of view that was really adjusting for that 26% increase. The 45% was really pretty well equivalent to the previous 60%. It was not that he was trying to do something even more than had been set out before. We would certainly agree with that approach because our debt is still rather high. As Deputy Noonan pointed out in one of his last speeches, on a *per capita* basis, Ireland's debt is the fourth highest in the world, behind Japan, the USA and Singapore. Looking at it on a *per capita* basis, we are above every other European country. In terms of GDP, we are a little below some of the others but in *per capita* terms we are still very high and we are still borrowing money. We need to get the debt level down in order to protect ourselves from shocks in the future and to give more room for manoeuvrer whenever there is a downturn once again. On that basis, we certainly support the aim of getting down to 45% or even below it in terms of GDP to debt ratio and getting it down in terms of our share of revenue or GNI to the appropriate level.

We certainly agree there is a need for infrastructural expenditure. The only issue is whether we have to borrow more or to change priorities in terms of what we are doing with the existing resources. We know that during the bad times capital expenditure was cut far more than other areas, but it is not clear that going off to borrow more money for capital expenditure is the way rather than to use the fiscal space for capital expenditure as opposed to current expenditure or tax reductions.

I will hand over to Mr. Coffey to speak on GNI*.

Mr. Seamus Coffey: In terms of GNI*, traditionally, the view in Ireland would have been that to get a measure of Irish national income, one would subtract the profits of the foreign multinationals and go from GDP, the measure of output to GNP, the measure of income, and one would have net factor income from abroad, how much of the profit earned here accrues to shareholders abroad, primarily in the US. Until recently that adjustment would have been sufficient. GNP would have given a pretty useful measure of what was happening to the incomes of Ireland and Irish residents. That would have been standard way of doing it. There is a gap between GDP and GNP. Until recently, it may have been appropriate to put some of these ratios, just in terms of GNP to get an Irish comparison. Now that has been distorted itself. We have additional factors that are causing the measure of national income that was previously used to be further distorted. For example, some of the companies are redomiciling to Ireland. Where are the profits being attributed to? Not only do we have US companies setting up operations in Ireland, but some have redomiciled here in recent years in so-called inversions. In this way, companies do not change their presence in Ireland and retain their presence around the world. If a company has a factory in the US, Germany or Kinsale, the profit generated by that factory gets attributed to the US. When the company redomiciles to Ireland, the profit generated by its factory in New Jersey or Germany gets attributed to Ireland. If the company distributes the profit as dividends to its shareholders, that is not an issue because there is money in, money out and the net effect is zero, but these companies do not distribute all their profits as dividends. Rather, they retain them for investment and many other purposes. As long as these companies have retained earnings that they are using for investment, it is counted as Irish income, but it is worth nothing to Irish people. Companies domiciled here might generate profits in Germany and invest them in France, but it is counted as Irish income. GNI* will account for these redomiciled companies by stripping out that income.

A second factor that is influencing the Irish measure of income has been the onshoring or shifting of intangible assets to Ireland, mainly by US companies. Once the intangible comes to Ireland, a large amount of profit is attributed to it. Many US companies generate their profits through their intellectual properties, IPs, for example, pharmaceutical companies with patents and products or communications technology companies with their software, branding or products. Once they shift their IPs to Ireland, the profit is declared here. One might not believe this to be an issue and that the profits attributed to Ireland will be stripped out in the traditional way before returning to the measure of Irish national income, but the issue is that the measures are all gross, for example, gross domestic product and gross national product. When these IPs - these intangible assets - are moved to Ireland, there is a large amount of depreciation. An intangible asset might be worth a great deal now, but if a patent or licence for a product has a fixed life, its value is written down as the end of that life nears. These assets are depreciating in value. They earn large profits that are attributed to Ireland, but nothing flows from them. Due to the depreciation, they do not show up in the accounts.

The role of GNI* is to correct for these two factors. It strips out the earnings of redomiciled plcs that are not attributable to Irish residence and accounts for the depreciation of intangible assets. The profits being generated by assets in Ireland are not going to Irish people. The traditional shift of stripping out the profits of US multinationals to go from GDP to GNP will still happen, but GNI* proposes two further adjustments: to account for the profits of redomiciled plcs, which in recent years amounted to a significant sum of between €8 billion and €10 billion; and to account for the depreciation associated with the IPs that are relocated to Ireland, which could be between €25 billion and €30 billion. These will be significant adjustments when they are made, given that the factors in question contributed to a 26% GDP growth. GNI* should give us a better indication of what is happening to the income of Irish residents. That is the hope. Perhaps there will be other distortions further down the line, but those two are significant.

The CSO will publish GNI* in the coming weeks, including on an historical basis for previous years, so we should be able to see what actually happened in 2015. We had a 26% GDP growth rate as well as an 18% GNP growth. We would like to know how the economy grew in 2016 and whether there were similar distortions. The future data sets will be useful. GNI* will allow us to get a better indication of the underlying position of the economy.

We would love to be able to answer the question on whether there is an infrastructure deficit in Ireland. This is not unique to Ireland. Most countries have poor data on their public capital stock. In terms of roads, buildings, schools, hospitals and transport, do we know how we compare with other countries? In that respect especially, it is difficult for us to know how we stand. We do not know whether we have an infrastructure deficit. We can say that we do, but it can be difficult to know what is happening in other countries to allow for that comparison to be made. Someone could argue for one project over another in terms of public transport, roads, hospitals and so on, but that is not the job of the IFAC. We examine the overall fiscal situation.

I tend to agree with EUROSTAT's view of where the risk in public private partnerships lies. The risk should not be shifted off the balance sheet, particularly in transport projects where a fixed number of users is required for the companies that developed the projects and the Government has to make up the shortfall. It is clear that the risk lies with the government sector.

Vice Chairman: Mr. Casey wished to contribute.

Mr. Eddie Casey: On the debt target, these are useful innovations, but it is important to remember they are being targeted for the mid-2020s, which is far away. We have no idea what will happen to GDP in the meantime, let alone GNI. It is difficult to get a fix on what happened to GDP last year, and we have seen significant revisions in the past. A more meaningful target for the Government to commit to in the present would be to abide by the fiscal rules from year to year. It is an easier basis on which to run-----

Deputy Joan Burton: May I just interject briefly?

Mr. Eddie Casey: Yes.

Deputy Joan Burton: I apologise, as I must attend the Dáil shortly. Does the IFAC have a calculation of the likely fiscal space ahead of the October budget?

Mr. Eddie Casey: We have not updated our estimates, but the latest were of a €12.4 billion gross fiscal space over the 2018 to 2021 period. The Department of Finance will probably update its figures in the coming weeks with the summer economic statement, SES.

Deputy Joan Burton: Did Mr. Casey say €12.4 billion?

Mr. Eddie Casey: In gross fiscal space.

Deputy Joan Burton: Between now and 2021.

Mr. Eddie Casey: From 2018 to 2021.

Deputy Joan Burton: Mr. Coffey's paper referred to our movement into various categories of quality or assessment, but will 2018 not be a relatively difficult year in terms of how the counting will be done? We will be freer in 2019 and thereafter.

Mr. Seamus Coffey: Yes. When we meet the medium-term objective, MTO, in 2018, we will have reached a balanced budget in structural terms. Rather than having to make an improvement each year, we will just have to maintain that level. Currently, we must make improvements of 0.6 percentage points of GDP, which limits the fiscal space that is available because we want to improve the structural deficit. Once we reach the medium-term deficit objective, we will no longer have to make that improvement. In a sense, the space that is taken up each year by making improvements will be available for use. We should be in a position to grow spending net of discretionary measures at the long-run potential growth of the economy. To make improvements now, we should be growing spending at less than the long-run potential growth of the economy. Once we reach the MTO, there will no longer be a need for that improvement. In the expenditure benchmark, this is called the convergence margin, that is, how quickly one must converge with one's MTO. This should be limiting our current spending. Once the MTO is reached in 2018, the convergence margin no longer applies. Hence, we will get more space in 2019, 2020 and 2021. There is so far that we must go and the rules require us to reach a balanced budget in structural terms. The issue for us is that we are not reaching that at the required pace.

Deputy Eamon Ryan: I appreciate the chance to get the witnesses' advice. I will make a couple of comments first. Mr. Coffey made a good point about the question of how to compare one country with another. An interesting experiment - a survey unlike any other - is under way currently. With Brexit, everyone is leaving London, but people are not coming to Dublin. As much as we would like them to, they will not go to Longford or Leitrim either, but they could come to Dublin. However, they are not coming here because of housing, transport, schools, etc. This is clear if one asks them why they are instead going to Luxembourg, Berlin or Paris. They would love to come to Dublin, but they cannot because there is no infrastructure. It is one real life measure by which it could be tested. That is the market in which we are competing.

Representatives from the Department of Finance were before the committee last week. God help us in terms of our economic data. We have real difficulties understanding what the size of our economy is. The witnesses are adding, correctly, to it today. We also have real concern about what our balance of payments is. We do not know some of the basic figures. In addition to the concern raised by the witnesses in that regard, another concern was raised by a representative from the Department of Finance who said the top five exporting companies account for 37% of our total exports. If we lost those five companies, we could lose 40% of our balance of payments. It is incredible. There are very few other economies in that sort of precarious position.

I will add a third caveat that the whole discipline of economics is in a state of complete crisis. It must be a shocking profession to be in at the moment when no one really believes anything in terms of the economic analysis. Kate Raworth, who wrote *Doughnut Economics*, says the basic tenets of the textbooks should be thrown out. The first lesson I learned in economics is that people are profit maximisers. However, all the assumptions of all the models arising from that have been completely debunked because we are not just profit maximisers. There is more to life than just making a profit. God help us because we are in a difficult situation in terms of making economic decisions. In a sense, one of the policy choices we have is in terms of the size of the State within the economy, however it is measured. As we have to live within fiscal rules, the choice is between a higher tax and higher spending policy approach versus a smaller one. We have a choice in budgets between giving tax cuts and increasing spending. Framing it in that way might help in some of the policy choices. Given what I have said about the infrastructure deficit, if the Irish Fiscal Advisory Council had a choice, as a policy maker, between a tax cut and a capital spending increase, what would it decide? Can it come to that level of political decision-making?

One of the ways in which we could assess things, given it is difficult because the economic figures are so uncertain, is to try to get assessments of productivity in all investment decisions and productivity increases. I am interested to know if the witnesses have any particular analysis of that. When it comes to infrastructure investment decisions, if we could show real productivity growth increases, perhaps it would overcome some of the concerns about the long-term budget implications.

Has the Irish Fiscal Advisory Council done further research or consideration on the risks to us in terms of not meeting our carbon targets? My understanding of the latest negotiations with Europe is we are facing a much more onerous 2030 regime. We may be starting from where we were expected to be in 2020 rather than from where we actually are. That more onerous approach might see not-insignificant fines, in the many hundreds of millions, introduced in 2021 and 2022 rather than later. Has the Irish Fiscal Advisory Council done any analysis or research on the fiscal risk involved in the failure to meet our carbon targets, given how far removed from them we are? The latest noises from Germany and France indicate they may be looking for us to count our targets straight away in 2020 rather than getting the pass we seem to be getting from the Commission, which would mean they would only really kick in in 2027.

Vice Chairman: The Deputy asked about four areas: risks regarding carbon targets, productivity assessments, choices between tax cuts and capital spending, and the size of the State in the economy.

Dr. Martina Lawless: On discussions of the size of the State and matching expenditure with revenues, it is very much the role of the fiscal rules, and it is the fiscal council's view, that any spending by the Government is sustainable. It does not limit the size of the State or the political decisions on the amount of spending so long as that spending is backed up by sustainable revenue sources. Beyond that, we do not make any particular recommendations on the allocation of spending and how it is distributed between taxes and current and capital spending. Our view is very much on the aggregate levels and that spending is sustainable and matched by regular revenues. With regard to the Deputy's first comment on the concentration of Irish exports, it is also a concern in terms of the concentration of corporate taxes. The volatility and concentration of corporate taxes is something the fiscal council has raised a number of times in terms of the risks of spending and of translating volatile one-off surges in revenues into permanent increases in expenditure, which gives rise to different risks.

If used productively, infrastructure spending will potentially feed through into the long-term potential growth rate of the economy and that is one of the objectives that determines the amount of expenditure that is allowed.

In terms of carbon targets being addressed, it is something the current fiscal assessment report mentioned. The timeline was that these targets are more likely to be missed after 2021. The horizon of the current fiscal objectives was a bit more focused on the more immediate 2018 to 2021 targets. It has been highlighted as a potential risk in terms of the amount of money that would either have to be spent to ensure we meet the targets or the potential fines that might be encountered if we miss them.

Mr. Eddie Casey: It looks as though we are unlikely to meet the targets for emissions by 2020. The fiscal implications for that in terms of having to purchase additional credits do not look to be drastically large. Estimates from an independent source were in the region of €230 million to €600 million by 2020. They expanded largely after that period. By 2030, Joseph Curtin has produced estimates of €2.7 billion to €5.5 billion, so they tend to ramp up quite quickly after the 2020 period. As the Deputy correctly noted, it depends on how the setting of those targets after 2020 will be treated. In terms of the horizon we look at, which is out to 2021, they do not look to be that large a risk.

Deputy Eamon Ryan: That is a problem with economics; it does not think far enough into the future.

Mr. Seamus Coffey: My colleague, Mr. Tutty, has said that during the crisis, capital spending was cut extensively. The fiscal council looked at the level of capital spending. It suffered a cut of more than 60% during the crisis and is below our long-run average. In terms of capital spending, the Deputy asked if it would be justified if there was sufficient productivity growth. In that sense and in all senses it is important to carry out the appropriate analysis of the projects that are being envisaged to establish whether they offer value for money and improve the infrastructure and areas where the deficit is felt. It is important to undertake the appropriate analysis of the spending. We have looked at the plans for capital spending that the current Government has and the figures in the most recent stability programme update. Although it is not getting there at a very fast rate, when we get to 2021, under existing plans, capital spending will return to what are considered typical levels for Ireland if one takes a long-run average from the mid-1990s right through to now. Although capital spending is below typical levels at the moment, if the plans as outlined are adhered to, capital spending will rise over the next couple of years to get back to those. Capital spending by the Government is due to rise this year by 10%, which is quite a rapid rate of growth and pretty high growth rates built in for the next number of years will get us back to more typical levels. We have to make an assessment of whether that is appropriate, as my colleague Dr. Lawless said. It is not really the fiscal council's job to say the Government should be allocating money to tax cuts or capital spending. We look at the overall pattern. Judging by the plans that have been laid out, capital spending will get back to typical levels by 2021. It is up to others to judge whether they think that is appropriate.

Deputy Colm Brophy: I will pick up on some of the things that have already been raised by some colleagues. With regard to Brexit, I will make a note about inwards investment. We have had some very good and positive inward investment stories recently of companies choosing to come in so there are a lot of positive reasons to relocate to Ireland. I will not go into the details of some of the stuff we are losing to Luxembourg but my understanding is that our regulators are looking at things in quite a good way and are ensuring we do not have inward investment that we will regret attracting at a later stage. What Luxembourg chooses to do is its own business.

I ask a question I have asked previously, and it goes back to another point. A great deal of effort was put into devising our own standard to examine the problem we are having with gross domestic product, GDP. GDP is an accepted internationally measured standard. I refer to having this conversation in a parliament in Norway, South America or whatever. Is there not a risk that we are going to a great deal of effort to create something that will have no international credibility because nobody else will use it? It is possible that it could be slightly damaging to our country because if other countries were applying a similar type standard, we might wonder where they would be coming up. My point is that I do not believe we will be able to change the world use of GDP and, therefore, I question the reason we have gone to such elaborate lengths to create something. The exercise could be done in a technical way. GDP will still be GDP, yet we have gone down this route.

In terms of the investment and Mr. Tutty's answer in that regard and to some of the follow-up questions, does he have a position he would definitively support that capital investment should be funded, even if that is by borrowing? Does he believe the long-term benefits to the State justify doing that on the grounds of the drastic cut in the investment during the recession years, which he outlined clearly, and that the long-term benefit to the State, even if it has a borrowing element to it, would justify a Government going down that route?

Vice Chairman: The Deputy has raised three issues, namely, positive investment and impact of Brexit, assessing the status of GDP and capital investment funding and borrowing.

Mr. Seamus Coffey: I will take the GDP question. What has been proposed for the CSO by a group, which has been put together to examine it, is not to change GDP. It will continue to be measured in Ireland, the figures will continue to be reported and they will continue to be used internationally. Many of our legal obligations are set in terms of GDP, so GDP figures will continue to be set out. Gross domestic product is a measure of output and what happens within the borders of a country. A huge amount of what happens within the borders of the Irish economy is driven by the presence of multinational companies so while they are generating output and profits, those profits are not accruing to Irish residents. We would like to know what is happening to the earnings of Irish residents, and that is the reason we need to make some of these adjustments.

Will GNI* be recognised internationally? The answer is “No”. It is complicated enough to explain it here where people might have some understanding of what is happening in the Irish economy. In terms of talking about redomiciled PLCs and onshoring of IP internationally, whatever glazing over of eyes happens when one tries to explain that to Irish people, it will not happen internationally. GNI* will not be recognised internationally. What we would like to get is a growth rate so that we could determine what is happening to the Irish economy and the incomes of Irish people, get a better measure of the Irish economy that way and have that feed into policy. A 26% GDP growth rate should not be driving any policy in Ireland. We would like to know what is happening to the Irish economy as opposed to the economy in Ireland. GNI* is important. I do not necessarily believe it has reputational damage for Ireland. Much of the damage was done by a 26% GDP growth rate. Stripping out some of the factors that caused that should have a positive implication if we can now say, “There are particular circumstances in Ireland. There is 26% growth in GDP, but let us do a bit of hand waving, see what is happening on the ground and get this measured GNI*.” I do not believe there will be reputational damage. It is a problem that has to be addressed, but it is very much for a domestic audience. The European Commission will not assess us in terms of GNI*. It is not something that will be used internationally, but it does solve a domestic problem.

Vice Chairman: They rate its value, do they not? I refer to the IMF. When we had the Government rating the CSO-----

Mr. Seamus Coffey: Yes, because they want to know what is happening in the Irish economy.

Deputy Colm Brophy: It will generate many interesting arguments among economists, politicians, commentators and so on. I have my reservations until I see it. It is an interesting exercise that we have engaged in, but at the end of the day GDP will still be GDP. Regardless of what we come up with, that will still be how matters are set and we will have to deal with the 26% or whatever version repeats itself in the future. No matter what way we look at It, it will still be off GDP.

Mr. Seamus Coffey: Correct.

Mr. Michael Tutty: On that particular issue, the reason we need to make this adjustment is because our figures are so peculiar compared with the other countries. In other countries, GDP and GNP are almost exactly the same so they do not have to go to GNI* to find out what is really happening. As Mr. Coffey said, internationally, GDP will still be used, but we need to know what is happening in the domestic economy to be able to run our affairs. That is the reason we have to go to GNI*.

On investment, we want to see investment taking place, but the issue is whether we will borrow for investment or use the existing resources for investment. That is where the difficult decisions are needed. If our debt level was at a much lower level and we had much more room for borrowing, we would say, “Go ahead and borrow for a greater investment”. However, in our current situation where we still have not got down to a balanced budget, we do not recommend that we start expanding investment on the basis of expanding the borrowing. As Mr. Coffey said, we will have more scope for investment after 2018 when we have reached our medium term objective of a deficit of minus 0.5%. We will then be able to ramp up the investment. Our main concern will be to make sure that it is investment that brings a return in the future. However, until we have got to our MTO we would advocate that we should adjust priorities in terms of expenditure so as to have more investment, but not at the expense of more borrowing.

Deputy Colm Brophy: That is what Mr. Tutty said earlier. What type of debt level is he talking about reaching before he would switch from opposing or being neutral on borrowing to advocate that borrowing could be part of it as a member of the advisory council?

Mr. Michael Tutty: To keep us on the trajectory we are supposed to have under the EU rules, which is heading towards the 60% GDP figure, we would not see that as the appropriate level in the long term, but until we get there we should continue to go down towards that. If we implement the fiscal rules in terms of complying with the expenditure benchmark and getting our deficit down to minus 0.5%, that will automatically get our debt level down as a percentage of GDP or anything else we want to measure. We are saying we should keep heading towards where we are supposed to be going and use the extra resources that will become available when we have got to our medium-term objective. That will automatically lead to a reduced debt to GDP or debt to any other item over time.

Mr. Eddie Casey: To follow up on that, the council has discussed the idea of targets for debt ratios in the past, but it has not landed on any single figure and has not seen a huge value to these types of targets in the sense that it depends on where one is in the cycle, expenditure pressures faced by changing demographics and matters like that. It is probably unlikely to find one point that is solid forever more. A neater way to get around that is simply to follow the rules on a year to year basis because they ensure that debt is reduced on a phased basis while still allowing us to grow spending in a manner that is in line with sustainable revenue growth. If we want to do more than that, we can do so through changes in discretionary tax policy.

Deputy Richard Boyd Barrett: Am I right in saying Mr. Coffey is warning against the debt financing of further economic expansion? Is that basically what he is saying?

Mr. Seamus Coffey: We are warning about the current levels of debt remaining high considering we have gone through a crisis where there was substantial borrowing undertaken by the State. It looks like GDP has fallen quite rapidly. We are well below the EU average but that GDP figure is not necessarily reflective of the debt repayment capacity of Irish people. Therefore, the debt remains high-----

Deputy Richard Boyd Barrett: I was going to get to that point. I understand it and want to move on to it. Having said that, is Mr. Coffey essentially warning that it is dangerous, given our real debt position as against one based on GDP - leading us to believe we are in a better position than we are - to debt finance further economic expansion?

Mr. Seamus Coffey: Carrying a high level of debt is dangerous. We saw how quickly governments in countries can, in a sense, end up not being able to borrow from financial markets or borrow to fund deficits or turn over debt. In 2007, we had what was considered a very low level of debt; yet three years later nobody would lend to us. At the current level of debt, people might not be looking through the figures and might say the debt-to-GDP ratio, which is close to 70%, looks quite good. If, however, they started analysing it more carefully and if we had trouble, they would realise we could find ourselves not being able to borrow independently and back with problems we simply want to avoid.

Deputy Richard Boyd Barrett: To be honest, I agree. I am coming from a slightly different perspective than the witnesses or the people who are often considered to comprise the pragmatic centre and who, I believe, are advocating a return to a more dangerous approach. Is Mr. Coffey not identifying two major distortions in making his warning? It seems he is. Would he agree with the characterisation that there are two major distortions in the Irish economy such that even the normal economic measurements that measure other economies are rendered almost meaningless and have dangerous consequences - that is, people can believe they are in a far better position than is actually the case. One of the two major distortions is over-dependence on foreign direct investment and what it does to our GDP and GNP figures. The other major distortion, on which Mr. Coffey rightly spent a bit of time meditating in his introduction, concerns the housing market. Apart from involving a social emergency, it is a major macroeconomic distortion and imbalance that has skewed our whole economic position in a quite dangerous way.

Mr. Seamus Coffey: All of the factors the Deputy refers to are very important and significant in the Irish economy. I am not sure I would categorise us as being overly dependent on foreign direct investment. It is clear that we are benefiting from the model that is in place. If there were over-dependence, would one reduce the level? With what would one replace it? The benefits that are accruing are large, and there is no doubt that there are risks associated with that. The simple fact that we are depending on them suggests they are positive and quite large. Admittedly, they are having an impact on our national accounts and GDP, but a couple of hundred thousand in employment and large tax payments point to a price worth paying. If the price is distorted GDP figures and we are getting employment and tax revenue, I will take that every day.

Deputy Richard Boyd Barrett: This is where I find there is great inconsistency in the thinking of the witnesses and, for that matter, the political mainstream. When the left would make the same argument in respect of public investment and public works programmes, in housing or health, the witnesses would be the first to jump on us and say it is dangerous and unsustainable and would lead to overheating. We would be told there has to be a need for a more balanced economy. The witnesses would be the first to jump down our throats but when they are identifying a massive distortion in our figures such that we have to create a new measurement of the economy because no normal measurement actually measures our economy in an accurate way, it is regarded as acceptable due to the fact that it creates 100,000 jobs. A distorted property market created 300,000 jobs before the boom. Is Mr. Coffey recommending a return to that model because it will create 300,000 jobs?

Mr. Seamus Coffey: Absolutely not. An issue with the foreign direct investment model is that it has, thankfully, tended to be stable. The employment numbers have remained stable over recent years. While there are potential risks, they are not materialising. There is a view that the impact of foreign direct investment on the Irish economy is going to fall. It is quite large but the hope is that it will continue to grow. With 300,000 working in construction, one can clearly see that there is an issue because we did not need, and do not need, 90,000 housing units per year. Now, however, we have gone in the opposite direction.

The Deputy is correct to categorise housing and construction as the second distortion and it is sending us in the other direction. The view, with which we agree, is that housing output is too low, but our concern is that once it picks up, which we expect and hope for, it could go above a level that is sustainable. If we believe that 30,000 to 35,000 housing units are needed per year, we are clearly well below that at the moment. There has been a build-up of pent-up, unmet demand for a period of three, four or five years. The longer housing supply remains low, the more the pent-up demand becomes. Then housing output does not just go to 30,000 but to 40,000 or 50,000. Then we say that is not sustainable. The issue is what we do at that point. Do we consider the revenue that 50,000 houses per year might bring in as being permanent, build that into our fiscal arithmetic and then suddenly finding that housing output falls? Again, given the nature of the Irish economy, it might not just fall to 30,000 but lower again.

Deputy Richard Boyd Barrett: I completely get the point. I read the documentation so I get the point. I wish to underline, however, that a double standard is being applied here. Mr. Coffey is arguing for prudence and great care when it comes to counting revenue or the economic impact of dealing with the backlog in housing - with which we absolutely have to deal - through increasing supply through construction, but not applying the same prudence when it comes to the distorting, unbalancing effect of foreign direct investment. We agree, I believe, that there should not be debt financing of any of these things and that we should keep an eye on them. Given what Mr. Coffey is saying and the distortion effects, involving in one case an actual social crisis which must be dealt with - namely, the housing supply crisis - and which is macroeconomic in nature at a range of levels, would it not be logical to say that if addressing those should be done by debt financing, it must be done by raising extra tax revenue? This is what we have always advocated. I agree on what we have do to regarding housing. Mr. Coffey seems to be saying we have to do it. I agree we have to do it. This gives rise to a question as to the most prudent place to raise the extra tax revenue. Would it not be logical and prudent, in the interests of macroeconomic balance - with which the council is concerned, although remaining careful about policy - to increase investment in that area from the revenues in those distorted sectors, as we have argued for some time? This might have the advantage of, to some extent, putting a lid on the more dangerous aspects of those sectors. I refer to raising extra taxes from the vulture funds, which are now distorting the property market and walking away paying almost no tax, and the multinational sector. From a macro-economic point of view, is that not the most obvious and prudent place to get the extra revenue we need to finance what is required?

Mr. Seamus Coffey: In principle, absolutely. We agree that if additional spending is warranted, it should be funded through sustainable sources of revenue. If they can be found, it would be ideal. It is up to the Oireachtas to decide where that additional revenue can or should be found. Our job is not to decide among various policy measures that can be chosen. We absolutely agree with the point made.

On volatility and the distortions, the Irish Fiscal Advisory Council, in considering the impact on the foreign direct investment sector over the past 12 to 18 months, has been very vocal on the volatility and the variability in corporation tax receipts. While the employment and impact on the broader economy might be relatively stable, we have seen quite substantial volatility in corporation tax receipts. We have not been remiss in pointing out there are potential distortions, because if revenue can rise as rapidly as it did in 2015 potentially it can fall as rapidly.

Deputy Richard Boyd Barrett: To follow through on this, would the logic of this be we need to move towards minimising the distorting impacts of the two areas? In the case of housing the obvious thing we need is planned housing based on actual social need over a period of time rather than letting the market completely control it. Mr. Coffey seems to be warning we could get overheating in the housing market unless it-----

Mr. Seamus Coffey: Overheating in the broader economy. We would like to see housing output increase.

Deputy Richard Boyd Barrett: Indeed, but Mr. Coffey is stating it actually could significantly exceed what is needed. We saw this before. The only way to prevent it is to plan it, and not to allow it to happen. Does Mr. Coffey agree this is necessary? Similarly we have at least to move away from the distorting impact of foreign direct investment on our figures. Does Mr. Coffey agree this is the rational and prudent thing to do in the medium and long term?

I am probably out of time, but I wish to make another point because I think it should be said. In the same way as our GDP and GNP figures are virtually meaningless in terms of the real state of our economy, is Mr. Coffey looking at this in terms of productivity and labour productivity, because one follows from the other? Labour productivity figures in this country, and this is not in anyway a critique of workers in this country who work very hard and have been forced to work harder for less, are also utterly distorted by the impact of foreign direct investment. They are a fantasy. They are leprechaun figures.

Mr. Michael Tutty: We have had a significant increase in corporation tax in the past two years. We have advocated this increase should not be used for ongoing expenditure because of the danger the tax revenue might not last. We would have been very happy to see the extra revenue being used for capital investment, which might not be ongoing, but instead it was used for current expenditure and tax reductions, which are ongoing. To some extent that horse has bolted. We got the tax increase but we have already used it, so we no longer have it. Unless we reverse the current expenditure or tax reductions we no longer have it available for capital investment.

I am not sure how we would curb this side of the economy. We will not tell the multinationals to go away and not show their profits in Ireland, which we are taxing, but show them somewhere else so we will not tax them and we will not have the volatility. They are there and we are benefitting from them. Over the past 30 years that I have been in the public sector, we have been talking about the need to build up the rest of the economy so we are less dependent on foreign investment and more dependent on the domestic economy and domestic Irish companies, but it has not worked. Until we find a way of making it work we must keep the foreign investment here. Unfortunately it has been distorting the economy even more over recent years than it had been up to now. This is why we have to get GNI* to see what is really happening in the economy.

I certainly agree with the Deputy that the productivity figures in Ireland are also totally distorted by the foreign companies. We are shown to have such huge productivity because of the way the multinationals operate. It is another area for which we need to adjust in order to see what is really happening in the Irish economy.

Deputy Pearse Doherty: I welcome the witnesses. I was delayed coming in. It was not that I was ignoring the witnesses.

Deputy Richard Boyd Barrett: It was the same for me.

Deputy Pearse Doherty: We had a meeting of the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach, which Deputy McGrath also attended. Unfortunately, we had a clash, but I am glad to be able to ask questions of the Irish Fiscal Advisory Council. My first question follows from the last conversation on revenue buoyancy and unexpected gains in terms of corporation tax receipts or otherwise. Will witnesses explain to the committee how this impacts on the expenditure benchmarks? If we have an expenditure benchmark and if the rate of growth in terms of expenditure is a certain amount how can these additional receipts, perhaps €2 billion extra that was not forecasted, impact on the expenditure benchmark, or does it?

Mr. Seamus Coffey: Windfall revenues have no impact on the expenditure benchmark. They are not included. Windfall benefit or revenue does not increase-----

Deputy Pearse Doherty: Windfall is categorised as corporation tax receipts going from €5 billion last year to €7 billion this year when that type of increase was not forecasted.

Mr. Seamus Coffey: That increase happened in 2015, when the expenditure benchmark did not apply.

Deputy Pearse Doherty: I know that.

Mr. Seamus Coffey: We were in the excessive deficit procedure. The only target that year was to keep the deficit below 3% of GDP. When the additional corporation tax came in in 2015 a large part of it could have been spent and we could still continue to have the deficit below 3% limit. The expenditure benchmark itself applied in 2016, but the issue here was not additional revenue but additional spending. The AIB transaction in 2015 was counted-----

Deputy Pearse Doherty: I understand that.

Mr. Seamus Coffey: -----and there was even more corporation tax.

Deputy Pearse Doherty: I will come back to that point.

Mr. Seamus Coffey: Windfall revenues do not impact the calculations of the expenditure benchmark.

Deputy Pearse Doherty: Going forward, where the expenditure benchmark is there, foreign direct investment and whether there is a €3 billion windfall in corporation tax receipts will not actually impact on our ability to increase expenditure year on year if we are compliant.

Mr. Seamus Coffey: If it is a once off it does not affect the expenditure benchmark. If it was recurring it would affect the structural balance.

Deputy Pearse Doherty: But that is only because of the ten year-----

Mr. Seamus Coffey: No revenue is included in the expenditure benchmark. It is the ten year potential growth rate of the economy and looking at what spending was the previous year and what it could be the following year, looking at what is being done on revenue raising measures and what policy changes are being made for revenue. It is not windfall benefits. The actual amount of revenue collected does not feed into the expenditure benchmark. It is the level of spending. It sets the limit for what can be done the following year, but one can choose to vary this depending on discretionary revenue measures. It is not varied by windfall tax receipts.

Deputy Pearse Doherty: When we talk about the volatility of corporation tax receipts, and those receipts being spent in the economy, and we know there are a lot of demands in terms of housing, health and infrastructure, if we are complying with the expenditure benchmark we can only spend a certain amount of money in any given year anyway.

Mr. Seamus Coffey: It is a growth formula.

Deputy Pearse Doherty: Is that discussion a moot discussion?

Mr. Seamus Coffey: About what?

Deputy Pearse Doherty: That we are spending all the corporation tax receipts and they are volatile.

Mr. Seamus Coffey: It has been spent already.

Deputy Pearse Doherty: I know.

Mr. Seamus Coffey: It does not feed into the expenditure benchmark. If corporation tax receipts remain volatile, as they have been and are likely to remain, the expenditure benchmarks sets the level of growth to the long-run potential of the economy. In a sense, it should even out those year to year fluctuations we see in corporation tax.

Deputy Pearse Doherty: An impression is being given the bumper corporation tax receipts result in increased expenditure, where the reality is even if we did not have the bumper corporation tax receipts we saw several years ago, and they are increasing bit by bit, the same level of expenditure would have taken place. It would have been just probably more debt borrowing to fund this type of expenditure, because the reality is the Government would have kept within the expenditure benchmark.

Mr. Seamus Coffey: In 2015 it would have been possible to increase spending without the corporation tax receipts. Possibly not in 2016, because both pillars were operating together with the structural balance and the expenditure benchmark. In 2016, when we entered our preventative arm, under the expenditure benchmark we could have had additional spending because of the AIB transaction but it would not have been possible under the structural balance. We did not improve the structural balance by enough. We breached the rule in 2016, given the increase in spending that happened. If we had even more borrowing the breach would have been significant.

Deputy Pearse Doherty: For how long will-----

Vice Chairman: Mr. Casey wants to speak on this question.

Mr. Eddie Casey: It might be easier to clear that up by reference to a different voice. We are moving from one system of rules to another system of rules. We might have given the impression that we are using those revenues to increase expenditure. That is what we intended and it was allowable under the old regime and the corrective arm. One could still get to the same deficit by increasing spending but offsetting it with higher revenues from corporate tax. Under the new system, it might have happened in 2016 to an extent as we showed, but that led to a breach of these new rules. We are saying that this should not happen in future. The new rules prevent one from doing that, which is appropriate, because there are potentially windfall revenues. We are saying that as they come in they should not be used to fund permanent expenditure increases. If we gave a different impression, that is the position.

Deputy Pearse Doherty: No, that is okay. The other point I want to make is in regard to the Commission's report. I wrote to Mr. Coffey about this and I am still waiting for a response. I wrote to him earlier this month seeking some clarification on this. We had an engagement with the Department on this issue but the Commission in its report stated: "Overall, the Council is of the opinion that further measure will be needed, notably in 2017...". This is in regard to a breach and the background to it is the AIB transaction in 2015, which allowed for the baseline to be increased, and now that one-offs are being disregarded, it has retrospectively said that this one-off should be disregarded as well. That means the €1 billion the fiscal council had in the baseline is now gone and the expenditure benchmark has been breached to such an extent that, to use the Commission's words "further measures will be needed, notably in 2017". The then Minister said that his officials had been taking this issue up bilaterally with the European Commission. I queried that with the Department and its officials had been involved in bilateral discussions with the Commission before it published its report. The Commission was of the view that it still needed to state this. Mr. Casey can correct me on this if I am wrong, but I believe that is the first time the Commission has come out and said there has been a significant breach that requires further measures, notably in 2017.

The Department's view is it will reach the other target next year so the approach is one of be damned with this target, which is the expenditure benchmark that the one the fiscal council is telling us to be guided by even when we do not have to comply with this. Can the witnesses elaborate on that? I presume they are aware there is no reference to this in their report. To me, that point is significant. The Commission is saying we are in breach but the fiscal council did not even mention that in its report. This was elaborated on further as a result of my writing to Mr. Coffey and from the discussion with the Minister and the Department, but there was no reference to this in Mr. Coffey's opening statement. Is there a reason for that? Does he agree with the Department's approach of forgetting about the expenditure benchmark and breaches and just proceeding?

Mr. Seamus Coffey: We received a query regarding the analysis undertaken by the Commission. Our reply is in the process of being produced. We have to check various things because it is not our analysis that is being assessed.

Regarding the broader question the Deputy asked about the breach of the expenditure benchmark, we point out in our report that if one takes the AIB transaction into account, the expenditure benchmark would have been breached, but at the time the policy was set, one-offs were not taken into account for the expenditure benchmark. When the AIB transaction was classified in April 2016, the fiscal council came out and stated in both the fiscal assessment report of that June and the prebudget statement prior to that budget that the fiscal space generated by the reclassification of the AIB transaction should not be used to increase spending. Yet in the budget, it was. In July we had additional spending and the budget had additional spending on the basis of using that AIB transaction.

In terms of what the fiscal council wanted, we did not want to see the increases in spending that were allowed by the classification of the AIB transaction and we were explicit about that. However, when it comes to the letter of the law, when the budget was set and when the spending was increased, the one-offs were not taken into account in the expenditure benchmark. It is a bit of a flaw in the fiscal rules in that we have a structural balance rule which takes into account one-offs and up to now we have had the expenditure benchmark which did not. Fixing it is a remedy that the fiscal rules need, but that remedy was not agreed until December 2016 and it was not published in the set of rules used for assessing the fiscal rules until April of this year. Therefore, we are talking about policy decisions taken in July 2016 and in October 2016 for a decision not reached until December 2016. We disagree with the increases in spending that happened on a technical level. We do not think they generate deviations from the fiscal rules.

Deputy Pearse Doherty: I know the fiscal council was very vocal about that. What I am trying to get from Mr. Coffey is where does the fiscal council come down in regard to the stand-off between the Commission and the Department because there is a stand-off now.

Mr. Seamus Coffey: We have sympathy for the Department of Finance.

Deputy Pearse Doherty: The fiscal council has sympathy for the Department of Finance.

Mr. Seamus Coffey: Yes, correct.

Deputy Pearse Doherty: Okay, on the basis that it should not apply the rules retrospectively or go with the medium-term objective, and even if expenditure benchmark is breached significantly, which would have required an adjustment in 2017, the only time it can make that analysis is in 2018 by which time it would have reached its MTO, on which side would the fiscal council come down, that the Commission is wrong or that the reaching the other target is the most urgent action?

Mr. Michael Tutty: From the point of view of the report published recently, we knew the Commission had changed the rules. It had published the rule change. We did not know whether it was going to be applied retrospectively. Our report mentions it and states that if that rule is applied there would be a significant breach. At the time of completing the report I certainly did not now the Commission had decided to implement it retrospectively. We would not think it right that it would be applied retrospectively because we produced a budget on the basis of rules that were in place and suddenly the rules were changed, so what can we be expected to do? From a practical point of view, we do not think it should be applied retrospectively.

Deputy Pearse Doherty: I agree with Mr. Tutty 100% and I agree with the Department on this one. The principle should apply. Rules were rules at the time and one cannot start changing the rules afterwards with the serious consequences that would have.

There is a reference in the fiscal council's report to the Brexit fallout and a stability programme update, which is based on a hard Brexit. I hate the terms "hard Brexit" and "soft Brexit". It a comfort blanket that the Irish people are being surrounding with at this time. The North is either out of the customs union and the Single Market or in them. The version suggested in the fiscal council's report is that it is more likely that it will be a hard Brexit. I presume the reason it has used those definitions is that it provides more clarity that it would be out of the customs union and out of the Single Market.

Mr. Seamus Coffey: We are not necessarily saying it will be a hard Brexit. We are saying that the current macro-economic forecasts are done on the basis that the UK would leave the customs union and the Single Market and the GDP and the macro-forecasts build in the impact of that. It appears more likely that this is what will happen but what we are specifically saying here is that the macro-forecast in the SPU builds in the estimations of the impact that those features the Deputy mentioned could have.

Deputy Pearse Doherty: That is the point I want to deal with. Mr. Coffey said that the expected impact of a hard Brexit may have been underestimated by the COSMO-simulations which inform the Department's views on the medium-term impact on the Irish economy. These were the simulations that considered higher debt, more unemployment or less employment, whatever way we want to view it, and less growth. If it was quite stark in terms of the figures - €20 billion, 3% and so on - what calculations has the fiscal council identified and how far out does it consider the simulations have underestimated the impact of a hard Brexit?

Vice Chairman: Which of the witnesses will take that question?

Mr. Eddie Casey: I will take that one. I cannot give the Deputy exact estimates because we do not have them. The estimates produced by the Department in conjunction with the ESRI were using a COSMO model. It considered a range scenarios from a soft Brexit to a hard Brexit but there are a few problems with the central scenario that the Department uses for its medium-term forecast, which are for the hard Brexit in that the COSMO model assumes several things. One is that the impact on the UK is basically the same as any other trading partner, so it is as labour intensive in terms of exports to the UK as it is in terms of exports to the Maltese economy, Luxembourg and to any other member state. We know there are much greater connections between the UK and Ireland and the labour intensity of these relationships is much greater. An exporter from Ireland to the UK tends to employ many more than a exporter to much more distant locations involved in, for example, the pharma industry. That is one impact that could lead to greater effects on the economy if it not accounted for correctly. COSMO, the ESRI structural econometric model of the Irish economy, by its nature of simplifying assumptions does not do that.

There is another possible area where the impact could be greater. COSMO tends to have a smooth impact on growth and the economy's shock from this. We know from examining other cases of countries dis-unifying or splitting up and having to export in future that often the impacts can be very non-linear and can happen very quickly or overnight. That is another area of concern.

It seems that exchange rate impacts were not taken into account in the Estimates produced for the Department as well. This could lead to additional negative impacts, but possibly not as severe as we might think. This is because exporters in the UK are subject to greater costs. Potentially, the competitiveness effects in Ireland are not as great as one might expect.

There are other downside risks but there are great uncertainties in both directions. We know that a hard Brexit might not be the actual outcome and that a soft Brexit is possible as well. There is considerable uncertainty.

Deputy Pearse Doherty: What is the Irish Fiscal Advisory Council analysis of the underestimation? I know the council does not have figures and cannot put the numbers on it, as the Department has done. Does the council believe that the underestimation could be significant given the three areas Mr. Casey has spoken to us about?

Mr. Eddie Casey: Again, I would have to see the figures. I suspect that they could be, especially given the labour market impacts that might be disproportionately large for the Union.

Deputy Pearse Doherty: What engagement, if any, has the council had with the Department and the ESRI? Whatever about the assessment in the past, we need to get this right. Obviously, future policy will be dependent on trying to get an understanding.

There will be some clarity at some stage on the outcome and whether we are looking at World Trade Organization tariffs and so on. We need to have the model right at that time to project. Has the Irish Fiscal Advisory Council been engaged with the Department and the ESRI in this regard? Do they accept the points raised by the council in respect of what has resulted in the underestimation of the impacts of a hard Brexit in the model they are using?

Mr. Eddie Casey: Yes, we have had some engagement through informal channels. We are housed in the same building as the ESRI so we have contact with its macro team in terms of how these things are produced. Those involved seem to share our views on how it was modelled and on the room for improvement. It was less so with the Department, but understanding COSMO is part of the IFAC long-term objectives. We would like to see under the bonnet a little more.

Mr. Seamus Coffey: At present, we do not have access to the COSMO model. It is something we would-----

Deputy Pearse Doherty: The council is lobbying for it or arguing for it. Is that correct?

Mr. Seamus Coffey: We hope that would be facilitated.

Deputy Pearse Doherty: My last question relates to the concentration of corporation tax receipts. Mr. Coffey can wear his other hat for this answer. We are all familiar with some of the statistics. We know about the 37%. We have been comforted in recent years in the sense that every time we ask a parliamentary question, the concentration levels are coming down. It used to be 40% and now it is 37% for the top ten companies, although I found out last week through questioning Revenue officials that the top ten is really the top nine, because two of the top ten companies are in the same group. It was said that the concentration had just got more concentrated. That would have been a great line if it was mine, but it came from the Revenue officials. It is concerning that the level of concentration exists at 37% from nine groups. I presume if we scaled it back a little further to the top 11, 12 or 13 companies, we would see more companies that are in the top level groups.

The report references one of the benefits of Brexit as increased foreign direct investment. This could mean increased concentration and increased reliance in terms of the tax take. Obviously, we are not going to turn away foreign direct investment if companies want to come to Gaoth Dobhair, Cork or wherever and invest and employ several hundred people. What is the IFAC view on what we should do in such a scenario in terms of having a more sustainable fiscal outlook in the context of greater concentration of foreign direct investment and a greater reliance on the tax that comes from it?

Mr. Seamus Coffey: There is no doubt that corporation tax receipts are highly concentrated, whether measured by group or by company. It would be useful if we could compare it internationally with other small countries and see what type of concentrations they have. However, we have been unable to find statistics. If we are the people looking at it, the suggestion is that it is more of an issue here. If it was an issue in other countries, we would expect those responsible to be looking at it.

We have an analytical note on the volatility of corporation tax. It is the most volatile of the main tax heads. The advice will remain the same. When we look at setting sustainable fiscal policy, we should not look at windfall revenues or volatile revenues. We are looking at setting the growth rate of expenditure at the potential long-run growth of the economy. That puts it on a more sustainable footing.

Receipts such as corporation tax should not be feeding in to budget discussions. If we are looking at Exchequer returns on a monthly basis and saying that corporation tax is below profile and that means we have a tighter budget, it may be problematic. We should be moving away from that type of conversation to setting our budgetary policy on a more long-term and sustainable footing.

There is important information within the Exchequer returns and what happens to various taxes every month, but taxes in any given year being below or behind profile should not affect the budgetary policy for the following year unless there are significant issues that have underlying macroeconomic problems. If it is simply a case of natural volatility in the receipts, then we should examine it and ask what happens with the overall pattern in the year. We should be looking at October's budget on the basis of what we need to do in 2018 rather than what is happening to the tax receipts in 2017. Our view is that we should move away from focusing on more short-term measures and having headlines changing based on what is coming out from month to month to a more long-term basis.

Corporation tax will remain volatile and concentrated. It has become an important source of revenue, up to 15% of Exchequer tax receipts. I do not believe it has ever been above that level, although it got close previously. It is now almost at the highest level. Contributions from previous speakers have suggested this increases our reliance on foreign direct investment and that we have employment and income tax benefits. Now, because of various changes, many of which are international, although some are domestic, there have been increases in corporation tax payments in Ireland. Our view would be to be cautious.

Deputy Michael McGrath: I was at the Joint Committee on Finance, Public Expenditure and Reform, and Taoiseach with Deputy Doherty. I have one question on the point about corporation tax receipts. In a scenario where corporation tax receipts continue to rise, is it the view of the council that it would be unwise of Government to make spending decisions and build up long-term permanent spending commitments on the back of those receipts? Does the council link this to the rainy day proposal? I know the IFAC is in favour of a rainy day fund from 2019 onwards. What are the views of the council on spending the money or not spending it? If we do not spend it, do we simply use the headroom to improve the deficit position and reduce debt? Should we put it aside as a buffer?

Mr. Seamus Coffey: To the extent that the increase in corporation tax reflects increases in the economy and in our long-run potential growth rate, then it will feed into the available resources that can be used on a sustainable basis. If resources are once-off or volatile and not of a recurring nature, then they should not be used. Let us suppose the economy continues to grow strongly and part of that growth comes from the FDI sector and this feeds into our potential growth rate. In that case it will feed in to the calculations using the expenditure benchmark, the ten-year potential growth rate. In the long run it will form part of those, but not year to year.

Deputy McGrath asked about the rainy day fund. This is something that I and the council are in favour of. There are significant issues over how it might operate. We see a rainy day fund having a role to play in setting countercyclical fiscal policy. We do not necessarily need a rainy day fund for that, but it can be an element that feeds into it to allow us to lean against the wind. If the economy is performing strongly, as it is now, we do not have to use all the available fiscal resources. Problems could potentially be coming down the track. For example, in the case of Brexit some years down the line, only God knows what will happen over a five, ten or 15-year period. If we have the capacity to build up fiscal resources now, it would be a benefit to have them in reserve.

There are operational issues. If we make savings now, how can we ensure we can avail of them in future? One issue with the expenditure benchmark is that if we have a certain amount of available fiscal space and we do not use it, we cannot put it in the bank, so to speak. We cannot draw on it the following year. The calculation is done each year on a separate basis in respect of how we can increase spending in a given year. Under the rules at present, if we do not use it, it is as if we lose it. The incentive is to use the available fiscal space every year. The rules themselves are not conducive to the establishment of a countercyclical rainy day fund. We were promised a paper on that from the Department of Finance and we believe work has been undertaken in that direction. The stability programme update suggests that the work is ongoing, and we hope that paper will be published in order that we can assess how a rainy day fund might operate, given the constraints of the fiscal rules and the objective, as we see it, of a move to a countercyclical policy in Ireland.

Deputy Michael McGrath: If there is a change of Government policy, we may not see such a paper.

Mr. Seamus Coffey: At present, it is stated that the work is ongoing and the paper will be published.

Deputy Michael McGrath: Is the summer economic statement due next week?

Mr. Seamus Coffey: We do not know the publication date, but the national economic dialogue is coming up soon and we imagine it will be published before that.

Deputy Michael McGrath: When the breach of fiscal rules happened, the Government was saved on the expenditure side by the AIB transaction of preference shares, but there was a categoric breach because the reduction in the structural balance did not meet the minimum 0.6% reduction. In the figures for 2017, there is a projected breach of both measures, the structural balance reduction and the expenditure ceiling.

Mr. Seamus Coffey: The two should work in tandem. There was a breach of the structural balance improvement in 2016. If there had not been the AIB transaction, there would have been a breach of a similar magnitude in the expenditure benchmark. The two should be consistent. There should not be the situation that arose in 2016 for Ireland where one is in breach and one is compliant. If the AIB transaction is stripped out, the breach of the expenditure benchmark then would be comparable to the breach in the structural balance. The problem is that the AIB was a once-off transaction and there was a mandate to remove it.

In 2017, based on the current figures, it looks like there will be a similar breach of the expenditure benchmark and the structural balance. Both have approximately 0.2% of gross domestic product, GDP, which is approximately €500 million to €600 million. One might say that in overall terms that is quite small, but if it is built up with a breach in 2016 and one in 2017, while the current plan suggests there will be compliance with fiscal rules from 2018, experience to date suggests that might not happen.

Deputy Michael McGrath: Is it the case that there is no sanction for what one might call a modest breach?

Mr. Seamus Coffey: Officially in the Stability and Growth pact, yes, a breach of less than 0.5% of GDP does not trigger sanctions. It is not guaranteed that a breach of more than that would trigger a sanction. We recently saw the introduction of a margin of appreciation which had us gathering around to see what that means. If there is a significant deviation, is it a margin of appreciation above a significant deviation?

Deputy Michael McGrath: There has been a breach and there are more projected, but not of a magnitude that would bring an automatic sanction or punitive consequences.

Mr. Seamus Coffey: Yes.

Deputy Michael McGrath: I know the council reported on the fiscal space issue, but I think for next year €600 million is factored in for the reconciliation of gross to net and the issue of demographics. What is the council's position on the appropriateness of that figure and its adequacy?

Mr. Seamus Coffey: We do our own analysis on the demographic impacts, and in rough terms we get a figure relatively close to that produced by the Department of Public Expenditure and Reform. Yes, it is an important consideration that if one starts off and looks across the overall increase in spending allowed under the fiscal rules, the most recent figures published suggest that for 2018 there will be an increase in spending of €1.8 billion, which is a bit more than was allowed by the rules for 2017 when I think it was €1.6 billion in gross terms. For 2018, the gross terms are €1.8 billion. The €600 million will be subtracted either automatically because of increased recipients of social welfare payments etc. or because there is a need to meet increased demand in education or health for additional population. That will leave a net amount that can be used by policy measures that have been announced, but in respect of 2018, many policy measures have already been announced in budget 2017, measures that were introduced on a partial year basis in 2017 and that have to be paid on a full year basis in 2018. They are using the fiscal space there in increases in spending. For example, the increase in social welfare payments that only began in March of this year will be paid on a 12-month basis in 2018. That will cost-----

Deputy Michael McGrath: They are the carry-over effects.

Mr. Seamus Coffey: That policy has been announced and will be approximately €700 million, and at present figures that brings us down to approximately €500 million. Various commitments on public sector pay have also been announced. Space is available but much of it has been used by pre-existing measures. In respect of the demographic figure, the assumptions we make and the outcomes tend to be quite close. We are more or less similar.

Deputy Michael McGrath: Projecting well into the future, are the long-term forecasts of demographics and the consequences for public services, old age pension, public service pensions and so on appropriate?

Mr. Eddie Casey: On the demographic front and accommodating changes in cohorts, it looks broadly appropriate. In box G of our report, pages 78 and 79, there is a table showing what we estimate as demographic pressures versus what the Department has allowed for those. For 2018 and 2019, they are almost exactly the same. For 2020 and 2021, there is a difference of €100 million to €200 million each year. On the demographic side, the difference is not enormous. Most of the difference is in what we allow for price pressures, and that is where we tend to diverge.

Deputy Michael McGrath: Mr. Coffey referred to budget 2018 which in net terms is coming down to €500 million or so, minus the cost of a public sector pay deal and so on.

Mr. Seamus Coffey: We are still waiting for the revised figures which are due in the next week or so.

Deputy Michael McGrath: The net fiscal space before the carry-forwards come into play is €1.2 billion as per the last publication we have in the budget. Is there likely to be movement in that? What variables are being examined? Is there movement in the undergrowth that we should be aware of?

Mr. Seamus Coffey: Given that the calculations those figures are based on were published last October, there is likely to be movement, but it is hard to know how significant it is. There are different elements that feed into it. There have been improvements in how the calculation is done. Previously, it was done on the basis of averages of numbers that were not available until August or September, particularly in respect of the deflator impacting on the nominal amount that could be increased. Now it is set on the spring forecast which is available rather than having to wait for a figure produced much later in the year. The summer economic statement may differ from what was published in the budget. There has not been a huge variability in any of the variables that feed into it, so the calculation should not be very different and it should be relatively stable from the time it is published in the summer economic statement to the budget, given the way it is now undertaken. Unless there is a dramatic change in how it is applied, we do not see the numbers changing.

Deputy Michael McGrath: Is the formula non-discretionary and matter of fact or are there elements that are the subject of debate or negotiation?

Mr. Seamus Coffey: There is not really discretion. It is a question of inputting figures that-----

Deputy Michael McGrath: It is a formula.

Mr. Seamus Coffey: -----either the Commission has forecast for various matters, last year's spending, the structural balance and how quickly that needs to be reduced for the coming year.

Deputy Michael McGrath: The council has not done an estimate of what it is likely to be.

Mr. Seamus Coffey: Looking at the various parameters and how they feed into it, we do not see huge changes in them. We will assess the figures the Department of Finance publishes and will assess what the Department does in terms of the fiscal rules, but we do not anticipate huge changes.

Vice Chairman: I thank the officials, the chairman and head of the secretariat of the Irish Fiscal Advisory Council for their attendance today. We look forward to seeing them again at some stage. The committee's work for today is finished.

The select committee adjourned at 6 p.m. until 10 a.m. on Thursday, 29 June 2017.