DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Céadaoin, 13 Meán Fómhair 2017

Wednesday, 13 September 2017

The Select Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Deputy Lisa Chambers,
Deputy Colm Brophy,	Deputy Pearse Doherty,
Deputy Thomas P. Broughan,	Deputy Martin Heydon,
Deputy Joan Burton,	Deputy John Lahart,
Deputy Dara Calleary,	Deputy Eamon Ryan.

DEPUTY JOSEPHA MADIGAN IN THE CHAIR.

The select committee sat in private session until 14.14 p.m.

Ex-ante Scrutiny of Budget 2018: Irish Fiscal Advisory Council and Economic and Social Research Institute

Chairman: I remind members and witnesses to turn off their mobile phones as the interference from these affects the sound quality and transmission of the meeting.

Good afternoon and welcome to the first of this committee's pre-budget scrutiny sessions, certainly the first to be held in public. The Committee on Budgetary Oversight was set up to improve the level of engagement with Parliament on budget decisions. An enhanced role for Parliament in budget scrutiny is very important and is based on the recognised international principle that in a democracy better decisions are made when policy makers are held to account and when the entire policy making process is subject to parliamentary oversight, scrutiny and active participation.

In advance of the 2018 budget, the committee will hold pre-budget meetings with a small number of national stakeholders to discuss particular topics prior to budget day on 10 October. The committee is also due to meet the Minister for Finance and Public Expenditure and Reform and his officials on 27 September.

I welcome Mr. Seamus Coffey, chairman of the Irish Fiscal Advisory Council. He is accompanied by Dr. Martina Lawless and Mr. Michael Tutty, council members, and Mr. Eddie Casey, chief economist and head of the secretariat. I thank the witnesses for making themselves available today. A copy of the pre-budget report has been circulated to the committee members and we will take it as read. The witnesses will be asked to deal with the following themes: their pre-budget statement, corporation tax, which is topical given Mr. Juncker's comments earlier today, volatility and risk and international tax policy in this area and possible efficiency savings in expenditure.

I draw the attention of witnesses to the fact that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to the committee. However, if they are directed by the committee to cease giving evidence on a particular matter and they continue to so do, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person, 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 they should not comment on, criticise or make charges against a person outside the House or an official either by name or in such a way as to make him or her identifiable.

Mr. Coffey has been allocated 15 minutes to make his opening statement.

Mr. Seamus Coffey: I wish the Chairman and members of the committee a good afternoon. On behalf of the council, I thank the committee for inviting us to meet it and for giving us the opportunity to publicly discuss our recent pre-budget 2018 statement. As the Chairman has outlined, joining me today are Dr. Martina Lawless and Mr. Michael Tutty. Unfortunately, Dr. Ide Kearney, who is based in the Dutch Central Bank in Netherlands, and Mr. Sebastian

Barnes, who is based in the OECD in Paris, cannot attend. Members of the council secretariat are also present, namely, Mr. Eddie Casey, our chief economist and head of the secretariat, Mr. Niall Conroy, Ms Kate Ivory and Ms Ainhoa Osés Arranz. We congratulate Deputy Josepha Madigan on her appointment as Chairman of the committee. The council's work has benefited from interaction with the committee and we believe that this will continue to be the case. I also acknowledge the ongoing interaction between our secretariat and the Oireachtas staff to support these meetings.

The council published its fourth pre-budget statement on 5 September. The report reviews the fiscal stance in advance of the budget, in line with the council's mandate as set out in the Fiscal Responsibility Acts 2012 and 2013. Our assessment is based on an economic analysis which assesses the appropriateness of the fiscal stance in terms of the principles of sound economic and budgetary management. It also provides an assessment of whether the Government's fiscal plans are in line with the requirements of the budgetary framework.

At the outset, we note the substantial progress that has been made since 2008 to move the public finances to a safer position. The Government is likely to run a budget balance in 2018 for the first time in a decade. Debt ratios look to be on a steady downward trajectory and near-term interest and growth prospects are relatively favourable. The positive backdrop means that Ireland is in a good position to move the public finances to a safer position without the need to stimulate the economy beyond what the fiscal rules allow. However, risks remain. While we do not see significant evidence of overheating in the economy at present, this is not a phenomenon with which the Irish economy has been unfamiliar and conditions are changing rapidly. Unemployment rates are already falling quickly and supply pressures are evident in the housing market. Were a sharper than expected recovery in housing construction to take hold and overshoot regular annual requirements for housing completions - what might be needed to satisfy a year's worth of new households and deal with any backlog of pent-up demand - overheating could materialise in future years. While such a response to apparent housing shortages would be welcome, offsetting actions might have to be taken elsewhere should it cause the economy to overheat. Fiscal policy could have an important role to play in this respect and developments should be monitored carefully.

It is also important to acknowledge that Government debt levels remain very high following the crisis. This leaves Ireland vulnerable to adverse shocks such as those from a harder than expected Brexit impact. On the basis that GNI* is a more appropriate measure of national income for Ireland than GDP, Ireland's net debt burden ranks as the fourth highest in the OECD. Although recent efforts have succeeded in setting debt ratios on a downward path, progress in moving the public finances to a safer position has slowed in recent years following the introduction of within-year spending increases. To manage the public finances prudently, we need to think carefully about what rate the economy and, by extension, Government revenues might be expected to grow at in a sustainable manner.

Looking further ahead, the council sees a risk that the trend in terms of long-term growth rates for Ireland might be weaker should a harder than expected Brexit occur or risks related to US economic and tax policy materialise. Productivity, the key driver of growth in the long run, has important links to trade, yet Brexit could reduce trade as Irish exporters face significant challenges in diversifying to other markets.

Recognising the risks, pressures and fiscal position Ireland currently faces, the council's pre-budget statement makes a number of recommendations. For 2017, additional within-year spending measures would not be advisable. The fiscal rules already risk being breached this year, and additional measures would result in a more expansionary stance than originally planned, unless offset by corresponding expenditure savings or new revenue measures elsewhere.

Within-year increases in expenditure like those in 2015 and 2016 contributed to limited compliance with the fiscal rules and a visible lack of progress in improving the primary balance during 2016 and 2017, despite favourable economic conditions. Had unexpected corporation tax receipts and interest savings been used for deficit reduction rather than for within-year spending increases in 2015 and 2016, the budget would have been in balance roughly two years earlier than is now projected.

For 2018, the Government should stick to existing spending and tax plans within the available gross fiscal space of around €1.7 billion as part of budget 2018. This would be consistent with the fiscal rule requirements for next year. If additional priorities are to be addressed, these should be funded by additional tax increases or through reallocations of existing spending.

Looking further ahead, the Government should commit to adhering to all elements of the fiscal framework, including the spending rule, which is called the expenditure benchmark, even if the objective for a structural deficit of 0.5% of GDP is exceeded. Once that objective is passed, as may happen next year under current plans, the spending rule ceases to apply as strictly. Differences in its calculation can provide some safeguards around measurement issues, and continuing to adhere to it would help to avoid the boom-bust cycles that have proved costly in the past.

So far Ireland has shown a minimalist approach to compliance with the fiscal rules, yet Ireland's fiscal framework is a positive legacy of the economic crisis and one which the Government has committed to respecting. Looking through short-run cyclical developments and only increasing budgetary measures in line with the economy's sustainable growth rate would be a sensible way to manage the economy and public finances.

A credible commitment to a framework which ensures debt sustainability can allow Ireland to expand rather than narrow the room for fiscal manoeuvre. For instance, our report highlights that public investment in Government plans already looks set to ramp up quite rapidly while still complying with the fiscal rules. Exchequer capital spending is set to rise from €4.2 billion in 2016 to €7.8 billion in 2021, with some of the allocated resources still available to commit to new initiatives. As a share of either Government spending or revenues, this would involve public investment in Ireland moving from relatively low levels to among the highest in the EU.

The recent experience in Ireland has seen a damaging pattern of pro-cyclical spending, and this has been a pronounced feature of public investment spending in particular. Adhering to all elements of the fiscal framework will help to prevent forced cuts in areas like investment spending in future downturns and will help to smooth out spending on investment projects over cycles yet to come.

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

Chairman: I thank Mr. Coffey. I have a few brief questions before I go to members. I will ask my questions and then allow him to answer. He said that the recent experience in Ireland has seen a damaging pattern of pro-cyclical spending. Will he tell the committee if there is an alternative to that, if it is a damaging pattern?

I refer to corporation tax. I note in a previous report the council mentioned the common consolidated corporate tax base, CCCTB, the fact it could be a threat to sustainability for budgetary planning and that we would lose about 50%. I would like to hear the views of the witnesses on that and whether it is something that will happen.

The pre-budget submission mentioned that other member states were able to relax the fiscal rules. Perhaps the witnesses would elaborate on whether Ireland will be in a position to do that at some point.

My last question relates to efficiency savings. The 2017 national reform programme has been established. Has it been helpful in examining the inefficiencies in specific programmes and policies?

Mr. Seamus Coffey: I will deal with the first question, and my colleagues can step in.

On the issue of pro-cyclical spending, particularly in terms of investment, if we look at it over the last two decades we see that investment spending grew quite rapidly in the growth phase until 2007 or 2008. It grew from perhaps €4 billion at the start of the decade. In 2008 public capital spending was touching on €10 billion, but three or four years later it was down to €4 billion. At the time the economy was going through a downturn. This was being exacerbated by fiscal policy, which involved taking resources out of the economy simply because we could not fund the spending. The tax revenues, on which the increases in the early 2000s had been built, disappeared quite quickly and we were left in a position of having to undertake forced consolidation and forced austerity.

Capital spending was one of the areas where the largest cuts were introduced. It is likely that capital spending was cut to a level that left us in a relatively low position in the EU. When we have looked at capital spending relative to income, Government revenue and Government spending, by the time we get to 2014-15 we are towards the bottom in terms of public spending and capital in the EU. Now, within the fiscal framework we have something that should allow the public finances to be put on a sustainable footing, and even within that we are seeing that there is scope to increase capital spending. As our statement suggests, between 2016 and 2021, Exchequer capital spending is expected to almost double, with an increase of 85% over those five years, while complying with the fiscal rules.

The fiscal rules are not a huge restriction on our ability to increase capital spending, but what they should allow us to do is make sure that we do not end up in the position where that increase has to be reversed. We should get to a position where we have an appropriate level of capital spending, and caution should be exercised in determining what that is. We are not saying whether the increased level is the appropriate level. It should be spent on appropriate projects. Individual projects are assessed, and the money should be wisely spent. Our point is that it is allowed to increase over the coming years, but we do not want to be in a position where we hit a downturn in three, four or five years time and we have to cut down again. As long as we keep the public finances sustainable we should be able to manage at those higher levels, rather than ramping up when money is coming in and then having to cut it back when the revenues on which it is based evaporate, as we have seen over the last 15 years. We would like it to be less pro-cyclical and have it on a more stable and steady basis, and there is the scope to do that within the fiscal framework.

On the issue of corporation tax and the common consolidated corporate tax base, CCCTB, yes, it is a threat to Ireland. It would be a dramatic shift in terms of the allocation of taxing rights. While not under the direct mandate of the fiscal council we can assess how the allocation of taxing rights might work. At present, taxing rights are allocated on the basis of the activity that generates the profits. Whatever companies undertake in Ireland, we get to tax the profit generated by the risks, functions and assets those companies have in Ireland. If the CCCTB was to be introduced it would be a whole new environment. The taxing rights are allocated on the basis of three things: where a company has its capital assets, excluding intangibles; where a company has its staff; and crucially from Ireland's point of view, where a company undertakes its final sales with its customers.

Chairman: I thought that the witness had said that Ireland could use its own voting power to protect itself.

Mr. Seamus Coffey: At present such tax changes are subject to unanimity, but as was pointed out in the initial statement, the Commission President has suggested that perhaps taxation should not be subject to veto. That would be an important change for Ireland. If the CCCTB was to be introduced it would have a big impact on our ability to collect corporation tax, which is now a relatively large share of overall tax revenue. It is approaching the highest it has ever been. Some 15% of tax revenue comes from corporation tax, which equates to between €7.5 billion and €8 billion a year. If that was subject to the threat that CCCTB would introduce we would see adverse consequences for Revenue, and of course there would be broader adverse consequences for our ability to attract foreign investment. We use tax as a key plank there.

Mr. Eddie Casey: On the fiscal rules, it was mentioned that other member states seem to be able to relax how the rules are applied. It is not that, but rather that other member states did not have to enforce large cuts to capital spending in the first place so that they were not put in the difficult position of having to chose between current or capital expenditure or revenue increases. We see Ireland as returning to EU norms by the end of the 2021 period.

Another thing to look at in terms of the rules is that it is not that they produce a contra-cyclical versus pro-cyclical policy, but rather that eventually one gets to a point at which it is acyclical and growing just in line with sustainable revenue growth and sustainable economic growth, which is an ideal position to be in once there is a balanced budget.

Chairman: Deputy Lahart has six minutes.

Deputy John Lahart: Thank you, Chair. I do not think I will use them. I have a number of questions. I am going to focus a little bit on housing from a budgetary point of view. When the IFAC was here the last time, it had some interesting points to make with regard to the difficulty and complexity of addressing the housing shortage. One of the issues raised was that the unemployment rate is at 6% and therefore, the amount of tradespeople left in that 6% is probably negligible. Therefore, from where will the trades come, that is, the tradespeople and the skills necessary to enable the building industry to gather the necessary momentum to deal with the crisis? Those skills and trades would have to be imported. Obviously, the difficulty with importing tradespeople is that they have to be housed. When we align that with one of the risks to the economy that IFAC suggested in terms of potential overheating areas, which is the building industry, it seems that the necessary workforce - even through the importation of skills - will take a long time to build up and to skill up, whether it is indigenous or imported. I wonder how realistic that risk is. We are nowhere near the kind of scale of building we are told we need. The witnesses might flesh that out a little bit.

My second question relates to the recent suggestion of my own party that I think might have been misunderstood. I would like to hear the view of the witnesses on it - not a party political view on it, but their objective view on it. The policy looked at the reduction of the VAT rate for building. A Department of Housing, Planning and Local Government report published today again reinforces the notion that building is not economical up to a certain point and scale. It cites apartments and how a builder has to go six storeys and beyond for it to be economical. The proposal put forward was there would be a sunset clause of two or three years and that a reduced VAT rate would be specifically aimed at those developers who were constructing affordable housing. Any loss in the VAT would be offset by the additional revenue that would be accrued through the construction of such housing. Those are two initial questions on housing.

I have one question on corporation tax arising from Mr. Coffey's report. To what extent do the witnesses think the concentration of corporation tax revenue in a small numbers of taxpayers is a revenue risk? I have a more of a philosophical question than anything else. The solution to the corporation tax issue is really a global approach, yet we are now seeing a drift towards nationalism in some of the major economies of the world. Do the witnesses have any overview comments to make on that?

Mr. Michael Tutty: I will leave the corporation tax question to the expert on corporation tax beside me. On housing, we were really just looking at the risk that housing development might accelerate. It would be good if it did because there is a need for houses to be built. However, all we were saying is that if it does ramp up, we cannot ramp up everything else in the economy at the same time or else there will be overheating. As the Deputy rightly pointed out, our unemployment rate has fallen quite low. Therefore, for housing to develop we either need to move resources from other things into housing or bring in people from abroad, which does take time. We have no magic formula. We are certainly not advocating slowing down the housing programme. Our advice is that if it is ramped up beyond what is now predicted, we need to be careful about what else is happening in the economy. Giving tax reliefs to have more consumer expenditure leading to more employment at the same time as ramping up housing development would not be a good idea. On the question of a VAT reduction, it is not within our remit to talk about particular measures so we cannot say it is a good or bad idea. I was formerly in the Department of Finance and in that time I heard too many proposals for tax cuts which claimed they would be self-financing but never were. I would be very wary of talk about a self-financing tax cut.

Deputy John Lahart: Mr. Tutty has interpreted it as many in the media have interpreted it but it was never intended as a tax cut. The self-financing bit of it was a piece at the end and it was suggested that it would cost the Exchequer €250 million to cut the VAT rate on building materials. I do not think anybody would argue that the VAT rate for the tourism industry was to benefit restaurants. It was to benefit the customer so that prices would be kept low and people would go out to eat. I see this as an incentive and it was targeted at affordable homes, of which there is a chronic shortage, as there is with all homes. Mr. Tutty has said he cannot comment on it so we will go to corporation tax.

Mr. Michael Tutty: It is not in our remit.

Mr. Seamus Coffey: We have highlighted the risk of the scale of corporation tax receipts which are now coming into the Government. They are at close to unprecedented levels as a proportion of tax revenue and there was a couple of years when they touched that level. At 15% the proportion is much higher than it has been on average. The concentration risk is present but this is not an issue for larger countries, where they get corporation tax from a large number of companies. It may, however, be an issue in other small countries and we may not be unique in the concentration we have. While the top ten contribute a large amount, the figures provided by the Revenue Commissioners show that those top ten paid €2.8 billion of the large increase in 2015, but in 2014 they had only paid €1.4 billion, meaning a large part of the increase in 2015 was from those ten companies. In 2016, however, they paid €2.3 billion and overall corporation tax revenue rose by €0.7 billion so there are clearly a lot of moving parts and there is a lot going on. We do not know who these companies are and they are not the same ten companies every year. The work the Revenue has done, however, allows us to track payments by groups of companies and there is definitely a risk. Corporation tax is our most volatile main tax head with the greatest movement, up and down. It was €4 billion a couple of years ago and now it has jumped to almost €8 billion.

Deputy Pearse Doherty: I welcome the witnesses to the committee and thank them for their contribution to the debate on the pre-budget statement. What is the fiscal space-----

Mr. Seamus Coffey: It is the resources available for new budgetary measures.

Deputy Pearse Doherty: I know what it is. I am asking for the number. What has IFAC settled on as the net fiscal space for this year?

Mr. Seamus Coffey: There are different definitions of net fiscal space. Our starting position, under the expenditure benchmark, is that the gross fiscal space is €1.7 billion but there are various changes within that. An addition is the extra revenue we will collect from the non-indexation of the tax system. As incomes rise we get additional revenue from keeping bands and credits at the same level. That will add about €0.5 billion. One then has to begin to subtract. One subtraction will be for demographic pressures as a result of automatic increases in spending, for example, in some social welfare payments due to an increased number of recipients. The Government does not do anything there but more money will have to be expended because there will be an increased number of recipients. Demographic pressures will have to be allowed for in other areas, including in education to provide for additional teachers to staff schools and keep student-teacher ratios relatively constant. That provision would be a subtraction. Furthermore, there would be a subtraction for previous measures that have been announced, measures that have to be paid for in a full year in 2018 that were not paid for in a full-year in 2017. In last year's budget the Government increased certain social welfare payments but only from start of March whereas for 2018 those provisions will have to be paid over a 12-month period. Some tax measures have a larger cost in the second year, and that will further subtract form the fiscal space. In our estimation, once those three elements are accounted for, the fiscal space will be down to about €650 million. One further element, which it seems likely will happen, is the public sector pay deal, which will probably cost around €150 million. That is not agreed yet but it looks like it will be. Our estimate is that on budget day, there will be €500 million available for fiscal measures. What that would achieve is-----

Deputy Pearse Doherty: Okay. I want to intervene as our chairperson is strict on time allocation, and we have a new chairperson and I have a limited time to contribute. I want to get to the core of this matter. I presume the Department is taking a Government position and is voluntarily reducing the fiscal space by another €150 million, which is the convergence or compliance margin.

Mr. Seamus Coffey: The margin of compliance.

Deputy Pearse Doherty: Yes, the margin of compliance, which according to the rules does not have to happen. The committee's job is to interpret the fiscal rules. The net fiscal space, as Mr. Coffey said, leaving aside the public pay deal and whether it will be accepted, is €650 million. Is that correct?

Mr. Seamus Coffey: That is correct, yes. Our calculation is based on an improvement in the structural balance of 0.6 percentages point of gross domestic product, GDP. The Department's calculation is based on hitting the medium-term objective, MTO, in 2018, but the rules set out that what is required is to stay on the adjustment path to the MTO and that requires a adjustment of 0.6 percentage points of GDP.

Deputy Pearse Doherty: Under Mr. Coffey's calculation of a reduction of 0.6% of GDP, we would be likely to hit the MTO next year anyway.

Mr. Seamus Coffey: No. There would be a risk that we would not hit the MTO if we did not introduce the additional margin of compliance that the Department set out in the summer economic statement. The reason it has introduced that is to ensure the MTO is hit in 2018.

Deputy Pearse Doherty: Okay. If we did not do that we would still be in compliance with the fiscal rules.

Mr. Seamus Coffey: For 2018, yes.

Deputy Pearse Doherty: For 2018.

Mr. Seamus Coffey: The risk is for 2016 and 2017.

Deputy Pearse Doherty: Yes, I understand that.

We have heard much comment about the potential overheating of the economy. We know where we are at with the housing crisis in terms of the number of units that are being built. Different reports have been submitted stating that we need to be building 50,000 units per year. Let us assume the Government gets its act together and 50,000 houses are being built, on the type of fiscal stance the Government has adopted, which is one third tax cuts and two thirds expenditure, is that sound, or will we overheat the economy if we have that number of houses being built with that level of tax cuts?

Mr. Seamus Coffey: I am not sure the distribution of the available fiscal resources between tax and spending would have a significantly different impact on the economy. If we have a tax cut or an expenditure increase, there might be some differences but the overall effect would be quite similar. We take account of the overall impact of the fiscal resources available. Whether the Government opts for a 50:50 split or 100% towards expenditure, I am not sure the impact on the economy would be significantly different. Different measures obviously would have a different impact but I do not believe it would be sufficiently significant to have an impact on growth or in terms of overheating the economy. We will not control such overheating by deciding to increase spending versus reducing taxes. It is the overall package that has the largest effect.

Deputy Pearse Doherty: Is Mr. Coffey's view that if we get to the point where the State is required to deal with the housing crisis, we will have to spend below what is the fiscal space for the next numbers of years?

Mr. Seamus Coffey: From observing what is happening in the economy, as we pointed out, we are not seeing significant overheating of it at the moment. One reason for that is that housing output remains low. It would not be necessarily down to the Government in terms of it getting its act together to build houses, the private sector also has a significant role to play, and it could change quite quickly. Deputy Lahart spoke abut the number of workers coming into the country. That pattern could change and accelerate very rapidly. We are just a small economy. If it is felt there is a construction boom in Ireland, workers can come quite quickly, so the impact can build up very rapidly. If we are looking at measures of overheating in the economy, we are not seeing it at present. Maybe one could point to some minor issues in some of the indicators, but in overall terms we have not reached that stage yet. Our warning is that it could happen very quickly.

Deputy Pearse Doherty: I will ask Mr. Coffey two final questions. Has the IFAC been able to liaise with the Department of Finance on its under-profiling of income tax receipts, which we understand was due to it misjudging the cost of the USC tax cut last year? If Mr. Coffey has the information, will he enlighten the committee as to how much the USC tax cut amounted to and also if he has any other information to help us understand why income tax receipts are €200 million below profile?

The final question relates to the report the IFAC produced, which was published yesterday and which I am currently going through, specifically the proposal for a cap of 80% of income against which capital allowances for intangible assets, including intellectual property rights, much of which have been shifted onshore in recent years and any other interest expenses may be deducted from profits by these companies. There was a change in terms of a relaxation of the rules. I understand the IFAC argues that it should go back to where it was, namely, the 80% level. Does the IFAC suggest that would take place in budget 2018? Is that is what is behind the proposal in the report? Does Mr. Coffey have any further information to give to this committee about the tax forgone as a result of the shifting of intellectual property into the State which allowed some of the multinational companies to write down their profits to very low levels and in some cases possibly to neutralise their tax liability altogether?

Mr. Seamus Coffey: I will deal with the universal social charge first. Yes, we have been in contact with the Department of Finance about the apparent shortfall in tax revenues we have progressed through 2017. Yes, it does appear to be down to a forecasting issue relating to, first, the impact of the cuts that have been introduced for universal social charge in recent years and, second, the relationship between the receipts from the universal social charge and the changes in the underlying drivers, such as the wage growth and the labour growth we are seeing in the economy. We would not be hugely concerned but we think budgetary measures should be estimated correctly. It is not something we undertake. We know the Department and the Revenue Commissioners in particular have updated their models for 2018 on, so it is something that will be addressed. We do not know the scale of it. We think the shortfall in revenue at the year end may indicate the size of the error that was made. One error seems to have been a misallocation between PAYE and self-employed, in that it was expected more would be collected from PAYE as we progressed through the year and that less would be collected from the self-employed. There may be some correction in November when the self-assessed tax returns are submitted. I think by the end of the year we will see the impact but there is no doubt the Department and Revenue have admitted that the models were wrong and they have updated them for 2018.

On overall income tax receipts, we would not have concerns about their growth. The PAYE component of income tax is growing at 7% to 8% and then, separately, PRSI is also growing at 7% to 8%. It is important and we do think budgetary measures should be estimated correctly, but it is to be hoped that will improve from 2018 onwards.

On corporation tax, that is outside our remit for today. The report on corporation tax was not undertaken by the IFAC so I would not like to associate my colleagues with it. If the committee wishes to discuss it, I can come back to address it.

Deputy Pearse Doherty: I think the committee is happy enough for questions to be taken on that.

Chairman: It is up to Mr. Coffey. He can indicate if he is not in a position to respond to questions.

Mr. Seamus Coffey: I wish to highlight that the report was not undertaken by IFAC, it was undertaken on an independent basis. IFAC is agnostic when it comes to individual tax measures. We do not have a view on them.

Deputy Pearse Doherty: One hat off and another hat on.

Mr. Seamus Coffey: I presume Deputy Doherty has read the 130 pages to get to the last line that contains this proposal. Yes, it is looking at intangible assets, of which there has been a substantial onshore return in recent years. It just looks at the tax treatment of the capital allowances and the depreciation of those in relation to the revenue that might flow from that. We could wait until companies have their full capital allowances exhausted and have the full amount of their profits subject to our 12.5% rate, but that takes quite a long time before the capital allowances are fully exhausted and there is a certain risk to that. To facilitate some tax smoothing, one can just reduce the amount of their profit which they can offset against this depreciation charge. The proposal in the report is that the limit should be set at 80%. At present, there is a limit and it is 100% because these capital allowances are ring-fenced and one can only offset them against income from the use of the asset in respect of which the allowances are being claimed. One cannot generate a loss and use that loss elsewhere. The 100% cap is there and what is proposed is to change it to 80% for capital allowances.

Deputy Richard Boyd Barrett: Does Mr. Coffey accept, as I think everybody does, that we have an enormous housing crisis? Apart from the social impact, it is now a macroeconomic problem and threat. If one does not have affordable accommodation, it becomes a problem for economic growth. It is now a serious disincentive for those who have left this country, including graduates, to come back and it may be a reason for starting to see a significant outflow of school and college leavers who simply cannot afford to live here. Does Mr. Coffey acknowledge it is a macroeconomic problem that must be addressed as a matter of urgency? Added to that, we have a major infrastructure deficit in other areas, including broadband, public transport, education and so on. Is it his job to comment on that and does he acknowledge those facts and the need to address them urgently? If so, is the fiscal space we are talking about sufficient to begin to address those problems in a serious way? Certainly, I do not think that €500 million can even touch the infrastructure deficit and housing problem before us. If he accepts those propositions, does Mr. Coffey have thoughts about what we should do given that he seems to think we should not borrow in a pro-cyclical way, which may be unsustainable, to increase expenditure to deal with those issues? It only leaves one option if the first two propositions are accepted, which is that we must raise additional revenue to expand the fiscal space. In other words, more tax must come in. That is the only sustainable way to do it within the fiscal constraints. I ask him to comment on all that. If it is true, must we not look forensically at where we can get extra revenue?

That brings me to Mr. Coffey's report on corporate tax, which I accept is not a report of the fiscal council. While I do not agree with all of the recommendations, which fail to go far enough, page 120 is very revealing and could help to answer some of the questions I have just posed and which are posed to the economy. I am surprised that the following has not been stated and someone should comment on it. I would like Mr. Coffey to do so. Corporate profits have increased by 100% in the last six years; that is, from €70 billion to €144 billion in gross trading profits. Does Mr. Coffey agree that by any definition, it is a spectacular increase in profits at a time when we are arguing with a miserable little bit of fiscal space, which is not enough to address our infrastructure needs? Do we not need to look at that? Why is Mr. Coffey not commenting on it? Even DKM came here yesterday and said there was €23 billion in tax expenditures, mostly in the form of allowances and breaks for the corporates, which we need to look at. Is it sensible that we are giving out what DKM estimates is €23 billion when Mr. Coffey shows, for example, there was €66 billion in 2015 in allowances for the corporate sector? They are making €149 billion in gross profits and another €12 billion in other income, a lot of which is probably rental income for vulture funds. Do we not need to look at this? Would Mr. Coffey accept that the effective corporate tax rate, however one defines it, is falling? When one looks at the figures over the last number of years, we are not even close to the 12.5%. Whatever way one defines it, it is reducing. We need to look at that and seriously tighten up on it. That is a black hole in the public finances which, if we plugged it, could give us the revenues we need for the housing investment.

Chairman: That is five minutes already.

Deputy Richard Boyd Barrett: I am finished.

Mr. Seamus Coffey: There were a lot of issues raised. There is no doubt we consider housing to be a serious issue. Our mandate is to assess prudent economic and budgetary management. If housing did not have an impact on that, it would not be in our reports. We recognise that housing is something that could have a severe impact on the economy. One issue we are looking at is its impact on the overall state of the economy in relation to the business cycle but, equally, there is an impact in the sense of having housing available. Housing output should and probably will increase. We just need to be cautious of the impact that has on the broader economy.

Whether there is an infrastructure deficit in Ireland is much more difficult to measure. We can talk about individual areas where we feel there are shortages but capital spending is something that happens on an ongoing basis. There always are areas where improvement can be made. Whether there is a significant deficit in Ireland relative to other countries is quite difficult to measure because understanding what the public capital stock is and how it compares to that of other countries is quite difficult. We have done some preliminary work on it and I am not sure whether it shows that we would have an infrastructure deficit. However, one can highlight priorities. If housing, particularly, say, the construction of public housing, is felt to be a priority, we feel that the private sector has a role to play.

Deputy Boyd Barrett asked if €500 million is enough. It is just a net figure. As the Deputy pointed out, within that one can reallocate existing resources - the Government spends close on €60 million - or one can raise additional tax revenue. If we feel there are priorities that we want resources to be allocated to, the fiscal rules do not prevent that. It is up to us to make the decision and ask, “What do we want to do?” The purpose of the fiscal rules is that once we make those decisions, we do not want to go back to a stage where one would have to make cutbacks and have forced consolidation again. If people feel that the role of the Government in the economy is important and the Government should be providing services and supports, they should be in favour of the fiscal rules because they put the provision of those services and supports on a more sustainable footing and, if the fiscal rules impose certain restraints, it is simply because we do not want to go back to the period where we had to cut back again.

Deputy Boyd Barrett made a number of points on corporation tax. One point I would make is that while there has been a dramatic increase in corporate profits, equally, there has been a dramatic increase in corporation tax receipts, which is having an impact on the economy. As the profits have risen, the receipts have risen. In 2014, we collected €4.6 billion. The following year, we collected €6.9 billion - a rise of 50% in one year. Most of our corporation tax, 80%, is paid by the multinationals. That increase alone for one year, in 2015, was worth approximately €1,500 to every household in the country.

Deputy Richard Boyd Barrett: I accept that. Is it fair to say that the proportionate increase in corporate tax revenue is not as great as the proportionate increase in gross profits?

Mr. Seamus Coffey: There is not much of a gap. I just picked on one year. Corporation tax receipts have grown for most years. The Deputy looked at the change in profits over a six year period. If he looks at the change in corporation tax receipts over a similar period - I do not have the figures with me - he would probably see-----

Deputy Richard Boyd Barrett: I have Mr. Coffey's report helpfully out here in front of me, and it shows the increase is not as great.

Mr. Seamus Coffey: -----that there has been an increase. We would not keep highlighting the risks of corporation tax, if it did not keep increasing and did not become such a large source of Government revenue. There are links. The Deputy talked about the effective tax. As the profits have increased, the corporation tax receipts have increased. We are seeing the effective rate. Once the profits have been reported, close on 12.5% is being charged. If one looks at the change in the profits and the change in the taxes, they are linked.

I previously did a report on the effective tax rates. One could think the turmoil in the economy in recent years in relation to some of the figures bouncing round would undermine it. It actually has strengthened the conclusion there.

Deputy Richard Boyd Barrett: Only if one accepts that the enormous allowances, which Mr. Coffey's paper gives the figures for, are all legitimate.

Mr. Seamus Coffey: These are elements that feature in all tax regimes. We are not unique in that.

Deputy Richard Boyd Barrett: Their extent is pretty staggering.

Mr. Seamus Coffey: Their extent in relative terms is quite large-----

Chairman: I will come back to Deputy Boyd Barrett later. He has had ten minutes already.

Mr. Seamus Coffey: -----but they are benchmark parts of international corporation tax. For instance, intangibles is one that will obviously attract attention on the capital allowances for depreciation. If one looks at the common consolidated corporate tax base, CCCTB, it is essentially very similar to what we have here. People view the CCCTB as being a progressive step for corporation tax. The expenditure on intangibles can be offset over 15 years as is in the case of Ireland, as can the allowances granted. We are not unique in offering these things and they are a benchmark part of most tax systems.

With regard to the tax expenditures, some of the largest are on the personal income tax side, including the personal tax credit, the tax credit for employees and maybe the addition of other tax credits, which sum to billions every year. We do not think they are too egregious in terms of trying to remove them. Equally, other elements are available in the personal income tax system that amount to billions of euro. The €23 billion is not necessarily all corporation tax.

Chairman: I thank Mr. Coffey. I call Deputy Burton. She has ten minutes because everyone else had six minutes.

Deputy Joan Burton: I want to recall that this week is the tenth anniversary of the queues outside Northern Rock. I think that was the first seminal event and the warning to the then Fianna Fáil-Green Party Government that things were going wrong with regard to banking. I was on various committees like this one at that stage and people came in, including many economists, to assure us that everything was sound. I appreciate, in a way, that having learned from the economic profession in terms of getting everything so wrong then that the witnesses are hedging their bets and advising caution, and psychologically that is totally reasonable. It has had to marry that with what the economy, country and people need now. I also appreciate the strategies around avoiding shocks.

The first thing I want to briefly comment on is the rainy day fund and also the witnesses' calculation of Ireland's debt position in relation to GDP and GNI*. On the rainy day fund, I struggle to understand the focus on that even though it is now halved. We had a Minister for Finance who wanted it reduced. He has retired now and I am not quite sure where it is. I think it has gone back up again. As a country, we are asked to meet a target of 60% in terms of debt-to-GDP ratio. At a time when, as previous speakers have said, we desperately need infrastructure development and investment so that we can expand and grow the economy, which is another way of reducing the debt burden, I do not understand the focus. At this point in time, the amount is modest. In the witnesses' various statistics, we also have a cash balance, which is a good thing to have, of effectively around €20 billion such that if there was a sudden shock, we would be able to meet current commitments for a period of time.

The key issue here is infrastructure, obviously housing and also particularly public transport. If one wanted to let people live in places like Portlaoise and Portarlington, and commute within an hour on electrified trains to Dublin and other big cities, we would be able to address this crippling problems of land prices and profiteering happening in the building sector, which also means that smaller builders are finding it very difficult to get credit or to get started again. I wonder if the witnesses could take a wider view. We have a situation where, in my own constituency in west Dublin, the mark for affordable houses - new builds - is €400,000 to €450,000, which implies that even if people have a dowry of a smaller house or apartment that they are selling, their loan figures are going to be about €200,000 to €250,000 at the same time.

Deputy Martin Heydon took the Chair.

Deputy Joan Burton: It is very typical that in this building, where many younger people work, their rent payments now significantly exceed a mortgage on a similar property to what they are paying rent on. As a collection of economists this is a conundrum that we have to try to solve. Would the witnesses agree that unless we can get this right, the long-term implications for the economy are that, in older age, those people are not going to have what their parents or grandparents had, which was an asset by the time they had paid off their mortgage?

I do not know if the witnesses have paid any attention to the supply of skills. The report notes that unemployment has fallen. That is very good and I spent much time working on that myself. The number of apprenticeships and people training to work in the building industry is flat and not rising, however. Can the Irish Fiscal Advisory Council, as a group, suggest that could be a priority? Otherwise we will return to a situation similar to the late boom, where we took in people to work on house building who themselves had to build houses to provide for their own housing. Unless we get the apprenticeship, training and education investment right, we will run into serious problems and put ourselves back in the cycle that the council warns against.

On the various tax breaks, I would appreciate comment by the IFAC on research and development tax credits. The study published earlier this year suggested that much of this was dead weight and the amounts involved are significant. That ties in with corporation tax reductions.

Does the IFAC agree that the economy needs more wage growth? In order for the economy to perform better, we need more wage growth. It should be moderate growth, but it is necessary. Does the fiscal council approve of the FEMPI restoration? Is that within its remit? Does it see scope to deepen that?

Further to the witnesses' charming and sweet comments on the fiscal space and the additional in-year spending measures, described in page 4 of the IFAC submission, there is another phenomenon occurring in this economy. There has been a massive expansion in so-called self-employment, much of which is bogus. As a Minister, I commissioned a report into this, which the Department has refused to publish, and has sat there for well over a year. The level of self-employment is such that a surge in self-employed tax returns will be evident in November. Last year, we had various discussions around figures which were ultimately wrong because the self-employed tax surge had not been factored in. To what extent has the IFAC done that? I reckon there will be probably be an extra €400 million to €500 million, perhaps a little more, which will enable the Minister for Finance to become a Santa Claus, because he will have the capacity to expand the fiscal space or more accurately the spending base of 2017. If the Minister is going to do that, and it is more than likely he will do it if if can, does the IFAC have any recommendations regarding what he should spend it on? Would it suggest spending it on areas such as education or more housing? Would the council agree that it will happen or does it have any model that would allow us to calculate that? Otherwise, as happened last year, most of our forecasts will be significantly out, notwithstanding all the council's good work..

Chairman: The Deputy's eight minutes are up and we must give the witnesses the opportunity to answer.

Dr. Martina Lawless: The Deputy began by mentioning the ten year anniversary of the start of the financial crisis. I would emphasise that Ireland went into the financial crisis with incredibly low levels of debt, internationally speaking. We went into the financial crisis with levels of debt of around 25%. The strength of the impact of the financial crisis and the speed with which the turnaround in the economy occurred emphasises why many of the fiscal rules were introduced later and why these targets were brought in to try to pin down tax and spending to a long-term sustainable basis, and why the debt-to-GDP ratio is still something on which the fiscal council puts quite a bit of focus. The economy and tax revenues are now on a good path. The debt-to-GDP ratio is trending downwards at a very impressive level but it is still is quite high historically. One element to which we drew a lot of attention is that the upward revision to Ireland's GDP numbers that happened in 2015 automatically gave a big reduction in our debt-to-GDP ratio. If we regard those GDP numbers as not really the correct measure of what is happening in the Irish economy or of Ireland's ability to pay back debt, then that debt-to-GDP ratio is also something we should treat with a bit of concern. That is why, in the pre-budget report and in the earlier fiscal assessment report, we looked at the Irish debt burden and compared it with various other indicators of the size of the Irish economy. To put in perspective the change in the Government target from a 60% debt-to-GDP ratio down to a 45% debt-to-GDP ratio, if we used GNI*, we would get back up to the 60% target almost automatically.

Deputy Joan Burton: What of GNI* in the other economies? Ireland is fourth on GNI* and ninth on GDP. Like Dr. Lawless, if I looked at other economies, I could point to stuff that is not in their measurements.

Dr. Martina Lawless: That is potentially-----

Deputy Joan Burton: The biggest tax avoidance countries in the world are the US and the UK. Are they on GNI*?

Dr. Martina Lawless: Perhaps Mr. Coffey could say more on this. This is a specifically Irish initiative to try to zone in on measures that better reflect the domestic economy and to try to abstract from a lot of the complications the multinational sector brings to our national accounts. We are certainly not replacing debt-to-GDP ratios, or GDP as a measure of the economy, with GNI*. We are just trying to use a range of different indicators, some of which will help to measure different things.

Obviously, some GDP and some tax revenue is being raised from multinationals, and Deputy Boyd Barrett talked about the increases in corporate tax. We cannot ignore GDP and the multinational sector entirely but we can look at a range of different measures. If a large shock was to hit the economy again, the current debt-to-GDP levels are still relatively high, both historically and internationally. That is why we continue to give quite a bit of focus to those and I believe they are still worth examining and keeping in mind. Running in line with the general fiscal rules and keeping a balanced budget will naturally lead to the debts trending down over time, so it is not really a separate target in that, as long as the budget continues to be balanced, that will get paid off over time.

The housing sector has been mentioned a number of times, in particular the high levels of housing payments for mortgages and in the rental sector. We have raised this as a concern in terms of the macroeconomic effects. Obviously, there is a big social effect but the high levels of spending on housing costs by households feeds into competitiveness and wage demands, and has a general negative impact on, as Deputy Boyd Barrett noted, attracting returning migrants to Ireland. There is a risk in terms of getting the housing sector restarted in that having people migrate to work in the building sector potentially has spiralling effects. That is something to be careful-----

Deputy Joan Burton: I ask Dr. Lawless to focus on her recommendations.

Chairman: Deputy Burton can come in later.

Deputy Joan Burton: I want to focus on the recommendations. That is the net point.

Chairman: We want everybody to have an opportunity. Deputy Burton can come in again.

Deputy Joan Burton: I would like Dr. Lawless to outline her recommendations in regard to housing. Is it for a rainy day fund as opposed to economic infrastructure, given that economic infrastructure includes housing? Which is she selecting? She seems to be going only for the rainy day fund.

Dr. Martina Lawless: We are not selecting either. We are discussing the rainy day fund as a proposal that the Department of Finance has put forward. In terms of preparing the economy for long-term shocks, the principle of a rainy day fund as a way of smoothing Government spending over the cycle is something we are interested in and supportive of. What we have pointed out in the report is that we currently have very little information on how a rainy day fund would be set up and how much funding would go in. There already have been changes in the proposed contributions and some uncertainty as to whether these would be flat or increasing over time, and whether they would be on a permanent basis or just for the current three-year proposal. We have very little information on how that rainy day fund would work or be funded. The Fiscal Advisory Council rarely says, "Spend money on this rather than this." We speak very much at a total level of having all expenditure be based on a sustained level of revenues. As to whether this should, as Mr. Coffey has already said, be funded by tax cuts, expenditure increases and so on-----

Chairman: I ask those present to switch off their phones. There is interference.

Dr. Martina Lawless: We are reasonably agnostic about the mix at that micro level as long as the total performance is pretty balanced and that leaves a lot of room for reallocation. Deputy Burton talked about skills shortages in the housing sector but there may be training going on in other sectors that are not growing as rapidly. There can be reallocation within the existing allocations of spending that could address some of these issues.

She also mentioned tax expenditures. In a very general sense - I will not get into tax expenditures on corporate taxes - it is very much the Fiscal Advisory Council's view that all tax expenditures and rebates should be reviewed on an ongoing basis to make sure that the rationale for introducing them in the first place continues to exist. Many tax expenditures and rebates may be introduced to fix a particular problem or market failure. They should be reviewed regularly to make sure they have done their job effectively and to ascertain whether they are still needed or whether there are now better ways to spend the money. It should be recognised that there is sometimes not much difference between a tax expenditure and an actual cash payment. Sometimes people take less notice of exemptions from taxes than of direct payments but from an overall fiscal position they should be treated reasonably similarly.

Finally, regarding the Government's spending, we have discussed in a number of reports that compliance with the fiscal rules has often been pushed to the maximum at the end of the year when the Government finds there is some extra money in the Exchequer that was not taken account of in the initial planning and it gets spent within the last two months of the year. In this context, the fiscal rules are very much set at trying to link the overall budgetary process to a long-run sustainable path of the economy. In that light, once-off revenues, whether increases or decreases, are taken into account. Really what we are looking at is a smooth and sustainable level. We do not think sudden ups and downs in the Exchequer balance over the course of the year should be taken into account. We would also say that if there were a sudden fall, spending should not be slashed in December if receipts come in under profile. We say exactly the same thing if they come in over profile: keep to the projected path at the start of the year when the spending was based on estimates of the long-run potential of the economy.

Mr. Seamus Coffey: May I make a couple of brief comments about GNI*? Deputy Burton referred to the impact on different tax ratios. In Ireland we have subtracted income that we feel does not contribute to our ability to service debts. If other countries were to adopt the GNI* methodology, it would increase their incomes and reduce their debt ratios because the income we are subtracting in Ireland is added somewhere else. It is being earned by non-residents.

We traditionally did this with the gap between GDP and GNP in the context of the repatriation of multinationals. That is no longer appropriate and additional things are being generated in Ireland that are not contributing to our ability to service debt. If other countries were to adopt GNI*, what we subtract here would be added on somewhere else so that the gap between Ireland and the UK or the US would probably get even larger.

Regarding infrastructure spend, as we pointed out at the start, between 2016 and 2021 public capital spending is set to almost double. Whatever restrictions are in place with the fiscal rules, it will go from €4.8 billion to almost €8 billion in the space of four or five years, which is quite a rapid increase. The resources there can be allocated to various areas - transport, housing, etc. - and one could have an awful lot of capital spending with that amount. The caution is that it is used in a cost-effective and beneficial manner.

Chairman: I thank Mr. Coffey. I call Deputy Calleary. He has ten minutes, since everyone else-----

Deputy Dara Calleary: I thank the Chairman. I will just ask questions. To pick up on Mr. Coffey's comments about capital expenditure, there is quite a degree of scepticism throughout the Fiscal Advisory Council's presentation about the increase in capital expenditure. I would suggest it is wary of it. An analytical note produced in 2016 by IFAC, Public Capital: Investment, Stocks and Depreciation, highlighted the cost to the economy of falling capital expenditure. Earlier I suggested we needed to assess projects carefully. What metrics would IFAC use to assess them?

The Department of Finance has got corporation figures completely wrong in recent years and there have also been serious forecasting issues. Deputy Pearse Doherty mentioned USC, but the Department has got corporation tax figures completely wrong. That brings us back to the mid part of the previous decade when it got income tax figures completely wrong. On the work done by IFAC and its experience of dealing with the Department since it got those forecasts wrong, does Mr. Coffey, as chairman of IFAC and with reference to the report it has just prepared, have confidence in the ability of the Department to forecast corporation tax figures? What is the importance of such forecasts to budgetary and expenditure projections?

Budget 2018 will be the last budget before Brexit. Budget 2019 will have to take into account the fact that Brexit will happen during the course of that year. Which is the bigger threat to Ireland - Brexit or the CCCTB? Which will hit harder and sooner?

Last December it became apparent that there was a very strained relationship between IFAC and the Department of Public Expenditure and Reform as, according to freedom of information material, the Department had felt IFAC was not engaging with it enough. What is the relationship like in advance of the budget? Is it necessary for IFAC to have a good relationship with the Department? Mr. Coffey has said that when he took office, he wanted to bare teeth. Has he had to do so in the time since his appointment?

Mr. Seamus Coffey: It is not necessarily the case that we are wary or weary of capital expenditure, but we point out that capital expenditure is set to increase very rapidly and that we should ensure that, if this is where scarce resources are to be allocated, we get the most value for them. In certain elements there was increased capital spending in the period to 2007 and 2008 and perhaps the money was not all spent in the best fashion. For example, the rail operator is proposing the closure of lines which received substantial public investment in recent years. If we use scarce resources, we must get the best value for them. From an economics perspective, we look at the cost versus the benefits and ensuring the projects undertaken offer the best cost-benefit analysis, however they are measured. We can measure the costs and benefits in a variety of ways. Given the amount of money set to be allocated for capital projects, our view is that they should be assessed carefully and it should not just be a case of something being a priority at present in order that money will be allocated for it to increase activity. We would also like to see some achievements.

On forecasting corporation tax figures, the Deputy said there had been a difficulty in recent years. There was a difficulty in one year, in particular. The forecasts for 2015 were out by a huge margin because of a huge unforeseen increase. We do not believe anybody was saying in that one year corporation tax receipts would increase by 50%. In that year it was down to a wide range of factors which seemed to coincide, with small companies paying a little more tax and companies which had not previously paid tax making positive payments. There was also taxation on capital, as well as taxation payments from multinationals. An entire gamut of factors came together in 2015 which caused tax revenue to increase by such a large amount. For 2016, the Department's forecast was fairly close to the outturn predicted and the forecast for 2017 equally looks to be appropriate. I do not think we have huge issues. If things are unforeseen, they are unforeseen. One of the reasons for making forecasts is not necessarily to be right but to have a sound basis for plans regarding what is expected to happen. The unexpected does happen and just because people get forecasts wrong is not a reason to state the entire approach taken is incorrect.

On whether Brexit or the CCCTB is more serious, assuming they both happen, the CCCTB is more serious as we can work our way around Brexit which will have an impact. The United Kingdom is a large country with significant links with Ireland, but in terms of our economic approach and attracting foreign direct investment, the long-term impact of the CCCTB would outweigh the risks associated with Brexit. In saying this I do not believe the CCCTB will happen; therefore, for which of these risks should we prepare? We should prepare ourselves for Brexit, since it is going to happen. I do not see the CCCTB happening.

Deputy Dara Calleary: Could Mr. Coffey put a figure on that exposure? In terms of GDP or the IFAC's version, GNI*, what would be the worst impact imaginable of the hardest Brexit?

Mr. Seamus Coffey: The Department has already downgraded its growth forecast by half a percentage point over the next number of years because of the impact of Brexit. It is likely to have a level effect. The ESRI, which will be the committee's next delegation, has done long-term work on the impact of Brexit and is probably in a better position to analyse it. Brexit will have an impact on the economy. Our view is that it could reduce our potential growth rates and will have an impact on trade. That could affect the economy's ability to generate resources and revenues for the Government, so it will have a significant impact. The growth forecast of half a percentage point for each year that the Department of Finance has built in is appropriate and takes the context into account.

However, the impact could be worse. Perhaps the impact on our trading relationships will be more severe, particularly given the fact that the types of industry - the domestic indigenous manufacturing and agrifood sectors - that trade with the UK are labour intensive. We do not know what Brexit will bring. It could be a soft Brexit. They might reach an agreement over the next 18 months. It does not look like they will at the moment, but such negotiations are renowned for their brinkmanship, so perhaps something might happen.

Were the CCCTB to be introduced, which I do not believe will happen, it would have a large effect on one of our key economic policies.

Deputy Dara Calleary: Could Mr. Coffey put a figure on that?

Mr. Seamus Coffey: Consider it in terms of tax revenue. Previously, I examined the impact on corporation tax receipts and it could have an impact of up to 50% on those, but the broader impact would be on employment and investment. At the moment, we seem to be in a sweet spot in terms of attracting investment and employment and our ability to raise tax revenue, particularly from US companies. The CCCTB would not leave us in that sweet spot.

Regarding the relationship between the Department of Public Expenditure and Reform and us, the issue is one of a difference in approaches. We were forecasting Government spending on the basis of a standstill situation, wherein one provides Government services and maintains them in real terms. The Department had a different view of what a standstill scenario was, namely, one in which there was no policy change. Some of the factors that we built in involved policy changes. It is just a matter of viewing this from a different perspective.

A certain degree of interaction or disagreement between various bodies is a good thing. If we make a mistake, we want the Department to point it out. If we disagree with it, there is no point in us not pointing that out. If there is not that type of interaction and, at times, dispute, it suggests that we are not examining these matters carefully enough. Even though there might be differences of opinion, the relationship in terms of gaining information and levels of interaction between our secretariat and departmental officials is excellent. There might be disagreements over approaches, but the interaction is positive.

Deputy Thomas P. Broughan: I welcome the delegation. Mr. Coffey stated that it was difficult to measure whether there was an infrastructure deficit, but surely it is not. In terms of public transport, for example, if one is in the capital of another European country with a much smaller economy than ours and uses a metro that the city has had for the past 40 years, surely one can see that Dublin is, in English terms, in the second division. It is not even in the championship or premiership. Other cities deal with the issues of housing and homelessness much better than us, are expanding their universities, have good apprenticeship schemes and so forth. Sometimes, the evidence of one's own eyes tells how there are significant infrastructure deficits in this country.

Mr. Seamus Coffey: One can always point to shortages and public capital spending is something that should be happening on an ongoing basis, but making international comparisons is difficult. The Deputy pointed out that Dublin, which is a capital city, did not have a metro network, but we also spent on capital investment projects in recent years that might not have been the most appropriate. If people are discussing shutting down rail lines that were developed in recent years where a motorway network ran along parts of them and that are operating at 10% or 15% capacity,-----

Deputy Thomas P. Broughan: Maybe they were built in the wrong places.

Mr. Seamus Coffey: The issue is not necessarily the amount of capital spending that we are undertaking, but the value that we are getting for it. If we are identifying shortfalls in public capital, maybe we should be better at directing the resources that we are committing to it. The long-term analysis undertaken does not suggest that Ireland has been an underspender in terms of public capital investment. If the Deputy identifies infrastructure deficits, perhaps those are down to how we are using that money.

Deputy Thomas P. Broughan: We might move on. I missed part of the debate but I know many speakers earlier spoke about housing. What was very striking for a number of us was that recently Professor Ronan Lyons tried to put figures on what would be a stable housing output and backlog for the country. He indicated that we immediately need 120,000 housing units and 50,000 more per annum. We have never had that kind of feedback from the witnesses' organisation on the infrastructural deficit, although week in, week out, we deal with desperate people and people on the verge of breakdown who are living in terrible accommodation. What is the kind of housing output we should achieve for equilibrium? Representatives from the Central Bank have indicated that figures from ESB Networks state there are 20,000 units for this year, which is way below what we need. It is a desperate position but there is immediate talk of overheating. This is an issue for tens of thousands of our people this very night in this city and country. The witnesses are not addressing these matters.

Mr. Seamus Coffey: We think, to a certain extent, that we are. We assess and analyse the housing market and part of our analysis suggests that housing output is way below that which is required to meet-----

Deputy Thomas P. Broughan: What is the number? What do we need?

Mr. Seamus Coffey: We do not undertake analyses of individual markets.

Deputy Thomas P. Broughan: What do we need to build in 2018?

Mr. Seamus Coffey: One matter is the backlog built over the past six or seven years. It is not enough to get to a position of equilibrium. Various approaches can be undertaken and figures probably range from 30,000 to recent figures of up to 50,000 units. The average output-----

Deputy Thomas P. Broughan: What data would establish that figure?

Mr. Seamus Coffey: One would look at household formation, demographics, inward migration, household size and a range of other factors. It is not an analysis we undertake. By and large, we look at what other people are saying. They say that housing output in Ireland should be somewhere in the region of 30,000 to 50,000 units per year. It is not there and, based on last year, the figure may be closer to 10,000 units. The figure is way below the requirement. The Department's forecast expects the number to rise by 3,000 units per annum, which is a slow, steady and stable increase. Our view is that when housing output picks up, as we all hope it does, it would pick up much more rapidly than that and the impact on the economy could be a cyclical surge in employment and tax revenue. We should view that as being temporary, as house building is quite tax-rich. It could be a case that people come in to build houses and once they are built, they move on again. We could be left with a legacy problem similar to what we had before. We are accepting that housing output must increase but we would like to see it increasing in a stable and sustainable fashion.

Deputy Thomas P. Broughan: Yes, but we need to know what the number would be, the data on which that is based and how we could carry that forward in a balanced budget scenario.

Mr. Seamus Coffey: That is not analysis we undertake. We take the work done elsewhere, and the range is somewhere from 30,000 to 50,000 houses per annum. We are way below that now. I have outlined some of the variables included and the analysis would be about the assumptions made and, for example, what population growth, household sizes and net inward migration will be. That would probably give the difference between 30,000 and 50,000 units. That is the range but it is not the work we undertake.

Chairman: I might be able to answer the Deputy's question.

Deputy Thomas P. Broughan: I note the pre-budget statement, which is a very interesting document. I thank the witnesses for the work put into it. There is not very much on tax expenditures. I know the council has stated it is kind of neutral on what should be done on taxation. When we are trying to frame a few numbers, we all think about the lower VAT rate evident in the hospitality industry and how it might be applied to building, etc. What is the view of the Irish Fiscal Advisory Council on that type of tax code and whether it is sustainable?

Mr. Seamus Coffey: The Deputy has answered the question. It is not an area for us to assess. As a fiscal council we do not assess individual tax measures. There are different groups, institutions and bodies which undertake that. Our mandate is to consider the overall fiscal position and management of the economy. In terms of an individual measure, such as reduced VAT-----

Deputy Thomas P. Broughan: The witness stated we were down to approximately €650 million of fiscal space. He also indicated a little hope, saying that with non-indexation we can push the boundary a little more.

Mr. Seamus Coffey: It is already factored into that.

Deputy Thomas P. Broughan: It is already in there. Given infrastructural deficits and the necessity for increased spending, etc., are tax expenditures a major barrier in maximising fiscal space?

Mr. Seamus Coffey: Yes. Our view is that if spending is sought to be increased faster than the available fiscal space, that can be achieved by increasing tax revenue. There are various measures by which that can be undertaken. We do not have a particular view on how they may be introduced or which measures should be introduced. What we want to do is set out the starting point. If we believe that is too little, as some are suggesting, and want to know how we can achieve greater increases in spending, we look at raising tax revenue. The movement of the debate in that direction is positive from our perspective in that we are looking at sustainable sources of funding, but how one should go about achieving those sustainable sources of funding is not something we address.

Deputy Thomas P. Broughan: On debt levels, there is a very interesting section in the report on the fiscal space in the context of GNI* and recalibrating or recalculating the debt-to-GNI* target at which we should aim. I ask Mr. Coffey to expand on it. Does the council still have concerns in that area? Recently the Minister for Finance, Deputy Paschal Donohoe, and the NTMA decided, with the permission of our European colleagues, to refinance or buy back the IMF loan, as well as the Danish and Swedish loans, although apparently we cannot move on the British loan. Concern has been expressed by Professor Colm Fitzgerald and others that the debt repayment due in 2018 and 2019 represents a huge risk to the economy. Given that we are facing the refinancing of approximately €40 billion, if anything were to go wrong, would the council have concerns?

Mr. Seamus Coffey: One of the reasons we have concerns about the debt is its scale and size. While our debt burden is being reduced, it is still quite high. The improvement can be exaggerated in using GDP, but, as we know, a large part of it is not increasing our ability to service our debt. Therefore, we favour GNI* as a better measure of national income. In terms of the various figures used, the Stability and Growth Pact refers to a figure of 60% of GDP, but that is not a target but a limit. It refers to the highest figure it should be. The issue with the Stability and Growth Pact is that if one is above that figure, one should be on a plan to reduce it to 60%. If one continues to adhere to the fiscal rules, it should fall below it. As I said, it is a limit rather than a target. As my colleague has pointed out, when we entered the crisis in 2008, our debt-to-GDP ratio was 25%, but that was not enough to deal with the impact of the negative shock we experienced at the time. By adhering naturally to the rules and running a balanced budget in structural terms, we will bring debt levels down.

The refinancing risks are quite significant, but we have a certain buffer available in terms of the cash balances managed by the NTMA which has been quite successful in the past three to four years in reducing some of the large windows of refinancing we have faced. I am not sure that in the current environment they present a huge risk, particularly as these debts are being refinanced at much lower interest rates than they were issued at initially. If these low interest rates continue for the next two or three years, the large amount of debt to which the Deputy referred should and will be refinanced at lower rates, reducing our interest costs further.

Deputy Martin Heydon: I thank the delegates for coming and their presentations which are very useful. I wish to comment on a point made earlier. Obviously, as a Government, we want to avoid a boom to bust cycle. We did not move to balance the budget two years earlier which the delegates said was possible because spending money in certain ways, rather than balancing the budget, made more sense, of which there are lots of practical examples. In the case of the health service, moving away from agency staff nurses to permanent staff resulted in higher costs in the short term but makes more sense in the long run. At the same time, we want to make sure any spending will avoid the boom to bust cycle.

The point was made that housing construction had the potential to overheat the economy. If we ramp up house building, as we are doing and hope to continue to do, can the council give specific examples of areas where it would like to see other measures being introduced? The delegates have said that if there is activity in housing, there should not be activity in other areas. I ask them to give some examples in that regard. What changes in policy might concern the council in the ramping up of housing construction activity?

The delegates spoke a lot about the national debt, but what is the position on personal debt? How does the council factor it in? Is it as big a consideration in the context of Government policy as the national debt and should it be? According to the most recent reports, personal debt levels have reduced by more than 10% in the past year, but they are still among the highest, which is an issue for us. How should this issue impact on Government policy and where does it fit in? The witnesses have stated that Brexit is obviously a significant risk for the Irish economy. Do they believe that more frequent monitoring of the economy or revisions of fiscal policy may be necessary to address it, because obviously things are changing very quickly? Mr. Coffey even said today that - who knows? - we could have a couple of good months of negotiations and that things then would look better but that we need to plan on the basis of a hard Brexit while hoping for the best. Other than that, how do we change our monitoring and our forecasting prospects in that area? While Mr. Coffey's report on corporation tax is separate to that of the Irish Fiscal Advisory Council, I refer to the volatility in forecasting future receipts of corporation tax and the comments in that regard. What steps can the Government take to try to mitigate those factors into the future?

Mr. Michael Tutty: In respect of the alternatives on housing, the first area to look at is capital expenditure. Can we rein in some of the other capital expenditure to put more capital into housing? That is certainly the easiest way to do it. Raising revenue obviously is a much more difficult operation and even cutting current expenditure is difficult. We have had the experience that capital expenditure always is what gets cut whenever we need to do other things. I would therefore be wary of saying that other capital expenditure should be cut but in practice it is the easiest thing to do.

On personal debt as opposed to the national debt, looking at personal debt is not within our remit as the Government's Fiscal Advisory Council but it certainly is a significant issue from an overall economic point of view and undoubtedly the Government must pay attention to it. The Central Bank is even more important in that area, that is, in keeping an eye on how personal debt is moving and in making sure it does not get out of control once again.

On Brexit, the Deputy is quite right; we, and all agencies, need to watch closely. Progress in identifying what exactly is going to happen has been rather slow as the British have not yet made it clear what their end goal is. The negotiations have been moving rather slowly. In looking at the next budget - or at the economic forecasts for the coming years which are being made to inform the next budget - assumptions have to be made about where negotiations are going and we must cut our cloth to meet whatever those predictions show. It is disturbing in terms of the uncertainty it causes but until something more specific comes from the negotiations it is hard to know exactly what the implications will be for the future.

On corporation tax -----

Mr. Seamus Coffey: Briefly, on corporation tax volatility, that inherent volatility will remain. One issue with the current scale and size of the corporation tax receipts is they will remain volatile. They may be volatile at a higher level than we have seen, for example, up to 2014. That inherent volatility remains. Measures could be introduced to try to smooth the receipts of corporation tax over a period. The report released yesterday includes a recommendation to try to smooth the receipts in terms of the capital allowance for intangibles. It recommends that the allowance be spread over a longer period and that revenue be collected every year, rather than waiting until the full capital allowances have been exhausted.

In respect of some of the other issues the Deputy mentioned, the issue with linking housing with things like public debt is that the housing output could increase. For most of us, if we want to do more of one thing we give up something else. Within our incomes we look at spending on different things. If I want to spend more on entertainment, I spend less on travel - or whatever it is that I move around. For a country or a Government that choice is not necessarily restrictive, particularly when it comes to housing output. We do not have to have less consumption to undertake more housing infrastructure because it can be funded through credit expansion. The issue is that, as the economy approaches its potential in terms of output, we could see further increases on the demand side, in terms of increased housing output, without having to cut back anywhere else. We could have an increase in consumption and an increase in capital spending and perhaps the economy would be performing above its capacity. There is a fear that could happen. Those who are calling for offsetting measures are looking at what the economy is capable of producing. If it is the case that housing output ramps up quickly, driven by credit expansion and bringing workers in, we should not consider that to be a structural or permanent feature in the economy because it could be reversed.

Mr. Eddie Casey: The issue of corporation tax and forecasts has been frequently raised. The IFAC has carried out work in this area and corporation tax is clearly the most volatile tax head of the main taxes. It also has the largest forecast errors of any of the main tax heads. It is probably not surprising that is the case given that there is huge concentration in the receipts and it is subject to idiosyncratic shocks, such as company-specific changes, for example, if a patent runs out, and changes to international tax regimes. There are many small factors and company-specific issues that can move the dial on it very quickly. In previous reports we have advised that rather than use shocks to corporation tax in individual years for additional spending, which is very often permanent if it is current expenditure, save it until it is known whether or not it will be sustainable. In 2015 corporation tax outperformed by €2.3 billion and gross voted expenditure was subsequently increased by €1 billion on the back of that. In 2016 there was a shock of €0.7 billion and gross voted expenditure rose by €0.7 billion, almost exactly in line with the shock. Rather than spend it immediately, its sustainability should be assessed before a decision is made.

Chairman: I thank Mr Casey. Deputy Eamon Ryan is next, followed by Deputy Brophy who has just a brief comment to make. Deputy Lisa Chambers is in the other room but will return. Dr. Lawless is also in attendance on behalf of the ESRI------

Dr. Martina Lawless: I will put on my thinking hat.

Chairman: -----and we might take a ten-minute break before the next session. Deputy Eamon Ryan has ten minutes.

Deputy Eamon Ryan: I will try to be brief. I am a member of the Committee on Procedure and Privileges. That committee has been discussing how members go about questioning witnesses and how witnesses should not be put under too much pressure, such as having to spend two hours answering questions and so on.

What has been said so far at this meeting has been very interesting and useful. One of the messages coming across is that if the economy overheats, as could happen in the housing sector in a similar fashion to what happened in the early 2000s if construction is stepped up, as all members agree needs to happen, the witnesses said that off-setting measures may have to be taken elsewhere to counteract this. Professor John FitzGerald expressed a similar view in an article he wrote which appeared in *The Irish Times* on Friday, 8 September 2017, although he was more specific and said that taxes would have to be raised as a way of damping that down. I have two questions on that issue. I note the answer in reply to Deputy Burton that the IFAC is not specific on one tax versus another but have the witnesses done any analysis on what tax should be raised? It is very easy to say in a general manner that taxes might have to be raised to damp down the economy but the poor politician who would have to introduce the measure would have to explain exactly how and why. Has any analysis been done as to what form of tax increase is most suitable if one wants to dampen down a heating economy? Would it be income tax, consumption tax, capital tax or another? Has any analysis been done? I do not want the witnesses to name their favourite tax but has any analysis been done as to what tax would be best to raise, if such is to be done? Would it be better to cut expenditure? What is the better instrument to use, if it has to be used?

In regard to the question on private debt, surely that is part of the equation in that the fiscal space is being looked at but if the overall economy is overheating, what is happening in the credit markets must affect that level of overheating. Is that not another so-called off-setting action? If there was a tightening of credit at the relevant time, would that suffice in place of a tax increase or a cut in current expenditure? That is my first question. Perhaps it could be addressed and I might then be permitted to ask a second.

Mr. Seamus Coffey: We do not have an opinion on the type of measure to be introduced.

The off-setting measures Deputy Ryan mentioned can be on the tax side - and there are various taxes which could be chosen - or on the spending side. We do not have a particular view on that issue. Professor FitzGerald clearly emphasised that he believes tax increases are the way to go but we have an issue with that.

Private debt has an important role to play and we take account of many economic indicators. In many of our reports we note indicators that might point to overheating, etc. The current issue in terms of credit is not necessarily that it is adding to growth or is growing quite rapidly but rather that it is relatively low. We do not have credit expansion in the household sector. As we have seen in the most recent figures, we continue to have de-leveraging with households having repaid large amounts of debt in the past ten years. Similarly, we do not have an expansion of credit in the commercial sector. While credit has not increased in the past ten years, if it were to increase, it could act as a further stimulus to the economy.

The Central Bank has been given responsibility for applying additional rules on credit and the credit cycle. We must be cautious, however, about how effective these rules could be, particularly in the case of a small economy such as Ireland into which money can flow from abroad. While the Central Bank may be able to control credit from domestic lending institutions, lending institutions from abroad may not be subject to the rules of the Central Bank, which could result in an increase in lending into the economy. This is a risk to the growth forecast - probably an upside risk - that may lead to problems with the size of output. This is a factor we should not ignore. The report features a series of charts, including on private sector credit. While we keep an eye on this issue, most of our focus is on the fiscal side, which is our primary remit.

Deputy Brendan Ryan: President Juncker, in his speech to the European Parliament in Strasbourg today, reiterated the point made by the French President last week regarding a move towards a fiscal as well as monetary union and the possibility of introducing a new fiscal compact. The European Commission is specifically championing ideas such as a European monetary fund, a eurozone budget, a European Union finance Minister, the introduction of euro bonds and a range of other measures to support a fiscal union. I mention this because I was taken with Mr. Casey's point that the Irish Fiscal Advisory Council is not seeking counter-cyclical economic tools but wishes to reach a steady state, which is the ideal position.

As the Government enters negotiations on the future of Europe, which I presume will ramp up after the German general election in two weeks, does the fiscal advisory council have any advice to give on the major structural issue with the Irish economy? The economic difficulties we experienced in recent years were caused by a variety of factors, one of which was that the economy was out of kilter with the German economy. We lost competitiveness and our growth rates and fiscal and monetary rules were very different from those of Germany. The Irish economy, with average growth rates of 5%, is still in a different position from the eurozone economy where average growth is 2.2%. Irrespective of what happens with Brexit, the economy will remain separate from the eurozone economy as a result of the influence of the British and American economies. Will the fiscal advisory council advise the Government on what position it should take in the forthcoming negotiations on the new fiscal compact? The proposals for the new compact are becoming much more tangible and will be negotiated in the next year or 18 months. We are not in a steady state where we must meet the fiscal compact rules of 2012. We are moving towards having new rules. Is there a European federation of fiscal advisory councils or another forum at which this issue is debated? Given that this is a fiscal advisory issue, who is managing this aspect of the future of Europe negotiations?

Mr. Michael Tutty: Wearing my other hat, I should point out that we, in the Institute for

International and European Affairs, IIEA, are looking at this issue. The Irish Fiscal Advisory Council has not been looking at it. If there are proposals put on the table, I am sure we will look at them, particularly if there is a new fiscal compact as that would certainly come within our remit.

The European Commission has produced a number of reflection papers on the future of Europe, including one on economic and monetary union and another on European finances. As I indicated, the IIEA is looking at this issue and I am actively involved in that work. While the Irish Fiscal Advisory Council has not yet addressed the matter, I am sure we will do so if it moves on to something more concrete. It would certainly be in our interests to have more co-ordination on the fiscal side at European level than we have at the moment. It would add to stability in the European Union. As of yet, however, we have not addressed the issue, nor have we been asked to do so.

Deputy Eamon Ryan: I think the President did say today that the Commission would be presenting official proposals. It will be interesting to see what comes of that.

Mr. Michael Tutty: At the moment they are awaiting responses on the reflection papers they have produced which do not go into detail on specifics. They have a range of options on all of these papers. I know the President of France has put forward proposals that will, I am sure, come through the Commission and will be reflected in what the Commission will put forward at the next stage of the process.

Deputy Eamon Ryan: I think we will wait for the results of the German election, in truth. Would the witnesses say, as I characterised when I introduced this issue, that we are in a sense still an Atlantic-oriented economy with regard to those inflows that Mr. Coffey spoke of? In the general influences on our very open trading economy we are very much in that space rather than a Continent-oriented economy. The economy is not tied in that respect. We have signals, and I think they are useful, but I do not see any measurement for how close we are. I remember at the height of the crisis someone said to me that if only Ireland had tucked in behind the German economy and kept our inflation below theirs, we could not have gone wrong because we would have been constantly competitive within the eurozone. Is that the case now? Are we tucked into the eurozone area or are we still out there in the Atlantic with two nutters - economic nationalists - either side? Are we exposed in that sense as they come to reset the fiscal compact rules?

Mr. Seamus Coffey: I think we are. In a sense we are isolated. There is no doubt that Ireland is different from other eurozone countries and our links to them tend to be quite weak. We have, for example, gone through a serious crisis where we moved from a position of inward migration to a position of what appeared to be large outward migration. Most of that migration, however, was not to countries we share a currency with. It was to the Anglosphere countries such as the UK, US, Canada, Australia and New Zealand. Some of those countries are much farther away than the countries with which we share a currency. When a key part of the economic infrastructure of any nation is to have a shared currency with countries, it would suggest close links. The Irish experience suggests we are peripheral and we are operating in a slightly different environment from the central EU countries. This is not necessarily a bad thing but it means we must accept we are operating slightly differently. With regard to some of the proposals the EU has made today, the EU seems to have moved to a position of constant change, and there are probably certain benefits in that if one is standing still and an economy may not have things right, so the President is just announcing various things that could happen. We see it in the various proposals for the tax fund, and it is good to see these aired. It does not necessarily mean they will happen.

Deputy Eamon Ryan: I do not know if the Irish Fiscal Advisory Council can advise this committee, but if it is possible, perhaps the next time the witnesses come back to this committee there could be some advice provided as to how we square that circle and what sort of fiscal union would suit Ireland. We are an island economy at the edge of Europe with the characteristics that were spoken of today. As a policy or broad academic review, as well as the Institute of International and European Affairs, it would be great to get any broad outline paper with the Irish Fiscal Advisory Council's expertise. It would be very useful if the witnesses could come back to the committee with any suggestions in that respect.

Mr. Seamus Coffey: We will look into it.

Deputy Pearse Doherty: I would suppose that everyone on this committee agrees with the idea of a fiscal union. I would say it was within the scope of the Irish Fiscal Advisory Council. If it cannot comment on whether they are sustainable tax proposals, I am not sure that commenting on proposals coming from the European Commission would be in its interests.

Chairman: I thank Deputy Ryan and Mr. Coffey.

Deputy Colm Brophy: I am conscious of the time allowed, so I will try to keep my contribution relatively brief.

Chairman: The Deputy is the last contributor before we take a break.

Deputy Colm Brophy: To be honest, I did not understand Mr. Coffey's last contribution to Deputy Ryan about where emigrants move to. If a person is in Iowa, he or she can move 1,700 miles to California for a job and not necessarily just next door. People do not make moves based on monetary union. They move to where believe the best opportunities are for them and their families. They may move quite a distance.

My main point is something about which I have always had an issue in terms of not so much an inability to understand, more a problem in accepting. It concerns our GNI* makey-up thing we came up with in order that we would not have to accept GDP. While I have a problem with it in general, something I am on the record as having said, I have a real problem with page 17 of the statement where the GNI* is incorporated into figures versus the GDP for other countries. In one of Mr. Coffey's contributions, I believe when answering Deputy Burton, he said that if the other countries did that, they would move as well. I wonder what type of chart the IFAC is preparing if that is the case and if Ireland has a chart that only we accept. One cannot say how the other countries would move, seeing as how it took us a year to come up with GNI*, so there is no real indication.

Even if GNI* is only for Ireland, the IFAC must devise a GNI* graph for everyone and incorporate it into the figures. It would be crazy if GNI* allowed people to walk out of this room claiming that we were fourth on GNI* versus this or that. We are not. It means nothing if the graph is done that way. I would be interested in Mr. Coffey's view as to why the IFAC did this.

Mr. Seamus Coffey: The Deputy raised a legitimate concern, in that, if one is making comparisons using a different base, are those comparisons legitimate? GNI* was established in Ireland's case because we wanted to have a growth rate and a measure of the size of the economy that reflected the economy. GDP was not doing that. Previously, we held the view that GNP was sufficient because it stripped out the profits of the multinationals to measure national income, the growth rate of which reflected our ability to service debt. However, GNP has been muddied by some of the activities of multinationals, particularly the onshoring of intellectual property, IP.

It is a legitimate comparison. The GNI* adjustments from GNP summed to approximately €30 billion. In the context of other countries, that is a tiny amount. For example, adding this subtracted income would not affect a €17 trillion or €18 trillion economy like that of the US. It would not even change the ratios of the UK, Germany or France significantly. A comparison of GNI* with the GDP of other countries has some merit. While the net flows in and out of those countries can be large, their measures of GDP and GNP tend to be similar in overall terms. In Ireland, the differences are large in relative terms, given the small size of our economy, the scale of multinationals' operations here and the funds that are flowing through them.

There is merit to GNI*. We have only had one round of estimates provided by the CSO which will conduct further work over the next 12 to 18 months that will give us additional information and provide an insight into the economy. We need to understand what is happening in the economy. We are largely driven by the labour market, that is, counting the number of people working. We would also like to add the value of their output, which GDP was not telling us. GDP was inflated significantly by the impact of the intangibles. GNI* gets us closer to a better measure of those impacts, although we are not there yet. GNI* has been a positive step by the CSO. Its work over the next 12 to 18 months will further improve our ability to assess the state of the economy and compare ourselves with other countries.

Deputy Colm Brophy: I accept Mr. Coffey's comments to a certain extent and it has been a good few years since I last studied economics in any way, shape or form. However, I still believe there is a problem in that each of those countries would effectively have to have an equivalent of GNI*, regardless of the differential level, to make for valid comparisons. We should not be comparing directly.

When I asked this question previously, I was given a particular answer, so I am wondering whether Mr. Coffey still concurs. Other countries do not accept GNI*. Internationally, Ireland's GDP is still the measure.

Mr. Seamus Coffey: Absolutely. GDP remains the key legal metric by which the economy will be judged. Given that GDP grew by 26% in 2015, though, we should not setting public policy on that basis.

Deputy Colm Brophy: I understand what Mr. Coffey is saying about what GNI* attempts to achieve and I am not disputing that. Rather, I am disputing how GNI* muddies comparisons with GDP when included in a chart like that one.

Chairman: I can only give Deputy Chambers five minutes. I apologise, but we ran over time while the Deputy was attending another committee. After her five minutes, we will take a break of ten.

Deputy Lisa Chambers: I will be brief. I thank Mr. Coffey and apologise to him and his team. I am a member of a committee that is sitting next door, which is why I have been in and out.

In terms of overheating, the witnesses referred to implementing offsetting actions. I would be interested to hear Mr. Coffey's views on the recent commentary from the Governor of the Central Bank that we risk overheating if we build too many houses too quickly to deal with the backlog we have created over the past ten years. He spoke about having potentially to slow down other areas of the economy to allow the construction sector to grow faster than it should. Does Mr. Coffey have any views on that? Should we do that and what sectors should we slow down? From Deputy Broughan's comments, we have a major crisis we must deal with and, politically, it is the biggest issue we are all getting into our offices.

Chairman: We did deal with some of this earlier.

Deputy Lisa Chambers: I apologise. I appreciate that, Chair, but I still want to ask my own questions on it.

Chairman: I appreciate that. I am just letting the Deputy know.

Deputy Lisa Chambers: In terms of dealing with the housing issue, I note that the Minister for Finance has suggested he is still considering altering personal taxation and reducing personal taxation. Again, the Governor of the Central Bank suggested that is possible, although we would need to then look at increasing revenues elsewhere. What are Mr. Coffey's views on adjusting personal taxation downwards and where else then can we make up the shortfall on that?

In terms of the level of spending on which we are about to embark for next year, when IFAC appeared before the committee last year, we were told that the fiscal space, as it was announced then before it changed miraculously the day before budget day, was at the upper limits of prudent spending and should not go any higher. Lo and behold, miraculously, it went a good bit higher as €200 million was found the day before the budget and subsequently extra money was found throughout the past year. Where are we at in that regard? Are we still at the upper limits of prudent spending today? What are Mr. Coffey's comments on the additional spending that was done last year, against the advice of the IFAC?

I have one final question on tax expenditures. I know it was addressed. We had a discussion yesterday on tax expenditures and an interesting point was made in terms of the research and development clawback that companies can avail of in terms of tax exemptions. The point was made that had we taken it in, that is money we could potentially have given to research and development in the public universities. The point was also made that we currently rank 25th in the OECD in terms of public research and development. What are Mr. Coffey's views? Is that money well spent? Should we be looking at that research and development tax exemption for companies and perhaps redirecting those funds to public spending? Is that money spent wisely currently?

Mr. Seamus Coffey: On housing, it is not necessarily the view that we would be building too many houses but that perhaps we are doing too much with the overall resources in the economy. The unemployment rate is at 6% and housing output looks like it will increase. The question is how we go about doing that and where the workers will come from with the necessary skills to undertake the work. In a sense, if we want to do more on the investment side, we should possibly do less on the consumption side. It is about balancing what the economy is trying to do versus what the economy can do, and trying to avoid situations where one has quite large cyclical turns in the economy. Given the nature of housing and the potential for rapid changes, it is one sector that can have a big impact on the economy. Our view is that we should be cautious about what is happening, we should observe what is happening and if off-setting measures are required, we should be willing to consider introducing them.

On the fiscal space that was found last year and the additional spending, the budget was framed last year with a €200 million breach of the expenditure rule built in. It was not that suddenly fiscal space was found or the calculation changed. It was just that the Government put together a package of measures that actually breached the expenditure benchmark and it is likely to breach it by even more given some of the measures that have been introduced throughout the year. Is this at the limit of prudent economic and budgetary management? Perhaps, and it may even be stepping over it, but the fiscal rules do identify that. In our report we flagged that there is potential for a significant deviation of the fiscal rules across 2016 and 2017 so that the policy choices that have been introduced could potentially have an impact. I think the Department of Finance and the Government have acknowledged that through this margin of compliance that they have applied for 2018. One way to address the problems that a significant deviation could achieve is, first, not to have the significant deviation in the first place, so they could introduce additional policy measures for 2017 that avoid that happening or, as it seems the choice is, to hit the medium-term objective and then no additional sanctions or requirements can be placed on the country. The summer economic statement as set out suggests that the choice would be perhaps to incur that significant deviation - it is still only a risk and we will judge it on outturn data early next year - for 2016 and 2017 on the basis of the additional spending plans that the Government has announced. If that happens, then an assessment will be made, but if the assessment then shows that we are reaching the medium-term objective for 2018, no additional steps will be taken. Where it would become an issue is if we have a significant deviation across 2016 and 2017 and we are not hitting the medium-term objective, MTO, for 2018, but how to address that is a matter for the Government.

Regarding tax expenditures, the research and development tax expenditure is quite large. The Department of Finance has undertaken an assessment of it and of the increase in it in recent years. There is potentially what we might call a deadweight loss. Are we spending much more on this tax credit than we are getting through additional activity? The report of the Department of Finance suggests there is a deadweight loss but because of the additional activity it generates, it is one that we can carry. In terms of its assessment, I would recommend members read the report of the Department of Finance about whether there is value for money there.

Chairman: I thank Mr. Coffey for that and for his presentation. There is not the time for all the members to speak again because the witnesses from the Economic and Social Research Institute, ESRI, are waiting to attend the committee. I thank Mr. Coffey, Mr. Tuffy, Mr. Casey and Dr. Lawless for attending and also for the presentation and answering all the questions. I propose we take a ten minute break.

Sitting suspended at 4.11 p.m. and resumed at 4.28 p.m.

Chairman: I welcome Professor Alan Barrett, Dr. Martina Lawless and Dr. Kieran McQuinn, and thank them for attending. They will be asked to deal with the following themes in their presentations: a macroeconomic analysis of the economy; income taxation, in particular the distributional impact of merging USC and income tax; Brexit; demographic pressures; and labour market participation.

Before we hear the witnesses’ opening statements, I wish to bring to their attention the fact that they are protected by absolute privilege in respect of their evidence to the committee. However, if they are directed by it to cease giving evidence on a particular matter and they continue to do so, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person or 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 they should not comment on, criticise or make charges against a person outside the House or an official either by name or in such a way as to make him or her identifiable.

I invite Dr. Lawless to make her opening statement. She will be given 15 minutes, after which I will open the discussion to members. Deputies Heydon, Burton, Boyd Barrett, Calleary, Broughan and Doherty have already indicated. Members will have five minutes and this will be applied strictly this time. I call Dr. Lawless.

Dr. Martina Lawless: I thank the committee for the invitation to appear here today and for the opportunity to discuss a range of economic and fiscal issues.

The core function of the ESRI is to produce rigorous, independent research to inform policy debate and policy-making. The primary route through which we fulfil this function is the publication of reports. However, we see direct engagement with policy makers as being an equally important route through which we inform the policy process. We also benefit from hearing the views of public representatives on the challenges facing the country so we look forward to the members' questions.

This presentation will begin with our view of economic developments and the implications for the overall fiscal stance, followed by some remarks the topic of Brexit and finally, some specific policy issues.

The economy looks set to register significant growth in 2017 following a continuously impressive performance since 2013. Unemployment is set to fall to approximately 5.5% by the end of the current year and to just over 5% by the end of 2018. Taxation revenues, which had shown some softening during the first quarter of the year, now look more robust in terms of year on year growth. Taking the increases in taxation receipts with the strong increase in employment, we believe the economy is now growing at approximately 5%.

From a budgetary perspective, a crucial question which arises is whether the current rate of growth is sustainable, namely, is the economy operating at or near its potential level? This is a difficult question to address at present, especially in light of the national accounting issues which have been widely discussed. However, our current position incorporating an assessment of the financial sector is that the economy is not overheating. There would still appear to be some spare capacity in the labour market, especially if we consider the migration channel and credit growth in the economy is still somewhat limited. In light of this, we believe budgetary policy should be neutral, in that it should not seek to actively stimulate or contract the economy. Overall, a budgetary package of around €400 million, the net fiscal space figure in the summer economic statement, is broadly in line with this concept.

Projections on the near-term performance of the economy are currently of continued steady growth and an improving fiscal position. Looking slightly further ahead, however, the impact of Brexit on the economy is a source of considerable concern. There is currently a great deal of uncertainty both in terms of the timing and severity of disruptions to trade patterns and other linkages between the two countries. The central scenario examined in ESRI research has been one of a hard Brexit, with the UK exiting the Single Market and World Trade Organization, WTO, tariff rates being imposed on Irish-UK trade. The long-term impact of this on Irish growth is estimated to be in the order of a 4% reduction in GDP.

The impact of Brexit is likely to be spread very unevenly across sectors and regions. Agriculture and food exports are likely to be the most severely affected, both because the tariff rates on these sectors are among the highest on the WTO schedule and because these sectors also tend to be more reliant on the UK as a main export destination. This differing exposure across sectors also suggests that the impact is likely to also be unevenly spread across geographically and to disproportionately affect Irish-owned SME exporters.

While this hard Brexit scenario has been estimated to have a reasonably substantial impact on the economy, the changes to the competitive environment in the UK market in the event of an exit from the customs union could pose even greater disruption to Irish business and to movement across the Border. A further note of caution should be attached to the timing and path of the impact as in the absence of a clear transition arrangement being put in place, disruption to trade could be felt very suddenly in a short space of time, perhaps overshooting the long-term projections. On the other hand, any potential benefits such as an increase in FDI are likely to take much longer to become apparent.

From the perspective of this committee, the question arising from this is to what extent the budgetary process can or should be used to alleviate this shock. Encouraging greater diversification across export markets will be critical in mitigating this risk to Irish exporters. To do this, opportunities in new markets will need to be identified; for example, in the event of a hard Brexit, Irish exporters may lose some access to the UK market but UK firms will also face barriers to exporting into the EU. The UK exports three times as much agricultural and food products to the EU as Ireland exports to the UK suggesting a substantial gap in the broader EU market for Irish exporters to explore diverting towards.

Firms will need to have sufficient access to financing to ensure that they can avail of opportunities and to undertake any adaptations of their products that might be needed to compete outside the UK marketplace. Ensuring that the infrastructure is in place to enable firms to identify and maximise opportunities for diversification will be a key factor in minimising the overall impact of Brexit on the Irish economy.

Given the pace of growth in the economy, the Government must be especially careful that any future investment does not cause the economy to experience the same overheating difficulties experienced prior to the 2007-08 financial crisis. One area where investment is warranted is in extra provision for social housing. At present, expenditure on social housing is approximately €800 million a year. This contrasts with expenditure of approximately €1.4 billion per annum in the period as recently as 2010-11. In addition to the direct provision of social housing one other policy option, aimed more at facilitating greater levels of private sector housing, is the implementation of a site tax which would tax empty development sites. This would incentivise those who may be hoarding land to either fully develop the sites or to sell them.

In general, Government policy in the housing area needs to be very carefully considered. For example, there have been calls recently for incentives to be provided to property developers as a means of increasing housing supply but recent research conducted by the ESRI on behalf of the Department of Finance would caution against such measures being introduced. Furthermore, other research conducted by the ESRI argues that apart from a site tax, Government measures aimed at housing markets across countries have had mixed fortunes in terms of achieving the desired outcomes.

We were asked to comment on the possible integration of USC into the broader tax code and we will offer one observation on this. We expressed concerns at this committee last year about the suggested abolition of USC and we remain concerned about possible revenue losses. However, if there is a move towards the integration of USC and PRSI, this might present an opportunity for an innovative approach to yet another policy challenge, namely, pensions.

In a paper published by the ESRI in 2007, Dr. Shane Whelan of UCD proposed that the PRSI system be expanded to provide an earnings related pension for lower and middle income people. He showed how both risk and administration costs could be reduced under such a public system, allowing for more generous pensions payments for the same costs as might apply in a private system. The pension challenge for middle income people in Ireland has been shown in more recent research by our colleague Dr. Sanna Nivakoski. Using replacement rates as an indicator of the effectiveness of pension coverage, Dr. Nivakoski has shown how the Irish pensions system works well for lower and higher income people but less so for those in the middle.

We were also asked to comment on population ageing. We will make some specific remarks on the issue, but we will also place population ageing among a number of other issues which will put upward pressure on public spending in the coming years. It is now generally recognised that Ireland's population is ageing. While this is to be celebrated, there will be some costs associated with that. For example, the Department of Finance has projected that spending on public pensions will rise by 3% of GDP between 2013 and 2040. This is a large figure but suggestions that public pensions are unsustainable is possibly overly alarmist. While it might not be a popular proposal, our colleague, Dr. Karina Doorley, has shown that across Europe, the costs of population ageing could be offset fully by extending the pension age to 70. The actual policy approach to population ageing will more likely involve a mix of increased contributions, delayed payments and extended working lives and there is a value in thinking now about how these components might be best achieved.

We have already referred to some drivers of public expenditure but will list them now. In addition to population ageing, it seems clear that infrastructural needs and climate change will also add to the upward pressures. On infrastructure, we have mentioned housing already but the committee knows well the other areas which include health, education and transport, to name but a few. On climate change, costs will arise in one of two ways. Failure to meet targets on emissions will result in fines. If we are to avoid those fines, we may need to invest more heavily in areas such as public transport and renewable energy.

These predictable pressures on the public finances led to us to raise concerns about tax cuts last year at this committee and this, understandably, was met with resistance from some members. Part of our concern relates to the difficulty of raising new revenue sources and recent years have provided ample evidence on this point. We will end these remarks by pointing to joint research by the ESRI and the Department of Finance on options for a wealth tax because it illustrates well the challenge of raising revenue. It is estimated that a 1% tax on wealth across the board in Ireland would raise €3.8 billion and would affect 86% of households. Clearly, such a tax is unrealistic and it is more likely that a range of thresholds and exemptions would be applied. The paper illustrates how the tax take is reduced as the system is amended. For example, if the parameters of the French wealth tax system were applied, only €22 million would be raised. If we adopted the Dutch system, €706 million would be raised but almost a quarter of households would be affected.

Our purpose in undertaking that research was not to be prescriptive on whether or not a wealth tax should be introduced. It was a purely mechanical exercise exploring the options. In the context of future spending pressures, this wealth tax example serves as a useful illustration of the difficulty in raising new revenue and hence how care should be taken in reducing current revenue sources.

Chairman: I thank the witness. As the Chair, I have two very quick questions. I note Dr. Lawless's references to Dr. Shane Whelan's proposal and to pensions. How does she think that any reforms to the USC could be made in a revenue-neutral way, because it will obviously be a huge loss? Does she think that, in those circumstances, there would have to be an intermediate tax? On labour participation, we all know that the higher earner is often male and is the assessable person in any joint policy. Therefore the female is the secondary earner. How does Dr. Lawless think that could be addressed? That is obviously one of the barriers to women in the market.

In respect of demographics, we have an ageing demographic. I see what Dr. Lawless has said about increasing the pension age to 70. Would she accept that, if that were the case, we would then have to increase the funding to promote health policies for older people? At the moment there is no uniform cross-Department approach to the costs of demographic changes in any guise. That is something I would advocate in terms of the Civil Service making policy in the future. I would like Dr. Lawless's views on that.

Professor Alan Barrett: I will try to answer the three questions. I will not say an awful lot on the first issue the Chair raised because the proposal or suggestion that the USC and PRSI be merged is very recent. Clearly there are very complicated logistics around it and I do not want to pretend for a moment that the ESRI has given an awful lot of thought to it. The one point we wanted to inject into the analysis is that, if one thinks about it, the USC is essentially a tax and PRSI is a social insurance system. If the two are merged, the PRSI system would be implicitly moved in more of a tax direction or the USC would be moved more in the direction of a social benefit system. If the USC was given more features of a social insurance system, the social insurance system could be enhanced. This point was based on the paper Dr. Shane Whelan produced ten years ago but I have heard others who still talk about it. There is a huge amount of work to be done in working through the logistics of the idea and, again, I do not want to pretend for a moment that we have done much work on it.

On demographics and the increasing of the retirement age to 70, the ESRI was remarkably misquoted on this issue in the newspaper today. I know that I am looking at very sensible people-----

Deputy Richard Boyd Barrett: It happens to us all the time.

Professor Alan Barrett: I feel really at home discussing this here. Essentially, my colleague, Dr. Doorley, carried out a purely mechanical exercise in the context of people often talking about the public pension system being unsustainable in the context of ageing. Dr. Karina Doorley was asking, as others have asked before, what kind of policy mix would get us to a stage where there would be a sustainable future for public pensions. One route to this would be to simply raise the pension age. Whether or not it is a good idea, the crucial point, about which people in this area increasingly talk, is that it is all about offering people choice. It was quite a long time ago that the notion of 65 being the retirement age became ingrained. The health status of 65 year olds has changed enormously. The Chair linked her question to health. The simple truth is that many 65 year olds are now perfectly capable of continuing to work in certain circumstances. There are other 65 year olds who are not capable of doing so. Obviously, occupations differ enormously so the trick and the policy prescription here need to be around facilitating people if they want to work longer because there is a clear potential benefit for the economy and the individuals but it is all about choice and facilitating people.

In respect of cross-departmental approaches to the issue of ageing, there is a common set of figures-----

Chairman: Demographics.

Professor Alan Barrett: There is a common set of figures. In respect of the EU, there is a working group on ageing that has met for many years and produces reports on this. The group uses common sets and agreed sets of population projections. The Department of Finance represents Ireland on this group and would have inputs. We have very good demographic projections linking those projections to things like pension costs, health care costs and education. Really elaborate work has been done on this. I often make the point that we should be very coy when economists start talking about economic forecasts because that is a very difficult thing to do. We are much better at demographic projections because we have a rough idea of what fertility and mortality are. Migration is a tricky one but we know an awful lot more. Population ageing is something that is way more predictable. Linking it to things like increases in pension costs is way more predictable. The data and projections are there and all Departments know what they are facing. It is just a question of getting people to lock in and really focus on the issues.

Dr. Kieran McQuinn: As a side issue that is relevant, I have done some work with a colleague in UCD, Karl Whelan, over a number of years where we have looked at the impact of demographic changes. We all think of demographic changes in a European and Irish context in terms of issues like pensions and future issues like that, but we have demonstrated that the ageing nature of the European population in general is having an impact on the growth prospects of the European area right now. It is not something that will happen ten, 20, 30 or 40 years down the road. It is actually hitting us at this time and those challenges will only increase from a general economic growth perspective.

Chairman: Deputy Heydon has five minutes

Deputy Martin Heydon: I will be brief.

Chairman: I have my gavel here.

Deputy Martin Heydon: I thank the witnesses for attending. I would welcome some clarification of their comments regarding pension age because it is a very different conversation when one is talking about making it optional for someone who wants to keep working at the age of 68, 69 or beyond that and a mandatory situation, which would present a lot of difficulties. Based on the witnesses' opening statement, it is fair to say that they are broadly supportive of the proposal to integrate USC and PRSI.

In respect of the potential overheating of the economy, I recognise from their opening statement that they say that the economy is not overheating now but as the Committee on Budgetary Oversight, we should be mindful of looking at the risks of that. We discussed the potential risk of that with the Irish Fiscal Advisory Council. As we continue to ramp up our housing production, do the witnesses agree that it is a potential threat with regard to that overheating? What mitigating measures can we take from a budgetary perspective to address that? There has been much media coverage recently of Fianna Fáil's proposal to reduce VAT rates for developers. Do the witnesses see any risks in that? What would be their view of such an initiative were it to come into play?

The witnesses have obviously recognised the specific impact of Brexit on agriculture and food and made the very wise point that Brexit will be felt differently in different sectors and geographic regions, probably no more so than in agriculture and food. On the basis of that, do the witnesses think there is merit in having specific budgetary measures that would look to tackle this? We always tend to talk about Brexit as something that will happen in a year and a half regardless of whether it is hard or soft, but the discussions around Brexit are already having a very real impact, particularly in the agriculture and food sector and no more so than in the area of currency volatility. Do the witnesses see merit in budgetary measures that would look to address those issues now for food producers and processors who are in very serious difficulty?

I asked a question earlier about corporation tax and forecasts.

Does the witness think that our forecasting system for corporation tax, as linked to the budgetary process, is adequate? It is clearly volatile because there are so many moving parts involved. Are there ways in which we can look to improve the forecasting system in this area, given that it is such a key component of our budgetary process? What are the ESRI's views on the current evaluation process for tax expenditure? How can we evaluate tax expenditure measures in the future so that we can prioritise the resources we have? Do the witnesses have any comments on how this is done at present and how we might improve it?

Speaking as somebody who is new to this committee since just before the summer, I would like to hear the witnesses' views on how the whole Oireachtas pre-budgetary scrutiny process, of which we on this committee are an integral part, is carried out. Do they have suggestions as to how this might be improved in the future?

Dr. Kieran McQuinn: I will deal with the overheating, the reduced VAT proposal and maybe the corporation tax forecasting. I will try to be as brief as possible because some of these issues were dealt with earlier. With regard to the overheating, we share the concerns of others such as the Fiscal Council and, more recently, the Governor of the Central Bank. Going back to the practice of building relatively large numbers of houses, up to 40,000 units per annum, for example, will certainly add a lot of economic activity and it has to be recognised that the economy, at present, is growing very strongly. We believe that it is growing at a rate of about 5% this year, which is on top of very strong growth rates both last year and in the previous years. It will certainly have that effect.

With regard to our own comments, there is renewed focus on investment at present. Many are talking about investment and the capital plan will be coming out shortly. What we in the ESRI have said is that we need to be careful about investment because of the economy's current position. We also need to prioritise the areas in which we need to invest. Over the past number of years we have argued strongly for the need for greater social housing. About three years ago or so, when I first started working on the commentary, we were struck by the lack of social housing activity. A sustained lack of social housing activity over time will clearly have huge implications, not just economically but also socially. We certainly think that investment should be prioritised in this area. Looking at where the fiscal space could go, for instance, particularly with regard to balancing the pressures of the clear need for more housing with the need to ensure that we do not cause the economy to overheat, social housing is the area we would target.

Our stance on housing policy overall could be summarised as wanting more social housing and more commitment to social housing. With regard to the measures that work or that appear to work, our research across other countries suggests that a site tax would be particularly appropriate, particularly in the Irish context. The chairman of NAMA has commented on the possibility of land hoarding. The cost of building houses is also frequently commented upon, and people such as Lorcan Sirr have identified factors such as development costs as an integral part of that. An adequately and accurately priced site tax could tackle that because there is a speculative element to much of the development land cost in that people can simply sit on the land and watch its value increase year on year without incurring any cost on themselves. The introduction of a cost such as a site tax would tackle this speculative element. A site tax, then, is certainly worthy of consideration. There is evidence of this from other jurisdictions such as Denmark.

Chairman: When Dr. McQuinn refers to a site tax does he mean one that is completely separate and distinct from the local property tax?

Dr. Kieran McQuinn: Yes. It would obviously vary depending on-----

Chairman: An additional tax?

Dr. Kieran McQuinn: -----the degree of infrastructure servicing a particular piece of property, for instance. If the site were clearly nearly ready to go then the tax would be set at a rate different to that for land that was not in such a position.

Deputy Martin Heydon: I am struck by Dr. McQuinn's absolute focus on social housing, which is a key area.

Dr. Kieran McQuinn: No. The site tax would also help the private sector. There are two elements here.

Deputy Martin Heydon: There is the question of affordable housing for those looking to start on the ladder, and so on.

Dr. Kieran McQuinn: Yes. There are two elements to the housing issue. First, we need a continuous, certain provision for social housing. Our colleagues at the National Institute of Economic and Social Research in London have remarked on the similar situation in the UK, where the stock of public housing was effectively run down because of the privatisation of social housing in the late 1980s. We have a similar issue here; we need a continuous provision.

Second, it is clear that we need a substantial response from the private sector. I think the site tax could go a long way towards addressing that issue.

In her opening comments, Dr. Lawless referenced a paper in which we assessed the role of taxation measures in helping to alleviate supply. We carried out a fairly detailed analysis and we were, broadly speaking, quite sceptical depending on the nature of the perceived logjams in the system. We would refer people to that in terms of a detailed description.

I know from the work we have done that corporation tax is a very difficult thing to estimate and forecast. Many taxation measures can be measured, estimated and forecasted reasonably accurately, but corporation tax is very difficult. We simply do not know what will happen from year to year. There are many unforeseen developments. An accountant somewhere can make a decision which can result in a major transfer of funds from one jurisdiction to another. It is very difficult to accurately forecast that. A lot of work is being done on that by the Department of Finance and elsewhere. It is something that is continually improving.

Dr. Martina Lawless: I want to come in on the question of Brexit. A lot of work is currently being done on trying to understand what it might mean for Irish businesses and, in particular, the agrifood sector. It has stood out in all analysis, including that of the ESRI and in work on sectoral exposure in the Department of Finance, as being the sector most at risk of being hit.

It is also true that businesses which export a lot to the UK are already being impacted by the fact that the sterling exchange rate has been affected. Most exporters are used to dealing with currency fluctuations to some extent. The concern for exporters now is to what extent this is a more permanent move rather than a standard short-term fluctuation which they have been able to hedge against. In terms of what can be done to aid exporters, we need to ensure funding is available to identify other market alternatives, determine whether some financing has to go into working capital while firms deal with the reallocation and provide some support in identifying where these new markets might emerge.

At the moment, businesses which are importing from the UK are gaining from the exchange rate. There is, perhaps, a limited incentive for some businesses to seek out alternative markets and supply links while they are getting imports at a cheaper rate. There is a balance to be struck in terms of how currency fluctuations impact on businesses.

There is a lot of uncertainty in terms of business planning about what Brexit might mean, when the effects might be felt and so on. This means that the planning process is very difficult for businesses in terms of what new investment they might need to put in place.

On that note, examining other market opportunities is probably somewhat of a no regrets policy for business. If Brexit turns out to be softer than expected, but a business has identified a new market opportunity in France or Germany, that is probably to its overall benefit rather than something that should only be done to replace a lost UK market opportunity.

Professor Alan Barrett: There was a question on the evaluation of tax expenditure. An interesting point was raised. Until about a year or 18 months ago there was a complete imbalance within the Department of Finance on the extent to which spending proposals were evaluated relative to the evaluation of tax expenditure. There was a complete disconnect and a series of manuals as to how capital expenditure was to be evaluated. There was an absence of information on giving people tax breaks.

In fairness to the Department of Finance, it put together a set of guidelines on this about 18 months ago. It is much more active in that space than it previously was. One possible example where it might be having an effect is in the area of tax breaks for developers. Members of the committee will be familiar with the fact that one of the issues which has floated around for quite a while is whether it is something we should be doing in the context of the housing crisis. Under the new guidelines, the Department was much more proactive in forcing people who are making a proposal to provide evidence that it will actually have an effect.

Dr. McQuinn alluded to the fact that the ESRI fed into this through a report we produced which raised questions about the actual effectiveness of some of the proposed tax reforms in the context of the specific difficulties which were affecting the housing market. It has upped its game in that regard. There is evidence that something is happening but, ultimately, politics tends to trump economics in these situations and if a decision is going to be made, it will be made.

The Deputy's final question was on the process. What is the Napoleonic phrase, "Is it still too early to tell"? It is still too early to tell.

Deputy Joan Burton: I welcome Professor Barrett's comment on the ESRI's proposal, which has been widely reported today, to raise the pension age to 70. Doing the latter would be little short of catastrophic. Socially and economically, many people who will rely on the

State pension would not be in a position to sustain work until they are 70. Some would, but the vast majority would not. In terms of the legitimate expectations of people, such a move would be extremely unfair. We have a very low rate of at-risk poverty and other indicators among pensioners. This is a very good and stabilising factor in Irish society. Certainly, over the six-year period I was involved with the Department of Social Protection, there was an additional spend on the social welfare pensions provision of approximately €200 million per year. This amounted to €1.2 billion over the six years in terms of expanding the base. This is likely to continue with the demographics, but it will be necessary to make provision for it. Some people resent that the Irish public pension system is not, as it were, funded. However, we have a capacity of people of the current generation who are at work and who pay towards the retirement - in terms of PRSI retirement pensions - of those of previous generations. I would not move away from this system.

I welcome the comments on the supplementary pension. All of the work has been done in the Department of Social Protection on this. We had this conversation. It was not possible to do it when the economy crashed, but the USC, combined with a supplementary pension, could be the initial contribution that many people in work would make to launch it. I acknowledge the work of Professor Shane Whelan and others on this matter. It is a workable scheme. I note that the ESRI would leave it in the public sector. Those in the private pensions industry, certainly in their conversations with me, did not quite agree with this. However, I agree with the recommendation.

The ESRI would do this committee a very great service if it were to elaborate on the site tax proposal and provide us with something we could seriously present to the Minister. It needs to be elaborated upon in order to arrive at something that will work. The previous Government, of which I was a member, developed a derelict sites levy. I would be the first to say it was a very restrictive proposal when compared with a broader site tax levy, which would also take the heat out of rising land valuations. I served on the original old Dublin County Council, and it was all about land speculation, rezoning and mega-profits. Unfortunately, we are heading back in that direction. Would the ESRI be willing to provide us with a worked proposal? It is possible to be fair on this and really try to take the heat out of the speculative end of it. There are many reasons sites cannot be developed and why the process time. We need to take account of these, but we could try to target this at the pure speculation, which, ultimately, is tax free in terms of the profits, by and large, in the Irish system that it engenders. This brings me to another point.

Chairman: The Deputy's final point.

Deputy Joan Burton: A cornerstone of people providing for their old age in Ireland is that they are in a position to buy houses and, by and large, pay off their mortgages before they retire. The property, in turn, becomes a valuable asset to be used if they require care or to be passed on to their families, in whole or in part. I agree with Deputy Martin Heydon's equal emphasis on affordable housing, on which I welcome Professor Barrett's view. There are many people renting who are paying more than if they had a comparable mortgage. That brings me to my last suggestion. Could we have a finance bond for housing via the NTMA? The Labour Party has proposed such a bond on a couple of occasions. We are accumulating a lot of savings, partly because of the crash. Could some of the funds be utilised to provide housing finance? I would consider putting it into the NTMA because I believe it has the capacity to actually deliver. That would be the add-on. Does Professor Barrett agree that the finance structures for the housing market are broken? They are significantly broken for many potential developers and builders.

Professor Alan Barrett: I shall respond to a couple of the points made about pensions, while my colleague Dr. McQuinn will address some of the housing related issues.

The Deputy made reference to the headline on pensions and the fact that costs were increasing over time. I will speak about the cost of the contributory and non-contributory old age pension. It is going to rise over time. It is absolutely critical, therefore, that we protect the system and discuss the funding pressures to make sure things will be in place. We in Ireland are very critical of many of the measures in place in Ireland, but the actual public social welfare pension system is one of the great success stories of Irish social policy. If one looks at poverty rates among elderly people going back 20 or 30 years, they were quite shocking. Nowadays the numbers are really small. It is important, therefore, that we protect the system by having conversations about the funding mechanisms. In particular, it is very hard to get away from the fact that we are going to have to increase contributions, reduce payment benefits or delay the point of payment. Mathematically, there is only so much one can do, but it is important to discuss these issues and come up with some blend. It is critically important that we protect a system that is working really well.

With regard to the suggestion that there be an enhanced pension or earnings related component in the public system rather than just in the private system, I shall give a small piece of the history. Dr. Shane Whelan produced a paper that was published by the institute in its 2007 quarterly economic commentary. In the same issue Professor Morgan Kelly of UCD produced a paper on house prices. Needless to say, the paper on house prices received a little more attention, not just on the day but for eight or nine years afterwards. I must get back to Dr. Whelan to tell him his time has finally come for his paper that should never have been ignored.

There were two key points made by Dr. Whelan, the first of which referred to the fees that applied to pension systems. We are talking about lower and middle income earners and it touches on the reason people have a problem in this respect. Deputy Joan Burton knows about this because the Department in which she was Minister commissioned work on the issue. The fees paid to private agencies make a significant dent in the final payment, whereas the Department of Social Protection administrates and runs a massive pensions system at relatively little cost. I am in a positive mood today in talking about successes. It is phenomenal when one considers the number of cheques issued each week and how well the Department does this. There is a sense of why not build on something that is working.

The other big point about doing it publicly concerns asking people in this day and age to hand over lots of money to private financial institutions to hold it safely for 30 years. It just does not work terribly well and a lot of people have a resistance to it. The State is in a much better position to give guarantees and smooth the risk. The issues, therefore, are related to fees and risk. These are not my ideas but the ten-year-old ideas of Dr. Whelan and it is important to put them back on the agenda. The possible link-up of USC and PRSI has opened that discussion.

My colleague Dr. McQuinn will address some of the housing related issues.

Dr. Kieran McQuinn: There is a site tax proposal to be brought forward during 2019. It will be quite a period of time before it will actually be in. We would heartily agree with any way it could be fast-tracked. As I said earlier, there is a case for having higher rates on land that is clearly ready to go and well serviced from an infrastructure point of view to differentiate it from land that is not well serviced. I can think of a scale of rates that would assist in that sense.

I echo the points the Deputy made earlier on affordable housing. The experience of the past five, six or seven years shows that the State has to provide some level of social housing every year. If it does not do that, the problems become huge and will, unfortunately, take a long period to resolve. Obviously, we had the model of the 8% of new developments. However, the problem with that was when 80,000 houses were being built, as was the case in 2005, 2006 and 2007, 8% of that was a sizeable amount. When practically no houses were being built, 8% is next to zero. Clearly, lessons are to be learned in that sense.

As far as the financing bond is concerned, credit is generally a huge issue and will need constant and careful marketing in future. House prices have risen very sharply in recent years and the expectation is that they will continue to do so, particularly in light of the slow supply response. All of that has happened without credit flowing freely because of the impaired nature of the financial services sector. As the banks' balance sheets recover - we are already seeing credit beginning to flow in the economy - we need to avoid the risk of house prices growing purely because credit is expanding. That was obviously the genesis of the difficulty we experienced in the lead-up to 2007, when we had a credit-fuelled bubble.

Credit is quite a tricky issue. The underlying concern I and others have is that the demand for housing has grown very substantially in the past five or six years in the absence of credit. Now, as credit becomes available - and as it will do in years to come - the danger is that price levels and demand-side pressures will be additionally fuelled by that. So-----

Deputy Joan Burton: May I say-----

Chairman: The Deputy may make one quick point because a number of other people wish to speak.

Deputy Joan Burton: A builder can construct 20, 30 or 50 houses and get credit flows. However, a builder might be renovating rooms, etc., above shops in cities and derelict areas of towns. A builder doing five, ten, 20 or 40 apartments will need to have a credit supply for the complete development. That person cannot sell one apartment and plan on the next year completing the next three or the next 20. That seems to be an enormous problem for medium-sized builders, who, admittedly, often have impaired credit ratings.

Chairman: I am sorry, Deputy,-----

Deputy Joan Burton: Is there a way to address that?

Chairman: Does Dr. McQuinn wish to answer?

Dr. Kieran McQuinn: I agree. From talking to people in the industry, it is clear that the change in the way credit institutions deal with developers with the new improved credit guidelines, which, ultimately, are there are for a good reason, is impacting the smaller developers more than anybody. That is obviously having knock-on impacts on the units those developers could provide.

Chairman: I call Deputy Boyd Barrett, who has five minutes. I mean that. I ask him to do the best he can. If he could ask his question in a focused way, it would be great.

Deputy Richard Boyd Barrett: I will not spend much time on Brexit. Would Dr. McQuinn agree that many of the things that could be issues for us as a result of Brexit are really difficult to pin down at this point? We had the fluctuations, but on a range of other things we just do know what could be the potential impacts. There could be upsides and downsides. While I agree with Dr. McQuinn's point about encouraging greater diversification in export markets, do we not just need greater diversification in the economy beyond that? It is not just in the export area and there may be a necessity to develop other sectors of the economy that are not quite as vulnerable to fluctuations in the international markets. I will say no more about that because much of it is intangible.

I welcome strongly the ESRI's comments on housing and pensions. It is absolutely right. Perhaps the witnesses can elaborate a little albeit they must obviously be slightly cautious about being too prescriptive. The ESRI seems to be saying in a fairly forthright manner that there are big questions about tax expenditures benefitting private developers as a mechanism to deal with the housing crisis. It is very strong on saying we must increase significantly the output of public and affordable housing. The ESRI notes that we are still well below the expenditure levels in those areas that obtained even back in 2011, which is a very important point. By the way, the level in 2011 was not enough either as we had a housing crisis then too. Perhaps the witnesses would like to elaborate on that. I agree with them strongly, if that is what they are hinting at.

It emerged today that developers are saying they cannot build anything for less than €320,000, which is partly linked to what the banks are demanding. All that points to the folly of reliance on private developers to get us out of this mess. It would be cheaper to borrow the money and use public land to build directly. At every level, it makes more sense to ramp up direct expenditure on public and affordable housing rather than to rely on the market and tax incentives to encourage developers. Perhaps the witnesses will comment on that. I agree on the site levy but one must think about the extent to which it would actually force these guys to do anything.

Do the witnesses have any comment on things like section 110 as a big area? Is it a problem, as I certainly believe it to be, that the Government cannot even tell us in response to parliamentary questions how much tax revenue has been forgone, or is likely to be, as a result of the section 110 break on rental income for vulture funds as well as on capital gains? That is shocking when we are looking for extra fiscal space. We have put down parliamentary questions, but the Government cannot tell us notwithstanding the fact that this is clearly a massive expenditure. There is no doubt that these people who have bought up all this stuff are going to make massive capital gains. They are clearly making big rental income profits currently but we do not know how much tax is being forgone in the area and cannot get an answer from the Department. I do not know what the ESRI thinks, but I find it shocking.

I agree that the public pensions system seems much more efficient and safe. Do we need to look at tax expenditures on private pension tax breaks where they are benefitting high income earners with what one might call "gold-plated pensions", in particular, and start to reduce those tax expenditures and redirect the money to a better public pensions system with higher pensions for pensioners?

Professor Alan Barrett: We will assist the Chair by being succinct in our answers. I will just rattle through and if I leave anything out, my colleagues can pick it up. Deputy Boyd Barrett kicked off with the statement that he understands we have to be coy or cautious. To qualify that, we do not, like the fiscal council, agonise about what our mandate is or anything like that. The only reason we are ever coy is that we try to say things that are based on the research we have produced. It is not that there is some sort of mandate restriction on us. It is just that if we have not done the research, we are shy. Very often, one only wants to push the research findings so far.

Let me now talk about tax incentives in the context of housing and developers. We did a very specific piece of research on that and I will just give the committee the highlights. We were presented with a series of reasons as to why there was not a greater supply of housing coming along. Deputy Burton talked about financing restrictions and others discussed the cost of building. A number of scenarios were presented to us. We sat down and used the basic tools of economics to work out what certain tax measures would do. For example, we examined tax measures in the context of a lack of finance. In many of the scenarios, we showed that there would be very little effect on supply. There would just be an increase in the profits and the money accruing to the builders. This would happen, not just in that particular tax expenditure but in a whole range of tax expenditures. That is what happens. We did the analysis. We certainly thought we did enough to point out that it was far from clear that one would get value for money in that particular route. We were quite strong on that and if it did not come through in the opening statement, apologies for that.

Tax expenditures in the pension area is a tricky one. I myself have tried to grapple with this. Let me say where the difficulty is. There is an argument that tax expenditures in the pension area is not so much a tax break but deferred taxation. At present, one does not pay the tax as it is going into the fund but one is taxed when taking the money out. There is the point that, typically, people are earning less by the time the money is coming out so that the average tax - I do not know whether that is the point Deputy Pearse Doherty was going to make - will be lower but I have never seen a good life-cycle analysis that gives us a sense of where the whole thing breaks down. I would like to see more on it. Certainly, it is an expensive tax expenditure. It is worth looking at but I am not sure about the simple notion that this is all going to the wealthier people. There is an element of truth in that but I think it is a little bit murkier. Also, it has been reduced in recent years and it is not as bad as it was. Kieran might want to pick up on any of the points.

Dr. Kieran McQuinn: I think Professor Barrett has covered them. There is one point I would make in response about addressing the housing supply issue. Personally, I think it has to be a mix of private and public. We cannot satisfy the overall levels of housing demand purely via the public channel. Clearly, we have seen the lessons of the last ten years of when we do not provide any public housing and work needs to be done identifying what is the level of social housing provision that we need year on year. Meeting the overall demand, which ranges from 35,000 to 55,000 houses per annum, will require a mix of both public and private.

Deputy Richard Boyd Barrett: Does Dr. McQuinn not want to comment on the section 110 issue?

Dr. Kieran McQuinn: I probably would not know enough about it.

Deputy Dara Calleary: I will start by commending the ESRI on its work on Brexit. It was one of the first organisations to give it to us, plain and simple and between the eyes. Dr. Lawless mentioned in her remarks that the differing exposure will be unevenly spread across geographically. She mentioned some solutions for SME exporters. What proposals has Dr. Lawless in mind to balance out the effects geographically?

I put the question to Mr. Coffey as to what is the biggest threat, Brexit or CCCTB. I will throw in a third one, climate change. Of those three issues, in Dr. Lawless's view, what is the biggest threat to the short-term future of the Irish economy? Dr. Lawless specifically mentioned climate change in an interesting manner.

Finally, Professor Barrett has probably a unique perspective among economists. Sometimes economists come into these committees in a little economic bubble and let the equations and solutions work. Professor Barrett sat through two days of the National Economic Dialogue. Not only has he had the experience of being misquoted today but he sat through two days of competing demands, all passionately given. All those giving them feel that they are the most important ones. I welcome Professor Barrett to our world. How does he, after two days of that experience on which he has a report, suggest we reconcile that particular circle? It is all very fine to do what Mr. Coffey was saying, namely that we could reallocate resources from here to there. When one reallocates resources, one is taking from somebody who feels that his or her issue is as important as the one being allocated. I welcome Professor Barrett to our world and welcome him to the decisions that have to be made by the Minister, Deputy Donohoe, in the coming weeks. From Professor Barrett's experience of those two days, did he get an understanding of the pressures that we face politically and why, to use his own phrase, politics will "trump economics" on many occasions?

Dr. Martina Lawless: I will start on the Brexit issue. All of the work we have done on Brexit has been looking at trade data and the focus has been very much on the food and agricultural sectors, which are the most exposed. It is not difficult to look across the country at where these economic activities are to see that it spreads the exposure more towards rural than urban areas. People have spoken occasionally about the potential positives of Brexit, for example, the possibility that some foreign direct investment will be diverted towards Ireland. This, too, is very much focused on an uneven geographic spread. If there is a reallocation of some financial sector activity from the United Kingdom to Ireland, it is likely to move towards Dublin or other urban centres, which would further exacerbate the potential for regional disparities resulting from Brexit.

On addressing or mitigating this risk, Deputy Boyd Barrett hinted that the impact of Brexit remains very much unknown. We have been trying to pin down the impact of Brexit in particular scenarios, for example, in the event of World Trade Organization tariffs being applied. However, as it is an ongoing political process, we do not know how it will pan out. A transition arrangement involving very little change could be in place for several years or there could be a failure to come to an agreement that results in a short, sharp shock to the Irish export market in 2019. It is difficult to put a range of probabilities on those outcomes.

Mitigating the risk will involve encouraging the identification of other opportunities, exploring alternative markets and seeking opportunities for diversification. This is what the individual firm can do. A budgetary process can support this by ensuring the financial infrastructure and working capital supports are in place. The aid provided by enterprise services in identifying these other markets and understanding what it takes to launch a product in a particular market, as well as the advice they give on that front, will probably be very important. Naturally, this aid will be taken up more by firms that are more exposed.

I am not sure if a particular regional Brexit strategy will be necessary. It will probably be rolled into the sectors that are exposed in certain regions. There is a move towards wider spatial strategy concerns in terms of how economic activity should be incentivised to disperse more evenly across regions. However, it is probably something that is a separate regional strategy or spatial process, rather than something that is directly in response to Brexit.

Dr. Kieran McQuinn: There is a danger that people will become fatigued with Brexit. It is an ongoing process about which we are listening to reports every day. We must keep in mind that the outcomes could be adverse for the economy and maintain a focus on it. We did some work earlier in the summer on the commentary, for example, we examined the impact of Brexit on the fiscal space. This issue may not have been fully teased out or clearly understood. We showed that Brexit could impact on the fiscal space because it impacts on the potential output of the economy, which is the key metric that determines the fiscal space. By impacting on potential output, Brexit will impact on the fiscal space in terms of the amount of money available to the Government when and if Brexit comes into play. This is just one example of a way in which Brexit could impact the economy that we may not yet fully realise.

Professor Alan Barrett: I will try to give a quick answer on the two further questions raised by Deputy Calleary, the first of which related to Brexit, the CCCTB and climate change. We have discussed previously Brexit and tax. I will speak briefly on climate change because I had not thought about it in the way in which the Deputy framed his question. If one looked at climate change in a very narrow way, namely, in terms of what fines or investments may be coming down the line, the issue is probably not as big as Brexit. However, there is a bigger issue to be discussed. For example, if Ireland fails to meet its targets or to undertake the investment required and we are fined, the signal it sends to the rest of the world is that we are not taking seriously the issue of climate change. If a group of countries starts to behave like this and it is in some sense acceptable not to try to meet targets or to do something about climate change, collectively or on a planetary level the impacts have the potential to be much greater than the combined impacts of Brexit and any tax changes. While there are different ways of looking at the climate change issue, it is certainly an issue that will feature more and more on the agenda. We discussed it only in terms of the feedback into how careful we need to be about hollowing out the current tax base because it is yet another thing that one can readily identify as presenting cost pressures in the future.

I will make a brief point before getting into the substance of the question about the national economic dialogue, NED. As chair, I was grateful that so many members of this committee came along and participated so actively. The NED is designed to ensure people can represent their groups and have their say, but elected officials represent large blocs of people so it was very important that they were there and I thank them for that. It is overwhelming to sit for two days and hear all the demands people make but its value is that we are exposed to these views and fully hear all the competing demands. As chair, I try to nudge people along to see if they can give reasonable justifications for their demands. This year was the third NED and I think it has improved in quality. People are beginning to realise that they cannot just come along and say they want more of X, Y or Z, and this feeds into a better discussion. I said to the Minister, Deputy Paschal Donohoe, that I did not envy him his task because it is bordering on an impossible position.

Chairman: Yesterday, DKM told us there would be fines of €610 million by 2020 in respect of climate change if we did not reach our targets, with between €3.7 billion and €5.5 billion by 2030. These figures are quite significant.

Professor Alan Barrett: I was unaware until very recently of just how major these fines were. Climate change is no longer just for environmental enthusiasts, it is also for fiscal conservatives.

Deputy Dara Calleary: The cost of damage from flooding and population change is also going to be enormous.

Deputy Pearse Doherty: I am also under a bit of pressure as I have another engagement at half past. I welcome the witnesses and the presentation was very good. There was a reference to difficult decisions and the value of members from the ESRI coming before us is that they can inform us of the consequences of those decisions.

I welcome the focus the ESRI has put on housing because the housing crisis did not happen by accident. It may not have been intentional as such, but decisions taken by people who occupy these Houses resulted in nearly 3,000 people, including children, in emergency accommodation. There is a lot of focus on what pensioners will get in the budget or what happens to cigarettes and alcohol but the decisions taken in previous years resulted in the current housing crisis.

The ESRI stated that approximately €800 million was being spent per year on social housing. Does it have a view on what the figure needs to be to get to grips with the crisis in social housing?

My second question is on the site levy. I assume this means a vacant site tax as opposed to a land valuation tax or a tax on land zoned for development. Does the ESRI have any views on the rate that would be applied? The tax for derelict sites, which will kick in on 1 January, is 3%.

I understand there is a report on the help-to-buy scheme and there has been commentary in the media suggesting it will be tweaked. There are a lot of vested interests behind the scenes, including at least one Opposition party, who are trying to ensure it remains in one shape or form. Has the ESRI carried out any analysis of the help-to-buy scheme? Has it worked? Has it pushed up house prices? Has it simply resulted in a transfer to individuals? It was to help people reach the Central Bank's macroprudential rules. Has it achieved that?

I had to take a call from someone on whom I was waiting so I did not hear the point about pensions. However, I take it from the other engagement that the article that I think appeared in the *Irish Independent* today, in which it was reported that the ESRI is not calling for an increase in the mandatory retirement age to 70 but that it is recommending that retirement at that age should be optional, accurately reflects the ESRI's position. We welcome that. A colleague of mine - it was not Deputy Jonathan O'Brien - has brought forward legislation in this regard which has passed First Stage, Second Stage and pre-legislative scrutiny and which, it is hoped, will pass through the Houses. The legislation would lift that barrier.

My other two questions concern pensions. There was a bit of a conversation about the amalgamation of the USC and PRSI. Basically, USC, which by 2020 will take in €5 billion, would, if this were to happen, be transferred and go into the Social Insurance Fund. That is fine because the Social Insurance Fund is not in the red anymore but in the black. However, there will be pressures on it in years to come, and this measure would alleviate some of those pressures. On the other end, however, there would be a €5 billion hole in the tax end, which that end cannot take from the Social Insurance Fund to pay for health, social housing and so on. Are the witnesses concerned that one part of our accounts is less sustainable because a very sustainable tax would be taken away to provide for those services? Is the real gap not the fact that we are completely out of kilter with our competitors in that we do not apply an appropriate rate of social insurance on income?

My next question is one I am concerned about. I hope the witnesses listened to one of our colleagues on the committee who said there may be a little backtracking on this, but it has been tabled as a demand, and by a party involved in the confidence and supply agreement, that €240 million be provided in this VAT tax break to developers. The ESRI's study, which is very good and which I know Dr. Lawless and Dr. McQuinn were involved in drafting, came to the conclusion that there is a risk that any tax break would simply lead to a transfer of tax revenue from the State to developers without any significant effect on supply. Are the witnesses standing over that robustly at this stage? Do they believe there is any space for such a tax break, which would amount to a 4.5% reduction in house prices if the developers were not just to push up prices, or do they believe it will just be absorbed and, as they say, be a direct transfer from Revenue into the pockets of developers?

The last question concerns IFAC. Not to start a fight between IFAC and the ESRI, but the ESRI has done-----

(Interruptions).

Deputy Pearse Doherty: I will ask Dr. Lawless this question. She can wear both hats for it. I agree completely with Deputy Calleary about the work the ESRI has done on Brexit and the report published in 2006, which was very clear. IFAC has raised suggestions that the position may be worse than what the ESRI is stating it to be and has said there may be an underestimation of labour supply, in particular due to the way it was modelled in that it was considered from the point of view of a trading partner but that the partnership with Britain and the intensity of labour and trade could make matters significantly worse than what was outlined in the ESRI's research, as bad as things were painted in that report. Do the witnesses concur with that assessment?

Dr. Kieran McQuinn: Regarding social housing, we have not identified how much it would cost, but the bottom line is obviously that to address the issue adequately would require a huge amount of money, which, ultimately, as far as the fiscal position and the budgetary position are concerned, could not be sustained on a one-year base. A multi-annual response is required. I have seen people produce estimates of how much it would cost to produce a unit of social housing. One can even go back to the figures we quoted from 2010-11, for example, when I think the social housing output at the level of approximately €1.5 billion was in the region of 3,000 units. One gets a rough, back-of-the-envelope estimate there. Unfortunately, the trick is, as I said, that a multi-annual response that must live within the parameters of the fiscal rules is required. That is why we have suggested saying something along the lines that we think most, if not all, the fiscal space should go in that direction.

The Deputy asked about possible rates in the context of site tax. The 3% figure seems a little low and, as I mentioned, one would need to stagger rates and particularly have much higher rates on land that is clearly well serviced, ready to go and has all the adequate levels of infrastructure associated with that. I could not give a figure for the rate but 3% seems on the low end of the spectrum as far as that is concerned. I would foresee a staggered rate depending on the nature of the land concerned.

With the help-to-buy scheme, the basic issue identified by everybody is that we need more housing supply. It was argued the scheme could facilitate greater levels of supply because it would make housing more profitable, essentially, in the building period. When supply is relatively fixed, as it is now, unfortunately when one stimulates demand - that is ultimately what happens with the scheme - the prices are shoved up. Ultimately, that is what is likely to happen with such a scheme. We have not analysed the scheme but I have seen some reports suggesting that it has not pushed up house prices. Looking at the scheme in general, the basic aim is undoubtedly to generate greater levels of affordability and, ultimately, that leads to greater levels of demand and higher house prices when supply is fixed.

Chairman: At one point the ESRI indicated that any benefit outweighed the costs of the help-to-buy scheme. Is that right?

Dr. Kieran McQuinn: No, I do not think we made that statement on the help-to-buy scheme.

Chairman: Okay.

Dr. Kieran McQuinn: We have always made the point that we feel it is a measure which ultimately stimulates demand. By stimulating demand, one will bring on supply but it is not the most efficient way to do it. With the COre Structural MOdel, COSMO, relating to Brexit, we have always been very careful to lay out that it only looks at one particular facet of Brexit, assessing, in particular, the trade impact. Brexit will hit the Irish economy in many different ways and, for example, Dr. Lawless has done detailed work indicating effects in supply chains, particularly in the agrifood sector. It is very difficult to quantify those. The macro modelling exercise focuses essentially on one element of Brexit, which is the trade element.

Professor Alan Barrett: There was a very focused question on whether we still stand over the concern about the use of tax breaks. The answer is "Yes". Let me put it like this: it is possible these elements would have an effect. Going back to the discussion we had about the new procedures for evaluating tax expenditures, the burden of proof is very much on people to say that they should give absolute certainty that by reducing taxes, more houses would be produced. They should be shown the channels through which this would happen so that the proposal and context of the blockages that we know to exist could be evaluated. That is the type of analysis we presented. We are saying to people that they should demolish our analysis and if it turns out to be wrong, that is absolutely fine. The burden of proof is there. I make a similar point about the tax break for first-time buyers that was mentioned. Again, any sort of basic analysis would indicate that injecting demand into a supply-constrained market will have one and only one effect. If people want to explain how it could be otherwise, that would be absolutely fine.

The Deputy also spoke about the merging of the USC into PRSI. He asked a very valid question in that if it goes to the Social Insurance Fund, a black hole would be left. I agree with that entirely. We spoke before this committee last year and our argument was that USC should be left where it was and that nothing should be done to it. We felt at a certain point that the train had left the station and there was a very strong political view that USC was either going to go or going to be merged. Then we made this proposal of enhancing the social insurance dimension because we thought it was more likely to get political acceptance. On linking it to the pension issue, everybody accepts that we need to do more on pensions in Ireland, but very few people are willing to say that we should start imposing the charges. This is not without good reason. We saw a blend of economics and political possibilities here under the USC, but it came from us accepting that, politically, there seemed to be a view that USC was not going to stay where it was.

Deputy Pearse Doherty: It increases our reliance on corporation tax and makes our tax receipts very vulnerable.

Professor Alan Barrett: It does. Link that to the sort of spending pressures that we have identified. Not to sound fiscal council-like, but if one wants to be cautious and to worry about the sustainability of the fiscal system, precisely to protect the sort of things that are working so well, those are moves that we cautioned against last year. I remember, and I was reminding him earlier, that Deputy Colm Brophy took great exception to a certain aspect. Having had a fight with the *Irish Independent* already today, I did not have the energy to face Deputy Brophy as well.

(Interruptions).

Chairman: I thank Professor Barrett. What I referenced there, as the clerk just pointed out to me, about the help to buy scheme is that the ESRI says that previous development incentives were extended to such a level that any benefit is outweighed by associated costs. I think I may have said it the other way around, according to the clerk. I have been here for three and a half hours.

Professor Alan Barrett: We were going to have an inquiry as to who in the institute had come out with that.

Chairman: I had a syntax malfunction. I thank Professor Barrett, Dr. McQuinn and Dr. Lawless. We appreciate their contributions and presentations. I thank members of the committee as well.

The select committee adjourned at 5.50 p.m. until 4 p.m. on Tuesday, 19 September.