DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Céadaoin, 19 Meán Fómhair 2018

Wednesday, 19 September 2018

The Joint Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Deputy Martin Heydon,
Deputy Declan Breathnach,	Deputy Michael McGrath,
Deputy Thomas P. Broughan,	Deputy Jonathan O'Brien,
Deputy Joan Burton,	Deputy Eamon Ryan.
Deputy Lisa Chambers,	

DEPUTY COLM BROPHY IN THE CHAIR.

Business of Select Committee

Chairman: No apologies have been received. Before the committee meets representatives of the Irish Fiscal Advisory Council to consider the council's most recent pre-budget statement and its priorities for budget 2019, I propose that we go into private session to do some housekeeping.

The select committee went into private session at 2.10 p.m. and resumed in public session at 2.15 p.m.

Priorities for Budget 2019: Irish Fiscal Advisory Council

Chairman: Before we begin, can I, as always, remind members and witnesses to turn off their mobile phones because interference from mobile phones affects sound quality and transmission during the meeting?

I welcome representatives from the Irish Fiscal Advisory Council, IFAC, to this meeting. The committee is joined by: Mr. Seamus Coffey, the chairperson; Mr. Eddie Casey, chief economist; and Mr. Niall Conroy, secretariat economist. I thank them and their colleagues for joining us today.

As I mentioned earlier, we are trying to work this to a conclusion for 3.30 p.m. The committee is today receiving its pre-budget briefing from IFAC. I was reminded that it is almost ten years to the day since the start of the global financial crisis which contributed to the establishment of IFAC and this committee. IFAC has had an extremely important role to play in assessing the Government's budget plans and the committee values its continued advice and assistance.

Before I ask Mr. Coffey to make his opening statement, there is a little bit of housekeeping which always has to be done. I advise our guests 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 or entity by name or in such a way as to make him or her identifiable.

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

With that bit of housekeeping over, I ask Mr. Coffey if he is ready. The committee has the opening statement so if Mr. Coffey would give a brief summary of it and enable the committee members to go into questions with him, if he finds that convenient.

Mr. Seamus Coffey: I think we will go through most of what I have here during the meeting. Thanks to the Chairman and the committee for the invitation. As the Chairman said, I am joined by Eddie Casey, chief economist and head of secretariat at IFAC, and Niall Conroy, an economist with the secretariat and other members of the secretariat.

The council published its fifth pre-budget statement on 7 September which reviews the fiscal stance in advance of the budget. The assessment is based on an economic analysis assessing the appropriateness of the fiscal stance and an assessment of the Government's fiscal plans in terms of the overall budgetary framework. At the outset, we think it is important to note the substantial progress that has been made to move the public finances to a safer position since 2008. The Government is running close to a balanced budget. Debt ratios look to be on a steady downward trajectory and near-term growth and interest prospects are relatively favourable. This means that Ireland is in a good position to move the public finances to safer levels and that there is no need to stimulate the economy any more than is already planned.

In assessing the appropriate fiscal stance for 2019, the council notes that the economy is close to its potential and that the budget deficit, excluding one-off items, is almost closed. This would imply that the structural budgetary position is also near balance. This suggests that little further adjustment is required in structural terms to close an underlying deficit or to enable a steady pace of reduction in the Government debt ratio.

To maintain this position, it is essential that spending increases or revenue reducing measures are introduced at a sustainable pace. The council therefore assesses that the Government should stick to its existing budget plans for 2019 of a budget day package of €800 million. This would increase Government expenditure, net of tax measures, in line with the sustainable long-term growth rate of the economy. Various estimates put this at approximately 3.25% per annum. When combined with inflation, this would imply an approximate limit of up to €3.5 billion for spending increases or tax cuts for 2019. There is no case for additional stimulus in 2019 beyond this figure.

The cost of previously announced measures, including sharp increases in public investment spending, means that the scope for new initiatives in budget 2019 is limited. If additional spending measures are to be addressed in 2019 beyond the quantity in the summer economic statement, these should be funded by additional tax increases or through re-allocations of existing spending.

An earlier than planned move to a small budget surplus would be warranted if cyclical growth and corporation tax receipts continue to exceed expectations. Any unexpected increases in tax revenues or lower interest costs that arise this year or in 2019 should not be used to fund budgetary measures beyond those currently planned.

The risks of overheating and the narrowing window of opportunity provided by a favourable external environment would suggest that improving the budget balance by more than currently planned would be desirable. This would be especially warranted if revenues were to outperform expectations for reasons that might prove to be temporary. This includes higher corporation tax receipts or stronger than expected growth in the domestic economy. The Government should instead use these receipts to build buffers either through additional contributions to the rainy day fund or through a budget surplus and faster debt reduction. Moreover, expenditure ceilings should not be allowed to continue to drift up as unexpected and likely cyclical or transitory revenues arise.

Most plausible estimates suggest that the domestic economy has been growing faster than its potential growth rate since 2014 and is now close to its potential. Central forecasts suggest that it will move beyond potential from 2019 onwards, with some overheating emerging in later years. Looking ahead, it is inevitable that adverse shocks will occur in coming years. Three major sources of potential downside risks to Ireland are apparent: Brexit, rising protectionism and the international tax environment.

The size and nature of potential impacts from various Brexit scenarios are highly uncertain. In the context of the international tax environment, the highly concentrated nature of Irish corporation tax receipts means that substantial reductions in Government revenue could arise if even one large firm was to relocate its operations elsewhere.

Although efforts to stabilise the public finances since the crisis have proven successful, improvements on the budgetary front have stalled since 2015. This comes despite a strong recovery in the economic cycle – both domestically and internationally – in addition to a supportive monetary policy environment. Non-interest spending has risen at essentially the same pace as tax revenue since 2015 and, as a result, the strong cyclical recovery and favourable external environment have not led to any notable improvement in the underlying budgetary position, excluding interest savings. Recent revenue growth has been supported by short-term cyclical developments and a possibly transient surge in corporation tax receipts. Looking through these effects, the underlying structural position would appear to have deteriorated since 2015.

Health spending for 2018 again looks set to exceed the level of planned increases set out at budget time. The Department of Health has experienced numerous overruns historically, and the problem of unrealistic forecasts coupled with a soft budget constraint has undermined the credibility of expenditure ceilings. To ensure that the overall level of spending increase for 2018 does not go beyond existing planned increases, and to ensure that the pattern of spending drift does not continue into 2018, it is important that pressures in the Department of Health budget should be absorbed elsewhere.

Ireland's debt burden is still among the highest in the OECD. When set against a more appropriate measure of national income such as GNI*, Ireland's net debt burden for 2017 was equivalent to 96%, the fourth highest in the OECD, behind only Portugal, Italy and Japan.

Looking beyond this budget, the council assesses that the Government should reinforce its medium-term plans to ensure they are credible. Focusing on the right budgetary stance and being prepared to be more cautious than the fiscal rules allow is the correct approach for the Government to follow over the medium term. This is particularly true given that the strict legal application of the current fiscal rules using the EU's commonly agreed methodology for potential output estimation will not necessarily prevent a repeat of pro-cyclical fiscal policy mistakes made in the past. The rainy day fund is potentially very useful in this regard, but is currently only half-formed and needs further development if it is to be effective.

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

Chairman: I thank Mr. Coffey. As always, he has provided a very interesting statement.

Deputy Jonathan O'Brien: I have two questions, the first of which relates to the health budget and, depending on how one looks at it, the projected underfunding, or overspend. For a number of weeks, Sinn Féin has been trying to discover how much of that overspend is going to be classed as a recurrent cost because the answer to that question will impact on the budgetary process. We have not been able to get an answer. In the document supplied by Mr. Coffey, it is stated that the overspend seems to be driven by recruitment, which indicates that the overall run on the health budget should be classed as a recurring spend. Perhaps Mr. Coffey could comment on that. We are close to budget time and are still unable to identify how much of that black hole is down to recurring costs or how it will impact on the budgetary process. Does Mr. Coffey have any thoughts or comments on how we are monitoring our health budgets? This is an ongoing issue. Estimates are calculated every year, but even the Estimate we are looking at this year ranges between €600 million and €800 million. There is no exact figure yet.

My second question relates to figure No. 2 on page 13 of the pre-budget statement provided by Mr. Coffey, which gives us an indication of areas which potentially could overheat. Much of the commentary we have heard to date has been about housing and construction and how that area might impact on the economy, which might lead to its overheating. However, the chart provided seems to suggest there is no risk of overheating, or that there is a very minimal risk of overheating, through housing construction, and that non-housing construction is a potential driver for overheating. Could Mr. Coffey go into more detail on that matter?

Mr. Seamus Coffey: The council has spent a lot of time discussing those two points. On the health budget, we are no more informed than the Deputy and are depending on Departments and Ministers to provide us with that information. We are told that not all of the overrun will be built into budget 2019, and it is not expected that all of the overrun will be recurring. However, we are not told the breakdown. The indication that a certain amount of the overrun was caused by recruitment suggests that it should have been predictable. Not only is it going to be a recurring item of expenditure - it will still be in place next year - but it should also be predictable. One of the issues with the constant overruns in the health budget is that they undermine our ability to assess budgetary policy. The Government has set out a plan for 2019, which we have assessed and which we believe to be in line with prudent economic and budgetary management. We also assessed the plan that was set out last year and thought the same. As we progress through 2018, however, those plans are not being adhered to. For example, the health budget overrun looks set to amount to hundreds of millions; we do not have the precise figure. It appears that much of the overrun will be recurring expenditure and will be built into the base figure for 2019.

From our perspective, one impact of this is that the underlying budgetary position is deteriorating. While it might appear in headline or nominal terms that we can absorb these increases because of corporation tax and lower interest, if we consider that some of those factors are transitory and look at what is happening on a sustainable basis, it is clear that our underlying position is deteriorating. We have no additional insight into the health budget beyond what the Department and the Minister are willing to offer. We agree there should be greater monitoring of the health budget and a greater ability to predict what is required. If resources are required, they should be made available at the start of the year. A Minister should not come before a committee in July and say that there should be a supplementary budget. It is now the middle of September and we do not know what the Supplementary Estimate will be or when it will be passed. In recent years, Estimates have been passed towards the middle of December, the end of the year, when most of the money has been spent. The White Paper published on the Friday night before the budget might provide an indication, but we are still left to pick between numbers and assess what is happening. Such information should be provided. We share the concerns of the Deputy, but unfortunately we - and others - do not yet have the answer.

Deputy Jonathan O'Brien: Will the White Paper tell us how much of the overrun is recurring expenditure that has to be built into the budget?

Mr. Seamus Coffey: No, it will only give the total.

Deputy Jonathan O'Brien: Will we ever find out how much is recurring expenditure? How do we find it out?

Mr. Eddie Casey: Not really. I do not believe there is a formal process for documenting how much of the budget is carried over. Until one sees the expenditure report with the budget and what the Department expects the carryover to be, one cannot tell. The only thing we have received that might be worth looking at is the major expenditure report from the Department of Public Expenditure and Reform. Early estimates for the year showed that the number of staff was to increase by 1,800, but 1,700 new staff had already been recruited by May. Recruitment was running at a much faster pace than had been expected for the full year. The Department extrapolated from this and concluded that if there were already 1,700 new staff by May and the target for the year was 1,800, then the overall number of new staff is likely to be much higher by the end of the year.

Deputy Jonathan O'Brien: I have looked at some of the recruitment trends in health. The fourth quarter of the year is usually when most recruitment is done, which indicates the number of new staff is likely to be above the target. Predicting the amount of new staff is becoming increasingly difficult. Do the witnesses believe that the Government should be providing that type of information? Should it tell us how much of this year's budget accounts for recurring spends and is therefore built into the base? Surely that information would help us in terms of budgetary planning.

Mr. Seamus Coffey: Our original position is that we should try to avoid the situation in the first place and that appropriate budgets should be set out across all areas to avoid repeated instances of ceilings being increased during the year they are introduced. If there are issues with the recurring nature of it, perhaps it should be clearly set out in a more coherent fashion. It is hard to pinpoint one-off or temporary increases in spending within the Department of Health. If it is driven by increases in recruitment, population or demand, a fairly safe assumption would be that a large part of them are recurring.

On the second question and the heat map introduced in this pre-budget statement by the council, we are delighted this innovation is having an impact. On the point regarding houses and housing completions and whether they would show up as a red light within this, the warning from the council is that housing output and construction is a potential source of overheating in the economy. What is shown on the map is the current forecast as set out by the Department of Finance, which shows relatively modest and stable increases in housing output over the next four to five years. The level in 2017 of 15,000 new housing units completed will increase in stages of three or four thousand each year out to 2021-2022 to reach 30,000 units, which the Department considers to be the equilibrium for State housing output. The council's fear is that housing output could reach a tipping point and could increase much faster than that. While the forecasts might be for stable and steady rises, given the nature of the housing sector and the cyclicality built into it there is potential for housing output to rise much more rapidly. While that might look fairly benign right now it is something that should be monitored in terms of commencement data and more reliable completions data. While it looks as if construction is not generating overheating concerns this will remain the case only if there are steady increases over a four or five year period. If we do reach a tipping point where housing output increases rapidly, given the labour intensity of it and the tax richness of it, we would see difficulties arising.

Deputy Jonathan O'Brien: We are in the middle of a housing crisis and we need to increase our housing output, I would argue, over and above the Government target. Mr. Coffey says that if we do this too quickly there is the potential for housing to be a driver in overheating the economy. How do we get around that? If we need more houses and we have to build them to accommodate the crisis how do we in doing so prevent the economy overheating? What measures can we take to offset that?

Mr. Eddie Casey: It is important to stress that we think it is a good thing that housing could increase at a faster pace than is currently the case and we would welcome that. The concern is that the rest of the economy appears to be getting to the point where it is close to its potential. In other words, it is entering a position where overheating more generally could arise. Rapid housing construction has the potential to push the economy over the edge and to overheat. Other levers that are available to the Government and policymakers would need to be used to dampen down the potential of any strong housing response. For example, fiscal policy, be it tax or expenditure changes, could be used in a way that offsets the increase in demand and the potential capacity constraints that arise due to housing elsewhere.

Chairman: Before I call Deputy Boyd Barrett, I would like to point that the heat map is one of the most colourful new innovations of this year's submissions. It is very powerful and effective. At a visible glance, one can see information. It is a very handy new addition.

Deputy Richard Boyd Barrett: I thank the Irish Fiscal Advisory Council for its presentation and its insights. On the housing issue and the references to overheating, are the witnesses saying that it would be perfectly okay to dramatically ramp up the provision of housing as long as it is not based on increasing the deficit or, for example, dramatic increases in tax revenue from other sectors of the economy? If that is what they are saying, I agree.

Mr. Seamus Coffey: From the point of view of public expenditure on housing, if there is to be a significant increase in public expenditure, given the commitments in respect of spending in other areas, it should be funded through additional revenue raising measures or reallocations in spending. This would be feasible. Taking the broader economy as a whole, can we dramatically increase housing output in an economy where the unemployment rate is 5.5%? A key question for us is where are the workers going to come from to build those houses if output is to rise at a much more rapid rate? For example, are workers from other sectors, including workers previously in construction who moved during the recovery to other sectors, to be drawn back into construction with promises of more attractive wages, leading to an increase in wage pressures across the economy, or are we going to bring in workers from abroad, which is what we did during the previous construction boom? If we are to bring workers in from abroad we will have to be able to house them. We would be bringing them in to build houses for themselves before they can build houses for us. This is just one area where difficulties can arise.

From a public finance perspective, if there are to be additional allocations to housing, they will need to be funded from sustainable resources of revenue.

Deputy Richard Boyd Barrett: I can help with that conundrum. Most of the construction workers that could be building houses are working as taxi drivers because the pay in construction is too low. If pay and security of employment in construction were better they would move out of taxi driving into construction. Also, there would be no requirement for new houses because they are already living here. When talking about housing output should we make a distinction between types of housing output? To me, overheating could arise if we return to private sector output of the scale we witnessed pre-2008. A dramatic increase in public sector housing output would be different, for two reasons. The houses that are being built are being sold at prices that nobody can afford. The banks, rightly, are not willing to lend to people amounts of money which their income cannot sustain, as they did in the past, leading to the market crash-ing. It was at the point everybody realised the emperor had no clothes. If the investment is in social and affordable housing this problem does not arise because it is creating a revenue stream for the Government. One would not be financing housing in an unsustainable way. In terms of current social and affordable housing provision a huge amount of the expenditure is current expenditure, which is an accident waiting to happen. If the State has its own stock, it is not an accident waiting to happen: it is a revenue stream. Should we not distinguish between sustainable housing output, which is public, and non-sustainable housing output, which is being produced at market prices that are unaffordable?

Mr. Seamus Coffey: There is merit in what the Deputy suggests, particularly if we link the increase in activity referenced in the previous question. If the increase in the public construction of housing was allied to additional revenue raising measures that created the space in the economy to facilitate that increase in output, it would be on a sustainable footing. If the majority of the output was sourced in the private sector, it is likely that much of it would be funded through borrowing as new houses tend to be bought by purchasers with mortgages. There would be no reduction in activity. Householders would not be cutting back in other areas to fund the initial construction activity in the economy and we could end up with an excess level of capacity. There definitely is merit in the Deputy's suggestion. The key point we are making is that if there is to be this increase in housing output, it must be funded by additional revenue measures that automatically generate the space for it. At the same, we will need to keep an eye on what is happening in the private sector to see if there is any ramp up in activity which could lead to problems, which would show up through measures in regard to debt and our current account balance *vis-à-vis* the rest of the world if we do start to live beyond our means. It is possible to identify these problems. If the public housing is done on the basis of sustainable revenue resources, there is an automatic cheque for it.

Deputy Richard Boyd Barrett: Perhaps it is straying into policy but a report produced by the Department of Public Expenditure and Reform confirmed a concern that had been raised by many members about the unsustainable cost of financing public housing output by leasing or renting social housing from the private sector. Mel Reynolds has recently said that even if Rebuilding Ireland targets were met in this way we could be talking about giving €1.7 billion each year to the private sector to lease or rent social housing, as opposed to the State building the housing itself. Even though the upfront capital cost would be greater it would be more sustainable in the long term because the drain on the current public finances would reduce over time. Does Mr. Coffey believe this is an important point to highlight?

Mr. Seamus Coffey: There is no doubt that there is a difference between the provision of public housing on a cost basis versus the provision of public housing on a market price basis. Doing so in the long term on a cost basis should be more sustainable, but the issue Ireland has had historically is that we have provided houses on a cost basis and then sold them off.

Chairman: I am going to allow people come in again later if there is time, but first I want to give everyone an opportunity.

Deputy Eamon Ryan: I will just go further with this point because I believe it is a critical public policy question currently. I shall hypothesise how it could work. I believe that emphasis in public housing particularly should be around the cost model. This has the benefit of retaining in State ownership and there is a future income stream that meets the pace for the capital upfront costs over time. Our construction costs for public housing previously were just a lump sum from the Department of the environment to the local authority; it was not clever and it was anticyclical in that it tended to stop and start. The cost rental model has real potential, especially in the long term, as we build up the asset of public cost rental properties. Critically, because it is also in the private rental market, that model has the prospect of dampening down the private market rented sector in a way that current housing subsidies will never do. In some ways that would manage some of the overheating concerns because it is rental pressures in Dublin, for example, that also push up wages and so on. I am specifically thinking that it must be large scale to effect that level of change on the private market.

I am very encouraged to hear Mr. Coffey refer to that sort of long-term investment, particularly where it is long-term borrowing met with revenue streams. If Ireland needed to fund this and if capital was needed up front to help it to get going, and if we were still to borrow from the European Investment Bank or from somewhere else, one prospect could be the sale of bank shares. I am aware that the Department of Finance would hate this hypothesising - but would love to bring the debt down - but if some percentage of AIB bank shares were sold and if there was a large lump sum in a cash pile would this be a way to allow for an intervention in the housing market, which we need to do, that does not affect the general budget financing figures? This could be a practical way of financing such a measure. Has Mr. Coffey a problem with the hypothetical allocation of a cash stream such as that, which is not coming from tax revenue?

Mr. Seamus Coffey: We would echo the concerns of the Department of Finance and would not be in favour of such hypothecation. It does not tend to work. Money is funded but if the same money came from the same source and is allocated to another source, by and large the appropriate thing to do is consider the overall budgetary situation one is addressing. There is no shortage of cash or funding within the Irish budgetary position. The National Treasury Management Agency, NTMA, is currently managing close to €20 billion in cash terms in the Exchequer account. Much of that is somewhat precautionary such as for bond redemptions that are coming down the line. If there are banking asset sales the proceeds would feed into the overall cash holdings that are managed by the NTMA.

I do not, however, believe that it would be appropriate to hypothecate, as the Deputy has said. Money is raised from the sale of assets and if it was to be spent on housing, or in a sense put it on the sidelines of the overall budgetary measures, I think we should be looking at the totality of what we are doing. If one considers the Government accounts and the allocation to capital spending, one can see that it is increasing significantly. In 2014-15 it was a little over €4 billion and by 2020 it will be more than €8 billion. In just five or six years the nominal amount will have almost doubled and Ireland will have gone from being a relatively low government spender on public infrastructure in EU terms to being up towards the top. There has been a large allocation. Perhaps one difference in Ireland compared to other EU countries is that their governments tend not to spend directly on capital housing projects. They do have public housing but in the main it tends to be done through approved housing bodies or housing associations.

I do have the long-term view, as referred to by the Deputy, that the cost rental of the older stock, which was produced and constructed at a lower cost, is subsidising the construction and renting of newer stock and could on average have a dampening down effect on the rents and costs in the housing system. That seems to be more successful than what we are doing, but the issue is to have the long-term view and if we do have housing units within the system that they are not sold off. It cannot work if older units are sold.

Chairman: I remind members, especially those who joined us late, that due to reasons beyond our circumstances, we have to stop this meeting at 3.30 p.m. That is our time limit and I ask members to be conscious of that.

Deputy Eamon Ryan: The per capita budget is rising, mainly for roads that will lead to more sprawl with all of us living in Mullingar and commuting to Dublin according to the Minister of State at the Department of Defence. There is another big capital project that has not been funded and I am interested to know how we do this. Professor John FitzGerald at another Oireachtas committee said that for Ireland to meet its climate change targets we need to spend €5 billion retrofitting just the social housing we already have to make it zero carbon and into quality housing. This is the best low carbon mitigation and we have to do this because Ireland will be spending €500 million per year in fines unless we start to do something. How will we fund €5 billion for retrofitting in the next ten years? If the constraint is such that the capital budget is constrained, and one can only take a certain amount there as there are other demands, then from where are we to get that money?

Mr. Seamus Coffey: Again, it is a matter of choice. As the economy begins to grow in a sustainable fashion there will be resources available. For the increase in spending in 2019 our tax measures are €3.5 billion. That alone is more than 70% of the €5 billion referred to by Deputy Ryan. I am not saying we have to devote all the resources to it but they are the resources that are generated in just one year. If the economy continues performing reasonably well over a five or six year period than one will get significant resources being generated. It then becomes an allocation decision and it is decided what the resources should be used for. If the economy is not generating sufficient resources on a sustainable basis to meet all those projects then should we introduce revenue raising measures? If this is a priority there is €3.5 billion available next year, and on an annual basis there may be something similar, and there is the possibility to raise even more resources through tax increases. Although €5 billion sounds like a significant amount, over ten years it is something we can do if we want to decide to do it.

Deputy Eamon Ryan: Or the sale of bank shares is revenue raising.

Mr. Seamus Coffey: That is not revenue raising; that is a one-off. It does not count on a long-term basis.

Deputy Eamon Ryan: It is the one-off investment in social housing stock.

Chairman: I will allow people back in, subject to time.

Deputy Joan Burton: In the context of Mr. Coffey's overall brief, does he find it extraordinary that at this point we are fairly certain there will be a minimum €600 million overspend in the Department of Health? There is quite a lot of speculation, probably reasonably well informed, that it may be much closer to €1 billion. I do not know if the Irish Fiscal Advisory Council has oversight on how the Government is actually governing and managing but for a long time it has now become an absolute part of the budget that health budgets are, at best, guesstimates. This impacts on the shortage of funds and access to funds for housing. The current Minister for Health seems absolutely helpless in relation to the budget at a time when the economy is doing well. Patients find themselves in vast queues. The council's remit is financial advisory. However, the Government simply cannot get the accounting economic value system correct. Has the committee met the Minister for Health or, indeed, the Minister for Finance, to find out why they appear to be wholly unable to get a handle on health? If it is the case that the figures are wrong and underestimated they should be fixed.

Chairman: We spent a rather long time discussing this in Deputy Burton's absence at the beginning of the meeting.

Deputy Joan Burton: I think I am saying something nobody else said.

Chairman: No, the Deputy is not. She is saying something that was dealt with in quite a bit of detail.

Deputy Joan Burton: Okay. I have two other points. On housing, rents are now significantly higher than the mortgage costs on a property. A generation of younger people who we would like to be able to commit to stay in Ireland are being driven out by the lack of affordable housing. In the centre of Dublin, on the northside, it is common to find landlords seeking considerably more than €2,000 for a modest two bedroom apartment. There are people who want to rent for a significant period while they build up to buying a house. However, there is a real market failure which I do not see that reflected in the statement here. It makes a nonsense of the rainy day fund that the council is sitting on two failures of Government accounting in housing and health. I wish it was possible to seriously address this and that we would get some rebalancing of the quality of Government accounting as the Government seems to have lost the plot in both.

Chairman: I ask Mr. Coffey when he answers to be conscious of what we have covered already as we are very tight for time.

Mr. Seamus Coffey: It is not within our mandate to comment on the structure of the housing system. It is something that we have discussed and that we look at but the structure of our housing system is something for others to propose and assess.

On the rainy day fund and issues that we have with provision of public services and supports in housing and health and so on, our view is that it is not an either-or choice. They are not mutually exclusive; one can do both. One can generate the additional resources needed for health and housing and have appropriate counter-cyclical fiscal policy.

Deputy Joan Burton: Will Mr. Coffey indicate how one might possibly do that? If there is a solution we could write a little letter to the Government.

Mr. Seamus Coffey: As mentioned previously, we are looking at €3.5 billion of additional space for spending for 2019. Priorities can be assessed on that and if that €3.5 billion, which we feel is in line with prudent economic and budgetary management, is not sufficient, then additional revenue raising measures can be introduced. If the €3.5 billion is adhered to, we hope that would lead to a budget surplus in 2019. If that is not sufficient, additional revenue measures can be introduced to maintain that hope, and I think that we should go beyond that hope, to having a budget surplus to have additional resources for health, housing and other areas and have the appropriate fiscal policy.

Mr. Niall Conroy: I will add briefly to our earlier remarks about health. We have discussed the vacuum in data on what is driving the increases and overruns during the year. One thing we have highlighted from the mid-year expenditure report indicated that there have been significantly higher levels of recruitment in the first five months of the year compared with what was expected. That is one thing which we might look at but there is a case for more data on what is going on in the health sector during the year.

On the forecast generally, we have seen that there have been issues with forecasts in the Department of Health. Significant increases were given to the Department in the last budget but they do not seem to be realistic for the provision of services. If the overrun is being driven by increases in employment, one would expect that to be budgeted for, as levels of hiring would not be unexpected.

Deputy Joan Burton: Since spending drift was referred to in relation to health, an explanation of the key areas the council would identify as spending drift in health would be helpful.

Mr. Seamus Coffey: Departments' individual spending is not the level of detail that the council goes into. We have seen the overall level of spending drift upwards in recent years. Aggregate levels of expenditure ceilings are set out and then as one gets closer to the year, those ceilings are increased within the year, as we have seen recently. That is the drift that we see. We do not pin down the actual source or cause of that spending drift. Our mandate is to look at the overall package of what is happening. One could probably look at the Supplementary Estimates and have details of where the additional spending is going but our key concern is the overall package and the fact that pre-announced plans are not being adhered to.

Deputy Michael McGrath: I welcome our guests and apologise for being late. If I repeat anything, they might cut me off straight away.

The headline conclusion of the council's pre-budget statement is that an overall package for next year of approximately €3.5 billion is appropriate, of which €800 million is left for previously unannounced decisions. According to the summer economic statement, that would give a headline general Government deficit of 0.1% and a structural deficit of 0.4%. There are advocates for going much further, including spending the extra €900 million under the expenditure benchmark and, indeed, spending the €500 million currently earmarked for the rainy day fund. My understanding is that would increase the deficit to 0.6% in headline terms and the structural deficit to 0.9%. If we did that, would we be outside the fiscal rules because there would be no improvement in the structural deficit of moving into the medium-term objective, MTO? Some advocate going beyond the €800 million, and others an extra €1.4 billion. Does this represent a breach of the rules?

Mr. Seamus Coffey: That would be a breach of the fiscal rules. The central part of the fiscal rules is the medium-term objective and structural balance which is currently set at a deficit of -0.5% of GDP for Ireland. The expenditure benchmark is something that is supposed to assist in moving a country towards, and keeping it at, the medium-term objective which is the primary benchmark. Complete legal adherence to the expenditure benchmark would see that breached in 2019. That is partly a result of the application of the expenditure benchmark which has some pro-cyclicality built into it. We think it is appropriate that the Government is assessing the pro-cyclicality in the expenditure benchmark and setting the appropriate fiscal stance. That has been driven by the achievement of the medium-term objective.

Deputy Michael McGrath: The actual requirement for Ireland in terms of its medium term objective is to move towards it by at least 0.5%. If this year, in 2018, we came in at 0.9% we would have to achieve the medium-term objective next year. That is the requirement.

Mr. Seamus Coffey: Yes, we should be at the medium-term objective next year. Anything else would be a breach of the rules.

Deputy Michael McGrath: I turn to my second question. Yesterday, the council issued an interesting tweet which showed what the forecast was in budget 2015 for 2018 for corporation tax and the interest bill. The inverse relationship is very interesting. The 2015 forecast for corporation tax in 2018 was €5.5 billion, while the outturn was €8.5 billion. Conversely, the interest bill was forecast to be €8.5 billion and has turned out to be €5.5 billion. Therefore, there has been a €6 billion swing in one year under those two headings. Consider how favourable the conditions have been for Ireland, that is, the factors outside our control such as corporate tax receipts, international flows, intellectual property and interest rates, which are central. Interest rates are out of our control as we continue to reduce the deficit. Does Mr. Coffey think how exposed we are and how open the Irish economy and public finances are to another shock is sufficiently understood? The difference between those two key variables is €6 billion in one year alone.

Mr. Seamus Coffey: I have tried to make a hugely important point. That €6 billion swing is outside of the general economic improvement we have seen. These things are largely outside of our control. Some 80% of corporation tax is paid by multinationals. Their profitability, activities and the amount of corporation tax they pay in Ireland does not affect economic activity. The interest bill is based on the interest rate environment. We have seen a huge swing in our favour with huge tailwinds even before considering the cyclical recovery we have experienced. Almost all of that €6 billion, which is an unexpected gain since 2015, has been absorbed through either additional increases in spending on health or through a ramping up of public capital spending. In 2018, even with that €6 billion gain, we are still projected to run a deficit. That leaves us in a vulnerable position where there could be an economic downturn. It is likely that it is inevitable that there will be a slowdown at some stage. There is a strong likelihood of there being a downturn at some stage. If that is allied with an increase in interest rates and, for some reason, a reduction in corporation tax receipts in Ireland, while it seems unlikely, a large deficit could open up rapidly. The increases we have seen in health spending and capital spending on the basis of what might turn out to be temporary increases in corporation tax and reductions in interest rates may be reversed. That is not a position we want to go back to.

Deputy Michael McGrath: On the issue of demographics, the Minister said that he will now outline five-year fiscal forecasting in the budget, which Mr. Coffey called for. That is welcome. Some €400 million is provided for demographic issues next year. I am concerned, looking to the future, that we are not providing enough at all for known demographic pressures that are emerging. In health, for example, there is an ageing population with growth in the numbers suffering from dementia and Alzheimer's disease. We know the nature of care is changing. With people living longer, pension coverage is a major issue. Is that an issue IFAC has looked at or intends to look at? It is not a secret that the requests from Departments every year for the following year's budget look for a certain amount of to stand still, with no change in service provision. The additional amount sought, particularly in health, just to stand to still, blows these figures out of the water. Do we have a handle on what the known demographic pressures are and what the costs associated with that are for the budget?

Mr. Eddie Casey: We have an annual publication where we look at the standstill costs of maintaining existing public services. We try to project forward, asking how much it will cost if the same services will be provided as were provided this year and policy did not change, given inflation and changes in demographics. We have a nice breakdown of how much is due to demographics and prices. in our last publication, we were largely in line with the Department, or maybe a bit higher because we had incorporated new census data and figured that demographic growth might be a little faster. We came in line with €600 million rather than the €400 million projected for next year. Most of the differences were where we saw price pressures emerging and trying to provide the same level of service while recognising inflation.

Deputy Michael McGrath: Is that one year ahead?

Mr. Eddie Casey: We looked as far as 2021. We are trying to move to much longer term forecasting of this. It is basically the same idea but goes as far as 30 years ahead. We have expanded our capacity for it a bit and hope to have a big publication next year to look at this. Many fiscal councils such as ours do this type of work internationally. The long-term picture is massively important for where policy is headed.

Deputy Declan Breathnach: I apologise for having to leave earlier. I missed the presentation. I want to make sure that I do not ask questions which were asked and will concentrate on housing. I was interested in the response to Deputy Burton that it was not the role of the council to evaluate the mechanisms or structures of housing systems. If it is not the council's job, whose is it? We have approximately 650 housing agencies in the country. Some time back, I asked how many they were employing. The top 100 employ more than 6,500 people. Do the witnesses consider that value for money? When they look at local authorities that have been denuded of technical staff from their housing offices since the boom, would it not make sense for some of these agencies to be affiliated with local authorities?

My second question relates to the issue of vacant housing. Today's paper mentioned incentives to bring some vacant housing back into use. Do the witnesses have a comment on how they see some of it being brought back into use? We have had rent-to-buy and other schemes that have not worked. I have traversed my county many times and there is no question that at least 10% of habitable properties are vacant. How would the witnesses incentivise using it or what advice do they have to do so? Vacant housing does not seem to be coming back into use. I ask the witnesses to forgive me if I am going outside their remit. I am new to the committee and want to see what their role is, but, equally, how value for money can be achieved and increased momentum generated in house building. We have dealt enough with health and know where some of the problems are there but we do not seem to be getting a handle on building houses.

There are 6,500 people employed in the 100 largest housing agencies. What if they were divided into and subsumed by the local authorities? Since I do not come back when I ask questions, my final point is on the issue of how one speeds up a system. We have people in the Department of Communications, Climate Action and Environment who are at a lesser grade than some of our planners and engineers at local authority level who are toing and froing on schemes. Would it not make more sense if a lump sum was given to local authorities with the freedom to go and get the job done?

Mr. Seamus Coffey: Much of that is outside our mandate and looks at areas for which we do not have direct responsibility. There is a plethora of housing agencies and we have picked up another in the past week or two. They are supposed to look at this area. I am not familiar with employment levels in approved housing bodies. Our concern with housing, as mentioned in the discussion we had with Deputy Boyd Barrett, is the impact housing activity and construction has on the economy and whether there are resources to meet the activity demand that might emerge. The design of our housing system is for somebody else to address. We are concerned with the impact on economic activity, especially of new housing, and, given the tax-rich nature of private housing construction, the impact that can have on public finances. That is our primary sphere of interest.

I will have to put on a completely personal hat in addressing vacant housing because it is not something that IFAC looks at. I am at a loss to say why there is vacant housing in urban centres and city centre locations, given the rent increases we have seen in recent years. If someone has a property and owns it, I cannot understand why he or she would leave it sitting idle when there are substantial rents to be collected. I am not sure what are the costs or hindrances to prevent those from being used or why one would just sit on an asset when substantial rents could be had. It seems contradictory. An issue with vacant housing in rural areas is that people prefer large houses outside the town and that is what has happened over a 20 to 30-year period. The centres of rural towns have become depopulated as people have moved to newer, bigger houses on bigger sites on the outskirts of the town. That is what people have chosen. I do not know if we can reverse that. With regard to the system itself, whether it can be sped up and whether lump sums should be given to local authorities to engage in activities, that is something for somebody else to decide.

Deputy Declan Breathnach: If it is not the IFAC's job, whose job is it? I cannot see who is taking any responsibility for it.

Chairman: It is not Mr. Coffey's job to answer that. I call Deputy Lisa Chambers.

Deputy Lisa Chambers: I apologise for being late but I had another appointment before this. It has been recommended that the Government should not exceed €800 million in the budget day package. I recall a similar conversation last year about the available fiscal space. The IFAC's statement was that it was at the upper limits of prudent budgeting. Lo and behold, with one week to go to the budget, some €300 million was found and it went beyond the council's recommendations for the year. It is likely that more than €800 million will be spent in the budget day package because it seems to be the practice to hold onto the available fiscal space until the last minute in order that the rest of us do not know about it. If the budget package is in excess of €800 million, what risks does that pose to our economy? If it is more than the package should be, what would the IFAC's advice to Government be, as well as to us as the committee that will report on this?

On Brexit, it is interesting that the witnesses say the standard models being used may not fully capture the integrated supply chains and the extent of our relationship with the UK. In our budgetary process, what should we do to try to offset or counteract the worst effects of whatever type of Brexit we get? We are still planning for the unknown but it will hit in 2019 so we need to do something financially to try to protect our country.

Mr. Seamus Coffey: On the budget package, the issue we have is how it is achieved and where those increases come from. Is it changing calculations slightly to give an answer that somebody might prefer, or is the space increased through additional revenue-raising measures? In last year's budget, additional space was created through increases in corporation tax, profits linked to intangible assets and a change in the stamp duty rate for commercial properties. They created the additional capacity for more measures to be introduced. In broad terms, if the net answer remains as set out in the summer economic statement, the additional space can be created through that. That was achieved in last year's budget and it is a useful template that shows that the technical calculation of fiscal space is not this straitjacket or limit that has been set out. While we would like to see the plans that were set out in the summer economic statement adhered to, it is not a massive restriction and additional space can be created through revenue-raising measures. By and large, that is what happened last year. We were reasonably favourable to the approach taken in last year's budget.

On Brexit and any financial measures that should be introduced, we do not need to introduce financial measures now, especially from a macroeconomic perspective. Brexit has yet to happen and it is uncertain. We can go through various scenarios that might impact on the public finances. While the fiscal council may call for greater improvement in the budgetary deficit for 2019, and perhaps even a move to a small surplus, there are a number of reasons one does that, one of which is to create fiscal buffers. We have fiscal buffers in order that we can use them, and in order that if we hit a downturn and experience a significant macroeconomic shock because of Brexit that could lead to a reduction in unemployment, an increase in social welfare, an increase in tax revenue, we just let it happen and the economy can then recover. We would run up a deficit but if we have the buffers there, the deficit should not be too large. We will not end up in a situation where we run close to a balanced budget, spend the resources being generated, have a macroeconomic shock with Brexit, along with potential changes in corporation tax or interest rates, and a large deficit opens up. In a situation where we should let things happen naturally and let those deficits stimulate the economy, we do not want to end up in a situation where Brexit happens and there are tax increases and spending cuts on top of it - the pro-cyclical policy of which we have 40 or 45 years of experience. While we might call for greater prudence now, the ability to use it is in the future. If financial measures are required to react to Brexit in a macroeconomic sense, let us wait until it has happened and we will have the space to react appropriately then.

Deputy Lisa Chambers: For example, a revenue-raising measure could be introduced for budget 2019 that we have not been told about such as a change to the hospitality VAT rate, but the argument from those working in the hospitality sector is that they need to protect themselves against Brexit and cannot deal with an increase, which is a different argument. If there is a revenue-raising measure, should that then be put aside for dealing with that shock, which is described as inevitable in the council's opening statement, or should we raise revenue with a view to spending it immediately?

Mr. Seamus Coffey: There are some views that the budgetary package of €800 million is appropriate. If there is an additional revenue-raising measure, that gives greater space to spend it on the other side, so it can be used. We think the €3.5 billion for next year is at the limit, and greater deficit reduction and moving to a surplus would be more appropriate. If there was the additional revenue-raising measure, however, and it was used to fund spending measures, it would still be within the envelope of prudent economic and budgetary management. It might not necessarily create a large enough buffer from our perspective but, in general terms, it would be a relatively appropriate approach to take.

Deputy Thomas P. Broughan: I suppose the major questions have been asked. One of the issues that arose at the meetings I attended related to the Irish Nurses and Midwives Organisation, INMO and pay equality. This committee began to realise early last year that the health Estimates were not sufficient to cover the costs of the HSE and the Department of Health. The basic point I want to ask about is the rainy-day fund that came up at that meeting. Is it a bit ridiculous to have a rainy-day fund and still run a deficit? The IFAC's report would prefer us to run a small surplus this year to get back among those exemplar countries in the OECD area. Is there any point leaving the rainy-day fund for 2019 to balance the books, with whatever additional spending being countered, as my colleague Deputy Chambers was implying, by additional revenue raising?

Mr. Seamus Coffey: It is not an "either/or" choice. Both can be achieved. If we want to devote additional resources to some sector, whether it be the level of pay in the health sector, which would have some of the largest impact given the number of staff in the HSE, that does not preclude us from running surpluses. We can do both; it is simply a matter of making choices. If there is not sufficient capacity in the €3.5 billion to meet all those demands, revenue-raising measures can be introduced. As long as we stay within the overall envelope, we should be able to move to a position of a small budget surplus and achieve whatever additional demands are deemed necessary. We do not see it as an "either/or" choice. We can have the appropriate counter-cyclical macroeconomic policy while also addressing some of the demands and pressures within the overall public system. It is not appropriate to play one off the other.

Deputy Thomas P. Broughan: One of our former colleagues in the Seanad, Mr. Sean Barrett, a professional of the so-called “dismal science”, was critical of our capital budget plan going into the future, given all the uncertainty with Brexit, Trump, trade wars, the possibility of instability and so on. There are many significant infrastructural gaps in public transport, health, housing above all and so forth. How does the IFAC line up on that? Is it happy with the projections for 2019 and onwards?

Mr. Seamus Coffey: We share some of the concerns that Mr. Barrett has, but only some. Our systems have improved in capital spending over recent years and decades, primarily driven by developments at EU level, when there were matching funds and various assessments, and undertakings had to be done before the money could be drawn down. In transport, in particular, we tend to get the appropriate matters undertaken, but there are other areas that could be improved. We have assessed the overall capital budget that has been set out, and given the resources the economy is generating, we feel a near doubling of capital spending in quite a short period can be achieved within a sustainable envelope. During the crash, we went to relatively low levels in EU terms and we were barely spending enough for maintenance of our public capital stock, whereas we are now moving to a high level in EU terms and a position where we can add to our public capital stock. There is no doubt that value for money is important. The IMF did a recent study, the public investment management assessment or PIMA study, which looked at capital spending in Ireland. It raised questions about whether we have been getting value for money, but we believe there is capacity to increase capital spending and to do it in a sustainable fashion. The problem will be if one commits to increasing capital spending and then tries to reduce taxes, increase public sector pay or increase social welfare supports at the same time. Doing everything is not sustainable. However, the plans that have been set out for capital spending can be achieved.

Deputy Thomas P. Broughan: Will it lead to overheating?

Mr. Seamus Coffey: No. The overall public capital spend looks as if it can be absorbed within the capacity of the economy. The issue we would have is if we see increases elsewhere and, perhaps, acceleration, particularly in private construction of housing that has an impact. The public capital plan itself does not generate massive concerns for us. We are looking at the overall level of demand in the economy and there is no doubt that public capital feeds into that, but in and of itself it does not raise concerns.

Chairman: I indicated that I would allow members to intervene again with supplementary questions. Only one member has indicated a wish to do so but if anybody else has a short question we will conclude with that. I call Deputy Boyd Barrett.

Deputy Richard Boyd Barrett: To continue on the housing issue, and I accept the witnesses cannot discuss the policy and the structures, but from the point of view of overheating and the macroeconomic questions that are the council’s remit, if the council sees a threat of overheating is it the council’s responsibility to warn the Government about it? It is indisputable that the price of accommodation in the private sector is clearly an overheating threat. One could argue all roads lead to it. The labour and skills shortage roads lead to it, as do potential wage demands and potential social welfare costs in terms of the cost of emergency accommodation or renting from the private sector. It is arguable that if one were to look for overheating threats, the housing threat is way beyond any other threat. The council should flag that more strongly. That is incumbent upon a body whose remit is to warn against overheating. For example, NAMA has more or less redeemed all its bonds. Whatever case is made about what it did with its assets up until now, I believe that NAMA continuing to sell off land is contributing to the overheating threat. Would the council accept that it is?

Mr. Seamus Coffey: We would accept that assessing overheating is absolutely within our mandate. The Fiscal Responsibility Act provides that we should assess budgetary policy to the extent that it is in line with prudent budgetary and economic management. That is why we developed the heat map, which gives a snapshot of overheating pressures within the economy. At present, we do not identify significant overheating pressures in the Irish economy and the most recent forecasts from the Department of Finance indicate that this relatively benign scenario is predicted to continue. Whether that happens is subject to question. In 2003 and 2004 forecasts at the time would have given a relatively benign scenario as well. When it comes to overheating the one area where we see potential problems emerging is in the housing sector, whether that relates to the level of prices, the rate of price changes or the impact of activity on the overall level of demand in the economy. At present, however, the major growth area has been in non-residential construction but we see a potential for that to change.

We believe we are highlighting overheating and we are pointing to housing as a potential source of it. The Fiscal Advisory Council has been raising overheating in its assessment reports since 2015, just as the recovery was finally beginning to emerge fully in the economy. We are glad that other people are now also taking on board the concerns about what an economy trying to do too much in too short a time can cause. If we are going to have an increase in housing activity it should be sustainable. We should not be going from 15,000 in 2017 to 65,000 or 70,000 by 2020 and then drop down to 20,000 again in 2024 or 2025. That is the roundabout or rollercoaster the Irish economy has been on for 30 years. If housing output is to increase we would like to see it increase in a sustainable manner.

Chairman: That point was made previously. I call Deputy Ryan.

Deputy Eamon Ryan: I have a short question. It is prompted by the word “overheating”. I am trying to recall if the council in its previous presentations to the committee did any analysis regarding climate risk in our economy or the fiscal aspect of it. It is a risk. As Professor John FitzGerald said, we are completely off course and heading rapidly in the wrong direction. We are facing fines of €0.5 billion. Has the council examined that at all?

Mr. Seamus Coffey: We include it as a fiscal risk. We look at economic risks, in which overheating in housing features prominently, and we assess fiscal risks. We consider the impact of climate change, emissions targets, potential fines or the need to purchase permits if targets are not hit. We give it a high impact.

Mr. Niall Conroy: We give it a high likelihood and high impact.

Chairman: That is our job. With the agreement that that area is our job, I will draw our exchange today to a conclusion. I thank the witnesses for attending, for their presentation and for the exchange on questions from the members. This is now an established part of the pre-budget process, and it is a good for the budget committee to have this interaction. There is a very positive framework although there are things to watch. Generally, however, as you indicated in the statement there are many positives in our current position.

I thank the members for agreeing on the time constraints and so forth today. Our next meeting will be at 1.30 p.m. on Wednesday, 26 September, when we will meet with the Minister for Finance and for Public Expenditure and Reform. Members should note that it is a 1.30 p.m. start as distinct from our normal 2 p.m. start.

The select committee adjourned at 3.38 p.m. until 1.30 p.m. on Wednesday, 26 September 2018.