DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Céadaoin, 5 Nollaig 2018

Wednesday, 5 December 2018

The Select Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Maria Bailey,	Deputy Pearse Doherty,
Deputy Richard Boyd Barrett,	Deputy John Lahart,
Deputy Declan Breathnach,	Deputy Michael McGrath,
Deputy Thomas P. Broughan,	Deputy Jonathan O'Brien.

DEPUTY COLM BROPHY IN THE CHAIR.

Business of Select Committee

Chairman: Apologies have been received from Deputies Cowen and Heydon.

Today the committee will meet members of the Irish Fiscal Advisory Council. We will engage with its chairman, Mr. Seamas Coffey, and other council members to discuss the fiscal assessment report that was published on 28 November. Before doing so, we will go into private session to deal with some housekeeping matters.

The select committee went into private session at 2.05 p.m. and resumed in public session at 2.20 p.m.

Fiscal Assessment Report November 2018: Irish Fiscal Advisory Council

Chairman: Before we begin, I remind the members and witnesses to turn off their mobile phones because the interference by phones affects the sound quality and transmission of the meeting.

I welcome Mr. Seamus Coffey to the committee. He is accompanied by his fellow council members, Mr. Sebastian Barnes, Ms Martina Lawless, Mr. Michael Tutty and Mr. Eddie Casey. We are meeting with the Irish Fiscal Advisory Council, IFAC, to discuss its November fiscal assessment report. It raises a number of concerns with the Government budgetary policy. The Committee on Budgetary Oversight will engage with the council to tease out these issues. As always, we acknowledge IFAC's engagement with the committee. As the witnesses will know, IFAC is a regular and frequent visitor to the committee, and we appreciate it accommodating us in its schedule. From the Committee on Budgetary Oversight's perspective, we wish to identify certain strategic issues that we will be able to raise with the Minister for Finance and Public Expenditure and Reform to improve the framework for parliamentary scrutiny of the budget.

By virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of the evidence they are to give to the joint committee. If, however, they are directed by it to cease giving evidence on a particular matter and continue to so do, they are entitled thereafter only to 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 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 Houses or an official either by name or in such a way as to make him or her identifiable.

I invite Mr. Coffey to make his opening statement.

Mr. Seamus Coffey: On behalf of the council, I thank the committee for the invitation to appear before it again. Joining me today are Mr. Sebastian Barnes, Ms Martina Lawless and Mr. Michael Tutty, who are all council members, as well as Mr. Eddie Casey, our chief economist and head of the secretariat. Mr. Niall Conroy, Mr. Kevin Timoney, Ms Ainhoa Osés Arranz, Ms Friederike Vogler and Mr. Killian Carroll, members of the council secretariat, are also present. We continue to value these engagements.

The council published its 15th fiscal assessment report on 28 November. The report covers all aspects of the council's mandate, as set out in the Fiscal Responsibility Acts 2012 and 2013. The council's mandate does not cover commenting on the choice of individual tax measures or spending items or priorities, but rather allows us comment on the overall fiscal stance.

There have been significant improvements to macroeconomic conditions in recent years. The council assesses that the pick-up in growth since approximately five years ago has been driven by a cyclical recovery in demand. These improvements have been most visible in the labour market, with unemployment falling to approximately 5.5%. Most plausible estimates suggest that the domestic economy has been growing faster than its potential growth rate since 2014 and is now, in 2018, close to its potential. Central forecasts suggest that it will move beyond potential from 2019 onwards, with overheating emerging in later years. While short-term growth prospects look favourable, there are significant risks evident in both directions, and a slowdown in coming years is inevitable. Significant overheating pressures could build up if a faster-than-expected pick-up in housing construction materialises. On the other hand, Brexit could be more costly than assumed. There are also risks posed by the concentration of Ireland's exporting sector in a handful of specialised areas, the global rise in protectionism and possible future changes in the international tax environment.

Substantial progress was made from 2008 to 2015 to move the public finances to a safer position. The Government is close to a balanced budget, debt ratios look to be on a downward trajectory and near-term growth and interest prospects are still relatively favourable. Although efforts to stabilise the public finances since the crisis have proven successful, improvements on the budgetary front have stalled since 2015. This is 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 virtually 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. It is clear that 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 budgetary position appears to have deteriorated since 2015. Budget 2019 forecasts indicate that a small deficit will be run again next year, with a surplus now planned for 2020. It is notable that budget 2016 had planned a budget surplus for 2018, budget 2017 had planned a surplus for 2019, while budget 2018 had planned a surplus for 2020.

These delays are against a backdrop of stalling improvements, while Ireland's debt burden is still among the highest in the OECD. When set against a more appropriate measure of national income, namely, GNI*, Ireland's net debt burden for 2017 is close to 100% and remains the fifth highest in the OECD, behind only Portugal, Italy, Japan and Greece. Two recent developments on the budgetary front have contributed to a further slowdown in improvements on the budgetary side: a substantial within-year increase in spending in 2018 and a larger-than-planned budget package for 2019.

Shortly before the budget, the Government decided to increase spending in 2018 by a further €1.1 billion beyond what was envisaged just four months earlier. The increases were largely due to health overruns. While some variation relative to initial plans is inevitable, these expenditure increases are likely to be long lasting. Within-year increases in expenditure of this nature should be funded through sustainable increases in taxation, reallocation of existing spending or by reduced spending increases in later years. The council assesses that the within-year spending increases this year are not consistent with prudent budgetary management.

For 2019, the council set out in its pre-budget 2019 statement how an appropriate fiscal policy could be arrived at. The council noted that the economy was close to its potential, that the budget deficit was almost closed and that the structural budgetary position appeared to be near balance. It noted that little further adjustment would be required to close an underlying deficit or enable a steady pace of reduction in the government debt ratio. To maintain this position, net policy spending could rise at or below the pace of sustainable revenues. Various estimates put this at approximately 3.25% per annum in real terms. When combined with inflation, this would imply a limit of up to €3.5 billion for spending increases or tax cuts for 2019, or a 4.5% increase. By not indexing the tax system, revenue would be raised, thus enabling a further €0.6 billion spending increase over and above that limit. This total of almost €4 billion is far from what might be considered a tight budgetary constraint.

The actual budget day package for 2019 amounted to €1.1 billion, which was higher than the €0.8 billion package that was planned prior to the budget. Taken together, the within-year increases introduced in 2018 and the larger-than-assumed budget package in budget 2019 exceed the limit that the council had assessed as appropriate. Government spending is now planned to increase, net of tax measures, by €4.5 billion in 2019 compared with what was originally planned for 2018. This compares with the €3.5 billion that the council had assessed as an appropriate limit. If additional spending measures beyond the quantity in the summer economic statement 2018 were to be addressed, the council assessed that these should have been funded by additional tax increases or through reallocations of existing spending.

The Department of Finance's own budget 2019 Estimates also indicated that Government plans were not consistent with complying with the fiscal rules for 2018 and 2019. The Government should aim to comply with the fiscal rules as a minimum standard when setting out its budgetary plans. A separate assessment by the European Commission has since assessed that 2017 outturns and 2018 plans showed a number of possible breaches of the fiscal rules, but that the 2019 plans were compliant. The European Commission also expressed concern about the overspending within the health sector, noting that, "much of the better-than-expected revenue for 2018 is being used to fund within-year current expenditure increases in healthcare, which raises concerns both about the long-term fiscal sustainability and the pace of adoption of the Strategy."

The council's assessment of the fiscal stance is based on a broader economic assessment than just a mechanical application of the fiscal rules. The council has highlighted on a number of occasions that the fiscal rules at this stage of the cycle are becoming less helpful for the overall sustainability of the public finances. 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, which will not necessarily prevent a repeat of pro-cyclical fiscal policy mistakes made in the past.

The Minister for Finance echoed these concerns in his foreword to the summer economic statement 2018. He noted the following:

> We must continue to be prudent in relation to management of the public finances. The fiscal rules are currently unhelpful in this regard. A full and literal application of the fiscal rules would involve the adoption of pro-cyclical policies not remotely appropriate to our position in the economic cycle.

The repeated failures to prevent unplanned spending increases have resulted in long-lasting increases in spending that are difficult to reverse. These failures represent a repeat of the policy mistakes of the past. Pressures in the health sector and elsewhere should be funded through sustainable tax revenues or decreases in spending categories elsewhere. These unfunded spending increases have left the public finances more exposed to adverse shocks, with the budget balance in deficit rather than in surplus.

Health spending for 2018 is set to exceed the level of spending budgeted yet again. 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. Given previous experience, there is a strong possibility that health spending will exceed budget forecasts in 2019. In addition, the Christmas bonus, which will be paid in full this year, has not been budgeted for in 2019. It is somewhat disappointing that the Oireachtas will pass a budget over the coming weeks that excludes significant spending that everyone in this room knows will happen. These two items alone pose significant upward risks to expenditure forecasts for 2019.

The council welcomes the return in budget 2019 to forecasting five years ahead. The council also wishes to acknowledge the substantial progress that the Department of Finance has made in terms of macroeconomic forecasting. The Department has developed and published its own estimates of the supply side of the economy. This means that better measures of medium-term economic growth and of the underlying state of the economy can be used to inform policy. However, the Government's budgetary plans for later years lack credibility. Specifically, the medium-term spending forecasts are based on technical assumptions that look and are unrealistic. Expenditure is assumed to grow at a modest pace, resulting in increasing surpluses in later years. The expenditure growth forecasts for the later years would only barely cover the council's stand-still estimates of the costs of maintaining current service levels, given demographic and price pressures. The current intention to run budget surpluses for the foreseeable future, if conditions allow, is vague. Previous commitments to outperform the requirements of the EU fiscal rules and reduce debt to 55% of GDP over the medium-term are no longer referenced.

In addition, the Government's system of three-year budget ceilings is not working, with repeated, procyclical, upward revisions to ceilings. The council welcomes the introduction of the rainy day fund, which is the national surplus (exceptional contingencies) reserve fund. Although it is useful, potentially, the current design is insufficient to offset faster than prudent growth rates allowed under the spending rule as it is currently applied. Annual allocations to the fund have been lowered from previously planned amounts, despite a surge in corporation tax receipts.

I thank the committee for again 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. A number of members have indicated a wish to speak. I remind members that I will, as normal, allow approximately five minutes each and there will be an additional round of questions later. I will allow everyone to make an initial comment. The first person to indicate a wish to comment was Deputy Michael McGrath.

Deputy Michael McGrath: I welcome Mr. Coffey and his colleagues. I compliment them on a very impactful report that is full of analysis and details. All the council's arguments have been comprehensively backed up.

I will start by discussing corporation tax, particularly as the Exchequer returns were announced yesterday. The Government has put forward the defence that Mr. Coffey, in a personal capacity, was commissioned by the Government to conduct a report in 2017. He said at that stage that the level of corporation tax receipts, with the step change in 2015, would be sustainable out to 2020. However, as one can see from the figures, we have had a few step changes since then. Does he still believe that the corporation tax receipts are sustainable?

The report is based on 2016 numbers and at that point we collected about €7.4 billion. This year we will probably break the €10 billion mark, as the profile for December is €600 million. The figure will be one third higher than the 2016 figures. Let us not forget that the assessment was based on 2016 figures. Can Mr. Coffey give us his perspective on the issue now? Is it his view or that of the council that corporation tax receipts are sustainable? To what extent is there a real risk to the Irish economy that we are, again, building up permanent expenditure commitments that will repeatedly recur on the back of receipts that could well prove to be temporary but we know to be volatile?

Mr. Seamus Coffey: The Deputy has asked for two separate views. The report I previously wrote showed my personal view and that of the council. Today, I am primarily here to represent the views of the Irish Fiscal Advisory Council. We have clearly highlighted this aspect as a risk. We referenced that the situation echoes our past reliance on significant amounts of receipts from one tax source. As the Deputy said, it looks like corporation tax will be 18% of the Exchequer tax revenue this year and that supports a huge amount of spending in the economy.

If I take off my IFAC hat and discuss the report, as published, within the past year I discussed the sustainability of receipts with either this committee or the Joint Committee on Finance and Public Expenditure and Reform, and Taoiseach. My view, in terms of the report, would not really have changed. I would consider that corporation tax is a volatile tax. It is likely to go down at some stage. I would continue to be of the view that the receipts are sustainable to at least 2020. Admittedly, the level is different so that means the risk is higher. Given that the step change occurred in 2015, and there has repeatedly been a step change since then, the evidence would suggest that the point I made around 2016-2017 still holds that the receipts are sustainable until 2020.

From the perspective of IFAC, the level of risk keeps getting higher and the amounts keep getting bigger. It is good to get this money. It is much better to collect €10 billion in corporation tax than not to do so. From the perspective of IFAC, we would be aware of the risk that this possesses. The report did not explain where the money came from. We have seen a huge surge but, as things stand, we have a limited knowledge as to why this happened. The amount could go back down. From the perspective of IFAC, we would be concerned about introducing permanent increases in spending on the basis of these, potentially, temporary revenue sources. That is what we have seen over the past number of years. We have referenced the fact that the delay in moving the public accounts into surplus has not been due to a deterioration in the economy. The delay could have happened naturally. The surplus has been pushed back even though the economy has performed stronger and we have these huge additional corporation tax receipts. The reason for the delay is policy, not the economic environment. I would hold the view that the receipts are sustainable. The year 2020 is not too far away so I am not putting myself too much on the block at this stage.

Deputy Michael McGrath: Less than two years.

Mr. Seamus Coffey: To date, nothing has happened to lead me to change the conclusions expressed in the report.

Deputy Michael McGrath: What is the possible impact of Brexit? The budget is based on the central scenario of a relatively benign outcome. I mean that a transition period will be followed by a deal with free trade terms. To what extent does Mr. Coffey think the Government should have provided a what-if or sensitivity analysis in terms of the impact in 2019 if all of this goes wrong?

A vote on Brexit is due to take place next week but it does not look positive. We will have to wait and see what happens next. There is a distinct possibility that we could be facing a cliff-edge Brexit. If that happens the basis for the budget will become obsolete overnight. Yet, no analysis or possible scenarios were included in the documentation available on Brexit. I ask the witnesses to make observations on the matter.

The fiscal council is very critical of the within-year changes or growth in expenditure. That is principally accounted for by the Department of Health and is in the region of €700 million. Let us say the Government asks the council what it can do when the HSE runs out of money with just a few months to go. We are all aware of the pressures on the health service such as life-saving operations and essential treatments for people. What would be the fiscal council's argument in response to that? How do we prevent this happening every year?

Dr. Martina Lawless: I can take the Brexit question. It is true that all the forecasts by the Department of Finance, and endorsed by the fiscal council, were based on what seemed like a very reasonable central scenario of a transition agreement and extension until 2021, and then some sort of deal. Obviously, given that it is a very fast-moving environment, it is difficult to update the what-if scenarios but we will know more after the parliamentary vote next Tuesday. It is difficult to update those types of "what if?" scenarios but we will know more with the parliamentary vote next Tuesday.

On the effects it could have on the Irish economy and it throwing the budget out of date, the work done by the Department of Finance and the ESRI on the overall effect of Brexit on the Irish economy showed long-term reductions in GDP in the order of 4%. Those were all based on a stable transition period and a long-term effect. If we look at analysis in the UK which was released last week by the Bank of England, it took what had been a similar analysis of a transition period and a smooth Brexit and looked at what the additional effects of a cliff edge, disorderly Brexit next March would be and it effectively doubled the size of its negative impact on the UK economy. Given the level of integration between the Irish and the UK economies, it is not unreasonable to assume that something similar in terms of the Irish forecasts if they were updated to include a disorderly Brexit. A lot of the-----

Deputy Michael McGrath: Is Dr. Lawless saying that it would double?

Dr. Martina Lawless: It would be reasonable to think that it would double the size of the effect. Much of the impact that it was taking into consideration in terms of why it would increase the impact so much was the length of time that it would take firms to adjust to delays on the

Border in terms of checks and customs. Given the amount of Irish trade that transits the UK, any delays in UK port processing times would potentially have a knock-on effect on Irish trade routes as well. Our report highlights that as a risk and that there is a central scenario, which seems reasonable based on the odds of a deal and a transition period being put in place, but that the current estimates of how large the impact would be on the economy in the long term could be understated if this deal does not come into play and there is a cliff edge Brexit next March.

Mr. Michael Tutty: I will take the question on health expenditure. If there are overruns every year, there is obviously something wrong in the system and it needs to be changed. The Department of Public Expenditure and Reform published a paper on this subject examining why it is happening and what needs to be done. Undoubtedly, the forecasts each year are not based on reality. Some €700 million does not just suddenly arrive as the year goes on, there has to have been a shortfall right from the start in the figures. We need to find a mechanism where correct or reasonable forecasts are given in the budget, rather than unrealistic ones. I know from my days in the Department of Finance that the Department can be at fault in saying that the HSE cannot have all the money it is looking for and so the HSE has to go back and see where it can cut back. The HSE then it finds that it cannot cut back so there are overruns. There may be fault on both sides in that respect.

There needs to be much more supervision of the expenditure as the year goes on so that big overruns are not just discovered in October but they are flagged as the year goes on so that there is time to take action. There is no time to cut back on other expenditure in October or to raise more revenue. We need to look at how the health expenditure estimates are formed and how they are supervised and managed over the year. Even the Irish Fiscal Advisory Council would not find ways of offsetting it if it was only identified in October.

Mr. Seamus Coffey: I echo what Mr. Tutty said. We are not absolutists when it comes to overruns. The Government's budget is very large and we do not expect every line to match the amounts set out at the start of the year. We focus on the overall amount. The issue in health is the systematic nature of these overruns that happen every year but in a budget this large there will be some items that are higher and some that are lower. We would expect that the overall aggregate would be close to what was set out at the start and that we should be able to accommodate those through one form or another. To some extent that happened last year. The overall amount of expenditure did not increase dramatically last year and what we have this year are Supplementary Estimates in health and a range of other areas and they are all adding to the full amount of spending and there are almost no savings elsewhere. Some variation in the budget is fine but the issue we have with health is the systematic nature of the repeated overruns and the fact that this year, by and large the additional spending is added into the total for 2018 and becomes part of the base for 2019.

Deputy Pearse Doherty: I welcome the witnesses and thank them for the report. There are a huge amount of data in the report and in the appendices so I would suggest it would be circulated at midnight as it is going out to the press because it leaves us at a disadvantage in that we are commenting on something we have not seen until the next morning. However, that is just a minor issue.

I want to pick up on the issue of Brexit and the commentary in the report on the reasonable probability that a transitional agreement may not be in place and, as the report mentioned, in the context of a hard Brexit, the reduction in Irish output would be 7% as opposed to a maximum of 2.8% in a soft Brexit. The Irish Fiscal Advisory Council has called even those figures into question again in terms of the model that is being used that underestimates the intensity of Irish labour in terms of exports and how we model that in the value of exports. To my knowledge this is the second time the Irish Fiscal Advisory Council has done this, so is it suggesting that the impact of a soft Brexit or a hard Brexit could be underestimated by the Department's modelling and how convinced of that is it?

Mr. Eddie Casey: We have looked at this a few times and the Deputy has put this question to us before. What we have noticed when we have used the models that are typically run to estimate the effects is that they treat the UK like any other trading partner, as though the labour intensity and the number of people working for each sector exporting to the UK is the same as any other export market but we know that there is way more labour involved in the types of sectors in question such as agrifood, machinery and equipment. Many more people work for each item exported to the UK and because of the way the models are set up, they work on averages and representative markets, and that means the models could be underplaying the extent of the impact that might happen because those labour channels are so much more important for the UK.

Deputy Pearse Doherty: Does the Irish Fiscal Advisory Council have a view on whether it is happening? Is it talking to the Department about this and does the council have a conclusion on what Mr. Casey has very reasonably outlined about the high intensity of the labour market in respect of those exports? Does the council have an opinion that this is what is happening or is it just a potential outcome?

Mr. Eddie Casey: We are fairly happy when we talk to other users of models such as this. We talked to the Central Bank, the ESRI and the Department to the extent that they seemed to agree with the principle that this model underestimates the impacts but we cannot say how much higher the impact would be. It would be a phenomenal amount of work to get into that level of detail and we just have not gotten there.

Deputy Pearse Doherty: I appreciate that.

Dr. Martina Lawless: I want to add a comment. I am sure members know that I also work at the ESRI, which is deeply involved in many of these forecasts. The type of modelling the ESRI has done and the scenarios are based on a long-term effect and the long-term impact Brexit will have on the Irish economy once it has happened. One of the issues that we and the Department of Finance raise as a risk is that we do not even know the timing of when Brexit will happen and while the long-term estimates might be exactly on point, the precise transition mechanism of how quickly that would come into play is still very much unknown.

Deputy Pearse Doherty: Many people have said that the report has been scathing of the Government's budgetary policy. There is language in these reports that we have not seen in previous reports. The Irish Fiscal Advisory Council talks about non-realistic projections, a lack of prudence and repeating the mistakes of the past and it draws conclusions around the stamp duty issue and suggests that at that time it was taking some of the heat out of the economy while what it happening at this point is not. It makes it clear that the budgetary projections are not credible into the future. Does IFAC expect anything to change or will we just have a nice note back from the Minister, thanking the council for its views? What does IFAC expect out of this? The council has put an enormous amount of work into this and the language therein is very strong. What would the council like to see happening, given that the Finance Bill has already been passed? All that is left to deal with is the social welfare Bill. The most significant point about that Bill is that it does not budget for €250 million in expenditure that is likely to happen next year.

Mr. Seamus Coffey: What we will be looking for is an assurance that this is not the start of a pattern that continues over a number of years. The public finances have recovered substantially in recent years and are in a reasonable position but there are still significant risks. If we are not leaving sufficient leeway to allow for those risks, both within the public finances themselves and the economy at large, that leaves us unnecessarily vulnerable. The report this year was slightly different to previous reports because what happened this year was different. In 2017, for example, the Government set out a plan and by and large, it stuck to it. There were within-year spending increases last year but there were savings elsewhere to offset them. The Government kept the amount of spending increases for 2018 at the time of last year's budget within the range that we assessed to be prudent. We did not use that strong language last year because the things we would look for were actually in the budget. This year, those things that we would look for were not there. The Government did not stick to the plan. The budget day package was larger than previously signalled. We had significantly greater within-year spending increases for 2018 with little or no savings elsewhere to offset them. When those spending increases are put into the base for 2019, we get a very large increase in spending for next year relative to what was originally planned for 2018.

In terms of what we would like to see happening, we would like to see the budget becoming credible, that budget 2019 as set out is delivered on and that we do not get more increases. The Government has already admitted that we are going to get €250 million of additional gross spending through the Christmas bonus next year and other overruns in health cannot be ruled out. When it comes to the summer economic statement of 2019, we would like to see the Government setting out a plan that is within the range that is considered prudent and then delivering on that. If we get that, the language of our report will be different next year. It is a cumulative thing in terms of the budget recently passed. There were things that we looked for and saw last year that we did not see this year.

Deputy Pearse Doherty: I have a question relating to health spending in particular. It was quite frustrating for us, as an Opposition party, when we were trying to get an estimate of the likely overrun in health. That overrun was not calculated by the Department of Health or the Department of Public Expenditure and Reform until days before the budget. They did not have the information. It was not that they were not providing it; they just did not have it. They came up with a Supplementary Estimate of €655 million, €625 million of which is current expenditure. The November report published yesterday shows that we have already surpassed that by €74 million. The current expenditure is now at €699 million above profile as opposed to €625 million. If just a couple of weeks ago they could not figure out what expenditure would be in six weeks' time, how are we ever going to get this right?

The excellent table on page 88 of the IFAC report shows that the overruns intensify at the latter end of the year. We are likely to see an even higher December figure, which could mean that we need a second Supplementary Estimate in health for the last eight weeks of the year. That is not a joke. We are probably overrunning the health budget again by another €100 million. This is because the Department of Health is not, as IFAC puts it, "credibly" budgeting in the first place. We describe this as an overrun but in reality there was no credible budget for health in the first place.

Mr. Seamus Coffey: To go back to what my colleague, Mr. Tutty, said in response to an earlier question, we would like to see increased monitoring and assessment of spending, particularly in health, as we progress through the year. At the moment a formal figure about the likely overrun does not come out until October but within two or three months of a new year, there should be information available that would allow a dynamic estimate of the expected spending amount for the year. We should have information on the level of spending and the level of likely overrun as we progress through the year. We should know whether it is on, below or above target. We would agree with Deputy Pearse Doherty's view that there should be increased monitoring and an increase in the information made available. Health is by far the largest spending area and within net voted spending, it will reach €17 billion next year. It is pretty clear that the overruns in recent years have a systematic pattern to them. Improved monitoring is required and if the information is not currently being collected, efforts should be made to collect it. We would like to see, if possible, dynamic assessments of those overruns as we progress through the year.

Deputy Pearse Doherty: Given that health spending is already €74 million above the existing Supplementary Estimate without factoring in the December figures, is it likely that we will need a further Supplementary Estimate?

Mr. Seamus Coffey: I am not sure. I would have to check the profile.

Mr. Eddie Casey: When we look at the profiles, we tend to look at gross spending. The overrun is about €460 million and €420 million on health in November. Part of it could be just down to timing and when receipts arrive in the Department. The Supplementary Estimate might not need to be increased in the next month if the Department does not get some of the receipts it is expecting. I would not see the need for a further Supplementary Estimate at this stage.

Chairman: Deputy Bailey is next.

Deputy Maria Bailey: I have a couple of questions which I will group together if that is okay.

Chairman: That is fine but the Deputy has only five minutes in which to do so.

Deputy Maria Bailey: I want to get the view of the council on increased expenditure on capital infrastructure including schools, housing, transport and so on. Given that we have had years of a lack of investment in these areas, I welcome the fact that we are increasing the future productivity capacity of the economy. What is the council's view on that? If the much-needed capital investment did not take place, would our deficit position be better?

On health and following on from what Deputy Pearse Doherty has said, there is a recruitment drive under way in the health sector at the moment. We have an ageing population which will put further financial strain on the health budget. I do not think anybody would argue against the need to streamline and overhaul expenditure in the Department of Health. As has been suggested by others, we need to keep a closer eye on it at particular points in the year. I ask the witnesses to give us their views on the health budget and where they believe the biggest increases will arise within that budget. Will the increases stem from investments in infrastructure, staffing or just general overspends?

Mention was made of additional tax increases. The council suggests that additional spending should have been funded by additional tax increases or through the reallocation of existing spending. What kinds of tax increases was the council referring to there? Was it referring to the introduction of new taxes or increases in existing taxes? The IFAC report also suggests that "significant overheating pressures could build up if a faster-than-expected pick-up in housing construction materialises". What is that suggestion based on? I ask because we have a significant skills shortage here and are probably not going to be building what we need by 2020. We need to be building approximately 30,000 new units per year and it will take us at least another two years to get to that point. What level of overheating does IFAC envisage?

My final question is on health. Are health spending overruns not a feature of most developed economies or are they unusual?

Mr. Sebastian Barnes: I will group the questions into those relating to investment and then those relating to health. In terms of investment, a couple of years ago the council expressed concern about investment which was at a very low level. Investment was exceptionally low by international standards and by way of historical comparison and was not even sufficient to maintain the existing capital, let alone expand it. In that context, increased capital investment is very welcome, particularly as there are very significant pressures in housing at the moment. It is good that there is space within the budget to allow for the higher investment that is necessary.

On the health side, there are pressures in many countries, as the Deputy suggests. Those pressures come from multiple sources, including ageing but also cost pressures. Health spending overruns can be related to specific drugs. They are also related to the fact that the sector is very labour intensive, with high demand for skilled labour in particular. There are many pressures on the health system.

The previous two points demonstrate the importance of medium term budget planning and good forecasting. We have not seen that with this budget but we did see it with previous budgets. Accommodating increased capital investment, all other forms of spending and pressures in health poses a big challenge. That is why the Government needs a clear plan around how it is going to do that with the revenue that is available. Those political choices need to be made. This budget, because it did not have credible medium term forecasts, does not help in that process. It does not very clearly illustrate the choices that people face. People take different views on how to allocate funding but one must have a clear baseline. What we have seen is that the overall amount of spending budgeted for is not even enough to keep things at a constant level in real terms. It does not leave space to improve services but only barely allows enough to keep things at their current level and in the outer years, not even that. These questions are political choices as to how much to tax and what to spend money on. It is vital there is a clear framework in this regard, and that is missing from this budget.

Mr. Seamus Coffey: We assessed capital spending previously and do see Ireland moving from a relatively low level to a relatively high level. The concern we would have raised, however, is that we cannot do everything and that if we choose to devote significant resources to capital spending, we will spend less in other areas or require additional tax increases. One point that was made about the budget is that for 2018, 2019 and 2020 current spending is growing at 4.5%, which seems to be in line with the fiscal council's view that it is fine to have increases of 4.5% for current spending, but capital spending this year is increasing by 27% and will increase next year by 13%. The overall increase in spending, current and capital, is therefore much above the level we would consider sustainable. The increase in capital spending is not a temporary spike; it is due to rise to a much higher level. It is a structural increase from low levels which is being maintained at high levels. This growth will not then be cancelled by a subsequent fall, so the overall package of spending is quite large. We assessed the increase in capital spending to be, as my colleague said, necessary to develop the capital stock in the country. It was not possible, however, to do everything. In this budget we see current spending rise to the limit of what we consider sustainable. If the capital spending is then put on top of that, one exceeds that level.

Deputy Maria Bailey: What about construction?

Mr. Seamus Coffey: We would agree with a certain number of the views expressed about the level of overheating of the economy. First, we need an increase in housing output. That is no doubt necessary, but is there space in the economy to do it? The unemployment rate has fallen to 5.3%. In construction and professions and skills related to construction there appear to be shortages. People have either left the country or left the industry and will not come back to it. It looks like housing output this year will be 18,000 or 19,000, again below most estimates of the equilibrium level for Ireland, which seems to be approximately 30,000 or 35,000, and that would cover only the houses we need annually. We have almost a decade of a deficit to meet so we need housing output to rise significantly above 30,000. This could happen but only if, as would be hoped, we rise temporarily to 50,000 to meet the 30,000 we need and cover some of the deficit that has built up in recent years. This could be a temporary or unsustainable level of output. Housing is very tax-rich, so this could have an impact on the public finances and lead to a temporary increase in demand in the economy. Our concern would be that an attempt be made to avoid such overheating pressures. Have the houses been built? We all recognise that more houses need to be built but, again, one cannot do everything. If it is necessary to take some money out of the economy to make the resource space, to provide the resources for this housing construction, we should be aware of what is happening and take some heat out of the economy if necessary.

Deputy John Lahart: I wish the witnesses and their officials a happy Christmas and thank them for their public service and their regular attendance here. I have a couple of questions.

To paraphrase, it seems that when the Government has it, it spends it. That seems to be the message the witnesses are conveying. I have a number of questions about the health spending. I think there is an expectation, notwithstanding what Mr. Barnes said, that when there is a serious overrun, that one particular aspect of health spending may account for it. It might be a matter of dealing with the trolley crisis or accident, emergency departments or whatever else. When one drills down into the spending, however, it looks like there is an equal distribution of this overrun right across the health budget, which seems to imply that the Department of Health is becoming used to overruns and is building them into its annual budgets. There is no one big chunk in health accounting for the overrun; each section within health seems to be getting an equal share of the overrun. Could the witnesses comment on this?

We are almost at full employment. The social protection budget has not declined correspondingly; in fact, it has increased. Do the witnesses have a comment on this? We are just lucky that additional 11th month windfall in corporation tax was not known to the Government at budget time. I am neither an economist nor an accountant and I am not great with figures but I remember the pain of the past, and we are back to overruns and underestimates. Do the witnesses have any handle yet on how corporation tax is being underestimated at such a scale by the Department of Finance?

The witnesses are not mind readers or crystal ball gazers, but why do they think a Government would not factor in a Christmas bonus payment for 2019?

Since last April, everyone who has come before the Committee on Budgetary Oversight - whether the IFAC, the Economic and Social Research Institute, ESRI, the Minister or any other agencies or witnesses - has highlighted four or five themes, one of which is our over-reliance on corporation tax. Do the witnesses think the Government has done anything in this budget, aside from the rainy day fund, to address this in a tangible way? The other measure that has been highlighted is carbon tax. The third is petrol and diesel equalisation. The Government fudged these two the day after a major climate change report reinforced the urgency of taking measures to deal with it. What is the witnesses' response to this?

My next question concerns what Mr. Coffey talked about. He mentioned oversight and the need for increased monitoring. Which Department's responsibility is this? We invited the Department of Public Expenditure and Reform before the committee and before the IFAC came in. We have correspondence from the Department stating that, having considered the matter carefully, the health budget is not really a matter for it but, rather, for the Department of Health. Either we have responded or we are going to respond. Who do the witnesses have in mind as having this oversight and invigilation responsibility when it comes to overruns in the health budget? The Minister, Deputy Donohoe, in his budget speech indicated that he would have the Minister, Deputy Simon Harris, into his office regularly over 2019 to check out how the budget is going. What kind of structures do the witnesses think we can put in place?

Mr. Coffey has hinted at my final point. This overrun pattern is becoming contagious. It is not applying only to health; it is now also applying to education and justice. What advices or response do the witnesses have to that?

Mr. Michael Tutty: The Deputy referred to the phrase "when we have money, we spend it". I have been through many decades in the Department of Finance looking at this happening time after time. While the Minister would say at this point that we are not spending all that we could spend, it is still spending more than we think is appropriate at this point in the cycle. The Government also says, "All the other parties tell us we should be doing more, so how can we avoid doing it?" However, one of the reasons the Irish Fiscal Advisory Council was set up was to try to stop this cycle of spending more and more in good times and then having to have big cutbacks in bad times. We must try to push this view and convince both Parliament and the people that there is a better way that could save us from the big cutbacks when we inevitably get into a slowdown. Even though we would not say that what is going on now is hugely over-expansionary compared with some of the things that happened in the past, it is still moving in the same direction as we had been moving in the past and not learning from the past. The Christmas bonus was never put into the Estimates. No matter how many times officials and people from the Irish Fiscal Advisory Council said it must be put in because it would be spent, Governments of all hues left it out and hoped there would be savings during the year that would finance it rather than showing it in the budget. They still spend it even if there are no savings. We think that long-standing practice should stop. A budget is not realistic if it does not make provision for it. However, another year and another budget come and it is still left out of the figures.

With regard to the widespread increases in health expenditure, we have not looked in detail at where exactly the increases are. We are not aware of specific increases or particular areas where there are big increases. It may be right there are just widespread overruns in all areas, which is what happens if no budget constraints are imposed. If people see the budget they are given every year can be exceeded and there are no consequences they will inevitably be lax in implementing budget controls.

The Department of Public Expenditure and Reform is probably a bit removed from the day-to-day supervision of what is happening in the Department of Health and other Departments. That is why we have line Departments which should be looking at it in detail. The Department of Public Expenditure and Reform should start setting down how the control should be exercised to make sure the Department of Health gets the information from the HSE and the HSE gets the information from all the bodies under it aegis on how expenditure is going every month and every quarter. It should then feed that information to the Department of Public Expenditure and Reform. Undoubtedly, the Department of Health should have primary control over the budget it has been given to run the health services.

Mr. Seamus Coffey: The point was made about the social protection budget being largely static over the past number of years without evidence of the decrease as a result of falling unemployment. Overall, the unemployment component is a relatively small part of the social protection budget. It is probably in the region of 20% to 25%. Pensions are by far the largest part. There are other areas such as child benefit and disability. The unemployment component has fallen significantly but that has been offset by increases elsewhere in the number of recipients. The number of people aged over 66 has increased by around 20,000 per annum as life expectancy has increased. There have been increases in rates for the past number of years. The unemployment element of it is falling but there have been demographic pressures elsewhere that have seen the number of recipients elsewhere rising. Policy decisions and increased rates have meant the effect is roughly neutral. The unemployment component is falling. Other elements are causing it to rise. We would not necessarily expect to see the overall social protection budget fall, given the demographic and policy decisions that have been taken.

On the rainy day fund and corporation tax, we have continued to see corporation tax surge. It was pointed out by Deputy Michael McGrath that there were further increases in corporation tax yet the contributions to the rainy day fund are not changing. They are about saving some of these windfalls in preparation for negative events that might happen in the future. However, at present, the design of the rainy day fund does not appear suitably dynamic to take into account the windfall revenues we are receiving now and the ability to spend it in the future. It has not changed even though corporation tax receipts have increased.

On some of the other overruns mentioned and why we treat the Supplementary Estimates for education and justice differently, if we look at education and justice, much of them are driven by issues in forecasting the number of people who are retiring. If one looks at the Estimates, by and large they are for superannuation and the lump sum payments made to public servants when they retire. This is expenditure that will happen anyway but if more people retire in a particular year, the amount of those lump sum payments will be greater. Essentially all it does is drag spending that would happen in the future into the current year.

The issue with health is somewhat different. It is not based on an increase in the number of people retiring, it is based on an increase in the number of people being hired. That spending becomes permanent and long-lasting. There are differences. In education, justice and other areas such as Army pensions, it looks like there are repeated Supplementary Estimates to address failures to correctly forecast retirements throughout the year. Perhaps there are issues there with how those forecasts can be assessed. The impact they have on public finances is not as severe as in the current spending increases in health.

Deputy Thomas P. Broughan: I welcome Mr. Coffey and the delegation. In terms of risks and our net debt ratio we seem to be moving up the table. We have almost moved out of the relegation zone if we compare it with Premier League football. Is the Irish Fiscal Advisory Council happier with the overall debt risk situation? It is still very large but net debt seems to be reasonably under control. We have the rainy day fund, which I understand from the Minister is also a net figure. Is it an overarching risk for the future that we should be much happier with?

Mr. Seamus Coffey: The reason we choose net debt is to offset some of those assets. The

State has significant assets. One can look at the gross debt and the overall amount owed but it is equally as important to look at what is owned. The State has significant cash assets built up through the NTMA and various other sources so we subtract that to get a measure of net indebtedness. We think that remains at an elevated level. It is close to 100% of GNI* for 2017. That is quite high. It is the fifth highest in the OECD.

Deputy Thomas P. Broughan: Have we not refinanced much of our debt this year and will do more next year? Are there not much safer structures now?

Mr. Seamus Coffey: The refinancing environment is relatively benign. The NTMA experiences significant demand when it issues bonds and far more than the amount it wishes to raise. The rates at which debt is being issued are historically low. The current refinancing environment is relatively benign but Irish experience shows that can change very quickly. If one goes back to 2006 and 2007, similar comments were made about our ability to refinance debt and the margin we were paying relative to larger countries such as Germany. While the environment may look relatively benign now, it can change quite quickly.

One issue with regard to Ireland is whether people are paying that much attention to what is going on, particularly if standard international metrics are done in terms of GDP. If one looks at the chart, Ireland's net debt to GDP is below 60%. People might view that as being a safe level. We are of the view that greater use should be made of the alternative measures provided by the CSO such as GNI* which would put our net debt ratio at about 100%. If we require to borrow significant amounts in the future, it leaves us with limited borrowing capacity. At present we are refinancing debt and doing so quite easily. There are legitimate reasons for Governments to borrow and run deficits. If we hit circumstances where large deficits need to be run and perhaps should be run, we may find there are difficulties in raising the amount of money and in refinancing debt. Our concern is the debt remains high. It is on a downward trajectory but we should look carefully at the level and continue to bring it down.

Mr. Sebastian Barnes: We have added stress scenarios for Government debt to the report this time. The reader has to work a bit harder to get to page 144 to see them. They are instructive because such a high level of debt is very sensitive to shocks. Ireland is very volatile. We can easily think of shocks that would mean the debt would either start decreasing or increasing. If it was on an upward trajectory, it would require more drastic policy action to cut spending or whatever is necessary to improve the budget balance. Those scenarios are hopefully helpful to people in understanding the risks associated with these high debt levels.

Deputy Thomas P. Broughan: May I ask about the assumptions? However one looks at this report, it is a devastating critique of the Fine Gael-Fianna Fáil Government and of the budgets. In terms of risks, does the Irish Fiscal Advisory Council ever think about including the electoral cycle? It is quite striking that 2015 was mentioned. We have been in election readiness for the past three years and will be, possibly, on the march next year. For example, at the Fine Gael Party conference the Taoiseach might announce major income tax cuts over a number of years but not announce carbon tax increases because he is not into sustainability. Given the nature of the electoral cycle, if parties and groups - I am an Independent myself at the moment-----

Chairman: At the moment?

Deputy Richard Boyd Barrett: Deputy Broughan is thinking of joining Solidarity-People Before Profit.

Deputy Thomas P. Broughan: Is there not a considerable risk in parties not coming forward with sustainable proposals? For example, I made a budget submission to the Minister for Finance which proposed a €4.5 billion package, as I am sure did other groups and parties. I balanced that budget with sustainable proposals, including equalisation of diesel and a few proposals around, for example, stamp duty, which are some of the areas which the witnesses have focused on. Along with Brexit, which is a nightmare, sustainability is a risk as well.

Mr. Seamus Coffey: We agree with the Deputy. Under our assessment of the fiscal risks for budget 2019, there is a general risk on budgetary pressures, within which we clearly say that the political cycle may also increase near-term budgetary pressures. As my colleague, Mr. Tutty, said earlier this something we have experienced in Ireland going back over many decades and it is something we are aware of.

Deputy Thomas P. Broughan: The witnesses mentioned inevitable downturns. The Australians recently celebrated a quarter of a century of unbroken growth. Taking into account the international situation, a downturn would seem pretty inevitable but given, as other colleagues have stated, our infrastructural deficits and so on and the desperate need for housing, this should not be the case. Reference was made to net policy spending. What does that mean and how is it determined?

Mr. Seamus Coffey: On our view regarding an inevitable slowdown in the economy, we are not necessarily saying that a downturn and return to negative growth is inevitable but we do think a slowdown in growth is inevitable. We have had very strong growth for four or five years, with the economy growing above its potential for a sustained period. No economy, not even Australia, can grow above its potential forever. If an economy could do that, its potential should be higher. Our view is that there will be a slowdown in growth, including employment growth and increases in domestic demand given the high rates we have experienced recently. We should not be expecting, as happened in recent years, to be able to continue with the rapid expansion in budgetary measures we have experienced in the past number of years, which we are now measuring with this new measure of net policy spending. We are trying to look at the impact of policy decisions on the level of spending by the Government. There are various reasons why Government spending changes, outside of policy.

Earlier, we were asked about changes in unemployment and the level of unemployment. If unemployment was to rise, we would not view that as a policy change. Currently, unemployment is decreasing and the savings being made do not constitute a policy change. We subtract those savings and take them out. Equally, if there was to be a slowdown and unemployment was to increase, we would not take the view that this should detract or subtract from the amount of the so-called fiscal space because that is separate. Also, Government spending can fall because of changes in interest rates. Again, that is not a policy change. It is based in the external environment when it comes to refinancing debt. We take both of those areas and we look at the policy measures, including the change in spending after adjusting for unemployment and interest. We also look at the change in revenue, particularly the change in revenue measures. For example, when looking at a measure of policy spending, we tend to reference spending but we are looking at both the tax and spending sides. We use shorthand. A tax cut is spending fiscal resources. We combine those to get the change in the adjusted measure of spending that is the result of policy, including what decisions are being taken and what might be the outcome. For example, in recent years the rate of spending increase has been accelerating. Throughout 2015, 2016, 2017 and 2018 Government expenditure growth has been accelerating but on the tax side, things have been changing. Budgets 2016 and 2017 were revenue reducing in that they provided for income tax cuts, which reduced the level of revenue. Budgets 2018 are 2019, however, have been revenue increasing on foot of the stamp duty change in 2018 and the increase in the VAT rate for the hospitality sector in 2019. Even though the rate of spending growth has been accelerating, once an adjustment is made to take account of that change in revenue the rate becomes quite flat but as it is flat at 5%, it is relatively rapid. What we are trying to do is assess the impact of policy on the level of spending. For the last number of years, it has grown at 5% in real terms, which we consider to be above the sustainable growth of the economy. For 2019, it is forecast to grow at 3.5%, which is, perhaps, right at the limit but we always have the issue of the Christmas bonus. We were asked why is it not in the budget but it seems to be a historical fact that we would like changed. Another issue is the possibility of health overruns. We are already starting at the limit for 2019 and it could be higher. The purpose of this measure is to isolate the impact of policy on spending changes because Government spending changes for a variety of reasons. We think it is a useful addition and one we intend to use into the future.

Deputy Jonathan O'Brien: The Christmas bonus is never in the budget because it would take away the Santa effect for Governments. On the issue of overheating, which we touched on previously in regard to non-residential construction, if we were to ramp up house construction we would have to dampen that sector, perhaps by way of stamp duties. The new heat map produced this year by the council indicated that another area with potential for overheating is employment. We are almost at full employment now. It is more difficult to dampen employment growth because it would require people to be laid off. How do we dampen it? Can it be done by investing in childcare or by bringing in workers from other jurisdictions? What are the real ways of dampening this particular sector?

Mr. Seamus Coffey: It is not necessarily about dampening housing construction. We agree that housing output is below the required levels and that it needs to increase above the required levels for a time to meet some of the shortfalls. The issue is what happens in the overall economy to avoid additions or stimulus in other areas. One could make room for housing construction through reduced spending in other areas and, possibly, increased taxes in other sectors to allow room for demand in the housing sector. It is not about dampening one particular sector, it is about looking at the overall aggregate of what the economy is trying to do. Increasing housing output to 30,000, 40,000 or 50,000 units per year in an environment where the unemployment rate is 5.5% is difficult to do. If there is continued strong cyclical growth in other sectors, from where do we get the workers to build those houses? If we have to bring them in from abroad we have to have housing in which to accommodate them. If there are workers coming in for other sectors, it may be that we are asking the economy to do too much. If we believe housing is the priority, we should be making the space in the economy to allow that housing output to increase. As I said, it is not necessarily about dampening down a particular sector; it is about making room in the overall level of activity in the economy. There are various ways in which this can be done.

Deputy Jonathan O'Brien: How do we address overheating in terms of employment? Outside of bringing in workers, what can we do to increase the workforce? We hear constantly that we do not have a childcare system in this country conducive to people working long hours. Instead, people in many cases work for reduced hours because of childcare costs. If we had a proper childcare system, would that help to free up people to work? What initiatives can we take to dampen overheating in this area?

Mr. Sebastian Barnes: There are two ways of tackling it. Mr. Coffey referenced overall demand in the economy and fiscal policy in terms of reducing spend in particular areas and increasing taxes in others. The Deputy is right that things also can be done on the supply side. The measures he mentioned to bring people back into the labour, such as training and childcare in order to help women join the labour force, are supportive policies as well and they must be built into the overall package. It needs to be tackled on both sides of the equation.

Deputy Jonathan O'Brien: Deputy Pearse Doherty wants to ask a question about corporation tax.

Deputy Declan Breathnach: I apologise for being late. I thank the Irish Fiscal Advisory Council, IFAC, for the information and advice it has given. I am one of the newer members of the committee and one of the newer Members of the Dáil. One issue that concerns me is that we are entering into a skills shortage right across the economy. Reference was made to building more than 30,000 houses but there are not enough plasterers or builders. Last week, 680 additional care packages were announced but we do not have the care staff. We experience that phenomenon all the time on the ground. We hear announcements to the effect that there will be new psychologists in the mental health area or new speech and language therapists in the education sector. There is a constant brain drain of teachers going to the United Arab Emirates, UAE, and other places to work. In the context of all the promises that are made to improve services, does the IFAC look at such shortages and how we can address them? We hear commitments on new services day in and day out. Perhaps that is not an area the IFAC examines but I would welcome a comment from the witnesses.

I am sure the witnesses have discussed Brexit and its implications. I come from a Border county. In the event of a cliff-edge Brexit, has an analysis been done on cross-Border trade and barriers to trade? Nobody wants to see customs and barriers to trade. Has the IFAC carried out any assessment in that regard? I do not know whether it is an area the IFAC has fully covered but I would welcome a comment.

Dr. Martina Lawless: The IFAC has not done a direct analysis on Brexit but work has been done by the ESRI and InterTradeIreland with the enterprise agency in Northern Ireland, which shows Northern Ireland firms to be considerably more exposed than firms in the rest of the UK. It shows pretty significant decreases in trade. The impact is felt in particular by small firms that do frequent but relatively low-value transactions across the Border, so the impact on the number of firms trading is a lot more substantial than the impact on the value of trade.

That analysis did not look at a cliff-edge major distortion such as, for example, major checks on the Border; it merely considered the impact of tariffs. Given the high degree of uncertainty currently, such as whether there will be a backstop or separate treatment for Northern Ireland and whether the UK will stay in the customs union for a significant amount of time, it is difficult to come up with an estimate based on any degree of precision about how it would impact, other than to get a sense of the ordering of priorities, whereby those firms in Northern Ireland will be more exposed than elsewhere. The exact magnitude of the effect is not really possible to estimate.

Mr. Seamus Coffey: On the first point on whether commitments can be delivered on, that is not something we explicitly assess. We do look at it in broad terms. To go back to housing and the unemployment rate, we consider whether we have the resource capacity in the economy to deliver the overall level of activity that is desirable but we do not assess the issue in terms of particular skills and professions.

Deputy Declan Breathnach: Whose role is it to do that?

Dr. Martina Lawless: The Expert Group on Future Skills Needs.

Deputy Pearse Doherty: I want to touch on corporation tax. Mr. Coffey referred to the sustainability of corporation tax out to 2020. The definition of sustainability probably goes beyond 24 months. Could Mr. Coffey elaborate on that? He answered a previous question by referring to a report from a number of years previously. If we can only predict that those revenues are likely to be maintained at the current level for the next two years, I do not think that equates to sustainability. I would like Mr. Coffey to elaborate on that.

Looking at the fiscal monitor that came out in November, the Government had projected €1.1 billion above profile, €700 million of it non-recurring, with the rest recurring. Now we see that it has gone up by another €470 million, and possibly one might see the same in December. We are now more than €1.5 billion above profile. We evidently have serious challenges in terms of predicting where corporation tax is at. I assume that is also due to the fact that there is a small number of very large players that can distort the figures in a very positive way. Does Mr. Coffey believe something can be done from the viewpoint of the IFAC to come up with better projections in terms of corporation tax?

The most alarming thing for me in terms of the budget is that we are funding the necessary increase in health expenditure from increased corporation tax receipts. While the IFAC report shows the increase in corporation tax and the reduction in the net interest rate and the in-year spending has increased, it became very obvious this year that we decided to use this year's bonanza to fund health and, to say the least, that is madness. Could Mr. Coffey comment on corporation tax? Sometimes one sees headlines such as that the Irish Fiscal Advisory Council says that corporation tax is sustainable but I would argue that if the council is only suggesting it will be at that level for the next two years, it probably is not sustainable. People could take the view that everything is okay and there is nothing to see here.

Mr. Seamus Coffey: I reiterate that it is not something the IFAC said. That was something I said in a different capacity. I am not sure I can elaborate very much on that. I still stick by the conclusions of the report. I agree with the Deputy that 2020 is not that much further into the distance but it would require further analysis to look ahead and that is not something I have undertaken. Subsequent research could be undertaken to look into that. Some of the reasons for the increases in 2015 and 2016 were assessed in the corporation tax review. The conclusion based on the evidence at the time was that it was sustainable until at least 2020. That is a personal view, and it is one I continue to hold. Further work would be required if one wants to go beyond that.

On the unpredictability of the receipts, to a certain extent the November receipts that were announced yesterday would not have been much of a surprise because of their links to the June receipts and the way in which corporation tax is paid. Companies make a preliminary payment in month six of their financial year and they pay the remaining amount, up to 90% of the amount due, in month 11. If companies have their year end on 31 December, month six is June and month 11 is November, so based on the June returns one can get a good indication of what will happen in November. The June returns were quite strong. If one extrapolates forward, one would expect to see quite strong receipts in November and that is what we did see, so it was not necessarily much of a surprise. June is halfway through the year. It does not allow one to predict at budget time, so if one wants to know what will happen in November 2019, the situation in June 2019 is a good indication but the budget is set already.

One issue with the predictability of the returns is that, by and large, although we are unsure of the sources of it, it is likely to remain highly concentrated. As the Revenue updates its figures for subsequent years, we think the concentration is likely to be maintained at the same level or possibly even increased, and potentially the amount being collected from multinationals could increase. Corporation tax should increase in an economy experiencing a cyclical upswing. It is just that we are seeing an increase in corporation tax far beyond that. In the context of capacity within the economy, which we discussed earlier, one area where we said we could make space was by an increase in taxes. We have seen a huge increase in tax revenue from corporation tax but it is not coming from the domestic economy. In the main, it is coming from multinational companies outside the economy. It is coming through this international trade but is staying in Ireland and is flowing into the Government coffers and, because of the delays in moving to a budget surplus, it is being spent. We try to assess the impact of fiscal policy on the economy. It is likely that we are underestimating it because the primary balance, ignoring interest payments, is being boosted by corporation tax receipts which come from an external source. It is possibly providing a stimulus to the economy because it is not tax revenue coming out of our pockets and being spent on providing services to us. It is coming from the pockets of American companies, something we highlight in the report.

The predictability of this remains quite difficult. It has clearly overshot for a number of years but, because it is not linked directly to changes in domestic economic activity, I am not sure how we can overcome that. As the year progresses, there can be changes. The Minister noted that a certain share of the 2018 receipts is deemed to be a one-off and there is no way a permanent increase in spending should be based on one-off receipts. We would like to see a clearer division between annual developments in revenue and annual developments in expenditure. If corporation tax was declining, our position would be that there should be no change on the spending side. As corporation tax has gone up, however, it has been linked to increases in spending. We feel that maybe half of our advice will be listened to and we will be ignored when we say there should not be spending increases. If corporation tax was to decline and we were to hold a consistent position, people would say the Irish Fiscal Advisory Council was happy for spending to be at this high level. They would say it should not decline but we say there should not be increases, and this would be to avoid a decline in the future.

Mr. Michael Tutty: The international position is also a factor. Changes in the US tax code can have a very big impact on our corporation tax revenue because of the high American presence here. In the OECD, to which Mr. Barnes belongs, the BEPS project is another thing that can be a factor and all these things are evolving. They have, to some extent, led to the increase in our corporation tax but they may also lead to a reduction in the tax in the future. Whenever there are big, unexpected increases that cannot be fully explained, one certainly should not base long-term expenditure decisions on the notion that one will have that revenue forever. We are a little dubious about all this tax revenue remaining with us in the long term, particularly the last half billion euro that arrived yesterday. We would need to know if it is a one-off and where it comes from. Mr. Coffey has a theory that it is associated with the June ones but if it was, surely the Department would have added it in on budget day as something it was expecting to get. However, it did not do that. We need to be very wary of this and I expect that to be the main stance of the Irish Fiscal Advisory Council.

Mr. Eddie Casey: A few years ago, we did a paper on whether we could forecast corporation tax better than the Department was doing at the time. We looked at almost ten different models and found that none of them was any good as it is a really unpredictable revenue source and the most volatile of the main tax heads, with the largest forecast mistakes year in, year out. It is also really concentrated so when an individual firm has a patent which runs out, or there is some other shock to profitability, it can lead to big changes in corporation tax receipts in a given year. As Mr. Tutty said, the international tax environment can also change and these are things that are beyond our control. The key is not to build up a reliance on this one tax head by spending it in a long-lasting way.

Deputy Pearse Doherty: Mr. Coffey spoke about the advice of the Irish Fiscal Advisory Council being taken. The council has beaten the drum about medium-term projections since I can remember its reports coming out but there is stronger language in this instance. It states that the plans are not credible and it has highlighted all the different figures which it thinks are dubious. Nevertheless, it is engaging with the Department of Finance, as well as this committee. If the figures are based on an expenditure increase of 1.2%, taking into account inflation and demographics etc, they are not credible as we all know this is not going to occur. Why, then, is the Department ignoring the council's advice? Why are we still getting projections for medium-term budgets that are the bare minimum? Everybody knows it is not going to be the case. Nobody believes social welfare is not going to increase for five years, or that there will not be an extra penny put into health above demographics and inflation, so why is the Department not responding?

Mr. Sebastian Barnes: There are long-standing issues and we have been discussing them in this room, or the one next door, for many years. Things have actually got better and in the past couple of years, the Department had moved to doing medium-term forecasts that were consistent with the Government's stated policy. Last year, it also produced the alternative presentation, which was an alternative table which broke the figures down across departmental areas. We welcomed both those things because they represented a step forward. However, this time around the Department went backwards on both of them. It moved back to the technical assumptions that do not really mean anything while, in the alternative presentation, which gave a very helpful breakdown by Department and which might have helped in the case of health, for example, it put in very low numbers and had a big unallocated amount. This is one of the reasons we used very strong language. Not only is this the wrong way of going about it, which is widely accepted, but it is a slip backwards.

Part of the reason it has happened is that the commitments for the medium term have weakened as well. Forecasting for the medium term is not actually that difficult and, like all forecasts, there will be mistakes but forecasting spending based on demographics is one of the easiest bits of the forecasting we do on the council. The really difficult bit is forecasting policy and in recent years the stated policy was to outperform the EU fiscal rules. The plan is to spend more or less what the expenditure benchmark would suggest, which is only a guide. That allows the Department to do the rest of the work, which was to come up with the forecast that was consistent with that. Unfortunately, there is no reference to that commitment any more. There is no reference to the debt-to-GDP ratio commitment and, by weakening the medium-term fiscal commitments by having less of an anchor and just having a policy to run surpluses and do the right thing, there is nothing which can be translated into forecasts. It is not really a technical forecasting problem but a political commitment problem.

In the letters from the Minister responding to our report, he often says this cannot be done because of parliamentary terms and such things. However, in the past, projections have been made that go beyond the life of a parliament. We understand that if there is an election and a new Government, the plans might change but to us there seems to be no logical reason why a Government cannot, at least for the medium term, set out the continuity of what it is doing as a baseline for others to work on.

Mr. Seamus Coffey: There have been changes in how these forecasts are made. During the crisis in 2010 and 2011, when the intention was to run the 3% GDP deficit target in 2014 and 2015, the projections were that it would be achieved but it was not clear what policies would be introduced to meet it. Realistic projections were set on the basis of expectations of policy to meet the 3% deficit target by 2015. Once that was achieved, there was a move to flat nominal forecasts but there was no change in anything. In recent years, there has been a change to demographics and to some of the precommitments that were being built in but, again, the forecasts were not realistic as to the likely policy. The forecasts were probably done on a realistic basis during the crisis, to signal that Ireland could deliver the 3% deficit target by 2015, but it was done on a completely unrealistic basis for a few years. There has been some improvement recently but we definitely feel more can be achieved. The overall fiscal figures set out for 2021, 2022 and 2023 are not what is going to happen. These are numbers that we have to assess. It would be better if it was done on a more realistic basis. I take the point about some of the political issues but a move to medium-term budgeting will happen and an improvement will come in this forecasting. We should be ahead of that, not waiting for it to be forced on us.

Deputy Pearse Doherty: While there are many things I could talk about since there was so much in the report, I want to return to the health issue. The committee will be involved in a number of meetings which look at health and, flowing from the report, the health expenditure. We need to start getting this right. The council has made a number of suggestions in the report. One which I was not aware of was the Connors report, with regard to what is set out in legislation about job increases and the number of staff. That is the main driver for the yearly increases in health expenditure. I was not aware that these reports were being submitted in October and November, which makes a farce of it all. They are technically within the law. I must look back at the legislation but it is helpful to have that footnote. We can pursue that as a committee.

The council has called for more adequate data to be made available and that the Government should develop and publish more data on health expenditure than are currently provided, including monthly in-year forecasts of the expected annual outturn for health expenditure. How challenging would that be? How difficult is that? Will the Government tell us it cannot do this? We know the challenges it has. We did not know what the overrun was until days before the budget. It is trying to forecast as well as it can. If it cannot do that up until a budget where it really needs to do it, otherwise it does not get the money, how difficult would it be to do what has been called for by the Irish Fiscal Advisory Council? Are there any other measures outside of the issues of staff recruitment and the monthly in-year forecast that the Irish Fiscal Advisory Council would suggest so that we can improve our forecasting and monitoring of health expenditure? We call these overruns for the HSE but I believe it is underprovision. The HSE tells us that it thanks us for the budget but cannot deliver the services. It is not like other services because we are dealing with HSE managers who have just knocked off all home care packages. Only palliative care patients now get it. Somebody was discharged from hospital last week but the home care package is not there because of the overrun.

It is an underprovision and an unrealistic budget. We can monitor how the Department of Health is spending the money that it has but is there not a step which needs to be before that? The confidence and supply letter between Fianna Fáil and Fine Gael said they will not allow for unrealistic budgets and they are supposed to be independently assessed. Every budget in the last three years has had an unrealistic overspend. What is the council's advice? Is there anything further? How difficult would it be to do monthly in-year forecasts? What would the council say about making sure that the budget provided to the agency which has to deliver the service is realistic? If it is not realistic in the first place, the council is only monitoring that it is overrunning again.

Mr. Seamus Coffey: We will address the requirements shortly. There are two necessary changes, as Mr. Tutty suggested earlier. We do not have a view on which side it should happen on. It is perhaps a case that both should change. Credible expenditure Estimates need to be set out. Once those Estimates and scenes are set out and adhered to, either one or both must change, but we do not have a view on which it is. It seems likely that both need to improve and what we have seen over recent years is what we consider to be a soft budget constraint. The budget is considered to lack credibility, which reduces the incentive of those who operate within that budget to stay within it, because I think it will be revised. Improvement could be made on both sides, to the credibility of the Estimate as set out and the adherence to it. I do not think we disagree on the fact that a number of things could change. It is not necessarily about reducing stocking spending but about improving budgetary practice.

Mr. Eddie Casey: The Deputy asked how difficult it would be. There is no doubt that it will be difficult. A good way to think of this is that the first step one needs to take in getting a handle on health expenditure is understanding what is happening. A good way to do that, which we have learned on the fiscal council from endorsing macroforecasts, is trying to forecast what expenditure will be. Through doing that, one puts in place a framework and system for understanding exactly what expenditure will be today and, eventually, tomorrow, looking into the medium term. Forecasting monthly will allow them to understand what is reasonable to expect and what is happening right now. Another way to understand what is happening right now is to move to a better accounting system in the sector. Right now in health, it is hard to get a clear sense of how much is being spent on all healthcare. We do not have a monthly, consolidated, general government and audited set of accounts for health spending. With regard to realistic forecasts, as Mr. Barnes said earlier, two basics need to be considered, which is what the demographic pressures are and what price pressures one will face. Those are important in health where price pressures tend to push drug prices and wage prices higher. If one gets those things on a realistic footing, since it is not that hard as a starting point to get them reasonably right, then one might have two arms improved.

Chairman: I thank the witnesses and Deputy Doherty. Before we conclude, speaking as a member of the committee more than as the Chairman, I have strong disagreements with some of the views the Irish Fiscal Advisory Council has on the budget. I think, as the Minister has indicated, that a solid, prudent approach has been taken on this and a number of budgets. I think various areas have been well-covered by members with their questions today. I am conscious of time so I am drawing this meeting to a conclusion. Rather than go into a number of areas, I will instead thank the witnesses-----

Deputy Pearse Doherty: Might I respond here? I think the Chairman's eyes say it all.

Chairman: I am conscious that it is 4 p.m. There are differences of opinions. Sometimes, one can see things as a glass half-full or a glass half-empty. There are many negatives which the witnesses pointed out in their previous statement. There are many positives in the budget too which is always worth mentioning. I thank the witnesses for their contributions. We will take on what they said. I know members and the committee will engage with the Minister about the points made.

The select committee adjourned at 4 p.m. until 4 p.m. on Tuesday, 11 December 2018.