

DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 25 Meitheamh 2019

Tuesday, 25 June 2019

The Select Committee met at 4 p.m.

Comhaltaí a bhí i láthair/Members present:

Richard Boyd Barrett,	
Declan Breathnach,	
Thomas P. Broughan,	
Barry Cowen,	
Pearse Doherty,	
John Lahart,	
Michael McGrath,	
Eamon Ryan.	

Teachta/Deputy Colm Brophy sa Chathaoir/in the Chair.

Business of Select Committee

Chairman: Apologies have been received for today's meeting from Deputy O'Brien and Deputy Chambers.

Today the committee will meet Colm McCarthy and Dr. Stephen Kinsella as part of our pre-budget hearings. Before we hold our public session we need to go into private session.

The select committee went into private session at 4.05 p.m. and resumed in public session at 5.15 p.m.

Budget 2020 and Macroeconomic Issues: Discussion

Chairman: I remind members to turn off their mobile phones.

I welcome Mr. Colm McCarthy, economist, University College Dublin, and Dr. Stephen Kinsella, associate professor of economics, University of Limerick. I thank them both for making themselves available for this meeting. We have been holding our pre-consultation budget hearings since April and these have included engagement with: the Parliamentary Budget Office, PBO; the Irish Fiscal Advisory Council, IFAC; the Economic and Social Research Institute, ESRI; and the Nevin Economic Research Institute, NERI. I have just realised that this list includes just about every collection of alphabet soup one could have. We are delighted to be joined by two nationally recognised economists in order to hear their perspectives on budget 2020.

Before we take opening statements, I will attend to some of the usual housekeeping duties with our statement on privilege. I advise those in attendance of the fact that by virtue of section 17(2)(I) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. However, if they are directed by the Chairman to cease giving evidence in relation to a particular matter and they continue to do so, they are entitled thereafter only to a qualified privilege in respect of their evidence. They are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that, where possible, they should not criticise nor make charges against any person or entity by name or in such a way as to make him, her identifiable. Members are reminded of the long-standing parliamentary practice members to the effect that they should not comment on, criticise or make charges against a person outside of the Houses, or an official either by name or in such a way as to make him or her identifiable.

I call on Mr. McCarthy to make his opening statement.

Mr. Colm McCarthy: Yesterday, I circulated some notes and I will now run through a few points very quickly. It is my view, and it is a view that I am sure committee members have heard from the entire alphabet soup referred to by the Chairman, that really we probably should have tightened budget policy a few years back as the recovery matured. We are now in a position where if things get troublesome we will not have as much latitude as we might have had.

Government spending can be financed by raising tax revenue, selling Government debt or, if a country has its own currency, it can get its central bank to buy government debt or just print currency. Since we abolished the currency in 1999, essentially we have been using an external

currency so we cannot create liquidity for the Government via the Central Bank. This is a constraint. The implication of this is if the Government ever does wish to run deficits, and there are perfectly good reasons it might from time to time, those deficits can only be financed through the sale of Government debt in the market.

We all remember that back in 2010, despite two years in which the Government did everything it could think of, as it raised taxes and cut current and capital spending, we failed to retain market access and ended up in an IMF troika programme, as committee members know. The trouble with leaving ourselves in this situation is we end up having an austerity programme that is not really of our choice and the timing of which is not of our choice.

This is year six of an expansion. The economy began to recover almost six years ago. The budget is balanced again, as the Minister for Finance pointed out in his statement earlier this afternoon. This is true, and it is tempting to argue that expenditure increases or even tax cuts can be afforded. The difficulty is there are various icebergs out there. There will be a public finance crisis at some stage over the next number of years; there always is. The reasons for expecting a slowdown include the end of the recovery phase, the difficult external environment and Brexit.

The point about recoveries is that they end. One can recover only once. We started off with a 16% unemployment rate and it has reduced to 4.5%. We cannot repeat this. We cannot use spare capacity in the economy more than once. There are already labour shortages in many sectors. More than 300,000 jobs were lost during the downturn and we had net outward migration and very high unemployment. A period of very rapid employment growth, as we have seen, eventually exhausts the excess labour supply.

We know about the external environment. There is the risk of a trade war. A slowdown in the USA, should it happen, and the recovery there is pretty mature also and the US economy is pretty close to full employment, would hit Ireland a bit harder than elsewhere. One of the reasons we have done well in recent years is because the US has been doing well. The US is a big export market for Ireland and it is also a big source of inward investment. This cuts both ways and if things slowdown in the US it will hurt us a little bit more than it would hurt others. The medium-term prospects in Europe are not very encouraging and, of course, Ireland is very exposed to Brexit.

I am now showing the committee a slide of the unplanned component in recent spending increases. It is from the recent report of the Fiscal Advisory Council. This is a particularly worrying feature of recent budgets. The economy was clearly recovering quickly three years ago. Arguably, we should have tried to move the fiscal position into a stronger place as long ago as 2016. One can see that there have been big spending increases in each of these years over and above what was voted by Dáil Éireann. These are the unplanned increases which had to be funded by Supplementary Estimates. The big worry, which was highlighted by IFAC, is corporation tax which is very volatile. Corporation tax could revenues could weaken for cyclical reasons or because there are changes in the international corporate tax regime. Along the way, steadier sources of tax revenue have been proposed and these have been sacrificed, particularly water charges. The residential property tax, which was introduced, has been kept at very low levels. These are, however, stable sources of tax revenue.

Another issue is that we tax cars on purchase quite heavily. We have VAT when one purchases a car but we also have vehicle registration tax. The number of new cars sold in Ireland fell by two thirds during the crash with several hundred million euro vanishing in purchase taxes on cars. There is an alternative where one can tax fuel or one can tax cars annually. We

do both of these things. When we were trying to remove the volatility from tax base, one of the proposals that was considered but was not implemented was to get rid of the big purchase tax on cars and push up fuel tax and the annual tax to make up for the lost revenue. That does not deliver any extra revenue, which will remain the same, but it will be less volatile. It is worth reminding ourselves of that as new car sales virtually disappeared from early 2008 until 2010. It was not as big a collapse as with stamp duty on commercial and residential property but it is a transactions tax.

There are other similar taxes. Inheritance tax is a kind of transaction tax as a lot of it is related to the realisation of property assets on death. Capital gains tax is a tax on the realisation of capital gains. There are good reasons for having taxes on capital and wealth but there are still quite a few taxes in the Irish tax code that are transactions-type taxes. We need to move away from them.

There is a risk in current policy. People who draw attention to the high level of outstanding sovereign debt and contrast that with the very low level of sovereign debt which did not save us. The last time we got into trouble the opening level of sovereign debt did not save us because we had borrowed so much so fast and the banks went bust. We ended up in an IMF programme anyway, even with a very favourable starting position relative to where we are now. The people who are saying that we should have been more cautious about budget policy in the last few years and should continue to be now are not saying that there are not occasionally reasons to run budget deficits, but on the other side of the coin is that one should be running budget surpluses when things are going really well and when one has full employment. The benefit of doing that is that one will avoid the imperative of unplanned and badly timed austerity down the road. That is the big risk. The last two Governors of the Central Bank, various people in the ESRI, the OECD, the IMF, and all sorts of people, have been pointing this out for the last few years, that because Ireland is now a heavily indebted country, and because these very low Government bond interest rates are not going to last forever, we are vulnerable if there is an international slowdown, and particularly if there is a resumption of trouble in the eurozone bond market. That is the case for being cautious about budget policy and for lamenting that we have not been cautious in the last few years. It is not because there is anything wrong with deficits. It is fine to have an active stabilisation policy but we need to ensure our balance sheet is in a position to sustain it and ours is not. We ought to have reassured the volunteer lenders, on whom we will have to rely unless we want to go into another IMF programme, that we have the budget in small surplus and will try to keep it there.

Dr. Stephen Kinsella: I am grateful for the invitation to speak. I have relatively similar points to make as Mr. McCarthy so I will not repeat what he said, with which I agree wholeheartedly. However, if two economists are in a room, there is not one opinion; there are probably three.

I wish to place where we are now in its international historical context and to discuss things this committee can push for in terms of the budget scrutiny process for the Government. Elva Bova and her IMF colleagues looked at the fiscal impact by crisis type for many different types of crisis, so crises of state-run enterprises, their percentage of GDP costs and subnational governments when they get into trouble. This is a data set from 1970 to today from across the world. Two things are very clear. The average cost of a crisis is about 3% of GDP across all different types. The financial crisis is the most expensive in terms of the fiscal cost - the actual cash cost - to the taxpayer. As Mr. McCarthy rightly said, this did not come because we printed a load of money. We did not get out of it that way; we got out of it by simply borrowing more.

The graph shows Ireland at 39% - the total cost of bailing out the banks and everything else. It is the fourth largest bailout of any kind anywhere in the world. That is the first and most important point to recognise. We tend to be relatively insular when it comes to our debate here. I want us to understand that this is the scale of the crisis we wish to avoid.

The same data are then ranked by time rather than by type. In 2008, the dot above Ireland is Iceland. I have done much work comparing the crises in Iceland and Ireland. One would imagine they would be relatively similar, but when one digs into the detail they are very different stories. Iceland in particular is a story of firms that built up too much debt, whereas Ireland is a story of households.

To echo Mr. McCarthy's point, I will look at the volatility of the various tax categories from 1984 to 2017. This comes from the Parliamentary Budget Office, one of the excellent new institutions that have been founded in recent years to increase the amount of economic analysis we can do. This compares the mean rate of growth which is on the vertical axis with volatility. Treating the tax category like a financial asset and comparing its rate of return with its risk - volatility is a way of measuring risk - we see capital taxes are up at the top. Corporation tax and stamp duty are also way out there, but excise duty, income tax, customs duty and VAT are at the bottom. The most predictable, most stable and least volatile categories are down in the bottom left hand corner.

The problem everyone has highlighted is that corporation tax is highly volatile. The problem is that it has been volatile upwards; it has been continually growing. Based on figures from the Department of Finance 2010 to 2013, inclusive, as the rate of tax revenue has come in, the rate of expenditure has levelled up to match it. The concern everyone has is that there will be a shock to corporation tax, but everyone is talking about a negative shock. I think an almost greater risk is with a further increase in corporation tax in the future. We tend to think in terms of negative or downside risks, but there are also upside risks. If the rate of increase in corporation tax yield continues for the next two, three or four years, Ireland could be in the position we were in 2005, two years ahead of stamp duty receipts reaching an all-time high in 2007. Let us imagine we were there in terms of our corporation tax yield and we were facing into another two years of it growing. With that unsustainable growth, the level of expenditure growth would increase and then the bottom might drop out of it. That is the concern I would have.

The next slide shows our sources of tax revenue over a 30-year time period. Every time we have faced a period of crisis, income tax is used to flex and make the economy work. Successive governments as they have come into periods of growth have weakened the income tax lever and revenue has magically appeared from other areas, for example, stamp duty and then obviously nowadays corporation tax.

The next slide on the uses of revenue shows we essentially spend our money on paying people and current tax transfers. Despite all the noise about the national development plan and everything else, it is essentially a payments system. While that is a pity, it means by definition decreasing Government expenditure automatically hammers transfers, resulting in increasing inequality.

I really like the next chart and not just because it took me ages to make it, but because it puts Ireland in our international perspective. Ireland is shown in the middle. It shows we spend a fair amount of our money on social protection. I stress that there are categorisation issues, as the OECD always has such issues. Ireland spends 32.7% on social protection, a fair amount on health and then there is everything else. We are a traditional northern European state in this

sense. However, we do not spend as much on social protection as other states. When we come to talk shortly about automatic stabilisers, I would like members to keep this in mind. We do not spend as much on lower-income households as other wealthy states.

What can this committee do? Essentially this committee exists to increase the amount of budget scrutiny. The Minister for Finance should never stand up and say something where the rest of the Cabinet say, “What? Is that really so?” We should not have that as an outcome. We want a far more stable budgetary process.

In the 1960s Richard Musgrave came up with a framework stating that the public finances should do three things: stabilise the macroeconomy; have an efficient resource allocation; and redistribute resources. The previous slide showed how we redistribute our State’s resources relative to the rest of our economy. It is difficult to compute the efficiency of the resource allocation element. We know there will be a macroeconomic stabilisation element to what we have to do in the coming period. We know this will be a problem - Brexit or otherwise. The summer economic statement, which was published a couple of hours ago, makes considerable mention of this.

The next slide has a blue box showing where we are in the budget cycle. We are at the budget preparation stage. However, I would like to see this committee sponsor far more analysis around the budget cycle. This is a really important point. The level of economic analysis we can do now is far greater than in 2005 or 2006 as highlighted in the Wright report. However, we still have not filled out the institutional architecture that countries like the Netherlands and the United States have. We still do not have, for example, dynamic scoring. It is not possible for a political party to propose introducing a wealth tax and be able to know how much it will cost; these things are not done yet.

In particular we do not have a study that shows if corporation tax yield drops by 5% how much it would cost and where will we get the money to fund overruns in education and health. We cannot do fiscal stress tests. I really believe that this committee should sponsor fiscal stress tests. It would also be useful to sponsor the development of policies around automatic stabilisers. By this I mean that we need to get away from this discussion, that is, talking about the €2.8 billion that is left after we pay for everything or talking about the budgetary envelope around the fiscal space. We need to get away from debate centred on the extra increment. We should be debating the larger issues of the day. This can be done by establishing an institutional architecture that is largely independent of the budget cycle, in other words, the particular process with which the Executive deals. We should find a way to integrate the climate advisory group, the fiscal advisory group, and the national risk assessment. It would be excellent if the knowledge from all three, which talk about aspects of the same function, could be brought together under this committee and if this committee could sponsor that work. It would be excellent because they are, in a way, the same thing. With a bit of extra costing, the development of budgetary strategy into the future could be informed.

Figure 7 presents the picture based on the Irish Fiscal Advisory Council’s excellent report. It refers to GDP by volume which, if one looks at the vertical axis, ranges between 120 and 140, with 2015 constituting the base value of 100. The range of outcomes is extremely broad. Communicating that level of uncertainty to the public is the job of this committee and of Members of the Oireachtas. As somebody who, as members might imagine, talks to people about the economy a fair bit, I am not convinced that people really understand the likely downsides of this for them. I firmly believe that people are still waiting for that understanding. Saying that it is going to be bad or that it might be bad is not precise enough for most people. I will stop there.

I thank the committee very much.

Chairman: I thank both witnesses for their very interesting opening remarks and presentations. I will open up the discussion.

Deputy John Lahart: I thank both our witnesses. We use the term “witnesses” for some strange reason. I thank them for their service over the years, particularly Mr. McCarthy who has done the State some service over decades. I will start with an observation or two on what Dr. Kinsella said. In some of the work we have done over recent months, the committee has picked away at the common themes that have been coming up over the past two years. These include our exposure to corporation tax receipts, doing something about the carbon tax in last year’s budget and equalising duty on petrol and duty. That is what I like about this committee. It is important for us to try to be objective, although we have political differences. The politics comes in when we go back to our parties.

Dr. Kinsella is right that there have been missed opportunities with regard to stable sources of revenues. The local property tax is one example, as he indicated. Objectively, these issues have been fudged. We have asked how one can tell that the corporation tax take will decrease. The most recent group we asked was IFAC but we have also asked the IMF in informal discussions. The answer is that, given enough time, it cannot do anything but drop. That response is just not scientific enough, although we all believe it is going to happen. The IMF was the only group to gesture to any kind of modelling having been done in this regard. I take Dr. Kinsella’s point and, if we have time, we should try to model the consequences of a 5% drop in corporation tax receipts and to ask how we will fund ourselves in the absence of that money.

We are getting a slightly better picture of why corporation tax receipts have ballooned in the past two years. Do the witnesses have any insight into the scenario beyond 2020, excluding aspects that are obvious to laypersons like me, for example, American pressure on corporation tax policy? Can they offer us any insight we have not been offered before with regard to the likely longevity of the current level of receipts? The revenue in this regard dropped last month. We are told that May is the biggest month and June the next biggest, so we will be watching out for the June statistics. Is there anything the witnesses feel needs to be said to this committee about corporation tax which has not been said?

Mr. Colm McCarthy: Dr. Kinsella was careful to avoid predicting what is going to happen to corporation tax revenue. This is the big point Seamus Coffey and his colleagues were making. These receipts are inherently very volatile. In the 1990s we decided to have a low rate of corporation tax. We used to have a 40% rate for services companies and a 10% rate for manufacturing companies. That had to go and it was decided to do two things simultaneously. One was to have a low rate for everybody. The rate chosen was 12.5%. The second thing decided at that time, which people have forgotten, was to close many of the loopholes. There used to be a magnificent stunt one could avail of under section 84 of the Finance Act. Under this the banks, and many others, did not pay the 40% rate. We had a pretend rate of 40%, which many did not pay. The decision taken in the 1990s was to introduce a low rate of corporation tax with the snag that it must actually be paid. Many European countries pretend to have high rates of corporation tax but, if one looks at the data, they do not collect as much as one would expect given their high nominal rates. There is a lot of hypocrisy about corporation tax internationally.

In the period since the rate was introduced, for reasons on which I am not an expert, with the benefit of lots of lawyers and tax accountants, corporations have found endless ways to not pay even the 12.5%. They have also managed to route profit through Ireland, much of which really

belongs to the US Department of the Treasury. There are weaknesses in the US tax code and, using international tax treaties, quick detours through the Dutch tax system, and so on, these outfits have been able to route a lot of taxable profits through Ireland, paying us some money while avoiding paying somebody else even more. This was not the intention of the corporation tax reforms introduced in the early 1990s. It is not what we set out to do but it is what has eventually happened.

To answer Deputy Lahart's question, these receipts are just very volatile. Mr. Coffey and his colleagues have said that a portion of the bonus unexpected receipts in recent years should not have been put into the State budget at all. We should have said "thanks very much" and used the money to reduce indebtedness. I agree with Dr. Kinsella that in the longer term we should seek to not be so dependant on this volatile type of revenue. The way to reduce dependence on it is to do precisely as has been suggested, that is, to use the unexpected corporation tax revenue to pay down debt.

On the other point about volatility, staff in the Parliamentary Budget Office have written some very interesting papers about volatility in tax revenue. Dr. Kinsella mentioned one of them. They have looked at a seven-way breakdown of tax heads, such as VAT, excise duty, and income tax, and at the volatility in each one. They could be broken down a bit further. There are a few volatile tax heads lurking inside some of these aggregates about which something could be done. I mentioned VRT. This could be substituted with fuel taxes and so on.

My final, very quick, point is that if the Government succeeds in getting everybody to drive electric cars - the Minister, Deputy Bruton, announced last Monday that we will all be driving electric cars in ten years' time - it will be a disaster for the Exchequer because electricity cannot be dyed green in the same way as diesel. The fuel tax component of tax revenues will become problematic if cars are powered by electricity. As I understand it, there is nothing technical that can be done about that. We are also now providing huge subsidies. We can afford to subsidise electric cars with benefit-in-kind relief and so on as long as nobody takes up the offer. If people start saying that is a great idea and everybody races off and buys electric cars, those subsidies will have to be withdrawn. We will have to dream up a new way of taxing road transport. I am not against significant taxes on road transport at all but the way we do it will have to be reviewed. The tax strategy group mentioned this in its mid-year report last year. We may have to look at congestion charges, more modern methods of tolling and so on because we may end up without a big slice of the fuel tax.

Dr. Stephen Kinsella: I will pick up on two points. The great value of this committee is that it is strategic. It is able to think beyond the day to day and if I was going to advise it to do anything, it would be to be cognisant of three issues. The first is that these fiscal stress tests matter. For example, if half the country wakes up tomorrow and decides not to pay their property tax, it will have no impact on the budgetary surplus of the State because it amounts to less than €1 billion. If half of the corporations wake up tomorrow and decide not to pay corporation tax, we will not be able to afford to run the health system. It matters which taxes do not get paid and where the volatility is. Fiscal stress tests should be part of what this committee reports on. They are not difficult to do and the Parliamentary Budget Office, PBO, can do them. The committee has had the International Monetary Fund, IMF, before it. The IMF has developed methodology that is not difficult and that can be done with an Excel spreadsheet.

Second, it is important that we understand that corporation tax the one that is volatile now. Via the base erosion and profit sharing, BEPS, process, it looks like we will have a co-ordinated tax system in five years where we are forced to have our corporation tax go up from 12.5% to,

let us say, 17% and that is true of everyone. We may end up flush with corporation tax revenue which is an upside risk. We still should not spend that massively because we do not understand the tax elasticity. We do not understand the responsiveness. If corporation tax that a small number of corporations pay is jacked up, we do not understand the impact that will have on their behaviours. We are going to be an interesting experimental case study for that but only to those studying us in the future. It is going to suck to do it in the present and politics is, of course, of the present.

The final issue relates to automatic stabilisers. The economic statement is two budgets. One is business as usual and the other means we allow automatic stabilisers do the job and go into deficit, which is grand except that Ireland has a poorly developed set of automatic stabilisers. We have unemployment assistance and jobseeker's allowance and so forth, as the committee will be aware. We do not have the kinds of stabilisers that kick in when unemployment reaches 7%, 8%, or 9%. We do not have, and have not designed, such policies. We all now know that it takes nine to 12 months to design one of these policies properly. If they are not ready to go before the crisis happens, it will take nine to 12 months to introduce them. This is a fundamental issue. These policies cannot be done right away. The committee knows better than anyone that the system takes a long time to do things even in a crisis. I urge the committee to think carefully about the sorts of automatic stabilisers that are out there. There is much new thinking about this topic. One particular stabiliser is an automatic offset for the motor tax. If it turns out that two thirds of new cars are electric vehicles, there is an automatic offset so the State's finances do not automatically get walloped in one way. During the crisis is absolutely the wrong time to develop these policies; now is the time to develop those policies before the economy starts overheating.

Deputy John Lahart: I have a brief second question.

Chairman: I am conscious that the summer economic statement kicks in at 6.05 p.m. and I appreciate that members must be in the Chamber to hear it. Deputy Lahart is always brief but I ask our guests to bear that in mind when replying.

Deputy John Lahart: Brexit has been characterised by chaos over the past two years. One does not need to be particularly bright to suggest that there is no reason that ought to change. It looks as if it will continue to be characterised by chaos. Dr. Kinsella mentioned the Government's twin budget approach. To a layman, it looks as if there is only one option to be taken. Brexit will be chaotic into the future and it seems as if it will be disorderly at best now for a period. Can our guests give us any insight into the impact that has had on the economy in respect of withdrawn or suspended investment? What would they do if they were advising the Government about the budget in October in the context of Brexit?

Mr. Colm McCarthy: I thought late last year that the economy might have begun to show a little weakness by now because of the maturity of the recovery. This is year six of recovery. The most recent unemployment rate was 4.4%, which is not far off the all-time lowest rate. I thought there might be a bit of a slowdown but recent figures do not show that. The economy seems to be trundling along just fine.

The UK economy has weakened. In particular, there has been a weakness in business capital formation in the UK which is a vital number for the long haul. That is probably due to uncertainty about Brexit. It was not very strong to begin with and it has weakened since the referendum.

I do not have a clue what form Brexit will take. I do not think anybody in British politics has a clue either so I guess I can be excused. I do not know what the impact on Ireland will be. I fear that the impact, even if it is a soft Brexit, will be negative. It is difficult to see any Brexit outcome that will not leave scars on the Irish economy and, of course, on the British economy.

There should be no giveaways at all in the budget in October. There should be no tax cuts or generous expenditure allocations to anybody, no sweets or gifts for everybody in the audience as happened in the past three budgets. If that is done, there will be some extra latitude to deal with the fallout of Brexit, which is unknowable at this stage.

Dr. Stephen Kinsella: The impact is being felt. I work at the University of Limerick and we are successful at getting in European research and development money through Horizon 2020 and its successor Horizon Europe. We have colleagues with whom we work in Oxford, Cambridge and the University of Warwick. These are very fine, world class academics, none of whom is part of the projects that we are putting in right now for 2020 and 2021. That is a good, simple, concrete example that tens of millions of euros that would go to the UK economy that simply is not going. Even if the UK turned around and said there will be no Brexit at all, that money still will not go to there. That is a permanent decrease in the UK's GDP. It is a small but perfect example of what I mean.

If I was advising the Minister for Finance, I would be far more specific about the nature of sectoral bailouts. In the event of even a soft Brexit, as Mr. McCarthy said, there are agrifood producers who will be walloped. I would love for there to be comfort for people in those businesses and sectors that they will be looked after and will be okay. There is one line in the summer economic statement that says the Government will have a look at bailing some people out. I want far more detail on that and I would disclose more on that. I presume that the good officials in the Department of Finance have those sectoral bailout plans built and ready to go and I am sure committee members are privy to them but, if they do not, I would apply shoe leather to areas of their bodies to ensure they get designed. These plans, again, cannot be done in five minutes. It takes time to develop them properly.

Deputy Richard Boyd Barrett: I thank Mr. McCarthy and Dr. Kinsella for their interesting contributions. Notwithstanding the dangers and threats they have outlined, do they believe there are certain problems that must be addressed and that they will cost money? If the Government works within the discretionary fiscal space it is talking about, the amount available is not enough to deal with those problems. I do not need to list them as we know what they are. They are issues in the areas of housing, childcare, primary care, water infrastructure, public transport and I can go down through the list. There are many demands or urgent necessities in which we must invest, yet we have only a small fiscal space available. The witnesses seem to be pointing in that direction, namely, that we must find extra sources of revenue.

Chairman: I do not usually do this but, from the point of view of fairness, before the witnesses reply I would ask the Deputy to ask all his questions and then I will bring in Deputy Pearse Doherty to ensure they can both pose all their questions, as I am conscious of the time factor. I am sure both Deputies will want to be in the Chamber to hear the Minister. Is that correct?

Deputy Richard Boyd Barrett: Yes, that is fine.

Chairman: Has the Deputy any further questions before I call Deputy Doherty?

Deputy Richard Boyd Barrett: The witnesses referred to stable sources of revenue. That was the basis of my first question. I take their point about volatile corporation tax heads and so on. Could they give examples of the more stable sources of revenue? The ones to which I would point include employers' PRSI, which is very low.

Mr. Colm McCarthy: Water charges.

Deputy Richard Boyd Barrett: We will agree to disagree on that one. What would Mr. McCarthy say about financial transactions taxes and wealth taxes? He pointed to this when referencing the opening up of loopholes. Our committee has started to examine this. Generally, a great deal of discussion focuses on what will be spent in current and capital expenditure but much less attention is given to tax reliefs, credits and allowances. We are starting to examine those and there is major scope in that regard. We should be as forensically focused on those tax reliefs and allowances as we are on budgetary expenditures, on which there is a great deal of focus.

Chairman: I note from the television monitor that Dáil is dealing with the third Topical Issue matter so we have more flexibility timewise.

Deputy Richard Boyd Barrett: In that case can I ask one further question?

Chairman: Yes.

Deputy Richard Boyd Barrett: Given the likely impact of Brexit being somewhat negative or the possibilities of the downside risks that threaten us, the Government must respond by radically diversifying our economy away from being over-dependent on a few sectors. That is our best medium to long-term insulation against some of these vulnerabilities we have. Dr. Kinsella mentioned the agrifood sector and said we should design supports. There is a good case for that but, on the other hand, one might argue in the context of climate change that we need to scale down parts the agrifood sector and rather than bailing those sectors out, we should think about how we can get a just transition for the people working in those sectors into more sustainable, diverse forms of agriculture.

Chairman: I will ask Mr. McCarthy to answer the Deputy's questions now as we have more time than I thought.

Mr. Colm McCarthy: The Deputy raised three points. In the context of fiscal space, there is some according to the Minister's statement earlier. It is important to remember that there is a real resource constraint in the economy. If the Government did not have a large amount of debt and if we had a strong balance sheet and we could readily and safely borrow a heap of money, it must be realised that we do not have a heap of real resources to reallocate with that money. To put it another way, if a few thousand guys are going to head off up the mountains of Ireland with trenching machines in order to install broadband, they will not be available to build houses. The idea of financial balance for the Government is the mirror of the balance in real resources for the economy. Even if we there was not a financial constraint, we could not summon non-existent resources out of thin air. It is important to bear that in mind. The ESRI hinted at that in some of its recent reports. If we want to spend more money on, for example, the provision of care services, we must increase taxes and tell people to stop buying ice cream because some of the folks who make the ice cream will have to go and work for the social services. There is a real resource constraint that is mirrored by the financial balance requirement to which the Government must adhere. That would not be the case if we had piles of underemployed resources and

a capacity to borrow. If, however, IFAC is right and we are running out of underemployed resources, we must make choices. The choices may well relate to the fact that we want to spend more on various items of the type the Deputy mentioned, but this means that we must increase taxes and hit consumers in their pockets in order that they will stop buying ice cream or whatever else it is they currently do. We must always bear that in mind.

The Deputy asked about more reliable sources of tax revenue. There are many possibilities and I mentioned some of them. We still have a fairly low level of residential property tax. At last we have a residential property tax. Residential rates were abolished in 1978 and we have finally got them back but they are at a fairly low level. Most people in the United States pay a few thousand dollars a year in local state and municipal property taxes. People in most parts of Europe also pay them. They also pay for water. There are certainly those possibilities.

The Deputy mentioned doing away with tax loopholes. There are tax loopholes but we would want to be careful about some of them. If, as Dr. Kinsella stated, we compare our overall spending on social transfers with the remainder of western European countries, we discover that it is higher than some and lower than others. However, some of those countries have state run pay-related pension schemes. In Germany, people pay a slice of their income into it but they pay pay-related pensions. In Ireland, that is done privately so the money is not in the Government's accounts. It could be put into the Government's accounts, but we do not do that. There is a comparability issue in this regard. We offer certain tax breaks for people who make private pension provision. If we did not, the State would be doing it. We must always bear that in mind.

The Deputy asked about wealth taxes. We could have a wealth tax. Every country in the world that has introduced a wealth tax, France being the most notable example, has ended up not collecting much money from it. Ireland has a partial gross wealth tax which is called property tax. There is huge resistance to it, including, bizarrely, on the political left which it is a source of great merriment to many people. There could be a higher property tax, or wealth taxes of various kinds.

Chairman: Does Dr. Kinsella wish to make a brief comment?

Dr. Stephen Kinsella: One could just do a site value tax. It would be hugely unpopular and it would stop any asset bubble developing in property. It would also generate a huge amount of money.

On a financial transaction tax, I thought it a poor choice when it first came up on my radar. I have since become very aware of the scale of the shadow banking system in Ireland which is absolutely phenomenal. It is on a scale comparable to very few other economies. The gross flows in and out of this economy are comparable to much larger economies. We facilitate the transfer of money in and out of different types of investment fund. This generates very few jobs and the social benefit to us is really low. Therefore my thinking on a financial transaction tax has changed substantially. I think it would be a good thing and view it the same way as I would regard a pollution tax, in that it should be done to discourage a certain type of behaviour. The scale of this sector is eight to 11 times the size of the Irish economy, it is absolutely massive. I would welcome the introduction of such a tax but it would have the down side of being extremely volatile.

I agree with the Deputy that we do need to diversify the economy and scale back, however one never wants to be in the situation where one is scaling back in the middle of crisis. If a

State wants to do it, it must be done in a strategic way with policies, it should not be done as part of a crisis. Strategically, the right way to think about it is what form local taxes and site value taxes should take. Do both of those things increase the democratic control felt by the average citizen? They fund local services but most importantly they discourage bubble-type behaviour. These are all positives.

Deputy Pearse Doherty: I am sure many viewers, if anyone is watching, are getting chills down their spine when they see Colm McCarthy before an Oireachtas committee. They might be asking are we heading for bust again. Mr. McCarthy's presentation today is about avoiding unplanned austerity. It is timely given our current position in the cycle. I welcome his presentation and that of Dr. Kinsella.

My time is brief, and it is a pity we do not have longer, but we have to discuss the summer economic statement. I will begin on that topic. We can only work with the statistics provided. If I look at the summer economic statement, and I am sure that the witnesses have glanced through it, table 3 gives budgetary projections for 2018 to 2024 which set out the key fiscal metrics consistent with SPU 2019. These projections represent the basis for the summer economic statement. However, the Irish Fiscal Advisory Council, IFAC, says:

The expenditure forecasts are not credible: they are based on technical assumptions which do not reflect either likely future policies or the future cost of meeting existing commitments. The technical assumptions used imply an implausible slowdown in expenditure growth, overstating the likely budget balance.

This is extremely frustrating. We have a document here that is fantasy. We look at expenditure, budget surplus and so on and we are having a debate, which Dr. Kinsella says is the wrong kind of debate, about the €700 million which the ESRI says is not there and IFAC says is fantasy. The Government tells us that these voices are being listened to but it is nonsense. What is the witnesses' view on this? It is the basis from which we need to build up and consider policy choices and options to see where the threats and risks really are.

Mr. Colm McCarthy: The IFAC report is comprehensive. Once upon a time, before we had a fiscal council, the role of grumbling about budget policy was that of the Governor of the Central Bank. Successive incumbents did that to no great effect. I am really pleased that we have a distinct State agency to grumble about fiscal policy and that the Central Bank is left to supervise the banking system, something in respect of which, as the Deputy might recall, it did not do a very good job. It is displacement activity for central banks to whinge at finance ministries about budget policy. We now have a better allocation of functions.

The IFAC report is technically a terrific piece of work. I read this kind of stuff for a hobby and it is one of the best documents that has been produced by the Irish public service for a long time. I am sure Dr. Kinsella would agree. It did make the comment quoted by Deputy Pearse Doherty that the fiscal projections were not credible. Since then, we have learned that an overshoot is coming in health this year, a matter about which IFAC did not know of when it compiled that part of the report. It also pointed out that Christmas is going to happen this year and that there is a so-called Christmas bonus in some of the social transfer payments which is not provided for even though it is the intention of all that it be paid. Some things are unpredictable, but Christmas is not one of them. It is unfortunate that the figures in the strategic programme update had to be described by IFAC as not credible.

Dr. Stephen Kinsella: I echo Mr. McCarthy's comments on the value of having indepen-

dent agencies that produce analytical work to this level of quality. It is a highly valuable thing. The report cannot be dismissed as mere grumbling, because it is IFAC's function to sound these alarms. I would like to see a formal reply from the Department of Finance setting out why it believes its assumptions to be credible. I have not seen this to date. Having gone through the report very carefully, IFAC's arguments look valid but we have not seen a reply from the Department of Finance, or at least I have not read one, to say why the council is wrong. That is a very important point.

The notion of a fiscal space is mandated by the European semesterisation process. However, having experienced it for five years, I am of the view that it is nonsense. Suddenly, when needed, €1 billion gets found down the back of the couch. It is not an actual constraint on our behaviour, as a polity, and that is not a good thing. If we are to compute these things and talk about them seriously, the first thing that we must do is assess the level of credibility of the budget envelope. One thing that I would seek from the Department of Finance in the future - I will discuss this at the national economic dialogue tomorrow - is this precise function. We need to debate our assumptions a little, particularly as we move into a very uncertain time. There will be a period in the future when even computing these things for a small open economy will not be that credible. Forget about whether the amount of money coming in matches the forecast, we must recognise that the forecasting methodology for a small open economy probably will not be right. We are being forced to treat the Irish economy the same as the German economy which is just nonsense. For those two reasons, I would like to see a much healthier dialogue between IFAC and the Department of Finance. Currently, it seems to be the case that the dog barks and it is ignored. I would like there to be some sort of conversation.

Deputy Pearse Doherty: The dog has been proven to be correct. IFAC also said that last year's projections were not credible - it has used stronger language in this case - and last year it was proven to be correct because there was a €1.2 billion increase in expenditure year on year. It is important to note that the Irish Fiscal Advisory Council believes more money will be spent than has been projected because the projection of €2.6 billion or €2.4 billion to 2021 is nearly half what was spent over the past two years and is simply not credible.

Dr. Stephen Kinsella: Yes.

Deputy Pearse Doherty: There is a lot of talk about overheating. We know the multiple causes of overheating which led to the last crisis, at the core of which was commercial rather than residential property. NAMA, which is a commercial property vehicle, is a manifestation of that. Commercial property is overheating and I am concerned that a bubble may be emerging in it. I wrote to the former Governor of the Central Bank more than a year ago on this issue. In fairness to Professor Lane, this week the Central Bank published important work which addresses some of the issues I raised. We gave examples of the leveraging of some funds and the sharp exit from the market, the impact it could have on commercial property and the possible knock-on effect on banks and the wider economy. What are the witnesses' assessments of commercial property? Given the pressures in terms of housing and construction workers, would the appropriate tool be to again increase stamp duty on commercial property to try to divert construction workers from commercial property into building social, affordable, cost rental and rental housing for the domestic market?

Mr. McCarthy pointed out that certain things cannot be done twice, such as unemployment rates and so on. One must focus on less low-hanging fruit and look at labour force participation rates. The summer economic statement indicates that the rates are dropping marginally, particularly in the case of women. Do we need to look at other levers, such as the cost of childcare,

and invest in them to support and increase labour force participation at a time when we will repeat some of the cycle previously experienced? Investment will be required in that regard.

On the health overspend, the Parliamentary Budget Office has indicated that there will again be a significant overrun in health this year. The Christmas bonus not being factored in is another obvious matter that should be considered. These figures are not credible. In addition, the spending that transpires over the year is completely different from the voted expenditure. How should we deal with that? If one budgets in an unreliable way and does not provide enough resources in the first place, it will be deemed an overrun and can also be deemed as under-provision in the first instance. We need to get that right.

Unfortunately, I do not have time to go into the detail of the important issue of how we look at the fiscal stabilisers and set ourselves up as a committee. I ask Dr. Kinsella to send us the names of individuals with whom he considers the committee ought to engage. It is an important point.

One of the ways in which our budgetary position has improved, apart from the fact that we are relying on corporation tax receipts that are at windfall level, is that the cost of debt has significantly decreased. This year, we will benefit in the amount of nearly €500 million from the fact that the cost of debt has decreased. It is not a factor of the domestic economy. Something could happen in Italy, for example, and very quickly cause things to spiral in regard to debt costs. What are the witnesses' views in that regard? The ECB has indicated that debt costs are likely to remain static and that we are in a golden position in terms of costs. How vulnerable are we in terms of a spike in costs as opposed to the magnitude of our debt? Obviously, Brexit is an issue that has been talked to death and we need to plan properly in that regard, but there is a serious vulnerability that may be outside our control in terms of an increase in the cost of debt. It will not remain at the current level in the medium to long term.

Mr. Colm McCarthy: To address the last question first, the National Treasury Management Agency, NTMA, has done a lot of reorganisation on the time profile of the national debt and it has a very good website that explains this. We have a very big inherited burden of Exchequer debt. It is true that the annual debt service cost that goes into the current accounts is several billion lower than we all thought it would be a few years ago. The Deputy referred to €500 million for this year. If one looks back at what people expected five years ago would be the debt service cost in the current year, the difference is €3 billion or €4 billion.

Dr. Stephen Kinsella: Some €3.5 billion.

Mr. Colm McCarthy: Something like that, yes. We have been very lucky. However, that happened in part because of the promissory note deal done with Mr. Mario Draghi, who managed to atone for some of the sins of his predecessor, Mr. Trichet, and took some of the debt service costs of the promissory notes off the Exchequer. In addition, as a result of the quantitative easing operated by the European Central Bank, the NTMA has been able to replace more expensive debt with cheaper debt and has managed to sell some longer-term bonds and manage the maturity structure quite well. It has done a good job.

Deputy Pearse Doherty: Yes.

Mr. Colm McCarthy: We now have a very big pile of debt. It is not very short term. There will be some rollovers in the next few years and they are not trivial, but it could have been far worse. The NTMA has managed to push some of it out further through borrowing money over

ten or 15 year terms at very low rates. Short-term interest rates in Europe may go the wrong way because of a screw-up in Italy. The upcoming election in Greece could threaten stability there. The real danger is not that our annual running interest bill will suddenly shoot up. It cannot do so because most of it is fixed. The real risk is that the market could go bananas, as it did in 2010, 2011 and, in particular, in 2012, when various countries could not borrow at all as the borrowing market froze. That is a bigger risk to us. The fixed coupons cannot be increased, but there is roll-over risk because we have significant rollovers in the coming years. Ireland was a Mediterranean country a few years ago. One did not notice the temperature changing. It has now been reclassified, perhaps somewhat undeservedly, as a northern European country, but our classification could very easily begin slipping southwards again if people start looking at the numbers. On the numbers, our ratio of debt to tax revenue is not as bad as that in Greece or Italy, but it is close. We have been labelled as the best boy in the class to a greater extent than we deserve. People will start focusing on those numbers again if things get messy.

Chairman: I am conscious that statements on the summer economic statement have commenced in the Dáil. Does Dr. Kinsella wish to quickly come back in?

Dr. Stephen Kinsella: On overheating, I have a significant worry regarding the commercial debt space because it is totally understudied and I do not know how big it is.

On the labour force participation rate, investment in childcare is quite helpful. Reform of the higher education system is also required. A friend of mine very much wants to go back to college, but cannot do so because I cannot tell her when her lectures will be and, as a result, she cannot organise childcare. The higher education system is not sufficiently flexible.

On the connection between voted and actual expenditure, the answer is programme budgeting. If expenditure was broken down by section such as radiology or oncology, rather than a load of money being allocated for the health system, one would be able to see which sections are performing and which are not. Programme budgeting has been around in the United States since the 1960s. It is the way forward and we should utilise it. I will send the committee a list of people it may wish to consider inviting to appear.

On the cost of debt, the debt is large, but it is far away. Unfortunately for us, the roll-over risk is quite great because we are very easily classified with other small open economies. That is something we need to manage.

If I were to pick one thing for the committee to take away, it would be the idea of sponsoring research into programme budgeting. We can do this; it is not rocket science. If we take that approach, we would know which parts of the health system work and which do not.

Deputy Pearse Doherty: That would be very helpful.

Chairman: I thank the delegates for their contributions. I am sorry that our time has been restricted. I thank them for attending.

The select committee adjourned at 6.25 p.m. until 1 p.m. on Tuesday, 2 July 2019.