DÁIL ÉIREANN

AN COISTE UM FHORMHAOIRSIÚ BUISÉID

SELECT COMMITTEE ON BUDGETARY OVERSIGHT

Dé Céadaoin, 11 Meán Fómhair 2019

Wednesday, 11 September 2019

The Select Committee met at 1.30 p.m.

Comhaltaí a bhí i láthair / Members present:

Maria Bailey,	
Richard Boyd Barrett,	
Declan Breathnach,	
Thomas P. Broughan,	
Joan Burton,	
Lisa Chambers,	
David Cullinane,*	
Martin Heydon,	
John Lahart,	
Michael McGrath,	
Eamon Ryan.	

* In éagmais / In the absence of Deputy Pearse Doherty.

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

Business of Select Committee

Chairman: Apologies have been received from Deputy Pearse Doherty. The committee will be holding two public sessions at approximately 3 p.m. In the first session we will meet with the Irish Tax Institute to continue our committee's scrutiny of tax expenditure, specifically research and development tax expenditure and the special assignee relief programme, SARP, tax relief. Our second session is scheduled for approximately 4 p.m., when the commitee will meet with representatives from the Irish Fiscal Advisory Council, IFAC, to consider its pre-budget report.

The select committee went into private session at 1.40 p.m. and resumed in public session at 3.05 p.m.

Scrutiny of Tax Expenditures (Resumed)

Chairman: We are now in public session. I remind members and witnesses to turn off their mobile telephones. I welcome the representatives from the Irish Tax Institute: Ms Anne Gunnell, director of tax policy, Ms Claire McGuinness, senior tax policy manager, and Ms Cathy Herbert, director of corporate affairs. I thank them for making themselves available to meet the committee. We are pleased to hear from the Irish Tax Institute as we continue the committee's work on the scrutiny of tax expenditures. This session will focus on a number of tax expenditures, including on research and development and on the special assignee relief programme, SARP, tax relief. We have also received the Irish Tax Institute's pre-budget submission. Its opening statement will cover some of that ground.

Before we begin I must outline the position with regard to privilege. I draw the attention of our guests to the fact that, by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to the committee. However, if they are directed by the committee to cease giving evidence on a particular matter and they continue to do so, they are entitled thereafter only to qualified privilege in respect of their evidence. They are directed that only evidence connected to the subject matter of these proceedings is to be given and asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person or entity either 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 Ms Gunnell to make her opening statement.

Ms Anne Gunnell: I thank the Chairman and members of the committee for giving us the opportunity to contribute to the committee's work on tax expenditures. As they said in their report, these measures are an important part of the tax system and the institute hopes their scrutiny of these reliefs will enhance their operation and evaluation.

In recent years, the Department of Finance has been putting existing tax expenditures out for public consultation. The institute welcomes this development and we have been enthusiastic participants. A recent consultation to which we contributed was a review of the special assignee relief programme, SARP, a tax measure on which the committee is currently focusing its attention.

SARP provides income tax relief to highly skilled executives who are assigned from overseas by multinational companies to work in their Irish-based operations. Introduced in 2012, it is due to end in 2020. The purpose of SARP is to attract talented, internationally mobile executives to support business expansion and job creation in Ireland. It has been a critical element of our foreign direct investment, FDI, offering over the past seven years and has operated very effectively in a range of sectors such as IT, financial services, pharmaceutical and medical, consumer and industrial products and services. The latest statistics show that almost 800 individuals are availing of the programme.

These are highly paid executives making a significant contribution to the Exchequer and to the economy. Other countries with similar assignee reliefs, such as the Netherlands, Luxembourg, Belgium and Spain, are actively competing for UK business that is expected to seek new locations within the EU following the departure of the UK. Post-Brexit, we can also expect the UK to sharpen its suite of incentives to enhance its capacity to retain and attract global investment.

Overarching all this, changes to the international tax framework have increased the focus on where multinationals locate their value-added activities and key decision makers in support of their substantive operations.

SARP has enabled multinationals to attract the necessary senior management personnel from parent locations like the US to help support and sustain substance and value creation in Ireland. SARP has helped generate profitability in the FDI sector following the implementation of base erosion and profit shifting, BEPS, reforms in Ireland and internationally.

We believe SARP should be retained and extended beyond 2020. We also believe consideration should be given to extending the relief to new hires. As members will know, an individual must have worked with the parent company for at least six months before arriving in Ireland to qualify under the current programme. This stipulation was introduced to prevent the risk of job displacement in the Irish labour market as SARP could have made it less costly for an employer to hire a foreign-based worker than an Irish worker.

However, Ireland is now almost at full employment and significant skill shortages in a number of sectors mean businesses have no option but to recruit from abroad for key specialised roles. To allay concerns about the impact on Irish jobs, new hires could be confined to sectors with acute skill shortages. These skills gaps could be identified with input from the Expert Group on Future Skills Needs. Combining a skills requirement with a minimum salary level could also be considered but, given our tight labour market, the institute believes it is timely to consider dropping the exclusion of new hires.

The committee has also asked us to comment on the research and development tax credit. This measure was first introduced in 2004 and has been updated and improved in the intervening years. Its cost to the State is very significant. It was €448 million in 2017. In our view, regular evaluation is essential to ensure the tax credit is meeting its objectives for our economy.

Innovation plays a central role in driving productivity and fostering competitiveness in economies. The consensus among international bodies is that governments must support research and development activity because the costs and risks for business are so high but the benefits for the economy are proven and long term. In Ireland, the competitiveness of our economy depends on innovation. The institute recently conducted a survey which found that the research and development tax credit was the second most important factor in the decision of companies to base their research and development activity in Ireland, the first being the availability of specialist skilled workers. In addition, all the businesses surveyed reported an increase in staff recruitment as a result of their research and development, with nearly one quarter saying they had hired more than 50 employees.

One aspect of the research and development tax credit that has been criticised is its restriction on outsourcing. It flies in the face of international best practice, which promotes collaboration between industry and third level institutions. The exchange of knowledge and ideas is the very essence of innovation. The institute believes the outsourcing restriction should be removed in line with Government policy to foster collaboration between third level institutions and private business.

While the research and development tax credit works well for multinationals, which account for almost three quarters of the relief claimed, it has been of limited benefit to Irish companies. Recent research by the ESRI in 2016 found that only 7% of Irish-owned companies had invested in innovation and research and development.

Our own members say that administrative blockers and the cost of claims are effectively excluding small indigenous companies from claiming the credit. In our recent survey, the majority of respondents who had undertaken research and development but had not made a claim cited anxiety that Revenue might subsequently challenge claims as their main reason for not claiming. Others cited the costs involved in preparing a claim. Asked what measures would help to improve their takeup of the credit, the majority said that a pre-approval process for first-time research and development tax credit claims with simplified documentation would greatly increase their likelihood of availing of the relief. Every authoritative advisory body, both nationally and internationally, recommends raising productivity in our indigenous businesses, through increased investment in research and development and innovation from the public and the private sectors. With Brexit fast approaching our shores, the Irish Tax Institute believes we need an innovation incentive that is tailored for Irish companies, so that they can grow their productivity and compete for new markets in a post-Brexit world.

Film tax relief is available to production companies on eligible expenditure on qualifying films and is a key factor in attracting projects to Ireland. The institute welcomes the move to self-certification following the Finance Act 2018. Clear Revenue guidance is needed to define eligible expenditure that qualifies for film relief. The institute is actively participating in discussions with Revenue at the Tax Administration Liaison Committee to agree such guidance.

This year our pre-budget submission, as in previous years, focused on the SME sector. We called for a more generous capital gains tax relief for entrepreneurs to make Ireland more competitive with the UK; changes to allow highly-prized angel investors to avail of the relief; changes to make the employment and investment incentive more effective; and the start-up relief for entrepreneurs, SURE, income tax refund scheme to be extended to the self-employed. We also repeated recommendations on the key employee engagement programme, KEEP, share scheme. Just 38 employees in ten companies have availed of KEEP since it was introduced in 2018 to address the urgent matter of key skill shortages in SMEs. These include management skills, which were highlighted by the OECD as a significant constraint on productivity in this sector. A recent consultation paper from the Department of Finance on KEEP largely reflects our recommendations of the last year. We are now hopeful that they may be enacted in the budget.

We welcome the practice of putting existing tax measures out for public consultation and we value the stakeholder events that have taken place as part of the consultation process this year. Discussion is healthy and listening to each other can only be productive. However, in the meantime, businesses are waiting for change. More consultation at the design stage of tax measures would be helpful. The system needs to be more responsive, as there is no point in having measures that are not effective. The resilience of our economy, at a time of growing uncertainty and risk, depends on our SMEs. They need the best support we can give them.

I thank the committee for its attention. We are happy to answer any questions.

Chairman: I thank Ms Gunnell for her opening remarks. I call Deputy Boyd Barrett.

Deputy Richard Boyd Barrett: Unlike the witnesses, I am an opponent of SARP. It is difficult for many people to swallow the fact that these extremely highly-paid executives get this tax relief. Given that there are so many other tax reliefs available, and that such large profits are being made by the corporations coming in here, what evidence do the witnesses have that there would be any less investment by these companies if we removed SARP? It seems like icing on a very big cake for people who are already making a lot of money and being very well paid. I would be interested in the witnesses' comments on that.

I refer to the research and development tax credit. We all want to see research and development, but as Ms Gunnell indicated, the small and medium enterprises are not really benefiting from it. They do not have the necessary resources or research and development departments, and they are fearful, from what Ms Gunnell said, of getting it. Who is getting it? I think we all know the answer to that. It is now worth €700 million, which is not an insubstantial figure, and is going to the usual suspects - the big multinational corporations, such as Google, Facebook, or pharmaceutical companies - which are also benefiting from a whole range of other tax reliefs, credits and allowances. If we want to have indigenous research and development and to encourage the SME sector, particularly in the context of something like climate change, would €700 million or even a fraction of that not be better targeted at encouraging indigenous research and development by SMEs or public universities? Universities were mentioned, but they are currently dependent on whether a big multinational wants to outsource something to them. Surely, there is a case for redirecting some or all of that money into public universities to increase their research and development capacities, which are more likely to be focused on what might be good for the country or help to advance renewable energy, instead of assisting someone to come up with the iPhone 11 or a new app that is only slightly different from a previous app. Would it be better to redirect that money to target things that are a priority for us?

Ms Gunnell kept her comments on the film relief quite brief and did not pass any judgment on it. I do not know how familiar she is with it. How can one test its effectiveness? The conditions attached to it are that it will provide quality employment and training and contribute to Irish cultural expression and endeavour. Is it achieving those goals? We were told by members of the film industry who were lobbying for it that we were getting 17,000 good jobs for it and so on. However, when the Department of Finance looked into the relief, it found that it led to far fewer jobs, a total of approximately 2,000. Some people maintain that the 2,000 jobs are completely precarious and that those employed in them have almost no rights. It is not quality employment and there is no proper training structure. At a minimum, we need a comparison of the cultural output since that type of relief was brought in and, for example, that under previous methods of financing the film industry. I am not convinced that the output in terms of the criteria set out in the relief has been better over the past ten years than was previously the case.

Ms Anne Gunnell: I will first address the questions on the SARP. Ireland is competing with many other countries for global capital investment. The individuals in question are highly skilled and can work anywhere. When a multinational is looking at whether it will invest in a particular jurisdiction, it considers all factors, including the tax system. Some aspects of our tax system, such as the high rates of personal tax, may deter some executives from coming here. One needs an incentive. It is internationally recognised that incentives such as SARP are effective in contributing to bringing people here. We need those individuals in order to support sustained investment and growth in the economy and the resultant spillover benefits, such as the jobs and long-term investment. We are competing with countries such as Spain, the Netherlands, Luxembourg and France, all of which offer a similar incentive because it is needed to encourage these key executives, who are very mobile and can work anywhere, to move to the country and encourage the growth and expansion of particular operations. I accept that there can be inherent inequity in any tax expenditure because one is always focused on trying to address a market failure and they are targeted at a particular cohort of taxpayers. In this case, we are trying to attract global investment for the benefit of the wider Irish economy and we need these individuals to be here to support that investment.

On the research and development tax credit, every international organisation, including the OECD, the IMF and the European Commission, recognises that research and development innovation is essential to the growth of the economy. We need research and development by all types of companies, including multinationals and indigenous firms. We recognise that multinationals have more in-house research and development and the capability to handle the complex requirements inherent in making a claim for the credit. It is a very good incentive and we should ensure that it can be tailored to be more effective for small and medium enterprises. We want a research and development incentive that works for all companies, multinationals and SMEs.

Third level instituions were mentioned. It is up to policymakers to decide how research and development is funded and the balance in doing it through tax incentives and Government expenditure. We have Government supports, while Enterprise Ireland has many grants and vouchers; therefore, there is already such an element. It is a way of linking up and encouraging SMEs to partner with third level institutions through incentives. Policymakers could consider investing more in that regard.

Our research and development incentive works. The feedback in our survey was that, for those claiming the incentive, more employment had been generated. Therefore, we should try to ensure we can get more SMEs to claim it.

I will ask Ms McGuinness to respond on the point about film tax relief. She has been more involved in what has been happening with Revenue and at the Tax Administration Liaison Committee, TALC, about film relief.

Ms Clare McGuinness: On the film credit, the system changed in last year's Finance Act such that there is now a two-stage process, whereby an application has to be made to the Department of Culture, Heritage and the Gaeltacht to show that quality employment and training and development opportunities will be provided. That is one of the conditions that has to be satisfied before one can apply to Revenue for the credit, the awarding of which is conditional on compliance with these conditions. Whether quality employment is being provided is a condition of receipt of the credit.

The Irish Tax Institute has not necessarily carried out research to determine what the cultural output has been. Revenue and the Department of Employment Affairs and Social Protection have stated multi-agency compliance operations are being carried out to ensure quality employment is being provided.

Ms Anne Gunnell: Similar to research and development, it is internationally recognised that attracting production companies through film credits is a competitive industry. Ireland is competing with the likes of the United Kingdom and France to attract productions. There has been research which shows that there is a spillover in the impact on tourism., but the institute has not carried out research to that effect.

Deputy Richard Boyd Barrett: I will return to the issue of research and development and direct expenditure by universities, grants or whatever else, as opposed to research and development tax relief. Would our guests accept that it is going to a relatively small number of private corporations? Do they know what the comparison is between how much is going in direct expenditure as against the approximately €700 million in tax credits, an amount which has risen dramatically in the past while? That is the thing at which we have to look. Which is getting better results for us? How much is going in tax relief to a relatively small group as against how much is going in direct expenditure and what is it giving us? Which would be better and how would the money be better spent? It is a choice between whether we should give more in tax relief and direct expenditure.

Ms Anne Gunnell: I do not have a figure for the amount given in grants or vouchers or what it comes to, for example, in funding from Enterprise Ireland or the Department of Business, Enterprise and Innovation. The figure for research and development was reduced to €448 million in 2017. It was €670 million in 2016. There were fewer claims, based on the most recent data, and the figure has gone down to €448 million which is still, obviously, a significant amount.

Deputy Eamon Ryan: On a similar theme I am interested in looking at a breakdown of the 800 people who are availing of the Special Assignee Relief Programme, SARP. I wonder how many are working in the constituency of Dublin Bay South. I would say a fair few are working in the Irish Financial Services Centre, IT and so on. There is a concern that we are in danger of creating what has happened in San Francisco where there is a two-tier society, a two-tier city. Those who are wealthy and well paid within the very high-tech sector are doing well, while everyone else cannot even afford to live there. That is what is happening in Dublin Bay South. A total of 1,000 apartments are being built in the docklands, of which more than two thirds have been contracted in advance for some of the high-tech multinational companies. Will we keep going with the Dutch, Luxembourgish or UK economic model, which involves deregulation and a race to the bottom? There are real risks attached to this model, particularly if we extend it, as has been proposed, to new hire employees. How do we make it fair for my constituency in which local people cannot afford to live and which if we keep on this route will only be a home for workers in high-tech multinationals who have a lower tax rate and probably have accommodation costs covered? At what point do we start saying that we do not want that divided city approach?

With regard to the research and development tax credit, the criticism cited by the witnesses about not veiling it through outsourcing was interesting. I would welcome an extension of it as I favour a change of emphasis towards the use of our universities as is international best practice as the witnesses noted. Have the universities commented on how this would work and be applied and what additional benefits it might bring them? Is there an estimate of what the increased cost might be? I am broadly in favour of a reorientation towards supporting indigenous industry and developing our universities. This is a strategic political objective on which we need to deliver. We need to wean ourselves off our dependence on foreign direct investment and high-tech large multinational investment.

Chairman: The Irish Universities Association will appear before the committee next week so there will be an opportunity to raise those points again with it.

Ms Anne Gunnell: For reasons of taxpayer confidentiality, I am not privy to information about who claims tax expenditure like that. Only the Revenue Commissioners would know that. Multinationals around the country are attracting these key executives so it does not necessarily involve Dublin Bay South. It could involve Cork, Galway, Limerick and other places around the country. I understand what the Deputy is saying. It goes back to the point that our tax expenditure can contain this inherent inequity if we are targeting a certain cohort of taxpayers but we need these people here. As that specialist skill is not available in Ireland, we need to attract these people to support the growing operations of multinationals that are basing their investment here and, ultimately, the spillover of that into suppliers and other companies that interact with those operations. That is where we see the merits and benefits of that approach.

We do not have any figures on the cost of extending the research and development tax credit to outsourcing. Research and best practice in countries like Germany recommends as much partnering as possible, as do the OECD and the European Commission. We do not have figures relating to outsourcing and we do not have direct comments from universities about whether they would have the capacity to do that. However, I am sure they would welcome that kind of collaboration.

Deputy Declan Breathnach: I thank the witnesses for their presentation. Most people will recognise that incentives work and multinationals and universities contribute greatly to the development of our economy and employment. I am sure those multinationals and universities are quite capable of sourcing the various incentives that are available and have the power to draw them down.

I will focus on SMEs. A recommendation that additional guidance be given to SMEs was made. Invariably, the backbone of the rural economy centres around SMEs. If someone is working alone in a firm, taking on one extra worker will represent a 100% increase in employment.

It is important that we compliment bodies such as local enterprise offices and Enterprise Ireland which distribute these incentives. As a Deputy from a rural area and, indeed, a former school teacher, the biggest issue I have come across is the smaller guy who has an idea and wants to go to his local enterprise board and who is concerned that his idea will be stolen and suggested to a larger enterprise. No doubt there is that concern. To what degree is information being made available to the small guy to give him the opportunity to apply for these incentives, but, more importantly, so that such guys would be able to get the same type of tax relief? We should ensure that a guy, who has not necessarily the time to take off work and who needs to take somebody on to develop his idea, gets tax relief no matter how small his enterprise is. Can Ms Gunnell develop that in terms of a proposal because in my experience such persons find it difficult? While the enterprise boards and Enterprise Ireland try to help, there is a reluctance to go there because they cannot get the incentives the larger guy can get. Would Ms Gunnell care to comment on how that can be improved?

Ms Anne Gunnell: Undoubtedly, the LEOs and Enterprise Ireland offices are doing excellent work in this space. We would always say that the more information one can give the better. I refer to information raising awareness of how to claim what is available, whether a direct subsidy through a grant or the research and development tax credit. We would always encourage the dissemination of information, for instance, through a co-ordinated campaign. That is done quite effectively, for example, in the UK, especially regarding research and development. Their information ranges from short videos to website entries. Everything amounts to a co-ordinated campaign that they have directly targeting SMEs. That is something we would suggest.

In terms of making the claim more accessible, if it is a research and development case, we would say that for small and micro companies there should be something akin to a pre-approval process. In 2017 Revenue introduced a provision that where there is a link between the Enterprise Ireland grant of up to €50,000 one is deemed to have satisfied the science test. However, one still has to meet the so-called "accounting test", which is the documentation checks that can be quite cumbersome. What we recommended in response to the public consultation carried out in June was that for first-time claims there would not only be a process of pre-approval for the science but also around accounting. If there was a standard template they could adhere to, that would make it so much easier. For example, when it comes to claiming the UK equivalent research and development tax incentive, in the UK, they have so-called "advance assurance" which they allow for up to three accounting periods.

There are definitely mechanisms with which one can make it a lot easier and much more accessible for the individual who, as Deputy Breathnach stated, has an idea, wants to develop it and is genuinely conducting research and development but does not have the time or the wherewithal to go about availing of the relieve.

Deputy Lisa Chambers: I thank Ms Gunnell for her presentation. On the special assignee relief programme, the main countries we are competing against are the Netherlands and the UK. With which other countries we competing?

Ms Anne Gunnell: Those countries include Luxembourg, the Netherlands, Belgium, France, and most European countries. They reason we focused on those is because we are looking at the UK and Brexit and the fact that now there is a lot of such global capital investment wanting to locate in Europe and they are looking at other jurisdictions. We looked at which are our competitor countries within Europe. In terms of global capital investments, there are incentives in Singapore, Hong Kong and all around the world. In terms of our submission earlier, in response to the SARP consultation, our focus was on these European countries.

Deputy Lisa Chambers: In terms of what we offer, how do we compare to our main competitors? Is ours a more favourable country to come to work in? Are the tax incentives a little better here?

Ms Anne Gunnell: Not necessarily, I would say we are mid-range. Some countries have a cap and others do not. Ireland has a cap. We have a ceiling now for salary levels. Some places do not have any specified salary level. It is €1 million here. The effective amount that one can claim for SARP is an absolute maximum of €111,000 in a year in Ireland, whereas some countries have no cap. Other countries have a cap or they have a skills requirement. There are different conditions attached to it. A country might not have a ceiling limit but might have a definite skills requirement attached. There are different conditions. We compete reasonably well but we are not the most favourable.

Deputy Lisa Chambers: Not the most attractive?

Ms Anne Gunnell: No.

Deputy Lisa Chambers: Besides extending it to new hires, are there any other changes that Ms Gunnell thinks should be made?

Ms Anne Gunnell: We had some administrative issues with the SARP. We previously recommended that there should be a notification period and that it had to be done in 30 days. Last year, that was extended to 90 days in the Finance Act. We recommended that because it was very difficult to meet that when somebody is coming in and getting a PPSN number and such. That is linked to the actual relief and it is something that the employer has to do. It can be difficult to conclude within that notification period.

Deputy Lisa Chambers: I refer more to the offering, whether the rate or the cap, to have more or less, or to have a skills requirement. Is Ms Gunnell in favour of any other changes in that regard?

Ms Anne Gunnell: The ceiling was brought in because the cost of SARP increased substantially when the ceiling was removed a couple of years ago. We recognise the need for the ceiling. Our concern is that if it is extended to new hires, there should be a link to the skills requirement so that it is being very targeted. We understand that could be quite costly.

Deputy Lisa Chambers: Is there a limit to how many years can be claimed for?

Ms Anne Gunnell: Yes. The maximum that can be claimed for is five years.

Deputy Lisa Chambers: The purpose of the programme is to allow highly skilled executives to come here to drive expansion in business and create jobs. I do not understand how a new hire, who was not involved in the business previously, can be the person to drive business expansion in a company that he or she is new to. I do not understand the logic behind that.

Ms Anne Gunnell: They are senior management people. They could be skilled in a particular area of the business. They could be related to the research and development facility in the US and could be brought over to drive it on here.

Deputy Lisa Chambers: The whole point is that they should be employed in the parent company for six months first.

Ms Anne Gunnell: That is right.

Deputy Lisa Chambers: Why does Ms Gunnell feel the need to remove that requirement? Would it not be unusual for somebody who has never worked in the company to be sent to start expanding the company that he or she has just joined?

Ms Anne Gunnell: It gives an opportunity to a person who could have worked in a similar business and has the required expertise but who has not worked in that particular multinational, instead of requiring that person to have worked in the company previously.

Deputy Lisa Chambers: Who did the Irish Tax Institute survey?

Ms Anne Gunnell: We surveyed businesses who carry out research and development and our members. We linked in with both IDA Ireland and Enterprise Ireland when we carried out that survey.

Deputy Lisa Chambers: Moving on to the research and development section, the Irish Tax Institute has identified that only 7% of Irish indigenous businesses are availing of this credit. Besides removing some of the administration or difficulties in accessing it, does Ms Gunnell have any recommendations about how we might improve that number?

Ms Anne Gunnell: That 7% comes from when the ESRI reviewed research and development. We feel that the biggest challenge for small and medium enterprises is in claiming it. The 25% tax credit is a good incentive. Being able actually to avail of it is an issue. The administration seems to be the primary block. When we surveyed small and medium enterprises which did not claim it, that is what they said. When there is significant expenditure, it should be scrutinised and we all accept that in any self-assessment system, Revenue needs to scrutinise that to protect the tax base. Businesses say that it is quite complicated and cumbersome, and administrative simplications would be welcome to enable them to claim the credit.

Deputy Richard Boyd Barrett: I had not read the figures helpfully provided by our secretariat on the beneficiaries, their numbers and the salary range. It would shock many people to learn that a small but significant number of incredibly well-paid individuals are paying less tax than they are. The salary ranges about which we are talking are morally shocking. It is worth noting that 359 people who have incomes of between €75,000 and €150,000 are getting tax breaks and 160 people who earn between €150,000 and €225,000 are paying less income tax than normal workers. Some 79 people who earn between €225,000 and €300,000, 56 who earn between €300,000 and €375,000, 95 who earn between €375,000 and €675,000, 26 who earn between €675,000 and €1 million a year, 14 who earn between €1 million and €3 million a year and four who earn between €3 million and €10 million a year are also getting tax breaks which allow them to pay proportionately less tax than average workers. That is unbelievable. Does Ms Gunnell believe there is a moral problem with that? I did not even know that anybody could earn between €3 million and €10 million in salary a year. It is staggering and beyond belief; it is morally quite obscene. Does Ms Gunnell believe there is any moral problem with it?

Ms Anne Gunnell: There is a cap. The salary can only be up to €1 million. The maximum a person could get is €111,000 per year.

Deputy Richard Boyd Barrett: That is the amount of tax relief. That is the tax break.

Ms Anne Gunnell: Yes.

Deputy Richard Boyd Barrett: A person can be given three times the average industrial wage in tax relief.

Ms Anne Gunnell: Yes. There is an inherent inequity that favours highly-skilled people who come over. These people would not come without the tax breaks, however. It is really a question for policymakers. If one wants to attract investment and support substantial operations here, these people are needed and it is this kind of tax break that attracts them. It is what other jurisdictions also offer.

Deputy Richard Boyd Barrett: I will make one additional brief comment. That is morally repugnant. Aside from the morality, Ms Gunnell is making a pragmatic argument that these people would not come here otherwise. She has mentioned other jurisdictions with which we are competing and which have similar tax break schemes for these incredibly well-paid people. Has the Irish Tax Institute carried out a comparison with countries that do not have such tax breaks for incredibly well-paid people which shows definitively that they do less well in getting skilled people into the various sectors where they are needed? The only way we could judge the matter at that level and in the terms by which Ms Gunnell is defending it—and I find those figures unacceptable at almost any level—is to determine whether countries which do not provide these tax breaks have problems in getting access to necessary skills. The only way to sustain that argument is to show that a given jurisdiction which does not have a special assignee relief programme providing these tax breaks has real problems in getting these people in.

Ms Anne Gunnell: We do not have that information. We looked at countries that are competing for this kind of investment and that are in the same kind of space to see if they had similar reliefs. In light of Brexit, we particularly focused on countries in Europe. I do not have information about other countries that do not have such schemes or about the impact of not having them.

Deputy Richard Boyd Barrett: Does Ms Gunnell believe it is a relevant question?

Ms Anne Gunnell: Information is always good to have when evaluating any tax expenditure.

Deputy Richard Boyd Barrett: I thank Ms Gunnell.

Chairman: Are there any additional questions? If there are none, I will thank the representatives from the Irish Tax Institute for their initial presentation to the committee and for the answers they provided to our questions. It is always welcome to interact as part of our continuing process in working towards this year's budget. I thank the witnesses for being here with us. I propose that we now take a very short break. We will suspend and resume at 4 p.m. with the Irish Fiscal Advisory Council.

Sitting suspended at 3.50 p.m. and resumed at 4 p.m.

Chairman: We are back in public session. I again remind members and witnesses to turn off their mobile telephones. I welcome the Irish Fiscal Advisory Council, IFAC, to the meeting. It is always a pleasure to engage with its members and we are very interested in today's session. I welcome Mr. Seamus Coffey, chairman, who is accompanied by Dr. Martina Lawless, Mr. Michael Tutty and Dr. Eddie Casey. We are meeting IFAC to consider input into our pre-budget report and we thank Mr. Coffey and his colleagues for making themselves available to the committee. This was at short notice so we appreciate that they were able to facilitate us by attending today. We are in preparation for budget 2020, which is particularly challenging due to Brexit issues, as everybody is aware. Our regular engagement with IFAC is a key part of the scrutiny in the build-up to the budget.

Before I invite Mr. Coffey to make his opening statement, I advise witnesses that, by virtue of section 17(2)(*l*) of the Defamation Act 2009, they are protected by absolute privilege in respect of their evidence to the committee. However, if they are directed by the committee to cease giving evidence on a particular matter and they continue to do so, they are entitled thereafter only to qualified privilege in respect of their evidence. They are directed that only evidence connected to the subject matter of these proceedings is to be given and asked to respect the parliamentary practice to the effect that, where possible, they should not criticise or make charges against any person or entity either 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 remind members that the normal practice of the committee is to take members in the order in which they indicate. We will have an opening round in which members will have approximately four minutes each to ask questions and receive replies. When we conclude the initial round, we will return to members if they wish to put follow-up questions. I ask Mr. Coffey to make his opening statement.

Mr. Seamus Coffey: The council thanks the Chairman and members for inviting us to meet the joint committee to discuss publicly our pre-budget 2020 statement which has just been published today. Joining me are Mr. Michael Tutty and Dr. Martina Lawless who are both council members and Dr. Eddie Casey, our chief economist and head of secretariat. Other members of the council's secretariat are also present: Mr. Kevin Timoney, Ms Ainhoa Osés Arranz and Mr. Killian Carroll. We continue to value these engagements.

It is important to note that the council's mandate does not cover commenting on the choice of individual tax measures or spending items and priorities but rather commenting on the overall fiscal stance. Our report's assessment is based, first, on an economic analysis which assesses the appropriateness of the fiscal stance in the context of the principles of sound economic and budgetary management and, second, on an assessment of whether the Government's fiscal plans are in line with the requirements of the budgetary framework.

Starting with the macroeconomic context, the council assesses that the domestic economy continues to perform strongly and even risks overheating, yet the international economic outlook has deteriorated in recent months. While the situation is volatile and evolving, the risks of a hard Brexit is high. Ireland's net debt ratio is the sixth highest in the OECD, at close to 90% of national income, while the pace of Government spending increases has been fast in recent years, accelerating from 4.9% in 2015 to 6.7% in 2018. This partly reflects large in-year spending increases over and above what had been budgeted for, including in health. In recent years Government revenues have been boosted by unexplained corporation tax receipts and a strong bounce back in the economy. These gains are likely to prove to be temporary. Corporation tax receipts accounted for a record 18.7% of taxes in 2018 and carry lots of risks. Recognising these temporary gains, the underlying budget balance appears to have deteriorated since 2015. Further spending slippages are likely to happen again in 2019. Another health overrun, the payment of the Christmas bonus and underestimated social payments could mean higher spending of €1.3 billion than previously budgeted for this year.

The council is of the view that repeating the pattern of slippages would be inappropriate. It could add further to overheating pressures and reduce scope for budgetary policy to support the economy in the future. The Government must deliver on its spending plans for 2019. If spending overruns occur, the Government should find offsetting savings in other areas. It should not rely on further surges in corporation tax receipts, which could prove to be unsustainable, to fund slippages. For 2020, the Government should stick to its plans for a €2.8 billion budgetary expansion compared with the planned 2019 level. This would mean a budget day package of €600 million, given that a sum of €2.2 billion has already been pre-committed. The €2.8 billion budgetary expansion would be slightly below the sustainable growth rate of the economy. It would also reflect the risk of a disorderly Brexit, the reliance on corporation tax receipts, possibilities of overheating and the rapid rise in spending between 2017 and 2019. There is a case for more caution, given the risks posed by Brexit and the worsening global outlook. If spending overshoots in 2019, the Government should scale back its pre-commitments for 2020. Brexit could mean severe budgetary costs. A large budget deficit could emerge due to falling taxes and rising unemployment-related costs. This is even before potential customs infrastructure and supports for hard-hit sectors are considered. The Government might need to cut spending or raise taxes to prevent debt ratios from rising. Measures to deal with the costs of a hard Brexit should, however, be accommodated as far as possible. The council has repeatedly criticised the Government's medium-term plans for not being credible. The Minister has noted that some of the concerns raised by the council are being explored. The Government should follow through on indications that it will develop a more credible medium-term plan in time for budget 2020.

I again thank the committee for giving us the opportunity to attend the meeting. We look forward to the members' questions.

Chairman: I thank Mr. Coffey for his opening statement. The first member to indicate was Deputy Eamon Ryan.

Deputy Eamon Ryan: I thank Mr. Coffey and his team. We are in an uncertain period. There is a tricky economic question. Given Brexit, international factors like the trade war between China and the United States and the general cycle of expansion that is coming to an end globally, we could be facing into a very severe contraction next year. In these circumstances, would it not be prudent economically to expand public expenditure? While I understand Mr. Coffey's concerns about high levels of public debt, next year we may well be facing into a very severe contraction and the correct counter-cyclical economic strategy would be to engage in additional borrowing to try to maintain general Government revenue and economic activity. I know that is a very simple proposition but the council seems to be coming out very strongly against this. It is very strong in stating the Government has blown the budget in the last two or three years, with an overspend of €10 billion compared to what was forecast for the period 2015 to 2017 and the health budget running amok, and that now is the time to hunker down a little. While it may seem like a counter-intuitive argument, is this not the time to borrow? That is my first question. I will come back in following the response.

Mr. Seamus Coffey: In principle, we agree with the Deputy that running a counter-cyclical policy would be appropriate, but that is not something we have done in the past few years. It is something that should be done on a consistent and continual basis, not just at a time when the economy is slowing down. While the risk of a severe contraction is low, it is possible. A more likely scenario in the context of a hard Brexit and the other risks we face is that there will be a slowdown in the economy, rather than an outright contraction. In principle, we are of the view that the Government should support the economy if there is a slowdown. That would happen naturally if there was a slowdown in tax revenue and an increase in unemployment-related spending. That stimulus would happen naturally, as Government spending would be rising faster than the growth rate of the economy. The risk we see is that if there were to be a more severe downturn or Brexit were to have a more negative impact on the public finances than that set out, we simply would not be able to allow those automatic stabilisers to proceed naturally. Our view is that while the Government should do it, there are risks that it might not be able to do so because one issue in running a budget deficit and spending money one does not have is that one must borrow. We face relatively benign conditions in the financial markets, but if we were to face a severe slowdown and a large deficit were to open up, given the very high level of debt we are already carrying, those benign financial conditions might not persist. It is not that the council is asking for a tight fiscal policy in case there is a hard Brexit or a severe contraction but that it might become a requirement of the financial markets to have such a policy, given the inappropriate policy we have had for the past few years.

Deputy Eamon Ryan: As Mr. Coffey said, the borrowing environment is still very positive. We can borrow ten-year money at a rate that is almost negative and that might continue to be the case. If the borrowings were to be invested in a green new deal, that would address some of the imbalances in the economy, to which the council refers on page 15 of its document. If the borrowings were actually used to address the three key imbalances - housing, transport and the need to decarbonise - it would be justified, particularly as it would take some time to ramp up such investment; we could not do it overnight. We could find ourselves in a downturn, with the stabilisers to which people refer not being sufficient to halt the downward spiral. It would probably then be too late to engage in borrowing to address the imbalances. If borrowing was focused on addressing these imbalances, would it help to reduce any of the concerns of the council about overheating or the economic impact of such borrowing?

Mr. Seamus Coffey: The answer to the question highlights the uncertain environment in which we find ourselves. The Government could undertake additional investment via low-cost borrowing, but we also face a risk of overheating in the economy. If we are to initiate widespread capital projects, we must ask if the economy has the capacity to deliver them in a sustainable fashion. We would, in particular, be looking at the labour market. The unemployment rate has dropped to 5%. We have seen a return to net inward migration and the beginning of some upward pressure on wages. That is widespread throughout the labour market. In principle, these are valid projects that could be undertaken. If they are to be undertaken in the current environment, we should ensure that there is space in the economy to do so. If we are going to do more in one area, then we will have to do less in others, and if the purpose is to be countercyclical, let us see if the slowdown happens first. The economy has been performing strongly and there is little indication of a slowdown in the labour market or in consumer spending. There is volatility in investment and housing construction remains more muted than we might have thought, but pumping more money now into a fast-growing economy would again just be further inappropriate policy. All of this highlights the confusing and uncertain environment in which we find ourselves. Within two questions we have been speaking about how to deal with a severe contraction that a hard Brexit might bring and then examining how excessive investment might lead to overheating pressures. That is simply a function of the unusually uncertain environment in which we find ourselves.

Deputy Eamon Ryan: I agree that we need to shift spending from roads to public transport and from office construction to housing construction. There are tactical things we can do with budget items. In its document, IFAC mentioned the possibility of what it called a “prudence account” being created from excess corporate tax revenues. I have some questions to help me understand this concept properly. Where are we on the projected use of the rainy day fund next year? How would such a prudence account relate to the rainy day fund, and if we do have a downturn, when do we crack into any rainy day fund? What would justify such expenditure? The rainy day fund has only been in existence for a year, but it was designed to increase expenditure in a downturn. When would that intervention be triggered? What are IFAC’s recommendations regarding what should be done on that issue next year? How much should be put into a prudence fund and would that be on top of a rainy day fund?

Mr. Michael Tutty: The prudence fund was designed to take out excess corporation tax. We have had significant overruns on corporation tax every year and we keep spending it. We we should not be spending that revenue but instead putting it away into the prudence fund during the year. That should then be put into the rainy day fund, or whatever its official name is, at the end of the year. The prudence fund would be on top of the rainy day fund, which we do not see as being adequate to fund significant countercyclical activity. The Minister does not even see it as countercyclical but we argue that it should be countercyclical. The rainy day fund has very little, if anything, in it as yet. I am not sure if €500 million has officially gone into it. Our view is that it is necessary to build up a significant amount of money in the fund if it is going to be useful as a countercyclical measure. We do not know what is coming down the road next year. In anticipation of the possibility of Brexit happening, and a resultant slowdown here, we certainly would not recommend raiding the rainy day fund at this stage.

We have been stating in recent years that the Government should be running surpluses now so that when the bad times come we have something built up. We have nothing built up as yet because the surpluses were not realised. It is a bit difficult, therefore, for us to state that we must have countercyclical measures. We have arrived at the situation that we were warning we should not be arriving at. I refer to when we might need countercyclical measures, but we have not done the right things in the good times to allow that to happen. We spent the money in the good times, we have not run surpluses and now we are faced with a possible downturn. The immediate question then is whether we can spend more money to avoid the downturn. We are now back where we have been in the past. It is to be hoped that, when we get through any slowdown that might occur, people will realise that what IFAC has been saying is right and we should build things up in the good times so that we will have money in the bad times. We find it difficult at this stage to say we should raid the rainy day fund or use any slack or borrowing we can get because we have not done the right thing before now. We are saying we should let the automatic stabilisers work. We are not saying that if there is a slowdown, we have to start raising taxes and reducing expenditure immediately. We will let the stabilisers work. We certainly do not see scope at this stage to start spending a large amount of money. If, in 12 months' time, we see that the effects of Brexit are more significant than we expect, perhaps we will start looking at that. At the moment, as Mr. Coffey said, our projection is that there will be a slowdown in the economy rather than that the economy will go into reverse.

Deputy Eamon Ryan: I have one final short question.

Chairman: A very short one, please Deputy.

Deputy Eamon Ryan: Has the Irish Fiscal Advisory Council done any analysis on the corporation tax changes envisaged in respect of the profits of multinational technology companies and under the OECD proposals? One could foresee an increase in our tax revenues as a result of these. One of the reasons for the increases in corporation tax revenues in recent years was that multinational companies are moving intellectual property here. Corporation tax now accounts for 18% of tax receipts. This shift may be a long-term one and may also be sustainable given the size of the foreign direct investment sector in the economy. The figure could even rise. Has the IFAC done any analysis to show the likely outcome of what is happening in Europe and the OECD?

Dr. Martina Lawless: We do not have any explicit analysis or forecast in respect of how tax changes under the base erosion and profit shifting, BEPS, process might affect Government revenues here. Much will depend on how individual companies reorganise their tax affairs in response to changes in the rules. This is difficult to foresee. The initial BEPS round, which was widely forecast would have negative impacts on the number of foreign multinationals using Ireland as a base, had quite the opposite effect. Companies reorganised in line with their substantive activities. This moved more resources to Ireland and is probably one of the reasons for the significant increase we have seen in corporate taxes, particularly in 2015. It is very difficult to know in advance until the precise detail of the tax changes and the behavioural response of individual companies become known.

One of the risks we continually highlight in our corporate tax analysis is not only the share of income that Ireland raises from corporate taxes but also how concentrated it is in a very small number of companies. That raises significant risk exposure. Decisions by individual companies on their global structures can have either extremely positive or negative impacts on the amount of corporate tax revenue raised in Ireland. It is one of the reasons we are always cautious about the possible transience of corporate tax revenues and the need to be prudent with regard to how much permanent expenditure is done on that basis.

This revenue has been temporary for four or five years but we could continue to collect it for a relatively long time. Obviously, we will always welcome additional tax revenue. What we are cautious about is translating that tax revenue, which could be temporary, into permanent public spending increases. Translating it into paying down the high national debt would have more positive long-term impacts than embedding it in permanent expenditures. If there is a big downturn in the economy, having a lower opening debt stock would put us in a stronger position with the financial markets if we needed to borrow later.

Mr. Seamus Coffey: Dr. Lawless elaborated on the Irish Fiscal Advisory Council's view. If I take off my fiscal council hat for a moment, I have done work on corporation tax. With regard to projections, one of the conclusions of the review of Ireland's corporation tax code was that the level of corporation tax pertaining at that time was sustainable until 2020. We are getting close to that date now but that conclusion from 2017 looks like it has been borne out and perhaps even exceeded. The Deputy is correct that, given the uncertain nature of this revenue source, the figure could go higher. As Dr. Lawless has pointed out, such is the level of risk involved that basing public finances, social supports and public spending programmes on such an unreliable source of tax revenue would not be appropriate. Given the level of uncertainty, there is a possibility it could go higher. It has proved to have existed for a number of years and it was not purely a one-off. It could go higher. It is a pretty unreliable source of revenue, however.

Deputy John Lahart: I thank Mr. Coffey and his team. For people who might be interested in this and following it, and for people who read committee and Dáil debates, it is worth recapping why the Irish Fiscal Advisory Council was established. It was to assist the Government in avoiding the mistakes of the past by providing a constant stream of advice. Most people would accept such advice was sadly lacking in the past. At the beginning of the crash, the august bodies that provided advice to the Government, with the very odd exception in the case of individuals, advised we were heading for a soft landing. It is interesting to hear Mr. Tutty state we are back where we were or in similar terrain. We are back to where we have been in the past. This is in spite of the establishment of the Committee on Budgetary Oversight and the Irish Fiscal Advisory Council. The commentary to the committee is consistent with the warnings IFAC has given over the past three years and particularly over the past two years.

Of particular interest to me in the context of budget 2020 is that the Government is stating the overall budget package is €2.8 billion. As the witnesses have rightly pointed out, approximately €600 million of this is discretionary and €2.2 billion of it is already accounted for. The Minister has hinted this will be a no-deal Brexit budget making contingencies for the worst-case scenario. This sounds prudent to me. He has hinted at the inclusion of Brexit supports in the overall budgetary package. I have read the council's report and I seek clarification on it. Should the package of Brexit supports we expect to be announced come out of the €2.8 billion and not be additional to it? The witnesses are hinting that if it is additional, it must be offset by savings in other areas. Is this correct?

Mr. Seamus Coffey: I thank the Deputy for his comments. On his initial point regarding the reason for IFAC, to quote my predecessor, the first chairman of IFAC, one of the purposes of having a body such as this is to institutionalise the memory of the crash so we always have somebody who is independent to focus on the problems that can emerge with inappropriate fiscal policy. If a body such as this were to come before the committee over the next 12, 18 or 24 months and state the appropriate fiscal policy was to increase taxes and cut spending at the time of a severe downturn it would be a failure of policy making, of the Oireachtas, of the committee and, perhaps, even of the fiscal council itself. One of our purposes is to try to avoid this. If we do have to come in and state this it would be difficult to take on.

With regard to the upcoming budget, our view is that €2.8 billion is probably appropriate in many settings, whether the outline would be for a withdrawal agreement and soft Brexit or a form of hard Brexit. The issue is the type of measures chosen with the €600 million that remains unallocated, given the precommitments on public capital and public sector pay, social welfare carryover costs and other pressures faced by the public finances.

When it comes to the type of measures that could be introduced to compensate for a hard Brexit, there needs to be a distinction between those that will be temporary and those that will be permanent. Brexit is a permanent and structural change. When it happens, it will be ongoing for decades or possibly even longer. If measures and supports are to be introduced for particular sectors, the shape they will take, particularly if they are temporary, will be important. For example, the cost of building the infrastructure to collect customs and tariffs would be temporary in nature and so it would not be viewed as part of the ongoing overall budgetary package that would take from the €2.8 billion. However, income supports offered to a particular sector that might be in long-term structural decline in any event could prove difficult to remove. We would not tend to view such supports as temporary. They may prove to be temporary and they could be withdrawn in the future, with the resultant fiscal resources then being used elsewhere.

In terms of assessing budget 2020, the introduction of measures that have a potentially long term basis would detract from the €2.8 billion. It is not a case of having a normal budget and proceeding as if everything is going to continue in a positive fashion and at the same time introducing measures to offset the impact of a hard Brexit. Choices need to be made. Earlier, the Minister set out that the framework in the context of which those choices are to be made will be in the expectation of a hard Brexit. That is what we expect to happen and it is essentially what the Minister said.

Deputy John Lahart: As I understand it, Mr. Coffey is saying is that the package of measures ought to come from within the €600 million and that any amount over and above that—in other words, additional to the €2.8 billion—ought to be offset by cost-cutting or savings measures across the board.

Mr. Seamus Coffey: Yes. The €2.8 billion is a net total. The amount could be increased by introducing additional revenue-raising measures similar to those brought in over the past couple of years, including, for example, the increase in stamp duty on commercial real estate and the restoration of the VAT rate in the hospitality and tourism sector. When those measures were introduced, questions were asked about the amount of revenue they would raise but they generated fiscal resources that could be included. In overall terms, the net figure would remain the same if the increase in tax is matched with an increase in spending. If the Government wishes to go beyond the €600 million, it is within its power to choose to do so. If additional spending measures are to be introduced, however, revenue resources to fund that spending must also come into play.

Deputy John Lahart: Mr. Coffey and his colleagues mentioned that a good way to view corporation tax is that it is to Ireland what oil was to Norway. In other words, it is a finite resource. I was taken with the comment that we have embedded much of that tax in our current expenditure. Can Mr. Coffey quantify the amount of corporation tax that has become embedded in our day-to-day spending?

Mr. Seamus Coffey: It is difficult to isolate. In 2015, the forecast for corporation tax was approximately €5 billion with the expectation that by last year or this we would be running close to a balanced budget. In 2018, corporation tax was €10 billion, which is €5 billion higher than in 2015, and we are running close to a balanced budget. The €5 billion excess has come in but it is not showing up on the bottom line. There must have been a change somewhere. That change has been additional spending. Much of the additional spending has been unplanned, with in-year spending across various Departments. Had the Government been in a position to stick to plans in respect of the €2.8 billion as set out by the Department of Finance, then, as frequently advised by the Irish Fiscal Advisory Council—including at similar meetings of this committee last year and in 2017—we would be running larger surpluses and we would be in a position whereby more of those excess corporation tax receipts would be set aside. As matters stand, as quickly as moneys are coming in, they are going back out. The difficulty is that we cannot rely on them to continue to come in in a sustainable fashion.

Deputy John Lahart: I wish to ask a question on the following comment, which can be found on page 18 of IFAC's report:

> Successive efforts to bring a large deficit down in the initial post-crisis period proved successful. Yet, in recent years, the Government has used most of the proceeds of a cyclical upswing; reduced interest costs; and unexpected—and possibly temporary—surges in corporation tax since 2015 to increase spending at a faster-than-planned rate.

Can Mr. Coffey quantify how much of this is embedded in the system? If corporation tax was to suddenly fall off the edge of a cliff - and it is unlikely to fall off the edge of a cliff - how much of the proceeds are deeply embedded in current day-to-day spending as opposed to spending on infrastructure and once-off capital spending?

Mr. Seamus Coffey: It is hard to isolate different parts of spending and earmark them as being funded by a particular revenue source. The Government accounts are an overall package of levers that move up and down. Previously we have looked at capital spending, which should not just be something that happens if there is a temporary revenue source. There were previous proposals to link capital spending to the disposal of the State's shares in the banks. We also received proposals suggesting that corporation tax should be used for capital spending. Capital spending is something the Government and the State should do on an ongoing basis. We should be looking for the right level of capital spending and to fund that in a sustainable fashion, not looking to have capital spending dependent on volatile revenue sources and perhaps use it in an inappropriate fashion. We have a surge in corporation tax now as the economy is performing quite well. Does this mean that we undertake a raft of public capital projects simply because the money is there? Perhaps it would be more appropriate to set that money aside, put capital spending on a more stable footing and even increase it in the future if there is a slowdown in the economy and an excess supply of labour. When the crash came in 2008 and some 200,000 people lost their jobs in the construction sector, the Government exacerbated that by cutting the public capital budget by 66%. It would have been great if it had increased it.

Deputy John Lahart: I could be wrong because emails can be difficult to understand, but I detected a sense of urgency in the request to appear today before the committee. Is that an incorrect understanding?

Mr. Seamus Coffey: Over recent years, it has become a standard feature in advance of the budget. We have this meeting once our pre-budget statement is published. It just seemed to be a timing issue that this year a date was not set and we simply requested that a date be set in advance of the budget, given the issues, the business of the committee and the number of meetings it has scheduled, to ensure that time was found for us to get our message across. I would not call it an urgency; it was just to maintain the meetings that have been had with our previous pre-budget statements, and to ensure our contribution to the overall process.

Chairman: The Deputy will note that I specifically requested that, if at all possible, the IFAC would come before us as close to the Budget Statement as possible so that the committee could work with the council.

Deputy Lisa Chambers: I thank Mr. Coffey and all of his team. As always, we welcome the engagement. Other members and I place a lot of weight on the advice provided to the committee by the council. I have concerns that perhaps the Minister does not place enough weight on what the council says on the basis that the advice over recent years appears to have been, for the most part, ignored and not acted upon.

Mr. Tutty's said that Governments spent money in the good times and had not run up surpluses when they could have done, and that we should build up reserves in the good times so we can adopt counter-cyclical measures when we need them. It appears that we are now at a point where the Government thinks we might need them but it is not in a position to do so. This is deeply disappointing. It seems the Government has not learned from the mistakes of the past. It regularly refers to the mistakes of the past for other purposes but it does not seem to want to learn from them, which is most unfortunate for the country.

When do Mr. Coffey and his team believe the Government would have been in a position to start running surpluses and in what year did the council first advise to do that? How many years could surpluses have been run?

Mr. Michael Tutty: We were saying that surpluses should have been run for the past three years at least If I remember correctly, three years ago the Government was projecting surpluses into the future. When we arrived at those years, though, the surpluses did not emerge. It was not just last year that we were saying this, but for at least three years. I cannot remember exactly when we started. Dr. Casey or Mr. Coffey might remember. It certainly had been going on for a few years when we had the potential to do so. Even when surpluses were not projected in the budget, there were substantial tax revenue increases during the year, but health expenditure increased beyond what was expected in the budget, as did other expenditures. The extra tax revenue went on those extra expenditures. There were opportunities and projections but, in practice, the surpluses did not happen.

Mr. Seamus Coffey: When it comes to surpluses, one should remember that we are not necessarily saying that surpluses should be targeted; rather, they should be the outcome of appropriate fiscal policy. If Government spending - we view spending as being on the revenue and expenditure sides - had been kept in line with the sustainable growth of the economy, we would have reached the surplus position that Mr. Tutty referenced and that the Department and the Government initially forecasted but which did not turn out to be the case.

Our concerns relate to the pace at which public spending is increasing and whether it is in line with the medium-term growth of the economy. In real terms, most estimates put the potential of the economy to grow in a sustainable fashion at between 2.5% and 3.5%. We do not do it too often, but if we were to hit our average growth rate, it would be in or around that level. Current inflation forecasts are between 0.5% and 1.5%, as inflation is low and muted. These factors would give a range of public spending increases from 3% at the low end to close to 5% under the highest growth and inflation forecasts. In recent years, the Government has presented plans that we said were within that range. The stability programme update, SPU, in April of the following year tends to give public spending increases of 3%. We view that as fine and say that the Government should stick to that plan. By the time the budget is reached, though, it has slipped to 4% and approaches the limit of what can be considered sustainable in light of growth and inflation. The outturns for the past three years have averaged 5.5%, which exceeds even the top growth and inflation. The outturn for 2018 was particularly worrying, in that the growth in public spending was 6.7%. That was beyond the sustainable growth rate of the economy and any reasonable forecast of inflation. It is for this reason that the surpluses projected as appropriate have not materialised. We are using fiscal resources at too fast a pace.

Deputy Lisa Chambers: I was going to reference the 6.7% growth rate for 2018. In the council's non-technical summary, it compared this to a 4.9% growth in 2015. That is a significant increase in the pace of spending.

The witnesses touched on the issue of spending drift. In 2018, spending was almost €10 billion higher than originally projected. That is a colossal amount. It seems as though spending is out of control without there being much of an explanation. Is it fair to say that, if those surpluses had been run in the past three years, a period in which we have been debating Brexit, the country might be in a better position to deal with the forecasted economic downturn that in the event of a no-deal Brexit, which appears to be the most likely outcome?

Dr. Eddie Casey: Going back to budget 2015 and considering where we thought we would have been by last year is telling. That document projected a close-to-balanced budget, if not a surplus, corporation tax of approximately €5 billion per annum and interest costs of approximately €9 billion. Let us consider the differences in what has happened since then. Corporation tax receipts have doubled and interest costs are approximately half of the forecasted figure, yet we are still just barely running a surplus. Most of the projected surpluses have been swallowed up in spending increases from budget to budget or within individual years outside of the budgetary process. Some of the revisions were due to the fact that the original projections were not that realistic. When the council says that medium-term plans are incredible, we are saying that we do not find realistic the very slow pace of spending growth that the Department of Finance and the Government are forecasting in their three-year, four-year and five-year projections. The same was true back then. We have a table in the report that shows what happens with budgets that are just one year ahead. Even over the course of one year, the pace of spending increase ramps up dramatically between the initial plans set out in April, the plans we see in October and the eventual outturn. It goes well beyond what we would consider a prudent pace of growth.

Deputy Lisa Chambers: My party has been very critical of forecasts and budgets not being credible and as we have been taken to task on that quite heavily, it is good to hear an independent voice saying the very same thing. Looking at corporate tax receipts, it appears the Government has become quite accustomed to using corporate tax windfalls to plug major holes in the budget and the State finances. This has masked excessive spending beyond our means. Far from balancing the books, which is what we have been hearing about from the Government for the last three years as it lauds the idea of running a surplus, the Government has not been spending what it has been taking in but has been heavily reliant on corporate tax receipts. They are projected to exceed the forecasts again this year, even more so than last year. Taking last year into account, have those corporate tax receipts been used to fund permanent expenditure in the past?

Dr. Martina Lawless: That is certainly our concern. Regarding the slippage from year to year, it is not simply the case that something unexpected comes up in one sector in one year and another sector in another year. We are seeing a systematic pattern of slippage in the same places year after year, particularly in health spending. It is very hard to see how that can be unwound or why it is not taken into account in formulating the projections for health spending. The extra €1 billion that was spent to fund the gap at the end of last year was then baked into the percentage increase received by the Department of Health the following year. A lot of these one-off within-year increases are baked into the projections in the long run. That is one of the causes of the slippage. If it was something dramatic and unexpected in one place in one year and another place another year, one might say that nobody expects the forecast to be perfect. However when the slippage is in exactly the same place year after year questions need to be asked.

There are other places where the slippages are perfectly foreseeable. The Christmas bonus is never included in spending projections at the start of the year. It is within the Government's power to not announce a Christmas bonus from one year to the next but that would be quite unlikely and a fairly considerable policy announcement. A highly foreseeable expenditure issue should be in the expenditure plans at the start of the year.

Deputy Lisa Chambers: Regarding the health overspends, I am quite concerned to hear the phrase "soft budget constraints". The witnesses are saying that because the overruns in health have been persistent, the Department of Health and the HSE have become accustomed to getting the surplus funds they require and management is therefore becoming more difficult. The more one facilitates overruns, the more they will happen. Does the Irish Fiscal Advisory Council forecast another significant overrun this year? Will that once again be plugged by corporate tax receipts, thereby funding permanent expenditure with volatile revenue on which we cannot rely, which we should never do?

Mr. Michael Tutty: We are expecting overruns in health spending this year. The profiles of expenditure over the year do not show much of an excess at the moment. However, the Department is talking about an excess. The profiles show a very small year-on-year increase in expenditure in the last quarter, which is most unusual. From what we have seen in the past, expenditure goes up significantly in the last quarter rather than going down as a percentage increase. We are certainly worried that there will be a significant overrun there. We do not have any particular inside information but we know that within the system there is already talk of €150 million or so. Given the way those profiles are set out, there is a lot of scope for a further overrun later in the year.

Chairman: The Deputy is out of time.

Deputy Lisa Chambers: Other members did go slightly over. I have one final question.

Chairman: For clarity, the other members did not go slightly over.

Deputy Lisa Chambers: A final comment related to the €2.8 billion package and that it could increase by a further €1.3 billion. Is that based on what the Government has already committed to? Is the council saying that we should stick to the €2.8 billion figure even in the event of a hard Brexit, but it is projecting a €4.1 billion spend by Government? Am I taking that up wrong?

Mr. Seamus Coffey: Rather than adding to the €2.8 billion we would look at the €1.3 billion as being a potential increase in the planned spending amount for 2019. If that €1.3 billion materialises, or there is any increase in spending for the year, and it is repeated in 2020, which happens to a significant degree in health as Dr. Lawless knows, it would subtract from the €2.8 billion. The Government would be undertaking additional fiscal expansion. Whether it happens in late 2019 or is planned for 2020, the policy decisions are being taken now. For instance, if there is an increase in health spending which leads to the base, we cannot just say that it happened in 2019 so we will ignore it and do €2.8 billion for 2020. The total would be more then, and go beyond the €2.8 billion. The Minister for Finance has indicated that he is looking to adhere to this in the in the Mid-Year Expenditure Report published in July. He said that if repeated spendings in various Departments arise, which first arose in 2019 and are repeated in 2020, these will not add but subtract from the space available for the 2020 budget.

Deputy Lisa Chambers: Where does the €200 million in extra spending committed to cover the overruns in the national children's hospital and the national broadband plan fit in? Is it in the €2.8 billion figure or is the Government seeking to spend that outside that figure?

Mr. Seamus Coffey: We view the €2.8 billion figure as being the limit for fiscal expansion in 2020. If, for example, the national children's hospital and the national broadband plan acquired the use of an additional €200 million of that, depending on how the calculations work, that would be subtracted so the figure would be reduced. If, say, there is €600 million available but those two projects will consume €200 million, then there is €400 million. The calculations of capital spending are somewhat more involved so it may only be a share of that. It depends on what happens in 2020.

Deputy Lisa Chambers: It tends to go up that way.

Chairman: I now call Deputy Cullinane.

Deputy David Cullinane: I welcome Mr. Coffey and his team. I think it was Deputy Lahart who spoke earlier of the reason IFAC was brought into existence, namely to remind politicians of our fiscal responsibility and of the Celtic tiger years and the recession which followed. Equally, I imagine that Mr. Coffey understands that we are politicians and that politicians are under fierce pressure from our constituents and representative groups. We are entering a budgetary cycle where we will all be invited to meetings where dozens or hundreds of groups will outline their budgetary plans and what they ask of Government. I ask Mr. Coffey to have that in mind as I put my questions to him.

I will begin with corporate tax receipts. It is fair to say that everyone now accepts that if we looked back at mistakes made during the Celtic Tiger that one was basing spending on an unrealistic tax take based on construction. Is there a danger that we are now doing something similar with corporation tax? Mr. Coffey has hinted somewhat at that. Of the overall corporation tax take, how much is potentially unsustainable? How much could be catagorised as a windfall tax that is not sustainable in the long term?

Mr. Seamus Coffey: On the purpose of IFAC and its role in the broader budgetary policy framework, IFAC does not have a bias for or against the provision of public supports, public services or public spending. Our view is that these should be done in a sustainable fashion. If constituents are telling Deputies that they wish for particular supports or services to be introduced, they should favour the framework in which IFAC operates as we seek to ensure that any supports or services offered by the Government are provided on the basis of sound public finances and sustainable revenue sources. One should not increase or expand the scope of government when there may be temporary revenue sources available and offer people the hope that those services can present and then just pull that away when those temporary revenue sources are gone. We saw the pain that caused in 2009, 2010 and 2011. We do not want to go back there. It is wholly inappropriate to use temporary revenue sources to provide State supports and services. We can expand revenue, services and supports in a sustainable fashion and it is about making those choices. We are not biased one way or another *per se*, but we are trying to avoid coming to a position where a body such as ours must come in when the economy might be performing poorly, for example, and state that supports should be pulled from people and that taxes should be increased. That would be a terrible indictment of the broad policymaking process.

Mr. Michael Tutty: In our reports, we had put a figure of €3 billion to €6 billion on the corporation tax that has come in over and above what would have been expected. We did this on the basis-----

Deputy David Cullinane: People might see a range from €3 billion to €6 billion as being quite big.

Mr. Michael Tutty: It is big.

Deputy David Cullinane: Could Mr. Tutty be a bit more specific?

Mr. Michael Tutty: The question as to how much constitutes excess is a bit wooly as well. There is no way we can state, for example, that it is definitely €5 billion.

Deputy David Cullinane: IFAC refers to the potential of an element of corporation tax receipts being unsustainable. I am just putting it back to our guests—not in a wooly way but in a direct fashion—and asking whether they have done an analysis of how much of that may be unsustainable. We have heard the range of €3 billion to €6 billion but is the true figure closer to the former or the latter?

Mr. Michael Tutty: With these matters, one normally goes to the middle if a specific figure is required. That would be €4.5 billion. It is a big figure and is just based on looking at what we would have expected corporation tax to yield in light of the normal increase in economic activity in the country and comparing it with what came in over and above that. That is where the range of €3 billion to €6 billion, or the €4.5 billion figure, comes in.

Deputy David Cullinane: I have a question on how the money is spent. Our guests are indicating that corporation tax receipts which may well be unsustainable should not be allocated towards day-to-day spending. Would they be as concerned if an element of this was used for capital spending?

Mr. Seamus Coffey: We would like to see the link between spending decisions and these surprises broken, although the corporation tax surprises have been positive. The decisions on spending should be about what the economy can produce in a sustainable fashion. We have gone through what we believe represents the sustainable growth rate and also the forecasts of inflation. If the wish is to increase spending beyond that, which the Government and the Oireachtas are free to do, sustainable revenue sources should be generated to allow spending to increase. We would like to see the link between corporation tax receipts and spending decisions broken.

Deputy David Cullinane: Would it be less risky to put it to capital spending rather than day-to-day spending?

Mr. Michael Tutty: We do not want to see any link.

Deputy David Cullinane: I know that but I am asking if such action would be less risky.

Mr. Michael Tutty: I am not sure it could be called less risky. When the crash occurred in 2008, capital spending was cut by 66% when stamp duty receipts evaporated. One of the issues with capital spending is that it is the easier option when it comes to cutting. Existing projects would be allowed to go to their conclusion but new projects would not start. It is very difficult to eliminate an ongoing payment or reduce a salary for a public sector worker but if a project does not commence, there is the question of who would get the contract, be employed by it and benefit from the presence of the capital project. These are unseen elements so it is easier to cut such spending. We would like to see spending being placed on a more sound and sustainable footing.

The Deputy is correct that perhaps we have a lack of precision in the estimates relating to corporation tax but our inability in this respect simply highlights the massive uncertainty that exists. If we could put a number on it, we would do so. It is very difficult to do that.

Deputy David Cullinane: Our guests referred to revenues being more sound. What do they mean by that? Where is the capacity to increase revenue from the State's perspective?

Mr. Michael Tutty: One would look at sources of revenue based on activity with a strong and continuous presence in the economy. We could look at income earned and spending in the economy. The issue with corporation tax is that 80% of it is paid by multinational companies.

Deputy David Cullinane: What does Mr. Tutty mean by income earned?

Mr. Michael Tutty: That is income tax.

Deputy David Cullinane: In what areas could tax be increased?

Mr. Seamus Coffey: Taxes on income.

Deputy David Cullinane: Would that apply across the board to everybody?

Mr. Seamus Coffey: If one wishes to increase income tax, one can choose how to go about doing so. The rates or bands can be changed, or additional rates or bands introduced. Those choices are available. If additional tax revenues are generated in a sustainable fashion, they can be included in the overall pool available and one can have additional spending on that basis. In recent years there was the increase in VAT from 9% to 13.5%, which generated an additional €500 million or €600 million. In 2019 that figure was available for spending and included, while in 2018 there was the increase in stamp duty on commercial real estate which generated a couple of hundred million euro. Once these figures are included in the arithmetic, the money is available for spending. We have no issue with that-----

Deputy David Cullinane: I do not disagree with Mr. Coffey in respect of some of the areas where he stated there was potential for increases. I will play devil's advocate, however, because I am often on his side when I propose similar measures. An argument is often made that increasing income tax for any sector of the economy could hurt our competitiveness. Some argue either that it is not a sustainable economic solution or that it is not good for the economy. Would Mr. Coffey argue against it? He has stated there is scope for increased revenue and the money to be spent more sustainably. Raising income taxes for some may not be as dangerous or risky as spending based on corporation tax receipts. Is that a fair analysis of what Mr. Coffey stated?

Mr. Seamus Coffey: It highlights that there are choices to be made. Where one sees the balance of risks may be dependent on one's perspective and what one considers to be the likely outcome of tax changes. In the main, when we refer to tax changes, in respect of corporation tax it is hard to identify the changes that have led to the increase in receipts in recent years. There might be no change or the receipts could fall. If one believes government services should be expanded, which would require an increase in spending, doing so sustainably would require revenue to be raised sustainably. The issue is one of choice. Different perspectives can have different opinions about where the balance should lie such as whether raising income tax would be damaging to competitiveness or whether it would generate additional revenue to provide necessary supports in the economy. They are the choices the political process must make. The Oireachtas, as elected officials dealing with the general public, has to decide where the balance lies. The issue is with trying to do everything and thinking there are excess receipts which we can use to provide supports. We have experienced difficulties with problems related to it. There are echoes of the past in some of the decisions now being taken.

Deputy David Cullinane: I will see Mr. Coffey again later on "The Tonight Show" and will put my second round of questions to him then.

Chairman: That is outside the committee's remit. I will stick with those who will continue their questioning here.

Deputy Declan Breathnach: I welcome Mr. Coffey to the bowels of the bubble, where Brexit, the budget and balancing are what it is all about. I thank him for his advice both earlier in the year and at other times. It sounds solid to me. I reiterate what Deputy Cullinane said about politicians who, unfortunately, do not always make the decisions that need to be made in the interests of the country but ones that will please the electorate.

When Mr. Coffey appeared before the committee in June, he presented an analysis of a potentially hard Brexit. He has had much time since to consider what further implications there might be. Will he give an update or share his concerns that may not be in the public domain? He mentioned the issue of pre-commitments that should be reversed in 2020. Will he elaborate on that matter?

We all know about the health and social protection overspends, but are other areas susceptible to demographic changes in the coming years?

On taxation and social welfare policy, will Mr. Coffey elaborate on the merits of indexation compared to a series of *ad hoc* changes?

As a Border Deputy, I would like Mr. Coffey to comment on the issue of a sectoral response to climate change. If there is not dual thinking from a North-South or an east-west point of view, is there a serious danger of major leakages in revenue streams? Could we move back to a situation where there is no consultation between our Department of Finance and Her Majesty's Revenue and Customs in respect of VAT and income tax, or for example on the issue of carbon tax?

Dr. Martina Lawless: I will take the first question. Brexit is obviously something that we have been raising as a risk for some time. We rather thought that when we came back in mid-September, there would be some greater degree of certainty about the outcome at the end of October. As it is, there has been considerable work done. The Department of Finance put together its summer economic statement on the basis of different scenarios for Brexit with a deal and a no-deal Brexit. We would consider that there could be a fairly significant hit to the economy. The ESRI numbers suggest a reduction of up to 4% in GDP. Those are pretty reasonable middle scenarios in terms of the impact of Brexit on the economy. Economic models can really only do so much in terms of forecasting. They take the current world, where the UK is part of the European Union, and compare it to the alternative world, where the UK is out of the EU, to work out what happens to trade flows, or what happens to migration and public finances. There is a risk that in moving from the current world to the world after Brexit, the initial disruptions could be sharper and more negative. That is where we are. We are not questioning the baseline projections of how significant a hit Brexit could be to the economy; we are just highlighting that it is a baseline projection and that all these economic projections come with some degree of risk. In the context of Brexit, the risks are mainly in the sense that things could be worse than expected, at least temporarily. We do not really know what the timing of the impact could be. There could be a few weeks of particular disruption. Economic models cannot take into account traffic queues at Dover, to give a very obvious example of where things could at least initially be somewhat worse than the longer-term scenarios that are being put forward. There is still a great degree of uncertainty about it. I am not even saying it is necessarily the most likely outcome come end of October but it is certainly prudent to take such a significant risk as the expected approach. The Minister's statement today that the budget would be done on the basis of a hard Brexit aligns very much with our own thinking. As we said, while there is a distinction between the packages that are put in place to try to mitigate that, there is also room for automatic stabilisers to operate if some of the impacts have bigger hits to employment or to tax than can be foreseen at this point.

Dr. Eddie Casey: I might just run through the pre-commitments. The plans we saw in April were the clearest indication of the Government's plans for the year ahead. The increase they set out for the wider general government was €2.8 billion. Within that, €2.2 billion was already pre-committed, leaving €0.6 billion to be allocated. The €2.2 billion they had pre-committed was made up of things like carry-over costs of €300 million from the previous budget, public sector pay increases of €400 million, costs of €500 million due to demographic changes such as aging of the population, and capital increases of €700 million. There were some other adjustments due to how we account for general government treatments. That left them with €600 million. Within that, we saw that net tax plans were about €300 million and the remainder was €300 million of unallocated spending increases. In the interim, it seems they have allocated some of that unallocated €300 million. They have set aside €200 million in an expenditure reserve for the children's hospital and the broadband plan. That would suggest there is possibly just €100 million.

Deputy Declan Breathnach: If Dr. Casey were the Minister, would he reverse-----

Dr. Eddie Casey: A lot of the precommitments are very difficult to reverse. Measures that were taken in a previous budget cannot be reversed unless legislation is introduced. Standard demographic costs have to be met. It is unlikely that the capital increases that were set out will be reversed. There is room for manoeuvre within the €600 million that has been mentioned, or €400 million as it may be now.

Deputy Declan Breathnach: I have asked whether we should work on the basis of indexation rather than taking an *ad hoc* approach. The last time the Minister was before the committee, he gave a commitment that EU packages would be put in place to deal with Brexit. Are the witnesses satisfied that such packages are in place? How can we use our influence to make sure they are put in place? When problems arose in the agriculture sector previously, promises were made but packages were not put in place. To what degree are the witnesses aware that packages have been finalised in the event of a no-deal Brexit?

Mr. Seamus Coffey: I will begin by speaking about the merits of indexation as a means of maintaining the purchasing power of various payments in real terms, taking account of inflation. I believe it is a legitimate approach to take. During his speech at last year's national economic dialogue, the Taoiseach suggested that a policy of indexation would be considered, particularly in respect of State pensions. It is something that has a role to play. Although we are not necessarily advocating the introduction of indexation as a policy for making changes to payments, we believe it could be introduced at the forecast stage as a sort of guide or principle when considering where it is expected that payments will go in overall aggregate terms. If this were done on the basis of forecasts of inflation, it might be a useful addition because it would give an indication of the level of payments and the overall amounts. It is something that should form part of the overall policy debate. The Taoiseach has indicated that it will. It remains to be seen whether we decide to formalise the linking of payments to expectations of inflation. We agree with the view that there are merits to considering indexation in various areas of the public finances.

The Deputy also asked about the impact on Border packages of issues like climate change and excise duty differences. Yesterday, we saw the impact that decisions taken elsewhere can have on trade and on prices. I refer to the UK's decision to return to duty-free shopping for international travellers who leave the jurisdiction by passing through an airport or ferry port check into some sort of free zone where goods will be available free of duty. Of course, Ireland will reciprocate that. A person who uses some form of transport to travel from Ireland to the UK through an airport or ferry port - I do not refer to someone who drives across a land border - will be able to make duty-free purchases up to certain limits. It is possible that this will have a revenue hit for Ireland and could lead to a change in behaviour. Equally, if Ireland increases excise duty on fuel beyond the level seen in the UK and if there are continued exchange rate changes, it could become more attractive to purchase fuel in sterling than in euro. Factors such as the exchange rate and the level of excise duty should be taken into consideration. I do not know whether we have the capacity to assess the effects of these important considerations in an ever-changing environment.

Deputy Martin Heydon: I thank our guests for their presentations and for the work they have done on their report. It was strange to listen to Deputies John Lahart and Lisa Chambers as they made strong political points and accused Fine Gael of failing to learn sufficiently quickly from the mistakes of previous Administrations. We recently learned from some work that was done by Deputy Peter Burke that in the first six months of this year, Fianna Fáil made extra spending demands amounting to €4.35 billion. That puts some of the concerns that have been raised into perspective. It proves that the approach taken by Fine Gael in government is very different from the approach taken by Fianna Fáil in opposition.

I take the points that have been made in the report. I welcome IFAC's assessment that "Government revenues have performed well in 2019 to date". As a result of the council's confirmation that tax receipts at the end of August were in line with expectations, with strong year-on-year growth of 8.1%, we can be confident that the €57.9 billion target, as set in budget 2019, will be achieved. IFAC's concerns regarding health expenditure have been mooted for a long time. I note from the comments of the Minister for Finance, Deputy Donohoe, on the health budget after the Cabinet meeting that, compared with last year, we are in in a much better position. It is very easy to talk about budgets when one is sitting in a room, and IFAC has been vocal on health spending, but health care costs relate to people and it is a very difficult budget to manage. Much progress has been made in that regard. We know how important it is to get the health budget right and we continue to work on it.

At our June meeting, IFAC highlighted the risk of the economy overheating. Given the current Brexit developments, does IFAC believe that these risks have reduced? IFAC uses a principles-based approach to analysing compliance with the fiscal rules. Will the witnesses elaborate further on this and how it diverges from the EU's commonly agreed methodology? The Government has been successful in bringing the country to its medium-term objective. Will the witnesses elaborate on why this is important from the perspective of public finances?

Mr. Seamus Coffey: I thank the Deputy. I will respond to the earlier comments on costings. IFAC has a narrow mandate to assess the fiscal and macroeconomic plans as set out by the Government. In other countries, bodies with a similar mandate to IFAC do similar work on the costings and plans set out by the opposition parties. The Deputy mentioned that this was something undertaken by a colleague of his and perhaps it might be worth considering in an Irish context having a broader costings function somewhere within our policy framework that offered this service.

IFAC does not have a bias against the spending on health. It has an issue, however, with the unplanned nature of many of the increases. IFAC's mandate is to assess the plans as set out by Government, and it produces significant documentation with detailed analysis on those plans. Despite this, IFAC finds when it goes through the plans the following year that the spending on those plans has been exceeded by between €400 million and €600 million. IFAC's analysis and assessment of the plans is of something that was promised but not delivered. The issue is one of planning, and if we wish to allocate additional resources to health, and as the Deputy said, it is an important area, let us do so in a transparent fashion and have the consequences of the allocation of those additional resources fully thought through.

My colleague, Dr. Casey, may wish to comment on some of the other points.

Dr. Eddie Casey: I will respond to the question on the principles-based approach. We had thought a great deal about this as the fiscal rules were not working well for Ireland. We saw evidence of that during the bust. The fiscal rules allowed growth rates that were far too slow for the Irish economy compared with what might be judged sustainable in terms of growth and spending. In good times they allowed growth rates that were far too fast. The idea was to get to some type of happy medium.

IFAC's principles-based approach is outlined on page 154 of our June report. The key elements and where IFAC differs from the EU fiscal rules are that we take alternative estimates of the cycle, potential output growth for Ireland, and what we think is sustainable growth, and we, along with the Department of Finance, have developed more plausible estimates than the measures that are typically used by the European Commission for countries, which are a standardised approach. We also take a more sensible approach to unemployment linked costs related to the cycle. Much of this is very technical. The idea is to get to a sensible basis on which to judge what is a sustainable pace of growth and spending.

Mr. Seamus Coffey: I do not think our views on overheating have changed dramatically since June. As we have said previously we have an unusually uncertain economic environment. At times one can be talking about a severe negative impact from a hard Brexit.

On potential overheating pressures, the short-term indicators of the Irish economy continue to indicate strong economic performance, be it the labour market, the number employed, and spending. In the labour market we are possibly beginning to see some overheating pressures beginning to emerge with wage pressures, although it is nothing of significant note. Looking at the changes in wage growth and the direction it is taking, it could be that, if the economy does not hit a big speed bump in the next 12 to 18 months, we could see those pressures emerging. Equally, in the population data being produced by the CSO, we had a significant net inward migration. My colleague, Dr. Casey, spoke about trying to assess our position in the economic cycle. That is extraordinarily difficult to do. As we think the Commission's approach is not appropriate, we have adopted this principles approach. Net migration is not a bad indicator of where the economy is in the economic cycle. When an economy is performing strongly or perhaps excessively, there can be very high levels of net inward migration, as we had up to 2007 and 2008 and then net outward migration during the crash. Now we are beginning to see it pick up again. We are seeing pressures emerge in housing and other areas. I do not think our views on overheating have changed since June. We are beginning to see a gradual overheating in wage levels in the labour market. We have a heat map and the colour orange is beginning to appear in the income indicators in the labour market that could point to problems.

I did not get the Deputy's final question.

Deputy Martin Heydon: In recent years the Government has been successful in bringing the country to its medium-term objective. Why does Mr. Coffey think that is important?

Mr. Seamus Coffey: Yes, the medium-term objective of a balanced budget has been achieved in structural terms, but we must understand the huge tailwinds that have been behind the public finances in helping to achieve it such as the reduced interest costs and the strong cyclical recovery. We talk about corporation tax, but income tax, value added tax, VAT, and pay-related social insurance, PRSI, receipts continue to perform strongly, most notably PRSI. Of course, the achievement of the medium-term objective is being helped greatly by the corporation tax receipts. If we were to adjust for some of the excess we see here, the achievement of the medium-term objective might not look as solid as it does in the overall headline figure. It has been achieved, but there are significant risks behind it.

Deputy Joan Burton: I am interested in some of the points Mr. Coffey has just made. The Minister has confirmed, at lunchtime or sometime before then, that there will be no income tax cuts in the budget. I imagine that allows for a certain amount of drag in that incomes will go up and with no additional cuts, there will be no cost. Does Mr. Coffey have a rough calculation of what that is likely to mean in respect of potential buoyancy?

Mr. Seamus Coffey: It is built into the figures. When we talk about the net figure of €2.8 billion, we consider non-indexation to be a revenue raising measure. Incomes are rising. If we do not change the credits and bands, a higher share of people's income will be taxed at the higher rate, which essentially is an increase in their effective tax rate. For 2020 we are looking at a figure of approximately €600 million which is already included in the €2.8 billion. It is considered to be a revenue increase. The fact that the Minister has announced no change in income tax does not mean that there is anything additional. It is something we already consider is bringing in additional revenue. It is a significant sum.

Deputy Joan Burton: Mr. Coffey thinks it will be approximately €600 million.

Mr. Seamus Coffey: Yes, €600 million.

Deputy Joan Burton: I heard an earlier estimate of €400 million, but it is higher because of what Mr. Coffey said about immigration earnings and PRSI receipts, which are incredibly strong this year.

Is the pensioners' bonus safe? It is very important for pensioners on fixed incomes. By and large, they do not have an opportunity to earn extra income. Even for those who earn interest on savings, the rate is at an all-time low. The Christmas bonus is an important stimulus, particularly in much of rural Ireland. Is it safe for the moment?

Mr. Seamus Coffey: As my colleague, Ms Lawless, said, it is predictable. There have been commitments from the Ministers for Finance and Employment Affairs and Social Protection that the payment will be made again in 2019. Our view is as predictable as the payment. If a commitment has been made to make it, it should be included in the figures. We have had no indication that it is at risk. Our concern is to see a credible plan set out. If the payment is to form part of Government spending, it should be included in the plans.

Deputy Joan Burton: I share that view and have shared it for a long period. Mr. Coffey has a point when he states there are certain things that should be reflected in the accounts, such as the Christmas bonus. The Christmas bonus was abolished by Fianna Fáil in the first cut and it was pretty shocking. There was much difficulty in trying to reinstate it. I think it is a positive payment in our system.

The second question I want to ask relates to the fact that there will be no tax cuts in terms of personal taxation for people at work. Does that not make a much stronger case for Ireland to have a minimum effective corporation tax because, as Mr. Coffey stressed, and I agree with his point, of the uncertainty of the corporation flows? It is ridiculous that we do not have a minimum effective rate of even 2% or 3%, which would give some stability. Mr. Coffey may argue, and I know others do, that this would result in a potential flight of businesses from Ireland but the EU and the US are saying, given the state of various economies, that they should have contributions from companies in different ways. The Department of Finance is adverse to this suggestion but would Mr. Coffey consider that there is now a serious case to do it as a way of stabilising some of the corporation tax receipts?

Mr. Seamus Coffey: The Irish Fiscal Advisory Council does not have a view on this. If I take off my fiscal council hat and look at some of the work done on corporation tax for 2018 when we collected just over €10 billion, and the effect of tax on profits to generate €10 billion was in the order of 2%, one is looking at profits in the region of €500 billion. I know the numbers in Ireland are big, but they are not of that scale. To collect €10 billion at 12.5% rate, or even a 10% rate, requires profits in the region of €90 billion to €100 billion, which are pretty substantial. There was one measure introduced to try to reduce the potential volatility of our corporation tax back in October 2017, when the 80% cap was restored for capital allowance claims under section 291A and that will offer some reduction in volatility in corporation tax, but the amounts themselves are quite large. We could introduce an effective rate of 2% to 3%, but I think the amount of additional revenue that it would generate would be zero, because for profits earned in Ireland the effective rate is substantially higher than that and there are two reasons companies have lower rates. The Comptroller and Auditor General did an excellent report on the effective tax rates on the top 100 companies and the two reasons that certain companies had lower rates was first, because they availed of research and development tax credit, so perhaps we could introduce limitations on the extent to which that can be used; or second, the significant sources of revenue was foreign revenue, that is, it was income earned abroad and that they paid a dividend back into Ireland and that was counted as part of their taxable revenue. The fact that the tax was paid abroad, the companies did not owe additional tax in Ireland. From an Irish perspective, the companies had a profit with very little Irish tax being paid but that was because the tax was paid elsewhere.

We could remove those profits from our tax base and that would see the effective tax rate rise because one would be just looking at Irish tax and Irish profits. I think the volatility of corporation tax is an issue. One measure has been introduced to address it and perhaps others could. That is not to say that the issue of an effective minimum corporate tax rate is not important. It is on the agenda at OECD level and it is possible that in the context of the OECD, a minimum effective tax rate could be a threat for Ireland, but that depends on whether it is done on a country-by-country basis, which would be significant for Ireland, or on a global basis. We would far prefer to see it done on a global basis.

Deputy Joan Burton: Mr. Coffey is talking about the stability of corporation tax, but in any event we are in the last chance saloon on some of the taxation measures we have. Sooner rather than later, certainly in terms of the OECD process, it would make sense to show, as we have done in other areas, including the area of corporation tax every year, that we are not, and do not want to be, the tax haven that others portray us as being. Politically, that claim as regards tax is incredibly damaging to Ireland and a day will come when the balance of inward investment will be heavily affected by it.

Chairman: The Deputy has run over time. To be fair to all members, each speaker has only four minutes in the first round. Deputy Lahart has indicated he wishes to ask a supplementary question. Deputy Burton may contribute again thereafter.

Deputy John Lahart: I am very taken with the words Mr. Coffey attributed to his predecessor that the Irish Fiscal Advisory Council was established "to institutionalise the memory" of the impact of the crash. We must keep that powerful statement in mind and mention it at the start of every meeting. Can Mr. Coffey quantify the proportion of State income stamp duty contributed at its height?

Mr. Seamus Coffey: At its peak in 2006, stamp duty amounted to around €7 billion. If one considers the broad gamut of property transaction-related taxes - stamp duty, capital acquisitions and capital gains tax - at their peak they provided roughly one fifth of Government revenue. Coincidentally, that is where corporation tax stands today.

Deputy John Lahart: All of those construction-related taxes and incomes-----

Mr. Seamus Coffey: Transaction taxes.

Deputy John Lahart: Transaction taxes accounted for 20% of the total tax take at that time and corporation tax currently accounts for 18% of the total tax take.

As Mr. Tutty stated, budget 2015 predicted a surplus for the first time. If I understood him correctly, corporation tax receipts were predicted to be €5 billion in 2018.

Mr. Seamus Coffey: Yes.

Deputy John Lahart: Interest rate payments were predicted to reach-----

Mr. Seamus Coffey: The figure was €9 billion for 2018.

Deputy John Lahart: In 2015, it was predicted that corporation tax would be €5 billion in 2018 and interest rate payments would be €9 billion in the same year. There has been little or no surplus since 2015. During this period, interest rates halved, which meant we paid half what we expected to pay in interest, and receipts from corporation tax were twice what was predicted. To quote Dr. Lawless, Government expenditure has absorbed a huge amount of that. These are not once-off emergency expenditures but expenditures that have become embedded and a systematic part of what we do. Is that an accurate summary?

Mr. Seamus Coffey: Agreed.

Deputy John Lahart: My final question is completely unrelated. We have talked about a hard Brexit and a crash-out Brexit. The IFAC has advised, as have others who appeared before the committee, that the Government's approach to Brexit was predicated on a benign outcome and it is only in the recent past that the emphasis has changed. There will be a Brexit of one shape or form. Do we have a sense of the impact of even a reasonable Brexit? I know there have been attempts to quantify the impact of Brexit with a deal.

Mr. Coffey will be unable to answer my ancillary question but it would be worthwhile for him to consider it. Many tentative solutions have been suggested as to how this problem may be solved. One suggestion is to have a Northern Ireland only backstop. Under this hypothetical scenario, an economic zone would be established, as originally anticipated in the withdrawal agreement, and the North would be able to take advantage of the best the EU has to offer while remaining part of the UK. What impact, if any, would Northern Ireland being a special economic zone have on the economy of the Republic?

Mr. Seamus Coffey: I will take the first part of the question and someone will step in for the second part. On the forecasts, the Minister today announced that a hard Brexit will form the central scenario for the macro forecast set out for budget 2020. It is important to realise that the central scenario beforehand was the withdrawal agreement, involving a transition period up to the end of 2021 and then a future relationship in the trading between the UK and the EU. That was the base case scenario. One can ask, taking in that soft Brexit, what the forecasts would be if Brexit did not happen at all. That was the base case.

As my colleague stated earlier, perhaps the change in our view of what would constitute a hard Brexit is that more of the costs are now upfront rather than delayed and there is perhaps an increase in the estimate of what those initial upfront costs could be and what ones will arise in a hard Brexit scenario because of trade disruption and the impact of non-tariff barriers, whether queues of traffic at Dover or trying to figure out what form to fill in to get goods over the Border. The previous case would have been the withdrawal agreement and the transition. There would have been some impact but those costs were much further out into the medium to long term, the view being that Brexit is a permanent structural change and could have an impact on the markets to which Ireland sells goods. It was not as if Brexit was not built into the forecast previously. It is just that it has been announced that we have introduced Brexit to the forecasts today. It was in the forecast previously. It is only the scenario that has now changed.

Dr. Martina Lawless: A Northern Ireland only backstop would do quite a bit to mitigate the extent of the hit to Ireland from an economic perspective. First, there would be no need for the Government to establish any checks on goods coming across the Border. That would result in an immediate saving in terms of customs officials and infrastructure. Also, it would reduce quite significantly the disruption to firms and employment in the Border counties, which are currently the most exposed. If any disruption to that trade and supply chains across the Border currently could be avoided, that would avoid one of the significant costs of Brexit to the Irish economy.

Dr. Eddie Casey: Deputy Lahart referred to what budget 2015 projected. The interesting point is that the surplus that had been forecast at that time was for 2018. We expected to have a surplus of €565 million, which is bigger than we had last year and is close to what we expect to have this year. We hope to have €610 million this year. At that time, without any knowledge of the kind of windfalls that we would get, that is what we expected - the surplus much earlier.

Deputy Joan Burton: I would like to take up the issue of Brexit and the Border. Deputy Breathnach is very much an expert on this, but I have my own connections to the area.

IFAC has no direct brief on Brexit but it seems, both to me and to many others with a knowledge of the Border, that the biggest problem will be smuggling, and we could face a 50 mile, or even 100 mile, zone on either side of the Border where there would be a potentially significant loss to the Irish Exchequer in VAT because of goods being moved without being recorded for tax purposes. In the North, there could be a comparative reaction. That is an enormous concern to traders and legitimate businesses all along the Border because other people will be going through. Has IFAC commissioned anyone to model what the likely hard Brexit impacts will be? There is a role for trusted traders and so on. We all know there is already a lot of smuggling along the Border to the detriment of traders. Has Mr. Coffey had any conversations about this? The potential risk loss to the Revenue in respect of VAT and other directly levied taxes, whether on fuel or other elements of trade, could be extensive and very damaging to the Government's revenue capacity North and South.

Mr. Seamus Coffey: We have not examined or seen estimates of potential losses. The risk of illegal activity and evasion in terms of the washing of marked gas oil and other activities is present regardless of whether Brexit happens, perhaps because of the different rates between the two jurisdictions. The point made earlier by Deputy Breathnach relates to what we would consider to be traditional avoidance. When a tax is lowered in another jurisdiction, people go there to buy their fuel. While there might not necessarily be anything illegal about doing that, it would raise concerns about the difference in price levels. This is not an issue we have considered or have seen information on, but when it comes to the setting of rates for excise and so on, it is likely to be a factor. One would hope there would be a form of co-operation between the two jurisdictions on a matter such as that. Co-operation has not been at its strongest in recent times, but it is to be hoped, once the process of the UK leaving the European Union has been completed, co-operation can be restored. The Deputy is correct that it is an issue, but it is not one on which we have undertaken work or seen work undertaken.

Deputy Joan Burton: On health, does the council have a ballpark figure at this point in regard to the likely deficit on the health side by the end of this year? Is the Supplementary Estimate likely to be €200 million or €300 million?

Mr. Seamus Coffey: We do not have a precise figure for 2019. As mentioned by my colleague, Mr. Tutty, the indication from the Department of Public Expenditure and Reform earlier this year is that approximately €150 million will be required. The concerns of the Irish Fiscal Advisory Council are primarily those as raised by the Department of Public Expenditure and Reform in regard to a potential Supplementary Estimate of €150 million. The average in recent years has been around €500 million, with most of that arising in the final quarter of the year. As of now, health spend is on track. As mentioned by Mr. Tutty, there appears to be an unusual profile pattern for the end of the year, with a dramatic slowdown in the growth of health spending forecast. That might materialise, but it does appear unusual and it suggests there is the possibility of an overrun again for 2019. As I said, we do not have a precise figure but the figure provided by the Department of Public Expenditure and Reform and the average over recent years indicate it could be significant.

Deputy Joan Burton: Additional spend has been provided for health for this year already. I assume that has been added to the base figure. All things being equal, the actual overrun by the end of the year should be relatively smaller.

Mr. Seamus Coffey: It would be of real concern if there was to be a significant overrun this year in line with previous years. The planned spend for 2018 was €15.3 billion. The planned spend for this year is €17.1 billion, which is an increase of €1.8 billion to meet last year's overrun of €600 million and an additional €1.1 million for 2019. In the context of this large amount of additional resources, if there is a significant overrun, the fact that these increases were not sufficient to keep the health spend within its budgets would be of huge concern.

Deputy Joan Burton: Is there likely to be a repeat of money being found behind the sofa as happened last year and the previous year?

Mr. Seamus Coffey: An outperformance of corporation tax could mask these spending increases. If corporation taxes perform strongly in the early part of the year, there could be strong receipts in November which would cover the overruns in spending. Spending on health should be done on a consistent, sustainable and ongoing basis. It should not be dependent on unreliable and possibly temporary corporation tax receipts.

Deputy Joan Burton: Does IFAC have any advice for the Dáil or the Government as to how extra spending should be targeted in the context of a very difficult Brexit? During the previous crisis, Germany spent a great deal of money on direct subsidies to employers aimed at allowing them to retain employees. Everybody referenced, three or four times, the fact that a lot of unemployment could be expected. This would result in people in our system shifting to social welfare. Does IFAC see scope for us to use the German system? I know it can be referred to as underemployment, under-activity and so on, but Germany did a lot better than Ireland. The old East Germany, which was not as economically dynamic as the old West Germany, also consistently did a lot better in trying to maintain firms, rather than allowing them to crash, by using, in an appropriate way, subsidies that had to be used to maintain people in employment.

Mr. Seamus Coffey: This is a matter on which IFAC does not have a view. We see Brexit as bringing about the potential need for additional spending but whether that happens through the social protection system or a system of employment supports is a matter for those involved in the political process to decide. We are more concerned about the outcome for the overall public finances. We do not have a view on how such supports, if they are to be offered, should be provided.

Chairman: That concludes today's meeting. I thank all the Deputies who participated. I also thank Mr. Coffey and his team for their ongoing engagement with the committee. Obviously, there are quite divergent political views on the committee. People who look at this from a Government perspective see things as having gone incredibly well over recent years in light of the improvements we have witnessed. I am sure many colleagues have different views. Regardless of where we come from in terms of our political thoughts, this engagement is important as we look at the facts with which we are presented in the run-up to the budget. As we have no further business, the meeting stands adjourned.

The select committee adjourned at 5.45 p.m. until 1 p.m. on Tuesday, 17 September 2019.