DÁIL ÉIREANN

AN ROGHCHOISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 8 Nollaig 2020

Tuesday, 8 December 2020

Tháinig an Roghchoiste le chéile ag 11 a.m.

The Select Committee met at 11 a.m.

Comhaltaí a bhí i láthair/Members present:

Teachtaí Dála/Deputies	
Richard Boyd Barrett,	
Bernard J. Durkan,	
Mairéad Farrell,	
John Lahart,	
Ged Nash,	
Kieran O'Donnell,	
Patricia Ryan.	

Teachta/Deputy Neasa Hourigan sa Chathaoir/in the Chair.

Post-Budget Analysis: Irish Fiscal Advisory Council

Chairman: Apologies have been received from Deputies Canney and Doherty.

Before we begin I remind all of those in attendance to ensure their mobile phones are on silent mode or switched off. From the Irish Fiscal Advisory Council I welcome Mr. Sebastian Barnes, Dr. Martina Lawless, Ms Dawn Holland, Professor Michael McMahon and Dr. Eddie Casey. I thank them for making themselves available to the committee.

All witnesses are reminded of the long-standing parliamentary practice that they should not criticise or make charges against any person or entity by name or in such a way as to make him, her or it identifiable or otherwise engage in speech that might be regarded as damaging to the good name of the person or entity. Therefore, if their statements are potentially defamatory in relation to an identifiable person or entity they will be directed to discontinue their remarks. It is imperative that they comply with any such direction.

For witnesses and members attending remotely, there are some limitations to parliamentary privilege and as such they may not benefit from the same level of immunity from legal proceedings as a witness who is physically present. Witnesses participating in this committee session from a jurisdiction outside the State are advised they should also be mindful of their domestic law and how it may apply to the evidence they give.

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 of the Houses or an official either by name or in such a way as to make him or her identifiable.

I remind members the meeting is limited to two hours due to the Covid-19 guidelines. This is to ensure the safety of members, witnesses and secretarial staff. We have agreed speaking times and slots and I ask members to remain within these agreed times. I suspect we will have some latitude towards the end if anyone wants to come in for a second round.

I also remind members that other members are due to attend later and if, when vacating their seats, they use the wipes available to wipe their area, it will allow the next set of members to arrive and take their seats in a safe way.

I invite Mr. Barnes to make his opening statement.

Mr. Sebastian Barnes: I am sorry but I do not know whether the committee members can hear us.

Chairman: We can, yes.

Mr. Sebastian Barnes: We cannot hear, unfortunately. If committee members could confirm whether they can hear us it would be very helpful.

Chairman: Yes, we can hear Mr. Barnes.

Mr. Sebastian Barnes: We can hear the Chairman now. This is a perfect situation for a dialogue.

As always, we thank the Chair and members of the committee for inviting us. Joining me remotely are council members Dr. Martina Lawless, Professor Michael McMahon and Ms

Dawn Holland, as well as our chief economist and head of secretariat, Dr. Eddie Casey. We hugely value our engagement with the Oireachtas and see these meetings as an important part of our work.

As committee members knows, the Irish Fiscal Advisory Council is an independent body established under the Fiscal Responsibility Act 2012. Its mandate is to endorse and assess the official macroeconomic forecast, assess the budgetary projections, assess compliance with the fiscal rules and assess the fiscal stance. This focuses on the overall fiscal stance rather than on individual tax measures or spending items and priorities.

The council's fiscal assessment report was published last week and assesses budget 2020. In terms of the economic outlook, Covid-19 continues to have a major impact on the Irish economy. The budget projections imply a 6% decline in real modified gross national income, GNI*, this year, followed by a muted 2% recovery in 2021. November's Covid-adjusted unemployment rate remains high, at 17.4% for those aged between 25 and 74. However, the outlook has improved since the spring. The domestic economy recovered strongly in the third quarter. Consumption has rebounded and multinational enterprises have supported activity.

For budget 2021, the Government assumed that a vaccine would not be widely available until at least 2022, and that trade between the UK and the EU would be based on a hard Brexit. This was prudent, given the uncertainties and risks involved. However, it did not factor in a tightening of the Covid restrictions, as we saw in October. The budget forecasts cover just one year ahead, compared with the normal five-year horizon. This gives an extremely narrow picture as to how today's policies might impact on the economy and on public finances. While medium-term projections are uncertain, they help to promote medium-term oriented fiscal policy. A return to five-year forecasting is essential for next April's stability programme.

In our report, we developed three scenarios to 2025 to help frame some of the medium-term challenges that Ireland faces. The extended budget 2021 projections would see the economy recover to pre-crisis levels of activity by the end of 2022. A milder scenario, with an effective vaccine next summer, and perhaps we have got closer to that, and an EU-UK free-trade agreement, could see the economy recover to pre-crisis levels somewhat earlier in 2022. By contrast, a repeat waves scenario, with further level 5 restrictions necessary in 2021 and 2022, could see the recovery delayed until well into 2023.

The outlook remains highly uncertain and the impacts of the crisis might be felt for a very long time. Sectors such as retail, hospitality, transport and the arts are especially vulnerable to the pandemic. Counties more reliant on tourism and hospitality have also been worst affected, especially in the western and Border regions. The impact of Brexit also is still unclear and could be much different from what is assumed. Ireland is also exposed to international tax policy changes.

Turning to the public finances, Covid-19 has led to massive Government spending on job supports, health responses and measures to stimulate demand. Tax revenues have fallen sharply in some areas, notably VAT. Yet corporation tax and income tax have fared better than expected. A very large deficit close to €20 billion, or approximately 10% of GNI*, is likely both this year and next year. This will lead to a sharp rise in the debt-to-GNI* ratio, which was already at high levels pre-crisis - the sixth highest in the OECD at the time.

The council assesses that the Government's decision to continue to borrow to support households and businesses through the Covid-19 crisis and to provide stimulus is appropriate, including up to €12 billion of supports in temporary stimulus for 2021. These measures should help to lessen the lasting damage of the economic crisis, and ultimately lead to a more sustainable path for Government debt. The council welcomes the use of contingencies in budget 2021 to cope with any additional costs of Covid-19 and Brexit and the use of the recovery fund, which has not been fully allocated at this point. Temporary and targeted supports should fall out of spending as the need for emergency measures diminishes and as the economy recovers, although there is some risk that some temporary spending may become permanent.

Budget 2021 also includes substantial, permanent increases in Government spending of at least €5.4 billion, however. Rather than being temporary and targeted, these will remain after the pandemic has passed. They are surprisingly large in the context of past budgets. Since 2015, budgets have included packages closer to an average of €3.5 billion a year. The permanent increases could even be as high as €8.5 billion as it is not possible to ascertain the nature of some of the increases in non-Exchequer elements of the public finances. This reflects ongoing transparency problems in areas outside of the Exchequer that have traditionally not been the focus of the Department in budget discussions.

The council assesses that permanent increases in spending without identifying sustainable funding is not conducive to prudent budgetary management. To be clear, the council is not opposed to increased spending itself, and the debt-financed stimulus at the moment is appropriate. However, there is no sense from the budget of how the lasting increases will be financed sustainably over the medium term. The programme for Government rules out tax increases and spending reductions over large parts of the tax base and existing spending. The risk is that this will tend to lead to larger deficits and leave debt on a riskier path.

Looking ahead, the council's simulations suggest that Ireland's budget balance by 2025 will be in deficit of between 2% and 3% of GNI* in the extended budget scenario. Assuming interest rates remain reasonably favourable, debt ratios, although high, should fall over the medium term except in a repeated wave scenario.

The €5.4 billion of core spending increases planned for 2021 will slow the pace of debt reduction. They will add to the deficit even by 2025 and they will contribute to debt being higher than it would have been otherwise.

The Government faces a number of significant challenges once the economy is on a path to recovery. Fiscal adjustment may be needed to put debt on a safer path and there are long-standing pressures on the public finances. These include Ireland's rapidly ageing population, which is set to add approximately €850 million a year to Government spending to 2025, measures to address climate change, reducing the over-reliance on corporation tax, which now amounts to €1 in €5 of Exchequer revenue, and fulfilling ambitions to upgrade the public services.

The Government must use its medium-term strategy in April 2021 to deliver credible plans. This should include five-year forecasts; details on non-Exchequer areas; plans for sustainably financing the large increases in permanent spending; proper costing of major reforms such as Sláintecare; and an explanation of how budgetary plans would change if revenues fall short. Three reforms would also help: debt targets set in GNI* terms; tools to save temporary receipts such as unexpected corporation tax; and setting sustainable growth limits for spending.

I thank the members and we look forward, as always, to their questions.

Chairman: I thank Mr. Barnes. I will begin our first round of questions with the primary speakers from each party who have nine minutes each for answers and questions. I call Deputy O'Donnell.

Deputy Kieran O'Donnell: I welcome Mr. Barnes and his colleagues and thank them for the great work they do in the Irish Fiscal Advisory Council. I have a couple of comments to make on Mr. Barnes's statement. We are in the eye of the storm in terms of Brexit. Discussions are ongoing between the EU, with Ireland being central to that, and the UK. In his statement, Mr. Barnes stated: "The impact of Brexit also [though assumed disorderly for the budget] is still unclear and could be much different what is assumed". What is his overview of the current Brexit discussions, the risks for Ireland as a small, open economy and the challenges we face?

Mr. Sebastian Barnes: As Dr. Martina Lawless is our Brexit expert, I think it would be unfair of me not to allow her to answer that question. I am sure she will do much better than-----

Deputy Kieran O'Donnell: Fair enough. We will defer to Dr. Lawless's expertise.

Dr. Martina Lawless: I thank Deputy O'Donnell for the question. The assumption that went into the budget, and which we thought was appropriate given the risks involved, was that there would be a hard Brexit, one without a free trade agreement. The work we have done at the council, and informed by the work with the Department of Finance and the Economic and Social Research Institute, ESRI, is that even a free trade agreement would probably reduce long-term Irish GDP by approximately 3%. A disorderly Brexit would increase that and bring it to almost double and there would be many differences across sectors in particular that we would be concerned about. The agri-food industry and the domestic SME sector would be particularly exposed, both because they trade more with the UK than the larger multinationals, which make up a lot of our total exports, and because they often export products such as agricultural products or food products, which would attract the highest tariffs under either the EU's tariff regime for imports or the UK's universal tariff, which it would apply to Irish exports going there.

Deputy Kieran O'Donnell: In the time I have-----

Dr. Martina Lawless: As time grows shorter in terms of the negotiations, there is also less time for firms to prepare in terms of documentation and setting out tariffs and more risk that there are less customs-----

Deputy Kieran O'Donnell: Can Dr. Lawless hear me?

Dr. Martina Lawless: I am sorry. Yes.

Deputy Kieran O'Donnell: Dr. Lawless is referring to a 3% reduction in GDP with a free trade agreement and that that would double in the event of a hard Brexit. I am surprised it is not more. While 3% is a sizeable reduction, Dr. Lawless has stated it will be only 6% if there is no free trade agreement. I would have thought the differential would be much higher.

Dr. Martina Lawless: It is important to realise that even with a free trade agreement, which takes away the direct cost of tariffs, there are a lot of other increases in non-tariff barriers, documentation, different registrations and the need for sanitary checks on food exports. There are still quite a lot of costs involved. With regard to the direct effect of the free trade agreement and moving to WTO terms, there are still a lot of costs in the free trade agreement that would negatively affect customs. There is also the risk that a hard Brexit would have a slightly worse effect in the initial couple of months as firms adjust to all of these new checks and while the customs capacities and so on are being-----

Deputy Kieran O'Donnell: To finish on the point-----

Dr. Martina Lawless: With a harder Brexit, that while the long-term effect does not sound so much greater than a free trade agreement, there is a risk that the effects would be more likely to be front-loaded into 2021.

Deputy Kieran O'Donnell: Mr. Barnes said that "the permanent increases could even be as high as €8.5 billion as it is not possible to ascertain the nature of some of the increases in non-Exchequer areas. This reflects ongoing transparency problems in areas outside of the Exchequer that are traditionally not the focus of the Department." Could he expand on that? Where are these areas? Where does he see the scarring effects of Covid-19 in Ireland? He spoke about the three reforms - debt reduction targets, tools to save temporary receipts and sustainable growth. What are the priorities for the Government? Could he identify what those metrics should be in terms of dealing with the aftermath of Covid and oncoming train of Brexit?

Mr. Sebastian Barnes: I will take those questions in a different order. The question of scarring effects on the economy, particularly transport and accommodation, is something about which we are very concerned. Some of these sectors have been very badly hit. We know the Government has put in a lot of support but ultimately we do not know how long those companies will be able to last under these conditions and we do not really know how quickly consumers will start travelling again. As with some of the effects of a hard Brexit, which, again, is a shock we have never seen, it is very hard for us to evaluate what those risks are but we just need to be aware of these risks, which is why we drew the committee's attention to them.

The second question concerns the difference between the €5.4 billion, which is on an Exchequer basis where we have a very good handle on what is being spent and what is going on and this non-Exchequer part that is also within the general Government. It is important in terms of public finances, and this is how the European rules are specified, that we should not just look at the Exchequer, which is an important part of the institutional mechanism in Ireland. We should also look at the overall role of the Government, as measured by the general Government. This is how the fiscal rules are specified, which is one of the reasons we are so interested in it. The part that is not covered by the Exchequer is some 20% of the total so it is very big but up until recent years, basically not very much was happening there so it did not have a large impact on the kind of fiscal aggregates at which we look.

Deputy Kieran O'Donnell: To which area of spending is Mr. Barnes referring?

Mr. Sebastian Barnes: That is a very good question. This is basically local government, commercial semi-State bodies and extra-budgetary funds. Collectively, they add up to quite a bit. Until recent years, there was not a great deal of action happening there. This arose in the previous budget and this year as well. Quite a lot of the increase is coming through in these areas. We lack two things. We lack actual information on where the money is being spent. What we receive is a net figure that gives the overall number but it does not tell us where it is coming from. There are some offsetting amounts between spending and revenue. We have asked the Department of Finance to provide us with a much clearer picture of the numbers. The Department is working on this, which is good news. It would also be good to understand more about what is going on. Quite a lot of it is probably capital investment. It would be good to know what the investment plans are so that we and others can factor those into budgetary projections. It is an issue that has arisen over the past couple of years that basically relates to local government, semi-State bodies and a few other things. We are asking for more transparency in terms of numbers and understanding what the underlying story is.

Regarding the Deputy's final question about the areas where the budgetary framework could be strengthened, it is very good that the Government plans to look at the medium term in April. As we have said, it will face a number of challenges and we believe those challenges may be easier to manage with some measures to strengthen the fiscal framework. We focused on three. One is having a target for the debt-to-GNI* ratio. Obviously, in a period when debt is very high and needs to be brought down, it is natural to target the debt-to-GNI* ratio, particularly a few years ahead where the Government will have a bit of time to control the dynamics. Regarding one particular concern, previous Governments have had a debt target but, in our view, without very much commitment. It was also specified in terms of GDP, which is not the appropriate measure of national income, so this really needs to be measured in these terms. Under European rules, the debt rule is done in GDP terms, which does not make a lot of sense for Ireland and does not give it an accurate picture. The second area is around a rainy day fund. We also talked about a prudence account in the past. These are ways of essentially building up precautionary buffers for future shocks. It would also be a very good way of saving the excess corporation tax receipts and helping to smooth that over time. This is a relevant measure to consider after this year where the Government is clearly trying to stimulate the economy in 2021. The third measure is the kind of control of spending in normal times. The expenditure ceiling system has not worked that well. We have also had periods in the past couple of years where expenditure growth has been a bit too fast relative to the speed of the economy so strengthening the domestic controls around that would be helpful. We also make one or two other suggestions as well. These could be very helpful measures for the Government to consider as it sets out its medium-term plan in the autumn. It could put these measures in place that would strengthen the institutional framework as well just announcing what it plans to do.

Deputy Kieran O'Donnell: What is the largest single risk to the economy?

Mr. Sebastian Barnes: In the short run, it is Covid while in the slightly longer run, it is Brexit. We have had some better news on Covid with the vaccine. The next few months will be quite difficult but beyond that, perhaps things will be less risky than we thought. Of course, there are many unknowns regarding the vaccines. In the short run, we hoped we would know by this point what will happen with Brexit. As Dr. Lawless explained, it is a large shock and the short-run effects in the early part of new year could be quite strong. There is significant uncertainty around both of those things. Those two things stand out but which of the two is the more important depends on the timeframe.

Deputy Mairéad Farrell: I have a number of questions concerning the council's report. The report highlights the fact that budget 2021 includes substantial permanent increases in spending that are not matched with a clear future funding source and that this cannot be considered a fiscally prudent approach to budgeting. Although the Government initially said it would not raise taxes in 2021, it is now saying that there may be some increases in tax. We know that a number of EU countries such as Spain, France, Norway and Belgium along with Switzerland have a wealth tax. We have also seen that Argentina is even experimenting with a once-off levy on its 12,000 richest citizens - the so-called millionaires tax - to help pay for the recovery from Covid-19. What is the council's view on the imposition of a tax on wealth more broadly defined as an additional revenue-raising measure to help to improve fiscal sustainability and overall budgetary balance?

Mr. Sebastian Barnes: The council's mandate is to look at the overall budgetary stance rather than specific measures so it is really a choice for the Government in terms of how it is going to manage the future challenges. That is one of the things we look forward to the Government announcing in the medium-term plan in April. We do not have a specific measure or view about any specific tax. We welcome the work of the tax commission. That is a good way of looking at this. It is important in the long run that the tax system supports growth, that it is fair, and that it is perceived to be fair, so it has a popular legitimacy. We welcome that work. That is the best we can say.

Deputy Mairéad Farrell: The December Fiscal Assessment Report also notes that budget 2021 includes substantial permanent increases in spending of at least €5.4 billion. This spending provides for measures that would remain post-pandemic. The report says that this could rise to €8.5 billion after considering non-Exchequer areas and that "There is no sense as to how these [lasting increases] will be financed sustainably over the medium term." We are aware that the programme for Government commits to no increases in income tax or USC, to indexing bands and credits in line with earnings growth, and to focusing only on tax rises that focus on behaviours including carbon, sugar and plastic. Throughout the general election campaign Fine Gael attacked Sinn Féin for committing to a progressive increase in employers' PRSI. In Mr. Barnes' view, can the Government fund €5.4 billion increase in permanent taxation through increases in tax on sugar and plastic?

Mr. Sebastian Barnes: Overall the choice is about how to prioritise spending and tax adjustments. This is very much a question for the Government. Deputy Farrell referred to the increase of €5.4 billion up to €8 billion, which is a very large increase in the context of recent budgets. It is also quite a large increase if one looks at it relative to the sum potential tax changes. Clearly, things such as the sugar tax raise a very small amount relative to that. It may well be desirable on public health grounds, but it is not something that radically changes the picture in Government revenue.

The imposition of the carbon tax, again, can be very helpful in reducing emissions, which is a goal that we all support. On the other hand, those revenues have already been allocated to specific things. Again, it does not provide a general solution for supporting further spending. If one looks at the increase in PRSI rates, the estimate from Revenue is that this would bring in another €750 million per year. It is important to view this as context for looking at the impact of these increases in spending. Of course, the economy will grow over the coming years also, which will provide additional revenue. At the same time, the costs of standing still, which is the cost of the Government continuing to provide the same services taking into account the costs of paying higher wages, higher welfare rates or maintaining welfare rates in real terms at their existing levels, and the costs of ageing, which will add another €850 million per year on average to public spending, will eat up a lot of the space that growth will create. It will probably eat up more than the amount that additional growth will generate over some of these, once we get beyond the recovery. It is a challenging environment and there are difficult choices to be made in terms of increasing spending and perhaps reviewing spending in existing areas. One thing we call on the Government to look at is to strengthen the spending review process. That does some good work, but it could be made into a genuine process for looking at whether Government spending is prioritised and delivered in the most effective ways. There are some very hard choices coming around taxation and spending.

Deputy Mairéad Farrell: I thank Mr. Barnes for that. I understand there will be hard choices but I hope we will not see a repeat of what happened previously where those most vulnerable in society were affected again and again, and harder and harder, under the so-called recovery, while so many people never saw any kind of recovery.

Mr. Barnes made another point around the lack of clarity on the non-voted expenditure. I am interested to hear if he is familiar with how other EU jurisdictions have oversight of non-voted expenditure, which could help inform the committee on how to improve transparency in that regard.

I am also quite interested in the whole issue of capital expenditure. We are being told that there will be an extra billion euro here, there and everywhere for capital expenditure but what it really boils down to is €9.3 billion in 2020 and it will be increased to €9.8 billion in 2021. We are aware of how important capital expenditure is in having a significant multiplier effect. If there is a vaccine in 2021, which could change the spending on income supports, does Mr. Barnes feel that this funding could be redeployed for capital spending to boost the growth in the overall budgetary balance?

Mr. Sebastian Barnes: I will attend to those points in turn. On the general Government figures, this is an issue that comes up in a lot of countries. Ireland in some ways has better transparency than other countries. We have a fairly precise idea in terms of providing information on the gross spending there and on a number of other things, including a thing called the “walk”, which allows one to move from the Exchequer to the general Government figures. There is a clear idea of how to do that. The Department of Finance is looking at it. We look forward to the Department making progress on that issue and hopefully reporting back to the committee on that.

On capital spending, the Deputy is absolutely right. We view capital spending as being very important and it has a very big multiplier. It also has a long-term benefit in increasing the capital base of the economy, providing a framework for structures for public services in the future and, potentially, to support growth. We welcome that this was part of the budget. Deputy Mairéad Farrell is right that the increase allocated in the budget was not huge but we must bear in mind that capital spending in Ireland has been growing very fast in recent years and is now at quite high levels by EU standards. That was very lucky. It takes a lot of time to plan capital spending and it just happened that Ireland was ramping up capital spending at the right time. The right thing to do is look at the level of capital spend during this crisis much more than to look at the change. In the past in Ireland we have seen that capital spending has been slashed during crises. This current situation actually represents progress in moving towards better fiscal policy.

Another issue in the context of capital spending, which we see a little bit from the Exchequer numbers from last week, is delivery. On our assessment it looks that capital spending this year will be less than planned. This raises big questions about delivery for next year also. Maybe the priority should not be to keep making ever-bigger promises about what the spend will be, which I am not sure would be helpful. What would be helpful is to make sure that the money already planned to be spent actually does get spent. The quality of the capital that comes out of this will be very important too.

Deputy Mairéad Farrell: I am conscious of the time but I do want to come in again. The report also notes that Ireland faces a threat from changes to the international tax system. A number of these changes have been enacted in recent years and more are coming down the line. We have had the OECD’s base erosion and profit shifting initiative and the EU’s anti-tax avoidance directive. Other proposals for EU corporate tax harmonisation and a digital sales tax are still being deliberated. Which of these, in Mr. Barnes’ view, is likely to have the biggest impact on the economy’s overall budgetary balance in the long term?

The Fiscal Assessment Report refers to Ireland’s over-reliance on corporate tax and states:

"The funding of Ireland's public services and supports has become increasingly dependent on corporation tax receipts." In the view of the Irish Fiscal Advisory Council, how fiscally sustainable is Ireland's low-tax model in light of threats from demographic changes, changes to the international tax regime, relocation risks posed by the concentrated nature of our corporate tax base and the longer-term trends of secular stagnation?

Mr. Sebastian Barnes: We follow the potential tax policy changes very carefully. It is, obviously, complicated on the political front in the context of what is going to happen and what is going to be agreed. There are also domestic considerations. The new Administration in the United States of America, for example, could also have an impact. It is very hard to have a good assessment of what the impact of that will be. Much of the revenue relates to a few companies in a few sectors. Their tax planning is very complicated and it is very hard to say exactly how any of this will play out. This cuts both ways. It could be that ultimately revenue increases, but it could also fall. It requires a cautious approach. This is what the council is arguing for here. The council has a measure of excess corporation tax. This looks at historical and across-country trends. We are seeing, given how much Ireland raises, how much of that fits with those longer-term patterns and how much of it seems to be unusual. This suggests that quite a lot of these revenues cannot be explained in that way. As this dependency is increased over time, we really think that, as part of the recovery in the medium term, there needs to be a plan to reduce Ireland's reliance on this. We are in a very risky situation. This money is being spent on public services and if it was to disappear quickly, which it could, it would leave a big hole in the public finances and that would lead to a painful adjustment. We therefore think it is much more appropriate that we anticipate that and that we do not spend it all now, excepting the short term, as there will be big pressure in the next two years. Beyond that, however, in the medium term we should not count on spending as much of this revenue as we are spending at present. We need a plan to reduce our reliance on it. The rainy day fund or prudence account could be a very good way of doing so. There are big questions about the sustainability of this model, and that pressure will add to the other points the Deputy made, including the point that in the medium term there are other things that are not sustainable. For example, more action is required on climate change, which is likely to have a fiscal cost. Ageing is accelerating at quite a fast pace. We have a young country now but that will not last all that long. In fact, our population is already ageing quite quickly.

There are therefore a lot of pressures which will all essentially come due at the same time, once we have moved beyond the Covid crisis and, it is hoped, the medium-term impact of Brexit. All these things will need to be addressed. This is why the choices are very difficult. It is not just a question of getting back to budget balance. There is a whole set of issues as to how we get there that need to be addressed at the same time.

Deputy Ged Nash: Mr. Barnes is very welcome. I wish to pick up again on the issue of spending this year. A significant quantum of resources, as Mr. Barnes referred to in his post-budget commentary, now looks like being a permanent expenditure across a range of different spending heads, particularly in health. To me, this is really a commentary on the deficiencies Covid-19 has exposed in our public health service. As much of that expenditure now will be repeat expenditure, it is now essentially in the base. There is a very clear question as to how we provide the resources to pay those bills over the next few years. Mr. Barnes very pointedly refers to this in his analysis.

Mr. Barnes also refers to the fact that the tax base is disproportionately dependent on volatile corporation tax receipts. We know the Government made a political choice not to have the adult, grown-up conversation we need to have in this country about diversifying our tax base and ensuring that those who have the most may pay more in the context of our economic growth, our economic recovery and investment in the public services on which we all depend. In light of the political straitjacket the Government has talked itself into, as far as Mr. Barnes is concerned what are the options in terms of diversifying the tax base to provide the resources we need to support the public services we demand and on which any modern, decent society should insist? Does he believe, for example, that wealth taxes have a role to play? Wealth has not been tapped and wealth taxes have not been identified as a priority by this Government or the previous one. Does he have a view on the evolution, for example, of property taxes in this country? We know, and all the evidence shows us, that the vast majority of wealth in this country is held in assets. Successive Central Bank reports have indicated that but there are untapped resources there that are required to resource our services going forward. I would like to hear Mr. Barnes's view on that.

Mr. Sebastian Barnes: That was a very interesting and wide-ranging set of questions. Health is a big issue to focus on in the public finances. As the Deputy notes, there has been a lot of temporary spending on health because of Covid-19 and it was very important that that was done. As he said, there is a risk that some of that could become permanent spending. We are not completely away from the kinds of pressures we saw in recent years. A striking figure is that the permanent health spending next year, taking out the Covid part, will be 30% higher in cash terms than it was five years ago. That is a very significant cash increase in health spending. As we know, and as we have discussed in our previous reports, most of that spending came about in an unplanned manner. It was not originally budgeted for and came about through supplementary budgets and then was locked into the base. There is also the implementation of Sláintecare on the horizon. That is estimated to cost €3 billion. Some of that, apparently, is in this year's budget. It was not very clear to us how much of that has been done. There has been no up-to-date costing of the implementation of that reform since, I think, 2017. A lot of things have changed since then. That is one of the reasons we think that, as part of the package in the spring, it would be good to have a good costing of that.

Health, of course, is one pressure among many others. As Deputy Nash noted, and as we have noted, the programme for Government essentially makes commitments not to increase taxes on approximately a third of the tax base. It also commits not to cut or adjust spending on approximately half of the expenditure base. It is therefore a very restrictive document. This is why it is important for the Government to clarify how it will prioritise these issues and address them going forward. As for the public finances and how these pressures can be reconciled, the choices are unfortunately very clear. One is higher taxation; another is adjustments on the spending side. Whether that comes through reprioritising certain programmes or increasing the efficiency of certain activities, those are basically the choices. The Irish Fiscal Advisory Council recognises that none of these choices are easy, but these are essentially the choices the country, the Government and everyone faces. In that context we do not have specific views about wealth taxes or any other way of achieving such an adjustment. That is really a choice for the Government and the political system.

As I noted earlier, the tax commission has an important role to play in coming up with ideas and proposals of ways of increasing the effectiveness of the tax system, making sure it is fair and contributes to growth. As I also noted, the spending review process could be strengthened. At the moment it is very much an analytical and technical exercise. It is good work but very technical work. In other countries, such as the Netherlands, they use it as a way to prioritise government spending and to consider the efficiency of what is done.

A third pillar in this regard - the council has engaged on it in the past week - is the pensions commission. As I said, pensions is partly a long-term issue about the public finances but it is also a short-term issue. Every year between now and 2025, ageing will on average add another €850 million to the spending base. This is a lot of money, so those things need to be considered. In that context, we were concerned about the change in the legislation on raising the pension age in the beginning of next year.

I will make one very specific point about taxation. We do not have general views about different tax instruments. One thing worth noting is the fact that property values for the purpose of the property tax have not been updated as planned. This is one area where a plan was in place which has not been implemented. It will be important to get back to that if that is what the Government intends. There is a risk otherwise - we have seen this in many countries - that if the properties are not revalued for the property tax, it never gets done and the tax base suffers as a result.

Deputy Ged Nash: I have two more observations and questions. The most recent Exchequer returns and the trajectory we are on at present would suggest, to me at least, that the deficit this year will ultimately not be anywhere close to €21 billion. Mr. Barnes may have a different view, but what does he believe is the lowest level at which it might potentially come in at the end of the year, given the trajectory we are on at present?

On public capital expenditure, the council recognises that public capital investment is an important stimulus. Regrettably, the very propitious lending environment we are in at the moment is not being exploited enough by the Government in terms of borrowing at very low rates for long-term capital investment. It is very underambitious to simply decide to spend an additional €500 million over the next 12 months, given the deficiencies we have in our public infrastructure and our social infrastructure - for example, in public housing. Does Mr. Barnes think it would be wiser to invest more now, on top of the €500 million, on top of what is already committed, to unleash the economic potential and address some of the social and public infrastructural gaps we have at the moment, particularly in the context of housing?

Mr. Sebastian Barnes: Let me start with that question. As I said in a reply to an earlier question, we would focus less on the increase in public investment this year and more on the level of investment. This happens to be a period during which public investment has been ramped up a lot in Ireland. By international standards our level of investment is now pretty high. The fact that it has not increased much is not too much of a concern. The good news is that there is a lot of money going into the economy through investment and we welcome that, both in respect of its contribution to stimulus and to wider public objectives. Therefore that is appropriate.

As to whether we should borrow more and what it should be spent on, these are very much political questions. The Deputy is right to say that this current interest rate environment is very favourable. The Government is borrowing a lot of money at long maturity, and is locking in those low rates. These actions are all consistent with the strategy that has been set out. Whether it should be doing more is a difficult question and some of it relates to the capacity of the economy and of the Government to take that money, to commit to spending it on capital projects and to do so wisely. We are not in a good position to make a judgment on that but overall, we welcome the high level of investment. Even though interest rates are very low, public debt is very high and that is a concern. There are constraints and money still must be used wisely; it is not as though it is free money.

On the issue of the Exchequer returns, we issued our report last week before the Exchequer returns and we were looking at a deficit of a little more than €20 billion this year. The Deputy is right that the Exchequer returns had quite a lot of news in them and there are quite a few moving parts involved. One is actually the shortfall on capital spending and it looks like there will be an underspend on the budget for the year as a whole. As there has been less spending than was built in as a contingency for the level 5 restrictions, it looks a though that spending will come in lower. Tax receipts through income tax and corporation tax have also been lower, so there are quite a few moving parts to the returns, but we would agree with the Deputy that the budget deficit will come in smaller than anticipated. I would have thought that around €18 billion or €19 billion would be a reasonable figure. I am not sure whether Dr. Casey wants to make a point here.

Dr. Eddie Casey: I completely agree. I think that the figure of €18 billion to €19 billion seems likely now, given the shortfall in capital spending we have seen in areas like transport and housing but also on current spending areas that were linked to Covid. There was a large contingency for Covid-related spending in the areas of social protection and health and that now seems unlikely to be needed even though the level 5 restrictions were put in place, which is encouraging. In respect of the lower bound, it is hard to say but it could be as low as €18 billion. I do not imagine, however, that it could be much lower than that. Again, there are many uncertainties and health spending could still be quite high in December. We do not know what kind of costs linked to Covid or to the effects of the regular flu season are going to be incurred. There potentially are other payments that were missing in the returns, so it is unclear at this stage. There could have been greater transparency on the Covid spending. For example, we would have liked to have seen more costings done on the measures that were introduced and the budget could have done a better job of presenting clear costings on things linked to Covid.

Deputy Richard Boyd Barrett: I thank the witnesses from the Irish Fiscal Advisory Council for their contributions, which I always enjoy and learn from, and I welcome them to the committee. I know that they are reluctant to comment on particular policy proposals but in their report, they are willing to go as far as using the word "appropriate" when it comes to, for example, the decision of the Government to borrow to finance Covid spending. Can the witnesses use the words "appropriate" or "legitimate" when it comes to the issue of wealth taxes as a possible response to the hard choices they say we have to make as a result of the risks that exist including Brexit, Covid, possible changes in the global corporate tax infrastructure and so on? Is it fair to say that it would be appropriate or at least a legitimate thing to consider that rather than continuing to borrow, which we cannot do indefinitely, it might even be more prudent to introduce wealth taxes, as is being done in places such as Argentina, on the back of the Covid crisis? I ask in particular because it is now becoming clear that while some sectors have been very hard hit, others have done well during Covid. Even from the point of view of balancing things up, is the introduction of redistributive taxes to pay for Covid expenditure, additional capital expenditure and so on, rather than borrowing, something that should be actively considered and taken seriously, as it is in other places in the world but rarely here?

Mr. Sebastian Barnes: As we are very aware of our mandate, when we use the word "appropriate", it is in terms of being conducive to sound economic and budgetary management, which is what we are required to assess under the Fiscal Responsibility Act. Therefore, we are very careful about that and to make clear that we supported and viewed as appropriate the overall stimulus being provided during the recovery. It is very important that borrowing is undertaken in 2020 and 2021 because that will stimulate the economy. We have concerns, however, about continuing to borrow during the recovery phase, when essentially that would not be appropriate, given the high level of public debts and the risks that this creates. As I said, we do not take a view on any specific spending or tax measures as a general rule. As these are not issues that we analyse, look at or have any expertise in, I would be reluctant to make those sorts of judgments here.

What I will say is there are legitimate questions - the Deputy has raised many of them - about taxation, fairness and the efficiency of different instruments and I think it is worth looking at these things. As there are many different forms of tax on wealth of different designs, these are legitimate questions for people to ask. We do not have an answer to them but they are legitimate questions. The Covid crisis, as the Deputy noted, has had very complex and differentiated effects. For example, some people have experienced very difficult circumstances and may have lost their jobs, income or businesses while other people have continued to be paid and have not spent very much. In its wake, we know there have been a lot of savings in the economy, so there is a legitimate question about whether such measures are may be warranted. Obviously, anything that would help to reduce the long-term pressure on the public finances would help to make the economy less vulnerable and would be desirable. There are reasonable questions to be asked in this regard. While we have no specific answers to them, there are questions there and international experience can be looked at. However, the outcomes, as well as the fact that actions have been taken, also must be considered.

Deputy Richard Boyd Barrett: I thank Mr. Barnes for that because I want us to legitimise the debate about wealth taxes, which has generally been considered to be off the radar to date. It is interesting that countries such as Argentina and others are now beginning to introduce these taxes on the back of the Covid-19 crisis.

I will press Mr. Barnes further on the question of wealth taxes, although I acknowledge there are limits to what he can say. Borrowing entails borrowing from those who have surplus money, at interest, to make up for the lack of money available to finance necessary expenditure in health or capital expenditure, for example. In the case of wealth taxes, instead of borrowing the money at interest from those with a surplus, one takes it from them. From a prudential point of view, does it not provide better value for the State to take the money from those who have a surplus rather than borrow from them at interest?

Mr. Sebastian Barnes: I know that Dr. Lawless has done some work on wealth taxes. Perhaps she has an answer to the question.

Dr. Martina Lawless: A number of years ago I did some work on wealth taxes, focusing on household ownership of assets in Ireland. It involved taking a number of existing wealth taxes from a number of different countries, including France, Spain and Switzerland, and looking at what revenue those wealth taxes would raise in Ireland, how many households would be covered and the total revenue that could be raised. It was a technical exercise in how different styles of wealth tax would impact Ireland. Along with the debate on whether we should have a wealth tax and the role it would play, there are many variations in the designs of wealth taxes to consider. They would have significant implications in terms of how many households would be affected and how much money would be raised. For example, approximately 80% of household wealth in Ireland is in the form of property. Wealth taxes across a number of countries frequently exclude the household's main residence. That makes a major difference in terms of the number of people affected and the amount of money raised. The broader one draws the definition of wealth, the more money one raises, but also the more households one impacts. There are many decisions to be made on a wealth tax's design.

Deputy Richard Boyd Barrett: I will press Dr. Lawless on that. I take her point. The wealth tax that we in People Before Profit have designed and proposed in our budget submissions excludes the family home but is there not a fairly simple calculation to be done? We have approximately 1.8 million or 1.9 million family homes in the country. We can work out roughly what they are worth on average. If we multiply one by the other, we get what component of property wealth in this country is comprised of family homes and what component is comprised of multiple homes, large tracts of land and other property. Any reasonable assessment of the enormous amount of property wealth will show that the bulk of it is not family homes. Rather, the main part of it, which is growing, is people with multiple properties and large tracts of land. These are not about putting a roof over their heads.

Dr. Martina Lawless: The recent Central Bank report on household wealth in Ireland showed that, for the top 20% of households in particular, properties other than the household's main residence were a large component of wealth. It also found that wealth inequality had decreased in Ireland because of rising property prices over the past number of years. There are still many issues to be considered, for example, what other assets people have. For example, there are business assets that one would not necessarily want to subject to a wealth take in case it had implications for entrepreneurship. There are other decisions to be made on whether there is a lower limit. There are many moving parts even with the design of a wealth tax. A simple 1% on all non-property assets would be difficult to implement.

As Mr. Barnes stated, we would welcome a commission on taxation examining the broad decisions that would need to be made on the design of the tax base and the interaction between a potential wealth tax with other taxes such as, for example, the local property tax and the capital acquisitions tax. There are many interactions between various taxes that would need to be considered before implementing one decision on its own.

Deputy Richard Boyd Barrett: My time is nearly up, so I might ask a couple of quick questions. A lesson we have learned from Covid is that, if we scrimp on health spending, particularly on capacity, staffing and so on, it can have more dire economic consequences in a health emergency. To a significant extent, our requirement to close down large sections of the economy was linked to the low level of capacity within our health service. That is a calculation that we must start thinking about. We might believe that we should reduce spending because it is fiscally prudent but it might suddenly catch up with us in a major way because we do not have the health capacity, thereby costing us more. Have the witnesses an opinion on reconsidering the relationship between these two matters in terms of whether it is more fiscally prudent to have the health infrastructure, which might cost more initially but save us in the long run?

In terms of reviewing our expenditure and so on, I am interested in tax expenditures and the fact that we do not examine them closely enough. Do the witnesses believe it would be important to examine those tax expenditures closely and make a comparison? This committee and its predecessor have heard evidence from an economist - it may have been one of the witnesses, but I cannot remember - that, in general, direct expenditures tend to be better than tax expenditures. What is gained from direct expenditure is more quantifiable whereas tax expenditure is more indirect and can often be a runaway train without anyone being sure what we are getting from it.

Mr. Sebastian Barnes: I will let Professor McMahon answer the Deputy's first question. To give him a little notice to think about it, I will answer hiss second question now.

The area of tax expenditures is important. People tend to focus a great deal on tax rates, but much of what matters is the tax expenditures. They get less attention and are typically a little less transparent. I am not sure that I would generalise completely across all of them. They are a legitimate instrument but, as Dr. Lawless stated, they should be examined as part of the general tax package. One of the main risks is legitimacy. Often, these tax expenditures are regressive. I agree that they comprise an area to consider in terms of strengthening and broadening the tax base in the years to come.

Professor Michael McMahon: The question of how to balance the issue of total capacity and how expenditure is directed towards specific types of capacity within health or any other part of the economy is a difficult one and certainly one on which I would defer to the health experts. I will give an analogy. One fact that is always rolled out when a little bit of snow falls and Dublin Airport or Heathrow Airport close is that the airport in Helsinki, which suffers far greater snowfall, has not closed in 30 years or something like that. It is a calculated decision. The infrastructure required to keep an airport open despite heavy snow is expensive. If it is only going to be rolled out for three days every two years, it is probably not the right thing to do whereas shutting down is sometimes the most prudent action even though it is disruptive at the time.

In the health sector, the decision is even more complicated than that. The questions that Covid has exposed relate to capacity in specific areas, in particular intensive care. We know that this is not an area that can be easily adjusted flexibly because specialist equipment, specialist hospital areas and specialist staff training are required.

Reverting to the earlier discussion, there are legitimate questions to be asked about what the right balance in spending is. I am not an expert on health spending, but in my own capacity, it is not obvious to me that, if we were having this conversation two years ago, we would be talking about expanding capacity in the health sector. It is not obvious to me that we would have expanded it in areas that Covid could then have drawn upon, for example, intensive care. It is a difficult matter and how we assess the probability of these events occurring and where we would put the extra capacity are important questions. Where other countries have handled this well, capacity and testing made the greatest initial difference in the crisis in the ability to stay open. For example, South Korea quickly got mass testing programmes up and running and was able to get results from tests quickly, and it was done in a cost-effective way. It meant that people were tested more frequently and outbreaks were more contained.

The Deputy is raising important questions. When a spending review takes place, the adult conversation that one of his colleagues referred to will have to take place about the right ways in which to manage these risks. We must view them as risks, not certainties.

Mr. Sebastian Barnes: One big lesson we learned from the crisis is that going into it with the public finances in good shape was much better than the alternative and gave us the margin to provide income supports and so on. In our area of expertise as fiscal experts, that is an important lesson to draw. Fortunately, we got that one right.

Deputy Bernard J. Durkan: I apologise for my late arrival. Other issues intervened. I thank our guests this morning.

We are talking about the impact that Covid is having but we must have a serious talk about the impact of Brexit on our economy. Can the witnesses give particular advice on this double whammy? I have advice that I wish to give as well. I am one of those who spent at least four or five years before the economic crash raising questions in the Houses. On the basis that it was not wise to suggest the country was going into a slide, as it would cause a rush on banks and all financial situations, we resorted to asking questions on whether the economy was keeping good economic fundamentals in mind. The reply I always got was "Yes, it was". That was not the case and was everything and anything but.

In this particular situation, I believe we need to be cautious about how we spend and be much more mindful of what other countries are doing for recovery than we were at any time in the past. Any extra taxation must be weighed against the degree to which that will encourage confidence in our economy, given that we have an open economy, are highly dependent on exports and are a small fish in a very big pool full of many predators. Is it wise to go for an early restoration of balance in spending in preference to retrenchment or austerity at an early stage? I know the answer but I seek reassurance from someone else, if possible.

Mr. Sebastian Barnes: On the Deputy's first point, Brexit and Covid are a double whammy in the sense of having two shocks at the same time. Hopefully, with the vaccine the resolution of the Covid crisis is more predictable and closer than we might have thought last spring.

One of the important things that we and others have shown is that the sectors that are hit are very different. That is probably better than the same sectors being hit twice, in the sense that the shock is spread more over the economy. It would be good if that second shock could be avoided as much as possible.

On fiscal rebalancing and the path ahead, we talked about different phases in our report. We are in a joint phase at the moment where some sectors are still very locked down and disrupted. Areas like transport and accommodation are really suffering a lot, as are some other parts of the domestic economy. Also, the unemployment rate in a broader measure is still at 16% and is likely to remain quite high, plus there is a greater weakness in demand. That is going to be the challenge during 2021 and that is why we welcome and support the measures and stimulus that have been provided in budget 2021. That is why we think it is appropriate.

Further ahead, as the shocks unwind, the economy must adjust. Using our five-year scenario, and this is why it is useful to do a five-year forecast rather than a one-year forecast like the Department of Finance did in the budget, we see the extended budget scenario. We take the budget numbers and roll them out to 2025, assuming no policy changes, and end up with a deficit of approximately 2.5% of national income at that point. We then did another exercise and asked, while the level of debt would be much higher, what would one need to bring debt to the same downward path as it was in 2019. In that scenario, we see there is a need for some fiscal adjustment. It is important to say, which we said last spring and now say again, this is nothing like the severe austerity that we saw from 2008 to 2010. It is a very different situation and that partly reflects, as the Deputy has said, the better fundamentals of the economy going into this crisis, so that is welcome.

We see that there is likely to be some need for fiscal adjustment. In the mild scenario that we have, if things work out very well, it might not be all that big. If things were to work out worse it would be bigger. We see that there probably is a need for some fiscal adjustment but we think it is very manageable. What complicates it is the fact that there are a number of other factors going on at the same time. One is the need to reduce reliance on corporation tax. Another two relate to dealing with climate change and ageing. A lot of other pressures will need to be dealt with. It is not just a question of getting back into balance but getting to the right sorts of level.

The Deputy is right that Ireland needs to be very mindful of what other countries do in terms of growth in corporation tax and the kind of things where Ireland is either competing or reliant on what happens in other countries. At the moment we still are in quite a complex environment for international trade on which Ireland depends heavily as well. There are a number of issues that Ireland needs to navigate and manage well.

Another issue is public debt. As we have seen in the past the costs of being viewed as a relatively weak country can be very high. In the current environment, where the ECB is running a very supportive policy and Ireland is very much within the pack, this is a manageable concern. We also know that a lot of the debt has been issued for very long horizons. Even if interest rates were to rise rapidly that would not actually show up in the public finance numbers for some time but it would show up eventually.

There are a number of things that Ireland needs to look at, and what we argue for in our report, which are really medium-term issues. We do not see that there is a need for a sharp adjustment. We think that this should be done in a managed way that has a minimal impact on growth but helps the economy to get back on track and puts the debt ratio on a downward level thus bringing it back to a level that is more sustainable, less vulnerable to shocks plus, potentially, gives Ireland the ability to absorb another shock of the sort that we have seen in the past because we have seen how valuable it is to be in that position.

Deputy Bernard J. Durkan: Is it possible to allow and encourage economic recovery to be the central factor in proportionate debt in respect of total debt and annual borrowing ratios? In the past it was found possible to encourage rapid or reasonably rapid economic growth up to this level of wisdom and to allow that to bring our borrowing, and debts, into a reasonable proportion in comparison with our economy.

Mr. Sebastian Barnes: Growth will clearly play a very big part both, hopefully, over this year, next year - in particular - and the following year to bring the deficit down. That is partly because of some of the additional Covid measures. That should, hopefully, no longer be required and will drop out. Growth should bring the tax base up significantly and as a significant part of both narrowing the budget deficit and increasing the GNI*, the ratio can be lowered that way but probably not quite enough. As our analysis shows, even if one allows all of that to play out one is still likely to end up with a deficit at the end and some adjustment is likely to be needed to bring the debt ratio on a sufficiently downward path.

At the same there is a question about what will happen to the sustainable rate of growth in the medium term. We expect that it is likely to be lower than Ireland has experienced in the past. At the same time there will be more demands on public services, for example, as a result of ageing. It will be much harder to keep the budget balance at the same rate and, particularly, to increase spending at the same time without either having other adjustments in spending to offset it or without increasing taxes.

Deputy John Lahart: I am mindful of the debt that this country owes to what I call the Covid generation. We must bear in mind that these people are aged between 16 and 25 years but it is they who must shoulder all of this along with climate action so the last thing I want to hear about is talk of restraint and austerity. I ask Mr. Barnes to comment generally on the fact that the entire planet is in debt. That may be what makes the current situation different from what happened on the previous occasion. How will that be handled?

Mr. Sebastian Barnes: I ask the Deputy to repeat his final sentence. I missed a crucial word.

Deputy John Lahart: How will it be handled? Does it make a difference that the whole world is in debt as a result of Covid? The whole world shut down, whereas the crash of ten years ago had different impacts in different places.

Mr. Sebastian Barnes: I think it does make a significant difference. It is a very good question. The answer to the narrow question is that, as many people have stated in terms of public debt, it is very helpful for a country not to be perceived as being worse than other countries. That is what happened from 2008 to 2010 and it was very costly. This time, there is stronger European support and Ireland's experience is similar to that of many other countries. That reduces our short-term concerns around the level of debt. In some ways, if Covid had not come along and we just had to deal with Brexit which, obviously, affects Ireland more than it does other countries, we might have been more concerned about the financing than we are. The fact that all countries are essentially in a similar boat in terms of debt provides some short-term reassurance.

The Deputy raised a key question with regard to the long term. These levels of debt are extremely high by post-Second World War standards, much higher than we have seen previously. On the other side, interest rates are probably at their lowest level in recorded history. That is a very interesting combination. Some of the best minds in economics are thinking about that question but have not really reached a firm conclusion. In terms of the public finances, what we do know is that even if interest rates were to rise quite quickly, it would take time for that to feed into the public finances because of the long maturity of the debt. Obviously, it would not help, but we would have a little time. In terms of long-term sustainability, if interest rates did go back to a much higher level, that would change the medium-term and long-term outlooks and, of course, would also affect how we think about the short term. The truth is that we do not really know how all of this will play out. It does raise very big questions.

As the Deputy stated, it raises intergenerational questions. We give a significant amount of consideration to public debt, but we should not forget that the State pension is not funded; it is a pay-as-you-go system. There are significant commitments that have been made for future generations as well. The sustainability of the pension system is also a big question and may partly be related to the low interest rate environment.

I do not know whether my colleagues, who are probably among the best minds in economics, have more insights on the issue. If they do not, I will leave it there.

Deputy John Lahart: I will pull back on the reins. Do the witnesses have any observations on the level of saving among members of the public and what the view of the Government may be in that regard? I refer to pent-up demand because consumers have not really had anything on which to spend their money.

Mr. Sebastian Barnes: From the perspective of forecasting, that is a big question. It is an upside risk to the forecast. The budget projections from the Department of Finance assumed that the savings rate would stay quite high. Our view is that it may be a little lower. Whether those savings are spend rapidly is difficult to say. I do not think I will go out to dinner every single night when the public health situation improves in order to make up for the fact that I missed out on many nice evenings in restaurants in 2020. It is very difficult to know how people will behave in that regard. It does create a risk that people will spend those savings. I think we can already see that a little in the figures. The way people have spent money on consumer durables and such products probably partly reflects that they have been equipping home offices, but also the fact that some of them believe they have cash they would not usually have and that allows them to make some of these purchases. It is difficult to say whether there is a role for public policy in that regard or whether it raises wider questions.

Deputy John Lahart: I refer to a scenario that was not addressed in the written submission. When the virus initially arrived in February, we thought it would last for five or six months. We have had an evolving understanding of it. Mr. Barnes rightly stated that the Government was prudent in preparing the budget on the basis of a no-deal Brexit and a vaccine not arriving until 2022. The vaccine will arrive sooner than that and we know a little more about the virus. To paraphrase Donald Rumsfeld, there are still a few unknown unknowns. What will the impact be if the virus returns, as the flu does, and requires an annual vaccine? I suppose it is impossible to plan for such a scenario, but it is not out of the question. Do the witnesses have any observations in that regard?

Mr. Sebastian Barnes: The Deputy is correct that there are many uncertainties. How those uncertainties resolve and become clear is a big question. In terms of vaccine costs and so on, we have estimates we took to the Department of Finance in our report. The sums involved are not huge. When one thinks of the savings in terms of not having to lock down the economy from time to time, there is obviously a significant gain in that sense. We hope the vaccine will eventually provide some kind of solution, whether that involves an annual vaccination or whatever. It is basically very encouraging but we do not really know how it works at scale. The experience so far is that the phase 3 trial is very extensive but, ultimately, does not involve a significant number of cases. We are still learning a significant amount about the vaccine. Much will depend on time. The months between now and the vaccine being distributed could be quite challenging. One of the pieces of good news from this autumn is that although lockdowns are obviously very costly and have a major impact on the economy and society, we have learned that we can be somewhat more selective in that regard than we were in spring. That can be seen in the way less of the economy has been badly disrupted compared with the situation in spring. The economic impact in autumn is much less than it was previously. We have a better handle on how to manage those things.

Deputy John Lahart: I have to interrupt Mr. Barnes because my time is running out. I have two final questions. If they cannot be answered in detail now, I will accept a reply in writing, as members always do. What does he make of the fact that, anecdotally, those in the hospitality industry are finding it difficult to attract staff who are doing reasonably well on the PUP and for whom it is not attractive to return to work?

For many years, Mr. Barnes and his predecessor, Mr. Coffey, have been telling us about the dangers relating to corporation tax, that the State is over-relying on it and it is bound to end at some stage or that there will be issues with it. The view seems to have changed in the sense that we are exposed internationally to it. The rules on corporation tax may change rather than the pot of gold shrinking because a company fails or something like that. It is an issue to which we will return. There is very little time for Mr. Barnes to respond.

Mr. Sebastian Barnes: On the question relating to the PUP, we have supported in general terms having those income supports. Exactly how they are designed and how we exit from them are legitimate questions that will need to be addressed. From the perspective of IFAC, if there is a permanent or longer-lasting change that results to the welfare system from those programmes, that would need to be reflected in the public finances. Obviously, it is important in terms of the public finances that once the recovery comes, we move out of the current phase.

On corporation tax, it has surprised us that it has lasted this long. In fact, it has increased so much in recent years that even Mr. Coffey, who is a great expert on these things, may have been surprised. There are two issues. One is the year-to-year short-term volatility, which may be linked to a company making more or fewer profits. It can have a big impact. Even if one looks to this year, our view is that corporation taxes can easily shift by €2 billion or €1 billion from month to month. That is quite volatile but, in the wider scheme of things, it is not a significant issue. The real issue is about the longer term. It is very complex to understand what is happening. It is on the tax policy side and it is also to do with the companies. We know that much of this money probably comes from companies in pharma or digital. Those companies have all done quite well during the Covid crisis. However, something could happen that means they do less well, which would have an impact on Ireland. It may be that, for whatever reason, they decide to structure their tax affairs differently, which could have an impact. That is why IFAC is still very cautious on this issue. We are likely to be closer to the day when these kinds of revenues drop than we were previously. We do not know when that will be but we do not believe that locking in permanent spending based on these large sums we cannot rely on is a good idea. We remain concerned about it. We have been surprised that it has lasted. Of course, this year helped us a good deal. It has been the one good news story on the public finances. This is essentially the one thing that beat the forecast made in a previous budget. Anyway, the concern is still there and it is very real.

Deputy Patricia Ryan: I thank the representatives from IFAC for attending. The report references Ireland's debt to growth ratio and the need for reporting to utilise GNI* rather than GDP. I will not rehash the various problems with the latter measure. However, I still have concerns since while using GNI* rather than GDP would be an improvement in terms of providing a more accurate picture when it comes to debt sustainability, there is a risk of hitting the target but missing the point. We should recognise that there has been secular decline in interest rates in recent decades. Many believe that we will be stuck in a world of near-zero interest rates for a significant period. We are dealing with nation states and not the crude household analogy that many ill-informed commentators like to use. Would a better measure of Government debt sustainability in the context of low interest rates not be net interest payments as a percentage of GNI*? An alternative proposed by former US Treasury Secretary, Mr. Larry Summers, would be to take the net present value of all future GDP, or, in our case GNI*, which increases in times of low interest rates, and then use that to compare it to the stock of total debt.

Mr. Sebastian Barnes: The Deputy is correct. There are two separate issues. However we look at it, using GNI* is a more appropriate measure than GDP. It is far closer to the real fundamental activity in the economy and it is far closer to the tax base. That is why we made the suggestion. Unfortunately, aspects of the rules under the Fiscal Responsibility Act are framed in terms of GDP. That is really what we were pushing against.

The second point raised by the Deputy is a very good one. It relates to the appropriate level of the debt ratio we should have bearing in mind that interest rates are especially low. I made two observations earlier and I will elaborate on them because they are relevant here. It is a reasonable question and one we plan to think about more - many people are thinking about it carefully.

One thing is clear. We do not know that interest rates are going to stay this low forever. They could fall further and become increasingly or ultimately negative. They could increase as well. We simply do not know. The extent to which we are sensitive to that risk depends on the debt ratio. That is why the debt ratio is still a highly relevant factor to look at.

We would obviously look at it differently now from how we did in the 1980s. However, it is still a useful metric and it is still the right thing to look at. It is something that adjusts slowly because it is a function of the stock of debt. It is also a good target because it is not too volatile. My concern is that if we simply looked at interest payments, which are low, we would miss this point about the riskiness of the position we are in.

The position of Ireland is not the same as a country like the United States. Ireland is a far smaller economy and far more dependent on external capital. Its economy is far more volatile too. Ireland is dependent on far fewer activities than the US. Ireland has been lucky in recent decades in its growth experience. We expect that to continue to a degree but it may not happen. Ireland, therefore, has to be far more cautious than the US, Germany, France or Italy for that matter. That is an important point.

The second point is that there are limits to looking at the debt ratio. This is why the council published its long-term sustainability report this summer. Basically, the report showed that if we got debt on a downward path but nothing was done about pensions and increasing health costs, then essentially the debt ratio would fall to not much below 100% of GNI*. Then, from the mid 2030s it would start to pick up. These pension issues are big as well. It would be a mistake to focus too much on the debt without taking into account these big long-term fiscal pressures that may come from an ageing population.

Deputy Patricia Ryan: I was going to come to pensions. I was going to say in respect of post-Covid challenges there is a section of the report dealing with demographic changes. The council makes a point that the pension deficit should start to bite after 2030. My understanding is that the council forecasts for economic growth for the period thereafter are approximately 1%. This means our economy would enter a phase of secular stagnation. Given that low growth is a driver of fiscal unsustainability, what policies for long-term growth does IFAC see as necessary to boost growth by extension of fiscal sustainability?

Mr. Sebastian Barnes: I am not sure whether we would qualify these slower long-term rates of growth as secular stagnation. Really, secular stagnation is a concept relating to the global economy or the advanced countries within the global economy. Ireland's trajectory may be different. The reason we see slower growth is essentially that there is lower productivity in the world. Ireland has reached higher levels of productivity and so its ability to catch up is reduced. Ireland will also have an ageing population and that will play into growth as well. It may be that growth simply ends up being lower.

As Deputy Ryan said, one of the tools that can be used to improve the outcomes of society and long-term fiscal sustainability is an increase in growth. Obviously, there are many policies that many people have recommended in that sense. I do not believe we have specific views about that. Obviously, continuing to invest in education and innovation and continuing to make Ireland an attractive place for businesses and investment are all part of it. Beyond that we do not have a specific view about how that could be achieved.

It is important to remember that growth is not necessarily the solution that people sometimes believe it to be for the public finances. It could help, but one of the problems with growth or one thing that goes along with many forms of growth is that if wage growth is high as well, it increases the cost of providing public services. There tends to be a natural offset between the two. The long-term sustainability of the public finances may be less dependent on growth than many would assume. This is because in practice wages and welfare rates are likely to track growth. If there is higher growth, everyone gets higher income, which is a good thing. However, that does not necessarily generate large amounts of additional fiscal space.

Deputy Patricia Ryan: My thanks to Mr. Barnes for that. I am aware of my time. The council has stated that spending on pensions and healthcare would increase from 13.3% of GNI* in 2019 to almost 25% in 2050. The council maintains this forecast is based on a no-policy-change basis. We know that employers' PRSI contributions in Ireland are low by EU standards. We also know it is likely they will be increased in the years ahead, thus improving fiscal sustainability. Has the council made any assessment of the potential increase to sustainability from great employers' PRSI contributions? How could they be used in the offset to increase the pension age?

Mr. Sebastian Barnes: Basically, the population is ageing and people are living longer. More people are reaching pension age because of the demographic trends we have had in the past. Many people were born in the late 1970s and early 1980s. As those people reach retirement age there will be major challenges, as noted by Deputy Ryan, in terms of pension sustainability. There are several solutions. In fact, the menu is fairly well defined. One option is to find the money somewhere else in terms of general increases in taxation or reductions in spending. Within the pensions system or related to it, one option is to raise PRSI contributions. Another thing would be to adjust the level of pension benefits. Yet another option would be to raise the retirement age. A one percentage point increase in PRSI would raise approximately €750 million. If we relied on that instrument only, we would have to raise PRSI rates by a significant amount to finance the pension system or address the pensions problem in that way. We will need a broader approach. As we said in our long-term report, we believe raising the pension age gradually and partially to reflect rising life expectancy would be a natural way of adjusting for this. It could be done in such a way that people spend the same share of their lives in terms of working and retirement. The amount of time people could expect in retirement would also be increasing but it would not be increasing as fast as if we held it fixed. We believe that is an important part of any package, because that is essentially where many of the pressures are coming from. Tackling that pressure at source is probably a key part of pensions sustainability. We will see what the Commission on Pensions comes up with. I am sure it will consider these issues very carefully.

What is striking is life expectancy at 65. The length of time one can expect to live to the age of 65 is rising by one year every five years. If we look to our children, they will be living at least five years longer than us or less, depending on which way we are going. These are major changes. I do not think we realise that looking at it every year but life expectancy is increasing very fast. That is where many of the pressures in the public finances will come from and that would seem a key part of any package to address.

Chairman: I have some questions. I will take the Green Party slot. I want to come back to the non-voted expenditure, which Mr. Barnes said is approximately 20% of spending. He will forgive my ignorance but when it comes to something like commercial semi-State bodies, which I presume are bodies such as ESB, he indicated that there has been quite an increase over the past period. Could he unpack that for me, so to speak, and explain what that looks like in terms of local government and commercial semi-State bodies? I presume that when he refers to extra spending he is talking about Supplementary Estimates. In that context, I am on the health committee, which had a meeting last week. Considering the times we find ourselves in, the numbers currently are eye-watering. What is the process in respect of commercial semi-State bodies? Is it multi-annual funding for capital spending that is the creep up in terms of spending or how does that happen?

Mr. Sebastian Barnes: The Chairman's questions are exactly the ones we ask and struggle to find answers to. That is why we are calling for additional transparency. I will let Dr. Casey, our chief economist, who is close to the details, tell the Chairman what we do and do not know.

Dr. Eddie Casey: It is a great question. It is something we have been trying to unpack, as Mr. Barnes said. The areas we are trying to look at are local government spending and teasing out exactly where the spending is going in that sector. Thankfully, the Department has published a bit more information on that but because it is still very limited, we cannot say how much of the spending that has been ramped up this year will be permanent versus temporary. In addition, non-commercial semi-State bodies are also included. If we think of all of the IT companies, technological universities, RTÉ and Irish Rail, those are the types of bodies whose spending from year to year is fairly predictable but every now and then we could see a sudden ramp-up for whatever reason. We do not know why it has increased this year but we suspect that it is probably linked to investment plans. That could be a temporary increase or a long-lasting one. We just do not know.

There are other parts as well, including what are referred to as extra budgetary funds. The Chairman is probably aware of the Ireland Strategic Investment Fund, which is a large fund that was set up with a commercial mandate to invest in the domestic economy to boost growth. There is spending from that as well that could be identified in general Government expenditure but we do not know how much. There are many unknowns and as we said, it is up to one fifth of all Government spending so it is very large. If it is not predictable, we have to ask why and it is very hard to find those answers.

Chairman: One of the reasons we wanted to have this session today was because we are carrying out a review of how budgetary oversight works and we are trying to put in place a fully verifiable and robust structure for that. The idea that we could have a 20% spend like that one, particularly by commercial semi-State bodies, and not fully understand where those decisions are being made and where it is being added to the base, is remarkable and worrying. During the Supplementary Estimate process at the health committee last week, the Minister accepted that a considerable proportion of the spending will add to the base year on year. I do not forecast a good answer for this budgetary oversight committee if we cannot unpack something like non-voted expenditure over the lifetime of a Government.

Mention was made earlier of the spending review process in its current format and how it is utilised in other jurisdictions as a way to prioritise spending but also to consider obsolescence. Deputy Boyd Barrett talked about tax expenditures. Can any of the witnesses talk to me about how we might better utilise the spending review process in the budgetary oversight process?

Mr. Sebastian Barnes: This is a very useful tool for the committee. A number of countries do it in different ways. The Netherlands is the outstanding example of how to do it. Currently, we have a process where IGs, the evaluation service, could be used more effectively. It did much good work on forecasting and describing what is going on in the public sector, which we do find useful, but it is not the same as the kind of process we would see in the Netherlands. The Netherlands look very closely at different programmes. Different countries can do it different ways. All the spending can be tested at the same time or have a regular programme of going through it. It is important to look at the priority areas. One of the aspects I recall from the past is that sometimes the areas that were taken out for reviews were not the obvious areas we would look at. They were areas that were quite small and where one would think the scope for significant savings was quite low.

As the Chairman said, there are two aspects of this. One is to look at the way spending is allocated between different activities and the other one is to look within activities to see whether there is scope to do things differently. In this tougher fiscal environment that we will be in choices will be more difficult. If there is scope on the spending side we might spend less money on activities that are lower priority and that may reflect priorities set a long time ago and see where there is scope to increase cost efficiencies. It is very useful to use that scope because it then freezes up resources for other areas and, from our perspective, it reduces the pressure on the public finances to borrow more just because we can find the money through what we are doing already. My understanding from other countries is that those kinds of reviews are most effective. It is easier to do things to do with prioritisation or setting the parameters of existing policies. It is much harder sometimes to go into the nitty-gritty of the efficiency. The Dutch example is very useful. They have significant expertise in doing this. They ask some hard questions of themselves about what they are doing. That kind of process would hugely strengthen the public finances in general. One of the mechanisms through which that works would be through strengthening the oversight procedure. It would give the committee the analysis it needs to ask the questions it wants to ask.

Chairman: I thank Mr. Barnes. In answers to numerous questions from Deputies, we have discussed the issue around debt targets and GNI*, which is GDP. It sounds to me that Mr. Barnes is recommending that our Government set a domestic debt target. That is so much about our borrowing and debt management in conjunction with our EU partners. How does that interact with our EU commitments? What does Mr. Barnes believe the Stability and Growth Pact will look like in a post Covid-19 world?

Mr. Sebastian Barnes: Those are very good questions. In the short run, for this year we have had exceptional circumstances under the EU rules. That has been very welcome. It looks as if that will continue next year, which is also appropriate. Where we go to after that is a big question. In principle, the rules will come back into play. Ireland is likely to be in an excessive deficit procedure at that point. It looks as if they will still go into this procedure despite the fact that there are exceptional circumstances.

Exactly how all that will look in one year or two years' time is very hard to tell, both in terms of how the EU might look at its rules and the way it might enforce them, but also in terms of some of the technical issues such as the way it measures the structural balance. It is very hard to know where that will be. The EU looks at issues in GDP terms. For Ireland, that means the rules apply in a slightly different way from other countries. One of the issues we are mindful of is that it may be that the rules are not too loose for Ireland at that point, partly because of this GDP issue and perhaps because of other issues. We do not know whether that will be the case but it is a risk; there is a risk on the other side as well. We believe it is partly helpful for the Government to think through what it wants to achieve. This should be in compliance with the EU rules. It is difficult to predict exactly what the rules will be but what is done should be the spirit of those rules. That is why the council promoted a principles-based approach to implementing the rules. The debt ratio should be thought about in this context. It is a good target. Particularly in the context where the debt ratio is very high, it is a very good objective. It is also something that moves in a relatively predictable way. As a medium-term target, it is quite good. In light of this, the Government can set intermediate objectives through its budgets. It can show how it plans to get to that level of the debt ratio. It can be a good focal point for policy over the coming years.

There have been a couple of attempts at having a debt target in recent years. They are specified in GDP, which is a weakness, but there was also a lack of commitment to them on the part of the Government. These considerations should really be at the centre of the way the Government discusses the budget if it is to be effective.

Dr. Eddie Casey: I have a general point on welcoming the committee's interest in obtaining relevant information before the budget, which we discussed in advance of this meeting. It is a great idea for the committee to consider such matters. There are three aspects on which it should be seeking information regarding the budget. Better, clearer costings on the spending side are desirable. Every year, just before the budget, we get a ready reckoner from the Revenue Commissioners. It gives a really clear sense of how much a 1% increase in the standard income tax rate and other such measures would raise. On the spending side, however, there is much less information. I am aware that people get this information in dribs and drabs from the Department but it would be better to have something along the lines of what the Revenue Commissioners produce, which is very transparent.

A second point concerns the walk. We have mentioned the so-called walk from the Exchequer spending, which is what many of the budgetary publications have focused on traditionally, and the question of how one gets from there to the extra fifth of spending in general government terms, which is the wider measure we are interested in. That expenditure should be presented in gross terms. It is really useful for us, members and others to see in very clear gross terms what exactly is being spent and the revenue being taken in. All we have at the moment is a net picture, which does not allow us to understand the goings-on.

On a somewhat self-promotional point, the standstill scenario we develop at council level is a really useful tool for understanding what is happening the budget from year to year. We are aware that there will be major increases in spending linked to public services already provided and the public service payments and social welfare payments that we provide. It is a question of how much extra the Government would be spending on those types of categories if it were to do nothing in its budget in 2021. The question is linked to determining the demographic changes and the general rates of inflation in the economy. If prices and wages were rising, what would it cost to increase public sector wages in line with those increases, and how much would it cost to raise social welfare and pension payments in line with them? If that clear picture were provided by the Departments, we would have a really good sense of how much space would be left over for new measures given general growth in the economy.

Chairman: That is interesting. We have heard the idea of the standstill scenario time and again in our work in the past few months. I have another question but I will open the floor to the other Deputies first. Has Deputy Patricia Ryan a second question?

Deputy Patricia Ryan: I thank the witnesses again. The stability programme update will be published in April, and the committee may meet the relevant Ministers in advance. What issues should the committee be discussing with the Minister during its meetings?

Mr. Sebastian Barnes: The spring is really crucial. The stability programme update is probably of particular interest to the council but perhaps of less interest in the general population. This year, however, is really crucial. We have included two reasons for that in the assessment report. First, the Government must make medium-term choices on how it is going to prioritise spending and taxation and how it is going to manage corporation tax and population ageing over the remainder of its term. This is the opportunity for it to set out its medium-term plan and it has committed to doing that. It is important that it does that and it is going to be difficult because any Government in that situation would face hard choices. It would be helpful if this Government makes those choices at that stage. Things may change in the years to come, but that is really the point to chart the course for the years ahead. That would be a good question to ask.

We set out in our report some specific suggestions for how that information should be presented. That includes having five-year forecasts that should be done on the basis of the standstill that Dr. Casey just mentioned. To me, that is the only sensible way of showing forecasts of public spending. It should include costings of major initiatives such as Sláintecare and should explain what the Government plans to do on the tax side. There is a whole set of basic information that we would expect to be in that report for us to judge it credible.

A final pillar of that is to ask about the institutional side. We have just discussed the debt ratio with the committee and have looked at spending limits, the rainy day fund and prudent accounting ideas. As the Government sets a course through the relatively difficult fiscal times to come, it would benefit a lot from strengthening the fiscal architecture at the same time. That would be complementary to achieving fiscal sustainability and that would be a good issue to explore.

Deputy Patricia Ryan: What are the implications of lowering the pension age to 65? Where would the opportunity be to fund this? I mean that question generally and do not mean to put our guests on the spot.

Mr. Sebastian Barnes: Changes in the pension age can either be funded through taxation, spending changes elsewhere, or changes in pension benefits and entitlements. We would be concerned if the pension age were lowered in this context. As I said, we know that the population is rapidly ageing. We also know that the number of people reaching pension age is increasing. A policy like that would add a lot of stress to the public finances at a time when we face many challenges, including a high level of public debt. It would also raise big questions of intergenerational equity. By being more generous today, are we potentially undermining the system for those who come behind?

Chairman: We could stay here asking questions for a long time because it is a fascinating area but we are at our two-hour limit. I thank Mr. Barnes. Dr. Lawless, Ms Holland, Professor McMahon and Dr. Casey for attending here today. I hope we will be in close contact with them over the next few months.

The select committee adjourned at 12.58 p.m. until 11 a.m. on Tuesday, 15 December 2020.