DÁIL ÉIREANN

AN ROGHCHOISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 9 Márta 2021

Tuesday, 9 March 2021

Tháinig an Comhchoiste le chéile ag 3.30 p.m.

The Select Committee met at 3.30 p.m.

Comhaltaí a bhí i láthair / Members present:

Teachtaí Dála / Deputies	
Richard Boyd Barrett,	
Seán Canney,	
Bernard J. Durkan,	
Mairéad Farrell,	
John Lahart,	
Brian Leddin,	
Aindrias Moynihan,	
Patricia Ryan.	

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

Stability Programme Update: Economic and Social Research Institute

Chairman: Apologies have been received from Deputies Michael Healy Rae and Ged Nash. The committee today will be engaging in *ex ante* scrutiny of the stability programme update report. We will now allow the witnesses to join the meeting.

The committee will be engaging with the representatives from the Economic and Social Research Institute, ESRI, to discuss the current economic and fiscal situation and the key issues that the medium-term fiscal strategy could consider and address. I welcome Dr. Kieran McQuinn, research professor, and Dr. Karina Doorley, senior research officer.

Before we begin, I wish to explain to the witnesses some limitations to parliamentary privilege and the practice of the Houses as regards reference they may make to other persons in their evidence. Pursuant to both the Constitution and statute, the evidence of witnesses physically present or who give evidence from within the parliamentary precincts is protected by absolute privilege. However, the witnesses are giving evidence remotely from a place outside of the parliamentary precincts, and as such they may not benefit from the same level of immunity from legal proceedings as a witness who is physically present. Witnesses are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a 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 statements are potentially defamatory in regard to an identifiable person or entity, witnesses will be directed to discontinue their remarks. It is imperative they comply with any such direction.

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 or it identifiable. I remind Members of the constitutional requirements that they must be physically present within the confines of the places in which Parliament has chosen to sit, namely, Leinster House and-or the Convention Centre Dublin, to participate in public meetings. I will not permit a Member to participate where he or she is not adhering to this constitutional requirement. Therefore, any Member who attempts to participate from outside the precincts will be asked to leave the meeting.

I ask Dr. McQuinn to give his opening statement.

Dr. Kieran McQuinn: I thank the Chair for the invitation to appear before the committee. We are grateful for the opportunity to provide our views on the present economic and fiscal situation and to discuss some key issues and risks which the medium-term fiscal strategy should consider.

Starting with the current economic and fiscal position, the sharp rise in Covid-19 infections through the latter half of quarter 4 of 2020 prompted the Irish authorities to reimpose a series of level 5 restrictions from 30 December 2020 to 5 April 2021, which is the earliest date on which they may cease. Compared with the measures introduced in September 2020, these measures were quite restrictive with all schools closed and construction, for example, included in the general shutdown.

The significant nature of the restrictions, along with the relatively long length of their duration, will have an adverse impact on the economic recovery, and that had been apparent throughout the latter part of 2020. The most obvious manifestation of this adverse impact is in the labour market where the unemployment rate, which had declined to less than 17% in quarter 3 of 2020, is now likely to average over 27% in quarter 1 of 2021. Previous ESRI research has shown that the pandemic unemployment payment, PUP, and the employment wage subsidy scheme, EWSS, have done much to cushion the incomes of those who have suffered pandemic-related job losses.

Young adults and those working in the hospitality and arts sectors would have experienced particularly steep income losses in the absence of these supports. We have quoted some of our own research in our written submission as evidence in this regard. Research has also shown that while the PUP and EWSS represent a significant cost to the Exchequer, much of this cost could have been incurred anyway in the absence of these supports due to automatic stabilisers such as jobseeker's benefit and jobseeker's assistance.

The first table in our written submission depicts the monthly costs to the Exchequer of pandemic-related unemployment and of the accompanying supports in income tax forgone and extra welfare payments, including the PUP and the EWSS. The monthly net Exchequer cost of the pandemic unemployment shock is estimated to be €144 million in the absence of the PUP or the EWSS. With the PUP and the EWSS in place, the monthly Exchequer cost is higher at €193 million per 100,000 people newly unemployed.

It is notable, however, that much of the estimated Exchequer loss would have been experienced in the absence of these policies. This is because in the absence of the PUP and EWSS, the existing tax-benefit system would have helped stabilise incomes, through increased jobseeker's benefit or assistance payments, for example. The EWSS, by facilitating job retention, also results in higher income tax if employers who receive the subsidy pay employees their pre-pandemic wage.

In our winter 2020 commentary, released in December, we had envisaged a further series of restrictions in 2021 in response to the easing of the measures prior to Christmas 2020. However, these restrictions were not assumed to take place until quarter 2 of 2021. They were also not assumed to be as restrictive as a level 5 lockdown. Consequently, we are now revising downwards our growth expectations for the Irish economy in 2021. We still believe the economy will register positive growth of approximately 4% this year. The expected path for unemployment in 2021 is also revised upward, albeit marginally. We now expect the unemployment rate to peak in quarter 1 of 2021, before falling consistently thereafter. The rate is forecast to be just above 10% by the end of the year. All this assumes vaccines will be rolled out successfully to most of the general population through the latter half of 2021.

The nature of the level 5 restrictions introduced in early 2021 means the fiscal accounts are likely to be in a more adverse state this year than previously thought. This is because more people are likely to be unemployed for longer than originally forecast. Consequently, we now believe a deficit of 4.8% or €18.9 billion is likely this year. That will result in the debt-to-GDP ratio increasing from 58.8% in 2019 to over 62% by the end of 2021. This comes on top of a sizeable deficit in 2020 of €23 billion or 6.2% of GDP. Previously, the State had run slight surpluses in 2018 and 2019 of 0.1% and 0.4% respectively.

In general, it is worth noting that the Irish economy performed much better than expected in 2020. Like most commentators, we had believed at the outset of the pandemic that the economy would contract significantly in 2020. However, it is now likely, and this was confirmed by the Central Statistics Office, CSO, last week, that the economy grew by approximately 3.5% last year. While a large part of that growth was due to the performance of a select number of multinational intensive sectors, it does underscore the point the Irish economy is better placed than most to emerge from the pandemic.

Turning now to the medium-term fiscal strategy, the state of the Government finances over the medium term will be significantly affected by developments in the labour market and how quickly the unemployment rate declines as the economy opens up. Our current forecast for 2022 indicates the unemployment rate is likely to average approximately 8% for the year. To put this in perspective, when the economy last had an unemployment rate of 8% in 2016, there was a general Government balance of almost 2%.

This increase in the debt levels associated with the pandemic has inevitably given rise to questions as to whether a contractionary fiscal policy will be required to pay for the additional costs to the Exchequer of Covid-19. While it is still too early to answer these conclusively, some recent analysis conducted in our winter commentary is informative, in that it assesses the likely implications of different recovery paths for the domestic economy on the sustainability of Irish sovereign debt levels. Drawing off work done by our colleagues, Dr. Adele Bergin and Dr. Abian Garcia Rodriguez, the analysis shows that if the future average interest rate on Irish debt remains constant over the next ten years, then apart from a delayed recovery scenario, the future higher debt levels will be sustainable. However, were the average interest rate to increase, then the debt dynamics would not be as reassuring. The analysis assumes that the State does not run a negative primary balance from 2022 onwards.

Most of the immediate fiscal pressures from the pandemic are tied in with the support payments provided by the Government. In that regard, there is much discussion over how long to continue Covid-related policies such as the pandemic unemployment payment, PUP, and the employment wage subsidy scheme, EWSS.

Should sufficient employment prospects exist, withdrawing the PUP could improve financial incentives for those seeking work to take up employment. So, too, would allowing existing recipients to maintain their payments for a period while taking up paid employment. This could encourage those in non-viable industries to seek employment in other sectors for which they may need additional training. However, if the labour market has not largely recovered, then the withdrawal of the PUP would disproportionately affect low-income, young, single workers. One option available to policymakers is a more gradual tapering of the PUP, which could help the groups most at risk of long-term unemployment after the pandemic to maintain a certain standard of living while searching for work. Existing welfare payments could also be reformed to better target this at-risk group. Much will depend on the post-Covid recovery and the availability of employment for different age cohorts and in different sectors.

Similarly, determining the optimal time to close or withdraw the EWSS will be challenging. In the long run, continuing the subsidy would mean supporting both employment that would exist even if the subsidy was no longer in place, which would be a deadweight cost, and employment that was no longer viable in the long term and where employees should be given the opportunity to retrain in other roles. However, withdrawing it too early may lead to some firms failing that would otherwise be viable. While close monitoring of the speed and scale of the recovery by sector might help inform this difficult decision, there is also a case for examining the design of the subsidy for any sector for which it continues. At present, the sharp cut-off in eligibility imposed by the requirement to be experiencing a 30% reduction in turnover means that some firms might face an incentive to suppress output, therefore inhibiting their recovery.

More generally, there is set to be considerable debate at European level about the future conduct of fiscal policy over the coming months and years. The European Commission is set to review the European fiscal framework following the forthcoming German elections. Recent comments by Dr. Isabel Schnabel, a member of the executive board of the European Central Bank, ECB, are interesting in that regard. She calls for unconventional fiscal policies that support the efforts of the ECB when inflation is below its aim. She points out that, in a European context, increased public investment, for example, has been found to crowd in as opposed to crowd out private investment.

The new European fiscal framework needs to be framed in such a manner that ensures a return to fiscal discipline among member states in the medium term but also enables governments to invest in key physical and social infrastructure over the same period. Fiscal rules could be formulated that allow for member state governments to invest in capital expenditure in areas such as social and affordable housing and green technologies on an ongoing basis but also ensure that, post the pandemic, current expenditure is maintained at a sustainable level.

My colleague, Dr. Doorley, and I will be happy to take members' questions.

Chairman: I thank Dr. McQuinn. I call Deputy Lahart.

Deputy John Lahart: How much time do I have?

Chairman: Nine minutes, but we will give latitude to members if the conversation is interesting.

Deputy John Lahart: Excellent. We could be here all evening.

I thank Dr. McQuinn for his presentation. My salutations will be brief to save time, but that was interesting. I will start at the end because I am excited about the points regarding the fiscal rules. There was a suggestion in the presentation that, in the context of Ireland if the situation goes well, state aid could be reviewed. Is that a misreading of the presentation?

Dr. Kieran McQuinn: We have not had much detail on the particulars of any reform of the fiscal rules. Much of the discussion has been more general and relates to the need for greater capital investment to be permitted under them. Under the existing rules, some form of investment is allowed; it is not that investment is prohibited. The point has been made that, over the past eight or nine years and reflecting what many people would argue was the flawed policy response to the financial crisis, Europe has suffered from an absence of significant investment across many economies. This has inhibited the growth performance of European economies during that period. It is worth remembering that most European economies were averaging approximately 1.5% growth before the pandemic.

There is a recognition among policymakers. It is interesting to note that, even in the ECB, which previously had a hawkish reputation as far as its stance on these matters was concerned, there is a growing debate about the need for any revision of the fiscal rules to be broader and more comprehensive and, in particular, to allow for greater investment to occur across European economies. I do not believe that we have yet seen particular details emerging about the likes of state aid being addressed, but the discussion is progressive in terms of more investment being facilitated.

Deputy John Lahart: As a layman, that struck me at a more basic level. I am glad, given how the EU's response to the crash and, now, its response to the vaccine roll-out, have left us all underwhelmed. The EU needs to do something symbolic and significant, given that we are all suffering and in this together.

I will ask some quick-fire questions. When will the economy emerge fully from Covid? What is the ESRI's projection?

Dr. Kieran McQuinn: It depends on how that is defined. For example, unemployment dipped below 5% last January or February just before the pandemic. Our expectation is that it will be at least 2023 before we get back to that rate of unemployment. Our forecast is that the unemployment rate will be approximately 10% at the end of this year, falling to approximately 6.5% by the end of 2022. As such, re-emergence will happen in 2023 in terms of unemployment, but we see there being significant growth in the economy at the end of this year and throughout next year.

Deputy John Lahart: Dr. McQuinn mentioned an unemployment rate of 10%, which would be five percentage points higher than the January 2020 figure. What will comprise those five points? Who will not get their jobs back?

Dr. Kieran McQuinn: At this point, it is difficult to assess the scarring effects of the crisis. This is one of the major issues that we have been trying to consider in examining the performance of SME sectors. Most concerns are about on the sectors that have been especially hit by the crisis, for example, hospitality, entertainment, retail, etc. This is particularly the case for SMEs that had reasonable levels of debt going into the crisis. The danger is that many of them could be overwhelmed by the levels of debt they have incurred over the past year and may incur in the coming months, if not well into the latter half of the year. Those are the sectors where we would expect to see a significant increase in employment, given that they are almost entirely shut down, but there is a likelihood that there will be a scarring effect among some of them. The danger, therefore, is that it will take quite some time for their employment levels to return to pre-pandemic levels.

Deputy John Lahart: I am asking Dr. McQuinn to gaze into a crystal ball and that is difficult.

He went on to talk about the non-viable industries in the context of the 10% unemployment rate. What does the ESRI envisage emerging as non-viable industries? Dr. McQuinn talked about the consequences of long-term unemployment for the State payments. Marrying those issues together, namely, the long-term unemployment rate of 10% and non-viable industries, could he develop the point a little?

Dr. Kieran McQuinn: At a micro level, it goes back to the idea that the industries or firms that we feel will be under most pressure are clearly in the designated sectors, that is, those that have been shut over the past year-----

Deputy John Lahart: Dr. McQuinn is almost afraid to name those sectors.

Dr. Kieran McQuinn: I think everybody knows which they are. They include sectors such as hospitality, food, entertainment, retail, tourism and so on. They are the major sectors that have been shut and they will have SMEs potentially carrying levels of debt that may make it difficult for those firms to return to a normal level of economic activity any time soon. Even after the initial shutdown, there was a strong bounceback in quarter 3 and into early quarter 4.

The danger for us, which is one of the factors we have been trying to assimilate in our forecast, is that the longer the economy and a significant number of sectors are in shutdown mode, the greater will be the risk of scarring effects and the slower the path back to the employment levels of pre-pandemic.

The sectors are easily identifiable. They are simply those that have been most significantly shut.

Deputy John Lahart: In the brief time I have remaining, I will fire some questions at Dr. McQuinn. My first question might feed in to those asked by other members, so I do not expect him to answer in full now. One of the consequences we expected from Brexit was that the UK could become very competitive in respect of corporation tax, but the Chancellor of the Exchequer, Rishi Sunak, has indicated the opposite. We talked about the large casualties, which I hope are temporary, arising from the economic impact, but clearly some companies and corporations have thrived during this period and will continue to do so, with profits growing exponentially. Is there a moral imperative on those companies whereby the State could say, given that they have thrived during the period while everybody else suffered, there is a financial and economic role for them to play in this?

If there are to be scarring effects, what new commerce, businesses or industries does Dr. McQuinn foresee emerging from this period? Does the ESRI have any information on that?

Dr. Kieran McQuinn: On the moral issue, what we observed last year, particularly in quarter 2, was quite remarkable. We all expected to see very adverse numbers, as far as economic performance was concerned, until we saw the trade figures and those for the export sector. In particular, some of the multinational sectors such as the pharmaceutical sector enjoyed significant increases in export levels. That caused our GDP figures to be positive for the year, which was quite remarkable when compared with other countries.

As for whether there is a moral imperative for those firms, it would be very difficult to implement such policies. Our general concern in regard to taxation is that at the moment, the economy is still in a fragile state. We expect it to emerge from that and to recover strongly, but it is still in a fragile state. Even to try to impose higher taxes, similar to the UK for example, significant risks are associated with that. It could slow down the recovery we are expecting. I would be-----

Deputy John Lahart: Even for the large multinationals?

Dr. Kieran McQuinn: One expects the multinationals to pay the required corporation tax rate but as for whether they should be targeted, the bottom line is they are a very important part of the economy, as evidenced last year. Our economy would have registered substantial declines but for the fact that a relatively small number of those firms enjoyed a particularly strong performance. Of course, some of that performance was due to the pandemic, given that they were producing products and services associated with the pandemic. There are always instances where people can benefit in a commercial sense, even from a crisis such as Covid-19. We have to be careful and ensure we do everything possible to support the recovery and that it is as broadly-based as possible.

On the question about new business ventures, it is difficult to say. Anecdotally, one issue that has struck me and others is the ingenuity that can be seen in the form of businesses that have adapted to Covid-19, where possible. We saw that even through the performance in the latter half of last year. There was the initial lockdown, followed by a strong recovery, and then there was another series of lockdown measures but they did not seem to have quite the same impact. While the measures of the second lockdown were not as significant, it seemed to suggest that many businesses were beginning to adjust their business models and to adapt in such a way that they could trade to a certain degree. It has shown there is remarkable ingenuity among mainly Irish businesses in adapting to the crisis and to the challenges posed. Hopefully, those businesses will be in a strong position when the economy fully reopens and will carry that forward.

Deputy Patricia Ryan: I thank both the witnesses for attending. Dr. McQuinn mentioned the calls for unconventional fiscal policies. What might they entail?

Dr. Kieran McQuinn: The ideas being thrown around relate to the kinds of measures that would promote capital investment in particular. They are the kinds of policies that are being discussed. As I was saying in response to Deputy Lahart, this comes the recognition that there has been a shortage of public investment in particular throughout Europe over the past ten years. They are policies that could promote public investment.

Deputy Patricia Ryan: Does Dr. McQuinn know why the European Commission is waiting until after the forthcoming German elections to reveal the European fiscal framework?

Dr. Kieran McQuinn: Since we drafted our opening statement, the Commission has formally stated that the fiscal framework is being suspended until next year, so it has confirmed that. To be fair, there is still much uncertainty about where the pandemic will lead us and about how quickly economies will be able to recover. In large part, the Commission is trying to see what the state of play will be throughout European economies before it reimposes the rules or engages in any reform or overhaul of them.

Deputy Patricia Ryan: Why are mortgage interest rates so high in Ireland, given the historically low interest rates throughout the eurozone, and what can be done to reduce them?

Dr. Kieran McQuinn: That is an interesting question and it almost warrants its own session. We have consistently talked about the issue in our economic commentary and it is not just mortgage interest rates but also interest rates for SMEs. The data clearly show that the average rates charged in the Irish market are typically higher than what prevails throughout Europe. There are a number of reasons for that, one of which relates to the lack of competition in the Irish market. The proposed exit of Ulster Bank from the market will, unfortunately, compound the difficulty of the relative lack of competition in the domestic market. The banks would claim that the reason they charge higher rates than those in other countries is that Irish banks have to carry higher levels of capital, which is a legacy of the financial crisis. There are a number of factors but the lack of competition in the domestic market is one of the major ones.

Deputy Patricia Ryan: We are in the middle of a housing crisis. I note criticism by the ESRI of the affordable housing Bill. What is the best way to approach solving this crisis?

Dr. Kieran McQuinn: It tallies with what we said in the opening statement, that basically the problem in the housing market currently, as most people would recognise and agree, is one of supply. We clearly need to provide greater levels of supply in the market and we need policies that can facilitate that. Obviously, there has been a fairly significant increase in capital investment in property in the recent years, certainly in the last budget, but we need more of that as we go forward. If the fiscal framework, for example, at a European level can be modified to reflect that and to enable investment in an area as crucially important as housing, it would be very beneficial from the economy's point of view as well as for all those people who might wish to get into the property market.

Deputy Patricia Ryan: What is Dr. McQuinn's opinion on the taxing of the pandemic unemployment payment and the temporary wage subsidy scheme? Does he consider the taxing these payments is counter-productive?

Dr. Kieran McQuinn: It is a difficult issue. It ties in with the need, at some stage, to taper and reform those policies and they will have to be incorporated within the more general taxation system. That was one of the points we raised in the document, namely, that there is a significant policy challenge as we move forward in terms of modifying the policies and the schemes in light of the economy opening up. It is a very difficult question, of that there is no doubt. There is a balance to be struck between supporting family incomes and making sure people can survive in the current climate but also making sure there are incentives for people in terms of the normal incentives that apply as far as the economy is concerned. Does Dr. Doorley wish to add a further comment?

Dr. Karina Doorley: I would add that like other jobseeker supports, in respect of the pandemic unemployment payment and the employment wage subsidy, a decision was made to tax them. Ideally, that would have been done at the time, with the tax being deducted as it was paid, and people would not be surprised with a bill at the end of the year. In the work we have done, we examined the impact of the pandemic unemployment payment and the employment wage subsidy scheme on families' incomes in light of the crisis. Even with taxation on top of it, we found these payments were significantly cushioning the lowest income groups who had suffered pandemic-related job loss. The bottom fifth of households in terms of income were still seeing their incomes up on average, completely cushioned, even taking into account the taxation on these payments. Administratively, the way the taxation was pushed to the end of the year is not ideal but as we move forward, it will be taken out at source or as we go along. Administratively, that is better from a household perspective.

Deputy Patricia Ryan: Dr. McQuinn mentioned in his statement that increased public investment has been found to crowd in as opposed to crowd out private investment. What area should public investment prioritise with a view to attracting private investment?

Dr. Kieran McQuinn: If the Deputy is asking where we need public investment the most in the economy at present, and we have made this point before Oireachtas committees on a number of occasions over the years and in our commentaries, the housing area is the main area where we need public investment. Obviously there are many other areas and we mentioned the need for investment in green technologies. That is very important also in facing up to the environmental challenges that exist. Those are the two most pressing areas we would see as warranting investment. If we consider it from country to country, from a cross-European perspective, there are different requirements for investment in other jurisdictions. However, in the Irish case, certainly it is mainly in the housing area and in developing green technologies to address the environmental challenges.

Deputy Patricia Ryan: I thank Dr. McQuinn for that. He mentioned in his statement that existing welfare payments could be reformed to better target at-risk groups. What reforms would he suggest in that respect?

Dr. Kieran McQuinn: Dr. Doorley might take that question.

Dr. Karina Doorley: The group we see as being most affected when these supports are withdrawn are the under 30s cohort of young people and they are predominantly renters also. They were disproportionately affected by pandemic-related job loss and in the absence of these supports, they would have seen a much larger loss in disposable income than other groups. When these supports are withdrawn young people stand to lose a substantial amount of income and a more targeted approach might then be needed to support them while the labour market recovers. I will cite two examples of areas arose when we examined this. We know those who are aged 18 to 25 and who live with their parents receive a rate of jobseeker's assistance that is much lower than the rate for those aged 25 and above. That could be one area to examine because that group of 18 to 25 year olds may suffer from scarring from the pandemic-related unemployment and may find it more difficult than other groups to re-enter the labour market. That is one rate that could be looked at. Another factor to consider is that many young people who are currently receiving the pandemic unemployment payment are students and students are not eligible for jobseeker's assistance or jobseeker's benefit in the first place. The CSO published statistics last year showing that about a quarter of pandemic unemployment payment recipients aged under 25 were registered as a full-time student. When this payment is withdrawn eventually and if students find it difficult to re-enter the labour market, a support targeted at them could be considered as well.

Deputy Patricia Ryan: I thank the witnesses for their responses. I have completed my questions.

Chairman: I call Deputy Canney.

Deputy Seán Canney: I thank Dr. McQuinn for his presentation. A number of issues arise from it on which I have a few questions. We talked about the withdrawal of pandemic unemployment benefit and the pressures there will be on employers with the withdrawal of the wage support scheme and how that will work out. What are the witnesses' thoughts on having an employment incentive scheme to help both employers and young people, who will be affected most by the withdrawal of the pandemic unemployment payment, to return to work and to increase our workforce.

Dr. Kieran McQuinn: Dr. Doorley might take that question.

Dr. Karina Doorley: Yes. That certainly sounds like a good idea on paper. When these supports are withdrawn if there are not enough job opportunities or enough of the right job opportunities for people given their training, some sort of retraining scheme or incentive for them to rejoin the labour market will be needed. One example would be tying extended pandemic unemployment payment or wage subsidy payment to training or job activation measures, or something like that, but it could also take the form of jobs incentive scheme. That kind of thing sounds sensible.

Deputy Seán Canney: Some of the evidence I have shows that employers who are trying to plan for post-pandemic growth are concerned they will find it hard to get people to work because they may not be available. How do they take people in, train them and retain them? That is part of the process. If we invest in training people, how do we retain them in their jobs. That will be a challenge.

Another area about which I have a concern and on which I would like to get the witnesses' thoughts relates to our construction industry, which is closed to an extent. It is 100% operational in the UK, Northern Ireland and beyond. We are the only country in which it is this way.

I understand many of those not so much in senior management but in middle management have migrated back to London or elsewhere to work rather than hanging around here. Post-Covid when we will be seeking resources to help us rebuild the economy, we will have a shortage of skill at management level in the construction industry. That will have an impact on the cost and pace as which we get projects done.

Another area of concern is that we have pent up savings and people will want to spend that money or to do things with it. Inflation could pop into the equation. How does the ESRI deal with inflation and what effects will inflation have in a recovery?

Dr. Kieran McQuinn: Is the Deputy speaking about house price inflation or inflation generally?

Deputy Seán Canney: I am speaking about inflation generally in terms of the additional cost of carrying out capital projects, the additional cost of building houses and the additional cost of purchasing a house, but also the cost of living in general, which will probably rise. That is my opinion. I would welcome Dr. McQuinn's opinion on it.

Dr. Kieran McQuinn: There are a couple of issues. On the property market, last year, we did a detailed piece of work for the Department of Housing, Local Government and Heritage assessing the impact of Covid-19 on the property market. The issues we raised are pretty much those suggested by the Deputy. We felt Covid-19 would have a negative impact on demand for a period of time because of the uncertainty, job losses and so on and that it would more than likely have a bigger impact on supply over the longer term. Demand in the housing market can recover quickly. As alluded to earlier, there is a significant build-up of savings which, if they were to come on stream significantly into the property market, could result in a scenario of heightened levels of demand, with supply still being constrained. In terms of where we are at with regard to supply, we still managed to build 20,000 houses last year, which was a good performance given where we sought to be at the mid point of the year. However, we are still 13,000 to 14,000 houses short of what we need on a per annum basis. This year, the danger is that we could end up with a significantly lower level of construction such that the build could be in the region of 13,000 to 15,000 units. Our main conclusion was that the Covid-19 pandemic could exacerbate the imbalance between supply and demand in the market. That is a real genuine concern. Like everybody, we would like to see construction up and running, but there are public health considerations around that. The supply levels coming out of the construction sector this year will need to be carefully monitored. This goes back to our general point on the issue of public investment and the need for it, particularly in the housing area. It is one area where the Government can make a significant contribution in terms of trying to stimulate the supply side of the market. There is, however, the issue raised by the Deputy, namely, that if we do not have the labour, the danger is we will face higher costs.

On inflation generally, concerns have been expressed in regard to the United States, where there is a large debate about the nature of the stimulus package that the Biden Administration is bringing in and whether it will have inflationary implications. In the current climate, concerns about inflation are still somewhat misplaced. It is a concern that is a good way down the list in terms of the other issues and pressing considerations that are there. The CPI and the rate of inflation in the Irish economy over the past number of years has been running at less than 0.5% and there has been significant disinflation over the last six to nine months because of the crisis. I do not think we will see a significant build-up of inflation in general inflation in the coming months and years. I do not see that as being an issue right now, but I would caveat that there is a danger, particularly if the housing supply issue is impacted adversely, that we could see house prices build up sharply and rents start to pick up again. Those are two real concerns about the post-pandemic situation.

Deputy Seán Canney: I would like to mention two other issues. The landscape of employment is changing in terms of remote working. How do we prepare for that and in what do we need to invest to ensure we have blended working and the proper mix? The other issue that comes to mind in the context of the opening statement is the need for interest rates to remain constant for the next ten years. I accept the following is crystal ball gazing, but how confident is Dr. McQuinn that interest rates will remain constant over the next ten years?

Dr. Kieran McQuinn: In referencing the next ten years, we were looking at the forecast horizon. In regard to the medium term, a great deal of work has been done on the future of interest rates and where they are likely to go. Many people have looked at this issue over recent years. Some of the most interesting work ties it in very closely with issues around demographics. If one parks the pandemic issue, we have had low interest rates across most western economies for some time now. The factors behind that, particularly in Europe, are demographic issues as the population becomes more ageing and also the slowdown we have observed generally in western economies in terms of productivity growth. As long as we have those two forces and trends, it is unlikely there will be any great substantial upper pressure on interest rates over the medium-term. Evidence of that is the sluggish inflationary figures we have observed across Europe over recent years.

In terms of the long-run factors that determine long-term interest rates, it is hard to see upper pressures in that regard. That does not mean people should conduct their fiscal policy assuming there will never be an increase in interest rates over the medium or longer term. It is safe to say that in the short to medium term there is unlikely to be a substantial pick-up in interest rates, certainly at a European level. The other point to remember, which we stress in the opening statement, is that we are likely to experience sharper and more accelerated growth rates than most European countries coming out of the pandemic. We entered the pandemic with strong growth rates and I think we will come out of it with strong growth rates. On average, growth rates in Europe are probably going to be less than what they are in the Irish economy. This means that, in general, monetary policy will favour a low interest rate environment for the foreseeable future.

The other question was on remote working. It is a very interesting question. We tried to tease it out a little in our work on the housing issue for the Department of Housing, Local Government and Heritage on how the pandemic would impact the housing market. At this stage, much of our work and thoughts on the issue are governed more by anecdotal evidence than anything else. There is no tangible evidence of that. My guess is that going forward - the institute is probably an example of this - there will be growth in blended working arrangements. There will be some return to offices over the next six to 12 months, particularly as the economy opens up. I do not think there will be a wholesale movement to remote working, but, equally, there will not be a return to everybody going into the office five days per week. That will present some challenges for businesses such as retail, particularly in city centres, but it also offers some opportunities in terms of the possibility of people being able to relocate to areas where, for example, housing is cheaper, there is less congestion and from which they do not have to undertake arduous commutes on a day-to-day basis. There will be opportunities but, equally, there will be challenges in that. On balance, we are more likely to see a blended style arrangement going forward rather than one extreme or the other.

Deputy Seán Canney: I agree with that assessment and I thank Dr. McQuinn for his forthrightness in his answers. Remote working is something we talk about. I do not like the word "remote" because one can work from any place in Ireland and not be remote if one has the technology. The challenge is to digitalise the regions such that everybody will have connectivity and the opportunity to work any place they want. I believe this will be a huge factor in terms of foreign direct investment locating in Ireland into the future. Foreign direct investment wishing to locate in Ireland will be looking at the ability of people to work in communities such that they do not have to provide huge office spaces or facilities. They have looked at this previously and will be doing so even more so now because it is more manageable for these companies to have people working from home for a number of days per week as it cuts down on the overall cost of real estate.

Chairman: I thank Deputy Canney. I had intended to ask a different question first, but as we discussing labour costs and the medium term, I will follow up on the issue raised by Deputy Canney.

The ESRI recently published some work on the minimum wage which related to the 2016 change. It showed that in 3% of firms it led to higher costs, but in around 90% of firms it did not. The programme for Government sets out a commitment to progress the living wage over the lifetime of the Government. Has the ESRI considered what impact that will have on labour costs in the medium term? Has it considered doing any work on the impact on equality and Irish businesses?

I would like to follow up on some of Deputy Canney's questions on what the future of work will look like post Covid, not just in terms of the living wage or remote working but also perhaps something like a four-day week.

Dr. Kieran McQuinn: Does Dr. Doorley want to talk about the labour cost work?

Dr. Karina Doorley: Quite a bit of work has been done on the minimum wage over the past few years in the ESRI. The particular study the Chair referenced was an examination of the 2016 change in the minimum wage, which was the first increase in a long time. It was a modest increase. Buckets of international literature show that when there are modest, progressive and successive increases in a minimum wage it does not negatively affect employment and firms are usually able to cope with it. It is considered a good idea for the minimum wage to at least keep pace with inflation or growth in other wages so that minimum wage workers are not left behind. This does not seem to have a significant effect on employment either way. If the minimum wage doubles, that would have an effect on employment.

When we speak about moving to a living wage, it would depend on the level at which that is set. If it is going to be quite a large increase, the things to consider are whether there will be a negative effect on employment and whether welfare payments will be able to keep pace with the increase. If we have a living wage that increases the standard of living for low-wage workers, this increases wage growth overall. We will then find that people in receipt of welfare payments are left behind which may increase income inequality, which is the last thing we want from an increase in the living wage.

Chairman: What percentage does the ESRI consider a large increase? I would like to get a sense of what we are talking about.

Dr. Karina Doorley: I do not have a number in my head.

Chairman: Okay.

Dr. Karina Doorley: The 2016 minimum wage increase was less than 10%. That would not be considered a large increase in the minimum wage. An increase of 20% might be a large increase and an increase of more than 20% would certainly be large. It really depends on how long it has been since the last increase and what wage growth has been over that period.

Dr. Kieran McQuinn: The second part of the Chair's question was on the future of work and issues around a four-day week. Dr. Dooley can correct me if I am wrong, but I am not aware of any work that we have planned on that issue, unless my colleague, Professor Seamus McGuinness, who works on the labour side, is looking at something like that. I am not aware that he is. If it is a tangible and real proposal, it is something we would be very interested in assessing. I am not aware off the top of my head of any plans to address that particular issue.

In one sense, one could look back over the past year. It would be interesting to quantify, if one could, the difference for those who have been in work over the past year and how much they managed to get through on a given week compared to what they would normally have been able to do before Covid, and whether there was a dramatic improvement in productivity or an increase in people's productivity. A lot of people were working fewer hours, in particular younger people with families etc. In terms of a structured assessment of the issue, I am not aware of any plans we have as of yet to examine the issue of the four-day week.

Chairman: To move to a slightly different area, in July last year the ESRI published its study on the environmental and economic impacts of Covid-19 on the Irish economy. From an environmental perspective, some of the findings were interesting. One of the main findings was that the results implied that: "[A]lthough lower energy prices will boost energy demand, the impacts of decreased energy demand due to decreased consumption and production will be larger. As a result, the economy-wide CO2 emissions decline by 9.5% in 2020".

The actual greenhouse gas emissions decline in 2020 was 5.9%. I am not as interested in the forecasting element because I am well aware that it is a bit of a dark art. I am not questioning the figures on that basis. However, I am interested in the factors the ESRI feel led to lower than expected emissions savings. How can we get better at forecasting energy use, emissions and costs? Do we have plans for how to integrate this into our medium-term financial forecasting?

Dr. Kieran McQuinn: That is a really interesting observation. We have to put our hands on our hearts and say that forecasting the impact of Covid-19 has been very difficult, in terms of the overall impact on the macroeconomy. When Covid-19 initially hit the economy in March last year, we had very draconian estimates for what we felt would happen to national output and national income. We talked about a decline of anywhere in the region of 8%, 9% or 10%. What we actually saw in the economy last year was growth of 3.5%. A lot of that was mainly down to the multinational sector and the relatively strong performance of certain exporting sectors of the economy.

It is possibly the case that we overestimated, in particular at the outset, the impact of Covid-19 on the economy. Equally, one could say that in some of our other forecasts in areas like consumption we were pretty accurate in what we said would happen, namely, the sharp downturn.

Overall, if the Chair is asking me to explain why the effects were more benign or why we did not have the fall-off in emissions that we forecasted at that time, it is probably down to the fact that there was a tendency initially to overestimate the impact of Covid-19 on the economy and, consequently, its impact on issues like carbon emissions or overall emission levels. It is a very good point.

At some stage we will carry out our next economic outlook. As the committee knows, we typically provide a quarterly economic commentary, which is a short-term forecast, four times a year. Every five or six years we carry out a longer term forecast over a ten-year horizon. We will do that at some point in the near future. Clearly, the work our teams are doing in the environmental area will be central to that work.

Chairman: I do not know if the ESRI has knowledge of whether there is a complication in terms of estimating the reduction in domestic emissions, as opposed to business or industry-led emissions.

Dr. Kieran McQuinn: I am not sure. I was not involved in the study. It is something we could discuss with Dr. Kelly de Bruin and Dr. Aykut Mert Yakut who were involved in the report and examined the source of the varying estimates.

Deputy Richard Boyd Barrett: I thank the witnesses for their very interesting and informative contributions. I wish to ask about the debt situation. For a long period during the time of austerity, terror and fear about the debt burden was instilled into the population. It was given as the reason we needed incredibly draconian fiscal rules and all of the terrible austerity that flowed from that. We were told we could not possibly sustain a debt which rose to €200 billion and a debt to GDP ratio of a similar amount to the one now under consideration. However, now it is all okay, and we have got a debt of €239 billion. Should we not be identifying the extraordinarily high levels of debt as a real risk to the economy? I would like the witnesses to give a response to that. I know there is a very relaxed approach on interest rates, and we think interest rates will stay as they are, but if they go up we are in deep trouble. The witnesses might comment on that. Our job on this committee is to identify macroeconomic risks and it seems to me that that is a serious risk. At the very least we should open up a debate about whether that is the best way to finance the public expenditure that we need. I would be the first to campaign for many of those expenditures, which I believe are necessary. The Covid expenditures are critical to sustain people. The capital expenditure on housing that has been identified by the witnesses is critical because we still have a very severe housing crisis. Would the witnesses say that we need to have a debate about whether debt financing is the best way to cover the costs of those investments and expenditures or if we need to look at taxation on accumulated wealth? I ask that question because, to put it bluntly, the borrowing we are doing is essentially from wealthy people. That is who the Government borrows money from. The Government sells bonds to wealthy people and they get an interest rate on those bonds. In crude terms, those who lend money to the State make money from the transaction, whereas the alternative is to tax some of that accumulated wealth, which I would argue is a better deal from the public's point of view but achieves the same end, in particular when it is clear that during Covid the wealth at the top has increased substantially. I would like the witnesses to comment on this. The people who have taken the hit have been the tourism workers, the entertainment workers, the retail workers, often women workers, and low-paid workers in areas of low-paid employment, while the people who have done quite well are the big owners of property, some of the big corporate interests and the very wealthy individuals. Oxfam recently suggested that the wealth of Ireland's billionaires had increased by €3.3 billion. Would we not be better off taxing those people or should we not at least discuss whether it might be a better deal to tax those people than to borrow money off them at interest?

Dr. Kieran McQuinn: I will deal with the questions on headline issues such as the fiscal rules and debt financing and Dr. Doorley might join in to respond to the questions on the impact of Covid on inequality.

I will make a number of points in response to what Deputy Boyd Barrett said. Rightly or wrongly, we are very heavily governed by what happens at a European level. Clearly, it is the European fiscal rules which have overseen our fiscal strategy in broad terms in the past ten years. I am sure we probably discussed this at previous Oireachtas committees. The Deputy might have seen what we published where we were very critical of the European response to the financial crisis, and the austerity-led response is perhaps the way people would couch it. From a technical point of view, the way we would have said it is that the idea of governments collectively across Europe pursuing a contractionary fiscal policy, which is what they did after 2010, at a time when nearly every single European country was running very substantial large negative output gaps, which showed that there was huge capacity in those economies, just did not tally and it did not make sense to a lot of commentators. Fortunately, the debate has moved on quite a bit in the past ten years, in particular among many more senior and more influential policymakers at a European level. That was why to a certain extent I instanced the comments from the executive board member of the ECB. It is interesting to note that these comments are now coming from places like the ECB, and even in German policy, which would traditionally have been regarded as very conservative as far as fiscal policy is concerned.

The underlying issue is clearly the low interest rate environment, as Deputy Boyd Barrett correctly pointed out. That is enabling us, as with most other countries, to borrow quite significantly at present, but the borrowing cost as a fraction of GDP for example or as a fraction of our total revenues is quite low relative to where it was previously when our borrowing was not as substantial but the interest rates were very high. It is very analogous to the mortgage market. People can take out large mortgages when the interest rates are very low but when interest rates are at running at 13%, 14% or 15% then clearly the scale of the mortgage one can take out is much more reduced. That does beg the question, as the Deputy correctly identified, as to where we see interest rates going. As I indicated to a previous speaker, I think all of the focus in all of the analysis that I have seen that I respect, does suggest that low interest rates are something that will be with us for quite some time. There is a broader issue here about the growth potential and dynamics within the European economy. They had been very much reduced in the past ten to 15 years. Europe is not growing as significantly as it did in the 1980s, 1990s and early 2000s. In the absence of the key trends being reversed in areas like demographics, where it is clearly incontrovertible that we are heading for a much older population, in particular in countries like Germany, and in the absence of a major turnaround in productivity, which has been slowing down gradually across western economies, it is hard to see how interest rates are going to escalate over the medium to longer term. I fully agree that it is something we need to be very careful about and we need to keep an eye on, because if interest rates do start to climb, we are in a lot of trouble. The only consideration is that an awful lot of other countries will be in similar trouble as well, so policymakers are very much focused on this issue.

On the point Deputy Boyd Barrett made about raising taxes and the need to increase or broaden the tax base in response to the crisis, there are very valid reasons and arguments there in certain areas. Property tax is one area where one could look to increase the tax burden going forward. We pointed out that we felt there should have been increases in property tax, in particular given the very sharp rate of house price inflation in recent years. We are confident about the future prospects of the Irish economy, but as a general point, when one is talking about the scale of this crisis and its impact on the economy, if one were to start increasing taxes in the manner in which they have done in the UK for instance very recently, the danger is that one could choke off the recovery. That is something we would be concerned about. Perhaps it is a case of seeing the economy recover over the short to medium term and then one could have a debate or policy discussion on where one might wish to broaden the tax base and where exactly one could do that. Dr. Doorley might wish to contribute now.

Dr. Karina Doorley: I echo what Dr. McQuinn said. While we would not be saying that raising taxes right now is the right way to go, certainly a date on whether revenue does need to be raised through taxes in the future is a good idea. It is possible that at some point in the medium to long term the State will have to raise extra revenue, either to pay for the extraordinary Exchequer costs incurred during the pandemic or to finance a larger role for the State going forward, which it seems there may be a public and political appetite for at the moment. That is something we are currently looking at and are doing some research on. We are looking at the options for raising revenue. We are looking at everything from direct tax, indirect tax, corporation tax, property tax, congestion charges and so on. The research, which is being done by colleagues of mine at the ESRI, is likely to be out in May. What we will be looking at is what is the likely revenue gain from changing the parameters of each of these types of taxation and, importantly, what are their distributional effects – who are they going to affect, who are the winners and who are the losers from each of these options. That is quite important.

Deputy Boyd Barrett mentioned inequality increasing. We do know that in the absence of the Covid supports last year that income inequality would have increased quite substantially and so would poverty rates. As it is, with the introduction of the PUP and the wage subsidy scheme, disposable income inequality, after tax and transfers, has been quite stable between the pre and post-pandemic period, but the caveat is there that when these supports are withdrawn it is quite possible that income inequality and poverty will increase if there are not enough labour market opportunities for people. High income inequality is linked to many things we would like to avoid, including lower economic growth, lack of social cohesion, worse population health and well-being and higher poverty. When these supports are withdrawn it will be important to ensure there are adequate labour market opportunities, or adequately targeted supports, to ensure income inequality will not increase.

Deputy Richard Boyd Barrett: I do not know how much time I have left.

Chairman: Deputy Boyd Barrett is out of time, but I suspect we will have time for another round.

Deputy Aindrias Moynihan: I have one or two points to make and will follow up on a number of other points raised earlier. The figures for savings are clearly showing that some people are not as impacted as others by the pandemic. Some are really heavily hit, with household income obliterated in many households. There are almost two different worlds going on there.

When moving towards recovery, have the witnesses any thoughts on making sure there is opportunity for people who have been hit harder to catch up and benefit from that recovery? If there are people doing well, they will be up and running a lot faster. However, there are sectors that have been hit harder, whether it is the entertainment, the arts or hospitality sectors or other sectors, that could be focused on. What are the witnesses' thoughts on how those sectors might have an opportunity to catch up with any recovery?

Dr. Kieran McQuinn: The reality is those sectors have been effectively shut down over the last eight or nine months, particularly over the last two to three months, since the level 5 restrictions were brought in. There are huge numbers of people in those sectors who are out of work and a huge number of businesses that have been temporarily closed. By definition, when we move into the vaccine period and the economy starts to reopen, we will then see, hopefully, dramatic improvements in employment in those sectors. We will begin to see the unemployment rate across those sectors begin to fall on a persistent basis.

The evidence last year would suggest that is likely to happen. We looked at the reaction of the economy when restrictions were eased initially. There was certainly a fairly quick bounce back and rebound in the sectors most affected, the ones mentioned by the Deputy. Our expectation is that something similar could happen this time around. However, the one drawback is the scarring effect. There is a great likelihood that a number of businesses that were just about able to survive the first lockdown will not be able to survive what happened this time, which is the lockdown last year and the one we have just experienced. There is that risk.

However, the point could be made that if we enter a general opening up of the economy due to the vaccines, and if Covid rescinds fairly quickly from the public consciousness, there will be a boost in confidence. People will feel that maybe they are over Covid now; it was a dreadful episode but it is in the past. Therefore, confidence can come back across all the different sectors, whether it is investor confidence, consumer sentiment and so on. That can drive the economy and recovery as well.

There are countervailing forces on whether that will offset the scarring effects or whether the scarring effects will have a large impact on the recovery. However, as the economy opens, there will certainly be a large increase in employment across the sectors that have been shut down.

Deputy Aindrias Moynihan: It makes sense that there will be a certain amount of bounce back. However, businesses have been closed down for some time and some businesses will be gone. Dr. McQuinn calls it a scarring effect. Does he see the need for a focused intervention or supports for different communities, or does he see a natural return? Surely there are particular interventions that might be needed for different sectors or cohorts of people.

Dr. Kieran McQuinn: My colleagues have a research programme with the Department of Finance which looks explicitly at banking issues, in particular small and medium enterprises, SMEs. It monitors the response of the SME sector to issues generally but in particular, at the moment, the pandemic. It may well be the case that some of that research is looking at targeting or identifying debt levels among SMEs and trying to identify whether something can be done from a policy perspective to alleviate debt levels so that when the opportunity arises, those firms are in a position to bounce back and bounce back fairly aggressively. That is something that should be considered, in that if there are firm which would have been perfectly viable before Covid-19 but are now saddled with higher levels of debt because of the pandemic and shutdown, can something be done to target those businesses and their debt positions so they can move forward and recover with a great degree of confidence? That is possibly a policy measure that could be considered. As I said, my colleagues are looking at those issues and will have research fairly imminently on the likely areas that could be pinpointed.

Deputy Aindrias Moynihan: In regard to the pandemic unemployment payment, PUP, have the witnesses any thoughts on whether it is something that would be gradually dropped off or could be stopped at a particular point in time? How do we get to a non-PUP world again?

Dr. Karina Doorley: It is a good idea to avoid a cliff edge. Withdrawing it on one day is probably to be avoided. The PUP obviously played a huge role in reducing income losses last year, but the difficulty is balancing safety nets with incentives to work. For many people the PUP is more generous than the corresponding jobseeker's payment. There is an inequity between people who lost their jobs before Covid and those who lost their jobs after it. The first point to make is that addressing that inequity is, at some point, desirable. Whether that is reducing the PUP to the rate of jobseeker's or increasing jobseeker's supports, it is a decision for policymakers, but addressing the inequity is important for a start.

One option available is the gradual tapering of the PUP over time, which could help groups at risk of long-term unemployment after the pandemic to maintain a certain standard of living while searching for work. Alternatively, recipients could be allowed keep some of their payment for a period while taking up paid employment. That is currently the case with the self-employed. This improves incentives to work. It could encourage those who are currently in non-viable industries to seek employment in other sectors where they may need some additional training. Increasing incentives to work as the economy reopens will be important and modifying the PUP, in some way, will be central to that.

Deputy Aindrias Moynihan: Dr. Doorley has half-answered my next question. I want to ask about people going into other sectors and training up. Does Dr. Doorley see the PUP, or a variation of it, running in parallel while somebody is training or reskilling to move from one sector to another?

Dr. Karina Doorley: It is certainly a policy tool that could be used in that respect. If extended receipt of the PUP is cut off for some individuals but not others, some activation measure could be linked to it that would either help them to retrain for, or get job experience in, another industry. That would certainly help with recovery. It will be important, in order to minimise the scarring effects after people have been out of work for so long, to get them back to work, if they want to and are able to. In order to do that, we need to improve incentives to work which may, given health concerns, need to be higher post-pandemic than they were before. The incentive to work needs to improve and the job opportunities need to be there. Whether they are different job opportunities from what was there before will dictate whether the PUP should be tied to some sort of activation measure or not.

Deputy Mairéad Farrell: I thank the witnesses for coming along today and answering our questions. My first question relates to comments made by the Minister for Finance at a recent ESRI event. He said that to keep the interest bill on the national debt down, Ireland's deficit will need to be reduced. That assumes that our borrowing rate is a function of our country's debt and deficit. In 2010, we ran a deficit of approximately €18 billion and, last year, we ran a deficit of €19 billion. In September 2010, prior to entering the bailout and before Mr. Mario Draghi made his "whatever it takes" speech, we issued a bond at 6.3% whereas, in recent times, we have issued bonds at negative rates. Many observers say that rather than being a function of our debt and deficit, our borrowing rate is largely a function of what the ECB is willing to backstop in the secondary market. Does the ESRI share the view that interest rates are a function of debt and deficits or does it see the actions of the ECB as a more determining factor?

Dr. Kieran McQuinn: It is clear that the role of the ECB is hugely influential in terms of its policies. Indeed, the Deputy referred to Mario Draghi. There is no doubt that his decision-making and policy initiatives have had a massive impact on Ireland's recovery. For example, it basically reduced substantially the interest payments that we were paying on the debt and made the debt, as a result, more affordable. It is interesting that the Deputy mentioned this because the whole concept of interest, the servicing of the debt and the interest repayments of the debt as a percentage of GDP, is one measure that has been advocated, particularly in the US literature by very notable economists such as Larry Summers and Jason Furman, who say that this should be a fiscal metric that is used more to determine sustainability rather than some of the metrics that are used, for example, in the fiscal framework that revolves around issues such as debt to GDP and coming along with a 3% deficit limit. There is no doubt that the ECB has a huge role to play. The ECB has kept interest rates very low on the market because of its policies over the recent period. That is very welcome and essential at the present time. Indeed, it is hoped that will continue over the foreseeable future.

Equally, there is no doubt that as a member state we cannot go on running sizeable deficits of between 5% and 7%. Over time that is not sustainable. Particularly for a small open economy like ourselves, it is prudent policy to try to accumulate some fiscal buffers for the rainy day. One could argue that our decision to run relatively prudent budgetary policy over the past five or six years - and we accumulated surpluses in 2018 and 2019 - led us to be in a position where we could cope with the fiscal challenges that we now cope with. It is a case of, on the one hand, ensuring that we return to a degree of fiscal normality and fiscal discipline after the crisis has passed. Equally, in terms of any debate on the fiscal framework, we would certainly call for it to be reformed to allow for greater investment in member state countries. This view goes back to the point that we made in our opening statement, which is recognised by policymakers across Europe, that it is not just about the policies of the ECB and keeping interest rates low, it is about unconventional, as they are called, fiscal policies as well being required to stimulate growth and economic activity right across the euro area.

Deputy Mairéad Farrell: As a committee, we have discussed the surpluses in 2018 and 2019. However, we do not talk about the deficit in terms of the infrastructure and the health infrastructure, which has naturally impacted and meant that we have been in long lockdowns because our infrastructure simply cannot cope.

My second question is on the shared equity scheme. I have heard the views that Dr. McQuinn expressed about the scheme but I would like a bit more detail. Recently, I wrote to the Minister for Housing, Local Government and Heritage, Deputy Darragh O'Brien, to ask him what risk analysis had been done on the shared equity scheme and to outline the nature of the risk model that he was employing and the assumptions made therein. I did not get an answer to any of my questions but the Minister, somewhat unreassuringly, said that work on the detailed design of the proposed scheme is ongoing and that the scheme would increase growth in the housing supply by improving confidence. That has not necessarily been the case over the past while. Perhaps he means there will be business confidence among those who may benefit from the scheme. Can Dr. McQuinn tell me how the scheme will inflate prices?

Dr. Kieran McQuinn: The shared equity scheme is one of a number of policy initiatives that the Minister has brought forward recently. Our view is that some of those measures certainly are constructive or positive. There is no doubt that they will have a positive impact on supply in the market. Our comments about the shared equity scheme reflect opinions held about schemes such as that by a number of different commentators that the danger with those schemes, particularly in a market such as the Irish one where our supply is relatively low, as it is, and relatively, as we would say in economic terms, inelastic so it is slow to respond to economic stimuli, is a significant boost to affordability would feed through to higher prices in terms of house price inflation. That is the general point that most people would feel about a scheme like that. The Minister said that they are looking at the details, and we will very interested to see the details when they are published, but that is the general point that people have made about the schemes such as that. Indeed, as the Deputy will know, that is a concern not just ourselves but many others have articulated.

Deputy Mairéad Farrell: Recently we have seen something quite contradictory with this State being both the EU country with the longest period of lockdown yet have the best growth figures as measured by GDP. IFAC has made the case for some time that we should not use GDP and should use GNI* instead. Economists and international experts tell us that GDP in an Irish context is so subject to distortions that it can be quite difficult to use it in any kind of a meaningful sense yet, at the same time, it is frequently used by Government politicians, presumably because it paints a rosier picture than the reality for most people, which they can then take credit for. I do not expect Dr. McQuinn to comment on that. Does the ESRI agree with the proposition that when examining Ireland's fiscal and monetary positions in an international comparison that the use of metrics like debt as a percentage of GDP, which Dr. McQuinn has said, is really flying blind from a policy perspective? What are his views on using GNI* rather than GDP?

Recently, Professor Patrick Honohan had a piece about the actual individual consumption, AIC, but for some reason it is not coming to me. I am interested in hearing Dr. McQuinn's views on that. I ask as it would be great to see international comparisons because GDP is simply not a good metric.

Dr. Kieran McQuinn: I totally agree. Indeed, we have produced quite a few bits of research on the issue. In fact, a former colleague, Professor John FitzGerald, whom she may remember has written a number of pieces for us. In our forthcoming commentary, he will update an indicator that he advocated last year - a net national product. We will have updated estimates of that in our commentary that will be published, I think, on 25 March.

We have long noted the difficulties with GDP. Going back to last year's performance of the economy, it is clear that not all of it was a GDP issue in the sense that it reflected the very strong performance by a relatively small number of multinational firms in the export sector. That is why output, as a whole, across the economy actually increased.

Let us consider the subaggregates. The effect on consumption in the economy was pretty similar to that across most European countries. There was a decline in consumption of about 9% last year. That was in the middle of the range experienced in most European economies. In that, we were quite similar to other countries. Ultimately, it was the multinational sector, and a relatively small section of it, that was responsible for Ireland registering a positive growth rate for the economy as a whole.

I could not agree more on the Deputy's point about GDP. When we publish our debt forecast, we always publish both debt to GDP and debt to GNI*. Debt to GNI* also has its issues; it is not a perfect measure. In fact, Professor Honohan discussed that in the recent note to which the Deputy referred. It is about looking at a variety of measures. The key metric or variable that the ESRI focuses on when we examine the strength and performance of the economy is the labour market because that gives the best indication of how well the economy is performing.

Chairman: We have time for a second round so I ask members to indicate if they wish to speak by raising the hand function on their screens. I will try to keep them to four minutes for each question. Deputy Boyd Barrett is quick off the mark.

Deputy Richard Boyd Barrett: Yes, the quickest hand function in the west. Dr. Doorley spoke earlier on education. We were talking about retraining and reskilling, etc. We might also throw in the clearly apparent skill shortages in a number of areas. It has become very evident that we need to train more people in various areas. Arguably, a lot more teachers are needed to reduce class sizes. There are many healthcare professions that need more people. More workers are needed in all aspects of construction. Then there are the industries that may be in trouble and where many people need to retrain and reskill. I take it from what Dr. Doorley has said that this is a time when we need to remove barriers to higher and further education and training and apprenticeships, fees being the most obvious. I think it is such a time, and People Before Profit has a motion on this matter before the Dáil this week. The very high fees are even higher if a person has previously been in third level. In graduate entry medicine, for example, the fees are €15,000 a year. These shockingly high fees are now the highest fees in the European Union since the exit of the UK. There are many other barriers associated with the cost of pursuing higher and further education, apprenticeships and postgraduate study. What is the ESRI's view? Is it time for a radical look at removing barriers to maximise people's potential to retrain and educate themselves to the standards that we need and they need to participate in the employment market post Covid?

Dr. Kieran McQuinn: Generally, I agree that key deficits arise particularly after a huge shock such as this. The construction sector, which the Deputy mentioned, is a classic example. When I was presenting at various construction-related conferences and forums, particularly from 2012 to 2015 onwards, and talking to people in the business, it was clear that there had been a near wipeout of people going into the basic trades that are necessary for construction-related activity. This is the kind of issue we were touching on when we were discussing the overall effects of Covid on the property market, for example. When there is a very sharp, profound shock such as the one we experienced, it tends to have much more of an impact on the supply side of the market because people are reluctant to go into construction, learn the various skills and take up the basic training programmes that are required to meet the day-to-day requirements of the sector because confidence is essentially wiped out. The Deputy is correct when he suggests that we need some kind of audit and an appreciation of where the different sectors are at. That will ultimately have an impact on the potential recovery of the economy overall. We need to see the ways that policymakers can intervene to reduce the restrictions that are there, including those which may always have been there and those which may have come about because of the pandemic. I return to my earlier point on the need to look at debt levels among SMEs to see if something can be done to try to get those businesses back up and running. We need some kind of audit on policy measures that could be undertaken in relation to logjams or rigidities that are there anyway but which have been brought on more by the Covid issue.

Dr. Karina Doorley: Members of our labour market and skills team might be better placed to answer questions like this. Broadly speaking, it seems like education will form a very important part of the recovery from Covid because jobs are changing and have changed already. Some industries may be less viable than they once were. I am not sure that the proposition of just knocking out fees will make much of a difference without addressing shortages of teachers and so on. If everyone goes to further or higher education, we will not have enough places available for them. I suppose what the Deputy is talking about is a complete overhaul of the education system. That is worth having a discussion about but I cannot give a great answer. Other members of the institute would be better placed.

Deputy John Lahart: I really enjoyed this session. Returning to the shared equity scheme, I am critical of it and share the ESRI's concerns. We are teasing it out from every angle in my own parliamentary party. I understand the ESRI's concerns. I have seen what has happened internationally. The witnesses will have read the steps the Minister is seeking to take maybe to try to obviate its worst effects.

If there are 30,000 or 40,000 outstanding extant planning permissions available nationally, it has taken a number of years to get to them. They will wither in a number of years if they are not acted on. There might be 10,000 to 15,000 of these in Dublin. I am not trying to be smart when I ask a sincerely motivated question: what other measures could the Government consider to activate those permissions?

Dr. Kieran McQuinn: We have talked a lot about this because we do a lot of work on housing. The key issue for us is the cost of supplying a house in the economy. That is the underlying issue. A lot of work was done in the aftermath of the financial crisis to compare price levels across jurisdictions. It is always a very fraught exercise to make sure one is comparing apples with apples rather than apples with oranges. Some detailed work has been done by the European Commission in the last couple of years which has sought to adjust for the different peculiarities of individual markets across the euro area in comparing house prices. The kind of estimates it has produced are as robust as anyone is going to get in a cross-country setting. It shows clearly that even adjusting for size, Irish house prices are among the highest in Europe. That is fairly incontrovertible. If the fundamental premise is that it is not profitable for developers to supply a house in the Irish market now, we have to ask why that is the case. What is the underlying problem here? I do not think there is much more scope for measures which may bid-up house prices, which is sometimes couched as “providing confidence to the market”, if we look at it in the context of where Irish house prices are relative to other jurisdictions. Then it returns to supply and the cost of supplying a house and what the difficulty with that is. One of the big problems is data. We have seen people coming out with estimates of what it costs to build an apartment in Dublin. The following day there is a letter in *The Irish Times* explaining why it is wrong, inaccurate and incorrect, etc. We actually have a difficulty with establishing the cost. One of the issues we have often raised - it is an issue other people have raised as well - is the whole issue of land costs. Why are land costs so high in the Irish market? It comes back inevitably to the issue of speculation. There is an issue about people hoarding land banks and consequently keeping the price of land banks and land generally at an artificially high level when compared to other jurisdictions. Those are some of the areas I would pretty vigorously tap. I know the Government has brought in measures to address some of those points. I believe that is where we can get a bang for our buck in addressing the underlying issues.

We welcomed other aspects of the Bill. In general, the origination of the LDA is good in terms of its ability to co-ordinate a supply response across public lands as long as there is a significant commitment to social and affordable housing as part of it. Several measures there are positive. As I said, the fundamental issue is the cost of supplying a house and the measures we can bring in to aggressively tackle that.

Deputy John Lahart: That is really useful. I wish to press the officials further on the EU Commission report. Could they save the committee a little work and have one of the team forward the salient aspects of that to the committee?

Dr. Kieran McQuinn: Sure.

Deputy John Lahart: That would be useful.

My second question relates to capital investment. It is close to home for many people. It relates to further extensions and expansions of MetroLink. That would be a major issue for parts of Dublin. Then everyone would have their project. There is nothing wrong with these projects. I will not hold the ESRI to the specific MetroLink I have in mind, but is that the kind of capital investment or project? Are these the types of capital projects the ESRI is thinking about?

Dr. Kieran McQuinn: We need to draw up the key requirements of the economy. Housing is the one we have always advocated because it is the most pressing one and the one that affects most citizens. We have done detailed work on how much people are paying for housing and how it compares through time. That is the main area I see. There are other areas around other elements of social infrastructure, including schools, hospitals, etc.

The Deputy referred to large infrastructural projects. I was somewhat heartened by the Minister's announcement recently that, in looking at the national development plan, there will be a key emphasis on trying to bring about monitoring of costs. The one nagging doubt I always have as an economist in advocating capital investment is that there is a danger we could see billions of euro in public funding going into projects without getting the required return. We have seen costs escalating and go out of control on several projects. I believe it is important that, whatever we do, we have strict monitoring of the costs and the returns for the investment. Ultimately, we are talking about substantial amounts. It is ultimately taxpayers' money so we have to be focused on that. In anything that is undertaken there has to be a rigorous cost-benefit analysis underpinning it and a rigorous monitoring of the costs to ensure that they do not escalate. Certainly, housing would be the main one in terms of priorities. It is important that we begin to invest in green technologies that could help us meet the kind of environmental targets abroad. Those are the key pressing issues I see.

Deputy Seán Canney: I will make comments having listened to the debate. One relates to capital expenditure and the fact that the north and western regions have been designated as areas in decline by the European Commission. There is an opportunity because of this new designation. We have to positively discriminate in terms of investment. Does the ESRI support that for a region?

The ESRI officials talked about housing. One of the biggest issues I have come across is that we talk about the LDA and the big-ticket items, yet what I am looking at in my constituency and throughout the west is small towns and villages - settlement centres - where a person cannot build a house or get planning permission to build a house because they do not have a wastewater treatment plant. The person will not be allowed to build a single septic tank for each unit. That has been ruled out by An Bord Pleanála and the local authorities.

Now we have a situation where the growth centres around Galway city, including Craughwell, Corofin, Abbeyknockmoy or wherever they may be, are areas where we cannot build a house. We have areas where the wastewater infrastructure is absent but the way it will be delivered it is not even on anyone's agenda.

We talk about delivering houses, affordable houses, regional development and remote working and how all of this will help the regions. How do we marry all that up? Do the officials have any thoughts or comments on that? I believe it is a major area we have to look at. For instance, there is considerable debate about whether the western rail corridor should reopen north from Athenry to Claremorris to create a link between Ballina, Westport, Galway and Limerick. It is small money in the overall context, perhaps costing €150 million. It seems it is being pushed back. I believe it would create leverage in a green environment to create public transport and to regenerate the area. This is not only relevant for cities such as Limerick and Galway. We need to regenerate the towns like Tuam and the growth centres around there so that they can grow as well. A person can buy a house in Tuam for €100,000 less than in Galway city. That is what I call affordability. People can live there but they need to have that connection, a guarantee of a job and they need to be able to live there.

Dr. Kieran McQuinn: In general, we very much agree with the need for more balanced growth across the economy. It is clear that if we stand back and look at the overall economy we see the concentration of economic activity on the eastern seaboard. It is essential that we have more balanced growth, including along the western corridor, as a way of rivalling the eastern seaboard. Again, it is about ensuring that whatever investment we make in infrastructure can unleash an area or the growth potential of an area. Ultimately, the investments made must generate a certain rate of return for the taxpayer.

I fully agree with the Deputy on the property issue. It is interesting. Some years ago, we had people into the institute, as we frequently do, to discuss the property sector. If I have it correct, people from the Construction Industry Federation made a prediction based on changes in financing that have come about as a result of the financial sector and the kind of equity that property developers need to raise. Ultimately, the federation saw the major shortage being in rural areas, for example, with smaller developments. These were the kinds of projects property developers were going to have difficulty in raising finance for because they simply would not have the scale to meet the equity requirements that financial institutions were requiring. That was because of the financial crisis. There is definitely an issue there in terms of scale and development and it is a difficult one to address.

Let us go back to the whole principle around the LDA. I am not here to advocate for it one way or the other but it seems that because it is a national organisation or nationally widespread in terms of its scope, it can negotiate with developers in a way that would lead to the likelihood of more regional construction being brought about, if that were required so rather than each local authority having to deal with property developers for construction, if we were able to do this on a national basis it may lead to greater economies of scale and efficiencies. In turn, that would then see construction in rural areas that would otherwise not materialise. That may be one possibility. Certainly, in terms of the broader issue and the need for more balanced growth, the national development plan is addressing those issues and I would certainly very much agree with that.

Deputy Seán Canney: I will finish on Irish Water, which is a national utility. Going back five years, before the utility was put into place or established, the places I have mentioned were on a list of wastewater treatment plants to be built by the local authorities. Once Irish Water came into being, however, what happened was that the focus of the company changed to carrying out projects in areas where those responsible see potential large growth. They are looking at the east coast and the cities. They are looking at firefighting and pollution into the sea in different places. That takes up all the money they have and they do not even have enough money to do those things. Houses have been built that do not have proper sewerage. There are two estates in Athenry where the wastewater is not working and they cannot connect to the treatment plant because the network has not yet been built out and will not be there for another four years. There is something amiss in what we are doing.

If we continue with our current policies regarding Irish Water and the Land Development Agency, we will create more problems for Dublin, rural areas and the regions because we will actually intensify the lack of balance that is there. I think Deputy Boyd Barrett said last week that it would cost someone €600,000 to buy a house in Dublin where I could give someone a beautiful house in the regions for €275,000. It is as much a problem for the people living in

Dublin as it is for the people living in the west, south or north. I have a fear of the Land Development Agency becoming this big body dealing with big stuff and forgetting about the real stuff that would matter to the regions.

Deputy Richard Boyd Barrett: Could I ask a supplementary question?

Chairman: I might come in with a quick question myself in four minutes. We will have time for the Deputy. I want to go back to the issue of recovery. In the next 12 to 14 months, this committee in particular will try to get to grips with a very febrile situation when it comes to macroeconomic forecasting. What do the witnesses think the outlook is for SMEs, particularly domestic SMEs, in terms of performance and accessing credit in the medium term? I am thinking not just in terms of a recovery or resilience fund but also in the context of Ulster Bank withdrawing from the market and the performance of bodies specifically geared towards accessing credit such as the Strategic Banking Corporation of Ireland. What are the witnesses' thoughts on the structural landscape for SMEs at the moment?

Dr. Kieran McQuinn: That is a very good question. Our colleagues have a research programme that explicitly looks at the general issue of access to finance among SMEs. This was a research programme that was there prior to the pandemic but it is obviously a key question it is addressing given the pandemic and the strains it will place. Clearly, the Irish banking sector needs more competition, not less. That is clear and evident from even our discussion about the interest rate a while back. If we look at the kind of credit conditions in the Irish market, especially focusing on the interest rate, it is clear that interest rates are higher on average in the Irish market, whether it relates to SMEs or mortgage holders, than they are for comparable households and firms across the euro area. This makes it more difficult for those firms to operate in the Irish market than if they were operating in other jurisdictions. That is going to be a key issue.

In terms of policy interventions, we discussed the need to look at targeted measures addressing the debt situation of many SMEs that come out of the current situation. It is a difficult issue because we must try to establish what firms we think are valid and viable and have a successful path in the economy going forward and those we simply feel are not likely to succeed and are not worth providing huge financial assistance to. It is a difficult question and issue. There are bound to be a lot of firms among SMEs that are struggling and will struggle when we get into the post-Covid situation. They will be carrying high levels of debt because of Covid. These are firms that would have been perfectly viable and valid otherwise. This is where policy measures need to be targeted to assist those firms to progress into the future.

Looking at it from the aggregate, the macro perspective, we would be fairly confident that most sectors of the economy that have been closed will recover quite strongly over the short to medium term. Our growth forecasts would reflect that not only in terms of our expectations of things like consumption and investment but also in terms of our future path of unemployment. I will not say we are optimistic but we are quite positive about how we see the economy opening up in the next six, nine or 12 months and we believe it will grow quite strongly in that period. Where the policy intervention needs to come is targeting those SMEs that are carrying high levels of debt mainly as a function of the pandemic but, ultimately, are very viable enterprises in terms of their prospects going forward.

Deputy Richard Boyd Barrett: I have a question about the Land Development Agency. I do not know if R. McQuinn looked very closely at the legislation. He may have, but I will not assume it. Many people hoped the Land Development Agency would be something that would intervene to reduce the costs of building houses, particularly intervening in a market where prices have gone out of control, as Dr. McQuinn said, and are some of the highest in Europe. Does it concern him that the legislation specifically prescribes that the housing that will be built will be benchmarked against local market conditions? As Deputy Canney said, local market conditions in Tuam may be prices that are manageable, but benchmarking the housing we desperately need to build against local market conditions in the areas where the housing crisis is most acute is a recipe for disaster because we are starting at prices that are astronomical and off the wall. There is very little mention of social housing in the legislation. The only reference to it is to the 10% figure, so it seems the Land Development Agency is only envisaging a very small proportion of social housing on public land and benchmarking against a distorted private market. Does that worry Dr. McQuinn?

Dr. Kieran McQuinn: I have not looked at it in detail. I have seen and followed some of the commentary around it. That was one of the points I made to Deputy Canney. It did strike me that the Land Development Agency would be in a strong position to negotiate at a much larger level in terms of dealing with prospective developers rather than individual local authorities in that there were efficiencies that could be gained in this respect and that may enable development in areas where there may not otherwise have been. The Deputy is right. The whole definition of social housing and what constitutes a social house or what is affordable constitute a key part of the equation.

In respect of any definitions that are used, especially the granularity work that is used, we have done a considerable amount of work in that regard, as the Deputy is aware since we probably discussed it with him in previous sessions. This is fairly detailed work looking at what Irish households pay on average. The results are very stark in terms of the significant cohorts of our households that are paying relatively large shares of their income on housing. This is a feature not just of the past two, three or four years. It has been a feature of the Irish property market going back as far as we have looked at it. It would be ideal if any definition of social housing and how social housing is couched would be with reference to that kind of analysis in terms of what people are paying, what they can afford to pay and possibly what people pay in other jurisdictions. We benchmarked Irish affordability against other jurisdictions using norms that are used in terms of whether it is 30% or the 30-40 rule used in other countries. It would be useful for the definition of social or affordable housing to be couched in that type of work and that kind of granularity of analysis.

Chairman: We are now at the end of our session. It was a very interesting conversation. I thank Dr. McQuinn and Dr. Doorley for their attendance today, the immense amount of information they imparted and their assistance to the committee. It is to be hoped we will talk again soon.

The committee adjourned at 5.29 p.m. until Thursday, 11 March 2021.