DÁIL ÉIREANN

AN COMHCHOISTE UM AIRGEADAS, CAITEACHAS POIBLÍ AND ATHCHÓIRIÚ

JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM

Déardaoin, 27 Meán Fómhair 2012

Thursday, 27 September 2012

The Joint Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Ciara Conway,*	Senator Thomas Byrne,
Deputy Jim Daly,	Senator Mary M. White.+
Deputy Pearse Doherty,	
Deputy Sean Fleming,	
Deputy Joe Higgins,	
Deputy Kevin Humphreys,	
Deputy Heather Humphreys,	
Deputy Peter Mathews,	
Deputy Mary Lou McDonald,	
Deputy Michael McGrath,	
Deputy Dara Murphy,	
Deputy Kieran O'Donnell,	
Deputy Arthur Spring,	

* In the absence of Deputy Alex White.

+ In the absence of Deputy Thomas Byrne, for part of meeting.

DEPUTY LIAM TWOMEY IN THE CHAIR.

The joint committee met in private session until 2.20 p.m.

Fiscal Assessment Report September 2012: Discussion with Irish Fiscal Advisory Council

Vice Chairman: We will begin our review of the fiscal assessment report, September 2012. From the Irish Fiscal Advisory Council, I welcome Professor John McHale, chairman, Professor Alan Barrett, council member, Mr. Sebastian Barnes, council member, Dr. Donal Donovan, council member, and Mr. Diarmaid Smyth, chief economist. I understand that Dr. Róisín O'Sullivan is unable to attend today's meeting and sends her apologies. Ms Eimear Leahy, economist and Ms Rachel Joyce are also in attendance. Professor McHale will make some opening remarks, which will be followed by a questions and answers session. I remind members, witnesses and those in the Visitors' Gallery that all mobile telephones must be switched off.

I wish to advise the witnesses that by virtue of section 17(2)(*l*) of the Defamation Act 2009, they are protected by absolute privilege in respect of their evidence to this committee. If witnesses are directed by this committee to cease giving evidence in relation to a particular matter and they continue to do so, they are entitled, thereafter, only to a qualified privilege in respect of their evidence. Witnesses are directed that only evidence connected with the subject matter of these proceedings is to be given and they are asked to respect the parliamentary practice to the effect that where possible, they should not criticise or make charges against any person, persons or entity by name, or in such a way as to make him or her identifiable. Finally, members are reminded of the long-standing ruling of the Chair to the effect that they should not comment on, criticise or make charges against a person outside the Houses or an official by name or in such a way as to make him or her identifiable.

Professor John McHale: Good afternoon Chairman and members of the committee. On behalf of the council, I thank the committee for providing us with the opportunity to appear here to publicly explain our assessments. The council has found earlier feedback from the committee extremely useful in developing the content of our reports. The other council members in attendance today are Mr. Sebastian Barnes, Professor Alan Barrett and Dr. Donal Donovan. Unfortunately, Dr. Róisín O'Sullivan, who is based in the United States of America, cannot attend today. The council's secretariat is also present, namely, Ms Rachel Joyce, Ms Eimear Leahy and Mr. Diarmaid Smyth.

Today we will deal with our third fiscal assessment report, which was published on 13 September. The report is written in line with the mandate of the council, set out in the fiscal responsibility Bill. The main purpose of this report is to assess the macro-economic and budgetary projections set out by the Government in the stability programme update, SPU, published in April 2012, including the appropriateness of the overall fiscal stance for the period to 2015, in advance of budget 2013. The report also sets out some background for our planned future assessments of compliance with fiscal rules. A number of themes are developed in this report. These include the uncertainty that surrounds economic and budgetary forecasts, the large size of remaining adjustments required for debt sustainability and the importance of transparency in the recording of revisions in the Government's fiscal accounts and plans.

In assessing the Government's macro-economic forecasts, a multi-step approach is followed. First, we assess the performance of past forecasts, using the most recently available national accounts data. Second, we compare the Government's forecast with contemporaneous forecasts from other agencies. Third, we examine the pattern of revisions to the forecasts and, fourth, we explore the uncertainties surrounding the forecasts using past forecast errors to develop confidence intervals around the forecasts of different horizons.

The national income and expenditure accounts for 2011, released in July, estimate that annual real GDP growth in 2011 was 1.4%. This was higher than official forecasts, while real GNP growth in 2011 was almost three percentage points lower than forecast by the Department of Finance in 2011. An analysis of the forecast errors over the period 1995 to 2011 indicates that the pattern of past forecast errors is similar across the main forecasting agencies and does not show evidence of bias. Current Department of Finance forecasts for 2012 to 2015 are also similar to the forecast of other agencies. In general, forecasters remain of the view that growth rates of about 3% will return over a two to three year horizon, although earlier forecasts of such a rebound have not materialised.

The uncertainties surrounding the growth outlook for the Irish economy, highlighted in the council's previous report, remain and are illustrated in this report through the use of fan charts. A fan chart shows the uncertainty that surrounds the forecasts at different horizons. The council sees the risks to growth as being weighted to the downside. More generally, we recommend that this uncertainty should be more explicitly factored into the presentation of official forecasts through a more detailed sensitivity analysis.

In assessing the budgetary projections, the council again follows a multi-step approach. First, we review the accuracy of past Department of Finance forecasts, including a detailed examination of data and forecast revisions. Second, we examine the SPU projections, using the most recent Exchequer data. Third, we compare the SPU forecasts with contemporaneous forecasts of other agencies and, fourth, we explore the uncertainty surrounding the projections using a combination of fiscal fan charts and sensitivity analysis.

The general Government deficit, adjusted for the impact of banking related transfers, is estimated to have improved to 9% of GDP last year. This is approximately €1.2 billion better than had been anticipated in last December's budget. For 2012, the forecast for the general Government deficit was revised to 8.3% of GDP in the SPU, from 8.6% in the budget. This reflected, in part, revisions to interest payments and the impact of banking related revenues. The council is of the view that a general Government deficit of 8.3% of GDP for 2012 looks achievable at this stage, based on the cumulative trends in the Exchequer data and the economic outlook. That said, there have been significant spending overruns in health and social protection over the first eight months of the year. There has also been a notable increase in non-tax revenues, partly related to the State's involvement in the banking sector. These sources of income should be closely monitored.

There were a number of significant changes to the official budgetary data and forecasts over the past year. To facilitate adequate assessment of budgetary projections, the council urges that comprehensive and timely explanations be provided on methodological changes in data revisions that impact on the fiscal outturn or official forecasts, on sources of major modifications to the forecasts and on the components of non-tax revenues.

For the period 2013 to 2015, the SPU budgetary projections are in line with projections from other agencies. This outlook is heavily dependent on achieving significant reductions in

Government expenditures and a sustained upturn in growth. Given the extent of the required total adjustment, the council again urges that all adjustment margins be kept under close review, including tax rates, public sector pay and pensions and welfare rates. In light of the uncertainty surrounding the growth outlook and a suggestion from this committee previously, the report also considered the sensitivity of the budgetary projections to changes in the macro-economic outlook, including the use of fan charts. This analysis serves, once again, to highlight the fragility of debt sustainability.

The council's view on the appropriate fiscal stance was again widely reported, following the publication of the report. As in earlier reports, the appropriateness of the fiscal stance is analysed in terms of a trade-off between supporting domestic demand and ensuring debt sustainability. The council assesses the Government's current fiscal stance to be conducive to prudent economic and budgetary management. However, debt sustainability and creditworthiness remain fragile. Weighing up the risks relating to debt sustainability and ongoing weakness in the real economy, the council supports an alternative fiscal stance involving a total of €1.9 billion of additional adjustments in the period to 2015 compared to the Government's baseline. This alternative stance does not involve additional adjustments beyond the €3.5 billion planned for 2013. Due to a continued weakness in demand and some further improvement in market assessments of Ireland's creditworthiness, the amount of additional adjustment for the period to 2015 has been scaled back by €900 million since our previous report. Model-based projections indicate that this alternative scenario would help with the debt-to-GDP ratio and a faster downward trajectory and would provide additional insurance, albeit limited, in the effort to ensure debt sustainability. While we recognise possible rationales for a separate stimulus programme, balancing various considerations, the council is of the view that any relaxation sought by the Government in the overall fiscal stance should be examined within the context of the main fiscal adjustment programme. The council does not see a case for a relaxation of the fiscal stance at present.

Debt sustainability remains fragile and judgments on this issue are coloured by whether it is believed GDP or GNP provides the most appropriate measure of Ireland's fiscal capacity. Both GDP and GNP have limitations as measures of fiscal capacity. In the report the council introduces a hybrid measure, which places a differential weight on GNP and the excess of GDP over GNP, as an intermediate measure of fiscal capacity. The required fiscal adjustment appears challenging under all three measures, but above all under the GNP measure. While relief on the banking-related part of Ireland's debt is unlikely to be a panacea, any relief will increase the chances of a successful outcome. This will be measured by a robust return to market creditworthiness.

In terms of fiscal rules, Ireland has an obligation to comply with the EU Stability and Growth Pact, revised in 2011, and the fiscal compact, which is being implemented in national law through the fiscal responsibility Bill. While the details are complicated, in essence the rules relate to the structural budget balance. This is consistent with the EU's medium-term objective or budgetary rule and a debt reduction requirement, known as the debt rule. To explore the implications of the fiscal rules, the report also presents an illustrative scenario that extends to 2020. The assumptions mirror those in the stability programme update, SPU, for the period to 2015. For the period 2016 to 2020, the scenario assumes average nominal growth of approximately 3.4% per year and a gradual closing of the output gap by 2018. It also assumes expenditure growth will be approximately flat in real terms. The scenarios assessed are consistent with meeting the budgetary rule throughout the period and meeting the debt rule after 2018, when it will become binding.

I thank the committee for the opportunity to appear before it today. The Irish Fiscal Advisory Council has been up and running for more than one year now, during which time it has produced four reports. Although the council will not be on a statutory basis until later in the year, we hope it has already had a positive impact on the public understanding of budgetary management. Anyway, the council's main value will be for the long term. At all times the council will strive to be independent and objective and to provide a voice in the best interests of sound fiscal policy. We look forward to taking the committee's questions and hearing the views of members.

Vice Chairman: In order to have a good question and answer session this afternoon I appeal to people to keep their contributions short and to the point, if possible. Deputy McGrath, you indicated that you wished to ask some questions.

Deputy Michael McGrath: I welcome Professor McHale and all his colleagues from the advisory council and I thank them for their work. It is an important contribution to the debate on the public finances, which will feed into the preparation of the budget in December. From reading the report and listening to the opening remarks of Professor McHale, the centrality of growth becomes clear. It seems that during recent years the halo of 3% growth is always next year or the year after but it has never come. Despite this we are basing all our fiscal projections on 3% real GDP growth in 2014. The Government is forecasting 2.2% real GDP growth for next year, although I suspect this will probably be revised downwards in the medium-term fiscal statement next month. Where does the council believe that growth will come from? It seems it would require a spectacular performance by exports over a sustained period to have real GDP growth of 3% on average in the coming years given that all the other elements of output are likely to remain depressed. Consumer demand in Ireland is likely to continue to contract because of the effect of the forthcoming budgets, Government spending will reduce and the environment for private sector investment does not appear to be especially positive at the moment. The concern I expressed last year in the budget debate was that we continue to be too optimistic in some of the forecasts. These form the basis of the plan to bring Ireland to within the 3% deficit target. I am keen to hear the council's views in this regard.

The council has addressed the issue of debt sustainability in its report. It indicated there is a 40% chance that the debt-to-GDP ratio will fail to come under control by 2015. Is it possible that this risk is higher? Ultimately, does it not come down to economic growth? At the moment there is no evidence that growth is materialising. Since the council signed off on the report before us, the latest CSO quarterly accounts have been published. They show GDP to be absolutely flat in quarter 2 at 0.0%. There was an unexpected rise in GDP but that has been explained by an anomaly relating to profit inflows. The forecast this year, a modest 0.7% growth, may not be achieved and the projected 2.2% growth for next year appears to be optimistic at the moment. I am keen to hear the council's views in this regard.

The council also addressed the need for the Government to keep adjustments under review, including in tax rates, public sector pay, pensions and welfare rates. The council will be aware that this runs contrary to commitments made in the programme for Government and repeated several times by the Taoiseach and the Minister for Finance. Recently, the Government recommitted itself to maintaining the Croke Park agreement through to 2014. How difficult will it be to achieve an adjustment of €3.5 billion in the coming budget without touching any of the three pillars that the Government indicated it would not revisit?

I am keen to hear the council's views on the statement by the three finance Ministers from Germany, the Netherlands and Finland some days ago. It would appear to unravel to some extent the spirit of the agreement reached by the Heads of State and Government last June. What impact will this development have? It seems the markets have factored into their thinking that Ireland will get some deal on the banking debt but it appears that if this does take place it will be some distance down the road when the single supervisory authority is up and running and has had its effectiveness proved. That is some distance away. The number of caveats and the conditionality set out in statement of two nights ago causes us some concern on the fiscal side and I am keen to hear the council's views in this regard.

The council recommended an extra €1.9 billion in fiscal consolidation. I realise the recommendation is not for next year but for 2014 and, substantially, 2015. The council has referred to trying to strike a balance between reducing the deficit and not killing the economy completely. This indicates that the council does not have full faith in the forecasts made or that it does not have confidence that, under the current strategy, projections and policy parameters, we will reach a 3% deficit by 2015. Is the council confident this will be achieved? Will the delegation explain how? It is a difficult sell for ordinary people, who are reeling from the effects of recent budgets. They know what is coming in future budgets as well. How would the council explain that the imposition of an additional €1.9 billion would be the right thing to do in the coming years?

Professor John McHale: These are important questions. Deputy McGrath suggested that growth is absolutely central to our pulling our way out of this crisis. One thing we stress in the report is the significant uncertainty that surrounds the growth prospects of the Irish economy, given that we are in a post-bubble economy whose dynamics are hard to predict. We also have a volatile international environment. Once a bubble bursts, there can be all sorts of adverse feedback effects which feed on each other and harm growth for a number of years. Problems in the banking sector spill over to the fiscal sector and problems in the fiscal sector spill back to the banking sector as the credibility of guarantees declines and holdings of Government assets are marked down on the balance sheets of the banks. As the fiscal sector adjusts this hurts demand in the real economy while decline in the real economy feeds back to worsen the fiscal situation. As the banking sector is impaired this harms credit growth, which harms the real economy, and as the real economy deteriorates this, in turn, harms the banks. All these adverse feedback loops can pull down growth and lead to a very uncertain growth environment.

I would stress the uncertainty aspect. It is not all bleak. If one can start to turn these dynamics around things can turn around fairly quickly. This is not easy to do and is certainly not guaranteed. There is, however, an upside. The Deputy mentioned the assumption that the economy will return to an underlying trend growth rate close to 3%. This is what modellers have been assuming will happen when these adverse feedbacks begin to turn around and domestic demand begins to turn around.

In the report, we draw on the literature on financial and economic crises that have followed the bursting of property bubbles in other countries, such as Japan. Economies can go through a long period during which things are pretty flat. In the report, we highlight the pattern of downward revisions to the forecasts as one comes closer to the date. We include a graph showing that some earlier forecasts assumed that by 2012 we would be back to 3% growth. Of course, that did not happen and the forecasts are continually revised downward. This suggests that there is a downside risk. Beyond the issue of uncertainty, we think the risks are to the down side and that we could be in for quite a flat period. That, of course, has important fiscal implications that should be planned for. It will make it hard to reach the target for a general Government deficit of less than 3% by 2015.

One of the things that contributes to low growth is fiscal adjustment. We are well aware of the adverse effect fiscal adjustment has on the economy. It is, however, important to note that the economy is facing other headwinds besides fiscal adjustment. Let me deal with the Deputy's fourth question, because it relates to this, and I will come back to the others. We think of an appropriate fiscal stance as a balancing act between trying to support the economy as much as possible in the here and now, while people's lives are being hugely affected by the state of the economy, and trying to ensure debt sustainability. Debt sustainability can sound like an abstract thing that cannot be compared to the pain people are experiencing now with unemployment and so on. Part of the concern about debt sustainability, however, is that if we were to lose control of the debt, with the debt-to-GDP ratio on an upward path and looking as though there were no chance of getting it under control, we could certainly lose access to market funding and maybe to official funding as well. Certainly, official funding would come with much stricter conditionality and tougher fiscal adjustment, and possibly a fourth restructuring of the debt. It is that risk that requires that we take action and plan for actions to prevent such unsustainability. It is also a concern about the real economy because it is a forestalling of a very serious risk in the future. That is the balancing act we are dealing with.

One could ask why we are engaging in the fiscal adjustment at all. I think everyone realises it is because we have to get our fiscal situation under control. The job is not fully done and, particularly with the uncertainties about growth the Deputy mentioned, there is a significant probability it will not be done if we get a bad draw on that growth. In the report, we estimate there is a 40% probability that the debt-to-GDP ratio will not have stabilised by 2015, given these uncertainties about growth. It is to make sure the job gets done, or to improve the chances that the job gets done, that we are recommending those additional adjustments.

In terms of keeping the various margins of adjustment under review, we note in the report that the planned adjustment to 2015, particularly on the expenditure side, is daunting, with two thirds of the €8.6 billion being on the expenditure side. We estimate that the average reduction in real expenditure is about 3.5% per year. This is a very significant, almost unprecedented, reduction, coming on top of big reductions so far. The more one narrows the margins of adjustment the harder it will be. Where the adjustment does take place - in health services, for example - the damage caused to people can be very great. We think it better to keep all margins on the table. We are concerned that a political equilibrium may be reached under which different sides are able to take different things off the table. This would make for a more damaging and, potentially, less feasible adjustment. If the adjustment is that damaging it will be less credible and it will be harder to regain our market creditworthiness. For that reason, we think it is important to keep all margins under review.

Deputy Michael McGrath: How difficult will the forthcoming budget be, with those three pillars off the table?

Professor John McHale: The fewer margins there are to adjust, the more difficult it will be. The more margins there are to adjust, so that one can spread the adjustment out and be more targeted in minimising the damage, the less damaging the adjustments will be.

With regard to the statement from the three European finance Ministers, I can give a personal rather than a council view, because this is not something we have had an opportunity to discuss at length. I was never optimistic that the taking of direct stakes in Irish banks by the European Stability Mechanism, ESM, was going to yield large benefits. Part of that was the result of scepticism: if the ESM did take stakes in the Irish banks, which was a big "if", it was unlikely to pay that much more than the market value of the banks. It could pay somewhat more. The banks might be more valuable in the hands of the ESM, as a different owner, than in the hands of the State, although that could be argued, but the gain was likely to be relatively small.

To the extent that the EMS funds were used to pay down gross debt, they could reduce Ireland's gross debt. However, one of the things we emphasise on the council - which will be the focus of a forthcoming paper from the council and will be emphasised in our next report - is the importance of looking at the broader State balance sheet and not just at gross debt. When one sells assets one reduces one's assets. One may be able to reduce one's liabilities as well, but it is the net effect and how the financial standing of the State is changed that really matters. The statement from the three finance Ministers makes it less likely that much progress will be made there, at least in the near term. I do not think much was likely to come from the arrangement in any event so I am not sure the statement contains any new bad news to be worried about. The reaction in bond yields was minor; they ticked up a little as a result of the announcement. I have not had a chance to check them today. In fact, the action is likely to be elsewhere. My sense of the issue, which is not as exciting as the alternative, is that a restructuring of the promissory note and emergency lending assistance, ELA, type of arrangements, might do more to reduce the real burden of the debt. It is difficult to explain to the public why those benefits are accruing, but the outcome in terms of the current discounted value of the debt could be quite significant.

Deputy Michael McGrath: Is Professor McHale saying that the June summit statement was not as ground-breaking or important a game changer as it was presented or interpreted to be?

Professor John McHale: That was my view, as I stated at the time. However, in regard to the proposal for the European Stability Mechanism to take direct equity stakes and the part relating to the restructuring of the promissory notes, while not exciting, that could be quite significant in terms of reducing the debt burden. I would distinguish those elements. I assure the Deputy that council members are following these events very closely.

Vice Chairman: In order to ensure there is balance in terms of how much time can be allocated to each member, I would be obliged if the delegates would try to sharpen up their answers.

Professor John McHale: There must be austerity on this side of the room.

Vice Chairman: I am hoping for short, sharp answers because there are several members wishing to speak and I want to accommodate as much to and fro as possible.

Professor John McHale: Of course.

Chairman: I now call Deputy Pearse Doherty.

Deputy Pearse Doherty: I thank the delegates for their presentation and for the research and analysis that went into their latest report. It is very useful to have the information collated in this manner from the various sources. This is the council's third report since it was established, albeit not on a statutory footing. It is not often I have cause to welcome any decision by the Government, given its current direction, but I did welcome its decision to ignore the report's recommendation in regard to additional fiscal adjustments. While the council has in fact rowed back in this latest report on the scale of additional adjustments it recommends, it continues to argue for some €1.9 billion in further cuts.

The report bases its projections on a hybrid model which shows debt to GDP peaking at higher than the 123% in 2013 which was envisaged at the time of the bailout. It was also predicted at that time that we would see growth levels approaching 3% very soon, a rise in GNP and an unemployment peak of 14.7%. Those expectations have not been met. The CSO figures released today show that 86,000 people have left the State in the past year, which is mirroring the unemployment challenge we face. Is it the case that we are effectively on a train that is out of control and going too fast for us to jump off, or is there a point where we must accept that the bailout has not worked and seek a different approach? I realise that the council reiterates in its report its resistance to a stimulus programme and encourages the Government to persist in its current fiscal stance. Did it, however, engage in any modelling or dialogue in respect of an alternative strategy which would include a stimulus programme for the domestic economy?

The council's remit is primarily concerned with debt sustainability, fiscal adjustments and projections, and we are all agreed on the importance of debt sustainability and the need for fiscal adjustments. The message from ordinary people, however, whether in Donegal, Dublin or elsewhere, is that they have nothing more to give. However, the council, in a recommendation which touches on matters of Government policy, proposes that welfare rates should be kept under review. How would a reduction in welfare rates assist in any way in growing the domestic economy? Given that such a reduction would take more money out of people's pockets, surely it would merely contribute further to the spiral of unemployment and the reduced working hours and staff numbers in shops and businesses throughout the State?

The section of the report dealing with projections was very interesting, and I understand the council's difficulties in this regard. In the context of its first report and the level of fiscal adjustments it proposed at that time, is the council still of the view that it would have been more prudent to take that direction, given what it now knows not only about the Irish economy but also the impact of developments in the European and world economy? Alternatively, is it of the view that the Government decision to stand firm on its own adjustment targets, albeit marginally increased, was the correct one? Has the Government issued a formal response to indicate why it has not taken on board the council's recommendations? Should we expect it to be a trend that the council will release its reports and the Government will either ignore or accept them? I am not arguing that the Government should not ignore them, but will there be a formal response mechanism that will allow us to understand why the Government is ignoring the council's recommendations?

I share the delegates' concerns in regard to debt sustainability. As I mentioned, it is due to peak at a higher level than anybody previously suggested. I recall the Minister for Finance, Deputy Michael Noonan, observing at one of the conferences with the troika representatives that he could not envisage Greece returning to the bond markets given that its debt-to-GDP ratio had passed 120%. Ireland itself is now at those levels although, fortunately, the spreads have come down. I am arguing that we should go much further than what is proposed in regard to debt sustainability because, as it stands, our debt is already unsustainable. Professor McHale's view, as reflected in the report, seems to be that an agreement on the banking portion of Ireland's debt will prove to be some type of panacea which will increase the chances of a successful adjustment as measured by a robust return to market creditworthiness.

The difficulty is that the June statement was utterly over-egged by the Government as a ground-breaking achievement of negotiating skill. I was at the ploughing championship yesterday when I heard the Taoiseach's claim that what was agreed in the June summit is as clear as day. On the contrary, it seems as clear to me as the mud I was stepping through down in Wexford. If there is to be a separation of sovereign and banking debt and if it is to be retrospective, then we must have a proper separation of these two types of debt. In other words, the sovereign debt, which is approximately one third of our banking debt, should be taken on board by the European Stability Mechanism. That, however, was never on the table and it is not what has been negotiated. It was disappointing but not unexpected to hear the comments by Ministers on this point yesterday. Has the council done any modelling in regard to the different possible impacts on our financial situation of having a deal in regard to the banking debt, whether by way of a restructuring of the promissory note or by the ESM taking over the full liabilities arising from the State's recapitalisation of the banks other than Anglo Irish Bank?

Will the delegates comment on the council's terms of reference? It is clearly focused on debt sustainability, the fiscal adjustment and projections made in the past, but does it believe there is a role for a committee such as this to examine the social impact arising from some of the policy decisions the council is advocating?

I do not agree with the headline figure of €1.9 billion, on which everybody will focus. The report contains a great many statistics and I do not doubt that our guests have done much work in respect of modelling, etc. It is easy to state that social welfare rates should be reviewed or that the adjustment should be increased by €1.9 billion but what does that mean for ordinary people? I accept this might not be the council's role at present but given that it has a particular standing and is going to be placed on a statutory footing, it has a responsibility to go that much further and deal with some of the issues to which I refer.

Vice Chairman: The Deputy took ten minutes to make his contribution. If there are no objections, I will ask Mr. McHale and his colleagues to be brief when replying.

Professor John McHale: I will certainly try to be brief. Some of the ground has been covered already in reply to Deputy Michael McGrath so that will probably allow me to proceed somewhat more quickly.

On the size of the adjustment we recommend or the fact that we do recommend an additional adjustment, this relates to the balancing act to which I referred earlier. We would very much like to be in a position where we could stimulate the economy because that is what is appropriate for an economy in recession. We are of the view that demand management can have a very positive effect, so we take a generally Keynesian approach from that perspective. That is wonderful if one's country is robustly credit worthy. If it is not, then one faces constraints in that one must achieve debt sustainability in order to establish that robust credit worthiness. There is a general sense that people want to get the State's sovereignty back and this requires that it must be robustly credit worthy. If we cannot do that, then at least we will have a reliable source of official funding that will not impose even more onerous conditionality upon us. This is why we are trying to achieve the balancing act to which I refer. That point sometimes seems to become lost in the debate.

As circumstances change, that which is in the different scales also changes. As the Deputy noted, in scaling back the amount of adjustment we were recommending, we considered two issues, namely, the fact that greater than anticipated weakness in the eurozone economy was having what we saw as a short-term further dampening effect on the Irish economy and that there had been substantial improvements in credit worthiness since our first report, in which we suggested the biggest additional adjustment. Given that the purpose of making such difficult additional adjustments is to regain the credit worthiness of the State and because the evidence of that credit worthiness is improving in any event in the context of the current programme, this allows us to scale back. If we can scale it back to having no additional adjustments or perhaps suggesting a greater stimulus beyond the Government programme - if we thought that was appropriate in light of the balancing act to which I refer - we certainly would do that. We are absolutely not pushing austerity just for the sake of it. In view of the essential aspect of debt sustainability and credit worthiness, however, we are of the view that this is the appropriate macroeconomic policy course for the Government to pursue.

In the context of the stimulus programme, a broader question arises with regard to the fiscal stance and how contractionary or stimulative it should be. What having a stimulus programme that is focused on specific capital investment projects is about is something that is somewhat separate from the main fiscal adjustment programme. In our report we seek possible rationales for having such a separate programme. There are arguments to be made in this regard. One set of such arguments relates to the fact that it can be financed without adding to the gross debt of the State. However, to repeat something I noted earlier, it is necessary to examine the broader balance sheet of the State in terms of financing it by running down assets, accessing the National Pensions Reserve Fund, using privatisation revenues that could have been used to pay down gross debt or taking on particular contingent liabilities relating to public private partnerships and so on. This matter must be considered in the round. It is sometimes presented as almost off-the-books money about which we do not have to worry in terms of what it is doing to the credit worthiness of the State. Taking that broader balance sheet perspective, we become less convinced of this separate stimulus idea.

Another rationale for having a separate stimulus programme is one which is very much part of the international debate on fiscal policy. Many countries are of the view that their economies must be stimulated in the present but that they must also credibly commit to carrying out fiscal adjustments in the long term when those economies are in better shape. One hears this in the UK and the US. The problem that arises in this regard relates to how to stimulate one's economy in the short term while making it credible that one will actually start behaving differently in the future. One could view the separate stimulus approach as giving one an extra instrument in the context of achieving a better trade off, whereby one sticks to one's main fiscal adjustment programme while also having an explicitly temporary stimulus programme in place. In theory, there is a rationale in this regard but it would be extremely difficult to credibly commit that this would be a once-off improvement in capital spending.

There are rationales to consider and we take these very seriously. Following much discussion, however, we reached the conclusion that if one was going to implement a special programme of capital spending, it would be better to build it into the main programme. This would be partly for reasons of transparency in order that it would be possible to see exactly what was happening and that matters would not hidden off balance sheet or whatever. Even if one is using some of these other funding mechanisms, which certainly have a great deal of merit to them, it should be made part of the main programme. The question then arises as to whether the fiscal stance should be relaxed. In that context, I return to the first matter we debated with regard to the trade off between supporting the economy in the short term - for which there are very good reasons - against the risks to debt sustainability, particularly in the uncertain environment in which we find ourselves. We reached the conclusion that at this point we do not really see an argument for relaxing the fiscal stance beyond where they Government is at present. We did, as I have already noted, scale back the additional adjustments for which we had been calling.

I accept that there are time constraints which apply. However, these are important and complicated questions and I hope the Chairman will forgive me for taking a long time to answer them.

Deputy Pearse Doherty inquired as to why we changed the advice we are giving since our first report. In the context of how the Government formally responded to our advice, the stability programme update contained a short response. We would perhaps like a more lengthy response. It is very important that the Government does not feel that it needs to respond immediately to what we say - sometimes such responses can come a little too quickly - but that it should take the advice on board and then provide a more considered reaction in the appropriate way. I refer, in this regard, to the budgetary documentation and the stability programme updates.

I did not take note of all the points the Deputy raised so I will, perhaps, allow some of my colleagues to reply in respect of any matters with which I do not deal. However, I will conclude by responding to his final question on the terms of reference of the council. I understand what he is saying with regard to the fact that we sometimes discuss big macroeconomic figures and adjustments which seem very divorced from the reality that such adjustments will have on people's lives. That is something with which we really struggle. We take the mandate we have been given seriously. We have not been given a mandate to discuss anything we want and put our own particular views or preferences forward. Our mandate is to assess the Government's macroeconomic and budgetary forecasts, its fiscal stance and, under the new fiscal responsibility legislation, the level of compliance with certain fiscal rules. This is what we are supposed to be doing and we have largely been focusing on that.

As we discuss making these adjustments, we see that we should be saying more about what are the possibilities and laying down certain criteria for judging good and bad adjustments. We are struggling with this ourselves, as a council. One of the matters about which we are concerned - this was discussed at earlier meetings we had with the committee - is that we do not wish to become only political in our outlook. It is one thing to talk about the size of these adjustments - which of course is a political question to a certain degree - but once we begin to suggest that welfare rates or public sector pay should be cut, we will, as a council, become much more politicised. That may take from our main function which relates to these macro-economic issues. We are struggling with that tension and it is something we will talk a good deal about before the preparation of our next report in terms of whether we need to say more in regard to the details of the adjustments. It is not to give our preferences but perhaps to give more analysis of the options as opposed to the dangers of going into those more micro questions.

Vice Chairman: One or two other members of the council might like to add their comments.

Professor Alan Barrett: In response to the question on whether we should take on board the social impacts or the issues we talk about, we should be clear on this. When we mentioned in the report that everything should be left on the table - that all the adjustment avenues should be explored - and we threw in social welfare, income tax rates and public sector pay, they, typically, get mentioned because they are precisely the things the Government has taken off the table. It is not the case that we are focusing on them.

I noted the Deputy in his comments very much focused on the fact that we had mentioned social welfare. It is perhaps important for us to stress that we also mentioned income tax precisely because we are worried about the social impacts the Deputy mentioned. Economists are often criticised as being a very right-wing group who only think in terms of expenditure cuts. From very early on we tried to steer away from the notion that austerity worked best if one went down the expenditure cuts road as opposed to the taxation road. We have tried to stress that we did not necessarily buy into that and that, collectively, we were quite open to the notion that taxation could well form a significant part of this overall. To the extent that the Deputy has given any impression that we focused on social welfare, it was part of that package for a very good reason and we are very open to the notion that this should be done through the income tax route for reasons of fairness.

Dr. Donal Donovan: The ESM agreement in July is a perfect example of something that was decided very late in the day or very early in the morning, to which not everybody subscribed, and which was written in a way that allowed everybody to go away with different interpretations of it, which they did starting the next morning. The same people are now interpreting this and it can be interpreted in different ways. One should be careful in interpreting communiqués with general statements signed at 4 a.m. because they mean different things to different people.

We have not modelled a specific number of a possible debt reduction in our work. One reason we did not do that is that we did not want to put out a number, say X, which could then be turned into the view that the council thinks that X is necessary or X will be or should be got. It is not too clear what we will get; we do not know that and nobody knows it.

The IMF was a little more brave than us, as one will note if one reads its last report, picked out as an illustrative scenario, as it called it, a €24 billion reduction in the debt, and it worked through the arithmetic of that. I do not recall the details but it is useful to have it. We did not do that although perhaps we should have but we decided not to.

Deputy Arthur Spring: I will be specific and deal with five topics. On growth and the models the witnesses have used to predict how the economy will grow over time, we are down to between 7% and 9% of the amount of the credit that was provided through the banks at the height of the boom. What do the witnesses consider would be an acceptable level of credit for banks to provide, how that would stimulate the economy and how they have projected that into the future?

Many of the representatives of the banks have appeared before us and they talked about the cost of funds being an enormous problem. Performing loans are burdensome and contribute to the losses banks make because they borrow money on the wholesale market and that is more expensive than the money they have lent out on other side. It is simple maths. What at a macro level can be done in Europe to sort out the cost of funding for our banks and how will that lead to lending being kick-started again in the future?

There are three ways we can go about fixing this. There is export demand, which is a global factor, quantitative easing and debt write-down but we have very little autonomy over those because of the lack of having our own currency and so on. Do the witnesses consider that enough is being done at European level by the Commissioners and our fellow member states in terms of comprehending the difficulty we face in meeting our deficit? If I could have some silence, it would be helpful.

Deputy Kieran O'Donnell: To see a Labour man-----

Deputy Arthur Spring: It was just too much for too long or perhaps I should chair the committee for a while.

(Interruptions).

Deputy Arthur Spring: Good. I was hoping the Deputy would listen to me for a while. I wonder if those in Europe look on Ireland as being a good citizen in that it is doing everything right according to what it is being told by the troika, but I would point, as was mentioned, to the high number of emigrants, the number of people unemployed and people who are struggling financially. This leads me on to my next question.

Property tax is something the troika wrote into the agreement. There are many examples of property taxes throughout the world and Dr. Donovan would know what the IMF would have implemented in property taxes from his time with it. Is there any model he believes to which Ireland should subscribe that would be equity based, and how would that deal with the fact that more than 100,000 people here are suffering mortgage stress? Is it fair that they should bear the burden of having to pay a property tax or should provision be made for an isolated group not to bear that burden, and how would that affect the overall economy?

Does the council engage with the troika. The troika is concerned with cuts and increases in taxes but for us to recover it is all about achieving growth. I do not have a sense that we are getting enough support internationally, which feeds into where we as a country are at, in order for us to have a sustainable economy in the long term. I ask the witnesses to deal with those five issues.

Professor John McHale: Professor Barrett will deal with the domestic questions and Mr. Sebastian Barnes will deal with the European ones, as the members have probably heard enough from me for a while.

Professor Alan Barrett: I made a fatal mistake in that I was jotting down the answer to the Deputy's first question and was then told I was to answer his third question.

(Interruptions).

Professor Alan Barrett: That is okay. If I only answer it partially, my apologies.

Deputy Arthur Spring: There are people here with the numbers.

Professor Alan Barrett: I was being distracted by the rowdy group on the far side.

Deputy Arthur Spring: That is their job.

Professor Alan Barrett: I presume the Deputy is still celebrating the great victory on Sunday-----

Deputy Arthur Spring: I should hope so.

Professor Alan Barrett: -----so that should give me a little bit of leeway. The Deputy asked a specific question on the level of credit that would hold in a normal economy. I am not sure there is an answer to that question, so I will come at it from a different route. There is obviously a problem and if one takes the Central Bank's work on this, there are difficulties for SMEs in getting credit. That is clearly a problem but in an economy that is under the pressure ours is under, it is absolutely the case that a certain proportion of SMEs will fail. Therefore, there are real risks to lending to this group. This is a very difficult question. I remember at the outset of this crisis being involved in a discussion along the lines that if we were not going to have a functioning banking system for a long period of time, that would act as a constraint on growth.

To return to the remarks about life in a post-bubble economy, one of the great difficulties is having an impaired banking system and it is very hard to see an economy growing in the absence of a banking system. We will have an impaired banking system for quite a while and a banking system that may not feel comfortable lending, precisely for the reasons that banks do not want to get burned again. There may not be the human capital in the banks to make good lending decisions. We had a banking system that was made up of people whose job was to lend on property transactions; they were not people who were able to analyse good investment decisions. There is a real problem. To use the economic term in that respect, we talk about a market failure, that the market will not deliver something that the economy really needs. It is a standard economic argument that if there is market failure what one wants to see is the government intervening. I noted with great interest earlier in the week an announcement at the Liberal Democrats conference of the notion that the British Government was simply going to short circuit the difficulty and establish a bank that would lend directly to people. That is something we have not explored, but it would be an issue this group would discuss. I remember early discussions on it and at the time it was arguing that the fear behind setting the up of a State entity was that the giving of loans would be politicised. Other such arguments were made that typically went against State involvement in a bank.

To return to a point made earlier, this long into the crisis there is no sign of banks being restored to active lending and health. Perhaps, therefore, it is time to short-circuit the process.

The second point was related to the design of the property tax.

Deputy Arthur Spring: May I intervene for one moment?

Professor Alan Barrett: Sure.

Deputy Arthur Spring: We are looking at property, wealth and income taxes as part of what Professor Barrett is prescribing. What is his view of the wealth tax model prescribed in France and how it has affected the state and wealth of the French nation?

Mr. Sebastian Barnes: I pay French property taxes and can say it is a badly designed system.

Professor Alan Barrett: I do not know the details of it, but in terms of the principle, if there is a collective sense that more taxes are required, the argument is always that one should widen the tax base rather than increase existing taxes. A property tax falls into that zone. As it is suggested more and more people should be exempt from the property tax, by definition, it means the rates will be higher. One can certainly make a case for the exemption of persons who are genuinely on low incomes because typically we make allowances for this. When the argument starts to be made, however, that one should be exempt from it if one paid a lot in stamp duty in recent times, it introduces a different consideration. It is not about one's current capacity to pay, rather it relates to a notion of tax previously paid. Philosophically, that seems different to me. To the extent that we can keep rates as low as possible, that means broadening the base. Current income is a reasonable criterion on which to exclude people, but if one goes beyond this, one is getting into a dangerous situation of limiting the base and thereby raising the amount that must be raised from every other person.

Deputy Arthur Spring: Does it have to do with negative equity?

Professor Alan Barrett: Not by definition, in the sense that many people are in negative equity, but their life carries on. Being in negative equity is not very pleasant, but if one can afford to repay the mortgage and pay all other bills, life goes on.

There is another practical consideration, in that given the proportion of the population in negative equity, if one were to exclude them, one could be talking about a property tax that would be double or more than it would otherwise be.

Deputy Arthur Spring: More than 100,000 people have a form of stressed mortgage and the level of mortgage arrears is increasing all the time. That is the negative equity generation. Property tax is usually a form of wealth tax, but if one is in negative equity-----

Professor Alan Barrett: On the last point, the terms we use are important. Negative equity is one thing, stressed mortgages are another. There are plenty of people in negative equity who do not have stressed mortgages. They are still managing to pay.

Mr. Sebastian Barnes: I will answer briefly Deputy Arthur Spring's questions about the situation in Europe. It is not an issue we have discussed explicitly at great length, but it obviously provides the context for all our discussions. The Deputy articulated very well some of the challenges being faced in Europe. In some ways, this country has an advantage because it is at the sharp end of the euro crisis and naturally people in this country understand it better than, for example, people in Germany who are experiencing something very different and facing a very different set of issues.

What has happened in Europe in recent months has been significant, in that three things that have fallen into place are important. The first is that the ESM has finally been approved and the detail is being worked out. I understand it will become operational within a few weeks. Second, the European Central Bank has launched an outright monetary transactions plan programme, which is a significant step forward and clarifies its role in the crisis. Third, we have the Commissions's proposals banking union and a political commitment to do something about it, although exactly what remains unclear. These three things, taken together, potentially are very powerful and change the game somewhat in Europe, in particular by breaking the sovereign-banking sector link that people in this country understand very well. However, they are significant, as what they all do is put the ball firmly in the politicians' court, in respect of countries such as Spain and Italy and also countries such as Germany that would have to approve some of these programmes, implicitly or explicitly. Unfortunately, there are still lots of risks. We have the instruments, but there is a deep question about whether they will be used and how the politics of it will work. I hope that answers some of the Deputy's questions.

The other point the Deputy made which is very important was on growth. Achieving stability is a necessary condition, but it is not sufficient for growth. Once stability is achieved because politicians do what they need to do in the right countries, there will have to be more thought given to the need for growth. If it works, potentially, it will create more fiscal space. If one compares the United States to the euro area, objectively it is in a much worse fiscal position but because it has a large federal government debt and a single central bank and is in a different position from that of European countries. There may be more to do on the monetary policy side.

A point that is worth emphasising is that many of the growth problems in Europe are structural. That may be less so in Ireland. It is a credit issue. In some ways, one has an economy that is flexible and dynamic, but if one looks at a country such as Italy, it is in trouble, but it did not have the kind of boom period that we had in this country or Spain. The Italian economy has not grown for ten years and its market share has been showing a downward trend. That is not a demand management problem, rather it is a structural problem. What Europe needs is ambitious reforms to deal with the structural problems. Fortunately, in Spain and Italy things have moved on quite a lot relative to the experience of the past decade, but in all countries there is a huge need to make the European economy competitive again on a global scale. I do not think the measures have been put in place will do that.

Deputy Arthur Spring: Could someone deal with the funds issue for banks? They are borrowing money on the wholesale market more expensively. My question is how this issue can be addressed in Europe.

Dr. Donal Donovan: The difficulty is that Irish banks are frozen out of the markets to a large extent. That is one of the reasons there is a domestic constraint in lending because banks are also under pressure to deleverage, sell their assets and use the proceeds to bring down the large outstanding debt to the European Central Bank. Since they have a difficulty in attracting new funds in terms of new deposits from abroad, that is a constraint. However, again referring to the work of my former employer, the IMF, there is a very interesting analysis of whether it is restrictive credit conditions or a lack of demand that has caused bank lending in Ireland to be weak in recent years. The conclusion is that while there is some evidence of more stringent lending criteria, in that the banks are super cautious, most of it is due to a lack of demand. That is not necessarily a conclusion that would fit with everyone's prior beliefs, but that is what the IMF has concluded, having analysed the situation and done a lot of statistical work.

Deputy Kevin Humphreys: I will keep it brief-----

Deputy Joe Higgins: That is the second Labour Party speaker in a row. Is there a balance?

Vice Chairman: There is. The way it works is that when there is legislation or a Government representative, all speakers on the Opposition side go first, followed by members on the Government side. When there is not a Minister present or legislation is not being taken, we move back and forth.

Deputy Joe Higgins: We are not moving back and forth; we have had two Labour Party speakers in a row.

Deputy Peter Mathews: Two Opposition speakers contributed first.

Vice Chairman: Now I am taking two members on the Government side. That is as fair as could be.

Deputy Peter Mathews: Will the Chairman indicate who is next on the list of speakers? I would like to know where I stand.

Vice Chairman: Deputy Peter Mathews is down the line. Deputy Joe Higgins is next.

Deputy Joe Higgins: The problem is that I am due to speak at another committee also.

Deputy Kevin Humphreys: I will be brief. Most of the time we receive report after report, many of which state different and contradictory things. It has been said that it is for politicians to make the decision as to who is right.

Professor McHale referred to taxation and fairness. The Nevin Economic Research Institute refers to freezing spending cuts and adjusting by way of taxation in 2013. I am paraphrasing to be brief. I am interested in the hearing the views of the delegates on the report of the Nevin Economic Research Institute. I ask for brief comments on that.

I accept that what is agreed at 4 o'clock in the morning does not represent everybody's viewpoint but in its report the council is advocating further savings of €1.9 billion up to 2015. Other people advocate the idea of stopping payment of the promissory notes, cutting our national debt by €30 billion, which would lead to a year to year saving on interest payments. Has that been analysed by the council's group in terms of the fallout or does it have a view on that type of radical approach?

Professor John McHale: We have looked at the Nevin institute's most recent report, which is a useful contribution to the debate. The headline is that it is recommending a €2.7 billion adjustment for 2013 instead of the €3.5 billion adjustment. There are many valuable recommendations in the report but I am not convinced by its particular proposal or the reasons it gives for it. One aspect is that it does not grapple with what is central to our report, namely, the basic trade-off between supporting the economy in the present and dealing with debt sustainability. That is missing from its report.

In terms of this €2.7 billion adjustment for 2013, it believes that the programme target, which is a general Government deficit of 7.5% of GDP, can still be met with the smaller adjustment, that is, the €2.7 billion instead of the €3.5 billion. The argument it makes is that we can have this different composition of the adjustment, as the Deputy said, that will be less damaging to the economy. It picks out particular multipliers for specific areas that makes that true in the sense that it assumes the damage done to the economy by tax increases are quite small and that the damage done by reduced capital spending is quite large, and it draws on some evidence to support the multipliers it uses.

However, there is no agreement in the economic literature on the relative size of these multipliers. The larger share of the evidence goes in the opposite direction where tax-based adjustments, that is, adjustments based on tax increases, probably do more short-term damage to the economy but those findings have been disputed. We have looked closely at that literature and we did not believe we had a basis for distinguishing between different types of adjustments in terms of their effects on the economy based on the existing state of knowledge. There is a somewhat selective use of the literature that ultimately produces this result that one could hit the 7.5% target with a smaller adjustment that is heavily weighted towards tax increases with minor expenditure changes, but it is a useful contribution to the debate in that it brings these important issues to light.

In terms of stopping payment on the promissory notes or other forms of default, at this stage we have to recognise that, rightly or wrongly, the senior bondholders in the banks have been almost completely paid off at this stage. To default on the promissory notes, therefore, essentially would be to default on the Central Bank of Ireland and, ultimately, on the euro system. It is important to note who we are defaulting on if we make that decision.

There is a huge amount of literature on the costs of default. The early part of the literature focused very much on the damage it would do to our reputation and, ultimately, our ability to borrow in the future. The empirical evidence does not support that strongly. Countries often make a surprisingly rapid return to markets after defaulting, and without apparently huge penalties in terms of the interest rates they pay in the future. There are some exceptions to that but as a general tendency what the literature has found is that the faults tend to be incredibly disruptive to the economy and are associated with often much deeper recessions.

There is also a lot of evidence that shows substantial reputational spillovers as a result of default which could be particularly important in the Irish case since it is so dependent on foreign direct investment. To the extent that it undermines confidence in the stability of Ireland's business environment for investment, those reputational costs could be severe. Based on this international evidence, default is something that should be avoided and strong commitments made to avoid default, which brings us back to the need to achieve debt sustainability so that we are not forced into a situation of default, but behind all that and the need to restore the creditworthiness of the State is the need to avoid the consequences of losing it in addition to losing official support as well.

Deputy Kevin Humphreys: Would it be worthwhile for Professor McHale's group to do an analysis of the likely spillover if that road was taken?

Professor John McHale: We can certainly look at that.

Deputy Joe Higgins: In deference to the members who have been waiting a long time to contribute and the fact that I have to speak in the Chamber, I will be pointed and brief in my remarks. I ask Professor McHale to pardon me for being blunt. I do not believe he and his colleagues live in the real world. Their prescriptions are from an ivory tower but in the real world people are suffering very badly the effects of austerity and of a criminal decision to bail out a system of speculation and profiteering on a European basis on the backs of the Irish working class, pensioners, low and middle income workers, and the poor, and Professor McHale and his colleagues want to pile more misery and more austerity on them. He said his role was to analyse Government policy. Why is he not proclaiming from the rooftops that it is a disastrous failure when 14,000 fewer people are at work in the second quarter than in the first quarter, investment has collapsed catastrophically in the past four years, our young people are leaving the country, and all the economic indicators indicate that this is a disastrous policy yet he wants to take more demand out of the domestic economy which is already eviscerated?

One of Professor McHale's economic colleagues, Professor Stephen Kinsella, said in recent days that domestic demand is now at 2003 levels and that any further drops in spending will cause an increase in unemployment and further hardship for the private sector. Professor McHale's prescriptions, on top of what the Government wants in this budget, will make the situation far worse. How does Professor McHale respond to that situation? Has he read, for example, the fairly mild suggestion in the Nevin Economic Research Institute report yesterday about an additional 30,000 jobs at risk of being lost under the current budget strategy to which it suggested an alternative?

Professor Barrett referred not just to cuts but to taxation, but taxation on whom? Have the witnesses ever come up with the suggestion that there should be an audit of real wealth among the top 5% or 10% who have substantial wealth which has increased even during the recession? What about an emergency tax on wealth rather than coming back to working people again?

On the so-called property tax, it is not a property tax; it is a home tax. What is the obsession of right wing economists with a tax on people's homes and the myth that it represents a broadening of the tax system? Did they hear another colleague of theirs, Dr. Peter Bacon, on "Morning Ireland" a few weeks ago demolish the idea of a so-called broadening of the tax base and saying it is coming from the same pot of income workers get from their wages and salaries, pensions or social welfare? That is where it is coming from; it is not coming from a secret hoard of gold that everybody has under his house and which he has been hiding heretofore. The measure would hit the same people, yet economist after economist blindly wants it. It is argued that every country in Europe has the tax. European countries have very different social and health systems, some of which are superior to those in Ireland.

One of the realities we face in Europe is that investment by big businesses and corporations has collapsed absolutely. I am sure the delegates have been reading the *Financial Times* and *The Wall Street Journal*, for example, which argue that trillions of euro is being sat upon by major corporations, or that it is swilling around in money markets, yet the corporations will not invest in the manufacturing industry, where real jobs could be created for real people. How about an emergency tax on uninvested profits in Ireland and every other country in Europe? This would result in a turning around from the disastrous policy of austerity.

Did the delegates ever carry out a moral or democratic analysis of how and why we should tolerate a system in which faceless, unelected, unaccountable major corporate and financial entities that are sitting on top of trillions of euro are allowed to speculate daily against countries, banks and governments for their own super-profit? Their victims are the millions of unemployed people in Europe. So-called democratically elected leaders are simply bending the knee.

Dr. Donovan referred to his former employers. The prescriptions of his former employers, as with those of the troika, for example, pertain to more privatisation, cuts in public expenditure and attacks on living standards. These are similar to those that were applied in the structural adjustment programmes in the 1980s and 1990s in poorer countries in Latin America and Africa, with devastating social and economic effects. Why should we believe these prescriptions will be successful now?

I will have to leave towards the end of the meeting and my doing so should not be interpreted as my being discourteous.

Professor Alan Barrett: I thank Deputy Higgins for his questions, to which my colleagues and I will respond. As the Deputy pointed out, current circumstances are bad. The Deputy used the word "disastrous" in this regard. Unfortunately, however, it is quite possible to make bad circumstances worse. Even today, if we were to repudiate completely all the debt, we would have to note the anticipated primary deficit for this year of 4.2% of GDP, assuming there are certain improvements. Essentially, we would have to close the deficit immediately, with greater pain for people and a much greater fiscal adjustment. If we want to phase the burden out over time and limit the pain, we must retain our ability to borrow. I hope we will be able to borrow from market sources or, failing that, official sources. It is not enough to say circumstances are bad without considering that some of the solutions being offered risk making circumstances much worse. We are balancing the risk of making circumstances much worse against the real cost of slowing the economy in the present.

The Deputy called the property tax a home tax. I believe he would support a substantial role for the Government in the economy, which necessitates substantial expenditure. This must be funded somehow, either by taxation or borrowing. Given that borrowing will, for the time being, be an important way to fund expenditure – this is why we need to retain our creditworthiness – there will be no really easy form of taxation. Therefore, one needs to develop a tax system that does as little damage to the economy and people as possible. All other developed economies have identified the property tax as a central component of any well-designed tax system. The Deputy is absolutely correct that, for the most part, it draws from the same income pool from which income tax, the universal social charge and PRSI are derived; the difference is that it does not raise marginal income tax rates in the sense that, depending on the design, there should not be a need for one to pay a higher property tax. It does not have the same incentive-damaging effects of bringing marginal income tax rates to very high levels - they are currently at 52%. Most people across the political spectrum who have considered well-designed tax systems see an important role for a property tax.

Let me discuss those whom the Deputy calls speculators. There are certainly speculators but many of the participants in the financial markets in whom we are most interested at present are the people we want to buy our debt. This is to allow us to continue to spend more than the income we are bringing in. It is a question of financial market participants deciding that we represent good credit so we can phase out the adjustment over time, thereby limiting the near-term damage to the economy and the people. It is not right to dismiss outright speculation as having a considerably adverse effect on the economy and people's lives. We are very much dependent on their judgment that we represent a good risk if we are to prevent further damage from being done.

Dr. Donal Donovan: I wish to respond on Deputy Higgins's remarks about the structural policy supported by the IMF. If one excludes China, probably the only area in the world that has actually performed better in the past ten years than ever before is sub-Saharan Africa. It has registered the highest growth rates since independence 60 years ago. This is remarkable in many ways given the world environment. Whether one likes it or not, many people would argue objectively that the countries in question did introduce structural reform policies, albeit not of the kind that would find favour with Deputy Higgins. The Deputy would probably agree that they did introduce them. The changes had a major impact on the countries' turnaround and impressive growth performance.

Professor Alan Barrett: We were asked to whom the extra taxes would apply and whether the tax should be a wealth tax. I assure Deputy Higgins that there is no ideological blockage hampering this committee. We would be perfectly open to exploring the type of wealth tax about which the Deputy talks. We would be responsible in doing so and we would want to explore fully all the implications. Some countries worry about wealth taxes if they mean discouraging people from saving for pensions, for example. There is a form of wealth accumulation that we want to encourage, and there is even an argument for incentivising some forms.

We would be quite practical in our views on all these matters. On occasion, it is suggested that there is an ideological blockage. I assure the Deputy that there is none and that we would look practically at all possibilities to ensure the austerity policy is successful and as fair as possible.

Deputy Joe Higgins: We need an audit first to determine where the wealth is.

Professor Alan Barrett: I have no problem with that either. The Deputy will be pleased to hear that, as of next year, the Central Bank, through the CSO, will be doing exactly what the Deputy is talking about. It will be good to have the data so we can finally start exploring the issues that the Deputy quite rightly talks about.

Deputy Joe Higgins: I thank the delegates.

Deputy Jim Daly: I thank the members of the council for their contributions and for devoting time to answering questions.

I will be as brief as I can. I refer to a line used by Professor McHale who stated:

> There has also been a notable increase in non-tax revenues, partly related to the State's involvement in the banking sector. These sources of income should be closely monitored.

I assume he is referring to the price of the bank guarantee the banks are paying.

Professor John McHale: Yes.

Deputy Jim Daly: Does the fiscal council have the figures to hand? I have heard Mr. Richie Boucher of Bank of Ireland speak of a figure of approximately €500 million per year. I am guessing-----

Professor John McHale: Our expert in such matters is the head of secretariat, Mr. Diarmaid Smyth, who may wish to respond.

Deputy Jim Daly: In the interests of expediency, I will conclude my questions before reverting to Mr. Smyth.

Broadly, what is the cumulative effect of such payments? My guess is that it amounts to approximately €1 billion between the two main institutions. What else is there in addition to this? I presume Professor McHale is also referring to the reliance of the State on that income of more than €1 billion, which is dangerous because I presume it is not sustainable in the long term. I seek elaboration on this point.

In addition, I am aware that some banks are now lending outside the guarantee, for which they will give someone a marginally higher rate. What is the council's view on the long-term necessity for the bank guarantee? Can it be got rid of in the shorter term, that is, within two to three years or will it be in place for much longer? Is there a counter-productive element associated with the cost of the guarantee? While I acknowledge that it is necessary in some way, we are trying to get the banks back to profitability and if the first cost Bank of Ireland and AIB must meet each year is the aforementioned €500 million, it will hamper their return to profitability.

Has the council viewed or analysed the corporation tax rate or is it a subject it would be willing to examine? The current Administration entered office 18 months ago with a resolute commitment not to interfere with the corporation tax rate. However, given the times we are in, everything and nothing can be agreed; one should be open to everything. Has the council conducted an analysis of the corporation tax rate? Do council members have views on whether it would be inherently dangerous to examine it? Alternatively, in their professional opinion, is it a possibility that could be countenanced?

Mr. Diarmaid Smyth: As for the numbers in respect of Exchequer non-tax revenues, they were approximately €2.4 billion in the first eight months of the year. This actually constitutes an increase of 50% year-on-year, which is partly due to timing factors. I believe there have been three bank guarantee payments in the year to date, whereas we only had two such payments last year. However, there have also been some interesting developments, in that €300 million has come in from interest paid on contingent capital notes which, again, are related to the possible over-capitalisation of the banking sector. In addition, I believe the Government received €1 billion in Central Bank profits, much of which, again, relates to emergency liquidity assistance, ELA, which we document in the report. On a broader scale, in terms of general Government figures, there has been a notable increase in non-tax revenues, much of which relates to the bank guarantee, as well as dividend and interest income. It is a subject we are exploring and we hope to bring out a paper within the next couple of months specifying what these items are, as they must be monitored. These are the main figures.

Professor John McHale: As the guarantee is not something we have discussed as a council, this is a personal view. I would be slow to get rid of the guarantee for the following reasons. From the banks' point of view, it certainly is extremely expensive and undermines their profitability. I acknowledge that we need to repair the banking system and bring banks back to profitability in order that they can play their proper role in the economy. On the other hand, as Mr.

Smyth outlined, those revenues are having a very positive effect on the size of the Government deficit. However, the reason I would be slow to get rid of the guarantee - this relates, in particular, to the extent to which the banking system is not State-owned - is that there is likely to be an implicit guarantee in place. One thing we have learned from the crisis is that even when there is no explicit guarantee, it can be very difficult for the State not to ultimately take on the liabilities. This applies, in particular, to the banks that are not actually State-owned because in that case it really is just a transfer from one pocket to the other. However, for instance, in respect of the 85% of Bank of Ireland, if the State really is taking on those liabilities and ultimately providing an implicit guarantee for the bank, the bank should be charged for it. I stress this, however, that is a personal view.

Deputy Jim Daly: That pertains to the short term. Is it necessary in the medium term also? Will it be necessary in five years time?

Professor John McHale: I refer to whether it will be necessary in respect of the banks being able to raise funding, which is the reason it is in place. It really is to allow the banks to be able to borrow. They are now well capitalised. Much of the uncertainty about the asset side of the balance sheet has been reduced, although certainly not eliminated, as I am sure Deputy Peter Mathews would underline. However, on foot of the transfer of the most toxic assets to NAMA, the uncertainty on the asset side of the balance sheet has reduced. Consequently, in respect of the ability of the banks to raise funding, including deposits but I hope longer term funding also, the guarantee is not as necessary as it was in the midst of the crisis. However, it was not what allowed the banks to sustain the deposits they had, particularly domestic deposits. When one does not have a state that ultimately is creditworthy, its guarantees do not mean an awful lot. What really stopped a complete run on deposits in the Irish banking system was the backing of the European Central Bank. That is the reason it was necessary to be extremely careful about how one dealt with issues relating to senior bonds. While that is a more complicated issue, one definitely needed to retain the support of the European Central Bank which often went beyond its normal lending operations to banks, particularly as it related to emergency liquidity assistance, ELA. However, to the extent that the guarantee implicitly is in place in order that the State can cover the losses of the banking system, I support charging the banks for the guarantee provided.

Deputy Jim Daly: What of the question I asked about corporation tax?

Professor John McHale: Mr. Barnes will respond to that question.

Mr. Sebastian Barnes: I realise this is a sensitive issue. The discussion of corporate taxation concerns not simply the rate but also the entire set of arrangements around corporation tax. As it obviously is important in Ireland, it has come into our discussions, but obviously it is not the main topic we discuss. However, as the work of the council develops and our analysis goes into greater detail, I am sure we will get into the subject more, as we will with many other subjects. As Professor Barrett noted, for us, all of the issues are on the table. It is not as though we are focusing on particular subjects for ideological reasons. One reason that is worth noting is the corporate tax arrangements are not entirely in Ireland's hands because they partly rely on agreements with other countries, as well as on tax competition and what goes on in other places. In a long-term sense, it actually is a significant fiscal risk that even if Ireland keeps its policies the same, other things might change in the world that would make it less favourable to Ireland.

One point that is also extremely striking and at which we look a little in the report concerns the GNP-GDP distinction. As we spell out in the report, some think it is GDP, while others think it is GNP, but, of course, the extent to which they are different is largely associated with multinational profits. I note there is some tax value in this, but it is probably just not as high as in the rest of the economy. In a way, this is true of a lot of other countries also because, typically, the tax rate on corporations is much lower than it is on individuals, for example. The issue in Ireland is that the size of profits in the economy relative to GNP which probably is the most appropriate measure in this sense is very big. Consequently, one of the things we wanted to do by showing this hybrid measure, between GDP and GNP, was to show those foreign multinational profits were not worth anything to the economy. It is simply the case that they are not taxed in the same way as others. Moreover, it would be surprising if they were taxed in that way because nowhere are corporate profits taxed as highly as individuals.

Professor Alan Barrett: I will make one more point on corporation tax with regard to something that makes it very hard to analyse. One can perform an analysis of most taxes to determine what might be the effect as the tax goes up or down. However, when it comes to Ireland's corporation tax rate, there is an argument that the certainty around the rate is something that always is sold. It is not really a question of moving the rate from 12.5% up to 15% and that this would be okay. The argument is that once one breaches this absolute commitment that it will remain the same forever, one may have created a worry in people's minds and may have lost the real value. Consequently, while increasing the rate by a couple of percentage points may seem like a small thing to do, one would be breaching a fundamental principle that appears to have continued for a long time. In a sense, as a group of economists, we cannot predict what the reaction might be to something such as this. While it is an experiment one might want to conduct, it could be a very costly one.

Deputy Kieran O'Donnell: Do you feel lucky?

A Member: It could be a lucrative one.

Professor Alan Barrett: It could be. Certainly, it is a risky strategy. It is bit like the default issue in some ways. There are these experiments that one might want to conduct which could work out splendidly. However, it would take a brave Minister to conduct such an experiment.

Deputy Jim Daly: It has become the tax increase that dare not speak its name. We are all afraid to go there. Does the council plan to do any more in-depth assessments of corporation tax?

Professor John McHale: We are currently planning our next report. We have an all-day meeting tomorrow, so we will put that on the agenda.

(Interruptions).

Dr. Donal Donovan: The corporate tax rate is a politically sensitive issue in Ireland, particularly *vis-à-vis* the United States, where it is talked about a great deal. We all know of international companies operating in Ireland that are important to us but whose activities, good or bad, have attracted a great deal of attention in the United States. There is also a European dimension about which we all know. As Professor Barrett implied, if one even starts talking about this question, one could be accused of raising subjects one should not, green jerseys not being worn and so forth. This cannot be approached in the same way as a simple issue such as putting another ten cent on the price of beer. I happen to have personal views about the corporate tax rate which I certainly am not going to share this evening.

(Interruptions).

Deputy Arthur Spring: Please do not open that debate.

Deputy Peter Mathews: I thank the delegation for attending the committee and for the papers they presented and the work they do. The key point I noted that resonated across the paper was that debt sustainability remains fragile. I concur with almost 90% of what Deputy Higgins said earlier. The council's brief is macroeconomically scaled. It does not go into the branches or the boughs of the trees; instead, it is looking at the forest outline. Within that forest, there is a larger landscape of the financial system, the eurozone and even the world financial system. If Ireland is fragile as regards debt sustainability, the eurozone's financial system is super-fragile.

In November 2010, Timothy Geithner vetoed a credit restructuring or write-down of Irish banking funding. Greece's write-downs had not occurred at that stage. If that had happened, we would have been the first in a cascade across the financial system. Tuesday's letter from the Dutch, Finnish and German finance Ministers is one hell of a disappointment. It is also one hell of an unacceptable U-turn. Ireland actually saved the euro back in November 2010. The euro system had an exposure of at least €135 billion to Ireland. If that had buckled, the whole framework would have buckled and God knows what would have happened. It is still fragile. Simon Johnson of Massachusetts Institute of Technology, MIT, wrote an article recently in which he examined Deutsche Bank, which I mentioned at the committee a year ago. My son, who has emigrated to Australia, prompted me to have a look at this article. Deutsche Bank is over-leveraged, under-capitalised and carrying suspect assets on its balance sheet. Its balance sheet is the equivalent of 80% of the German economy's gross domestic product. That is how serious the whole matter is. Here we are frightening ourselves, walking on eggshells, when the eggshells are smashed. We can put on boots to walk around the mess that has been left. We should not be afraid, on the next due date of a bond for AIB - a bank we own - to say that borrowing more European Central Bank or emergency liquidity assistance, ELA, moneys to pay this bond is a farce and we actually want to discuss creditor restructuring.

We have already raided the pension fund, robbing it of €20 billion to stick into banks that are bust. Leaving a residual shareholder proportion of 15% in Bank of Ireland is the daftest move, considering the earlier discussion of covering all liabilities. There would be no deposits in that bank if the State did not support it, admittedly in a fragile and wobbly way through the euro system. It is all so interconnected and so farcical.

It is true the processing of €70 billion of loans into sovereign loans on the backs of Irish citizens is misplaced, odious, unjustified and should not happen. Instead, a restructuring and write-off is long overdue. We should all stand up for the people of Ireland and take off any of the restrictive paraphernalia that we have worn from yesteryear when the establishment had certain norms and protocols of discussion. We have gone beyond that; we are in a battle zone. I am not saying we should become brutal or boorish in our approach. Instead, we must become assertive. We have to tell Mr. Draghi that we do not have the money for the bond now coming due and we are not borrowing on historical terms. They will be over here fast - cash concentrates the mind. The euro system will buckle. They will want us instead to pretend that all is well.

We should all get down and talk real. Deutsche Bank should talk real, as well as all the other European banks such as the Spanish banks. The latter claim they need only €100 billion when they need at least €500 billion.

Vice Chairman: Has the Deputy a question?

Deputy Peter Mathews: I have waited two hours. I think the audience has the patience.

Vice Chairman: Sorry, Deputy; other members have also waited two hours and are still waiting to speak. The Deputy should pose a series of questions to the delegation.

Deputy Peter Mathews: We are in a conversation with these very kind visitors. The conversations cannot all go on one side.

Vice Chairman: Deputy Mathews, I could stop you from contributing.

Deputy Peter Mathews: I know you could.

Vice Chairman: Will you ask questions rather than making a statement to the delegation? They have been with us for two hours and they have at least another hour to spend here. Will you please put some questions?

Deputy Peter Mathews: I am going to ask the question when I have had the opportunity to lay out the tray.

A recent Harvard advanced management programme was addressed by top-tier people including myself, Mr. Barry O'Leary from the IDA, Mr. John Herlihy from Google, and Mr. Austin Hughes from KBC Bank. I made my short presentation honestly and there were no holds barred, no holds that I was afraid to go into. In the questions and answers afterwards, I raised corporation tax. I raised it also with the European senior management of Wells Fargo, which is probably the strongest bank in the world because it was the most conservative in the past ten years. I asked would it blink if corporation tax was raised from 12.5% to 15% for ten years and was told, "Not at all." We have frightened ourselves with false prophecies.

Vice Chairman: Sorry, Deputy Mathews.

Deputy Peter Mathews: Are they aware what 2.5% on the last corporate tax returns would raise for the economy?

Vice Chairman: I know Deputy Mathews can hear me.

Deputy Peter Mathews: It would raise almost €700 million.

Vice Chairman: Sorry, Deputy Mathews.

Deputy Peter Mathews: Of course, the Department of Finance provided a caveat-----

Vice Chairman: Deputy Mathews, I am going to ask-----

Deputy Peter Mathews: Excuse me, Chairman. They provided the caveat that these could have other internal repercussions - the sort mentioned earlier - and one does not know which way the balls will go. I do not believe that.

Vice Chairman: I will ask for Deputy Mathews's microphone to be switched off.

Deputy Peter Mathews: These 24 visitors did not even blink.

Vice Chairman: Would Deputy Mathews please show a little respect for the Chair?

Deputy Peter Mathews: Sorry, I did not hear the Vice Chairman. I beg his pardon.

Vice Chairman: The reply will be fairly short because I do not remember hearing any questions being asked. That contribution was long enough and Professor McHale can keep the reply fairly short.

Deputy Peter Mathews: Does Professor McHale agree?

Professor John McHale: For the most part, no. Initially, in terms of the Deputy's strong pessimism about where we stand,-----

Deputy Peter Mathews: Realism. I am not afraid. If I was afraid, I would not be saying this. However, everybody else is afraid and that is why, as I stated, they walk on eggshells when the eggshells are well and truly broken

Professor John McHale: I would not share that assessment of the reality of the situation as Deputy Mathews would see it. As this report notes that there are substantial risks to debt sustainability because Ireland has this uncertain growth future, we also must look at what is happening to market assessments of Ireland's creditworthiness. These are people who are putting money on the line and making judgments in terms of whether Ireland can do it or not, and of whether Ireland will end up defaulting.

Deputy Peter Mathews: That is a necessary good. Does Professor McHale know why? It is because all the bank debt is now national debt and the creditworthiness of the nation is-----

Vice Chairman: Deputy Mathews is out of order. I ask Professor McHale not to respond to that because Deputy Mathews was asked not to interrupt. When he was asked to stay quiet by the Chair, he refused to do so. I must move on. I am sorry about that. I ask Deputy O'Donnell to ask his questions.

Deputy Kieran O'Donnell: I welcome the members of the council.

I have a few short questions. First, how much is the bank guarantee worth to the State? What is the figure? They made reference to it. If the bank guarantee was effectively to be withdrawn, what level of tax revenues would the Exchequer forsake per annum? Professor McHale states there is an implicit guarantee regardless of whether there is a direct guarantee in place. If the bank guarantee was to be removed, would he expect Ireland's cost of borrowing externally to reduce? Would it have an impact on our cost of borrowing?

Second, on the question of the impact on the economy of the austerity in terms of the level of cuts, the council stated it wants to see €1.9 billion of extra adjustments up to 2015, above what is planned at present. What is the council's view on pushing it out, say, for another two years or whatever, and making the corrections over a longer period? Would that have a positive impact? We have not spoken about the domestic economy. The export economy and the multinational sector is doing well. The domestic economy is where the long-term unemployed are. The domestic economy is a matter that needs to be addressed.

Finally, throughout its report, the council makes reference to debt sustainability and creditworthiness remaining fragile. It comes up everywhere in the report. Dr. Donovan made reference to the IMF viewing a figure of €24 billion in debt write-off in terms of the banks. What do they perceive - they may not want to go there - is the requirement for our debt to be sustainable and what do we need to get? How do they view the pronouncements of the German, Finnish and Dutch Finance Ministers in the past couple of days in that regard, linking into the ESM and the issue of banking debt? When one looks at it, the €64 billion of bank debt is a significant burden for any economy, particularly a small economy like Ireland, to be carrying on its back.

Those are specific issues: the bank guarantee; pushing out the number of years; the impact on the domestic economy; and debt sustainability and what the council would like to see in any bank renegotiation, in terms of the split of the sovereign versus banking debt and in the context of what the three Finance Ministers stated two or three days ago.

Professor John McHale: I will ask Mr. Smyth to answer on the bank guarantee.

Mr. Diarmaid Smyth: I thank Deputy O'Donnell for the questions. It is something we go into in the report. We talk about these non-tax revenues and how important they are. We asked in the report for more information to be provided in the budget, in particular, on the SPU, because we only get a category of other revenue and they do not really break it down.

Deputy Kieran O'Donnell: What is the estimate?

Mr. Diarmaid Smyth: According to EUROSTAT, if I go back a couple of years, the fees received were as follows: In 2009, €1 billion related to banking income, of which bank guarantee fees amounted to approximately a half; in 2010, €2 billion, of which guarantee fees were €1 billion; and last year, €2.6 billion in revenues related to the banking sector, of which guarantee fees were €1.2 billion.

Deputy Kieran O'Donnell: Quite significant.

Mr. Diarmaid Smyth: It is a significant sum.

Deputy Kieran O'Donnell: If the bank guarantee was to be withdrawn, would it have an impact on Ireland's cost of borrowing? Would the cost of borrowing come down for the State? Ultimately, our objective is to come out of the programme and that is predicated on Ireland's bond yields internationally coming down to sustainable levels.

Professor John McHale: I cannot see an argument that our bond yields would come down as a result of removing the guarantee. It goes back to the reasons I gave previously in the sense that the implicit guarantee is still there and the revenues are not coming in. Part of those revenues are coming from State-owned banks,-----

Deputy Kieran O'Donnell: The is the point I am making.

Professor John McHale: ----- which is not really a gain, but part of them are not.

Deputy Kieran O'Donnell: It could be a gain to the ordinary taxpayer in the context that we must make fiscal adjustments. Obviously, we are dealing with people on the ground. Certainly, if one pulls out that banking revenue, it must be plugged somewhere.

Professor John McHale: Absolutely. In answer to Deputy O'Donnell, getting rid of the guarantee would not help and would possibly hurt.

In terms of pushing out the adjustment for an extra two years, I wish I were able to say that we had such scope at present. I am sorry I keep referring to debt sustainability and creditworthiness, but given these concerns,-----

Deputy Kieran O'Donnell: I want Professor McHale's viewpoint on it.

Professor John McHale: Essentially, our fiscal stance is that we have to do more out to 2015. Pushing it out for another couple of years would be going in exactly the opposite direction and our assessment, balancing the different factors, is that there is not scope for that.

In terms of relief on the official debt, Deputy O'Donnell's final question,-----

Deputy Kieran O'Donnell: I tried to tuck it in under the radar.

Professor John McHale: -----any relief would help and the more, the better.

Deputy Kieran O'Donnell: That is a political rather than an economic answer.

Professor John McHale: I am getting better. While there are many risks ahead and we really need to stick to the task in terms of the fiscal adjustment to ensure we finish the job, I do not agree with those who would say that if we do not get very substantial relief, we are done for. That is not the case. Returning to what I stated earlier, the current yields are not factoring in that much relief and that is why the statement from the three Finance Minister did not seem to have much effect on yields. It all is not hinging on that. The better the deal that we can get,-----

Deputy Kieran O'Donnell: Define-----

Professor John McHale: We support the efforts that the Minister is making.

Deputy Kieran O'Donnell: In layman's terms, would Professor McHale define what the council regards as debt sustainability for Ireland? At what point does our debt become sustainable?

Professor John McHale: A necessary condition for debt sustainability is a peak and then a decrease in the debt-to-GDP ratio. This is projected to occur in 2013. However, our report shows that, due to the uncertainties concerning growth, there is a 40% probability that the decrease will not have occurred by 2015. The fiscal adjustment needs to be reinforced to buy extra insurance against that uncertainty.

I keep using the words "debt sustainability" and "creditworthiness" together for a reason. Given the level of debt and the path it will take - namely, peaking before decreasing - the real test of sustainability is whether one is creditworthy. Our nine-year bond yields are a little over 5%. They were higher than 14% in July of last year. Despite the negatives that have been mentioned and the risks outlined in our report, it is important that we not forget that substantial progress has been made. At the risk of making what sounds like a political, but balanced, statement, the fiscal adjustments of this and the former Governments have been successful to date. By no means was that guaranteed. We are now on the path out. We need a bit of luck, although people sometimes do not like hearing that. If we pursue the right policies and get some help, we will be going in the right direction. It can be done even without substantial relief on the official debt. We need to stick to the job.

Deputy Peter Mathews: What is the validity of the debt?

Professor John McHale: That sounds like a philosophical question.

Deputy Peter Mathews: No; it is a truthful question. Since it was legal for people to own slaves in the Congo, they could argue that it was right to have and crush slaves. The debt has no validity.

Vice Chairman: Dr. Donovan wishes to comment.

Dr. Donal Donovan: I hesitate to respond to Deputy Mathews, but I will take my life into my hands. In my experience, most debt issues are resolved not on the basis of one side claiming a moral high ground, but on pragmatic grounds as to what is in the mutual interests of both parties. Moral arguments about debt, stirring and heartfelt though they may be, do not tend to get one far. The debtor and the creditor will say many things and there will be a stand-off. What matters is whether doing a deal is in the parties' mutual interests when the cost of not doing a deal is high for both of them. Clearly, discussions-----

Deputy Peter Mathews: That is when one pushes the plunger on the dynamite of the euro system.

Dr. Donal Donovan: It becomes a discussion on the benefits to our European partners of giving us a deal and the costs to them if they do not. One can go through all of these factors. I hate to sound pragmatic, but this is the way in which one should always approach these issues.

As to debt sustainability, the figure of 120% is high and is even higher in GNP terms. It is the second highest after Greece.

Deputy Peter Mathews: Including household and corporate debt raises it even higher.

Dr. Donal Donovan: To put it crudely, reducing the figure solely on the basis of adjustments is tough going. It can be done, but it is difficult. Exactly how difficult is for the Members of the Oireachtas to determine, as that is a political question and they have a much better appreciation than any of us of people's tolerance and forbearance for whatever is done. Help would be helpful, if I might phrase it that way, but expectations about what might be on the table should be reduced. We may or may not get something from the ESM. What that something is might not be much, particularly in terms of the net debt. We could sell the banks to a hedge fund in the morning and get €10 billion or thereabouts. We need more than that, but the question of how much more anyone is willing to give is a partly political, partly economic issue. It will not be trillions or even tens of billions of euro more.

A delay or related arraignments will not reduce the stock of this debt - that is, what is already in the debt - but would hopefully stretch it out, thereby allowing for a lower interest rate and a longer amortisation. Help can come from that corner, but it would not solve the problem as much as some people would hope.

Mr. Sebastian Barnes: Deputy O'Donnell raised a number of good questions that have been answered to an extent by my colleagues, but I will add a few more comments. In terms of delaying, as Professor McHale stated, the basic issue is that Ireland is still in a fragile position from which it must extricate itself, albeit not as quickly as possible, since it would be a trade-off.

Deputy Kieran O'Donnell: My comments were in the context of the domestic economy. The core of unemployment is found in the small to medium-sized enterprise, SME, sector. As spending power decreases, SMEs' revenues are affected. I understand the macro situation in terms of Ireland Inc., but I am considering the profile of those who are unemployed. Many used to work in construction, but a cohort are from the SME sector, which relies on spending power in the domestic economy. A rising tide lifts all boats and it is a question of making balanced choices. If the debt reduced to sustainable levels, we could have the freedom to push its repayments out further if that option were available to us.

Mr. Sebastian Barnes: Although Professor McHale did not speak directly on that point, he referred to the fiscal situation in the near term. We have primarily been focusing on 2015 as the deadline, but we hope the world will continue after that time. Ireland will continue to have a high level of debt. That could be a risk, as there could be new shocks and Ireland would need to face them with only small margins. A great deal of the evidence that economists examine suggests that high public debt has an impact on growth. It is important that we move beyond having such a debt. Fairness is also an issue. How much do we want to push onto younger people? Significant questions remain and it is clear that debt needs to reduce. As our report showed, additional consolidation will be required.

In this regard, we began to discuss an important context in the report, namely, Ireland's new fiscal rules, which will be introduced under the fiscal responsibility legislation and our European commitments. Those rules apply a debt target of 60%. There is nothing magic about that number; it just happens to be the one we signed up to. This is an important context in the medium term. By increasing the sustainability of the public finances and future stability, that framework and many other measures will hopefully allow us to avoid returning to our current position. In principle, macroeconomic stability should be good, and we know that can be incredibly damaging to small businesses and the functioning of the real economy, but reaching that point from where we are today will be difficult.

Deputy Dara Murphy: I welcome the witnesses and thank them for attending. I apologise for being late. This meeting forms part of an interesting debate. Indeed, it is the core debate. According to the Nevin report, the witnesses' report and stated Government policy, we must arrive at a certain point. The question is how to get there and how quickly that should be done.

Luck was mentioned. It is linked with what level of growth will be achieved in Ireland and, more importantly, the countries to which we export. Were the witnesses' report implemented, would our levels of growth be damaged? We are bouncing along the bottom of an L-shaped economic pattern. The fear would be that this might force us into further recession. There has been some discussion here even from colleagues in our party about corporation tax. It is important to repeat the comments of the Taoiseach, the Tánaiste, the Minister for Finance and the Minister for Jobs, Enterprise and Innovation that our corporation tax is not a subject for debate or discussion. Obviously the Irish Fiscal Advisory Council is free to have its own deliberations but I would hate it to waste its valuable time in any way. Politicians in the United States frequently advertise to their own corporations and to the world that Ireland is a country in which to invest in order to secure a reasonable level of tax for those seeking to export into the European Union. We welcome that promotion from our colleagues in America. However, it is not just about the 12.5% rate but also about us having an open economy. If it went to 15% or 13% or even if we started discussing it, it would be a serious dent in a massive piece of marketing ammunition we have. We are blessed that we have St. Patrick's Day and that we have a very low corporation tax rate. It is not just that I am saying it - it has been said by the Taoiseach, the Minister for Finance and other senior Ministers. It is also the position of the Opposition parties. We are very lucky to have it and, more important, to be known to have it. I compliment the witnesses on this interesting and comprehensive debate. It is a pleasure to be here.

It appears our Chairman, Deputy White, will not be returning to his position in this committee, following his promotion to Minister of State and I wish him luck.

Deputy Peter Mathews: The Vice Chairman might be next.

Vice Chairman: Did Deputy Dara Murphy ask a question?

Deputy Dara Murphy: I do not believe I asked a question.

Vice Chairman: The appointment of Deputy White as a Minister of State is a fantastic achievement and we wish him the best.

The witnesses have been very forthright in answering their questions, but they say that in writing their report they did not want to be political and to nuance things, for example, by suggesting that pensions and social welfare rates should be under review. While we do not want to do things that might frighten people internationally, the witnesses could give clarity and state what they believe. When they ask whether the Government will give its views consideration, the council may have to wait a while but it will get the Government's consideration on 8 December or whenever the budget is presented. That is ultimately when we express our views on what the witnesses are saying.

The committee and the debate overall would benefit from the witnesses giving their view on the sustainability issue as they have given this afternoon. They could write that in a report. Their views were extremely clear and they did not hedge around the issue today. They discussed the option of a new bank and they could outline clearly how we could investigate the issue. They have suggested getting information from the CSO regarding where wealth lies and its potential for taxation. They have discussed whether wealth would stay in the country depending on the taxation issues. They could add to the debate on property tax and whether it should be based on site valuation or property valuation by giving clear views.

We did not spend much time this afternoon discussing jobs, nor was there much mention of the matter in the report. Jobs represent the solution to our growth problems. The Irish Fiscal Advisory Council could make proposals on how we could get people back to work.

Professor John McHale: The Vice Chairman's suggestions are very well timed and as we will discuss our medium terms tomorrow, we will keep this under considerations. I will let the committee know the dilemma with which we are struggling. To have an effect for the long term it will probably be well after the present membership of the council has moved on. That is the value of having this independent body. We want to ensure we are seen as independent and not political. If we get into specific issues involving very strong political divides there is a risk that we become associated with one side or the other. That is not to say that we cannot get into more issues as we feel our way.

I would like people to understand that we believe that the perception of our independence is critical to our functioning and we need to maintain that while expanding the scope of what we review. We have a mandate that will be set down by legislation and we also need to be sensitive to that. Within the constraints of that and the constraint of having to protect our independence for reasons of impartiality, we will certainly try to expand the scope of what we consider and give an opinion on it in the report as much as possible. In many cases it may be laying out, based on the economic knowledge of these areas, various criteria of good policies and finding options that look good across a range of those criteria. That might be the way we can say more on the specifics of adjustments without seeming to take sides on very politically charged issues. I just wanted to outline the dilemma with which we are struggling.

Mr. Sebastian Barnes: From working in the council, I have learned how complicated the public finances are. The amount of work required to make analysis that is credible, error-free and properly thought through is immense. It is good that we have our chief economist and our secretariat who do a great job. It is not in the interests of our credibility to spread ourselves too thinly. Ireland is lucky in having many good commentators. One may not agree with everything they say and some people on the council in a private capacity express their views as such. The council tries to make very sound evidence-based analysis which naturally limits how much we can do. That is not a plea for extra resources - I am just pointing out there is considerable work for the council to reach a view and ensure the analysis is soundly based, which is what I hope gives us authority and credibility in public debate. We are very much aware of the risk of spreading ourselves too thinly and being found wanting, which is not what we want.

Dr. Donal Donovan: When we write reports, we hope people will read them carefully line by line and, therefore, considerable effort goes into ensuring that what is reported is done in a precise, careful and balanced way because these are sensitive issues. Coming here affords us the opportunity to speak a little more freely. I might need to be careful of some things I might have mentioned in passing. I would not necessarily want to see it reported that the fiscal council suggests that 4 a.m. is not a good time to have meetings as people might go away confused. I said that and I believe it, but it is different from having it written down in a report that is circulated. I hope the Vice Chairman will indulge a certain amount of our being able to speak a little more freely and expressively with perhaps more of a personal element when we come here because we gain much from hearing the committee's views and I hope it is useful for the members of the committee. That is a slightly different forum from a very carefully written crafted report. Perhaps we craft them too carefully, a point we will certainly consider. We may be too nuanced and not so blunt. However, we need to be careful.

Vice Chairman: Does Professor Barrett wish to add anything?

Professor Alan Barrett: Deputy Joe Higgins would be surprised by the range of views expressed at the council. When writing a document, one of the challenges is to come up with something with which everybody will feel comfortable. One of the pleasures in coming to this committee is that there can be a more free-flowing exchange of ideas, which is very valuable. I should not focus on Deputy Joe Higgins, but I know he thinks this economist factory produces widgets at night and right-wing economists by day. There is a diversity of views.

Vice Chairman: Does Mr. Smyth wish to add anything?

Mr. Diarmaid Smyth: Going back to the ivory tower comment, I wish we did not have a fiscal council. The reason it is in place is we have made mistakes in the past. There is a harmless chart in chapter 3 showing the level of primary spending in Ireland in the 1970s. There was a period during which spending increased too quickly. There were also periods during which taxes were cut too rapidly. The fact is, however, that we have a fiscal council. Most of us are fortunate in that we have been seconded and have other jobs, but we are here because we believe in the long-term value of having the council, that it can make a real difference and that we must try to avoid the budgetary mistakes made in the past. We are positive as much has been achieved in the past few years in terms of consolidation and the deficit is coming down. There are, therefore, grounds for optimism. I, again, thank the committee for giving me the opportunity to come before it.

Deputy Peter Mathews: I appreciate the kindness of the Vice Chairman in letting me ask one or two questions.

On debt sustainability, I know the focus has been on sovereign debt. However, Ireland is the country which has been most crushed and burdened by debt, even more so than Japan. The paper produced by the Bank for International Settlement economists for a conference in

Wyoming in the United States in August 2011 tabulated the 18 nations in the OECD. Ireland was not even considered in that exercise, but when one superimposes or introduces household debt and non-financial corporate debt, we are way ahead of anyone else. That is the problem because in addition to the sovereign debt that must be repaid and serviced from tax revenue and the things the troika is asking us to do, households are crushed by debt that will become multi-generational. That is what is wrong. We have 130,000 people with problematic mortgage loans and there are far more beyond. With the insolvency law we are only putting a toe in the water in terms of what needs to be done. That is what I feel professionally and from my experience and that is what Deputy Joe Higgins means when he refers to ivory towers. It is not meant to be in any way deprecating to the delegation. The Deputy acknowledges and salutes the work done by the council. He was the only politician in the European Parliament who more than two years ago asserted to the President of the European Commission that it was wrong for citizens to be saddled with debts arising from the private banking sector collapse. That was the only time the president lost his temper, not because Deputy Joe Higgins was rude but because he spoke the truth. That is what is so telling in all of this. I ask the leaders and finance Ministers of all countries to come together to honestly add up the bill and possibly mutualise and perpetualise it in 2.5% consoles. They should add up the bill - be it €3 trillion or €4 trillion or perhaps €5 trillion - sweep out the balance sheets and start from scratch.

As regards the macroeconomic wheels, we know society likes to have three platforms in providing support - education, health and social welfare - for those who are temporarily out of work. If one thinks it through, this can only be funded from income - corporate, individual and household. In conurbations and places where people live, they live in properties which command a market rent. Every property does, regardless of whether it is a farm, a factory, an office or a school. There is an economic rent. The site values of these properties are the residual values from the capitalisation of the yields-----

Vice Chairman: I ask the Deputy to, please, not start again.

Deputy Peter Mathews: This is very simple, although nobody is saying it.

Vice Chairman: When the Chair speaks, the Deputy is expected to stop.

Deputy Peter Mathews: The Chair should gag me the next time.

Vice Chairman: I will do more than that. The Deputy should conclude immediately

Deputy Peter Mathews: I will, but, first, I ask that the issue of household debt be examined because that is the problem the country has.

Vice Chairman: I thank Professor McHale and the members of his advisory committee for coming. I thank them for giving of their time - nearly three hours. The discussion has been extremely useful and engaging.

The joint committee adjourned at 4.45 p.m. until 2 p.m. on Wednesday 10 October 2012.