DÁIL ÉIREANN

AN COMHCHOISTE UM AIRGEADAS, CAITEACHAS POIBLÍ AND ATHCHÓIRIÚ

JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM

Dé Céadaoin, 24 Aibreán 2013

Wednesday, 24 April 2013

The Joint Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Senator Thomas Byrne,
Deputy Pearse Doherty,	Senator Paul Coghlan.
Deputy Stephen S. Donnelly,	
Deputy Simon Harris,	
Deputy Joe Higgins,	
Deputy Heather Humphreys,	
Deputy Kevin Humphreys,	
Deputy Mary Lou McDonald,	
Deputy Michael McGrath,	
Deputy Peter Mathews,	
Deputy Kieran O'Donnell,	
Deputy Arthur Spring,	

DEPUTY LIAM TWOMEY IN THE CHAIR.

The joint committee met in private session until 2.10 p.m.

Fiscal Assessment Report 2013: Discussion with Irish Fiscal Advisory Council

Vice Chairman: I welcome members of the Irish Fiscal Advisory Council: 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. Dr. Róisín O'Sullivan is unable to attend today's meeting and has sent her apologies. Ms Rachel Joyce is also in attendance.

The format of the meeting is that Professor McHale will make some opening remarks, followed by a question and answer session. I remember members, witnesses and those in the Public Gallery that all mobile telephones must be switched off. I advise the witnesses that by virtue of section 17(2)*(l)* of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you are directed by the committee to cease giving evidence in relation to a particular matter and continue to so do, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given and are asked to respect the parliamentary practice to the effect that, where possible, you should not criticise nor make charges against any person or entity by name or in such a way as to make him, her or it identifiable. Members are reminded of the long-standing rule 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 either by name or in such a way as to make him or her identifiable.

I call on Professor McHale to begin.

Professor John McHale: On behalf of the council, I thank the committee for providing us with the opportunity to attend to explain our most recent assessment. The council views interactions with this committee as integral to our work. In addition, this is our first appearance as a statutory body before the committee, following the passing of the Fiscal Responsibility Act. Other members in attendance today are Mr. Sebastian Barnes, Dr. Alan Barrett and Dr. Donal Donovan. Unfortunately, Ms Róisín O'Sullivan, who is based in the United States, cannot attend today. Mr. Diarmaid Smyth from the council secretariat is also present.

Today I will cover our fourth assessment report which was published on 10 April. The report is written in line with the mandate of the council. Its main purpose is to assess the macroeconomic and budgetary projections set out by the Government in budget 2013, including the appropriateness of the overall fiscal stance in advance of the stability programme update. The report also considers compliance with the budgetary rule set out in the Fiscal Responsibility Act.

There were a number of developments post budget 2013 that had a bearing on the conclusions reached in the report. First, the fiscal outturn in 2012 was significantly better than had been estimated in budget 2013. The Department of Finance had estimated a general Government deficit of 8.2% of GDP in 2012. Based on end of year Exchequer returns and higher than expected nominal GDP, a deficit of 7.7% of GDP was assumed in the fiscal assessment report. On Monday, the CSO reported that the 2012 general Government deficit was 7.6% of GDP which was also well below the programme target of 8.6%. Second, the promissory note transaction, while having a limited effect on the deficit this year, is estimated to reduce the deficit in 2015 by 0.6% of GDP. Cumulatively, the impact of these developments is estimated to be equivalent to about €1.6 billion of additional adjustments over the period 2014-15. This is based on technical adjustments made by the council to budget 2013 projections. Given this and assuming full implementation of the Government's planned €5.1 billion in adjustments over 2012-1015, the general Government deficit in 2015 now appears likely to be close to 2% of GDP compared to the official forecast of 2.9%.

In our previous assessment report last September the council assessed that the fiscal stance was conducive to prudent economic and budgetary management. However, recognising the uncertainties surrounding growth and credit worthiness at the time we made a case for the need for a further €1.9 billion in additional budgetary adjustments. We argued that this would provide a margin of safety to ensure the successful achievement of programme targets, given the fragility of the Government's fiscal position. In this report, taking on board post budget 2013 developments, we are no longer making the case for this additional adjustment. Given the recent developments, the margin of safety argued for by the council in previous reports has been largely achieved. However, the Government's planned adjustments of €3.1 billion in 2014 and €2 billion in 2015 should not be reduced. There is no room for complacency, notwithstanding the recent success in meeting fiscal targets. Even with the implementation of the planned €5.1 billion in adjustment in 2014-15, analysis by the council suggests there is approximately a one-in-three probability that the deficit to GDP ratio would be above 3% of GDP in 2015 in the absence of offsetting adjustments.

The fiscal assessment report again highlights the significant challenges remaining on the expenditure side to 2015. Expenditure pressures in health and social protection in 2012, in part driven by service demand, have underlined the implementation challenge. The payroll savings envisioned under the Croke Park extension agreement represent a significant component of total planned expenditure reduction. The macroeconomic environment also remains unusually uncertain. While there are tentative signs that the domestic economy is stabilising, the external environment - especially in Europe - has weakened since the publication of the budget.

Budget 2013 projections imply compliance with the national budgetary rule in 2013, 2014 and 2015. The structural balance, namely, the general Government balance adjusted for the cycle and one-off factors, plays a key role in both domestic and EU rules. In this report, we have drawn attention to the need for the development of a more comprehensive domestic analysis around estimates of the structural budget balance. A robust return to State creditworthiness, which has continued to show the improvement highlighted in the September 2012 fiscal assessment report, should be further reinforced by the recently announced extensions to the maturities on EFSF-EFSM loans. Post-programme precautionary funding arrangements could also help underpin a sustainable return to market funding.

Again, I thank the committee for providing us with the opportunity to attend today. Since our last appearance, the budgetary outlook has improved and fiscal objectives in 2012 were complied with by a comfortable margin. However, significant challenges remain. We look forward to once again hearing the views of members and taking any questions.

Senator Thomas Byrne: I apologise on behalf of my colleague, Deputy Michael McGrath, who cannot be present for the entirety of the meeting. The council's assessment, restated today, is that the planned adjustments of €3.1 billion in 2014 and €2 billion in 2015 should not be reduced. Given that we are likely to overshoot the runway, so to speak, by going beyond the 3% target, is there a case for easing up by approximately €500 million to €600 million this year in order to give a boost to consumer spending and confidence in the economy? There appears to be some talk of that and Ministers seem to be rushing to the press with predictions of tax cuts. Do the council members believe it would be a good idea for the Government to do that? Would it benefit the economy?

Professor McHale stated that by 2015 there should be some room for pay increases or tax cuts and increases in social welfare benefits. What would the council opt for in the in the first instance?

My next question relates to capital expenditure. Does the council believe the Government is getting the mix right in regard to current and capital expenditure? The capital budget was underspent last year by €145 million and the consequences are plain to be seen. In County Meath and other counties one can see the roads crumbling which has to do with the fact that this money was not spent. To the end of March 2013 only €387 million was spent on capital projects, which is a very low figure. Is the Government depriving the economy of much-needed investment? Should it do more on capital spending this year? Is it getting the mix right between current and capital expenditure?

The Government did not listen to the Irish Fiscal Advisory Council when it asked for further measures. Whatever happened last year with one-off measures etc., the Government is going to exceed the targets the council set. The council needs to become trusted to deliver a clear and objective analysis on budgetary issues in its statutory role. However, the Government ignores it on a regular basis as we have seen. Does the council have work to do in getting its message across both to the Government and the general public?

My next question relates to the Department of Finance's archaic accounting methods. At one stage the council indicated that the Department will never go beyond stating that tax revenues appear to be on target. I believe the council admonished the Department over the lack of transparency in why and how it changes its projections throughout the year. Could the Department do more to improve the transparency of the monthly Exchequer returns?

A debate has emerged in recent weeks, including an intervention by the Minister for Social Protection, Deputy Burton, and the President of the European Commission, over austerity and whether we need more measures to stimulate growth at a European level. Does the council have any views on this debate?

Vice Chairman: I thank the Senator for being clear and concise - I hope everybody can do likewise. I will outline the sequence of speakers so that everybody will understand the running order. It will be Deputies O'Donnell, Pearse Doherty, Spring, Donnelly and Mathews. I ask them all to be as concise as Senator Byrne - not looking at Deputy Mathews in particular.

Professor John McHale: I thank Senator Byrne for his important questions. I may call on my colleagues to answer some of them. He asked whether the planned adjustments of €5.1 billion for 2014 and 2015 should be reduced. I will recap on the council's analysis in calling for this margin of safety. It relates to the huge uncertainty about the fiscal picture, in particular uncertainty about growth but also uncertainty relating to the potential for additional bank losses. While there are many different sources of uncertainty, we have mainly focused on the uncertain growth picture.

Even with these new developments, including the promissory note deal, based on past forecast errors on growth we project there is about a one in three chance that the target of 3% of GDP will be missed in 2015. If we could be certain that the 3% target could be achieved, there would be scope for reducing the €5.1 billion in adjustments. Unfortunately because there is so much uncertainty on growth, to give us the margin of safety to ensure the 3% target will be achieved, we believe it is useful to aim for something closer to 2% of GDP under the central growth forecasts. Then if there are some adverse growth shocks, we could still meet the target.

That raises the question of why it is so important to meet the target. We have seen that Ireland's success in meeting its main fiscal targets has had a very positive effect on Ireland's credit worthiness - ten-year bond yields have now moved down to approximately 3.5%. There has been considerable success on a key objective of the programme, which was to restore Ireland's borrowing capacity. Much of that is due to the success in meeting the targets. Having this additional buffer or margin of safety to ensure we can meet that key 3% target by 2015 keeps us on track in terms of the perception that Ireland's fiscal situation is being brought under control, that the deficit is bring brought down according to plan, and that we are on track to stabilise and start to reduce our debt-GDP ratio.

Senator Thomas Byrne: If the Government were to introduce measures in the next budget, would that increase uncertainty over us reaching our targets?

Professor John McHale: If the Government reduces the planned adjustments, the probability of meeting the 3% target gets reduced. The Senator mentioned €500 million or €600 million worth of easing relative to that €5.1 billion target. The central forecast would probably be for a deficit still below 3% of GDP by 2015, but given the huge uncertainty over growth, things do not work out according to those central growth forecasts. There is still considerable downside risk relating to uncertainties about the balance-sheet recession that is affecting the domestic economy, but also huge uncertainty over the European economy. So there are still major uncertainties. To keep things on track and reinforce the progress that has been made already, we believe it is appropriate to keep this margin of safety in place.

There is good news. In our previous report we had indicated that additional adjustments beyond the €5.1 billion would have been required to achieve this margin of safety. There is very welcome news with last year's Exchequer returns coming in somewhat better than had been anticipated in budget 2013, the fact that nominal GDP turned out to be slightly higher than anticipated in the budget, and also the significant effects of the promissory note deal. These are welcome developments that allow the margin of safety, which we believe to be the wise course, to be in place without having to go beyond the planned €5.1 billion adjustment.

Professor Alan Barrett: Senator Byrne asked about capital expenditure. I cannot give a very clear answer, but I can talk about principles and a bit of history. We all know that in an austerity programme capital spending is the first thing to go. Obviously it is easier for the Government not to do things than to stop doing the things it is doing. With the austerity programme in the 1980s there was very little capital investment in that period, which acted as a blockage to economic growth in the late 1980s because the problems became so acute. We were somewhat lucky because it was in the late 1980s that the European moneys came in and, in a sense, provided the sort of money required to carry out the sort of investment the Senator mentioned. There is a real concern that politics being politics capital expenditure gets depressed and it could well happen that we overdo it. We need to be clear and careful that we do not do this.

What is needed is a much more strategic approach to the austerity programme. A group such as ours is sometimes concerned that the Government's approach might simply be to make the savings wherever they can be achieved - that it would not be done on a strategic basis, as we would wish, but more in a pragmatic way. We would be urging that these issues be considered much more carefully than has probably happened to date.

Senator Thomas Byrne: Is the Government's approach to capital expenditure with the undershooting of capital targets a blockage to economic growth, similar to what Professor Barrett described happened in the 1980s?

Professor Alan Barrett: Ultimately it could be. I will not try to give a definitive answer on it. One would certainly worry that with a prolonged period without public investment, when the economy takes off again there could be problems. With the economy so much smaller than it is, there are good reasons for saying we do not need the levels of investment we previously had or that might have been envisaged. This needs to be considered in a clear and strategic way. One wants to get away from austerity being simply based on what can be got away with rather than what makes good economic sense.

Vice Chairman: I call Mr. Smyth who should be good at accounting.

Mr. Diarmaid Smyth: A couple of points were made on the transparency of the Department of Finance and Exchequer returns. It is the council's job to raise awareness about these matters. The way the Department of Finance does its forecasting and presents its figures is complex and is a bit of a black box. It is part of the council's job to raise awareness. For example, in the report the council went to great lengths to explain how the Department makes short-term and medium-term forecasts. To our knowledge that process has not been documented in Ireland before. Obviously we examine the accuracy of its forecasts and check for errors. We knew that the budget was overly pessimistic about the outlook for last year and the error was about 0.5% of GDP.

Exchequer returns evolve. The Deputy may have said that they were archaic but the Government has made progress. Exchequer returns now have an information note attached every month to describe the main developments. The Department also publishes tax profiles and explains how taxes are relative to profiles. It has done the same for expenditure in the past. There have been improvements. It also an analytical presentation on Exchequer returns. That is a great advance. It shows things like PRSI receipts, appropriations-in-aid, non-tax revenues and a lot more details. More information is being provided on the Exchequer.

There is one big positive about the Exchequer numbers. They are released very quickly and are usually published on the second working day following the end of the month. As members will know, there is a time lag when it comes to a lot of data in Ireland. In defence of the Department, its information is timely.

A great advance was made this week. The Central Statistics Office published Government statistics that showed a lot of information on the financial and fixed assets of the Government, measures of gross debt and net debt. That is a major advance and the council will examine the data in more detail in future reports.

Dr. Donal Donovan: Senator Byrne made an important distinction between austerity in Ireland and the euro area. Sometimes that is not recognised when people talk about austerity in general. The report and the council's chairman comments cover austerity in Ireland and I do not have anything much to add.

Euro-wide austerity is not within the remit of the Irish Fiscal Council. I shall offer my personal view, one that my colleagues may not share. When one examines macroeconomics in Europe a case can be made to do more given that there is not much scope for further stimulus arising from monetary policies. I am not saying that an overwhelming case can be made, just a strong and respectable one. The northern countries who are not under the same debt constraints could do more by way of fiscal stimulus or they could do less by way of fiscal consolidation. Quite a number of economists, though not all, share my view, including many with a centrist position and not only the liberal position. It is not for Ireland to determine the matter, but the Germans. So far, and partly as a result of timing, the view that Germany and others should expand more has not found sufficient favour with a fairly significant majority of the German electorate, and not only the Chancellor. That is where we are.

Professor John McHale: If I could return to the question by Senator Byrne that Ireland is being ignored. Many people have said the same. Perhaps the council is less sensitive because we have not seen it that way.

Each of our reports has stated that the Government's fiscal stance is appropriate and in accord with the language of the new fiscal responsibility Act "conducive to prudent economic and budgetary management". We recognise that a judgment call must be made on how to trade the damage done to the economy by additional fiscal adjustments against the advantages in order to improve the fiscal situation and credit worthiness of the State in the long run. That is a difficult call to make. In the reports we made a case for going a bit further in terms of planning adjustments to provide the margin of safety that we talked about before. We made it very clear that we would not, considering that the Government would be following an imprudent overall policy if it did not follow that particular piece of advice. That fact has been missed along the way.

We have asked the Government to provide a more formal response to our reports. It began doing that in response to our last report, the Medium Term Fiscal Statement, MTFS, and it will respond accordingly to our most recent report, the Stability Programme Update. The council felt that the Government's reaction was a little too quick and off the cuff initially. It is important for us to put a more considered response in the appropriate publication and we are happy that the Government is pursuing that.

Some people thought that as soon as the Government did not do exactly what the council told it to do that we should resign. If we were a bunch of prima donnas perhaps that is what we would have done. However, we see ourselves in it for the long haul. The real value of the council will be seen in the longer term, particularly in good times which will come again. I hope that the good times will come again and that we do not repeat the same mistakes.

In the short term, I hope that the council will add to the debate on fiscal policy, give different views and various types of analysis. A small fraction of what is covered in the report was revealed in the opening statement or covered in the press. We carry out a lot of analysis. Mr. Diarmaid Smyth talked about some of it when he mentioned that we analyse macroeconomic and budgetary forecast methods and errors. The council hopes that its analysis will add value and deepen the debate on fiscal policy.

Vice Chairman: Before I move to Deputy Pearse Doherty perhaps the delegation will say more on the way Europe seems to be a little behind the international economic trend of quantitative easing. The United States, the UK and China are doing it and Japan has launched a huge programme on same. What advice can the council give to the Government if Europe decides to take up what Mr. Barroso is saying or is said to be saying?

Professor John McHale: Does the Vice Chairman mean quantitative easing should be given to European countries?

Vice Chairman: No, to us.

Professor John McHale: Is he asking what we should be pushing for in Europe?

Vice Chairman: Yes.

Professor John McHale: I agree with the distinction between an evaluation of a fiscal policy and a broader macroeconomic policy at European level and what is happening at the Irish level. There are clear signs that overall European policy, both monetary and fiscal, is too contractionary given the weak growth and weak employment performance of the European economy. On the fiscal side, under the rules of the Stability and Growth Pact, it has a national focus. It focuses on each country in order to reach budgetary targets but not enough attention has been placed on the overall fiscal stance of the eurozone economy, particularly no real source of pressure is placed on the stronger countries, that Dr. Donal Donovan mentioned, to use their fiscal space. It could give the eurozone a more expansionary stance which is important for improving Ireland's growth performance and the European economy more generally.

On the monetary side, the institutional set up of the European Central Bank has almost completely focused on price stability. The US Federal Reserve has a dual mandate that focuses on employment and price stability. Unlike the Federal Reserve, the single mandate in the European context creates a bias against taking the type of stimulatory policies that may be needed.

The European Central Bank has done some important things but not quantitative easing. That is not part of its toolkit. I am talking in terms of the longer-term refinancing operation, LTROs, which provide finance to banks for a three-year period by way of a huge injection of liquidity. The LTRO was introduced towards the end of 2011 when there were major concerns about where Europe was heading and the survival of the euro. The operation is having a very positive effect. The outright monetary transactions, OMT, programme was announced during a period of great concern about the survival of the euro. This had led to substantial increases in bond yields in countries that were considered in some way vulnerable. The programme had a highly positive effect on countries such as Spain, Italy, Portugal and Ireland and has been partly behind the significant falls in bond yields that occurred since.

It is not the case, therefore, that the ECB has not done anything. It has taken some important and critical steps for the survival of the eurozone. There is, however, a strong argument that it should do more, for example, it could further reduce interest rates. While the current rate of 0.75% is low, there is scope to reduce it further. There is also a need for greater clarity on the outright monetary transactions because they have not been used and strict conditions are in place about when the ECB would use them. Certain countries qualify for an outright monetary transaction when they do not need one, while I sometimes wonder if countries which needed one would qualify for one. This has yet to be tested and Ireland could provide a useful test case to show that the OMT programme can make a positive contribution to securely allowing countries to regain access to market funding. We will have to see how that plays out. To give a general answer to the question, both on the fiscal and monetary side, I agree with Dr. Donovan that there is certainly scope for Europe to do more.

Deputy Kieran O'Donnell: I welcome Professor McHale and his colleagues and commend them on their comprehensive report. To return to the issue of the domestic economy and employment, I note an interesting figure on the outturn for 2012 showing that growth in GNP was significantly higher than growth in GDP. This is not usually the case in Ireland. Real GNP growth in 2012 was 3.4%, whereas real GDP growth was 0.9%. This leads one to believe there are issues with the domestic economy. I ask Professor McHale to comment.

Higher growth is forecast in GDP than GNP in 2014. The projections in the budget were for 1.5% growth in GDP and 0.9% growth in GNP, which is a reversal of the outturn in 2012. Why is this the case?

Consumption declined in 2012 and projections from the Government, ESRI, Central Bank, European Commission and International Monetary Fund all indicate consumption will decline in 2013. Projections on investment vary, with some of the forecasts indicating growth while others indicate a contraction will occur. What are the witnesses' views on the performance of the domestic economy? I ask them to respond in the context of investment and to decouple the international and domestic economies. How will we secure significant employment growth? I ask them to respond in the context of President Barroso's comment on austerity.

Professor John McHale: Deputy O'Donnell has asked some very important questions. An examination of the performance of the domestic economy, net export economy and the forecasts made by the Department of Finance for these separate economies, shows clear evidence of the highly negative effects of what economists describe as the balance sheet recession in the wake of the financial crisis. The financial crisis devastated balance sheets across the economy, not only the Government's balance sheet but those of financial institutions, businesses and households. This has affected credit availability and led households and businesses to try to repair their balance sheets. One aspect of repairing balance sheets is to cut expenditure and investment, which has been a significant drag on the performance of the domestic economy.

Deputy Kieran O'Donnell: Why was real GNP growth 3.4% in 2012 while GDP growth was only 0.9%? This gives a differential of 2.5%.

Professor John McHale: I was building up to that issue, which I will address in a moment. The bad news is the devastating effects of the balance sheet recession. There were tentative signs last year that the domestic economy was stabilising. If we compare domestic demand in the fourth quarter of 2012 with domestic demand in the fourth quarter of 2011, one finds that it was essentially stable in the period. While stable is nowhere near good enough, given what we had been through, stabilisation is the first step we need to take. In addition, consumption and investment grew in the second half of 2012 and members will see a pattern of retail sales that was broadly consistent with a stabilisation of domestic demand and the domestic economy.

There are renewed signs in the early part of 2013 of weakness in retail sales. It is too early to tell if this is the case and it is hoped the pattern of stabilisation of domestic demand will continue. Just as the news on domestic demand was getting better, we see a worsening of export performance, ultimately in terms of net exports, as a result of weaknesses in our trading partners, particularly the eurozone and United Kingdom. The UK's official forecasting agency has revised its growth forecast for the country for 2012 by halving it to 0.6%. These factors are acting as a drag on the economy and some of this is probably spilling back over to domestic demand. There are signs, however, that stabilisation is occurring.

In terms of the distinction between GNP and GDP, growth in the former lagged behind growth in the latter for a number of years. People viewed this as a sign of weakness in the domestic economy as the difference between GNP and GDP is largely accounted for by the profits of multinational companies. If the international sector is doing well, profits among these companies will be high. A significant portion of GDP growth will then be subtracted when calculating GNP, which is, therefore, reduced. That this did not occur last year, when GNP grew, indicates that, based on the type of analysis that has been applied, there has been a strengthening of the domestic economy. As it happens, I would not read too much into these figures in terms of them being a positive sign. It seems certain that multinational companies are now domiciling themselves in Ireland. As a result, their profits are now considered an inflow of profits, which skews the numbers. There is considerable noise at present in these international income flow statistics.

Deputy Kieran O'Donnell: Are these figures a one-off event?

Professor John McHale: We will have to wait and see. While I do not wish to put Professor Barrett on the spot, he may wish to comment on this matter. However, we should be very careful with the GNP figures at present. There is a sense that people do not fully understand what is driving them.

Deputy Kieran O'Donnell: Normally one strips out repatriated profits from FDI so that GNP is lower than GDP. That is the case for the forecast for this year.

Professor John McHale: To be clear, in terms of it being lower, that would be the level. Even last year the level of GNP was significantly below that of GDP.

Deputy Kieran O'Donnell: I accept that.

Professor John McHale: The growth in GDP was higher. Due to the nature of the Irish economy and its dependence on the multinational sector, GNP each year-----

Deputy Peter Mathews: It is a difference of approximately 25% of GNP. That is significant.

Professor John McHale: It is perhaps closer to 20% lower.

Vice Chairman: I ask members to refrain from interrupting. A little bit is okay but not too much.

Professor John McHale: Certainly the domestic economy faces major problems but hopefully there are signs that the worst is over.

Deputy Kieran O'Donnell: I want to cut to the chase in the time remaining. Given that investment may increase or decrease this year, what is required? The majority of the people in Ireland are employed in the domestic economy. If we are to deal with the issue of unemployment, the key driver will come from the domestic economy. FDI is extremely important in providing employment but how do we get to the point where consumption increases, the domestic economy recovers and the banks lend for entrepreneurial projects? The banks will lend for a gilt edged project but we have to create an entrepreneurial culture so that people create employment. We seem to face the same question every year. We are dealing with people in the domestic economy who employ three, four or ten staff. They are struggling. We have had the macro discussion but I want to get to the real discussion. In the opinion of the witnesses, who are the experts in this area - I will not call them prima donnas but I want them to act as such for five minutes - and what is required to get the domestic economy going again? We have plastered the walls but now we want to put furniture in the rooms. That is a matter of putting people into jobs. The house is built and the walls are stabilised, which is great. What do we have to do to get lift off in the domestic economy?

Professor John McHale: Unfortunately, I do not have a silver bullet but it has been a significant achievement to begin this stabilisation process. We were in a situation where the vicious feedback loops between the banking system, the real economy and the public finances were driving the economy downwards and a key first step had to be restoring the creditworthiness of the State. Matters might have become significantly worse if that stabilisation had not occurred. Having said that, however, there is no doubt that SMEs are facing a difficult situation at present. The credit system is broken to a significant extent, in respect of the balance sheets problems of both the banks and business. Although the banks have been substantially recapitalised, they remain highly risk averse in the context of the uncertainties on the asset side of their balance sheets to which Deputy Mathews adverted. The Central Bank has also reported that 50% of SME loans are impaired, which is a legacy of the past. Many of these loans were associated with property-related borrowing. However these debts were incurred, they affect the creditworthiness of SMEs when they try to fund projects. As Deputy O'Donnell noted, a decent number of these projects potentially offer high returns but a legacy of past debt makes a company uncreditworthy even in respect of financing new and attractive projects. There certainly is a problem in the credit system and significant efforts are required to address it.

At the risk of saying something with which certain people will disagree, the win-win opportunities for restructuring debt are probably much larger in the SME sector than with mortgage debt. There is a general idea that the solutions exist for mortgage debt and if we only proceed with them, everybody will gain. The banks would gain by writing down debt and the mortgage holder also gains. It is much harder in the case of mortgage debt to achieve those win-win solutions, however, because in effect the bank is giving up an option in the hope that by reducing debt it will change incentives, possibly to earn more income, so that it ends up getting paid more. Those opportunities exist but they are scarce. SMEs are in a different position, however, because of the legacy of these debts from the past. SMEs have opportunities for profitable investments but they are not creditworthy because of this overhang of debt from the past. The possibility is higher for restructuring those debts in a way that will ultimately be good for the bank and the small business.

In terms of pressing things forward in a way that supports investment in the domestic economy and, ultimately, in jobs, it is important that we deal with the lack of credit flow to SMEs as a priority. This is not only a domestic issue because initiatives could also be taken at European level, such as supports from the European Investment Bank and, ultimately, the European Central Bank, for SMEs. This is a problem that needs urgent attention if we are to get the domestic economy going.

Professor Alan Barrett: The great problem for Ireland is how we get the domestic economy going but history will show that in the absence of a buoyant international economy it is next to impossible to do this. We have achieved a certain amount in the context of the international environment but, in regard to the points made earlier about being more proactive in developing supportive policies at European level, these will be critical to Ireland. Unfortunately, however, there is a sense that we have to wait.

We know economies fluctuate and that a European take off will happen eventually. We want to be in a position to take advantage of it, however. We spoke earlier about the need for infrastructure to be in place and to ensure it does not dwindle. Two issues arise on the SME front. The first is credit availability. One of the themes which emerged at a conference I attended on this topic which was organised by the ESRI last Friday was that we have to ensure our SME leaders are sufficiently equipped to engage with the banking system. A number of people argue that one of the effects of the Celtic tiger years was that it was so easy to get credit one did not really need the skills to make a convincing case. The bank was going to offer money no matter how bad the business case might have been. A generation of Irish entrepreneurs operated in that sort of system and they may not have the sort of training now required. There is also a problem on the banking side because an entire group of people were not trained. These two groups of people now deal with one another, when it was not part of the training to do so.

This leads on to a much bigger issue, the strength of entrepreneurship in Ireland. I do not mean the spirit of entrepreneurship but the technical ability to engage on the issues.

Deputy Peter Mathews: Capable lending?

Professor Alan Barrett: Essentially that is it. To the extent that we think our hands are tied on policy in Ireland, this is potentially an issue. We do not want blockages to growth when the system finally starts to move around. These are some of the issues that are coming to the fore. Even if one has a better flow of credit, unless the people who can go in and make the convincing case, there is another problem. This is an issue that policy makers need to think about.

Vice Chairman: I call Deputy Doherty.

Deputy Pearse Doherty: Cuirim fáilte roimh an Irish Fiscal Advisory Council anseo inniu.

The members of the Irish Fiscal Advisory Council may not be aware that following the publication of each of their reports I have called on the Government not to accept the main recommendation, in which it calls for more austerity measures. I am glad the Government did not accept its recommendation at that time. I see in this report, the members of the IFAC are suggesting the Government continues with the adjustment path in spite of the fact that a further €1.6 billion adjustment may not be required to reach the 3% target. If the Government had adopted the original position suggested by the IFAC, we would be overshooting by approximately €3.5 billion at this point. I know it is very difficult to predict and project the economic situation, but the council has got off to a shaky start to say the least.

I have made this point repeatedly but those who are watching this discussion at home are probably tearing their hair out at the failure of the members of the council to understand where people are at in their real lives and how they are trying to deal with additional charges and taxes when their pay has been reduced. They must listen to the five members of the council, each with high academic qualifications, including professors, arguing the case that the Government should overshoot the fiscal targets which will mean more pain and suffering. To some it will mean emigration and to others it might mean their family home is repossessed and all the other effects of austerity. I know the council members are limited by the way the Irish Fiscal Advisory Council was set up as a statutory body but there must be some recognition of what is happening in the country.

Why do the members of the council believe that we should overshoot the targets by €1.6 billion? They have argued to have a safety buffer but have they no understanding that while it may be great to have that level of protection, people want to have a little personal protection in their own lives? It is irresponsible of the council to recommend that the Government try to overshoot the targets because of the impact this would have on citizen and communities across the State.

Professor John McHale: I will try to separate out the points made by Deputy Doherty. He made the point about our shaky start. It is true that between the report that issued in September and our most recent report, the situation changed so that the additional adjustments beyond the Government's plan for which we had made a case were no longer required. We had to see what facts changed and whether we should have foreseen them. The main change was the promissory note deal. I do not think we could have been expected to have been in a position to anticipate the nature of that deal and as members will recall it was highly uncertain as to whether it would take place at all. Our basic thinking and the strategy we have been recommending, which is to have a margin of safety in place, has not changed but as certain facts changed the way the strategy gets translated into actual advice about the fiscal policy stands will change. I know people perceive us to have been wrong but I do not see how we could have anticipated what the savings on the promissory note deal would have been. I think it would be much worse, if in order not to make a mistake we just kept making the same advice even though the facts had changed. I do not accept that we have got off to a shaky start in terms of getting it wrong on that dimension.

The Deputy is right that austerity is having a significant negative impact on many people's lives. Nobody should recommend it lightly, given the pain that it causes. We must recognise that as bad as things are, if they are badly managed they could get substantially worse. In order to be able to phase the adjustment out over time, we need to be able to borrow. For a number of years we had not been able to borrow until quite recently from the financial markets so we were relying on official lenders. To remain creditworthy with the official lenders, we had to meet the conditions. To ensure one meets those conditions in a highly uncertain environment creates an argument for having some buffer in place. The important point is that the reason we are arguing for this margin of safety is to ensure we do not reach a situation in which we lose our ability to borrow when that ability to borrow is so critical to maintaining social spending, social protection, social services and so on. In terms of what matters in people's lives and avoiding imposing pain on them, I think we agree on the end point, which is to find the best way to ensure that as bad as things are at present, we do not take a risk of them getting much worse and we stay on a path to improving the situation. To respond to Deputy O'Donnell's question, we are starting to see positives. We have had two years of positive growth and while I accept the rate is far too low, we see signs of domestic demand stabilising. In terms of what the austerity programme set out to do, which was to get control of the public finances, bring down the deficit, initially stabilise the debt and then put it on a downward path and regain the creditworthiness of the State, in the middle of 2011 the bond yield was 15% whereas it is now down below 4%.

Deputy Pearse Doherty: I am well aware of that. May I make this point, and I am open to correction, the advice of the council to Government is to target a 2% deficit by 2015. The council would like the Government to hit that target and to sustain the adjustment which it believes will be 2% in 2015. Is that correct?

Professor John McHale: The advice is to try to ensure as best we can that we meet the 3% target. That is what we are trying to do.

Deputy Pearse Doherty: Let me put it to Professor McHale, the council has published a report which shows that with the current adjustments, it will reach 2% in 2015.

Professor John McHale: We have a one in three chance of it being over 3%.

Deputy Pearse Doherty: I understand that, and there is always a risk in making projections but the council has come down on the side that sticking to the adjustment will bring it down to 2%. It is not stated in the report that if the Government is reaching the target in the final year 2014, it could ease off the austerity measures. Professor McHale would want the Government to continue with these measures even if it had reached the target of 3% so that it could meet the

2% target by 2015. Is that correct?

Professor John McHale: No actually, I take the Deputy's point that perhaps this should have been covered in the report. Thinking ahead to being in that situation and being a little bit at risk of speaking for the other council members, if there was no uncertainty about meeting the 3% target we would not argue the case for sticking with the €5 billion adjustment and we would seek to lower it. We are getting to a situation where because we were getting close the uncertainty did not exist because we pretty much knew what the situation would be in late 2015. There was room to perhaps pursue an investment programme late in 2015. That is something I believe we would be able to support. The key thing is to meet the target.

Deputy Pearse Doherty: Professor McHale acknowledged in the report that there is nothing in it to the effect that the fiscal advisory council believes there should be a 3% target. The projections are that the Government will hit 2% and the council is saying it should stay on target, which can only be read as that the Government should stay on target and hit 2% by 2015. Is the advice to Government that it should hit 3% in 2015 and ease off if it believes when approaching that point that it will overshoot 3%?

Professor John McHale: Certainly the advice is to make sure the 3% target is met. In terms of planning the fiscal adjustments and putting them in place, which is what we were focused on, we believed that it was right to pursue the plan for the €5.1 billion adjustment. If, as we get closer to the end of 2015 it seems that the 3% target can be met without the full adjustments that have been planned, I do not see a reason why we would not be able to support such an easing. I take the point that it could have probably been better dealt with in the report.

Deputy Pearse Doherty: I welcome that, because from my reading of the report it is clear that the fiscal advisory council's target is 2%. What it is saying to the Government is not to overshoot the 3% target but to come in on it. There are different ways of doing that. The adjustments could have been done closer to the time if there was a belief that it would overshoot. The problem with the approach taken by the fiscal advisory council is that it has front-loaded the adjustments. For example, in the previous report it asked for additional austerity which would have been imposed on people and then if the Government found out it was overshooting the targets it would ease off, whereas where people and the economy require the Government to ease off is now in this period. Would it not be more appropriate to say that the Government should reach the 3% target but to make the necessary adjustments in each year to ensure that it comes in on target?

Professor John McHale: We will certainly give that approach some thought. I will allow my colleagues to contribute in a moment. I wish to say one thing in terms of the additional adjustments we had called for earlier; they were largely back-loaded to 2014 and 2015 so if it had turned out that they were not needed, as is the case, we would have been in a position then to say that they were not needed. It is a question of timing.

Mr. Sebastian Barnes: I want to emphasise the uncertainty. The year 2015 is a long way away in terms of both the amount of consolidation that still needs to be done and all the things that can happen in the economy. If one wishes to look back the other way, three years ago it was before the Greek crisis had reached its pinnacle and kicked off in a serious way. So much has happened in the three years. Inevitably, it means that for planning horizons one needs to have an idea of where one is going but one must adjust a bit along the way. We have adjusted our advice in the light of that but this discussion is useful in terms of thinking hypothetically about what we might do in 2015. Honestly, none of us really has much of an idea of what 2015 will look like so we must have an open mind about exactly what we think we will be doing at that stage and we need to make progress along the way as well, given the massive uncertainties to which Professor McHale referred.

Deputy Pearse Doherty: I have a few other questions. There has been much discussion on the flawed way the programme was designed. The head of the IMF mission said it was flawed and that it was the wrong type of programme. Others, including our great leaders in Europe, told us that austerity is not working. They said we had reached breaking point. Ministers have come out with similar statements in recent days. It is great that the penny has finally dropped. Some of us have been saying that for quite a long time. Does the fiscal advisory council believe that austerity has not worked in the context of the debate that has been taking place both internationally and domestically?

Dr. Donal Donovan: I will respond to Deputy Doherty, and if you do not mind, Chairman, I will make one or two comments about the remarks of Mr. Mody. He was part of the troika mission. He was not the head of mission; that was Mr. Chopra. I wish to correct that point for the record. He was one of a team of ten. When Mr. Mody retired from the IMF about six months ago, he gave an interview, which is slightly unusual because civil servants typically do not in general discuss all of the details of the decisions that were taken which involved ultimately political decisions by the head of the IMF, subject to the board of the IMF, which is itself a politically appointed board. In my experience that is a little bit unusual anywhere. That is one point.

Looking at the substance of what was said, Mr. Mody said that there were three options as he described it. The first was to burn senior bondholders, the second was the provision of long-term concessional assistance and the third was austerity. The way it came across was that it was all austerity and that austerity was a bad thing. We know about the bondholder story. There were debates at the time of the bailout and we know it was the intervention of the United States in the form of the US Treasury Secretary, not the ECB, who decided for good or bad, taking into account worldwide considerations. I am not trying to say it was right or wrong. That was decided by the IMF not to be an option.

I am a little puzzled by the second option because in November 2010 I do not think anybody was offering this country long-term concessional assistance. It certainly was not the IMF because it does not offer long-term concessional assistance to any country except the poorest countries in Africa. We are not and hope not to be in a situation such as Mali, which is the type of country that receives long-term concessional assistance. I do not think Chancellor Merkel and German taxpayers were willing to provide this country with long-term concessional assistance in November 2010. I found it a little odd that this option was suggested because I do not see it as an option and I certainly was not around at the time. Given those two options, such as they were, then one was left with austerity.

Deputy Peter Mathews: Were they not alternatives rather than options? There is a difference.

Dr. Donal Donovan: Realistically, one could talk about-----

Deputy Peter Mathews: An option is an offer. An alternative is a difference of opportunity.

Dr. Donal Donovan: No. Of course there were many alternatives. It is an alternative if someone comes and writes off all our debt but it is not necessarily an option. An option is something that is practical and meaningful and that is as I understood the way Mr. Mody expressed himself in the debate. The impression was given that he was against austerity. I find that hard to believe because I do not think anyone said that with a deficit of 11% of GDP - or 32%, depending on which year one calculates it - that we did not need to reduce our deficit, and the debt to GDP ratio was heading towards 120%. Of course one may argue on the margin as to whether the speed was too fast or too slow, as we are discussing today. The impression that came across, which I believe was wrong, was that austerity was imposed because the other two options should have been considered but were not and that austerity is a bad thing. That is wrong because regardless of anything, even burning senior bondholders, we would still have needed to reduce an unsustainable deficit from 12% down to 3% or other level. I do think a strong intellectual argument has been made that one did not need to do that and that one did not need significant austerity.

Deputy Peter Mathews: Adjustments could be made by taxes as well as cuts.

Deputy Pearse Doherty: While the joint committee could spend an entire session on that contribution, I will not do so. I acknowledge the Vice Chairman has being generous with his time. I have two further brief questions. Earlier, Professor McHale mentioned that the council had not factored in the taking on of the promissory notes as sovereign debt over a longer period and the impossibility of so doing. The Government continues to claim it is arguing for the retroactive recapitalisation of the banks through the European Stability Mechanism, ESM. Might the Irish Fiscal Advisory Council examine a number of scenarios as to how that might affect Ireland's deficit and the projections to 2015? Were such an occasion to arise, in which the ESM recapitalised the banks and we got back that money, the witnesses could appear before this joint committee stating we now needed to readjust. Can some forward thinking be done in this regard and would the council be willing to model it?

Before coming to my final question, I wish to make a point on one-off events such as the sale of the 4G network and so on. Is there a way to isolate one-off events when considering the deficit figures? My final point concerns the stimulus debate and I am glad the council has started to open up this debate. Despite not agreeing with the Irish Fiscal Advisory Council's major headline regarding the current path, I note its function is to provide advice, analysis and data. The key point in this regard is that the council is independent and this is the point at which I have something of an issue with this report. For example, in the context of the debate on the multiplier, the council has simply accepted the Government's model. What independent analysis has the council undertaken on the Government's model? While the council notes the extant literature and makes reference to the work of Professor Philip Lane, as well as to other models from the IMF and the Commission, it has come down strongly in favour of the Government's own model and its fiscal multiplier of 0.5. Moreover, the council has provided single year and single digit figures for multipliers in its report whereas, as the witnesses are aware, all the international literature states multipliers have a multi-year effect. However, the council does not outline this point. For example, the Bénétrix-Lane model has an average multiplier of four in the first four years, whereas according to the council's report, the Bénétrix-Lane model has a multiplier of 0.7 in the first year and that it turns negative in the third year. I am not 100% sure that is accurate. Moreover, there are other models and one could consider the analysis carried out by Bradley and Morgenroth on the multiplier in the south from European Union Structural Funds. They got an average of 2.88 in the long run but yet the council is opting for a figure of 0.5. The key to being an independent fiscal advisory council is that there is independent analysis but I am concerned the council has simply chosen the Government's multiplier in this debate. What independent analysis has the council carried out in this regard?

I also wish to discuss the ESRI's HERMES macroeconomic model. As a statutory body, would it be appropriate for the council to publish when it makes reference to that model? In the context of the HERMES model, when one considers an adjustment of €1 billion in terms of the deficit, do the witnesses agree that tax increases are the best way to reduce the deficit instead of expenditure cuts? If one examines the six areas the council has chosen, public sector pay cuts are the least effective way to reduce the deficit. I asked the witnesses to comment on some of these issues.

Vice Chairman: Before Professor McHale responds, I must ask for the answers to be short and concise because we have run on a little timewise.

Mr. Sebastian Barnes: Having conferred, Professor John McHale will engage with the multiplier questions, which are very important. As for the scenarios around the things that are hard to model but which can have an impact, such as the promissory notes previously, and obviously other issues concerning the ESM in particular, we have looked at those things a little. We have also looked internally at some scenarios. However, for the promissory note deal in particular, it was so complex that we thought it was not really helpful. Before we knew what was the actual deal it was very difficult because there were so many scenarios one could consider. We did not really have the full information. However, we certainly would think about taking on the Deputy's suggestion in the future, which is very helpful. Moreover, to do a little bit of advertising for our future work, Mr. Diarmaid Smyth and I soon will publish a paper that takes a comprehensive perspective on the Government's balance sheet. While I will not promise the Deputy that it will include scenarios, it will examine these general issues and is a way of trying to inform the debate because these issues are very complicated to think about. The use of scenarios is a good way to deal with problems when one does not know what is the probability but there is an impact and they are useful to have in the back of one's mind. As I stated, it was particularly difficult with the promissory notes because there were so many different things one could envisage. In addition, we were aware of the sensitivity of those discussions and consequently, it is right for the council to be cautious in that area.

As for the impact of the universal mobile telecommunications system, UMTS, licences, these are identified as one-offs in the data and, consequently, we try to look through that in our analysis of structural balances and the like. While I think it was documented anyway, our report also documents what were the Government's assumptions about that. It assumed it would be less than it actually was, which probably is a sensible approach to take, that is, to not spend money one is not really sure of getting and obviously there also were commercial issues. While we will continue to consider the validity of these assumptions and whether we think they are making reasonable judgments in these kinds of difficult situations, it is very hard to call the valuation.

Professor John McHale: On the multiplier question, as the Deputy will have seen, the council provided quite a comprehensive treatment of multipliers here, including a review of related literature, both domestic and international. We also have reviewed the recent debate that has been taking place between the financial institutions about multipliers that was kicked off by the IMF analysis indicating it may have been underestimating multipliers for a number of countries. Moreover, because of the uncertainty that exists in respect of multipliers, we have carried out a sensitivity analysis on the budgetary projections, based on alternative multipliers. Consequently, while based on our reading of the evidence, we saw no reason to think the overall deficit multiplier of 0.5 was not in the right ballpark. I acknowledge there always will be uncertainties around that but even in the case of the IMF analysis, its analysis did not point to an underestimation in the Irish case. In addition, while recognising that at present there are different factors affecting the Irish multiplier, a review of the literature shows on the one hand that economies in recession and coming out of financial crises tend to have higher multipliers. On the other hand, countries with high debt levels, particularly countries undergoing a credit-worthiness crisis, tend to have low multipliers. I refer to a highly influential study that has got a lot of attention for showing that multipliers are larger in recession. It actually shows the net effect of having a 100% debt-to-GDP ratio and being in a recession is a multiplier of close to zero. Based on the totality of the evidence, however, I do not believe this to be true. I believe there truly is a positive deficit multiplier in the Irish case. However, looking carefully at the evidence, limited though it is in terms of specific studies focusing on Ireland, there did not appear to be a reason to believe there was an obvious bias in terms of the estimate of a multiplier of 0.5. However, there is huge uncertainty, which is the reason the sensitivity analysis was important, in order that people who had different views could plug their multiplier in there and find out what would be the effects.

Deputy Pearse Doherty: I refer to the Bénétrix-Lane model, which studies the impact of a shock to the system. Does Professor McHale believe this does not apply in respect of the figures they have provided, which show an average multiplier of four over a four-year period?

Professor John McHale: We must take this discussion off-line, as I believe the Deputy is looking at the wrong figure. The key figure we must look at here is the impact on real GDP. They have a number of tables and one must do a little bit of digging in the paper to identify the multiplier estimate that matches the other literature we are considering, which is the overall GDP multiplier. There, the initial effect is 0.7 and then it declines rapidly. If anything, we are going in the direction of these multipliers having bigger effects over time, because essentially, we are assuming that 0.5 is not just 0.5 in the first year but also in the second year, third year and so on. It is likely that in Bénétrix and Lane these multiplier effects fall off over time, particularly when we look at after 2015. If I had any concern about these estimates, it would be that we may be overestimating the negative effects of adjustments that take place from 2013 to 2015, because we are looking at the cumulative adjustment and continuing to apply a 0.5 multiplier. Therefore, if there is a concern, I do not think it is that we are underestimating the multiplier effects, particularly for accumulated adjustments. We felt we did not have enough information to apply what is referred to in the literature as "impulse response functions", which show that if there is an adjustment in a particular year, the effect of it is on GDP over time. Effectively, we assume that to be constant multiplier of 0.5 over time.

There is room for debate about the size of these multipliers and that is why we thought it would be useful for the committee and people interested in this to see the effect of alternative multiplier assumptions on the key fiscal projections, both multipliers that are lower than 0.5, down to zero, and multipliers that are as high as 1. If the committee is interested in looking at the effect of multipliers that are higher than that, we would be happy to supply it with those simulations.

Deputy Arthur Spring: I welcome the advisory council here today. It is very beneficial for us to see that the council is conducting a critical analysis of the progress of the country, but that it is doing so in a conservative fashion. It is important for us to remind people that is the council's job. Other organisations, particularly financial institutions, are adept at conducting aggressive financial modelling.

The overarching question is when will austerity end. Many people take a simplified view and believe it will take approximately ten years before the country rights itself. We are trying to get to a position of prosperity, the opposite of austerity. However, we need a level of hope and a particular timeframe that will give people the confidence that we will attack this problem and overcome it. The question is quite general, but people would like to know when the council thinks austerity will come to an end and prosperity will return.

Professor John McHale: Unfortunately, I cannot give a precise answer to that. However, we can talk about some preliminary analysis the council has done, which we hope to publish in our next assessment report. The Department will have similar analysis in its upcoming stability programme update. However, we make the caveat that huge uncertainties surround the outlook.

The exercise we conducted was to see what fiscal adjustments would be required to do enough to meet all the fiscal rules that are now part of the Fiscal Responsibility Act, the budgetary rule and the Stability and Growth Pact, taking essential assumptions about likely growth out to 2020 and doing enough to meet all the fiscal rules. The key numbers coming from that are the numbers equivalent to the fiscal adjustment numbers we have become so used to, the €3.5 billion for this year, the €3.1 billion for 2014 and the €2 billion for 2015. Essentially, we were asking what those numbers would be from 2016 to 2020 under central growth assumptions and ensuring we stayed on the right side of all the fiscal rules. While the answer is only provisional and not ready for publication yet, the good news is that in 2016 we turn from having to make these difficult adjustments to positive numbers, which seem to be, in the ball park, in line to keep expenditure in line with inflation. It is far from a bonanza at that point, but it is a very different situation from what we face up to 2015.

This is based on a lot of assumptions and we have to see how things will unfold.

Deputy Arthur Spring: Does the professor think the budget for 2015 will see the end of austerity, if things go according to what we know at the moment?

Professor John McHale: Yes, if things go according to what appear to be the best estimates of growth projections.

Deputy Arthur Spring: That is something people here would like to hear. Then we would be back in clover, potentially, just before the next general election of course.

Professor John McHale: Do not forget all the caveats.

Deputy Arthur Spring: I am only kidding. I would like to move on now to forecasting. The professor has said that the models to which he has referred are quite simplistic. We are looking at different elements of modelling. The comments made in the debate generated here over the past two weeks about quantitative easing have been like a broken record. It has been said that austerity is not the only way and that we must have a level of quantitative easing because there is a knock-on effect for the Germans, the French and everybody else if we do not consume their goods. As the Chairman said a while ago, the other large economies of the world have commenced quantitative easing and in order to give ourselves a relative advantage, we need to get to that position. I have been advocating for this for two years, but the debate at European level seems to have kicked off that we cannot keep imposing further austerity. The Government would like to be finished with austerity as soon as possible, but if there is quantitative easing of any size, what kind of effect will that have on our economy?

I have another question related to forecasting. If there is an increase in disposable income for people currently in arrears on their mortgages and if the personal insolvency resolutions allow them to get back to contributing a little more to the economy, what impact will this have on the economy? Will it be positive? How will we deal with the recapitalising of the banks in order to have the write-down or write-off to which the professor referred? Also, we were told that in a prudent economy, some 6% of GDP should be held in savings at any point in time. At the height of the boom we held approximately 2%, and now we are being told we are at approximately 15%. People are being overly conservative with regard to how they approach the savings model currently. In terms of forecasting, the professor mentioned a probability of 1 in 3 of getting to 3% of GDP, a 33% chance. That is a conservative outlook. However if quantitative easing kicks in and we have a little more disposable income in the economy and if people start to release their savings and spend, how much of an impact will that have on finishing with austerity?

Professor John McHale: Mr. Barnes will begin with the question on quantitative easing.

Mr. Sebastian Barnes: Quantitative easing is a very relevant issue. However, with quantitative easing central banks are essentially in unknown territory and as economists we are very uncertain about how and whether it works. Before we get there, the ECB should use its existing policy space to cut rates from their current levels. I do not think this will make a huge difference, but it will help. It would particularly help banks that are having to lend at the main re-financing rate of the ECB, not in the market, particularly in peripheral countries. For that reason, rather than for the overall reduction, this would be useful.

At the same time, a key problem in Europe is that even if they cut the rates, the monetary transmission mechanism is basically broken. Therefore, we see massive spreads to real economy lending and difficult credit conditions in many countries, including Ireland. The ECB, through its operations, has done a lot already to help in that regard, but it has not gone far enough. The ECB needs to look at ways of helping credit for small businesses and a range of other measures that one might think would have a quantitative easing aspect but which are really aimed at trying to get monetary transmission working again. In this respect, a key message is that the ECB needs to follow its mandate more carefully.

There is discussion with the US regarding a joint jobs growth and inflation mandate, but in Europe core inflation is 1%. It has been 1% for a long time and predictably it will remain at 1% unless they do something about it. I believe it is not about asking the ECB to do anything. It does not need to change the mandate, but it needs to take the actions required to meet its existing mandate.

Deputy Arthur Spring: What effect would the implementation of a little quantitative easing over the next two years have if it was just simply targeted at the peripheral regions in the form of credit?

Mr. Sebastian Barnes: Over and above these issues that are aimed at trying to make monetary union come together more, there is a need to ease overall monetary policy generally. This is my view rather than necessarily that of my colleagues or my employers. In that context, it is long past time in Europe to engage in quantitative easing programmes. As economists, we know very little about how quantitative easing works. In particular, it is clear that it has an impact on banks' balance sheets but whether that translates into things in the real economy and how it is supposed to translate is very uncertain and, therefore, to some extent, it is a bit of a leap in the dark. We know that it seems to have an impact on exchange rates and the strength of the euro, which is unhelpful to Irish businesses. This is in no small part due to the fact that we have not engaged in quantitative easing. That is also relevant to the exchange rate against sterling. The UK example shows that depreciation does not necessarily create miracles for export performance. Hopefully, Ireland will be better placed to profit from that but it is difficult. All central banks are in the mode of trying to use unconventional policies, whatever they may be, to push things forward. The exchange rate will clearly help in the Irish case but we should not expect miracles because these are policies that are untested and untried and we do not understand their impact.

Dr. Donal Donovan: It is useful to look directly at the Irish banking system and ask what is the nature of the problem and whether quantitative easing will have any impact. Indirectly, as Mr. Barnes pointed out, it could have a broad, euro-wide impact in terms of improving activity but in the case of the Irish banking system, at least as I understand it, the issue is not one of lack of liquidity - it is not as though the Irish banks do not have money to lend - it is that they do not wish to lend for various reasons as they are constrained. The pressures exercised by the Central Bank and the Government in strongly urging the banks to engage with their customers - households, SMEs, buy to let and so on - to address the problem of debt arrears is extremely important. This is not just a question of getting the banks to recognise the reality of their situation, use up the capital they have to make provisions, which they should have done earlier, and write their balance sheets to make them look better.

There are economic advantages. The first is huge numbers of people in the banks now are devoting themselves to looking after arrears, chasing up money from people and so on. The sooner they deal with this and get it over with, the sooner they can go back to doing their real business, which is to lend money to creditworthy people but it has become an all-consuming exercise for many of the banks. The second advantage, to which Mr. McHale referred earlier, is there is huge uncertainty among lenders and borrowers as to the true status of the borrowers financial situation because in the absence of sorting this out, which may mean write-offs or whatever, nobody quite knows whether SMEs or households are in a position to borrow. We do not know how creditworthy they are but once we sort it out, park or write down some of the debt, it will be better.

The third advantage, which is often forgotten, is foreigners who are thinking positively of coming back into Ireland and investing in Irish banks do not see the banks recognising these losses. They worry that the losses that could be out there are large - greater than have even been allowed for by the bank recapitalisation by the Government. Naturally, if they do not know, they think the worst but if the losses are crystallised and if as seems not unlikely they will turn out to be broadly consistent, though one cannot be sure, with the provisions for which there is capital, everyone can breathe a sigh of relief because we will know where we are and they can go back into profitable Irish banks and start doing business.

I see these as the key issues rather than worrying too much about the quantitative easing at European level because it is a bit academic from Ireland's direct point of view.

Deputy Arthur Spring: If we think that there are elements outside of our control, which could go in our favour, what is the general thinking on front-loading versus back-loading the adjustments domestically? If elements can go in our favour, surely we should back-load the adjustment because it will make it easier for people in their day-to-day lives.

Dr. Donal Donovan: I am sure there are many thoughts on this but if one looks at the one measure of the figures Ireland's adjustment has not been particularly front-loaded compared to experiences in other countries and historically. Going from 11% to 7.5% with full respect for what Deputy Doherty and others said, this is tough for many people. One reason for that is that they were at a totally unsustainable level-----

Deputy Arthur Spring: And they are at an unsustainable level debt wise and in the context of the cost of living.

Dr. Donal Donovan: It is very tough. Going from 11% to 7.5% in four years is not in my experience close to the draconian end of the spectrum. It is in the middle based on historical experience. Although people may feel it has been front-loaded, one can argue that it has not been that much. People have different views on whether it should have been more front-loaded or back-loaded. My personal view is that there are significant merits in many ways to front-loading. There are advantages in terms of being able to get things over and reducing uncertainty. Austerity would be over sooner under front-loading and it offers more confidence going forward and perhaps more flexibility.

Mr. Sebastian Barnes: To the extent that the kind of good news that might come from the ECB is good news must be seen in the context that they are only acting because things are worse in the euro area than expected. At best, it will only be a partial response to the problem. It is a serious concern that one of the downside risks going forward is that not enough will not be done in Europe and there will be stagnation in the eurozone as a whole in the coming years. That would be a difficult environment for Ireland to grow in. In some ways the OMT has been successful in reducing spreads but it has also let governments around Europe off the hook a little because markets do not respond to bad decisions in the way they used to. If members look at what happened with Cyprus or the spreads for Italy, despite the political events over the past few weeks, there has been little response to that in the markets because the OMT is holding everything together but that means some important decisions are not being taken because market pressure has eased. Hopefully, there will be good news from the ECB but it has to be seen in context.

Professor Alan Barrett: The Deputy began his questioning referring to simplistic economic models. We use that term when we talk about forecasting but when it comes to policy analysis and its impact, we have the HERMES model referred to by Deputy Doherty earlier, which is housed at the ESRI. One of the things one finds when one does the sort of policy simulations mentioned by Deputy Spring, which taps into what Mr. Barnes said, is the importance of what happens in Europe is so critical that it feeds into the model quickly and one sees the effects are seen dramatically. This is the great difficulty. If Europe stays where it currently is for a prolonged period, things will be difficult. We can also then measure consumption and what would happen if we experienced a turnaround in consumption. That is the virtuous cycle that we would like to see because consumption is not just good as an end in itself because it tends to be tax and employment intensive and one gets the positive feedback loops that one wants. We can do the policy analysis - I do not have the figures in my head - with a much greater degree of sophistication. It is not perfect but there is a tool to do the things the Deputy is asking about. Intuitively, they show up if one runs them through the model.

Deputy Arthur Spring: Would front-loading or back-loading be Professor Barrett's preferred option?

Professor Alan Barrett: I am in the Donovan camp on this one. There is a political dimension to this in that it is very hard for governments to sustain austerity programmes. That is probably not a big shock.

Deputy Arthur Spring: Is Professor Barrett free to attend a few public meetings?

Professor Alan Barrett: I would not even attend a private meeting on that issue. If people have a sense that a government is getting this over more quickly, it holds out the prospect of a return to more normal times whereas extending the possibility that austerity will hang over the country is problematic. The Deputy made the point that because things might run in Ireland's favour, perhaps we should postpone. For every thing that can go favourably other things can go against.

Deputy Arthur Spring: We no longer think like that around here.

Potentially the ESM may recapitalise the banks retrospectively. Representatives of AIB and Bank of Ireland have suggested to the committee that might not be necessary and they could approach private institutions to recapitalise themselves. On the banks' cost of funds, the blended rate filters down to the interest rate people pay for their mortgages, day-to-day spending, etc. At the moment we have extensive access to the European Central Bank as a source of funding. If we went towards the ESM, would we have a higher level? If we went to private investors would we secure more money from the international markets at a higher rate? Therefore, would it filter down to higher interest rates for people ultimately having a negative impact on the economy? I know that is somewhat complex, but I want to be clear on it when we are voting on how to resolve the capitalisation of the banks.

Professor John McHale: If new capital had to be raised for a bank such as AIB that is almost 100% State owned, the State would want to raise that as cheaply as possible. So if that capital could be raised more cheaply from the private sector than from the ESM, then it should definitely raise that capital from the private sector. When I say cheaply, it is somewhat like "Dragon's Den" where people must decide how much of their company they are willing to give up in return for these funds. It wants to give up as little of its current stake which is effectively owned by the Government as possible.

Deputy Arthur Spring: Will interest rates end up increasing as a result?

Professor John McHale: I would not think so. If the ESM took a minority stake in AIB, it would still be effectively a Government-controlled bank.

Deputy Arthur Spring: We have access to the ECB through the ESM. Would we not have more secure funding at Euribor rates or thereabouts?

Professor John McHale: I do not believe the ESM being an owner of the banks would change the funding access for the banks. The banks currently have access to ECB quite long-term funds through the LTRO.

Deputy Arthur Spring: The ECB has claimed it wants to reduce the amount of funding it provides to our banks.

Professor John McHale: The ESM being the owner of the Irish banks would not change that particular equation. As the funding markets normalise within the eurozone, certainly the ECB wants to cut back on what is quite exceptional liquidity support to the European banking system, including the Irish banking system. However, it would only do that as funding conditions normalise. I do not believe the ESM becoming an owner of the Irish banks would change the way the ECB would treat individual banks. The way it would treat individual banks would be completely independent of the ownership structure of those banks.

Deputy Arthur Spring: Has anyone else got thoughts on that?

Dr. Donal Donovan: Certainly the ECB would very strongly take the view that it does not matter who owns the banks, but what matters is the creditworthiness of the collateral with which it is provided in respect of the loans it makes. As Professor McHale has said, one would not see any reason in itself for that to be affected necessarily. If the ESM were to take a stake in the bank some people might think the bank would be run better than it is now. Who knows? That is for consideration. That might improve profitability and generally make the bank somewhat more attractive. That is one hypothesis. That might indirectly lead to lower cost of additional capital, which could be needed down the road depending on stress tests, results and so on.

Alternatively if the bank wanted to float some bonds to get some funding perhaps the existence of the ESM, in that sense, could make people believe this is a better bank. That is a pure hypothesis. One has no idea as yet - it is one of the complications associated with this ESM scheme - what it means for the ESM to have a stake in a bank. Does it mean somebody will be sitting on the board or coming every day or every month to Dublin to see how the bank is running? It is quite a big issue, particularly for the Germans, who have reservations about this proposal. They cannot quite see how this would work.

Professor Alan Barrett: One gets the sense that this is one of the longer-run policy issues. Obviously the Government will want to sell off. Should it sell it to some major European bank or is it important to have some Irish ownership? While I do not necessarily know the answer, it will be an interesting issue. It is a bit like the Aer Lingus one. There is a sense that it does not matter who owns the airline as the planes will fly into and out of Ireland. However, there may be a sense there is a strategic importance to have-----

Deputy Arthur Spring: Ryanair will claim to be able to do it cheaper and get more people in.

Professor Alan Barrett: That could well be the case. Ultimately the hope might be that a major European bank which accesses funds on a more cost-effective basis might come into Ireland and lend to Irish people on that more cost-effective rate. That might be what the economy ultimately needs. That will be a policy question for the Minister for Finance at that time. I am guessing the Aer Lingus-type debate will happen again.

Vice Chairman: Did Deputy Higgins indicate that he was sharing a slot?

Deputy Joe Higgins: No. Deputy Donnelly should be the next Opposition speaker. I will come in myself at some stage.

Deputy Steven S. Donnelly: I welcome the witnesses and thank them for giving us their time and expertise today. Deputy Spring asked about the end of austerity and I believe I heard 2015 mentioned. However, in 2015 we will still have a 2% or 3% deficit. The troika target is 3%, which is about €5 billion off. Someone in the Government press office obviously concocted a beautiful number suggesting that we are 80% of the way through the adjustment, which is of course nonsense. The 80% is based on an accounting adjustment in 2010 for the promissory notes. I believe Dr. Donovan correctly said we were at 7.5% having started at 11%, which indicates we are less than half way in getting the deficit back to zero. In 2015 we will still be at minus 3%. By 2015 we will have got from negative 11% to negative 3% and there is still €5 billion to go. Is it the view of the council - or some of its members - that by 2015 there is a rationale that being at negative 3% debt to GDP would signal the end of austerity?

Mr. Sebastian Barnes: As I said earlier, 2015 is a long way away and many things could happen by then. Even if we get to these numbers, it would depend on the circumstances. Picking up on what Professor McHale said earlier, by approximately that time if things work out more or less as expected the extremely tough measures that are being taken now of cutting public spending and things could start to ease off. It would not become a bonanza and we would not quite be back in clover, as the phrase is. It would be when this really tough period would start to stop. At that point we could envisage things such as spending increasing in line with inflation. GDP would probably still be shrinking but we would be out of the very difficult phase. There would be a gradual easing of the conditions.

Under the budgetary rule to which Ireland is committed, the current medium-term objective is for a structural deficit of minus 0.5%. So the country can have a structural deficit which allows it some space. It is not necessary in structural terms to get back to zero. Given that the economy is still likely to be below trend and still suffering the effects of the recession somewhat, including some of the effects of the consolidation, most likely we would still have a cyclical deficit in 2015 but the structural deficit would be somewhat smaller. The problem is that it is very difficult to know what the structural deficit would be at this point given many of the issues we discuss in the report. This is from where much of the ambiguity comes. If we take the official measures of the structural balance we would be quite a long way away from where we needed to be, but if we take the IMF's measures which seemed to us to be somewhat more plausible, we would be getting there in structural terms. It would not be back to clover but it would be back to easing the extremely tight situation we are in now. It looks like some of the deficit would be cyclical at that point so in structural terms we would be more or less where we needed to be, and as the economy picked up the rest of it would close.

Professor John McHale: To add a little to this, we do not have to get to this requirement of 0.5% structural deficit immediately. There is an adjustment path towards it. In the simulations we did we assumed Ireland did the minimum it had to do which was improve the structural balance by 0.5% of GDP per year. It was on this basis, still using the Commissions estimates, that we calculated there would be room for very substantial easing of the austerity measures and allowing, as Mr. Barnes stated, for expenditure to allow Ireland keep up with inflation from 2016. However, matters such as economic growth must work out as anticipated. One of the messages of the report is there is much uncertainty around this. This is very preliminary but we will publish a more in-depth analysis in the next report.

Deputy Stephen S. Donnelly: I ask the witnesses to clarify an issue with regard to growth. The 2012 GDP growth, which is the outrun in the table, is 0.9%, but the IMF April 2013 figure is 0.7%. What is the figure for 2012 GDP growth? Why did the IMF come back with a lower figure after the fact?

Professor Alan Barrett: The CSO published the 0.9% figure in April. It is always a bizarre situation in which one forecasts something which happened previously. The correct figure is 0.9% because it is not a forecast but the actual outturn based on CSO data. Having said that, it can be revised. It is as good as it gets for now.

Deputy Stephen S. Donnelly: I thank Professor Barrett. It was causing me confusion at 10 p.m. last night.

Professor Alan Barrett: I will give the Deputy my mobile number so he will not have to endure that in future.

Vice Chairman: You all live very exciting lives.

Deputy Stephen S. Donnelly: We have established the figure for 2012 is 0.9%. The most striking thing I took from the recent report was the graph showing the quarterly revision downwards of 2012 GDP growth by everybody. This is a clear inherent bias towards optimism. In the budget for 2013 the Department of Finance projects 1.5% for this year, 2.5% for next year and 2.9% for 2015, which is exactly the type of thing we see every time, that it was rough last year but there will be growth of basis points in the coming years and it will all be gravy.

The eurozone is back in recession and the forecasts are that it will stay in negative growth for a while. The UK is in serious trouble. The US is growing, thank goodness, and I believe the figure is approximately 2%. The advisory council's figures for 2012 show the number of people at work has fallen and we had negative growth last year again. Unemployment figures have fallen, but this is obviously because people are either retiring or leaving the country. For this year and the following two years we will still be in fiscal consolidation and a lot of pain is still to be had. As the witnesses have pointed out repeatedly, the trading environment is hugely difficult, and yet the Department of Finance is once again stating we will get a lovely hockey stick this year, next year and the following year. Do the witnesses believe it? This is a loaded question.

Professor John McHale: The report breaks apart past growth and past forecasting errors to get a better understanding of why it got it wrong and why there is a pattern of continual downward revisions. It was very much on the domestic demand side. If anything the net export side tends to be underestimated. Last year, we saw real signs of stabilisation in domestic demand but these are tentative and we will not know until well into this year whether stabilisation in domestic demand is really taking place.

Deputy Stephen S. Donnelly: Wait until people get their property tax bills and see what happens.

Professor John McHale: It certainly will not help and it is a further effect of fiscal adjustment measures, but if we compare the last quarter in 2011 to the last quarter in 2012 domestic demand was largely stable.

If the international economy had continued to perform it as it had been performing until last year we would now be moving into quite solid growth and the growth projections to 2014 and 2015 would look very reasonable. It shows the level of uncertainties which exist. We cannot control the international economies. There are real questions about some of the policies being pursued, particularly in the eurozone, which are certainly not helping the situation in terms of the growth of the eurozone economy. We will have to see what will happen in Europe and whether the recent comments by President Barroso signal a softening of policies which may provide a positive boost to eurozone growth. In terms of the recent forecast of a stabilisation in domestic demand, which had been made in previous years also and was not well underpinned given what we could see happening with the balance sheet recession, there is more evidence now that this stabilisation is finally beginning to take place. If we could get a reasonable draw in terms of what happens in the international economy we should be able to return to reasonable growth, but these are big ifs.

Deputy Stephen S. Donnelly: Given all of this do the witnesses believe the Department? Part of their job is to examine these issues.

Professor Alan Barrett: To answer the question, it has produced a forecast of 1.5% for GDP growth next year. At the time of the budget this was not a crazy forecast. There is no doubt the eurozone developments now raise a question as to whether this can be achieved. All else equal, one would expect a reduction in the forecast in the stability programme update in the coming weeks. In the report we state we expect either a reduction in the forecast or an explanation with regard to developments in the eurozone, and in exchange rates which is another problem area. We have asked the Department to explain the forecast if it stays with it.

Deputy Stephen S. Donnelly: That is a very diplomatic answer.

Dr. Donal Donovan: There is a difference between an estimate or short-term forecast on what one thinks is happening right now, what will happen in the next six to nine months and what will happen in the remainder of the year and longer-term forecasts. One can have a fairly good idea about these because matters are already in train which will produce an outcome and one will have a fairly good idea of it. I honestly think that in years two, three and four it is perfectly possible to provide a list of good reasons it could turn out and a list of very plausible reasons it could not do so. Totally unknown issues are involved, over which the forecasters have no particular control or, to be quite honest, no particular insider knowledge. Nobody sitting in Ireland knows the effect of President Barroso's call for this or that. No one knows whether there will be another Cyprus or what will happen in the Italian elections. These forecasts should not be interpreted as predictions, but as statements of what could happen with reasonable plausibility, which is what we try to do. I would rephrase Deputy Donnelly's query. It is not a question of whether we believe them, as they are plausible, but it is equally possible to arrive at a set of circumstances that make them quite implausible. No one in this room or in most places in Europe knows which it will be.

Mr. Sebastian Barnes: In our report, we point to there being clear risks, given the pattern of revisions. This has shifted from the domestic side, where the evidence of stabilisation means that the forecasts are more reasonable than they were, to the international side. One should also make a distinction. Consider a country like France, the Government of which systematically overestimates GDP in its forecasts. No one else forecasts similar growth rates. Clearly, there is a problem. Our counterparts on the new fiscal council in France have been critical of its Government for making unreasonable forecasts.

We view the Irish forecasts as being plausible. Although they may not be right, they make sense and do not result from a process that is inherently biased towards optimism in a purely political way. People have misread the balance sheet recession not just in the Department of Finance, but also elsewhere. This has also been the case internationally. The more naive errors-----

Deputy Stephen S. Donnelly: It seems strange. I agree that the Department of Finance has not been politicised in its forecasts and I accept that there is no way to get the forecasts right, as there are two many large unknowns, but the logic that we have heard for ages is that the austerity-only approach can work if we have sufficient growth. Obviously, there will be no growth in the country because we are taking everyone's money, but we are told not to worry because we will be able to export to the eurozone and the UK. Here the narrative seems to stop, but those countries are taking their citizens' money as well, so they will probably not be able to buy our stuff. It seems to have come as a great surprise that our trade partners, which are suffering fiscal consolidation challenges similar to our own, are not buying our exports any more than we are. That these two elements were not joined up surprises me.

Regarding a technical point on GDP growth, and while I have nothing to support it, it was put to me by an economist who examined the issue that some or all of the growth has been due to perfectly legal tax optimisation by firms. We referenced this matter when Deputy McDonald discussed the bizarre anomaly of a growth in real GNP of 3.4% versus a 0.9% growth in real GDP. Legal issues are involved, in that companies have reregistered as being domiciled in Ireland, presumably for tax reasons. Has the council examined how much, if any, of the growth is due to tax optimisation? Companies are here, at least partly, for tax reasons. In recessions, large and small companies focus heavily on tax optimisation because they cannot grow. It is a way to increase profits. Has an analysis been conducted or has the council seen evidence to suggest that a chunk of the growth is not reflected in the real economy but is instead legal tax optimisation by companies based in Ireland?

Professor John McHale: In terms of tax optimisation, the usual concern is that it might distort GDP, which includes the profits of the multinationals. If they set up their operations and engaged in practices such as the transfer of pricing, they could distort their profits for tax reasons in a way that then distorts GDP. This is one reason for people examining GNP, which subtracts multinationals' profits. As mentioned, GNP grew strongly last year and is projected to grow less than GDP this year. These are some of the issues around Ireland's national accounts.

In terms of GNP, there are issues concerning how account is taken of royalties in the services sector. There is strong export growth in the software sector, boosting GDP and GNP, but this seems to be largely offset by high royalty payments, as the intellectual properties are owned by companies' head offices. Therefore, the royalties show up as high imports, in which instance they probably do not even distort GDP. While these are issues, we have not come across evidence of a significant bias to make us doubt the GNP figures.

Deputy Stephen S. Donnelly: I am more concerned by the GDP distortion.

Professor John McHale: There is a greater concern in that respect.

Vice Chairman: Deputy Donnelly should conclude.

Deputy Stephen S. Donnelly: The average time that other members received was approximately 25 minutes, but I have only received 15 minutes.

Vice Chairman: No.

Deputy Stephen S. Donnelly: I am the fifth questioner. Divide the time. Can I have a further five minutes?

Vice Chairman: The Deputy has actually had more than 20 minutes, but he can have a couple more.

Deputy Stephen S. Donnelly: I thank the Vice Chairman. I wish to ask about the 1% margin of safety. In 2015, it hit 2%, not 3%. Last year, we were approximately 1% within the troika target. The council advocates that this is good, but we can quantify the flip side. One percentage point of GDP is approximately €1.67 billion. To stay 1% within the troika target in 2013, 2014 and 2015, the total figure will be approximately €5 billion. This is potentially €5 billion in missed investment opportunities.

European Commission President Barroso has stated that the austerity-only approach does not work. Professor Ashoka Mody has stated that this approach should not have been taken and that it would never have worked. While I accept that fiscal consolidation must happen, there seems to be a growing consensus that the austerity-only approach is not working.

Were the Government to take the council's advice and maintain the 1% safety margin, there will be a clear cost of €5 billion in missed investment. Of what is the council scared? If we tried to hit the actual target and used the €5 billion for job-rich investments, the risk of hitting 3.1%, 3.2% or so on would grow, but so what? These are made-up targets. A bunch of economists got together under considerable pressure and cobbled together a bunch of targets. They are not right or wrong. They are made-up numbers for fiscal consolidation. What concern of the council's is sufficient to offset the significant opportunity of targeted investment of €5 billion?

Professor John McHale: On the question of whether austerity is working, we must recall why we engaged in this process. It turned out that Ireland's debt was not considered sustainable, that is, it could not be financed in the markets. We essentially lost access to funding and could not borrow. Being able to borrow is critical to the running of the State, given the large deficit that continues to exist. The fiscal adjustments needed to be engaged in to reduce the deficit and to put our debt onto a sustainable path. Given we could not borrow from anybody else, we set these targets to ensure we were eligible to borrow from official creditors. In terms of the success of the policy, the adverse impact on growth has been hugely unwelcome. However, the regaining of the creditworthiness of the State is a significant achievement. The implied probability of default in mid-2011 - which is not that long ago - was approximately 90%. It has fallen dramatically and ten year bond yields, although still somewhat higher than equivalent German yields, are now down to about 3.5%, which implies a low probability of default. In terms of ensuring that the Irish State continues to have access to borrowings - hopefully from the market but failing that from official lenders - that has been secured, allowing us the scope to phase out this adjustment over time. If we had lost complete access to funding and essentially had to close a deficit cold turkey, the impact on people's lives and on the economy through the effects mentioned would have been much greater. We have been balancing this with the need to restore the creditworthiness of the State, which in itself has a positive effect on growth because when a State is not creditworthy confidence and interest rates are affected. We are trading off these direct affects on growth against the need to restore the borrowing capacity of the State and indirectly support growth. A key element of this is the creation of confidence that we will be able to achieve these targets, which relates back to the rationale for having the margin of safety in place.

Deputy Stephen S. Donnelly: Am I correct that what Professor McHale is saying is that while obviously we will try to remain within the targets, should we miss them the optics for the international money markets are such that this would drive up bond yields, because, since we are rolling over our debt, the borrowing cost in that regard would increase and that increase in quantitative and qualitative terms would be more detrimental than the potential benefits of a €5 billion stimulus package?

Professor John McHale: We have achieved a great deal already. To start missing the targets at this point would undo much of the benefits. It should also be noted that we will have to make these adjustments anyway. If we borrow more now we will have a bigger debt that will have to be repaid in the future by us when we are older or by our children. If it were just that this money was being lost, this would change the calculation and we might be willing to take bigger risks and have a smaller margin of safety. It should not be forgotten that we are repaying what we borrowed plus interest, which affects the cost-benefit calculation.

Deputy Stephen S. Donnelly: I thank the witnesses for their responses, which have been very useful.

Vice Chairman: We will now move on to questions from other members.

Deputy Peter Mathews: The delegates should be afforded an opportunity to use the rest room if they wish.

Vice Chairman: I am sure they are happy to take the chance that Deputy Mathews will not ramble on too long.

Deputy Peter Mathews: I would like them to feel no physical tension while listening to me.

Vice Chairman: I will allow questions now from Deputies Mathews, Higgins and Kevin Humphreys.

Deputy Peter Mathews: Would any of the delegates like to use the rest room first?

Professor Alan Barrett: As I have to pick up my son from crèche I will have to leave by 5.25 p.m.

Vice Chairman: Professor Barrett will be out of here sooner than that. Each speaker has ten minutes.

Deputy Peter Mathews: A great deal of territory has been already covered in terms of the council's mandate, which is very fiscal concentrated, as set out at the bottom of page 1. Professor McHale stated in his presentation that the balance sheet recession shadows everything not alone in Ireland, but abroad. I have been saying that since 2009, including officially on paper to the late Brian Lenihan, in which I predicted that the heads of balance of the six main banks, their liabilities and assets would be not less than €40 billion. He would have thought I was on drugs had I told him what I really believed, namely, that there would be a minimum of €50 billion on NAMA-type loan losses. I also told him that the proposition as designed, the purpose of which was to restore the solvency-liquidity of the banks, would not work, and what I believed needed to be done with the banks.

As Dr. Donovan stated earlier, the banks need capability to address the problem which has only belatedly been admitted, the scale of which is 180,000 mortgages on top of what they shipped out to NAMA. When Bank of Ireland did its bill of lading to NAMA, it reduced its first estimate from €18 billion to €12 billion. How it did that in three months I do not know. It would have had, on average, 35% write-downs or provisions on that €12 billion. The remainder of Bank of Ireland's loan book - it may have an update on these figures which I obtained from it last year - is €105 billion. Its provision against that €105 billion is €7 billion, which is a 6.7% provision. That is absurd. I will explain why. Bank of Scotland Ireland had a peaked loan book of €42 billion. It has written off 40% of that. That percentage includes loans that would have gone to NAMA but did not and had to be written off within Bank of Scotland Ireland's books. Bank of Ireland's loan book of €105 billion includes €81 billion in the following categories of development land loans, development loans, property investment loans, mortgage loans, mortgage-to-let loans and construction industry exposure, yet it has made only €7 billion in provision against that €81 million.

PCAR of March 2011 is as unreliable as PCAR March 2010. I told Mr. Elderfield in his office in April 2010 that the €7.4 billion pencilled in as needed for AIB by the end of that year was absurd and that it needed €10 million immediately and that the figure of €3.6 billion in respect of Bank of Ireland was equally stupid because it needed €6.5 billion immediately. If we have a balance sheet problem in the economy, we should, as set out in the council's mandate, ensure the needle on the dial is aimed towards 3% of GDP by 2015. We hope in the long term to get debt to GDP down to 60%. During the past four years it has increased to €104 billion and is now spinning out of control. The paper by Cecchetti, Mohanty, Zampolli and Jackson Hole states that the real effects of debt over 28 years in the 18 OECD countries were indicative of when economies stagnate. Household debt is that which holds people back from spending, saving and investing. Non-financial corporate debt is the type, if too large, that weighs down investment enthusiasm or otherwise to do new business and projects and repay old loans. We all know that with national debt, the Government struggles just to make ends meet. If we add all these, Ireland's debt to GDP figure was at 450%, the highest in the world, and it was not even admitted. It was dismissed as kindergarten economics. Addressing those problems is like going behind the hands on the dial to see the cogs.

These cogs include the household debt. Some 180,000 households will all now feel diminished, embarrassed and talked down to. The insolvency legislation will make them feel that they have to sit up, listen and pay attention while getting in a professional insolvency practitioner to work it out. It is appalling as the banks for seven years had a run of disobeying all essential and basic rules of prudential and fiduciary banking, even if we forget about lending. These basics mean banks should take in streams of deposits from a multitude of sources and maturities, mind them safely, honestly and well, and they should lend out 90% of them while reserving 10% in cash to meet the calls of depositors. Those loans should go to sectors across the economy. If all banks did that, there would not be a chance of a credit bubble emerging.

Professor Niels Thygesen from Denmark confirmed this to me two years ago at an international financial convention at the Four Seasons hotel. Some of the people here today presented at that meeting. That is the key to the issue. If the banks loaned at 150% of deposits, as they were doing, they were straying at 60% above the prudential limit of 90%, which is time-tested. It is a two thirds error, meaning the banks created the super-pricing or bubble pricing of assets. This was a dereliction of duty. If Joe and Mary borrow €750,000 for a €1 million property when the economy was fairly hot, they are buying a house for that money. When the bubble bursts, the asset price and value disappears and the house may now be valued at €450,000. The loan, on a tracker mortgage, still exists. How dare the banking sector and its individual players insist that there is any commercial and moral right, having created an economy that destroyed investment value, to look for the full repayment. They want to collect the mortgage with interest over as many years as it takes on an asset reduced to €450,000, with a destruction of asset value of €550,000. This should be behind the wall of anybody discussing what has happened with private borrowers. The bankers must take responsibility for two thirds of the funding in that seven-year run. If the loss is €550,000 and the negative equity is €200,000 or so, two thirds of that should come from the bank's account.

Vice Chairman: I thank the Deputy.

Deputy Peter Mathews: This is the Irish Fiscal Advisory Council and this is a policy matter for the country; it hit the entire economy for seven years because of the banking sector and the regulator.

Dr. Donal Donovan: I would like to make a very brief comment. Deputy Mathews correctly pointed out that one does not quite know if the 2011 prudential capital assessment review estimates will hold up in the 2013 review. In a way I am sorry Deputy Donnelly is not with us any more because this points out exactly the kind of unknown but not insubstantial risk that could arise if there were to be some fiscal implications, directly or indirectly, of additional capital needs. It is prudent for us or anybody else to be thinking about such matters. There must be a margin of safety.

Deputy Peter Mathews: Dr. Donovan is dead right and I thank him for his work. Thanking people takes up time and I am being cornered again in a five-minute bundle, with people before having 25 minutes. I have listened to everybody else. That is the irony of these committees. If I stay in here, listen and respect other people's views, when everybody else disappears and I want to make a genuine contribution, I cannot.

Vice Chairman: Deputy Mathews-----

Deputy Peter Mathews: Small and medium enterprises had €50 billion in exposure, and 50% of it-----

Vice Chairman: Every time, Deputy Mathews-----

Deputy Peter Mathews: These are the highlights that must be amended.

Vice Chairman: In future I will give the Deputy even less time to allow for the fact that he does not respect the Chair when he speaks.

Deputy Peter Mathews: I completely respect the Chair. That is why I am here all this time.

Deputy Joe Higgins: Dr. Donovan did not state as much but it seems that the estimates for growth come from a bunch of economists chancing their arm. On one set of assumptions, there may be growth etc. but this may not be the case if demand weakens across Europe etc. and there could be entirely different projections. What the hell are we talking about in terms of a firm perspective for the next three years, and how can Professor McHale say that we will be out of austerity in 2015 when the scenario is so tentative?

The role of the Irish Fiscal Advisory Council is to assess the Department of Finance officials' projections and to consider the appropriateness of the fiscal stance. Can I put it to the witnesses that they never challenge the fiscal stance and they are part of the austerity choir, as if it is the only show in town? That is despite the fact that European Commission President Barroso, a right-wing neoliberal to his fingertips, is even raising questions verbally about the viability of ongoing austerity. Dr. Donovan's former colleague, Mr. Ashoka Mody, has lacerated the austerity policy but the fiscal council has made no challenge whatever. I put it that the council should be challenging the view rather than enforcing it. Austerity works for bankers and bondholders but not for working class people and the poor, who have been hammered by it.

Professor John McHale: The Deputy has argued that we have not challenged the fiscal stance but we have made arguments for changing the fiscal stance. If it is because on the opposite side from where the Deputy feels the fiscal stance should be, that does not mean we are not challenging it. The Deputy has argued that we are not advocating the policy that is best for working people but we very much try to identify the fiscal policy we think works best for ordinary people. If Ireland were to lose complete access to funding, the austerity would be much worse. We are trying to achieve that very difficult balancing act between making sure we can sustain the spending of the State, which requires access to borrowing, while at the same time trying to minimise the immediate negative effects of austerity. It is unfair for the Deputy to imply that our goal is somewhat different from his in terms of making people's lives go as well as possible and having as much opportunity as possible. This is not about trying to increase returns in financial markets. When we talk about restoring the credit worthiness of the State, it is not about trying to help financial markets; it is about trying to make sure the State has the borrowing capacity to be able to do what it needs to do to make people's lives go as well as possible.

Deputy Joe Higgins: Essentially, everything done is predicated on the dictatorship of the financial markets. There is a moral issue here - what is morally right and morally wrong.

Professor John McHale: If one chooses not to run deficits and not to have debt, then one does not need any dependence on financial markets but once one decides to spend more than one raises in revenue and starts to run deficits and accumulate debt, then one puts oneself in a situation where one needs to be able to continue to borrow to fund those deficits-----

Deputy Joe Higgins: When a government makes a decision that private debt be foisted onto the shoulders of the working class, then we are in an entirely different situation and a crazed logic and morality, which is what is being implemented. Virtually every economist in town goes along with that and does not challenge it.

I need to move forward quickly. I refer to the end of austerity and 2015-16. The projections being made cannot be hard and fast as they are related to the macro projections of growth, deficit, etc., but what about this whole raft of new taxes - for example, the property tax and the water tax - if allowed to be implemented? There will be a massive people's movement of opposition. They may well be abolished by 2016. I believe they will be because there will be a revolt. However, let us say for the sake of argument that they are not, when things start to come right in terms of the council's projections, one could have another huge attack on the ability of working people to purchase. One could have maybe €500 million or €750 million in property tax, which is the equivalent of two week's pay for low paid workers and which is not going into the economy but out of it. If water tax is added to that, one is talking about perhaps up to €1 billion between two taxes being taken out of the economy. Will that not affect the projections for a resuscitation of the domestic economy as well?

Professor John McHale: The property tax and the water charges are built into the €5.1 billion of adjustments and indeed including what is happening for 2013, the €8.6 billion of adjustments that are to happen between 2013-15. The negative effects are built into those growth projections. What we were arguing earlier - again with all of the caveats the Deputy noted - is that there should not be a need for more measures beyond those after 2015. Unfortunately, it does not mean that those measures can be taken back, the property tax rescinded and so on. It is based on the assumption that those measures stay in place but additional austerity measures would not be needed, based on the best projections we can make.

Deputy Joe Higgins: To come back to Dr. Donovan's caveats in regard to projections, etc., this country will leave the troika programme at the end of this year. It must do so because the troika above all and the whole political establishment of Europe needs it to leave for political reasons and to validate their austerity agenda and to say Ireland was the poster boy and it is leaving. Will Dr. Donovan look at next year and the year after? On the basis of a weakening economic situation within the eurozone and the European Union and the stalled growth in this State, can he see a situation where, in the next year or two years, the sharks in the financial markets might suddenly look at the real figures for the Irish economy, say they do not have too much confidence in giving it rakes of money at cheap interests and that the interest rates could be ratcheted up and the country could be forced to go back into another programme?

Vice Chairman: We will have to suspend the meeting for a vote in the Dáil.

Sitting suspended at 4.45 p.m. and resumed at 5 p.m.

Vice Chairman: We will now resume in public session. I ask Dr. Donovan to respond to Deputy Higgins.

Dr. Donal Donovan: I will respond to three specific points made by Deputy Higgins. First, it is right for him to point out the uncertainty and fragility of these forecasts. He might have put it a little more colourfully than I would but there is a lot of truth in what the Deputy said. There is huge uncertainty about this and things could turn out one way or an entirely different way. This should be recognised more than it often is in public debate. Often the Department of Finance will signal that its forecasts are dependent on other factors but unfortunately, many in the media who take up the issue remove the first half of the sentence which contains the qualifications and simply say that the Government is forecasting 3% growth for next year and so forth. In that context, I am very much in agreement with Deputy Higgins. We simply do not know for sure and we should be more humble about not knowing.

The second point concerns what Mr. Ashoka Mody and others have said about austerity. Coming back to what Mr. Mody and others have said about austerity, my point is that there is a deficit of 11% of GDP and it must be reduced; that is what I mean by austerity. If Mr. Mody or anyone else from the IMF says that is not the case, I will listen to him, because we listen to everyone, but the fact that we listen does not mean we agree. I do not agree with anyone, including Mr. Mody, who says that with a deficit of 11% of GDP we do not need austerity. I would defend that position, as would many others.

The third question was whether it was possible, after the current bail-out, that things might go badly and bond yields might rise, leading to another potential mire. Yes, that is a possibility, because we do not know what will happen in the euro area. To a significant extent, if there were to be problems in the euro area, it would have a large knock-on effect on Irish bond yields, almost irrespective of what we were doing. When people take fright about the euro area, they tend to have a generalised concern about all debtors. That is why the fiscal council in its report gave some thought to this possibility. We talked about it among ourselves and stated in our report that a back-up precautionary arrangement could help to reduce the costs associated with such an eventuality. That is prudent planning.

Deputy Higgins described a scenario where if there were outright monetary transactions in operation, the risk of bond yields getting out of control, as could otherwise happen under this scenario, would be greatly diminished. It is an important part of planning and prudent management. There would be a lot of support for the sentiment the Deputy expressed.

Deputy Joe Higgins: We have heard a lot about the sustainability of the total national debt, which now stands at 120% of GDP. If memory serves me correctly, interest payments must be close to €9 billion per year. What is the council's comment on that situation? Is it sustainable and what do the markets think about it? What are the prospects for the debt, particularly interest rates, which are a horrific drain on society from resources that should otherwise be going into developing social services and investment? What will happen over the next three or four years?

Dr. Donal Donovan: The interest rate is pretty low. It is not 0% but there is a concessional rate on much of the debt of 3% or thereabouts. The debt associated with the ECB portion has an interest rate of less than 1% when we work through all the accounting. It would be great if it was 0% but it is still actually substantial support from the lenders. They are doing it partly in their own interest but I would not take for granted the fact that we are getting a very low interest rate that is highly subsidised and we are getting it for a very lengthy period.

Professor John McHale: Debt sustainability is a difficult thing to measure and there are different measures for it. One basic requirement is that the debt stops rising as a share of the economy. It looks as though the debt-to-GDP ratio will peak at 123% of GDP this year, a bit higher than originally thought, partly because the Government is building up quite large cash balances, which could rise to as much as €30 billion. On that criterion, it looks as if sustainability will be achieved.

The more basic measure of sustainability is funding the debt when it must be rolled over and, if it is being added to through deficits, whether those can be funded. The eurozone crisis has revealed the fragility of a country's debt sustainability within the eurozone. Probably it will remain fragile at debt levels as a share of GDP that are quite a bit lower than 120%. If we did not have access to official lending, either actual or potential, through a precautionary programme or a full programme, Ireland's debt would probably not be refundable at anywhere close to the debt-to-GDP ratios we currently have. That is why retaining our creditworthiness with those official funders is so important to ensuring we can sustain that debt and not be forced into a default and a much more severe programme of austerity.

This is why, going back to the theme the Deputy raised about the uncertainty around these forecasts, given that uncertainty, we have argued for this margin of safety to make sure we can at least stop the debt-to-GDP ratio from rising. Already, even with the additional planned adjustments of €5.1 billion up to 2015, we estimate there is a one in four chance the debt-to-GDP ratio will not have stopped rising by 2015 if there are negative shocks to growth. It is still very much on the edge but to the extent that we can put that margin of safety in place, we can reduce the probability that the debt-to-GDP ratio will not have stabilised. That goes back to why we are making the argument for having that margin of safety in place to ensure we can maximise the chances of debt sustainability and minimise the chances of the disruptive effects of default and further austerity.

Deputy Kevin Humphreys: The work the council does is very much appreciated and I find it challenging when it comes before the committee. The reports are very helpful, as are the witnesses' contributions.

I want to start off with the benefit from the promissory notes and the extra €2 billion needed in 2014, with €400 million of that coming from the Department of Social Protection. Our growth base has been supported by exports but that is starting to taper off because of the problems in Europe and Britain. The gains we have made in competitiveness have also started to taper off. Page 11 of the report states that domestic demand has a tendency to be overestimated. Has any thought been given to taking a breather and spending the €1 billion in savings to avoid cutting expenditure in the Department of Social Protection and the Department of Education and Skills? What would the knock-on effect be in the domestic economy?

When talking about structural balance, the major contributory factor is high unemployment having a knock-on effect on domestic demand. It is unsustainable that the construction industry and the retail industry are on the floor. Has any study been done of what would happen to the structural deficit if unemployment dropped by 5%, 10% or 20%? Are we talking about profiling such as that for the next report? Is it worthwhile considering that?

I agree fundamentally with the idea of a property tax. There is, however, a dogma that if we tax property and not labour, it will encourage growth. That is dealt with on page 80. We are in different circumstances - a harsh economic cycle - and are starting to implement a property tax from scratch. Has research been conducted on the impact of confidence on domestic growth? Confidence in growth leads to spending in the market. Deputy Joe Higgins touched on this in his questions. I support property tax, but has an analysis been done on its introduction from scratch in an economy such as ours?

Mr. Sebastian Barnes: I will address the issue in terms of the structural balance and unemployment. The specific point we make in the report is that when one looks at the official estimates of potential output, they seem to understate how deep the cyclical problems are now. The main component of that, at least in what the European Commission does, seems to relate to unemployment, where it interprets all the unemployment that exists today as being structural. It seems to us that is implausible. There is clearly a cyclical effect there. It does point to the fact, once again - we always say there is a lot of uncertainty around this - that structural unemployment is likely to be higher than it was in the past, particularly because of job losses, for example in the construction sector where there is a category of people and skills that are unlikely to be required in the same numbers in the future. In terms of public policy, that points to an important conclusion that labour market policies should work effectively and that a solution should be found for this group of people, whom it will be difficult to reintegrate into other jobs. It points to an area of some public policy effort or spending that should be prioritised because it is very important that unemployment does not become hard-wired. We must ensure that at some point those people start paying taxes again and stop relying on benefits. There is a policy conclusion from that.

I know the property tax is a very sensitive issue in Ireland. From the perspective of the OECD, which is my day job, property taxes are seen as a form of taxation that has a number of benefits. Most countries apply property taxes. In some sense it can be expected to have a relatively low impact on long-term growth prospects compared to taxing labour directly.

Deputy Kevin Humphreys: Very short-term.

Mr. Sebastian Barnes: I think even in the short term it will be seen as not the most harmful tax to increase. I am sure I could find OECD papers that would support that case. One of the things the Deputy has been asking about is the impact on confidence, and of course that is a very difficult thing to measure. Many taxes have risen but it may be the taxes that are most obvious to people that have the greatest psychological impact. However, I am just speculating.

Professor John McHale: I will respond to Deputy Humphreys's first question. This goes to the essence of the trade-off we examined when we assessed the fiscal statistics. If one was to reduce the adjustments by €1.6 billion, that would probably improve nominal GDP in the case of our model by €800 million. That certainly would be a significant benefit. Currently we estimate that there is approximately a one in three chance, as I mentioned earlier, that the 3% target will not be hit, even if one makes the adjustments of €5.1 billion. That would probably rise - my colleague Mr. Diarmaid Smyth might remember the exact number - by approximately ten percentage points, which gives close to a 50% chance of not meeting that target. That is the trade-off one is looking at. The costs associated with not meeting the target would be greater if it were the result of our not implementing the plan to which we initially agreed. It would compound the fact that we had missed the targets if the reason was not just adverse growth but non-implementation of the plan that had been set out and agreed.

These are judgment calls, and there are trade-offs to be made. We absolutely understand that people may weigh these things differently, but given what we have achieved so far in the programme in terms of regaining the creditworthiness of the State and ensuring the State has the borrowing capacity that it needs, it would be a pity to risk those gains more than we need to. There is risk because of the uncertainly around the growth picture; however, the risk of not following through on the planned adjustment in our judgment is a risk that at this point is not worth taking. If the growth picture were to turn out better and it looked as though we would meet the target with fewer adjustments, that is something that could be considered as we got closer to the end of 2015.

Professor Alan Barrett: I will make a quick point on property taxes. As I have explained to the Chairman, I will then have to leave the meeting, so I apologise for that.

In terms of comparing the property tax to other taxes - the Deputy raised the element of confidence - it would be very hard to make an argument that in some sense a property tax would be more damaging to confidence. Among the suite of taxes that one might choose, the point Mr. Barnes was making is that most economists would say, and the analysis shows, that in terms of economic efficiency a property tax is a good way to go. The real arguments against property tax are the distributional issues and the question of whether it is a fair tax. There is general agreement that economically it is a sensible tax, but one can make a very good case for saying it is not a fair tax. Of course, one of the great dilemmas of property tax is how to make it fairer by trying to relate it to income in some form. For instance, one gives exemptions for low-income people, but once one starts to do that the property tax starts to look like an income tax, so one loses some of the benefits. The design of taxes is terribly difficult, but I am making the point because I can see Deputy Higgins-----

Deputy Joe Higgins: It is an income tax, because it is coming from workers' wages.

Professor Alan Barrett: But it is not a tax on income. The Deputy is right to the extent that in the same way, a sales tax comes out of a person's wages.

Deputy Joe Higgins: That is semantics.

Professor Alan Barrett: No, it is not. It is important that we are discussing the same thing. It is not a tax on income. Of course it comes out of income, but by that logic every tax is an income tax.

Deputy Joe Higgins: On workers.

Professor Alan Barrett: Everybody pays tax.

Vice Chairman: It is Deputy Kevin Humphreys who has the floor.

Professor Alan Barrett: I will leave on that note, and I apologise again for having to do so.

Deputy Kevin Humphreys: I have one issue that I want to follow up. Perhaps I did not explain the question on the structural balance or deficit correctly.

The construction industry is now operating at a level below the sustainable level. Based on population growth, it should be operating at a slightly higher level to cater for this growth. My question is whether it is worthwhile to examine the growth in population. Currently, there is increased demand for three-bedroom family homes. We should start to see growth in the construction industry. If we look slightly forward, we can see the start of growth in employment, which may lead to a drop of 20% in unemployment, and we will then see a subsequent drop in social welfare spending and health spending and a boost to tax receipts. Have the witnesses profiled the effect that would have on the Irish economy in the future?

Mr. Sebastian Barnes: No; we have not done that explicitly. I think some of that will be captured by the cyclical recovery. If one looks at the projections from the Department of Finance, the area where investment picks up is partly because of construction investment.

A deeper point, which relates to something that is said in the report, is that it would be helpful to have a much more developed analysis of potential output and what we think the trend is for the economy. At present, there is not a significant amount of formalised thinking about that. The point the Deputy makes is that the construction industry will not be at the level it was before but it will not be at the level it is now in the future. We must think that through in terms of the structural factors that will drive that growth in terms of population, the need for housing and demographic factors. That is the kind of thing that should be built on in the future so that we can try to have a clearer idea of where the economy is heading by thinking more carefully about how it will work.

Mr. Diarmaid Smyth: We have examined the impact of possible stronger growth and its effect on the deficit. We have not gone into that level of detail on specific sectors, but that is something we might consider. I know the ESRI is in the process of producing its medium-term view and it will have high-growth and low-growth scenarios, but it is probably the best body to do that detailed analysis.

Deputy Kevin Humphreys: The two sectors I would choose are the construction and retail sectors. That is where we can actually break down that structural unemployment.

Vice Chairman: Our final contributor is Deputy Boyd Barrett, who has ten minutes.

Deputy Richard Boyd Barrett: I thank the representatives of the Irish Fiscal Advisory Council for their attendance. I always find our engagements interesting. The council's reports contain weeks of reading. The information is always interesting. I want to follow up on the questions asked by Deputy Humphreys by asking about alternatives that could be considered. I apologise for not being here for the entire meeting as I wanted to be. I was in and out of the Dáil. When we propose alternatives to property taxes or cuts in public expenditure, for example by suggesting that the rate of tax imposed on those on higher incomes or corporation tax should be increased, we are usually rubbished as living in cloud-cuckoo land and told we are engaging in fantasy economics. The debate does not go much further than that. Frankly, that does the debate a disservice.

What would the witnesses say in response to the proposition that we need to look at alternative scenarios, particularly given that pretty mainstream people - even bondholders quite recently - are now saying that austerity has reached its limits and is potentially becoming counterproductive as it is applied across Europe? One of the big trading houses - I think it is called Pimco - recently said that the effect of austerity on growth is worrying. This is one of the entities that is dictating our future. The same people who panicked because we were not imposing enough austerity are potentially going to panic because we have imposed too much austerity and it could cripple growth.

Is the council looking at alternative scenarios as part of its monitoring of our macroeconomic strategy? What would it say? Our view, following on from what Professor Barrett said, is that all taxes are taxes on income. What would the witnesses say to that? We do not think there is a dichotomy between fairness and economic efficiency. We would say that if something is fair, by definition, it will be more efficient. What would the witnesses say in response to that proposition? We are dealing with human beings rather than with abstract categories. If one is fairer, one will motivate people to do more and to generate more economic activity and growth. If one is unfair, one will demoralise and depress people and, in the process, depress the economy which they comprise. In light of that analysis, should we not explore whether we should use redistributive taxes such as corporation tax and higher income taxes to take back some of the money that is locked up at the top of the economy and put it back into investment, growth and employment measures?

Professor John McHale: I will ask Dr. Donovan to start.

Deputy Richard Boyd Barrett: I am not asking the witnesses to agree with me. I am merely asking whether we should be looking at these scenarios.

Dr. Donal Donovan: It is important to distinguish between austerity and fairness. One can conclude, as the Government and the council have clearly done, that austerity in the sense of reducing the budget deficit by a certain amount over time - one can argue about the amount and the timeframe - is desirable for all the reasons we have been talking about this afternoon. In my view, the question of the fairest and most efficient way of achieving this is a different one. This is where I think a given amount of austerity can be achieved in a fair and equitable way. I think this is what Deputy Boyd Barrett was emphasising, to a large extent. As economists, we are not particularly great at what we do. We are not politicians. We cannot make social choices that have to be made by politicians. One man's fairness is another man's unfairness. One man's level of income at a certain tax rate might be considered too high by another man. Decisions on these matters have ultimately been made by every government, including the Irish Government, over the recent period. I have a personal view, as everyone sitting here probably does. As an economist, it is not relevant. As a citizen, it is. I vote for whoever happens to belong to my persuasion.

The fiscal council has been quite careful about this. We have thought about it a lot. We do not believe our role involves entering into the composition of taxation or expenditure from a fairness or equity point of view. It is not actually in the mandate that was given to us. Obviously, that debate is carried out in a different forum. We all have personal views. As a council, we do not have a position. Efficiency issues are slightly in between. It is more of an area for an economist than for Joe Citizen. There are questions of when taxation becomes inefficient in terms of growth, etc. The council has not gone there either because when one talks about the merits of high or low income taxation, it is usually rather difficult to sort the issues relating to fairness and equity and the personal views one might have about the money people should earn net of taxes from the issues of efficiency and the question of whether an income tax rate of a certain level will have adverse effects on growth. That is a very slippery area. For that reason, the council has decided not to go there. It would involve getting into a very political debate. There might be some economics in it, but there would be an awful lot of politics and many social views in it. That is not our space. I do not know whether that helps the Deputy.

Deputy Richard Boyd Barrett: I would like to elaborate on this question a little. Maybe others would like to comment. I take Dr. Donovan's point. The lines begin to get very blurry when one examines the matter a little. It seems to me that the council believes it has a role in examining what might happen if we do not make the adjustment. It considers whether we might meet certain targets. The issue of unemployment is considered when it is making its projections. It looks at what certain decisions might do to the rate of unemployment. That is where it begins to get tricky. I would argue - it is just my view - that if we took an additional €4 billion in tax from the corporate sector instead of taking it from low and middle income workers, and if we invested €4 billion in public works programmes to develop renewable energy, forestry or generic medicines, to give three examples, this would be a far more efficient form of expenditure and would have a positive impact on our deficit, unemployment, etc. Why would the council not look at that, given that it looks at why we must make cuts in public expenditure?

Dr. Donal Donovan: The answer from my perspective is that it would involve a debate about issues which might be relatively clearcut, from the Deputy's point of view, but would not be clearcut in a broader sense. People might argue that such an approach would unfairly penalise corporation incentives, affect Ireland's image as a place with a certain degree of taxation, penalise work or unfairly hit the rich. Those are not my points of view. I am just saying that is what people could immediately say. I stress the point that we do not want to get into this area because it is very sensitive politically. That is why we do not do it.

Vice Chairman: I ask Deputy Boyd Barrett to let some of the other members of the committee speak. His time is nearly up.

Deputy Richard Boyd Barrett: I would like to ask two more brief questions that require very short answers. Maybe I will get an opportunity to do so.

Mr. Sebastian Barnes: I would like to follow up briefly on what Dr. Donovan was saying. These are vital public policy issues. In a sense, the council is constrained by its mandate. We are essentially looking at the fiscal stance rather than the composition. The latter involves judgments and social choices that the Irish Fiscal Advisory Council is not competent to make.

To make a different point from that made by Dr. Donovan, there is also an issue of the council's capacity in the sense that the job we do is already extremely demanding. We have given some thought to this issue of achieving the right level of credibility and seriousness in our analysis. For example, carrying out an analysis of distributional impacts is a very difficult analytical job that we do not have the tools to do.

Deputy Richard Boyd Barrett: The issue of housing was raised. Evidence is emerging that we have a shortage of housing in areas of housing need. This is about to create a problem, not from the point of view of those who want houses, which is my concern, but from the point of view of the impact this shortage could have on the economy. Is the Irish Fiscal Advisory Council concerned about his looming problem?

Mr. Sebastian Barnes: While there is a point at which such matters could become a concern, they would first have to reach a certain level of impact on the overall economy. One must also remember that the council has been operating for only two years and is gradually building up its analytical tools. As time passes, our analysis will become more granular and precise. We are not currently at a point where we address issues of the type raised by the Deputy, although we may do so at some stage.

Vice Chairman: I understand Deputy Boyd Barrett has two specific questions.

Deputy Richard Boyd Barrett: Yes, on projections for unemployment, which I could not find among the tables, is it the case that if we continue to pursue the current adjustment path, unemployment will be approximately 13% when the programme expires in late 2015? In other words, if we meet all the targets and everything goes well, we will still have more than 400,000 people unemployed. Is this a concern for the council to the extent that it may perhaps consider the issue?

How is the sale of State assets connected to the arithmetic the council is monitoring? I am delighted that none of the sales of State assets committed to under the troika programme has been realised. What requirements are there in this regard if we are to meet the targets set out by the council? How soon must these asset sales take place to keep everything on track from the point of view of the council?

Dr. Donal Donovan: On the first point, as economists, individuals and human beings, all members of the Irish Fiscal Advisory Council are extremely concerned that unemployment is likely to be at such a high level. This is not a matter of different projections. The figure among all analysts is in the ballpark of between 13% and 14%, which is deeply upsetting. I am not an expert in this area - Professor Alan Barrett knows more about it than I do - but it is an extremely difficult problem given the structural unemployment that was created as a result of the collapse of the construction boom. Immigration is an additional factor because many of those who came to Ireland during the boom have remained. They are now working in certain sectors, which reduces the possibilities for Irish people who may otherwise have been in the jobs concerned. These are all factors. I understand the term "historisis" applies. Is that the correct word?

Mr. Sebastian Barnes: Yes, it is historisis.

Dr. Donal Donovan: This relates to the difficulty of effecting change where the labour force is ageing and part of it has become unemployed. Deputy Boyd Barrett asked whether we are concerned about unemployment and if we think about the issue. We think about and are concerned by the issue. I hope everybody is concerned about it, including politicians. Solving it, however, is a much harder task.

I cannot speak authoritatively on the second point raised by the Deputy but it is my understanding that there is not an explicit amount identified as regards expected privatisation receipts that are in the budget for this year. While that statement is correct, the budgetary projections for next year and the following year and the aggregate contained in the memorandum of understanding with the troika and so forth may implicitly include savings or proceeds from privatisation. I do not believe such proceeds have been identified explicitly, although the Deputy should not hold me to that.

Vice Chairman: I ask for final comments as we have another meeting at 7 p.m.

Professor John McHale: My information is that information will be in the stability programme update which will be published in a couple of weeks. The update will identify the anticipated revenues. We do not have that information in the current documents.

Deputy Peter Mathews: With the indulgence of the Chair, I will make a brief contribution on taxation.

Vice Chairman: No, I am concluding the meeting. I thank Professor McHale and the other members of the Irish Fiscal Advisory Council for their time. This was a useful meeting in which we heard a broad range of opinions and had a good discussion. We will not abuse our guests' kindness as they may decide not to come back.

Professor John McHale: We will certainly come back. The meeting has also been very useful for us.

The joint committee adjourned at 5.35 p.m. until 5.30 p.m. on Tuesday, 30 April 2013.