DÁIL ÉIREANN

AN COMHCHOISTE UM AIRGEADAS, CAITEACHAS POIBLÍ AND ATHCHÓIRIÚ

JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM

Déardaoin, 19 Meitheamh 2014

Thursday, 19 June 2014

The Joint Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Senator Sean D. Barrett,
Deputy Pearse Doherty,	Senator Thomas Byrne,
Deputy Regina Doherty,	Senator Mark Daly,+
Deputy Stephen S. Donnelly,	Senator Aideen Hayden.
Deputy Timmy Dooley,	
Deputy Joe Higgins,	
Deputy Heather Humphreys,	
Deputy Kevin Humphreys,	
Deputy Michael McGrath,	
Deputy Kieran O'Donnell,	
Deputy Arthur Spring,	

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

In attendance: Deputy Peter Mathews.

DEPUTY CIARÁN LYNCH IN THE CHAIR.

Business of Joint Committee

Chairman: I propose that we commence proceedings and suspend them immediately until 2.20 p.m. Is that agreed? Agreed.

Sitting suspended at 2.10 p.m. and resumed in private session at 2.25 p.m. The joint committee went into public session at 2.30 p.m.

Fiscal Assessment Report 2014: Irish Fiscal Advisory Council

Acting Chairman (Deputy Kieran O'Donnell): I welcome Professor John McHale, chairperson, Professor Alan Barrett, council member, Mr. Sebastian Barnes, council member, Dr. Róisín O'Sullivan, council member, and Mr. Diarmuid Smyth, chief economist, from the Irish Fiscal Advisory Council who are here to discuss the fiscal assessment report for 2014. I understand Dr. Donal O'Donovan is unable to attend and sends his apologies. Mr. John Howlin, Mr. Eddie Casey, Mr. Andrew Hannon and Ms Rachel Joyce are also in attendance. The format of the meeting will be that Professor McHale will make some opening remarks and there will then be a question and answer session. I remind members, witnesses and all those in the gallery that all mobile phones must be switched off to avoid interference with the broadcasting of the meeting.

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

I invite Professor McHale to make his opening statement.

Professor John McHale: On behalf of the council, I thank the committee for once more providing us with an opportunity to discuss our assessment. The council views interactions with this committee as integral to our work and they have proven to be extremely valuable. Other members in attendance with me today are Mr. Sebastian Barnes, Professor Alan Barrett and Dr Róisín O'Sullivan. Unfortunately, Dr. Donal Donovan, who is based in the United States, cannot attend today. The council secretariat is also present: Ms Rachel Joyce, Mr. Eddie Casey, Mr. Andrew Hannon, Mr. John Howlin and Mr. Diarmaid Smyth, head of the secretariat and chief economist. I would also like to take this opportunity to acknowledge the ongoing interaction between the secretariat and the staff of the Oireachtas. This work supports the very useful engagement we as a council have had with this committee.

Today I will cover our sixth assessment report, which was published last Tuesday, 17 June. The report is written in line with the mandate of the council set out in the Fiscal Responsibility Acts 2012 and 2013 and also with the memorandum of understanding between the council and the Department of Finance.

At the outset of this discussion, it is worth noting the significant progress that has been achieved in resolving the fiscal crisis. Ireland's debt-to-GDP ratio should now be on a declining path, underpinned by nominal GDP growth, record low interest rates and the move to a planned balanced budget between 2013 and 2018. The borrowing capacity of the State has also been restored, with secondary market bond yields falling to low levels. Furthermore, the five main rating agencies all now rate Irish sovereign debt at investment grade. However, this is not to downplay the significant macroeconomic and fiscal risks and challenges that remain, not least high debt levels and uncertain growth prospects. It is part of the role of the council to analyse these risks and challenges as part of its assessment of the macroeconomic and fiscal position.

On the basis of the analysis in our report, the planned €2 billion adjustment for budget 2015 should be implemented. There are three main reasons for this recommendation. First, while significant progress has been made in repairing Ireland's public finances, the gap between general government expenditure and revenue is still projected to be close to €8 billion in 2014. Slowing the pace of deficit and debt reduction would leave the public finances more exposed to shocks that create unsustainable debt dynamics. Second, even with the encouraging recent fiscal performance, the central projections of the stability programme update, SPU, 2014 indicate no margin of safety around the EDP deficit ceiling for 2015. Recognising the high level of uncertainty surrounding the level and composition of growth, reducing the planned adjustments would increase the probability of missing the target and put the EDP exit in jeopardy. Third, the dramatic reduction in the risk premium on Irish debt has reflected, among other factors, the increasing credibility of Ireland's capacity to make necessary fiscal adjustments. While the relatively small reduction in planned consolidation in the last budget does not appear to have harmed Ireland's credibility, a second year of scaled-back adjustment effort could raise doubts about the political capacity to make necessary adjustments outside of a formal external programme. This is particularly important as this will be the first budget following the ending of Ireland's programme of official assistance.

Two separate fiscal objectives frame the 2104 stability programme update projections. The more immediate target is the requirement to achieve a general government deficit of less than 3% of GDP in 2015 under the EDP, to which I have already referred. The next objective is to meet the medium-term budgetary objective of a balanced budget in structural terms by 2018. This deadline is ambitious and exceeds minimum requirements under the rules. As part of the report, the council calls for a clear rationale to be provided for this deadline.

While the Government's medium-term fiscal stance is assessed to be within the range of appropriate policies, it implies a stronger drag on demand and even greater pressures on spending than meeting the minimum requirements under the rules. Recognising the trade-off between supporting domestic demand and improving debt sustainability, there is a case for a less ambitious medium-term fiscal stance that more closely follows these minimum requirements.

Moving beyond the headline figures, the medium-term fiscal adjustment plans imply a sustained fall in non-interest Government spending as a share of GDP. In fact, the SPU projects that Government non-interest spending will fall by approximately 8 percentage points of GDP by 2018. This leaves non-interest spending at an historically low proportion of economic output and implies considerable pressures on Government services, public investment and social payments.

The prolonged tight spending plans will be difficult to achieve given demand pressures and rigidities in certain areas of expenditure. The forthcoming comprehensive review of expenditure needs to be used to identify appropriately detailed expenditure plans. This would help to promote informed public debate and enhance the credibility of budgetary projections over the medium term.

One area of particular relevance for this committee highlighted in the report is the strengthening of Ireland's fiscal framework. This is an important positive legacy of the economic crisis and one which the Government has made a strong commitment to respecting. The framework is a combination of European-level elements under the reformed Stability and Growth Pact and national-level elements that are designed to complement and extend the European rules. Consistency between the national and European frameworks allows the two sets of formal rules and enforcement procedures to reinforce each other. The monitoring, peer pressure and financial sanction procedures of the SGP help give credibility to the national rules, while the monitoring and enforcement procedures of the national rules provide a degree of domestic oversight and ownership of the overall rules framework. This later element of monitoring and enforcement of the national rules includes roles for both the Oireachtas and the fiscal council. Adhering to the new fiscal framework should help to smooth future boom-bust cycles, guide Government debt to safer levels, and underpin borrowing capacity during the period when debt will remain unavoidably high.

However, for the framework to be an effective bulwark against instability, it is important that it has broad public understanding and support. In assessing the constraints imposed by the new fiscal framework, the constraints that are also imposed by debt markets on fiscal policies should not be forgotten. As experienced by Ireland in 2010, debt markets can be even more demanding in terms of the fiscal policies viewed as consistent with access to funding to cover deficits and roll-over debts. A credible commitment to a framework that ensures debt sustainability can, therefore, expand rather than narrow the room for fiscal manoeuvre.

Our assessment is that the plans in the SPU are consistent with this new framework. Post-2015, the Government is committed to meeting the requirements of the national budgetary rule and the requirements of the preventive arm of the Stability and Growth Pact.

At our last meeting, I highlighted the new role for the council in independently scrutinising and endorsing, if appropriate, the macroeconomic projections underpinning budgets and stability programme updates. This significant change in Ireland's budgetary architecture was extended in this round to include medium-term macroeconomic forecasts. The SPU forecasts are within an endorsable range, taking into account the methodology and the plausibility of the judgments involved, as well as the uncertainty surrounding any growth forecast. However, the forecast medium-term real GDP growth rate of 3.5% is at the relatively optimistic end of the range.

At our last meeting, several members of the committee highlighted concerns over recent developments in house prices. In response to this, our latest report includes an analytical note examining house price risks. In summary, we find that the recent price appreciation is likely to be driven by a reversal of some over-correction, while supply constraints are also likely to be key drivers. However, even if supply issues are at the core of the recent appreciations, the authorities should remain vigilant. More detailed fundamental analysis of the housing market, if made publicly available, should also limit risks of price growth expectations becoming dislodged from fundamentals. This is obviously an area of concern for the committee and we will continue to monitor housing market developments closely. I thank the committee for providing us again with the opportunity to attend today and we look forward to taking questions and hearing the views of members.

Acting Chairman (Deputy Kieran O'Donnell): I thank Professor McHale. Is it in order to publish his statement?

Professor John McHale: Yes.

Acting Chairman (Deputy Kieran O'Donnell): Before I proceed to Deputy Michael McGrath I wish to make a few points of clarification. Was the opinion that €2 billion of tax and cuts should take place in the 2015 budget a unanimous decision or a majority decision of the Fiscal Advisory Council?

Professor John McHale: It was a consensus decision. In all our decisions so far we have not had to take any votes. We have very extensive-----

Acting Chairman (Deputy Kieran O'Donnell): That does not mean there were not differing opinions.

Professor John McHale: We have extensive discussions and we seek to convince each other but all our decisions so far have been by consensus.

Acting Chairman (Deputy Kieran O'Donnell): How do the other members feel? The forthcoming budget is a huge issue. Would the other members care to comment?

Professor Alan Barrett: Let me put it in relative terms. In earlier years there would have been more disagreement among the council members about the precise level of adjustment. The other members can correct me if I am wrong but there was a stronger degree of consensus this time around. It was a firm degree of consensus. Relatively speaking, it was much tighter this time.

Mr. Sebastian Barnes: I would support the way the decision has been characterised.

Dr. Róisín O'Sullivan: I also agree with what was said by Professor Barrett.

(Interruptions).

Professor John McHale: Dr. O'Donovan is very much part of the consensus.

Acting Chairman (Deputy Kieran O'Donnell): Very good. We are all into consensus at the moment. The fact is that taxes are just short of €500 million ahead of target at the moment. The ordinary person is under enormous financial pressure. The sum of €2 billion is significant. Did the council not factor into its considerations the fact that the economy is doing well and there is employment growth?

Professor John McHale: Yes, we certainly did. The framework that we have used in considering the appropriate fiscal stance has always balanced the harm that fiscal adjustments do to the domestic economy and to the living standards of households in the economy against the need to ensure the borrowing capacity of the State and that the debt is on a sustainable path. The way we see it, we made significant progress in correcting the public finances and restoring the borrowing capacity of the State. We see borrowing costs now coming down to record low levels. Significant credibility has been built up in the adjustment process so far and much of that has come from following through on the plans with successive Governments doing what they said they were going to do; not just meeting the headline targets in percentage GDP terms but delivering the adjustments that have been promised. That has been significantly behind the progress that has been made.

Thinking about the headline 3% target, it very much depends on the growth of the economy. As you said, Acting Chairman, the economy seems to be performing reasonably well in the early part of this year. Exchequer returns have been encouraging but there is still a lot of uncertainty around growth for this year and also, looking out to 2015, one of the things we know from the international experience on financial crises of the kind we have been through is that growth can be erratic and prone to setbacks. While we do seem to be on an encouraging path at the moment, there are no guarantees that will continue.

Acting Chairman (Deputy Kieran O'Donnell): Where does Professor McHale see the risks to the Irish economy? The council has reached a consensus following deliberations. What is the underlying reason for its decision and where does he see the risks to the Irish economy in the next 12 months?

Professor John McHale: There are a number of risks. In terms of the domestic economy, we know the balance sheets are still very much impaired across the economy. Again, looking at the international experience, we know that can have a considerable drag on spending. We also see that credit is still very much impaired and that could affect domestic demand, in particular investment demand. The prospects in the international economy, unfortunately, are still quite uncertain. The United Kingdom economy seems to be performing strongly. In the US, Chairman Yellen downgraded growth forecasts. There is a lot of uncertainty as to whether the eurozone economy is really pulling out of the recession it is in. There are concerns about falling into a low inflation and possibly deflationary trap. There are still a lot of uncertainties around the international economy.

When it comes to our borrowing costs, what has brought bond yields down has been the combination of success in the fiscal adjustment process and also developments internationally at the European level, in addition to the actions taken by many central banks around the world. There is a possibility that some of those positive developments could reverse and if at the same time we were losing credibility to stick with the adjustment programme, that could lead interest rates to rise back up again. There are a number of risks. It is to be hoped that none of those negative scenarios will come to pass, but one thing we know from watching the economy – I am sure you know this yourself, Acting Chairman - is that the economy will surprise one. Given the importance of getting out of the excessive deficit procedure which requires that we get the deficit down below 3% of GDP, at this point in time, given what we have achieved already and given the risks that remain, we think that it is appropriate to follow through on those plans for an adjustment of €2 billion, giving us a very reasonable chance that we can put the excessive deficit procedure behind us.

Deputy Michael McGrath: I welcome Professor McHale and his colleagues. I thank him for his opening statement. We have already looked at the report. To continue on from where the Acting Chairman left off on the €2 billion adjustment – Professor McHale made his views on it very clear – does he think that if the Government goes with its stated intent of making an adjustment of less than €2 billion, but we do not know how much less, there is a significant risk that we could not achieve a deficit of less than 3% by the end of next year? How would Professor McHale characterise the risk if the Government were to make an adjustment of €1 billion or €1.5 billion, for example? What would be the consequences of missing the target in that regard?

Professor John McHale: The forecasts we are assessing in the report are the Government's forecasts on the stability programme update. The forecasts factor in a €2 billion adjustment and based on that adjustment assumption, the projection is that the deficit would be 2.9% of GDP in 2015. It would just meet it. If one were to do less, based on those projections the risk of missing the target would be greater than 50% unless one were to pursue other policies such as perhaps delaying capital spending in 2015 if one thought one would miss the target, but that is not something we would want to do either and that is not the way to allocate public expenditure. Given the strong Exchequer returns to which Deputy O'Donnell referred, based on a €2 billion adjustment, the projection for the deficit in 2015 might now be a bit below 2.9% but probably not that far below it. Significantly reducing the adjustment below €2 billion substantially increases the risk of not meeting the target or being forced to pursue sub-optimal policies to meet the target, which is not something we would welcome.

Deputy Michael McGrath: What are the consequences of missing the deficit target, which is actually a limit? It is referred to as a target but it is a limit in that it has to be less than 3%; it is not a target. What are the consequences, directly and indirectly?

Professor John McHale: Starting with the more indirect consequences, it would be a blow to the credibility that has been hard won. We have met all the targets to this point and if we were seen to pursue policies that lead us to start missing the targets in the first budget post-troika, much of that credibility would be undermined, particularly the ability to follow an appropriate fiscal policy outside an official assistance programme.

The potentially more direct consequences could be sanctions from the European Commission. Getting the deficit below 3% of GDP is enough to get out of the excessive deficit procedure. If we miss that target the Commission will do an analysis of what it calls effective action to see if we pursued the right policies but ended up missing the target because of a bad outcome on economic growth. Where we have pursued what it views as effective action, it can extend the target so the consequences are not all that severe. If we are viewed not to have taken effective action, the sanctions process could begin, initially leading to a fine of approximately €300 million, which is significant. Going through that sanctions process would be very damaging to credibility and is certainly something that would be much better avoided.

Deputy Michael McGrath: On the issue of the budget, as Professor McHale is aware, the Government has signalled that there will be some reductions in income tax, focusing on the income threshold at which a person enters into the marginal rate. What are Professor McHale's views on whether it is an appropriate policy at this time to reduce income tax and, if we do reduce it, what is the best way to configure it by changing the threshold at which people hit the marginal rate?

Professor John McHale: Unfortunately, that goes beyond our mandate. In terms of the role we can play in the process, it is better that we stick close to that mandate, which focuses on the broader macro picture. If the Government were to choose to make adjustments to taxes, lowering some tax rates or changing tax bands, offsetting it with other measures either on the tax or the expenditure side, that is very much a decision for the democratically elected Government. It is not our place to give specific advice on that.

Deputy Michael McGrath: Professor McHale has made some comments on the issue of whether it is wise to reduce the income earning capacity of the State at this time.

Professor John McHale: Yes, at an aggregate level. We are looking beyond 2015, and something we do in this report is look at the expenditure projections to 2018. A quite startling figure can be seen if we look at non-interest spending over the period 2013 to 2018. It is projected to fall by eight percentage points of GDP, which is a very significant fall.

As we look over the period 2016 to 2018, in money terms non-interest spending is being held constant but the presumption is that we will have growth in the economy. Therefore, spending will be shrinking as a share in the economy. It will also be a time of significant demographic pressures and other demand in cost pressures on spending. Therefore, we need to be aware that even though the worst of the fiscal adjustment should be over in 2015, it will still be quite a difficult period after that, particularly given those underlying spending pressures. Care would need to be taken in reducing aggregate revenue raising capacity in that situation, but we are not providing advice about particular taxes. That is very much a decision for Government.

The other aspect we note in the report is the importance of the upcoming comprehensive review of expenditure. Given those very strong underlying spending pressures, it would be important to plan expenditure very carefully to identify areas where spending can be restrained in a way that does least damage to public services and to people relying on social payments. It is a combination of not undermining that revenue raising capacity and also very carefully planning expenditure over the next number of years.

Deputy Michael McGrath: I want to probe Professor McHale further on the medium-term objective of a balanced budget in structural terms by 2018. Yesterday, the Minister for Finance stated that the Department's assessment is that if the growth projections are achieved, beyond the budget for 2015 there will be no need for any further fiscal consolidation to achieve a balanced structural budget by 2018. We can contrast that with the IMF's report yesterday which indicates additional fiscal consolidation in the region of €7.5 billion between now and 2018. Will Professor McHale discuss that? He has said that based on the SPU 2014, non-interest expenditure would have to fall by about 8% of GDP by 2018. What are we facing into after the budget this coming October?

Professor John McHale: Based on the Department's forecasts, additional nominal adjustments of the kind that make up the planned €2 billion for the coming budget do not seem to be required for the period 2016 to 2018. Things will change a little as we get closer to that but that is the assumption under which those medium-term projections are being made.

The reason we still get an improvement in the structural balance is that essentially we are holding spending growth below the growth rate of nominal GDP. Also, given the progressive nature of the tax system, even holding tax rates and tax bands constant in nominal terms, we can also get increases in revenue as a share of GDP. We can get improvement in the underlying structural balance.

It is important to note that just keeping expenditure constant in nominal terms, particularly given these underlying pressures, can be extremely difficult to achieve. We saw with health last year that because of demographic pressures, the amount of savings it had to achieve were well in excess of the overall cut in its gross expenditure because our savings had to make up for the underlying demographic and other service related pressures. It will still be quite a challenging period, even though the worst will be over.

Deputy Michael McGrath: If I interpret him correctly, Professor McHale is saying there will not necessarily be a need for new budget day measures in terms of fiscal consolidation, but if we are standing still in terms of spending levels and on the tax side - credits and so forth - in real terms *vis-à-vis* the nominal GDP and inflation, that is a real cut in terms of standard of living, which is what it will translate into. Professor McHale is envisaging a very significant cut in spending.

While Professor McHale is making the point that the Government does not have to do this by 2018, what are our options in terms of meeting our responsibilities under the fiscal compact treaty to achieve the medium-term objective? Over what period of time could we be doing that, and would that be better in terms of more gradually achieving that objective instead of doing it over a tight three-year window after next year?

Professor John McHale: That is something on which we are looking for further clarity. I will give the Deputy some background on the rules that will apply to us post-2015, assuming we make a successful exit from the excessive deficit procedure. Currently, we are in the corrective arm of the Stability and Growth Pact, also known as the excessive deficit procedure. Once we are out of the corrective arm we are into what is called the preventive arm, which is a different set of rules. The preventive arm is largely mirrored in our own national budgetary rule, which is part of a fiscal responsibility Act that effectively implements the fiscal treaty. Under the preventive arm, one either must be at what is called one's medium-term objective - which in Ireland's case is a structural budget balance - or one must be on an adjustment path to that medium-term objective. While the minimum required adjustment is 0.5% of GDP, the Commission has noted that for high-debt countries, a reduction of 0.6% of GDP is required. If one considers the plans set out in the stability programme update, SPU, for the period 2016 to 2018, it provides a total adjustment in the structural balance of 2.7% of GDP. However, if one implemented the reduction of 0.6% each year, that would amount to a cumulative adjustment of 1.8% of GDP. As this involves an additional fiscal tightening in nominal terms of approximately €2 billion, it is quite significant. Consequently, it is not at all clear at this point that it actually is required to get to that structural balance by 2018. If one follows the 0.6% annual reduction, one potentially could do it by 2020 or even possibly by 2021. We have had extensive background discussions with both the Commission and the Department of Finance and based on those discussions, we really still do not have a clear picture as to how the 2018 date has been set. The main thing for which the Irish Fiscal Advisory Council is asking is to set out a clear rationale as to how that relatively early target date was decided on, because against this background of strong expenditure pressures, we do not wish to be setting targets that in a sense are needlessly ambitious, given the pressures that will create.

If I may add one last point in this regard, given the council has tended to call for more and not less fiscal adjustment, it may seem a little unusual to members that in this case, we are worried about being too ambitious in terms of the fiscal targets. However, this is all based on having in place a credible fiscal framework. If such a framework is in place, hopefully with buy-in across the political spectrum, as well as from the public, it gives more space basically to follow the requirements of that framework and to avoid being obliged to do more to convince debt markets that their investments are safe. However, assuming that such a credible fiscal framework is in place, following the requirements of that fiscal framework should be sufficient to ensure ongoing borrowing capacity for the State.

Acting Chairman (Deputy Kieran O'Donnell): As a small aside following on from Deputy Michael McGrath's questions, what level of growth rates would Ireland need to enable the meeting of the targets post-2015 without needing to have adjustments? Has the council considered that type of analysis? I mean the growth rates required to meet the balanced budget. Deputy McGrath made reference to the Government's growth path figures. Did the Irish Fiscal

Advisory Council examine this issue?

Professor John McHale: To go back to my response to Deputy Michael McGrath, in terms of nominal adjustments at budget time, the assumption is that further nominal adjustments would not be required under the Government's current nominal growth projections.

Acting Chairman (Deputy Kieran O'Donnell): Does the council concur with that projected level of growth?

Professor John McHale: While we have no reason to argue with it, I again note this still does not mean this is not quite a difficult period, albeit much less difficult than the sorts of adjustments through which we have gone in recent years and once again in the coming budget.

Mr. Sebastian Barnes: If I may come in on this point, one way of looking at the question is that if everything works out like the Department of Finance forecasts state, we will get to the medium-term objective, MTO, in 2018. However, there are many risks around that. For example, if one looks at the Department of Finance's forecasts for GDP, they are higher than those of the Commission or the IMF. While we have endorsed them, we did say they were at the optimistic end of the range that we would consider for endorsement. It may well be that things do not turn out like the Department of Finance assumes and then it will be much more difficult to meet this 2018 target.

Deputy Arthur Spring: First, I will play on the subject that has just been brought up. The targets to which the council subscribed both last year and this year are roughly what were put in place by the troika. Last year, the Irish Fiscal Advisory Council recommended an adjustment of €3.2 billion and this year it is talking about €2 billion to €2.1 million. Does this give recognition to the fact that the State's finances have improved dramatically since 2011? There have been some draft reports from the Commission in the wake of its departure and it believes the economy is improving. Should this not blend into the form of adjustment that should be made?

My second point is that we made approximately €600 million - this is a debatable figure as some say it was €400 million - less of an adjustment last year in the budget. Did that affect yields on Irish ten-year bonds, which are the quintessential barometer by which one measures it? Professor McHale referred in his opening statement to how this could be detrimental if we were to not meet our targets. My opening question is how do both those factors play out?

Professor John McHale: I refer to the €2 billion planned for this year and the €3.1 billion the Deputy mentioned for last year. As for the €2 billion adjustment for this year, the Deputy mentioned the European Commission, which actually believes we will need adjustments of €2.6 billion in the coming budget to meet the 2.9% target and that largely reflects a more pessimistic assumption about growth. Even though the fiscal correction has evolved according to plan and there are tentative signs that the economy is recovering, this again merely underlines the uncertainty that still remains. As for the yields on Irish bonds, the Deputy is absolutely right and yields have fallen since budget 2014. It does not appear as though reducing the size of the adjustment from €3.1 billion to €2.5 billion has done any significant damage. However, one must realise there are many factors affecting bond yields, which include international factors such as the quantitative easing programmes undertaken by different central banks, including those of the United Kingdom and the United States. In addition, developments at eurozone level have strengthened confidence that support would be there at a European level, which makes it less likely that countries could end up defaulting and therefore, investors are not demanding such large risk premia.

Deputy Arthur Spring: Are there factors outside of the subjects under discussion here that Professor McHale could envisage having a detrimental effect on the Government's ten-year bonds, were we to not stick with the figure the council and the Commission are proposing? Can Professor McHale foresee anything he can highlight to members?

Professor John McHale: There certainly are lots of risks out there. I have mentioned some of the growth-related risks at the domestic and international levels. There also are-----

Deputy Arthur Spring: While there always are risks, are some becoming more prevalent?

Professor John McHale: Just to mention another type of risk that is more of the policy side, one thing that certainly supported the fall in borrowing costs has been the European Central Bank's outright monetary transaction, OMT, programme even though it has never actually had to be put into effect. However, the fact it is there seems to have had a very positive effect in bringing down bond yields. Relatively recently, the German constitutional court has raised major concerns about that and there also have been statements from the German finance minister noting that since one requires a European Stability Mechanism, ESM, programme in order to qualify for OMT, any ESM programme would require unanimity among all countries. Again, this could raise doubts about whether OMT would be available when needed. Consequently, there always is a risk of setbacks and the sorts of developments that really have helped to underpin the fall in Irish borrowing costs could reverse themselves. However, I wish to stress I do not believe the fall in Irish borrowing costs is just because of these international developments. There has been a positive interaction between our demonstration of our capacity to make the fiscal adjustments, which often makes us eligible for these types of programmes. Those two matters have interacted positively together which is why we certainly do not want to have backsliding at the international policy level. Also, if we were to move away from that demonstration that we can make those adjustments, that could have a negative effect as well. We really need both continuing to work together to keep the low bond yields that we have at present.

Professor Alan Barrett: To add an additional point which arises in the context of the question about risks, bond yields, etc., there is an important context here. If we were all sitting around and rationally discussing fiscal policy, what was optimal, etc., and it was all about the economics, maybe one could make a case. However, we all know that the background here is the local election results. The international community looking in will know that a lot of the discussion around the potential slippage from the targets is related to this domestic event and the forthcoming general election, even though it is whatever number of months away. Although we have not mentioned it, it is a reality. Even if one goes back to a year ago, we might have had discussions around the weakening of austerity, loosening our resolve and things like that. The context has now changed a little and it is important that we take-----

Deputy Arthur Spring: It was as important for the Commission as it was for everybody else.

Professor Alan Barrett: It is important that we recognise that the context matters. Even though we loosened last year, relatively, the reason behind it has to be taken into account next year, and it raises the worry that this could be quite a damaging own goal.

Deputy Arthur Spring: I suppose the result of the local elections and European elections was because of the pressure of people's lives. It feeds into the system. It is relative to people's lives. That is the way the system works.

The last part of this is the adjustment that the Irish Fiscal Advisory Council purports to be necessary. If one makes an adjustment of €2 billion in cuts and taxes, what effect will it have on GDP?

Professor John McHale: The multiplier assumption that we use in our own modelling is 0.5, which is in line with the international evidence for a small open economy in the kind of circumstances in which we find ourselves and also the limited amount of domestic indicators of events.

Deputy Arthur Spring: Is that 0.5 of GDP or 0.5 of the adjustment?

Professor John McHale: It is 0.5 of a multiplier. If one was to implement a €2 billion adjustment, that essentially knocks off approximately €1 billion from nominal GDP. It is significant. Going back to what I stated at the outset, this trade-off between the damage that fiscal adjustments do the economy and ensuring that we retain the borrowing capacity of the State and the sustainable debt situation is the thing we are always grappling with.

As I have stated to this committee in the past, all the members of the council approach macroeconomic issues from a Keynesian-type perspective. There are certainly differences among us in the kinds of model that we bring, but that really means that we recognise that fiscal adjustment slows the economy. If we were not facing any constraints in borrowing capacity, good macroeconomic management would tell one to try to phase the adjustment out to better times. We recognise that one does not want to be making the adjustment when the economy is on its knees. The unfortunate aspect is that we faced major constraints in borrowing capacity, and even though there have been improvements, there still remain substantial fragilities. We are grappling constantly with that particular trade-off.

Deputy Kevin Humphreys: I would nearly ask Professor Barrett, if he is into forecasting and he has gone into elections, whether he wants to forecast the date of the next general election, but I will not.

A Member: He said “months”.

Professor Alan Barrett: I was going to say “Next week”.

Acting Chairman (Deputy Kieran O’Donnell): He certainly put it back when he was saying “whatever number of months.”

Deputy Kevin Humphreys: Professor McHale answered Deputy Spring on the adjustment resulting in a reduction of €1 billion in GDP. There is also a confidence shock for the ordinary punter, which affects whether they spend or save their money. Would he agree that at this stage an adjustment of €2 billion could undermine GDP by a far greater figure than €1 billion?

Professor John McHale: The 0.5 multiplier captures the full range of effects, but I take the point made by Deputy Humphreys.

Deputy Kevin Humphreys: We have gone through several years.

Professor John McHale: Multipliers can vary over time, and 0.5 is our best guess.

Deputy Kevin Humphreys: If one looks at what the Irish economy has gone through, 0.5 may not be the optimal figure. If €2 billion was taken out of the economy at this stage, the effect on GDP could be far greater than €1 billion. I accept that it is a question of forecasting and there is no specific figure.

Professor John McHale: I take that point. There are other uncertainties as well. If scaling back the adjustments were to undermine the hard-won credibility that we have achieved on the borrowing side, the spectre of falling back from the progress we have made over the past number of years could also be a significant hit to confidence. It can work in different ways.

I take Deputy Kevin Humphreys's general point. There is a lot of uncertainty around that particular multiplier figure and there are many factors that feed into it.

Deputy Kevin Humphreys: My point is that if one makes an adjustment of €2 billion in this budget, one could tear the arse out of consumers' confidence and put us into a different position, and that is quite possible. Would Professor McHale agree with that?

Professor John McHale: In a sense, Deputy Kevin Humphreys is saying that this trade-off that I was talking about can be severe in both directions. If one does not make the adjustments, one could undermine a lot of the progress we have made so far, which itself could have negative effects on the economy, but making the adjustments also has negative effects. There really are no easy answers. It is a balancing act.

Deputy Kevin Humphreys: At the end of the day, it is a judgment call that will have to be made by the Cabinet. There are equal dangers in the recommendation. With hindsight, if one looks back to last year, when there was a decision to be made between a €3.1 billion adjustment and a €2.6 billion adjustment, which, like a table tennis ball, went back and forth, would Professor McHale agree that the correction that was made was the correct one, rather than the €3.1 billion recommended by the fiscal council?

Professor John McHale: My colleagues will give their views. We still believe that an adjustment of €3.1 billion would have been appropriate. That might have allowed for scope to reduce the adjustments as we moved out to 2016, but sticking with the plan was the appropriate adjustment.

Deputy Kevin Humphreys is correct in stating that the Cabinet will make the decision. What we are giving the committee is our judgment. One aspect of our judgment is that it is totally based on the economics. Ultimately, the decision will be a political one, and political factors will enter into that.

Deputy Kevin Humphreys: There is also a consumer confidence element in it.

Professor John McHale: I understand that.

Deputy Kevin Humphreys: That cannot be captured by raw data.

Professor John McHale: Even on the economics, I can understand that judgments can differ in terms of the nature of that trade-off, but we are weighing that trade-off as well in our judgment that, based on the way we see the economics, the €2 billion is appropriate.

Deputy Kevin Humphreys: Based on the fiscal council's figures and forecast, if one takes the figure for the first five months as €404 million, we are talking about approximately €600 million at six months. In last year's returns, it was the second half of the year when the tax take improved. What figures for the tax take has the fiscal advisory council included in its forecast? Did it expect the €404 million in the first five months?

Professor John McHale: We certainly had that data in putting together this report.

Deputy Kevin Humphreys: What did the fiscal advisory council forecast for the full year? If it is €404 million for five months, did they forecast what it would be for 12 months?

Professor John McHale: Will Mr. Smyth deal with that?

Mr. Diarmaid Smyth: Yes. Generally, I would wait. We have had only five months of Exchequer data, and we have had only two months of Exchequer data since the stability programme, and it would be prudent to wait until at least we have had eight to nine months of data. Deputy Humphreys is correct that taxes are ahead by €500 million, although approximately half of that reflects income tax and corporate tax, the latter of which is particularly volatile. Some of the other savings probably do not reflect big structural improvements. For example, we have seen Central Bank profits go up as well as interest savings. Some of the headline figures may overstate the improvement. It is probably a little early in the year. Certainly, so far taxes are ahead, but there are some big months ahead, particularly November. It is prudent to wait and see at present.

Deputy Kevin Humphreys: I very much agree with Mr. Smyth that it would be prudent to wait until later in the year to make this kind of definite decision on a correction of €2 billion, or how far ahead we will be on the tax take and how the employment figures will go. It is still very much a forecast but the Cabinet makes a decision on the correction as there will be far more data available to it. Is that correct?

Mr. Sebastian Barnes: That is true but one is talking about October. There will still be a lot of uncertainty even about what happened in 2014 come this October. There is still a fair amount of uncertainty about 2015. On page 63 of our report we have a fan chart that expresses the uncertainty around the Government deficit. The range of uncertainty is narrowing over time but it is still quite big at that point. It is important to bear in mind that since last year, the budget has been moved forward. Critically, it has been moved forward ahead of the November Exchequer returns which are pretty hard to predict.

In our previous report we did some analysis which pointed out that the uncertainty around budget day forecasts is now significantly higher than it was in the past. Although there will be more information by October, it is not as if 2014 or 2015 will be a done deal; there will still be a lot of uncertainty around.

Mr. Diarmaid Smyth: Although there is tight control on spending, last year the pressures in the health sector became apparent from August, September and October onwards. In March, April and May this year we saw the overrun has gone from €50 million, to €100 million to €165 million. There are expenditure pressures on the Department of Health, so there are some concerns as well as positive news on the tax side.

Acting Chairman (Deputy Kieran O'Donnell): Time is running short.

Deputy Kevin Humphreys: Okay, I will finish. As regards the unemployment figures and the growth in jobs there are two elements: the reduction in expenditure and an increase in taxation and PRSI income. In what way has the Fiscal Advisory Council calculated that in forecasting for the continuation of the year?

Mr. Diarmaid Smyth: PRSI receipts are ahead of profile as are the income tax ones. Taxes look good so far but on the basis of five months I would not go too much away from the SP's

4.8% forecast for this year, given the data we have since the stability programme came out.

Deputy Kevin Humphreys: I would make the same argument back to Mr. Smyth. It is too early to say that the correction should be €2 billion until further data come in. I think we broadly agree on that point.

Deputy Pearse Doherty: I again welcome the representatives of the Fiscal Advisory Council to the committee. They have provided a wealth of data that we can pore over. I have not been able to go through all the data since the report was published but it is good to see that an analysis has been done on housing. That issue will be monitored in future so we should revert to it.

It is regrettable that we and the public end up focusing on one line in the data, which is the overall adjustment figure, although that is important. More important is where the adjustment is made, be it in public services, the low-paid or highly-paid, but that is outside the council's remit. That is the real debate on those type of adjustments. Given the amount of detail and research that has gone into the report, however, it is a pity to focus on only one aspect.

Having said that, I do not agree that society can take a €2 billion adjustment in the next budget. I understand the authority that the Fiscal Advisory Council has been given is to ensure that we meet the rules under the fiscal compact or austerity treaty. If that is the council's task, it is important for it to ensure that the State meets the rules in acting prudently, conservatively and cautiously.

Acting Chairman (Deputy Kieran O'Donnell): Deputy Doherty's i-Pad is interfering.

Deputy Pearse Doherty: Therefore, it is always asking to go further than necessary in order to give itself that little bit of leeway. I do not think the Government has ever agreed with the council's position on the level of adjustment. There is a long-term problem, however. Whether or not we agree with the Government's position, the Fiscal Advisory Council is statutorily bound to provide data, yet within a day of that data being published, the Minister for Finance may say he is not accepting it. The Minister has to weigh up public concerns and he is right in making that call. He may say that is because the council does not have all the data. He told the committee yesterday that the council does not have the soft data which the Department has. The problem is that the council should have whatever data the Department has. It does not make any sense for the council to assess whether we will reach targets, if the Minister tells the committee that the council does not have all the soft data available to the Department concerning the €2 billion adjustment being made. How can we strengthen that situation and deal with it? Does the council see that as a problem in future?

Professor John McHale: I will take Deputy Doherty's points in order. First, I agree with him about the excessive focus on the sum of €2 billion. It is something that we struggle with because there is quite a lot in the report. It is what the media wants to focus on and it is an easy message to get across. One of the benefits of our interaction with this committee is that we can talk more broadly about the report.

Deputy Doherty noted that we are focused on following the rules. It is true that part of our mandate is to assess compliance with the national budgetary rules under the Fiscal Responsibility Act, but we also assess the overall fiscal stance separately from the rules. While sometimes it may not come across this way, we share the committee's concerns. Ultimately, it is what all of this means for households in the economy. The challenge is to have as little austerity as possible.

When the Fiscal Advisory Council first came into being in 2011, the markets were pricing in close to a 90% probability of an Irish default. That loss of capacity would likely have led to much greater austerity.

Deputy Arthur Spring: Is Professor McHale saying that 90% was projected in the markets?

Professor John McHale: In mid-2011, the ten-year Irish bond yield was close to 16%. If one looks at the differential between German and Irish bond yields using a standard formula, one can work out the implied probability of default. It is based on certain assumptions in terms of how much money investors will get back in the event of a default. That particular calculation assumes they will get back 50% of their money but the numbers can vary. The general point is that the markets thought it was highly likely that Ireland would default. The implications of that would probably have been far greater austerity. Even if we did get official support, it would probably have come with much tougher conditions than the ones we faced and - depending on how that default unfolded - the possibility that we would not get support at all. We would have to have immediately closed our primary deficit which at that point in time was still very large.

Even thought it may not always seem that way, the goal here is austerity avoidance. We have been focused on ensuring that we are following a fiscal policy that retains that borrowing capacity and dealing with the trade-off I discussed before with Deputy Kevin Humphreys.

Thinking of the council as just following the rules and being completely divorced from what this means for families in the economy, does not capture what we see ourselves as doing.

Deputy Pearse Doherty: That was not my question but that was a good defence.

Professor John McHale: I took the opportunity.

Deputy Pearse Doherty: The council's report this time is different from what I have seen in other reports. It is probably the most critical of the Government's assumptions that I have seen so far. Even though everybody is fixated on the €2 billion target, when we look at the other targets and projections the council is signalling a note of caution. My question was more about a structural issue. The Fiscal Advisory Council comes out with a report and the following day, the Minister says we are not doing that because we do not need that level of adjustment. His argument is that the Fiscal Advisory Council and other bodies do not have the soft data, as he described it here at yesterday's meeting, which are available to him. There is no point in the council providing that type of report if the data are not also available to it.

Professor John McHale: I would not exaggerate the data advantage of the Department of Finance. We have an excellent secretariat which is absolutely on top of all the numbers available. It is also fair to say that we get excellent co-operation from the Department of Finance. There has been no request from us for data which has not been met by the Department. The reason for the differences in views is not the superior access to data. It could be different analysis or the political factors which also weigh in with the economics. The data advantage is a very small part of it.

Mr. Sebastian Barnes: One way of looking at that is that any difference in data is very small compared with the simple uncertainty about the future. Unless they have a perfect crystal ball in Merrion Street, they do not have that great an advantage over us.

Deputy Pearse Doherty: History tells us that they do not have a perfect crystal ball although it is obviously coming into better focus in recent years.

Professor Alan Barrett: When anybody comes before a committee like this and starts to say they disagree with others because they have the information and others do not, it is generally an indication that they are in a pretty weak space.

Acting Chairman (Deputy Kieran O'Donnell): Tell us what you really think.

Professor Alan Barrett: I will. The Deputy is a very skilled parliamentarian, so I presume he teased the Minister out and worked out what precisely these soft data were.

Deputy Pearse Doherty: It was not in my questioning. If people watched the committee yesterday, they will have seen a ding-dong between the Minister and me when he would not answer my questions. He suggested that is more a feeling involving where sales, PRSI levels, the sale of cement and the construction industry are at. They are data on car sales, etc. They are publicly available data of which he is perhaps getting advance notice from the CSO. I am not sure. My question related more to a structural issue. If the council was not getting the up-to-date soft data, it would be something to address.

Professor John McHale: We have a secretariat member who follows a website on airplane sales. In terms of the detail of following soft data, we can match the Department.

Acting Chairman (Deputy Kieran O'Donnell): How would that fit into the Irish economy?

Professor Alan Barrett: The aviation industry, leasing and taxes.

Professor John McHale: In terms of import data and trying to understand what is driving movements and investment, it is important to follow these kinds of things.

Deputy Pearse Doherty: One of the stark things in the council's report is the spotlight it has put on expenditure over the period to 2018. It is something I am very concerned about myself. The discussion has happened earlier in terms of having no more austerity but an 8% drop comparative with GDP. What was very helpful in the report was the cross-country comparison which shows that Ireland has one of the lowest levels among comparable countries at the lowest level. The United States of America is only marginally below us. No one in the room would want to follow the US policy in terms of investment in public supports.

This is a major challenge. When one puts it alongside the growth rates identified by the Government at 3.5%, which the council says is at the optimistic end of the range, serious concern is raised for the stability of the service. There is a major issue in terms of the delivery of the service for users but also for the economy itself. Society cannot take that level of cuts. This is a real cut in real effect over the next five years. It puts us in a vulnerable position for any future shock that may happen to the economy over the next five years. It is only six years ago, which seems like a lifetime ago given all that has happened, that we had the eruption of the banking crisis, which was already under way. Looking forward, we are looking at no increase in spending despite an ageing population, young people coming forward and huge pressures in education and health. There will be no increases in social welfare while inflation takes place. How serious does the council consider this is as an area of concern?

Mr. Sebastian Barnes: The Deputy has done an excellent job of summarising our report. I am glad he found this medium-term analysis important. In some ways, it is much more interesting and important than the €2 billion next October while setting a context for that as well. It is a big concern that we have highlighted. There is the real cuts element and the fact the economy will be growing. That means that if one is fixing things that are constant such as welfare rates, those rates will be moving away from wages. There are demographic pressures, including population ageing. If one is committed to keeping welfare rates where they are in that regard, extra money will have to be found somewhere else. Of course, there are some very big parts of spending, which means the margin to adjust outside that is potentially very small. This is a very major concern.

It all fits together with the fact that it is very difficult to live with high public debt. We are still in a very risky situation with our high public debt levels, which means a strategy must be found to manage that. There must be very deep thinking about how it is done. It is not for the council to say whether specific expenditure or taxation or some balance of the two should be followed. That is a political decision which involves important social choices. What we wanted to do is bring the matter to the table and highlight it to provide for a more informed public debate about what is at stake.

Currently, what we see is that much of the reduction is focused on the expenditure side in the SPU plans leading to the 8.4% as a share of GDP. That raises real questions about its viability. In asking whether it makes sense, questions arise as to whether the public and economy will support it. There is also the question of its desirability. Even if one can make it all add up, is this the right thing to have? One area we highlight is public investment. One can cut public investment for a while without doing that much damage as one can catch up. After a while, things start to fall apart where one has not had investment for a long time. Public investment is very important for supporting growth. If one's roads are falling apart and the public investment is not keeping up, it makes one wonder why people in the private sector would invest here. These are very serious issues. The comprehensive spending review in the autumn provides a good place to start thinking about the strategy that will be needed over these next few years and to have this discussion about where the country is heading.

Acting Chairman (Deputy Kieran O'Donnell): I think it is time to conclude.

Deputy Pearse Doherty: I ask for some latitude to ask a couple of very quick questions. The council has approved the medium-term growth rates although it raised question marks about them. The council says they are at the optimistic end of the range. What is the range within which the council operates?

Professor John McHale: We do not have a specific endorsable range with which we enter into the process. We have that for shorter-term forecasts, even though we do not publish the detail. We can use past forecast errors to generate those ranges. It is more judgmental as we go out to the medium term. We realise that those bands of uncertainty increase as one goes further out in time and it become wider. That is why even though we felt it looked optimistic and ahead of the most likely outcome for 2017 and 2018, it still falls within the range of reasonable estimates given the uncertainty around growth estimates at that horizon.

Mr. Sebastian Barnes: This is the first time we have undertaken an endorsement of the medium term. How one conducts short-term forecasting is relatively established. It does not always work, but there is a set approach. Considering the medium term is much more difficult and on our side is a work in progress to a much greater extent. Due to the greater uncertainty, we endorse these as being appropriate forecasts for the medium term while noting our sense that they are relatively optimistic. The question about the assumptions on which one should plan is a different one. The report says it is a reasonable forecast, but if one is prudent, one might have a slightly lower number aiming off that kind of thing.

Deputy Pearse Doherty: Today, the chair of the Eurogroup stated it was unlikely that Ireland, or any country for that matter, would get retroactive bank capitalisation. Given that compliance with the debt rule is one on which the fiscal council must concentrate, does Professor McHale see any scope in this area? Yesterday, the Minister said the State will make an application for retroactive capitalisation but it does not figure in the council's calculations.

I brought up the issue of the structural deficit with the Minister yesterday. I understand what Professor McHale said earlier about the convergence towards the structural deficit being met by 2018 or that process beginning then. The Government's April stability programme update sees the structural deficit being at 0%, basically a balanced budget, by 2018. The actual target, however, is 0.5%.

Professor John McHale: The maximum deficit that one is allowed to have under these rules is 0.5%. Each country gets a specific medium-term objective that depends on several factors including debt level, growth uncertainties and other matters. It has been set for Ireland at 0% which is our medium-term objective. One cannot have a medium-term objective that allows for 1% structural deficit which is why the 0.5% comes in.

Deputy Pearse Doherty: Prior to the fiscal compact treaty, our medium-term objective was set at 0.5%. Those countries with a debt level below 60% of GDP would be deemed to have a balanced budget if their structural deficit were not more than 1% while for countries such as Ireland's it must be 0.5%. How does a different structural deficit rate through a country-specific recommendation lie with the fiscal compact treaty?

Professor John McHale: Previously, the maximum was 1%. Then the treaty stated the maximum deficit any country could have would be 0.5%. It has always been the case, however, that each country has its own specific medium-term objective which is revised every three years. Ireland's medium-term objective had been a deficit of 0.5% but was revised to 0%. One can separate out what the maximum level that applies to all countries and the actual medium-term objectives which are periodically reset by the country-specific recommendations.

Mr. Sebastian Barnes: The country's specific objectives are reset every several years according to a formula. Ireland's is tight because the public debt went up.

Deputy Richard Boyd Barrett: I thank the Irish Fiscal Advisory Council, IFAC, for attending the committee. Its reports are helpful and packed full of information.

The requirements to get to a 0.5% structural deficit rate and reduce our debt by half over 20 years under the fiscal treaty are terrifying challenges for the economy. The council members are very pleasant in the way they put across information.

Acting Chairman (Deputy Kieran O'Donnell): Deputy Boyd Barrett is going on a charm offensive.

Deputy Richard Boyd Barrett: When I listen to what they are actually saying, however, I find it quite scary. They reiterate constantly that the risks are on the downside and the forecasts are very uncertain. I agree with that because, particularly, the growth forecasts vary quite widely. The Government depends on the more optimistic growth scenario to materialise which makes me worry even more. Even after the €2 billion adjustment in the forthcoming budget, we have to reduce spending by 2018 by another 8%, which does not necessarily require cuts at the nominal level. This is against a background where demographic pressures and other demands from real human beings in the economy are likely to significantly increase. However nicely one puts it, this is beginning to look like a bleak and grim scenario. The circle that cannot be squared will be the big demand on our public service by our growing population when we have to continue to reduce spending. This looks grim for people living in our society. It may also be impossible because everything the council says is on the downside. It is difficult to imagine the scenario where some of those downside risks do not materialise.

Professor John McHale: It certainly is a challenging situation that needs to be managed well. I do not believe it is quite as grim as the Deputy describes.

One argument we made in our report is that we see the new fiscal framework being put in place, with European and certain national elements including the increased role for the Oireachtas, as a positive legacy of the crisis. We know from our own past, and from that of other countries, that fiscal policy is often badly managed, excessively pro-cyclical and contributed to boom-and-busts cycles which have done so much damage to the economy in the past. It is not the only element of good management to avoid these kinds of damaging cycles. Much more must be done on the financial and credit side and so on but it is an important component.

The big advantage to having a strong fiscal framework is that it will allow us to guide the debt level down to safer levels. Part of the risks described by the Deputy really reflect the fragility of the situation we are in when we have these incredibly high debt levels. We really cannot stay there unless we want to remain in this highly risky situation where domestic or international shocks could knock us off course.

The third reason, which could be most relevant, is that if one has a strong fiscal framework in place, it gives credibility and actually gives one more room for fiscal manoeuvre. One can point to these rules and say they are placing terrible constraints on Irish fiscal policy but the debt markets could impose much greater constraints on fiscal policy and force much greater levels of austerity. It goes back to the point I made earlier about austerity avoidance. It is a mistake to view the fiscal framework in purely negative terms as something that is being imposed on us, particularly by Europe. I see it as something that is in the national interest, not because we like-----

Deputy Richard Boyd Barrett: It sounds like a “lose-lose” scenario. Professor McHale’s essential argument is that if we ease up on the austerity, the markets panic and increase the cost of lending to us so we cannot possibly do that. We must keep them happy so that we keep the cost of borrowing low. However, if we do that, we effectively strangle any hopes for growth. Professor McHale pointed out that one can have historically low levels of investment, which we have at the moment, for a short period of time but if one continues with historically low levels of investment, one will potentially destroy the capacity of the economy to recover at any point and do very severe long-term damage to it. I put it to him that we are at that stage. We have had a massive retrenchment in capital investment and are at the point that if this continues, we will do long-term structural damage to the economy that will remove our capacity to recover in any serious way and put us at a serious disadvantage. If one combines that with all the pressures Professor McHale has also referred to, it sounds like a “lose-lose” scenario.

Mr. Sebastian Barnes: The underlying problem is high debt levels which means the options are not as good as if one had much lower debt. It is a very difficult thing to manage. I would mostly agree with the Deputy's assessment although the question of tone is a subjective thing. Maybe it is not as-----

Deputy Richard Boyd Barrett: The council has a very nice tone.

Mr. Sebastian Barnes: Perhaps our tone is too polite. I do share many of the Deputy's concerns but perhaps not quite the full bleakness of the picture he brilliantly painted.

Deputy Arthur Spring: That is the Opposition.

Mr. Sebastian Barnes: I have two observations. Conditional on starting from a situation of high debt, one of the messages we discussed in the report is that if there was not so much of an attempt to go beyond the minimum fiscal requirements, these pressures would be less. The choice has been made but as we pointed out in the report, that has a cost - to be more aggressive in the tightening over the coming years than the minimum required under the fiscal rules. That is a choice that has been made but it is one that costs.

Deputy Richard Boyd Barrett: In terms of the medium-term objectives that the Government has set itself.

Mr. Sebastian Barnes: Exactly. It is planning to do more compared to what appears to be the minimum requirement under the EU rules.

Deputy Richard Boyd Barrett: Is that a bit of an anomaly? On the one hand, the council is the bad cop when it comes to the forthcoming budget, saying that we must stick to the €2 billion while the Government is saying, possibly for political reasons, that it should be less. However, Mr. Barnes seems to be saying that over the long term, the Government is arguing for a more aggressive consolidation whereas the council is saying that this is overly ambitious and potentially damaging.

Mr. Sebastian Barnes: That is a very reasonable way of showing it. The Government managed to disagree with us on both things. It comes back to this trade-off framework we have always used for thinking about things. At the moment, particularly coming to the end of the programme and the 3% target that has been the anchor for a long time, we are very concerned about what happens in 2015. Having achieved that, things should then be more relaxed in terms of the environment and credibility and this should create the space that would allow less pressure on expenditure in the outer years. There is a question of how much consolidation is being done.

The second question is that it depends how that consolidation is achieved. If it is done badly, it will obviously be much more damaging to the economy than if it is done well. There needs to be very careful discussion about how it will achieved - whether it will be on expenditure or taxes - and within that, how it will be achieved. For example, squeezing something like investment seems like a bad idea for the reasons set out by the Deputy but it also means that there is a very high cost to carrying pieces of public expenditure that are inefficient, of which there are surely going to be some. There are many important choices to be made to make it less bleak than the Deputy suggests.

Deputy Richard Boyd Barrett: Sure.

Professor Alan Barrett: I wish to re-emphasise the point touched by the Deputy that while we are arguing for the €2 billion, we have a different perspective on the medium term. From the council's perspective, it is important that this message is out there. We are not austerity hawks for the sake of it. It was a year or two ago when we sat in this room. Somebody essentially said that we would always call for more austerity. At the time, we put it in an international context when we said that if we were the fiscal council in Germany or the Netherlands, we would be telling them to do less austerity. We are not ideologues for the sake of it. This point is illustrated again with this balance. It is very important to emphasise that.

The Deputy has portrayed a bleak future, which is an interesting perspective. What the fiscal council is trying to add here is to get away from that phrase we used to have in Ireland where there used to be a sense that one could have it all. One could have the tax reductions and the additional expenditure. Part of the role we are trying to fulfil here is to present a clearly based analytical view that, as Mr. Barnes put it, there are choices to be made. It is up to the political class to make those choices but at least let them be made with clear knowledge and not in the sense that one can have one's cake and eat it.

Deputy Richard Boyd Barrett: I accept that. There are some areas where I think we could change the goalposts and move the parameters of this discussion, which is not the council's job because they must work within existing parameters. I think we should tell Europe to take a hike for €8 billion in interest but the council cannot say that and cannot step outside those parameters.

Deputy Arthur Spring: It can.

Deputy Richard Boyd Barrett: It can say we will give Europe €5 billion this year, not €8 billion, and that it recommends that?

Deputy Arthur Spring: It can recommend whatever it wants. The reason it does not do this is because of how reckless it would be.

Deputy Richard Boyd Barrett: I think that is more a political battle we have with the Government. I also think that the question of whether one makes this adjustment through taxing the financial services sector, the FTT, wealth tax or taxes on higher earners as against cuts in public expenditure is a political battle we must fight.

It is the council's job to flag the dangers and down sides if they are coming up. I think I was the first Deputy the last time to ask about the area of housing, the potential for a housing bubble and the macro-economic danger that might represent. Since we had that discussion, at which point the council said it would look at it, it has become more manifest. Could the witnesses comment on the danger that represents? What seems to be happening encouraged by Government policy is that the big outside investors who are coming in and buying up all of the property are quickly developing a monopoly and rents are going up. One spin-off of that is a housing crisis and it will also affect small and medium enterprise. Given the tax breaks that are available for this kind of activity, much of that money could go out of the economy. We recently held a meeting with the finance committee of the German Bundestag. I am probably in a minority in thinking our policies *vis-à-vis* multinationals and corporate taxation are dangerous, but there was agreement from our German counterparts in this regard. We have a big gap between GNP and GDP which is essentially accounted for by multinationals, which appears to make us vulnerable to problems in that sector. The Bausch & Lomb events suggested we could face real dangers. An aggressive multinational employer demanded 20% pay cuts across the board and got its way through fear. If other multinationals were to act in the same way, we could be facing a wave of wage deflation which could pose a serious threat to the capacity of the domestic economy to recover. This highlights the vulnerable position in which we are putting ourselves by our heavy reliance on this sector. The Germans advised us to develop our own industrial capacity, including small and medium enterprises. Given the huge gap between GNP and GDP, do the delegates see our disproportionate reliance on this sector as a structural danger to the economy?

Professor John McHale: On the question of house prices, we thank the committee for emphasising this issue so strongly on our last visit. We promised then that we would examine it carefully. It is something we would have considered carefully anyway in the light of recent trends in the economy, but we took the matter even more seriously after hearing the committee's concerns. We are constantly looking out for bubbles forming in house prices given the damage done to the economy by the last bubble. At this time we do not see excessive credit growth; if anything, it is the opposite. The big spike in prices appears to be partly the result of a bounce back from an initial overcorrection. There also appears to be severe supply constraints in many urban centres, including Dublin, in particular. That explains the recent movement in prices. We are, however, starting to see signs of expectations of house price increases becoming ingrained. This is at an early stage, but it is something that deserves careful monitoring. The Central Bank's recent macro-financial review outlined survey evidence that while 92% of respondents expected prices to increase, nobody expected them to fall. A significant percentage expected a price increase of more than 10%.

It is early days and, given what has been happening recently, it is not surprising that people predict the likely trend to be upwards, but it is an early sign of issue about which we need to worry. Even though initial price rises can be due to changing fundamentals and the last boom began with fundamental demographic and income changes, the price increases created a bubble like phenomenon as people extrapolated forward from past price increases. We are not there yet, but it bears careful monitoring. We must make sure we have learned the lessons from the last crisis in order that we use available tools, whether in terms of macro-prudential policy being controlled by the Central Bank or through fiscal policy, including the overall stance of fiscal policy, as well as specific instruments aimed at the housing market.

Deputy Richard Boyd Barrett: Would Professor McHale encourage preventive action at this stage?

Professor John McHale: It is where one sees credit chasing prices that one should be concerned. We previously had a triple bubble, involving a construction bubble, a price bubble and a credit bubble. Usually a supply response brings prices down, but the underlying pressure was so strong that even the supply response had no effect. There were multiple hits against the economy, involving the collapse of an overextended construction sector, massive loss of wealth and the ensuing economic destruction. Given what happened previously, it is the job of bodies such as the Fiscal Advisory Council to monitor developments very closely in order that damage is not inflicted again. However, we should not overreact by identifying bubbles where they do not exist. Our analysis does not indicate that a bubble is emerging, but we have to be watchful and there are signs that should be monitored. We will continue to report to the committee on our analysis of the housing market in our future appearances before it.

On corporate taxation, as we are getting into a more specific area, I will not speak for the council.

Deputy Richard Boyd Barrett: I am not asking for a comment on the 12.5% rate, rather I am asking about the weighting of foreign direct investment from the multinational sector in the economy. It accounts for a high proportion of our economic activity and we have a unique gap between GNP and GDP in European terms because of our heavy reliance on the sector. The visitors from the Bundestag finance committee advised us to watch it.

Professor John McHale: On a more general point, this issue has to be considered from its historical perspective. Even prior to independence, the State struggled to develop. It was not until the 1950s that we hit on a strategy, as a small open economy at the edge of Europe, that has worked well in integrating us into international production changes and getting global companies to locate part of their activities in Ireland. On the whole this strategy has served us well and the economy and living standards have improved more than they would have otherwise done.

Acting Chairman (Deputy Kieran O'Donnell): Is the indigenous sector underdeveloped relative to the multinational sector?

Professor John McHale: It is, but the question arises of whether it would be more developed in the absence of the multinational sector. That is unlikely. On Deputy Richard Boyd Barrett's specific point on risk, investment is concentrated in particular sectors such as information technology, medical devices and pharmaceuticals, which makes us vulnerable. However, during the recent recession the net export sector of the economy which is largely driven by multinationals kept the economy from a much deeper recession. There is a level of diversification in being part of these international production chains, as well as having a strong indigenous sector. There are, undoubtedly, risks, but they would be greater if we concentrated more heavily. If we did not have the multinational sector, we would still probably be concentrating on particular industries. We probably would have concentrated heavily on agriculture, which can be a very volatile sector, and been more dependent on domestic demand, which was severely hit in the recent recession. In terms of risk, therefore, I do not share the Deputy's view that the presence of a strong multinational sector puts us in a more risky position.

Professor Alan Barrett: The Deputy's analysis that in some sense the presence of multinationals leads to wages falling-----

Deputy Richard Boyd Barrett: I was referring to a recent example, not necessarily the general case.

Professor Alan Barrett: If we consider the issue in broader terms, any group of workers in the world would prefer more rather than less demand for their labour. To extend the Deputy's analysis, if in some sense we got this crowd out of the country, that would reduce labour demand significantly and our suspicion is that wages would decline. It would significantly reduce labour demand and, based on that, we suspect wages would decline.

Acting Chairman (Deputy Kieran O'Donnell): The Deputy is asking whether a situation in which wages have declined sets a precedent for wages to decline throughout the economy, bringing about wage deflation, and whether Professor Barrett is worried about it.

Professor Alan Barrett: My core point is that employing more people is protective of wage levels. Domestic companies and the public sector are equally capable of asking people to take pay cuts. We must think through the issue. To return to the history about which Professor McHale spoke, there is a serious issue regarding SMEs and the indigenous sector in the sense that the idea of many of the development policies instituted in the late 1950s and early 1960s was that they would be stepping stones towards a stronger indigenous policy. Given that Ken Whitaker is still around, maybe we should ask him about it. The original idea was that one needed the big players here to develop a managerial, entrepreneurial base, which would carry on from there. I do not think in the early 1960s Mr. Whitaker envisaged that 60 or 70 years later the policy would still be the same and that we would be out there hoping to recruit. As Professor McHale said, the idea was always that there would be a blend and a balance. There has been a failure of the indigenous group to take over. One often hears this from international visitors. The Germans were mentioned, but visitors from countries more on our scale, such as Sweden, Finland, Denmark and Israel, often ask where the indigenous Irish group is. It does not exist, and this is another medium- to long-term challenge for us.

Acting Chairman (Deputy Kieran O'Donnell): There is a Europe-led initiative on standardising the measurement of GDP, and yesterday the Minister told the committee it might boost the measurement of Ireland's GDP. Has the council been following it and would it be a bonus? How does the council see the possibility of deflation in the eurozone impacting on Ireland?

Professor John McHale: We have certainly been following the measurement issue, known as the European System of Accounts 2010, ESA2010. It seems there will be an increase in measured GDP, particularly regarding the treatment of research and development. Regarding its effect on the deficit targets-----

Acting Chairman (Deputy Kieran O'Donnell): What impact will it have on the deficit in 2014?

Professor John McHale: The effects will be small, and the smaller the deficit, the smaller the effect. Based on a deficit of 3% of GDP, if Ireland's nominal GDP were to increase by 1%, the deficit would be reduced by 0.03% of GDP. It is relatively small. If Ireland's nominal GDP were to increase by 2%, the deficit would be reduced by 0.06%, which is starting to add up and move in the right direction, but it would not be transformative.

Deputy Pearse Doherty: IFAC's report estimated that as a result of the CSO calculations in June, GDP will increase by €4.5 billion to €5 billion, increasing our GDP from 2.5% to 3%. If those calculations prove correct, our deficit should decrease by approximately 0.12%.

Professor John McHale: An increase of 3% would get us to approximately 0.1%.

Deputy Pearse Doherty: That is what IFAC is forecasting.

Professor John McHale: Although there are indications of a revision of that size, we have no-----

Acting Chairman (Deputy Kieran O'Donnell): The 3% would go to just below 2.9%.

Mr. Diarmaid Smyth: Those numbers are our best guess at the moment. The CSO is supposed to publish its national accounts today, but they have been postponed until next week. The Deputy is correct about the 0.1%.

Acting Chairman (Deputy Kieran O'Donnell): What about deflation?

Professor John McHale: We are concerned about deflation, which could have a negative effect on the economy since competitiveness gains are harder to achieve in an deflationary environment. The policies are moving in the right direction. While we would have preferred them to have come sooner, it is better late than never.

Acting Chairman (Deputy Kieran O'Donnell): Does the council have major concerns about the possibility of deflation? Is it a risk for the Irish economy?

Professor John McHale: While the risk of outright deflation at eurozone level is reasonably low, it must be avoided because the consequences would be so serious. Even getting into a low-inflation trap would be damaging to the real economy and make the challenge of the public finances more difficult.

Acting Chairman (Deputy Kieran O'Donnell): Regarding the wedge between our GNP and GDP compared to our employment growth, it is said that the disparity is due to the patent cliff. While we had effectively no growth last year, our GNP grew by approximately 3.4%. Nobody has ever done a proper analysis. We appear to get very little credit for it, yet it is probably a better measure of real growth in the Irish economy. Has it been factored into the council's deliberations or does it see it as relevant?

Professor John McHale: It is factored in. It is unfortunate that all the European measures use GDP. The Acting Chairman is correct that GNP is a better indicator of what is happening overall in the Irish economy. It partly explains why the Exchequer returns are better than might be indicated.

Acting Chairman (Deputy Kieran O'Donnell): Is there a danger that we are not getting a little bit of substance over form? Should we get some form of weighting for the fact that our GNP is so far ahead of our GDP, based in Ireland's unique set of circumstances regarding the patent cliff?

Professor John McHale: We have developed the hybrid measure of fiscal capacity because although the standard is GDP, GNP is potentially relevant for Ireland. If one subtracts GNP from GDP, the fiscal capacity that comes from that excess is less than GNP, but is not zero. Our hybrid measure uses differential weights and the reality of an overall fiscal capacity measure is somewhere between GDP and GNP. An ideal measure for Ireland would be closer to the hybrid measure.

Professor Alan Barrett: If we were examined based on GNP rather than GDP, we could be under much more pressure to resolve our debt situation. Therefore, I would not necessarily go around trumpeting that concept.

Acting Chairman (Deputy Kieran O'Donnell): Point taken.

Mr. Diarmaid Smyth: We can distinguish between levels and growth rates. Professor Barrett's point is about the level, which would work against us. The Acting Chairman's point is that the GNP growth rate has recently been better than that of the GDP, which may change.

Acting Chairman (Deputy Kieran O'Donnell): The council has brought in a medium-term forecast and is examining it over the next four years rather than two years. It feels the Irish economy can take the strain a bit more over these years and wants the economy not to have as much of a burden from 2015 onwards. Am I correct?

Professor John McHale: Yes, and, a little contrary to what I said to Deputy Barrett earlier, the nature of the rules affects this. We need to exit the excessive deficit procedure. Failure to do so could bring sanctions on us and would not be good for our credibility.

Acting Chairman (Deputy Kieran O'Donnell): That underlies the council's premise.

Professor John McHale: It has a major effect on the €2 billion. Once out of that, we would have more freedom to follow the minimum requirements of the rules while making a credible commitment to the overall-----

Acting Chairman (Deputy Kieran O'Donnell): A summary of the council's argument would be that exiting the excessive deficit procedure is a red-line issue.

Professor John McHale: Yes.

Senator Sean D. Barrett: I welcome our visitors. We had a call to the office from the chairman of the fiscal council of Cyprus, who wants to get in touch with Professor McHale.

Acting Chairman (Deputy Kieran O'Donnell): The Senator can make the introductions. I am worried about the bubble in house prices. How does one combine house price inflation of 10% with an unemployment rate of 11%? We should think in terms of rules, as we have mentioned to the Governor during his appearances, whereby no loan should be in excess of 80% of the house price and a limit of two and a half times income should be applied. As long as house price appreciation remains a tax-free form of income with huge leverage, particularly when deposits are low, people will keep buying and selling. There should be a health warning in property supplements in newspapers, which are increasing to between 30 and 40 pages, as we seem to be set to do the same all over again.

Dr. Ronan Lyons pointed out our construction costs are still in excess of those in Germany. The industry, therefore, has not adjusted to eight years of recession. We still have excessive construction costs. Is the industry full of restrictive practices? I recall the rumpus when GAMA built roads in Ireland cheaper than domestic construction firms. It was demanded that the company build them just as expensively as the domestic construction industry. If we are going to use construction as the main instrument to change economics in Ireland, we should get a better industry than we have. Anything the council can find for us in the context of international competitiveness before another booms starts would be appreciated.

Have we wasted a good recession? We still do not use cost benefit analysis. When Professor Barrett was editor of the quarterly economic commentary, we used to always say, "Don't just throw out the cash. Would you please check back and see has it had any impact at all?".

I refer to the restructuring issues mentioned by Deputy Boyd Barrett. If people are rewarded as heavily as we do for entering sheltered sector occupations, there will be a shortage of people interested in investment and, therefore, there will be a reliance on foreign multinationals to develop the economy. We pretend to be interested in tourism but during the boom people from eastern Europe ran the industry. We were not interested. We pretend to be interested in fishing but if a boat goes down, the bulk of the crew tends not to be from Ireland. Are we going to be serious about entrepreneurship or rent seeking, subsidy seeking, sheltered sector employment? We have rich doctors and lawyers.

Deputy Doherty and I attended a banking inquiry committee meeting earlier. Some of the numbers we heard regarding legal advice would absorb all the funding. We are, therefore, not changing the structure of the economy to respond the world Professor McHale is describing. The view that we got back our sovereignty and the troika is gone is bizarre. We are still borrowing. Have we learned enough lessons from how we got into trouble, particularly in the context of property and other sheltered sector activities?

If the health sector continues to be immune from budget constraints, what impact will that have? The Leader of the Seanad was given figures that he put in the Library regarding the high cost of health insurance. We have treatments for which patients are kept in hospital for 11.6 days when the international average is 3.7 days. That adds €10,000 in bed and breakfast cost by keeping every patient in hospital longer because that is what doctors and hospitals are paid for. That has not been reformed, which means we do not want a competitive health insurance market. I am worried after three years in the Seanad that apart from blaming the fiscal council for the €2 billion adjustment, the Government has done nothing to make the economy respond to the world. The State cannot keep borrowing, although at reduced rates, with the voracious appetite it had previously because we will end up with massively indebted households because of a property bubble and a massively indebted State. To redress that, I have always felt the fiscal council should have a wider mandate than to be a caste of economic advisors. If the people doing the economic forecasts are so good, let us give them a few quid to go to Leopardstown and see how they fare picking winners.

Acting Chairman (Deputy Kieran O'Donnell): Are the Senator's lectures always this interesting?

Senator Sean D. Barrett: Forecasting is not an important part of economics unlike resource allocation. That is what is wrong with the economy. I will hand over after that soliloquy.

Acting Chairman (Deputy Kieran O'Donnell): The witnesses can make observations rather than provide answers.

Professor John McHale: We do not choose the mandate; we are given it. Other people in this room have more influence on changes to the mandate than we do.

The Senator mentioned policy tools regarding house prices. Debt-to-income and loan-to-value ratios have to be kept in the table. Given the current price inflation is not driven by credit growth - the banks are being quite restrictive in the credit they are giving out - they are not the main drivers at the moment but that could change, particularly if bubble dynamics take hold. It was good to see a nice outline of the Central Bank's macro prudential policy tools in the most recent macro financial assessment. They seem to be very aware that these tools have to be there and can play an important role if bubble dynamics take hold.

Regarding what the Senator said about micro-economic reforms, that goes outside our mandate but certainly an awful lot more needs to be done. Hopefully, the new Irish Government Economic and Evaluation Service will also help in cost benefit analysis and pushing the agenda of structural reform.

We are not health experts but, as part of our mandate, we must assess the Government's budgetary forecasts. As we outlined in this and previous reports, there has been series of missed targets and overspending. In our previous report, we referred to the phenomenon of a soft budget constraint, which has been used in other contexts but applies here, where the anticipation that budget constraints will relax leads one to act differently in the belief that one will essentially be bailed out in the end. In the international literature on the soft budget constraint one of the things that is referred to is having career consequences for the people involved. This is relevant to comments made by the Chairman of the Committee of Public Accounts. On the other hand, we have to recognise that the people running the health services are also responsible for the health services themselves and, therefore, it is not just about balancing the books. We have to recognise the very difficult situations they may face.

In a way it comes back to a point emphasised by Mr. Barnes earlier about the importance of advance planning. This is not just about giving a budget to the health sector that may not be achievable. One has to think about the consequences and where the savings can be made by raising various inefficiencies. If one is going to cut spending, it must be done in the right way, otherwise it will have a huge effect on health services. That requires significant advance planning and, therefore, there must be broader ownership of the quantum of spending in the health area. That underlines the broader point made by the Senator about the importance of microeconomic reforms and how they are organised.

Dr. Róisín O'Sullivan: The Senator asked whether we had wasted this recession and what else we got out of it. One of the things that Professor McHale mentioned earlier is the new fiscal framework. With that, we should be able to avoid mistakes such as using windfall tax revenues to finance permanent expenditure increases. We now have a framework within which to identify those dangers and to provide additional analysis. Additional analysis of the housing market should help to avoid the problems materialising again.

Acting Chairman (Deputy Kieran O'Donnell): I refer to the excessive deficit procedure. This will be the first year in which there is growth in consumption. The rate was -0.3% in 2012 and -1.1% in 2013. We are looking at 2% in 2014. These are Government figures. Is there a danger that if there are the full €2 billion of cuts this year, and Deputy Humphreys referred to this earlier, it will have an adverse impact on consumption? There comes a point where there must be a balance between the human and the financial. We constantly hear from people about the financial pressure on them. If they are not spending and they do not have money to spend, that must have an impact on growth. The question is weighing that up. I know the aim is to get out of the excessive deficit procedure by 2015. Bearing in mind that 2014 is the first year we will see consumption growth, has that been factored into the council's deliberations?

Mr. Sebastian Barnes: One thing that applies to both comments is that all of those things are perfectly true, but to some extent they are already factored into these forecasts. Perhaps these forecasts are factored in the wrong way and you disagree with that but, in principle, it is already factored into that baseline.

Acting Chairman (Deputy Kieran O'Donnell): I appreciate that.

Mr. Sebastian Barnes: It is already there. Our view is that those factors are going to weigh a little more, so in the benchmark projections prepared by our secretariat we had a somewhat weaker picture, if memory serves. The issue is that it is already essentially factored into these numbers.

Deputy Arthur Spring: I have some general questions. Does the council meet with the European Commission, the ECB, the IMF or any particular bodies on a regular basis?

Dr. Diarmaid Smyth: On the benchmark projections that Mr. Barnes mentioned, we would have regular contact with the Commission and the IMF, in particular. We would discuss their views on the economy and give our views and talk about risks, the upside risks and the downside risks. Representatives of the Commission and the IMF are in this country twice a year and they typically would meet with us to talk about economic forecasts.

Deputy Arthur Spring: Would it be fair to say that the council is more or less in agreement with most of what they suggest?

Professor John McHale: They seem to be in agreement with us, when reading the recent

IMF report. There is no co-ordination in any of this but we are approaching it from a similar economics point of view. The analyses of any of the bodies the Deputy mentioned are not factoring in the politics. It is not too surprising that we do not end up in greatly different places, even though there are differences.

Deputy Arthur Spring: I find it very difficult to impress this on European partners. Labour Party Deputies talk to the Social Democrats. If one put it to the Germans or the French that essentially 10% of their population, 6.8 million people, were going to leave the eurozone for the purpose of gaining employment in Anglophone countries or a similar language country, and asked them what would happen in their countries, they would say there would be a revolution or that the country would collapse. They do not appear to grasp the magnitude of our problems. I am on the same chapter as every other Member of the House at present. There was talk at one stage of putting a water charge of €5 per week on a person on €188 per week. People are really at breaking point and I do not get a sense from the representatives of the OECD, the Commission and the IMF that the committee has met that they see the daily lives or feel it as badly as people do. One can talk about the political consequences of it, which are as plain as day, but the objective of everybody here is austerity avoidance. Some people believe it can be abolished or banished altogether.

Do the witnesses get a feeling from the Commission, in particular, of awareness of the level of pressure Irish people's lives are under? When I tell European representatives that there are 400,000 people in negative equity and 130,000 people in arrears with their mortgages, they ask why we own our own property and why we are not renting. They should look at the model and understand it before they ask those questions. I do not get the feeling that they comprehend how people's lives are in this country. Will the witnesses comment on that?

Professor John McHale: I am not sure I agree with that. I do not know them well enough to really understand their personal views on these issues but, in general, the people we have met are sympathetic and understand what the implications of the recession and the policy response to the recession have been. There can be different views about how the economy operates. One view that appears to be quite influential in the European context is the concept of expansionary fiscal contraction, where one believes the adjustments actually expand the economy. Unfortunately, it is a view that appears to have a degree of support at the European Central Bank. Each month it reiterates that doing more consolidation will lead to faster growth, and that is very unlikely to be true in the short term. Sometimes people's views on things and ideas about how the economy works can lead them astray and potentially to propose policies that can do real damage while not understanding the damage those policies are doing.

In terms of the people themselves and their own values, I do not get a sense of a lack of sympathy.

Deputy Arthur Spring: If one compares the Chinese, US and Japanese economies with the eurozone, which of those would have quantative eased the least over the last five or six years? Would it be fair to say the eurozone has done the least?

Professor John McHale: I am not familiar with the quantative easing policies China has pursued. Certainly, Japan, the US and also the UK have been in the vanguard of quantative easing policies.

Deputy Arthur Spring: The eurozone would be a great deal less.

Professor John McHale: It is less in the eurozone, but it is important to distinguish between quantative easing, which is a quite specific unconventional monetary policy, and broader unconventional monetary policies. To the credit of the ECB, it has pursued other types of unconventional monetary policies, such as long-term refinancing operations. That is partly in response to the fact that there is a different type of financial system in Europe. It is more bank based and quantative easing, which is more focused on market financing, is probably less effective than it would be in the US context or even in the UK context. It is not that the ECB has been completely avoiding unconventional policies. My personal view is that it did not do enough and did not do enough early enough, but to say it has not done anything would not be correct.

Deputy Arthur Spring: I would not say it has not done anything, but I do not get the feeling that it is doing enough.

On a second point, I was speaking to some people who would be somewhat in the know. They say that the world is awash with money trying to find a home, particularly on the bond market. I was taken aback by this and I asked why Greek and Irish bonds were so low. It was in the context of the implications for Europe after the European Parliament elections. They felt that extremism had kicked into the European Parliament in a way not seen before and although they thought there was more instability in political parameters within countries, it did not spike bonds at all because there is so much money available. Would Professor McHale agree with that? Second, if that is the case and if there is so much money looking for a home, why are we going to stick to the parameters set by the troika agreement? Is not everything open for renegotiation? Is it not the art of politics to make everything possible?

Professor John McHale: There is something to what the Deputy has said and it is a result of the broad quantative easing policies. Quantative easing drives down the yields on certain assets. What happens then is investors, to try to maintain returns on portfolios, engage in what is sometimes called “reaching for yield”, where they take on more risk to keep the returns on the portfolios up. They will look to sovereign bonds which might be considered riskier and offer a risk premium. However, as there is demand it drives the price up and drives the yields down, so one gets yields falling across a range of assets. Sovereign bond yields in the eurozone have been helped by this. However, that could reverse if there was a change in quantative easing policies, which are already being tapered in a US context, or if there was a broader reassessment of risk. This explains, in part, the fall in Irish bond yields which may not be sustainable. Developing a fiscal policy based on the idea that one will always be able to borrow at a rate of 2.5% would not be wise at this point.

Deputy Pearse Doherty: My questions are not about the bond yields, although I propose to comment briefly on that issue. On Professor McHale’s comment that the quantative easing programme was responsible in part for the fall in Irish bonds, it could also be argued that it also played a part in the fall of bond yields in Greece. I do not believe Greece reaching its targets was the result of it being subject to a bigger drop than any other European country.

I have a couple of questions for the delegates. Reference was made to the house price study carried out by the Irish Fiscal Advisory Council in which issues such as supply and demand and so on were addressed. There has been no lending in the economy, yet house prices in certain parts of Dublin are increasing dramatically. This increase is also starting to filter countrywide. If there is an increase in the availability of credit, is there a chance it will push up house prices even further? While it may not create a bubble, it could cause a major problem that would have effects in other areas. Is that not what we should be concerned about? Regardless of what we do, we cannot turn back the clock by six years and start building the 7,500 houses per annum required. We are not at this time in a position to build those houses. As such, a problem will arise when the banks start to lend. Is it not the case that we can reasonably expect the banks to lend more into this market and that this will have the automatic consequence of further increasing house prices in the capital?

Professor John McHale: Without a supply response, it will be a matter of concern. The policy should be to bring forth as strongly as possible a supply response. The impediments to that response should be identified and addressed to the extent that it is possible to do so. Without a supply response, strong credit growth would lead us into dangerous territory, thus returning us to the necessity for the types of instrument mentioned by Deputy Richard Boyd Barrett and Senator Sean B. Barrett, namely, the use of macro-prudential policies such as debt-to-income ratios and loan-to-valuations and so on to ensure this time round credit growth was controlled in a way that it was not previously.

Deputy Pearse Doherty: The council's report identifies as an area of control the possible dampening of the property tax if house prices were to increase. The Government already has a strategy for housing. One of the areas identified is Government support where loan-to-value ratios are at 95%. This was criticised by the IMF in its report yesterday. Is this an issue of concern for the Irish Fiscal Advisory Council?

Professor John McHale: It would be. As I said, the issue in the housing area is one of supply rather than demand. As such, policies that boost demand would not appear to be the right approach. As a fiscal council, we are also concerned about the contingent liability associated with any sort of Government guarantee. We have seen the damage caused in the past by liability guarantees. This is another form of contingent liability. For both of these reasons, we would be wary of that type of policy.

Deputy Pearse Doherty: In relation to debt sustainability and the commentary today that it is unlikely that the retroactive recapitalisation of any instrument will be used for any country, is the reason this does not figure in the council's calculations the fact that it does not see it as being on the agenda?

Professor John McHale: Wisely or unwisely, in June 2012 I wrote that this was highly unlikely to happen. It involved other governments putting in money to pay above market values for Irish banks. I did not see that happening politically in a European context. However, the fact that there was a commitment in this regard did provide a degree of leverage which was worth pursuing. I believed the possibilities were low to begin with and have seen nothing since that would make me change my mind. If anything, given recent statements, it seems even less likely to occur. I must stress that that is a personal rather than a council position.

Deputy Pearse Doherty: I accept that.

Professor Alan Barrett: Perhaps I might add a little to what Professor McHale said. Although he is probably right that there is little likelihood that this will happen, it does not mean that the Government should not continue to make the argument that it will happen.

Professor John McHale: My concern was partly that it would distract attention from areas in which real relief could be achieved in terms of lowering interest rates, extending maturities and so on. It probably helped in the negotiations in that because this was not going to happen there was more likelihood of relief being provided in other areas. It has been useful as part of the broader negotiation strategy. I never thought it would yield anything in and of itself.

Deputy Pearse Doherty: In its report the council focuses on a number of particular areas outside its remit, including, for example, how a particular tax could be projected and so on. Perhaps the delegates might inform the committee of the area on which the council proposes to focus in its next report or is that decision made closer to the time? Is that information a secret at this point?

Professor John McHale: That decision will be made tomorrow. There will be an all-day meeting tomorrow at which our strategy will be thrashed out. We are taking a deep breadth after the last report.

Acting Chairman (Deputy Kieran O'Donnell): I have no doubt that there will be consensus.

Deputy Pearse Doherty: I note that in terms of capital expenditure, there is a net capital reduction over the five year programme period provided for in the stability programme update. Is that an area the council is likely to examine in more detail?

On the composition of the council - I may have asked this question previously and as such, it should not be taken as a reflection on anybody's ability - when it was established, on average length of membership was to be three years and membership was to be staggered. If I am correct, one person drew the short straw and was to be a member for two years; two people were to be members for three years and two were to be members for four years. Some might say the two people who were to be members for four years were the ones who drew the short straw. The council was established in July 2011. The five current members are the five original members. Will some be bidding farewell to the council or have they been appointed without our knowledge?

Professor John McHale: On the first question, we are open to suggestions from the committee. As I said, we genuinely value our interactions with it. As an independent body that reports in the main to the public through the Oireachtas, we see this as an integral part of what we do. We would welcome particular suggestions the committee might have consistent with our mandate. While I cannot promise that we will deal with them because we must at all times adhere to our mandate and resources, we will consider them very seriously. The Deputy's point on capital expenditure is one we could take up in our discussions tomorrow to see if something could be done on that side.

In regard to appointments, once the council was placed on a statutory footing - on 1 January 2013 or the last day of 2012 - that was when the appointments officially started. They were made on the same basis, with one person being appointed for a two year term and the others on a two or four year basis. Under the fiscal responsibility Act we can, at the discretion of the Minister, be reappointed once. The first year term is due to expire at the end of the year.

Deputy Pearse Doherty: Is the council informed of the person who has been appointed for a two year term or is that a secret?

Professor John McHale: It is not a secret but I would prefer not to mention it.

Deputy Pearse Doherty: That is fine.

Acting Chairman (Deputy Kieran O'Donnell): Professor McHale is keeping them all guessing.

Professor John McHale: I want to underline the important role of the Oireachtas in the Act.

Acting Chairman (Deputy Kieran O'Donnell): We appreciate the great work done by the Irish Fiscal Advisory Council.

Professor John McHale: I appreciate the great work done by the Oireachtas as a protection of the independence of the council. We cannot be dismissed without a resolution of the Dáil. I am sure the committee members are aware of their own powers. It is a very important protection of an independent body that it cannot be dismissed because it gave advice or stated something not popular with the Government of the day. In other countries, including Hungary, when fiscal councils have stated something the government did not like, they were dismissed. The fact a resolution of the Dáil needs to be forthcoming is an important protection.

Deputy Richard Boyd Barrett: I wish to make several points. My first point relates to an issue raised by Deputy Spring and leads towards a suggestion on something the Irish Fiscal Advisory Council could examine, but I do not know whether it will take me up on it. We spoke about Keynes earlier, and a name rarely mentioned but which should be mentioned more in my opinion is Marx. Marx made the point that along with the boom-slump cycle, the longer-term problem of capitalism is that the rate of return on investment on aggregate across the economy tends to decline, and when this happens pressure is brought to increase or maintain profit levels by driving down wages and extending working hours, and speculation begins so money begins to rush around places where people think they can make a higher return. This relates to Deputy Spring's point on huge amounts of money sloshing around in the global economy in relatively few hands, lurching from place to place looking for a higher rate of return. Generally, because of declining rates of profits in real industry and enterprise, people are risk averse to investing in the real economy. Why take the risk of setting up an industry when one could make a quick return on buying cheap property in Dublin and jacking up rents knowing there is huge demand for property? This is exactly what is happening. To my mind there is over-financialisation of the global economy and the Irish economy.

Something which I believe is an extension of this, and which has come sharply into focus recently as it has been highlighted by Mr. Piketty, is growing inequality. An important point to make is that inequality becomes a drag on growth. Growing inequality begins to undermine the dynamism of an economy. Much money is concentrated in few hands, which are risk averse and afraid of real investment. This inequality and the lack of demand produced among ordinary people who do not have any money to spend becomes at a certain point a significant drag on economic growth. This is the space we are in and Mr. Piketty is absolutely right to identify it. Should the Irish Fiscal Advisory Council examine inequality as a macroeconomic question and how it is a structural danger to the economy? As politicians we are very concerned about the human impacts of inequality, but inequality is actually a serious drag on growth.

Acting Chairman (Deputy Kieran O'Donnell): Professor McHale has one topic for the agenda tomorrow anyway.

Professor John McHale: The Piketty work is extremely interesting and as a professional economist I have found much in it. In some ways I see it a little bit differently from Deputy Boyd Barrett. The relatively high rate of return on capital is emphasised. One gets tendencies towards wealth divergences and greater wealth inequality, particularly when the gap between the rate of return on capital and the growth rate is high. This is a little different from the analysis of Marx. For the most part I would say it is not a matter for the Irish Fiscal Advisory Council, even though it is something each of us as an individual economist could take on board.

On the narrow question of whether inequality affects growth, given part of what we do is examining growth projections, it is relevant to the extent it enters in this way and to the forecast assessment exercise, but this is a much narrower idea than what the Deputy has in mind. To be completely honest, such a level of discussion would be beyond the mandate of the Irish Fiscal Advisory Council, but we are all very much paying attention to the debate and it informs our review of the world as economists.

We do not necessarily agree with everything in the Piketty book but he does an excellent job in documenting what is happening with regard to wealth inequality. His basic point on the dynamics of the market economy could lead either to the convergence of incomes, which is done over a certain time period, or to divergence of income. There is no guarantee a market economy would produce an equal economy and he is absolutely right on this. There have been many critiques of some of the mechanisms on which he focuses.

Deputy Richard Boyd Barrett: I take Professor McHale's point that certain aspects of the book are not the business of the Irish Fiscal Advisory Council, but if it is a factor in producing instability in the economy, is this not something about which the council has to worry? This is something towards which he is pointing, and I agree that rapidly growing levels of inequality are a factor of instability in an economy.

Acting Chairman (Deputy Kieran O'Donnell): Extremes polarise the political and economic systems of a society. Is this a factor in the fiscal area of the economy?

Professor John McHale: It is, but I do not want to give the impression the Fiscal Advisory Council spends its meetings debating these issues. Unfortunately, the meetings are much more focused on the mundane. We listen to these debates and they inform the views which we bring to the more mundane issues with which we deal under a mandate. This is not a particularly satisfactory answer.

Professor Alan Barrett: The instability created by bust-boom cycles goes to the heart of much economic thinking over the past 150 years. It is a critical point. The Irish Fiscal Advisory Council is a very small player but the issue has been raised. Inappropriate fiscal policy has aggravated the bust-boom cycle, and in our small mundane way, as Professor McHale put it, at least if we can play our role in ensuring this part of the cycle is dampened, it is worthwhile.

Deputy Arthur Spring: If we could have a spike in March 2016-----

Professor Alan Barrett: We will do our best. I wish to make a point on inequality. Deputy Boyd Barrett came at it from a demand side analysis, that it is bad for the economy to have many poor people who do not have money to spend. I see it as more of a supply side issue. In a country where a lot of people are in poverty or in a sense are socially excluded, it means the talent pool represented by those people simply is not available to the economy in general. One has a privileged group of people who by accident of birth are then in a position whereby they can capitalise on that accident of birth and do particularly well. I always perceive inequality and its relationship with the sort of economic issues about which the Deputy is talking as having a more supply-side dimension. One of the frightening things about the current recession is the extent that we have this big build up in people who became unemployed and the worry is that group will now become long-term unemployed. There is both the human loss and an economic loss of their skills and talents. Likewise, to the extent that schools and other places are being affected-----

Acting Chairman (Deputy Kieran O'Donnell): Education.

Professor Alan Barrett: -----there is a real, serious issue there. Sometimes in these discussions, members think they are over there, while we are over here, but perhaps next time we will sit somewhere in the middle or the room in an act of symbolism.

Acting Chairman (Deputy Kieran O'Donnell): I am conscious of time and I wish to conclude in the next five minutes or so.

Deputy Arthur Spring: We are in no hurry.

Acting Chairman (Deputy Kieran O'Donnell): The Deputy can ask a brief question, after which I wish to let in Deputy Mathews to conclude.

Deputy Arthur Spring: Has the council considered the sale of some State assets? For example, we have acquired the banks, unfortunately or fortunately. Has the council considered the value that will be built into those assets in the future? As for the sale thereof, has the council made recommendations to the State or the Department of Finance as to how that could be used to offset some of the burden?

Mr. Diarmaid Smyth: Mr. Sebastian Barnes and I have done a bit of work on looking at the €64 billion that went into the banks. Looking at the data, our best estimate last year was the value of those assets was approximately €11 billion. We did not make any recommendations on it and that is an issue for the Government. We are really conscious of the focus on the deficit and the debt and have come back to it today a bit in respect of the €2 billion. However, there needs to be a broader focus on the Government's stock of financial assets, as well as its liabilities. The Government has substantial assets, which I believe were valued at approximately €80 billion at the end of last year, of which €30 billion really is cash and deposits in these liquid balances. However, the banks obviously had a very low value last year. There has been good news this year and since we did our report, the value of the banks has improved and the Government has been able to make some money through Irish Life and Bank of Ireland. However, we did not make any-----

Deputy Arthur Spring: For example, Irish Water has been set up but no payment was made to the Irish State. I am aware it was for the purposes of allowing it to borrow off-balance sheet and so on but is that typical best practice internationally, whereby the assets essentially were bequeathed to an organisation without the State getting a payment or that organisation borrowing money to fund it?

Professor John McHale: The one point I would make in this regard is that Irish Water is still 100% owned by the State.

Deputy Arthur Spring: Yes, but it is off-balance sheet. I believe it had the capacity to borrow €1.6 billion without putting it on the State balance sheet. However, if it is an entity in its own right, should it not borrow money and give that to the State for the purposes of it being a special purpose vehicle or whatever?

Professor John McHale: Even though in that case, the funds it had borrowed would not be available for the company to invest.

Deputy Arthur Spring: Some of it would be. I was just wondering-----

Professor John McHale: But it is important to remember that it is currently 100% State-owned. Consequently, any implication of assets essentially being given away would be-----

Deputy Arthur Spring: From the sounds of things, the Acting Chairman is catching a train so I will turn to the bank recapitalisation. I am aware the council thinks there is a small chance and we should keep asking for it. Is that the best chance we have of a silver bullet or, as a country, should we be examining anything else such as the sale of the banks or something else? Is there anything that is not being put into the common discourse at present as to how the country can get moving and become a little more successful? Is there anything that is being missed?

Professor John McHale: I cannot identify a silver bullet. However, contrary to some of the discussion, which may seem very negative in terms of where we are going, our basic analysis is that we have made great progress. We faced very significant risks in the last couple of years and have managed to avoid some disasters and credit to the previous Government and the current Government for getting us to this point. There are tentative signs of growth returning but there are uncertainties surrounding it. Our basic message is that we are on the right track but there are a lot of risks and challenges. It will require careful and forward-looking management, really focused more on the macroeconomics side, as Deputy Boyd Barrett said, as well as very good management in terms of the structural policies on the microeconomic side. I do not want members to come away from this with a pessimistic message. Essentially, our job is to worry about stuff and so we do but sometimes, it may sound as though we have only seen the downsides.

Deputy Arthur Spring: I find it very frustrating to be around organisations that say what a great success the programme has been for Ireland. I hear from the OECD, the Commission and all the rest. I am sure the Acting Chairman and I, together with the other parliamentarians, would state that when one goes to people's doors, they say the programme has been a disaster, as people's standard of life has decreased. When we are talking about it, we are looking at a pure economic mindset rather than actual lives.

Professor John McHale: I disagree with that, in the following sense. I wrote a piece for the *Irish Independent* on this issue the week before last. It really is understanding the dilemma members face as politicians, whereby they get very little credit for disasters avoided. However, this country was facing very serious risks and things could have gone an awful lot worse than they have.

Deputy Arthur Spring: Do the witnesses want to come canvassing in north County Kerry in the early part of 2016 and explain that on the doors?

Professor Alan Barrett: If the Deputy really wants.

(Interruptions).

Deputy Arthur Spring: By the looks of things, I could do with a couple of the witnesses.

The other point I wished to make was that I appeared on "Prime Time" last September and got something wrong, in that I stated the Irish Fiscal Advisory Council was okay with an adjustment of €2.6 billion instead of €3.1 billion. I was wrong and the witnesses did a fantastic job of getting me back on the airwaves the following day but I just want to apologise about that.

Professor John McHale: The Deputy was not the only one.

Acting Chairman (Deputy Kieran O'Donnell): It took the Deputy about an hour of questioning to get to that point.

Deputy Arthur Spring: I was always going to say it.

Senator Sean D. Barrett: On some of the Piketty stuff, about which Professor McHale was telling members and which was raised by Deputy Boyd Barrett, one problem with it is tax avoidance, tax lawyers and tax accountants, whereby so much of fiscal policy is exempt if one happens to have enough tax lawyers and tax accountants in one's stable. The council is proposing macro measures, from which very rich individuals and corporations are exempt, and it all falls on Deputy Spring's constituents, who want to know why. While I acknowledge the OECD is examining this, it also is a complete waste of money in terms of sheltered sector activities. This is rent seeking *par excellence* involving tax lawyers and accountants. Again, I do not know how they are held to be some kind of heroes creating economic development. I believe last Sunday's edition of *The Sunday Business Post* reported on €480 million of tax breaks to make films. Deputy Spring's constituents may have had many better uses for it, involving much more basic items in their budget. A long time ago, Kenneth Carter in Canada proposed having a tax system in which a dollar is a dollar is a dollar and in which one does not have all these exemptions, allowances or rent-seeking lobbying in which one does not pay anything if one qualifies. As the witnesses are aware, tax avoidance is a major industry and it distorts seriously the operation of fiscal policy in the way to which Piketty and others have drawn attention.

On the Irish Water issue, part of it was creative accountancy in that were this quango to be created, one could borrow money that would not appear in the national accounts. It was a factor and I tried to amend the Bill in the Senate loads of times. Members did not know what was the price or what would be the exemption and the generous free allowance remains unknown. The best comment in this regard came from Ben Dunne, who stated that if he had a business in which 40% of the stock disappeared, he would not blame the customers. That simply is what the water legislation was and it was entirely engineer-driven. A much lower percentage of households in the United Kingdom have meters. We took €600 million out of the pension fund for metering, for which I believe the comparable figure in the United Kingdom is 40%. However, ordinary economics in those kinds of resource allocations still does not have any impact, which is rather worrying. Putting in the meters became the goal, rather than the 40% waste, loss or whatever it is.

On housing, I have a brief observation on somewhere close to Professor McHale's area. In Tuam recently, apartments were sold at €20,000. We know the bubble, if it appears in Galway, will be at Taylor's Hill. It would not be a bad thing to spend €20,000 and being able to commute to Salthill every day. One would not be working for a bank or building society by paying inflated prices. Are we keeping empty houses on ghost estates up and down the country because they look better at asset prices in bank accounts rather than letting the price fall and using low house prices as a way of developing the economy or encouraging people to commute from high-price house zones to low-price zones? People commute in all other countries, and half an hour would be regarded as mild for a commuting time in New York, for example. Have we created this position by keeping houses off the market to make bank balance sheets look better?

Mr. Sebastian Barnes: On the tax side the Senator's analysis makes much sense and from an Irish Fiscal Advisory Council perspective, particularly with these kinds of tough trade-offs to be made post 2015 to ensure the tax system is efficient rather than full of holes, it is an extremely important issue. Somewhat facetiously I could say that legislators make the tax code rather than the fiscal council so members may wish to think about that. International competition has made it more difficult for legislators, as well as pressure from outside. Much progress is being made through the OECD and G20 base erosion and profit shifting, BEPS, initiative, which I understand is progressing. There will be significant announcements at the Brisbane summit in November, and I hope that will make legislators' jobs easier.

Deputy Peter Mathews: I welcome the witnesses. I will take up Deputy Spring's comments about the realities and aggregates in lever-arch files containing informing and advising documents and papers, etc. Will the council be more radical, adventurous and courageous in dealing with matters affecting the 4.5 million citizens living in this country, with at least 1.5 million having had their lives ripped apart. My question is whether the council can be braver and more radical. Mr. Barnes indicated that we are legislators who make the tax code, and the OECD and G20, among others, are thinking about these matters, moving forward and deliberating on issues. We are moving into fog.

In the immediate interim we can say that companies report profits at approximately €75 billion per year, 10% of which is €7.5 billion and 6% of which is approximately €4.5 billion. That is a big uplift from what is actually paid. We are all for debating, discussion and considerations but in the meantime there are 1.5 million people comprised of 390,000 people who are long-term unemployed and 170,000 households or 500,000 people in deep mortgage distress, with an estimated 30,000 households where grandparents are using savings to prevent mortgages going into distress. I know that is happening. There are also 90,000 families or 275,000 citizens and souls on the housing waiting list. Fr. Peter McVerry has stated it is disgraceful that 5,000 people are sleeping on the streets. This is the stuff that does not appear in the cover letter of the German-Irish Chamber of Commerce, which sent us a book. It is in both German and English, and it had a self-congratulating cover letter outlining the "marvellous success" of the recovery programme to date. What country is it talking about?

Acting Chairman (Deputy Kieran O'Donnell): Does the Deputy have a question?

Deputy Peter Mathews: There is much inequality, and it is not nice but rather ugly. That is why I put forward my name three and half years ago to become a public representative. I am not interested in the greasy bowl of politics. I am interested that today the banking inquiry is kicking off. It should already have been stated publicly that the committee will examine what happened with bank balance sheets. That is objective evidence from 2001 to 2008, measured every six months, as every licensed deposit-taking institution has evidence of what its board - forget the executives - has done. The boards direct the bank and they are the prudential fiduciary custodians of banks' financial engineering. If railway bridges started to fall in Ireland, everybody would look to engineers to see why it happened, taking in loads and distances between pillars. The same process should occur with balance sheets, as the evidence exists that banks were out of control. The domestic banking statistics rose from three times national income to five or nearly six times national income at 2008. Bank of Ireland had €61 billion of senior secured bonds on its balance sheet in 2008, so it was lending all its customer deposits.

Acting Chairman (Deputy Kieran O'Donnell): Deputy Mathews-----

Deputy Peter Mathews: In three minutes I will be gone. This is the starting point. The Irish Fiscal Advisory Council is composed of experts and the red carpet is thrown out to them, with doctors and professors hanging on its words. There is a simple way for the 1.5 million souls to see the truth of what happened in the building of a massive credit Ponzi bubble scheme, with an asset price getting out of control. The effect is measurable and, for example, Bank of Ireland is 75% culpable for the overall credit boom it allowed to happen. That relates to its board of directors and auditors. AIB is 72% culpable and the overall banking sector is 92% culpable. One can get the figures, particularly the loan to deposit ratios of the overall sector and individually above the 90% prudential level. That is measurable culpability but nevertheless, the banks are chasing everybody. They are chasing the people in 170,000 households into suicide, illness, family break-ups etc., by insisting they collect 100% of the loans. They created the bubble.

All the banks, including AIB, the former Anglo Irish Bank, EBS, Bank of Ireland, Ulster Bank and Danske, were licensed deposit takers and they broke the rules. The people on the boards in 2001 should be assembled with their auditors and shown the evidence from the accounts. That is not made up as the problem was caused by the banks. We should see whether they would blush, blink or bow their heads. That is what is needed. We do not need any more from KPMG, PwC, Deloitte or Ernst & Young. They have charged big money for pretty lousy reports.

I do not enjoy saying this but the country must wash itself out. The little Independent group of Deputies over the past few months has shone a light and brought power hoses in for the Garda and the justice system. When the Dáil met for the first time in 2011, they were laughed at because their fashion is different from the conventional and conservative establishment. That establishment has caused 1.5 million people to have their lives ripped inside out. Let us begin with objective balance sheets and by corralling the appropriate people. At that stage we can look into the forensic bits and pieces.

Acting Chairman (Deputy Kieran O'Donnell): Thank you.

Deputy Peter Mathews: I am sure the witnesses have read the article by Dr. Sahra Wagenknecht of Die Linke Party from March. She stated that Irish people are still paying the painful price for a bank folly, and she is right. It is true. Will the council be brave and radical by ringing the bells?

Acting Chairman (Deputy Kieran O'Donnell): I have no doubt they will take all that on board. As we have met for almost three and a half hours, I thank Professor McHale, his colleagues and his back-room team.

The joint committee adjourned at 5 p.m. until 2.05 p.m. on Wednesday, 9 July 2014.