DÁIL ÉIREANN

AN COMHCHOISTE UM AIRGEADAS, CAITEACHAS POIBLÍ AND ATHCHÓIRIÚ

JOINT COMMITTEE ON FINANCE, PUBLIC EXPENDITURE AND REFORM

Déardaoin, 3 Nollaig 2015

Thursday, 3 December 2015

The Joint Committee met at 2 p.m.

MEMBERS PRESENT:

Deputy Richard Boyd Barrett,	Senator Imelda Henry.*
Deputy Pat Deering,*	
Deputy Robert Dowds,*	
Deputy Anthony Lawlor,*	
Deputy Paul Murphy,	
Deputy Pat Rabbitte,	
Deputy Peadar Tóibín,	

* In the absence of Deputies Barry, Ciarán Lynch and Cannon and Senator Paul Coghlan, respectively.

DEPUTY LIAM TWOMEY IN THE CHAIR.

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

Fiscal Assessment Report: Irish Fiscal Advisory Council

Chairman: I remind members to ensure their mobile phones are switched off. This is important as it causes serious problems for broadcasting, editorial and sound staff.

I welcome from the Irish Fiscal Advisory Council, Professor John McHale, chairman, Mr. Sebastian Barnes, Dr. Íde Kearney, Dr. Róisín O'Sullivan, Mr. Michael G. Tutty and Dr. Thomas Conefrey. As we approach the year end, it is fitting that we have the opportunity to discuss the council's latest fiscal assessment report. I thank the council members for their attendance today. As always, I expect we will have an interesting discussion and debate. The format of the meeting will be that Professor McHale will make some opening remarks which will be followed by a question and answer session.

I 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 the committee. However, if they are directed by the committee to cease giving evidence on a particular matter and they continue to so do, 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 are asked to respect the parliamentary practice to the effect that, where possible, they should not comment on, criticise or make charges against any person or an entity by name or in such a way as to make him, her or it identifiable. Members are reminded of the long-standing ruling of the Chair to the effect that they should not comment on, criticise or make charges against a person outside the Houses or an official by name or in such a way as to make him or her identifiable.

Before I ask Professor McHale to begin, I welcome Mr. Tutty here, as I believe it is his first visit.

Professor John McHale: I thank the Chairman. I note that for once, we outnumber the committee.

On behalf of the council, I thank the committee for the opportunity to discuss our recent assessment published on Thursday, 26 November. We view the opportunity to publicly explain our assessments as integral to the fulfilment of the council's mandate and important in fostering greater public awareness and debate around macroeconomic and budgetary issues. In our eight previous appearances before this committee, the engagement with Members of the Oireachtas has been of great value in the development of our work and we welcome further feedback from the committee today. With me are council members Mr. Sebastian Barnes, Dr. Íde Kearney, Dr. Róisín O'Sullivan and Mr. Michael Tutty. As the Chairman noted, this is Michael's first appearance before the committee following his recent appointment to the council in September 2015. I am sorry to say it is Róisín's last appearance with us, as she comes to the end of her four and a half year term. I thank her for the significant contribution she has made to the council. The council's secretariat is also present. The council would like to thank the staff of the Oireachtas for their ongoing, useful co-operation.

Today, I will cover our ninth assessment. The report is written in line with the mandate of the council, as set out in the Fiscal Responsibility Act 2012. Since our last appearance before the committee in June, there has been further welcome evidence that the recovery in the Irish economy continues to strengthen. Behind the impressive growth in headline aggregates, such as GDP and GNP, are signs of a broad-based economic recovery. Domestic demand is now making a positive contribution to economic growth through higher consumer spending and domestic investment. Meanwhile, a favourable exchange rate and external demand environment is benefiting Irish exports. The combination of strong output growth in the internationally traded sectors of the economy along with the positive impetus from domestic spending is driving rapid growth in the Irish economy, faster than that of its EU neighbours.

Importantly, the fruits of the economic recovery are to be seen in both the labour market and the public finances. The unemployment rate has dipped below 9% for the first time since 2009 and employment growth has averaged 2.7% on an annual basis over the first three quarters of 2015. It is important to note that even with this impressive employment growth, the employment rate – the ratio of the number at work to the working age population – is still back at early 2000 levels. This indicates that although output, as measured by GDP and GNP, has regained its 2007 peak, the recovery is incomplete and more progress is needed to repair the economy and labour market and to restore living standards following the deep recession.

The public finances have continued to improve despite budgetary overruns in some areas through a combination of strong tax receipts and savings from lower debt servicing costs and falling unemployment. The general government deficit fell to 3.9% of GDP in 2014 and is likely to be lower than the budget day forecast of 2.1% this year. The general government gross debt-to-GDP ratio has continued to fall and is expected to measure around 97% of GDP by the end of 2015 compared to a peak of 120% of GDP in 2013.

Although the near-term prospects for the economy are positive, substantial risks surround the central projections. These risks, which are detailed in our report, stem from both internal and external sources. Among the domestic risks is the highly concentrated nature of production in the Irish economy, whereby a small number of sectors and firms account for the bulk of manufacturing output and exports. External risks include the impact on the Irish economy of a slowdown in the US, UK or euro area economies. Were one or more of these risks to materialise, growth would be slower and unemployment higher than envisaged in current forecasts. This would make it more challenging to reduce the debt-to-GDP ratio in line with current projections and there is a risk that the debt ratio could start rising again.

Weighing up these considerations, the rapid growth now being observed and the pace at which the economy's spare capacity is being reduced argue against the need for an expansionary fiscal stance at present. With domestic demand recovering strongly and unemployment falling, the need to eliminate the remaining budget deficit and to put the debt on a firm downward path takes precedence over using a more expansionary fiscal stance to stimulate an already rapidly growing economy.

The April 2015 spring economic statement formed the basis of the discussions at the national economic dialogue held in July. In a departure from the plan announced in the spring statement, budget 2016 showed an increase in Government expenditure for 2015 of €1.5 billion compared to the projection in April. Since the majority of the current spending in 2015 is carried into the base level of spending for 2016, the overall package of budgetary measures, combining the announcements in budget 2016 and additional White Paper spending, implies a significantly looser fiscal stance for both 2015 and 2016 than projected in the April 2015 spring economic statement.

The council assesses that the decision to increase expenditure in 2015 beyond what was originally budgeted was a deviation from prudent economic and budgetary management. There are a number of reasons for this assessment that we detailed in last week's report. The additional spending absorbs the majority of the better than expected tax revenues in 2015. This keeps the deficit and debt higher than could have been achieved and provides an unnecessary stimulus at a time of strong economic growth. Had total spending not been increased in 2015, the general Government deficit would likely be around a half a percentage point of GDP lower than currently anticipated for this year.

Using unexpected incoming revenues to fund permanent increases in expenditure at a time of strong economic growth has echoes of the last boom, when property-related revenues funded large increases in spending. In addition, an unusually large surge in corporation tax receipts accounts for a large proportion of the better than expected tax revenue in 2015. While the Revenue Commissioners have noted that the majority of the corporation tax overperformance in 2015 is not due to one-off factors, further analysis is needed to ascertain the drivers of this exceptional growth in 2015 and to determine the likely growth in this tax heading over the medium term. The Revenue Commissioners have confirmed that they have agreed to review the forecasting method for corporation tax and have established an internal working group. The council looks forward to the publication of the review's findings. In the meantime, until there is more certainty as to the sustainability of the corporation tax increase in 2015, the council is concerned about the decision to use unexpected revenues to increase expenditure.

More positively, for 2016 the Government has signalled its intention to follow the requirements of the Stability and Growth Pact and the national budgetary rule from 2016. Government revenues in 2016 are forecast to grow faster than non-interest Government spending by some margin, which is appropriate given the ongoing recovery and consistent with prudent policy.

I will address the second major theme of the fiscal assessment report concerning the projections for the public finances beyond 2016. Following exit from the excessive deficit procedure in 2016, Ireland's national budgetary framework comprising the domestic budgetary rule, which mirrors the requirements of the preventative arm of the Stability and Growth Pact, SGP, along with the expenditure ceilings will come into operation. Despite its complexity and imperfections in some areas, the budgetary framework provides a valuable structure to guide Irish fiscal policy and is consistent with moving Ireland's debt to safer levels. A core requirement of Ireland's budgetary framework is the need to provide credible medium-term plans for the public finances. As well as being a requirement of the Government's budgetary framework, proper medium-term fiscal plans are vital for a number of reasons. Such plans provide a comprehensive and realistic framework for the planning and management of public expenditure over the medium term by linking annual budgets to longer-term fiscal targets. Well-specified medium-term plans increase the predictability of the budgetary planning process by providing realistic estimates of revenue, expenditure, deficit and debt over a three-year period. Medium-term planning is important in providing a link between resource allocation and Government policy and priorities and can guard against a return to short-term, incremental budgeting.

Providing detailed medium-term projections for the public finances is a much more demanding task relative to current practice, and the Government has made some progress in the recent budget and the April stability programme update, SPU. Nevertheless, the absence of a realistic medium-term plan for the public finances has not been fully addressed in budget 2016. Expenditure projections after 2016 explicitly provide for an additional €400 million each year to cover demographics but do not fully incorporate the cost of providing current levels of public services in future years, with the ratio of government spending to GDP projected to fall by more than five percentage points by 2021. The tax forecasts do not reflect commitments announced in budget 2016, including the plan to abolish the universal social charge, USC. As a result, the projections for the budget balance in budget 2016 do not provide a useful picture of the fiscal position over the medium term.

Based on the projections in budget 2016, the council's analysis compares the estimated expenditure growth necessary to accommodate spending pressures with the allowable expenditure growth when there are no new tax changes and all the space under the rules is used for additional spending. The analysis shows that meeting likely future expenditure needs would absorb the majority of the estimated fiscal space available after 2016. Further tax cuts would make it very difficult to fund these expenditure pressures, if fully accommodated, while complying with the rules.

Another challenge that has emerged regarding the implementation of Ireland's budgetary framework concerns the operation of the system of expenditure ceilings. Multi-annual ceilings were introduced in 2012 to address serious expenditure management problems evident in Ireland prior to the recent fiscal crisis. These problems were manifested by a pattern of *ad hoc* year-to-year budgeting that inevitably contributed to pro-cyclicality in fiscal policy during the boom. Even before 2015, there have been regular upward revisions to the expenditure ceilings. Such persistent revisions undermine multi-annual public expenditure management by creating uncertainty around the scale of future resources, both in aggregate and for individual Departments. Without improvements to the existing system of expenditure planning, it is likely the recent upward revisions to expenditure ceilings will continue to revert to the pre-crisis pattern of pro-cyclical adjustments. The failure to respect expenditure ceilings raises the risk of funding increases in expenditure from windfall revenue sources. The domestic medium-term expenditure framework should be strengthened to ensure multi-annual planning becomes a central element of the budget process.

As economic conditions improve, it is timely to remember Ireland's tendency to make budgetary mistakes during good times that have helped set the stage for the crises that followed. Avoiding a repeat of the pattern of mistakes that undermined the public finances in the past should remain foremost in the minds of policy-makers. Prudent policy is a necessary ingredient of sustainable growth in incomes and employment in a fragile global economy, and all the more so given the crisis legacy of high debt. Ireland's post-crisis budget framework should help avoid boom-bust cycles and guide government debt to safer levels. It is important, therefore, that the framework, in both letter and spirit, is respected in fiscal plans. Adherence to the budgetary framework during good times will help ensure a sustainable growth path and limit the need for austerity measures in any future downturn. I thank the committee for providing us with the opportunity to attend today and we look forward to taking questions and hearing the views of members.

Deputy Peadar Tóibín: Cuirim fáilte roimh na toscairí. Bhí an anailís ar fheabhas. The IFAC has done a great service to the State with its recent analysis. Having read the report and examined elements of the economy, there is an awful feeling of *déjà vu*. While everybody welcomes the increased Exchequer returns, three elements are manifesting themselves in the economy. One is the imbalance in the economy, with 90% of our exports in the foreign direct investment, FDI, sector and 70% of corporation tax coming from approximately 140 firms. We are dependent on a very small pool.

There seems to be a shifting of revenue generation towards more volatile revenue generation centres. For example, in the past there was a shift from personal taxation to stamp duty and the construction industry. Now, we seem to have a shift from personal taxation towards the likes of the volatile corporation tax sector.

In the lead-up to the crash of 2007, there was an uncontrolled economic factor, namely, the low interest rates set by the EU which had a major effect on the overheating of the economy. While the bounce-back is welcome, there is an enormous array of external economic factors over which the State has no control and which are blowing very strongly in favour of the State. As Professor McHale's report states, there in an output gap which is reducing quickly, and there is a danger again of the economy overheating, which is shocking. Professor McHale seems to be saying there are very strong echoes in government fiscal policy between now and before 2007. Is this the case?

Professor John McHale: There are echoes of past policy mistakes. The one point on which we all agree is that we need to have sustainable growth and the key to avoiding the boom-bust cycle is not to pursue a pro-cyclical fiscal policy. The essence of pro-cyclical fiscal policy is that the revenue surge that occurs in good times is used for large, permanent increases in government spending. As the Deputy pointed out, there has been a surge in corporation tax revenues that, while very welcome, is poorly understood. Although the Revenue Commissioners have said they do not believe the bulk of it is once-off, corporation taxes are very volatile, and some of the factors that may have been driving them, such as the strength of the dollar, could reverse.

Deputy Peadar Tóibín: Some of the volatility in corporation tax seems to be coming from changes in accounting systems between some companies due to new corporate tax rules. Is it a likely contributor to some of the overrun, in Professor McHale's estimation?

Professor John McHale: We do not fully understand it. It is one of the possible factors, and we are trying as best we can to get to the bottom of it and improve our forecasting models for corporation taxes. Given the limited understanding of what is driving the strength of corporation tax, we must be very cautious in relying on the recent surge continuing in terms of funding permanent spending increases.

Deputy Peadar Tóibín: Professor McHale's report mentioned that the Government estimates the fiscal space to be approximately €8 billion and discussed the fact that much of the fiscal space will be consumed by demographic pressures and expenditure responsibilities the State will have in the future. This means the estimate of the actual fiscal space, if current delivery stands still, is far smaller. What would Professor McHale imagine that to be?

Professor John McHale: One of the things we emphasise in this report is the importance of medium-term plans being based on realistic medium-term projections. We note in this report that the projections for expenditure do not fully allow for likely demographic growth. Even more important, they do not really allow for the pressures caused by the rising cost of Government services and benefits as a result of general inflation in the economy.

Deputy Peadar Tóibín: Can it be said on that basis that the tax cuts of €4 billion that have been estimated are not feasible?

Professor John McHale: We estimate, using an alternative scenario for government expenditure that takes account of what we consider to be a realistic provision for these demographic pressures and essentially indexes the budget, that the bulk of the available fiscal space would be used up if such provision were made. The Government can decide to reduce government spending, in which case those pressures would not be fully accommodated. That would create space to do other things, such as other expenditure initiatives or tax cuts. Our point is not really to advise the Government or the Oireachtas on what the medium-term plans should be. Our point is that regardless of the plans that are drawn up, they should be based on realistic projections that recognise the underlying spending pressures.

Deputy Peadar Tóibín: Professor McHale's report mentioned health. Everybody believes the health budget will be exceeded every year because that is the way it has been. Does Professor McHale have any understanding of what is necessary in health? What is a reasonable budget for health that would fulfil the service pressures within it?

Professor John McHale: If I were to say what the health budget should be, I would be going beyond the role of the Irish Fiscal Advisory Council. We recently published an analytical note on the problems of overruns and cost control in the health sector. We really look at it from a more structural sort of perspective. On the one hand, there seems to be a sort of pattern of unrealistic forecasts for health. This is combined with what we refer to as a soft budget constraint in health. All of this essentially means the health managers who are told "this is your budget and you cannot overrun on it" realise that if they overrun their budgets, they will be bailed out, essentially. That has an effect on the incentive structure. That can feed back and lead into the setting of even more demanding targets, which in turn causes the soft budget constraint phenomenon to become even more pronounced. They feed on each other. Structural reform of expenditure management in health is certainly needed if the problems mentioned by the Deputy, which have been persistent over recent years, are to be overcome.

Deputy Peadar Tóibín: The overheating that was a feature of the pre-crash period around 2003 manifested itself mostly in the property market, etc. Professor John McHale mentioned in his report that the output gap is shrinking and is close to being totally consumed. He suggested that overheating is likely to happen for this reason. How would that manifest itself? What tools has the Government at its disposal to prevent this from happening?

Professor John McHale: It is a very interesting question. The Deputy is absolutely right when he says that the official measures of the output gap currently show that the economy is overheating. There is actually a positive output gap. The projections are that we will come back to balance. These projections are based on the harmonised methodology that has been agreed between governments and the European Commission. We think the commonly agreed methodology is giving misleading signals at the moment. We believe a degree of slack probably still exists in the economy. That can be seen in the unemployment rate, which has come down quite significantly but is still quite high at close to 9%. Given the strength of growth in the economy at the moment, we see that outward gap closing. We think it is a negative outward gap, which is contrary to the official measure, but it is closing. For that reason, we do not think an expansionary fiscal policy is warranted from a counter-cyclical perspective at this time. The Deputy asked a further question.

Deputy Peadar Tóibín: I asked how this can be resolved if it has manifested itself.

Professor John McHale: Typically, people look at what is happening to inflationary pressures. I think we know from experience in Ireland that there is a need to look beyond that. The signs of unsustainability that showed up during the last unsustainable boom included the very large current account balance, the loss of competitiveness, the overheating in the housing market and the excessive credit growth. In each of our reports, we monitor for signs of these imbalances. At the moment, we do not see signs of serious overheating in the Irish economy across most of these indicators. If the sort of growth we have been experiencing recently were to continue, we would probably be moving into a phase where signs of overheating across the broad range of indicators we monitor would begin to become apparent.

Deputy Peadar Tóibín: It seems that we are still in the middle of an extreme pro-cyclical space. In other words, we came from a very deep trough. Typically, after a very deep trough, one has a very strong bounce back. That is what is happening at the moment. Ideally, a Government should be flattening out these ends of the cycle. It seems from some of the research and the estimates that have been produced by the Department of Finance that this is not being taken into consideration at all. For example, the profile of the approach that is being taken to corporation tax and some other elements of the economy seems to be significantly out of sync with what the Department of Finance is saying. Is Professor McHale happy with the level of research and analysis available to the State for medium-term forecasting?

Professor John McHale: The first thing to be said is that the Irish economy is a volatile economy, partly because it is so open and it has a large multinational sector. The problem is inherently difficult. We struggle with it as well. The Deputy raised the particular issue of medium-term forecasting. We have said in a number of reports and directly to the Department of Finance that we believe it needs to strengthen its tools for medium-term forecasting, particularly if it is to develop its understanding of the supply side of the economy. There is some good news on that front. The Department of Finance is beginning to develop those tools. We are also engaged in a significant research programme to try to develop such tools. We need to develop a much better understanding of medium-term forecasting at the level of the Department of Finance and at the level of the economics community as a whole in Ireland.

Deputy Peadar Tóibín: I would like to ask a supplementary question on that. Professor McHale mentioned that we could be at the edge of overheating, etc. What effect would the imposition by a Government of tax cuts of €4 billion have on that?

Professor John McHale: It would depend on what was happening on the expenditure side.

Deputy Peadar Tóibín: Obviously, expenditure cannot retreat any further.

Professor John McHale: If we assume the fiscal rules are binding, whatever is done on the tax side will have to be offset on the expenditure side, given the amount of fiscal space that is available.

Deputy Peadar Tóibín: Would it not have an inflationary effect?

Professor John McHale: If it were not offset, it would have such an effect. It would be very difficult to do that within the fiscal rules. It is mainly an issue of priorities. It is a question of whether one wants to prioritise tax cuts or spending.

Deputy Peadar Tóibín: Okay. I thank Professor McHale.

Deputy Pat Rabbitte: I have a couple of questions. I thank Professor McHale and his colleagues for being here. I agree with Deputy Tóibín that the Irish Fiscal Advisory Council has done the State some service. It has certainly done some service if it has converted Sinn Féin to the views to which I have been listening for the last 12 or 15 minutes. I calculated recently that some of the commitments made by Sinn Féin-----

Deputy Peadar Tóibín: We would be less inflationary than this Government.

Deputy Pat Rabbitte: -----would involve a spend of approximately €11 billion in modest terms. I welcome the influence of the Irish Fiscal Advisory Council purely for that contribution alone. Is Professor McHale not being a bit severe? When Professor McHale says the unplanned expenditure at the end of 2015 echoes the last boom, when property-related revenues funded large increases in spending, I am not sure I fully understand it. As I understand it, what happened during the boom was that when stamp duty receipts and transaction taxes on building and property fell away, like melting snow on a ditch, we could not fund the services to which we had committed to provide. In this case, the Revenue Commissioners are not conferring approval on the use of the much-used word "volatility" in relation to corporate taxes, although they can, of course, be derailed for any number of reasons. In their opinion, corporate taxes seem consistent, stable and solid for the future, with the exception of a figure of some €300 million. Is it fair for Professor McHale to cause the resonance he has caused with his calculated decision to say this echoes what happened during the boom?

Professor John McHale: We have tried to calibrate our language, which is why we use the word "echoes" in respect of the boom.

Deputy Richard Boyd Barrett: The Professor is saying it is much worse.

Professor John McHale: We also say it is a deviation from the prudent path. Based on the plan the Government has laid out to follow the fiscal rules, we hope and expect it will return to that prudent path. On the comparison with the property boom, if one thinks back to 2005 or 2006, at the time it did not seem that these were unsustainable sources of revenue either. One could say that, year on year, they were not one-off sources, but ultimately, of course, they did not prove sustainable and revenues collapsed and we all know the very serious difficulties that followed. There are some similarities with what is happening to corporation tax.

Deputy Pat Rabbitte: Is it a fair parallel? Building 95,000 houses for the population, as we were doing at the time, was manifestly unwise but only a policy of devastation would cause international companies to withdraw, or to retrench dramatically, causing something similar to what happened in 2006, 2007 and 2008. Is it fair to raise the fear that something such as this could happen to the export sector?

Professor John McHale: At the time, not everyone could imagine the things that could go wrong. The figure for corporation tax this year is 53% above what was profiled and the international tax policy environment, whether as a result of the OECD-led BEPS initiative, developments in the common consolidated corporation tax base at euro area level or potential developments in the United States where this is a major issue, even in the presidential contest, leads to many uncertainties.

Deputy Pat Rabbitte: Is the professor saying some in the international sector might be declaring more tax than they would otherwise do in preparation for the implementation of the BEPS? Does implementation of the BEPS threaten the quantum of corporation tax we are likely to see in the future?

Professor John McHale: As I said to Deputy Peadar Tóibín, there is a general lack of understanding of what is driving this. Even though the Revenue Commissioners stated they believed the bulk of the increase was not a one-off, they are clearly struggling with this also in their own forecasting. There is a lot of uncertainty and having a permanent increase in spending based on a surge in tax revenues echoes the mistake we made in the past. In coming out of the crisis we want to make sure we do not follow the pro-cyclical policy that got us into trouble before. The essence of a pro-cyclical policy is to follow a revenue surge with an increase in spending and that has occurred most recently within the year. Even in the past the increase in spending took place in the year following a revenue surge. We have been given this oversight role as part of the fiscal responsibility Act and have to assess the prudence of the fiscal stance taken. The core mistake in pro-cyclical policy is that in good times and when there is a surge in revenue we increase spending. We have seen that happening this year. It would be a very strange fiscal council that did not react quite strongly to it.

Deputy Pat Rabbitte: If the professor was not chairman of the Irish Fiscal Advisory Council but spoke simply as a professional economist, would he give any credence at all to the strains put on the system in the seven years we have been through? I refer, in particular, to the health sector and the cases my eminent colleagues raise every day in the Dáil in the course of looking for more expenditure. Does he agree that our infrastructure has been badly run down and, to maintain the tax take in the future, we need to start building it up again?

Professor John McHale: Yes, we are very much aware of that and it goes back to the other area on which we focus in the report, namely, the underlying spending pressures. Spending has had to be curtailed to pull ourselves out of the crisis and there will be strong pressures on the system down the line. We have to set priorities and, given the stringent fiscal rules we face, there is a limited amount of fiscal space available. We have to make hard decisions when it comes to tax cuts, as opposed to making sure there is adequate provision of public services and social protections. While recognising the extreme pressures politically and on the public, we do not want to repeat the mistakes that brought such devastation on us in the past. That came from following a pro-cyclical fiscal policy and we really want to come out of the crisis with a framework to ensure we do not repeat those mistakes again.

Deputy Pat Rabbitte: Professor McHale made reference to the extra spending at the end of 2015, saying we could have reduced the deficit by a further 0.5% of GDP had it not taken place, but is it not remarkable that we are forecasting the figures we are forecasting for the deficit? The latest Department of Finance figure is somewhat below what the professor suggested it would be - 1.7% at the end of the year. Is that not remarkable compared to where we were four or five years ago?

Professor John McHale: I have been talking a great deal, so I will share some of that responsibility.

Mr. Sebastian Barnes: The Deputy is absolutely correct that it is remarkable. It also reflects the fact that the economy has turned around in a way that is quite remarkable as well. The report is about how one balances those two things. In our view it could be balanced in a better way by saving the money that came from this specific source of corporation tax.

Deputy Pat Rabbitte: When this Government was formed all of the emphasis and all of the lecturing to it concerned the deficit. The deficit was the Holy Grail we had to aim for at the end of the lifetime of the Government and further down the line into 2018. I doubt that any economist reasonably could have forecast that we would be heading into the end of 2016 with a balanced budget, arguably, given the redefinition of 0.5% or minus 0.5% that is in prospect in terms of the European rules.

Professor John McHale: The progress on the deficit has been extremely impressive and very welcome. In our pre-budget statement, we basically considered the plan the Government had set out for 2016 to be broadly appropriate. Everybody did not agree with that. There was more criticism from other institutions. However, we take into account the underlying growth in the economy. There is a mildly contractionary stance in the way an economist typically measures these things. We were looking at the improvement in the public finances, including the deficit, and we were reasonably satisfied with the course policy was on.

In this report, we expected for once to be able to say that we were supportive of the course that is being followed. It is not that we are always going out of our way to be critical but one must understand, to return to the previous point, that the one thing we do not wish to repeat is pro-cyclicality in policy. It follows the pattern we discussed earlier. Despite the improvement in the deficit, which is quite impressive, that is why we felt we had to respond so strongly and took the unusual step of responding the morning after the budget. We had said something in the pre-budget statement, which basically signalled our support for the plan, but that was not what we were supporting. It is that, in particular, which has led to this quite strong response, to which the Deputy is reacting. However, I take his point in terms of some very impressive improvement in key public finance aggregates, both the deficit and the speed with which it is coming down.

Deputy Pat Rabbitte: I have a final question. Is the witness articulating his conviction about the analysis he is making about the dangers of procyclical budgeting and so forth or is he expressing his satisfaction with the fiscal rules as they have been laid down for us?

Professor John McHale: We do not think the fiscal rules are perfect by any means. On the other hand, they broadly get us in the direction we need to go in terms of moving towards a balanced budget. There is nothing sacred about a balanced budget in particular. It also puts us on a path to bring the debt down in order that we can move to a safer level so that if we are hit with some negative shock in the future, we will not have to implement a big austerity programme to pull ourselves out of it. Also, elements of the rules, including the expenditure benchmark, are designed to prevent the type of pro-cyclical response to revenue surges that we have been discussing. The reason that it was able to occur this year is that we are in an odd transition between one phase of the rules, the corrective arm of the Stability and Growth Pact, and what is called the preventive arm. It allows this to happen within the rules but we think it is very much against the spirit of those rules.

The rules are not perfect but when one puts it together with the overall budgetary framework, including our system of expenditure ceilings and the fact they are not just European rules but also national rules as part of our Fiscal Responsibility Act, we now have a framework which, if we follow and respect it both in the letter and the spirit, means we have a very good chance of avoiding the pattern of mistakes we made over the decades of boom and bust that have done such damage to us. In that sense overall, we are supportive of the budgetary framework but we are also supportive of efforts to fine-tune it, identify the problems with it and make it even better.

Deputy Richard Boyd Barrett: I thank the members of the Irish Fiscal Advisory Council. I do not always agree with their recommendations but I appreciate the work they do in these engagements. The witnesses identify two key vulnerabilities for us, one external and one domestic. My question is about the external one first. This is the one that is often mentioned but is not thought about much beyond that, namely, the possibility of a significant global downturn or external shock because of what is happening in the global economy. Is it fair to say that the Government is not factoring this into its projections for steady growth over the next period and its generally upbeat story about what is happening in the Irish economy and that it is extreme folly for the Government not to factor in what I consider to be the growing likelihood - the witnesses can say if they agree on this - of a significant external shock?

I wish to hear what the witnesses have to say on that but I will outline why I view it as a growing likelihood. First, mainstream people are saying it. My young nephew who is in my Dáil office did some research for me today and he picked out some examples of this. Willem Buiter of Citigroup, a New York based bank, is warning that it is very likely that China is facing a hard cyclical downturn and that this will have a very significant impact on the rest of the global economy due to falling demand and so forth. Similarly, the IMF has warned of a strong likelihood of a new global recession. Its head has said that the scenario the IMF is depicting does not rely on extreme assumptions at all. In other words, it is saying it is very likely. Frankly, when one looks at what is happening in China, it appears to be almost inevitable that this will happen. All of the money that exited from the banks in Europe and the western economies after 2008, which we bailed out, ran to China. It over-heated the Chinese economy and now China will face a downturn.

Is this not almost a racing certainty? In addition, there is a simple historical fact. The recession happened in 2007 and it is now 2015. Can we think of a period in recent history when there has not been a recession at least every eight to ten years? Is it not almost a racing certainty that there will be a shock of some type? We do not know the exact depth of it but it is not factored into the Government's projections.

Professor John McHale: The collective wisdom of the OECD is represented through Sebastian Barnes, so I will let him respond.

Mr. Sebastian Barnes: The Deputy makes very good points. The council has included a risk matrix in its fiscal assessment report. From memory, we gave a high relative likelihood for the type of scenario the Deputy outlines. We definitely agree on the substance. Putting on my OECD hat very briefly, this is the fifth year in a row in which the global growth rate has slowed. Organisations such as the OECD and the IMF consistently revise down their forecasts for global growth which is a big source of concern for us. The centre of this is a collapse in world trade. World trade growth has been very slow since the crisis - slower than past relationships would suggest - and that situation has got worse during the course of the last year. That is a great source of concern. Times when trade growth has been this weak have typically been associated with recession or recession-like conditions in the global economy. We are very concerned about that. The mechanisms the Deputy referred to through which this might happen are very familiar to people in Ireland and include, in essence, the accumulation of debt in China and other emerging economies. We are about to go through an interesting couple of days. The ECB met today and the Fed meets next week. That may well be the trigger of some of these things, but it may not and there may be other triggers. There is definitely good reason to be concerned. Partly because it is so concentrated on very specific activities, Ireland can prosper even though things around it are not so good, but we should not be too complacent about that. If there were a big global economic crisis, particularly one that went through into financial markets, it would clearly have very big consequences for everyone. Everyone would be affected to some degree.

In terms of the forecasts by the Department of Finance, and this covers all OECD forecasts, we have a central scenario that assumes these things will not happen within the forecast period. It is very hard to predict when a crisis is going to happen and exactly what the triggers would be. The Department of Finance refers to a downside risk in its forecast material and that is surely the right thing to do. I have not looked at the budget documents closely enough to say whether the Department has got the balance right but it is right that it has set out that there is a downside risk. What this points to is not really a forecasting issue, but is rather a policy one.

One of the reasons we are arguing for caution, particularly on the 2015 decision, is that we have had a whole series of positive shocks for Ireland, which has been very helpful, but there is no guarantee that they will carry on being positive. If one looks back at the typical scale of forecast shocks, one can quite easily see things that make life look a lot more difficult and less rosy than it does.

Deputy Richard Boyd Barrett: I am sorry to interrupt but my time is short. I appreciate Mr. Barnes's response, which confirms what my fears are. He clearly echoes those. I note two things in passing. It is not Mr. Barnes's responsibility but we should all learn the folly of bailing out the banks, not just for us but internationally. We gave the moneys back to the banks to go off and speculate somewhere else and it is going to blow back on us. That is a bigger international issue.

On the projection side, it is fair to say the downside risk is always mentioned as a "by the way" to cover ourselves, but it is not taken seriously. It is mentioned as a matter of course that there is upward, downward and central, but that picture is changing. The likelihood of the downside risk materialising is now significantly greater than it was when it was mentioned in a perfunctory way three or four years ago. On the domestic side, I find myself again in total agreement with the witnesses. We have been saying for some time that over-reliance on the multinational sector is dangerous. I would be interested to hear from the witnesses what we should do about it. What is the council's role in advising on this? Our view is that we should get as much out of these multinationals as possible now while we can and apply it to the development of our domestic economy. We should invest it in infrastructure that provides a basis and some protection on a medium to long-term basis against the fluctuations, volatility and uncertainties of the global economy, in particular for an open economy like ours. Is that not what we need to start saying? Do we not need to say that we are too reliant on multinationals?

My theory for the boost in corporate tax revenues is as follows, and I do not know if the witnesses agree. Microsoft was recently reported to have bought a huge amount of intellectual property from itself in the game of one subsidiary moving rights and patents from another to avoid tax. I understand that it bought an incredible €1.5 billion worth of intellectual property from itself which means the charging being done previously to subsidiaries in tax havens is now being done here. Some of the profits will be allocated here that were previously allocated elsewhere and that relates to the closing off of the double Irish and the opening up of the knowledge box. It is done precisely in order to benefit in the longer term from the knowledge box and to keep down the tax liability. That is my theory. What must we do and what should we be saying about insulating ourselves from the vulnerability that arises from an over-reliance on the multinational sector? Is it not about investing in our own domestic industrial and infrastructural capacity and so on?

My last question flows from the above. An area of this which is macro in scale as well as a very immediate social problem is the housing market, about which I have spoken to the council on a number of occasions. This is now a big problem. Some of us have been warning about it for a couple of years. I read a very interesting article in *The Irish Times* today which acknowledges that the hope that the private sector would deliver the housing we need is not materialising. In fact, the article explains quite well why that is not the case. I will quote it briefly:

> A difficult dynamic of recent years is that very little land in Ireland is owned by developers, instead it's owned by international funds, receivers, and private equity. Most of the multi-unit planning permissions of recent times have been run through by receivers and banks simply trying to add value to assets they already held, with no intention of ever

building houses. Project Clear and Nama among others have been a big driver of planning permission applications and renewals and this is now moving towards a natural end.

Ultimately, the article continues, this land has to get into the hands of capitalised builders or, I might add, the State before houses will be built. The people who bought up all the land and assets have no intention of building. They are just inflating the value of their assets. The private sector does not have the capacity or the will to do it and we have a major problem as a result, including a major social crisis. It will also be a macro-economic problem. If people do not have anywhere to live, it will put upward pressures on pay demands and choke off investment. Who wants to come to a place nobody can afford to live in? This is a developing global problem. I would be interested to hear what the witnesses have to say about it. The answer is for the State to marshal more resources to itself. It must increase taxes on capital and on those who hold all that wealth and those assets to invest them in key strategic areas of the economy. If we do not do that, we will be riding for a big crash.

Professor John McHale: Dr. Thomas Conefrey will answer the multinational question first and I will come back to the housing question.

Dr. Thomas Conefrey: We agree that the economy is hugely dependent on the traded side on multinational enterprises. In a way, it is a sign of success that the economy has been so successful at attracting foreign companies and is, as a result, very dependent on those companies for a large share of its output. As the Deputy said, that presents risks in terms of a potential loss of output if there were a downturn outside Ireland and also, as we have said, on the corporation tax side.

The Deputy asked how we might go about insulating ourselves from that concentration of risk. With regard to the point we make on corporation tax, one way of insulating ourselves is to be cautious in using the considerable increase in revenue we have seen from the multinational sector this year until we are more certain about what is driving it. I refer not only to next year because it is likely that these revenues will continue to feature in 2016, as the Revenue Commissioners have indicated. However, we need to be sure over many years or in the medium term, and not just 2016, that these revenues will exist. One insurance policy is to be cautious in using those revenues until we can be more certain they will be sustainable.

Deputy Richard Boyd Barrett: May I cut across Dr. Conefrey? The cautious approach partly concerns identifying the revenue sources. However, is it not also a question of determining what the money should be spent on, considering the view that we need to increase capital investment in infrastructure and domestic industrial and enterprise capacity?

Dr. Thomas Conefrey: Again, it is not our specific role to recommend expenditure in particular areas. The important point is more on what we can do to insure ourselves against this very real risk. Even before the huge increases in corporation tax revenue we saw this year, there was reason to be cautious about corporation tax given the concentration associated with a very small number of firms.

Professor John McHale: I wish to answer the question on housing, which as Deputy Boyd Barrett said, we have discussed previously. I agree on the seriousness of the issue. It is a great risk to Irish growth. One of the factors that should be feeding positively into growth is the return of emigrants. It is incredibly difficult to come back to Ireland, particularly Dublin or one of the other cities, because of the cost of housing. This could choke off the very positive growth dynamic. In addition, there are social issues to be considered in relation to the housing crisis.

I agree with the Deputy on the seriousness of the problem.

Perhaps the lack of housing supply is so severe that a private sector response will be an important component along with identifying all the factors that are holding this back, such as people sitting on development land, as mentioned by the Deputy. A vacant site levy could be important, bearing in mind that the cost of providing housing is still very high. We have a chart in the report that compares the evolution of the cost of house building with house prices. There are finance issues, as the Deputy stated, in addition to regulation issues. Many challenges need to be tackled to try to have a private sector response. Clearly, however, we cannot rely on the private sector alone, such is the severity of the problem. People's housing needs are so great that the social housing side must comprise an important part of the solution. We probably do not disagree that both sectors are required. One could argue about the mix but I agree on the seriousness of the problem. It is one of the major issues we will be facing in a couple of years and it has to be a major policy priority.

Deputy Paul Murphy: I thank the delegation for attending and for the presentation. The engagement between the Government and the IFAC over recent weeks has been amusing to watch. Although the Government, at the suggestion and demand of the Commission, set up a body designed to push for austerity at all times and to be independent of public pressure, it expressed its discomfort with that body when it did precisely that.

I appreciate that we are operating in the dark somewhat but it would be interesting to explore a little more the unexpected significant increase in corporation tax and the potential reasons for it. I accept the answers the council has given and the potential vulnerabilities.

I understand the corporation tax intake is 58% ahead of that projected, which is very significant. There is an article by Mr. Seamus Coffey in yesterday's *Irish Independent* that argues the increase is associated with a small number of corporations. Mr. Coffey states that in the first ten months of last year, the top ten payers of corporation tax paid €1.3 billion. In the first ten months of this year, the top ten contributed €2.5 billion.

The statement of the Revenue Commissioners that revenues are acceptable for next year is satisfactory. These trends can be acceptable for the following year, but I take the point that was made on the period from 2017 onwards. Is the most likely explanation not that corporations are putting their tax affairs in a certain order to maximise tax efficiency and minimise the amount of tax they pay in the context of the introduction of base erosion and profit shifting, BEPS, in terms of the OECD? Surely that or something akin to it is the case. Is there not a shifting of profit locations, thereby having an impact on tax? Surely, if it were all fundamental and the companies were just producing and selling more goods and services, we would see what I describe to a greater extent than at present.

Professor John McHale: I thank the Deputy for the question. Deputy Boyd Barrett said on the previous occasion that we grew on him over time. We may not have had the chance to grow on Deputy Paul Murphy yet but we are moving in the right direction. The Deputy is correct to point out the massive unexpected increase in corporation tax this year. He mentioned an increase in the order of 58%. While it seems on the basis of what the Revenue Commissioners have said that this is partly attributable to more fundamental factors relating to profitability, it is difficult to believe an increase of that size is based purely on profits. While we must admit again that we do not have any solid insight into that, one must wonder where it is coming from and, therefore, be very cautious in depending on the revenue stream being in place for the future. As the Deputy said, we may have the revenue next year but we have to be cautious beyond that.

Deputy Paul Murphy: Surely the most obvious vulnerability is US politics, especially in light of the Pfizer–Allergan merger. The merger, which will minimise the amount of tax paid by locating in Ireland, has brought the question to the centre of US politics. It is featuring to some extent in the US presidential election campaign. The most obvious vulnerability is the United States changing its tax code very quickly to limit the attractiveness to multinationals of directing profits through Ireland.

Professor John McHale: It certainly is a risk. There is significant anger across the US political spectrum on this issue. In US politics, anger does not necessarily lead to action. There seems to be gridlock in the US political system.

Deputy Richard Boyd Barrett: That is true here also.

Professor John McHale: It may be more true in the United States because of the nature of the political system, but sometimes changes that seem almost impossible for a long time occur all of a sudden. I certainly would not rule out a change. There could be a measure such as a tax amnesty allowing companies to repatriate their profits at a much lower rate than at the statutory rate of 35%. Other longer-term changes to the way non-repatriated profits are treated could have a substantial impact on the attractiveness of Ireland as a destination, and it could affect the companies' tax management strategies. That is a risk among other risks. It is another reason we need to be very careful.

Deputy Paul Murphy: It speaks to a broader point about the extent of our reliance on multinationals for the driving of economic growth and about the nature of the activity that takes place here. We do not deny that real economic activity by multinationals in Ireland has resulted in significant job creation. I believe they account for approximately 7% of jobs. I have read some statistics relating to the files that are submitted by US corporations in America with regard to the profits they make in Ireland. I think they said last year that they made approximately $100 billion in Ireland. That is where they said they were located. David McWilliams has worked out that this equates to $1 million per employee. Although we think Irish workers are skilled and well-educated - they speak English and have many other attractive attributes - the statistics to which I refer do not seem to be real. We have spoken about our vulnerability because of our over-reliance on the multinational sector in general, but is there a broader point to be made about the fact that a large proportion of the profits that are said to be made here are not actually made here?

Professor John McHale: I ask my colleague, Mr. Tutty, to respond to that question.

Mr. Michael Tutty: I will make a point that I was going to make earlier. I have been in the Irish public sector for a long time. We worried all along about the dominance of the multinational sector in terms of what we would do if multinational companies were to disappear and how they could be substituted with domestic enterprise. Over the years, the Department of Jobs, Enterprise and Innovation and its predecessors have tried to devise policies to reduce our dependence on multinationals and to build up the domestic system. Clearly they have failed to do this. Domestic activity is good, but it is not good enough to soften our dependence on multinationals. This is something that has been around for a long time. If anyone on the Deputy's side of the House can come up with good ideas for how to divert activity away from multinationals and towards domestic companies, that would be great.

The Revenue letter which says that all of this will be okay next year is couched in all kinds of qualifications. It starts off by referring to this as a volatile tax head. It then says that the forecasting error has ranged from -32% in 2009 to 23% in 2010. Of course it is now 57% or more. There is great uncertainty in this area and I do not doubt it will continue to fluctuate. It is too early for us to be able to say exactly what is behind the current fluctuation. The Deputy is right when he says the profits which are shown as being in Ireland do not always reflect the economic activity that is here. That is the most worrying aspect of the matter. It comes to the fore when we come through a base erosion and profit-sharing process, which tries to fix the tax in different countries in line with the activities in such countries.

The Deputy is right to raise these issues. The Fiscal Advisory Council, the Department of Finance and the Revenue Commissioners should be looking closely at them. Our warning is that we should not start spending this money until we know exactly what it is. It may be around for a long while or a short while. In the meantime, we should examine the reasons behind it and where the profits are coming from. Even the changed forecasts for profitability in the economy in 2015, as set out in the latest economic projections, do not reflect the level of profitability that is showing up in the corporation tax returns. We do not have the answers. We have the same sort of concerns as the Deputy on this issue.

Deputy Paul Murphy: My final question may relate to what we have just been discussing. Many people feel it is something of a paradox that the substantial and impressive headline growth rates that are undoubtedly being achieved are not being felt by the majority of people. That is not just a political statement. In opinion polls, a slight majority of people say they do not feel a recovery. Clearly, some people are feeling a recovery. I am not asking about what that says about the nature of the recovery. Are there things, perhaps in the extent of the GDP growth rates, that explain why this seems to be a recovery that exists among certain sections of the economy, the country or the population but is not felt by a substantial number of people? It is clear that the increase in VAT receipts is real. It can be seen that this shows there is increased money in people's pockets. People are spending. That is real. Most people will accept that there is increased economic activity that can be witnessed. However, I do not think people would have a sense that they are experiencing a growth rate of 6% or higher. Are there things the witnesses can see in the figures that explain the gap between the headline figures and the experience that people actually have?

Professor John McHale: The Deputy makes a very good point. Although most people have a sense that things are improving, they do not feel things are improving in line with the eye-popping overall growth rates that are being seen. There are some substantive improvements. The unemployment rate, for example, had reached 15% but is now below 9%. That is a very important and tangible gain. Despite the tax cuts, income tax receipts have increased by over 5% year on year. The Deputy mentioned VAT, which has increased by 8.6% year on year. People have more money to spend. I would like to expand on one of the big reasons more people are not feeling it. This relates to those who had jobs throughout the crisis. Wage growth is still quite limited. That is certainly the case in the public sector, but I think it applies across the economy. Perhaps I will put my colleague, Dr. Conefrey, on the spot by asking him to tell us about average wage growth last year.

Dr. Thomas Conefrey: There is a range of estimates. The maximum estimate is just under 1%, which is quite modest.

Professor John McHale: I think that is why many people are not feeling it. There might have been quite a transformative effect on people who did not have jobs and now have jobs, but not that much has changed for those who were lucky enough to have been in employment throughout the period in question. People in the latter group are benefitting from small tax cuts, but there has been no huge change in their disposable incomes. It will take a number of years for wage growth to start catching up somewhat with the overall growth in the economy. People will begin to feel it more then. The big challenge is to keep that growth sustainable. I suppose that brings us back to the main point of the report, which is the need to ensure we do not put this at risk by making mistakes of the kind we might have made in the past.

Dr. Thomas Conefrey: I will add a little to that. It relates to the Deputy's previous question about multinational-driven growth. We know that a significant part of the growth in the economy is driven by what is happening on the export side. Companies that have high levels of productivity can increase their output substantially without increasing employment directly in line with that. That is part of what we are seeing in the multinational tradeable sector of the economy. It has increased output hugely, but the effect on employment has been smaller.

Deputy Paul Murphy: Is contract manufacturing a part of that? It appears on the balance sheets and is included in GDP, but it does not necessarily relate to anyone producing anything in this country.

Dr. Thomas Conefrey: It is still in the gross export numbers we are seeing. When we spoke about this matter this time last year, we were concerned that the gross export numbers were being boosted, but we were not seeing the offset we expected on the imports side. This very strong boost was temporary. The offset on the imports side now seems to be happening more or less in line with the growth in exports. On the basis of the numbers available to us, we think they are broadly cancelling each other out. The Irish economy has always been like this. There can be very large increases in output in high-productivity sectors without the same gains in employment. Employment growth is increasing at 2.7% year on year and output growth is growing at over 6%. The truth, in terms of how people can feel it, is somewhere between the level of employment growth and the strong output growth.

There is also the question of debt. People still have a good deal of debt. A person with a large mortgage, who took out that mortgage during the boom, will have made some progress but a significant cohort of the population is still dealing with that.

Deputy Richard Boyd Barrett: Can we come back in again? Is the Chair trying to get rid of us?

Chairman: You can, although I wish to put some questions.

Let us go back to the beginning and the conversation with Deputy Pat Rabbitte. The representatives of the Irish Fiscal Advisory Council have said there were echoes of where we were. We are not really dealing with the same figures as was the case in 2003 and 2004. The echoes do not correspond. I was a Member of the Parliament at the time and I remember budgets for health alone were increasing year on year by more than €1 billion per annum during the course of the Celtic tiger. That was only one Department. There were also the benchmarking one and benchmarking two agreements as well as extra expenditure in all Departments. As the Irish Fiscal Advisory Council representatives have said, it was all built on the loose foundation of tax receipts from one sector of the economy. We are not in that scenario at the moment. Some of my colleagues in the House may choose to read one part of the report but, in fact, they want to spend like crazy as well on other aspects.

Deputy Paul Murphy: You say “as well”.

Chairman: You want to spend like crazy. It is not at the level of what we are talking about or what is being budgeted for. The current position is nowhere near the scenario the Irish Fiscal Advisory Council representatives have referred to. The risk is very low for what they have referred to as the expansionary budget. This economy has come through seven years of austerity and as we often hear, people are well and truly fed up with it. However, there have been improvements and people have repaid vast amounts of debt. Things are stabilising. There are more than 100,000 extra people in the economy. VAT receipts are up because people have more confidence, even those who worked through the recession. They are far more confident about their jobs now. There was a time four or five years ago when everyone was concerned that they might lose their jobs. They did not have the same job security as they have now. Will the representatives of Irish Fiscal Advisory Council comment on that?

Do the Irish Fiscal Advisory Council representatives believe we have an enterprise culture in this country? We have done a great deal in regard to taxation issues, how we promote enterprise and how we encourage people to set up their own businesses. However, there are still huge barriers to making this country an enterprise country. The Irish Fiscal Advisory Council maintains we rely on multinationals. I know from experience the views of people who have tried to set up and grow businesses. They believe this country is not at the races in comparison to other countries when it comes to promoting enterprise and the relevant people valuing the contribution such people make. Will the Irish Fiscal Advisory Council representatives comment on Ireland in comparison with others other countries, such as Germany or the United Kingdom? Those countries do far more to give people a start. Let us consider the bankruptcy issue, for example. The people who go bankrupt are the people who take chances and risks. For years in this country, we more or less told those people that they were out of the market for five years. That is not how an enterprise culture works. People go broke because they take risks. During the Celtic tiger, people took silly and disproportionate risks. However, in a proper country which has a good SME culture, people take risks and they may lose their business but they should be given an opportunity start quickly. Will the Irish Fiscal Advisory Council representatives comment on that?

This is an open economy, so it is expected to be volatile. As a small country on the periphery of Europe with a small population, what else can the economy be, only volatile? No one in this room believes we can have the same sort of economy as others - one for which we can plan ten years hence, for example, between now and 2025. That would be ludicrous given the type of economy we have and how it is expected to work. Can the Irish Fiscal Advisory Council representatives comment on that?

I realise the discussion of short-term, medium-term and long-term projections is important. However, the nature of our economy makes this something that cannot be tied down. The Irish Fiscal Advisory Council representatives have referred to how we have made revisions to what we expect will happen to the economy. I almost see that as a positive thing, something we must do because of the nature of our economy. Even larger economies that are far more developed and stable cannot make the predictions expected by the Irish Fiscal Advisory Council.

Dr. Róisín O’Sullivan: I will address the question of the parallels between the spending of excess corporation tax versus the property tax issue during the Celtic tiger years. It is really a case of a parallel approach to policy that concerns us most. Our difficulty is with the idea that when unexpected revenues come in, those in government take the view that they have it so they will spend it. This is happening in the context of an economy that is doing far better and growing strongly. It does not need the fiscal stimulus at this point that extra spending provides.

Chairman: What if the expenditure is targeted? The members opposite will tell you that mental health, ambulance services and schools all need extra investment. We could double the salaries of doctors, nurses and teachers. In that case, maybe there would be a point to what you are saying. However, if we invested in the infrastructure of health, education and social services of the country, would it really be that dangerous?

Dr. Róisín O'Sullivan: It is also a question of the composition of the expenditure because the Government is boosting the overall level of expenditure. The Government always has choices and can choose to spend on something that will improve the productive capacity of the economy but that does not have to come at the cost of increasing expenditure overall.

Let us consider it over the business cycle as a whole. By spending at this point, the Government is making itself vulnerable to the next inevitable downturn. This means when the economy turns down, the Government will not have the cushion to be able to handle the shock. Therefore, we will end up in a situation where we are facing austerity at a time when the economy is hurting.

I am keen to go back to something Deputy Murphy said earlier in the interests of trying to help him warm up to us. It is my parting gift to the council. He describes the council as being designed to push austerity at all times. I take issue with that description. We are trying to push a fiscal framework to counteract tendencies to spend in good times. Those tendencies, in turn, leave us vulnerable to imposing austerity at a time when the economy is in a downturn. We are not in favour of austerity at all costs at all times.

Dr. Thomas Conefrey: I wish to add to Dr. O'Sullivan's comments on comparing what happened during the boom and whether it is fair to compare the increase in spending to what happened before. The scale and magnitude of the increases in spending are not like what happened during the boom but neither is the debt level. The debt level now is close to 100% of GDP. We know how vulnerable that leaves the economy if there is a downturn. We saw what happened when the debt level was 20% of GDP and the crisis hit. We saw how fast it increased.

Deputy Boyd Barrett spoke of the risks of another shock. We need to realise how little room for manoeuvre we have if we are starting out from a debt level of 100% of GDP. It may not be fully comparable to what happened during the boom but the economy is also far more vulnerable than it was during the boom. Therefore, we have to tailor our policies and the degree of caution to where the public finances are now.

Chairman: I am concerned because sometimes the Irish Fiscal Advisory Council is so fixated on the pro-cyclical concern that those involved miss the main point, which is that we must also get this country out of austerity and start giving something back, if I can put it that way. It is as much about giving confidence after so many austerity budgets which cut expenditure. If we were to take the approach of reducing the national debt it would kill off whatever confidence the people have that they will ever see the end of this.

Dr. Íde Kearney: Our criticism was not of the budget, it was of the supplementary expenditure. The issue is about planning, to a certain extent, with regard to the €1.5 billion. We made a pre-budget statement on the contours of the budget issued in April and we were broadly favourable of it. Our issue was the unexpected increase in expenditure in late September and early October on the basis of an unexpected increase in revenue. It is not about the budget, but the almost *ex post* increase in expenditure just because extra revenue came in. Much of our concern has to do with planning rather than the amount of money in and of itself. This is the big concern.

Professor John McHale: I was going to make the same point. I take the point that people cannot see austerity continuing indefinitely, which is why we were supportive of what looked like a reasonable plan for 2016, which was a package of €1.5 billion, but even then, for the next couple of years until we achieve a balanced budget, adjusting for cyclical factors, it will still be pretty tight. I hope we can reach this sooner than had been initially forecast and get there by 2017 or 2018. At that point things will loosen up and expenditure will be able to be increased at the underlying growth rate of the economy. Coming up to this, the stringency with which we have been living for quite some time - the idea it would go on indefinitely would be very depressing - will start to lift in a more phased way. I take the point that people need to see some light at the end of this. As has been said, it is a reaction to the within-year increase in spending because of the surge in revenue. This is the type of thing that got us into trouble before, and if we want to ensure we have sustainable growth, we should avoid making such mistakes again. We believe it is our role to point this out very strongly to the public and to politicians.

The points made on enterprise culture go beyond the mandate of the Irish Fiscal Advisory Council. I understand the point that at times it seems entrepreneurship and enterprise do not get valued in this society in the way they are valued in other places, although I would not exaggerate this too much. It is difficult to defend the fact the self-employed face the top marginal tax rate of 55%, which is three points higher than that for PAYE workers. There are reasons for this, in terms of the way the social security system is organised and the benefits one gets, but it is a very negative signal to the self-employed. On the positive side, Ireland scores quite well in the World Bank's doing business surveys which compare the ease of doing business in various countries. I would not exaggerate the anti-enterprise culture too much.

On the specific issue of bankruptcy, Ireland has a fairly tough bankruptcy regime even though it has been reformed significantly in recent years and these reforms continue. Even from the point of view of an entrepreneur, getting the bankruptcy regime right is a balancing act. On the one hand, one would like bankruptcy to be relatively easy in order that one can make a fresh start and failure is not punished, which may happen here more than elsewhere. On the other hand, if people giving loans do not feel secure about giving them because the value of the underlying collateral is less because of bankruptcy procedures being too easy, it can make credit more difficult to obtain. If the bankruptcy regime is designed badly so that it undermines a borrower's creditworthiness, it would not be good for entrepreneurs as it would affect their ability to start new ventures. Even from the point of view of the entrepreneur and enterprise, getting the bankruptcy system right is a balancing act.

The volatility of the Irish economy has come up in various ways throughout the discussion. Ireland has an incredibly volatile economy because of its openness and the importance of the multinational sector. In addition to avoiding pro-cyclicality in policy, the other big lesson that came from the crisis is that we must think in a risk management way. During the boom there was too much focus on central scenarios, with the soft landing scenario been the famous example. This may not have been a bad central forecast. As it turned out, it was desperately wrong, but given the uncertainties of the time, it may have been a reasonable central forecast. However, people should have been able to see that things could have gone desperately wrong given the volatility of the economy and planned accordingly. What we need to do now is recognise this volatility and that we are vulnerable because of our high debt, the multinational sector and other issues we have mentioned. Many things can go desperately wrong. Deputy Boyd Barrett sees a very high likelihood of the negative scenario unfolding. Even if one still thought the central scenario was the right one, the Deputy is right to say many things could go wrong, and we need to plan for this. One of the important things is to reduce our debt.

Chairman: If one were to plan for Deputy Boyd Barrett's scenario, one would be expected to have even more regression on expenditure.

Professor John McHale: We think the pace of deficit reduction and debt reduction under the framework in place is-----

Chairman: Too slow.

Professor John McHale: No, we would say it is about right. This is why we supported the plans in the coming budget. What we then saw was a deviation from what was a sound prudent plan. In each of our reports, even though we had suggestions for how things might be done better, we stated the underlying policy is prudent. We see the plans, particularly if the Government follows through on its plan to follow the rules, as prudent. We saw what happened this year, when there was a surge in revenue and there was a big increase in expenditure, as a deviation from this prudent path. The underlying path of deficit and debt reduction is a balancing act and it is not the case we think the past was better.

Chairman: To get an idea of Professor McHale's thinking on this, if he were using a system similar to the weather alerts, is the deviation at orange or red?

Professor John McHale: We would need to have discussions as a council before moving to that particular system.

Chairman: The public feels that what we have done is the right thing.

Deputy Richard Boyd Barrett: I think the public might be mixed on that one.

Chairman: The trouble is Deputy Boyd Barrett would be looking to spend more. He thinks we do not spend enough.

Deputy Peadar Tóibín: It is not necessarily an issue of spending more. The issue that whatever is spent must be raised.

Chairman: It has been raised.

Deputy Peadar Tóibín: The major difficulty in this State is we promise European public services on US tax rates. This is where the fiscal irresponsibility lies. If European public services are promised on a European tax rate, it fits in and certain people are happy. This is the key issue. The cycle would be flattened. In other words, one takes heat out when the economy is at its peak and one puts it back in when it is frozen. If these two aspects are adhered to, one is more likely to have an economy in which people can be confident that their house will be worth roughly the same in 20 years time, rather than having the massive shocks we have seen in recent years.

Chairman: That is what we are doing.

Deputy Richard Boyd Barrett: The delegates seem to be saying it was what the Government was doing until it went on a splurge with the extra €2 billion.

Chairman: We have seen the context to the additional expenditure. It is important that the public knows what the delegates' view is on that matter, whether they consider it to be a red alert or an orange alert. They are saying there has been aggro between themselves and the Government. I do not really see where that aggro has arisen.

Professor John McHale: We do see what is being done as serious. I do not want to get into colour coding because it is not something we have discussed.

Chairman: It seems there has not been any aggro between the Government and the council on this issue. The delegates have a view which we accept.

Professor John McHale: Under the Fiscal Responsibility Act, we are obliged to assess the prudence of the fiscal stance taken. We would not have said there was a deviation from the prudent path the Government had been on if we did not consider the situation to be serious. It goes back to what we have been discussing all along, that for the longer term, we must stop the pattern of pro-cyclical policy. What was done this year was very much fitting that pattern and very much against the spirit of the new framework being put in place. In that sense, we do think it is serious. However, the hope is that as we move into the next phase of the rules to which the Government has committed, we can put this behind us. If we follow the rules into the future and really internalise their spirit as being in our own interests, not something that is being imposed on us by the European Union but something we want to do ourselves because we do not want to go through a crisis again, this will be seen as somewhat of a blip along the way and not very serious after all. However, at this time, given that this has just happened and we do not know what will happen in the future, we do see it as-----

Chairman: Is the council putting down a marker for the future as much as anything else?

Professor John McHale: We are certainly pointing out that we take this quite seriously in terms of our mandate to examine whether the overall fiscal policy being pursued by the Government is conducive to our long-term interests and to prudent economic and budgetary management, the words actually used in the Fiscal Responsibility Act.

Deputy Peadar Tóibín: To sum up, the Irish Fiscal Advisory Council is stating there are several risks, the first of which is posed by a pro-cyclical economic policy. The second is there is a lack of proper mid-term planning; the third is in the trapped sectors within the economy, whether they be people in debt distress or on low wages; while the fourth is Government debt. Does Professor McHale agree that these four issues need to be the subject of policy, with a view to evening out the risks to the economy?

Professor John McHale: The first, second and fourth are very much part of our responsibility to examine. I am not quite sure about the third factor which seems to be more of a micro issue.

Deputy Peadar Tóibín: I am referring to the sector of society which comprises people who are economically trapped. While they might not be a risk to the fiscal health of the general economy, their position is a manifestation of the social ill health of the economy.

Professor John McHale: I absolutely agree that it is an important issue. However, we have been given a particular mandate and it is not part of it. Certainly, the other three issues the Deputy mentioned are relevant to our mandate, namely, avoiding pro-cyclicality, ensuring there is good medium-term planning based on realistic medium-term projections and reducing Government debt. We certainly see a high level of Government debt as being a risk factor because it makes us more vulnerable in the event of a shock.

Deputy Peadar Tóibín: As a new Deputy in 2011, I recall the Minister of Finance speaking on a regular basis about how our debt was unsustainable. By contrast, there is now a view, one that is proclaimed both here and abroad, that the debt is sustainable. Back in 2012 and 2013 there was pressure on the Government to achieve retrospective recapitalisation, in other words, to ensure our European partners treated us like partners by helping to ease our burden of debt. What steps can the Government now take in terms of debt recapitalisation, a debt write-down and so on that would actually ease the risk factor that is the level of debt within the economy? Paying down debt will reduce it, obviously, but there are other approaches the Government could take to bring it down.

Professor John McHale: As the Deputy says, getting the deficit down is central to putting us on a more stable path over time. At this stage, being realistic, having part of the banking-related debt written off is highly unlikely. It will not be a source of significant debt relief. On the other hand, the State has significant banking-related assets on the balance sheet which are estimated to be worth €18.5 billion. If we look at Allied Irish Banks alone, the estimate is that these assets are worth €15.4 billion, less than the €20.7 billion put in but still a significant sum. Selling these assets is a way to get the debt down, but I would not exaggerate the benefit of it from an overall balance sheet perspective because these are assets on the balance sheet. One can sell assets to reduce liabilities if the goal is to bring the debt down because there are risks associated with having high levels of sovereign debt. Even if one has assets on the other side of the balance sheet, however, it can be hard to liquidate them quickly in a crisis. As such, it can make sense from a risk management perspective to deleverage in the sense of bringing down the debt by selling assets. On other ways to bring down the debt-to-GDP ratio, faster growth certainly will bring it down, as will a larger budget surplus or a smaller deficit. The possibility of selling assets, as I have outlined, is another possibility.

Deputy Peadar Tóibín: Going back to the exchange between Deputy Pat Rabbitte and the Chairman, one of the concerns I have is that sometimes actors on the right figure they own fiscal responsibility. Is it not the case, in fact, that fiscal responsibility is neither a right nor a left issue but is about paying for the services we deliver in a sustainable fashion? We can have small government and small taxes which end up being fiscally responsible in some ways, but, by the same token, larger government, greater public service delivery and higher taxation, as long as they are balanced in the long run, can also be fiscally responsible. Neither side can claim ownership of fiscal responsibility.

Professor John McHale: I could not agree more. Fiscal responsibility is independent of one's view of the appropriate size of government. If anything, I would say the more one believes in government, the more one should believe in fiscal stability because the latter is necessary to ensure one has the funding to pay for the government one believes in. We saw during the crisis what happened when the capacity to fund government was lost. People referred to it as austerity, but it was more a reflection of the fact that once a state lost access to funding, whatever alternative financing it sourced would come with conditions attached. As that is impossible to avoid, the ideal is not to get oneself into that situation in the first place. It would be something positive that would come out of our interventions, if we can ensure that it does not become a party political or a left-right issue. It is something that we all believe in and whatever are one's goals in terms of the appropriate way to organise society, we see fiscal stability and sustainability as instrumental to achieving those goals.

Deputy Richard Boyd Barrett: Our resentment in our initial engagements towards the

IFAC was that the demand for balancing the books came against a background where they had become unbalanced by the activities of others in circumstances where the can in respect of getting revenue and expenditure back to balance was being carried by those who, by and large, had not put them out of balance or who had not made the decisions. However, anybody who is sane should subscribe to the principle that one should spend what one can raise. Indeed, it raises the question, is there any such thing as good borrowing. Who was it who said, “Neither a borrower nor a lender be”?

Deputy Peadar Tóibín: Shakespeare.

Deputy Richard Boyd Barrett: I have two questions. The IFAC has said that it is imprudent to spend money the origins of which are uncertain. There is this unexplained jump in corporate tax revenue which was not in the initial budget projections and it would be unwise to merely go on a splurge and spend it. The IFAC has said that the Government is imprudent in this regard. Would it be less imprudent to spend it if one knew that the expenditure was guaranteed to give one back revenue and the spending, if you like, would wash its own face in the medium to long term so that there is not a risk associated with the expenditure? The reason I ask relates to my second question in respect of housing and the financing of housing, which I have already touched on but the importance of which I cannot overemphasise. It is often said - but we do not think through the implications - that the question of housing and the financing of housing is at the centre of the economic crisis, domestically and internationally. Buying a house is the biggest expenditure that anybody ever has in his or her life. On an ongoing basis, it is the biggest investment. It is central. It links to so many different matters. Is it a serious risk if the State is vulnerable to the volatility of the financing of an essential sector?

I highlight for the IFAC this danger of which it should be aware. The vast majority of the Government’s housing strategy, even in its social housing provision, is dependent on outsourcing to the private sector. The State will have to pay for that. It is money out - in the form of leasing arrangements, rent allowances, etc. - that will not come back in. The cost is running at approximately €1 billion per year. If property prices and rents continue to rise, the State could be in a really serious position. Is it not, to use the IFAC’s word, “prudent” to reduce our risk in that regard? The way in which we would do that is to have a bigger stock of State housing which generates revenue. That would not be money out, it would be investment which guarantees money coming back in. There would be less current expenditure than there is at present. Through upfront capital investment for which we could use this €2 billion we would reduce the current expenditure going out on the private sector that is just money literally going out the door. Would that be prudent because there is no risk associated with it? The rents will come back, if the State builds this housing. I say that because one of the features of a more stable period of the world economy was in the post-war era when there was a much bigger stock of state housing across the western world. At certain times in Ireland, 40% to 50% of all housing would have been provide by the State and that created stability at the centre of the economy. Now the State provides less than 5% and its stock of housing is much reduced compared to what it was at that period of much greater stability. Is this something that we need to consider and that must be a much bigger feature of the IFAC’s analysis?

Professor John McHale: Mr. Tutty will respond.

Mr. Michael Tutty: I will respond generally on investment. This is one of the weak areas in the new EU budgetary rules, namely, that everyone is to get to balance, whether for current expenditure or capital expenditure. There is no special provision for investment. If one states one can have an extra 1% or 2% as long as it is productive investment, it is difficult to define what that is. There are many items we call investment that do not really bring a return at all and many items we call current expenditure that do bring a return, for example, in the education area. I have sympathy with Deputy Boyd Barrett on the question of whether there should be more leeway for investment than is the case under the existing rules. Once we get the rules bedded down and everyone back towards a balanced budget, maybe we can start addressing that sort of issue.

On the housing side, I certainly will not get into whether the Government or others should be the investor. That, to some extent, is a political judgment as to whether one wants the State involved. With State involvement and through some of the State agencies, it can be done off the balance sheet in various ways through public private partnerships.

Deputy Richard Boyd Barrett: That increases borrowing.

Mr. Michael Tutty: It increases borrowing but not directly in the general government debt. If it is public private partnership, the annual payments that come later would affect the deficit all right.

Deputy Richard Boyd Barrett: It is still spending money one does not have, if Mr. Tutty does not mind me saying so.

Mr. Michael Tutty: That is what the current rules are pushing governments into doing. They are pushing governments into making the investment through mechanisms that are outside the general government deficit and general government borrowing. As a result, public private partnerships become even more significant than they were in the past because they can escape the rules. I would much prefer to see some mechanism within the rules that can allow for more investment to take place. As I said, that may come a bit later once the rules are bedded down.

Chairman: We will conclude on that point. On behalf of the joint committee, I thank all the witnesses from the Irish Fiscal Advisory Council for participating and for the material they supplied to the committee. I should also take this opportunity go say goodbye to Dr. O'Sullivan and thank her for her participation in the council over the past four years. As there is no other business, the meeting is adjourned.

The joint committee adjourned at 4.10 p.m. until 2 p.m. on Tuesday, 26 January 2016.