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AN COMHCHOISTE FIOSRÚCHÁIN I DTAOBH NA GÉARCHÉIME BAINCÉIREACHTA

JOINT COMMITTEE OF INQUIRY INTO THE BANKING CRISIS

Dé Céadaoin, 1 Iúil 2015

Wednesday, 1 July 2015

The Committee met at 9.30 a.m.

MEMBERS PRESENT:

Deputy Pearse Doherty,	Senator Sean D. Barrett,
Deputy Joe Higgins,	Senator Michael D'Arcy,
Deputy Michael McGrath,	Senator Marc MacSharry,
Deputy Eoghan Murphy,	Senator Susan O'Keeffe.
Deputy Kieran O'Donnell,	
Deputy John Paul Phelan,	

DEPUTY CIARÁN LYNCH IN THE CHAIR.

recommendations, you'd like to make in that regard, we'd be most welcome to actually hear them. So if I can ask you maybe to make your closing remarks now, Ms. Nolan.

Ms Ann Nolan: Okay. Well, listen, I really would like to thank you very much and wish you well. It's a very difficult thing and I know that ... having to come here has made me think very carefully about everything I've done for the last seven years and it's been quite a challenge. So I really do wish you well in trying to put together everyone's views of it ... into a coherent narrative that will allow us have very positive, hopefully, recommendations for going into the future.

Chairman: Thank you very much, Ms. Nolan. With that said, I'd like to thank you for your participation today and for your engagement with the inquiry, to now formally excuse you and, in doing so, to propose to suspend the meeting until 11.50 a.m. Is that agreed? Agreed. Thank you.

Sitting suspended at 11.36 a.m. and resumed at 11.59 a.m.

Department of Finance - Mr. Donal McNally

Chairman: Thank you very much. Okay, with that said, I now bring the meeting the meeting back into public session, is that agreed? For session 2 of today ... which is a public hearing and discussion with Mr. Donal McNally, former second secretary general of the Department of Finance. The Committee of Inquiry into the Banking Crisis is now resuming in public session. Can I ask members and those in public Gallery to ensure that their mobile devices are switched off? This morning we continue our hearings with the senior officials from Department of Finance who had key roles during and after the crisis period. At our next session we will hear from Mr. Donal McNally, former second secretary general at the Department. Mr. McNally joined the Civil Service in 1969, and joined the Department of Finance in 1986. He has worked in the Department at various levels in banking policy, health spending, tax policy, budget and economic division, and finally public expenditure division. He was appointed second secretary general in 2000, and headed the budget and economic division until 2008, and the public expenditure division until his retirement in 2012. So, Mr. McNally, you're very welcome before-----

Mr. Donal McNally: Thank you.

Chairman: -----the committee today. Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you are directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given. I would remind members and those present that there are currently criminal proceedings ongoing and further criminal proceedings are scheduled during the lifetime of the inquiry which overlap with the subject matter of the inquiry and, therefore, the utmost caution should be taken not to prejudice those proceedings.

Members of the public are reminded that photography is prohibited in the committee room. To assist the smooth running of the inquiry, we will display certain documents on the screens here in the committee room. For those sitting in the Gallery, these documents will be displayed on the screens to your left and right. Members of the public and journalists are reminded that these documents are confidential and should not publish any of the documents so displayed.

The witness has been directed to attend the meeting of the Joint Committee of Inquiry into the Banking Crisis. You have been furnished with booklets of core documents. These are before the committee, will be relied upon in questioning and form part of the evidence of the inquiry. So with that said, if I can now ask the clerk to administer the oath to Mr. McNally please.

The following witness was sworn in by the Clerk to the Committee:

Mr. Donal McNally, former Second Secretary General, Department of Finance.

Chairman: Once again, Mr. McNally, welcome before the committee today, and if I can invite you now to make your opening remarks to the committee please.

Mr. Donal McNally: Thank you, Mr. Chairman. My opening remarks are quite brief. First of all, I'd like to thank you and the members for the opportunity to make this brief opening statement today. The task of inquiring into the banking crisis and the events surrounding it will, I hope, reveal lessons for the future guidance of policy makers which will help reduce the risks of a recurrence of these events to a remote one. I don't think we could have another such unaffordable crisis.

I would like at the outset to express my regret at how matters turned out for the people of Ireland and for the period of austerity that affected so many, and for the increased burden of debt that we now carry. As set out in my written statement, my connection in this was as a senior civil servant providing economic and fiscal policy advice to Ministers and Government, who then decided on the policy actions to pursue.

I believe that, as confirmed by the Wright report, that the policy advice was appropriate, although not always followed. The advice was to run a fiscal policy close to balance or a surplus, and to avoid adding unnecessarily to demand in the economy, to improve supply and to guard our competitiveness. I did not provide advice on monetary or credit issues, that being the preserve of the Central Bank, or on credit growth, seeing that is a matter for the Central Bank to handle. While giving advice I also took advice, notably that the likely growth scenario was one of a soft landing, i.e. that the housing market would return to more normal levels in a manageable way. This was the view of economic advisers in the Department as well as outside, official and private sector commentators.

I did not foresee events as they happened. Others didn't do so either. I was aware of only limited contrarian advice at the time. It is difficult, as I said in my written statement, for cautionary or contrarian views to be got across when the economic news is so positive and when the country has been widely complimented on its economic performance.

The rise in asset prices was a factor of accommodating monetary policy and fiscal policy, strong domestic demand and certain property tax incentives. These incentives were introduced at various times since the 1980s. The motivation for these reliefs was to develop, restore, renew certain areas, and to stimulate employment and job creation. Some of these were more successful than others, and all were generally supported at political level. A number of these were terminated after 1997, some limited in extent, and some new ones introduced. The case for such reliefs was much diminished in the strong property market, but it took time to eliminate these from the tax system.

I accept that there was a deficiency in economic advice resources, which it also took time to address effectively. The situation was improved, but the problem is not just recruiting but retaining staff. The current Government economic and evaluation service model seeks to address these issues in a constructive way. Fiscal policy decisions take place in a different context to monetary policy action. That context is a democratic one. Government must marshal support for policy actions, and justify and defend these to parliament and the electorate. It is not easy to garner support for restraint when resources appear plentiful. A key challenge for the future, I believe, will be the need to communicate the wisdom of restraint to the public, even when resources allow, and the desirability of using surplus funds to reduce debt now to lessen the burden for the future. It also seems that the EU believes that closer monitoring of member states, more constraints on our freedom of action, and firmer rules on budgetary policies will bring about greater fiscal responsibility. Hopefully this will not be at the expense of democratic responsibility. In short, there are important lessons to be learned and there are important issues to be reflected on in the remit of the inquiry on which I hope I can help in that regard. Thank you, Mr. Chairman.

Chairman: Thank you very much, Mr. McNally, for your opening comments. If I can now invite Senator Michael D'Arcy to commence questioning. Senator, you've 25 minutes.

Senator Michael D'Arcy: Thank you, Chairman. Mr. McNally, you're very welcome.

Mr. Donal McNally: Thank you.

Senator Michael D'Arcy: I'm going to start, Mr. McNally, with a quotation from the former Taoiseach, Garret FitzGerald, who said in 1984 that the Government is going to keep its hand out of the till from now on. In terms of expenditure in your period, in the senior role in expenditure, did the Governments, successive Governments, keep their hand out of the public expenditure till or not?

Mr. Donal McNally: Well, my role in public expenditure was after the ... after the crisis started, and in that case there was significant cutbacks in spending. As regards the period from 2000, I think the picture varied. There was some years in which there was quite strong expenditure growth, and I think in 2003 and 2004 that fell to 7% or 6%. And then, after that, it returned to a level of 10%. So there was very strong expenditure growth. I mean, it was a time of plentiful resources. There were also Government commitments and social partnership commitments, so that these added to the pressures for public spending.

Senator Michael D'Arcy: Mr. McNally, the level of expenditure from 1998 by the State was €20.5 billion. Ten years later it was €62.5 billion. That's a trebling of expenditure on behalf of the State in a relatively short period. Did the Department do any international peer reviews with trading partners or anything of that nature to see ... to gauge the expenditure by the Irish State with other states?

Mr. Donal McNally: I don't think so. I think the metric we used was as a percentage of GDP. And, you know, it remained around the 32%, 33%, 34%, which was far less than in neighbouring countries, maybe with the exception of the UK, and on the same level as the US. So that is the ... that's the main metric we used. I mean, different countries had different traditions. The Scandinavian countries have high expenditure, high taxes. We were trying to run high expenditure and low taxes, which the growth and the economic resources allowed, for a time.

Senator Michael D'Arcy: Mr. John Moran, in his evidence before us, I'm not sure if you had the opportunity to hear what he said in relation to the deficit from your period '08 to when you left, or to date, that the deficit for that period was in the region of €100 billion. And that on the basis of that €100 billion, that that is part of the national debt. Could I ask your analysis of the €100 billion and how, in the future, the future generations will be obliged to pay that back?

Mr. Donal McNally: Well, I'm not quite sure of the figures, but I take it-----

Senator Michael D'Arcy: Yes.

Mr. Donal McNally: -----what's said. I mean, we had this problem before in the '80s when we had debt, GDP, or GNP ratios of over 100%, that you got up to 130%, or close to it at one stage. And the interest rate regime, I think, payments were taking up a lot of the income tax receipts were going on paying the national debt. Unless there's some debt forgiveness, then the only way we can fund that is by growing and reducing the burden in that way, so that we have more capacity to pay the interest. We did it before. It took some time to do but that's the main way. Now, obviously, before there were high interest rates we weren't part of the euro. So, you know, to the extent that the monetary policy in the euro works, and fiscal policy ... the debt burden in terms of interest rates will be a bit more manageable than it was before.

Senator Michael D'Arcy: Mr. McNally, can I ask you, in relation to the narrowing of the tax base over that period, and the reliance ... the over-reliance on the transactional taxes that were attached to the construction sector, was there comment within the Department that there was a prospect that if those taxes were not as buoyant as they were, that the State could be exposed, potentially, to a shock?

Mr. Donal McNally: Well, there are various figures given for the reliance on these taxes. There's a figure mentioned of 30%. That includes corporation tax, and corporation tax is paid mainly by the multinational sector and is more related to foreign GDP than it is to domestic. And, in the case of stamp duties, the fact is that there's no stamp duty on new houses, it's ... stamp duty is on second-hand houses; it's VAT that's on the new houses. So, there was a concern that if the economy turned down sharply we could be exposed, but the general opinion was that there would be a soft landing, in which case there would be less tax, but there would be some facility either to raise tax in other ways or to let the deficit ... incur a deficit, which is allowable if ... to a certain extent, if growth reduces.

Senator Michael D'Arcy: Okay. The ... can I ask, Mr. McNally, is it possible for a civil servant, even a very senior, experienced civil servant to say, "No, you can't do that, Minister, it's too far, it's beyond the pale", that it's irresponsible to implement a specific type of policy?

Mr. Donal McNally: Well, I suppose it is. It depends on the context. But if you put the arguments to the Minister, and put them in the budget strategy and memorandum, then there is a matter for political decision what the level of public spending should be and what the tax to fund that should be. So, I'd say, yes, you could say ... you could argue against it but if the Minister decides, or the Government decides, generally, as a civil servant, you do what the Government decides.

Senator Michael D'Arcy: Can ... can I ask ... you were involved in ... during the period of ... two high-profile policy decisions. The SSIAs: can I ask what was your view about the SSIAs? They were €15 billion with the State contributing a portion of that.

Mr. Donal McNally: Well, the advice that was presented to the Minister was not to introduce such a system, or, that tax on savings ... it was difficult to know if it increased net savings or not. I think there was some OECD evidence to suggest that it just moved the savings around.

I don't know whether that was the case or not, but the Minister was strongly of the view that, given the - this is what he expressed to us - given the prosperity, given the level of consumption, that people had forgotten how to save, and that this was a way of encouraging people to think of the future and put some money aside. So, my advice was against the SSIAs, as was the Department. I didn't have an SSIA myself because I believed that if I'd argued against it, I would have been, I won't say dishonest, but I just thought I shouldn't invest in something that I had argued against myself.

Senator Michael D'Arcy: And, the extent in which you can argue against the Minister, how far can you go? How far can you take it?

Mr. Donal McNally: Well, generally, what ... in making tax submissions, what we did was marshal the arguments on both sides, and the Minister made a decision on that basis. But, I mean, you can argue ... you're free to argue with the Minister and put the point of view, but if he decides, then that's the policy.

Senator Michael D'Arcy: And, can I ask you in relation to the budget 2003 decentralisation programme that was announced ... can I ask your view in relation to that?

Mr. Donal McNally: Well, I'll-----

Senator Michael D'Arcy: It was a cost to the Exchequer for the decentralisation.

Mr. Donal McNally: Well, there was a cost. I'm not quite sure what the cost was, but it was also felt that there was a benefit in terms of spreading around some of the prosperity throughout the country, and in helping some areas. I wasn't involved in the decentralisation It was kept a fairly closely guarded secret until it was announced, and there was a small team working on it. I mean, there are pros and cons in favour of it. I must say I had a neutral viewpoint on it.

Senator Michael D'Arcy: Okay. If I could just go back to the SSIAs, Mr. McNally, could you give me ... could you outline the reasons why you opposed the Minister's savings programme?

Mr. Donal McNally: Well, I ... we marshalled arguments. We looked at various different incentives, incentives on the principal amount, incentives on the interest, but the main reason would have been possible cost and the fact that we weren't sure that this would incentivise savings. I mean, it may have; I don't know if it did or not. We tried to build in factors to stop the SSIAs being used to finance consumption. So, they were the two main reasons - the cost and whether it would be effective in stimulating saving.

Senator Michael D'Arcy: And were you just opposed to all SSIAs? The idea that people that are very wealthy getting a 20% top-up from the State - did that occur that that was unfair and unreasonable?

Mr. Donal McNally: Well, all I can remember at the time was the lady who spoke ... who was, I think it was the Joe ... what's the thing at 2 o'clock? Joe Duffy.

Chairman: Talk to Joe.

Mr. Donal McNally: I think she was complaining about the fact that ACC had closed some current accounts, and she explained that she used to put the children's allowance money into the SSIA, so I said to myself, that's tax-free money being put into a tax-free account. So, you know, I ... I'm not too sure ... I didn't favour SSIAs, and I favoured it even less when I heard that.

Senator Michael D'Arcy: I just want to move on to the ... to your core booklet, Mr. McNally, page 101, in relation to the report. Sorry now, it's not 101, it is page 105 onwards about economic and fiscal implications of a reduction in housing output, where it says that for every 10,000 units, private units ... would reduce that there would be a fiscal deterioration of €1.8 billion. It's 105 onwards.

Mr. Donal McNally: Yes, I have the reference there. I think the €1.8 billion was that ... a question was asked, if private housing output decreased by 10,000 and you built 10,000 local authority housing, what would be the cost? And the €1.8 billion refers to that, as far as I can see from the documentation. The actual cost in terms of the 10,000 decline, for each 10,000 decline it was €570 million. The 1,800 was made up by the increased capital expenditure on the local authority houses.

Senator Michael D'Arcy: And were ... was that a major concern for the public expenditure side of the Department, in terms of the reduced revenue that would be coming in every ... because there was a ... analysis concluded that there would be tens of thousands of units that would not be built in that period, going forward.

Mr. Donal McNally: Well, as I recall it, the analysis suggested a soft landing, which would have meant that housing output would decline. I think there was a figure of 6,000 or 8,000 per annum, in which case there would be lower income taxes and VAT, and higher live register payments. If it proceeded at that rate, it was possible, I mean, it could be possible to raise money in some other ways to try and offset that or to run a small deficit. We were in surplus or in balance for most of the period.

Senator Michael D'Arcy: Okay. As early as 2001, a paper presented to the MAC meeting on 26 April shows the Department were facing a specific skills challenge and had a broad spectrum of skills requirements among others in economic modelling. Can you give us your view if efforts were made by the Department, if they were sufficient after 2001 to improve the skills shortage?

Mr. Donal McNally: My main area was the economic side. I don't know about the other side but the financial side, there would have been also IT skills but I do admit there was a problem in terms of resourcing on the economic side. I found this out early on when the economic forecaster, who I think was Robert Watt, who is now the Secretary General of PER, I think he was the short-term economic forecaster. I was seeking somebody to replace him and I had some difficulty because there was a reluctance to go on to the economic side, because people thought that their career prospects were better if they had a more broader experience and they weren't identified as being too technical or working too long in one particular area. I said to the person that "look you will only be there for a couple of years, you will be replaced" as a way of trying to get him to agree. As a result of that, I spoke to the Secretary General, John Hurley, who became Governor of the Central Bank, and he arranged for the Central Bank to second an economist, John McCarthy, who has since gone on to be the chief economist. That was sort of a stop-gap measure to an extent.

When Derek Moran, the current Secretary General, came in, he conducted an analysis of the leads of the section and proposed a plan to recruit economists directly, which was done, and to bring in some other people from other parts of the Department, from the NDP - the national development plan side - who were, that was running down their engagement there. We also took on another economist in 2006 from the Central Bank. So something, things were done. I don't think there was any lack of quality, it was more an issue of quantity. The Wright report did say that the analysis presented by the economic side was as good as any else and there were no complaints that I heard from any of the international bodies they dealt with to that extent. While they might have had a small economic side, it did work with the ESRI and the Central Bank and the Commission so to an extent they were able to use their resources as well in their activities and the Commission would have had regular meetings to discuss the economic methodology and the economic forecast.

Senator Michael D'Arcy: Could you explain to me, Mr. McNally, then if, as you say, the Wright report said that there was nothing wrong with the quality of the analysis, how did the downturn ... how did the recession sneak up on the Department of Finance to the extent that it did and how was it so bad if the forecasting was of quality?

Mr. Donal McNally: I looked at the figures for 2008 and we were predicting growth of, I think, 4.5% or so. So was the IMF and the OECD and the Commission. So it wasn't just us that were taken by surprise. We just got it wrong and I can't explain it in any more detail than that. We relied on ... perhaps we placed too much trust in a soft landing, not allowing for the fact that these things could go wrong.

Senator Michael D'Arcy: Was the Department of Finance aware of the level of bank balance sheet growth that was occurring for the previous years?

Mr. Donal McNally: I knew there was a credit expansion but I regarded that as part of the remit of the Central Bank to address and if they had any problems in that respect, they had the tools and the policies ... levers to use, so I didn't take ... I didn't look in that great detail at the credit expansion.

Senator Michael D'Arcy: And in terms of, say, financial stability within the Department, did nobody ever raise that issue?

Mr. Donal McNally: I don't recall that, no. I mean, the financial stability report indicated that the banks were well capitalised and as far as I can remember, did not give explicit warnings that there was doom around the corner.

Senator Michael D'Arcy: What policy initiatives, withdrawal of tax incentives, increased capital requirements across the sector were considered by Government to address the risks emerging in the economy during your tenure in the Department of Finance?

Mr. Donal McNally: I do not understand what-----

Senator Michael D'Arcy: What initiatives, what changes did the Government engage in to address the risks emerging in the economy?

Mr. Donal McNally: The main one that was done was to finally get rid of the tax reliefs. I mean, since 1997, some of them had been got rid of - the seaside resort scheme, the Temple Bar scheme, the Custom House docks scheme - and we would have recommended to the Minister certainly that these reliefs should go and I recall reading the 2003 budget where it said they would go in 2004 but when 2004 came, they were extended because as far as I remember, because of worries that there were schemes still incomplete. So when the new Minister came in, we put a proposal to him to try and get rid of most of these property reliefs but he asked for a special study to be done so that it could be explained to the public why this was being done, and not sudden. So that was the main one within my purview.

Senator Michael D'Arcy: In terms of that report, can I ask your opinion of the appropriateness of some of those schemes, seaside resort one, there are others? Can I ask your view, your personal view on the appropriateness of them, the benefit that they had to the Irish economy?

Mr. Donal McNally: Well there are numbers. The urban renewal scheme was brought in in 1986 and, I think, as was the Custom House docks scheme. So the Custom House docks scheme certainly did help develop the IFSC and there was also a BES, which was ... I think property was allowed in the BES scheme. That was got rid of because property was ... the BES was supposed to be risk-taking, not investing in bricks and mortar. The schemes were reviewed in 1996 and I think the conclusion was that there was some benefit in the areas in which the schemes were concentrated and some which ... what they call a shadow effect in areas beside it, but it was difficult to conclude whether that had led to an overall increase in output in the economy or not. The seaside resort scheme, we were never convinced of the wisdom of it, and I think the idea was, and it may have been well-founded in the sense that some of the traditional resorts had ... were a bit down at heel and the accommodation wasn't as good as it should be and the amusements and facilities.

Chairman: Senator, maybe you can ask Mr. McNally as to who was not convinced of the wisdom, if we could just establish that there?

Senator Michael D'Arcy: Yes. Who was not convinced? Was it you personally or-----

Mr. Donal McNally: I was talking about myself and the view in the Department.

Senator Michael D'Arcy: It was the view within Department.

Mr. Donal McNally: Yes, just on ... within the tax side of the Department, yes.

Senator Michael D'Arcy: Was it the accepted view or was it the general view?

Mr. Donal McNally: I would say it was ... well, it was the view amongst those who were directly concerned with it. I don't know about the generality of everybody else.

Senator Michael D'Arcy: Okay. So it was a political decision to advance those schemes. It wasn't with the behest of the Department of Finance?

Mr. Donal McNally: No, we didn't propose the schemes. They had been proposed, I think, in 1992 ... I think the Department ... the Minister didn't proceed, but in 1995 it was decided to go ahead with them. While there may have been some sense behind them in terms of trying to restore the attractiveness of seaside resorts in Ireland, I think most of the investment went into accommodation, rather than into facilities and, I suppose, that is to be expected if there is tax relief for investing in property or for investing in amusements and things, the likelihood is that property will win out.

Senator Michael D'Arcy: Okay. And then just to revert back to my question previously, Mr. McNally, in relation to transactional taxes which, in 1987, were a total tax take of 8%. That increased up to 30% in 2006; you said corporation tax was a portion of that. Did the Department highlight that concern, that issue, to the Minister over those number of years because it wasn't just-----

Mr. Donal McNally: Well, I think-----

Senator Michael D'Arcy: -----a single year?

Mr. Donal McNally: Yes, I think, from reading the documents, it was highlighted by the Secretary General that the ... that it wasn't wise to rely on ... on taxes that might not remain permanent, that might not yield the same. I mean, the problem ... one of the issues with the stamp duty was ... the stamp duty was raised from 6% to 9% in 1996 when residential property tax and, I think, local authority charges were removed. This was a way of restoring the ... the revenue. But the stamp duty rates applied not on a tranche basis, not, sort of,1% of the first €100,000; 2% of the next. Once you went over the-----

Senator Michael D'Arcy: Threshold.

Mr. Donal McNally: -----the threshold, you paid the whole lot. You paid 2% on €101,000 as opposed to 1% on €90,000. So, that meant, when prices rose, there was ... there was significant elasticity and that was one of the reasons why the yield went up so much. We did think was there a better way of restructuring the stamp duty because, you know, 9% was quite a high rate and we didn't go to the Minister on this because this was just talking amongst ourselves in the tax division. But the problem was that any attempt to ... to restructure the stamp duty rates would probably have meant a lowering of the rates ... just the way the process works. And lowering the stamp duty rates could have added fuel to the fire of the house prices, so, you know, we were ... we had a system that brought in a lot of money. It probably wasn't the most judicious system but making changes in it could have raised other problems.

Senator Michael D'Arcy: And did the Department ... did the Department-----

Chairman: Final question.

Senator Michael D'Arcy: -----communicate that advice to the Minister or was it ... or not?

Mr. Donal McNally: That was just internally, ourselves.

Senator Michael D'Arcy: You didn't communicate that advice to the Minister?

Mr. Donal McNally: Well, we didn't suggest revising the ... or revamping the stamp duty. We just talked about it amongst ourselves.

Senator Michael D'Arcy: Thank you.

Chairman: Senator Sean Barrett. Senator, 25 minutes.

Senator Sean D. Barrett: Thank you. And welcome to-----

Mr. Donal McNally: Thank you.

Senator Sean D. Barrett: -----Mr. McNally. One of the earlier witnesses, Mr. McNally, Professor John FitzGerald, said:

> There was a culture change in the Department of Finance in the last decade. It became more concerned about the politics of things and less interested in the technical detail. I would have had less interaction.

What's your own view of John FitzGerald's comments there?

Mr. Donal McNally: Well, I think ... I think he must have been referring to the number of instances mentioned by him when some people took exception to what was being said in the report-----

Senator Sean D. Barrett: Yes.

Mr. Donal McNally: -----but, you know, I didn't detect a political change, as he ... as he had done. I mean, the Ministers didn't get involved in economic forecasting or anything of that matter, so I was a bit surprised when I ... when I read it.

Senator Sean D. Barrett: Okay, thank you for that. The Regling and Watson evidence book has that after 2004, the IMF, the OECD and ECOFIN all clearly recommended a tighter fiscal stance and the building up of a cushion for the time when the income from the property-related transactions would fall. Why, in your opinion, were these recommendations not more forcefully highlighted in policy?

Mr. Donal McNally: Well, I mean, they were highlighted in the budget strategy memorandums, as far as I recall, but it was Government decisions on the level of public spending. We did have a very low debt ratio, I think it fell towards 20%. We also had assets in the National Pension Reserve Fund which, I know, were to be ring-fenced for other purposes but they did reduce the net debt, so I think we thought we were doing as much as we ... as we could.

Senator Sean D. Barrett: And just in this segment, the final one, that the Department advised the Minister in July '08 that economic growth would recover, even after allowing for a 45% decline in housing completions to 45,000 a year. And there was earlier research, in 2004, that every 10,000 reduction in housing output would cost the Government €500 million, so what was happening to our forecasts in that period?

Mr. Donal McNally: Well, I'm not quite ... I'm not quite sure. This is in 2008?

Senator Sean D. Barrett: 2008, yes. Well, I'll give it to you again: the Department advised the Minister that economic growth would recover after allowing for a 45% decline in housing completions to 45,000 a year and a further decline of 23% to 33,000 units in 2009. And the earlier work had been, in 2004 ... that every 10,000 reduction in housing output would cost the Government €500 million in ... in revenue.

Mr. Donal McNally: Well, the earlier report was in relation to a specific question and that was the metric in terms of the loss of revenue. I left the budget side on 1 May, so I don't ... I don't recall the forecasts that were made. I'm sorry.

Senator Sean D. Barrett: Okay, thank you. Could I bring you back to your ... your first posting in banking in the Department of Finance, I see here, 1986 to 1992. So, I'll put that question to you: when Donal McNally was in charge of banking supervision, the banks were solvent, the bank manager in the local town was an honoured member of the community - where did it all go wrong, the €64 billion of what we're investigating now? What ... have you been keeping an eye on this sector ever since you were its ... involved in its supervision back then?

Mr. Donal McNally: Well, just before that, I was involved in insurance supervision in the Department of Industry and Commerce-----

Senator Sean D. Barrett: Yes.

Mr. Donal McNally: -----and had some peripheral ... I wasn't centrally involved in the PMPA and the ICI events in 1982 and '84, I think it was, or 1982 and 1985, so I knew the value of close supervision. I wouldn't have gone for this light touch regulation because, as in most of these cases, the State ends up having to pay the bill and the State should be extra vigilant. In terms of banking policy at the time, I was involved in the Central Bank Act, which was passed in 1989, which was to strengthen the powers of the bank to ... the Central Bank to supervise banks, to attach conditions to licences, to apply codes of conduct and other matters. But my recollection was of trying to take initiatives with the banks to get them to lend to ... especially to ... I think there was a young entrepreneur scheme which the Minister at the time, Minister Reynolds, persuaded the banks to lend ... or to provide €100 million for. I'm not quite sure how he did it but he managed to do it. And there wasn't the ... there wasn't the culture of ... I didn't detect a culture of profit maximisation; they might have wanted to grow the size of the banks. And I don't think there was the same culture of bonuses so, you know, the culture ... there was a cultural change in terms of seeking after profits and rewarding those who sold the most and contributed most of the profits.

Senator Sean D. Barrett: So, in your early time, would banks have a different philosophy, interpreting what you said, a sort of community-----

Mr. Donal McNally: Well that's-----

Senator Sean D. Barrett: -----service, minding people's savings, was that, sort of, their emphasis?

Mr. Donal McNally: Well, I don't know if they were as ... as altruistic as that, but I do remember one gentleman who was in the ... head of the Trustee Savings Bank in the UK relating that when he joined and somebody came in to take out money, they would do their best to persuade them to leave the money where it was; that, "You don't need this money really, you don't need a car, you have a bicycle, you can use that." Whereas, you know, 20 years later when he was in charge of the organisation, he was finding ways to get people to borrow money. So I think the emphasis changed from guardianship to-----

Senator Sean D. Barrett: Yes.

Mr. Donal McNally: -----seeking to lend as much as possible.

Senator Sean D. Barrett: And do you think the culture of the management and the boards of Irish banks changed?

Mr. Donal McNally: Well, I think so, from the ... from my experience, from my observation, I would think so, yes.

Senator Sean D. Barrett: When you were then back in Finance, you mentioned to my colleague, Senator D'Arcy, that you were trying to restrain the growth of public expenditure and to drive down the debt-to-GDP ratio. Did it ever occur in those conversations that maybe the correct stance from the Department of Finance would be to look at the rate of growth of credit? Central Bank was telling you to control cost and improve competitiveness. Did you ever say, "We could do with some assistance from Dame Street in view of the high rate of credit growth"?

Mr. Donal McNally: Well, as I said earlier, I'd left that to the Central Bank, and, as you remarked to some other witness, maybe we should have been writing letters to the Governor instead of the other way round. So I didn't focus on the credit expansion; I'd left that to the bank itself.

Senator Sean D. Barrett: Wouldn't it have required massive physical surpluses to counteract such huge monetary expansion?

Mr. Donal McNally: Yes. I remember that, when we were subject to the recommendation, asking my Italian colleague what were we doing wrong. We had a surplus of 4%, and what he said was, “Well, with your rate of growth, you should have a surplus of 8%”, which is probably true economically, but not really ... I don’t see how you could do that politically. I did ask him if Italy ever had a surplus and he said once, in 1861. So I was speaking to the right man, obviously.

Senator Sean D. Barrett: Yes. Did it ever arise that people would say, “We’re now in a currency union dominated by Germany and that it’s risky for Ireland to expand credit into the economy faster than the dominant country”, i.e. Germany?

Mr. Donal McNally: No, I wouldn’t have asked that question myself. I’m sure that’s a question the Central Bank must have asked.

Senator Sean D. Barrett: Was the definition of competitiveness - and you have that on page 3 of your written address - was it inadequate in that the very rapid rise in house prices was not really reflected in the consumer price index so that houses were getting from two and a half times incomes up to ten times incomes and ... and there was nothing to restrain that, in the interest of competitiveness?

Mr. Donal McNally: Well, the competitiveness was looking at the unit labour cost compared with other countries. A lot of the competitiveness may have been due to compositional shifts in the economy so that, you know, when housing assumed such a greater proportion, the overall competitiveness would have gone down.

Senator Sean D. Barrett: And the sectoral concentration of all this lending did that ... was that discussed in the Department of Finance?

Mr. Donal McNally: Not in ... not to my knowledge, and I wasn’t aware of the breakdown of the credit.

Senator Sean D. Barrett: Yes. Thank you. And the commercial lending, which the evidence to this committee was extremely volatile was ... did that set off any alarm bells or discussions and so on in the Department?

Mr. Donal McNally: Not that I recall, no.

Senator Sean D. Barrett: The ... so we were operating ... your own quote there, on page 6, “To offset the pro-cyclical effect of low interest rates and easy money would have required running a significant General Government Surplus ...”. Was that going beyond any bounds of political feasibility, that the surplus required to have €64 billion ready on 29 September 2008 would have been impossible for any Government to generate?

Mr. Donal McNally: Well, I think what we tried in the memorandum to suggest was not huge surpluses, but they stayed close to balance or in a surplus and that would keep the overall debt down, which would give you the facility to borrow when economic circumstances change.

Senator Sean D. Barrett: You said, on page 7, that there was only limited contrarian views in the Department of Finance, but I think you’ve expressed a good number of them about those property proposals and the SSIAs and so could you tell us about how decisions were made?

Mr. Donal McNally: In relation to the Department?

Senator Sean D. Barrett: In the Department of Finance, yes.

Mr. Donal McNally: Well, on the tax side, proposals would be considered in the run up to the budget, the Minister might have some proposals, the Department might want to propose some changes. A memorandum was prepared, which set out the ... analysed the proposal and set out the pros and cons and then there'd be a discussion with the Minister and the Minister would give his ... either his agreement or not, and there would be discussion within the tax side ... on the relevant side between the various people involved in coming up with the proposals.

Senator Sean D. Barrett: But you presented this morning a picture of more discussion than might be indicated here. You say that there was ... in your presentation there was only "limited contrarian views", but there seemed to have been a bit more discussion than that, that if you had doubts about the SSIAs or certain seaside resort building schemes and so on, that that was actually discussed within the Department.

Mr. Donal McNally: Yes, well, maybe I was understating the case. I mean Finance does tend to express doubts and scepticism on ... I don't want to say nearly everything, but I mean there is a tradition of debate and discussion.

Senator Sean D. Barrett: Yes, there was a famous member, who shall be nameless, of course, whose nickname was "Dr. No" for that purpose.

Mr. Donal McNally: Yes.

Chairman: Are you talking about James Bond or a politician there like?

Senator Sean D. Barrett: He was in the Department of Finance, Chairman.

Chairman: All right.

Senator Sean D. Barrett: In relation to the Wright report, how did you react when you saw that? Because he was ... he's very critical of the lack of specialist economists. In fact, I think he had only 7% of people at the top level had degrees in economics at master's level or above.

Mr. Donal McNally: Yes, well I ... you know, I think the Wright report was a fair review of the Department, and we initiated it ourselves to see what lessons could be learned from it. I was surprised at the level of economists they mentioned in the finance in Canada. I mean, we're a smaller country with smaller resources, and, as I said, even though there might have been limited numbers on the economic side, the quality, as far as I could see, was good, and they had available the economic ... economists in the other institutions that were being dealt with. So, I was a bit surprised to find that we were so underweight, and, you know, we had tried to improve that. And I think the initiative of the Government in the Government Economic and Evaluation Service is a worthwhile initiative in trying to recruit people to that particular job, and then giving them the opportunity for career development.

Senator Sean D. Barrett: And your advice to us, I think, on page 9 is that you found it difficult to recruit staff being labelled in a technical area, which presumably includes economists. And there was also some documents we saw that those people should have only a three-year contract, I mean ... I think ... you're an integrationist, I think, if I interpreted you correct that those economists should be, in the general scheme of things, in the Department. Is that correct?

Mr. Donal McNally: Well, yes, but across the ... the Civil Service as well. I mean, a lot of work was being done on evaluation, and the ... more could have been done on the use of economists in that respect, and that's what's being done now in the Government Economic and Evaluation Service. The idea ... there was a feeling that at interviews what people were looking for was people with broader experience having worked in different areas and not being ... I mean, it's wrong to say technical, because being an ... and having studied economics, it is broader than simply crunching numbers. But there were ... there was a view that people were hampered in some way by being too closely defined with a special area. I mean, I did experience it myself in interviewing people who were excellent on the budgetary numbers and on all the number crunching but when asked a question outside their area, showed great difficulty. So there was something in what was being said, but we needed to have economists; we needed people to work in the area, and, you know, getting somebody from the Central Bank was a help, but it was only a ... it was a stop-gap in some ways.

Senator Sean D. Barrett: Now, you've two clear experiences from your CV that are, I think, of interest to this committee as we, sort of, try to plan future recommendations. You served on an bord snip, the second one, isn't that right? And ... or was ... or was it way back the first one? I think it is the second.

Mr. Donal McNally: I'm not quite sure which one - it's called an bord snip nua.

Senator Sean D. Barrett: Yes. The more recent one with Colm McCarthy. Was that-----

Mr. Donal McNally: That was the one I was on, yes.

Senator Sean D. Barrett: And you also, I think, served on the McLaughlin report on local government.

Mr. Donal McNally: That's right, yes.

Senator Sean D. Barrett: So, you know, how should governance be addressed in Ireland, you know, to make sure we don't get into the kind of troubles of 2008-'11 and, indeed, the years leading up to that time?

Mr. Donal McNally: Well, the very fact that we have gone through the experience means that there will be more caution in future and people will understand the need to run surpluses. I mean, as I understand it, the Finns run a large surplus because of the history they had, as do some of the other Scandinavian countries. As to how governance should work, I did suggest that there is ... possibly it needs to be explained or some sort of social compact or social consensus that you don't have to spend all the money just because you have the money and that there's a need to ... whatever you have, rainy day funds or some way of segregating some of the surplus to be used later. The other way is to have some sort of rule which limits expenditure. I know there's one in the EU which was changed a bit at our request. So it's either learn the lesson, agree something at a social level or have a rule that limits the growth to spending when the resources are there - a sort of counter-cyclical spending rule.

Senator Sean D. Barrett: Can I ask you, finally, on the one-off tax revenues that you described with my colleague, Senator D'Arcy, was there any recognition in the Department of Finance, "These are one-offs"?

Mr. Donal McNally: Well, there were one-offs for a succession ... over a good number of years. There was a recognition that, you know, it couldn't keep going at the same rate, but if you subscribe to the view of a soft landing then it was possible to cope with that when the revenue reduced.

Senator Sean D. Barrett: Because when we've moved to the recurrent taxes like the property tax annual and the water charge annual, we've kept development levies, I think, at €60,000 a house in south Dublin, so is the Department of Finance getting the best of both worlds? It both gets the one-off taxes and has invented new forms of recurrent taxes.

Mr. Donal McNally: Perhaps. I thought ... didn't think development levies were raising that much money nowadays. That was one of the most cyclical taxes because when development stopped the revenue went. I mean, the stamp duty was a good revenue earner but it could not be relied upon. It obviously depended on the amount of transactions. The property tax is better because it'll be more stable but I didn't detect, during my time, a great enthusiasm for property tax. We had done some work on it for the tax strategy group in 1996 but it wasn't really on the agenda.

Senator Sean D. Barrett: Thank you very much. Thank you, Chairman.

Chairman: Very good. Can I just deal with a couple of matters there, if you don't mind, before we move on? Just in follow up there to Senator Barrett's question, Mr. McNally, and it's just to ask that after 2004, did you or the Department undertake any additional or new reviews on housing completions and the impact upon economic growth?

Mr. Donal McNally: Well, the impact on economic growth would have been as set out in this document in terms of, I think it was a 0.5% reduction for every 10,000. I'm not aware that we did anything further than that.

Chairman: Okay. And maybe if I could-----

Mr. Donal McNally: And the ... the-----

Chairman: Yes, sure.

Mr. Donal McNally: It wouldn't change. I mean, the same metric would apply.

Chairman: And that kind of brings me into the space of the whole issue of a soft landing and what attempts were made to quantify the effects of a soft landing and what impact this would have on Government finances in terms of loss of revenue and increased expenditure and so forth, and what advice was given to Government on this regard. So maybe if I could ask you to recall, what was the discussion kind of going on from that period afterwards then as to what was the discourse and evidence that was supporting the discourse of a soft landing?

Mr. Donal McNally: Well, what I took was from the work done by the economics side and the information of the OECD, the IMF-----

Chairman: Yes.

Mr. Donal McNally: -----who foresaw continued growth, that there was the capacity to grow. I'm not quite sure how one can prove it or not.

Chairman: You didn't see any proof yourself. Is that what you're saying, is it?

Mr. Donal McNally: Well, you know, it's a forecast. It's an estimate.

Chairman: Okay. Maybe if I can draw attention to one document there. It's in your evidence book and it's the Central Bank 2007 annual report and a summary is given at the top of it there, Mr. McNally:

> ... the Central Bank is forecasting that growth in both GDP and GNP terms will be "significantly less than 1 per cent" this year, with some modest improvement in prospect next year with growth forecast to be about 2 per cent. Unemployment is forecast to average 6 per cent this year, mainly on foot of the construction and slowdown, and Ireland like others is facing ... difficult inflationary pressures. In terms of public finances, the Bank concurs with our assessment. The Bank reiterates the assessment that Irish Bank's [sic] are well capitalised with good quality assets and that the banking sector's shock absorption capacity remains strong.

Do you recall that document and that advice at the time, do you?

Mr. Donal McNally: Well, I don't recall it particularly-----

Chairman: Yes.

Mr. Donal McNally: -----because there was ... this was a common enough-----

Chairman: Yes, but the general projection of that advice, yes?

Mr. Donal McNally: There was a ... it was a common enough document that we gave a synopsis to the Minister of what the Central Bank was saying. So, I mean, there seems to be nothing exceptional there that the-----

Chairman: Yes, okay. And was this the advice that was being given to Government from the Department of Finance then as to how to base your budgets and decisions upon?

Mr. Donal McNally: Well, my recollection was that the forecasts, from what I remember, were 4% or 5% for 2008.

Chairman: Right, okay. Looking back at it now, given that a lot of these figures were based upon the construction sector, incomes coming from consumption taxes, a lot of them construction-related, so you'd have the VAT on a house being constructed, you'd have white goods that would come afterwards, carpets and all the rest of it, and 24% of the Irish economy and the construction sector employment levels inside there and all the net cost that would come with that. How do you view that advice now in terms of what actually happened subsequently?

Mr. Donal McNally: Well, in retrospect, we didn't give enough attention to the fact that the construction sector was such a large part of the economy and that was probably generating some of the fundamentals on which we were basing our assessment of a soft landing.

Chairman: And where did that gap of information or knowledge of awareness come from? It would have been ... the general discourse at the time would have been morning, noon and night, every radio show, newspaper had property construction or something very much to the forefront.

Mr. Donal McNally: I'm not sure, and I ... that was the general view that there would be a soft landing. I'm not quite sure.

Chairman: Was there any evidence that the Department of Finance, to your knowledge, engaged, researched, carried out, that supported their soft landing theory or was it drawn from external commentaries and a general consensus, or was there a hard book-----

Mr. Donal McNally: Well, I don't think there was such research. I think it was from the internal analysis and from what others were saying as well.

Chairman: I just need you to ... to clarify that with you. Is it that this was a mirroring and a re-echoing of ... it's like somebody going ... if I was heading to the doctor this morning and somebody says, "You're all right, you don't have to go to the doctor." And I go up to the doctor and I says, "Well, I don't need to be here this morning, because somebody said I'm all right on my way down." That's external advice. What I'm trying to find out here is that the Department of Finance would be the nation's doctor in terms of its finances. Were you carrying out your own diagnostics or were you taking second-hand information and making a diagnosis on that?

Mr. Donal McNally: Well, there would have been ... there would have been analysis carried out within the economics side and there would have also been compared with what others were saying as well.

Chairman: Okay. And what detail was that diagnostics carried out at? How detailed and how in-depth?

Mr. Donal McNally: I didn't go into details of that.

Chairman: Okay.

Mr. Donal McNally: And I can't recall.

Chairman: Okay. All right. Thank you. Deputy Pearse Doherty.

Deputy Pearse Doherty: I just want to pick up ... go raibh maith agat, a Chathaoirligh, agus fáilte roimh an tUasal. I just want to pick up on that point because we've been hearing evidence from different agencies, the Department of Finance as well, and your own evidence, and from the ESRI, the Central Bank. Can you explain to me this ... because we've heard a lot of people say, well, in terms of the soft landing or in terms of that consensus view, that, "Well, the Department of Finance said it." And then the Department of Finance say, "Well, the IMF were saying it," and the IMF don't do their own analysis so they're saying, "Well, the Central Bank were saying it." The Central Bank will tell us, "The Department of Finance were saying it." So, where did this originate from? Did it come from on high and everybody just started passing the parcel, or was there original work done within the Department of Finance that concluded that there was a soft landing was what was going to happen?

Mr. Donal McNally: Well, there was ... there would have been projections made within the economic side and they would have been compared with what others were saying, but, maybe, we were relying a bit much on each other and going round in a bit of a circle.

Deputy Pearse Doherty: And you would have seen those projections?

Mr. Donal McNally: The projections from others?

Deputy Pearse Doherty: No, the projections ... forget about others for this point, because you're speaking on behalf of the Department-----

Mr. Donal McNally: Yes, I would have seen those.

Deputy Pearse Doherty: You would have see those. So what did the projections say? What did the ... how did, what-----

Mr. Donal McNally: This would've been projections in growth, broken down into consumption and investment. And this ... I would have compared this with what others were saying in the private sector as well as international bodies.

Deputy Pearse Doherty: So, the projections for a soft landing, we're talking about. So what did they look like in terms of how soft was this landing going to be or how hard was this landing going to be? What did you see?

Mr. Donal McNally: Well ... what was ... what I took from it was that it could be managed, that that was what a soft landing meant.

Deputy Pearse Doherty: So what type of drop in house prices were they suggesting, and ... on the document, the internal document to the Department-----

Mr. Donal McNally: I'm not quite sure about the prices, but the ... that housing output would return to more normal levels of 40,000, 50,000 and that projections were made of, I think, 6,000 to 8,000 per annum, which, you know, if it happened like that would have been capable of being managed.

Deputy Pearse Doherty: And what was the impact, from your point of view, in relation to taxation and employment and, therefore, other pressures on the service as result of that? What hole did that create, in terms of the soft landing, from a budgetary point of view?

Mr. Donal McNally: Well, the figures that were given there in terms of the lower income tax and VAT and the higher payments, which is higher live register payments, which is €570 million.

Deputy Pearse Doherty: And was that first round effects only?

Mr. Donal McNally: That would be the first round effects.

Deputy Pearse Doherty: Did you model the entire effects of a soft landing?

Mr. Donal McNally: I'm not sure on that.

Deputy Pearse Doherty: Okay. How did you get it so wrong in relation to the soft landing, first of all. And it seems that there would have been more effects even if you were to see a drop in house prices of the nature that was suggested by the ... to the Department or by the Department?

Mr. Donal McNally: I'm not quite sure how we got it so wrong; we just did get it wrong. We relied on external advice and on our own assessment but it turned out much worse.

Deputy Pearse Doherty: Mr. McNally, there's a parable in the book that you swore your oath on; it's called the parable of the two builders. It talks about one builder who builds his house on rock and the other who builds his house on sand. One was foolish and one was wise. Was the Department's strategy, budgetary strategy, foolish or wise during your time in office?

Mr. Donal McNally: Well, it wasn't wise, as events turned out; I can't quibble with that.

Deputy Pearse Doherty: You've been employed with the Department of Finance in a range of roles since 1986, and appointed to the second secretary general in 2002. In your views, what changes do you believe were necessary to the operation of the Department prior to your appointment to the Department, and what steps have you taken to highlight any perceived shortcomings or improvements in fiscal strategy and budgetary strategy, or the interaction with the Central Bank?

Mr. Donal McNally: Well, I didn't have very much interaction with the Central Bank at my level. I mean, the main things I've tried to do, in terms of the strategy to try and reduce the rate of growth in public spending and to remove the property tax reliefs from the economic environment. But I can't claim much for change or ... I mean, I took the system as it was. Maybe I was wrong but I can't claim credit for change.

Deputy Pearse Doherty: Did you believe that changes were needed prior to your appointment as ... in the Department of Finance as second secretary general?

Mr. Donal McNally: I can't say that I did, no.

Deputy Pearse Doherty: Okay, okay. You mentioned in ... on, in your opening statement, page 10, you talk about external, expert advice. You say:

> In relation to the use of outside expert advice in my time this was mainly in the area of tax issues and tax relief schemes where independent advice was seen as necessary. The standard of this advice was good and generally followed.

So what were the main tax issues and tax relief issues that you were getting outside advice? And who was giving that outside advice? And how was it generally followed?

Mr. Donal McNally: Well, the main advice that I recall was, first of all, the study of the urban renewal incentives in 1996. I forget who carried that out. There was also the Bacon report, which made some changes and suggestions, which the Government accepted at the time-----

Deputy Pearse Doherty: Would you say they accepted ... sorry for interrupting, would you say they accepted the majority of those recommendations, or a minority of them, or all of them?

Mr. Donal McNally: Of the Bacon?

Deputy Pearse Doherty: Yes.

Mr. Donal McNally: I think it was accepted fairly generally, from my recollection. There was also the review carried out in 2005 or 2006 ... 2005. And then there were various reviews by ... of individual schemes, like the film relief, BES and things like that, which were carried out, one of them, by Indecon. So that ... I mean, you could review these internally, but generally, given that we would have a particular view on tax, I think it was felt that it was wiser to get some independent advice.

Deputy Pearse Doherty: Okay, and in relation to your own ... the internal opinion, as opposed to the external advice. The internal opinion in the Department of Finance in relation to the continuous extension of property tax reliefs was in the negative, you were ... am I right in saying you were arguing with the Minister, or recommended to the Minister that they should be abolished or not extended?

Mr. Donal McNally: Well, the general view was that it was better to, if you had the resources, to lower the tax rate generally rather than to favour reliefs. So we would have been sceptical about them and would have sought to bring them to an end, especially in a ... at a time when the property market was booming and there's less need for them.

Deputy Pearse Doherty: You mentioned the Minister for Finance, which would be Charlie McCreevy at the time of 2003 and 2004. You said there was an expectation, or there was an announcement that the rates would be abolished, and in 2004 they were extended. Clarify one thing for me, first of all, if Minister McCreevy did nothing on budget day, those tax reliefs would be gone, am I correct in relation to that, because there was a cut-off point for them?

Mr. Donal McNally: Well, if they weren't extended in 2004 they would have gone, yes.

Deputy Pearse Doherty: Basically, if he did nothing ... as in ... if the Finance Bill wasn't changed, then they-----

Mr. Donal McNally: They would have terminated, yes-----

Deputy Pearse Doherty: They would have terminated.

Mr. Donal McNally: But, you know a conscious decision has to be made whether to let that go ahead or not. I mean you wouldn't ... you would mention to the Minister that these were due to end, and the Minister might have a view on whether they should or should not.

Deputy Pearse Doherty: Yes, but they were due to terminate in 2004?

Mr. Donal McNally: Well, there was a termination date put in. I mean, part of putting in so-called sunset clauses was to make sure these were reviewed periodically.

Deputy Pearse Doherty: Yes, but the point I'm making, they're not like income tax, where the tax is there indefinitely. These were tax reliefs for a period ... a set period of time, which were supposed to ... and the decision was taken by Minister McCreevy, am I right in saying, against the recommendation of the Department to extend those for another period of two years?

Mr. Donal McNally: Well, I think we would have set out the pros and cons. I'm not quite sure if we recommended ... I mean, our general view was that they should have ended, yes.

Deputy Pearse Doherty: Okay. Well, if it's your general view, did you ever express that to the Minister? Or was ... did anybody express that to the Minister?

Mr. Donal McNally: Well, they would have been expressed in the notes going to him, yes.

Deputy Pearse Doherty: Do you understand why the Minister rejected the views of the Department in that regard?

Mr. Donal McNally: Well, I think the Minister was persuaded by representations that some of these schemes should continue, that they were a work in progress.

Deputy Pearse Doherty: Which representations would they be? Were they representations from the sector, representations from other-----

Mr. Donal McNally: Well, in general, they would be from people who are making use of the reliefs.

Deputy Pearse Doherty: So the property developers, speculators, individuals who were investing into the reliefs?

Mr. Donal McNally: Well, I don't know if they were speculators or whatever. They were people who were using the reliefs would have made representations.

Deputy Pearse Doherty: And the reliefs in ... the reliefs, the review of the reliefs ... am I right in saying this that they were to the benefit to the most wealthiest in society as opposed to those in the middle or those on the bottom?

Mr. Donal McNally: Well, in 1996 and 1997 when we were talking ... in fact, it was with Ann Nolan, who was with you just this morning ... we were talking about these reliefs and what could be done to ... to attenuate them, or what effect they had. We did persuade revenue to do a survey of the top 400 earners, trying to find out which reliefs were being used or not. And, you know, the conclusion was that these were favouring those with the money to invest and with the taxable income to offset it against and as a result ... and those reviews are published each year, but there was a change made in 1998 Finance Act which limited the amount that could be set off by passive investors against other income. So, you know, it was known that these reliefs benefited high earners, yes.

Deputy Pearse Doherty: Thank you.

Chairman: Okay, thank you. Senator Marc MacSharry. Senator.

Senator Marc MacSharry: Thanks very much. I think Deputy Doherty has covered most of the specific questions that we'd agreed to ask. Just to follow on slightly from the soft landing, was there ever a forum internally where assistant secretaries, senior principal officers would sit down and say, "Okay, the consensus from the IMF and the ESRI and the OECD and various other people and the data and, indeed, our own individual units, is that we are going to have a soft landing."? So, was there a forum that that was discussed at ... that you can recall where it was decided, "Yes, that is the likely outcome so, therefore, that's the position"?

Mr. Donal McNally: Well, there would've been annual presentations by the different business units, which is the only one that I'm aware of. There wasn't a general policy committee as there is now and, you know, perhaps that would've been a useful thing to have ... to have a general discussion outside the area of whether this soft landing ... was it just an assumption or was it a hope or was it a reality?

Senator Marc MacSharry: In the absence of the general advice council that operates now internally, were the various divisions a set of pigeonholes that didn't, perhaps, interrelate to the extent that they should?

Mr. Donal McNally: Well, each did its own work and it was integrated at the management advisory committee and that ... the business presentations for people explained what they were doing and what the issues were.

Senator Marc MacSharry: So at the management advisory committee, was it never considered that, "Look, do we all agree that this is a soft landing situation?" or-----

Mr. Donal McNally: I think it just took the advice from the economic side that this was the general consensus.

Senator Marc MacSharry: Okay, and so ... would it always be the case or was it often the case that when stuff came up from the various units, that the advice was taken as read, as was the case with the soft landing as you've suggested there?

Mr. Donal McNally: I ... not necessarily. I mean-----

Senator Marc MacSharry: Okay, but on the soft landing one it was-----

Mr. Donal McNally: Well that's what I said, I was never-----

Senator Marc MacSharry: -----at management council, that was accepted?

Mr. Donal McNally: Well, that's what I said. I wasn't aware of that much contrarian views. It was-----

Senator Marc MacSharry: And you were on that at the time, the management council, so there was just a kind of a contentedness to accept that as the-----

Mr. Donal McNally: Well, I don't know if you'd call it contentedness, but there was-----

Senator Marc MacSharry: How would you describe it, if it wasn't contentedness?

Mr. Donal McNally: It was a consensus view.

Senator Marc MacSharry: So would that be ... if it was consensus, you were happy with the view, would that be-----

Mr. Donal McNally: Yes.

Senator Marc MacSharry: Okay. So that view then ... would that view then, following a management ... would that be shared with the Minister or what way did it work from then?

Mr. Donal McNally: Well, the Minister would be given forecasts and informed that that was the assumption. That's my recollection.

Senator Marc MacSharry: Can you ever recall the Minister saying, "Look, are you sure about this?" I mean-----

Mr. Donal McNally: No.

Senator Marc MacSharry: No. He was equally content.

Mr. Donal McNally: Well, I don't know.

Senator Marc MacSharry: Okay. Did you ever feel that the Government deliberately ignored your advice?

Mr. Donal McNally: I don't think so. I think the Government assessed it or would've talked about it. I wouldn't think they ignored it or they ... they didn't have to follow it. I mean, the Department of Finance is not always right. So, you know, it's up to the Government to decide, in the public interest, what the ... what should be done.

Senator Marc MacSharry: The Economic and Financial Council, under Article 99(4) of the treaty in 2001, recommended that - now I'm quoting from your own speech - that Ireland would "take countervailing budgetary measures [in] 2001 to avoid overheating." And I think you said in your statement that that was dismissed at the time. Was it dismissed by the management council or by the Government or by the Government having been advised as such by the management council or ... why was this dismissed?

Mr. Donal McNally: Well, it wasn't dismissed as much in ... it was not accepted by the Government because we had one of the fastest-growing economies, we had very good competitiveness, we had recorded a surplus of 4% in 2000 and we were projecting one for 2001 and it was felt that, you know, we were the best pupil in the class and were being unfairly picked out for this piece of advice, which was a formal recommendation. I mean, there could've been other ways of dealing with it rather than - as, perhaps, we thought - trying to make some sort of example of us. So, you know, we didn't feel it was a justified ... especially when other countries were struggling to make the 3% deficit and were using a lot of one-off measures to comply with the Stability and Growth Pact.

Senator Marc MacSharry: And could-----

Mr. Donal McNally: And the decision would've been ... I mean, it was a half a per cent, which was a small adjustment, but it came post-budget and I think the Government decided that the budget was right and that they weren't going to alter it.

Senator Marc MacSharry: Can you remember the reason for saying that we were overheating? Can you remember why they were, I mean, in a sentence or two, could you outline ... why were they saying that we were overheating?

Mr. Donal McNally: Well, I think it was because of the fast growth rate and the service sector inflation, which is part ... I mean, if you're catching up with other countries, you will find that that inflation will be a bit higher on the services sector side, which has less productivity than the traded side ... that that will tend to show higher rates with inflation. So, I think that was their motivation.

Senator Marc MacSharry: Was there any focus on the reducing percentage of exports as a contribution to national income as opposed to-----

Mr. Donal McNally: Not that I recall-----

Senator Marc MacSharry: -----transaction taxes?

Mr. Donal McNally: Not that I recall in the-----

Senator Marc MacSharry: Would your unit ever have recommended tax cuts?

Mr. Donal McNally: There were ... I don't know whether you'd use the word "recommended". There would be a tax package which was set out in the memorandum, with resources available for that tax package. And then, when it came to the actual formulation of these, you would've put proposals to the Minister, or a range of options, in terms of whether it should be rates or bands or allowances, and then for the Minister to decide on that. I mean, formerly, in the budget strategy memorandum, we were only recommending indexation. We were recommending limited tax reductions.

Senator Marc MacSharry: So, the-----

Mr. Donal McNally: But we wouldn't have recommended that they cut the top rated tax by X%.

Senator Marc MacSharry: And how would it work typically? Would a Minister say to the other Department or say to the secretary of the Department, who, in turn, might say to yourself, or maybe directly to you, "Look, we want to cut taxes this year. What are the options?" Does it happen like that or-----

Mr. Donal McNally: Well, a range of options would be given to the Minister in terms of changes to the tax rate ... well, not so much the tax rates but to the bands and the allowances and keeping people out of the tax net and what this would cost. And the Minister would make the decision on the amount of resources he wanted to give. I mean, it wasn't always huge cuts, there was ... there were very substantial cuts. In 1999 I think it was €1.5 billion and in 2003 it was €300 million. And I remember the Minister saying to me that because of the advance publicity, people seemed to more grateful to get the €300 million than they were to get the €1,500 million because of the expectations that there were.

Senator Marc MacSharry: Okay, just three very last questions. Just quickly, I got your advice in terms of the SSIAs which were covered earlier on. Was that introduced at the time as a countermeasure to inflation ... to rising inflation? Was that the theory anyway, behind it, from a Government perspective or-----

Mr. Donal McNally: Well, as I understood from the Minister, he wanted to encourage people to save rather than to spend and to put something aside.

Senator Marc MacSharry: To spend. Okay. And did it work?

Mr. Donal McNally: Well, it certainly cost a lot of money and-----

Senator Marc MacSharry: No, no, I didn't ask that. We know how much it cost. I'm just wondering, did it work as a countermeasure to inflation or consumer spending at the time?

Mr. Donal McNally: I can't say. There wasn't any study ... regrettably, there wasn't any study-----

Senator Marc MacSharry: There's no study done on it, okay.

Mr. Donal McNally: So ... and I'm not quite sure how you would prove this.

Senator Marc MacSharry: No problem, I've just two more now. The ... you mentioned, in terms of tax issues and tax relief and something like that, sometimes independent advice was seen as necessary. Which areas of tax policy were looked at as necessary and what independent bodies was it sought from? I've one very last one after this, Chairman.

Mr. Donal McNally: Well, as I mentioned, there was a review in 1996 of the urban renewal. There were regular reviews of the film relief following which there were some changes made and, as far as I recall, it was Indecon who did those. It was just ... obviously the Department of Finance, if it had it's way, would have liked to curtail or get rid of some of these reliefs, whereas there were those who felt that they were important for the economy. We would have thought that, for example, the film relief was too generous and it was necessary ... it felt necessary for somebody outside who would have the confidence of both sides to review both the reliefs.

Senator Marc MacSharry: Yes, okay.

Mr. Donal McNally: That was the main reason for going for independent advice.

Senator Marc MacSharry: Just very finally and on a different issue, we had Tony O'Connell, the chief economist of the Central Bank in here, who, as part of his evidence, made reference to what he called "the political and property interests on the board". Can I ask, from your perspective in the Department of Finance, did the Department of Finance, you and your colleagues feel that there was any, sort of, a political or property complexion among the authorities in the Central Bank?

Mr. Donal McNally: I wouldn't have been that aware of the membership but I take the evidence of others that they fulfilled their duty in a public interest manner. I mean-----

Senator Marc MacSharry: But I mean, you could have a view, I mean, if ... did you have a view at the time, the Central Bank was working well or there seems to be a very-----

Mr. Donal McNally: No I didn't have a view.

Senator Marc MacSharry: -----political property type-----

Mr. Donal McNally: I didn't have any view that there was any political property type in the-----

Senator Marc MacSharry: Okay, thank you.

Chairman: Deputy, you want ... actually on that before I ... you move on from Senator MacSharry's questioning. Just on the SSIA scheme; was there any study before or after its implementation as to its merits, goals, objectives and if or how these were achieved?

Mr. Donal McNally: No, there wasn't any study carried out subsequent. The only evidence there was, I think, OECD work on savings schemes and savings incentivised schemes, which suggested that the money was moved around rather than that there was an actual increase in the amount of savings. I mean, there should have been a follow-up review of it but there wasn't.

Chairman: Was there something to review, when the SSIA scheme came out first, was it saying, "Here's a big document, this is what this going to achieve, this is what the rationale for it is", and all the rest of it, then four years later, when the scheme expired-----

Mr. Donal McNally: No, it didn't ... it didn't work like that, no.

Chairman: There wasn't ... was there anything at the start?

Mr. Donal McNally: Sorry?

Chairman: Was there any document at the start saying this is what the SSIA is going to do or the SSIA-----

Mr. Donal McNally: Well, there would have been a submission to the Minister outlining the various schemes.

Chairman: Where did it originate if you don't mind me asking you, Mr. McNally? Did it originate from the Department or was it a political orientation?

Mr. Donal McNally: I think it was the Minister's wish to encourage people to save, that people had forgotten about saving and that this would be a prudent measure.

Chairman: So this ... the genesis of this came at a political level not at a Department level, yes?

Mr. Donal McNally: Yes.

Chairman: And was it the Minister himself or-----

Mr. Donal McNally: It was the Minster himself, as far as I recall.

Chairman: Okay, thank you very much. Deputy Eoghan Murphy.

Deputy Eoghan Murphy: Thank you, Chairman. Thank you, Mr. McNally, you're very welcome. Earlier today, you spoke about challenging the Minister on different areas of policy or different proposals that were being put forward because you disagreed with them. Is that correct? You would disagree with the idea or policy that was being proposed so you would-----

Mr. Donal McNally: Well, we'd put forward ... if there was a proposal, we'd analyse it and give the reasons for and against and it wasn't challenging the Minister; it was just trying to advise the Minister as best we could.

Deputy Eoghan Murphy: But would you come down on a certain ... would you favour a certain advice? I mean, for example you talked about the SSIA and you talked about the holiday resort tax reliefs and you not being in favour of them. So would the Department present ... analyse the proposal and come back and say, you know, "We think X and Y but we're in favour of X"?

Mr. Donal McNally: But we would have, well ... the memoranda would have set out pros and cons, but I think it would have been clear from the pros and cons where the Department's feelings were.

Deputy Eoghan Murphy: And, in those two instances, you think it was clear from the memo where the Department's feelings were and they were against those two schemes?

Mr. Donal McNally: I think so, yes-----

Deputy Eoghan Murphy: What-----

Mr. Donal McNally: -----because we were expressing doubt over whether this would incentivise savings.

Deputy Eoghan Murphy: Okay, what other proposals that came from the Ministers you served under? Would memos have come back where the emphasis was clearly on the con side?

Mr. Donal McNally: Well, the memo set out the options and when reading the pros and cons, you'd be able to get a good idea where the Department's view lay.

Deputy Eoghan Murphy: Okay, so-----

Mr. Donal McNally: It was up to the Minister to make the decision.

Deputy Eoghan Murphy: So what other proposals that came from the Ministers that you worked for did the Department basically disagree with?

Mr. Donal McNally: Well, the SSIA one is just the only one I can think at the moment. The rural renewal - we would have expressed some doubts as to the generosity of the reliefs.

Deputy Eoghan Murphy: What about decentralisation?

Mr. Donal McNally: I wasn't involved in the decentralisation. I don't know what advice was given in that regard.

Deputy Eoghan Murphy: What about tax policies like halving CGT?

Mr. Donal McNally: Well ... the ... we would have taken the view that there would have been a cost. And ... to my ... I'm telling a story against myself but I estimated that the cut in CGT would cost something like €19 million, but over the next four or five years, the revenue increased by tenfold, so there was obviously a behavioural change. People used the lower rate to cash in. So I mean, wouldn't say we opposed the cut. We pointed out the consequences there might be, which, in my case, it was wrong, plain and simple.

Deputy Eoghan Murphy: And so following something like that where the Department provides advices and they prove to be incorrect - and I suppose in that case it's dramatically incorrect - do you think then that has an effect on the way those advices are then treated or regarded going into future budgets?

Mr. Donal McNally: I don't think so. I don't think the Minister discounted the advice but he always said that it's up to us to propose and him to decide.

Deputy Eoghan Murphy: Okay, and so again in terms of this culture of ... I suppose robust culture of challenging the Minister on different ideas and different proposals and writing memos, did you ever do this work in relation to what was happening in the property sector and the housing boom and what contribution that was making to the economy?

Mr. Donal McNally: I don't recall having inputted on that.

Deputy Eoghan Murphy: Okay. Right, so ... one of the pieces of evidence we've heard about in previous sessions in relation to Morgan Kelly's work and how he published an article on a potential house price bubble in *The Irish Times* at the end of 2006, and later published a report on the same theme as part of the ESRI's quarterly bulletin in the summer of 2007. So, when outside people, were, you know, having an impact on the debate in that way, what was happening in the Department at the official level in terms of analysing that advice and considering whether or not to take it to Government?

Mr. Donal McNally: We would have analysed the advice and looked at what the OECD had said in 1986 where they felt that a soft landing was the likely outcome but a hard landing couldn't be ruled out.

Deputy Eoghan Murphy: So this is written in 2006 and 2007 and you went back to work from the OECD from 1996, is that-----

Mr. Donal McNally: No, 2006.

Deputy Eoghan Murphy: 2006, okay.

Mr. Donal McNally: Yes.

Deputy Eoghan Murphy: So you would have given serious consideration to Morgan Kelly's work at the time?

Mr. Donal McNally: It would have been looked at, yes.

Deputy Eoghan Murphy: Okay. And then when we look at things like the pre-budget letters coming in from the Central Bank, I mean, how much consideration would have been given to them? Because in the pre-budget letter from 2000, towards the end of 2000, looking ahead to 2001, it warned of a hard landing. It drew attention to the commercial price rise in property, to the residential price rise in property, to overheating in the economy and it talked about a risk of a hard landing so-----

Mr. Donal McNally: I don't remember this particular letter. Sorry, Deputy.

Deputy Eoghan Murphy: Okay, well, we have it in evidence but you don't recall anyone going back, say, instead to a Central Bank pre-budget letter to look for ... to test against what Morgan Kelly was saying?

Mr. Donal McNally: Not as far as I recall, no.

Deputy Eoghan Murphy: Okay. In the Nyberg report on the banking crisis, he states that there was a general ... in general a pervasive pressure for consensus and conformity of views across institutions and one of the reasons was to "adopt specific policies and accepted practices that later proved unsound". So, in your opinion, was there a pressure in the Department of Finance in the years up to 2006, this pervasive pressure for consensus?

Mr. Donal McNally: I don't think there was a pervasive pressure for consensus. I think that was the view; it wasn't forced on people. That was the view that was taken having analysed in economic data.

Deputy Eoghan Murphy: Okay. So you didn't feel like it was a culture or political pressure at work within the Department?

Mr. Donal McNally: No, there wasn't ... I mean, Ministers didn't get involved in economic projections. There wasn't any political input of that sort.

Deputy Eoghan Murphy: Okay. Can you comment on what changes, if any, occurred with the change in Ministers in 2004 in the workings of the Department?

Mr. Donal McNally: I don't think there was any real change in the workings of the Department, the process continued as before. I mean, the main change that was made was the abolition of the tax reliefs, as far as I was concerned.

Deputy Eoghan Murphy: But in relation, in terms of practices, preparations for the budgetary process, was there any change in how that went?

Mr. Donal McNally: It would have continued the same, as far as I ... I mean, there are things that have to be done, the Estimates settled, the decisions made on tax policy. It follows a particular course, there's a schedule of things and when decisions have to be made, which is normal, I presume the same happens now.

Deputy Eoghan Murphy: But the Department continued to play the central role it had played up to 2004, after 2004?

Mr. Donal McNally: Yes, I think so, yes.

Deputy Eoghan Murphy: Okay. The final question I wanted to ask was in relation to lessons for the future. You spoke about prudent being not spending all your tax receipts in a given year, so I just wondered what the current thinking is, in relation to when you have a surplus, is it to run a surplus, is it to direct a surplus into some sort of fund like a pension reserve fund, or is it to pay off the debt? What would be the prudent thing, looking forward?

Mr. Donal McNally: At the moment, I think we still are trying to make the 3% deficit, so a surplus may be a bit off. But I would think that the main recommendation of the Department would be to use the surplus to run down the debt as that's a burden on the people, which, you know, if interest rates rise will be ... will absorb more of the tax revenue. That's what I would imagine; I haven't asked in the Department what the priority is, but that would be my sense of it. That's what I would be recommending anyway, to use the resources to get down the debt or to find some way of minimising the debt.

Deputy Eoghan Murphy: Okay. Thank you. Thank you, Chair.

Chairman: Thank you very much. Okay, I'll just deal with one question myself, Mr. McNally, and then we'll move towards the wrap-up and I'll invite both Senator Barrett and Senator D'Arcy back in again. If I could just relate to, and I think Senator MacSharry touched upon this with you just a moment ago, on 24 January 2001, the European Commission concluded that Irish fiscal policy was inconsistent with the broad European policy guidelines. They further asked Ireland to avoid further overheating of its economy, and there's a document, I think, coming up on the screen there now, but you make reference to this, I think, actually in your own opening address today, where you mention, I think, it's on page 4 of your opening statement:

> The only notable exception to this is the recommendation issued to the State in 2001 by the Economic and Finance Council under Article 99(4) of the Treaty to take countervailing budgetary measures during 2001 to avoid overheating. This recommendation was not felt warranted and was not accepted by the Irish authorities.

And if I just, the document is there, if I just move one or two pages into it, it's page 13 of the document itself, on the bottom, it's ... next one ... next one again ... just page 13 of it. And if you look at the last paragraph of it there, Mr. McNally, just come in there about three lines down, it says:

> Against this background, the Council finds that **the planned contribution of fiscal policy to the macroeconomic policy mix in Ireland is inappropriate**. The Council recalls that it has repeatedly urged the Irish authorities, most recently in its 2000 broad guidelines of the economic policies, to ensure economic stability by means of fiscal policy. The Council regrets that this advice was not reflected in the budget [of] 2001, despite developments in the course of 2000 indicating an increasing extent of overheating. The Council considers that **Irish fiscal policy** [of] **2001 is not consistent with** ... **broad guidelines of the economic policies** as regards budgetary policy.

And it goes on and on.

Now, we've had reports from some institutions like the IMF and others that said in around 2005, 2006, they were getting things wrong. But this one would seem to be very, very strident in its language and in its indication of action required and so forth. So could you, as I say, I think the document is of 12 February 2001, this, so ... and the European Council recommend that countervailing measures be taken, as I just cited. Could you tell us what action was taken by the Department of Finance on receipt of this very, very strong advice as outlined from the European Council?

Mr. Donal McNally: Well, the ... I would have been advised just before that meeting of the Economic and Finance Committee, that they were planning to make this recommendation and I would have reported back to the Minister, who felt that it wasn't justified, and I would have argued at the Economic and Finance Committee that the recommendation was not warranted. I agree that they did, in the 2000 broad guidelines, say that we should stand ready to use countervailing measures. But we had a surplus of 4.3% in 2000 and were planning another surplus of 4%, so, you know, that is taking a lot of resources out of the economy. What they were suggesting was another 0.5%. In the end, the economy slowed in 2001, and the Commission did not renew the recommendation, it, sort of ... a draw was called, I suppose.

Chairman: But, was the slowdown at the end of that year what you might call a quarter aberration that you get, you get a couple of weeks or a couple of months in the year but then the Christmas retail market comes along, expenditure, then growth and inflation kick off again, and it's business as usual? So is a one-quarter observation of an economic trend sufficient to say that things have changed?

Mr. Donal McNally: Well, I just note the point that the Commission were asking us to do a lot more, or somewhat more, than what we were doing. And the economy did slow down; the initial forecasts were for no growth, that turned out to be growth in the end. But, you know, it's ... there was a feeling that we were being picked on, somewhat unfairly, and that did influence the view that was taken.

Chairman: Was that an official view or a political view, that you were being picked on?

Mr. Donal McNally: It would have been both, because I would have been at meetings where some countries managed to stay within the deficit by the use of once-off measures that couldn't be relied upon and others who managed to stay within minus 2.94%, just barely scraping within, and there wasn't that great level of growth in Europe. My view would be that they should have been concentrating on those issues, rather than on ourselves.

Chairman: Okay, thank you. Senator Michael D'Arcy, five minutes to wrap up, please.

Senator Michael D'Arcy: Mr. McNally, can I just ask your view on the SSIAs again, please? Was that an example of the Government putting its hand into the national till for their electoral gain, in your opinion?

Mr. Donal McNally: I think that what it was, was the Minister trying to encourage people to save and this was the way he saw as best doing so. The relief was given at 20%, which was the standard rate, and was given by means of a top-up, so everybody got it, irrespective of income. But I didn't see a political motivation behind it; at least, I wasn't aware of one.

Senator Michael D'Arcy: And the decentralisation programme, could you clarify for me, please, you were unaware of that being announced in budget '04, is that ... did you say that?

Mr. Donal McNally: Well, I knew there was work going on on decentralisation but it was kept within a fairly tight team, so that I wouldn't have known the details beforehand.

Senator Michael D'Arcy: You didn't know the-----

Mr. Donal McNally: I didn't, no.

Senator Michael D'Arcy: You didn't.

Mr. Donal McNally: I just knew that there was space in the budget speech for this announcement.

Senator Michael D'Arcy: Okay. But you were one of the most senior people in the expenditure side.

Mr. Donal McNally: No, I was on the budget side at that time, I wasn't on the expenditure side.

Senator Michael D'Arcy: But you were one of the most senior people on the budget side.

Mr. Donal McNally: Yes.

Senator Michael D'Arcy: And how many people were above you?

Mr. Donal McNally: Just the Secretary General.

Senator Michael D'Arcy: Just the Secretary General. And you didn't know about it in the-----

Mr. Donal McNally: I knew there was something planned on decentralisation but I didn't know the details.

Senator Michael D'Arcy: You didn't know the details, okay. Can I just ask one final question, Mr. McNally, and it's ... Rob Wright said he would have pressed the red button within the Department of Finance if he had been there. Is there a red button in the Department of Finance to press?

Mr. Donal McNally: Well, I haven't seen one, myself.

Senator Michael D'Arcy: Thank you very much.

Mr. Donal McNally: But you know, if, the Department would, if it saw the danger, would advise the Minister.

Senator Michael D'Arcy: But there's no red button as such to press?

Mr. Donal McNally: Not that I'm ... well-----

Chairman: I think the question is very pertinent to a time that he would have pressed the proverbial red button. Do you have a view as to when that proverbial red button would have been pressed, Mr. McNally?

Mr. Donal McNally: I beg your pardon?

Senator Michael D'Arcy: The question ... the concept of the red button arose when it was put to Mr. Wright as to when should the brakes have been put upon things and would you have had a view as to when the brakes should have been put upon things?

Mr. Donal McNally: Well, we were trying to advise the Government to step on the brakes ... that when you're ... when the economy is favourable, the time is to put some money in reserve and to, you know, slow down. So, I don't know whether it would have been a specific moment but we were trying to get this message across for some time.

Chairman: Okay. Thank you. Senator, that it? Okay, thank you. Senator Barrett.

Senator Sean D. Barrett: Thank you, Chairman, and thanks, Mr. McNally. When you were in the budget and economic advice section, Mr. McNally, 2000-2008, do you recall being "under siege" in 2007? Did that phrase be ... was it used at that time?

Mr. Donal McNally: I don't recall being under siege in 2007, no.

Senator Sean D. Barrett: Because Simon Carswell gave it in evidence and I'll give you the context now:

> At one point the Department of Finance was described by one of its own officials as being "under siege" in [a] lobbying campaign by the financial industry. The aim was to get legislation passed to allow banks to issue bonds backed by commercial mortgages. The financial sector won out. The legislation was passed in early 2007, [right] at the peak of the property boom, making it easier for banks to borrow more money to provide more loans to more customers.

And this was the Asset Covered Security (Amendment) Act, No. 13, 2007. Were you involved in that debate?

Mr. Donal McNally: No, no.

Senator Sean D. Barrett: That doesn't refresh your memory?

Mr. Donal McNally: No, not in any way and, I mean, I don't doubt ... I accept what is said there but I wasn't involved in that piece of legislation.

Senator Sean D. Barrett: Because Mr. Carswell gave evidence that named bankers were particularly active at knocking on doors in the Department of Finance but yours wasn't one of them?

Mr. Donal McNally: No, there was nobody knocking on my door on that piece of legislation.

Senator Sean D. Barrett: In relation to your work on the McLaughlin commission, how does that stand now? Do you see the reforms that were recommended having had any impact at all or do you feel a certain amount of frustration?

Mr. Donal McNally: Well, we were ... I know one of them was done in relation to motor tax and when vehicles are off the road. I'm not quite sure what was done in the follow-up on the other efficiency measures. I didn't keep track of that.

Senator Sean D. Barrett: Because there were concerns about managerialism and bureaucracy and so on in that report, quite strong ones, directors of services, I mean, large surpluses. In fact, the excess numbers were quantified.

Mr. Donal McNally: Yes. I didn't keep up with that, I'm afraid.

Senator Sean D. Barrett: No. Have we wasted a good recession in that phrase then if we don't reform when these reports are there and we go through all the financial stringencies that we have had in this number of years?

Mr. Donal McNally: Well, there have been cutbacks in numbers in the public service and there have been reforms undertaken. There's been the pay issue dealt with where pay scales got a bit too ... too generous but I don't know whether we've wasted this recession or not.

Senator Sean D. Barrett: Thank you very much. Thank you, Chairman.

Chairman: Excellent. Thank you very much, Senator, and I'll bring things to a conclusion, Mr. McNally, and before I do, I just would like to give you the opportunity, if you have any final comments or remarks or a consideration that you might like to add as I bring matters to a close.

Mr. Donal McNally: Thank you, Mr. Chairman, and thank you, committee members. I'm conscious that I may not have been as helpful as I set out to be because some of the issues were not directly my concern but I do hope that some lessons can be learned for the future, that some device is found whereby the natural inclination to spend the money when you have it, can be replaced by a more prudent and far-seeing course and I wish you well in that regard.

Chairman: Are you familiar with the term "euphoric recall", Mr. McNally, are you? The term "euphoric recall". It's used in terms of recovery, particularly with addiction studies and stuff like this, and by means of a time to find a relapse. They also ... they note with addicts that they start recalling the past in a different type of light to the type of damaging way it was. Would you ... considering that you are maybe now retired but you're observing things as we move into the future, do you see any sort of dangers like this? That we look back to the past? Things like the SSIA scheme that we were discussing earlier and we might reshape them in our heads that might create difficulties for us going into the future.

Mr. Donal McNally: Well, there's always that ... there's always that danger but hopefully the work and recommendations of the committee might be able to dispel that particular phenomenon. I'm not familiar with addiction.

Chairman: Well put, that's a good point to close with, we'll keep you on. With that said, I would like to thank Mr. McNally for his participation today and for his engagement with the inquiry. The witness is now excused and I propose that we will break for one hour, resuming at 2.45 p.m. Is that agreed? At which time, we will hear from Mr. Charlie McCreevy, former Minister for Finance.

Sitting suspended at 1.50 p.m. and resumed at 2.50 p.m.

Department of Finance - Mr. Charlie McCreevy

Chairman: So, will I call the meeting back into public session? Is that agreed? Okay. And we'll now commence with session 2 of today's public hearings with a discussion with Mr. Charlie McCreevy, former Minister for Finance. The Committee of Inquiry into the Banking Crisis is now resuming in public session. And can I ask members and those in public Gallery to ensure that their mobile devices are switched off? This afternoon we have the first of a number of hearings with senior members of Government who had key roles in the run-up to the crisis period. At this afternoon's session we will hear from Mr. Charlie McCreevy, former Minister for Finance. Charlie McCreevy was a member of the Dail for County Kildare from 1977 to 2004. He held several senior posts in Government and was Minister for Finance from 1997 to September 2004, after which he became EU Commissioner for Internal Market and Services from 2004 to 2010. Mr. McCreevy, you're very welcome before the committee this afternoon.

Mr. Charlie McCreevy: Thank you.

Chairman: Before hearing from the witness, I wish to advise the witness that by virtue of section 17(2)(*l*) of the Defamation Act 2009, witnesses are protected by absolute privilege in respect of their evidence to this committee. If you are directed by the Chairman to cease giving evidence in relation to a particular matter and you continue to do so, you are entitled thereafter only to a qualified privilege in respect of your evidence. You are directed that only evidence connected with the subject matter of these proceedings is to be given. And I would remind members and those present that there are currently criminal proceedings ongoing and further