

Opening Statement – Oireachtas Committee on Budgetary Oversight

‘Views on the Overall Budgetary Package as set out in the Summer Economic Statement and Specific Issues to be addressed in the Budget’

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Introduction

My name is Tom McDonnell. I am co-director of the NERI, and I am joined today by my colleague Ciarán Nugent.

First of all we would like to thank the Cathaoirleach, and members and staff of the Committee for the invitation to appear before you.

We will comment on the overall budgetary package as set out in the Summer Economic Statement and touch on the questions asked of us by the Committee.

Before doing so we will comment briefly on how the economy is doing and the implications for what that means for the optimal fiscal stance in Budget 2026.

1. Assessment of the economy

The Irish economy is now at least 3 years into a prolonged boom and the employment rate is at a record level. The number of people working in the economy has increased by over half a million since 2019 and is up 2.3% in just the last year. All sectors have seen employment growth over this time and there is now clear tightness in certain parts of the labour market, most notably construction.

Data for the first half of 2025 shows a continuation of healthy economic growth with a frontloading of trade to the United States in advance of expected tariffs. Price inflation is now under control and fluctuating narrowly around 2%, albeit the cost of living has increased 20% in the last four years. The combination of a tight labour market and disinflation is driving significant real wage growth and increasing real disposable income for

most households. Indeed, the economy is arguably overheating with capacity constraints driven by infrastructure and housing deficits.

Business and consumer sentiment are understandably mixed given the uncertainty around tariffs; geopolitics; technological disruption, and the fragile economic health of our main trading partners. Nevertheless the short-run outlook remains positive. Price inflation should be close to 2% next year and well below expected nominal wage growth of circa 4% to 5%. We also anticipate employment will continue to expand albeit at a lower rate. The strong growth in disposable household income should compensate for the potentially higher savings rate arising from the aforementioned uncertainties.

Key risks to the economy include further tariff shocks (including to services); trading partner slowdowns with the US, France, UK and China all exhibiting their own weaknesses; domestic capacity constraints, and of course the ongoing vulnerability of our corporation tax receipts to decisions made outside of the country.

Overall, the economy is clearly experiencing a boom and, on balance, we anticipate healthy if moderate growth next year.

2. Views on the overall package

Two key factors should always underpin budgetary policy. First, what is the current state of the public finances excluding once-offs and, second, what is our understanding of the current cyclical position of the economy. We've already noted that the economy is performing very strongly by most metrics. In addition, while the public finances are in surplus, these surpluses turn into deficits once we exclude the windfall portion of the corporation tax receipts.

We also know that these corporation tax receipts are largely dependent on a very small number of foreign companies. This is an inherently fragile position. It should be evident that a booming economy should not be running an underlying fiscal deficit and that therefore fiscal policy prior to Budget 2026 is already running too hot. This suggests that spending

increases net of tax changes should arguably be less than the potential growth rate of the economy though there are of course nuances and caveats to this view.

The proposed €9.4 billion package is clearly expansionary and clearly pro-cyclical. €7.9 billion of the budget package is for public spending increases (an increase of 7.3%) of which €2 billion is for increased capital spending. This type of budget will modestly add to inflation, undermine competitiveness and ultimately reduce the economy's resilience in the face of future shocks. It is also counterintuitive that the Summer Economic Statement promises that a deterioration of the tariff landscape will cause the government to recalibrate the size of the budget package downwards. Logic suggests that the Government should instead respond to a negative economic shock with a more expansionary budget. Cutting public spending in the wake of a shock would simply exacerbate any tariff induced downturn. It would have been better to start with a net spending increase in the region of around 5% or at least something close to the economy's potential growth rate, with additional measures held in reserve if needed for deployment as a response to a recession or sectoral shock.

The NERI's view is that the €7.9 billion in spending increases would be better accompanied by a €1.5 billion *increase* in taxes leaving an overall €6.4 billion net package. Cutting taxes during a boom makes little economic sense and flies in the face of the analysis and recommendations from the Commission on Taxation and Welfare that there is a need for gradual but material increases in government revenue as a share of the size of the economy over the medium-to-long term. This is to compensate for Ireland's fiscal position gradually deteriorating under various future pressures most significantly population ageing.

More positive is the government's decision to ramp up its level of spending on infrastructure. The economy is already suffering from years of underinvestment and infrastructure bottlenecks are now a major constraint on our competitiveness and are a barrier to future economic development. Much higher public investment is needed in housing, energy, water and transport and the additional capital allocations are both necessary and welcome. We would note that much higher levels of spending on public R&D is also needed to bring us in line with other advanced economies. This has been a consistent and frustrating policy failure.

The emphasis on capital spending casts the budget in a slightly different light. An expansionary budget that nevertheless enhances the economy's productive capacity, and as a consequence enhances its medium-term fiscal capacity, can certainly make sense if done properly. We have the fiscal headroom to do it provided the windfall corporation tax receipts don't evaporate although there are legitimate concerns about where the additional construction workers will come from given we are at or close to full employment. More inward migration will be needed. The Government's commitment to continue funding the longer-term savings vehicles is also very welcome though the annual levels of funding should be increased.

Overall, the budgetary package is much too large albeit the pivot towards capital spending is a very welcome shift. The five-year medium-term fiscal and structural plan needs to be expedited and needs to be serious. This document should then frame the budgetary parameters for the rest of this government. The plan will need to be a mature attempt to adequately tackle questions about medium-term sustainability with a credible plan developed for achieving a fiscally sustainable equilibrium over the longer-term.

3. Budget Priorities

- We strongly supports the prioritisation of government spending on infrastructure but believe that a more holistic approach should be taken to the concept of 'investment' with greater allocations needed for annual spending on human capital (education and skills) and on innovation (public R&D, technology diffusion)
- The government should abandon its Budget 2026 plans to extend the 9% VAT rate to include hospitality. Instead, over time the government should broaden the tax base by bringing the VAT rate on hospitality into line with the standard VAT rate. Some of the yield from this measure could be used to simultaneously reduce the standard VAT rate.
- The Commission on Taxation and Welfare's broad approach to strengthening the revenue base of the state should be pursued over the medium-to-long-term and, in

particular, we note their suggestions to gradually minimise the use of tax expenditures and increase taxes on capital.

- The government should increase the minimum wage to the level of the living wage in 2026, as was previously committed to by the main parties in government.
- The government should introduce a 2nd tier of child benefit in Budget 2026 in order to reduce by 50,000 the incidence of child poverty in Ireland.
- The once-off payments from previous budgets should be replaced by a system of empirically based adequacy payments throughout the welfare system with a rationalisation of the system to minimise cliff edges, and distortions as per the recommendations of the Commission on Taxation and Welfare.
- The government should begin the process of developing a public childcare option over the medium-term beginning with geographic areas (often low income areas) that are currently underserved in terms of affordable childcare availability.
- The government should ensure that Budget 2026 and subsequent budgets are countercyclical. Net spending should not exceed 5% in Budget 2026 with higher levels of actual spending increases funded by a broadening of the state's revenue base with an emphasis on capital taxes and the watering down of tax expenditures.
- The government should move to a 'carrot over stick' approach to managing the green transition with much more significant and generous funding made available for public transport and for green subsidies to enable lower income households invest in housing retrofits and in electric vehicles.

There is of course a tremendous amount to unpack in each of these policy areas.

Ciarán and I are happy to elaborate upon any of these points and to take your questions.

End.