National Competitiveness and Productivity Council

Budget 2025 and Competitiveness: Investing in Ireland's Future Prosperity

NCPC
National Competitiveness & Productivity Council
An Chomhairle Náisiúnta Iomaíochais agus Táirgiúlachta

- **At this time of international uncertainty, it is vital that Ireland continues to pursue domestic policies which enable it to compete globally. In the context of strong – but uncertain – Corporation Tax receipts, prudent productivity-enhancing capital investment should be prioritised.**
- **Government should focus on ensuring that the necessary and fundamental conditions for firms to compete are fair and adequate, and that one-off broad supports are considered only as a last recourse.**
- **The innovation performance of smaller firms is critical to a country's competitiveness over the long-term. Changes to the structure of the R&D Tax Credit or alternatively the introduction an innovation-based incentive could help drive an increase in innovation among SMEs.**
- **The effective matching of skills and lifelong learning play a critical role in easing constraints and increasing productivity. In an economy at capacity, this is particularly important. The National Training Fund surplus should be deployed to assist in meeting current and future skills needs.**
- **Increasing the efficiency and effectiveness of our planning and regulatory system is a matter of urgency in addressing our infrastructural deficits. The implementation of the Planning and Development Bill and the establishment of the new Planning and Environment Court are of key importance in enhancing infrastructure delivery and making effective use of available capital funds.**

INTRODUCTION

Over the past year, competitiveness has come to the fore of the political agenda at both the national and the EU-level. The publication this year of the Letta report on the Single Market and the Draghi report on the future of European competitiveness has brought increased focus to the EU's declining competitiveness, and the innovation gap between it and competitor blocs. Many of the issues for the EU are also relevant to Ireland's own competitiveness. Among its European peers, Ireland has performed strongly in terms of competitiveness throughout 2023 and 2024.

There remain, however, significant and longstanding challenges which threaten Ireland's competitiveness. These include infrastructural deficits, the cost of doing business in Ireland (including the degree to which this impact business operations) and the need to support the enterprise sector through the twin green and digital transition. Addressing these issues is imperative if Ireland is to retain and advance its competitiveness position. With an economy operating at capacity, this will require the strategic prioritisation of capital projects that are crucial for sustainable growth, and increased efficiency in the delivery of those projects.

The publication of the annual *Ireland's Competitiveness Challenge* report was brought forward this year in order to provide a greater opportunity for the Council's recommendations to feed into the Budgetary process. Following publication of the report, the Taoiseach convened a Competitiveness Summit following which Government agreed a number of actions including: the recognition of the need to adequately resource the CCPC to identify and remove barriers to competition, establishing a pathway for a sustainable utilisation of the National Training Fund, and consideration to be given to options to further incentivise business investment in R&D and innovation (including enhancements to the R&D Tax Credit).

Whilst it is inevitable that a given Budget will be characterised by a focus on immediate priorities, competitiveness issues are more often medium to long-term considerations. The Budget does, however, play a significant role in shaping our broader fiscal approach, and so the objective of this paper is to specifically highlight those recommendations from this year's *Challenge* report[1] that are most pertinent to Budget 2025.

BUDGET CONTEXT

Budget 2025 occurs against a backdrop of increased fragmentation in trade relations, increasingly active industrial policy in many regions, defensive trade policy across major trading blocs, and the continued legacy of

[1] These are labelled as **ICC Recommendations** in the following sections and set out in full in the Appendix.

the extraordinary scale of fiscal measures deployed during the pandemic and periods of increased energy costs.

As assessed by the Irish Fiscal Advisory Council (IFAC), Government is set to repeatedly breach its own National Spending Rule (i.e. a limit on the growth in permanent net spending to match the long-run sustainable growth rate of the economy, at 5%).[2] IFAC has determined that, since the rule was introduced in 2021, the level of budgetary measures by 2024 is 9.7% above what would be implied by a 5% growth path, on a cumulatively basis. As assessed by the Central Bank, even maintaining net growth in government spending at five per cent could result in trend inflation in Ireland in excess of two per cent in the medium-to-long term.[3]

The Summer Economic Statement commits to an overall budgetary package of €8.3 billion – including €6.9 billion for spending and a €1.4 billion tax package. Of this €8.3 billion, €3.2 billion relates to new measures to be announced on budget day, with the remainder allocated to the Existing Level of Service and the National Development Plan. This expenditure package represents an increase of 6.9% on last year.[4]

As a small, open economy that is part of a large economic union, our competitiveness position is shaped by developments at the global and EU level. The degree to which Ireland can effectively influence the EU on issues such as State Aid and the Single Market is limited. This means Ireland must continue to take action to improve competitiveness in those areas under which it has control domestically, irrespective of global developments on subsidies and protectionism **(ICC Recommendation 2.3)**. One element of this is our macroeconomic sustainability.

While the continued strength of Corporation Tax returns is positive, we need to be aware of the risks associated with a highly concentrated and potentially volatile source of tax revenue and a general narrowness of the tax base, particularly in facilitating expansions in current expenditure or reducing tax rates. The use of potentially "windfall" revenues to fund day-to-day spending is inconsistent with achieving policy stability and certainty – key elements of Ireland's international competitiveness. This revenue should instead be targeted at productivity enhancing infrastructural investments that serve to tackle bottlenecks and boost the capacity of the economy to deliver services to meet business and societal needs.

We need to also be aware of our position in the economic cycle and the risk of rising public expenditure and potential cuts to tax acting pro-cyclically in an economy already at capacity. The recent Court of Justice of the European Union ruling on the Apple State Aid case[5] underscores the importance on ensuring any increases to expenditure are primarily productivity enhancing capital investment (rather than ongoing increases in current expenditure).

Ireland's relatively elevated business cost environment reflects the country's position as a price-taker on most international markets and the economy's susceptibility to external price shocks. Domestically, firms continue to face challenging increases in the cost of doing business arising from outstanding and continuing legacy issues, such as managing debt, legal and insurance costs, in addition to further increases in indirect costs such as housing.

Cost pressures – whether domestic or external in origin – have motivated the Government to provide one-off supports to firms at critical moments. While this may have been considered necessary, the Government should reflect on the continued use of one-off grant support. Irish firms must be able to effectively compete without continual recourse to Government assistance. The ongoing use of such supports can also give rise to questionable value for money (particularly if it is not highly targeted).

In shaping Budget 2025, the Government should focus on ensuring that the necessary and fundamental conditions for firms to compete are fair and adequate, and that one-off broad supports are considered only as a last recourse in Government intervention (**ICC Recommendation 3.2**).

EMBRACING TECHNOLOGICAL CHANGE

Digitalisation and the adoption of advanced technologies, such as AI, has the potential to facilitate innovation and productivity gains in Irish enterprises. Comparatively low levels of digitisation in SMEs at present have implications for the adoption of advanced technologies such as AI, as digitalisation is seen as a pre-requisite for adoption. Policy action to encourage digitalisation and technology adoption, particularly by SMEs, is of urgent importance.

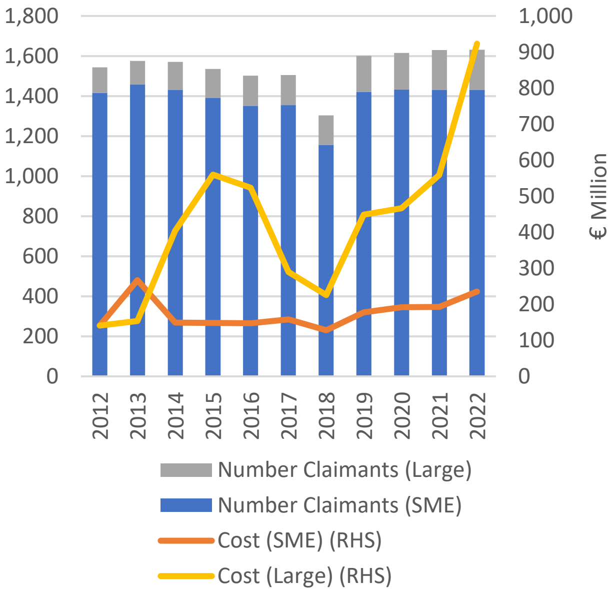
There is evidence (see Figure 1) to suggest that the R&D Tax Credit may be relatively less accessible to smaller firms. While smaller firms are the majority claimants of the

[2] Fiscal Assessment Report, Irish Fiscal Advisory Council, June 2024.
[3] Quarterly Bulletin – QB2, Central Bank of Ireland, June 2024.
[4] Summer Economic Statement, Government of Ireland, July 2024.
[5] The value of the Escrow Account stood at €14.1bn as of 9th September 2024 (after third country adjustments of almost €500m).

R&D tax credit, they represent less than 10% of the total cost of the scheme. As a proportion of the total SME firm base the number of firms accessing the credit is low. Changes to the structure of the R&D Tax Credit could help address these issues, while the introduction of a separate – but similar – innovation-based incentive could help drive adoption rates of advanced technologies by smaller firms (**ICC Recommendation 5.1**). An increased innovation capacity in the SME sector will also better enable these firms to compete in international export markets.

These changes include the introduction of a pre-approval mechanism to remove some of the uncertainty faced by SMEs in availing of the Credit, and an adjustment to the limits on outsourcing of expenditure, to assist SMEs who lack the in-house expertise required to carry out qualifying R&D. Incentives which expedite the twin transition can help firms to compete more effectively and reduce operation costs.

Figure 1: R&D Tax Credit by firm size, number of claimants and cost to Exchequer, 2012-2022



Source: Authors (based on data from the Revenue Commissioners)

Figure 2: Number of Enterprises and % Exporting in Selected Sectors 2022

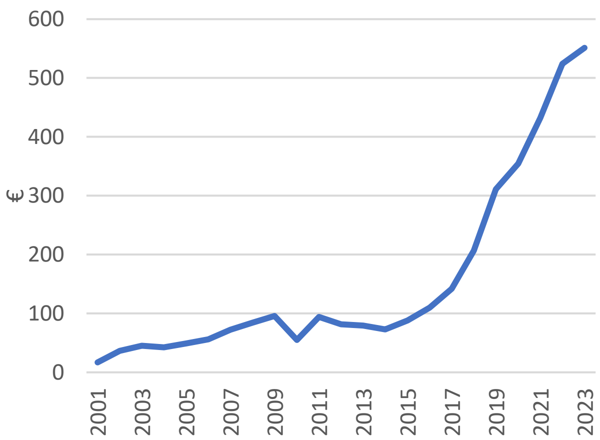
Source: NCPC Calculations from CSO Data[6]

Note: Retail refers to Wholsale, Retail Trade and Repair of Motor Vehicles and Motorcycles

LIFELONG LEARNING: UNLOCKING THE NATIONAL TRAINING FUND

Meeting current and future skills needs, especially in the context of the green and digital transitions, will be crucial for sustainable economic growth. With an economy effectively at full employment, there are capacity restraints that limit the country's ability to expand output, particularly in infrastructure. This is a key competitiveness concern. Effective matching of skills and lifelong learning can help ease these constraints.

Figure 3: National Training Fund Surplus Per Person at Work, 2001 -2023



Source: Revised Estimates Volume, DPER

[6] Note the data number of enterprises is from 2021

Skills mismatches and the need for more lifelong learning have been recognised as issues in the Irish labour market. The Annual Education Survey (AES) results show that 55% of adults in Ireland participated in lifelong learning in 2022. This is well below the 64.2% target set out under the European Pillar of Social Rights Action Plan. Participation rates for older cohorts and the unemployed are lower still.

The National Training Fund (NTF) has a key part to play in this, particularly in the context of the growing surplus in the fund (over €1.5bn). The NTF surplus could be deployed to fund training programmes that directly assist in meeting current and future skills needs (**ICC Recommendation 4.3**), particularly in the areas of construction – for example, helping to drive uptake of modern methods of construction – and the digital and green transitions. In addition, reforms to the Fund to better foster lifelong learning in the workplace could follow recommendations set out in the OECD's review of Ireland's National Skills Strategy.

PLANNING AND REGULATION

Infrastructure has been a persistent drag on Ireland's competitiveness, evident in the low ranking in this area over the last decade of IMD World Competitiveness Rankings[7]. Although not the sole impediment to delivery, planning is a very significant bottleneck, particularly as it relates to the delivery of new housing and the completion of major national strategic projects. These delays incur direct costs to the infrastructure provider, through increased finance risk and increased input costs, while indirect costs are borne by wider society, which suffers at large from delayed delivery.

Reform our planning and regulatory system is critical to increasing the effectiveness of capital expenditure and addressing infrastructure deficits. The adequate resourcing of public bodies responsible for the regulation of economic activity will also be necessary to improve the effectiveness of expenditure while also minimising delays.

Analysis undertaken by the Department of Finance (April 2024) has found that the time elapsed between the granting of permission and commencement of construction for a housing development has been increasing over recent years. Among the factors underpinning this change are a preponderance of planning appeals and judicial reviews. Once enacted, it is fundamental that the Planning and Development Bill is implemented speedily (**ICC Recommendation 6.2**) and that the establishment of the new Planning and Environment Court proceeds without delay.

The NCPC reports to An Taoiseach and the Government, through the Minister for Enterprise, Trade and Employment, on the key competitiveness and productivity issues facing the Irish economy and makes recommendations to Government on how best to address these issues. The latest NCPC publications can be found at: www.competitiveness.ie.

This Bulletin has been issued by the Chair, Dr. Frances Ruane, and was prepared by Dr. Dermot Coates, Rory Mulholland, Dr. Keith Fitzgerald, Jordan O'Donoghue and Erika Valiukaite in the NCPC Secretariat.

[7] Ireland - IMD business school for management and leadership courses

APPENDIX: RELEVANT RECOMMENDATIONS

Below are listed the specific recommendations in ICC 2024 that are relevant to Budget 2025.

Recommendation 1.2:
The Council recommends that in the assessment by the local government sector of new planning applications in respect of commercial property developments, careful consideration be given to vacancy rates in the commercial property sector, the labour input required to complete these developments, and the excess demand for residential property.

Responsibility: Department of Housing, Local Government and Heritage

Recommendation 2.1:
In the context of the forthcoming Single Market Strategy in 2025, the Council recommends that Ireland continues to advocate strongly for an approach to EU competitiveness that emphasises further integration of the Single Market, the maintenance of the level playing field, the importance of reduced regulatory and administration burden to enhanced EU competitiveness, and an open approach to trade and investment coupled with a commitment to working with like-minded international partners.

Responsibility: Department of Foreign Affairs; Department of Enterprise, Trade and Employment; Department of the Taoiseach

Recommendation 2.2:
The Council recommends that:

(i) Ireland continues to advocate for further progress on the achievement of a Capital Markets Union in the EU. In particular Ireland should seek for progress to be made on an EU long-term saving product, and in expanding the availability of equity and venture capital financing options, for start-ups, high-growth firms, and more broadly those firms seeking to scale-up activity.
(ii) Government progress the implementation of the recommendations in the Department of Enterprise, Trade and Employment's report on using finance as a catalyst to develop a scaling ecosystem.

Responsibility: Department of Foreign Affairs, Department of Finance, Department of Enterprise, Trade and Employment

Recommendation 2.3:
In light of previous recommendations made by the Council, Ireland should continue to actively pursue domestic policies which will enable it to compete globally into the future (whether that be a high or low subsidy international environment).

Responsibility: Department of Enterprise, Trade and Employment

Recommendation 3.1:
In order to improve the regulatory environment, the Council recommends that:

(i) The enhanced SME test be implemented swiftly, applied on a 'Think Small First' principle, and that it be embedded in a comprehensive streamlined framework that carries out ex ante evaluations to inform decision making and ex post evaluations to draw learnings, and;
(ii) With reference to the application of the SME test, Government should publish annually a consolidated summary of forthcoming measures likely to impact the SME sector over the following 12-months
(iii) Government Departments streamline, where practicable, existing regulations with a view to improving the business regulatory environment without compromising consumer and employee rights.
(iv) Government should consider establishing a central oversight body to perform core oversight functions, such as reviewing the quality of RIA (and of other regulatory management tools) in order to monitor and assess the quality of RIA implementation more effectively.

Responsibility: Department of Enterprise, Trade and Employment; Department of the Taoiseach; Department of Public Expenditure, NDP Delivery and Reform

Recommendation 3.2:
The Council recommends that the Government focus on ensuring that the necessary and fundamental conditions for firms to compete are fair and adequate, and that one-off broad supports are considered only as a last recourse in Government intervention and be phased out within a defined (and short) time.

Responsibility: Department of Enterprise; Trade and Employment; Department of Social Protection; Department of Finance

Recommendation 4.3:
To build and retain a skilled labour force, the Council recommends the Government should:

(i) Reform the National Training Fund (NTF) to better foster lifelong learning in workplaces in line with the recommendations outlined in the OECD's review of Ireland's National Skills Strategy; and,
(ii) Ensure that the NTF surplus is deployed to deliver training programmes that directly assist in meeting current and future skills needs, particularly in relation to the skills needed for the digital and green transitions, and for the adoption of emerging technologies (including AI).

Responsibility: Department of Further and Higher Education, Research, Innovation and Science; Department of Public Expenditure, NDP Delivery and Reform; Department of Enterprise, Trade and Employment

Recommendation 5.1:
The Council recommends that ambitious action be undertaken to support the take-up of advanced technologies – including AI – by enterprise, particularly by SMEs. This should include:

(i) The introduction of an investment incentive, particularly for SMEs, to operate alongside the R&D Tax Credit, that could be availed of to support advancement in the form of new-to-firm investments, including those related to digitalisation and the take-up of advanced technologies.
(ii) Amendments to the outsourcing limits, and the maximum limit allowable under the Science Test, in order to incentivise collaboration and drive take-up of the R&D Tax Credit, by SMEs in particular;
(iii) The introduction of a pre-approval mechanism for SMEs when engaging with the R&D Tax Credit, to minimise uncertainty – particularly regarding the eligibility of projects involving emerging technologies – and to streamline the application process.

Responsibility: Department of Finance; Department of Further and Higher Education, Research, Innovation and Science; Department of Enterprise, Trade and Employment

Recommendation 6.2:
The Council considers that reforms to the planning system are fundamental to address issues relating to the delivery of infrastructure. As part of these reforms, the Council recommends:

(i) That the Planning and Development Bill 2023, once enacted, is speedily implemented;
(ii) That priority is given to addressing the exceptional data deficiencies in the planning permission data and housing commencement data, such as through the action proposed in Housing for All to improve the quality of Building Control and Management System (BCMS) data; and,
(iii) That the work of the new Planning and Environment division of the High Court is kept under constant review to ensure that sufficient resources have been allocated to address the backlog of existing cases and clear incoming cases within a defined period, and that relevant training is provided. It is further recommended that a strong data collection system is put in place from the outset, in the context of overall improvement in data systems related to legal and justice issues so that policymakers can continue to monitor progress. Responsibility: Department of Housing, Local Government and Heritage, Court Services

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