

2nd NATIONAL MANUFACTURING CONFERENCE

Introductory Paper

UNIT COSTS

by

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UNIT COSTS – INTRODUCTORY PAPER

The possibility of growth in the Irish economy over the next few years has improved substantially over the last year. This is due to a number of factors – (a) the recovery of the major industrial economies from the recession and the subsequent increase in international trade and (b) a reduction in cost increase pressures to which the recent ratified national pay agreement has contributed. As a result of both these trends, the level of confidence in business has improved and has led to a substantially higher level of investment. Growth in Ireland has to be led by the productive sector, particularly the manufacturing sector as agriculture is faced by many structural problems which limit its ability to expand. The potential of industry to provide the basis for closing the gap in living standards between Ireland and the EEC and for providing full employment, will be judged by its performance over the next few years.

One of the main causes of the substantial decline in manufacturing employment during the recession was the inability of industry to achieve productivity increases large enough to absorb the increases in labour costs. The net fall out in employment totalled 20,000 between the beginning of 1974 and the beginning of 1976. When one takes into account that job creation was about 10,000 per annum during those two years, the implication is that nearly 20% of manufacturing jobs existing prior to the recession were lost during 1974 and 1975. While it is not possible to provide data on the absolute level of competitiveness between Ireland and her trading partners, the huge fall out of employment is ample evidence that costs in Ireland increased at a rate in excess of industry's ability to absorb them and still compete successfully on international markets. Chart 1 shows the increase in unit wage costs for a number of countries since 1970. Only Italy has a higher increase than Ireland. Even when these figures are adjusted for changes in exchange rates, there is still a significant gap between Ireland and most other European countries. The effect of this is to lessen our ability to compete on both the home and international markets.

However, the outlook with regard to labour costs in 1977 is much more promising. The recently ratified national pay agreement, when combined with the increases in social welfare contributions, is estimated to increase labour costs in Ireland during 1977 at a similar rate to that estimated for Britain. As a result, it is unlikely that Irish industry's

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competitive position will deteriorate further this year and if industry here can achieve a higher rate of productivity growth than the UK, some relative improvement in unit costs should occur. This could provide the basis for substantial growth.

However, while the cost position of industry on average will not deteriorate relative to the UK, the same cannot be said for all sectors of industry. Certain low-wage labour intensive sectors of industry will be faced by higher than average labour cost increases in 1977 due to the structure of both the wage increases in the national pay agreement and the social security tax increases. These are the sectors which were worst hit by the recession and indeed recovery has still not occurred in many of them. Also because of the labour intensive nature of these sectors, it is more difficult to achieve the necessary productivity growth. The outlook for many firms in these sectors remains bleak.

Labour costs is only one area of manufacturing costs. It is the area of costs which is most directly affected by national policies. Its importance in maintaining competitiveness and hence employment has been recognised by the new national pay agreement.

The other area where Irish management can have a significant effect on unit cost control is the efficiency of the production process. Because national pay agreements set the increases in wage costs for the coming year, the wage bargaining process has been taken out of the hands of management by a centralised system. Management at the level of firm cannot influence this area of costs except in regard to productivity deals and bonuses. What is required from management nowadays is to make the most efficient use possible of the resources available to us. I feel that there is room for improvement here and later I mention four areas, some of which are dealt with in greater detail by the main contributors, which I believe could lead to larger increases in productivity.

We must accept that improvements in productivity are necessary in order to create employment. Improvements in productivity mean lower prices and more orders. On the other hand, if we do not choose this path and still retain the aspiration to maintain our living standards, the result will be greatly increased unemployment. The output per worker in the Irish economy was 21% below that in Britain and 47% below that in Denmark in 1971. (Chart 2) I am not suggesting that this means that we work less hard. There are many reasons for this low level of productivity, for example, inadequate equipment, low level of technology, resistance to change restrictive practices, inefficient management, inadequate specialisation and a relatively low average level of skill in the workforce.

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Since this country does not have access to the massive funds which would be required to raise our productivity levels through increased mechanisation the improvement must be achieved to a very large extent by making greater use of existing resources, of materials, labour, equipment and money.

The low level of productivity in Ireland is the main reason for the large gap in living standards which exists between Ireland and the more developed European countries. For example, in 1971 the output per head of population was 60% higher in Britain and 155% higher in Denmark. (Chart 3) The gap in living standards is even wider than the gap in productivity, due to the higher proportion of the population in the dependent categories in Ireland. The gap in productivity occurs in all three sectors of the economy. (Chart 4) The relative gap is widest in agriculture and least wide in industry. Output per worker in Irish industry is about the same level as in Britain and Italy, but falls far short of that in other EEC countries. The low level of productivity in agriculture and the wide gap between Ireland and other countries has a large effect on our overall level of productivity since we have a much greater proportion of the workforce employed in agriculture than other EEC countries. Assuming a 3% growth rate for Britain, the rate of growth in total national output needed over the next decade, if Ireland is to achieve equality of living standards with Britain, and provide adequate employment, would be about 11% per annum. This implies a rate of growth in productivity of about 8½% per annum and a rapid increase in employment towards the full employment level.

This indicates the task before us. On past performance it does not seem possible. Over the last fifteen years, output per worker increased by about 4% per annum. If we are to follow the path of the other developed economies in Western Europe, this growth in output and employment must be achieved by developing the industrial sector, which still accounts for less than 20% of total employment. The introduction of new foreign enterprise which tends to be capital intensive, has helped to raise productivity levels. However, the problem will not be solved until the overall level of productivity in existing Irish industry is raised substantially.

New foreign owned industry has made a major contribution to raising the average level of productivity in Ireland. One study has claimed that the gap in productivity between foreign and native firms is such as to lead to a dual economy in the manufacturing sector. This cannot be explained fully by higher capital intensity in these foreign firms.

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A new industry has got certain advantages because it starts with new equipment and can train its employees in modern methods without having to overcome established attitudes and procedures. However, part of the gap is accounted for by the use of different management techniques. Another study found that the management techniques employed by quoted Irish public companies were ahead of those employed by private foreign owned firms in Ireland, and did not lag far behind those of the public foreign owned enterprise.

Improvements in productivity are also a necessary element in keeping down the rate of inflation. Low rates of increase in productivity, relative to those in competing countries, can induce strong inflationary pressures, given the same rate of increase in wages. This results in a loss of competitiveness unless the exchange rate is adjusted.

I would now like to concentrate on four approaches to increasing productivity which I believe could yield beneficial results. (Chart 5)

1. Attitudes

At present, many of our labour intensive sectors are in danger of collapse because manufacturing costs have got out of line with international competition. Traditional practices and attitudes are preventing change. It is an understandable mistaken view that resistance to change preserves employment. It is more likely to ensure that the firm eventually closes down. On the other hand, significant improvements in productivity each year, enables firms to stay ahead of international competition, increase orders and increase employment. It is far better that the emphasis should be placed on ensuring that adequate marketing steps are taken so that improvements in productivity result in increased business, than to resist the continuing process of change which is an essential part of a dynamic industry. For every firm that adheres to traditional practices in the face of change, there are many others keeping up to date and, therefore, in a position to benefit from the competitive edge thereby obtained.

2. Management

This aspect of the subject will be dealt with in more detail in the first session by Mr Wahlberg. However, there are a few points of specific relevance to Ireland I should like to make. The study published in the Economic and Social Review, referred to previously, pointed to the emergence of a dual industrial economy. The main reasons for this dualism were differences in technology, both managerial and production. The

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cost of raising production technology tends to be high, since it usually requires an increased level of capital investment. The cost of raising managerial efficiency and the level of technical expertise, is not great. Many Irish managers have proved themselves as chief executives of foreign owned enterprises in this country and, also, abroad. However, we do need to increase the number of highly skilled managers. Good innovative management can achieve a great deal with a mediocre plant. It is most important that full use is made of the techniques of industrial engineering to ensure that the greatest possible level of efficiency is achieved from our existing resources.

In 1975, the IMI published a study which demonstrated that there was a close relationship between the use of modern management techniques and the financial performance of companies. The study indicated that there was not a wide divergence between the techniques employed by leading Irish companies and foreign companies. Further evidence of the capability of Irish industrial firms is the recent phenomenon of Irish public companies expanding their operations abroad. The greatest scope for improvement appears to lie in unquoted and family owned enterprises. The aim must be to bring the level of management of these companies up to the high standard already achieved by the leading firms. Use of industrial engineering techniques will ensure that goods are designed for ease of production, that work is organised to keep machines fully loaded, that the minimum amount of time is spent in handling materials, that the yield from materials is improved, and that operators are trained to a high level of skill and performance.

3. Labour

This subject will be given more comprehensive treatment in Session III by Mr Walsh. however I would like to concentrate for a few moments on the development of skill. The development of a higher level of technological education in the Regional Technical Colleges and the wide expansion of AnCO's activity in direct training centres have been welcome developments in recent years. We are still in the process of developing industrial skills. As yet we do not have a large number of people with experience in the common industrial skills. These skills are vital for efficient production. I emphasise again that less than 20% of the total workforce is employed in industry, compared with over one third in the rest of the EEC. The Confederation sees as a welcome development the growth in the throughput of the direct training centres to 5,500 adults in 1975 and the plans to expand this to an annual rate of over 11,000 by 1980. These figures give some idea of the efforts which are being made to provide the number and variety of skills needed to raise the level of productivity in the Irish economy. We

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would strongly urge that continuing efforts are made to match the supply of the different skill categories with potential demand.

It is also worth noting that the desire to acquire industrial skills is developing in the Irish labour force. In the year to March 1975, there were over 11,000 applicants for the 5,500 places which AnCO had at its disposal. This 11,000 represents 1% of the total workforce in the country, and 5% of the manufacturing labour force. To have this quantity of newly trained, or retained workers each year could rapidly transform the industrial scene, if the demand for our products could be expanded and employment opportunities thereby provided.

4. Investment

Increased investment is the most obvious way of increasing productivity. Mr Walne in Session II deals in depth with the effects of changing technology. In Ireland the possibilities of achieving growth through this process are limited because of the scarcity of resources available for investment in industry. It costs more to provide a job by establishing a new enterprise than by expanding an existing one. For this reason, one of the prime aims of industrial development must be the maintenance of existing industry and the provision of incentives for re-equipment and adaptation to a higher level of productivity. This is the least expensive way to provide viable long term employment. Thus, when a higher level of productivity is achieved by making better use of existing resources, existing industry can be expected to be in a better position to justify further investment in new equipment in order to meet the expanded demand for its products.

Given the scarcity of capital, it is vital to use that which we have to its maximum efficiency if we are to reach high levels of productivity. In Ireland there is a great need for the more intensified use of productive capital. This requires that greater consideration should be given to the extension of shift work and personal incentive schemes. Shift work will ensure that machinery is used for a longer period. Does it make sense to have utilisation of expensive equipment for only one third of each day. The more extended use of material handling and work aids, in conjunction with personal incentive schemes, can increase the productivity of machinery.

There has been much discussion recently about the desirability of developing more labour intensive industry in Ireland. International competition determines whether

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labour intensive industries can be viable at our cost levels. I believe that the retention of labour intensive industries can be fully justified if the level of productivity matches international standards. For example, the clothing industry is not a capital intensive industry in any country. Nevertheless, Germany can still justify producing 40% of the clothing in the European Community, but the average productivity per head there is twice as high as that in Ireland, which produces only 1% of Community output.

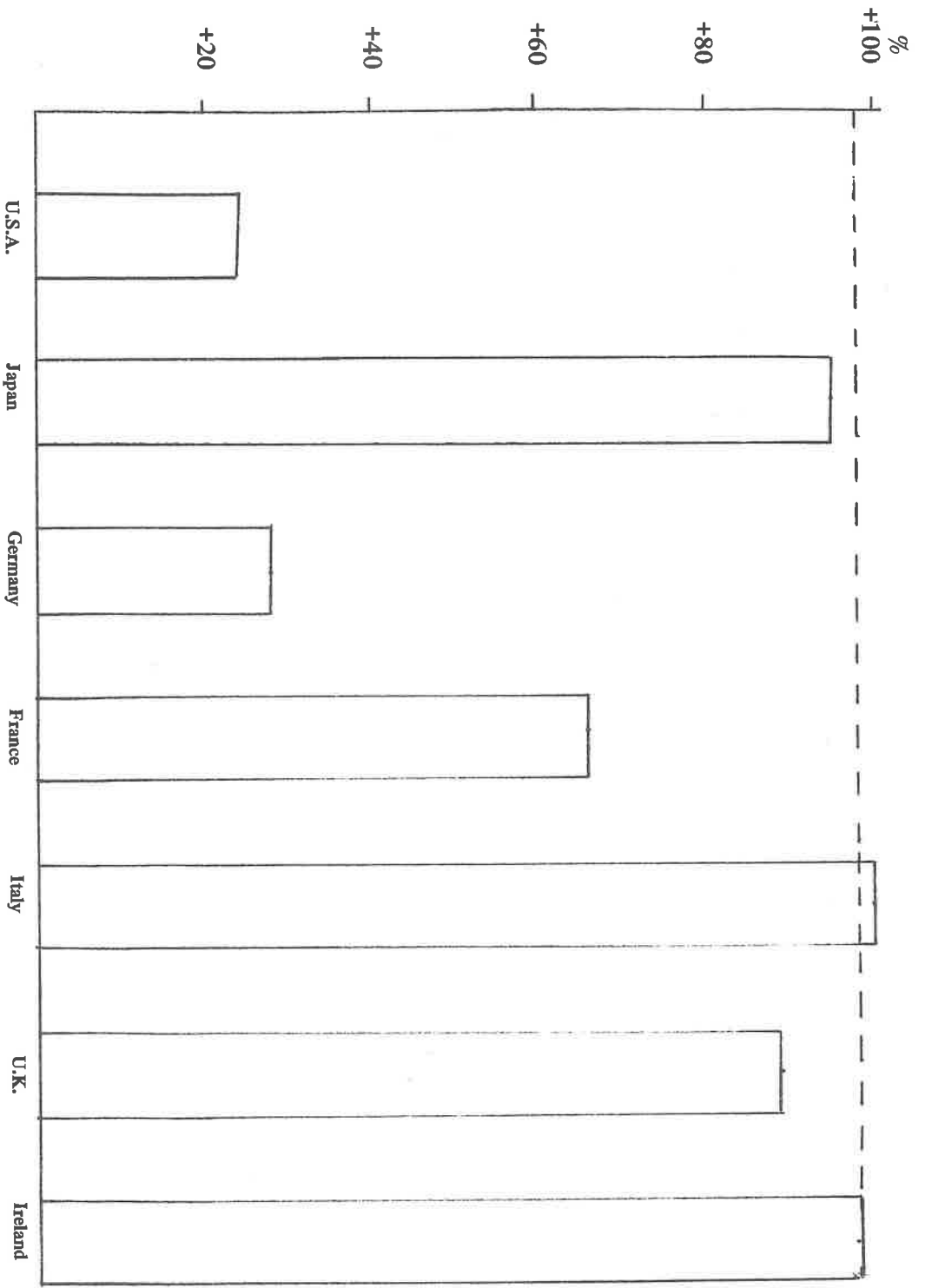
Conclusion

Improvements in productivity must not be confined solely to the industrial sector. The changes must be, at least, as rapid in agriculture and the services sector. Otherwise, even with tremendous effort by industry, additional costs due to slower improvements in productivity in other sectors, can reduce the rate of industrial development. In this aspect attention must also be given to cost increases in other sectors of the economy. It is a fallacy to believe that industry can escape the effect of these increased costs. It is clearly undesirable that sheltered sectors of the economy should be able to incur and pass on greater cost increases than the industrial sector which is open to the full force of international competition. Many instances of this occurred during the recent recession. Such a situation must not be repeated.

Higher productivity is not synonymous with large volume output. Small industries also have a vital complementary role to play in raising productivity levels throughout the economy. They are particularly suitable for manufacturing the short run, specialist products which cannot be produced efficiently by machinery designed for large batches. They provide valuable backup local services which ensure that larger units can operate efficiently. The productivity emphasis in smaller firms tends to be concentrated more on innovation, design, identification of local need, and adaptability of skills and machinery, than on trying to compete with larger firms in high volume production.

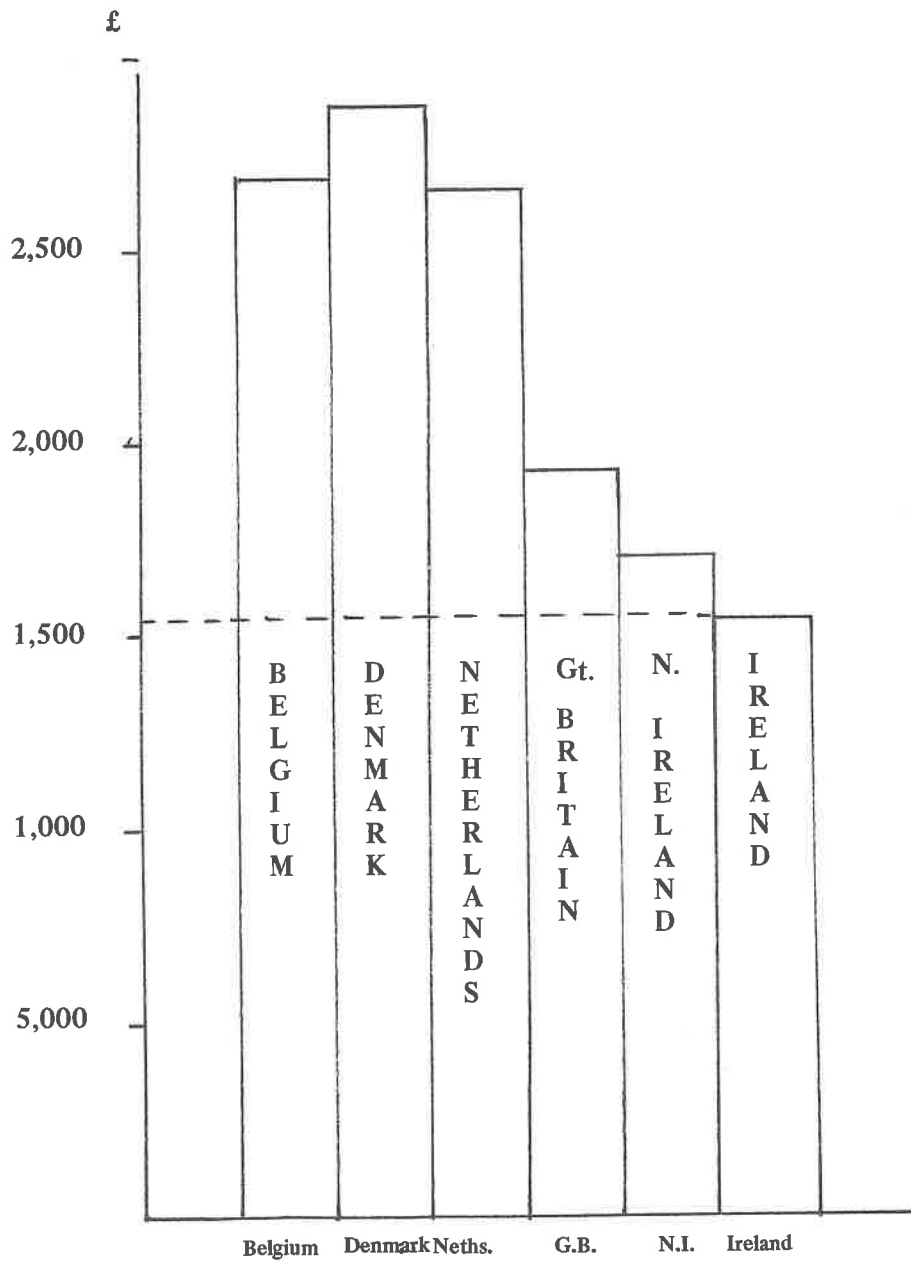
Equality of living standards with other European countries, combined with a much higher level of employment, will be a challenging target for Ireland to achieve over the next decade. We have disadvantages relating to a higher dependency ratio, high unemployment, and a shortage of capital for investment. We can overcome these obstacles by a sustained drive to raise productivity levels and ensure that this is combined with increased effort to sell our goods abroad. If we are successful in achieving productivity increases which will result in lower relative prices, that marketing effort is much more likely to be successful.

CHART 1. INCREASES IN UNIT WAGE COSTS - 1970/1975



Source: Economic Review and Outlook - July 1976

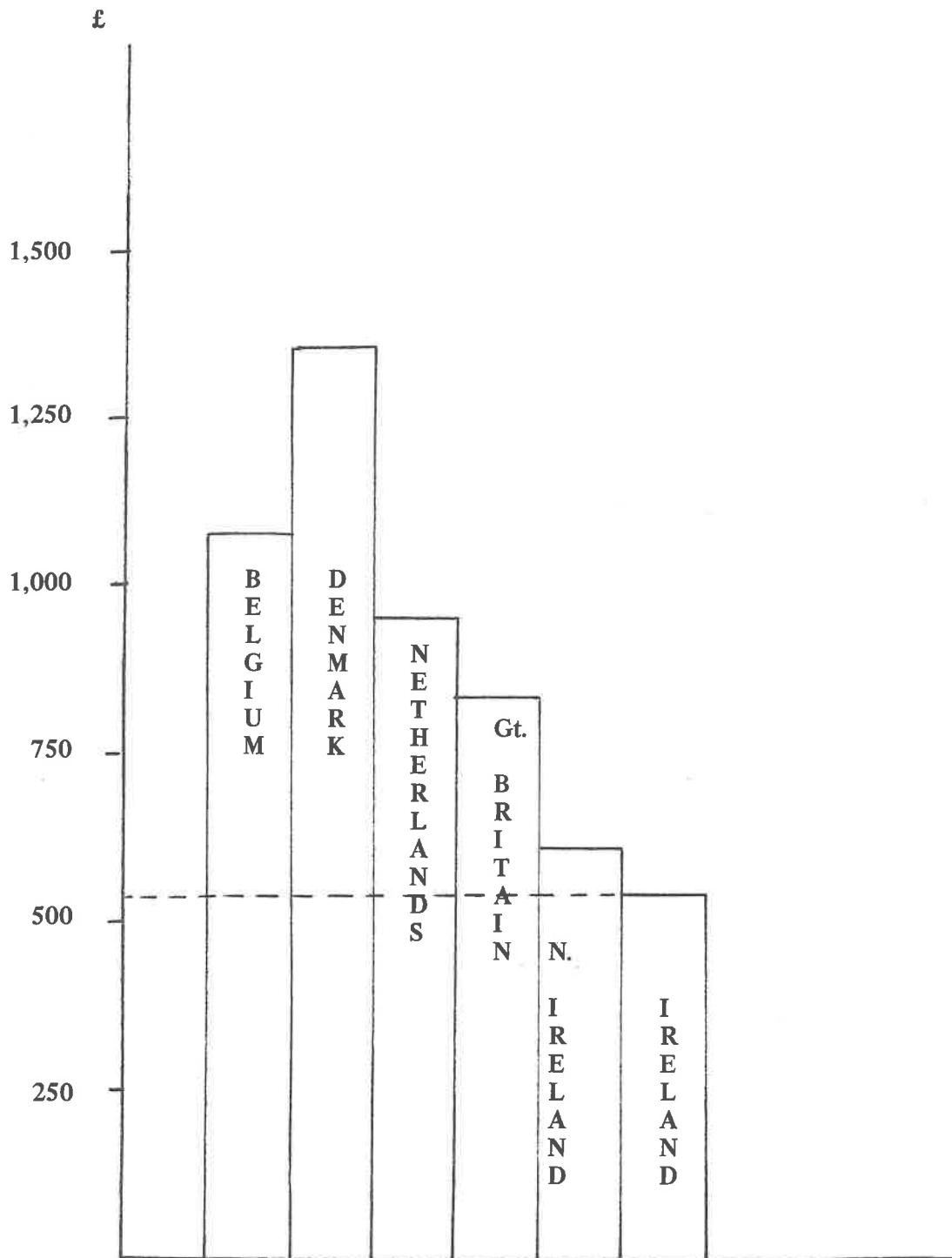
**CHART 2. PRODUCTIVITY 1971
INTERNATIONAL COMPARISON
(£ per person employed)**



Source: NESc Report No. 7
Jobs and Living Standards

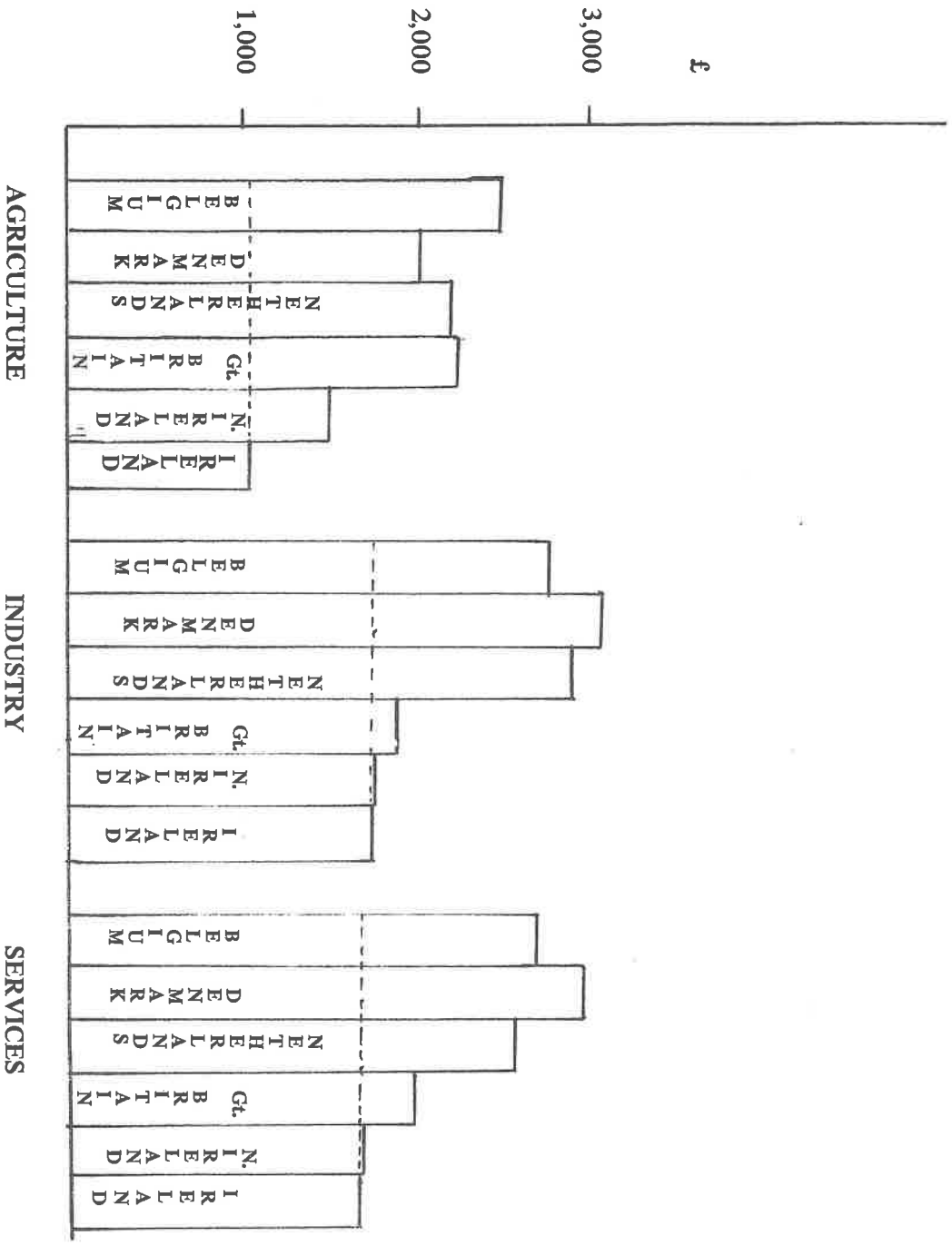
CHART 3. OUTPUT PER CAPITA 1971
– International Comparison

(£ per person)



Source: NESC Report No. 7
Jobs and Living Standards

CHART 4. PRODUCTIVITY BY SECTOR 1971
 International Comparison
 (£ per person employed)



Source: NESIC Report No. 7
 Jobs and Living Standards

