

TOWARDS A SOLUTION

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IRISH MANAGEMENT INSTITUTE 23RD NATIONAL CONFERENCE

at

GREAT SOUTHERN HOTEL, KILLARNEY

24 – 26 April 1975

Session 1 : Friday, April 25.

1. INTRODUCTION

Industry is now going through its most difficult time since the depression of the mid-50s. The increase in oil and raw material prices of twelve months ago combined to place a major strain on the Irish balance of payments and on that of all our major trading partners. Most economies initially reacted by attempting to depress home demand and expand exports. Since all countries had similar ideas, the result was a rapid decline in the rate of growth of world trade. The OECD economies gradually slipped towards recession, with falling production, high inflation and increased unemployment.

Industrial output in Ireland declined steadily from March 1974 onwards, with the result that now production has fallen to the level of two years ago, and unemployment in manufacturing has, probably now dropped to the 1969 level. Unemployment is 103,000, and when seasonally corrected, is still rising. The inflation rate had reached 23.8% by mid-February. Cash flow in industry has steadily become tighter, due to the combination of higher working capital requirements and low market demand, with the result that production has had to be cut back in line with the cash available.

The cash problems of industry were further aggravated by the ten per cent wage payments due as a result of the escalator clause of the Third National Wage Agreement. The Fourth Agreement which is also related to the Consumer Price Index will place an additional strain on company liquidity.

There is some evidence from the most recent CII/ESRI survey that the decline in production now appears to have levelled out, and that output is expected to remain stable in the coming months. At best, we can expect employment in industry to be maintained at its current level during 1975. This means that the seasonally adjusted level of unemployment will continue to grow as the labour force expands.

2. PROBLEM AREAS

2.1 Population and Employment Projections

The NESC Report No. 5 on Population and Employment Projections 1971–1986, stated that the net number of new non-farm jobs required annually from 1971 to 1986 was 20,000. This assumes an unemployment rate of 4% in 1986. Since this country already has 44% of its working population in service industries, compared with 46% in the EEC as a whole, it is clear that, unless our development pattern is significantly different from that in the rest of the EEC, the great majority of these net new jobs must be provided in the manufacturing sector. Despite tremendous efforts by the Industrial Development Authority, employment in manufacturing industry is now no higher than that in 1969. Even before the present recession, the average net new job creation in manufacturing industry in the five-year period from 1969 to 1974 was just over 2,000 per annum. It is obvious that existing policies will not achieve 20,000 net new jobs per annum and that either emigration or unemployment must increase by this amount.

2.2 Cash Flow Requirements

In November 1974, the Confederation estimated that the cash flow required by manufacturing industry, in order to hold employment during 1974, was £312 million. It now appears that actual cash flow probably fell short of this figure by about £30 million to £280 million, with the consequential reduction in employment. This cash flow, which was the sum of depreciation, profit after tax, loans and grants, was required in order to finance the increased burden of working capital and the replacement and purchase of new equipment.

On the other hand, the cash flow required from all sources to support 20,000 net new jobs per annum in 1975 money terms would, probably, be close to £700 million. Ideally, about half of this money should come from retained earnings. Capital grants can substitute, in part, for retained earnings, but even if full use were made of allocations by the IDA and current European funds, these

would be unlikely to exceed £55 million during 1975.

2.3 Inflation

We are firmly caught in an inflationary spiral and recent trends are very disquieting for the future. Inflation increases the costs of industry and also its financing requirements. When our inflation rate exceeds that of our major trading partners, as it has done consistently since 1969, the competitiveness of our manufactured products declines. It is worth noting that almost three of the eight percentage points rise in the Consumer Price Index, between November and February, were caused by increases in indirect taxation. This, in turn, added to the level of wage increases which had to be paid by the manufacturing sector under the escalator clause. Fuel costs in industry were allowed to increase faster here than in Britain. In the middle of a depression and a wage agreement negotiation, the Government decided to increase the social welfare contributions from both industry and employees. The Green Pound adjustments of the last six months, while producing additional revenue to the country, increased the Consumer Price Index, and therefore wages, still further. The combination of these actions has helped to increase our inflation rate faster than that of our trading partners.

The service overheads, which have to be carried by a productive sector subject to the forces of international competition, are increasing annually. When unemployment in manufacturing increases, these overheads grow even faster. The consequence of an increasing public and private sector service overhead is demonstrated by the more rapid rise of the Consumer Price Index over the Wholesale Price Index, (which reflects manufacturing prices) in recent years.

Price control on manufactured goods can no longer have a significant impact on moderating the rate of inflation. Since manufactured goods are now open to the forces of international competition this is the factor, and not the degree of cost increases, which determines the maximum prices which can be obtained for most transportable goods. Modified Government guidelines, which recognise the cash flow requirements and the negative real profits of most Irish industry, can,

however contribute to the survival of the limited number of firms which, for one reason or another, are not subject to the full force of international competition.

2.4 Competitiveness

There are many indicators that the competitiveness of Irish products has fallen since 1970. Approximately, 25,000 net new jobs were actually introduced from abroad by the IDA during this period. However, employment in manufacturing industry increased by about 7,000 during the period between 1970 and mid-1974, indicating that employment in existing firms dropped by 18,000, or, approximately, 3,500 per annum.

We may rationalise this as restructuring and an inevitable shakeout. These are euphemisms for the disease of falling competitiveness. The process of adapting to tariff barriers, which were falling by four percentage points per annum, was compounded by an Irish rate of cost inflation which has averaged a percentage point above the annual rate in our neighbouring island for the last seven years.

The textiles, clothing and footwear industries, which are relatively labour intensive, provide the starkest example of the consequences. Since 1969, employment in these sectors has dropped from 50,000 to less than 40,000 and this, despite the introduction of many new firms from abroad. Imports from Britain and the rest of the EEC have increased faster than our exports abroad. The rate of employment decline has accelerated during the last twelve months to about 6,000, and taken in conjunction with the faster growth of imports, and the decline in the share of the home market held by Irish firms provides a clear indication of our decreased competitiveness. Not only will these sectors be unable to meet the cost of equal pay and survive, many of them cannot afford even the terms of Clause 3 of the proposed National Wage Agreement. The issue at stake is a major one – it is the survival of a segment of Irish industry, employing 21% of all manufacturing employees. The result of rapid inflation, of which 50% is now within our control, are being demonstrated in this and other labour intensive sectors, such as furniture, paper and printing. The same process is, also, in train, though less obviously, in other sectors.

Further examples of our falling competitiveness are shown by the decline of Irish products as a proportion of British manufactured imports, and the increase in the proportion of the Irish market taken by competing imports, which has increased from 18% in 1969 to about 30% today. These competing imports come, primarily, not from low cost countries, but from our partners in the European Community. The loss in competitiveness will remain even when there is an economic upturn. The recession has merely served to highlight the underlying cause. Furthermore, we have the two 20% tariff cuts against the old EEC and Third Countries, and a final 4% reduction against imports from Britain, still to come.

2.5 Potential Abuses of Free Trade

The free movement of goods is one of the cardinal freedoms of the Treaty of Rome. It does, however, raise the issue of fair competition. It will always be very difficult to prove that dumping takes place from Britain, with whom we now have a Free Trade Area, or from other Member States of the EEC. We are concerned that some large companies from the industrial regions of the Community will be tempted to use their power in a small economy, either to offload production during a recession, or as part of a planned market strategy. We believe this problem requires very close surveillance. Otherwise, there will be a tendency to pull economic power towards the major industrialised centres which would negate any attempts at European regional development. We consider that this issue should be urgently examined by the Regional and Competition Commissioners in Brussels. It may be necessary to impose orderly marketing constraints on major companies which sell to the developing regions of the Community.

3. TOWARDS A SOLUTION

3.1 Moderate the Rate of Inflation

It is obvious that a reduction in the Irish rate of inflation to a rate below that of Britain is a primary requirement. Falling employment in the productive sector increases current public expenditure on unemployment benefits and therefore the overheads which have to be carried by a diminishing productive base. This increases production costs and, thereby, contributes to a higher rate of inflation. It should be pointed out that 75% of the increase in unemployment, which occurred in the last twelve months, has come from the 31% of the workforce engaged in industry. The increase in unemployment in the services sector, and particularly the Public Service, has been much less dramatic.

Since the Fourth National Wage Agreement is directly related to the Consumer Price Index it is essential to control the rate of growth in the Consumer Price Index. Payments can be 8%, 4%, 4%, 4% at quarterly intervals, or 8%, 5%, 5%, 8%, depending on the behaviour of the Index. Could a selective downward adjustment in indirect taxation be combined with a cost reduction programme in current public expenditure? Indirect taxation cuts, even if compensated for partially by borrowing, would make some contribution to slowing the growth in the Consumer Price Index. We have little choice but to redress the imbalance between the services sector of the economy and the manufacturing sector, in order to give manufacturing industry some hope of restoring competitiveness.

3.2 Maximise Growth from Within

Industries from abroad have made a major contribution to the development of our economy during the last ten years. They have become an integral part of industry in Ireland and now comprise about one-third of all manufacturing.

We should now place a greater emphasis on the development of existing industry, while continuing to supplement its growth with additional firms from

abroad. Achievement of growth from within our present structure has many advantages. Firms grow naturally within their communities. The development is gradual and the whole community can adapt its educational and training requirements and infrastructure accordingly. The impact of growing, successful industries would have a major psychological effect on the dynamism of the whole economy.

There is a need for a clear Government policy to accelerate the process of transferring funds towards investment in industry at a rate which will make possible the attainment of full employment. Unless we can succeed in speeding up the rate of investment in industry now, the current recession will slow down the underlying growth for the rest of the decade. Since industry is now operating with, at least, 15% slack capacity, some additional incentives are necessary to stimulate investment by existing industry at this time. Even a return to working at full existing capacity would be unlikely to require a manufacturing labour force greater than that of March 1974 – and this may take 2 to 3 years. The following measures should assist the growth of existing industry, and also, increase the proportion of national output which is allocated to productive investment:

- i. Exempt manufacturing industry from company taxation for a 5-year period.*

There is no longer any logic in retaining the differential between exports profits tax and the tax paid by manufacturing firms, supplying the home market in free trade conditions. Trading conditions have changed completely since the present policies were devised in the early 60s. Tariff barriers have been removed. Competition is now as keen on the home market as on export markets. Profits tax relief has proved a major incentive in attracting foreign industry to Ireland. There is no reason to assume that it would not also stimulate the growth of investment by existing industry. This approach would, also, remove the anomaly, whereby firms which were major exporters before 1957 can no longer benefit from profits tax relief.

It would also increase the attractiveness of investment in manufacturing, compared with services. There are now many more Irish people with an

industrial background capable of starting companies themselves.

The cost of this profits tax relief proposal would be recovered quickly through lower unemployment payments, and the direct and indirect taxes paid by an expanding industrial work force.

ii *Value Added Tax Anomalies.* The operation of the Value Added Tax system should be equitable and not favour one sector over another. At present the retail sector achieves a positive cash flow, since its sales are for cash and the payment of Value Added Tax occurs nine weeks later. On the other hand, the manufacturing sector must pay its Value Added Tax bills in advance of payment by the customer, since average credit is ten weeks. The retail sector therefore has a cash flow advantage of ten weeks over manufacturing. Furthermore, the anomaly in the legislation which makes it more attractive for retailers to purchase imported finished products, rather than Irish manufactured products, should be removed without delay.

iii *Grants to Industry.* The level of investment in industry is a function of the level of grant obtainable. This has been recognised in the differential grant scheme, between the designated and non-designated areas. We consider that the level of Capital Equipment grants should be increased from 25% to 35% in the non-designated areas, and from 35% to 50% in the designated areas. There should also be a flat level of grant at 50% for small industries which are labour intensive and provide the high job return per pound of investment. We have argued that these supplementary grants should be paid from the resources of the European Regional Fund. This would provide clear evidence that the Fund was being used to supplement national aids for productive development, and would be very much in keeping with the spirit of the Fund.

Every opportunity should be taken to maximise the degree of funding to industry from European sources. Priority must be given to investment in the productive sector. Direct grant approvals for Irish industry, last year, from

European funds amounted to about £4 million. This year, if industrial investment was given top priority, approvals could reach an additional £12 million – but achievement of this target would require a change of policy, particularly in relation to the Regional Fund.

- iv Export Credit.* The development of exports is, apparently, being hindered by inadequate cash flow. High levels of inflation further exacerbate the situation. For this reason, the existence of competitive export credit finance scheme is essential.

It is diequieting that, despite our formal submission to the Minister for Industry and Commerce last August, Irish exporters of capital goods have still not got a satisfactory export credit finance scheme. Machinery and transport exports now comprise 11% of total exports. These are the products which are required, both by the growing markets such as the OPEC countries and also by more developed economies. Irish exporters of capital goods must be able to offer credit facilities which are, at least competitive with those being offered by countries, such as Britain and France. Otherwise, our exporters are at a disadvantage.

It is also necessary to develop an export credit scheme for non-capital products. Many export orders for developing markets require a financing period in excess of six months, due to shipping and administrative delays. This places an exceptional strain, which cannot always be overcome, on the working capital of firms endeavouring to develop market growth.

3.3 Sowing the Seeds for Future Growth

Over 90% of the manufacturing units in the country have got less than 100 employees, and these firms account for about one-third of industrial output. This is the seedbed from which the large firms of the future can grow. They have many advantages in speed, service, innovation and adaptability. They can, efficiently, produce short-run, high quality products and services.

These firms can make a particularly important contribution to the development of the engineering sector. This sector, at present, provides employment for about 0% of our manufacturing labour force, compared with almost 50% in many European countries. We have a large reservoir of technologists and technicians, but very few of them set up their own businesses. This may often be because they are young marrieds, without cash. This does not mean that they are without ability or entrepreneurial skill. Could a number of these technologists be recruited, given the use of a workshop and a guaranteed salary for three years, at the end of which period they could either buy over the workshop, or return to normal salaried employment? The integrated workforce training programme of the Northern Ireland Industrial Training Board could also provide an interesting approach.

3.4 Survival of Vulnerable Sectors

The textiles, clothing and footwear industries are in serious difficulty. As a short term measure, the time has come for Government to take steps which will regulate the rapid growth of imports. This should, ideally, be combined with a selective stimulation of consumer demand for these products by a reduction in Value Added Tax.

These actions will provide a temporary respite. The, if we succeed in reducing our inflation rate below that in Britain, there should be a reasonable prospect for the survival of the sector. It is worth noting that even in the more developed economies of the EEC these industries still comprise about 15% of manufacturing employment. A relatively low cost economy should be able to remain competitive, but the rate of change must be more finely regulated. A 35% price/cost change in seven years has obviously proved too fast.

4. CONCLUSION

We have attempted to identify the magnitude of the industrial development task facing this country if it is ever to approach full employment objectives. We suggest that this task requires

- (a) *A reallocation of resources within the economy from the services sector and private consumption to manufacturing industry.*

The cash flow of industry, and the attractiveness of industrial investment can be improved by tax reliefs and additional grants.

- (b) *Improved competitiveness* which will ensure a greater volume of trading, and provide the main dynamic for expansion. As an immediate objective the Irish rate of inflation must be reduced below that of Britain. This would increase our exports and diminish the share of the home market taken by competing imports.

Unless we are prepared to adopt these targets there is little hope that the economy will ever be capable of providing the 20,000 net new jobs in manufacturing, which are required annually to meet the needs of a growing population. If the implications of this argument are not acceptable, then let us say so.