

Speech by Liam Connellan, Director General, Confederation of Irish Industry at Annual Conference of Chambers of Commerce of Ireland, The Old Ground Hotel, Ennis, Co. Clare, on Saturday, 30th April 1988 at 11.00a.m.

INDUSTRIAL INVESTMENT BEGINNING TO RECOVER
WILL LEAD TO REDUCTION IN UNEMPLOYMENT

- * Competitive input costs preferred to grants
- * International competition in industrial incentives
- * Irish industry wants to compete on level playing field within European Community
- * Must prepare for Single European Market more rapidly than others
- * Investment beginning to recover

Last year the annual rate of industrial investment was about 15% below the level attained in 1979. Investment in manufacturing industry hit its lowest point in 1983 when it fell to 25% below the 1979 level and since then had shown a modest recovery. However, it has picked up markedly since mid-1987, and current indications are that 1988 may show the highest rate of investment in industrial equipment of any year since the beginning of this decade.

Investment cannot be looked at in isolation since it reflects the level of business confidence, the competitive conditions in which industry operates which determines profitability, and the international outlook.

The most important factor impacting on business confidence has been the emergence of a national consensus that progress had to be made in halting the upward spiral

of Government debt, and the subsequent action taken by Government. Significant progress is now being made in tackling the very high level of Exchequer borrowing, which has helped to stabilise the exchange rate and substantially reduce bank interest and mortgage rates.

While some economists had expressed concern that a reduction in Exchequer borrowing would send the economy into a tailspin, the reverse has proved to be the case.

Last year Exchequer borrowing was reduced by 3% of national output and the economy grew by more than 3%, the best growth rate since 1978. It seems likely that employment which had been falling steadily for a number of years has now stabilised, and there is a prospect of modest improvement for the first time this decade.

The process of reducing public borrowing has increased confidence, and contributed to a faster rate of economic growth. This experience was not unique. During the period from 1982 to 1986 when public sector borrowing was being reduced in Denmark by 2% of GNP per annum, the Danish economy had maintained a steady rate of expansion.

Investment in the economy is influenced by three main factors :

1. Business confidence;

2. The competitive conditions in which industry operates; and
3. The international outlook.

(a) **Business Confidence**

There are grounds for cautious optimism. Business confidence is determined in large measure by each firm's capacity to win orders in open competition. At present, orders on the books of Irish industry are at a healthy level, and should ensure continued expansion in the coming months. Export performance over the last year has been very strong. Exports expanded in volume by 14% in 1987, and should increase by a further 12% this year. Most of Irish industrial output is now exported with the result that total industrial output, which grew by almost 11% last year, is likely to grow by a further 9% this year. This sharp expansion in output has enabled firms to increase their utilisation of machinery and many factories are now operating close to full capacity. As industry comes up against capacity constraints firms invest more in equipment which will enable them to increase output, and consequently the demand for service and sub-contracting activities throughout the economy.

(b) **Competitive Costs**

The second major influence on investment is competitive cost conditions. Significant progress has been made in improving the cost competitiveness of the economy, but much more needs to be done. Ireland is not a low wage

economy. In fact, average industrial earnings in Ireland in 1986 were slightly higher than in Britain and Spain and significantly higher than in Greece and Portugal.

The fall in Irish inflation to 1.9% - well below the European average, and the consequential reduction in cost increases should enable Irish industry to recover some of the competitive losses of recent years.

Three years ago Irish interest rates were much higher than in competing countries but now the three month inter bank rate at about 8% is within 2% of the European average. It is essential that strong pressure is exerted to bring Irish interest rates down by a further two percentage points in order to remove excess cost on the economy. This will require continued attention to reducing Exchequer borrowing.

Electricity costs, which four years ago had been 25% higher than the European average, are now broadly in line. Irish insurance costs continue to be much higher than in other European countries due to an archaic legal system; lack of professionally worked-out actuarial assessment of damages in personal injury claims; and inadequate attention to safety audits as a means for accident prevention.

Transport costs for Irish industry remain exceptionally high. I estimate that transport costs amount to 9% of total product sales for Irish industry and cost industry £1,000 million per annum. The main culprit is the poor quality of our strategic road network which means that more vehicles have to be used for a longer time to transport goods than in other European countries. Road freight costs can be reduced by £300 million per annum by upgrading our national primary routes to European standards. But it must also be recognised that there are other costs which add to inflation and reduce the competitiveness of the economy.

The rate of inflation in Ireland, and therefore business costs will be significantly reduced through the process of creating the Single European Market. This means that commercial borders between member states will be eliminated and indirect taxes harmonised. The harmonisation of indirect taxes can reduce inflation by a total of three percentage points between now and 1992 and the EEC Report on "The cost of non-Europe" (the Cecchini Report) estimates that the level of prices in Europe will be reduced by a further 6% over a five year period due to the economies of scale and lower administrative costs arising from the creation of a large single market in the Community. This will make European industry and therefore Irish industry more competitive.

Taken together, the cost reductions arising from completion of the Internal Market; reduced industrial input costs arising from eliminating inefficiencies in our transport system; lower insurance costs; and lower interest charges should mean that with determination and effort the competitiveness of industry in Ireland can be sharply improved by 1992, and that this process will continue for at least a further five years as the benefits of the single market percolates throughout the European Community.

(c) The International Outlook

The third major influence on investment is the international business outlook. The impact of the American deficit, the stock market crash, and wide swings in major international currencies has created conditions of increased uncertainty for industry. However, Ireland's main market is the European Community in which more than 70% of Irish industrial products are sold. Ireland is a small specialist producer in a very large market supplying only 1% of total European industrial demand, although a much higher proportion in some sectors such as beef, milk, computers and pharmaceuticals. Small scale has the advantage of flexibility. Even in a period of slow international growth Irish industry has a greater possibility of adapting its product strategy in order to

maintain a strong positive rate of growth.

Industrial Investment Incentives

It is frequently alleged that Irish industry is too dependent on State grants. The reality is quite different. A survey conducted by the Confederation some months ago showed that the great majority of firms would favour the elimination of grants if Irish input costs, such as interest rates, energy costs, telecommunications, postal and transport costs, were brought into line with international competitors. The message is clear. A competitive environment which rewards enterprise is preferred to State intervention.

But it must be recognised that other European countries which already have a highly efficient infrastructure, and competitive cost conditions also provide industrial incentives to promote more rapid expansion. The typical European member state spends up to 3% of GDP on industrial incentives to complement a competitive environment. We have little choice but to do likewise if new projects are not to be lured away to other parts of the Community, or if we wish to attract mobile international investment.

However, it is vitally important that such industrial incentives are not seen as a substitute for a

competitive environment as has frequently happened in the past. There is something unreal about statements by some official representatives that industrial firms are too dependent on grants while others bemoan the slow take of grants. Primary attention must be focused on ensuring that Irish industry has the opportunity to compete on a level playing field within the European Community.

Investment in Industry

The sharp rise in industrial output since mid-1986 has been followed by a recovery in investment in industrial machinery since mid-1987. While there is still a substantial surplus of advance factories scattered throughout the country in some areas there is now a shortage of advance factories. Further evidence of increasing demand for industrial buildings is provided by the survey earlier this month of the Society of Chartered Surveyors which showed that industrial rents are rising.

Investment and Jobs

The investment sequence is continuing to unfold. Improved competitiveness has led to more orders for industry. More orders have resulted in increased manufacturing output; more output requires more equipment, and greater investment creates the capacity for the further expansion of output. Expanding output creates demand for jobs not only in factories, but also for

services such as transport, sub-contracting, maintenance, insurance, electricity, telecommunications, etc. The expansion in output in 1987 has now led to a stabilisation of employment, and a fall in the level of unemployment since mid-1987.

However, the process of recovery is only beginning. There is still a long, long way to go but we are on the right road. There must be unremitting pressure to improve the competitiveness of firms operating in Ireland. Every inefficiency in the economy must be eliminated so as to reduce costs. Lower industrial input costs will lead to more orders for our factories, higher output and more jobs.

The creation of a Single European Market offers the opportunity for rapid growth - if we take up the challenge. It will place a high premium on efficiency. We must move rapidly, faster than other European countries to gain a competitive edge and increase our share of the European market. There must be a crash programme to bring the quality of our transport infrastructure fully up to European standards; to rapidly expand the teaching of modern Continental languages in our schools; to promote European economic integration in every conceivable way by harmonising our indirect taxes and eliminating inefficiencies. Our thinking must be geared

towards increasing the penetration of Irish products and services in the large single European "home" market which currently buys 70% of our industrial output. The way to stimulate more rapid growth of economic activity in Ireland is to create an economic environment which is not surpassed elsewhere. I have little doubt that this objective can be achieved.

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