

Speech by Liam Connellan, Director General, Confederation of Irish Industry, at Meeting of Dublin No.1. Rotary Club, at Jurys Hotel, Ballsbridge at 1 p.m. on Monday 7 January 1985

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PRIVATE INVESTMENT MUST BE ENCOURAGED AND REWARDED

INDUSTRIAL OUTPUT

Manufacturing industry has completed a second year of emergence from the 1979-82 recession. Output expanded by about 10% in 1984. The balance of payments deficit was about 5% of national output, indicating the extent to which we are still living beyond our means. Foreign borrowing increased by a similar amount.

The high growth in manufacturing output was made up of 17% increase in the volume of export, which now accounts for about 60% of output, and a 1% fall in demand on the home market, which accounts for the remaining 40% of output. It is surprising that the fall in home market demand was not greater in view of an estimated loss of 2% of sales to cross border shopping and the deflationary effect of the 1984 budget. Export growth was dominated by electronics and pharmaceutical firms, mainly comprising new overseas industries.

The output of established manufacturing firms expanded by only 1%, while the output of the electronics and chemical firms expanded by over 25%. Indigenous manufacturers account for about 60% of manufacturing employment and are characterised by exceptionally high borrowing and very low profitability. They have been caught in a price/cost squeeze over the last five years, when domestic costs rose much more rapidly than the prices at which products could be sold. The average Irish owned manufacturing company had a debt to net worth ratio of 59% in 1982, and earned a return on assets of only 4% at a time when investment in Government stocks yielded a return four times as high.

Greater investment in industrial equity would improve the financial structure of companies and their prospects for growth and employment creation. Many indigenous companies are being squeezed out of business because of high interest rates, the high cost of essential services, the differential in value added tax rates between here and Northern Ireland, poor motivation because of high personal taxation, all of which combine to depress the performance of many of these firms below their competitors in other countries.

#### NEED TO REDUCE STATE INVOLVEMENT

Over the last decade the Irish economy has become increasingly more dominated by the State. Public expenditure now accounts for two thirds of national output compared with 45% on average throughout the European Community. It has been demonstrated in all countries where the State becomes so dominant, that the underlying rate of economic development declines. Taxes are increased, risk taking is discouraged and the ability to respond to market pressure is blunted. Ireland now has a combination of the highest level of Government borrowing among the industrialised countries, a personal tax burden which has reduced the incentive to work, and a level of value added tax which has reached the point of diminishing returns on many products.

I believe that it is essential to reduce the involvement of the State in many activities, and at the same time to stimulate a more rapid growth in economic output and employment. We must look fundamentally at the role of the State in economic development. The State should adopt, primarily, a legislative, custodial, regulatory and catalytic role, and should be a provider of goods and services only as a last resort. It should act as a catalyst which enables investment to take place rather than be the sole investor as so often happens.

The blunt fact must be faced that the public sector overhead is so high that it is now stifling the expansion of industry. Public sector borrowing is crowding out the private sector, whether corporate or individual, and in the process is forcing the contraction and sometimes the closure of manufacturing firms. To quote only one example - the total cost to the manufacturing sector of the recent increase in interest rates will be about £20 million over a full year. This is equivalent to the working capital required to maintain about 2,000 people in manufacturing employment.

State borrowing must be reduced if the tax burden is to fall. Last year, Exchequer borrowing increased by £1,800 million and will continue to rise over the next few years.

ACTION WHICH COULD BE TAKEN

There is an urgent need to unleash the full dynamic of private investment towards productive assets which support employment. I would like to make some comments on action which could be taken.

It is currently more attractive for individuals to invest their savings in tax free and risk free Government bonds and savings than in manufacturing industry. A further new index savings scheme was introduced some months ago. In contrast, personal investment in industry involves risk and provides average profits of only 4% before tax. Dividends are taxed at company level and at personal level, and capital gains on the sale of shares are subject to a very high level of taxation. It is not surprising that very few private individuals invest their savings in job creating industry. As a result indigenous firms must rely on grants or loans to raise development capital. The bias against personal investment in industry must be removed so that companies can place a greater emphasis on equity finance, rather than debt, and would therefore be in a stronger position to cope with periods of recession.

The Business Expansion Scheme announced in the 1984 Finance Act has had very little impact, mainly because no designated investment funds have been set up. Unless individuals are provided with a means for investing funds (which the Act specifies can be as low as £200 per annum to be eligible for tax relief) nothing will happen.

It has been traditional for the State to provide all of the funds for infrastructural development. There is an urgent need for a massive injection of funds in infrastructure such as roads, bridges, gas pipelines, sanitary services and telecommunications over the next decade. Many of these services can be paid for by the user in the form of tolls or charges. In many instances the State could confine its involvement to offering a grant, if necessary, in order to make a project economically viable. The private company would then finance and operate the facility in accordance with regulations laid down by the State, and remunerate its investment from tolls or charges. In this way three times the level of activity could be generated for the same State funding.

It would also be desirable to examine the feasibility of floating some or all of the shares of appropriate State commercial companies on the Stock Exchange. Purchasers of shares would be investing risk capital in these companies and the funds received would enable public sector borrowing to be reduced.

Other possibilities such as joint ventures between State owned and private companies, and the selling off of dormant assets would also have beneficial effects.

these approaches would have the benefit of reducing public spending and enabling taxation to be reduced, while at the same time, increasing the level of economic activity and job creation.

CONCLUSION

The incentive to work and to invest in productive assets must be restored. However, people will not invest their savings in industry or productive infrastructure unless they have a reasonable chance to earn a return on their investment. Fiscal measures should ensure that it is at least as attractive for individuals to take risks by investing in industry and job creation as to invest in Government securities.

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