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Forfás Annual Report 1995

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CHAIRMANS STATEMENT

IMPRESSIVE ECONOMIC ACHIEVEMENTS

Ireland's economy has made huge strides in recent years. GNP growth has averaged 4.2 per cent over the last five years. In 1995 alone the GNP increase in Ireland was over 7 per cent - the highest growth rate in the EU.

Increased economic growth has been accompanied by significant increases in employment. The number of people at work is at the highest level since the foundation of the state. Total employment increased by 52,000 to 1.2m or by over 4.4 per cent in the year to April 1995. Official figures for the year to April 1996, when available, are expected to show further significant increases. A notable feature is that many of these jobs are being created directly in the manufacturing sector - something that few other developed economies are achieving at the present time.

A great deal has been achieved in restoring order to the public finances. It is the case, however, that public expenditure is higher than desirable at a strongly rising stage of the economic cycle. Other positive features of economic performance include:

- the continued partnership approach between employers, trade unions and government which has supported overall policy stability and encouraged investment;
- a rate of export growth at historically high levels;
- the increasing role of the enterprise sector in driving economic growth and employment creation;
- increasing investment in R&D driven innovation throughout the economy and, especially, in the private sector.

Significant investment in infrastructure over the past decade in areas such as transportation, energy and telecommunications has begun to pay dividends but the scope for further improvements in service and efficiency to achieve best international standards remains high. Similarly, considerable progress in education and in the upgrading of skills has been achieved. In a global economy where the knowledge and skills of the workforce are increasingly the basis of competitive advantage for firms and nations, this is an area where further substantive progress is essential.

THE OPPORTUNITIES TO BE GRASPED

While significant social and economic progress has been achieved, there is no room for complacency. The rate of unemployment remains stubbornly high and well above the average for other member states of the EU. In the case of long term unemployment, Ireland fares even less well with over 40 per cent of the unemployed being without work for more than two years.

The level of Government debt as a proportion of GDP, while falling, also remains well above international norms and underscores the need to make further progress in the control of public expenditure.

The social consensus between Government, trade unions and employers, which has helped over the last nine years to create the conditions which have supported a major turnaround in economic performance, is being re-evaluated by the different participants at the time of publication of this report. It is important that this process of re-evaluation is brought to an early conclusion.

Despite these uncertainties the pace of progress in recent years has been such that the basic conditions are now in place to enable Ireland to make a major leap forward over the next ten

years in increasing employment and living standards and in enhancing the quality of life of its people. This requires a widely shared will across the different sectors of the economy and society to grasp the opportunities for growth and employment creation now available. It also necessitates the consolidation and further development of the sensible economic policies of successive Governments in recent years.

THE DETERMINANTS OF SUCCESS

Ireland has the capability to influence many of the key determinants of economic success.

Competitiveness

The factor that will most determine whether or not Ireland makes a major leap forward in social and economic development over the next decade and beyond is competitiveness. Competitiveness is determined by the complex of factors which enables Irish firms to sell goods and services profitably on home and export markets. The economic policies pursued in recent years have resulted in low inflation and interest rates and in moderate wage settlements. It is essential that the progress made in these areas continues to be safeguarded. Research also shows that, in many areas, Ireland still has significant scope to improve competitiveness across a wide range of factors.

For example, national telecommunications policy has increasingly become a major instrument of competitiveness between countries. Significant progress in the efficiency and scope of telecommunications services in Ireland has been made in recent years. Success in attracting a wide range of internationally mobile investments in projects which depend on good telecommunications infrastructure bears testimony to this and Telecom Eireann has worked well with the development agencies in helping to secure such projects. However, surveys show that significant scope remains to improve telecommunications costs and services in Ireland. Similar possibilities arise in the areas of access to finance and the cost of energy - particularly for smaller firms.

Only by improving competitiveness can Ireland expect to maintain its current strong economic growth and further improve the outlook for employment in the future.

Innovation

Innovation is a central characteristic of successful firms but investment in R&D in Ireland, a proxy for innovation, is low by international standards. Although such investment has been increasing rapidly in recent years, it still remains low. R&D expenditure by Irish firms must be brought up to international norms as part of the general upgrading of the competitive capability of firms.

Flexibility

The nature of work, its organisational structure and the skills required to work effectively are undergoing profound change under the impact of technological change, the increasing globalisation of production and the accelerating deregulation of markets. The pace of change in all of these areas is quickening and is fundamentally changing the basis of competition. In order to respond effectively to these changes, management and workers must, together, achieve greater flexibility in work practices and move beyond the old, unproductive adversarial approach to labour relations. In Ireland this means that the partnership approach between employers and trade unions, which has operated well at national level, must be reflected and further developed in the workplace itself.

Human resources

A defining characteristic of the international business environment in which Irish firms compete is that materials, final products, technologies and services are traded freely across

national frontiers. In these circumstances the success of firms on both the domestic and overseas markets depends increasingly on the skills, talents, knowledge and potential for development of Ireland's workforce. This is why it is essential that the educational and training systems that are put in place now and in the future need to be constantly redesigned, evaluated and developed to promote the development of a learning society where the knowledge of individuals is continually renewed to enable them to participate more fully and effectively in a society and a workplace that is undergoing radical change.

Science and technology

The commercialisation of science through technological innovation has become a principal driving force for firms in developing competitive advantage. The achievement of high capability in scientific knowledge and its application in the development of products in both industry and services is central to the creation of the knowledge-driven economy which is the best basis for the creation of increased employment and higher living standards in Ireland. In Ireland, high-technology industry has been a principal source of employment growth and wealth creation in recent years. However investment in science and technology in Ireland lags behind that of comparable countries. It is essential that this gap is closed.

EMU

For Ireland, participation in EMU will have profound and irreversible consequences for economic and social policy. Major benefits in terms of macroeconomic stability, low inflation and interest rates, the elimination of currency transaction costs and diversification from an over-reliance on the UK should be facilitated. It seems increasingly likely that Ireland will meet the participation criteria for EMU as set out in the Maastricht Treaty. However, should Ireland join EMU, the possibility of using exchange rate policy to achieve short term improvements in the competitive position of the traded goods and services sector would be ruled out. This will mean that achieving and sustaining the competitiveness necessary to drive the creation of jobs and higher living standards in Ireland will depend fundamentally on increased innovation, productivity and efficiency in both the traded and non-traded sectors of the economy and in maintaining the macro-economic policies that support low interest rates and low inflation. These are issues which must be given priority in any further national programmes between the social partners.

Clear vision and framework

Perhaps the most important requirement for achieving a significant move forward in employment creation and living standards in Ireland is to establish a clear and widely shared vision of what exactly it is possible to achieve over the next 10-15 years. Fundamental to any such vision is the establishment of a more long term framework for the development of economic and enterprise policies. Such a framework should systematically monitor and anticipate significant geo-political, trading and technological changes in the global markets in which Ireland competes. It should also identify the actions required in public policies to support the competitiveness of the enterprise sector in the face of these changes.

THE GOALS WITHIN OUR GRASP

Work undertaken by Forfás in 1995 indicates that, with the correct policy framework and with a sustained and widely based commitment across different sectors and interest groups, ambitious targets can be achieved over the next 10-15 years which will:

- bring the rate of unemployment to 6 per cent - less than half the present rate;
- reduce the number of long term unemployed from 127,000 in 1995 to no more than 50,000 by 2010;
- increase living standards to the EU average;
- raise the quality of life to among the best in the world.

THE CHOICES TO BE MADE

These ambitious targets will not be met without sustained and systematic effort in the formulation and implementation of public policies.

- There must be a recognition both in concept and in practice that the creation of a vibrant and competitive enterprise sector is the only sustainable means by which the increased employment levels and higher living standards can be achieved. This will come about only if an increased proportion of the resources of the economy becomes subject to market disciplines.
- At the macro-economic level, fiscal, budgetary and low inflation policies must remain firmly within the Maastricht criteria for EMU participation.
- The national programmes between the social partners have achieved a great deal in helping to sustain social and economic progress over the past nine years. Provided that all participants are realistic and pragmatic in achieving a balance of interest, such programmes can continue to work well. Further development of such programmes should be set within a longer term framework of objectives and policy directions and make provision for giving greater effect to national partnership arrangements at local level.
- There must be a greater effort to reduce the rate of growth of public expenditure* which has increased by 64 per cent over the period 1990-1995 compared with a 17 per cent increase in inflation over the same period. All programmes should be subjected to systematic value for money audits which are published and disseminated.

** Public expenditure is measured as gross government expenditure less debt servicing costs.*

- In the case of taxation, a specific target for national debt as a proportion of GDP, lower than that required under the Maastricht criteria for EMU membership, should be established, to be achieved over the next 10-15 years. In addition, the level of taxation as a proportion of GNP should also be reduced. Both these targets would clearly signal a shift in the relative share of national output accounted for by the enterprise sector and they should be part of the framework within which public expenditure programmes would be developed.
- There must be a practical recognition that knowledge is now the factor of greatest importance in achieving and sustaining economic growth. This recognition must be reflected in education and training policies that meet both the symbiotic needs of individuals for self development and of the enterprise sector for a skilled and innovative workforce.
- EU financial support has been of crucial importance in bringing infrastructure in Ireland towards good international standards. There is still some distance to go and further investment in the development of telecommunications and transportation/logistics infrastructure must be given particular priority. The development and diffusion of information technologies are central to the achievement of a knowledge-based economy which will allow Ireland to compete successfully in the high value-added sectors which will sustain employment growth and higher living standards in future years.

ACKNOWLEDGEMENTS

As Chairman, I extend my thanks and appreciation to my fellow Board Members and to the many organisations and individuals who have contributed to the work of Forfás in its second year.

I wish to thank in particular the Minister for Enterprise and Employment, the Department of Enterprise and Employment and other Government departments for their support and co-operation. I also wish to acknowledge the significant financial support provided by the EU for

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industrial development in Ireland through the Operational Programme for Industry and through a range of other programmes which have a strong impact on the environment for enterprise.

I also extend my thanks to the State development agencies and other organisations with whom we worked closely throughout the year for their co-operation - specifically Forbairt and IDA Ireland, An Bord Tráchtála and FÁS, the third level education sector, employer bodies and business organisations, employee representative groups, trade unions and the media, all of who have been supportive of our endeavours.

Finally, I want to thank sincerely the staff of Forfás for their continued dedication, hard work and professionalism throughout the year.

Tom Toner

Chairman

CHIEF EXECUTIVE'S REPORT

During 1995 Forfás completed an extensive programme of work in the analysis of policies for industry, the services sector and science and technology, and in co-ordinating the work of An Bord Tráchtála, FÁS, Forbairt and IDA Ireland and in evaluating their programmes. In addition Forfás effectively discharged its executive functions in the areas of the provision of land and buildings for industrial development purposes, standards development and certification and the accreditation of laboratories and certification bodies.

During 1995 Forfás also undertook, at the request of the Minister for Enterprise and Employment, a detailed socio-economic review of the evolution of the enterprise sector in Ireland together with the international factors and public policies that impact significantly upon it. Arising out of the review, Forfás has developed a long term and substantive strategy for the development of the enterprise sector in Ireland.

The employment creation challenge

Recent years have seen significant levels of employment creation in Ireland and the number employed is at historically high levels. The manufacturing sector has shared in this expansion of employment creation in contrast with the situation in most other developed countries where manufacturing employment continues to fall. Each additional job created does not, however, result in a commensurate fall in the level of unemployment as new entrants to the labour force and the return of emigrants take their share of new employment opportunities. Accordingly, the employment creation challenge in Ireland remains immense. Employment creation must remain at the heart of development policies.

The role of the enterprise sector

In contrast with the position at previous times of rapid employment creation, the private sector is now by far the primary source of new jobs. It is clear that a dynamic and profitable enterprise sector is the key to the achievement of higher job creation and improved living standards in Ireland. This reality must be reflected in cost effective public policies so that the enterprise sector continues to account for an increasing share of national economic activity.

The emerging knowledge-driven economy

The structure of Ireland's employed labour force differs significantly from other EU member states. Because of the relatively large proportion of the workforce still engaged in agriculture (11.3 per cent in 1995) the proportions engaged in both industry and services remains well below the EU averages.

Success in attracting internationally mobile investment, combined with the competitiveness of the Irish economy, has contributed to a strong rise in employment in manufacturing industry. Ireland is unique in displaying significantly increased manufacturing employment over the last decade. Employment in the manufacturing sector has increased by 15 per cent since 1986.

This compares very favourably with the experience of other countries. Over the same period, for example, the UK lost 25 per cent of its manufacturing jobs while in the US the number of manufacturing jobs fell by 3 per cent. Portugal and Japan were the only other countries to achieve employment growth in manufacturing over the same period and the growth in both of these countries has been only a fraction of the growth achieved in Ireland.

While employment growth in manufacturing has not increased as fast as in the services sector, a distinctive feature of Ireland's economic growth over the past 10 years is the high

and increasing share of output growth accounted for by the manufacturing sector. In the 1970s the transportable goods sector (which includes manufacturing) accounted for less than 28 per cent of the growth in GDP. But in the second half of the 1980s its share of output growth had doubled to almost 53 per cent.

Strong growth in manufacturing output and employment has been a significant contributory factor to the exceptional growth that has occurred in employment in the services sector in recent years. In the five years to April 1995 official figures show that employment in the services sector increased by over 108,000.

Growth rates have been particularly strong in the knowledge-intensive segments of the sector, including computer software and telecommunications based services. This is a characteristic shared with the manufacturing sector where output and employment growth is also highest in the high technology sectors, including computers and electronics where the production, distribution and use of knowledge is a key requirement. The emerging trends in both the manufacturing and services sectors indicate that output and employment growth in future years will increasingly depend on Ireland becoming a knowledge-driven economy.

The shift to services as the main source of employment growth in Ireland is in line with international trends. The market services sector has become a key direct source of employment growth in most countries. The increase in service sector employment in Ireland has, in the past, lagged behind the experience of other European countries. Services employment in the EU, for example, increased by over 25 per cent from 1981 to 1992 - more than twice the increase in Ireland over the same period. More recently employment change in the services sector in Ireland has been more in line with long term international experience. This trend is set to continue.

The requirements from public policy

A pro-enterprise public policy environment is vital to sustain social and economic progress. The creation of additional, sustainable jobs will be highly dependent on support policies which encourage businesses to take advantage of the significant opportunities which exist in domestic and world markets. Areas of particular importance include:

- changes in the corporate and personal taxation systems to pro-actively support the importance of enterprise and job creation;
- the further development and active implementation of a competition policy which both fosters innovative, successful, market-driven enterprise and which safeguards the interest of consumers;
- the achievement of higher levels of educational attainment and skills as a source of both individual development and national competitive advantage;
- the development of policies in science and technology to support innovation by industrial and services sector firms and within the public services.

LOOKING TO THE FUTURE

Services

Work undertaken by Forfás during 1995 indicates that, with the right policy framework, over 300,000 jobs can be created in the services sector over the next 15 years. The annual increase involved is no greater than what has been achieved over the past five years but requires that the high performance of recent years is sustained over a further 15 year period. This represents a major but achievable challenge and at policy level will require:

- an outflow of third level graduates well qualified in the emerging new disciplines. As well as the full range of engineering skills for consultancy work, computer science, financial services, economics and tourist related sectors;

- initiatives to achieve an early leadership position in telecommunications based services which can be traded internationally in areas such as financial services, education and tele-medical services;
- actions to establish Ireland as a multi-lingual European services hub for activities such as back office administration, centralised marketing and technical support services;
- the promotion of a pro-active competition policy;
- a review of the corporation tax regime in the context of the changing nature of the services sector as a source of employment growth, inward investment and exports;
- a further strengthening of measures to promote the tourism sector.

Information society

Information and communication technologies are not just revolutionising all aspects of business but are also having a major impact on many aspects of the day to day personal lives of people - at work, in education and in the home.

The enterprise sector will continue to be the main stimulus in the development of the information society. Many companies have already made significant improvements in their operations using new information technologies. These range from more rapid and cost effective electronic mail communication with customers and suppliers to tighter financial and inventory controls and more sophisticated training programmes. The transmission of data, voice and imaging for business purposes is growing strongly.

Many countries have already developed broad based strategies to secure the benefits of the information technology revolution for both economic and social development. There is an urgent need to ensure that Ireland is not left behind, so that the opportunities which will arise in business, employment creation and the improvement of the social services are fully exploited and any threats to existing businesses or activities are anticipated and effectively planned for. The arrangements announced by the Minister for Enterprise and Employment to develop a strategy for the information society with the aid of an expert group are, therefore, particularly important. Forfás provides the secretariat and technical support for the group.

1995 OUTTURN

Overview

There are now clear signs that Ireland's strong economic performance is translating into substantial improvements in living standards and job creation. The GNP growth level of over 7 per cent in 1995 was particularly strong in view of the relatively poor economic performance of most European countries and is due in part to the efforts of successive Governments over recent years in pursuing policies to enhance Irish competitiveness. Total employment in 1995 is estimated to have increased by 52,000 with employment in industry increasing by 13,000 and in services by 39,000.

Irish-owned enterprise

1995 was another good year for Irish-owned industry, building on the recovery achieved in 1994. It was a year of strong overall performance with sales increasing by 7 per cent and the creation and filling of over 12,000 new jobs. A net increase in employment in Irish-owned businesses of over 3,500 jobs was the best performance for more than six years.

The 1995 performance of Irish-owned industry indicates what can be achieved but significant changes will be required if the potential of the sector is to be further developed.

Irish-owned industry, with some notable exceptions, is poorly positioned in terms of emerging growth sectors and export markets. Typically, Irish-owned firms are located in traditional low

growth sectors at a point in the value chain where returns on investment are low. Dependence on the domestic and UK markets is high.

As a result of poor strategic positioning, a vicious circle exists so that the scale of Irish-owned companies and the level of profits which they earn are generally insufficient to enable firms to invest adequately in upgrading their products, processes, skills and technological capabilities.

With the increasing opening up of markets to cross border trade, Irish-owned firms will face more intense pressures in terms of margins and greater levels of competition. But increased market access and deregulation will also provide opportunities in the UK and other overseas markets for Irish firms that have the competitive capability in terms of scale, technology, products and services to take advantage of them. This will require a significant repositioning of Irish firms towards high growth sectors and towards more profitable elements of the value chain in traditional sectors over the next decade.

Foreign direct investment

1995 was a record year for foreign direct investment in Ireland with 12,100 new jobs and a net increase in employment in foreign-owned industry of over 6,400. An increasing share of activity is coming from the expansion of existing foreign-owned industry in Ireland. This is a positive development because it helps to anchor and integrate foreign-owned industry more deeply into the Irish economy and it reflects a good experience in Ireland by existing foreign-owned enterprises.

In the years immediately ahead, foreign-owned industry will continue to be the main driver of manufacturing output, exports and employment increase. Investment from foreign-owned industry is likely to move to a greater extent towards joint ventures and the services sector will continue to account for an increasing share of projects.

Competition for foreign-owned investment from countries elsewhere in Europe and in non-European developing countries will continue to intensify. The approach that Ireland must adopt in response to this competition must encompass:

- the early identification of opportunities for inward investment in the telecommunications based services sector;
- a shift towards higher value-added products based on knowledge intensive activities in electronics, pharmaceuticals, bio-technology and telecommunications. This will include research, design, marketing, customer support, headquarter and administration activities;
- the further development and expansion of existing foreign-owned industry in Ireland;
- the further development of the support services in education, training and utilities, and the overall management of the economy to continue to achieve moderate wage settlements and low levels of inflation and interest rates and a stable currency regime; and
- an overall, cost effective incentive package that remains internationally competitive.

Science, technology and innovation

No country can compete effectively on world markets without a deep understanding and vision of the role of science and technology and a strategy to implement it. Ireland is no exception.

Research and development is an important indicator of a country's innovation performance; a strong research system is essential for a vibrant national system of innovation and helps to contribute to the development of skills and new knowledge. Ireland's expenditure on research and development is low by international standards at 1.2 per cent of GDP compared to an EU average of 2 per cent.

There is also strong evidence that our performance in the other main route to technological innovation - technology transfer into enterprises - is similarly below that of our competitors. It is clear that an increased effort is still required from both the private and the public sector to achieve national competitive advantage through innovation.

LOOKING AHEAD

1995 was a good year for economic development and employment creation in Ireland. The industrial development agencies, following their restructuring over the 1994-1995 period, made a strong contribution to the achievement of top class results in promoting new projects, output, exports and employment in the manufacturing sector and in associated development in the services sector. Irish enterprise has shown it can compete with the best in the world and, in the process, contribute to strong increases in employment and living standards. The benefits that derive from public policies that promote a strong dynamic enterprise sector are manifest. The objective in future years must be to build on what has been achieved; to drive unemployment to much lower levels and to further increase the living standards and the quality of life of people living and working in Ireland. To this end, Forfás will continue to identify the public policies which can best support the further development of a strong and successful enterprise sector in Ireland.

John Travers

Chief Executive