Address to the Trinidad and Tobago Manufacturers Association

Lifetime Achievement Award

Presented to

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Hyatt Regency

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Address by Arthur Lok Jack:

Trinidad and Tobago has a domestic population of approximately 1.2Million people. Being a member of Caricom which is a Free Trade area, the domestic population now increases to 6Million people and if one includes the Dominican Republic, Costa Rica and some other Central American countries where we also have Free Trade Agreements, the domestic population now increases to approximately 30Million plus people. Trinidad and Tobago with 1.2 Million people accounts for only 4% of this market, in terms of population. What a great opportunity exists… The difference between the various countries that make up this wider domestic market is that each country has its own currency and some countries are English whilst some are Spanish speaking. In addition to the above, we have one-way duty-free access to the Colombian market which is approximately 40Million (plus) people, thereby increasing our domestic market to 70Million people.

There is a great opportunity however, that with the right policies manufacturers who have not yet started to export can begin to do so, and manufacturers who are already doing so could continue to increase their market shares and earn even more foreign exchange as many of them have only touched the surface. There is significant potential for them to further expand their sales and production capacity which means capital investment and greater employment and increased net foreign exchange earnings

TT Environment

A Simple Scenario

Your salary has suddenly been cut by 50%. You were accustomed to a standard of living to suit your previous salary i.e. living conditions (Mortgage/Rent), car payments and social activities etc.

The question is, what do you do when this happens? Some of the options are as follows:

1. Find ways to replace the income lost.
2. Cut your expenditure to suit your income.
3. Utilize whatever savings you have to meet the shortfall in expenditure for a while.
4. Borrow from the Banks to meet the shortfall of expenditure while you reduce your standard of living, i.e. move to a lower standard house (lower mortgage or lower rent) cut your social activities (overseas travel etc.)

This is exactly the position that the Government of Trinidad and Tobago finds itself in.

The reason for the above is due to the precipitous fall in the price of oil which has resulted in reduced revenue streams to the Government due to the significant over concentration of oil and gas revenue to the Government relative to other income producing areas due to the lack of diversification). The result of the above has been negative GDP growth of minus 3%. The Government has no choice but to implement policies in order to balance income and expenditure (budgetary measures).

Conversely, the other countries of the Free Trade area (30Million plus people) will benefit greatly from the significant drop in the price of oil, therefore it is anticipated that their economies will experience growth.

What then should Trinidad and Tobago do to increase our market shares in these markets?

Whilst we may have savings and reserves to meet the gap, the country has to have a stragetic plan so that we are not that dependant on oil and gas which are commodities where we have no influence over the pricing.

The economic well being of Trinidad and Tobago have always been based on the price and production of energy, i.e. oil and gas and over the years we have had cycles of boom and bust. Some years ago, an effort was made to create a strategic plan for the country which would mitigate the significant impact that energy prices had on the economy. This was the Vision 2020 Multisectoral Strategic Plan in which over 500 influential leaders from civil society from business, academia, Government participated - there were 30 sub-sectors.

The Plan was synthesized and presented to the Government. Unfortunately, the implementation of the plan, whilst already started, did not continue under the new Government. There are now discussions taking place as to whether there should be a Vision 2030 Plan.
What is to prevent this plan from being another Vision 2020? The question arrises… Why are we developing medium or long term plans when there is no system or structure in place for continuity?

There is no doubt that unless the country has a national diversification strategic plan, we will continue to be at the vagaries of the energy prices. The word <u>national</u> is important to prevent various political parties from derailing the implementation of the plan for political reasons.

Efforts should be made to make any future plans bi-partisan for instance, one suggestion is for Board of Directors of state owned companies and public utilities should include members from the Opposition Party and business. This is important so that decisions being made could be consensual, once Directors understand that the first requisite of a Director of an institution is to seek the best interest of the organization and not necessarily to seek the interest of the stakeholder who nominated them, which could at times be at variance with the best interest of the organisation.

Once this is understood by all appointees to the Board, then the interest of the shareholders (citizens) who are the tax-payers would be better served.

Forex

At the present time the Government of Trinidad and Tobago is faced with substantial decline in foreign exchange earnings and are utilizing our foreign exchange reserves in order to bridge the gap between supply and demand.

Some facts:

1. Foreign Exchange earnings fell by 30.2% compared to one year ago , whilst Forex Sales from authorized dealers to the market only declined by 7%.

2. The difference is made up by disbursements from the Central Bank to the authorized dealers.

3. The Central Bank for the first five (5) months of this year drew down US$810M to support the market, an increase of 41.6% compared to the same period last year. If annualized, this means a disbursement of approximately $2 Billion dollars per year to authorized dealers. Obviously this cannot continue as we would quickly draw down the reserves which would leave us with no altertnative but to approach the IMF. In order for the country to get through this difficult period without approaching the IMF, we would have to institute plans and policies to try to accomplish the following:
    (a) Curb the demand for foreign exchange
    (b) Increase foreign exchange earnings
    (c) A combination of (a) and (b).

   Drawing down reserves, and increasing our foreign debt is only short-term and not sustainable. It does however gives us some time in order to restructure our econoomy to live within our means

Curbing Demand:

Option 1:
Forex Allocation: Allocating Foreign Exchange to certain companies is extremely inefficent and disriminatory. It also opens up opportunities for corruption.

Many manufacturers own importing companies and many importers own manufacturing companies. Allocating foreign exchange to such groups for specific purposes would be impossible to control, i.e. conglomerates etc.

Option 2:
Devalue the currency which makes imported products more expensive than locally produced products. Generally, the local manufacturer use approximately 30% - 40% foreign exchange to purchase its imported inputs. The local value added (in TT dollars), i.e. labour, plant overheads, electricity, depreciation etc averages around 60%-70%. If the dollar devalues by, say 25%, i.e. to $8.50, the local manufacturer's total cost would increase by approximately 10%.
The cost of the imported product would increase by at least 25% as there is no local TT Dollar value added. This would make the local manufacturer a lot more competitive in the Trinidad and Tobago market and the importer less competitive. All things being equal, the importer's market share should reduce whilst the local manufacturers would increase. The importer would therfore be importing less products and using less foreign exchange. In order for the importer to compete with the local manufacturer, he would have to find cheaper sources of supply for his products. In any event, much less foreign exchange would be used.

Increase foreign exchange earnings

The only way the country can increase its foreign exchange earnings is by exports. Exports emanate from manufacturers in the main. There are some exports from services i.e. banking etc but these are relatively small. There is great existing opportunity for Trinidad manufacturers to export our high quality and well packaged products to other countries within the Free Trade area mentioned before however, our products must become and/or remain price competitive in those markets.

Trinidad manufacturers are very efficient producers and utilize modern plant and equipment however, in order to compete in these markets, we need to have an adjustment in the exchange rate given the fact that many of these Spanish speaking countries, over time devalue their currencies.

With an adjustment in the foreign exchange rate, the Trinidad exporter has three (3) alternative:

1. Products that arrive in the Dominican Republic, Jamaica, Suriname etc. for US$1.00 gets a return TT$6.80 to his company. If the rate is adjusted to $8.50, the company would receive TT$8.50 instead of TT$6.80, thereby making his exports much more profitable. This is a great incentive to manufacturers.

2. He can reduce his price from US$1.00 to US$0.80 and still earn the same revenue prior to any adjustment. However, he would be more competitive and therefore increase his sales and volumes to get a larger market share. The benefit would be more investment in Plant and/or more employment in order to product more thereby reducing the unit cost of production and increasing his margins… the greatest incentive of all.

3. He can utilize some of his export profits to subsidize his price increase in Trinidad brought about by the adjustment of the rate and still be better off overall.

An over-valued exchange rate is a serious disadvantage to exports.

The major incentive to all manufacturers to export is to fill idle capacity and to earn foreign exchange. Given the slack demand in Trinidad & Tobago, manufacturers would have to export or cut back on the production, i.e. from 3 shifts to 2 or 2 shifts to 1 etc.

Consideration should be given to reinstituting the export incentives that were formulated by the Export Development Corporation some years ago but it must be noted that whilst incentives are important they are useless unless the products can compete in the foreign markets.

An over-valued exchange rate encourages imports.

Manufacturers in Trinidad and Tobago have all of their distribution systems in place, for example the ABIL Group runs over 100 trucks in Trinidad visiting its customers once per week to distribute its products, so does Bermudez, SM Jaleel etc.

An option that's open to all manufacturers in Trinidad and Tobago is to have their products manufactured for them by other manufacturers in the rest of the Free Trade area. The source of the product is not important, what is important is the brand, the goodwill, the distribution system, pricing etc. If manufacturers can source their products from other countries to land in Trinidad at less than their locally manufactured cost then, there is a strong possibility to close the factory and import the products using their brands. Manufacturers will then become importers and make the same level of profits without the attendant problems of labour, maintenance, plant maintenance etc. They can dismantle their plant and equipment and sell it in the used equipment market abroad (this is a huge market) thereby recouping a large percentage of their capital. This phenomenon is called <u>"Private Label Manufacturing"</u>.

Alternatively, local manufacturers can continue to produce locally but if there is a need for increased production to meet sales demand, such production can be contracted out to supplement the local production rather than expand the local plant. In addition, the contracting plant within the Free Trade area can also export to other markets within the region, if Trinidad becomes uncompetitive.

Political considerations for an Exchange Rate Adjustment

The concerns most politicians would have regarding the devaluation of the currency are:

1. Inflation
2. Labour demand for wage increases given the perception that a devaluation would contribute to inflation.

<u>Inflation/Downsizing due to Forex shortages</u>

Whether or not the currency is adjusted, there will be price increases as Importers who used to import and sell 100 units can only now import 80 units due to the foreign exchange allocation. They have two choices:

1. Increase the price of the product to maintain the revenue they had at 100 units (i.e. inflation).
2. Downsize their business to adjust to the lower revenue.
3. Buy foreign exchange on the black-market and increase their prices accordingly.

As can be seen from the above, even if we did not shift the exchange rate, the foreign exchange shortage will result in increased prices and/or labour retrenchment as companies restructure to operate within their foreign exchange allocation.

Labour demand for wage increases

Labour Unions needs to understand the above and therefore temper their demands accordingly. They should also be made to understand that if Trinidad and Tobago do not structurally adjust ourselves, the IMF would have to do it for us. There are not a lot of choices available. At the same time, they should recognize that exports will keep employment levels up and also increase capital investment and employment as we increase our market shares in the various countries especially in the manufacturing sector.

Manufacturers as Entrepreneurs

Manufacturers, either owners or CEO's need to be more entrepreneurial. Over the years, many manufacturers have done well and have become very complacent. They go to their offices and spend 8 or 10 hours every day, in most cases, over administrating the business, holding time-consuming meetings etc. which adds limited value.

Manufacturers once again need to become entrepreneurs, creating new products, building new relationships in foreign markets with a view to increasing their export business. The environment and the mechanism are already there i.e. good shipping lanes, no impediments to market entry (duty-free access) etc.

Exports gives the opportunity to increase our throughput in the factory thereby reducing our unit cost of production and increasing our profit margins, the result of which would be plant expansion and greater employment.

Ask yourselves, if you left the business for three months…

- Would it not continue as normal?
- Wouldn't your production people not continue to produce the required goods on a daily basis?
- Wouldn't your purchasing manager not continue to purchase as usual?
- Would your salesmen and distribution fleet not visit customers every day, as is normal?

What value then do you add, given that the organization is more or less on auto-pilot and really does not require your time to that full extent. We need to travel, simply put, go Sell and Market your Products. Spend more of your time in creating new products and creating new markets in order to substantially grow your business and earn your own foreign exchange. Do not allow your businesses to either shrink or be stifled by some Government intervention, through the Central Bank in the allocation of foreign exchange. There are new horizons to conquer, using your expertise and knowledge… you have already done it in T&T.