Daniel Boamah: The state of the manufacturing sector in Barbados

Remarks by Dr Daniel Boamah, Deputy Governor of the Central Bank of Barbados, at a meeting of manufacturers and private sector officials, Bridgetown, 27 April 2010.

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To say that the manufacturing sector has been in a secular decline would be an understatement because it is so obvious to the keen and not so keen observer.

Let us look at its performance during the last decade or so beginning in 1998. As a proportion of GDP, the sector has so far declined from a position just under 7.6% of real GDP in 1998 to approximately 4.9% in 2009. At the same time, employment in the sector has fallen from about 10,900 persons in 1998 to approximately 6,800 in 2008. If we were to take a much longer view, the secular decline becomes even starker. In 1980, for instance, the share of manufacturing in real economic activity was 11.8%, while the sector employed approximately 15,000 persons.

Part of the reason for the secular decline may be related to the fact that the country has indeed become a service-based economy. A major part of the fall may be attributed to a gradual loss of market share to regional and international competitors. In its last statement on the performance of the economy during the first quarter, the Central Bank reported that the recession in the economy appears to be bottoming out. Real output declined by about 0.1% compared with a decline of 4.8% witnessed during the first quarter of 2009.

New and emerging evidence from international forecasters suggest that the world economy is poised to emerge from the worst recession in eighty years. The IMF has raised its forecast of world growth in 2010 to 4.2% in its April 2010 analysis from about 3.9% while affirming growth of 4.3% in 2011, with little inflation.

The United States is expected to record growth of about 3.1% in 2010, followed by a slightly reduced expansion of 2.6% in 2011. The United Kingdom is projected to grow at about 1.3% in 2010 and 2.5% in 2011, following a decline of 4.9% in 2009. Canada is also expected to experience growth of about 3.1% and 3.2% in 2010 and 2011, respectively.

Based on the new evidence, the Central Bank of Barbados has also revised the outlook for the Barbados economy. We now expect economic growth to be between 0.5% and 1% in 2010 and between 2% and 2.5% for 2011. We therefore see some light at the end of the proverbial tunnel but one is not sure how helpful this new found optimism would be for the manufacturing sector. Although the sector is estimated to have expanded by 1% during the first quarter of 2010, the Bank is forecasting a decline of nearly 4% for the sector in 2010, following a fall of nearly 13% in 2009.

It goes without saying that the revised projection is largely predicated on the performance of tourism, as the sector's performance has a spill-over effect on several industries, notably wholesale and retail, transportation and construction activity. Various reasons have been suggested for the continued weaknesses in the manufacturing sector. These include:

(a) High cost of production, particularly for energy, and hence the inability of the sector to compete with regional and international products.

(b) Low productivity, partly due to the adoption of relatively inefficient processes which in turn may be attributed to.

(c) The continued reliance on aging and obsolete plants.

A few years ago I read an article about the US auto industry. The author was trying to explain why the US industry was becoming increasingly unable to compete with its Asian competitors, during the period from the mid 1980s to 1990s. The indicator used by the author was the labour-income ratio. This is the proportion of value added that goes to wages and fringe benefits. If that ratio goes above a certain threshold, apparently between 80% and 85%, productivity declines and capital formation falls too low to maintain present jobs, let alone create new ones. The author intimated that the US auto industry was operating with a labour – income ratio of between 85% to 90%. In contrast, the Germans and Japanese auto makers were operating on labour – income ratio of 75% to 80%. It was not surprising therefore that the Germans and especially the Japanese auto industry gained significant market shares at the expense of the US auto makers in the US market. The fact is that the labour – income ratios of 85% to 90% made capital formation impossible as US companies were barely able to generate or raise the investment capital needed to modernize their plants and convert them to the production of fuel efficient cars. We should recall that only recently General Motors had to be supported by the US Federal Government, otherwise the company would have collapsed. It is my considered opinion that the manufacturing sector in Barbados can take a valuable lesson from this. It would not be easy to estimate the labour – income ratio for the entire industry in Barbados (as data may not easily be available). What I can suggest is for each firm to do its own analysis. One is assuming here that the average manufacturer operates with factors of production consisting of labour (including management) and physical capital. A company may estimate value added in its operations by netting out purchases of inputs from other firms from total sales. After that if it is a simple issue of estimating the proportion of income that goes to pay wages, including the cost of absenteeism and fringe benefits. Each firm may then be able to roughly determine where it stands with respect to the labour – income ratio yardstick. In conclusion, one could say that prospects for the traditional manufacturing products are weak. Only certain niches could survive and the industry needs to create more niches. One can note that the Jamaican jerk food industry has caught the imagination of North America and Europe to such an extent that jerk meat products are gradually becoming standard fare in many restaurants in these areas. It is even difficult to obtain some of the leading jerk products in Jamaica because of the high demand by foreigners.

The Barbados manufacturing sector should be ready to diversify product lines and markets, including export markets. Some of the larger firms have already tightened their operations, shed labour and re-visited investment plans.

There are indications that finance is not a major constraint. The Central Bank's own financing schemes are under-utilized. Nevertheless, available evidence points to about 30% delinquency rate among small and medium-sized companies which access funds to finance their operations. In order to ensure uninterrupted availability of finance, it may be necessary to provide basic accounting skills to companies in the sector so as to keep the proportion of companies which are unable to service their debts to the minimum.