TRENDS: 1973-1982

Between 1973 and 1980, the international oil market was essentially a seller's market, characterised by tight supply and excess demand. Such a market facilitated the phenomenal increases in nominal oil prices from $11.60 U.S. per barrel in 1974 to $28 U.S. in 1980 and then to $34 U.S. per barrel in 1982. This price increase is partly responsible for the increased revenue earned from exports of the petroleum sector which jumped from $887.9 million in 1974 to $3,551.4 million in 1982. An increase in the volume of crude oil production also occurred, peaking at 85.7 million barrels in 1978. Crude oil exports also peaked in 1978, at a level of 54 million barrels.

Just as Trinidad and Tobago benefitted from the buoyant and profitable international petroleum market during most of the seventies, it could not escape the reversal in market conditions over the last two years, during which time the buyers have held sway. Persistent glut conditions, due to a sustained decline in demand, coupled with the expansion of supply from non-OPEC sources and the heavy drawdown of oil stocks in the industrial countries, exerted considerable downward pressure on prices. The result was an average price reduction of 15 per cent in March 1982.

While recent unfavourable conditions in the internationa petroleum industry have certainly had adverse effects on the domesti petroleum industry, internal conditions and arrangements have seriousl aggravated the situation. Declines in most major areas of activity including production, refining and ancillary services, are evident. After 1978, crude oil production declined steadily by 6.3 per cen annually to 64.4 million barrels in 1982. This has been due to th natural decline in crude flows from maturing fields, particularly in the marine areas, and depressed international markets.

Since 1970 refinery throughput has declined in every single yea except 1976. Between 1976 and 1981, refinery throughput fell from 117.6 million barrels to 63.3 million barrels and to a crisis level of 55.1 million barrels in 1982 - the lowest since 1957. The decline in refinery throughput after 1976, has been due almost entirely to the sharp and continuous fall in demand, particularly by the United States, for the principal product - residual fuel oil, which has historically accounted for 60 per cent of output of the refineries.

Developments in the petroleum sector impacted on the rest of the economy mainly through government fiscal operations. It is therefore important to trace and understand the interaction between the petroleum sector and the government, over the years. Revenues from the petroleum sector have been the major contributor to progressively higher levels of total government revenues since 1973. Its actual contribution rose from

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23 per cent in 1973 to 52 per cent in 1982. The second most important contributor to increasing government revenues was personal income tax which was itself an indirect result of the fortunes of the petroleum sector and which amounted to $1,400 million or 21 per cent of total revenue in 1982, compared to $89.5 million in 1973 or 18 per cent of total revenue.

While revenues grew at an average annual rate of 34 per cent over the 1973-1982 period, the average annual growth rate of expenditure was 38 per cent over the same period. In 1982 however, current expenditure jumped by 76 per cent compared to a decline of 0.4 per cent in current revenue. This resulted in a huge deficit of $3,300 million on government's overall fiscal operations and was the second deficit since 1973. In 1979 a small deficit of $168.5 million was recorded.

With respect to current expenditure, wages and salaries which represent the major component, grew twelve - fold from $227 million in 1973 to $2,812 million in 1982, representing 45 per cent of recurrent expenditure in 1982. The pattern of Government recurrent expenditure over the years clearly reflected a welfare bias. Expenditures on transfers and subsidies recorded a dramatic rise from 20 per cent of current expenditure in 1973 to 42 per cent in 1982. Loans and grants to Statutory Authorities which are in fact transfers, increased from $19 million in 1973 to $775 million in 1982 - an increase of $756 million.

The pattern of government capital expenditure over the last eight years reflected concentration on heavy industries largely based on natural gas, and on the expansion and improvement of infrastructure including electricity, water, telephones, roads and educational facilities. Whereas in 1973 capital expenditure was $109 million or 20 per cent of total expenditure, by 1982 this figure had increased to $3,808 million or 38 per cent of total expenditure.

Between 1974 and 1977, substantial amounts of petroleum revenues were virtually sterilized in the so-called Long Term Special Funds (L.T.P.F.) In the years which followed, these funds were largely used up in the financing of the energy based industries and infrastructure development.

The Non-Oil Economy

Over the 1976-1980 period the oil sector grew at an average annual rate of just 0.6 per cent. But the financial surpluses resulting in part from the oil price increases of 1973/74 and 1979/80, indirectly financed and facilitated the growth of the non-oil economy. Real GDP in the non-oil sector registered an average annual rate of growth of 7.8 per cent.

This compares with a 4.0 per cent average annual growth rate over the 1971-1975 period. Some declin as evident over the 1981-1982 period when the average annual growth rate was 5.5 per cent. In fact, growth in real value added in the non-oil sector has declined continuously from a peak of 10 per cent in 1977 to 4.7 per cent in 1982.

But growth in the individual sectors of the non-oil economy has been uneven. Sectors which showed significant growth rates over the 1976-1980 period include the Construction sector which recorded an average annual growth rate of 10.3 per cent and The Finance and Real Estate sector which grew at an average annual rate of 12.3 per cent. On the other hand, real GDP in the Agriculture sector, fell at an average annual rate of 4.2 per cent per annum over the 1976 -1980 period.

Available data indicate substantially lower growth rates over 1981-1982. The Construction sector, previously the leading sector, grew by only 3.9 per cent while Finance and Real Estate grew by 8.2 per cent.

Inflation

Trinidad and Tobago has been experiencing double digit in.atio since 1973. Over the period of 1973-1982, the rate of price increase ha averaged 14.5 per cent per annum, compared to 4.2 per cent per annum ove the 1966-1972 period. These high rates of price increase in th post-1974 period are partly explained by unprecedented growth i government expenditure increasing aggregate domestic demand and creatin severe supply bottlenecks in certain sectors in the process.

Over the last two years some moderation in the rate of pric increase has occurred with rates of 14.3 per cent and 11.4 per cent i 1981 and 1982, respectively. The deceleration might be partly attribute to lower inflation rates in the major industrial countries and henc slower growth in import prices, and the effective appreciation of the Trinidad and Tobago dollar, concomitant with the appreciation of the U.S. dollar throughout most of 1982.

Balance of Payments

The country's rising command over a greater proportion of goods and services is vividly reflected in its balance of payments account. Over the years 1974-1981 the balance of payments surplus averaged $950 million. The healthy balance of payments position has been due to substantial surpluses on both the current and capital accounts over most of the period. The current account balance rose from $407 million in 1974 to $1,019.0 million in 1981. Exports reached a record level of $6,256 million at the end of 1981 from $1,907 million in 1974. In the past five years 90 per cent of Trinidad and Tobago's exports have been accounted for by petroleum and petroleum products.

But while exports have grown at an average annual rate of 13.6 per cent, imports have increased by 25.5 per cent per annum over the same period, from $1,084 million in 1974 to $6,678.2 million in 1982. There was a deficit on the merchandise trade account of $1170.4 million in 1982. The outflows had previously been offset by growth in the value of exports, but in 1982, merchandise exports fell by about 15 per cent as a result of weak international demand for oil and the continuing decline in local crude oil exports.

Increase in domestic demand for foreign goods and services has resulted in growing outflows for transportation, travel and other services, while the recessionary conditions abroad have caused slower growth, and in some cases absolute declines in inflows. Indeed, since 1979, Trinidad and Tobago has been a net importer of services. However, the deficit on the services account fell from $337 million in 1979 to $174 million in 1982.

The capital account has recorded substantial surpluses for most of the 1974-1982 period, reflecting considerable direct foreign investment inflows (mainly in the petroleum sector) and other borrowing by private and public sector enterprises. The surplus on the capital account averaged $769 million over the five-year period 1978-1982.

Capital Market

The growth in total financial resources into the banking system, together with the increased demand for investible funds by the private, public and government sectors dictated that the local capital market be developed at a much faster rate, in order to provide additional and alternative means of savings as well as to make investment funds readily available. In an attempt to enhance such a process the Stock Exchange and the Unit Trust were established in 1981 and 1982, respectively.

Unemployment

Between 1973 and 1982, employment grew at an average annual rate of 2.3 per cent compared to an average annual growth rate of the labour force of 1.8 per cent over the same period. The construction and commercial sectors were the areas generating the largest amount of employment, registering average annual rates of 6.6 per cent and 1.6 per cent, respectively. The agricultural sector, on the other hand, showed a substantial decline of 4.5 per cent per annum in the number of people employed in this sector. The actual numbers employed declined from 56.2 thousand in 1973 to 37.1 thousand in 1982.

Policies

The unprecedented growth in revenues over the 1974 -1982 period presented the government with a range of opportunities as well as with a host of potential problems. The policies adopted to exploit and harness the unfamiliar economic circumstances might be broadly classified as (a) monetary (b) fiscal and (c) developmental.

Fiscal policy essentially sought to distribute a substantial proportion of the large revenue surpluses generated in the oil sector, over a wide area of the population, in the form of expenditures on transfers and subsidies. With the dramatic growth in oil revenues, the tax burdens on the non-oil sector were reduced. Thus, personal income taxes for example were progressively liberalized in successive budgets after 1973.

Expenditure policies focussed strongly on welfare objectives. A primary concern was the mitigation of the effects of inflation on the population as evidenced by substantial expenditure on transfers and

subsidies which increased from a share of 20 per cent of current expenditure in 1973 to 42 per cent in 1982. This includes substantial transfers to statutory bodies and public utilities whose tariffs, as a matter of deliberate social policy, were not permitted to rise.

These increases in government expenditure were not matched by increases in domestic (non-oil) revenues but were in fact accommodated by the partial monetization of the foreign exchange inflows accruing to the petroleum sector. Thus the domestic budget deficit financed in this way increased from $172 million in 1973 to $4,724 million in 1982.

Development policy in Trinidad and Tobago like several other policies has been articulated against a back-ground of strong fiscal surpluses generated by the petroleum sector. The government embraced the opportunity to embark upon a bold drive to diversify the economic base of the country. The strategy of Resource Based Industrialization (R.B.I.) is the centerpiece of the development policy in Trinidad and Tobago in the post-1974 period. The strategy necessitated the establishment of industries for production and processing of natural gas mainly for export to metropolitan markets. This new strategy marked in some respects a significant departure from the Import Substitution Strategy of the sixties and early seventies.

The rationale for the new R.B.I. strategy lies in the recognition that the fortuitous circumstances of the oil crisis would not last forever and consequently, it was prudent that the available resources be used to diversify the economy, by establishing industries that were able to take up the slack, if and when the oil sector declined. The actual plans envisaged a number of natural gas-based projects including Iron and Steel, Ammonia, Gas Transmission (all of which are currently in operation) and Urea and Methanol which are expected to come on stream by 1984.

The arguably narrow focus of the R.B.I. strategy was partly responsible for the near neglect or sacrifice of the other sectors such as agriculture and light manufacturing. The overall poor performance of these sectors over the 1974-1982 period has already been noted.

The monetary system constitutes the primary link between the government sector and the private domestic sector and as such, reflects the financial transactions within the entire economy. The financial system has played a significant role in the expansion of the economy over the 1974-1982 period. Monetary policy has largely been restricted to the instrument of moral suasion, and arguably has been somewhat passive in the light of tremendous growth in banking system deposits. The growth in bank and non-bank deposits resulted in dramatic increases in credit expansion for total business and non-business purposes. While commercial bank deposit liabilities increased more than five-fold, from $1,040

million in 1974 to $6,662.0 in 1982, total bank credit rose more than six-fold from $728.1 million to $5,346.6 over the same period.

By 1979, the economy was seriously overheated and, in an attempt to control money supply growth and the credit creation capability of the banking system, a marginal reserve requirement of 15 per cent was imposed on incremental deposits from February 1980. In 1979 (November), the selective credit control guideline was instituted, to redirect a higher proportion of new credit to productive purposes by limiting the proportion of new lending for personal non-business purposes to 25 per cent.

With respect of the non-banking institutions which did play a role in mobilising financial resources, particularly for investment in the medium and long term market, a reserve ratio of 3 per cent was imposed under the Financial Institutions (Non-Banking) Act of 1979 and was subsequently increased in March 1983 to 5 per cent. The total assets of these institutions grew from $518.6 million in 1974 to $1,752.7 million in 1982.

Prospects

The prospects for the Trinidad and Tobago economy over the short term will be largely determined by developments in the leading petroleum sector. Since likely movements with respect to prices, production and refining activities are fairly well known, then overall economic trends in the short run can be considered as predetermined. Developments over the medium and long term are highly dependent on the strategies and policies of the government.

After falling to $29 U.S. per barrel (marker crude price) on the international market in 1983, crude oil prices are likely to remain relatively static over the next two years. In the current year, domestic crude oil production is expected to decline by about 10 per cent. The decline may well continue into 1984. However, in an effort to stem the rate of decline in production, government has recently granted certain tax concessions to land-based producers. Marine operations may also receive a similar type of incentive. The net effect of this move is uncertain in the short run. In respect of refinery operations, current data suggest that a further reduction of the order of 40 per cent is likely for 1983. The government is now seriously confronted with broader issues of the rationalization of the entire petroleum industry.

While some reduction in expenditure might be realised in the short run, the revenue base can be expected to show a much larger

reduction, resulting in a continuing high deficit government fis operations. In the light of this, borrowing, both locally and abroad, expected to play a much greater role in financing over the medium term.

The anticipated decline in the oil sector is expected to have ripple effect throughout the non-oil sector. The prospect for t immediate future is a continued slow-down in the rate of econom growth. For all of 1983, real GDP is not expected to grow by more than per cent because of the reduced level of economic activity in secto such as Oil, Construction, Finance and Real Estate and the lower outp level in the sugar industry.

Unemployment can be expected to rise over the next two years Indeed, retrenchment in the oil sector as well as in the non-oil secto has already begun.

Trade data for the first five months of 1983 indicate that th growth in imports persists, though at a slower rate than in the last fe years. Exports have increased marginally, mainly as a result o increased fertilizer exports. The decline in crude oil production an refinery throughput has already been noted. In the short run therefore provided no corrective measures are taken, it is likely that the country will continue to experience current account deficits in the face o adverse trade balances and growing outflows for services. Even if private sector capital inflows are maintained at historical levels and substantial external borrowing effected by the Government, it seems doubtful that the capital account surpluses will be sufficient to offset the anticipated current account deficits. The country's reserves are therefore expected to decline over the medium term.