EXTERNAL INDEBTEDNESS IN TRINIDAD AND TOBAGO:

THE CASE OF A MIDDLE INCOME OIL EXPORTER

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(Paper Presented at The 19th Regional Programme of Monetary Studies

Conference, Belize City, Belize

November 15 - 17, 1987).

NOVEMBER, 1987

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INTRODUCTION

In August 1982 the government of Mexico informed a group of its major creditors that Mexico was no longer able to continue meeting its external debt service commitments on schedule. For a while a disbelieving world wishfully tried to pretend that the problem was simply one of liquidity, but this optimism quickly perished in the avalanche of defaults that followed the publication of Mexico's plight. The term 'debt crisis' has since become firmly entrenched in the lexicon of analysts and observers everywhere.

It has also become something of a generalization which, like all such descriptions, often overlooks certain inner dimensions of the phenomenon it is trying to represent. Such analytical differentiation as has occurred has sought to dualise the debt problem into the Latin American crisis on the one hand, and the African crisis on the other. The classification should be viewed as generic rather than geographical. The former is characterized by a high reliance on relatively short-term lending from mostly private commercial sources, and the latter by a predominance of bilateral and multilateral debt, usually on concessional terms.

An unfortunate consequence of this simple taxonomy is that it has tended to steer the search for solutions in directions that exclude

those countries which do not fall neatly into either category. Trinidad and Tobago is one such. A small middle income oil producer, this country finds itself poised on the brink of, if not a full blown external debt crisis, then certainly an extended period of acute discomfort. In fact, the difference between the two may well depend on the ability or willingness of the international community to recongnise this third variant of the debt problem and to devise appropriate solutions.

This paper is intended to highlight the peculiar nature of the external debt problem which faces countries like Trinidad and Tobago whose levels of indebtedness are not large enough to be a substantial threat to international financial stability, but which may be a substantial threat to their own survival and prospects for economic growth. The discussion excludes consideration of the considerable debt of the state enterprise sector but this is not viewed as a serious omission since the paper is meant to be merely illustrative of a particular class of problem.

Structural Foundations of the Debt Problem

For most heavily indebted developing countries the roots of their present predicament are traceable to the oil price increases of 1973-74 which plunged their current accounts deeply into deficit. These same events provided the catalyst for the rapid growth of Trinidad and Tobago's external indebtedness but the underlying rationale for borrowing differed fundamentally from the general case.

Trinidad and Tobago, despite its relative insignificance as an oil exporter, stood to benefit enormously from the quadrupling of oil prices engineered by OPEC. In fact the authorities at the time might well have viewed the OPEC intervention as something of a deus ex machina as reserves at the end of 1973 amounted to just $67.1 million or the equivalent of a mere six weeks' imports. By the end of 1974 however the deficit on current account was transformed into a comfortable surplus which averaged 7 per cent of GDP over the next four years before a temporary deficit emerged in 1979. And since revenues from oil accrued to the economy through government taxation of oil companies, the current fiscal balance was similarly transformed, averaging 18.5 per cent of GDP in 1974.

In 1973, the year which marked the beginning of the petrodollar windfall, the external debt of the central government stood at $256 million or just over 10 per cent of GDP. Debt service in that year was $22.6 million or a mere 2.1 per cent of export earnings. In 1986 the debt stood at $3,822.2 million, a fifteenfold increase over 1973, and debt service pre-empted an estimated 10 per cent of export earnings. The factors underlying the transition were alternatively both exogenous and discretionary in nature. These must be understood and placed in perspective since current approaches to the debt problem do not appear overwhelmingly sensitive to the fact that the extant crisis is perhaps due more to irresistible global forces than to naive policymaking on the part of developing countries.

When certain trends are examined it is possible to conclude that even if the effects of higher energy prices are discounted, sufficient

conditions exist to sustain the presence of the external debt crisis. An uncomfortable fact of life is that the nature of capital and the terms of its availability to developing countries have changed dramatically over the last two decades. In particular there has been a marked secular decline in direct foreign investment which has tended to be supplanted by debt creating flows. Whereas direct foreign investment constituted 19.8 per cent of all net capital flows to developing countries in 1960-65 this proportion fell to 15.5 per cent in 1975-80 and further to 12.9 per cent in 1980-83.

But if the progressive diminution of direct inflows has forced up underlying borrowing propensities, the revival of protectionism since 1974 after an extended period of quiescence has severely impaired the ability of developing countries to meet their rising debt obligations through their own efforts. Under the so-called 'new protectionism' which replaces overt tariff barriers with a range of less transparent non-tariff devices, the relatively low technology, labour intensive manufactures of developing countries, as well as their agricultural products, have found themselves increasingly locked out of developed country markets. Even so the clamour for increased protectionism continues to grow more shrill, particularly the United States where the current account deficit has burgeoned to unprecedented levels.

The virtual collapse of non-fuel commodity prices over the last ten years has compounded the growing impenetrability of metropolitan markets. The decline has been both severe and widespread, affecting virtually all commodity groups and sharply aggravating the current account imbalances of those developing countries which do not have

significant manufacturing exports. The World Bank has estimated that in 1984-86 the current dollar index for agricultural commodities declined by as much as 13 per cent, and that export prices as a whole have experienced average annual declines of approximately 3 per cent since 1982.

It is significant that the decline in commodity prices has remained largely unaffected by output trends in industrial countries and vice versa. Drucker has referred to this growing North-South disjuncture as the uncoupling of the primary products economy from the industrial economy, a phenomenon he ascribes in part to technical change, the effect of which has been to reduce the raw materials intensity of production. It is a lesson with which large oil producers have already become painfully familiar.

The Role of Policy

Once the structural roots of the problem are understood it is useful to examine the role which domestic policies may have played in contributing to its severity. There is little gainsaying the fact that perhaps the most consistently recurring factor among countries experiencing a debt problem has been the effect on the balance of payments of monetary and fiscal imbalances. In Trinidad and Tobago it was inevitable that economic management, and in particular monetary management, would be severely tested by the sudden onset of the petrodollar boom. The government attempted to provide some measure of insulation by creating special investment funds into which poured an average of $1 billion annually in 1974-80.

Despite this large scale sterilization effort government current spending soon gathered momentum, expanding at an annual rate of 29 per cent in 1974-80. Throughout this period the current fiscal balance continued to show a strong surplus, but fiscal policy was nevertheless expansionary since much of domestic expenditure was financed from exogenously derived petroleum revenues. The first cracks appeared in 1979 when a 7 per cent drop in crude oil production led to a current external deficit of $87 million, but this was quickly ignored in the new wave of euphoria that followed the second oil shock.

The highly expansionist fiscal policies pursued in the latter half of the seventies shifted a disproportionate share of the burden of stabilization to monetary policy. The internal aspect of the problem to some extent found a partial though perverse solution in rising imports which were increasing at an annual rate of 27 per cent, faster than the growth rate of GDP.

The inertia of monetary policy during this period remains something of a curiousity. Notwithstanding the fact that the statutory cash reserves had been raised to 9 per cent from 7 per cent late in 1974, the primary money supply experienced runaway growth over the next six years unimpeded by any further monetary policy intervention of any significance. Despite the vent provided by imports, inflation averaged 13.8 per cent in 1975-80, in the process achieving a significant inadvertent revaluation of the domestic currency which was fixed to the U.S. dollar. It was not until 1980 that any meaningful restraint on monetary growth was implemented in the form of an increased reserve

requirement specified in terms of incremental deposits above a selected benchmark level. In effect it was left up to the vagaries of the international oil market to impose the required discipline when both real and nominal prices of petroleum declined in 1982.

Trinidad and Tobago is numbered among that group of debtors whose rapid rise in indebtedness was linked to the attempt to harness windfall gains from commodity exports to high-growth strategies. Typical of these countries was a strong direct correlation between rising terms-of-trade and debt indicators, usually with an intervening lag of about two years.

But although the sharp rise in oil prices in 1973 was for Trinidad and Tobago a unique development opportunity it was not an unqualified one since one of its consequences was to promote the country out of the ranks of those considered eligible for concessional development funding from traditional sources. Certain creeping manifestations of the policy of graduation became evident even before the new development effort could be launched in earnest. The Minister of Finance in his 1975 Budget Speech complained bitterly of World Bank proposals to require Trinidad and Tobago to offset any loans made to it by the Bank by a similar loan to the Bank.

The government also found to its chagrin that neither the international financial community nor its own joint venture partners were prepared to allow it to separate itself from debt obligations associated with state-led industrial projects, and reluctantly found itself in the

role of loan guarantor in respect of virtually every major project in which it had a stake. These were the major factors which set the stage for Trinidad and Tobago's entry in earnest into the world of large scale commercial project financing, and for the radical transformation of its external debt profile.

EXTERNAL DEBT FLOWS: 1971-1985

	1971-1975	1976-1980	1981-1985
Loans	207.3	1,354.4	2,052.1
Repayments	119.1	535.5	748.8
Outstanding[1]	222.5	1,047.9	2,338.7
Interest	77.2	243.5	796.4
Total Debt Service	196.3	779.0	1,545.2

1 Refers to end of sub-period

Given Trinidad and Tobago's resource position in the 1970s and early 1980s the cost of exclusion from multilateral sources of funds was not so much development opportunities foregone, but rather the negative consequences of the largely inappropriate financing arrangements to which the country was forced to turn. It might be argued that because of the largely commercial nature of many of the large scale state projects being undertaken at the time, financing on commercial terms was appropriate and, in a particular sense, even desirable since the ability of the projects to survive the scrutiny and win the approval of the capital market could be taken as a useful indicator of their expected viability.

However, this rationale ignores the fact that substantial investment in infrastructure was necessary as a prerequisite to the

commercial thrust and that the nature and cost of market finance were wholly unsuited to large investments in water, telephones, ports and electricity, among other things. Nevertheless, this was precisely the route taken by Trinidad and Tobago with the incongruous result that the distribution of external debt, at the height of the project implementation phase in 1980, showed that an extraordinary 60 per cent of the debt, consisting almost entirely of relatively high cost market loans was incurred 'for purposes of the general development of Trinidad and Tobago' rather than for specific income generating projects as might be expected for loans of this nature.

The involuntary strategy of market borrowing also had the predictable effect of compressing the maturity profile of the external debt as well as increasing nominal interest rates. The tendency of the market to supply loans at floating rates of interest, usually tied to LIBOR, increased vulnerability to rate fluctuations, while the diversification of borrowing away from dollar denominated loans heightened the risk of exchange rate penalties.

DISTRIBUTION OF EXTERNAL DEBT BY CURRENCY

	1980		1985	
	$	%	$	%
US Dollar	789.5	72.1	1,822.9	49.5
Pound Sterling	3.3	0.3	254.6	6.9
Swiss Franc	68.9	6.3	192.1	5.2
Canadian Dollar	20.0	1.8	15.0	0.4
Deutsche Mark	93.0	8.5	-	-
Japanese Yen	120.0	11.0	1,134.6	30.8
French Franc	-	-	266.3	7.2
E.U.A.	-	-	0.8	-
	1,094.7	100.0	3,686.3	100.0

The growth of external debt was fastest in 1976-80, averaging 36 per cent compared with 9 per cent in the previous quinquennium and 27 per cent in 1981-85. This was due in part to initial grace periods which delayed the commencement of repayments in the early stages of the borrowing thrust. It was also during this period that the government negotiated one of the single largest loans on record of US$150 million, for the stated purpose of market conditioning. The loan was subsequently refinanced in order to reduce associated servicing costs.

More rapid than the growth of external debt itself, however, was the increase in debt service. Under different circumstances this may have been enough to raise a red flag of caution. In Trinidad and Tobago, caught in the midst of the petrodollar cornucopia, it was not viewed as a cause for concern since the increasing absolute burden of the debt and debt service appeared well within the economy's sustainable limits. The debt service ratio remained below 3 per cent for the duration of the seventies while the ratio of debt to GDP actually declined from 10.5 per cent in 1973 to an average of 6 per cent in 1974-79.

However there are at least two reasons these measures of debt capacity should be used with more than the usual caution when applied to Trinidad and Tobago. The first is the dominance of output and exports of petroleum in total output and exports. Taken together with the volatility of oil prices this adds up to an extremely high susceptibility of output and, in particular, export earnings to exogenous shocks or to fluctuations in the level of domestic crude output, which is itself not entirely within local control. Low debt/GDP and debt service ratios are

therefore liable to be misleading and to convey a false sense of security if taken too seriously.

The second reason is even more substantial and has to do with the fact that, due to certain institutional arrangements a large proportion of the country's foreign exchange earnings never find their way into the country's official reserves in the first place. Internal Central Bank estimates have placed this porportion at approximately 60 per cent which translates into a huge downward bias in the conventionally estimated debt service ratio. Appropriately adjusted, the debt service ratio averaged 4.2 per cent in the latter half of the seventies and stood as high as 16 per cent in 1985. The current tenuous external debt situation in Trinidad and Tobago probably owes a great deal to the overestimation of debt capacity as measured by standard indicators. It is significant that the 1983 report of a specially appointed planning Task Force focussed exclusively on the debt service ratio in defining prudent limits for external borrowing.

The Limits to Adjustment

The first half of the 1980's has exposed, much more clearly than any analytical treatment ever could, the vulnerability of the Trinidad and Tobago economy to the vicissitudes of the petroleum industry. It has also witnessed the transformation of what by conventional standards was a moderate level of indebtedness to one verging on the critical, and one which perhaps the country is fast exhausting its capacity to manage through its own efforts at adjustment.

Although oil production had been on the decline since 1979 the implications for the economy had been effectively postponed by what came to be called the second oil shock, which saw the average price for Trinidad and Tobago's main export crude increasing by 50 per cent and 65 per cent in 1979 and 1980, respectively. However prices fell again in 1983 and continued down to what now appears to be levels which are closer to their long run equilibrium values. The prospects for speedy recovery this time around therefore now appear extremely remote.

The impact on the Trinidad and Tobago economy was rapid and severe. The current balance of payments which, as in 1979, was the first to presage the changing state of health of the economy had already turned negative in 1982. Real output declined sharply by 8 per cent in 1983, but even this subsequently appeared moderate compared with a more precipitous decline of nearly 13 per cent which occurred in 1984 when oil prices dipped further. The current fiscal balance dwindled but remained positive (until 1986), but an overall deficit, equivalent to 14 per cent of GDP in 1982, has persisted to the present though on a smaller scale.

TRINIDAD AND TOBAGO: SELECTED DATA 1976-86

	1976	1979	1980	1982	1984	1986
GDP	2,205.0	2,565.1	2,713.7	3,005.2	2,416.8	2,195.9[e]
Current Fiscal Balance	1,255.7	1,418.1	3,127.4	931.2	251.3	-350.7
Total Imports	2,855.9	3,971.6	7,110.8	9,075.2	7,360.3	7,876.2
Inflation Rate	11.7	10.2	17.5	11.4	13.3	7.7
External Reserves	2,201.9	4,058.7	6,336.7	7,160.1	2,850.0	1,190.6

[e] estimate

Despite the obvious signs of a weakening economy, or perhaps because of them, borrowing activity appeared to quicken. In fact gross inflows in 1980-85 averaged well over $400 per year.

Given the rapid rate of dissipation of its own accumulated savings the governemnt's rationale for borrowing had now clearly become one of necessity, based on the requirement to sustain reasonable levels of capital expenditure. The high rate of gross inflows was however deceptive as capital repayments were now averaging close to $200 million per year with the expiry of grace periods on earlier borrowing. It was misleading in another sense as well, since it gave no indication of the growing difficulties and frequent failure of the government to achieve its budgetary borrowing targets despite heightened campaigns on international capital markets. The severity of this problem was driven home forcefully in 1986 when, with an announced borrowing target of over $1 billion only $44 million was realized, resulting for the first time since 1976 in a net outflow of over $300 on the external loan account.

These developments go to the heart of the issue which surround the plight of small, moderately indebted countries such as Trinidad and Tobago. It is clear that any lasting trend towards net outflows could not long be supported by the economy and would precipitate in short order the transition to the full blown debt crisis that clearly now looms on the horizon and which it is unlikely can be avoided by any continuing exclusive reliance on the tools of adjustment.

The capacity to adjust is finite and is defined within social and economic limits which cannot afford to be ignored except at the risk of social disorder and economic collapse. But whose crisis is this? For the small moderately indebted country it is theirs alone. For Brazil, Mexico or Argentina it is a crisis of world proportions which threatens the very foundations of international finance and which therefore elicits attempts at solutions on an appropriate scale.

In Trinidad and Tobago recourse to adjustment has already been substantial. The current external deficit which peaked at $2.5 billion in 1983 was reduced by 47 per cent in the following year and by a further 88 per cent in 1985. This was achieved largely through a contraction in imports which were made to fall by an average of 21 per cent in each of the two years. The country also imposed a 50 per cent devaluation at the end of 1985 in spite of which both the current deficit and the level of imports managed to rise in 1986.

Other manifestations of self-administered austerity included progressive reductions in the government's overall fiscal deficit at an annual rate of 19 per cent since 1982 and annual reductions, on average, of 7 per cent in the primary money supply. As a result, inflation declerated to the lowest annual rates in over a decade in 1985 and 1986.

But the implications of such drastic deflationary measures in so short a time should not be missed. In particular the containment of the government's budget deficit was achieved largely by trimming capital expenditure in 1986 down to less than one quarter of its 1982 level. Similarly, the abrupt curtailment of imports was realized partly at the

expense of the availability of productive inputs, clearly giving rise to the possibility that the medicine, if administered for too long may end up by killing the patient.

CONCLUSION

The plea for a case by case approach to external debt problems has been widely articulated in the literature and is repeated here. Trinidad and Tobago finds itself in a curious state of in-betweenity, disqualified from any significant access to concessional funds by virtue of income levels that are 'too high', and shunned by the capital markets, apparently by virtue of its close proximity to problem-ridden Latin America with whom it is customarily grouped in regional classifications of indebted countries. But guilt by association, if in fact that is what it is, is hardly a fair principle particularly when applied to a country which has been nothing short of scrupulous in meeting its external debt service obligations on schedule, and which has demonstrated a willingness to undertake the adjustments that circumstances dictate.

One of the curiousities of present approaches to the international debt problem is the apparent determination to ignore potential debt problems until they acutally materialise. Trinidad and Tobago, well served by newly installed infrastructure and a shiny new industrial sector is a case in point. It is now everywhere acknowledged that the only viable solution to the debt problem is one that allows indebted countries to maximise their potential for growth while at the same time meeting their debt service commitments. Creative and co-ordinated approaches by the various lenders is in fact the only way in which they can safeguard the growth and development in which, ultimately, they themselves have invested.

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