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**ECONOMIC MANAGEMENT IN
BOOM AND RECESSION:
THE CASE OF
TRINIDAD AND TOBAGO
1973 - 1991**

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Abstract

In an important sense, over the past two decades, the economy of Trinidad and Tobago has been both the strongest and the most vulnerable of the CARICOM economies.

It is no doubt true that Trinidad and Tobago alone in the CARICOM group did not suffer any immediate negative effects of the oil shocks of 1973 and 1979. Being an oil exporter, Trinidad and Tobago was, in fact, in a position to assist some of the other member states to survive these shocks.

However, it is also true that when oil prices began to slide in 1983 and collapsed in 1985/86, the vulnerability of the Trinidad and Tobago economy became very glaring indeed.

In this context, an obvious question is whether the Trinidad and Tobago economy was managed in a way which properly reflected its structure.

With the wisdom of hindsight, the answer to this question has usually been no. However, there are two more important questions which we propose to address in this paper.

- (a) Were the policy adjustments to the changing oil market conditions reasonable? and
- (b) What are the most important lessons that could be learnt from the Trinidad and Tobago experience?

Our answer to the first question is a qualified yes. Our argument will be that some of the popular criticism of the economic management of the period is not empirically well founded.

On the question of the lessons to be learnt, we will argue that a new approach to fiscal policy is probably the key to minimizing the impact of unexpected changes in external conditions.

THE EVALUATION OF ECONOMIC MANAGEMENT IN BOOM AND RECESSION:
THE CASE OF TRINIDAD AND TOBAGO 1973-1991

Introduction:

The purpose of any review is primarily to put ourselves in a position to learn from mistakes, presumably in order to improve our understanding of the type of system under study. Using the wisdom of hindsight, it should be possible to match objectives with outcomes in a way which enables us to distinguish those phenomena which can genuinely be said to be out of our control.

In the case of Trinidad and Tobago, even the wisdom of hindsight has not been without controversy - a controversy due in part to the change of political leadership at the end of 1986. With the zeal that attends the new accession to power and probably without intending to do so, the regime of 1986-1991 was partly responsible for what now appears to be a distorted evaluation of the economic management of the country up to 1986.

One of the aims of this paper therefore is to put the record straight. More importantly, however, the paper will seek to make the case that Caribbean economic managers must be willing to consider a different approach to fiscal policy, if the economies of this region are to find themselves on a path of sustainable development.

The paper is divided into four sections. Section I presents an outline of the economic structure and the main features of the boom-recession period of the Trinidad and Tobago economy. Section II will review the methodology of evaluating macro-economic performance using (i) a System-wide Approach and (ii) a Partial Indicator Approach. Section III will undertake an assessment of the mismanagement charge while Section IV will seek to identify the lessons to be learnt from the Trinidad and Tobago experience. The Paper ends with a few concluding remarks.

SECTION I

ECONOMIC STRUCTURE AND MAIN FEATURES OF THE BOOM-RECESSION PERIOD IN THE TRINIDAD AND TOBAGO ECONOMY

I.1 The Trinidad and Tobago Economy: Structure and Economic Objectives

Perhaps the most important features of the Trinidad and Tobago economy have been the dominance of a traditional export sector and the key role of the public sector. Table I-1 below shows the trends in the major traditional exports.

TABLE I-1
EXPORT TRENDS, 1955-1990

YEAR	TOTAL EXPORTS (\$Mn)	CRUDE PETROLEUM (\$Mn)	% SHARE	SUGAR (\$Mn)	% SHARE	COCOA COFFEE CITRUS (\$Mn)	% SHARE
1955	284.9	11.7	4.1	30.7	10.8	15.4	5.4
1960	491.8	21.9	4.5	37.4	7.6	14.1	2.9
1965	320.8	17.9	5.6	40.8	12.7	12.7	4.0
1970	527.2	10.1	1.9	42.0	8.0	17.0	3.2
1975	2330.7	1248.1	53.6	166.0	7.1	24.6	1.1
1980	6614.8	3924.2	59.3	67.0	1.0	39.1	0.6
1985	5159.8	2450.3	47.5	52.7	1.0	16.1	0.03
1990	8224.6	3219.8	39.2	129.8	1.6	n.a.	n.a.

Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Indicators; and Annual Economic Survey 1991.

The two single dominant items have been Crude Petroleum and Sugar. What we note however, is that while the share of petroleum in total exports moved from 4.1 percent in 1955 to 39.2 percent by 1990 after peaking at 59.3 percent in 1980, the share of sugar declined from 10.8 percent in 1955 to 1.6 percent by 1990, after peaking at 12.7 percent in 1965. In fact 1971 was the last year when export earnings from sugar (\$44.1 million) exceeded export earnings from petroleum (\$1.9 million).

With respect to Cocoa, Coffee and Citrus, the share in total export declined from 5.4 percent in 1955 to less than 1 percent in 1985. It is interesting to note that in 1955 Cocoa, Coffee and Citrus were together more important than Petroleum, and half as important as Sugar in terms of contribution share of total exports. Moreover, as time went on, all the agriculture items dwindled away and Petroleum became the significant component of total exports.

The significance of the public sector in the economy and the reliance of the public sector on oil revenues are seen in Table I-2 below.

TABLE I-2
SIGNIFICANCE OF THE PUBLIC SECTOR AND OIL REVENUES

YEAR	GDP (CURRENT) (\$Mn)	PETROLEUM SHARE IN GDP (%)	GOV'T REVENUE (\$Mn)	OILREV SHARE IN GOV'T REV. (%)	GOV'T EXP. SHARE IN GDP (%)
1955	476.1	29.2	81.3	48.1	18.7
1960	865.9	30.4	148.6	45.8	18.1
1965	1188.1	23.9	206.2	41.4	21.1
1970	1664.5	21.4	313.2	36.0	23.4
1975	5210.0	44.1	1680.3	74.7	23.1
1980	15554.4	42.8	5795.4	71.4	35.1
1985	17999.1	26.8	6361.2	38.6	42.9
1990	19690.2	31.8	5662.8	40.9	28.3

Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Indicators; and Annual Economic Survey 1991.

While the export earnings show that the economy effectively became a petroleum-dominated economy after 1972, Table I-2 shows that the public sector's reliance on petroleum predates the year 1972. For while the share of petroleum in GDP was just under 30 percent in 1955 it was just over this level in 1990, after peaking to between 40 and 50 percent during the boom period. The share of government expenditure in GDP seemed to show an upward structural shift in moving from just under 19 percent in 1955 to a little over 28 percent in 1990, after also peaking between 40 and 50 percent during the boom period.

To get an idea of how these trends were impacting on the level of welfare in general, and on the social sectors in particular, it may be instructive to portray the trend in per capita income and in government expenditure over the period. In Table I-3 we portray these trends together with the trend in the consumer price index.

TABLE I-3
TRENDS IN NNP, GOVERNMENT EXPENDITURE AND PRICES
[1955 - 1990]

YEAR	PER CAPITA NNP (TT\$)	GOVERNMENT EXPENDITURE (TT\$Mn)	CONSUMER PRICE INDEX
1955	592.0	89.0	100.0
1960	876.0	156.3	112.4
1965	1024.0	250.7	125.1
1970	1408.0	390.1	151.2
1975	4738.0	1201.1	280.4
1980	12353.0	5466.3	513.7
1985	13978.0	7723.0	932.1
1990	14000.0	5816.0	1482.3

Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Indicators; and Annual Economic Survey 1991.

According to Table I-3, while prices increased almost fifteen fold, between 1955 and 1990, government expenditure increased sixty-five fold and per capita NNP almost twenty-four fold. From a structural point of view it is instructive to note that the price increase in the 19-year period before the boom was less than twofold, while for the 19-year period after the onset of the boom it was almost six-fold. The corresponding cases of per capita income and government expenditure are compared to the case of prices in Table I-4 below.

TABLE I-4
CHANGES IN SELECTED KEY VARIABLES

Variable	Entire period	First 19 years	Second 19 years
Per capita Income	> 24-fold	> 5-fold	> 4-fold
Government Expenditure	> 65-fold	> 6-fold	> 11-fold
Consumer Prices	< 15-fold	< 2-fold	< 6-fold

Source: Computed from Table I-3.

These data point to the fact that by the time the recession had taken hold of the economy, real per capita incomes were below pre-boom levels, but real government expenditure was probably higher.

The sectorial distribution of the gross domestic product in Table I-5 below also confirms the stability of the government's contribution to real value added. The share remained relatively stable from 13.5 percent of GDP in 1955 to 13.2 percent by 1990,

after peaking at 17.8 percent in 1985. Perhaps the only other outstanding feature of distribution is the drastic fall in the share of Agriculture, from 17.0 percent in 1955 to 2.8 percent in 1990.

TABLE I-5
SECTORIAL DISTRIBUTION OF GDP
(% SHARES)

YEAR	PETRO- LEUM & MINING (\$Mn)	CONSTRUC- TION (\$Mn)	AGRI- CULTURE (\$Mn)	MANU- FACTURING (\$Mn)	GOV'T (\$Mn)	OTHER (\$Mn)
1955	29.2	3.5	17.0	12.5	13.5	24.5
1960	30.4	5.3	11.9	12.5	12.8	27.1
1965	23.9	4.4	8.4	17.6	11.7	34.1
1970	21.4	8.0	6.0	9.8	10.8	43.9
1975	44.1	7.6	4.9	6.2	9.9	27.2
1980	42.8	10.9	3.2	5.9	8.9	28.3
1985	26.8	11.1	4.8	6.6	17.8	32.9
1990	31.8	8.4	2.8	9.5	13.2	34.2

Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Indicators; and Annual Economic Survey 1991.

Having briefly considered the structure of the economy, it may be useful to consider the objectives of economic management. We turn to this in the next sub-section.

I.1.1 Objectives and Strategy 1955-1982: Diversification and The Use of Petroleum Income

It is probably safe to say that according to the first two Five Year Development Plans the major objective of economic policy was to attain as high a level of economic growth as possible.¹ This growth-maximization objective was justified on the usual grounds of the need to provide a higher standard of living for the vast majority of the population.² Proximate objectives included providing an expanding number of jobs and educational opportunities for the growing but relatively young population.³

¹ Government of Trinidad and Tobago, National Commission, Draft First Five-Year Plan, 1958-62.

² Government of Trinidad and Tobago, National Commission, Draft Second Five-Year Plan, 1964-68, pp. 3-8.

³ Draft Second Five-Year Plan, 1964-68, pp. 143-164.

The underlying strategy of development between 1955 and 1968, although influenced by the work of Professor Arthur Lewis, basically involved a reliance on private foreign investment to kick-start the domestic manufacturing sector. The expansion of this sector was seen as essential to entrepreneurial development, job creation, skills acquisition, and diversification of the production base. The sector was, however, never really seen as critical to the earning of foreign exchange which essentially was what the Arthur Lewis model had in mind.⁴

After fourteen years of following this strategy, the government concluded that a drastic change had to be made. The Third Five Year Development Plan therefore proclaimed a strategy which sought to have local decision makers, in general, and the public sector, in particular, play the key role in the development process. This proclamation took on a more urgent dimension after the social disturbances of 1970 which brought the government to the brink of collapse.

Having survived the 1970 social upheaval, the government articulated a strategy which emphasized the role of small business and the development of producer cooperatives. It is safe to say, that by the end of 1973, not only did this strategy not take root, but given the fiscal position of the government, it simply could not take root. Table I-6 below summarizes the fiscal position of the government in the nine years prior to 1974.

TABLE I-6
TRENDS IN REVENUE, EXPENDITURE AND FISCAL BALANCE

YEAR	TOTAL REVENUE (\$Mn)	TOTAL EXPENDITURE (\$Mn)	FISCAL BALANCE (\$Mn)	FISCAL BALANCE/GDP (\$Mn)
1965	232.4	250.7	-18.3	-1.5
1966	228.4	266.5	-38.1	-3.2
1967	230.4	271.0	-40.6	-3.2
1968	284.0	304.8	-20.8	-1.4
1969	308.3	325.7	-17.4	-1.2
1970	317.5	390.1	-72.2	-4.7
1971	351.9	465.1	-113.2	-6.8
1972	403.0	538.2	-135.2	-6.9
1973	481.1	556.2	-75.1	-3.1
AVERAGE				-3.6

Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Indicators.

⁴ W. Arthur Lewis, Development Planning, Unwin, 1966, pp. 48-50.

Table I-6 shows that over the period from 1965-1973, the fiscal balance registered an increasing deficit trend. In 1965, the nominal fiscal deficit was TT\$ 18.3 million. The deficit peaked in 1972 at TT\$ 135.2 million dollars and declined in 1973 under the initial impact of the first oil shock. Following similar lines, the ratio of fiscal balance to gross domestic product (GDP) more than doubled from -1.5 percent in 1965 to -3.1 percent in 1973 after attaining its peak in 1972 at -6.9 percent. The average share of the fiscal balance to GDP ratio for the period was -3.6 percent.

After oil prices rose in late 1973 the government's strategy apparently reverted to the one which was articulated in the Third Five Year Development Plan. The productive asset base of the public sector was vastly expanded, the public utilities were all targeted for major expansion and a previously drafted, very ambitious plan to develop a modern industrial complex at Point Lisas, was taken out, dusted off, and converted into a number of investment projects. It is probably worth noting that just about this time the government had decided that "planning had lost its mystique", and development planning in the true sense was apparently replaced by what we might call project planning.

The government apparently adopted a resource-base development strategy, relying initially on foreign technology and foreign skills. This was seen in some circles as the great opportunity to transform the country into a bona-fide industrialized country. Side by side with these developments was an ongoing development of the educational infrastructure and the development of the health sector with the latter's trail being blazed by the planned construction of a state-of-the-art Medical Sciences Complex at Mount Hope.

With these grandiose schemes in mind and with the rapid expansion in the quantity and the size of a number of welfare items in the budget, the government became concerned about the rapid growth in its expenditure. Having set up a committee to review and advise on its future expenditure behavior, it was counselled to be much more cautious in the future. To its eternal credit the 1978 Bobb Committee Report on Public Expenditure suggested that no new major expenditures should be entered into except a clear plan was also in place for recovery of the sums expended.⁵

However, when the second and more impressive round of oil price hikes took place in late 1979, the government breathed more easily and may have put the Bobb Committee Report on the shelf. In real terms recurrent expenditure grew by 57.3 percent between 1979 and 1982!

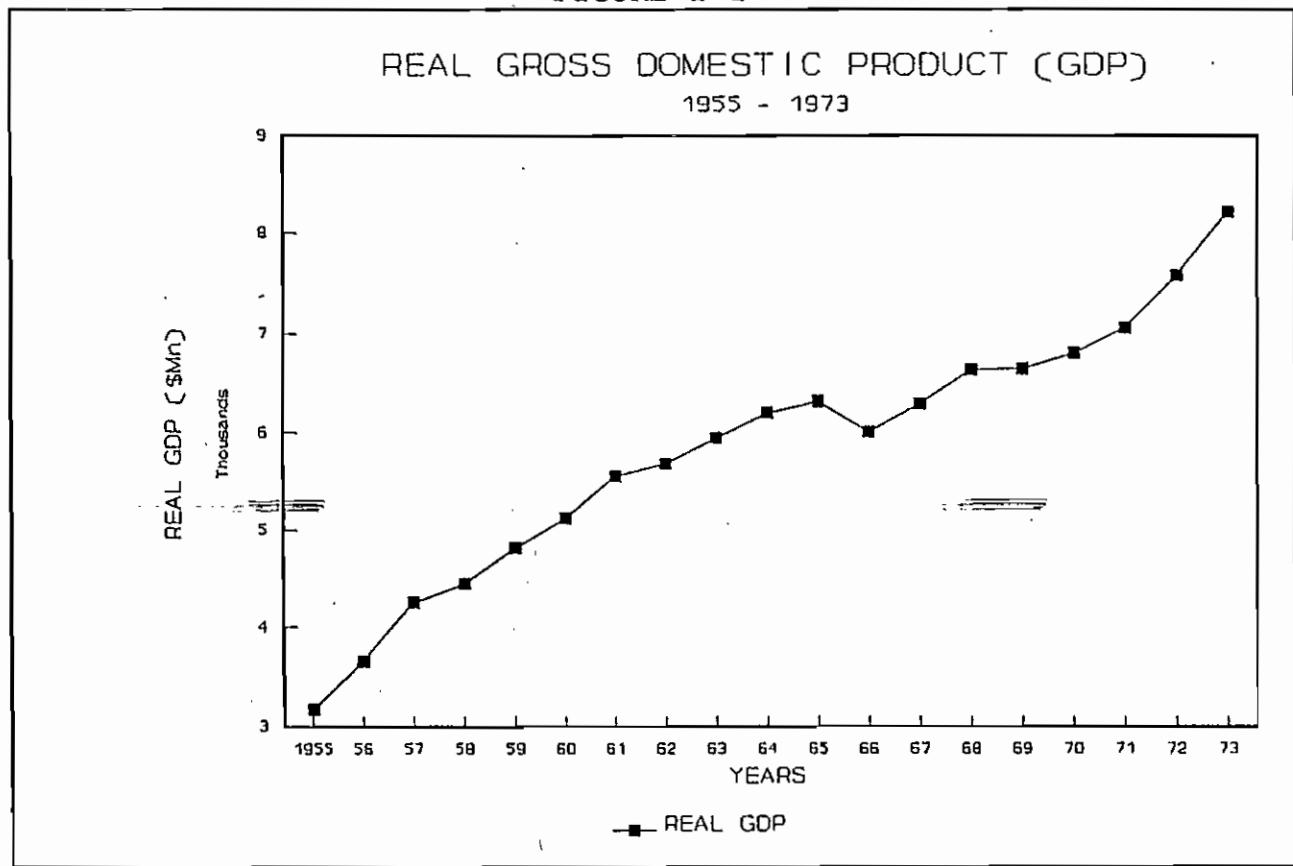
⁵ Report of the Committee to Review Government Expenditure, 1978.

Having considered some aspects of the impact of the boom on the economy, it is now necessary to provide some estimates of the quantitative dimensions of the boom and recession. We turn to this in the second part of this Section.

I.2 The Boom and Recession in Quantitative Terms

We begin with the assumption that what matters in a quantitative investigation of this kind is the relative changes that took place in the economy over a given period. For this reason we begin with the hypothesis that the pre-boom period 1955-1973 was a normal one for the economy. As Table I-5 showed, the evidence suggests that except for Agriculture, the sectorial distribution of output for the pre-boom period remained more or less unchanged while the rate of economic expansion followed an almost linear trend. The GDP trend for the pre-boom period is shown in the diagram below.

FIGURE I-1



We also make the assumption that if the boom and the recession had not taken place, the 1955-73 trends would have continued into the

future.⁶ In this context therefore, we can regard the post-1973 period as being comprised of two abnormal sub-periods namely, the boom period of 1974-1982 and the recessionary period of 1983-1990. With this approach, we will then be able to measure the "deviations" from the pre-boom trend which characterized these two sub-periods.

For purposes of this presentation we propose to look at the trends as they have emerged in respect of a few key variables: aggregate real gross domestic product (GDP); per capita real GDP (PCGDP); recurrent government expenditure (RGOVEX); total government expenditure (TGOVEX); the level of employment (EMPL); the balance of payments (BOP); and the level of oil revenues (OILREV).

TABLE I-7
SOME KEY MACRO-ECONOMIC VARIABLES, 1955-1990

YEAR	REAL GDP (1982) TT\$Mn	PER CAP. GDP TT\$	REAL RGOVEX TT\$Mn	REAL TGOVEX TT\$Mn	EMPL ('000)	C/A BALANCE TT\$Mn	OIL REVENUES TT\$Mn
1955	3174.0	4408.3	469.3	593.3	N/A	-33.3	260.7
1960	5123.7	6099.6	703.6	924.9	N/A	-86.4	402.4
1965	6319.2	6514.6	1027.1	1333.5	305.5	-156.7	453.7
1970	6799.1	7009.4	1229.8	1711.0	317.2	-116.3	494.3
1975	12316.8	12194.8	2003.8	2839.5	332.4	715.9	2966.4
1980	20095.6	18607.5	3972.9	7062.2	388.1	1132.3	5344.3
1985	12810.7	10856.6	4325.9	5496.8	399.5	-263.4	1748.8
1990	8813.8	6779.9	2492.5	2696.5	374.0	430.0	1037.1

Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Indicators; and Annual Economic Survey 1991.

Based on the data shown in Table I-7 above it is obvious that for a number of the key macro-economic variables the positive impact of the boom was substantially exhausted by 1985 and since then the economy has been operating below the extrapolated pre-boom trend levels.

In order to arrive at an estimate of the contribution of the boom and the recession as distinct for the influence of the underlying trend, we can use the technique of summing the residuals on the estimated time trend. In the case of employment, for example, we see that the average job-creation due to the boom of 1974 to 1982 was close to 28 thousand per annum. By the same standard the extent of job loss due to the recession over the period 1987 to

⁶ A similar assumption is made by Alvin Hilaire, Economic Reactions to a Sectoral Boom: Trinidad and Tobago, Ph.D. Thesis, 1989, pp. 42, Columbia University.

1990, was 11 thousand per annum. Similar estimates can be derived for each of the other macro-economic variables. The behaviour of the actual and trend values for the relevant variables in Table I-7 are shown in Appendix I-1.

The technique used can probably shed some light on the controversy over the estimates of the oil revenue windfall which became available to the government over the 1974-1982 period. Estimates have varied between twenty-two billion and sixty-four billion.⁷ Based on the method suggested above we arrive at an average nominal windfall estimate of TT\$32457.3 million.

Although much of the discussion has been (wrongly) carried out in nominal terms we see that even on that basis, the windfall was nowhere near TT\$ 64 billion. Using another similar method, Gelb [1988] has estimated the windfall to be 39 percent of non-mining output for the 1974-78 part of the boom and 35 percent for the later part.⁸

Using the (more appropriate) constant dollar measure we see that in 1982 dollars the extent of the oil revenue windfall was TT\$29627.2. The revenues earned in the 1974-78 period was TT\$14954.5 which was as much as 1.8 times that earned in the 1955-73 period.

Although we have been using the period 1974-1982 as the boom period it is obvious that most of the variables experienced a tail-wind effect of the boom in that their levels remained above the trend even after the decline in oil prices started in 1982. In the case of each variable we can therefore describe the boom and tail-wind (BAT) effect as the full above trend effect due to the boom.

Using the sum-of-the-residuals technique we can estimate the constant dollar net effect on the variables as the difference between the BAT effect and the recession effect. These net-effects are portrayed in Table I-8 below.

⁷ These figures represent the range of estimates used by several speakers during the 1980 Election Campaign..

⁸ Gelb, A. Oil Windfalls: Blessing or Curse?, Oxford, 1988, pp. 266, 274.

TABLE I-8
BOOM AND TAIL-WIND, RECESSION AND NET EFFECTS
OVER THE PERIOD 1974-1982

VARIABLE	BAT EFFECT	RECESSION EFFECT	NET EFFECT	AVERAGE NET EFFECT
GDP	70241.1	13791.3	56449.8	3320.6
PCGDP	74672.9	7877.2	66795.7	3929.2
OILREV	29627.2	72.9	29554.3	1738.5
RGOVEX	16206.6	4029.6	12177.0	716.3
TGOVEX	34395.4	6105.6	28289.8	1664.1
EMPL	5331.1	1111.3	4219.8	248.2
C/A BAL	4423.7	-7886.8	-3463.1	-203.7

Source: Computed

The figures in the last column of Table I-8 tell us what the country has been left with after the boom and its subsequent recession. The significance of these figures is that they tell us the values that stand threatened by further recession. For since positive net effects indicate that at 1990 the country was still better off for having experienced the boom, the prospect of further recession is really the prospect of these net effects becoming negative at some stage.

Having quantified the impact of the boom and the recession on key variables and having earlier discussed the objectives of economic policy, we are now in a position to discuss the evaluation of the economic management of the period 1973-1991. This is done in the next Section.

SECTION II

THE METHODOLOGY OF EVALUATING MACROECONOMIC PERFORMANCE

II.1 General Approaches

It should come as no surprise that evaluations of economic performance or of economic management are usually the subject of serious controversy. Perhaps a classic case of the potential for such controversy was demonstrated in a recent article by Moshin Khan [1990], in which the author sought to evaluate the impact of IMF Stabilization/Structural Adjustment Programmes in a number of countries.¹

In the article, Khan [1990] differentiated between four evaluation methodologies and not surprisingly, ended up by expressing a preference for the method that was most favourable to the Fund programmes. The evaluation methods considered were the following:

- (a) The Before/After Method;
- (b) The With/Without Method;
- (c) The Actual/Target Method; and
- (d) The Comparison-of-Simulations Method.

As the name suggests, the Before/After method is essentially a time series comparison of different states of the economy - the state prior to policy implementation and the state which has been presumably influenced by the policies implemented. Khan [1990] is understandably not happy with this approach because of the difficulty of isolating the effects of a specific policy measure in a context where other factors introduced might be also important.

The With/Without method or Counterfactual method represents an improvement on the first method. It is more a case study approach, either cross-sectional, or cross-sectional mixed with time series. The problem with this method, according to Khan [1990], is that the difficulty of isolating particular effects is now replaced by the fact that the countries or periods in the sample cannot be randomly selected.

In spite of this limitation this is the method that is strongly endorsed by Mosley, Toye and Harrigan [1991] in a recent very

¹ Reference to Moshin Khan's article entitled "The Macroeconomic Effects of Fund-Supported Adjustment Programmes" in IMF Staff Papers, Vol: 37, No. 2, June 1990.

impressive review of World Bank adjustment lending. These authors hold that with slight modification, this method can do what is expected of any evaluation method.

Perhaps it should be pointed out at this stage that the use in this paper of the pre-boom data to arrive at a hypothetical post-boom trend is an application of the With/Without method.

The third approach, the Actual /Target method seeks to answer the question: How the actual outcomes of a certain set of policies compare with what was expected to happen when the policies were implemented?

The fourth approach mentioned by Khan [1990] is the Comparison-of-Simulations method. By this method we simulate the effects of a number of alternative policy packages - one of which, in his case, was the IMF package. We then compare the sets of hypothetical outcomes. Although it might be argued that Khan's preference for the simulation approach was a convenient one since it was the only one that was consistently benign to Fund programmes, we should not lose sight of the fact that this last method is a most useful tool in the hands of those concerned with scientific policymaking.

The four approaches discussed above share in common the need for a fully articulated model of the economy which incorporates the main features likely to be affected by specific policy instruments. Yet it may be argued that since the essence of performance evaluation is first and foremost qualitative, it would be very helpful if we could initially make use of a less elaborate method to get a sense of where the overall evaluation exercise might take us. This paper proposes to make an attempt to use such a method in the next sub-Section.

II.2 ~~A Partial~~ Indicator Approach to Evaluation

The basis for the approach being suggested in this paper can be gleaned from suggestions made by Williamson [1982]² on the one hand, and by Greene and Villanueva [1991] on the other.

It was Williamson who reminded us that as diverse as economies might be, there are four key economic management concerns which most economists would agree on as components of "good" policy making. These are:

² John Williamson, "On the Characterization of Good Economic Policy: Is There a Consensus?", World Development, September, 1982.
Greene and Villanueva, World Development, Vol. 10, No. 9, 1982.

- (i) The concern to minimize efficiency distortions in the economy, or to get the economy operating on its production possibility frontier;
- (ii) The concern to keep the rate of inflation from crossing some national threshold of "significant" welfare loss, due to the impact of distorted expectations on the decision making on the part of investors;
- (iii) The concern to maintain internal balance on a continuous basis - keeping the inflation rate and the rate of unemployment from simultaneously imposing avoidable but permanent losses on the society; and
- (iv) The concern to maintain external balance on a medium term basis, recognizing that the international economic system comprises institutional arrangements which do not make continuous balance necessary.

In similar vein, more recently Greene and Villanueva [1991] have reminded us that the inflation is probably the most frequently used indicator in discussions of macroeconomic stability.³

In both literature references we seem to have a case being implicitly made for cautious but productive use of partial indicators of good economic management. It is well known that one of the major problems with partial indicators is the possibility of these indicators pointing in opposite directions. It would seem therefore that a prima facie case for a qualitative judgement on performance may be made if apparently divergent indicators can be shown not to be divergent after all.

Moreover, the position taken in this paper is that since economic performance is partly management-determined and partly determined by factors ~~outside of the~~ control of managers, ~~relevant additional~~ information can be used to reconcile apparently divergent implications of any pair of partial indicators.

Therefore while we grant the usefulness of the Comparison-of-Simulation approach preferred by Moshin Khan [1990] and the With-Without approach of Mosley, Toye and Harrigan [1991], the non-existence of an appropriate model at this time precludes application of these methods to Trinidad and Tobago. The partial indicator method will therefore be employed as we seek to answer

³ Reference to an article by Greene, J. and Delana Villanueva entitled, "Private Investment in Developing Countries: An Empirical Analysis", in IMF Staff Papers, Vol 38, No. 1, March 1991.

in the next section the major question about economic management.⁴

⁴ Although Hillaire [1989] provides an interesting empirical analysis of the boom period against the backdrop of a neo-classical price-theoretic model, the model itself was not calibrated to data on the economy.

SECTION III

HOW WELL WAS THE TRINIDAD AND TOBAGO ECONOMY MANAGED IN THE PERIOD 1974 - 1982?

We have already suggested that the public sector's access to petroleum revenues made it possible for this sector to become a key determinant of economic outcomes in Trinidad and Tobago. It would seem therefore that perhaps the simplest way in which we can enter upon a discussion of management during the boom period is to consider how the windfall earnings from the petroleum industry were distributed. The use of the windfall earnings has been categorized by one author in terms of the shares going to domestic consumption, investment and foreign savings.¹ The estimated distribution is shown in Table III-1.

TABLE III-1
DISTRIBUTION OF CONSUMPTION, INVESTMENT AND FOREIGN SAVINGS

PERIOD	CONSUMPTION	INVESTMENT	FOREIGN SAVINGS
1974-78	18%	12%	70%
1979-82	25%	25%	50%

Source: Alan Gelb, op.cit. pgs. 269 & 274.

In the Gelb [1988] study which compared Trinidad and Tobago to five other oil exporters², Trinidad and Tobago was at the top of the list with respect to foreign savings, and at the bottom of the list with respect to consumption. These observations suggest an effort to manage the new resources properly. In seeking to explain this bias towards foreign savings and relatively low consumption, there are three hypotheses which can be considered:

1. The government was prudent in that it did not see the boom as lasting forever;
2. The government was able to act in a dictatorial manner and resist opposition pressures to spend; or

¹ Alan Gelb [1988], Oil Windfalls: Blessing or Curse, Oxford University Press, 1988.

² Algeria, Ecuador, Indonesia, Nigeria and Venezuela.

3. The Government was limited by the lack of an expenditure infrastructure to deal with the large sums of revenues that were coming in.³

These three hypotheses are of course not mutually exclusive. Due to the lack of independent data to test the third hypothesis the rest of this Section will concentrate on the first two hypotheses.

The Hypothesis of Prudent Management

In evaluating the first hypothesis of prudent management, it will be useful to make reference to Williamson's [1982] four criteria of "good" economic policy:

- (a) micro-efficiency;
- (b) inflation control;
- (c) internal balance; and
- (d) external balance.

These criteria will be examined for the positive and negative impressions that they bring to bear on the evaluation exercise.

Micro-efficiency

Here we briefly focus on two areas that are supposed to create efficiency distortions:

- (i) The exchange rate - the fact that this rate was adjusted from TT\$2.0 = US\$1 in 1976 to TT\$2.4 = US\$1 suggests a positive ~~contribution to economic management during~~ the first phase of the boom. The assumption here is that this devaluation was part of a response to the recognition that the exchange rate was overvalued.
- (ii) The State Enterprise Sector - This sector was expanded apparently using the principle of price less than average costs ($P < AC$). So for declining cost industries, depending on the level of the price, this might also imply price being less than marginal cost ($P < MC$). Since there is no study done to refute or confirm the relationship between price and marginal cost for the State Enterprise Sector the focus was on the huge financial losses which these enterprises incurred.

³. Although this hypothesis is associated with the name of Steve De Castro, an appropriate reference was not available while this paper was being prepared.

Without some evidence that the funds used to finance these deficits had a social opportunity cost higher than the benefits accruing to users of the goods and services provided, no definitive evaluative statement can be made.

Taking these two factors of micro-efficiency into consideration, it would appear that the weight of the evidence does not point in the direction of mismanagement. More information is clearly needed before any definitive conclusions about economic management can be drawn.

We turn now to a discussion of Williamson's inflation and internal balance criteria in the context of Trinidad and Tobago. We discuss these criteria in the context of the stabilization responsibility of the government. We begin with a discussion of the taxation performance of the government.

The Tax System

As far as stabilization or demand management is concerned, it is useful to consider what was happening to non-oil revenue collections when the oil revenues were on the increase. Did the government significantly reduce the effort to collect non-oil revenues? If so, this may be interpreted as a management weakness since the basic theory of stabilization tells us that as incomes increase, a progressive tax system should lead to higher revenue collection. The intention here would be partly to provide savings for the future to facilitate stabilization when recession begins, and partly to maintain what Williamson has called internal balance - keeping the inflation rate and the unemployment rate from imposing avoidable significant losses on the society.

The data for the period 1974 to 1982 showed that as oil revenues increased, ~~non-oil revenues~~ increased at more or less an equivalent rate. This is summarized in the regression equation below which shows that the standard error of the elasticity estimate is consistent with a unit elasticity coefficient linking non-oil revenues to lagged oil revenues:

$$\ln_{oil} = 1.06 + 0.733 \ln_{oil} (-1) \\ (1.02) \quad (0.139)$$

$$R^2 = 0.77 \quad D.W. = 1.33$$

What appears to be an accepted stabilization record by the government is confirmed by the behaviour of the inflation rate during the boom period. As already indicated, the partial-

⁴ The 95% range of the estimate is $0.733 \pm 2(0.139)$ that is, (0.455, 1.011).

indicator methodology being employed in this presentation accepts the position in Greene and Villanueva [1991] that "high inflation rates are often considered as an indicator of macro-economic instability, and a country's ability to control macro-economic policy"....⁵ It would seem that this thesis can be applied to yield a useful guide to the quality of economic management during booms and recession.

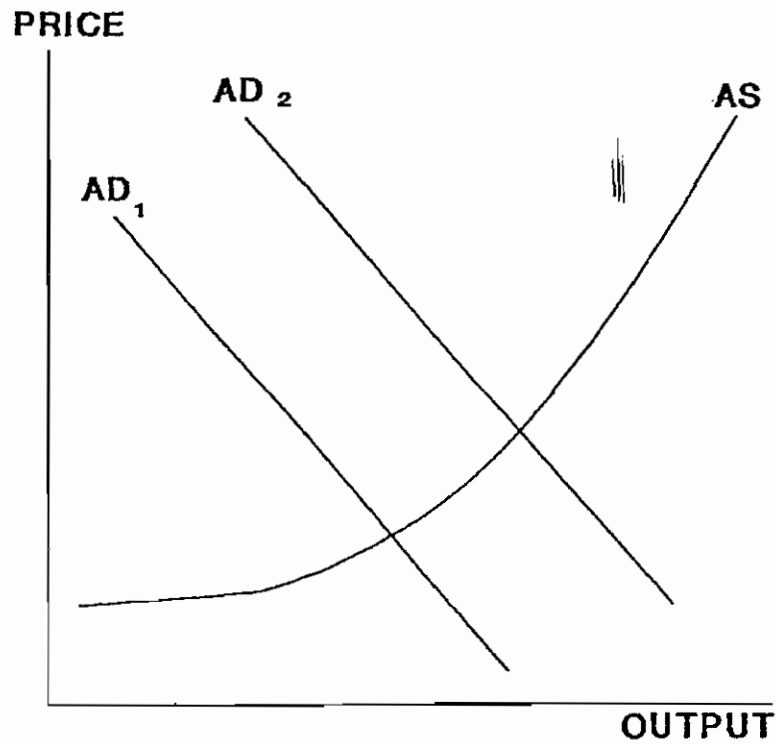
The basic idea is as follows. When an economy begins to experience a boom, it is reasonable to expect that the supply response to the boom will lag behind the demand response. If the economy is at or near capacity utilization therefore, we would expect a sudden jump in the price level. Two possible cases are shown in Figure III-1 below.

For capital-scarce developing countries, represented by Diagram III(b) we would expect that the rate of inflation immediately following the arrival of buoyant conditions would show signs of significant acceleration. However, where the economy is being deliberately managed we would expect that a combination of fiscal and monetary policy will be applied to control the inflation rate in the short term, while efforts are being made to boost supply either domestically or by an appropriate sourcing of imports.

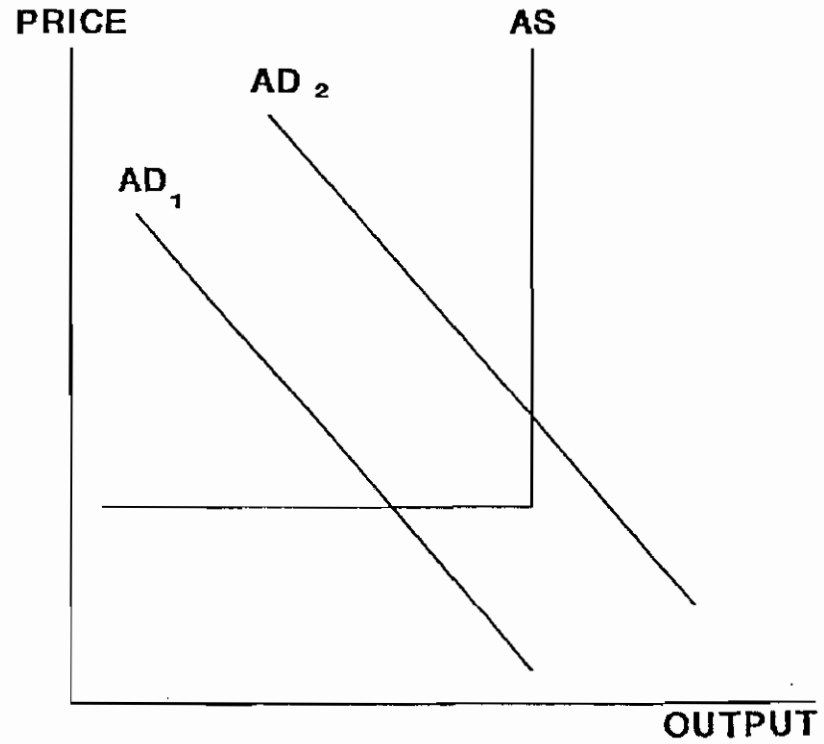
⁵. Greene and Villanueva, "op. cit.", pp. 41.

FIGURE III - 1

PRICE REACTION AND SUPPLY CONSTRAINTS



(a) General Case



(b) Developing Country Case

The impact of the policies applied will not necessarily reverse a long term upward trend in the price level but the rate of inflation should be non-accelerating. Where the economy is not being deliberately managed, we should expect that under the continued impact of the boom, the rate of inflation will continue to accelerate.

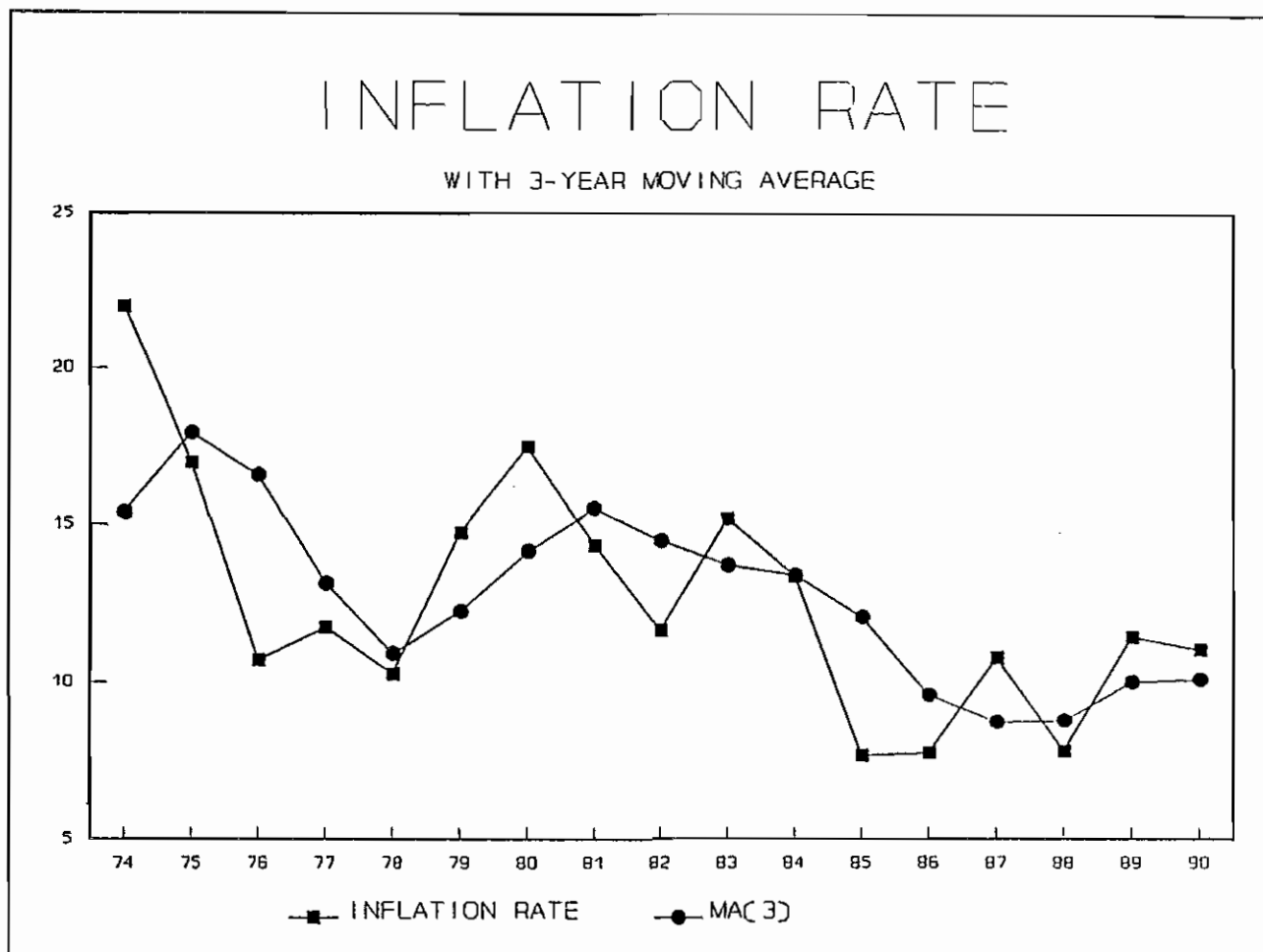
What of the behaviour of the inflation rate during the recessionary period? In small open economies a recession would normally be reflected in the worsening of the foreign exchange constraint partly due to unfavourable export conditions and partly due to a drastic decline in private foreign investment.⁶ In these circumstances the aggregate supply constraint becomes immediately effective. However, since the recession also implies a fall in income, we have two opposing tendencies on the inflation rate.

Partly because of the tendency to maintain consumption by using up personal savings, and partly because of the difficulty in effecting sudden cuts in government recurrent expenditure, we would normally expect the demand response to the recession to lag behind the supply response. In this case therefore, *ceteris paribus*, we would expect the rate of inflation at the start of the recession to be higher than the rate which prevails after the efforts to cut public expenditure have begun to bear fruit.

In summary therefore, it would seem that deliberate economic management in both boom and recession is consistent with a pattern of sudden acceleration followed by a more prolonged deceleration in the inflation rate. The experience of Trinidad and Tobago is portrayed in the diagram below. The picture is clearly one which not consistent with economic mismanagement: the rate of inflation accelerates in response to each spike in the oil price and decelerates afterwards.

⁶ Helleiner, G.K., "Balance of Payments Experience and Growth Prospects of Developing Countries", World Development, 1986.

FIGURE III-2



It is interesting to note that compared to the other five oil exporters in the Gelb [1988] study, only the Indonesian case compares favourably with that of Trinidad and Tobago. The inflation story of some of these countries is portrayed in the Appendix III-1.

We turn finally to the last of the Williamson criteria - the maintenance of external balance.

External Balance

It must be admitted that the dominant factor determining the external balance - the value of oil exports - probably had nothing to do with the efficiency of the management of the economy. Neither the price of oil or the quantity of oil exported was under the control of the government of Trinidad and Tobago. What one may wish to look at is the rate of growth of imports relative to the

the behaviour of imports relative to the rate of decline in oil revenues when the recession set in.

It seems reasonable to expect that the boom would have an immediate demand response which, given the structure and traditions of the economy, would be partly manifest in a dramatic rise in imports. However, a concern with balance of payments equilibrium would point to the need for policy to give some priority to the boosting of domestic production. Ideally we would expect the rate of growth of imports to be less than the rate of growth of domestic production.

Applying this criterion we have compared the real value of imports (using a domestic expenditure deflator) with the All-Industry Index of Production, using 1977 as the base year.⁷ Data for the period 1977 to 1990 are shown in Table III-2 below and the picture is summarized in Figure III-3.

TABLE III-2

YEAR	TOTAL IMPORTS TT\$m	DOMESTIC EXP. DEFLATOR	REAL IMPORTS TT\$m	IMPORTS INDEX	ALL-INDUSTRY PRODUCTION INDEX
1977	4371.1	1.00	4371.1	100	100
1978	4751.8	1.06	4499.8	103	114
1979	5067.1	1.23	4129.4	94	115
1980	7664.1	1.41	5435.9	124	123
1981	7462.0	1.63	4582.3	105	118
1982	8878.4	1.95	4562.4	104	125
1983	6190.9	2.13	2902.7	66	177
1984	4605.9	2.36	1952.6	45	165
1985	3739.0	2.27	1644.3	38	161
1986	4794.1	2.50	1920.1	44	205
1987	4241.1	2.55	1663.7	38	210
1988	4181.3	2.80	1491.1	34	203
1989	5110.8	3.08	1656.9	38	204
1990	5361.8	3.39	1580.2	36	209

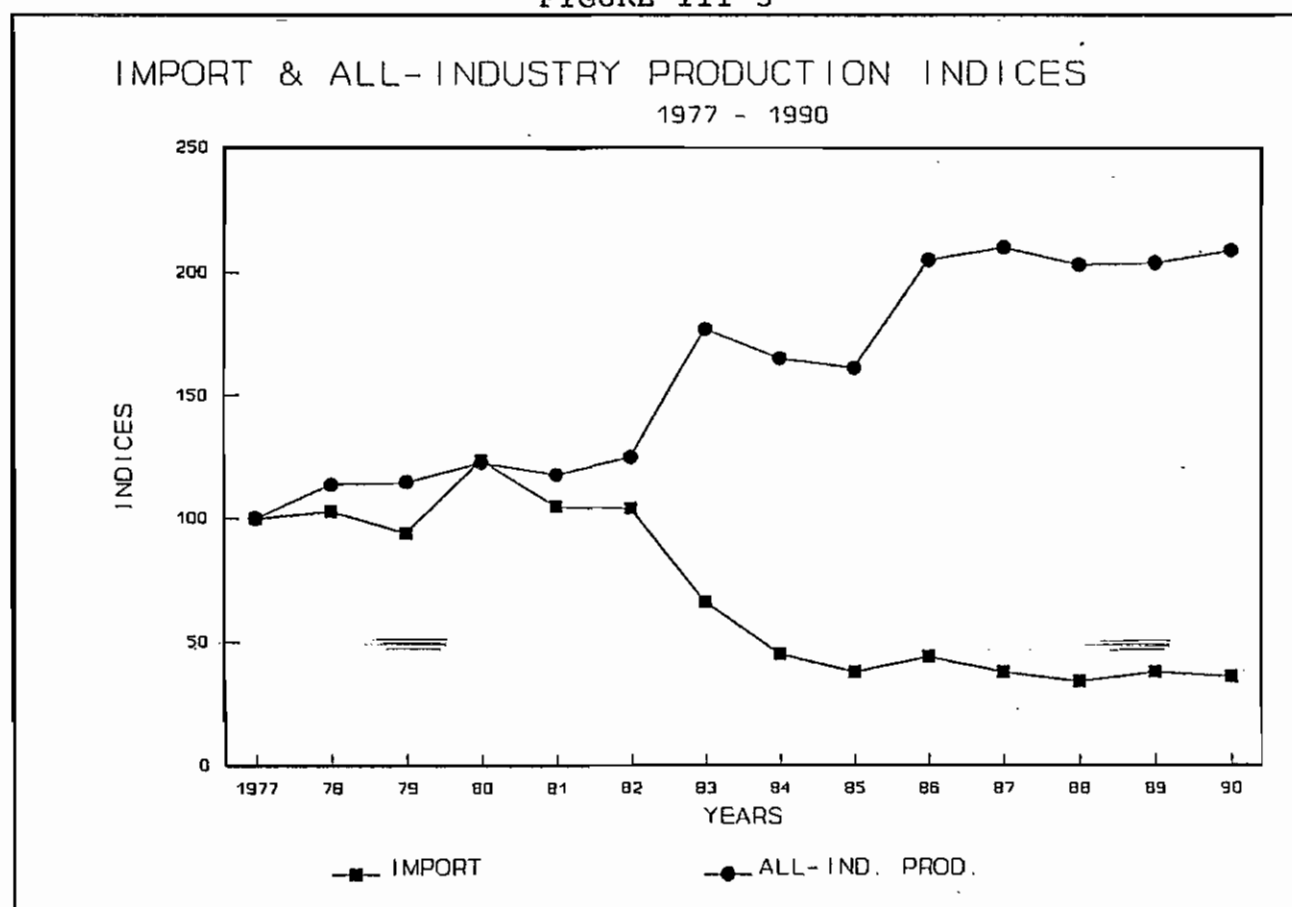
Source: Central Bank of Trinidad and Tobago, Handbook of Key Economic Statistics, 1989; Quarterly Economic Bulletin, March 1992.

From Table 10 we see that while over the 1977 to 1982 period nominal imports grew by more than 100 percent, the domestic expenditure deflator grew by almost the same amount. In fact in

⁷. Data on Industrial Production for the period 1974 - 1976 were not available at the time of writing.

real terms, imports grew from TT\$ 4371.1 million in 1977 to TT\$ 4582 million in 1982, an increase of a mere 4.8 percent. Over the same period the Index of Industrial Production moved for 100 to 125, an increase of 25 percent. What is even more remarkable is the fact that once the oil revenues began to decline real imports fell away very dramatically while industrial production was still increasing significantly enough. The Table shows that between 1983 and 1990 real imports fell from TT\$ 2902.7 million to TT\$ 1580.2 million, a decline of 45.6 percent. On the other hand, the Production Index rose from a level of 176.7 to 209, an increase of 18.3 percent. The widening gap between the simple index of real imports and the index of All-Industry Production is shown in the Figure below.

FIGURE III-3



On balance therefore, it would seem that the Partial-Indicator Method has not confirmed popular notions of mismanagement of the Trinidad and Tobago economy. The bias towards foreign savings was therefore consistent with a cautious management style on the part of the government.

Of course, the question of whether the foreign savings bias was the result of the peculiar political circumstances of the government still needs to be answered.

The Absence-of-Opposition Hypothesis

We now turn to the second hypothesis - one put forward by Gelb [1988]. We can refer to this one as the Absence-of-Opposition hypothesis. Basically, the point Gelb makes is that since there is always enormous pressure on the government to spend the money that it gets, one sensible explanation for the relatively low rate of spending by the Trinidad and Tobago government is the fact that at the onset of the boom there was no Parliamentary Opposition. The General Elections of 1971 were boycotted by the Opposition parties, and this left the government of the Peoples National Movement (PNM) with all the seats in Parliament. In this situation the government cannot be said to have been under the normal democratic pressures to increase its rate of spending.

The government therefore had the opportunity to act in a dictatorial manner if it chose to, and hold back on spending.

The implicit suggestion is that the boom period of 1974-82 can be divided up into two sub-periods: 1974-76 when there was no Opposition, and 1977-82 when the Opposition was back in Parliament. In Table 10 below we have portrayed the rates of growth in real government spending during both sub-periods of the boom. On the face of it, the observed lower rate of spending during the second boom period of 1979-82, as compared with the 1974-78 period, seems not to provide prima facie support for the Gelb hypothesis.

For if the Gelb hypothesis is correct, then, ceteris paribus, we should see higher rates of growth in public expenditure in the latter of the two sub-periods, that is, when the Opposition was active in the Parliament. A key point here relates to the ceteris paribus assumption. For example, it would be misleading to include those items of capital expenditure which were planned in the 1974-76 period but which only came on stream in the latter period.

Our comparison of the two periods therefore should relate only to the government's recurrent expenditure. This is what is done in Table III-3 below where we also show the 3-year moving average of the growth rate in the final column.

TABLE III-3
REAL GOVERNMENT RECURRENT EXPENDITURE
[1974 - 1982]

YEAR	REAL (1985) GOVT. EXPEN. (TT\$ Mn.)	RATE OF GROWTH %	3-YEAR MOV. AV. %
1974	3622.8	41.3	-
1975	3882.1	7.2	12.8
1976	5560.9	43.2	30.6

1977	6002.4	7.9	19.4
1978	6981.2	16.3	22.5
1979	9200.3	31.8	18.7
1980	9787.3	6.4	18.2
1981	10372.8	6.0	14.7
1982	13225.7	27.5	13.3

Source: Computed

Table III-3 shows that during the three boom years, with no Opposition in Parliament, the average of the annual rates of increase in spending was a little more than 30 percent. On the other hand, during the first three years after the Opposition returned to the Parliament, the average of the annual rates of increase in spending was a little less than 19 percent. Since the three-year averages in the second period are all less than in the first period, Table 10 therefore appears not to confirm that the rate of expansion in government expenditure tended to be higher in the "Opposition" period of the oil boom.

In all fairness, it must be pointed out that since the pre-boom period was one of relatively low rates of growth in expenditure, it must be expected that the post-boom rates would have been appreciably higher. Even so, the difference in the average rates seems to disqualify the Gelb hypothesis.

It would seem therefore, that the popular notion that the economy of Trinidad and Tobago was not well managed during the boom years is not supported by the facts. The prudent management hypothesis not only stood up reasonably well to testing, but the alternative hypothesis suggested was not supported by the evidence. While it would take a much more detailed analysis to "prove" that the economy was well managed, our analysis has certainly pointed to caution in coming to any general conclusion that the economy was not well managed.

Where does this conclusion leave us? If, as the data suggest, the economy may have been reasonably well managed during the boom, why has it been so difficult for the Trinidad and Tobago economy to

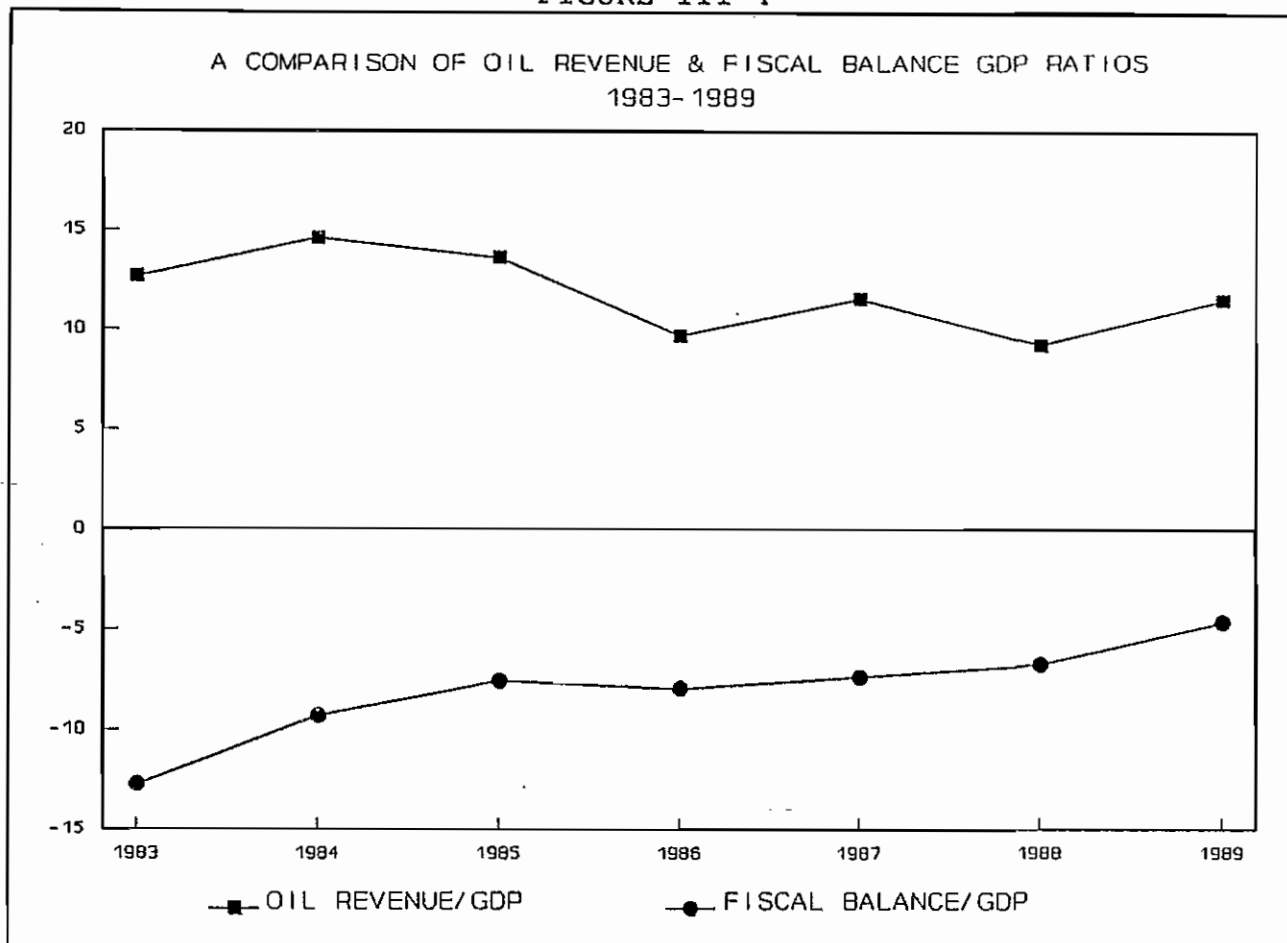
get back on its feet, once it became clear that oil prices and oil production were not going to be a solid basis for future economic planning? Why has the adjustment been so painful? First we will explore the some of the responses that were made in the face of the falling oil prices and then we will attempt to answer these questions by considering the main lessons of the Trinidad and Tobago experience.

Adjustment to Falling Oil Prices

As would be expected, the adjustment to falling oil prices should be visible in four key policy areas: fiscal policy, monetary policy, exchange rate policy and incomes policy. We will briefly consider the fiscal policy response. We focus of fiscal policy since this paper accepts the validity of the Premchand [1979] dictum that fiscal policy is the key instrument of development planning. A similar suggestion was made by Jones-Hendrickson [1988] to the effect that the small open economies of the Caribbean have little else to fall back on.

One of the criticisms that might be made of the Trinidad and Tobago government's response to the falling oil prices is the slow reaction to the emerging downward trend in its oil revenues. The concept of a "soft landing" which was used in the 1983 Demas Report seemed to be an implicit assumption that the emerging trend was going to be temporary. While the wisdom of hindsight broadly confirms this type of criticism, it is instructive to consider the specific fiscal policy response by the government. In the diagram below we summarize this response as being incorporated in the trend of the fiscal balance/GDP ratio.

FIGURE 111-4



When oil revenue/GDP is increasing, we expect, ceteris paribus, that the fiscal balance/GDP would be also be increasing. By the same token when the oil revenue/GDP ratio falls we should expect the fiscal balance/GDP ratio to be falling. A positive fiscal policy intervention would be exhibited if in the face of a falling oil revenue trend the corresponding trend in the fiscal balance/GDP ratio was upward. This is precisely the picture that emerges for Trinidad and Tobago after the recession started in 1983. As Figure III-4 shows while the oil revenue ratio was falling from 12.7 percent in 1983 to 11.5 percent in 1989, the fiscal deficit/GDP ratio was increasing, from -12.7 percent to -4.6 percent!

A more detailed examination of this phenomenon can be done by considering the separate responses of total revenues (TOTREV) and of expenditure to the falling oil revenues (OILREV). The double-log regressions below summarize these results.

In the case of total revenues we obtain the result:⁸

$$\begin{aligned} \text{LTOTREV} &= 4.68 + 0.54 \cdot \text{LOILREV} + 0.89 \cdot \text{AR}(1) \\ &\quad (0.57) \quad (0.07) \quad (0.06)^9 \\ \text{R-bar Sqd.} &= 0.98 \quad \quad \quad \text{F} = 532.9 \end{aligned}$$

This result says that for the period 1973 to 1990 as a whole, a 10 percent increase in oil revenues led to a 5.4 percent increase in total revenues.

Similarly, in the case of total expenditure (TOTEXP) we have the result:

$$\begin{aligned} \text{LTOTEXP} &= 7.56 + 0.19 \cdot \text{LOILREV} + 0.89 \cdot \text{AR}(1) \\ &\quad (1.00) \quad (0.13) \quad (0.06) \\ \text{R-bar Sqd.} &= 0.96 \quad \quad \quad \text{F} = 224.6 \end{aligned}$$

This result actually suggests that the expenditure response to changes in oil revenues was insignificant compared with the extent of inertia in the expenditure system.

When the more appropriate expenditure variable - recurrent expenditure - is regressed against oil revenues we obtain an even more insignificant response.

What these results seem to be showing is that the major determinant of current government expenditure is past government expenditure. In other words, the government apparently tends to get itself locked in to expenditure patterns which are not particularly responsive to its main source of revenues. In these circumstances the ability of the government to reduce the deficit/GDP ratio while the oil revenue/GDP ratio was falling is therefore not surprising. We may not yet have a clear notion of how this was achieved but the evidence points to a much higher degree of fiscal discipline than is generally assumed in respect of Trinidad and Tobago governments.

The downside of the inertia in government expenditure is that even when the government may get the general direction of its policy response correct it remains thoroughly exposed to major exogenous "surprises". This is probably what happened in 1986 when the oil price fell dramatically from US\$ 28 to below US\$ 10, levelling out for the year around US\$ 13. What then can we learn from the Trinidad and Tobago experience? We turn to this in the final section of the paper.

⁸. The regressions have all been corrected for first-order autocorrelation, using the TSP Program.

⁹. All numbers in parentheses are standard errors.

SECTION IV

LESSONS FROM THE TRINIDAD AND TOBAGO EXPERIENCE

There are at least four lessons that seem to emerge from the Trinidad and Tobago experience. For reasons already indicated we will concentrate on the lessons that relate to fiscal policy. Our approach will be to highlight instances where the problems that emerged could have been addressed by "correct" fiscal policy. These "lessons" can be listed as follows:

Lesson 1: Foreign savings are a necessary but not sufficient component of fiscal policy.

This is perhaps the single most important lesson of the Trinidad and Tobago experience, that is, if we accept the Gelb [1988] analysis which shows that compared to other oil-exporters, Trinidad and Tobago had a strong bias to saving the greater part of its windfall earnings abroad.

In order to get some sense of what happened to the country's foreign savings over the 1974 - 1990 period we portray the trend in net foreign reserves (NFR) both in TT and in US dollars, as well as in terms of the number of months of import cover. This is shown in Table IV-1 below.

TABLE IV-1
NET FOREIGN RESERVES (NFR) AND MONTHS OF IMPORT COVER

YEAR	NFR TT\$	NFR US\$	IMPORT COVER (MONTHS)
1974	698.3	342.3	7.7
1975	1640.1	804.0	12.2
1976	2125.1	885.5	12.1
1977	3204.1	1335.0	16.3
1978	3950.8	1646.2	16.6
1979	4837.8	2015.8	15.9
1980	6336.7	2640.3	15.8
1981	7686.2	3202.6	19.5
1982	7160.1	2983.4	12.9
1983	4998.4	2085.7	9.9
1984	2850.0	1187.5	7.4
1985	3579.9	994.4	11.5
1986	1184.5	329.0	2.9
1987	284.9	79.1	0.8
1988	-23.8	-5.6	-
1989	434.3	102.2	1.0
1990	796.8	187.5	1.8

Source: Central Bank of Trinidad and Tobago: Handbook of Key Economic Indicators, pp. 133 and Quarterly Economic Bulletin, March 1992, pp. 55.

Table IV-1 shows that even after building up reserves equivalent to almost 20 months import cover, the country was without any import cover in the space of six years. Except therefore we opt for a savings programme which is consistent with reserves amounting to many years' import cover, fiscal policy will need to include some mechanism which consciously protects the level of foreign reserves. While accepting the principle that such a mechanism should not distort price signals, there seems to be a case for saying that once the country's reserves begin to decline, net users of foreign exchange must pay a scarcity premium in the form of higher border taxes. Once the reserves resume an upward trend these taxes will cease to apply.

Lesson 2: Fiscal policy needs to be more multi-pronged in its approach to the balance of payments

This second lesson is related to the first. In this case, however, we recognize explicitly that a country's balance of payments problem may not be due solely to its Visible Trade Account. The Services Account and the Capital Account are often the direct sources of an overall balance of payments problem. Table IV-2 below demonstrates the experience of Trinidad and Tobago in this regard.

As the Table shows, the country's external account problems began in 1982 when the current account balance which was TT\$ 956.4 million in the previous year, now stood at minus TT\$ 1,615.7: a deterioration of TT\$ 2,572.1 million in a one-year period! While it is true that for 1982 and 1983 the trade balance was significantly responsible for the state of the current account balance, as the Table also shows, while the trade balance was on the improve other accounts - notably the Services Account (Investment Income) and the Capital Account (Direct Investment) - were generally deteriorating.

TABLE IV-2
CURRENT ACCOUNT BALANCE, ADJUSTED TRADE BALANCE,
INVESTMENT INCOME AND DIRECT FOREIGN INVESTMENT, 1981-1990

YEAR	CURRENT ACCOUNT BALANCE	ADJUSTED TRADE BALANCE	INVESTMENT INCOME	DIRECT FOREIGN INVESTMENT
1981	956.4	1330.9	-223.0	439.9
1982	-1615.7	-1333.1	144.3	506.4
1983	-2464.0	-1171.1	-296.4	195.6
1984	-1336.9	461.9	-719.1	271.7
1985	-263.4	1429.9	-818.3	121.7
1986	-2275.0	-386.8	-861.9	71.7
1987	-890.5	800.6	-971.7	119.3
1988	-452.3	1078.8	-1145.0	241.8
1989	-283.7	1411.2	-1596.7	632.8
1990	1827.5	3512.3	-1677.7	465.0

SOURCE: Central Bank of Trinidad and Tobago: Handbook of Key Economic Indicators, pp. 129-131.
Central Statistical Office, The Balance of Payments of Trinidad & Tobago 1990, pp. 21.

In the case of the Investment Income component, foreign interest payments were the dominant element. Since the structure of government borrowing and the repayments schedule agreed to are important concerns of fiscal policy, it is probably necessary to make the link between debt management and other aspects of fiscal policy much more explicit. The truth is that the higher the level of foreign payments the government agrees to make the smaller will be the disposable income to carry out its other fiscal responsibilities.

In this sense, foreign interest payments need to be more directly related to both the revenue and the expenditure plans of the government. Part of the cost of these payments is, for example, the opportunity cost of the health care and the education provisions that the government might have otherwise made. The

call here is to make these connections more explicit when the borrowing and repayment decisions are being made.

As far as direct foreign investment is concerned, the role of fiscal policy remains one of enhancing the climate of confidence which is so necessary for any investment to take place. In this regard, it would seem that fiscal policy must be flexible enough to be able to monitor and to respond to the phenomenon of capital flight.¹ For it is reasonable to suppose that if domestic capital is fleeing the country, foreign capital will not come in. In this regard we cannot continue to formulate fiscal policy under the assumption that no capital flight is taking place. If we do, the balance of payments will continue to experience a double negative effect - the direct effect of the capital flight and the induced effect on direct foreign investment.

Lesson 3: Fiscal policy must be designed with the direct aim of sustaining the Public Sector Investment Programme.

The point here is one that is probably relevant to the explanation for the puzzling condition into which the Trinidad and Tobago economy found itself: having managed the boom fairly well but then being shown to be relatively unprepared for the depth of the recession that ensued.²

In trying to provide an answer to the question posed at the end of the last section, Gelb [1988] argued that the government's massive investment programme which included steel, petrochemicals and telecommunications, together with its decision to fully carry the burden of its loss-making State enterprises, simply gobbled up its savings when these investments went sour.

The experience seems to confirm a point made by Baum and Tolbert [1987] to the effect that over-programming and revenue instability have been the two most fatal dimensions of public sector investment programming in the developing countries.³

To the extent that the Trinidad and Tobago government took on more mega-projects than it had the capability to properly manage, the

¹. A recent unpublished UWI St. Augustine study using the World Bank approach to computing capital flight estimated the capital flight from Trinidad and Tobago between 1983 and 1990 to be close to TT\$ 6.7 billion, while the Current Account Balance was -TT\$ 6.14.

² Gelb [1988] op. cit.

³ Baum and Tolbert, Investing in Development, World Bank, 1987.

over-programming criticism seems to be valid. To the extent that major borrowing to finance the projects was arranged after the boom was already many years old suggests that the threat of a revenue reversal really should have been taken more seriously.

Export commodity earnings have been a notoriously consistent cause of revenue instability and perhaps the Trinidad and Tobago government needed to be much more cautious in respect of its investment programmes. The concept of a soft landing simply does not make sense when revenues are largely derived from one source of foreign exchange over which the government has no control.

Lesson 4: Fiscal Policy needs to be tilted in the direction of permanent income budgeting.

In one sense this is the most obvious and the most difficult of the lessons to be learnt. As Seers [1964] had seen very early, the open petroleum economy seems to rest on a time bomb: the government will not implement the policies that are consistent with good economic management since it will soon lose power to the Opposition which will implement the wrong policies in any case.

The problem here is partly one of attitudes and partly one of education. It should not be difficult to accept that the only basis for meaningful fiscal equilibrium is to try to get the government's long term expenditure trend in line with its long run revenue trend. This is the permanent income approach to budgeting. Yet what this means in practice is that the government will have to refuse to respond to very legitimate demands being made by different groups in the society. Of course, if the population operates with very high time preference rates, or if the population is substantially ignorant of the possible consequences of chronic fiscal disequilibrium, the pressure on the government will remain very intense.

One possibility is for the government to keep its subsidy and other welfare programmes in tact, but to follow the Bobb [1978] recommendations and provide for revenue recovery either by higher taxation or by more economic charges for services rendered. Part of the political problem presumably stems from the withdrawal of benefits to which the population has become accustomed.

Moreover, if these welfare programmes are put on a permanent income or cost-recovery basis, there will be a built-in tendency to efficient delivery.

In the case of Trinidad and Tobago it is probably instructive to ask what level of income should have been targeted as permanent? Certainly this is not a simple question, but there are several ways in which it might be addressed. Gelb [1988] has suggested an exponential formula along the following lines:

$$z_p = i \int_0^n e^{-it} z dt$$

where z_p is projected permanent oil income, n is the expected life of the oil reserves, i refers to the rate of discounting and t is time.

In the case of Trinidad and Tobago, probably an interesting approach would have been to pitch the revenue trend midway between the pre-boom trend and the levels experienced during the first boom. This would have meant that all the post 1978 budgets would have been based on an oil price of around US\$18. It certainly will not be too difficult to calculate what the net-effect of the boom will have been if the US\$18 line was held. It is possible that the foreign reserves position would have been able to survive the oil shock of 1985/86 and the confidence and unemployment problems which actually emerged would not have been so damaging.

The real question is whether citizens of the country would have allowed the government to budget at US\$18 when the actual price was twice that level. If that was not possible then probably there was no form of economic management which could have prevented the painful developments which are still very much a part of life in Trinidad and Tobago.

Concluding Comment

Apart from the general observation that overall economic planning was probably not costlessly dispensed with, the experience of Trinidad and Tobago over the boom and the recession period seemed highlight the known fragility of economies that depend on one major export commodity for general income as well as for government revenues. While this is not a new problem to the Caribbean the cost of not addressing it properly has risen astronomically. For this cost is now not measured simply in terms of output foregone or in terms of prolonged unemployment.

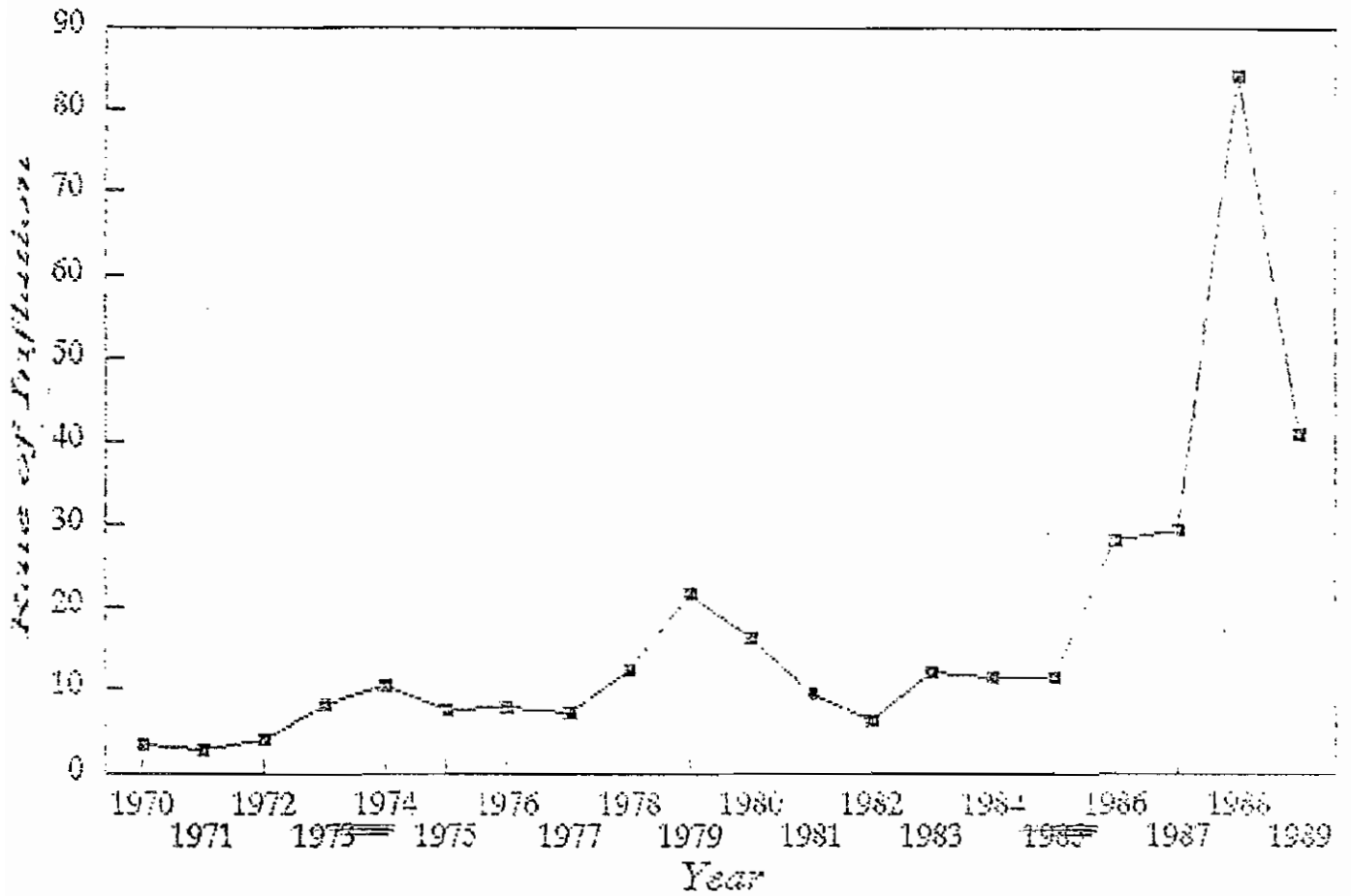
We now live in a period when the cost of not being able to provide a sustainable source of income has to be measured in terms of the loss of control over our economic affairs. In one sense, if there was one country in the region which seemed to have the opportunity of keeping that possibility at bay, that country was Trinidad and Tobago. Yet today Trinidad and Tobago stands mired in a web of foreign debt with the attendant conditionalities, and with only a very slight prospect of regaining control over its economic affairs in the foreseeable future. While it is very tempting to say that this situation is the result of economic mismanagement, we have attempted to show that the matter is not so simple.

On a wide range of acceptable indicators the economy was being pointed in the right direction, given the circumstances. What is evident is that being pointed in the right direction was not enough to save the economy from the throes of structural adjustment. One wonders whether in countries such as these the best guide for fiscal policy is not the Williamson/Worrell recommendation that all upswings must be treated as temporary, and all downturns as permanent.⁴ At the very least, we may be laying the foundation for a sustainable path to economic development.

⁴ A Study done by Delisle Worrell entitled, A Common Currency for the Caribbean, West Indian Commission Occasional Paper No. 4.

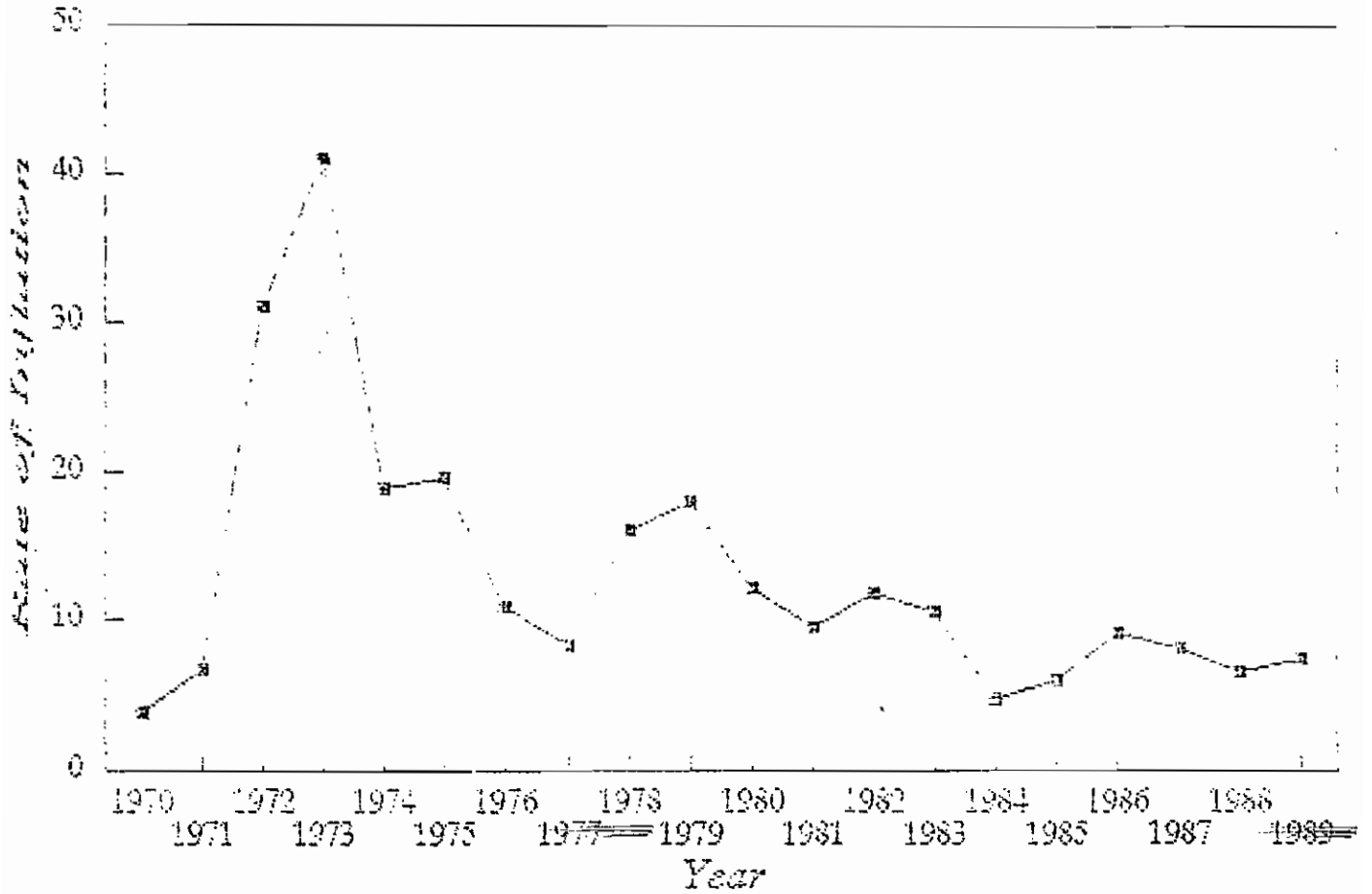
APPENDIX III-1

VENEZUELA
INFLATION RATE



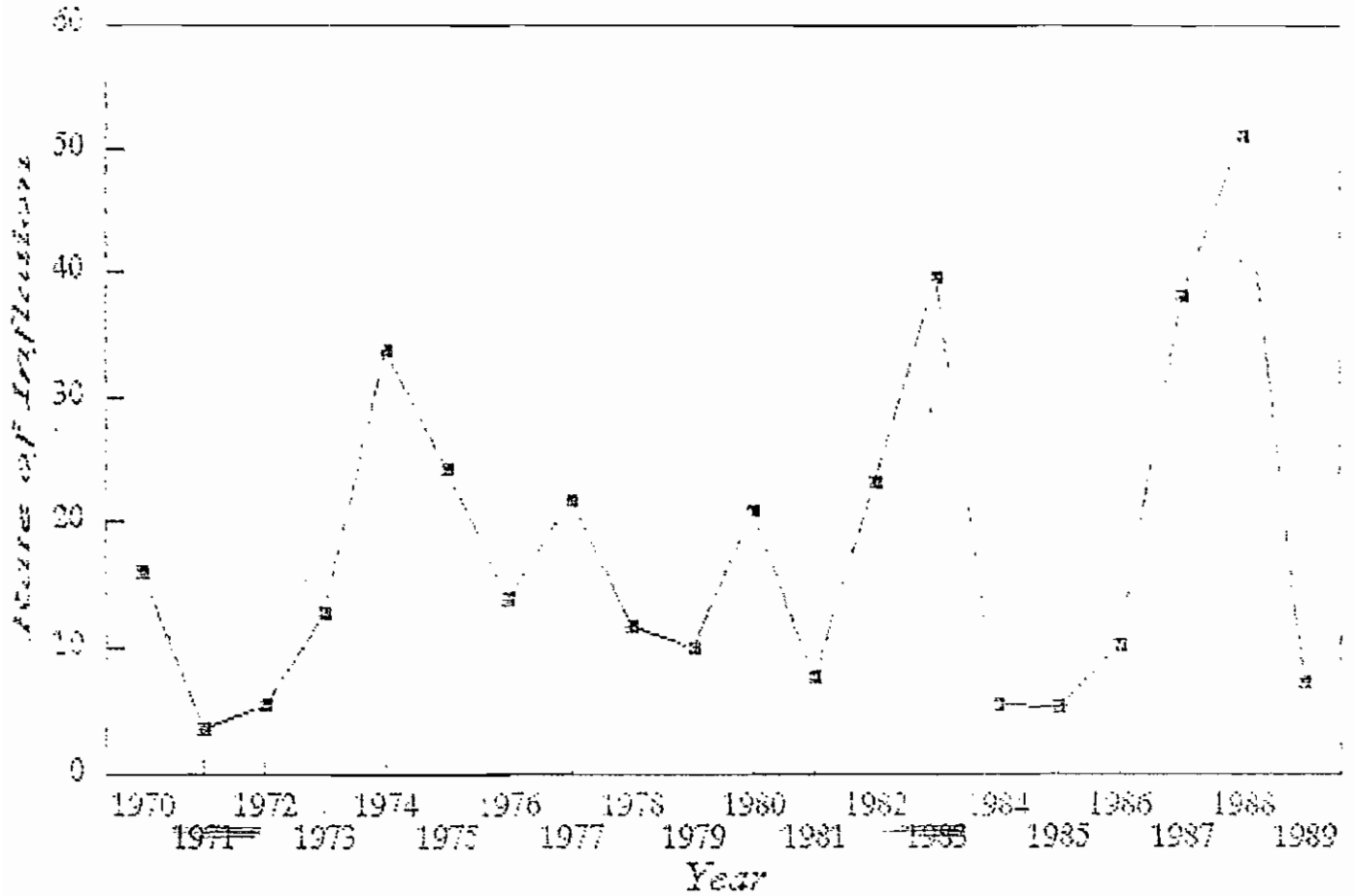
APPENDIX III-1

INDONESIA
INFLATION RATE



APPENDIX III-1

NIGERIA
INFLATION RATE

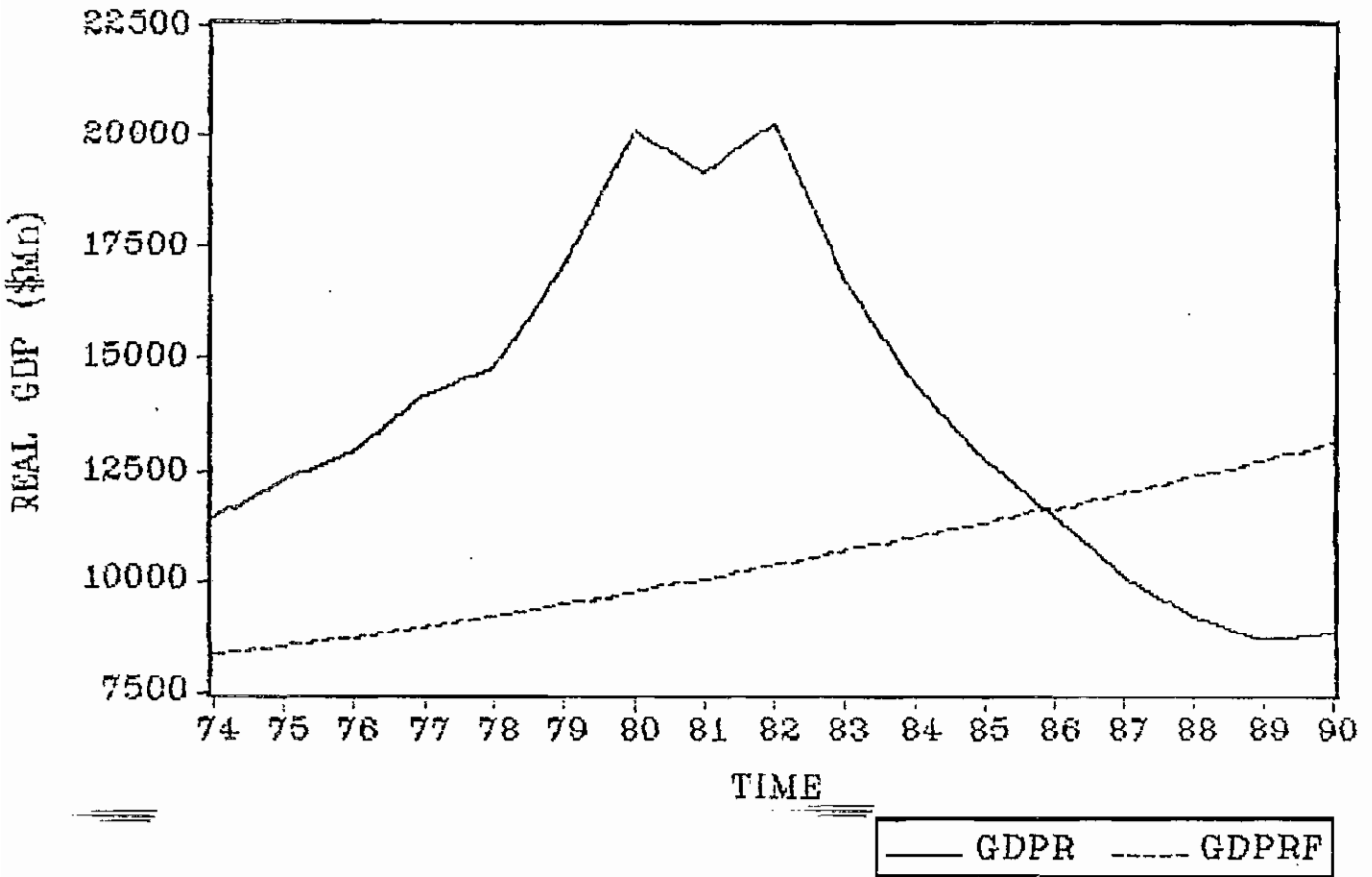


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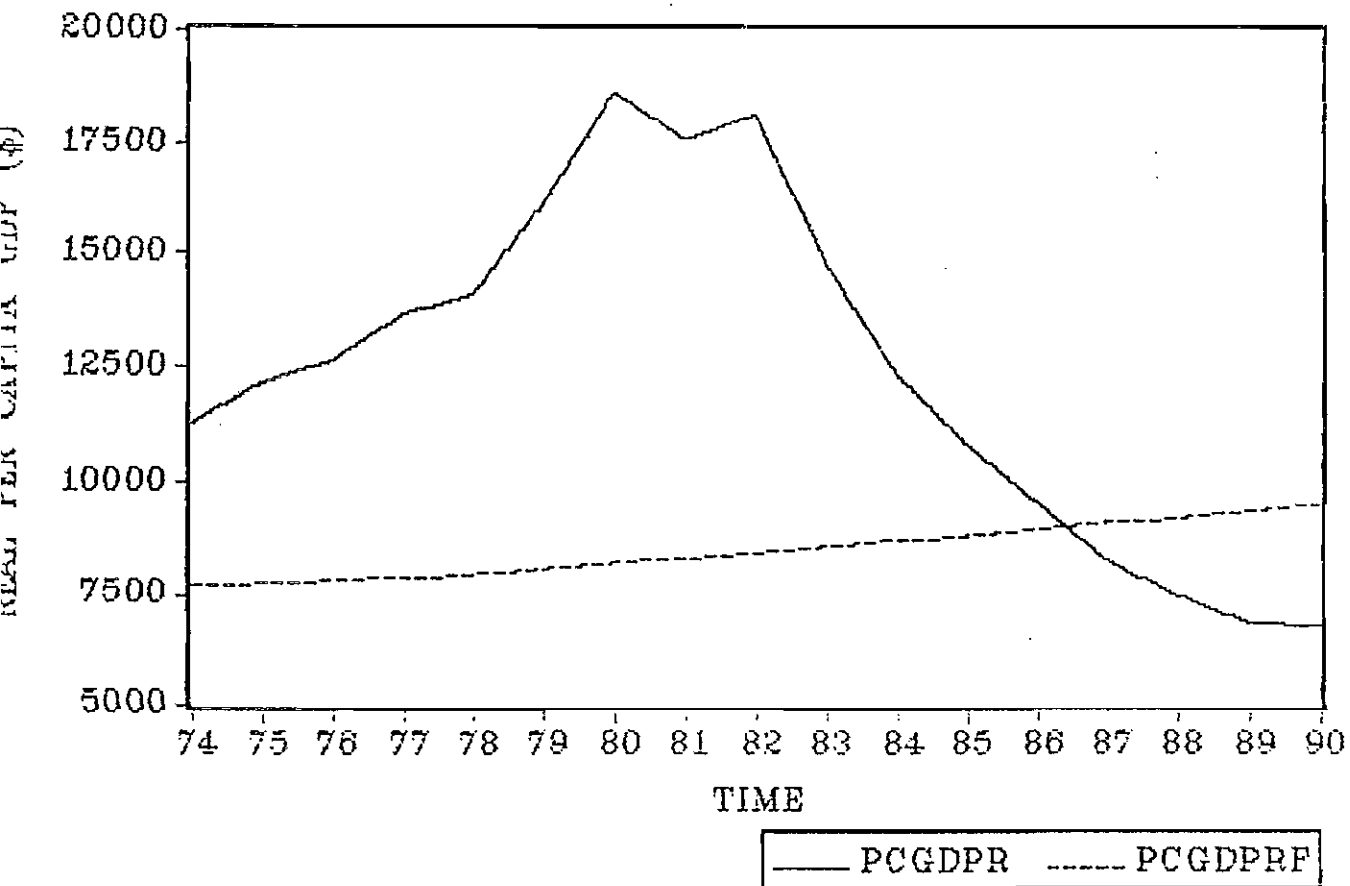
APPENDIX I-1

REAL GROSS DOMESTIC PRODUCT 1974-1990 (ACTUAL & TREND)



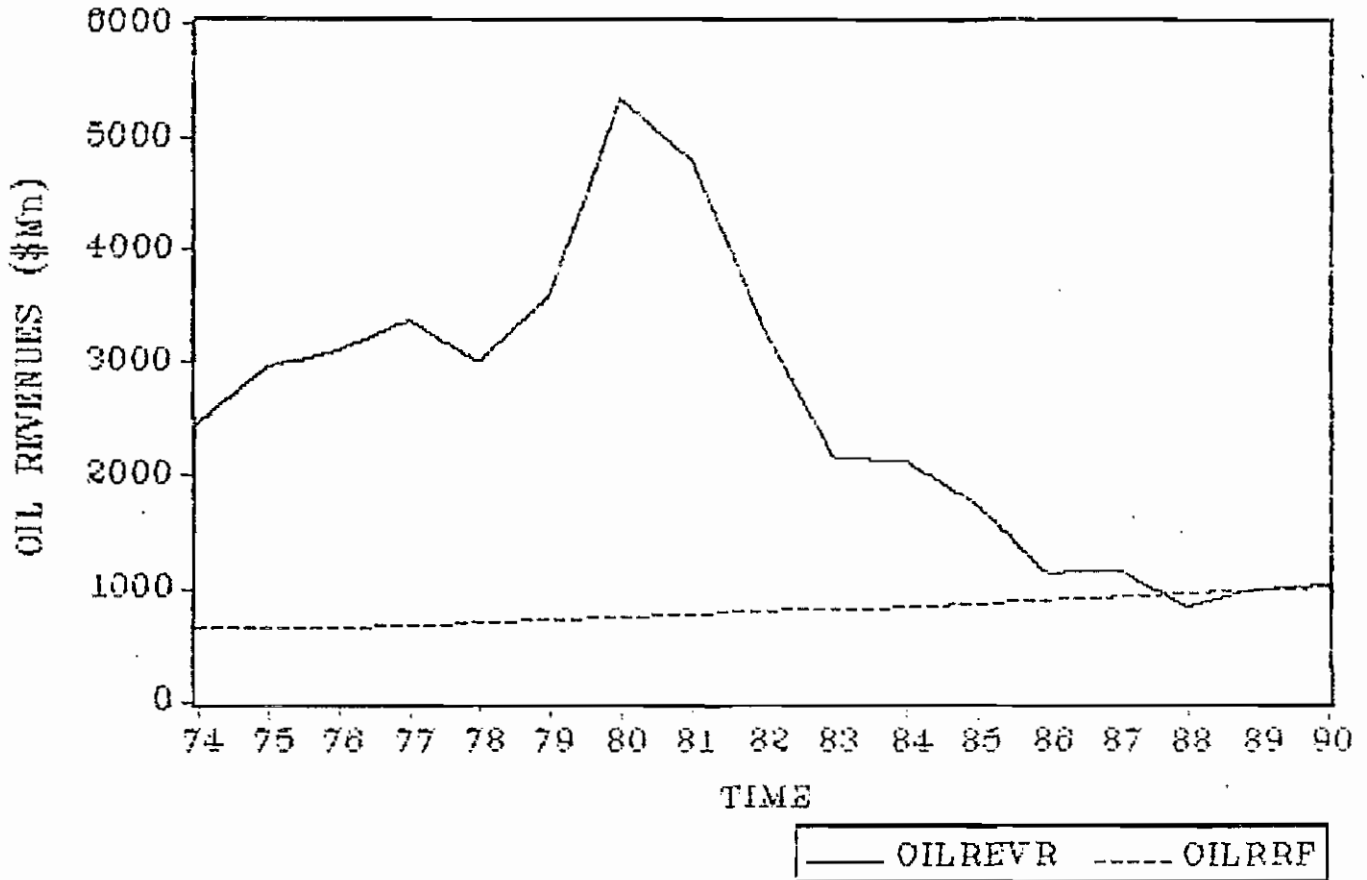
APPENDIX I-1

REAL PER CAPITA GDP 1974-1990

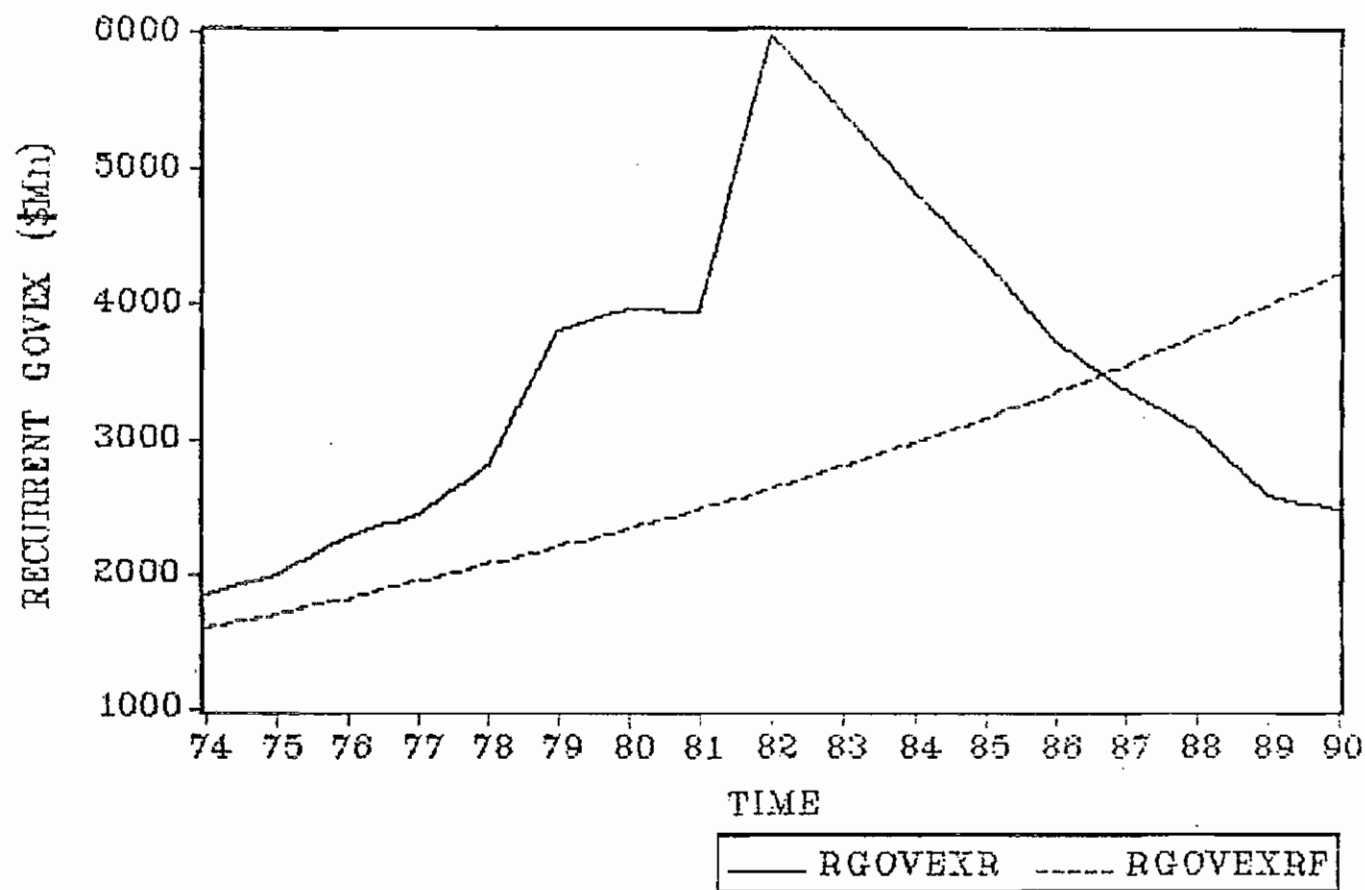


APPENDIX I-1

ACTUAL AND TREND OIL REVENUES 1974-1990

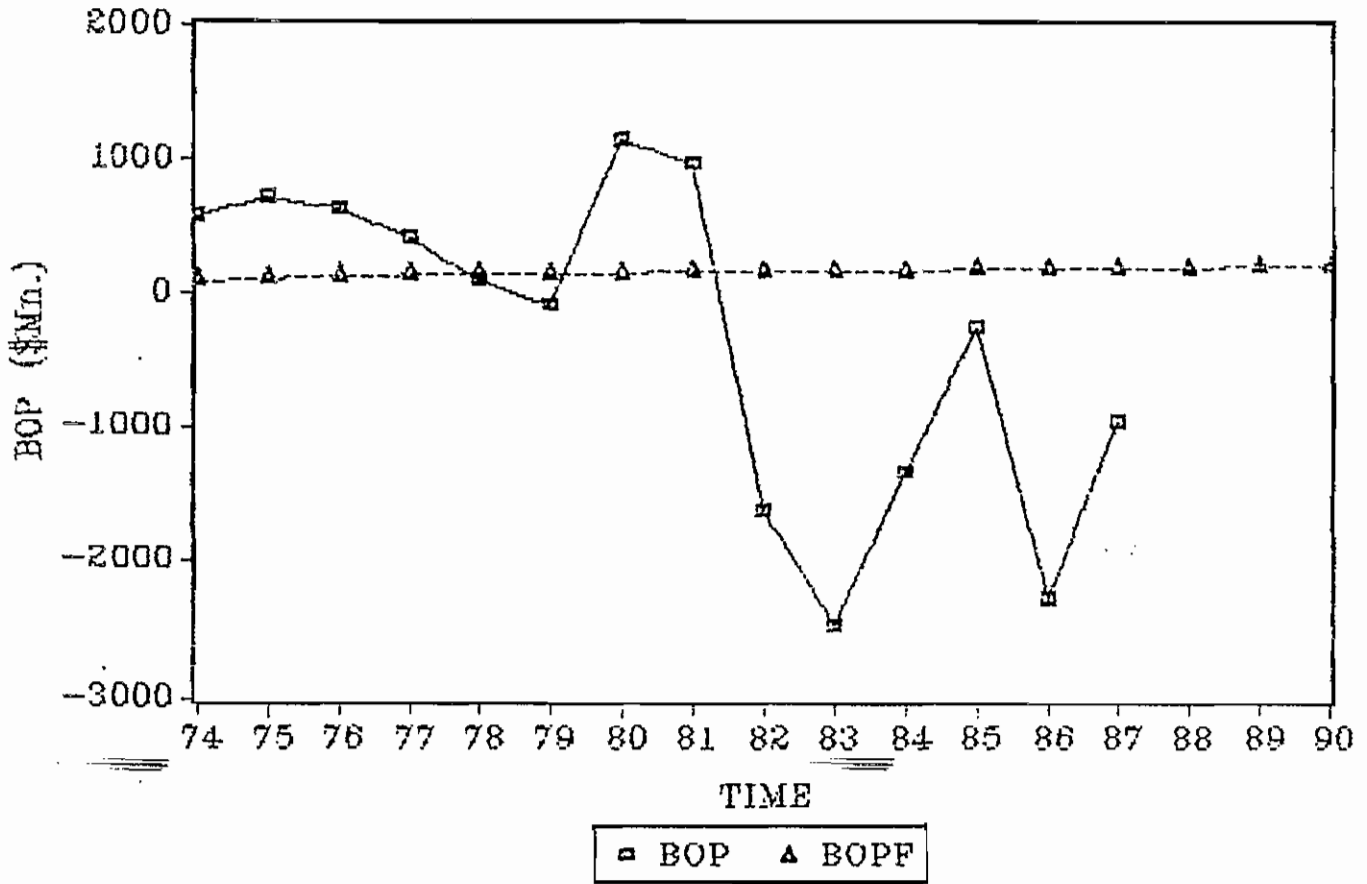


REAL RECURRENT GOV'T EXPENDITURE 1974-1990 (ACTUAL & TREND)



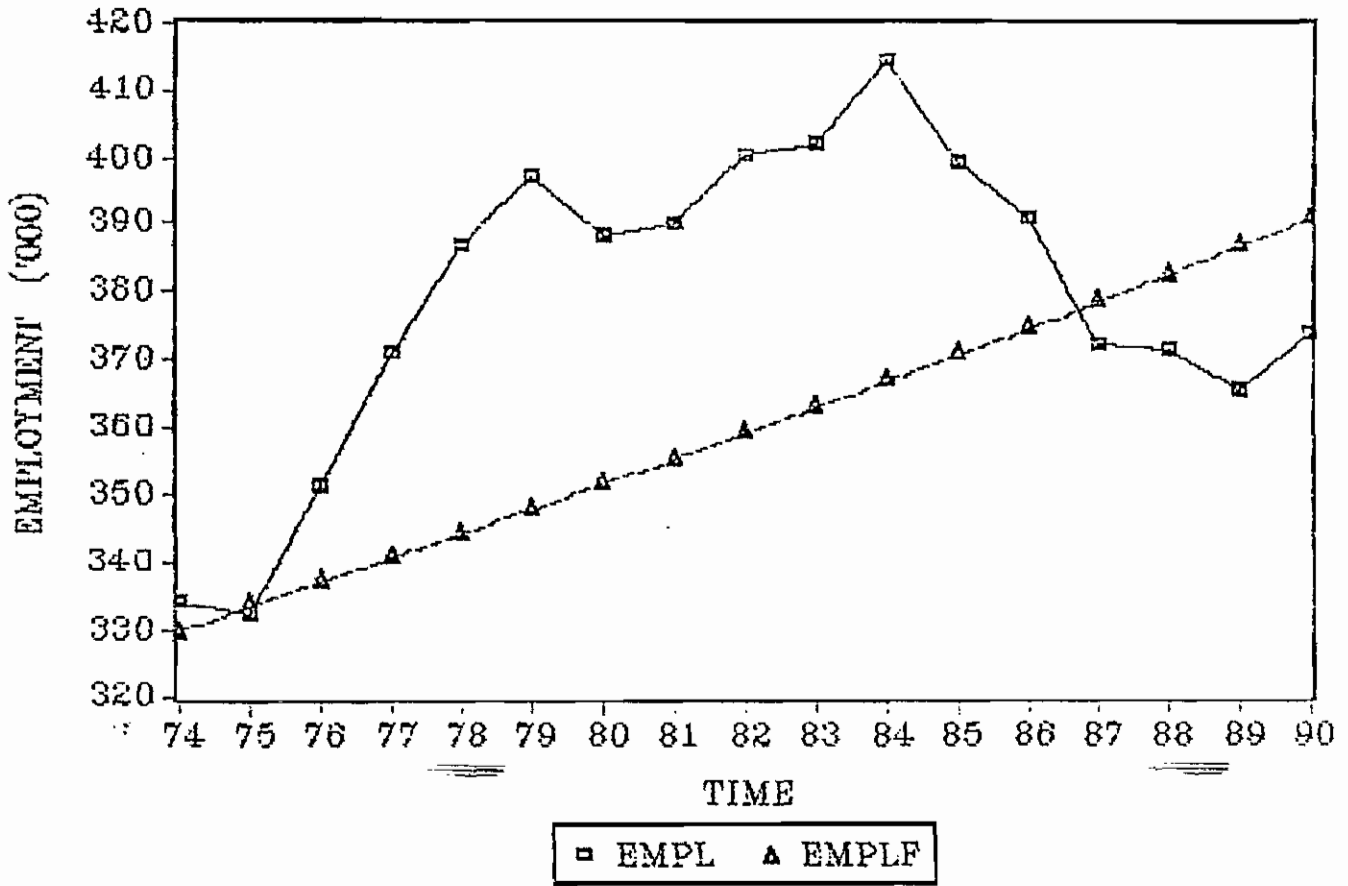
APPENDIX I-1

BALANCE OF PAYMENTS - ACTUAL & TREND VALUES 1974-90



APPENDIX I-1

EMPLOYMENT - ACTUAL & TREND 1974-90



APPENDIX I-1

TOTAL REAL GOV'T EXPENDITURE 1974-1990 (ACTUAL & TREND)

