GROWTH AND ADJUSTMENT IN A PETROLEUM-BASED ECONOMY:
SOME ASPECTS OF THE TRINIDAD AND TOBAGO EXPERIENCE SINCE THE 1970's

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Introduction

As a result of persistent imbalances between aggregate supply and aggregate demand, macro-economic adjustment has become a major pre-occupation in a large number of countries with varying economic structures and policy frameworks. In some countries this has come about after a period of reasonably high growth rates, while in others an already bad situation simply got worse. The decline of traditional activities and the emergence of unfavourable market conditions for key exports have found some countries unprepared to cope with a rapidly changing international environment. A firm economic foundation geared towards meeting domestic needs and foreign demand has proved elusive. Poorly conceived policies leading to resource misalloation have not helped. Failure to take appropriate and timely action was also a factor in the deterioriation of the financial situation. Without the political will to make adjustments on their own as required by changing conditions, some governments have opted to concede autonomy in decision-making to the international aid agencies who now increasingly tie economic assistance to changes in the policy framework.

Historical and political factors which have traditionally informed the approach to economic management and development have come increasing scrutiny against the background of persistent resource imbalances and social deterioration. Differences in economic performance among states have raised interesting questions about policy. Empirical work has opened new paths of analyses and added to our knowledge, but

rarely is there consensus on explanations. Conflicting results are commonplace. Yet there are some who subscribe to universal applications of policies or approaches that have worked in one country or in particular situations. The institutional environment and cultural factors have implications for the efficacy of certain approaches. Policies that may be appropriate at one point in time may cease to do so at another stage. Economies change their characteristics over time and the way they respond to particular measures is not likely to remain the same.

There are no clear cut paths to growth. There is no 'the' theory of development. There is no unique box of management tools. What we do have is a body of theories and a set of propositions founded in observations and empiricism. Depending on the premises on which they are constructed every model tends to generate different policy prescriptions. The presence of questionable assumptions and methodical flaws in empirical exercises often undermine the policy usefulness of such works. What is cause and what is effect is often difficult to disentangle. The absence of basic data does not help policy formulation and implementation. Behaviour changes in ways not always easily understood, thus complicating the task of both micro and macro-management of the economy. Parameters relating to the consumption function, the savings function, the import function and money demand function cannot be taken for granted. The transmission mechanism between money and income or between the balance of payments and money is not well established. Government response to a problem reflect a variety of concerns that go beyond pure financial or economic considerations. In the same way private economic actors in the domestic economy condition their behaviour not only by current policies, but by past experience and external factors. The outcome of a given policy or set of policies is therefore not always easy to predict. The recent experience with adjustment programmes in developing countries highlight some of these issues, and their content have shown some

improvement over time. It is recognized that adjustment which destroys the potential for growth is not worth the effort. A programme which ignores the sharing of the burden of adjustment or is insufficiently funded will be difficult to sustain. The speed with which objectives can be realised often depend on the stage of development.

This paper looks at some selected issues relating to growth, adjustment and management in the context of the Trinidad and Tobago experience. The first part examines the recent growth experience. The second discusses developments in the external sector while the third is concerned with issues affecting the government finances. The fourth seeks to explain the relationship between domestic credit and the balance of payments. The fifth and final section provides some concluding comments.

The Growth Experience

The Gross Domestic Product (GDP), or some version of it, tends to be a major objective of economic policy. It is perhaps the most important indicator used to measure the success of a programme, a policy or set of policies. The growth of GDP is seen as necessary to raise the standard of living. But growth need not have the desired impact. It does not necessarily lead to a stronger economic foundation. With it can come increased inequality and poverty, or higher unemployment. Growth impacts on inflation, the distribution of income, on consumption and savings, on the environment etc., and the trade off is not always 'negotiable'. The uncertain relationship between growth and other concerns often makes it difficult to target an optional growth rate. What causes growth remains a major preoccupation in the literature. The availability of land and other resources, a better trained labour force, the use of modern technology and greater investment are generally accepted as having a positive effect on production. Some propositions relating to the investment ratio and exports are more controversial. Some growth can be instigated from outside such as

the increase in the price of a lead export, or a boom in major trading partners.

In the last 18 years Trinidad and Tobago has experienced both a 'boom' and a 'bust' situation. The boom was triggered by the increases in oil prices in the 1970s and early 1980s. The 'bust' resulted from lower oil prices and economic mismanagement. Between 1967 and 1973, the growth of GDP (at constant market prices) averaged 3.1%. Between 1973 and 1982, the growth rate almost doubled averaging 6% in the period (See Tables 1 and 2). This was followed by seven consecutive years of decline. The GDP in 1990 was estimated to be 30% below that of 1982. Real per capita GDP grew by over 4% per annum between 1973 and 1982, and this was more than double the average rate of the previous seven years. Between 1982 and 1990 it declined by an average of over 5% per year. Per capita GDP in 1991 was 36% lower than the 1982 figure.

With the increase in oil prices the oil sector became increasingly buoyant in the latter part of the 1970s and early 1980s. Oil production increased from 61 million barrels a year in 1973 to 84 million in 1978. Since then production has fallen steadily. The share of the petroleum sector in GDP (at current prices) increased from 27% in 1973 to almost 50% in 1975. By 1991 it had fallen to around 23% as a result of lower prices in the 1980s and reduced production. Agriculture's share in GDP is small averaging less than 3% in recent years. The availability of foreign exchange during the boom years to buy imported food removed the urgency to encourage agricultural production. Higher wages in the non-agricultural sectors also served to pull labour away from the land. The availability of foreign exchange also made possible a wide range of consumer goods. Assembly and packaging industries flourished within the framework of an import substitution strategy that provided little incentive for local value added or exports. Even with the decline of petroleum sector in recent years manufacturing share has remained around 8-10% of GDP. With the enhanced import

capacity in the boom years, the pressure to adjust the trade regime to encourage a more competitive structure was not present. The Government was more preoccupied with the establishment of a number of energy based enterprises whose impact on the export trade has been increasing, even if slowly.

TABLE I

SELECTED MACRO-ECONOMIC INDICATORS, 1973-1991

Period	Growth of GDP[1] %	Growth of Per Capita GDP[1] %	Unemployment Ratio %	Gross National Savings Ratio %	Gross Investment Ratio %	Inflation Rate %
1973-79	5.2	3.8	13.7	34.0	26.5	14.1
1980	10.4	8.9	9.9	38.2	30.6	17.5
1981	6.4	4.5	10.4	34.0	27.6	14.3
1982	3.8	2.0	9.9	18.7	28.2	11.4
1983	-10.2	-12.0	11.1	14.2	27.1	15.2
1984	-6.0	-8.4	13.4	16.8	23.2	13.3
1985	-5.6	-6.3	15.6	16.7	17.4	7.7
1986	-1.8	-3.3	17.2	10.4	23.2	7.7
1987	-4.6	-5.9	22.3	14.8	19.9	10.8
1988	-3.8	-3.8	22.0	14.6	17.2	7.8
1989	-2.3	-2.3	22.0	17.8	19.4	11.4
1990	0.5	-0.6	20.0	25.7	17.0	11.0
1991[p]	2.5	0.4	18.8	18.3	19.3	3.8

1 At constant market prices

p. Provisional

Sources: Central Statistical Office and Official Publications

TABLE 2

GROWTH OF GDP, PER CAPITA GDP, CONSUMPTION AND INVESTMENT AT CONSTANT MARKET PRICES 1966-90

Period	GDP	Per Capita GDP	Private Consumption	Government Consumption	Gross Capital Formation
1966-73	3.1	2.0	3.3	8.4	4.3
1973-82	5.9	4.4	10.2	0.9	14.4
1982-90	-4.2	-5.4	-9.5	-3.9	-13.8

Source: Calculated from CSO data and publications.

Over 60% of the value added in the Trinidad and Tobago economy originate in the service sectors in which government is a major player. What the present structure indicates is that growth during the 1970s and early 1980s was not translated into diversification. Oil continues to be the key sector of the economy.

The decline of GDP in the 1980s coincided with a sharp decline in the national savings ratio which fell from an average of over 30% in the 1973-1981 period to an average of under 20% since. The decline of Central Government savings was a major factor in this trend. The investment ratio (Gross Domestic Capital Formation) also declined in the 1980s though less sharply than the savings. ratio. During the 1974-84 period the ratio averaged almost 30% as compared to an average of 19% since then. Resort to past saving by the government and public borrowing helped in maintaining the investment ratio at a higher level than the savings ratio in the period since 1982.

By the end of the 1980s and particularly in 1990 and 1991 there were signs that the slide was coming to an end. Gross Domestic Product (at constant market prices)

ceased declining in 1990 and grew for the first time in 8 years in 1991. After a period of 8 years of consecutive deficits in the current account of the balance of payments a surplus was registered in 1990 and a small deficit in 1991. The unemployment rate dropped from 22% in 1989 to 20% in 1990. In 1991 the rate fell to 18.8% but the number of persons without jobs did not increase. The fiscal deficit on current account moved from an average of 2.4% of GDP in 1987/89 to a surplus position in 1990 and 1991. The inflation rate dropped to less than 4% in 1991--the lowest in modern times. All this was taking place in the face of falling oil production and a depressed petroleum sector. There are signs in 1992 that the little progress made in certain areas are being reversed, and this may not be unrelated to some of the measures instituted in the 1992 budget by the new administration.

It is acknowledged that revenue from the oil industry enabled the government to increase expenditure and this was a major factor in growth during the 1970s and early 1980s. With oil prices at the present level and with production falling, the oil sector could not be expected to provide the level of resources it did in the boom years. As the major foreign exchange earner the general approach is to provide tax and other incentives for the expansion while encouraging development in other sectors of the economy. It is widely believed growth will be helped by increased savings, investment and exports, though how significant these factors are is open to question. One of the conditionalities of the 1989 World Bank structural adjustment loan is the dismantling of the protective structure to facilitate trade liberalization which it is hoped will encourage a more competitive production structure capable of producing a wider range of exports. Some sections of the manufacturing sector are convinced that they will be put out of existence particularly in the absence of adequate safeguards. The government, however, is proceeding with the programme since it is intent on drawing down the rest of the loan. As far as investment is concerned, it is not just the quantum that counts,

but where it is invested and how efficiently it is used. Renewed efforts are being made to attract private foreign investment to accelerate the pace of capital formation, but the response so far is not satisfactory. The traditional type of incentives is unlikely to be effective in the competitive international environment of today.

The External Sector

With highly open economy, it is difficult for Trinidad and Tobago to isolate itself from developments in the world economy. Movements in exchange rates among major currencies, changes in prices of imports and exports, international interest and inflation rates can have major implications for the domestic economy. Imports and exports average between 35 and 40% of GDP (at current prices) respectively. On average the export ratio tends to be higher than the import ratio. During the boom years of 1973-82 the export ratio rose to almost 50% but has since declined to an average of around 36%. Even though imports rose sharply the boom years did not witness a significant change in the proportion of imports to GDP. From the mid-1960s to 1983 the import ratio averaged around 30-40% but declined to an average of 35% in the latter part of the 1980s, no doubt reflecting the fall in import capacity and the measures taken to protect the balance of payments. In the 1980s the share of both private consumption and government consumption expenditure in GDP rose, but the increase in the government ratio was much sharper. Between 1973 and 1982 the marginal propensity to consume coefficient was generally higher than the average. It fell in the following four years, rose in 1987 and 1988 and then showed signs of declining again.

Despite the fall in oil prices and production in the 1980s the trade balance was negative in only three years between 1980 and 1991. The services balance has been consistently negative since 1983. In fact between 1979 and 1991, it was positive in

TABLE 3

SELECTED BALANCE OF PAYMENTS DATA, 1973-1991

Period	(1) Trade Balance $mn	(2) Services Balance $mn	(3) Current Account Balance $mn	(4) Overall Balance $mn	(5) (2) as a % of GDP	(6 (3) as a % of GDP	(7) External Reserves[1] $mn	(8) Net Terms of Trade	(9) Exchange Rate[3]
1973	-143	112	-28	-28	-1.1	-1.1	67	100.0[2]	1.96
1980	1,292	-115	803	1,472	5.4	9.8	6,337	124.1	2.40
1981	1,331	-183	956	1,365	5.8	8.3	7,687	121.1	2.40
1982	-1,333	52	-1,616	-525	-8.4	-2.7	7,160	102.5	2.40
1983	-1,171	-1,018	-2,464	-2,163	-13.2	11.6	4,998	97.9	2.40
1984	462	-1,529	-1,337	-1,749	-7.2	-9.4	2,850	100.2	2.40
1985	1,430	-1,542	-263	-262	-1.5	-1.5	3,580	91.6	2.45
1986	-387	-1,751	-2,275	-2,414	-13.2	-14.0	1,191	72.6	3.60
1987	801	-1,559	-891	-900	-5.1	-5.2	285	63.5	3.65
1988	1,079	-1,417	-452	-634	-2.6	-3.7	-24	54.3	3.84
1989	1,411	-1,590	-284	-661	-1.6	-3.6	434	59.8	4.25
1990	3,512	-1,577	1,828	-808	8.6	-3.8	797	70.1	4.25
1991	1,449	-1,479	-88	-1,326	-0.4	-6.3	101	n.a	4.25

1. end of year position
2. 1974
3. TT$ dollar equivalent of 1US dollar; Average for the year

n.a. not available

Sources: Official Publications; IMF, *International Financial Statistics*, Various Issues.

only one year. The negative service balance has generally been larger than the trade balances, leading to a persistent deficit in the current account since 1982. Between 1982 and 1991 the current account deficit averaged over 4% of GDP. Given this situation, it would seem that the external deficit could not be addressed without focusing on the services account. The travel account deficit was reduced from almost TT$300 million in 1985 to TT$39 million in 1991. The largest item in the services account is investment income in which interest payments by the public sector on external loans and foreign investment profits loom large. Of the total investment payments of TT$15,167 million between 1980 and 1991, interest on public sector loans amounted to TT$5,743 million (75%) and foreign investment profits to TT$3,445 million (23%). Between 1980 and 1988 the capital account balance (excluding reserves) was generally positive, but moved into a sizable deficit position after 1988, even though net direct investment inflows continued to be positive. The items influencing the trend in this account are the net 'other private' outflows and repayment of the public debt incured both by the central government and the state enterprises sector. In recent years repayments have exceeded new inflows and this has worsened the balance of payments position. The overall deficit has been consistently negative since 1982, averaging around 6% of GDP. As a result of this situation the external reserves dropped from TT$7.7 billion (19 months imports) at the end of 1981 to TT$-23.8 million at the end of 1988. At the end of 1991 it stood at TT$101.2 million (0.2 months imports).

Even with the oil windfall the country was unable to make significant headway in diversifying the production and export base. The setting up of a few energy based industries have helped to boost non-oil exports, but the country remains heavily dependent on petroleum and petroleum products which accounted for 74% of export earnings in 1991. Between 1973 and 1980 the value of total exports (in current dollars

grew from less than TT$0.7 billion to TT$6.2 billion. Since then it has averaged TT$5.8 billion per annum. In the period 1973 to 1980 the value of imports grew from TT$0.8 billion to TT$4.9 billion but by 1982/83 it had crossed TT$6 billion. Since then it has averaged TT$4.8 billion per year. With the decline in earnings from oil, accumulated reserves were used to cushion the impact on the economy. Judged from official reaction there was no doubt a feeling that the dip in oil prices in the early 1980s was temporary. The significant drop in 1986 when a considerable part of the savings was already used up underlined the fact that the country was indeed in deep crisis.

The approach to correcting the persistent external deficit took several forms, including monetary policy, administrative controls and changes in the exchange rates. Monetary policy has generally been used to address the local liquidity situation when there is pressure on the reserves. At the same time it cannot be unmindful of the need for domestic expansion and job creation. A tight reserves position puts immense pressure on this latter role. Devaluation was used sparingly in the 1980s. The local currency was devalued by $33^{1}/3\%$ on December 18, 1985 with the aim of stimulating non-oil exports and switching expenditure from imports to domestic production. A two tiered system was adopted in which essential food, drugs and other items such as agricultural inputs continued to be imported at the oil exchange rate. In addition, importers were given until the expiry of existing credit terms or June 30, 1986 to effect payments at the previous exchange rate for foreign exchange commitments entered into prior to the date of the devaluation. This arrangement resulted in a considerable loss of foreign exchange reserves in 1986, and in 1987 the exchange rates were unified at the higher level i.e. TT$3.60 = US$1.00. Since a devaluation tends to increase the local currency value of imports and since other measures tend to accompany the use of the exchange rate instrument it is often difficult to gauge the

impact on imports and exports. In 1986 the value of imports (in terms of local currency) increased by 41% but declined by 20% in 1987. Non-oil domestic exports increased by 45% in 1986 and by 6% in 1987. These exports, however, were dominated by chemicals. In August 1988 there was a further devaluation of the TT dollar by 18% bringing the rate to TT$4.25 US$1.00. The value of imports increased by 13% in 1989 but declined the following year by 8%. Exports increased by 17% and 26% respectively in 1989 and 1990, but these increases were largely accounted for by petroleum which is priced in foreign currency and therefore would not be influenced by the devaluation.

As a market instrument devaluation has certain theoretical attractions which lead policymakers to use it even when its net impact is uncertain. Used in a situation where the necessary elasticities do not obtain it may simply increase the value of imports and worsen the debt service burden without having any effect on exports. The devaluations undertaken in the latter half of the 1980s in Trinidad and Tobago came at a time when increases in earnings had fallen significantly from the 1970s and early 1980s. Productivity increases were also generally higher than average increases in earnings.[1] Adjustments of a kind which can weaken the case for a devaluation were in fact being made.

The Fiscal Situation

The state of the government finances often gives a good indication of how well or how poorly an economy is performing. In the early 1970s there were clear signs that the fiscal situation was deteriorating. The current account surplus fell from over 4% of GDP in 1969 to an average of 1.5% in the 1970/73 period. This position changed dramatically from 1974. As a result of revenues from the oil sector the current account surplus as a percentage of GDP increased from 1.8% in 1973 to an average of 17.6%

TABLE 4

SELECTED GOVERNMENT FINANCES, 1973-1991

Year	(1) Total Tax Revenue $mn	(2) of which oil	(3) (1) as a % of GDP[1]	(4) Current Fiscal Balance $mn	(5) Overall Fiscal Balance $mn	(6) (4) as a % of GDP[1]	(7) (5) as a % of GDP[1]
1973	452	116	17.6	46	-61	1.8	-2.4
1974	1,254	888	29.9	628	422	15.0	10.0
1975	1,712	1,246	32.5	940	618	17.7	11.7
1976	2,037	1,391	33.4	1,172	373	19.9	6.1
1977	2,734	1,759	36.2	1,623	669	21.5	8.9
1978	2,749	1,714	32.1	1,308	167	15.3	6.1
1979	3,673	2,379	33.2	1,285	-169	11.6	-1.5
1980	5,933	4,137	39.6	3,067	924	20.5	6.2
1981	6,515	4,253	39.7	3,254	237	19.8	1.4
1982	6,478	3,274	33.8	931	-2,653	4.8	-13.8
1983	5,940	2,461	31.7	196	-2,344	1.0	12.5
1984	6,130	2,760	31.6	251	-1,757	1.3	-9.4
1985	5,874	2,457	32.5	283	-1,362	1.6	-7.6
1986	4,609	1,691	26.7	-402	-1,380	-2.3	-7.9
1987	4,665	1,958	26.9	-397	-1,248	-2.3	-7.2
1988	4,329	1,538	25.0	-606	-1,113	-3.5	-6.4
1989	4,436	2,004	24.4	-231	-764	-1.3	-4.2
1990	5,296	2,317	25.1	95	-274	0.4	-1.3
1991p	6,212	2,717	29.6	660	-89	3.1	0.4

between 1974 and 1981 (See Table 4). Current revenues increased by an average of almost 40.9% per year between 1973 and 1981 while current expenditure increased by 44% over the same period. In value terms current revenue grew from TT$0.5 billion in 1973 to TT$6.8 billion in 1981, while current expenditure increased from TT$0.5 billion to TT$3.6 billion over the period. The public sector work force was expanded , wages and salaries increased, welfare programmes were enhanced or enlarged and state enterprises highly subsidised. By 1982 current expenditure was structured as follows: wages and salaries ((50%), goods and services (5%), interest payments (3%), and subsidies and transfers (40%). The government was also able to finance a significant part of its development programme from its own resources. Some savings were also diverted to Special Funds for long term development. Between 1974 and 1981 the overall budget was negative in only one year.

Despite the buoyant revenue situation in the 1970s and early 1980s the government continued to borrow both locally and abroad. By 1982 the internal debt had reached TT$752 million[2] and the external debt (including contingent liabilities) TT$2,818 million (US$1,174 million). Total debt service payments in 1982 amounted to 4% of current revenue. Servicing of the external debt amounted to less than 4% of export earnings. In response to declining foreign exchange earnings and revenue in the 1980s, public borrowing was to increase significantly. Between 1981 and 1986 the public sector debt had grown by over 15%. By 1991 the internal debt of the Central Government was estimated to be TT$4,901 million (TT$631 million in 1981) while the total public sector external debt was TT$10,331 million (US$2,431 million). This latter figure was estimated to be almost 50% of GDP. The public debt is now a major issue, now that servicing is a problem. A rescheduling agreement reached in 1988 postponed the payment of almost US$800 million falling due between 1988 and 1992. Debt service payments between 1992 and 1994 are as follows: 1992 = TT$2,601

million (US$ .612 million); 1993 - TT$2,129 million, (US$501 million). The external debt service ratio is estimated to be about 30% in 1992 as compared to 21% in 1991. Some state enterprises are targeted to be sold in order to raise money to service debt.

Between 1982 and 1988 current revenue declined by 28%, but in 1991 had increased by 36% largely as a result of the new Value Added Tax. Current expenditures are not easy to reverse and continued to increase even while current revenues were declining. The surplus on current account was reduced to an average of 2.1% of GDP in the 1982-85 period, and eventually turned negative in the period 1986 to 1989. A small surplus appeared in 1990 and 1991. Following the reduction and eventual disappearance of the current account surplus in the post-1982 period capital expenditure was financed by past savings and by borrowing. By 1986 the Funds for long term projects were exhausted and the financing of the Development Programme became more dependent on borrowing. Average capital spending in the period 1986-1991 amounted to only 27% of average expenditure in the previous six years. The overall budget has been in deficit since 1982, with the balance averaging 7% of GDP.

'Wages and Salaries' and 'Subsidies and Transfers' are the two most important items in current expenditure. In 1981 they accounted for 85% of the total with interest payments accounting for about 5%. By 1991 the interest share had increased to 18% , while wages and salaries had dropped to 37% and transfers and subsidies to 34%. Given the composition of expenditure in the 1980s the choice for action was limited. Reduction in the wage bill entailed either a cut in wages or a reduction of the work force. The new government elected in 1986 put the emphasis on the reduction in emoluments. In 1987 the Cost of Living Allowances and merit increases were suspended. To project an air of equity Ministers of Government salaries were cut by 5% while Boards of Directors of the State Enterprises and firms in the private sector

were urged to consider applying an across-the-board reduction of at least 5% in the emoluments of Management Staff. In 1989 the salaries and wages of the Central Government including the Tobago House of Assembly, Local Government Bodies and Statutory Boards were cut by 10 percent. A range of subsidies were reduced or eliminated while a programme of rationalisation of the state enterprises sector was initiated. Charges for certain government services were also increased. Notwithstanding these actions, wages and salaries were still estimated to account for 37% of current expenditure and subsidies and transfers for 34% in 1991. The share of interest had increased more than threefold between 1981 and 1991.

Conscious of the need to promote growth while making adjustment the tax system was also addressed by the then government. The objective enunciated was to simplify the system and encourage savings and investment without reducing government revenue. The tax reform program implemented in 1989 and 1990 addressed both direct and indirect taxes. With respect to the former both the number of tax bands and the marginal rates relating to individuals were reduced. The corporation tax was also lowered from 50% to 45% in 1989 and to 40% in 1990. Concomitant with these measures was the introduction of a value added tax in 1990. The net effect of these measures was an estimated increase of 18% in current revenue which helped in realising a current account surplus amounting to about 3% of GDP, notwithstanding an increase of 9% in current expenditure. A contributory factor to expenditure growth was the full restoration of the 10% cut in salaries and wages effected in 1991 and partial liquidation of the arrears in respect of the accumulated arrears of the Cost of Living Allowance. These two measures added $310 million to current expenditure. The then government, however, took a decision not to implement the Industrial Court decision awarding public servants a 2 percent increase in salaries with a new Cost of Living Allowance formula effective from the beginning of 1989. This would have added

almost $500 million per year to current expenditure. The new government elected in December 1991, however, did precisely that in the 1992 budget presentation in order to fulfill an election pledge. To help finance the increased expenditure the rate of excise duties on certain products were raised, as did the corporation tax from 40 to 45%, and the top two marginal rates for personal income tax by 5% respectively.

The indications in 1992 are that government is experiencing serious problems in meeting its financial commitments. The growth momentum of 1991 continued into the first quarter of 1992, but real GDP at current factor cost declined by almost 2% in the second quarter. Data available for the first quarter of 1992 also indicate a drop in the number of persons employed.

Money, Prices and the Balance of Payments

By operating on the reserve requirements for commercial banks the Central bank can contract or expand credit depending on the state of the economy and the level of foreign reserves. Monetary policy is often used to complement othermeasures for encouraging the growth of output or protecting the balance of payments. The relationship, however, between money and prices, money and income and money and the balance of payments has long been the subject of considerable speculation in the literature. Many years ago J.J. Polak[3] formulated a simple monetarist-oriented model to analyse the effects of imports, exports and money supply within the circular flow economy. A number of monetarist propositions have since sprung up on the determination of income and relationship between key macro variables. One such proposition is that there is a direct albeit lagged relationship between changes in the money supply and inflation. Implicit here is the assumption of a constant income velocity of money and full employment of resources. In a situation, however, where domestic prices are significantly influenced by foreign prices, the use of the money

supply to control inflation would seem to have limited use. Again there is the problem of the extent to which the Central Bank can control the money supply. In Trinidad and Tobago currency accounts for between 30 and 40% of the narrow money stock and for less than 10% of broad money. The public's preference for currency which is not under the control of the Central Bank is a key determinant (influences the money multiplier) of monetary expansion or contraction. What the Central Bank tends to control are proximate policy targets such as bank reserves and monetary base.

Between 1981 and 1991 outstanding domestic credit by the banking system to the private sector rose by 90% and to the state enterprises and Statutory Boards by almost 400%. The Central Government was a net lender to the system until 1985. The position was reversed after this year. Its outstanding indebtedness to the banking system at the end of 1991 was $2.7 billion. The bulk of that ($2.4 billion) was owed to the Central Bank.

Monetary policy assumes that there is a relationship between domestic credit and the balance of payments. But since spending also stimulates domestic expansion the challenge is to find a growth rate of credit which neither encourages contraction nor dissipate foreign reserves. As indicated earlier, however, this is not all within the control of the Central Bank.

Between 1981 and 1991 credit expansion was a major factor in the loss of foreign reserves. A regression carried out with year end reserves as the dependent variable (RES) and year end outstanding domestic credit of the banking system (DCR) yielded the result in Equation (1). The values were in million of dollars. The figures in parentheses are standard errors.

Eq. (1) $RES = \underset{(490.23)}{8145.51} - \underset{(0.06)}{0.73}\ DCR$

$\bar{R}^2 = 0.94$

$D.W. = 1.59$

The growth of domestic credit impacts on the balance of payments not only through imports , but through exports. To the extent that money growth fuels local prices, exports could also suffer. In fact high domestic price increases in relation to those in trading partners is a major reason for devaluation. Our investigation did not find a strong relationship between money supply growth and the local inflation rate.

Concluding Observations

In 1992 the economy of Trinidad and Tobago continues to be in deep trouble and the prospects point to further declines in the standard of living in the absence of any significant increase in the price of oil. The tax regime has again (1992) been adjusted to halt the decline in the oil sector which is being affected not only by international developments but more recently by labour/management disputes which are taking place in the midst of a financial crisis.

In recent years petroleum and petroleum products have been accounting for between 60 and 70% of domestic exports. Ammonia, urea, iron and steel account for another 15 to 20%. The traditional manufacturing sector has made little impact on exports. As the major foreign exchange earner the policy of respective administrations has been to encourage mining and refining activities in the oil sector while trying to stimulate non-oil activities. Despite good intentions the policy has not worked. The ability to import at high levels supported by foreign exchange availability and exchange rate policies have militated against both agricultural production and manufacturing activities. While diversifying the production and export base continues to be a major objective of development policy, there is need for a new approach to this challenge. Under the 1989 World Bank's structural adjustment loan, the Government is required to liberalise the trade regime and rely more on tariffs rather than quantitative

restrictions for protection. While one understands the need for export development, particularly in the non-oil areas, this should not preclude exploiting the scope for efficient import substitution. With respect to implementation one suspects, particularly in the light of the difficulties facing the CARICOM Common External Tariff, that the new trade policy has not been properly thought out. In the absence of an adequate foreign exchange cushion, there are likely to be strong pressures to revert back to a protective mode.

The approach to stabilization and adjustment in recent years has been deeply influenced by two Stand-by Agreements with the IMF over the period 1989-1991 and a US$80 million Structural Adjustment Loan from the World Bank. The Inter-American Development Bank which is the major external lender to the country has also tied its resources to the objectives of the programme. Put differently, whether for better or worse there is now a deepn foreign input in policy relating not only to fiscal management but to medium term growth. With the resources available in the 1970s and early 1980s, the government may have lost a golden opportunity to introduce desired policy changes at its own pace and at lower costs. The level of consumption encouraged in those years raised expectations to heights which the Government now find difficult to satisfy. The downward adjustment to a lower standard of living is not a simple or easy process, and calls for skillful political management that must reflect concerns over sharing of the burden of adjustment as well as prospects for future growth. Action to curb the growth of current spending was postponed for too long. Eventually investment and employment also suffered and ultimately the standard of living.

Despite the decline in per capita income, per capita GDP in (1985) prices was estimated to be TT$12.900 or US$3,000. The rate of inflation is at a reasonable level and the skill base of the country is still largely in tact. The productive base is also not

insignificant. The grocery stores are alsowell stocked—for the time being. Unemployment, however, is a serious problem and poverty is increasing. With the pressure on available financial resources there are no short term solutions. The present government has complained about the level of the public debt and its associated servicing burden, but feels it has to continue to borrow if there is to be a satisfactory development programme which is critical to growth. While criticising the previous administration for abusing the lending facilities of the Central Bank, it has continued to borrow from this institution. There is a real prospect of the debt situation becoming increasingly worse and the government being forced into further IMF programmes. Taxes were increased in the 1992 budget on upper income individuals and companies to raise revenue and avowedly to distribute the burden of adjustment more equitably. The previous administration saw downward revision of taxes on individuals and companies as a way to stimulate savings and investment i.e. as a supply side measure. The new government has not only reversed this policy to some extent, but gone against its own election rhetoric in order to fulfill another campaign promise to public servants.

In a democratic setting there are certain constraints to economic management and optimal resource allocation. Playing to the public gallery to get elected is part of that process. In hindsight one can make certain judgements about the distribution of resources between investment and consumption, between infrastructure and directly productive assets and between agriculture and manufacturing. One wonders though, whether the approach would be any different if there were to be a repeat of the last oil 'boom'.

NOTES

1. For example between 1986 and 1990 the all industries weekly earnings index increased by an annual average rate of 2.9% (19.8% between 1979 and 1984) while the productivity index grew by over 5%.

2. Excludes loans and advances extended by the Central Bank to the Central Government.

3. See J.J. Polak, "Monetary Analysis of Income Formation and Payments Problems" in IMF, The Monetary Approach to the Balance of Payments. Washington, D.C. 1977.

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