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ASPECTS OF GROWTH AND ADJUSTMENT IN POST-INDEPENDENCE TRINIDAD AND TOBAGO

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> "Thinking on development has shifted repeatedly during the past forty years. Progress has not moved along a straight line from darkness to light. Instead there have been successes and failures and a gradual accumulation of knowledge and insight. On some matters, a fairly clear understanding has emerged, but many questions still remain contentious and unanswered.[1]

The assumption in the early post-war years that development could be neatly engineered along prescribed paths spawned a variety of simplistic theories and models that ignored fundamental constraints and rigidities in the social and economic environment being addressed. Some of the mistakes were to be repeated in the design of the structural adjustment programmes of the early 1980s, which led to new patterns of poverty, achieved little in many cases, and created pressures for more imaginative safety net programmes. Despite a movement towards a more doctrinaire approach to economic management, there remains many outstanding questions about causality and the nature of relationship between key variables such as growth and equity, growth and employment, exports and growth and interest rate and savings. How to increase income without excluding large sections of the population from the benefits of the process has remained a major challenge.

For many years the world economy has been moving inexorably from a protectionist stance to a more open framework increasingly accommodating to the easy movement of capital labour, goods, services and resources across national frontiers. There have been varying perspectives on these trends and national policies have adapted differently to the changes. Many countries have been slow in recognizing the growing irrelevance of certain traditional ideas and approaches and the fundamental shifts instigated by technology on the global pattern of production and trade. Despite the spectacular success achieved by a small number of developing countries, unsatisfactory

rates of transformation and persistent high levels of poverty in most of the others continue to raise critical questions about economic policies and management. Experience has shown that there is no unique political or economic framework in which development can take place, and neither is there any neatly prepackaged intellectual tool kit that could be applied to the realities of all societies, given the vast differences in the social, political , cultural and economic fabrics, and the rapid and profound changes taking place in the international financial and goods markets. Even the International Financial Institutions with their vast intellectual and financial resources have been found wanting in trying to predict or explain certain phenomena in seemingly strong economies and in world financial markets.

The development experience has helped in identifying certain key factors and policies which assist the process of growth and transformation;or which can retard expansion; but there still remains within the liberal paradigm considerable controversy in individual situations over the correct blend of policies, the extent and pace of liberalisation in both the financial and non-financial sectors, the role of government and the depth of its involvement , the extent of reliance on market forces to allocate resources, the sequencing of policies, the use of incentives, wage policy, mechanisms to promote equity and so on. The problems being experienced by a number of oil-exporting states following the windfall of the 1970s and early 1980s point to the importance of the efficient use of resources, project selection, greater emphasis on investment, policy orientation and the speed of reforms. The relatively massive transfer of resources could not by itself provide a foundation for sustained development as was assumed in the early post-war years. In fact, there is a view that some of these countries might have been better off without a boom that raised expectations, encouraged inefficiency and government borrowing and distorted the structure of wages and prices in the economy. Among the casualties was the agricultural sector already suffering from neglect and badly conceived policies. The more recent experience in some countries under stress has shown that stablisation by itself may not produce growth, and the transient poor could become a permanent addition to the chronic poor in the absence of policies that do not sufficiently reflect domestic, historical and cultural realities and the vagaries of an international system becoming increasingly competitive and unpredictable.

In the context of the discussions for the political independence of the small British Caribbean islands in the early 1960s, the question of economic viability of these states was not an

unimportant issue. A narrow resource base and small markets posed a major challenge to policy formulation in terms of diversifying small export-oriented mono-cultural economies and providing a basis for sustained growth. Some of the theorising of the early post-war years overestimated the possibilities stemming from the blending of foreign capital with surplus labour in terms of developing a diversified export-oriented manufacturing sector, while increasing efficiency in agriculture at the same time. The judicious use of controls, regulations and incentives to influence behaviour and resource allocation was seen as a sufficiently powerful strategy to effect structural change. The existence of some mineral resources and the potential for inter-sectoral linkages offered promise for income and employment generation. The continuation of preferential markets for traditional exports, stable commodity prices, the promise of aid and a conducive international environment for private capital flows provided good reason for the development optimism of the 1960s which the United Nations came to recognize as the first Development Decade.

Following the attainment of political independence by Trinidad and Tobago in 1962, economic nationalism increased, and the need for greater self reliance and control of the economy were seen as key elements in reducing vulnerability and re-inforcing independence. The external environment, however, changed radically in the 1970s and 1980s and despite increased national ownership and the establishment of a wide array of institutions, the country lacked a comprehensive and well articulated programme for change. The government of the day seemed unprepared for the oil windfall of the 1970s/early 1980s and some of the resources were used (together with borrowed funds) to expand the state sector through exploitation of the oil and gas reserves. A significant part went into consumption through the expansion of welfare and other programmes. The non-oil sectors of the economy benefit through the revenues government derives from oil activities, and when the latter is depressed, there tends to be a ripple effect through the rest of the economy. Despite the growth of petro-chemical exports there was little to cushion the effects stemming from the dramatic fall in oil prices in the early 1980s.

Basically the Paper examines the performance of the economy in the post-colonial period and discusses the efforts and policies aimed at effecting transformation and implementing adjustment programmes in the aftermath of the slump. The Paper is divided into four parts. The first part discusses the philosophy and performance of the economy since independence. The second part deals largely with the adjustment experience following the end of the oil boom. In the

third section we look at the effectiveness of exchange rate and monetary policy in economic management. The fourth presents some concluding observations.

I. Economic Philosophy and Performance Since Indpendence

The attainment of political independence in 1962 was preceded by a period of very buoyant growth with real GDP growth averaging over 10 per cent per year and per capita GDP over 7 per cent between 1955 and 1961. This largely coincided with the expansion of domestic crude oil production and a Gross Fixed Capital Formation rate of around 25 per cent per year. Gross Domestic Savings averaged around 30 per cent of GDP per year. The period also coincided with a more systematic approach to economic planning. The newly elected Chief Minister and Minister of Finance, Planning and Development Dr. Eric Williams declared in his first Budget presentation in 1957 that the "hit–and–miss age of Trinidad and Tobago is over. We enter the stage of intelligent planning." The Five-Year Economic Programme for the period 1956-1960 adopted by the previous administration in 1956 was dismissed as "merely a collection of projects put together between two covers, whose relation one to another is not immediately obvious." A Planning Unit was set up but in his 1961 Budget presentation Dr. Williams complained that the unit had become too confused with the control of Development Expenditure and the supervision and execution of projects had not given sufficient attention to basic economic planning.

Three Five-Year Development Programmes followed. The pre-independence Five-Year Plan (1958-62) was largely a public sector program aimed at developing the infrastructure and basic services required for agricultural and industrial expansion. The Second (1964-68) and Third (1969-73) Plans emphasised the need for reducing dependence on the petroleum sector and increasing diversification and self-reliance.[2] Development of an industrial sector through the import substitution strategy was a major goal. A more efficient agricultural sector and an expansion of the tourism industry were also envisaged as part of the diversification process. As far as unemployment was concerned, the Second Plan saw the problem as intricately linked to the problem of transformation and development, namely the expansion of the modern sector and the raising of productivity and incomes in the traditional sector to limit the excessive flow of persons to

the modern sector[3]. Even then it was recognised that output could grow without any corresponding growth in the number of jobs. It was also noted that with improvement in general education and in methods of communication there is a relative decline in self-employment and unpaid family work.[4]The Third Plan noted that the industrial programme had failed to provide an adequate volume of direct employment in relation either to the amount of capital invested or to the needs of the economy. Though the Third Plan saw full employment as an objective, it did not see this being realised until the mid-1980s, given the high population growth rate (over 2% per year), dependence of the economy on petroleum and a few agricultural exports, and too heavy a reliance on foreign investment capital.

The rise of economic nationalism following the attainment of political independence in 1962 was reflected both in the Second and Third Plans. The fact that over 90 per cent of the first Plan was financed from local funds (with the rest borrowed abroad on commercial terms) encouraged the view that the country was capable of meeting a large part of its financing need from local sources.[5] The Second Plan enunciated that if the country were to realise its full potential, there was need to free "the human and economic resources" from "dependence on direction from abroad." The Plan called for increased domestic savings and for both an absolute and relative increase in local private investment between 1962 and 1968. "Local capital must accept and play a far more important role than hitherto in the economic life of the country if assurance is to be had that the nation's economic future will be guided by people with a permanent stake in the independence of the country and its people." In the late 1950s/early 1960s it was estimated that some 60 per cent of average annual gross capital investment came from foreign sources. The basic objectives of the Government's fiscal policy were defined as increasing "the rate of total domestic saving (including both public and private saving)" and ensuring "that such saving is channelled into forms of investment, which will facilitate the long run growth of the economy.[6] In the period of the Second Plan (1964-68) it was estimated that foreign capital inflows into both the public and private sectors financed some 46 per cent of total net investment and that net national savings (of both the public and private sectors) financed some 53 per cent of the total. It was noted, however, that the term 'foreign capital inflows' included reinvested profits of foreign-owned enterprises operating locally, and to that extent it underestimated the domestic savings potential.

A major concern in the immediate post-independence years were the policies of the financial institutions. In his 1963 Budget presentation, the Minister of Finance had this to say: "One of the most serious disadvantages from which developing countries have suffered, and from which we in Trinidad and Tobago have not escaped has been the nature of the policies of the banks and other financial institutions operating in the country, which have tended to siphon domestic savings for investment abroad even while the country itself is desperately in need of capital. Moreover, the credit policies of these institutions have been dictated by their metropolitan head offices and have tended to reflect metropolitan rather than local requirements."[7] With the aim of eventually developing 'an indigenous banking system', Dr. Williams announced in late 1968 (1969 Budget Speech) that he was 'encouraging' the foreign branch banks "to incorporate their local operations in subsidiaries and to provide opportunities for local participation." He further announced that commercial banks "will not be allowed to open new branches without the prior permission of the Minister of Finance. And, finally, the Government has decided that except in special cases new foreign commercial banking operations will be permitted in the country only if they are joint venture operations involving local participation; a limit will also be imposed on such new admissions." In early 1979 the Government acquired the local branch of the Bank of Montreal and in July of that year the first indigenous commercial bank (the National Commercial Bank of Trinidad and Tobago Limited) was opened with great fanfare. "This indeed is an important milestone in the history of Trinidad and Tobago. It is an occasion for pride, for happiness. Above all, it is an occasion for dedication to service for achievement to the goals and aspirations of our nation."[8] The establishment of the National Commercial Bank (NCB) in 1970 was followed by the setting up of the Workers' Bank in 1971 which was also government sponsored. These indigenous banks never rose to challenge the established banks and by the late 1980s problems of survival had arisen and in 1993 the Government merged the NCB, the Worker's Bank and the Trinidad Cooperative Bank as part of a salvage operation. In 1998 the new entity is reportedly up for sale. Most of the foreign banks in the meantime had established local subsidiaries and over time have become majority or fully locally-owned without losing the confidence of the local population. Many of the basic questions of their orientation and *modus operandi* in a development context, however, have not gone away. One of these is the high proportion of bank lending for

consumption.

A recurring theme in the Third Plan was the need for greater 'self-reliance' and 'internally propelled growth' as a means of developing a 'truly national economy'. As the Plan saw it, creating conditions for self-reliance and greater national control of the economy did not mean closing off the economy from foreign trade, or from the inflows of foreign capital from relatively free foreign 'invisible' transactions. Rather it suggests the necessity for more positive steps to promote tastes for local goods and services, local technological research, local engineering and other technical skills, local enterprise (both public and private) and the mobilisation of local capital. "It was stipulated that building a national economy required the establishment of locally- owned financial institutions, locally-owned enterprises in industry, agriculture and tourism, more local technology, greater use of local raw materials, more local entrepreneurship and management and greater internal capacity for mobilising savings. Key economic decisions should be in local hands.

By the beginning of the Third Five Year Plan , there was evidence that the economy was in difficulty. The production of crude and natural gasoline dropped from 67.0 million barrels in 1968 to 57.6 million barrels in 1969 and to 47.3 million barrels in 1971. With stagnant or falling crude oil prices net foreign reserves dropped from TT$129 million at the end of 1968 to TT$107 million at the end of 1970. This was to decline further to TT$67 million at the end of 1973. In June of 1969 the unemployment rate was estimated to be 14 per cent of the labour force and a year later 12 per cent. The large number of young school leavers and unskilled young people among the unemployed however, was cause for concern and the eruption of social unrest in the early part of 1970 underscored the need for a more intense effort in job creation and training. To this end an Un-Employment Levy was enacted in 1970 and Government underscored its objective to increase local participation in the economy as a means of creating and saving jobs. The unrest of 1970 was not only about unemployment, however, but about the pace of change in a number of areas. "It was due in no small measure to heightened expectations of a fundamental change in the circumstances of the lower classes which seemed long in coming and the delay sharpened the perception of social inequity and injustice which a new political dispensaiton was not addressing quickly or radically enough."[9]

Following the social disturbances of 1970 the vision of a "People's Sector' began to take more concrete form and greater participation in business activities by trade unions, the cooperative, the small business, the small farm and the handricraft industry was more firmly underlined. "The PNM perspectives reject both liberal capitalism (with its concomitant of penetration and take-over of the economy by multinational corporations) and the communist organization of the economy and the society. Instead we follow the pattern that is being increasingly developed in developing countries, of state participation in the economy, to the extent of 51 per cent in particular enterprises to ensure that decision-making remains in local hands."[10]

Even before 1970, Government had already increased ownership in several sectors of the economy and this was to intensify in the 1970s. In his 1972 Budget presentation the then Minister of Finance Mr. G.M. Chambers stated the Govenment's position very clearly: "As I said, participation by Government is one of the means which we have employed to accelerate the transfer of control and ownership of foreign-owned firms in the country and to ensure that substantial national participation is achieved from the very outset in important new operations." The policy towards private foreign investment was summarised as follows:

1. We welcome new foreign investment which brings in expertise, new technology and access to export markets to assist and supplement national efforts in our development;

2. No new 100 per cent foreign-owned enterprise will be allowed in key sectors of the economy and national participation in joint ventures involving new foreign firms must be of meaningful proportion;

3. Alienation of land will not be permitted;

4. Existing foreign-owned enterprises must take steps to facilitate national participation, including in particular worker-participation;

5. Certain areas of our economy are reserved exclusively for national effort;

6. All firms, whatever the structure of their ownership, must in their operations give ample opportunity to transfer to nationals the skills, knowledge and expertise required to run the business;

7. Government will take a leading part, including the use of direct participation to expedite national control and ownership.

At the end of the Third Five Year Plan in 1973 it was evident that not a great deal had changed in terms of the structure and functioning of the economy. The Draft Development Plan of 1983-86 noted that by the start of the oil boom towards the end of 1973 the economy of Trinidad and Tobago "suffered from an number of structural weaknesses, the principal of which were: domination of the economy by oil; heavy dependence on imported food; the consequent lack of diversification of the production and export structure; a wage and salary level more appropriate to the petroleum industry than to the other sectors of the economy; and a high level of open unemployment. One of the major historical weakness – namely, very little national control in key sectors of the economy – was gradually being addressed."[11] Despite the gains made in the standard of living and improvements in the infrastructure between Independence and the end of the oil boom, the desired degree of diversification and resilience had not materialised. In his 1987 Budget Speech the then Prime Minister and Minister of Finance Mr. A.N.R. Robinson had this to say: "The basic reality confronting Trinidad and Tobago in 1987 is that ...we have failed to meet the challenge of independence. We achieved political independence in 1962 with an economy dependent on one resource, oil. Twenty-five years later we are more than even dependent on the vagaries of the international oil market." The Medium Term Macro Planning Framework (1989-95) also later lamented that despite a small measure of economic diversification perhaps "the most important structural weaknesses is the continued acute dependence of the economy on a single commodity, namely petroleum."[12]

Boom, Bust and Consequences

In the early 1960s with the slackening of the oil sector, the economy lost some of its earlier momentum, and per capita income stagnated. For the decade as a whole the economy grew by an average of 4.3 per cent per year and per capita income by about 2 per cent (See Table 1) In the decade between 1951 and 1961 GDP had grown by an average of 8.6 per year, as compared to 5.3 per cent for per capita income. The Second Plan (1962-68) had projected a GDP growth rate of 5.1 per cent per year and a rate of 2.1 per cent per year for per capita GDP.

Table 1

Selected Macro-economic Indicators

Period	GDP Growth Rate at Constant Market Prices %	Real Per Capita GDP Growth Rate %	Unemployment Ratio %	Inflation Rate %	Population Growth Rate %	Nominal Per Capita GNP US$
1952-1960[a]	8.5	6.0	...	2.4	2.6	570[b]
1960-1970[a]	4.3	1.9	14.0	3.2	1.5	860[c]
1970-1979[a]	4.7	3.5	13.5	12.9	1.2	3,910[d]
80	10.4	8.9	9.9	17.5	1.3	6,270
81	4.6	2.6	10.4	14.3	1.8	6,270
82	4.0	2.3	9.9	11.4	1.6	7,330
83	-10.1	-11.0	11.1	15.2	1.9	6,690
84	-6.6	8.7	13.4	13.3	2.7	6,360
85	-4.3	-5.0	15.6	7.7	0.8	5,960
86	-3.4	-5.0	17.2	7.7	1.5	3,790
87	-4.8	-6.0	22.3	10.8	1.3	3,730
88	-4.0	-4.0	22.0	7.8	0.1	3,460
89	-0.8	-1.0	21.6	11.4	0.1	3,240
90	1.5	1.3	20.0	11.0	0.2	4,170
91	2.7	1.8	18.5	3.8	0.8	4,330
92	-1.7	-3.0	19.9	6.5	1.2	4,390
93	-1.4	-2.0	19.8	10.8	0.5	3,670
94	3.6	3.2	18.4	8.8	0.2	3,900
95	2.4	1.7	17.2	5.3	0.8	4,090
96	3.1	2.3	16.3	3.3	0.7	4,100
97[p]	3.2	2.4	15.0	3.7	0.5	4,310
1984-96[a]	-0.9	-1.8	16.6	9.8	1.0	

a. average per year
b. 1960
c. 1970
d. 1979.
P. Provisional
... not available

Source: Official Publications and World Bank Atlas, Various Issues

Table 2

Trends in the Oil Sector and Impact on Selected Variables

	Terms of Trade Index (Net)		Crude Oil Production[I]	Average	Total	Recurrent
	1974 = 100	% Charge	(Million Barrels)	Crude Oil Price US$/barrel	Exports US$ mn.	Revenue TT$ mn.
1973	85.4		60.6	3.14	333	491
74	100.0	17.1	68.1	11.22	928	1,307
75	110.7	10.7	78.6	10.60	987	1,816
76	98.7	-10.8	77.7	11.83	1,183	2,303
77	104.5	5.9	83.6	12.84	1,175	2,985
78	100.6	-3.9	83.8	12.95	1,222	3,124
79	116.7	16.0	78.2	29.22	1,649	4,060
80	124.1	6.3	77.6	36.68	2,542	6,379
81	121.1	-2.4	69.1	35.27	2,608	7,019
82	102.5	-18.3	64.6	32.95	1,433	7,067
83	101.8	-0.7	58.3	29.66	2,023	6,551
84	100.9	-0.9	62.0	28.56	2,106	6,609
85	93.6	-7.8	64.2	27.31	1,522	6,492
86	81.0	-15.5	61.6	14.23	1,465	5,456
87	71.0	-14.0	56.6	18.15	1,174	5,232
88	54.3	-30.7	55.2	14.72	1,172	4,958
89	60.0	10.5	54.5	17.84	1,202	4,836
90	70.3	17.2	55.2	22.97	2,081	5,663
91	...	...	52.6	19.33	1,986	6,779
92	...	...	49.5	19.03	1,890	6,215
93	...	...	45.5	16.82	1,662	6,721
94	...	...	48.0	15.90	1,972	7,505
95	...	...	48.1	17.16	2,477	8,456
96	...	...	47.2	20.42	2,506	9,537
97[P]	...	...	45.2	19.27	2,427	9,134

... not available
P. Provisional
I. including con....

Source: Official Publications and IMF International Financial Statistics; Various Issues.

In terms of structural change, agriculture's share in GDP (at current market prices) fell from 16 per cent in 1951 to 11 per cent in 1961 and by the early 1970s its contribution had been reduced to less than 5 per cent. Mining's share dropped from over 25 per cent in the late 1950s/early 1960s to less than 10 per cent in the early 1970s. This trend, however, was to be reversed with the increase in oil prices in the 1970s and early 1980s. Petroleum's share in GDP climbed to 40 per cent in 1980. The contribution of manufacturing averaged around 15 per cent in the 1950s, but this share rose to over 20 per cent in the 1960s and early 1970s. The production of chemicals, however, was contributing about half of this figure (See Table 3).

Table 3

Sectoral Composition of GDP at Current Market Prices
(Percentages)

Activity	1951[a]	1960[a]	1966	1970	1975	1980	1985	1990	1996	1997[P]
Agriculture	17.8	12.6	4.7	4.9	3.3	2.3	2.4	2.5	2.2	2.2
Petroleum Industries	30.0	30.5	12.4	8.1	35.2	40.0	26.6	29.6	28.2	26.7
Manufacturing	16.7	17.4	20.5	24.2	14.9	9.0	7.3	8.6	7.7	8.5
Electricity and Water	...	...	1.8	2.0	0.7	0.2	1.0	1.2	1.2	1.7
Construction	...	...	5.6	6.8	8.3	12.6	11.2	8.0	7.9	8.6
Transport, Storage and Communication	...	...	13.8	14.4	6.9	9.7	8.9	8.1	9.2	9.2
Distribution	...	...	19.0	18.1	12.7	8.6	12.2	12.6	15.3	16.0
Finance, Insurance and Real Estate	...	...	7.4	7.4	6.9	9.6	12.1	10.6	11.3	11.5
Government	...	...	8.4	8.4	8.5	7.8	15.2	10.7	9.1	8.3
Other	35.5	39.5	6.4	5.7	2.6	0.2	3.4	8.1	7.9	7.3
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

P. provisional
a. at current factor cost
... included in 'other'

Sources: Official Publications.

With respect to employment, the agricultural sector employed 25 per cent of the (employed) labour force in 1970 – more than the manufacturing and petroleum sectors put together. Though now accounting for a little over two per cent of GDP, agricultural activities still provide 10 per cent of the jobs compared to 4 per cent for the petroleum sectors and 10 per cent for manufacturing. As a creator of employment, the latter has been extremely disappointing. At the height of the boom in the early 1980s the construction sector was providing about 20 per cent of the employment, and despite the mini-boom conditions now prevailing, only about 12 per cent of the jobs are being generated by construction activities. The share of services has been increasing steadily, and now contributes over 60 per cent of the employment opportunities (See Table 4).

Table 4

Sectoral Distribution of Employment, 1970–1997

	1970[1]		1980		1990		1997	
Sectors	'000	% of Total	'000	% of Total	'000	% of Total	'000	% of Total
Agriculture	81.8	25.5	39.6	10.2	46.2	12.4	43.7	9.5
Petroleum (including mining and quarrying)	a	a	a	a	16.8	4.5	16.7	3.6
Manufacturing	66.8	20.8	62.2	16.0	37.2	9.9	47.6	10.4
Construction (including electricity and water)	38.4	12.0	81.0	20.9	47.5	12.7	56.9	12.4
Transport, Storage and Communications	21.7	6.8	32.4	8.3	27.3	7.3	31.8	6.9
Other Services	111.7	34.9	171.8	44.3	198.9	53.2	262.9	57.2
Not Classified	–	–	0.9	0.2	0.1	0.0	0.2	0.0
Total	320.4	100.0	387.9	100.0	374.0	100.0	459.9	100.0

1. end of June ,
a included in 'manufacturing'
b. average of first, third and fourth quarters.

Source: Official Publications.

The significant impact of the oil price increases starting in 1973 on all the major macro-economic variables was not only an indication of the extent of dependence on a single commodity, but also showed how vulnerable the country was to developments in the oil industry. The Three Five Year Plans and the various incentive legislations dating back to the 1950s had failed to produce a diversified competitive industrial sector which was seen as a means to modernisation and a higher standard of living. By the early 1970s, planning through the formulation of comprehensive long term blue-prints had lost a great deal of its attraction.

Between 1974 and 1982 the economy grew by almost 6 per cent per year in real terms, while per capita GDP expanded by an average rate of 4.4 per cent per year. With the decline of oil prices following the peak of 1982 and the drop in crude oil production, the economy went into a sharp decline with real GDP falling by almost 30 per cent between 1982 and 1989 at an average rate of 4.8 per cent per year. Real per capita income fell by over 30 per cent in the period. Aggregate private consumption in 1989 was 54 per cent of the 1982 level, and gross capital formation 37 per cent. The unemployment rate which averaged 10 per cent in the 1980/82 period rose sharply to over 20 per cent in the late 1980s. Recurrent revenue rose from TT$0.5 billion in 1973 to over TT$7 billion in 1981/1982, but by the late 1980s this had dropped to under TT$5 billion (See Table 2). Current budgetary savings which averaged 17.6 per cent of GDP between 1974 and 1981 disappeared by the mid-1980s. The position of overall surpluses between 1974 and 1981 had also turned into a deficit by 1982. A substantial part of the savings of the boom years was diverted to Special Funds, but these were drawn down between 1982 and 1986 to finance both current and capital expenditure. As a percentage of GDP capital expenditure had averaged 13 per cent between 1974 and 1981, but by the mid-1980s, this had dropped to around five per cent. Not surprisingly, current expenditure did not fall as sharply as revenue, and as a percentage of GDP it rose in the 1980s as production declined (See Table 5).

Table 5

Fiscal Performance of the Central Government, 1965-1997
(as a % of GDP)

Period	Current Revenue	Tax Revenue	Curent Expenditure	Capital Expenditure	Current Surplus Deficit (–)	Overall Surplus Deficit (–)
1965-73[a]	18.2	16.1	16.2	5.6	2.0	-2.5
1974-81[b]	36.7	34.3	19.0	13.0	17.6	5.6
1982	35.6	33.8	30.7	18.7	4.8	-13.8
83	34.4	31.7	33.3	13.6	1.0	-12.5
84	35.2	32.9	33.8	10.8	1.3	-9.2
85	35.7	33.0	34.1	9.2	1.6	-7.5
86	30.3	26.6	32.6	5.7	-2.3	-8.0
87	30.3	27.0	32.6	4.9	-2.3	-7.3
88	28.5	25.0	32.1	3.0	-3.5	-6.3
89	27.3	24.4	28.5	3..1	-1.3	-4.2
90	26.8	25.0	31.1	2.2	0.4	-1.3
91	32.3	29.6	29.0	3.6	3.1	-0.2
92	26.9	24.6	27.8	1.9	-0.8	-2.8
93	27.4	25.4	26.5	1.2	1.0	-0.2
94	25.6	22.8	24.2	1.6	1.4	-0.0
95	26.8	24.5	24.8	2.0	2.0	0.2
96	28.0	25.7	26.8	1.7	1.2	-0.5
97[p]	25.1	24.1	23.4	2.8	1.7	0.9

a. average

p. Provisional

Sources: Ministry of Finance and Central Bank.

At the end height of the boom in the late 1970s/early 1980s the Gross Domestic Savings ratio had risen to over 35 per cent and the Capital Formation ratio to over 25 per cent (See Table 6).

Table 6

Trends in Savings and Investment Ratios, 1951-1997

(as a % of GDP)

Period	Gross Domestic Savings	Gross National Savings	Net National Savings	Gross Capital Formation
1951-60[a]	28.5	18.5	10.3	25.2
1966-70[a]	26.5	17.2	7.7	20.7
1971-75[a]	35.4	26.9	18.5	28.1
1976-80[a]	38.2	32.5	25.3	28.2
1980	42.0	36.0	30.3	30.6
81	36.2	33.5	27.8	27.6
82	22.1	20.9	14.7	29.1
83	15.9	12.6	4.7	25.7
84	22.4	16.8	8.4	24.0
85	22.9	17.3	7.4	18.8
86	14.5	8.4	2.4	21.6
87	20.7	14.2	2.9	19.3
88	17.9	10.4	1.3	13.0
89	24.5	15.0	3.4	16.6
90	29.5	21.1	11.2	13.8
91	24.6	15.9	5.0	16.3
92	24.7	16.0	4.7	13.8
93	19.7	12.0	1.2	14.4
94	33.6	24.7	14.4	20.2
95	30.5	21.0	10.6	16.0
96	27.7	18.4	8.3	17.2
97[p]	15.1	9.7	..	21.8

p. Provisional
.. not available
a. average for the priod.

Source: Computed from official publications

These figures declined dramatically after 1982 with the fall of government savings. By the mid-1990s government's contribution to domestic savings was less than 20 per cent as compared to over 30 per cent in the early 1980s.

When we look at the expenditure components of GDP (See Table 7), we get a better idea of the dramatic downturn in the economy in the 1986-96 period. Both private consumption, per capita GDP and Gross Capital Formation declined. Government consumption hardly grew. Nominal per capita GNP fell from around US$7,000 in 1982 to a little over US$3,000 in 1989 (See Table 1). The inflation rate which had risen significantly in the 1970s from the 1960s level remained fairly high in the 1980s, notwithstanding the downturn in the economy.

Table 7

Growth in the Components of Real GDP, 1951-1996

(Average Annual Growth Rate %)

	1951-1961	1966-1973	1973-1985	1986-1996
GDP	8.7	3.1	2.6	0.0
Private Consumption	8.1	3.3	3.6	-2.3
Government Consumption	4.7	8.4	6.8	0.0
Gross Capital Formation	7.5	4.3	6.0	-4.0
Exports of Goods and Services	10.7	5.8	1.6	4.9
Imports of Goods and Services	9.5	7.6	8.5	-0.5
GDP Per Head	4.5	2.0	1.1	-0.6

Source: Computed from Official Publications.

At the end of 1973 net international reserves had reached a critical level, just being able to cover about one month's imports. Positive trade and current account balances assisted by capital inflows between 1974 and 1981 were critical factors in enhancing the net reserves position which

in 1981 amounted to almost 20 months imports. Six years later, by 1987 the net reserves position was negative.

With the fall in export earnings, debt servicing of the external debt also emerged as a major problem. Even during the boom years the government continued to borrow to finance a number of capital intensive gas-based projects, and with the decline in revenues in the 1980s borrowing both internally and externally was undertaken to finance both current and capital expenditures. As a per cent of GDP the internal debt outstanding grew from less than 5 per cent in the early 1980s to over 20 per cent in the early 1990s. Outstanding Central Bank advances to government increased from TT$1,003.2 million in 1986 (22% of the Bank's asset) to TT$2,209.4 million in 1992 (37% of the Bank's assets).

The outstanding external debt increased from around US$150 million in 1975 (6.6% of GDP) to over US$2 billion in 1986 (44% of GDP). In the early part of the 1980s, with the debt service ratio averaging less than 5 per cent, the debt service was not regarded as a problem. With the decline of the foreign exchange earnings, however, the ratio climbed to around 30 per cent in the late 1980s and the government was forced to seek relief through the rescheduling process.

Table 8

Growth of the Public Debt, 1970-1997.

End of Period	(1) Internal Debt TT$mn	(2) External Debt[1] US$mn	(3) (1) as a % of GDP	(4) (2) as a % of GDP	(5) External Debt Service (a)	Ratio[2] (b)
1970	202.6	150.8	12.3[3]	12.1[3]	2.3	
75	413.5	148.8	7.8	6.6	1.8	
80	661.8	828.5	4.4	6.6	1.8	
81	631.2	1,049.8	3.8	15.0	2.1	
82	756.9	1,202.8	3.9	14.8	2.4	
83	1,024.2	1,438.2	5.5	18.7	6.8	
84	1,089.8	1,221.8	5.8	15.7	5.5	
85	1,301.9	1,448.2	7.2	28.8	11.1	
86	1,552.1	2,103.8	9.0	43.8	19.5	
87	2,717.0	2,318.9	15.7	48.3	29.1	29.1
88	3,207.1	2,410.0	18.6	59.0	26.9	21.9
89	3,388.3	2,413.0	18.4	56.0	32.9	19.7
90	3,953.5	2,520.0	18.3	50.0	31.8	19.9
91	4,717.7	2,438.1	20.9	46.0	25.2	20.0
92	5,023.2	2,215.0	21.7	41.0	29.7	26.7
93	5,360.3	2,102.1	21.5	59.0	30.6	30.6
94	5,572.2	2,063.5	18.3	42.0	25.5	25.5
95	6,324.4	1,905.2	20.0	36.1	15.0	15.0
96	6,315.8	1,875.7	18.6	34.2	13.3	13.3
97	8,155.7	1,526.8	22.4	26.4	16.4	16.4

1. includes guaranteed debt.
2. (a) is actual debt service ratio and (b) is scheduled debt service ratio.
3. 1973

Sources: Ministry of Finance, Central Bank and Central Statistical Office.

II. The Adjustment Experience

The rapid deterioration of social and economic conditions in the 1980s may have been a significant factor in the removal from power in 1986 of the People's National Movement (PNM) which had formed the government of the country for some 30 consecutive years. Popular expectations had grown during the boom years, and much was expected from the National Alliance for Reconstruction (NAR) Government which won 33 of the 36 seats in the 1986 general election. The prospects facing the new government, however, were grim. Almost all the fiscal savings generated during the years of the oil bonanza were exhausted. Even amidst signs of problems in the oil sector, between 1981 and 1986 the country spent US$2,874 million of its reserves or 90 per cent of the 1981 level. Export earnings and recurrent revenue were also falling. As a per cent of GDP the current account balance of the balance of payments declined from a positive 5.5 per cent in 1980/81 to a negative 13.1 per cent in 1986. The overall balance had also worsened (See Table 9). The surplus in the current account in the budget which had averaged 18 per cent of GDP in the 1974-81 period had turned into a deficit in 1986. Capital spending also fell sharply with the disappearance of the accumulated savings. Debt service payments on both the internal and external debt of the Central Government increased from 4.2 per cent of recurrent revenue in 1981 to 16.3 per cent in 1986 and the projection was this proportion was likely to grow further in the following few years. The share of foreign exchange earnings taken by external debt service payments increased from 2 per cent in 1981 to 20 per cent in 1986 and the projections was this was likely to grow to over 30 per cent by the late 1980s.

Tables 9

Selected Balance of Payemnts Statistics, 1960-1997

Period	As a % of GDP[1]					Net Internal Reserves		As a % of GDP	
	Trade Balance	Services Balance	Curerent Account Balance	Capital Account Balance[2]	Overall Balance	US$ mn.	In months of Imports	Imports (M)	Exports (E)
1960	-7.8	-2.6	-10.6	7.5	-2.6	...	...	61	60
65	-3.4	-3.2	-10.5	9.4	-3.2	56.0	1.4	65	64
70	-6.0	-0.8	-1.3	10.9	-0.8	53.3	2.3	42	43
73	-5.6	-4.3	-2.0	4.6	-1.1	32.4	1.1	38	44
75	10.1	4.3	13.5	8.3	4.3	728.5	13.0	35	53
80	8.6	-2.2	5.3	2.6	-2.2	2,640.0	16.0	39	50
81	8.1	-1.1	5.8	3.2	-1.1	3,203.0	19.5	36	46
82	-7.0	2.2	-8.4	5.1	2.2	2,983.3	12.9	42	35
83	-6.3	-5.4	-13.1	1.3	-5.4	2,082.5	10.0	41	31
84	2.5	-8.2	-7.1	-0.3	-8.2	1,187.5	7.4	33	32
85	8.0	-8.7	-1.4	1.8	-8.7	994.4	11.5	28	33
86	-2.2	-10.1	-13.1	0.6	-10.1	329.0	2.7	40	33
87	5.0	-9.0	-5.1	0.8	-9.0	79.6	0.8	32	34
88	6.2	-8.2	-2.6	3.4	-8.2	-6.9	–	34	39
89	7.8	-8.7	-1.5	-3.4	-8.7	102.2	1.0	35	43
90	16.6	-7.5	8.6	-10.5	-7.5	187.5	2.0	28	45
91	6.9	-7.5	-1.3	-5.0	-7.5	23.8	0.2	38	45
92	8.0	-7.1	0.5	3.2	-7.1	-21.2	–	33	43
93	3.6	-5.8	-2.3	2.0	3.3	206.3	2.9	39	44
94	12.2	-7.5	4.5	-0.6	3.6	206.3	4.5	39	46
95	11.1	-5.8	5.0	-0.5	0.6	460.2	3.9	39	54
96	6.1	-4.8	1.2	0.8	2.7	701.1	3.9	42	52
97[P]	-10.5	-1.7	-12.2	10.3	4.4?	854.4	3.4	39	44

1. at current market prices
2. excluding reserves
P. provisional.

... not available
M imports of goods and services
E exports of goods and services

Source: Central Statistical Office and Central Bank.

As indicated earlier, unemployment had increased sharply between the early 1980s and 1986, while real per capita GDP fell by 27 per cent between 1982 and 1986. Even in nominal terms per capita GNP declined from over US$7,000 to US$3,800 or by 46per cent over the period. By 1986, wages and salaries were accounting for almost 50 per cent of current expenditure while transfers and subsidies were taking 37 per cent as compared to 27 per cent in 1973 (See Table 10). A bloated public sector and a large and inefficient state enterprises sector had helped to weaken the government's savings capacity.

Table 10

Composition of Central Government Recurrent Revenue and Recurrent Expenditure (Percentage)

	1966	1973	1975	1980	1985	1990	1996	1997
Oil Revenue	28	23	69	65	39	41	32	22
Non-oil Revenue	72	77	31	35	61	59	68	78
Invome Taxes	21	31	13	17	34	20	32	35
(Individuals)	(14)	(18)	(8)	(10)	(23)	(10)	(19)	(19)
Property Taxes	6	1	...	...	...	1	1	1
Taxes on Goods and Services	12	22	6	4	11	24	22	26
International Trade Taxes	22	14	6	7	9	8	5	6
Non-Tax Revenue	11	9	5	7	7	6	8	10
Total Recurrent Revenue	100	100	100	100	100	100	100	100
Recurrent Expenditure								
Wages and Salaries	41	51	44	39	45	36	38	39
Goods and Services	32	15	20	15	6	10	10	9
Interest	6	7	6	4	5	18	17	18
Transfers and Subsidies	21	27	30	42	44	36	35	34
Total Recurrent Expenditure	100	100	100	100	100	100	100	100

... Less than 0.5%

Source: Ministry of Finance

By 1987 a good case could have been made for an immediate approach to the International Monetary Fund for financial and technical assistance, and fears to this end had already surfaced among the population. Given the concern over the conditionalities normally attached to the use of Fund resources and their possible adverse social impact, the new Government had clear reservations about this course of action. The then Prime Minister and Minister of Finance Mr. A.N.R. Robinson saw the imperative of 1987 as threefold:[13]

1. We must at all cost escape the debt trap and dependence on the IMF;

2. We must avoid the route into which so many countries have been diverted – of inflation, hyper-inflation, successive devaluations and institutionalised misery;

3. We must resist the temptation to spend more than we earn.

With the persistent financial problems, the Government's position had changed significantly by 1988 and a request for a fourteen-month Stand-by Arrangement was approved by the Fund in January, 1989. The need for immediate balance of payments support and to restructure the foreign debt were given as major reasons for approaching the Fund. Without "a Fund agreement, it would have been necessary to cut our wages and salaries bill by some 50% or alternatively, make similarly draconian cuts in our welfare appropriations, capital program and goods and services."[14] He went further. "The point is that there was, and is, no realistic alternative to an accommodation with the Fund, and there is no escape form the pain of adjustment, whether this adjustment takes place with a Fund program or without a Fund program."[15]

The first Stand-by of 1989 was followed by a request for a second 12-month Agreement in March 1990 for SDR 85 billion and this came to an end in March 1991 with the Government exercising the option not to make the final two draw downs in the light of the improvement in the reserves position.[16] To complement the IMF's resources the Government also sought a Structural Adjustment Loan (SAL) of US$40 million from the World Bank, and this was co-financed to the extent of another US$40 million by the Export-Import Bank of Japan. These resources were supplemented by loans from the Inter-American Development Bank which amounted to US$650 million between 1990 and 1993. The funds provided by these financial institutions served to ease

the debt service burden and improve import capacity.

On the other hand, the conditionalities associated with these loans were to radically alter the philosophy and development strategy embraced since independence by giving greater play to market forces and reducing government's role in the economy. The World Bank's Structural Adjustment Loan had several components relating to public enterprises reform, the incentive regime as it related to foreign direct investment and the petroleum sector, trade reform and the establishment of mechanisms to ameliorate the social costs of adjustment. Trade reform ranked high in the list of conditionalities. The first stage of the programme involved a shift in the pattern of protection from import licensing to import tariffs at fairly high levels. In the second phase (1992-94) tariffs were to be reduced to the level of the CARICOM Common External Tariff or about 45 per cent. The trade reform programme also involved rationalising the system of import duty exemption and establishing mechanisms that essentially provide duty free status to exporters. In addition, export and import procedures would be simplified and export licensing requirements will be eliminated with limited exception for products justified on grounds of international agreements, national security, national heritage and public health and products that receive Government subsidies.[17]

In order to reduce if not eliminate the fiscal deficit a number of short term measures were introduced in the late 1980s. While some taxes were raised, or new ones introduced, it was recognised that rationalising and simplifying the tax system was a longer term objective since the need for revenue had to be balanced by the presence of a sensible system of incentives for both individuals and businesses. All the governments since 1986 have been committed to reducing the level of taxation but the actions taken have often created a great deal of uncertainty and raised questions of confidence about government's decisions. For example, in 1988 the maximum marginal tax rate was reduced from 70 per cent to 50 per cent in addition to a reduction of other marginal rates. In 1989 and 1990 the marginal rates for individuals were again simplified and reduced with a maximum rate of 35 per cent. The corporate tax for the non-oil sector was also reduced from 55 per cent in 1988 to 40 per cent in 1990. In 1992, however, the new government again raised the top marginal rate to 40 per cent and the corporation tax went from 40 to 45 per cent. In 1995 the latter was again lowered to 38 per cent and to 35 per cent in 1996, with the top

marginal rate for individuals moving from 38 per cent to 35 per cent. A major change to the tax regime was the introduction of a Value Added Tax (VAT) in 1990 to replace a number of other indirect taxes and to broaden the tax base. The VAT replaced existing purchase taxes ranging from 20 per cent to 85 per cent, and other indirect taxes. It covers all goods and services. Exports, certain food items and some public services are excluded from the charge. Over time additional items have been zero rated. The argument was that bynot taxing inputs used in production and not taxing exports or discriminating between imports and domestic production it would improve the efficiency and competitive base of the economy.[18]

On the expenditure side the measures included cuts in wages and salaries, suspension of Cost-of- Living-Allowances and merit increases, reduction of the public sector work force, reduction in subsidies and transfers. A critical exercise included the restructuring or rationalisation of the state enterprise sector which was commanding an increasing share of government's revenue. By the early 1980s, the Government had acquired 34 wholly-owned companies, 14 majority-owned, one equal partnership and 17 with minority interest. The Draft Development Plan of 1983-86 had concluded that taken "as a whole, the sector reveals no common financial, economic or strategic organising principle and the companies display no common factor or group of factors which may have determined their status."[19] Since then several state companies have been wholly or partially divested, while some others have been liquidated or restructured. The Government is still a major player in certain key sectors of the economy including the activities where the strategy has been to bring in private management. As the government seeks to reduce its ownership involvement in the economy, there is still some uncertainty in terms of how it deals with state companies in strategic areas of the economy. Certain state enterprises are seen as representing the country's patrimony or 'family jewels' in some circles and it is felt the state should retain control, particularly in those that are profit making.

With those measures the current fiscal balance showed a gradual improvement from 1988, and the overall deficit which had averaged 6.9 per cent of GDP between 1983 and 1989 has generally been kept to less than one per cent in recent years. Between 1975 and 1980 the oil sector was contributing over 60 per cent of total tax revenue, but this rapidly declined to around 20 per cent in 1997. Both in absolute terms and as a share of total recurrent revenue, tax revenue from the

non-oil has increased significantly in the 1990s. The contribution by individuals to recurrent revenue now amounts to about 20 per cent after dropping in the late 1980s. Individuals' share exceed that of the non-oil companies. With the introduction of VAT, the proportion contributed by taxes on goods and services rose from less than 20 per cent of recurrent revenue in the late 1980s to an average of over 25 per cent in the 1990s. Correspondingly, the contribution by international trade taxes has tended to fall.

The external accounts has improved significantly since 1988, when net international reserves became negative. As a per cent of GDP the current account deficit which averaged 6.5 per cent between 1981 and 1989, has shown a surplus in five of the eight years between 1990 and 1997. At the end of 1997 net international reserves was the equivalent of over three months' imports as compared to a negative position in 1992. Other economic indicators were also reflecting improvements in the macro-environment. The unemployment rate dropped from a high of 22 per cent in 1987 to 18.5 per cent in 1991, but this was still a major source of concern, given the large number of young people in the labour force and even some newly unemployed. While some indicators were moving in the right direction (or put differently, while the internal and external balances were being corrected) there was no apparent improvement in the social situation. Falling real wages and salaries in this period combined with the effects of some of the other adjustment measures taken to increase efficiency and reduce current expenditure created a considerable amount of disaffection in the society, which no doubt provided encouragement to the group that attempted to remove the government by force in July 1990.

In the general election of 1991 the PNM was returned to power with the ruling NAR Party losing 31 of its 33 seats in the House of Representatives. In essential ways the PNM continued the policies of the previous administration, emphasising the need for stability and a sound macro-economic environment and embracing the same medium and long term goals. In the short term it continued with the fiscal reforms both in the oil and non-oil sectors, generally holding current expenditure in check, reforming or privatising state enterprises, improving the climate for foreign and local investment and limiting government's participation in commercial activity and ownership in strategic sectors. The Government committed itself to the on-going trade liberalising programme and to the reduction of the Common External Tariff to a maximum rate of 20 per cent by January, 1998. During 1993 a major step in the liberalization process was taken with the abolition of

exchange controls and the flotation of the Trinidad and Tobago dollar. This action eliminated the 'black-market' in foreign currency and permitted the bank to offer foreign currency accounts to residents and non-residents. Foreign currency deposits in local banks increased from TT$875 million at the end of 1993 to TT$3,931 million at the end of April, 1998. This latter figure amounted to 32 per cent of the broad money supply aggregate at that date.

By the early 1990s there were encouraging signs that the economy was beginning to recover from the downward slide of the previous few years. After growing by 1.5 per cent and 2.7 per cent respectively in 1990 and 1991, it again declined in 1992 and 1993, but returned to a positive growth path in 1994 and 1995 with both real GDP and real per capita income increasing. The government continued to keep a tight rein on current spending with current expenditure falling from 29 per cent of GDP in 1991 to 25 per cent in 1995. Though both crude oil production and oil prices continued their declining trend between 1991 and 1995, the current account of the balance of payments improved from a deficit in 1993 to a surplus of over 4 per cent in 1994 and 1995 respectively. Non-oil exports almost doubled between 1991 and 1995. Net international reserves increased from a minus position in 1992 to US$460 million at the end of 1995 or the equivalent of almost four month's imports. The scheduled external debt service ratio had also come down from almost 30 per cent in 1992 to 15 per cent in 1995. Though declining slightly between 1992 and 1995, the adjustment did not have a significant impact on the level of employment. Real per capita GDP hardly changed between 1991 and 1995.

By the time the 1995 general election was called, many basic reforms relating to the trade and development framework and improving the investment climate were still being conceptualized or implemented. The move to a more open trade and exchange regime had evoked a mixed reaction from the manufacturing sector. The liberalisation programme had hardly touched agriculture however. Legislation relating to anti-dumping, unfair trade practices and competition policy were still not in place. It was widely recognised that in an increasingly competitive world the social and physical infrastructure needed to be vastly improved. The divestment programme was only partially completed and public sector reform remained a major challenge. The social services, in particular health, and education, were in need of major reorientation, and restructuring. In other words, the process of structural reforms needed to create a more competitive environment had hardly begun.

Failing to adequately read the mood of the population, the ruling PNM called a general election in 1995 long before it was constitutionally due and narrowly lost it to the combined force of the United National Congress (UNC) and the National Alliance for Reconstruction (NAR). Since the leader of the new Government was a trade unionist often given to making strident statements about the business community, there were fears in some quarters that the gains made in the adjustment process thus far might be quickly dissipated through greater spending and the creation of an environment hostile to saving and investment. The new Government, however, was quick to dispel any such fears, and in its first Budget presentation, it indicated that the Government "intends to consolidate whatever may have been achieved thus far, and fine tune the existing policy framework, where appropriate, to extract a higher level of effectiveness and efficiency."[20] It saw sound 'macro-economic fundamentals', 'economic growth with social equity' and 'empowerment of the socially disadvantaged' as essential goals which could only be achieved through 'forging a consensus with the social partners – Labour, Business and the Government'.[21] Tax rates were reduced, and the Government re-affirmed its commitment to trade liberalisation, fiscal discipline, prudent financial management and a framework to increase fair competition. In the 1997 Budget it promised to "liberalise further the financial sectors and deepen the level of competitiveness by encouraging an increase in the number of new players and entrants into the market without compromising entry requirements and prudential standards."

The recovery momentum continued in 1996 and 1997 with GDP growing by over 3 per cent in the respective years and the unemployment rate declining to 15 per cent. The fiscal situation was held tight and inflation rate dropped to record levels of under 4 per cent. The net foreign reserves at the end of 1997 was 85 per cent above the level at the end of 1995. This was helped by the continued inflows of foreign direct investment in the oil and gas sector. The projections for 1998 is a growth rate of around 5 per cent and a further fall in the unemployment level notwithstanding a significant drop in the price of oil during the year. The unemployment rate of 13.4 per cent recorded in June was the lowest in fourteen years.

An Assessment of the Adjustment Experience

Historically, economic booms are followed by slumps which make it difficult to sustain the expectations associated with a high level of economic activity. In these circumstances and in a context where governments are elected by the population, policy-makers often find themselves in a dilemma. Maintaining a standard of living which the country cannot afford through borrowing or money creation can lead to further deterioration in economic conditions that eventually would require stringent corrective measures. On the other hand, swift actions to halt the economic slide and create the conditions for a resumption of economic growth can lead to bitterness and unpopularity. Changes in governments can follow quickly.

It is interesting to note that long before the oil boom in Trinidad and Tobago came to an end, fears about the effects of the possible decline in oil production and revenues, and concern about the way the oil windfall was being used had already surfaced. In May of 1978 the Government set up a Committee under the Chairmanship of the then Governor of the Central Bank, Dr. Euric Bobb, "to review the pattern of Government expenditure, with particular reference to its distribution between productive (investment) and non-productive (welfare) expenditure. Among other things the Committee recommended:[22]

1. that government should not adopt any new welfare programmes nor approve improvements in the real value of existing welfare programmes at the present time;

2. that a greater degree of caution be exercised in the expansion of permanent exmployment in the public service;

3. that there should be a moratorium on further tax reduction effective from 1979;

4. that Government should commission a comprehensive review of the tax system and the structure of utility tariffs in order to ascertain the scope for additional taxation and higher user charges.

Notwithstanding this caution, a pending general election in 1981 and a doubling of recurrent revenue between 1978 and 1980 encouraged the expansion of current expenditure which increased by 113 per cent between 1978 and 1981. Even though recurrent revenue was almost at the same level in 1982 as in 1981, recurrent expenditure almost doubted between 1981 and 1982. A large

part of the increase was accounted for by the wages and salaries bill which more than doubled in this period as a result of higher pay scales under a new three year industrial agreement, including retro-active payments of salary increases due in 1981 which was the first year of the agreement. The wage increase consisted of an across the board element and a percentage increase ranging from 30 per cent to 37 per cent in 1981 and from 10 per cent to 11.5 per cent in 1982. By 1983 wages and salaries were accounting for 42 per cent of recurrent expenditure as compared to 48 per cent for subsidies and transfers.

The challenges facing the Government at the end of the oil boom was not simply one of bringing expenditure in line with revenue, but a rethinking of the entire development policy framework which had failed to transform agriculture and move the import substitution strategy into an export mode. Problems of productivity was be-devilling all sectors of the economy and the burgeoning state enterprises sector (which was built on the philosophy of taking control of the commanding heights of the economy) included a number of entities highly dependent on the Central Government for support. Besides loans and credits guaranteed by the government, financial support was in the region of TT$1,000 million in the early 1980s.

While recognising the emerging crisis, the Government of 1981-86 seemed to lack the will either to take the kind of short term measures to make a soft landing, or to make the policy changes necessary to re-orient the development strategy with a view to reducing the vulnerability of the economy. With the loss of almost US$1 billion in foreign reserves between 1982 and 1983, a few tentative demand management measures were instituted. One was the introduction of a system of foreign exchange budgeting in 1983 giving high priority to essential and developmental imports. The other was the devaluation of the TT dollar by 33.3 per cent in December 1985 and the adoption of a dual exchange rate system designed to cushion the impact of the cost of living. The avowed aim of the devaluation was to discourage imports and enhance the competitiveness of the non-oil sector. The argument was since the last exchange rate adjustment in 1976, the real effective exchange rate had appreciated by 80 per cent "much of which was unwarranted in that it was not due to greater productivity in the Trinidad and Tobago economy." The result was net international reserves dropped from US$994 million at the end of 1985 (equivalent of 11.5 months imports) to US$329 million (the equivalent of 2.7 months imports) at the end of 1986.

The George Chamber's Government of 1981-86 could not deal with the changed

circumstances in which the economy found itself. The 1986 general election was crucial in that the new government was quick in sizing up the situation and making a number of hard decisions which had to be made with or without external assistance. As indicated earlier, this was not without economic, and eventually political costs.

With declining revenues in the 1980s, the welfare state had come under severe threat, and it was evident that there was little alternative to a reduction of current expenditure. By 1986 capital expenditure had already fallen to 28 per cent of the 1982 level. With the external debt service projected to cross 30 per cent by the late 1980s/early 1990s restructuring of the external debt and reducing debt service payments offered one alternative in terms of reducing the pressures on foreign exchange earnings. This required an agreement with the IMF whose assistance by this time had become increasingly tied to policy changes over a wide front. With the financial problems afflicting a large number of developing countries in the 1980s, the concern of the IMF was more with 'getting the balances right' rather than with problems of equity or poverty, or the sharing of the burden of adjustment. The feeling was once growth was resumed these problems would look after themselves. The growth and depth of poverty following the adoption of stabilization measures in some countries changed this attitude to some extent and this was reflected in the proliferation of poverty studies that followed, many calling for adjustment 'with a more human face.'

In Trinidad and Tobago, what really has been achieved? Between 1982 and 1987, real GDP declined by some 25 per cent, but the rate of decline slowed in the following four years. Between 1994 and 1997 the economy grew in every year at an average rate of 3 per cent. Real GDP in 1997, however, was still almost 20 per cent below that of 1992. Between 1973 and 1982 real per capita GDP had increased by 47 per cent, but between 1982 and 1989, it had dropped by 51 per cent. By 1997 it was estimated to be 8 per cent above the 1989 level, but still 40 per cent below the 1982 level. In terms of nominal per capita GNP, the figure had increased from around US$1,200 in the early 1970s to US$7,000 in 1982, but by 1989 this had dropped to US$3,200. The 1997 figure was estimated to be US$4,300.

The fiscal decisions taken in the mid-1980s to stabilise the economy was helped to a considerable extent by the increase in oil prices from the low points in 1986. The current account surpluses achieved since, and the improvement in the country's credit rating have impacted

positively on the capital budget which increased from TT$300 million in 1990 to over TT$1 billion in 1997.

Since 1987 the petroleum industries have generally maintained their share in total real output, averaging 26 per cent between 1987 and 1996. There has been some diversification, however, based largely on activities in the gas sector which has attracted most of the foreign direct investment. The share of petroleum in exports has fallen to under 50 per cent as compared to over 70 per cent in the mid-1980s. Chemical exports have increased steadily since the early 1980s, accounting for 24 per cent of total exports in 1987 as compared to less than 5 per cent in the early 1980s. Manufactured goods (other than chemicals) have also increased their contribution in total exports from less than 10 per cent in the mid-1980s to almost 20 per cent in recent years.

Even though it had long been recognised that there was need for a radical re-orientation of the manufacturing sector, there was fear in some quarters that the decision to remove quantitative restrictions and eventually to even lower tariffs and surcharges would destroy the light manufacturing sector producing largely for the local and regional market and also deprive a large number of people of jobs. In keeping with the conditionalities attached to the World Bank Structural Adjustment Loan, the Government contracted the Maxwell Stamp firm in 1991 to do a study on trade policy reform. The study pointed to the strong anti-export bias in the protection framework and recommended a number of measures for improving efficiency in all sectors of the economy. "A broad conclusion from the policy simulation is that trade liberalisation has a positive effect on economic growth. Real growth is higher in each policy case study between 1993 and 1995 with no liberalization."[23] The apparent advantages flowing from a course of unilateral liberalisation and export-oriented policies were sufficiently powerful to downplay or override the fears of job losses. In a Report commissioned by the Trinidad and Tobago Manufacturers' Association in 1992, questions were raised not only about the methodology and assumptions used in the Stamp Report, but about the benefits of unilateral trade liberalisation.[24] Though the link between exports and development had long been a contentious issue in the literature, for the Government the die was cast. In his 1993 Budget presentation, the Minister of Finance had this to say: "It is clear that if Trinidad and Tobago wishes to continue to be an economy open to foreign investment, external financial flows from multilateral and bilateral sources, and to the transfer of

technology, it has to create a more open trading and investment environment." Even though the quantitative restrictions were removed within a short period of time, many of the pieces of legislation needed to ensure fair trade and protect local producers have been slow in coming. The criticism that the government was moving too quickly to open the economy had some foundation

The anticipated adverse impact on the balance of payments and on the unemployment situation seems to have been greatly exaggerated. Between 1992 and 1996 the trade surplus as a proportion of GDP averaged over 8 per cent. The current account experienced a deficit in only one year in the period. Though the trade account deteriorated in 1987, inflows of direct investment contributed to a surplus in the overall position and an increase in the external reserves. As noted earlier, net international reserves have been increasing since 1992.

With respect to unemployment, the evidence is that the liberalization that has taken place thus far has not resulted in any significant number of job losses. Since 1992 almost 50,000 additional jobs have been created, while the labour force is estimated to have grown by 34,700. One may argue about the permanence of some of these jobs in the context of a construction boom, but certainly the new employment opportunities would have mitigated any fall out effects of the adjustment programme. In 1997 the number of jobs in the manufacturing sector was higher than that in 1990. In the Public Enterprises sector, however, the number of jobs fell from over 40,000 in the early 1990s to around 32,000 in 1996.

One of the major criticisms levelled against structural adjustment programmes is that they create social misery or worsens the poverty situation. To improve the fiscal situation governments are often forced to reduce the public sector work force, cut wages and salaries and close or restructure state enterprises. When public expenditure is reduced, the level and quality of the social services can also suffer. Devaluations intended to improve the trade balance can also affect the cost of living and increase social misery. In Trinidad and Tobago current expenditure on social services as a per cent of GDP has tended to be high compared to a large number of other countries (See Table 11). In 1983 the proportion rose to 12 per cent from 8 per cent in 1972. By 1998, however, it had fallen back to the levels of the early 1970s. The share going to education dropped from 5 per cent of GDP in 1985 to less than 3 per cent in 1997, while health's share was reduced to around 3 per cent to less than 2 per cent over the period. Despite this trend, one study has noted that the failures in social service delivery have more to do with inefficiencies in the systems themselves

Table 11

Social and Economic Indicators for Selected Countries

Countries	Average Annual % Growth of GNP Total 1965-95	Per Capita 1965-96	Human Development Index, 1995	Life Expectancy at Birth 1980	1996	Infant Mortality Rate[1] 1970	1996	Public Expenditure on Education (% of GDP) 1985	1995	Public Expenditure on Health (% of GDP) 1990–95
Canada	3.3	2.0	.960	75	79	19	6	6.9	7.3	6.8
USA	2.4	1.4	.943	74	77	20	7	6.7	5.3	6.6
Japan	4.5	3.6	.940	76	80	13	4	5.8	3.8	5.7
U.K	2.1	1.9	.932	74	77	19	6	5.6	5.5	5.8
Italy	2.8	2.6	.922	74	78	30	6	...	4.9	5.4
Hong Kong	7.5[a]	5.6[a]	.909	74	79	19	4	...	2.8	1.9
Singapore	8.3	6.3	.896	71	76	20	4	2.8	3.0	1.3
South Korea	8.9	7.3	.894	67	72	46	9	3.7	3.7	1.8
Chile	3.3	1.6	.893	69	75	77	12	4.6	2.9	2.5
Costa Rica	4.0	1.2	.892	73	77	62	12	7.8	4.5	6.3
Trinidad & Tobago	1.5	0.3	.880	68	73	52	13	4.0	4.5	2.6
Venezuela	2.2	-0.8	.860	68	73	53	22	4.4	5.2	2.3
Thailand	7.3	5.0	.838	63	69	73	34	3.4	4.2	1.4
Mauritius	5.2	3.9	.833	66	71	60	17	5.3	4.3	2.2
Brazil	4.6	2.4	.809	63	67	95	36	3.6	...	2.7
Jamaica	0.7	-0.5	.735	71	74	43	12	7.0	8.2	3.0
Indonesia	6.7	4.6	.679	55	65	118	49	1.7	...	0.7
China	8.5	6.7	.650	67	70	69	33	2.5	2.3	2.1
Ghana	1.7	-0.9	.473	53	59	111	71	3.1	...	1.3
India	4.5	2.3	.453	54	63	137	65	2.8	3.5	0.7
Nigeria	3.1	0.1	.391	46	53	139	78	6.4	...	0.3
Zambia	1.0	-2.0	.378	51	44	106	112	4.5	1.8	2.4

1. per 1000 live birth; a. provisional; ... not available

Source: World Bank, World Development Indicators, 1998.

than with the level of spending.[25] With respect to the general level of poverty, it was estimated that in the late 1980s some 21 per cent of the population, or roughly 265,000 people fell below the TT$2,420 poverty line. Some eleven per cent was classified as extremely poor, that is as unable to afford the cost of the minimum food basket.[26] The figure of 21 per cent, however, was lower than that for Guyana (43 per cent) and Jamaica (34 per cent).[27] It was also estimated that the distribution of income worsened during the 1980s with the Gini coefficient increasing from 0.45 in 1981/82 to 0.47 in 1988.[28] A more recent consumption-based Gini coefficient has been estimated to move from 0.41 in 1988 to 0.42 in 1992 suggesting a further widening of the gap in recent years.[29] Comparable figures for some other countries were 0.51 for Belize, 0.49 for the Dominican Republic, 0.43 for Jamaica, 0.423 for Guyana and 0.468 for St. Lucia.[30]

Despite the setbacks suffered in 1980s from the various shocks, the economy has resumed growing in a situation where fundamental reforms are yet to be effected in critical areas such as health, education, modernisation of the bureaucracy, agriculture and so on. With life expectancy at 73.1 years at birth and an adult literacy rate of 97.9 per cent in 1995, Trinidad and Tobago with a Human Development Index of .880 was ranked 40th among a group of 174 countries by the UNDP in 1995.[31]

III. Exchange Rate Policy and Monetary Policy

The establishment of Central Banks in newly independent developing countries had raised questions about what really should be the function of such an institution in a situation where money and capital markets hardly existed. A major rationale for their creation was that such institutions could initially play a developmental role by helping to create an environment for greater saving and investment. In the case Trinidad and Tobago it was argued that "whatever may be the traditional functions of a central bank in industrialised societies, the main function of a central bank in Trinidad and Tobago must be to assist in doing in the monetary field all such things as would promote development, primarily by producing conditions most conducive to the flow of long-term

investment into the productive sectors of the economy."[32] It was argued that an independent Trinidad and Tobago required an independent currency. The Central Bank was established in 1964 – two years after independence – and assumed responsibility for the currency arrangements from the British Caribbean Currency Board which at the time was issuing and redeeming local currency (the West Indian dollar) against sterling at the fixed rate of 4s 2d. There was a fiduciary issue of approximately 12 per cent – that is the part of the backing consisting of the securities of participating governments. The currency in circulation was adjusted mainly to changes in the balance of payments. One of the main arguments in favour of the Currency Board System was that "it provided the colonies with a completely convertible currency with a guaranteed parity and that it offered the security necessary for private investment."[33] At the same time, however, the Board was seen to lack the powers to influence fiscal policy or manage credit in an economy where "a significant proposition of the money supply was not currency but bank credit over which the currency board had absolutely no control."[34]

The establishment of the Central Bank in the situation where there were powerful international banks operating was not without controversy. The two main objections to the Bank was that it was "an expensive luxury and that it was a dangerous institution whose cutting edge should be blunted. The latter point was the chief complaint of the Trinidad and Tobago Chamber of Commerce which objected to the central bank's authority to regulate the operations of the commercial banks."[34] It was felt that the six long established international banks backed by huge external resources did not need formal control, and consultation was enough.

Upon establishment the Bank was given exclusive right to issue and redeem currency notes and coin in Trinidad and Tobago. Among other functions it was required to "maintain, influence and regulate the volume and condition of supply of credit and currency in the best interest of the economic life" of the country and also to "maintain monetary stability, control and protect the external value" of the currency. The Bank was also authorised to make advances to the government up to a stipulated amount.

Upon its creation the Trinidad and Tobago dollar was pegged to sterling, given the strong economic relationship with Britain which was the country's largest single trading partner. To calm fears about the new Trinidad and Tobago dollar a firm commitment was given that the existing

exchange rate of 4s. 2d. sterling to the West Indian dollar would be maintained.[36] Because of free convertibility of TT dollar into sterling the Rediscount rate between 1966 and 1973 "were motivated largely be the need to have the structure of domestic interest rates conform to the structure of interest rate in the U.K."[37] Interestingly, with the removal of exchange controls and the integration of international capital markets foreign interest rates are by no means an irrelevant consideration in setting domestic rates.

When sterling was devalued in November 1967, the TT dollar was devalued to the same extent. The reasons given were "first of all, the necessity to protect the markets of the already high-cost sugar and citrus industries in the U.K. (which between them offered employment to 30,000 persons), the necessity to retain our competitive position vis a vis member countries of CARIFTA, all of whom had devalued to the same extent as Britain, and the desire generally not only to increase the competitiveness of our exports in countries which had not devalued as well but also to restrict imports."[38] The devaluation also had favourable revenue effects both through raising local currency tax and royalty receipts from the oil companies and through increasing the yield from ad valorem import duties. These reasons overrode the contra arguments that the devaluation would raise domestic costs of production and would also increase in terms of local currency the servicing of U.S. and Canadian dollar indebtedness.

The TT dollar remained pegged to the pound, even while it was floating against other currencies between 1973 and 1976. The relationship to the U.S. dollar is shown in Table12.

Table 12

Movements in Selected Exchange Rates, 1956-1998

Trinidad & Tobago (TT$ per US$1)

Period	Nominal Exchange Rate[1]	Nominal Effective Exchange Rate 1990 = 100	Real Effective Exchange Rate 1990 = 100	US$ Per £[1]	Yens Per US$[1]
1956-66[1]	1.7143	...	...	2.800	360.00
1967-75[1]	2.2270	...	...	2.4351	328.11
76	2.4358	...	...	1.8062	296.55
77	2.4000	...	...	1.7455	268.51
78	2.4000	...	...	1.9195	210.44
79	2.4000	163.73	95.87	2.1216	219.14
80	2.4000	161.92	98.33	2.3263	226.74
81	2.4000	171.73	108.16	2.0279	220.34
82	2.4000	182.44	119.87	1.7505	249.08
83	2.4000	189.33	137.32	1.5170	237.51
84	2.4000	201.35	157.68	1.3363	237.52
85	2.4000	204.69	164.86	1.2963	238.54
86	3.6000	134.76	114.04	1.4670	168.52
87	3.6000	116.28	105.70	1.6389	144.64
88	3.8438	105.02	99.14	1.7814	128.15
89	4.2500	97.50	97.80	1.6397	137.96
90	4.2500	100.00	100.00	1.7847	144.79
91	4.2500	107.16	100.38	1.7694	134.71
92	4.2500	114.97	102.44	1.7655	126.65
93	5.3511	105.10	92.36	1.5020	111.20
94	5.9249	102.17	85.34	1.5316	102.21
95	5.9478	100.53	83.58	1.5785	94.06
96	6.0051	104.37	85.22	1.5617	108.78
97	6.2517	104.94	84.46	1.6377	120.99
98[2]	6.2996	107.27	87.30	1.6394	126.00

... not available
1. average for the period
2. February

Source: IMF, International Financial Statistics, Various Issues.

With the weakening of the sterling against the US dollar in the mid-1970s, the TT dollar was revalued (by 12%) in May 1976 and pegged to the US dollar at a rate of US$1 = TT$2.40. With a healthy reserves position in the following 8 years, this rate was maintained until the end of 1985 when a devaluation of 33 per cent was made. A dual exchange rate regime was introduced with the old rate of TT$2.40 = US$1 being maintained for imports of essential goods, including certain food items, medicines, agricultural imports and school books. The new rate of US$1 = TT$3.60 was applicable to about 75 per cent of imports. The arguments advanced to support the change were that it would restore competition to industry and tourism, while providing a fillip to foreign investment. The dual rate would minimise the impact on the cost of living.[39] Between the end of 1985 and the end of 1986, however, the country lost almost US$700 million in reserves, and the dual rate was abandoned in January 1987. With a persistent current and overall deficit in the balance of payments and a further dramatic loss of reserves in 1987, the TT dollar was again devalued in August 1988 to US$1 = TT$4.25 or by 18 per cent. It should be noted that apart from the devaluations against the US dollar, the TT dollar was also depreciating against other currencies as a result of a weak dollar. Though there were signs of improvement in the current account position in the early 1990s, the foreign exchange position was still weak and in April 1993 the government devalued the currency by 25 per cent, abandoned the peg to the U.S. dollar and adopted a managed system of floating as part of trade and exchange liberalisation process. Though the exchange rate is determined in the inter-bank market on the basis of supply and demand conditions, commercial banks must notify the central Bank in advance of any planned significant adjustment to the exchange rate. The Central Bank can intervene by providing foreign exchange to keep the exchange rate at some desirable level.

Between 1993 and 1998, the nominal exchange rate of the TT dollar depreciated by about 18 per cent at an average rate of 3.6 per cent per year. In the period 1985 to 1993 of the fixed regime era the currency was devalued by some 120 per cent at an average rate of 15 per cent per year. The new regime has not proved as unstable as was widely expected, and during the more recent period both the current and capital accounts, as well as the foreign exchange position have generally been in a reasonably satisfactory position, though the nominal rate has come under pressure from time to time. Since 1993 the real effective rate has appreciated by about only 9 per

cent. The contribution of the various factors to this situation is not easy to guage. In recent bouts of nominal exchange rate stress, the authorities have pointed to the soundness of the 'fundamentals'. As Table 13 shows since 1993, the inflation rate has been falling, averaging a little over 5 per cent since 1994. The index of average weekly earnings has also reflected considerable wage restraint since 1994. In fact real wages and salaries have been falling. The all industries productivity index has also been showing good readings. Increasing foreign exchange reserves would also have impacted on confidence.

The Central Bank has occasionally intervened in the foreign exchange market to keep the nominal rate at a desirable level, and the relative stability associated with the system since 1993 has sometimes drawn comments to the effect that it is akin to a 'fixed float'. Despite the significant drop in oil prices in 1998, capital inflows have impacted favourably on the net foreign reserves position which was over US$1 billion at the end of June 1998 or almost five times the 1993 figure. The population is not accustomed to the workings of the new regime and any depreciation in the rate, however, small is often viewed as the beginning of a major catastrophe.

The debate over fixed versus flexible exchange rate systems had long preceded the collapse of the international monetary system based on fixed (but flexible) exchange rates in 1973. When the major currencies went on float, developing countries found themselves in a dilemma. The then prevailing wisdom was that only the developed countries with diversified economic structures and markets could afford to float. Developing countries without forward and future markets for their currencies and without developed financial structures were not too sure they could do so. Some continued to peg to a major currency. But pegging to a currency in a situation where all the major currencies are floating is not the same as pegging in a situation where all the currencies have a fixed relationship to each other. The pegging currency floats with the currency to which it is pegged.

Table 13
Selected Employment and Productivity Data, 19974-97

Year	(1) Labour Force '000	(2) Employed Labour Force '000	(3) Real GDP (1974 prices) TT$ mn.	(4) Output Per Worker (3) ÷ (2) TT$	(5) Index of Average Weekly Earnings %	(6) Inflation Rate %	(7) (5) –)6)	(8) Index of Productivity (All Industries/ All Workers) %
1974	393.9	333.9	4,193	12,554	17.5	21.9	-4.4	2.2
95	390.1	332.4	4,260	12,831	19.3	16.9	2.4	-29.9
76	...	...	4,530	...	31.6	8.7	22.9	14.7
77	403.5	348.9	4,943	14,163	18.8	11.7	7.1	-2.3
78	415.0	364.9	5,440	14,904	15.4	10.2	5.2	-1.6
79	417.0	370.9	5,636	15,190	24.0	14.7	9.3	-4.1
80	428.9	386.5	6,220	16,072	22.9	17.5	5.4	6.3
81	435.1	389.7	6,502	16,672	20.5	14.3	6.2	-4.4
82	445.0	401.0	6,766	16,873	17.2	11.4	5.8	-6.5
83	449.5	399.4	6,150	15,413	19.9	15.2	4.0	23.8
84	469.9	406.8	5,760	14,152	14.4	13.3	1.1	5.5
85	473.6	399.6	5,444	13,610	7.4	7.7	-0.3	10.2
86	471.7	390.5	5,342	13,700	1.8	7.7	-5.9	24.9
87	478.8	372.2	5,096	13,700	4.3	10.8	-6.5	6.7
88	476.1	371.6	4,900	13,172	1.6	7.8	-6.2	3.8
89	469.1	365.7	4,814	13,153	0.8	11.4	-10.6	4.9
90	467.7	374.1	4,837	12,933	5.8	11.0	-5.2	4.4
91	492.2	401.0	4,710	11,746	0.1	3.8	-3.7	8.1
92	505.1	405.9	4,980	12,266	2.9	6.5	-3.6	11.8
93	504.1	404.5	4,907	12,146	1.6	10.8	-9.2	-4.4
94	509.4	415.6	5,212	12,529	5.1	8.8	-3.7	-3.5
95	521.0	431.5	5,334	12,375	4.1	5.3	-1.2	16.2
96	530.4	444.2	5,553	12,507	8.5	3.3	-5.2	3.4
97	539.8	454.4	5,760	12,687	...	3.7	...	...

... not available
Sources: CSO and computations based on data from official sources.

With the introduction of structural adjustment programmes in the 1980s flexible exchange rate arrangements became increasingly tied to trade and liberalisation programmes. Two Fund researchers rationalised the practice in this way:

> "After a decade of experiments with flexible rates, the evidence is buildling that developing countries with diverse economic structures can satisfactorily operate floating rate systems, even if they have relatively simple financial systems. The key is to support the floating arrangement with conservative monetary and fiscal policies to ensure macro-economic stability."[40]

The solution, we now know from experience is not as simple at this. Monetary and fiscal policies may affect the demand for foreign currency. But the supply in a critical sense is exagenously determined, often dependent on a range of factors outside the control of the national authorities. Adverse movements in the terms of trade can have a catastrophic effect on the supply of foreign exchange and on the exchange rate. Any fall in supply, however temporary, tends to be seen as a crisis, and this further increases the demand for foreign currency, putting greater pressure on the exchange rate. The question of stability in the exchange rate, therefore, would seem to rest more on a diversified export base that can provide a foreign exchange flow to match demand behaviour than with monetary and fiscal policies which themselves can trigger fears of impending doom. Capital inflows may provide temporary relief. The psychology in the situation is by no means an unimportant factor, since the tendency in developing countries is for the national currency to depreciate continuously. In an unstable situation the US dollar is often sought not so much for the interest rate returns, but to safeguard the value of savings. With respect to the demand for foreign currency, the question is , can a developing country aspire to meet any level of demand, given the variety of factors that affect this demand, and the unpredictable forces that influence them. The realistic approach in a situation where the supply is highly volatile appears to be one based on a modified free market model that allows some control over the demand for foreign exchange, without reintroducing the whole gamut of foreign exchange controls associated with a fixed rate regime. The use of fiscal and monetary policies in some situations often carry side effects which economic conditions may not warrant.

The behaviour of exchange rates since the 1970s has not only challenged traditional

theories of exchange rate determination, but has made nonsense of conventional wisdom and the many sophisticated economic and econometric models designed to explain exchange rate changes. There were certain attributes the floating system was supposed to possess. Among them were:

1. Exchange rates were supposed to be as stable as macro-economic fundamentals;
2. Central Banks would have less need to hold foreign exchange reserves, because they would have less need to use them;
3. There would be a general tendency for exchange rates in the long run to be determined by relative price levels, that is by Purchasing Power Parity (PPP).

Assessing the floating exchange rate system in practice Goldstein and Young had this to say:

> "The structure of exchange rates was expected to alter in response to the dispersion of inflation rates, but such exchange rate changes in the recent period have been very abrupt, reversible and difficult to relate underlying economic conditions."[41]

In a later Article, Goldstein observed as follows:[42]

> 1. floating rates have not provided complete or even good insulation against all types of external disturbances;
> 2. they have not provided rapid and automatic equilibration of external payments imbalances;
> 3. they have not eliminated or significantly reduced the demand for international reserves; and
> 4. they have not encouraged enough speculation to help real exchange rate movements within bands corresponding to permanent changes in the terms of trade.

In Trinidad and Tobago, officials have often expressed dismay over the pressure exerted on exchange rates, even when the 'fundamentals' appear to be strong, or moving in the right direction. While accepting that the exchange rate is a price, many analysts argue that he foreign exchange market does not function like any commodity market. There is clearly a great deal we do not understand about exchange rate behaviour. Even if the policy environment is stable, there is no guarantee that the exchange rate will behave in the expected way. Recent exchange rate behaviour

has raised new questions that have challenge existing theories. The purchasing power parity (PPP) is not a complete theory of exchange rate determination, and explanations for the results of financial tests are now being sought in portfolio decision-making theory. There is no consensus on how variables interact to produce changes in the real exchange rate. "Like any asset price, real exchange rates are related to the determinants of the relevant supply and demand curve now and in the future. With real exchange rates, the relevant determinants are those affecting the relative supply and demand for the currencies of the two countries. Claims have been made, however, that the real exchange rates often differ substantially from levels consistent with the underlying economic fundamentals and that those differences persisted for long periods."[43]

Monetary Policy and Financial Sector Reforms

In developing countries the critical role of the financial sector in supporting growth and development has for long been recognised. The critical role of optimal resource allocation, however, has not always been appreciated. The increasing emphasis being placed on making the private sector the 'engine of growth' has underscored the need for a sound and efficient financial sector capable of meeting the needs of savers and investors. "Twenty years ago developing countries saw financial systems primarily as tools to tap finance for their government or state enterprises or to use the direct credit for the use of priority sectors. Today, this approach is changing, and financial systems are increasingly viewed as important in their own right for the mobilization of resources; for the efficient allocation of credit; and for the pooling, pricing and trading of risk."[44] There is also increasing recognition that the importance of finance in supporting long term transformation cannot be separated from short term stabilization and management concerns relating to domestic prices, interest rates, exchange rates and allocation and availability of credit. Economic growth itself may help in the development of financial markets, institutions and instruments, but capital accumulation is also crucial to development.

The failure of the import substitution strategy in some countries and the resource distortions created by the myriad economic and bureaucratic controls had their parallel in the performance of financial systems which were influenced by excessive government intervention, and financial policies with uncertain ends or designed to serve too many objectives at the same time. A low

interest rate policy, for instance, may have been pursued to encourage investment, but it also may have been a disincentive to saving in a situation where investment funds were in critical shortage. High reserves requirements, too, may have served prudential purposes but they also may have contributed to high lending rates. The inefficiency in the intermediation process and the mobilisation of financial resources at sub-optimal levels had been made an issue long before the emergence of structural adjustment programmes in the 1980s, which incorporated the need for financial sector reforms along with changes in policies in the real sector. High growth performances were linked to high saving rates and a stable macro-economic environment. The financing of government deficits through money creation in some countries raised questions about the independence of the central bank, and the adoption of Currency Board arrangements were adopted as solutions in certain cases. Low investment rates were seen not only as a result of poor infrastructure and an inept bureaucracy, but as a reflection of ineffective policies and the failure to adequately develop financial instruments and markets by providing a competitive environment with an adequate prudential framework. In view of the increasingly integrated international financial markets and the improvement in technology, many of the old tools of control will no longer suffice and new approaches are required to influence financial actors and shape the financial infrastructure.

Reforms encompass much more than de-regulation or liberalization. In some countries financial liberalisation in an unstable macro-economic environment has led to financial crises and loss of confidence in the system. The pace of liberalisation and incorrect sequencing of policies can increase instability. The approach to dealing with sensitive capital flows has to be carefully thought out in a liberalised environment.

Trinidad and Tobago is in the process of liberalising both the real and financial sectors and faces the challenge of developing innovative techniques of management, new skills and even a new mind-set. Besides the Central Bank, the sector now has a fairly diversified group of institutions including 6 commercial banks, 10 finance companies and merchant banks, a number of Trust and Mortgage Finance Companies, Thrift Institutions, Development Finance Companies, Unit Trust Corporations, Insurance Companies, the Deposit Insurance Corporation and the National Insurance Board. Before the oil boom of the 1970s/early 1990s the Central Bank was concerned largely with the activities of the commercial banks. With the growth of incomes in the 1970s the non-banks assumed an increasingly significant role, and not being subject to the same

controls as the commercial banks were able to offer more competitive interest rates. In the case of the finance houses alone total deposits increased from $7.7 million in 1970 to $801 million in 1982. Against the background of a need for greater oversight and complaints from the banks about unfair competition the Financial Institutions (Non-Banking Act) was proclaimed in early 1981 and a reserve ratio of 3 per cent was imposed on licensed institutions. This was a classic case of too little too late and with the downturn of the economy in the 1980s a number of them collapsed causing great distress to depositors. To restore confidence in the financial system, the Deposit Insurance Corporation was set up and provides cover for up to TT$50,000.

Commercial banks are by far the largest element in the financial sector. With assets exceeding TT$27 billion in 1997, they accounted for 48 per cent of the total, as compared to 15 per cent for the Central Bank, 4.2 per cent for the Finance Companies and Merchant Banks and 10 per cent for the Trust and Mortgage Finance Companies. The number of banks have not changed significantly since the 1960s, but the number of branches have grown. In 1965, for example, there were 7 banks with 54 branches (18,000 persons per branch, but in 1996 there were 6 banks with 127 branches (10,500 persons per bank). Bank deposits account for over 70 per cent of the 'narrow' money supply (MI) and for around 90 per cent for the broadly defined monetary aggregate (M2). If we take the ratio of M2 to GDP as a measure of financial deepening, the proportion increased to almost 50 per cent in the late 1980s, but has since dropped back to the levels of the early 1970s (See Table 14). In many of the fast growing economies the M2/GDP ratio is over 70 per cent.

Table 14

Growth of the Money Supply[1] and Movements in the Selected Monetary Variables, 1970-87

Period	Growth of the Nominal Money Supply (%)		Velocity of Circulation		Curency Ratio		M2 as a % of GDP
	M1	M2	V1	V2	C1	C2	
1970	12.7	21.5	10.8	3.5	35.8	11.5	28.8
71	17.3	21.4	10.0	3.1	35.4	11.0	32.4
72	21.8	22.8	9.6	2.9	35.3	10.8	33.9
73	11.2	18.0	10.6	3.1	34.0	9.8	32.4
74	19.4	21.9	14.6	4.4	43.0	8.8	24.2
75	45.3	34.1	12.7	3.9	28.0	8.6	25.7
76	49.0	34.8	9.8	3.3	25.4	8.6	30.1
77	27.2	25.1	9.5	3.3	25.7	8.8	30.4
78	35.5	29.0	8.0	2.9	25.0	9.0	34.6
79	26.1	27.2	8.2	2.9	26.1	9.4	24.1
80	24.8	21.5	8.9	3.3	25.6	9.4	30.6
81	-8.3	9.0	10.6	3.3	31.8	9.9	29.7
82	31.4	31.9	9.4	2.9	30.7	9.5	33.7
83	12.3	15.8	8.2	2.4	33.4	10.0	41.3
84	-6.0	7.6	8.6	2.5	34.8	9.1	44.0
85	-8.3	1.0	9.0	2.1	35.6	8.5	45.9
86	-5.6	-2.0	9.3	2.1	37.4	8.6	47.0
87	-8.5	1.0	10.0	2.1	39.9	8.4	47.7
88	-7.1	1.7	10.9	2.1	43.0	8.1	48.3
89	4.0	3.9	11.0	2.0	40.2	7.7	47.2
90	11.0	4.0	11.5	2.3	38.7	7.8	44.8
91	26.3	7.0	9.1	2.2	31.8	7.6	40.0
82	2.8	-5.0	9.7	2.5	29.0	7.5	39.7
93	-0.5	2.0	10.3	2.6	29.4	7.4	38.2
94	10.2	2.4	11.2	3.0	27.9	7.6	32.7
95	14.9	4.9	10.5	3.1	25.9	7.7	31.9
96	5.3	1.3	10.8	3.3	27.0	8.3	30.0
97	17.4	9.2	9.8	3.3	25.9	8.6	30.6

1 Based on average end of quarter balances

M1 = Curency in Active Circulation Plus Bank Demand Deposits

M2 = M1 + Bank Savings and Time Deposits

V1 = GDP at Current Market Prices divided by M1.

V2 = GDP at Current Market Mprices divided by M2.

C1 = Currency in Active Circulation as a % of M1.

C2 = Currency in Active Circulation as a % of M2.

Source: Computed from official publications.

Because of the ability of commercial banks to expand and create credit, and given the relationship between the money supply, the price level, the exchange rate and foreign exchange reserves, the Central Bank pays special attention to the activities of the commercial banks. Under the Central Bank Act of 1964, the Bank was empowered with many of the traditional instruments of control such as the ability to vary discount and rediscount rates, imposing and changing cash reserve requirements, and controlling the volume terms and conditions "upon which credit may be made available to all or any sectors of the economy." The latter control could also be applied to non-bank institutions, but the latter were generally left to their own devices until 1981 when they were required to hold a cash reserve account with the Central Bank equivalent to 3 per cent of deposit liabilities. The commercial banks had always complained about the unfair competitive edge enjoyed by these institutions. The collapse of one finance company in the early 1980s and the difficulties faced by others later in the decade forced the Central Bank to take greater monitoring and support measures.

With the limited scope for open market operations, the Central Bank has relied heavily over the years on moral suasion and changes in the Rediscount Rate and manipulation of the reserve ratio to influence the behaviour of the banks and control liquidity. The reserve ratio has not only been changed frequently, but has increased steadily since the early 1970s from around 10 per cent to 24 per cent in 1997. From the late 1960s the statutory ratio was supplemented by a secondary reserve requirement of 5 per cent comprising of Treasury Bills, Special Deposits (on which interest was paid) and later Government Securities with a maturity of under one year (See Table 15).

Between 1974 and 1979 the commercial banks operated with high levels of liquidity far in excess of the required amounts. In early 1980 the Central Bank introduced a marginal reserve requirement of 15 per cent of the increase in deposit liabilities after December 26, 1979. This often resulted in the effective cash reserve requirements being higher than the required ratio. This measure was abolished in 1984. In order to increase credit for business purposes, select credit controls were introduced in late 1979. Banks were requested to limit personal and non-business lending to a maximum of 25 per cent of new lending after November 5, 1979. With the decline in foreign exchange reserves after 1982 a system of import budgeting was introduced, which required the importer to apply to the Central Bank for foreign exchange prior to placing orders for importation of goods.

Table 15

Changes in Banks' Reserve Ratios and Key Interest[1] Rates, 1972-98.

Period	As a % of Total Deposits: Required Cash Reserves	Actual Cash Reserves	Required Liquidity[2]	Bank or Rediscount Rate %	Basic Prime Rate [3] %
1972	5.0	5.0	10.0	5.0	6.88
73	7.0	7.0	12.0	6.0	9.12
74	9.0	9.0	14.0	6.0	9.12
75	9.0	8.9	14.0	6.0	8.62
76	9.0	9.0	14.0	6.0	8.38
77	9.0	9.0	14.0	6.0	8.38
78	9.0	9.2	14.0	6.0	8.25
79	9.0	9.0	14.0	6.0	9.00
80	11.0	11.3	16.0	6.0	10.00
81	13.6	13.9	18.6	6.0	11.38
82	16.1	16.5	21.1	6.0	11.50
83	16.9	16.9	21.1	7.5	11.50
84	17.0	16.9	21.9	7.5	12.75
85	17.0	16.8	22.0	7.5	12.75
86	15.0	14.7	22.0	7.5	12.00
87	9.0	9.0	20.0	7.5	11.50
88	9.0	8.6	20.0	9.5	13.50
89	12.0	11.4		9.5	13.50
90	12.0	11.2		9.5	12.88
91	16.0	15.3		11.5	12.88
92	16.0	13.8		13.0	15.50
93	16.0	12.8		13.0	15.50
94	20.0	20.0		13.0	15.88
95	20.0	21.4		13.0	15.00
96	23.0	23.1		13.0	15.50
97	24.0	24.1		13.0	15.00
98[4]	21.0	21.2		13.0	17.50

1. end of year position.

.2 includes 'secondary reserves' of 5% of Treasury Bills, Special Deposits and Government Securities up to one year's maturity, and between February 1980 and November 1984, a 'marginal reserve requirement' calculated as 15% of the increase in deposit liabilities after December 26, 1979. The secondary reserve requirement was removed as well in January 1991. The statutory cash reserve requirement of 12% in effect since July 26, 1989 was raised to 16^ on August 22, 1991.

3. 1972 to 83 reflect medium rates.

4. end of June

Source: Central Bank's Publications.

Faced with the dilemma of declining economic activities in the mid-1980s and the need to stimulate the economy, the Central Bank took several measures. With the tight liquidity situation prevailing in this period, the commercial banks became increasingly reliant on advances from the Central Bank. Against the background of a declining foreign reserves position, the rediscount rate increased from an average of 7.5 per cent between 1983-85 to 9.5 per cent in 1988. The basic Prime Rate increased from 12.75 to 13.50 per cent over the period. As a stimulant action the Central Bank reduced the cash reserve requirement from 17 per cent in 1985 to 15 per cent in 1986. The rate of interest paid on Special Deposits held in the secondary reserves was also raised to reduce the banks' costs. The Central Bank also increased repayment periods for hire purchase loans to consumers and waived the requirement of a minimum down payment. The banks could not shield themselves from the fall in incomes in the economy and found themselves in crisis. The banks' profits (before tax) plummeted from a high of TT$257 million in 1983 to a low of TT$49 million in 1988 or by over 400 per cent (See Table 16).

The phased reduction of the reserve requirement started in 1989 was halted in early 1991. To depress demand selected credit control guidelines were tightened and the cash reserve requirement increased form 12 to 16 per cent. The Re-discount rate also increased. Because of the limited effect of these measures and the continued loss of reserves, the Re-discount rate was increased in 1992 to discourage bank borrowing from the Central Bank which also issued a timetable to liquidate outstanding borrowings. The Central Bank announced that it would no longer accommodate demand for borrowed reserves.

In 1992 real GDP declined by 1.7 per cent after growing in the previous two years. In the same year the net reserves position moved into a minus position. The response of the government was to accelerate the liberalisation process and in 1993 exchange controls were abolished and the TT dollar floated. There was an immediate depreciation by 25.1 per cent, and an eventual depreciation of 26.9 per cent by year's end. The inflation rate rose to over 10 per cent in 1993 and interest rates also rose. With the liberalisation the commercial banks experienced some inflows of foreign currency and at the end of 1993, the net international reserves was the equivalent of over four months' imports. With this improvement the Central Bank in early 1994 announced the removal of a range of credit market restrictions which were more in the nature of guidelines. These included:

- restrictions on bank loans to non-residents;
- removal of the need for Central Bank approval for banks to lend to public sector institutions;
- removal of restrictions on consumer loans to a maximum of 30 per cent of banks' total loans and advances;
- removal of stipulated minimum down payments and maximum repayment periods in respect of instalments credit;
- removal of stipulated maximum loan rate of 4 per cent above prime lending rate for individuals.

With the loss of reserves in 1995 and with the pressure on the exchange rate in the latter part of the year, the Central Bank initiated Open Market Operations as a way of influencing the level of liquidity in the system. Beside the initial sale of TT$90 million in treasury bills on September 24, 1996, other measures taken in 1996 included:

i) the requirement for commercial banks to hold, in cash or treasury bills, non-statutory reserves equivalent to 5 per cent of deposits with effect from February 28, 1996;

ii) sales of US$102 million to the foreign exchange market, and the concomitant sterilization of about TT$600 million;

iii) an increase in the statutory reserve requirement for commercial banks from 20 to 23 per cent of deposits with effect from October 16, 1996, simultaneously with the removal of a requirement introduced in December 1995 for banks collectively to hold $100 million (about 1.1 per cent of deposits) in a special reserve account at the Central Bank. The statutory reserve requirement for non-bank financial institutions was also increased from 5 to 8 per cent of deposits.

With the introduction of the non-statutory reserve requirement in February 1996, the required liquidity ratio for commercial banks was raised to 26.1 from an effective 21.1 per cent of deposits. This notwithstanding, and in spite of a further rise in the required liquidity ratio to 28 per cent in October, actual liquidity trended comfortably above the requirement. Notwithstanding the

liquidity position the commercial banks responded by raising the Prime Rate.

Table 16

Selected Data on Commercial Banks' Operations, 1970–97

Period	Number of Commercial Banks	Number of Branches	Population Per Branch '000	Banks' Profit (before tax) TT$mn.	Weighted Interest Rates[1] Lending Rate %	Deposit Rate %	Interest Rate Spread %
1970	7	81	11.8	7.6	8.62	4.97	3.65
71	8	87	11.0	9.7	8.43	4.50	3.93
72	8	87	11.7	11.5	8.18	3.59	4.59
73	8	88	11.2	18.6	10.26	4.01	6.25
74	8	91	10.9	22.3	10.66	4.91	5.75
75	8	91	11.1	27.9	10.11	4.15	5.96
76	9	92	11.1	46.7	9.80	3.66	6.14
77	9	95	10.9	69.0	9.09	4.87	4.22
78	9	99	10.6	80.9	9.94	4.75	5.19
79	9	99	10.7	103.2	10.79	5.94.	4.85
80	9	105	10.3	136.6	11.70	6.06	5.64
81	8	109	10.1	162.8	12.55	6.00	6.55
82	8	112	10.0	204.2	12.67	6.05	6.62
83	8	114	10.0	257.0	13.31	6.83	6.48
84	8	114	10.2	244.6	13.65	6.71	6.90
85	8	115	10.2	174.0	13.41	6.26	7.15
86	8	117	10.2	77.8	13.16	6.11	7.05
87	8	118	10.3	53.8	13.47	6.03	7.04
88	8	112	10.8	49.0	12.05	5.83	6.22
89	8	116	10.5	82.1	12.04	5.90	6.14
90	8	117	10.4	83.6	11.73	5.53	6.20
91	8	119	10.3	136.0	11.77	5.50	6.27
92	8	123	10.1	188.7	12.77	6.30	6.47
93	6	123	10.1	262.0	13.08	6.53	6.55
94	6	118	10.6	248.2	13.85	6.50	7.35
95	6	117	10.8	291.4	13.36	5.84	7.52
96	6	121	10.5	345.6	14.24	6.39	7.85
97					11.87	5.26	6.61

1. end of year (% per annum).

Source: Official Publications.

A growth rate of over 3 per cent in 1996 with an inflation rate of a historically low 3.3 per cent accompanied by a significant improvement in the foreign reserves position again led the authorities to modify their approach and commit themselves to an eventual reduction on reliance on direct controls. In January of 1997 the cash reserve ratios for commercial banks and non-bank financial institutions were reduced by 1 percentage point respectively and in April they were each further reduced by another percentage point bringing the ratios to 21 per cent for the commercial banks and 8 per cent for non-bank financial institutions. With the rapid growth of the Central Government's domestic budget deficit in the face of weak revenue collection, an extremely liquid situation was created with increasing pressure on the exchange rate. Fiscal policy was not in line with the monetary stance, and with the resulting lower interest rates bank lending increased. The absorption of almost TT$500 million through open market operations was of little help and the Central Bank suspended its policy of reducing reserve requirements. In fact in December 1997 the Bank increased the reserve ratios for commercial banks and non-bank financial institutions to 24 per cent and 9 per cent respectively, 3 percentage points higher than at the beginning of the year.

Monetary policy has always been a controversial area and over the years there have been differences over what should be its main goals and how best to achieve them. Defining money, and discussions over how the money supply is determined, have featured significantly in the evaluation of monetary policy. Related to these issues is the extent to which the central bank should confine its attention to commercial banks and ignore the activities of the non-bank financial institutions which provide competitive services and products. The assumption that stability was important to growth and development underpinned a great deal of the powers given to central banks in developing countries, where safeguarding the value of the currency was seen as perhaps its most critical function. Ironically, the flexibility contained in the provision of currency issue also carried the potential for action that could undermine the value of the currency. Experience has shown that fiscal policy can offset the effects of monetary policy. In an open open external shocks can overturn well defined policy paths, and the authorities' capacity to deal with this often frustrated by the behaviour profit-oriented financial institutions or the absence of well developed money and capital markets. Faced with an immediate crisis the authorities themselves may adopt monetary stances which distort resource allocation and reduce growth possibilities.

Developing countries are at different levels of financial development, and some depend

more on direct controls than others. After more than 30 years the Central Bank in Trinidad and Tobago is only now beginning to use Open Market Operations as a means of liquidity control. The Bank has relied heavily on changes in the statutory reserve ratio to remove pressures on the exchange position. Since floating, the ratio has climbed from 16 per cent in 1993 to over 20 per cent in recent years. One of the main arguments in favour of reserve requirement is that they not only serve a prudential purpose, but they are simple to use and can have a quick impact on the money supply. They also improve the precision with which monetary policy can be conducted and variations can themselves be used to implement monetary policy. They also represent a tax, and since no interest is paid on them, commercial banks tend to feel this puts them at a competitive disadvantage *vis-a-vis* non-bank financial institutions. The banks also argue that the sterilization of a large part of their resources on which they have to pay interest also help explain the high lending rates for which they are often criticised.

There is a commitment in Trinidad and Tobago to adopt more indirect monetary controls. The limited use of open market operations to date has not been very effective. A great deal more has to be done in developing the breadth, depth and resilience of the financial markets. New instruments have to be devised which institutions are willing to hold, and encouragement of secondary markets in the changing financial configuration has to be part of the incentive framework.

Among other things liberalisation also calls for a more competitive environment, but established players are not always willing to welcome new competition. With respect to the banking sector in Trinidad and Tobago, there is a view that sector is 'over-banked' or nearly so, and too many new entrants can destabilise the sytem.[45] There is also a different view which calls for opening up of the system. While the banks have done a great deal to reduce costs, these have not been passed on to customers.[46] An interest rate spread of over 6 per cent is reportedly more than twice that prevailing in the developed countries and significantly higher than that of even Caribbean countries, with the exception of Jamaica. The return on equity between 1992 and 1996 averaged almost 15 per cent. "The banking industry in Trinidad and Tobago presents a mixed picture with regard to competitiveness. None of the six banks is large enough to exercise monopoly power. However, their relatively small number, absence of new entry over many years,

the large interest rate spreads, and record profits suggest a degree of monopolistic market power. This situation makes the banking system appear financially sound but it carries a hidden cost for the rest of the economy by keeping the cost of capital high and the incentive for financial savings low."[47] It has been argued that "the rate of return on bank equity should be generally within the range of profits elsewhere in the economy, given a reasonably competitive environment and normal risk."[48] The Government has indicated it is prepared to allow new banks to enter, and one has already started operation.

Interest rate liberalization is a very complex issue, and can cause a great deal of problem to the real sector of the economy if not handled carefully. There is not one interest rate to be addressed but a whole spectrum reflecting preferences, risks and costs. There is also a wide range of financial products, and rates tend to reflect certain factors in the economy. The high commercial bank spread in Trinidad and Tobago, for example, is certainly not unrelated to the high legal reserve requirements. Sequencing is crucial in the liberalisation process.

Another issue which has featured in the financial liberalisation debate relates to the question of a real interest rate policy. The neo-classical view argued that low interest rates promote growth and development. The Mc Kinnon-Shaw thesis holds 'that artificially low interest rates discourages saving and investment and retards growth and development.[49] The link between interest rates and savings has been subject to a great deal of testing, but the relationship has not always been strong or positive. In a situation with high inflation rates, a positive real interest rate policy will tend to result in high lending rates and this could be a disincentive to investment and the undertaking of certain critical projects which may not yield the desired rate of return. Relatively high interest rates may also attract speculative capital flows which could have a destabalizing effect on the economy.

Studies done on Trinidad and Tobago have produced conflicting results. In one, the relationship between the rate of savings and interest was found to be uncertain[50]. In another "a positive relationship between deposit rates, savings and economic growth (as measured by the growth in national income)" was indicated.[51] The author was quick to point out, however, that the savings concept used included both public and private savings and covered a period when there

was a high level of government savings in boom conditions.

IV. Concluding Observations

Over the long haul, Trinidad and Tobago's economic performance has been unimpressive. While in certain essential respects it has outperformed a few countries like Jamaica and El Salvador, several other small states (e.g. Cost Rica, Mauritius, Singapore) have experienced far superior growth rates over the last three decades. Between 1965 and 1996 Trinidad and Tobago's GNP grew at an average annual rate of 1.5 per cent as compared to 8.3 per cent for Singapore, 4 per cent for Costa Rica and 5.2 per cent for Mauritius. Over the period per capita GNP expanded by 0.3 per cent per year, as compared to 6.3 per cent for Singapore and 3.9 per cent for Mautitius (See Table 17).

Table 17

Long Term Trends in Selected Variables: A Comparison of Seven Countries

	Average Annual % Growth 1965-96						
	Jamaica	Trinidad & Tobago	Singapore	Mauritius	South Korea	Costa Rica	United States
Gross GNP							
Total	0.7	1.5	8.3	5.2	8.9	4.0	2.4
Per Capita	-0.5	0.3	6.3	3.9	7.3	1.2	1.4
Population	1.2	1.2	1.8	1.3	1.5	2.6	1.0
Labour Force	2.0	1.8	3.0	2.4	2.5	3.4	1.6
Sectors							
Agriculture	0.9	-2.3	-1.4	-0.3	2.0	3.2	4.0
Industry	-0.2	0.1	8.6	7.6	13.8	4.8	1.7
Services	2.2	1.7	8.3	7.0	9.0	4.1	2.5
Private Consumption	2.0	3.8	6.6	5.0	7.5	3.2	3.0
Gross Domestic Fixed Investment	-2.7	0.8[a]	9.6	4.1	12.1	4.8	2.3
Exportis of Goods and Services	1.7	3.3	12.2	5.6	16.1	6.9	5.5

a. author's estimate

Source: World Bank, World Development Indicators, 1998.

A noticable feauture of the comparison is that the high growth countries are generally associated with high saving, investment and exports growth rates (See Tables 17 and 18.). If the recent oil boom period is excluded, Trinidad and Tobago's Net National Savings rate has been inadequate to finance the desired level of investment. Since 1983, it has been averaged around 6 per cent of GDP as compared to 25 per cent for Gross Domestic Savings. Countries like Botswana, Singapore, Malaysia and China are associated with Gross Domestic Savings rates of over 40 per cent. Since 1965, gross investment in Trinidad and Tobago has grown at less than 1 per cent per year as compared to almost 10 per cent for Singapore, 4.1 per cent for Mauritius and 4.8 per cent for Costa Rica. The improvement in growth performance in recent years is not unrelated to the large inflows of foreign private capital, even though this investment is highly concentrated in the gas and oil sectors. Between 1991 and 1996 Trinidad and Tobago received almost US$2 billion in foreign direct investment. One of the dangers here is that inflows of foreign savings can discourage a stronger domestic savings effort.

Though there has been some reduction in dependence on trade since the 1950s, and notwithstanding some diversification in the economic structure, the economy remains highly dependent on a few commodities, prices for which are determined by world economic conditions. In the context of present financial developments in the world economy instability is more likely to come from fluctuations in the price of export commodities than from movements in short term speculative capital. Though there has been some improvement in economic conditions in recent years, the economy remains precariously perched, and reversals can easily set in. There is nothing in terms of 'real fundamentals' to suggest that this economy is ready for a return to significant increases in wages and salaries or high consumption spending. The economy is in a critical transition phase. As far as the real sectors are concerned there is still the need for a clearly defined philosophy and for a policy framework that could address the service sectors. The fastest growing economies in the world are associated with very dynamic service sectors and the development of not only physical, but human capital.

Table 18

Growth, Saving and Investment Performance in Selected Countries, 1980 and 1996

Countries Grouped by Saving Rates	Gross DomesticProduct (Average % Growth Rate)		Private Consumption		As a % of GDP: Gross Domestic Investment		As a % of GDP: Gross Domestic Savings		Per Capita GNP 1996 US$
	1980-1990	1990-1996	1980	1996	1980	1996	1980	1996	
Less Than 10%									
Bangladesh	4.3	4.3	92	79	15	17	2	7	260
Bolivia	0.0	3.8	67	79	15	15	19	8	830
Ghana	3.0	4.4	84	79	6	19	5	8	360
Uganda	3.1	7.2	89	84	6	16	0	6	300
Zambia	0.8	-1.1	55	74	23	15	19	8	360
10-20%									
Brazil	2.7	2.9	70	66	23	19	21	18	4,400
Dominican Republic	3.0	4.7	77	75	25	24	15	19	1,600
Jamaica	2.0	0.8	71	64	16	27	16	14	1,600
Kenya	4.2	1.9	62	69	29	20	18	17	320
United States	2.9	2.4	64	68	20	18	19	16	28,020
21-30%									
Canada	3.4	1.9	55	60	24	18	25	21	19,020
Chile	4.1	7.2	71	65	21	28	17	26	4,860
Costa Rica	3.0	4.3	66	60	27	23	16	22	2,640
France	2.4	1.1	59	60	24	18	23	21	26,270
Mexico	1.1	1.8	65	66	27	21	25	23	3,670
Mauritius	6.2	5.0	75	68	21	26	25	23	3,710
Nigeria	1.8	2.6	56	64	21	19	31	24	240
Trinidad & Tobago	-2.5	1.2	46	63	31	15	42	26	3,870

Table 18 (continued)

Growth, Saving and Investment Performance in Selected Countries, 1980 and 1996

Countries Grouped by Saving Rates	Gross Domestic Product (Average % Growth Rate)		Private Consumption		As a % of GDP: Gross Domestic Investment		As a % of GDP: Gross Domestic Savings		Per Capita GNP 1996 USA
	1980-1990	1990-1996	1980	1996	1980	1996	1980	1996	
Over 30%									
Botswana	10.3	4.1	47	28	35	24	36	43	...
China	10.2	12.3	51	45	35	42	35	44	750
Hong Kong	6.9	5.5	60	60	35	32	34	31	24,290
Japan	4.0	1.4	59	60	32	29	31	30	40,940
Malaysia	5.2	8.7	51	47	30	41	33	42	4,370
Indonesia	6.1	7.7	51	59	24	32	38	33	1,080
Singapore	6.6	8.7	53	41	46	35	38	50	30,550
South Korea	9.4	7.3	64	55	32	38	25	34	10,610
Thailand	7.6	8.3	65	55	29	41	23	35	2,960

.. not available.

Source: World Bank, World Economic Indicators, 1998.

Over the last ten years the adjustment process has involved reversal or reform of a whole range of policies built on the thinking of the 1950s and 1960s, but how these are going to play out is yet far from certain. A market environment is quite different from one steeped in controls, and new skills have to be acquired and new instruments forged. A smaller state presence may require a higher state responsibility, and the question is no longer more state or less state, but a more effective state. Reforms not only entail changes in general policy, but concomitant with this is the need for new and operational frameworks, and fundamental changes in service delivery which often challenge established mind-sets. Greater effeciency is a key objective of adjustment and this does not always come simply from higher levels of spending.

Greater resource mobilisation is widely accepted as a critical factor in accelerating growth and development, and not surprisingly more official efficient intermediation tends to be seen as a critical objective in adjustment programmes. In this connection, a sound and well managed financial system that can inspire confidence is a major pre-requisite. One observer has defined financial sector reform "as a set of actions aimed at reducing or eliminating distortions in financial markets, deepening the financial sector, and strengthening financial institutions."[52] With the gradual abandonment of some of its traditional policies and instruments the Central Bank now has to find new ways to influence credit and encourage savings and investment, even while it deals with the daily vagaries of the market, stemming from a fragile economic system. Liberalisation is not a once and for all deal, but may entail a continuous process to find the appropriate policies and achieve the legal and institutional framework that can generate the desired response in a context of changing constraints and opportunities. In a fragile economy libealisation may induce a positive shock, but it may also bring greater risks that requires well thought-out policies and instruments to minimise disruptions and inspire confidence.

Endnotes

1. World Bank, *World Development Report, 1991*, Oxford University Press, New York, 1991, p. 4.

2. See particularly Chapter 5 of the Draft Second Plan and Chapter 7 of the Draft Third.

3. See Chapter 12 of the Second Plan.

4. Ibid.

5. Draft Second Plan, Ch. 8.

6. Ibid.

7. In 1953 53% of the deposits of local banks were held in foreign money markets, but with the issuance of local Treasury Bills in the early 1960s this dropped to around 20%.

8. Qyoted in P.K. Sutton (ed.) *Forged From the Love of Liberty, Selected Speeches of Dr. Eric Williams,* Longman Caribbean, Trinidad 1981, p. 42.

9. T.W. Farrell, *Central Banking in a Developing Economy: A Study of Trinidad and Tobago, 1964-1989,* I.S.E.R., Mona, 1990, p. 25.

10. Quoted in P.K. Sutton, Op. cit., p. 49.

11. *The Imperatives of Adjustment Draft Development Plan 1983-1986,* Port of Spain, 1983, p. 1.

12. p. 5

13. Budget Speech, 1987.

14. Statement to Parliament by Mr. A.N.R. Robinson (Prime Minister and Minister of Finance and the Economy) on 6th January, 1989.

15. Ibid.

16. See Budget Speech, 1991.

17. See Budget Speech, 1990.

18. See Budget Speech, 1991.

19. *The Imperatives of Adjustment*, op. cit., p. 158.

20. Budget Speech, 1996.

21. Ibid.

22. *Report of the Committee to Review Government Expenditure*, 1978, p. xi.

23. Maxwell Stamp PLC, *Trinidad and Tobago Trade Policy Study,* December, 1991, p. 21. of the Executive Summary.

24. Dennis Pantin, *The Impact of Trade Liberalisation on Import Competing Sectors in Trinidad and Tobago, with Particular Reference to the Manufacturing Sector,* Dec., 1992.

25. See IDB, *Economic and Social Progress in Latin America 1996 Report.* Washington, D.C., 1996, p. 242.

26. See World Bank, *Poverty and Unemployment in the Oil-Based Economy,* Washington, D.C., 1995, p. 4.

27. Judy Baker, *Poverty Reduction and Human Development in the Caribbean,* World Bank, Washington, D.C., 1997, p. 162.

28. IMF, *Trinidad and Tobago – Selected Issues,* (IMF Staff Country Report No. 97/41, May 1997), p. 69.

29. Ibid.

30. See Judy Baker, op. cit., p. 163.

31. UNDP, *Human Development Report, 1998,* Oxford University Press, New York, 1998, pp. 128-131.

32. Minister of Finance Mr. A.N.R. Robinson, quoted in Hansard Report, 4 (1964): 280.

33. A.N.R. Robinson, *The Mechanics of Independence: Patterns of Political and Economic Transformation in Trinidad and Tobago,* MIT, 1971, p. 37.

34. Ibid.

35. Ibid., p. 80.

36. See 1963 Budget Speech.

37. See T.W. Farrell and R. Ramkissoon "Monetary Management in Trinidad and Tobago: A Chronology 1964-1982", Central Bank, *Quarterly Economic Bulletin,* Sept. 1982.

38. Draft Third Five-Year Plan 1969-1973, pp. 37-38.

39. See 1986 Budget Speech. See also Euric Bobb and T.W. Farrell, "Exchange Rate Policy and the Devaluation of the Trinidad and Tobago Dollar," *Quarterlly Economic* Bulletin, Dec., 1985.

40. P. Quirk and H. Cortés-Douglas, "The Experience with Floating Rates," *Finance and Development*, June, 1993.

41. M. Goldsmith and J.H. Young, "Exchange Rate Policy: Some Current Issues," *Finance and Development,* March, 1979.

42. M. Goldsmith, "Wither the Exchange Rate System," *Finance and Development,* June, 1984.

43. C.C. Coughlin and K. Koedjik, "What do we know about the Long-run Real Exchange Rate?" Review, the Federal Reserve Bank of St. Louis, Jan./Feb., 1990.

44. Phillipe Callier, (ed.) *Financial Systems and Development in Afric*a, the World Bank, Washington, D.C., 1991, p. 7.

45. See comments by Mr. Peter July (CEO and Managing Director of Royal Bank) quoted in the *Sunday Guardian* of May 11, 1997.

46. IMF Staff Report No. 97/41. (May 1997), op. cit., p. 52.

47. Ibid.

48. Ibid.

49. See M.J. Fry, *Money Interest and in Economic Development* (2nd edition), The Johns Hopkins University Press, Baltimore, 1995, p. 20.

50. See R. Ramsaran, "Determinants of Aggregate Savings in Post-War Trinidad and Tobago" in C. Bourne and R. Ramsaran (eds.) *Money and Finance in Trinidad and Tobago,* I.S.E.R., Mona, 1988, pp. 220-221.

51. See P.K. Watson, "Savings, The Rate of Interest and Growth in a Small Open Economy: The Trinidad & Tobago Experience," Social and Economic Studies, Dec. 1992.

52. N. Mathieu, Financial Sector Reform, The World Bank, Washington, D.C., 1998, p. 1.

Figure I

Real GDP (at 1990 prices)

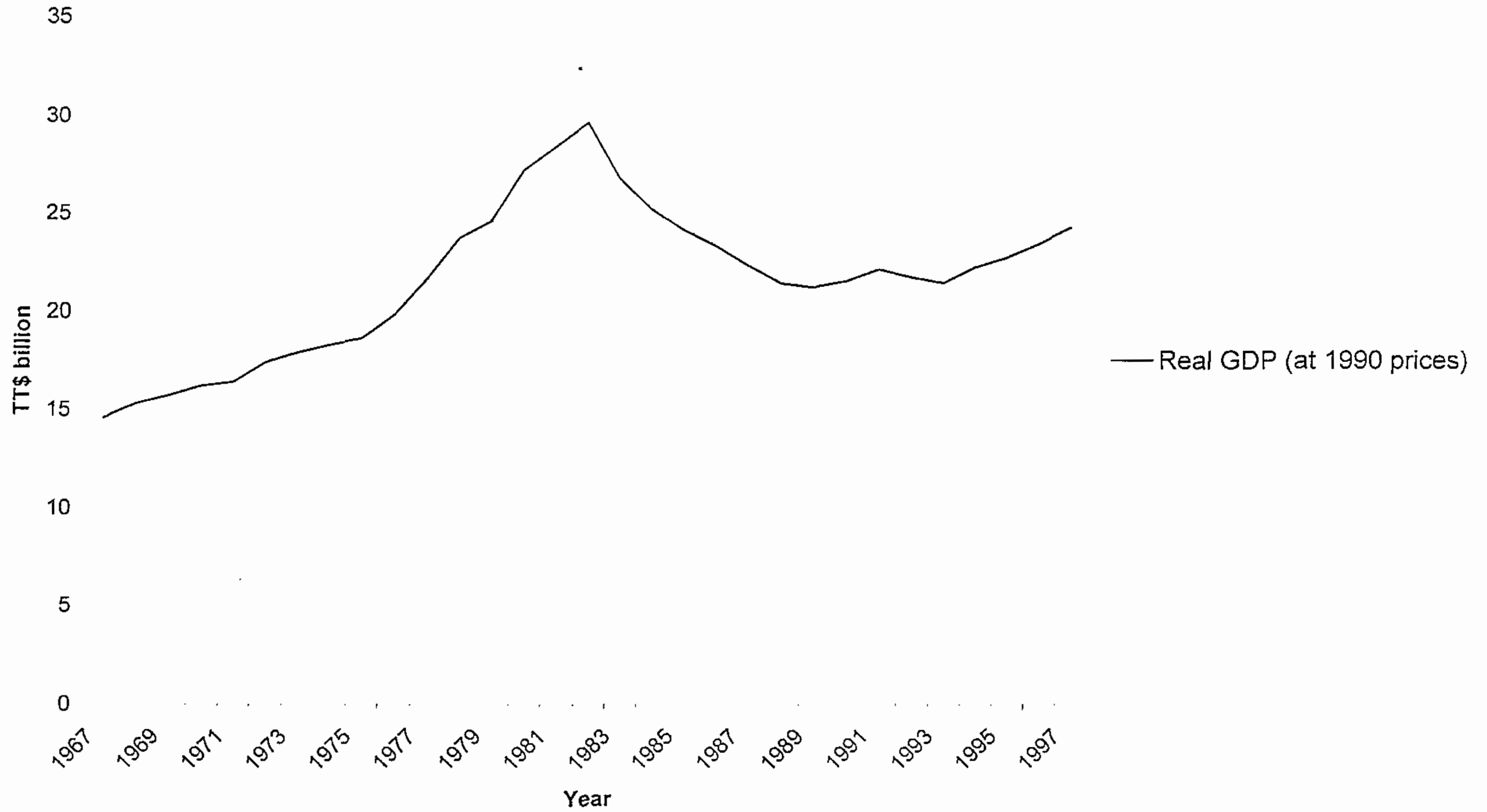

Figure 2

Growth Rate of real GDP (GDP) and Per Capita Real GDP (PCGDP)

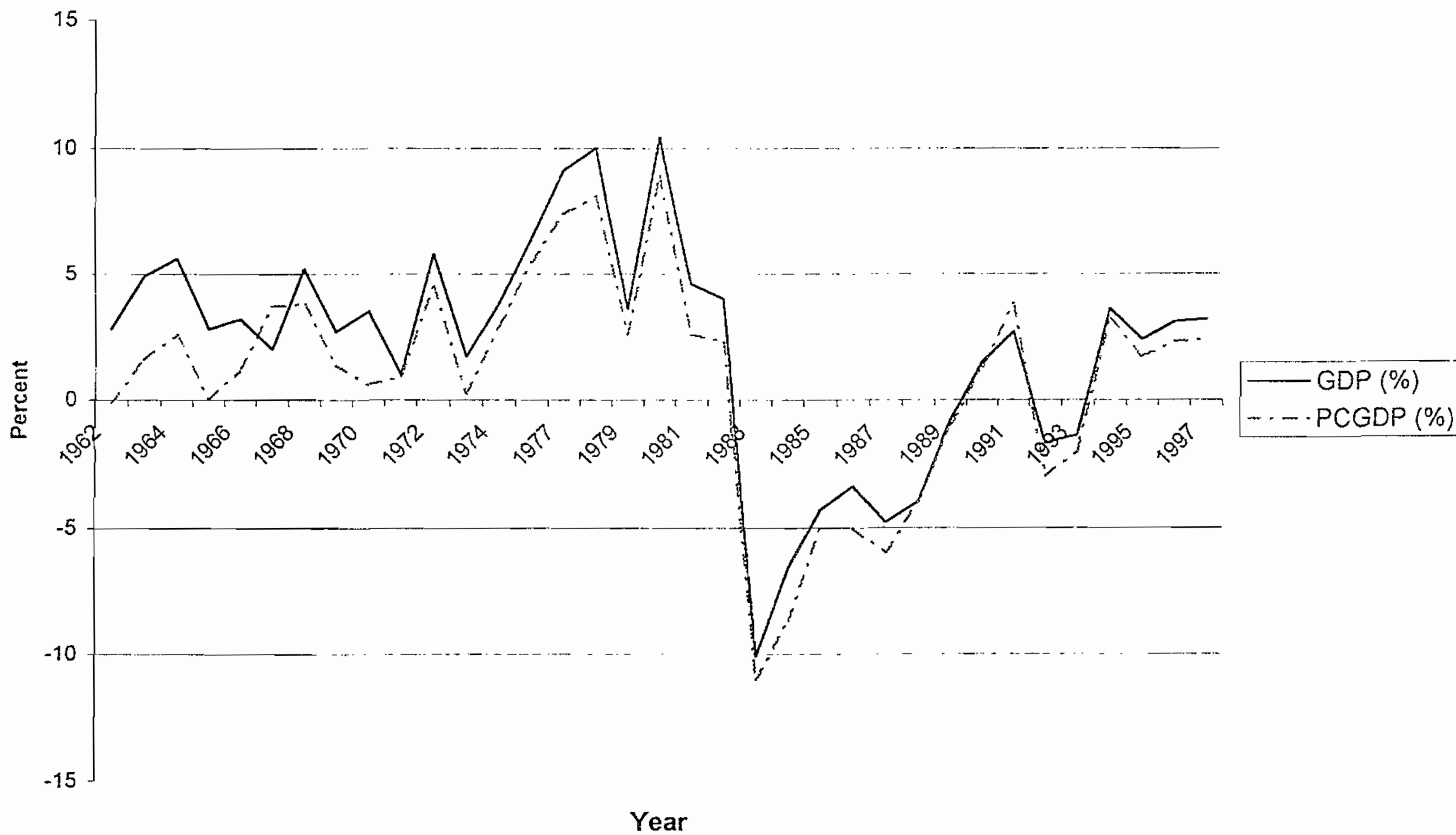

Figure 3

Gross Domestic Savings (GDS). Gross National Savings (GNS), Net National Savings (NNS) and Gross Capital Fermation (GCF) as a percentage of GDP

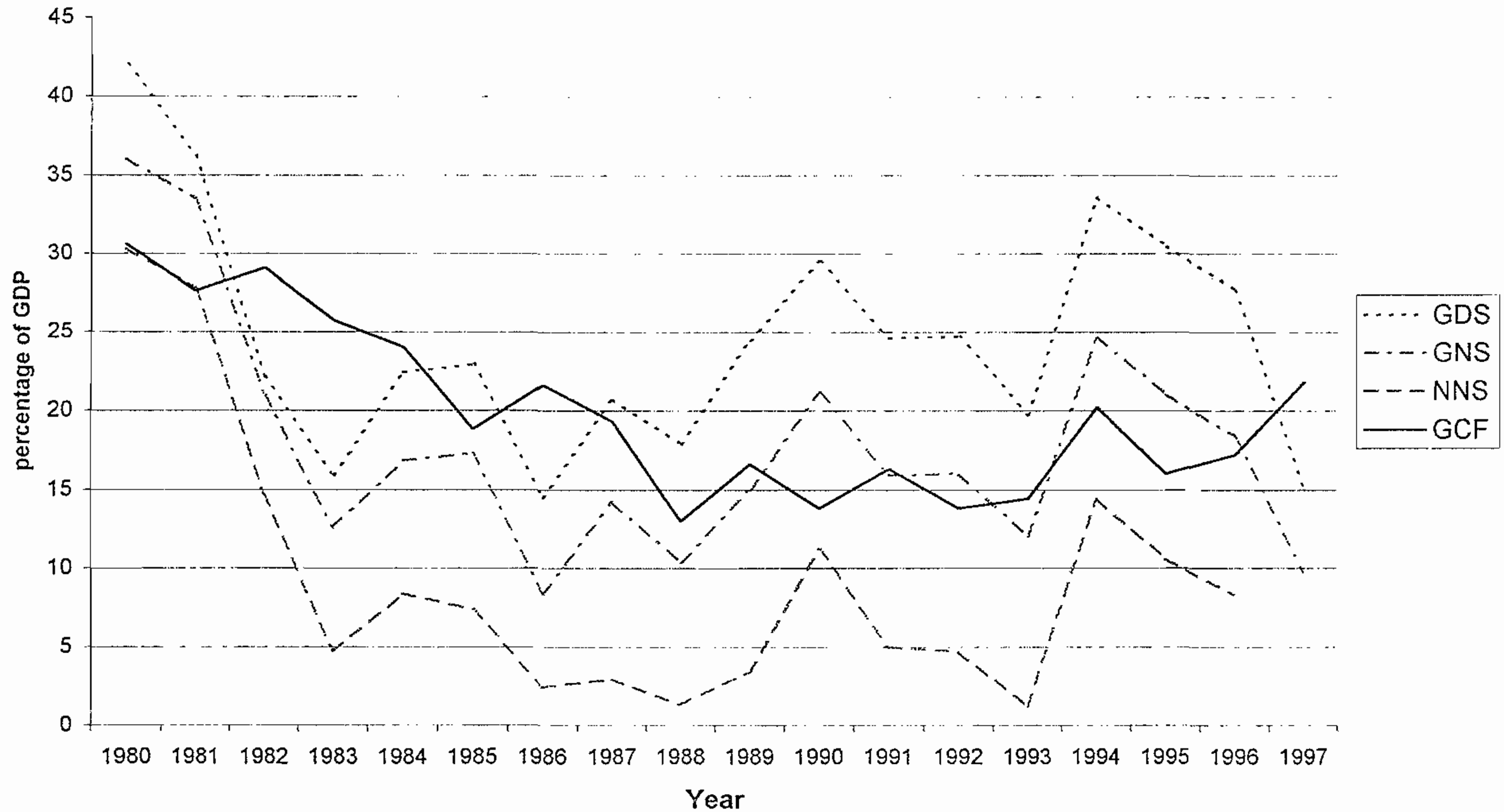

Figure 4
Real GDP Growth Rate (GDP) and the Un-employment Rate (UR)

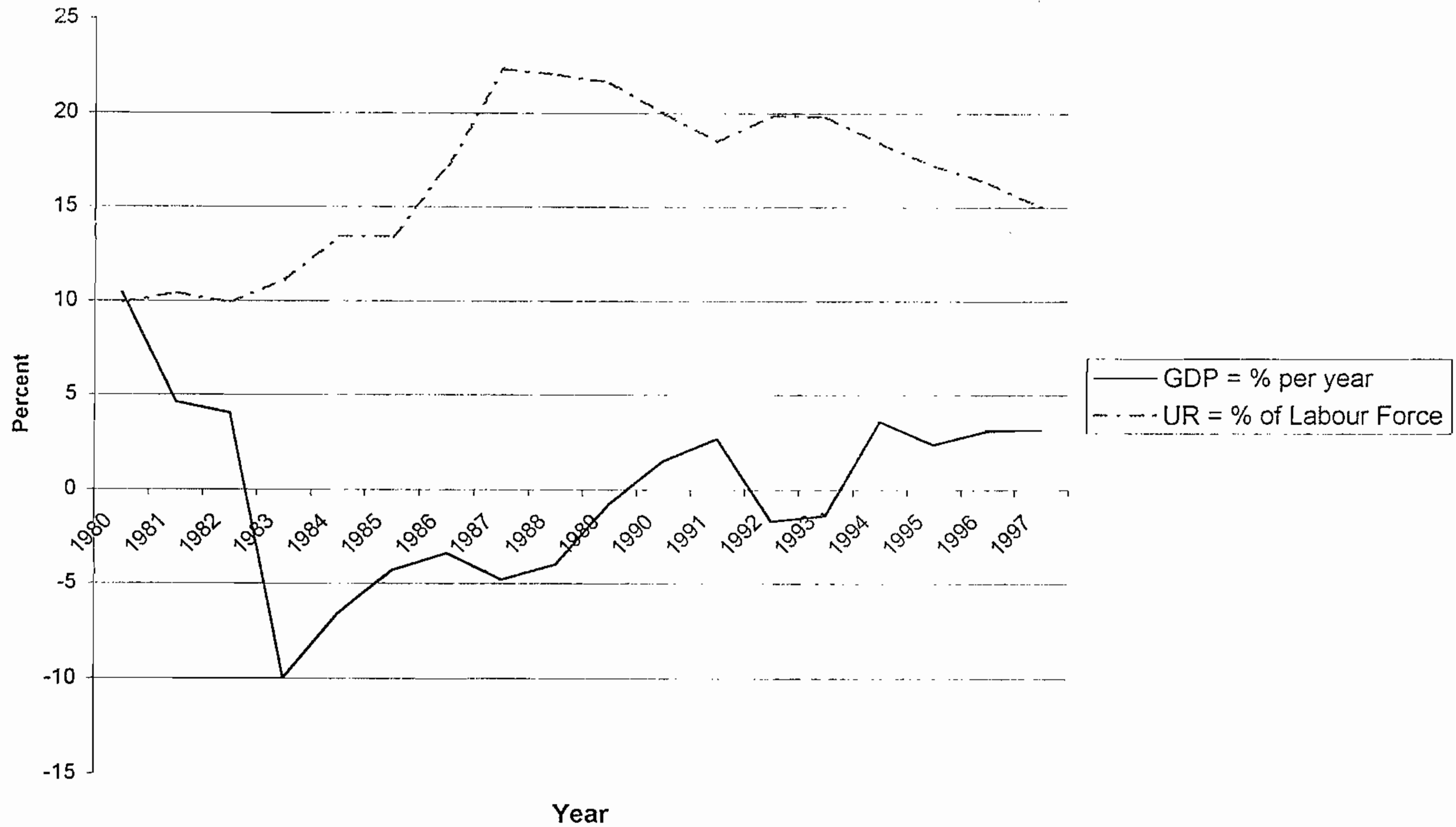

Figure 5

The *Inflation* Rate [INF] and the Trade Balance (TR), the Current Account (CAB) of the Balance of Payments as a Percentage of GDP

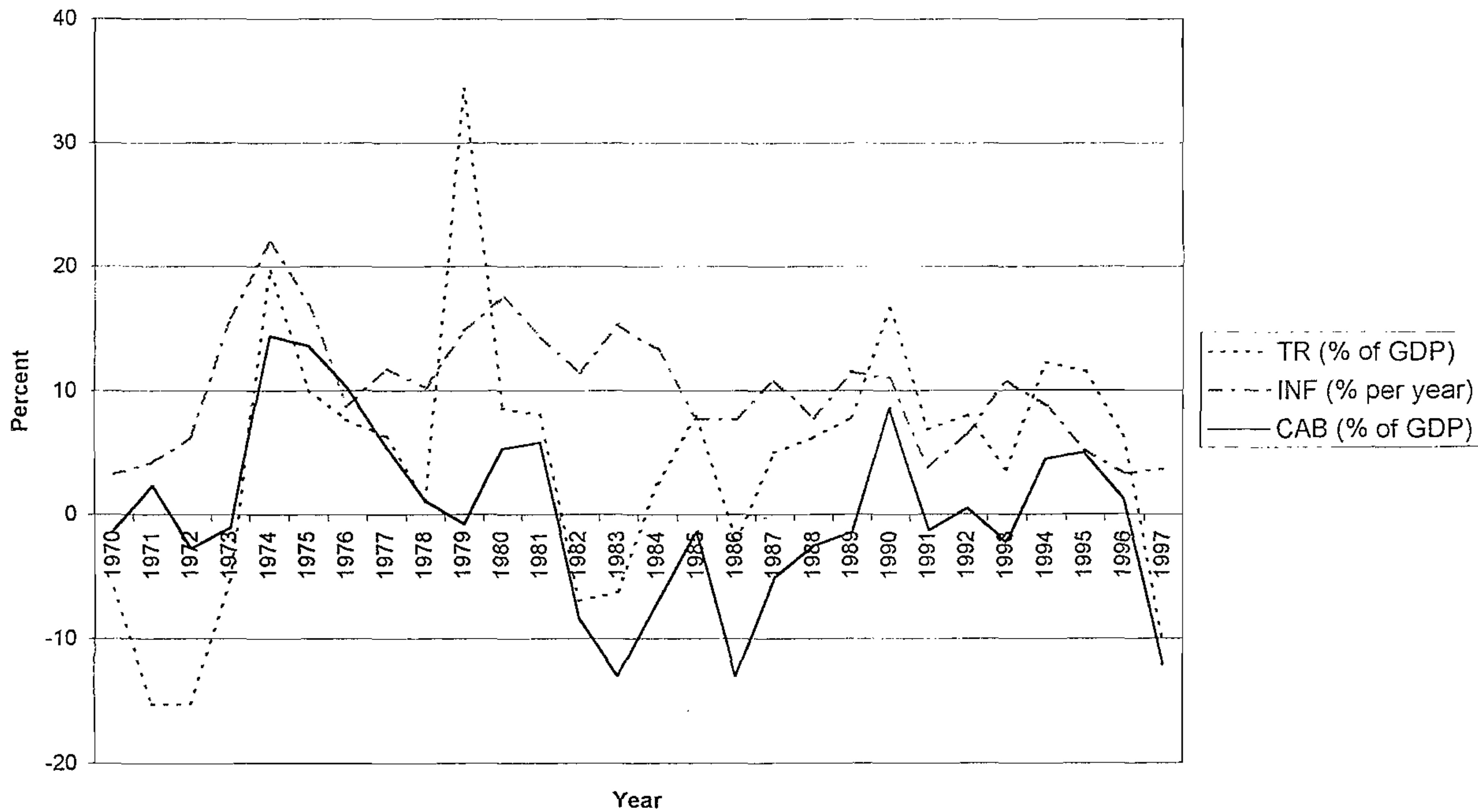

Figure 6

Movements in the Nominal Effective Exchange Rate (1990 = 100) and the Real Effective Exchange Rate (1990 = 100)

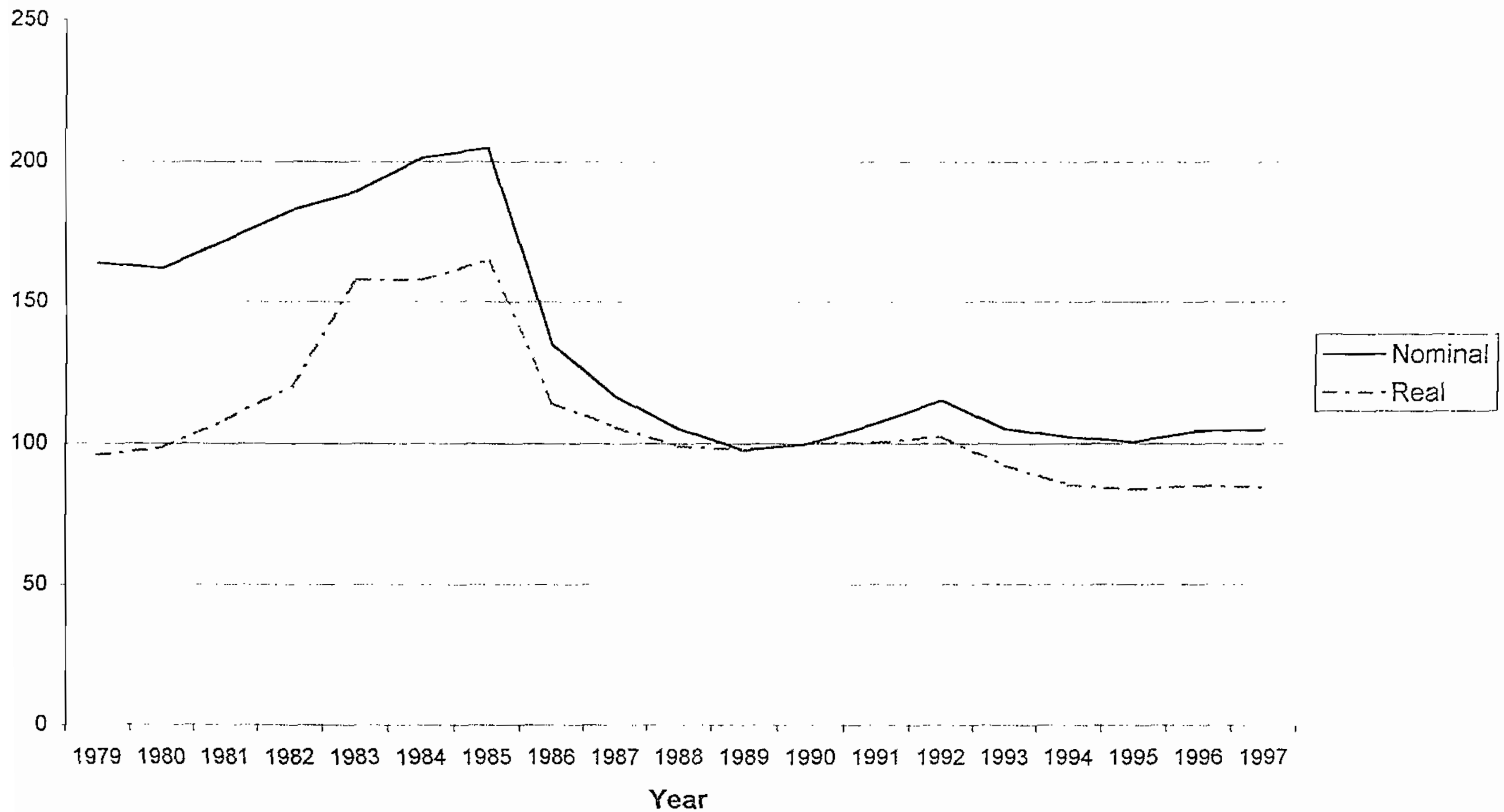

Figure 7
Growth in the Narrow Money Supply (MI), the Broad Money Supply (M2), and the Inflation Rate (INF)

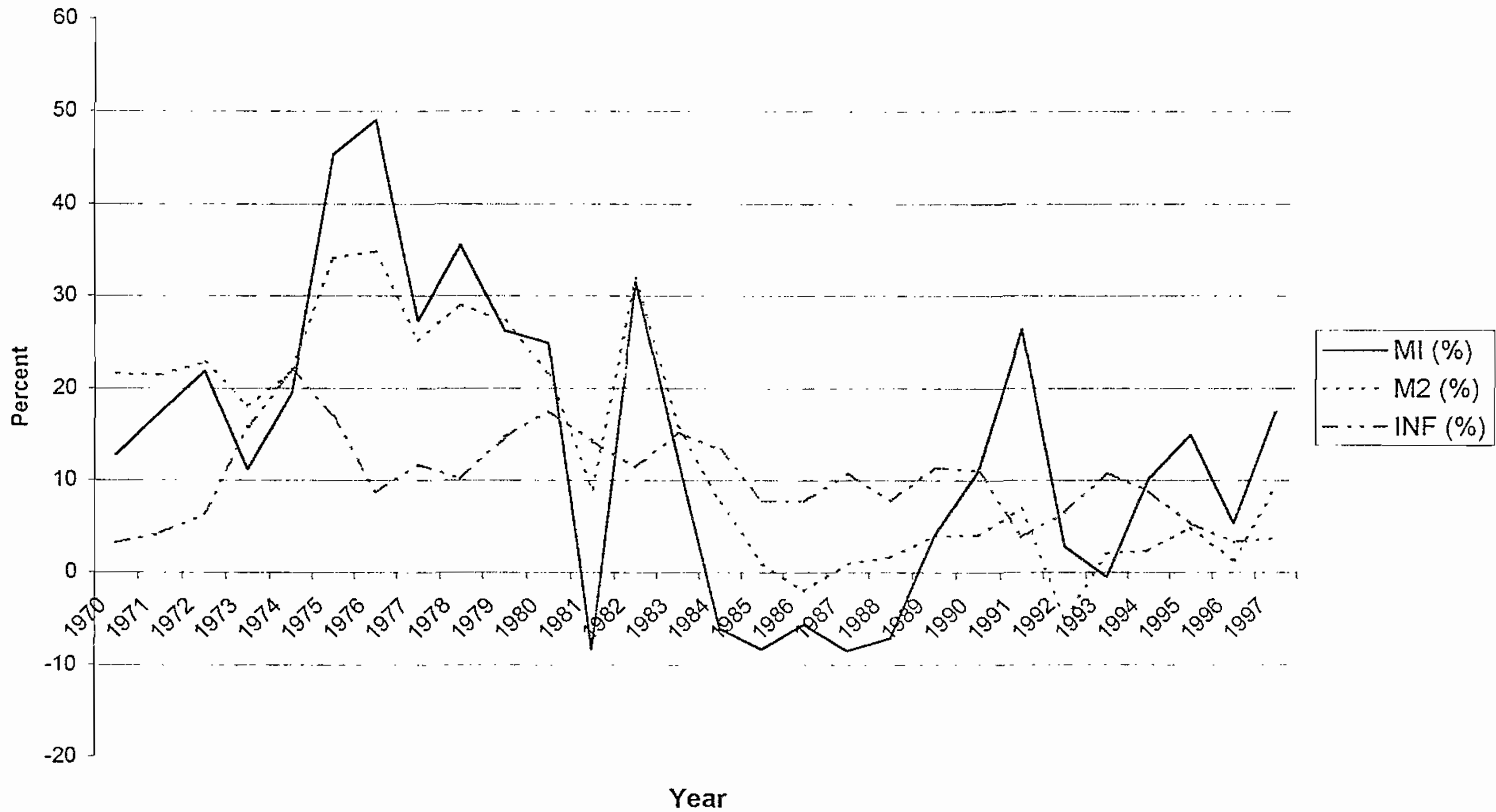

Figure 8

Inflation Rate (INF) and the Weighted Lending Rate (LR) and Weighted Deposit Rate (DR) of Commercial Banks