"Adjustment and Growth in Trinidad and Tobago in the Aftermath of First Generation Reforms 1994- 2000."

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Paper presented at the XXXIV Annual Monetary Studies Conference

Georgetown, Guyana

November 12-16, 2002

CENTRAL BANK OF TRINIDAD AND TOBAGO

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Research Department **November 2002**

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ABSTRACT

Trinidad and Tobago followed the trend of most countries in Latin America and the Caribbean (LAC) and initiated a series of structural reform policies between 1988 and 1993. The paper argues that while fiscal reform and capital account liberalisation were critical elements of the reform process the judicious management of the latter has contributed to the success of macro-economic performance in the post reform period. The paper closes with some key lessons from the experience but warns that recent weakening of the fiscal consolidation process can undermine the relative success that has been achieved.

ADJUSTMENT AND GROWTH IN TRINIDAD AND TOBAGO IN THE AFTERMATH OF FIRST GENERATION REFORMS 1994-2000

Penelope Forde[*]

I. Introduction

Many analysts have characterised the 1980's as a lost decade for Latin America and the Caribbean (LAC) as the vast majority of these economies experienced severe bouts of internal and external disequilibria. The disequilibria were characterised by persistent fiscal deficits, double digit inflation, public sector debt crises, relatively high levels of unemployment and falling levels of GDP. Economic policy varied from one country to the next with a mix of orthodox as well as heterodox stabilisation policies, but by the start of the 1990's most of the LAC region had undergone a series of structural reforms now generally referred to as first generation reforms. These reforms have had a positive impact on economic performance in the mid and late 1990's and so prospects are brighter for some of these countries at the start of the new century.

Trinidad and Tobago's (TT) experience was in many ways typical and yet at times atypical of the rest of the LAC region. Nonetheless the economy experienced a period (1974-1982) of upward adjustment to positive terms of trade shocks which was followed by a near decade long recession starting in 1983. The onset of the recession initiated a period of structural adjustment which consisted of both formal and informal policies. In particular the movement away from state-led industrialisation to more market oriented economic policies provided the backdrop for the process of structural reform with the following key elements:- trade and tariff reform, privatisation, tax reform, liberalisation of the domestic financial system and finally opening the capital account of the balance of payments. Trinidad and Tobago followed the trend in the region and undertook most of these reforms between 1988 and 1993, although some initiatives had been put in place in the early 1980's.

On the basis of an IADB study, which includes an Index of Structural Reform in LAC, the study suggests that by 1995 the Index for Trinidad and Tobago (TT) stood at 0.715 compared with 0.684 for Jamaica and 0.713 for Barbados and an average of 0.621 for LAC.[1] In the TT situation however what was important was the **timing** and **sequencing** of the reforms rather than the depths of the reform. In this regard the reform sequence was as follows:- stabilisation and adjustment, trade and tax reform and then the dismantling of the regime of exchange controls which culminated in the flotation of the exchange rate in April 1993. The remainder of this paper examines the following: the key elements of the reform process, with special emphasis on fiscal reform, capital account liberalisation and macro-economic performance after the reforms. Next there is a close look at the operations of the foreign exchange market which has been key to the success of macro-economic performance. The paper closes with some lessons from the experiences.

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[*] The author is Manager, Research Department. The views expressed are those of the author and not necessarily those of the Central Bank of Trinidad and Tobago.

[1] The Index represents the degree of market freedom created by structural policies implemented in five areas – trade, tax, finance, privatisation and labour. On a scale of 0 to 1, 0 is the lowest or worst observation, and 1 is the highest score over the total period for all the countries concerned.

II. Adjustment and First Generation Reforms

The Trinidad and Tobago economy experienced a period of structural adjustment to affluence following the oil shock of 1973 and the economic rents which fuelled a boom in economic conditions. This boom was followed by almost ten years of unrelieved economic contraction between 1983 and 1993 with sustained losses in real income, employment and government revenues. These latter years witnessed the introduction of structural adjustment – initially home grown (1983-1987) and then under the auspices of the multilateral lending agencies (1988-1991). In the latter case the access to the resources of the IMF and IBRD opened the door to a series of structural reforms which have become known as first generation reforms. These reforms ranged from trade and tariff reforms to tax reform and privatization initiatives, financial reform and capital account liberalization. Together with labour reform, these structural changes, the so called as first generation reforms, have been introduced throughout the LAC region.

Before there is any detailed discussion of the reforms introduced in TT it is interesting to consider how some analysts have characterized many of the LAC reformers:- e.g. aggressive versus slow or cautious reformers and early versus late reformers.[2] In particular aggressive reformers carried out their reforms in a relatively short space of time while slow reformers implemented these in a gradual manner and were more selective in their changes. Examples of early reformers were Chile and Argentina in the area of trade and financial reform, while Jamaica, Brazil and Mexico have been identified as cautious reformers. While the IADB Index does not take cognisance of early (1983/1984) rather than gradual attempts at adjustment in TT, it is a matter of record that initiatives commenced in the early 1980's in similar fashion to Jamaica and Argentina for example. What is different in the Jamaica experience for example is that the consistency of policy changes was not maintained throughout the 1980's and early 1990's. There has also been some *ex post* criticism of these reform policies even though some countries in LAC performed initially extremely well because they adopted some of these polices. Perhaps the most outstanding example of this is Argentina whose Index of Structural Reform stood at 0.679 by 1995. It may well be that policy choices beyond 1995 were inappropriate for the Argentine reality. Nonetheless as IADB (1997) indicates by 1995 all countries in the region without exception displayed better policy efficiency than ten years earlier.

In contrast TT may be characterised as an intense or aggressive rather than a slow reformer as the authorities embarked on a sustained period of adjustment to tariff levels (1988), changing the tax system (1989/1990), privatization (1990's) and capital account liberalization (1993). While the cornerstone of these reforms was tax reform and privatization initiatives, adjustments to the tariff reform had proceeded alongside financial sector reform. In the latter instance the failure of a number of non-bank financial institutions in the early 1980's had led to the overhaul of the financial system legislation as early as 1986 with the establishment of a Deposit Insurance Corporation. By 1993 modernization of the financial institutions legislation was completed with much emphasis placed on banking supervision issues.

In respect of trade reform special attention was given to tariff reduction to relatively low rates and the removal of quantitative restrictions such as the negative list. Trade reform had commenced as early as 1991 with the reduction of the negative list and the gradual

[2] See Stallings and Peres (2000) for example.

removal of quantitative restrictions. By 1993 with the flotation of the exchange rate and the removal of the foreign exchange restrictions TT had completed the implementation of an open trade regime. As indicated below the capital account liberalisation would contribute in large measure to the success of macro-performance in the post 1994 period.

Prior to 1989 the tax regime was dominated by taxes on income (both corporate and personal) with high marginal rates and a wide range of exemptions and deductions. The high corporate tax regime represented a disincentive to investment and in some sense there was an over reliance on direct taxes. Tax reforms consisted of two main elements: the removal of the range of exemptions and deductions in the income tax structure and the introduction of a value added tax of the consumption variety at the rate of 15 per cent. The latter was accompanied by a lowering of the marginal income tax rates from average of 50 per cent to around 40 per cent for companies and 35 per cent for individuals.

Another key element in the fiscal reform process was the reduction in the transfer and subsidy budget and the privatisation initiatives undertaken by the state. At the onset (1988) of the adjustment process, transfers and subsidies to households and firms represented just over one third (35.2 per cent) of current expenditure but this had fallen to around 31 per cent of current expenditure and was on the decline by 1991. In many instances these subsidies were directed to a number of inefficient state enterprises which were either closed or divested by the mid 1990's. By 2000 the privatization programme had resulted in almost $4,000 million in proceeds, 80 per cent of which had been received in foreign exchange.

III. Macro Economic Performance: 1994 - 2000

The flotation of the TT dollar in April 1993 marked a watershed in economic management after a long process of adjustment and reform. How well the economy responded to these changes can be gauged by the evolution of key macroeconomic indicators in the 1990's described in Annex I below. Several analysts have attributed the return to growth in LAC as a direct consequence of the structural reforms and some studies Lora and Barrera (1997) for example have also attempted to decompose the effect of each type of reform on total growth, productivity and investment. In particular their estimates suggest that the long term growth in the region rose by 2 percentage points a year because of the reforms and for TT in particular the growth due to stabilization and reform (1993-1995) was 2.1 per cent compared with the simple average of 2.2 per cent for a typical LAC country and 0.5 per cent for Jamaica for example. It is against this background however that we consider the TT performance in greater detail.

Following a near decade long recession a sustained economic recovery began in the last half of 1993 and has continued to the present (mid 2002) with GDP growing at an average rate of just under 4 per cent per annum. The current economic expansion is significantly different from that of the 1970's boom in that it is not directly driven by improvements in the country's terms of trade. The growth is wide spread among both the oil and gas sector and the non-energy based sectors. In the case of the former real valued added has grown in light of continued investment in the petrochemical sub-sector. By 2000, Trinidad and Tobago had constructed seven (7) world scale petrochemical plants between 1996 and 2000 as well as the second liquefied natural gas plant (LNG) in the Western

Hemisphere which was commissioned in 1999.[3] Thus real value added in petrochemicals grew on average by 12.7 per cent compared with 3.7 per cent in the previous seven years. Yet, while the oil and gas sector has experienced some relatively weak years (1997 for example) the non-energy sectors led by Manufacturing, Construction, Transport and other Services have performed exceptionally well since 1994.

The non-energy based sectors have grown on average at just over 4 per cent with leading sectors such as Construction (9.5 per cent), Distribution (12.8 per cent) at around double digit rates while Manufacturing (3.3 per cent) and Transport, Storage and Communications (6.9 per cent) exhibiting solid performances. The buoyancy of the Construction and Distribution sectors was linked to investment in the petrochemical sub-sectors as well as the shake-out in Manufacturing as some domestic manufacturers re-organized their production and distribution structures. Indeed the low but steady growth in Manufacturing is also tied to export performance in the CARICOM region.

Prior to the adjustment effort TT's inflationary experiences reflected influences from domestic and international sources. Nonetheless the evolution of inflation since 1993 has shown a downward trend to "headline inflation" in the absence of any temporary shocks (supply shocks, etc.). Except for the initial period (about 4 quarters) following the change in the exchange rate arrangements in April 1993, core inflation (i.e. the changes in the Index of Retail Prices (RPI) excluding food) has averaged well under 4 per cent and is fairly close to that of the country's major trading partners. The economic expansion has been accompanied by reductions in the level of unemployment from 18.4 per cent (1994) to 12.2 per cent (2000). Although the unemployment rate may be considered high by international standards it is important to note that the measure excludes informal sector activity which has been conservatively estimated at 1-3 per cent of the labour force. In addition, real wages, which had grown ahead of productivity during the late 1970's and early 1980's deteriorated during the recession but had recovered by 1995.

An important element of the structural reform process was the complete overhaul of the public finances. At the onset of the economic recession in 1983 the fiscal deficit had peaked at just under 13 per cent of GDP - a situation which was clearly unsustainable. As already indicated the process of fiscal consolidation characterised by tax reform and drastic cuts in the transfer and subsidy budget was complete by 1993. Indeed the public sector deficit fell to -0.2 per cent by GDP in 1994 and turned into surpluses between 1995 and 1998.[4]

The economic expansion has also been accompanied by overall balance of payments surpluses since 1993 and external current account surpluses averaging 3.5 per cent of GDP between 1994 and 1996. However, the current account deficits registered between 1997 and 1998 were associated with capital goods imports consequent on the investment boom in the energy sector in the second half of the 1990's as the economy absorbed approximately US$4000 million in foreign direct investment over a 7 year period. The majority of this investment was directed towards the oil and gas sector with US$999.6 million to the LNG plant which became operational in mid 1999.

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[3] Between 2000 and mid 2002 two additional plants were commissioned.

[4] Since then the process of consolidation has weakened and by the end of calendar 1999 a fiscal deficit had re-emerged (-3.2 per cent of GDP).

A prudent debt management strategy has led to the reduction in the external debt service ratio from a peak of 30.3 per cent in 1993 to 7.9 per cent by 2000. The external dis-equilibrium associated with the onset of the adjustment period had been characterized by balance of payments deficits and a bunching of external debt repayments in the 1988-1990 period. The debt rescheduling under the Paris and London Clubs postponed the debt bunching to the early 1990's when the debt service ratio peaked at around US$600 million but has since fallen to just under US$300 million per annum. More importantly, this reduction in the debt service has been accompanied by a rebuilding of the foreign reserves to US$1.9 billion or 5.5 months import cover by end 2000.

In evaluating the macro-economic performance after the reforms several features stand out. As already indicated the period of structural reform was clearly a sustained one especially if one includes the early 1980's when the adjustment process was home grown. The initial conditions were also very favourable as the inflation rate was falling, the GDP growth rate negative but improving and the economy stabilised sufficiently. The reform measures were consistent and undertaken with gradual speed except in the case of privatisation which was well sequenced. This last feature needs to be underscored since the evidence suggests that the liberalisation has contributed immensely to current macro economic management. In short the reforms led to increased growth, productivity and gross capital formation. Gross capital formation which had averaged 22.6 per cent of GDP between 1983 and 1986 was compressed to 16.1 per cent during the adjustment period but thereafter averaged 24.6 per cent of GDP between 1995 and 2000.

IV. Capital Account Liberalisation 1993-2000

On April 13 1993 the last element of the elaborate system of exchange controls established since 1970 was removed and the TT dollar was allowed to float independently. At the onset of the new system commercial banks initially maintained in place the same restrictions which had prevailed prior to the float. This system of administrative controls functioned as a method of preventing the depletion in reserves given the possibility of unusual and heavy demand. In less than 6 months however most of these restrictions were removed and gradually the banking system's preference for satisfying trade related transactions was extended to imports of service and capital account transactions.

When the foreign exchange market opened under the new arrangement the TT dollar (weighted average selling rate) began to trade at US$1 = TT$5.77. This represented an initial depreciation of 26.3 per cent as the nominal value of the TT dollar had fallen from US$1 = TT$4.25 prior to the float. In the 6 3/4 years or so to December 2000 the nominal value of the TT dollar depreciated by 8.4 per cent. In real effective terms however the Trade Weighted Real Effective Exchange Rate Index (TWREER) (September 1990 = 100) has depreciated on a cumulative basis by 13.5 per cent or an average gain in international competitiveness of 1.7 per cent per annum. This overall change masks periods of appreciation (1998-2000) as well as depreciation (1993-1997). The latter period of appreciation has also been accompanied by intervention in the foreign exchange market by the Central Bank, especially in the aftermath of the Asian crisis but simultaneous with structural changes in the external accounts. On the basis of some indicators the flotation of the TT dollar has been a relative success. This success may well be related to certain characteristics of the TT foreign exchange market, the macro-economic conditions prevailing in 1993, as well as complementary monetary and financial policies pursued since then.

The timing of the flotation was critical to the initial success as the macroeconomic conditions at the time pointed to the fact that the economy had achieved some degree of stabilisation. The evidence suggests that the bottom of the recession had occurred over 1989-1990 and by 1991 the non-energy based sectors had resumed a growth path which was delinked from developments in the oil and gas sector. The non-oil and gas sector is a mix of tradable and non-tradable sectors (Construction, Manufacturing, Transport etc) which had begun to recover from the recession. The initial pass through effects of the 1993 depreciation had been worked out by the second quarter of 1994 and in the absence of major domestic sources of inflation, headline inflation remained fairly close to that of the major industrialised economies.

V. The Foreign Exchange Market and the Exchange Rate: 1993 - 2000

Mainstream economic theory provides little or no guide to the evolution of nascent markets although developments in the transition economies have led to some interest in this specialised area. The changed domestic foreign exchange market in the post 1993 period had to operate with some form of guidelines as contrary to some popularly held views markets cannot operate in a vacuum. However, before these guidelines are discussed, it maybe important to describe some peculiarities of the foreign exchange market in TT. Indeed the very peculiarities of the market implied that special arrangements may have been warranted. Some of the features are described below and these have at times hindered as well as assisted in the workings of the market. The market is characterised as follows:

(i) a small number of major foreign exchange suppliers whose earnings derive from the oil and gas sector which is generally subject to terms of trade shocks;
(ii) the government is not a major purchaser of foreign exchange in the market since oil taxes and royalties are received in foreign exchange and placed at the Central Bank;
(iii) there are six licensed foreign exchange traders (commercial banks) who dominate the financial system and at least four of these traders possess a large branch network throughout the country; and
(iv) earnings from the tourism sector are relatively low so that *bureaux de change* are marginal institutions.

Institutional Arrangements

At the outset in April 1993 the Central Bank in collaboration with the commercial banks introduced several measures to help promote stability in the newly emerging market. These measures included -*An Agreed Minute* on the operations of the market, a *Code of Conduct for Market Participants* and *A Sharing Arrangement.* A key element of the *Agreed Minute* is the guideline on the daily setting of buying and selling rates as well as the upper limit on the spread between buy and sell rates. This cap ensured that no one foreign exchange dealer could make 'super profits' on foreign exchange transactions.[5]

While the *Code of Conduct* allowed for an appropriate dispute mechanism among foreign exchange traders, the *Sharing Arrangement* enhanced the distribution of foreign exchange in the absence of significant inter-banking activity. Without this arrangement and

[5] This is in sharp contrast to the initial experience in Jamaica when even though exchange controls were abolished in September 1991 it was not until April 1992 that the Bank of Jamaica required all commercial banks to publish a daily rate and carry out all transactions at that rate.

given the lumpiness of inflows from a few large earners there was some concern that the two largest banks would dominate and cause undue volatility in the exchange rate. This arrangement allowed for purchases of foreign exchange from designated companies to be shared equally among the traders. Originally these pooled funds encompassed some nineteen (19) companies in 1994 but by the end of 2000 the number had been reduced to four (4) companies. In 1994 and 1995 almost 30 per cent of the total purchases of foreign exchange was subject to the sharing arrangement. By mid 1996 with seven (7) sharing companies this proportion had fallen to about 25 per cent and just under 24 per cent by the end of 2000.

The evidence is clear that the *Sharing Arrangement* contributed to the stability in and a reduction in volatility in the foreign exchange market. The reduction in the number of companies is designed to ensure the phasing out of the arrangement over the long term. The TT experience suggest that the liberalization of foreign exchange markets **does not** imply the absence of rules and guidelines within which market participants must operate. However while these institutional arrangements provide the background against which the exchange rate is determined, the nature and structure of the economy can also impact on the operations of the exchange rate regime.

As a typical open Caribbean economy with a single monocrop, movements in the country's terms of trade have always impacted directly on the economy and in particular on the operations of the foreign exchange market. The period of stabilization and adjustment had been marked by a deterioration in the net barter terms of trade between 1981 and 1988 and especially in 1986 when the price of oil collapsed in mid year and contributed to a 28.3 per cent decline in the terms of trade. Despite a recovery in 1989 and 1990 as the build up to the 1991 Gulf War began the deterioration continued until 1993, coincident with the fall off in international prices for crude oil, iron and steel and fertilisers (ammonia, urea). The recovery commenced in 1994 with the surge in methanol prices which peaked at US$525 per tonne in March 1995 and was accompanied by improvements in the prices of the other major export commodities. The net barter terms of trade improved between 1994 and 1997 which latter year witnessed the onset of the Asian crisis. The first four years of the float were therefore characterised by adequate supplies of foreign exchange despite occasional tensions caused by lumpiness in supply. The Asian crisis however, reversed some of these gains and raised issues of an appropriate intervention policy by the monetary authorities.

As already indicated the government is not a major purchaser in the foreign exchange market. Further, even though the external debt service peaked in the 1992-1994 period (30.3 per cent) the strategy undertaken at the time was one of refinancing and lengthening of the external debt maturities. In sharp contrast to other CARICOM experiences there was also no need for the central government to purchase foreign exchange for certain basics (e.g. petroleum products) and debt service. Thus the build up in the gross official reserves between 1995 (US$352.1 million or 2 months import cover) and 1998 (US$783 million or 2.9 months import cover) also allowed for the possibility of intervention by the Central Bank. Nevertheless in the wake of the Asian crisis there was a major change in intervention strategy by the Central Bank.

Central Bank Intervention

In the period April 1993 - December 1995, Central Bank intervention in the foreign exchange market can be described as minimal. Total support for the market amounted to US$41.9 compared with sales of US$149.9 million by the commercial banks to the Central Bank. By the end of 1996 however, the position was reversed as the Central Bank had sold

US$102 million to the market in the wake of a crisis of confidence given the advent of a new political administration. The sharp reversal in the terms of trade in 1998 and 1999 impacted severely on the operations of the major foreign exchange earners in 1999 and 2000.

Average monthly purchases by commercial banks fell to a low of US$107.1 million in 1999 compared with US$131.3 million in 1998 and US$116.5 million in 1997. Along with these developments some degree of pressure began to appear and the weighted average selling rate which had depreciated by 3.8 per cent in 1996 fell further in 1997 (1 per cent). Since then the nominal rate has hovered around the US$1 = TT$6.30 mark. Average spreads which fell to a low of 0.5356 per cent in 1998 rose in 1999 (0.8618 per cent) but levelled off in 2000 (0.7929 per cent). Over this period the monetary authorities intervened heavily and sold US$551.5 million in the three years to 2000 while purchases from the commercial banks amounted to just under US$100 million. The intervention peaked in 2000 at 8.8 per cent of the market at the same time in which TT began to emerge as a financial centre for the CARICOM region.

One consequence of the liberalisation of the capital account has been the internationalization of the domestic capital market as TT begins to operate as a major regional financial centre. This development has also coincided with a surge in foreign direct investment by TT entrepreneurs in several CARICOM countries and against the background of heavy intervention by the Central Bank. Between 1998 and 2000 several regional governments including the Government of Trinidad and Tobago raised US$245 million in the local capital market with US165 million issued in 1999 alone. Capital investment in Jamaica and Barbados by TT entrepreneurs amounted to US$266 million over the same period. In contrast however corporate bond issues have been relatively small although foreign currency loans outstanding at the end of 2000 amounted to US$442.6 million compared with US$193.1 million at the end of 1996 and approximately 30 per cent of the total volume of loans.

Foreign Currency Accounts

These activities have been partly supported by the strength of the foreign currency accounts in the domestic banking system. At the end of 1993 foreign currency deposits in the banking system stood at just under US$100 million but by December 2000 had grown to around US$800 million. These deposits grew sharply between 1993 and 1997 but have since levelled off and now account for 27 per cent of total banking system deposits such that some analysts have characterised the financial system as moderately dollarised. The size distribution of deposits has remained relatively stable over the period, as 97 per cent of deposits were in accounts of US$50,000 and under and accounted for around one third of the value of the deposits. The remaining 3 per cent of deposits were held in accounts valued at over US$50,000 and represented around 65 per cent of the value of these deposits.

Monetary Policy

The relative success of exchange rate policy over the years is not independent of macroeconomic policy and monetary policy in particular. Since 1993 the focus of policy has been on the maintenance of internal and external price stability and the curtailment of excess liquidity through the use of open market operations. The change to a flexible exchange rate regime has been consistent with a move towards more market oriented policies and hence a movement away from direct instruments of monetary control (e.g. reserve ratios).

Open market operations (OMO) were introduced in 1996 and over the past four and a half (4½) years the monetary authorities have attempted to fine-tune these operations. Given the structure of the economy a cumulative fiscal injection of around $500 million per annum which derives from the net domestic budget deficit is not altogether uncommon. Difficulties have arisen since 1998 however as the process of fiscal consolidation has weakened and the fiscal injection has almost doubled. Monetary policy has been unduly overburdened in light of these developments with the amount of OMO paper outstanding peaking at $2,900 million in April 2000 given a net fiscal injection of almost $2,000 million. The position has been further exacerbated as fiscal deficits emerged in calendar 1998 (-3.2 per cent of GDP) and 1999 (-1.9 per cent of GDP). The spike in oil prices in 2000 masked the underlying fiscal deficit and if fiscal imbalances continue from 2001 and over the medium term they will pose major challenges for economic policymaking.

The emergence of fiscal disequilibrium about a decade after the reforms raises some questions about the need to revisit the reform process. Unlike the disequilibrium of the 1980's there are no accompanying pressures on the balance of payments, but instead this imbalance is characterised by:- a rise in the domestic debt stock from about $6,589.8 million (1995) to $9755.2 (2000 or 22.9 per cent of GDP), some underlying weakness in non-oil revenues and the burgeoning of transfers and subsidies. In this regard there are many challenges ahead for fiscal policy makers if the gains achieved over the last decade are not to be eroded. Some critical elements of this must include appropriate expenditure and tax reform with a special focus on transfers and subsidies. An important lesson from the current Argentine crisis shows that fiscal policy during the boom years was inappropriate and contributed in no small measure to their current position. This is an important lesson on which our CARICOM policy makers may wish to reflect.

VI. Some Lessons from the Experience of the Post Reform Period

Some economists have argued that given the nature and depth of the reforms, the growth rates in the post reform period should have been higher in TT. However unpublished research (Colthrust: 2000) at the Central Bank suggest that the TT economy is growing faster than its long-run potential and yet at the same time there are no indications that the economy is overheating. The current economic expansion is also significantly different from the 1970's boom in that it is not **directly** driven by improvements in the country's terms of trade, which was characteristic of the 1970's[6]. The data show that TT's macroeconomic performance has been stronger after the period of structural reform. There has been steady growth in a low inflation environment, the unemployment rate has fallen significantly and there have been improvements in productivity. The investment boom while concentrated in the oil and gas sectors has laid the foundation for further downstream investment over the medium term.

There are several lessons to be learnt from the experience with reform and adjustment. We have argued that the tax reform was critical to the success of the adjustment process while the liberalisation of the foreign exchange market was important to the growth phase. The observations which follow while reflective of the foreign exchange rate regime in particular are also applicable for the overall reform process. The TT experience suggests the initial conditions prevailing prior to capital account liberalisation that is stabilisation and

[6] The net barter terms of trade rose by 48.4 per cent between 1972 and 1980 and by 8.7 per cent between 1994 and 1998.

proper sequencing of structural reforms are critical success factors. Inconsistency in the reform process and a cautious approach rather than one of aggression may hinder the ultimate success of the reform. In this regard the TT authorities remained committed to the first generation reforms of the late 1980's and 1990's.

A second lesson derives from the recognition that the liberalisation of a foreign exchange market or any other market does not imply the absence of rules or regulation in the market. As Blackman (1996) has argued:

> *"A market is not a supply and demand curve. A market is an institution, a social institution and it does not exist by itself. It results from the interaction of the constraints which both the government and players put on the market .... The most highly effective market in the world - the New York Stock Exchange - is most carefully and minutely regulated." (Blackman 1996)*

A great deal of careful thought was given to the conditions under which the domestic foreign exchange market and the open trade regime would operate when the capital account of the balance of payments was liberalised. The rules of engagement were refined over time and as the need arises will be adjusted in the future as well.

Finally as the Caricom examples indicates there must be complementary macroeconomic policy especially fiscal and monetary policy which support the viability of an open trade regime. Appropriate demand management policies must be continually introduced to ensure the continued maintenance of internal as well as external price stability.

November 2002

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SELECTED ECONOMIC INDICATORS 1994 - 2000
/per cent/

Item[1]	1994	1995	1996	1997	1998	1999	2000
Changes in Real GDP (factor cost) (1985=100)	5.2	3.2	2.8	3.0	4.0	5.0	4.7
GDP at Current Market Prices (US$Mn)	5,428.0	5,372.0	5,765.0	5,784.0	6,105.0	6,760.0	7,973.0
Inflation Rate	8.8	5.3	3.3	3.7	5.6	3.4	3.6
Unemployment Rate	18.4	17.2	16.3	15.0	14.2	13.1	12.2
Fiscal Balance/GDP	-0.2	0.2	0.5	0.1	-1.9	-3.2	1.6
Primary Fiscal Balance[2]/GDP		5.1	5.1	4.8	3.1	2.4	6.4
Net Barter Terms of Trade Index (1988=100)	101.5	108.7	111.4	120.2	110.4	117.2	n.a
% change in Terms of Trade Index	9.2	7.1	2.5	7.9	-8.2	6.2	n.a
Current Account/GDP	4.4	5.0	1.2	-9.9	-10.2	0.4	6.7
Capital Account/GDP	-0.7	-0.5	0.8	14.4	10.9	3.2	3.3
Overall BOP/GDP	3.6	0.6	3.9	3.0	1.3	2.4	5.4
External Public Debt (US$M)	2,063.5	1,905.2	1,877.2	1,564.8	1,471.1	1,584.8	1,679.8
Debt Service/Exports of Goods & Services	25.2	15.0	13.4	15.4	9.9	8.0	7.9
Exchange Rate (TT$/US$)[3]	5.87	5.89	5.99	6.25	6.28	6.27	6.28
Real Effective Exchange Rate Index (Sept 1990=100)	88.01	85.98	86.37	83.41	86.31	89.09	91.49
W.T.I. (US$/barrel)[4]	17.14	18.44	22.12	20.40	14.40	19.25	30.30
Gross International Reserves (US$Mn)[5]	678.9	652.3	937.7	1,120.3	1,184.5	1,367.8	1,890.4
(in months of imports of Goods & Services)	4.9	3.7	4.7	4.1	4.4	4.8	5.5
Gross Official Reserves (US$Mn)	354.4	352.1	546.3	706.2	783.0	945.5	1,386.2
(in months of imports of Goods & Services)	2.6	2.0	2.8	2.6	2.9	3.3	4.0

NOTES
1 Changes in real GDP are based on the Central Bank's Index of Quarterly Real GDP (Factor Cost). Balance of Payments items are expressed as percentages of nominal GDP estimates (current market prices) supplied by the Central Statistical Office.
2 The primary fiscal balance is defined as the overall fiscal balance excluding all interest payments.
3 This rate represents the mid-point of the period average of the buying and selling rates of the TT/US dollar.
4 West Texas Intermediate (WTI) most closely approximates the price of Trinidad and Tobago's crude oil exports (Figures represent annual averages).
5 Import cover ratio expressed in terms of months of imports of prospective goods and services.

Annex II

Existing Gas-Based Plants

Company	Start up Year	Estimated Cost (US $M)	Product
Hydro Agri Trinidad	1959	n.a.	Ammonia
Trinidad Nitrogen (Tringen) I	1977	125.0	Ammonia
Caribbean Ispat Ltd.	1980	468.3	Direct reduced iron, steel billets & wire rods
PCS Nitrogen I (formerly Arcadian)	1981	333.3	Ammonia
PCS Nitrogen II	1984	172.5	Granular urea
Trinidad and Tobago Methanol Company (TTMC)	1984	182.8	Methanol
Tringen II	1988	350.0	Ammonia
Phoenix Park Gas Processors Ltd. (NGLs)	1991	98.8	Propane, butane, and natural gasolene
Caribbean Methanol Company	1993	200.0	Methanol
TTMC II	1996	235.0	Methanol
PCS Nitrogen III	1996	75.0	Ammonia
Petrotrin	1997	12.0	MTBE
PCS Nitrogen IV	1998	252.0	Ammonia
Farmland/Miss Chem	1998	300.0	Ammonia
Methanol IV	1998	265.0	Methanol
Cleveland Cliffs DRI	1999	115.0	Direct reduced iron, steel billets & wire rods
Ispat DRI	1999	200.0	Direct reduced iron
Atlantic LNG 1	1999	930.0	LNG
Titan Methanol	1999	261	Methanol
LNG11	2002	550.0	LNG
CNC	2002	300	ammonia
LNG 111*	2003	550	LNG
Atlas*	2003	300	methanol
N2000*	2004	315	ammonia
M5000*	2004	325	methanol

* - Indicates that this plant is currently under construction.

Dated 03/October,02