Statement by Mr. Portugal and Mr. Dhanpaul on Trinidad and Tobago
June 9, 1999

My Trinidad and Tobago authorities are in broad agreement with the comments and analysis contained in the staff report. They would like to thank the staff and management of the Fund for their usual helpful advice emanating from the recent policy discussions and for the technical assistance and continued support given to Trinidad and Tobago.

I. Recent Economic Developments

2. There is little doubt that the protracted decline in international commodity prices affected the economy in 1998, as the terms of trade deteriorated by over 8 percent. The impact was felt in both the fiscal accounts and the external balance of payments. Against this background, the growth in real GDP in 1998 of 3.2 percent was particularly gratifying, demonstrating an emerging resilience of the economy to external shocks, a welcome improvement from the effects of the oil price decline of 1986, which precipitated a severe economic recession and subsequent recourse to Fund resources. While the revenue effects in 1998 posed challenges for fiscal management, the growth in real output largely mitigated the effects of the terms of trade decline on the broader economy.

3. The diversification and additional plant capacity in the petrochemical sector was mainly responsible for the fifth consecutive year of positive economic growth although the non-energy sector continued to exhibit dynamism. In the energy sector, shortfalls in the prices of methanol, ammonia and urea were somewhat compensated by higher production levels with the coming on stream of an additional methanol plant and two new ammonia production facilities. The non-energy sector expanded by 3.6 percent in 1998, with growth evident particularly in the construction, manufacturing and tourism sub-sectors. However, the agricultural sector sustained heavy losses due to adverse weather conditions. This performance in the non-energy sector has been driven by high capital investment by both the private and public sectors, and an intensification of the effort towards positioning Trinidad and Tobago as an attractive tourist destination.

4. The expansion in economic activity continued to have a positive impact on the unemployment rate which averaged 14.2 percent in 1998, the lowest level of unemployment recorded in more than a decade. While this trend is encouraging, my authorities are nevertheless concerned with the high level of unemployment and continue to seek solutions for achieving a faster pace of employment creation. Inflation continued to be moderate although it rose from 3.8 percent at the end of 1997 to 5.6 percent at the end of 1998 mainly due to higher domestic food prices induced by the unusual weather conditions.

5. The impact on the fiscal accounts of lower commodity prices and oil in particular was demonstrated by the emergence of a fiscal deficit of 1.6 percent of GDP for 1998 compared to a small surplus of 0.1 percent of GDP in 1997. Total revenue and grants fell from 27.6 percent of GDP in 1997 to 26.9 percent of GDP in 1998 as a result of the lower than budgeted oil prices. However, the shortfall in oil tax revenue was partly compensated by the enhanced administrative capabilities of the tax authorities in other areas of tax collection, specifically PAYE and Value Added Tax. However, at the same time, total expenditure

increased almost 1 percentage point of GDP from the previous year to reach 28.5 percent of GDP. This was largely the result of the payment of wage arrears bonds as well as bringing to account of an outstanding off-budget capital obligation. The Government did not borrow from the Central Bank in 1998 although its balances which had been accumulated from previous surpluses were partly drawn, with an effect not dissimilar perhaps to borrowing from the Central Bank. The staff report has recognized the policy dilemma of the fiscal authorities in balancing the need for fiscal retrenchment in the face of declining revenue while refraining from an overly contractionary policy.

6. Monetary policy focussed on the maintenance of price and exchange rate stability as well as a sound financial system. During 1998 the authorities re-structured the reserve requirement of the banking system by extending the coverage of the statutory reserve requirements to include fundraising instruments other than deposits and by lowering the ratio of reserves from 24 to 21 percent for commercial banks. The impetus for monetary expansion stemmed mainly from fiscal operations, but as a result of the reserve requirement measures and an active program of open market operations, credit expansion to the private sector was restricted to 4½ percent, substantially lower than the 1997 expansion, while credit to the public sector contracted significantly.

7. The authorities are mindful of the cost of the high reserve requirement on the banking system and, as a prelude to embarking on a sustained program of reserve reduction, began a process of strengthening the institutional framework for trading in government securities and for open market operations. They also introduced repurchase agreements in their open market activity as a response to comparatively short-term liquidity movements. In response to the changes in monetary policy, prime lending rates increased by 250 basis points over 1997, the median rates on demand, overdraft and real estate mortgage loans rose between 125-230 basis points while the median rates for savings and time deposits rose between 29-90 basis points.

8. The overall balance of payments recorded a surplus for the fifth consecutive year in 1998, notwithstanding a current account deficit of 10 percent of GDP, the same as in 1997. Exports declined in value terms in response to falling international commodity prices, and the level of capital goods imports continued to expand to meet the demands of the energy sector projects. The deficit on the current account was more than offset by significant inflows on the capital account, as the country continued to attract substantial levels of foreign direct investment. Gross international reserves stood at US$800 million or 3.2 months of import cover while debt service as a percent of exports of goods and non-factor services declined from 15.3 percent in 1997 to 9.6 percent by end-1998. The nominal exchange rate remained relatively stable throughout 1998 at an average of TT$6.29 per US dollar.

9. In the case of structural policies, the authorities have made several significant changes aimed at ensuring the solvency of the national insurance pension system. The aim of the new pension program is to assist retired people in maintaining an adequate standard of living using an appropriate combination of social assistance and social insurance programs. Its goal is to target vital national resources towards the needy while encouraging individual and corporate retirement savings.

10. The privatization program continued in 1998 with the sale of Trinidad and Tobago Methanol Company and shares in Trinidad Cement Limited, while private sector participation has been introduced into the mail delivery system. The authorities also implemented several of the recommendations of the FAD and the US Internal Revenue Service with respect to improving tax compliance and collections.

II. Economic Prospects and Policy Considerations

11. Real GDP is projected to grow by 4½ percent in 1999 led by the startup of a liquefied natural gas plant and a methanol plant during the year. In the non-energy sector, output will probably grow at a slower pace than in previous years as activity in the construction and distribution sectors contracts in response to the completion of major projects following the peak performance over the 1996-1998 period. Inflation is expected to decline to 4.2 percent as the authorities continue their tight monetary stance.

12. In the absence of any further adverse exogenous shocks, the overall central government fiscal account is programmed to be in virtual balance in 1999. The authorities are intent on strengthening the fiscal consolidation process and have been curtailing discretionary expenditure to compensate for possible revenue shortfalls from fluctuating oil prices. The major policy objective of the consolidation process is to avoid the accumulation of arrears by channeling appropriate funding to the relevant agencies on a timely basis and to maintain a reasonable level of capital expenditure. They are also exploring several revenue raising measures including the review of the generous loss carry forward provision for corporate taxes, increasing the efficiency of VAT collection, and strengthening the administration for all small businesses to improve their tax contribution.

13. The authorities are also committed to fiscal transparency and will continue to use the annual budget to ensure that the appropriate data are placed in the public domain. All activities, including project financing facilities, are being brought under the control of the budget process in a transparent manner. The authorities recognize the impact on staffing at the senior levels of the public service of pay disparity relative to the private sector. Recommendations have been laid in the Parliament to address the imbalance.

14. The Government is cognizant of the risks of recourse to central bank financing and have put in train the legislative machinery to increase the ceiling on domestic borrowing to ensure that any fiscal deficit is financed by the market. Steps are also being taken to ensure more effective co-ordination of the activities of the non-financial public sector in the context of the government's fiscal objectives.

15. While the economy remains vulnerable to commodity prices, the structural changes in the energy sector have mitigated the impact of the fall in oil prices, traditionally the major bell-weather of domestic developments. The falling share of oil revenue is not altogether unexpected as the authorities continue to encourage diversification of downstream and gas related industries.

16. Monetary policy will be guided by the need to limit the growth of monetary aggregates to accommodate the projected growth objectives for GDP, while limiting the inflation rate to moderate levels, close to that of major trading partners. The authorities have entered into discussions with the commercial banks to ensure that there is a proper framework in which the reserve requirement can be reduced, since the readjustment of the reserve ratio will also involve the issue of securities. The authorities are of the view that reducing the reserve requirement to prudential levels is a policy measure of a long-term structural nature and its implementation will depend crucially on the development of the primary and secondary markets. To this end, they are currently in the process of strengthening market mechanisms for trading securities and for effective implementation of open market operations.

17. While monetary and financial conditions of the domestic financial system continued to be healthy, the monetary authority felt that there are lessons to be learnt from the events in Asia. The introduction of a Financial Stability Committee within the Central Bank is intended to provide early warning signals of potential threats to the domestic financial system from events in the international and domestic macro- and micro-economic environment. The authorities view the entry of two new institutions, the consolidation of existing institutions and the internationalization of domestic banking groups through expansion in the Caribbean area as healthy developments. The supervisory authority is maintaining an active monitoring program of licensed institutions in the context of Basle Core Principles and is intent on ensuring that international standards are met by domestic financial institutions.

18. In the external sector, the deficit on the current account is programmed to decline to 6½ percent of GDP in 1999 as the deterioration in the terms of trade is compensated for somewhat by the increase in export volume. The capital account surplus is programmed to reach 9.6 percent of GDP led by continued substantial foreign direct investment inflows coupled with the government's re-entry into the international commercial market. Gross international reserves are projected to reach US$991 million by end-1999, the equivalent of 3.9 months of imports, while the debt service as a percent of export of goods and nonfactor services is estimated at 10.2 percent.

19. Exchange rate stability is a major policy priority of the authorities and they agree with the staff that the current exchange rate is realistic and competitive. Additionally, they believe that there is technical merit in the staff's recommendation of a greater degree of flexibility in exchange rate management and the use of market-based instruments to deal with pressures on the rate. Given the fact that the flows into the foreign exchange market are discrete and lumpy, and bearing in mind the current competitiveness of the rate, the Central Bank is of the view that intervention may be necessary from time to time, perhaps on a more timely basis, to prevent volatility which is likely to create an unstable situation with respect to savings, investment and external flows.

20. On the structural front, the authorities will continue the privatization program. They will retain or acquire equity in the state enterprises sector only where such ownership is integral to the achievement of policy objectives for the sector in which the enterprise is located. In the case of the sugar company Caroni (1975) Limited, they are taking steps to restructure the company into a holding company with separate subsidiaries under private

management. In addition, the second phase of the pension reform program involving the introduction of a defined contribution mechanism will be implemented while work will continue on the operational restructuring of the Inland Revenue and Customs and Excise Divisions.

21. My authorities have expressed a desire to adopt a formal Staff Monitored Program (SMP), which would include a Memorandum of Economic and Financial Policies (MEFP) and monitorable targets. As has been clearly stated in the staff report, my authorities wish to emphasize that it should be made very clear that the purpose of the SMP is to provide an appropriate macroeconomic framework, and as a signal to private commercial markets, and not as an indication of economic difficulties. They have also requested that the Staff Report for the 1999 Article IV Consultation be published as part of the pilot project following today's Board meeting.