Trinidad and Tobago faces the challenges of managing an energy-based economy

The Trinidad and Tobago economy is the largest among member countries of the Caribbean Community (CARICOM), with a gross domestic product in 2000 of almost $8 billion.

Since the discovery of petroleum in the 1950s, the relative importance of agriculture has declined, while the role of the energy sector has increased markedly. This latter sector—which comprises oil, liquefied natural gas (LNG), and LNG-based industries, such as methanol and ammonia—accounted for about 40 percent of GDP at peak oil prices in 1980, but now contributes about one-fourth of total economic activity and government revenue and 80 percent of merchandise exports.

The crisis of the 1980s

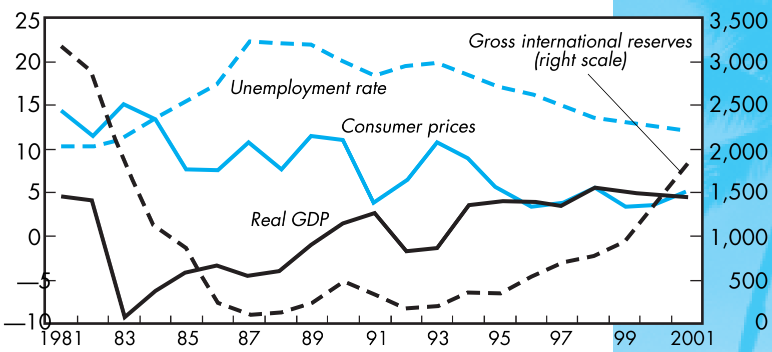
The sharp fall in oil prices in the mid-1980s triggered a recession that spanned virtually a decade. Between 1982 and 1993, real GDP declined cumulatively by more than 25 percent, while the average GDP per capita fell from $7,000 to $3,600; international reserves plummeted from $3 billion to US$200 million; and the external debt rose from 13 percent of GDP to almost 50 percent, reflecting the weakening of the public finances. In addition, unemployment rose from 10 percent to a peak of near 25 percent in the late 1980s, before falling back to 19 percent in 1993; spending on poverty alleviation and social development was cut back; and emigration of skilled labor rose sharply.

The authorities sought to tackle this crisis through a combination of financing, adjustment, and reform under programs that were supported by the IMF, the World Bank, and the Inter-American Development Bank. Adjustment measures intensified beginning in 1988 and included adjustments of public utility tariffs; cuts in public expenditure, including temporary wage cuts; and increases in interest rates. In addition, to help correct the appreciation of the currency by about two-thirds, the government implemented two devaluations in 1985 and 1988 and, in 1993, floated the exchange rate. The result was a rate of TT$5.8 per U.S. dollar by end-1993. The pace of reform accelerated in the early 1990s, with the further liberalization of the exchange and trade systems, privatization, and tax reforms—including a simplification of the income tax and the introduction of a value-added tax (VAT).

Recovery in the mid-1990s

The adjustment measures and reforms went a long way toward stabilizing the economy and increasing efficiency. A period of sustained growth—the first in about 12 years—began in 1994, reflecting a recovery in the energy sector following an easing of the tax regime and the regulations governing investments in that sector. Also, inflation slowed to 5 percent, the unemployment rate fell slightly, the finances of the public sector improved, and the international reserve position strengthened. The turnaround was maintained during the remainder of the decade. After some softness in the energy sector in 1994–97 related to a

Trinidad and Tobago: selected economic indicators



Note: Data for consumer prices and real GDP reflect annual percentage changes; those for unemployment refer to annual rates, in percent; while those for international reserves represent end-year stocks in millions of U.S. dollars.

Data: IMF *International financial statistics*; Central Bank of Trinidad and Tobago; and IMF staff estimates.

slowdown in crude oil production, real GDP growth picked up to 5 percent a year in 1998–2000, reflecting substantial new discoveries of natural gas. The most positive aspect of the turnaround has been the sustained growth of the non-energy sectors—by about 5 percent a year—reflecting a pickup in the demand for manufactured goods exports, and strong growth in construction, distribution, and services. By contrast, the agricultural sector experienced alternating periods of growth and decline related to weather conditions but, overall, has been weak because of the financial and other difficulties facing the state-owned agricultural company, CARONI.

The recovery was accompanied by a further decline in inflation to 3½ percent in 2000, reflecting a shift toward balanced budgets, effective liquidity management, a stable exchange rate, and low import prices. The current account of the balance of payments shifted from significant deficits in 1997–98 to small surpluses in 1999–2000 on account of increased energy exports, and international reserves reached $1.4 billion at the end of 2000. Unemployment declined to 12.5 percent in 2000, real GDP per capita has been rising by about 4 percent a year, and Trinidad and Tobago ranks 41 out of 160

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countries in the United Nations Human Development Index. The country has benefited from an investment grade rating for its foreign debt since 1999. Economic performance is likely to continue to be favorable in 2001, with real GDP growing by 4–5 percent, inflation falling to 2–3 percent, and international reserves reaching $1.8 billion, or four months of imports of goods and services. An easing of liquidity conditions in the financial sector allowed a reduction in banks' reserve requirements from 21 percent to 18 percent in late May 2001, and banks' lending rates have declined by about 1–1½ percentage points during the year to date.

Prospects for growth over the medium term are good. Real GDP is projected to expand by 4½–5 percent, and, on present trends, unemployment would decline to about 10–11 percent by 2005. Construction of two additional gas-processing terminals is expected to be completed by 2003, and engineering studies have begun on another terminal that would raise the country's total LNG capacity to 14 million tons a year—converting it into one of the world's top five LNG producers. Increased LNG output would provide a further stimulus to downstream activities like petrochemicals and help generate additional demand in some other sectors, including construction and manufacturing. Prospects for the services sectors—such as telecommunications and distribution—also appear favorable, and, in recent years, the country has become one of the Caribbean region's main financial centers and an important source of capital. In agriculture, however, short-term prospects are not encouraging, as sugar-producing operations remain unprofitable and efforts to restructure CARONI and diversify its activities are still in the initial phases.

Trinidad and Tobago: basic indicators

Area (sq. km)	5,130
GDP at market prices (million U.S. dollars, 2000)	7,800
Population (2000)	
Total (million)	1.4
Rate of growth (percent a year)	0.6
GDP per capita (U.S. dollars)	5,800
Rate of growth of GDP per capita (average: 1997–2001)	4.1
Population characteristics	
Life expectancy at birth (years)	73
Physicians per thousand	3.2
Infant mortality (per 1,000 live births)	12
Access to electricity	92
Access to safe water	96
Primary enrollment rate	88
Human Development Index	41

Sources: World Bank; United Nations Development Program; and IMF staff estimates.

Policy framework and challenges ahead

While an important part of Trinidad and Tobago's recent performance can be attributed to favorable prices for oil and gas, a sound economic policy has also played a key role. This has included

- prudent fiscal policies;
- steps to save part of the windfall tax revenues from the energy sector in a revenue stabilization fund—about two-thirds of the windfall was set aside in fiscal year 1999/2000, and by the end of the current fiscal year, resources in the fund are expected to reach the equivalent of 2 percent of GDP;
- effective liquidity management by the central bank through open market operations;
- exchange rate stability—the exchange rate has been stable at about TT$6.3 per U.S. dollar since 1997, without adversely affecting competitiveness; and
- progress in structural reforms—particularly privatization, the regulatory framework for public utilities and the financial system, and the further development of money, capital, and foreign exchange markets.

The key challenge facing Trinidad and Tobago is how to strengthen the policy framework to ensure continued growth, including in jobs, and social progress. Clearly, macroeconomic stability will be essential, and the key factor in ensuring this stability will be a sound fiscal position. The government has begun to address the weak control and accountability over procurement and spending in some public enterprises, which have led to the recent increase in transfers to these bodies and to the growth in the public debt from 54 percent of GDP in 1986 to about 60 percent in 2000. It will also be important to contain the increase in the government wage bill and improve tax yields—especially on the VAT and in the energy sector. A strengthened fiscal performance would enable the government to increase spending on health, education and skills training, public safety, and poverty reduction without increasing the debt, and also help reduce pressures on interest rates.

It would also be important to ensure that macroeconomic stability is complemented by additional reforms to create a favorable environment for business, characterized, in part, by efficient basic services and a simple, rules-based regulatory framework. In such an environment, the speeding up of the government's privatization program could be expected, over time, to help generate a wide range of opportunities for new investment and job creation. Similar opportunities are likely to result from the further expansion by Trinidad and Tobago businesses into new markets, including in CARICOM, Latin America, and the proposed Free Trade Area of the Americas (FTAA). ■

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