Government of the Republic of Trinidad and Tobago

2016 MID YEAR BUDGET REVIEW

Presented by the Honourable Colm Imbert, Minister of Finance

MID-YEAR FISCAL REVIEW

APRIL 8, 2016

MINISTRY OF FINANCE
Finance Building, Eric Williams Financial Complex, Independence Square, Port of Spain, Trinidad and Tobago W.I.

Madame Speaker,

In the context of the proposed variation of appropriations for fiscal 2016, I rise in this Honourable House to present the budgetary framework for these measures, by way of the mid-year review of Budget 2016. It is to be noted that the 2016 Budget was presented on October 5, 2015, less than one month after the new Government was sworn in, and at the time, we made it clear that it was based on the limited information available to the new Government upon assuming office.

The purpose of this presentation is two-fold.

Firstly, to present a review of economic developments in the first half of the fiscal year 2016, and to identify the policy changes required to meet our medium term economic objectives; and secondly, to present for the approval of Parliament, certain variations to the Appropriation Act 2016. The variations to the appropriations are by and large as a result of portfolio changes and adjustments to Ministries, but they involve expenditure, which must be supported by revenue. It is incumbent on me therefore to give details of the fiscal outturn for the first half of fiscal 2016 and the projections to the end of the financial year, as well the proposed budgetary measures to generate the necessary revenue. If I did not do so, the proposed variations would be left hanging in a policy vacuum.

Several of the policy changes and fiscal measures that are proposed will require amendments to a number of pieces of legislation which will be identified in due course. Some of these legislative changes will take effect immediately, while others will take effect upon the passage of the Finance Bill No.2 of 2016, which I propose to introduce and debate in this House in the first week of May 2016, i.e. within the next month.

Madam Speaker, when this Government presented the 2016 budget in October 2015, we had no illusions that we were in a difficult economic situation caused by radical changes in global energy markets, which led to a collapse of oil prices in 2015, and a consequent drastic reduction in revenues from petroleum. This difficult revenue situation was compounded by five years of mismanagement of our finances. In October 2015, we fully recognized the risks for fiscal planning, given the uncertain prospects for oil and gas prices and the unclear position with respect to extent of liabilities incurred by the previous administration. We thus made what were considered by the experts at the time to be conservative price and revenue assumptions, with the proviso that these assumptions were to be revisited at the time of the mid-term review, in April 2016.

We are at now at the stage of the mid-term review and it is no secret that the economic environment has turned out to be significantly worse than envisaged at the time of the 2016 Budget presentation. Before I begin, allow me to debunk the mischief that is being peddled in the public domain by certain propagandists and armchair theorists that this mid-year review has come too late. By definition, the middle of the Government's financial year is March 31st. It is therefore impossible to do a proper mid-year review until the month of April. Any review done before that would be inaccurate, questionable and irresponsible, and we have thus come to the Parliament in 2016, one week after the end of the mid-year period. By any standards, this is a record, since mid-year reviews in Trinidad and Tobago have been routinely done in May and even in June. I trust this puts to rest the old talk that has been propagated in the public domain.

On the flip side, while I appreciate the calls for a deferral of the review to sometime year later in the year, to allow widespread public discussion on the most appropriate fiscal measures, it is just not practical or feasible to do so. We do not have the luxury of time. We therefore ask the various interest groups to bear with us, as the economic situation is very serious and corrective action must be taken immediately, lest we find ourselves in such dire straits that we would have no choice but to request the IMF for balance of payments support, with all of the attendant adverse conditionalities that come with that scenario. Indeed, we must avoid an IMF programme at all costs and must therefore be proactive and chart our own economic course without being forced into structural adjustment.

The reality is that the current severely depressed oil and gas prices have had a significant adverse impact on the public finances, notwithstanding the Government's considerable efforts at fiscal consolidation, careful debt management and prudent expenditure restraint.

In order to understand where we are, it is necessary to look at our macroeconomic situation. Based on data available from the CSO in September 2015, it was assumed that there would be virtually no economic growth in 2015, i.e. a flat economy, and there would be a decline of approximately 1.4% of GDP in 2016. While there are still no official estimates of GDP from the CSO for 2015, because of the dysfunctional condition that that organization was left in by our predecessors, it is clear that the actual economic performance in fiscal 2015 was much worse than originally anticipated. Rather than zero growth, real GDP in 2015 is now estimated by the Central Bank to have declined by 2%. In fact, the latest data from the Central bank has indicated that there was a decline in economic growth in all four quarters of 2015, starting from January 2015.

And for 2016, because of the inordinately long slump in oil prices, it is now estimated that there will be a further decline of 2% of GDP.

Madam Speaker, this Honourable House will recall that the 2016 budget was based on an oil price of US$45 per barrel for WTI crude, a level that was considered fairly conservative even by international experts, since at the time the WTI price was averaging US$46 per barrel, with a projection that it would average $53 per barrel in 2016. The gas price assumed in the Budget was US$2.75 per mmbtu, Henry Hub, at a time when the market price was US$2.66 per mmbtu.

As it turned out, due to the hardline position taken by OPEC, where Saudi Arabia and other OPEC countries, in their ongoing battle for market share with shale oil and gas producers in the USA, chose not to cut production in the face of a global oversupply of oil. Accordingly, notwithstanding the predictions of international energy experts, such as the highly respected USEIA, the average oil price for the first six months of fiscal 2016 was US$37 per barrel while the average gas price was US$ 2.00 per mmbtu. By way of comparison, Madam Speaker, in the previous fiscal year 2014/2015, the corresponding oil and gas prices were $61 per barrel for WTI and $3.35 per mmbtu for Henry Hub, respectively.

It is also worth noting that because we are a mature hydrocarbon province with declining rates of production. This aggravated by the fact that it is becoming increasing difficult to produce petroleum at the current depressed prices. As a result, both oil and gas production in the first six months of this year were lower than envisaged in the Budget.

It is no secret, Madam Speaker that commodity producers all over the world are experiencing very trying times. Energy and energy-related companies have been slashing investment budgets, laying off workers and several international companies have gone out of business. Unfortunately, Trinidad and Tobago is not immune to these difficult conditions. With oil prices at unprecedented low levels, exploration budgets have been trimmed and there have been layoffs in the energy sector. Some of the smaller operators are now on the brink of going under, which has had spillover effects throughout the economy,

Madam Speaker, if anyone in Trinidad and Tobago doubted that we are in a new paradigm in terms of national income and expenditure, those doubts should have been erased by now. Indeed, the change in the global economic environment, particularly for oil-based economies, has caused what is referred to in the literature as a “sea change”, or profound transformation, in Trinidad and Tobago’s modern economic history.

It must therefore be understood, Madam Speaker, by all concerned, that the dramatic collapse of energy prices is tantamount to a sharp and sudden drop in Trinidad and Tobago’s national wealth. All persons with a stake in the future of this country need to understand and appreciate that we are no longer as wealthy as we were before and we simply cannot afford to continue with the fiscal indiscipline that occurred over the last 5 years. We must of necessity now exercise restraint and financial discipline.

In March 2016, Madame Speaker, we were subject to the annual Article 4 Consultation by the International Monetary Fund. For those who may wondering why such consultations occur, and may even incorrectly attribute a sinister motivation to them, it is necessary to appreciate that when a country joins the IMF, it agrees to subject its economic and financial policies to the scrutiny of the international community. The IMF's regular monitoring of economies and associated provision of policy advice is intended to identify weaknesses that are causing or could lead to financial or economic instability. This process is known as country surveillance. It is an ongoing process that culminates in regular (usually annual) comprehensive consultations with individual member countries, with discussions in between as needed. The consultations are known as "Article IV consultations" because they are required by Article IV of the IMF's Articles of Agreement.

During an Article IV consultation, an IMF team of economists visits a country to assess economic and financial developments and discuss the country's economic and financial policies with government and central bank officials. IMF staff missions also often meet with parliamentarians and representatives of business, labour unions, and civil society.

The team reports its findings to IMF management and then presents them for discussion to the Executive Board, which represents all of the IMF's member countries in the world. A summary of the Board's views is subsequently transmitted to the country's government and published for the information of the general public. In this way, the views of the global community and the lessons of international experience are brought to bear on national policies. These consultations are vital to maintain a country’s reputation and creditworthiness in the international financial community.

Trinidad and Tobago joined the IMF in September 1963. We have therefore been subject to routine Article 4 consultations for over 50 years. There is thus nothing untoward about this relationship with the IMF, as some on the other side would wish to pretend.

Madame Speaker, you should note that the previous Article 4 consultation should have taken place one year ago in March 2015. However, the previous Government, obviously afraid of the effect of a negative IMF report on the outcome of the 2015 election, chose to avoid a visit by the IMF to Trinidad and Tobago in 2015. In similar fashion, the previous Government postponed a scheduled review by Standard and Poor's Financial Services, an international credit rating agency that this country subscribes to, as well as a review by Moody's Investment Services, another international credit rating agency that we subscribe to. Clearly, they were afraid of what these international agencies might find.

We on the other hand have no such fears. Where others may wish to duck, run and hide, we believe in transparency and full disclosure. We believe in levelling with the population.

I can therefore confirm that not only did we complete this year's regular Article 4 consultation with the IMF during last month, March 2016, but we also facilitated visits by Standard and Poor's and Moody's in the same month of March, and just last week, we accommodated a visit by CariCris, the Caribbean's regional credit rating agency. In the first 6 months of this Government, therefore, we have accommodated all of the required visits by all of the international rating agencies.

We look forward to the final reports from these international agencies in due course and we shall take careful note of their findings and recommendations as we chart the way forward for Trinidad and Tobago.

It is noteworthy that at the end of their visit, the IMF Team issued a press release, as is their practice, and made the following important statement:

"Despite the great challenges posed by the need to adjust to energy prices, Trinidad and Tobago still has enormous strengths, including a well-educated work force and a stable political system. With substantial financial buffers and low, albeit rising levels of public debt, Trinidad and Tobago is not in a crisis. ***Nonetheless, in recent years, taking into account the size of energy revenue windfalls, the country has under-saved and under-invested in its future****. As a consequence, the imbalances that are now starting to build up could lead the country to uncomfortable levels of debt and external financial cushions absent further action."*

In other words, although we are not in a crisis, if we are to survive the present economic difficulties, we need to recognize and quickly adapt to the new reality. We must also avoid the mistakes made in the last 5 years (i.e. underinvesting and undersaving).

It should also be noted that in its March 17 press release, the IMF recognised that the new PNM Government had already taken some difficult but necessary steps in the face of sharply lower energy revenues, including widening the tax base, cutting fuel subsidies, reducing the number of Ministries with a view to streamlining the civil service, and instituting spending cuts.

The Fiscal Outturn (October 2015 - February 2016).

I now come to the fiscal outturn. As a result of significant cutbacks in expenditure, the net fiscal outturn in the first half of the year is on the face of it a little better than anticipated. However, policy changes are critically needed in order to strike a better balance between adjustment and the promotion of economic growth, so that we can spend the money proposed in this variation of appropriation.

This Government is also intent on ensuring that the required adjustment is done in an equitable manner. This Government is absolutely committed to minimizing hardship on the poor and lower income groups even as we maintain and improve incentives for increased investment and production by the business community over the medium term.

Madam Speaker, in the first five months of the fiscal year revenue collection was **$2.96 Billion lower than expected**. However, on the positive side, government expenditure was **$7.75 Billion lower than programmed in the Budget.** It is to be noted that the 2016 Budget had initially assumed early payment of high cost items, such as arrears of salary (i.e. backpay), and was thus front-loaded. However, the very tight cash flow and the heavily overdrawn exchequer account that we were faced with upon assumption of office did not permit these payments to be made in the first half of fiscal 2016.

As a result of the deferral of payments of backpay and other arrears, such as debts owed to suppliers and contractors, which were incurred in the run-up to the September 2015 election, the fiscal accounts show that the budget deficit for the period was $2.91

Billion as compared to a programmed deficit up to March 2016 of $7.70 Billion. Members should note that although the fiscal deficit fluctuates throughout the year, consistent with monthly fluctuations in revenue, the final end of year deficit for 2016 was originally programmed at just under $3 billion.

Madam Speaker, the revenue shortfall was primarily in tax receipts from the energy companies, reflecting a sharp decline in projected income from oil and gas companies in the first 6 months of this fiscal year of over $2 billion. And this was even after the revenue projections from petroleum were cut drastically in preparing the 2016 Budget. There was also a further shortfall of $1 Billion in other corporation tax receipts from then non-oil sector, due to the slowdown in economic activity, among other revenue shortfalls.

To counteract this shortfall in revenue, the cutbacks in expenditure were informed and influenced by two main factors namely (1) the Government's decision in December 2015 that all ministries and departments would be required to reduce operational expenditure by 7 per cent; and (2) the acute cash flow problems faced by the Central Government. We have thus had no choice but to drastically cut programmed expenditure, otherwise we would be faced with a situation where the Central Bank would have to cease honouring Government cheques. For fiscal 2016, therefore, we are now looking at revised expenditure of $59 Billion.

You would recall, Madam Speaker, that in my 2016 Budget presentation I pointed to the unprecedented recourse by the previous administration to the Central Bank overdraft and their excessive short term borrowing. By way of reminder, just a few days before the September 2015 election, the former Cabinet approved a short-term loan (a 6 month financing facility) of $1.6 Billion for TTEC, which matured in February 2016.

Can you imagine being faced with a requirement to repay in full a $1.6 Billion short term loan with oil prices below US$30 per barrel, the Government overdraft maxed out to the limit, and the Exchequer account overdrawn by over $30 billion, less than 6 months after assuming office?

This was a thoughtless move on the part of the former administration and we had to move quickly to convert this imprudent billion-dollar short term loan into a proper long term arrangement, to ease the burden on the Treasury. And this is just one of many such irresponsible short-term loans.

These two factors sharply reduced available liquidity in the financial system, which also acted as a brake on Government spending. At the same time, we were close to the limits in Government borrowings and thus could not finalize a number of loan arrangements entered by the previous administration for Government projects, simply because we did not have the lawful authority to conclude these financing arrangements. These included billion-dollar loans for hospitals, infrastructure, housing, military vessels, security equipment and so on.

Madam Speaker, to give the country breathing space, to honour contractual obligations, and to facilitate our development programme, we came to Parliament and obtained approval for increases in Government borrowing ceilings, something the previous Administration was afraid to do. However, with the financial system strapped for liquidity there is not much room for new Government bond issues, unless adjustments are made to the reserve requirements in the Central Bank or alternatively, the Central Bank improves liquidity through open market operations. We are therefore working closely with the Central Bank to facilitate this, since we must raise funding on the domestic market to finance the budget deficit.

As stated before, these funding constraints led to an unprogrammed accumulation of arrears, mostly to public officers, to suppliers and contractors and on VAT refunds.

Fiscal Operations April-September 2016 (looking forward)

Revenue

To be safe, fiscal operations during the second half of the fiscal year will now be based on an oil price of **US$35 per barrel** and a gas price of **$2.00 per mmbtu**. This would imply another sizable shortfall in energy tax receipts, compared with the budget projections.

Collections of domestic taxes (including VAT) are still lagging behind budget projections due in large part to the economic slowdown, the depressed energy sector, and compliance issues. The Government therefore intends in the second half of this year to launch an aggressive effort to collect all tax arrears and to enforce compliance, and in particular, in respect of VAT and gaming taxes.

Madam Speaker, it will take some time before the full impact of the value added tax reform and the enhanced tax administration efforts are fully realized. For this reason we will continue to have recourse to one-off capital revenues in the form of extra-ordinary dividends from some state enterprises and divestment proceeds.

For example the interest earned by the Central Bank on the large Government overdraft will give rise to an increase in profit transfers from the Central Bank in this year of about $500 million, since after deducting its expenses for the year, the Central Bank pays all of its surplus income back to the Government. In addition, having already received US$300 million (TT$1.9 billion) from TGU, we expect to collect a further US$255 million (TT$1.7 billion) from TGU in the second half of this fiscal year. The sale of some Clico assets, including MIHL, will add another $3 Billion in revenue.

Regarding Clico, it is necessary to briefly explain what has happened with that difficult and contentious issue, so that the public will understand our approach to asset sales and recovery of the money spent on the Clico bailout.

From the information available to me at this time, the Government has spent in excess of $20 billion bailing out and supporting Clico. This was done to avoid a systemic collapse of the Trinidad and Tobago economy since Clico was so large and affected so many people and so many economic interests and factors that if it had been allowed to collapse, it would have had a severe adverse effect on the country, which we might not have recovered from.

From 2009, the plan always was to consolidate, strengthen and sell or liquidate Clico's assets to repay the Government for the money that it put into Clico, since it is taxpayers'funds that were used to repay depositors and creditors.

For reasons best known to itself, the last Government dragged its feet with this matter. The original plan was to resolve all issues and repay the Government for money owed no later than 2012. However, by September 2015, when we came in, all that had occurred in the 2010 to 2015 period was, as result of an irresponsible breach of a shareholders' agreement, a contentious arbitration and an order to the previous Government to sell Clico's methanol shares at a price considered by many to be $2 billion below market, thus losing billions of dollars of asset value in the process. In the interim, various Clico policyholders and depositors had taken the PP Government to Court for what they considered to be a breach of trust and a breach of contract.

The remaining assets sales were left hanging in the air and we found the Clico resolution plan in limbo, with no apparent purpose or direction, consumed by internal power plays, inertia, dithering, apathy and stagnation.

As the new Minister of Finance, I have restored order and business common sense to this process, and we are now back on track in terms of recovering the $20 billion plus of public funds that has been pumped into Clico.

Accordingly, I have requested the Central Bank, with whom I now meet regularly, to dispose, strictly in accordance with the shareholders' agreement, of the remaining MIHL shares owned by Clico, at the valuation price, which is in the vicinity of $2 billion, as well as Clico's traditional portfolio of insurance policies and other associated assets, valued at approximately $1 billion.

We expect these asset sales to be completed during this fiscal year, since, as Max Senhouse used to say, "we need the money".

We have also requested the Central Bank to transfer to the Government, Clico's shares in Angostura, Home Construction and CL World Brands, valued at $3 billion more or less, and after this transfer, we will take appropriate decisions to dispose of these assets in a sensible and productive manner. With particular reference to lands owned by Angostura and/or Home Construction, it is the Government's intention to acquire these assets for public purposes such as housing, tourism and infrastructure development.

It is also expected that since Clico's Statutory Fund has recovered, that all legitimate creditors and policyholders of Clico that still remain on the books will be repaid in full by the Central Bank during this year, 2016.

With regard to the other assets held by Clico, such as its shares in Republic Bank, we have requested the Central Bank to start the required preparatory work to allow the orderly disposal of these shares in 2017.

Members should note that these proposals only relate to Clico and in due course, I will report on our plans to monetise the other assets held directly by CL Financial, all in the interest of recovering as much of taxpayers'' funds as is possible and settling liabilities to policyholders and depositors

Returning to our overall revenue situation, we must now find ways and means of creating new revenue streams. To bolster the revenue picture and support ongoing efforts to conserve foreign exchange, the Government intends to introduce the following measures, among others viz:

i) A levy of 7% on online purchases of goods and services through the Internet from retail companies resident overseas, that are not subject to taxation in Trinidad and Tobago, such as for example, Dell, Walmart, Staples and Amazon. This is not a new concept and there is well established precedent for a tax of this nature in countries such as the USA, UK and New Zealand. Online purchases are now a significant area of foreign exchange demand, which is putting a strain on our reserves, since credit card transactions are settled almost immediately. This tax is intended to help manage the increase in foreign exchange outflows from online purchases, reduce revenue leakage and assist local manufacturers and service companies to compete with overseas retailers. This measure is scheduled to take effect by September 2016 and it will require discussions with the banks and credit card companies to make it work;

ii) An increase of 50% in customs duty and motor vehicle tax on luxury vehicles, starting with private motor vehicles with an engine size exceeding 1999cc. This measure will take effect immediately;

iii) Better collections of taxes due from the Gaming and Gambling Industry under existing legislation

iv) Increased taxes on alcohol and tobacco products. This measure will take effect in May 2016 after the passage of the Finance Bill No. 2

However, with all these measures, including the new taxes and improvements in tax administration, total revenue receipts will not by themselves achieve the original Budget estimate, nor allow all of the planned expenditure, such as the full amounts of expenditure contemplated by these variations of appropriation. The revised estimate for current revenue in fiscal 2016 is now $52.68 billion as compared to $60.28 billion in the original Budget estimates, a shortfall of $7.6 billion. The major shortfalls in revenue include taxes from oil companies, at an estimated $2.4 billion, other companies at $1 billion and VAT at $3 billion, due in no small measure to the downturn in the energy sector

Expenditure

While we will continue to cut out waste and reduce the cost to Government of goods and services, which spiralled out of control over the last 5 years, and keep tight controls on spending, Government expenditures in the second half of the year will need to provide for:-

1) allocations to address the payment of salary arrears to public officers, and contractors. **In this regard, I wish to confirm that it is the Government's intention to pay 50% of the outstanding arrears of salary to public officers by the end of June 2016. The remaining 50% will either be paid in interest-bearing Government Bonds by the end of September 2016, or in two further instalments in cash in 2017, at the option of the workers.**

2) an increase in capital expenditure to set the platform for future growth.

Madam Speaker, for years the fuel subsidy has drained public resources. I think that it is safe to say that finally there is an emerging view that the country can no longer afford this level of expenditure, given the sharp reduction in oil and gas revenues.

We thus need to engage a national dialogue on this issue as a matter of priority.

It is not widely known that the fuel subsidy has cost Trinidad and Tobago **$31 billion** over the last 10 years and as oil prices trended upwards in the 2009 to 2014 period, the subsidy averaged over $3.5 billion per year and exceeded 2% of GDP. It is also not widely understood that for years, we have imported expensive oil, processed it in our refinery and then sold petroleum products to the public at a loss. At one stage when the price of oil exceeded $100 per barrel, the fuel subsidy cost in excess of $6 billion per year.

A number of studies have also demonstrated that fuel subsidies disproportionately benefit the rich, rather than the poor. In fact, based on consumption patterns, the average benefit of the fuel subsidy to low households is less than $1,000 per month, whereas the benefit to upper income households exceeds $2,000 per month.

Fuel subsidies also contribute to traffic congestion, pollution, damage to roads, environmental damage and revenue leakage. Further, in terms of total cost to taxpayers, Trinidad and Tobago has been determined to be among the top 12 fuel subsidizers in the world, which has even resulted in smuggling and illegal resale of diesel fuel to foreign pirates, among other undesirable side effects.

Even after the adjustment in domestic fuel prices in November 2015, the current cost of the fuel subsidy, including arrears, remains at close to $600 million, at current oil prices. If oil prices rise to $45, which is not an unreasonable assumption, the subsidy will exceed $850 million for 2016 and at an oil price of $50, the fuel subsidy will exceed $1 billion.

The Government has thus decided to initiate the process of phasing out the fuel subsidy over time. However, in so doing, the savings that are achieved will be targeted towards improving our social safety net and introducing measures aimed at reducing costs for low income groups.

Further, since diesel is used primarily for public transportation, which absorbs a larger part of the income of the lower income groups, in the interest of equity, a gradual approach will be taken towards the phasing out of the diesel subsidy, and, before completely eliminating the subsidy on diesel the Government will explore all possible options for minimizing the adverse impact on lower income groups. One such measure will be a reduction in taxes on maxi taxis and taxis, thus reducing the cost of public transport vehicles. We plan to introduce these tax reductions in May 2016.

Premium gasoline is already unsubsidized, while at an oil price of $45, the unsubsidized price of super gasoline would be in the vicinity of $3.61 per litre. The unsubsidized price of diesel fuel, which is the fuel most commonly used by maxi taxis and goods vehicles is $3.13 per litre at an oil price of $45 per barrel, rising to $3.45 a litre at an oil price of $50 per barrel.

Accordingly, Madam Speaker, to kickstart the process of national dialogue on this matter, the following prices will take immediate effect:

- the price of super gasoline will be increased by 15% to $3.58 per litre; and
- the price of diesel will be similarly increased by 15% to $2.00 per litre.

This will mean that super gasoline will no longer be subsidized at current oil prices, whereas diesel will continue to be subsidized at this time by approximately $1 per litre.

Further, it is the Government's intention to introduce a new fuel pricing regime in this year 2016, that will result in price adjustments for fuel, up or down, based on changes in the price of oil and petroleum products, as obtains in most countries. We await the comments of the national community on this proposal.

On the flip side, Madam Speaker, as part of our energy policy and to help protect the environment, the Government will remove all taxes on CNG, electric and hybrid cars with engine sizes up to a maximum of 1999cc. The Government will also begin the process of converting all government vehicles as well as the fast ferries and water taxis to CNG and/or alternative power sources.

I had mentioned, Madam Speaker, the Government's intention to increase capital expenditure during the second half of this fiscal year. We have been working over the last 6 months and we now ready to go with a number of major development projects, including major public housing initiatives and road improvement projects, among other projects, such as schools, community and sporting facilities, which my colleagues will address in more detail during this debate.

However, I wish at this stage to advise this House and the national population of the Government's decision with regard to the proposed mass transit project. As we indicated during the 2015 election campaign, it was our intention upon assuming office to immediately request technical assistance from the Inter-American Development Bank to review the cost and feasibility of this project. We have done so, and it has been determined by the experts at the IDB that the proposed mass transit project is expensive and not feasible at this time in the present environment of severely depressed oil and gas prices. If oil were still $100 per barrel, it would be a different story, but with oil at $37 per barrel, we simply cannot as a country afford to proceed with this project at this time.

Accordingly, we are shifting focus towards improving our road infrastructure in order to ease traffic congestion and to assist the travelling public, we will also put more public transportation vehicles on the road, thus facilitating public transport at subsidized prices. Some of the road improvement projects that we have identified for immediate implementation include the following:

- the Wallerfield to Manzanilla Highway, which includes a ring road round Sangre Grande
- the Curepe Interchange
- the Valencia to Toco Freeway
- upgrade of the Moruga Road
- completion of the Pt Fortin Highway
- the San Fernando to Princes Town Highway

Most of these projects have the advantage that they have already been designed and are ready for the immediate invitation of tenders, while others are in an advanced stage of preparation. Indeed, projects such as the Wallerfield to Manzanilla Highway and the Princes Town Highway have been ready for construction since as far back as 2010.

And as we proceed into 2017, it is our intention to construct interchanges at all major intersections along the Churchill Roosevelt Highway all the way to Piarco in the first instance, as this is one of the country's most heavily trafficked roads, as well as a number of other improvements to heavily trafficked areas in and around Chaguanas, Diego Martin and Tobago, among other areas.

Madam Speaker, as a result of the severe shortfall in revenue, the Government's intention is to contain total expenditure in 2016 to $59 billion, i.e. $4 billion less than in the original Budget. As a result, the fiscal deficit for 2016 is now expected to be about $6.7 billion or about 4% of GDP, which we will finance through borrowings and an appropriate drawdown from, if necessary.

However, I must emphasise that current revenue in fiscal 2016 is only expected to be of the order of $44 billion, whereas expenditure will be of the order of $59 billion. **Even with expenditure cuts and new revenue raising measures, therefore, we are still facing a gap between current revenue and expenditure in 2016 of $15 billion.**

In 2016, we will to close this $15 billion gap with borrowings and one off items of extraordinary income, such as proceeds from the sale of Clico assets, repayment of past lending to TGU, dividends from NGC, drawdowns from the HSF, the proceeds of the Phoenix Park IPO, and so on. Again, in 2017, to conserve jobs and maintain economic momentum, we will have to resort to further borrowings and further asset sales, including the remaining Clico assets, such as the shares in Republic Bank, further drawdowns from the HSF, etc, since we anticipate another large gap between income and expenditure in 2017.

By 2018, however, we must put our house in order. By this time, the gap between current revenue and total expenditure, including capital expenditure, must not exceed $10 billion. All things being equal, therefore, if our revenue position does not improve significantly over the next two years, we will have to cut expenditure by 2018 to $55 billion. To use the old idiom, we must cut our cloth to suit our measure, or as we say in Trini – "we must adjust to suit"

We cannot continue to spend more than we earn and we cannot continue to borrow and use our assets and savings to balance our budget. By 2018, therefore, we must be well on the way to achieving a balance between current income and

current expenditure, one way or another, with reliance on borrowings only for capital expenditure.

And with specific reference to the Heritage and Stabilisation Fund, it must be emphasized that the purpose of this Fund is to offset serious shortfalls in revenue in periods of depressed petroleum prices. It is not, as some believe, a trophy to be kept on a shelf, and never to be touched. In fact the legislation that established the Heritage Fund caters for drawdowns when the revenues from petroleum are lower than projected by a factor of 10%, whereas at this time, we are facing a 75% reduction in the revenues from petroleum in fiscal 2016.

We are therefore way beyond the legal threshold for drawdowns from the Heritage Fund and in order to maintain economic momentum and ensure that we preserve jobs, as our first priority, we intend to use the Fund, if need be, for the purpose that it was intended, as have the vast majority of oil producing countries in the world. Saudi Arabia for example, has withdrawn over US$100 billion in the last 18 months from its Sovereign Fund, the equivalent of our Heritage Fund, to make up shortfalls in revenue, to protect jobs and to maintain its social programmes.

Financing

Madam Speaker, as stated previously fiscal management this year has been further complicated by a significant increase in short-term borrowing by state enterprises and autonomous agencies. These short term loans, contracted to replace budgeted central government transfers, were used to circumvent the Government's financing challenges. As a result of these short maturities, debt servicing ballooned in fiscal 2016. As a responsible manager, the new Government is in the process of converting these short term loans into longer term financing arrangements as part of a more comprehensive **debt management strategy, i.e. a prudent sensible approach to borrowing, already recognized by the IMF and other agencies.**

Madam Speaker, to stimulate growth, the Government also intends to make a concerted effort to activate the domestic capital market. This is part of an integrated strategy to reduce reliance on the Central Bank overdraft for budget financing. The Central Bank and the Ministry of Finance are now working out a schedule of quarterly auctions to raise budgetary financing. The idea is to allow institutional lenders to better plan their resource allocation strategies and to minimize the occurrence of Central Government cash flow problems.

A Medium Term Fiscal Strategy

The dramatic weakening of oil and gas prices during the first half of the year has prompted a reconsideration of the government's original target of achieving fiscal balance by 2018. Instead spreading the fiscal adjustment to 2019-2020 would seem to be a more realistic target.

This fiscal objective is predicated on the assumption that i) GDP growth will begin to recover in 2017, based on an expected rise in gas production, ii) a pick-up in public investment; and iii) an increase in private sector activity as consumer and business confidence strengthens and the private sector takes advantage of the fiscal incentives that we intend to develop and introduce to stimulate investment in manufacturing, construction and services. The medium term fiscal scenario also assumes a modest recovery in oil and gas prices which are projected to reach US$55 by 2018.

Madam Speaker, the comprehensive tax reform programme that this Government has started will gain momentum over the next twelve to eighteen months. Our plans envisage reform of both the energy and non-energy tax regimes.

Madam Speaker, reform of our energy tax regime has become critical in the new global energy environment. In 2014, given the prognosis for oil and gas production and the emerging demand for gas, the then Government took the decision to amend the oil and gas fiscal regime to allow oil companies to write off their capital investment in one calendar year. These incentives have done what they were intended to do, i.e. stimulate investment in the energy sector, but they have come at a serious cost to the exchequer. With the dramatic slump in oil and gas prices, and with expenditure already committed or undertaken, the new accelerated capital expenditure write off incentive, which took effect in 2014, now means that some **the major oil and gas companies may pay little or no corporation income taxes in fiscal 2016.**

With oil and gas prices expected to stabilize significantly below the levels of the recent past, it is important that we accelerate discussions with the energy companies on a suitable fiscal regime that works for all parties, by continuing to provide sufficient incentives for investment and exploration while recognizing the Government's need for adequate revenues from the country's vital natural resources.

Madam Speaker, we intend to review this regime further, to encourage production in marginal fields and areas of so-called "stranded gas", to encourage drilling and increased production of oil and gas in general and to review the penalty imposed by the supplemental petroleum tax on oil prices moderately higher than US$50 per barrel. Further, with the reactivated Energy subcommittee of Cabinet, which now meets on a regular basis, decision-making on matters of oil and gas will now be much quicker and far more purposeful and focused than previously. This is especially important since in the short term, after we get over the current slump, and while we pursue alternative streams of income, the energy sector will continue to be a major source of revenue. **The Cabinet has now adopted the position that every barrel of oil and every cubic foot of gas matters and we will do whatever we can to accelerate and maximize income generating activity in our energy sector**.

It is thus our hope that the discussions with the energy companies will be successfully completed by September 2016 and most importantly, that we can also reach agreement with the upstream companies in 2016 on new natural gas supply contracts, since we recognize that the present uncertainty is a serious disincentive to investment in exploration and production.

For several years high oil prices masked the weaknesses in our tax non-energy tax regime. The structural decline in oil and gas prices has brought these weaknesses into sharp focus. Perhaps the most pressing need is for an immediate and significant improvement in tax administration.

In most countries the value added tax is a major source of government revenue because of its simplicity, it is broad-based and it is relatively easy to administer. In 2014, the former administration in its misguided populist approach to governance very unwisely sought to use the VAT as an instrument of social policy by zero-rating over 7,000 food items. This ill-advised move damaged the VAT revenue base. Our Administration has taken the more conventional and sensible route by returning the zero-rated list to only basic food items and by instead providing more targeted relief through an increase in the personal income tax allowance and increases in pension and security benefits. In our view, we must not as country succumb to the temptation to tamper with major revenue streams by sacrificing fiscal prudence and discipline practical business common sense on the altar of political expediency.

Even after this reform of tax policy it is clear that the present administration of the value added tax system is seriously compromising the potential yield, The IMF had estimated that in 2006 we were collecting less than 40 per cent of the VAT due. There is an urgent need to increase the collection ratio.

There is also extremely poor administration of the betting and gaming taxes. For example, only three of an estimated 250 private members clubs have made the required statutory deposit and the tax on gaming machines is seldom enforced. **And this is under existing law**. Available evidence indicates that while the number of gaming machines has increased exponentially, tax collections have not increased and gaming houses are avoiding paying existing taxes.

The Government thus intends to launch a concerted effort to increase tax administration. We clearly need to strengthen the Board of Inland Revenue (BIR) and the BIR clearly needs to reform its systems – to be more agile, more proactive. The BIR needs to go out and collect the nation's taxes; it needs to deliver tax assessments more expeditiously since the uncertainties created by long delays in addressing tax issues affects investment decisions. The BIR also needs to pay refunds more promptly as the delay in tax refunds, especially VAT refunds, has the potential to stifle growth and suppress business activity. **We are thus seriously considering reducing the statutory period for an acceptable delay in VAT refunds from 6 months to 3 months.** We also need to strengthen tax auditing systems and we have already begun the process to recruit field auditors to support the administration of the value-added, gaming and other taxes.

We also plan to examine current legislation to see whether the level of penalties provide sufficient incentives for increased tax compliance.

Madam Speaker, preparations are well in train for the introduction of a comprehensive property tax in FY 2017. As indicated in the budget speech, we will shortly bring legislation to the Parliament to allow the Government to collect the amount payable under the old Land and Buildings Taxes for 2009. Madam Speaker, the Government is fully aware that the land and property valuation rolls are incomplete; and that it is quite possible that up to 40 per cent of properties in Trinidad and Tobago have not yet been assessed. However a team is currently in the field doing assessments and we expect that 100 per cent of the assessments will be completed in 2017, so that the property tax can be fully implemented next year

Expenditure restraint will also play an important part in the fiscal adjustment effort. Given the urgent need to increase infrastructure investment, the Government plans to focus on rationalizing social programmes, improving the effectiveness of existing "short-term" employment programmes and constraining the growth of transfers and subsidies.

Let me re-affirm, Madam Speaker that this Government remains absolutely committed to protect the disadvantaged and the most vulnerable in our society. We are also fully aware that the difficult economic environment and increasing unemployment will increase the hardships faced by some sections of the society. We plan to review all our social programmes, in consultation with civil society, with a view to reducing overlap and ensuring that they are well targeted.

Madam Speaker, CEPEP and URP have turned out to be very expensive inefficient programmes. These programmes have grown from a combined cost of just over $400 million in 2004/2005 to $1.3 billion in 2015, an increase of over 200%. While they provide employment there is no doubt that the output generated cannot justify this level of expenditure. Moreover, Madam Speaker there is ample evidence to suggest that these programmes have distorted the labour market in that some people prefer to remain in these relatively low-productivity programmes rather than take up more demanding but higher paid jobs in the private sector.

Madam Speaker, CEPEP in particular was never intended to be a permanent program. Rather, in its original concept, **CEPEP** was to be a business incubator providing government assistance for 3-4 years, after which the CEPEP contractor was expected to operate in the private sector without government support. We intend to return the program to its original moorings. Starting in FY2017, therefore, the Government's direct financial support for contractors in CEPEP will be reduced over time, to encourage CEPEP contractors to become entrepreneurs

The **URP** which consumed over $600 million in dubious expenditure last year**,** will also be restructured shifting its focus from maintenance activities of questionable value to substantive community construction projects and other infrastructure projects with clearly defined outputs. In rural areas, the focus of the URP will be on agricultural production. We must insist that we get value for money and production in URP, otherwise this will continue to be an area of wastage and leakage.

Madam Speaker the Government has already established a High-level Committee to examine the reform of **the GATE programme.** GATE now consumes over $600 million per year, and now that we have achieved a significant increase in the tertiary education participation rate (from 11 per cent in 2001 to an estimated 55 per cent in 2015) it is time for the programme to conserve expenditure and make a paradigm shift towards a better alignment with the country's development needs, coupled with the introduction of some form of means testing. The GATE Committee is expected to report by July, with changes going into effect the next academic year.

Diversification

Madam Speaker, This Government recognizes, as indeed every commentator has advised, that diversification is absolutely critical to ensure long term economic growth and sustainability. Earlier PNM administrations achieved record -breaking success in diversifying our energy sector but it may be argued that as a country, we have paid inadequate attention to diversifying the economy. We are committed to do that now.

But, Madam Speaker, economic diversification is a long difficult process. You can't diversify overnight. You need to set the preconditions for economic diversification and these include: macro-economic stability; the right incentive system; modern infrastructure and a socio-economic environment that is attractive to domestic and foreign investment. We are making steady progress in most of these areas and we are working tirelessly to seriously address crime and corruption and the other remaining obstacles to private investment.

Madam Speaker, in my October budget presentation I mentioned that our diversification strategy would center around international financial services, tourism and some related maritime activities. We have now begun discussions with some foreign investors on a set of integrated projects comprising an expanded international financial centre, a five star hotel and a convention centre, located in Invaders Bay, coupled with a new commercial Port, Maritime and Shipbuilding Complex, Industrial Park and Free Zone Development to be located south of the Beetham. The landfill activities now associated with the Port of Spain dump will thus be relocated to make way for these new industrial developments, giving a lift to a depressed area of the City. In tandem, we will aggressively promote recycling, incineration of waste and waste-to-energy projects.

The International Financial Centre could include one or more Chinese banks as anchor tenants, dedicated to servicing China's considerable lending programmes in Latin America and the Caribbean. The presence of these Chinese institutions should also serve as a strong attraction for other international banks to the International Financial Centre. The existing TTIFC will continue to focus on back office operations, business processes, outsourcing and capital market activity.

The manufacturing sector is also targeted to play a major role in the diversification effort. Local manufacturers have indicated that uncertainties about foreign exchange availability and low labour productivity are major setbacks to manufacturing investment. Accordingly the Government will soon start negotiations for a US dollar credit line, to be channelled through the TT Exim Bank to provide raw material funding for export manufacturing. We also intend to introduce incentives to investment in the manufacturing sector along similar lines to the energy sector, such as accelerated depreciation. Moreover, you are aware, Madam Speaker, The Government recently established a National Tripartite Advisory Council one of whose objectives is the development of a national campaign on productivity and proper work ethic.

Several programmes are currently being implemented to expand agricultural production. In order to promote linkages with the manufacturing sector, it is our intention to give tax holidays and other incentives to agricultural processing industries.

To incentivize the private sector, the present tax concessions for the construction of multi-storey car parks and commercial buildings will be extended to 2025, because we recognize that private investors need time to plan. These concessions currently involve tax holidays on income from property rentals and property sales. However, we recognize that it can take up to 7 years to complete a major building project, from conceptualization to completion of construction and commissioning of the facilities, hence the reason to extend the concessions to the year 2025. To stimulate private housing construction, we also intend to include in the tax concessions, the construction of multi-family residential buildings.

We are also considering Government grants and other fiscal incentives to motivate the private sector to get involved in urban renewal and rural development in designated areas.

These measures will take effect in May 2016 with the passage of the Finance Bill No. 2.

The Foreign Exchange Regime

Madam Speaker, the Government working in collaboration with the Central Bank, is committed to strengthening confidence in the foreign exchange regime

Madam Speaker, the dramatic fall in our energy receipts has created a severe imbalance in the supply and demand for foreign exchange. While over the last 6-12 months, our net foreign reserves have remained stable at approximately US$9.5

billion, equivalent to over 11 months of import cover, other factors such as the sharp increase in bank credit, particularly for automobiles, undoubtedly some capital flight due to the economic uncertainties and the widespread availability of credit cards for online shopping, have added to the pressures in the foreign exchange market.

In response to these pressures, the Central Bank has sought to stabilize the market by intervening at regular intervals and by allowing the exchange rate to adjust. It should be noted that we are far ahead of other countries in the Caribbean in terms of our foreign reserves and foreign exchange buffers. Some countries have a mere 3 month's import cover, as compared to our 11 months of import cover.

Madam Speaker, I wish to give the national population the assurance that we do not intend to allow our currency to become unstable and the Government will intervene as and when necessary to defend and stabilize our exchange rate. Other oil producing countries or provinces have suffered rapid and dramatic currency devaluations in the last 12 months as a result of the collapse of oil prices. In some oil based economies, including wealthy Middle East oil producing countries, currency devaluations of up to 30% have occurred almost overnight. Closer to home, the Venezuelan Bolivar was allowed to depreciate by 70% in one day in February 2016, just two months ago

This has not happened here. Instead, over the last 6 months, the rate of exchange of the Trinidad and Tobago dollar to the US dollar has depreciated by only 3.7 %, from $6.37 to 1 USD in September 2015 to $6.61 TT dollars to 1 USD in April 2016

And, contrary to popular belief, this has not happened by chance. This adjustment or resetting of the exchange rate has been carefully managed by the Central Bank, based on a pragmatic approach to supply and demand for foreign currency and wider macroeconomic factors.

It is not widely known, although the data is readily available on the Central Bank's website, that the amount of foreign exchange that has been available in the commercial banking sector in Trinidad and Tobago has increased significantly over the last 5 years, from US$5.5 billion in 2010 to US$7.4 billion in 2015. Further, while conversions of foreign exchange by the private sector have decreased, the Central Bank has been injecting more and more foreign exchange into the system.

In 2015, for example, the Central Bank injected US$2.6 billion into the system, compared to US$1.5 billion in 2010. And so, while the general perception is that there is a dire shortage of foreign exchange, the reality is that more and more foreign exchange has been made available over the last 5 years.

When one drills deeper and sees that our nominal GDP in 2015 at market prices, or current prices, is the same as it was in 2012, i.e. $165 billion, the reasons for the shortage of foreign exchange become more elusive. In fact, it is counter intuitive for the demand for foreign exchange to be increasing so dramatically when our nominal GDP is the same now as it was three years ago.

The logical conclusion, therefore, is that uncertainty about our exchange rate is fuelling demand and giving rise to speculation and some degree of hoarding. What we need instead is a level of certainty and confidence so that persons who are holding foreign exchange in overseas accounts feel comfortable enough to repatriate their foreign exchange.

It is my intention therefore to put an end to the current speculation. Over the last 6 months, our exchange rate has moved 3.7%, from 6.37 TT dollars to 1 US dollar to 6.61 TT dollars to 1 US dollar. As Minister of Finance, I am of the view, after consideration of all relevant factors and after seeking the advice of experts, both here in Trinidad and overseas, that our exchange rate should not fluctuate at this time by more than 7% from the rate of exchange that prevailed in September 2015. Appropriate measures will therefore be taken to ensure that our exchange rate does not move by more than a further 3.3% from today's rate.

We will thus utilize a combination of fiscal and monetary policies to manage foreign exchange demand and supply, allowing the exchange rate to adjust in response to demand, prudently utilizing our foreign reserves and considerable foreign exchange buffers to make adequate supplies of foreign exchange available, while at the same time staying within the 7% range of the exchange rate prevailing in September 2015.

It is also my intention, as Minister of Finance, to continue discussions with the commercial banks, with a view to arriving at some form of consensus on guidelines for the distribution of foreign exchange that will see priority being given to trade, inputs into manufacturing, medical expenses, tuition fees and the like, as well as greater availability of foreign exchange for small and medium sized businesses.

To sum it up Madame Speaker, while we are in difficult times, and our economy has been dealt a heavy blow, this Government has a plan for economic recovery, a workable plan. It involves spreading the burden of adjustment across the society and getting use to the fact that as the Economists like to say, that we are in an era of a “new normal”, where we can no longer depend on oil to save us and we must now turn to the non-oil sector, to manufacturing, to commerce and to trade in services to maintain our standard of living, protect jobs and achieve our national development objectives. Most importantly, we must now cut our cloth to suit our measure. We can longer operate, as the locals say, with Champagne taste and Mauby pocket.

The Government stands ready to work with all social partners to achieve this paradigm shift. But I have confidence in the resilience and creativity of our people, and I am certain that we can do this, if we all strive to work together.

Finally, allow me to explain the reasons for the variations of appropriation that are before us today and to explain the underlying principles behind these transfers of expenditure (go to the Report of the Finance Committee).

I beg to move.