

HERITAGE AND STABILISATION FUND FORUM

Speech by the

THE HONOURABLE MINISTER OF FINANCE

September 06, 2011 at the Central Bank

This forum could not be timelier as it comes at a critical juncture- both in terms of where the world financial challenges lie and also in terms of Trinidad and Tobago's response. Over the last few months we have seen a return of an old vocabulary. This is not just in terms of world recovery but more so the fragility of the world economy since the 2008/2009 financial crisis. We have been reintroduced to words such as volatility, uncertainty, posterity and contagion. These are the words I recollect were in the domain of public conversation when this fund was first established in 2000 and the subsequent enactment in 2007. These words are also located however, in the structured risks that economies like ours had to face at that time and continue to face even today. These structured risks are very much linked to our fiscal sustainability on one hand and our pattern of expenditure on the other. There is no doubt that we continue to face those structured risks and that has been somewhat reflected by those structures in the economic balance sheets of Trinidad and Tobago.

Oil and gas remains dominant both in terms of revenue and exports for Trinidad and Tobago. On the last occasion that we were faced with these challenges- during the oil boom years of the 1970s- what emerged in Trinidad and Tobago was a pattern of expenditure based on a projected revenue stream that obviously could not be sustained. That led to major challenges in terms of economic adjustment and in terms of financial rearrangement. It is out of that history of structured risk facing the economy a conversation took place - as I said in the context of the vocabulary that is on today's tv screens- as to how we should respond as a nation and on what basis that response should be built.

So it was in 2002 (*and I must say that in 2002 I worked very closely with the present Governor of the Central Bank who was with the International Monetary Fund at that time and I was the Governor*) that we eventually got the agreement to establish the Heritage and Stabilisation Fund and immediately we planned to look at ways and means to achieve two goals.

1. One is to provide a sense of comfort in terms of providing a buffer from the economy's finances for the future and
2. Secondly to be able to encourage savings that will bring to the fore the issue of savings from the country's exhaustible assets of oil and gas for future generations.

Those were our concerns hence the name; stabilisation and heritage. In putting the new institution in place, we acknowledged that we were charting a new role in Trinidad and Tobago and we may perhaps want to review the institution at an appropriate time. The time for such a review has come when the

world economy and the Trinidad and Tobago trajectory for the future must now be charted. I would like to compliment the Central Bank and the World Bank's Treasury Department for making this forum possible. The World Bank Treasury Department has played a significant partnering role in the fund and I appreciate their continued support in trying to ensure that this particular institution is operationally sound. In what we are faced with today, there will be disruptive effects on our pattern of expenditure in this era of posterity and to that extent the fund is an important measurement of the soundness of our financial system.

The Heritage and Stabilisation Fund is one of the major pillars of confidence in our financial future. This must remain. And perhaps we must work the rest of the journey to give it much more than a 'buffering' role but one that will indeed give us the "stabilisation" funds we require as we look to the future of our public finances. The emphasis of course is on savings – a key issue in establishing the basis for growth. There has always been the debate between fiscal responsibility on one hand and the stimulus for growth on the next. And even today as I look at the events taking place in Europe and the United States, I see this debate in the international scene. Fiscal responsibility- by which I mean establishing the right balance between revenue and expenditure and removing the risk of unsustainable fiscal deficits- sometimes is viewed as a hindrance in the stimulation of an economy. I do not share the view that this is necessarily so. To be contrary, I believe it is that sense of fiscal responsibility that sets the conditions for live stimulus for growth.

The missing link in the equation has to do with the quality of the projects that are to be funded through fiscal deficits and such projects should be biased towards the creation of investment, the creation of jobs and the creation of security in the context of our economy. It is therefore a challenge to alter the pattern of expenditure to create both the objectives of fiscal responsibility and create the stimulus for growth. We cannot do one without the other. But for the commentators who believe that we should in fact spend more by creating higher fiscal deficits – they should caution their remarks and suggest in what way we should spend more. I have no doubt that Trinidad and Tobago has to continue to walk the tightrope of fiscal responsibility. It is therefore in that context, that the issues before us in not just about public expenditure but it is also about the depletion of our resources and the value added that such depletion will create.

So we cannot openly discuss the HSF in the narrow confines of fiscal revenue and expenditure and buffers for the future. It has to deal with the peculiar requirements of Trinidad and Tobago in which the issue of wealth management emerges and therefore this exercise is also a study in operations of wealth management in Trinidad and Tobago. Wealth Management - not only in the context of depletion of non-renewable resources but also - in the context of inter-generational transfers which must become a hallmark in long-term sustainability.

The Heritage and Stabilisation Act looked at these challenges and was very careful in identifying the appropriate formula that would bring the right equilibrium between fiscal responsibility and the stimulus for growth. The legislation at this time requires that 60% of the excess tax revenue from oil and gas be transferred to the HSF annually. The oil and gas prices to be used for the budget estimate take into account the recent price history as well as projected (future) prices. In Trinidad and Tobago we

have found that this is always a challenge for us and now with the increased role of the gas sector – it is also another economic risk that we face. We must ensure that withdrawals from the fund be done at a prescribed formula. We have hesitated as a nation to withdraw from the fund as we need to get the fund to a level where it can be a real buffer. My recollection is that the fund has grown with the formula that has been put into place- significantly but not sufficiently. Correct me if I'm wrong but I believe the fund represents something like 18% of GDP. When we look at that in the context of other funds that have been established –particularly in Norway and New Zealand- this is a small figure but for us it is a large undertaking. And therefore the challenge is to continue to build on the fund to give us the future financial security in the Trinidad and Tobago balance sheet. It should be noted that we also ensure that the returns on the fund is acceptable in terms of profitability at the same time...

For me, the answer is rather simple because we cannot operate on a cash basis but we must provide the resource for the future security in the financial system. We must establish the right management approaches in dealing with the fund to ensure that the returns within an acceptable level of risk can be maximized. The Fund has weathered volatile financial markets in its relatively short existence, some way say better than some of our larger and older peers. In 2008 when there was the global financial crisis, Norway's Permanent Fund lost in excess of 23 per cent (US\$53.2 billion) of its value while New Zealand Superannuation Fund lost 22 per cent (US\$5 billion). Over the same period, the HSF generated, some may consider a meager return of 3.62 per cent. This was a period where Funds were happy to see the return of their capital rather than return on their portfolios.

There has been an average annual return of 5.9% over the past five years. It speaks to an acceptable risk profile. The Heritage and Stabilization Fund for T&T has certainly weathered the storm very credibly. As we begin to rebuild the fund we can do so now against the backdrop of having successfully travelled that road since 2002 and legislatively since 2007. Clearly there is more at stake when we look to the future than what we presently see. Three months ago when I attended the meetings of the IMF and the World Bank in Washington (Spring Meetings) there was a sense of optimism in the world economy. Two months later however, it is now felt that we are in an era of posterity. To be able to predict these changes have become a major challenge for professionals. In this period we may need to relook the tools of forecasting. As we continue to build this fund we bear in mind that public policy requires that we show a high level of effective management that still gains a return on the fund.

Fiscal deficits as I said have been a part of our recent history in Trinidad and Tobago and as Minister of Finance I had to face up to that issue. We recognize that it is necessary to put back therefore, we will be looking at ways and means to reduce the possible risk in the future of sustaining high fiscal deficits. In the short term it will become necessary to continue in that light so as to ensure that the stimulus for growth is

- reflected in jobs,
- reflected in incomes,
- reflected in investment and
- reflected in security

It is in that context therefore that I believe we have walked a very difficult road in placing Trinidad and Tobago in a position where our fiscal equation remains a creditable one. I have made this point on a previous occasion but I feel that I should do so once more.... Our financial institutions should rely less on receiving the revenue via government and rely more on generating incomes based on business loans. This is a challenge on innovation and enterprise that must now become part of the arsenal of values ascribed to the business and banking sector. That is why I welcome the opportunity for the banking sector and the insurance sector to partner with this government in solving what could be a financial catastrophe and the derailment of our financial system- and to here I refer to the Clico situation. We have come a long way and we are hoping to see the final resolution of that situation but I urge the banking sector to join in partnership with the Government's efforts in this regard.

This Forum has the important task of reviewing the performance of the HSF over the past four years to review best practices in the governance of sovereign wealth funds and address the issues to which I have made reference to today. In so doing we are fortunate to have on our agenda the presentation of the Santiago principles by the International Forum of Sovereign Wealth Funds. We will therefore embrace the ideas relevant to T&T and review our situation as it stands today. Clearly our ultimate objective is to identify responses to our challenges- a different forum to what you get at the universities. At universities you have the freedom to diagnose without prescription but here you need to make sure you can prescribe and make it happen.

So the vocabulary has turned from where it once was.... where the risk remains fundamentally structured in our case. We will ensure that we find the right equilibrium between today's demands and tomorrow's requirements. I would like to congratulate the Central Bank and the World Bank Treasury Department for ensuring that this takes place. There will be interested parties from other parts of the Caribbean who are looking forward to the deliberations of this forum as they too begin to look at how this matter will be dealt with in their own jurisdictions. So there are many who will be looking at the outcome of this forum as the first step as we begin to consolidate the gains of the past to protect us in the future.

Thank you all.