Government of the Republic of Trinidad and Tobago

MINISTRY OF FINANCE

CAF Seminar "Envisioning long-term sustainability in Trinidad and Tobago: productivity, innovation and resilience"

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Keynote Address

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"Restructuring a Commodity Dependent Economy

for Growth Without External Intervention"

- The Honourable Rohan Sinanan, Minister of Works and Transport
- The Honourable Kelvin Charles, Chief Secretary of the Tobago House of Assembly
- Assemblyman Joel Jack, Secretary of Finance and the Economy
- Other Government Ministers
- Mr. Alvin Hilaire, Governor of the Central Bank of Trinidad and Tobago
- Mr. Antonio Silveira, Vice President of Infrastructure of CAF – Development Bank of Latin America
- Permanent Secretaries
- Distinguished speakers
- Members of the Media
- Distinguished Guests

For the last 45 years, Trinidad and Tobago's economy has moved up and down, in sync with commodity prices, particularly oil, gas and petrochemical prices.

The oil crisis of 1973 is particularly relevant. In that year, members of the Organization of Arab Petroleum Exporting Countries declared an oil embargo, aimed at countries perceived as supporting Israel during the Yom Kippur War. This caused a 400% increase in the price of oil and in less than 6 months, international oil prices moved from US$3 per barrel to US$12 per barrel, with even higher prices in the USA. This was the first global oil shock and it caused Trinidad and Tobago's GDP to double in just 3 years, from US$1.3 billion in 1973 to US$2.6 billion in 1976.

The second oil shock occurred in 1979 in the aftermath of the Iranian Revolution, and by 1981, the price of oil virtually doubled and hit a high of US$39 a barrel. Our economy followed suit, with Trinidad and Tobago's GDP increasing to US$8 billion by 1982.

Then came the collapse in 1985. By 1986, the price of oil had dropped to US$10 a barrel and our GDP declined to US$4.3 billion. It took us 14 long and difficult years to get back up to US$8 billion after that.

In 2003, oil prices began to rebound, hitting a high of US$127 a barrel in 2008. With the coming onstream of the Atlantic LNG Plant in the early 2000s, our economy also shifted from an oil-based economy to a gas-based economy, with natural gas prices also reaching a high of US$13 per MMBtu in 2008. By this time, our GDP had increased to over US$27 billion in 2008, over 6 times what it was in 1986.

And I am pleased to report that in 2019, despite another collapse of oil prices from US$100 a barrel in 2014 to US$26 a barrel in 2016, coupled with a collapse of natural gas prices from over US$5 per MMBtu in 2014 to less than US$3 in 2019, and a reduction of 90% between 2014 and 2016 in our annual Government revenue from petroleum, or a loss of US$3 billion, equivalent to one third of annual national revenue, our GDP is still healthy at $24.4 billion in 2019, with a per capita GDP of over US$18,750.

But as you can see, we, as a country, have always been subject to the vagaries of international commodity prices.

In the previous energy price collapse in the late 1980s, the then Trinidad and Tobago government chose to engage with the International Monetary Fund (IMF) in two standby arrangements totalling US$184 million. At the time, they must have felt they had no choice. However, the drastic decline in the price of oil, coupled with an international environment crippled by stagflation took its toll on our small island state. The one-size-fits-all austerity plan proposed by the IMF at the time, and implemented by the then government led to the collapse and downsizing of numerous companies, with industries like the automotive, construction, retail and manufacturing industries suffering tremendously.

That economic contraction, which saw our GDP decline by **40%** in just 4 years, was swift and severe with significant job losses, a high rate of defaults on loans and mortgages and double-digit unemployment. Stabilization policies by the international agencies also demanded the dismantling of our social safety net and welfare programmes with a view towards lowering Government expenditure. The Cost of Living Allowance was unilaterally removed from public servants, a negative list was instituted for imports, and the dreaded devaluation occurred, with the unification of the then dual exchange rate of TT$3.60 to US$1.00 in 1987, and a further devaluation of TT$4.25 to US$1.00 in *1988*.

The adverse effects of the IMF’s structural adjustment programme created the necessity for a wide-ranging programme of economic and financial reform in Trinidad and Tobago. For the most part, monetary policy was conducted within the framework of a stabilization programme, whose main focus was on restricting domestic demand and restoring external balance. However, the decline in government expenditure and in real wages, created considerable social and economic pressure especially among the most vulnerable income groups in the society. This period of economic austerity also had a profound impact on the fortunes of some non-bank financial institutions and the Central Bank suspended the operations of three such institutions which ran into financial difficulties.

Our then Central Bank Governor William Demas and his team provided a steadying hand to economic management during these difficult years in which the Central Bank implemented a number of tough measures that were geared towards economic stabilization and returning the economy towards a sustainable growth path. By 1991, the economy began to respond to the stabilization measures and to show signs of a recovery. For the next 10 years, from 1991 to 2001, there was slow growth, followed by a tripling of our GDP between 2001 and 2008 as both our energy and non-energy sectors took off, as commodity prices skyrocketed.

Fast forward to September 2015, when the present Government assumed office. Oil prices were again dropping like a stone, gas production was on the decline and gas prices were depressed, sending our economy into turmoil.

Over the years, several missions from the International Monetary Fund (IMF) had conducted their own in-depth review of our economy in their annual Article IV Consultation Reports.

We reviewed those Reports and met with major stakeholder groups upon assuming office, who provided us with their own assessment of the economy as well as their own solutions. We also benefited from the findings of an IMF Technical Team, who came at our request, just after the 2015 Election.

Many of the proposals from the various interest groups, organisations and experts had a common theme, and included:

- Implementing a property tax system;
- Expanding the tax base;
- Increasing tax collection
- Increasing excise taxes, i.e. “sin taxes” on alcohol and tobacco;
- Increasing personal income tax;
- Increasing corporation tax;
- Eliminating fuel subsidies;
- Reducing or eliminating other subsidies and transfers;
- Introducing wage and hiring restraint mechanisms
- Reducing the size of the public sector
- Reducing Government expenditure to match income to the point of achieving a budget surplus

Does any of this sound familiar?

Indeed, 25 years after we got ourselves out of an IMF Programme, we were advised to embrace the same old sterile measures from 1990, focused on contraction without due consideration of the short- and long-term adverse effects on our citizens.

However, blind adherence to this severe model of structural adjustment at the expense of our human capital was not a road that we wished to travel again. While understanding the lessons of the past, we focused on our future, and carefully reviewed all of these proposals. Some, but not all of them, were found to be appropriate, fair and equitable, and were included in our first fiscal consolidation packages in 2016 and 2017.

However, our economy was in an even more perilous state than we, the new Administration, had initially envisaged. Although our economy was basically flat over the 2010-2015 period, with just a 2% overall increase in real GDP over that period, the previous Government had grown Government expenditure to unsustainable levels, from TT$46 billion in 2010, or just over US$7 billion to TT$63 billion in 2014, or US$10 billion, an increase of 37%.

Even before the 2015 Elections, we had reason to believe that our economy had deteriorated significantly. Indeed, several independent commentators, including the international credit rating agencies were of a similar view. When we were able to establish the reality, we had to balance the need to ensure that the economy had sufficient stimulus for recovery, with the need for reducing expenditure and restoring discipline in a medium-term fiscal framework. This was particularly difficult in the context of depressed commodity prices.

But we chose not to return to the IMF for financial assistance. We had had enough of that. We chose a different path.

We immediately embarked on reducing Government expenditure to what we felt were manageable levels, from TT$63 billion, to TT$52 billion in the first year, and eventually down to $50 billion by 2018. It may sound facetious, but we were able to do this by cutting out waste, mismanagement and inflated costs, also known as corruption.

We also chose NOT to reduce the size of the public service and to pay public sector salaries on time, despite being faced with a huge backpay bill of almost TT$6 billion, caused by wage increases granted by the previous Government in the election year. We did increase some taxes, notably taxes on wealthy corporations, such as banks, and taxes on imported motor cars, and we increased the royalty rate on oil and natural gas, a measure I will discuss later on.

We also decided that it was time to reduce the fuel subsidy, which had reached as high as US$1 billion per year, a sum that we could no longer afford as a country, and we thus increased the prices of gasoline at the pump in line with international prices. However, we chose to maintain a significant subsidy on diesel fuel, in order to keep the cost of public transportation and the transport of goods at affordable levels.

Consistent with our fiscal and monetary policy, and against advice from the IMF and local pundits, we also resisted the temptation to drastically devalue the Trinidad and Tobago dollar. We also maintained interest rates at reasonable levels.

The purpose of these policies was to suppress inflation and keep the cost of living down at manageable levels, so that the burden of adjustment on our citizens, would not be too severe. Our policies have resulted in an annual inflation rate of just 1% in 2019, down from 6% in 2015. We have also managed to maintain 8 months of import cover in terms of our foreign reserves, despite injecting US$8 billion in foreign exchange into the commercial banking sector over the last 4 years, in order to defend our exchange rate.

We also took a long and hard look at those state enterprises that were bleeding the Treasury, in particular our national oil company and our national airline.

We found our national oil company to be losing on average US$300 million a year and our national airline having lost a total of US$500 million over a 5-year period. We thus set about to address these chronic money losers, lest they crippled our economy.

In November 2018, we restructured our national oil company, shutting down our national oil refinery, which was the main source of billion-dollar losses over the years, and creating a number of lean, focused and efficient subsidiaries to deal with oil production and fuel trading. I am pleased to report that the restructured operations have taken our national oil company from an annual loss of US$300 million to a profit before tax of US$100 million a year! In just one year. And while doing this, we were also able to successfully refinance, without a sovereign guarantee, a US$850 million bond taken out by the company 12 years ago, that became due for payment in August of 2019.

With respect to our national airline, we changed the management and re-engineered the business processes at the company for optimum efficiency, moving the company, in just 3 years, from losing on average US$100 million a year, into profitability, with net income projected at US$20 million in 2019.

These are just some examples of the fiscal measures we took, to increase revenue and reduce expenditure; but, we did it our way. If we had sought international assistance from the lender of last resort, there is little doubt that we would have been forced to cut expenditure to the point that there would have been mass retrenchment in the public sector; the cost of electricity and water would have increased significantly; free education, which the Trinidad and Tobago Government pays for up to the tertiary level, and free health care, would have disappeared; and our social safety net would have been severely damaged. We would also have been forced to devalue our currency, in order to achieve the 6% budget surplus that appears to be the fate of those countries forced into standby arrangements with the IMF.

Allow me now to speak about the structure of our economy. Governments of commodity-based economies are always urged to “diversify” their economies in order to be able to better manage price shocks. But that is easier said than done. It is not easy to diversify an economy that for over 45 years has derived a substantial part of its income from oil, gas and gas-based industries. No disrespect to the advocates of diversification, but buzzwords like the Blue Economy, the Green Economy and the Silver Economy sound nice, but these transformations cannot be achieved overnight.

Notwithstanding this fact, the economy of Trinidad and Tobago is in fact changing. In 2019, the mining sector and the petroleum and chemical products sector, which are essentially the core areas of our energy sector, make up just 28% of our economy. The other 72% is made up of non-oil manufacturing and a range of non-oil services, which has helped us to weather the storm created by the collapse of oil prices in 2014.

However, 11 years ago in 2008, the petroleum sector made up 50% of our economy. So, there has been a significant shift away over the years from absolute dependence on oil and gas, but it is still our engine of growth.

Recognising this, in Washington, back in 2016, we asked the IMF to provide us with technical assistance with respect to the reform of our oil and gas fiscal regime. They obliged, at no cost to Trinidad and Tobago, and advised us that oil and gas fiscal regimes should always seek to incorporate a balance among objectives.

Accordingly, while Governments should seek to promote investment by reducing the fiscal burden on energy sector projects of low profitability, they should also seek to assure the public that extraction of the country's natural resources always results in some minimum payment, such as an appropriate royalty.

In addition, where a petroleum project generates a significant surplus over the initial outlay and the cost of production and continuing investment, the Government, and by extension the population, should share substantially in that surplus. This underscores the justification for a supplemental petroleum tax, when oil prices are high.

Fortuitously, while in Opposition in the 2010-2015 period, I had decided to go back to school and just before the 2015 Election, I completed a master's degree in Oil and Gas Law at the Aberdeen Business School. My dissertation, by happy coincidence, involved an examination of an appropriate fiscal regime for an energy dependant economy in a period of low oil prices. In my studies, I had looked at a number of oil producing countries, in particular Russia, and I had taken note of the fact that over the years, as oil prices fluctuated, Russia had insisted on maintaining a royalty regime, or volume-based tax, for its oil and gas sector, as opposed to a profits-based tax. It had done so in order to ensure that whatever the price of oil and gas, it would always earn income from its hydrocarbon reserves.

By contrast, in Trinidad and Tobago, because the focus was on a profits-based tax, the new Government in 2015 was faced with the prospect of earning no revenue from the energy sector at all for up to 9 years. One major oil company actually told us that they would pay no petroleum profits tax until 2024!

So, when the IMF Technical Team recommended in 2016 that we review our oil and gas royalty regime, it was consistent with what I knew to be correct, and in short order we introduced a wide ranging royalty of 12.5% on all oil and gas production in Trinidad and Tobago that is the subject of Exploration and Production Licenses.

In addition, we set about arresting the decline in oil and gas production, utilising an Empowered Team of Government Ministers and Energy Sector experts, to negotiate more equitable terms and conditions for the production of oil and gas by the major upstream energy companies and to create the conditions for enhanced oil and gas production and a greater share of energy sector revenue for the country. Our very own honourable Prime Minister himself led some of these negotiations in the various energy capitals of the world.

The net result of these initiatives is a doubling of our energy sector revenues between 2016 and 2019, from TT$7 billion in 2016 to TT$14 billion in 2019, the stabilisation of oil production and a 20% increase in natural gas production over the last 3 years, coupled with an increase in our gas reserves

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We are also now on the threshold of sustainable growth for the future as we move towards our objective of a balanced national budget in the medium term. In 2019, because of our fiscal discipline and our revenue generating measures, we have been able to narrow our fiscal deficit to just over 2% of GDP, a far cry from the difficulties we faced in 2016. We have also stabilised our debt to GDP ratio at 62% for the last two years.

Going forward, our national development agenda will build on our achievements, as we continue to take the necessary measures to avoid a debt trap and external intervention. In the context of the theme of this CAF Seminar, we intend to focus on:

i. Expanding exports and increasing foreign exchange earnings and employment;
ii. Suppressing crime;
iii. Reversing non-progressive values, attitudes and behaviours such as low productivity and poor work ethos;
iv. Undertaking constitutional and institutional reform;
v. Addressing the impact of shale gas on our market and lower gas reserves and production;
vi. Discouraging the culture of irresponsibility and dampening unreasonable expectations;
vii. Ensuring effective and efficient public service delivery and implementation of development interventions and measurement of results

viii. Transforming the existing economic growth model into one that is environmentally friendly while addressing climate change, including reducing greenhouse gas emissions and building resilience to its adverse impacts; and,

ix. Protecting and sustainably using our environmental resources.

These are essential attributes of our development strategy and we are already witnessing some benefits from the sustained interactive process of development. On this foundation, the economy is being rebalanced, with revenue and expenditure levels significantly lower than they were in 2015; and strengthened with appropriate reforms and policies. This has resulted in our unemployment rate remaining at low levels, less than 5%, thus maintaining social and economic stability and inclusiveness.

And so, if I may be so bold, what is the lesson for other energy dependent countries or economies faced with a similar challenge, i.e. a collapse in commodity prices?

The answer, in my view, is the following:

- while adjusting to a recession, strive to maintain social peace and a decent standard of living for your citizens;
- be moderate and gradual in the reduction of subsidies;
- stimulate economic growth while maintaining social equity;
- focus on your strengths as a country, by which I mean, do not ignore or de-emphasise your energy sector;

- avoid cost overruns, reckless or unnecessary spending;
- maximise the revenue potential of your natural resources;
- maintain a social safety net;
- avoid inflation and devaluation
- ensure that you get the best deal possible from the multinational oil and gas companies
- and at all costs, stay away from IMF standby arrangements!

Thank you.