50 Years of Managing for Development in an Ever-changing Economic Environment: Lessons learnt and the Way Forward

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by

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Salutations.

I would like to join previous speakers in paying tribute to Professor Compton Bourne, recognizing the contribution that he has made to the economic development of the region through his work as Principal of the St. Augustine

Campus of UWI and through his ten years as President of the Caribbean Development Bank.

Sincere thanks also to Dr. Martin Franklin and the UWI Economics Department for inviting me to speak at this Conference.

Let me confess that while honored and humbled by the invitation, I accepted with some initial trepidation, recognizing the amount of preparatory work involved and somewhat reluctant to interrupt the honeymoon of my retirement.

I must confess though that, once I started, I found the process of retracing our post-independence economic history rather fascinating. First of all, there was a certain nostalgia for the excitement and the impassioned economic debate of the post-independence period; secondly, the look back (and the maturity that comes with age) gave me a better appreciation of the complexity of our early economic challenges and of our many successes over that period.

There was also, however, a feeling of profound disappointment at our failure to find the holy grail; to resolve the fundamental problem of economic transformation --- a problem that was identified since oil took over from sugar in the 1950s and one that has been the main focus of our policy-makers, since 1969 when the first comprehensive Development Plan was launched.

The policy-makers at the time (all very competent people – the likes of William Demas, Frank Rampersad, and several others) correctly identified the problem as one of utilizing the rents from the offshore economy to build a vibrant, internationally competitive onshore economy.

Notwithstanding their considerable efforts, our post-independence economic history is a trail of booms and busts, triggered by the vagaries of our energy sector, for the most part, reflecting commodity price volatility.

As most of you know all too well, in our dual economy, economic booms are created when increases in government revenue from the energy sector prompt a corresponding rise in government spending on infrastructural works, on make-work schemes, and on various welfare programmes. Government spending gives purchasing power to households, which creates economic and business opportunities for the private sector. The response of the private sector is therefore crucial to the type of economic spill-off that ensue.

Over the past five decades, buoyant energy sector revenues have financed improvements in economic and social infrastructure, facilitated the expansion of employment, and led to significant increases in personal incomes and improvements in social welfare.

Our economic base has been broadened, largely by the downstream extension of the energy sector, and by an expansion of the non-tradable services sector. Facilitated by regional trading arrangements which provide considerable market protection from international competitors, a rudimentary manufacturing sector has also emerged.

Notwithstanding these very important gains, the fact that economic transformation continues to be our most pressing goal, suggests that the story of our last fifty years is in some sense, a story of "opportunities wasted".

Later on, I will also argue that we may be coming to the point where the impulse from the energy sector could be getting progressively weaker. In these circumstances, without the benefit of a competitive non-energy tradable sector, our medium term economic sustainability and our current standard of living could be under threat.

In my remaining remarks, I will briefly trace the evolution of the Trinidad and Tobago economy since Independence, after which I will seek to draw some major lessons that should inform policy-making going forward.

During the 1950s, oil began to displace agriculture as the prime mover of the economy.

By the time of our Independence in 1962, the dominance of oil in the economy was fairly well established.

Perhaps a convenient starting point for our post-independence economic journey, is 1973, when the Trinidad and Tobago economy experienced a dramatic rise in the price of oil along with a considerable increase in output from new marine fields. In the period 1974-82, government revenue rose more than ten-fold to an annual average around $4 billion, compared with a mere $300 million a year, in the previous decade 1964-73. Of course, Government expenditure rose in step to about $4.5 billion a year.

Driven by the surge in construction activity in the non-energy sector, real GDP growth averaged about 6 per cent over the ten year period, about twice the growth rate registered in the period 1967-73.

The Eric Williams government which had come to office in 1956 had launched two five year Development Plans (1958-62 and 1964-68) which were essentially public sector investment programmes. Its Five Year Development Plan (1968-73) went a bit further in articulating a development policy. Along with the focus on infrastructural development – roads, water, electricity etc., it envisaged a marked shift to government involvement in commercial activities. With the sharp increase in energy sector revenues after 1973, the Government initiated "a move to take control of the commanding heights of the economy".

The strategy involved a decision to fully exploit the country's considerable gas reserves (much of which was previously flared) through joint- venture investments in a whole range of downstream industries - - - methanol, fertilizer, petrochemicals, steel and aluminum. These industries, the supporting infrastructure (a major port, power facilities, a network of gas pipelines) along with the associated policy framework -- came to be known as the Point Lisas Model.

Professor Ken Julien, one of the architects of the Point Lisas model, sought to capture what he calls, "the boldness of the journey" when in delivering the "Nineteenth Dr Eric Williams Memorial Lecture", he reminded us that:

- **"Trinidad and Tobago had less than 1 per cent of the natural gas reserves of the world;**
- **We had never produced a single kilo-gram of steel;**

- **No new harbor or port facilities had been created since colonial times;**
- **Our peak demand for electricity was 300MW, the demand of the steel plant was 180MW, more than half the peak demand of the whole country;**
- **Methanol was a foreign word;**
- **A single 16" gas pipeline existed between Penal and Port of Spain. There was no natural gas offshore or cross country lines;**

In short, he was reminding us that

- **The challenges to monetize our natural gas were formidable and included a skeptical national community that did not historically identify with the Energy Sector."**

Professor Julien recalled (and I quote):

"Many people tried to persuade us that the simplest and easiest thing to do

would have been to sit back, export our oil, export our gas, do nothing else and just receive the revenues derived from such exports and lead a life of luxury, at least, for some limited period".

"Instead, we took the more difficult road, accepting the challenge of entering the world of steel, aluminum, methanol, fertilizer and petrochemicals. We accepted the challenge of using our hydrocarbon resources in a very definite industrialization process"

Despite a number of challenges along the way, the Point Lisas Industrial Estate remains, (arguably) the major economic success of our post-independence period.

I say this, ladies and gentlemen, notwithstanding the fact that, strictly in analytical terms, Point Lisas represented more of the same – a diversification of the offshore energy sector, rather than a step towards the transformation of the economy.

Of course, what goes up, invariably comes down, and oil prices, began a steady and significant decline starting in 1983. What's worse, the price decline coincided with a secular fall in oil production, which had begun in 1979.

Some of you may recall that the period 1983-88 were years of major crisis as real GDP declined by 5 per cent a year and unemployment reached a peak of 22 per cent. The petroleum sector, which had triggered the earlier boom and the government, construction and distribution sectors which had transmitted the impulse throughout the economy, now led the decline in economic activity.

In the firm hope that the decline in international energy prices would have been short-lived, the Government of the day tried to postpone adjustment by running down savings and finally resorting to borrowing. However, by 1988 we could not meet our external debt obligations and we needed to approach the IMF and World Bank.

This is perhaps not the time nor place to discuss the merits of the IMF standby arrangement and the World Bank's Structural Adjustment Programme.

(Moreover, I am (perhaps) not the right person to make a judgment on the impact of these programmes since, in the interest of full disclosure, I must state that I was on the staff of the IMF at the time, and what's more, I was on an eighteen-month sabbatical attached to our Central Bank).

Suffice it to say that, the adjustment programme contained some of the standard elements; exchange rate depreciation; trade and financial sector liberalization and commitments about reducing the size of the public sector (a euphemism for privatization). Not surprisingly, the center-piece of the programme was a sharp reduction in the unsustainable fiscal deficit.

The fiscal adjustment strategy included a nominal 10 per cent cut in public sector salaries, which was understandably very unpopular, and which more than anything else, undermined popular support for the adjustment effort.

This notwithstanding the programme was effectively implemented and the most of the major macro economic targets were achieved.

From my perspective, it is difficult to argue that the adjustment effort was not absolutely inevitable. The country's income had declined sharply; at first, assuming that the drop was temporary, we used up our savings; and then we borrowed and when we could borrow no more we needed to adjust our living standards.

I fully accept that economic adjustment is always difficult and painful, because it implies hardship. Moreover, in the real world, hardship is never distributed evenly. Some groups bear a larger burden than others and, in our case, the poor and the public servants bore the brunt. One can argue that a more judicious calibration of the fiscal adjustment programme would have spread the burden more equitably, obviating the need for a wage cut. Ex post, I am convinced that the wage cut was a big mistake.

Having said that, many analysts (my-self included) believe that the exchange rate adjustment, the external debt rescheduling, the trade and financial sector liberalization and the fiscal reforms set the stage for a more competitive economy and established a potential platform for a stronger transformation effort.

Unfortunately or fortunately, depending on your particular point of view, the pressure to continue the transformation effort was eased by a strong recovery of energy prices, new oil and gas discoveries and a surge in foreign direct investment in the petrochemical sector.

As you well know, the period 1994 to 2008 saw fourteen consecutive years of economic growth. The years 2000 to 2006 saw real GDP growth averaging close to 9 per cent a year, in part, reflecting the coming on stream of new productive capacity in the petro-chemical sector.

As I recall the period, I remember the feeling that some of the figures were staggering.

- Crude oil prices, which averaged US$13 per barrel in 1998, rose to an average of US$75 per barrel in 2007. In May 2008, it reached US$ 147 per barrel.
- Natural gas prices, which had been around US$ 2 per mmbtu at the beginning of the decade of the nineties averaged close to US$9 per mmbtu in 2008.
- Around the middle of the decade, construction was increasing at an average rate of 15-20 per cent a year.
- Unemployment which was 18 per cent as late as 1994 fell to a historic low of under 4 per cent my mid-2008.
- Ours was an economy that was clearly overheating. We began to import labour from neigbouring countries and then from further afield; construction

prices were going through the roof; with labor shortages wage increases were generous and all of this was reflected in a surge to double-digit inflation.

Against the background of a severe over-heating of the economy, in 2007, the Government introduced the Heritage and Stabilization Fund. By sterilizing part of the energy revenues, the Fund is expected to contain government expenditure in good times and in so doing, put aside part of the energy bonanza for future generations. While the Fund is potentially an excellent macro-economic instrument, its effectiveness depends critically of the amount of savings sterilized. I happen to think that we are not saving enough.

Moving along chronologically, as we know all too well, in 2008, came the international financial crisis. The global economy went into recession and market conditions facing our energy exports deteriorated significantly; oil prices fell from a high of US$147 per barrel to a low of US$30 per barrel during 2008, while natural gas prices fell from US$9 per mmbtu to US$4 per mmbtu. The prices of our other petrochemicals also declined in step.

Against this background, by the end of 2008, for yet another time, our boom turned into a bust, from which we are still trying to emerge more than three years later.

In this episode of the boom-bust cycle the quick reversal of international oil prices ought to have signaled an early turn-around in the domestic economy. However, domestic factors – some temporary, some structural, have conspired to postpone any meaningful recovery.

In the energy sector, the impact of stronger international prices in 2011-2012 is being offset by supply setbacks with respect to both oil (a structural decline) and gas (technical problems).

In the non-energy sector, efforts to conduct an anti-cyclical fiscal policy are being stymied by problems of project implementation, while a recovery in private sector activity awaits a return investor confidence. There is a view among some analysts, that uncertainty about the long term prospects for the energy sector and concern about the slow pace of economic transformation may be important factors contributing to the current level of investor confidence.

There are reports of renewed interest in oil and gas exploration, which, if successful, could mean increased production some five years or so down the road, at a minimum. Even on this optimistic scenario, we could be in for several years of tepid economic growth.

Of course in the absence of any new oil finds, we face the chilling Scott Ryder report, which forecasts only twelve years of proven reserves.

But, ladies and gentlemen, even assuming away domestic supply uncertainties, our energy sector outlook is not particularly bright. Firstly, some experts argue that, given the costs of deep water exploration, exceptionally high international oil prices will be needed to make any new oil discoveries profitable. Second the rapid expansion of shale gas production, could significantly reduce demand for our gas and our petro-chemicals, and drive prices way below current levels.

These scenarios make economic transformation all the more urgent, if we are to insulate our economy from boom/bust cycles in the future; raise our current growth rates and achieve some measure of long-run economic sustainability.

While not pretending to provide definitive proposals, I would like to take a few minutes to reflect on the major lessons of the past decades, and in so doing point to some key areas for policy attention in the future.

LESSON NO 1:

Inappropriate fiscal policies have contributed significantly to the undeveloped state of our non-energy tradable sector. Firstly, **the pro-cyclicality of our fiscal policy** has encouraged over-heating in the booms, leading to inflationary pressures and the appreciation of the real exchange rate.

Second, for the most part, our fiscal policy has not found **the right balance between social objectives** (as reflected in allocations to subsidies and transfers) **and in the development of our economic infrastructure.**

For this reason, compared with the fast-growing developing countries, our economy lags with respect to roads, electricity, ports and communications infrastructure – all areas of critical importance to our investment climate.

Declining productivity is also a major problem, which is ascribed to, inter alia, the poor quality of education and training. Fortunately, steps are being taken to address the education gap, particularly with respect to tertiary education. We, however, need to implement a more comprehensive approach.

Of course, because, over the past several years, so much of government capital spending has not been of the highest quality, we now face the challenge of accelerating our infrastructural investment expenditure, while maintaining a sustainable fiscal position, which is also an -- important component of our investment climate.

Lesson No. 2

Our pro-cyclical fiscal policy has contributed to a severe case of Dutch Disease – that is, a condition whereby the predominance of our energy sector has limited the scope of our non-energy sector and, in particular, has hampered the development of a competitive non-energy tradable sector.

The facts are glaring; every index of international competitiveness (the World development Index; the Global Competitiveness

Index...and there are others)....all of them rank Trinidad and Tobago deep in the lower half of their chosen samples. Now, these studies always include a broad mix of countries. If we compare ourselves with the more dynamic developing countries (Mauritius, Malaysia, Chile, Singapore etc) we will be at the bottom of that group.

A 2007 IDB study (name) makes the point that while we have been the largest recipient of foreign direct investment in Latin America, almost all of it has been in the energy sector. In contrast, the study estimates that the capital stock in the non-energy tradable sector has increased by a mere 1.5 per cent since 1991.

Agriculture, which once accounted for 10-12 per cent of GDP now contributes a mere 3 per cent; manufacturing's share of GDP has also been declining; as well as tourism, in which we are acknowledged to have a decided comparative advantage.

You ask yourself .....over the past decade or so, we have seen lots of malls, we have seen **Pricemart**, and sundry variations, which have upgraded our distribution sector.

However, can you think about any major investment in the non-energy, export sector; and particularly, in manufacturing (and remember I am excluding down-stream petrochemicals, whose fortunes are correlated with those of oil and gas).

Clearly a major challenge we face is that of encouraging investment in the non-energy tradable goods sector and that brings us to

LESSON NO.3:

Our experience over the past five decades and that of the fast growing developing countries suggests that economic transformation needs active government involvement; long term planning and national mobilization.

It is clear that, left to the market mechanism the private sector will establish malls, engage in the construction of luxury apartments and get involved in areas where short-term risk-adjusted returns are high. But these are not necessarily the areas that will produce long term transformation.

In addition, to improvements in the quality of government spending, long term transformation also requires, considerable policy support, a reorientation of the investment horizon of the private sector and the promotion of organizational and technological innovation.

This kind of strategy could only be articulated in the context of serious long term visionary planning. It cannot be done (vie qui vie) and certainly not through the medium of annual budgets.

The strategy calls for the careful selection of growth poles or target industries, based on our comparative advantage; it requires convincing entrepreneurs of the need to take long term risks (at times the Government may have to mitigate these risks through guarantees or through joint financing arrangements); it requires a strategy for increasing public sector efficiency; for opening up new export markets ; and it involves serious decisions about the appropriate roles for foreign direct investment and for local investors.

In this comprehensive planning exercise, the population at large as well as organized labour needs to be brought on board, if only for the fact that the effort will involve trade-offs between current consumption and savings; and on occasions trade-offs between wage increases and longer term benefits; above all, it will involve agreements on tying wage increases to productivity gains, all in the interest of achieving long term growth and sustainability.

This is the kind of detailed approach that has been employed by the Singapore, and Malaysia and Mauritius and closer to home, Chile –countries that have had success in long term transformation.

The closest we have come to this kind of long term planning is the Vision 2020 exercise of a decade ago. Of course, we also need to be serious and resolute about implementing the plan.

But, rather than planning for the long term, there is a temptation for energy-rich countries like ours to be won over by the short term gains. (You see), each energy boom produces good times, which encourage inertia and tend to mask the deep-seated problems of the economy. Of course, when the favorable export environment no longer prevails an economy in long run crisis, is exposed.

I would like to close, Ladies and Gentlemen, by making reference to a body of economic literature on the theme of "the Natural Resource Curse". This body of literature focuses on the growth-related problems associated with natural resource abundance. It argues for instance, that countries (and particularly developing countries) that are blessed by abundant natural resources invariably fall prey to "curses" such as fiscal irresponsibility, inefficient and wasteful public expenditure and weak institutions leading to corruption, inadequate procurement arrangements and other forms of poor governance.

I am sure that we have our fair share of all these sins – how much of it, it is for you to judge.

Personally, however, I do not subscribe to the view that our oil and gas resources necessarily constitute a curse; in fact, I think that is a blessing –a blessing to be skillfully managed in the interest of the people of Trinidad and Tobago.

Everybody accepts that managing scarcity is a major challenge. Our experience has shown that managing plenty is equally challenging.

As I said earlier, our history is a case of "opportunities missed"... It might be late in the day, but I don't believe that it is as yet, a case of "opportunities lost".

I thank you.