

## **BEYOND MACROECONOMIC POLICY: SOME POLICY ISSUES TO BE ADDRESSED**

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I am delighted to be here at this conference which is becoming a fixture on the national calendar of intellectual activities. This conference honours Martin Franklin who laboured at the coal face here for many years trying to improve the numeracy, mathematical skills and ability to reason logically of a generation of young economists. I too salute his sterling efforts.

Let me begin with what might be two provocative observations. The first is the perception that the UWI as a whole and the Department of Economics are not impacting the progress of our economy and society in the ways and to the extent that some would like or expect. That is a very broad brush perception which, like all such statements, is almost certainly wrong. Yet, it is an enduring perception. UWI has become an undergraduate degree factory, lost much of its regional character, and despite excellent individual research work in some quarters, is weak in research and innovation. In the case of the Economics Department, the research work there is having little or no impact on policymaking in Trinidad and Tobago and the wider region.

Secondly, I was chatting with an economist friend, a former permanent secretary from one of the OECS countries, who commented that persons without any training in Economics have no difficulty making pronouncements, offering policy prescriptions and even challenging the work of trained economists while they would never do the same with Engineering, Actuarial Science or some other such discipline. Part of the reason lies in the fact that economists use everyday words like 'price', 'demand', 'supply', 'money' and so on, and even very technical and complex concepts like 'GDP' have been appropriated by non economists who really have no idea what it really means and still less how it is computed and hence how it should be interpreted. But part of the reason I think, is that the profession has never determined who should and should not be called an 'economist' and as a result, there are persons who call themselves or are called economists who do the profession a grave disservice with their utterances in the public media and on social media.

We economists have no professional certification, but for myself, I do not personally regard someone as an economist who does not have post-graduate degree in Economics from a good university so that they are equipped with a good grasp of economic theory, and in addition, who has 3 to 5 years of practice doing economic work which requires that person to understand where economic data come from, how they are constructed and how data should be used and not abused. Even after that, it takes years of such practice dealing with real economic problems and issues before one can be called 'expert', a designation which the media lavishes on almost anyone willing to speak on an issue, and in this country we are never short of speakers.

Having got that off my chest, I would like to address some questions of economic policy which have become salient for me in the issues that I have encountered in recent months as chairman of

the Economic Development Advisory Board. While issues of fiscal, monetary and exchange rate policy are always being discussed, I have been more intrigued by a set of micro-economic issues relating to subsidies, the operation and regulation of certain markets, and the distribution of wealth and incomes in our society. Some of these issues are of considerable significance for government fiscal operations and for economic growth and development, but seem to be overlooked by commentators and economists alike. I would like to focus on three issues – (a) subsidies, (b) income and wealth inequality and (c) the labour market and work ethic.

## **Subsidies**

It is true that many have commented on the size and growth of 'Transfers and Subsidies'. We can look at the gross numbers and they are indeed startling. The trouble is that the way in which the Ministry of Finance puts these numbers together does not really help us to understand what the policies underlying the data are intended to do and what they are in fact doing. The Ministry of Finance puts together its budget for the 'service of Trinidad and Tobago', but the Budget numbers have to be recast by economists who are trying to understand the economic impact of the budget and by the statisticians to understand the impact on the National Income Accounts.

A couple of observations can be made about the data and the classification of the data on Transfers and Subsidies:

1. The Current Transfers and Subsidies category is a very mixed bag. In the Estimates of Expenditure it includes transfers to the Infrastructure Development Fund which is used for capital formation; direct transfers to households in the form of pension payments, senior citizens grant, social assistance, disability grants which would go to consumption expenditure; production subsidies and consumption subsidies; and payments to international and regional organisations such as the CDB, Council of Legal Education and so on.
2. There is anomalous treatment of state enterprises and statutory bodies. Current Transfers to Statutory Bodies includes transfers to entities like WASA, but the Regional Health Authorities are classified under 'Other Transfers' under the Current Transfers and Subsidies head of expenditure of the Ministry of Health.

I would point out, parenthetically, that the continuation of Government's unfunded pension system is a major issue which we have not addressed over the years, electing it seems, to kick the can down the road because it is a tough issue to deal with. But postponing this problem does not make it get any better and indeed it gets worse as retired persons are living longer and social justice will require that public service pensions be periodically adjusted to compensate for increases in the cost of living. In effect, unfunded pension liabilities, like debt service, mortgage future government revenues.

Turning then to the issue of the subsidies. The first point I would like to make here is that there are hidden subsidies, cross-subsidies, and tax expenditures which we can note at the outset. Hidden subsidies occur where the private sector or individuals benefit from acquiring state-owned assets or benefits at prices that are below market rates but which are not explicitly intended to be subsidised. For example, if state-owned lands are leased at some original lease rent which at the time was market-based but the lease rent fails to be adjusted over time, the lessee is getting the

benefit of a subsidy of which the Minister of Finance may be none the wiser. This example, which is real, goes to the larger question of subsidies which were established years or decades ago and have simply remained in effect without review and reform. Cross subsidies arise where revenue from one area are used to meet expenses in another area which is loss-making. The loss-making activity is effectively cross-subsidised and may also be a hidden subsidy if the management of the state enterprise or statutory board does not explicitly recognise and acknowledge the subsidy.

Tax expenditure are deductions or exemptions which have the effect of reducing government revenue and subsidizing the beneficiaries of the deduction or exemption. The special capital allowance enjoyed by the upstream companies is an example of a tax expenditure with dramatic impact on government revenues.

The importance of identifying hidden and cross subsidies and tax expenditures is that the analysis of subsidies must be based on transparency and clarity about the beneficiaries and what the subsidy is or was intended to do.

There are a host of explicit subsidies. These include:

- Fuel Subsidy
- Other Transportation Subsidies including water, ferry, bus transportation
- GATE
- Housing subsidies including the mortgage interest subsidy
- Utility subsidies: WASA and TTEC
- Food Price Support Programme

I have no information on the Food Price Support Programme and it is not addressed here.

#### Fuel Subsidy and Other Transportation Subsidies

I don't need to say much about the fuel subsidy because of the excellent work done by Marissa Chester on this issue. The 2017 Budget has an allocation of \$800 million for the fuel subsidy, mainly diesel, as super and premium are not subsidised at current price levels. This allocation should have been zero in my view, that is, the subsidy should have been removed completely and a regime formulated and announced for price adjustments at the pump as oil prices increase. The case for removal of the subsidy has always been compelling. Removal would (a) change the transportation preferences of the traveling public away from single occupancy vehicles; (b) reduce use of fossil fuels and reduce greenhouse gas emissions; (c) shift the fuel mix toward CNG; and (d) eliminate the smuggling of diesel to offshore fishing vessels and other Caribbean territories. In addition, it is almost certain that the subsidy is regressive, benefitting upper income persons more than lower income persons.

From a policy perspective one would need to examine the implications of the removal of the fuel subsidy. Certainly, we would expect that the cost of transportation will increase and some prices will rise as the cost of commercial deliveries is passed on the form of higher prices. This will, ceteris paribus, lead to a reduction in disposable incomes of consumers, the wealth effect. I would focus on the substitution effect of higher transportation costs and how that is expected to influence

the consumption of transportation and the mode of transportation. We know that public transportation is in terrible shape and it is not clear to me why the PTSC does not respond to what appears to be deficiency in the private provision of public transportation. So there is the challenge and here is the opportunity. We need to effect a massive increase in the bus fleet, placing these buses on dedicated routes with accessible well-designed bus terminals, parking spaces for Park and Ride, published schedules (including smartphone apps) and reliable, safe and comfortable vehicles using CNG. The service should include shuttles circulating within the city centres – Port of Spain, Arima, San Fernando and Chaguanas. Service into the valleys of the Northern Range with large populations but inadequate road capacity for large buses should be served by maxi taxi (using CNG) on contract with the public transportation organisation to provide scheduled services into those areas with special provision for off-route transportation of the elderly and disabled.

You might well say that that plan is likely to cost as much as the \$800 million, maybe more. And indeed it probably would. The key differences which I think make the idea attractive are: (1) the plan would be developed and implemented by a Transportation Authority, a regulatory body which will set the rules and regulations by which public transportation will be provided by both state-owned providers, e.g. PTSC, CAL and Port Authority, and by private operators (taxis and maxi-taxis, including Uber); (2) the Transportation Authority could insist on minimum levels of service to be provided by public transportation systems –PTSC, airbridge; (3) when the system is sufficiently mature and regulatory capacity fully developed, elements of the public system may be privatized and the subsidy element of public transportation (which will always be present) can be even better targeted at the lowest cost to taxpayers; a Transportation Authority will have as its mandate to ensure the safe, reliable, cost-effective provision of public transportation and will therefore keep the subsidy transparent and work toward ensuring that it is effective.

This brings me to the water taxis and the Tobago ferry which are allocated \$36 million and \$240 million respectively in the Current Transfers budget. I feel certain there is cross-subsidisation of the water taxis beyond the allocation since NIDCO is responsible for the service and I am not sure the overheads related to the operation of the service are fully allocated to the water taxi service. Whatever the case there, it is not clear to me how the water taxi service is positioned in the transportation mix. I recall that the intention was to extend the service to Point Fortin and Chaguaramas but this has not happened. There is the suggestion that it has taken business away from the North-South maxi taxi private operators, but it has had no discernible impact on traffic in the North-South corridor.

In respect of the Tobago ferry service, I am not myself clear who the target of the subsidy is. It could be for Tobagonians to facilitate their travel to Trinidad for business, or it could be to facilitate internal tourism and Trinidad holiday spending in Tobago. Given the way the ferry service is configured and how it is used, I suspect it is the latter reason. I also do not know whether the full cost of operating the ferry service is taken into account in the computation of the subsidy by the Port Authority which operates the service. The question that would need to be addressed is what level of subsidy is appropriate for the intended purpose.

The analysis of the effectiveness of these subsidies and their design clearly intersect several other socio-economic issues, other than providing cheap transportation. These include: (a) environmental impact and the national goals in respect of achieving a Green economy; (b) worker

productivity, which is influenced by traffic congestion and ease of movement; and (c) preferences for modes of transportation which may be influenced by socio-cultural factors and biases. You will note immediately then that the design of subsidies for transportation cannot involve only economists and transportation engineers, but also environmentalists, sociologists or cultural anthropologists or psychologists. How, for example, do we get middle and upper class Trinbagonians for whom a car is a status symbol, to happily board a bus as they do in London, New York or Boston?

### GATE Subsidy

The GATE Task Force report has documented the expenditure on the subsidy for tertiary education over the last ten (10) years and the number of beneficiaries. From the viewpoint of the economist, the Report provides no theoretical appreciation of subsidies for education and was content to draw conclusions based on comparison with other countries, while, faced with a lack of data, the empirical basis for assessing regressivity and programme effectiveness seems to me to be questionable. Nonetheless, the Report reveals a subsidy programme that was poorly designed from the outset and as a consequence, the programme grew exponentially. Increased supply was met by the rapid expansion of UWI, distance learning degrees delivered by private operators, and new entrants. Any evaluation of the GATE programme would have to examine the quality of the tertiary level programmes and hence the quality of the graduates, and whether graduates are able to meet the demands of the current and future workforce requirements. That evaluation would also have to examine the quality of the distance learning programmes offered by foreign universities. There is therefore a case for a study which traces the academic and career progress of GATE beneficiaries and makes an assessment of how they have contributed to workforce productivity.

### Housing and Mortgage Interest Subsidies

In terms of quantum, the housing subsidy is the largest that any beneficiary could get from the Government. In some instances it is like winning a lottery and indeed the allocation of units is done partly on the basis of a lottery! The size of the subsidy results from the implementation of the policy, as distinct from the policy itself, has provided housing for middle and even upper income persons and because the cost of the housing provided has not taken fully into account the cost of the land and in some instances the cost of the infrastructure. The most egregious example of this is perhaps the residential lots each of 5000 square feet developed by a state enterprise for former Caroni workers. To the extent that the development cost becomes reflected in the market price of those lots, it would constitute a significant transfer of wealth to the beneficiaries. It is little wonder then that the waiting list for state-provided housing by the HDC has grown exponentially from about 20,000 under the old National Housing Authority to about 160,000 today. Applicants appreciate the value of what they are getting, know that similar accommodation is beyond their means, and are prepared to wait.

In contrast to the housing subsidy which is variable and opaque, the mortgage interest subsidy provided through the Trinidad and Tobago Mortgage Finance Company has been transparent in the budgetary allocation to the TTMF. The TTMF programme also graduates mortgagors to

market rates over time as their incomes improve. The mortgage interest subsidy is additional to the mortgage interest tax deduction available to first time home owners and an examination of the overall level of subsidy is warranted.

### Utility Subsidies

In respect of electricity, there is a production subsidy in the form of a preferential natural gas price for electricity generation and electricity rates are among the lowest in the region. The Government has now seen it fit to rebate households with bi-monthly billings of less than \$300. The intention behind this subsidy is opaque. It clearly is not intended to *increase* consumption of electricity by low income households; so the intention is probably to increase the disposable income of those households. If so, the question that arises is whether there may be more efficient and effective ways of achieving that objective. I presume that T&TEC will claim the rebate back from the Treasury and there would be costs to T&TEC to reprogram its systems and to manage its cash flows.

Our water rates are also subsidised in that WASA operates at a substantial deficit. The budget allocation for 2017 is about \$1.7 billion. I can do no better than Raffique Shah who in his column this week pointed out that our water rates for residential and industrial users are extremely low in his case, about \$2 per day, in mine about \$4 per day that allows us to consume as much water for cooking, bathing, washing and sanitation as we would like.

### **Income and Wealth Inequality**

The second issue concerns income levels and disparities and welfare and is actually related to the question of subsidies. The aggregate data on GDP and GDP per capita tell a story of an economy and society which is not doing badly. We are among the upper middle income countries; we are classified as “Innovation-driven” under the Global Competitiveness Report and based on the Human Development Index, we are classified High Human Development at rank #64 in 2015.. Yet poverty levels are reportedly high and stubbornly so; underemployment is apparently also high, and the perennial complaint in response to budgetary measures which impact the prices of goods and services is that a lot of people will suffer and will not be able to make ends meet. So here again, we have what seems to be an inconsistency between what the aggregate data tell us and what other data are suggesting.

If the perception is valid, there are several possible explanations, not mutually exclusive, which might usefully be developed and explored. First, income and wealth inequality is worse than we think. The Economic Development Advisory Board has begun a research project on the question of income and wealth inequality. Our concern is not only to refresh the calculation of the Gini coefficient and the distribution of reported income by deciles, but to enquire into questions of land ownership and land values, and executive pay. In other words we need to begin to understand the processes which produce the outcomes reflected in the conventional measures of income distribution. Second, the informal and underground economies are larger than we think and are not captured in the official statistics. For a long time, I certainly have assumed that the informal economy here is relatively small, unlike say Jamaica where it has been estimated to be as large as 35% of GDP. I am not so sure any more. The explosion of gambling casinos in upscale premises

as well as lottery based gambling in corner shops all over the country are one set of indicators that money is circulating in activities which we are almost certainly not capturing. The high and increasing incidence of so-called gang violence reflects underground economic activity which is organized and which finds expression in money laundering through property acquisition and sale and so on.

Third, transfers and subsidies are important to welfare, but the delivery is distorted so that beneficiaries are not impacted sufficiently. The point here is that some proportion of transfers and subsidies is flowing into the wrong hands. The recent exercise conducted by the Ministry of Social Development to clean up the allocation of so-called 'food cards' was instructive in the large proportion of recipients who dropped off the rolls when required to re-register and provide more secure personal identification. What would be the impact on expenditure on subsidies if we could devise criteria and methods of delivery that minimise fraud and wastage? Fourth, transfers and subsidies are important but their impact on beneficiaries is not captured well in the surveys. This is more of a technical issue in the design of the population census and household budgetary surveys which should allow us to correlate household incomes arising from government transfers with the data from the Budget itself. How should we account for water and electricity which are consumed at subsidized prices, food cards and other benefits provided by the Government?

### **Poor Work Ethic and Labour Markets**

The third and last broad issue I would like to highlight is our poor work ethic and the functioning of labour markets. In the Global Competitiveness Report 2016 for Trinidad and Tobago and in reports for previous years, Poor Work Ethic is by far the most significant factor affecting doing business, exceeding Corruption, Inefficient Government Bureaucracy and Crime. The newly formed National Tripartite Advisory Council has placed the issue of 'poor work ethic' on its agenda. Everyone seems to agree that the country has a problem of a 'poor work ethic', but what does this really mean? Does it mean that the business executives who respond to the GCR survey think that workers are lazy, that they are unmotivated or demotivated, that they are not prepared for the world of work, that they are poorly supervised and managed? Is it that workers routinely turn up late, are not diligent in the performance of their tasks, or what? Is the so-called 'poor work ethic' cause or effect?

I have a few thoughts/hypotheses on this issue which may be worthy of research. Strangely, or perhaps not so strangely, in thinking about this issue, I have found myself going right back to Arthur Lewis. The modern or capitalist sector, which in our case is the Energy sector and a few export manufacturers, produce for export and employ few persons. Wage levels in that sector are however not established in relation to the 'subsistence sector' but in relation to international wage levels. The subsistence sector is the rest of the economy, including and especially the public sector, where demand is domestic demand and is insufficient to employ everyone if the wage rate were set at the level of the capitalist sector. What then evolves is an elaborate work-sharing system in which at the end of the day, the marginal productivity of labour in that sector is low and below the average product or wage. The consequences of this work-sharing arrangement are reflected or manifested in the behaviours we observe: (1) because there is insufficient work to keep everyone busy, the available work is parceled out and workers are inclined to stretch the task out as long as

possible; there is a resistance to the introduction of technology which will eliminate jobs; customers of the public service experience the effects of this as poor service; (2) the second effect is rather more insidious; real work does have to get done – crimes detected and prosecuted, judgments handed down – so that there must be persons who can get it done; but the work-sharing arrangement means that average wage levels are low and these persons at the management and professional levels are underpaid or perceive themselves to be underpaid relative to the modern sector; they in turn do not manage or supervise diligently and the whole system works slowly.

If I am right about this characterization of the problem and how the labour market operates, all the talk about public service reform will not work. Indeed the answer ultimately must be on the demand side: how do we re-orient or diversify the economy so that it is driven by external demand on a scale sufficient to employ the labour force at high wages? Yes, I do say ‘external demand’ which I know puts me at odds with the proponents of the so-called ‘onshore economy’. I can’t discuss my position on that now, and although I consider my thinking in some areas to be very much influenced by Lloyd Best, I have never bought into the ‘offshore’ ‘onshore’ dichotomy and instead I have always argued that the issue has been our mode of insertion into the global economy, and we have to engage the global economy but do so in ways which we craft ourselves and are not imposed by others.

## **Conclusion**

Let me return to where I started. Professional economists need to reassert their value and their role in the national discourse on economic issues. We have ceded the field to others, or we dilute the analytical rigour of what we say to such an extent that we run the risk of making statements that are wishy washy, and without theoretical or empirical foundation. The media’s approach to dealing with complex issues does not help, based as it seems to be on the notion that complex economic issues can be reduced to a screaming headline which ends up misleading the public. Fortunately, we are no longer completely reliant on the traditional media for getting our message across in a way that meets the standards of the profession without being abstract or ‘academic’. In this regard, I would like to compliment Sunity Maharaj and Gregory McGuire for the Seminar for Professionals series which attempts to create a forum where issues can be properly defined, articulated and discussed in a way that educates and informs.

Turning finally to the role of UWI and the Economics Department in influencing policymaking. I would first say that to the extent that that influence is weak or lacking, it is not entirely the fault of the university or the Department. Policymaking based on research and professional input is lacking within Government. The decline of the CSO was emblematic of that approach to policy making. If the National Statistical Institute is properly constructed as a genuinely independent institution staffed and guided by professionals with the highest standards, we would have begun the process of putting policymaking on a better footing. But the questions which concern policymakers are not necessarily formulated in a helpful way by academics. The interaction between academics and policymaking has to be closer and more intense for the questions and issues which trouble policymakers to be taken on board by academic research.



I have tried to identify some of these questions and issues which I think might usefully be researched, the conclusions of which could directly and immediately assist in the design and implementation of better policies. These are:

### **Some Research Questions for the Department of Economics**

- How should incentives and disincentives be designed so as to achieve an optimal transportation mix? If status is a barrier to the use of public transportation, what techniques from the field of Behavioral Economics might be used to change behaviours?
- Tracer Study of GATE Beneficiaries to determine to what extent the society has benefited from their education and training
- How can transfers and subsidies be taken into account in measuring household incomes and welfare
- What explains relative wage levels between the public and private sector? Does work sharing occur and does it have a depressive effect on public sector wage levels?
- Is the housing allocation system equitable and if not, how should an equitable allocation system be designed?

There is a lot of work that needs to be done to move this country forward. We need better policies and better policy making, which means asking the right questions and getting the right people – real professional economists—to address those questions, working with other professionals – transportation engineers, planners, architects and others. That is what the Economic Development Advisory Board is beginning to do. We would love to engage the UWI in the work that needs to be done, specifically the Department of Economics in addressing impactful policy issues such as those I have suggested, but also other UWI Departments in Science, Technology and Innovation.