Accounting for the Petro-Dollar

The Macroeconomics of Petro-Exporting Economies: Discussion of papers by Dennis Pantin and Dale James of UWI and by Dr Ewart Williams of CBTT – Eric St Cyr

In a serious nation "Accounting for the Petro-Dollar" cannot mean the publication *ex post* of the financial details of expenditure from oil revenue (c f Ministry of Finance publications of the same name). On the contrary, it has to be *ex ante* the mapping out of strategies for garnering likely revenue inflows, securing them from dissipation and, in the context of an informed understanding of how the economic system works, the rational setting out of plans for use of these resources and mechanisms for attaining desired goals.

Both presentations, by Dennis Pantin and Dale James of UWI and Ewart Williams of CBTT, are of high technical quality and enhance our understanding of the problem

We readily agree with Pantin and James that Trinidad and Tobago might be termed a *rentier* economy. But this is hardly the whole story. There are in addition deeply ingrained cultural features and historically fashioned institutions which even moreso serve to shape the imperatives of economic behaviour. Their proposal to spend in the current fiscal year the quantum of revenues collected last fiscal year, while a useful device for containing expenditure and workable when revenues are rising may be impractical where there are steep declines. Neither is the suggestion analytically reasoned to a stated purpose. The use of a long run average price of the staple to determine the stable long run revenue would seem preferable. Pantin and James' proposal for a Stabilisation Fund, accessible only with Parliamentary approval, and a Permanent Fund to be accessed only by referendum, usefully point in the correct direction. But here again the goals of expenditure would seem more critical than the mechanisms for restraining profligate spending and it would seem necessary to specify the majority margin for decision in either case.

On its part, Governor Williams' paper provides insights into the functioning of the Trinidad and Tobago economy far beyond the technical details of the foreign exchange market he describes. From his presentation it is clear that foreign exchange is one of the critical resources sought after in the economy and the exchange rate the key price. Evident also is the vast difference between the onshore and offshore sectors regarding generation and use of foreign exchange as also would be their conflicting attitude regarding the exchange rate. Interestingly this rate has been held at just under 6.3 over the last 8 years, not by fiat, but by market intervention made possible only because of massive inflows from the offshore sector. Now that there is rapidly rising demand from the onshore sector, not only on current account, but increasingly on capital account for purchase of foreign assets, stemming the outflow of this resource has become contentious. Net sales of foreign exchange by the Central Bank to the commercial banks rose from US$305 million in 2004 to US$545 million in the first 10 months of 2005, most of the increase on capital account. Is this evidence of capital flight? Is it speculation against the TT$? Did we not go far enough with foreign exchange liberalization in 1993? Or is this typical behaviour in Caribbean-type economy?

We seem to be faced with a dilemma. The structure of the economy puts the lion share of the nation's foreign exchange in the hands of the authorities. This makes it possible for the rate to be managed and kept at 6.3, a position favoured by consumers of imports and politically comfortable. In the context of excess demand, allowing the rate to rise would stem the outflow, stimulate onshore output where the foreign exchange input in the production process is low, and raise incomes generated onshore. Imports would however become more expensive.

More importantly however is the golden opportunity which the present situation opens up for the economy as a whole to liberate itself from the centuries old *Caribbean epidemic* of dizzy overall expansion with an offshore boom followed by sharp decline. In recent memory the boom years 1973 to 1982 were followed by the depressed years 1983 to 1992. We are once again in boom time. The historical response of the economy in boom time has been for businesses to stash cash abroad in foreign assets to tide them over the downturn while awaiting the next offshore boom. Now however we understand that an alternative path exists. The surplus foreign exchange could instead be protected from flight and used instead to transform the economy. In particular investment in the onshore sector by firms which use indigenous technology, make use of capital high in local content (mainly software) and low in import content (largely hardware) and which are low net users of foreign exchange could impart to the onshore economy a long sought after dynamism and autonomy.

It is therefore axiomatic that if we are to intervene to give direction to the economy of Trinidad and Tobago we must understand its structure, its functioning and the dynamics of its operations.

We know now that it is not Ricardian – with capitalists capturing the surplus generated in primary production and investing it in secondary activities where factor productivity is constantly being enhanced by technical progress and increasing capital intensity giving rise to increased *per capita* income: the Lewis analysis.

We also know that large capital injections largely of foreign investment in staple production usually raise wages in those activities, while overall unemployment remains high and intractable: contrary, as Seers has pointed out, to the tenets of the Keynesian analysis. Nor is the economy "export-led" as is the case of Japan, Singapore, New Zealand or England.

We assert rather that the Trinidad and Tobago economy – like the other economies of the Caribbean of which it is perhaps the extreme case – is "export propelled". This has been so historically, key institutions having been fashioned to serve the purpose of staple extraction for worldwide markets using international capital and best practice corporate management strategy and technology, with the objective of generating a surplus in foreign exchange.

That the staple today in Trinidad and Tobago is natural gas/oil should not divert us from the ALGEBRA of how Caribbean-type economies work as a macroeconomic system to the ARITHMETIC of "petro-exporting economies"

Algebraically, but with differing degrees of intensity, Caribbean economies exhibit and have historically exhibited distinct and similar features. Schematically, an offshore sector generates primary income in foreign exchange. Injections of income from this offshore sector are made through purchases of factors and services onshore but sometimes largely through payment of taxes, royalties and dividends to the state. As these are spent onshore, secondary rounds of incomes and taxes are generated in domestic currency onshore through the operation of *expenditure* and *revenue multipliers*. Over time and across territories of the Caribbean, staples have variously been agricultural (sugar, cocoa, bananas, etc), mineral (asphalt, petroleum, bauxite, natural gas, etc), services (tourism, offshore banking, labour in export processing zones, etc).
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However, the salient feature of the offshore sector has been that it is integrally part of the world or overseas economy. The focus of the onshore sector, by contrast, has been provisioning the residentiary population. The state sector occupies an intermediary position, brokering as it were between the two, harvesting primary income offshore and injecting it onshore.

The first consequence of these scientific, that is, factual observations is that to be of use our macroeconomics must recognize and take explicit account of these two quite distinct parts of the economy. Consider the following. The offshore energy sector of T&T contributes about 40% of GDP, 40% of Government Revenue, 85% of commodity exports and foreign exchange BUT only 3% of employment. The onshore non-energy sector accounts for 87% of employment and is further looked to as the place where the 10% unemployed should be absorbed. Or again, in 2003 when GDP in the economy as a whole grew by a sizeable 13.2%, the offshore energy sector grew by 31.2% while the onshore sector grew by a modest 3.2%. Clearly the offshore and onshore sectors constitute different worlds.

From our discussion of the economy's structure we now consider its functioning. The offshore sector is clearly the engine or locomotive while the onshore sector is the trailer or carriage of the economy. When the offshore sector is booming the onshore sector is drawn along; and *vice versa*. The rhythm of the economy as a whole mirrors what takes place in the offshore sector on which it depends for critical inputs of foreign exchange.

The onshore sector where 97% of the population is located has no dynamic of its own. The dynamic force in the economy resides in the offshore sector where the strategic decisions regarding production, technology, investment and marketing are taken in transnational corporations with global – not national – objectives.

It is evident that national escape from historical dependency, low and fluctuating incomes with highly skewed distribution, and intractable unemployment requires that the onshore sector be infused with internal dynamic. It will have to be set on course to

innovate with production technology and products/outputs with international appeal. Critical to this must be the emergence in the onshore sector of relevant business and entrepreneurial skills and firms capable of navigating the global economy.

The necessary **transformation** of the economy (as distinct from **diversification** of which we have experienced much over the years) would show itself progressively in the ability of the onshore sector to earn its own foreign exchange and to prosper independently of what is taking place in the offshore sector. Indicators that such transformation is taking place would be a progressively rising share of onshore output in total output, reduced dependence of the onshore sector for foreign exchange earned by the offshore sector, and an upward trend in the productivity of factors engaged onshore.

Public policy must therefore support the emergence of autonomous (*maroon*) firms in the onshore sector which use indigenous technology, which make use of capital which is high in local content (mainly software) and low in import content (largely hardware), and which are low net users of foreign exchange per unit of output (or employment). While redistribution of rents earned offshore must be desirable on grounds of social justice and necessary to promote peace and commitment to the process of transformation, and while astute foreign exchange management should ensure correct social valuation on this scarce resource, the long term objective of liberating onshore economy from the stultifying dominance of offshore economy must be the dominant thrust of macroeconomic policy.

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