

Development Challenges in Trinidad and Tobago

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Abstract

This policy brief presents a summary of the development challenges facing the country.

Key Words: Regional Integration, Economic Growth, Productivity and Growth, Economic Integration, Investment, and Global Trade

JEL Codes: H30, F15, F31, F32, F34, Q32



Development Challenges in Trinidad and Tobago

Medium-Term Economic and Social Trends

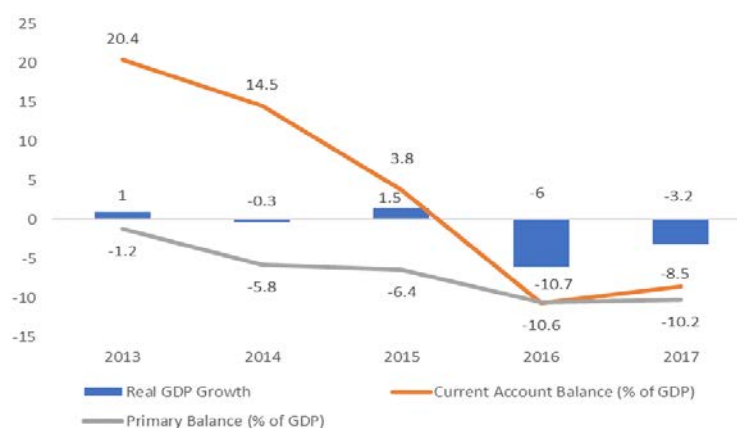
Trinidad and Tobago is a resource-based economy dependent on the performance of the energy sector. During 2010-2015, the energy sector—producing oil, gas and petrochemicals—generated 40 percent of nominal GDP. However, declining oil and gas prices in global markets and technical disruptions in domestic energy production led to an economic recession. Real GDP declined 6 percent in 2016, mainly driven by an 11 percent contraction of the energy sector. For 2017, GDP is expected to drop by another 3.2 percent (Figure 1).

Foreign trade declined, and external imbalances deteriorated significantly due to the depressed commodity prices and reduced energy exports. In 2016, a current account deficit of -10.4 percent was recorded, down from a surplus of 20.4 percent in 2013 (Figure 1). Preliminary trade data for the first six months of 2017 suggest that the trade balance may be narrowing. In January-June 2017, the export volumes of crude oil and methanol increased by 10 percent relative to the last six months of 2016. Also, energy prices have risen over the past year due to increased global demand. According to the IMF, the current account balance is expected to narrow to 8.5 percent of GDP.

In a related trend, government finances weakened significantly in 2015-2016 as global energy prices collapsed. In FY2016, total revenues amounted to 23.1 percent of GDP, down from 31.1 percent in FY2013, and energy revenues dropped to a mere 4.6 percent of GDP in FY2016. While revenues declined significantly, expenditures remained stable. In FY2016, budgetary expenditures reached 35.2 percent of GDP, which is 1 percentage point higher than FY2013. This has led to a deficit of -10.6 percent in FY2016 (see Figure 1). Recognizing that global energy prices are unlikely to return to boom-era levels, the Government of the Republic of Trinidad and Tobago adopted adjustment measures in FY2017 to consolidate the country's fiscal position and stabilize public debt. Some key measures included tax reforms in the energy and non-energy sector, reduction in fuel subsidies, a public expenditure review and the establishment of a procurement board and revenue authority.



Figure 1. Recent Economic Developments



Source: IMF (2017).

Large investments in health, education and social safety programs have put Trinidad and Tobago in 64th place in the 2013 Human Development Index (HDI) ranking. Life expectancy, mean years of schooling, and GNI per capita have all increased—by 2.9 years, 3.8 years and 89.6 percent, respectively—from 1980 to 2013. Recently, however, Trinidad and Tobago has not been able to make much progress, and the country has therefore dropped one place in the 2016 HDI ranking. According to the last official measurement—in 2005—16.7 percent of the total population was considered poor.

Medium-Term Economic Outlook

To restore macroeconomic stability, Trinidad and Tobago needs to adopt a comprehensive fiscal consolidation package. The IMF estimates that the Government needs to make fiscal adjustments of about 6.5 percent of GDP, balancing revenue increases with expenditure reductions. While the government is already taking some measures, as noted above, further effort is needed. The IMF notes that addressing tax arrears, introducing VAT reforms and new transfer pricing legislation as well as optimizing transfers and subsidies and restructuring state-owned enterprises are important reform areas to pursue. In the longer term, structural reforms—particularly in regard to economic diversification and public-sector governance—are necessary to support sustainable and inclusive growth (see below).

Failing to restructure government finances may put public debt—61.2 percent of GDP in 2017—on an unsustainable path. In the short term, Trinidad and Tobago can rely on substantial financial buffers to finance fiscal deficits, but in the medium term consolidation is necessary to ensure growth and debt sustainability. Next, the sizeable current account deficit has reduced the official reserves to about 9 months of import cover; failing to address the deficit in the external account



increases the risk of a balance of payments crisis. Expected increases in U.S. interest rates and unchanged exchange rate policies may also tilt risks to the downside.

Development Challenges

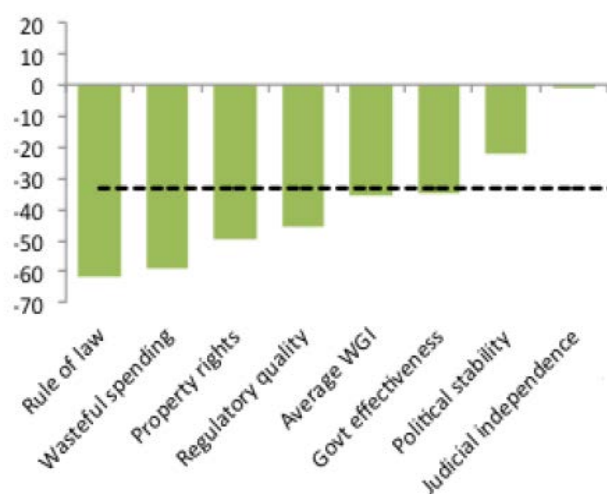
Exploring Trinidad and Tobago's growth and development challenges, three critical areas emerge. First, like many resource-dependent countries, Trinidad and Tobago faces public sector governance challenges. These difficulties include civil service management, tax and revenue policies, financial sector policies that reduce competition and allocative inefficiencies in government expenditures. A development gap analysis—which shows the distance between the observed and expected value of a development indicator (see Borensztein et al., 2014)—indicates Trinidad and Tobago is below its potential in terms of public sector performance. As shown in Figure 2, inefficient spending is one of the biggest obstacles faced by the country, along with a fragile rule of law, weak protection of property rights and low regulatory quality.

Second, even though Trinidad and Tobago has made gains in human capital development (see above), significant reforms in this area are still needed to improve productivity and efficiency and support sustainable growth. In education, evidence from international and regional assessments shows that student performance lags countries with comparable income. The Labour Confidence Report by the Central Bank of Trinidad and Tobago (2015) finds that the main obstacle for increasing firm productivity is the unavailability of a skilled workforce. In the health sector, the low quality of primary care services and non-communicable diseases remain a major challenge. Furthermore, public spending in health is concentrated on treatment rather than prevention.

Third, Trinidad and Tobago faces several structural constraints to becoming a competitive and diversified economy. The underlying factors contributing to these constraints have been identified as crime and violence, rigidities in public-private sector coordination to develop industries outside the energy sector, mobility and traffic congestion and limited incentives for entrepreneurship. Addressing those constraints will be important for improving private sector competitiveness and diversifying the product space.



Figure 2. Development Gap Analysis of Trinidad and Tobago's Institutions



Source: IDB.

Conclusion

The above analysis indicates Trinidad and Tobago is facing both short-term macroeconomic challenges and structural constraints to inclusive and sustainable growth in the medium term. The authorities, however, have shown willingness to engage in critical reforms. For instance, the latest budget statement includes a host of measures on both the expenditure and revenue side to reduce the budget deficit. Furthermore, the country has shown the ability to solve difficult commitment problems. In 2007, the authorities introduced the Heritage and Stabilization Fund, a mechanism to cope with energy revenue volatility and to provide for future generations. Finally, when facing difficulties, the government has been willing to cooperate with international partners to make use of their knowledge and financial resources. In light of these facts, it is expected that Trinidad and Tobago has the ability to tackle its main development challenges.



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