DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/88/234

CONFIDENTIAL

November 16, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Trinidad and Tobago - Request for Stand-By Arrangement - Letter of Intent

Attached for the information of the Executive Directors is a letter from the Trinidad and Tobago authorities requesting a stand-by arrangement equivalent to SDR 99 million. The tables and annex referred to in the letter will be included in the staff report describing the Government's economic program which is expected to be circulated next month.

Mr. Elson (ext. 8477) is available to answer technical or factual questions relating to this paper.

Att: (1)

Port of Spain
Trinidad and Tobago
November 15, 1988

Mr. Michel Camdessus
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. Camdessus:

1. Between 1982 and 1987, the Trinidad and Tobago economy registered six consecutive years of negative economic growth. Over this period, earnings from the petroleum sector fell by close to one half, and government revenues from petroleum by 40 percent. The unemployment rate more than doubled from 10 to 22 percent, and real GDP in 1987 was some 28 percent below the level of 1982. In addition, despite a significant reduction in imports, there was a loss in foreign exchange reserves of some US$2.8 billion between 1982 and 1987.

2. This severe economic contraction is a product of both domestic and external factors, the most important of which are:

(i) the weakening, and ultimate collapse, of oil prices;

(ii) declining oil production;

(iii) imprudent demand management policies during the period of the oil boom (1974-82); and

(iv) the failure of efforts at diversification of the economy, and particularly the failure of the energy-based investments at Pt. Lisas to perform as expected. This failure has been a major contributor to levels of debt service payments which are now inadequately matched by foreign exchange earnings.

3. During 1984-85, the Government made attempts to adjust the economy to the deterioration in its terms of trade, but in 1986 these advances were reversed by a further pronounced drop in crude petroleum prices. As a result, the external current account deficit jumped to 14 percent of GDP in 1986 from 2 percent of GDP in 1985 and the overall fiscal deficit rose to 11 1/2 percent of GDP from around 5 percent of GDP in 1985.

4. In 1987, the administration which assumed office in December 1986 began more concerted efforts to stabilize the economy in response to the weak international petroleum market. In the fiscal area, the wage and salary bill of the Central Administration was reduced through a

temporary suspension of cost-of-living allowances (COLA) and merit pay increases. This measure resulted in fiscal savings of TT$540 million, or 3 percent of GDP. In the 1987 Budget, the Government also slashed transfers and subsidies to the state enterprises and public utilities, which during 1982-85 had averaged around 12 percent of GDP. Significant reductions were achieved during the year as a result of cost- cutting adjustments and financial improvements carried out by the public enterprise sector. At the same time, the Government introduced a number of tax measures to strengthen the Central Administration's revenue performance. All in all, these measures resulted in a decline in the overall public sector deficit from around 11 1/2 percent of GDP in 1986 to about 8 percent of GDP in 1987.

5. In the area of external policy, the Government unified the exchange rate at TT$3.60 per U.S. dollar, by eliminating the preferential exchange rate for "essential" imports. Together with the fall of the U.S. dollar against other major currencies, this action resulted in a real effective depreciation of the Trinidad and Tobago dollar of 10 percent with respect to the level of December 1986 and brought the cumulative depreciation, in real effective terms, since the beginning of 1985 to around 40 percent.

6. Further corrective measures were introduced in 1988. In the context of the 1988 Budget the oil tax regime was revised with the aim of giving the oil companies the incentives required to increase production and exploration activity. Further, direct taxation on corporations was reduced, but this was more than offset by increases in direct taxation on individuals and a rise in the rates of indirect taxation. In a series of midterm policy adjustments announced in August, the Trinidad and Tobago dollar was devalued by 15.3 percent which reduced the real effective exchange rate index to about 50 percent below its level at the beginning of 1985; cuts in government expenditures amounting to the equivalent of 4 percent of GDP on an annual basis were introduced; and the central bank discount rate was increased from 7.5 percent to 8.5 percent.

7. On assuming office the present Administration began developing a planning framework for restructuring the economy. This framework, which was recently tabled in Parliament, was developed after elaborate consultation and dialogue with all the major sectors and interest groups in the country. The program includes a comprehensive seven-year macroeconomic plan (1989-95), a public sector investment plan covering the period 1989-91, and a medium-term economic program (1989-91) which details the major reforms and policies to be pursued over the next three years. In implementing the medium-term economic program the Government would like to count on the support of the International Monetary Fund, the World Bank, and the Inter-American Development Bank, as well as other multilateral financial institutions. The Government hereby requests a 14-month stand-by arrangement from the Fund in the amount of SDR 99 million. The Government also requests that the Fund decide that, if adverse external contingencies occur during the period of the

stand-by arrangement, the Fund will provide, in association with the stand-by arrangement, external contingency financing under the compensatory and contingency financing facility up to a maximum amount of SDR 42.5 million, in accordance with the factors set out in the Annex attached to this letter. Trinidad and Tobago understands that accordingly, in case of favorable contingencies, adjustments up to the same maximum amount may have to be made under the facility.

8. The Government's medium-term economic program is designed to restore the economy to a positive growth path in 1990-91 within a framework of reduced external and internal imbalances. The Government intends to reduce the external current account deficit from an estimated 6 1/2 percent of GDP in 1987 to around 4 percent of GDP in 1989 and about 2 1/2 percent of GDP by 1991. Over the same period, the gross foreign reserves of the Central Bank would be restored to the equivalent of at least three months of imports. In order to achieve these targets, the Government will reduce significantly the overall public sector deficit and will take steps to improve the incentives for both domestic and foreign investment in the tradeable goods sector. The Government's policies and principal financial targets for 1989 are set out in the following paragraphs of this letter.

9. In the area of the public finances, the Government intends to reduce the overall deficit of the public sector from an estimated 8 percent of GDP in 1987 and 7 percent of GDP in 1988, to around 4 percent of GDP in 1989 and around 1 percent of GDP by 1991. Such an improvement in the fiscal position will strengthen domestic savings and facilitate the recovery of investment that is needed to enhance the prospects for economic growth and a restoration of external viability. The improvement in the public finances will be achieved through a strengthening of the operations of both the Central Administration and the state enterprises.

10. In the case of the Central Administration, measures are being introduced to reduce its overall deficit from around 7 percent of GDP in 1988 to 4 percent of GDP in 1989. Consistent with these targets, quarterly limits for the central government borrowing requirement have been established which are set out in Table 1 (attached).

11. The Government has introduced a Voluntary Termination of Employment Plan (VTEP) that includes a voluntary early retirement scheme for employees aged 50 to 60 years and a voluntary severance scheme for employees under 50 years of age. Both schemes provide enhanced termination and pension benefits based on the number of years of service. The termination benefits are to be paid with a combination of cash and bonds in a ratio of 30:70 after a payment of TT$20,000. Assuming that 9,600 persons (15 percent of the central government employment) will enter the scheme over the next two years, the net reduction in the wage bill in 1989 and 1990 (after allowance for income taxes) would about be offset by the cost of termination and pension

benefits to be paid in cash. Thereafter, the net savings in current expenditure would be about TT$190 million per year.

12. In July 1988, the Industrial Court ruled that cost- of-living allowances, which had been suspended since the beginning of 1987, must be re-instated and that a salary increase of 2 percent based on a consolidation of basic salary and COLA should be granted effective January 1989 to central government workers. The Government has indicated that the tight fiscal situation precludes the timely implementation of the wage award in 1989. The Government will seek to reach agreement with the unions on a formula for implementing the award when economic conditions improve.

13. Within its tight expenditure constraints, the Government, mindful of the social and human aspects of adjustment, has taken steps to ensure that some protection is given to less privileged groups of society. Thus, the school feeding program, which was discontinued, would resume with effect from February 1989, albeit in a restructured and more targeted form. A small package of subsidies on basic foods will be maintained, as will the present programs of assistance to the elderly. In addition, programs have been introduced to provide training for self-employed workers, those who opt for early retirement and voluntary severance schemes, and other retrenched workers. Preparations are also under way for a training program for the widest possible participation of citizens in business enterprise. Also relevant is the recent decision of the government to establish a small business development company and to strengthen the Agricultural Development Bank.

14. Since the beginning of 1987, the Government has been focusing a major part of its fiscal efforts on improvements in the state enterprise sector with a view to reducing its burden on the budget. A Committee on the Restructuring of the Public Enterprises was established early last year with a mandate to formulate wide-ranging reforms of the state corporations, involving financial restructuring, divestment, and closure in some cases. In 1987-88, three state enterprises, which received combined transfers of TT$150 million in 1987, were closed down. Negotiations for the sale of 49 percent of the telephone company (TELCO) to a foreign investor are in progress. In addition, the Government has offered for sale some of its shareholdings in the Trinidad Cement Company and the National Commercial Bank.

15. In 1987, ISCOTT (the state-owned steel company) entered into a management contract with a foreign firm. As a result of some restructuring of the company and new management arrangements, the company's operating losses were reduced from an average of about TT$210 million a year in 1984-86 to an estimated TT$80 million in 1988. The Government has now completed negotiations for the lease of ISCOTT to a foreign company with many years of experience in the steel industry. Under the terms of the contract, the Government of Trinidad and Tobago will receive an annual lease payment, as well as a percentage of profits. Outstanding liabilities of ISCOTT will continue to be

guaranteed by the Government of Trinidad and Tobago. It is anticipated that under the negotiated lease arrangement ISCOTT would make a positive net contribution to the budget within the next few years.

16. In 1989 the Government plans to reduce transfers to the state enterprise sector by TT$186 million. Transfers to the public utilities will be reduced as a result of the rationalization of employment and the adjustment of tariffs. The Port Authority has eliminated overtime, as well as leave premium and perk payments. These actions, in addition to the retrenchment of casual workers and the voluntary early retirement scheme to be implemented not later than January 1, 1989, are projected to reduce the wage bill by about one third. The Port has also taken steps to increase revenues through the establishment of a cruise ship passenger terminal and the rental of certain assets (e.g., storage sheds and coastal vessels). The Water and Sewerage Authority (WASA) has begun to rationalize its operations through a cutback in employment (including a reduction in the schedule for casual workers from 10 to 8 days a fortnight). On the receipts side, steps are being taken to improve revenue collections and to collect outstanding arrears. The Public Transport Service Corporation (PTSC) has begun to streamline its operations by reducing the number of bus routes to be covered from 147 to 97. Arrangements have been made to ensure that the routes yielded by PTSC are adequately covered by private operators. In line with the reduction of operations, employment in the PTSC is to be reduced by 15 percent through retrenchment and a voluntary early retirement plan.

17. The impact of the devaluation of the Trinidad and Tobago dollar, the high prices prevailing in international markets for methanol and urea and the debt restructuring arrangements being negotiated will obviate the need for transfers to the Methanol and Urea Companies in 1989. Also, transfers to CARONI (the state sugar company) are to be reduced following a number of internal rationalization measures and an increase in the domestic price of sugar by about one third. In addition, reductions are targeted in transfers to the local authorities which would be required to cut back on the use of casual labor and reduce the scope of the services they supply.

18. A special committee has been set up in the Ministry of Finance and the Economy to monitor the operations of the state enterprises. The committee, which will include representation from the Ministry of Industry, Enterprise and Tourism, will focus on those enterprises (including public utilities) that receive transfers from the Central Government. These enterprises will be required to submit quarterly reports to the committee showing that their operations are consistent with their approved annual budgets and the level of central government transfers programmed for the year as a whole. In the case of deviations of individual enterprises from the fiscal plan, the Government will take actions to ensure that enterprise operations are brought into line with the fiscal objectives of the program. The Government will ensure that all other enterprises provide quarterly financial reports to the

Ministry of Industry, Enterprise and Tourism according to existing regulations.

19. In August 1988 the Government unveiled its three- year Public Sector Investment Program (PSIP). The PSIP is composed of projects to be executed by the Central Administration and state enterprises amounting to TT$3.5 billion over the next three years. The major areas of concentration are the energy sector, tourism, agriculture and manufacturing. The investment program for the Central Government, which is fully integrated into the annual budget exercise, is supported in 1989 by external funding of around US$75 million to be secured from a variety of bilateral and multilateral sources.

20. The Government's fiscal position also will be strengthened by the implementation of the first phase of a tax reform program which will be introduced with the 1989 Budget. The aim of the reform program is to widen the tax net, to make the tax system simpler to administer and to strengthen incentives for savings and investment. Ultimately, the objective of the reform is to shift more of the burden of the tax system toward indirect taxation. To this effect, the direct tax regime is being restructured effective 1989. Specifically, the system of special reliefs and investment incentives will be eliminated and marginal tax rates will be reduced. In the second phase of the tax reform program, it is intended to introduce a value-added type tax with effect from January 1990, at which time the marginal income tax rates for individuals and corporations would be further reduced.

21. The improvements being made in the public finances will reduce substantially the public sector's domestic borrowing requirement. As a result, a greater flow of financial resources will be available to support a recovery of private investment and business activity. Under the fiscal program outlined above, during 1989 the stock of net credit from the financial system to the nonfinancial public sector will not increase by more than TT$245 million with respect to the level of December 1988, compared with an estimated increase of around TT$610 million during 1988. Consistent with this target, quarterly ceilings for the stock of net financial system credit to the public sector have been established which take into account seasonal factors (Table 2).

22. Because of the pronounced effects of the economic contraction on the financial position of the business sector, loan recovery by the financial institutions has weakened and commercial banks have increased their recourse to central bank lending to cover legal reserve deficiencies. During 1986-87, the Central Bank took steps to close down four finance houses and provide assistance to several other institutions which found themselves in financial difficulty. The Bank has since established a Deposit Insurance Corporation and, in addition, has taken steps to strengthen its supervisory function over the nonbank financial institutions.

23. In its effort to reduce commercial banks' recourse to the Central Bank, the Central Bank increased its rediscount rate from 8 1/2 percent to 9 1/2 percent in late October, and henceforth will seek to maintain at least the existing differential between the rediscount rate and the weighted average of time deposit rates. The Central Bank is currently devising a schedule according to which commercial banks will be required to reduce their outstanding advances from the Central Bank. Beginning in November 1988, the operation of the Treasury bill market will be restructured so that the ensuing yields will be more closely market determined. With the new system, average yields on Treasury bills are expected to rise from around 4.85 percent to around 6 percent. Beginning in January 1989, the Central Bank intends to phase out the secondary reserve requirement. This action, together with the expected increases in Treasury bill rates, should enhance the earnings of the commercial banks and facilitate a reduction in the spread between commercial banks deposit and lending rates.

24. The Central Bank will conduct monetary and credit policy with a view to achieving the balance of payments objectives of the program. Taking into account the outlook for the growth in financial savings, total financial system credit has been projected to expand by around 2 percent in 1989. Consistent with this target and no change in net official international reserves, the net domestic assets of the Central Bank have been targeted to grow by TT$40 million in 1989, compared with TT$490 million in 1988. As a guide to credit policy, quarterly ceilings for the net domestic assets of the Central Bank have been established, which are set out in Table 3.

25. The Government believes that as much as possible prices should reflect the interplay of market forces. For this reason price controls are limited to a selected number of essential goods and services (about 20 items) which are critically important in the consumption basket of low-income groups. The prices of most controlled items were adjusted upward to reflect the full effect of the exchange rate adjustment of August 1988. In September, poultry and animal feeds were removed from price controls. Five other items are to be decontrolled by year-end, thus reducing the number of items still subject to price controls to thirteen. Administrative steps are being taken to shorten the delays in granting approvals for price increases.

26. Real wages in the private sector have declined sharply over the last few years. Real weekly earnings fell by 6 percent in 1987 following a similar decline in 1986. This trend persisted in 1988 and could be expected to continue in 1989. These wage developments, together with the exchange rate action taken since 1985, have significantly improved the competitiveness of export and import-substitution industries. The Government fully recognizes the importance of developing non-oil exports and consequently is committed to a flexible management of the exchange rate. Quarterly targets for the net international reserves of the Central Bank have been established which are set out in Table 4. Exchange rate management will take into account

developments in the balance of payments, as well as trends in external competitiveness.

27. The Government intends to reduce the scope of exchange controls during the period of the stand-by arrangement. With effect from January 1, 1989 petroleum service companies, selected tourist-related enterprises and manufacturers who are net earners of foreign exchange will be exempted from the ex ante allocation process. The Central Bank will continue to authorize foreign exchange allocations for invisible payments above the limits delegated to authorized dealers on the basis of bona fide requests. The Central Bank will take further steps by no later than September 30, 1989 to liberalize substantially the existing restriction on import payments with a view to eliminating the allocation system for imports in 1990.

28. The Government is committed to reducing quantitative restrictions on imports (the "negative list") over the next few years. Imports of items on the negative list amounted to around US$400 million in 1986, or about 28 percent of total imports. By the end of 1989, the Government intends to eliminate items from the "negative list" representing a value of at least US$150 million in terms of 1986 imports. As a first step, a group of items, representing import value of at least US$50 million in 1986, will be eliminated from the negative list before the end of 1988. Further deletions equivalent to at least US$50 million would be implemented by mid-1989. The trade system will be further liberalized and rationalized in 1989 in the context of a policy-based loan that is expected to be negotiated with the World Bank.

29. To expand the production base of the economy and the foreign trade-orientation of economic activity, the Government has adopted new strategies to promote foreign investment. An Investment Coordinating Committee (or One-Stop Shop) has been established and procedures simplified in order to eliminate the bureaucratic delays normally associated with the processing of investment applications through the Industrial Development Corporation and the Ministry of Finance and the Economy. The Government intends to introduce certain amendments to the Aliens Landholding Act before the end of 1988 with a view to removing certain restrictions which now exist.

30. The Government does not intend to impose or intensify restrictions on payments and transfers for current international transactions during the period of the stand-by arrangement, or introduce multiple currency practices, or to conclude new bilateral payments agreements which are inconsistent with Article VIII of the Fund's Articles of Agreement, or to impose new or intensify existing import restrictions for balance of payments reasons.

31. During the period of the stand-by arrangement, the Government intends to pursue a prudent external debt policy. Over the next three years, Trinidad and Tobago faces a heavy concentration of foreign commercial debt service obligations, and for this reason the Government has approached its commercial bank creditors to seek a multi-year rescheduling of principal obligations falling due in the period September 1, 1988 through August 31, 1992. At the same time, the Government intends to seek a rescheduling of principal obligations to official bilateral creditors under the aegis of the Paris Club. These arrangements are expected to result in debt relief of around US$270 million in 1989. Arrangements have been established to ensure that state enterprises, whose external debt has been rescheduled, will continue to make debt service payments in local currency into a special blocked account in the Central Bank according to existing terms and conditions of the indebtedness.

32. During the implementation of its medium-term economic program, the Government intends to rely mainly on new credits from multilateral lending institutions. Accordingly, disbursements of external public debt (and debt guaranteed by the public sector) in the range of 1 to 12 years (excluding those from multilateral lending institutions) will be limited to US$99 million during 1989 (and those in the range of 1 to 5 years will be limited to US$60 million). Quarterly limits on such disbursements have been established consistent with the execution of the public sector investment program which are set out in Table 5 attached. The outstanding stock of short-term external debt of the public sector (excluding normal trade credits) which amounted to US$-- million at the end of September 1988 will not increase during the period of the stand-by arrangement.

33. The Trinidad and Tobago authorities believe that the policies set forth in this letter are adequate to achieve the objectives of the Government's program, but will take any further measures that may become appropriate for this purpose. The authorities will consult with the Fund on the adoption of any measures that may be appropriate in accordance with the Fund's policies on such consultations. In this context, progress made in the implementation of the program, especially in the area of fiscal and exchange rate policies, will be reviewed with the Fund before July 31, 1989.

Sincerely yours,

A.N.R. Robinson Prime Minister and Minister of Finance and the Economy	William Demas Governor Central Bank of Trinidad and Tobago