ABSTRACT

Foreign Capital Flows in Trinidad and Tobago : Experience, Macroeconomic Impacts, and Policy Responses.

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Trinidad and Tobago experienced a nearly unprecedented inflow of foreign capital during the period 1988-1998. As a percentage of the Trinidad and Tobago GDP, these inflows increased from an average of about 7 per cent during 1987-91 to an average of around 17 per cent during the five years ended December 1998. The inflows, however, were distinctive in terms of the greatly increased importance of FDI (equity capital) and the greatly decreased importance of bank borrowing (debt capital). Whereas FDI amounted to almost US $500 million in the 1987-91 period, that figure increased almost six fold to US $3 billion in the 1994-98 period. Large capital inflows into some countries have held the promise of significantly increasing investment and growth by relieving some of the problems associated with limited capital resources and a deficiency in foreign exchange reserves. These inflows also help to push down domestic interest rates. However, large inflows can result in macroeconomic instability by contributing to an acceleration in domestic demand, a deterioration in the external current account, and pressures on the prices of goods, real estate and financial assets.

The thesis examines the extent to which capital inflows have altered the macroeconomic performance in Trinidad and Tobago over the last thirty years. An examination of the macroeconomic impacts of capital inflows was undertaken using a Block-Recursive Simultaneous Equation System Model. The results indicate that inflows of capital show no clear effect on investment and are inversely related to consumption in Trinidad and Tobago. The results confirm that foreign capital inflows do have a significant and positive impact on the employment generation process in Trinidad and Tobago. The study found that increases in capital inflows are positively correlated with changes in the interest rates but had no effect on the determination of the real exchange rate in Trinidad and Tobago.

There have been various approaches to maximizing the much needed growth and investment afforded by the inflows in the light of their potentially destabilizing effects. The conventional wisdom on policies is to exercise fiscal constraint; accept some real appreciation and avoid sterilization. However, the appropriate policy response clearly depends on the composition of the inflows, the availability of various policy instruments, and the nature of the domestic financial markets.

Keywords : Arjoon Harripaul; Capital Inflows; Capital Mobility; Macroeconomic Impacts of Capital Inflows.