The Energy Chamber of Trinidad & Tobago

Review of the National Budget 2011

October 2011

Contents

1 Introduction

The Energy Chamber's review of the national budget 2011 is based on an analysis of all of the national budget documents, rather than simply the Minister of Finance's budget statement. These documents are:

- The Minister of Finance's *Budget Statement* 2011
- Ministry of Finance *Review of the Economy* 2011
- Ministry of Finance *Public Sector Investment Programme* 2012
- Ministry of Planning and Development *Medium-term Policy Framework* 2011 – 2014
- Republic of Trinidad & Tobago *Draft Estimates: Details of Estimates of Recurrent Expenditure* 2012
- Republic of Trinidad & Tobago *Draft Estimates of Development Programme* 2012
- Republic of Trinidad & Tobago *Draft Estimates of Revenue* 2012
- Republic of Trinidad & Tobago *Draft Estimates of Revenue and Expenditure of Statutory Boards and Similar Bodies and of the Tobago House of Assembly* 2012
- Ministry of Finance *State Enterprise Investment Programme* 2012

The last of these documents is released this year for the first time. It includes details on projects to be implemented in the State Enterprise sector and is an excellent new addition to the annual budget documents.

A review of all of these documents, rather than just the statement of the Minister of Finance is necessary in order to fully understand the budget and the implications for the energy sector. There are, however, many questions that may only be fully addressed during the budget debate and specifically during the presentation of the Minister of Energy.

2 Review of the Energy Sector

While the overall gross domestic product (GDP) contracted by 1.4% in 2011 the energy sector has show a very marginal increase of 0.03%.[1] However, there are divergent experiences in the different sub-sectors. The largest sector of the economy, the exploration and production sector, is reported as declining by 2.3% in 2011, despite robust international and local oil and gas prices (other than the North American natural gas price). The petro-chemical sector also showed year-on-year declines of 0.9%, again despite very good commodity prices. The decline in both of these sub-sectors is primarily related to problems of constrained production, with both the widely reported declines in crude oil production and constrained natural gas production, which has had knock-on effects on the petrochemical sector.

The refining and LNG sector has show strong overall growth of 4.2%, with high prices for petroleum products in key markets, especially over the "summer-driving" months in the United States.

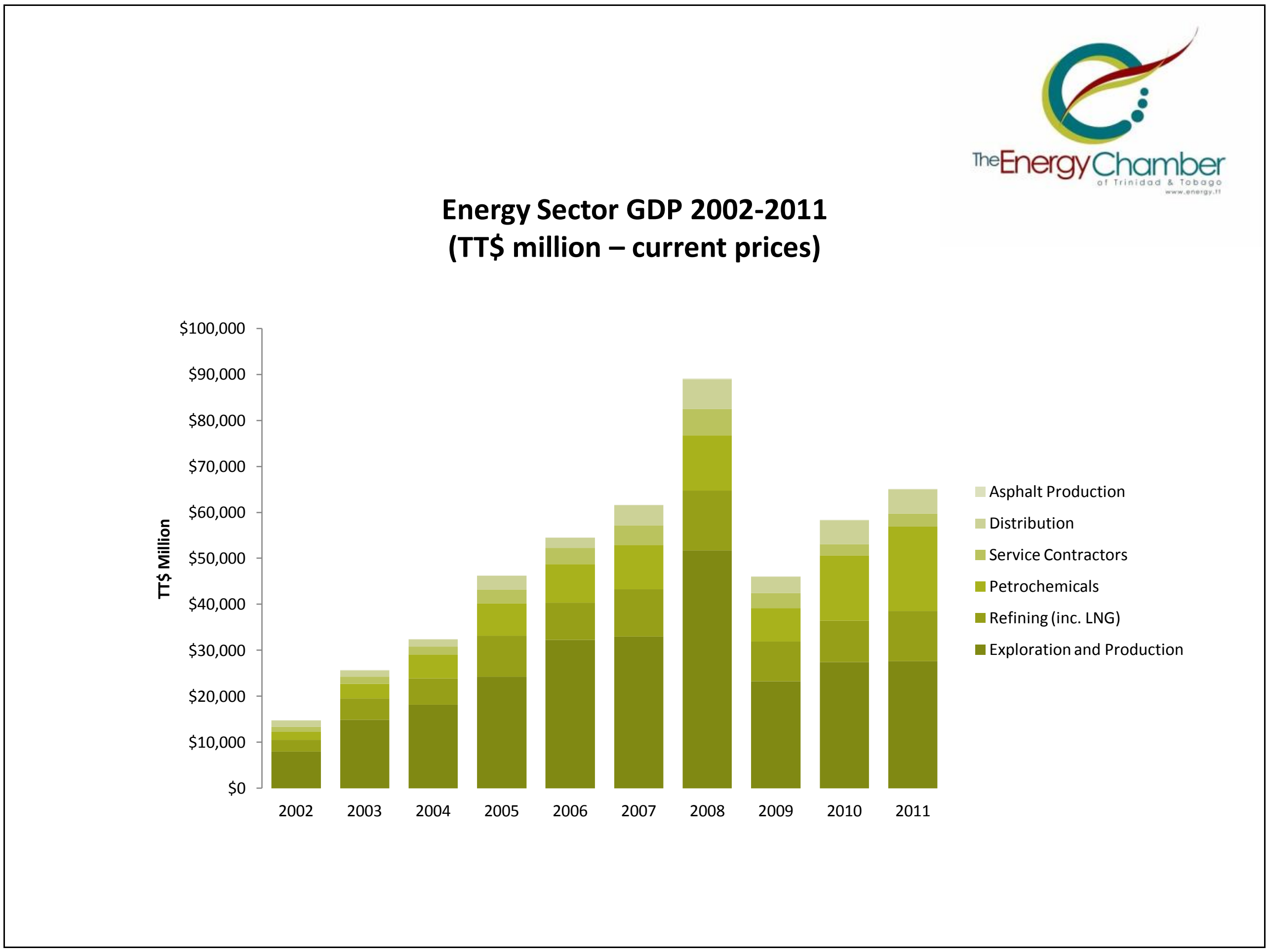
The most positive news in the energy sector is the strong growth in the service contractor sub-sector, which is predicated to show an overall growth rate of 17.1% in 2011. This sub-sector tends to show strong growth when investments in the upstream energy sector are increasing. The growth in this sub-sector could be considered as a leading indicator for future growth in oil and gas production and has been driven by a return to drilling activity, especially in the on-shore oil sector. This rebound in the services sector in 2011 comes on the back of three years of very significant declines.

While the upstream services sector has shown strong growth in 2011, there has been a decline in the downstream construction sub-sector with no new plants under construction for the first time in many years. This lack of activity in the downstream petrochemical construction sub-sector is likely to have contributed to the overall decline in the construction and quarrying sub-sector, which showed a 7.9% contraction in 2011. The plant construction sector is the major source of employment within the wider energy sector.

[1] Based on GDP at constant 2000 prices.

While being a minor contributor to GDP, the very positive growth rates in the asphalt production sub-sector (43.5 %) should be noted, as they indicate improved management of the La Brea pitch lake resources.

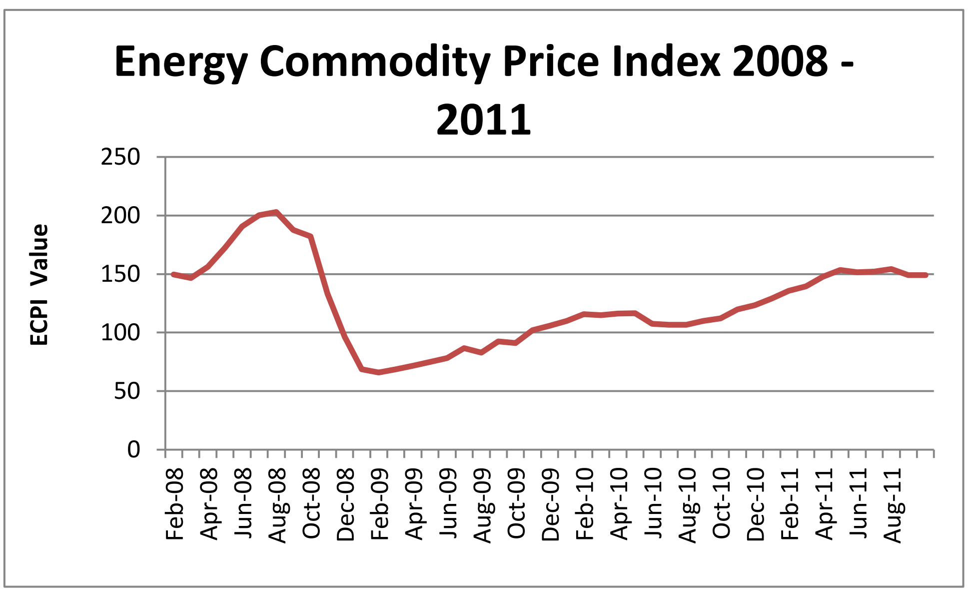
The energy sector continues to dominate the economy, estimated to be contributing over 45.3% of total GDP at current prices in 2011, up slightly from the figure in 43.9% in 2010. The exploration and production sector remains the largest sector of the economy (19.2% of overall GDP), though its contribution remains significantly lower than in the 2006 – 2008 era (see Graph 1).



3 Energy Sector Revenue and Expenditure

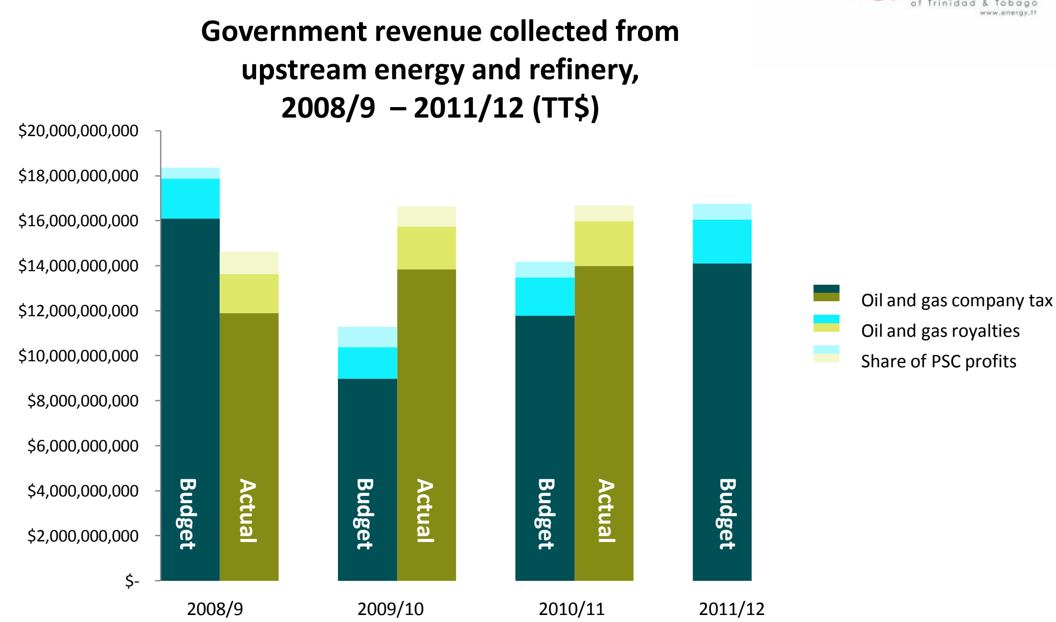
During fiscal year 2010/2011 taxation from oil and gas producers and the refinery stood at just under TT$14 billion, surpassing the budgeted figure by TT$ 2.2 billion (or 16% above budget) and showed a marginal (1%) increase over the actual receipts for 2009/10. While it is encouraging that oil and gas company taxation surpassed budget, it should be noted that this has been driven primarily by good commodity prices.

While the Energy Commodity Price Index[2] has approached levels last seen in mid-2008 (see Graph 2), revenue collected from the oil and gas production sector remains a long way below the peak year of 2007/8, when oil and gas company taxation was TT$25.6 billion. The lower levels of total revenue collection, despite a good price environment, highlights the importance of production levels and the adverse impact of declining oil production in particular.



[2] The Energy Commodity Price Index is a collaborative effort between the Central Bank and the Energy Chamber. It is based on a weighted average of the ten major energy sector commodities and it designed to provide a more nuanced snap-shot of the value of Trinidad & Tobago's commodity exports, rather than oil price alone.

In 2010/11, oil and gas company taxation represented a 37% of total government taxation. On top of the direct taxation, royalties and the Government shares from Production Sharing Contractor profits represented a significant contribution to overall Government revenue, contributing just under TT$3.0 billion in 2010/11. This represented 54% of non-tax revenue received by the Government.



3.1 *Energy sector revenue contributions beyond direct oil company taxation*

In addition to taxation and royalties, the petrochemical sector and Atlantic would have contributed a very significant percentage of the TT$8.8 billion collected in Corporation Tax. It should be noted that these companies are taxed at a rate of 35% compared to 25% for all other companies. State enterprises in the energy sector, in particular NGC and Petrotrin, have also been major contributors to the estimated TT$1.0 billion paid as dividends to the Ministry of Finance.

Furthermore, energy sector companies would have been major contributors to a number of other tax and non-tax revenue streams, including Value Added Tax, and Withholding Tax. In total the energy sector has again safely contributed significantly more than 50% of total Government revenue.

3.2 Revenue projections 2011/12

Government is projecting similar levels of energy sector revenue in fiscal 2011/12 as received in 2010/11. Given the conservative commodity price projections announced by the Minister of Finance in his budget statements (US$ 75 per barrel of oil and US$2.75 per mmbtu of natural gas), the revenue estimates must factor in increased levels of oil and gas production if the estimates (based on lower prices) are to match this year's actual receipts.

While the Government is projecting a small decline in Corporation Tax receipts, from TT$8.8 billion to TT$ 8.5 billion it should be noted that the 2010/11 figure was bolstered by a very successful tax amnesty. Improved delivery of natural gas to Point Lisas will assist in maintaining high-levels of Corporation Tax receipts from the petrochemical sector, though this assumes a continued high price environment. The Government has not made any statement on their pricing assumptions for methanol and ammonia.

It appears that the Government's tax assumptions for 2011/12 are, therefore, based on assumptions of improved oil and gas production and hence better utilization and production rates in the petrochemical sector. While these assumptions may be reasonable, the Energy Chamber would welcome more explicit statements about the production assumptions underlying the revenue projections.

It is also possible that the Government may be assuming that the adoption of a best practice transfer pricing regime, announced in the Ministers of Finance's budget statement may also contribute to improved Corporation Tax receipts.

The Minister of Finances budget statement indicated a total projected revenue stream from the energy sector of TT$18.1 billion, though it is unclear exactly what this figure covers. The direct revenue collected from oil and gas taxation and directly by the Ministry of Energy is projected at just under TT$17 billion in 2011/12. A significant projected proportion of the Corporation Tax will certainly come from Atlantic and the petrochemical companies, giving a much higher total energy sector revenue figure than the TT$18.1 billion mentioned in the statement.

Table 1: Direct oil and gas revenue streams (TT$)

	2010 (actual)	2011 (est.)	2012 (budget)
Oil Company tax	13,834,359,052	13,989,027,000	14,109,951,000
Royalties on oil and gas	1,898,863,469	1,979,000,000	1,950,959,800
Share of Profits from oil companies under PSC	900,000,000	700,000,000	700,000,000
Other Ministry of Energy fees and licenses	104,507,075	288,488,650	177,631,030
Total revenue from unique energy line items	**16,737,729,596**	**16,956,515,650**	**16,938,541,830**

3.3 Heritage and Stabilisation Fund

During 2010/11, the Government again ran an overall deficit despite the higher than budgeted revenue figures. The deficit was, however, lower than projected and the Government did not have to resort to the same levels of borrowing as projected in October 2010. The 2010/11 budget was originally predicated on additional borrowing of close to TT$6.0 billion; the better than budgeted revenue collection meant that actual borrowing was TT$1.4 billion in 2010/11. Of this TT$400 million was borrowed on the domestic market.

It should also be noted that while the Government borrowed an additional TT$1.4 billion, they also set aside an additional TT$2.9 billion in the Heritage and Stabilization Fund (HSF). Under the Government accounting system the transfer to the HSF is counted as recurrent expenditure. The budget figures therefore suggest that the Government actually saved more than it borrowed in 2010/11. However, this does not take into account the fact that the Government may owe significant sums to various trade creditors (see section below on the petroleum subsidy).

In 2011/12 the Government is again projecting that it will run a budget deficit of TT$7.6 billion. This projection is based on a very small current account surplus of TT$180 million, but with borrowing of TT$6.6 billion to cover increased capital account expenditure.

3.4 Petroleum Subsidy and Petrotrin Receivables

The biggest increases in expenditure between budget and actual in 2010/11 was in the area of transfers and subsidies (TT$2.5 billion overall increase), which was also the major overall item of expenditure at just under TT$27 billion. Subsidy and transfer payments cover a wide range of different items of expenditure, from grants to poor and disadvantaged households to transfers to the Infrastructure Development Fund. The increase in this item of expenditure was mainly caused by the payment into the HSF noted above.

It is noteworthy that the expenditure figures in the 2010/11 budget included only TT$1.12 billion in subsidy for petroleum product subsidies, one of the major issues of discussion in the run up to the budget. Data released by the Ministry of Energy's CNG Task Force earlier this year suggested that the total cost of the transport fuel subsidy would be in the region of TT$ 2.5 to 3.0 billion given average oil prices over the past year. As Government accounts are calculated on a cash basis, this suggests that a significant debt may be accruing to National Petroleum and Unipet – and ultimately to Petrotrin – which may not be fully accounted for in the national accounts. The financial report from Petrotrin for 2010 indicated trade receivables of TT$ 1.3 billion as of December 2010. It is likely that this figure was largely made up of subsidy payments not yet forthcoming.

Only TT$ 1.5 billion has been allocated for the petroleum subsidy, under the Ministry of Energy's accounts, for the 2011/12 financial year. Given the oil price assumptions contained in the budget, this figure appears to be under budget unless there is a very significant reduction in the cost of the subsidy by a successful programme of preventing all "leakage" through illegal diesel exports. The announced measures to control the illegal trade should help in cutting costs, but it remains to be seen whether this will be enough to bring down costs to the budgeted figure.

The budgeted figure would also appear not to include any provision for payment of past arrears, which it is safe to assume have risen during 2010/11. This suggests that there is a potentially significant debt that is not fully accounted for in the national accounts. It also means that Petrotrin may be ultimately carrying significant and growing receivables on its books, limiting its ability to access the cash needed to implement its aggressive investment programme in 2011/12.

4 New measures introduced in 2011/12

In contrast to 2010/11, there were only limited new measures introduced in the 2011/12 national budget that directly impact on the energy sector.

4.1 Removal of VAT from equipment for oil and gas exploration

The removal of VAT from imports relating to offshore exploration and development activities is the most noteworthy measure introduced in 2011/12. This is a very positive development and one that will be welcomed by the energy sector. It will significantly increase efficiency within the offshore exploration and development sector and will reduce the cost of doing business, with no overall reduction in Government revenue (as under the previous system VAT was refunded once the equipment left Trinidad & Tobago). The change will also reduce the working capital needed by service companies operating in the sector and will, therefore, also benefit local energy service companies who need to import equipment to carry-out contracts in the sector.

4.2 Transfer pricing

The Minister of Finance announced that the Government would introduce a new best practice transfer pricing regime, based on OECD guidelines. The introduction of this new regime is presumably targeted mainly at companies in the oil, gas and petrochemical sector who conduct business with related parties along their marketing chain (though it should be noted that Petroleum Taxes Act already includes provisions relating to "arms length" transactions). The Ernst & Young commentary on the national budget notes that the OECD guidelines would be welcomed by most multi-national companies, given their familiarity with the provisions. They further state that they hope that the introduction of the guidelines will see the removal of the current "arbitrary" 2% cap on management charges paid to non-residents under the Income Tax Act.[3]

4.3 Further incentives for CNG and renewable energy

The Minister of Finance announced new tax allowances of 50% for expenditure relating to equipment for both CNG and LNG filling stations and a 50% reduction in import duties on vehicles manufactured for

[3] Ernst & Young (2011), *Focus on Trinidad & Tobago Budget 2012* (Port of Spain, October 2011).

use of natural gas. The reduction on import duties only applies to vehicles with an engine capacity smaller than 2300 cc. Given the desire to switch as much transport fuel as possible from diesel and gasoline to natural gas it is unclear why the reduced import subsidy is restricted to smaller vehicles, especially as there is a growing fleet of LNG fuelled trucks which could potentially displace existing diesel trucks.

The Minister of Finance also outlined further measures to encourage adoption of renewable energy technology. The new measures involve a 150% of expenditure allowance for wear and tear for plant, machinery, parts and equipment used in the manufacturer to solar water heaters, wind turbines and photovoltaic systems. These seem to be in addition to the allowances introduced last year for the purchase of these items.

4.4 New Fees for Petroleum Licenses

The Minister of Finance also outlined increases in the fees associated with licenses granted by the Minister of Energy under the Petroleum Act. While on a percentage basis these increases in licenses look high, the reality is that within the overall context of the energy sector these represent generally only a very small portion of total costs and will have an insignificant impact on the competitiveness of the sector.

4.5 Increased fines under the Petroleum Production Levy and Subsidy Act

The Minister of Finance announced increased fines for illegal sale of subsidized fuels and general contravention of the licensing and similar requirements for the fuel transport and retail sector. The existing fines are extremely small and the increases are very necessary.

5 Energy Chamber's Comments on the 2011/12 national budget

5.1 Private-sector led growth

The Government has continued to place a welcome emphasis on private-sector led economic growth in Trinidad & Tobago. The general approach outlined in the *Medium-term Policy Framework 2011-2014,* released at the same time as the national budget, is for the Government to create an environment conducive to investment and innovation by the private-sector, both domestic and international. There is a particular emphasis on productivity and on increasing competitiveness, with the Government making specific commitments to improve Trinidad & Tobago's ranking on the Global Competitiveness Index by 20 points by 2014.

The private-sector led approach has perhaps led to fewer headline grabbing announcements of new projects and 'goodies' than has been the pattern over recent budgets. This approach must be welcomed by the private-sector and is certainly welcomed by the Energy Chamber.

5.2 Fiscal changes

The fiscal changes introduced in 2010/11 do appear to have had a positive impact on the energy sector, with the significant increase in on-shore drilling and strong growth in the energy services sector being good indicators of new investment and improved confidence. The fiscal changes introduced in 2011/12 may appear minor, but are very positive for the energy sector. The removal of VAT from offshore exploration and production related equipment in particular is a most welcome change. There may be some additional items of equipment that could also be zero-rated to also help reduce costs in the on-shore oil sector.

5.3 Energy sector investment

The budget statement and the *Medium-term Policy Framework* identify the need for increased investment as the key for driving forward economic growth. The energy sector has traditionally been the major location for investment in Trinidad & Tobago.

Over the recent past there has been a lack of new projects coming on stream in the downstream sector. The mention of the AUM II Plant, the Solar Park and the CARISAL Calcium Chloride Plant in the budget sends a positive signal, but both the budget statement and the *Medium-term Policy Framework* make very little mention of the need for new investment in the upstream energy sector.

The reality is that the majority of the TT$ 20 billion annual investment from the private-sector anticipated in the *Medium-term Policy Framework* will be in the upstream energy sector. While the number one target of the Ministry of Energy is stated to be to increase oil production, this target is not mirrored in the cross-cutting targets outlined in the *Medium-term Policy Framework.* While improving competitiveness generally will help the oil production sector, there are particular issues of red-tape and bureaucracy facing the sector that need to be urgently addressed. The Minister of Energy does not have direct control over these, so it would have been a positive signal if they were addressed in the overarching *Medium-term Policy Framework.*

It is also striking that the oil industry is not mentioned as a driving force for the South West Peninsula growth pole outline in the *Medium-term Policy Framework.* Given that this sector is one of the major employers within the South West Peninsular and the major contributor to economic growth in the region, it is surprising that it is not targeted as an industry for development, especially given the Ministry of Energy's priorities. This lacuna speaks to a need for greater co-ordination between the objectives of the various Ministries. The Energy Chamber trusts that the *Medium-term Policy Framework* is regarded as a working document, rather than a finishes product.

5.4 Union Industrial Estate

There is also a lack of clear statements on the Union Estate in La Brea and its role in the development of the South West Peninsula. There has been very significant investment into this heavy industrial estate and its related port infrastructure and urgent measures need to be taken to ensure that there is now significant investment into major industrial plants to ensure that the nation receives a return for its investment.

5.5 Equity investments and public offerings of State-owned Companies

The announcement that the Government will seek equity investment into First Citizens Bank and PLIPDECO, through a listing on the stock exchange, is welcomed by the Energy Chamber. However, given the urgent need to increase oil production and the difficulty associated with Petrotrin taking on further debt, we expected to see a more definitive announcement about the introduction of equity investment into Petrotrin.

5.6 Equity participation in Petrotrin

The *State Enterprise Investment Programme 2012* outlines a large number of proposed investment projects by both Petrotrin and the National Gas Company. In the case of Petrotrin, the *State Enterprise Investment Programme* report outlines TT$ 2.8 billion of investments over the next 12 months. The majority of this investment is listed as coming from the company's internal funds, including a TT$725 million Soldado drilling campaign and a TT$698 million for phase I of a Southwest Soldado development project. Given the cash-flow issues facing the company, primarily due to delays in receiving petroleum subsidy reimbursements, it may be a challenge to the company to raise these funds from internal sources.

The Energy Chamber has made strong and repeated calls for Petrotrin to seek equity participation, rather than seeking to take on more debt to finance investments. The recent presentation by Mr Wendell Mottley to the Energy Chamber's AGM Luncheon outlined a strong case for a public-listing of Trinidad & Tobago state-owned energy assets and provided the Colombian state-owned company, EcoPetrol as an excellent example that we should emulate.[4]

5.7 Energy services sector and local content

While both the Minister of Finances budget statement and the *Medium-term Policy Framework* address the potential of the energy services sector to increase exports, there is a lack of specific measures outlined in the budget to support this objective. Local content is acknowledged but there are few commitments on concrete steps that will be taken to increase the participation by local companies in the energy sector.

[4] Speech available at http://www.energy.tt/index.php?categoryid=1&p2001_articleid=1153

While the *Medium-term Policy Framework* lists "Taking Trinidad & Tobago's energy sector global" and "increase local content" as two of the top priorities for the Ministry of Energy, the specific measures to be undertaken have not yet been fully outlined. Funds for market intelligence and export promotion activities are allocated under the Ministry of Trade.

In the past the Energy Chamber has encountered some difficulties in accessing funding from the Ministry of Trade and the Business Development Company, given their mandates to support the non-energy sector. In recent years this has been much easier and there has been a clear recognition from the Ministry of Trade of the role in energy services in economic diversification, but the Energy Chamber would like to see further clarity about how these resources can be accessed by energy service companies seeking new markets.

5.8 Renewable Energy and exports

In addition to the further fiscal measures for renewable energy, the Ministry of Energy has been allocated TT$ 1.0 million under the Public Sector Investment Programme for activities in this area, while the Ministry of Trade and Industry has been allocated TT$ 14.0 million for a "Solar Energy Initiative". Presumably the Solar Energy Initiative refers to the solar industrial park that has been proposed.

The reality of the energy market in Trinidad & Tobago, with our very cheap electricity for gas-fired power stations means that there is limited potential to deploy renewable energy technology in Trinidad & Tobago. There is, however, a good potential for Trinidad & Tobago companies to deploy renewable energy projects in other Caribbean countries where power costs are very high. The solar park initiative recognizes this potential, but a deliberate policy of incorporating this concept into the general policy of widening the economic space should be explicitly developed.

5.9 Realising the Corporation Tax revenue projections and balancing the budget

The 2011/12 budget is again based on a projected deficit. Expenditure is again expected to increase to an overall figure of TT$ 54.6 billion. While there is a clear need to continue to expand investment into new infrastructure if the economy is to flourish, the budget also anticipates an increase in current account expenditure. Personnel related expenditure is set to rise from TT$6.5 billion to TT$ 7.2 billion, with acquisition of goods and services rising from TT$5.8 billion to TT$7.3 billion.

The budget is based on a fairly conservative oil and gas price and once oil and gas prices remain buoyant, oil and gas company taxation and royalties should meet expectations, assuming that there are no major upsets to production. The current investments in development drilling will, hopefully, also result in improved oil production. Nevertheless, under the HSF legislation oil and gas revenue in excess of budget is earmarked to be set aside, as happened this year.

The Energy Chamber is more concerned about the Government meeting the projected revenue figures from Corporation Tax. The “amnesty” effect in 2010/11 will not be repeated in 2011/12 and even with significantly improved collection methodology and new transfer pricing rules it may be ambitious to expect to match the 2010/11 revenue figures. It should be noted that transfer pricing rules could cut both ways, especially with respect to the cap on management charges. The economic contraction of the last few years means that many companies will be carrying forward loses, so a return to economic growth may not necessarily result in significant new Corporation Tax inflows.

While Trinidad & Tobago does have more macro-economic space than many other countries, it does not mean that further unnecessary debt needs to be taken on-board. A more aggressive approach to cutting waste in the public sector should be pursued, with the transfer and subsidies expenditure line being a particular concern. This does not necessarily mean cuts to social safety net expenditure: there are many items of expenditure under this heading that are earmarked for expenses relating to non-productive companies or companies in the process of being wound-up. In many cases these on-going expenses are a result of slow or indecisive decision-making.

5.10 Disposal of unproductive assets

On the revenue side, there are also a wide range of assets that the Government owns or controls that produce no return to the country. An aggressive and deliberate process of disposing of these assets could both realize additional revenue and reduce on-going administrative and other expenditure. The assets of the former Caroni (1975) Ltd are probably the most glaring example. During 2010/11 the Government received direct revenue of just TT$840,000 from rental and TT$1.8 million from sales of former Caroni lands. At the same time it continued to service loans for Caroni to the tune of TT$370 million, plus a further TT$ 19 million in other transfers to the company. Given the very valuable land assets previously owned by the company and now transferred to the State, the more prudent approach surely must be to realize the value of the assets and fully repay any outstanding liabilities. This approach would also ensure that a portion of the land holding would end up in private-sector hands and may unlock new private-sector investment.

The Energy Chamber encourages the Minister of Finance to continue to closely monitor and review all expenditure and especially transfers and subsidies. Budgeted expenditure does not always need to be spent.