SEYCHELLES: A SUCCESSFUL FISCAL CONSOLIDATION PROGRAM COMPATIBLE WITH THE JAMAICAN CASE

Seychelles

Initial situation

In the years 2007-08 Seychelles was in the midst of an acute balance of payments and public debt crisis (see Table 1). Despite step devaluations, the exchange rate was not aligned with economic fundamentals for some years. Competitiveness was undermined by expansionary fiscal and monetary policies inconsistent with the maintenance of the pegged exchange rate regime. External debt rose to unsustainable levels, complex exchange controls and restrictions were progressively introduced and foreign exchange shortages ensued.

Table 1: Seychelles Economic Indicators

	2005	2006	2007	2008
	(Annual % change, unless indicated)			
National income and prices				
Nominal GDP (in millions of Seychelles rupees)	4,861	5,342	6,113	7,878
Real GDP	7.5	8.3	7.3	3.1
Retail price index [1]	0.8	-1.4	5.7	32.2
Government budget				
Total revenue, excluding grants	41.1	42.0	35.9	35.4
Identified expenditure and net lending	40.4	49.6	46.0	37.6
Current expenditure	35.1	41.5	40.8	32.2
Capital expenditure and net lending	5.3	8.0	5.1	5.4
Overall balance, including grants (above the line)	1.7	-6.2	-9.8	-1.8
Primary balance	7.3	-0.6	-2.3	7.1
Total public debt[4]	147.1	139.5	146.0	151.3
Domestic	100.5	85.8	74.1	53.5
External	46.6	53.7	71.9	97.8
External sector				
Current account balance after official transfers	-19.7	-13.9	-23.4	-28.8
	(US$ millions, unless otherwise indicated)			
Gross official reserves (end of year)	56.1	112.7	9.8	18.7
Source: IMV Article IV. February 2009				

Reform efforts since 2003 brought about some fiscal adjustment, trade reform and partial economic liberalization, but were insufficient to address longstanding macroeconomic imbalances and vulnerabilities. In mid-2008, facing the near exhaustion of official foreign reserves, the authorities missed a payment on a privately-placed external debt issue in July and on a Eurobond payment in October. Standard and Poor's downgraded Seychelles to SD (selective default).

The oil and food price shocks, together with the global slowdown, exacerbated vulnerabilities. Inflation had risen rapidly following the increase in world food and fuel prices. The external current account deficit widen due to lower growth in tourism receipts, the petroleum and food price shock, and higher costs of transportation services. Official reserves fell to very low levels and the balance of payments deteriorated significantly. At almost 151 percent of GDP, public debt was unsustainable. In light of these developments, in 2008 the authorities began to tighten fiscal and monetary policy.

The authorities initiated in 2009 a comprehensive reform strategy aimed at restoring internal and external balances. The reforms included a fundamental liberalization of the exchange regime, involving the elimination of all exchange restrictions and a float of the rupee; a significant and sustained tightening of fiscal policy backed by a reduction in public employment and the replacement of indirect subsidies with a targeted social safety net; a reform of the monetary policy framework to focus on liquidity management based on indirect instruments; and a reduction in the role of the state in the economy to boost private sector development, through further privatization, enhanced fiscal governance, and a review of the tax regime.

As the result of the Fiscal Consolidation Program in Seychelles, the near-term outlook has increased substantially. A robust rise in tourism earnings in 2013 supported growth, as well as a reduction in the current account deficit as a share of GDP. The exchange rate strengthened slightly, at the same time as the central bank accumulated more international reserves than expected. Inflation decelerated below 5 percent, and the government is on track to achieve its 5 percent of GDP primary surplus target, as a shortfall in tax revenue and grants has been offset by lower-than-anticipated capital expenditure.

The authorities' macroeconomic policy framework for 2014 provides a solid basis to continue to reinforce external and fiscal sustainability (see Table 2). The authorities remain on track with their objective to reduce public debt below 50 percent of GDP by 2018, while increasing allocations to address social needs. Monetary policy will continue to aim to stabilize inflation at low levels and to accumulate international reserves, and the authorities and staff agreed on the need to strengthen the monetary policy framework to improve the transmission mechanism. Structural reforms aim to extend improvements in financial discipline to the broader public sector, including through rebalancing utility prices to reduce implicit subsidies and through better oversight of parastatals.

Under the fiscal program's key objective of placing the economy firmly on the path to external and fiscal sustainability has been achieved, based on the successful implementation of the debt restructuring, robust fiscal consolidation, and the resumption of growth. Public debt has been brought down from 124 percent of GDP at end-2009 to an estimated 71 percent at the end of 2013, reflecting an average primary surplus of over 6 percent of GDP and growth of 3½ percent. Inflation has fallen below 5 percent. External reserves, a vital buffer for such an open economy, have improved from just over 2 months of imports at the start of the program to over 3½ months at the end of 2013. While substantial progress has been achieved, the economy faces continuing vulnerabilities from still high debt levels, low reserve coverage, and an unfinished reform process.

Table 2: Seychelles: Selected Economic and Financial Indicators, 2010–14

	2010	**2011**	**2012**	**2013**	**2014**
	(Percentage change, unless otherwise indicated)				
Nominal GDP (billions of Seychelles rupees)	11.76	13.11	14.14	15.29	16.46
Real GDP	5.6	5.0	2.9	3.3	3.9
CPI (annual average)	2.4	2.6	7.1	4.5	3.4
Government budge					
Total revenue, excluding grants	34.1	35.8	37.6	36.4	35.6
Expenditure and net lending	32.5	35.7	40.2	38.5	36.0
Current expenditure	27.2	27.6	28.8	28.8	27.3
Capital expenditure and net lending	5.3	8.1	11.4	9.8	8.7
Overall balance, including grants	2.5	2.5	2.4	1.8	2.0
Primary balance	8.6	5.4	6.2	5.1	4.4
Total public debt	**81.6**	**74.3**	**77.3**	**72.0**	**65.3**

Table 3 illustrates the similarities between the program followed by Seychelles and the one proposed by the Bank in Jamaica. If implemented successfully, the Bank program may follow the same path as the one in Seychelles.

Table 3: Program similarities between Seychelles and Jamaica

SEYCHELLES		JAMAICA	
Reform	**Purpose of the reform**	**Reform**	**Purpose of the reform**
Eliminate / reduce tax expenditures	Broaden the base and level playing field for all business and individual taxpayers	Curtail tax expenditures by affecting the Charities Act and the FIA. New incentives will take the form of tax credits for PIT and CIT only, and will be defined as the amount credited against the CIT/PIT payable in any fiscal year.	Broaden the base and level playing field for all business and individual taxpayers
Amend the Business Tax Act in line with the tax reform strategy and Reduce rates and broadening the tax base. The Goods and Services Tax (GST) base was expanded, cascading effects were eliminated, and concessional rates were phased out.	To broaden the tax base, modernize tax policy, and remove distortions.	Lower the CIT rate from 30% to 25% for unregulated companies; increase the Initial Capital Allowances (ICA); and allow for an Employment Tax Credit (ETC)	Reduce economic distortions and promote economic growth
Cabinet approval of customs reform strategy and	To transform customs into a modern and efficient	Simplify the tariff structure by reducing import tariff dispersion.	to reduce economic distortions and inequities resulting from the tax

SEYCHELLES		JAMAICA	
Reform	**Purpose of the reform**	**Reform**	**Purpose of the reform**
implementation plan	entity.		system
Introduce Personal Income Tax	To broader the tax base and provide for more equitable taxation	Establish a Minimum Business Tax (MBT), and a cap of 50% on claims for deduction of tax losses forwarded in any year of assessment on chargeable income (CIT and PIT).	Broaden the tax base and provide a more equitable taxation
Submit to National Assembly a new customs management act	To institutionalize best international practice and a better business climate.	Require that all large taxpayers and all employers with more than 20 employees file their tax returns electronically; that the TAJ and JCA issue regulations to establish tax and customs duty e-Payment systems; and that the JCA implement a proprietary software package (ACCPAC) to strengthen its accounting and financial IT systems.	Institutionalize best practices and better business climate in Tax Administration and Customs Jamaica
Adopt Public Enterprise Monitoring and Control act.	To improve oversight over public enterprises and reduce quasi-fiscal risks.	Update the 2010 Master Rationalisation Plan (MRP) that calls for divestment, merger or winding up of the PBs.	To improve oversight over public enterprises
Ministry of Finance also has submitted the financial audits of several public enterprises to the scrutiny of the Public Accounts Committee of the National Assembly	To improve oversight and accountability of Public Enterprises	The PBs are also to be held more accountable by means of requiring an increasing proportion of them to comply with a six-month deadline for filing their annual financial statements after the close of the financial year.	To extend full financial oversight to the partially funded entities, the PED will be restructured and a strengthened monitoring and reporting system will be in place, with the goal of expanding its capability to examine balance sheet and P&L