Is small beautiful?

Economic policy-making in a small and open economy—the case of Suriname

Gillmore Hoefdraad

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Highlights World Economic Outlook
Global growth has decelerated. Growth projections 2012 and 2013 downgraded by the IMF across regions.

Substantial uncertainties and downside risks remain.

Critical need to rebuild confidence and action to restore strong, sustainable and balanced growth.

Advanced economies need to deliver necessary structural reforms and implement credible fiscal plans.

Emerging market economies need to use policy flexibility to respond to shocks and support growth.
Growth projections October 2012 compared with April 2012: downward adjustment

Source: IMF, WEO October 2012
Growth slow down: But prospects much better in Emerging Markets and Developing Countries

Source: IMF, WEO October 2012
Need to secure a sustained recovery from the crisis.
Growth advanced economies too low and slow to combat high unemployment
Monetary easing has created more accommodative financial conditions.
Medium-term fiscal consolidation remains critical in many advanced economies, but fiscal policy needs to be as growth-friendly as possible.
In the euro area, we need a timely implementation of an effective banking and a stronger fiscal union, and structural reforms to boost growth and employment.
In the U.S., we need to resolve the fiscal cliff, raise the debt ceiling, and make progress toward a comprehensive plan to ensure fiscal sustainability.
Worsening of already low growth in Advanced Economies

Source: IMF, WEO October 2012
Activity is slowing in emerging markets and developing economies due to weaker external and domestic demand and, in some cases, policy tightening to combat inflationary pressures.

Some countries face falling prices for non-food commodities and upward price pressures on food items.

Some countries continue to be affected or face the risk of large and volatile cross-border capital flows.
Significant growth slow down in large Emerging Markets and Developing Economies

Source: IMF, WEO October 2012
Emerging Markets and Developing Economies (cont’d)

- **Caribbean**
  - Tourism based economies worse off: high debt levels and deteriorating competitiveness. Prospects are gloomy.
  - Commodities exporters relative better off: higher growth and more fiscal space. However, decline in commodities prices may harm growth.

- **Suriname**
  - Lower world demand for commodities may affect Suriname through the trade channel.
  - Prudent monetary and fiscal policies together with fiscal buffers may ensure resilience.
Growth in large CARICOM countries: Suriname in the forefront

Source: IMF, WEO October 2012
Developments in Suriname
A small, open, commodity-based economy

- Small GDP (US$4.9 billion in 2012), but growing fast.
- Small population (about ½ million).
- High dependency on commodity exports, mainly gold, oil, alumina.
- Significant dependence of budgetary revenue on volatile mining revenue (about one third of revenue).
Small is not beautiful

- High risk through an undiversified production and export base.
  - Mining exports account for 95% of export value in 2012.
  - Mining revenue accounts for 34% of government revenue in 2012.

- Highly vulnerable to exogenous commodity price shocks.
  - Volatility of aluminum prices triggered 2 episodes of near-hyperinflation in the 1990s.
  - Government revenue from mining has increased by an annual average of 28% during 2000-2012, but with a standard deviation 16 percentage points.

- High administrative costs in relation to the size of the economy.
  - Central government employment accounts for about 25% of employment.

- Limited local physical, financial, and human resources.
  - Limited pool of professionals, specialists, and know-how.

- Low tolerance to debt.
  - Even modest increases in debt levels can undermine macroeconomic stability.
Commodity price shocks

- Sharp swings in international alumina prices were the leading cause of 2 episodes of near-hyperinflation in the 1990s, coupled with inadequate policy responses.
- Sharp falls in oil and alumina prices in 2008 led to external and internal imbalances.
Mining revenue and government finances

- Mining revenue fell substantially during 2008-10.
- Fiscal and monetary policy remained expansionary until 2010.
- Political considerations prior to the 2010 elections prevented a swifter policy adjustment.
Small can be beautiful

- Short distance between policy-makers, academia, private sector, and administration.
- Ability to swiftly modify institutional and legal frameworks.
- Ability to swiftly identify shortcomings and secure sufficient international physical, financial, and human resources to address shortcomings.
- Ability to swiftly adjust policy stance. Example 2011:
  - Corrected the sharp deterioration in the fiscal position.
  - Increased non-mining revenue to reduce reliance on volatile mining sector.
  - Reduced expenditure.
  - Addressed domestic and external arrears.
  - Moderated monetary policy.
  - Addressed exchange rate imbalance.
Economic instability: 2008-10

- Internal and external imbalances due to:
  - Fall in mining revenue by 3.3% of GDP during 2008-10.
  - Pre-election spending (including domestic arrears buildup).
  - Loose monetary policy (lowered reserve requirement ratio).

- Results:
  - Fiscal balance deteriorates from +5.7% of GDP in 2007 to -2.5% in 2010.
  - Depreciation of the parallel market rate.
Fiscal correction 2011

- Increase in non-mining tax revenue:
  - Fuel tax increase.
  - Tobacco and alcohol excise increase.
- Repayment of all domestic arrears in 2011.
- Clearance of all external arrears in 2011.
- Reduction in expenditure from 26.9% of GDP in 2009 to 24.6% in 2012.
Devaluation in January 2011 eliminated the disparity between parallel and official rates.

Created a wider US$/SRD exchange rate band within which market participant can freely set their buying and selling rates.

The parallel market rate has stayed within the band, aided by:

- Moderate demand policies.
- Confidence in the macroeconomic policy stance and economic prospects.
- Ample foreign exchange availability from mining sector exports.
Tightening of monetary policy 2011

- Increase in reserve requirement ratios.
- Increased sales of Treasury bills to absorb liquidity.
- Temporary increase in interest rates.
- Temporary increase in foreign exchange sales to anchor market expectations.
Inflation 2011-12

- 12-month inflation peaked at 22.7% in April 2011 due to exchange rate adjustment and tax increases.
- 12-month inflation has fallen to 3.7% in September 2012.
- Inflationary expectations have been kept at bay through moderate fiscal and monetary policies.
- Responsible wage policies prevented wage-price pressures.

Suriname: 12-month inflation rates 2011-2012
Central government debt

- Debt levels have fallen due to:
  - Fiscal surpluses or deficits smaller than GDP growth.
  - Restructuring and repayment of arrears.
  - High economic growth.

- Arrears eliminated:
  - U.S. rescheduling July 2011.
  - Early repayment May 2012.

- Debt increase in 2010-2011:
  - Fiscal deficits.
  - Exchange rate adjustment.
  - Government increase in deposits at CBvS instead of liability reductions.
International approval

- IMF reports since 2011 have been fully supportive of the authorities’ policies and forward-looking policy stance.

- 4Credit rating upgrades due to:
  - Stable macroeconomic environment.
  - Elimination of arrears.
  - Relative low debt levels.
  - Structural BOP improvement.
  - Robust medium term growth prospects.

- Conditions for further rating upgrades:
  - Institutional reforms.
Small economies have to be nimble

- Advantages of a small economy are the ability to modify policies swiftly, adapt institutions and legal and regulatory frameworks rapidly, access resources from abroad when necessary.
- For a long time, Suriname did not modernize, accumulating instead a large and cumbersome administration.
- Since 2011, the Central Bank of Suriname and the Ministry of Finance have embarked on a comprehensive set of reforms.
Fiscal sector reforms

- Amendments of the State Debt Act (Dec. 2010).
- Modernization of the Public Financial Management law (law under preparation).
- Establishment of a modern Procurement Office (under preparation).
- Upgrading and modernization of Customs administration (ongoing).
- Introduction of a Value-Added Tax to replace sales tax (under preparation; planned introduction in 2014).
- Comprehensive reform of the direct tax regime (under preparation; planned introduction in 2014).
- Elimination of small nuisance taxes (under preparation; planned introduction in 2014).
- Establishment of a Sovereign Wealth Fund (draft law being discussed).
Central Bank reforms

- Coordinated fiscal and monetary policies through an integrated financial programming framework to reduce inflation expectations and maintain exchange rate stability (in place).
- Change the scope of Central Bank monetary policy towards active monitoring of liquidity in the system and the use of indirect market-based instruments (know-how, institutions, and regulations being prepared).
- Develop local money and capital market to enhance the effectiveness of monetary policy, to facilitate non-inflationary budget financing, and to create additional vehicles for private sector investment and financing (in planning).
- Modernize the reserve management framework and expertise to actively manage reserve assets and SWF assets (in place and ongoing).
- Gradually de-dollarize the economy through market-conform mechanisms and increased confidence in the currency and policy-making ability.
Conclusion: making small beautiful

- We are addressing the inherent disadvantages of being small:
  - High concentration on a few key sectors ➔ export promotion, avoidance of Dutch disease effects, SWF, increased non-mining taxation.
  - Low debt tolerance ➔ continued moderation of fiscal policies, reliance on multilateral borrowing.

- We are embracing the inherent advantages of being small:
  - Ease of policy adjustments ➔ proactive and better-informed policy-making, shorter decision-making lines, effective use of data collection mechanisms and modern technology in administration.
  - Ease of institutional change ➔ accessing specialized international expertise to modernize key institutions and legal framework.