

## ***Macroeconomic Reform Programme***

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Seychelles embarked on a macroeconomic reform programme in November 2008 to primarily address serious balance of payments and external debt difficulties. In the past, attempts at redressing the economy through home-grown reform programmes faced significant challenges and were unsuccessful as the measures were largely piecemeal and selective. As such, just prior to the financial crisis when Seychelles defaulted on an external commercial bond in 2008, the authorities requested the assistance of the IMF to put the domestic economy on a sustainable path.

Following intensive consultations, the Seychelles authorities launched the reforms beginning with the removal of exchange restrictions and floating of the Seychelles rupee, which were programme prior actions, in November 2008. In December 2008, the IMF Board approved a two-year Stand-By Arrangement (SBA) during which the country agreed to implement a series of far-reaching adjustments in its monetary, fiscal, exchange rate and structural policies, which were accompanied by some structural reforms. It is to note that an SBA is a framework which allows the IMF to respond to the financial needs of member countries and to support policies designed to help them emerge from crisis and ultimately restore sustainable growth.

Whilst in the past the Central Bank's monetary policy generally accommodated the fiscal stance, the reform programme focuses on strict fiscal discipline, containment of inflation, and the need to ensure proper liquidity management in the banking system. The complexity of Seychelles' economic problems also required a complete overhaul of the exchange rate regime. The liberalisation of the foreign exchange market was accompanied by the elimination of all administrative controls and restrictions on foreign exchange transactions.

The main objectives of the SBA were to promote macroeconomic stability and sustainable growth by:

- (i) Introducing a floating exchange rate regime and achieving full convertibility of the rupee;
- (ii) Placing public debt on a sustainable path through the implementation of a comprehensive debt restructuring strategy and tightening of the fiscal and monetary policy; and
- (iii) Reducing the role of the state in economic activities, whilst creating an environment that is conducive for private investment.

The programme was front-loaded, meaning that most of the adjustments had to be made at the beginning and closely monitored throughout the duration of the exercise. During its quarterly reviews, the IMF consistently confirmed the country's progress in all areas. By the end of the first year of the SBA, Seychelles had already achieved macro-economic stability, with the exchange rate stable, inflation firmly under control, fiscal surpluses and foreign exchange reserve build-up exceeding programme targets, and the external debt restructuring very advanced, the Seychelles authorities and the IMF came to a mutual agreement to cancel the SBA and move to a longer-term arrangement which would focus more on structural issues. Hence, on December 18,

2009 the IMF Board approved Seychelles' request to move on to an Extended Fund Facility (EFF).

The successful transformation under the SBA laid the groundwork for the second generation of reforms that would be implemented under the EFF. This medium-term framework will guide the necessary policies to secure macroeconomic stability and improve the country's economic performance.

The aim is to strengthen public financial management, institutionalise higher governance standards, downsize the public sector, reform the taxation system, bolster the financial system and improve the business environment. This would consolidate the efforts to create a market-driven economy and also address long-standing structural imbalances.

During 2010, emphasis was placed on the introduction of various laws and regulations, and also guidelines and procedures to strengthen the existing legal and operational framework where public finance is concerned, whilst creating an environment that would encourage private sector investment.

For instance, significant structural benchmarks were attained during the year in the taxation area as well as in terms of public financial management and expenditure reforms. The tax reform focused on three main areas:

- (i) The introduction of a revised Business Tax Act as of January 1, 2010, which broadened the tax base and provided for a step-wise reduction in rates to encourage competitiveness and achieve harmonisation across sectors. The maximum business tax rate was reduced from 40 per cent to 33 per cent.
- (ii) Replacing the existing social security contributions with the "Income Tax on Monetary and Non-Monetary Benefits" effective July 1, 2010. The new law expanded the income tax base to resident expatriate workers and eliminated all sectoral concessions.
- (iii) Introducing a Value Added Tax (VAT) from January 1, 2012. Work on the necessary legislation, which aims to modernise the tax system and remove distortions has already started. The VAT will replace the current multiple-rate Goods and Services Tax (GST).

As regards the strengthening of public financial management and expenditure, positive steps were made in that direction. New procedures and protocols for budget submissions were introduced in order to ensure better budget preparation. The budget document presented to the National Assembly gave a more comprehensive analysis of the fiscal position and macroeconomic context than in previous years. In line with good governance practices, the Ministry of Finance has also started to publish government finance statistics on their website.

To achieve the objectives of the programme, several quantitative and structural targets were agreed between the IMF and the Seychelles authorities. The table below shows the quantitative performance criteria since the start of the programme and performance during 2010 (actual versus target).

### Quantitative Performance Criteria

	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4
<b>Reserve Money</b> <sup>1</sup>	<i>SCR million</i>								
Target	1151	1146	1266	1311	1480	1537	1592	1676	1753
Actual	1120	1051	1119	1169	1296	1424	1544	1596	1746
<b>Net International Reserves</b> <sup>2</sup>	<i>USD million</i>								
Target	26	25	66	83	130	133	128	142	168
Actual	50	76	83	122	152	189	162	177	207
<b>Primary Fiscal Balance</b> <sup>3</sup>	<i>SCR million</i>								
Target	336	292	121	1143	1385	265	460	675	823
Actual	560	607	322	1381	1586	298	707	1071	1006

1. The stated target is a ceiling.

2. The stated target is a floor.

3. The stated target is a cumulative floor.