Is small beautiful?

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

Gillmore Hoefdraad

November 2012

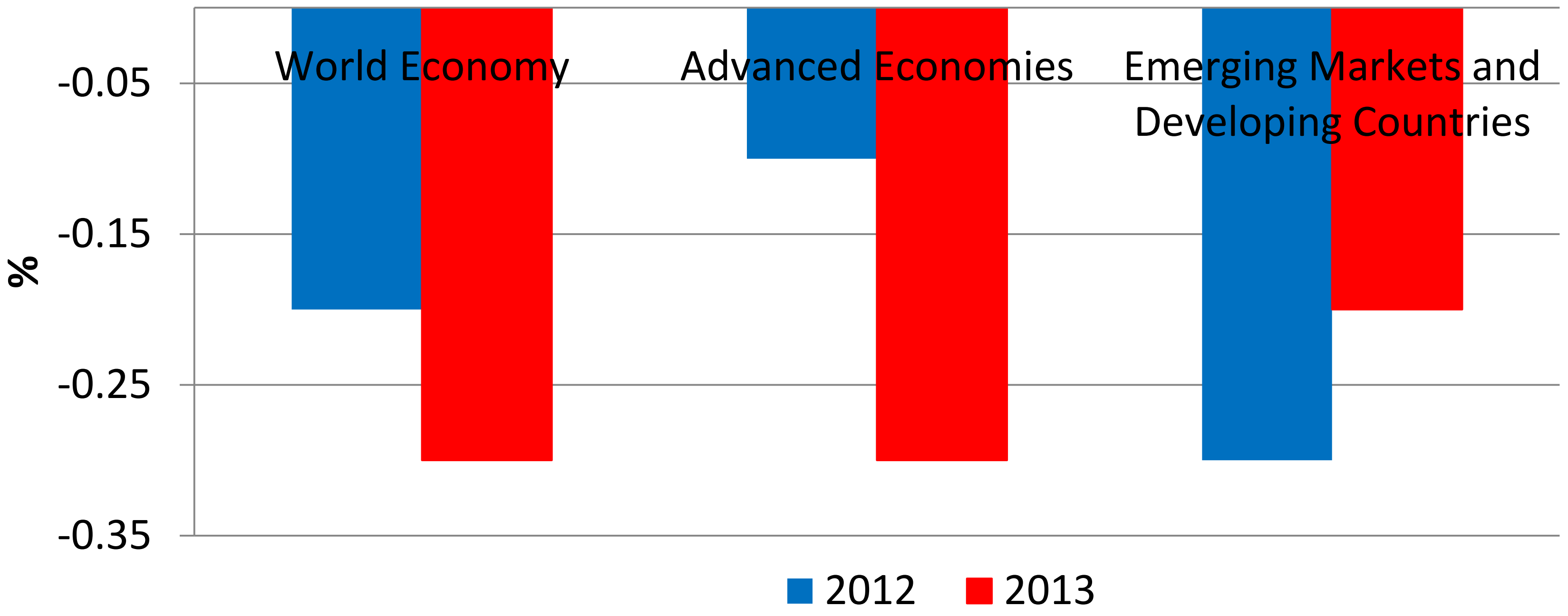
CENTRALE BANK VAN SURINAME

Highlights World Economic Outlook

Summary

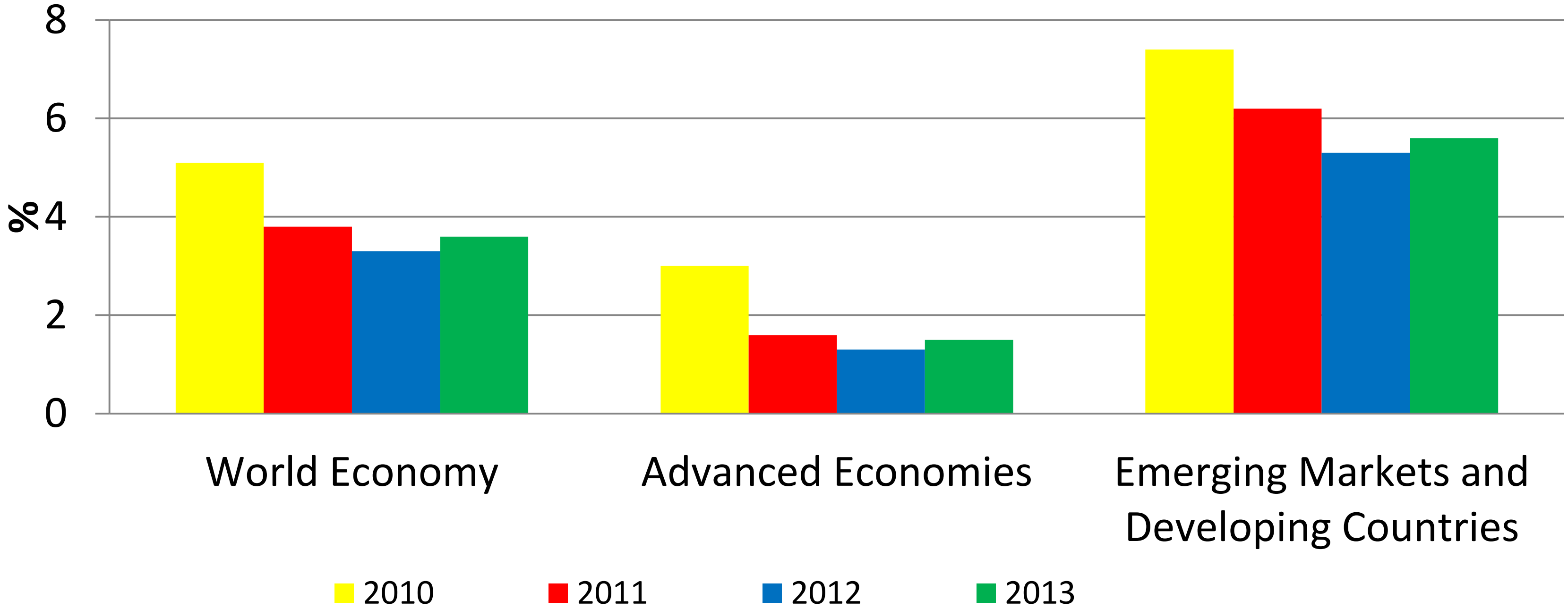
- Global growth has decelerated. Growth projections 2012 and 2013 downgraded by the IMF across regions.
- Substantial uncertainties and downside risks remain.
- Critical need to rebuild confidence and action to restore strong, sustainable and balanced growth.
- Advanced economies need to deliver necessary 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

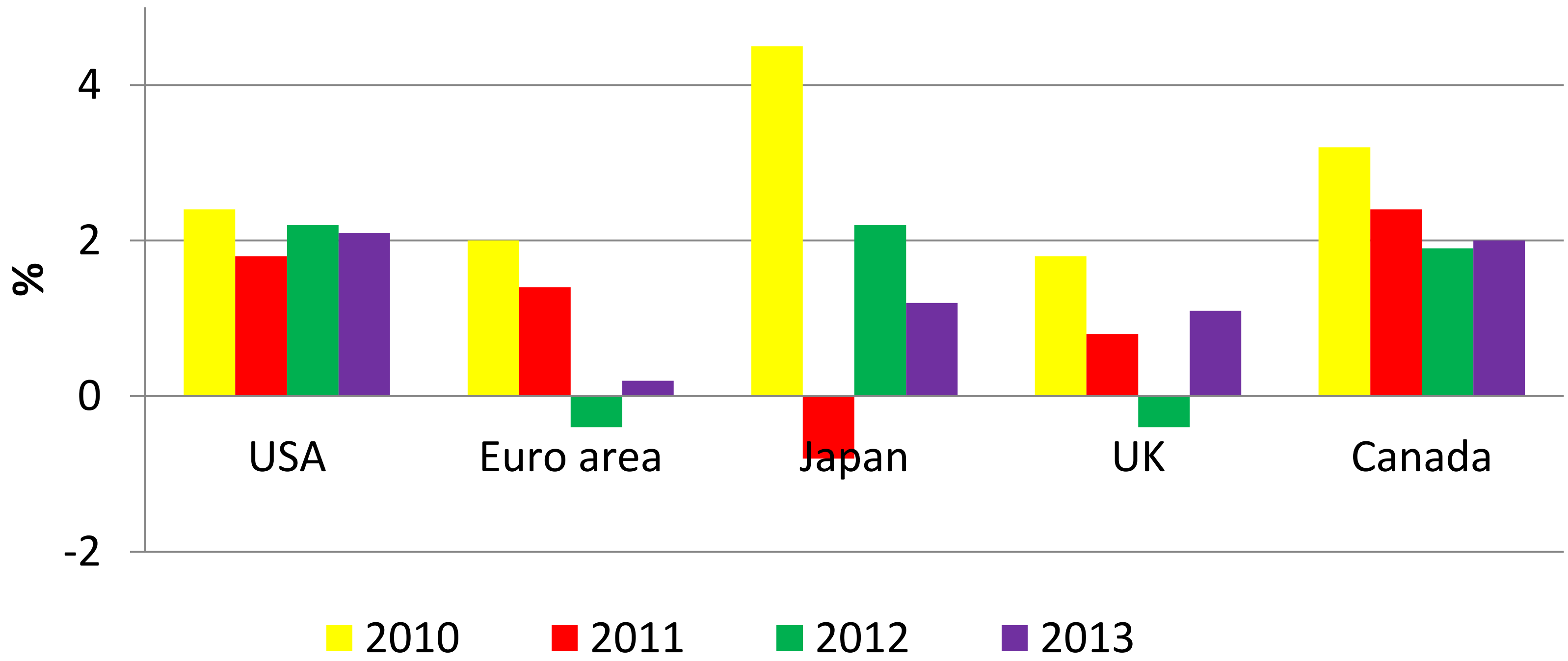


Source: IMF, WEO October 2012

Advanced Economies

- 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

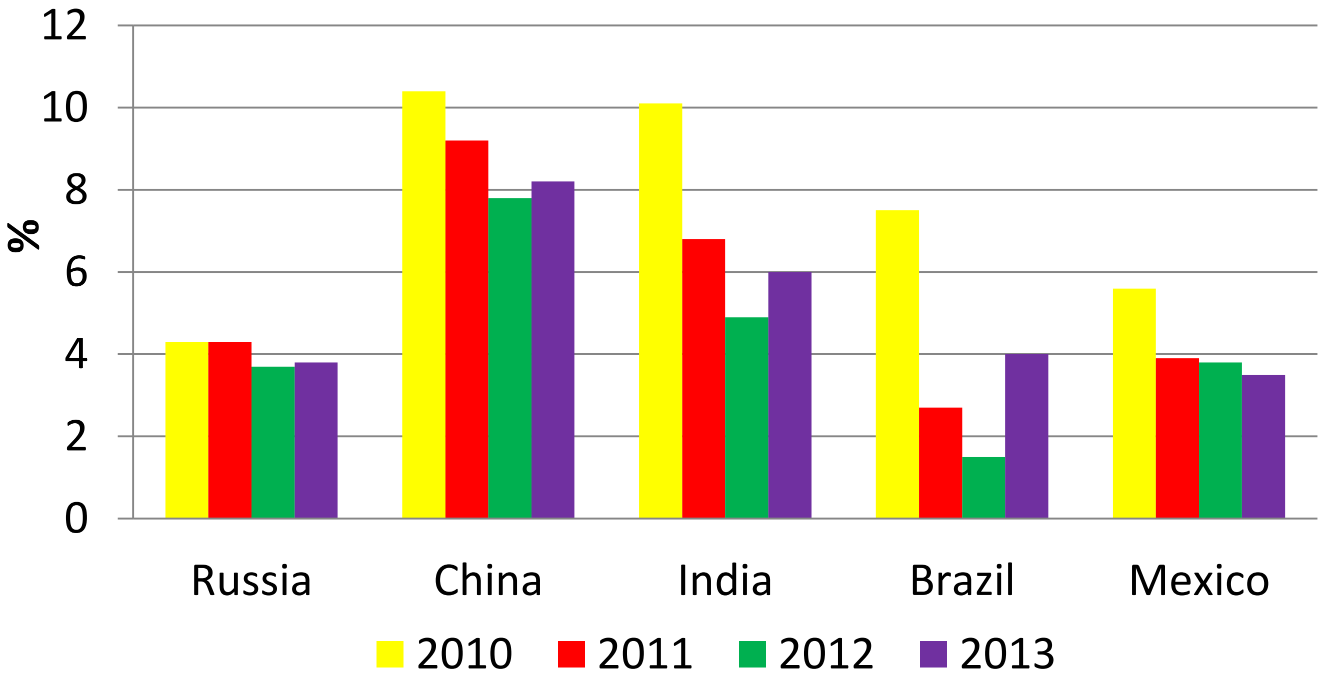
Emerging Markets and Developing Economies

- 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



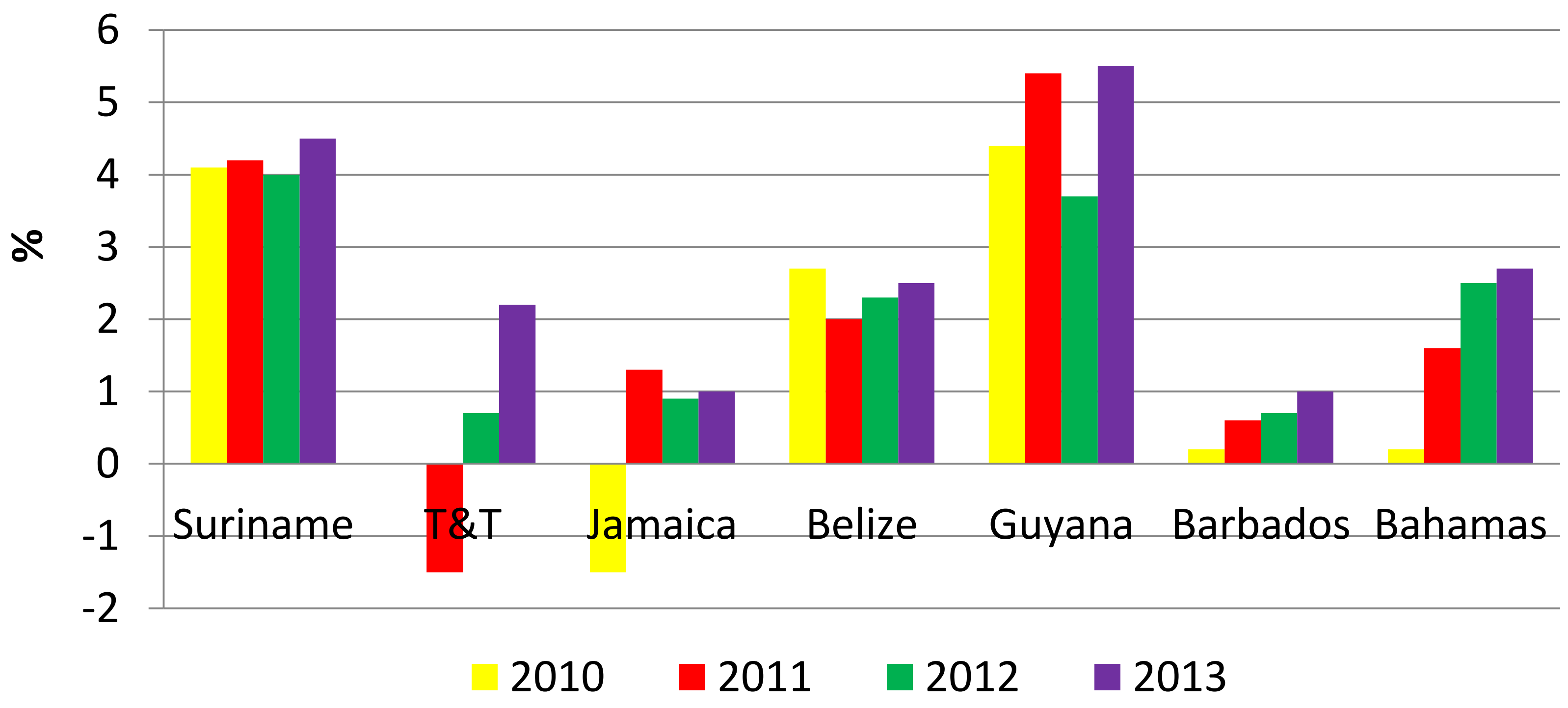
Source: IMF, WEO October 2012

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

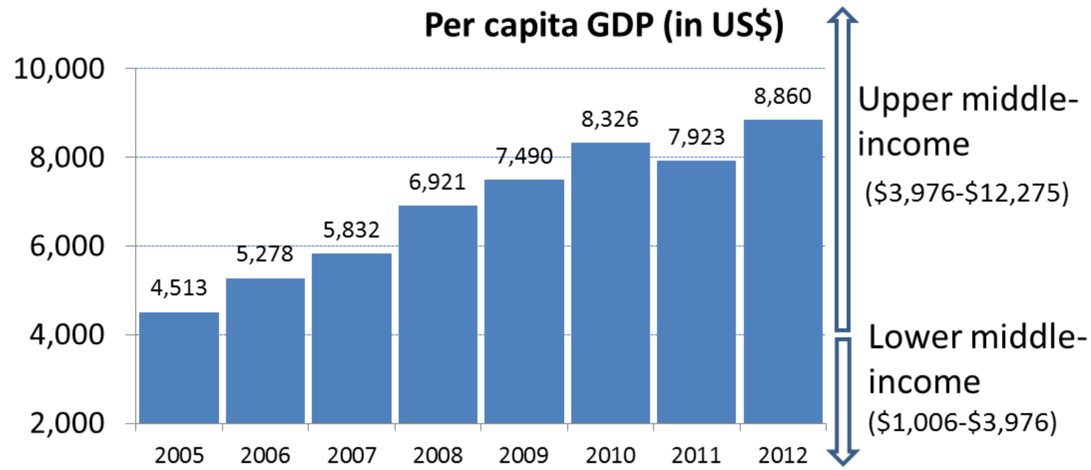


Source: IMF, WEO October 2012

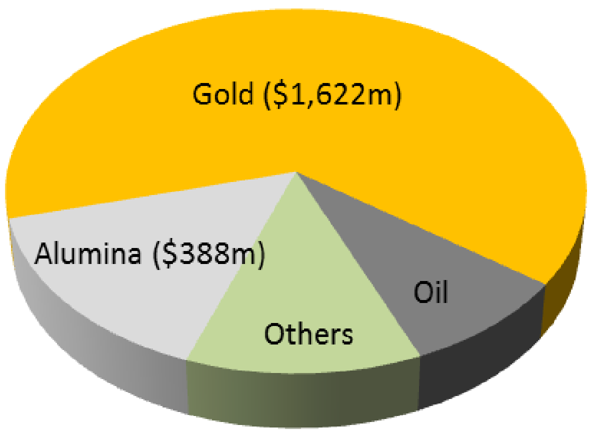
Developments in Suriname

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).

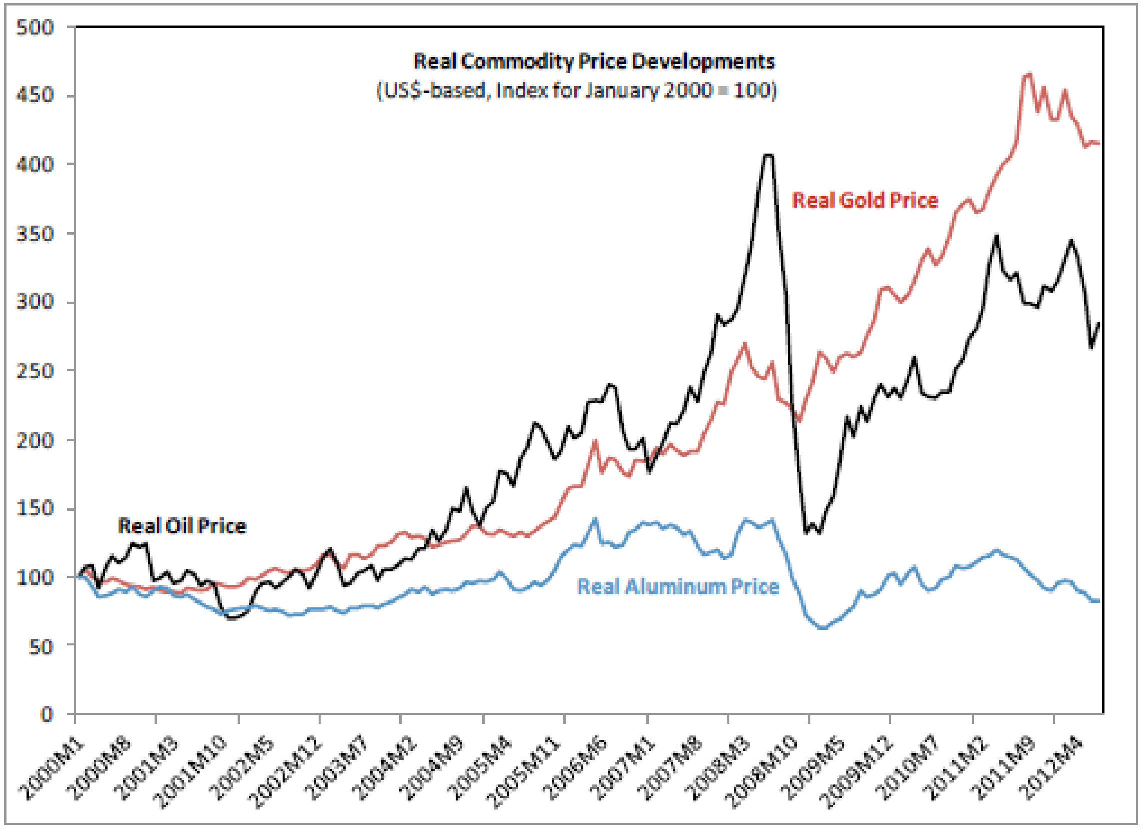


Small is not beautiful

- 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.

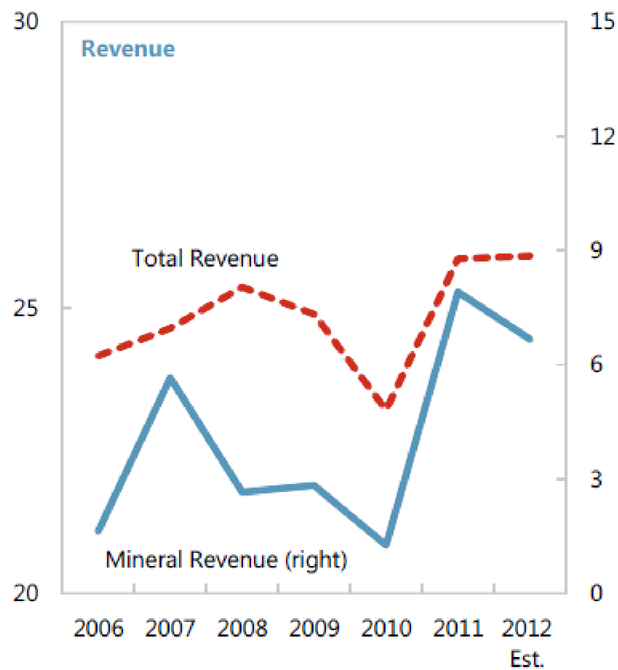
Commodity price shocks

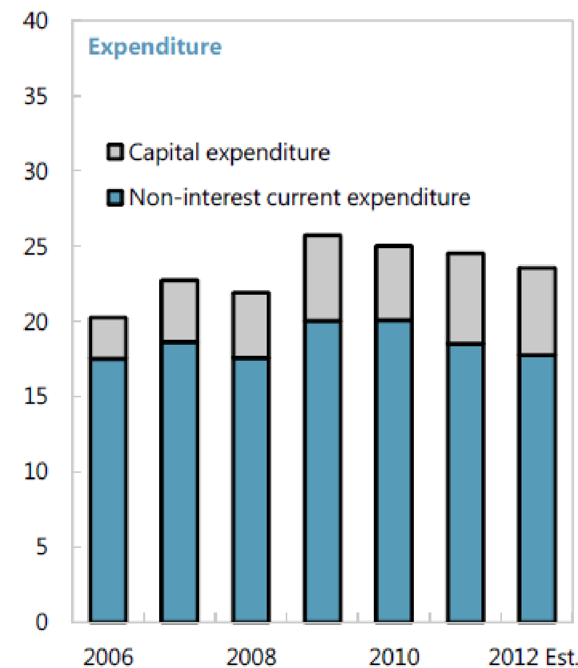
- Sharp swings in international alumina prices were the leading cause of 2 episodes of near-hyperinflation in the 1990s, coupled with inadequate policy responses.
- Sharp falls in oil and alumina prices in 2008 led to external and internal imbalances.



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.



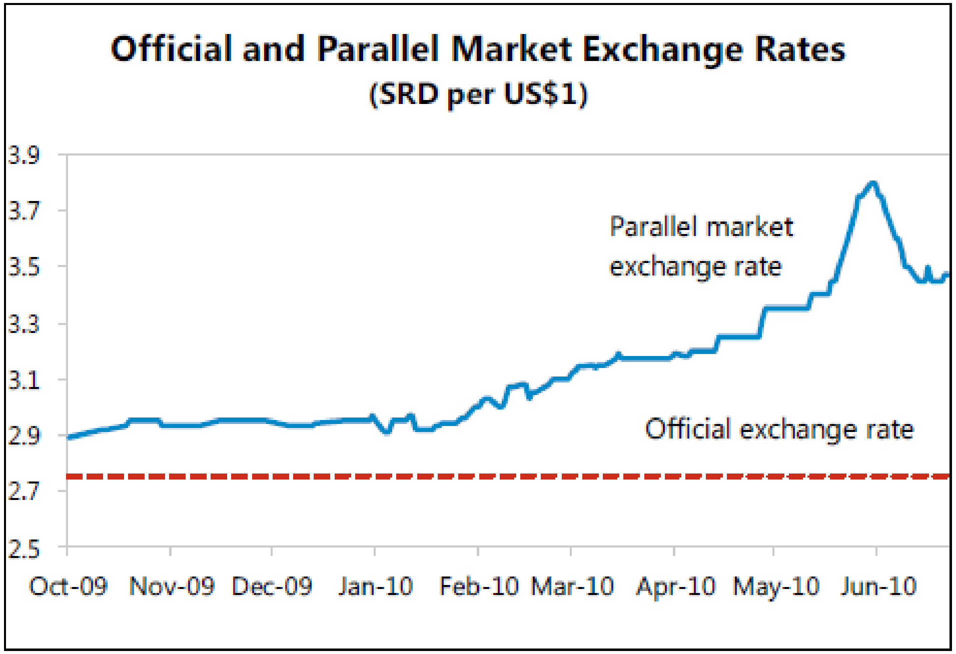


Small can be beautiful

- 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).

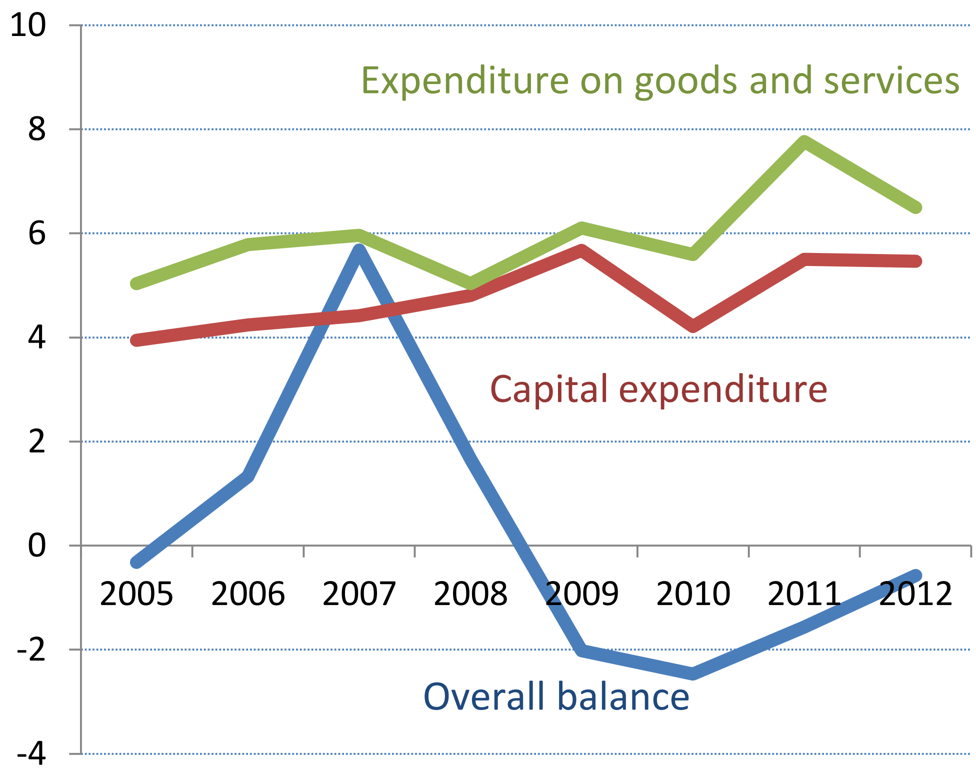


- Results:
  - Fiscal balance deteriorates from +5.7% of GDP in 2007 to -2.5% in 2010.
  - Depreciation of the parallel market rate.

Fiscal correction 2011

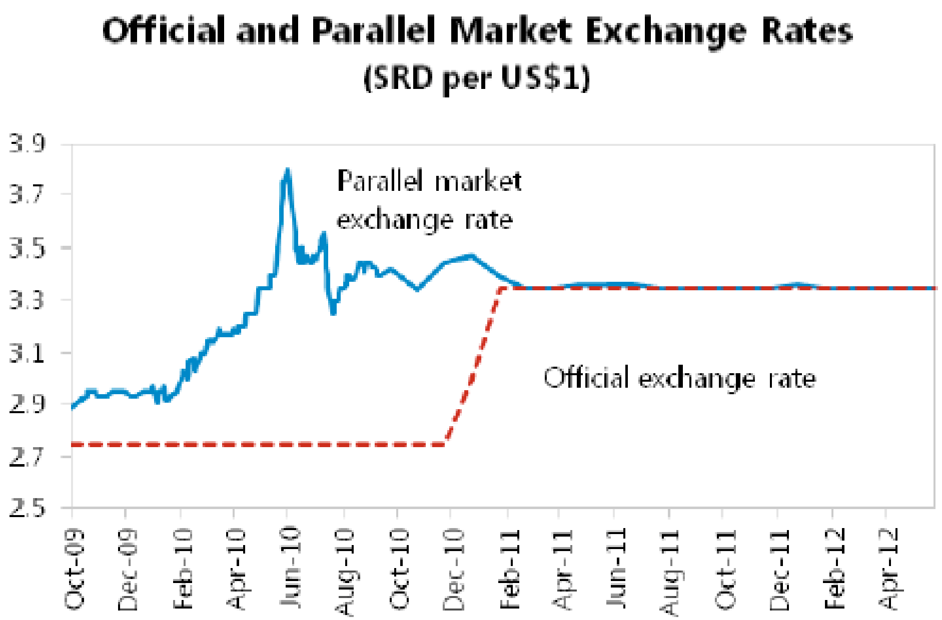
- Increase in non-mining tax revenue:
  - Fuel tax increase.
  - Tobacco and alcohol excise increase.
- Repayment of all domestic arrears in 2011.
- Clearance of all external arrears in 2011.
- Reduction in expenditure from 26.9% of GDP in 2009 to 24.6% in 2012.

Fiscal performance 2005-2012 (% of GDP)



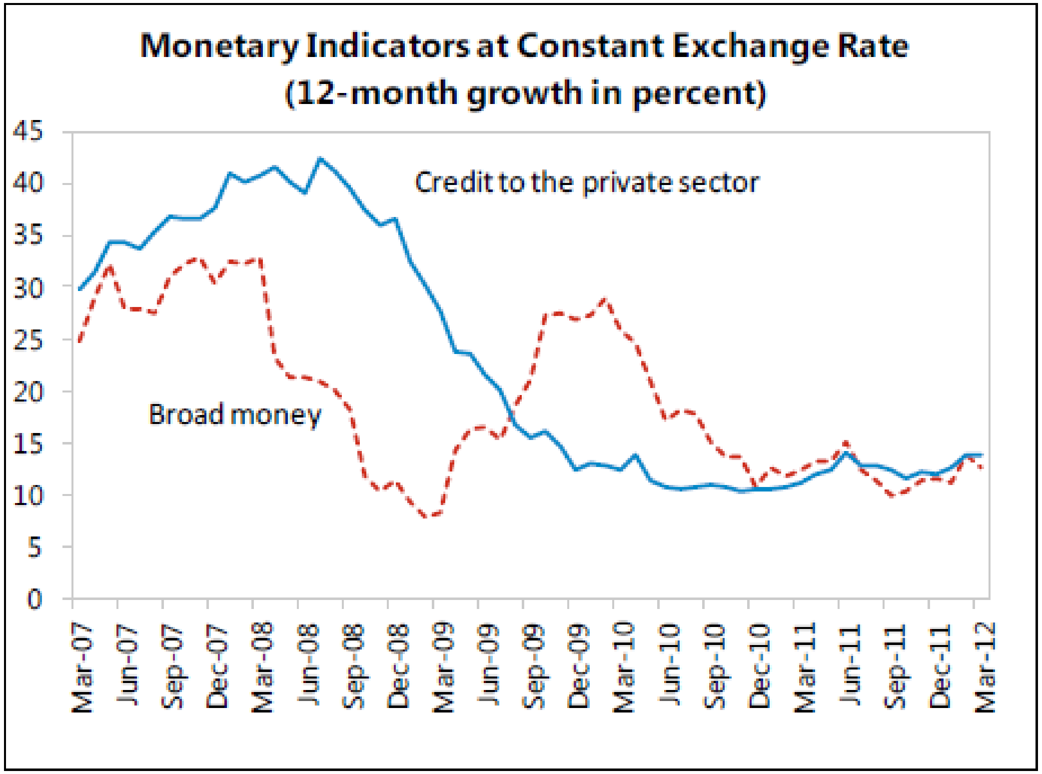
Exchange rate adjustment 2011

- 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.



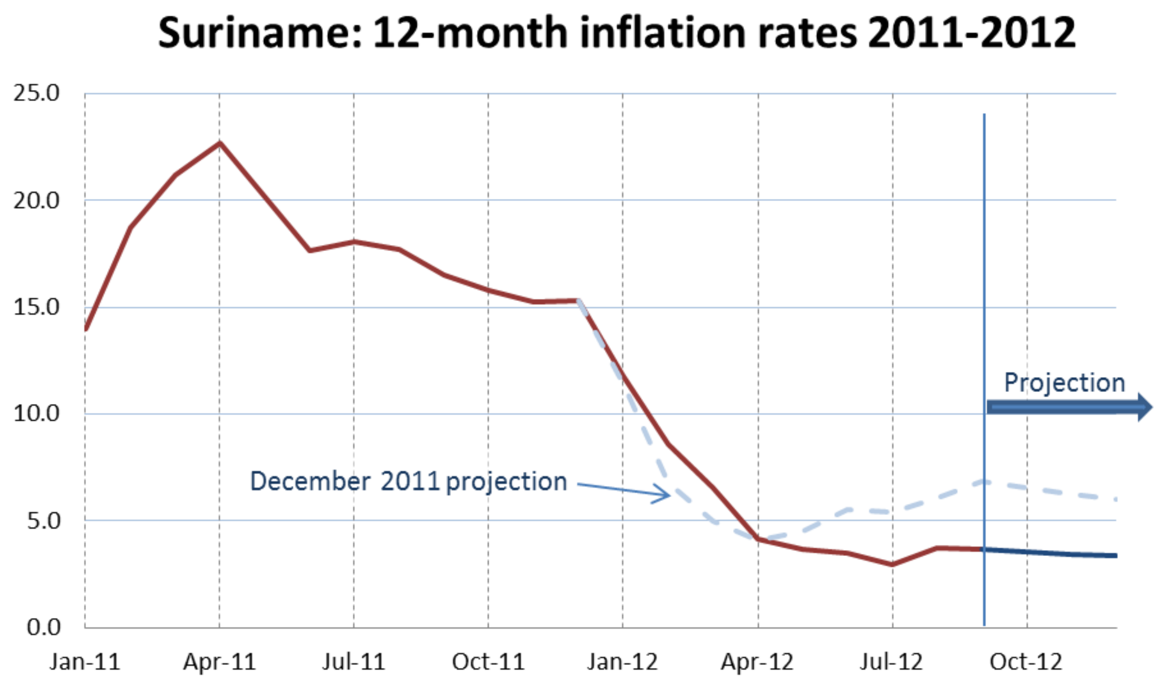
Tightening of monetary policy 2011

- 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.



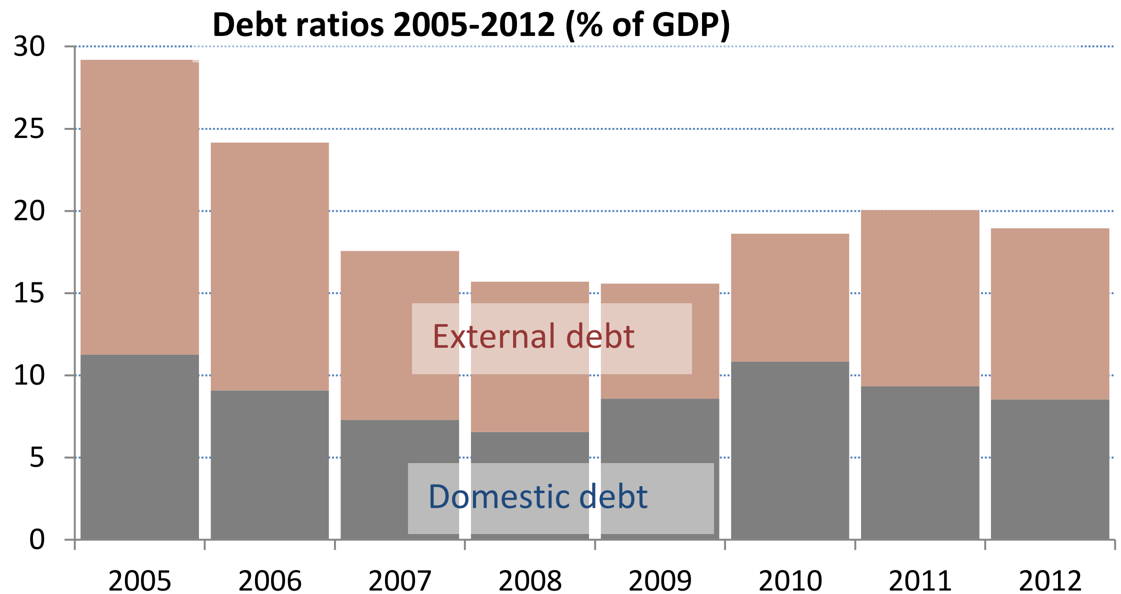
Inflation 2011-12

- 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.



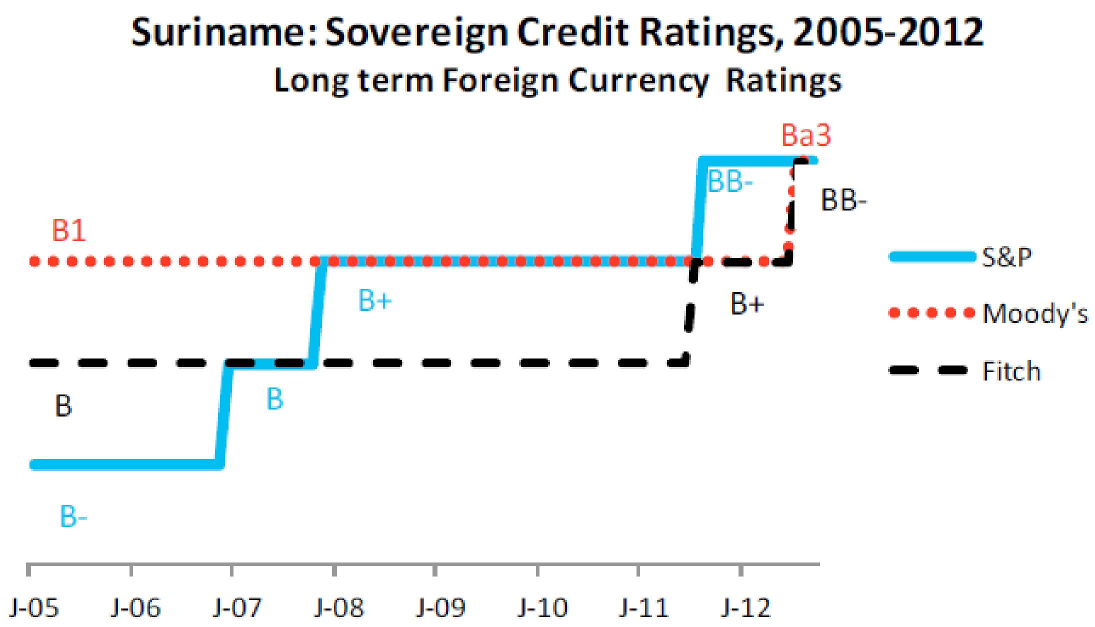
Central government debt

- 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).
- Macroeconomic forecasts and budget preparation based on a Financial Programming exercise (completed in 2012).
- Modernization of the Public Financial Management law (law under preparation).
- Introduction of an modern computerized budget execution and control system, new public sector chart of accounts, and Treasury Single Account (started implementation in 2012).
- 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.