

The contents of this document are preliminary and subject to change.

GRAY/06/842

March 9, 2006

**Statement by Mr. Charleton and Mr. Campbell on Seychelles  
(Preliminary)**

**Executive Board Meeting 06/24**

**March 10, 2006**

We thank the staff for the well written set of papers and Mr. Murray for his insightful Buff statement.

The recent economic malaise has persisted in the Seychelles over the last year, with real output declining by 2.3 percent. By Mr. Murray's estimate, real GDP has contracted by a staggering 11.6 percent from 2001 to 2005. With a further contraction in growth of 1.4 percent projected for 2006, and the consequent build-up in macroeconomic imbalances, the Seychelles risks being unable to maintain the enviable social development indicators it has achieved over the past two decades. We believe, and the authorities appear to accept, that the state centered economic model that produced these results has run its course, resulting in declining output, high debt build-up, arrears accumulation, and a misaligned exchange rate.

The authorities' "home grown" macroeconomic reform program (MERP) adopted since 2003, while commendable, has met with, at best, limited success – debt levels have stabilized, albeit at very high levels. In the main, however, the program has not delivered the desired results, and addressing existing macroeconomic imbalances and restoring competitiveness should be top priority for the Seychelles authorities. In this regard, the broad consensus reached on the need for a substantial fiscal effort, complemented by a credible exchange rate adjustment, and a well sequenced set of reforms to reduce the state sector and encourage more private sector participation is a crucial step going forward.

Despite broad agreement to address the issue of the exchange rate and foreign exchange liberalization in the context of a recovery program, Mr. Murray's Buff statement indicates that his authorities believe that more detailed consideration of the staff's recommended exchange rate adjustment and accompanying mechanism is needed. We understand the authorities' desire to proceed cautiously on this issue, and agree that the determination of magnitude of the exchange rate adjustment and the choice of a new exchange rate regime require careful consideration. We are, however, more mindful of the cost of inaction - the medium term outlook under unchanged policies points to a perilous set of circumstances. A credible upfront exchange rate realignment in the context of the overvalued currency seems unavoidable in order to improve the economy's competitiveness, better establish policy credibility as well as a more effective anchor.

Resolving the long outstanding debt problem remains a major concern. The authorities' recent accumulation of relatively large primary surpluses has stabilized debt levels but has not reduced debt significantly. We welcome the recent progress made in restructuring domestic and external creditors' claims on government, as well as the agreement with the World Bank and other multilateral and bilateral creditors to reduce the stock of arrears. Nevertheless, we believe that a more comprehensive debt restructuring plan may be more effective in bringing about a more orderly resolution of the debt problem. At the same time, we wonder how much scope remains for using privatization receipts to pay down the debt. The staff's comments on this would be welcome.

While the debt restructuring efforts are welcome, the rather unambitious 2006 budget will not be helpful in the near term. Mr. Murray's indication that the authorities remain committed to further fiscal consolidation over the medium term, in order to place public debt on a downward trend, is encouraging, however, stronger efforts are needed to contain spending and achieve budget targets in the run up to the 2006 election. This remains a serious concern as recent evidence suggests that actual fiscal outcomes have exhibited substantial variation relative to the budget. In this regard, adopting a formal medium term spending framework could be an important tool going forward.

We welcome ongoing efforts to enhance private sector participation in the economy, and the privatization program is an important element that must be supported through a transparent process. We agree with the staff that further domestic price liberalization and broader trade liberalization must be key complementary components of the reform process.

Finally, given the current challenges, we believe that the authorities could benefit from a more intensive policy dialogue with the Fund, to include staff visits between Article IV consultations. With this, we wish the authorities success in their future efforts.