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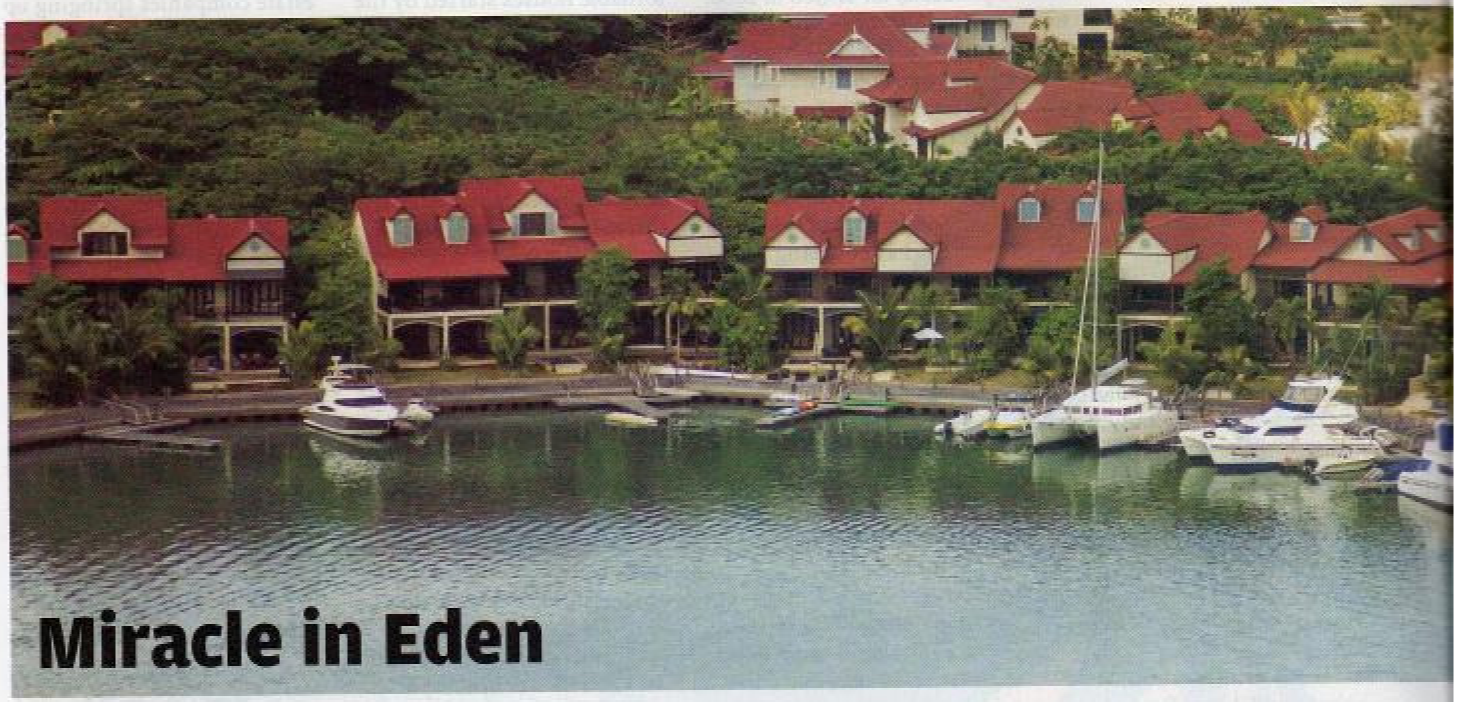


Miracle in Eden

Five years ago, the island state of the Seychelles was on the brink of economic disaster. It was drowning in debt, growth has come to a halt and its output from its mostly state-owned industries had shrunk to a trickle. Drastic measures were needed and the administration of President James Michel bit the bullet and set into motion a wholesale set of reforms. **Wanjohi Kabukuru** tells the story of what has been dubbed an economic miracle.

Five years ago the phrase "traffic jam" was unknown in the Seychelles. Not any more. Today traffic snarl-ups are a daily nightmare in the capital, Victoria. What has changed in a span of five years?

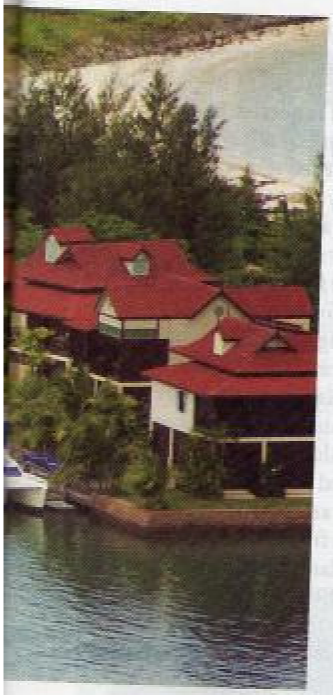
What has happened is that the Seychelles transformed its economy from a state of near collapse into what can be regarded as a boom. This has opened new opportunities and spawned a vibrant wealth stream in the island nation. The growth of high-end residential estates, for example, is becoming one of the fastest on the continent.

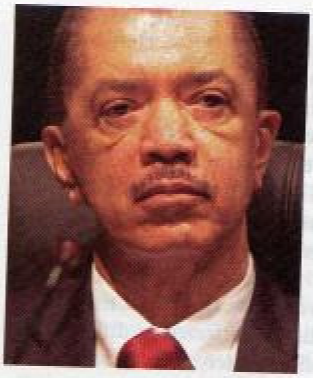
But the situation was very different around 2006. It was clear that Seychelles was headed towards a financial meltdown and only an economic miracle would stem the tide. Critical medical supplies were missing in hospitals, currency controls necessitated long queues at banks and international suppliers no longer accepted letters of credit from Seychelles banks.

Government bureaucrats and the private sector managers were becoming increasingly hostile and adverserial in their dealings as forex became scarce. Seychelles was steeped in debt and was facing a serious balance of payments crisis.

The credibility of the Seychelles government had reached rock bottom. President James Michel, who had just taken over from President France-Albert René some two years earlier, was having a difficult time containing the crisis. As a former Vice-President and Minister for Finance for decades, President Michel knew was well aware of the structural weaknesses in the economy. Now, as president, his political career was on the line and Seychelle's status as "the jewel of the Indian Ocean" seemed like a bad joke. Michel was walking a tightrope and had to make tough decisions. First, the economy had to be stabilised and the free fall threat contained. Secondly, the political situation had to be reformed as it was centrally tied to the economy owing to Seychelles' welfare-state form of government. Indeed, for 30 years the Seychelles government has retained an unmatched welfare system in Africa, largely supported by a socialist-style intense state presence in the economy.

Right from independence in 1976, the economic model pur-





Left: Eden Island new estate. Right: President James Michel, engineer of the economic miracle.

sued by Seychelles has been characterised by heavy investments in tourism and infrastructure accompanied by steady income growth. These investments led to rapid growth of the tourism sector, generating handsome revenues which helped finance Africa's most comprehensive welfare system and social service. Seychelles citizens still enjoy some of the highest per capita incomes in Africa today.

This template for a remarkable welfare state was designed in the 1980s and was vigorously pursued through extensive borrowing from banks and an open state involvement in the financial system. Between 1985 and 1990 economic growth averaged 6%. As tourism and fisheries became established in the 1990s, the economy recorded a steady 4.9% growth.

However, with the passage of time, the Seychelles accumulated an unsustainable debt which depleted its foreign exchange reserves and it failure to honour commitments to creditors. The debt mountain, between 1990 and 2000, brought stern trade and exchange limitations.

During this same decade, its strategic location in the Indian Ocean became of interest among the major powers. During the Cold War period, both the Soviet and the Western blocs wooed Seychelles. The US military set up a satellite tracking station in La Misère, a district in Mahé, which generated an $8m annual fee for the Seychelles government. The US military fees helped to cover fuel importation expenses.

It is not just the US that was interested in the Seychelles. The Soviet Union, India, China, Cuba and Maghreb nations were falling over their themselves in courting Seychelles with gifts like scholarships, aid, loans, grants and support for concessional balance of payments. President René used this courtship to clear the country's extended spending and beef up investments in the Seychelles public sector. Then *perestroika* came knocking. The change of the world order following the end of the Cold War and the break-up of the Soviet Union exposed Seychelles' vulnerability. Matters were not helped either when technological changes forced the US military to close down its satellite tracking station.

Both aid and grants from the two main Cold War antagonists were reduced to an unreliable trickle. In these straitened circumstances, a commitment the Seychelles had made earlier to construct new sports infrastructure in readiness of that year's Indian Ocean Games led it to spend $30m and impose a further serious drain on the Seychelles economy.

The Seychelles transformed its economy from a state of near collapse into what can be regarded as a boom. This has opened new opportunities and spawned a vibrant wealth stream

They say troubles come in droves. For the first time in Seychelles, a black market for forex emerged and speedily took root. By 1995, all international creditors suspended all lending to Seychelles. Even with the danger signs, René did not pull back on his agenda of a thriving welfare state. Government spending spiralled as the foreign exchange crunch continued to bite.

Between 1995 and 2008, government doggedly pursued its $130m capital intensive public investment undertaking. This involved grants to two state corporations, the Seychelles Public Transport Corporation (SPTC) and the Public Utilities Corporation (PUC). Others grants went to the East Coast Reclamation Project (ECRP) and on roads, sewerage, housing, water desalination and distribution projects.

In April 2004, Michel took over after René stepped down exactly two years before the date of the next general election. This move thrust Michel into the limelight politically but economically he was sailing in a leaking boat. On the one hand, he had to bring the economy back from the brink of collapse and on the other, he had to win popular support with the masses in readiness for the 2006 general elections.

Pulling back from the brink

Initially, Michel was seen as a protégé of Rene and many expected him to stick to socialist model. In July 2006, Michel won the elections. This win was a public endorsement and in more ways than one redefined Michel. He started to cut an image of being his own man and worked out a formula to reform Seychelles' economy.

In 2007 Michel tasked Danny Faure, whom he had just appointed as his new Trade and Finance Minister, to work together with his principal secretary, Ahmed Afif, to prepare a strategy that would push the Seychelles away from the economic precipice.

After exploring all options, it was clear that only a radical change of course was going to save this island nation. For an entire year, together with a team from the IMF, the government prepared a new departure for the economy. It was the most radical change to take place in Seychelles in 20 years.

Four issues were already clear to Michel and the change managers. One, the realisation that the era of state controls and monopolies was over. Two, a complete re-evaluation of Seychelles' marine resources, mostly fisheries, and how they benefited the economy, was necessary. Three, devaluation of the Seychelles rupee was the only answer to a black market that offered 50% and more premium to the major currencies. Finally, was the acceptance that privatisation of state enterprises, reforming the civil service, and removal of universal subsidies to eliminate budget deficits was a necessary option, as well as the general liberalisation of the market to allow market forces to work.

But just as they were discussing the changes to adopt for the economy, global recession kicked in. Lehman Brothers, who were the single largest commercial creditor to Seychelles, filed for bankruptcy. Seychelles' financial managers could not imagine a worse time. At the back of their mind, the changes portended various scenarios which were politically and economically uncertain.

Three hard choices were identified as the key priorities for the government. They were the removal of price and currency controls to allow market forces to drive and restore confidence in the economy; a reversal of budget deficits to pay accumulated debt; and the creation of a surplus and the reduction of external indebtedness by repaying private and commercial arrears.

While these decisions sounded great to economic planners, politically they were risky if mishandled. A dozen experts from the IMF arrived in the Seychelles in 2008 to team up with the Seychelles' team and draw up a reform timetable. But while the economic plan was being crafted, a similar outreach programme was being devised to bring in the private sector, convince the public and influence the political class to buy into the idea of change.

But this change was not easy even for financial technocrats. Francis Chang-Leng, who was governor of the Central Bank of Seychelles (CBS), resigned a month before the reform programme was unveiled. In his place came in Pierre Laporte, a former IMF insider whose task was to restructure the CBS in readiness for the major changes. The triumvirate of Faure, Afif and Laporte were the public faces of change.

Right: Danny Faure, Trade and Finance Minister, one of the public faces of change.

Before the launch, a public education campaign, mass mobilisation effected on different levels of society, was carried out. On the one front, there were media experts explaining to the public what the new changes meant; on the other, the political class was holding public meetings at the district level. This was to prepare the public to accept changes, among them price increases on essential commodities, a market forces-driven economy and removal of subsidies from public enterprises. Government was now going to be only a regulator and allow businesses to prosper on their own.

'I was aware that I was taking a massive political gamble but I was prepared to do it because I was convinced that it was not only the right thing to do but also the only option'

Turnaround completed

The key aim of the reforms was to boost private sector development by reducing the state's overbearing role in the economy, to overhaul the monetary policy, tighten the fiscal strategy and, the most critical of all, to liberalise the existing exchange-rate regime.

The IMF approved a $28m standby arrangement with a time frame of 18 months. Shortly afterwards, the World Bank and African Development Bank (AfDB) cautiously advanced in excess of $30m in budget support. Soon other bilateral partners such as Abu Dhabi and European Union stepped in.

In October 2008, President Michel went on national television and declared that the turnaround had began. The next day (1st November 2008) the Seychelles rupee (SR) was floated and caused a depreciation of more than 50%. In December the licensing of foreign exchange bureaux began. By February 2009, monthly inflation had been reduced from 25% to zero.

When Faure presented the budget in 2009, he removed all universal subsidies, lifted all exchange restrictions and freed all interest rates. This, however, did not affect low-income households and individuals. The government was adamant it would not let go its income support programme to these groups despite tough IMF and World Bank conditions.

For overseeing such a successful economic make-over, Faure is now the Vice-President and Laporte is the Minister of Finance, Trade and Investment, his position at CBS having been taken by Caroline Abel.

Before VAT was introduced on 1st January 2013 to replace the Goods and Services Tax (GST), a comprehensive tax reform was rolled out. This included the introduction of a personal income tax to replace the social security tax, broadening excise taxes and limiting exemptions. Through these tax reforms, distortions, exemptions and differential sector treatment were eliminated.

The Seychelles' five-year turnaround is notable because it did not dent essential services or stir unrest even though government employment reduced by 4% between 2006–2009 through voluntary retirement.

The fisheries sector is also being reformed, with contracts favouring Seychelles' economy being drawn. Seychelles' status as a tourist destination has not yet diminished and a new approach to cushion the island from untoward effects of the Eurozone crisis are bearing fruit, with arrivals from the Middle East and mainland Africa, South America and the Far East increasing.

By the end of 2010, the external public debt had been reduced to $483m, which is 49% of the GDP, and current projections indicate a substantial growth by 2015. Inflation has now been contained and interest rates are falling. Realistic assessment of the situation, open exploration of home-grown solutions, engagement with outsiders for a balanced approach, supporting the key people running the reforms and an open-door policy form the simple five-point plan that stabilised and transformed Seychelles in five years.

In 2011, as the general presidential elections were around the corner, President Michel was advised to suspend the economic reforms for short-term political gains but he refused to waver and instead turned the reform agenda as his political platform.

"I was aware that I was taking a massive political gamble but I was prepared to do it because I was convinced that it was not only the right thing to do but also the only option to extract Seychelles from the crisis." Michel says, "We stayed the course and did not waver not even when confronted by the exigencies of politics." He won the re-election. ■