

Economic Implication of Events in Suriname

Page 1 of 4 Pages

Copy 1 of 6 Copies

Summary

The recent events in Suriname, particularly the suspension of Dutch aid disbursements, could have a significant adverse effect on the Suriname economy. Over the next 6-12 months, the effects will be somewhat attenuated by Suriname's current high reserves. However, if the poor world bauxite market and the suspension of Dutch aid continue, and if Suriname's policymakers continue their erratic recent economic policies, we believe the Suriname economy could begin a rapid deterioration by late 1983 or early 1984. Expected increases in emigration, capital flight, and private disinvestment will aggravate the situation.

The severity of the decline will depend on the extent to which Dutch aid is either restored or replaced by capital inflows from other sources. Even if Suriname manages to find alternate sources for its external capital needs, we expect increasing economic disruption, popular discontent, political tension, and increasing radicalization of the regime.

BACKGROUND

Suriname is a relatively prosperous developing country (per capita GNP \$3000 in 1981), but its prosperity rests on two shaky pillars, the bauxite sector and Dutch aid. Bauxite products comprise about 80 percent of export earnings, and the bauxite sector supplies 20-25 percent of government revenues. In 1975 the Netherlands promised Suriname \$1.5 billion in economic assistance over fifteen years, and the roughly \$100 million per year in disbursements have given Suriname one of the world's highest levels of per capita foreign aid. The Netherlands cancelled Suriname's debts upon independence, and the country's miniscule external debt was only \$26 million in 1981 (3% of GDP). Despite such emigration and investor caution since independence, and despite the recent downturn in the bauxite market, Suriname's international reserves still stood at \$200 million in October 1982, sufficient for about 4-6 months' imports.

During the first five years of Independence Suriname kept its books balanced. The public sector current account showed a slight surplus in 1979 and 1980, and Dutch assistance covered the development budget. The balance-of-payments showed a current account deficit of about 5% of GDP those years, also covered easily by capital inflows from the Netherlands.

~~CONFIDENTIAL~~

DECL:1/11/89

The economy began to fall out of balance late in 1980. The world bauxite market deteriorated rapidly, and export earnings from bauxite products fell from \$416 million in 1980 to \$378 million in 1981 and \$326 million in 1982 (the latter figure obtained by INR from Alcoa). The military government which followed the February 1980 coup increased government spending significantly, especially military spending, and government operating expenditures jumped 24% in 1981. The public sector operating budget was in deficit by \$28 million in 1981 (2.5% of GDP), still covered by Dutch assistance. The current account of the balance-of-payments worsened from -\$58 million in 1980 to -\$120 million in 1981, offset by official inflows of \$95 million.

\$ million	<u>1979</u>	<u>1980</u>	<u>1981</u>
GOVT. BUDGET			
Current Expenditures	232	256	316
Domestic Revenue	236	267	288
(bauxite levy)	(49)	(51)	(54)
Current Account	+4	+11	-28
Development Expenditures	74	72	97
Dutch Assistance	81	74	95
BALANCE-OF-PAYMENTS DEFICIT			
(current account)	-37	-58	-120
(bauxite prod. exports)	342	416	378

1983 OUTLOOK

The world bauxite market continues depressed. The military regime has shown little sophistication in economic matters, and may continue its recent path of expanded military and public spending and government involvement in the economy. Under these circumstances the current account deficit and the public sector operating deficit will continue to worsen. With 1983 bauxite levy revenue expected to be down \$20 million from 1980's level and with customs duties and income taxes stagnant, Suriname's public sector operations deficit could increase to \$100 million in 1983 (10% of GDP). Development expenditures could add up to \$100 million to this deficit, depending on how many development activities are continued without Dutch aid. On the external side, bauxite sector export earnings will be around \$130 million less than in 1980, so that even with no real increase in 1983 imports the current account deficit of the balance-of-payments could surpass \$200 million in 1983, 20% of GDP.

CONFIDENTIAL

Suriname's \$200 million in reserves will cover these gaps for a while, but perhaps not as long as expected. In such an unstable situation, with increases in emigration and capital flight, reserves may be drawn down faster than expected. (Nervous GOS officials may be among those trying to stow hard currency abroad.) The GOS has a tight system of government licenses for capital transfers, and the GOS screens large import license applications, but while such measures will retard capital flight they will not prevent it. With a possible current account deficit of \$200 million or more, with many Dutch banks reluctant to continue traditional trade credits with Suriname, with continued high public sector and military spending, and with the pressure of emigration and capital flight, we believe that the GOS could conceivably exhaust its \$200 million nest egg by the end of 1983. If that happened, and especially if the world bauxite market were still soft, the GOS would begin 1984 facing high deficits, unsympathetic trading partners, and an empty treasury.

Col. Bouterse and the "group of 16" may be slow to accept the gravity of the economic prospects. The technocrats in the Central Bank may urge austerity, cuts in public spending and increased taxes, but Bouterse's leftist advisors will counsel continued expansion of government control and a crackdown on the private sector and other perceived enemies of the revolution. In view of Bouterse's past decision-making record, we would expect him to follow his leftist advisors, ignore his technocrats, and reject a meaningful austerity program.

MEDIUM-TERM OUTLOOK

At this point the crucial element in the scenario becomes the degree to which Dutch aid is replaced by official bilateral aid from other sources or by external borrowing. We are confident that neither the IMF nor the World Bank will return phone calls from Suriname during the current unstable situation, and we doubt that Venezuela or Brazil have the cash and inclination to step in with major assistance. Prudent major commercial banks will be wary of involvement in Suriname, but the small country's finance requirements are not massive and its capacity for additional borrowing is high. At high enough interest rates the GOS might well be able to borrow enough in international financial markets to remain solvent for a few more years, albeit by mortgaging its future in the process. Its preferred route, of course, will be concessional bilateral assistance. We have no basis for judging at this time whether non-Hemispheric donors, e.g. Libya or the Soviet Union, would step in to replace the Dutch aid.

CONFIDENTIAL

During the coming years Suriname will need to modernize its bauxite processing facilities in order to remain competitive in this vital sector. Alcoa faces a major investment program, and any change in its investment plans could have significant effects on export earnings. Should the GOS later decide to take over some or all of Alcoa's operations, it would face a need for huge levels of financing to continue needed investments. To date the GOS has taken pains to reassure Alcoa that its status is not endangered, and the company appears to be continuing its operations as before.

Even with increased aid or borrowings abroad, public discontent will increase as emigration and capital flight disrupt the private sector and cause spot shortages of consumer goods and services. We expect the December 1982 crackdown to produce a sharp increase in emigration and to virtually stop new private investment (which at any rate has been minimal since the February 1980 coup). Much of Surinamese society is composed of a middle-class, urban population not accustomed to economic hardship, among which the GOS even now has little popular support. Bouterse will be tempted to react to the disruptions in the private economy by increasing government involvement and control of the economy, further radicalizing the regime. If the regime is forced to borrow on international financial markets at high interest rates to maintain its consumption, then by the middle of the decade Suriname's debt burden could begin to constrain economic growth.

Without substitutes for Dutch aid, the decline of the Surinamese economy would be sharper and more disruptive. In that case the GOS would have to choose between austerity and inflationary domestic financing; we guess Bouterse would choose the second, meaning a possible sharp increase in inflation as soon as 1984. A more severe economic decline would exacerbate tensions within the military, leading perhaps to a counter-coup or to a more repressive crackdown on perceived civilian and military opponents. A grim long-term scenario could see the progressive "Guayanization" of Suriname, in INR's words, as the country's educated citizens continue to flee and an increasingly more poorly led government steps in to take over control over the sectors of the economy left behind.

The above analysis assumes the continuation of the Bouterse regime or of something like it. A change in regime might prevent this scenario, especially if Dutch aid is restored and the new regime does not inherit a heavy debt burden. But much damage will have already been done. Many competent people will have left the country not to return, and the country's reputation will take years to restore.