SMALL PROGRAM STRATEGY STATEMENT

Seychelles
FY 85

A. Political Update

In August 1982 the Rene government, already beset with threats of invasion from exile political groups, was rocked by serious mutiny in the Army. Although ostensibly not aimed at Rene's overthrow, the mutiny underscored his fragile political base in the islands. Above all, the mutiny was but one more factor leading to decreased tourist revenues, the mainstay of the island's economy.

In November 1982 Rene announced a major government reshuffle which was aimed at restoring a measure of "non-aligned balance" in Seychelles' external policies and to reassure businessmen and the middle class that there was room for the private sector in his socialist government. The new Minister of Planning and External Relations, Maxime Ferrari, is known by many in the West as an open, honest and reliable partner. Ferrari has sought to emphasize his government's desire for improved relations with the West, in general, and with the United States specifically. The Seychelles absented itself on six issues of importance to the U.S. in the United Nations this year, in marked contrast to previous years when its voting pattern on issues against our interests exceeded even those of Libya and the USSR. A number of possibly contentious issues regarding the U.S.A.F. Tracking Station on the island have been quietly dropped, as have charges that the U.S. Embassy was distributing propaganda inimical to the government's interest. The government has recently sought a practical solution which would allow the return of U.S. Navy vessels to the Seychelles for port calls.

These recent policies are aimed, in the first instance, in attracting more financial support from potential Western donors. Minister Ferrari has approached Sweden, France, the UK, Germany and others in a bid to increase grant and/or loan assistance. Secondly, the Government of the Seychelles appears to have recognized that its financial future is tied inextricably with Western tourism. Having appointed an expatriate Director of tourism, and having invested nearly $1.5 million dollars in 1982 on tourism promotion, the Government recognizes that its past pro-Soviet rhethoric, leftist slogans and sometimes hostile attitude will do little to promote tourism from the West.

Tourism by the end of 1982, while still the lowest in recent years, appears to have made a slight recovery during the last two months of the year and in January 1983. However, the future is problematical and much will depend on the world economic recovery, particularly in Western Europe. The decision by two major airlines (Lufthansa and British Airways) to drop their Seychelles service in mid-1983 will be a negative factor, even if alternative arrangements are made using charter aircraft.

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The outlook for 1983 is uncertain, both politically and economically. Pressures from exiles abroad will no doubt continue. Internal dissatisfaction is unlikely to be calmed. This political uncertainty, coupled with a cloudy economic picture, is not a pleasant prospect for the Rene government as it looks for means to increase its ties to the West.

B. Economic Update

In 1982 the domestic economy remained depressed; the external account continued under pressure with a further drop in tourism revenues and a continued high level of imports. The balance of payments deficit slowed down in the second half of 1982 compared with the first two quarters, so that the year end (1982) net loss was estimated to be about $5 million, or almost the same level as the previous year (1981).

The past year has been a disastrous one for the tourist industry. In the peak year of 1979 approximately 79,000 tourists came to the islands. The following years showed a decline, to 72,000 in 1980 and 60,000 in 1981. The 1982 figure shows a further drop to 46,000, though revenue per tourist has remained stable during 1981 and 1982. The decline has been due to a combination of factors: Unfavorable publicity after incidents indicating political instability; rising costs due to the revaluation of the Seychelles Rupee; higher air fares; and the world recession. The GOS launched a major marketing campaign in Europe in September 1981 to try to counteract this downward trend. However, the most recent negative factor, the plans to discontinue regular flights to the Seychelles by two major airlines, will be more difficult and potentially expensive for the GOS to overcome. The GOS remains guardedly optimistic on the future for tourism, projecting a 10 per cent increase for 1983 over the low point of 1982.

In the foreign trade sector, imports were higher in the first half of 1982 than in the same period the prior year. The March 1981 currency revaluation served to reduce certain exports. Export receipts also dropped in the first three quarters of 1982, almost 40 percent below the same period of 1981. Exports, including re-exports, cover only about one-sixth of the import bill.

The stagnation of agricultural production is of major concern to the government. The new plan, (1982-86) continues to emphasize the potential growth of both agriculture and fisheries, but this may be difficult to achieve. Copra production has been slowly declining, though 1981 export earnings were cushioned by higher world prices. Similarly, earnings from exports of cinnamon were expected to be higher in 1982 than in 1981. Although frozen fish constitutes the second most important export 1981 production

declined to only half that of the prior year in terms both of value and quantity marketed. In spite of substantial foreign assistance in the fishing sector its potential for cost effective development may be limited. With food accounting for about one sixth of all imports the government is attempting to encourage expansion of domestic food production and influence taste preferences. Prices of most fertilizers and insecticides were reduced in June 1982 to encourage farmers to increase production.

For the past three years the levels of development expenditures have increased from $25 million in 1980 to about $30 million in 1981; 1982 is expected to show an additional increase. With a tightening of foreign assistance it will become increasingly difficult to sustain the level of development expenditure from domestic sources. The estimated government revenues by source for 1983 projected a 7 percent decrease from 1982 levels, while total expenditure estimates submitted by all Ministries and Departments had increased by 18 percent.

The future for the Seychelles economy does not appear to be brightening. High levels of government expenditure have increased employment in the public sector in 1982, while private sector employment is thought to have decreased, particularly in the tourism sector. Increased GOS participation in industrial enterprises will probably add to the balance of payments problem. Inflation did slow in 1981-82; however, until there is a revival in the tourism sector (and the concommitant rise in revenues to help finance the country's capital budget expenditures), the GOS will find it increasingly difficult to sustain the high level of social services to which its population has grown accustomed.

C. Development Problems and Priorities

The backdrop against which the country's developmnt problems and priorities must be viewed consists of several important factors. The economy of the Seychelles is very small, its arable land area is very limited and, with the exception of tourism, it has only limited potential for development. Prior to 1970, the country relied largely on a few plantation crops for export. Its imports were similarly modest. However, following the construction of an international airport in 1971, tourism and the role that it played in the country's economy expanded rapidly. Tourism easily became the most significant growth sector in the economy. This was accompanied by a rapid rise in imports, in large part to service the tourist industry. A decade later the economy continues to expand and contract in response to the level of tourism. The major problem confronting the Seychelles at the present time is the marked decline in tourism revenues. Conversely, a rejuvenation of the tourism sector would do much to stimulate the development prospects of the country. An encouraging sign in that direction in the fact that the government is taking very active steps to promote additional tourism in its principal European markets.

Viewed in the context, there are three problems areas which are expected to prove troublesome over the near term: a growing gap between exports and imports (the latter outweigh the former by a factor of 25), which can only realistically be closed by a resurgence of tourism; the increasing dependence of the country upon foreign donor assistance to finance its development activities; and, the continued small but steady exocus of trained Seychellois who oppose many of the government's policies. These are problem areas for which no solutions are readily evident. The first two, in particular, are strongly influenced by exogenous factors, such as the world economic recession, which impact directly on both donor assistance levels and tourism prospects.

D. Development Prospects and External Assistance Needs

Although the importance of the tourist industry to the general economy was underplayed in the Government's recently issued National Development Plan, it nonetheless remains critical to the country's future development prospects. Recent events in that sector have provided both good and bad news. The good news is that tourism figures have shown increases during the past three months over similar figures for last year. The bad news is the threatened withdrawal of two major European carriers from the Seychelles by April 1. The impact of such a move would be extremely grave on all economic growth projections. It underscores the vulnerability of the economy to factors outside the control of the Government. Until the transport issue is adequately resolved the development picture must remain cloudy.

The level of external assistance for the Seychelles has continued to grow in recent years, with a figure in excess of $30 million expected during 1982. It has resulted in one of the highest per capita assistance figures in the world (approximately $500). Great Britain is the single largest donor, followed by a number of other European countries and international organizations. As a result of these high assistance levels the Seychelles has been able to finance the bulk of its capital investment budget as well as several recurrent cost activities with external resources. Whether the Seychelles will continue to receive increased levels in the future is uncertain. The uncertainty is carried through into the discussion on resources required for public sector capital projects in the National Development Plan. The Plan projects investments of almost $200 million during the 1982-86 period, of which less than $50 million will come from domestic revenues. The inference is that external resources will make up the difference, although the Plan states that "any estimate of the total finances that will be available for the country's development programmes becomes a highly conjectural exercise." Even if one discounts several of the activities proposed in the Plan, the country's dependence on continued, high levels of external assistance is evident.

E. Proposed AID Strategy and Recommended AID Activities

For mainly political and strategic reasons the US has a strong interest in continuing to provide AID asssistance to the Seychelles at the present level for at least the near term. Given those parameters, the principal question to address is the form such assistance should take. The very small size of the country's economy greatly reduces the options open for developing an assistance strategy. Furthermore, the presence of numerous other donors (several providing much more substantial assistance) has constrained our development planning efforts.

After examining several alternatives last year, it was decided to provide assistance in the form of a CIP that financed the importation of fuel oil. This year we examined various AID modalities and have again opted to provide balance of payments support through a CIP that will finance the imports of fuel oil. In reaching that decision we examined and rejected both project assistance and a cash transfer. The difficulties of monitoring projects from a distance, plus the adminstrative burdens it would place on the Embassy's limited staff, argued strongly against the project approach. The absence of exchange controls and other difficulties argued against a cash transfer. Although a CIP is our preferred mode of assistance, the possibility of importing commodities other than fuel oil was discussed. We were particularly interested in other commodities that might offer a potential for stimulating U.S. trade. Unfortunately, no viable opportunities were identified. This is not surprising given the Seychelles' Lilliputian economy, its distance from the U.S. and the fact that several of its principal European trading partners also offer the Seychelles external assistance. Although 1980 trade statistics indicate imports from the U.S. of over $2 million, these consist of a wide vareity of commodities and do not lend themselves to easy packaging. Narrowing further the list of commodities to those required and which make economic sense, REDSO/ESA, the Embassy and the GOS have jointly agreed to continue the importation of fuel oil.

We intend to examine our options a new in 1984. However, barring a sudden demand for other commodities which AID would be willing to supply, we anticipate continuing the procurement pattern established last year.

REDSO/ESA has taken a pragmatic approach to the programming of local currencies generated under the CIP. Although our preference is to work within the agriculture sector, the limited number of farmers and absorptive capacity makes a concentration of effort in that one sector unrealistic. Therefore, we have adopted a flexible approach that will enable AID to respond to GOS development needs across a broad range of sectors. In addition to agriculture, these include public services (water and

sewage), human resource training, other islands development, road maintenance and improvement, housing and, possibly, entrepreneurial development. In consideration of the key role that tourism plays in the economic well-being of the country, we are prepared to give consideration to assisting that sector as well.

With regard to the ongoing PL 480 Title II program, REDSO/ESA will shortly undertake an evaluation of the current program and an assessment of future needs. A determination of the nature and extent of any further assistance will be made soon thereafter in consultation with the Embassy.

In summary, given the nature of US interests in the Seychelles, the size and absorptive capacity of the economy and our own limited resources, REDSO/ESA and the Embassy have chosen a flexible approach which takes into account the realities of the situation. In proceeding with a CIP that finances medium fuel oil, we have, we believe, selected an appropriate assistance strategy which responds to a real Seychelles requirement and, at the same time, generates local currencies for use for sound economic and social development purposes.