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## **SURINAME: SUPPORTING PRIVATE SECTOR DEVELOPMENT**

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# **SURINAME:**

## **SUPPORTING PRIVATE SECTOR DEVELOPMENT**

DANIEL ARTANA, JUAN LUIS BOUR and MONICA PANADEIROS\*

The report draws and elaborates on FIEL's findings of a mission to Suriname. The executive summary was prepared by RE3/FI3 based on FIEL's document. Most valuable input and support was provided by: the Field Office in Suriname, and comments made by Pablo Adam (COF/CSU), Carlos Elias (OD6) and Frank Nieder (FI3).

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## Foreword

After two decades of weak economic performance, in the past four years Suriname has experienced stability and growth. This has resulted from a combination of prudent macroeconomic management, favorable external conditions, especially as a result of a buoyant commodity markets, and increased foreign investments, albeit limited to the mining and oil sectors. Despite this favorable performance, its narrow production and export base renders the economy extremely vulnerable to external shocks, especially to fluctuations in commodity prices.

Suriname will be forced to face increased competitive pressures as a result of the regional integration process in which it has embarked through CARICOM and the CSME. In this context, promoting private sector development and improving the competitiveness of key economic sectors will be important underpinnings of any sustainable growth strategy.

Historically, the public sector has been a major actor in the economy -public employment represents 60% of total formal employment, public sector expenditures represent 40% of GDP, and there are around 120 state-owned enterprises, many of them providing pure private goods. Additionally, existing regulations impose high transaction costs in areas such as labor hiring and firing, land tenure and the acquisition of business licenses, thus hindering entrepreneurship. Moreover, the feasibility of private sector projects is very restricted by poor infrastructure and financial support services.

This study examines the barriers that have traditionally hindered private sector development in Suriname and presents a set of proposals to promote the role of the private sector as a driving force of Suriname's economic growth.

Daniel Artana, Juan Luis Bour and Mónica Panadeiros, economists at Foundation for Latin American Economic Research ( FIEL ), prepared the report. The authors wish to thank the team that drafted the Strategic Guidelines for Private Sector Development in Suriname (SGPSD)<sup>1</sup>. The findings of this study have been incorporated in the formulation of the SGPSD, a coordinated effort to orient the actions of the different units of the Bank Group in their common goal of fostering the development of the private sector in Suriname. A special thanks to Jesus Bengoechea (RE3/RE3), and Maria Andrea Llarena (RE3/RE3), who were in charge of this publication.

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## I. INTRODUCTION

After two decades of weak economic performance, Suriname has experienced stability and growth in recent years, mainly as a result of a careful and responsible macroeconomic management, increased investments in the mining sector and higher international prices for some of the country's main export commodities.

While prospects for growth are more promising than they have been for many years, its medium to long-term sustainability is not guaranteed. Suriname's relative economic openness and its narrow production and export base, renders it extremely vulnerable to external shocks, especially due to fluctuations in commodity prices.

In addition, Suriname faces substantial challenges ahead because the sectors which account for a significant share of employment do not seem to have a promising future, while mining, the most competitive and dynamic activity, contributes little in terms of direct employment.

Under this scenario, it is clear that any strategy aimed at sustainable development and employment creation has to be based on the promotion of the domestic private sector and foreign investment, and that such a strategy should focus on broadening the country's productive structure. But private sector can only flourish when incentives facing investors and entrepreneurs are conducive to growth and increased investments.

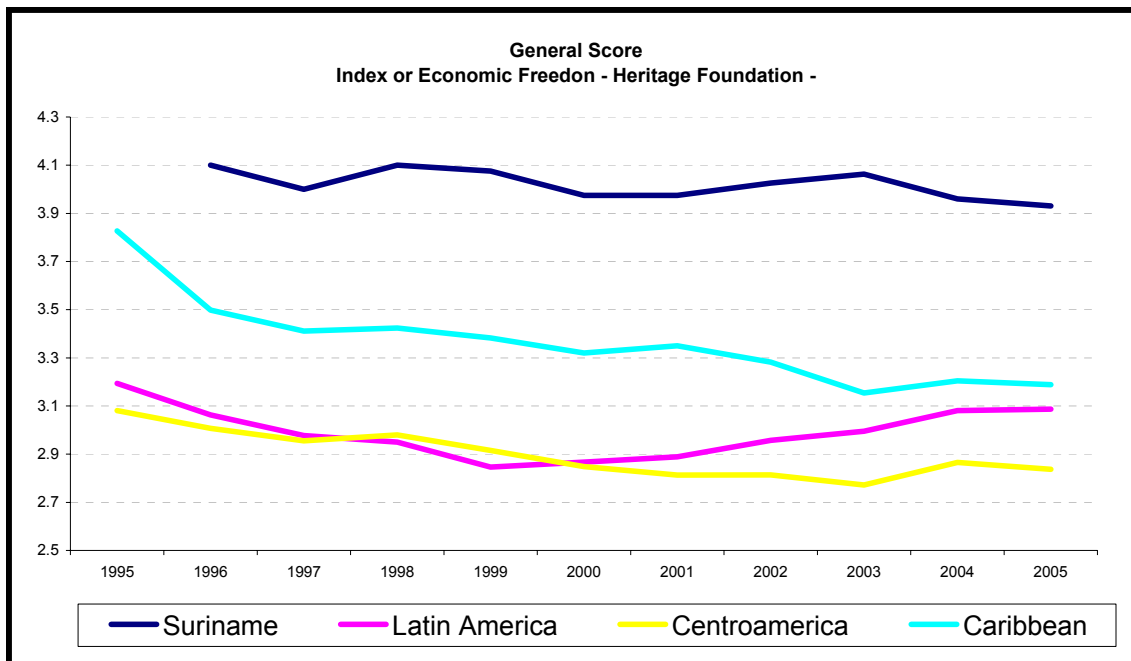
The incentive framework in Suriname works contrary to these objectives. On the one hand, Suriname's small market size and isolation impose barriers for development and, on the other hand, the government institutions and regulations create additional costs, making it difficult for the country to exploit its potential. Therefore, investors, in particular foreign ones, do not look favourably at Suriname, as its investment climate is less attractive in comparison, except for natural resource extraction, with most other countries in the region.

Suriname does not rank well in the few measures available to assess the overall business environment. For example, according to the Heritage Foundation Index of Freedom, an indicator that intends to summarize different aspects of the business climate, Suriname is ranked 140 out of 155 countries and its score is significantly worse than the averages for South America, Central America and the Caribbean. It also is generally close to the bottom in comparison with 20 countries in the Caribbean Region included in the World Bank indicators of governance.

Sustainable and balanced growth in the future will only be achieved by implementing a substantial realignment of policies affecting the investment climate. However, removing the obstacles that fall in the realm of public policy might not be enough to stimulate private sector development in a small and isolated country like Suriname. For example, firms may face constraints associated to scale issues and direct interventions may be needed to overcome them.



**Chart I.1 Heritage Foundation Index of Freedom**



Source: FIEL based on Heritage Foundation.

Note: Higher numbers indicate worse performance.

This concept paper identifies and assesses the conditions and obstacles for private sector development in Suriname, and includes recommendations to help the IDB group to orient activities to support private sector development in Suriname. Chapter II provides a description of the key characteristics of the Surinamese economy, Chapter III briefly examines the private sector structure, its weaknesses and capabilities, and Chapter IV identifies and analyzes the main obstacles and issues to improve the enabling environment for private sector development. Chapter V points out the challenges and opportunities faced by a small and isolated country that had a poor economic record because it encouraged the private sector to enter into rent seeking activities instead of focusing on productivity gains. Finally, Chapter VI provides recommendations on areas of focus for the IDB groups and suggestions for the overall strategy for the Bank to support private sector development in Suriname.

One important shortcoming to prepare this report was the lack of statistics that are usually available in other countries of the region. This has made more difficult, and in some cases impossible, a quantitative assessment of the issues and identified obstacles. This challenge was partially addressed through qualitative data obtained from interviews with government officials, private managers and entrepreneurs, as well as representatives from foreign institutions and labor unions.

## II. KEY CHARACTERISTICS OF THE COUNTRY AND ITS ECONOMY

**Small and isolated economy:** The Republic of Suriname, a former Dutch colony, has a land surface of 164.000 km<sup>2</sup>. With less than a half million inhabitants and 2.7 persons per km<sup>2</sup>, Suriname is sparsely populated<sup>1</sup>. On top of this, the rate of population growth is low (0.5% between 2000 and 2004), as natural growth is offset by migration, primarily to the Netherlands<sup>2</sup>. As a consequence of this small population, the economy is also small, with a total GDP of only US\$1.1 billion. This small size greatly limits the economies of scale that any producer for the local market can obtain, and therefore limits their ability to compete with international producers.

Situated on the north coast of the South American continent, Suriname is physically isolated from any regional population centres, and unlike the case of other small economies in the region, it also is located relatively far from the North American market. The geographic isolation is compounded by the fact that the official language, Dutch, is rarely used in the rest of the world. The physical and cultural isolation both impose costs on the economy, the former by increasing transportation and other connection costs, and the second by keeping the country relatively apart from international trends and technological innovations.

**Rich endowment of natural resources:** Suriname is a rich country in terms of natural resources. Mining resources are the most important, with bauxite, gold and crude oil as the most important products. The country is covered with tropical rainforest on 80% of its total land surface, providing a rich biodiversity. Some of its land resources are suitable for a range of crops and its rivers offer the possibility for large-scale irrigation, where needed. Suriname is relatively well endowed with fishery resources, primarily sea-based, and also has ideal conditions for aquaculture.

**Medium income country and open economy:** With GDP per capita around US\$ 2,400, Surinam is a medium income country. It is a highly open economy given that exports of goods and services account for approximately 65% of GDP and imports of good and services account for about 80% of GDP (see Table II.1).

**Mining dependent economy and narrow productive structure:** The country has a limited basket of export goods, almost all of which are natural resource based, and increasingly dominated by alumina and gold, which together account for over 80% of total exports. Crude oil, rice, shrimp, timber and bananas account for most of the remaining 20%. The overall productive structure is strongly biased towards service activities (more than 70% of GDP), so Suriname must import most final, intermediate and capital goods.

This economic structure is partially explained by the small market size of Suriname that limits producers to capture economies of scale. Although it is possible to overcome this restriction through exports, tradable activities have suffered in the past from a highly volatile real exchange rate that only producers of natural resources could withstand. These limitations also restrict competition and thus reduce the dynamism of the economy. As a result, the economy has a narrow range of production and exports, and a high concentration of economic activity in a few products.

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<sup>1</sup> Its population is composed of six different ethnic groups, which have developed a very peaceful way of living together.

<sup>2</sup> There is a Surinamese community of 309,000 in the Netherlands, made up of 185,000 people born in Suriname and 124,000 born in the Netherlands of at least one Surinamese parent.

**Table II.1 Macroeconomic characteristics by group of countries (2001/02)**

	<b>Per capita GDP (U\$S)</b>	<b>Trade opening (X + M)/ GDP</b>	<b>Tax revenues (2000/01, % GDP)</b>
Low income countries	614	74.2	14.9
Low medium income countries	1,642	84.4	15.8
<b>SURINAME (2003/04)</b>	<b>2,470</b>	<b>145.0</b>	<b>27.8</b>
High medium income countries	4,142	93.4	21.0
High income countries	21,387	98.2	27.5
Developing countries in America 1/	3,301	63.7	16.0

1/ Developing countries in America are included in the first three categories.

Source: FIEL, IMF (2005) and Keen and Simone (2004)

**Dependence on Transfers (Dutch assistance and remittances):** Suriname receives considerable inflows of transfers from two different sources: (i) Dutch financial assistance provided through the Treaty Fund, the main Suriname-The Netherlands bilateral agreement created after Suriname's independence in 1975; and (ii) family remittances mainly from the Netherlands, sent by the Surinamese community. Remittances have been relatively stable at about 2% of GDP, while Dutch grants averaged 7.7% of GDP for the period 1990-2000, but have fluctuated considerably depending on the relations between the two countries. Currently they represent less than 2% of GDP.

**Sizeable government intervention:** The State has a dominant position in the economy. Public sector expenditures have fluctuated between 35 and 40% of GDP during the last few years, the highest proportion among IDB borrowing countries, while the tax burden is higher than in most of countries at a similar level of development (see Table II.1). To some extent the high ratio of government expenditures to GDP may reflect the higher average cost of producing public goods in small economies, but the presence of government in Suriname is unusually large, even adjusting for the small size of the economy. There are also about 120 state-owned enterprises, many of them providing pure private goods. In addition to its large size, the government over-regulates the economy in many fields, such as labor firing, land tenure and business licences.<sup>3</sup> These last two characteristics are not captured in the traditional estimates of government size, so that the impact of state intervention is underestimated.

**Macroeconomic instability:** Suriname has suffered from macroeconomic instability: short periods of stability and growth have been followed by periods of macroeconomic crisis and inflation. The sources of instability are related to: i) strong dependence on the production of commodities, mostly bauxite and gold, whose world market prices are highly volatile; ii) the size and fluctuation of Dutch development assistance, and iii) poor economic management, especially because the government has run a pro-cyclical expenditure policy with excessive fiscal deficits (during the 1990's the fiscal deficit averaged 9% of the GDP)<sup>4</sup>.

<sup>3</sup> An analysis of the importance of the size of the government and its regulatory framework on private sector development is covered in more detail in Chapter IV.

<sup>4</sup> In terms of size and volatility Dutch grant funding had a larger effect than bauxite taxes on government revenues for the period 1990-2000. It averaged 7.7% of GDP and 25.7% of total revenues and grants, as compared to 2.9% of GDP and 9.6% of total revenues and grants for direct bauxite taxes.

In recent years, Suriname has achieved substantial progress on the macroeconomic front. Nevertheless, the economy remains vulnerable to external shocks, particularly due to its narrow production and export basis. So the risks to stability are high.

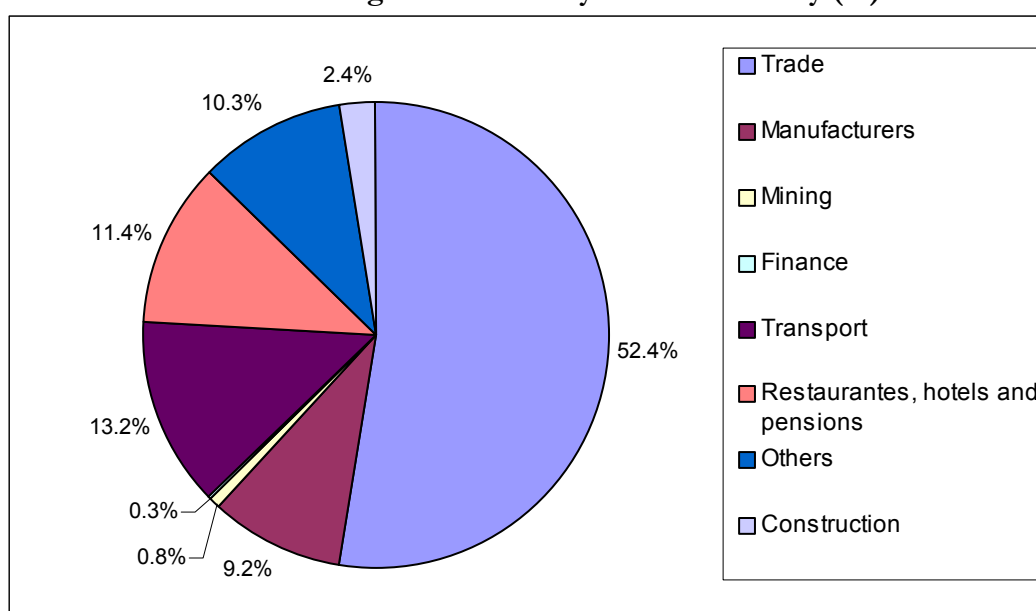
### III. PRIVATE SECTOR STRUCTURE, CAPABILITIES AND WEAKNESSES

**Characterizing the private sector:** The lack of official statistical information and the widespread public intervention in activities concerning private goods and services makes it difficult to characterize precisely the private sector in Suriname<sup>5</sup>. Nonetheless, even based on poor data from a range of sources, the analysis that follows shows that the key characteristics of the private sector structure include: i) a large number of small firms dedicated to non tradable activities, which account for a significant contribution in terms of GDP and total employment; ii) a relatively more concentrated tradable sector outside mining, with larger firms which account for a moderate share of GDP, employment and export earnings, iii) the mining sector, composed of a few large firms, which account for most export earnings but contribute little to employment, and iv) a large informal sector, both in terms of GDP and employment.

**Number of firms by sector of activity:** Based on the register of commerce administered by the Chamber of Commerce and Industry (KKF), it is estimated that there are 20,000 firms in Suriname, of which some 14 to 15,000 are active. More than half of the registered firms are oriented to trade or retail activities, while only about 10% are dedicated to tradable activities (manufactures and mining). Agricultural firms are not included, as they do not need to register (see Chart III.1).

Taking into account the estimated labor force not employed by the Central Government (see below), the average size of firms in Suriname would be around 3 workers. The KKF estimates that the number of companies with over 300 employees (including subcontracting) is less than 50, and that there are about 400 firms which are incorporated as limited liability companies

**Chart III.1 Registered firms by sector of activity (%)**



Source: FIEL based on KKF information.

<sup>5</sup> For example, the number of firms operating in the economy is not available.

**Composition of GDP by sector of origin:** According to IMF (2005), by far the largest sector in Suriname is the State, which directly accounted for 18.1% of GDP in 2003. Table III.1 also shows the bias of productive structure towards non-tradable activities, which account for 41.1% of GDP, and 59.2% of GDP if the public sector is included. Tradable sectors represent 24.4%, of which 8.7% is Mining, while the remaining is explained by the informal sector (16.4%).<sup>6</sup>

**Employment by sector:** The government and the state companies remain the largest employer in Suriname (48% of the total labor force). Taking into account that informal workers and self employed represent around 25% of total employment, it means that only 27% of the labor force is allocated to private formal activities.<sup>7</sup> The largest private formal employer is the Trade sector, accounting for more than 35%, followed by the Construction sector (17%) and Agriculture. Direct employment in Mining represents less than 7%.

**Table III.1 GDP by Sectors of Origin at Current Prices (2003)**

	% of GDP at market prices	% of GDP at factor costs
Tradables	21.7%	24.4%
Agriculture	9.2%	10.4%
Mining	7.7%	8.7%
Manufacturing	4.8%	5.4%
Non tradables	52.6%	59.2%
Electricity, Water and Gas	2.7%	3.0%
Construction	3.0%	3.4%
Trade, Restaurants and Hotels	10.9%	12.3%
Transport and Communication	6.9%	7.7%
Finance	11.0%	12.4%
Government	16.1%	18.1%
Personal Services	2.0%	2.2%
Informal Sector	14.6%	16.4%
Less: inputted service charge	3.0%	
Plus: indirect taxes-subsidies	14.1%	
<b>TOTAL</b>	<b>100.0%</b>	<b>100.0%</b>

Source: FIEL based on IMF Art.IV Mission Reports (2005).

**Informality:** By most indicators, the private sector in Suriname is characterized by a high degree of informality. Informality is apparently concentrated in small-scale gold mining carried on mostly by Brazilians and Maroons (some 6 to 8 thousand miners), logging, fishing, trade, construction and services. Illegal activities are also reported to be increasing. They include drug trafficking, money laundering, smuggling and illegal immigration (mainly from China). Inadequate access and weak policing allow the inland areas of the country to be an ideal operating area for these activities. This harms legitimate businesses and creates perverse incentives elsewhere in the economy.

<sup>6</sup> The contribution of mining to total GDP seems to be underestimated. Considering that exports of mining products are about 50% of the GDP, the ratio of Value Added to Sales is about 0.2. In Chile, for example, this ratio is 0.5 (exports of copper are 30% of GDP and copper contributes 15% of total value added).

<sup>7</sup> The Public Sector employs about 57.000 people and the formal private sector around 33.000. It is estimated that 30.000 persons work in informal activities

Informality has many causes. On the one hand, formality requires compliance with bureaucratic rules and regulations, which are extensive and increase the costs of doing business. If these costs are high, as they are in Suriname, the number of workers and firms who are willing to go through the process to become formal is reduced. On the other hand, the main reasons to become formal are to gain access to finance investment and working capital, and to the legal system for entering and enforcing contracts. But in Suriname there are few benefits from being formal, as neither finance, nor the legal system are, in practice, accessible for smaller firms.

Informality traps participants in the informal sector in low wage, low productivity activities. It also means that formal firms pay larger taxes and face unfair competition.

**Private sector market structure in the export sectors:** The market structure of the main export sectors is highly concentrated, with one multinational firm (under the agreement of Suralco<sup>8</sup> and BHP) controlling bauxite mining and alumina production, one multinational firm in large scale gold mining (Cambior), and state owned enterprises monopolizing oil and banana production<sup>9</sup>. Only the market structure of rice and fishery industries is more diversified.

The mining sector, the primary foreign exchange earner for the country, is internationally competitive and faces favorable prospects<sup>10</sup>, but it accounts for a small share of employment. In the case of rice and bananas, Suriname faces renegotiation of its preferences in the EU market and stronger competition in international markets in the coming years. Although these products constitute only a small share of the country's exports, they contribute significantly in terms of employment. Diversification of the export base is therefore of high importance for a sustainable and balanced growth.

Some of the non traditional activities that could have some scope for growth in a more conducive business environment are the following:

*Tourism:* this activity attracted more interest in Suriname, since in 2004 the number of visitors increased by more than 30%, reaching 138 thousand, of which 23% arrived for leisure and recreation. The country has several comparative advantages that could be exploited. They include eco-tourism focusing on the interior rainforest, the coastal wetlands, casinos in Paramaribo focusing on the Brazilian market (a country for which a visa is not needed).

The obstacles to a rapidly growing tourism sector are however high: i) low availability of airline capacity, both to North American and European markets; b) the low number of high quality hotel facilities that the country can currently offer, c) the difficulties to obtain a visa, d) limited supply of tourist operators. However, discussions are underway to establish an open-skies policy, which should allow for increased flights and airline capacity into Suriname.

*Manufacturing:* the manufacturing sector includes the processing of local agricultural products –which accounts for about 60% of all manufacturing activities- and import-substituting industries using local and imported inputs. With the exception of alumina production and some (mainly fisheries-related) food-processing industries, manufacturing activity is mostly limited to supplying the small domestic market. In recent years, since the country's entry into the CARICOM market, local firms have lost

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<sup>8</sup> Suralco is a branch of the multinational Alcoa.

<sup>9</sup> The government has started a rehabilitation plan for the banana sector in 2002 with the aim of its privatization.

<sup>10</sup> The largest project (Bakhuys) would be located in western Suriname and includes the development of a new bauxite mine, a 500 MW hydroelectric dam and a large smelter. The overall cost of the project is over US\$3 billion. As such the project would provide an enormous boost to the economy during its construction and during its operation, but its development faces several difficult environmental obstacles and land decisions. No firm decisions have yet been made by the government or Alcoa. Bakhuys is one among eight potential large projects of Alcoa around the world, and it could be developed in the next 4 to 5 years.

market share to competing imports, mainly from Trinidad and Tobago. Moreover, it is likely that greater competition in domestic markets spurred by further trade liberalization threatens some local manufacturing production, like beer, soft drinks, fruit juices, furniture, paints, detergents, etc. On the contrary, growing worldwide liberalization could represent an opportunity for stimulating new businesses for only a few manufactured products. Owing to the abundance of tropical forest, there would be some potential for development of the timber industry. Some products that have some chances to enter foreign markets are wood-block flooring and timber moldings, among others. At present, Suriname exports small amounts of lumber (less than 0.5% of total exports in 2003). Another promising sector is the processing of some agricultural products, like food sauces or palm oil<sup>11</sup>. On a larger scale, if the Bakhuis project were implemented, aluminum exports would become, by far, Suriname's major manufactured export good.

*Aquaculture:* there is a small fish-farming sector producing fish, shrimp, tilapia and crabmeat, mainly for domestic consumption. It could have some good prospects to enter foreign markets, especially if air capacity is increased.

*Products based on the biodiversity of rainforest* are considered to have promising export potential. For example, there is an innovative firm that has a butterfly nursery for exports to US and EU markets. In a similar way, tropical fruits, organic vegetables, exotic flowers, plants, medicinal herbs, snakes and also handicraft done by the Maroons could have good prospects in foreign markets.

*Other services:* due to wage differentials between the Netherlands and Suriname, offshore activities like call centers in Dutch could be a promising activity as a foreign exchange earner and an additional source of employment. This industry would require changes in telecommunication regulations to allow for inexpensive high volume long-distance telecommunications.

**Private sector capabilities and weaknesses:** there is some concern about the capability of the local business community to develop non-traditional sectors to face challenges posed by the increased competition resulting from regional economic integration and trade liberalization. The limited size of the non-mining private sector, mostly oriented to service activities, may be an obstacle for developing products to markets abroad. At the business community level, for example, there is limited information on how to get access to international markets, limited or no experience in the required packaging, quality and standardization of products, or other key requirements to enter export markets.

Private sector representatives have voiced scepticism about the economic prospects of these new areas of activities. Limited managerial and technical skills are considered key constraints for the development and growth of the private sector. It was mentioned, for example, that domestic firms do not assign a high value to business development services, partly because of their scepticism about their potential return and partly because of the small nature of the domestic market, which limits their knowledge about new technologies and trends in business.

Another weak area seems to be the lack of entrepreneurial spirit and initiative in many small and medium firms (Menke, 2001), which are necessary factors for the private sector to develop. This could be a natural characteristic of small-populated countries, which experience less innovation because of the reduced size of the group from which to learn skills, interact and compete (the so

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<sup>11</sup> In July 2002 a Chinese company signed a Memorandum of Understanding for a 400 km<sup>2</sup> palm-oil project in eastern Suriname. Following initial feasibility studies, the company proposed in May 2003 to make a total investment of US\$ 116 million over a 12-year period. An outline proposal was approved in the National Assembly in January 2004. The project would produce palm oil for export to China, with by-products to be used for cattle feed, margarine manufacturing and fish farming.



called “synergy effect”). Emigration could have worsened this situation because the people who leave the country might be the most qualified and the most entrepreneurial, and their departure reduces the “synergy effect” among those that opted to stay.

## IV. MAJOR OBSTACLES AND ISSUES TO IMPROVE THE ENABLING ENVIRONMENT FOR PRIVATE SECTOR DEVELOPMENT

Suriname's natural conditions of small market size and isolation represent disadvantages for business activity: the former may inhibit the exploitation of scale economies and raises the market power of some firms; the latter increases the unit cost of goods and services because of the associated transportation and connection costs. While the isolation and small size of the economy increase the costs of doing business in Suriname they alone cannot be blamed for the relatively low per capita GDP<sup>12</sup>. It is possible to overcome those restrictions by establishing policies and institutions that improve the enabling environment for the private sector or "investment climate". Unfortunately, government regulations in Suriname have created additional barriers that increase the geographic isolation of the economy and discouraged the diversified and dynamic export growth needed to overcome the small size of the local economy.

Although it is difficult to define "investment climate" precisely, it should include various components grouped in three categories: a) macroeconomic or country-level dimensions, such as fiscal, monetary and exchange rate policies, and political stability; b) governance and institutions, including bureaucratic procedures and legal framework and c) the cost and quality of infrastructure, utilities, financial services and human resources. These elements define the transaction costs faced by business and, ultimately, the incentives for firms and individuals to undertake entrepreneurial activities. A sound "investment climate" can be broadly thought of as an environment where governance and institutions support entrepreneurship and well-functioning markets in order to help generate growth and development.

However, a business climate conducive to investments might not be enough to stimulate private sector development in a small and isolated country like Suriname. For example, scale issues could raise barriers to some efficient outcomes, which would require coordination among different economic agents to be overcome. Thus, a solution to these "coordination failures" might demand proactive policies or measures supported by institutions such as the IDB.

### IV.1 Macroeconomic issues and government macro-policies

A list of the key macroeconomic policy dimensions that explain a poor private sector performance in Suriname, except for large scale mining, includes at least the following aspects: a) fluctuations in natural resource exports and a pro-cyclical fiscal policy that contributed in the past to the volatility of the exchange rate and of the economic activity, b) the direct provision –sometimes in monopolistic conditions- of goods and services from the State, crowding out the private sector in product markets, c) the size of a State that is by far the largest employer in the country, maintains out of the market a sizeable proportion of cultivable land, and demands funds from the capital markets to finance its deficit, crowding out the private sector in all factor markets (labour, capital and land), d) an inadequate tax design, with a high tax burden combined with high tax incentives. These macro issues, together with an ill-designed microeconomic regulatory framework that introduces high transaction costs, encourage illegal and informal, low productivity, activities.

**Commodity price instability and pro-cyclical fiscal policy.** Suriname is increasingly dependent on the mining sector: by 2005, more than 80% of its exports of goods and services will be bauxite derivatives, and gold. A prudent fiscal policy would have tried to isolate the economy from the

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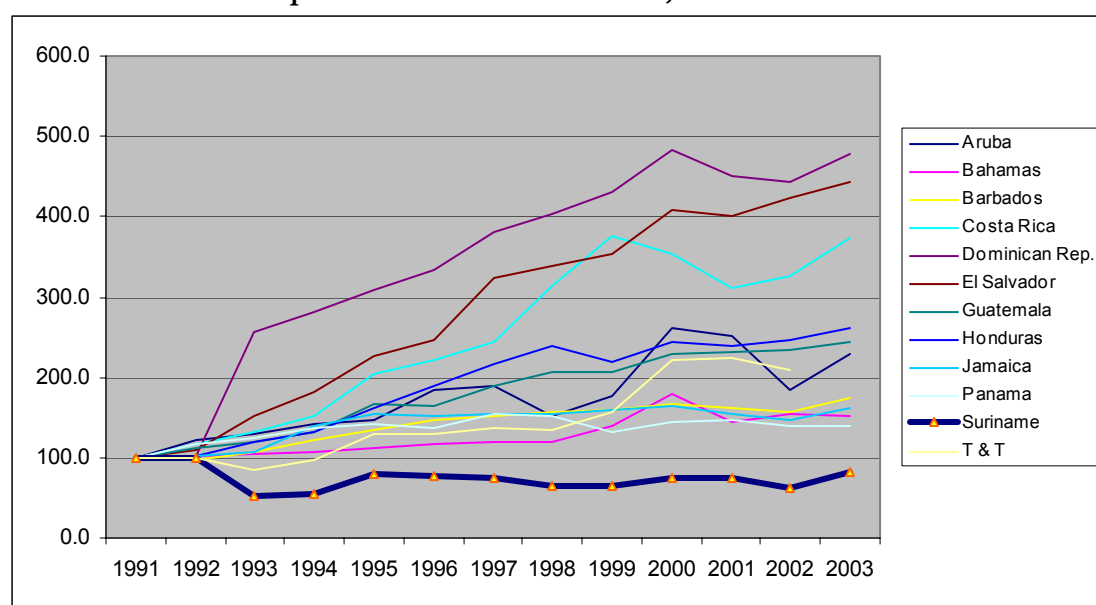
<sup>12</sup>There are other isolated and small countries, rich in natural resources, that enjoy a standard of living much higher than Suriname.

fluctuations in commodity prices. Instead, in Suriname government expenditures and deficits have frequently been pro-cyclical. This might have increased the demand for non-tradable activities precisely when abundant export flows were also working in the same direction. Volatile export prices, poor anti-inflationary policies and a pro-cyclical fiscal policy have increased the volatility in the effective real exchange rate<sup>13</sup>.

The resulting macroeconomic instability has been a major contributing factor to low domestic private investment, little FDI outside of the mining sector, and GDP annual growth of only 1.7% in the period 1991-2003, which was relatively low compared to most Latin American and Caribbean countries.

Also striking in this weak macro performance of Suriname was its poor export record. While most countries in the region have relied on an export-led growth strategy during the 1990s, given the limited sources of their own domestic markets, Suriname's exports remained essentially unchanged until very recently (See Chart IV.1).

**Chart IV.1: Exports of Goods and Services, 1991-2003. Index 1991=100**



Source: FIEL, based on IMF.

In recent years, Suriname has achieved substantial progress on the macroeconomic front. Careful and responsible macroeconomic management –fiscal discipline and tight monetary policy- coupled with increases in the international prices of minerals, has led to low inflation rates and growth.<sup>14</sup> Nevertheless, the economy remains vulnerable to external shocks, particularly due to its narrow production and export basis. So the risks to stability are high.

**The size of the state.** A large government sector crowds out private firms both at the product and at factor markets. For example, there are about 120 state firms, many of which provide private

<sup>13</sup> IMF (2005) shows that the volatility of the effective real exchange rate of Suriname was the highest among a group of 20 Latin American and Caribbean countries. The risk of any project increases if key relative prices (like the real exchange rate) are very volatile and there are no adequate instruments to hedge it.

<sup>14</sup> The average fiscal deficit of the period 2001-2004 was only 1% of the GDP, compared to 9% during the 1990's.

goods and services that could be supplied by private companies (e.g., commercial banks, car insurance companies, accountant services, agricultural and manufacturing firms, an airline carrier, a hotel, radio, TV and news agencies). Most public firms have low productivity, weak auditing mechanisms and provide poor economic and financial information.

Large fiscal deficits in the 1990's crowded the private sector out of credit markets. And by employing more than 60% of the formal labor force, (the wage bill of civil servants accounts for 15% of GDP), the government has a large influence on the setting of the average wage of the economy.

As a consequence of the large participation of the Government in the economy, purchases of goods and services currently represent about 10% of GDP. They are supplied through non-transparent methods, in which firms largely do not compete through price or by quality criteria. This creates disincentives for the production of high quality goods and services and greater productivity at the firms level.

**High tax burden/high tax incentives.** Tax rates are high as compared to neighboring countries, with a corporate income tax rate of 36%, although tax breaks –based on a 2001 Investment Law- are very attractive. This creates wide differences in effective income tax rates, ranging from important subsidies for the most preferred projects to high marginal tax rates for those projects that cannot get access to the tax benefits.<sup>15</sup>

The use of tax advantages has not been very effective to foster private sector growth in other countries. Although investment usually increases after the tax incentives are introduced, social costs (including the fiscal loss produced by the tax breaks) usually are higher than the social benefits.<sup>16</sup> Moreover, pretax rates of return vary widely across sectors resulting in an allocation of capital that is not efficient. There are some clues that point to a low-productivity environment in Suriname. In the six years from 1998 to 2003 the average investment ratio was almost 22% of the GDP (17.5% private and 4.4% public) and growth only averaged 2.3%.<sup>17</sup> Such an investment rate should have been enough to achieve a rate of growth, roughly speaking, of about double the one showed in the official statistics.<sup>18</sup>

## IV.2 Governance and institutions

One of the main obstacles to private sector investment in Suriname is the extreme administrative complexity with too much discretionary decision-making, in both starting up and operating businesses. In addition, there are some regulations that introduce strong rigidities in the economy while, in other dimensions, the legal framework is weak or non-existent.

**Administrative barriers.** International experience shows that host countries need to facilitate the establishment and operation of businesses of both local and foreign investors. Instead, in Suriname these procedures are administratively complex and discretionary.

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<sup>15</sup> Currently, there is an attempt to simplify this incentive scheme with a new law that has been prepared but not yet presented to Congress. The draft law would eliminate most tax incentives and would, in return, progressively lower the overall corporate tax rate. Although this proposal is well oriented, it seems that no study has been done to estimate its, probably negative, fiscal impact. At the same time, import duties and Dutch assistance are expected to decline during the next years, while, on the contrary, revenues from mining (gold) would be adding resources to the budget on a transitory basis. It seems that it is necessary to evaluate the need of a comprehensive tax reform, including an eventually broadening of the VAT base, to guarantee the fiscal sustainability of the proposal.

<sup>16</sup> See Zee et al (2002). The authors also mention that surveys show that tax issues are not relevant in the decision of multinational companies about where to invest.

<sup>17</sup> The rate of investment is lower than that achieved in emerging economies: these economies grow faster than developed economies by investing about 27% of the GDP.

<sup>18</sup> It is likely that Suriname's GDP is underestimated by the Central Bank (e.g. the consumption of electricity almost doubled between 1991 and 2003 and cumulated GDP growth was only 25% in the same period). A correction for the underestimation of the GDP would show a lower investment ratio and a higher GDP, but this would not reverse the conclusion that investment –outside the mining sector- appears to be of low productivity.

*Licenses and permits.* For example, most modern investment codes take the approach of providing automatic admission, confining exclusions or approval requirements to specified types of investment or investors in strategic activities, through “negative lists”. Instead, Suriname requires the previous approval for the vast majority of economic activities<sup>19</sup> by the District Commissioner and the Unit of Business Licenses of the Ministry of Trade and Industry.<sup>20</sup>

Obtaining a business license, which is valid only for three years, requires about two years, so investors have to deal with these licensing procedures almost continuously.<sup>21</sup> In some sectors there are also specific obligations, such as the forestry license, the mining license, the fishing license, the sanitation approval, among others. The procedures for obtaining such documents are usually cumbersome and confusing.

Obsolete procedures are also major impediments to international trade, as importers and exporters face cumbersome licensing requirements, unclear description of goods in the customs code, and inappropriate software configuration and operational procedures. Thus, for example, no risk analysis concepts are applied, and in principle a 100% revision of documentation and goods is performed.

*Labor market rigidities.* Labor regulations are adequate in some areas and very restrictive in others. For example, as collective bargaining is set at the firm level, wage and working condition negotiations are relatively efficient. However the labor contract is extremely rigid, because the so-called “Dismissal Decree” introduces severe restraints to firing procedures. According to the norm, firms are not allowed to lay off a worker without the approval of a special tripartite Dismissal Committee at the Ministry of Labour, whose decisions can be objected and overruled by an independent court. Large firms generally have the resources to go through this procedure successfully, but small firms do not, and as a result suffer an increase in their labor costs.<sup>22</sup>

Managers cannot make a precise estimate of the impact of the firing restriction on their costs (as it would be the case with other kind of compensations, like insurance mechanisms or severance payments). Some firms may react to this uncertainty by reducing the amount of labor they demand or hire labor on short-term contracts; some other firms may prefer to go informal. In any event, the system leads to a reduction of the demand for formal sector employment, protecting only incumbents at the expense of potential entrants.

On the other hand, Suriname lacks certain provisions, such as regulations on the workers’ right to strike or unemployment insurance that may reduce labor costs.

*Other bureaucratic procedures.* Other examples of the complexity of Surinamese administrative system are the following:

- It takes an average of 3 to 6 months to obtain a construction license from the Ministry of Natural Resources for business purposes.
- Leasing land from the State, the most common way of holding land in Suriname, requires approval by the Ministry of Natural Resources. These transactions are reported to be extremely

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<sup>19</sup> Licenses are not required in agriculture, horticulture and several “new” services, such as computer business, secretarial services and consultancies.

<sup>20</sup> The process to allocate the tax incentives included in the 2001 Investment Law is also cumbersome.

<sup>21</sup> Actually, investors start their operations after they registered their firms with the Chamber of Commerce and submitted their application for their license. Although this is usually satisfactory for the authorities, an investor is never sure of being in compliance with laws and regulations.

<sup>22</sup> The largest firms have developed administrative procedures to prepare every case for the Committee. When the case goes to the courts, the Company’s decision is confirmed in most cases. For small and medium firms, however, procedures are not usually well documented and it is much more difficult to fire redundant workers. The process is also very cumbersome and bureaucratic, leading to serious delays.

difficult and to facilitate corruption, as there is no time limit for authorities to take into consideration the application.

- A visa is required for most visitors (tourists or businessmen). As Suriname has Consulates in a very few cities in the world, complying with the visa requirement is a very cumbersome procedure.
- Getting a residence and work permits for employment of foreign staff is subject to approval under unspecified rules.

All these administrative barriers help to explain Suriname's position at the very low end of the scale of the Government Effectiveness and Regulatory Quality Indicators estimated by the World Bank (Kaufman et al, 2005)<sup>23</sup>.

**Weak protection of property rights:** Property rights in Suriname are not adequately protected in two important fields for doing business: land tenure and intellectual activities. Although in both areas laws were drafted to deal with these issues, they have not yet been implemented.

*Land tenure.* Land tenure affects the development of Suriname, especially in inland areas. Conflicts between national laws, traditional laws and user rights, create an insecure investment environment, aggravated because the State does not provide adequate mechanisms to settle disputes. Customary rules of the various Amerindians and Maroons groups assign user rights to land and natural resources based on group, clans and family membership. These tribal laws are well known to, and generally respected by, all members of the ethnic group. By national law, however, Amerindians and Maroons' rights to land in the interior are not specifically assigned, so when large scale mining and logging concessions are sought on tribal lands, serious problems arise. Concessionaires need to address both national and tribal land rights.<sup>24</sup> Besides these conflicts in the inland areas of the country, land tenure is generating some distortions to the housing market in urban areas as well, in particular in poor districts, where informal ownership is still prevalent on public land plots.

Although there is a plan to liberalize land ownership from the state (some laws related to it have been passed), it is not a simple task to implement, as it implies deciding on ownership, taking into account current land tenure rights –legal or based on customs-, and developing a valuation method.

*Intellectual property rights.* Protection of intellectual property rights is still governed by outdated laws that do not satisfy the minimum requirements stated by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Up to now, for example, it is legal for local producers to copy, since the current legislation does not protect industrial designs.<sup>25</sup>

**Weak legal system:** Suriname's legal framework constitutes a high barrier to private sector development: not only it is characterized by old and restrictive rules applied on a highly discretionary basis, but also the Judiciary –although generally regarded as fair and impartial- is considered extremely slow and investors are not granted the usual guarantees granted in other emerging

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<sup>23</sup> The Government Effectiveness Index measures the competence of the bureaucracy and the quality of public service delivery. The Regulatory Quality Index measures the incidence of market unfriendly policies.

<sup>24</sup> For example, land issues will be some of the most difficult to address for the Bakhuis bauxite project.

<sup>25</sup> New legislation on industrial property rights has been drafted with the assistance of the International Bureau of WIPO and is awaiting the approval of Suriname's National Assembly. However, authorities recognized that it is difficult to indicate the actual time when this legislation will come into force (WTO, 2004). Compliance with copyright protection seems to be even less advanced: Government is still working on the creation of new norms, which would be based on the model that was drafted by the WIPO, i.e., they have not got yet a draft ready for Parliament approval.

countries. These features explain the low score of Suriname in the Rule of Law Index estimated by the World Bank (Kaufman et al, 2005).<sup>26</sup>

*Judiciary performance.* Going through the judiciary is an extremely slow process. The Cantonal Courts normally deliver a judgment in 3 to 4 years, according to interviewed attorneys, and the next instance, Suriname Court of Justice, adds another 4 to 5 years. The problem appears to be a lack of judges<sup>27</sup> apparently caused by unattractive wages. The long delays to obtain a judgment are a strong disincentive for anyone to seek judicial recourse through the regular court system. Moreover, although the government, according to the international agreements signed (Cotonou Partnership Agreement –CPA- and CARICOM), should introduce measures to reduce the commercial risks for investors, such as arbitration mechanisms, the existing Arbitral Tribunal of Suriname has not been active for the last 30 years.

*Lack of traditional investors' guarantees.* Most of the capital stock of any economy is sunk (it has low value in alternative uses after the investment has been completed). Sunk capital raises the temptation for the government of a host country to “expropriate” its return: the investor will stay in business if he covers the variable costs. Therefore, the cost of the government decision is shifted to the future when new investment has to be made.

Investors can try to cover this uncertainty demanding a higher return on the investment or simply not investing at all. One instrument to moderate this “time inconsistency” problem is to include some protection for investors like Minimum Standard of Treatment (all direct investors will be treated in accordance with international law), National Treatment (foreign investors are granted the right to invest under the same rules that apply to national investors), Most-favored Nation Treatment (which prohibits discrimination among foreign investors on grounds of their nationality) and International Arbitration (to protect against local administration’s abuses). None of these types of guarantees are included in Suriname’s legal framework.

### IV.3 Other factors

**Financial markets.** Investment has to be financed by domestic or foreign savings. In the past, the most important limitation on savings has been the high fiscal deficits that reduced the amount of savings in Suriname. Better fiscal management will help the economy to have more available funds for private investment.

Capital markets are not an important vehicle to finance private sector projects in Suriname. The history of macroeconomic instability combined with the small size of the economy and the lack of an appropriate regulatory framework are key factors for the lack of significant debt or equity markets. Therefore, banks are the main source of financing for the private sector.<sup>28</sup>

Bank capitalization is low and the non-performing loan ratio is high (15.3% in 2004). These non-performing loans are, however, concentrated in three small troubled publicly owned banks. Lending to the private sector, although growing, is relatively limited. In 2004 it represented 25% of GDP, compared to an average of 62% for other CARICOM countries. It is estimated that only around a fifth of the registered firms have access to credit from financial institutions. The banking system provides insufficient term financing for all businesses. It is more oriented to short term lending for

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<sup>26</sup> The Rule of Law Index measures the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence.

<sup>27</sup> In different interviews, it was stressed that there are less than ten judges for the whole country.

<sup>28</sup> Total financial assets represent 80% in Suriname, while other CARICOM countries average close to 100% (Nieder, 2005).

trade, to loans to utility companies and their suppliers and to mining companies, retail and construction.<sup>29</sup>

Real lending interest rates, although decreasing, are relatively high (10% in 2004), reflecting high reserve requirements and sovereign risk.

Many of the inadequacies of the financial market might flow from information problems and weak protection of property rights. For example, the lack of a registry containing the credit and payment histories of banking clients (and other payment behavior related information) may be an obstacle for expanding financial intermediation. Collaterals might also be an impediment. The most accepted asset used for collateral is real estate. A mortgage on real estate is considered a secure vehicle whereby the creditor<sup>30</sup> can auction the property in case of default of the debtor, without any intervention from a Judge.<sup>31</sup> With moveable assets the experience is quite different because clients tend to literally “move” these goods so that the banks cannot retrieve them. Vehicles seem to be an exception because the legal owner of the car is the financial entity until the loan is cancelled and if the debtor runs into arrears the bank can seize the asset.<sup>32</sup>

**Human resources.** Human resources should not be a limiting factor for sustainable growth in Suriname for two reasons: a) as the labor force participation rate is the lowest in Latin America there seems to be a large room to increase employment if opportunities arise, and b) the population is relatively well educated (illiteracy is low and enrolment rates are high).<sup>33</sup>

However, there are complaints on the shortage of technical skilled labor as well as medium level managers. The problem seems not to be one of formal education but one of training opportunities. The large participation of public employment in labor market –by reducing the scale of training services- could be one of the roots of the perceived lack of skilled labor force.

**Infrastructure.** Good infrastructure at adequate costs is important for private sector development. The business community in Suriname faces a poor supporting infrastructure environment, especially for exports because of poor port facilities, warehousing, transportation by air and by sea, energy supply and roads. This poor export infrastructure exacerbates the isolation of the Surinamese economy. Although businessmen less frequently report it, there are also problems of reliability with water supply for agricultural purposes and high costs of communications. Most utilities are publicly owned, poorly regulated (the regulator and the supplier are frequently the same entity), and have low productivity. The government has begun to introduce a new regulatory framework, to induce competition and private ownership in some areas, including telecommunications, albeit at a slow pace.

There are several problems:

*Insufficient investment.* Often prices do not cover economic costs. In the short term, consumers may enjoy low prices, but, at the end, a policy of collecting scarcely more than variable costs forces

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<sup>29</sup> Informal firms do not qualify for loans in most cases, although a credit union (Godo) reports they do lend to small informal firms with collateral and with which they have over time developed a good credit relationship.

<sup>30</sup> The mortgage of real estate is established by Civil Notary and needs to be registered at the Public Mortgage Office. The registry of mortgages is reported to function adequately. Lenders can foreclose on a loan and exercise an auction within six weeks. The only requirement is that a notary gives proper notice of this foreclosure.

<sup>31</sup> Note, however, that most land in Suriname is leased and property rights are not well defined.

<sup>32</sup> However, the debtor can stop the process and although the Courts usually rule in favor of the financial entity, the delay (six months or more) deteriorates the value of the collateral.

<sup>33</sup> The opinion of the business community is that the educational system generally guarantees a reasonable proficiency in basic subjects. Besides, Surinamers seem to be very proficient in learning other languages, as a consequence of the different languages that most of them speak as their basic tongue. Suriname is ranked 67<sup>th</sup> out of 177 countries in the human development index of the UN Development Program (UNDP).



investment decisions to depend on budgetary allocations to pay for capital costs. This is the case for example in the electricity (power) sector.

*Cross subsidies.* Cross subsidies from business users to households are present in sectors that are key inputs for the private sector (e.g. electricity, telecoms). These pricing structures increase the costs of these key inputs for the private sector.

*Low expenditures in maintenance.* There is some evidence that in spite of a large state involvement in the economy, expenditures in maintenance are below what it is required to guarantee an adequate level of service (e.g. roads).

*Technological gap.* Reducing connection costs is particularly important to minimize isolation. An index of technological diffusion shows that Suriname is in an intermediate position in the penetration rate of fixed line telephones, it is well ranked in cellularity, but lags behind most countries in the region in Internet facilities. Improving access to Internet and telecoms would be a means to reduce somewhat the isolation of the country.

**Anticompetitive pricing behavior.** Small economies tend to have concentrated markets and this exposes them to non-competitive pricing behavior. Opening the economy to trade in goods and services is usually an effective instrument to deal with this problem. Suriname decision to enter fully in CARICOM is positive in this respect, because this should encourage more competition in most of the sectors where the supply of goods comes from firms of medium and large size. Small firms that are characteristic of retailing activities in Suriname usually cannot collude to maintain non-competitive prices.

**Statistics and databases.** In Suriname, the availability and quality of economic statistics and registries are very poor. For example, the actual number of public enterprises is unknown, there are no national accounts by expenditure approach (so that growth accounting is a guesstimate), labor statistics are extremely poor, there is no wholesale price index, trade statistics by volume are not reliable (the Central Statistical Office only collects information on value and weight), there are no official statistics on the structure of the private sector, no credit bureau, no property registry for movables, etc. The lack of information is an obstacle to carry on adequate public policy and business planning, while the lack of registries doesn't facilitate the working of markets.

#### IV.4 “Coordination failures”

There might be examples of profitable projects that are not undertaken because of the inability of the private sector to include all the potential beneficiaries as cost financiers, or because not all benefits and costs are internalized. In other cases there might be high start-up costs that delay a project.

Private sector development also may be hindered by “coordination failures”. Many transaction costs have significant fixed components and are felt more by smaller firms than by larger ones. Small firms dominate Suriname's private sector and, therefore, “scale-related problems” might be a deterrent to private sector development.

Some examples of these problems are:

1. Training is an activity with fixed costs aggravated by the fact that there are no particular means to retain the manager after the training has been completed. This could lead to under investment in training of managers and other technical positions.
2. Obtaining information on foreign markets or new technologies is too expensive for smaller firms given the high fixed costs to get this information from Suriname.

3. Contractual failures. For example, if the new bauxite project is constructed, a larger dam than necessary for the mine could be the least cost alternative to expand the generation of electricity for the country. In the absence of a competitive market for electricity at the wholesale level, potential demanders might need to make a credible offer to Suralco to encourage it to sink more capital than strictly needed for its project (ex-post the construction of the dam, the marginal cost of generating electricity is virtually zero and the risk of opportunistic behavior is high). The aggregation of small demands can only be done through the public electricity company, that itself may not have enough credibility to sign a long-term commitment.

## V. CHALLENGES AND OPPORTUNITIES

Suriname is a small and isolated country. But how relevant are isolation or size for long-term growth?

**Economic consequences of isolation.** Countries that are distant from the world markets face additional transport costs to import and export. Therefore, isolation can be understood as a worsening in the terms of trade. As Suriname is a price taker in world markets of goods and capital, higher transport costs, in the long run, will be offset by lower payments to less mobile factors (labor and land) and, therefore, they cannot be blamed for a recurrent poor economic performance. What the government should do is to do an extra effort to offset the costs of isolation through good economic policies that attract investment.<sup>34</sup>

**Economic consequences of small size.** Being small creates some difficulties. Scale economies are more difficult to be exploited and competition may be restricted because potential entrants are afraid of large start up costs.

The private sector may find more difficult to progress in such environment and this may require some intervention. However, the desired intervention is very different from what is observed in Suriname today. Instead of facilitating new ventures trying to reduce coordination costs, the government of Suriname over regulates the private sector.

**Expected changes in the economic environment.** In the next years there are some changes that will influence the nature of the Surinamese economy. For example, grants from the Netherlands are being phased out, import duties will decline with further trade liberalization, and Suriname may lose the preferential access to the EU market that it currently enjoys for bananas and rice. But new discoveries of gold, bauxite and oil may provide revenues that more than offset the natural depletion of production fields. However, mining contributes little in terms of employment. Under this scenario, a sustainable and balanced growth strategy should focus on broadening the country's productive structure through an export-led strategy based on the promotion of the private sector.

**The quest for growth.** Successful growth stories do not depend on the evolution of foreign aid or preferential access to some markets; rather they are based on two key characteristics: a good macroeconomic environment through sound fiscal and monetary policies that reduce volatility and inflation, and by creating a good business climate that allows potential successful projects to materialize.<sup>35</sup>

In the past Suriname has failed in both dimensions. The country has been unable to advance in many of the so-called first generation reforms (macroeconomic stability, trade reform and privatization) and second-generation reforms (property rights, collateral frameworks, legal systems, deregulation)<sup>36</sup> that have been implemented in most of the countries in the region.

Although sound fiscal and monetary policies have largely been put in place over the past few years, the risk of instability remains high. The consolidation of a better macroeconomic policy will be easier to achieve through the introduction of institutional arrangements able to reduce volatility. For example, the creation of a Fiscal Stabilization Fund has been one key instrument to address this

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<sup>34</sup>Although the costs of bad domestic policies would also be shifted to less mobile factors, there are two important differences: a) bad policies create incentives for rent-seeking activities that waste additional resources and reduce economic welfare; and b) it is possible to improve government policies, while not much can be done to change the geographic location of one country.

<sup>35</sup> Quoting professor Arnold Harberger, growth is more about mushrooms stories than yeast.

<sup>36</sup> For a definition of first and second generation reforms see IDB (2004).

problem in other natural resources rich economies, and it would be very important if new mining ventures (Bakhuys) and oil discoveries materialize.<sup>37</sup>

Beyond consolidating macroeconomic stability, the focus of Suriname's growth strategy should be completing first generation reforms, such as privatization process, and the implementation of second generation ones. This provides a unique opportunity. In some cases much can be gained simply by allowing competition to public monopolies or by simplifying complex and unnecessary procedures.<sup>38</sup>

Although this should be the focus of a private sector development strategy, there is also the need to address the obstacles related to the small size of the local economy and the consequent "coordination" failures in the private sector that may deter profitable projects from being implemented.

Such reforms will turn around the way of doing business in Suriname, where still today profits largely depend more on the ability of businessmen to manage its relations with government institutions than on the managers ability to reduce costs and innovate.

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<sup>37</sup> The direct contribution to the budget of taxes obtained from mining (bauxite and gold) and oil extraction is not easy to estimate but it might be over 4% of the GDP in 2005/06. This contribution will rise if the Bakhuys project is developed. Moreover, the indirect contribution is surely important. Taken into consideration that exports of bauxite, gold and oil are about 50% of the country's GDP, a 10% rise in world prices of these commodities changes the "availability" of foreign exchange by about 5% of the country's GDP. Assuming that the marginal tax rate is about 25%, if there are no stabilization funds (or policies to accumulate extra reserves in the Central Bank during good times) tax revenues should increase by about 1.25% of the GDP. Therefore, the direct cum indirect effect on government revenues of mining and oil is more important than what is shown in the official statistics.

<sup>38</sup> There are also many reform cases in the region that allow Suriname to learn from successful (and also from failed) stories. Sometimes, being a latecomer might save some costs.

## VI. SUPPORTING PRIVATE SECTOR DEVELOPMENT STRATEGY

In recent years Suriname private firms made substantial efforts to increase investment and exports, and to restructure activities in face of changing world and local conditions. Private investment rose from a mere 10% of GDP in 1998/2000 to 24% in 2001/05 (IMF, 2005), exports of goods and services reached more than 80% of GDP in spite of the declining role of state firms in agriculture and manufacturing, and strong employment shifts took place among firms, mainly in the private sector. Together with more prudent fiscal and monetary policies, this helped to improve Suriname macroeconomic performance, raising GDP growth to an average of 4.4% in the last 5 years.

However, in spite of this highly dynamic picture, once the two big mining firms are excluded the private sector of Suriname is still characterized as a universe of *very small* firms, most of them oriented to *trade activities*, with *low productivity* and *informally run*. Throughout the document, it was shown that public policies have not contributed to overcome the natural disadvantages that the country faces (*isolation and smallness*). Instead, incentives faced by businesses encourage them to seek special government treatment for taxation, starting and operating businesses, getting access to land and in some cases credit, etc.

The document has listed the major obstacles to attract private sector investments, beyond mining and oil, in Suriname. As was previously noted, first and second order generation reforms are critical to improve the business climate in Suriname. There is also room to build an agenda of actions directly involved with the private sector that can support its development, taking into account the unique characteristics of the country and the coordination failures related to its small scale. The priorities for this reform process in both dimensions, as well as recommendations for the IDB role in their implementation are described in this chapter.

### Priority areas for action

Ideally, a list of priorities should be based on a cost benefit analysis that allows establishing a ranking of actions. This is rarely done due to information restrictions. A useful alternative to identify the key constraints for private sector development is to survey private firms.<sup>39</sup> Unfortunately there are no surveys available in Suriname yet.<sup>40</sup> Therefore, in the following paragraphs we listed some areas that need to be reformed based upon our experience of successful reforms programs in other countries but taking into consideration their feasibility in Suriname. We also took in consideration IDB's objectives "...to deepen and complement the essential role of the private sector in promoting economic growth..."<sup>41</sup>

Progress in achieving a political and macroeconomic stability is essential; reforms in other areas will gain little traction in a poor macroeconomic environment. And given the large burden of the government in Suriname it is important to downsize the state to "crowd in" the private sector. Finally, enhancing policy credibility can also leverage the investment response to reforms in any particular policy area.

This analysis led us to distinguish three categories: a) the most urgent reforms that are needed to open opportunities for private sector development; b) a list of actions that are important to facilitate the development of the private sector; and c) other reforms that are needed to improve business decisions.

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<sup>39</sup> See for example World Bank (2005).

<sup>40</sup> Dookeran's report for the IDB will include a survey on firms following the structure of the World Business Forum. This will be a useful instrument to help in setting priorities of reform.

<sup>41</sup> See IDB (2004).

## a) Most urgent reforms

1. **State performance and regulations.** Many indicators point to a large and inefficient public sector that interferes with private firms both at the product and factor markets. Some state firms provide purely private goods and services while others operate in non-competitive markets; they all share a lack of transparent procurement practices and an extremely poor auditing mechanism. An overstaffed Central Government performs many activities that could be outsourced to private firms. Although there have been several initiatives to reform the State, a more coordinated effort is needed.

First, activities related to the provision of purely private goods could be privatized, including manufacturing and agricultural firms, airline transportation, commercial banks, car insurance and other services, and many activities performed at the Central Government that, in other countries, are provided by the private sector (e.g., legal and accountant services, maintenance and cleaning services, etc) could be outsourced.

Second, there is room to increase private public partnerships in the area of public utilities and infrastructure. The priorities for action could be linked to the poor performance of public firms in Communications, Air Transportation and Energy, and to the role of these areas to mitigate the consequences of isolation and smallness.

Third, new regulatory mechanisms should be designed in order to introduce competitive practices when markets are open to private suppliers and also when the State remains (for any reason) as the main provider of a service. Simply by allowing competition when it is technically feasible, the private sector may find niches or activities that help to reduce monopolistic margins.

Fourth, the large participation of the State in the purchases of goods and services in the economy implies that a comprehensive reform of the procurement system could have direct benefits by reducing costs, and at the same time would increase competition among government suppliers. This should be complemented with an improvement of the auditing mechanisms of all public entities.

This coordinated strategy, together with a limitation to increase the size of the public workforce, would reduce the crowding out effects of a large State. Most new employments would be translated from the public formal into the private formal sector, and second round effects (through higher economic growth) could increase the share of private formal relative to informal workers.

The IDB can assist the government with Technical Cooperation support (loan ATN/SF-8664 Road Map for Public Sector Reform is expected to contribute in this dimension) and with other programs, in order to: a) identify which public firms can be privatized, b) improve the regulatory frameworks and the design of regulatory agencies (as is planned to be done in a telecom MIF operation), c) analyzing the different available schemes (privatization, BOT, etc.), evaluate and, eventually, finance (through PRI<sup>42</sup> and IIC) privatization of firms, including the possibility of public private sector partnerships in infrastructure, d) improve the procurement system (as it was envisaged through the third component of the Public Sector Management Strengthening Program, loan 1547/OC), and e) advise the government about how to mitigate the costs of a restructuring of the public labor force.

2. **Flexibility in labor contracts and workers protection.** It is usual that first generation reforms create tensions in rigid labor markets. Suriname has a rigid labor formal market mainly explained by the “Dismissal Decree”, which introduces severe restraints on the dismissal of employees, especially

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<sup>42</sup> Currently PRI is considering to support the winner of wireless licenses that may be awarded as part of the opening of the Telecom sector.

for economic reasons. There is a need to eliminate the Tripartite Council that currently makes decisions regarding labor dismissals, or to clarify and liberalize the grounds upon which dismissals are permitted. The former would be preferred. It should be noted that there already exists a limited severance payment system, which provides laid-off workers a payment equal to three months of their annual salary. The IDB could assist authorities with the design of the alternative means to provide greater flexibility in the labor market by eliminating or liberalizing the Dismissal Decree.

3. **Advocacy campaign.** Multilateral and donors support may lead to the preparation of reform drafts in many areas, but political decision to develop the whole process of change may be lacking such that the projects may not be converted into laws, or the laws may never be implemented. The areas of frustrated reform in Suriname in the last years include different topics as tax incentives, land tenure, new regulatory agencies, intellectual property rights, etc.

This recent evolution suggests that the message on the urgency of reform did not reach the whole population and/or the main stakeholders. The Government and the business community, with the support of donors and multilateral agencies, should devote a considerable effort in the future to develop a consensus for the need to improve the climate for private sector development in Suriname. Without gathering a strong support from the main stakeholders, the country can miss the opportunity that leads to sustained growth and stability. But once support is obtained to proceed with the reform process, sequencing will become the next key issue. Isolated reforms to promote the development of the private sector may deliver only minor progress if the main first and second-generation reforms are postponed.

#### **b) Important reforms**

1. **Administrative barriers.** The Company law and other provisions demand a long and protracted process of registration and authorization for doing business and investing in Suriname. Permits and licenses are required for most activities from different offices, and long delays and lack of transparency are a common characteristic for: company registration, registration with different authorities, investment approvals, construction and building, visas, work and resident permits, environmental permits, operational formalities (export, import, transportation, etc.), etc.

There is a clear need to simplify and accelerate this process of business licensing. For example, except for those activities considered “strategic” and that could be included in a negative list, licensing should be automatic and firms can be required just to provide information to the government. The issuing of a new Investment Law that eliminates most licensing requirements to operate businesses not related to health, safety and environmental issues, would be a positive step to introduce a more transparent framework and to reduce administrative barriers for doing business. The IDB could assist the government to simplify the whole current system of registration and authorizations for doing business (e.g. summarizing the best practice used in other countries of the region). The complete reform process may be complex and take considerable time, for changes – once defined- would have to be consistently made in several legal instruments.

2. **Judicial system.** Suriname has an extremely slow judicial system and also lacks potential substitutes, like arbitration, to solve private disputes. Revitalizing alternative dispute settlements mechanisms is an attractive option, as arbitration is a simple instrument to improve the enforcement of contracts at a low cost. This is an area that could benefit both from donor funding and technical assistance. It would also be useful to recognize international arbitration to reduce the uncertainty to foreign investors. There are now global standards in international arbitration, conducted through the rules and procedures of institutions such as the International Center for Settlement of Investment Disputes (ICSID), the International Chamber of Commerce (ICC) rules, or the United Nations

Commission for International Trade Law (UNCITRAL). Finally, the lack of some standard guarantees for foreign investors in Suriname's legal framework should be reviewed. These last issues were incorporated in the new Investment Law project that was not yet presented to Congress. The MIF could potentially assist in the development of arbitration mechanisms in Suriname, if an effective executing agency could be identified.

**3. Working of financial markets.** Financing is especially lacking in two areas: term financing for all businesses and all types of financing for small businesses. Public intermediation in the area has not solved these issues, and state bank performance is extremely poor. The Bank is cooperating with a Financial Sector Strengthening and Rationalization program (ATN/SF-8311) that would provide the authorities with recommendations on reform options for public banks, and with a detailed action plan for the selected reform strategy<sup>43</sup>.

An agenda to improve financing should also include the removal of some obstacles that increase the risks and cost of financial intermediation for small and medium firms, in particular the lack of a credit bureau and the inadequate registries for moveable property. The Bank is supporting the initiative to create a privately managed credit bureau through the Low Income Shelters loan (1342/OC), but the start up of the project was slow due to the lack of expertise of participating NGOs. In order to accelerate the implementation a more specialized Project Unit should be developed. The Bank could also address the problem related to property registries for moveable goods, by supporting the study for adopting a modern framework for secured financial transactions building on the efficient and effective systems already in place for loans guaranteed with real estate assets. Improving the security of financial transactions and expanding the types of collateral should expand access to credit, and also allow for an extension of the terms of financing.

A series of other measures working more directly with financial intermediaries can also be conducted to improve access to finance both via expanding the capabilities of local financial institutions and by serving as a demonstration effect. For the latter, the MIF is currently cooperating in an initiative to support to Development Finance Limited, in which the IIC is an equity partner, to operate in Suriname to finance small and medium sized enterprises. Other efforts that should be considered would be to support the institutional and financial strengthening of institutions such as savings and credit cooperatives that focus on small enterprises and lower income households. In addition, given the large scale of remittances in Suriname, it has potential as a market for a remittance supported line of credit with the MIF and the PRI.

**4. Bureau of Standards.** The establishment of a Bureau of Standards is another step that will help the country to face the challenges of increasing trade liberalization and competition. Most CARICOM countries have introduced this instrument that helps to improve access to markets, through norms that certify processes and products. The Bank could support the Government and the private sector in different phases of development of this project, including setting up the agency, training the staff, and promoting standardization practices within the business community. This initiative is currently under consideration through an IDB Technical Cooperation that would complement a trade facility loan.

**5. Provision of Business Services.** Taking into account the small-scale issue in Suriname, the provision of business services could be an important area to promote the private sector and to address some of the coordination failures previously discussed.

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<sup>43</sup> Subsequently to the completion of the Sector Strengthening and Rationalization program, a Financial Sector Reform loan is in the pipeline of the IDB, including the redefinition of the role of the state in the financial system, and the strengthening of prudential supervision and CB functions, together with a technical cooperation program to establish a Financial Intelligence Unit (TC0201055) to support the Government on money laundering issues.



*Network Externalities.* One of the pillars of the knowledge economy is the availability of information and communication technology. The country does not fully exploit this instrument to reduce isolation, and as a consequence it doesn't share the benefits of the global environment. The Bank can support the development of a more dynamic infrastructure to facilitate effective communication, dissemination and processing of information. This could be facilitated by accelerating the liberalization of the telecommunication sector, in which greater competition should allow for a reduction in Internet connection costs, and should improve the reliability of telecommunication services.

*Business Development and Training Centre.* This initiative would contribute to improve and disseminate trade and market information, to provide Internet access, to guide entrepreneurs on how to start and operate a business and to face the scale-related costs of training managers. Several IDB windows can support related projects that should involve NGOs and individual firms. Based on experiences in other countries, the business centre should be managed by a private organization, such as one of the business organizations, and services should be provided on a fee-basis, to ensure that their users value them.

In a second stage the business center also can be used to promote technological research in private and/or public institutions, a natural complement to training. The IDB could support these programs through the MIF.

### **c) Other reforms**

1. **Property rights.** Land tenure is poorly defined in Suriname. There are some distortions in the housing market in urban areas and ill-defined property rights in the inland of the country. The IDB currently has a land management program in its pipeline (contingent to a Land Policy Directive approval by the Council of Ministers) that would help improve the effectiveness and efficiency of land markets and the government's abilities to support them. The program could also support the drafting and approval of legislation to clarify the working of land markets and the role of the state as the primary owner of land.

2. **Economic statistics.** Suriname lacks most of the basic statistics in national accounts, prices, labor and trade that are available in other countries of similar development. This is an obstacle to reliable public policy and business planning. The IDB could contribute to strengthen the national capacity to collect, process and analyze relevant economic data. Participants in this project should include not only the national bureau of statistics, but also key private sector associations (e.g., VSB, ASFA and the Chamber of Commerce). The Bank is currently supporting the Government through a Census Program (loan 1446/OC), and could restructure and increase its scope in order to support the GBS and private NGOs in other areas where the Bureau has shown a weak performance (national accounts, business surveys, price indexes etc.). Related to the (lack of) information issue, and the existence of several areas of knowledge gaps, it would help to build a Virtual Library to include all studies prepared for Suriname in the last decade or so. The Bank has had conversations in order to support this initiative that would gathered both the Government's and the private sector interest.

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