September 2001
IMF Country Report No. 01/159

Kingdom of the Netherlands—Aruba: 2001 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of the Kingdom of the Netherlands—Aruba

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with the Kingdom of the Netherlands—Aruba, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation prepared by a staff team of the IMF, following discussions that ended on **June 4, 2001** with the officials of the Kingdom of the Netherlands—Aruba on economic developments and policies. **The staff report was completed on August 1, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its August 22, 2001 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- a Statement by the Authorities of the Kingdom of the Netherlands—Aruba.

The documents listed below have been or will be separately released.

Mission Concluding Statement
Statistical Appendix

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—ARUBA

Staff Report for the 2001 Article IV Consultation Discussions

Prepared by the Staff Representatives for the 2001 Consultation
with the Kingdom of the Netherlands—Aruba

Approved by C. Maxwell Watson and Martin Fetherston

August 1, 2001

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Executive Summary

Background: Aruba has a small open economy highly dependent on the tourism sector. In 2000, GDP per capita was slightly below US$22,000, among the highest in the region. Output growth picked up in 1999 but subsequently appears to have moderated to 2½ percent in 2000. The most likely prospect for 2001 is a further deceleration of output reflecting the external environment. After falling for several years, inflation rebounded in 1999 and accelerated in 2000 to 4 percent, owing mainly to imported fuel costs, but also to rapid domestic credit expansion through the first quarter of 2000. Following an initial fiscal consolidation effort in 1998-1999 that failed to contain current outlays, the public finances entered a deteriorating trend. The budget deficit is expected to widen from 0.8 percent of GDP in 2000 to 2½ percent of GDP in 2001 as a consequence of the cost of the newly introduced public health care system (AZV), increased labor costs, and subdued revenues. The primary monetary policy objective of the Central Bank of Aruba (CBA) has been to preserve the fixed exchange rate to the U.S. dollar, supported by a strong foreign reserve position. The CBA maintained a tight monetary stance in 2000, curbing broad money growth and building up reserves.

Policy issues: Since gaining autonomous status within the Kingdom of the Netherlands in 1986, the performance of the Aruban economy has been impressive, underpinned by growth-oriented policies, financial stability, and a robust peg of the Aruban florin to the U.S. dollar. Given the fixed exchange rate regime and the openness of the economy, sustained growth will hinge on the buffer provided by a steady supply of public savings; a well capitalized and effectively regulated financial sector; and a dynamic market environment able to elicit private savings and investment.

The authorities' objective of eliminating the budget deficit remains appropriate and should be complemented by aiming for a modest but sustained surplus in the medium term. As an early priority, the ongoing fiscal deterioration should be reversed and budgetary discipline restored by containing current spending, notably on wages and health expenditure, as well as intensifying tax collection efforts. Policies with a medium-term orientation should include a redefinition of health care and pension benefits with a view to ensure the long-term solvency of the public finances and reduce pressures on the budget. The plan to reform the tax system should aim at simplifying the system and its administration, improving compliance, eliminating tax holidays, and increasing reliance on broad consumption taxes.

The CBA is to be commended for a prudent monetary policy, as demonstrated by the continued credibility and strength of the peg to the U.S. dollar, buttressed by a robust foreign reserve position. The authorities' efforts to introduce more flexibility in the monetary policy framework should aim at coordinating the sequenced liberalization of remaining financial and capital account restrictions with measures to strengthen the prudential and liquidity position of the financial system. The authorities should also be commended for significant progress in expanding and strengthening the supervisory and regulatory framework of both onshore and offshore financial activities.

Renewed privatization initiatives—particularly in telecommunications—and structural reforms will be needed to improve efficiency and attract investment. Further statistical progress will be crucial to allow effective surveillance and improve transparency and economic decision making.

I. Introduction

1. A mission visited Aruba during May 23-June 4, 2001 to conduct the 2001 Article IV Consultation discussions.[1] The mission met with the Prime Minister, the Minister of Finance, and other members of the Council of Ministers, the President of the Central Bank of Aruba (CBA), and senior government and CBA officials. The mission also met with representatives of the private sector including business and trade associations and labor unions. Aruba has had an autonomous status within the Kingdom of the Netherlands since January 1986. The Aruban government has jurisdiction over all domestic matters, including fiscal, monetary, and other economic policies. The domestic currency—the Aruban florin (Af.), issued by the CBA—has been pegged to the U.S. dollar at the rate of Af. 1.79 per U.S. dollar since its introduction.[2] Although Aruba is not, by itself, a member of the Fund, the Dutch and Aruban authorities have requested separate Article IV Consultation discussions with Aruba, which have been held on a two-year cycle. As part of the Kingdom of the Netherlands, Aruba has accepted the obligations of Article VIII, Sections 2(a), 3, and 4.

2. At the conclusion of the last Article IV Consultation on May 7, 1999, Directors commended the performance of the Aruban economy during most of the 1990s. Directors noted, however, that this record had recently been threatened by fiscal relaxation and encouraged the authorities to return the public finances to a sustainable path and to address outstanding structural issues. They urged strengthened budgetary discipline in order to achieve a balanced budget in 1999. Directors agreed that the present exchange rate arrangement had served Aruba well and commended the Central Bank for its skillful monetary policy. They welcomed measures to increase reliance on market-based instruments of monetary policy and strengthen the legal framework of the central bank's supervisory powers over onshore and offshore financial activities, as well as to prevent money laundering. Directors stressed the scope for reducing the public sector's involvement in tourism and telecommunications. They also called for improvements in the provision of statistics, as data deficiencies remained a serious obstacle to effective surveillance and policy design.

3. The two-party coalition that formed the government following the last general elections, in December 1997, broke up in June 2001—after the return of the mission to headquarters. As a result, advanced elections were called for September 2001—rather than end-2001, as expected at the time of the mission's discussions.

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[1] The team comprised Mr. Escolano (head), Ms. Kollau and Ms. Louppe (all EU1).

[2] Prior to gaining *status aparte* in 1986, Aruba was a member of the Netherlands Antilles federation, whose currency, the Netherlands Antilles guilder, had also been pegged to the U.S. dollar since 1971 at the same rate as the Aruban florin is now.

II. Recent Developments and Outlook

4. **Aruba has a small open economy highly dependent on the tourism sector, which generates current account receipts of 43 percent of GDP and is the main target of foreign investment inflows.**[3] The population of Aruba is estimated at about 90,000 in 2000 with a GDP per capita slightly below US$22,000, among the highest in the region (Table 1). An oil refinery—Coastal Aruba N.V., owned and operated by a U.S.-based company—conducts operations for reexport. Other important economic activities include transshipment and warehousing operations located in a duty-free zone, and financial services—including an offshore component; but like oil refining, these activities have a relatively small impact on the rest of the economy, being generally owned and operated by foreign companies, enjoying a tax exempt status, and relying minimally on local inputs.

5. **After an investment boom in the tourism sector and upgrades in the refinery that supported an average growth rate of 10 percent during the period from 1986 through the mid-1990s, output growth declined to a more sustainable average slightly below 4 percent since 1995 (Figures 1 and 2).** Growth in tourism receipts peaked at about 18 percent in 1996 and slowed down subsequently to 6 percent in 2000, as capacity constraints were approached and a moratorium on the construction of new hotels was adopted in the mid-1990s. Over the 1990s, unemployment declined sharply to levels consistent with full employment, which has prevailed until now. Labor demand was partly met by means of large immigration flows, which contributed to an increase in the resident population of about 50 percent.

6. **Output growth picked up in 1999 and early-2000 as a consequence of buoyant tourism receipts, foreign investment, and domestic demand conditions; subsequently growth appears to have moderated, reflecting external developments (Table 2).** Although the paucity of economic statistics in Aruba makes it difficult to assess with precision the economic conjuncture, it appears that output growth accelerated in 1999 to about 4.5 percent on the strength of demand for tourism services, fostered by increases in airlift capacity and cruise tourism, as well as investment and renovations in the airport, refinery, hotels, and other infrastructure. Since mid-2000, output and demand growth have softened—reflecting a decline in investment, as several large construction projects were completed, and the evolution of tourism demand (Table 3).

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[3] Most statistical data on Aruba are subject to a high degree of uncertainty—with particular weaknesses in the areas of national accounts, labor markets, and public finances. The most recently published national accounts are for 1994. In particular, since that date, there are no official estimates of GDP based on standard methodologies, nor of its supply, demand, and income components; also, a decomposition of value added by sectors is not available. Data presented here are either official or provisional estimates prepared by the authorities or the staff. All national accounts data, however, should be regarded as approximations having below-standard accuracy.

7. **After falling for several years, inflation rebounded in 1999 and accelerated in 2000, owing mainly to imported fuel costs, but also to rapid domestic credit expansion through the first quarter of 2000 and government consumption outlays.** The inflation rate declined from a peak of 6.3 percent in 1994 to 1.9 percent in 1998 following a moderation in the pace of output growth. Inflation picked up, however, in 1999 and accelerated further in 2000 to 4 percent (Figure 3). The immediate causes of the price increases in 2000 were imported fuel costs and price hikes in fuel-intensive utilities such as water and electricity. Nevertheless, indirect evidence points to broader-based price increases as the initial cost push was sustained by buoyant private demand stimulated by rapid credit expansion and government spending. Given the peg of the Aruban florin to the U.S. dollar, the persistence of an inflation differential vis-à-vis the United States has resulted in a steady appreciation of the bilateral real exchange rate with respect to the U.S. dollar and some erosion of competitiveness (Figure 4).

8. **The non-oil balance of payments experienced a slight deterioration in 2000 as a result of net financial outflows, despite a modest improvement in the current account (Figure 5 and Table 4).** In 2000, the improvement in the non-oil current account resulted from strong tourism receipts and import declines due to the completion of several import-intensive investment projects, including renovations in the airport and in a large hotel, and a decelerating trend in consumption. The current account oil balance, which reflects the refining operations of Coastal Aruba, improved markedly in 2000 as a consequence of high international oil prices. The oil trade surplus, however, was matched by counterpart financial transactions of Coastal Aruba, resulting in an overall oil sector surplus of just above one percent of GDP, similar to that in 1999. Official grants and transfers from the government of the Netherlands for development projects increased in 2000 following the 1999 Aruba-Netherlands cooperation agreement, but are to be phased out gradually through 2009. A debt write-off, which is also covered under the agreement, has not yet taken place since it is conditioned on Aruba achieving a balanced budget.

9. **Following an initial fiscal consolidation effort in 1998-1999 that failed to contain current outlays, the public finances experienced a deteriorating trend, with recurrent budgetary liquidity shortages and an accumulation of arrears (Figure 6 and Table 5).** After a virtually balanced budget in 1998, a deficit of 0.3 percent of GDP reopened in 1999 and widened to 0.8 percent of GDP in 2000.[4] Despite plans to freeze employment and

[4] In March 2001, the Government reached an agreement with the public employees' pension fund (APFA) on the basis of provisional results of an actuarial analysis. These preliminary results indicated that the pension liability component that must be fully capitalized by statutory mandate (the basic APFA pension, excluding the inflation indexation) was sufficiently funded given existing assets. As a consequence of the agreement, outstanding budgetary arrears to APFA, amounting to about 4 percent of GDP at end-2000, were officially cancelled, implying a revision of past budgetary outturns. Budgetary data reported here have been revised to exclude past unmet budgetary obligations to APFA. A final determination of budgetary obligations will be reached when the ongoing actuarial analysis is finalized. However, substantial changes with respect to the current agreement are not expected.

contain wages, labor costs increased in 1999 and 2000, while spending on goods and nonfactor services also increased substantially in 2000. Capital spending has been below one percent of GDP since 1998 mainly as a result of expenditure containment efforts, but also because administrative delays in initiating the operations of the Aruban Development Fund (FDA), jointly financed by the Netherlands. On the revenue side, tax collections were temporarily boosted in 1999 by a tax regularization program and, in 2000, by a temporary lower rate on dividend distributions. Nevertheless, these one-time measures did not address an underlying tendency for tax revenue to decline as a ratio to GDP, which reflects the administrative complexity and lack of buoyancy of the tax system and difficulties in tax administration. Overall, budget implementation and expenditure management have suffered from weak administration procedures and cash-flow shortages leading to the reemergence of payment arrears in 2000. The 2000 deficit was financed, in addition to the accumulation of arrears, by a foreign commercial loan that also allowed the government to reduce liabilities with the domestic financial system and meet substantial repayments of maturing domestic and foreign debt.

10. **The 2001 budget projects a small fiscal surplus but, in view of developments thus far, this appears unrealistic. Instead, the deficit will probably widen to about 2½ percent of GDP in 2001 as a consequence of the universal coverage health system (AZV) introduced in January 2001, increased public employment, and subdued revenue.**[5] The AZV is estimated to add 1.1 percent of GDP to budgetary expenditure (net of savings in previously existing health programs), as it was introduced with low contribution rates, no co-payments or deductible, and insufficient definition of covered services. In addition, government hiring in 2000 and wage increases will keep wage costs above 10 percent of GDP. The revenue-to-GDP ratio is estimated to fall slightly as output growth softens and the revenue windfall from special measures adopted in 1999 and 2000 fades away.

11. **The primary monetary policy objective of the CBA has been to preserve the fixed exchange rate to the U.S. dollar, supported by a strong foreign reserve position and implemented through liquidity reserve requirements and ceilings on domestic credit growth.**[6] In order to guarantee the peg, the main objective of the CBA is to maintain a comfortable level of foreign reserves—both in terms of official reserves (currently covering

[5] The staff deficit estimates assume that, in accordance with the preliminary agreement reached between the Government and APFA, all past budgetary obligations are cancelled. They also assume, however, that current obligations will be paid by the budget—amounting to a transfer to APFA of Af. 61 million (1.6 percent of GDP) in 2001, including the present statutory government contribution as employer and the indexation component of current pensions (dearness allowance). The eventual final assessment of budgetary obligations to APFA may lead to differences with respect to these staff assumptions.

[6] The Central Bank Ordinance does not establish explicitly the exchange rate as the objective of the CBA or its monetary policy, but it confers responsibility to the CBA for the "stability of the value of the currency" and for conducting a "monetary policy directed towards maintaining this stability" (Central Bank Ordinance, Article 10).

about 150 percent of base money) and of overall net foreign assets of the monetary system (which currently stand at about 5½ months of non-oil merchandise imports). Operationally, the CBA targets credit growth as a means to achieve the desired level of foreign reserves. Despite efforts to liberalize the financial framework and introduce some flexibility in the guidelines for credit growth, the array of instruments available to the CBA remains limited to liquidity reserve requirements and credit ceilings, enforced by moral suasion and, if necessary, direct allocation of bank-by-bank ceilings.

12. **The CBA maintained a tight monetary stance in 2000, curbing broad money growth and shoring up reserves by reimposing strict constraints on bank credit expansion (Table 6).** Reserves rose substantially in 1998 after the CBA increased the banks' liquidity reserve requirement from 6 to 7 percent. On this basis, the CBA took a further step in liberalizing the monetary framework by suspending the aggregate ceiling on bank credit in April 1999 and replacing it with a more informal and flexible aggregate target for credit growth in line with the expected growth in nominal GDP. In the wake of these measures, however, aggregate bank lending amply exceeded the CBA target, owing, inter alia, to a surge in consumer and mortgage loans, and in March 2000 the CBA forcefully called upon the banks to restrain their credit—thus, de facto, reestablishing credit ceilings, given the absence of alternative monetary policy instruments. This succeeded in moderating the expansion of household credit and money growth during 2000. As a consequence, the reserve position strengthened and net foreign assets of the monetary system are now within the CBA confidence margin of 5-6 months of non-oil imports (Table 7).

13. **Looking forward, the most likely prospect for 2001 is a further deceleration of output growth to about 1½ percent.** The primary cause of this envisaged slowdown is the ongoing deterioration in the external environment which will negatively affect both demand for tourism services in the main markets of origin, notably the United States, and foreign investment and capital inflows. Further ahead, economic growth is projected to stabilize and experience a modest recovery in 2002 reflecting the expected evolution of the U.S. economy as well as marketing efforts and diversification into non-U.S. markets.

14. **These projections, however, are subject to a high degree of uncertainty as the openness and small size of the Aruban economy make it difficult to forecast the effects of external shocks.** From the standpoint of the likely evolution of aggregate world demand, including for tourism services, the balance of risks to the outlook appears to be on the downside. Nevertheless, the authorities pointed out that Aruba was well established in a stable market niche, and in addition, they were undertaking marketing campaigns to increase demand from non-U.S. markets and deepen the U.S. market base. Given the small size of the economy, this strategy had proven successful in previous market downturns—for example, market development campaigns (undertaken partly by the private sector) in Venezuela and elsewhere offset to some extent weak tourist arrivals from the United States in 1996-1997

and from Europe in 1998.[7] Thus, the authorities viewed the staff growth projection as downward biased. The staff did not disagree with these considerations, but noted that, unlike in previous occasions, the ongoing deterioration in the external outlook was likely to affect most of the Aruban markets simultaneously and argued for a conservative central projection—particularly for fiscal and monetary policy purposes—until more evidence was available.

III. Policy Discussions

15. **The staff broadly concurred with the overall economic policy objectives of the authorities.** These focused on enhancing long-term growth prospects and minimizing output volatility by fostering the diversification of the economy while consolidating Aruba's position in the upper segment of the market for tourism services. Efforts at diversification aimed at high value-added sectors that profit from the comparative advantages of Aruba—including a skilled labor force and enviable financial stability. Future economic growth, although more moderate than in the past, should also be more balanced and sustainable, broadening the sources of the economic prosperity of Aruba.

16. **Given the fixed exchange rate regime and the external dependence of the economy, sustained growth will hinge on the buffer provided by a steady supply of public savings; a well capitalized and effectively regulated financial sector; and a dynamic market environment able to elicit private savings and investment.** Success in this direction requires a multipronged policy agenda that firms up macroeconomic and financial stability in an increasingly open environment. An immediate task is correcting the ongoing fiscal deterioration and restoring budgetary discipline. Policy slippages already have adverse macroeconomic consequences and should be addressed before they threaten financial stability. On policies with a medium-term orientation, the staff argued for the following priorities.

- First, undertaking reforms of entitlements, budget administration, and the tax system to ensure the long-term solvency of the public finances. Sustained public savings will be needed to expand the pool of funds available for private investment, underpin investors' confidence, and free budgetary resources for investment in infrastructure and human capital.

- Second, maintaining the strength of the monetary and financial framework through a sound foreign reserve position and increasingly effective supervision and regulation of onshore and offshore financial activities. This would enhance financial stability and transparency as well as the international attraction of Aruba as a safe destination for long-term investment.

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[7] A detailed analysis of the demand for tourism services in Aruba can be found in "Aruba Tourism Market Development Trends," (Aruba Tourism Authority and Ministry of Economic Affairs) and in "Evaluation of Demand: US Tourists to Aruba" (Vanegas, Sr. and Croes, *Annals of Tourism Research*, 2000).

- And third, continuing progress in the orderly liberalization of financial and external capital account transactions; advancing in the privatization process; and avoiding involvement of the government in business ventures—thus, fostering the efficient use of available resources and attracting investments and entrepreneurship.

A. Public Finances

17. **The authorities saw the need to consolidate the public finances in order to increase the public contribution to national savings and reduce—and eventually eliminate—the budgetary dependence on external assistance. Nevertheless, after initial efforts in 1998-1999 at fiscal consolidation, the thrust of fundamental public finance reform had lost momentum.** At the time of the mission, specific initiatives for future reforms in this area were only in an incipient stage of definition and, perhaps owing to the proximity of general elections, appeared to have taken a second place on the agenda of public policy priorities.

18. **In this context, policy slippages and new health care entitlements are expected to result in a significant widening of the fiscal deficit in 2001.** Growing entitlement obligations and overruns in current spending had resulted in a steady erosion of the fiscal position through 2000, which is forecast to worsen sharply in 2001 to 2½ percent of GDP, as the effect of one-time revenue measures adopted in 1999 and 2000 fades away and the cost of the new AZV adds to structural spending. The authorities acknowledged the likely deterioration of the budgetary position with respect to both the 2000 outturn and the 2001 budget projection, but in their opinion it could be contained within manageable limits. They argued that the net cash requirement would be lower than the deficit projected by the staff, as some cash payments would be carried forward to 2002; the actuarial analysis of APFA could result in a lower transfer; some government assets (including a stake in the Radisson Hotel) could be sold; and finally, the budget provided for a moderate amount of foreign borrowing.

19. **In the staff's view, however, although these expedients could provide the necessary financing for the deficit, they would not alter the fiscal position of the public sector as a whole.** Rather, they would all amount to different forms of financing the overall fiscal deficit, and would not change the public claim on the national savings pool or mitigate the strain on available financing to the private sector. Lower transfers to APFA or fund transfers from other public institutions, inasmuch as they were not saved by the budget, would reduce the overall net financial position of the public sector, hence ultimately implying an indirect recourse to the banking system—a consequence unintended by the authorities. The authorities agreed with the staff on the importance of not incurring arrears to finance the deficit. An eventual increase in outstanding payment obligations would prompt distress credit demand by liquidity-squeezed government suppliers, which had been a factor in the recent expansion of bank credit, and could lead to a deterioration in the banks' loan portfolios.

20. **The staff urged the adoption of measures to forestall the expected budgetary deterioration in 2001 and encouraged the authorities to reinvigorate medium-term plans to eliminate fiscal imbalances.** The fiscal consolidation strategy should aim to achieve the authorities' objective of a balanced budget within two years and, subsequently, a

steady surplus to cement the financial stability of Aruba and provide for future liabilities. Staff projections indicate that expenditure restraint and implementation of reforms would place these objectives within reach. Eliminating the fiscal deficit remains an appropriate objective in light of recurring difficulties in raising domestic financing and the need to maintain a low level of external public indebtedness to buttress confidence in the peg and reassure investors—thus, minimizing the perceived country risk of Aruba. Further, a more ambitious objective of a sustained surplus would allow for the gradual capitalization of future public liabilities of the pay-as-you-go component of the pension system—which currently represents about 86 percent of annual pension outlays—and contingent liabilities related to commercial guarantees extended in the past.[8] The precise magnitude of future pension liabilities is not yet known but the authorities are conducting actuarial studies to this effect and there was a general consensus that, given demographic trends, these liabilities could be sizable. From a macroeconomic policy standpoint, fiscal savings and eventual privatization proceeds would provide a crucial safety cushion in the process of capital account and financial liberalization.

21. **Restraining government current expenditure in the short term is perhaps the most difficult task but also the most needed, given the recent unsustainable slippages in this area.** Wage hikes and an expansion of public employment raised government labor costs by 7 and 11 percent in 1999 and 2000, respectively. This was due to increases in both average labor costs per employee and, particularly in 2000, the number of public employees.[9] The recent agreement on a 2.8 percent wage increase for the public sector (compared to 2.7 percent in 2000) is forecast to raise the wage bill by a further 5½ percent in 2001. From this high level of current spending, consolidating the public finances will require future wage bill increases below expected inflation, including policies to bring public employment down in the context of a medium-term rationalization of public employment. Although the authorities agreed on the need for wage restraint, they pointed out that international comparisons do not provide an unequivocal guide as to the optimal absolute level of the public wage bill. In the opinion of the staff, however, this optimal level could not be seen independently of the level of available budgetary resources (Table 8). And in this regard, the proportion of tax revenue that is needed in Aruba to cover government labor costs, currently 60 percent, is above that of most countries with a good economic performance—particularly since Aruba does not have a military or a foreign service.

22. **The authorities agreed on the need to eliminate arrears and strengthen budgetary discipline as a short-term priority, underpinned by reforms in budgetary management.** Substantial progress was made in clearing the stock of outstanding obligations

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[8] The only fully-funded component of the public pension system is the basic pension paid by APFA. The indexation complement to that pension (dearness allowance) and the general pension system (AOV) are financed on a pay-as-you-go basis, supplemented if necessary by transfers from general budgetary resources.

[9] Average labor costs per employee increased by 4 and 6 percent in 1999 and 2000, respectively; the number of employees increased by 1.6 and 5 percent in the same years.

in 1999, but arrears accumulated again in 2000 with deleterious effects on budgetary management and tax compliance through hard-to-control tax offsets. The staff encouraged the authorities to accelerate plans to improve the budgetary process and its transparency. In this regard, the staff suggested that international standards of budgetary accounting and reporting be introduced along the lines of the European System of Accounts (ESA 95) and budgetary and treasury management be reinforced through administration and procedural reform.

23. **Reform of the new public health-care system will be necessary to ensure its financial viability and mitigate budgetary costs.** In view of early indications of cost overruns and detected cases of waste and abuse, the authorities had started a cost study of the AZV and were considering immediate cost-cutting measures, albeit of a limited scope. The staff agreed with the high priority accorded to health care by the authorities, but argued that ensuring continued provision of these services would require a definition of entitlements consistent with available revenue. Specifically, the staff indicated that the present open-ended coverage of all health-related spending limited only by specific exceptions should be tightened. Also, an efficient system of incentives would call for the introduction of co-payments and deductibles. On the revenue side, premium contribution rates for all but the low-income sectors of the population should be set in consonance with actual costs.

24. **Consolidation of the public finances will require a reform of the pension system that ensures its long-term sustainability and bolsters national savings.** The pension system could constitute a major contributor to public surpluses and financial market deepening. Instead, the expansion of unfunded entitlements over time in both the public employees' (APFA) and general (AOV) pension systems—including reductions in the retirement age and generous indexation provisions—have created a permanent cause of budgetary strain and resulted in a minimal capitalization of future pension liabilities. The authorities' initiatives in this regard have focused on reducing the present level of budgetary transfers to the pension funds, but have not yet tackled the definition of entitlements and the long-term solvency of the system. The ongoing actuarial analysis of APFA should be accompanied by a similar analysis of AOV and followed up by a farsighted reform of pension entitlements and future government obligations with a view to guarantee their financial viability and reduce the present burden on the public finances. This reform should contemplate a gradual increase in the retirement age and a realistic definition of the level of public pensions, which could be complemented by a fully capitalized privately-provided second tier pension, as is being considered by the authorities.

25. **On the revenue side, the staff encouraged the authorities to intensify efforts at tax collection and accelerate plans to reform the tax system and administration aiming to improve compliance, rebalance the tax mix toward broad consumption taxes, and enhance the tax yield (Box 1).** The current tax system—based on direct taxes, specific excises, and import duties—lacks buoyancy, is complex and difficult to administer, and offers multiple opportunities for tax avoidance and evasion. In line with recent FAD technical assistance, reforms are needed to simplify direct taxes (allowing self-assessment and widespread withholding at source), eliminate tax holidays, narrow the current rate dispersion, and introduce a general consumption tax such as a VAT or sales tax. Although there was agreement on the general features of the needed tax system and administration

Box 1. Aruba: The Tax System

The current tax system

Tax revenues in Aruba are derived from four major taxes; a personal income tax (largely levied on wages), a profit tax, import duties, and excises.

The personal income tax has a complex structure with many tax brackets and multiple exemptions and deductions, and the system lacks revenue buoyancy. The only income tax withheld at source is the wage tax. In addition, administration difficulties have caused a loss of tax revenue from nonwage incomes.

The corporate tax system has a multiple-rate schedule, and many special tax treatments are available (e.g. to promote diversification and tourism). For tax purposes, offshore activities are treated differently from onshore activities and many offshore companies effectively pay a (close to) zero corporate tax.

Import duties are levied at a number of different rates. The most common (standard) tariff is 7.5 percent, with no duty on primary foodstuffs and higher duties on luxury goods. Excises are levied on alcohol, tobacco, and fuel products under specific rates. Activities in the Aruba free zone are largely exempt from import and excise duties. Failure to adjust excise rates for inflation has led to a decline in excise revenues as a share of GDP.

Tax reform

The lack of revenue buoyancy of the current tax system, its complexity, and the difficulty of accurate tax administration, have led the authorities to consider a comprehensive tax reform.

With the aim of increasing tax revenues, the authorities plan to reform the **tax administration**. The reform will entail: a simplification of the tax system; a reduction in the costs associated with tax compliance; the adoption of the principle of self assessment; the encouragement of voluntary compliance through increased auditing; and the implementation of an efficient system for the registration of taxpayers (including the introduction of a single taxpayer identification number) and the processing of tax declarations.

The reform of the **tax system** will include a simplification of the personal income tax and a reduction of marginal tax rates, as well as a shift in the tax burden from direct to indirect taxes. To raise revenues from indirect taxation, the authorities plan to consolidate the import tariff rate schedule in a way that will lift the weighted average tariff rate from 7.5 to 8.5 percent.

Regarding the **corporate tax structure**, the authorities' plans would entail the introduction of a single rate of 35 percent, a withholding tax on dividends of 10 percent (5 percent for listed companies), and a flat income tax of 25 percent on dividends received by individuals. It would also encompass abolishing one of two special offshore tax regimes while leaving the tax status of the 'Aruban exempt companies' (the AVVs) largely intact. This would be accompanied by a tightening of the qualification requirements for AVVs, eliminating the differences in treatment of foreign and domestic companies (i.e. the ring fencing). Finally, it would provide an imputation credit on dividend payments by companies undertaking certain activities or operating in specific areas.

reform, the authorities did not favor the introduction of a consumption tax. They were of the opinion that a consolidation of the import tariff rate schedule would increase the weighted average tariff rate and improve compliance, providing the necessary revenue gains. The staff argued that, unlike a VAT, raising the effective tax burden on imports would increase the general costs of business inputs—already quite high in Aruba owing to transportation costs and the small scale of operations—and erode competitiveness. Further, from a budgetary standpoint, import tariffs do not provide a reliable revenue source in the medium term, as indicated by the experience of most industrialized and emerging economies, where the importance of trade tax revenue has dwindled over time (Table 9).

B. Monetary and Financial Sector Policies

26. **The authorities and the staff agreed that the tight monetary policy implemented by the CBA since early-2000 had been appropriate in the face of credit developments and the need to counteract pressures on reserves.** The CBA's policy stance had already succeeded in stemming net domestic credit growth and the 12-month inflation rate had receded by more than one percentage point since its peak in mid-2000. Inflation was set to decline further as a result of softer external demand and the lagged effects of tight liquidity. The staff also concurred with the authorities that given the absence of more flexible instruments of monetary policy, the current ceiling on aggregate bank credit growth in line with expected nominal GDP growth had proven effective and should remain in the short term.

27. **For the future, the authorities are intent on introducing more flexibility in the monetary policy framework and discussions focused on the adequate strategy to continue progress on financial sector and capital account liberalization.** The authorities are fully aware that credit ceilings—although they have proven effective so far in containing demand and buttressing the reserve backing of the peg—have negative side effects. When maintained for a long period of time, as has been the case in Aruba, they tend to freeze market shares and hamper competition in the banking sector.[10] Moreover, given the openness of the Aruban economy and its already quite liberal regime for external capital transactions, direct credit constraints are bound to erode over time and encourage desintermediation.

[10] The banking sector in Aruba consists of six commercial banks, of which five are associated with foreign banking groups, and two mortgage banks (see Box 2). There are no barriers to entry of foreign banks and by law the CBA must issue a license to all applicants that meet the established criteria. Nevertheless, latent competition from potential entrants, although present, is mitigated by the small size of the local economy, since the banking market is generally considered already oversupplied.

28. **The staff suggested consideration of an incremental approach to further financial liberalization—including a sequenced relaxation of remaining restrictions on external capital transactions—on the basis of a parallel strengthening of prudential and liquidity requirements and the introduction of market-based indirect instruments of liquidity management.**[11] International experience indicates that financial liberalization can be achieved without compromising the stability of the exchange rate or the external balance, including in relatively small open economies, by employing a variety of regulatory and financial instruments alternative to credit ceilings (Table 10). Progress in this direction will foster innovation, productivity, and cost-efficiency in the financial sector—to the benefit of economy-wide productivity and business costs—while deepening the local market in financial instruments. As the Aruban banking sector as a whole shows at present an excess liquidity position and there is a pent-up demand for credit, the relaxation of credit limits should be gradual and accompanied by a rise in liquidity requirements and the issuance of securities. This would prevent a credit boom and the associated reserve losses. In addition to removing credit constraints, the financial liberalization process should encompass the relaxation of restrictions on intermediation of foreign funds by banks while bolstering prudential and financial system integrity safeguards. Strengthening prudential requirements would place the banking system in a better position to withstand external shocks and increased competition in a liberalized environment.

29. **The staff explored with the authorities possible measures in this direction, including the use of indirect instruments of monetary policy that would aim to operate at the margin, smoothing fluctuations in liquidity and interest rates.** Their use could also elicit demand from institutional investors and large local businesses for cash-flow management purposes—hence, deepening domestic financial markets. In the context of a small open economy with a fixed exchange rate regime, however, market-based indirect instruments of liquidity management should not be intended as a means to sustain any predetermined target level of inflation or interest rates; instead they should be used to facilitate adjustment to shocks and palliate unwarranted temporary fluctuations in monetary conditions. Steps to enhance prudential requirements could include making mandatory the general loan provision, introducing capital requirements on currency risk, and allowing the imposition by the CBA of supplementary capital charges according to individual bank risk profiles.

30. **Staff emphasized that, as a guide, the pace of financial liberalization should be attuned to the increasing robustness of the banking system as well as to the strength of the CBA reserve position; it will also require prudent macroeconomic policies.** The authorities considered that the banking sector as a whole was profitable and sound and would

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[11] Aruba has no restrictions on current account transactions. Capital account restrictions comprise licenses for inward capital transactions and remittances abroad exceeding some thresholds (Af. 200,000 for individuals and Af. 500,000 for corporations); and notification of accounts held abroad by residents. Permissions and waivers regarding these restrictions are extended liberally. Also, financial regulations require that resident onshore banks maintain a positive net foreign asset position, which prevents intermediation of foreign funds.

be able to keep pace with the liberalization process—particularly since the rehabilitation of a small bank that experienced financial distress in the past had recently been successfully completed through its sale to a well capitalized mortgage bank. Still, there was agreement that although the banking system may conform to the prudential requirements in the current rather restricted environment, the process of financial liberalization would pose increased challenges and require continued CBA vigilance and reinforced supervision. The authorities were interested in additional discussions on these issues and intended to request technical assistance from MAE.

31. **Aruba has made extensive progress in strengthening the regulation and supervision of the onshore and offshore financial sectors, and in fighting crime related to financial activities (Box 2).** Testimony to substantial advances in this area are the recent passage by Parliament of the law on insurance supervision which became effective on July 1, 2001; the ongoing review with MAE assistance of the regulation and supervision of the offshore sector; and the planned strengthening of the draft law on company service provider legislation in the offshore sector, including the introduction of a licensing system that will introduce 'fit and proper' management requirements, reporting obligations for unusual transactions, and standards of disclosure and transparency. On the basis of progress in implementing know-your-customer standards and anti-money laundering measures, the U.S. Internal Revenue Service granted recently to Aruba a Qualified Intermediary status. Aruba currently chairs the Caribbean Financial Action Task Force (CFATF), and in May 2001 the Government reached a preliminary agreement with the OECD committing to enhanced international cooperation that is expected to result in the removal of Aruba from the OECD list of jurisdictions with harmful tax practices. Also, Aruba is in the process of completing the first phase of an offshore financial sector assessment (OFC) and participates in the Coordinated Portfolio Investment Survey (CPIS), both with assistance of the Fund. Staff noted the momentum in the pace of these reforms and encouraged the authorities to sustain it through the passage of pending legislation and complementary regulations as well as by allocating adequate resources to their implementation. In particular, the staff concurred with the Government's decision to designate the CBA as the regulator of company service providers in the offshore sector. This measure, however, will require prompt passage of the necessary legislation.

C. Structural Reforms

32. **Although the authorities' policy priorities comprise ambitious privatization and structural reform plans, political consensus in this area has remained elusive and progress has been scant and protracted.** Some progress was achieved by closing the national airline, which had remained an onerous financial liability despite a prior partial privatization. Also, the authorities plan to sell their stake in the Radisson Hotel and have not extended any new government guarantees to businesses. On the other hand, union opposition prevented any significant steps in the privatization of the telecommunications operator (SETAR). The current plans are to transform SETAR into an autonomous public corporation

Box 2. Aruba: Offshore and Onshore Financial Regulatory Developments

Both the offshore and onshore Aruban financial sectors are relatively small. The former consists of two banks and many smaller non-bank corporations and the latter of six commercial banks and two mortgage banks. The scope for systemic risk is limited by the conservative range of commercial banks' activities: investment in securities is low, foreign exposures are hedged, and risks of spillovers are limited by minimal interbank exposures. In addition, banks maintain a high liquidity position, and a loan-to-deposit ratio below the prudential ceiling of 80 percent. Aruba is in the process of completing the first phase of a self-assessment of financial standards for offshore centers (OFC) with MAE assistance, which is expected to lead to an FSAP. It also participates in the Coordinated Portfolio Investment Survey (CPIS) with STA assistance.

Prudential supervision of credit institutions. Regulations were strengthened by the adoption in May 1998 of the State Ordinance on the Supervision of the Credit System based on Dutch legislation. The law provides the Central Bank of Aruba (CBA) with the powers and information needed to monitor both onshore and offshore banks closely, and to issue promptly recommendations or directives. CBA's regulations now include fit and proper tests for banks' managers and board members. According to a self-assessment of banking supervision by the CBA, rules and regulations largely comply with international standards but some issues need to be addressed. Improvements should aim at achieving best practices, notably increasing the authority to impose penalties in case of noncompliance. In line with the 1996 legislation on money laundering, financial institutions must report unusual transactions to a special center (the MOT) since 1997. Criminal offense provisions were introduced in 1999 and the CBA also issued guidelines to promote sound corporate governance practices by financial institutions under its supervision. As a number of banks in Aruba are subsidiaries of foreign banks, much emphasis is placed on the cooperation and information exchange with foreign supervisors. The CBA has endorsed the Basel Committee standards for banking supervision, including supervision of international banking groups and their cross-border establishments. It also emphasizes membership in regional and international supervisory bodies.

Prudential supervision of offshore non-credit institutions. About 5,000 offshore entities domiciled in Aruba cater to non-residents for tax and estate planning and investment activities ("company service providers"). Most of them have the status of an "Aruba Tax Exempt Company" (AVV), a zero-tax vehicle. In 1999 the Financial Stability Forum (FSF) placed Aruba in the third tier (lowest level) of quality of supervision of offshore activities. In line with FSF recommendations and the ongoing OFC, the existing legislation of trust companies is being changed. Supervision will move away from a self-regulatory system to an independent and standard regulatory framework under the sole authority of the CBA; offshore companies are to be subject to a licensing system and will have to comply with a number of transparency requirements, notably on-site examinations and annual statements prepared by certified independent auditors, complete records of their clients, 'fit and proper' management, and rigorous know-your-customer policies. Following the recommendations of the Financial Action Task Force on money laundering (FATF), the following two initiatives were taken to improve the supervisory framework of the non-bank sector.

First, to formalize supervision in the insurance sector, that had been based on voluntary agreement since 1998, Parliament adopted a law on supervision of the insurance sector (including non-life insurance) in August 2000. This law became effective on July 1, 2001. The CBA will be the supervisor and insurance companies will have to report unusual transactions. In addition, the obligation to report exports and imports of cash exceeding US$10,000 at customs was approved by Parliament.

Second, supervision of money transfer companies (MTC) by the CBA has been started on a voluntary basis and have to report unusual transactions to the MOT, while a new law will be prepared to formalize this agreement. Out of the 16 MTC, four are currently on the list of compliers with CBA regulations, representing 90 percent of total turnover.

A preliminary agreement was reached with the OECD in May 2001 that is expected to result in the removal of Aruba from the OECD list of jurisdictions with harmful tax practices. Also, recently Aruba has been granted "qualified intermediary" status by the U.S. Internal Revenue Service.

Despite the ongoing strengthening of the legal and regulatory framework, weaknesses remain in banking supervision and in the regulation and supervision of the offshore sector. Financial institutions are not required by law to publish their audited annual statements and the law on supervision of the insurance sector needs to be tightened in some areas. Also, the lack of qualified resources to ensure the effectiveness of the reporting system of unusual transactions must be addressed.

run on the basis of commercial criteria. The staff noted that, although this would be a positive development, the aim should remain the full privatization of SETAR through its sale to a strategic private investor in order to attract investment and upgrade the telecommunications network—a key factor in promoting economic diversification into high value-added services and enhance economy-wide productivity. In June 2001, opposition to the operational autonomy of the Aruban Tourism Agency (ATA) from the minority partner in the governing coalition led to anticipated general elections. In the staff's view, private sector participation in the management of ATA and independence from political influences would facilitate the cost-efficiency, effectiveness, and transparency of its marketing operations. More broadly, staff argued that privatization and divestment policies should regain a prominent place in the Government's agenda to attract needed investment, know-how, and entrepreneurship, as well as to cut budgetary losses.

33. **The timely compilation and publication of economic and budgetary statistics remains an area in need of improvement.** The CBA has made significant progress in the publication (including on the internet) of statistics on money, banking, the balance of payments, and other data under its purview. Also, the upcoming publication of the Census 2000 by the Central Bureau of Statistics (CBS) will be a valuable contribution to the statistical base. In contrast, progress in the timely production of statistics on national and public sector accounts, labor markets, and other basic economic indicators remains disappointing. The authorities were aware of the weaknesses of the statistical base and had recently increased the resources of the CBS, although these had mainly been devoted to the production of the Census 2000. In the case of public sector and budgetary statistics, their regular compilation and publication by the Ministry of Finance under standard international accounting conventions (for example, along the lines of the ESA 95) would be an important contribution to the transparency of the budgetary process.

IV. Staff Appraisal

34. **Since gaining autonomous status within the Kingdom of the Netherlands in 1986, the performance of the Aruban economy has been impressive.** As a result, Aruba's per capita GDP is one of the highest in the region. Key to this success has been a high level of human capital and a stable and market-friendly institutional environment fostered by growth-oriented economic policies. In particular, the monetary and financial stability—epitomized by the fixed exchange rate of the Aruban florin with respect to the U.S. dollar—has proved instrumental in sustaining investors' confidence and capital inflows. Aruba faces now the task of diversifying its economic activity while consolidating the position achieved in the tourism market in order to minimize the vulnerability to external shocks and output volatility.

35. **Maintaining a path of sustained growth and economic diversification will require policies to enhance the pool of available savings as a cushion against external shocks and to elicit domestic and foreign investment.** These policies should encompass

fiscal reforms that place the public finances on a sound basis and increase public savings; a sequenced liberalization of remaining credit and capital account constraints in parallel with prudential policies to further strengthen financial stability; and structural reforms that attract private funds and entrepreneurship and improve transparency.

36. **In this regard, the authorities' objective of eliminating the budget deficit remains appropriate and should be complemented by aiming for a modest but sustained surplus in the medium term.** Achieving lasting fiscal consolidation will be crucial in underpinning financial stability in an increasingly open environment and reassuring investors. Also, given demographic trends and government contingent liabilities acquired in the past, the accumulation of public savings will prove a crucial contribution to facing future public obligations for which the budget stands as ultimate guarantor.

37. **As an early priority in this direction, the ongoing budgetary deterioration stemming from expansions in benefit entitlements, wages, and other structural consumption spending, needs to be contained without delay.** This should be addressed through restraint of current expenditure and efforts at tax collection in the coming months. Notably, the authorities' initiatives at identifying cost-cutting measures in the newly introduced public health-care system (AZV) should be continued and complemented by a realistic redefinition of benefits and contributions. Budgetary subsidies should eventually be limited to health care provided to the poorer segment of the population. The recent public wage increase will require offsetting savings in labor and goods and services costs, including a freeze on public hiring and a cap on future wage bill increases below expected inflation.

38. **To be successful, retrenchment in current spending needs to be implemented in a context of restored budgetary discipline and buttressed by the reform of budgetary procedures, avoiding the accumulation of arrears and clearing existing obligations.** Expenditure management reform should link budgetary appropriations with the spending authorization, commitment, and payment stages—eliminating the resort to cash rationing and improving the transparency of the budget execution process. It should also include the adoption of internationally standard methodologies for budgetary accounting and reporting, such as the ESA 95.

39. **The ongoing actuarial study of APFA should be extended to the AOV and constitute the basis for a farsighted reform of the pension system.** This reform should aim at ensuring the financial self-sufficiency of the pension plans by tightening entitlements, while at the same time, generating long-term savings and deepening financial markets. To this end, consideration should be given to the introduction of a privately-provided fully-funded second tier pension.

40. **The authorities' plans to reform the tax system and administration are well founded.** The tax reform should aim at simplifying the tax system and its administration, improving compliance, eliminating tax holidays, and increasing reliance on broad

consumption taxes. In this regard, consideration should be given to introducing a VAT rather than tilting the tax burden towards imports, since the latter would be detrimental to Aruban competitiveness and would not provide a buoyant tax handle.

41. **The CBA is to be commended for its prudent management of monetary policy, as demonstrated by the continued credibility and strength of the peg to the U.S. dollar, buttressed by a robust foreign reserve position.** The tight credit stance adopted by the CBA in early 2000 in response to signs of overheating was appropriate and should be maintained until demand pressures abate—a tendency which is already underway. Also, the authorities' efforts to introduce more flexibility in the monetary policy framework should be continued. These should aim at coordinating the sequenced liberalization of remaining financial and capital account restrictions with measures to strengthen the prudential and liquidity position of the financial system.

42. **The authorities should also be commended for significant progress in expanding and strengthening the supervisory and regulatory framework of both onshore and offshore financial activities.** The decisive actions taken and the authorities' proactive approach to fighting crime related to international transactions should go a long way in consolidating the standing of Aruba as a safe and stable destination for long-term investment. The recent preliminary agreement with the OECD on harmful tax practices as well as the Qualified Intermediary designation by the U.S. Internal Revenue Service were important steps in this direction. The pace of reforms in this area should be maintained through prompt passage of the necessary legislation—including that related to the designation of the CBA as the regulator of company service providers in the offshore sector—as well as by allocation of sufficient resources for its implementation.

43. **Renewed initiatives on structural reforms will be needed to improve efficiency in the use of resources and attract strategic investment.** The privatization of SETAR could be a starting point to upgrade the telecommunications infrastructure and trigger productivity growth and development of new service activities. The operational autonomy of ATA with private sector participation will increase the effectiveness of the resources devoted to tourism promotion. Also, divestment of government stakes in the Radisson Hotel and other businesses should be accelerated with a view to avoid future business involvements.

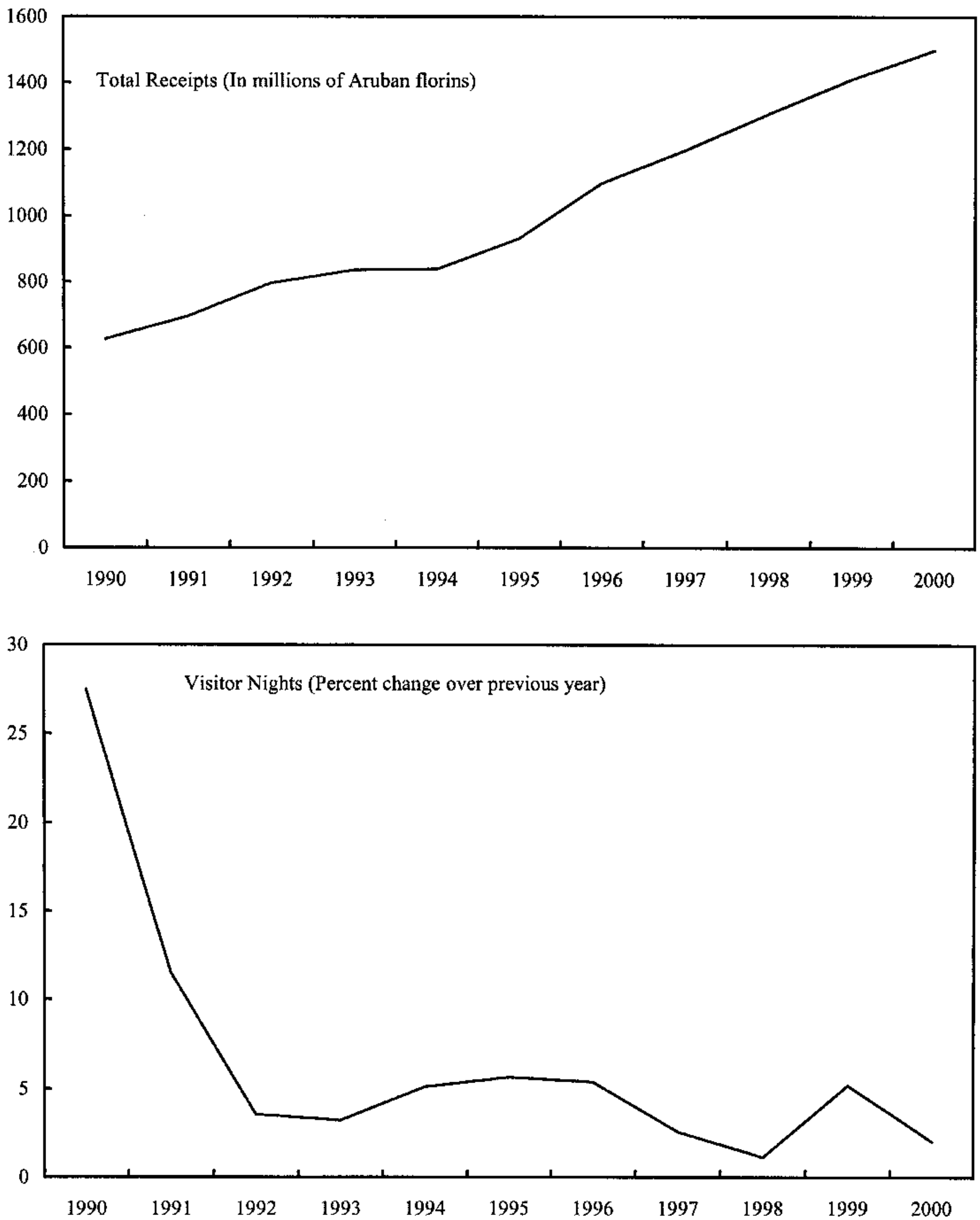
44. **Further progress in the statistical base will be crucial to improve transparency and decision making.** Improvements were made in the publication of monetary, banking, and balance of payments statistics. Nevertheless, lack of national accounts and real activity indicators, as well as public finance statistics on a standard accounting methodology hampers effective surveillance, private decision making, and public policy design. Looking ahead, priority should be accorded to producing timely reporting of budgetary and public sector operations with an internationally standard methodology, labor markets and activity indicators, and national accounts.

45. It is proposed that the next Article IV consultation discussions continue to be held on a 24-month cycle.

Figure 1. Aruba: Real GDP Growth
(In Percent)

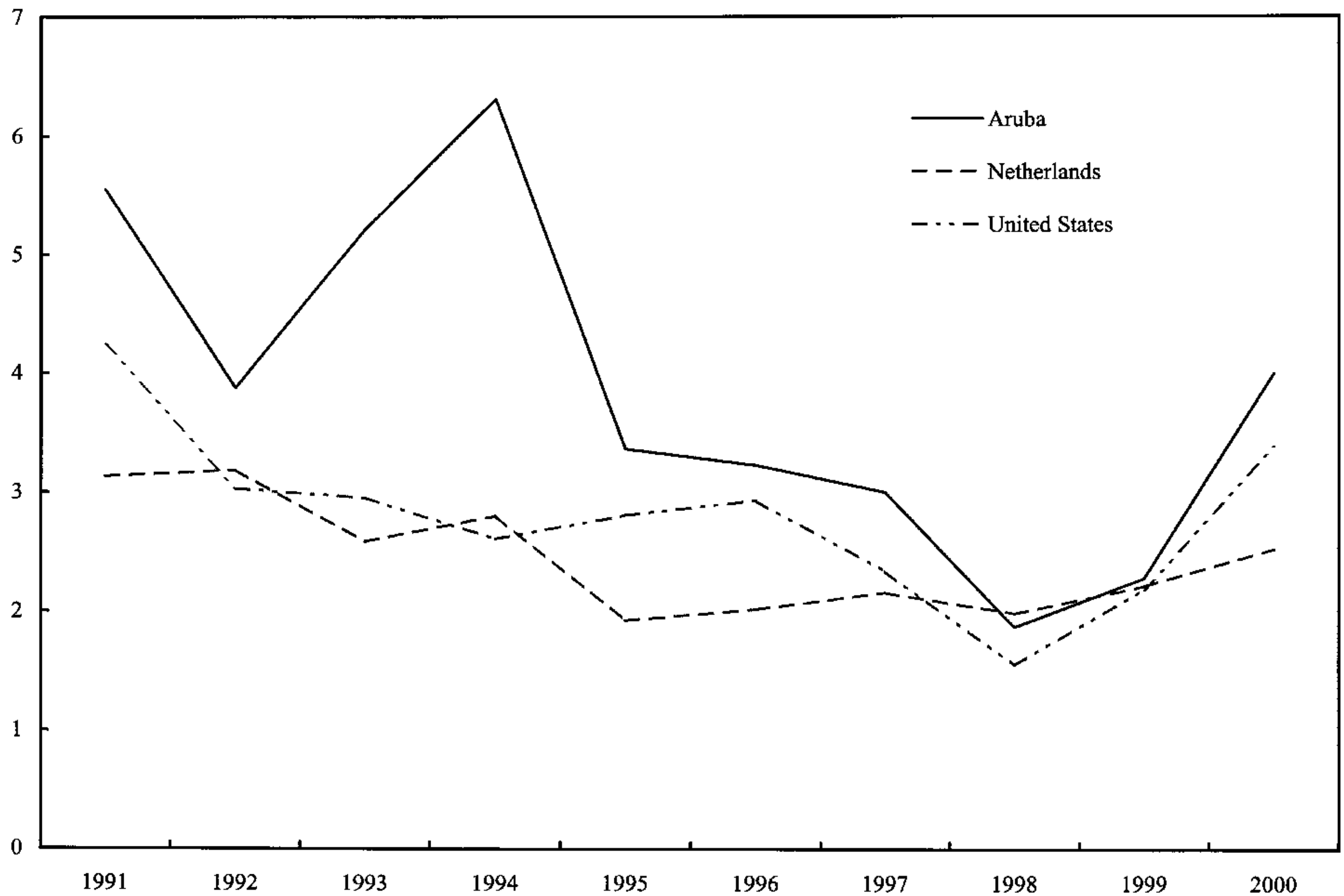
Sources: Data provided by the authorities; and staff estimates.

Figure 2. Aruba: Indicators of Tourism Activity



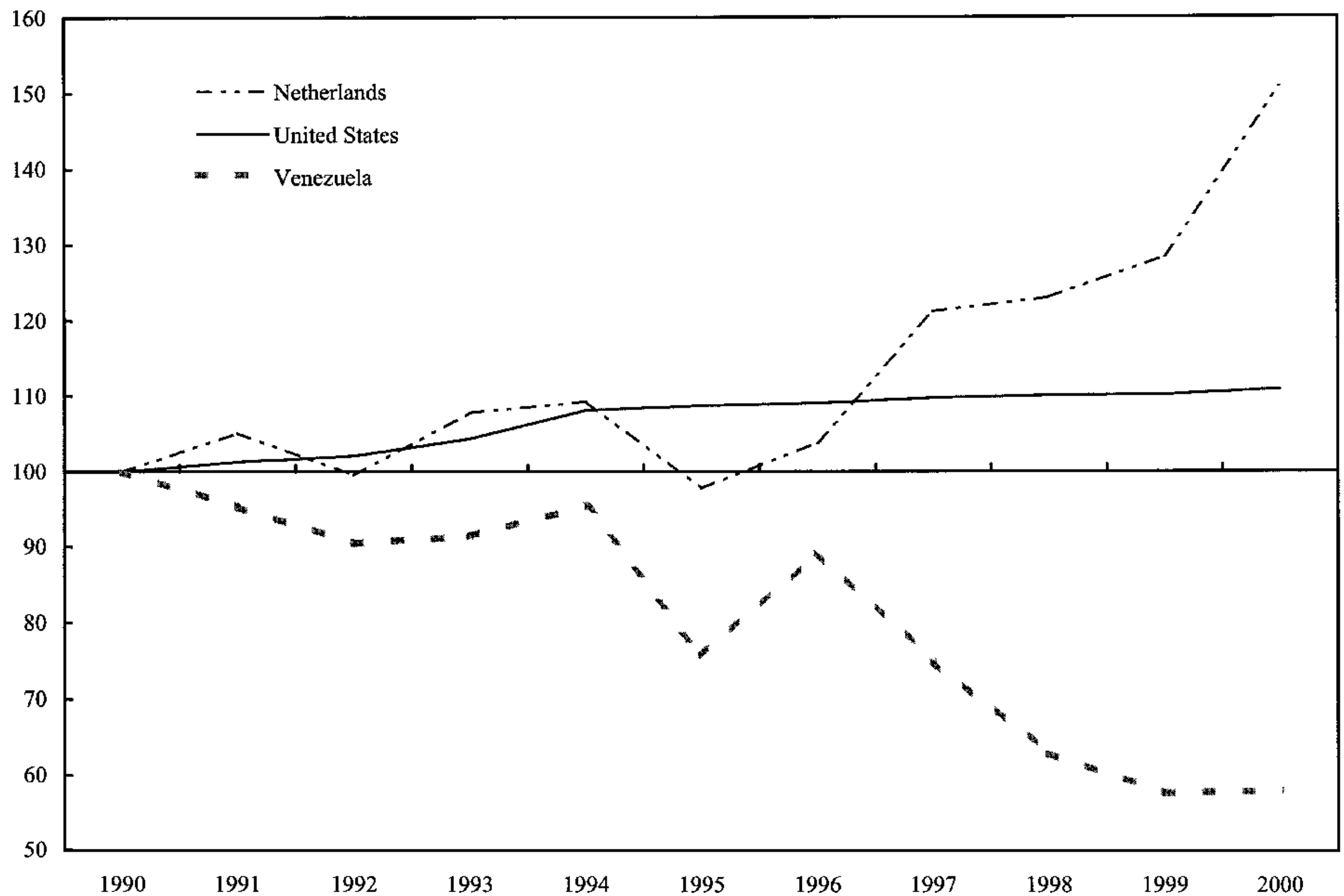
Source: Central Bank of Aruba.

Figure 3. Aruba: CPI Inflation
(Annual averages, in percent)



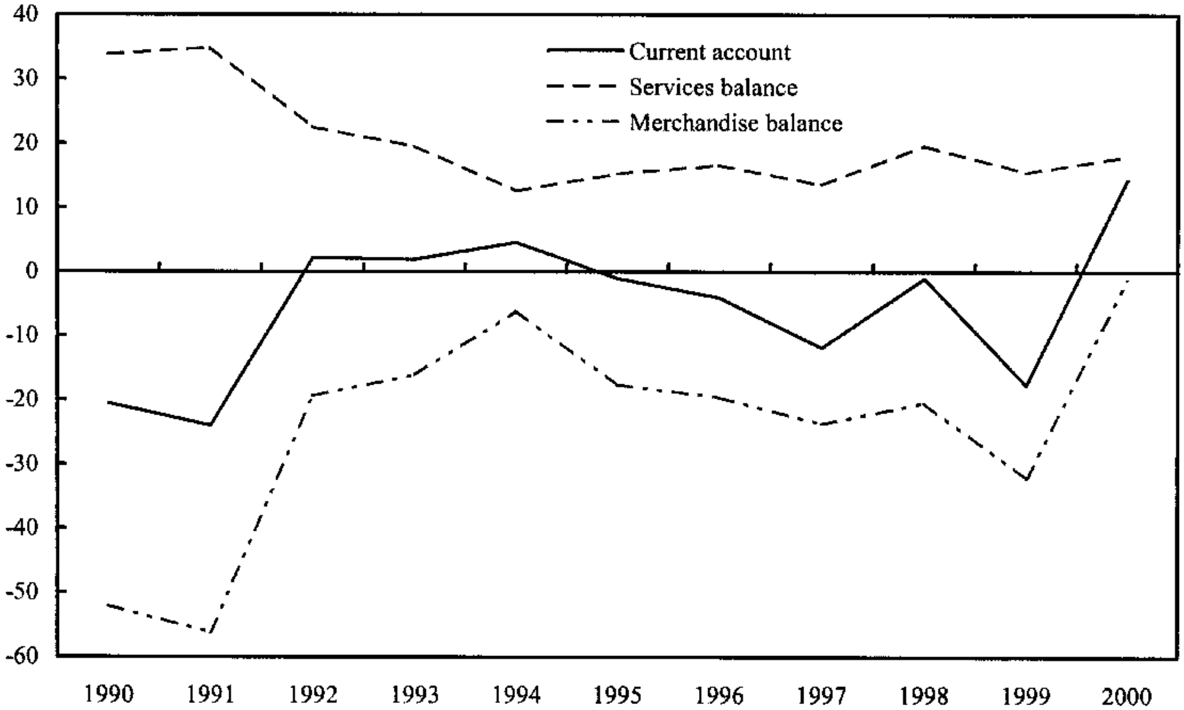
Sources: Central Bank of Aruba; and staff calculations.

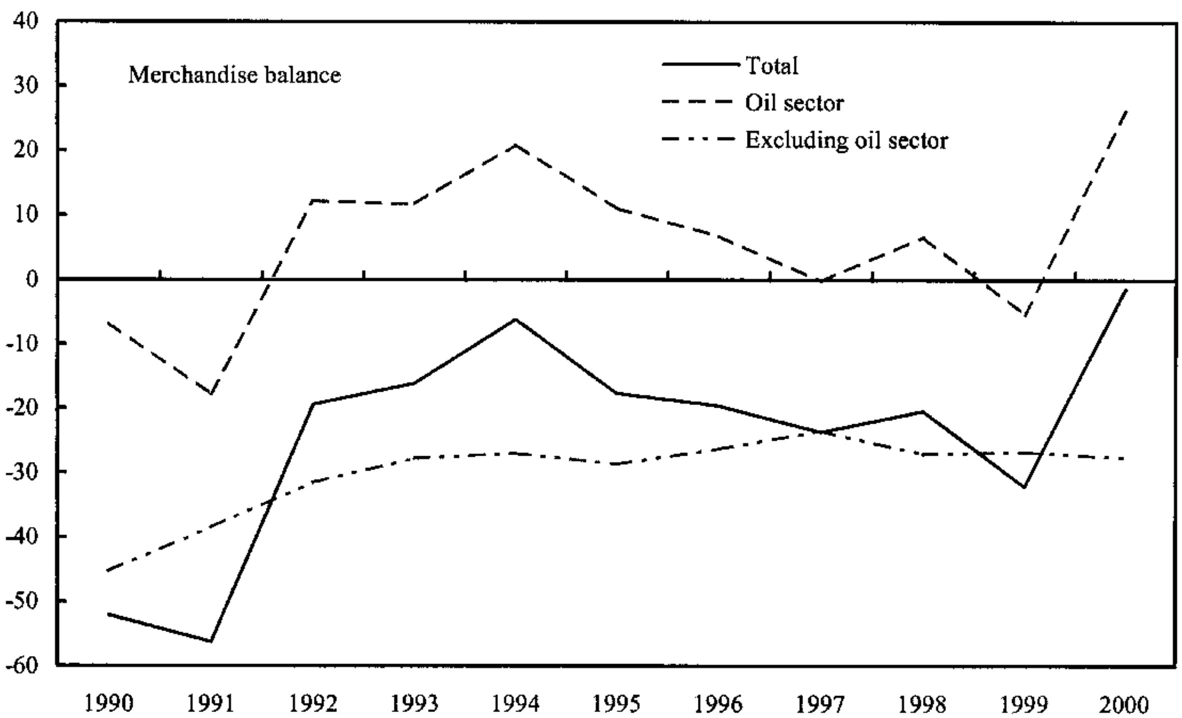
Figure 4. Aruba: Bilateral CPI-Based Real Exchange Rates
(Indices, 1990=100)



Sources: Central Bank of Aruba; and staff calculations.

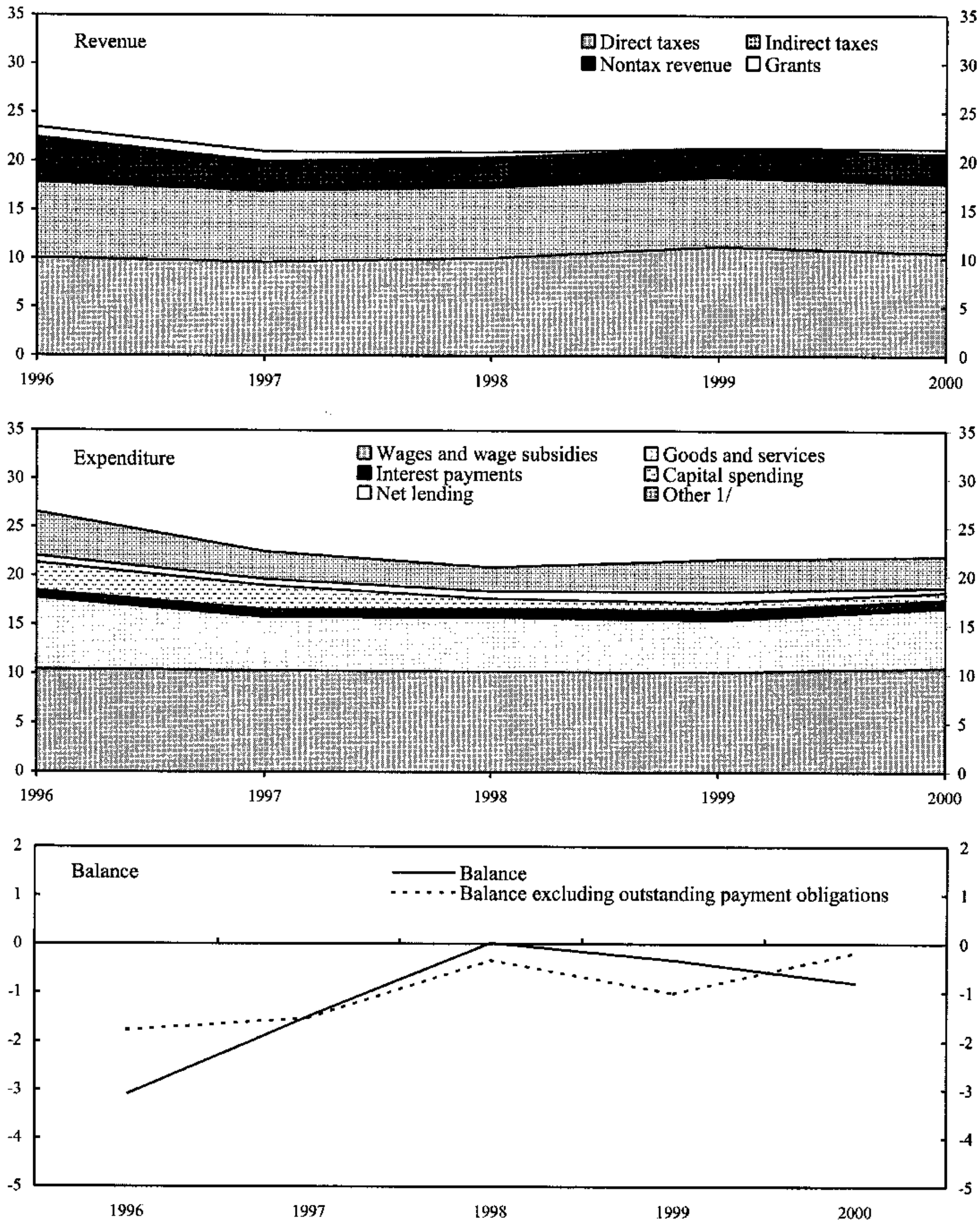
Figure 5. Aruba: Current Account Components
(In percent of GDP)





Sources: Central Bank of Aruba; and staff calculations.

Figure 6. Aruba: Budgetary Operations
(In Percent of GDP)



Sources: Central Bank of Aruba; and staff calculations.
1/ Including outstanding payment obligations.

Table 1. Aruba: A Regional Perspective

(In percent, average 1994-98 unless otherwise indicated)

	Nominal GDP per capita (US$ thousands) 1998	Real GDP growth	CPI Inflation	Gross tourism receipts (share of GDP)	Current Account (share of GDP)	Official reserves (months of GNFS imports) 1998	Prime lending rates 1998 1/	Tax revenue (share of GDP) 1998	Interest rates 1998 1/	Land area km^2
Aruba	19,097	4.7	3.6	39.0	-2.7	3.8	11.3	17.3	5.9	180
Antigua and Barbuda	8,833	3.5	1.9	52.5	-11.2	1.4	10-13.5	17.6	3.1	440
The Bahamas	14,450	2.4	1.4	29.9	-10.3	1.8	6.8	16.5	2.4	10,070
Barbados	8,212	4.0	2.2	36.0	3.5	2.5	10.4	30.0	4.6	430
Belize	2,820	2.4	2.3	11.6	-3.3	1.2	16.5	19.7	2.0	22,800
Dominica	3,100	2.6	1.4	18.8	-12.3	2.1	9-10.5	23.8	2.5	750
Grenada	3,209	4.5	1.9	30.9	-9.5	2.2	10.5	22.7	1.6	340
Guyana	932	5.8	8.6	9.3	-14.7	4.4	16.6	28.6	8.0	196,850
Jamaica	2,604	-0.5	23.5	19.1	-2.4	2.2	30.4	26.3	13.7	10,830
Netherlands Antilles	11,823	1.9	2.5	25.4	-5.0	1.9	13.9	25.4	3.8	800
St. Kitts and Nevis	6,935	5.2	4.1	34.0	-22.0	2.7	9.5-13	21.8	3.1	269
St. Lucia	4,013	2.7	2.8	42.3	-9.9	2.0	9.5-10.5	23.7	1.3	610
St. Vincent and the Grenadines	2,745	3.2	2.4	21.7	-15.3	2.1	10-12.5	24.6	1.6	340
Suriname	1,495	7.2	246.4	2.0	6.4	2.8		23.0	0.6	161,470
Trinidad and Tobago	4,596	4.1	5.0	2.3	-2.0	2.7	17.5	22.0	5.0	5,130
Venezuela	4,132	1.6	61.3	...	4.0	7.0	46.4	10.6	...	882,050
Memorandum item:										
Netherlands	25,060	3.3	2.2	...	6.0	1.2	6.5	24.0	3.7	41,500

Sources: Authorities; and staff calculations.

1/ For Aruba: September-December 1998 average.

Table 2. Aruba: Contributions to Real GDP Growth, 1996-2004

(In percent)

	1996	1997	1998	1999	2000	2001 Proj.	2002 Proj.	2003 Proj.	2004 Proj.
Private absorption non-oil sector	1.3	3.8	4.3	1.4	0.4	-1.3	2.0	2.3	2.7
Consumption 1/	1.7	2.7	4.1	1.4	0.6	-1.2	1.8	1.8	2.1
Private investment	-0.4	1.1	0.2	0.0	-0.1	-0.1	0.2	0.5	0.6
Government absorption	0.9	0.2	-0.4	0.8	0.8	3.1	-0.2	0.5	0.4
Consumption 1/	0.2	0.2	1.1	1.0	1.0	3.1	-0.9	0.4	0.4
Investment	0.7	0.0	-1.4	-0.2	-0.2	0.0	0.6	0.1	-0.1
Trade and nonfactor services, non-oil	4.0	-0.2	-1.2	2.6	1.2	-0.5	0.6	0.6	0.5
Trade balance	1.0	2.2	-4.9	-0.9	-1.5	-0.6	-0.7	-1.2	-1.3
Nonfactor services	3.0	-2.4	3.7	3.6	2.6	0.1	1.3	1.8	1.8
Oil sector	-0.6	0.2	0.3	-0.3	0.1	0.3	0.1	0.1	0.1
Growth real GDP	5.6	4.1	3.0	4.5	2.5	1.6	2.5	3.5	3.7
Memorandum Items:									
Nominal growth rate	9.0	7.2	4.9	6.9	6.6	4.7	5.3	6.6	6.8
GDP deflator	3.2	3.0	1.9	2.3	4.0	3.0	2.8	3.0	3.0

Sources: Staff estimates based on data supplied by the authorities.
1/ For 2001, includes a switch in health care spending from the private to the public sector equal to 2.9 percent of GDP, owing to the introduction of the general health care system (AZV).

Table 3. Aruba: Stayover Visitors in 2000
(In percent change, year-on-year)

	January-April	May-December
Aruba	12.1	2.4
Anguilla	-14.8	3.1
Antigua and Barbuda	-8.5	5.6
Barbados	6.4	4.6
Belize	13.3	...
Bonaire	-11.5	-19.7
Cayman Islands 1/	-0.3	6.1
Curacao	-5.2	-2.7
Dominica	-0.4	...
Grenada	6.5	0.7
Jamaica	5.5	6.4
Martinique	5.6	-6.0
Montserrat	4.5	4.6
St. Eustatius	-13.6	9.1
St. Kitts and Nevis 2/	-23.1	-48.2
St. Lucia	-3.7	-0.1
St. Maarten	-11.6	4.0
St. Vincent	6.9	6.6
Turcs and Caicos Islands 3/	31.8	35.4

Source: The Economist Intelligence Unit.
1/ For May-December, January to June.
2/ For May-December, May only.
3/ For May-December, January to September.

Table 4. Aruba: Balance of Payments Summary, 1996-2004

	1996	1997	1998	1999	2000	2001 Staff prj.	2002 Staff prj.	2003 Staff prj.	2004 Staff prj.
					(In millions of Aruban florins)				
Current account	-110.8	-350.9	-33.6	-585.0	506.8	580.6	554.1	556.5	556.9
Merchandise balance	-539.8	-700.1	-632.5	-1063.5	-50.6	-21.9	-162.8	-279.4	-402.6
Services	456.7	399.8	606.8	511.4	632.3	680.5	798.7	922.6	1051.6
Income and current transfers	-27.7	-50.6	-7.9	-32.9	-74.9	-78.1	-81.9	-86.8	-92.2
Financial and capital accounts	53.6	315.7	192.0	618.4	-559.8	-566.3	-511.2	-485.0	-456.9
Errors and omissions	12.2	-4.5	1.1	-14.9	12.1	0.0	0.0	0.0	0.0
Banking sector (net increase in liabilities)	-2.1	6.9	-67.7	-14.0	14.5	-4.3	-12.9	-21.4	-30.0
Change in reserves (-) 1/	47.1	32.8	-91.8	-4.5	26.4	-10.0	-30.0	-50.0	-70.0
					(In percent of GDP)				
Current Account	-4.0	-11.9	-1.1	-17.7	14.4	15.7	14.3	13.4	12.6
Merchandise balance	-19.6	-23.7	-20.4	-32.2	-1.4	-0.6	-4.2	-6.7	-9.1
Services	16.6	13.6	19.6	15.5	17.9	18.5	20.6	22.3	23.8
Financial and capital accounts	1.9	10.7	6.2	18.7	-15.9	-15.4	-13.2	-11.7	-10.3
Banking sector (net increase in liabilities)	-0.1	0.2	-2.2	-0.4	0.4	-0.1	-0.3	-0.5	-0.7
Change in reserves (-)	1.7	1.1	-3.0	-0.1	0.7	-0.3	-0.8	-1.2	-1.6
Memorandum items:									
Non-oil trade balance (goods and services)	0.6	0.5	-0.8	1.8	2.9	2.4	3.0	3.4	3.8
Non-oil current account	-0.2	-1.0	-0.8	1.0	1.0	0.5	1.0	1.5	1.8
Non-oil financial and capital accounts	-2.1	-0.3	2.7	-1.3	-3.6	-1.1	-0.9	-0.8	-0.6
Oil sector balance	0.2	0.1	3.2	1.2	1.1	1.0	1.0	1.0	1.0

Sources: Central Bank of Aruba; and staff projections.
1/ Including gold, excluding revaluation differences.

Table 5. Aruba: Budgetary Operations, 1996-2004

	1996	1997	1998	1999	2000		2001		2002	2003	2004
					budget 1/	actual	budget 1/	staff prj.	staff prj.	staff prj.	staff prj.
					(In millions of Aruban florins)						
Revenue	645.4	619.4	646.5	707.4	816.3	748.9	850.4	766.1	803.9	862.0	922.3
Taxes	491.4	499.9	535.5	608.7	637.1	624.4	666.3	634.1	667.3	720.3	777.9
Nontax revenue	126.1	89.6	95.3	97.4	139.2	107.5	160.6	111.1	114.3	117.7	121.2
Grants	27.9	29.9	15.7	1.4	40.0	16.9	23.5	20.8	22.4	24.0	23.2
Expenditure	730.4	663.2	645.9	718.6	796.6	777.4	816.8	859.9	838.3	863.0	884.1
Current spending	...	571.7	591.5	654.4	731.4	732.8	785.0	820.7	774.1	795.1	817.6
Labor costs	...	303.7	316.0	337.0	395.1	375.0	389.7	395.5	407.3	419.5	432.1
Goods and services	200.0	161.4	170.8	174.9	167.1	216.3	143.1	154.1	158.4	168.8	180.2
Interest payments	20.0	23.6	29.0	33.4	44.9	30.2	40.8	40.8	41.0	41.5	42.0
Other current spending	...	83.1	75.7	109.3	124.3	111.4	211.4	230.4	167.3	165.3	163.3
Capital spending	...	72.8	30.9	26.8	59.9	28.4	29.7	29.7	54.7	58.4	57.0
Net lending	...	18.7	23.6	37.4	5.3	16.2	2.1	9.5	9.5	9.5	9.5
Balance	-85.0	-43.8	0.5	-11.2	19.7	-28.5	33.6	-93.9	-34.4	-1.0	38.2
Statistical discrepancy	-1.4	1.8	7.5	-9.6	...	-11.3	...	...	...	...	...
Financing	83.6	45.6	6.9	1.6	...	17.2	-33.6	93.9	34.4	1.0	-38.2
Foreign	-19.0	-16.0	39.7	13.3	...	23.9	22.5	22.5	21.3	27.5	30.2
Domestic	102.6	61.6	-32.8	-11.7	...	-6.7	-56.2	71.3	13.1	-26.5	-68.4
Monetary system	19.1	31.8	0.8	21.3	...	-13.4	...	...	...	...	...
Change in payment obligations 2/	36.4	-1.2	-10.9	-22.5	...	23.6	...	...	...	...	...
Other	47.1	31.0	-22.7	-10.5	...	-16.9	...	...	...	...	...
					(In percent of GDP)						
Revenue	23.5	21.0	20.9	21.4	23.2	21.2	23.0	20.8	20.7	20.8	20.9
Taxes	17.9	17.0	17.3	18.4	18.1	17.7	18.1	17.2	17.2	17.4	17.6
Nontax revenue	4.6	3.0	3.1	2.9	3.9	3.1	4.4	3.0	2.9	2.8	2.7
Grants	1.0	1.0	0.5	0.0	1.1	0.5	0.6	0.6	0.6	0.6	0.5
Expenditure	26.6	22.5	20.9	21.7	22.6	22.1	22.1	23.3	21.6	20.8	20.0
Current spending	...	19.4	19.1	19.8	20.7	20.8	21.3	22.2	19.9	19.2	18.5
Labor costs	...	10.3	10.2	10.2	11.2	10.6	10.6	10.7	10.5	10.1	9.8
Goods and services	7.3	5.5	5.5	5.3	4.7	6.1	3.9	4.2	4.1	4.1	4.1
Interest	0.7	0.8	0.9	1.0	1.3	0.9	1.1	1.1	1.1	1.0	1.0
Other current spending	...	2.8	2.4	3.3	3.5	3.2	5.7	6.2	4.3	4.0	3.7
Capital spending	...	2.5	1.0	0.8	1.7	0.8	0.8	0.8	1.4	1.4	1.3
Net lending	...	0.6	0.8	1.1	0.1	0.5	0.1	0.3	0.2	0.2	0.2
Balance	-3.1	-1.5	0.0	-0.3	0.6	-0.8	0.9	-2.5	-0.9	0.0	0.9
Statistical discrepancy	...	0.1	0.2	-0.3	...	-0.3	...	...	...	...	...
Financing	3.0	1.5	0.2	0.0	...	0.5	-0.9	2.5	0.9	0.0	-0.9
Foreign	-0.7	-0.5	1.3	0.4	...	0.7	0.6	0.6	0.5	0.7	0.7
Domestic	3.7	2.1	-1.1	-0.4	...	-0.2	-1.5	1.9	0.3	-0.6	-1.5
Monetary system	0.7	1.1	0.0	0.6	...	-0.4	...	...	...	...	...
Change in payment obligations 2/	1.3	0.0	-0.4	-0.7	...	0.7	...	...	...	...	...
Other	1.7	1.1	-0.7	-0.3	...	-0.5	...	...	...	...	...
					(In percent of GDP)						
Memorandum items:											
Stock of payment obligations 2/ 3/	1.9	1.7	1.3	0.5	...	1.2	...	1.2	...	...	...

Sources: Ministry of Finance; Central Bank of Aruba; and staff calculations and projections.

1/ Data based on budget information from the authorities adjusted by staff to match standard reporting.
2/ Includes payment arrears, except payment arrears to APFA, which were canceled following the March 2001 consensus on a framework for the actuarial analysis of APFA and reevaluation of government obligations to this fund.
3/ Stock of domestic payment obligations at end of period as a percent of (estimated) annual GDP.

Table 6. Aruba: Monetary Developments, 1996-2001

	1996	1997	1998	1999	2000 Q1 1/	2000 Year	2001 Q1 1/
	(Percent change relative to previous year)						
Net foreign assets	-9.4	-9.2	40.5	3.3	5.6	-7.2	16.3
Central bank 2/	-11.9	-9.4	29.0	1.1	-1.1	-6.4	9.4
Commercial banks	2.6	-8.2	87.7	9.7	22.8	-9.2	34.8
Net domestic credit	13.4	8.3	5.8	12.1	4.6	8.1	0.9
Public sector 3/	36.0	75.0	8.2	238.2	14.6	-108.9	172.7
Private sector	10.5	5.5	5.7	10.3	4.5	9.1	0.8
Enterprises	1.8	2.5	0.1	5.3	7.1	8.3	1.3
Consumer credit	8.7	15.4	6.9	16.6	1.4	6.4	-0.4
Housing mortgages	30.8	8.3	14.3	16.5	2.9	14.3	1.9
Other	237.8	-37.5	61.8	-6.8	-0.4	-3.4	-12.3
Other items (net)	23.5	-2.8	23.8	3.3	10.1	12.1	9.4
Money supply (M2)	3.2	4.6	13.1	10.4	4.1	2.3	4.2
Money (M1)	2.2	6.3	15.6	7.9	0.1	1.0	5.0
Quasi-money	3.7	3.7	11.7	11.8	6.2	3.0	3.8
	(Contribution to broad money growth)						
Net foreign assets	-3.6	-3.1	11.7	1.2	1.9	-2.4	5.0
Central bank 2/	-3.7	-2.5	6.7	0.3	-0.3	-1.5	2.1
Commercial banks	0.2	-0.5	5.0	0.9	2.1	-0.9	2.9
Net domestic credit	10.2	7.0	5.0	9.8	3.8	6.6	0.8
Public sector	1.7	2.2	0.1	1.4	0.1	-0.8	0.1
Private sector	8.4	4.7	5.0	8.4	3.7	7.4	0.7
Enterprises	0.9	1.2	0.0	2.2	2.8	3.3	0.5
Consumer credit	1.5	2.8	1.4	3.1	0.3	1.3	-0.1
Housing mortgages	4.5	1.5	2.8	3.2	0.6	2.9	0.4
Other	1.5	-0.8	0.8	-0.1	0.0	-0.1	-0.2
Other items (net)	-3.2	0.5	-3.7	-0.6	-1.6	-1.9	-1.6
Money supply (M2)	3.2	4.6	13.1	10.4	4.1	2.3	4.2
Money (M1)	0.8	2.2	5.4	2.8	0.0	0.4	1.7
Quasi-money	2.4	2.4	7.6	7.6	4.0	2.0	2.5
Memorandum items							
Official reserves of the central bank (in US$ million) 4/	215.6	200.3	245.1	242.8	240.9	231.8	252.3
Ratio of official reserves to base money 4/	1.7	1.7	1.4	1.3	1.3	1.5	1.5
Ratio of net foreign assets to broad money 2/ 5/	0.3	0.3	0.4	0.3	0.3	0.3	0.3
Ratio of net foreign assets to non-oil merchandise imports 4/ 5/	4.2	3.6	4.6	5.3	5.4	5.3	...
Inflation differential with the United States	0.3	0.7	0.3	0.1	0.8	0.6	0.4
Velocity of money	2.1	2.2	2.0	1.9	2.0	2.0	2.0

Sources: Central Bank of Aruba; and staff calculations.

1/ Compared to the end of the previous year.
2/ Including gold, excluding revaluation differences.
3/ Stock series is typically low and contains negative values; percent change calculations based on the convention that a less negative number or a change to a positive number constitute an increase in domestic credit to the public sector.
4/ Including gold and revaluation differences.
5/ Concerns net foreign assets of the monetary sector. Import data for Q1 2001 are not yet available.

Table 7. Aruba: Indicators of External and Financial Vulnerability, 1996-2000

(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000
External indicators					
Exports goods and services (annual percent change, in US dollars)	24.9	1.7	-19.2	17.3	49.8
Imports goods and services (annual percent change, in US dollars)	25.1	6.4	-23.6	31.4	20.9
Terms of trade goods (annual percent change)	20.8	29.7	-9.7	68.1	-95.2
Current account balance	-4.0	-11.9	-1.1	-17.7	14.4
Capital and financial account balance	1.9	10.7	6.2	18.7	-15.9
Portfolio investment , net	-0.4	2.7	-2.8	-2.6	-2.1
Foreign direct investment, net	5.5	12.0	4.8	21.6	-12.1
Other investment liabilities	9.3	16.4	15.6	28.4	13.6
Official reserves (in US dollars, millions) 1/	215.6	200.3	245.1	242.8	231.8
Official reserves to base money (ratio)	1.7	1.7	1.4	1.3	1.5
Official reserves in months of non-oil imports	3.7	3.3	3.8	4.2	4.3
Broad money to official reserves (ratio)	3.4	3.8	3.5	3.9	4.2
Central bank foreign liabilities (in US dollars, millions)	0.6	1.4	0.9	0.1	1.3
Foreign assets of the monetary system (in US dollars, millions) 2/	414.4	432.6	493.9	499.9	509.0
Foreign liabilities of the monetary system (in US dollars, millions)	180.4	218.5	191.7	191.2	221.6
Total external government debt 3/	13.0	10.1	11.4	10.0	10.6
Total external government debt to exports of goods and services (ratio in percent)	8.0	6.5	9.6	7.6	5.8
Exchange rate (per U.S. dollar, period average)	1.79	1.79	1.79	1.79	1.79
Financial Market Indicators					
Public sector debt	25.6	25.8	25.8	22.4	22.2
Financial Sector Risk Indicators					
Mortgage credit to total assets (in percent)	12.5	13.5	14.0	14.7	15.3
Risk based capital-asset ratio (in percent)	10.7	11.1	10.6	8.3	9.3

Sources: Data provided by the authorities; and IMF, *International Financial Statistics.*

1/ Including gold and revaluation differences

2/ Excluding gold, including revaluation differences.

3/ Data on private sector external debt are not available.

Table 8. Aruba: International Comparison of the Government Wage Bill and Tax Revenue 1/

	Wage bill 2/ (Percent of GDP)	Tax revenue 3/ (Percent of GDP)	Ratio of wage bill to tax revenue (In percent)
Canada 4/	12.0	32.5	36.8
Denmark 5/	17.3	47.6	36.3
Mexico 4/	3.9	13.2	29.4
United Kingdom 5/	7.4	30.0	24.7
United States 4/	9.3	21.5	43.3
Euro area 5/			
Ireland	8.8	27.1	32.5
Netherlands	10.2	23.7	43.0
Portugal	14.2	24.6	57.7
Spain	10.7	21.3	50.2
Colombia 6/	2.5	10.5	23.9
Hong Kong	4.5	9.1	49.0
Malta 6/	12.5	22.6	55.4
Singapore 6/	5.0	14.5	34.3
Venezuela 6/	3.2	10.8	29.8
Aruba 7/	10.2	17.3	59.0
Other Caribbean 7/			
Antigua and Barbuda	11.6	17.6	66.1
The Bahamas	9.3	16.5	56.4
Barbados 8/	11.5	30.9	37.2
Belize 8/	10.2	19.7	51.8
St. Kitts and Nevis	14.2	22.6	62.8
St. Lucia	11.9	23.4	50.9
Netherlands Antilles 9/	14.7	25.4	57.9

Sources: IMF Occasional Paper 195 "The Eastern Caribbean Currency Union Institutions, Performance, and Policy Issues"; IMF country staff reports; OECD Revenue Statistics (2000); OECD analytical database; Eurostat database; and IMF, Government Financial Statistics (GFS).

1/ 2000 for Aruba, 1997 for Malta, and 1998 for all other countries. Differences in data sources and definitions may result in methodological differences across countries.
2/ Including employers' contributions to social insurance funds.
3/ Excluding social contributions.
4/ Based on the OECD analytical database.
5/ Based on Eurostat data (ESA95 definition).
6/ Based on the GFS database.
7/ Central government.
8/ 1998-99.
9/ General government, excluding the pension fund.

Table 9. Aruba: International Comparison of Unweighted Average Statutory Import Tariffs and Tariff Revenue 1/

	Unweighted Average Statutory Import Tariff 2/ (In percent)	Tariff Revenue (Percent of GDP)
Canada	7.8	0.3
Denmark	6.0	0.2
Mexico	14.0	0.6
United Kingdom	6.0	0.3
United States	6.6	0.2
Euro area		
Ireland	6.0	0.4
Netherlands	6.0	0.5
Portugal	6.0	0.2
Spain	6.0	0.2
Colombia	11.6	1.2
Hong Kong	0.0	0.0
Malta	7.6	1.4
Singapore	0.0	0.0
Venezuela	14.0	1.9
Aruba 3/	21.4	2.9
Other Caribbean		
Antigua and Barbuda	19.5	...
The Bahamas	35.0	8.4
Barbados	11.0	2.8
Belize	11.2	7.2
St. Kitts and Nevis	12.6	11.1
St. Lucia	14.4	4.0

Sources: OECD trade statistics; IMF, GFS Data base; and IMF Trade Policy Information Database (TPID).
1/ Reflects the year 2000 for Aruba, 1997 for Denmark, Ireland, The Netherlands, Portugal, Spain, the United Kingdom and Malta, and 1998 for all other countries.
2/ Simple average import tariff, including other duties or surcharges.
3/ The weighted average statutory import tariff is 7.5 percent.

Table 10. Aruba: Central Banking Operations in Selected Currency Board and Similar Arrangements

Monetary instruments	Argentina	Eastern Caribbean Central Bank (ECCB)	Estonia	Hong Kong	Lithuania
Reserve requirements	Yes; until replaced by liquidity requirements in August 1995.	Yes; 6 percent of deposits; nonremunerated; averaged over weekly maintenance period.	Yes; effectively reduced by including vault cash holding in July 1994.	No.	Yes; in December 1994, the Bank of Lithuania (BOL) temporarily waived reserve requirements for the Agriculture Bank so that it could extend a loan to the energy sector; in April 1995, lowered from 12 percent to 10 percent; December 1995, banks were temporarily allowed to count treasury bills towards reserve requirements.
Liquidity requirements	Yes, since September 1995; satisfied through holdings of interest-earning Bank Liquidity Certificate (issued by the treasury), a special account abroad, central bank's reverse repurchase agreements, OECD government bonds, or certain Argentine government securities.	ECCB is allowed to require financial institutions to hold government securities up to 10 percent of any institution's deposits and liabilities.	No.	No.	No.
Rediscounts and advances	Yes; the central bank can provide discounts against collateralized.	Yes; with treasury bills; for reserve management; it has not been used since March 1994.	n.a.	Yes; direct borrowing and lending by the Hong Kong Monetary Authority to the interbank market; stand-by credit facilities arranged by commercial banks.	n.a.
Treasury bills	n.a.	Issued by five member governments within each country's limit on its recurrent revenue.	No.	No.	Yes, since July 1994; weekly auction; one- and three-month maturities.
Central bank bills	No.	No.	Yes; BOE CDs were initially issued in May 1993 with a view to increasing collateral that banks can use in interbank market.	Yes; Exchange Fund bills (since 1990) and notes (since 1993) to be used for open market operations by HKMA.	No.
Swaps	Yes.	No.	No.	Yes.	No.
Repos and reverse repos	Yes; in pesos or in dollars; collateralized by dollar-denominated public securities or foreign exchange; rate set by the central bank.	n.a.	n.a.	Yes; overnight repo and reverse repo of eligible assets with the HKMA's Liquidity Adjustment Facility to smooth short-term interest rate around the target rate, that is, with fixed bid and offer rates (June 1992); broadening of the scope of assets eligible for repos	Repo operations in treasury bills and short-term credit facility for commercial banks to be developed in 1997.

				(1994 and 1996).	
Others	n.a.	n.a.	n.a.	Transfer of government deposits between EF and commercial banks; accounting arrangement between EF and Hongkong and Shanghai Banking Corporation (HSBC) to control clearing balance of commercial banks at HSBC (1988); introduction of a charge on interests earned from Hong Kong dollar deposits to reduce Hong Kong dollar liquidity (1988).	BOL reduced the stock of credits outstanding granted to banks before the CBA period, over time to tighten monetary conditions.

Source: IMF Occasional Paper 151, *Currency Board Arrangements: Issues and Experiences (August 1997).*

Aruba - Basic Data

	1994	1995	1996	1997	1998	1999	2000
				(Percent change)			
Real economy							
Real GDP	8.2	2.6	5.6	4.1	3.0	4.5	2.5
Nominal GDP	15.0	6.0	9.0	7.2	4.9	6.9	6.6
Tourist nights	5.1	5.7	5.4	2.6	1.1	5.2	0.6
Tourism earnings	0.3	11.2	17.8	8.9	9.2	8.0	6.2
Real tourism earnings	-6.0	7.8	14.6	5.9	7.3	5.8	2.2
Inflation (period average)							
CPI (Aruba)	6.3	3.4	3.2	3.0	1.9	2.3	4.0
CPI (Curaçao)	1.8	2.8	3.6	3.3	1.1	0.4	5.8
CPI (U.S.)	2.6	2.8	2.9	2.3	1.6	2.2	3.4
Real exchange rate index (1995=100) 1/	99.5	100.0	100.3	100.9	101.2	101.3	102.1
				(In millions of U.S. dollars)			
Balance of payments							
Current Account	60	-15	-62	-196	-19	-327	283
(In percent of GDP)	4.5	-1.1	-4.0	-11.9	-1.1	-17.7	14.4
Of which: non-oil	-54	-25	-3	-17	-13	19	19
(In percent of GDP)	-4.1	-1.8	-0.2	-1.0	-0.8	1.0	1.0
Merchandise balance	-82	-250	-302	-391	-353	-594	-28
Oil sector	278	155	104	-4	115	-99	516
Free zone	13	16	40	47	24	28	3
Other	-373	-420	-446	-435	-492	-523	-547
Services	167	215	255	223	339	286	353
Of which: tourism revenues	468	521	613	668	730	789	837
Income	-14	-9	-12	-17	0	-32	-6
Current Transfers	-11	28	-4	-11	-5	14	-36
Financial and capital account	-60	62	29	180	69	338	-305
Errors and omissions	-2	-4	7	-3	1	-8	7
Change in reserves (-=increase) 2/	2	-43	26	18	-51	-3	15

Aruba - Basic Data (continued)

	1994	1995	1996	1997	1998	1999	2000
				(Percent change)			
Monetary aggregates							
Net foreign assets 2/	7.8	6.3	-9.4	-9.2	40.5	3.3	-7.2
Net domestic assets	15.7	4.6	11.2	11.1	1.9	14.4	7.1
Domestic credit	17.2	4.5	13.4	8.3	5.8	12.1	8.1
To private sector	17.0	7.2	10.5	5.5	5.7	10.3	9.1
Money and quasi-money	12.6	5.2	3.2	4.6	13.1	10.4	2.3
Money	16.8	-1.4	2.2	6.3	15.6	7.9	1.0
Quasi-money	10.3	9.1	3.7	3.7	11.7	11.8	3.0
				(In percent of GDP)			
Public finances central government							
Revenue and grants	22.3	23.9	23.5	21.0	20.9	21.4	21.2
Expenditure 3/	22.1	23.6	26.6	22.5	20.9	21.7	22.1
Balance 3/	0.2	0.2	-3.1	-1.5	0.0	-0.3	-0.8
Government debt							
External	16.3	15.9	13.0	10.1	11.4	10.0	10.6
Domestic 3/	18.9	22.1	12.6	15.7	14.4	12.4	11.5
				(In percent)			
Interest rates							
Deposit rate 4/	4.4	4.3	4.2	4.4	4.8	6.2	5.8
Lending rate 4/	10.6	10.6	10.3	10.2	10.4	13.1	12.0
Exchange rates:							
U.S. dollar	1.79	1.79	1.79	1.79	1.79	1.79	1.79
SDR (end of period)	2.61	2.66	2.57	2.42	2.52	2.46	2.33

Sources: Data provided by the Aruban authorities; and staff estimates.

1/ Relative to the U.S. dollar. CPI based. Period average.

2/ Including gold, excluding revaluation differences.

3/ From 1996 onward excludes payment obligations to APFA.

4/ June for 2000.

Aruba: Fund Relations

Aruba is part of the Kingdom of the Netherlands, which consists of the Netherlands Antilles, Aruba, and the Netherlands itself. The Kingdom of the Netherlands is an original member of the Fund. On February 15, 1961, the Kingdom formally accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Articles of Agreement for all territories. The initial par value of the Netherlands Antillean guilder which at the time also circulated in Aruba—NA. f. 1.88585 = US$1—was established with the Fund on December 18, 1946. The authorities communicated to the Fund a rate of NA f. 1.79 per US$1 to take effect as a central rate on December 23, 1971. Since then, the Netherlands Antillean guilder has been pegged to the U.S. dollar at this rate. With the separation from the Netherlands Antilles and the acquisition of an autonomous status (*status aparte*) within the Kingdom of the Netherlands on January 1, 1986, Aruba introduced its own currency, the Aruban florin, which is also pegged to the U.S. dollar at Af. 1.79 per US$1.

In setting up a new central bank and introducing a new currency, Aruba obtained extensive technical assistance from the Fund's Central Banking Department. Moreover, a Statistical Review Mission of the Bureau of Statistics provided technical assistance in the area of the organization of fundamental statistics. In 1989, and again in 2000, a special mission of the Fiscal Affairs Department visited Aruba to advise the authorities on the possibilities of a comprehensive reform of the tax system. In 1999 and 2000, the Fiscal Affairs Department also provided technical assistance regarding a reform of the public pension system. Aruba participated in the Coordinated Portfolio Investment Survey (CPIS) in 2000-2001 with assistance of the Statistics Department. Finally, to assist the authorities in a self-assessment of the financial standards of its offshore center activities, a special mission from the Monetary and Exchange Affairs Department visited Aruba in late 2000 and early 2001.

The Board concluded the last Article IV consultation discussions for Aruba on May 7,1999 (EBM/99/52) on the basis of staff report SM/99/83 (4/1/99) and recent economic developments SM/99/88 (4/13/99).

Aruba—Statistical Issues

1. Real sector

Aruba produces CPI data and the CBS published an estimate of GDP for 1994. Preliminary calculations of national accounts for 1995-1997 using a supply and use framework are being prepared but are not finalized yet. STA encouraged the authorities to build a producer price index. In addition, the authorities are interested in developing deflators and trade price data.

2. Government finance

Aruba does not report government finance statistics to STA, either for publication in the *GSF Yearbook* or for the *IFS.*

3. Money and Banking

There are no major outstanding issues for money and banking statistics. The CBA reports monetary data to STA on a timely basis with the exception of interest rate data.

4. Balance of Payments

There are no major outstanding issues for balance-of-payments statistics. The CBA reports quarterly data. However, it would be useful to publish a more detailed breakdown of exports and imports, for example by economic use (consumer goods, fuels, raw materials and capital goods) or by commodities.

5. Technical assistance missions in statistics

In April 2001, a STA mission visited Aruba to follow up progress on the CPIS.

Kingdom of the Netherlands—Aruba: Core Statistical Indicators
as of July 18, 2001

	Exchange Rates 1/	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	External debt/ Debt Service 2/	Overall Government Balance	GDP/GNP 3/
Date of Latest Observation	7/18/01	5/01	6/01	5/01	5/01	4/01	5/01	Q4/00	Q4/00	2000	Q4/00	1994
Date Received	7/18/01	7/18/01	7/18/01	7/18/01	7/18/01	7/18/01	7/18/01	4/17/01	6/27/01	5/15/00	4/17/01	...
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly	Irregular
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly	Irregular
Source of Update	CBA 4/	CBA	CBA	CBA	CBA	CBA	CBA	CBA	CBA	CBA	CBA	CBS
Mode of Reporting	—	5/	5/	5/	5/	Electronic	5/	5/	5/	5/	5/	5/
Confidentiality	No	No	No	No	No	No	No	No	No	No	No	No
Frequency of Publication	—	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly	Irregular

1/ Fixed exchange rate against the U.S. dollar since 1986; the Fund would be notified of a parity change.
2/ For government only.
3/ Data in staff papers are estimates.
4/ CBA = Central Bank of Aruba.
5/ Publication

INTERNATIONAL MONETARY FUND
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Public Information Notice (PIN) No. 01/93
FOR IMMEDIATE RELEASE
September 7, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with the Kingdom of the Netherlands—Aruba

On August, 22, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Aruba.[1]

Background

After an investment boom in the tourism sector and upgrades in the oil refinery that supported output growth of 10 percent per year through the mid-1990s, growth declined to a more sustainable level, reaching 4.5 percent in 1999. From mid–2000, output and demand growth have moderated, largely reflecting external developments and tight monetary policy. The most likely prospect for 2001 is a further deceleration in growth to about 1½ percent, caused by the ongoing deterioration in the external environment. Price inflation accelerated from 2.3 percent in 1999 to 4 percent in 2000, owing mainly to imported fuel costs, but also to rapid domestic credit expansion and government consumption outlays. The persistence of an inflation differential vis-à-vis the United States has led to a steady appreciation of the bilateral real exchange rate against the U.S. dollar and some erosion of competitiveness.

Following fiscal consolidation efforts and a virtually balanced budget in 1998, public finances in 1999 and 2000 showed a deteriorating trend, with recurrent liquidity shortages and an accumulation of arrears in 2000. A deficit of 0.3 percent of GDP reopened in 1999 and widened to 0.8 percent in 2000. Despite plans to freeze public employment and contain wages, labor costs increased, while spending on goods and services also rose substantially—encroaching on capital spending, which has remained low. On the revenue side, tax collections in 1999 and

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the August, 22, 2001 Executive Board discussion based on the staff report.

2000 were temporarily boosted by special measures. In 2001 the deficit is expected to widen to about 2½ percent of GDP, reflecting the cost of the universal coverage health system (AZV) introduced in January 2001, increased public employment, and subdued revenue as the tax windfall from the temporary measures fades away.

Since beginning its operations in 1986, the Central Bank of Aruba (CBA) has successfully preserved the fixed exchange rate to the U.S. dollar—its primary monetary policy objective—supported by a strong foreign reserve position. However, despite efforts to liberalize the monetary policy framework, the array of policy instruments has remained essentially limited to credit limits, moral suasion, and liquidity reserve requirements. Following a relaxation of the credit ceiling in 1999 and an ensuing surge in credit growth, the CBA returned to a tight monetary stance in 2000, curbing broad money growth and shoring up reserves by reimposing strict constraints on bank credit expansion. As a consequence, the reserve position strengthened to 150 percent coverage of base money and the net foreign assets of the monetary system are within the CBA confidence margin of 5-6 months of non-oil imports.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the positive performance of the Aruban economy over the past decade. Directors noted that the economy's sustained expansion had been underpinned by growth-oriented economic policies and accompanied by low inflation and financial stability.

Looking ahead, Directors agreed that the challenge now was to diversify economic activity while consolidating Aruba's position in the tourism market, so as to minimize vulnerability to external shocks and output volatility. Directors emphasized that success in this direction would hinge on policies that strengthen financial stability and attract domestic and foreign savings. These policies should be geared to increasing the public sector's contribution to national savings; reinforcing financial safeguards and the monetary policy framework, coupled with a sequenced liberalization of remaining credit and capital restrictions; and improving transparency and promoting entrepreneurship.

Directors agreed that the authorities' objective of eliminating the budget deficit was appropriate and should be complemented by a modest surplus over the medium term. Directors expressed concern at the deterioration of the budgetary position and urged the authorities to address existing fiscal imbalances without delay. They stressed that it was essential to contain current spending, notably on payroll costs, and restore budgetary discipline, particularly by eliminating payment arrears. Directors also encouraged the authorities to limit the strain on the budget from the public health system by tightening entitlements, introducing co-payments and deductibles, and increasing contribution rates, if necessary. They welcomed the ongoing review of the public employees' pension fund (APFA) and called for a revision of pension entitlements with a view to ensuring the pension system's financial viability.

Directors encouraged the authorities to strengthen budgetary management procedures, and supported the authorities' intentions to reform the tax system and its administration. Directors agreed with the authorities' objectives to simplify the tax system, curtail special tax treatments, and increase reliance on indirect taxes. They suggested that the authorities consider introducing a broad-based consumption tax.

Directors commended the authorities for their prudent management of monetary policy as demonstrated by the credibility of the peg of the Aruban florin to the U.S. dollar, supported by a strong reserves position. Directors considered that the tight monetary policy stance adopted by the Central Bank of Aruba in early 2000 was appropriate and should be maintained until demand pressures abate—a development that was already underway. They endorsed the authorities' efforts to introduce flexibility in the monetary policy framework, and further liberalize external capital transactions. Directors considered that the gradual elimination of remaining credit and capital balance restrictions should be implemented in parallel with measures to strengthen the liquidity and prudential requirements on the banking system, and with reinforced supervision.

Directors observed that Aruba had made substantial progress in strengthening the regulatory and supervisory framework for onshore and offshore financial activities, including in the area of fighting crime related to international financial transactions. They also welcomed the agreement reached with the OECD on harmful tax practices. The authorities were encouraged to sustain the pace of reforms in the supervisory area through prompt passage of the necessary legislation regarding the regulation of company service providers in the offshore sector.

Directors encouraged the authorities to advance the pace of privatization, particularly in telecommunications, in order to boost private investment and improve productivity and competitiveness. Plans to grant operational autonomy to the Aruban Tourism Agency (ATA) and include the private sector in its management were welcomed.

Directors urged the authorities to intensify their efforts to improve the statistical base, and noted that progress in this area was essential to increase transparency, facilitate economic decision making, and allow effective surveillance. In particular, Directors emphasized the importance of providing timely budgetary data, economic activity and labor market indicators, and national accounts in accordance with standard international methodologies.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2001 Article IV Consultation with Kingdom of the Netherlands—Aruba is also available.

Kingdom of the Netherlands—Aruba: Selected Economic Indicators

	1997	1998	1999	2000
		(Percent change)		
Real economy				
Real GDP	4.1	3.0	4.5	2.5
Nominal GDP	7.2	4.9	6.9	6.6
Tourist earnings	8.9	9.2	8.0	6.2
Inflation (period average)				
CPI (Aruba)	3.0	1.9	2.3	4.0
Real exchange rate index (1995=100)[1]	100.9	101.2	101.3	102.1
		(In millions of U.S. dollars)		
Balance of payments				
Current account	-196	-19	-327	283
(In percent of GDP)	-11.9	-1.1	-17.1	14.4
Non-oil current account	-17	-13	19	19
(In percent of GDP)	-1.0	-0.8	1.0	1.0
Financial and capital account	180	69	338	-305
Errors and omissions	-3	1	-8	7
Change in reserves (- = increase)[2]	18	-51	-3	15
		(Percent change)		
Monetary aggregates				
Net foreign assets	-9.2	40.5	3.3	-7.2
Net domestic assets	11.1	1.9	14.4	7.1
Quasi-money	3.7	11.7	11.8	3.0
		(In percent of GDP)		
Public finances central government				
Balance	-1.5	0.0	-0.3	-0.8
External debt	10.1	11.4	10.0	10.6
Domestic debt	15.7	14.4	12.4	11.5
U.S. dollar	The Aruban florin is pegged to the U.S. at Af. 1.79=US$1			
SDR (end of period)	2.42	2.52	2.46	2.33

Sources: Data provided by the Aruban authorities; and IMF staff estimates.

[1]Relative to the U.S. dollar. CPI based. Period average.
[2]Including gold, excluding revaluation differences.

Statement by J. de Beaufort Wijnholds, Executive Director for the Kingdom of the Netherlands—Aruba
August 22, 2001

Introduction

The authorities concur with the broad thrust of the staff's recommendations, and thank them for the thorough and well-balanced analysis of both the achievements and the remaining challenges for the Aruban economy.

Aruba stands out as a positive example of an economy where the Fund's surveillance has a significant impact. The central bank, for instance, is presently already preparing an action plan to implement recommendations made by the mission. Also, given some of the shortcomings that still exist in certain data categories, the report serves as an authoritative document describing the state of the economy (the Fund's numbers are an important part of the official dataset on which policy is based). This underscores the importance attributed by both the government and the general public to the Fund's bi-annual Article IV report. Needless to say, the authorities intend to publish the staff documentation.

General Outlook and Fiscal Policy

Aruba remains one of the successful economies in the Caribbean with average growth of roughly 5 percent over the past decade and GDP per capita at roughly $ 22,000. However, partly due to the unfavorable external environment growth decelerated quite sharply as of the second half of 2000, with growth in 2001 now expected to come out at 1.5 percent. Inflation remains subdued, reserves comfortable (at roughly 5-6 months of imports), public debt levels very low albeit increasing (22 percent of which roughly half is external), and unemployment is virtually non-existent (despite a roughly 50 percent increase in the size of the population in the last 15 years). The exchange rate peg to the dollar has been unchanged since 1986 when the Aruban florin was first issued and, coupled with a healthy financial sector, this has produced a climate of stability conducive to private sector enterprise.

The authorities agree that there are fiscal issues that need to be tackled, including the need to curb entitlements, strengthen tax administration, and further bolstering the pension and health system. The new health system AZV in particular is being closely monitored in its first full year of operation, as cost overruns are already putting pressure on the budget. This is contributing to a deterioration in the fiscal position and in 2001 a fiscal deficit of 2.5 percent GDP may be reached. Nevertheless, Aruba remains committed to achieving a balanced budget.

Monetary Policy and Financial Sector

The Central Bank of Aruba (CBA) continues to successfully maintain the exchange rate peg with the dollar through an appropriately tight monetary stance. Staff rightly notes that, as a result, Aruba has "enviable financial stability". CBA and staff had extensive discussions on the possibility of moving to more indirect instruments of monetary policy. There is general agreement on the desirability of doing so, but there are sequencing issues not least due to the absence of a well-developed capital market. The authorities are in agreement with the road map sketched by staff in the report and are considering the preparatory steps needed in this regard. They are also seeking assistance from the Netherlands to study if it is feasible to move away from the direct credit control system and the switch to more market based instruments. As part of this overall strategy it is also being considered to raise the limits under which capital transactions can freely take place. This will be a cautious and gradual process, moving hand in hand with a further strengthening of prudential supervision.

The banking sector is considered sound with capital adequacy at over 10 percent. Foreign presence is high with five out of six commercial banks being associated with foreign banking groups. Aruba has only two offshore banks, both of which are US-based (a branch and a subsidiary of Citibank) and fall under the consolidated supervision of the US authorities. An important development is that the Central Bank, aside from supervising all credit institutions and company pension funds, is now also responsible for supervising the insurance sector. The government is also considering to have CBA take over the supervision of company service providers in order to strengthen supervision and subject these companies to greater transparency and a proper licensing system. It should be noted though that Aruba's offshore sector is quite small compared to other islands in the region. As the staff report notes, Aruba is in the process of completing the first phase of an offshore financial sector assessment.

Structural Issues and Tourism

Tourism remains the mainstay of the Aruban economy. Aruba is now the seventh largest tourism destination in the Caribbean with over 700,000 stayover tourists (and another 500,000 cruise tourists), putting it just behind Jamaica and Puerto Rico, two much larger countries. Tourism arrivals increased by 5.5 percent in 2000 while hotel occupancy fell to 76 percent, due largely to the completion of the expansion of one large hotel. This is still among the highest occupancy rates in the region. The US continues to be the most important market with roughly 64 percent of tourists. This is followed by Venezuela (16 percent), Colombia and the Netherlands (each roughly 4 percent). Particularly noteworthy was the 70 percent surge in the number of cruise ship passenger arrivals. More large ships included Aruba in their itinerary, partly because it lies outside the hurricane belt.

A positive recent development is that Aruba has been able to increase the number of flights from all major US carriers to Aruba. This has partly allowed it to increase the number of US tourists, while tourists from Europe and South America remain relatively constrained in their flying options. Air Aruba accounted for 50 percent of flights from South America. Following its bankruptcy, its slack was picked up by other airlines but the number of flights to/from South America has still not been fully restored.

Thanks to the agreement reached with the OECD in May/June, Aruba has been removed from the list of jurisdictions with harmful tax practices. As regards anti-money laundering efforts, Aruba spearheads efforts in the region as the current chair of the Caribbean Financial Action Task Force. It also recently received a favorable assessment from the FATF when it was determined that it met 26 of 28 FATF recommendations requiring specific actions. This is only one less than the Netherlands and substantially more than most major industrial countries.