



TECHNICAL ASSISTANCE REPORT

KINGDOM OF THE NETHERLANDS- ARUBA

Options for a New Rules-Based Fiscal Framework

MARCH 2025

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Abbreviations and Acronyms

AFS	Annual Financial Statement
ATA	Aruba Tourism Authority
AZV	Algemene ziektekostenverzekering
CD	Capacity Development
CAD	Central Audit Department
CAft	College Aruba Financieel Toezicht
CBA	Central Bank of Aruba
CBS	Central Bureau of Statistics
CCRIF SPC	Caribbean Catastrophic Risk Insurance Facility Segregated Portfolio Company
CG	Central Government
COM	Council of Ministers
DEACI	Department of Economic Affairs, Commerce, and Industry of Aruba
DOF	Directorate of Finance
FAD	IMF's Fiscal Affairs Department
FPB	Fiscal Policy and Budget Division
FRAT	IMF's Fiscal Risk Assessment Tool
FROC	Grenada's Fiscal Responsibility Oversight Committee
FRS	Fiscal Risk Statement
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GG	General Government
GOA	Government of Aruba
HCT	IMF's SOE Health-Check Tool
ICT	Information and Communication Technology
IFMIS	Integrated Financial Management Information System
LAft	Financial Supervision Law
LVO	Landsverordening (National Ordinance)
MARUBA	Forecasting Model of the Aruban Economy
MoF	Ministry of Finance
MTBF	Medium-Term Budget Framework
MTFF	Medium-Term Fiscal Framework
NIE	Non-Interest Expenditure
NFPS	Non-financial Public Sector
PFM	Public Financial Management
PPPs	Public private partnerships
SIDS	Small Island Development State
SNA	System of National Accounts
SOEs	State-owned enterprises
SVB	Sociale Verzekeringsbank

Preface

In response to a request made by the Aruban's Minister of Finance and Culture, Mrs. Xiomara Maduro, in June 2024, a team from the Fiscal Affairs Department (FAD) of the International Monetary Fund organized virtual meetings, prepared technical analyses, and performed virtual presentations to the Aruban authorities from August 29 until November 1, 2024. Subsequently, the team went on an in-person mission from November 5-12, 2024, to conclude its analyses aiming to support the Aruban authorities with designing a new fiscal rule. The goal of the new fiscal rules is to enhance Aruba's public debt sustainability, integrating a new law as part of a Protocol with the Kingdom of the Netherlands. The mission team comprised Mmes. Lesley Fisher (CARTAC) and Sophia Whyte-Givans (FAD), and Messrs. Marcos Poplawski-Ribeiro (head) and Ervin Prifti (both from FAD).

The analyses and findings were presented during the in-person mission to the Prime Minister of Aruba, Her Excellency, Ms. Evelyn Wever-Croes; to the Governor of Aruba, His Excellency J.A. Alfonso Boekhoudt; and to the Minister of Finance and Culture. The IMF team further met with several members of the Ministry of Finance as well as other Ministries, including Mr. Nilo Swaen (Advisor to the Minister of Finance), Mrs. Mildred G.M. Schwengle (Chair of the Aruba negotiation committee, Advisor to the Government of Aruba), Mr. Derrick Werleman (Director of the Department of Finance), Mrs. Jo-Ann Kock (Head of Budget and Fiscal Affairs), Mrs. Yshela Geerman (Economist) and Mr. Louis Paris (Head of Treasury). Mrs. Luenne Gomez-Pieters (Director of the Department of Taxes), Mrs. Maria Dijkhoff-Pita (Director of Department of Economic Affairs, Commerce and Industry), The findings were shared also with the Central Bank of Aruba in a meeting including Mr. Prakash Mungra (Executive Director Supervision & Enforcement), Mr. Ryan R. Peterson (Division Manager Economic Policy & Financial Stability), Mrs. Miriam Gonzalez (Executive Director), and Mr. Giancarlo Croes (Division Manager Research). Meetings were also held with Mr. George Croes (Director of the Department of Legislation and Legal Affairs), Mrs. Jancis Tromp (Legislative Lawyer) and Mrs. Mariska Koolman (Legislative Lawyer) from the Ministry of General Affairs, and teams from the Ministry of Tourism, the Boards of financial supervision (CAft), the Aruba Tourism Authority, and the Aruba Bankers Association. In a special hearing, the IMF team further met with members of the Budget Commission of Aruba's Parliament, including the President of Parliament's Budget Commission, Mr. Miguel Mansur. Moreover, prior to and during the mission, the team also met virtually the Dutch team in charge of the drafting and negotiation of the new Kingdom Act in the person of Mrs. Inge Mulders as well as other representatives of the Ministry of Internal and Kingdom Affairs of the Netherlands and Ministry of Finance of the Netherlands.

The mission wishes to express its sincere appreciation for the excellent support and cooperation given by senior-level authorities, officials, and staff of these various entities and agencies from Aruba and from the Netherlands. The mission is also thankful to outstanding support provided by Mr. Marco Arena (IMF Mission Chief for Aruba), Mrs. Olga Bepalova (IMF Desk for Aruba), Mrs. Shelley Li (research assistant), and Mrs. Viviane Passarani (FAD), who provided exceptional administrative support.

Executive Summary

Public debt management is a key policy objective for Aruba, especially in the context of economic vulnerabilities stemming from its reliance on tourism and external factors. These vulnerabilities became increasingly evident in the decade following the Global Financial Crisis of 2008, during which central government debt surged by more than 30 percentage points of GDP, with a debt level in 2019 above 70 percent of GDP. The onset of the COVID-19 pandemic further exacerbated these challenges, starkly highlighting Aruba's economic vulnerabilities. The dramatic decline in tourism revenue during the pandemic resulted in a significant spike in public debt, with gross central government debt reaching 112.3 percent of GDP in 2020. However, since that peak, there has been a notable reduction in public debt, primarily driven by fiscal tightening measures and the implementation of a revised fiscal rule aimed at achieving a minimum annual overall surplus of 1 percent of GDP and reducing public debt to 50 percent of GDP by 2040. This strategic approach reflects Aruba's commitment to enhancing its fiscal resilience and ensuring sustainable economic growth in the future.

The recent improvements in macroeconomic and fiscal dynamics have paved the way for initiating discussions to prepare a new Consensus Kingdom Act with the Netherlands. Two primary objectives are envisaged: first, to reformulate Aruba's fiscal rules and introduce a preferential capital loans facility; and second, to implement a restructuring of the Dutch liquidity support loan by reducing the interest rate to below 3.5 percent and to refinance part of Aruba's external debt. Such a reduction and refinancing would significantly alleviate Aruba's debt servicing burden, fostering greater financial stability, and enabling the government to allocate resources more effectively towards economic recovery and growth.

Against this backdrop, the IMF capacity development (CD) mission was requested by the Government of Aruba to support the design of a new set of fiscal rules and improvements in public financial management (PFM). Both measures aim at enhancing the credibility of Aruba's fiscal framework. While the table in the next section outlines key recommendations derived from the analyses, detailing specific topics, proposed institutions for implementation, and suggested timelines; below, some of the most critical recommendations are highlighted for consideration.

First, a key recommendation is to simplify the existing fiscal rules while ensuring alignment with international best practices. In line with this principle, the mission advises that Aruba should establish only one or two fiscal rules, eliminating provisions related to the wage bill ceiling and the allocation of windfall revenues. Given the current macroeconomic landscape and potential future shocks, it is recommended that public debt be aimed at 50 percent of GDP in order to confidently remain below the 70 percent debt limit. Therefore, the Aruban authorities could adopt a central government debt anchor set at 50 percent of GDP, targeted to be achieved within a decade by 2035. Given Aruba's recent fiscal performance and fiscal projections, the time horizon suggested appears to be feasible, in line with authorities' objectives, while strongly safeguarding fiscal sustainability. Incorporating this anchor into legislation associated with the new Kingdom Act would constitute the first of the two recommended fiscal rules. Presently, Aruba's economy is constrained by a debt level of 70.8 percent of GDP, and it is crucial that fiscal efforts continue as outlined in the IMF's 2024 baseline projections to sustain a trajectory of debt reduction and successfully reach the proposed debt anchor. Extending the timeline for achieving this debt

anchor could introduce increased uncertainty regarding future fiscal outcomes, particularly given the significant risks the island faces related to climate change, demographic shifts, and delays in enhancing PFM capacities.

Second, this report offers various operational rule options that Aruba can implement to facilitate the convergence of its public debt toward the medium-term anchor, without intending to provide a definitive prescription. To assist the authorities in reaching the medium-term debt anchor of 50 percent of GDP by a particular horizon (e.g., 2035), the mission analyzed and calibrated two main types of operational rules: primary balance rules and expenditure rules. In examining a primary surplus rule, our baseline simulations suggest that the target for the primary surplus could be set between 3.1 and 3.7 percent of GDP, depending on the timeline for achieving the debt anchor (set for 2035) and the duration of the convergence period toward this fixed primary surplus target. Alternatively, the implementation of an expenditure rule presents another viable operational target. This rule would impose limits on the fiscal policy component that the Aruban government can effectively manage through its budgetary processes and cash management practices: expenditures. One advantage of a primary balance rule compared with an expenditure rule is that the former incentivizes a closer attention to revenue collection and potential coordination with other departments of the Ministry of Finance during the budget formulation and execution, with the rule providing more options to the government in achieving its fiscal targets.¹

Third, the new fiscal rules would greatly benefit from several key components: (i) well-defined escape clauses that allow for flexibility in response to extraordinary circumstances, ensuring that the rules can adapt to unforeseen challenges; (ii) a clear correction mechanism designed to address deviations from the established rule limits, providing a structured approach for transitioning back to compliance; and (iii) the establishment of a national fiscal council that could come into effect in the coming months, or once the debt anchor is achieved and certain provisions of the Kingdom Act are no longer applicable.

Fourth, to enhance the effectiveness of fiscal rules and public debt management, Aruba should consider implementing a more robust Medium-Term Fiscal Framework (MTFF) that builds up from its current one. The report elaborates on how the new suggested framework advances Aruba's current MTFF and Medium-Term Budget Framework. This framework, anchored by the established debt target, would facilitate a comprehensive approach to fiscal management, enabling a more coherent alignment between short-term budgetary decisions and long-term economic objectives. By enhancing its fiscal framework, Aruba can significantly improve transparency, accountability, and sustainability in its public finances, ultimately creating a healthier economic environment for its citizens and future generations.

Simultaneously, it is essential to assess and strengthen the institutional capacity of the Directorate of Finance to ensure the effective implementation of the fiscal rule. This review would help identify areas for capacity building and resource allocation that are critical for the successful execution of a credible MTFF. Furthermore, the legal framework supporting the fiscal rule requires thorough examination, and relevant transitional arrangements should be established to ensure alignment with the budget cycle and other PFM requirements. Additionally, to further enhance credibility with creditors and lower borrowing costs, authorities should further enhance transparency through improved communication and the publication of documents and information related to the budget process and fiscal

¹ Meanwhile, the adoption of an expenditure rule could help in addressing the main source of fiscal slippages observed in Aruba in recent years.

policy. By addressing these elements, Aruba can create a solid foundation for sustainable fiscal governance and economic resilience.

In addition to the recommendations detailed in the forthcoming table, each section of the report provides more granular proposals tailored to specific areas of focus. These sections not only outline the recommendations but also offer essential background information that supports their inclusion in the table below.

Recommendations

Recommendations	Responsibility ¹	Timeline ²
Ensure consistency between the operational targets of the fiscal rule and the medium-term debt anchor	MoF	Short Term
Establish a sound correction mechanism to guide the transition or return to the fiscal rule targets in case temporary deviations of the debt path towards the debt anchor are observed	MoF	Short Term
Enhance the MTFF, including by adopting binding aggregate and individual fiscal ceilings	FPB, Treasury, DOF, Tax Department	Short Term
Clarify the effective date for transitional fiscal rules provisions in the legal framework to address, for example, coverage of general government and the public sector	Legal Department, DOF	Short term
Enshrine fiscal transparency to allow easy and direct public access on DoF website	Legal Department, FPB, DOF	Medium Term
Strengthen fiscal risk analysis and produce a more comprehensive fiscal risk statement	FPB, Treasury, DOF	Short Term
Make greater use of State Decrees, for example, to innovate and allow flexibility to adapt to changes	Legal Department, DOF	Short Term
Introduce a home-grown fiscal council	DOF, Legal Department, Parliament	Medium Term

Improve transparency by reporting on performance against fiscal rule and publishing all budget and fiscal reports on MoF website	FPB, DOF, and Court of Audit	Short Term
Integrate tax policy and revenue collection strategies to adhere to the fiscal rule	Tax Department, FPB, DOF	Short Term
Address backlog in annual financial statements, audit, and backlog in national accounts up to 2024	DOF, Court of Audit, CBS, CAD	Short Term
Maintain annual financial statements as well as annual national accounts updated from 2024 onwards	DOF, Court of Audit, CAD, CBS	Short Term
Introduce a contingency reserve to address fiscal shocks	FPB, Treasury, DOF, Legal Department	Short Term
Explore contingent financing instruments and parametric insurance with multilaterals and CCRIF SPC	FPB, Treasury, DOF	Medium Term
Improve coordination and reinforce liquidity management by establishing a cash management committee and regular fiscal policy meetings	Treasury, FPB, DOF	Medium Term
Conduct a comprehensive gap assessment vis-à-vis capacity to implement the new fiscal rules framework	DOF, Department of Human Resources	Medium Term

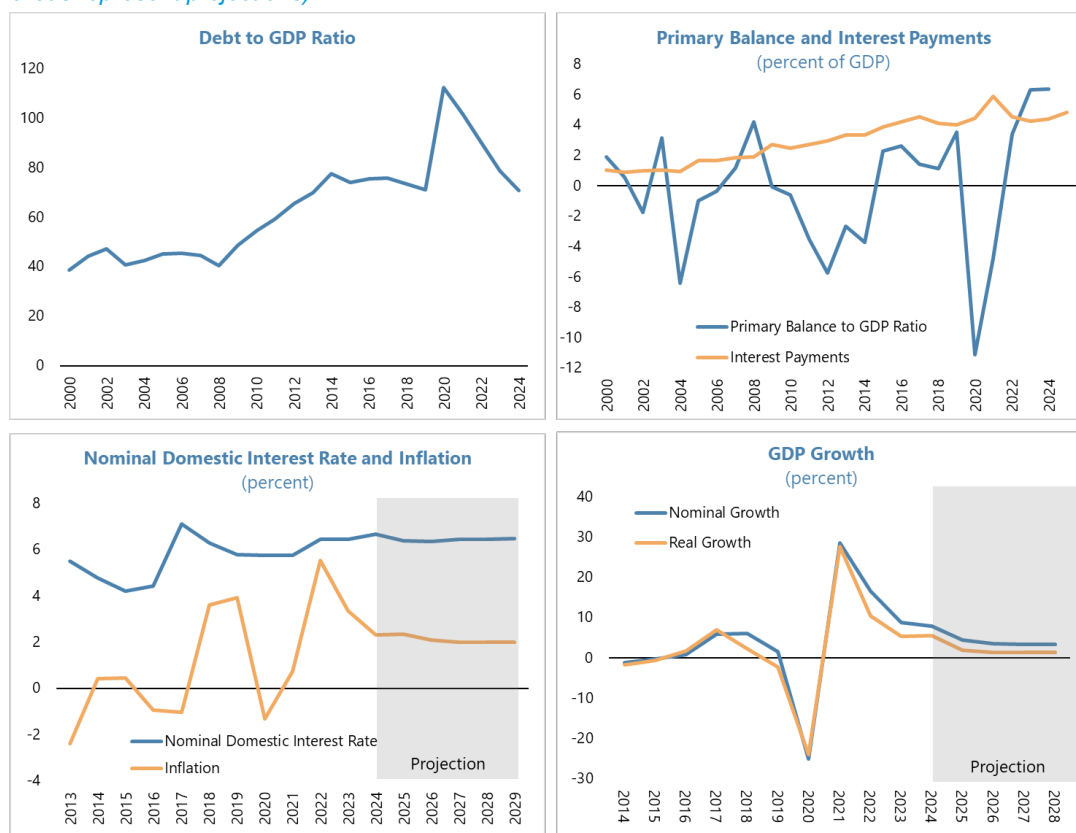
Source: IMF staff analyses.

Notes:¹ The acronym of the entity can be found in our list of acronyms.² Short-term is here defined as a horizon of 12 months, whereas Medium-term is here defined as a horizon of 24 months.

I. Introduction

1. In the decade following the global financial crisis (GFC), Aruba's central government debt steadily increased, remaining at around 70 percent of GDP in 2019 (Figure 1).² This rise in public debt, which exceeded 30 percentage points of GDP since the GFC and until 2019, can be attributed to a volatile primary balance. Additionally, patterns of public spending, particularly the growing cost of debt servicing, have played a crucial role in contributing to the volatility of fiscal balances and the overall increase in public debt (Figure 2). As a response to these challenges, Aruba agreed with the Netherlands, as part of available cooperation structures in the Kingdom of the Netherlands established in the Charter for the Kingdom (*Statuut voor het Koninkrijk der Nederlanden*), on a protocol of financial supervision. And, as a result thereof, Aruba implemented reforms to its fiscal rules in 2015, followed by further adjustments in 2018 and 2023 (see Box 1).

Figure 1. Evolution of Macroeconomic Variables in Aruba
(Shaded areas represent projections)



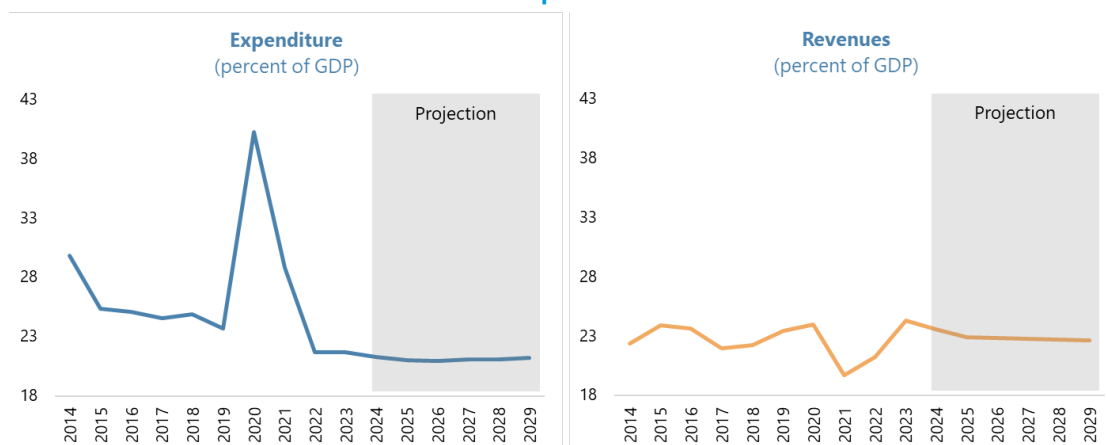
Source: IMF, World Economic Outlook database; and IMF staff calculations.

2. The impact of the COVID-19 pandemic on public finances was particularly severe in Aruba, as the global halt in tourism in 2020 resulted in significant economic challenges. This

² All data used in this report have been provided by the authorities and may not fully coincide with the data from the IMF's World Economic Outlook database.

unprecedented situation led to a peak public debt of 112.3 percent of GDP, driven by low revenue mobilization coupled with heightened spending needs during the pandemic and a dramatic contraction in GDP. During this critical period, the Kingdom of the Netherlands extended financial support to help stabilize Aruba's public finances. However, with the recovery of the tourism sector and the gradual reduction of pandemic-related expenditures since 2021, the debt-to-GDP ratio has significantly improved, falling below 80 percent in 2023. This reduction has been achieved through a combination of enhanced revenue measures and prudent expenditure controls.

Figure 2. Evolution of Fiscal Revenues and Expenditure in Aruba



Source: IMF, World Economic Outlook database; and IMF staff calculations

3. The improvements in macroeconomic and fiscal dynamics have initiated discussions to revise the existing supervisory arrangements, focusing on two primary objectives: (i) to establish a Kingdom Act with reformulated fiscal rules and introduce a preferential capital expenditure financing facility; and (ii) to implement a restructuring of the Dutch liquidity support loan, specifically by reducing the interest rate to below 3.5 percent and refinancing part of Aruba's external debt. This adjustment would alleviate debt servicing burdens for Aruba and enhance overall financial stability. In this context, the Government of Aruba has requested support from the IMF CD mission to assist in the design of a new set of fiscal rules and public financial management (PFM) reforms aimed at bolstering the credibility of its fiscal framework.

4. The first objective of this report is to explore various options for fiscal rule designs, considering the current macro-fiscal context of Aruba. In conducting this analysis of potential fiscal rules, the report specifically focuses on three key aspects: (i) it evaluates the likelihood of achieving the debt anchor of 50 percent of GDP across several alternative convergence horizons, including the timeframe established in the existing rule; (ii) it assesses the potential debt dynamics in the medium term, taking into account projections of macroeconomic drivers and the impact of likely future shocks; and (iii) it proposes operational rules to guide the attainment of the desired debt anchor through various alternative fiscal paths.

Box 1. Aruba's Current Fiscal Framework

As Aruba's public debt nearly doubled in the six years following the 2008 Global Financial Crisis, a protocol concerning Aruba's public finances was established between Aruba and the Netherlands in May 2015. One of the primary objectives of this protocol was to create a structurally independent framework for overseeing Aruban public finances, particularly regarding the formulation and implementation of government budgets. This initiative aimed to maintain fiscal credibility and prevent excessive growth in debt levels.

The resulting legislation, known as the National Ordinance Aruba Temporary Financial Supervision (LAft), outlines rules for the independent monitoring of the country's budgets and related financial matters. The rules envisaged by the LAft apply to the collective sector which includes the State (Land) or central government (CG), statutory bodies responsible for the implementation of social and national insurance, and statutory bodies that rely on collective levies for more than 50 percent of their income. Oversight is conducted by an independent body—the Aruba Financial Supervision Board (CAft). Article 14 of the LAft further establishes an operational rule, but without specifying a medium-term debt anchor. The ordinance stipulates a defined four-year trajectory for the overall balance (as a percentage of GDP) for the years 2015 to 2018, with targets set at -3.7, -2, -0.5, and 0.5 percent of GDP, respectively.

As a follow-up to the 2015 Protocol, the 2018 Protocol was agreed in November 2018, framing the path towards solid, transparent, and sustainable public finances of Aruba. Under the new protocol, the LAft was amended to add new budgetary norms, including an explicit debt anchor that further restrains budget management to increase fiscal discipline. The latter provisions created a tradeoff in terms of complexity of the fiscal rule and the ability of the authorities to monitor and track performance. Key elements include:

Overall balance target for years 2019-21 of -0.5, 0.5, and 1 percent of GDP, respectively.

Debt-to-GDP ratio target of 70 percent of GDP by 2027, and 50 percent of GDP by 2039.

Personnel costs reduction of Aruban Florins (AWG) 479 million by 1 January 2019.

Spending of **windfall revenues** in equal share in debt reduction and investments.

Compensation rules for structural and incidental setbacks.

The pandemic severely impacted Aruba, particularly its tourism sector. The Council of Ministers of The Kingdom granted Aruba's requests for temporary deviation from the budgetary norms in 2020, 2021 and 2022, as the COVID-19 pandemic greatly impacted the economy and public finances. In January 2022, the 2018 Protocol was extended by 2 years until December 31, 2023. Financial supervision has therefore been continuous and without any interruption since 2015.

The interest-free COVID-19 loans of AWG 916 million were refinanced and converted into a 20-year amortized at 6.9 percent in October 2023. In June 2024, Aruba and the Netherlands formally signed an administrative agreement to reduce the interest rate on the COVID loans from 6.9 percent to 5.1 percent for up to two years. After the Kingdom Act comes into effect, the interest rate will be further reduced to the yield on Dutch government bonds plus 20 basis points.

The LAft was amended in December 2023 to incorporate the new budgetary norms and thus extending supervision beyond 2023. The budgetary norms are as follows: a fiscal surplus of minimum 1 percent of GDP from 2023 onwards, a public wage bill of no more than 10 percent of GDP in 2027, and a debt-to-GDP ratio of maximum 50 percent in 2040.

5. The second objective of this report is to offer recommendations regarding essential PFM foundations that are critical for establishing a credible and effective new fiscal rule. To achieve this, the report assesses the current PFM institutions that underpin the budget process and facilitate the implementation of existing fiscal rules. Additionally, it provides international examples and best practices related to legal provisions for the design and implementation of PFM clauses, such as escape clauses, which are vital for the success of the new fiscal rules. By leveraging these insights, the report aims to enhance the robustness of Aruba's fiscal framework.

6. One of the main recommendations of the TA mission is to simplify fiscal rules while ensuring they are aligned with international good practices. This involves establishing a clear debt anchor set at 50 percent of GDP, aimed for achievement by 2035, which would signify a strong commitment to fiscal responsibility and long-term economic stability. Additionally, the team conducted simulations to explore numerical rules that utilize the primary balance or the expenditure ratio to GDP as operational targets, providing a practical framework for maintaining fiscal discipline and guiding budgetary decisions.

7. On the PFM front, the mission underscored the critical importance of further developing a MTFF to ensure that fiscal plans are effectively aligned with economic objectives. Key proposed amendments to the legal framework include the introduction of escape clauses and correction mechanisms designed to address deviations from the established fiscal path and facilitate a return to fiscal discipline. These provisions would offer essential flexibility during periods of external shocks while reinforcing the commitment to sound fiscal management. Furthermore, other essential elements of the proposed framework involve enhancing transparency, promoting better coordination, and improving communication among authorities during the formulation of fiscal policy. Timely preparation of high-quality year-end financial statements is also crucial, as it supports accountability and informed decision-making in fiscal management.

8. This report also advocates for the establishment of a national fiscal council tasked with overseeing the implementation of the new fiscal rules and ensuring accountability, particularly when the current local supervisory legislation is replaced by a Kingdom Law. The proposed fiscal council would be instrumental in monitoring fiscal compliance and delivering independent assessments of fiscal policy outcomes.

9. The remainder of this report is organized as follows. Section II evaluates the design and performance of the current fiscal rule against two key contexts: international best practices in fiscal rule design and the economic outcomes associated with the existing rule. Section III employs an empirical framework to identify the prudent range for the debt limit and anchor in Aruba, while also calibrating a consistent fiscal deficit path aimed at achieving the proposed debt anchor set by the authorities. This section considers the risks related to the economic outlook and the adoption of either an operational rule focused either on the primary balance or one based on primary expenditures. Section IV examines the necessary public financial management (PFM) reforms and budget institutions required for Aruba to implement a credible and effective fiscal rule. Section V concludes the report.

II. International Experience and Challenges

10. Despite recent challenges, Aruba's explicit medium-term debt anchor, along with operational limit(s), appears in line with international experience in terms of fiscal rule design.

Indeed, the fiscal anchor should be linked to the objective of fiscal sustainability and defined in terms of a stock variable (generally, gross, or net debt). Anchoring fiscal policy to a stock variable is appropriate because the government's balance sheet position, the debt servicing cost and financing needs, as well as the liquidity and solvency risks that this position originates, ultimately drive considerations about fiscal sustainability. However, because stock variables are not under the full and direct control of the authorities, the anchor should guide fiscal policy only over the medium term (Eyraud and others, 2018a).³ One (or few) operational limit(s) should instead guide fiscal policy over the short run. The operational limits should be set on a flow variable—e.g., either the primary balance or government expenditure—under the direct control of the authorities and be linked to the short-term objective of economic stability. Such operational limits are meant only to define a perimeter within which discretion can be exercised; they should not be interpreted as targets for fiscal policy. To ensure fiscal policy remains anchored, the short-run operational limits should be consistent with the medium-term anchor, that is, at a level such that, given the features and structural parameters of the economy, the stock variable remains at or around the anchor over the medium-term, on average.

11. **Not only is anchoring recommendable, conceptually, but it is also common in practice.** As of 2021, about 105 countries worldwide had adopted a framework that included at least one type of fiscal rule (Davoodi and others, 2022),⁴ many of which (85) include an explicit cap on gross public debt (Figure 3). For operational limits, budget balance rules are often used to anchor debt within the ceilings.⁵ About 70 percent of countries that adopted fiscal rules have a debt rule combined with operational limits on annual budget aggregates. Among those, one third had a debt rule together with a deficit limit and an expenditure ceiling, while another quarter of economies had a debt rule combined with a budget balance rule (Figure 3).

12. **A second pillar of a well-designed fiscal rule relates to flexibility.** Flexibility, underpinned by correction mechanisms, strengthens the credibility of a rules-based framework by preserving the economic stabilization function of fiscal policy. The fiscal rule design can contain some appropriate flexibility, primarily by avoiding constraining the fiscal deficit path to strict values and allowing automatic stabilizers to work,⁶ potentially affecting such deficit path. Flexibility can also be incorporated in fiscal

³ Eyraud, L., X. Debrun, A. Hodge, V. Lledó, and C. Pattillo. 2018. "Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability", IMF Staff Discussion Note No. 18/04, International Monetary Fund, Washington, D.C.

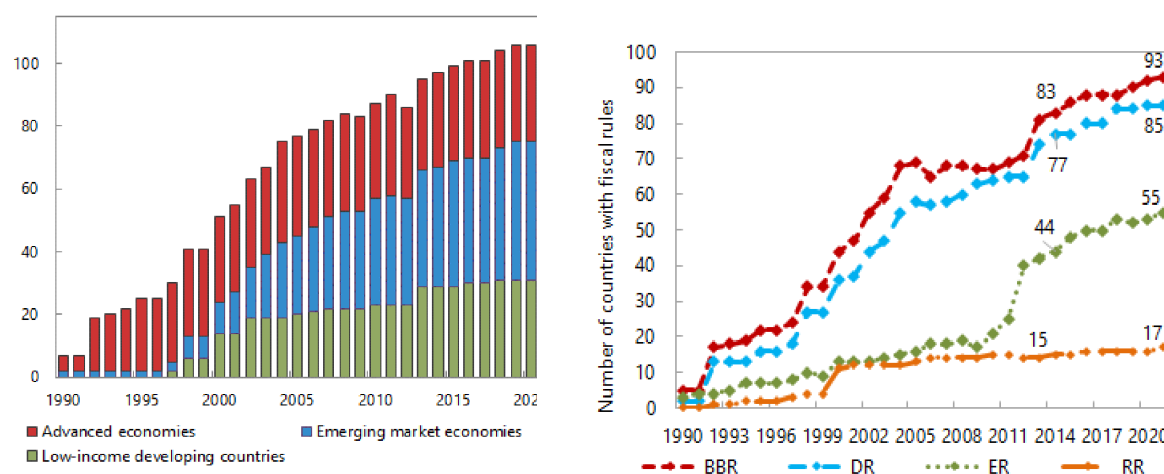
⁴ Davoodi, H. R., P. Elger, A. Fotiou, D. Garcia-Macia, X. Han, A. Lagerborg, W.R. Lam, and P. Medas. 2022. "Fiscal Rules and Fiscal Councils: Recent Trends and Performance during the Pandemic", IMF Working Paper No. 22/11, International Monetary Fund, Washington, D.C.

⁵ This is the case in Europe since the introduction of the Maastricht Treaty in 1992 and the Stability and Growth Pact in 1997. See, for example, Poplawski-Ribeiro, M. 2009. "New evidence of the effectiveness of Europe's fiscal restrictions," CEPII Working Paper No. 2009-13, Centre d'Études Prospectives et d'Informations Internationales, Paris, July.

⁶ Automatic stabilizers are economic policies and programs that automatically adjust government spending and taxation in response to changes in economic conditions, without the need for explicit policy intervention. These stabilizers, such as unemployment benefits and progressive tax systems, help to dampen the effects of economic fluctuations by increasing government spending during downturns and reducing it during expansions, contributing to stabilizing aggregate demand and supporting economic growth.

rules through counter-cyclical provisions and well-defined escape clauses to allow more proactive counter-cyclical policies in response to large and exceptional unexpected shocks. Adaptability, however, should not come at the cost of simplicity: complex provisions are hard to implement, monitor, and communicate. Also, while an appropriate level of flexibility strengthens the rule, too much of it weakens the grip of the anchor and ultimately erodes its credibility. Well-designed correction mechanisms that clearly specify the triggers and remedial actions to take in case of slippages provide an appropriate level of constrained discretion, safeguard the role of the anchor, and add credibility to the rule.

Figure 3. Fiscal Rules of Debt Anchor and Operational Limits Around the World
(Share in percent; unless stated otherwise)



Source: Davoodi and others (2022).

Note: BBR: Budget balance rule; DR: Debt rule; ER: Expenditure rule; RR: Revenue rule.

13. Aruba could strengthen its correction mechanism further to ensure a gradual return to the fiscal rule limits. As described in Box 1, Aruba's fiscal rule seems overly determined imposing restrictions on three dimensions of its fiscal policy and leaving little room for maneuver in case of unexpected shocks. The rule imposes limits on the general government's current spending. Moreover, the fiscal framework puts a significant weight on the NFPS debt anchor.

14. The third pillar of a well-designed fiscal rule is the combination of effective monitoring and reputation-based incentives for compliance. Even the best-designed fiscal rule would not serve its purposes if not complied with, either in letter or in spirit, either ex-ante or ex-post. In Aruba's case, the **Aruba Financial Supervision Board (CAft)** is responsible for monitoring compliance with the LAft and can cause an intervention by advising the Council of Ministers of the Kingdom of the Netherlands to assist if fiscal targets are not being met, thereby ensuring accountability and adherence to the fiscal framework. The CAft has an oversight role potentially intervening when a corrective mechanism has to be activated. If the government fails to comply with the established fiscal norms, the CAft has the authority to recommend corrective measures. Since the LAft explicitly mentions a debt anchor, monitoring should broaden its focus and take a more forward look at fiscal policy, including the trajectory of the debt path and the reasonableness of underlying macroeconomic assumptions. Country experience shows that transparency and monitoring by independent fiscal institutions (for example, a fiscal council) are a more

promising way than formal enforcement mechanisms to increase reputational costs and incentivize compliance with the fiscal rule.

15. Aruba has elements of a MTFF, but key components are not yet in place (see also Section IV). MTFFs complement fiscal rules by providing a structured, multi-year plan that aligns government revenue and expenditure projections with fiscal targets. The MTFF's forecasts and medium-term budget ceilings facilitate adherence to fiscal rules by offering a clear pathway to meet targets through annual budget cycles. As Section IV will elaborate in detail, including by providing recommendations, Aruba should embed its MTFF in a strong legal framework to enhance compliance with fiscal rules. Authorities should evaluate and update fiscal projections regularly, maintain fiscal transparency, and incorporate these plans within the broader budget process. This interaction between fiscal rules and MTFFs encourages policy continuity beyond individual administrations and strengthens fiscal accountability, as adherence to fiscal rules is routinely monitored within the MTFF's structured projections.

III. Fiscal Rules for Aruba—Key Design Considerations

A. A Probabilistic Approach to Aruba's Debt-to-GDP Ratio Evolution

16. In this section, we carry out several simulation exercises on Aruba's public debt using Eyraud and others (2018b)'s fiscal rule toolkit.⁷ In terms of simulations,⁸ first, we estimate a medium-term debt anchor that, if reached, would allow for sufficient buffers for the economy to face future shocks. Second, we analyze the sensitivity of the estimated anchor to changes in the fiscal stance of authorities. Third, we estimate the likelihood of debt to remain below the upper debt limit under alternative fiscal stance scenarios and starting values of debt. The analysis is done at the Central Government (CG) level, due to lack of data at the collective sector level.

17. The estimated debt anchor and the range that Aruba's debt ratio might take in the following six years are shown in Figure 4. In broad terms, the procedure to estimate this range is as follows.

- The basic framework uses the public debt dynamics identity, which links debt in the future to current debt levels, the primary balance, and macro variables (GDP growth, domestic and external real interest rates, exchange rate depreciation, terms of trade gap to GDP ratio, and foreign loan disbursements).
- A baseline path for each of the macro variables above is projected using annual data from 1996 to 2023, and a joint distribution of shocks is estimated.
- Primary balances are calculated using a fiscal reaction function (which relates changes in the primary balance to changes in debt).⁹ The reaction function itself is estimated using data specific to emerging market economies.
- To capture the fundamental uncertainties about future realizations of macro variables, 1,000 different paths are calculated by drawing shocks from the joint distribution (estimated using previous data). Each of these paths leads to a different path of the debt ratio, which are then used to calculate the bands in Figure 4.

18. In addition to the steps above, three key assumptions are made. First, the calculation includes an augmentation of the public debt owing to contingent liabilities of 4 percent of GDP accumulated over the next six years. This value is mostly driven by an assumption of positive stock-flow adjustments amounting to close to 0.67 percent of GDP per year, as discussed with the Aruban authorities. Second, the ratio of foreign-to-total debt is set at 58.8 percent, the last data point available from Aruba's national accounts. Importantly, the 5-year moving average of primary balances is set to not

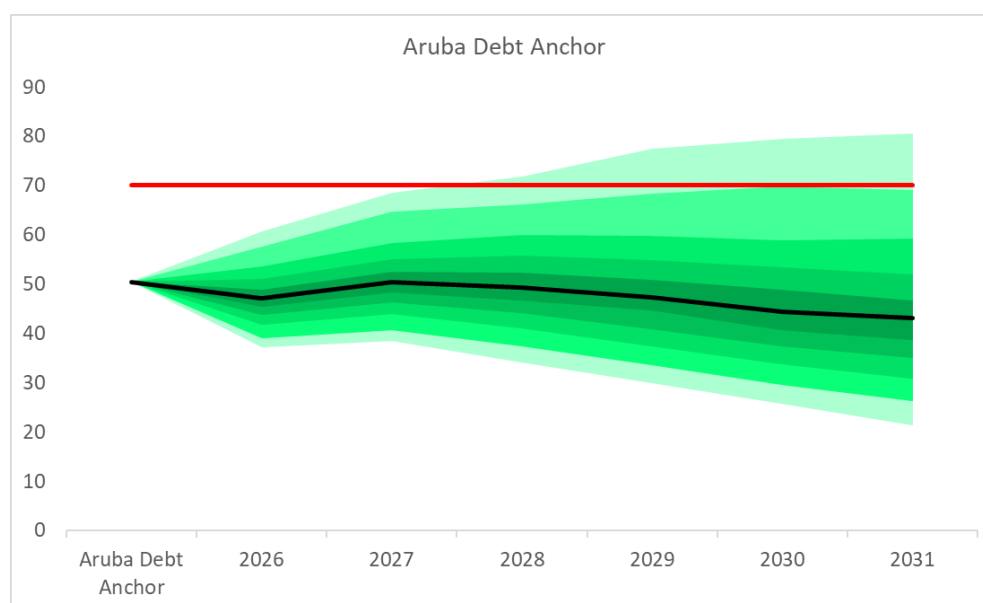
⁷ Eyraud, L., V.D. Lledo, P. Dudine, and A. Peralta Alva. 2018. "How to Select Fiscal Rules: A Primer." Fiscal Affairs Department—How to Note, International Monetary Fund, March.

⁸ For the PFM considerations related to the choice and design of the fiscal rules, please, see also Section IV of this report.

⁹ Aruba's currently has a fiscal rule set at the overall fiscal balance, which includes both the primary balance and the net interest payments (interest paid on debt minus interest received, if any). While the overall balance represents the government's total fiscal position, a positive primary balance is often required to reduce the debt-to-GDP ratio over time, especially for highly indebted governments.

exceed 5 percent of GDP, which implies a downward correction from the high surpluses of above 6 percent of GDP that Aruba has seen in the last couple of years. Given that interest payments amount to around 4 percent of GDP, a primary surplus of 5 percent should broadly equate to an overall surplus of 1 percent, which is the overall surplus level that Aruba currently has in its fiscal rule. At last, any potential risk from climate change is not currently in the simulations. Although the report will discuss these risks later, for Aruba, these risks are difficult to quantify, given the lack of data, but they do not appear to be as large as for other Caribbean economies.

Figure 4. Estimated Medium-Term Debt Anchor in Aruba Under Macroeconomic Shocks
(Percent of GDP)



Sources: Aruban authorities and IMF staff calculations.

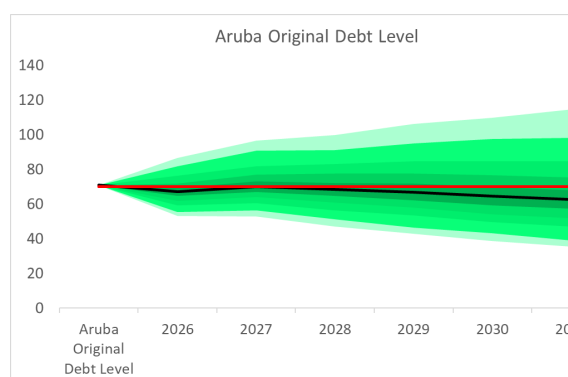
Notes: The black line in the center shows the median projected path, while the green bands represent confidence intervals around this baseline simulation. Lighter colors represent higher confidence: there is a 60 percent probability that debt over GDP remains below the upper limit of the darkest band; the subsequent band represents a 70 percent probability, followed by 80, 90, and 95 percent probabilities.

19. The estimated medium-term debt anchor for Aruba under the current macroeconomic conditions is around 50 percent of GDP, in line with the current provisions of the fiscal rule (Figure 4). Such a hypothetical starting level of debt would allow the country to remain below the 70 percent debt limit with high probability in the following six years through 2031, even if it was faced with sizable but likely shocks. The median trajectory of debt remains stable at the beginning of the period sample and falls further by the end of the six-year period, confirming the sustainability of such a debt level.

20. The estimation also suggests that Aruba's debt anchor and its primary balance path in the current fiscal rule are broadly consistent. Figure 5 shows the likely debt trajectory starting from its actual level of 70.9 percent of GDP in 2024. Table 1 shows instead the likelihood of reaching a certain debt value as percent of GDP from 2026 till 2031. The median trajectory is on a downward slope and reaches 62 percent of GDP by 2031, which is probably slightly above the level it should be in order to

reach 50 percent of GDP by 2035.¹⁰ The slow decline in debt despite the considerable fiscal effort assumed in this exercise reflects the negative differential between the real interest rate growth rate and the real economic growth ($r > g$) and the high weight of interest payments.¹¹ As seen in Table 2, which displays the numbers shown in Figure 5, there is approximately a 65 percent chance that the debt-to-GDP ratio remains below the 70 percent limit in 2031 *if it starts from the current level estimated for 2024*.

Figure 5. Projected Evolution of Debt/GDP in Aruba under Macroeconomic Shocks (Percent of GDP)



Sources: Aruban authorities and IMF staff calculations.
Notes: The black line in the center shows the median projected path, while the green bands represent confidence intervals around this baseline simulation. Lighter colors represent higher confidence: there is a 60 percent probability that debt over GDP remains below the upper limit of the darkest band; the subsequent band represents a 70 percent probability, followed by 80, 90, and 95 percent probabilities.

Table 1. Projected Evolution of Debt/GDP in Aruba under Macroeconomic Shocks (Percent)

Likelihood	2026	2027	2028	2029	2030
95	86.7	96.4	99.7	106.1	109.6
90	81.9	90.7	91.0	94.9	97.5
85	79.0	85.8	86.4	88.5	90.3
80	76.4	81.7	83.1	84.6	84.5
75	73.9	78.8	79.8	80.6	79.8
70	71.9	76.9	77.5	77.4	76.6
65	70.6	74.9	74.4	74.6	73.0
60	69.3	73.2	72.1	71.9	69.9
55	68.0	71.6	70.1	69.1	66.9
50	66.9	70.0	68.4	66.8	64.5
45	65.8	68.7	66.2	64.5	61.5
40	64.6	67.1	64.6	62.0	59.2
35	63.2	65.4	62.7	59.8	56.4
30	61.9	64.1	60.8	57.8	53.9
25	60.8	62.5	58.6	55.9	51.8
20	59.1	60.6	56.3	53.4	49.4
15	57.3	58.6	54.0	49.9	46.5
10	55.4	56.3	51.0	46.3	43.3
5	53.2	52.9	47.0	42.8	38.7

Sources: Aruban authorities and IMF Staff calculations.
Notes: The debt limit under consideration is 70 percent of GDP. The starting point is 70.8 percent, debt ratio as of 2024:Q3. Values in the table are presented in percentage of GDP.

21. The debt trajectory is sensitive to both the authorities' fiscal stance and the initial debt level. Table 2 (last column) displays the probability that debt-to-GDP does not exceed the debt limit of 70 percent by 2031 under different initial levels and under different fiscal stances. Starting from the baseline fiscal stance of an average primary surplus of no more than 5 percent of GDP over a five-year window, there is a 65 percent probability that the debt-to-GDP ratio does not exceed the limit when starting from the anchor. Two main effects are observed when reducing the primary balance average path by two percentage points to 3 percent of GDP—which implies an overall balance more in line with the historical fiscal performance and lower than what is targeted in the current fiscal rule. First, that lower primary balance pushes the estimated debt anchor down (first column) as the economy needs to start from a

¹⁰ Nevertheless, Figure 5 illustrates a probabilistic approach in which we have imposed a 1 percent of GDP cap on the average primary balance over a five-year window. Such an assumption for the primary balance is lower than what is projected by the IMF and the authorities under their commitment to a minimum 1 percent of GDP overall balance in the coming years.

¹¹ Next section also shows that the median trajectory is not far from the debt dynamics required to reach the anchor level by 2035.

cautiously lower debt to be able to remain under the upper limit (70 percent of GDP). Second, the looser fiscal stance also reduces the probability of remaining below the debt limit, regardless of the initial debt level (last column). For example, adopting a fiscal path with average primary surpluses reaching at most 3 percent of GDP (instead of 5 percent of GDP) in our simulations lowers the probability of staying below the debt limit by 10 percentage points—i.e., it brings that probability down to 55 percent instead of 65 percent.¹²

22. The projected debt range widens over longer forecast horizons increasing uncertainty about the outcome of debt ratios over time. As also illustrated in Figure 4, with each passing year, fiscal outcomes face additional shocks, which raises forecast variance. In practice this means that delaying fiscal consolidation pushes adjustments into more unpredictable scenarios, heightening the risk that these paths may not achieve the targeted debt level. Therefore, aiming for a convergence horizon by 2035 would help reduce this outcome uncertainty.

Table 2. Probability that Debt over GDP Remains Below a Specific Threshold

Initial Debt Level (Percent of GDP)	Maximum Primary Surplus on a 5-year average (Percent of GDP)	Average Primary Balance over 2009-19 (Percent of GDP)	Probability Under Two Debt Upper Limits (Percent)	
			50	70
46.5 (anchor)	3	-0.5	65	89
50.4 (anchor)	5 (baseline)	-0.5	69	90
70.8 (current)	3	-0.5	18	55
	5 (baseline)	-0.5	28	65

Note: horizon = 6 years from 2025; stock flow adjustment assumed = 4 percent of GDP over the 6-year horizon.

B. Deficit Paths Toward the Debt Anchor under a Primary Balance Rule

Framework

23. Several alternative fiscal balance rules can lead to the debt dynamics above, including a primary balance rule. One advantage of a primary balance rule compared with an expenditure rule (that will be analyzed next) is that the former incentivizes a closer attention to revenue collection and potential coordination with other departments of the Ministry of Finance during the budget formulation and execution. Since the target in a primary balance rule can be achieved both by extra effort on the revenue and expenditure sides, the rule provides more options to the government in achieving its fiscal targets and reinforce the role of revenue collection in the government's macro-fiscal management.

¹² The second last column further shows that the probability that debt remains below the anchor level (50 percent of GDP) by 2031 is small (only 28 percent) in the baseline case.

24. This section analyzes different calibrations of primary balance rules—including the ones proposed in law—that could bring the debt-to-GDP ratio to its 50-percent anchor after a convergence period.

25. Different scenarios are presented, taking into consideration the pace of the fiscal effort in terms of primary balances, the adjustment period, and the time to convergence. The analysis considers two alternatives for the convergence period, reflecting either the current provision in Aruba's LAft of 2040, or an anticipated alternative of debt convergence to its anchor by 2035. Moreover, three options of adjustment of the primary balance to reach its permanent targeted level for the fiscal rule are assumed in the exercises: (i) one-shot adjustment, in which the primary balance adjusts only once and remains constant thereafter; (ii) 3-year adjustment scenario, in which the primary balance gradually declines over 3 years until it reaches a constant level to be maintained through 2035 or 2040; and (iii) 5-year adjustment scenario.

26. Accordingly, the exercises use a simplified version of the public debt law of motion as follows (see also Escolano, 2010):¹³

$$d_t = \left(\frac{1+i^*}{1+l^*} \right) d_{t-1} - pb_t, \quad (1)$$

where d_t is the debt ratio in period t ; and pb_t is the primary balance to GDP ratio in t . In line with current IMF projections, the nominal interest and growth rates (i^* and l^*) are assumed to be fixed at 6.5 and 3.4 percent, respectively. The initial debt level is set at its current end-2024 projection of 70.8 percent of GDP. The targeted debt is set at its anchor level of 50 percent of GDP. Note that this exercise abstracts from macroeconomic shocks, exogenous changes in the primary balance (e.g., a natural disaster that requires higher spending), other contingent liabilities, and from stock-flow adjustments to debt.

Results

27. Figure 6 plots the paths for the debt-to-GDP ratio and primary balance as percent of GDP under the latest set of IMF fiscal projections for Aruba. The primary balance path starts at 6.4 percent of GDP in 2024, moving to 5.7 percent of GDP in 2025, and converging to 4.3 percent of GDP by 2029. Under this path, the debt ratio reaches 50.1 percent by 2031. Adherence to the primary balance path is key to achieve the timeline objectives in terms of return to the debt anchor. As a result, if the envisaged primary balance in the first year of this path is not achieved, for example, the timeline for returning to the debt ceiling is compromised, unless a correction mechanism is implemented, and a tighter fiscal adjustment is pursued in the subsequent years. Notice further that this fiscal path is less conservative than IMF current projections (see also IMF 2023),¹⁴ with the debt trajectory descending less steeply.

28. It is important to distinguish between an ad hoc correction and a correction mechanism, as the latter implies a pre-specified, automatic adjustment rule. A correction is appropriate when,

¹³ Escolano, Julio, 2010. "A Practical Guide to Public Debt Dynamics, Fiscal Sustainability, and Cyclical Adjustment of Budgetary Aggregates," FAD Technical Notes and Manuals, Fiscal Affairs Department, International Monetary Fund, January (available at: <https://www.imf.org/en/Publications/TNM/Issues/2016/12/31/A-Practical-Guide-to-Public-Debt-Dynamics-Fiscal-Sustainability-and-Cyclical-Adjustment-of-23498>).

¹⁴ International Monetary Fund (IMF), 2023. "Kingdom of the Netherlands—Aruba – 2023 Article IV Consultation Discussions—Press Release; and Staff Report." International Monetary Fund, IMF Country Report No. 23/284, Washington, DC, July.

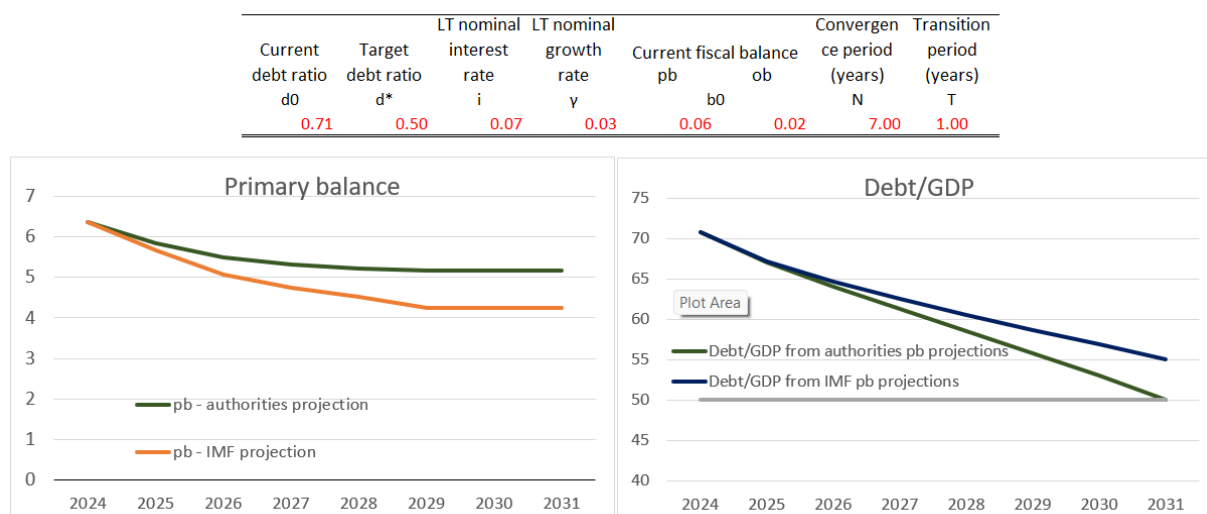
once the fiscal rule is calibrated based on initial assumptions about key input values, any deviation from the operational target necessitates an adjustment to remain aligned with the medium-term objective of debt reduction. In practice, this means recalibrating the framework using updated starting values for the primary balance and determining the required fiscal adjustment over the remaining horizon. Alternatively, if the necessary correction is too large to be implemented within the initial timeframe, an extension of the adjustment horizon may be warranted to ensure a credible convergence toward the medium-term anchor. By contrast, a **correction mechanism** would imply a predefined, automatic fiscal response that adjusts the operational target by a fixed amount when certain deviations occur. We illustrate this for the case of an expenditure-based operational rule.

29. A similar correction mechanism can be explicitly incorporated into a primary balance-based operational rule to ensure adherence to the medium-term debt objective. For instance, if the public debt-to-GDP ratio exceeds the previous year's level, deviating from its planned declining trajectory, an automatic adjustment in real primary expenditure by 1 percent of GDP could be triggered to strengthen the primary balance target in the following year. This could be achieved through a reduction in primary expenditure, similar to the mechanism described for an expenditure rule below. Such a framework ensures that fiscal adjustments are implemented systematically in response to slippages while maintaining flexibility in the consolidation horizon to balance economic and social considerations.

30. Moreover, for simplicity, and unlike the previous section, the framework adopted here assumes *perfect foresight* to calculate those paths (i.e., individuals can predict with precision future variables); so, the likelihood of them happening is equal to 1. Hence, the framework is deterministic, and there are no surprises or economic shocks that can affect the analysis. In reality, if a *large* negative economic shock (such as a natural disaster) was to happen, *the full path* would require adjustment by reducing the deficit levels at each year unless the horizon of convergence back to the debt ceiling is extended. Such decisions of changing deficit levels or extending horizons could be formally included in escape clauses or correction mechanisms, depending on the country's need and the likelihood that they happen. Notice that a similar reasoning applies for expenditure rule as well.

31. Figures 7 and 8 indicate the alternative (hypothetical) overall and primary balance paths that could bring the debt-to-GDP ratio to its anchor (50 percent of GDP) over two other time horizons, 2035 and 2040. Even if the year by which convergence must be achieved is fixed (2035 or 2040), the pace of the adjustment can still vary. As previously discussed, both figures consider the three options of adjustment of the primary balance to reach its permanent targeted level for the fiscal rule thereafter: (i) one-shot adjustment, in which the primary balance adjusts only once and remains constant thereafter; (ii) 3-year adjustment scenario, in which the primary balance gradually declines over 3 years until it reaches a constant level to be maintained through 2035 or 2040; and (iii) 5-year adjustment scenario, in which the primary balance is reduced over 5 years until it reaches its constant level. A longer adjustment period to a constant primary balance target under the rule allows a smoother transition and requires lower targets of constant primary balances thereafter to reach convergence at the same horizon (2035 or 2040). That is because in these simulations, the government is expected to sustain higher primary balances (or fiscal tightening) for longer before converging to a constant and lower targeted primary balance.

Figure 6. Primary Balance and Debt Paths under the Current Set of Projections
(Percent of GDP)



Sources: Aruban authorities and IMF staff calculations.

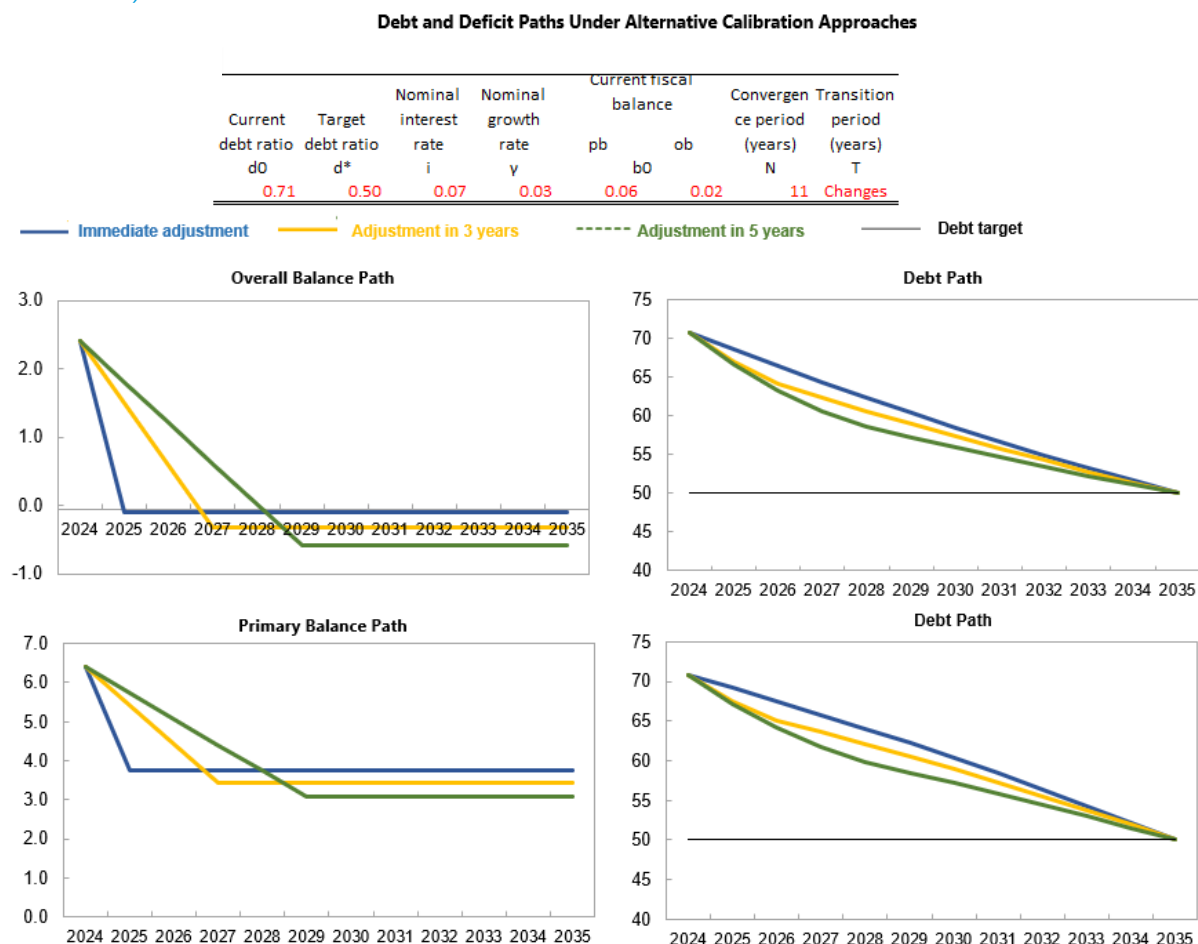
Note: The figure shows the primary deficit and debt paths under the current set of fiscal projections in Aruba presented in the table.

32. In the scenario in which the debt anchor is achieved by 2035, the required primary balance (as percent of GDP) ranges between 3.7 percent and 3.1 percent, depending on the adjustment period that goes from 1 till 5 years. The corresponding overall balances vary between -0.6 percent of GDP and -0.1 percent of GDP, depending on the adjustment period. In all three scenarios, the fiscal effort required to bring the debt level to the anchor is lower than the one currently projected by the authorities through 2029, even though our simulations remain deterministic and do not account for any future macroeconomic risks or contingencies. Moreover, as in the previous simulation, these results do not account for deviations of the primary balance path. So, if in a given year the primary balance undershoots the target, a correction mechanism needs to compensate the initial primary balance deviation in the following years with an additional primary surplus on top of the regulated 3.7 percent of GDP to reach debt convergence to its anchor in the same time horizon. Here, the report avoids prescribing a precise mechanism, but options for such policy could include an increase in the primary balance for a subsequent year in which the debt in the previous year ($t-1$) has increased instead of decreasing compared to the year before ($t-2$)—i.e., $d_{t-1} > d_{t-2}$ —according to the path that brings the public debt to its anchor. Notice that an example of such a correction mechanism is provided when simulating the expenditure rule.¹⁵

33. Figure 8 shows results for a convergence horizon towards the debt anchor by 2040—i.e., the one currently envisaged in the Aruban fiscal rule. The targeted primary balance in this case ranges between 3.2 percent of GDP and 2.6 percent of GDP, depending on the adjustment period among 1, 3, and 5 years. The corresponding constant overall balance ranges between -1 percent and -0.7 percent. Again, with a longer adjustment time at the authorities' disposal to steer debt to its anchor, a smaller fiscal effort is required.

¹⁵ Other options of correction mechanism include a carry forward rule. Moreover, if the economic shock is too large, the government can also consider triggering the escape clause and recalibrating the fiscal targets altogether.

Figure 7. Debt and Fiscal Balances Paths Assuming Debt-Anchor Convergence by 2035
(Percent of GDP)



Sources: Aruban authorities and IMF staff calculations.

Note: Paths differ by the length of the adjustment period, but they are all calculated to ensure the debt ratio converges to 50 percent by 2035.

Conclusions

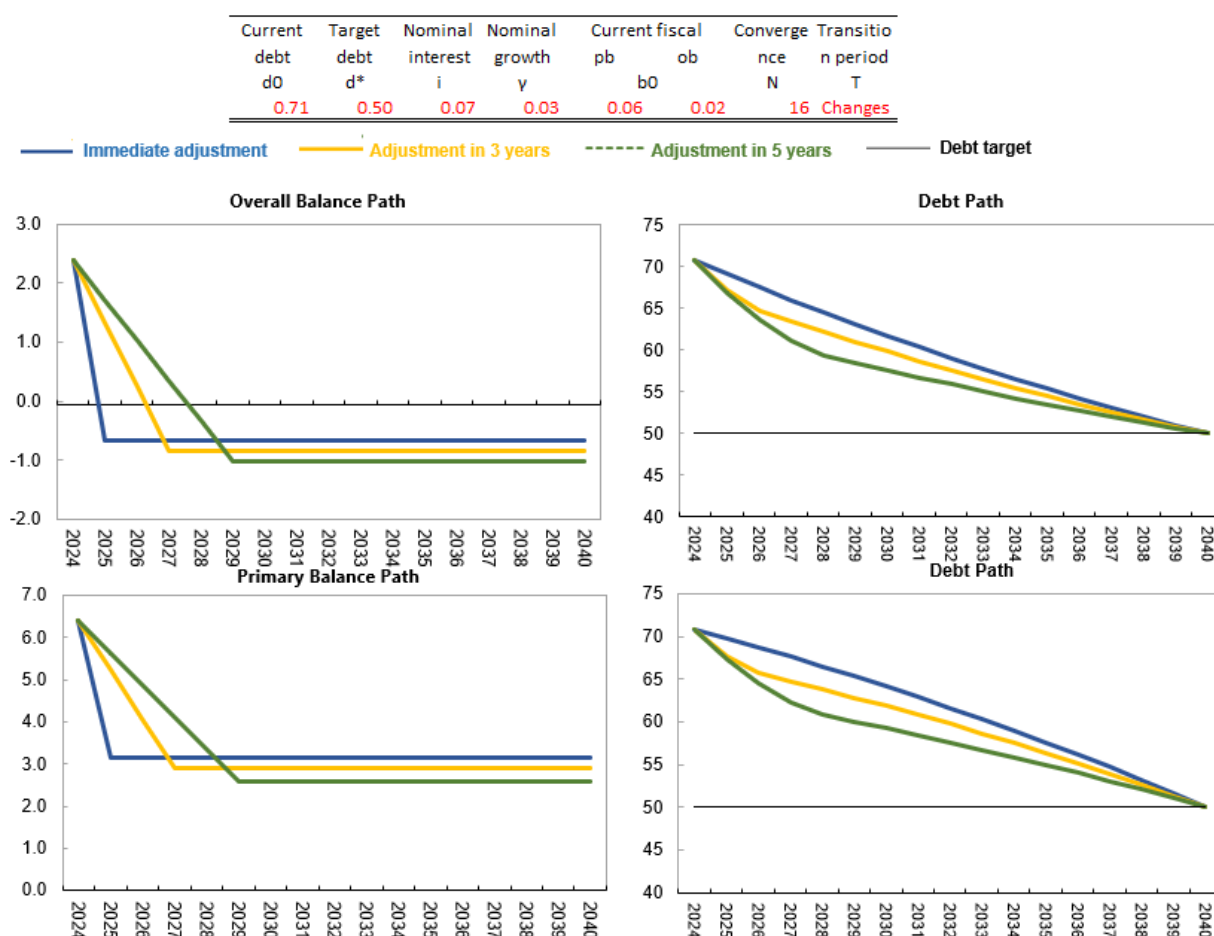
34. Given that the goal of reducing debt to its target level by 2035 appears feasible, committing to a shorter time frame could send a stronger signal to all stakeholders regarding fiscal discipline. This could, for example, boost confidence and lower borrowing costs for the government of Aruba. The increased flexibility of the proposed adjustment can also facilitate diversification and promote growth-enhancing investments.

35. If a primary balance operational rule is chosen by the government, their paths and calibration of transition to a constant target can be set in various ways. The government should adopt operational targets that allow them to reach the debt anchor within the defined horizon while providing flexibility to pursue other important goals of their fiscal policy.

36. The choice between a fiscal rule set on the primary or overall balance includes considerations about communication and the integration of interest payments on the fiscal target.

The government and population may be more accustomed to communicating on the overall fiscal balance than on the primary balance, which would involve explaining the level of interest payments and how it is excluded from the fiscal rule. Yet, a primary balance rule is sufficient to guarantee debt sustainability and avoids setting a target involving uncertain and volatile interest rates and interest payments. Moreover, various countries have transitioned among different operational targets (e.g., Brazil and the United Kingdom), overcoming this communication issue of the change in fiscal rules (see Pimentel and Portugal, 2024; and Keep, 2025; respectively).¹⁶

Figure 8. Debt and Fiscal Balances Paths Assuming Debt-Anchor Convergence by 2040
(Percent of GDP)



Sources: Aruban authorities and IMF Staff calculations.

Note: Paths differ by the length of the adjustment period, but they are all calculated to ensure the debt ratio converges to 50 percent by 2040.

¹⁶ Pimentel, Matheus Porto, and Marcelo Savino Portugal, 2024. "Fiscal Policy Rules: A New Keynesian Model for Brazil with Bayesian Estimation." Mimeo (available at: https://www.anpec.org.br/sul/2024/submissao/files_1/i6-9b9e21ba99ed2166556dd2f1adf2c73e.pdf). Keep, Matthew, 2025. "The UK's Fiscal Targets" House of Commons Library No. CBP 9329, British Parliament, January (available at: <https://researchbriefings.files.parliament.uk/documents/CBP-9329/CBP-9329.pdf>).

C. Deficit Paths Towards the Debt Anchor under a Primary Expenditure Rule

37. Expenditure rules are another option that could be considered by the Aruba government.

This type of fiscal rule may have advantages over a primary balance rule. For example, expenditure rules can be designed to allow automatic stabilizers to work more effectively, when the expenditure target is set as a cap or growth limit on public spending, often tied to potential GDP or long-term economic growth. By setting limits on expenditure growth, instead of as percent of GDP, these rules can accommodate economic fluctuations better. These rules allow revenues to fluctuate naturally with the economic cycle (including through the work of automatic stabilizers) without imposing immediate adjustments to spending. An expenditure rule allows government spending to remain stable during downturns, as there is no obligation to cut expenditures in response to falling revenues, enabling automatic stabilizers—such as lower tax revenues and higher social spending—to function effectively. Likewise, during booms, it prevents excessive spending driven by temporary revenue increases, reducing the risk of overheating and of procyclical policy measures in general. In addition, expenditure rules are generally simpler to monitor and enforce, focusing on controlling the growth rate of government spending, which is more easily controlled by the government than the revenue side and primary balances. This simplicity enhances transparency and compliance. Additionally, by capping expenditure growth, these rules help ensure that government spending does not outpace revenue growth over the long term, contributing to debt sustainability.

38. For these reasons, this section simulates three expenditure rules that may be applicable to the Aruban context. First, we convert the primary balance rule obtained from Equation (1) in the previous section into an expenditure rule by imposing convergence of the debt to the 50 percent anchor by 2035. The effectiveness of the expenditure rule in this case would depend on the accuracy and stability of revenue and GDP projections and outturns used in setting the expenditure target and monitoring it. Second, we propose an *ad hoc* expenditure rule that caps the growth rate of real and nominal primary expenditure. Effectiveness of the rule in this case would depend significantly on the accuracy of inflation and GDP projections and outturns. Finally, we experiment with an expenditure rule that has an inbuilt correction mechanism. For the analysis of the last two rules, we use the current revenue projections from the authorities to back out the corresponding primary balance and compute the debt dynamics.

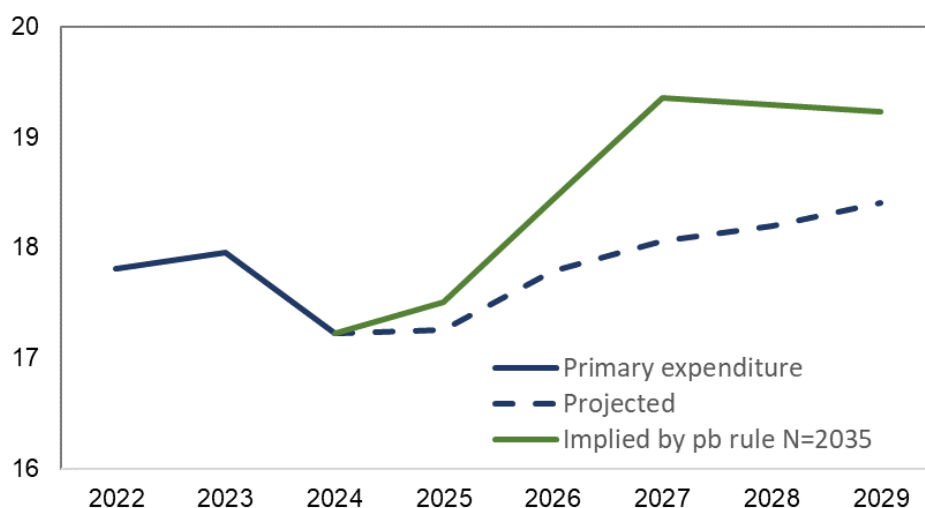
Results

39. Figure 9 derives the implied expenditure rule as the difference between projected fiscal revenues and the primary balance path that leads debt to the 50 percent anchor by 2035 ($NIE = Revenues - pb^*$). Formulating the fiscal target in terms of an expenditure rule has the advantage of a greater ease of monitoring and enforcement, since this fiscal variable is under a more direct control by authorities through the budget cycle than revenue collection and, so, primary balances. Again, as discussed in the previous section, this specific expenditure rule would give more flexibility to authorities in terms of spending than their baseline expenditure projection for the medium term.

40. Figure 10 shows, in turn, results from an illustrative rule that limits the growth rate of nominal primary expenditure to the inflation rate, while real primary expenditure remains constant. The corresponding primary balance path implies a higher fiscal effort and a steeper decline in debt compared to the paths leading to the debt convergence at 50 percent of GDP by 2035. The top right

chart shows a decline in nominal primary expenditure as share of GDP, since the latter incorporates both inflation and positive real growth. Again, this is an illustrative example to show how an expenditure rule could be set. However, the parameters of that rule can be fine-tuned to better map the current macroeconomic context of Aruba, for example by allowing nominal primary expenditure to grow by inflation rate plus half of the real output growth percentage rate. Other expenditure growth percentage rates could be tested.

Figure 9. Primary Expenditure under an Expenditure Rule Assuming Debt-Anchor Convergence by 2035
(Percent of GDP)



Sources: Aruban authorities and IMF staff calculations.

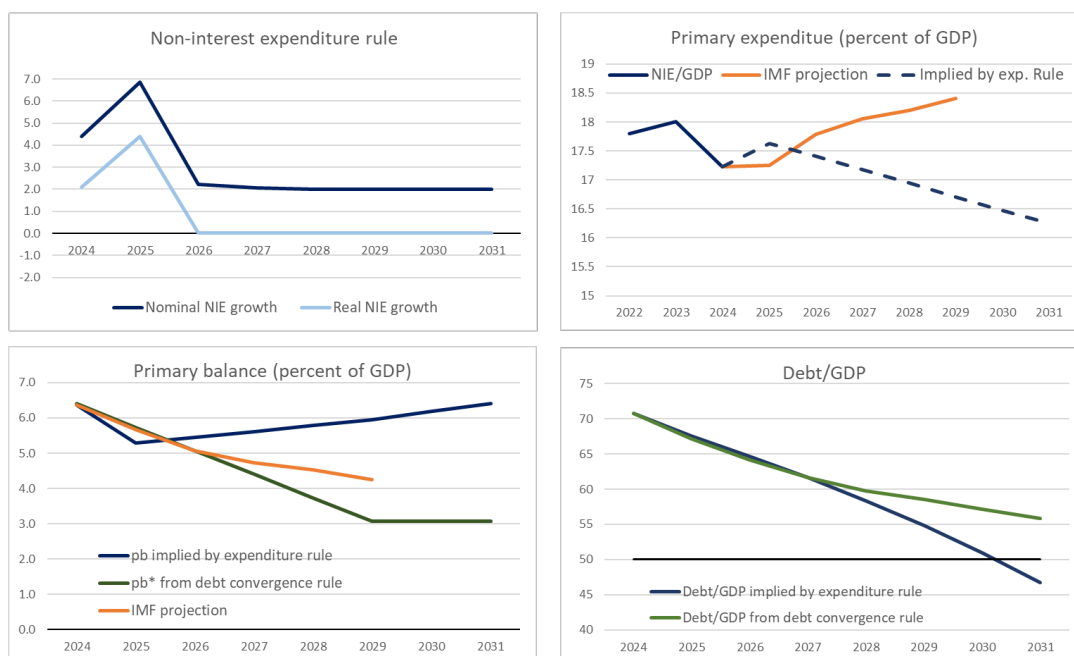
Note: "Projected" indicates authorities' projections in line with current IMF projections as well. "Implied" is the expenditure path implied by keeping the primary balance constant after 5 years of adjustment to reach the debt anchor in 2035 as presented in the previous section.

41. Our final example of an expenditure rule includes an automatic correction mechanism to illustrate how this scheme could work (Figure 11). For example, a correction mechanism could be set to reduce primary expenditure in case the public debt-to-GDP ratio in the previous year is larger than the year before, deviating from its declining path towards the debt anchor. In the illustrative calibration of Figure 11, we set primary expenditure to fall by 1 percent of GDP in a particular year if debt in the previous year increased ($d_{t-1} > d_{t-2}$), deviating from its planned declining trajectory. So, if we assume in Figure 11 that debt increases to 80 percent in 2025, the correction mechanism implies that primary expenditure will contract by 1 percent of GDP in 2026. Consequently, as shown in the bottom right chart, the debt trajectory is put back on a downward trend thanks to the correction in the primary expenditure, but with a convergence horizon to the debt anchor that is longer than the initial one.

Conclusions From the Expenditure Rule Simulations

42. The Aruban authorities could consider adopting an expenditure rule that allows for automatic stabilizers to function effectively. Defining these rules in terms of a primary expenditure growth rate may enable the government to be countercyclical during economic downturns and expansions, potentially enhancing fiscal sustainability and economic resilience.

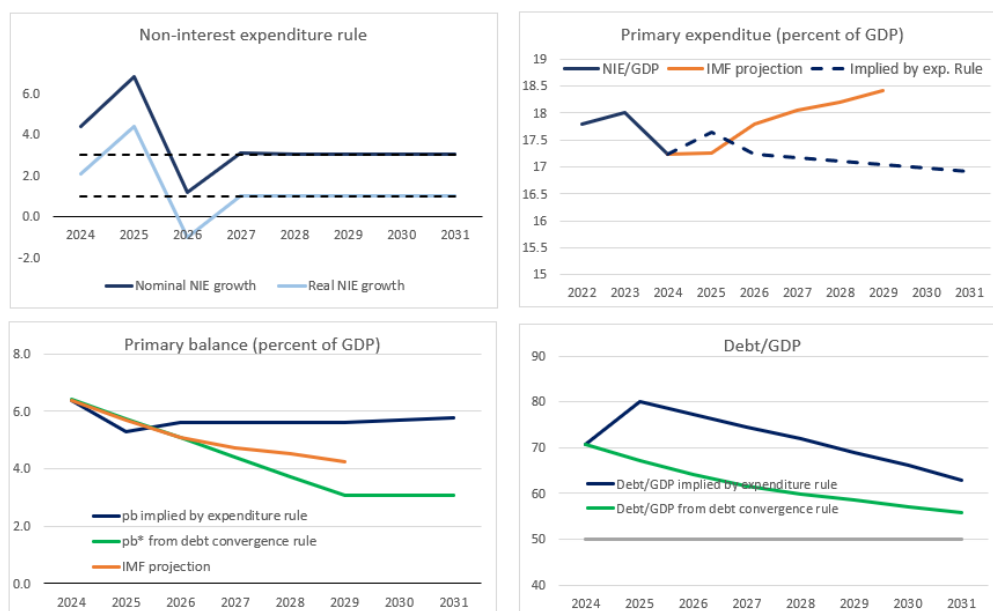
Figure 10. Fiscal Variables' Paths under a Constant Real Primary Expenditure Rule
(Percent, unless stated otherwise)



Source: Aruban authorities and IMF staff calculations.

Note: "Projected" indicates projections in line with current IMF projections of macro aggregates. "Implied" is the path derived by keeping the real primary expenditure constant.

Figure 11. Fiscal Variables' Paths under a Primary Expenditure Rule with Correction Mechanism
(Percent, unless stated otherwise)



Source: Aruban authorities and IMF staff calculations.

43. The choice of an expenditure rule also depends on how good and volatile revenues are. In this sense accurate revenue projections play a critical role. Given that Aruba's fiscal revenues largely

stem from the tourism sector, which can be volatile, ensuring that revenue forecasts are realistic and regularly updated is essential for effective fiscal planning and adherence to expenditure rules.¹⁷ In case, revenues keep surprising authorities on the downside, even the expenditure rule would need to be recalibrated to assure that the debt anchor will be reached in the horizon requested.

D. Recommendations from the Simulations

44. Independently of the type of fiscal rule chosen, additional considerations need to be factored in to achieve the objective of reaching the debt anchor by the planned time horizon:

- a. Ensure consistency between the operational targets of the fiscal rule and the medium-term debt anchor;
- b. Establish a sound correction mechanism to guide the transition or return to the fiscal rule targets in case temporary deviations of the debt path towards the debt anchor are observed;
- c. Over time, in case downside fiscal risks materialize, adjust the fiscal rule to ensure reaching the debt anchor at the planned horizon.

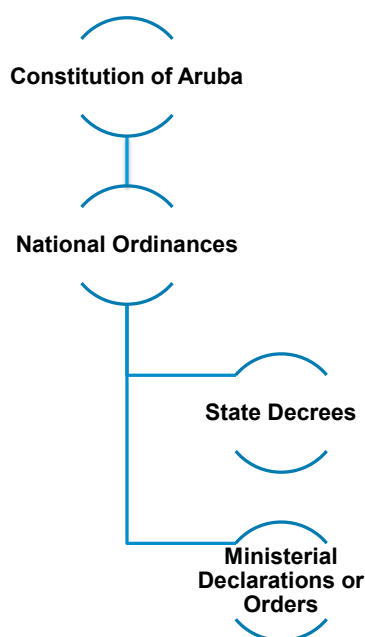
¹⁷ In the case of Aruba, it is important to notice that fiscal revenues show a smaller volatility than government spending, at least in the last 15 years.

IV. Developing Supporting Budget Institutions

A. Legal Framework and Institutional Arrangements

45. Aruba has three main layers to its legal fiscal framework (Figure 12). There is a Charter of the Kingdom of the Netherlands as Aruba is a part of the Kingdom of the Netherlands, followed by the Aruban Constitution and the National Ordinances or laws. Part of the constitutional framework that emanates from the Charter is the possibility of enacting Kingdom Laws as collective legal arrangements. For the purposes of the fiscal rules and to ensure that the focus is Aruba-centric, the evaluation of the PFM legal framework is limited to the PFM laws which are operational—the Accountability Law of 1989 (*Comptabiliteitsverordening*) and the Financial Supervision Law of 2015 (*Landsverordening Aruba Tijdelijk Financieel Toezicht* or *LAft*).

Figure 12. Aruba's PFM Legal Framework



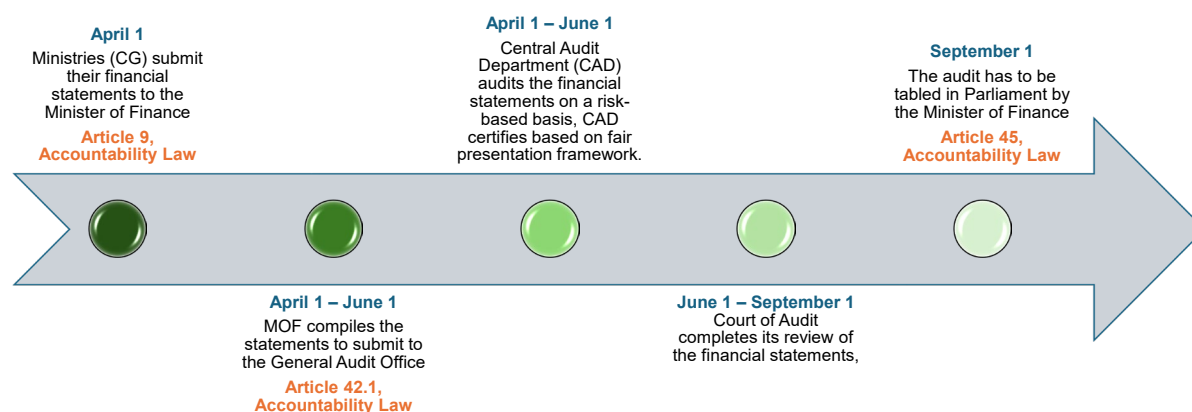
Source: IMF staff analysis.

46. The first national PFM ordinance was the Accountability Law of 1989. This law focused on the management of the Budget, the financial statements of the country, the role of the Minister of Finance and established some of the roles of the Directorate of Finance (DOF), among other things. The DOF is responsible, besides other responsibilities, for the central budget and financial administration,¹⁸ while

¹⁸ Government of Aruba (GOA). 1989. Accountability Law. Article 8.

each ministry is also responsible for its own budget¹⁹ and financial administration,²⁰ and required to share the statements of the previous financial year with the Minister of Finance before April 1 of each year.²¹ The Minister of Finance is responsible for compiling these reports within a two-month period and submitting to the Court of Audit by June 1 (see the budgetary calendar in Figure 13).²² Between April 1 and June 1, the Central Audit Office of Aruba conducts an audit on the financial statements in order to certify them. The Central Audit Office is also tasked with conducting regular audits of all ministries²³ Within twelve weeks, or by September 1, the Court of Audit has to submit the report on the financial statements to the Minister of Finance. The Minister of Finance then submits the audited financial statements and audit report from the previous financial year to the Parliament no later than September 1.²⁴ There are no accounting standards for the audit of the financial statements of the central government in any legal instruments; a new State Decree will be enacted in the coming year on the accounting standards, against which the audits should be compared.²⁵

Figure 13. Key Audit Dates and Legal Provisions for Fiscal Reporting



Source: IMF staff analysis.

¹⁹ GOA 1989; Article 40b. This provision assigns responsibility for the budgets and accounts of the *state organs to the* Minister/Ministry of General Affairs. Organs of the state include the Parliament, the Advisory Council, and the Court of Audit and the Ombudsman's Office.

²⁰ GOA 1989; Article 7.2. Note that Article 9 requires the Central Audit Office to audit each of these ministries.

²¹ GOA 1989; Article 41.

²² GOA 1989; Article 42.1

²³ GOA 1989; Article 9.

²⁴ GOA 1989; Article 45.

²⁵ GOA 1989; Article 43.

47. There are differences between the 1989 law and the Financial Supervision Law (LAft)²⁶ concerning aspects of fiscal discipline. One difference is that the perspective of the 1989 law was annual. Article 12 allowed the Minister of Finance to delegate his authority to open bank accounts for defined operational purpose to other Ministers by national decree. Another difference is the level of discretion the 1989 law provided. Article 14 of the Accountability Law provided the Minister of Finance with authority to exceed budget ceilings for existing policies approved in the budget or for new expenditures that were not previously budgeted. But such new expenditures are not unlimited. They must refer to expenditures that cannot be otherwise avoided and that are tied to a procedure under which a budget amendment process is initiated. The LAft removed some of the discretion provided by the Accountability Act.

48. The LAft is the basis of the PFM arrangement between the Kingdom of the Netherlands and the government of Aruba (GOA). It defines key terms, including the collective sector, which includes: (i) the State (Land) or central government (CG); (ii) the statutory bodies (entities created by laws or statutes) in charge of the implementation of social and national insurance; and (iii) the statutory bodies that depend on collective levies for more than 50 percent of their income, in line with the United Nations System of National Accounts (SNA). The collective sector, therefore, encompasses the SVB (Sociale Verzekeringsbank) and AZV (Algemene ziektekostenverzekering) as well as those statutory bodies that receive a majority of their operating revenue from CG. The Central government consists of 8 ministries.²⁷ The SVB and AZV are social security funds (SSFs) and, according to Government Finance Statistics Manual 2014, they should be categorized as part of the general government.²⁸

49. The Supervision Law (LAft) establishes the financial supervision board (College Aruba financieel toezicht or CAft).²⁹ The law establishes a mechanism for establishing internal policy rules for the CAft as well as general and specific instructions that can be given to the CAft, subject to joint agreement between the Kingdom's Council of Ministers and the Council of Ministers (CoM) of the Government of Aruba.³⁰ The governance arrangements for the CAft and its responsibilities are outlined, including providing opinions on both draft as well as approved budgets, provided that the Minister of Finance requires it in the case of the draft.³¹ The CAft must receive the approved budget for the fiscal year³² no later than December 15 of each year or it has recourse to report this as non-compliance to the

²⁶ The LAFT was first enacted on August 31, 2015 (AB 2015 no. 39) but was amended and updated in 2023 (AB 2023 no. 67). The review relates to the amended LAft.

²⁷ The 8 ministries in 2024 are: Ministry of Finance and Culture; Ministry of Economic Affairs, Communication and Sustainable Development; Ministry of General Affairs, Innovation, Government Organization, Infrastructure and Spatial Planning; Ministry of Education and Sport; Ministry of Tourism and Public Health; Ministry of Justice and Social Affairs; Ministry of Transport, Integrity, Nature, and Elderly Affairs; and Ministry of Labour, Integration and Energy.

²⁸ It is good practice to include all entities within budgetary central government and those which are part of general government that rely on the CG for more than 50 percent of their operating revenue.

²⁹ Government of Aruba (GOA). 2015. Financial Supervision Law. Article 2.1

³⁰ GOA 2015; Article 2.2.

³¹ GOA 2015; Article 10.

³² The fiscal year or service year in Aruba is January 1 to December 31 of each year (calendar year = fiscal year).

Kingdom of the Netherlands.³³ If no budget has been adopted by the beginning of the new financial year, the budget of the previous year becomes preliminary budget for the fiscal year.³⁴

50. Budget flexibility is implied in Article 14.2 of the LAft. If there is a need for additional expenditure, either due to setbacks or policy actions that result in requirements for an increase in budget, these setbacks must be financed by budget flexibility mechanisms, such as reallocations from areas where less expenditure is needed.³⁵ These reallocations, in principle, cannot exceed the aggregate budgetary envelope in that particular year. There are, however, no legislated budget flexibility mechanisms setting out the rules. Examples include a virement provision which would prevent movement of resources from personnel costs or capital expenditure; or a reallocation provision that allows movement of resources within the same budget line, or within the same ministry, or even across ministries. Budget flexibility provides discretion. But such flexibility should also come with guidance so that a well-meaning provision is not abused.

51. The LAft refers to “windfalls,” but this term is not defined in law. Further, a “windfall” is just a surplus above the fiscal balance target (i.e., 1 percent of GDP). The provision states: “in the event of a surplus lower than the minimum financial surplus, [referred to in the fiscal balance rule] the expenditure windfalls in relation to the adopted budget shall accrue 100 percent to the debt reduction.”³⁶ The expenditure windfall provision in the LAft creates a perverse incentive for the GOA to use the expenditure budget to meet the fiscal surplus target. This is also reinforced in Article 14.2.g, which states: “within the expenditure framework, compensatory measures are included to compensate structural setbacks structurally and incidental setbacks incidentally or structurally”. In essence, given that revenue projections are taken as given and no intra-year effort is usually made to achieve the fiscal rule, the fiscal balance rule can be actually interpreted an expenditure rule at the outcome level.

52. Accountability requirements for public debt management are outlined in the LAft. The requirement to raise debt is recognized in Article 15 with the caveat that the Minister of Finance ensures that this is included in the adopted Budget. This only applies to the collective sector, excluding other statutory bodies, such as state-owned enterprises (SOEs). Importantly, Article 27a bans the creation of public private partnerships (PPPs), and their associated financial commitments.

53. It is an international good practice for the Minister of Finance to have responsibility for all public finances. In many jurisdictions, in particular small island states, SOEs or statutory bodies cannot borrow without approval from the Minister of Finance since either a guarantee may be required or there is a (fiscal) risk that contingent liabilities could arise. Authority to borrow is authority that belongs only to the Minister of Finance, at least at the level of central government, and for entities within general government that are dependent on the central government for more than half of their operating revenues. In contrast, Aruba has no overarching fiscal governance framework for SOEs. There are various articles of association, deeds of incorporation and statutes, particularly *Landsverordening* (LVO) that allow the Minister to incorporate SOEs. (see section on *Fiscal Risk Analysis*).

³³ GOA 2015; Article 13.1.

³⁴ GOA 2015; Article 13.4.

³⁵ This can be due to fiscal savings or re-prioritization within the specific resource envelope.

³⁶ GOA 2015; Article 14.2.c.

54. The Accountability Act and the LAft exhibit inconsistencies. Consideration should be given to either consolidating the two ordinances into one updated PFM ordinance to remove outdated provisions and conflicting information, among other things; and to sustain the achievements after the expiration of the new LAft or repealing these ordinances and replacing with a new ordinance. Article 38 of the Accountability Act requires all companies and institutions (statutory bodies) incorporated through national ordinance to submit annual financial statements to the Minister of Finance within three months of the close of their fiscal year—i.e., before April 1.³⁷ This supervision includes the review of the general financial policy.³⁸ This authority was established in the Accountability law. But there were also many exceptions that, effectively, diluted the Minister of Finance’s authority.

B. PFM Issues Related to the Design of the Fiscal Rule

55. The IMF has prepared a note on how to develop credible fiscal rules (Eyraud and others, 2018b),³⁹ which remains its guidance on the topic, including on its PFM component. Those authors draw on experiences of the typologies of fiscal rules that countries have implemented. The rule selection process can benefit from three steps, and these can be applied in Aruba’s case: (i) identify rules that minimize trade-offs; (ii) take into account country preference; and (iii) consider multiple rules.

56. As also discussed in the previous section, it is important to look at fiscal rules collectively rather than individually. The better designed rules are those that have a fiscal anchor linked to the outcome of the fiscal rules—in Aruba’s case fiscal/debt sustainability—and one or more operational rules on fiscal aggregates. Short-term operational rules linked to debt dynamics can also be effective, but these should be “under the direct control of the government”.⁴⁰

57. Multiplicity of fiscal rules should be limited because these can result in redundancy and inconsistency (Eyraud and others, 2018b). Over-deterministic rules can undermine achievement of fiscal policy objectives. They can “undermine the credibility of the framework and create inconsistencies between the requirements of different rules”.⁴¹ That is the current case in Aruba, where the existing fiscal rules have overlap between fiscal targets.

58. Moreover, overlaps in fiscal targets should be further minimized as they apply to the same fiscal aggregates, but constraining them in different ways. For example, Item 14.1.d of Article 14 discusses the collective sector’s new debt ceiling for refinancing with capital expenditure as an input to the debt target in 14.1.c. But the same article, in Item 14.1.b, includes a target on the output of the fiscal balance target, whereas the collective sector wage bill further enters as another rule in Article 14.2.a, even though, it is also a (expenditure) component of the fiscal balance.

³⁷ See GOA 1989; Article 38.2 (which is also reinforced in Article 17.1). “The companies and institutions referred to in paragraph one shall send to the Minister of Finance their estimates referred to in paragraph two of Article 2 before April 1 of the current fiscal year”.

³⁸ See GOA 1989; Article 38.2.” Article 38.2 further states that: “The Minister of Finance supervises the use of the country’s funds, even after the necessary funds have been expressly granted to a minister by national ordinance.”

³⁹ Eyraud, L., V.D. Lledo, P. Dudine, and A. Peralta Alva. 2018. “How to Select Fiscal Rules: A Primer.” Fiscal Affairs Department—How to Note, International Monetary Fund, March.

⁴⁰ Eyraud and others (2018b), pp. 3.

⁴¹ IMF 2017; p.3.

Escape Clauses

59. The escape clause is an important design feature of the fiscal rule. The escape clause is a necessary provision and a risk mitigation measure to address the uncertainty of a fiscal shock. Aruba is considered a small island development state (SIDS) in the Caribbean that is outside of the hurricane belt. However, the hurricane risk is still more likely to materialize in the island than an earthquake risk.⁴² Given the changes in weather patterns that have occurred due to climate change, Aruba should enhance its fiscal risk management. An escape clause puts a pause on the adherence to the fiscal rules, for example, in the event of disasters, such as effects of rapid sea-level rise or pandemic, stipulated in law.⁴³

60. Aruba's current fiscal rule already contains escape clauses, but there is room to improve their parameters in the revised fiscal rules regime. Escape clause provisions are contained in Articles 14 and 23 of the current rules. The Minister of Finance in agreement with the COM and the Kingdom's government may deviate. However, there are no criteria for validating the deviations and no indication of what body verifies that the precondition for suspension has been met. A good practice from the region (Box 2) includes five key design elements.

Box 2. Design Elements for an Escape Clause from the Region

- Establish what constitutes a fiscal shock in clear, simple, objective, and verifiable terms;
- Validate the need to trigger the escape clause to suspend the fiscal rules;
- Ensure that there is a competent body with capacity to evaluate and certify if the criteria for the escape clause have been satisfied, as well as to extend the suspension, if needed;
- Require regular reporting during suspension of the fiscal rules to demonstrate how the fiscal path will be returned to—i.e., adjustment or correction mechanisms;
- Include a sunset clause provision for the natural expiration of the suspension of fiscal rules.

Source: IMF staff analysis.

61. Jamaica is a stellar example from the region in terms of its fiscal consolidation, design of fiscal rules, and of escape clauses (Box 3). Since 2014, the country has reduced its debt by 57.3 percentage points, from 130.6 percent of GDP at the end of fiscal year 2014/15 to 73.3 percent of GDP at the end of fiscal year 2023/24, by implementing a significant and hard-won fiscal consolidation.⁴⁴ This process was facilitated by the implementation of a new fiscal rule in 2014, which contains escape clauses that could serve as an example to Aruba. The crucial point about this mechanism is that it mitigates discretion or arbitrary decisions about what constitutes fiscal impact large enough for the escape clause to be invoked. Deviations from the fiscal path may be necessary but they should be managed in a way

⁴² <https://www.preventionweb.net/publication/disaster-risk-profile-aruba>.

⁴³ Nonetheless, other measures to build financial/fiscal resilience are also needed to prepare Aruba for events, such as natural disasters, including sea-level rise. These other measures include, for instance, the development of a Disaster Risk Financing Strategy that does not only consider natural hazards (see also Section IV.C below).

⁴⁴ See Arslanalp, Serkan, Barry Eichengreen, and Peter Blair Henry, 2024. "Sustained Debt Reduction: The Jamaica Exception." *Brookings Papers on Economic Activity*, Spring, pp. 133–181.

that allows the public to have confidence in the system. The design of the escape clause should deliver credibility.

Box 3. An Example of Escape Clause Provision in Fiscal Rules from Jamaica

The fiscal rule included in the Jamaican Financial Administration and Audit (FAA) Act provides a potential example of escape clauses. For example, on its Section 48A, the act states:

(2) Subject to subsection (3), compliance with the requirements referred to in sub-section (1) (a) and (b) may be suspended on the grounds of any one or more of the following occurrences (hereinafter referred to as "the eventuality"), as determined having regard to subsection (5), namely:

- (a) a period of public disaster within the meaning of section 20 of the Constitution of Jamaica;
- (b) a severe economic contraction;
- (c) a financial sector crisis;
- (d) a public emergency within the meaning of section 20 of the Constitution of Jamaica

(3) Subsection (2) applies where:

- (a) the Auditor-General has validated in the prescribed manner that the estimated fiscal impact of the eventuality is equal to or greater than one and a half per cent of gross domestic product; and thereafter
- (b) the Minister, having regard to the validation of the Auditor-General, has, in accordance with subsection (4), made an order, subject to affirmative resolution, permitting the requirements to be suspended for an initial period, and, as the case may require, for an extended period.

(4) The initial period during which compliance with the requirements referred to in subsection (1) (a) and (b) may be suspended shall terminate at the end of the financial year following the eventuality; however, where the Auditor-General has validated in the prescribed manner that the residual impact of the eventuality is significant enough to warrant the continued suspension of the requirements in subsection (1)(a) and (b), the suspension of the requirements may be continued for an extended period of one more financial year, immediately following the initial period of suspension.

(5) For the purposes of subsection (2):

- (a) the Planning Institute of Jamaica shall submit to the Minister and the Auditor-General, respectively, a report relating to the eventuality, where it relates to an occurrence specified in paragraph (a) or (b) of that subsection;
- (b) the Bank of Jamaica shall certify, by a written statement of the Governor of the Bank, to the Minister and the Auditor-General, respectively, the information confirming the eventuality, where it relates to an occurrence specified in paragraph (c) of that subsection.

(6) The Minister shall, at the end of the initial period or where applicable, the extended period during which, pursuant to this section, compliance with the requirements specified in paragraphs (a) and (b) of subsection (1) may be suspended, table in each House of Parliament a report in relation to the approval of each House of Parliament, recommendations for recalibration of the [fiscal rule(s)].

Source: <https://laws.moj.gov.jm/library/statute/the-financial-administration-and-audit-act>.

Fiscal Council

62. Fiscal councils are important complements to fiscal rules. Fiscal councils should be independent, non-partisan, institutions within the rules-based framework, preferably with a legal mandate

to: (i) assess fiscal plans and performance; (ii) evaluate macroeconomic and budgetary forecasts; (iii) monitor the implementation of fiscal rules; and (iv) cost government measures.⁴⁵ In 2021, there were 51 fiscal councils worldwide. But only 10 are established in countries belonging to the Americas, where Aruba is located.

63. Grenada’s Fiscal Responsibility Oversight Committee (FROC) is a good example of a national fiscal council in the region. Since 2021, Grenada has enacted a new law, the Fiscal Resilience Act (FRA) 2023,⁴⁶ which has further clarified and expanded the role of the fiscal council. Section 12 of the FRA outlines the responsibilities of the FROC. These responsibilities include: what it is to do; by when it is to be done; and how the responsibility is to be carried out. Chief among these requirements is the written assessment of compliance with the fiscal rules. The FROC is empowered to request any necessary information from the Ministry of Finance in the conduct of its evaluation. The Schedule to the Act specifies, *inter alia*, the composition of the FROC; its tenure and revocation; meetings; and its costs. The GOA could use this model as a basis to develop its own national fiscal council.

64. It is important to plan for the transition to a national, home-grown, fiscal council for Aruba. The current fiscal council, the CAft, will be responsible for monitoring and oversight of the new fiscal rules’ regime. The legislation should have a sunset clause which specifies when this fiscal council should expire. It should incorporate knowledge transfer and a handing-over period during which the new fiscal council learns by doing. If the CAft should cease to exist before the new fiscal council is established, there could be a steep learning curve due to loss of institutional knowledge. The establishment of a national fiscal council and the expiration of the CAft should be treated as transitional provisions to ensure that both the outgoing and the incoming fiscal councils overlap.

C. PFM Prerequisites for Implementation of a Fiscal Rule

65. As discussed in Section IV.A, Aruba’s PFM architecture already contains notable strengths to support the implementation of a numerical fiscal rule. The budgetary rules and guidelines for the 2025 financial year contain a detailed budget calendar including key submission and reporting dates. The PFM legal framework is articulated in the Accountability Law of 1989 and the Financial Supervision Law of 2015 (*LAft*). Debt and cash management are integrated in the Treasury function and staff are committed with strong competency in budget formulation. The forecasting model of the Aruban economy (MARUBA) produces consistent nominal GDP forecasts, informed by regular meetings of the macro-model commission—a committee consisting of key staff of the DOF, Aruba Tourism Authority (ATA), and the Central Bank of Aruba (CBA). Various budget reports are prepared and tabled in Parliament. More recently, the budget and fiscal policy division has introduced a medium-term budget framework (MTBF) and started to collect data on some SOEs with a view to undertake fiscal risk analysis.

⁴⁵ Davoodi, H. R., P. Elger, A. Fotiou, D. Garcia-Macia, X. Han, A. Lagerborg, W.R. Lam, and P. Medas. 2022. “Fiscal Rules and Fiscal Councils: Recent Trends and Performance during the Pandemic”, IMF Working Paper No. 22/11, International Monetary Fund, Washington, D.C. See page 10 of that working paper.

⁴⁶ Government of Grenada. 2023. Fiscal Resilience Act. <https://laws.gov.gd/index.php/acts/981-act-no-11-of-2023-fiscal-resilience-act-2023/viewdocument/981>.

66. Despite these strengths, several gaps in PFM—including budget credibility, budget execution, fiscal reporting, and oversight—could weaken the fiscal rule. Table 3 summarizes Aruba’s compliance with the PFM pre-requisites for the fiscal rule implementation—these are minimum PFM standards to implement an effective numerical fiscal rule. Some of the weaknesses with that compliance are due to factors, such as the outdated legal framework (1989), thin staff numbers, and/or insufficient automation of manual processes. Many of the issues raised in this report and subsequent recommendations will require careful identification of the skills and capabilities within government and reassignment of staff with analytical, financial and economics training to strengthen fiscal analyses.

Table 3. Aruba’s Compliance with Pre-requisite for Fiscal Rule Implementation

Prerequisites	Practice in Aruba
Clear fiscal objectives and rules to anchor the formulation of medium-term ceilings and projections	Unclear, complex, and inflexible fiscal rules
Accurate macro-fiscal forecasts to inform realistic budget resource envelopes	Significant deviations in forecasts
	No forecast error analysis
Credible budgeting to deliver over the medium term	Recent introduction of medium-term budgeting
Top-down and comprehensive budget process to maintain aggregate expenditure and prioritize allocation of limited resources	Bottom-up budgeting without aggregate or individual budget ceilings provided ⁴⁷
	Fiscal rule not acting as a binding constraint—authorities could deviate from the fiscal rule if revenue does not materialize or if cash is constrained

Source: IMF staff analysis.

Medium-Term Fiscal Planning and Framework

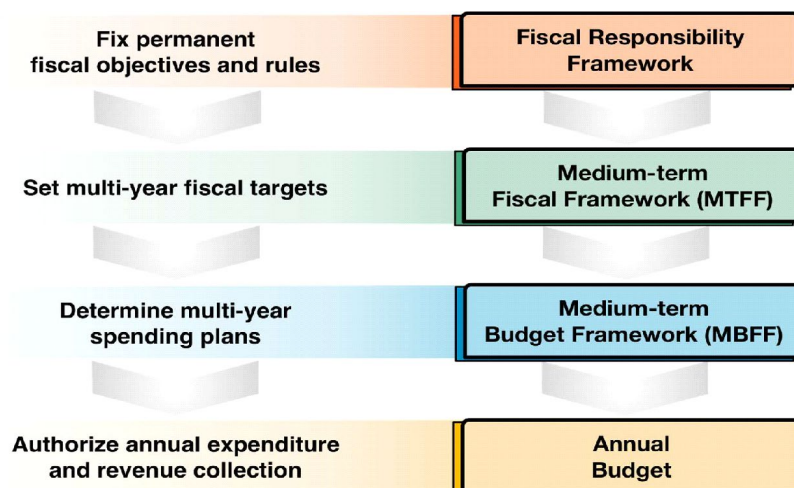
67. A legislated MTFF can be a binding policy instrument to guide fiscal policy formulation and support the implementation of fiscal rules.⁴⁸ A MTFF is an institutional framework for setting aggregate fiscal targets or objectives within a projected macro-fiscal environment over the medium term. Figure 14 illustrates the components of the budget, including an MTFF. The MTFF includes (i) realistic revenue projections; (ii) expenditure projections at an aggregate level reflecting unchanged policies and macroeconomic projections; (iii) a fiscal balance informed by the fiscal rule; and (iv) financing

⁴⁷ This is partly related to underdeveloped technical capacity and know-how at the departments. See par 102 which recommends a comprehensive gap analysis.

⁴⁸ Doherty, Laura *et al.* 2021. Kingdom of Aruba: Strengthening Fiscal Planning.

assumptions which generate a corresponding debt trajectory. For the purpose of transparency and accountability, the MTFF should be tabled in Parliament.

Figure 14. Components of a Modern Budget Process



Source: IMF staff analysis.

68. Although the Budget and Fiscal Policy Division produces a MTBF with 4-year forecasts, there is no credible MTFF guided by the fiscal anchor (debt to GDP). Previous IMF advice in 2021 recommended the introduction of a MTFF in Aruba.⁴⁹ The current MTFF is still very embryonic in Aruba. An enhanced MTFF would provide the GOA with discretion to set binding ceilings on expenditure categories over the medium term that satisfy the debt to GDP trajectory and guarantee a fiscal constraint. Figure 15 illustrates the components of a medium-term expenditure framework, which includes an MTFF and a MTBF.⁵⁰

69. Credible fiscal policy formulation requires iterations of the potential fiscal path to achieve the fiscal rule. The process requires scenario analysis based on assumptions regarding potential global and domestic shocks to the fiscal framework. Optimistic (high growth), pessimistic (low growth) and likely scenarios should be modeled and discussed in a fiscal policy coordinating committee before deciding on the most credible option. Box 4 provides steps on translating the fiscal rule into specific revenue and expenditure policies. Once the path has been decided, an aggregate binding expenditure ceiling is determined and broken down into departmental spending ceilings based on policy priorities agreed by the Council of Ministers.

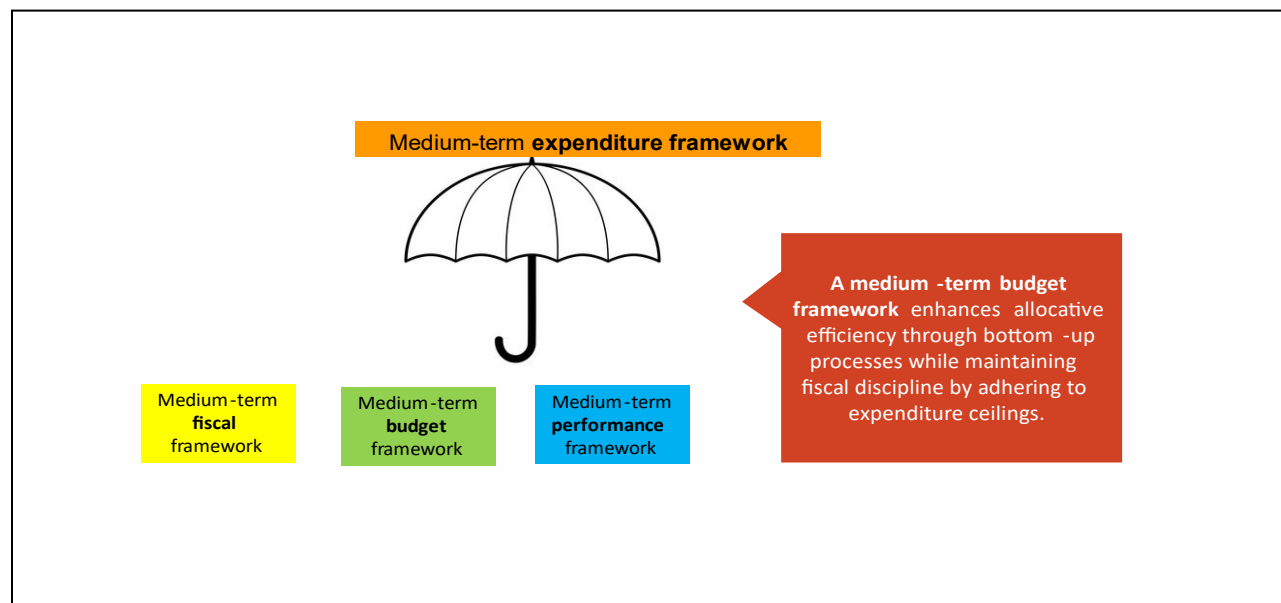
70. Credible forecasting is another pre-requisite for a credible fiscal rule. The Budget and Fiscal Affairs Division is understaffed with just one of its members responsible for technical forecasting. It is essential to strengthen this unit with at least one more economist to help model fiscal shocks, update the

⁴⁹ International Monetary Fund. 2021. IMF Technical Report Kingdom of the Netherlands – Aruba: Strengthening Fiscal Planning.

⁵⁰ In practice, a MTFF provides a broader fiscal strategy and sustainability framework, while the MTBF focuses on the practical implementation of that strategy through budgetary allocations and management. Both frameworks are complementary and essential for effective fiscal governance, as shown in Figure 15.

model with assumptions, and maintain the fiscal database. Box 5 provides an overview of the role of modern macro-fiscal units to develop a credible MTFF.

Figure 15. Components of a Medium-Term Expenditure Framework



Source: World Bank. 2013. "Beyond the Annual Budget." Washington, DC: World Bank.

Box 4. Steps for Translating a Fiscal Rule into Specific Revenue and Expenditure Policies

The basic problem: Moving from fiscal rules to specific policies



Fiscal Rule



Specific revenue and expenditure policies

- ☐ **Keep revenues and expenditure policies initially constant**, i.e., assume that there are no policy changes.
- ☐ **Generate a set of realistic macroeconomic forecasts** (especially growth, inflation, imports, exchange rate, key prices).
- ☐ **Determine how revenues and expenditures will evolve** given the macroeconomic forecasts, still assuming constant policies
- ☐ **Compute trajectories for fiscal balances and debt**: are these trajectories consistent with your fiscal rule?
- ☐ **Consider now changes to your revenue and expenditure policies**: what would you need to change in order to reach your fiscal targets?
- ☐ **Keep iterating** until you have found a set of policies that is consistent with your fiscal rule.

Source: IMF mission.

Box 5. Roles of a Macro-Fiscal Unit

Ministries of Finance have macro-fiscal units which coordinate fiscal policy with key agencies, including the revenue authority, treasury, and budget departments. They prepare the MTFF, develop forecasts, summarize the assumptions underpinning fiscal planning and prepare a fiscal risk analysis.

Macroeconomic forecasting. Producing annual and medium-term forecasts for macroeconomic variables such as GDP and inflation, exchange rates, interest rates.

The medium-term fiscal framework (MTFF). Preparing all fiscal forecasts, or bringing together components of the MTFF prepared by other units or departments.

Revenue forecasting. Often responsible for preparing forecasts of tax and non-tax revenues.

Expenditure forecasting. Coordinate the forecasts of total government expenditure over the medium-term with input from the budget department.

Debt projections and sustainability analysis. Advise on the implications of macroeconomic shocks and policy measures for medium-term debt profile.

Fiscal policy analysis. Advise on the fiscal policy strategy, including the setting of fiscal rules.

Fiscal risk analysis. Coordinate government's risk exposure by producing a fiscal risk statement.

Monitoring macroeconomic developments. Produce in-year reports on domestic and international macroeconomic developments and their implications for the macroeconomic outlook and fiscal forecasts.

Monitoring the fiscal framework. Assessing whether fiscal outcomes are in line with fiscal forecasts and identifying whether fiscal policy targets or fiscal rules might be breached.

Source: Fainboim, Israel, and Ian Lienert. 2018. "The Macro-Fiscal Function and its Organizational Arrangements." IMF Technical Notes and Manual.

71. Regular discussions of forecasting assumptions by all key actors are essential on this identification of the potential fiscal path to achieve the fiscal rule. Although the Department of Finance participates in monthly meetings with the Central Bank of Aruba on standard agenda items, there is limited discussion on fiscal policy assumptions. The macro-model commission chaired by the Department of Economic Affairs, Commerce, and Industry of Aruba (DEACI) discusses assumptions for growth forecasts but is not a substitute for fiscal policy coordination. Ideally, a fiscal policy committee should be established to coordinate regular assumptions which affect the MTFF. To formalize the committee's work, a term of reference should be developed and shared with all members. The committee could be chaired by the head of the fiscal policy and budget division or the head of the treasury and should be scheduled monthly. Members should formally be appointed by the Minister and include the Budget Unit, Treasury, Tax Policy, ATA, CBA, the Central Accounting Department, and the Department of Economic Affairs. Decisions could be escalated to the Director of Fiscal Policy and Budget once the committee has agreed on their fiscal assumptions. The minister should regularly be briefed on emerging fiscal pressures and non-adherence to the fiscal rule. If necessary, the minister should address bottlenecks in reporting, data sharing and transparency.

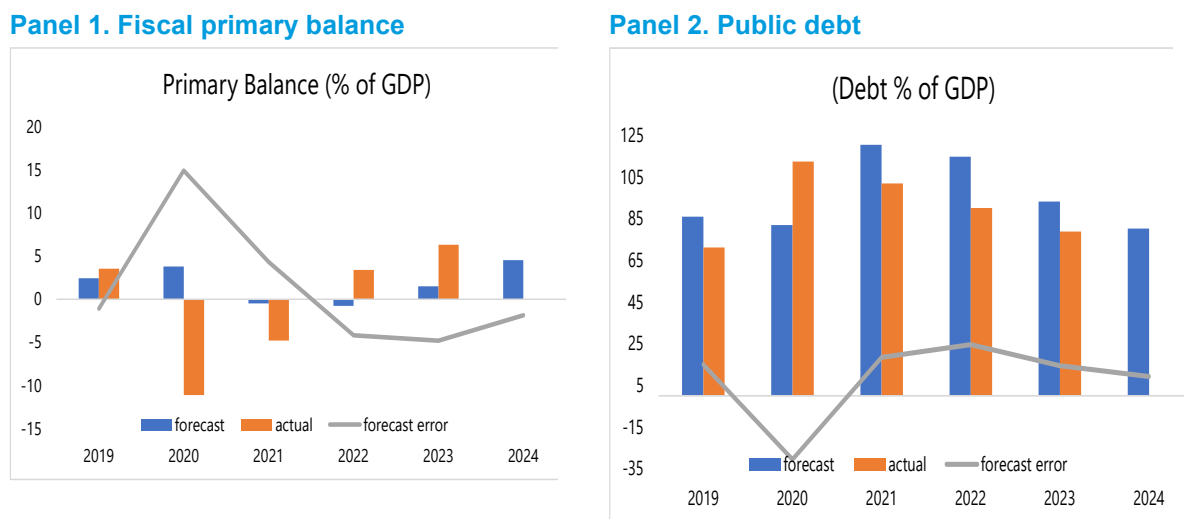
72. Currently, forecast errors for economic activity and growth, public debt, and fiscal balances are needed to enhance the credibility of the MTFF and the identification of the fiscal path. An analysis of GDP forecast errors in Aruba indicates optimistic (pre pandemic) and pessimistic (post pandemic) biases. Given that Aruba relies on 70 percent of its economic activity from tourism, the GDP forecasts should follow closely the forecasts for that sector, including the best methodology to

perform that forecast. Usefully, ATA has developed a highly elaborated forecasting model, whose methodology could be replicated or adapted for the GDP forecasting model of the government. ATA's forecasting model is named *Tourism Impact Model*, which provides reliable nominal GDP forecast based on 4 indicators—tourism receipts, stayover arrivals, cruise stayover arrivals, and revenue per available room (i.e., hotel products). The model is populated with historical data from 1986, and regular forecast error analyses are performed. The model assumes that a 1 percent increase in tourism results in 0.6 percent growth in nominal GDP. Other assumptions include slower growth in tourism based on the cap in hotel expansions, given sewerage, hospital capacity, employment, congestion, and other constraints. The rebasing of GDP, potentially expected for 2025, has also implications for the assumptions and the forecasts. It provides an opportunity to implement good practices and streamline coordination and practices among the departments.

73. ATA's model and forecasting methodology provides a useful example for the Fiscal Policy and Budget division to improve the credibility of its GDP forecasts. The forecast from the Fiscal Policy and Budget division are informed by the MARUBA model of Ministry of Economic Affairs. Although the MARUBA model contains comprehensive assumptions prepared by the macro model commission, it remains limited on its forecasting capacity given the outdated national accounts data used as a key input, and whose most recent information dates from 2019. Moreover, there is no forecast reconciliation of key macro-fiscal variables including GDP, debt, revenue, expenditure, and the fiscal balance. Forecast reconciliations are a powerful exercise to improve the credibility of the MTFF. This is a review of forecast against actual outcomes and reveals optimistic or pessimistic bias. ATA uses forecast reconciliations for tourist revenues, which could easily be applied to other variables.

74. Greater precision and coordination are further required when forecasting the fiscal primary balance as an operational target for reducing debt (Figure 16, panels 1 and 2). Consistent debt reduction requires a credible MTFF to be based on a stable fiscal primary balance, binding aggregate expenditure ceilings, and corresponding revenue efforts to achieve the primary balance target. Accordingly, the quality of fiscal statistics and the governance structure of their preparation should also improve to make sure that not only forecasts, but within-year estimates and outturns are as precise as possible. Moreover, as discussed before, in the case of Aruba, forecast errors on the overall balance create an additional concern in the sense that it can create “windfalls” (i.e., any overall balance above the 1 percent of GDP surplus target). Those “windfalls” have a clear use stipulated by the fiscal rule, which requires that 50 percent of them to be used to pay off debt, whereas the other 50 percent to be used towards capital spending.

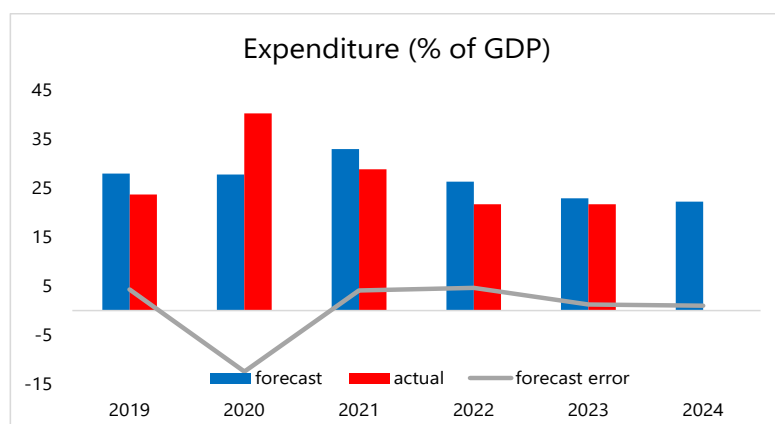
Figure 16. Fiscal Primary Balance and Public Debt Forecast Errors
(Percent of GDP)



Source: World Economic Outlook database; and IMF staff calculations.

75. The lack of a binding aggregate expenditure ceiling limits the effectiveness of the MTFF. Each year, the eight-line ministries (including their respective departments) are requested by the DOF to provide their multi-annual projections based on the previous year's forecast. Line ministries and departments are not provided with separate recurrent or capital spending ceilings to prepare their budget estimates within a constrained environment. The absence of binding budget ceilings limits the credibility of spending estimates as they can be changed at least twice a year during supplementary budgets. Figure 17 shows a comparison between projected and realized spending between 2019 and 2024, demonstrating the volatility of public spending, and quantifying the size of expenditure forecast errors. Even if one excludes COVID volatility, the forecast errors persist.

Figure 17. Public Expenditure Forecast Errors
(Percent of GDP)



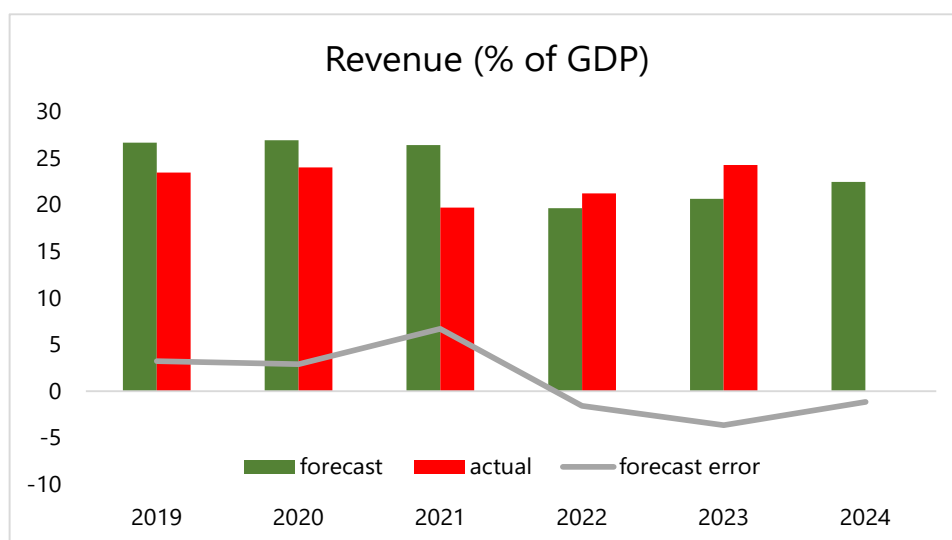
Source: World Economic Outlook database; and IMF staff calculations.

76. Revenue forecasts could also be improved (Figure 18). Robust growth in tourism has contributed to a sharp post pandemic recovery in fiscal revenues. In Aruba, tax revenues consist primarily of wage tax, profit tax, turnover tax and various tourism levies collected by the tax department. Forecasts are prepared for two forward years and based on $t-2$. For example, the forecast for 2026 is based on 2024 forecasts, since 2025 numbers are not available. These inputs are shared in March of each year with the Budget and Fiscal Affairs Unit, who then extrapolates a four-year time series based on the estimates provided by the tax department. The misalignment between the Tax Department 2-year forecasts and the Budget and Fiscal Affairs Unit 4-year forecasts contribute to the revenue forecast errors observed in Figure 18. Ideally, the 4-year forecasts of the Budget and Fiscal Affairs Unit should be prepared in consultation with the Tax Department.⁵¹

Budget Preparation and Calendar

77. The DOF is not currently implementing a top-down strategic budget process for budget formulation determined by the MoF. As previously mentioned, a strategic approach to budgeting includes a strategy setting phase to determine the aggregate ceiling and amount of fiscal space available for spending. The strategic phase is based on a fiscal anchor (the debt target) and includes multi-year macroeconomic forecasts (GDP, inflation, exchange rate) and fiscal targets (revenue, fiscal balance, expenditure).

Figure 18. Revenue Forecast Errors
(Percent of GDP)



Source: World Economic Outlook database; and IMF staff calculations.

78. The new fiscal rules' regime will need to align with the GOA's Budget calendar. Budget and Fiscal Affairs will need to provide guidance and sensitize line ministries on the implications in the Budgetary Rules and Guidelines after these rules and guidelines are approved by the MoF. Training or capacity building may also be required. A transitional provision serves several purposes: (i) it allows the

⁵¹ The alignment would require a policy directive which instructs all departments involved in forecasting to homogenize practices. Firstly, capacity building in revenue forecasting is needed for all staff involved.

government to phase in implementation of provisions based on capacity to implement; (it) it recognizes the importance of institutional capacity in meeting the fiscal rules; (iii) it ensures that there is no timing mismatch at the time of audit in that the DoF would be audited for compliance with the fiscal rules provisions before it is able to comply; and (iv) it facilitates sustainability and ownership of the fiscal rules and their implementation. As an example, Box 6 presents the transitional provisions of the 2023 PFM law of the Bahamas.

Budget Execution and Coordination

79. GOA produces good reports of quarterly budget execution that support the monitoring of its fiscal rules. The reports track the flow and stock of the components of the fiscal balance rule as well as the debt to GDP rule for general government (general government operations).⁵² General government expenditure is determined bi-annually, and the components of the fiscal balance are disaggregated by GOA or central government and the other entities that comprise general government. The quarterlies give an account of expenditure and revenue performance relative to annual targets (execution rate). For revenues, there is a statement on seasonality relative to performance. The quarterly budget execution report presents the five-year trends for revenues and expenditures, year-over-year for each quarter.

Box 6. Transitional Provisions in the 2023 PFM Law of the Bahamas

SECTION	REQUIREMENT DATE
41 Budget Reserve Appropriation	1 July, 2023
42 Contingencies Fund	1 July, 2023
49 Reallocations	1 July, 2023
50 Virements effect on budget and annual plan	1 July, 2023
51 Cash Planning and Management	1 July, 2023
54 Special Fund	1 July, 2023
57 Trust Assets	1 July, 2023
61 Financial asset management strategy	1 July, 2023
67 Remissions	1 July, 2023
68 Settlements	1 July, 2023
69 Write-offs	1 July, 2023
70 Accounting for remissions, settlements and write-offs	1 July, 2023
95 Monthly summary report	1 July, 2023
96 (1)(c) Schedule of capital assets	1 July, 2027
98 Annual Report of non-financial performance	1 July, 2024
106 Synchronization of financial years	1 July, 2024
107 Agency annual plan	1 July, 2024

Source: Government of Bahamas. 2023. Public Financial Management Act, Section 152; p. 82; and laws.bahamas.gov.bs/cms/images/LEGISLATION/PRINCIPAL/2023/2023-0004/2023-0004_1.PDF.

80. Yet, budget execution is also impacted by the lack of technical coordination among different units, both within the MoF as well as between MoF and other Government entities. Currently, there is no cash coordination at the technical level among key departments within the MoF which both, manage and forecast revenues and expenditures. Line ministries are also not producing

⁵² This is central government operations plus the other entities that comprise the general government.

liquidity plans to be submitted to MoF to optimize overall liquidity planning.⁵³ Improved cash coordination is required to enable effective, efficient, and timely information exchange among the key entities.

81. A weekly Cash Management Committee is an important mechanism for ensuring that risks to budget execution are minimized. The committee could consist of the, at a minimum, DoF (Budget and Fiscal Affairs, Financial Accounting, Treasury as the Secretariat, or co-chair), DoT, Economic Affairs (DEACI) and Customs Department. In fact, a similar committee existed in the past, with DoF and DoT, and should be now reinstated with expanded membership. It could have a Terms of Reference, which specifies membership, quorum, outputs, and an escalation mechanism for decision-making. For accountability, the minutes of its meetings should be circulated. This can decrease the cost of financing and cash management itself—when debt management is a concern—and ensure adequate liquidity for financing the approved budget.

Fiscal Risk Analysis

82. Fiscal risk analysis is also key in strengthening fiscal planning. Fiscal risks are defined as the deviation between forecasts and outcomes, which include macroeconomic shocks, SOE fiscal risks, contingent liabilities (e.g., guarantees), financial sector, and climate fiscal risks. Potential fiscal risks should be identified, and their likely materialization should be quantified in a fiscal risk statement (FRS). Uncertainty presented by forecasting could be mitigated by disclosing all assumptions, providing sensitivity analysis, alternative scenarios, and probabilistic methods including confidence intervals and fan charts. These methodologies could be elaborated in a new Aruba's FRS.

83. Fiscal risk analysis is at a developmental stage in Aruba. The DOF includes a summary of risks in its budget documentation for fiscal year 2025. Four risks are identified: institutional, economic, legal, and operational. Only macroeconomic indicators are identified in the risk matrix (deviations in macroeconomic forecasts and inflation). Those economic risks could per se be better described using new technologies, such as growth-at-risk, described in Annex V of IMF (2023).⁵⁴ Moreover, fiscal risks, such as from SOEs, for example, are not included possibly due to the coverage of the budget (central government). Capacity building is needed before implementation of new fiscal rules. Fiscal risk analysis will help determine the necessary interventions for a credible fiscal rules' framework.

84. The risk matrix that GOA presents in the budget documentation does not comply with the international best practice on standard risk matrix frameworks. A simple start to building capacity to prepare a FRS is the identification and prioritization of fiscal risks using standard risk matrices. A likelihood⁵⁵ by severity⁵⁶ matrix allows the GOA to prioritize risks and allow for more granular analysis of the respective risks based on the probable impact.⁵⁷ One approach is to create a 5x5 matrix, which uses

⁵³ Capacity building would help in producing and improving the liquidity planning.

⁵⁴ IMF (2023) "Kingdom of the Netherlands—Aruba: 2023 Article IV Consultation Discussions—Press Release; and Staff Report" IMF Country Report No. 23/284, July. Annex V of that report on "Growth at Risk in Aruba" quantifies macroeconomic risks to the Aruban economy, indicating that it is sensitive to shocks to real GDP growth in the United States, tourist arrivals, and domestic and external financial conditions.

⁵⁵ Likelihood is defined as the level of probability that a risk will materialize.

⁵⁶ Severity is the consequence of the risk.

⁵⁷ Severity x Likelihood = Risk Impact. Impact is the level of severity that will be experienced if the risk materializes.

a Likert scale scoring from 1 to 5⁵⁸ (Figure 19). The products or scores justify the risk treatment—i.e., whether the GOA would, for example, (i) avoid the risk (risk avoidance); (ii) reduce the risk (risk reduction); (iii) retain the risk (risk retention); (iv) spread the risk (risk spreading); or (v) transfer the risk (risk transfer). The IMF's Fiscal Risk Assessment Tool (FRAT) is a simple tool which can support the risk matrix.

Figure 19. Heat Mapping of Risk Impact
(Unit values)

Impact	Likelihood	Very Unlikely	Not Likely	Possible	Probable	Very likely
	Values	1	2	3	4	5
Negligible	1	1x1	2x1	3x1	4x1	5x1
Minor	2	2x1	2x2	2x3	2x4	2x5
Moderate	3	3x1	3x2	3x3	3x4	3x5
Major	4	4x1	4x2	4x3	4x4	4x5
Catastrophic	5	5x1	5x2	5x3	5x4	5x5

Source: IMF staff analysis.

85. The fiscal risk assessment prepared by the GOA does not evaluate each risk. Rather, the type of risk is evaluated at an aggregate level (Table 4). For the next budget, this simple likelihood by severity matrix approach can result in prioritization of the various risks based on their impact. The wage bill fiscal rule, for example, is not specified as the binding constraint on GOA's ability to attract more qualified and competent staff. Rather, projects resulting from the Dutch government initiative to support PFM capacity building in Aruba, known as the *Country Package*, are cited as directly impacting institutional weaknesses.

Table 4. Fiscal Risk Identification in GOA's Budget Documentation⁵⁹

Type of Risk	Likelihood (Chance ⁶⁰)	Manifestation ⁶¹	Risk Mitigation
Institutional	High	Delays in preparation of budget execution reports and annual financial statements	Investments and skilled staff for core services
		Effectiveness, efficiency and legality of policy implementation and business operations ⁶²	

⁵⁸ Scores would range from a product of 1 to one of 25.

⁵⁹ Information extracted from 2025 budget documentation in summary form.

⁶⁰ GOA refers to this as chance. Severity is not included. Impact is not represented as a product of likelihood and severity.

⁶¹ GOA refers to this as impact – what is expected.

⁶² It is unclear what this refers to or its significance.

Economic	Medium	Modification of financial framework and balance	Supplementary budgets
Legal	High	Deterioration of the balance and debt	Supplementary budgets
Operational	High	Deterioration of the balance and debt	Internal control and risk management framework

Source: GOA.

86. Fiscal risks that may arise from SOEs are not included as part of budgetary risks. They are not included despite recent IMF CARTAC technical assistance to Aruba in 2024 (Whyte-Givans, van Schaik, and Gallardo, 2024).⁶³ Those authors reveal that SOEs are a significant source of fiscal risk in Aruba. The SOE Health-check Tool (HCT) was used to evaluate 32 entities over the six-year period, 2017–2022. Forty-two percent of financial statements were missing for that six-year period. For the four years 2019–2022, the percentage of financial statements missing was 59.1. This means that the DOF had not have access to those statements at that time. As such, it has not had either a full grasp of the financial status of all SOEs, or full visibility regarding their compliance with legal requirements for timely submission of annual financial statements. This creates important fiscal risks for liquidity, profitability, and solvency among the SOEs evaluated. Some entities have both solvency and profitability risks, or other combinations; and GOA has to provide capital injections to address solvency in a few entities. Going forward, the GOA is working to include the results of the SOE HCT in the annual financial reports.

87. While SOE oversight by the MOF is an international good practice, there is currently a high level of discretion among SOEs in Aruba. SOEs are currently not required in their respective statutes to report to the Minister of Finance on financial matters. They are authorized to borrow without having to refer to the Minister of Finance. This means that there is no visibility of public sector debt both from statistical coverage and monitoring perspectives. Without visibility of SOEs and accountability to the Minister of Finance, the DOF cannot quantify their contingent liabilities and include them in the statistics of public sector debt.

88. Whyte-Givans, van Shaik, and Gallardo (2024) concludes that there is a need for overarching reforms to SOE governance in Aruba. As part of the overhaul of the PFM legal framework, all SOEs should be mandated to provide *ex ante* and *ex post* fiscal data on financial, liquidity, profitability, and other performance indicators to DOF. An oversight mechanism needs to be identified, and staff need to be trained in analyzing the fiscal data of SOEs *ex ante* to avoid bailouts and other fiscal shocks. There were six specific recommendations: (i) enact, through legislation, a clear separation between policy oversight and financial oversight; (ii) standardize accounting standards; (iii) establish capacity in the DOF for monitoring of financial reporting compliance; (iv) sanction entities that do not comply and require support from central government; (v) request technical assistance from the IMF's

⁶³ Whyte-Givans, Sophia, Frans van Schaik, and Noel Gallardo. 2024. CARTAC TA Report Aruba: Health Check of Non-Financial State-owned Enterprises (SOEs) and Other Entities.

Statistical Department to develop a complete institutional table; and (vi) rationalize SOEs, on completion of institutional table, and reintegrate some SOEs back to central government. Ideally, institutional responsibility should be vested within the DOF in a division or section that also manages macro-fiscal functions.

89. The Accountability Law has created opportunities to improve the analysis of fiscal risks.

For example, there is a number of funds that were created under Article 39 of the Accountability Law,⁶⁴ for which the line minister and the Minister of Finance are accountable. Article 40 requires financial statements for each of these funds, which should follow the same financial reporting timelines as the central government financial statements. Yet, almost no financial statements for these funds have been prepared, and none of them has been audited, with limited to no transparency for these funds.⁶⁵ Consequently, before the statistical coverage of the fiscal rules can be expanded to the public sector, there is a need for transparency on all of government's operations (see further discussion on the coverage below).

Contingency Reserves and Climate Funds

90. Contingency reserves contribute to the mitigation of unexpected fiscal shocks. Many countries include a contingency reserve or other buffer funds to mitigate against the impact of external shocks. Although Aruba has limited experience with natural disasters due to climate change, there is growing evidence that temperature- and sea level rises are becoming more common globally. In line with international experience, initially, a percentage of the budget (between 1 and 5 percent) could be considered, and the size of the contingency could be increased over time. The contingency fund is not typically allocated until an emergency or shock materializes. It should be appropriated by Parliament in an adjustment budget. Rules for accessing the contingency fund need to be clearly specified in decrees or ordinances to ensure that access is triggered during a qualifying event. The contingency fund, depending on its size, can reduce the need to resort to an escape clause. Clear and robust fiscal rules indicate the size of the impact that is required to necessitate an escape clause and the validation by a competent authority. These design features ensure fiscal discipline.

91. Indeed, the GOA has indicated its interest in establishing mitigation measures against climate and other risks. Articles 15 and 16 of the Accountability Law allow the Minister to receive allocations for exigent expenditure from the contingencies item set aside in Article 2(4)—and which is only under the Ministry of Finance (MOF) budget—if there is urgency. This has been allowed if the situation is so urgent that it makes it difficult for other Ministers to comply with provisions set out in Article 14, requesting a national decree to precede excess expenditure. This provision is an authorization for incurring financial commitments for which no expenditure is actually available. It does not provide immediate liquidity. In the aftermath of a disaster, timeliness of allocations and availability of resources are paramount. Article 2(4) can be enhanced in a new PFM law, with an accompanying state decree or it can be expanded into the contingency fund. **The lack of a borrowing relationship with multilateral development partners is another key constraint for Aruba's mitigation strategies against fiscal and economic shocks.**⁶⁶ Multilateral development partners (e.g., the World Bank) have existing

⁶⁴ There are 8 or 9 of these funds which have never been audited.

⁶⁵ Examples of financial statements already prepared include the one from the Tourism Product Enhancement Fund, for example.

⁶⁶ It is the Kingdom of the Netherlands that has the borrowing relationship with the multilaterals.

contingent clauses in debt instruments that defer payments or allow reallocation of resources to disaster response.⁶⁷ There is also opportunity for international cooperation on risk pooling—e.g., subscription to the Caribbean Catastrophic Risk Insurance Facility Segregated Portfolio Company (CCRIF SPC) for excess rainfall or tropical cyclone.⁶⁸ These risk mitigation measures could help Aruba to develop resilience to climate and other types of fiscal risks.

Institutional and Statistical Coverage

92. Country experience shows that successful fiscal rules have broad institutional coverage, but practical implications must be considered before enlarging their perimeter. Aruba's current fiscal rule applies to the central government and the collective sector, though there is no clear criteria of how the classification of the collective sector is determined.⁶⁹ According to one interpretation by the authorities, surpluses that supersede the fiscal norm and that are considered as part of a windfall from the AZV (general health insurance) and SVB (social insurance) funds are to be split, with 50 percent allocated to public debt repayment and the other 50 percent directed toward public investment. However, the legal framework governing these funds prohibits their surpluses from being used for debt repayment. Ideally the fiscal rule should extend to the general government and, over time, encompass the broader public sector.

93. Including SOEs in the fiscal rule would increase the complexity of the rule and raise concerns regarding compliance with the rule. The DOF has recently started to review SOE fiscal risks. However, as previously discussed, data are sparse. Consideration should be given to extending the fiscal rule analysis to SOEs only once the MoF is able to include their debt in a debt sustainability analysis and a recalibration of numerical rules. Figure 20 illustrates the phasing that governments should pursue in terms of coverage of the boundary for fiscal reporting.

Fiscal Transparency, Financial Reporting, and Accounting Basis

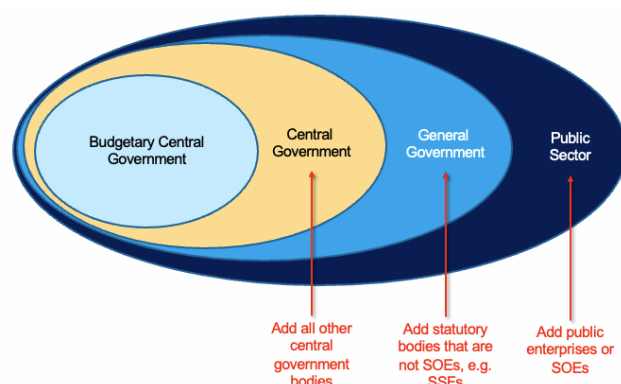
94. Accountability and transparency are essential for the implementation of credible fiscal rules. Key budget documents produced by the DOF on behalf of the MoF are currently not transparently published nor easily located by the public in Aruba. Relevant budget documents include: (i) an explanation of the budget law including attachments (debt sustainability); (ii) Fall Note; (iii) Spring Note; and (iv) the two budget amendments. More recently, the DOF has produced for the MoF a May note, which is similar to a fiscal strategy statement. These documents contain significant analyses and forecasts, but they are published at the discretion of the Minister.

⁶⁷ <https://thedocs.worldbank.org/en/doc/6c3130f7ec820c91cde12d2a730ff1a5-0340012023/original/Case-Study-IPF-DDO.pdf>.

⁶⁸ https://www.ccrif.org/aboutus/ccrif-products?language_content_entity=en.

⁶⁹ Kingdom of the Netherlands Aruba: Strengthening fiscal planning – L Doherty et al, January 2021, P 13

Figure 20. Phased Widening of the Coverage Boundary for Fiscal Reporting



Source: IMF staff analysis.

95. Good practice requires all budget documents to be transparently published annually on the Ministry of Finance’s website. In addition to the documents mentioned above, other planning, policy, and fiscally related documents should be publicly disclosed and accessible on the MOF’s website. This is a verification and accountability mechanism that can be strengthened. Citizen engagement is one way of institutional checks and balances into the fiscal rules’ framework and of engendering ownership.

96. Performance on compliance with provisions for quarterly and annual financial reporting is mixed. At the time of the mission, annual accounts had not yet been completed for 2021. The quarterly implementation or execution reports are required in Article 17 of the LAft. They are requested to be published by the Minister of Finance on behalf of COM no later than 6 weeks after the end of each quarter.

97. Any new policies with financial implications, as well as the progress towards meeting the fiscal rule, must be included in the quarterly budget execution report. Additionally, these reports are required to outline how any imminent or realized deficits will be addressed, for example, through compensating measures.⁷⁰ The Central Bureau of Statistics (CBS) is mandated to report to the Minister of Finance on expenditure, revenue, deficit, and debt figures for the collective sector for the previous year by September 1 each year.⁷¹ Annual financial reporting is also required,⁷² with a deadline for the Minister of Finance to submit the certified annual financial statements (referred to as annual accounts) by August 31 of each year.⁷³ While compliance with quarterly reporting has been achieved, there is a significant gap in compliance with annual financial statements. The most recent audited annual financial statement pertains to the fiscal year 2019.

98. The accounting basis for the fiscal rule should be based on the accounting standard used by government. Aruba is implementing partial accrual accounting: there is accrual accounting on the expenditure side and cash accounting on the revenue side. The law is accrual-based, but the practice has

⁷⁰ GOA 2015; Article 17.3.

⁷¹ GOA 2015; Article 22.1.

⁷² GOA 2015; Article 17.5.

⁷³ The Accountability Law requires the Minister of Finance in Article 45 to do this no later than September 1.

never been fully compliant. Good practice is to implement cash accounting fully, address all audit concerns, and then transition to accrual. Although Aruba attempts to comply with partial accrual accounting standards, the lack of capacity in the Central Audit Department (CAD) and the backlog in financial statements dating to 2019⁷⁴ require a more pragmatic approach. Incomplete and unaudited financial statements present a credibility risk. The cash basis of accounting should be used for reporting on the fiscal rule until the backlog and capacity constraints have been addressed, and there is capacity to attempt accrual accounting. The software system should be configured to enable cash accounting until suitable capacity is developed to prepare accrual accounts annually and on time.

99. The DOF is aware of the importance of timely financial reporting for fiscal rule validation, in particular certified audits.⁷⁵ A Consultant has been hired for a two-year period to eliminate the annual financial statement (AFS) backlog. Currently, the AFS for 2020 has been submitted for audit. The 2020 annual statement has benefited from a fiscal risk analysis that profited from capacity building in the SOE Health-check Tool (HCT). The DOF plans to integrate the analysis from the tool in all financial statements from 2020 onwards.

100. Yet, GOA is currently unable to fully comply with the existent PFM legal framework. The CAD is currently not adequately resourced to meet its legislated responsibilities. The GOA has an agreement with the Kingdom of the Netherlands to have a fully compliant audit of the financial statements for fiscal year 2026. The CAD has been conducting simulated audits, which have resulted in unqualified opinions. The focus should be on addressing CAD constraints, such as its understaffing, which is indeed the case with *Country Package*. The lack of accounting standards mentioned earlier limits the basis on which audit opinions are given. The amendments to the Accountability Law as well as the proposed (accrual-based) accounting standards will state that the audit is to be done by the CAD and that if the CAD does not have the capacity to complete the audits, the Minister of Finance should provide resources to procure external auditors. Certification of audits is a critical function for fiscal rules.

Institutional Capacity

101. Aruba has additional capacity constraints across the government's PFM workstream. The human resource capacity risk is significant to the fiscal rules' framework. The capacity gaps have been filled with consultants in CAD and in Financial Accounting. But this is unsustainable. In Financial Accounting, for example, once the consultant leaves, there is a risk of backlogs accumulating again. Authorities should follow a concerted effort to build and institutionalize capacity within the GOA if reforms, including fiscal rules, are to be sustainable.

102. The *Country Package*, again a Dutch government initiative to support PFM capacity building in Aruba, should be implemented in a gradual manner and with support with other international institutions to avoid the burdening of Aruba's already resource-constrained system. With the support of the *Country Package* and other capacity-building institutions, GOA should prioritize attracting skilled workers; upskilling existing staff and making critical investments in ICT (software and

⁷⁴ This is the last audited financial statement is for fiscal year 2019.

⁷⁵ The CAD, and not the Court of Audit (*Algemene Rekenkamer*) certifies the financial statements. This is common in Dutch overseas territories as well as in Suriname.

hardware) to support the digital transition. By focusing on these areas—enhancing staff capacity and advancing digitization—GOA can achieve significant gains in both effectiveness and efficiency.

103. In terms of the Financial Accounting Unit, the following issues are the main ones the DOF needs to address. The Unit needs capacity enhancement and the fulfilment of vacant management positions. It needs certified accountants. It needs capacity building, knowledge retention, and institutionalization of that capacity and knowledge, including through the development of manuals and standard operating procedures for system use. Another potential risk is ICT. There are plans to replace the current integrated financial management information system (IFMIS), as it approaches the end of its shelf life. Measures must be put in place to phase in the implementation with adequate capacity building so that the transition itself does not compound the backlog issue.

104. There should be a comprehensive gap analysis vis-à-vis implementation of the new fiscal rules regime to develop a capacity development plan. Reforms should be sequenced in parallel with institutional capacity building to make achievement of the rules credible or realizable. Preference should be given to institutionalization rather than outsourcing of capacity needs. The gap analysis should inform the transitional provisions in the successor LAft or new, modern PFM Act, regarding the effective date for the fiscal rules.

D. Recommendations

105. Aruba should design a fiscal rule that is clear, simple, and transparent to avoid redundancy and inconsistency.

106. In terms of PFM pre-requisites to implement the fiscal rule, Aruba should:

- a. Enhance the MTFF, including by adopting binding aggregate and individual fiscal ceilings;
- b. Strengthen fiscal risk analysis and improve on the existing fiscal risk statement;
- c. Improve coordination and reinforce liquidity management by establishing a cash management committee and regular fiscal policy meetings;
- d. Improve transparency by reporting on performance against fiscal rule and publishing all budget and fiscal reports on MoF website;
- e. Integrate tax policy and revenue collection strategies to adhere to the fiscal rule;
- f. Address backlog in annual financial statements, audit, and backlog in national accounts up to 2024;
- g. Maintain annual financial statements as well as annual national accounts updated from 2024 onwards;
- h. Use a contingency reserve to address fiscal shocks;
- i. Explore contingent financing instruments and parametric insurance with multilaterals and CCRIF SPC;
- j. Conduct a comprehensive gap assessment vis-à-vis capacity to implement the new fiscal rules framework.

107. In terms of legislation, GOA should enact a home-grown PFM law that supports Aruba's fiscal sustainability. Considerations include:

- a. Enact an entirely new GOA PFM Law;
- b. Legislate a MTFF through the GOA PFM Law;
- c. Make greater use of State Decrees, for example, to innovate and allow flexibility to adapt to changes;
- d. Improve the escape clause in the new Supervision Legislation and successor GOA PFM Law;
- e. Introduce a home-grown fiscal council.
- f. Abandon the definition of surplus “windfalls”;
- g. Enshrine fiscal transparency to allow easy and direct public access on DoF website;
- h. Clarify transitional provisions in the legal framework on effective date of fiscal rules provisions to address, for example, coverage of general government and the public sector;
- i. Maintain the contingency provision in the 1989 Law and strengthen it through a State Decree
- j. Introduce provisions for fiscal resilience to disasters in the legal framework.

108. Experience with reforming the budget law and the fiscal rules in the region indicate that home-grown measures are more sustainable. The guiding principles for the fiscal rules can be articulated in the Kingdom Law and translated to the local law. There are other instruments that can be used for operational practices such as the State Decree. The law should not be hardwired with provisions that make it too complex as this violates the principles of simplicity, clarity, transparency, and flexibility.

109. Aruba will also need a transitional period between the adoption and implementation of the proposed new fiscal rules framework. This will allow for capacity building within the MOF as well as widening of the consolidation boundary for coverage. The implementation of the new fiscal rules will need to align with the budget cycle and with accounting reforms, which will indicate coverage aligned with transition to accrual accounting, including consolidation of SOEs. The Ministry of Interior Affairs of the Kingdom has indicated that May 1, 2025, is the date for the new proposal and this is separate from the implementation date. Incidentally, this is the timeline for Budget submissions for fiscal year 2025, which are articulated in the *May letter*.

V. Concluding Remarks

110. Aruba is currently reviewing its fiscal rules to reinforce its fiscal framework and guarantee that public debt goes gradually back to its anchor. The island's reliance on tourism and external factors underscores the importance of prudent debt management strategies, given that in the decade prior to the COVID-19 pandemic, central government debt was higher than 70 percent of GDP in 2019. The pandemic was another harsh reminder of Aruba's debt vulnerabilities, bringing a sharp fall in tourism receipts, and leading to an additional spike in public debt that reached 112.3 percent of GDP in 2020. Since then, public debt has receded, thanks to considerable fiscal effort by the Aruban government.

111. The Government of Aruba has invited this IMF mission to provide recommendations on the design of a new fiscal rule and supporting PFM reforms, which make part of a revision of Aruba's COVID-19 loan protocol with the Netherlands. The report outlines several key recommendations to facilitate this process, including the need to simplify fiscal rules and establish a central government debt anchor. Simplification will enhance clarity and compliance, allowing stakeholders to better understand their roles and responsibilities in managing public finances.

112. The report advocates that Aruba establishes a new debt anchor of 50 percent of GDP by 2035. Such target would help maintaining fiscal discipline and ensuring that the government operates within sustainable financial limits. This long-term objective would further guide fiscal policy decisions and set a course for reducing the debt burden in a structured manner.

113. Moreover, the report emphasizes the importance of implementing one single operational rule in the form of a primary balance or expenditure rule, to ensure that fiscal policy reaches the debt anchor by 2035. The fiscal rule framework should further include escape clauses that allow for temporary deviations during extraordinary events, thereby preventing rigid adherence to rules that may not be feasible in times of crisis. Additionally, the fiscal rule framework should envisage a national independent fiscal council as a permanent institution in promoting accountability and compliance to Aruba's fiscal governance. Similar to the CAft, the national independent fiscal council would be enshrined either in PFM legislation, as in Grenada's case,⁷⁶ or its own national ordinance or law as in Jamaica's case,⁷⁷ with a governance framework. Both escape clauses and a fiscal council would enable Aruba to maintain fiscal discipline while also being responsive to unforeseen economic challenges.

114. Additionally, the revision of the fiscal rule framework should be accompanied by PFM reforms. The Minister of Finance should develop a credible MTFF to provide a structured approach to fiscal planning, enabling the government to align its revenue and expenditure projections with its long-term fiscal goals. The Ministry of Finance should moreover enforce its procedures to increase fiscal transparency, and enhance budget formulation, execution, and reporting, including through larger coordination among the different institutions connected to budget execution. Legislative changes should also be pursued to clearly delineate the roles of the DOF in policy and financial oversight, standardization

⁷⁶ Government of Grenada. 2023. Fiscal Resilience Act. <https://grenadaparlament.gd/wp-content/uploads/2024/11/Act-No.-11-of-2023-Fiscal-Resilience-Act-2023.pdf>.

⁷⁷ Government of Jamaica. 2021. The Independent Fiscal Commission Act. https://www.japarlament.gov.jm/attachments/article/341/The-Independent-Fiscal-Commission-Act--2021-No.-4_.pdf

of accounting practices, and the establishment of strong compliance mechanisms. To address these challenges, it further advocates the importance of building the capacity and increase the number of staff at the ministry. By implementing these reforms, Aruba can strengthen its fiscal governance framework, improve public financial management, and ensure that the fiscal rule is credible and achievable.

115. Effective communication and announcing of the new rule and credible fiscal targets will be essential to achieve the objectives of the updated fiscal rules. That would set a strong precedent and build credibility for the rule. Importantly, the Aruban authorities should signal a strong commitment to the medium-term debt anchor.

116. Over time Aruba's fiscal rules should be assessed depending on changes in economic circumstances and on the objectives and performance of the rule. Such assessment could be done periodically, but not frequently, possibly every 6 years to minimize overlaps with electoral cycles.

Annex 1. Previous Technical Assistance Reports

Kingdom of the Netherlands – Aruba: Strengthening Fiscal Planning – Laura Doherty, Guohua Huang, Bruce Stacey, Marco Cangiano and Dana Frey. January 2021

Aruba Government Wage Bill Assessment and Options – Mercedes Garcia Escribano, Christopher Bender, Emmanouil Kitsios and Mauricio Soto. April 2020

Aruba: Health Check of Non-Financial State-owned Enterprises (SOEs) and Other Entities – Sophia Whyte-Givans, Frans van Schaik, and Noel Gallardo – January 2024