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Kingdom of the Netherlands—Netherlands Antilles: 2003 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with the Kingdom of the Netherlands—Netherlands Antilles, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 20, 2003,** with the officials of the Kingdom of the Netherlands—Netherlands Antilles on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on May 16, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its June 4, 2003 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Selected Issues and Statistical Appendix

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS ANTILLES

Staff Report for the 2003 Article IV Consultation Discussions

Prepared by the Staff Representatives for the 2003 Article IV Consultation
with the Kingdom of the Netherlands—Netherlands Antilles

Approved by Alessandro Leipold and Martin Fetherston

May 16, 2003

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I. Introduction

1. The Netherlands Antilles comprise a federation of five Caribbean islands and are part of the Kingdom of the Netherlands. In addition to the central government for the federation, each island has its own autonomous government; 75 percent of the population of 176,000 reside in Curaçao.[1] The country does not have a separate quota or other financial relations with the Fund (Appendix I), and the Kingdom's acceptance of Article VIII, Sections 2, 3, and 4 also applies to the Netherlands Antilles. The Netherlands Antilles have their own currency, the Netherlands Antilles guilder (NA f.) which has been pegged to the U.S. dollar at a rate of NA f. 1.79 per $1 since December 23, 1971. The Netherlands Antilles are on a 24-month consultation cycle, and the last consultation was concluded on May 7, 2001.

2. **In recent years, the authorities have requested frequent staff involvement in designing economic adjustment programs, adherence to which formed the basis for Dutch budget support**. An initial staff monitored program was adopted in 1997 and expired in 1998. Subsequently, regular less formal staff involvement continued through 2001. Going back to the mid 1990s, the Fund has urged the authorities to bring public finances under control in order to avoid an impending fiscal crisis. In particular, it called on the authorities to reverse the secular decline in revenue resulting from the shrinking offshore and oil-refining sectors, and to trim public spending, mainly by reducing the size of the civil service. The introduction of indirect monetary policy instruments was also recommended. Structural reform advice was centered on the need to liberalize onerous labor regulations; lower protection; promote a more enabling environment for private enterprise; and improve the efficiency of public enterprises. The sound development of the financial sector and strengthened supervision of the international financial sector were also stressed. Finally, weaknesses in the statistical base needed to be addressed.

3. **The track record in implementing Fund advice has been mixed.** The authorities' efforts at fiscal consolidation were repeatedly frustrated by adverse shocks as well as difficulties encountered in forging the needed policy consensus. Notwithstanding some progress in cutting the civil service and broadening the revenue base through the introduction of a turnover/sales tax, the accumulation of public debt continued largely unabated. Other reforms, notably more efficient tax administration and the streamlining of the public service, remain unfinished. Some progress occurred on structural reforms: in 2000 labor market regulation in Curaçao was liberalized, and a trade-reform program was launched.[2] Financial

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[1] Curaçao and Bonaire are located off the Venezuelan coast and Saba, St. Eustatius, and the southern part of St. Maarten are in the Eastern Caribbean windward islands.

[2] In mid-2000, Curaçao abolished the requirement for individual dismissal permits and liberalized contractual employment and labor market mediation. Subsequently, the immigration of skilled professionals was liberalized, while a temporary amnesty was extended to employed illegal immigrants.

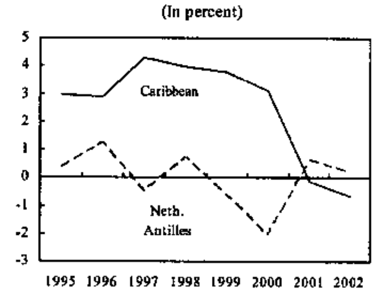
supervision of both onshore and offshore institutions has been strengthened, and the authorities have made important strides in introducing indirect monetary policy instruments. A privatization program is slowly getting under way. Data quality remains wanting.

4. General elections in January 2002 resulted in a defeat of the then-ruling coalition. Intensive negotiations over the following months succeeded in attracting a previous opposition party into the government, and a new 6-party coalition, led by Prime Minister Ys, was formed in June 2002. Political attention in 2003 has focused on the island-level elections in May 2003. The election results from the main island of Curaçao—which became available as this report was being finalized—have added to political uncertainty. The principal opposition party almost doubled its share of votes, making it the largest party, and putting it in charge of forming a new governing coalition for the island.

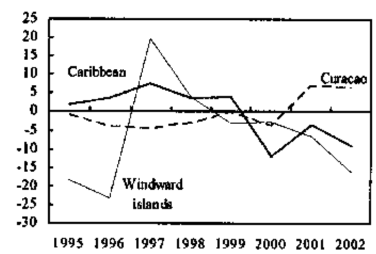
II. Background to the Discussions[3]

5. **Recently, the economy has proved surprisingly resilient, recording a private-sector led rebound from a deep recession, but the situation remains fragile.** Since the mid-90s, the Antillean economy has recorded low rates of growth, followed by a double-dip recession (Table 1, Figures 1 and 2). In contrast to the generally favorable external environment over that period, the last two years were marked by the fallout of the September 11 attacks, the slowdown in the United States, and turmoil in Venezuela, which spilled over through the temporary closure of the Venezuelan-managed refinery in late 2002 and the adverse effects of Venezuelan exchange controls on bilateral commerce. Nevertheless, and in contrast to many neighboring economies, which registered significant economic contractions, the Antillean economy grew, albeit modestly (a cumulative ¾ percent) over the period. Buoyant tourism in Curaçao was the main factor, with the other islands only recently participating in the upturn.

Real Growth
(In percent)



Stayover Tourism
(Annual percentage change)



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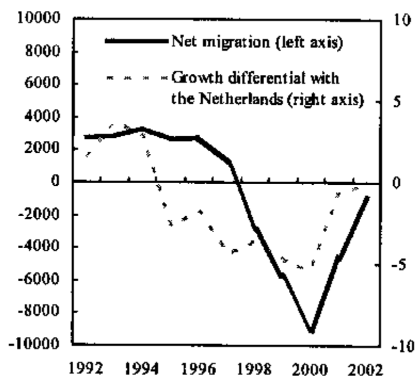
[3] A staff team comprising Messrs. Bell (head), Annaert, and Dyczewski (all EU1) visited Willemstad during March 6–20, 2003. The mission met with the Prime Minister, the President of the Central Bank, the Deputy Prime Minister, the Minister of Finance, and other members of the central government cabinet, the executive council of the government of Curaçao, and senior officials from the central government, the central bank, and the Curaçao government. In addition, meetings were held with the civil servants' pension fund, the social insurance bank, the Curaçao health administration, the privatization foundation, the poverty-relief foundation, the statistics office, and representatives of labor unions, employers, and the tourism and international financial sectors.

Encouragingly, private-sector activity led the recovery, with private investment growing more than 20 percent. In contrast, public consumption and investment expenditure declined significantly. Inflationary pressures abated sharply with consumer prices up only ½ percent in 2002, reflecting continued slack in the economy, indirect tax cuts, and a waning of cost-push pressures related to energy cost and indirect tax increases in 2000 (Figure 3). These positive developments are clouded, however, by the sharp deterioration in public finances (see below).

6. **Employment prospects are improving and emigration has begun to slow.** With free labor mobility to the Netherlands, migration has traditionally played a prominent role in the economy's adjustment to shocks. Two channels have been at play: higher-skilled professionals have found more lucrative employment options in the Netherlands, while Dutch welfare benefits provided an incentive for the unskilled and unemployed to emigrate rather than accept lower wages. At the same time, mostly illegal immigration from within the region—where per capita income levels are considerably lower (see Table 2 for a regional comparison of key data)—has served to fill the low-skill worker pool.[4] While the combined effect of these trends has arguably limited the deterioration in the unemployment rate, the economy has also lost prospects for longer-term productivity growth along with skilled labor. After peaking at 9 percent of the population in 2000, emigration has recently slowed in line with the narrowing growth differential between the Netherlands and the Antilles and the associated worsening of the Dutch labor market.



7. **The external accounts have improved, though impediments to competitiveness remain.** The 2002 current account deficit is estimated at 4¾ percent of GDP, ¼ percentage point below the average since 1995, boosted by expanding tourism inflows and buoyant growth in the duty-free zone for exports (Table 3 and Figure 4). In addition, the offshore sector has begun to recover following the implementation of the new fiscal framework with the Netherlands.[5] However, traditional merchandise exports have not fared well, declining by some 12 percent over the last two years, a 6 percent loss in market share. While developments in the CPI-based effective exchange rate index do not give rise to obvious concern (Figure 5), past studies by the World Bank and FIAS have stressed that the

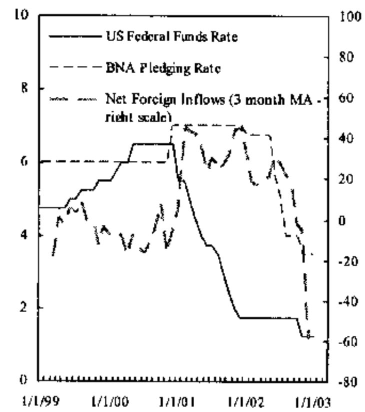
[4] Foreign nationals do not enjoy free mobility to the Netherlands, and their reservation wages are thus not influenced by the level of Dutch welfare benefits.

[5] The new arrangement was specifically designed to address OECD concerns about harmful tax competition, and features the imposition of a standard tax rate on Dutch dividend flows to the Antilles, with a grandfathering arrangement covering tax structures existing prior to 2001.

economy's underlying competitiveness is impaired by its high cost structure, importantly related to inefficiencies in public utility companies, high labor costs, and still considerable import protection.

8. **Monetary conditions under the exchange rate peg with the U.S. dollar have been appropriately supportive, however, they mainly resulted in easier financing for the budget**. After a series of interest rate cuts in the U.S., a substantial gap between Antillean and U.S. policy interest rates had opened up by end-2001, and foreign exchange inflows began to accelerate. Moreover, with a depreciating euro, a Dutch bank was successful in marketing euro-denominated mortgages on the Antilles. As a result, reserves reached the authorities' target of three months of imports and broad money expanded by 14½ percent. In 2002, the monetary authorities reacted with a sequence of rate cuts and early in the year also lifted the ceiling on bank credit to government; subsequently, net credit to government more than doubled, underpinning money growth of 11¾ percent (Table 4).

Interest Rate Differential and Inflows
(SA)



9. **Public finances have deteriorated sharply**. Falling revenue collections and increasing interest expenditure raised the general government deficit by 1¼ percent of GDP, to a historical high of 5½ percent of GDP (Table 5 and Figure 6).[6] The poor revenue performance reflected the end of a tour of duty of Dutch tax administration experts—after which direct tax collections retreated to previous levels—as well as the unfinished integration of the tax collection agencies.[7] Higher interest expenditure arose from the conversion of some previous arrears into formal interest-bearing debt. Some savings in primary expenditure were counteracted by an increase in the public sector wage bill of ½ percent of GDP, which reflected the lifting of the wage freeze imposed in 2000 and higher pension premia. As a result, net public debt climbed to 75 percent of GDP.

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[6] The staff adjusts official cash budget data for expenditure arrears to permit an assessment of the underlying accrual trends. The method minimizes the discrepancy between the deficit and financing (including recorded expenditure arrears). However, these estimates are subject to some uncertainty, especially to the extent that not all expenditure arrears are recorded.

[7] As part of the civil service reform, the authorities undertook to eliminate the overlap between the tax collection agencies of the Curaçao and central governments. The associated staff cuts were realized, but not the actual unification of the agencies, resulting in personnel shortages in key areas.

III. Policy Discussions

10. **The mission took place on the heels of the publication of the new government's economic program for 2003–06.** This program envisages the restoration of growth and consolidation of public finances over the next four years. The staff supported these objectives, but noted that macroeconomic policies had recently weakened substantially and that a comprehensive and detailed policy framework in support of the authorities' objectives had yet to be developed. The discussions accordingly focused on the policy requirements ahead: a quick return to sustainable macroeconomic policies—notably through sizable fiscal adjustment—and further structural reforms to boost growth.

A. The Short–Term Outlook

11. **A gradual, if fragile, pickup in real economic activity in 2003 was jointly seen to be the most likely scenario.** Based on the recovery in tourism already underway, private investment projects in the pipeline, and expanded airlift capacity, staff projected economic growth of ½ percent in 2003. Further impulse would be forthcoming from higher employment and wages bolstering consumption, and the projected increase in trading partner import demand growth. Inflation was projected to rise to 2 percent, in line with developments in the U.S.

12. **There are, however, substantial downside risks, only some of which outside the authorities' control.** The authorities cautioned that apart from tourism, there were few other concrete indicators of stronger growth. They were also concerned about the uncertain geopolitical environment at the time of the mission and contagion from Venezuela. The staff concurred, but underscored that home-grown drags on confidence and growth were as, if not more, important. In particular, the authorities needed to be seen to firmly tackle the public debt problem—beginning with upfront fiscal adjustment—and to resist political pressures for a rollback of structural reforms that had arisen in the run-up to the island-level elections.

B. Fiscal Policy

13. **The discussions highlighted the need to arrest and reverse the unsustainable public debt dynamics.** The staff developed two benchmark medium-term scenarios: one based on current policies, as set out in the 2003 budget, and a second one based on its recommended policies (Table 6).[8] These benchmarks reveal a markedly different picture:

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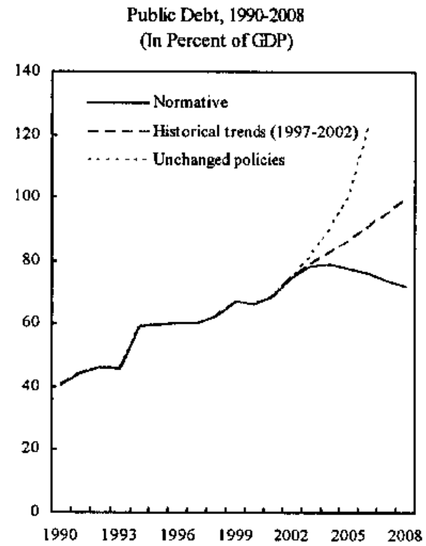
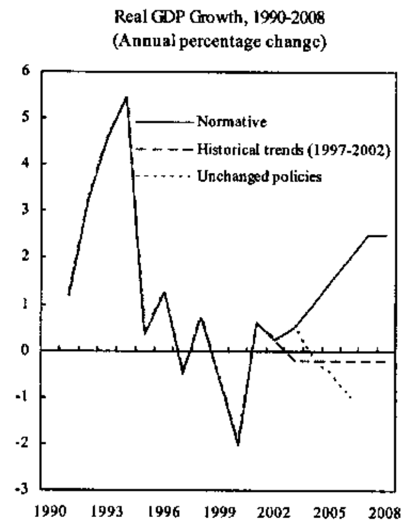
[8] For illustrative purposes, another scenario, based on the average macroeconomic environment and fiscal stance over the last five years has also been included in the charts. This scenario also results in unsustainable debt dynamics, albeit less pronounced than in the unchanged-policy case.





- Unchanged policies become unsustainable already over the next three years. The adverse debt-deficit cycle quickly accelerates, resulting in a debt stock of 120 percent of GDP by 2006. The associated financing needs would by then exceed the loanable funds of the banking system, putting the peg at serious risk, and raising the specter of subsequent high inflation if the peg is abandoned or significant parallel market premia if exchange controls are tightened.

- The normative scenario highlights the requirements for a sustainable policy framework. Fiscal consolidation and structural reform mutually reinforce each other, and the economy's potential rate of growth reaches 2½ percent over the medium term. On the back of significant primary surpluses, public debt would begin to decline starting in 2005, and sufficient private sector credit would become available. Moreover, after the initial fiscal adjustment, the declining interest bill would create adequate room for significant real primary expenditure increases.

14. **The authorities agreed that a critical juncture had been reached and recognized the importance of adapting policies, albeit not yet in 2003**. They considered it important to provide economic stimulus in a still weak environment and saw little room for maneuver to effect fiscal retrenchment in an election year. Accordingly, their draft budget for 2003 includes additional capital expenditure of 2 percent of GDP in the newly established Economic Development Fund, that provides cofinancing to kick-start private investment.[9] There is also a further increase in the wage bill, reflecting the payment of previously

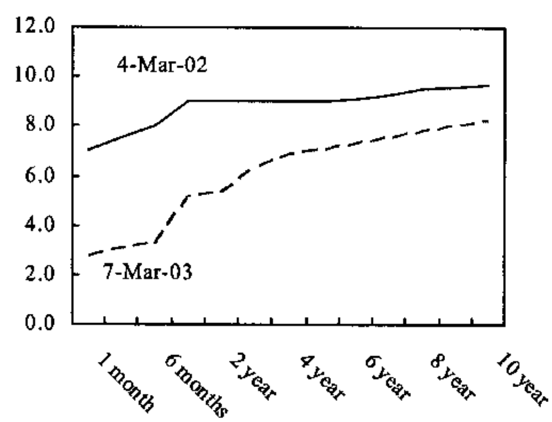
[9] At the time of the mission, the 2003 budget for the federal government had not yet been discussed in parliament.

suspended vacation allowances for civil servants, as well as higher pension premia for civil servants. Meanwhile, interest expenditures are set to rise further as previous arrears to the social insurance bank of some 7 percent of GDP are being converted into interest-bearing debt.

15. **The staff pointed to the risks entailed by the authorities' fiscal policy stance and emphasized its adverse effects on growth.** The staff regretted that key expenditure items had not been accounted for in the 2003 budget and called on the authorities to take stock of all spending plans and commitments. As it stands, the draft budget would propel the deficit to more than 8 percent of GDP—notably driven by a deterioration in the primary balance of almost 2 percentage points of GDP—and public debt would rise to 80 percent of GDP.[10] In addition, the staff noted that such a deficit, contrary to intentions, would not help the private sector, as the monetary authorities would have to offset the associated liquidity creation by raising interest rates. Instead, the fiscal stance needed to be tightened to unburden monetary policy and safeguard the peg.

16. **Moreover the public finances are still subject to a number of risks.** Contingent liabilities on already called-up loan guarantees are not fully budgeted (1½ percent of GDP); a legal challenge to the bankruptcy of the state-owned airline may yet result in a claim on government (up to 5 percent of GDP); and the budget provides no funds to finance the smaller islands' budgets, which received some ¼ percent of GDP in financial support in the last month of 2002. Moreover, interest expenditure projections appear to count on a continuing shortening of maturities to benefit from low short-term rates, a trend which may quickly reverse. Finally, there are some 8 percent of GDP in arrears that would need to be regularized, preferably by converting them into interest-bearing debt. The authorities agreed with these risks but countered that higher dividend receipts from public companies may yet yield some additional revenue.

Term Structure
on Government Paper



17. **Significant fiscal savings can be realized in 2003.** For 2003, the staff suggested that the budget deficit be capped at the 2002 level, implying an improvement in the primary balance of 1 percent of GDP. This would require fiscal measures of some 2¾ percent of GDP, which could be realized quickly. In the first place, the aborted 2001 health reform

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[10] Based on data then available, the staff had estimated a deficit of 6¾ percent of GDP for 2003 at the time of the mission.

program, which targeted some 1½ percent of GDP in savings—among others, by unifying the health care packages of different government providers—could be reinstated. Moreover, the Economic Development Fund could be shelved and alternative financing be obtained in the framework of the multi-year economic development program, financed through Dutch grants.

18. **Beyond 2003, staff recommended a primary surplus target sufficient to reverse the accumulation of debt.** Staff calculated that a primary surplus of 5 percent of GDP would stabilize the level of public debt by 2005.[11] This target was consistent with the government's intentions to move toward balanced budgets, and also provided a sufficient margin in case the significant contingent liabilities turn into actual liabilities. The mission suggested the following avenues to realize the needed fiscal savings:

- First, deep reform of the **health care sector**. With expenses of some 11 percent of GDP, the Antillean health care system is costly by international standards. The authorities felt that in a small island economy, significant diseconomies of scale were unavoidable. Moreover, owing to close links with the Netherlands, the population expected health care of comparable quality. While acknowledging these points, the staff still saw scope for significant savings. Limits on the open-ended nature of benefits—for example by introducing budgets for providers and extending co-payment obligations—could serve to address inefficiencies.[12] Diseconomies of scale could be partly overcome by sourcing supplies (pharmaceutical licensing, laboratory and pharmaceutical services, and use of rarely utilized expensive medical equipment) from more competitive international markets.

- Second, tighter control of extrabudgetary units and the smaller island budgets. As part of earlier civil service reform, a number of government agencies were spun off into **extrabudgetary units**. There was agreement that these units' operations were poorly audited and controlled, resulting in weak financial discipline and a need for government subsidies to fill their budget gaps. The staff suggested that transfers and subsidies to these units be capped at 2002 levels, pending the results of stringent cost audits of their operations. The **smaller islands** have also experienced chronic budget problems, in spite of their increased revenues following the implementation of the new solidarity fund, and the central government staged a bailout in late 2002. The staff saw a need for considerably tighter financial control of these islands' budgets to prevent a recurrence.

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[11] At the time of the mission, the staff had recommended a primary surplus target of 4 percent of GDP. The higher target reflects the subsequent upward adjustment in the official debt data.

[12] There are 28 pharmacies on Curaçao—about twice the level considered adequate in international benchmarking—that are supplied by 27 pharmaceutical wholesalers, all of which charge guaranteed markups over costs. Similarly, the number of general practitioners per capita is twice that of the Netherlands.

- Third, the **protection of the revenue base**. As a matter of urgency, the mission called on the authorities to merge the tax collection agencies of the central and Curaçao governments. This would help address the current staffing imbalance where the enforcement of some high-priority taxes is jeopardized by personnel shortages, while less significant and more self-enforcing taxes enjoy ample staffing. A unified agency would be free to redeploy collectors to priority areas as needed. Further ahead, the mission saw a need to ensure that future tax policy changes—notably the announced 2004 reform (see Section D)—be at least revenue neutral. Given the lack of preparations, a delay in the reform by at least one year would appear prudent.

- **An explicit medium-term fiscal framework could help fiscal consolidation to gain a foothold**. The staff recommended the adoption of a more formal medium-term fiscal framework, built around the above primary surplus targets. Such a framework would place a premium on high-quality and durable adjustment, and provide a yardstick against which voters could assess fiscal performance. The authorities agreed on the need to credibly anchor fiscal adjustment over the medium term and indicated that the recently established expert group advising the government on public debt would consider these points.

19. **The aging problem is comparatively less severe, but the civil service pension fund is under strain.** With funded pension schemes being the norm, the Antilles are better placed than other economies to weather population aging. However, the soundness of the civil service fund (APNA) has become an issue, with the emergence of large government contribution arrears and the fund's recent poor investment performance. Indeed APNA's funding ratio has fallen below 100 percent—against a target of 125 percent—and, in response, a series of premia increases has commenced.[13] The staff called on the government to honor its obligations in full and in a timely fashion, and to regularize any remaining payment arrears by converting them into interest-bearing debt. PAYG pensions are limited to the AOV scheme, which provides a base pension, indexed to the CPI and determined by the length of service.[14] While the scheme was sustainable, past emigration had burdened the islands with an unfortunate age profile and a large "missing contingent" in the 18–40 year cohort. The implied seesawing dependency ratio could trigger additional pension expenditures of some 1 percent of GDP by 2025, after which the cost would start to fall again. Beyond these factors, the eventual return of Antilleans currently residing abroad could impose additional costs, including for health care. Against this background, the staff endorsed the policy of strictly limiting AOV benefits, while encouraging the provision of pensions through funded schemes.

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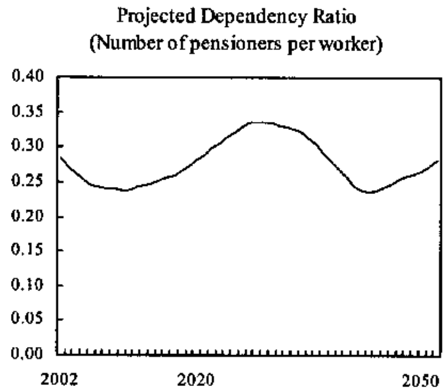
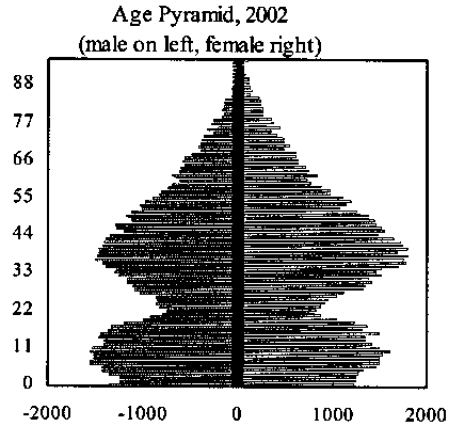
[13] By a bilateral agreement with government, APNA may only increase premia by 2 percentage points per year, and only up to a maximum of 25 percent. Any remaining funding shortfall would be addressed by benefit reform.

[14] The total AOV pension bill amounts to 3⅔ percent of GDP.





C. Monetary and Exchange Rate Policy

20. **The authorities and staff agreed that the exchange rate peg remains appropriate, but staff stressed the need to realign macroeconomic policies in its support.** The peg has delivered low inflation and bolstered the credibility of the central bank. Moreover, any beneficial effect of a devaluation on international competitiveness would likely be outweighed by the associated loss of confidence; to the extent that collective labor agreements provide for full indexation, no competitiveness gains would be forthcoming, but even in the absence of such indexation, the mobility to the Netherlands in practice establishes a wage floor. However, the current fiscal policy stance is inconsistent with the peg, as high levels of domestic liquidity expansion, fueled by large budget deficits, put the monetary authorities in a position to have to chose between risking the peg's credibility, sharply raising interest rates (and potentially triggering volatile short-term inflows), or tightening capital controls. Against this backdrop, the staff suggested that the authorities place less reliance on the reserve cover as an intermediate monetary target, as—apart from being subject to large errors in calculating imports—it failed to take into account rising public debt and domestic liquidity. The staff also noted that the liberal administration of existing controls on capital transactions had already introduced significant *de facto* capital convertibility, but recommended that further formal capital account liberalization should await substantial progress in fiscal consolidation.

21. **There was agreement that liquidity expansion needed to be reined in, particularly by curtailing credit to the government, but also by extending the use of indirect monetary policy instruments**. Accordingly, the authorities agreed to reimpose the previous ceiling on bank lending to the government. They have also recently raised reserve requirements and established bi-weekly auctions of central bank certificates of deposit (CDs), even though a ceiling on CD yields is applied to limit costs. The staff welcomed these steps. However, limiting credit to government—while important in containing liquidity expansion—would need to be accompanied by actual fiscal consolidation so as not to trigger the accumulation of new payments arrears. The introduction of the CD auctions was welcome

but the staff recommended that the ceilings on yields be lifted. Meanwhile, changes in reserve requirements remained an important tool in the authorities' policy arsenal as the scope for independent interest rate policy was limited by the exchange rate peg, the relatively open capital account, and the attendant risk of large swings in capital flows.

22. **The authorities reported signs that the health of the banking system is improving**. The most recent data depict a declining share of bad loans and sufficient provisioning by banks (Table 7). Nevertheless, there was agreement on the need to remain vigilant given anemic growth, the banking system's considerable exposure to the bearish real estate market—through mortgage lending and loan collateral—and the risk of contagion from events in Venezuela. The authorities pointed to their recent decisions to introduce greater flexibility in the on-site inspections schedule; to commence daily reporting requirements on Venezuelan-owned banks in response to events there; to place the mid-sized Giro bank, that had failed to meet capital adequacy requirements, under special administration; and to publish macro-prudential indicators regularly. The staff welcomed these steps but cautioned that further problems may lie ahead especially given the poor state of public finances. While the direct exposure of the banking system to the government is contained at 7 percent of GDP, there are important indirect links that may yet imperil the health of banks; further suppliers arrears could trigger a new wave of problem loans as the affected entrepreneurs would not be able to service their loans; moreover, banks' earnings from lending to government may to some extent have masked underlying weaknesses in their balance sheet that would come to the fore as such credit is curtailed. Finally, the needed acceleration of structural reforms may be accompanied by an increase in the number of nonperforming loans, as some borrowers may find it hard to adjust to stronger competitive pressures in their markets.

D. Structural Policies

23. **The key challenge for structural policies is raising productivity and long-term growth**. The staff argued that the task of raising growth rested with structural reforms, and emphasized the limited role of macroeconomic policies. In a highly import-dependent economy, the multiplier applying to fiscal expansions was likely to be negligible, while higher deficits would undermine a return to sustainable growth. Nor could monetary policy be pursued independently of the anchor currency, where interest rates had already reached historic lows. Instead, lifting the economy's long-term potential required a more enabling environment for the private sector, and heightened exposure of the economy to competition.[15]

24. **The effectiveness of structural reform was debated**. The authorities felt that the still depressed level of economic activity cast doubt on the effectiveness of past reform and felt a pause was called for to review the experience and build a social consensus on how to proceed. In contrast, the staff pointed to the generally spotty past reform record. However, the

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[15] A background paper discusses growth performance in small-island economies.

reforms that had been enacted, such as the 2000 labor market reforms in Curaçao, had yielded tangible benefits, even in the short-term, as evidenced by that island's recent resilient employment and growth performance.

25. **The authorities felt their planned tax reform would significantly boost growth.** For 2004, the authorities are planning to lower direct tax rates while canceling tax holidays and broadening the existing sales/turnover tax. They saw this reform as providing incentives for employment creation and investment. The staff observed that the overall tax burden was in line with the region—another reason to strive for revenue neutrality of the reform—but agreed that the share of direct taxes was on the high side. Nevertheless, it viewed the current system as a reasonable compromise. In a small, highly open and undiversified economy, taxes typically fell on labor—through direct taxes—or exports—through indirect taxes on imported inputs. A shift from direct to indirect taxes, may thus just shift the incidence of taxation from labor to exports with no clear-cut conclusions on the net effect on growth. However, undesirable distributional side effects may well arise as the poor consume a higher share of their income, and therefore may shoulder a higher tax burden.

Composition of Tax Revenue, 2000[1]

	Caribbean average[2]	Netherlands Antilles
	(In percent of GDP)	
Tax revenue	21.8	23.0
	(5.7)	
Direct taxes	7.4	11.8
	(4.6)	
Indirect taxes	14.4	11.2
	(4.1)	
	(In percent of of total tax revenue)	
Direct taxes	32.2	51.3
	(18.1)	
Indirect taxes	67.8	48.7
	(25.3)	

Source: IMF country reports.
[1]Numbers in parentheses indicate standard deviations.
[2]This aggregate comprises Anguila, Antigua and Barbuda, Aruba, The Bahamas, Barbados, Dominica, Dominican Republic, Grenada, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines, Trinidad and Tobago.

26. **Labor market reforms needed to address the twin challenges of providing opportunity for the unemployed and entrants to the labor market, as well as alleviating shortages in important skills.** In this light, the staff regretted the recent decision to increase minimum wages and suggested to forego the implementation of the final stage. The staff also urged the authorities not to heed calls for a rollback of past labor market reforms in Curaçao—which they indeed to date have resisted—but to instead extend such reforms to the other islands. Staff also advocated additional measures to redress remaining obstacles to employment growth, for example the mandatory overtime and severance pay regulations, as well as the elimination of employment traps in the welfare system. Shortages of key skills could be addressed through liberal extension of work permits.

27. **The authorities looked toward accelerating the privatization program through strategic partnerships**. Such partnerships with reputable multinationals were seen as key to increase efficiency in public enterprises. The staff suggested considering a broader menu of options, including outright divestiture. This would provide resources to lower public debt, and may also result in more efficiency gains as the owner would put his investment at risk, a feature that was absent in the strategic partnerships negotiated so far. At the same time, the staff also stressed the importance of setting up an independent regulatory body in network sectors. The presence of such an agency, with arms-length relationship with the government, would provide an additional incentive for foreign investors to enter into privatization deals.

28. **There was agreement on the need to increase competition in the banking system,** where the dominant bank still holds the majority of deposits. As an important step in improving competition, the mission suggested that the authorities strive to sell Giro bank to a reputable foreign bank. It would also be important to guarantee a level regulatory playing field, and the staff welcomed the recent abolition of the preferential reserve requirements for smaller banks, which may give some impetus to further consolidation.

29. **Limited competition is also a feature of product markets.** Extensive protection in the past shielded domestic producers, and the associated inefficiencies are coming to the fore as trade is being liberalized.[16] The authorities remained skeptical on the merits of further liberalization and pointed to better quality control practiced by local companies that hampered them in international competition. They felt that further product market reform needed to await the implementation of stricter quality control and licensing requirements on the part of potential competitors. The staff emphasized that insulating enterprises from competitive pressure would forestall needed resource reallocation and noted a competition law could address abuses if they occur.

30. **Trade reform continues along its multi-year path, but the staff suggested to widen its scope**. The authorities' trade reform program targets the full elimination of the import surcharge by 2005.[17] As a next step, the authorities saw merit in increased regional

[16] After the recent trade liberalization, local retailers have found parallel imports of brand products from the region cheaper than purchasing the same locally produced brands.

[17] In 2002, taxes on international trade amounted to 2.6 percent of GDP. They comprise (specific and ad valorem) import tariffs and economic levies, the latter specifically aimed at protecting domestic producers. Tariffs *stricto sensu* range from 0 percent on basic goods to 63 percent (tobacco products). They have not been modified since the last consultation, with the exception of duties on computers and computer parts, which were reduced to zero in 2003. Since 2001, economic levies are being progressively dismantled with their full elimination targeted for 2005. The levy on cars was already abolished in 2003 and, in keeping with the schedule, other economic levies have been reduced by three-quarters of their 2000 level by 2003. These steps have resulted in a decline of the unweighted average tariff rate (inclusive of levies) from 27.2 percent in 2000 to 18.4 percent in 2003.

cooperation to exploit synergies. The staff, while not contesting potential gains from regional cooperation, suggested that the authorities also set their sights farther by entering negotiations within the FTAA framework, as well as expediting the accession to the WTO. Further trade opening options may also be pursued with the EU. The authorities, while agreeing in principle, felt that more extensive studies were needed to decide on these far-reaching issues.

E. Other Issues

31. **The offshore sector has begun to recover and received favorable assessments.** The authorities reported that following the adoption of the new fiscal framework with the Netherlands, the offshore sector was removed from several countries' negative lists, and that negotiations of new tax treaties had already commenced. Nevertheless, some actors in the sector were concerned about regulatory arbitrage by investors into less strict jurisdictions, but saw no option to reverse past reforms. The Netherlands Antilles have undergone Module II of the OFC assessment (finalization is envisaged for mid–2003) with generally favorable results. In an effort to address one key weakness, a draft law placing company service provider supervision inside the central bank has recently been prepared, and staff recommended its quick adoption. The AML/CFT framework is generally comprehensive and well designed, but its coverage could usefully be broadened and on-site inspections be conducted more frequently.[18]

32. **The database—while improved—still poses challenges for effective surveillance** (Appendix II). The authorities reported that they will shortly finalize national accounts through 2000. The staff, while welcoming the plan, called for additional efforts on fiscal statistics, where accrual data were not available, and the balance of payments, which recorded considerable errors and omissions and was subject to large unexplained swings.

IV. Staff Appraisal

33. **While the Antillean economy has weathered the recent global slowdown relatively well, growth prospects remain fragile in the face of macroeconomic imbalances and continued structural weaknesses**. The fragile recovery over the last two years has occurred in the trying environment marked by the September 11 attacks, the U.S. slowdown, and economic difficulties in neighboring countries. With early indications of a good tourism season and a less uncertain environment, the growth momentum could accelerate in 2003. However public debt has reached a critical level, raising the specter of an eventual financial crisis, while high costs and onerous regulations continue to put a brake on higher sustainable growth.

34. **Economic and financial policies have to address the twin challenge of reversing the explosive public debt and raising the economy's long-run productive potential.** A

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[18] It would be desirable to extent coverage to non-life insurance companies, lawyers, notaries, accountants, real-estate agents, and high-end goods merchants.

quick return to sustainable macroeconomic policies—notably through sizable fiscal adjustment—is imperative. At the same time, macroeconomic policies, while essential to prevent a further weakening of fundamentals, can only provide flanking support to the key challenge of raising the economy's productivity. This task needs deep structural reform.

35. **Redressing the rapidly deteriorating and unsustainable fiscal situation with the implementation of a tighter fiscal stance in 2003 is the immediate priority**. On the basis of current policies, the public debt outlook is unsustainable and any further increase in the fiscal deficit from the already high 2002 level needs to be avoided. Fiscal savings in the needed amount are at hand, including by completing the reform of tax administration, implementing already identified health-care savings, and suspending the Economic Development Fund.

36. **In the years ahead, primary surpluses of some 5 percent of GDP will be required to arrest and reverse the rise in public debt**. Significant expenditure savings can be realized in the health care system, which is expensive by international standards. Limiting the open-ended character of the benefits is one approach, but the authorities should also explore options to minimize the inherent diseconomies of scale, importantly through sourcing medical services from more competitive international markets. There is also a need to improve financial discipline in extrabudgetary units and the smaller islands. The case for fundamental tax reform is at present not strong, and efforts should instead be geared toward securing revenue collections.

37. **Fiscal adjustment needs to be firmly grounded in a medium-term framework.** A binding and transparent framework favoring durable and high-quality fiscal consolidation is needed to anchor fiscal policy and break with past stop-and-go episodes of fiscal adjustment.

38. **An eye will need to be kept on the soundness of the civil service pension fund and demographic developments**. While aging alone is not projected to imply a significant budgetary burden, APNA's funding shortfall must be quickly reversed. Moreover, the longer-term outlook for public finances could be critically affected by net migration patterns. Against this backdrop, the authorities should continue to limit the PAYG system to a basic pension—with any additional pensions provided through private schemes—refrain from raising the real value of the benefit, and meet all their obligations to APNA in a timely manner.

39. **Credit growth needs to be curtailed, consistent with the need to protect the currency peg, which has served the economy well**. The large monetary expansion in 2002, fueled by bank lending to government, cannot be repeated without risks. The reimposition of the limit on bank financing of government is important, but needs to be flanked by actual fiscal retrenchment to prevent the accumulation of arrears. The increased reliance on indirect monetary policy instruments is welcome. Their use should be further extended, including by lifting the ceiling on yields in the auctions for central bank paper. The potential for large and disruptive swings in foreign exchange inflows will require a continued role for changes in reserve requirements.

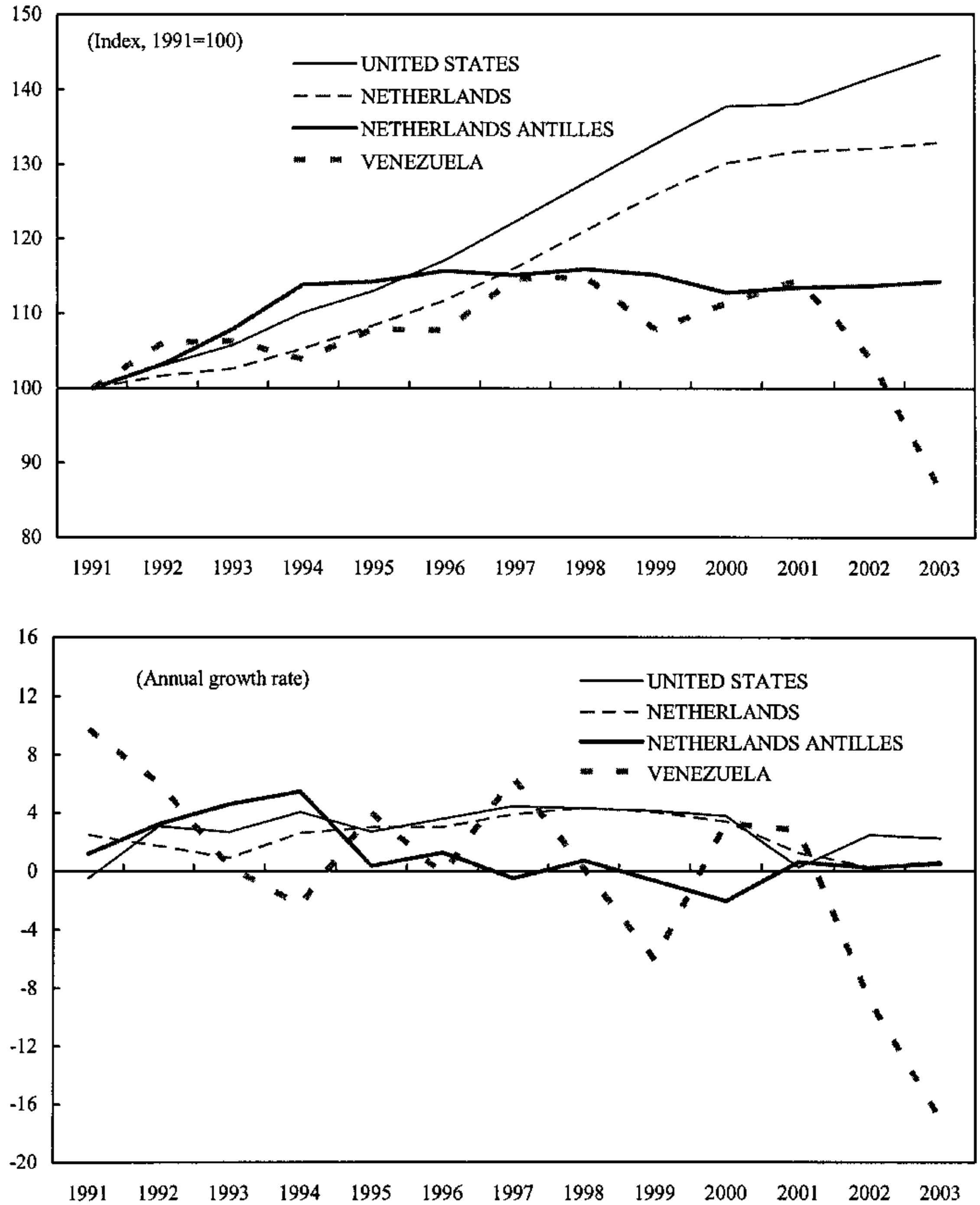
40. **A sound financial system is essential and remaining weaknesses in both the onshore and offshore sectors should be redressed.** The recent strengthening of supervisory capacity and enforcement is welcome. However, continued vigilance is essential, as the poor state of public finances and structural reforms in the economy may yet trigger or expose additional banking system weaknesses. The draft law placing company service provider supervision under the central bank should be adopted without further delay. The coverage of the generally well-designed AML/CFT framework should be further extended and more frequent inspections undertaken.

41. **Structural reforms are key to boosting longer-term performance.** Further liberalization of labor markets, importantly in the smaller islands, divestiture of public enterprises, and accelerated product market and trade reform are important to attract new investment. These reforms need to be buttressed by the establishment of an independent regulatory agency and the adoption of a competition law. Competition in the banking system could be enhanced by the entrance of reputable foreign banks, and the sale of the bank previously placed under special administration offers a unique opportunity in this regard.

42. **The assessment of economic developments and design of policies would greatly benefit from an improved statistical base.** In particular, the coverage and timeliness of real sector statistics will need to be significantly improved, while more effort is needed to document the underlying fiscal position through comprehensive accounting of expenditure arrears and the activities of extrabudgetary units and the smaller islands. A greater focus on explaining anomalies in the balance of payments would also be welcome.

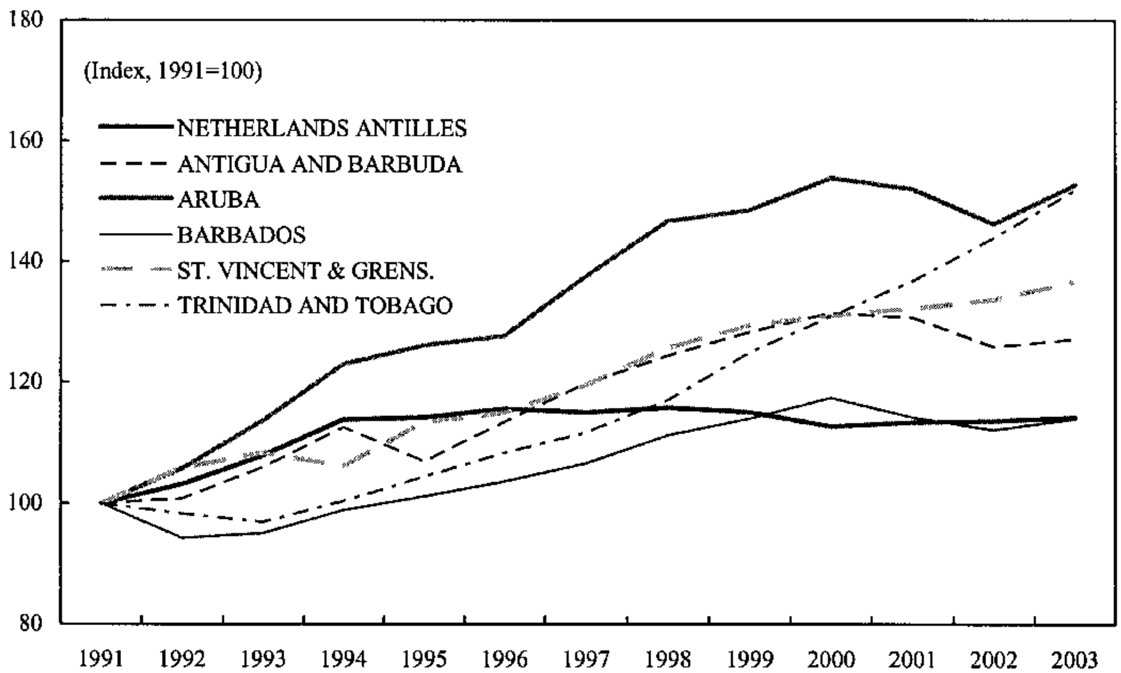
43. It is proposed that the **next Article IV consultation** take place on a 24-month cycle.

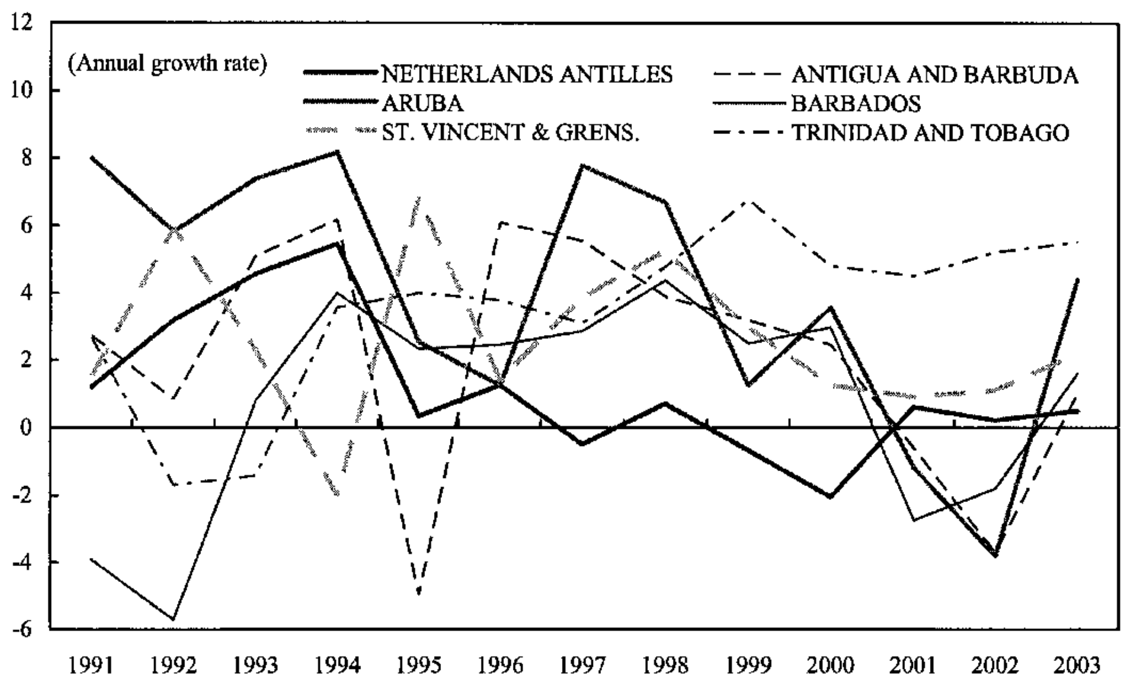
Figure 1. Netherlands Antilles and Trading Partners: Real GDP 1/



Source: IMF, WEO.
1/ Projections in 2003.

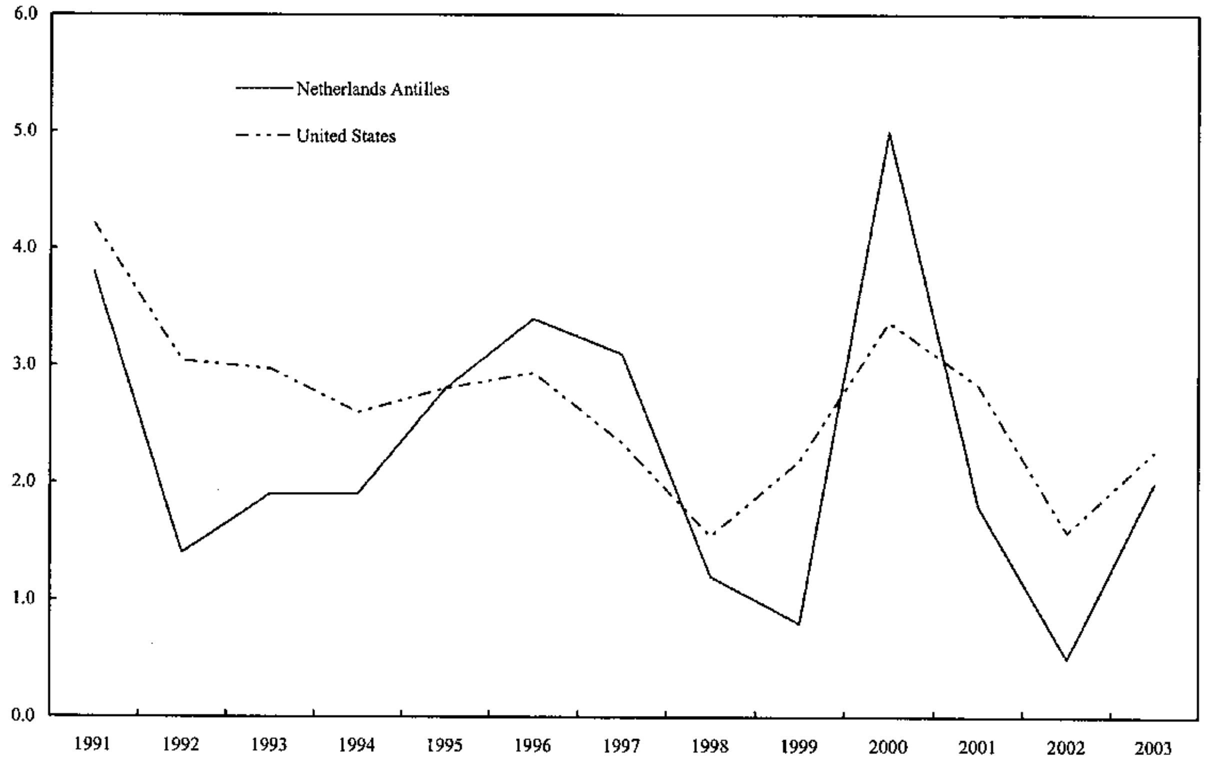
Figure 2. Netherlands Antilles and Selected Caribbean Countries: Real GDP 1/





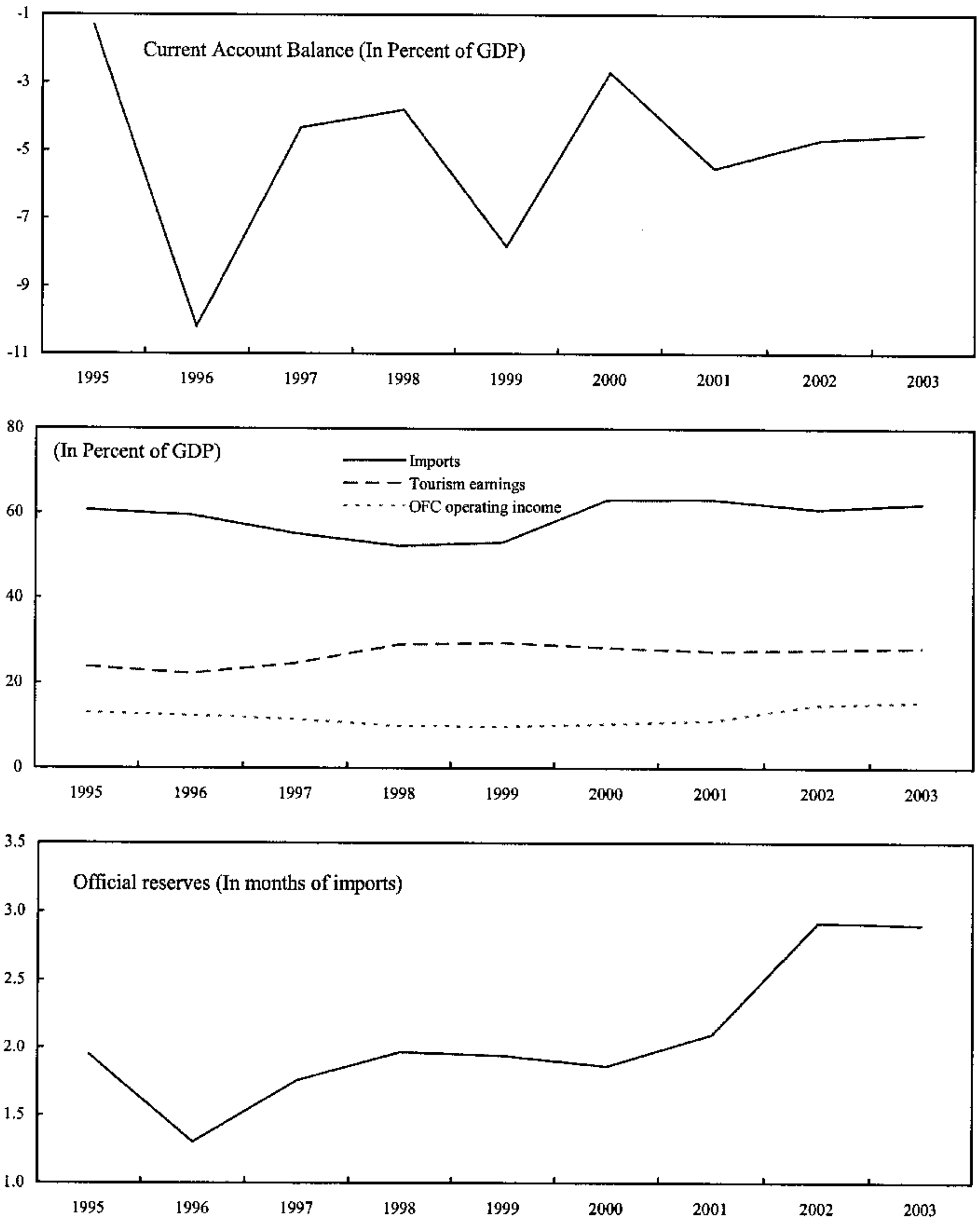
Source: IMF, WEO.
1/ Projections in 2003.

Figure 3. Netherlands Antilles: Consumer Price Inflation 1/



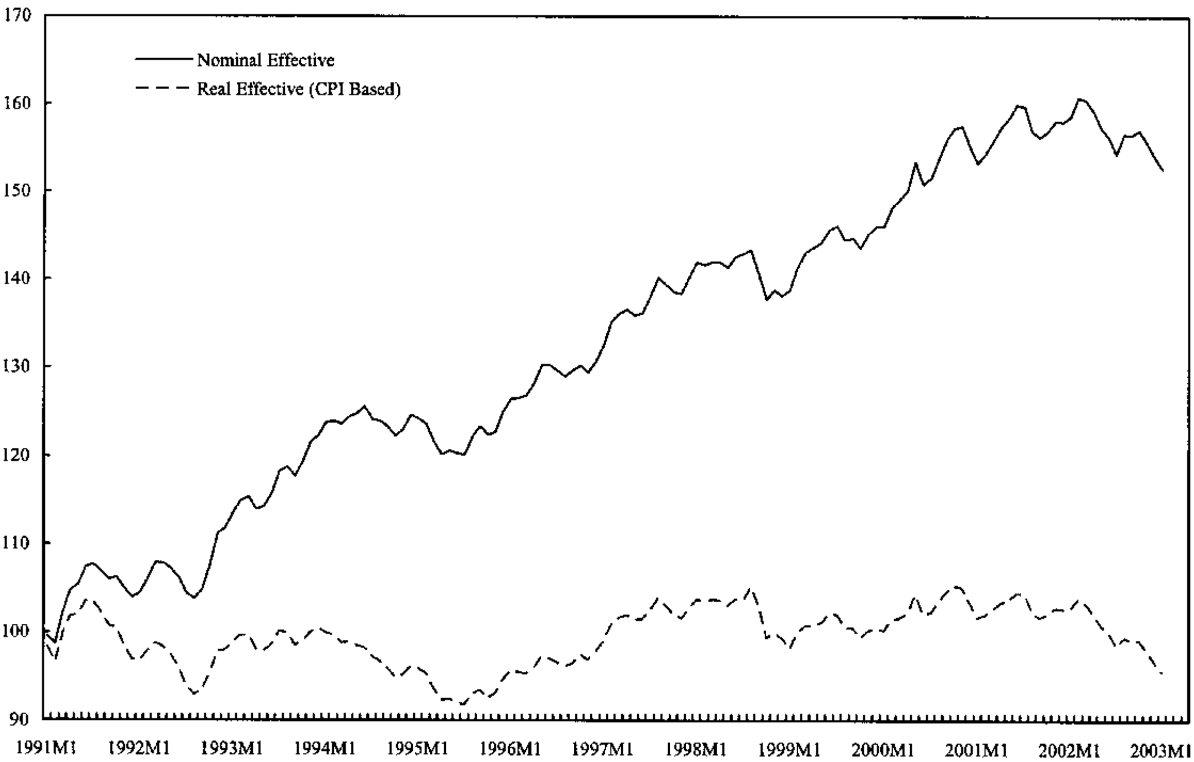
Sources: Data provided by the Antillean authorities; and IMF, WEO.
1/ Projections in 2003.

Figure 4. Netherlands Antilles: External Sector Developments



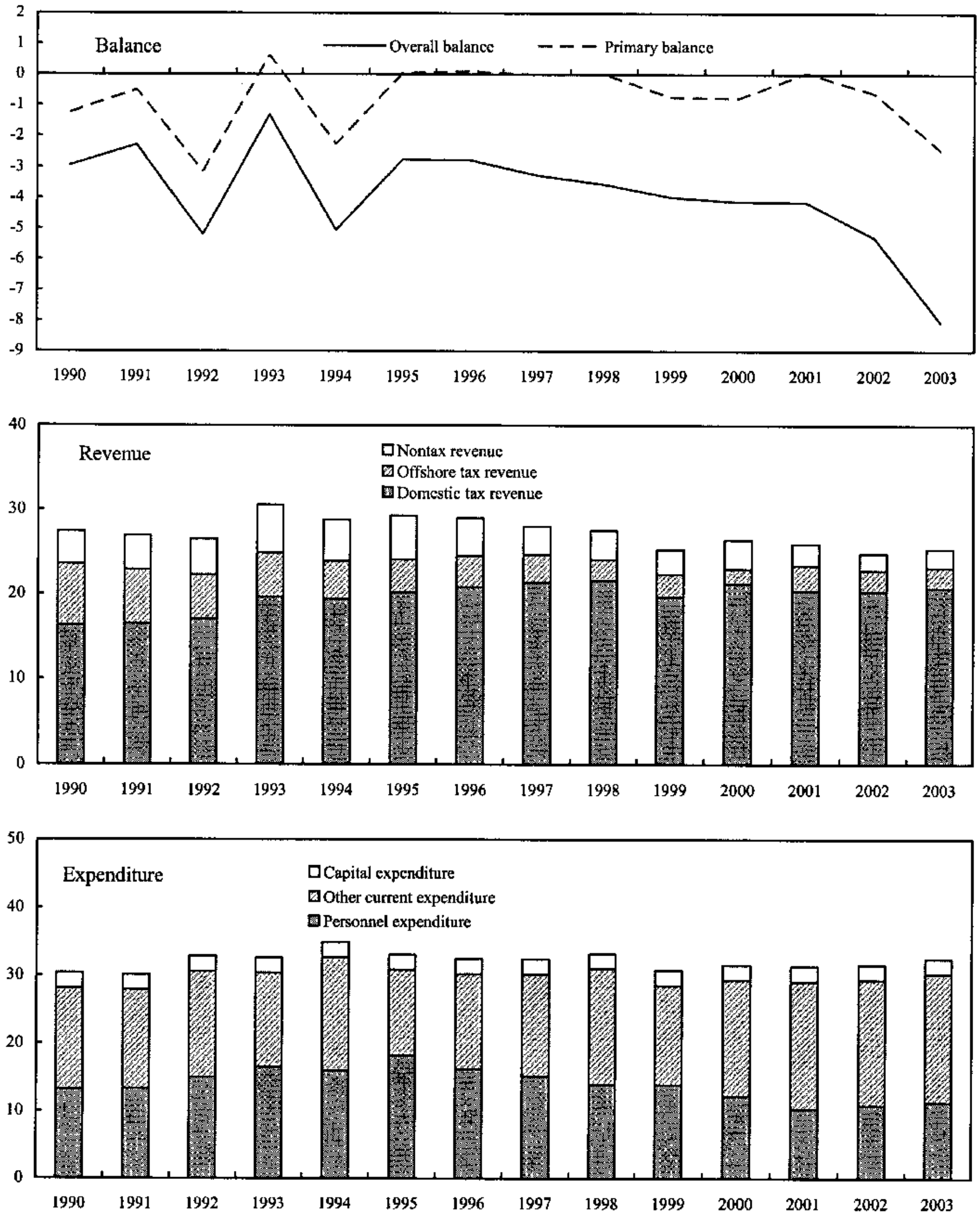
Source: Data provided by the authorities; and staff estimates and projections.

Figure 5. Netherlands Antilles: Effective Exchange Rates
(1990=100)



Source: IMF, IFS.

Figure 6. Netherlands Antilles: Operations of the General Government
(In Percent of GDP)



Source: Data provided by the authorities; and staff estimates and projections.

Table 1. Netherlands Antilles: Selected Economic and Financial Indicators, 1997–2003

	1997	1998 Est.	1999 Est.	2000 Est.	2001 Est.	2002 Est.	2003 Proj.
Real economy (change in percent)							
Real GDP[1]	-0.5	0.7	-0.7	-2.0	0.6	0.2	0.5
Cruise Tourism	33.2	-0.3	-33.9	42.9	-0.8	2.0	...
Stayover Tourism	9.9	3.5	-1.3	-1.1	-5.1	-3.5	...
Per capita real GDP	-1.1	2.1	2.2	2.7	3.2	4.2	0.5
CPI	3.1	1.2	0.8	5.0	1.7	0.4	2.0
Unemployment rate (in percent)[2]	15.3	16.6	16.5	14.0	15.8	15.6	...
Public finances (percent of GDP)							
Central government balance	-1.4	-1.7	-2.6	-3.4	-3.7	-3.3	-3.1
General government balance	-3.3	-3.6	-4.0	-4.1	-4.1	-5.3	-8.1
Public debt	60.1	62.7	67.2	66.5	68.5	74.6	80.8
Money and credit (end of year, change in percent)							
Reserve Money	15.6	11.3	-7.1	22.2	11.9	27.8	...
Domestic credit	-0.6	0.4	8.3	4.7	3.0	10.1	3.1
Private sector	-0.6	1.6	10.3	5.6	0.5	3.4	3.4
Government	-1.2	-17.0	-24.0	-15.6	76.5	125.4	0.7
M2	2.6	3.7	7.1	2.2	14.4	11.7	3.0
Interest rates (percent)							
Deposit rate (passbook)	3.7	3.6	3.6	3.6	3.7	3.6	...
Government bond yield	8.7	8.6	8.8	8.8	9.0	7.3	...
Balance of payments (percent of GDP)							
Trade balance	-38.5	-38.9	-39.6	-38.6	-39.8	-40.0	-41.1
Current account	-2.6	-3.6	-9.2	-2.7	-5.5	-4.7	-4.5
Reserves (US$ millions)[3]	214.0	248.0	265.0	261.0	301.0	406.3	423.1
(in months of merchandise imports)	1.8	2.0	1.9	1.9	2.1	2.9	2.9
Fund position	The Netherlands Antilles is part of the Kingdom of the Netherlands and does not have a separate quota.						
Exchange rate	The Netherlands Antilles guilder is pegged to the U.S. dollar at NA f. 1.79 = US$1						
Nominal effective rate (1995=100)	112.39	115.51	117.83	124.76	128.56	129.06	...
Real effective rate (1995=100)	109.13	110.00	107.71	110.37	110.20	108.25	...

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

[1]National account statistics are not available for years after 1997, nor are GDP-deflators. The real GDP figures are Fund staff estimates.

[2]For 1998-2002, Curaçao only.

[3]Total reserves of the central bank, excluding gold, end of period.

Table 2. Netherlands Antilles: A Regional Perspective (2001, or most recent prior year)

	Nominal GDP/ capita (US$thousands)	GDP in million U.S.$	Population (thousands)	Current account	Fiscal deficit	Gross tourism receipts	Official reserves	Tax revenue (percent of GDP)	Population density per km^2
				(percent of GDP)			(import cover)		
Netherlands Antilles	15.624	2,744.4	175	-5.5	-4.1	27.8	2.1	23.5	219
Aruba	20.310	1,888.8	93	21.7	-3.9	39.4	1.6	17.9	489
Antigua and Barbuda	9.841	662.3	67	-13.8	-2.1	41.1	1.9	17.6	152
The Bahamas	16.424	4,970.9	303	-3.9	-2.5	35.2	1.2	16.5	30
Barbados	9.534	2,483.9	261	-6.4	-2.0	28.7	5.5	30.0	604
Belize	3.166	786.0	248	-14.2	-12.6	15.5	2.6	19.7	11
Dominica	3.730	276.7	74	-18.9	-2.1	16.4	2.0	23.8	98
Grenada	4.866	434.1	89	-15.9	-3.6	21.3	2.5	22.7	259
Guyana	0.908	697.5	768	-18.8	-7.2	9.3	4.4	28.6	4
Jamaica	3.758	9,845.5	2,620	-5.3	-3.5	12.5	5.1	25.3	242
St. Kitts and Nevis	8.014	342.8	43	-32.9	-10.5	17.0	2.7	21.8	164
St. Lucia	4.233	724.0	171	-12.5	0.0	38.2	2.5	23.7	282
St. Vincent and the Grenadines	3.165	354.0	112	-12.3	-2.2	21.3	3.6	27.1	288
Suriname	1.663	749.4	451	-25.4	0.2	1.9	3.1	23.0	3
Trinidad and Tobago	6.212	8,323.0	1,340	3.8	-0.5	2.3	2.7	22.0	261
Venezuela	5.166	126,158.2	24,420	3.2	-6.4	0.5	5.6	12.2	28

Source: Data provided by the Netherlands Antilles authorities; and IMF country reports and WEO.

Table 3. Netherlands Antilles: Balance of Payments, 2000–2008
(In millions of NA. f)

	2000	2001	2002	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
Current account	-128.3	-269.7	-230.3	-228.0	-194.8	-165.1	-156.1	-169.1	-162.5
Trade Balance	-1,838.7	-1,943.3	-1,962.8	-2,067.8	-2,143.0	-2,198.9	-2,258.6	-2,349.9	-2,438.5
Exports	1,168.6	1,140.6	1,030.0	1,065.8	1,097.6	1,145.7	1,204.5	1,253.2	1,310.4
Imports	3,007.4	3,083.8	2,992.8	3,133.6	3,240.6	3,344.6	3,463.0	3,603.0	3,748.9
Services balance	1,604.5	1,609.0	1,666.0	1,762.5	1,838.2	1,931.3	2,045.5	2,142.5	2,256.5
Earnings	2,889.3	2,958.3	3,096.6	3,250.0	3,369.9	3,517.9	3,687.2	3,842.7	4,018.7
Expenses	1,284.7	1,349.3	1,430.6	1,487.5	1,531.7	1,586.7	1,641.7	1,700.3	1,762.2
Transportation	150.2	155.8	150.0	156.5	162.9	170.4	179.6	188.5	198.4
Earnings	291.0	316.1	304.6	317.7	331.3	347.3	366.9	385.6	406.7
Expenses	140.7	160.3	154.6	161.3	168.4	176.9	187.3	197.2	208.3
Tourism	874.0	875.6	815.0	859.7	922.5	1,001.2	1,100.6	1,183.3	1,282.0
Earnings	1,353.2	1,341.4	1,368.4	1,426.4	1,504.5	1,603.0	1,725.9	1,836.2	1,963.7
Expenses	479.2	465.8	553.4	566.7	582.1	601.7	625.3	652.9	681.7
Other services	580.3	577.6	701.0	746.3	752.8	759.6	765.3	770.7	776.1
Earnings, of which	1,245.1	1,300.8	1,423.6	1,505.9	1,534.1	1,567.6	1,594.4	1,620.9	1,648.3
of which: int.fin. & bus.sector op.income	498.8	549.2	731.2	786.2	786.2	786.2	786.2	786.2	786.2
of which: Refining	380.3	350.0	297.1	304.4	315.9	328.9	339.6	349.9	360.5
Expenses	664.8	723.1	722.6	759.5	781.3	808.1	829.1	850.2	872.1
Income balance	38.0	29.5	-8.6	-15.6	-30.4	-37.5	-52.5	-70.7	-89.0
Earnings	225.6	187.5	162.7	150.5	150.7	155.8	161.0	166.3	171.7
Expenses	187.6	158.0	171.3	166.1	181.2	193.3	213.5	237.0	260.7
Current transfers balance	67.8	35.1	75.1	92.9	140.5	140.0	109.5	109.0	108.5
Incoming transfers	434.0	392.0	493.2	533.0	602.2	624.5	617.9	642.5	668.3
of which: offshore tax	81.5	87.3	83.7	90.0	90.0	90.0	90.0	90.0	90.0
Transfered abroad	366.2	357.0	418.1	440.0	461.7	484.5	508.4	533.5	559.8
Capital and financial account	68.6	164.1	157.0	228.0	194.8	165.1	156.1	169.1	162.5
Capital account	53.3	66.5	49.5	17.1	47.2	47.1	47.0	46.9	46.8
Capital transfers balance	53.3	66.5	49.5	17.1	47.2	47.1	47.0	46.9	46.8
Incoming transfers	56.0	67.6	52.4	20.1	50.3	50.3	50.3	50.3	50.3
of which: development aid	54.3	60.2	52.1	20.0	50.0	50.0	50.0	50.0	50.0
Transfered abroad	2.6	1.1	2.9	3.0	3.1	3.2	3.3	3.4	3.5
Other Nonfinancial transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	15.3	97.6	107.5	210.9	147.6	118.0	109.1	122.2	115.7
Direct Investment balance	-108.9	-2.3	-29.5	-4.4	-2.0	67.0	66.0	65.0	64.0
Incoming capital	-113.0	-1.5	-27.6	-2.4	0.0	69.1	68.2	67.2	66.2
Outgoing capital	-4.1	0.8	1.9	2.0	2.0	2.1	2.1	2.2	2.3
Portfolio investment balance	-67.7	-47.4	-67.3	-69.6	-71.7	-73.9	-76.2	-78.5	-80.9
Incoming capital	0.1	-0.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Outgoing capital	67.8	47.0	68.8	71.1	73.2	75.4	77.7	80.0	82.4
Other investment balance	106.3	561.6	339.5	314.8	291.3	184.8	169.2	185.7	182.6
Incoming capital	157.4	423.1	366.0	342.2	341.2	236.2	222.1	240.2	238.8
Outgoing capital	51.1	-138.5	26.5	27.4	49.9	51.4	52.9	54.5	56.2
Change in reserves (-=increase)	85.6	-414.3	-135.2	-30.0	-70.0	-60.0	-50.0	-50.0	-50.0
Net errors and omissions	59.7	105.6	73.3	0.0	0.0	0.0	0.0	0.0	0.0
Official reserves	466.7	539.0	727.2	757.2	827.2	887.2	937.2	987.2	1,037.2
In months of merchandise imports	1.9	2.1	2.9	2.9	3.1	3.2	3.2	3.3	3.3
Memorandum item:									
Current account balance (in percent of GDP)	-2.7	-5.5	-4.7	-4.5	-3.7	-3.0	-2.8	-2.8	-2.6

Source: Data provided by the Netherlands Antilles authorities; and Fund staff estimates and projections.

Table 4. Netherlands Antilles: Monetary Survey, 1996–2003

	1996 Dec	1997 Dec	1998 Dec	1999 Dec	2000 Dec	2001 Dec	2002 Dec	2003 Dec Proj.
	(In millions of NA f., end of period)							
Net foreign assets[1]	524.6	584.6	714.1	693.9	575.6	1,011.1	1,146.3	1,176.4
of which NIR:	602.4	652.1	777.7	762.9	636.4	1,051.5	1,186.7	1,216.7
Net domestic assets[1]	2,012.1	2,017.4	1,984.5	2,197.4	2,379.4	2,369.8	2,630.5	2,713.6
Domestic credit	2,443.8	2,429.0	2,437.6	2,640.9	2,765.8	2,847.5	3,134.1	3,229.8
Government (net)	168.0	166.0	137.8	104.7	88.4	156.0	351.6	354.0
Private sector	2,275.8	2,263.0	2,299.8	2,536.2	2,677.4	2,691.5	2,782.5	2,875.8
Other items, net[1]	-431.7	-411.6	-453.1	-443.5	-386.4	-477.7	-503.6	-516.2
Money and quasi-money	2,536.7	2,602.0	2,698.6	2,891.3	2,955.0	3,380.9	3,776.8	3,889.9
Money	1,028.4	1,052.7	1,075.2	1,187.1	1,155.5	1,309.7	1,497.2	1,542.1
Quasi-money	1,508.3	1,549.3	1,623.4	1,704.2	1,799.5	2,071.2	2,279.6	2,347.9
	(Changes in percent from end of previous year)							
Net foreign assets	-26.9	11.4	22.2	-2.8	-17.0	75.7	13.4	2.6
Net domestic assets	6.8	0.3	-1.6	10.7	8.3	-0.4	11.0	3.2
Domestic credit	5.1	-0.6	0.4	8.3	4.7	3.0	10.1	3.1
Government (net)	-13.4	-1.2	-17.0	-24.0	-15.6	76.5	125.4	0.7
Private sector	6.8	-0.6	1.6	10.3	5.6	0.5	3.4	3.4
Money and quasi-money	-2.5	2.6	3.7	7.1	2.2	14.4	11.7	3.0
	(Changes in percent beginning-of-period broad money)							
Net foreign assets	-7.4	2.4	5.0	-0.7	-4.1	14.7	4.0	0.8
Net domestic assets	4.9	0.2	-1.3	7.9	6.3	-0.3	7.7	2.2
Domestic credit	4.6	-0.6	0.3	7.5	4.3	2.8	8.5	2.5
Government (net)	-1.0	-0.1	-1.1	-1.2	-0.6	2.3	5.8	0.1
Private sector	5.6	-0.5	1.4	8.8	4.9	0.5	2.7	2.5
Money and quasi-money	-2.5	2.6	3.7	7.1	2.2	14.4	11.7	3.0

Sources: Bank van de Nederlandse Antillen; and Fund staff projections.

[1] Includes gold revaluations from NA f. 189.5 million in January 1996 to NA f. 179.8 in November 1998 and to NA f. 138.9 million in December 2000.

Table 5. Netherlands Antilles: Operations of the General Government, 1997–2003

	1997	1998	1999	2000	2001	2002	2003 Proj.
	(In percent of GDP)						
Total revenue	28.0	27.6	25.3	26.5	26.0	24.9	25.4
Tax revenue	24.7	24.1	22.4	23.0	23.5	22.9	23.2
Taxes on income and profits	13.6	13.1	12.2	10.8	11.9	11.1	11.3
Of which: offshore	3.2	2.5	2.7	1.7	3.0	2.5	2.4
Taxes on property	0.9	0.7	0.8	1.0	0.8	0.7	0.7
Taxes on goods and services	7.3	7.2	6.1	8.4	8.2	8.4	8.5
Of which: sales and turnover tax	2.8	3.1	2.3	4.9	5.0	5.1	5.1
Taxes on international transactions	2.7	2.9	3.1	2.7	2.5	2.6	2.5
Other taxes	0.2	0.2	0.2	0.2	0.1	0.1	0.2
Nontax revenue	3.2	3.3	2.7	2.5	2.2	1.7	1.9
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants	0.2	0.2	0.2	1.0	0.2	0.2	0.2
Total expenditure	31.3	31.1	29.3	30.6	30.1	30.2	33.5
Current expenditure	30.1	30.9	28.5	29.2	29.0	29.2	30.1
Wages and salaries	15.1	13.9	13.9	12.2	10.3	10.8	11.3
Excl. pension premiums	11.4	11.0	11.1	9.5	7.8	8.1	8.4
Pension premiums	3.7	3.0	2.8	2.7	2.5	2.7	2.9
Goods and services	6.2	6.9	7.3	6.2	6.0	5.6	5.5
Subsidies to enterprises	2.0	1.7	1.4	1.3	1.2	1.6	1.4
Transfers	3.5	4.8	2.6	6.2	7.3	6.5	6.4
Of which: to households	1.0	1.0	1.0	2.0	2.1	1.6	1.4
Interest payments	3.3	3.6	3.2	3.4	4.2	4.7	5.6
Capital expenditure	1.2	0.2	0.8	1.4	1.1	1.0	3.2
Investment	1.1	0.8	0.8	0.6	0.7	0.4	1.1
Capital transfers and net lending	0.1	-0.6	0.0	0.8	0.4	0.5	2.2
Contingency	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Sinking fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance before additional measures	-3.3	-3.6	-4.0	-4.1	-4.1	-5.3	-8.1
Additional measures	0.0	0.0	0.0	0.0	0.0	0.0	2.8
Balance incl. sinking fund and measures	-3.3	-3.6	-4.0	-4.1	-4.1	-5.3	-5.3
Memorandum Items:							
Primary balance	0.0	0.0	-0.7	-0.8	0.0	-0.6	-2.5
Primary expenditure	28.1	27.6	26.1	27.3	25.9	25.5	27.9
Debt	60.1	62.7	67.2	66.5	68.5	74.6	80.8

Sources: Data provided by the Netherlands Antilles authorities; and Fund staff projections.

Table 6. Netherlands Antilles: Medium-Term Macroeconomic Framework, 2002–2008

	2002	2003	2004	2005	2006	2007	2008	2003	2004	2005	2006
	Est.	Normative Scenario						Unchanged Policies Scenario[1]			
					(Percentage change)						
Real GDP growth	0.2	0.5	1.0	1.5	2.0	2.5	2.5	0.5	-0.2	-0.5	-1.0
GDP deflator	0.4	2.0	2.5	2.5	2.5	2.5	2.5	2.0	1.5	2.0	2.5
CPI	0.4	2.0	2.5	2.5	2.5	2.5	2.5	2.0	1.5	2.0	2.5
Broad money	11.7	3.0	3.0	3.0	4.0	4.2	4.5	3.1	1.0	1.5	1.5
Domestic credit	10.1	3.1	2.0	2.5	4.2	4.5	5.0	3.1	-0.4	-1.7	-0.1
Of which: Private sector	3.4	3.4	2.2	5.0	4.8	5.3	5.9	-2.2	-15.7	-25.9	-67.3
Real expenditure growth[2]											
overall	0.4	2.3	-6.3	-3.5	2.3	1.9	1.9	11.6	3.6	6.3	29.7
primary	-1.4	-1.0	-10.4	-7.5	2.2	2.6	2.6	10.0	-2.0	-0.3	-0.8
					(In percent of GDP)						
General government											
Total revenue	24.9	25.4	25.4	25.4	25.4	25.4	25.4	25.4	25.4	25.4	25.4
Of which: Tax revenue	22.9	23.2	23.2	23.2	23.2	23.2	23.2	23.2	23.2	23.2	23.2
Total expenditure	30.2	33.5	33.5	34.1	34.2	34.0	33.9	33.4	34.7	37.0	48.2
Of which: Interest	4.7	5.6	6.2	6.7	6.8	6.6	6.4	5.6	7.3	9.6	20.7
Overall balance before additional measures	-5.3	-8.1	-8.1	-8.7	-8.8	-8.6	-8.5	-8.1	-9.3	-11.6	-22.8
Cumulative Measures	0.0	2.8	5.0	7.0	7.0	7.0	7.0	0.0	0.0	0.0	0.0
Overall balance	-5.3	-5.3	-3.1	-1.7	-1.8	-1.6	-1.5	-8.1	-9.3	-11.6	-22.8
Primary balance	-0.6	0.3	3.0	5.0	5.0	5.0	5.0	-2.5	-2.0	-2.0	-2.1
Total government debt	74.6	78.1	78.6	77.2	75.7	73.7	71.6	80.8	89.1	99.4	120.7
Balance of payments											
Current account	-4.7	-4.5	-3.7	-3.0	-2.8	-2.8	-2.6	-4.8	-3.9	-1.9	0.0
Private sector net savings	0.6	0.8	-0.6	-1.3	-0.9	-1.2	-1.1	3.3	5.4	9.7	22.8

Sources: Data provided by the authorities; and Fund staff projections.

[1]The unchanged policy scenario is only carried through 2006. Subsequently, the budget financing requirement would require a change in policies.

[2]Assuming that all fiscal measures result in primary expenditure savings.

Table 7. Netherlands Antilles: Indicators of External and Financial Vulnerability, 1998–2002
(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002
External indicators					
Exports (annual percent change, in U.S. dollars)	4.5	1.3	20.4	1.0	0.7
Imports (annual percent change, in U.S. dollars)	2.2	6.5	14.8	3.3	-0.2
Current account balance	-3.8	-7.8	-2.7	-5.5	-4.7
Official reserves (in U.S. dollars, millions)	371.8	382.4	378.5	301.0	406.3
Reserves (incl. domestic banks; in U.S. dollars, millions)	458.0	439.1	395.7	519.7	520.4
Official reserves (incl. gold) in months of imports (goods and services)	2.2	2.2	1.9	2.1	2.9
Broad money (M2) to official reserves (ratio)	4.1	4.2	4.4	6.3	5.2
Central bank foreign liabilities (in U.S. dollars, millions)	1.4	0.5	1.7	0.4	0.9
Foreign assets of the banking sector[1]	0.47	0.47	0.55	0.86	0.65
Foreign liabilities of the banking sector[1]	0.42	0.45	0.57	0.66	0.50
Foreign assets of offshore banking units[1]	36.4	32.8	34.5	38.3	42.6
Foreign liabilities of offshore banking units[1]	33.8	30.0	31.4	34.6	39.0
External public debt (in U.S. dollars, millions)	349.3	350.7	314.4	296.8	302.3
Exchange rate (per U.S. dollar, period average)	1.79	1.79	1.79	1.79	1.79
Financial Market Indicators					
Public sector debt	62.7	67.2	66.5	68.5	74.6
Public sector debt incl. guarantees	69.0	72.5	...	...	...
Government bond yield	8.6	8.8	8.8	9.0	8.2
Government bond yield (real)	7.4	8.0	3.8	7.2	7.7
Spread of government bond yield with the U.S.	3.34	3.11	2.74	3.98	3.59
Average lending spread (lending-deposit rate)	8.7	5.8	4.9	5.4	4.3
Average pretax profit on total assets	3.9	1.4	1.5	0.6	1.1
Financial Sector Risk Indicators[2]					
Mortgage credit to total assets (in percent)	26.9	29.7	36.9	38.0	...
Nonperforming loans (in percent of total loans)	4.3	3.7	4.6	6.0	5.9
Provision for loan losses (in percent of nonperforming loans)	68.0	94.0	70.0	62.0	74.0
Risk based capital-asset ratio	8.4	10.3	8.9	8.2	8.2

Sources: Data provided by the Netherlands Antilles authorities, and IMF, International Financial Statistics.

[1] In billions of U.S. dollars.
[2] Domestic banking sector only.

Kingdom of the Netherlands—Netherlands Antilles: Fund Relations

The Netherlands Antilles is part of the Kingdom of the Netherlands and does not have a separate quota, nor other financial relationships with the Fund. Since January 1, 1986, when Aruba split from the Netherlands Antilles, the Kingdom of the Netherlands consists of the Netherlands itself, the Netherlands Antilles, and Aruba. The Kingdom of the Netherlands is an original member of the Fund. On February 15, 1961, the Kingdom formally accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Articles of Agreement for all its territories. The initial par value of the Netherlands Antillean guilder—NA f. 1.88585 = US$1—was established with the Fund on December 18, 1946. The authorities communicated to the Fund a rate of NA f. 1.79 per US$1 to take effect as a central rate on December 23, 1971. Since then, the Netherlands Antillean guilder has been pegged to the U.S. dollar at this rate.

The Fund's Statistics Department provided technical assistance on balance of payments statistics and on money and banking statistics in October 1997 and December 1997, respectively. The Monetary and Exchange Affairs Department provided assistance on a self-assessment of supervision of the offshore financial sector in November 2000 and is currently conducting an OFC assessment. The Fiscal Affairs Department assessed the pension system and the civil servants' pension fund in February 2001.

A Fund resident representative was present in Willemstad from October 1, 1996 to August 31, 1998. The costs of this position were borne by the Dutch authorities.

The Executive Board conducted the last Article IV consultation discussions for the Netherlands Antilles on May 7, 2001 (EBM/01/45) on the basis of staff report SM/01/114 (04/19/01) and Selected Issues and Statistical Appendix paper SM/01/122.

Kingdom of the Netherlands—Netherlands Antilles: Statistical Issues

1. General

Data problems make the effective surveillance of the economy of the Netherlands Antilles difficult. Most data are published with considerable lags, and are often subject to large measurement errors and revisions. The frequency and timeliness of data availability of the core statistical indicators are shown in the attached table. The central bank (BNA) continues to provide comprehensive reviews of the economy in its Annual Reports, Quarterly Bulletins, and through data disseminated on its website. The authorities have made a commitment to adopt the GDDS. In December 2000, both the Central Bureau of Statistics (CBS) and BNA adopted data release calendars and signed a detailed protocol of cooperation on statistics.

2. Real Sector

Final **national accounts** are available until 1997, only at current prices, and only on the production and expenditure sides. Preliminary national accounts estimates from the production side are available through 2001. No deflators are calculated in the official data, and it is difficult to assess real growth of the economy. Recently, the CBS has begun to publish estimates of real GDP growth and projections for the current year on the basis of selected indicators of **production and trade**. Private sector **employment** figures are based on annual surveys of the labor market and subject to large revisions, while for government employment several, inconsistent series are available. The national **consumer price index** is generally adequate and published with a lag of two months by the CBS, while the separate consumer price indices for each of the three main islands are published by the BNA on its website with a slightly longer lag. A consistent time series on **wages** is available in a timely manner only for minimum wages, while economy-wide wage data are unavailable.

3. Government Finance

Data on the cash budget execution of the central government and the island government of Curacao are publicly available, with an about 6 weeks lag. Coverage of data reporting still needs to be extended to the other islands and several autonomous public institutions. Data on unpaid expenditure commitments are spotty for island governments.

4. Money and Banking

Monetary and financial statistics are published in the BNA's Quarterly Bulletin with a lag of almost six months, but summary indicators are published on the central bank's website with a two-three month delay, and data in ***International Financial Statistics*** are timely and published three months after the reference period.

5. External Sector

The **balance of payments** statistics are reported on a transactions basis in accordance with the fifth edition of the BOP manual, but some teething problems remain. In any case, the small size and undiversified nature of the economy impart considerably volatility to individual items, making it difficult to interpret the statistics. In addition, the diversified and ever-changing structure of the offshore sector makes an appropriate classification of capital account in- and outflows problematic.

Kingdom of the Netherlands—Netherlands Antilles: Core Statistical Indicators as of April 15, 2003

	Exchange Rates 1/	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	External Public Debt	Overall Government Balance/Debt Service 2/	GDP/GNP
Date of Latest Observation	4/15/03	4/4/03	1/31/03	1/31/03	1/31/03	1/31/03	12/02	02Q3	02Q3	12/02	12/02	1997
Date Received	4/15/03	4/15/03	3/20/03	3/31/03	3/31/03	3/31/03	3/03	11/15/00	11/15/00	3/15/03	3/15/03	12/00
Frequency of Data	daily	weekly	monthly	monthly	monthly	monthly	monthly	quarterly	quarterly	quarterly	monthly	annual
Frequency of Reporting	daily	weekly	monthly	monthly	monthly	monthly	monthly	quarterly	quarterly	irregular	monthly	Annual
Source of Update	Bloomberg	BNA 3/	BNA	BNA	BNA	BNA	CBS 4/	BNA	BNA	BNA	Treasury	CBS 4/
Mode of Reporting	elec.	website	fax	Elec./mail	website	website	website	website	website	mission	Elec./mail	publication
Confidentiality	no	no	yes	no	no	no	no	no	no	No	no	no
Frequency of Publication	daily	weekly	monthly	monthly	monthly	monthly	monthly	irregular	irregular	Irregular	n.a.	Annual

1/ Fixed exchange rate against the U.S. dollar; the Fund would be notified of a parity change.
2/ Including external.
3/ BNA= Bank van de Nederlandse Antillen (central bank).
4/ CBS= Central Bureau of Statistics.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/70
June 13, 2003

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

IMF Concludes 2003 Article IV Consultation with the Kingdom of the Netherlands—Netherlands Antilles

On June 4, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Netherlands Antilles.[1]

Background

After a prolonged recession through the second half of the 1990s the Antillean economy has recently shown some important resilience. Resisting the adverse affects of the September 11, 2001 attacks and the U.S. recession on tourism, as well as economic difficulties in neighboring countries, the Antillean economy was able to register cumulative economic growth of some 0.8 percent over 2001 and 2002, in contrast to other countries in the region that experienced significant contractions. Strong performance of the Curacao tourism sector and of private investment were the main factors. For 2003, economic growth is projected at 0.5 percent on the back of the continuing rebound in tourism, expanded airlift capacity and higher consumption. These positive trends are, however, clouded by the sharp deterioration in the public finances.

With the exchange rate pegged to the U.S. dollar, the Netherlands Antilles have enjoyed low inflation, and with waning cost-push pressures related to higher energy costs and indirect tax increases, inflation has moderated to 0.5 percent in 2002. For 2003, inflation is projected to reach 2 percent in line with developments projected for the U.S. The external accounts have recently improved, largely reflecting trends in tourism and growth in the export free zone. Driven by strong inflows over 2001 and 2002, international reserves have reached a level of three months of imports.

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

The banking sector has shown some fragile signs of improvement, but high public debt and weak growth continue to pose a challenge to durable progress. The new fiscal framework with the Netherlands has provided some impetus to the international financial sector and more regulatory reforms are underway.

Past unsustained fiscal adjustment and weak growth have resulted in a rapidly increasing debt burden, now exceeding 75 percent of GDP. Problems in tax administration and the lifting of wage controls in the civil service, along with ongoing difficulties in controlling health care costs and the finances of extrabudgetary units and smaller islands contributed to a deterioration of the fiscal deficit to 5.3 percent in 2002. The associated financing needs were met by a large acceleration of bank lending after the ceiling on extending bank credit to the government was lifted.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They were encouraged that the Antillean economy has weathered the difficult external environment of the past two years comparatively well, and is staging a modest recovery with low inflation. Directors observed, however, that large macroeconomic imbalances and continued structural weaknesses are clouding the prospects for higher sustainable growth going forward, and, in particular, expressed concern about the rapid rise in public debt to a critical level.

Against this background, Directors emphasized that the authorities face the urgent challenge of reversing the unsustainable accumulation of public debt and raising the economy's long-run growth potential. This will require expeditious and sizable fiscal adjustment, which will also be key to curtailing excessive credit growth, as well as the sustained implementation of a well-considered structural reform agenda to raise productivity and improve employment prospects.

Directors expressed concern about the significant increase in public spending envisaged in the 2003 budget, and called for an immediate fiscal tightening to avoid a further increase in the fiscal deficit from last year's level. Needed short-term fiscal savings can be achieved by implementing already identified savings in the health care system, completing the unification of tax collection agencies, and suspending the newly established Economic Development Fund.

Directors stressed that, over the medium term, further decisive action will be required to stem and reverse the rise in public debt. They shared the view that the authorities should aim for a sufficiently ambitious primary surplus target in order to reverse the unsustainable debt dynamics over the next few years. On the expenditure side, Directors urged the authorities to enhance budgetary discipline in extrabudgetary units and in the smaller islands, and saw room for further efficiency gains and savings in the health care system. On the revenue side, they agreed with the view that protecting revenue by broadening the tax base and strengthening tax administration should be given priority over the planned tax reform. Directors encouraged the authorities to adopt a binding and transparent medium-term fiscal framework, which would foster high-quality and durable adjustment over time.

Directors noted that the prevalence of funded pension systems places the Netherlands Antilles in a better position than other economies to weather population aging. Demographic developments, including the possible return of Antilleans currently residing abroad, could, nevertheless, pose additional costs, which will continue to warrant close monitoring. Directors encouraged the authorities to continue to limit the PAYG benefits to a basic pension only, and refrain from increasing the real value of these benefits. They noted that large government contribution arrears had led to a funding shortfall in the civil service pension fund (APNA), and urged the government to take steps to maintain its soundness.

Directors considered that the currency peg has served the Antillean economy well, but underscored the importance of curtailing credit growth to ensure the peg's continued credibility. They welcomed the reimposition of the limit on bank lending to the government, which will help address the root cause of recent monetary expansion, but stressed that this measure will need to be accompanied by fiscal retrenchment to prevent the emergence of arrears. Directors also welcomed the recent increased reliance on indirect monetary policy instruments.

Directors commended the authorities for strengthening supervisory capacity and enforcement in both onshore and offshore financial sectors. They stressed the need for continued vigilance and strong supervision, given the potential effects on the banking system of the weakened state of public finances and continued low economic growth. Directors welcomed the generally well-designed AML/CFT framework, and looked forward to its further extension, along with more frequent on-site inspections.

Directors saw the sustained implementation of structural reforms as key to attracting foreign investment and enhancing the economy's competitiveness and longer-term performance. Priority will need to be given to further labor market reform—particularly in the smaller islands—divestiture of public enterprises, and accelerated product market and trade reform. To enhance competition, Directors also highlighted the importance of establishing an independent regulatory agency, adopting a competition law, and reducing concentration in and deepening of the banking system.

Directors urged the authorities to make further efforts to improve the Antilles' statistical base to facilitate the assessment of economic developments and the design of policies.

It is expected that the next Article IV consultation with the Netherlands Antilles will be held on a 24-month cycle.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with Kingdom of the Netherlands—Netherlands Antilles is also available.

The Kingdom of the Netherlands—Netherlands Antilles: Selected Economic Indicators

	1999	2000	2001	2002	2003[1]
	Change in percent [2]				
Domestic Economy					
Real GDP	-0.7	-2.0	0.6	0.2	0.5
Unemployment rate (in percent of labor force)[3]	16.5	14.0	15.8	15.6	...
Consumer prices (period average)	0.8	5.0	1.8	0.5	2.0
Money, credit, and interest rates					
Broad money	7.1	2.2	14.4	11.7	3.0
Domestic credit	8.3	4.7	3.0	10.1	3.1
Interest rate on 12 month deposits (in percent)	3.6	3.6	3.7	3.6	...
Government bond yield (in percent)	8.8	8.8	9.0	7.3	...
Exchange rates					
Exchange rate regime	Fixed exchange rate at 1.7895 NA guilder/U.S. dollars since December 23, 1971.				
Real effective exchange rate[4]	-2.1	2.5	-0.1	-1.8	...
	In percent of GDP[2/]				
Public Finance					
General government balance	-4.0	-4.1	-4.1	-5.3	-8.1
Public debt	67.2	66.5	68.5	74.6	80.8
Balance of payments					
Current account balance	-7.8	-2.7	-5.5	-4.7	-4.5
Trade balance (goods and nonfactor services)	-36.9	-38.6	-39.8	-40.0	-41.1
Official reserves (in millions of U.S. dollars)[5]	265.0	261.0	301.0	376.5	393.3
Official reserves (in months of merchandise imports)[5]	2.2	1.9	2.1	2.9	2.9

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

[1]Staff projections.

[2]Unless otherwise noted.

[3]Curacao only in 1998 to 2000.

[4](+) = appreciation.

[5]Reserves of the central bank, excluding gold, end of period.