Economic Perspectives of Curacao

Speech by Dr. Emsley Tromp on the occasion of the Corporate and Commercial Breakfast Meeting organized by RBTT Bank, May 3rd, 2007

Good morning ladies and gentlemen,

For this morning, I have been asked to give you an overview of the outlook for Curacao’s economy. However, given the fact that our host, RBTT, is a regional player in the financial market, I cannot do this without taking the regional outlook and our current political and socio-economic situation into consideration.

Ladies and gentlemen, the Caribbean region has made impressive economic progress in recent years. With a growth rate of around 5 percent in 2006, this progress was supported by strong private sector performance, mainly in the construction and tourism sectors. The International Monetary Fund expects 2007 to become the fifth year of what is already the most vigorous period of recovery and expansion since the 1970s. The outlook remains bright, as a growth rate of 4.2 percent is expected for 2008.

Similar to other economies in the Caribbean, Curacao’s economy is characterized by its smallness and openness, which makes it highly vulnerable to external shocks. Furthermore, the Caribbean economies are relatively less diversified—relying oftentimes on one export product. Contrary to most economies in the region, Curacao experienced an average annual economic growth of less than 1 percent during the past five years. Our weak economic performance has been accompanied by high unemployment rates—especially among the youth—and increasing marginalization. Without pretending that Curacao’s economic structure or factor markets are completely similar to those of other economies in the region, I do believe that given these numbers, we can conclude that Curacao is lagging behind. The question then arises, what are we doing wrong?

Before answering this question, allow me first to put into perspective the recent economic developments on the island of Curacao. In 2005, the economy grew by a mere 0.8 percent, largely owing to the financial services, wholesale and retail, and construction sectors. Although the official figures for 2006 have not been published yet, it is expected that the economy has again grown, albeit at a slightly slower pace than in 2005.

Growth in 2006 was mainly due to an encouraging performance in Curacao’s stay-over tourism. Rising occupancy rates triggered a wave of new hotel projects and expansion of existing hotels. Furthermore, the wholesale and retail sectors grew as a result of more activities in the free-zone and tourism, and higher domestic spending. Activities in the construction sector also rose, due mainly to investments in the tourism and transportation sectors on the island.

Ladies and gentlemen, Curacao’s economic recovery, however, is greatly affected by an increasing fiscal imbalance, related to the high government debt. In addition, despite Curacao being very open to investment, the attractiveness of our investment climate to foreign and domestic investors still needs major improvements. Due to the weaknesses in our investment climate, investment growth has been modest compared to the region. In addition, for the last several years, we have been suffering from constant changes in the Island’s territory executive council. This has led to a lack of consistency in government policy, which has not been very conducive to a good investment climate.

If we are to address our economic ills in an effective manner, we must try at least to grow at the regional average. It is not only a matter of reaching more economic growth through higher domestic demand, but more importantly through raising productivity growth and foreign demand. Hence, we must catch up by reaching sustainable economic growth. Ladies and gentlemen, sustainable economic growth is the key to improving the standard of living in our society. It is therefore of the utmost importance for us to pursue sound policies to address the fiscal imbalance and to strengthen our competitive advantage in order to attract more investments and hence promote sustainable economic growth. In addressing these issues, we must also take into account the ongoing constitutional reforms.

Ladies and gentlemen, as we all know Curacao has arrived at an important historical cross-road. By December next year, it is expected that the Antillean constellation will cease to exist and Curacao will become a separate country within the Dutch Kingdom. This status aparte will provide us with the unique opportunity to address our social and economic problems in a more island-specific context. However, constitutional changes alone should not be seen as a solution for all our social and economic problems. The constitutional reform must therefore be accompanied by social and economic reforms to foster sustainable economic growth.

As I have pointed out repeatedly, sound public finances are crucial to promote higher sustainable growth, to create jobs, and to achieve social progress. Although several measures have been taken to reduce public expenditures and public sector debt, the public finances have worsened over the years. High fiscal deficits, combined with weak
economic growth, resulted in a rising debt-to-GDP ratio. In 2005, the Island Territory of Curaçao reached a debt of NAf.2.5 billion, equivalent to a debt-to-GDP ratio of 59 percent. When speaking about the debt of the country Curaçao we must also take the debt of the Netherlands Antilles into consideration. I must stress that being part of the Netherlands Antilles, each island has contributed to the accumulation to this high debt. In 2005, the Netherlands Antilles had a debt of NAf.2.9 billion. By December 15, 2008, the Netherlands Antilles will cease to exist. Then, each island will be allocated its share in the debt of the Netherlands Antilles. Therefore, given that the debt of the Netherlands Antilles should be re-allocated among the islands of the Netherlands Antilles, Curaçao’s actual debt will increase to NAf.3.9 billion, leading to a debt-to-GDP ratio of 93 percent.

Such a debt burden poses serious risks to a sustained growth and hence the goal of improving our standard of living. That is why debt relief is so important. As you all know, I have been a proponent of the solution as contained in the “Concluding Statement” or “Slotverklaring”, which was signed between Curaçao, St. Maarten, and the Netherlands in November 2006, as it gives us the opportunity to eliminate our unsustainable debt and start with a clean slate in the new constitutional status. In addition, the “Slotverklaring” incorporates immediate economic stimulation through the Social Economic Initiative. However, it is for our policymakers to decide whether a solution along the lines of the “Slotverklaring” will be adopted or other solutions will be pursued. Up till now, no feasible alternatives have been presented to solve our structural fiscal problems.

The so-called Monte alternative is fallacious on several grounds and as such cannot be considered a credible alternative:

1. The central tenet of this plan is the so-called zero coupon bond alternative. By implementing this solution which has been advanced in 2003 by the Debt Commission, it is contended that we can substantially reduce our debt-to-GDP ratio. The momentum for refinancing part of the debt with a zero coupon bond has passed. Since interest rates are now much higher than in 2003, when the debt commission recommended this, refinancing our debt (with the 0% bond as collateral) will not yield the then envisioned interest savings. In addition, the debt ratio will not fall due to this refinancing.

2. Due to some miscalculations, interest expenses will not decrease as much as the Monte commission presented. Hence, the need for additional measures will become more pressing.

3. The expected yield of privatization is too optimistic. Moreover, the analogy with Holland is also not substantiated by facts. Privatization had only a limited impact on the debt ratio in Holland; the largest impact came from strong economic growth.

4. Fiscal discipline, an important aspect of the Monte-plan, will be undermined by the suggestion of the committee itself to borrow from the central bank to redeem outstanding treasury paper.

5. Monetary stability will become subordinate to central bank profits. The most important task of a central bank is to promote monetary stability and not to maximize profit. Earmarking central bank profits to guarantee interest payments by the Curacao government, as suggested by Monte, will create unnecessary uncertainties, erosion of investors' confidence and may therefore erode monetary stability.

6. The establishment of various new institutions will increase bureaucratic tangles and competition in laxity.

Credible and realistic alternatives for the debt solution in the “Slotverklaring” require a swift and major reduction in our debt and interest burden to free funds for our ailing health care, education, and poverty alleviation. These alternatives should raise consumers’ and investors’ confidence, and not distort our capital market.

Moreover, debt relief must be accompanied by safeguards to prevent a new build-up of debt to unsustainable proportions. Fiscal discipline is not only needed for macro-economic stability, but also to preserve funds essential for public investment, especially in health care, education, infrastructure, and social safety nets.

Ladies and gentlemen, achieving significant and sustainable increases in per capita income require higher investment and, more importantly, a substantial improvement in total factor productivity growth. As a share of GDP, investment in Curacao lags behind the Latin American and Caribbean region. Therefore, we must strengthen our competitive advantage vis-à-vis the region.

Several studies have revealed the weaknesses of our investment climate, such as high utility and labor costs, rigid labor laws, a qualitative mismatch between labor demand and supply, complicated and time-consuming licensing procedures, and a complex tax system with opaque tax incentive schemes. These weaknesses are compounded by the absence of a clear and consistent investment-driven growth-oriented economic policy and a weakened
government administrative apparatus. Therefore, it is important to have policies in place that foster both higher investment and a more efficient use of resources.

The first area that should be addressed is the functioning of the labor market. Ladies and gentlemen, the current rigid rules on hiring and firing, the mandatory benefits, and the high overtime compensation are not attractive for investors. The current situation has led to socially unacceptably high unemployment rates. Tight labor market regulations have adverse effects on economic performance because they create rigidities that allow vacancies and unemployment to coexist, contributing to high overall unemployment rates. To improve our competitiveness, it is crucial to be able to deploy labor more flexibly, as long as individual protection against abuse is preserved.

Furthermore, our investment climate will benefit greatly from investment in education and training to reduce the qualitative mismatch between labor demand and supply. Currently, both the construction and hospitality sectors are experiencing a lack of qualified labor on our labor market. Improving the quality of education is important for developing an adequate stock of human capital and hence fostering economic growth. In sum, a more flexible labor market and a higher educated labor force improve productivity, which is essential for a more sustainable long-term growth prospects.

Ladies and gentlemen, another area that needs our attention is the further development of our capital market to promote a wider range of financing possibilities for investors. An inherent feature of corporate financing in developing countries is the prevalence of bank-based financing. Because of the limited degree of development of our capital market, equity-based financing is very rare on the island. Equity-based financing could, however, be an alternative, especially for large investment projects and projects with a high risk profile. Therefore, a good initiative to overcome this bottleneck would be the introduction of a venture capital fund for risky investment projects. Through such a fund, equity financing of start-up firms with promising projects can be stimulated by offering higher than usual returns to investors. In addition, we should step up our efforts for the creation of a securities exchange. In this respect, we can learn from the experiences of countries in the region, such as Barbados, Jamaica, and Trinidad & Tobago, that have known securities exchanges for over twenty years.

Another weakness of our investment climate is the current administrative barriers, the long and unjustifiable delays in administrative decisions by government departments and excessive discretion in administrative functions. The existing red tape and bureaucracy weaken our competitiveness relative to other economies in the region. Therefore, I hope that with the new constitutional status of Curaçao, the elimination of the double layer of government will reduce the administrative barriers in the government apparatus considerably. This will facilitate the decision-making process of policies and projects.

Finally, numerous studies on the Curaçao economy in recent years have indicated that there is a need for fiscal reform. With the new status approaching, Curaçao is going to have the opportunity to include all the necessary reforms in a new tax system, which could have a positive impact on the investment climate. In my view, the new tax system of Curaçao should be simple and transparent. Direct tax rates should be competitive compared to other countries, especially in our region. These reforms are to promote consumer spending and investment by increasing disposable income. This will lead to more economic activities, and hence more tax revenues to finance the government’s policy programs. In that regard I welcome the study of the Ellis committee which should report to the government before long.

Ladies and gentlemen, before I conclude, I like to emphasize that there cannot be sustainable economic growth if we do not address our social ills. Therefore, we should continue to explore possibilities to raise the old age pension (AOV) further to guarantee a decent life for our senior citizens that depend solely on this state pension.

Second, we should improve the availability of low cost housing. If financial institutions in the Netherlands Antilles provide, for example, for a period of say five years a limited number of mortgage loans annually at concessionary terms to low income households, this will go a long way in alleviating our housing problem. I am referring to loans at a 30-year term and 2% interest. This should help reduce the backlog in low cost housing of the public housing foundation FKP and hence improve the living conditions of more low income households.

Third, the necessary investments in the refinery should be accelerated with the aim of also lowering the utility costs. A more lasting solution to our high utility costs together with our environmental problem can be achieved by investing in the modernization of our refinery. This will not only improve the purchasing power of the consumer, but it will also improve our competitive situation leading to more growth.

Fourth, we should expand investments in our education also to attain social goals. Equipping our socially weaker citizens with the right skills increases their chance for a job considerably and therefore their prospects for a better life.
Ladies and gentlemen, we are in the midst of important constitutional changes. Changes that will have far reaching implications for generations to come. I understand that due to the inherent uncertainties of these changes and their implications for economic recovery, financial institutions, investors, and entrepreneurs may be reticent towards taking risks. This attitude could slow down investments on the island. To prevent a reversal of the economic recovery, the authorities should therefore address the debt issue and the necessary macro-economic reforms in an adequate and swift manner. This will create a solid foundation to become an autonomous country with bright prospects for the future. Looking to the medium term, Curaçao’s main challenge remains to reach a higher and sustainable growth rate, and share the benefits of growth more equitably. With a more equitable and less divided society, macroeconomic volatility will also be reduced. Towards the status of a country, Curaçao’s economic agenda should aim at building on past achievements and address current challenges and to accomplish a stable macro-economic climate benefiting all layers of our society.

Thank you for your attention.