

## On the crossroads to the year 2000

*Speech presented by Dr. E.D. Tromp, President Bank van de Nederlandse Antillen for the IOBA Junior Chamber  
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Ladies and gentlemen, good evening.

It was with a great deal of pleasure that I accepted the invitation to address you tonight on the current economic situation in the Netherlands Antilles. I have been asked to talk about the implications of our current economic situation in the context of the Year 2000, and particularly, to talk about the implications of the current economic situation for the next century.

More than three years ago, I was asked by the Female Jaycees to give a similar speech. The title of my speech then was: "The Year 2000: Facts or Fiction?" In that speech I said that I would not try to predict the future but would try to shed some light on the future implications of the prevailing economic situation.

It was clear to me then that even though we were going through an economic expansion, a number of concerns and uncertainties weighed on the outlook, putting the balance of risks on the downside. It was against that background that I urged policymakers to take timely corrective actions.

Three years have passed since I gave that speech, which came to be known as the Rita and Jossy speech. It is true that several painful measures were taken to address our fiscal problems. But regrettably, they came much too late and were not sufficient to avert the situation I warned against then.

Let me briefly recall the situation I warned against in the context of what is taking place today.

I warned that the economic downturn resulting from the unsustainable high fiscal deficit might make it difficult for taxpayers to meet their tax obligations. Given the prevailing economic situation, the government's current policy of accelerating the collection of back-taxes together with self-assessment has made it increasingly difficult for many people and businesses to meet their tax obligations. If left unattended, this situation will exacerbate and prolong the current downward cycle.

I cautioned the government that continuing their policy of building arrears would eventually put an unbearable burden on the private sector. We all know now the extent to which the governments resort to the building up of arrears as a way to finance their deficits. This situation, coupled with a restrictive monetary policy, is forcing a lot of businesses to rationalize and/or cease operations.

The government's policy of building up arrears at the APNA also has implications for the pension system. I warned three years ago that if no timely actions were taken, we would have to increase the pension age and eventually reduce the pension payments. To make the civil servants pension system more viable, the government last year raised the age eligibility for pensions. Further reform is inevitable if we want to provide security for the pensioners in the years to come. To ensure availability of pension payments in the future, a sinking fund was established. However, due to the liquidity strains, the governments have not yet made the necessary contributions to this fund.

The problems of the SVB I have alluded to have not been completely resolved as yet. Our social security system has become unaffordable. This burden will only increase if we do not address adequately the financial implications of the aging of our population on the system. Ladies and gentlemen, the security umbrella is security only if we can pay for it.

I also warned that if the fiscal situation were not corrected in a timely way, the result could be a crisis of confidence in the government. When a government cannot meet its liquidity needs, payments to its suppliers, including salaries of the civil servants, are endangered. Today we all know that the crisis of confidence in the Netherlands Antillean government is such that the government is finding it difficult to finance its deficit through the issuing of bonds.

Ladies and gentlemen, these issues always seem to arise when we direct our attention to constitutional issues. If we recall the years 1983-85 and 1992-94, the current situation becomes self-evident.

I noted three years ago that according to MONEDA, the Central Bank's econometric model for the Netherlands Antillean economy, the public sector debt, if not properly addressed, was projected to be about Naf. 3 billion by the

Year 2000. The debt service obligations of the public sector debt would put a heavy burden on the government's finances. The only way to finance this, I continued, would then have to be through increased taxation.

Ladies and gentlemen, today in 1997 our public sector debt is about Naf. 3 billion with an annual interest burden of Naf. 150 million. As I warned against then, this is being financed through increased taxation.

We all share the basic economic goals of high level employment and incomes. Yet we do not seem to be in agreement as to how we should go about achieving it. Recent discussions among the social partners have only pointed out this lack of agreement. Let me assure you though, that the economic lessons of the last few decades have taught us that those objectives can be achieved only if we pursue sound macroeconomic policies, which include opening up our economies for foreign trade.

If we had addressed our economic problems with more probity, the adjustment cost would have been much less. During the last few years, several policy initiatives and actions were proposed to achieve fiscal soundness. Most of those initiatives were implemented but later reversed or postponed. These initiatives, if fully implemented, would have gone a long way toward achieving fiscal consolidation and providing the necessary conditions for sustainable growth. Let me consider just three of them.

The first such initiative is the crisis-levy. In the aftermath of the overcapacity crisis in the refinery industry in the mid-eighties and the consequent decision of the Shell Oil refinery to cease the operations of its facilities in Curaçao, the government implemented a 10% levy to bolster economic activities, reduce fiscal deficits, and contain the rise in imports. That action was estimated to yield around Naf. 120 million per annum. As we all know, that measure has been reversed. If that measure, which was implemented in 1985 had remained in place, it would have yielded over Naf. 1.2 billion by now.

The second measure, which was proposed but never implemented, was the sales tax. As part of the policy to broaden the tax base, the government proposed to lower direct taxes and to introduce a broad-based sales tax. That policy initiative, which was ready for implementation by 1993, was later postponed. If it had been implemented in 1993, it would have yielded over Naf. 400 million by now.

The third policy action, which was at a very advanced stage of implementation, was the privatization of the then Landsradio dienst. As part of the government's policy to reduce government involvement in the economy and to rely more on the marketplace, the government began negotiating the sale of the LRD. The sale would have yielded an estimated Naf700 million. We all know too well that the initiative to privatize the LRD was abandoned amidst public resistance and accusations of allegedly improper dealings.

Taken together, those three measures would have yielded over Naf. 2.4 billion, approximately the size of the current outstanding debt. Put differently, if implemented then, today we might not be overburdened with the current public debt. In addition, the current annual amount of Naf1. 50 million of interest expense would have been available to finance the much needed infrastructure - both social and physical - to support economic growth. The result would also have meant a much more vibrant and technologically competitive telecommunications industry, an essential element in today's global marketplace.

Ladies and gentlemen, today we are approaching the Year 2000. The past three years have driven home the lesson of how quickly the economic situation can deteriorate if timely actions are not taken. But more important, they have taught us that the economic and social cost of adjustment will not decrease with postponement; rather, it will increase.

At the beginning of this year, 1997, we have embarked on an adjustment path with the assistance of the IMF to restore confidence in our economy. While the targets envisaged in the program were not met for the first half of the year, the decision to pursue this path has greatly altered the environment in which economic policy is made. Implementation of this program is essential, because it provides the crucial link for the more lasting reforms to take hold.

I have to say, however, that the successful implementation of any program depends to a great extent on the economic policy conditions attached to it. It is therefore essential that conditions be created to facilitate the full implementation of the program. It is well known that countries undergoing adjustment, as envisaged in Fund programs, are extended credit to facilitate the adoption of otherwise painful economic policies. In the case of the structural adjustment program adopted by the Netherlands Antilles, the financing elements were limited to a precautionary line of credit among the central banks and the refinancing of the Dutch development aid. Credit should not be accorded though in a way that masks the true magnitude of our structural problem, thereby reducing the need

to take appropriate policy actions to address our fiscal problems. Rather, credit should be based on actions taken to ensure the full and successful implementation of the program.

Ladies and gentlemen, this brings me to the agenda for the future. We are at the crossroads to the Year 2000. If we are to set the basis for a sustainable growth of the Netherlands Antillean economy, some unfinished business needs to be addressed now.

The fiscal consolidation efforts need to be continued to restore confidence in our economy. It is largely a matter of moving ahead along the lines to which we have already committed ourselves. Despite the progress made during the last few months, the outlook for carrying the fiscal consolidation further remains mixed. The long-term pressures on the fiscal policy have not abated, and little offset can apparently be expected.

The budget deficits of the public sector have reached proportions that have become increasingly difficult to finance. In addition, financing these deficits means higher taxes for both current and future generations. We have to bear the consequences of higher rates of interest due to the crowding-out effect of government borrowing, and future generations will have to pay higher taxes to pay off these debts.

To restore order in the public finances of the nation, it is essential that the governments increase their efforts to reduce their expenditures. These reductions should be achieved by bringing the cost of personnel to more manageable proportions through the accelerated implementation of the core-task analysis and improved efficiency in the public apparatus. Similarly, on the structural front, the government should accelerate the process of privatization, the restructuring of the public health system, and finish the restructuring of the public pension system. To improve the investment climate, the functioning of the marketplace should be enhanced. Toward that end, government intervention should be brought back to more appropriate proportions through privatization and the reduction of the regulatory burden on the private sector.

The current regulatory system has created competition in laxity that has taken its toll on our economy. Individual regulations may not appear material. But taken as a whole, their cumulative effect is problematic. This is an issue that needs to be addressed urgently.

The functioning of the labor market also should be improved while the quality of the labor force should be enhanced by more investment in education. The current unemployment is perhaps our greatest social problem. The high youth unemployment is especially worrisome.

High unemployment means that a smaller percentage of the labor force has to bear the increasing burden of the social safety net system. High unemployment increases the cost of labor thereby reducing the demand for low-skilled labor—the core of our unemployment problem. High unemployment also means a potential budgetary burden for the governments.

To address this problem, investment in the quality of labor is essential to increase labor mobility. But the flexibility of the labor market should also be increased. Just as competition encourages the efficient allocation of resources in the product market, let us encourage competition in the labor market. The current system of overprotection reduces labor market flexibility and increases unemployment. The system has to be transparent and fair. Good governance should be in place to guarantee workers' rights.

Ladies and gentlemen, Tomorrow will be the beginning of the second Ministerial meeting between the governments of the Netherlands Antilles and the Netherlands. While this is a political meeting, the economic consequences of the issues that will be discussed will have their impact on the economy. I will therefore focus on the economic aspects of tomorrow's meeting.

The process of structural adjustment will be greatly facilitated by economic growth. For an open economy such as ours, trade is a very important engine of growth in the restructuring process. The market is international; so is the competition. In terms of economic policies, protective barriers must be eliminated, and we should open up our market and seek access to new markets. In this context, inter- and intra-Kingdom trade is essential. Every effort should be directed at putting policies in place to encourage free trade.

Another important issue for establishing confidence and improving our investment climate is constructive cooperation within the Kingdom. Cooperation within the Kingdom enhances the image of the Netherlands Antilles in the region and the world and thereby attracts new investments. In the context of the recently signed Economic Partnership between the Netherlands and the Netherlands Antilles, we must encourage Dutch investments in the Netherlands Antilles, strategic alliances between Dutch and local investors, and the use of the Netherlands Antilles as the regional headquarters of Dutch companies. Toward this end, the policies of both countries should be consistent with this objective.

The Dutch government can make another important contribution toward encouraging more economic growth by reorienting the development aid program. This program should place more emphasis on improving our infrastructure, a very essential variable in the competitive equation.

In the days to come, we will be discussing the IDB report on the development strategy we have to follow to fully exploit our growth potential. Let us use the development aid funds to support our growth potential. It is only when we direct all efforts in the same direction that we will be able to achieve success.

Ladies and gentlemen, after seven years of economic expansion, the Netherlands Antilles experienced an economic contraction in 1996. This contraction was due to both internal and external factors. Contrary to expectations, the economic performance worsened in the first half of 1997, as production contracted by almost 2.3% in real terms compared with the same period in 1996. The outlook for the second half of 1997 continues to be clouded by the unsustainably high fiscal deficits. There is no more important contribution to the economic recovery than getting the public finances under control.

The balance of payments outcome also lags behind the program targets. While substantial progress has been made in reducing the current account deficit from a record high of Naf. 424 million in 1996 to an estimated Naf. 90 million deficit this year, the capital account of the balance of payments turned into a deficit. This deficit reflects the confidence crisis I alluded to earlier. Unless fiscal discipline is restored, no reversal of this trend can be expected in the near future.

### **Concluding remarks**

We are at the crossroads to the Year 2000. If we want to set the basis for a better Netherlands Antilles, we have to address our problems now. The fiscal situation continues to be a cause for concern. The outcome of the first half of 1997 indicates a substantial overshooting of the objectives set forth in the adjustment program. The programmed deficit will be exceeded by almost 100% to an estimated deficit of Naf165 million this year. The outlook for 1998 continues to be clouded by wage pressure emanating from the introduction of the new salary structure. Next year's deficit is estimated at Naf. 190 million, a worsening compared to this year's deficit.

It is clear from this situation that the current adjustment efforts are not working. Substantial additional action is required to restore fiscal discipline. I would like to emphasize, however, the crucial importance of credibility in sustaining the momentum of any adjustment problem. Credibility cannot, of course, be achieved overnight, but it can be helped by providing clear signals.

In this regard, I would like to caution that the recent conflicting signals from the Island government with respect to privatization only serve to undermine the government's own credibility.

Ladies and gentlemen, fiscal consolidation is still a desirable and realistic goal. However, a minimum condition for success is to reestablish credibility. Credibility is asymmetric: it is difficult to build but very easy to undermine. I, therefore, would like to suggest the following policy prescription:

We have seen that our economic ills seem to coincide with discussions about constitutional issues. Let us declare a ten-year moratorium on constitutional talks. We should direct every effort strengthening our economy, creating employment and ensuring a better future for all the citizens of the Netherlands Antilles.

We have to put a forward strategy to bring about fiscal consolidation. Caution should be exercised, however, not to overlook the social dimensions of the fiscal consolidation. Initiatives as the "Reda Social" should therefore be enhanced and continued.

The budget results for the first half of 1997 indicate that the fiscal targets we set out to achieve this year are no longer attainable. The full effect of fiscal measures will take time to manifest themselves. Therefore, we should direct our efforts to the second half of the year. We should strive to keep the second half deficit in line with the programmed target. The deficit for 1998 also should represent an improvement compared to this year's deficit.

To achieve this improvement, the following actions are in order. The public sector's wage bill will have to be reduced to more manageable proportions. I believe that the current percentage of 70 percent of tax revenues will have to come down to approximately 40 percent. The authorities will have to start by prolonging the current wage freeze in the public sector. Non-essential tasks will have to be disposed of. In this regard, we have to emphasize the need to privatize.

Aside from providing revenue to the governments, privatization will revive the private sector, the engine of growth. Privatization, however, does not have to be a sell out. We have to set out the legal framework within which privatization has to take place and engage experienced professionals to execute this task for us.

Finally, this brings me to the role of monetary policy in the adjustment process. Monetary policy will continue to play its part in preserving a climate of stability conducive to a continued expansion of economic activities. The recent firming of monetary conditions will remain in place as long as necessary to achieve that goal.

Another key requirement is achieving equilibrium in the balance of payments. As I mentioned, while the current adjustment path has led to a substantial improvement in the current account of the balance of payments, the capital account has turned into a deficit reflecting the loss of confidence in the economy. Our efforts in the medium-term will be directed at restoring equilibrium in both the current and capital accounts of the balance of payments.

Ladies and gentlemen, to pursue this strategy I would like to suggest the following consultative model to restore economic prosperity. This model, which has been very successful in Holland, calls for gradual reform with broadly consultative implementation. Fifteen years of gradual but mutually reinforcing reforms led to economic growth, macroeconomic stability, and employment growth in Holland. The recovery of profitability was very important in this improved economic performance.

If our objective is to bring about fiscal consolidation with due regard to the social constraints, wage moderation, and the creation of jobs, we have to try to build consensus at the central level among the social partners. This means that labor unions have to change their approach toward wage bargaining, and the governments, in their pursuit of fiscal consolidation, have to give the right incentives to promote productivity growth and bolster investment. It is only through a consensus model that we will be able to rise above our problems and bring prosperity to all the citizens of the Netherlands Antilles.

Ladies and Gentlemen, we have to be prepared for the Year 2000.  
I thank you all.