Recent Financial-economic Developments in the Netherlands Antilles in general and in St. Maarten in particular.

Address delivered by dr. Emsley D. Tromp, President of the Bank van de Nederlandse Antillen on the occasion of the start of phase II of Princess Juliana International Airport's expansion project in Philipsburg, St. Maarten, June 18, 2004

Ladies and gentlemen, good morning,
I would like to start by congratulating St. Maarten and, in particular, my former colleague at the central bank and current president of Princess Juliana International Airport, Eugene Holiday, on the financial conclusion of phase II of the airport's expansion. A great deal of skill and perseverance is required to conclude the financing of such a multi-million dollar project, whose size is large compared with St. Maarten's economy. The total investment of approximately US$ 100 million comprises about 18% of the island's GDP. I am convinced that Eugene's experiences during his career at the central bank and at Winair contributed significantly to this achievement.

Let me also congratulate RBTT Merchant Bank for its decision to finance this important investment project. That decision underscores the success of RBTT Financial Group in expanding its presence in the financial sector of the Netherlands Antilles. This expansion, ladies and gentlemen, should contribute to a more competitive domestic financial market. More competition will lead to lower cost of borrowing, lower prices for banking services, and a wider range of financial products, contributing positively to economic growth. Moreover, the financing of this project in the form of negotiable bonds offers a welcome domestic investment alternative for banks, institutional investors, and private investors.

The expansion of St. Maarten's airport is a welcome impetus to the strengthening of its economy and the economy of the Netherlands Antilles in general. This project along with some large investment projects in Curacao, such as the expansion of the airport there, the construction of a utility plant, and the expansion of the economic zone, suggest an encouraging outlook for further economic growth.

Let me give you a brief overview of the financial-economic developments in the Netherlands Antilles in 2003 and the prospects for 2004. Since we are here together to launch an important project for St. Maarten, I shall include some references specifically to developments in St. Maarten's economy.

The Netherlands Antillean economy recorded its third consecutive year of economic growth in 2003, reflected by an expansion of 1.4% in real Gross Domestic Product. St. Maarten's economy showed the largest growth rate, 4.3%, while the economies of Curacao and Bonaire grew by 0.5% and 3.4%, respectively. St. Maarten's economy represents approximately 17% of the Antillean economy, second to Curacao whose share is 75%. The expansion in net exports and higher private and government consumption were the main contributors to the overall growth in 2003. In contrast, investment declined because private investors put investment decisions on hold due to growing uncertainty surrounding the sustainability of the economic recovery. The inflation rate increased from 0.4% in 2002 to 1.9% in 2003, due mainly to a rise in world oil prices, the appreciation of the euro, and higher inflation rates of our main trading partners, the United States and Venezuela. St. Maarten's inflation accelerated to a lesser extent from 0.5% to 1.5% during this period.

The improvement in exports in 2003 was attributable primarily to the tourism and transportation sectors. Tourism showed healthy growth with increases of 10% in the number of stay-over visitors, 6% in the number of cruise visitors, and 8% in the foreign exchange income generated. St. Maarten's corresponding growth rates of 12%, 11%, and 7%, respectively, were a major contributor to the overall tourism performance. The importance of St. Maarten for the tourist sector in the Netherlands Antilles is well established: the island generated 60% of stay-over tourism, 75% of cruise tourism, and 63% of tourism-related foreign exchange earnings in 2003.

The transportation sector also performed well in 2003. The Antillean carrier, Dutch Caribbean Airlines (DCA), registered a substantial growth in both the number of passengers and the amount of freight transported. In line with the growth in stay-over tourism, activities at the airports in the Netherlands Antilles also expanded. St. Maarten's airport was the busiest in 2003 with 1.5 million passengers,12% more than in 2002. This number exceeds the current maximum capacity of the airport facilities by 300,000 passengers, illustrating that the expansion is urgently needed. After the expansion, the airport will be able to handle 2.5 million passengers, 67% more than currently. The airport of Curacao handled 1.2 million passengers in 2003, an increase of only 1.5%. Bonaire's airport handled 0.6 million passengers, but this number implied a growth of 54% because the number of transit passengers doubled. A shift in transit passengers from Curacao to Bonaire, resulted from the rerouting of the intermediate stops on KLM's flights between Amsterdam and Latin America from Curacao and Aruba to Bonaire beginning in the summer of 2002. This

development illustrates how susceptible the performance of our airports is to decisions of large carriers. This factor should be taken into account when developing and implementing big projects like the one at hand.
Developments in the harbor industry were mixed. Curacao's harbor reported a marginal growth in the amount of freight handled, but the number of ship calls, especially tankers, declined. In contrast, Bonaire's harbor registered a marked increase in the number of ship calls, particularly in the tankers category. The development in tanker calls was related to the general strike in Venezuela at the end of 2002, which also affected the Venezuelan state oil company, PDVSA, which leases the refinery from the Curacao government. Because the refined products could no longer be exported, they were transshipped primarily to Bonaire's oil terminal. As a result, oil storage and transshipment activities expanded considerably. Unfortunately, no data were available on the performance of St. Maarten's harbor. However, the new container facilities strengthened the island's comparative advantage as a regional hub for cargo handling. In addition, information gathered by staff of our research department during a recent visit to St. Maarten revealed that cruise tourism is the main source of revenues for the harbor with a share of 60%. The remaining 40% is earned from cargo handling.

Two other important pillars of the Netherlands Antillean economy, but less relevant for St. Maarten -- the oil refining industry and the international financial and business services industry -- did not perform well in 2003. The production of the oil refinery did not fully recover from the impact of the temporary shutdown at the end of 2002 related to the general strike in Venezuela. In addition, receipts for services rendered in the international financial and business services sector declined. This decline is related to the elimination of the distinction between onshore and offshore activities, effectuated with the introduction of the new fiscal framework (NFR), which ended the low tax regime for offshore activities. This disadvantage would be more than compensated for by the improved competitive position of the Netherlands Antilles in negotiating new tax treaties, supported also by the new tax arrangement for the Kingdom of the Netherlands (BRK). However, progress in this area has been slow, affecting the creation of new business in the sector. On the other hand, the new BRK resulted in higher tax revenues for the government because the withholding tax on dividends from the Netherlands to the Netherlands Antilles collected by the Dutch tax office is transferred entirely to the Antillean government.

The balance of payments of the Netherlands Antilles improved for the third consecutive year in 2003. A significant part of this result was due to the improvement of the current account, which recorded a small surplus, because of higher exports related to bunker sales and tourism, the transfer of the dividend tax by the Netherlands, and higher transfers by individuals from abroad.

The public finances remained an area of major concern, reflected by a further deterioration of the cash deficit of the general government in 2003 to 5% of GDP. Noteworthy is that the general government is defined here as the central government and the island government of Curacao only because the other island governments, including St. Maarten, do not have a regular reporting framework. I welcome the recently drafted legislation stipulating regular reporting on the government finances of St. Maarten as a condition for the islands government's permission to borrow.

The deterioration of the general government's deficit was attributable entirely to the rise in expenditures, facilitated by the ample availability of finance on the local capital market since domestic government securities continued to offer more attractive yields compared to alternatives abroad. Consumptive expenditures, domestic interest payments, and the settlement of loan guarantees accounted mainly for the rise in total expenditures. The financing of the cash deficit, the formalization of accumulated funds deficits of the social security bank, SVB, and the appreciation of the euro contributed to the further accumulation of government debt in 2003, reaching 90% of GDP.
Since St. Maarten does not submit data on its government finances to the Bank on a regular basis, assessing outright the island's current financial state remains difficult. However, the island government has not approached the central government for support since the last quarter of 2003, indicating that the finances must have improved or at least not deteriorated further. The financial situation of the island government seems stable, supported by the collection of back taxes and expenditure control. I welcome this development and hope that the authorities persevere with their fiscal consolidation efforts, an important condition for making viable the desired transition towards more autonomy.

Let me state, however, that the lack of transparency in the government finances in terms of the delay in regular and complete publication of budget and actual figures will stand in the way of transactions like the one we are celebrating today. A more autonomous St. Maarten means that the current indebtedness of the island government will take a more prominent position in the evaluation of transactions like this one.

The current constitutional arrangement masks the indebtedness of the various island territories giving them a false sense of security. With a share of 17 percent of the Antillean economy, an eventual division and distribution of assets and liabilities means that St. Maarten's share in the nation's outstanding stock of debt will be well over Naf 500 million. Ladies and gentlemen, to a great extent this debt stems from arrears built by the St. Maarten government to the Civil Servant Pension Fund and the Social Security Bank. If this important macro-economic aggregate is taken into account, a completely different macro-economic picture will emerge after St. Maarten obtains its autonomous status. I, therefore, encourage the local authorities to continue with their efforts towards institutional capacity building to create the necessary institutional infrastructure to make the dissemination of financial and macro-economic information possible. Collecting and disseminating this information is critical for ambitious investment decisions like the current one and for macro-economic policymaking.

Ladies and gentlemen, the monetary aggregates expanded further in 2003, albeit at a slightly slower pace than in 2002. The surplus on the balance of payments and the expansionary impact of the government, particularly the central government, contributed primarily to the monetary expansion in 2003. In addition, credit extension to the private sector grew moderately by 2%, but the developments on the two island groups diverged considerably with stagnation on the Leeward Islands and a growth of 9% on the Windward Islands.

Based on this overview, we can conclude that St. Maarten's economy performed better than the Antillean average, and I expect this to continue in 2004. For example, first-quarter tourism data indicate a growth of approximately 20% each in the number of stay-over tourists, the number of cruise tourists, and the amount of tourism earnings in St. Maarten. Given the dominance of tourism in the island's economy, buoyant growth in the tourist sector will translate into buoyant growth of the entire economy, supported further by the start of the airport expansion project.

The strong growth prospects for St. Maarten's economy will contribute significantly to the projected further expansion of the Netherlands Antillean economy by 1% in 2004. This growth is, however, a slowdown compared to the 1.4% growth rate in 2003 because of lower growth of net exports, private consumption, and the need for fiscal consolidation. The lower growth of net export is due mainly to the expected decline in bunker sales, while the slowing of private consumption growth can be attributed to the projected decline in private transfers from abroad. In contrast, private investment is expected to improve because of the implementation of various projects in the oil, utilities, tourism, and transportation sectors. Moreover, inflation is projected to moderate to 1.5%, but this outcome depends heavily on developments in world oil prices. Developments in bunker sales and private transfers from abroad, together with higher imports related to the growth in private investment, will result in a lower balance-of-payments surplus than in 2003.

In concluding, ladies and gentlemen, I would like to state that while the growth prospects for St. Maarten are promising, we should not overlook the susceptibility of the tourism industry to exogenous factors. Since the terrorist attacks of 9/11 in the United States and the passage of hurricanes like Luis and Lenny, we have to realize that these outside forces can render our predictions useless. The authorities must take those exogenous factors into account when devising macro-economic policy and must build the necessary absorption capacity to withstand eventual adversities. A critical look at our sister island, Aruba, should illustrate that with similar conditions and growth prospects, outside forces have clouded the economics of an otherwise important investment project, there.

Finally, let me wish Eugene and all stakeholders success with the timely completion of the airport expansion project. This project will make a significant contribution to the long-term growth prospects of the economy of St. Maarten.