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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/51

10:00 a.m., May 19, 1997

Contents

Executive Board Attendance

S. Sugisaki, Acting Chairman

Executive Directors	**Alternate Executive Directors**
	M.F. Melhen, Temporary
	N.R.F. Blancher, Temporary
	T. Turner-Huggins, Temporary
	R.J. Heinbuecher, Temporary
	F. Mercusa, Temporary
	Y. Patel, Temporary
	U.Y. Tilyayev, Temporary
	H.F. O'Brien
	D.G. Loevinger, Temporary
	M.A. Ahmed, Temporary
	B.M. Lvin, Temporary
	M. Kell, Temporary
	Y.Y. Mohammed
	R. Kannan, Temporary
	A.R. Palmason, Temporary
	A.G. Yakub, Temporary
	T. Brizuela, Temporary
J. de Beaufort Wijnholds	
	A. Barro Chambrier
	S. Fukushima, Temporary
	H.W. Cocker, Temporary
	Zheng H., Temporary
	D. Merino, Temporary

R.H. Munzberg, Secretary
M.M. Cuc, Assistant

Also Present
European I Department: M.C. Deppler, Director; K.F. Habermeier, K.K. Meyers, C.M. Watson. External Relations Department: K.L. White. Policy Development and Review Department: J.P. Pujol. Secretary's Department: K.S. Friedman.

1. KINGDOM OF THE NETHERLANDS—ARUBA—1997 ARTICLE IV CONSULTATION DISCUSSIONS

The Executive Directors considered the staff report for the 1997 Article IV consultation discussions with Aruba (SM/97/106, 4/30/97). They also had before them a background paper on recent economic developments in Aruba (SM/97/109, 5/2/97).

The staff representative from the European I Department stated that the pilots of American Airlines had voted to accept the management's contract offer. That development had removed a major threat to Aruba's economy in 1997.

Mr. Wijnholds made the following statement:

> The Aruban economy has experienced a remarkable rebound since the Lago refinery closed down in 1985, slashing GDP by a third. The rapid development of the tourism sector spurred double-digit growth rates in the late-1980s. However, the strains on the island's limited resources, in particular on labor and housing, lead to some inflationary pressures. Therefore, staff observed at the time of the previous consultation (1995) that "Aruba is facing the strains of success." The authorities clearly recognized these concerns, and have taken a number of measures to address these "strains."
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> Taking stock of the current situation, it seems that the threat of overheating has been averted. Inflation is back to US levels, thus securing the long-term competitiveness of the Aruban economy. Housing costs, previously one of the main sources of inflation, are now growing at only half the rate of total consumer price index. GDP growth has slowed down to a more sustainable (though still comfortable) range of 3–4 percent. Official employment has been steady over the last two years, with the composition shifting toward higher-skilled labor since the beginning of this decade. The nonoil current account has improved markedly over the last two years, with a modest deficit of 1 percent of GDP remaining in 1997.
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> Even though overheating no longer seems a major source of concern, the Aruban authorities recognize that several issues deserve their continued attention. To put this in perspective though, staff rightly notes that "Aruba faces no major economic problems over the near term." Four areas have received particular attention since the previous consultation.
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> First, the authorities are thoroughly aware of the importance of fiscal prudence in a small open economy, vulnerable to external shocks and committed to maintain a fixed exchange rate. This is exemplified by their track record, with the borrowing requirement of the government (as a percentage of GDP) fluctuating between 2 and -1 (i.e., net savings) since 1990. When confronted with the risk of a deficit beyond this range for 1997, the government enacted a supplementary budget intended to contain the borrowing requirement to 2 percent of GDP.
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> Second, the Central Bank of Aruba (CBA) faces the challenge of shaping monetary policy in a very small open economy. In a move to more

market-oriented instruments, the Bank suspended direct credit ceilings and replaced these with remunerated cash reserve requirements. This has contributed to the disappearance of the earlier liquidity overhang. With the CBA acting as a matchmaker, a modest interbank money market has now developed. In addition, the CBA is working on new policies to reduce dollarization.

At the beginning of this year, all exchange restrictions on current account transactions were eliminated and restrictions on capital controls were further relaxed. While capital outflows are now largely liberalized, the CBA also recognizes the desirability of removing remaining restrictions on capital inflows. This will have to be weighed, however, against the objective of preventing a recurrence of overheating and retaining some room for pursuing domestic monetary policy.

The authorities have devoted considerable energy to improving the soundness and integrity of the Aruban financial system. The staff report clearly lays out the comfortable prudential position of the commercial banks. In addition, a new supervision act will be enacted later this year, which would place off-shore companies under the supervision of the CBA.

Third, the authorities recognize that there is further room to improve the quality of economic statistics. These 'overhead costs of governance' weigh particularly heavy on small economies. Still, important strides have been made over the past two years. In particular, the authorities started the production of (partial) national accounts and introduced a computerized system to track fiscal income and expenditures. The authorities are interested in subscribing to the GDDS, although they recognize that this requires additional efforts to improve the quality and timeliness of data.

Finally, government guarantees for hotel development, a legacy of the very rapid growth in the late 1980s, constitute a potential claim on government finances. While this seemed an important concern in the early 1990s, the step-by-step resolution for each of the failed projects has borne fruit. Guarantees have now declined to about 12 percent of GDP. Moreover, the potential claims associated with the (three) remaining guarantees are disputed by the Aruban government in court. The authorities strongly expect that if any claims will be granted by the court, the amount will be a fraction of the total. To be on the safe side however, they have been depositing Af 18 million per year in an escrow account with the central bank, as a provision against potential claims.

Given Aruba's small size and the associated risks of overbuilding and environmental degradation, the authorities have signaled their intention to limit new hotel construction through an administrative moratorium. Though they see the merits of the staff's proposal to use a tax on new development instead, they have concluded that this might prove too difficult to implement in a small island economy.

To conclude, the authorities recognize that regardless of their favorable situation, the challenges of managing a small and open economy requires continued vigilance. The ultimate result of this stance is the fact that the fixed parity to the US dollar has entered its 26th year, and is as unquestioned as ever.

Mr. Kannan, speaking on behalf of Mr. Sivaraman, made the following statement:

Although the economic situation in Aruba does not cause any serious concerns at this stage, compared to last year's performance, we noticed a number of areas where progress has not taken place as expected. The output growth during 1996 is on its downward path at 4 percent in 1996 as against 5.5 percent in 1995. The fiscal deficit increased to 1.5 percent of GDP in 1996 from 0.5 percent in 1995. Current account deficit as a percentage of GDP also increased to 4.8 percent in 1996 as against 1.1 percent in 1995. However, we must recognize a few positive developments namely, the inflation is at the lowest level of 3.2 percent in 1996 and the external debt is reduced to 1.7 percent of GDP from 16 percent earlier. We equally recognize that Aruba is better placed than many developing economies in terms of per capita income. Their closeness to the Kingdom of Netherlands and the interest that the latter is taking in their affairs would easily put this country on a proper footing. As we are in general agreement with the staff report, let me highlight a few important issues which deserve the attention of the authorities.

During 1977 real GDP is projected to grow by 3–4 percent and even the medium- term growth projection given in page 27 does not indicate any substantial improvement. This strongly emphasizes the importance of diversification in the economy. With activities concentrated in low productive sectors such as tourism, GDP is expected to grow only at a moderate level during the 1990s. We fully agree with the authorities that improvements in the physical location and regulation of the free trade zone would attract a variety of high-skill service providers. Staff may indicate to what extent Aruba is equipped to handle such demand for service in future.

Although inflation is projected to remain around 3–3.5 percent in the coming years, to what extent this is achievable is not clear in view of the limited room available in the monetary sector. Hence, in order to maintain this low inflation scenario, we strongly encourage the authorities to achieve the fiscal balance in 1998 and maintain the same in subsequent years. In this context, the reduction of public sector borrowing requirements from 3 percent of GDP to 2 percent of GDP in 1997 is a welcome step. However, authorities must keep a close watch on the wage bill and wage pressures must be restrained, especially in view of mid-1998 elections.

What is however striking is that in the case of Aruba, the current revenues have always been more than targeted since 1994 and that while taxes on income have exceeded the budget targets, taxes on goods and services have been consistently lower. Nevertheless, I am not able to understand as to why the authorities shift away from direct taxes as they were facing difficulties in collecting taxes as indicated by significant increase in arrears. Taxes on goods and services have not yielded as per budget estimates. In fact a further study is more warranted in this area. The staff could clarify the reasons.

In the light of the risks associated with maintaining expenditure as planned during 1997, the staff have suggested that additional measures would be needed in 1997 in order to set the public finance on a course toward balance in 1998. The staff may like to explain what additional measures are possible and whether the authorities agree with these views/measures.

We commend the Central Bank of Aruba for maintaining a tight monetary policy and approve the staff suggestion that in the interest of improving the allocation of credit, the overall increase in bank credit in 1997 could be limited to the nominal growth of GDP. We duly recognize the need to enhance competition among banks which would allow greater role for market forces in setting the interest rates. However, the authorities have expressed some reservation in using the methods used in other countries (page 14, paragraph 18). The staff may like to elaborate on the reservation of the authorities.

While we encourage the authorities to use the indirect methods of monetary policy, we would like to caution that the present interest spread of 4 percentage points is ideal for an economy like Aruba and hence in the event of adopting indirect instruments, care should be exercised in maintaining this spread.

With reference to the exchange rate policy, the authorities have successfully managed the peg of the Aruban florin to the U.S. dollar. However given the share of tourism in GDP and the need to develop a competitive domestic money and securities market, we encourage the staff to prepare a detailed paper bringing out the costs and benefits of pegging to the U.S. dollar vis-à-vis a basket of currencies of major trading partners.

Not only from the anchoring of the peg but also from the credibility point of view, we encourage the authorities to move toward maintaining the foreign exchange reserves at about 5–6 months of nonoil imports. However, in view of the risks explained in page 26, significant increase in government borrowing undermines official reserves and the credibility of the monetary system. Hence the loan guarantees ought to be judicially used. The improvement in various macro-parameters would no doubt instil an element of confidence which would alone pave the way toward strengthening new economic sectors rather than mere loan guarantees.

A matter of concern in Aruba is the money laundering crime. The U.S. BIN Report of March 1997 clearly brings out that there are increasing indications that money launderers are using legitimate business houses as front end companies in Aruba. In this context, it is encouraging to note that the government of Aruba introduced criminal procedure reforms and is also taking a number of steps to prevent and punish official corruption.

> Finally, we support the staff proposal that Aruba's Article IV consultation could continue to be held at the 24-month cycle.
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> With these remarks, we wish the authorities every success in their endeavors.

Mr. Wijnholds said that he welcomed Mr. Kannan's words of caution about changes in monetary policy instruments, as the 4 percentage point interest rate spread appeared ideal for an economy like Aruba's.

Aruba had a strong record with regard to adopting new rules and regulations to combat money laundering, Mr. Wijnholds stated. Aruba, together with the Netherlands Antilles, was the only country in the region that was a member of the Financial Action Task Force (FATF). Both were part of the Kingdom of the Netherlands. Aruba had acted as the forerunner for the CFATF, the Caribbean equivalent of the FATF, the Central Bank of Aruba having adopted in 1993 a strict admission policy for the offshore banking system. One of the requirements under the policy was that the parent company be under comprehensive consolidated supervision by the home country. In 1996, legislation on the reporting of unusual or suspicious transactions had been passed, in order to comply with the FATF's recommendations, and an FATF evaluation had concluded in June 1996 that the Aruban authorities had adequately implemented its recommendations. As noted in the staff report for that year, a complete overhaul of the supervision framework had been prepared, which would place offshore banks under the Central Bank of Aruba's supervision. The law was to be presented to parliament in the fall. In 1998, Aruba would be subjected to another evaluation by the FATF, and, in that context, the Netherlands would conduct a pre-examination at the end of the current year. At present, only two offshore banks remained in Aruba, both falling under consolidated supervision by U.S. agencies.

Perhaps the allusion in Mr. Sivaraman's statement had more to do with activities that might be occurring in the so-called free zone, Mr. Wijnholds continued. The authorities were currently working on a law to increase regulation of the free zone with a view to curtailing any undesirable activities there.

Mr. Kannan said that he fully agreed with Mr. Wijnholds on money laundering.

Ms. Turner-Huggins made the following statement:

> I thank the staff for a straightforward report and helpful RED. In particular, I found the comparisons of the size of government in Box 2 Table 1 illuminating. Why would Aruba for example, less than one-third the population size of The Bahamas and one-quarter that of Luxembourg have roughly the same sized civil service—around 12 percent of the workforce—which Staff note is on the low end, and how is it that Aruban civil servants are the best paid of all the countries in the sample—1.8 times GDP per capita. These details aside, however, like Mr. Wijnholds, we echo the staff view that "Aruba faces no major economic problems over the near term." We commend the authorities for their prudent macroeconomic management which has restored health to the Aruban economy after the 1993 slowdown. Despite the promising picture today, we note the proverbial room for improvement and wish to highlight some fiscal issues which call attention over the medium term.

The Budget for 1997. We detect some apprehension on the part of Staff that the measures contained in the supplementary budget to narrow the deficit to 2 percent of GDP may fall short of what might be necessary. I agree with the staff's less sanguine outlook on whether the authorities will be able to achieve this deficit target—firstly, the Aruban revenue projections may be somewhat overstated and secondly, based on the 1996 spending outturn, the goods and services and salary bill may turn out to be higher than the authorities estimate—especially with possible elections. We urge the authorities' to resist raising import tariffs to meet any revenue shortfall (despite the very low level of tariffs by regional standards) and to begin considering other ways to broaden the tax base—along the lines of the staff's suggestion of a general sales tax and improvements in tax administration. In this connection, I support Mr. Sivaraman's request for staff to clarify reasons for the shortfall in taxes on goods and services relative to budget estimates and possible additional measures that might put the public finances on a credible course for obtaining budgetary balance in 1998. The focus on fiscal restraint cannot be overemphasized in this case, given the limitations of monetary policy under a fixed exchange rate regime. On monetary policy issues, I share the views expressed in Mr. Sivaraman's statement and emphasize in particular, the need to elevate the foreign reserve cushion beyond the 3-month coverage mark—for all the reasons cited but also in light of the increased liberalization of Aruba's capital account.

Wage policy in the public sector. The statistic cited earlier on civil service wages as a share of GDP per capita coupled with the size of the last wage award are surprising given the authorities' intention to achieve a desirable budgetary outcome in 1998 and beyond. As staff rightly notes, this would require a durable reduction in the public sector payroll and a slowdown in public sector wages (as described in paragraph 21 of the staff report). It was disappointing to find that savings from the 500 odd retrenched workers were offset by new hires. On this point we support the staff's proposal to limit new hires on the basis of attrition. This would be crucial over the course of the period leading up to elections, and the Aruban authorities are encouraged to resist the pressures to add numbers to the public sector payroll.

Policies affecting tourism and long-term growth. The importance of tourism in the Aruban economy cannot be overstated and the government's policies directed at the long term development of the sector are critical to the long-term growth of the economy. We have some difficulty appreciating the moratorium on new hotel construction, and view this constraint as inimical to growth. Like staff, we would prefer a more transparent, rules-based approach to future development. We see no harm in imposing a tax on new development and agree that this would be more desirable that the current discretionary approach. We wonder whether or not the plan to hold an equity position in Air Aruba was sound given the ample supply of airlift to Aruba and we are not convinced that there is a strategic need. In light of national airline dilemmas throughout the region, the government may wish to evaluate this decision very carefully. On the sale of the Radisson Hotel, we commend the government's approach to fully divest and hope that they will follow through on their commitment to eliminating government loan guarantees and tax holidays.

Financial Sector Issues. We commend the prudential framework and approach of the Aruban authorities to safeguard the financial sector as described extensively by staff in the RED. Staff have indicated that further pieces of legislation dealing with money laundering, supervision of the credit system and the insurance industry are due to be debated this year in Parliament. We encourage the adoption of this new legislation at the earliest opportunity—all the more urgent against the backdrop of the report quoted in Sivaraman's Gray.

On data issues. We note that some strides have been made in the area of national accounts and would encourage the authorities to place additional emphasis on building up a more solid base of economic statistics—particularly in the area of wage and trade data.

Lastly, we wonder if a PIN has been drafted by staff and whether the Arubans have announced their willingness in this regard.

We wish the authorities well in their endeavors ahead.

Mr. Yakub made the following statement:

I am generally in agreement with the staff report, so I have only a few comments I would like to make.

Firstly, I would tend to agree with the part of Mr. Sivaraman's statement where he mentions the need to exercise caution on the use of indirect monetary instruments. The reliance on the reserve requirement mechanism alone has worked reasonably well for Aruba, so I would tend to support the authorities, if they are cautious, at this stage, on the staff's idea of introducing indirect instruments. I think we have to take into account the size of the domestic market, which is too small or not significant enough, for, say, money market operations.

We are also told that there are no major problems envisaged in the near term, but to me an obvious potential challenge for the country is the likely pressure on the public sector wages, which is bound to be one of the major issues in the upcoming elections in mid-1998. As such, I would not be surprised if the medium-term projections of the staff on the budget will have to be revised.

On tax reform, I must say I see some similarities to other island states, especially the Seychelles, because my authorities have also not followed the textbook principles of policy management. We have moved away from personal direct income taxes, much to the dismay of the Fund missions that have been coming to the Seychelles every 12 to 18 months or so. The Fund mission has also been pressuring Seychelles, as it has done here with Aruba, to introduce a value-added tax system, but I understand now it has realized that perhaps it is not so practical. So, I think, other than the introduction of a general sales tax, we should be very cautious as to what policies we recommend to our member countries. What I think is most needed in the case of Aruba is improved tax administration. That is where the emphasis has to be if we want to increase the buoyancy of tax revenue. On that score, perhaps, technical assistance on tax administration could be one form of help that could be considered for the Aruban authorities. In contrast to Ms. Turner Huggins, I support the administrative controls on regulating hotel construction, which takes into account the environmental impact and other pertinent factors. To me, this is more practical than the introduction of a tax. However, I do understand the motivation to introduce the tax, and that we do not want the government to interfere too much in commercial decisions, and that the staff favor a more transparent system based on purely economic considerations.

On a final note, I very much welcome the authorities' intention to resell the Radisson Hotel to the private sector so as to avoid government intervention in commercial activity. I think, as much as possible, the government should keep away from getting directly involved in the productive sectors of the economy. I believe the government's role should be that of a catalyst or facilitator in the overall economy.

Mr. Loevinger wondered whether, given Aruba's relatively high per capita income, and given the demands on Fund staff, Fund technical assistance would be better channeled to the poorer countries.

Mr. Kannan noted that the technical assistance requirements of a member country, rather than its per capita income, governed the considerations about whether the country should receive Fund technical assistance.

Mr. Barro Chambrier said that he agreed with Mr. Kannan's remarks. The Fund was a cooperative institution, and technical assistance should be related to the needs of the country.

Mr. Wijnholds indicated that, at the present juncture, Aruba was not seeking technical assistance from the Fund. It was not a matter of immediate concern, because the country had been receiving technical assistance from the Netherlands.

Mrs. Brizuela made the following statement:

Let me start by commending the Aruban authorities for the impressive performance of their economy: inflation has been reduced from 5.5 percent during the early 1990s, to 3.2 in 1996; external debt is reduced to 2.7 percent of GDP from 16 percent in the previous years; official employment has been steady over the last two years toward skilled labor.

Aruban authorities have faced the "strains of success" that hampered the economy and it seems that the overheating has been averted.

Since I fully agree with the staff appraisal, my remarks will be made on three issues: fiscal policy, monetary policy and structural policy.

In relation to fiscal policy: it should continue restraining the aggregate demand expansion with a moderation of government support to economic development and public investment.

As it was discussed in the last Article IV consultation, additional reduction of public expenditures through the reduction of public sector staffing should be carefully planned.

In order for this program to be adequately implemented, it should evaluate the risk of letting-go highly qualified people as a result of its enforcement. However, authorities must keep watch on the wage bill.

In relation to monetary policy: the Central Bank of Aruba should maintain the same tight monetary policy implemented over the last years. Besides, the authorities must implement the use of market-oriented instruments and absorb market liquidity without compromising its independence. They should also develop a competitive domestic money and securities market.

In relation to structural policy: it is clear that shortages in the labor market are necessary. The planned investment in an infrastructure and social program can increase the present labor market

On the other hand, we encourage the authorities to accelerate the tax reform which should comprise a reduction in direct taxes, an increase in import duties, an increase in the tax on petroleum products and the introduction of a general sales tax, in order to increase the buoyancy of the tax system, minimize the distortions and keep the public finances close to balance.

With these remarks, I wish the Aruban authorities the best in their future endeavors.

Mr. O'Brien made the following statement:

The Aruban authorities must be commended for their management of the economy. GDP growth, although on a lower plateau than in 1980s, has been steady and with good prospects and appears to be based on a sustainable platform of economic activities. Despite a rapid increase in population since 1991, and with its concomitant strains on the demand for consumer goods and social amenities, particularly housing, inflation, apart from a brief surge in 1994, has been very low in terms of most Caribbean economies. Monetary policy, and primarily credit control, has been very tight and the parity of the Aruban florin vis-à-vis the U.S. dollar has been comfortably maintained. Export earnings from the tourism sector and the oil refinery have been steady and the prospects remain good. The major area of weakness in the economy appears to be the fiscal accounts, on which there has been a growing deficit.

The decision of the Aruban authorities to revise their 1997 budget so as to reduce expenditure, increase revenue collections, and to restrain the deficit financing requirement to no more than 2 percent of GDP is very encouraging, and demonstrates a commitment on their part to achieve fiscal balance. However, there appears to be three factors which might militate against achieving such balance.

The staff report indicates that the sluggish growth in revenue in 1995/96 was associated with a rollback in import surcharges in late 1994 and the removal of certain increases in property transfer taxes. It would appear that there is a need for some greater consistency in the tax structure and significant improvements in the collection mechanisms. Here, we fully support the comments made by other speakers with regard to the need for review of the tax structure.

Perhaps the staff may wish to consider further discussions with the Aruban authorities in these areas.

Another area to be addressed is the civil service reform. The data in the staff report shows that while some 10 percent of the civil service was voluntarily separated in 1995, they were replaced to a large extent through new hiring. This suggests that the wrong people made use of the voluntary separation opportunity, that is those with the skill and competence which are needed. I agree with the staff that the authorities should be encouraged to review the voluntary separation program to make it more targeted, and to make greater use of the process of attrition.

Finally, the growing demand for social and economic infrastructure, as the authorities seek to diversify the economy, will place enormous pressure on the government's commitment to contain expenditure. There will be the need to exercise strong political will. As mentioned earlier, the Aruban authorities must be commended for adopting a monetary policy stance which has facilitated low inflation, a generally healthy balance of payments position, and the maintenance of the parity of the Aruban florin. Nonetheless, the staff has raised the issue of the use of monetary policy instruments and the mode of implementation. I agree fully with the staff that while the present level of development of the financial infrastructure necessitates a heavy reliance on administrative instruments, a movement toward more market-oriented instruments should be explored and pursued. In this regard, the movement toward a global credit ceiling for the commercial banks as a group, as against specific ceilings for each bank, is most welcome. This would certainly make the credit market more competitive. However, the staff reports are silent on the existence of treasury bills, which can be used as instruments to regulate liquidity while at the same time facilitating the government's cash flow situation, and broadening the spectrum of securities. If it is that such instruments do not exist, or are not utilized fully by the Aruban authorities, the staff may wish to explore such issues with the authorities.

In the area of tourism, the tourism sector has, indeed, been the mainstay of the Aruban economy since the mid-1980s. And so the authorities should be congratulated for their wisdom in recognizing the need to limit the physical expansion of the sector and to raise the quality of the product in order to ensure its sustainability. The staff has raised questions with regard to the imposition of a moratorium on new hotel construction vis-à-vis the use of fiscal penalties which is deemed to be more transparent. While I support fully the precept that market forces should be allowed to regulate the marketplace, it must be considered that there are instances in which the imperfections of the marketplace reduce the reliability of this process. In this instance, I tend to agree with the use of the direct control exercised through the moratorium since the issues of carrying capacity and the long-term impact on the environment so fundamentally affect the sustainability of the industry and the quality of life of the residents of Aruba. Further, it is common and accepted practice for most developing tourism destinations that, with the active support of international lending agencies, physical limitations of the size and the level of exploitation of tourism facilities are implemented by the authorities.

Further, while it is acknowledged that governments generally should seek to limit their involvement or participation in enterprises such as airlines, the merits and demerits of each case should be carefully considered. For a small island economy, which is heavily dependent on tourism, the issue of airlift is most crucial and is the area in which it is most vulnerable to externalities over which the authorities have no control. Ultimately, the success of any tourism destination depends not only on the quality of the tourism product, but on the issue of access to the destination. A total reliance on international air carriers, whose decisions to cut routes depend only on their internal considerations, may not provide the necessary assurances of access. The effects of the threatened strike by American Airlines have been noted in the staff reports. It appears that perhaps based on their experiences, the Aruban authorities do not have the necessary confidence in the reliability of the services provided by international carriers.

I take this opportunity to wish the Aruban authorities continued success in the management and development of their economy.

The staff representative from the European I Department stated that indirect tax receipts had fallen short of the amounts indicated in the budgets for 1995 and 1996 because the impact of the elimination of the 5 percentage point import duty surcharge, which had taken place in late 1994, had been considerably underestimated. The authorities were now reevaluating their estimation procedures to ensure a more accurate estimate for 1997.

The staff strongly agreed with a number of Directors about the need to improve tax administration, the staff representative continued. The seriousness of the situation had been underscored by the substantial arrears in income tax collection.

The staff had not received any indication from the authorities as to whether any additional measures were under consideration to achieve the 2 percent of GDP target for the 1997 borrowing requirement, the staff representative indicated. Possible measures could include some further scaling back of public investment; a number of large projects could perhaps be made somewhat less ambitious. Also, there was a need to do more in the area of civil service staffing. The authorities had indicated their wish to use an early retirement plan and a voluntary separation plan to encourage the separation of staff without the required qualifications. The pay was particularly high among the lower levels of civil service employees, and the government was experiencing difficulties attracting qualified personnel while paying fairly high wages to low-skilled workers.

Mr. Wijnholds made the following statement:

First, let me express my appreciation for the interest shown in Aruba. I had not visited the country since 1986 when I recently joined the staff for a few days on this quite delightful island, and I was almost shocked by the extent of economic development in those intervening years. This is an island that in the mid-1980s was depressed because of the closure of a major oil refinery. Seeing what happened in the meantime, in terms of new construction, is quite staggering. This also makes the point that indeed the small size of the island remains a predominant feature in the authorities' policy-making framework. The island has 190 square kilometers, which is very small, certainly smaller than the greater Washington area. The current population of perhaps 90,000 people is one third greater than a decade ago. There is a lot of pressure on the small, desert-like island, which is blessed with beaches and a nice climate, but not with water. One has to realize that all of the water is desalinated from the sea, so if one is talking about further development, there are a lot of problems in terms of environmental capacity and living space for the population. This, indeed, underlines the background of the authorities' decision to call for a moratorium on hotel construction. Notwithstanding my general preference for a more market-oriented policy approach, there is some merit in such a more administrative approach in this case, in light of the special circumstances of this island. I should also add that competition among hotels is not lacking. Different countries and different types of hotels are well represented on the island, so the moratorium cannot be viewed as an effort to stifle competition. Rather, the objective is to protect the environment and avoid further booming construction.

One should also keep in mind that until recently there was a serious concern of overheating of the economy, which has abated somewhat now. The labor market remains extremely tight. Unemployment is estimated at 0.6 percent of the labor force. There are not many countries in the world that can boast such a situation. It is fair to mention the concern regarding the high wage level in the civil service. It should be pointed out, however, that it is also caused by the labor market pressures.

The country's small size remains an important reason for the authorities' reluctance to move very fast toward full panoply of indirect instruments. I would caution the Fund against being dogmatic in concluding that one particular monetary policy framework was perhaps applicable everywhere.

I agree certainly with what has been said about taxes by Directors and by the staff. Tax administration remains a serious problem which needs to be addressed. The authorities are quite aware of it, so that is an area for close monitoring.

Finally, Ms. Turner-Huggins asked about a PIN. The authorities are considering this, but have not made their decision for the time being.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended Aruba on the strong economic growth and moderate inflation that had been achieved over the past decade, and on the sound macroeconomic policy that had underpinned that performance. Directors noted that the key challenge facing Aruba now was to ensure continued growth in per capita GDP, while avoiding overheating. Directors, therefore, welcomed the government's intention to foster productivity growth by emphasizing quality in the tourist sector, and by diversifying the economy.

Directors observed that the continuation of stability-oriented fiscal and monetary policies would also be essential to facilitate economic growth. Directors accordingly commended the prudent fiscal policy followed in Aruba. They welcomed that the supplementary budget for 1997 aimed at containing the government's borrowing requirement to 2 percent of GDP. They also encouraged the authorities to pursue their objective of returning to near budgetary balance in the next two years. To that end, further measures to restrain public expenditure would be needed in 1997 and the medium term. They should include an enduring reduction in public sector employment and wage restraint. In that connection, some Directors stressed that due regard would need to be paid to retaining quality personnel. Directors thought it advisable to review some large investment projects. Directors also encouraged the Aruban authorities to improve tax administration with a view to increasing the buoyancy of public revenue, and to undertake a study of the structure of the tax system.

Directors agreed that the peg of the florin to the U.S. dollar had served Aruba well. They noted that the central bank had skillfully managed the monetary and banking system in a very open environment. The suspension of direct credit controls as of January 1997 was a welcome step toward allowing greater play for market forces in determining the allocation of credit. It will be crucial to monitor developments under the new system closely to forestall an excessive expansion of monetary and credit aggregates. Directors also said that they understood the authorities' wish to move cautiously to a more fully market-oriented system of monetary control.

Directors noted that important steps had already been taken to modernize the prudential supervision and regulation of the banking system. They observed that the central bank appeared to have the information and regulatory instruments it needed to detect and correct emerging financial problems in individual institutions before they adversely affected the system as a whole. The priority now was to enact the laws and regulations to provide a comprehensive legal framework for supervision that would formalize the methods already used in practice.

Directors commended Aruba on its generally liberal trade policy. On other structural issues, Directors welcomed the government's intention to resell a major hotel without a loan guarantee and to use the proceeds to replenish Aruba's foreign exchange reserves. With respect to the national airline, Directors urged the authorities to eschew any further financial commitments and allow market forces to fill the demand for air transport.

Directors welcomed the efforts at data improvement and called for further improvement in the statistical base, especially trade data, in order to facilitate the formulation, implementation, and surveillance of macroeconomic policies.

It is expected that the next Article IV consultation discussions with Aruba will be held on the 24-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/50 (5/16/97) and EBM/97/51 (5/19/97).

2. RELEASE OF INFORMATION—GENERAL DATA DISSEMINATION SYSTEM

The Executive Board approves the proposal as set forth in EBD/97/53 (5/12/97).

Adopted May 16, 1997

3. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAM/97/74 (5/13/97) is approved.

APPROVAL: October 27, 1997

REINHARD H. MUNZBERG
Secretary