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August 18, 2008

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Kingdom of the Netherlands—Netherlands Antilles—Staff Report for the 2008 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2008 Article IV consultation with the Kingdom of the Netherlands—Netherlands Antilles, which is tentatively scheduled for discussion on **Monday, September 15, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Kingdom of the Netherlands—Netherlands Antilles indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Ms. Banerji (ext. 34780), Mr. Daal (ext. 39047), and Mr. Moore (ext. 39391) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Commission, following its consideration by the Executive Board.

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INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS ANTILLES

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the 2008 Consultation
with the Kingdom of the Netherlands—Netherlands Antilles

Approved by Alessandro Leipold and Martin Fetherston

August 18, 2008

EXECUTIVE SUMMARY

Background: The promise of fiscal discipline and debt relief, under the agreement to dissolve the Netherlands Antilles, has boosted investor confidence and growth. Implementation of the dissolution agreement has begun, although the actual constitutional changes are now scheduled for January 2010. The new fiscal framework (a balanced budget, debt limits and supervision) is already in place in the BES islands (Bonaire, St. Eustatius, and Saba) and due to start in 2009 in Curaçao and St. Maarten. The authorities are pushing ahead with welcome reform proposals to improve: tax policy, labor markets, public enterprise finances, pensions, and healthcare.

Challenges: The immediate challenge is complete the transition phase expeditiously by finalizing important details, including the terms of debt relief. An ongoing challenge will be economic management in the absence of key macroeconomic policy tools—structural reforms will be crucial for improving competitiveness and maintaining external viability. The authorities will also need to address the strain on public finances from entitlement costs, and the impact of debt relief-related liquidity on financial sector balance sheets.

Staff views: On current trends, growth is expected to stay strong in 2008 and over the medium term, provided investor confidence can be preserved. The authorities' push for reforms and the direction of policies is welcome, but implementation will be key to preserving investor confidence. Pension reforms and healthcare cost controls would help ensure fiscal sustainability. The liquidity injection from debt relief will need to be managed judiciously, including through a phased reduction in capital controls.

Authorities' views: The authorities were in broad agreement and have already taken several measures. Pension reform (raising the retirement age) and labor market reform are likely to be particularly challenging.

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I. Recent Economic Developments

1. **The promise of large-scale debt relief and fiscal responsibility under the dissolution agreement for the Netherlands Antilles has boosted investor confidence and ended a long period of stagnation** (Box 1, Table 1, Figure 1). Economic growth accelerated sharply in 2007 to 3.8 percent, driven by investments in infrastructure, housing[1] and tourism sectors, and increased private consumption, supported by income tax cuts and higher employment. The expansion was partly supported by credit growth, reflecting monetary easing in the United States. Preliminary indications are that the growth momentum is continuing in 2008.

2. **Inflation, historically low, jumped in 2008 due to an elimination of implicit oil subsidies**. Earlier in 2008, parliament approved a full pass-through of energy price increases to consumers, which it had delayed since 2006, forcing the budget to absorb the costs as lower dividends. As a result, inflation, which usually broadly tracks U.S. inflation due to the anchor of the exchange rate peg to the dollar, rose, reaching 4.2 percent in Curaçao in May 2008. Food price increases have had less impact, given a low weight in the CPI basket.

3. **The current account deficit increased sharply in 2007 in line with the surge in FDI flows related to large hotel projects**. Exports moderated temporarily due to fire-related damages in the free-trade zone. However, tourism was a bright spot; notwithstanding the U.S. slowdown,[2] competitiveness was boosted by prior investments in infrastructure, the euro appreciation, strong growth in the Netherlands, and downward pressures on costs from immigration. Imports surged in tandem with high oil prices and domestic demand, as could be expected given high import elasticities typical for small open economies with limited domestic agricultural and manufacturing production. The large current account deficit—16 percent of GDP in 2007—was more than financed by FDI, increased Dutch aid, and private sector trade credits. As a result, reserve coverage improved, fully covering short-term liabilities.

4. **The government retrenched its finances through 2007, mainly through controls on spending**. Notwithstanding income tax cuts in 2006, revenues held steady due to improvements in collections, including reductions in tax backlogs, and more recently, the introduction of modern techniques (container scanning) to prevent evasion of import and sales taxes. Spending cuts focused on curtailing current primary spending through reductions

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[1] The strong euro, longstanding tax rebates, and high Dutch house prices have fuelled demand for retirement and vacation homes in the Antilles.

[2] U.S. tourism, predominantly time-shares in St. Maarten, is less sensitive to economic fluctuations than hotel- or cruise-based tourism. Most Curaçao tourists are Europeans.

Box 1. Constitutional Changes and a New Fiscal Framework: The Key Elements

According to the December 2005 agreement to dissolve the Netherlands Antilles federation, Curaçao and St. Maarten will gain *status aparte* (as did Aruba in 1986), while the BES islands will become part of the Netherlands. While some specific details remain to be finalized, key elements of the dissolution agreement are:

- Debt cancellation of about 80 percent of total public debt as of December 31, 2005 by the Netherlands. Details of the coverage, schedule, and modality of debt relief remain to be finalized, and the actual operations have been delayed. Debt relief will be conditional on the establishment of a fiscal framework, applicable to the local government of each island, and including:

    - The introduction of medium-term budgeting;

    - The establishment of a fiscal supervisor (chaired by a Dutch appointee) to supervise borrowing decisions, ensure that the fiscal rule (see below) is fully implemented, and advise responsible ministers.

    - A balanced current budget rule, with borrowing restricted to within-year cash management needs. Deviations will be allowed only in case of a disaster, with disaster relief subject to the approval of the fiscal supervisor.

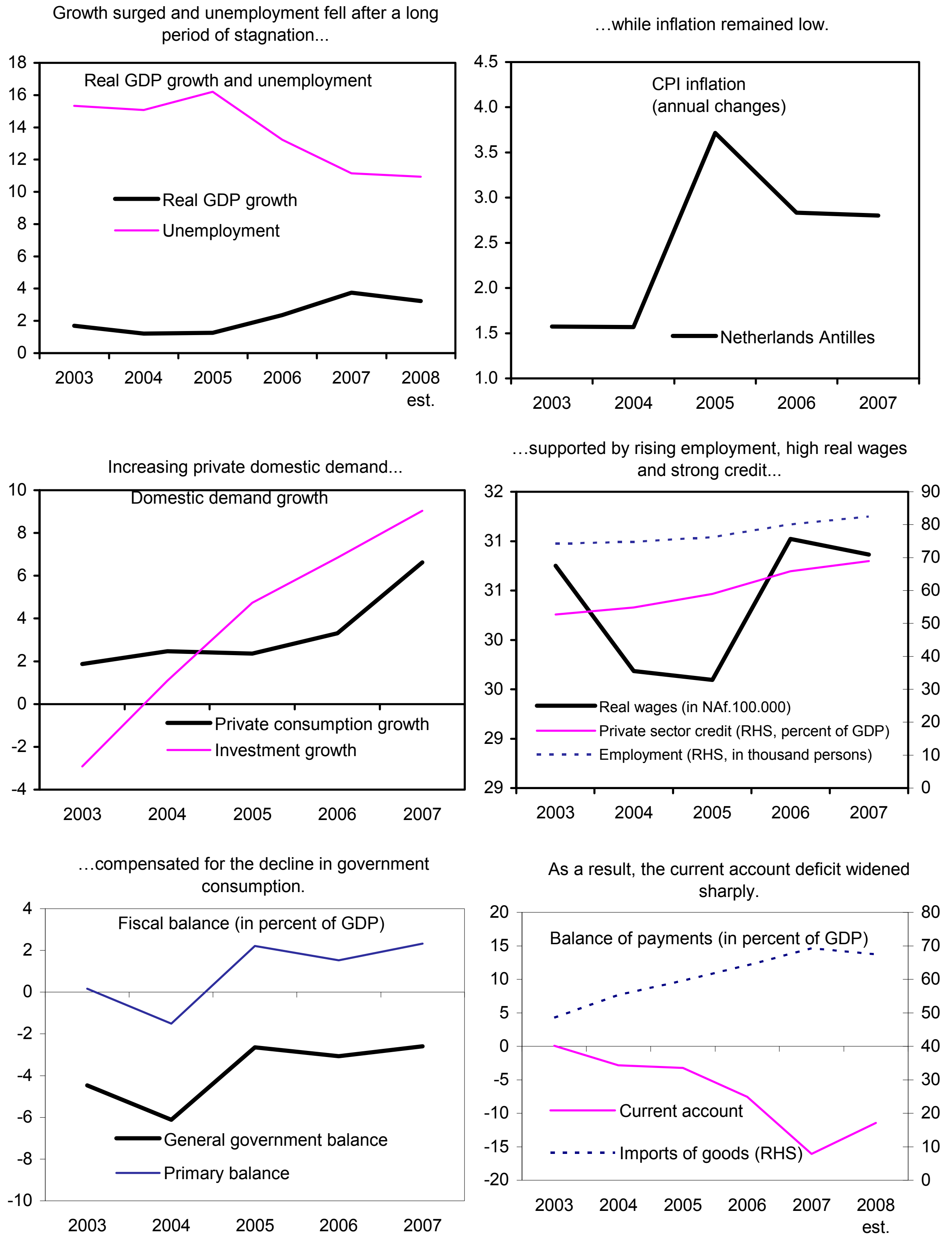
    - Borrowing caps for capital expenditure, limiting annual interest payments to five percent of the average total revenue of the preceding three years, with investments to be approved by the fiscal supervisor only if budget implementation is in line with the fiscal rule.

- A common central bank for Curaçao and St. Maarten responsible for monetary policy and financial sector supervision for both islands.

- A socio-economic initiative (SEI) to tackle social and economic problems.

The implementation of the dissolution agreement has already started, although the technical changes in the islands' status (the "constitutional changes") have now been postponed until January 2010. The BES islands have already introduced the fiscal framework, which Curaçao and St. Maarten are scheduled to begin implementing as from 2009. They have also agreed in principle to remain in a currency union, with the central bank (BNA) in charge of monetary and exchange rate policies and financial sector supervision in both islands. The BNA's charter is being modified accordingly, with agreement on the Board's composition still pending.

Figure 1. Netherlands Antilles: Recent Economic Developments



Sources: National authorities and Fund staff estimates.

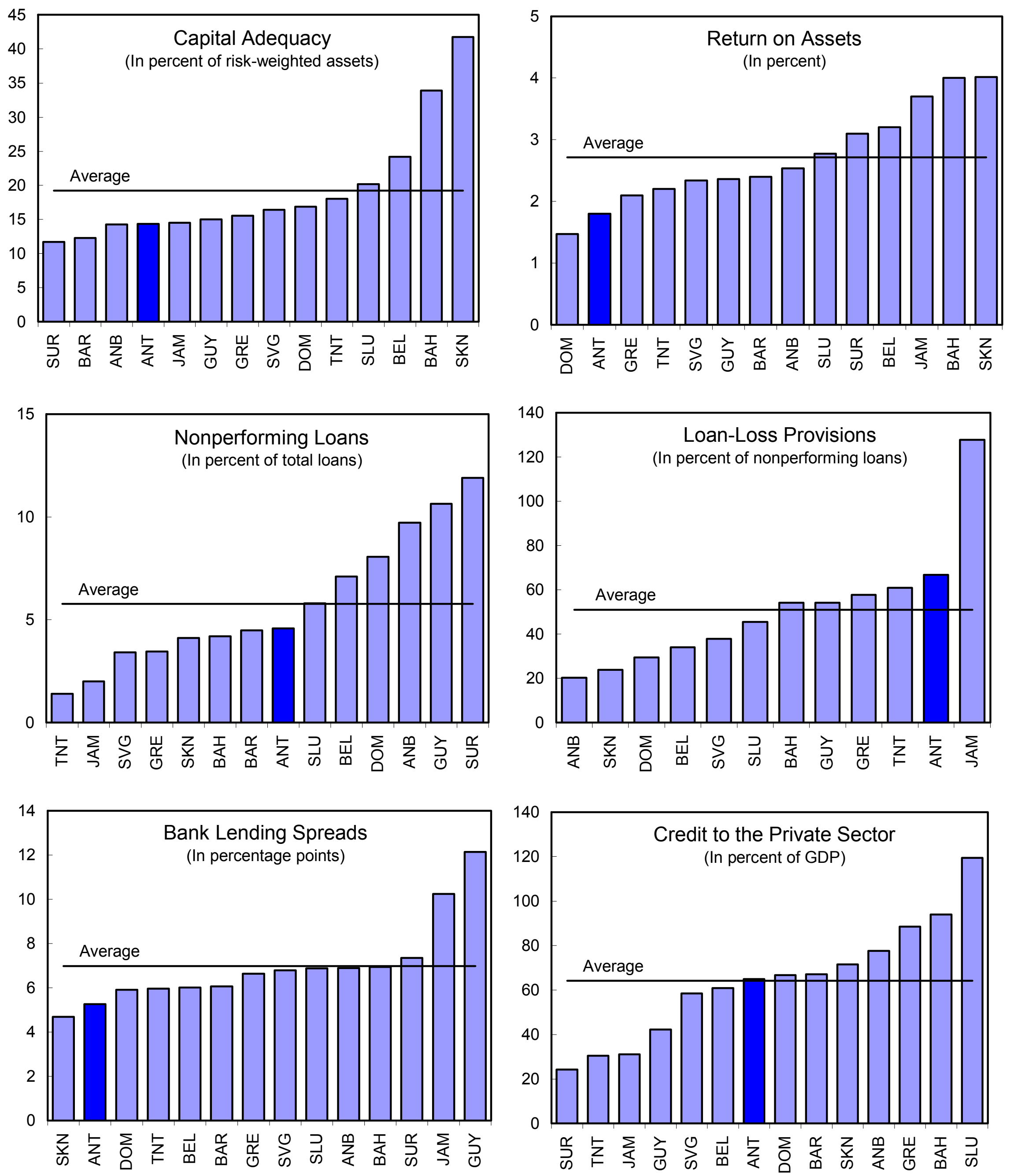
in the civil service and spending on goods and services, and low wage increases, though, in 2007, some arrears to APNA (the civil service pension fund) were incurred. However, total spending has remained high because of interest payments. Public debt remains close to 80 percent of GDP ahead of debt relief. All in all, the current budget balance has been held at 2⅓ percent of GDP during 2005–07.

5. **The Bank of the Netherlands Antilles (BNA) tightened monetary policy, restraining credit growth**. To offset the reduction in its benchmark pledging rate following cuts in the target U.S. federal funds rate, and to mop up excess liquidity, the BNA raised reserve requirements—its main policy instrument, besides CD auctions—from 12¼ to 13¼ percent in several steps since 2005. Credit to the private sector has grown steadily (12 percent year-on-year in May 2008), reflecting increased investor confidence and lower lending rates associated with intensified competition. Meanwhile, with inflows strong, the BNA has exceeded its target for reserve coverage (three months of imports).

6. **The financial sector seems broadly healthy and compares favorably with the region** (Table 2, Figure 2). Financial soundness indicators show adequate capitalization and profitability. Nonperforming loans remain moderate by Caribbean standards, notwithstanding some increase recently. Banking sector assets remain concentrated in the top two banks, reflecting limited competition on the funding side due to capital controls on institutional investors (pension funds and insurance companies), and market segmentation. However, increasing competition from smaller banks has compressed lending spreads modestly. Following a loss of market share earlier in the decade, assets of the international financial sector[3] have since begun to recover (Table 3). Neither the domestic nor the international financial sectors have been affected by the global financial turbulence. Supervision and AML/CFT efforts have been strengthened (Informational Annex I, including implementation of Fund policy recommendations).

[3] IMF Country Report No. 04/271.

Figure 2. Netherlands Antilles and Selected Caribbean Countries: Financial Sector Indicators
(2007, or latest available observation)



Sources: Bank van de Nederlandse Antillen; *International Financial Statistics*; and Fund staff estimates.
ANT–Netherlands Antilles; ANB–Antigua & Barbuda; BAH–The Bahamas; BAR–Barbados; BEL–Belize; DOM–Dominica; GRE–Grenada; GUY–Guyana; JAM–Jamaica; SKN–St. Kitts & Nevis; SLU–St. Lucia; SUR–Suriname; SVG–St. Vincent & the Grenadines; TNT–Trinidad & Tobago.

II. Prospects, Opportunities and Challenges

7. **Discussions focused on the opportunities and challenges presented by the dissolution agreement:**

- **Although many reforms are planned (Informational Annex I), unresolved details in some areas are complicating decision-making**. For instance, the terms of debt relief payments remain unclear, with important implications for fiscal policy, liquidity management, and financial sector balance sheets. Decisions regarding post-dissolution public sector institutional arrangements (including mechanisms to transfer central government tasks to local governments) are also pending.

- **An ongoing challenge for policymakers will be how to use the limited tools at their disposal to support growth, while containing vulnerabilities**. The exchange rate peg constrains monetary policy and the forthcoming rule will all but eliminate the fiscal policy tool. The freedom of Antilleans to migrate to the Netherlands poses an additional constraint by contributing to downward inflexibility in wages in key sectors (especially high-skilled labor); high wages and large structural unemployment impede cost competitiveness. Finally, the small size of the economy limits the scope to diversify economic activities and improve cost competitiveness through large-scale immigration.

8. **Against this background, discussions focused on the macroeconomic outlook with emphasis on policies to deal with three main areas of vulnerability**:

- Accommodating the strains on public finances from ageing related costs;

- Managing the impact of debt relief on financial sector balance sheets; and,

- Maintaining the viability of the peg through measures to improve competitiveness and foster investor confidence.

A. Macroeconomic Outlook and External Sustainability

9. **On current trends, growth is likely to remain strong in 2008 and above historical norms over the medium term provided investor confidence can be sustained** (Table 4). Growth is estimated at about 3 percent in 2008, broadly in line with the expectations of the Ministry of Finance; the BNA was more cautious. Growth is expected to be shored up by imported monetary easing, and ongoing investments in infrastructure, housing and tourism. Private consumption growth is likely to be more subdued than in 2007, as the impact of higher employment and planned minimum wage increases is partly offset by the decline in purchasing power due to the uptick in inflation. Staff estimates are cautiously optimistic for the medium term (2½ percent by 2011), predicated on the expectation that export markets

will recover; recent infrastructure investments will have increased potential output; and the introduction of a fiscal rule and debt forgiveness will foster crowding-in of the private sector.

10. **Following a sharp uptick in 2008, inflation is expected to broadly track that of the U.S**. Staff and the authorities project inflation to reach 5 percent by end-2008, reflecting energy and utility price increases. Thereafter, inflation should again converge to U.S. levels; pending regulatory changes should eliminate significant future delays in passing international oil price developments through to domestic prices. The containment of average wages through low-wage immigration and the high import elasticity of demand will also limit inflationary pressures.

11. **The 2008 current budget deficit is expected to decline, despite the delay in debt relief**. This improvement can be attributed to higher revenues from stronger-than-budgeted economic growth, larger dividends from enterprises (reflecting the large adjustment in oil and utility prices), and the full-year effect of the improvements in tax collection introduced in late 2007. Current primary spending—on a downward track since 2004—has been restrained to the 2007 level, despite modest increases in outlays related to the constitutional changes and payment-in-full of APNA premiums. Thus, the current budget deficit is on track to remain below the 2007 level, despite the delay in debt relief (adding an additional 3½ percent of GDP to expenditures). A steep increase in aid-financed investment cofinancing (decided when debt relief was expected to occur in 2008) will, however, widen the overall deficit sharply, to some 3¾ percent of GDP.

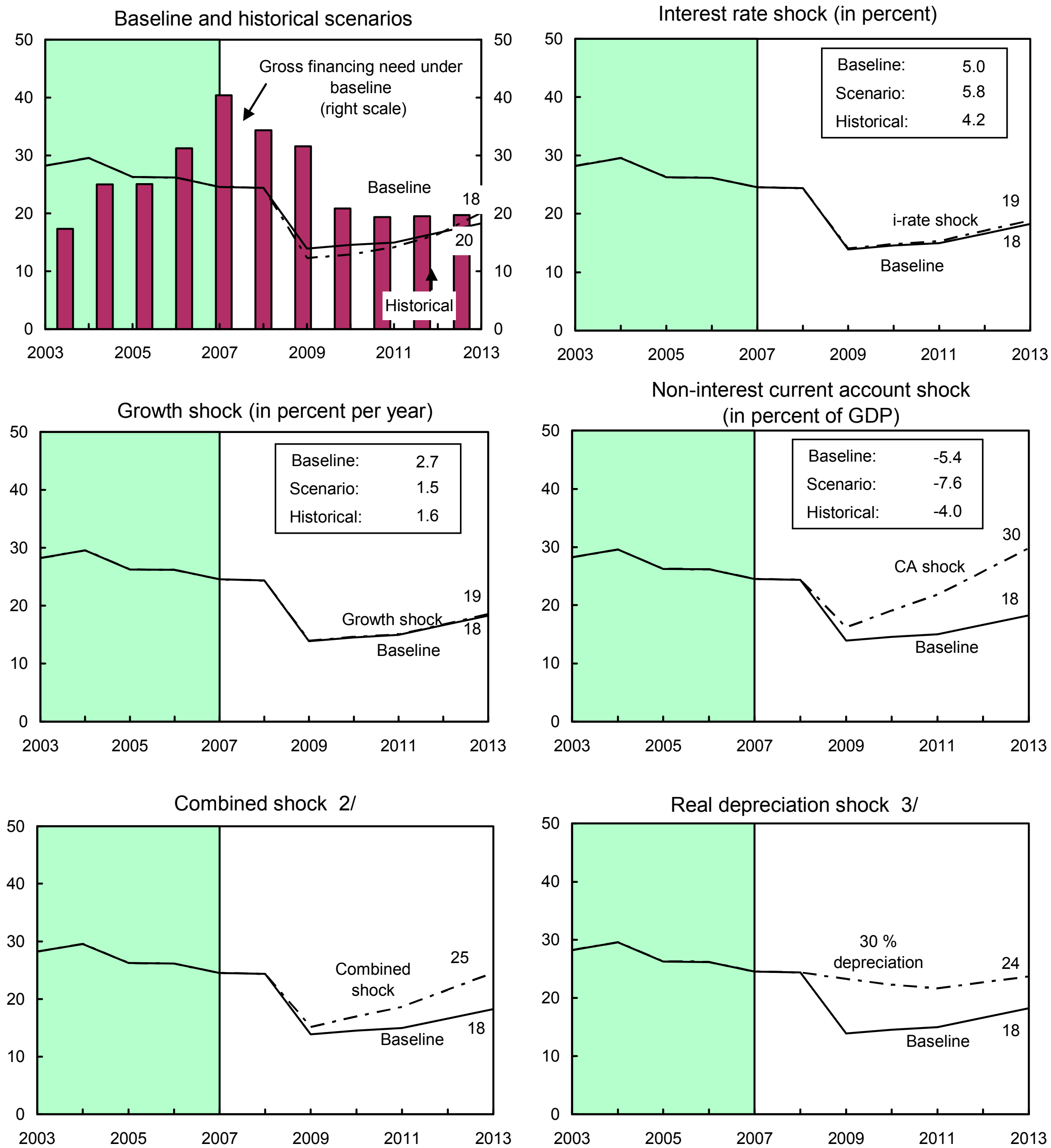
Netherlands Antilles: Fiscal Adjustment
(In percent of GDP)

	2007	2008 Without debt relief
Total revenue	23.7	23.9
Total expenditure	26.3	27.6
Capital expenditure	0.3	1.8
Current expenditure	26.0	25.8
Non-interest payments	21.1	21.1
Interest payments	4.9	4.7
Overall deficit	-2.6	-3.7
Primary balance	2.3	1.0
Current balance	-2.3	-1.9
Current primary balance	2.6	2.8

Sources: National authorities and Fund staff estimates.

12. **External current account developments are likely to remain manageable** (Table 5). Following the completion of big-ticket tourism-related projects, the current account deficit is likely to narrow, but remain significant, over the medium term assuming that investment needs continue to be financed by foreign savings in the form of grants and FDI. While the “headline” current account deficit will remain significant, the deficit net of grant aid and FDI—a better measure of vulnerability—will be much smaller. In the absence of such financing, the current account deficit would automatically adjust—import demand generated by these inflows would not materialize. Reserve coverage is expected to remain sufficient at 3½ months of imports. External debt, already moderate, is expected to fall further after debt relief. Its projected evolution, consistent with the benign current account outlook, is robust to shocks (Figure 3).

Figure 3. Netherlands Antilles: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

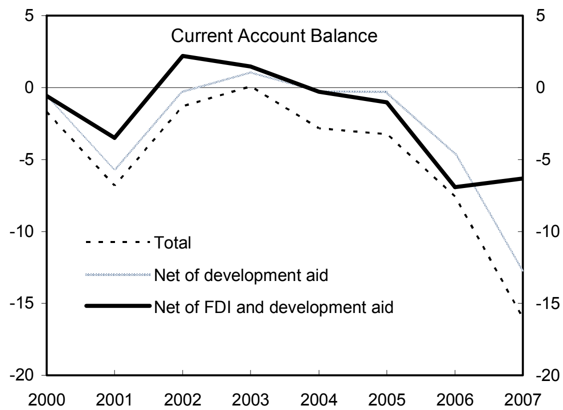
3/ One-time real depreciation of 30 percent occurs in 2009.

13. **Provided reforms are implemented, the improvement in various competitiveness indicators should continue** (Figure 4). Low inflation, as well as a sharp depreciation vis-à-vis the euro by virtue of the dollar peg, has implied a significant depreciation of the CPI-based real effective exchange rate (REER). The estimated equilibrium REER has fallen since the beginning of the decade owing to reductions in government consumption and the terms of trade. The actual REER appears to be broadly in line with fundamentals (3 percentage points from its estimated equilibrium rate in the past four years). If planned reforms are implemented, then the recent gains in market share for goods exports, and tourism market shares relative to Caribbean competitors, should also hold up.

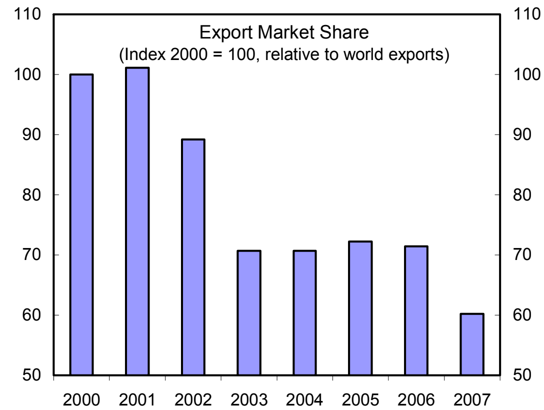
14. **In this environment, the long-standing peg to the U.S. dollar remains viable**. The economy's small size and its strong economic and commercial ties with the U.S., argue for maintaining the peg. The authorities view the peg as a durable and effective nominal anchor, instrumental in keeping inflation and inflationary expectations low, and fostering trade and investment by allowing long-term investment planning. Maintenance of a nominal peg is also consistent with policies in similarly situated competitor countries in the region (Figure 5). Staff concurred and also supported St. Maarten's decision to continue its currency union with Curaçao, since a separate central bank (under consideration at one point) would entail high costs relative to the seigniorage and monetary policy benefits. In this context, staff urged that changes to the BNA's charter not undermine its political independence.

Figure 4. Netherlands Antilles: Competitiveness Indicators, 1990–2008
(In percent of GDP, unless otherwise indicated)

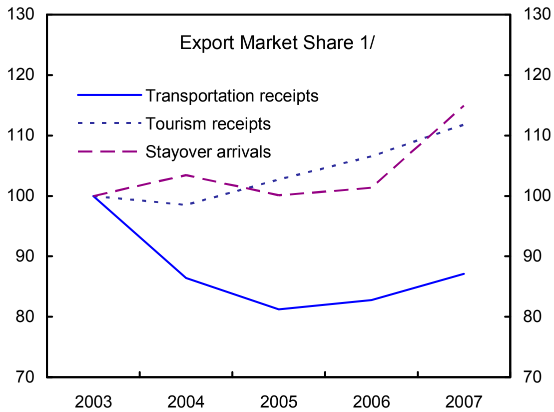
The current account deficit has widened, partly reflecting FDI inflows.



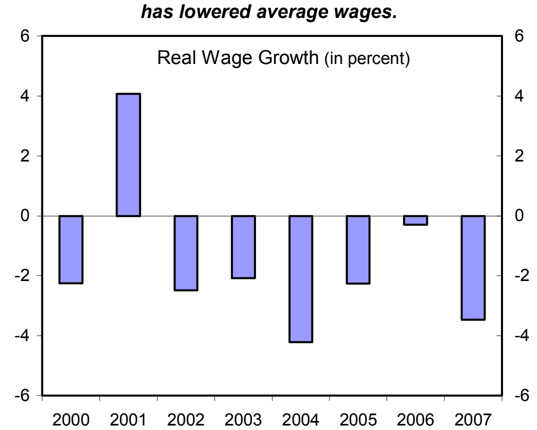
Market share of goods exports has held up since 2003, notwithstanding a one-off shock in 2007.



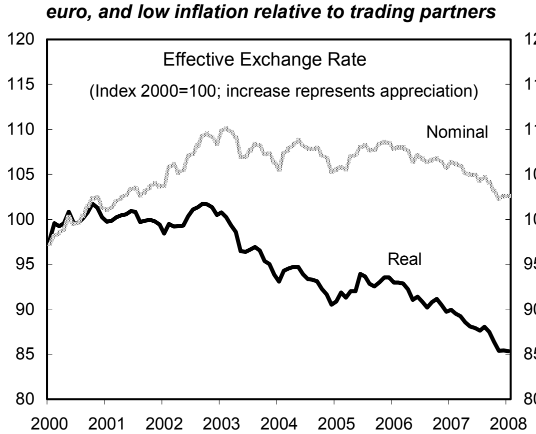
The tourism sector has become more competitive.



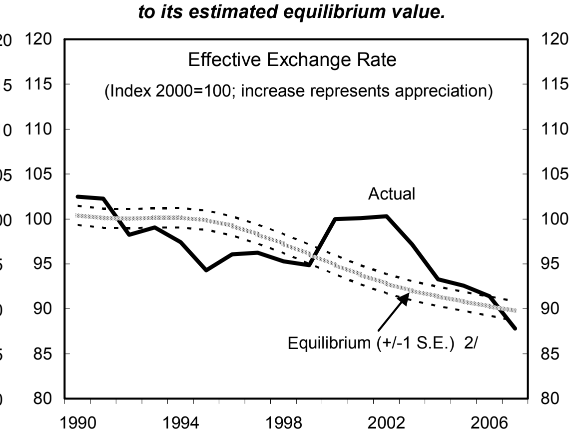
A large increase in low-skilled immigrant labor has lowered average wages.



The peg to the U.S. dollar, depreciation vis-à-vis the euro, and low inflation relative to trading partners



... have resulted in a depreciating REER, which is close to its estimated equilibrium value.

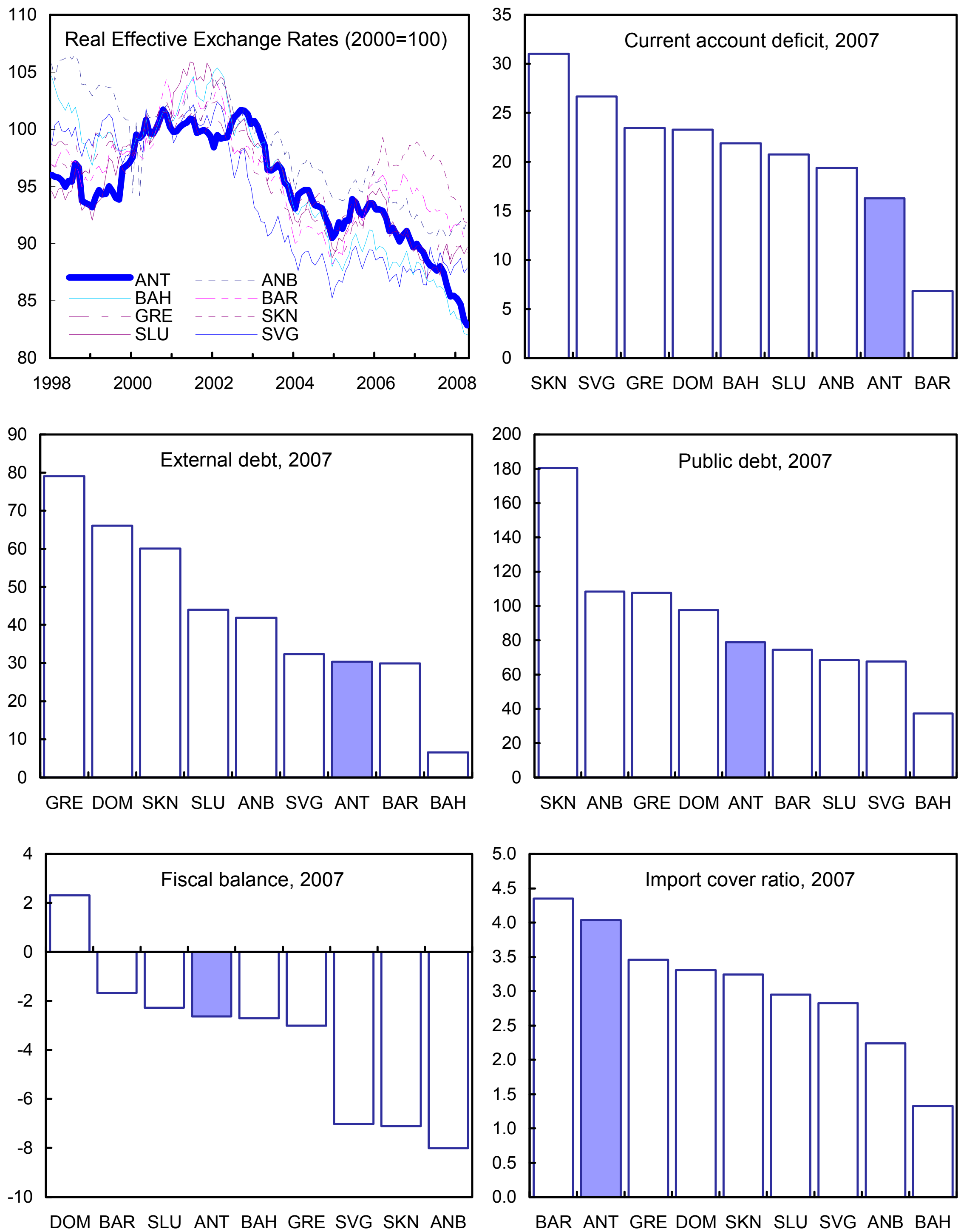


Sources: Bank van de Nederlandse Antillen; and Fund staff estimates.

1/ For transportation and tourism receipts, market share relative to Eastern Caribbean partners; for stayover arrivals, relative to The Bahamas and Barbados.

2/ See Cashin and Pineda (forthcoming Working Paper). Equilibrium REER estimated using panel data for 11 eastern Caribbean economies, with the REER a function of the following fundamentals: productivity differentials, terms of trade, government consumption and net foreign assets.

Figure 5. Cross-Country Competitiveness and Vulnerability Indicators, 1995–2008
(In percent of GDP, unless otherwise indicated)



Source: National authorities and IMF, IFS.
Netherlands Antilles=ANT, Antigua and Barbuda=ANB, Bahamas= BAH, Barbados=BAR, Dominica=DOM, Grenada=GRE , St. Kitts and Nevis=SKN, St. Lucia =SLU, St. Vincent and the Grenadines=SVG.

B. Fiscal Sustainability

15. **The balanced budget rule and fiscal supervision will start in 2009; implementation will be key.** Given the benign macroeconomic outlook, the authorities and staff agreed that the establishment of the proposed fiscal rule as from 2009—and the implied fiscal consolidation—would be appropriate. The annual deficit-cum-debt limits are designed to constrain fiscal policy and ensure that the benefits of debt forgiveness are not undercut by new public borrowing (a recurrent problem in the past). Staff cautioned that the successful implementation of the fiscal rule would be key. This time, the rule may be more successful in imposing fiscal discipline, given the merger of different layers of government (hitherto a key source of friction) in the new structure and a reduced expectation of future bailouts. The authorities saw the participation of the Dutch government in the supervisory body and the ability of the supervisor to escalate concerns to the Kingdom of Netherlands as being the most important deterrents. Staff also stressed the critical importance of ensuring proper accountability and insulating the supervisory body from political pressure.

16. **Going forward, fiscal policy will need to balance the twin objectives of preserving competitiveness and remaining sustainable within the constraints of the fiscal rule**. Competitiveness considerations argued for lower tax, wage, and social contribution rates relative to competitors to attract business; yet, wages, pensions, and safety nets needed to remain competitive with the Netherlands to attract and retain skilled labor. At the same time, public finances would need to make room for commitments arising from the entitlement policies. Public debt will be sustainable post-debt relief (Figure 6).

17. **Preliminary balanced budget plans for 2009-11 assume revenue neutral tax policy changes**. The authorities intend to broaden the tax base through a revenue-neutral rebalancing of the tax burden with lower direct tax rates[4] and higher indirect tax rates; to convert the turnover tax into a "VAT" by eliminating cascading; and, to continue improving collections by upgrading databases, simplifying procedures and rationalizing tax rates.[5] They also intend to improve public enterprise finances by introducing automatic adjustment of tariffs and better oversight of balance sheets.

18. **On spending, additional measures would be required to balance the current budget**. If interest savings from debt relief—some 3½ percent of GDP per year—could be fully saved, this would be more than sufficient to bring the current budget deficit of 2008 into balance from 2009 onwards. However, absent reform, additional spending pressures will arise from three sources starting 2009. First, the government's pension premium payments to

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[4] Initial proposals envisage cutting personal and corporate income tax rates by some 5−8 percent and 8−10 percent respectively, and increasing the turnover tax from 5 to 12 percent.

[5] Tax revenues could be further bolstered after the eventual privatization of the state-owned oil refinery.

APNA are set to increase due to inflation indexation. Second, there will be a need—within the constraints of the fiscal rule— for effectively targeted social transfers to vulnerable sections of society to mitigate the impact of food and fuel price increases and indirect taxes. Finally, without entitlement reforms, the SVB (Social Insurance Bank) is set to face rising deficits every year due to increasing healthcare costs and pension payments to an ageing population. These must be met through budget transfers of some ½ percent of GDP per year during 2009–11. Together, these new spending pressures would absorb the debt relief-induced interest savings, and, furthermore, require current budget surpluses of some ½ percent of GDP to be set aside every year as transfers to SVB (Table 6).

19. **Discussions focused on expenditure-saving measures**. The authorities' current plans (still preliminary) entail sharp real cuts in all categories of current primary spending, mostly through rationalization and greater oversight of subsidies. Given past cuts in civil service size and pay, the authorities considered further civil service downsizing would be difficult, especially since work processes had not been streamlined. Staff was sympathetic to these concerns, but noted that—given additional spending pressures in the absence of reform—there may be no alternative but to seeking further savings from rationalizing the civil service and processes in the new political structure, and limiting wage increases to productivity growth.

20. **The reform of entitlements, already started, should now be completed**. Staff welcomed recent actions to control healthcare costs, and reform APNA, by making inflation indexation conditional on the asset-liability coverage ratio, and changing the pension base to the average salary. However, staff also urged that the remaining reforms under consideration, namely raising the retirement age to 65 and, for SVB, eliminating the regressive income ceiling for social contributions, be completed. The authorities considered raising the retirement age an important, but politically difficult task. Staff noted that these reforms taken together would not only bring pension parameters in line with those in the Netherlands (the main competitor in the labor market), but could potentially create room for a future reduction in contribution rates and pension premiums, thereby improving competitiveness and fostering buy-in. Staff also stressed that improving the pension funds' ability to earn higher returns on their assets—without undue risk—by gradually easing investment restrictions would be important to easing their financial burden.

Pension Systems in the Kingdom of the Netherlands 1/

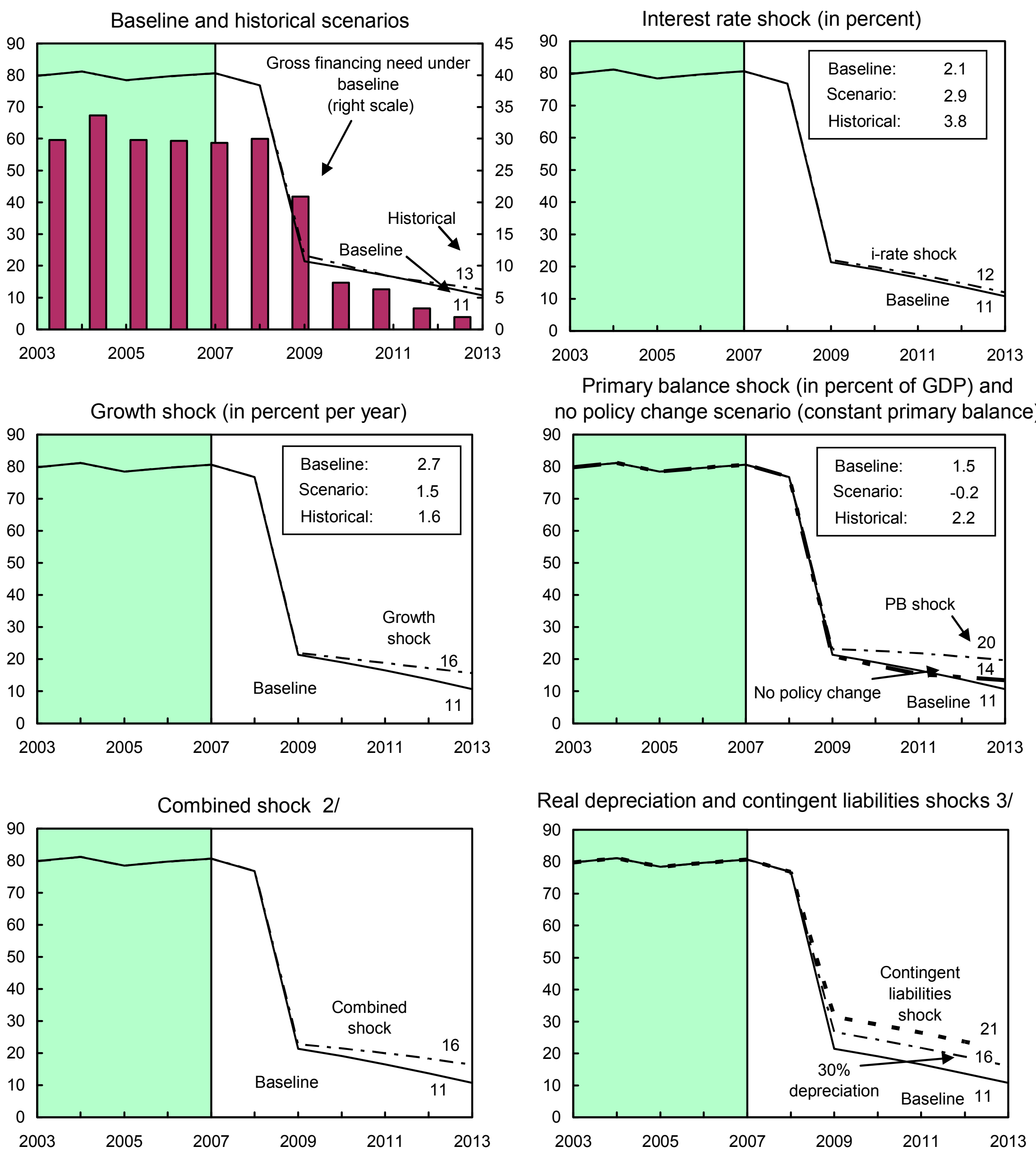
	Gross Replacement Rate	Minimum Retirement Age	Contribution Years for Early Retirement	Minimum Contribution Years
Netherlands Antilles 2/	66.2	60	30/35	10
Netherlands	68.3	65	40	10/5

Source: National authorities.

1/ Includes all mandatory parts of the pension system, both public and private. Excludes voluntary pensions.

2/ The number of contribution years for early retirment is 30 and 35 years for APNA under the old and the new arrangement respectively.

Figure 6. Netherlands Antilles: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



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

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2009, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator). The depreciation shock scenario is equivalent to the baseline if debt relief results in zero foreign-currency public debt.

C. Financial Sector Development and Stability

21. **The authorities are taking steps to manage the liquidity impact of debt relief**. Debt relief is likely to take the form of government security buybacks funded by the Netherlands, which could flood the economy with liquidity beyond its capacity to absorb, at a time when the fiscal rule limits opportunities to invest in new government securities. In the first instance, this would provide liquidity to the main holders of existing government securities, namely, the local institutional investors, which face restrictions on the amounts they can invest abroad (the "60:40" rule).[6] These restrictions—which force institutional investors to earn lower returns on domestic investments compared with alternatives abroad—have been a source of concern for some time; matters are now more pressing given the lack of new government securities and the need for higher payouts to an ageing population. The BNA has responded to these concerns by exploring ways to develop alternative investment opportunities (e.g. the corporate bond market), and has also reduced the "60:40" penalty to make it less costly to invest abroad. Nevertheless, it is reluctant to ease the capital controls in case this would lead to capital outflows.

22. **Staff proposed a three-pronged approach to addressing this problem, which the BNA has since publicly adopted**. First, an effort—already underway—to reach agreement with the Dutch government on a sufficiently gradual schedule of debt relief payments to avoid excess liquidity. Second, some tightening of monetary policy instruments by the BNA may be appropriate, although all acknowledged the limited scope for further tightening, since reserve requirements are already quite high and conventional sterilization on a large scale would be cost-prohibitive, hurting the BNA's balance sheet, and therefore the budget.[7] Third, the "60:40" investment rule for institutional investors should be gradually phased out. The discussion focused mainly on the rationale and pace of phasing out capital controls.

23. **A gradual easing of capital controls to accommodate the liquidity impact of debt relief would help protect financial sector balance sheets, without undermining the exchange rate peg**. Staff urged the BNA to avoid removing the controls in one go (e.g. by reducing the penalty to zero) as it could generate macroeconomic imbalances in an economy used to captive funding sources. On the other hand, forcing institutional investors with large holdings of government securities to invest large amounts of liquidity locally would drive down domestic interest rates and endanger their balance sheets (with eventual fiscal consequences), given the scarcity of alternate domestic assets. Developing alternative domestic assets for investment would take time, and may not be of the size and risk-return

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[6] Local institutional investors are required to domestically invest 40 and 50 percent, respectively, of the first and second NAf. 10 million of their reserves and debts, and 60 percent of the remainder. In 2006, the rule was partly relaxed, with deviations allowed but subject to a penalty (5.9 percent at end-2007).

[7] It would also defeat the purpose of debt relief by transferring liabilities from the government to the BNA.

profile suitable for institutional investors. Staff also cautioned that while banks could invest their additional liquidity abroad, they may instead seek higher rates of return by on-lending these funds domestically. This could translate into pressure on bank balance sheets as banks undertake more risky lending, and further increase asset prices. Unduly rapid domestic credit expansion could—in the extreme—fuel an import boom, thereby realizing the BNA's fears about capital outflows.

24. **The phased removal of capital controls would have the additional benefit of fostering financial sector competition**. Banks would be forced to compete on the funding side and further improve operational efficiency and diversify income sources. The improvement in competition could be further facilitated by greater financial integration with Caribbean countries (supported by strong supervision), and the consolidation of smaller banks—as is underway—to level the playing field.

25. **Institutions and supervisors are likely to face a more difficult environment in the period ahead**. Financial institutions' profit margins are likely to come under pressure from the disappearance of risk-free investment opportunities, and—as a side-effect of debt relief—lower income from high-yielding government securities. Banks may face incentives for greater risk-taking to maintain profitability, requiring the BNA to be especially vigilant against a deterioration in lending standards. The BNA considered these risks to be more acute in the smaller banks, on the grounds that the large banks were subject to more rigorous risk management by their parent banks. The decision to vest supervisory powers in the BNA post-dissolution was welcome, since it has the necessary expertise.

D. Structural Reforms and Competitiveness

26. **With fiscal and monetary policy locked in, structural reforms take on added importance as the chief instrument for boosting competitiveness and preserving investor confidence**. The broad range of reforms proposed in the draft tripartite protocol agreed between labor, government and businesses to improve productivity, and the social economic initiative, indicate strong support for seizing this "once-in-a-lifetime opportunity" to undertake necessary reforms.

27. **The planned reforms are welcome, but implementation would be key**. Discussions focused on two areas in particular—taxation and labor market reform—as follows:

- **On tax reforms, competitiveness considerations should also be taken into account when setting tax rates**. Direct tax rates are high by regional standards, with the tax burden borne disproportionately by the largest firms and workers, deterring foreign investors and skilled labor. Thus, in setting direct tax rates, and streamlining procedures, the authorities would also need to take into account the impact on the competitiveness of businesses. In addition, representatives of the international financial sector stressed the importance of double taxation agreements for their competitiveness.

Cross-Country Comparison of Tax Rates

	Personal income	Corporate	Indirect
British Virgin Islands	15	--	--
Bahamas	3.4	--	--
Anguilla	--	--	3
Barbados	35	25	15
Netherlands	52	25.5	19
Aruba	58.95	28	3
Dominica	40	30	15
Average	**33.7**	**30.7**	**12.2**
Jamaica	25	33.33	16.5
Venezuela	34	34	14
Netherlands Antilles 1/	**49.4**	**34.5**	**5**
St. Vincent & the Grenadines	40	35	--
St. Kitts and Nevis	--	35	--

Source: KPMG; Daten Info Service Eibl GmbH at http://www.icl-directory.com/

1/ The standard rate of turnover tax is 5 percent in Curacao and Bonaire and 3 percent in St. Maarten.

- **The draft tripartite protocol was encouraging, but implementation of the proposals as a package was required**. The draft strategy emphasizes "flexicurity," and puts the onus on all parties to contribute collectively to improving productivity. Thus, it proposes easing dismissal and work permit regulations, while emphasizing training and measures to encourage labor force participation. Staff was encouraged by the business communities' willingness to accommodate labor costs increases (e.g. the planned minimum wage hike), provided these could be ameliorated by flexibility in other areas.

Staff also suggested that in determining which institutions and regulatory bodies to share or duplicate post-dissolution, the Curaçao and St. Maarten authorities should keep agency costs down by exploiting economies of scale where possible.

E. Statistics

28. **While improvements have been made in compilation (Informational Annex I), there is scope to further shorten the lag in producing statistics and improving dissemination**. The production of additional core statistical indicators remains stalled for want of funding. Earlier dissemination of preliminary financial sector data would be helpful, and the BNA's plans to automate and accelerate the frequency of reporting by institutional investors is welcome. It also urged that the pending decision on how to produce statistics for St. Maarten after dissolution should take into account the large overhead costs and time required to form a separate statistics agency.

III. Staff Appraisal

29. **The prospective dissolution of the Netherlands Antilles poses both opportunities and challenges**. A large write-down of public debt provides a unique opportunity to put the budget and the economy on a sustainable footing once for all. The push to enact reforms is therefore encouraging, and should proceed expeditiously. To this end, it would be helpful to complete the transition to the new economic structure as a matter of priority, by clarifying issues that are yet to be resolved, particularly regarding debt relief and the post-dissolution institutional structures.

30. **Balanced growth should continue provided investor confidence, instigated by prospective fiscal discipline and debt relief, can be maintained**. Medium-term growth will likely moderate from its current pace, but it is expected to remain above historical norms, as export markets recover, and fiscal tightening promotes private sector crowding-in. With medium-term current account deficits expected to be manageable, and given recent improvements in competitiveness indicators, the dollar peg remains appropriate.

31. **Conditions are favorable for introducing a balanced-budget rule; implementation will be key**. The envisaged measures to underpin the fiscal framework are reassuring. However, proper accountability and insulation of the fiscal supervisory body from political pressure are also necessary.

32. **Additional expenditure savings will be needed to achieve balanced budgets from 2009, including by completing entitlement reforms**. Plans to sustain revenues—by broadening the tax base, rebalancing the tax burden, and improving collections—are appropriate. But expenditure savings will be critical. They will need to go beyond the proposed cost-containment measures to make room for targeted income subsidies to the poor to mitigate the impact of higher oil and food prices and indirect taxes, and, absent reform, rising entitlement costs. Recent, welcome steps to control healthcare costs and reform the pension system should partly alleviate the strains on public finances. Additional savings should come from civil service rationalization, wage restraint, and further pension reforms, namely, raising the retirement age and changing regressive contribution thresholds.

33. **Managing the impact of debt relief on financial sector balance sheets will be crucial**. The BNA's endorsement of a three-part policy response—to seek agreement with the Dutch government on a more graduated schedule of debt relief to avoid excess liquidity, some monetary tightening, and finally, a gradual easing of capital controls on institutional investors—is therefore welcome. The latter will allow institutional investors to earn higher returns on their assets, easing the fiscal burden, with the additional benefit of further improving financial sector competition on the funding side.

34. **The financial sector is broadly healthy, but institutions and supervisors must be vigilant as they face a more difficult environment in the period ahead**. The BNA will need to guard against a deterioration in lending standards as financial institutions undertake

more risky lending to preserve profitability when faced with a gradual reduction in risk-free government securities, and a decline in interest rates due to excess liquidity.

35. Given the limited macro policy tools available, structural reform implementation will be key to preserving investor confidence and external competitiveness. In particular, pro-competitive tax and labor market policies would be vital. In setting tax rates, which—for direct taxes—are high by regional standards, the authorities should not only ensure revenue neutrality, but also business competitiveness. The broad spectrum of reforms envisaged in the draft tripartite protocol would represent a major step forward. Their implementation as a complete package would reap maximum benefits and foster buy-in among the concerned parties.

36. It is expected that the next Article IV consultation with the Netherlands Antilles will be held on a 24-month cycle. However, if within this 24-month period, the constitutional changes are enacted and the federation of the Netherlands Antilles is dissolved, the appropriate modalities of the Fund's engagement will be revisited in consultation with the authorities concerned.

Table 1. Netherlands Antilles: Selected Economic and Financial Indicators, 2003–07

Area	960 (km^2)	Population (2004)	180,870
Percent of population below age 15 (2005)	24.2		
Percent of population aged 65+ (2005)	8.5	Literacy rate, in percent (2003)	96.7
Infant mortality, over 1,000 live births (2004)	10.0	Life expectancy at birth (2005)	75.8

	2003	2004	2005	2006	2007
Real economy (change in percent)					
Real GDP 1/	1.7	1.2	1.3	2.4	3.8
Private consumption	1.9	2.5	2.4	3.3	6.6
Public consumption	5.9	-3.2	1.3	2.8	2.3
Gross fixed investment	-2.9	1.1	4.7	6.8	9.0
Net foreign balance 2/	2.0	-1.5	-2.9	-1.9	-7.8
CPI (12-month average)	1.6	1.6	3.7	2.8	2.8
Unemployment rate (in percent)	15.3	15.1	16.2	13.2	11.1
General government finances (in percent of GDP)					
Revenue	24.8	24.2	27.6	24.1	23.7
Expenditure	29.3	30.3	30.2	27.2	26.3
Current expenditure	28.0	29.1	29.9	26.5	26.0
Capital expenditure	1.6	1.2	0.4	0.6	0.3
Primary balance	0.2	-1.5	2.2	1.5	2.3
Overall balance	-4.5	-6.1	-2.6	-3.1	-2.6
Public debt	79.8	81.2	78.4	79.7	80.6
Money and credit (end of year, change in percent)					
Reserve money	-6.0	19.8	13.0	11.0	18.6
Domestic credit	5.4	11.4	10.6	13.6	11.5
Private sector	1.9	7.9	12.8	17.6	11.7
Government	33.7	32.2	0.1	-8.4	10.3
M2	8.4	10.2	9.4	10.0	12.1
M2 to net foreign assets (ratio)	3.1	3.1	3.0	3.1	2.9
Money multiplier	5.1	4.7	4.6	4.5	4.3
Interest rates (percent)					
Pledging rate	2.3	2.8	4.5	5.5	5.0
Government bond yield	6.7	7.1	6.5	6.8	7.3
Balance of payments (in percent of GDP)					
Trade balance	-34.4	-38.6	-41.0	-44.0	-50.8
Exports of goods	14.2	16.7	18.6	20.2	18.4
Imports of goods	48.6	55.3	59.6	64.2	69.3
Current account	0.1	-2.8	-3.2	-7.6	-16.1
Capital and financial account	-0.2	1.9	2.3	6.5	13.8
Aid (grants)	1.0	2.6	2.9	2.9	3.3
Net FDI	0.4	0.0	-0.7	-2.3	6.4
Reserves (in millions of U.S. dollars) 3/	505.3	567.2	624.5	699.4	905.4
(in months of next year's imports of goods)	3.5	3.5	3.4	3.3	4.0
(in months of next year's imports of GNFS)	2.5	2.5	2.5	2.5	3.1
(In percent of short-term debt)	91.3	96.9	91.8	92.3	117.9
External debt (in percent of GDP)	28.2	29.6	26.3	26.2	24.5
(in percent of exports of GNFS)	40.3	39.7	34.6	33.6	32.5
Memorandum items:					
Nominal GDP (in millions of U.S. dollars)	3,002	3,115	3,270	3,442	3,671
Average nominal wage level (In thousands of NA f.)	42.9	41.8	42.4	43.4	43.2
Per capita GDP (change in percent)	-0.7	0.0	-1.4	0.4	1.3
Nominal effective rate (2000=100)	108	107	107	107	105
Real effective rate (2000=100)	97	93	93	91	88
Fund position	The Netherlands Antilles is part of the Kingdom of the Netherlands and does not have a separate quota.				
Exchange rate	The Netherlands Antilles guilder is pegged to the U.S. dollar at NA f. 1.79 = US$1.				

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

1/ National account deflators are not available. CPI index is used instead.
2/ Contribution to GDP growth.
3/ Net international reserves of the central bank, end of period.

Table 2. Netherlands Antilles: Indicators of External and Financial Vulnerability, 2003–07
(In percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007
External indicators					
Exports (annual percent change, in U.S. dollars) 1/	2.8	9.5	7.0	8.2	3.4
Imports (annual percent change, in U.S. dollars) 1/	0.8	9.7	9.7	10.6	12.7
Current account balance	0.1	-2.8	-3.2	-7.6	-16.1
Net of FDI	0.5	-2.8	-4.0	-9.8	-9.7
Net of development aid	1.1	-0.3	-0.3	-4.6	-12.7
Net of FDI and development aid	1.5	-0.3	-1.0	-6.9	-6.3
Capital and financial account balance	-0.2	1.9	2.3	6.5	13.8
Net foreign direct investment	0.4	0.0	-0.7	-2.3	6.4
Net portfolio investment	0.1	0.0	-0.7	1.6	-2.2
Net official reserves (in months of imports) 1/	2.5	2.5	2.5	2.5	3.1
Net official reserves (in percent of short-term debt)	91.3	96.9	91.8	92.3	117.9
Net foreign assets (banking system)	25.1	26.2	27.8	28.8	32.3
Broad money to net foreign assets (ratio)	3.1	3.1	3.0	3.1	2.9
Total external debt	28.2	29.6	26.3	26.2	24.5
Total external debt to exports (ratio in percent) 1/	22.5	22.2	19.3	18.7	18.1
Exchange rate (per U.S. dollar, period average)	1.79	1.79	1.79	1.79	1.79
Fiscal indicators					
General government balance	-4.5	-6.1	-2.6	-3.1	-2.6
Public sector debt	79.8	81.2	78.4	79.7	80.6
Public external debt	14.9	13.0	11.2	12.0	12.5
Financial sector risk indicators					
Mortgage credit (in percent of total assets)	21.5	18.1	16.9	16.3	14.9
Consumer credit (in percent of total assets)	12.9	13.9	13.9	14.7	13.3
Business credit (in percent of total assets)	16.7	17.5	17.7	19.3	17.6
Contingent and off-balance sheet accounts (foreign exchange)	3.2	3.8	3.8	4.1	3.7
Contingent and off-balance sheet accounts	9.8	9.7	8.9	8.8	8.0
Capital adequacy					
Capital/adjusted-asset ratio 2/	11.8	12.9	13.2	13.9	14.4
Asset quality					
Nonperforming loans (in percent of total loans)	5.9	3.6	2.6	3.6	4.6
Provision for loan losses (in percent of nonperforming loans)	61.1	93.5	106.0	87.3	66.8
Earnings and profitability					
Return on assets (before taxes and dividends)	1.5	1.7	2.3	2.2	1.8
Return on equity (before taxes and dividends)	19.3	21.5	28.1	24.1	19.5
Interest margin to gross income	46.2	49.5	48.9	46.9	47.1
Noninterest expenses to gross income	56.3	56.7	53.0	49.5	51.4
Liquidity					
Loan-to-deposit ratio	66.3	64.9	61.9	64.2	61.4
Liquid assets to short-term liabilities	39.9	39.4	36.3	37.9	37.3
Total assets to total liabilities	124.2	123.8	143.7	144.3	153.4
Sensitivity to market risk					
Interest rate margin	3.1	2.9	4.5	4.4	4.2
Net foreign assets to regulatory capital	4.5	3.9	5.6	5.5	5.1

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

1/ Refers to exports and imports including goods and nonfactor services.
2/ Adjusted-total-assets is defined as total assets minus the asset categories that are subject to a zero risk-weighted factor.

Table 3. Netherlands Antilles: Structure of the Financial Sector, 2003–07
(In percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007
Domestic financial sector: assets	230	241	253	261	…
Banks					
Assets	99	108	119	124	128
Credit to the private sector	50	53	57	62	65
Credit to enterprises	28	30	32	35	36
Credit to households	22	23	25	27	29
Total deposits, excluding interbank deposits	72	78	80	83	87
Nonbanks: assets	130	133	135	138	…
Life insurance companies					
Assets	28	28	31	32	…
Capital and reserves	3	3	3	3	…
Non-life insurance companies					
Assets	8	8	8	8	…
Capital and reserves	2	2	2	3	…
Pension funds					
Assets	94	97	97	98	…
International financial sector: assets	1,371	1,410	1,103	972	…
Banks					
Assets	1,318	1,352	1,045	909	1,008
Demand deposits	175	220	197	267	434
Time deposits	293	344	455	317	325
Borrowed funds	714	640	268	194	139
Equity	115	124	100	98	86
Nonbanks: assets	53	58	58	62	…
Life insurance companies					
Assets	3	3	3	3	…
Capital	1	1	1	1	…
Reserves	2	1	2	2	…
Non-life insurance companies					
Assets	50	55	55	59	…
Capital	18	22	22	26	…
Reserves	30	32	32	32	…
Memorandum items:					
Number of licensed banks	9	9	9	9	9
Of which: majority state-owned	1	0	0	0	0
In percent of total assets	6	0	0	0	0
Majority foreign-owned (number)	3	4	4	5	5
In percent of total assets	27	27	34	49	57
Number of branches of foreign banks	2	2	2	2	2
In percent of total assets	9	7	7	8	8
Number of banks accounting for:					
25 percent of total assets	1	1	1	1	1
75 percent of total assets	3	3	3	3	4

Source: Bank van de Nederlandse Antillen.

Table 4. Netherlands Antilles: Medium-Term Macroeconomic Framework, 2003–11

	2003	2004	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.
Real economy (change in percent)									
Real GDP 1/	1.7	1.2	1.3	2.4	3.8	3.2	2.9	2.7	2.5
Private consumption	1.9	2.5	2.4	3.3	6.6	4.5	3.5	3.3	2.5
Public consumption	5.9	-3.2	1.3	2.8	2.3	2.4	2.1	2.1	1.8
Gross fixed investment	-2.9	1.1	4.7	6.8	9.0	7.9	3.8	2.3	1.6
Net foreign balance 2/	2.0	-1.5	-2.9	-1.9	-7.8	3.4	0.4	1.2	1.3
CPI (12-month average)	1.6	1.6	3.7	2.8	2.8	5.0	2.0	2.3	2.4
Unemployment rate (in percent)	15.3	15.1	16.2	13.2	11.1	10.9	10.7	10.5	10.5
General government finances (in percent of GDP)									
Revenue	24.8	24.2	27.6	24.1	23.7	23.9	23.9	23.9	23.9
Expenditure	29.3	30.3	30.2	27.2	26.3	27.6	24.4	24.3	24.0
Current expenditure	28.0	29.1	29.9	26.5	26.0	25.8	23.4	23.3	23.0
Capital expenditure	1.6	1.2	0.4	0.6	0.3	1.8	1.0	1.0	1.0
Primary balance	0.2	-1.5	2.2	1.5	2.3	1.0	2.4	2.4	2.6
Balance on the current account			-2.3	-2.4	-2.3	-1.9	0.2	0.3	0.6
Overall balance	-4.5	-6.1	-2.6	-3.1	-2.6	-3.7	-0.5	-0.3	-0.1
Public debt 3/	79.8	81.2	78.4	79.7	80.6	76.8	21.4	19.1	16.5
Money and credit (end of year, change in percent)									
Reserve money	-6.0	19.8	13.0	11.0	18.6	17.2	12.4	13.4	13.1
Domestic credit	5.4	11.4	10.6	13.6	11.5	10.4	9.5	7.8	6.9
Private sector	1.9	7.9	12.8	17.6	11.7	11.0	10.7	8.7	7.7
Government	33.7	32.2	0.1	-8.4	10.3	6.3	0.8	0.6	0.2
M2	8.4	10.2	9.4	10.0	12.1	13.4	8.8	9.8	9.4
M2 to net foreign assets (ratio)	3.1	3.1	3.0	3.1	2.9	3.1	3.4	3.6	3.7
Money multiplier	5.1	4.7	4.6	4.5	4.3	4.1	4.0	3.9	3.8
Balance of payments (in percent of GDP)									
Trade balance	-34.4	-38.6	-41.0	-44.0	-50.8	-48.8	-48.1	-46.6	-45.1
Exports of goods	14.2	16.7	18.6	20.2	18.4	18.6	18.7	18.7	18.8
Imports of goods	48.6	55.3	59.6	64.2	69.3	67.4	66.8	65.3	63.9
Current account	0.1	-2.8	-3.2	-7.6	-16.1	-11.4	-9.7	-7.4	-5.3
Capital and financial account	-0.2	1.9	2.3	6.5	13.8	11.4	9.7	7.4	5.3
Aid (grants)	1.0	2.6	2.9	2.9	3.3	2.8	1.8	1.8	1.8
Net FDI	0.4	0.0	-0.7	-2.3	6.4	5.4	3.8	3.5	2.3
Reserves (in millions of U.S. dollars) 4/	505.3	567.2	624.5	699.4	905.4	969.6	967.7	1,012.2	1,064.1
(in months of next year's imports of goods)	3.5	3.5	3.4	3.3	4.0	4.2	4.1	4.1	4.1
(in months of next year's imports of GNFS)	2.5	2.5	2.5	2.5	3.1	3.1	3.0	3.1	3.1
(In percent of short-term debt)	91.3	96.9	91.8	92.3	117.9	117.3	195.4	185.9	181.0
External debt (in percent of GDP) 3/	28.2	29.6	26.3	26.2	24.5	24.4	13.9	14.6	15.0
(in percent of exports of GNFS)	40.3	39.7	34.6	33.6	32.5	31.5	17.9	18.6	19.0
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	3,002	3,115	3,270	3,442	3,671	3,981	4,178	4,390	4,609
Per capita GDP (change in percent)	-0.7	0.0	-1.4	0.4	1.3	0.9	0.5	0.3	0.1

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

1/ National account deflators are not available. CPI index is used instead.

2/ Contribution to GDP growth.

3/ Assumes debt relief in 2009 of about 80 percent of total debt at end-2005 (specific details still under negotiation). It is assumed that the full amount of debt relief will be immediately available to the budget, but that the actual debt relief will be disbursed by the Dutch (if the preconditions relating to the fiscal framework are met) in accordance with the maturity schedule of the government bonds.

4/ Net international reserves of the central bank, end of period.

Table 5. Netherlands Antilles: Balance of Payments, 2003–11

(In percent of GDP, unless otherwise indicated)

	2003	2004	2005	2006	2007	2008 Proj.	2009 Proj.	2010 Proj.	2011 Proj.
Current account	0.1	-2.8	-3.2	-7.6	-16.1	-11.4	-9.7	-7.4	-5.3
Trade balance	-34.4	-38.6	-41.0	-44.0	-50.8	-48.8	-48.1	-46.6	-45.1
Exports	14.2	16.7	18.6	20.2	18.4	18.6	18.7	18.7	18.8
Imports	48.6	55.3	59.6	64.2	69.3	67.4	66.8	65.3	63.9
Services balance	30.8	34.5	34.9	35.8	35.3	36.8	37.2	37.8	38.4
Transportation	2.3	2.5	2.6	2.4	2.5	2.5	2.4	2.4	2.4
Tourism	18.0	21.1	22.2	21.4	21.4	22.8	23.2	23.9	24.4
International financial sector	4.7	5.1	4.5	4.2	3.3	3.6	3.8	3.6	3.7
Refining	6.6	5.6	5.9	6.9	7.2	7.0	6.8	7.0	6.9
Other services	-0.7	0.3	-0.3	1.0	0.8	1.0	0.9	0.9	1.1
Income balance 1/	-0.2	-0.5	-0.5	0.0	0.3	0.2	0.3	0.4	0.2
Current transfers balance	3.9	1.8	3.4	0.7	-0.8	0.5	0.9	1.0	1.1
Incoming transfers	13.1	10.4	12.7	9.6	8.1	8.6	8.9	9.0	9.1
Of which: taxes 2/	2.2	1.8	5.0	2.1	1.0	1.1	1.1	1.1	1.1
Transferred abroad	9.2	8.6	9.3	8.9	8.9	8.2	8.0	8.0	8.0
Capital and financial accounts	-0.2	1.9	2.3	6.5	13.8	11.4	9.7	7.4	5.3
Capital account	0.9	2.5	2.9	2.9	3.3	2.8	1.7	1.7	1.8
Capital transfers balance	0.8	2.5	2.9	2.9	3.3	2.8	1.7	1.7	1.8
Of which: development aid	1.0	2.6	2.9	2.9	3.3	2.8	1.8	1.8	1.8
Financial account	-1.1	-0.6	-0.7	3.6	10.5	8.7	8.0	5.6	3.6
Direct investment balance	0.4	0.0	-0.7	-2.3	6.4	5.4	3.8	3.5	2.3
Portfolio investment balance	0.1	0.0	-0.7	1.6	-2.2	0.1	0.1	0.1	0.1
Other investment balance	0.0	0.6	3.1	5.6	10.5	4.8	4.0	3.1	2.3
Change in reserves (-=increase) 3/	-1.6	-1.2	-2.3	-1.4	-4.2	-1.6	0.0	-1.0	-1.1
Net errors and omissions	0.1	0.9	1.0	1.0	2.2	0.0	0.0	0.0	0.0
Exceptional financing 1/	0.0	0.0	0.0	0.0	0.0	4.9	8.2	8.1	7.7
Net official reserves	16.7	18.2	19.1	20.3	24.7	24.4	23.2	23.1	23.1
In months of next year's merchandise imports	3.5	3.5	3.4	3.3	4.0	4.2	4.1	4.1	4.1
In months of next year's imports of GNFS	2.5	2.5	2.5	2.5	3.1	3.1	3.0	3.1	3.1
In percent of short-term debt 1/	91.3	96.9	91.8	92.3	117.9	117.3	195.4	185.9	181.0
Gross official reserves, excluding gold	12.3	13.3	13.9	21.2	28.1	27.5	26.2	25.9	25.8
In months of next year's merchandise imports	2.6	2.6	2.5	3.4	4.6	4.7	4.6	4.6	4.6
In months of next year's imports of GNFS	1.8	1.9	1.8	2.6	3.5	3.6	3.4	3.5	3.5
In percent of short-term debt 1/	67.4	71.0	67.0	96.4	134.5	132.7	221.0	209.2	202.5
Memorandum items:									
Current account balance net of FDI	0.5	-2.8	-4.0	-9.8	-9.7	-6.0	-5.9	-3.9	-3.0
Current account balance net of development aid	1.1	-0.3	-0.3	-4.6	-12.7	-8.6	-7.9	-5.6	-3.5
Current account balance net of FDI and aid	1.5	-0.3	-1.0	-6.9	-6.3	-3.3	-4.1	-2.1	-1.2
Domestic public and external debt 1/									
External debt	28.2	29.6	26.3	26.2	24.5	24.4	13.9	14.6	15.0
Short-term	18.3	18.8	20.8	22.0	20.9	20.8	11.9	12.4	12.8
Of which: public debt	6.0	5.3	5.2	6.5	7.5	6.9	0.0	0.0	0.0
Long-term	9.9	10.8	5.5	4.2	3.6	3.6	3.4	2.2	2.2
Of which: public debt	8.9	7.7	6.0	5.6	5.0	4.6	0.0	0.0	0.0
Domestic public debt	65.0	68.1	67.2	67.6	68.1	65.2	21.4	19.1	16.5

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

1/ Assumes debt relief in 2009 of about 80 percent of total debt at end-2005 (specific details still under negotiation). It is assumed that the full amount of debt relief will be immediately available to the budget, but that the actual debt relief will be disbursed by the Dutch (if the preconditions relating to the fiscal framework are met) in accordance with the maturity schedule of the government bonds.

2/ Mainly taxes on the international financial and business sector.

3/ Including commercial banks; excluding gold revaluation.

Table 6. Netherlands Antilles: Operations of the General Government, 2003–11
(In percent of GDP)

	2003	2004	2005	2006	2007	2008 Est.	2009 Proj.	2010 Proj.	2011 Proj.
Total revenue 1/	24.8	24.2	27.6	24.1	23.7	23.9	23.9	23.9	23.9
Tax revenue	21.0	21.6	21.4	20.8	21.4	21.7	21.7	21.7	21.7
Taxes on income and profits	10.2	10.4	10.2	9.5	9.4	9.4	9.4	9.4	9.4
Taxes on property	0.6	0.6	0.6	0.8	1.2	1.2	1.2	1.2	1.2
Taxes on goods and services	7.9	8.2	8.2	8.1	8.1	8.3	8.3	8.3	8.3
Of which : sales and turnover tax	4.8	5.1	5.3	5.3	5.4	5.7	5.7	5.7	5.7
Taxes on international transactions	2.2	2.3	2.2	2.3	2.5	2.7	2.7	2.7	2.7
Other taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nontax revenue	2.4	1.9	2.6	1.8	1.9	1.9	1.9	1.9	1.9
Capital revenue	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants 2/	1.2	0.6	3.6	1.5	0.5	0.3	0.3	0.3	0.3
Total expenditure	29.3	30.3	30.2	27.2	26.3	27.6	24.4	24.3	24.0
Current expenditure	28.0	29.1	29.9	26.5	26.0	25.8	23.4	23.3	23.0
Wages and salaries 3/	9.9	10.0	11.6	9.1	8.9	9.2	9.4	9.4	9.4
Goods and services 4/	6.8	7.8	7.4	6.8	6.5	6.7	7.1	7.1	7.1
Subsidies to enterprises	1.5	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Transfers 2/	4.9	6.0	5.3	5.4	5.0	4.6	5.2	5.2	5.0
Interest payments 5/	4.6	4.6	4.9	4.6	4.9	4.7	0.9	0.9	0.9
Capital expenditure	1.6	1.2	0.4	0.6	0.3	1.8	1.0	1.0	1.0
Balance	-4.5	-6.1	-2.6	-3.1	-2.6	-3.7	-0.5	-0.3	-0.1
Memorandum items:									
Primary balance	0.2	-1.5	2.2	1.5	2.3	1.0	2.4	2.4	2.6
Balance on the current account	-3.4	-5.0	-2.3	-2.4	-2.3	-1.9	0.2	0.3	0.6
Current primary balance	1.7	-0.3	2.6	2.2	2.7	2.8	3.4	3.4	3.6
Health care fund 6/	…	…	…	0.1	0.1	-0.1	-0.2	-0.3	-0.4
General old age pension (AOV) deficits 7/	…	…	…	0.2	0.2	0.5	0.3	0.0	-0.2
Total government debt 5/	79.8	81.2	78.4	79.7	80.6	76.8	21.4	19.1	16.5

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

1/ Assumes constant elasticity with respect to GDP over the projection period and no change in tax policy. Future changes in tax policy would be revenue neutral but would change the composition of revenue.

2/ Net of ERNA transfers between different levels of government.

3/ 2008 estimate includes wage increases, payment of backlogs to police, and no build-up of arreas in pension premium payments. 2009–11 projections assume increase in APNA pension premiums and lower civil service wage bill.

4/ 2008 estimate includes expenses related to the constitutional changes. 2009–11 includes transfers for healthcare services.

5/ Assumes debt relief in 2009 of about 80 percent of total debt at end-2005 (specific details still under negotiation). Also assumes that the full amount of debt relief will be immediately available to the budget, but that the actual debt relief will be disbursed by the Dutch (if the preconditions relating to the fiscal framework are met) in accordance with the maturity schedule of the government bonds.

6/ Projected operational deficits at the health care fund related to increasing cost of health care may affect the fiscal balance.

7/ Projected operational deficits at the AOV funds related to aging population may affect the fiscal balance.

Appendix I. Draft Public Information Notice

Public Information Notice (PIN) No. 08/xx
FOR IMMEDIATE RELEASE
[Month, dd, yyyy]

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

IMF Executive Board Concludes 2008 Article IV Consultation with the Kingdom of the Netherlands—Netherlands Antilles

On September 15, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Netherlands Antilles.[1]

Background

A long period of stagnation has ended in the Netherlands Antilles as investor confidence has been boosted by the prospect of large-scale debt relief and fiscal responsibility under the December 2005 agreement to dissolve the federation. Economic growth accelerated sharply in 2007 to 3.8 percent, driven by investments in infrastructure, the housing and tourism sectors, and increased private consumption. Preliminary indications are that the growth momentum is continuing in 2008. Inflation, which broadly tracks U.S. inflation due to the exchange rate anchor, and has been historically low, is set to jump sharply due to the elimination of implicit oil subsidies in place since 2006.

The current account deficit widened markedly in 2007, to 16 percent of GDP, in line with the surge in FDI flows related to large hotel projects. While exports moderated temporarily, tourism was a bright spot due to improvements in competitiveness as a result of infrastructure investments, the euro appreciation, and cost controls from immigration. Imports surged in tandem with high oil prices and domestic demand, as could be expected given high import

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

elasticities, typical for small open economies with limited domestic agricultural and manufacturing production. The large current account deficit was more than financed by Foreign Direct Investment (FDI), increased Dutch aid, and private sector trade credits. As a result, reserve coverage improved, fully covering short-term liabilities.

The government retrenched its finances, mainly through controls on spending. Notwithstanding income tax cuts, revenues have held steady due to improvements in collections. Spending cuts focused on curtailing current primary expenditure through reductions in the civil service and spending on goods and services, and low wage increases. However, total spending has remained high because of interest payments. Public debt remains close to 80 percent of GDP ahead of debt relief. All in all, the current budget balance has been held at 2⅓ percent of GDP during 2005–07, and is expected to decline further in 2008.

The financial sector seems broadly healthy and compares favorably with the region, with financial soundness indicators showing adequate capitalization, profitability and low nonperforming loans. Banking sector assets remain concentrated in the top two banks, reflecting limited competition on the funding side due to capital controls on institutional investors (pension funds and insurance companies), and market segmentation. However, increasing competition from smaller banks has compressed lending spreads modestly. Supervision and Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) efforts have been strengthened.

Looking forward, constitutional changes—now delayed to January 2010—present both opportunities and challenges. Implementation of the dissolution agreement has started, with a balanced budget rule and fiscal supervision already in place in Bonaire, St. Eustasius, and Saba, and about to begin in St. Maarten and Curaçao starting 2009. A big push is underway to implement necessary policy changes and reforms. The broad range of reforms proposed in the draft tripartite protocol agreed between labor, government and business representatives to improve productivity, and the social economic initiative, indicate strong support for seizing this “once-in-a-lifetime opportunity” to undertake necessary reforms.

Executive Board Assessment

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Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Netherlands Antilles: Selected Economic Indicators, 2003–09

	2003	2004	2005	2006	2007	2008	2009
					Prel.	Proj.	
	(Change in percent unless otherwise indicated)						
Domestic economy							
Real GDP	1.7	1.2	1.3	2.4	3.8	3.2	2.9
Unemployment rate (in percent of labor force) 1/	15.3	15.1	16.2	13.2	11.1	10.9	10.7
Consumer Prices (period average)	1.6	1.6	3.7	2.8	2.8	5.0	2.0
Money, credit, and interest rates							
Broad money	8.4	10.2	9.4	10.0	12.1	13.4	8.8
Domestic credit	5.4	11.4	10.6	13.6	11.5	10.4	9.5
Interest rate on 12 month deposit (in percent)	3.5	3.0	2.8	2.8	…	...	...
Government bond yield (in percent)	6.7	7.1	6.5	6.8	…	...	...
Exchange rates							
Exchange rate regime	Fixed exchange rate (1.79 NA f. per U.S. dollar)						
Real effective exchange 2/	-3.1	-4.0	-0.8	-1.3	-3.9	...	...
	(In percent of GDP, unless otherwise indicated)						
Public finance							
General government balance	-4.5	-6.1	-2.6	-3.1	-2.6	-3.7	1.3
Public debt	79.8	81.2	78.4	79.7	80.6	76.8	21.4
Balance of payments							
Current account balance	0.1	-2.8	-3.2	-7.6	-16.1	-11.4	-9.7
Trade balance (goods and nonfactor services)	-34.4	-38.6	-41.0	-44.0	-50.8	-48.8	-48.1
Official reserves (in millions of U.S. dollars) 1/	505.3	567.2	624.5	699.4	905.4	969.6	967.7
Official reserves (in months of merchandise imports) 1/ 3/	2.5	2.5	2.5	2.5	3.1	3.1	3.0

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

1/ Net international reserves of the central bank, end of period.
2/ An increase represents an appreciation.
3/ Refers to next year's imports of goods and nonfactor services.