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April 18, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Kingdom of the Netherlands - Netherlands Antilles - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with the Netherlands Antilles, which is now proposed to be brought to the agenda for discussion on Monday, May 12, 1986.

Mr. Van't dack (ext. 4545) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS - NETHERLANDS ANTILLES

Staff Report for the 1986 Article IV Consultation

Prepared by the Staff Representatives for the 1986 Consultation with the Netherlands Antilles

Approved by L. A. Whittome and J. T. Boorman

April 17, 1986

Article IV consultation discussions were held in Willemstad on January 18-27, 1986 and March 19-25, 1986. The staff team included Messrs. P. Dhonte, U. Dell'Anno, J. Van't dack (all EUR), V. Marie (BUR), and Ms. M. Owen (TRE), as secretary. Meetings were held with the Prime Minister, the Minister of Finance, the Executive Council of the Island Government of Curaçao, and the President of the Bank of the Netherlands Antilles. The mission also met with representatives of the business and banking communities. Mr. Polak, Executive Director, participated in some of the meetings as an observer.

Until the end of 1985, the Netherlands Antilles, which form part of the Kingdom of the Netherlands consisted of six islands, the largest of which were Curaçao and Aruba, off the coast of Venezuela. Effective January 1, 1986, the island of Aruba obtained a separate status within the Kingdom of the Netherlands, and gained complete fiscal and monetary autonomy from the other islands as of that date. On the occasion of this constitutional change, general elections were held in October 1985, leading to the formation of a new government in January 1986. General elections are due on the island of Curaçao in mid-1987.

The currency of the five islands, now constituting the Netherlands Antilles, is the Netherlands Antillean guilder, which since 1971 has been pegged to the U.S. dollar at a rate of NA f. 1.79 per U.S. dollar. Effective January 1, 1986, the island of Aruba established its own monetary authority, the Central Bank of Aruba, and adopted its own currency, the Aruban florin, which is pegged to the U.S. dollar at the same rate as the NA guilder. The Kingdom of the Netherlands accepted the obligations of Article VIII as of February 15, 1961. The last consultation discussions with the Netherlands Antilles were concluded at EBM 85/24 (February 15, 1985). In view of the separate status of Aruba, the emphasis of the present report is on economic conditions in the "Antilles of the Five."

I. Background

The Netherlands Antilles economy is widely open, with exports equivalent to about 75 percent of GNP. Adverse external developments have undermined activity in the main export sectors, and there is a threat of a steep decline in tax revenues in 1987 and beyond. The task of the authorities is to reduce public sector spending while attempting to develop new export activities.

1. The external conditions

At the outset of the 1980s, the Netherlands Antilles were enjoying a period of affluence. The two large refineries, operated by Exxon on Aruba and by Shell on Curaçao, were profitable and activity levels in the islands' oil storage and transshipment facilities were high. Furthermore, the advent of two-digit interest rates in international financial markets, in conjunction with the preferential tax treatment of interest payments from the U.S. to the Antilles, caused a major expansion of the offshore financial activities in Curaçao. Tourism, meanwhile, was buoyed by the proximity of oil-rich Venezuela. Gross domestic product reached US$6,300 per capita in 1982, a third below the US$9,600 of the Netherlands but one half above Venezuela or Barbados. The presence of high wage industries pulled up the entire wage structure, while large tax revenues from the offshore financial sector and the refineries allowed annual increases in public spending at real rates of 5 percent or more.

Economic conditions deteriorated abruptly. The first blow was dealt when the bolivar devaluation in 1983 all but ended shopping tourism from Venezuela. Next, new legislation repealing the U.S. withholding tax on interest payments to non-U.S. residents was passed in July 1984. This made irrelevant the exemption granted to Antillean residents, and reduced the attractiveness of the Antilles as a channel for borrowing on the Eurodollar market. Finally, oil market conditions, compounded by uncompetitiveness of domestic refining operations, led to the closure of the oil refinery on Aruba in March 1985 and to the takeover by the Venezuelan group PDVSA of the Shell oil refinery on Curaçao in September 1985, but at a much reduced wage bill. Developments in the refinery sector in turn had a depressing impact on oil storage and transshipment and on harbor-related services, including the Curaçao Drydock Company.

The financial impact of these adverse shocks was cushioned by two windfalls. In the first place, the repeal of the U.S. witholding tax was not made retroactive, and loans that had been previously issued remained taxable. The offshore companies that had been created in the Antilles to take advantage of the tax exemption given to Antillean residents, therefore, continued to operate and to pay the local profits tax; indeed, due to the reduction of a backlog of assessments, the revenues from this source rose to record levels in 1985 when they accounted for one third of government revenues, and were not expected to fall sharply until 1987. The second windfall was the receipt of large amounts for severance pay and other liquidation costs from the two oil companies when they ceased operations.

The large weight of the U.S. dollar, to which the Netherlands Antillean guilder is pegged, in the Antilles' external transactions dampens movements in the effective exchange rate of the guilder. Nevertheless, the nominal effective exchange rate rose by 25.5 percent between 1980 and its peak in February 1985 and declined by 5 percent in the following 12 months. Reflecting the Antilles' good inflation performance, the real effective appreciation (CPI basis) was less; between 1980 and February 1985, the real effective exchange rate rose by 18 percent and it declined by 7.8 percent in the next 12 months.

2. Developments in the domestic economy

A consequence of the external shocks has been a deterioration in employment prospects. In the absence of current GDP data, and of reliable unemployment figures, the situation of the labor markets cannot be analyzed precisely. It is nevertheless clear that the Antilles enjoy a highly qualified labor force, that the main employers have been shedding labor over the past three years, and that youth unemployment is large. It is also clear that because of the presence of high wage industries acting as wage setters and because of generous wage policies in the public sector, labor costs in the Netherlands Antilles are relatively high, a situation which until early-1985 was compounded by the effective appreciation of the guilder.

As the situation of export oriented activities deteriorated, steps were taken on a case-by-case basis, especially in 1985, to contain labor costs. In many instances arrangements involved employment cuts as well as reductions of the cost of labor. Significant wage cuts were recorded in a few enterprises, such as the refinery on Curaçao, but in most instances cuts in compensation were confined to nonwage labor costs. On the background of a very low rate of inflation, down to 0.3 percent in 1985, and of the decline in the effective exchange rate since March 1985 these measures partly reversed the previous deterioration in labor cost competitiveness. Nevertheless, many of the large enterprises, especially those in the public sector, remained loss-makers.

The government structure in the Netherlands Antilles consists of a Central Government and of Island Governments. The Central Government and the Island Governments of Curaçao and Aruba are linked by revenue-sharing arrangements (which have ceased to apply in respect of Aruba). The largest budget by far is that of the island of Curaçao. Because of rising tax payments by the offshore financial sector, annual revenue growth of the consolidated public sector 1/ averaged nearly 10 percent between 1980 and 1985, but expenditure growth was also very strong.

1/ The Central Government and the Island Government of Curaçao.

About one half of the growth in expenditures in this period was explained by the increase in the public sector wage bill. Much of the other half was accounted for by increased transfers to government-controlled enterprises. Under those circumstances, the deficit ranged between NA f. 60 million and NA f. 90 million a year throughout the period.

Developments in the money supply were influenced by the inflow of severance payments from the Lago refinery on Aruba in March and from the Shell refinery on Curaçao in November and December. These payments imparted an irregular growth to the money supply in the course of the year; year on year, a decline of 5 percent was recorded in September, and an increase, also of 5 percent, in December. The currency composition of the money supply was little changed, with the U.S. dollar accounting for around 10 percent of banking deposits, perhaps in part because controls on the banks' external positions prevented a stronger growth of dollar deposits. Among the counterparts, increases in credit to the Government were only partly offset by declines in credit to the private sector, so that net foreign assets fell by around NA f. 100 million in the year to September 1985. However, the large transfers received from the refinery at year-end, together with the bunching of aid transfers from the Netherlands, allowed net foreign assets to recover strongly in the last quarter and to rise by NA f. 122 million for the year.

As the adjustment in public finances and wage costs was delayed, the current account of the balance of payments recorded large deficits, of the order of NA f. 70 to 80 million in 1983 and 1984, despite the sharp rise in offshore tax receipts. The deficit shrunk markedly in 1985, because of the receipt of severance payments by the two refineries; abstracting from these transfers, the underlying deficit was of the order of NA f. 100 million.

3. Economic outlook

The medium-term outlook for the Antilles is dominated by two largely irreversible developments which will have a negative impact on foreign exchange inflows (Table 1). First, the contribution of oil refining is expected to remain well below the figures recorded in the early 1980s. Second, the staff projects that tax revenues paid in foreign exchange by the offshore financial sector will drop from NA f. 321 million in 1984 (chosen as a base year because of the availability of data) to NA f. 150 million in 1989. 1/ High costs and a lack of definite plans on the other hand restrict the scope for expanding other activities or attracting new ones. Altogether, gross

1/ The projections use 1989 as a reference because it is assumed that in that year the transition to a lower permanent level of offshore tax receipts will be completed. As indicated below the authorities have set themselves the target of balancing the government accounts by 1988.

exchange receipts might fall by some 10 percent between 1984 and 1989. Taking into account the import requirements of the export sectors, and allowing for the elimination of the current account deficit of 1984, general imports must fall by 20 percent over that period.

Table 1. Netherlands Antilles: External Current Account Revenues

(In millions of NA guilders)

	1984 1/	1989	Difference
Merchandise	111	125	+ 14
Tourism	363	458	+ 95
Oil sector	410	255	-155
Offshore sector	533	370	-163
Drydock	36	60	+ 24
Other transportation	170	200	+ 30
Other	194	156	- 38
Total	1,817	1,624	-193
Of which:			
Taxes 2/	400	200	-200
Other	1,417	1,424	7

Source: IMF staff estimates and projections.
1/ Excluding Aruba.
2/ Taxes paid by the offshore financial sector, the refinery, and the wage tax paid by refinery employees.

While the fall in foreign exchange earnings will to some extent reduce income, and thus absorption, in the private sector, it will particularly affect revenues of the public sector (Chart 1). Unless the fall in revenues is suitably matched by a reduction in outlays, the public sector deficit will be unsustainable and will result in an unsustainable external imbalance. The adjustment required to balance the fiscal and external accounts in 1989 includes the need to eliminate the deficit recorded in 1984, the expected fall in offshore and oil revenues, and the feedbacks of expenditure cuts on the tax receipts. On this basis, the staff estimates that a package of expenditure cuts and revenue increases of NA f. 360 million, representing 40 percent of expenditure or 20 percent of estimated GNP in 1984, is needed over the period 1984-89.

Table 2. Netherlands Antilles:
Selected Budgetary Data

(In millions of NA guilders)

	1984 1/	1989 2/	Difference
Revenues	820	550	-270
Of which: Offshore and oil sector	(400)	(200)	(-200)
Expenditures	910	550	-360
Deficit	90	--	-90

Sources: IMF staff estimates and projections.
1/ Excluding Aruba and the operations of the Central Government with Aruba.
2/ Illustrative case of a full adjustment by expenditure cuts.

The recent decline in oil prices, however, provides significant relief in this respect, because the Antilles are a heavy user of oil products with an import bill equivalent to some 9 percent of GNP in 1984. Assuming a price of US$20 per barrel of crude oil, and assuming that the savings in fuel costs will directly or indirectly be channeled to the benefit of the government sector, the staff estimates that the relief resulting from lower oil prices may contribute some NA f. 70 million toward the required adjustment. (A difference of US$1 per barrel can be estimated to contribute about NA f. 10 million.)

In the absence of major adjustment measures, serious pressures on the fiscal and the external position would develop in late 1986 or early 1987; until then, the combination of large liquidation payments by the Shell refinery, lower oil prices, and a continued high level of tax payments by the offshore financial sector may conceal the underlying imbalances.

II. The Policy Discussions

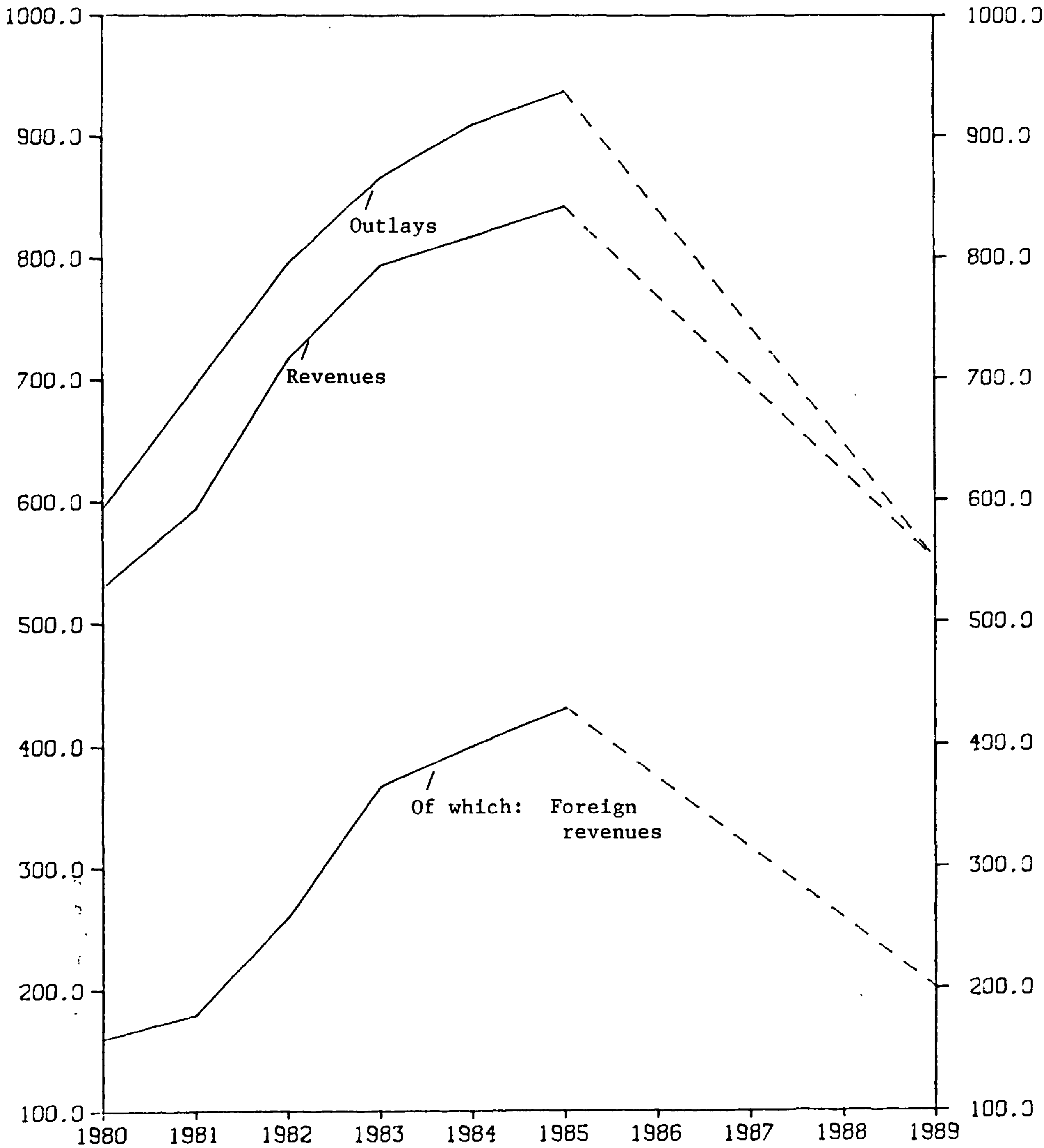
In concluding the 1984 Article IV consultation with the Netherlands Antilles, Executive Directors stressed the need for strong fiscal action and wage adjustments to ensure a decline in domestic absorption and to promote investment and export opportunities. Against the background of poor employment prospects and declining revenues in the public sector these recommendations provided the focus for policy discussions in which the staff emphasized the need for reductions in wage costs to improve both competitiveness and the fiscal position.

Chart 1

NETHERLANDS ANTILLES 1/

Public Finances

(In millions of NA f.)



Sources: Table 2; and staff estimates.

1/ Excludes Aruba and the transactions of the Central Government with Aruba.

1. Wage and development policies

Unemployment trends on the island of Curaçao were viewed with concern by the authorities. While registrations, which served various administrative purposes, notably the eligibility for welfare benefits, were not considered a reliable indicator, it was clear that employment prospects in most sectors of the economy were declining. A number of public enterprises were overstaffed, and government employment itself was considered excessive. Equally worrisome was the limited number of new employment opportunities in the private sector.

Several studies of employment prospects which had been made in the past year suggested that initiatives in the services sector offered the most promising prospects. Such initiatives could build around the existence of a large offshore financial services sector and around tourism. In order to support these developments, an international trade center was under construction. Extensive studies of the development of the tourism sector had also been conducted, and would be further pursued. The assistance of the World Bank had been requested to review the necessary structural adjustments in this and other economic sectors.

All these studies identified the high level of wage costs as an obstacle to the creation of new service activities on the island. This had led an advisory group within the Administration to propose a general 15 percent wage cut. That proposal had been considered unacceptable, and indeed, when the purchase of the Curaçao refinery by a Venezuelan group had removed one of the most immediate threats on the economic future of the islands, the sense of urgency had diminished.

The authorities emphasized that progress in reducing wage costs was nevertheless beginning to show. The minimum wage had only risen by less than 2 percent since 1982. The vacation allowance, equivalent to 6 percent of annual salary, had been discontinued in the public sector, and had last been paid in installments in 1985 on account of the year 1984. In several of the large public enterprises, significant reductions in labor costs had been achieved by reducing pension contributions or overtime pay; in the refinery, a combination of wage cuts, reductions in employment, and higher activity had cut unit labor costs by half. Finally, greater flexibility was being introduced in labor practices, and labor contracts that had been renegotiated in the hotel sector notably provided for a more flexible distribution of working hours.

A factor contributing to the moderation of nominal wages had been the success of the islands in achieving a very low rate of inflation. Consumer price increases averaged 2 percent a year in 1983 and 1984, and dropped to 0.3 percent in 1985, so that the Netherlands Antilles ranked among the best performers in this respect worldwide. The authorities explained that this favorable outturn reflected the ability of the trade sector in the Antilles to switch sources of supply between Europe and the Western Hemisphere depending on changing exchange rate relationships, and was also attributable to the depressing effect on demand in the local market of the drop in tourism purchases since 1983. They further commented that generally established wage indexation practices on the islands provided for adjustments of wages each time the CPI had risen by more than 4 percent from its previous threshold. Given the low rate of consumer price inflation, this provision had in fact not applied since 1983.

A further factor contributing to disinflation in the Antilles in recent months was the drop in oil prices. This drop was particularly important to the Antilles, the authorities noted, given the large size of its oil import bill. Besides its direct or indirect effects on domestic costs, the decline in oil prices favored the Antilles because it facilitated the development of cruise tourism in respect of which Curaçao suffered the handicap of a greater distance from the main tourist markets.

The authorities altogether emphasized that the competitiveness of the Antilles was presently improving as a result of the drop in the effective exchange rate of the dollar, to which the Antillean guilder was pegged, of the moderation or decline in nominal wage costs, and of the decline in oil prices.

In order to develop local small scale manufacturing activities, the authorities had proposed special protection to an edible oil processing plant. The staff warned strongly of the dangers associated with this approach which had until then been limited to a small list of products, generally recognized on the islands to be of inferior quality and higher price. The staff emphasized that the openness of the islands could not accommodate itself of such expedients.

2. Fiscal policy

Although the prospect of a sharp decline in revenues of the public sector had been recognized for some time, it had not yet been possible at the time of the discussions to sustain strong action to cut expenditure or to raise revenue. As with the need to reduce labor costs, a sense of urgency had developed in the summer of 1985, when it appeared likely that the Shell refinery would be closed, while, at the same time, the Island Government of Curaçao faced an acute liquidity crisis. In these circumstances, it had been possible to push through a "crisis levy" consisting of a 10 percent withholding tax on wage earnings, which was effectively implemented from September 1, 1985, and was estimated to yield NA f. 80 million at an annual rate. However, in keeping with electoral commitments, the new Government formed in January 1986 in the wake of general elections cancelled this levy effective February 1, 1986. Since then, only a limited number of measures had been taken.

The authorities indicated that they had set for themselves in the short run the target of balancing the 1986 budget of the Central Government, whose initial deficit was estimated at NA f. 52 million. The budget that had been prepared for the Island Government of Curaçao by the outgoing administration was considered unrealistic, and a reliable estimate of the initial deficit was not available; it was thought that the financing gap was in the order of NA f. 50 to 80 million, and the authorities intended to reduce it sharply.

In pursuit of balanced budgets for the two Governments, the authorities had announced a number of decisions in principle in the first two months of 1986. Wage costs in the civil service would be trimmed by promoting early retirement, instituting a hiring freeze, and reducing compensation for health costs. In addition, a sharp reduction in nonwage current expenditure had been decided. Finally, an increase in the excise tax on gasoline had been put in effect, which more than offset the impact of declining wholesale prices. In discussing these measures, the staff noted that many of them remained unspecified or would only produce significant economies in 1987 and beyond. Only the increase in the excise tax on gasoline, representing NA f. 21 million a year, was seen to be effective immediately. The staff emphasized that given the weight of wages in government spending, directly or in the form of subsidies to public enterprises, and the need to improve competitiveness, a 10 percent reduction in wage costs per employee within a year appeared to be necessary.

The authorities were also determined to make a major effort to collect outstanding claims which they held on account of unpaid utility bills or other advances to households. Poor collection of utility bills was a major drain on the budget of the Island Government of Curaçao, contributing to a need for NA f. 30 million to NA f. 40 million annually in subsidies. The authorities feared however that this effort would run into severe difficulties at a time of declining incomes, and noted that when the crisis levy had been enforced, a rash of demands for financial assistance had emanated from Government employees. They feared that in many cases the water bills would not be collectible without undue hardship. They sought therefore to establish a more explicit identification of those cases where the bill could remain uncollected on humanitarian grounds, and of those where it should be collected.

The mission warned that the deficiencies in budget control constituted a major problem. The practice of the authorities, especially at the level of the Island Government, was to monitor the liquidity position of the Government, and to screen expenditure authorizations on the basis of a short-term liquidity forecast. While this approach had been successful in the past, in times of buoyant revenues, the staff warned that it left many possibilities open to build up arrears and unauthorized expenditure commitments. The staff warned in this connection of the particular risk that external debt might be contracted by a number of the public corporations. Such debts had so far been incurred by the airline, the water company, and the hotel holding corporation. The authorities noted however that these debts were small in total, and that the statutes of the Kingdom of the Netherlands provided that a government guarantee to such liabilities could only be given with the approval of the Kingdom authorities. In fact, the bulk of the limited external debt of the Antilles resulted from soft loans received from the Netherlands as development assistance.

For the longer term, the authorities had also set themselves the objective of balancing the government accounts by 1988. This objective implied that the public sector would have to adjust to the decline in taxes received from the offshore sector, a decline which would be particularly sharp in 1987. They agreed with the mission's estimate that the expenditure cuts or revenue increases required to balance the government accounts would be of the order of NA f. 360 million by 1989.

In addressing this issue, the authorities emphasized actions that would increase the long-term efficiency of the public sector. They thought that, especially since the separation of Aruba from the rest of the islands, the government structure in the Antilles had become unnecessarily heavy, and that there was scope for the streamlining of functions between the Central Government and the Island Governments. Within each Government moreover, they felt that more staff was present than was needed. They thought it essential therefore to first establish the credibility of their policies by improving the efficiency of Government before taking more general steps to increase revenue or cut expenditure. The staff accepted the merits of this approach, but stressed the need to cut not only the total wage bill of Government, but also wage costs in the economy, and that it belonged to the public sector to set a standard in that respect.

3. Monetary and exchange rate policies

The authorities explained that a main focus of their monetary policies had been to sustain the public's confidence in the guilder and to protect the external reserves of the Central Bank. Initial projections in early-1985 had suggested a sharp drop in reserves. In the event, this drop had been reversed after September, and reserves had risen to record levels by early-1986 on account of large payments made by Shell following the liquidation of its interests in Curaçao. Nevertheless, the authorities were anxious that this one-time payment should not disguise the need for domestic financial adjustments.

The authorities expressed their commitment to the existing exchange rate of the Netherlands Antillean guilder vis-à-vis the U.S. dollar. They said that the stability of this exchange rate was an important factor underlying the confidence of residents in the guilder. The stability of the exchange rate had also been helpful in securing the excellent inflation performance of recent years. The staff recalled that, in concluding the 1984 consultation, Executive Directors had noted that the recent difficulties in reducing nominal wages should lead the authorities to reassess the policy of maintaining a fixed rate for the U.S. dollar against the alternative of greater exchange rate flexibility. However, the authorities pointed to the progress that had been made in obtaining nominal wage concessions, and added that this gain in competitiveness was reflected in the 7.8 percent decline in the real effective exchange rate since February 1985. They took the progress so far to be a definite indication that an improvement in competitiveness could be achieved in a noninflationary manner.

The authorities explained that the liquidity of the banks had been large because of a weak demand for credit in the private sector, and of reluctance of the banking system to increase its lending to the Central Government. Credit to the private sector had been flat through August and had then declined by some NA f. 60 million, mainly as the Shell refinery repaid loans received from the local banks. As the banks were reluctant to raise their exposure, the Government had experienced difficulties in rolling over its Treasury bills, causing the advances of the Central Bank to the Central Government to rise by NA f. 70 million in 1985. The authorities explained that in order to reduce the outstanding advances to the Central Government it had been agreed that 55 percent of the proceeds of the special "crisis levy" introduced in October would be applied toward a reduction of the Government's liabilities to the BNA.

To mop up the liquidity of the banks, the Central Bank had made a new deposit facility available to the banks. This facility, which was intended for term deposits, offered relatively high remuneration rates on a graduated scale depending on the size of the deposits. In this manner, the Central Bank hoped to influence the commercial banks and to give them an opportunity to increase their own creditor interest rates. This was seen to be necessary to enhance the attractiveness of the Netherlands Antillean guilder with respect to the U.S. dollar. The approach had been successful in improving the remuneration on the larger fixed term deposits, which were presumably more volatile and more liable to be invested abroad. The remuneration of passbook savings deposits for its part remained unchanged.

The monetary authorities explained that they had taken several initiatives in response to the large inflow of U.S. dollars at the end of 1985 because of the termination of Shell's operations in Curaçao. A special deposit facility in the Central Bank had been opened for the benefit of the commercial banks which had received a repayment of their dollar claims on the refinery. Furthermore, the Central Bank had authorized all employees who received severence payments to invest their money abroad making use of ad hoc institutional investors funds.

New statutes for the Central Bank had been approved in 1985. The authorities explained that the new statutes gave the BNA greater monetary autonomy; they limited the amount of the overdraft facility available to the Central Government to 10 percent of total revenue in the previous year. The overdraft facility was to be made available on a temporary basis to allow the Government to deal with seasonal difficulties. Greater access to Central Bank advances would only be available to the Central Government if it was approved by Parliament.

III. Staff Appraisal

The Antillean economy has suffered severe setbacks since 1983, due to external circumstances largely beyond its control, but also due to a lack of restraint on wages and government spending. Far from being temporary, these setbacks have significantly eroded the foreign exchange earning capacity of the islands. It is therefore necessary for the short run to adjust expenditure down to the new level of output, and, for the longer run, to increase the productive capacity of the islands.

The developments that have occurred since the past consultation have improved the short-term prospects, but the need to improve competitiveness and to cut expenditure by reducing labor costs and other measures remains great. The favorable developments include the successful restructuring of the oil refinery in Curaçao, the fall in oil prices, the drop in the effective exchange rate in line with movements in the U.S. dollar, and some reductions in nominal wage costs. As a result of these developments, reserves are at a high level and the current account is expected to be close to balance in 1986. However, the prospects for 1987 and beyond are still that foreign exchange and tax revenues will fall sharply, and that unemployment will rise; the favorable recent developments should not allow the necessary adjustments to be put off into the future.

The key role in the adjustment of domestic expenditures to the permanent drop in foreign exchange inflows must be played by fiscal policy especially because the fall in inflows mainly affects the public revenues. The underlying trends for public revenue have been long neglected and the temporary buoyancy of revenue has mistakenly provided a rationale for a larger public sector. Measures to reduce spending must be taken at an early stage so as to take advantage of the temporary reprieve afforded by the windfall revenues expected in 1986, and to strengthen the confidence in the Antillean economy, a necessary condition for attracting potential new activities.

Improvements in competitiveness must pave the way for a recovery in economic activity. The level of wage costs remains too high to allow the profitability of a number of existing industries and to attract new ones. The effort to balance the accounts of the public sector must therefore bear primarily on labor costs. Wage restraint serves the dual purpose of balancing the accounts of the public sector, and, because of its wage leadership, of improving the competitiveness of the economy. The size of the subsidies to public enterprises indicates that the consolidation effort cannot be limited to the government sector. The economic importance of these enterprises underscores the urgency of early and extensive action to redress their financial position. The effort should be concentrated on a reduction of labor costs, and the elimination of waste and inefficiencies, and in improvements in the collection of user fees.

The adjustment measures that have been implemented or decided so far fall short of meeting the twin requirement of balancing the government accounts in the medium term and of improving competitiveness in line with labor market conditions. The staff therefore hopes that the measures presently under consideration will be fully implemented, and urges the authorities to initiate a sizable reduction of wage costs per employee in the public sector within the coming year.

A particular difficulty of the situation, which needs correcting, is the unreliability of data on public finances. One implication of this situation is that unrecorded commitments and even arrears can be accumulated and develop some day into a substantial problem. The threat is increased because a good deal of the authority to spend is in fact decentralized to the public enterprises. The accumulation of debts and arrears by the public sector and the credit guarantees which it grants also need careful monitoring.

Monetary policy is rightly geared to the defense of the exchange rate of the guilder. Confidence in the currency is backed by a long tradition of stability of the peg to the U.S. dollar and by a remarkable degree of price stability; it needs to be supported by avoiding an excessive expansion of credit. The staff therefore welcomes the adoption of new statutes for the Central Bank and notably the fact that they specify more clearly the limits on central bank credit to the public sector. These limits are an important safeguard, and liquidity constraints, when they materialize, must be recognized as a signal of deeper financial imbalances.

Although the economy is widely open, several references in policy papers indicate a revival of protectionist sentiments. The staff wishes to warn strongly of the damage that can be caused by such an approach, which would be plainly counterproductive in an economy which is totally based on foreign trade. Imposition of foreign exchange restrictions as a means to support demand for guilders could only damage confidence and should similarly be avoided.

It is recommended that the next Article IV consultation with the Netherlands Antilles be held within 18 months.

Fund Relations with the Kingdom of the Netherlands - Netherlands Antilles

The Netherlands Antilles is part of the Kingdom of the Netherlands, which consists of the Netherlands Antilles and the Netherlands itself. The Kingdom of the Netherlands is an original member of the Fund. On February 15, 1961, the Kingdom formally accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund Agreement for all territories. The initial par value of the Netherlands Antillean guilder--NA f. 1.88585 = US$1--was established with the Fund on December 18, 1946. The authorities communicated to the Fund a rate of NA f. 1.79 per US$1 to take effect as a central rate on December 23, 1971. Since then, the Netherlands Antillean guilder has been pegged to the U.S. dollar at this rate.

The Executive Board conducted the last Article IV consultation on the basis of staff reports SM/85/21 (1/22/85 and 2/13/85) and SM/85/24 (1/25/85).

Basic Data

Population (1981)	257,589
Of which:	
Curaçao	164,579
Aruba	65,533
Bonaire	9,222
Windward islands	18,255
Population density	234 inhabitants per square kilometer
Annual average population growth (1974-81)	1.1 percent

	1980	1981	1982	1983	1984	1985 1/
	(Annual percentage change)					
Consumer price index (Leeward Islands)						
Period average	14.9	12.2	6.2	2.7	2.2	0.3
Selected indices of economic activity, excluding Aruba						
Oil refining	-8.5	-15.0	10.0	1.5	-13.8	-25.0
Shipping activity 2/	-8.3	-5.7	-5.5	-16.4	2.6	1.0
Construction 3/	3.3	32.0	1.2	15.1	-11.3	-25.7
Stay-over tourism (visitors)	-0.7	-4.7	5.6	-4.9	19.9	5.3
Cruise tourism (passengers)	-6.3	-10.8	-13.1	-16.1	7.0	37.9
Real offshore revenues 4/	38.0	14.1	17.7	30.5	0.6	7.5
	(In millions of NA guilders)					
Balance of payments (cash basis)						
Trade balance	-1,364	-1,299	-1,450	-1,407	-1,296	-1,362
Services	1,445	1,569	1,674	1,444	1,383	1,485
Private transfers and investment income	-186	-176	-118	-119	-158	-131
Current account	-105	95	106	-82	-71	-8
Official capital	151	111	62	112	93	103
Private capital	-18	-130	-95	-123	-125	2
Errors and omissions	24	20	18	45	33	25
Change in net foreign assets, increase (-)	-52	-96	-91	47	70	-122
Memorandum items:						
Net foreign assets	246	342	433	386	316	438
(in months of merchandise imports)	(1.8)	(2.6)	(3.1)	(3.1)	(2.7)	(3.5)

Basic Data (Continued)

	1980	1981	1982	1983	1984	1985 1/
Public finance						
Central Government						
Expenditure	248.1	285.3	372.1	414.8	400.9	391.5
Revenue 5/	194.6	209.3	300.1	333.2	363.4	352.5
Fiscal balance	-53.5	-76.0	-72.0	-81.6	-37.5	-39.0
Curaçao Island Government						
Expenditure	385.2	438.2	497.8	541.0	594.4	612.1
Revenue 5/	396.8	445.0	506.3	568.0	578.0	583.6
Fiscal balance	11.6	6.8	8.5	27.0	-16.4	-28.5
Consolidated public sector 6/						
Expenditure	633.3	723.5	869.9	955.8	995.3	1,003.6
Revenue	591.4	654.3	806.4	901.2	941.4	936.1
Fiscal balance	-41.9	-69.2	-63.5	-54.6	-53.9	-67.5
Monetary data						
Change in money and quasi-money (M_2)	87.3	120.9	146.5	61.4	25.9	68.6
(Percent growth)	(10.2)	(12.8)	(13.7)	(5.1)	(2.0)	(5.3)
Counterparts to M_2 growth						
Net foreign assets	52.2	96.4	90.7	-47.2	-70.0	122.3
Domestic credit	48.9	71.6	83.8	107.9	105.5	-44.4
(Percent change)	(6.1)	(8.4)	(9.1)	(10.7)	(9.5)	(-3.6)
Claims on government, net	-26.7	-72.5	-11.1	-26.7	95.5	25.7
Central government	-3.4	-5.0	50.8	-11.5	4.9	-10.8
Island governments	-23.3	-67.5	-61.9	-15.2	90.6	36.5
Claims on the private sector	75.6	144.1	94.9	134.7	10.0	-70.1
(Percent change)	(11.8)	(20.0)	(11.0)	(14.1)	(0.9)	(-6.4)
Miscellaneous other	-13.9	-47.2	-27.9	0.6	-9.6	7.4
Exchange Rates						
Central rate: NA f. 1.79 = US$1						
NA guilder per SDR (period average)	2.330	2.111	1.976	1.914	1.835	1.817
Real effective rate (annual percentage change; period average) 7/	0.9	6.1	1.5	3.1	4.6	-1.8

Sources: Official publications; data provided by the authorities; and staff estimates.

1/ Partly estimated.
2/ Annual tonnage of nonoil shipping traffic in the port of Curaçao.
3/ Value of completed buildings on Curaçao, deflated by the CPI.
4/ Offshore foreign exchange inflows, deflated by the CPI.
5/ Revenue sharing transfers are deducted from the Curaçao Island Government revenues and added to the Central Government revenues.
6/ Includes the Central Government and the Island Government of Curaçao.
7/ Corrected for changes in consumer prices.

Netherlands Antilles - Statistical Issues

1. Outstanding Statistical Issues

a. Financial statistics

The authorities informed the mission of their interest in deriving an historical data base for the Netherlands Antilles excluding Aruba, which obtained a separate status in the Kingdom of the Netherlands at the beginning of 1986. They also agreed to provide the Bureau of Statistics with data on Offshore Banking Unit (OBU) positions with the monetary authorities and with the deposit money banks. At a later stage, it is hoped to increase the coverage of financial data published in IFS to encompass the nonmonetary financial institutions, including the OBUs.

b. Government finance

As a result of a technical assistance mission in government finance statistics held in May 1985, data for 1982 for the central government and for the consolidated general government were published in the 1985 GFS Yearbook.

c. National accounts

At present, no national accounts data are published for the Netherlands Antilles in IFS. The authorities informed the mission that work on the derivation of national accounts had been renewed and that the results would be available for publication in IFS when the estimates are finalized.

d. Balance of payments

Balance of payments data are derived from the Quarterly Bulletin, published by the Central Bank. The latest period for which data are published is 1983.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for the Netherlands Antilles in the April 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank van de Nederlandse Antillen which, during the past year, have been provided on an irregular basis.

Status of IFS Data

		Latest Data in April 1986 IFS
Real Sector	- National Accounts	n.a.
	- Prices: CPI	Q4 1984
	- Production	Q4 1984
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1982 1/
	- Financing	1982
	- Debt	1982
Monetary Accounts	- Central Bank	October 1985
	- Deposit Money Banks	October 1985
	- Other Financial Institutions	n.a.
External Sector	- Merchandise Trade: Values	1983
	Prices	n.a.
	- Balance of Payments	1983
	- International Reserves	January 1986
	- Exchange Rates	February 1986

1/ Data are not available for 1980 and 1981.