FOR AGENDA

SM/86/257

CONTAINS CONFIDENTIAL
INFORMATION

October 20, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Kingdom of the Netherlands - Aruba -
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 Aruba, which has been tentatively scheduled for discussion on Friday, November 21, 1986.

Mrs. Liuksila (ext. 4547) 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 - ARUBA

Staff Report for the 1986 Article IV Consultation

Prepared by Staff Representatives for the 1986 Consultation with Aruba

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

October 17, 1986

I. Introduction

A staff team consisting of Messrs. P. Dhonte and K. W. Riechel and Mrs. C. Liuksila, with Miss P. Emerson as secretary (all EUR), visited Aruba from September 10-19, 1986 to conduct the 1986 Article IV consultation. Aruba was part of the Netherlands Antilles until January 1, 1986 when it achieved complete monetary and fiscal autonomy from the remaining five islands that now comprise the Antilles. The current consultations are the first to be held with Aruba. During the mission the staff met with the Prime Minister, Mr. Eman, other members of the Government, the Governor of the Central Bank, Mr. Williams, and representatives of the Administration and the Central Bank. Mr. J. de Beaufort Wijnholds, Alternate Executive Director for the Netherlands, also attended the meetings as an observer.

II. Background to the Discussions

The closure of an oil refinery in early 1985 and the move to autonomous status within the Kingdom of the Netherlands have presented a major challenge to the Aruban economy. The consultation discussions centered on the assessment of the progress made in meeting this double challenge and on an appraisal of the adjustment effort still required to put the economy back on a sound footing by 1988.

1. The adjustment to the closure of the refinery

The Lago refinery had been the mainstay of the Aruban economy for over 60 years. At its peak the refinery employed 8,300 people and earnings from refining and related activities allowed Arubans to enjoy one of the highest standards of living in the Caribbean. After some difficult years in the late 1970s, the refinery made large profits in 1981-83, and the related tax payments supported a strong expansion of public expenditure in Aruba. However, in 1984 changing oil market conditions caused the refinery to run heavy losses and it was closed in March 1985.

The closure of the refinery has been a disruptive shock to the Aruban economy. During 1982-84, on average, Lago contributed one quarter of Aruba's GDP, over half of the island's net foreign exchange earnings, over one third of its fiscal revenues, and employed directly 1,600 people out of a work force of roughly 21,000 (Table 1). After the refinery's closure, and given only limited scope for import substitution, Aruba urgently needed to develop new resources to supplement incomes and foreign exchange earnings, as well as to adapt its fiscal position to the change in circumstances.

Table 1. Aruba: Contribution to Economic Activity of the Lago Refinery

	Annual average 1982-84
Contribution to GDP (in percent)	25.2
Contribution to fiscal revenues (in percent) 1/	38.8
Net contribution to current foreign exchange earnings (in percent) 2/	51.7
Employment (number of persons) 3/	1,600

Sources: Central Bank of Aruba; Aruban Department of Finance; UNDP, National Development Plan; and staff estimates.

1/ Profit and wage taxes.
2/ Foreign exchange inflows from refining less outflows associated with refining, as a proportion of current account inflows, net of export-related imports.
3/ Direct employment only.

The most evident avenue to increase foreign exchange resources was, and remains, the development of tourism. Aruba already offers 2,050 hotel rooms for which it has been able to achieve high occupancy rates, but there is considerable room for expansion. Other sources of foreign exchange are more limited and uncertain. The development of agriculture is hampered by lack of water (all water on the island must be obtained by desalination) and by strong winds. Light manufacturing industries currently employ 400 people under the cover of strong external protection. Further expansion of manufacturing is limited by the relatively high level of wages in that sector compared with some low cost producers in the Caribbean region and by the small domestic market. Government studies have investigated the scope available to foster local manufacturing within the context of the Caribbean Basin Initiative (CBI) or the EC Association Treaty. This, however, was found to be very narrow due to the many restrictions attached to the opportunities offered by these treaties. 1/ A resumption of petroleum-related activities remains a prospect. The Government is considering a variety of possibilities including offering oil exploration licenses off the shores of Aruba, the possible reactivation of the Lago plant on a limited scale, or using the plant for transshipment purposes.

The closing of Lago has severely affected government resources, especially taking into account the multiplier effect of its operations on the economy. In addition, the assured revenues from Lago had fostered lax practices in government spending and accounting. At the time of the plant's closure, collection of income taxes was five years in arrears and cost control over government expenditures was nonexistent. Thus, along with an increase in foreign exchange revenues, there was a need for fiscal adjustment which will persist even in the face of improved foreign exchange earnings.

As part of their efforts to address these difficulties, the Aruban authorities requested technical assistance from the Fund to explore the possibilities for adjustment to post-Lago conditions (EBM/85/82/4, 5/29/85). In June 1985 a technical assistance mission was sent to Aruba to see how fiscal and external balance could be achieved by 1988. The mission emphasized positive adjustment through a combination of developing new sources of domestic activity and foreign exchange earnings, as well as fiscal retrenchment. Otherwise, the deflationary effects of relying solely on fiscal adjustment, added to the loss of Lago, could have proven to be excessive. Given the limited scope for import substitution the staff mission therefore looked to tourism to fill the income gap left by the closure of Lago. After reviewing the outlook for Caribbean tourism in general and the characteristics of and prospects for the tourism industry already in existence in Aruba, it was estimated that the number of hotel rooms in operation could be increased by 50 percent between 1985 and 1988. This was projected to provide approximately Af. 60 million in additional foreign exchange earnings net of related imports, generate an additional 18 percent of GDP through tourism itself as well as hotel construction, and to create 1,500 new jobs between 1985 and 1988.

Even under this assumption the estimate of the required fiscal adjustment was large, amounting to Af. 168 million or 17 percent of 1984 GDP (internal studies prepared subsequently by the Aruban Department of Economic Affairs were in broad agreement with these orders of magnitude). Despite the boost given to activity by the projected growth of tourism, adoption of the fiscal adjustment measures together with the impact of the loss of income from the refinery was expected to result in an approximately 30 percent fall in nominal GDP between 1984 and

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1/ See Recent Economic Developments, 1986, Appendix I.

1986. 1/ Growth was projected to resume after 1986, however, as tourism projects came on stream. In support of the program the Aruban authorities negotiated special budgetary assistance of f. 100 million from the Netherlands to be disbursed during 1985-86. For subsequent years Aruba expected to continue to receive approximately Af. 15 million in development aid annually from the Dutch.

2. Moving to autonomous status

On January 1, 1986 Aruba was established as a separate entity within the Kingdom of the Netherlands. As one of the more visible consequences of this change, the Aruban florin was introduced as the island's currency, and the Central Bank of Aruba (CBA) was formed (EBD/86/24 and EBD/86/24, Supplement 1). A rate of exchange of Af. 1.79 = US$1 was fixed, implying parity with the Netherlands Antillean guilder which had previously been the legal tender of the island. The exchange of Netherlands Antilles notes and coins for Aruban florins was successfully completed during the first quarter of 1986, and, following an earlier agreement with the Central Bank of the Netherlands Antilles (BNA), NA f. 42 million in notes which had been circulating in Aruba were exchanged for U.S. dollars by the BNA.

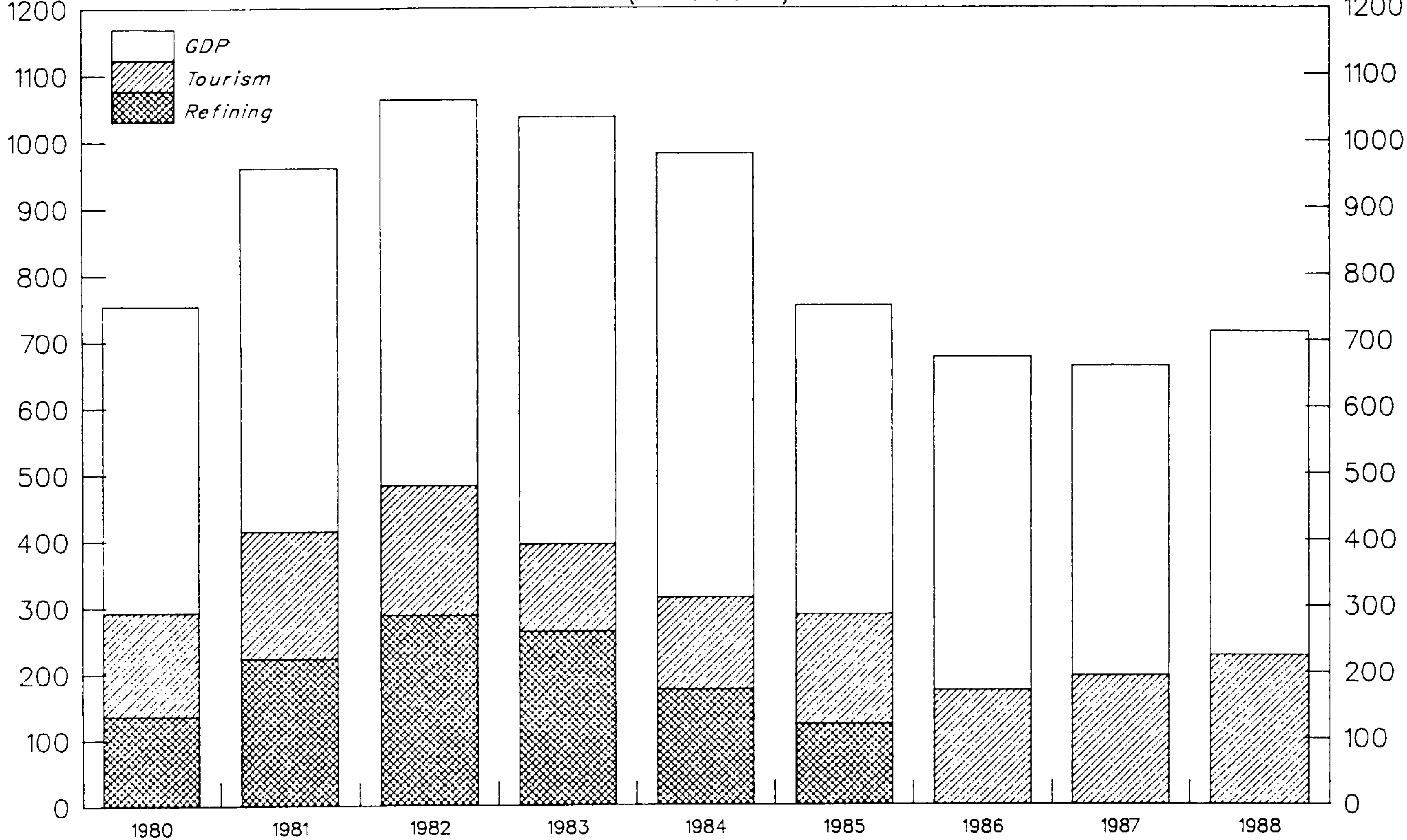
The separation of the Antilles also required a distribution of the assets and liabilities of its public sector. Regarding the Central Bank, it was agreed that the gold stock would be sold to redeem the advances made to the Government of the Netherlands Antilles, and that the surplus would be shared between the Central Bank of Aruba (30 percent) and the BNA (70 percent). In the rest of the public sector, the same distribution would apply; however, the finalization of this arrangement is not expected for some time. As a result of these operations and earlier commitments, the external indebtedness of the Government of Aruba as of January 1, 1986 consisted of Af. 162 million debt to the Netherlands for development aid received, Af. 5.1 million in suppliers' credits to the telephone company, accumulated liabilities to the Netherlands Antilles equivalent to an estimated Af. 65.2 million and Af. 130 million in government guarantees, for a total of Af. 362.3 million in direct and contingent liabilities, or 48.5 percent of 1985 GDP.

3. Recent developments and short-term outlook

Although the data covering recent developments are still fragmentary, it would seem that, as expected, the loss of income from Lago operations together with the fiscal adjustment have led to a considerable drop in personal disposable income and a cumulative decline in GDP over 1985-86 of around a third (Chart 1).

1/ All GDP data referred to in this report are expressed in nominal terms due to the absence of reliable information on deflators. The rate of inflation in Aruba as measured by the consumer price index has been moderate (2.7 percent on average over 1983-85).

CHART 1
ARUBA
TRENDS IN GDP
(In millions of Af.)



Sources: Department of Economic Affairs and staff estimates.

Recent data on employment trends are not available. However, an effort was made in early 1986 to register the unemployed. This yielded an estimate of 5,400 people, but government experts felt that in view of the magnitude of the drop in economic activity this figure was rather low. They felt that relatively large scale migrations to the Netherlands or to neighboring countries in the Caribbean had taken place, in the absence of which unemployment could have risen to perhaps 8,000. Information on trends in consumer prices during 1986 has been delayed by the preparation of a new consumer price index for Aruba. Inflation rose by 3.2 percent on average in 1985 (3.6 percent through the year) mainly due to increases in utility rates. Minimum wages have been frozen in nominal terms since December 1983. In the trade and hotel sectors recent revisions of collective agreements have resulted in reductions in nominal wages of as much as 40 percent this year in response to a sharp decline in tourism activity. In other sectors, the sharp decline in economic activity triggered by the closure of the refinery led many employers to cut wage costs through outright wage reductions or by putting workers on half-time.

Although the refinery officially closed in March 1985, severance payments and intercompany remittances helped to maintain foreign exchange earnings from Lago in 1985 at roughly 60 percent of their 1984 level, and to keep the current account deficit of the balance of payments in 1985 steady with respect to the preceding year. Disbursement of the first tranche (f. 40 million) of Dutch financial assistance limited the decline in international reserves to Af. 42.3 million.

In contrast to 1985, tourism activity weakened in the first half of 1986; the number of tourists visiting Aruba dropped by 12.9 percent over the same period in 1985. Although foreign exchange earnings from tourism were poor, Aruba's change to autonomous status buoyed other current revenues, as exports of goods and services to the rest of the Antilles were now classified as foreign transactions. On the other hand, imports declined sharply, mainly due to depressed domestic demand. Extrapolating from these developments, Aruba's external current account deficit could decline to around Af. 58 million in 1986, or 8.6 percent of GDP, from Af. 82 million last year (10.9 percent of GDP). Although this still represents a deficit, a closer look at the trend over the past two years highlights the magnitude of the adjustment made since 1984. The loss of income from Lago lopped Af. 155.5 million from Aruba's foreign exchange earnings over 1984-86 (Chart 2 and Table 2). However, the current account deficit should still be some Af. 23.5 million lower in 1986 than in 1984, due to a massive cut in imports and a small increase in non-Lago foreign exchange earnings. As for capital transactions, the projected disbursement of Dutch financial assistance and large private capital inflows, linked to a reflow of short-term funds placed abroad in late-1985 and special funding operations by companies which had formerly maintained their head offices in Curaçao, should allow Aruba to build up foreign exchange reserves by some Af. 60 million this year to Af. 134 million or the equivalent of 4.5 months of imports of goods and services.

Table 2. Aruba: The Adjustment Effort

(In millions of Aruban florins)

Impact of the closing of Lago and the adjustment effort, comparing 1986 with 1984, on:	
1. The fiscal position	
Loss of tax revenue from Lago 1/	-48.1
Impact of GDP decline	-105.1
Offset by:	
Increase in tax pressure	88.4
Decreased expenditure	54.1
Net deterioration	-10.7
2. The balance of payments	
Loss of foreign exchange earnings from Lago	-155.5
Offset by:	
Improved earnings from tourism and other current receipts	53.7
Lower imports	125.3
Net improvement	23.5

Source: Staff calculations.

1/ Profit tax only.

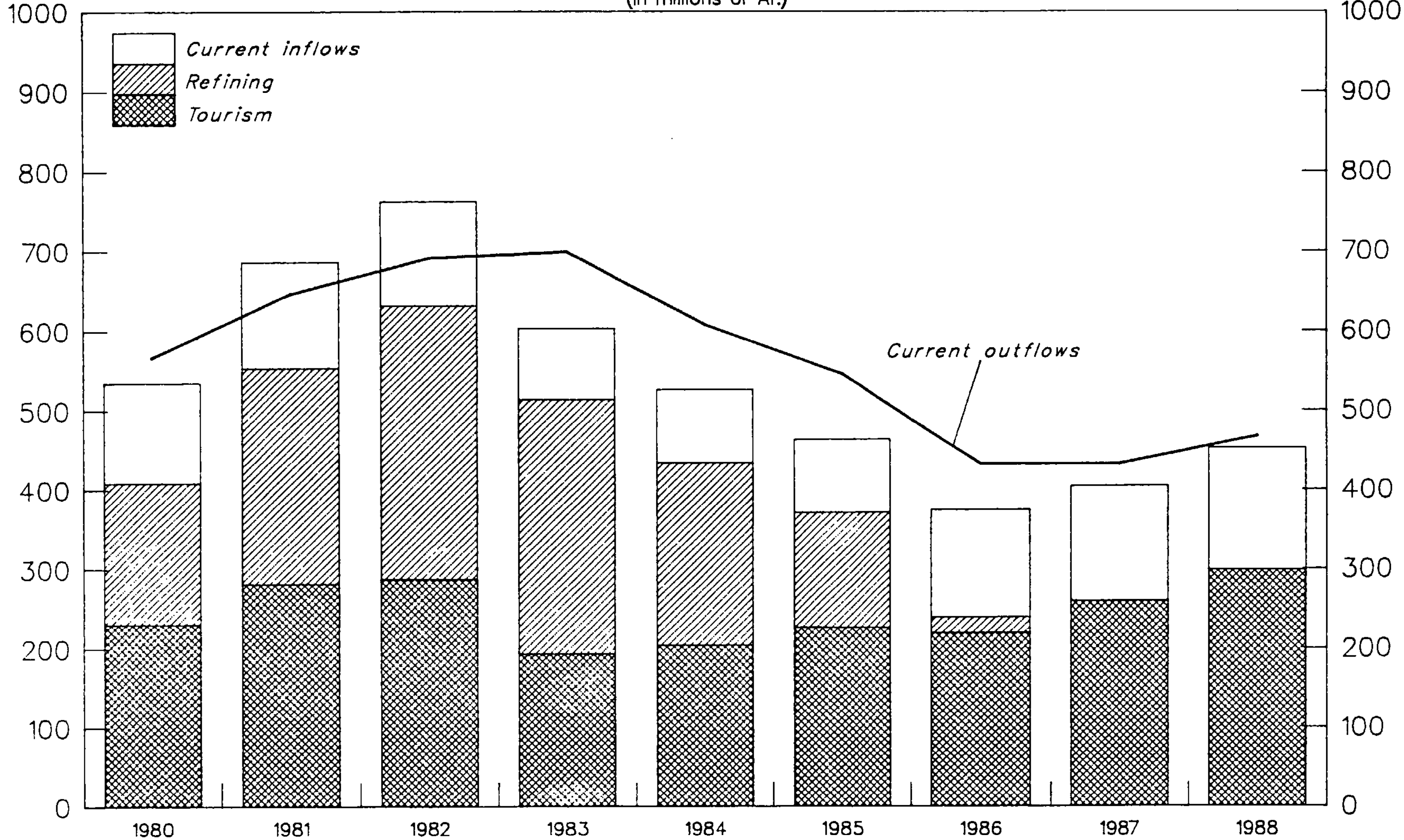
Developments in the fiscal situation over the past 18 months also reflect the impact of the adjustment measures put in place to deal with the loss of revenue from the refinery (Chart 3 and Table 2). The loss of direct tax revenue from refining operations together with the direct and indirect impact on tax revenues from the decline in GDP would of itself have led to a deterioration in the fiscal position between 1984 and 1986 of around Af. 150 million. However, this was almost wholly offset through the implementation of the adjustment measures, which included: a solidarity tax of 8.2 percent of taxable income which covers Aruba's contribution to the Netherlands Antilles' regional fund; an increase from 25 to 30 percent in the surcharge on the income tax; a 7.75 percent reduction in civil service compensation in addition to the elimination of the vacation allowance equivalent to roughly 6 percent of salary; a gradual increase of Af. 0.20 in the excise tax on gasoline designed to capture the benefit of falling oil prices; and a tightening

CHART 2

ARUBA

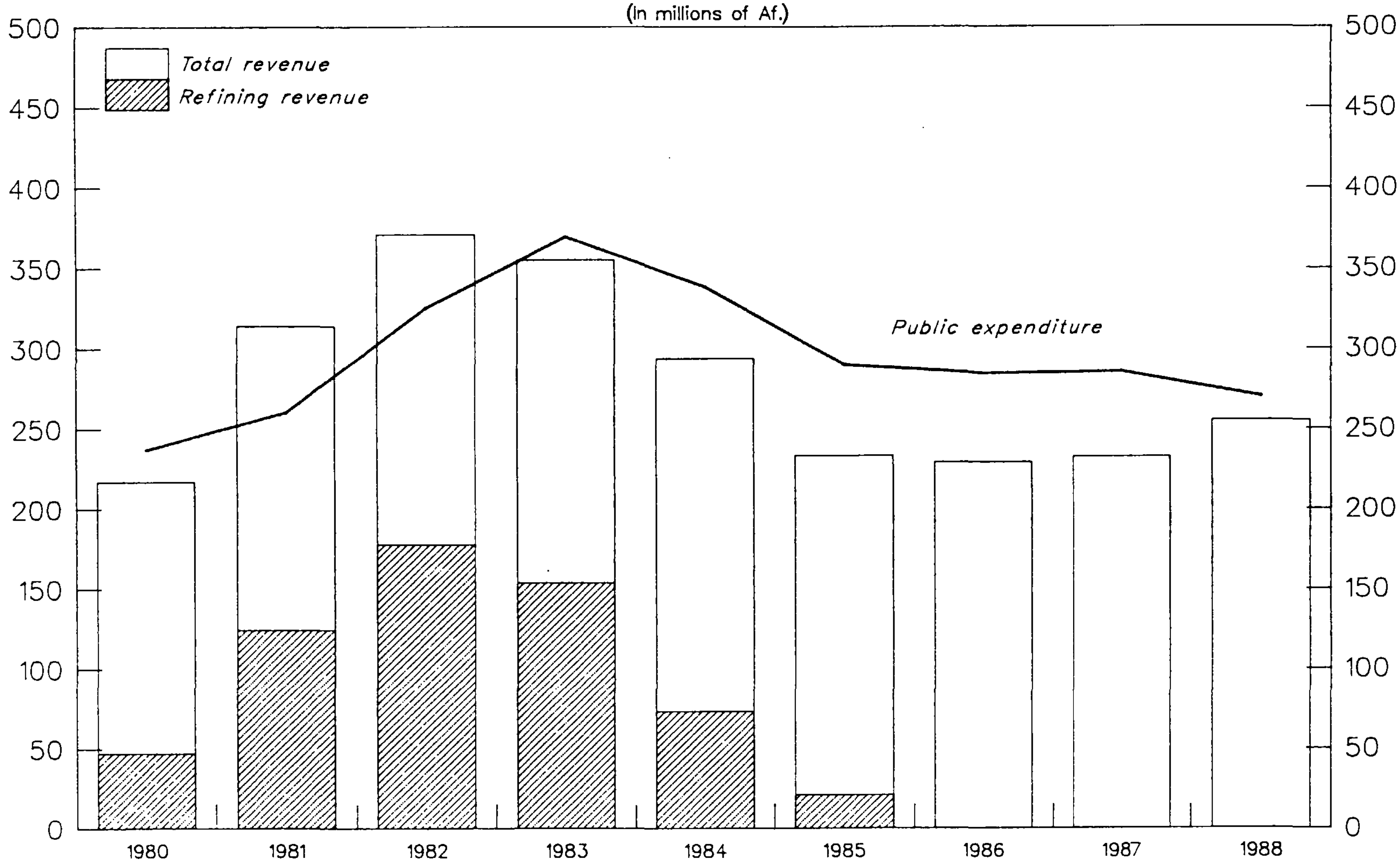
BALANCE OF PAYMENTS TRENDS

(In millions of Af.)



Sources: Central Bank of Aruba and staff estimates.

CHART 3
ARUBA
FISCAL TRENDS
(In millions of Af.)



Sources: Department of Finance and staff estimates.

of health insurance provisions. The impact of these measures on the fiscal position was enhanced by a strong improvement in tax administration, allowing the collection of part of the large backlog of arrears, and by a decline in subsidies to public enterprises made possible by cheaper oil, some increases in user fees and the extension of central government wage cuts to employees of these organizations. Taking into account all these factors it should be possible to hold the government deficit to around Af. 55 million in 1986, just Af. 11 million above its 1984 level, and broadly in line with the projections made by the technical assistance mission of 1985.

Monetary developments have reflected the improvement in the balance of payments and the fiscal position in the first half of 1986. Heavy capital inflows together with stagnant private credit demand and a temporary increase in government deposits held with the banking system helped raise Aruba's net foreign assets from Af. 74.4 million at the beginning of the year to Af. 142.5 million by the end of July (Chart 4). This was reflected in a relatively rapid growth of the money supply.

The outlook for 1987-88 will largely depend upon whether and to what extent the remaining measures envisioned in the 1985 adjustment program are implemented. This will be clear when the 1987 government budget is finalized. However, assuming that the additional measures, equivalent to some 6 percent of GDP, are taken, both the current external and the fiscal deficits could decline to around Af. 30 million in 1987, and fall further to their target levels of about Af. 15 million in 1988. The additional fiscal measures would delay the recovery of GDP in 1987. However, GDP is projected to rebound in 1988 as the impact of the expansion of tourism capacity on activity begins to be more strongly felt.

III. The Policy Discussions

The main theme of the discussions was to assess the progress achieved in adjusting to "post-Lago" conditions, and to measure the need for further adjustment measures. The discussions followed closely, as a reference, the previous technical assistance report which indicated a need for fiscal adjustment through discretionary measures equivalent in total to 17 percent of GNP over 1985-88, supported by a strong expansion of tourism.

1. Development policies

The authorities' target for tourism development is to double the number of hotel rooms available on the island by 1990, with hotel capacity to rise by 50 percent by 1988. Achieving this would imply an increase in Aruba's market share in Caribbean tourism from its present level of 2.6 percent to 4.3 percent by 1990, assuming an overall growth of tourism in the region of 4 percent. The authorities recognized that this could be difficult but still saw it as feasible. Construction was already underway on around 400 rooms representing 20 percent of existing capacity and other projects which would contribute an additional 574 rooms by 1988 were at various stages of development. Securing the external financing for the projects tended to be something of a bottleneck as, given generally established practices in the financing of tourism projects in the region, project financing could not generally be secured without a government guarantee.

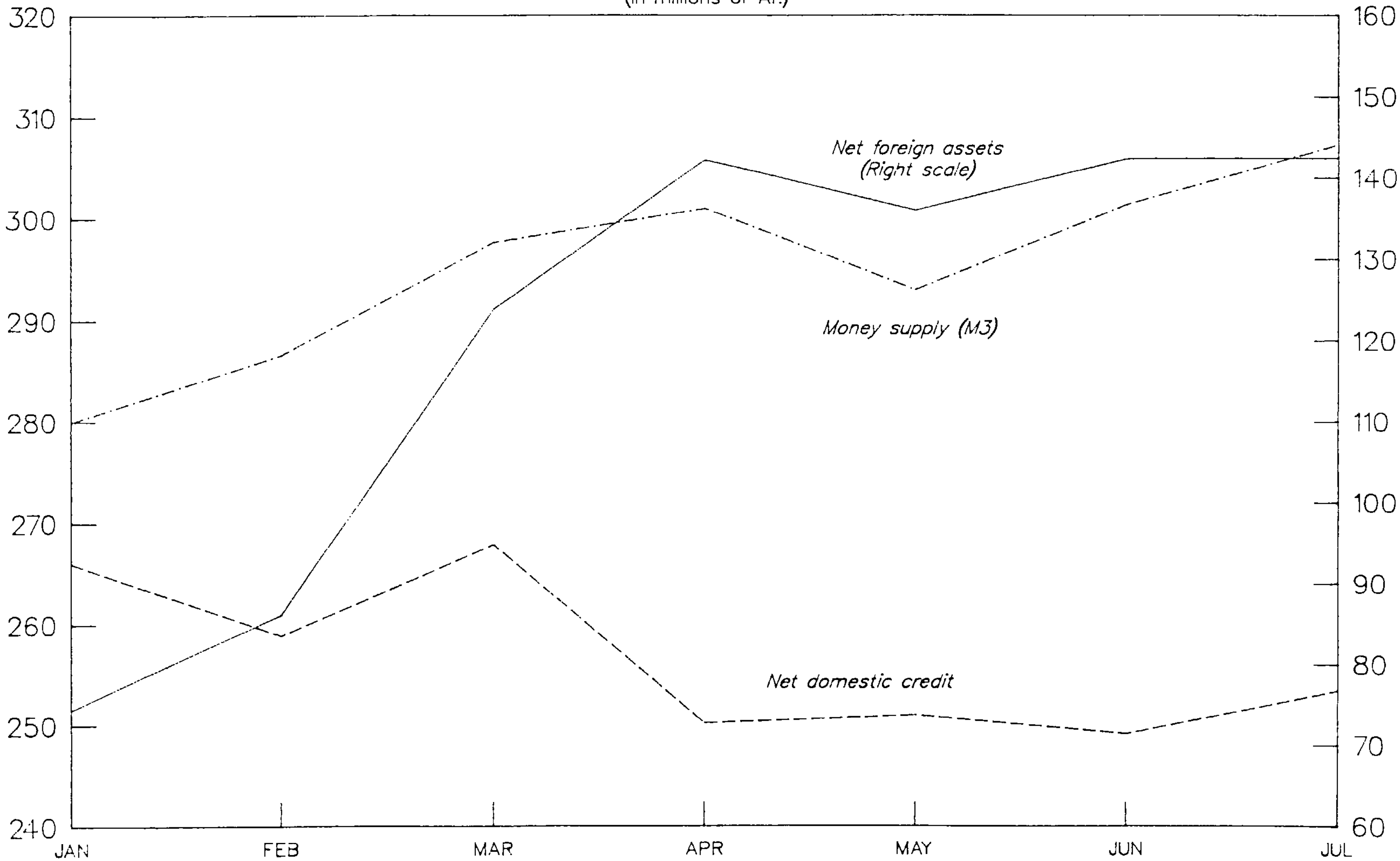
Another drawback which the authorities recognized was that, especially given the distance from the island's major markets, Aruba was a relatively high-cost destination in the Caribbean. This situation reflected in part the high income standards of the island compared with the rest of the Caribbean, which they did not think possible or advisable to reduce further on competitiveness grounds in the present depressed economic circumstances. Nominal wages in the tourism sector had already fallen sharply. They rejected depreciation of the exchange rate as a means of improving competitiveness because of its negative effects on confidence and because the very close linkage between import prices, domestic prices and wages would make such a course of action self-defeating. Furthermore, the large apparent migratory movement of the past year was in their view an indication that depressing domestic income would only lead Arubans to leave the island. Aruba could better compete by offering quality products and by trying to tap new market segments. The staff broadly concurred with this approach, and noted that despite some delays in securing the confirmation of hotel projects, there was a reasonable prospect that the expansion of capacity required to restore growth rates could be achieved in the coming years. However, given the volatility of the tourism market it was wise to consider other foreign exchange generating alternatives as well.

The authorities agreed and felt that despite the restrictions attached to them there was some scope for using the tariff facilities proposed under the CBI or EC arrangements to expand light manufacturing industries on the island. They were also optimistic that other, oil-related activities and offshore petroleum exploration could be developed. The staff mission felt that this was encouraging but cautioned that existing manufacturing activities on the island had developed under heavy protection. The authorities indicated that they intended to gradually dismantle this protection. They also indicated that a liberal economic policy would prevail in the field of price controls. Similarly, the privatization of government-owned hotels was underway; one hotel had already been sold in September 1986.

2. Fiscal policy

The closing of Lago had severely reduced government revenues, both directly and indirectly through its depressing effect on economic activity. The authorities nevertheless were determined to limit the inevitable short-run deterioration of the fiscal balance and had taken strong action by cutting civil service wages, increasing taxes, and improving tax collection. The staff mission commended the authorities

CHART 4
ARUBA
MONETARY TRENDS
(In millions of Af.)



Source: Central Bank of Aruba.

for taking these difficult steps. As a result, it had been possible to stabilize the fiscal deficit. However, its level was too high to be sustained in the medium term. In addition, the adjustment measures taken so far had relied too heavily on tax increases, progress in reducing overmanning and waste had been limited.

The authorities affirmed their intention to reduce the budget deficit by 1988 to a level which could be financed entirely by the normal allocation of Dutch development aid. At the same time, however, they indicated that the compression of personal disposable incomes caused by the closure of Lago and by the fiscal adjustment measures taken so far had been severe. They saw no scope for further direct tax increases, and preferred to take many small, well targeted measures instead of a sweeping approach. Additional expenditure cuts would be sought, to be complemented by selective increases in import duties designed to discourage luxury consumption and by improved administrative efficiency. A more aggressive collection of tax arrears had yielded good results so far in 1986. The authorities were unsure how much of this represented a once-and-for-all clearing of back taxes. However, they stressed that assessment and collection procedures were being strengthened and hoped that this could pave the way for increased revenues in the future.

The staff mission was provided with very preliminary proposals for the 1987 budget which incorporated the policy approach outlined above. The authorities expected to submit the budget to Parliament for approval by the end of October. Reflecting the authorities' feeling that the compression of disposable incomes had gone far enough and taking into account the effect on the 1986 base of the collection of arrears, direct taxes were budgeted to rise only modestly in 1987, with this increase to come solely from the extension of the solidarity tax to nonwage incomes. Indirect taxes would be raised, but the magnitude of the increase and which taxes would be affected was still to be worked out. As for expenditure, purchases of goods and services were projected to decline due to firmer controls on spending and the directive to lower outlays by a minimum of 5 percent. Decisions on other expenditure items were still pending.

The authorities expressed concern that obtaining external financing for development projects, other than from the Netherlands, was hampered by the fact that Aruba was little known in financial circles. The staff observed that progress could be made in putting Aruba on the "financial map" by improving the timeliness and quality of the information available to outsiders, particularly the fiscal data. Indeed, fiscal control itself required the punctual presentation of accounts, something which so far had not been achieved. The authorities noted that steps were being taken to speed up the auditing of the government accounts. While the need to revise the 1985 budget after the closure of Lago and the change in political status in 1986 had somewhat delayed the normal process, they would return to the normal timetable with the budget for 1987.

3. Monetary policy

The establishment of a central bank and a national currency in January 1986 marked the beginning of a separate monetary policy for Aruba. The introduction of the Aruban florin had been successful as demonstrated by the reflow of short-term capital placed abroad in 1985, in reaction to uncertainty over economic trends and over the impact of the imminent change in the island's political status. The staff estimated that the reflow of capital in the opening months of 1986 could have been as much as Af. 40 million. The switch to autonomy had implied a change of residency status for many companies on the island and this had also resulted in some inflow of capital from their former head offices in Curaçao to strengthen their funding. As a result the net foreign assets of the banking system had doubled during the first seven months of the year.

An important concern in the initial months of operations of the Central Bank of Aruba had been to adjust the banks to the new conditions created by the island's autonomy. Capital requirements had been imposed, banking supervision had been strengthened, and by the time of the mission all banks on the island had been audited. The elements of an interbank market had been put in place. It was expected that this institutional development would be complemented by the creation of Treasury bills in the coming months.

Taken as a group, the Aruban banks had not been in a very liquid position at the beginning of 1986 when the Central Bank was established. The monetary authorities explained that they had sought, and gradually succeeded, in improving the banks' loan-to-deposit ratio. They had been helped in this by increasing demand for the florin as confidence was established, a more aggressive approach to attracting deposits by the banks, and weak loan demand. The Central Bank had not imposed a formal reserve requirement but proceeded rather by moral suasion. The Central Bank took a rather restrictive view of monetary management and had made it clear to the banks that it would not be available, except in extreme circumstances, to extricate them from difficulties. No quantitative limits were imposed on banks' borrowing from the Central Bank. However the rate on central bank advances was set at a punitive level and banks which used this facility were obliged to borrow for a minimum of seven days. As for the public sector, advances by the Central Bank to the Treasury were limited to 10 percent of the preceding year's budget revenues.

Interest rates tended to be set in line with U.S. rates, and the authorities observed that until now the range of financial instruments in which banks could invest was rather limited. Exchange control regulations limited their foreign asset positions, while domestically they were forced to choose between holding deposits with the Central

Bank or expanding their loans. The authorities felt that this situation would be eased by the introduction of Treasury bills and by future innovations in financial markets.

The authorities maintained the foreign exchange regulations which prevailed in the Netherlands Antilles. Regarding the banking system, the main regulation was a limitation on the banks' net foreign asset position. The authorities explained that this regulation served the dual purpose of encouraging banks to collect florin deposits rather than foreign currency deposits, and to concentrate in the Central Bank the exchange reserves of the island. Regarding nonbanks, exchange controls were administered liberally. Nonbank residents could obtain foreign exchange freely for most current transactions. Limitations applied to purchases of foreign exchange for tourism, health care abroad, education expenses and certain other transactions, but additional foreign exchange beyond these limits could be obtained by application to the Central Bank. Permission to exceed the limits was liberally granted. 1/ Capital transactions required a license, but licenses were liberally granted, and were given automatically, for repayments of loans received from abroad at the time the loans were received. The staff questioned the need for restrictions noting that, ultimately, confidence in the island's economic policies should assure the stability of the flow of foreign exchange. The authorities fully recognized this point, but observed that their continued maintenance was required by the fact that the Aruban monetary system was still very new and fragile. These regulations offered necessary, if short-term, safeguards.

The island also continued to maintain the system of import duties and import surcharges prevailing before achieving autonomous status, with the exception that the level of protection on goods competing with those produced in the Netherlands Antilles had been reduced by 30 percent. It was planned to phase out protective duties for these goods by 1991. Goods originating in the Antilles were exempt from import duties. A foreign exchange tax of 1.3 percent on all purchases of foreign exchange continued to be levied.

1/ For details see Recent Economic Developments, 1986, Appendix I.

Staff Appraisal

The economy's successful adjustment to the loss of the Lago refinery depends on the promotion of new sources of foreign exchange and the implementation of fiscal restraint. The suddenness of the closure of the refinery and the lack of short-run alternative sources of income have put a heavy burden on demand management. In the circumstances, the adjustment measures, equivalent to some 12 percent of GDP, implemented since early 1985 have averted a fiscal and external crisis. Moreover, by fostering confidence they have allowed the successful introduction of the Aruban florin and have permitted the Central Bank of Aruba to build up its international reserves.

The authorities are to be congratulated on the success of the adjustment measures taken so far. Nevertheless the fiscal deficit which remains for 1986, estimated at 6 percent of GDP, excluding normal Dutch development aid, is excessive. Given Aruba's need to give priority to financing expansion in the tourism sector, the small size of the domestic banking system and Aruba's limited international borrowing opportunities, the staff support the authorities' goal of eliminating the budget deficit, excluding normal Dutch development aid, by 1988.

Reaching fiscal balance by 1988 will require further discretionary measures equivalent to some 6 percent of GDP and a substantial portion of these should be in place in 1987. The staff urge the authorities to speed-up the elaboration of the 1987 budget, ensuring that it does incorporate the necessary measures so that further substantial progress towards fiscal balance can be made. So far, heavy reliance has been placed on revenue raising measures. Progress in reducing overmanning and waste in the public sector has been limited and greater emphasis should now be placed on expenditure reduction to carry on the fiscal adjustment effort. As for revenue, an improvement in tax administration, if durable and not limited to a one-time collection of arrears, could be a welcome substitute for alternative discretionary measures.

Most of Aruba's external debt excluding guarantees has been contracted on concessional terms and its servicing does not represent a major drain on foreign exchange earnings. Nevertheless, in view of the Government's interest in providing guarantees to facilitate the financing of tourism development, the staff recommend a strengthening of procedures to centralize and monitor external debt developments. Present procedures could be improved through the active participation of the Central Bank in debt monitoring and in establishing criteria for granting guarantees.

The other pillar of Aruba's adjustment effort, along with demand management, must be the promotion of new sources of foreign exchange. The authorities' development strategy recognizes that tourism will continue to be the mainstay of the economy despite the volatility of earnings from this activity but it also seeks development of other export-oriented activities. There is reasonable assurance, in the staff's opinion, that hotel capacity can be significantly increased within the next few years and that the island can attract sufficient new business to meet this expanded capacity. Still, the fickleness of the tourism market this year should serve as a reminder to the authorities to press forward with projects unrelated to tourism. The development of the manufacturing sector has, until today, relied on heavy protection; the staff welcome the Government's intention to move gradually away from this approach.

The staff commend the authorities for the successful introduction of the Aruban florin. Confidence in the currency has been strengthened by the establishment of the Central Bank of Aruba. The staff welcome the Central Bank's efforts to provide Aruba with a sound monetary system through improved bank supervision and by its plan to broaden the range of financial instruments available for bank asset and liability management.

It is expected that the next Article IV consultation with Aruba will take place on a two-year cycle.

Fund Relations with the Kingdom of the Netherlands, Aruba

Aruba is part of the Kingdom of the Netherlands, which consists of the Netherlands Antilles, Aruba, 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 which at the time also circulated on Aruba--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. With status aparte on January 1, 1986, Aruba introduced its own currency, the Aruban florin, which is also pegged to the U.S. dollar at Af. 1.79 per US$1.

The Board conducted the last Article IV consultation on the Netherlands Antilles, including Aruba, on the basis of staff reports SM/85/21 (1/22/85 and 2/13/85) and SM/85/24 (1/25/85). Technical assistance for the establishment of the Central Bank of Aruba has been provided by the Central Banking Department since November 1985.

Aruba - Basic Data

Population (end-1985)	*64,300*
GDP per capita (1985)	US$6,544
Exchange rate 1/	Af. 1.79 = US$1.00

	1980	1981	1982	1983	1984	1985	1986 proj.
			(In millions of Af.)				
National Accounts							
GDP	753.9	960.5	1,062.8	1,036.9	982.0	753.2	675.6
Refining	136.0	223.0	288.0	263.0	175.0	122.0	--
Tourism	156.8	191.5	195.5	131.8	139.0	166.0	173.2
Other activities	461.1	546.0	579.3	642.1	668.0	465.2	502.4
Employment, prices, wages							
Employment (000)	...	22.9	...	...	...	21.0	19.0
Unemployment (000)	...	2.4	...	...	...	4.7	5.4
Consumer prices (avg. % change)	14.9	12.2	6.2	2.7	2.2	3.2	...
Average monthly minimum wage (Af.)	465	533	594	615	623	623	623
Balance of payments							
Exports (net of related imports)	417.5	547.6	614.0	404.4	406.4	380.3	304.6
Refining	135.2	223.2	288.1	263.0	175.5	134.1	20.0
Tourism	156.8	191.5	195.5	131.8	139.0	154.0	149.2
Imports of goods and services	449.8	507.9	543.3	580.3	488.0	462.3	362.7
Current account	-32.3	39.7	70.7	-95.9	-81.6	-82.0	-58.1
(In percent of GDP)	(-4.3)	(4.1)	(6.7)	(-9.3)	(-7.9)	(-10.9)	(-8.6)
Overall balance	-5.2	63.4	67.2	-63.6	-69.5	-42.3	57.9

	1986 January	1986 March	1986 June	1986 July
		(In millions of Af.)		
Monetary aggregates				
Net foreign assets	74.4	123.9	142.4	142.5
Domestic credit	266.0	267.9	249.1	253.4
Public	-22.4	-26.5	-40.1	-34.5
Private	288.4	294.4	289.2	287.9
Money supply (M3)	280.0	297.7	301.4	307.3

	1980	1981	1982	1983	1984	1985	1986 proj.
			(In millions of Af.)				
Public finances							
Revenue	217.0	314.1	371.2	355.5	294.0	233.5	229.2
Current	208.5	304.9	364.8	353.0	282.0	223.5	220.2
Capital	8.5	9.2	6.4	2.5	12.0	10.0	9.0
Expenditure	236.9	260.3	325.7	369.8	338.6	290.1	284.5
Balance	-19.9	53.8	45.5	-14.3	-44.6	-56.6	-55.3
Financed by:							
Development aid	19.7	29.8	18.3	36.5	15.6	29.5	60.0
Other	0.2	-83.6	-63.8	-22.2	29.0	27.1	-4.7

1/ Pegged to the U.S. dollar.

Aruba--Statistical Issues

There is no country page for Aruba in IFS. A Bureau of Statistics Mission to review statistical issues is tentatively scheduled to take place in November.

1. General economic statistics

General economic statistics are prepared by the Central Bureau of Statistics and the Department of Economic Affairs, however, these statistics are not published. Work has begun on a new consumer price index, base 1986=100.

2. Government finance

Government finance statistics are weak but data collection procedures are being improved. Government accounts for 1984 and 1985 are being audited by a government appointed external auditor.

3. Monetary accounts

The Central Bank of Aruba began compiling comprehensive monetary accounts in January 1986. Publication of a monthly bulletin is planned.

4. Balance of payments

Cash balance of payments data are prepared quarterly by the Central Bank which plans to publish them in its new bulletin.