

**LAPSE OF  
TIME**

SM/16/222

Correction 1

July 25, 2016

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of the Netherlands—Curaçao and Sint Maarten—Staff Report for the 2016 Article IV Consultation Discussions**

Board Action:

The attached corrections to SM/16/222 (7/13/16) have been provided by the staff:

**Factual Errors  
Affecting the  
Presentation of Staff's  
Analysis or Views**

**Pages 5 (box 1, row 6), 6, 8, 10, 13, 15 (footnote 9), 17 (para. 26), 19 (box 3, para. 4, bullet 4, line 2; para. 4, line 5), 20, 35 (row 4), 56 (paras. 2 and 3), 57, 60**

**Typographical Errors**

**Pages 5 (box 1, rows 3–5), 11, 12, 14, 15 (para. 23), 16, 17 (para. 27), 18, 19 (box 3, para. 3, bullet 4, line 3), 21, 22, 25, 30, 31, 32, 35 (rows 1 and 5), 36, 39, 41, 54, 56 (paras. 1, 4, 5)**

Questions:

Mr. McIntyre, WHD (ext. 34503)  
Mr. Li, WHD (ext. 36917)



**2. Efforts have been made to implement the policy recommendations from the 2014 Article IV Consultation discussions, however, progress has been slow (Box 1).** Considerable progress in reducing risks associated with pension funds and state-owned enterprises (SOEs) has been made, and additional reforms are forthcoming. While neither island has formally adopted a VAT as recommended by the technical assistance provided by the IMF's Fiscal Affairs Department in 2009, the fiscal position has benefited from progress in keeping public wage developments in check. The central bank has also made steady progress in implementing monetary and financial policy recommendations to ensure financial stability. Less progress has been made however, in implementing recommendations to improve labor market conditions.

### Box 1. Progress on 2014 Article IV Policy Recommendations

Recommendations	Implementation status
<b>The Union</b>	
<b>Fiscal policy</b>	
<b>Tax policy:</b> Replace turnover tax with value-added tax (VAT).	Both countries continue to maintain a turnover tax.
<b>Wages:</b> Efforts to keep public wage developments in check, including by reviewing the indexation mechanism.	Progress is ongoing.
<b>Financial sector policy</b>	
<b>Excess liquidity:</b> Utilize more conventional tools (CD's with attractive rates, higher reserve requirements, and higher interest charges to banks for liquidity). Utilize macro-prudential tools to address growth in mortgages. Gradually eliminate remaining limits on outward investments by pension funds.	Progress is ongoing.
<b>Direct financing of non-financial companies:</b> CBCS should discontinue funding to private corporations and SOEs.	The CBCS has discontinued these streams of funding and <b>are</b> making efforts to onwind existing loans.
<b>Competitiveness and growth</b>	
<b>Labor market:</b> Render labor laws more conducive to cyclical shifts in labor demand. Ease restrictions on hiring foreign workers.	No progress made.
<b>Doing business:</b> Streamline business licensing and permit regimes. Consider introducing automatic approval for some classes of permits/licenses.	Progress is ongoing, Curaçao has taken steps to centralize processes and are looking at digitalizing processes.
<b>Statistical infrastructure</b>	
<b>Data:</b> Improve the availability of data, including by investing more in human capital.	Budgetary constraints limit progress in this area.
<b>Curaçao</b>	
<b>Fiscal policy</b>	
<b>Tax policy:</b> Gradually towards more indirect taxes (2009 FAD technical assistance).	<del>No progress made.</del> Progress is ongoing.
<b>Pension reform:</b> Extend the 2013 old age pension reform to the public sector.	Public sector pensions no longer indexed to inflation.
<b>State-owned enterprises:</b> Improve transparency and oversight, including through timely financial statements and a clear dividend policy.	Progress is ongoing.
<b>Financial sector policy</b>	
<b>AML/CFT:</b> Further strengthen and implementation of Anti-Money Laundering/Combating the Financing of Terrorism international standards.	Progress is ongoing.
<b>Competitiveness and growth</b>	
<b>Labor market:</b> Limit welfare support to unemployed (time and eligibility).	No progress made.
<b>Sint Maarten</b>	
<b>Fiscal policy</b>	
<b>Tax administration:</b> Strengthen tax administration, by increasing the number of suitably trained tax inspectors and administrators.	Progress is ongoing
<b>State-owned enterprises:</b> Improve transparency and oversight, including through timely financial statements and a clear dividend policy.	Progress is ongoing. Dividend policy drafted.
<b>Pension reform:</b> Follow through with proposal to increase retirement age to 62. Consider gradually increasing to retirement age to 65.	In discussions towards implementing pension reform in 2018

**3. Staff urges the authorities to implement measures to improve the quality of statistics, to better support effective macro-economic surveillance.** There is significant room for improvement in the coverage and timeliness of data, in particular on national accounts, public finance in GFS format, and international investment positions (IIP). In both countries, staff noted large data gaps with GDP estimates, with lags as far back as 2006 for various expenditure components.<sup>2</sup> Besides, with no reliable deflator, or deflators by sector, the real GDP series are derived based on the consumer price index. In addition, some components of Sint Maarten's balance of payments (BOP) statistics have been compiled as the difference between the Union and Curaçao's, inevitably resulting in large unexplained swings in the island's BOP developments in certain years.

## RECENT ECONOMIC DEVELOPMENTS

**4. Economic performance remains weak in both countries.** For several years now, both countries have experienced lackluster growth, trailing behind regional peers. Curaçao experienced modest growth in 2015 of 0.1 percent, reflecting a turnaround from the contraction of 1.1 percent in 2014. Growth in Curaçao mainly reflected an increase in investment (both public and private), driven largely by the construction of the new hospital and the upgrade of road infrastructure. Meanwhile, the economy of Sint Maarten expanded by 0.5 percent in 2015, a slowdown compared to the 1.5 percent recorded in 2014. The expansion in Sint Maarten's GDP mainly reflected an increase in stay-over tourist arrivals, though at a slower pace than in 2014. With the exception of the recent expansion project at the Princess Juliana International Airport, there was no major private investment in 2015, underscoring the need to boost investor confidence. Unemployment in both countries remains relatively high at 11.7 percent and 8.9 percent for Curaçao and Sint Maarten, respectively. However, youth unemployment is estimated to be significantly higher, in the region of 30 percent for Curaçao and 25 percent for Sint Maarten.

Curaçao and Sint Maarten vis-à-vis Regional Peers (2015)			
	Real GDP Growth (%)	FDI (% of GDP)	Real GDP per Capita (US\$)
Antigua and Barbuda	2.2	12.0	14,753
Bahamas	0.5	2.0	24,213
Barbados	0.5	5.8	16,044
Belize	1.5	-0.4	4,866
<b>Curaçao</b>	<b>0.1</b>	<b>2.8</b>	<b>20,260</b>
Grenada	0.5	5.8	16,044
Guyana	3.0	6.7	4,335
Jamaica	0.8	5.1	4,909
<b>Sint Maarten</b>	<b>0.5</b>	<b>2.6</b>	<b>26,025</b>
St. Kitts and Nevis	6.6	18.2	16,794
St. Lucia	1.6	6.2	8,188
St. Vincent and the Grenadines	1.6	18.6	7,124
Sources: National Authorities; CBCS; WEO; and IMF Staff Estimates.			

<sup>2</sup> Production approach GDP statistics are not available.

investment. Nonetheless, the public debt of the Union increased from 30.5 percent of GDP in 2013 to 41.5 percent of GDP in 2015—partly but not entirely reflecting pre-financing—and fiscal performance for the two countries diverged noticeably.

- a. **Curaçao's** fiscal position deteriorated in 2015 with its primary balance widening to 1.7 percent of GDP from 0.7 percent in 2014. This reflected an increase in capital expenditure, with the construction of a new hospital, and budgetary transfers to cover

<b>Curaçao: Operations of the Government</b> (in percent of GDP)					
	2011	2012	2013	2014	2015
Total Revenue and Grants	29.0	29.7	29.8	28.4	30.9
o.w. Tax Revenue	26.2	25.5	25.3	24.8	25.7
Total Expenditure	32.2	31.2	31.4	31.0	34.6
o.w. Wages and Salaries	13.0	12.5	12.6	12.3	12.3
o.w. Capital Expenditure	1.5	1.7	4.0	3.5	4.8
Primary Balance	-1.4	0.2	0.2	-0.7	-1.7
w/o Debt Relief Grants	-2.3	-1.4	-0.7	-1.5	-2.3
Overall Balance	-2.3	-0.7	-0.7	-1.8	-2.8
Public Debt	40.6	33.1	34.1	38.6	44.3

Sources: CBCS; and IMF Staff Estimates.

operational deficits of the SEHOS hospital and the national health insurance fund. The tax-to-GDP ratio moderately recovered to 25.7 percent in 2015, ending a four-year downward trend, due to improved tax compliance and increases in property tax rates. With interest payments at around 1 percent of GDP (or around 3½ percent of total ~~central~~ government revenue), the overall fiscal deficit was 2.8 percent of GDP in 2015. The government issued three long term loans during 2014-15, totaling NAF 526 million (or 9.3 percent of 2015 GDP) to pre-finance the new hospital, resulting in a rapid buildup in public debt to 44.3 percent of GDP at end 2015 (compared with 34.6 percent in 2010).

- b. **In contrast, Sint Maarten's** underlying fiscal position improved in 2015 with lower spending and higher tax revenues. The primary deficit narrowed to 0.6 percent of GDP in 2015, from 3.9 percent in 2014, largely due to a

<b>Sint Maarten: Operations of the Government</b> (in percent of GDP)					
	2011	2012	2013	2014	2015
Total Revenue and Grants	22.1	25.6	27.0	22.9	23.1
o.w. Tax Revenue	17.8	19.7	19.5	19.7	20.3
Total Expenditure	21.5	25.3	27.9	27.4	24.4
o.w. Wages and Salaries	7.7	9.1	10.8	10.6	10.1
o.w. Capital Expenditure	0.7	2.3	1.4	4.6	2.0
Primary Balance	1.3	1.0	-0.3	-3.9	-0.6
w/o Debt Relief Grants	1.3	1.0	-0.3	-3.9	-0.6
Overall Balance	0.7	0.4	-0.8	-4.5	-1.3
Public Debt	27.3	20.0	24.3	37.1	36.5

Sources: CBCS; and IMF Staff Estimates.

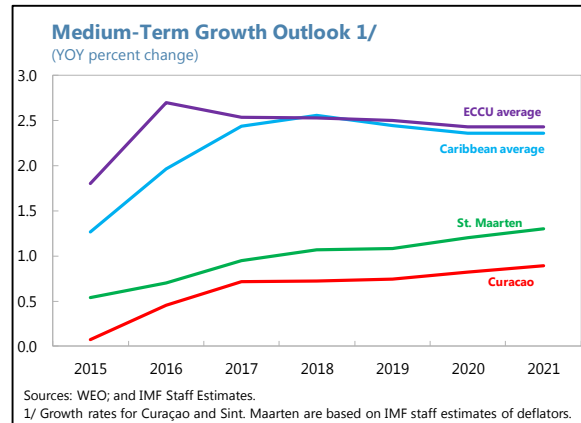
decrease in capital spending and lower wage bill (which declined to 10.1 percent of GDP from 10.6 percent in 2014). Tax revenues increased to 20.3 percent of GDP from 19.7 percent in 2014, largely reflecting higher taxes on income and profits. The debt ratio declined to 36.5 percent in 2015 from 37.1 percent at end 2014.

**8. Credit growth remained weak despite ample liquidity in the banking system.** Despite robust deposit growth, which has led to further accumulation of bank reserves to well above the

## OUTLOOK AND RISKS

### 10. Growth is expected to pick up slightly in the near term.

Real GDP growth in 2016 is expected to reach 0.5 percent in Curaçao and 0.7 percent in Sint Maarten. For Curaçao, economic activity is projected to accelerate reflecting continued economic recovery in their main trading partners (especially the U.S.) and a continuation of both private and public investment projects (e.g. the hospital renovation/construction). Higher growth in Sint Maarten reflects expectations for higher private spending, particularly in the tourism and transportation sectors, and a moderate increase of tourism flows. Meanwhile, inflation is expected to accelerate gradually to 0.8 percent in Curaçao and 1 percent in Sint Maarten, as the effect of lower oil prices is countered by an increase in prices in the U.S. and the Netherlands, the Union's main trading partners.



### 11. Medium-term prospects remain broadly positive but will depend on the authorities' efforts to address structural bottlenecks.

Over the medium term, growth is expected to moderately pick up to 0.9 percent and 1.3 percent for Curaçao and Sint Maarten, respectively. The expansion in both countries will mainly depend on the timely implementation of structural reforms aimed at attracting more FDI, relaxing restrictions on hiring foreign labor, and reducing costs of doing business (¶18-21).

Selected Medium-Term Indicators											
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<b>Curaçao</b>											
Real GDP growth (% change)	0.6	-0.1	-0.8	-1.1	0.1	0.5	0.7	0.7	0.7	0.8	0.9
Current account (% of GDP)	-27.3	-27.9	-21.0	-11.9	-15.3	-15.3	-13.6	-12.7	-12.0	-10.5	-8.9
Fiscal balance (% of GDP)	-2.3	-0.7	-0.7	-1.8	-2.8	-2.5	-2.7	-2.7	-2.0	-2.0	-2.1
Public debt (% of GDP)	40.6	33.1	34.1	38.6	44.3	44.5	44.5	44.2	44.8	45.5	46.2
<b>Sint Maarten</b>											
Real GDP growth (% change)	-1.5	1.7	0.9	1.5	0.5	0.7	0.9	1.1	1.1	1.2	1.3
Current account (% of GDP)	-0.5	9.5	0.4	-10.5	2.2	2.3	2.6	2.3	2.5	2.5	2.9
Fiscal balance (% of GDP)	0.7	0.4	-0.8	-4.5	-1.3	-0.8	-1.0	-0.8	-0.7	-0.7	-0.7
Public debt (% of GDP)	27.3	20.0	24.3	37.1	36.5	36.7	36.7	36.3	35.7	35.0	34.3

Sources: Central Bank; and IMF Staff Estimates.

### 12. On the external side, the Union's current account deficit is projected to gradually improve over the medium term.

The deficit is expected to narrow in 2016, reflecting projections for lower oil prices and higher tourism receipts, notwithstanding higher imports of construction material related to public investment projects (particularly the construction of a new hospital in Curaçao). Given adequate external financing, including from foreign direct investments, debt issues, and a decrease in foreign assets, the Union's net international reserves are projected to increase in 2016. Going forward, the Union's external imbalances are expected to gradually decline as tourism demand picks up. Nevertheless, given the reliance on a narrow scope of products and markets,

considerable risks remain, underscoring the need to improve competitiveness, reduce vulnerabilities to external shocks, and build external buffers to ensure external sustainability going forward. Staff estimates, which are based on limited data and subject to considerable uncertainty, suggest that Curaçao's REER is somewhat undervalued, while that of Sint Maarten is somewhat overvalued (Annex II).

**13. On current policies, Curaçao's fiscal position is expected to gradually improve, but public debt will continue to build up.** The primary deficit is projected to narrow to 1.4 percent of GDP in 2016, and will further decline to 0.8 percent of GDP over the medium term, as the hospital

construction gradually winds down. The tax-to-GDP-ratio is projected to decrease moderately as another round of profit tax rate cut (from 25 percent to 22 percent) became effective in

2016, with revenue losses expected to be only partially offset by reduced deductions and strengthened compliance.<sup>6</sup> The government's current account balance (after accounting for the consumption of fixed capital, i.e. depreciation), is just above zero in 2016. Close expenditure management and strict budget execution will be needed to ensure compliance with the fiscal rules (¶26).

Curaçao: Selected Medium-Term Fiscal Indicators							
(In percent of GDP)							
	2015	2016	2017	2018	2019	2020	2021
Total revenue	30.9	43.7	42.8	42.1	41.6	41.5	41.4
Tax revenue	25.7	25.1	25.3	25.3	25.2	25.2	25.2
Total expenditure	29.7	42.6	41.9	41.3	40.7	40.6	40.6
Overall balance	-2.8	-2.5	-2.7	-2.7	-2.0	-2.0	-2.1
Primary balance	-1.7	-1.4	-1.5	-1.5	-0.8	-0.8	-0.8
Public Debt	44.3	44.5	44.5	44.2	44.8	45.5	46.2

Sources: Central Bank; and IMF Staff Estimates.

**14. Sint Maarten's fiscal position is expected to improve, with higher revenue mobilization.** The

primary deficit is expected to decline slightly to 0.1 percent of GDP in 2016, from 0.6 percent in 2015. The tax-to-GDP ratio is expected to increase to

Sint Maarten: Selected Medium-Term Fiscal Indicators							
(In percent of GDP)							
	2015	2016	2017	2018	2019	2020	2021
Total revenue	23.1	23.9	23.6	23.7	23.8	23.8	23.8
Tax revenue	20.3	20.5	20.4	20.5	20.5	20.5	20.5
Total expenditure	24.4	24.7	24.6	24.6	24.6	24.5	24.5
Overall balance	-1.3	-0.8	-1.0	-0.8	-0.7	-0.7	-0.7
Primary balance	-0.6	-0.1	-0.3	-0.2	-0.2	-0.2	-0.2
Public Debt	36.5	36.7	36.7	36.3	35.7	35.0	34.3

Sources: Central Bank; and IMF Staff Estimates.

20.5 percent in 2016, from 20.3 percent in 2015, based on stronger tax collection (including on casino tax). Other revenues are also expected to increase in 2016, with the projected receipt of dividends from the central bank. The debt-to-GDP ratio will increase marginally to 36.7 percent of GDP at end 2016, relative to 36.5 percent at end 2015.

**15. Risks to the macroeconomic outlook are tilted to the downside (Annex I).** Continued low growth in the Euro-euro Area-area could negatively affect Curaçao and Sint Maarten through trade, tourism, remittances, and investment channels. Persistent strengthening in the U.S. dollar

<sup>6</sup> The profit tax (levied on corporate income) rate has been reduced from 34.5 percent to 27.5 percent in 2012, and then from 27.5 percent to 25 percent in 2015.

could lead to further appreciation of the REER, and a loss in competitiveness vis-à-vis European and Canadian tourists. Reduced financial services by global/regional banks could result in disruptions to banking services, hindering cross-border financial transactions. Given the close trade relationship, Curaçao remains vulnerable to a further disruption of economic activity in Venezuela (Annex IV). Other downside risks include slow implementation of planned structural reforms, an outbreak of Zika, and a natural disaster in Sint Maarten. Upside risks include improving economic prospects in the U.S. generating tourism for Sint Maarten, higher investment flows through major tourism projects, and spillover and productivity gains through higher public investment if managed prudently.

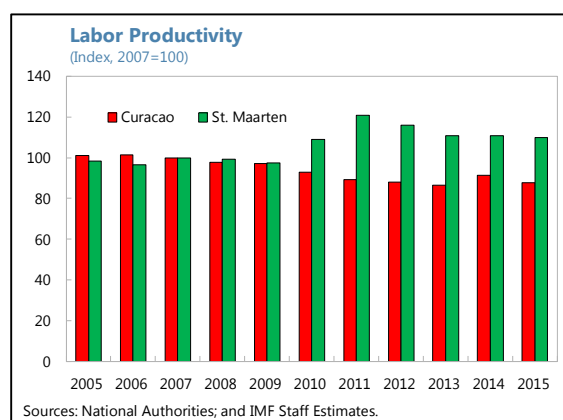
**16. With the current low levels and favorable public and external debt dynamics for Curaçao and Sint Maarten, the Debt Sustainability Analysis (DSA) finds the risk of debt distress low, but the debt paths are sensitive to shocks** (Annex III). In Curaçao, while public debt is already on an upward trend, a combined macro-fiscal shock<sup>7</sup> could add another 10 percentage points to its debt-to-GDP ratio. Besides, under a full-blown Venezuela shock scenario (where all trade links between the two countries are removed and the refinery business comes to a complete stop in 2019), Curaçao's debt-to-GDP ratio could end up 7½ percentage points above the baseline by 2021. In Sint Maarten, the debt-to-GDP ratio is projected to increase by 10 percentage points under a hurricane scenario (assuming a 10 percent of GDP increase in government expenditure in 2017 to cover post-disaster reconstruction needs). Both island's significant vulnerability to shocks calls for the authorities' sustained efforts on reforms to strengthen their fiscal frameworks, build policy buffers, improve external competitiveness, and unlock growth potential.

## POLICY DISCUSSIONS

### A. Growth and Competitiveness

#### Background

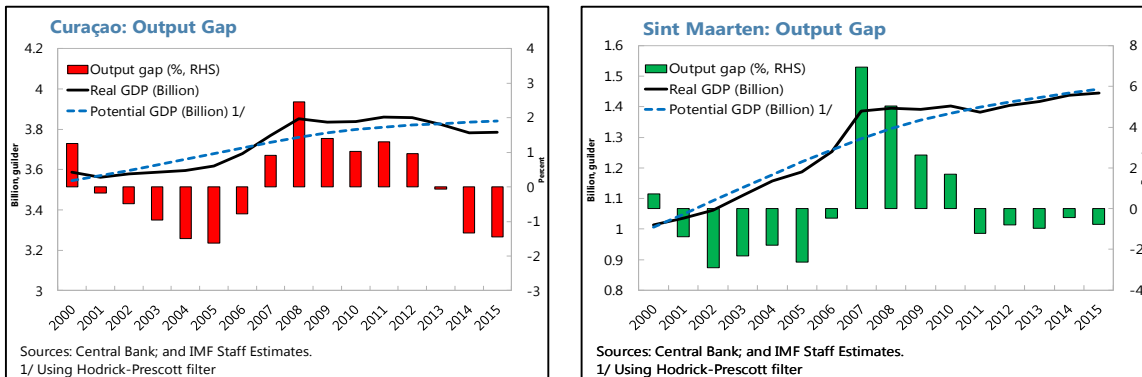
**17. Both economies continue to operate below capacity, exhibiting low convergence towards potential growth.** Labor productivity growth remains low, negatively impacting output growth and competitiveness (text chart), particularly in Curaçao, where labor productivity growth has averaged -0.2 percent over 2012-15. Meanwhile, broader competitiveness indicators are mixed, pointing to high labor costs, subdued inflation and a moderate increase in the number



<sup>7</sup> Real growth one standard deviation lower and primary balance one half standard deviation lower than the baseline in 2017-18



of stay-over tourist arrivals (but a decline in market share) in both countries (Annex II).



## Policy Discussions

**18. The mission welcomes the authorities' ambitious plans to strengthen competitiveness and reinvigorate their economies through important structural reforms.** In Curaçao, the National Development Plan 2015–30 aims at encouraging foreign direct investment, stimulating priority sectors with potential for higher value added (including the free zone, maritime and aviation sectors), ensuring inclusive quality education, and promoting good governance. In Sint Maarten, where tourism represents ~~a the higher highest~~ share of the economy, a tourism authority has been recently established and a development plan is currently being discussed, to diversify the tourism sector, reduce its seasonality, and increase value-added.

**19. Given the Union's small population base, a flexible labor market equipped with appropriate skills is needed to improve competitiveness and growth potential.** In Curaçao, labor market reforms should focus on addressing restrictive dismissal laws and protective work permit policies (for foreign labor) that hinder labor market flexibility (Box 2). Although the labor market in Sint Maarten is less restrictive, efforts are needed to improve efficiency and timeliness in granting required permits for foreign workers. To address mismatches in skills, the authorities in both islands have recognized the need to refocus the education system. The mission recommends renewed efforts to improve vocational education and develop targeted training programs to strengthen skills and improve productivity. The Sint Maarten authorities have recently embarked on a government-sponsored employment program to address high youth unemployment. Close monitoring and assessment of program deliverables will be critical to ensure the effective deployment of public resources.

### Box 2. Labor Market Issues

**Low growth and high unemployment underscore the need to address declining labor market productivity and improve labor market flexibility in the Union.** Unemployment remains high, especially among the youth in both Curaçao and Sint Maarten. At the same time, the work force cannot adequately meet the demand for labor. The focus of labor market policy, including on flexibility, has shifted frequently and contributes to uncertainty.

**Education systems and technical and vocational training are currently not fully aligned to meet the countries' needs.** This exacerbates issues related to small populations and migration, which also contribute to a mismatch between the supply and the demand for labor. There are also limited quality technical and vocational training institutions and no certifying institutions. The authorities also recognize the need for greater focus on building soft skills and on career mentoring to help better prepare young people for the work place.

**Generous welfare benefits act as a disincentive to employment in the formal sector contributing to a high reservation wage, particularly in Curaçao.** Unemployment benefits in Curaçao often exceed the minimum wage, covering, among other things, housing, healthcare costs, and provide subsidies for water and electricity. This could incentivize persons to work in the informal sector while collecting benefits. Although Curaçao has implemented reforms to reduce fraud and now requires that persons receiving welfare undergo training and actively seek employment, controls are often weak. Sint Maarten's welfare benefits are less generous at approximately 67 percent of the minimum wage.

**Restrictions on hiring foreign workers limit the ability to fill employment gaps.** Both countries require that persons seeking employment are sponsored by an employer, and that the employer initiates the application for the work permit. In addition, the employer must show that the vacancy was advertised in the local market without success. In Curaçao, the Permit department is faced with a number of challenges, including an insufficient budget, understaffing, and inadequate office space, which has led to a backlog in permits, beyond the six weeks' maximum required by law. While Sint Maarten processes work permits in 2 weeks, the process is lengthened by the need to first obtain a landing permit, which can take 3-4 weeks.

**Dismissal laws are also inflexible in both countries.** This has encouraged the use of short-term contracts rather than the creation of stable employment. As such, even where the skills required are available locally, these posts may not be filled, given the limited job security they provide.

**20. Staff emphasized that improving the business climate is critical to reigniting investor confidence, promoting private sector activity, and attracting foreign direct investment.** The mission therefore welcomes the authorities' efforts in both islands to rationalize business licensing requirements, reduce transportation costs, and promote fair competition. The mission also endorses the authorities' plan to proactively address red tape through centralization and streamlining of business registration processes, and to improve efficiency in government services and reduce transaction costs. In addition, maintaining a stable political environment and ensuring policy continuity is critical to promoting long term business investment decisions.

**21. Staff urged the authorities to quickly advance implementation of energy sector reforms geared toward cost reduction and long term sustainability to improve competitiveness and build resilience.** As in many other Caribbean islands, energy costs are high in Curaçao and Sint Maarten, where high reliance on imported-fossil-fuel-based generation increases their vulnerability to external shocks.<sup>8</sup> The authorities in both islands have recognized, through their national development plans, the importance of diversifying the generation mix through the development of renewable energy. Follow through with steadfast implementation is critical to reducing energy costs and achieving a stable, sustainable and clean energy future. Moreover, the energy sector regulatory framework needs to be strengthened in Sint Maarten by introducing an independent regulator.<sup>9</sup>

**22. Authorities' views.** The authorities concurred with staff about the importance of removing impediments to private sector activity by enhancing the doing business and labor market conditions. They stressed that vocational education and skills training are among the key priorities for addressing skills mismatches, unlocking growth, and improving competitiveness over the medium term. Regarding energy sector reforms, the authorities noted that several initiatives for renewable energy have been considered, including wind and solar power, seawater cooling, and "waste-to-energy", under their national development plans.

## B. Strengthening Fiscal Framework and Building Buffers

### Background

**23. The Union has a rules-based fiscal policy framework monitored by the Board for Financial Oversight (CftCF in Dutch).** Each island submits its budget to the CftCF, who verifies the realism of the assumptions and the adherence to the rules-based framework, and if necessary recommends changes to the budget. The CftCF's function is reviewed every three years, to ascertain whether there remains a need for continued oversight and the accompanying low-cost "standing subscription" borrowing arrangement, which allows both countries to borrow at prevailing rates in

<sup>8</sup> In both Curaçao and Sint Maarten, electricity generation is provided by a single government-owned company with a monopoly also on distribution. Although state-owned, no subsidy currently exists and the electricity tariffs comprise two components: i) the base component to cover all non-direct production costs, and ii) the fuel component that is determined by international oil prices and adjusted monthly.

<sup>9</sup> Energy pricing has been regulated by an independent regulator in Curaçao since ~~2009~~2010.

the Dutch capital market. The most recent review was undertaken in 2015, which extended the CftFF's function till 2018.

## Policy Discussions

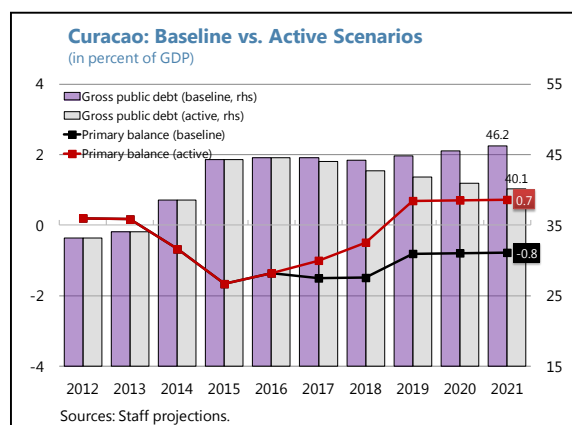
**24. Staff proposed that the current rules-based framework be strengthened to ensure fiscal and debt sustainability.** While the framework provides a strong basis for containing short-term fiscal risks, it does not provide a sufficient medium term anchor for debt sustainability. A strengthened fiscal framework is particularly important in the context of the upcoming 2018 review of the Board ~~of for~~ Financial Supervision (CftFF in Dutch) oversight function and the current low-cost “standing subscription” borrowing arrangement.<sup>10</sup> If the agreement was to be discontinued following the review without an agreement for the refinancing of debt incurred under the current access to low rate financing, net flows from the Dutch borrowing arrangement could turn negative, resulting in higher interest costs going forward. The increase in borrowing costs, would over time erode the gains from debt relief and put public debt on an upward trend. Moreover, rising interest costs will make it increasingly difficult to satisfy the “interest burden rule” and accelerate debt accumulation. Hence, staff proposes that the rules be supported by adopting a medium-term macro-fiscal framework that includes a primary balance target consistent with a long-run debt anchor of 40 percent of GDP, which is around the median level of developing and emerging countries. The 40 percent of GDP target is also the benchmark debt ratio used in the standard Fiscal Monitor long-term adjustment needs scenario for emerging market economies, and is consistent with the debt norm proposed by the CftFF for Curaçao and Sint Maarten.

**25. In addition, the fiscal framework should allow adequate flexibility and be complemented by improved effectiveness of public spending and capacity building to strengthen public institutions and fiscal discipline.** Staff's proposed strengthened framework would ensure the flexibility needed to accommodate the investment in skills development, crucial to unlocking growth, and allows adequate flexibility to accommodate temporary deviations over economic cycles and in the case of natural disasters and other emergencies. The fiscal framework should also include a corrective mechanism with clearly spelt out fiscal measures to correct for any temporary deviations from the target.

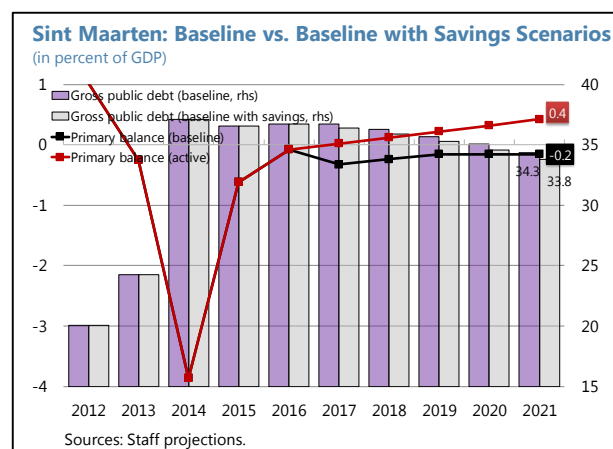
<sup>10</sup> There has been no formal commitment that the CftFF oversight and the “standing subscription” arrangement will or will not be extended after the 2018 review. However, staff suggested to the authorities that a stronger fiscal framework would increase their ability to avoid and/or withstand a potential large interest rate risk.

**(i) Curaçao**

**26. To mitigate medium-term risks, staff discussed with the authorities a fiscal framework that envisages a 1.5 percent of GDP adjustment phased evenly over 2017-19.** This framework is anchored by a 40 percent of GDP long term debt target, and is operated via targets on the primary balance. The adjustments in the primary balance needed for the public debt to gradually decline and stabilize at 40 percent could be achieved by: (i) improving tax compliance (0.5 percent of GDP), (ii) reducing personnel expenditure through attrition and implementation of merit-based salary increments (0.4 percent of GDP), and (iii) containing national health insurance expenses through cost restructuring (0.6 percent of GDP). In this respect, the authorities have made significant efforts to strengthen tax administration (¶29). Important progress has also been made in improving the financial performance of state-owned enterprises, except for the financially-challenged postal corporation, for which an action plan is being finalized (Box 3). However, despite recent reforms, the ~~old-age pension~~national health insurance fund (BVZAQV) remains in deficit and heavily reliant on budgetary transfers, which could pose a risk to medium-term fiscal sustainability (¶29 and Annex V).

**(ii) Sint Maarten**

**27. Staff recommended that policy focus on building fiscal buffers for natural disasters, and strengthening institutional capacity to support prudent fiscal management and preserve fiscal and debt sustainability.** As public debt in Sint Maarten is projected to remain below 40 percent of GDP under staff's baseline scenario, staff do<sup>es</sup> not envision a need for immediate upfront fiscal consolidation. However, unlike Curaçao, Sint Maarten lies within the Hurricane belt, underscoring the need to build fiscal buffers for natural disasters. The authorities agree with staff's recommendation to set aside budget resources annually as precautionary savings for natural disasters, and indicate that while the annual budget already includes a buffer for natural disasters, unspent amounts are not saved. The staff recommended the authorities establish a dedicated account for this purpose to support immediate rehabilitation needs. The mission proposes that the authorities target saving a minimum of 0.1 percent of GDP per annum, relative to staff's baseline projections, based on estimated damages from previous



natural disaster events in the region. In this regard, the authorities agree that this goal can be achieved through measures to improve tax administration, and mobilize revenues. In addition, future consideration could be given to replacing the sales turnover tax with an efficient and sufficiently broad based value added tax (VAT). While the authorities do not see much room to adjust expenditures, staff encouraged the authorities to explore measures to contain the wage bill, which remains above 10 percent of GDP, to make room for other critical spending, including on human capital development.

**28. Staff welcomes the authorities' capacity building efforts, particularly to improve tax administration and public financial management (PFM), and achieve compliance with the fiscal rules.** The mission welcomes steps taken by the authorities in Curaçao to improve tax administration, by reducing backlogs in tax assessments and the treatment of objections, rationalizing tax receivables, as well as efforts to improve compliance (including the introduction of fiscal cash registers). Staff encourages Sint Maarten to implement similar measures and, importantly, to take steps to develop human capacity in tax administration. Further efforts are needed in both islands to improve budget formulation and cash flow management, and other key areas highlighted in the 2015 [Public Expenditure and Financial Accountability \(PEFA\)](#) assessments, supported by the [CfEFF](#). Addressing these weaknesses will require a clear action plan supported by systematic technical assistance to assist the authorities to implement the plan. It is also critical that both governments implement measures to support the production of timely fiscal and macroeconomic statistics, essential to public policy formulation.

**29. Staff welcomed the progress made in reducing risks associated with state-owned enterprises (SOEs) and social security systems.** The financial position of SOEs has improved significantly, however, further steps should be taken to address deficit making institutions, in particular Curaçao's post office, and to ensure transparency and good governance (Box 3). Recent reforms to the social security and pension systems have helped mitigate short term risks, but policy focus should shift toward addressing medium to long term system shortfalls, and ensuring their sustainability. Strong efforts are also required to reduce risks related to increasing healthcare costs.

### Box 3. Fiscal Risks and State-owned Enterprises

**State-owned enterprises (SOEs) are a key source of fiscal risk for Curaçao and Sint Maarten.**

Risks related to unexpected changes in macroeconomic variables are relatively low, following the debt relief program, which assures low cost financing in local currency. However, SOEs present a potentially significant source of fiscal risk, underscoring the need to ensure transparency and accountability within these institutions, and for measures to address inefficiencies.

**At the time of the 2014 Article IV Consultation discussions, staff identified several issues related to transparency and oversight of SOEs.** For Curaçao, above-market wages and other inefficiencies translated into a high cost of doing business. While in Sint Maarten, in the absence of a clear dividend policy, profitable SOEs minimized their contribution to the public budget.

**Since then, Curaçao has made significant progress in strengthening the financial position of SOEs.** The financial situation in all but one of four high-risk state-owned enterprises has improved significantly over the last two years, based on reforms instituted by the authorities.

- **Aqualectra**, the utility company, took steps to better align employee compensation with market norms, and to ensure that prices reflect the full pass-through of oil prices. Importantly, Aqualectra has been able to recover losses from previous years by adding a “recovery price” to the regular price. The authorities are also negotiating the return of assets, previously distributed to the refinery at no cost.
- **Analytic Diagnostic Center**, the medical laboratory, in addition to realigning employee compensation, took steps to reduce over-staffing, improve the invoicing process, contain operational costs, and improve debt collection.
- **Curaçao Dry Dock Company (CDM)** settled claims from previous employees, related to poor working conditions and underpayment, and prospects for the company have improved with the signing of a LOI with an international strategic partner. The partnership is expected to bring in new investments and increase the Dry Dock’s capacity to meet the demand for its main line of business, ship repair services.
- **CPost**, the post office, remains a high-risk entity as the action plan, developed to improve its financial position, has not been fully implemented. The cost of providing services remains higher than revenues, with losses amounting to NA f.f. 3-4 million guilders (US\$1.7 million – US\$2.2 million) annually. This in part reflects discounts to the government and the Social Security Bank, making the plans politically challenging to implement.

**In Sint Maarten, SOEs have historically not been a drain on government resources.** The authorities have recently drafted a dividend policy to provide a framework for remitting dividends to the government. While the draft policy identifies the relevant financial ratios that can be used to determine whether a dividend can be paid to the government, the decisions to pay a dividend and the amount are left to the institutionshareholders. The authorities believe that the SOEs are better able to decide when they can pay a dividend, based on their position and future plans, and prefer not to set explicit terms.

**30. Authorities' views.** The authorities agreed in principle on the appropriateness of staff's proposed medium-term fiscal framework, but were of the view that, while 40 percent is a reasonable target, the decision on the level of the debt target should be left to the individual governing authorities. In the area of tax administration, the Sint Maarten authorities highlight human capital as the most significant challenge, and note that the need to balance the current budget constrains spending on skills development and capacity building, therefore limiting progress in this area. The authorities are taking steps to integrate the tax administration function, which is currently separated into two departments, the Tax Assessment Department and the Audit and Control Department. They are also exploring the possibility of utilizing the ~~ICT~~-financial tax software system shared by the Dutch municipalities (Bonaire, St Eustatius, and Saba) and Curaçao. This would not only be an improvement over the current system<sup>s</sup>, which is outdated, but would allow for shared costs. They recognize the potential benefits from adopting a VAT but indicate their first priority is improving tax administration.

## C. Maintaining Financial Stability

### Policy Discussions

**31. The financial sector is generally stable with no imminent systemic risk, supported by strengthened supervision at both sector and institution levels.** The central bank's Early Warning Monitoring System has been enhanced to allow better assessment of financial sector soundness and to enable the central bank to perform regular stress tests to assess financial sector resilience. A risk-based rating model is also embedded in the system to detect financial sector weak spots, complementing targeted supervision. Stability indices, on financial sector soundness, tracked by the central bank for the domestic banking, insurance and pension sectors (which account for approximately 95 percent of total financial sector assets) have remained stable over the past five years.<sup>11</sup> However, given macroeconomic uncertainties going forward and recent deterioration in bank asset quality and profitability, staff encouraged the authorities to continue their efforts to strengthen financial oversight (especially in the non-bank sector), through on-site and off-site supervision.

**32. Sustained efforts are needed to strengthen the AML/CFT framework in line with the FATF standard and mitigate perceived ML/TF risks.** In this regard, the authorities have recently updated their AML/CFT legislation and issued new compliance guidelines and criteria to the financial institutions based on FATF recommendations. An action plan to address strategic deficiencies identified following Sint Maarten's assessment of its AML/CFT framework by the CFATF is currently under review. The authorities are encouraged to fully address remaining regulatory gaps and ensure effective risk-based implementation of the AML/CFT regime.

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<sup>11</sup> Stability indices comprise five indicators including asset quality, capital adequacy, liquidity, profitability, and sensitivity to market risk.



**33. Some small local banks in Curaçao have recently experienced a loss of CBRs.** While existing CBRs with large European banks could provide a temporary buffer in the short run, staff encouraged the authorities to continue monitoring the status of CBRs and address reputational risk by strengthening their compliance with AML/CFT and transparency of tax information standards.

**34. Staff continued to emphasize that the central bank should refrain from direct lending to SOEs, which could cause market distortions.** The central bank embarked on an asset purchase program to build a portfolio of corporate bonds with an ultimate goal to create a substitute for the conduct of open-market operations, as [the](#) short term government security market dried up since 2010.<sup>12</sup> There has been no new purchase since 2012 and currently there are two loans (both to SOEs) in the portfolio. Staff has urged the authorities to restrain from further central bank direct lending and to continue their efforts to further develop a corporate bond market, to provide financing alternative to bank financing for SOEs and private entities, and to create more local investment opportunities.

**35. Authorities' views.** The authorities concurred with staff about the importance of strengthening financial regulation and supervision. They noted that draft legislation to harmonize and update prevailing supervision laws, which is in the last phase of the legislative process, will enable the central bank to execute its supervisory tasks more effectively, and a new Chart of Accounts reporting system will further strengthen the central bank's oversight function. The authorities expressed their deep concerns over the recent and potential further loss of CBRs and are committed to proactively identifying and addressing vulnerabilities in the financial sector.<sup>13</sup> Regarding the central bank's lending to SOEs, the authorities committed to bring it to a close once the two existing loans mature.<sup>14</sup>

## STAFF APPRAISAL

**36. The economic recovery and a stronger fiscal position have helped reduce near-term risks.** Curaçao ended a three-year recession in 2015, despite the deterioration in macroeconomic conditions in Venezuela—one of the island's main trading partners. Expansion in Sint Maarten's economy continued into the fourth consecutive year, despite a modest deceleration. The Union's external and fiscal imbalances have also declined, with favorable external conditions and the authorities' fiscal consolidation efforts, but vulnerabilities to external shocks remain given its reliance on a narrow scope of products and markets.

<sup>12</sup> The "standing subscription" arrangement under the 2010 debt relief agreement allows the governments to borrow at ultralow rates (Dutch levels) from the Dutch Treasury, which inadvertently caused the local market for government securities to dry up, depriving the central bank of an important policy instrument.

<sup>13</sup> A high level delegation (consisting of the central bank president and the ministers of finance from both islands) visited Washington and held discussions with the U.S. officials in June 2016.

<sup>14</sup> They are currently in discussion with a regional bank for divestment of one of the two loans before its maturity.

**37. However, risks to medium-term growth prospects remain to the downside.** Continued low growth in the euro area could have serious economic repercussions for Curaçao and Sint Maarten through various channels, given that both islands remain heavily reliant on the euro area. Further disruptions in Venezuela could worsen Curaçao's growth prospects and balance of payments if no alternative export markets are identified. Meanwhile, a loss of CBRs could hinder cross-border transactions, adding to the macroeconomic uncertainties. In addition, slow progress in implementing needed structural reforms also poses an important downside risk to growth prospects going forward.

**38. Unlocking growth through economic diversification and investment promotion is therefore imperative in this environment.** In this respect, the authorities' national development plans are an important step toward charting a clearer direction for strategic sectors and markets and removing impediments to private sector activity. Implementation of the plans is key, in particular, on decisive structural reforms to improve the labor market and doing business conditions, as well as energy sector reforms to diversify energy generation via renewable sources.

**39. A sound medium term fiscal framework will help reinforce macro stability anchored by the fixed exchange rate.** With the limited effective monetary and exchange rate policy instruments, given the fixed exchange rate regime, fiscal policy is the authorities' only available option to cushion economic shocks. A sound medium term fiscal framework, equipped with clear objectives and targets and supported by a proven track record could improve credibility, bolster investor confidence, and promote investment.

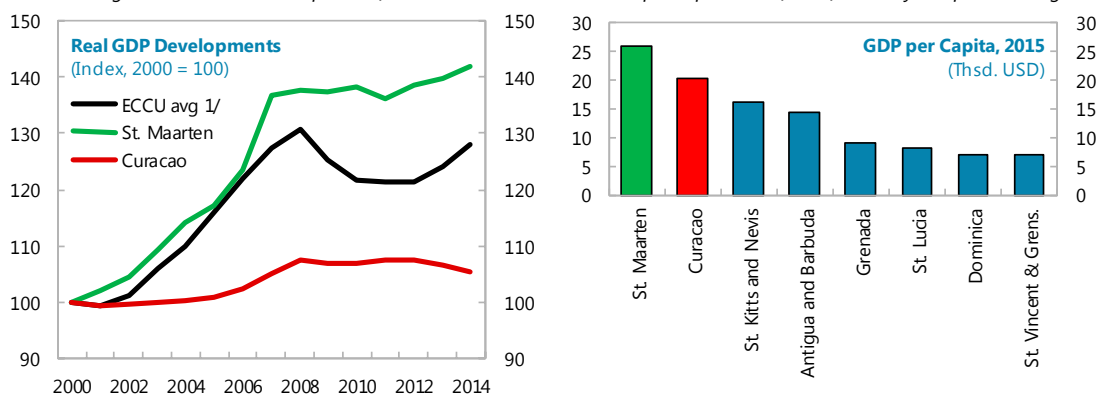
**40. In this regard, important structural fiscal reforms are needed to further strengthen fiscal discipline.** In particular, weaknesses in tax administration and public financial management have been identified in both islands. Staff welcome the authorities' efforts to strengthen tax administration to enhance revenue mobilization, improve taxpayer services, and increase tax compliance. These are important prerequisites for future tax policy reforms contemplated by the authorities. In addition, an action plan is greatly needed to ensure timely and decisive implementation of measures to strengthening public financial management, in line with PEFA assessment recommendations.

**41. Strengthened financial supervision has become more important given increasing international scrutiny.** The authorities are advised to strengthen risk-based financial supervision and effective implementation of cross-border tax information sharing, as well as AML/CFT frameworks in line with international standards. In a context of evolving regulatory requirements and enforcement landscape, Curaçao and Sint Maarten's ability to strengthen transparency, including in Curaçao's international financial center, will help reduce the perceived reputational risks. A stable financial sector is also critical to supporting economic growth and private sector activities.

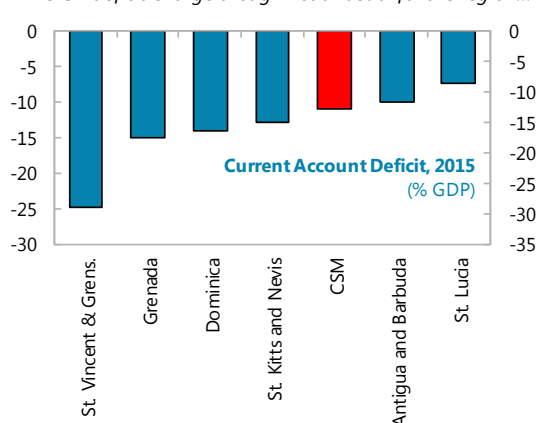
**42. Capacity building is needed to strengthen public institutions.** Policy implementation has been greatly challenged by capacity issues in both islands, as in most other Caribbean small states. Investment in human capital development is critical to strengthening public institutions and

**Figure 1. Key indicators for Curaçao and Sint Maarten in a Regional Comparison**

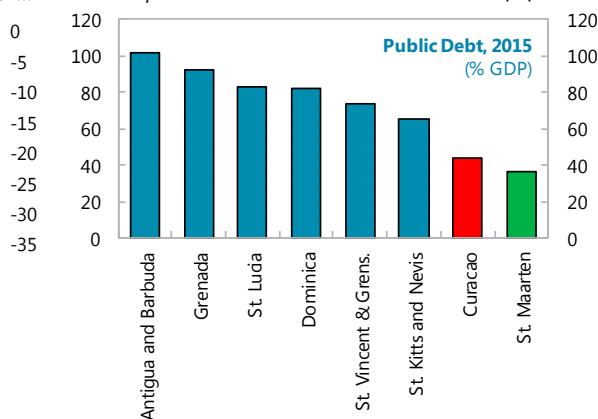
Real GDP growth shows a mixed picture for the two countries.....while per capita GDP fares favorably compared to regional peers.



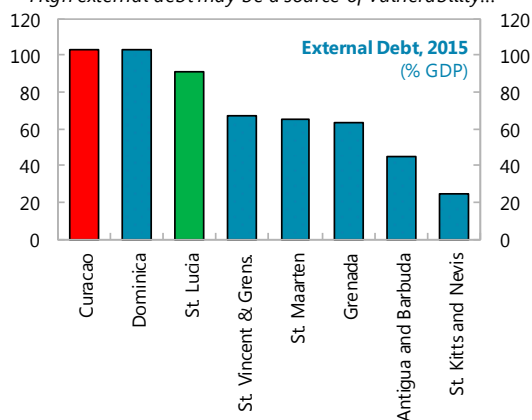
The CA deficit is large though not unusual for the region...



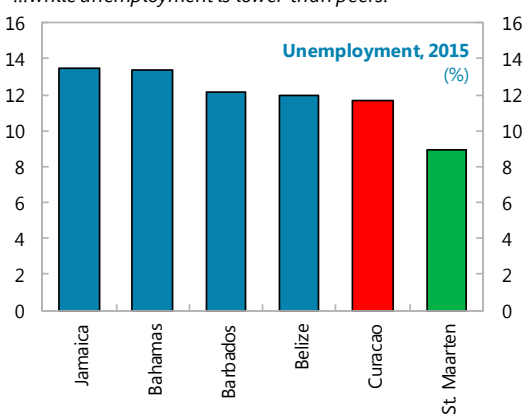
...while public debt is low thanks to the debt relief of 2010.



High external debt may be a source of vulnerability...



...while unemployment is lower than peers.



Sources: IMF World Economic Outlook, CBCS, National Authorities; and IMF Staff Estimates.

1/ Unweighted average of indices for Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines.

**Table 5. Curaçao and Sint Maarten: Balance of Payments, 2011–21**

(In millions of Netherlands' Antilles-Guilders) (In millions of US dollars)

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
									Proj.		
<b>Current account</b>	-835	-782	-659	-486	-458	-458	-420	-396	-373	-331	-282
(percent of GDP)	-20.6	-19.0	-15.8	-11.5	-10.9	-10.8	-9.5	-8.8	-8.2	-7.0	-5.8
Goods and services	-711	-619	-482	-336	-343	-363	-342	-317	-295	-249	-203
(percent of GDP)	-17.5	-15.0	-11.6	-8.0	-8.2	-8.6	-7.7	-7.1	-6.5	-5.3	-4.2
Exports of goods and services	3188	3543	3502	3663	3240	3203	3286	3383	3491	3637	3789
Goods	1057	1079	866	832	606	595	614	638	666	699	733
Services	2131	2464	2636	2832	2634	2608	2672	2745	2825	2938	3056
Imports of goods and services	3899	4163	3984	4000	3583	3565	3628	3700	3785	3886	3992
Goods	2865	3022	2831	2832	2402	2398	2443	2495	2555	2631	2711
Services	1033	1141	1154	1168	1181	1168	1185	1205	1231	1255	1281
Income	-48.8	-74.2	-76.6	-73.3	-50.0	-42.3	-28.2	-22.4	-21.5	-22.4	-16.9
Compensation of employees	1.2	-4.7	7.3	-0.8	6.5	7.2	13.6	18.6	19.8	20.2	27.0
Investment income	-50.0	-69.5	-83.9	-72.5	-56.5	-49.4	-41.9	-41.0	-41.3	-42.6	-43.9
Current transfers	-75.3	-88.7	-99.5	-76.5	-64.7	-53.1	-49.7	-56.3	-57.5	-59.6	-61.8
(percent of GDP)	-1.9	-2.2	-2.4	-1.8	-1.5	-1.3	-1.1	-1.3	-1.3	-1.3	-1.3
<b>Capital and financial account</b>	823	553	573	677	421	484	448	420	394	357	305
Capital account	69	39	35	13	-4	-4	-4	-4	-4	-4	-4
Financial account	754	514	538	664	425	488	452	424	397	360	308
Direct investment	49	74	78	72	116	148	149	151	153	141	146
Portfolio investment	103	327	157	440	326	204	192	193	163	134	108
Financial derivatives	0	0	0	0	0	0	0	0	0	0	0
Other investment	602	113	303	152	-17	136	112	80	81	85	54
Reserve assets	-27	155	27	-257	-16	-26	-29	-24	-20	-25	-23
<b>Reserves and external debt</b>	-115.5	-155.1	-27.0	256.9	15.5	26.1	28.9	24.1	20.2	25.3	23.0
Gross Reserves, excluding gold	1290	1135	1108	1365	1380	1406	1435	1459	1480	1505	1528
Net Official reserves	1493	1496	1316	1605	1614	1645	1681	1710	1734	1765	1793
in months of goods imports	6.3	5.9	5.6	6.8	8.1	8.2	8.3	8.2	8.1	8.0	7.9
over short term debt	1.1	1.3	1.0	1.2	1.2	1.2	1.2	1.2	1.1	1.1	1.1
Gross external debt (percent of GDP)	83.4	76.3	80.0	86.6	93.7	98.9	100.2	103.7	106.2	106.1	105.1
of which short term debt	33.0	27.2	30.9	32.0	32.4	32.0	32.2	33.1	33.7	33.5	33.0
<b>Memorandum item:</b>											
GDP at current prices	4054	4116	4164	4211	4206	4235	4413	4480	4553	4712	4875
Current Account (percent of GDP)											
St. Maarten	-0.5	9.5	0.4	-10.5	2.2	2.3	2.6	2.3	2.5	2.5	2.9
Curacao	-27.3	-27.9	-21.0	-11.9	-15.3	-15.3	-13.6	-12.7	-12.0	-10.5	-8.9
G & S Balance (percent of GDP)											
St. Maarten	5.7	14.3	4.0	-5.0	8.5	7.2	6.5	6.1	6.3	6.3	6.2
Curacao	-25.3	-24.2	-16.6	-9.0	-13.8	-14.0	-12.5	-11.6	-11.0	-9.5	-7.9
Exports of Goods											
St. Maarten	127	131	164	132	129	130	134	143	154	167	180
Curacao	930	948	701	699	477	465	480	496	512	532	553
Exports of Services											
St. Maarten	903	1043	1065	1120	1131	1142	1159	1182	1212	1260	1311
Curacao	1228	1422	1571	1712	1503	1466	1513	1563	1613	1678	1745
Imports of Goods and Services											
St. Maarten	972	1033	1190	1305	1169	1194	1221	1255	1291	1348	1409
Curacao	2926	3130	2795	2695	2414	2371	2407	2446	2494	2538	2583

Sources: Central Bank of Curaçao and St. Maarten; and IMF Staff Estimates.

**Table 6. Curaçao: Balance of Payments, 2011–21**

	(In millions of Netherlands' Antilles Guilders) (In millions of US dollars)										
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
									Proj.		
<b>Current account</b>	-830	-876	-663	-376	-481	-484	-448	-422	-403	-363	-320
(percent of GDP)	-27.3	-27.9	-21.0	-11.9	-15.3	-15.3	-13.6	-12.7	-12.0	-10.5	-8.9
Goods and services	-768	-760	-523	-283	-434	-441	-414	-387	-369	-328	-284
(percent of GDP)	-25.3	-24.2	-16.6	-9.0	-13.8	-14.0	-12.5	-11.6	-11.0	-9.5	-7.9
Exports of goods and services	2158	2370	2272	2412	1980	1931	1993	2058	2125	2210	2298
Goods	930	948	701	699	477	465	480	496	512	532	553
Services	1228	1422	1571	1712	1503	1466	1513	1563	1613	1678	1745
Imports of goods and services	2,926	3,130	2,795	2,695	2,414	2,371	2,407	2,446	2,494	2,538	2,583
Goods	2,132	2,254	1,906	1,819	1,512	1,486	1,508	1,532	1,563	1,590	1,618
Services	795	875	889	876	901	885	899	913	931	948	964
Income	-13.8	-43.6	-53.8	-27.5	0.9	-11.1	-1.7	-1.7	0.0	0.0	0.0
Compensation of employees	27.9	23.2	26.7	33.7	42.6	39.5	41.3	41.6	43.7	45.1	46.5
Investment income	-41.7	-66.8	-80.5	-61.2	-41.8	-50.5	-43.0	-43.3	-43.7	-45.1	-46.5
Current transfers	-48.0	-72.4	-86.1	-65.1	-48.4	-31.6	-33.0	-33.3	-33.6	-34.7	-35.8
(percent of GDP)	-1.6	-2.3	-2.7	-2.1	-1.5	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
<b>Capital and financial account</b>	817	739	637	529	457	502	459	429	417	378	329
Capital account	54	27	26	9	-3	-3	-3	-3	-3	-3	-3
Financial account	764	712	611	520	460	505	463	433	420	381	333
Direct investment	99	58	34	25	88	111	116	117	118	104	107
Portfolio investment	132	365	198	340	335	205	182	183	168	139	118
Financial derivatives	0	0	0	0	0	0	0	0	0	0	0
Other investment	532	289	379	155	37	189	165	133	134	139	107
Reserve assets	-20	115	20	-190	-11	-18	-11	-7	-14	-15	-9
<b>Reserves and external debt</b>	22.9	-131.2	-22.8	217.3	13.1	18.3	10.8	7.0	13.5	15.2	9.2
Gross Reserves, excluding gold	1,091	960	937	1,154	1,167	1,186	1,197	1,204	1,217	1,232	1,242
Net Official reserves	1,244	1,246	1,096	1,337	1,345	1,366	1,378	1,387	1,402	1,420	1,430
in months of goods imports	7.0	6.6	6.9	8.8	10.7	11.0	11.0	10.9	10.8	10.7	10.6
over short term debt	1.2	1.5	1.1	1.2	1.3	1.3	1.2	1.1	1.1	1.1	1.0
Gross external debt (percent of GDP)	89.1	81.3	86.9	93.7	103.4	111.9	114.7	121.1	126.8	128.7	129.4
of which short term debt	34.7	27.1	31.9	33.9	34.0	33.6	34.4	36.3	38.0	38.6	38.8
<b>Memorandum item:</b>											
GDP at current prices	3,039	3,133	3,148	3,160	3,146	3,158	3,305	3,330	3,360	3,468	3,576

Sources: Central Bank of Curaçao and St. Maarten; and IMF Staff Estimates.

**Table 7. Sint Maarten: Balance of Payments, 2011–21**

	(In millions of Netherlands' Antilles Guilders) (In millions of US dollars)										
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
	Proj.										
<b>Current account</b>	-5	93	4	-110	23	25	29	26	30	31	38
(percent of GDP)	-0.5	9.5	0.4	-10.5	2.2	2.3	2.6	2.3	2.5	2.5	2.9
Goods and services	58	140	40	-53	90	78	72	70	75	79	81
(percent of GDP)	5.7	14.3	4.0	-5.0	8.5	7.2	6.5	6.1	6.3	6.3	6.2
Exports of goods and services	1,030	1,173	1,230	1,252	1,259	1,272	1,293	1,325	1,366	1,427	1,490
Goods	127	131	164	132	129	130	134	143	154	167	180
Services	903	1,043	1,065	1,120	1,131	1,142	1,159	1,182	1,212	1,260	1,311
Imports of goods and services	972	1,033	1,190	1,305	1,169	1,194	1,221	1,255	1,291	1,348	1,409
Goods	734	768	925	1,013	889	912	935	963	991	1,041	1,093
Services	239	265	265	292	279	282	287	292	300	307	316
Income	-35.0	-30.6	-22.8	-45.8	-50.9	-31.2	-26.6	-20.7	-21.5	-22.4	-16.9
Compensation of employees	-26.7	-27.9	-19.4	-34.5	-36.1	-32.3	-27.7	-23.0	-23.9	-24.9	-19.5
Investment income	-8.3	-2.7	-3.4	-11.3	-14.8	1.1	1.1	2.3	2.4	2.5	2.6
Current transfers	-27.3	-16.3	-13.5	-11.5	-16.4	-21.5	-16.6	-23.0	-23.9	-24.9	-26.0
(percent of GDP)	-2.7	-1.7	-1.3	-1.1	-1.5	-2.0	-1.5	-2.0	-2.0	-2.0	-2.0
<b>Capital and financial account</b>	5	-186	-65	148	-36	-17	-11	-9	-23	-21	-25
Capital account	15	12	9	4	0	0	0	0	0	0	0
Financial account	-10	-198	-73	144	-36	-17	-10	-9	-23	-21	-24
Direct investment	-50	16	44	47	28	38	33	34	36	37	39
Portfolio investment	-30	-38	-41	100	-9	-1	10	10	-5	-5	-10
Financial derivatives	0	0	0	0	0	0	0	0	0	0	0
Other investment	69	-176	-76	-2	-54	-54	-54	-54	-53	-53	-53
Reserve assets	-7	40	7	-67	-4	-8	-18	-17	-7	-10	-14
<b>Reserves and external debt</b>	-138.4	-23.9	-4.2	39.6	2.4	7.8	18.1	17.1	6.7	10.1	13.8
Gross Reserves, excluding gold	199	175	171	210	213	221	239	256	262	273	286
Net Official reserves	249	250	220	268	269	279	302	324	332	345	362
in months of goods imports	4.1	3.9	2.8	3.2	3.6	3.7	3.9	4.0	4.0	4.0	4.0
over short term debt	0.9	0.9	0.8	1.0	0.9	0.9	1.1	1.2	1.3	1.4	1.6
Gross external debt (percent of GDP)	66.4	60.4	58.6	65.1	65.0	60.8	57.1	53.1	48.1	43.1	38.1
of which short term debt	28.0	27.6	28.0	26.5	27.8	27.4	25.7	23.9	21.6	19.4	17.1
<b>Memorandum item:</b>											
GDP at current prices	1,015	983	1,016	1,051	1,059	1,077	1,108	1,150	1,193	1,244	1,300

Sources: Central Bank of Curaçao and St. Maarten; and IMF Staff Estimates.

Annex I. Curaçao and Sint Maarten: Risk Assessment Matrix (RAM)<sup>1</sup>

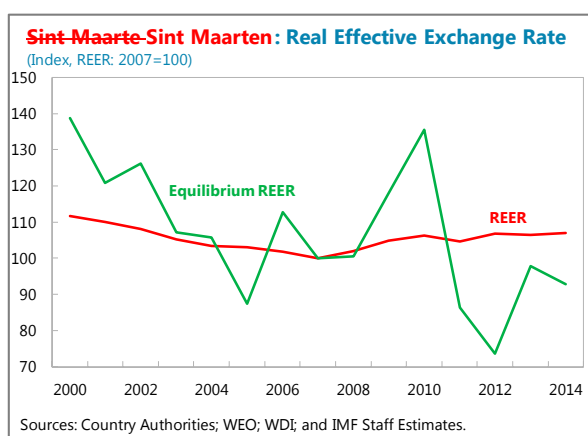
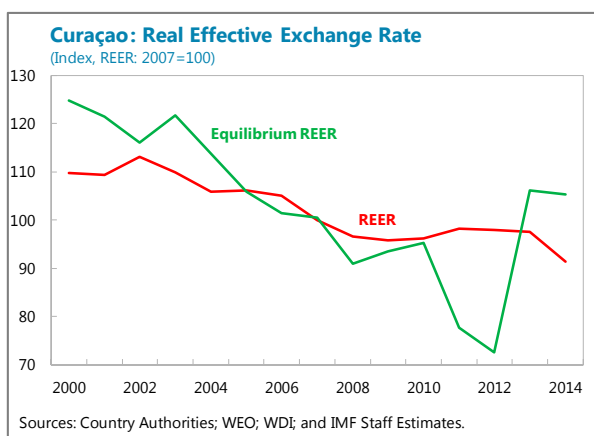
<i>Nature/source of main risk</i>	<i>Relative likelihood</i>	<i>Potential impact if realized</i>	<i>Suggested policy response</i>
<b>Structurally weak growth in the Euro-euro Areaarea.</b> Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms lead to low medium-term growth.	<b>High</b>	<b>High</b> Slower growth in the Euro-euro Area-area could directly dampen growth in Curaçao and Sint Maarten through lower tourism arrivals, remittances, and FDI. The fiscal position could also worsen with weaker revenues.	Support growth through effective public investment (and structural reforms). Build fiscal buffers to cushion potential shocks.
<b>Surge in the US dollar.</b> Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge, boosting non-U.S. trade but creating balance sheet strains for dollar debtors.	<b>High</b>	<b>Medium</b> A surge in the U.S. dollar, to which the regional currency is pegged, could lead to further appreciation of the real exchange rate, making Curaçao and Sint Maarten a more expensive destination for tourists from Europe and Canada.	Increase productivity and reduce labor costs to improve competitiveness and promote tourism sector through better targeted marketing strategies.
<b>Reduced financial services by global/regional banks:</b> Further loss of correspondent banking services significantly curtails cross-border payments, trade finance, and remittances in small economies.	<b>Medium</b>	<b>Medium</b> Shock to remittance flows could have a short-run impact on BOP net inflows and reduced consumption spending. Disrupted banking services could also hinder cross-border financial transactions.	Strengthen AML/CFT compliance and risk-based supervision; ensure full compliance with international standards on transparency of tax information; continue monitoring the status of correspondent banking relationships.
<b>Further deterioration of macroeconomic stability in Venezuela,</b> while growth is plummeting and hyperinflation is settling in.	<b>High</b>	<b>High</b> for Curaçao <b>Low</b> for Sint Maarten Venezuela is <u>one of</u> Curaçao's main trading partners and accounts for a large share of tourists. Further disruption of economic activity in Venezuela could also complicate the fate of <u>PDVSA's the</u> refinery plant in Curaçao <u>leased to PDVSA</u> .	Build fiscal buffers to cushion potential shocks.
<b>Outbreak of Zika Virus,</b> a virus transmitted by mosquitoes that causes flu-like symptoms but is suspected to be associated with microcephaly.	<b>Medium</b>	<b>High</b> for Sint Maarten <b>Medium</b> for Curaçao Local mosquito transmission of Zika Virus has been reported in both Curaçao and Sint Maarten. An outbreak of the virus could significantly discourage tourist arrivals, widen current account deficit and dampen growth.	Raise public awareness of the virus and related health issues and urge proactive prevention measures by tourism facilities (e.g. regular mosquito fogging).
<b>Natural disasters,</b> mainly hurricanes, could cause severe damage to infrastructure and disrupt tourism flows.	<b>High</b> in Sint Maarten <b>Low</b> in Curaçao	<b>High</b> The cost of infrastructure rehabilitation would put pressure on the fiscal position. The disruption to the hotel <u>plant sector</u> would slow tourism inflows, reduce growth and widen the current account deficit.	Build fiscal buffers and increase coverage of natural disaster insurance. In the long-term, strengthen resilience to climate change.

<sup>1</sup> The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

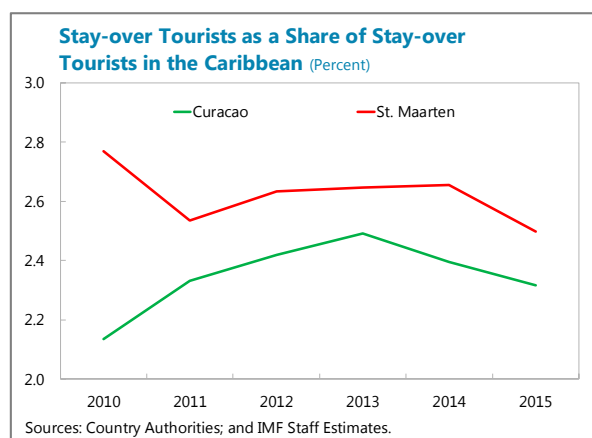
## Annex II. External Sector Assessment

Competitiveness indicators for Curaçao and Sint Maarten are mixed, highlighting current and potential issues faced by the Union and the need for structural reforms to address impediments.

1. **Despite the same nominal peg, Curaçao and Sint Maarten's real effective exchange rates (REER) moved in different directions in 2015.** Curaçao's REER depreciated in 2015, largely reflecting lower inflation relative to one of its main trading partners—Venezuela. In contrast, Sint Maarten's REER appreciated in 2015, given the relatively low inflation in the United States, its main trading partner. A comparison of the REERs relative to equilibrium values suggest that Curaçao's REER is below its equilibrium level, while Sint Maarten's REER shows slight overvaluation.<sup>1</sup> However, staff cautions that these assessments are subject to large statistical errors given limited data availability and in some cases the quality is below that required for the standard IMF EBA-lite assessment.



2. **Curaçao and Sint Maarten's tourism market share in the Caribbean has declined.** Curaçao's share of stay-over tourists in the Caribbean declined, for a second consecutive year, to 2.3 percent in 2015 from 2.4 percent in 2014. Similarly, following three years of steady improvement, Sint Maarten's share of stay-over tourists in the Caribbean fell to 2.5 percent in 2015 from 2.7 percent in 2014.



3. **The Union's share in world exports remained relatively unchanged, with contrasting results for Curaçao and Sint Maarten.** Curaçao's share in world exports declined in

<sup>1</sup> The equilibrium values are derived from a PPP-based panel estimation of a sample of Latin American and Caribbean countries for the period 1985–2014. These results should be treated with caution as many relevant variables had to be omitted from the model due to data limitations.



**Real GDP growth** is expected to gradually pick up to 1 percent in Curaçao and 1½ percent in Sint Maarten, supported by the continuation of private and public investment projects and a moderate increase in tourism flows. However, downside risks to medium-term growth prospects remain, including structurally weak growth in the euro area, reduced financial services by global/regional banks, further deterioration of macroeconomic stability in Venezuela (in the case of Curaçao), and natural disasters (in the case of Sint Maarten), among others (see Annex I in the Staff Report).

**Inflation** is also expected to increase to around 2½ percent in Curaçao and 2¾ percent in Sint Maarten over the medium term, as the deflationary impact of the current low international oil prices dissipates and domestic demand gradually recovers.

**The fiscal position, on current policies** is expected to slowly improve in both islands over the latter part of the projection horizon, as large public investment projects begin to wind down and the authorities continue their efforts on increasing revenues. However, going forward, close expenditure management and strict budget execution will be needed to ensure compliance with the fiscal rules. The current fiscal policy framework could be further strengthened through the adoption of a medium term fiscal framework to ensure fiscal and debt sustainability, while providing policy cushion and flexibility to accommodate potential external shocks.

**Market Access** is assumed to remain adequate to cover fiscal deficits and maturing debt under the presumption that the current low cost “standing subscription” borrowing arrangement with the Netherlands (under the CftFF’s oversight) will remain in place throughout the projection horizon. However, interest rates are projected to gradually increase over time, in line with the forecast for the Netherlands’ long-term borrowing costs.

### Shocks and stress tests

**Growth shock.** In an adverse growth shock scenario with lower output growth of one standard deviation for 2 years starting 2017, the debt-to-GDP ratio would increase by 3½ percentage points in Curaçao and by 6 percentage points in Sint Maarten compared to the baseline.

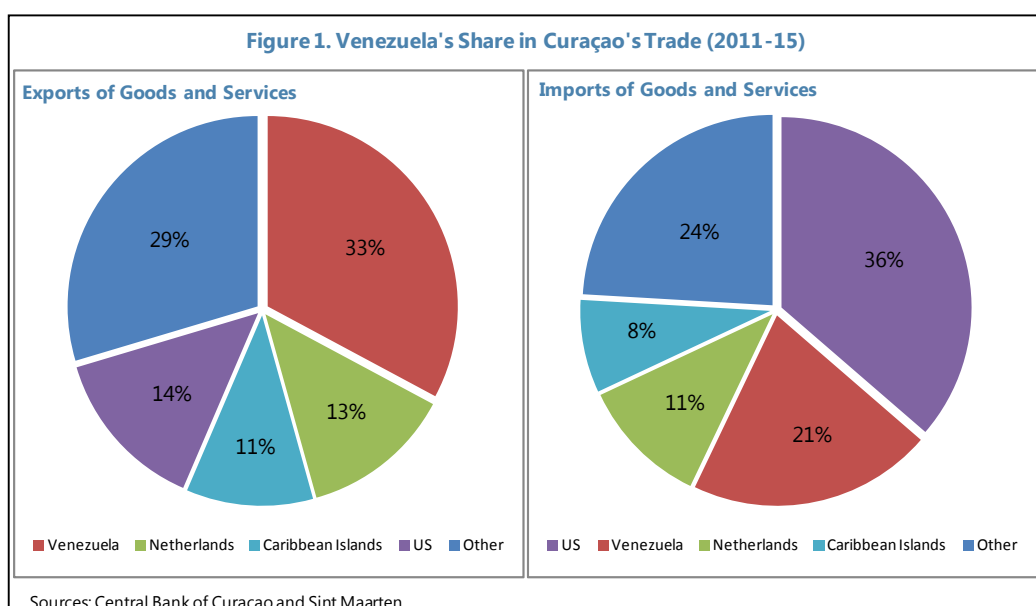
**Primary balance shock.** A temporary shock equivalent to one-half of standard deviation in 2017-18 would entail a deterioration of 3½ percent of GDP in the primary balance in Curaçao and 1¾ percent in Sint Maarten. Accordingly, the debt-to-GDP ratio would increase by about 7 percent in Curaçao and 3 percent in Sint Maarten, as a result of the higher gross financing needs than in the baseline scenario.

**Interest rate shock.** The standard interest rate shock is expected to have relatively moderate impact over the projection horizon given the islands’ favorable maturity profile with most borrowing at fixed rates and low refinancing needs. Combined with a permanent increase in the nominal interest rate by 300 bps starting 2019 (assuming the low cost “standing subscription” arrangement will lapse following the 2018 review of the CftFF oversight), public debt would expand by 0.6 percent of GDP higher in Curaçao and by 0.1 percent of GDP higher in Sint Maarten, compared with the baseline scenario, which assumes the “standing subscription” arrangement will remain.

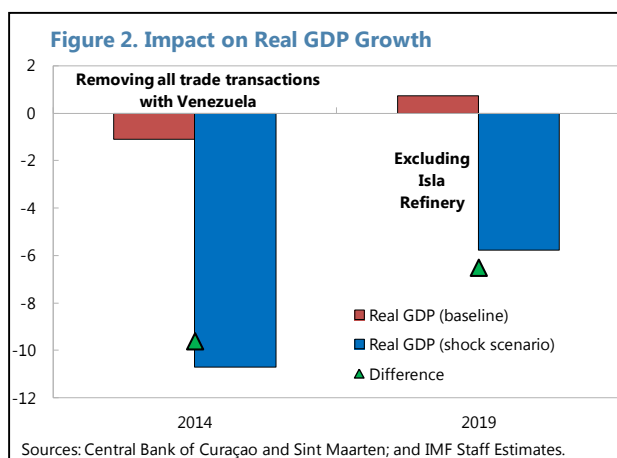
island's long term debt sustainability. As such, staff has proposed a medium term fiscal framework that aims to gradually reduce and stabilize Curaçao's public debt (see paragraph 27 in the Staff Report). Besides, both island's public and external debt are found to be vulnerable to shocks, which calls for the authorities' sustained efforts and decisive reforms to strengthen their fiscal framework, build policy buffers, improve external competitiveness, and unlock growth potential.

## ANNEX IV. Curaçao's Exposure to a Potential Economic Disruption in Venezuela

**As one of Curaçao's main trading partners, the worsening economic situation in Venezuela poses major risks to Curaçao's growth prospects.** With a market share of 33 percent for exports and 21 percent for imports (see figure 1), a potential economic collapse in Venezuela could lead to series-serious economic repercussions for the island's near and medium-term outlook.



**Trade disruptions with Venezuela pose a serious threat to Curaçao through various channels, including tourism, transportation, the free-zone, and the refinery.** Tourism expenditure of Venezuelan tourists (18.9 percent of total) also declined, as more of them are traveling to Curaçao to obtain U.S. dollars that they can exchange for bolívars in their home country instead of for leisure. In the transportation industry, the unstable economic situation and currency restrictions in Venezuela seem to have affected this sector particularly in 2015 where both air and sea transportation services registered a decline. Moreover, since the devaluation of the bolívar and currency restrictions, there has also been a decline in foreign exchange income coming from re-exports of domestic free-zone companies. In addition, given that activities at the refinery represent 15.2 percent (2011-15) of foreign exchange income and are highly dependent on oil supply from Venezuela, any decline in this supply can have severe repercussions on foreign exchange and harbor activity.



## ANNEX V. Risks Related to Pensions and Social Security

**Curaçao and Sint Maarten's have taken important steps to allay short term risks related to pensions funds, however, residual risks must be addressed to ensure long term sustainability.** Sluggish growth, rising healthcare costs, and an aging population underscore the need to address inefficiencies in pension funds, and the social security system to ensure continued fiscal and debt sustainability.

**Despite some successful reforms to Curaçao's basic pension system in 2013<sup>1</sup>, it remains underfunded.** The reforms included an increase in the retirement age from 60 years to 65 years, with a transition period of 3 years. The transition period ended recently, so there are no new retirees expected this year after February. The shortfall is, however, expected to remain in the near term, reflecting continued high unemployment and low growth. Recommendations made during the 2014 Article IV Consultation discussions included extending the pension reforms to public sector workers. At the time pension benefits were indexed to inflation. Since then the authorities have implemented reforms to ensure the sustainability of the public pensions, including by granting increases to pensioners only when the pension fund backing is over 105 percent and civil servants receive a salary increase.

**Benefits related to healthcare remain the largest fiscal risk, reflecting inefficiencies in healthcare delivery.** Of note, medical doctors are for the most part not employed by the hospital and have private practices, limiting cost savings from pooling resources. Only recently are new doctors required to work for the hospital. While premiums are considered high, rising costs and an aging population underscore the need to increase contributions through higher employment and improved compliance. The authorities have reduced old-age pension benefits to persons living outside Curaçao and are looking at further cuts to help reduce the shortfall. They are also considering a further increase in the retirement age (to 67 years).

**A 2015 ALM study exposed underfunding in three funds managed by Sint Maarten's Social Security Bank (SSB), the Sickness Insurance, OV (Accident) Insurance, and the Retired Civil Servants Sickness funds.** Low compliance, in the region of 60 to 65 percent, was highlighted as the main factor behind underfunding. On the expenditure side, high medical costs and waste in the pharmaceutical industry have also contributed to underfunding. The SSB is currently in the process of increasing its audit capacity, and automating systems to help reduce fraud. These measures are expected to improve compliance to 75 percent over the near term.

**A recent audit of pension assets suggests underfunding of 95 percent at end 2015.** Notably, eliminating arrears, including from the government, would improve the funded-status to 102 percent, in line with the pension fund, AFO's-APS's target. The AFO-APS is exploring a number of

<sup>1</sup> Details on the 2013 pension reform are provided in IMF Country Report 14/239.

local investments, including in the tourism and housing sectors to improve the return on assets. The age of retirement will be increased to 62 years, effective July 2016. The authorities are currently in discussions with unions and other stakeholders towards implementing further pension reform, by 2018, to improve the viability of the pension fund and reduce the required contribution of the government.

**Risks going forward relate to increasing healthcare costs and aging.** These increasing cost also reflect the cost of sending persons abroad for treatment not available in the country. Notably, the Sint Maarten authorities are exploring a joint hospital-working relationship with St. Martin, which could allow for lower costs and a more efficient provision of healthcare.

mainly reflected an increase in stay-over tourist arrivals, though at a slower pace than in 2014. With the exception of the recent expansion project at the Princess Juliana International Airport, there were no major private investment in 2015, underscoring the need to boost investor confidence.

Real GDP growth in 2016 is expected to reach 0.5 percent in Curaçao and 0.7 percent in Sint Maarten. For Curaçao, economic activity is projected to accelerate reflecting continued economic recovery in main trading partners (especially the U.S.) and a continuation of both private and public investment projects, mostly supported by the hospital ~~renovation~~construction. Higher growth in Sint Maarten reflects expectations for higher private spending, particularly in the tourism and transportation sectors, and a moderate increase of tourism flows.

Over the medium term, growth is expected to moderately pick up to 0.9 percent and 1.3 percent for Curaçao and Sint Maarten, respectively. The expansion in both countries will mainly depend on the implementation of structural reforms aimed at attracting more FDI, relaxing restrictions on hiring foreign labor, and reducing costs of doing business.

### **Executive Board Assessment**

In concluding the 2016 Article IV consultation discussions with Curaçao and Sint Maarten, Executive Directors endorsed the staff's appraisal, as follows:

The economic recovery and a stronger fiscal position have helped reduce near-term risks. Curaçao ended a three-year recession in 2015, despite the deterioration in macroeconomic conditions in Venezuela—one of the island's main trading partners. Expansion in Sint Maarten's economy continued into the fourth consecutive year, despite a modest deceleration. The Union's external and fiscal imbalances have also declined, with favorable external conditions and the authorities' fiscal consolidation efforts, but vulnerabilities to external shocks remain given its reliance on a narrow scope of products and markets.

However, risks to medium-term growth prospects remain to the downside. Continued low growth in the euro area could have serious economic repercussions for Curaçao and Sint Maarten through various channels, given that both islands remain heavily reliant on the euro area. Further disruptions in Venezuela could worsen Curaçao's growth prospects and balance of payments if no alternative export markets are identified. Meanwhile, a loss of CBRs could hinder cross-border transactions, adding to the macroeconomic uncertainties. In addition, slow progress in implementing needed structural forms also poses an important downside risk to growth prospects going forward.

Unlocking growth through economic diversification and investment promotion is therefore imperative in this environment. In this respect, the authorities' national development plans are an important step toward charting a clearer direction for strategic sectors and markets and removing impediments to private sector activity. Implementation of the plans is key, in particular, on decisive structural reforms to improve the labor market and doing business conditions, as well as energy sector reforms to diversify energy generation via renewable sources.