

## **Emsley Tromp: The state of Curaçao's economy – developments and vulnerabilities**

Speech by Dr Emsley Tromp, President of the Central Bank of Curacao and Sint Maarten, on the occasion of the opening of the LB Smith Luncheon of the VBC, Willemstad, 20 May 2011.

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Good afternoon, ladies and gentlemen,

### **Introduction**

It has already been seven months since Curaçao became an autonomous country within the Dutch Kingdom. The new country status brought with it a reminder that the world in which we are living is complex and constantly changing. Change brings uncertainty. At the same time, we have to recognize that in uncertainty and change lies opportunity and hope. The question, therefore, becomes: What will be the overarching strategy of the newly formed country Curacao to advance the hopes and aspirations of its people? Where are we going in the world? How can we get there? What are the guiding stars that will illuminate our path? We need a strategy that will transcend our political divisions, orient us as one country, and give us both a common direction and the confidence and commitment to get to our destination.

As I have stated on several occasions, the new constitutional status by itself does not lead to a higher level of sustainable economic growth and prosperity. To achieve sustained growth and prosperity today requires a new set of strategies because of the universal awareness that we are living through a time of rapid and universal change. The assumptions of the past make little sense because the Curacao with thriving offshore, transportation, refining, and tourism sectors are as distant to the young generation today as the autonomy of 1954 was to those who designed the new constitutional arrangement. Moreover, Curacao is experiencing its latest round of decline: the certainty that we are losing all the things that once made us a great island. We are living on the labor of the past. Our crumbling roads reflect a crumbling self-confidence. Our education reformers often seem to despair that we can ever educate new generations effectively for today's economy. Our health care system lags increasingly behind those of other nations.

It is against this backdrop, ladies and gentlemen, that I consider this a propitious time to discuss what to me are the most important challenges facing us. The risks that emanate from this interdependent world pose perhaps the greatest threat to our economic growth and prosperity. I will review recent economic developments in the context of those vulnerabilities and then conclude with some policy prescriptions that should be on the national policy agenda to strengthen and underpin the resilience of the Curaçao economy towards sustainable prosperity.

### **Recent economic developments**

Preliminary data indicate that the economy of Curaçao grew an estimated 0.2% in 2010, compared to a contraction of 0.5% in 2009. Meanwhile, consumer price inflation accelerated to 2.8% in 2010, up from 1.6% in 2009. The anemic economic expansion was due mainly to an upturn in the wholesale & retail trade and financial services sectors and in the public sector. The upturn in the public sector can be attributed to larger outlays on wages & salaries and goods & services. These gains were the result of salary adjustments, additions to payrolls, and expenses for technical assistance. Activities in the wholesale & retail trade sector rose, matching gains in domestic spending and tourist spending. By contrast, decreases in the manufacturing, construction, and transport, storage & communication

sectors mitigated the upturn in the wholesale & retail trade and financial services sectors. The unfavorable development in manufacturing was due mainly to a drop in value added by the Isla refinery caused by the prolonged shutdown of the refinery from March till December 2010 because of problems in the BOO plant. Also, activities in the ship repair industry shrank. Meanwhile, construction investment activities were down in 2010, but less than in 2009.

Ladies and gentlemen, you are what you owe. Our history speaks unnervingly on this matter. Curacao's deficit spending since the mid-eighties led to a debt build-up that resulted in a debt-to-GDP ratio that virtually rendered the government function as one of keeping creditors happy. This situation drove home that unfettered debt build-up can quickly compromise a country's autonomy. But, thanks to the debt relief program that was an integral part of the constitutional reform, the Netherlands Antilles was able to reduce its debt-to-GDP ratio to approximately 32% on October 9, 2010 **<Graph debt-to-GDP ratio, Netherlands Antilles, Curaçao and St. Maarten>**. This is a substantial improvement over the 82.2% registered at the end of 2008, just prior to the initiation of the debt relief program in January 2009.

The debt relief program allowed Curaçao and Sint Maarten to start their new status as autonomous countries with sound public finances and with budgetary rules and procedures in place to keep their finances in check. The estimated debt-to-GDP ratio of Curaçao at the end of October 2010 was 35%, while that of Sint Maarten was about 24%. These ratios can be categorized as sound according to international standards.

Looking ahead, the question remains whether the fiscal policy now being pursued is consistent with sustainable fiscal balances given the overconfidence in the soundness and resiliency of the economy that is the banner message of the current administration. To be sustainable, economic growth has to be consistently higher than projected, and fiscal discipline has to underpin government policies.

Ladies and gentlemen, another mounting risk is the widening deficit on the current account of our balance of payments. This deficit widened in 2010 compared to 2009, largely due to a decline in the net exports of goods and services **<Graph Balance of Payments Developments>**. The latter decline resulted from an increase in imports accompanied by a decline in exports. The growth in imports can be ascribed to increased international oil prices. In contrast, exports shrank as a result of a contraction in re-exports by the free-zone companies. This contraction in re-exports was related to, among other things, lower demand from Venezuela due to the devaluation of the Bolivar, and the tightened foreign exchange controls by the Venezuelan authorities. The fee received for oil refining contracted due to the temporary shutdown of the refinery. Furthermore, oil storage fees received from abroad declined as a result of a drop in oil storage activities. The decline in exports was mitigated by increased foreign exchange revenues from bunkering activities, related to the higher international average oil prices. Foreign exchange earnings from the tourism industry also rose in both Curaçao and Sint Maarten. This deficit on the current account of our balance of payments has been financed by the inflow of funds to finance the debt relief and by the surpluses on the capital account. As a result, we have been recording overall surpluses on our balance of payments.

Needless to say, this situation is unsustainable in the medium term. The sense of urgency to address this risk or possible severe adverse outcomes does not seem to be widely shared. The insufficient attention being paid to this factor, caused by a high degree of group-think and the lack of incentives to raise contrarian views, severely undermines our ability to discern risks and vulnerabilities associated with impending crisis before its outbreak.

Ladies and gentlemen, with the relatively slow recovery in the advanced economies, Curacao's real GDP is projected to grow by a mere 0.3% in 2011, not much more than the estimated 0.2% in 2010. The 2011 growth will be backed by domestic demand resulting from gains in private demand and public investment. Meanwhile, the decline in net foreign demand will moderate the increase in domestic spending. Accompanying this slight

economic growth will be a higher inflation of 4.8% due to higher world food prices and the pass-through of higher international oil prices in domestic gasoline and utility prices.

**<Graph GDP growth and inflation Curaçao>** An analysis of the growth and inflation figures of Curaçao over the period 2005 to 2011 shows an economic performance averaging one percent. Our headline inflation peaked in 2008 due mainly to the increased international oil and food prices. It should be noted, however, that the impact of the international financial and economic crisis on the Curaçao economy was relatively moderate, in contrast to its effect on most countries in the region. Curacao emerged relatively unscathed mainly because of the implementation of the debt relief program and the socioeconomic initiatives. Moving forward, however, inflation is bound to increase due to rising commodities prices. To insulate the domestic economy from this risk requires a different approach to problem-solving than we are currently pursuing. We need to leverage all our strength to achieve this goal by developing a plan for sustainable access to the resources we need for our continued well-being, prosperity, and economic growth.

**<Graph unemployment rate Curaçao>** Ladies and gentlemen, economic growth in Curaçao has not been robust enough to make substantial progress toward lowering the socially unacceptable high unemployment rate. Unemployment is not only destroying the lives of many, it is undermining Curacao's future. The longer this goes on, the more workers will find it impossible ever to return to employment, the more young people will find their prospects destroyed because they cannot find a decent starting job. The unemployment is eating away at our society. We seem to have developed a strange apprehension about our ability to create an investment climate conducive to sustainable high growth to address the issue of high unemployment and social exclusion. We need a credible macroeconomic policy mix. Such a mix cannot be won through intimidation and threat, and it cannot be sustained through exclusion. It requires a commitment and investment in the future. Our investment priority, therefore, must be intellectual capital and a sustainable infrastructure of education, health, and social services to provide for the continuing development and growth of Curacao's youth.

So, the question becomes: What has kept us from achieving a higher level of sustainable economic growth?

In my opinion, ladies and gentlemen, our weak economic performance is the result of, among other things, lack of resiliency to external shocks. Small economies like ours are susceptible to these external shocks because of their openness, size of domestic markets, lack of economic diversification, and the high dependence on strategic imports such as food and oil.

Some of these shocks are caused by Nature, and little can be done to insulate us from their consequences. But some of these shocks are related to trade and exchange, such as a contraction in external demand and increased international oil and food prices. These types of shocks have a direct impact on our balance of payments and domestic consumption and investment. In the past couple of years, our balance of payments increasingly has become affected by this category of shocks because of, among other things, increased international oil and food prices with far-reaching implications for the real economy. The rapidly expanding current account deficit during the last few years, financed by capital inflows from abroad, exposes an increasing external vulnerability, which has been masked by the inflows of funds for the debt relief program. A sudden reversal of capital flows could deplete our foreign exchange reserves quickly, undermining confidence in our currency. A third category of shocks includes those that result from our own policy mistakes. Hence, these types of shocks are more endogenous and reflect our own political choices.

Ladies and gentlemen, to achieve higher levels of sustainable growth, our priority must be to pursue policies that strengthen our ability to weather those storms and policies to foster rapid growth. Therefore, our policy agenda needs to address three crucial areas.

The first item on the national policy agenda to achieve the mentioned objectives should be macro-economic stability. To mitigate the adverse impact of shocks, fiscal and monetary

policies should be able to respond quickly by mobilizing resources to address these imbalances. Sound fiscal balances as measured by a low debt-to-GDP ratio are crucial. A low debt-to-GDP ratio provides authorities with room to maneuver and hence increases their choices of which policy instruments to use to address the crisis. Thanks to the implementation of the debt relief program, the debt-to-GDP ratio of Curaçao is currently sound. Curaçao was required to meet several conditions to qualify for debt relief. The main requirement was financial supervision by an independent board, the *College Financieel Toezicht (CFT)*, established to temporarily assess and monitor the public finances of the countries. Other conditions included the strengthening of financial management and adherence to a balanced budget rule and an interest burden rule. The interest burden rule stipulates a yearly interest ceiling of 5% of government revenues. These conditions are designed to prevent the uncontrolled build-up of debt in the future and hence, contribute to macroeconomic stability.

With regard to Curaçao's monetary policy, since 2009 I have been advocating the following policy response: rather than focusing all our attention on specific threats and risks, as we have in the past, we should evaluate the possibility of removing the constraints and seek opportunities to credibly influence these risks to our advantage. To that end, I have advocated a new foreign exchange arrangement. Having the US dollar as legal tender removes the risk of exchange rate adjustments. Hence, an economic downturn or reversal of capital flows would not turn into a currency crisis. In addition, dollarization has other advantages, including lower transaction costs, the promotion of financial sector soundness, and the integration of the domestic financial system with the rest of the world.

The second area to be addressed in terms of a national policy agenda is the functioning of markets. Ladies and gentlemen, in the case of adverse shocks, resources will be reallocated rapidly through the price mechanism in markets that are functioning efficiently, freely, and competitively. Hence, market efficiency will enable us to cope better with economic shocks. One of the most important markets we should address is our labor market. Tight labor market regulations have adverse effects on economic performance because they allow vacancies and unemployment to coexist, contributing to high overall unemployment rates. To improve our competitiveness, we must be able to deploy labor in a more flexible way, as long as individual protection against abuse is preserved. Competition is what has driven nations to achieve greatness.

The efficient functioning of markets also is affected by bureaucracy and administrative barriers. One of the most common complaints from the business sector is the number and complexity of government formalities and paperwork that frustrate new investment initiatives and, hence, the opportunity for stronger economic growth. The elimination of the double layer of government on the island is certainly a step in the right direction. However, this change should be complemented by streamlining administrative procedures aimed at eliminating all unnecessary bureaucracy and simplifying the procedures for obtaining business and work permits and business visas.

A third important topic for our national policy agenda is good governance. Good governance ensures that resources are allocated to those who will use them most effectively and efficiently. Therefore, good governance enhances both productivity and growth. We can distinguish between public governance and corporate governance. Public governance is defined as the traditions and institutions that determine how authority is exercised in a particular country. It includes the capacity of the government to manage resources efficiently and to formulate, implement, and enforce sound policies and regulations.

Public governance is good when quality resources are managed and provided efficiently. Predictability, accountability, transparency, and participation are key factors for good public governance. Government decisions must be based on the rule of law, and firms and individuals must be protected from arbitrary decisions. Good public governance requires an effective and impartial legal system. Segregation of powers, and a system of checks and

balances must be at the core of the political system. Good governance rests on the establishment of criteria for evaluating the performance of public sector institutions. Institutions such as the Court of Audit or *Rekenkamer* and the Ombudsmen are crucial to strengthen the accountability of the government.

The general public will be able to ascertain the government's adherence to law and regulations and evaluate its performance only if information about government activities is available, timely, and clear. Therefore, transparency is imperative for predictability and accountability. Finally, participation refers to the engagement of citizens in the decision making related to government plans and budgeting. By encouraging the participation of citizens, the government can have better insight into their needs and priorities. Public participation can be achieved through public consultation, hearings, and referenda.

Ladies and gentlemen, although corporate governance and public governance have similarities, differences also exist. Corporate governance refers to the rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders. A good system of corporate governance contributes to sustainable economic development as it promotes market confidence, facilitates long-term capital funding, and stimulates market discipline through appropriate disclosure and transparency. Also, corporate governance helps to ensure that the corporation takes into account the interests of a wide range of stakeholders. Good corporate governance is based on responsibility, accountability, fairness, and transparency, and promotes diversity of rules and regulations.

The autonomy of Curacao was based on the core values and principles that served the Netherlands Antilles as anchor and compass for more than fifty years. Our values defined our national character, and they are our source of credibility and legitimacy in everything we do. When these values are no longer sustainable, we have failed as a nation, because without these values, we do not have credibility. Today, we find ourselves in a very different environment. The challenges and opportunities facing us are far more complex than we could have imagined in 1954. Therefore, we must recognize the need to take a hard look at the governance of state-owned enterprises. Governance impediments and an institutional culture that discourages contrarian views risk triggering an environment not conducive to growth and prosperity.

In Curaçao, state-owned enterprises are prevalent in several key sectors, including the utilities and telecommunication sectors. The governance of these companies is critical to ensure their positive contribution to Curacao's overall economic performance and competitiveness. The OECD has defined some key guidelines for the governance of state-owned enterprises.

First, to avoid market distortions, the legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete. Second, the government should act as an informed and active owner and establish a clear and consistent ownership policy ensuring that the governance of the state-owned enterprises is carried out in a transparent and accountable way, with the necessary degree of professionalism and effectiveness. Therefore, the government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in the corporate governance of the state-owned enterprises, and how the state will implement its ownership policy. Moreover, the government should not be involved in the day-to-day management of state-owned enterprises and should allow them full operational autonomy to achieve the agreed-upon objectives. In addition, the state should let the executive and supervisory boards of state-owned enterprises exercise their responsibilities in freedom and respect their independence. In other words, the shareholder should not be sitting in the chair of the director or supervisory director.

Third, the state and state-owned enterprises should recognize the rights of all shareholders and in accordance with the OECD Principles of Corporate Governance ensure their equitable

treatment and equal access to corporate information. Fourth, state-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance. And finally, the supervisory boards of state-owned enterprises should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

The recent experience in Curaçao has underscored the importance of these principles to promote market confidence in and attract long-term capital for state-owned enterprises. The exuberance in the preparation of the new constitutional arrangement led to a situation where the attention paid to these issues apparently was insufficient. The failure to segregate duties and responsibilities in the governance structure and unfettered interference of shareholders and supervisory directors in the day-to-day affairs of these enterprises have created incentive structures not well aligned to foster the candid exchange of ideas necessary for transparency. This situation is bound to lead to lapses in oversight and weak accountability and ultimately undermine economic growth.

### **Concluding remarks**

Ladies and gentlemen, I have been asked to give an assessment of the current state of the Curacao economy and the risks associated with the build-up of vulnerabilities associated with the economic shocks that Curaçao is susceptible to as a small and open economy. This assessment has been made in the context of the new constitutional arrangement, which went into effect on the 10th of October last year. As I have mentioned on several occasions, Curacao's new status as a country is not an end in itself. Rather, it is a means to achieve a better tomorrow.

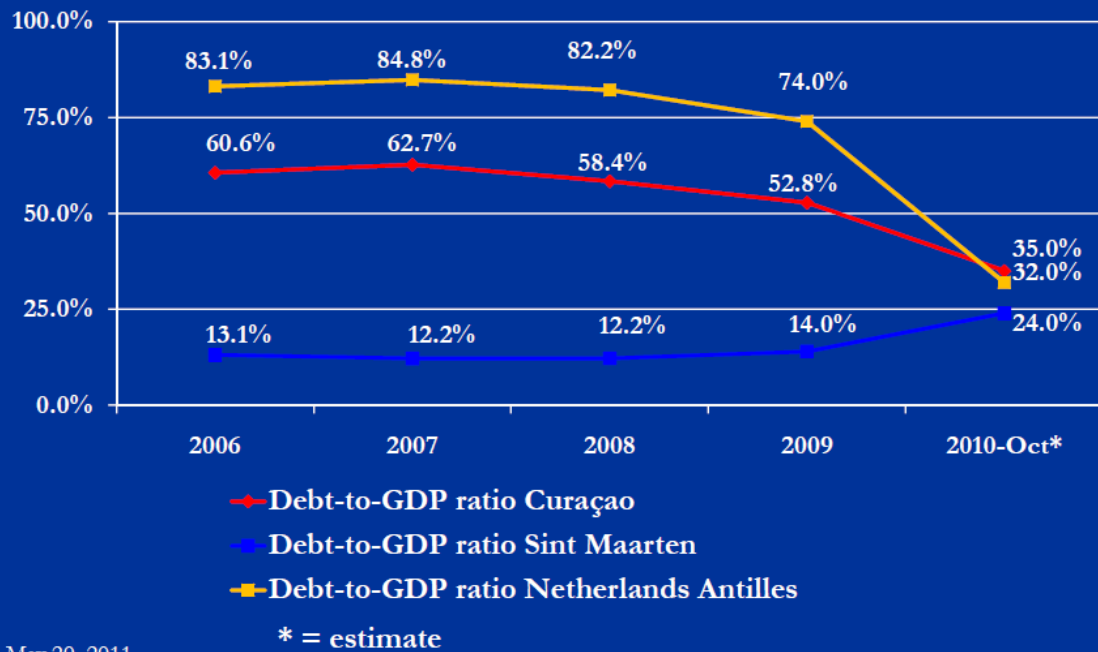
My assessment has made it abundantly clear that we need a strong, effective, and well-equipped government to face the many economic and financial challenges that lie ahead. Yet the problems uncovered by this assessment are long-standing and difficult to solve: addressing them will require close collaboration between authorities and social partners. To achieve this collaboration, we need to create an environment that encourages candor and considers dissenting views. We need to modify incentives to speak truth to power. We need to pursue sustainable macroeconomic policies consistent with the global outlook and risks. We need to overcome the insular culture.

Ladies and gentlemen, to achieve this better tomorrow, we need a vision, a national strategy that embraces these issues. Without doubt, our greatest resource is Curacao's young people, who will have to shape and execute the vision needed to take this island forward into an uncertain future. A reawakening of some sort may be required. Perhaps because we have been so blessed over time, many of us have forgotten that rewards must be earned, that there is no such thing as a free lunch. Fair competition and hard work bring with them a true sense of accomplishment. We can no longer expect the generosity of the Kingdom or the ingenuity and labor of the past generations to sustain our growth as a nation for generations to come. We must embrace the reality that with opportunity comes challenge, and that for us to succeed as an autonomous nation, requires a commitment and investment in the future.

Our vulnerabilities have restrained us from achieving a higher level of sustainable economic growth and, hence, prosperity for us all. Therefore, through strengthening of our economic resilience based on policies aimed at a stable macroeconomic environment, efficient-functioning markets, and good governance, we will be able to break with the past and provide our new country with a bright future.

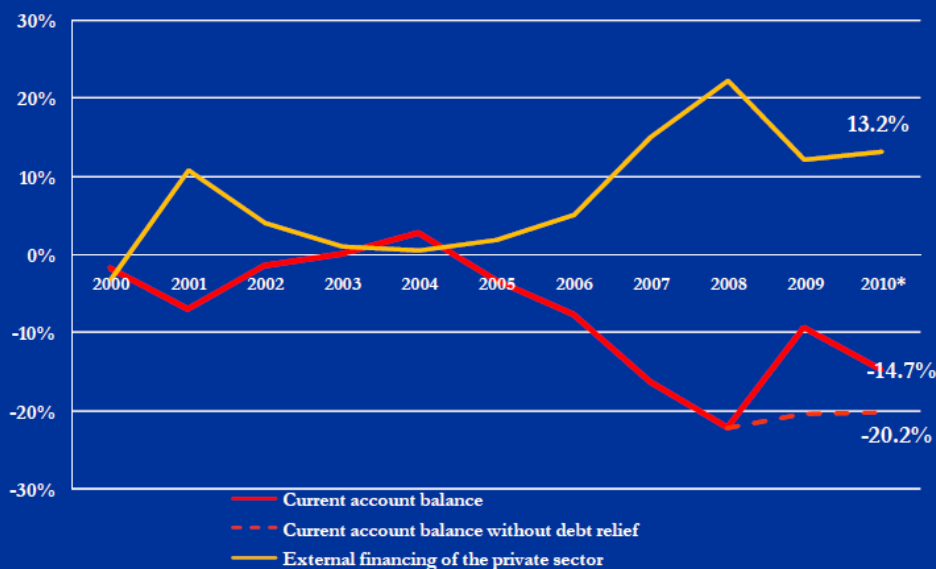
I thank you for your attention.

# Development public debt-to-GDP ratios



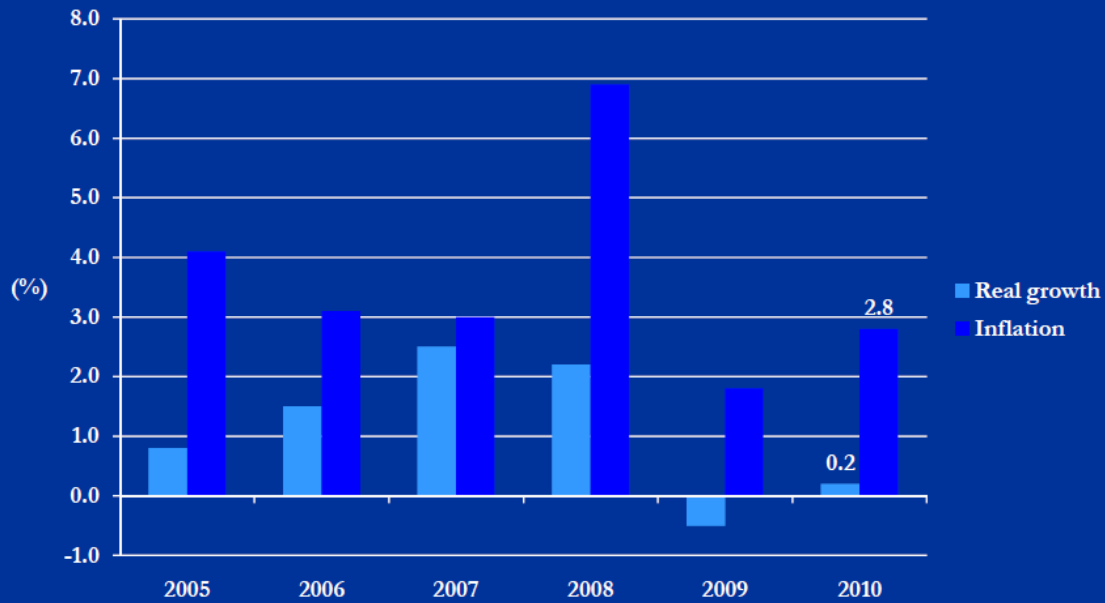
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# Balance of payments development (in % of GDP)



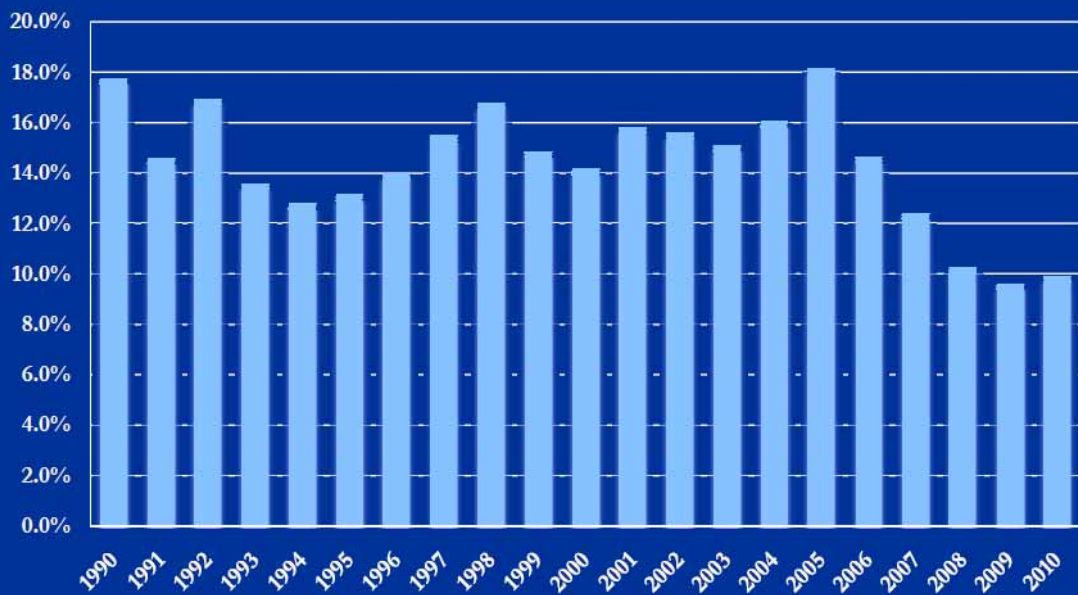
May 20, 2011

# Growth and inflation Curaçao



May 20, 2011

# Unemployment in Curaçao (%)



May 20, 2011