

Government finance and beyond, who can bring the economy back in motion?

Luncheon lecture by Prof. dr. Age Bakker, Chairman Cft

Vereniging Bedrijfsleven Curaçao

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Members of the business community of Curaçao!

It is a great pleasure to speak to you at this luncheon meeting of the VBC and discuss with you the economic situation of Curaçao.

The Cft and the VBC have the same objective; in the end we both want to strengthen the economy of Curaçao. The VBC takes a business perspective, whilst the Cft has a task to ensure that public finance is sound and healthy.

The Cft believes a healthy government budget is necessary. Much has been achieved in this respect over the past years. You, as business people, know how important it is to have your finances under control and strive for the most efficient conduct of business.

Trust is everything in the economy and even more so when it concerns government finance. The business community will only invest in Curaçao if there is trust that the government can pay its bills and does not need to raise taxes to fill the budgetary holes.

Putting your fiscal house in order is a necessary precondition for creating the right environment for private investment and job creation.

But it is not sufficient as there is clearly lingering doubt about the economy.

You have challenged me to provide an answer to the question, which I will paraphrase as follows: now that government has put its house in order, who can bring the economy back in motion?

I like challenges. Otherwise I would not have become the chairman of the Cft!

So, this provides the agenda for my lecture. First, I will take a look back at the experience of the past four years of financial supervision in Curaçao. What has been achieved and what can we expect for the near future? Then I will move on to what seems to me to be the road forward for Curaçao to put the economy back on a sustainable track of economic growth.

#### *The need for fiscal reform*

When Curaçao became a country in the Kingdom on 10-10-10, a sizeable debt reduction was given in order to provide the new country with a good starting position. At the same time, as a quid-pro-quo, financial supervision was

established with the goal to preserve this good starting position and avoid a new build-up of government debt.

Despite the debt reduction, however, the financial position of Curaçao clearly started to slide back soon after 10/10/10.

It quickly became clear that the underlying reasons for the debt build-up of the Netherlands Antilles had not been addressed.

Where did these budget problems come from? Basically, there were three reasons. First of all, Curaçao suffered from the aftermath of the economic crisis which had dampened economic growth. Secondly, life expectancy had been increasing and the population is aging rapidly. This was not taken into account, back then when Curaçao set up its pension plans. Finally, due to the aging population and technological innovation, the costs of healthcare were increasing rapidly.

Curaçao did not stand alone in this. Rising pension and healthcare costs are a global phenomenon and all countries have been struggling to cope with resulting financial pressures.

And many countries have resorted to some form of financial supervision to ensure fiscal discipline.

All countries in the Kingdom are under a form of financial supervision, with the exception of Aruba. In Aruba, however, the Cft has been asked to provide a report to help Prime Minister Eman in his ambitious plans to achieve a balanced budget in the coming years. This report will be presented to the Governor of Aruba next week.

Obviously it is difficult to maintain sound public finances on your own.

What makes Curaçao, like the other countries within the Kingdom, particular is that they all have small and open economies. Being small and open means that a fiscal stimulus will quickly leak abroad in the form of increased imports.

Budgetary policy is thus not a good instrument to stimulate economic growth. To create jobs, investments in the private sector are needed. And this can only be done when prudent fiscal policy is in place.

Back to Curaçao after 10-10-10. The consequence of not addressing the budgetary challenges would have been soaring government debt, well on its way to the levels of pre 10/10/10. Clearly, this would have been a disaster for the country and would adversely impact the trust of investors and entrepreneurs alike.

The measures taken by the Curaçao government were painful, but necessary. Of course one can always doubt whether the right measures were taken or whether the burden was divided in a fair manner. These are political choices.

But it had to be done.

I believe that after a hesitant start this budgetary framework of financial supervision and adherence to strong fiscal rules now has gained traction and has helped steer budgetary policies in the right direction.

One can say that Curaçao's public finances have been put on a sustainable footing.

This has also proven to be an important factor in the judgments of outside observers such as Standard & Poor's and the IMF, which recently came out with a positive report on Curaçao and Sint Maarten. In their appraisal they take into account that being part of the Kingdom and the presence of an independent supervisor like the Cft has proven its value in providing trust.

With the restoration of sound public finance a necessary precondition for restoring economic growth has been achieved.

#### *The budget and economic growth*

The challenges facing the government in balancing the budget, in Curaçao as elsewhere, are even more significant because they go hand in hand with low economic growth.

It sometimes seems as if we are in a vicious circle of low growth, rising deficits, budget cuts, leading in turn to lower growth. How can we escape from this vicious circle?

I believe that the fiscal rules that came with financial supervision can help break this vicious circle.

One such rule is the requirement of a balanced budget. The government cannot spend more than it receives.

At first sight this may seem stricter than what is the case in the European Union where governments are allowed to have a deficit of up to 3% of GDP. On closer inspection, however, this is not the case because of another fiscal rule which allows Curaçao to have a deficit on its capital account to finance public investment.

In the world of public finance this arrangement is called 'the golden rule'. It owes that beautiful name to the following rationale: public investment strengthens the economy, provides business opportunities and therefore future generations benefit from it. Therefore, borrowing is allowed: investments pay back after all.

So, if the capital account is also taken into consideration, budget deficits of Curaçao and the Netherlands do not differ that much.

For its capital expenditures Curaçao can borrow from the government of the Netherlands, which currently, because of its triple A rating, has a very low 10 year yield of around 1 %.

This is a special advantage of Curaçao being a country of the Kingdom of the Netherlands.

The government of Curaçao has seized this opportunity and has borrowed for improvement of infrastructure. Curaçao also has been allowed to borrow NAF 435 million for the building of a new hospital, which accounts for 8% of GDP.

Moreover, a number of infrastructural projects are in the pipeline and these will, when they are executed, provide a sizeable impulse to the economy.

At the same time, one would wish to avoid a new debt build-up. Therefore, we advise to keep debt below 40% of GDP for the foreseeable future.

At this point a caveat is in place. Experience shows that it is easier to prepare plans than to actually execute them. It is therefore important for the government of Curaçao to make an extra effort to get its ambitious capital budget realized within the given timeframes. This includes having to strengthen its implementation capacity.

At this moment in time, lack of finance is not constraining public investments but implementation capacity.

This year up till now only ANF 10 million in public investment has actually been spent whereas under the fiscal rules much more would have been possible if not for lack of implementation capacity of the government.

One of the most disconcerting findings in the IMF report, which otherwise is positive about Curaçao, is that bottlenecks in fact have worsened over the past years. The still not completed merger of the former Netherlands Antilles central government and the Curaçao island government staff is a factor here.

We are in constant discussion with the government how to improve the efficiency of government.

The recent gains in fiscal soundness should be consolidated, and all attention should now be directed towards improving the efficiency and effectiveness of government. The agenda is threefold:

- pension and health system reforms should be extended to public sector workers;
- the administrative apparatus should be further streamlined;
- weak governance and finance in state companies should be addressed.

#### *A stagnating economy*

This is probably the right moment to turn to the economy.

This year will be a year of only very modest economic growth. Nevertheless, this is an improvement over what was expected when the fiscal reforms were put through, which increased taxes and social premiums and took away purchasing power from the economy.

Economic growth has been lackluster in recent years.

In this Curaçao does not stand alone. Many economies have suffered from the global crisis and the subsequent slow global recovery and there are many countries which have shown much more pronounced cyclical swings than Curaçao. And surely, the necessary fiscal adjustment in 2012-13 has also had some negative impact on growth, although less so than initially feared.

What is more disconcerting is that this phenomenon of a stagnating economy is a longer standing phenomenon.

Looking a little further back the economy basically has been flat since the millennium change. Curaçao has trailed its regional peers at least since the early 2000s. The IMF attributes this to long-standing structural weaknesses and the Central Bank in its recent Annual Report comes to a similar conclusion.

This mediocre performance – also when compared to peer countries in the region - is reflected in the unemployment figures, especially when it comes to youth unemployment. The unemployment rate is high at 13%, and youth unemployment in particular is disconcerting.

Recent figures of the CBS show that only 42% of the population works. This means that everybody that works, has to work for at least someone else as well.

The low participation of the population means that there are abundant possibilities to produce and for the economy to grow. This waste of human capital must be stopped.

Furthermore, the high unemployment of youngsters points to something else as well. A few years ago the Cft organized a conference in which a former minister of the Bahamas made a statement which I remember vividly because of the importance of it. He said 'the biggest threat to society are idle young men'.

I believe there is a simple but basic truth here. If we can't solve the unemployment under the youth, we face serious problems. The 'Lei de Bion', the law to boost youth employment certainly is a first step in combating youth unemployment. But I am sure more has to be done.

*Making doing business easier*

For this we need to go back to the structural drivers underlying the economic problems facing Curaçao right now.

Curaçao, as I feel it now, is facing its second greatest challenge after 10-10-10. After having put its fiscal house in order, urgent action is needed to get the economy growing again.

Government's attention should be directed toward taking away structural impediments to growth. The government should become a facilitator of economic growth in the private sector.

Let's take the IMF's analysis as a starting point. Curaçao's lackluster growth and job creation, so the IMF says, can be basically ascribed to weak competitiveness, red tape and rigid labor laws.

The IMF in particular ascribes the lackluster performance to the inability of the economy to effectively absorb declining productivity in major sectors, such as oil refining and the financial sector, and relocate workers from these sectors to more promising ones, like tourism and IT related services. The diversified economy of Curaçao needs greater scope for reallocating labor from declining sectors to growing ones.

For this the social dialogue between government and the private sector should define a vision for the future and a concrete agenda to get there.

I believe that we all know what the common agenda for enhancing flexibility and competitiveness is:

- reduce red tape;
- remove disincentives to hire people; and
- lower the cost of doing business.

The issuance of licenses should become flexible and rapid. The cost and time to get these has been an impediment to doing business. Businesses need to be able to find skilled personnel and not be hampered in the process with high fees and lengthy waiting times as is the case today. The labor market should be liberalized, as should immigration policies for skilled labor. The cost of doing business should be lowered.

In such an agenda for liberalization of the economy Curaçao can benchmark itself to regional peers, like Panama and Colombia.

In my view the liberalization agenda should also include divestment of one or two of the government entities and seek a strong commercial partner, which is willing to invest. Privatization of government-owned companies and other public private partnerships should be explored.

But let's not fool ourselves. Change will not come overnight. There is not a lack of big plans, waiting in the drawers of the public and private sector alike.

What is lacking is the execution of these plans.

Curaçao can no longer afford that this waiting game between the public and private sector continues.

If everyone looks at each other, in the end no one is responsible. But if no one takes the first step, we will stay where we are.

I, for myself, have great belief in the possibilities for an economic take-off of Curaçao.

I base that belief on the great assets Curaçao has, which could help to get the economy to grow.

- The fixed exchange rate regime is a great asset for a small open economy as Curaçao and it should be preserved. This requires that competitiveness and flexibility is maintained through structural reforms.
- Another notable strength of the economy has been its diversity, where Curaçao sets itself apart from the region. Diversity, though, also means that one has to accept that some sectors will go down in importance over time, while others will grow.
- Curaçao disposes of a sound financial system, which has withstood the financial crisis remarkably well. Therefore, I do not believe that finance is the issue. There is ample bank liquidity for business investment and there is access to low-cost funding for public sector investment from the Netherlands.
- Last but not least, Curaçao has a unique prime location where it can profit from the closeness of three markets, the European, the Latin American and the US market.

These assets have regained importance in the new global economy.

Being a small country means that you need to be just that little bit smarter than the big ones. This can be done by giving a quality jump to education and improve Curaçao's main asset - human capital. This means education should be outward looking, innovation oriented and be directed towards the target that each student leaving school speaks at least one, preferably two foreign languages, like English, Spanish or Dutch, fluently.

Building on these assets and creating a shared vision for the future will help re-install self-confidence, which I feel has sometimes notably been lacking in Curaçao.

#### *A kick-start of the economy*

Now that fiscal balance has been restored and is here to stay, a new kick-start of the economy is possible.

Government can play its share. There are a number of identified public investment plans in the pipeline, amounting to 10% of GDP including the new hospital, which can help give the initial impulse to the economy. Low-cost finance is available.

But this kick-start needs to be followed up by private sector investment.

A joint effort is needed by the private and public sector, in good cooperation and in mutual trust.

Antagonistic attitudes and self interest should make place for the common good.

In a paraphrase of John Kennedy's famous words: 'Do not ask not what your government can do for you, ask what you can do for your country'.

When Curaçao became a country four years ago, expectations ran high. What then followed was something like a false start. Disappointment was great.

But this is the way how countries grow. I believe much has been learned and time has come for a new start. Outside observers like the IMF predict positive economic growth for the first time since Curaçao became a country on its own.

Better be part of it than stand on the side!

Investors must be able to have trust in the society they operate in and in the politics that rule our society. Strong independent institutions can help preserve that trust.

So, government's task, now that fiscal soundness by and large has been restored, is a limited but important one. The government should strengthen its role as a facilitator of economic growth in the private sector.

This means that the government should provide a safe and secure environment in which people feel safe and investments are secure. Antitrust legislation and an independent authority to guarantee competition need to be in place. Taxes should be steady and fair. Special favors only result in destruction of competition.

But government can't steer the economy and create jobs for a very long time. Jobs are created by the private sector.

This means there has to be a serious discussion about the roles everyone plays in the economy. Governments and politicians seem to feel that they can steer the economy, that they know what is good for the country and how to achieve that.

Businessmen on the other hand are perhaps used to this government attitude, as is the rest of society.



Calls for government to take action are all around. The result of this attitude is that one waits for another. And in the end there is much disappointment.

So, the answer to the question who should bring the economy back in motion is clear. What is needed is a joint effort of government and the private sector, whereby government is predictable and creates the right environment for businesses to create jobs.

### *Conclusion*

Let me sum up.

Government finance by and large has been put on a sound footing. Fiscal rules prevent a relapse in wrong old habits. By having restored healthy public finances, a major contribution has been made to provide a predictable, trustworthy environment with stability of taxes.

I believe that financial supervision, whether done by the Cft or by another independent body, is a game changer, which can break the deadlock in which the economy of Curaçao is lingering.

Efficiency enhancing reforms over time may even provide scope for reduction of the direct tax burden over time.

The fiscal room created by restoring healthy public finance allows for a pipeline of public investment to be executed.

This in turn enables a kick-start of the economy which should be taken up by the private sector. Plans in your drawers should now be executed.

As for economic growth and job creation, I believe that it is now time for the Curaçao business community to take up the challenge and play the leading role.

Government cannot create economic growth for you. Government cannot determine where the business opportunities of tomorrow are. What government can and should do is remove structural impediments to growth.

I have discussed the structural reform agenda here. This is feasible. Other successful countries in the region have done so.

I often hear comments and remarks about the quality of government, but I hardly hear and see stories about successful businessmen. But I know there are many young and successful business people amongst you.

I call upon you to let yourself be heard and to play a leading and inspiring role in the economic recovery of the island; we need your stories and your examples for others to follow.

It is your task to lead to economy into the future, to see where the opportunities are and act.