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Aiming for fiscal consolidation: From debt overhang to financial management

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Abstract

This paper analyzes the short-run effects on Curaçao's public finances of the "restructuring package," which has been implemented since 2009. The package comprised a public debt restructuring program, tied to a constitutional restructuring process. The debt restructuring program was guided by the belief of a "fresh start" for the public finances for the islands of the former Netherlands Antilles, in their new constitutional status within the Kingdom of the Netherlands. The new status meant the disbandment of the former Netherlands Antillean federation, with subsequently, Curaçao and Sint Maarten becoming autonomous countries within the Dutch Kingdom, and the BSS islands (Bonaire, Sint Eustatius, and Saba) obtaining the status of special municipalities of the Netherlands. The countries' and special municipalities' statuses became effective as of October 10, 2010, symbolically, "10-10-10."

Our analysis covers public finance developments in the period 1986-2014 on the island Curaçao. We compare the period prior to the implementation of the "restructuring package" (1986-2008) with the period starting 2009. The analysis shows that to achieve sustainable public finances, the restructuring package implemented in Curaçao needs fine tuning.

Keywords: Debt relief, government finances, Curaçao.

1. Introduction

Prior to the start of the implementation of the "restructuring package" in 2009, the public finances of the Netherlands Antilles were characterized by debt overhang/roll-over. The debt roll-over meant continuous and growing government demand for funds, which in turn led to rising interest rates on the domestic money and capital markets. The public sector's interest payments crowded out other expenses and basic capital investments. As a consequence, the investments in public capital goods were funded mainly by development aid capital transfers.

Curaçao being the largest island of the Netherlands Antillean federation was also responsible for the debt roll-over. Despite many austerity programs initiated over the years, these programs did not lead to sustainable and healthy public finances. Curaçao continued to run fiscal deficits and its outstanding debt and arrears continued to grow (Commissie Schuldenproblematiek, 2003). Many reports repeatedly mentioned external shocks, such as the repeal of US withholding tax treaty in the mid 1980s and the closure of the Curaçao operations by the Shell refinery in 1985, as the causes for the growing government deficit (Dilworth, 1985; Berenschot, B.V., 1986; Van Lennep, 1996; Commissie Schuldenproblematiek, 2003). The steady growth of the personnel costs related to Curaçao's government apparatus over the years has been identified as another major budget expenditure-raising factor (Commissie Financiële Perspectieven Land Curaçao, 2007). In addition, many considered the multi-island governance arrangement – the federal government and the governments at island level – to be a costly and inefficient administration system (Balkenende, 2008; Gardner & Prassl, 2009).

At the turn of the millennium, the general discontent of the Netherlands Antilles with the functioning of the multi-island governance arrangement resulted in the Netherlands Antilles requesting to have a referendum on each island to choose its own constitutional status. All of the five islands could opt for one of the four options: A) to remain within the Netherlands

Antillean federation, B) to become an autonomous country within the Kingdom of the Netherlands, C) to fully integrate into the Netherlands, or D) to pursue complete independence from the Kingdom. Curaçao and Sint Maarten each voted for option B, to become an autonomous country within the Kingdom of the Netherlands. Bonaire and Saba chose for option C, to become part of the Netherlands, whereas Sint Eustatius voted for option A, to remain part of the autonomous country of the Netherlands Antilles. These referenda formed the base for the new constitutional order for the islands (Kingdom of the Netherlands, 2005). Consequently, the multi-island governance arrangement was dismantled and the new order was ratified on October 10, 2010 (symbolically, 10-10-10). Under the new arrangement, the federal government tasks were transferred to the island governments, but similar to the old order, the Dutch government remained accountable for defense, the judicial system, and foreign policy in the Kingdom (Gardner & Prassl, 2009).

The start of the new country of Curaçao was tied to a debt relief in a so-called restructuring package. The package consisted of debt relief, the introduction of several budgetary norms and policies, the supervision of public finances, and compulsory improvement of financial management. It was also agreed that the Netherlands would have a standing subscription on all new government loans, as such creating the possibility for Curaçao to borrow at substantially lower rates. Lastly, the package contained the improvement of the investment climate and the socio-economic conditions on the island, through the development aid programs, SEI (Social Economic Initiative).

The negotiations on the restructuring package started in 2005 and were characterized by several drawbacks, e.g., the lack of yearly financial statements, incomplete government debt data, and different interpretations of definitions. These issues led to the repeated postponement of the date of completion of the constitutional reform. During the negotiations of the package, the debt relief itself was one of the controversial issues in the process of disbanding the

Netherlands Antillean federation and simultaneously starting the new entities in the Kingdom of the Netherlands. The debt relief was not well received by the Dutch taxpayers, as a Dutch Parliamentarian, remarked that their money was poured into a “bottomless pit” (Trouw, 2007; Linthorst, 2009). Some politicians of Curaçao brought forward that the debt was mainly domestic and had to be dealt with internally (La Prensa, 2008). Ultimately, the Dutch government agreed to settle the debt under the condition that Curaçao accepted to be supervised by the independent supervisory board, ‘College Financieel Toezicht’ (CFT), and work towards structurally improving its financial management (Kingdom of the Netherlands, 2006 (III)).

After the package was agreed upon by the parties involved, the SEI and the financial supervision got a go-ahead in 2008, while the debt relief and the standing subscription started at the beginning of 2009. In our analysis, we use 2009 as the starting point of the entire restructuring package. From the onset, it was agreed that the progress of the new constitutional order would be evaluated after 5 years of the ratification of the new entities, which ended up being on 10-10-10. So far, the constitutional reform process, the debt relief, and the development aid program (SEI) have been completed. The other package components: the supervision of public finances, standing subscription, and compulsory improvement of financial management are still ongoing. The effects measured in this paper therefore are based on those parts of the package components that have been implemented so far.

Prior to the implementation of the restructuring package, the government finances of Curaçao were unsustainable, as they were characterized by a vicious debt roll-over cycle, and increasing interest payments. This begs the question whether the implementation of the restructuring package has improved fiscal discipline, led to a balanced budget, and prevented further debt buildup. Hence, the focus of this paper is to assess whether the restructuring package led to strong financial management in Curaçao in the period of 2009-2014. The analysis consists of an evaluation of the public finances prior to and after the implementation of the restructuring package.

The paper is partitioned as follows. Section 2 gives a literature overview of the public finance literature in developing countries. To assess the developments of the public finances, the following key variables are used: the number of civil servants, personnel expenditures, interest payments, the primary balance and budget balance, formal public debt, and arrears. Sections 3 and 4 provide a general overview of public finance developments in Curaçao based on the key variables. Section 3 covers the period prior to the implementation of the restructuring package (1986-2008). Section 4 covers the period after the implementation of the package (2009-2014) and describes the restructuring package. Section 5 analyzes the developments in public finances by using international benchmarks to assess if progress has been achieved in the key variables, and whether the levels thereof correspond with strong financial management. This section offers recommendations to further improve the government finances of Curaçao and concludes.

2. Literature Overview

This section reviews the literature on common practices and benchmarks in public finances. We start with a review of the hypotheses that describe the relation between public revenues and expenditure. “Tax and spend” or “Spend and tax,” “Fiscal synchronization,” and “Institutional separation/fiscal neutrality” are four hypotheses that describe government behavior related to public finances. In the “Tax and spend” hypothesis, Friedman (1978) argues that there is a positive and causal relation between government taxation and spending: Higher taxes lead to increases in government expenditures. While others, like Barro (1974), consent on the “Spend and tax” hypothesis. According to this hypothesis, higher government spending and public borrowing will result in higher taxes. The “Fiscal synchronization hypothesis,” propagated by Meltzer and Richard (1981), states that governments’ choices on optimal tax and expenditure levels are decided upon simultaneously, based on voters’ utility maximizing demand for public services, and on voters’ perception of the government’s retribution function. In the “Institutional separation/Fiscal neutrality” hypothesis introduced by Baghestani and McNown (1994), there is no causal relation between government revenues and expenditures.

Schuknecht (2000) empirically shows the opportunistic behavior of policymakers around the period of elections (political business cycle theory). The study was conducted in 24 developing countries in the period of 1973–1992. The findings support the theory on political business cycle and led to the conclusion that the weak institutional structures in the developing countries may facilitate election-oriented fiscal policies. The incumbent policymaker exercises great efforts to increase the chances for his re-election and shows opportunistic and myopic behavior. As a result, the policymaker would focus on activities that provide immediate and visible results, when faced with the choice between reducing tax and increasing project investments**.** In developing countries, the tax base is too small, and a tax rate reduction will therefore not lead to an increase in support for the government. Furthermore, the impact of a tax rate reduction will in most cases not be felt immediately. By contrast, the impact of project investments is far more noticeable, as these create employment. As a consequence, project investment policies are more effective at attracting votes than tax reduction in the developing countries. Policymakers often increase public expenditures, in particular by increasing public investment in times of election. Both temporary employment in public infrastructure and the government wage bill have the tendency to rise in the pre-election periods. On the downside, when these government investments are set in motion they are difficult to reverse (Schuknecht, 2000).

Bose and Osborn (2007) examined the relation of the government's capital expenditures and current expenditures on the education, transport & communication, and defence sectors, on growth in the developing countries. Their main finding is that in particular in these resource-restrained countries, it is important to prioritize public expenditures and to provide incentives in the area of education.

Agénor and Neandidis (2011) studied the optimal allocation of public expenditures to achieve growth. The paper emphasized the need to allocate public expenditure on health, education, and infrastructure. An optimal allocation between these three sectors will lead to growth, as these areas are interlinked. Other studies also highlight the importance of health, education, and infrastructure. The consumption of nutritious food contributes to good health, which increases productivity (Arcand, 2001). Countries with high adult mortality have low growth rates (Lorentzen et al., 2008). Increase of the life span (as an indicator of health) has a positive impact on growth (Sala-i-Martin et al., 2004). Higher education levels can improve health (Glewwe, 1999). Highly educated mothers tend to be more aware of health issues and raise healthier children (Baldacci et al., 2004). Good infrastructure, e.g., a good transportation system tends to improve the number of children attending school, leading to a reduction in dropout rates (Levy, 2004). As aforementioned, investing in human capital, health, and infrastructure are interconnected and are important determinants of economic growth. In light of public budget constraints, it is often argued that governments should prioritize investing in these three areas of growth.

To curb public finance imbalances, benchmarks are needed. Benchmarks provide guidelines to manage (a) specific area(s) in public finances. To achieve sustainable public finances two benchmarks are often used: the wage bill ceiling and the debt-to-GDP ratio. The wage bill ceiling is a maximum cap to the public wage bill, and is defined as wage bill % of GDP. The wage bill is a large component of the government's expenditure. According to Fedelino, Schwartz, and Verhoeven (2006), a high wage bill has a direct impact on the performance of the economy, which includes: (1) crowding out of other spending by diverting funds to consumption at the expense of durable investments; (2) fiscal slippages; and (3) loss of competitiveness when public wage increases get into a general wage-price spiral. Also, under a fixed exchange regime, the macroeconomic effect of large gains in public wages and employment are more difficult to absorb than under a floating regime. As a result, many countries have responded by introducing wage bill ceilings to tackle issues about wage bill dynamics and to encourage structural reforms of public sector employment and wages.

Wage bill ceilings need to be accompanied by structural reforms to address inefficiencies of civil service employment and pay structures. The implementation of wage bill ceilings without structural reforms is insufficient to curb wage outlays to a sustainable level. Wage bill ceilings may create non-wage benefits, such as housing allowances and other types of rewards, which can lead to non-transparency in wage-related spending (Fedelino et al., 2006). Wage bill ceilings in Sub-Saharan Africa, Central America, and the Caribbean were reported to be on average 7% of GDP in 2003-2005. Whereas, in Asia, Europe, Middle East, and Central Asia, the wage bill ceilings are lower at 4% of GDP (Fedelino et al., 2006).

The debt-to-GDP ratio is a commonly used benchmark to curb public debt and deficit. For developed countries a public debt-to-GDP ratios of 60% is often considered optimal, while for emerging and developing countries 40% is generally viewed as a safe or sustainable level. Still, empirical data shows that actual debt-to-GDP ratios of countries in both categories often deviate largely from these benchmarks, especially following the global financial crisis of the late 2000s. These findings have prompted research aimed at identifying which levels of public debt can be considered detrimental to economic growth in developed countries. The results seem to suggest that debt-to-GDP ratios between the range of 90-96% of GDP may have a more dampening effect on growth compared to lower levels (Reinhart & Rogoff, 2010; Cecchetti, Mohanty, & Zampolli, 2011). Meanwhile, a recent IMF publication (Ostry, Ghosh, & Espinoza, 2015) states that for developed countries for which the risk of a financial crisis occurring is not high, the costs of bringing down their public debt level outweighs the benefits. However, these results cannot be applied blindly to developing countries. The benchmark for the developing countries is mainly aimed at risk management. In the specific case of Curaçao, the proposed ceiling is aimed at enabling the government to expand its spending, among other things, in the case of any unexpected shocks or contingent events (IMF, 2014). According to the IMF, Curaçao should aim to maintain its public debt ratio in a safe territory, that is, below the benchmark of 40% of GDP.

3. Overview of the public finances in the period 1986 - 2008

This section covers the period prior to the restructuring package, the period of 1986-2008. The government structure presented in Subsection 3.1 provides the background information on the government decisions made in the public finances during 1986-2008. This period was characterized by several austerity programs, shown in Subsection 3.2. In Subsection 3.3, a few key public finance indicators are analyzed.

3.1. The government structure: An overview

The Dutch Kingdom was composed of 3 countries, the Netherlands, the Netherlands Antilles, and Aruba between 1986, and October 9, 2010. The foundation of the Dutch Kingdom is stated in the 'Statuut voor het Koninkrijk der Nederlanden,' a law which defines the constellation and the relationship between the countries. The Netherlands Antilles was a democratic federation formed by the five islands of Curaçao, Bonaire, Sint Maarten, Sint Eustatius, and Saba. The country of the Netherlands Antilles was governed according to the 'Staatsregeling van de Nederlandse Antillen.' This law instituted the federal or central government, which had to perform tasks for the country of the Netherlands Antilles. The main responsibility of the central government was policy preparation. The central government consisted of three bodies, namely a governor, a council of ministers, and a parliament. Each of the five island governments had a lieutenant governor, an executive council, and an island council. The 'Eilandenregeling Nederlandse Antillen' (ERNA) was a law that stated the responsibilities of the authorities of the island governments. The island governments were primarily responsible for the formulation and implementation of government policies (Government of Curaçao, 2006). As a consequence of the 'Staatsregeling van de Nederlandse Antillen' and the 'ERNA,' the government structure of the federation was two-tiered: A federal (central) government located on Curaçao, and a local public entity on each island territory (island government).

The islands of Curaçao and Sint Maarten drafted their respective budgets independently, while the budgets of the islands of Bonaire, Sint Eustatius, and Saba (BSS islands) were produced at the central government level. The 'ERNA' provided for additional revenues for BSS islands, as their tax base was very small and insufficient to provide for basic tasks. It was agreed that the BSS islands would receive revenues from the "Solidarity Fund," funded by the island of Aruba (20%), the central government (55%), and the Netherlands (25%) (Berenschot, B.V., 1986; Havermans, Martes & Peterson, 2008). In practice, only the central government and the Netherlands contributed to the solidarity fund (Damoen, 2015). Prior to the dissolution of the federation of the Netherlands Antilles, the 'ERNA' was removed from the 'Statuut voor het Koninkrijk der Nederlanden' (Damoen, 2015).

3.2 The austerity programs

The high budget deficit was one of the main problem areas of the political arena in Curaçao. Over the years, policymakers reached out many times to national and international expertise for advice in these areas. The list of drafted plans and programs is substantial, as shown in Table 1. The period of the plan, in Column 2, shows the proposed time line of each program. The period of implementation, Column 3 shows when the programs were executed. Columns 4 to 9 present an overview of the value as % of GDP of the wage bill and the debt level prior to and at the end of each program. Table 1 shows the following: (1) several austerity programs have been proposed and implemented during 1986-2001; (2) all these programs ended up being short-term; (3) these programs accomplished in reducing the wage bill % of GDP; (4) these programs in contrast, failed to reduce the public debt % of GDP; and (5) despite several austerity programs, the public debt continued to expand. The programs frequently got off track, due to changes of governments after the election periods, which usually occurred every 2 years. During 2002-2008, the authorities failed to come up with a plausible program. The developments in the policy areas, including public finances, were overshadowed by the increased attention required from the policymakers to prepare for the new constitutional status of the islands of the Netherlands Antilles (BNA, 2003-2007).

Table 1
The Austerity Programs

Austerity program	Period of the plan	Period of implementation	Indicators			
			Wage bill		Public debt	
			Start (% of GDP)	End (% of GDP)	Start (% of GDP)	End (% of GDP)
(1)	(2)	(3)	(4)	(5)	(8)	(9)
Ekilibrio	1986 - 1989	1986- 1989	18.2	15.8	22.3	26.1
SAP-I- IMF program	1996 -	1997- 1998	16.8	15.5	45.7	48.7
Economic Recovery Plan	1998-2002	1998-1998	15.5	15.5	48.7	48.7
Urgency program	1999-	1999-2000	15.8	11.1	48.7	56.7
SAP-II- IMF program	2000-	2000-2001	11.1	9.7	56.7	56.4

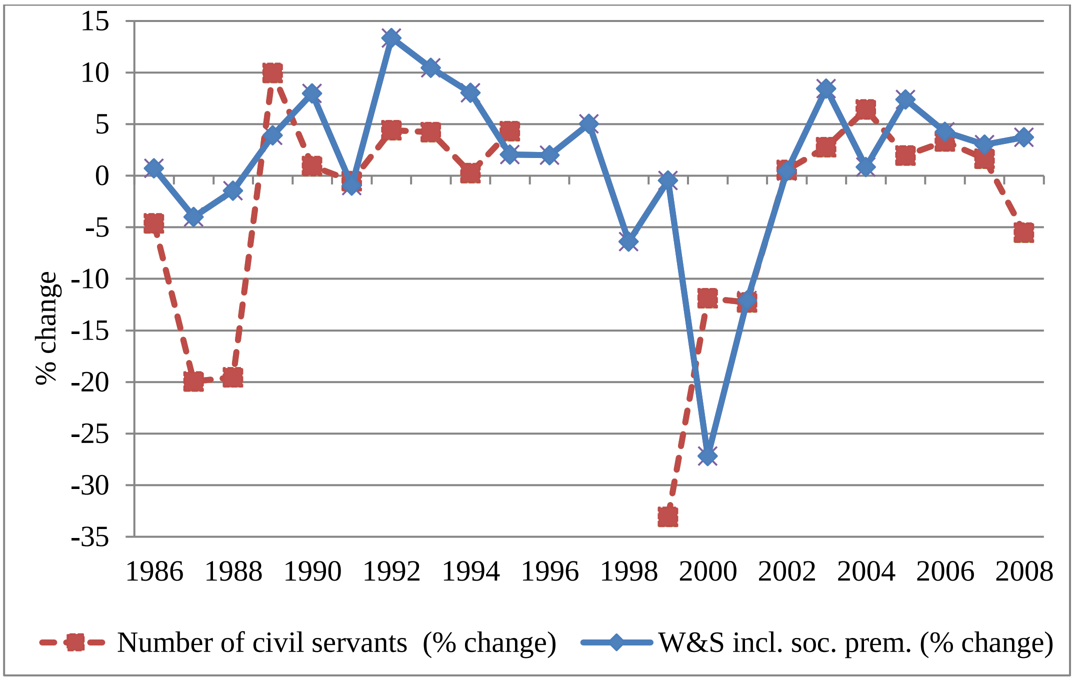
3.3 Public finance developments prior to the restructuring package

In the following sections, the developments in the public finances of Curaçao prior the restructuring package are discussed. The analysis focuses on the developments in civil servant employment and wage bill (3.3.1), interest costs, primary balance and budget balance (3.3.2), and formal public debt and arrears (3.3.3).

3.3.1 Civil servant employment and wage bill

The government deficit of the Netherlands Antilles and Curaçao became structural after the sharp reduction in revenues led by the repeal of the U.S. withholding tax since the mid 1980s. In addition, Shell, which operated the refinery, shut down their Curaçao operations in 1985, causing a large decline in the profit tax. In order to balance their respective budget, the central government and the island government of Curaçao proposed to implement the 'Ekilibrio' project for the years 1986-1989 (Berenschot, B.V., 1986). The plan was to gradually reduce the deficit by a projected 18% of GDP and reach a balanced budget by the end of 1989. The aim of the plan was to reduce the wage bill from 18.2% of GDP in 1986 to 5.9% of GDP in 1989. Figure 1 shows that in 1987 and 1988, the number of civil servants was reduced by respectively, 19.9% and 19.5%. As the government had to provide severance payment to the laid off civil servants, the impact of the decline in personnel was not immediately reflected in the wage bill and only a moderate decline was registered in the period 1987-1988. In 1989, the wage bill was reduced to 15.8% of GDP, which was 9.9 percentage points off target of the projected 'Ekilibrio' plan. After the general elections in 1988 and the change of island government, the project was discontinued in 1989. Figure 1 shows that the number of civil servants as well as the outlays on wages & salaries expanded following the discontinuation of the plan.

Figure 1
Developments in the Number of Civil Servants and Wages & Salaries (% change)
In 1986-2008



Sources: National Accounts, Statistical Yearbook, and Centrale Bank van Curaçao en Sint Maarten (CBCS).
Note: Civil servant employment data for the years 1996-1997 have been omitted because they are unreliable.

In 1991, the wage bill showed a temporary decline, which was in line with the drop in the civil servant employment. The gains in the government's wage bill in the period of 1992-1994 were the result of a reintroduction of fringe benefits for civil servants and the upward adjustments of the salaries and compensation of civil servants and teachers, the latter was to comply with the cost of living adjustment demands (Commissie Schuldenproblematiek, 2003). The growth in the wage bill was also due to the fact that the number of civil servants expanded (Figure 1).

In order to obtain budgetary assistance from the Netherlands, the Minister of Finance of the Netherlands Antilles reached an agreement in 1995 on the first International Monetary Fund (IMF)-supported program, named the Structural Adjusted Program (SAP-I). In the period 1995-1996, the government made the back payments owed to the civil servants, due to the unequal pay based on gender and marital status. Besides these payments, more civil servants were hired in 1995. These outlays resulted in an increase of the wage bill to 16.7% of GDP in 1995. Unfortunately, the data for the civil servant employment are unreliable for the period of 1996-1997. During 1996-1998, the Netherlands Antilles and Curaçao worked closely with the IMF to restructure the public finances and implement structural reforms to contain personnel costs. Nevertheless, the SAP-I was not completely implemented and the wage bill was reduced only moderately to 15.5 % of GDP in 1998.

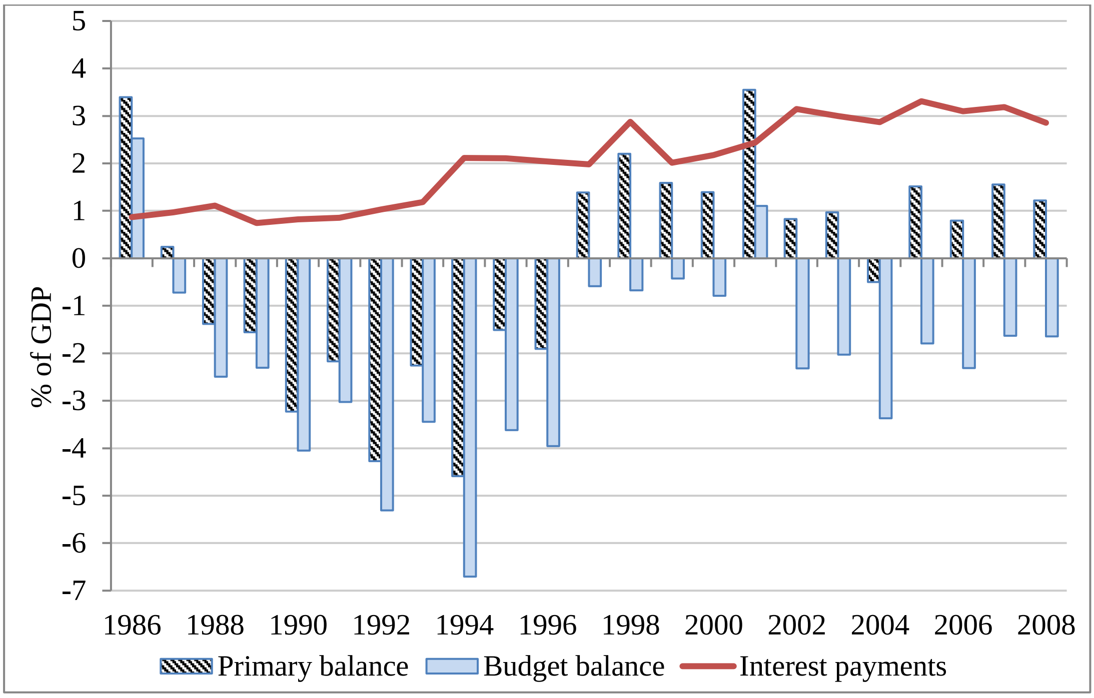
A new plan, the "Economic Recovery Plan" was initiated by the government in late 1998. However, the lack of consensus on expenditure reduction measures among the parties in the government, led to the dissolution of the government (BNA, 1999). Again, no action was taken to reduce the wage bill. In November 1999, a new government implemented an "Urgency Program" based on the recommendations of the National Plan Commission and the Inter-American Development Bank reports. The expenditure reduction measures included, among other things, a reduction in the government apparatus through lay-offs and privatization. The government apparatus was reduced by 30%, vacation allowance by 50%, periodic salary increments and indexation were frozen, and the period of the severance pay was lowered from 4 to 2 years in 1999 (BNA, 1999).

In September 2000, with the assistance of the IMF, the second SAP (SAP-II) was set up. Its measures aimed at re-establishing budgetary discipline, bringing the budget's financing needs in line with available resources, and settling the unpaid claims and arrears. Policy measures to keep personnel expenses in check involved a lay-off scheme for civil servants, the elimination of vacation allowance, and extension of the freeze of periodic salary increments. As a result, the civil servant employment and the wage bill shrank steadily in the period of 1999-2001 (see Figure 1). As the severance payments to the laid-off civil servants were included in the wage bill, the full impact of the measures was lagged. The lack of a credible government program and the reversal of structural reforms led to an increase in civil servant employment and, consequently, the wage bill rose to 10.1% of GDP in 2007.

3.3.2 Interest costs, primary balance, and budget balance

The primary balance is defined as the budget balance excluding interest payments. In the absence of interest costs, the primary and the budget balance are equal. In the case of Curaçao, the government finance figures published by the Centrale Bank van Curaçao en Sint Maarten (CBCS) for the 1986-2010 period contained both current account and capital account transactions, excluding financial transactions. As a result, an overall budget balance is shown in Figure 2 for this period rather than separate current account and capital account balances. An analysis of the data reveals that the Curaçao government bore positive interest cost in the entire period preceding the implementation of the restructuring package. Also noteworthy is that the government's interest payments show an upward tendency, reflecting the government's debt rollover and the crowding out on the domestic money and capital markets discussed earlier.

Figure 2
Developments in Interest Payments, the Primary Balance and the Budget Balance (% of GDP) In 1986-2008



Source: Centrale Bank van Curaçao en Sint Maarten (CBCS).

Figure 2 shows that in 1986, Curaçao's primary and budget balance were both positive, indicating that the government's interest payments were still manageable. However, dwindling revenues as a result of the repeal of the U.S. withholding tax and the departure of the Shell caused the tides to turn. Although the 'Ekilibrio' project started in 1987, this did not prevent the public finances of Curaçao from deteriorating, as only the primary balance was positive by the end of 1987. What's more, compared to the year before, the primary balance had deteriorated substantially. Throughout 1988-1996, both the primary and budget balance of Curaçao were negative, indicating that the government would have incurred a budget deficit even in the absence of interest payments. The introduction of cost saving measures implemented under the SAP-I in 1997, resulted in a positive primary balance in 1997. However, interest costs rose to 2.9% of GDP in 1998. This increase may have been led by back payments on the foreign debt. Since there were no such back payments in 1999, total interest payment dropped to 2.0% of

GDP. Despite the implementation of the "Urgency Program," the government still recorded a deficit on its budget during this period. Following the kick off at the turn of the millennium of new budgetary and reform measures under the SAP-II, the Curaçao government registered a budgetary 'surplus' in 2001 (BNA, 2001). This surplus was accompanied by large arrears due to non-payment of the pension contributions of civil servants for the year 2001 to the public pension fund, APNA.[1] Meanwhile, interest expenses rose because investors were willing to buy government securities only at very short maturities and higher interest rates (BNA, 2001).

The dire situation of Curaçao's public finances did not improve in the next few years, with its interest burden continuing to increase steadily reaching 3.0% of GDP in 2003. Although the primary balance of the government remained positive in most years, the government continued to incur budget deficits. In 2004, Curaçao had both a budget deficit and a negative primary balance, due to the fact that during that year medical expenses ballooned, while the island government also had to increase its health insurance premiums, on behalf of the family members of those insured with the social security bank (SVB[2]). In 2005, the government ran a positive primary balance, while its deficit narrowed compared to 2004. This improvement was mainly due to the large amount in withholding tax grants received from the Netherlands related to the tax arrangement for the Kingdom of the Netherlands (BRK).[3] Developments in the 2006-2008 period mirrored that of the 2002-2003 period: the government ran positive primary balances, but ran overall budget deficits due to its large interest payments. Similar to 1998, the interest payments were 2.9% of GDP in 2008.

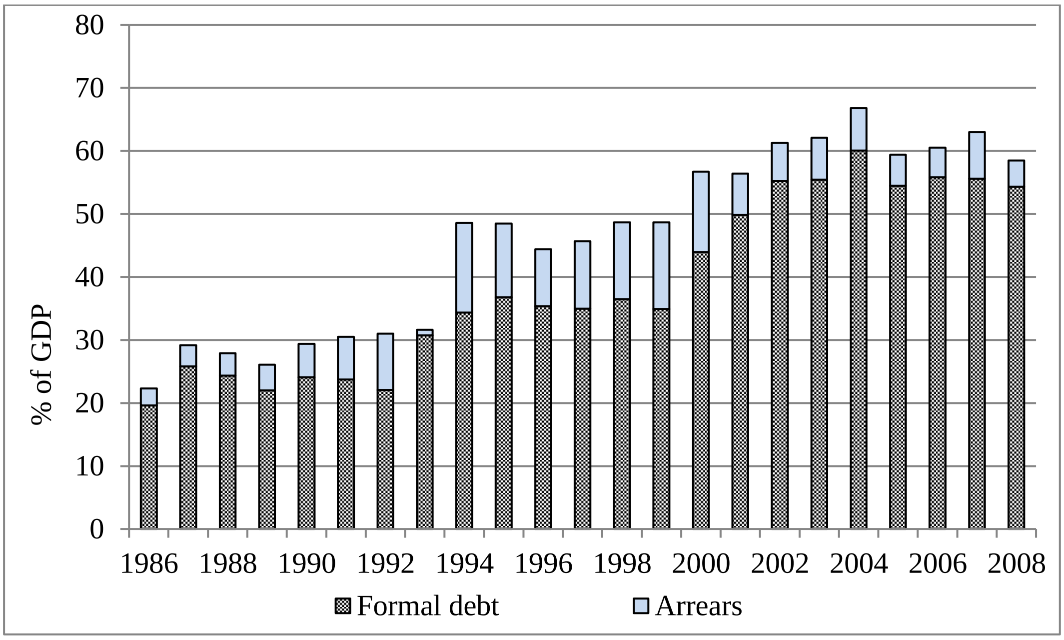
[1] 'Algemeen Pensioenfonds van de Nederlandse Antillen' (APNA)
[2] 'Sociale Verzekeringsbank' (SVB)
[3] As part of the 'Belastingregeling Koninkrijk' (BRK), all withholding tax collected on dividends paid by Dutch companies to their parent companies in Curaçao was transferred to the government of Curaçao.

3.3.3 Formal public debt and arrears

One of the indicators that are often used to measure the soundness of the public finances is the debt-to-GDP ratio. The public debt data described in this section shows Curaçao's formal debts separate from its arrears, because the latter were often poorly documented and not formalized. Particularly during the 1986-1992 period, the government barely published or reported the unpaid bills that it incurred. This buildup of arrears by Curaçao had its roots in the government's inadequate financial administration and its inability over time to service its existing liabilities (Romero, 2014). Rather than issue interest-incurring securities, the government often dealt with its cash shortfalls by not complying with its obligations to the central government, the public pension fund (APNA), and the social security bank (SVB). The formalization of accumulated arrears often resulted in jumps in the debt-to-GDP ratio, as revealed in Figure 3.

In 1987-1989, the 'Ekilibrio' project was implemented. However, despite the efforts to balance the government budget, the public debt-to-GDP ratio rose from 22.3% in 1986 to 29.2% in 1987, as shown in Figure 3. Subsequently, the public debt-to-GDP ratio trended down, to 27.9% in 1988 and 26.1% in 1989. The lower level of debt-to-GDP in 1988 was owed to the drop in the foreign-currency denominated debt, due to the appreciation of the US dollar, and hence the Netherlands Antillean guilder. Meanwhile, the decline of debt-to-GDP ratio in 1989 was contributed by an autonomous gain of the nominal GDP increase of 13.1%. Since the discontinuation of the 'Ekilibrio' program in 1989, the level of debt-to-GDP grew steadily, reaching 31.6% in 1993. The shift in the composition of public debt in 1993 was the result of an inquest into the government's outstanding arrears, which led to a large amount of arrears being converted into formal interest bearing liabilities. In 1994, Curaçao's public debt-to-GDP ratio jumped to 48.6%, largely ascribable to further inventorying and formalization of a substantial amount of arrears that had remained unregistered until then. This debt-to-GDP ratio was above the benchmark (40% of GDP), which is currently considered to be unsustainable for Curaçao (IMF, 2014).

Figure 3
Developments of Formal Debts and Arrears (% of GDP)
In 1986-2008



Source: Centrale Bank van Curaçao en Sint Maarten (CBCS).

In 1996, the somewhat lower debt-to-GDP ratio of 44.4% was owed to the drop in the foreign-currency denominated debt component, due to the appreciation of the US dollar, and hence, the Netherlands Antillean guilder. The foreign debt accounted for about 26% of Curaçao's total public debt by the end of 1996. The public finances of Curaçao continued to deteriorate despite the SAP-I (1997-1998). The growing public deficit led to a steady increase in the public debt during this period, as the lack of proper expenditure supervision control systems led to expenditure overruns. The financing constraints resulted in a sizeable buildup of arrears. According to the IMF, the SAP-I failed to bring the public finances under control because the policy measures were not carried out as expected, and no proper corrective action was taken to address further shortfalls in the international financial sector's profit taxes and non-tax revenues (IMF, 1999; BNA, 1996-2008).

The sales tax or 'Algemene Bestedingsbelasting' (ABB) was abolished in January 1999 and was gradually replaced by a 2% turnover tax or 'Omzetbelasting' (OB) during March-May 1999. In mid-1999, policy measures to raise the government revenues under the "Urgency Program" included broadening of the tax base of the turnover, wage, and income tax, and strengthening of tax enforcement and collection. The first step of this program was to raise this turnover tax in phases from 2% to 5% in October 1999. Despite the efforts of the "Urgency Program," government spending grew at a much faster pace than tax revenues, showing a "Tax and spend" behavior. As shown in Figure 3, under the "Urgency program," the debt-to-GDP ratio trended up from 48.7% in 1999 to 56.7% in 2000.

By the end of 2004, the outstanding public debt of Curaçao amounted to 66.8% of its GDP. After peaking in 2004, Curaçao's debt-to-GDP dipped just below 60% in 2005, as a result of a large amount in withholding tax grants related to the tax arrangement for the Kingdom of the Netherlands (BRK)[4] received in 2005 from the Netherlands. This revenue influx enabled the government to cancel part of its outstanding obligations, as well as settle some of its arrears. The debt-to-GDP ratio rose above 60% in the following two years, before declining to 58.4% in 2008, partly as a result of an autonomous gain of the nominal GDP of 9.2%.

4. Overview of the public finances in the period 2009-2014

This section provides an overview of developments in Curaçao's public finances following the initiation of the implementation of the restructuring package in 2009. First, the components of the restructuring package itself are discussed in section 4.1. Subsequently, general

[4] As part of the 'Belastingregeling Koninkrijk' (BRK), all withholding tax collected on dividends paid by Dutch companies to their parent companies in Curaçao was transferred to the government of Curaçao.

developments in the public finances of Curaçao are discussed for the period 2009-2014, followed by an analysis of key public finance indicators.

4.1 The restructuring package

The restructuring package was designed to create a "fresh start" for Curaçao before embarking on its new path as an autonomous country within the Dutch Kingdom. The package is partitioned in the following components:

4.1.1. Compulsory budgetary norms and financial supervision

4.1.2. Compulsory improvement of financial management

4.1.3. Public debt relief

4.1.4. Standing subscription

4.1.5. Improvement of the investment climate and the socio-economic conditions

The subsections will shed some light on the package components and their status since 2009. The constitutional reform to which the restructuring package was tied, culminated on 10-10-10, and the package continued its due course since. By the end of 2014, the debt relief and the SEI were completed. The other package components are still ongoing.

4.1.1 Compulsory budgetary norms and financial supervision

Early on during the negotiations to disband the Netherlands Antillean federation, the Netherlands announced it would be willing to restructure the public debt of the Netherlands Antilles, provided that this was accompanied by healthy budgetary policy and strict financial management to guarantee the sound financial position obtained through the relief (Kingdom of the Netherlands, 2006 (III)). The legislation underlying the current supervision of Curaçao's public finances by the 'College Financieel Toezicht' (CFT) was laid down in the Final Accord of November 2, 2006, and later on in the Kingdom Act Financial Supervision Curaçao and Sint Maarten of 2010 (the Financial Supervision Act). The supervision of the public finances of the island government of Curaçao started in December 2008. The supervision entails that the CFT has a signaling and advisory function in the processes related to the drafting and execution of Curaçao's public budget. The CFT supervises whether the public budget and related processes comply with the existing norms and regulations, and oversees the issuance of public loans by the government of Curaçao. In a nutshell, the CFT assures that Curaçao adheres to (1) the balanced budget rule, (2) the interest burden rule, and (3) the public loan issuance policies and procedures.

1. The balanced budget rule involves:

    a) The drafting and maintaining of a balanced public budget for each fiscal year, along with a balanced multiannual projection (for the following three years). The budget for a fiscal year has to be approved before the end of the preceding year.
    b) Maintaining a balanced current account of the public budget. A deficit is permissible on the capital account of the public budget, provided that the ceiling stipulated by the interest burden rule has not been reached.
    c) Compensating for any budget deficit incurred in a fiscal year by running surpluses in the next year(s).

2. The 5% interest burden rule involves:

    a) Maintaining yearly interest costs at or below the level corresponding with 5% of the average government revenues[5] of the three years prior to the fiscal year in which a

[5] The interest burden rule is based on the revenues of the 'collectieve sector,' a broad definition of the public sector which includes the "central government of Curaçao" and several other public entities, based on criteria derived from the System of National Accounts (SNA).

budget is drafted. In essence, the interest burden rule defines a loan ceiling based on the government's revenue-generating power.

3. The public loan issuance policies and procedures entail that:

   a) Public loans may only be issued for the purpose of making capital investments.
   b) Public loans may only be issued in compliance with a balanced current account on the government budget.
   c) Public loans may only be issued up to the ceiling defined by the interest burden rule.
   d) All public loans are subject to the standing subscription of the Netherlands (see Section 4.1.4).

When a government budget is adopted by the Parliament, it also requires the approval of the CFT. Similarly, the CFT has to ascertain whether the budget is balanced before giving the green light for the Curaçao government to issue loans. Pursuant to the Financial Supervision Act, the CFT may provide Curaçao with unrequested counsel as it sees fit. In the case that the Curaçao government fails to adhere to the compulsory budgetary norms, policies and procedures, and subsequently fails to mend its ways when advised to do so, the CFT may choose to proceed with an escalation procedure. Pursuant to the Financial Act, the CFT may advise the Kingdom Council of Ministers to instruct the Curaçao government to comply with the compulsory budgetary norms, policies and procedures. If the Kingdom Council of Ministers opts to follow the CFT's advice, the Curaçao government would then be given an official instruction to implement - or refrain from carrying out - certain tasks or activities. Although the Financial Supervision Act does not specify this, failure to comply with an instruction, may result in the government of Curaçao being placed under legal guardianship of the Kingdom Council of Ministers.

4.1.2 Compulsory improvement of financial management

For years, the financial management of the Curaçao government was not up to par, with many annual accounts not being drafted or not being able to pass the checks of any audits. Moreover, the day-to-day financial management and administration often breached the prescribed budgetary policies and procedures. For example, liabilities were often incurred without the necessary approvals, often resulting in higher-than-expected budget deficits and the piling up of arrears. The Netherlands was willing to restructure the public debt of the island of Curaçao, but only if this was accompanied by healthy budgetary policy and strict financial management. Hence, Curaçao was forced to step up its efforts at improving its financial management.

The CFT is in charge of supervising the progress of the processes that Curaçao has been putting in place in order to improve its financial management. The methodology applied by the CFT for this purpose is based on the Performance Measurement Framework (PMF) of the Public Expenditure and Financial Accountability (PEFA) Program (PEFA, 2014). The financial management of Curaçao government is evaluated by scoring 29 different indicators, amongst them, the reliability, completeness, and transparency of the government budget, and the accuracy and internal control of the budget execution process. The indicators are assessed on a yearly basis to monitor the government's progress. In late 2015, an evaluation to ascertain the advancement achieved in the 2011-2015 period will be finalized. The conclusions from the evaluation include the fact that Curaçao did not fully nor independently comply with the norms of the Kingdom Act. After the public finances derailed in 2011, Curaçao was given an instruction by the Kingdom Council of Ministers, after which the public finances improved. The evaluation commission recommends that the financial supervision be kept in place in the meantime (Evaluatiecommissie Rijkswet financieel toezicht Curaçao en Sint Maarten, 2015) (Evaluatiecommissie Rijkswet financieel toezicht Curaçao en Sint Maarten, 2015).

4.1.3 Public debt relief

The restructuring of Curaçao's consolidated public debt by the Netherlands started in the beginning of 2009 and lasted up to 2010. The agreements reached with the Netherlands were as follows:

1. The Netherlands agreed to restructure 70% of the formal consolidated public debt of the central government of the Netherlands Antilles and the island government of Curaçao, as outstanding on December 31, 2005. In the case of Curaçao, this corresponded with USD 1,058.4 million in debt relief grants, equal to 45.1% of GDP in 2005.

2. The Netherlands also agreed to settle a maximum amount of USD 83.2 million (3.5% of GDP in 2005) of the Curaçao government's arrears, as outstanding on December 31, 2005. Government arrears were often poorly documented and not formalized; hence they were dealt with separately from the government's formal debts.

3. Upon the dissolution of the central government of the Netherlands Antilles, the non-restructured 30% of the central government's debt would be 'inherited' by the five islands according to the following ratios: Curaçao 74.3%, Sint Maarten 17.7%, and the BSS islands 8%.

4. Throughout 2009 and up to 9-10-10, Curaçao received debt relief in the form of debt service payment assistance: the Netherlands settled 100% of maturing principal and 70% of Curaçao's interest payments due during this time. These payments were considered as advance payments on the amount of USD 1,058.4 million in debt relief, which Curaçao had been promised. On October 10, 2010, the day the constitutional reform was completed, and on October 15, 2010, the Netherlands and Curaçao made the necessary final transactions to settle the agreed 70% relief on Curaçao's formal debt.

5. The arrears of the Curaçao government were gradually settled by the Netherlands throughout 2009 and 2010, after they received the approval of independent auditors. By the end of October 2010, only USD 9.1 million of the USD 83.2 million had actually been used to pay off outstanding government arrears. The data about the exact amount that was applied in the end to settle arrears is not available.

Table 2 provides an overview of the restructuring of Curaçao's public debt. It shows that the outstanding *formal* public debt of the island (that is, excluding arrears) declined from 53.0% of GDP in 2005 to 15.7% of GDP on October 10, 2010. After inheriting its share of the central government's formal debt, Curaçao's debt-to-GDP rose to 31.8% of GDP on October 15, 2010. By the end of 2010, Curaçao's *total* public debt (that is, including arrears) was 34.6% of GDP (not shown in Table 2).

Table 2
Overview restructuring formal public debt

	Amount (in mln. USD)	**% of GDP**
Outstanding consolidated formal debt on 31-12-2005	1,242.5	53.0
Agreed debt relief on formal debt (principal & interest)[1]	1,058.4	45.1
Outstanding formal debt on 10-10-2010 after 70% debt relief[2]	459.5	15.7
Inheritance from the former central government[2]	481.4	16.4
Outstanding formal debt on 15-10-2010	931.5	31.8

Sources: Stichting Overheids Accountants Bureau (SOAB), Centrale Bank van Curaçao en Sint Maarten (CBCS).
Notes: 1) Values per December 31, 2005.
2) Values per October 10, 2010. Due to present value calculations, other computations and rounding, numbers do not add up.

4.1.4 Standing subscription

The standing subscription of the Dutch State Treasury Agency (DSTA)[6] was introduced in early 2009, with the primary aim of bringing down the interest costs borne by Netherlands Antillean government entities. The standing subscription entails that whenever the government of Curaçao issues loans, the DSTA is obliged to bid on these loans, while asking relatively lower effective yields, comparable to those that apply on Dutch State loans with similar maturities. The Financial Supervision Act not only obliges the DSTA to bid; in addition, the full amount requested by the Curaçao government must be offered by the DSTA. The implication of the standing subscription is that the Dutch euro yield, which in the last several years has been lower than the US dollar yield, is applied on Curaçao's public loans. However, the Dutch euro yield corresponds with the Netherland's sovereign risk, which is considerably lower than Curaçao's relatively high country risk. Hence, the standing subscription means that the Curaçao government can borrow at artificially low rates that do not reflect its risk.

Since the introduction of the standing subscription, the landscape on Curaçao's capital market changed completely. Local investors hardly ever purchase government securities, since the yield on government paper is too low relative to the risk. What's more, since the Curaçao government has to adhere to the balanced budget rule, the interest burden rule, and the borrow-for-capital-investments-only loan policy, government financing demand has remained relatively subdued in the last four years, compared to before the debt relief. The crowding out and interest-hike effect exerted in the past by the government on the domestic money and capital markets have eased, exacerbating the long-lasting excess liquidity in Curaçao's economy.

[6] The DSTA is a subdivision of the Dutch Ministry of Finance that is in charge of managing the Dutch public debt.

4.1.5 Improvement of the investment climate and the socio-economic conditions

The Netherlands made an initial USD 33.8 million (1.4% of GDP in 2005) available for the implementation of a multi-annual development aid program in Curaçao, aimed at improving the investment climate and the socio-economic circumstances on the island. This initiative was called Social Economic Initiative (SEI). The idea behind the SEI was to enable the new country not to depend on development aid in the future. The SEI commenced in 2008, and was supposed to culminate in 2012. The SEI projects included, among other things, projects to restructure the economy of Curaçao, improve the government's financial management and organization, upgrade the physical infrastructure and educational systems on the island, promote the establishment of sound small- and medium-sized enterprises, and fight unemployment. Due to delays in the implementation of projects, the SEI was extended until the end of 2014. In the meantime, the SEI budget was supplemented by funds reallocated from other development projects, bringing the total up USD 54.9 million (2.3% of GDP in 2005). Table 3 provides an overview of the SEI budget and spending. Throughout the period 2008-2013, USD 49.3 million was spent, which is on average about 0.35% of GDP per year.

Table 3
Social Economic Initiative (SEI) budget and spending

	Amount (in mln. USD)	**(% GDP in 2005)**
Budgeted	54.9	2.3
Spending[1]	49.3	2.1

Source: USONA - Implementation report year 2013.
Notes: [1)] Values per December 31, 2013.

4.2 Public finance developments after the restructuring package

In the following sections, the developments in the public finances of Curaçao after the implementation of the restructuring package are discussed. First, general public finance developments in the period 2009-2014 will be discussed. Subsequently, the analysis focuses on the developments in civil servant employment and wage bill (4.2.2), interest costs, primary balance and budget balance (4.2.3), and formal public debt and arrears (4.2.4).

4.2.1 General developments in the public finances[7]

The implementation of the debt relief package brought about many changes in the area of public finances in Curaçao. One of the most noteworthy changes was the fact that after many years of running structural deficits, the Curaçao government ran a large budget surplus in 2009 (7.7% of GDP) as well as 2010 (9.6% of GDP). These surpluses were a direct result of the way the debt relief received from the Netherlands was administered. The debt relief grants were included in the revenues of the Curaçao government in 2009 and 2010. By contrast, the amortizations paid for with these funds were not included in the government's expenditures. As a result, Curaçao was able to register a budget surplus in both years. In 2011, however, the tides seemed to have turned, as Curaçao's public finances started to derail again. By mid-2012, it became clear that the government ran a deficit on its current account in 2010, in the period between October 10, 2010 and the end of that year, as well as in 2011 (2.8% of GDP). It also became evident that if no immediate measures were taken, the following years would be concluded with progressively larger budget deficits. Besides the uncontrolled rise in current

[7] The debt figures in this section and beyond are based on the narrow definition of government that is the 'central government only. Hence, these figures may differ from debt figures based on Curaçao's 'collectieve sector,' a broader definition of the public sector which includes the "central government of Curaçao" and several other public entities, based on criteria derived from the System of National Accounts (SNA).

expenditures, 2011’s deficit was due to the shortfall of the social security bank, SVB. What's more, according to the SVB's projections, its deficits would continue to increase sharply each year if no policy changes were implemented. Since the government is legally obliged to cover any shortfalls of the SVB, this meant that the public budget would be under strain for many years to come if no measures were taken by the government.

Seeing that the Curaçao government had breached the compulsory budgetary norms in the Financial Supervision Act by running a deficit at the end of 2010 as well as during 2011, and that little headway was being made to avoid future deficits, the CFT advised the Kingdom Council of Ministers to give Curaçao an instruction. In July 2012, the Curaçao government was given an official instruction by the Kingdom Council of Ministers to sort out its budget woes and bring the 2012 budget back in line with the norms stipulated in the Financial Supervision Act. The instruction obliged the Curaçao government to implement several cost reducing and revenue increasing measures. The government was coerced to, among other things, immediately introduce a vacancy stop, address the SVB crisis by raising the old age pension age in one go from 60 to 65, and reform the health insurance system by launching a new standard health insurance package. These and other measures led to a slow but steady improvement in Curaçao’s public finances. The current account deficit was narrowed to 0.6% of GDP in 2012, while 2013 was closed with a current account surplus of 1.5% of GDP. As a result of the improvements in Curaçao’s public finances, the instruction was finally removed in March of 2014. By the end of 2014, the Curaçao government ran a surplus of 0.3% of GDP.

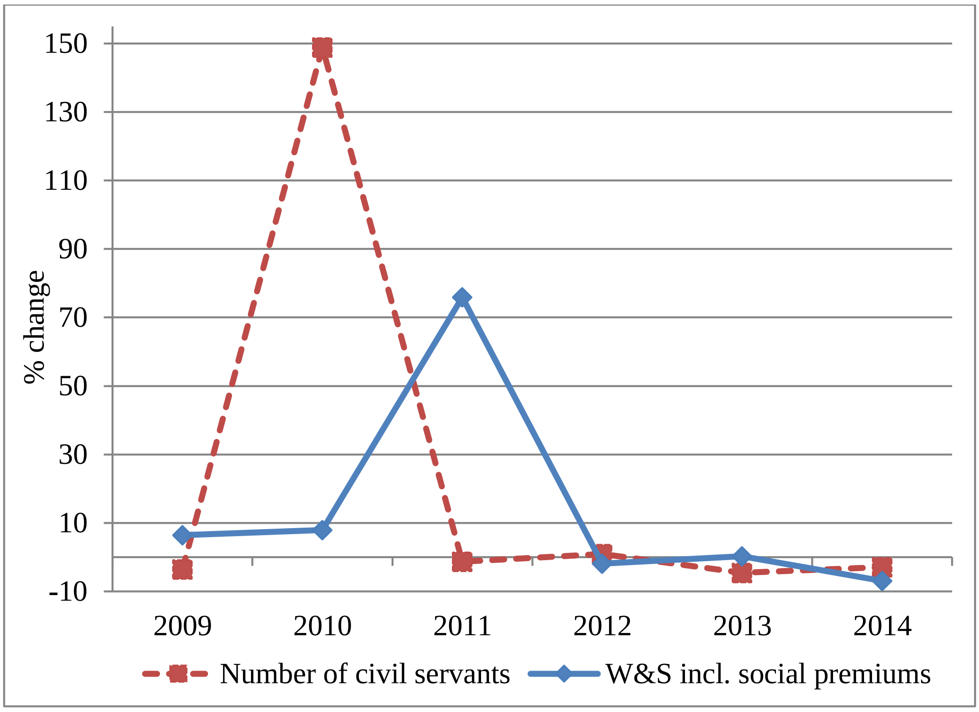
4.2.2 Civil servant employment and wage bill

In 2009, the number of civil servants dipped slightly, before increasing by about 150% in late 2010, as a result of the merger of the two tiers of the public administration system. This increase roughly coincides with 75%[8] of the central government's total employees up to October 2010. The jump in Curaçao's number of civil servants was not surprising, as prior to the dissolution of the central government on 10-10-10, all civil servants had been granted job security. This job guarantee had been laid down in a so-called 'Social Statute' agreed upon with the civil servant labor unions. As a result, however, no short-term efficiency or cost-saving was expected in the short-term from the merger of the two government layers. In 2009, outlays on wages and salaries continued the upward trend of the preceding few years, at a more accelerated pace (see Figure 4). This acceleration was owed partly to gains in personnel costs related to the indexation of salaries to compensate for the elevated inflation (6.9%) in 2008. At the same time, the Curaçao government increased its consumptive outlays to speed up the necessary tasks and processes to finish off the constitutional reform by the chosen date of 10-10-10 (BNA, 2009). Consequently, wage and salary disbursement climbed to 10.7% of GDP in 2010.

Figure 4 shows that in 2011, the number of civil employees dropped somewhat compared to 2010, contrasting with the major rise (75.9%) in personnel expenses. This jump was due to the lag in wage bill payments following the addition of the former central government employees to Curaçao's payroll. Curaçao's wage bill reached 13.2% of GDP in 2011. During 2012, the government received an instruction from the Kingdom Council of Ministers, forcing Curaçao to introduce a hiring stop, among other things. As a result, the number of civil employees grew only marginally, while total wage and salary outlays fell. During 2013 and 2014, the quantity of civil employees dropped by 4.6% and 2.9%, respectively, as a net outflow of employees took place. Although the hiring stop was repealed in March 2014, the government opted voluntarily to uphold it, in order to continue to contain personnel costs. Consequently, outlays on wages and salaries declined further, reaching 12.2% of GDP in 2014.

[8] As a rule of thumb, Curaçao could be allocated about 75% of the operations and resources of the central government of the Netherlands Antilles.

Figure 4
Developments in the Number of Civil Servants and Wages & Salaries (% change)
In 2009-2014



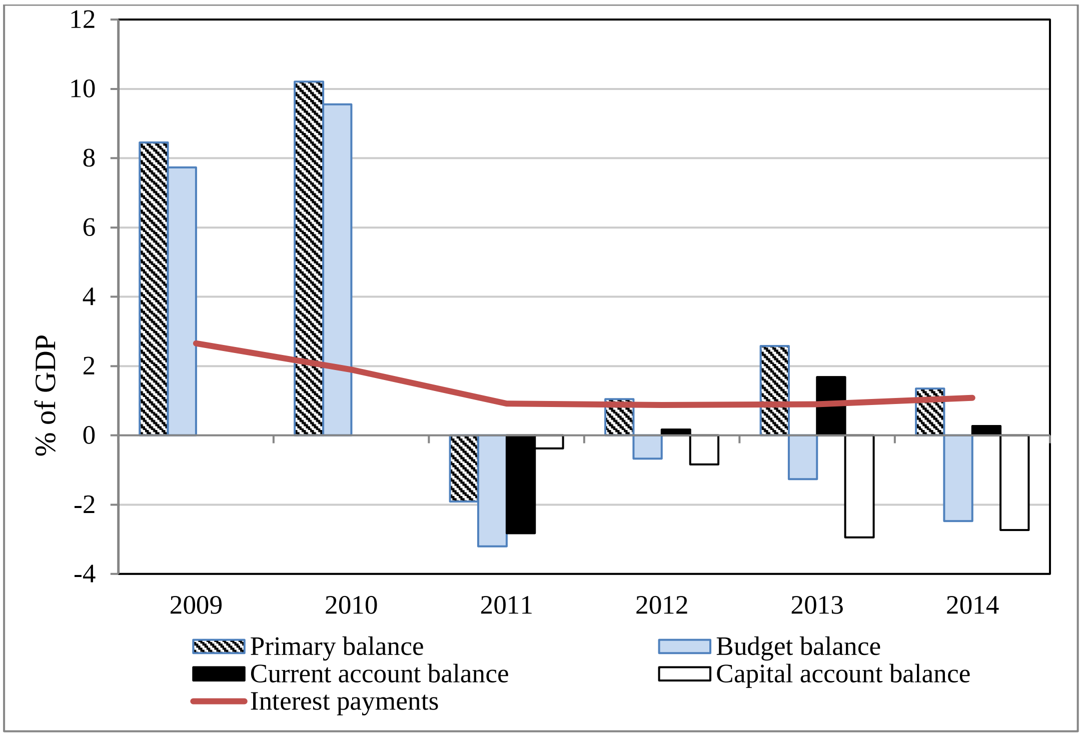
Sources: National Accounts, Statistical Yearbook, and Centrale Bank van Curaçao en Sint Maarten (CBCS).

4.2.3 Interest costs, primary balance, and budget balance

In 2009 and 2010, the government of Curaçao received debt relief from the Netherlands. During this period the Netherlands covered 100% of maturing principal and 70% of interest payments due by the Curaçao government. As was mentioned in Section 3.3.2, the government budget balance as registered in the 1986-2008 period was the result of both current account and capital account transactions, excluding financing and amortizations. The same was the case for 2009 and 2010, when Curaçao obtained debt relief from the Netherlands. The fact that the debt relief grants were included in the government's revenues, while the amortizations paid for with these grants were not part of the government's expenditures, led to a large budget surplus being recorded in both years. For the first time since 2001, Curaçao registered a budget surplus (7.7%) in 2009. The following year, the government was able to run a budget surplus amounting to

9.6% of GDP, as revealed in Figure 5. Meanwhile, the primary surplus registered at 8.5% of GDP in 2009, before climbing to 10.2% of GDP in 2010. Since 70% of the interest payments were covered by the Netherlands, the primary balance in 2009 and 2010 is defined as the budget balance excluding the 30% of the interest payments that were actually paid for by the Curaçao government.

Figure 5
Developments in Interest Payments, the Primary Balance and the Budget Balance (% of GDP) In 2009-2014



Source: Centrale Bank van Curaçao en Sint Maarten (CBCS).
Note: Due to improvements in the government's administration since the merger of the two government layers, the budget balances data from 2011 onwards are not entirely comparable to earlier data.

In 2011, the government of Curaçao improved its financial reporting somewhat, following the merger of the former two-tiered government system. One key noticeable improvement in the government finance figures published by the Centrale Bank van Curaçao en Sint Maarten (CBCS) is the clear distinction between the current account and the capital account of the government budget. Therefore, Figure 5 shows both a current account and a capital account balance for the year 2011 and beyond, in contrast to the 1986-2010 period, when only an overall budget balance was registered. The capital account balances shown for the 2011-2014 period include the proceeds of all loans received and given out by the government. Figure 5 shows that 2011 was concluded with all negative balances. In 2012, when Curaçao was instructed to end its budgetary woes, the government recorded a positive primary balance and current account balance. Although initially a current account deficit was registered in 2012, this turned into a current surplus following the resolution of a pending legal case regarding withholding tax grants to be received from the Netherlands under the tax arrangement for the Kingdom of the Netherlands (BRK).[9] In 2013 and 2014, the contractionary measures introduced by the government to comply with the instruction it received in 2012 led to positive primary and current account balances. However, the capital balance in these two years were negative, as a result of loans the government issued to finance, among other things, the construction of a new public hospital.

4.2.4 Formal public debt and arrears[10]

In this section, the arrears of the Curaçao government's are shown separately from its formal debts, consistent with previous sections. Figure 6 shows that following the initiation of the debt relief program in February 2009, Curaçao's public debt dropped from 58.5% of GDP in 2008 to 52.9% at the end of 2009. Throughout 2009 and up to October 9, 2010, Curaçao received debt relief from the Netherlands in the form of payments assistance, enabling the government to record a cash surplus by the end of 2009, its first surplus since many years. After

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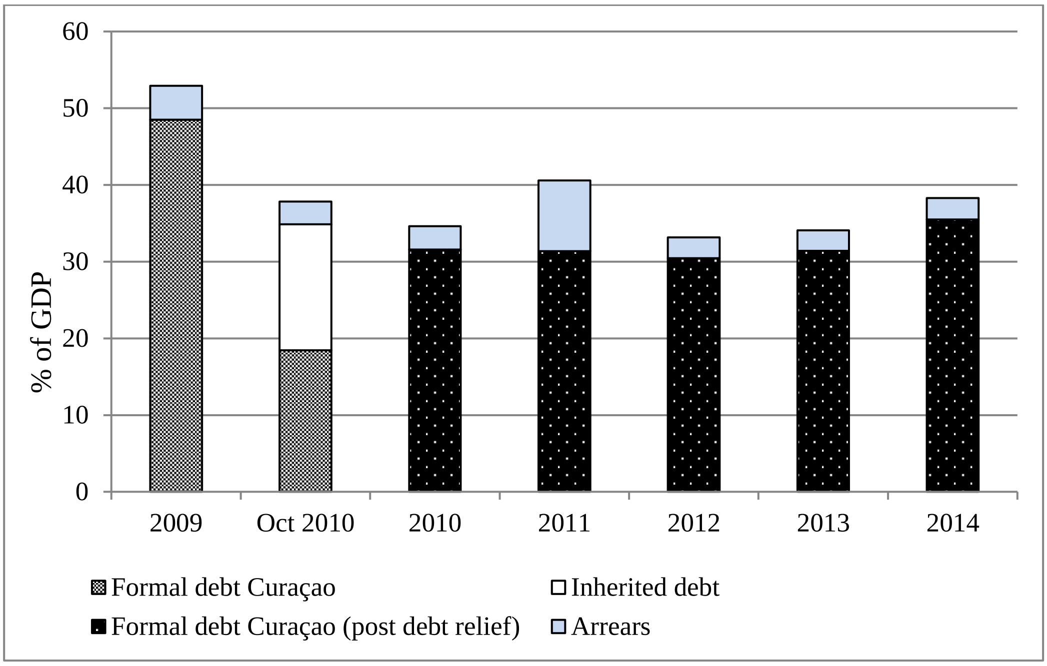
[9] As part of the 'Belastingregeling Koninkrijk' (BRK), all withholding tax collected on dividends paid by Dutch companies to their parent companies in Curaçao was to be transferred to the government of Curaçao.

[10] The debt figures in this section and beyond are based on the narrow definition of government that is the "central government of Curaçao" only. Hence, these figures may differ from debt figures based on Curaçao's 'collectieve sector,' a broader definition of the public sector which includes the "central government of Curaçao" and several other public entities, based on criteria derived from the System of National Accounts (SNA).

receiving the promised 70% debt relief on its formal debt, 73.4% of the central government's post-debt-relief debt was allocated to the Curaçao government on October 10, 2010. As a result of this inherited debt, Curaçao's *total* public debt (formal debt and arrears) registered at USD 1,022.3 billion, or 34.6% of GDP by the end of 2010. This ratio is below the 40% benchmark that can be considered sustainable for Curaçao.

Figure 6
Developments of Formal Debts and Arrears (% of GDP)
In 2009-2014



Source: Centrale Bank van Curaçao en Sint Maarten (CBCS).

In 2011, Curaçao's debt-to-GDP ratio jumped to 40.6%, as a result of the rapid accumulation of arrears by its new government. Government arrears grew fast in 2011, reaching 9.2% of GDP, particularly as a result of the buildup of liabilities with the social security bank, SVB. Following the instruction of 2012, however, Curaçao was forced to improve its financial management and payment discipline, bringing down its public debt to 33.2% of GDP, and its arrears to 2.7% of GDP. In 2013 and 2014, Curaçao met the complementary budgetary and loan requirements, which enabled the country to issue USD 173.5 million in new loans, in order to make capital investments, particularly in a new hospital and the road infrastructure. These investments had been postponed for decades prior to the restructuring package, as the government lacked the necessary funds. As a result of these new debt issuances, however, Curaçao’s public debt rose to 34.1% in 2013, before reaching 38.2% in 2014. The government’s outstanding arrears remained fairly stable in 2013 as well as in 2014, registering at 2.6% and 2.8% of GDP, respectively.

The rise in Curaçao’s public debt over the course of the last few years, has led to concerns, among others the IMF and the CFT, about the debt-to-GDP ratio approaching and eventually exceeding the benchmark of 40% of GDP. These concerns arose due to the low Dutch interest rates applied during the debt relief program, which led to a debt-to-GDP ratio of 34.6% by the end of 2010 for Curaçao. In addition, interest rates have been historically low for years now. As a result, the 5% interest burden rule has been stipulating maximum loan ceilings for Curaçao at debt levels that by far exceed 40% of the country’s GDP (CFT, 2014). However, public debt ratios beyond this benchmark would not be sustainable for an open and small economy like Curaçao, and could cause the country to end up in a situation of debt roll-over all over again once global interest rates rise.

5. Conclusion and recommendations

The public finances of Curaçao have been marked by frequent shocks. The main negative shock, the repeal of the U.S. withholding tax led to increasing government budget deficits and debt roll-over. The government was never able to recover from this loss of tax revenues. Moreover, despite considerable efforts put into the austerity programs, the government was not able to attain sustainable public finances. Often, unpopular austerity programs got sidetracked because of the frequent tensions between the coalition partners and the change of governments. With the change of each government, there's a tendency to increase the number of personnel, which is consistent with the political business cycle theory of Schuknecht (2000). The experiences with austerity programs show that it is difficult to reverse measures, especially those related to personnel.

The wage bill has been one of the major expenditures of the budget, and strict rules must be applied to this area. The austerity programs executed till now, did not set a rule or benchmark to maintain a sustainable level of wage bill. Curaçao, with a 2014 wage bill of 12.1% of GDP was way above the regional benchmark of 7% of GDP, which is propagated by Fedelino, Schwartz, & Verhoeven (2006). One of the disadvantages of the wage bill ceiling is that in periods of autonomous GDP growth, wage bill ceilings may cause an increase in the number of civil servant employees, as this benchmark may be used as a focal point. The increase in the number of civil servants, as a result of an autonomous GDP growth, will be difficult to reverse in times of economic contraction. In view of this, we propose a benchmark of 7% to be maintained as an upper level of the wage-bill-to-GDP ratio. We suggest adapting the benchmark by using the last 5-years average of the final National Accounts GDP data. The final National Accounts are important, as they provide the actual GDP data, and the 5-years average balances out outliers in the GDP. The proposed benchmark of the wage bill is relevant, as a large wage bill crowds out important investment in the areas of growth, which are health, education, and infrastructure (Agénor & Neanidis, 2011).

Another important benchmark to curb the deficit is a debt-to-GDP ratio ceiling. According to the IMF, staying below the 40% benchmark can be viewed as safe for Curaçao (IMF, 2014). Before the implementation of the restructuring package, the public finances were characterized by debt roll-over and continuous crowding out on the domestic money and capital markets. In addition, the country's debt-to-GDP ratio registered at 58.5% in 2008, which was much higher than the IMF benchmark.

Following the implementation of the debt relief, the new country of Curaçao was able to start off in 2010 with a debt-to-GDP ratio of 34.6%, which is below the IMF benchmark. This could be characterized as a fresh start, as intended by the implementation of the package. The improvement in Curaçao's debt-to-GDP ratio was also attributable to the standing subscription, since it enabled the government to issue new debts at considerably lower interest rates. In addition, the financial supervision by the CFT and the compulsory financial management, have contributed to the noticeable improvement in Curaçao's public finances. However, as Curaçao's public debt-to-GDP ratio steadily approaches 40% of GDP, it raises concerns that its public debt is not curbed appropriately by the interest burden rule, a result of the historically low interest rates. Moving beyond the "safe" debt to GDP ratio of 40%, could cause the country to end up in a debt roll-over situation once more, which is highly undesired. Therefore, we suggest that a debt-to-GDP ceiling of 40% be introduced.

The implementation of the restructuring package improved the public finances of Curaçao in 2009-2010, but they deteriorated again in 2011. The public finances went back on track the following year, after the Curaçao government received an instruction from the Kingdom Council of Ministers to sort out its budget problems. The Curaçao government was forced to introduce contractionary measures, which led to a positive current account balance in

2013 and 2014. The main question that arises when comparing the period before and after the restructuring package is whether Curaçao would have been able to achieve the noted improvements in its public finances without the implementation of the package. Given the poor track record of the many austerity plans implemented in the period 1986-2001, it is fairly safe to assume that this is very unlikely. Another question, whether Curaçao will be able to stay on track if the financial supervision is removed, requires additional research. However, in order to create a sound foundation for long-term economic growth, strong financial management is necessary. Admittedly, there is room for improvement in Curaçao's public finances.

To conclude, the restructuring package did improve the public finances of Curaçao, however, to further improve the financial management and reach sustainable public finances, the package needs fine tuning. We propose two benchmarks: the debt-to-GDP ratio ceiling of 40% and the wage bill ceiling of 7% of GDP.[11]

[11] GDP of the last 5 years average

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