



Presentation Aruba Trade and Industry Association (ATIA)

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Ladies and gentlemen, welcome to this lecture on “Aruba and sustainable public finances”.

I am pleased to give this lecture for the members of ATIA as they play important role in the process of achieving economic growth, and therefore sustainable public finance. I will get back to this during my presentation.

SHEET 2

Today, I would like to discuss the following with you:

- Part I: The situation before the COVID-crisis
- Part II: The economic development and public finance of Aruba from 2000 till now
- Part III: The role of the CAft, also during the COVID-crisis
- Part IV: How to achieve sustainable finance for Aruba?

SHEET 4

Let me start with the situation in Aruba before the COVID-crisis. The GDP per capita was in 2019 relatively high with \$ 29,50 Curaçao’s GDP per capita is lower with \$ 18,000 and the GDP per capita of many Caribbean small states is even lower with approximately \$ 9,000.¹ The unemployment with 5.2% in 2019 was relatively low if we compare it to that of other Caribbean small states.

¹ Source: Lezing door R. Gradus op 21 oktober 2019 te Willemstad, slide 4, www.cft.cw.

In the years before COVID, tourism has experienced a sharp increase and in 2019 this increase was 3.2%. Aruba has a good market position as well as a sound level of safety. Furthermore, the preclearance for tourists from the United States of America is an important element. Lastly, Aruba is a partner in the Kingdom of the Netherlands and this relation is an advantage as well. Before COVID, Aruba was on track in some aspects, although there were many challenges, which I will now discuss.

SHEET 6

Let us take a look at the real economic growth of Aruba between 2000 and this year. Economic growth till 2019 was an average of 0.9 % per year. However, economic growth has many ups and downs: it is rather cyclical. According to the IMF the normal standard deviation of economic growth in small economics is between 1% and 2%. Remarkably, for Aruba over the period 1990-2015 the standard deviation was approximately 4.5%.² The strong dependency on the tourism from North America is one of the causes of this volatility and economic diversification is therefore important.

The COVID-crisis has hit Aruba strongly and the CBA has estimated a shrink of the economy with 26% in 2020. In the draft 2021 budget a modest real growth of about 3.7% has been taken into account.³

SHEET 7

Let us take a watch at the budget deficit of Aruba. From 2004 till 2018 (except for 2008) Aruba has had a deficit. Especially, in the period 2010-2014 the deficit was large, in 2011 and 2013 even though there was a strong economic growth in those years. Remarkably, a large debt of more than hundred million guilders had been used to stimulate the economy. However, for a small economy as Aruba this is not a wise economic policy.

² Source: IMF Working Paper - Economic Benefits of Export Diversification in Small States, 2018.

³ DEZHI Begrotingsraming nominale groei 5,6 procent, IMF inflatie 1,8 procent);

After 2015, there was a trend break. There was still a deficit, but it was much smaller than in the prior years. According to the draft financial report of 2019, for the first year since a decade there was a surplus of 0.7% GDP.

For 2020 mainly due to the COVID-crisis there was a large deficit. According to the draft budget, in 2021 there will be an even higher deficit than in 2020, although we are still waiting for the final budget of Aruba.

SHEET 8

Let us take a look at public debt of Aruba. Since 2000, the government debt has increased in an accelerated pace. Especially in the period of 2010-2014 there was sharp rise of the debt in Aruba.

After 2015, the increase was more modest, but still rising. In 2019 the debt of the government was AWG 4.3 billion. Presented as a percentage of the GDP, this was 72. This means that every Aruban born today, starts his/her life with a government debt of more than 40,000 guilders.

In 2020, the debt has increased with more than 500 million guilders, mostly due to the liquidity support provided for by the Netherlands (mentioned in yellow in this figure). This liquidity support has been granted as a zero-interest loan that will mature in April 2022.

For 2021 this figure has been based on the draft budget. In CAft' advice on the draft budget for this year, we recommend more restrictions on spending.⁴

⁴ See *Advies bij ontwerpbegroting 2021 van Aruba (Cft 202100004)*, www.cft.cw.

SHEET 9

Finally let us discuss Aruba's interest payments. Since 2004, there was a sharp rise in the interest payments of Aruba. In the 2019 budget, Aruba paid AWG 230 million on interests, which is almost 5% of GDP. The interest payments for 2020 is similar to that of 2019.

For this year, we see that the interest payments have increased with AWG 30 million (compared with 2020). This is mainly due to the fact that Aruba has financed the 2020 deficit partly on a private bond with 5.3% interest and refinances its current loans with higher interest payments. From a public finance point of view, I strongly recommend that Aruba should use Dutch's liquidity support (with zero interest rate) to finance its deficits in 2021.

SHEET 10

An important element of the LAft is that Aruba should meet the central deficit or surplus norm. Let us focus on the period of 2015-2019. In 2015 and 2016 the norm was met. However, albeit with many incidental measures, for example the introduction of a declaration-based payment system of corporate income tax.

In 2017 the goal of a deficit of a half percent and in 2018 the goal of a surplus of a half percent were both not reached. The elections and an over-estimation of taxes and income that resulted to be 200 million guilders too high, were the reasons for not reaching this goal. In 2018 the government started with a "Financieel Economisch Memorandum" (FEM) with importantly a modest economic growth and a 1% surplus in 2021.

In 2019 Aruba met the fiscal deficit target with a margin, although too much emphasis was given to tax increases instead of budget cutbacks in the opinion of the CAft. Also, from the viewpoint of economic growth, budget cutbacks especially focused on inefficiencies are better than tax increases, such as rising sales tax to finance health care expenditures.

SHEET 11

Let me give some intermediate conclusions.

- (1) Aruba is a reasonably prosperous country compared to other Caribbean small states, but the economy is highly cyclical and therefore prone to crises.
- (2) Public finances and rising interest costs are major concerns.
- (3) From 2015 (until 2020) there was a slight change in the public finance development, but insufficient to allow the nominal debt to decrease. Therefore, a surplus on the budget as soon as possible is needed.
- (4) Importantly, after the COVID-crisis, restructuring public finances and strengthening the economy must be undertaken and I will discuss this shortly.

SHEET 13

Let me first discuss Aruba's financial supervision, which has a shorter history than is the case with the other countries of Kingdom as Curaçao and Sint Maarten.

In 2014, the Cft carried out an investigation of the budget, at the request of the governor. At that time, Aruba was facing a debt ratio of more than 80% GDP. Based on a protocol, it was finally decided to establish independent financial supervision, being the CAft.

The CAft has a chairman on behalf of the Kingdom and a member on behalf of Aruba and the Netherlands. For the CAft, Mrs. Hellen van der Wal is the member on behalf of Aruba and Mr. Henk Kamp the member on behalf of the Netherlands.

The protocol of 2015 formed the basis for financial supervision and the Ordinance on Aruba financial supervision.

The aforementioned brings us to the question: what are the results of supervision till now? In general, I can say the following:

- There is more discipline in the budget cycle, although Aruba still has a challenge to overcome.
- Quarterly reports and annual accounts are now being drawn up, submitted and approved.
- Supervision has a positive effect on the public debate regarding government finances and has created more transparency.
- There is more confidence by international institutions such as the IMF or financial markets.

SHEET 14

In 2020, CAft also gave advices on liquidity support. Every quarter an advice was issued by the CAft on the amount of liquidity support that was needed. In 2020, the liquidity support was AWG 414 million, of which AWG 271 million was intended for wage subsidies. This wage subsidy is essential to maintain employment opportunities.

Moreover, as a result of the agreement between the Netherlands and Aruba in November 2020, the Netherlands refinances the foreign loans at low interest rates in 2021 and 2022. In January 2021 an advance payment of AWG 71 million was done.

Tomorrow the Kingdom Council of Ministers will discuss a new round of liquidity support for the second quarter of this year.

SHEET 15

Of course, the prospects for 2021 are uncertain. With regard to the significant uncertainty concerning the duration of the COVID-19 pandemic, the CBA recently offered three scenarios ranging from -3.4% (pessimistic) to 5.2% (optimistic).⁵

Although especially the recovery of tourism this year is highly uncertain, Aruba has a good tourism product equipped for the American and European markets with a large latent demand for when the pandemic is finally over. Interestingly, business sentiments in Aruba already improved in the fourth quarter of 2020 as a recent study of CBA is showing.⁶

SHEET 17

I finally come to the issue of sustainable public finances. I start with the budget of Aruba. First, there are a number of expenditures that cannot easily be influenced. As I hereby show, interest payments are still rising and public debt should be lowered through the creation of a surplus as soon as possible.

In addition, there are PPP projects. Their availability payments increased from AWG 37 million in 2017 to AWG 82 million this year and will continue till 2043. Important is that there is no room for new PPP projects.

Moreover, fiscal consolidation should not take the form of tax or premium increases. The tax burden is already too high in Aruba and a further increase will erode the competitiveness of the country.

⁵ CBA, Economic Outlook, February 2021

⁶ CBA, Business Sentiments improved in the Fourth Quarter of 2020, 25 February 2021

Therefore, it is important to reduce expenses and - to be honest - Aruba currently does not have a good track record. It is important to reduce the public wage bill, which is too high, also from an international point of view. Furthermore, it is important to reform the social security and health care sectors and to reduce their expenses.

SHEET 18

Let me focus on health care as there is a public debate on this topic. Notably, the public healthcare expenses in Aruba increased from AWG 359 million in 2011 to AWG 463 million in 2019.

In recent years, the way that health care was financed, has changed fundamentally. First, the premium, mainly financed by employers, increased from 235 million in 2011 to 264 million in 2019. Second, the earmarked AZV levy has existed since 2015, which amounted to AWG 215 million in 2019 (the levy percentage increased from 2% to 3% in 2018).

So, there is a heavy health care burden on the private sector. Moreover, due to the aging population and more people with chronic diseases (such as cardiovascular diseases and diabetes), it is estimated that additional healthcare expenses will amount to approximately AWG 200 million in the next 10 years.⁷ Therefore, in the most unfavorable case, the health care expenses will rise to 18% of GDP. So, the sustainability of health care will be an important issue the coming years.

SHEET 19

First of all, a further increase of the premiums and the (destination) tax for health care is not desirable. Therefore, cuts to health care spending are unavoidable. At least AWG 200 million in savings must be found in the coming years.

⁷ Presentation of E. Jacobs for CAft, February 2020. Sociale zekerheid onder druk: de uitdaging van de financiële houdbaarheid in de jaren '20.

I hereby mention some opportunities. It is possible to limit health care coverage. Also, individual contributions in healthcare can be introduced. Other possibilities are to limit the unnecessary usage of ER facilities, introduce more generic medicines, restrict privately owned health care facilities, allow for fewer treatments abroad, lower the allowances for companions that travels with the patient, etc.

Let me finally make a remark on the discussion between the Kingdom Council and Aruba what is possible on the short term. First, it should be noted that Aruba gets in 2020 and 2021 extra funds of AWG 25 million for extra COVID-19 expenditures.

I believe that some pressure from the Netherlands is necessary to enhance a sustainable health care system and to avoid inefficiencies as soon as possible. Notably, on November 30, 2020 'finally' a decision was made to introduce listed medicines.⁸

SHEET 20

Reforms are very important and necessary to solve the sustainability issue of public finance. These reforms will have a positive effect on the productivity. The IMF indicates that the growth path may be adjusted upwards by almost half a percent on the basis of reforms.

The elements of the country package are mentioned on this slide and let me focus on the labor markets. It is important to have a more inclusive labor market. Therefore, in my view, an adjustment of the dismissal law is necessary and reform of the social safety net as well. As the economy picks up, moving from income support programs to active employment schemes is important. And I would encourage ATIA to also participate actively in this debate.

⁸ LANDSBESLUIT, houdende algemene maatregelen, van 24 november 2020 tot wijziging van het Landsbesluit aanspraken genees- en verbandmiddelen, uitgegeven 30 november (AB 2004 no. 18) (versoering positieve lijst AZV)

SHEET 21

Let me conclude.

First, Aruba has a considerable debt and currently unsustainable interest payments: it is necessary to have a surplus of 1% in the coming years. This is the only way to lower the public debt with high interest rates.

Second, the aging population and diseases of affluence also require reforms in health care and social security. This is necessary to maintain good public facilities such as health care and education for future generations.

Third, it is important to realize economic growth through labor market and capital market reforms, among others, and I hope that ATIA plays an important role to maintain Aruba as a happy island also for future generations.