CENTRALE BANK VAN CURACAO EN SINT MAARTEN

Alternatives for covering the financing gap of 2020 of the country of Sint Maarten

1. Introduction

This note is a follow-up of the note '*Medium term projections of Sint Maarten's gross financing need and financing gap'* by the Centrale Bank van Curaçao en Sint Maarten (CBCS) of October 1, 2020. In this follow-up study, the financial-economic effects of four alternatives to cover the government of Sint Maarten's financiering gap over the year 2020 are presented.

Amid the deep economic contraction caused by the pandemic and related containment measures, the government of Sint Maarten requested in April 2020 financial support of NAf.250.0 million from the Netherlands to limit the negative social-economic and financial consequences of the corona crisis through stimulus and relief measures. The financial support would also compensate for the loss of government income. The stimulus and relief measures included payroll support for businesses and income support for affected groups in society. The country of Sint Maarten received in May 2020 a first tranche of NAf.44.1 million of liquidity support related to the corona crisis. In addition, a second tranche of NAf.19.4 million was received in August 2020. The received liquidity support was in the form of a 2-year bullet loan against zero interest. However, the liquidity support that Sint Maarten has received so far is not sufficient to meet its gross financing need. Based on the latest projections, the financing gap for the year 2020 is NAf.208.5 million. So far, no agreement has been reached between Sint Maarten and the Netherlands on additional liquidity support, which has been bound to strict conditions, including the implementation of structural measures.

In this note, the financial and economic implications if Sint Maarten would not receive additional liquidity support from the Netherlands are presented. In that case, Sint Maarten would depend on local financing. This analysis only addresses the short-term effects, i.e., the year 2020. Four scenarios are presented: one in which it is assumed that Sint Maarten will receive additional liquidity support from the Netherlands and three other scenarios in which the government borrows NAf.150,0 million, NAf.100,0 million, and NAf.75,0 million on the local market, respectively.

2. Information and data used for the calculations

The calculations in this note are based on the projected gross financing need and financing gap from the note of October 1, 2020. These projections were based on the actual figures of the current expenditures and revenues over the period January – August 2020 and the forecast for the period

September – December. Both the actual figures and the forecast were obtained from the Ministry of Finance. In addition, the CBCS used the figures from the *September 2020 Aide Mémoire – Sint Maarten Macro-Fiscal Framework* of the IMF to make a projection of the capital expenditures. Table 1 provides an overview of the projected government figures that are used in this note.

Table 1. Sint Maarten's projected gross financing need and financing gap in 2020

In millions NAf.	**2020**
Current revenues	**344.5**
Taxes	*282.9*
Other revenues	*61.6*
Total expenditures	**597.8**
Current expenditures	577.8
Expenditures related to the budget	*462.1*
Expenditures related to COVID-19	*115.7*
Capital expenditures	20.0
Overall balance	**-253.3**
Amortization	**11.0**
Financial balance[1]	**-264.3**
Debt service	**57.7**
Gross financing need	**322.0**
Received liquidity support	**113.5**
Liquidity support Hurricane Irma[2]	*50.0*
Liquidity support COVID-19	*63.5*
Financing gap	**208.5**
Gross financing need excluding debt service	**264.3**
Financing gap excluding debt service	**150.8**

[1] +sign represents a surplus / - sign represents a deficit.

[2] Regarding the liquidity support related to Hurricane Irma, it should be noted however, that only NAf.44.0 million was in fact transferred to Sint Maarten as the Netherlands deducted an outstanding NAf.6.0 million that the government of Sint Maarten had incurred related to expenditures to house detainees from Sint Maarten in Dutch prisons after Hurricane Irma.

As shown in Table 1, total government expenditures are projected at NAf.597.8 million in 2020, of which NAf.577.8 million current expenditures and NAf.20.0 million capital expenditures. It should be noted that the projected current expenditures include spending on the COVID-19 stimulus & relief for the year 2020. The government estimates the spending on the COVID-19 stimulus & relief measures in the months of October – December 2020 on NAf.39.0 million but needs financing to cover this amount.

Including debt service, the gross financing need of the government of Sint Maarten in 2020 amounts to NAf.322.0 million. The debt service includes a bond of NAf.50.0 million that matured on October

21, 2020. In this note it is assumed that the Netherlands will refinance the matured debt securities.[1] Therefore, excluding debt service, the gross financing need in 2020 amounts to NAf.264.3 million. The financing gap excluding debt service in 2020 is projected at NAf.150.8 million.

Hence, if Sint Maarten does not receive additional liquidity support, the NAf.150.8 million financing gap will have to be covered in an alternative way. The government needs financing to cover the stimulus and relief measures and to meet its current financial obligations including the payment of creditors and transfers. Because NAf.39.0 million is needed for the stimulus & relief measures in the last three months of 2020, it is assumed that the government will spend NAf.111.8 million[2] on other expenditures.

If the government cannot meet its current financial obligations or finance the stimulus and relief measures, the economic contraction will be deeper than initially projected. According to the projection of September 2020, the economy of Sint Maarten will contract by 24.8% in 2020. However, the September projection only included the effects of the first and second tranche of COVID-19 liquidity support. Implicitly, it was assumed that the government would receive budget support for meeting its current obligations.

3. Scenarios

The CBCS has calculated the financial-economic impact of four scenarios:

1. The government receives additional liquidity support of NAf.150.8 million from the Netherlands in the form of 2-year bullet loans against zero interest rate to cover the financing gap.
2. The government does not receive any additional liquidity support from the Netherlands and borrows NAf.150.0 million on the local capital market against 5.0% interest.
3. The government does not receive any additional liquidity support from the Netherlands and borrows NA.100.0 million on the local capital market against 5.0% interest.
4. The government does not receive any additional liquidity support from the Netherlands and borrows NAf.75.0 million on the local capital market against 5.0% interest.

Scenario 1 will be used as a reference scenario against which the other scenarios will be compared. The results from the calculation of these four scenarios are presented in Table 2 and are discussed below.

Scenario 1

In scenario 1, the government will receive additional liquidity support of NAf.150.8 million from the Netherlands to cover the financing gap. The funds will be used to cover the projected expenditures including the COVID-19 stimulus and relief measures in the last quarter of 2020. With the additional

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[1] The Dutch government has given the country of Sint Maarten a four weeks suspension for the repayment of the NAf.50.0 million bond that matured on October 21, 2020.

[2] The difference between the financing gap (NAf.150.8 million) and the amount that is budgeted for the stimulus and relief measures (NAf.39.0 million).

liquidity support, the government will be able to comply with all its current obligations including payments and transfers up until the end of 2020.

In this scenario, real GDP is projected to contract by 24.0% in 2020. The projected contraction is slightly lower than the September projection as the COVID-19 stimulus and relief measures in the last three months of 2020 will support private spending. The overall fiscal balance will amount to NAf.253.3 million in 2020, while the deficit on the current budget will reach NAf.233.3 million. As the liquidity support is in the form of a zero-interest bullet loan of two years, the additional liquidity support will not result in extra interest expenditures in 2021 and 2022.

Table 2. Four scenarios to cover the financing gap in 2020

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
Total projected government expenditures	597.8	597.8	597.8	597.8
Projected expenditures on COVID-19 stimulus & relief measures budgeted for October – December	*39.0*	*39.0*	*39.0*	*39.0*
Projected other expenditures excluding COVID-1 stimulus and relief measures	*558.8*	*558.8*	*558.8*	*558.8*
Financing gap excluding debt service	150.8	150.8	150.8	150.8
Financing needed for COVID-19 stimulus & relief	*39.0*	*39.0*	*39.0*	*39.0*
Financing needed for other expenditures excluding COVID-19 stimulus & relief	*111.8*	*111.8*	*111.8*	*111.8*
Financing	150.8	150.0[1]	100.0	75.0
Additional liquidity support	150.8	0.0	0.0	0.0
Borrowing on the local market	0.0	150.0	100.0	75.0
Available for COVID-19 stimulus & relief	*39.0*	*39.0*	*39.0*	*39.0*
Available for other expenditures excluding COVID-19 stimulus & relief measures	*111.8*	*111.0*	*61.0*	*36.0*
Financing gap excluding debt service and corrected for financing	0.0	0.0	50.8	75.8
Amount of budget cut[2]	0.0	0.0	51.0	85.0
Total government expenditures after financing and budget cuts	597.8	597.8	546.8	512.8
Current revenues following economic effect of financing and budget cuts	344.5	344.5	340.4	336.9
Overall balance of the government	-253.3	-253.3	-206.4	-175.9
Current budget balance	*-233.3*	*-233.3*	*-186.4*	*-155.9*
Real GDP growth (%)	*-24.0*	*-24.0*	*-25.4*	*-26.4*
GDP	*1,476.9*	*1,476.9*	*1,488.9*	*1,430.2*
Additional interest expenditures as of 2021	*0.0*	*7.5*	*5.0*	*3.8*

[1] As the difference between the financing gap (NAf.150.8 million) and the amount borrowed on the local market (NAf.150.0 million) is relatively small (NAf.0.8 million,) it is excluded from the further calculation.

[2] The required budget cut tends to be higher than the financing gap excluding debt service and corrected for financing. The CBCS has used an iteration process to calculate the required budget cut. The budget cut has a negative effect on the economy. Subsequently, the sharper economic contraction will result in lower government revenues, notably tax revenues. As a result, ceteris paribus, the gross financing need and financing gap increase. This iteration process is repeated until the financing gap becomes zero as a result of the budget cuts.

Scenario 2
In scenario 2, it is assumed that the government will not receive any additional liquidity support from the Netherlands. To cover the financing gap in 2020 excluding debt service, the government will borrow NAf.150.0 million on the local capital market.

Of the borrowed funds, NAf.39.0 million will be allocated for the COVID-19 stimulus & relief measures. The remaining NAf.111.0 million will cover the net expenditures excluding the COVID-19 stimulus & relief measures.

The projected real GDP contraction, overall fiscal balance and current budget deficit are equal to scenario 1 as the amount of borrowing is practically the same as the assumed additional liquidity support. The difference between scenario 1 and scenario 2 lies in the additional interest expenditures as of 2021. While the additional liquidity support in scenario 1 will not result in higher interest expenditures, interest expenditures will increase by NAf.7.5 million annually in scenario 2 as it is assumed that the local bond will bear a 5.0% interest rate.

Scenario 3
Scenario 3 assumes that the government will not receive additional liquidity support from the Netherlands and will borrow NAf.100.0 million on the local capital market. In this scenario, the government will use NAf.39.0 million of the borrowed funds to cover the COVID-19 stimulus & relief measures in October – December 2020. The remaining NAf.61.0 million will be allocated for the projected other expenditures excluding those related to the COVID-19 measures, while the government needs NAf.111.8 million. Through an iteration process whereby the negative effect of a budget cut on the economy is calculated and subsequently the effect of a deeper economic contraction on government revenues, notably tax revenues, it is estimated that the government of Sint Maarten will have to cut its expenditures and/or default on payments for a total amount of NAf.51.0 million.

An expenditure cut of NAf.51.0 million will result in a real GDP contraction of 25.4%, which is 1.4 percentage point higher than in scenario 1. This is ascribable to a sharper decline in private and public spending, moderated by a faster drop in imports.

Meanwhile, the overall fiscal balance will amount to NAf.206.4 million while the deficit on the current budget will reach NAf.186.4 million. Compared to scenario 1, the overall fiscal deficit and the current budget deficit are lower in scenario 3 largely because the government reduces its expenditures by NAf.51.0 million. Government revenues, particularly tax revenues, will be lower in scenario 3 compared to scenario 1 due to the sharper decline in economic activity. Furthermore, the interest expenditures will increase by NAf.5.0 million annually as of 2021.

Scenario 4
In scenario 4, the government of Sint Maarten will borrow NAf.75.0 million on the local capital market if no additional liquidity support from the Netherlands is received. In this scenario, the government

will use NAf.39.0 million of the borrowed funds to cover the COVID-19 stimulus and relief measures in October – December 2020. The remaining NAf.36.0 million will be allocated for the projected other expenditures excluding those related the COVID-19 measures, while the government needs NAf.111.8 million. Through an iteration process whereby the negative effect of a budget cut on the economy is calculated and subsequently the effect of a deeper economic contraction on government revenues, notably tax revenues, it is estimated that the government of Sint Maarten will have to cut its expenditures and/or default on payments for a total amount of NAf.85.0 million

Real GDP is projected to contact by 26.4% in scenario 4. This is 2.4 percentage point higher than in scenario 1 as the budget cuts will result in a faster decline in private and public consumption. Furthermore, because of the sharper decline in domestic demand, imports will drop at a faster pace in scenario 4 than in scenario 1.

The government will register an overall fiscal deficit of NAf.175.9 million and a current deficit of NAf.155.9 million because of the higher expenditure cut to close the gap. Government revenues, notably tax revenues, will be lower in scenario 4 than in scenario 1 due to the deeper economic contraction. Interest expenditures will increase by NAf.3.8 million on an annual basis due to the NAf.75.0 million borrowing at a 5% interest rate on the local capital market.

5. Conclusion

In this note, the financial-economic implications of no additional liquidity support from the Netherlands in 2020 are presented. The three alternative scenarios that were calculated show that without additional liquidity support, the economic contraction in Sint Maarten will be deeper than in the scenario with liquidity support. The lower the amount that can be borrowed on the local capital market, the higher the cut in expenditures and/or default on payments will be to close the financing gap. Given the relatively small scale of the economy, it seems not feasible to realize expenditure cuts of between NAf.50.0 million and NAf.75.0 million in a 3-month period without seriously affecting the provision of essential public services.

The multi-annual projections of the budget of Sint Maarten indicate that also in 2021 and 2022, a significant financing need exists to cover the overall fiscal balance. Hence, the alternative of seeking financing on the local capital market is only a temporary solution that will at the same time dampen the pace of economic recovery and result in higher interest expenditures in the future.

It should be noted also that the liquidity support from the Netherlands results in an inflow of foreign exchange reserves that compensates the eventual outflow to pay for imports related to domestic spending. However, in the case of local financing, no compensating inflow of foreign exchange reserves will occur. Hence, local financing will eventually have a negative effect on the foreign exchange reserves.

It is therefore recommended that the government of Sint Maarten increases its efforts to break the current impasse in the negotiations with the Netherlands on additional liquidity support. At the same time, Sint Maarten should implement structural reforms to stimulate sustainable economic recovery, which will also reduce the projected multi-annual fiscal deficits.

The liquidity support that Sint Maarten has received so far is in the form of 2-year bullet loans at a zero-interest rate. However, it is not likely that Sint Maarten will be able to pay back these loans after two years. Therefore, it is recommended to negotiate with the Netherlands on the conditions of the already received and future liquidity support. Conversion into grants and/or longer-term loans would help reduce the pressure on the public finances in the medium term.

Centrale Bank van Curaçao en Sint Maarten
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