



CENTRALE BANK VAN CURAÇAO EN SINT MAARTEN

Macroeconomic impact of an increase in the license fee

1. Introduction

The government of Curaçao is currently considering increasing the license fee that is being charged on transfers from residents to nonresidents of the monetary union and the sale of foreign exchange. The idea is to increase the fee from 1.0% to 1.5% and use the extra proceeds to settle the outstanding claim of the Centrale Bank van Curaçao en Sint Maarten (CBCS) on Girobank. As Curaçao and Sint Maarten form a monetary union, a uniform license fee rate should be applied in both countries. Hence, an increase in the license fee would have repercussions for the economies of both Curaçao and Sint Maarten. In this note, the effect of an increase in the license fee from 1.0% to 1.5% as of January 1, 2021, on real GDP growth in 2021 is calculated. In the analysis, the effects on the economy of Curaçao and the economy of Sint Maarten are discussed separately.

The note is structured as follows. Section 2 provides some background information on the license fee. Section 3 deals with the effect of the increase of the license fee on the economy of Curacao, while the effect on the economy of Sint Maarten is discussed in section 4. In section 5, another solution for the settlement of the outstanding claim of the CBCS on Girobank is presented, namely a surcharge on the *Algemene Bestedingsbelasting* (ABB) that the government of Curacao intends to implement on January 1, 2021. In that case, only the economy of Curacao would be affected. Finally, section 6 provides some concluding remarks.

2. Background

Starting January 1, 1996, a fee was introduced for the license to operate as a foreign exchange bank. This license fee is assessed on the transfers from residents to nonresidents and the sale of foreign exchange through foreign exchange banks and replaced the foreign exchange tax in force through December 1995. Exempted from the license fee are the re-investment of funds abroad, the re-exports by the free-zone companies, and foreign payments by the government. The CBCS assesses and collects the license fee in Curaçao and Sint Maarten while the proceeds are remitted to the government of each country.

Table 1 provides an overview of the license fees collected in Curaçao and Sint Maarten from 2011 through 2019.

Table 1 License fees collected from 2011 through 2019 (in thousands NAf.)

	Curaçao	Sint Maarten
2011	52,809	23,542
2012	51,655	23,855
2013	51,431	25,297
2014	49,605	24,796
2015	47,043	23,887
2016	48,066	24,215
2017	48,591	23,026
2018	52,118	26,663
2019	48,728	26,221
Average	50,005	24,611

Between 2011 and 2019, NAf.50.0 million on average was collected in Curaçao. This represents 0.9% of the country's GDP. In the case of Sint Maarten, NAf.24.6 million on average was earned annually over the period 2011 – 2019. This represents 1.1% of Sint Maarten's GDP.

So far in 2020, license fee earnings in both Curaçao and Sint Maarten have dropped on the back of the deep economic crisis caused by the pandemic and the capital restriction introduced in March. The amount of license fees collected in Curaçao decreased by NAf.7.3 million (18.1%) to NAf.32.9 million in the period January-October 2020 compared to the corresponding period in 2019. For Sint Maarten, the amount of license fees collected decreased by NAf.6.5 million (29.8%) to NAf.15.3 million in the same period.

Based on the collected license fees between January and October 2020, the CBCS expects that for the entire year the license fee earnings in Curaçao will amount to NAf.39.4 million and in Sint Maarten NAf.18.4 million. An increase of the license fee by 0.5 percentage point in 2020 would, therefore, have resulted in extra license fee earnings of NAf.19.7 million for Curaçao and NAf.9.2 for Sint Maarten.

Since the economies of Curaçao and Sint Maarten are both projected to increase in real terms in 2021 (although the GDP will still be below the pre-COVID level), license fee earnings will probably also increase. However, as the current economic projections are surrounded by high uncertainty, the CBCS conservatively assumes that in the case of a 0.5 percentage point increase in the license fee, the extra earnings in 2021 will be the same as calculated for 2020.

Below, the effects of an increase in the license fee are discussed.

1. Higher inflation

An increase in the license fee will put upward pressure on inflation. Both Curaçao and Sint Maarten are highly dependent on imports. Since the license fee is included in the selling rate of foreign exchange, a higher fee will de facto make imports more expensive. This will result in higher average domestic prices, i.e., increased inflation. The higher inflation will primarily reduce consumers' purchasing power and, hence, have a negative effect on real private consumption. The other components of domestic demand, i.e., private investment, public consumption, and public investment, will also be affected in real terms by the higher average prices.

In addition, the increase in the license fee will affect the exports in both countries. Tourism is the main economic pillar of both Curaçao and Sint Maarten. In Curaçao, the sector represented 41% of the foreign exchange earnings from the export of goods and services in 2019, while in Sint Maarten tourism accounted for 64%. At the same time, tourism has a high-import content. The higher inflation due to the increase in the license fee will therefore also imply a real appreciation of the guilder vis-à-vis the US dollar and, hence, affect the competitiveness of Curaçao and Sint Maarten. In other words, the increase in the license fee will have a negative effect on exports, particularly the foreign exchange earnings from the tourism sector.

2. Increased government revenues

As mentioned before, the increase in the license fee will result in an estimated NAf.19.7 million extra earnings for Curaçao and NAf.9.2 million extra for Sint Maarten. In the case of Curaçao, these extra earnings will be allocated for the settlement of the outstanding claim of the CBCS on the Girobank. In the case of Sint Maarten, the government can allocate the extra license fee earnings for reduction of the projected current budget deficit¹ in 2021.

It should be noted, however, that the current license fee of 1.0% is already being considered as high by many residents. As a result, many companies hold foreign bank accounts for the payment of imports to avoid the license fee that is being charged in Curaçao and Sint Maarten. The increase in the license fee may intensify this development as well as attempts to evade the fee. As a result, the extra license fee revenues could turn out lower than projected in this note.

3. Increased restriction on cross-border capital flows

Under the right conditions, (cross-border) capital flows are beneficial for a country's economic development and growth. On the micro level, capital flows can improve the efficiency of resource allocation and the competitiveness of the domestic financial sector. Furthermore, capital flows can facilitate the transfer of technology and management practices through foreign direct investment. Meanwhile, on the macro level, capital flows enable countries to finance welfare-enhancing current account imbalances, including productive investment and consumption smoothing. As a result,

¹ For 2021, a current budget deficit of NAf.118.0 million is projected. Source: International Monetary Fund, Aide-Mémoire The Kingdom of the Netherlands – Sint Maarten Macro Fiscal Framework, September 2020.

international organizations such as the IMF and the OECD have underscored the importance of capital flow liberalization, i.e., the unrestricted convertibility of local currency for international financial transactions.²

The license fee de facto restricts the convertibility of the NAf. for international financial transactions by making transfers to abroad more expensive. Hence, further increasing the license fee will raise the barrier for cross-border capital flows and, as a result, have a negative impact on Curaçao's and Sint Maarten's economic development and growth. In particular, an increase of the license fee may affect the inflow of foreign direct investment in the long run, thereby affecting total factor productivity growth and, hence, the growth of GDP.

4. Negative effect on gross official reserves

Prior to the increase in the license fee, residents of Curaçao and Sint Maarten may want to benefit from the current lower fee. This could result in more transfers to abroad and, consequently, a decline in the gross official reserves and the import coverage. It should be noted, however, that the import coverage is currently well-above the norm of 3 months (approximately 6 months). This is largely due to the liquidity support that Curaçao and Sint Maarten received from the Netherlands amid the corona crisis. Based on the current projections, only a net outflow of more than NAf.1,200 million in the last quarter of 2020 would result in an import coverage below the norm of 3 months by the end of 2020. Such a large outflow does not seem realistic, even if residents would like to benefit of a lower license fee before the increase in the rate. In addition, the current capital restriction will dampen the outflow.

In this note, only the short-term effect of the increase of the license fee is calculated. Therefore, the effect of an increase by 0.5 percentage point on the real GDP growth in Curacao and Sint Maarten in 2021 is calculated. The most recent economic projection that the CBCS has published for Curaçao and Sint Maarten³ will be used as the reference scenario against which the impact of the increase of the license fee will be calculated. It should be noted, however, that the current economic projections are surrounded with high uncertainty and include several downward risks, including the dynamics of the pandemic and delays in the development and disbursement of a vaccine.

In the analysis, it is assumed that the license fee will be increased as of January 1, 2021. Furthermore, it is assumed that the increase of the license fee will result in NAf.19.7 million extra revenues for the government of Curaçao that will be allocated fully for the settlement of the outstanding claim of the CBCS on the Girobank. Meanwhile, Sint Maarten will obtain NAf.9.2 million extra license fee earnings that will be used to reduce the projected current budget deficit in 2021.

² International Monetary Fund, *The Liberalization and Management of Capital Flows: An Institutional View*, November 2012.

³ Published in the CBCS' first quarterly bulletin of 2020.

3. Curaçao

The reference scenario and the impact scenario for Curaçao assuming an increase in the license fee of 0.5 percentage point is presented in Table 2. In the reference scenario, the economy of Curaçao is projected to grow by 6.5% in 2021 caused by an increase in net foreign demand mitigated by a decrease in domestic demand. Net foreign demand will contribute positively to GDP as the increase in exports will surpass the gain in imports. The increase in exports reflects primarily more foreign exchange earnings from tourism, transportation, and ship repair. Meanwhile, increased merchandise imports on the back of higher tourism demand and private investment activities will result in a higher import bill. Also, the volume of oil products imported will increase in line with the projected increase in bunkering activities.

Table 2 Curaçao: effect of the increase in the license fee

	2020	2021 Reference scenario	2021 Impact scenario
Domestic demand, of which	-9.7%	-2.5%	-3.5%
Private sector	-9.8%	-2.1%	-3.0%
Investment	-2.6%	1.1%	0.7%
Consumption	-7.2%	-3.2%	-3.7%
Public sector	0.1%	-0.4%	-0.5%
Investment	0.0%	0.1%	0.1%
Consumption	0.1%	-0.5%	-0.6%
Changes in inventory	-0.1%	0.0%	0.0%
Net foreign demand, of which	-11.6%	9.0%	9.3%
Export of goods and services	-31.6%	19.0%	18.7%
Import of goods and services	-20.0%	10.0%	9.4%
GDP (% , real)	-21.4%	6.5%	5.8%
Inflation	2.7%	3.7%	4.1%
GDP in mln NAf. (nominal)	4,515.6	4,976.2	4,962.6
GDP in mln NAf. (real prices of 2010)	3,773.7	4,019.0	3,992.6

In contrast, domestic demand will decrease in 2021, although at a slower pace than in 2020, as the continuation of private investment projects delayed in 2020 will mitigate the decline in private consumption and public demand. Investments in the construction and tourism sectors in particular are expected to increase. However, private consumption is expected to decline as the higher inflation and deteriorated labor market will affect consumers' purchasing power. Government spending will decrease as the decline in consumption will surpass the slight increase in projected investments. Public consumption will decline reflecting, among other things, austerity measures to reduce the wage bill and the outlays on goods & services.

Meanwhile, inflation is expected to surge to 3.7% in 2021, primarily because of the introduction of a general consumption tax (*Algemene Bestedingsbelasting* or ABB). The ABB will replace the current

turnover tax (*omzetbelasting* or OB). Despite the turnaround in real GDP in 2021 compared to 2020, the level of GDP will still be lower than the pre-COVID-level.

The impact scenario presents the breakdown of real GDP growth by expenditure for 2021 if the license fee is increased by 0.5 percentage point. In this case, real GDP will grow by 5.8%, 0.7 percentage point lower than in the reference scenario. Meanwhile, the increase in the license fee will cause an increase in average prices. Consequently, inflation will reach 4.1%, 0.4 percentage point higher than in the reference scenario.

The lower growth of real GDP compared to the reference scenario is caused by a stronger decline in domestic demand.⁴ In particular, private consumption will drop at a faster pace as the higher inflation will further erode purchasing power. In addition, the higher average prices will affect private investment and public consumption. Meanwhile, the contribution of net foreign demand to GDP growth will be 0.1 percentage point higher than in the reference scenario. The increase in the license fee will have a negative effect on both the export and import of goods and services. Exports will increase at a slower pace than in the reference scenario due the real exchange rate appreciation caused by the increase in the license fee. Meanwhile, the gain in imports will be lower than in the reference scenario because of the sharper decline in domestic spending and the slower growth of export.

4. Sint Maarten

Table 3 shows the reference and impact scenarios for Sint Maarten.

Table 3 Sint Maarten: effect of the increase in the license fee

	2020	2021 Reference scenario	2021 Impact scenario
Domestic demand, of which	-5.0%	-0.6%	-1.4%
Private sector	-2.3%	-0.9%	-1.5%
Investment	0.2%	1.1%	0.9%
Consumption	-2.5%	-2.0%	-2.4%
Public sector	-2.7%	0.3%	0.1%
Investment	0.2%	1.3%	1.2%
Consumption	-2.9%	-1.0%	-1.1%
Changes in inventory	0.0%	-0.1%	-0.1%
Net foreign demand, of which	-19.8%	11.3%	11.4%
Export of goods and services	-48.0%	33.5%	32.9%
Import of goods and services	-28.2%	22.2%	21.5%
GDP (% , real)	-24.8%	10.6%	9.9%
Inflation	1.2%	1.8%	2.3%
GDP in mln Naf. (nominal)	1,760.5	1,978.8	1,975.3
GDP in mln Naf. (real prices of 2010)	1,610.1	1,780.7	1,769.9

⁴ In this note, a tax multiplier of 0.6 was applied.

In the reference scenario, real GDP will increase by 10.6% in 2021 driven by a surge in net foreign demand, moderated by a decline in domestic demand. The projected increase in net foreign demand is the result of an increase in exports moderated by higher imports. The gain in exports reflects primarily a gradual recovery of tourism. Nevertheless, the foreign exchange earnings from tourism activities will be still 20% below the pre-corona crisis level.⁵ The higher import bill is caused primarily by more tourism spending.

Meanwhile, domestic demand will put a drag on growth in 2021 due to lower private and public consumption. Consumer spending will drop due to lower disposable income caused by higher inflation combined with the 12.5% cut in labor compensation in the (semi) government sector. The drop in public consumption reflects primarily an anticipated further decline in the outlays on wages & salaries due to austerity measures. Private and public investment growth will accelerate in 2021 as construction projects, such as the reconstruction of the airport and the new hospital which were delayed in 2020 due to the containment measures, will gather pace.

Furthermore, inflation is expected to increase to 1.8% in 2021, in line with the forecast rise in the inflation rate of the United States, Sint Maarten's main trading partner. Despite the rebound of the economy of Sint Maarten in 2021, real GDP will still be significantly below the pre-COVID level.

The increase in the license fee will have a negative effect on the economy of Sint Maarten. Real GDP will increase by 9.9% in 2021 in the impact scenario compared to 10.6% in the reference scenario. The higher license fee will put an upward pressure on inflation of 0.5 percentage point to 2.3% in 2021 compared to the reference scenario.

Domestic demand will be affected mostly by the increase in the license fee.⁶ Private demand will decline at a faster pace (0.6 percentage point) in the impact scenario due to the higher inflation. Particularly private consumption will decline at a faster pace (0.4 percentage point). In addition, the faster increase in average prices will have a negative effect on real private investment, real public consumption and real public investment. Meanwhile, the contribution of net foreign demand to GDP growth is in the impact scenario 0.1 percentage point higher than in the reference scenario because of a slower increase in import moderated by a lower export gain. The slower recovery of exports is largely the result of the real exchange rate appreciation caused by the higher inflation. Meanwhile, imports will increase at a slower pace due to the faster decline in domestic spending and the slower gain in exports.

5. Surcharge in the ABB to settle the claim of the CBCS on Girobank

As mentioned in section 3, the government of Curacao is planning to introduce a general consumption tax (*Algemene Bestedingsbelasting* or ABB) on January 1, 2021 that will replace the current turnover tax (*omzetbelasting* or OB). The idea is to levy an ABB of 9.0% on all locally manufactured goods and

⁵ Level of foreign exchange earnings from tourism in 2019.

⁶ A tax multiplier of 0.6 was used.

services, and an ABB of 12.5% on all imports. Due primarily to the introduction of the ABB, the inflation rate in 2021 will increase to 3.7%.

The government of Curaçao has also considered applying a surcharge on the ABB to settle the claim of the CBCS on Girobank. Including the surcharge, the ABB on imports would be 12.84% and the ABB on locally produced goods and services 9.63%. Hence, the surcharges would be 0.34 percentage point and 0.63 percentage point, respectively.⁷ The CBCS already calculated in March 2020 the macroeconomic effect of applying such a surcharge. It should be noted, however, that the CBCS does not have information on how much extra tax revenues the surcharges will generate but estimates these at approximately NAf.25.0 million.

Table 4 Curaçao: effect of surcharge on ABB

	2020	2021 Reference scenario	2021 Impact scenario (A) License fee	2021 Impact scenario (B) Surcharge ABB
Domestic demand, of which	-9.7%	-2.5%	-3.5%	-3.1%
Private sector	-9.8%	-2.1%	-3.0%	-2.7%
Investment	-2.6%	1.1%	0.7%	0.8%
Consumption	-7.2%	-3.2%	-3.7%	-3.5%
Public sector	0.1%	-0.4%	-0.5%	-0.4%
Investment	0.0%	0.1%	0.1%	0.1%
Consumption	0.1%	-0.5%	-0.6%	-0.5%
Changes in inventory	-0.1%	0.0%	0.0%	0.0%
Net foreign demand, of which	-11.6%	9.0%	9.3%	9.2%
Export of goods and services	-31.6%	19.0%	18.7%	18.9%
Import of goods and services	-20.0%	10.0%	9.4%	9.7%
GDP (% , real)	-21.4%	6.5%	5.8%	6.1%
Inflation	2.7%	3.7%	4.1%	3.8%
GDP in mln NAf. (nominal)	4,515.6	4,976.2	4,962.6	4,962.6
GDP in mln NAf. (real prices of 2010)	3,773.7	4,019.0	3,992.6	4,003.9

As shown in Table 4, both the increase in the license fee and the surcharge on the ABB will result in a higher inflation and a lower real GDP growth compared to the reference scenario. However, in the impact scenario with a surcharge on the ABB (impact scenario B), the inflation rate is 0.3 percentage point lower than in the impact scenario with an increase in the license fee (impact scenario A). Furthermore, real GDP will increase at a faster pace in impact scenario B (0.3 percentage point) than in impact scenario A.

⁷ In March 2020, the government was considering introducing a third ABB category, i.e., the short-term lease of real estate. The ABB for this category would be 7.00% and the idea was then to apply a surcharge of 0.49 percentage point, resulting in a tariff of 7.49%. In this note, the surcharge on the ABB on short-term lease of real estate is not considered as the government now only plans to apply two tariffs (12.5% and 9.0%).

In particular, private consumption will drop at a slower pace (0.2 percentage point) in impact scenario B compared to impact scenario A due to the lower inflation. Furthermore, while the license fee will make all imported goods more expensive, some goods that are considered necessities are exempted from the ABB and, as a result, will not be affected by the surcharge.⁸ In addition, the surcharge has a less negative effect on private investment and public consumption than the increase in the license fee. The gain in exports in scenario B will be slightly higher (0.2 percentage point) than in scenario A because the real exchange appreciation caused by inflation will be somewhat lower. Meanwhile, imports will increase at a faster pace than in scenario A (0.3 percentage point) due primarily to the lower decline in private consumption.

6. Conclusion

In the monetary union of Curaçao and Sint Maarten a license fee of 1.0% is charged on transfers from residents to nonresidents and the purchase of foreign exchange, with the exception of the re-investment of funds abroad, the re-exports of the free-zone companies, and foreign payments by the government. The license fee collected by the CBCS is transferred to the governments of Curaçao and Sint Maarten.

Currently, the government of Curaçao is considering an increase of the license fee by 0.5 percentage point and use the additional earnings to settle the outstanding claim of the CBCS on the Girobank. Meanwhile, the government of Sint Maarten would benefit from additional earnings in its current budget.

The analysis shows that an increase in the license fee will put an upward pressure on the inflation in Curaçao and Sint Maarten. For Curaçao, the projected inflation for 2021 was already relatively high due to the introduction of the ABB. Therefore, the license fee will further increase average prices, reduce purchasing power, and result in a real exchange rate appreciation. Consequently, the economic recovery in both Curaçao and Sint Maarten will be slower than in the reference scenario.

The government of Curaçao has also considered applying a surcharge on the ABB to settle the claim of the CBCS on the Girobank. In that case, the economy of Sint Maarten would not be affected by the measure. The analysis shows that a surcharge on the ABB would have a lower negative effect on the economy of Curaçao than an increase in the license fee because inflation will be lower while real GDP growth will be higher. Therefore, it seems that a surcharge on the ABB may be less distortionary than increasing the license fee.

The CBCS would like to bring to the governments' attention that the IMF might disapprove the intended increase of the license fee. The Kingdom of the Netherlands is a member of the IMF which

⁸ For example, electricity, water, grain products, and dairy products are exempted from the ABB. However, the higher license fee associated with imports related to these products will translate into higher consumer prices.

implies that Curaçao and Sint Maarten must also comply with the rules of the Fund. Article 8 of the Articles of Agreement of the IMF states that “actions by a member country or its fiscal agencies that of itself gives rise to a spread of more than 2 percent between the buying and selling rates of spot exchange transactions between the member’s currency and another member’s currency would be considered a multiple currency practice and would require the prior approval of the Fund”.

Currently, the selling rate for the US dollar is NAf.1.82 and the buying rate NAf.1.78. Even though this results in a spread of 2.25%, the IMF has not disapproved this deviation. However, if the license fee is increased by 0.5 percentage point, the selling rate would become NAf.1.83 (1.829) and the spread 2.75%. The CBCS has raised this issue with the IMF for an opinion and is awaiting a reaction.

Centrale Bank van Curaçao en Sint Maarten
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