

Additional investments through a new development approach

*Speech of Drs.A.G.Romero, Executive Director on the occasion of the seminar on development cooperation in the Netherlands Antilles hosted by the Department of Economic Affairs
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Introduction

It is with a great deal of pleasure that I am here today to share with you my views of on the various proposals that have been advanced regarding development finances. Investments, ladies and gentlemen, are crucial to the development of countries. Through investments we enhance the productive capacity of a country and hence generate economic growth. This is particularly important if these countries are facing new challenges in the development of their economy.

This is the situation that we as the Netherlands Antilles are facing today. We have reached a point where investments are indispensable to spur economic growth and create the much-needed employment.

My presentation is structured along the following lines. First, I will outline my views of economic development from an institutional perspective. Important in this context is the concept of a new institutional arrangement that should ideally focus on removing the impediments for structural public and private sector investments on the islands.

Secondly I will work out a "best model" for this so-called Development Bank that has to deal with the complex problems facing small open economies like ours.

I will try to answer the question of how a Development Bank can contribute to economic growth in a small economy.

Finally, I will address the conditions under which this Development Bank has the best chances to succeed in the Netherlands Antilles.

The institutional framework for a Development Bank

The first point of concern for a Development Bank has to do with the institutional framework. The principal objective for a development institution in general is the promotion of sustainable socio-economic development by attracting capital resources to the end of providing services to the public and private sector.

The development Bank serves as a financial intermediary that provides specific types of financing in terms of risks, repayment period, interest rates, securities offered and investment returns.

Due to the small scale of our economy our financial markets differ in many aspects of the well-developed United States or European financial markets. Consequently, when designing and discussing financial issues it is very important to keep this in mind.

Investigations in the past years showed that the major bottlenecks for investments in the Netherlands Antilles are related to the lack of long term financing, the implicit high interest rates and the absence of vehicles to provide equity capital to various projects that are being undertaken.

Generally speaking the financial services provided by development banks are mainly intended to promote investment in a country. In the specific case of the Netherlands Antilles the major tasks that the Development Bank could undertake can be outlined as follows:

- Provide financial services to governments and their agencies for the financing of priority projects mainly in areas such as physical- and human infrastructure;
- Facilitate technical cooperation with regard to the transfer of knowledge and technology to local entrepreneurs;
- Contribute to the development of national and regional capital markets;
- Provide loans and lines of credit to the financial sector in order to channel resources to various productive sectors;
- Finance human resource development in the low socio-income sectors of the population as well as support growth and consolidation of micro enterprises.

In the next section I will elaborate further and in more detail on the impediments for local investments.

Besides the financial market difficulties facing investors on the islands of the Netherlands Antilles there are other non-financial matters also playing a big role. These are: a complicated tax structure and bureaucracy which makes it more difficult to generate sustainable and viable investment projects on the islands.

From a more historical context the idea of the establishing of a Development Bank in the Netherlands Antilles is not new. In 1989 the Government of the Netherlands Antilles commissioned a study on the availability of funds to finance high-risk investments projects through venture capital.

One of the problems facing the Netherlands Antilles then was that various investment projects were experiencing the lack of, or the insufficient local equity capital. From the perspective of local financial institutions the financing of various projects were not feasible because there was an imbalance between the risks that the financial institutions were running and that which the project developers were willing to accept into the new ventures.

The outcome of particularly some hotel and tourism projects has proven that the concerns of the financial intermediaries were not entirely misplaced. The best and most viable solution when evaluating financing proposals is the commitment of the project developer to commit equity funds into the project. At that time the study concluded that the concept of a Venture Capital Fund was the best alternative to overcome the problems the Netherlands Antilles were encountering.

The Venture Capital Fund would provide that part of the financing funds needed as equity, offering higher than normal returns to investors in these funds, while the financing of these projects could be completed.

Particularly, in the Information and Technology Sector, Technical Infrastructure and Tourism Infrastructure the proposed financial structure through a Venture Capital Fund would have channeled sufficient funds into the respective sectors of the economy.

A second idea on a Development Bank was proposed in the 1992 Annual Report of the Central Bank where we proposed the establishment of a Development Bank aimed at particularly the sectorial use of the development cooperation funds received from the Netherlands.

This proposal should be seen against the background of the growing development debt with the Netherlands at that time. The aim of this proposal was to reduce the long-term dependency of the development aid that the Netherlands Antilles received from the Netherlands and optimize the complicated approval procedures of projects through the development cooperation channel of the Netherlands.

We went on by saying: *"To reduce our reliance on the Netherlands in the future the Bank proposes that a revolving fund be established which should receive and rechannel the grants in the form of concessionary loans to the respective projects. This will over time allow the funds to build up resources to finance future projects".*

As you know last year a similar plan was agreed with the government of Aruba where the development aid will be deposited with the Aruba Investment Bank.

In a time span of 10 years the Aruban government will phase out development funds received from the Netherlands and rely from then on only on their own budgets for the development of the island.

A third plan was launched in July 1995 when the Bank Nederlandse Gemeenten (BNG) worked out a financing proposal for a new Government Bank. The objectives of this bank were to finance public investments, reduce the public debt, and refinance the public debt over longer terms and guarantee cheaper funding for the public sector.

In 1997 a working group chaired by Ir. G. Wawoe worked on a new plan for development cooperation between the Netherlands and the Netherlands Antilles. The working group proposed two concepts for a new Development Bank in order to optimize the use and channeling of funds through financing investment projects on the islands of the Netherlands Antilles. This Antillean Development Bank should in principal only focus on the financing and development projects in the Netherlands Antilles.

In the same year the 'Nationale Investeringsbank' (NIB) proposed the incorporation of a Caribbean Investment and Development Bank. In their final report NIB focused on the urgent need for new investments in the region to create employment opportunities on the islands. The main reason was to absorb the great number of civil servants that had to be laid off because of the macro-economic programs designed by the authorities together with the IMF.

The NIB proposals were different in the sense that the funding of development projects should not only come from Dutch aid received but also tap from the local and international capital markets. Furthermore the Caribbean Investment and Development Bank should work together with the respective authorities on the islands on the implementation of structural economic growth strategies, resolve issues concerning government guarantees and finally guide the privatization process in the region.

Here I have tried to illustrate that the ideas for a new approach towards development cooperation, funding and financing of the economic growth strategies on the islands have been a topic of intense discussion during the last two decades here in the Netherlands Antilles.

Let me now turn to the second part of my presentation today, which is related to the Best Model of the Development Bank.

The new development bank: it's purpose and benefits

Among the various plans for the establishing of a Development Bank in the Netherlands Antilles or the region some important similarities in function and purpose can be observed.

One important element of the concept of a Development Bank outlined during the last decade is that the bank should be centered on the primary task of promotion and co-financing of public investments on the islands of the Netherlands Antilles. The advocates of the idea of a Development Bank foresee that this bank should actively seek funds in the (international) markets to improve the socio-economic environment in which we live today in the region. In addition the Development Bank should seek cheap funding and attractive financing conditions to spur the needed private- and public sector investment in our region.

The World Bank has been actively involved with the Government of the Netherlands Antilles since last year in designing an economic program with strategies intended to generate economic growth in the near future.

The World Bank also supports the idea of a Development Bank because this gives the best guarantee for the implementation of the designed and approved economic programs of the islands.

How do I see a Development Bank in the Netherlands Antilles?

The main tasks of this bank should be centered on the following:

Channel Dutch development aid and tap other sources of funding to finance the socio-economic programs agreed upon between both the Netherlands and Netherlands Antilles (island) governments;

Make available long term funding for various projects in the private- and public sector;

Make available cheaper funding for projects in selected economic areas for growth;

Advise, guide and review projects being promoted for financing;

Participate in equity capital of the projects in order to realize a better mix between equity and bank financing;

There are some conditions that should be met before the new Development Bank can operate at an optimum level and reach the goals described here.

The experiences of the past have thought us that we need to build the local capacity and expertise in the field of socio-economic development in order to compete within the region.

In addition the local expertise is in a better position to assess the cultural and socio-economic needs of the islands. This calls for the Development Bank to organize, promote, and train local professionals to gain knowledge and experience in this field.

If we analyze the benefits in this context from the present system of development cooperation we all agree, and I have heard this argument time after time during the past decade, that we have not succeeded in building the local capacity. In retrospect one can conclude that the local authorities were not able to built 'ownership' of the project.

A second important lesson from the past is that the bureaucratic involvement in project review and approval procedures did not contribute to the efficient and swift implementation of projects proposed for financing. The substantial amount of funds that remained underutilized in the past and therefore gone is a good indicator of the scope for further improvements.

A third area of constant discussion between the donor country, the Netherlands, and the recipient country, the Netherlands Antilles (islands) has been the ex-post audit of the funds and aid donated. The focus of the accountability until now remained with the Netherlands and one can give many good reasons for that approach. If on the other hand we are able to set-up and run a professional Development Bank with a Managing Board and

Management Team of competent and professional persons, the issue of governance should be relegated to annual audits.

Development bank and economic growth

So far I have focused on the importance of a new development approach through institutional changes in order to stimulate growth. By doing this we should not forget that there are other factors for growth that are of paramount importance. These factors are not directly related to inefficiencies in the financial markets but are related to other institutional weaknesses.

As it is well known to you, the World Bank has been involved with the Netherlands Antilles authorities for nearly a year now. They have designed together with the island authority areas where potential growth can be achieved in the near future.

An important challenge that the World Bank team has recommended the authorities on the island to work on is a comprehensive social consensus between all the stakeholders to realize the necessary paradigm shift on the island.

Further, in completing the essential economic paradigm shift exercise that we will have to develop, there are other critical areas where new development is of utmost importance for our future economic growth.

The World Bank has recommended to look into the following areas:

Relaxing restrictions on work permits for managers and senior staff from foreign countries to help expedite economic recovery;

Focus more on retraining programs and education;

Reduce cost in the economy through efficiency exercises and put more emphasis on productivity growth;

Achieve a balanced budget on the basis of the IMF approved program.

In addition to the World Bank we are involved with the Foreign Investment Agency Services (FIAS) in the process of refocusing the economy of the Netherlands Antilles. The Foreign Investment Agency Services has conducted a study on the barriers to attract new investments.

There are some preliminary findings that I would like to share with you.

The foreign direct investment study (FDI) concluded that Curacao has many attractive features that can draw foreign investors.

These features are skilled managers, specialized experts in international taxation and accounting and a judicial system that gives us a competitive edge compared to the region.

On the other hand, there are also numerous negative barriers that discourage potential investors.

The two important areas that need urgent improvement are:

Reduce administrative barriers, red tape and excessive long delays and the difficult processes to get licenses.

Simplify, streamline and strengthen the tax system, which has too many brackets, too complex, contains excessively high marginal rates and suffers from inefficient collection and enforcement.

The other important area where our authorities will have to do further reforms is the taxation system of the islands. The serious problems relating to taxation have roots on several levels.

Some are:

On a day-to-day level and closest to the operations of businesses is the complexity and the frequent changes of the tax system.

A second level of risk relates to a lax and inefficient system of collection and enforcement of taxes.

At the inter-island level is the present system of tax collection and how the revenues are subsequently distributed which forms a source of many problems.

Concluding remarks

Ladies and Gentlemen,

The establishing of a Development Bank in the Netherlands Antilles is important and necessary.

The experiences of the last years have showed us that we have to do away with the impediments to local investment, a complicated financial tax structure, bureaucracy, and a slow progress.

As a country we need to take the challenge.

I am an advocate for the establishing of a Development Bank that will spur the needed investments, seek inexpensive funding and entice attractive financing.

It will improve our economic growth; it will stabilize the income and wealth accumulation of the past decades. And, it will most certainly improve the socio-economic environment in which the Netherlands Antilles lives in today.