

General economic equilibrium: The case of the Netherlands Antilles

1. Introduction

With the departure of Miguel Pourier from the political scene, the Netherlands Antilles will miss one of its greatest minds in the area of Public Finance. Prime Minister Pourier has come to symbolize the continuous and persistent efforts to bring our fiscal house in order. Our fiscal ills are the consequences of a series of external shocks that beset our nation in the early eighties. Mr. Pourier played a pivotal role in raising our awareness of the necessity of a sound fiscal policy as a necessary condition to create a climate conducive to sustainable economic growth to ultimately improve the welfare of all the inhabitants of the Netherlands Antilles.

His tenure as Prime Minister has been characterized by the colossal operation to restructure the government bureaucracy, overhauling our tax system and the initiation of the privatization effort. This operation has been initiated with the support of the International Monetary Fund. As members of the Managing Board of Directors of the Central Bank, we have worked closely with Prime Minister Pourier in the design and implementation of this program. We can confidently say that this adjustment effort initiated by Mr. Pourier has gone a long way in addressing our macro-economic imbalances. For example, when Mr. Pourier assumed office in 1994, the primary balance was in deficit. Since 1997 the primary balance has been showing an increasing surplus. Not all the structural imbalances could have been effectively addressed. As we will contend later on, this is due to the imperfections in one of our most import inputs market, namely the labor market.

In this article, we want to reflect on the labor-market imperfections in the Netherlands Antilles and analyze some reasons for the high structural unemployment on the islands. The (un) employment problem can be singled out as perhaps the most important cause of social difficulties on the islands. In designing and implementing any adjustment program, particular attention therefore has to be given to this nagging problem.

In the classical general economic equilibrium theory of *Léon Walras*, a pioneer in mathematical economy, unemployment and overproduction cannot exist because the efficient working of the price and wage mechanism automatically will produce the necessary changes and shifts in demand and supply to bring about equilibrium in the labor and product markets. The crucial element in the Walrasian long-term equilibrium theory is that the price flexibility in all markets results in a continuous equilibrium situation in the long-term.

How can this classical macroeconomic equilibrium theory explain the structural unemployment situation in the Netherlands Antilles? Or to put it differently, does this general theory apply to the case of the Netherlands Antilles or do we have to resort to other competing theories to explain the prevailing case of the Netherlands Antilles?

2. Labor market imperfections in the Netherlands Antilles

In analyzing the average unemployment rate and economic growth rate for the last two decades, one can deduce that the unemployment rate for the entire Netherlands Antilles remains high despite periods of rapid economic growth. As we operate under a regime of fixed exchange rates, we already know that one channel of adjustment (i.e., exchange rate adjustment) is no longer a policy variable. Given the downward rigidity of wages, the question then becomes how can we correct the high structural unemployment in a way that will lead to lower unemployment?

Table 1

	1981-85	1986-90	1991-95	1996 -2000
Unemployment	17.7%	21.4%	13.4%	14.3%
Economic growth	3.5%	8.1%	2.9%	-2.1%

One of the main causes of the increase in the unemployment rate was the external shocks that beset the Antillean economy in the mid-80s and 90s. Because of the downward rigidity of wages, private sector reacted by reducing the work force through a series of rationalization and streamlining processes in the main sector of the economy: ship-repair, refinery, transshipment, and harbor activities.

The above served to illustrate that the absence of price adjustment resulted in a quantity adjustment in the labor market to restore equilibrium. Aside from that imperfection, the labor-market in the Netherlands Antilles is further complicated by the island-specific dynamics in the wage-and price-formation process. An important methodology used in economic theory to assess the performance of the labor market is to study the relation between economic growth and unemployment. In an economy where responsiveness in the labor market is slow, economic growth scenarios typically result in a reduction in unemployment, but at a very slow pace. For the Netherlands Antilles, an IMF study conducted during the period 1990-98 supports this weak responsiveness of the labor market to economic growth.

Equation (I) shows the degree of flexibility of the labor markets due to changes in economic growth.

$$(I) \mu_t - \mu_{t-1} = -0.33 (y_t + y_{t-1})/2 + 0.42$$

where: μ_t = the unemployment rate at time t,
 y_t = the GDP growth at time t.

This formula shows that for every percentage point increase in economic growth (GDP growth), the unemployment rate will decrease by one-third of one percentage point. The

coefficient of 0.33 reflects the labor market rigidity coefficient, which in comparison to other countries is relatively low.

Given this fact, a reduction in the unemployment rate from the current 14 % to, say, 4% would take a sustainable annual average growth in the real GDP of 3% for a period of 10 years. If we are to design a program to reduce the unemployment rate as suggested, only high rates of economic growth or further improvements in the functioning of the labor market will bring this about. This implies that a solution to the problem of unemployment is a medium term objective since the rigidities in the labor market are structural in nature, requiring well-conceived and targeted employment programs.

To resolve the (un) employment problem that faces our country structurally is to focus on resolving the various factors that affect labor-market rigidity. Therefore, policy efforts should be directed toward increasing the responsiveness of the market by augmenting the rigidity parameter (0.33).

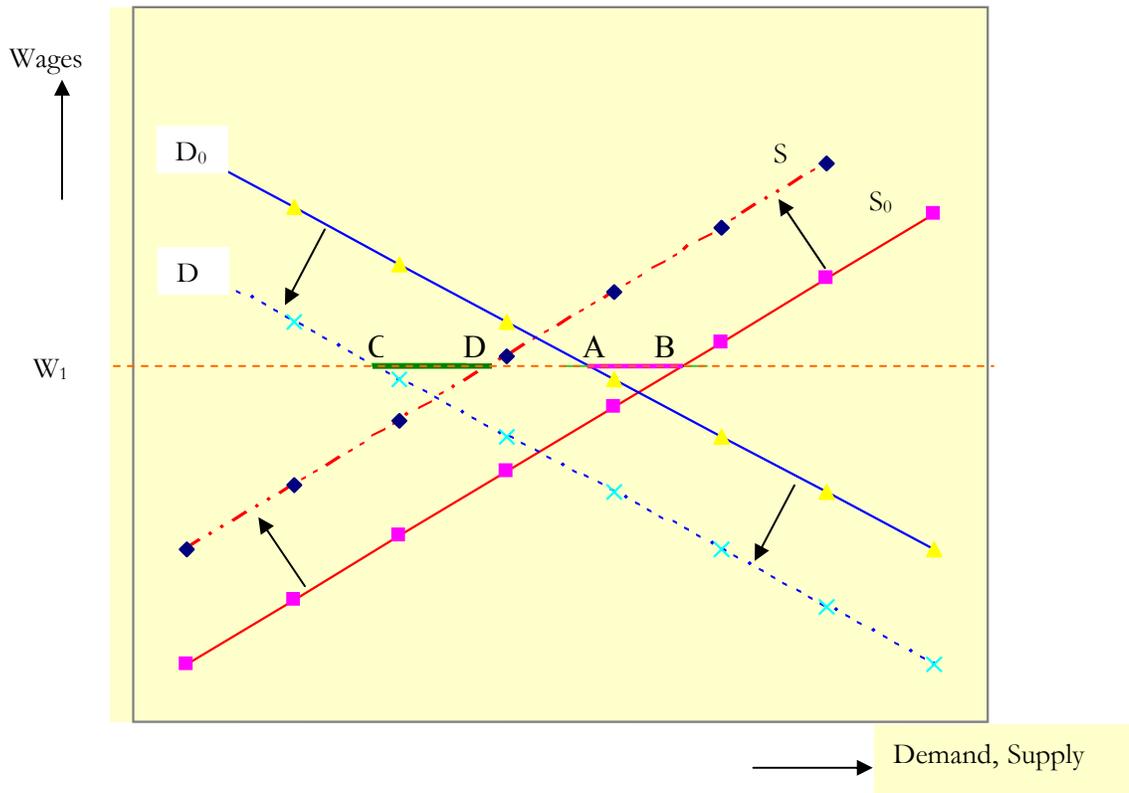
Besides the relatively slow responsiveness of the wage-and price-adjustment mechanism in the labor market, another factor that contributed to the structural high unemployment during the last decade is average compensation per employee in relation to the labor productivity gains. According to the classical Walrasian general equilibrium model, an essential element in maintaining the equilibrium in all markets is the flexibility in wages and prices. All growth in real wages over and above the productivity of labor will result in higher cost to the business sector, and as a consequence, to a reduction in employment opportunities. Table 2 outlines the major development in these variables during the period 1993-98.

From table 2 one can conclude that average wage compensation for the entire economy has been in line with labor-productivity gains. Thus, wide changes in the unemployment rate could not be explained solely from the discrepancies between wage compensation and labor-productivity growth. If we break down the wage compensation by sectors and use the compensation in the public enterprises to the value-added per worker (an indicator of labor productivity), we can conclude that wage compensation consistently has overshoot productivity. This situation, combined with the fact that wage formation in public enterprises has exerted an upward pressure on wages in all markets, has resulted in a less competitive economy in general.

Table 2 Netherlands Antilles, Curacao:
 Compensation per employee and Productivity 1993-98
 (Index 1993=100)

	Average Monthly Compensation per Employee				Real value added per worker
	Economy Wide	Public enterprises	General government	Tourism sector	
1993	100	100	100	100	100
1994	100	105	98	96	103
1995	101	123	97	100	98
1996	103	124	102	102	101
1997	108	125	111	108	102
1998	108	129	112	109	111

Aside from the rigidities brought about by the lack of responsiveness in the labor market, there are other factors mainly institutional in nature that led to high levels of unemployment. The recent overhaul in the labor legislation has addressed some of these issues and should result in a much more flexible market. Another factor that affected the level of unemployment in the Netherlands Antilles is the fact that the fiscal consolidation process was not complemented with a timely growth strategy.



The drag on the fiscal consolidation process created an uncertain environment that affected the investment climate and hence employment decisions negatively.

Figure 1 illustrates graphically the structural nature of unemployment on the islands. The demand for labor is shifting downward whereas the supply of labor is moving in the same direction. Given a stable level of real wages, the same outcome for unemployment will result. Thus, the unemployment rate more or less remained at the same high structural level. The reasons for the shift in demand downward in the past two decades were associated with the growing uncertainty with regard to the government's actions to reduce its fiscal deficits. Uncertainty in the private sector also led to postponement in investments and the relatively low labor productivity in specific sectors. The shift in the supply could be explained by the massive migration to the Netherlands by Antillean residents in pursuit of a better future. In a growing economy both these development should be reversed to bring about equilibrium in the labor market.

3. Developments in the USA, Europe (the Netherlands), and Japan

Developments in the labor-market can best be evaluated by using 'simple' models of the economy that relate various economic- and social variables to the unemployment situation or to job creation in a country during a certain period of time. For this purpose, we can provide an overview of the basic elements of the labor-market situation in the USA, Europe, and Japan and show the results as measured by employment in these countries during the recent decade. This exercise is intended to create a similar 'modelistic' thinking for our own situation in the Netherlands Antilles and to compare the results of the last few years with the aforementioned countries.

The US model:¹

The labor-market model in the USA contains several basic elements.

- Labor-market mobility and wage flexibility are relatively high; i.e., the participants in the market are very mobile in moving from one area to another of the country to take advantage of higher relative wages or will accept wage-cuts during a recession or if a company is experiencing financial difficulties.
- The market functions with little regulation; i.e., government intervention, particularly in the distribution of income is relatively minimal.
- Negotiations on labor conditions take place at the company level, and few impediments exist to dismissing employees.

The Japanese model:¹

- Negotiations on labor conditions take place at the company level whereas agreements on income compensation are related directly to the company's future.

¹ *Werk boven inkomen: wensdroom of werkelijkheid?* C.J.A. van Lede, Economische Statistische Berichten October 1995.

- Economic setbacks are dealt with by reducing the time of work; i.e., adapting daily work hours constitutes an important element in reducing the wage bill when the economy moves in a downward trend.
- The labor relations are that of ‘life-time employment’; e.g., 20 percent of the workforce works for more than 20 years in the same company.²

The European model:¹

- Negotiations on labor conditions take place at a relatively central level.
- Labor mobility and wage flexibility are less pronounced than in the US model.
- Institutional arrangements are focused on protecting the labor force against dismissal and income loss.
- Governments are more inclined to influence income distribution through policy actions at any time.

4. What are the lessons to be drawn in dealing with the unemployment problem?

The study of the major characteristics of labor market models in the world has given us some tools to develop solutions for (un) employment here on the islands. Experiences in Japan and the USA suggest that flexibility in prices and wages and less restrictive labor laws give a better perspective for the solutions of problems. Particular attention should be given to:

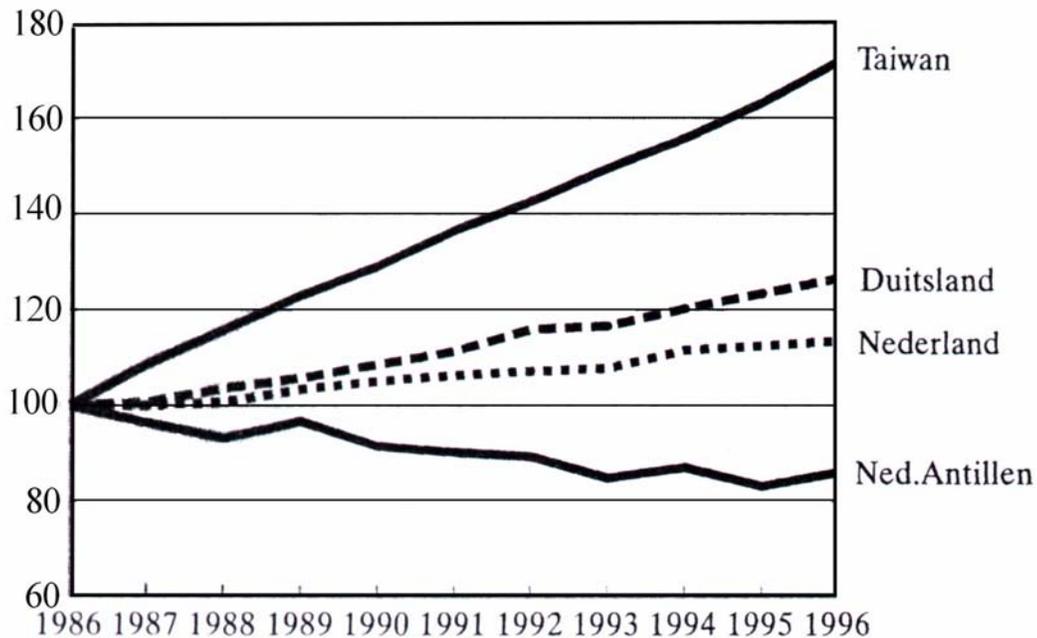
Increase in productivity:

We should pursue policies directed at enhancing labor flexibility in general. A *Central Bureau of Statistics (CBS)* study³ shows that during the period 1986-96, labor productivity in the Netherlands Antilles consistently dropped while, in contrast, labor productivity in the Netherlands, Germany, and Taiwan grew (see graph 2). This study indicates that not only was our productivity low and declining, but our competitive position vis-à-vis some important markets in Europe and the Far East deteriorated substantially.

² OECD, Employment outlook, Paris 1993.

³ De sociaal-economische situatie in de Nederlandse Antillen; MODUS CBD of December 1998.

Graph 2. Labor productivity (Index 1986=100)



Allocate more resources on education to reduce unemployment.

One important area of neglect on the islands has been expenditures on education. World Bank studies in recent years in the Caribbean area have shown that those countries that have invested heavily in education, e.g., Barbados, St. Kitts, and Nevis, have reduced their unemployment rate and poverty levels considerably. Therefore, one of the main elements for a successful employment program is to invest heavily and consistently in the coming years in education. Furthermore studies in recent years have consistently indicated that there is demand for skilled labor, while the oversupply of unskilled labor continues to rise. This is a typical problem of mismatch in the labor market.

Create possibilities for part-time work.

In the Japanese labor-market model, an important instrument used to alleviate the unemployment situation there is the reduction of working hours. In this Japan scenario, the employees will work fewer hours in a day to compensate for a drop in workflow in their company. In Holland a somewhat similar policy of reduction of working hours in combination with lower wages has driven down the unemployment rate considerably during the last decade. By sharing the available jobs in times of economic recession, an equitable distribution of jobs between the employed and unemployed have resulted in lower unemployment. We have to study this possibility in the immediate future and

analyze whether this can be part of a solution to the persistent unemployment in the Netherlands Antilles.

The attractiveness of migration to the Netherlands.

Another peculiarity of the domestic labor market that affects the wage flexibility is the 'escape route' to the Netherlands. Migration to Holland during the last decade has grown steadily due to the higher wages, better social benefits, and the steady economic expansion there. This situation has led to a shift of the better-educated and skilled labor to Holland. The education and health sectors have attracted many of the Antillean middle-class to Holland. In addition, 80 percent of the well-educated younger professionals of the Antilleans remain in Holland after completing their higher education. This situation provides an additional challenge for policy makers to create a domestic environment to attract young professionals now living and working in Holland.

5. Concluding remarks

One can conclude that two of the major impediments in the labor market are (1) the downward rigidities of wages despite the structural high unemployment, and (2) the lack of mobility. The low mobility factor within the Netherlands Antilles may be due to the lack of educational training of the unemployed. A significant number of the unemployed (63%) has an educational level of mavo/lbo or lower.

Another impediment to Antillean labor-market has to do with the better job opportunities and better welfare benefits in the Netherlands. These factors generated a constant flow of both well-educated and skilled Antillean labors and those with low education level to immigrate to the Netherlands. In the last decade alone (1992-2001), the number of Antillean residents that migrated to Holland totaled approximately 16.700. During 1992-1996 the number of people migrating from Holland to the Netherlands Antilles was positive, this number changed dramatically between 1997-2001. During this period over 22.000 Antilleans migrated to Holland.

Mr. Pourier efforts to restore macro-economic equilibrium entailed more than just fiscal consolidation. It contained an important structural element directed at improving the functioning of our markets. As is evident from the above, the current constitutional arrangement also brought its pressure to bear on his adjustment efforts. Given this fact, the current situation in the Netherlands Antilles cannot be earmarked as a recession but rather a typical case of a depressed area!

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