

# Curacao 2020: The Road to Realizing a Vision

*Speech delivered by Alberto Romero, Executive Director Bank van de Nederlandse Antillen, at the Rotary Curacao luncheon  
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Ladies and gentlemen, good afternoon,

It is a privilege to be here today to share with you a vision of the future of our island and the challenges ahead. I invite you to join me on my journey through time to the year 2020.

We are in the year 2020, and the economy has grown for the 10th consecutive year at an average rate of 5 percent per year. As a result of this buoyant economic performance, our labor market conditions are among the best from both a regional and an international perspective with a frictional unemployment of only 3 percent. Inflation has remained subdued due to the modest imported inflation and stable domestic costs. The government, adhering to its policy of sustained development, has applied part of the surplus to its primary balance to finance capital investments in infrastructural improvement, such as the highways to "Bandabou" and "Bandariba". The government has used its surplus also to finance the further expansion of our national university, especially the establishment of a bio-marine research facility.

Domestic production has been growing due mainly to increased domestic and foreign demand. Worth mentioning is the accelerated pace of investment spending in the tourism sector and in infrastructural expansion. We have just finalized the third Mega pier, where the largest cruise ships in the world can easily be docked.

At the opening ceremony, the Prime Minister welcomed the 3 millionth visitor to our island, and the prospects for further growth look even better as we have just finished the fourth and final stage of the eco-resort at Oostpunt.

This eco-resort is one of the largest in the Caribbean region and will attract around 1 million visitors a year. Marriott and Hyatt are considering opening another hotel facility on the island.

Other sectors also have recorded remarkable growth over the past 10 years. Due to the recent large-scale investments, the refinery's production capacity has doubled and complies with the highest international environmental standards. This investment has been financed entirely by the local private sector and foreign direct investment, a clear indication of the high confidence in the long-term prospects of our economy and a further boost to the local equity market.

Due to our excellent business climate, high-speed telecommunication network, and high level of education, Curaçao has become one of the most important countries supplying e-business activities. This e-business provides increasing job opportunities and generates a considerable amount of foreign exchange for our country.

Airbus has moved its regional service facilities to Curaçao, thanks to the large-scale upgrading and expansion of our airport facilities and our favorable geographic position in the region. This was the third such expansion of Curaçao's airport, which has become one of the busiest in the Caribbean and Latin America. Consequently, Curacao has become an important regional hub for major airlines.

The economic impact of the airport zone is substantial as it generates low, medium, and high skilled jobs, foreign exchange, and higher tax revenues.

Ladies and gentlemen, in summary, Curacao has developed into a knowledge-based economy, attracting knowledge-based industries and services groups, particularly in high value-creating activities. State-of-the-art physical and IT infrastructure accompanied by a high transportation and logistics capacity have made Curacao a center of trade activities between the Caribbean, Latin America, and Europe. Our superior airport and logistics infrastructure has boosted airport activities and aviation services. As a result, airlift has expanded significantly, and Airbus has chosen our island as its regional maintenance, repair, and overhaul center. The airport free trade zone has developed into the largest in the Caribbean region. Also, Curacao's container port has expanded into an important regional handler of mega container vessels. Curacao possesses a world-class oil refinery with minimal environmental impact, stemming from a robust physical infrastructure and modern technology. With the broadening and deepening of our own stock exchange, we have developed into a key international financial center.

Ladies and gentlemen, this vision of Curacao's future makes it one of the best places to live. Now it is time for a wakeup call to face the harsh realities of today. Although the latest recession ended five years ago, economic growth still has not taken off, our growth rates barely exceed 1% a year due mainly to a lack of investments. Consequently, our high unemployment rate of around 15% does not show signs of abating and would have gone even higher if a significant part of our population had not migrated abroad to escape the lack of decent prospects on our island. In addition, youth unemployment has reached a high of 37%.

A closer look at our main pillars of economic activity reveals the following picture. Tourism is currently doing well despite the temporary decline in airlift caused by the demise of DCA. Occupancy rates climbed to levels we haven't seen for years and triggered a wave of new hotel projects and the expansion of existing hotels. However, the current growth depends largely on external factors, such as our cheap currency vis-à-vis the euro and the terrorist threats around the world, which have prompted American tourists, in particular, to stay closer to home. A change in these conditions could hurt our tourist sector and, hence, our economy significantly in the absence of a broad diversification among different markets.

The international financial and business services sector still suffers from the elimination of the low tax regime for offshore activities to prevent being labeled by the OECD and the European Union as a country promoting harmful tax practices. The resulting loss of business would be more than compensated for by our improved competitive position in negotiating new tax treaties, but progress in this area is slow.

The oil refinery is subject to increasing criticism concerning its impact on public health and the environment. Eventually, a choice will have to be made between upgrading the refinery to meet international standards, a decision that will require enormous investments, or closing it down, which will have a significant negative economic impact.

Furthermore, after decades of market protection, our local industry is still not capable of facing international competition. During the period in which the protection was being phased out, several companies closed, trimmed down, or are in trouble, prompting the government to reintroduce protective measures.

It has also been difficult attracting foreign investors. Several studies have revealed the weaknesses of our investment climate, such as high utility and labor costs, rigid labor laws, a qualitative mismatch between labor demand and supply, complicated and time-sensitive licensing procedures, and a complex tax system with opaque tax incentive schemes. On top of that, the authorities often show a lack of unity and commitment in concluding foreign investment projects. This situation results in slow decision-making and sometimes the retreat of an investor. However, instead of implementing policies to eliminate these weaknesses, every new government starts a new study on the investment climate. The result is a loss of precious time to boost investments and growth.

In the area of the public finances, our problems are even more daunting. Deficits and debt levels are rising rapidly. In addition to the burden of a double layer of government, a lack of fiscal discipline explains a large part of this development. Adherence to the laws, rules, and policy decisions regarding the budget is weak in part because of a lack of sanctions. Shortfalls or new policy initiatives almost always result in higher deficits. Compensating measures to prevent a deficit overrun are hardly considered. Moreover, the absence of a regulatory framework for government enterprises has led to inefficient operations, high prices for often mediocre services, and low or even absent dividend payments.

The derailment of our public finances is also caused by weak governance. Several times, wrong decisions have cost us dearly. One could cite loan guarantees for investors that were called upon, and claims because promises to investors were not kept or licensing procedures were slowed to protect vested interests.

The high deficits and, consequently, the rising interest payments to finance those deficits have put pressure on the funds available for important policy areas, such as crime control, education, health care, infrastructure, and poverty alleviation. As a result, crime has increased drastically, school dropout rates are rising, the average level of education and skills of our youth entering the labor market is declining, the quality of our health care is deteriorating, our roads are full of potholes, and poverty is spreading.

The harsh reality of the present situation seems to make our vision of Curaçao in 2020 an unlikely utopia. However, I believe that we can achieve this vision if we take the proper corrective measures now.

Ladies and gentlemen, 2020 is only 15 years from now. We have to start today to build an economy capable of realizing this vision of our society in 2020. In this context, I would like to share with you one notion of sustainable development that covers the economy, the environment, and the social framework. The notion of sustainable development presents a challenge for policymakers that goes beyond the traditional concerns for economic growth.

Given its importance in achieving the other two aspects of sustainable development and the time constraint of my presentation, I will concentrate only on the economic aspect of sustainable development.

To realize the vision I have set forth, a great deal of work needs to be done. We must focus on the key factors determining economic growth in the long run: investment in physical and human capital. The rate of accumulation of physical capital is one of the main factors determining the level of real output per capita.

The investment in physical capital will have a more permanent impact on the long-term growth process if combined with increased investment in human capital – for example, expenditures on education and training because the adoption of new technologies is facilitated by a highly skilled workforce.

Therefore, we can state that the main factors driving economic growth are investment growth and policy. The links between economic growth and policy can be classified into two categories. One category comprises the influences of macroeconomic and structural policy settings, trade policy, and financial market conditions on economic efficiency. The second category comprises the effects of the same policy variables on investment in physical capital.

With so many policies influencing investment-driven economic growth, priorities are essential, and care is needed to ensure that they are combined in a coherent manner. If I had to make a selection, I would single out the following challenges:

- Pursuing stability-oriented macroeconomic policies, something that is absolutely necessary, but not sufficient;
- Increasing competition in service and product markets to foster efficient allocation of scarce resources; and
- Lowering barriers to entrepreneurship to improve the business environment for start-ups.

Let me first discuss two fundamental issues related to stability-oriented macroeconomic policies – national savings and the cost of doing business in Curacao – and their impact on our growth prospects.

Textbook economics teaches us that the most important driving force behind investment growth is the level of domestic savings. Therefore, we must ask: is the savings level in our country high enough to finance the capital investments needed to spur the sustainable development we envisage? A second question is: what is the role of macroeconomic policies in this development? Bear in mind that given the marginal propensity of households to consume, the level of private sector savings is determined by the effective tax rate, the rate of return on savings, and the depth of the financial markets.

The first question is very difficult to answer because it depends on several factors, such as the desired rate of economic growth, the investment needed to support this growth, accessibility to international financial markets, and our attractiveness for foreign direct investments. But, independent of its adequacy, we know that a substantial part of our domestic private savings is being allocated to finance the unsustainable large fiscal deficits. This phenomenon is the so-called crowding-out effect.

Another problem related to the adequacy of our national savings level is the depth of our local financial markets or – correctly phrased – the lack of depth in our financial markets. Even if the level of our private sector savings was adequate, the absence of a well-developed equity market makes the transmission of financial resources from savers to investors very inefficient and costly. As a result, equity financing in our economy is practically nonexistent. This shortcoming implies that local investors have to rely solely on bank financing, which is more expensive because of the intermediation costs.

Ladies and gentlemen, I would like to put forward the following structural policy consideration as a key element of a stability-oriented macroeconomic policy : a full fledged “debt-for-equity” swap. Let us stop for a moment and consider the implications of this proposal. Under the present conditions of an unsustainable large fiscal deficit, the growing fixed stream of interest payments is putting an undue burden on the fiscal balance. In the absence of such a burden, the primary fiscal balance (i.e., excluding interest expenses) would likely become positive. On the other hand, the government owns several fixed assets, such as government-owned companies, which generate in principle a variable endless stream of income. Through a debt-for-equity swap, the government would cancel a substantial part of its debts, thereby reducing the burden of interest payments. Combined with other efficiency-enhancing measures, a

debt-for-equity swap can result in a fiscal surplus, which could be used to reduce the tax burden on society. A tax reduction immediately leads to a lower cost of doing business in our country.

What are the additional benefits of this proposal? As discussed, the local financial market is not deep enough to finance fixed capital investment. A debt-for-equity swap adds more depth to the local financial markets with other types of financial instruments. Adding equity trading to the local financial market may trigger a more active participation of surplus and deficit households on the financial market. This disintermediation could lead to a lower cost of funding, increased return on savings, and, hence, increased domestic private savings and investments. In turn, the lower cost of funding also would contribute to a lower cost of doing business in Curacao.

Another benefit of the debt-for-equity swap is that it would reduce the government's role in the economy.

Increased private sector management of our economy, driven by profit-maximizing behavior and competition, would lead to a more efficient allocation of our scarce resources. This process should be supported by a further liberalization of all economic activities in our economy.

This brings us to my second policy proposal: the further liberalization of all markets. Increased competition in service and product markets has far-reaching benefits for economic growth and sustained development of our country. First, free competition leads to a more efficient use and better allocation of the available scarce resources in our economy. The resulting downward pressure on prices has a positive effect on the purchasing power of wages and our international competitive position. Therefore, both domestic and foreign demand benefits from free competition. In turn, increased demand boosts domestic production and economic growth.

Finally, I would like to stress the importance of lowering the barriers to entrepreneurship, particularly for start-ups. Currently, a major obstacle is the amount of red tape. However, no less important is the availability of investment funds. In this context, we have to strive to create a venture capital base for new entrepreneurs.

In summary, the policy proposal of a debt-for-equity swap is not only beneficial for attaining structural fiscal consolidation. The resulting market efficiency combined with a further liberalization of all markets and an improved business climate simultaneously will contribute to a high sustainable level of economic growth, lower prices, greater product diversity, rising incomes, and higher purchasing power for the society as a whole.

With the implementation of this policy approach, we will take a significant step forward toward realizing the vision of Curacao in 2020.

Thank you for your attention