

Recent economic developments and their implications for the Sint Maarten Hospitality and Trade Industry



Speech delivered by Dr. Emsley Tromp, at the SHTA General Membership Meeting. Friday, 23 October 2009

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Our economy is currently facing many challenges. First, the world economy is experiencing its greatest slowdown since the Second World War. This slowdown undoubtedly affects the Sint Maarten economy in general, and the hospitality and trade industry in particular. At the same time, we are in a process of constitutional changes that will lead to a status aparte for Sint Maarten. This process provides us a unique opportunity to address certain weaknesses in our investment climate that, if corrected, would benefit the industry.

I have been asked to discuss the recent economic developments and their impact on the hospitality and trade companies in Sint Maarten. However, before discussing the local situation, I will take a look at the international environment. As small open economies, both Curaçao and Sint Maarten are very vulnerable to external shocks. Therefore, I will also spend some time on the benefits and costs of dollarizing the economies of Curaçao and Sint Maarten to reduce these external vulnerabilities. Finally, I will discuss some structural reforms needed to stimulate sustainable economic growth in Sint Maarten.

Ladies and gentlemen, since July 2007 the global economy has experienced a severe financial crisis originating in the US housing and credit sectors. Due to the increased integration of goods, services, and financial markets, the crisis has spread from the housing and credit markets in the United States to other markets and countries around the world. This crisis has resulted in a deep worldwide recession with severe economic and social impacts. Few, if any economies have not been affected by the crisis. Output has contracted in the major industrial countries, including the United States and the Euro area, and has slowed in the emerging economies.

Fortunately, global economic growth has started to rebound recently, and financial conditions have improved markedly. World economic recovery has been driven largely by wide-ranging and coordinated public intervention, particularly in the industrial countries, through supporting demand and reducing uncertainty and systemic risk in the financial markets.

However, the pace of recovery is expected to be slow as uncertainties remain in the financial markets and public intervention will gradually have to be withdrawn. Against this background, it is projected that the world economy will contract by 1% in 2009 and recover by about 3% in 2010.

The global economic downturn has had severe repercussions for the Caribbean region. As external demand dropped, output in countries with relatively large manufacturing sectors contracted. In addition, foreign exchange revenues from tourism have been dropping, reflecting the weakening US, Canadian and European markets. Inflows from remittances and foreign direct investment have also been declining. As a consequence, real Gross Domestic Product is expected to contract in most countries in 2009, including the Bahamas by 3.9%, Barbados by 3.0%, and Aruba by 5.5%.

Contrary to most countries in the region, the economy of the Netherlands Antilles is not expected to contract in 2009. One of the main reasons why our economy is an exception in the region, is the implementation of the debt relief

program and the Social Economic Initiative. The inflow of debt relief funds has a positive impact on the current account of the balance of payments. In addition, it contributes to a cash surplus at the general government level and, hence, a decline in public sector debt.

Thanks to the debt relief program, our debt-to-GDP ratio is projected to decline from 82% to 62% during 2009.

However, an analysis by sector shows that activities in the tourism-related industries have been negatively affected by the world economic recession. The island of Sint Maarten was affected most severely in stay-over tourism, which dropped by 13% during the January – June period of 2009 compared to 2008. This development was seen in all markets. With 56% of Sint Maarten's tourist arrivals from the United States, the recession in the world's largest economy has taken a visible toll on the island. Meanwhile, hotel occupancy rates in Sint Maarten dropped from 72% in the first half of 2008 to 50% in the first six months of 2009. The number of cruise tourists remained about the same during the first half of 2009 compared to the first half of 2008.

Activities in the trade sector, particularly the retail trade, weakened during the first months of 2009 reflecting the decline in stay-over tourism and lower domestic demand. The following graph shows the developments in the turnover tax revenues in Sint Maarten, which can be considered an indicator of developments in the trade sector. So far, revenues in 2009 have been lower than in 2008.

The transport, storage, and communication sector showed a mixed performance in the first half of 2009. On the one hand, airport activities, as measured by the number of passengers handled, declined in line with the downturn in tourism. Sint Maarten, for example, recorded a decline of 12% in the number of passengers handled at the airport during the first half of 2009. The number of passengers transported by the national carriers declined as well. On the other hand, harbor activities in the Netherlands Antilles declined reflecting mainly less cargo movements. The Netherlands Antilles' manufacturing sector recorded a remarkable decline in value added, attributable to the poor performance of both the "Isla" refinery and the Curaçao dry dock company.

The financial and construction sectors were the main contributors to economic growth in the first months of 2009. The increase in financial sector activities was driven entirely by the good performance of domestic financial services as activities in the international financial sector declined due to the financial crisis. Construction work expanded largely because of ongoing tourism-related projects. However, the growth in construction moderated compared to the first months of 2008, in line with the slower growth in private investment.

In the case of Sint Maarten, license fee revenues are considered an important indicator of economic activity. As shown in the following graph, license fee revenues dropped over the period January – June 2009.

Against this background and in line with the latest forecast of world economic growth, we expect economic growth in the Netherlands Antilles to slow to 0.8% this year. However, based on the economic indicators for the first six months of 2009, and in particular, the indicators for the tourism industry, the wholesale and retail sector, and license fee revenues, we project that Sint Maarten economy may experience a contraction this year.

For 2010, we project the economy of the Netherlands Antilles will expand by 1.3% given the expected recovery of the world economy. The Sint Maarten economy is also expected to expand in 2010 as the economies in its main tourism markets are projected to recover.

Needless to say, the projected economic slowdown for this year translates into reduced activities in Sint Maarten's tourism industry and the trade sector. In addition, companies that provide goods and services to these industries will also experience a decline in activities. The main pressures faced by these companies are weak demand, both domestic and foreign, and tighter credit conditions.

Given their importance, it is imperative that actions be taken to help these industries survive the present economic slowdown, and subsequently, benefit from the opportunities the projected economic recovery will offer.

Ladies and gentlemen, we are currently in the historic process of the dismantling of the Netherlands Antilles. In the near future, Sint Maarten will become an autonomous country within the Dutch Kingdom. An autonomous status will provide us with the unique opportunity to address certain economic issues in a more island-specific way, thereby stimulating economic growth. This new perspective should be beneficial for the business community, in particular the tourism and trade industries, which are the economic pillars of Sint Maarten.

A crucial factor in this context is macroeconomic stability. In my view, one of the greatest threats to our macroeconomic stability is our vulnerability to external shocks. Our balance of payments has become more susceptible to external shocks with far-reaching implications for the real economy. The rapidly expanding current

account deficit during the last few years, financed by capital inflows from abroad, exposes an increasing external vulnerability, which has been masked by the recent inflows of funds related to the debt relief program. A sudden reversal of capital flows could deplete our foreign exchange reserves quickly, undermining confidence in our currency.

As we are preparing to close the last chapter of the Netherlands Antilles, it is crucial that we address these vulnerabilities to promote the welfare of the new countries' citizens. With regard to the monetary system in the new constitutional structure, it has been agreed that the countries of Curacao and Sint Maarten will form a monetary union with one central bank and a common currency. However, the balance of payments vulnerability compels us to consider alternatives, one of which is dollarization.

Three of the five islands comprising the Netherlands Antilles, i.e., the BES islands, have chosen to introduce the US dollar as the legal tender once their new status takes effect, while Sint Maarten is already de facto dollarized. Moreover, the US dollar is widely accepted in Curaçao. Therefore, it would not be such a big step to formally dollarize Sint Maarten and Curaçao.

Having the dollar as legal tender removes the possibility of a balance of payments crisis with the risk of devaluation. An economic downturn or reversal of capital flows would not turn into a currency crisis. An immediate benefit from the elimination of currency crises would be a reduction of the country risk premium, consequently lowering interest rates. In other words, the spread between the interest rates of the dollarized economy and the United States is reduced. Lower interest rates benefit growth by reducing the cost of credit, encouraging investments.

In addition, as a result of dollarization, transaction costs, related to the conversion into foreign currency, are lowered. Lower transaction costs would benefit trade, including tourism and foreign direct investments. Due to the perceived currency risk, local financial institutions might be more inclined to invest in foreign assets. In the absence of currency risk, the appetite to invest capital locally might increase.

By adopting the US dollar, the financial system becomes more open to international capital flows. Capital mobility promotes financial intermediation, competition and efficiency among institutions, and promotes confidence in the financial system. It also encourages integration of the domestic financial system with the rest of the world.

Although the public finances of Sint Maarten and Curaçao are closely monitored by the budget supervisor CFT, dollarization would provide an extra long-term constraint for fiscal policy as it eliminates the possibility of printing money to finance fiscal deficits. Given our long history of fiscal deficits and troubled adjustment programs, restrictions on increasing the money supply could improve our policy credibility.

Nevertheless, dollarization has some disadvantages. First, the authorities lose monetary policy as an instrument to steer the economy, limiting the available policy mix to correcting macroeconomic disequilibria. Second, the "lender of last resort" function of the central bank disappears. Finally, under dollarization, the central bank would lose its main sources of income, i.e., investment of the foreign exchange reserves and seigniorage from issuing banknotes.

With respect to the first argument against dollarization, the loss of a policy instrument, the following counter argument can be made. Given the limited scope to pursue independent monetary policy under the current exchange rate regime, this loss would not be substantial. The recent adjustment periods have indicated that small open economies like ours are limited to fiscal policies and structural measures to remain competitive and thus improve their investment climates. With regard to the issue of profitability and the function of the central bank as lender of last resort, it is important to put the current reality into perspective. The lion's share of the central bank's profit consists of license fees, which will continue to exist under dollarization. In addition, since the balance of payments constraint is no longer binding, the need to hold foreign exchange reserves to maintain the peg no longer applies. Therefore, the Bank's reserves will all become investable funds, thereby preserving the Bank's profitability. To address the issue of lender of last resort, we need to accelerate the introduction of a deposit insurance scheme. Aside from providing depositors with added security, the funds of such a scheme, some of which can come from the current reserve requirements, will support the function of lender of last resort. Moreover, the government would have to assume this function even under the current exchange rate regime, something which became abundantly clear during the recent international financial crisis.

Hence, dollarization would result in no perceptible changes in the profit of the central bank and hence have no impact on the government budget. Rather, dollarization might lead to an increase in the Bank's profit since the balance of payments constraint always has confined the Bank to pursue a policy of profit maximization. The Bank also has non-interest sources of income in terms of the fees it charges the financial institutions to cover the costs of financial sector supervision.

Realistically assessing and balancing the advantages and disadvantages of dollarization for Sint Maarten and Curaçao should be part of the public debate in choosing the most suitable monetary system for the future countries in the Kingdom. The balance seems to point in the direction of dollarization, given our vulnerabilities in the present world economic order.

However, dollarization does not stand alone as a remedy for economic ills. A series of structural reforms also are needed to achieve economic growth and development in the long term. These reforms will improve our competitiveness and create opportunities for businesses. The first area for reform is increasing market flexibility and balancing demand and supply. In the absence of monetary policy instruments, external shocks that require a change in real wages will not have lasting effects on the rate of unemployment if the labor market is flexible. This flexibility may need to take the form of downward flexibility of nominal wages, and low hiring and firing costs. Another aspect of the labor market that needs to be addressed is the reduction of the qualitative mismatch between demand and supply. In my opinion, education is crucial to reduce this mismatch. Our vocational institutions should take into account to a much greater degree the skill needs in the private sector.

A second area for reform is the further development of our capital market, promoting more financing opportunities for entrepreneurs and more local investment opportunities for investors. More investment opportunities for investors has become even more relevant as a result of the declining significance of government bonds as an investment instrument in light of the debt relief. The development of private debt instruments and equity-based financing especially should be promoted. These types of financing are still rarely used on our island, but they are significantly cheaper than bank financing. Specifically for start-ups and small and medium-sized enterprises, the establishment of a venture capital fund could be crucial to raise the necessary financing for promising investment projects.

Another important area of reform is the reduction of administrative barriers. One of the most common complaints from the business sector is the number and complexity of government formalities and paperwork that frustrate new investment initiatives and, hence, the opportunity for stronger economic growth. The elimination of the double layer of government on the island is certainly a step in the right direction. Also needed is a streamlining of administrative procedures aimed at eliminating all unnecessary bureaucracy, and simplifying the procedures for obtaining business and work permits and business visas.

Finally, medium- and long-term policy efforts should be aimed at making the Sint Maarten economy less susceptible to future shocks. Hence, the recent initiative to develop an international financial and business services sector on the island is a step in the right direction. In addition, the policy agenda should include efforts to make Sint Maarten a regional hub for the transportation of passengers and freight.

We must realize that “entrepreneurial firms” are the ones that will really benefit from the arising economic opportunities. In addition, the likelihood of surviving is also higher among firms that are creative and entrepreneurial. In this context, being entrepreneurial entails identifying and introducing new products, new ways of production, distribution, and marketing. At the same time, an entrepreneur is not afraid to take risks. In my opinion, our business owners should become more entrepreneurial to maximize the benefits from the economic opportunities offered by the future country of Sint Maarten.

Ladies and gentlemen, the hospitality and trade industry plays a crucial role in Sint Maarten’s economy as it is the major contributor to employment and GDP. As a result, we should take all the necessary steps to create a business environment that stimulates the creation and a growth of the businesses in this industry. This is especially relevant in these times of the world economy recovering from a severe crisis and a new world economic order is being developed.

Thank you for your attention.