

# The Economic Situation of the Netherlands Antilles in the Aftermath of the Terrorist Attacks in the United States: Looking Ahead

Speech delivered by Dr. Emsley D. Tromp, President of the Bank van de Nederlandse Antillen on the Occasion of the Fundraising Lunch of Mesora N.V. 2001

Ladies and gentlemen, good afternoon,

I would like to thank the organizing committee of this fundraising event for inviting me as the keynote speaker at this Luncheon. Mesora N.V. is an organization established with the needs of people uppermost in mind. Our standards of living, ladies and gentlemen, depend largely on the productive use of the available resources in our society—be they human, capital, or natural resources. The suboptimal use of our limited resources -whether the result of unfortunate addiction to drugs or otherwise- implies underutilization of our productive capacity. Mesora N.V. attempts to meet this challenge by rehabilitating drug addicts. This effort, it is hoped, will enable former drug addicts to make a valuable contribution to the economic process of our country.

The Central Bank, in the conduct of monetary policy, also strives to create an environment conducive to economic growth and, hence, better standards of living. Given our objectives, I think it is fair to say that both Mesora N.V. and the Central Bank are working toward a common future.

Ladies and gentlemen, this brings me to the topic of my speech: "The Economic Situation of the Netherlands Antilles in the Aftermath of the Terrorist Attacks in the United States: Looking Ahead." This is the fifth year that our economy is in a recession and the sixth year since we initiated a traumatic struggle to restore balance in the government's budgets and economic growth. As our adjustment efforts seem to be bearing fruits, we are confronted with the nagging impact of the terrorist acts of September 11 on our economic situation, the consequences of which may be large and prolonged.

Recent events have served to remind us that the economic well being of a small open economy is largely determined by external shocks. The current financial-economic crisis, for example, has its roots in a number of external shocks, dating back more than 15 years ago. I do not need to dwell on these; suffice it to remind you of the repeal of the US withholding tax, the closure of the Shell refinery in 1985, a number of devastating hurricanes on the Windward Islands, the discontinuation of certain trade privileges on the European market, and the long period of uncertainty surrounding the change of the tax arrangement within the Kingdom. The combined effect of these external shocks was estimated at 20 to 25% of GDP.

Because these shocks were not addressed adequately, macroeconomic disequilibria increased, and it became evident that only a major restructuring of the economy would create a basis for sustainable growth. At the end of 1995, the Netherlands Antilles began a structural adjustment of the economy in close cooperation with international organizations, such as the IMF, the IDB, the FIAS, and the World Bank. Our structural adjustment process is characterized by a three-pronged approach: (i) restructuring of the public finances, (ii) structural reform, and (iii) a growth strategy.

During the past five years, we have made considerable progress in the restructuring of the public finances and the implementation of structural reform. The government bureaucracy has been reduced, wage costs have been brought under control, and the civil servants pension scheme has been partially reformed. These measures have reduced personnel costs substantially. Expenditures have been reduced further by health care reforms and the improvement of cost efficiency in the government apparatus. Finally, the government has started with the regularization of arrears and intergovernmental claims.

On the revenue side, a shift from direct to indirect taxes was initiated with the introduction of the turnover tax, the base of which has been broadened gradually. Tax assessment and collection have been improved, while arrears have been reduced. Furthermore, user fees for government services are applied more broadly. In addition, public sector financial administration and reporting has been enhanced.

In the field of structural reform, various measures have been implemented to foster competition and to create a business climate conducive to more investments. Labor legislation has been modernized, and the product market is being made much more competitive. Progress also has been made in the capital market: disclosures have improved, and the level of the rate of interest has declined. The privatization process also has started. All of this has been done with the objective of improving our business climate and, hence, restoring economic growth.

The third prong of the structural adjustment process, the development and implementation of a long-term investment program, is being undertaken in close cooperation with the World Bank. During a workshop last month, the various islands presented their medium-term development plans, which will be consolidated into a long-term growth strategy for the Netherlands Antilles.

On various occasions I have expressed my views on the financing of this growth strategy. I am an advocate of the establishment of a local institution – a so-called Development and Reconstruction Bank– with good governance to channel the funds, that will become available. A local institution will create local ownership of the program and the needed local expertise. Projects should be evaluated on the basis of sound business principles and their contribution to the overall development of our economy. The funding of this agency should come primarily from Dutch development aid, but additional funds could be raised on the capital market. The financing of projects should be tailored to specific needs and circumstances, ranging from grants to near-commercial terms. In my opinion, such an institutional framework is the best guarantee for the successful implementation of long-term investment projects to support a sustainable growth of our economy.

The above discussion serves to illustrate that a broad adjustment process has been set in motion. Unfortunately, the terrorist attacks in the United States on September 11, ladies and gentlemen, have created a different policy environment within which we now must analyze our adjustment efforts. The attacks will have severe implications for the world economy. Growth estimates are being revised downward worldwide, and a recession in the second half of this year seems very likely. The length of this recession is difficult to forecast and will depend on the nature and duration of the U.S. response and its aftermath.

In my opinion, two scenarios should be considered. According to the optimistic scenario, the international war against terrorism will not escalate. Confidence will return gradually, and the world economy may recover in 2002. According to the pessimistic scenario, the international campaign against terrorism will escalate into a large-scale conflict, uncertainty will increase further, and the world economy will fall into a deep recession. Whatever the actual scenario, the economy of the Netherlands Antilles will not escape the repercussions.

This external shock, ladies and gentlemen, resembles to a certain extent the disaster of hurricanes Lewis and Marilyn that hit the Windward Islands in September 1995. These hurricanes destroyed a major part of the tourism infrastructure on these islands. In the fourth quarter of 1995, the number of stay-over tourists and the number of cruise tourists visiting the island had dropped by 75% and 66%, respectively, compared to the fourth quarter of 1994. Foreign-exchange revenues from tourism had declined by approximately NAf 100 million, while total foreign exchange reserve were down about NAf 150 million, excluding the inflow from insurance companies and the reconstruction aid from the Netherlands. By the first and second quarters of 1996, a recovery was noticeable. Stay-over and cruise tourism increased to 50% and 65%, respectively, of their levels in the corresponding quarters of 1995. Cruise tourism recovered fully in the second quarter of 1996, while the first quarter registered 90% of the number of visitors in 1995. In the first half of 1996, foreign-exchange income from tourism was still NAf 75 million less than in the same period of 1995. From a broader macroeconomic perspective, the hurricane disaster caused real GDP growth to slow by 0.4% in 1995. The Windward Islands suffered a 2% decline in real GDP in 2001 guilders. Moreover, unemployment increased from 11.5% in 1994 to 13.6% in 1995. This shock was largely a supply shock with important demand ramifications. The subsequent inflows from the insurance companies and the Netherlands helped to mitigate the impact of the decline in aggregate demand.

Contrary to the hurricane disasters, the recent terrorist-related shock affects us mainly on the demand side. Again, our tourism sector incurs the strongest hit. Based on the assumption of no escalation of the conflict, the economic impact under the optimistic scenario corresponds roughly with the impact of the hurricane disaster. However, the two shocks have major differences. First, the present shock affects all islands, while the hurricanes were limited to the Windward Islands. Second, after the hurricanes, a substantial amount of funds became available from insurance companies and the Dutch government for the reconstruction of the islands, not the case now. Third, the impact of the attacks affects more sectors of our economy than the hurricane disaster: the increased international pressure on our international financial sector to investigate whether terrorists had access to our financial system, the effect of the drop in travel demand on the air transportation sector, and its impact on the already sorry state of Air ALM, the harbor, and the ship repair sector. In addition, the uncertain outlook for the tourism industry will cast some dark clouds on this sector, which has been identified as having the most growth potential for the Netherlands Antilles. Consequently, all the investment projects, which have been in the final stage of preparation, will have to be revisited. Finally, the present shock is surrounded by uncertainties about its duration and intensity, while the passing of a hurricane is a short-term event after which the recovery process can start. Therefore, the attacks in the United States have the potential for a longer and deeper impact on our economy than the hurricane disaster.

Looking ahead, the question becomes, given the changing domestic and international policy environment, how should we proceed with the IMF-supported program, now being negotiated? As is evident from the analysis, we are

entering a period of great economic uncertainty while still facing medium-term economic problems.

This situation may call for significant additional short-term external financing without compromising medium-term objectives. The impact of the terrorist attack on the economy is extremely uncertain and could produce a large decline in government revenues, hence throwing the economic recovery program off track. A fiscal stimulus also may be required. Therefore it is only prudent that we prepare to implement appropriate measures to cope with this situation. Fiscal stimulus must be temporary and combined with credible commitment to adhere to the program objectives. I, therefore, call for the swift implementation of the IMF-suggested private-led foundation to raise public and private expenditures to moderate the impact of this shock.

The current policy environment is clouded by enormous uncertainty, yet at the same time it presents new challenges for us: it helps unmask the vulnerability we are subjecting ourselves to if we do not diversify our economy. While tourism has the most growth potential, it increases our susceptibility to outside shocks. We must use this opportunity to define carefully our long-term economic objectives and to pursue policies to achieve those objectives. Our long-term economic strengths depend on how we manage this crisis. As mentioned, the response to previous shocks was inadequate. Let us not repeat this mistake. To meet our medium-term objectives, we must restore economic growth. This will continue to require further fiscal consolidation, structural reforms, and a monetary policy supportive of these policy objectives.

In this new policy environment, inevitably we will have to accelerate the negotiations with the Fund, but at the same time we will have to undertake a thorough re-examination of our medium-term policies. We should not only examine our budget priorities and the effectiveness of many expenditure programs as recently done by AnswerThink, but we also must examine our revenue policies as they affect investment and growth. This review has to be coupled with additional external financing in the context of program financing.

Ladies and gentlemen, in this regard I am pleased to take note of the encouraging progress made in the context of the IMF-supported program. After the progress has been evaluated by the IMF staff, I expect negotiations to finalize the agreement to start soon. I like to clarify one issue though. When I talk about finalizing negotiations, I am alluding to the following: (i) after the basis has been established for a Fund supported program as seems to be the case now, we will have to negotiate the quarterly quantitative targets and the policy bench marks against which progress in the implementation of the program will be evaluated; (ii) some of the policies on which the program are based will have to be implemented prior to the initiation of the program—the so-called prior actions such as the approval of the respective budgets by parliament; (iii) the financing requirement of the program will have to be recalculated. We are no longer talking about a program for 2001. Rather, we are talking about the fiscal year 2002. This means that the amount of Naf 238.0 million which was the envisaged program financing for 2001, no longer applies. The new financing requirement becomes the sum of the following components: the budget deficits of 2002, the partial refinancing of maturing debt in 2002 and the elimination of the 2001 arrears. I am saying this to have expectations set in the proper context. It does not serve any purpose and certainly not the one we are trying to achieve with the program to harbor unrealistic expectations.

As soon as we have reached an agreement, ladies and gentlemen, the necessary financial resources should become available. This financial support will not only alleviate the liquidity constraints of the government and, hence, its creditors, but also will be used to start a number of much-needed investment projects that will help mitigate the impact of the current economic downturn. In this respect, we can consolidate our structural adjustment efforts and provide the stimulus for the gradual restoration of confidence in our economy. Regaining confidence is essential for an increase in investments and the creation of much-needed jobs.

Let me return briefly to the activities of Mesora N.V. As I mentioned in the introduction of my address, a close relation exists between our two institutions as far as our objectives are concerned. But ladies and gentlemen, there also exists a close relationship between the economic situation and drug addiction. I believe that a lasting economic recovery will provide the economic resources to enhance our standards of living and hopefully create an environment that discourages the misuse of illegal substances. Not only will fewer people be misguided to use drugs as a solution to their problems, but also the chance of lasting rehabilitation will increase as more financial resources become available. However, this relationship is valid only under the condition of a broad-based economic recovery from which all groups in our society benefit. Therefore, our medium-term objective should not be merely balancing in some measure the budget deficits but also vigorous and sustainable economic growth.

I wish Mesora N.V. success with their important work to create a brighter future for some of our less fortunate fellow citizens.

Thank you very much.