CENTRALE BANK VAN ARUBA

# A sustainable relationship in times of uncertainty.

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## 1. Introduction

Ladies and gentlemen, good morning.

First of all, I would like to thank InterExpo for organizing this conference. It is not that easy, but looking at the program and ample topics, you have succeeded again. Congratulations!

Allow me now to briefly share with you possible ways to strengthen further cooperation within the Kingdom of the Netherlands in times of high uncertainty. This partnership has become even more crucial to the much smaller members states in the new and ever-evolving world we are currently living in.

Because of time constraints, I will specifically focus on the cooperation between Aruba and the Netherlands.

## 2. Cooperation throughout the years

I remember that as a young economist, I had the privilege of witnessing, first-hand, the collaboration between Aruba and the Netherlands in the mid- to late 80’s. I was a starting economist at the Department of Economic Affairs in Aruba, and I was privy to the deliberations between the Government of Aruba and that of the Netherlands on development aid.

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While at that time, interest rates were substantially higher than today, and grants and interest subsidies were a normal thing back then, what has stuck with me is the amicable and constructive ambiance in which these talks took place back then.

While Dutch financial support evolved over the years, and conditions for this had become even more stricter for Aruba, the past ambiance seems to be a sharp contrast to the most recent situation of the negotiations regarding the Covid-19 loans. From the outside looking in – I say this because the CBA was not involved in the negotiations -, it appears that there is an enormous lack of trust and expressions of great frustration on both sides.

It is not because Aruba owed money to the Netherlands, as a matter of fact, just before the pandemic occurred, the debt balance was almost nihil. And that is not because of any debt forgiveness granted to Aruba. Over the course of many years, the Government of Aruba has diligently comply with all its interests and debt repayments, how difficult that may had been in some years. As of matter of fact, the last loans Aruba received prior to Covid-19 from the Netherlands date from 1995, and will be fully cancelled in 2024 and 2026.

So why the huge distrust on both sides? Perhaps, on the one hand, with the many conditions set, and the other hand, the non-compliance herewith. The recent outcome reached for the COVID loan refinancing indicates that also, costing the Aruban government an additional Afl 30 million or 15.5 million euro annually in interest payments.

I believe this is a very unfortunate situation. It is in both countries' best interest to have a good relationship, and to reach agreements beneficial to both countries. For Aruba, this is especially the case, since it does not have access to any international multi-lateral facilities, like the IMF or the European Union, due to its position within the Kingdom.

It is, therefore, important to emphasize, at least from the Aruban side, that going forward, tangible efforts should be made to improve the relationship in a sustainable way to ensure best possible outcomes in future negotiations. In my opinion, there are many lessons to be learned from the recent negotiations that resulted in, to put it mildly, a less than desirable outcome.

Now, I would like to briefly go over one of the items of contention during the negotiations, specifically, the RAft vs LAft discussion. Afterwards, I want to talk about how the Government of Aruba (GoA) can further strengthen its fiscal governance.

I will do this by referring to recommendations that the Central Bank of Aruba communicated to the GoA in the past years. In concluding, I will give my view on how the recent unfavorable outcome related to the refinancing of the COVID loans may still be put to good use in the interest of bolstering the future resilience of Aruba.

3. LAft vs RAft

Based on the information communicated by both parties, the main dispute during the Covid-19 loan negotiations was whether financial supervision should be arranged in a local law, the LAft, or in a law at Kingdom level, the RAft.

Both sides are in agreement on the need for financial supervision to strengthen the financial position of the GoA and achieve sustainable public finances. They appear to just differ on the legal form of this supervision.

So why is this? To attempt to get a better understanding of the differing viewpoints of the GoA on one hand and of the Dutch government on the other, I will next elaborate on the main characteristics of both the LAft and the RAft, and also on the differences between them.

The LAft is the State Decree on Aruba Financial Supervision, an Aruban law that covers financial supervision of the GoA. It encompasses several norms to which the GoA has to comply with and states that the College Financial Supervision Aruba (CAft) is tasked with the assessment of the performance of the GoA relative to the fiscal norms and has to ensure that norms are applied by the GoA in the drafting and execution of the budget.

The CAft reports to the Council of Minister of the Kingdom. The main fiscal norms under the LAft are:

- A budget surplus of at least 1.0 percent of GDP. This norm has gradually evolved from a maximum deficit in 2015 to a minimum surplus currently based on a protocol between Aruba and the Netherlands. During the pandemic, the norms were adapted whereby the GoA was permitted to temporarily run a fiscal deficit up to a certain amount.
- Debt-to-GDP to be reduced to at most 70 percent in 2027 and then to a maximum of 50 percent as of 2039.
- Personnel expenses are limited to a maximum of Afl. 479 million.

Recently, the GoA has submitted a bill to Parliament to amend the LAft. In this bill, the main fiscal norms are:

- A budget surplus of at least 1.0 percent of GDP, thus no change from current LAft.
- Personnel expenses limited to 10 percent of GDP by 2027, with a broader definition of personnel expenses compared to the current LAft and similar to the definition in the RAft, which I will come to shortly.
- Debt-to-GDP to be reduced to a maximum of 50 percent by 2040, one year later than in the current LAft.
- In addition, the bill includes an article that prohibits the GoA from entering into new public-private partnership (PPP) agreements.
- The allocation of financial windfalls and the maximum loan amount are similar to what is determined in the RAft.

Meanwhile, the RAft is, or will be, a Kingdom law on Financial Supervision for the GoA. It contains financial norms, which the GoA have to comply with. From a political point of view, the main difference is that the RAft cannot be amended by the Aruban Parliament, while a LAft is an Aruban law and is amended and voted on in the Aruban Parliament and does not need approval from the Council of Ministers of the Kingdom. The main fiscal norms proposed in the RAft are:

- A budget surplus of at least 1.0 percent of GDP. Anything lower than the 1 percent surplus needs to be compensated in the following year.
- A debt-to-GDP ratio of 70 percent by 2031 and 50 percent by 2040.

- The public wage bill (broader definition than LAft) will be reduced to no more than 10 percent of GDP. This includes all personnel costs in the budget of Aruba, including consultants, personnel costs of Parliament, High Councils, and the Department of Public Works, the agencies charged with the social insurances, wage subsidies for special education, and costs related to former personnel.
- The RAft contains an escape clause, meaning that Aruba can, in case of an imported deep economic recession and equal economic development within the Caribbean region, temporarily deviate from the fiscal balance norm. Under such circumstances, Aruba would have the possibility to request the Council of Ministers of the Kingdom to deviate from the norm and to spread the compensation over a period up to 5 years. The burden of proof to show that Aruba cannot comply with the budget norm despite fiscal discipline, lies with the GoA. This means that a decision can be made to allow:

  A temporary deficit on the current expenditure account.

  A temporary deficit on the capital account.

  A temporary release from the obligation of a 1 percent of GDP budget surplus in a given year.

  The government debt to temporarily increase instead of decrease in a given year.

  Temporarily borrow for current expenses.

  Temporarily surpass the maximum loan amount.
- The GoA is allowed to borrow only to refinance maturing debt or to finance capital investment.
- The maximum loan amount is equal to the amount to be refinanced minus the budget surplus. This means that Aruba is not allowed to borrow to finance current budget deficits or to compensate for shortfalls in the budget surplus of previous years.
- Any financial windfalls during times of financing shortage, will fully (100%) go towards the reduction of deficit. Windfalls occurring whenever there is a surplus above the established financing balance, will be divided 50-50% between debt reduction and potential investments (capital service) to stimulate the economy.

- The Netherlands will assess the possibilities to subscribe to a public offering of a bond loan from Aruba based on criteria of sustainable public finances and repayment capacity used in the Kingdom and internationally.
- Requirement for Netherlands to subscribe on Aruban debt: has to be for capital investment.

If the draft is approved in Parliament, several major gaps are closed with the Raft. During the discussions on the debt refinancing, the aspect that was probably most talked about was the preferential interest rate that the Dutch government said it was willing to provide if the GoA would agree to formalize the financial supervision in the RAft. A preferential interest rate of 3.1 percent was mentioned. This is notably lower than the 6.9 percent rate that eventually resulted from recent negotiations.

From an economic and sustainable public finance perspective, such a preferential rate would have been of course much more advantageous than the interest rate of 6.9 percent.

4. Improving fiscal governance

Whether financial supervision is done through LAft and/or RAft, the primary goal is for Aruba to achieve sound and sustainable government finance over the medium term and to improve its fiscal governance.

Fiscal governance comprises those rules, regulations, and procedures that influence how budgetary policy is planned, approved, carried out, and monitored (Giosi, Testarmata, Brunelli & Stagliano,2014).
Consequently, fiscal governance has many dimensions, such as numerical fiscal rules, independent fiscal institutions, the medium term budgetary frameworks, and the budgeting procedures.

I believe there is ample room for the GoA to improve its fiscal governance. Good governance is critical for better informed and longer-term decision making, more efficient use of resources, and creating safeguards and critical needed financial buffers for achieving policy objectives.

Over the course of many years, if not decades, the CBA has issued several recommendations on ways for the GoA to bolster the sustainability of its finances and its fiscal governance. For instance, the CBA advised the GoA to implement fiscal rules to promote fiscal responsibility. The call for fiscal rules was than already not new, and had already been echoed by several national committees and in a motion approved by the Aruban Parliament.

In its advice, the CBA argued that to help strengthen its public financial management, the GoA should install a fiscal council. This would be an independent body charged with monitoring compliance with the fiscal rules. The CBA recommended that the introduction of such a council should be accompanied by the implementation of regulations to ensure adherence to the stipulated rules.

To this extent, consistent with previous reports on the matter, it would be advisable to incorporate clearly defined policy goals into a constitutional amendment. The independent body should be empowered with the mandate to monitor the compliance with the fiscal rules.

In addition to a fiscal council, the CBA also advocated for the implementation of well-designed numerical rules. In 2013 already, before LAft, the CBA had recommended that the GoA should work toward a balanced budget from 2016 onwards.

Moreover, the CBA advised to use windfalls only to reduce government debt and not to increase expenditures; impose a limit on the government debt-to-GDP ratio of 55 percent, starting in 2021; and to cap the annual payment commitment related to PPP-projects to 3.5 percent of a 5-year moving average of total government tax revenues (excluding one-off revenues).

Though numerical fiscal rules were introduced in 2015 for the period 2015-2018, as a result of the adoption of the LAft by the Parliament of Aruba,[1] the CBA was of the opinion that further strengthening of the fiscal frameworks is a sine qua non for achieving sustainable public finances over the medium term.

[1] The College Financieel Toezicht Aruba (CAft), acting as the fiscal council, is responsible for monitoring the compliance with these fiscal rules, while the Council of Ministers of the Kingdom of the Netherlands is the Supervisor.

A CBA paper by Peterson & Croes (2017) noted that forward-looking fiscal rules and capable fiscal institutions are quintessential for assuring effective fiscal policy and ensuring sustainable public finance.

The paper suggested different pathways for strengthening fiscal rules and fiscal institutions, among others: (i) enacting and/or enforcing a fiscal responsibility law, encompassing fiscal rules and fiscal institutions, (ii) diversifying and designing comprehensive fiscal rules, including (at a minimum) expenditures and debt rules, and a golden rule for capital expenditures, (iii) establishing a national fiscal council, and (iv) expanding the time-horizon of the medium-term budget framework to at least 5 years.

To improve fiscal governance further, the CBA advised the GoA to consider introducing a balanced budget rule, a rule for a maximum debt-to-GDP ratio, a golden rule for capital expenditures, and a minimum expenditure rule for education expenses.

To ensure appropriate coverage, the CBA proposed that fiscal rules also should address off-budget fiscal activity (e.g., spending on PPP projects), of which the non-debt obligations are in fact akin to debt. Great care should also be exercised to ensure that the fiscal rules are comprehensive, to prevent shifting the source of fiscal indiscipline to areas not covered.

On the other hand, the fiscal council may consider limited escape clauses to provide some flexibility in fiscal rules to respond to business cycle developments.

The CBA also recommended the GoA to adopt the philosophy of Open Government Data (OGD), i.e., a philosophy – and increasingly a set of policies – that promote transparency, accountability, and value creation by making government data available to all.

By making government data available, public institutions become more transparent and accountable to citizens. According to the World Bank, open data support public oversight of governments and help reduce corruption by enabling greater transparency.

To promote good governance in the public sector, the CBA also advised the GoA to adopt an anti-corruption strategy. After all, corruption is the antithesis of good governance (Fourie, 2016).

According to Rose-Ackerman (1999), high levels of corruption limit investment and growth and lead to ineffective government.

Furthermore, corruption can weaken the state's ability to provide inclusive economic growth in a number of different areas (IMF, 2016a). Therefore, the CBA recommended the GoA to adopt, in close collaboration with relevant stakeholders, a holistic anti-corruption strategy, focusing, among others, on creating the right incentives, tackling vulnerable sectors, promoting transparency, building shared values, and strengthening the controlling institutions.

The anti-corruption roadmap includes drafting specific laws and code of conduct for all public officials, the public disclosure of campaign finance, whistleblowing processes, digital transformation, policy for dealing with conflict of interest, and campaigns to educate the public to require public benefits from the political system and not personal favors.

It was also noted that policy on openness of information, such as OGD, could be one element of a possible anti-corruption strategy.

In addition to these recommendations, the CBA advised the GoA to consider strengthening public institutions that control or advise the government such as the *Centrale Accountantsdienst*, *Algemene Rekenkamer*, and *Raad van Advies*.

Additionally, a dedicated department within the government, preferably under the responsibility of the prime minister, should be in charge of good governance.

Another important recommendation, that the CBA has made on more than one occasion, regards reforming fiscal revenues and introducing a revenue authority (RA) with the aim to enhance revenue administration.

A RA is a governance regime for an organization engaged in revenue administration that provides more autonomy than that afforded a normal department in a ministry (Kidd and Crandall, 2006). In this context, autonomy refers to the degree to which a government department or agency is able to operate independently from government, in terms of legal form and status, funding and budget, and financial, human resources, and administrative practices.

However, the RAs remain accountable to the government and should execute its tax policy. More autonomy could be given in the following areas: (i) human resource management; (ii) financial resource management; and (iii) general management.

In general, giving a revenue administration more autonomy than a normal department in a ministry, has a number of benefits. For instance, more autonomy can lead to better performance by removing impediments to effective and efficient management, while maintaining appropriate accountability and transparency.

Also, more autonomy can solve administrative and corporate governance problems, such as (i) low pay and low quality staff as well as patronage-based staff appointments, (ii) undue political influence, (iii) adequate funding such as a percentage-based cost-of-collection formula.

The latter could provide hard incentives to increase collections. In addition to the earlier mentioned advantages, the literature lists the following advantages: (i) enhanced revenues, (ii) greater efficiency, (iii) reduced corruption, (iv) comprehensive accounting for tax revenues, and (v) integration of databases.

An IMF Survey (Kidd and Crandall, 2006) among countries with RAs shows that low effectiveness of tax administration and poor levels of compliance were the main reasons these countries adopted RAs.

The CBA recommended that prior to introducing an RA in Aruba, a full assessment of the problems at the Tax Department and a cost/benefit analysis be made. For instance, it is important to determine whether the conditions for success and sustainability are present.

Critical success factors include, among others things, strong political support, senior management commitment and determination, the provision of adequate resources, a strong project management approach for implementation, and the development of a sound policy framework.

It is also important to bear in mind that the implementation process is time consuming. The CBA has stressed the importance of not raising the fiscal burden on economic agents, who are already paying their fair share and improving the effectiveness of tax administration and the levels of compliance to ensure that every taxpayer contributes fairly.

This requires efforts to strengthen the organization and management of the Tax Department, implementing robust collection systems, and building capacity in core tax administration functions, including digitizing further the tax administration.

I personally believe that raising the effectiveness of tax administration and the level of compliance is key for Aruba to structurally reach fiscal sustainability. In my opinion, Aruba has now an economic base that is sufficient to generate the necessary funds to ensure that its roads are in good condition, its education system is up to par, and that its infrastructure is fit for future.

In other words, the current economic base is solid enough to cover GoA's (fiscal) expenses, to limit its borrowing needs, generate financial buffer for the future, and to eventually enable it to become debt-free.

More recently, the CBA has advised the GoA on the required innovation capabilities in public sector governance, in particular given the fundamental role and responsibility of government and regulatory innovation for realizing Sustainable Development Goals (SDGs) related to fostering innovation (SDG 9).

Innovation, in turn, plays a vital role in making communities safe, climate resilient, and sustainable (SDG 11 and SDG 13). Moreover, it is a nurturer of SDG's centered around inclusive growth through technology that ensures inclusive quality education and lowers the barriers to lifelong learning (SDG 4).

In addition, it can fortify social security and strengthen health care insurance, as well as foster societal wellbeing in the face of demographic changes. Furthermore, innovation plays an important role in reducing income inequality (SDG 10) through financial inclusion, and is essential in increasing productivity (SDG 8); an issue that has been a challenge for Aruba for quite some time.

The CBA further recommended the GoA to strengthen innovation complementarities. This involves lowering cost of doing business, broaden financial markets, and mitigate macroeconomic volatility.

In addition, it revolves around the government cultivating solid and reliable institutions (political stability, property rights protection, among others), overseeing the interactive process between innovation stakeholders, and intervening when necessary.

5. Financing the repayments/destination of repayments

Going back to the negotiations between the GoA and the Dutch government, the current reality is that Aruba has to repay annually a substantial amount, including interest that is about Afl. 30 million higher than it could have been.

While the CBA's projections for the government's finances in the coming years are relatively positive, and the GoA can probably carry this additional interest burden at the cost of other pressing issues, these funds can of course be put to much more productive use that is beneficial to the Aruban community.

I should also note that current projections are based on a certain level of economic growth going forward and do not take into account future expenditure for issues, such as climate change, population aging, affordable housing, and education, just to name a few.

What makes this outcome, an annual interest rate of 6.9 percent, extra hard to swallow is the availability of facilities by the IMF and the EU that may have more favorable conditions than the loan received from the Dutch government, but to which Aruba does not have access. The IMF facility, for instance, provides long-term loans (20 years, with a 10.5 year grace period) to eligible countries with concessional interest rates, with lower-income countries benefitting from more concessional terms. The loan is conditional on progress on policy reform, similar to the Covid loans received from the Dutch government but with a favorable interest rate.

Meanwhile, the EU has a facility in place to support the recovery from the pandemic and build a greener, more digital and more resilient future. Under the facility, grants and loans are provided under favorable conditions to member states to recover from the pandemic and enhance resilience. Repayment of these loans will start in 2028 and will take place over a long time-horizon until 2058.

So under the EU facility, loans are spread out over a longer time-horizon than is the case with Covid loans received from the Dutch government, while there is also the possibility that part of the funds received are in the form of a grant. The latter has been something the Dutch government has (so far) been unwilling to discuss.

On the surface, it would seem then that these facilities have conditions more favorable than the loans extended by the Dutch government to its partner countries within the Kingdom, which does not seem to be fully consistent with the principle of the countries helping each other in times of extra-ordinary crises.

While I do agree with the need for the Aruban government to maintain fiscal discipline and ward off moral hazard, and that reasonable loan and repayment conditions could be a way to incentivize this, I also believe that at least the additional interest payments can be put to much better use.

In keeping with the spirit of countries in the Kingdom helping each other when needed, perhaps an alternative destination for the (interest) payments on the Covid-19 loans, beneficial to the Aruban community, could be considered.

The repaid funds could be channeled into a resiliency fund that would be used to finance investments or reforms in Aruba related to the aforementioned topics of climate change, population aging, affordable housing, and education. The fund could be managed by a Dutch entity if so desired.

Alternatively, the Aruba Investment Bank could serve as custodian of the fund, given its proven track-record in effectively managing the Aruba Development Fund in the past. There are also other stakeholders in Aruba interested in helping set up such a fund.

Clearly, there should be a list of criteria for investment projects to be considered eligible for the funds with disbursements, contingent on complying with progress indicators monitored by the managing entity.

In this way, at least partial proceeds of the covid loan repayments could be put to good use by supporting future-proofing Aruban infrastructure and enhancing Aruba’s resiliency.

## 6. Closing

It is obvious that to obtain the best results for both countries, Aruba and the Netherlands can achieve much more by working together, as has been demonstrated on numerous occasions in the past, and which I had the privilege to bear witness to.

With open dialogue, timely public disclosure of government’s fiscal performance data, strengthening public governance, effective cooperation, and regained trust, great feats can be realized.

I believe that Aruba has an economic base that is sufficient to generate the necessary funds to cover its (fiscal) expenses, to limit its borrowing needs, to be a sustainable and resilient partner, and to eventually enable it to also become debt-free.

This aim may sound too ambitious, but it is feasible in my opinion. However, besides strict compliance with the LAft and/or the RAft, it requires the government of Aruba to further improve current tax laws as well as revenue collection, and to raise tax compliance by investing in the effectiveness of its tax department.

These coupled with perhaps partial debt and interest repayments being invested back into the Aruban community with the cooperation of the Netherlands, a debt-free Aruba does not have to remain a too far-fetched goal but can become a reality in the longer term.

In closing, I am not asking for free-give aways but strengthening further cooperation within the Kingdom. As Henry Ford once said: “Coming together is a beginning; keeping together is progress; working together is success”.

Thank you very much for your attention.