



CENTRALE BANK VAN ARUBA

A Roadmap to Fiscal Sustainability in Aruba

*Policy recommendations to the Government of Aruba
for the period 2013 - 2017*

DECEMBER 16, 2013

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LIST OF ABBREVIATIONS

Afl.	Aruban florin
AOV	Algemene Ouderdomsverzekering (the general old age pension system)
APFA	Stichting Algemeen Pensioenfonds Aruba (the civil servants pension fund)
ATA	Aruba Tourism Authority
AWW	Algemene Weduwen-en Wezenverzekering (the general widowers and orphans insurance)
AZV	Algemene Ziektekostenverzekering (the general health insurance)
BBO	Belasting op Bedrijfsomzetten (the turnover tax)
CBA	Centrale Bank van Aruba (i.e., the central bank of Aruba)
CBS	Centraal Bureau voor de Statistiek (the central bureau of statistics)
DF	Department of Finance
DOW	Dienst Openbare Werken (the department of public works)
DTI	Dienst Technische Inspectie (the department of technical inspections)
ECCU	Eastern Caribbean Currency Union
GDP	Gross domestic product
GOA	Government of Aruba
GP	General practitioner
IMF	International Monetary Fund
NCPF	National Commission on Public Finance
PPP	Public Private Partnerships
PVL	Pensioenverordening Landsdienaren (the former pension scheme for civil servants)
SOGA	Stichting Onroerend Goed Aruba
SVB	Sociale Verzekeringsbank (the social security bank)
VAT	Value added tax

EXECUTIVE SUMMARY AND RECOMMENDATIONS

EXECUTIVE SUMMARY AND RECOMMENDATIONS

In this report, the Centrale Bank van Aruba (CBA) presents a number of recommendations that could serve as important building blocks towards achieving fiscal sustainability. Sound public finances reflected in prudent fiscal balances and supportable debt position are a prerequisite for sustainable economic development in Aruba. With a few exceptions, the Government of Aruba (GOA) has been recording financial deficits since the eve of Status Aparte. At the end of June 2013, government debt had jumped to nearly Afl. 3.2 billion or 68.7 percent of GDP. The fiscal outlook in an unchanged government policy scenario is a government debt of about 87 percent in 2017. In its Staff Report for the 2013 Article IV Consultation, the International Monetary Fund (IMF) concludes that “ambitious fiscal consolidation, relying on both revenue and expenditure measures, is needed to bring public debt below 60 percent of GDP”. Moreover, Standard & Poor’s Rating Services (2013) and Fitch Ratings (2013) note that a failure to improve the fiscal profile and debt sustainability prospects could result in a downgrade of Aruba’s current ratings.

One precondition for achieving fiscal sustainability is that the medium-term budgetary policies of the GOA should focus on (i) achieving a balanced budget in 2016, i.e., the sum of total operating costs and investments should be financed from government revenues, (ii) promoting sustained noninflationary economic growth, and (iii) directing government expenditure on providing essential public goods and services, such as education, infrastructure, health care, public safety, and social protection. Another requirement is that the GOA should increase financial accountability through periodic publication of government financial statistics applying international standards. The government also should pursue an active debt management policy to ensure timely compliance (at the lowest possible costs) with its financial (debt) obligations. To this end, it is also of crucial importance that the GOA must present its budget to the Parliament in a timely way and be in compliance with the law.

Three approaches are suggested in this report for a return to fiscal sustainability:

1. Actions to raise government revenues, including how the government raises its revenues;
2. Spending reduction measures; and
3. A complementary path entailing changes that target decentralization of government functions, fiscal rules and public debt management.

Revenue-enhancing measures

An analysis of the fiscal burden, i.e., the share of government tax and nontax revenues as well as social security contributions as a percent of GDP, shows that Aruba has one of the highest fiscal burdens among a number of selected Caribbean countries. This position implies that merely introducing and/or increasing existing taxes and other nontax revenues as well as social security contributions, should be short term and limited to the most necessary changes to prevent a further rise in the fiscal deficit. Simultaneously, the GOA should focus on measures to further improve the effectiveness of tax administration (eliminating the backlog of tax-processing work) and the levels of compliance to ensure that every taxpayer contributes his fair share.

In this context, the CBA recommends that the GOA consider introducing a new governance regime, i.e., a ‘sui generis’ status, for the Tax Department (i.e., ‘Departamento di Impuesto’) with the aim of further increasing the efficiency (costs versus revenues) and effectiveness (tax goals) of tax collection, and promoting a high level of (voluntary) compliance. Note that the Tax Department collected 59.7 percent of total government revenues in 2012. Specifically, this department should be given more autonomy, particularly in the areas of human resource management, financial resource management, and general management. The GOA has already gained positive experience with the ‘sui generis’ model, including the ‘sui generis’ status of the CBA and the Aruba Tourism Authority (ATA), which could be used as a basis for the department’s new governance structure. A ‘Departamento di Impuesto’ *Sui Generis* could serve as a catalyst to enable the necessary reforms in

revenue administration to support economic growth through proactive review of tax policies and rules, to promote a high level of (voluntary) compliance (through education and enforcement programs and making tax-filing convenient and easy), and to strengthen internal capabilities. The expected benefits of these reforms would more than compensate for the expected cost increase for hiring the required personnel and enhancing technological capabilities.

In addition to creating a ‘Departamento di Impuesto’ *Sui Generis*, the CBA has the following recommendations with respect to the revenue side of public finances:

1. The GOA should shift the burden of taxation away from direct to indirect taxes, which implies a broadening of the tax base and a more fair distribution of the tax burden between the payers and the evaders. The GOA should provide compensation for the less fortunate to offset the ensuing loss of purchasing power by strengthening social safety networks.
2. Furthermore, the GOA should consider introducing and/or increasing less distortive and corrective taxes, including:
 - a. The introduction of a junk food/sugar tax, which will contribute to a reduction of the consumption of unhealthy food products; and
 - b. An increase in the excises taxes on alcohol and tobacco.
3. Applying the user pays principle (i.e., a user of a service or resource pays directly for the amount they use, rather than the cost being shared equally by all the users or a community), the GOA should evaluate replacing the motor vehicle tax with increases excises on gasoline.
4. Moreover, the GOA should consider increasing the reliance on nontax revenues by:
 - a. Introducing a tendering program for government land and properties; and

- b. Indexing land lease tariffs.

Reducing government spending

Evidence from fiscal consolidation exercises in other countries shows that targeting cuts in primary expenditures, especially social spending (including pension and health spending) and the wage bill, is the most conducive to successful fiscal adjustment and the least damaging to economic growth.

Many stumbling blocks exist on the expenditure side Aruba's public finances. A few important ones include:

1. The large share of personnel costs in total expenditures;
2. The high contribution of the GOA to the General Health Insurance (AZV);
3. The deficits of the General Old Age Pension System (AOV), which are projected to result in a depletion of the AOV reserves in 2014, conducting to a government contribution to the AOV fund;
4. The high burden of the civil servants' pension fund APFA premiums;
5. The forthcoming extremely large burden of the PPP¹ projects (ongoing or in the pipeline); and
6. Rising interest payments.

To address some of these hindrances, the CBA has the following recommendations:

1. Reform health care spending and entitlements
 - a. Increase the effectiveness of the collection of the AZV premiums and the compliance of employers by giving the AZV the responsibility for the control/audit of the premium revenues;
 - b. Introduce co-payments for general practitioners' services;

¹ Public Private Partnerships.

- c. Reduce the AZV insurance package, e.g., lower coverage of certain types of drugs;
- d. Monitor more strictly general practitioners and specialists, which may reduce costs related to supplier-induced demand;
- e. Focus on preventive health care, including more attention to promoting awareness of healthy behavior;
- f. Introduce laws that require employers to introduce a social wellness program for their employees;
- g. Increase the AZV premium as a last resort, taking into account the already high fiscal burden compared to other Caribbean nations.

2. Reform the AOV

Considering the deficits of the AOV and the upcoming depletion of the AOV reserves, the GOA would have to pay a contribution to the Social Security Bank (SVB) to cover the AOV deficits from 2014 onwards. Taking into account the ageing of the population, the expectation is that the AOV deficit will steepen in the coming years, becoming a significant financial burden to the GOA. Therefore, the CBA proposes to reform the AOV by the following actions:

- a. Increase the effectiveness of the collection of the AOV premiums and the compliance of employers by giving the SVB the responsibility for the control/audit of the premium revenues;
- b. Raise the retirement age to 65 years as of January 2014, and link the retirement age to the dynamics in the life expectancy of the population;
- c. Individualize the AOV benefit payments;
- d. Increase the wage cap and the AOV employees' premium as an ultimate alternative, only if the previous recommendations are not sufficient to cover the AOV deficits.

3. Restructure the APFA further

The significant changes in the civil servants pension scheme as of 2011 were an important step in curbing pension costs. However, more actions are needed to further

lower the current burden on the government budget and to contain possible risks for higher costs in the near future. The CBA suggests additional restructuring of the current scheme by:

- a. Raising the retirement age to 65 years consistent with the proposed increase in the pension age of the AOV; and
- b. Increasing the AOV franchise to the maximum allowable AOV franchise according to the 'Landsverordenen Inkomstenbelasting AB 1991 no. GT 51'.

4. Cap the payment commitments related to PPP projects

The CBA advises the GOA to limit the annual payment commitments related to PPP projects to 3.5 percent of a 5-year moving average of total government tax revenues (excluding one-off revenues). Moreover, the GOA is advised to undertake user-funded PPPs that would shift some or all of the costs to users, such as commercial rental space in buildings intended for public services. In addition, as a prerequisite for temporarily containing the pressure on Aruba's international reserves, it is recommended that PPP projects be funded largely externally.

A complementary path to fiscal sustainability

In addition to the two strategies for achieving fiscal sustainability just discussed—raising public revenues and capping spending—the GOA should consider a complementary path that includes assessing the desired size and scope of government, the role of the government in the provision of goods and services, the role of fiscal rules in improving fiscal discipline, and the need for public debt management.

With respect to this complementary path, the CBA has the following recommendations:

1. Cap the financial involvement of the GOA in the foundations:
 - a. Enforce compliance of subsidized foundations and increase their accountability as a requirement for obtaining government subsidy;

- b. Increase the efficiency of work done by foundations by requiring cooperation and collaboration between foundations (many of the foundations are, for example, renting separate offices);
 - c. Consider the introduction of a long-term care insurance (if proven feasible for Aruba) to reduce (future) subsidies to foundations providing long-term care (e.g., to the elderly).
2. Decentralize as many functions as possible from the central government to the public sector by creating semi-autonomous institutions that are financially self-supporting. By focusing on its core tasks, the GOA may lower its personnel expenses as well as other expenses of non-core activities. Semi-autonomous organizations that are self-supporting are vehicles for, among other things, increasing efficiency, encouraging professional management, reducing political interference, and allowing the GOA to focus on the main policy issues. Decentralizing some non-core functions entails the creation of a new governance model for a number of government departments. One possible governance regime that could be applied is the 'sui generis' model. Possible government departments that could be moved outside the scope of the central government are the Department of Technical Inspections, the Department of Public Works, Department of Civil Aviation ('Directie Luchtvaart'), Department of Shipping ('Directie Scheepvaart'), and the Laboratory. The Serlimar (Aruban waste management company), which already has a 'sui generis' status, should be further moved from the scope of the central government by eliminating the subsidy paid by the government to the Serlimar.
3. Introduce numerical fiscal rules. Specifically, the CBA recommends the following numerical rules:
 - a. A balanced budget rule from 2016 onwards;
 - b. The use of windfalls only to reduce government debt and not to increase expenditures;

- c. A maximum debt to GDP ratio of 55 percent starting by 2021;
 - d. A limit on the annual payment commitment related to PPP projects of 3.5 percent of a 5-year moving average of total government tax revenues (excluding one-off revenues).
4. Establish an independent body to monitor compliance with the numerical rules by introducing a fiscal council or by incorporating this task as an additional responsibility of the State Council ('Raad van Advies').
5. Delineate a debt management strategy to address the structure and the composition of debt that is within Aruba's debt-servicing capacity. The latter is particularly important in the context of the outlook of the continued decline in international reserves. For the near term, the GOA should contemplate covering its financing needs by foreign financing to mitigate the expected fall in Aruba's international reserves. In addition, the GOA should consider restructuring its outstanding (foreign) debt by negotiating with its creditors with the aim of promoting a more balanced debt maturity profile. Moreover, the debt management strategy for Aruba should include an indicative multi-year borrowing plan.

Concluding remarks

Given the current state of Aruba's public finances and its worsening by unchanged policy, more difficult but necessary actions must be taken swiftly, particularly taking into account the additional pressure on public finances arising from the ageing of the population and rapidly rising public debt.

In summary, the main recommendations presented in this report are:

- 1. The GOA should aim to achieve a balanced budget in 2016 and a maximum debt to GDP ratio of 55 percent by 2021.

2. The focus should be towards cutting back and/or containing government spending, particularly health care spending, (AOV and civil servant) pension costs, and PPP-related costs.
3. In addition, the GOA should focus on decentralizing certain government functions from the central government to the public sector by creating financially self-supporting semi-autonomous public institutions.
4. The ‘Departamento di Impuesto’ should be transformed into a ‘sui generis’ status, which will serve as a catalyst for necessary reforms in the tax administration.
5. The GOA should consider shifting from direct to indirect taxes and introducing less distortive and corrective taxes.
6. The GOA should delineate a debt management strategy to address the structure and the composition of debt within Aruba’s debt-servicing strategy.

More intensified contact between the Minister of Finance and the Central Bank of Aruba is essential to have an appropriate policy-coordinating mechanism in place.

PART I THE NEED FOR FISCAL CONSOLIDATION

1 INTRODUCTION

Sound public finances reflected in prudent fiscal balances and supportable debt position are a prerequisite for a sustainable economic development in Aruba for a number of reasons. They contribute to credible government policies, macroeconomic and financial stability, and a pro-business and pro-growth climate. Also, they provide the necessary resilience to timely and adequately address adverse economic shocks. Prudent fiscal policy also is essential to be able to properly manage future pressures on the public finances, such as population ageing and rising public debt.

From the perspective of the CBA, sound public finances are, together with a prudent monetary policy, a precondition for safeguarding the value of the Aruban florin (Afl.). Fiscal and monetary policies do not operate in isolation and are interrelated. Both have an impact on key macroeconomic variables. Excessive government expenditures result in steep demand, which may ignite inflationary pressures, thereby weakening the value of the Aruban florin. Furthermore, protracted fiscal deficits and disproportionate government expenditures can cause balance of payments problems because of the related rise in foreign exchange outflows (e.g., import payments), which in turn negatively impacts our international reserves.² Adequate levels of international reserves are indispensable to maintain the current peg with the U.S. dollar. All in all, coordination between monetary and fiscal policies is relevant for a sustainable balance of payments position and to contain inflation in Aruba. For that reason, more intensified contact between the Minister of Finance and the CBA is essential to have an appropriate policy-coordinating mechanism in place.

² The current CBA projection shows a downward trend in the net foreign assets (including the revaluation differences) reflecting - besides the high dependence on imports of oil products for domestic use - the excessive government spending (See Annex 1).

But what are sound public finances? Defining fiscal sustainability

Sound or sustainable public finances can be defined in several ways. For instance, a straightforward way to define fiscal sustainability is a situation in which the ratio of government debt to GDP is stable or moving down over the longer term (Bernanke, 2011). The International Monetary Fund (IMF) (2007) states that a set of policies is sustainable if a borrower is expected to be able to continue servicing its debt without an unrealistically large future correction to the balance of income and expenditure. In spite of diverse definitions of fiscal sustainability, broad consensus exists that fiscal sustainability entails fiscal policies that sustain economic growth,³ maintain solvency (implying that the government can continue servicing its public debt without requiring an unrealistically large correction to its future revenues or primary expenditure path), create stable taxes, and are fair across generations (Schick, 2005). However, in a small and open economy with a fixed exchange rate, the key element of fiscal sustainability is the foreign exchange constraint (Belgrave, LaCorbiniere, Worrell & Applewhaite, 2011).

The foreign exchange constraint denotes that a minimum level of reserves is needed to stabilize market expectations about the exchange rate. According to Belgrave et al. (2011), it is the one criterion that truly determines fiscal stance, since this limit kicks in far sooner than any overall limit of the ability to service the overall debt. For example, fiscal deficits can become unsustainable much earlier than reaching any prudent debt to GDP ratio if the debt service requirements deplete the country's foreign exchange reserves. Moreover, dwindling reserves could create worries about the stability of the exchange rate, leading to capital outflows. As a central bank in charge of safeguarding the value of the Aruban florin, the CBA considers this element of fiscal sustainability of utmost importance.

³ For the specific case of the Caribbean region, Greenidge, Graigwell, Thomas, and Drakes (2012) conclude that public debt beyond the 55 percent of GDP threshold becomes a drag on economic growth.

The urgency of working towards fiscal sustainability in Aruba

The GOA has been recording financial deficits since the eve of Status Aparte, with some exceptions.⁴ Consequently, at the end of June 2013, government debt jumped to nearly Afl. 3.2 billion or 68.7 percent of GDP. In a scenario of constant government noninterest

Box 1: Fiscal risks

Fiscal risks are deviations of fiscal outcomes from what was expected at the time of the budget or other forecast (Cebotari, Davis, Lusinyan, Mati, Mauro, Petrie, & Velloso, 2009). Properly assessing and preparing for these risks is crucial, since failure to do so can cause additional government obligations, larger public debt, and sometimes even refinancing difficulties and crises. Cebotari et al. (2009) notes that identification of all relevant fiscal risks requires clearly established responsibilities for the collection, transmission, and analysis of the information on such risks. Furthermore, procedures need to be in place to ensure that policymakers have access to relevant data.

Sources of risks include, among other things, various shocks to macroeconomic variables, such as economic growth, commodity prices, interest rates, or exchange rates, as well as calls on contingent liabilities (explicit or implicit). Some of the largest fiscal costs have arisen from contingent liabilities, like bank crises, natural disasters, state-owned enterprises, legal claims, guarantees, and PPPs.

Public disclosure of fiscal risks plays an important role in the solidification of a country's resilience to potential threats that may arise. Besides enhancing the fiscal transparency, this proactive measure "promotes earlier and smoother policy responses; strengthens accountability for risk management; and improves the quality of decisions on whether the government should take on risks in the first place" (Cebotari et al., 2009). The availability of such information remains invaluable for the management of impending fiscal risks.

In the case of Aruba, the most pressing fiscal risks are contingent liabilities arising from the general old age pension system (AOV), the General Health Insurance (AZV), the civil servants pension fund APFA, and public private partnerships (PPPs). Chapters 5, 6, and 7 will provide detailed information on these risks. One other important fiscal risk is related to the risk of obtaining the necessary funding to cover the forthcoming financing needs of the government, especially taking into account the maturing debt in the coming years (see chapter 10, Chart 10.1 for more information on the maturity schedule). A thorough analysis must be conducted to identify other possible risks. Therefore, the GOA should undertake a full assessment of the fiscal risks in the near future to budget for their impact and to take actions to mitigate them. Fiscal risk management should grow into an integral part of public financial management.

⁴ 1986, 1991, 1993, 1994, 2000, 2003, and 2008.

expenditures and with forecasted real GDP growth of 2.9 percent in 2013, 3.4 percent in 2014, and 1.9 percent in the period 2015-2017, the CBA projects government debt will rise to nearly 80 percent in 2017.⁵ This scenario does not even account for the prospect of potential fiscal risks (see Box 1).

In its Staff Report for the 2013 Article IV Consultation, the IMF (2013) concluded that “ambitious fiscal consolidation, relying on both revenue and expenditure measures, is needed to bring public debt below 60 percent of GDP”.⁶ Moreover, both Standard & Poor’s Rating Services (2013) and Fitch Ratings (2013) note that a failure to improve the fiscal profile and debt sustainability prospects could result in a downgrade of Aruba’s current ratings.⁷ In view of the upcoming financing needs of the GOA and the recent agreement with the Dutch government (see Box 2), maintaining the current ratings has the greatest priority at this moment to guarantee access to international capital markets,

Box 2: Agreement of 28 March 2013 between the Dutch government and the GOA

Following the cooperation protocol signed on October 11, 2011, between the governments of Aruba and the Netherlands, both governments signed an execution protocol with regard to Article IV-B of the mentioned cooperation protocol. This cooperation protocol states that the two governments will explore under what conditions the debt of the Aruban government might be refinanced under more favorable conditions.

The execution protocol contains a number of conditions under which the Dutch government might participate in a GOA bond issue: (i) The assessments of independent institutions, including Fitch Ratings, Standard and Poor’s, the IMF, the State Council, the General Chamber of Auditors, and the CBA would be decisive in the Dutch government’s decision, (ii) Budget rules would be included in the constitution, while an Advisory College (“College van Advies”) must be founded to gauge compliance with the budget rules and policy; (iii) The interest savings resulting from any Dutch participation in the GOA’s bond issues would be used exclusively to lessen the debt service payments and the nominal government debt; and (iv) the GOA would submit a semi-annual financial review to the Council of the Ministers of the Kingdom.

⁵ See Chapter 2 for the details of the unchanged policy scenario.

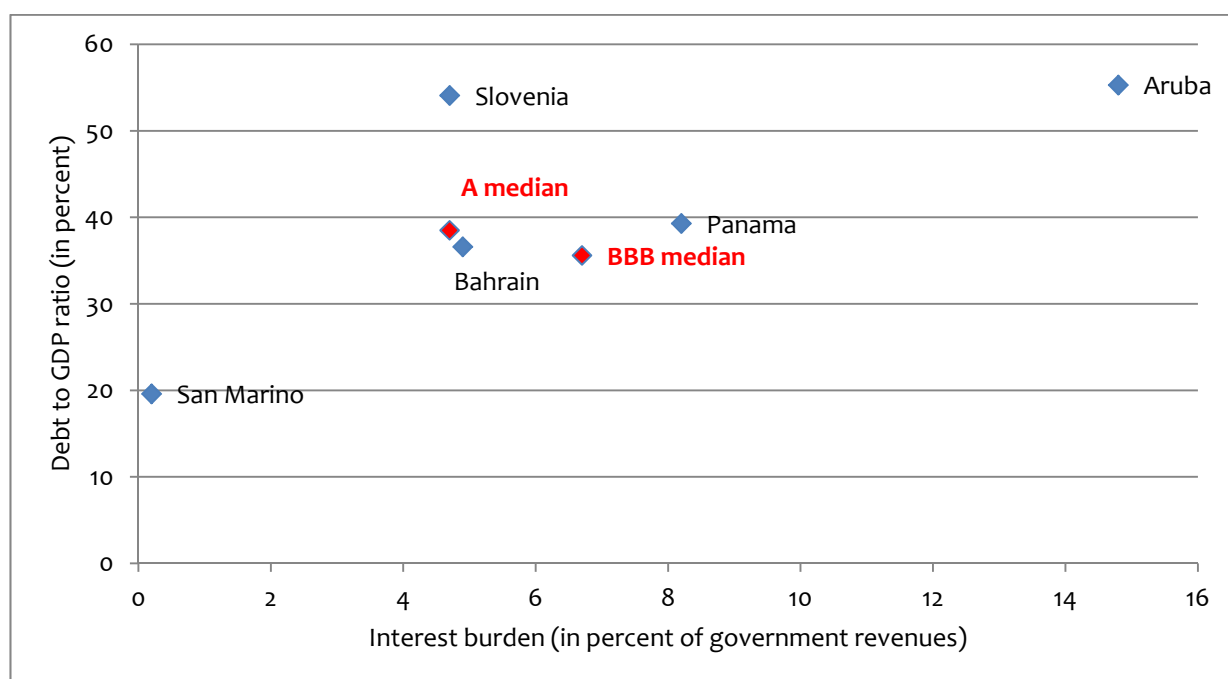
⁶ See Annex 2 for the details of the recommendations of the IMF.

⁷ See Annex 3 for the details of the conclusions of both rating agencies.

particularly considering the tight domestic liquidity, and to ensure low interest rates as well as qualifying for debt refinancing by the Dutch government.

Charts 1.1 and 1.2 give an indication of the fiscal consolidation efforts needed to steer Aruba's public finances towards calm water and to maintain the current ratings.⁸ For instance, Aruba's interest burden should be more than halved, and the debt to GDP ratio should be brought back by almost 20 percentage points to be more in line with the BBB median and to maintain the current BBB rating. Also, the government financial deficit is more than three times the BBB median. Of course, the rating agencies consider a number of other factors that mitigate the weak public finances, such as the contingent fiscal

Chart 1.1: Debt¹⁾ to GDP ratio and interest burden of Aruba and its peers in 2012

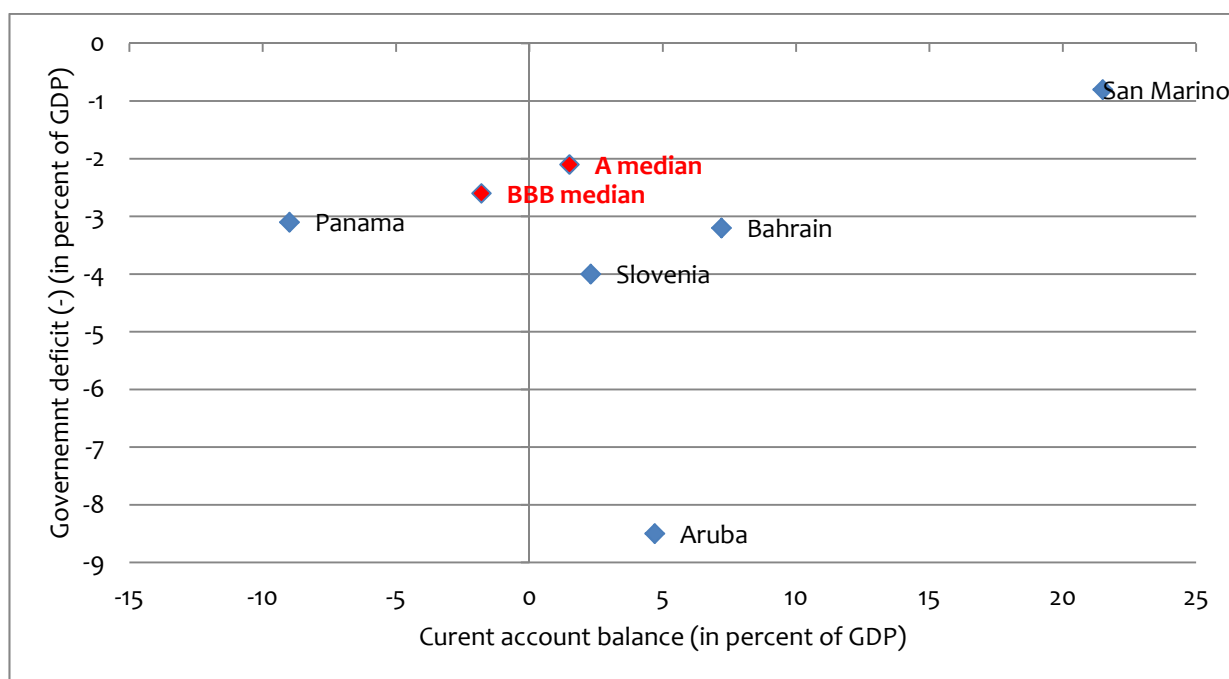


Source: Fitch Ratings.

1) Excluding the holdings of central government debt by APFA and SVB.

⁸ See Annex 4 for more benchmarks used by Fitch Ratings.

Chart 1.2: Government deficit and current account balance of Aruba and its peers in 2012



Source: Fitch Ratings.

support from the Netherlands. Nevertheless, the IMF's message recommending fiscal consolidation is rather strong.

Purpose and structure of this report

In this report, the CBA presents a number of recommendations that could provide some important building blocks to achieve fiscal sustainability. One precondition is that the GOA's medium-term budgetary policies should focus on (i) achieving a balanced budget in 2016, i.e., meaning the sum of total operating costs and investments should be financed from government revenues, (ii) promoting sustained noninflationary economic growth; and (iii) directing government expenditures on providing essential public goods and services, such as education, infrastructure, health care, public safety, and social protection. Another requirement is that the GOA should increase financial accountability through periodic publication of government financial statistics applying international standards. Also, it should pursue an active debt management policy to ensure timely compliance (at

the lowest possible costs) with its financial (debt) obligations. To this end, it is also of crucial importance that the GOA presents its budget to the Parliament in a timely way and that the budget is in compliance with the law.

Three approaches are suggested in this report for the return to fiscal sustainability:

1. Actions to raise government revenues, including how the government raises revenues;
2. Spending reduction measures; and
3. A complementary path entailing changes that target decentralization of government functions, fiscal rules, and public debt management.

The remainder of part I discusses Aruba's fiscal performance since 1986 and the country's fiscal outlook, showing the need for fiscal consolidation. Part II of this report focuses on suggestions for enhancing government revenues, while part III discusses possible measures to cut back government expenditures. Next, part IV describes other measures to improve Aruba's fiscal situation, including decentralization of government functions, fiscal rules, and public debt management.

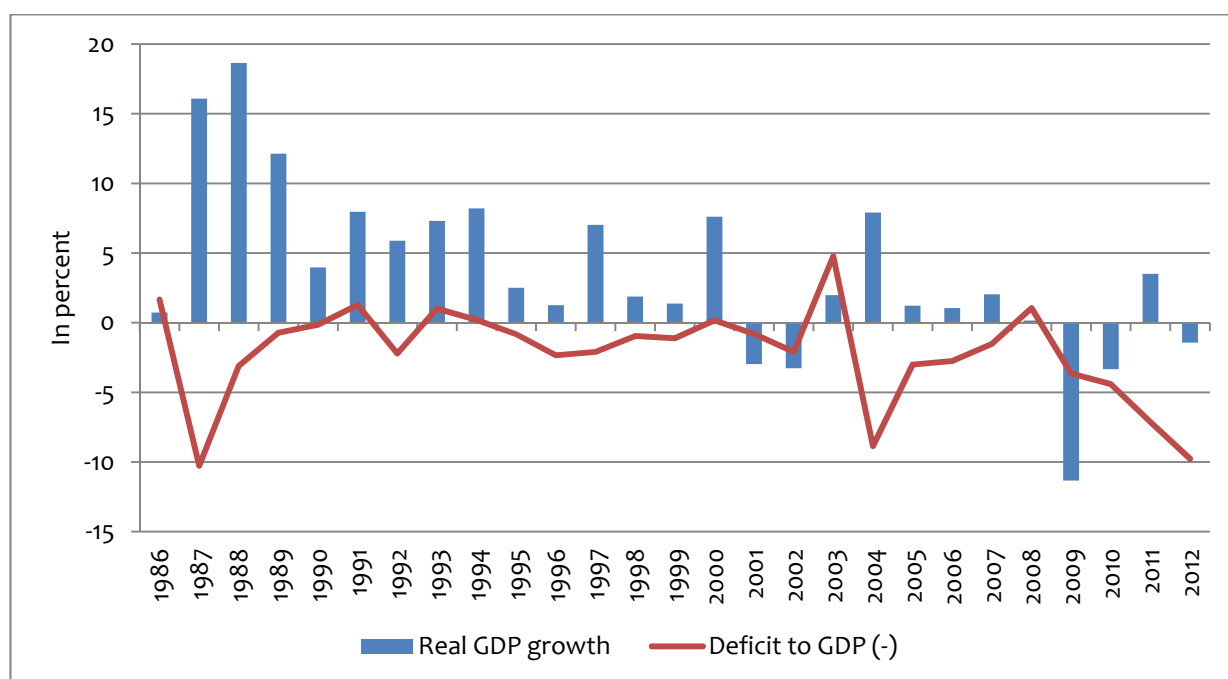
2 FISCAL PERFORMANCE AND OUTLOOK

This chapter provides a brief background to the fiscal performance and the government debt development in Aruba for the last 27 years. Section 2.1 discusses the public finances, while section 2.2 elaborates on the public debt. In addition, section 2.3 of this chapter presents a medium-term scenario for public finances and debt.

2.1 Government finances 1986-2012

In 1985, on the eve of the Status Aparte, government revenues plummeted 20.6 percent (IMF, 1986) due to the loss of tax revenues from Lago and because of the ensuing contraction in economic activities. Faced with this loss in revenues, the GOA adopted a

Chart 2.1: Government financial deficit on a cash-basis (in percent of GDP)¹⁾



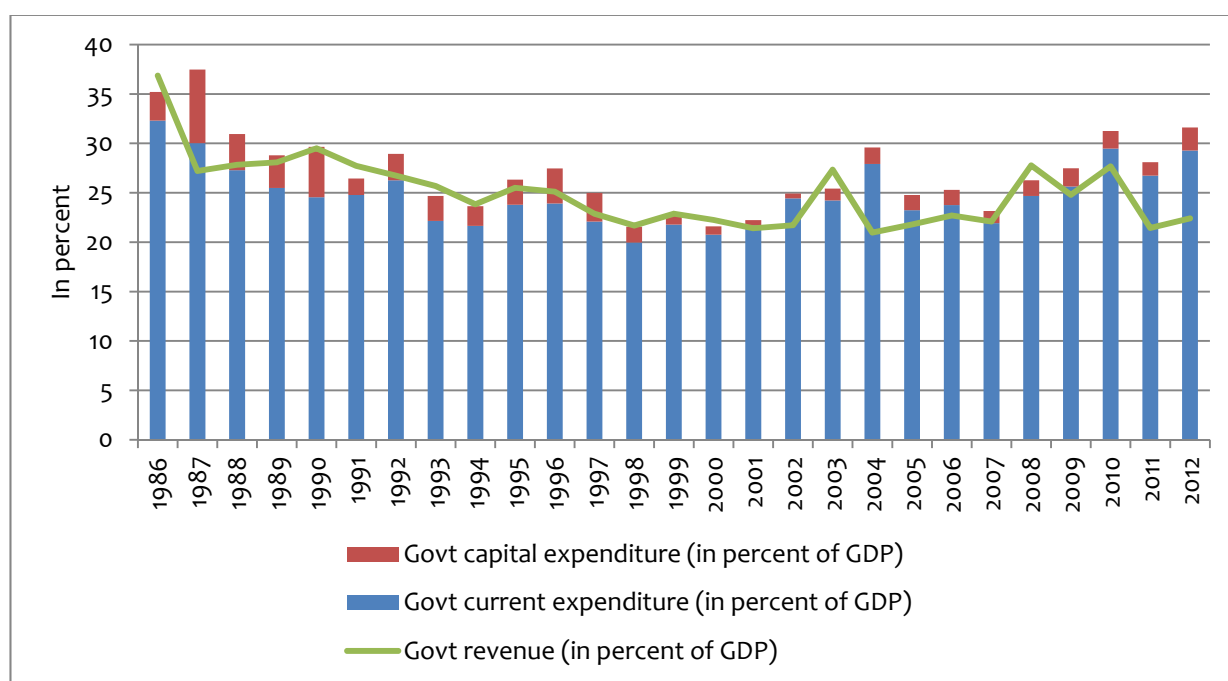
Source: CBA; IMF (1995); IMF (1997); IMF (1999).

1) The financial deficits of the period 1986-1994 are based on various reports of IMF Article IV Consultation Missions and exclude the (US\$ 146 million) debt assumption in 1992 (and related interest accumulation between 1992 and 2003) related to the hotel guarantees issued by the government in the eighties.

fiscal adjustment program designed by the IMF. This adjustment program in conjunction with an intensified tax arrears collection (CBA, 1988) was conducive to an overall financial surplus of almost 2 percent of GDP in 1986. However, since 1986, the government of Aruba has in general recorded deficits (see Chart 2.1), with some exceptions which are largely related to incidental revenues.

Between 1987-1990, the GOA maintained its capital expenditure on a historically high level of nearly 5 percent of GDP in an effort to stimulate the economy (see Chart 2.2). Particularly in 1987, the government more than tripled its investment resulting in a record fiscal deficit of close to 10 percent. After that year, the financial deficit of the GOA fell continuously till reaching a surplus in 1991, in part reflecting slower expanding government expenditure than government revenue.

Chart 2.2: Government revenues and expenditures on a cash-basis (in percent of GDP)¹⁾

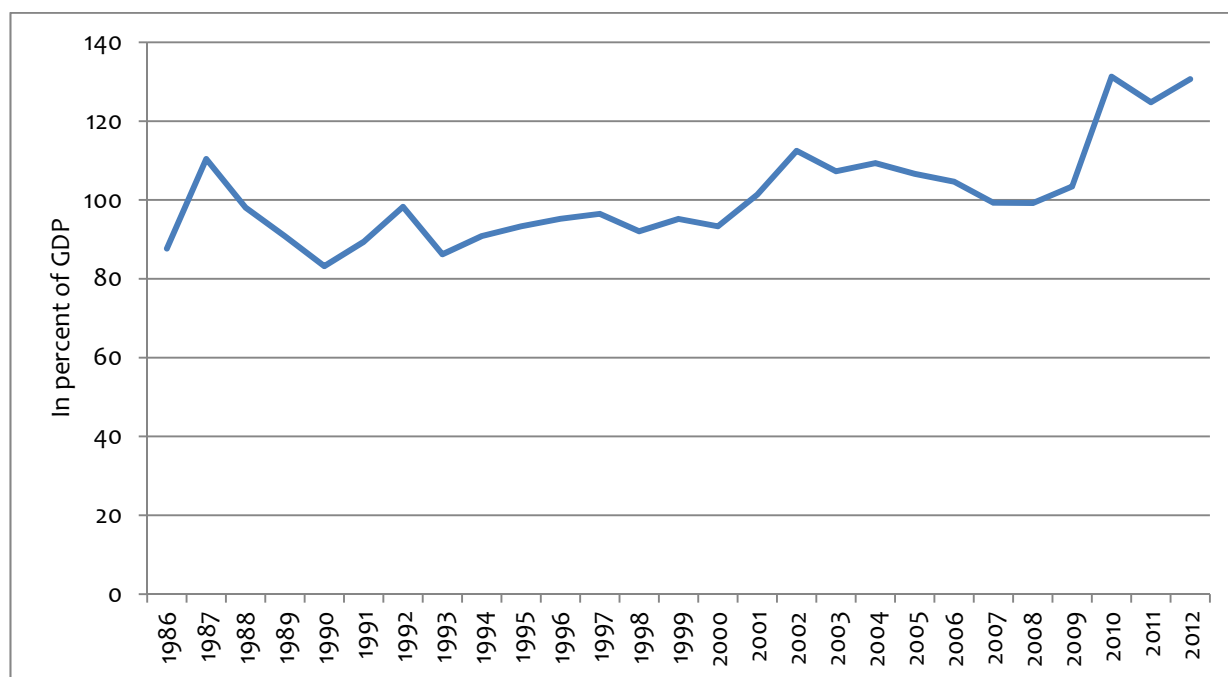


Source: CBA; IMF (1995); IMF (1997); IMF (1999).

1) The data of the period 1986-1994 are based on various reports of IMF Article IV Consultation missions.

During the period 1992-2000 of sustained economic growth, fiscal performance improved. The GOA posted moderate financial deficits of on average nearly 1 percent of GDP. A decline in capital expenditures to around 2 percent of GDP contributed to this outcome. Noticeably, the share of current expenditures in total government revenues shows an increasing trend since the early 1990s (see Chart 2.3). The public finances deteriorated during the domestic economic recession of 2001 and 2002, posting financial deficits of on average 1.5 percent of GDP. Falling government revenues (excluding grants) and the introduction of the General Health Insurance (AZV) in 2001 contributed to the fiscal weakening.

Chart 2.3: Government current expenditure on a cash basis in percent of government revenue¹⁾

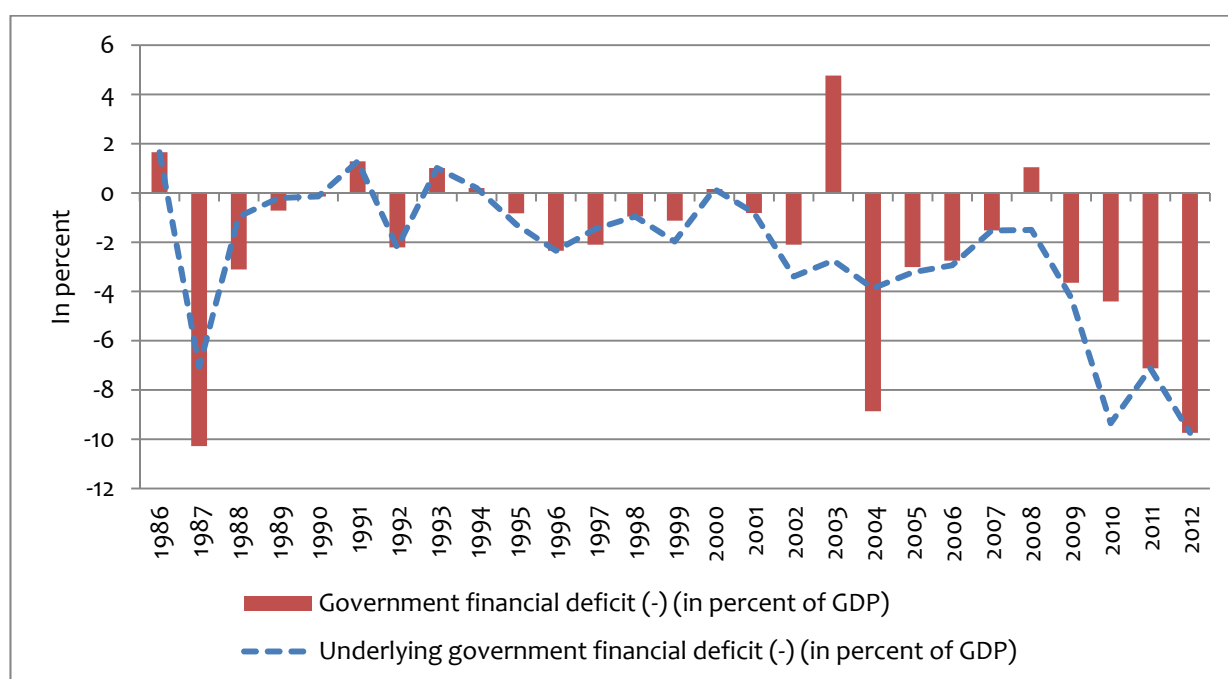


Source: CBA calculations.

1) Revenues for 2003 exclude the incidental revenues from the SACE debt forgiveness; current expenditures for 2004 exclude the conversion of APFA expenditure arrears into a formal loan; the 2008 data exclude the receipts of the Plant Hotel and the payments of expenditure arrears with these proceeds; the 2010 revenues exclude the incidental revenue from the Valero tax settlement agreement.

The year 2002 marked the start of increasing fiscal vulnerability, with underlying government financial deficits from somewhat below 1 percent in the period 1986-2001 to around 3 percent in the period 2002-2008 and increasing to nearly 8 percent in the period 2009-2012, reflecting a worrisome development (see Chart 2.4). The headline government financial deficits were impacted on the revenue side by a number of incidental transactions, including the receipt of the privatization proceeds of the telecommunication company SETAR in 2003, the debt forgiveness in 2003 related to hotel guarantees issued in the past, proceeds of the sale of the Plant Hotel in 2008, receipt of grants earmarked for debt repayment and investment purposes from the Netherlands in 2008 and 2009, and the tax settlement agreement with the Valero oil refinery in 2010. The expenditure side also involved incidental transactions, including the expenses related to the racetrack issue in 2003, the debt conversion of the expenditure arrears (premiums, cost of living

Chart 2.4: (Underlying) government financial deficit on a cash basis (in percent of GDP)¹⁾



Source: CBA calculations.

1) The underlying government financial deficit excludes incidental revenues and expenditures, which have been identified from the CBA publications.

allowances, and interest payments) to the APFA in 2004, the use of part of the proceeds of the Plant hotel to pay APFA arrears comprising employers' contribution, interest expenses, and cost of living allowances in 2008.

The worsening of the underlying government financial deficits was largely the result of rising interest payments (from 1.3 percent of GDP in 2003 to 2.3 percent in 2007 to 3.3 percent in 2012), a rising public sector wage bill (from around 11 percent of GDP in 2007 to about 15 percent in 2012), and the halving of the turnover tax rate in 2010.

Many stumbling blocks currently exist on the expenditure side of Aruba's public finances. A few important ones are:

1. The large share of personnel costs in total expenditure;
2. The high contribution of the GOA to the General Health Insurance (AZV);
3. The deficits of the General Old Age Pension System (the AOV), which are projected to deplete the AOV reserves in 2014, requiring a government contribution to the AOV fund;
4. The high burden of the civil servants pension fund APFA premiums;
5. The forthcoming extremely large burden of the PPP projects (ongoing or in the pipeline); and
6. Rising interest payments.

Table 2.1: Burden of a number of expenditures on government finances (in Afl. million)

	2008	2009	2010	2011	2012
Share of personnel costs in total expenditure (in percent)	46.8	46.4	45.5	48.1	48.2
Interest payments	114.9	119.4	129.7	136.1	146.4
Total contributions to the AZV (including financial deficits)	140.0	153.3	161.1	122.7	122.9
Financial deficits of the AOV	-9.6	-20.9	-53.7	-52.4	-39.9

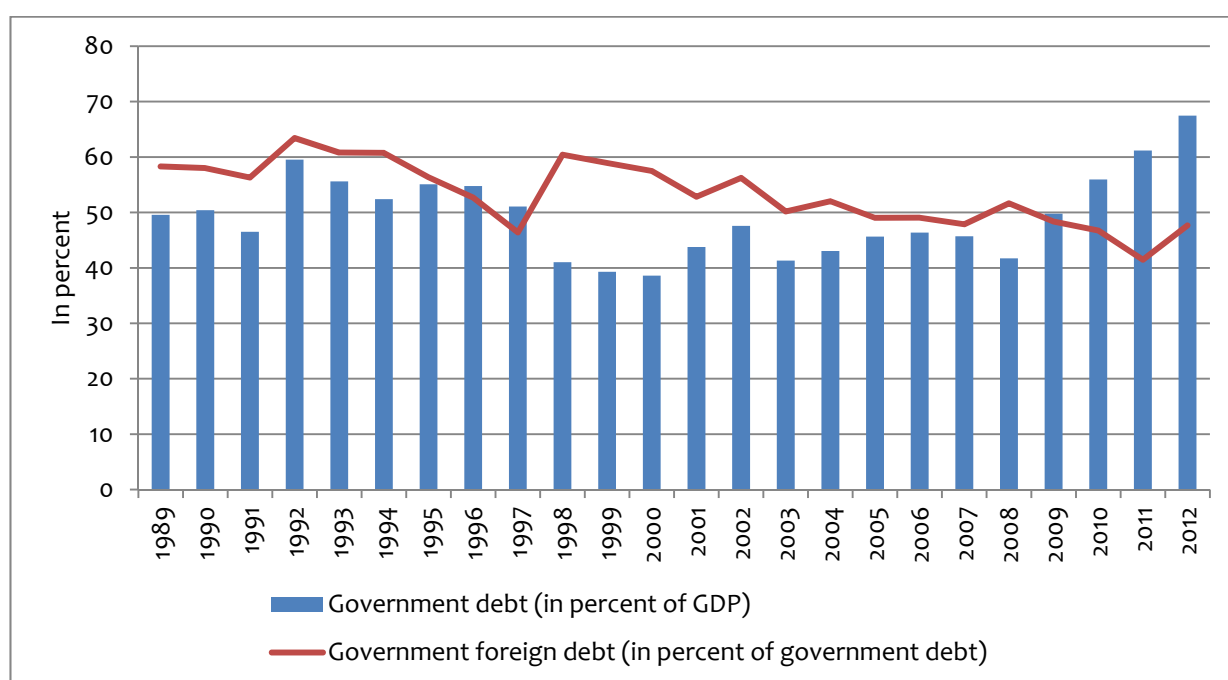
Source: CBA; SVB.

2.2 Debt Level and Composition

As a result of the persistent fiscal deficits, the gross government debt has increased steadily in recent decades, i.e., from Afl. 0.6 billion or 49.6 percent of GDP in 1989 to Afl. 3.1

billion or 67.5 percent of GDP in 2012 (see Chart 2.5). Note that in 1992 government debt jumped from 46.5 percent to 59.5 percent, reflecting the debt assumption in the amount of US\$ 146 million related to a hotel guarantee issued in the past. The GOA has had to progressively borrow on commercial terms both domestically and abroad (since 1998, see Chart 2.6), which in turn led to higher interest payments. As a result of the moderate fiscal deficits in the period 1992-2000, the debt to GDP ratio decreased in that period, reaching 38.6 percent in 2000.

Chart 2.5: Government debt

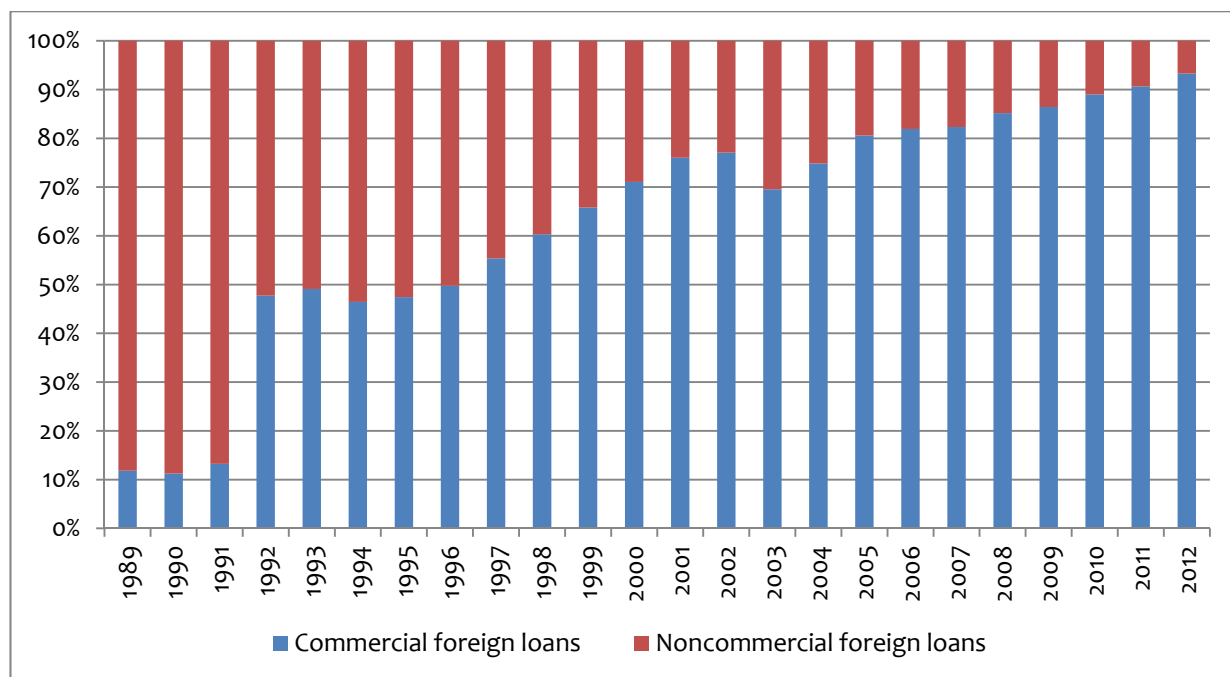


Source: CBA.

However, the 2001-2002 domestic economic recession together with the higher fiscal deficits conducted to a rise in the debt to GDP ratio to 47.6 percent in 2002. In 2003, the GOA received debt forgiveness, lowering the debt to GDP ratio to somewhat below 42 percent. After 2003, the debt to GDP ratio was on an increasing trend (with the exception of 2008 when the government used money received from the Netherlands to repay debt), accelerating after 2008.

Up to the mid-1990s, about 60 percent of total government debt was financed externally. This share decreased over the years to nearly 48 percent in 2012, reflecting the aim of the government to shift the composition of debt to domestic debt. In the period

Chart 2.6: Composition of government foreign debt



Source: CBA.

2009-2011, the government issued only domestic bonds on the domestic capital market. A portion of these bonds was purchased by institutional investors on the neighboring island of Curaçao. However, due to the size of the financing needs and the tightened domestic liquidity conditions, the GOA has had to resort to foreign borrowing in the last two years.

2.3 Fiscal outlook

The CBA has estimated a scenario of government finances for the period 2013-2017 (see Table 2.1). The point of departure for this scenario is the 2013 GOA supplementary budget submitted to Parliament in December 2013 and the government revenue performance in the first eight months of 2013. The estimates of government revenues for the period 2014-

2017 are based largely on the nominal GDP forecasts (see Annex 1). These calculated tax revenues include an estimate for the collection of tax arrears. With some exceptions, government noninterest expenditures are supposed to remain unchanged. This entails that payments for PPP projects are assumed to be budget neutral. Finally, higher agreed-upon payments to the APFA also are included (33.1% of the total premium, plus an additional 3% premium). Note that the medium-term scenario does not take into account potential deficits of the AZV and the AOV or any other additional government contribution to the APFA, which will impact government finances negatively.

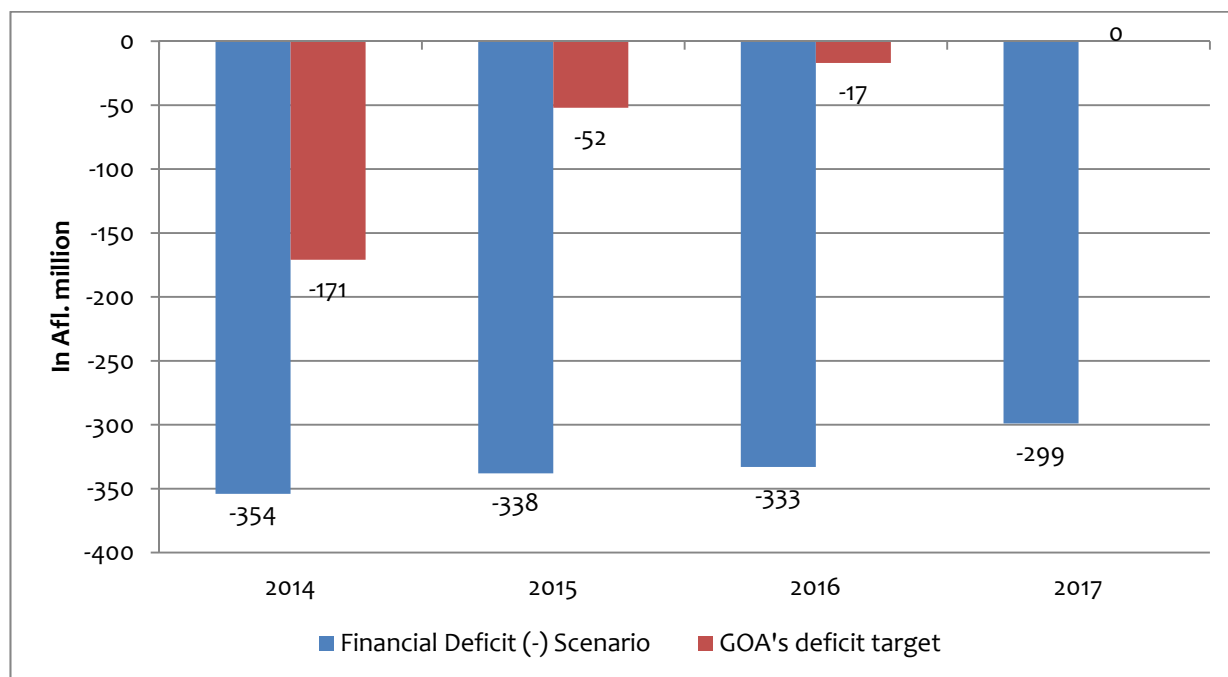
The calculated deficits are higher than the GOA's financial deficit targets, demonstrating that the GOA should take fiscal measures to close the gaps for the coming years. This gap amounts to Afl. 183 million in 2014, Afl. 286 million in 2015, Afl. 316 million in 2016, and Afl. 299 million in 2017 (see Chart 2.2).

Table 2.2: Government financial operations in an unchanged government policy scenario, on a cash-adjusted basis (in Afl. million, unless stated otherwise)

	Budget 2013	2013	2014	2015	2016	2017
1 Total Revenue	1,163	1,160	1,092	1,105	1,125	1,175
1. Tax Revenue	993	941	967	975	991	1,035
2. Non-tax Revenue including Grants	170	228	126	130	134	141
2 Total Expenditures	1,436	1,432	1,426	1,422	1,437	1,452
2.1 Total Current Expenditures	1,373	1,370	1,380	1,399	1,414	1,430
1. Personnel	703	703	703	703	703	703
2. Goods and Services	238	238	238	238	238	238
3. Interest Payments	165	162	172	191	206	222
4. General Health Transfers	115	115	115	115	115	115
5. Other Expenditures	152	152	152	152	152	152
2.2 Total Capital Expenditures	62	62	45	22	22	22
1. Transfer to the FDA	40	40	23	0	0	0
2. Other Investments	22	22	22	22	22	22
3 Lending minus Repayment	21	21	21	21	21	21
4 Financial Deficit (-)	-294	-293	-354	-338	-333	-299
Deficit/GDP (%)	-6.2%	-6.4%	-7.4%	-6.8%	-6.5%	-5.6%
5 Outstanding government debt	3,348	3,348	3,702	4,040	4,373	4,672
Debt/GDP (%)	71.3%	73.2%	77.2%	81.6%	85.7%	87.3%
6 Financing needs of the government	538	538	513	460	514	612
Nominal GDP Growth (%)	3.5%	0.7%	4.9%	3.3%	3.0%	4.9%
Real GDP Growth (%)	5.1%	2.9%	3.4%	1.9%	1.9%	1.9%

Source: CBA staff estimates

Chart 2.7: The GOA's financial deficit targets compared to financial deficits estimated in the unchanged government policy scenario (in Afl. million) ¹⁾



Source: CBA staff estimates.

1) In June 2013, the GOA provided a medium-term scenario for government finances for the period 2014-2016 to Fitch Ratings in which the mentioned deficit targets are included.

2.4 Concluding remarks

All in all, the state of Aruba's public finances is worrisome, especially the outlook which shows potentially high deficits in an unchanged policy scenario. This scenario clearly shows the need for further fiscal consolidation to put the country's public finances on a sustainable path on a medium or long term basis. Without additional measures, the government debt may continue to rise to around 87 percent in the future. Moreover, fiscal risks are looming (see Box 1 in Chapter 1) that could further negatively impact public finances.

PART II REVENUE-ENHANCING MEASURES

3 REFORMING FISCAL REVENUES

The objective of this chapter is to suggest several general measures that could be taken to increase government revenues. These recommendations take into consideration a number of important lessons learned from fiscal consolidation exercises around the globe. First, most countries concentrate on broadening the tax base by fighting tax evasion, reducing tax exemptions, or increasing coverage. For instance, they direct their efforts to broadening the base of the value added tax (VAT) and reducing the number of tax rates. The IMF favors a broad base, single rate, and fairly high threshold. The average VAT rate for a low-income country is 16 percent, for lower middle-income country 13 percent, for upper middle-income country 15 percent, and for high-income country 20 percent (IMF, 2011).⁹ The negative repercussions of these high rates for low-income households could be compensated through targeted cash transfers. In addition, countries that have broadened their tax base limit the use of tax expenditures (e.g., deductions and exemptions) under the personal income tax. The priority is to introduce and/or increase less distortive and corrective taxes (e.g., taxation on property, environmental fees or taxes, and taxation on alcohol and tobacco). Also, the focus should be on increasing the reliance on user charges (i.e., individual payments for services provided, e.g., on transport, water, and waste collection). Furthermore, countries aiming for higher tax revenues have developed a tax administration regime that makes it easy for taxpayers to comply, have reformed their tax administration operations, and increased the collection of tax arrears.

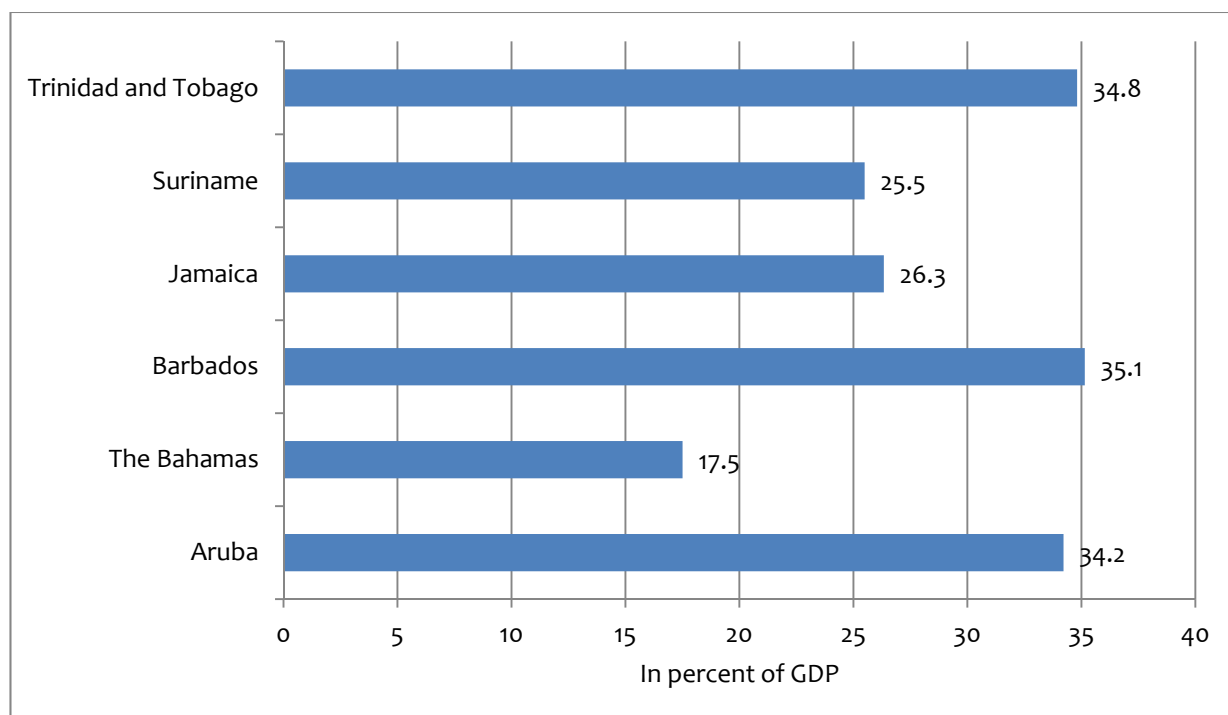
The remainder of this chapter is organized as follows: section 3.1 discusses the amount of “space” existing to further increase the fiscal burden, and section 3.2 presents the recommendations with regard to fiscal revenues.

⁹ Gross national income per capita: low-income country US\$ 995 or less, lower middle-income country US\$ 996 – US\$ 3,945, upper middle-income country US\$ 3,946 – US\$ 12,195, high-income country US\$ 12,196 or more (IMF, 2011).

3.1 Is there room for further increase in the fiscal burden in Aruba?

Government tax revenues in Aruba were around 20 percent of GDP during the period 2008-2012. In comparison to its Caribbean peers such as Barbados (2008-2010: 30.4 percent) and Trinidad & Tobago (2008-2009: 28.2 percent), this ratio is rather low. However, an analysis of the fiscal burden, i.e., the share of government tax and nontax revenues as well as social security contributions as a percent of GDP, shows that Aruba has one of the highest fiscal burdens (i.e., on average 34.2 percent in the period 2008-2012) among a number of selected Caribbean countries (see Chart 3.1). Countries such as Cyprus and Malta, which are considered peer countries by Standard & Poor's, have somewhat higher government revenue to GDP ratios (on average close to 40 percent in 2008-2012). This higher revenue could be the result of Cyprus and Malta's being part of the euro area and therefore obliged to harmonize their tax rates with the generally higher level of the euro area.

Chart 3.1: Average fiscal burden (including tax and nontax revenues, and social security contributions)
2008-2012



Source: IMF World Economic Outlook database; CBA; SVB.

While the tax to GDP ratio of Aruba in comparison to its Caribbean peers may suggest ample room to raise taxes, total government revenues (including social security contributions) to GDP in Aruba appears to be on par with other Caribbean countries. Consequently, not a lot of space exists to increase government revenues (including social security contributions) relative to GDP, as increasing revenues risks curtailing economic growth. Therefore, merely introducing and/or increasing existing taxes and other nontax revenues as well as social security contributions should be limited to the most necessary changes in the very short term to prevent further rise in the fiscal deficit.

3.2 Recommendations concerning fiscal revenues

When increasing taxes, the government should be mindful of which taxes it raises. The top rates of the wage tax are already very high (IMF, 2013), so increasing these further would make it more difficult for Aruba to attract high skilled labor. Moreover, at some point higher tax rates may cause taxpayers to look for more ways to evade the tax, which could cause tax revenues to drop rather than increase as intended. In addition, increasing the profit tax is not desirable since that would deteriorate the competitive position of enterprises in Aruba and make Aruba less attractive for potential new companies. Higher income and profit tax rates also would be undesirable given the government's plan regarding the creation of a "Green Gateway" that involves the recruitment of high skilled labor. Consequently the avenues through which revenues should be boosted are increased efficiency and mainly a shift from direct to indirect taxation.

The following are the recommendations to reform Aruba's fiscal revenues.

1. The GOA should shift the burden of taxation away from direct to indirect taxes: a system of indirect taxes is more efficient than direct taxes, mainly because indirect taxes broaden the tax base. Residents who currently do not pay income taxes will have to pay tax under a tax regime that includes some kind of tax on purchases. In addition, tourists visiting Aruba will contribute when they pay for goods and services on the

island. The necessity of a shift to indirect taxes was also recommended by the IMF in its 2013 Article IV report in the form of the implementation of a value added tax (VAT).

Several Caribbean nations have introduced a VAT in recent years, e.g., the countries belonging to the Eastern Caribbean Currency Union (ECCU) Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, St. Vincent, and the Grenadines. The introduction of the VAT in these countries reshaped the structure of tax revenues as the VAT replaced several other taxes on consumption and hotel accommodations. Consequently, revenues from taxes on goods and services (mainly VAT, consumption, and excise taxes) grew from 8.1 percent of GDP in 2001 to more than 10 percent of GDP in 2008, making it the largest source of tax revenue for the ECCU countries (Schipke et al., 2013). Most of the ECCU countries adopted a standard rate of 15 percent along with a lower rate of 10 percent on tourism industries. Other Caricom countries have similar VAT rates, while the rates in Central America are generally lower (on average 12.5 percent).

Since introduction of a VAT in the ECCU, the collection of VAT revenues has been positive by international standards. Nonetheless, Cebotari, A., Tashu, M., Caner, S., Edwards-Dowe, D., Jones, B., Keene, V., Mills, R., Ogawa, S. (2013) point out two areas that weaken the VAT systems: exemptions, and the treatment of tourism services. The problem with exemptions is that they narrow the tax base, and the list of exemptions tends to expand over time. In addition to exemptions, most countries in the world that have a VAT apply a zero rate to items such as basic foods and a defined portion of monthly household electricity consumption. The objection against a lower rate for tourism services is that it reduces revenues. The justification often given for the lower rate in the Caribbean region is that the demand for tourist services has a high price elasticity, so these rates are necessary to attract tourists who have the option of other destinations. However, Cebotari et al. (2013) argue that while price elasticity in isolation may be high, elasticity is probably much lower for the region as a whole. Since many Caribbean countries have a VAT, a higher rate would not hurt the tourism industry. Moreover, having multiple VAT rates makes administration and compliance more

complicated and creates opportunities for abuse. For instance, hotels would have an incentive to package other goods and services as part of the hotel service to access the lower rate.

Box 3: Report Committee Tax Reform Social Dialogue

In 2011, the Prime Minister of Aruba installed a tripartite Committee on Tax Reform in connection with the Social Dialogue. The committee consisted of representatives of employers, employees, and the government. The task of the committee was to provide recommendations for a new and modern tax regime, comprising tax reform, competitive tariffs for the taxation of income, a competitive and practical regime for profit tax, and the meaning of tax treaties. Soon after its installment, the committee identified (Oosterwijk et al., 2011) a number of issues on which the participants in the Social Dialogue would have to make a decision. These issues were:

- Is a shift from direct to indirect taxes desirable?
- If it is, should taxation at the border be chosen or another form of indirect taxation?
- Is it desirable to replace the motor vehicle tax with excises on petroleum products?
- Is it desirable to charge the social premiums in the first bracket from now on together with the income tax?

It is important to note that the committee did not reach agreement on all these questions. The report does give an overview of the discussions held and the arguments brought forward by the committee. It also includes some recommendations, which were intended to serve as a basis for the further discussion within the Social Dialogue. The committee did identify some quick fixes, which are mentioned below.

- Use a uniform wage definition for the wage tax and social security premiums;
- Charge the casino tax based on revenues;
- Broaden the tax base by revoking exemptions and identify real estate that is not yet valued;
- Revoke the reduced tariff for the motor vehicle tax for some categories of vehicle;
- Bring the excises on gasoline and diesel to the same level;
- Increase the permit fee for rental cars.

The implementation of a VAT requires significant preparation time. If the GOA chooses to implement a VAT, the preparations should start immediately. The GOA could replace the BBO with a VAT, which could generate on average at least 3.4 percent of GDP (i.e., equal to the share of BBO in the period 2007-2009). To compensate for the loss of

purchasing power caused by an increase in indirect taxes, the income tax rate could be reduced. In addition, the profit tax could be lowered to offset the potential loss of competitiveness for businesses. According to the Committee Tax Reform Social Dialogue (Oosterwijk et al., 2011), the shift to more indirect taxation is the only way a lowering of the income tax rate can be realized, which is desirable to attract foreign investors and skilled labor (see Box 3).

2. The GOA should consider introducing and/or increasing less distortive and corrective taxes, including:
 - a. The introduction of a junk food/sugar tax on junk food and unhealthy food & beverage products. In addition to being an extra revenue stream for the GOA, this measure will ideally help improve the health of the Aruban community and, thus, decrease the GOA's contribution to health costs. Countries such as Hungary, Denmark, Romania, and France have implemented similar taxes.¹⁰ Meanwhile countries including Peru, Israel, Ireland, and Belgium are contemplating the introduction of such a tax. Evidence suggests that bigger health gains result from increasing the price of a broad range of foods rather than a narrow one. The tax should include various types of unhealthy food products regardless of whether they are sold in supermarkets or (fast food) restaurants. Moreover, it is important to discourage people from substituting one unhealthy food or ingredient for another.

An objection to this junk food/sugar tax may be that it is regressive, since persons with a lower income are likely to be more impacted. However, persons with lower income may ultimately receive greater benefit from such a tax because progressive health benefits are expected since people in this demographic group often consume less healthy food and have a higher incidence of most diet-related

¹⁰ In November 2012, the Danish Tax Ministry announced that it would abolish the fat tax. The reasons were that the tax failed to change the eating habits of the Danes, it had encouraged cross-border trading, put Danish jobs at risk, and had been a bureaucratic nightmare for producers and outlets. Source: BBC News, 11 November 2012.

diseases. Another counterargument to this tax is the administrative burden for both businesses and the Tax Department. To counteract the last criticism, the GOA could raise the import duties for the relevant products instead of introducing a separate tax, especially given that the majority of these products are being imported.

To estimate what such a tax would generate for the government, it is necessary to have an idea of the current revenues from the relevant products. A very rough estimate indicates that the import value of relevant products is around Afl. 65 million. According to the British Medical Journal, “fat taxes” would have to increase the price of unhealthy food and drinks by as much as 20 percent to be effective in reducing obesity and other diet-related diseases^{11 12}. If a rate of 20 percent is levied on unhealthy food products in Aruba, the potential additional revenues for the government would be at least Afl. 13 million (based on the import value of the relevant products without taking into consideration trade margin on these products and the sales of unhealthy products by (fast food) restaurants).

- b. An increase in the excise taxes on alcohol, liquor, and tobacco. The consumption of products containing alcohol and tobacco is not considered essential, implying that they could be made more expensive. While a higher price will probably not deter the use of these products, an increase in the excises will help raise government revenues. In 2012, proceeds from excises on alcohol, liquor, and tobacco were a bit over Afl. 60 million. Thus, a 1 percent increase in the excises on these products would generate additional revenues of Afl. 600,000, assuming they are price inelastic.
3. Applying the user-pays principle (i.e., a user of a service or resource pays directly for the amount they use, rather than the cost equally being shared equally by all users or a community), the GOA should evaluate the impact of replacing the motor vehicle tax by

¹¹ <http://www.bmj.com/content/344/bmj.e2931.full?ijkey=anbZhoTu5xuqTVc&keytype=ref>

¹² <http://www.theguardian.com/society/2012/may/16/fat-tax-unhealthy-food-effect>

increasing the excises on gasoline, while simultaneously introducing a license plate that does not have to be changed every year. This recommendation also was proposed by the Committee Modernization Revenue Sources Government (Timmer et al., 1997), while the representatives of the employers in the Committee Tax Reform Social Dialogue made the same suggestion (Oosterwijk et al., 2011). The advantage of this new system is that revenues are much simpler to collect. No longer do people have to waste time standing in line at the tax office. The tax office frees up man-hours that are used each year to collect the motor vehicle tax and distribute the new license plates. In addition, this system will broaden the tax base as tourists also contribute directly as will the persons who don't pay the motor vehicle tax under the current system. Moreover, a heavier burden is placed on drivers who drive more miles and make more use of the road infrastructure. This tax regime can also be considered more social than the current system, because the cars that consume the most fuel often are the more expensive vehicles and, therefore, more frequently owned by persons with higher incomes. Another consequence of such a regime could be that over time drivers might switch to hybrid or more fuel efficient vehicles. This switch would be desirable from an environmental point of view and would reduce domestic demand for fuel imports. Reducing fuel imports would benefit Aruba's international reserve position. However, the degree to which such a shift would occur depends on the price elasticity of demand for fuel in the long term, a figure currently unknown. A disadvantage of the proposed system of excises would be that certain economic activities such as public transportation would see an increase in costs. Often the tariffs for these activities are limited by the government and could be revised as also pointed out by the Committee Tax Reform Social Dialogue.

The motor vehicle tax revenues in 2012 were Afl. 21.4 million; thus, this is the amount that the increase in the excise on gasoline would have to generate at a minimum. Based on the Afl. 57.4 million in revenues from the excise on gasoline received in 2012 and the excise rate of Afl. 0.614 per liter, the excise rate would have to increase by about Afl. 0.23 per liter to recuperate the amount lost by the elimination of

the motor vehicle tax. For instance, an Afl. 0.30 rise per liter in the excise on gasoline would generate Afl. 6.5 million in additional fiscal revenues. This calculation assumes that the demand for gasoline is inelastic, at least in the short-term.

4. The GOA should consider Increasing the reliance on nontax revenues by doing the following:

a. Introduce a tendering program for government land and properties:

The government should adjust its current regime regarding the leasing of land. Currently private citizens or corporations can obtain land for specific purposes (such as home construction or establishing a business) for relatively inexpensive prices. Sometimes this land is misused by recipients to realize profits by selling the land. Resale is not the purpose for which this program exists. If profit is to be made from the government's land, this profit should be realized by the government. One way the government could "fix" this is to distribute its land through auctions. Land for construction would then go to the highest bidder. Of course, some criteria would have to be established for eligibility to participate in such auctions. For example, participants cannot already own a home or a piece of land, similar to the current criteria to obtain land through this tendering program. An auction system is currently used in Singapore, for example. The land held by the government in Singapore is sold through closed-bid auctions. To participate in these auctions, interested parties have to purchase a tender packet. In addition, the properties are assigned a minimum value beforehand. Applicants have to pay a deposit of 5 percent of this value to participate in the auction. If the bids don't exceed this predetermined value, the bids are rejected. The auction system pushes up the value of properties and, thus, also increases property taxes received by the government in the future.¹³

b. Adapt the lease contracts of lands to be able to increase the lease to reflect inflation. Currently, the lease prices are set for periods of as long as 60 years, not a

¹³ www.sla.gov.sg

desirable situation for the government, as the value of land is likely to change significantly over a period of 60 years, and the lease paid should reflect this value to some degree.

3.3 Concluding remarks

When considering revenue-enhancement measures, the GOA should aim to avoid raising the fiscal burden on the economic agents who are already paying their fair share. This could be achieved primarily by broadening the tax base by shifting the burden of taxation away from direct to indirect taxes. A shift to indirect taxes is probably the only way to enable a reduction in income tax and profit tax, which will make Aruba more attractive for the high skilled labor and foreign companies the government wishes to attract with regard to the “Green Gateway”. Also, simultaneously, the government should focus on measures to further improve the effectiveness of tax administration (eliminating the backlog of tax-processing work) and the levels of compliance to ensure that every taxpayer contributes his fair share. To achieve this, long term efforts are required. These efforts include strengthening the organization and management of the Tax Department, implementing robust collection systems and building capacity in core tax administration functions (registration, filing and payment enforcement, debt collection, audit, taxpayer services, and processing of appeals) (Russell, 2010). Additionally, reform of the legal framework and judiciary often is necessary to ensure that the required powers, penalty regimes, and dispute resolution processes are in place.

4 INTRODUCING A REVENUE AUTHORITY IN ARUBA

In 2013, the former Tax Department ‘Servicio di Impuesto y Aduana Aruba’ (SIAD) was split into two separate government departments, the Tax Department ‘Departamento di Impuesto’ and the Customs Department ‘Departamento di Aduana’. The aim of this separation was to improve the quality of the taxpayer services provided by each department. Both departments continue to be normal government departments under the Ministry of Finance.

Many countries (such as Argentina, Canada, Mexico, and Peru) have adopted an alternative governance model, i.e., a revenue authority, for improved revenue administration. A revenue authority (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. According to Crandall (2010), almost 40 RAs exist around the world clustered largely in Africa and Latin America. In addition to dealing with direct and indirect taxes, RAs usually deal with customs administration.

The objective of this chapter is to suggest that the GOA consider introducing a Revenue Authority in Aruba as a means of improving revenue administration and increasing the capacity to generate more revenues. Section 4.1 elaborates on the principal characteristics of the RAs around the world. Next, section 4.2 discusses the rationale for establishing an RA in Aruba.

4.1 What are the principal characteristics of the RAs around the world?

According to Kidd and Crandall (2010), the RAs around the world have the following main characteristics:

- a) A legislative instrument (law or decree) was used to establish the RA.
- b) About 80 percent of RAs have a separate legal status.
- c) Almost all RAs have the mandate to assess and collect taxes and to administer and enforce the revenue laws. In addition, they have a further mandate to provide advice on tax laws to the minister of finance.
- d) The minister of finance is considered to have at least general supervision and oversight of the RA.
- e) Different funding arrangements exist for RAs:
 - o Normal budget and appropriation funding only – 40 percent.
 - o Normal budget and appropriation funding with an option for a percentage of revenues normally as an incentive payment – 30 percent.
 - o Funding based on a percentage of tax collection – 30 percent.
- f) About 70 percent of RAs are outside the normal public service.
- g) All RAs have arrangements in place for external audit, usually by the auditor general.
- h) 75 percent of RAs have boards, ranging in size from 5 to 15 members including private sector representation.
- i) In most cases, the chair of the board is named by the government, while alternatively the chair is specified in the legislation or the chairperson is chosen by the board.
- j) In most cases, the CEO is appointed by the government, or alternatively the appointment is made by the government on the recommendation of the board, or the board itself appoints the CEO.
- k) RAs administer direct and indirect taxes, and include customs administration.

4.2 What is the rationale for establishing an RA in Aruba?

In general, giving a revenue administration more autonomy than a normal department in a ministry has a number of benefits. For instance, Crandall and Kidd (2010) note that more autonomy can lead to better performance by removing impediments to effective and efficient management while maintaining appropriate accountability and transparency. Taliercio (2004) argues that 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, Mann (2004) 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 (see Table 4.1 for more reasons).

Table 4.1: Reasons for initially establishing a revenue authority

Rank	Reason
1	Low effectiveness of tax administration and poor levels of compliance
2	Need for a catalyst to launch broader revenue administration reform (modernized operations, improved automation, integrated and function-based structures, and so on)
3	Impediments caused by poor civil service human resources policies (recruitment, remuneration, promotion, training, discipline)
4	Poor communication and data exchange among the existing revenue departments (e.g., income tax, sales tax, customs)
5	Desire to create “islands of excellence” within the public sector
6	Perceptions of political/ministerial interference
7	High levels of corruption

Source: Kidd and Crandall (2006).

However, RAs should not be seen as quick-fix remedies to tax administration inefficiencies. Arguments against the concept of RAs include (i) reduction in the accountability to the

Table 4.2: A framework for policy choices

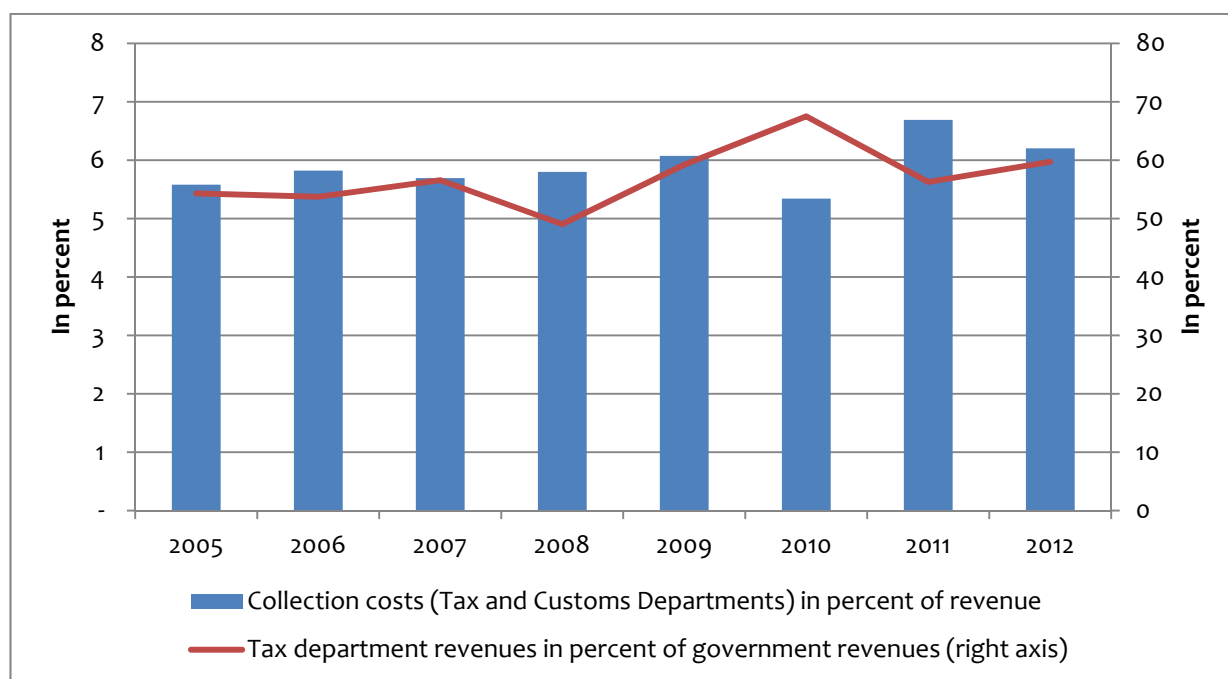
Components of the framework	
➤ Degree of autonomy	
▪	Legal form and status – legislation could establish an agency relatively similar to a normal government organization, or set up a corporate body with considerable independence from government.
▪	Funding – could range from normal funding via parliamentary appropriations to direct retention of a percentage of collected revenues.
▪	Budget flexibility – from limited flexibility to the complete flexibility of a one-line budget.
▪	Financial policies (such as accounting, asset ownership and management, procurement) – subject to standard civil service laws and regulations or as determined by “corporate body” status.
▪	Human resources – within the civil service control framework, or outside it.
▪	Operational autonomy – from a situation where the minister has day-to-day authority to one where there is no involvement on the part of the minister in operational decisions.
➤ Governance framework	
▪	Role of the minister of finance – direct supervision of the authority by the minister, or role limited to appointment of board or board chair only.
▪	Role of the board – advisory, or fully empowered in legislation to take management decisions.
▪	Role of director/commissioner general – coordinating role only, or full responsibility for revenue operations with all vested powers from revenue laws.
➤ Accountability	
▪	Reporting to the government and parliament – part of general government reporting, or special requirements specified in legislation.
▪	External audit – responsibility of auditor-general, or the board selects private sector external auditor.
➤ Scope - Refers to the scope of taxes and taxing agencies to be included.	

Source: Crandall and Kidd (2010).

ministry of finance, (ii) a weakening in the authority of the minister of finance, (iii) the improvement in tax administration could be achieved within already existing government departments, (iv) special treatment to the tax agency could have negative externalities throughout the rest of the government; (v) concentration on RA reform could divert attention from the basic operational functions of tax administration; (vi). What really matters is professionalization or good management, not autonomy per se (e.g., Taliercio, 2004; Mann, 2004).

In the case of Aruba, the GOA could consider converting the ‘Departamento di Impuesto’ into an RA. In 2012, the Tax Department generated about 59.7 percent of total government revenues (see Chart 4.1). The conversion into an RA could be accomplished by introducing a new governance regime, i.e., a ‘sui generis’ status for this department, with the aim of

Chart 4.1: Share of Tax Department in total government revenues and collection costs 1)



Source: CBA staff estimates.

1) 2012 collection costs are based on the budget.

further increasing the efficiency (costs versus revenues) and effectiveness (tax goals) of tax collection and promoting a high level of (voluntary) compliance. Specifically, this department should be given more autonomy, particularly in the areas of human resource management, financial resource management, and general management. GOA has already gained positive experience with the ‘sui generis’ model of the CBA and the Aruba Tourism Authority (ATA), which could be used as a basis for the new governance structure of this department. A ‘Departamento di Impuesto’ *Sui Generis* could serve as a catalyst to enable the necessary reforms in revenue administration to support economic growth through proactive review of tax policies and rules, to promote a high level of (voluntary) compliance (through education and enforcement programs, and making tax-filing convenient and easy), and to strengthen internal capabilities. The expected benefits of these reforms would more than compensate for the expected cost increase for hiring the required personnel and enhancing technological capabilities.

A number of policy choices need to be made with regard to the creation of the RA, such as the degree of autonomy, the governance framework, accountability and scope. The framework for policy choices presented in Table 4.2 can be used as a basis for the necessary choices.

4.3 Concluding remarks

Prior to introducing an RA in Aruba, a full assessment of the problems at the Tax Department and a cost/benefit analysis should 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 and could take about two years.

PART III REDUCING GOVERNMENT SPENDING

5 A PRESCRIPTION FOR RISING HEALTH CARE EXPENDITURES

Global health care expenditures have been rising for several years now. In 2011, global health care expenditures per capita totaled US\$ 951 compared to US\$ 459 in 1995.¹⁴ During fiscal consolidation exercises in the area of health care spending, countries around the globe focus on (i) strengthening the role of incentives in conditioning the demand for health care services, by increasing the role of cost-sharing to enhance patient cost-consciousness and increasing the role of private insurances, (ii) changing reimbursement schemes, (iii) improving public management and control, and (iv) imposing budget caps. In Aruba, the Executive Body of the General Health Insurance of Aruba (AZV) aims to maintain Aruban health care expenditures below global trends. This chapter presents some measures that could be taken to contain rising health care expenditures in Aruba. The chapter is structured as follows: section 5.1 elaborates on the current AZV system. Section 5.2 describes the strategy the AZV¹⁵ has already implemented to contain its costs. Then, in section 5.3, various new measures are proposed which the AZV could implement in order to further contain its deficit.

5.1 The AZV system

The AZV health insurance system covers all Aruban citizens enrolled in AZV's basic administration and who have Aruba as their principal place of residence. The AZV covers only curative health services and rehabilitative health services (up to an extent) (see Table 5.1). Preventive care and health promotion services are not covered in the package.

Premium obligations, GOA's contribution, and other income are the resources used to cover AZV's operations.¹⁶ The GOA's contribution has been fixed since 2011 at

¹⁴ The figures were calculated using The World Bank's online database.

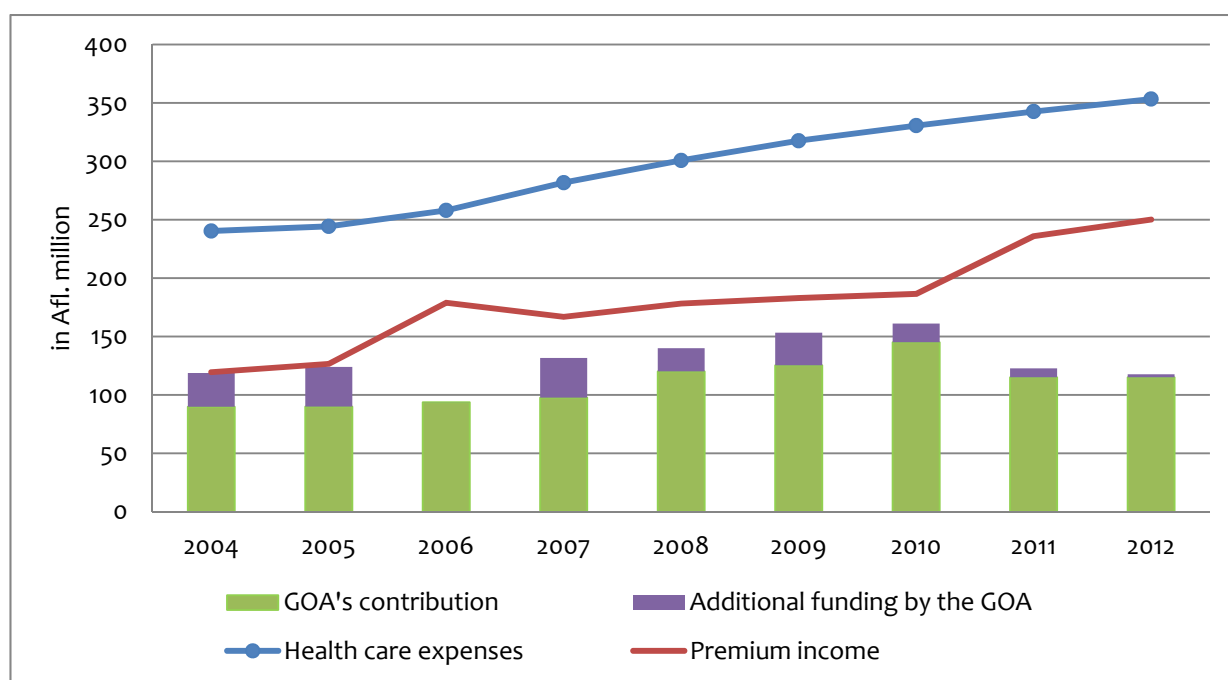
¹⁵ Please note that the abbreviation AZV will be used interchangeably to denote both the General Health Insurance and the Executive Body of the AZV ('Uitvoeringsorgaan AZV').

¹⁶ Other incomes include income from administration services and recovery of costs paid.

Table 5.1: Health services covered by the AZV

Entitlements
A general practitioner
A medical specialist
Hospital
Obstetric care
Treatment by a physiotherapist
Speech therapy
Pharmaceutical medicines and bandages
Admission, nursing, and care in the lowest class of hospital
Dental and dental hygienist
Sick and ambulance transport
Health care in an institution abroad if it is determined that the treatment of the insured cannot be achieved in Aruba.

Source: Centraal Wettenregister (2007)

Chart 5.1: Financial operations of the AZV (in Afl. million)

Source: Financial statements of the AZV.

Afl. 115 million annually, equal to about 31 percent of AZV's income in 2012 (see Chart 5.1). Moreover, the GOA is obliged legally to cover the financial deficit of the AZV. Currently, the employer pays an 8.9 percent AZV premium, while the employee contributes 2.6 percent in premium. The AZV cannot be held responsible for the completeness and accuracy of the premium income other than that reported by the Tax Department, which is in charge of the premium collection.

5.2 AZV's cost containment strategy

For each sector of the health care system (pharmacies, general practitioners, specialists, and hospital), the AZV has a different strategy for keeping health care expenditures below global trends (Figaroa, 2013). In the case of pharmacies, the AZV covers the cost price of the medicine plus a standard reimbursement fee. The cost price is based on the cheapest price available from suppliers. In general, the AZV policy is to compensate primarily generic drugs (the AZV has a 'positive list' of drugs). The money saved through generics is used to pay for expensive drugs.

General practitioners (GPs) receive a fee for each patient they have registered at their practice regardless of the number of patient visits (in 2012 on average each GP had 2,475 patients). The Aruban system has GPs acting as gatekeepers, meaning that a sick patient has to visit his or her GP first and then get referred to a specialist. This system makes it attractive for a GP to have more patients (even the ones who never visit, or only visit to get referred to a specialist). The AZV is trying to improve the service quality of GPs.

Specialists work on a fee-for-service basis which may create supplier induced demand (i.e., the specialist adds extra unnecessary tests to earn more money). The AZV monitors each specialist by comparing him or her to their peers to assess whether the specialist is charging unreasonably higher fees. If this is the case, the AZV will open an investigation on the specialist in question.

The hospital is the sector with the highest expenses, driven by personnel costs. The AZV is updating hospital's service tariffs as a way to lower costs. Moreover, the AZV is looking into increasing efficiency in the hospital as well as the possibility of treating more

diseases locally and requesting the hospital bring in more specialists. This requirement might bring extra expenses to the hospital sector but might lower the costs related to care abroad.

5.3 Possible measures to contain the AZV health care deficit

The burden of the AZV on the GOA could be reduced by a number of measures:

1. Increase the effectiveness of the collection of the AZV premiums and employer compliance by giving the AZV the responsibility for the control/audit of the premium revenues. Currently, the AZV premiums are collected by the Tax Department. However, this recommendation entails that the AZV be accountable for premium collection. By placing the responsibility for the control of premium contributions at the AZV, the AZV could concentrate more on ensuring that employers are paying the correct amount of premiums and detecting some employers who are withholding these premiums.
2. Introduce a co-payment system for GPs. Under this system, patients would have to pay a fee when they visit their GP, while the fee paid by the AZV to the GPs would be reduced simultaneously. The AZV could lower its GP costs by 22.5 percent (Afl. 4.1 million) if a fee of Afl. 10 per visit were implemented.¹⁷

This measure could also bring with it some indirect effects. Cost sharing for GP care does have some effect on the demand for care by patients. More precisely, patients would rather postpone going to the doctor than pay the fee. This is somewhat of a double-edged sword, since it would eliminate visits to the doctor for minor illnesses, but it also might make patients with the beginning of a serious illnesses postpone going to the doctor, thus aggravating the disease. Van Vliet (2004) found in a study of 100,048 privately insured persons in the Netherlands a price elasticity of -0.40 for GP care when patients had to pay a deductible. The co-payment system may also lower the

¹⁷ Based on an average of 4 visits per year per patients, number of insured persons of 102,021 (Financial Statements of the AZV of 2012) and an average annual cost of Afl. 180 per patient as informed by Figaroa (2013).

cost of some medicines. Moreover, doctors could create supplier-induced demand, but the extra Afl. 10 they receive by doing this does not seem a big incentive.

3. Reduce the AZV health insurance package. This reduction could include lowering the types of drugs that are covered, a potential issue for patients with chronic illnesses since their out-of-pocket costs could rise due to this measure. An exemption could be made for these type of patients. Also, the costs related to medical care abroad, more specifically the costs related to the companion traveler, could be tackled. Let's assume AZV reduced its coverage of related pharmacies and care abroad by 10 percent. The resulting cost reduction would be about Afl. 9 million.
4. Monitor the GPs and specialists more strictly to control for supplier-induced demand. This increased control could reduce the costs related to administering unnecessary tests, and the costs related to prescription of medicine. The benefits of this measure would probably outweigh the expected increase in the monitoring costs. A proper calculation of the cost savings must be conducted before considering implementation of the measure.
5. Raise the AZV premium as an ultimate alternative. Rough estimation indicates that a one percent increase in the AZV premium could generate an additional Afl. 21 million in revenues.

5.4 Concluding remarks

The proposed measures in this chapter could reduce the health care burden by at least Afl. 34 million, a figure does not include the indirect effects of these measures. Moreover, it is also important to focus on improving the quality of health care services and the availability of health care providers. In addition to the measures suggested here, the GOA should consider a complementary path towards containing health care costs. In this context, the GOA should focus on preventive care, education, and awareness in an effort to contain (future) health care costs. One area that needs extra attention is the problem of obesity on the island. The GOA also should consider introducing a law that requires employers to provide a social wellness program for their employees, particularly related to health. Such

a program could include the reimbursement of gym memberships, the provision of exercise equipment and lectures on improving health. Social wellness programs can reduce AZV costs if these programs improve the health of employees.

6 REFORMS IN PUBLIC PENSION SCHEMES

Economies worldwide are finding themselves faced with serious challenges in funding their pension systems, especially in light of an ageing population, the recent global economic downturn, and the current sluggish economic growth. According to Cotarelli (2011), pension spending in advanced and emerging economies is projected to rise by an average of 1 and 2.5 percentage points of GDP over the next two and four decades, respectively. Public pension reform will be a key policy challenge in both advanced and emerging economies over the coming decades.

To improve the sustainability of public pension schemes, countries are opting for lengthening the contribution period required for full pension, increasing the minimum age for full pension, raising the number of years of earnings used for calculating the pension base, increasing incentives to postpone retirement and remain employed, and linking the pension age to life expectancy. Recognizing the already high social contributions, countries do not opt for increases in social contribution premiums as a first-best policy option in view of the adverse consequences of high marginal effective tax rates on labor demand and supply.

In the case of Aruba, the General Old Age pension system (AOV) has been recording financial deficits since 2004, while the Civil Servants Pension Fund (APFA) has a significant negative equity position. This chapter explores possible solutions for both the AOV and the APFA pension schemes. Section 6.1 gives some background information on the AOV, followed by a discussion of the recent reforms in the AOV. Section 6.2 presents possible policy reforms in the AOV, while section 6.3 discusses further reforms in the APFA.

6.1. The AOV law

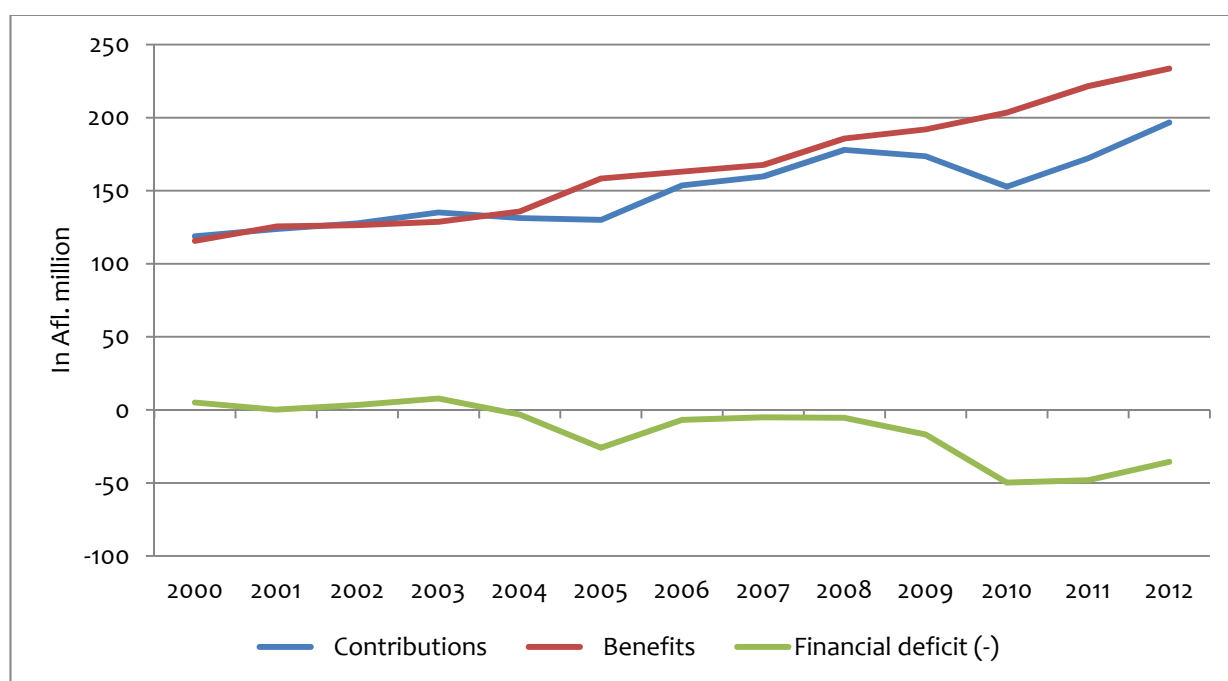
The AOV ('Algemene Ouderdoms Verzekering'), administered by the Social Security Bank (SVB) was introduced in 1960 with the aim of fighting poverty among the elderly. To implement the AOV, the AOV fund was set up. In addition, a so-called '*schommelfonds*' was set up, in which any surpluses of either the AOV or the AWW ('Algemene Weduwen-en

Wezenverzekering’) are placed. This fund can then be drawn upon in the case of any deficits of either the AOV or the AWW fund.

The AOV is a pay-as-you-go (PAYG) system, where the AOV contributions of the employees (and their employers) of each generation support the pensioners of the previous generation. At present, the total premium of 12.5 percent consists of a 9.0 percent employer premium and a 3.5 percent employee premium. The current maximum annual wage on which this premium can be levied is Afl. 65,052, for a total maximum annual contribution of Afl. 8,132 per worker.

The amount of the AOV benefit varies depending on marital status as well as living situation. Currently, an unmarried person is entitled to receive a monthly pension of Afl. 1,057, while a married couple is eligible to receive Afl. 1,780 a month. When a married

Chart 6.1: Financial operations of the AOV fund¹⁾



Source: SVB

1) The 2012 figures are preliminary and have not been audited. The final audit report is almost ready.

couple is permanently separated, or if an unmarried couple is living together and both partners are at least 60 years old, each person has the right to receive Afl. 890 per month.

Since 2004, the AOV fund has been running financial deficits as AOV benefits have been exceeding the income from AOV premium contributions (see Chart 6.1). The SVB so far has been able to cover these deficits by either drawing from the AOV/AWW ‘*schommelfonds*’ or by drawing on its reserves. However, the SVB expects its reserves to be depleted in the coming year. If that occurs, the GOA would have to cover the expected shortfall (Sociale Verzekeringsbank, 2013), because the liabilities of the SVB are unconditionally guaranteed by the GOA. The SVB has calculated a scenario to analyze the long-term position of the AOV fund. When assuming unchanged policies, the scenario shows an expected severe deterioration of the AOV fund in the coming years (see Table 6.1).

In 2011, the government recognized the serious problem with the current pension system—about 60.0 percent of the workforce at that time did not have pension income apart from the AOV pension benefit (Landsverorderening, 2011). In other words, almost two-thirds of the workforce would experience a substantial drop in income after retirement. Furthermore, the GOA estimated that the number of pension-age and older (60+) persons would double in the next 20 years. Based on these projections, the GOA concluded that the liabilities of the AOV system would double in the coming 20 years and that the contribution payments would not keep up with this trend. With that in mind, the GOA acknowledged the need to reform the AOV system, as well as the need for a supplementary pension income separate from the AOV benefit.

To that end, the GOA introduced a mandatory pension scheme for the private sector in January 2012. Moreover, the GOA individualized AOV premium contributions, increased the wage cap from Afl. 54,600 to Afl. 65,052, and introduced incentives for those willing to postpone retirement beyond the mandatory age of 60. However, despite the government’s efforts, these measures have not been sufficient to contain the negative effects of the ageing of the population. Recent reports on Aruba’s fiscal sustainability have come to the same conclusions. The IMF (2013) notes in its recent Article IV consultation that, albeit a move in the right direction, these measures have proved insufficient to

reverse the worsening of the AOV balance and that with its reserves soon being depleted, the burden of covering the deficits would fall on the government. Moreover, the IMF mentions that failure to rein in the financial deficits of the AOV poses downside risks in the medium-term. Fitch Ratings also reported the unfunded contingent liabilities in the AOV as one of the main downside risks to its fiscal deficit projections (Fitch Ratings, 2013).

Table 6.1: Overview of AOV financial deficit 2012-2030 in a base scenario without migration (in nominal terms)

In Afl. million											
Year	Number of pensioners	Total benefit payments 1)	AZV cost	Funeral payments	Administration costs	Total cost AOV	Premium contributions 2)	Deficit (-) AOV	Deficit (-) AWW	Reserves	Needed AOV premium rate
2012	18,710	203.3	18.9	1.4	2.9	226.5	186.7	-39.9	1.4	88.3	14.4%
2013	19,618	211.2	20.9	1.6	2.9	236.6	189.7	-46.9	-1.0	40.3	14.9%
2014	20,520	221.4	21.9	1.7	3.0	247.9	196.6	-51.3	-1.0	-11.9	14.9%
2015	21,555	232.9	23.0	1.8	3.1	260.8	203.5	-57.2	-1.0	-70.2	15.1%
2016	22,526	243.9	24.1	1.9	3.2	273.1	222.0	-51.1	-1.0	-122.3	15.4%
2017	23,523	255.5	25.2	2.2	3.3	286.2	232.9	-53.3	-1.0	-176.5	15.4%
2018	24,637	268.3	26.5	2.1	3.4	300.4	244.3	-56.0	-1.0	-233.6	15.4%
2019	25,643	280.3	27.7	2.2	3.5	313.7	256.3	-57.5	-1.0	-292.0	15.3%
2020	26,811	294.0	29.0	2.4	3.6	329.0	268.8	-60.1	-1.0	-353.2	15.3%
2021	27,924	307.3	30.3	2.5	3.7	343.9	282.0	-61.9	-1.0	-416.0	15.2%
2022	28,936	319.8	31.6	2.9	3.9	358.1	295.8	-62.2	-1.0	-479.2	15.1%
2023	30,042	333.2	32.9	2.8	4.0	372.9	310.3	-62.5	-1.0	-542.8	15.0%
2024	31,064	345.8	34.1	2.9	4.1	387.0	325.5	-61.5	-1.0	-605.2	14.9%
2025	31,964	357.4	35.3	3.1	4.2	400.0	341.5	-58.5	-1.0	-664.7	14.6%
2026	32,669	367.0	36.2	3.3	4.3	410.9	358.2	-52.6	-1.0	-718.3	14.3%
2027	33,308	375.8	37.1	3.7	4.5	421.1	375.8	-45.3	-1.0	-764.6	14.0%
2028	33,967	385.1	38.0	3.6	4.6	431.3	394.2	-37.1	-1.0	-802.8	13.7%
2029	34,572	394.0	38.9	3.8	4.7	441.4	413.5	-27.9	-1.0	-831.6	13.3%
2030	35,222	403.6	39.8	3.9	4.9	452.2	433.8	-18.5	-1.0	-851.1	13.0%

Source: SVB

- 1) Assumption: a 1 percent annual increase in the nominal AOV benefits.
- 2) In principle, premium contributions are presumed to grow in line with the nominal GDP.

6.2 Further reform measures to contain future government transfers to the AOV fund

Considering the deficits of the AOV and the upcoming depletion of the AOV reserves, the GOA would have to contribute to the SVB to cover the AOV deficits from 2014 onwards. Taking into account the ageing of the population, the expectation is that the AOV deficit will steepen in the coming years, becoming a significant financial burden to the GOA. Therefore, the GOA should consider further reforming the AOV by taking the following measures:

1. Increase the effectiveness of the collection of the AOV premiums and the compliance of employers by giving the SVB the responsibility for the control/audit of the premium revenues. Normally, tax agencies are required to manage with a limited budget and as a result are never able to tackle all risks in the system at one time. If the SVB were to set up a taxpayer compliance program for the AOV system, it could identify the most severe risks in the system and then determine the most rational allocation of resources to these risks. Furthermore, the program would provide a transparent and defensible record of how plans have been created (Russell, 2010). Currently, the SVB does not have proper insight into the collection of AOV premium contributions by the Tax Department. However, by placing the responsibility for the control of premium contributions at the SVB, which has the principal interest in these revenues, more concentration could be focused on ensuring that employers are paying the correct amount of premiums, or identifying any employers that are withholding these premiums. The proposed measure would help to raise revenue, help mitigate the negative effects of the dwindling AOV reserves, and contain contributions by the GOA.
2. Raise the pension age to 65 years as of January 2014 and link the pension age to the dynamics in the life expectancy of the population. Increasing the eligibility age would help to provide higher employment levels and economic growth, and raise the overall level of worker contributions to the system. Second, increasing the pension age might be easier for the public to understand in light of increasing life expectancies. Linking pension age to the average life expectancy beyond the age of 65 is currently being proposed in the Dutch pension system (Broeders & Ponds, 2012). One objection often

raised is that increasing the pension age could lead to a rise in unemployment in the long-run by crowding out the young by elderly employment. However, little evidence exists that increased labor force participation of the elderly would increase the aggregate unemployment rate in the long run (Cotarelli, 2011). Furthermore, in light of the AOV situation, the benefits gained by raising the retirement age would outweigh the possible drawbacks. However, it is important to note that increases in pension age should be accompanied by measures that protect the incomes of those people who cannot continue to work to avoid an increase in poverty rates.

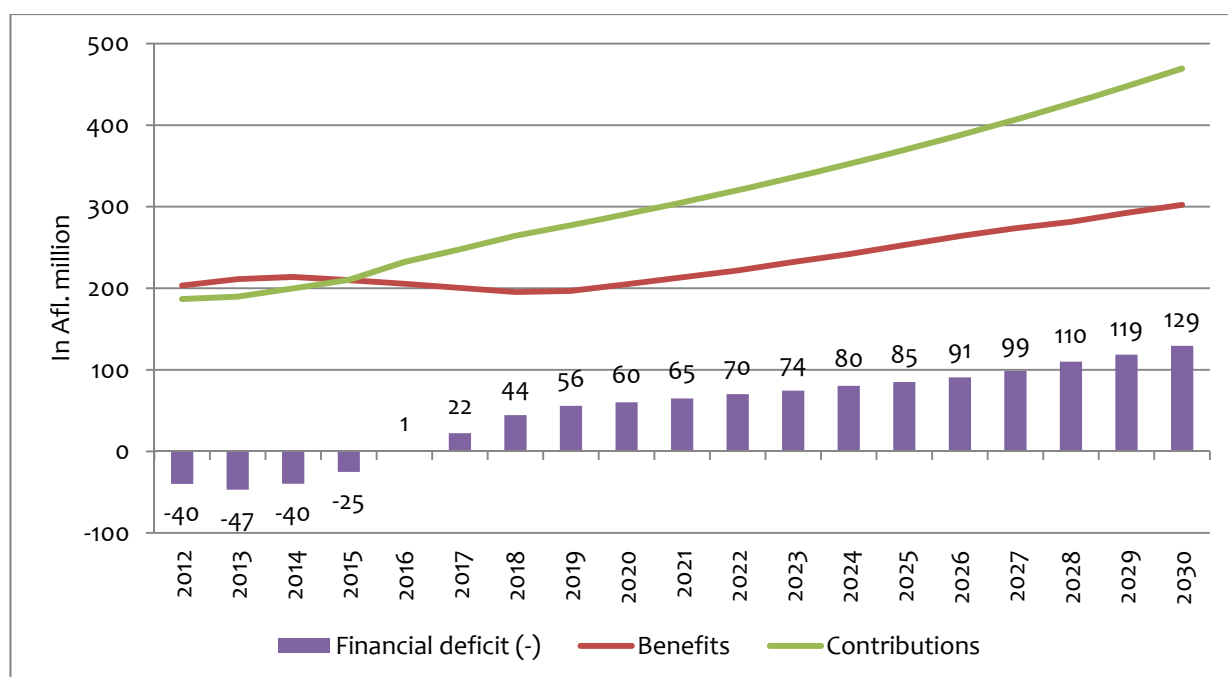
3. Individualize the AOV benefit payments as of January 2014. This measure would reduce the costs associated with paying out a higher benefit to a person that has reached the pension age on the basis of their marital status.
4. Increase the wage cap and the AOV employees' premium as an alternative only if the previous recommendations are not sufficient to cover the AOV deficits. This measure should be used only as a last resort action because in countries where the tax wedge – income and payroll taxes as a share of labor earnings – is already high, contribution hikes could have adverse labor market effects (Cotarelli, 2011). This would be especially true in light of the GOA's aim to increase the specialization level in the labor market and to create a "Green Gateway" that involves the recruitment of high skilled labor. Apart from these negative impacts, the measure also places a disproportionately high burden of funding on the persons already paying their fair share.

Chart 6.2 shows a scenario that takes into account the proposed increase in pension age to 65 years and the individualization of the pension benefits,¹⁸ illustrating that these measures would be sufficient to eliminate the AOV financial shortfall in the long-term. However, other measures are necessary in the short and medium-term to reduce the expected AOV financial deficit. Therefore, the GOA should consider focusing immediately on increasing

¹⁸ See Annex 1 for the real and nominal GDP growth rates in the period 2013-2016. From 2017 on, real GDP and nominal GDP are assumed to grow by 1.9 percent and 4.9 percent, respectively. Moreover, the AOV benefits are assumed to increase by 1 percent on a yearly basis.

the effectiveness of the collection of the AOV premiums and the compliance of employers. If necessary, the AOV premium could be increased temporarily to cover the expected shortfalls in 2014 and 2016.

Chart 6.2: Financial operations of the AOV fund in a scenario with the pension age of 65 years and individualization of the AOV benefits as of January 2014¹⁾



Source: SVB.

1) This scenario was calculated by the SVB at the request of the CBA and takes into account the CBA assumptions with regard to GDP and inflation.

6.3 Further reforms in the Civil Servants' Pension Fund (APFA)

In January 2005, the State Ordinance on the Privatization of the Civil Servants Pension Fund (AB 2005, No. 2) was enacted. This Ordinance became effective on May 1, 2005. As part of the privatization process, the APFA was converted into a foundation on April 29, 2005. Also, the new pension scheme (the so-called NPR 2005 pension scheme) based on average income was introduced for all new participants in May 2005, while existing participants remained in the 'Pensioenverordening Landsdienaren' PVL pension scheme.

Due largely to the significant losses incurred in 2008 and 2009 on its portfolio investments abroad, resulting from the turbulences on the international financial markets, the APFA has recorded a significant negative equity position. In August 2010, the GOA entered into a series of social dialogues with relevant stakeholders to discuss, among other things, the required reforms to what is called the PVL pension scheme to restore its financial viability. After reaching a consensus, the PVL pension scheme was abolished and effective January 2011, the participants in the PVL pension scheme were transferred to a more sober pension scheme (the so-called ‘Nieuw Pensioen Regeling’ (NPR) 2011 pension scheme). The main changes in the NPR compared to the PVL pension scheme are the increase of the retirement age to 60 years as of January 2011. An AOV component (or AOV franchise) amounting to Afl. 14,059 was introduced. In addition, the new pension system is based on average salary. These changes have led to lower annual pension premium obligations vis-à-vis the APFA. Furthermore, participants in the NPR 2005 pension scheme, with no relationship to the PVL pension scheme, were allowed to remain in the NPR 2005 pension scheme and were not transferred to the NPR 2011 pension scheme. Consequently, although most participants in the NPR 2005 pension scheme were transferred to the NPR 2011 pension scheme, the NPR 2005 pension remains active.

As of January 2011, the APFA, which manages both the NPR 2011 and NPR 2005 pension schemes, fell under the supervision of the CBA. Prior to this date, the APFA was under the supervision of the Minister of Finance. In view of its significant negative equity position, the APFA had to submit a recovery plan to the CBA delineating how the shortfall would be addressed within the agreed-upon timeframe. On July 20, 2012, this proposed recovery plan was approved by the CBA.

Significant actions already have been taken to restructure the current pension scheme. To further lower the current burden on the government budget and to contain possible risks for higher costs in the future, the current pension scheme could be further restructured by raising the retirement age to 65 years, consistent with the proposed increase in the pension age of the AOV. Another action would be to increase the AOV

franchise to the maximum allowable AOV franchise according to the ‘Landsverordening Inkomstenbelasting (AB 1991, no. GT51)’, which at the moment amounts to Afl. 17,616.

6.4 Concluding remarks

In view of the fiscal consolidation necessary for the government to achieve a balanced budget and the role of the government financial profile in its ratings outlook, and hence its ability to obtain financing, pension reform plays a critical role. The efforts already made have been commendable and necessary. However, further measures are needed in the short term. The government must address these issues as promptly as possible and continue finding solutions in its social dialogue meetings.

7 PUBLIC-PRIVATE PARTNERSHIPS: THE SUSTAINABLE WAY FORWARD

The ongoing need for infrastructural development in countries with economic constraints has popularized the use of public-private partnerships (PPPs) globally. PPPs, by definition, are long-term “arrangements where the private sector supplies infrastructure assets and infrastructure-based services that traditionally have been provided by the government” (Hemming, 2006). These privately executed and financed public investment projects permit governments to transfer financing needs and certain risks to the private sector. The private party, the legal owner of the infrastructure, is the holder of the assets and liabilities, and the government agrees to make long-term lease payments for the project, which customarily reflects “a combined charge amortizing capital financing and operating and maintenance costs” (Posner, Ryu, & Tkachenko, 2009).

PPPs are used in both developing and developed countries “as a way of getting investment financed without immediately increasing reported spending and debt” (Funke, Urwin, & Rial, 2013). Consequently, PPPs in numerous countries have been statistically treated as contingent liabilities, and thus, do not form part of the government’s balance sheet. In most cases, PPP contracts are commissioned for periods of 20 years or longer, wherein the contractual terms could be renegotiated based on certain economic conditions. “In Hungary, for instance, PPPs for motorways are contracted for 20-35 years and airports for 75 years” (Posner et al., 2009). The result is that PPPs have a long-term budget encumbering element that must be considered before execution. While this method of public procurement is particularly attractive to “solve the problem of public sector budget restraint” (Ismail, 2013), the costs associated with PPPs should be carefully monitored. In this context, the IMF (2013) notes in its Article IV Staff Report that the expected rise in PPP-related payment commitments in Aruba associated with the additional projects in the pipeline is a risk to the sustainability of the public finances.

This chapter seeks to provide an overview of PPPs in Aruba that have already been executed or are otherwise in the pipeline to be implemented (in section 7.1). Section 7.2

proposes a limit on PPP long-term commitments, while section 7.3 discusses others requirements for the PPP projects in the pipeline.

7.1 PPPs in Aruba

The PPP method of public procurement was first used in the construction of two buildings for the Ministry of Justice—a police station and a justice center. Under this agreement, the legal owner, Albo Real Estate Holding N.V. (Albo), financed and constructed these buildings on behalf of the GOA in return for monthly payments under a so-called operational lease of 25 years. Consistent with guidelines presented in the “Government Finance Statistics Manual 2001” of the IMF, “System of National Accounts 2003” of the United Nations, “Balance of Payments Manual, fifth edition, 1993” of the IMF and an IMF-paper “Public Private Partnerships” of March 12, 2004, the CBA assessed the terms of the lease agreement and determined that the GOA is the economic owner of these buildings throughout the contract period, and thus statistically treated it as a financial lease. Consequently, as of September 2005, the construction and financing costs (Afl. 16.2 million) for these buildings were considered as government debt.

Also, in 2005, a special purpose vehicle was incorporated by the APFA and the AIB Bank N.V. called SOGA (i.e., Stichting Onroerend Goed Aruba) to develop, maintain, and manage investment projects for the GOA. In light of this development, three buildings were constructed to lease to the government for a period of 25 years. The terms of this lease agreement emulate those of a traditional Build-Operate-Transfer project, in which the long-lease land (including buildings) is transferred back to the government at the conclusion of the lease period. The BelFin, the INFRA, and the L.G. Smith boulevard buildings currently house the operations of the Tax and Finance departments, the Department of Public Works, and the Aruba Tourism Authority, respectively. Lease payments for these facilities presently amount to about Afl. 6.6 million annually.

The current government has placed a strong emphasis on infrastructure projects and intends to continue investing in these via PPPs. Projects that have been promulgated include the following: (i) renovation and expansion of the Dr. Horacio Oduber Hospital

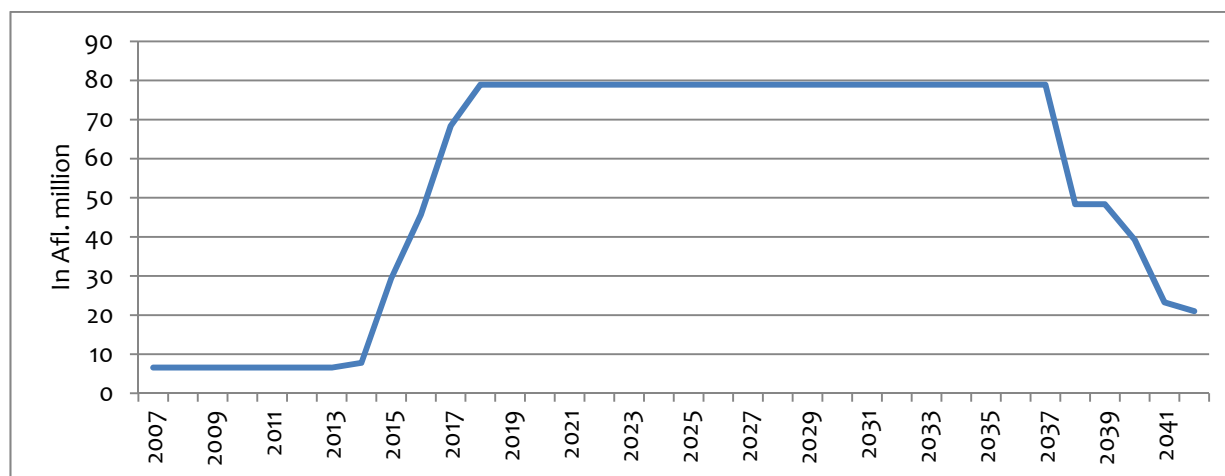
facilities (in progress); (ii) Multifunctional Accommodation Centers (5 units) (approved by Parliament); (iii) J.F.Kennedy Education Center; (iv) J.F.Kennedy Community Auditorium; (v) Ex-DOW building; (vi) New MAVO/HAVO/VWO in Noord; (vii) Green Corridor; and (viii) Ring Road 3.

Table 7.1: Overview of the PPP-projects (ongoing and in the pipeline)

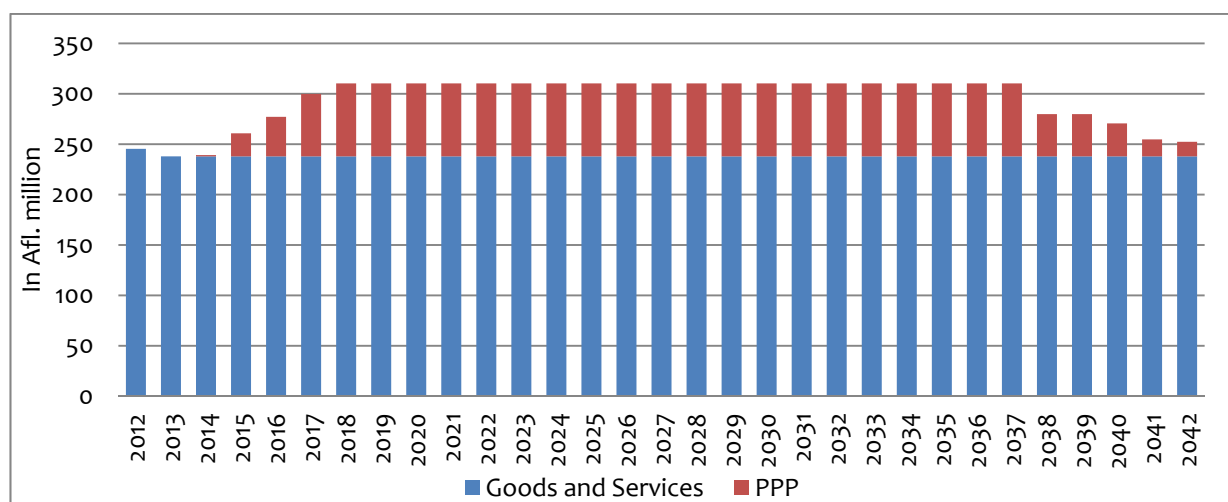
	Payment Period (2017 onwards)	Investment amount (in Afl. million)	Estimated annual payment (in Afl. million)
Hospital	29	253.2	24.0
Green Corridor	25	90.3	16.0
Ring Road 3	25	110.1	21.0
Multifunctional Accommodation Centers (MFA)	25	22.8	2.2
JFK education dept.	25	34.3	3.4
JFK community auditorium	25	13.0	1.3
New MAVO/HAVO/VWO	25	22.0	2.2
Ex-DOW building	25	23.0	2.3
Total		568.7	72.4

Source: GOA; CBA staff estimates.

Chart 7.1: Annual PPP payment obligations



Source: CBA staff estimates.

Chart 7.2 Expenditures on goods and services, including PPP-related payments¹⁾

Source: CBA staff estimates.

- 1) Expenditures on goods and services (excluding PPP-related payments) are assumed to remain unchanged from 2013 onwards.

Should the same terms and conditions described in the previous PPP agreements persist in future projects, the estimated annual payment commitments to PPPs are set to rise to about Afl. 80 million as early as 2018 (see Charts 7.1 and 7.2 and Table 7.1). Consistent with this estimate, the IMF believes that “the annual fiscal costs from PPP projects that have been signed or under discussion may amount up to another 1 percent of GDP starting in 2016” (IMF, 2013).

7.2 PPP budget ceiling

Financing public investment projects through PPPs conduces to a situation in which a government binds future government budgets via a single budget approval during any given year. The current budgetary rules do not properly address long-term payment commitments such as PPPs and expose governments to fiscal uncertainties in the future. While no specific rules of thumb exist for establishing fiscal rules for payment commitments arising from PPPs, “a ceiling on the size of the PPP program helps limit the government’s exposure to fiscal risks and prevent circumvention of the flow ceiling by

pushing payments further into the future at a higher fiscal cost” (Funke *et al.*, 2013). In addition, “the size of the PPP program should be measured using an unambiguous measure that captures fiscal costs and risks as far as possible” (Funke *et al.*, 2013). These guiding principles place priority on the affordability of PPPs and alert policymakers to potential fiscal consequences.

To limit the fiscal risks associated with PPPs, many countries have introduced an annual spending limit for payment commitments arising from PPPs. In Brazil, for instance, “a ceiling on current spending from PPP contracts of 3 percent of net current revenues applies to all levels of government” (Funke *et al.*, 2013). Hungary is another country where “in a given budget year, the nominal value of new long-term commitments cannot exceed 3 percent of total state budget revenues” (Funke *et al.*, 2013). Less conservative measures have been used in countries like Peru and El Salvador, where the spending limits may reach up to 5 and 7 percent of GDP, respectively. PPP spending limits have also been implemented in South Korea and the United Kingdom, where only specific levels of expenditure can be dedicated to PPP payments. However, this measure is less restrictive and would lead to possible loopholes whereby the government could raise total expenditure to further accommodate payment commitments arising from PPPs in the future.

Considering that Aruba’s government financial operations are already highly committed with other fixed payment obligations, such as “personnel appointments to the civil service and lease and rental agreements” (National Commission on Public Finance, 2007), the GOA should consider introducing a limit on the annual payment commitments of 3.5 percent of a moving average of total government tax revenues (excluding one-off receipts). Based on the past five years (2008-2012), this formula would amount to a limit of Afl. 32.8 million annually.

7.3 Other requirements with regard to PPPs

To date, only government-funded PPPs have been conducted in Aruba. These PPPs rely completely on the government's financial operations for funding. In general, governments must be keener to opportunities that would lower costs. In this context, it is advisable to use more user-funded PPPs that would shift some or all of the costs to users, such as including commercial rental space in buildings intended for public services or charging fees for the use of certain public spaces. "In developing countries, user-funded PPPs are sometimes used for projects that are very large in relation to the government's limited resources" (Funke et al., 2013). Posner et al., (2009) note that "PPPs are better suited to economic infrastructure than social infrastructure due to the greater return of sound economic projects for business and the higher potential to charge users for services." Therefore, governments should pursue projects that will feasibly produce revenues to replace or supplement their payment obligations. User-funded PPPs are currently present in numerous countries. In the case of Aruba, the GOA should contemplate using more user-funded PPPs.

Moreover, taking into account the downward trend in the net foreign assets as projected by the CBA,¹⁹ it is crucial that the PPP projects in the pipeline be financed largely abroad, preferably via foreign direct investment. Investment projects are generally import-intensive due to the openness of the Aruban economy. If these PPP projects were financed entirely in Aruba, the related imports would cause an immediate further decline in the net foreign assets than now projected. Foreign financing for these projects would mitigate the negative effect of the imports on the international reserves. This measure would strengthen Aruba's foreign exchange position in the short run. However, in the medium- and long-term, foreign financing could lead to an outflow of foreign funds in the form of dividends, repatriation of equity, or debt service payments. Therefore, foreign funding of PPPs would buy some time for Aruba to solve the country's structural problems, which are causing a decline in our international reserves.

¹⁹ See Annex 1.

7.4 Concluding remarks

PPPs have proven an appealing method for public procurement. However, proper attention must be placed on the affordability of such projects. The GOA could prevent the accumulation of unsustainable long-term payment commitments to PPPs by adopting budget-limiting measures that are currently practiced around the world. Moreover, careful consideration should be placed on generating revenue inflows from PPPs that would lighten or remove the fiscal burden arising from annual obligations to PPPs. Finally, it is recommended to finance PPP projects largely externally to strengthen Aruba's foreign exchange position in the short run.

PART IV OTHER REFORMS

8 DECENTRALIZING GOVERNMENT FUNCTIONS

Evidence from other countries shows that one of the first steps of a fiscal consolidation strategy is to assess the desired size and scope of government and the role of the government in providing goods and services. One reason for government intervention is the existence of market failures or externalities in the provision of goods and services. However, government involvement is often based on the aspiration to accomplish social objectives. Therefore, how much government is ‘too much’ or ‘too little’ is not just a question of economics. This chapter begins with an overview of government functions in section 8.1. Section 8.2 discusses possible government departments that could be decentralized. Section 8.3 elaborates on the role of foundations subsidized by the GOA.

8.1 Government functions and the move towards privatization

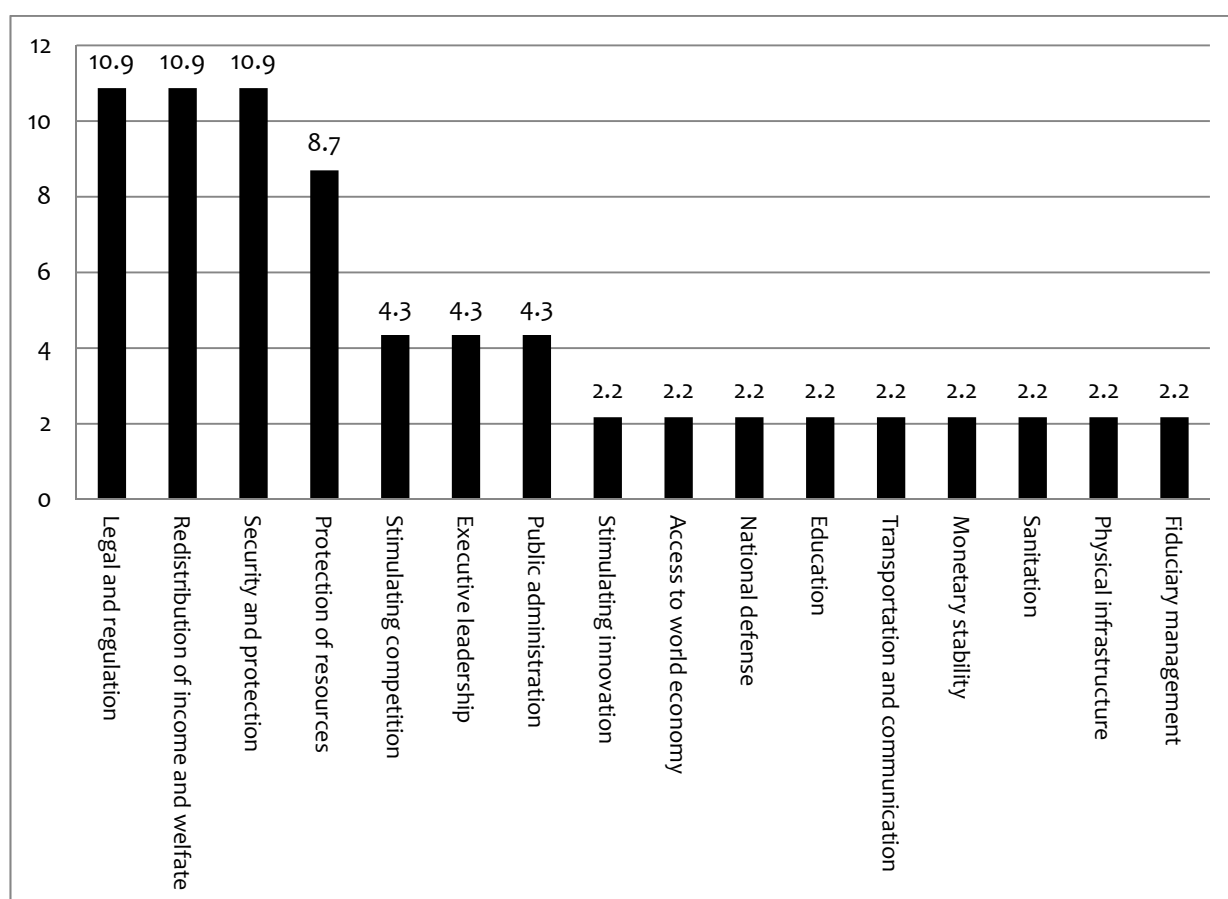
Governments are important protagonists in the daily economic life of a country. The literature suggests several important functions for the government. Table 8.1 gives an overview of the main government functions put forward by several authors. For example, McConnel and Brue distinguish between (i) providing regulation and a social environment conducive to effective functioning of the market; (ii) stimulating competition; (iii) redistributing income and wealth; (iv) adjusting the allocation of resources in order to modify the composition of the national output; and (v) stabilizing the economy by, among other things, reducing unemployment and promoting economic growth. The data suggest that the principal functions of the government are legal and regulation, redistribution of income and welfare, security and protection, and protection of resources. Chart 8.1 provides an indication of the relative importance of several government functions according to the literature. The most relevant functions according to the literature are ‘legal and regulation’, ‘redistribution of income and welfare’, ‘security and protection’, and ‘protection of resources’. The limited number of functions in the international context probably has to do with inabilities of governments to adequately provide all kinds of services.

Table 8.1: Primary functions of the government (based on the literature)

Author	Primary functions
McConnel and Brue (1990)	(1) provide legal foundation and a social environment conducive to the effective operation of the market system; (2) stimulating competition; (3) redistributing income and wealth; (4) adjusting the allocation of resources to alter the composition of national output; (5) stabilizing the economy.
Koopmans et al. (1995)	(1) influencing allocation of resources; (2) realizing reasonable income distribution; (3) stabilizing macroeconomic development.
Gwartner et al. (1998)	(1) public order and safety; (2) national defense; (3) education; (4) transportation and communication; (5) operation of a central banking system (monetary stability); (6) sanitation; (7) environmental protection; (8) legal and physical operation of a market economy; (9) limited set of public goods that can provide a framework conducive for economic growth; (10) physical infrastructure.
Schram et al. (2000)	(1) stabilizing macroeconomic development; (2) redistributing of income and wealth; (3) allocating goods and services.
Tabellini (2005)	(1) provide a stable macroeconomic environment; (2) generalized access to the world economy; (3) protection of individual property rights; (4) spending in public goods that provide benefit to all people.
United Nations (2007)	(1) poverty reduction (social justice)/protecting society's vulnerable groups; (2) maintenance of law and order; (3) setting societal standards and goals; (4) safeguarding the environment.
World Bank and Independent Evaluation Group (2007)	(1) budget decision/allocation of resources; (2) management; (3) national planning; (4) development of policies and programs.
PriceWaterhouseCoopers (2010)	(1) stimulating innovation
Kauffman (2010)	(1) provide security and protect public order; (2) administer justice and fairness; (3) provide essential services and infrastructure; (4) provide for the public welfare; (5) provide an environment conducive to economic prosperity; (6) protect the commons (e.g., natural resources (like air and water), cultural resources (like monuments and documents) and intangible resources (like electronic spectrum for wireless communication).
UNDP (2010)	(1) executive leadership; (2) security; (3) rule of law/law enforcement; (4) fiduciary management; (5) public administration; (6) natural resources.

Source: CBA.

Chart 8.1: Primary functions of the government in the literature (in percent of total)



Source: CBA staff estimates.

Governments are not always effective and efficient in complying with their functions, what is generally known as government failure (Howard, 2001). According to Krueger (1990), government failures in the 1970s and 1980s were particularly influenced by: (1) exceptionally high-cost public sector exercises engaged in a variety of manufacturing and other economic activities not traditionally related to the public sector; (2) highly inefficient and wasteful government investment programs; (3) pervasive and costly government controls over private sector activities; (5) public sector deficits fuelled by public sector enterprise deficits, excessive investment programs and other government expenditures leading to high rates of inflation, with consequences for resource allocation, saving behavior, and the allocation of private investment. The result of this government failure was a move towards a market-oriented strategy, what is also known as the structural

adjustment process, which includes, among other things, the sale of state enterprises to the private sector to improve the market mechanism by increasing overall productive and allocative efficiency and stimulating economic growth (Howard, 2001). The privatization process has been happening on a worldwide scale for more than two decades in a variety of forms “ranging from outright sale of government’s entire stake, to partial sale, to concessions, leases, and management contracts, to the hiving off and sale of non-core business activities, to the opening of previously restricted sectors to new private entrants and competitors” (Nellis, 2007: 3-4).

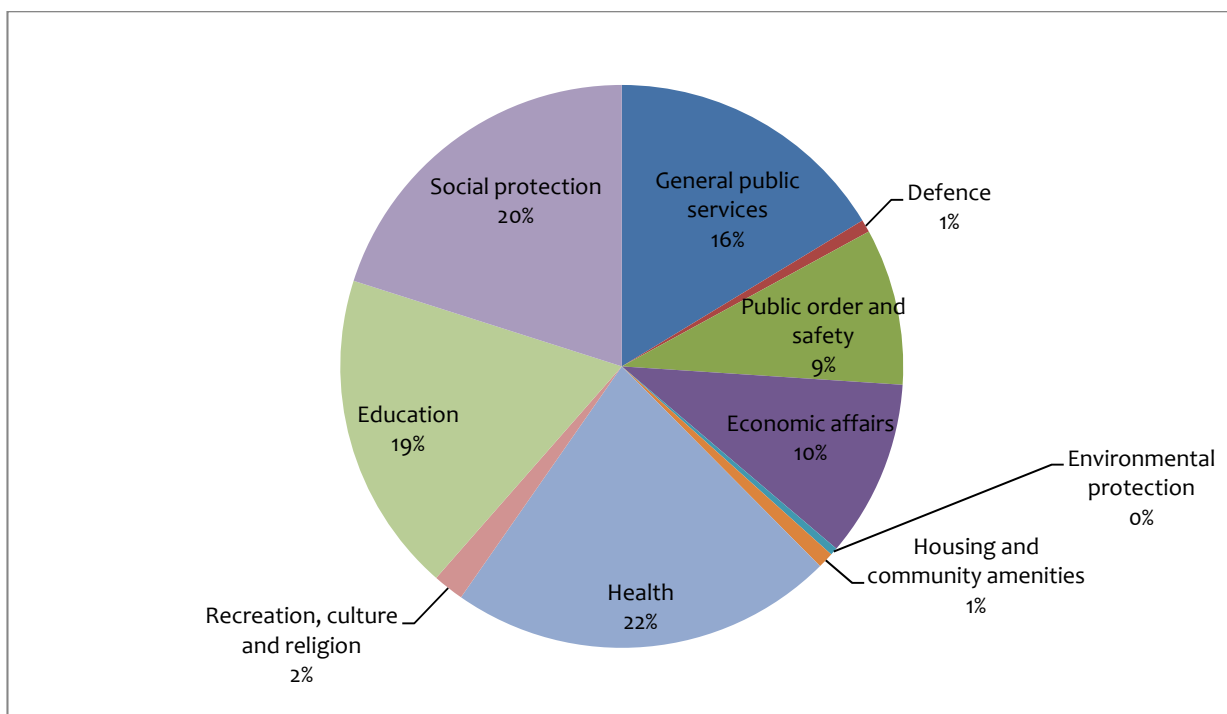
8.2 The case of Aruba

The small scale of island economies may hinder the reduction of government functions through the application of privatization strategies to lower the financial costs associated with these tasks. In the case of Aruba, the optimal number of functions of the government cannot be limited to the four core government activities presented above given the small scale characteristics of the island and the wish to guarantee all members of the community a minimum accessibility to certain services (see Chart 8.2 for the current government functions in Aruba). The small scale of the economy prevents a number of services from being carried out independently from the government at a reasonable cost. Demand is too small to enable adequate funding for these activities. As a result, the government still has to provide funding for the proper execution of these services. For example, if the government wishes to ensure everyone accessibility to education, this activity cannot be privatized. Privatization would limit the access to education for certain groups within the community based on economic background. The generated financial benefit to the government of privatization of education would be overshadowed by the undesirable result of increased educational inequality among groups in the community. Strategies other than privatization may be required in these cases to reduce the cost of government financial involvement in these departments.

A possible strategy in this context is to decentralize as many functions as possible from the central government to the public sector, i.e., by creating semi-autonomous institutions

that are financially self-supporting. One possible governance regime that could be applied is the ‘sui generis’ model. This strategy may help reduce personnel-related expenditures of the government, but also other expenses of non-core activities.

Chart 8.2: General government expenditure by function in 2010¹⁾



Source: CBS Aruba.

1) The general government comprises the GOA, DOW, SVB, AZV, FDA, ARA, State Council, Parliament and the private non-profit institutions with salary subsidy from the government.

A second possible strategy entails increasing the efficiency of the department by charging a more market-oriented fee for the services the department provides. A third strategy involves scaling down (partial privatization) the activities of the department so that these are more closely related to the core functions of government.

Based on the core government functions put forward in the literature, the small scale of the island and the wish to guarantee a minimum standard of living, as well as the cost of operation of the services, a number of current government departments were selected, where the financial involvement of the government possibly could be reduced. Table 8.2

provides an overview of the selected departments and the different strategies proposed for each department.

Table 8.2: Recommended strategies on selected government departments

Departments to be privatized or reorganized	Current cost in Afl.	Current revenue (middelen) in Afl.	Net cost to Land Aruba	Employees	Recommended strategy		
					Decentralize	More market- oriented	Leaner/ more efficient
Dienst Technische Inspectie	8,378,400	1,396,900	6,981,500	41		x	x
- monitoring the electrical concession						x	x
- monitoring the electrical inspection						x	
- providing calibration and steam engineering services (ijk- en stoomwezendiensten)						x	
- providing safety inspections						x	
- performing vehicle inspections					x	x	x
- providing technical measurements						x	
- involved in chemical and radioactive substances						x	
Centrale Accountants Dienst	1,584,600	0	1,584,600	8	x		
- internal accountant function							x
- auditing the annual accounts of the government and providing them with an audit					x		
- auditing of state-owned enterprises					x	x	
Dienst Openbare Werken	44,337,700	0	44,337,700	202			
- design and planning and award of master architectural and civil engineering projects of the government							
- management and monitoring the implementation of designed and planned projects							
- general advising and the preparation and implementation of policies related to the area of responsibility of the public works							
- management of infrastructure and traffic, waste water treatment, landscape, architectural works and administration and equipment							
Directie Informatievoorziening en Automatisering (DIA)	3,277,900	4,321,200	-1,043,300	20	x		
- exploitation of information and communication infrastructure as used within the Aruban government							
- engaged in the daily management of the in-service networks and computer							
- involved in a large number of government projects that are to a greater or lesser extent with ICT					x		
Laboratory	13,062,900	17,400,000	-4,337,100	69		x	
- Clinical Chemistry & Hematology						x	
- The Microbiology & Infection Serology						x	
- The Pathology department						x	
Enseñansa pa Empleo	1,955,600	607,000	1,348,600	18		x	x
- Retraining and further training						x	x
High Commissioner	572,600	360,000	212,600	4			x

Sources: www.overheid.aw; budgets of the government 2013.

Please note that more than one strategy is possible for each department. The table contains both the costs and income generated by the departments (based on the approved 2013 budget). Of particular importance are the net costs of these departments, as these are the costs that the government will have to finance. Some departments like the laboratory are a net provider of revenues to the government, but most departments involve expenditures for the government, the largest being the department of public works.

The departments selected for decentralization have in common that all provide services that already are being provided by the private sector in other countries. The third strategy of making departments leaner or more efficient is about decentralizing part or parts of the activities of the department, or grouping the department together with another department to make it more efficient. The implementation of this strategy requires identifying what the core activities of a department should be. One possible criterion could be whether an activity could relatively easily be provided by a private party. For example, Education for Employment should consider which courses are really essential and which are not. The nonessential courses should be left to the market. Another example is the periodic examination of car conditions by the Department of Technical Inspection. This activity could easily be done by local car dealers. The benefit would not only be for the government, but also the consumer would be expected to experience increased convenience through decentralizing the location of these examinations. Other government departments that could possibly be moved outside the scope of the central government are the Department of Public Works, Department of Civil Aviation ('Directie Luchtvaart'), Department of Shipping ('Directie Scheepvaart'), and the Laboratory. The Serlimar (Aruban waste management company), which already has a 'sui generis' status, should be further moved from the scope of the central government by eliminating the subsidy paid by the government to the Serlimar. The preceding discussion suggests that room still exists for reforming certain government activities.

8.3 Capping the financial involvement of the GOA in foundations in Aruba

Currently, the GOA subsidizes several foundations in Aruba for a total budgeted amount of Afl. 204.0 million in 2013. Of this total, Afl. 134.9 million goes for education, Afl. 45.9 million for the social sector, and Afl. 13.6 million for health care and sports. The GOA should review its policy with regard to these foundations when reducing its core functions. In particular, subsidies to foundations providing long-term care (e.g., to the elderly) could be reduced in the future if the introduction of a long-term care insurance is feasible for Aruba. In Germany, this type of insurance is compulsory (see Box 4). Long-term care is provided

when an individual cannot perform basic activities of daily living (such as dressing, bathing, eating, toileting, continence, transferring (getting in and out of a bed or chair), and walking). Long-term care insurance may cover home care, assisted living, adult daycare, respite care, hospice care, nursing home and Alzheimer's facilities. For instance, SABA received a total of Afl. 15.8 million in subsidies for personnel expenses and Afl. 2.3 million for operational expenses (SABA, 2011). Of course, in-depth research, along with advice of insurance experts is needed to explore the possibility of introducing such an insurance scheme in Aruba. If this insurance is possible this measure would help contain the future long-term care expenses, especially in light of the ageing of the population.

Box 4: Long-term Care insurance in Germany as described by Riedel (2003)

Compulsory long-term care insurance was established in 1995 in Germany. Private insurers undertook to implement compulsory long-term care insurance for the part of the population that had a supplementary private health insurance. The other part of the population was covered by the statutory (social) health insurance. Both cash and noncash benefits are included under the social long-term care insurance scheme and a reimbursement of costs under the private scheme. The calculation of the premiums are the same as in the system for private health insurance, i.e., based on the principle of equivalence and the formation of an ageing reserve in order to safeguard future claims. This means the sum of all future benefits must be equal to the sum of future premiums. For a more comprehensive look at long-term care insurance in Germany, please review Riedel (2003).

In the meantime, the policy regarding subsidies to foundations should be strictly enforced. The GOA should make sufficient resources available to ensure the compliance of the foundations receiving subsidies. Given that legislation is already in place, it is not really necessary to add more. More important, the government may be able to increase efficiency in the work done by these foundations by stimulating more cooperation between the different foundations. Several foundations that receive subsidies are working in similar or overlapping areas. Many of these foundations are renting separate offices. It does not seem necessary for all these foundations to be housed in separate buildings. For these cases, the government could play a useful coordinating role. Allocating foundations with similar work areas to the same building would help save on rent. In addition, efficiency

could be improved if certain common tasks currently being performed by each foundation individually (e.g. administration) could be brought under one roof. In this way, the costs of the foundations could go down, while the activities might be carried out more effectively.

8.4 Concluding remarks

The ideas put forward here are suggestions only. Further research is needed to work out the feasibility and details of implementing the suggested strategies for these departments. One of the issues to be dealt with is the human aspect. As Table 8.2 shows, the suggestions involve people's jobs in these departments. The GOA should involve all stakeholders, including the employees, in both the preparatory stage and the execution phase to gain the necessary support for the reform.

9 FISCAL RULES TO PROMOTE FISCAL RESPONSIBILITY

In April 2013, the ‘Advisory Committee Balanced Budget for Aruba’ presented its report in which it recommended adopting a combination of fiscal rules starting with a balanced budget rule in the Constitution and to set up an independent body (i.e., a fiscal council) by an act of Parliament to monitor these rules (Mehran et al., 2013). These recommendations are consistent with the advice the ‘National Commission on Public Finances’ (NCPF) published in its report “Sound Public Finance and Public Accountability in Aruba” in 2007. Furthermore, in 2010, Parliament approved a motion stating that the GOA would commit to a financial framework for the time period 2011-2014 (see Table 9.1). This motion further urged the GOA to introduce fiscal rules similar to the ones in place for the Dutch government to guarantee sustainability of public finance. The motion, which urged the GOA to present the budget rules to Parliament within three months, was ultimately not adopted as adverse economic conditions swayed the government to pursue an expansionary fiscal policy.

Table 9.1: Financial framework approved by Parliament in 2010

	2011	2012	2013	2014
Financial deficit (in Afl. million)	325	250	175	100

Source: Parliament of Aruba, motioned carried on the 24th of May 2010.

This chapter argues that many of the above mentioned recommendations are valid and that the current state of public finances warrants measures to increase discipline by strengthening fiscal frameworks. More specifically, these measures include prudent fiscal balances, a sustainable debt level, the avoidance of excessive borrowing and cushions to respond to shocks. Section 9.1 discusses briefly the introduction of a fiscal council for Aruba. Section 9.2 elaborates on a number of recommendation with regard to the introduction of numerical rules.

9.1 A fiscal council for Aruba

Internationally, fiscal councils are granted a wide range of specific mandates. These include the provision of normative fiscal policy assessment and advice, independent macroeconomic and fiscal projections, and objective policy analysis. They increase the transparency of fiscal policy, thereby raising the reputational cost of misuse of discretion.

In the case of Aruba, an independent body charged with monitoring compliance with the fiscal rules could help strengthen Aruba's public financial management. This could be done by introducing an independent fiscal council analog to the ones in place in a number of countries,²⁰ or by incorporating the task of monitoring compliance as an additional responsibility of the State Council. 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 the NCPF report and the Report of the Advisory Committee on Balanced Budget Rule for Aruba 2013, it is 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.

9.2 Well-designed numerical rules

Numerical fiscal rules have become increasingly common internationally,²¹ and their use has intensified following the financial crisis. High levels of public debt or adverse debt dynamics have been shown detrimental to economic growth not only due to financing risk, but also they can crowd out private investment through reduced availability or increased cost of financing. In the specific case of the Caribbean region, a recent empirical study by Greenidge et al. (2012) concludes that public debt beyond the 55 percent of GDP threshold becomes a drag on growth.

Table 9.2 displays the expected government debt-to-GDP ratio when taking into account the GOA's financial deficit targets and its aim to reach a balanced budget in 2016.

²⁰ See Annex 5.

²¹ <http://www.imf.org/external/datamapper/FiscalRules/map/map.htm>

This scenario shows that the desirable debt to GDP ratio of 55 percent will not be achieved until 2021, even after achieving a balanced budget in 2016 and maintaining this in the medium term. It is important for the GOA to focus on reducing the debt to prudent levels to be able to conduct countercyclical policy should an economic downturn occur. Therefore, any windfalls must be utilized to reduce the debt level to ensure the sustainability of the debt to GDP ratio in the medium term. Also given the previously mentioned estimated future financial burden of PPP commitments and the subsequent impact of that burden on the GOA's financial position, it would be advisable to restrict the GOA's commitment to this type of financial construction.

Table 9.2: GOA's financial position ¹⁾

	2014	2015	2016	2017	2018	2019	2020	2021
Debt/GDP (%)	73.4	72.1	70.3	67.0	63.9	60.9	58.1	55.4
Financial Deficit/Surplus (in Afl. million)	-171	-52	-17	0	0	0	0	0

Source: CBA staff estimates.

1) According to CBA simulations, following the GOA fiscal consolidation plan to achieve a balanced budget as indicated to Fitch Ratings in June 2013.

In view of the above, the GOA should consider introducing the following numerical rules:

1. A balanced budget from 2016 onwards;
2. The use of windfalls only to reduce government debt and not to increase expenditures;
3. A limit on the government debt to GDP ratio of 55 percent, starting in 2021, by following the path outlined in Table 9.2; and
4. A limit on the annual payment commitment related to PPP-projects of 3.5 percent of a 5-year moving average of total government tax revenues (excluding one-off revenues).

To ensure appropriate coverage, going forward, 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. To

prevent fiscal indiscipline, the fiscal laws should include procedural protocols to hold delinquent civil servants accountable for noncompliance. 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.

9.3 Concluding remarks

Evidence suggests that about a quarter of successful major debt reduction episodes achieved through fiscal consolidation were preceded or accompanied by the introduction of fiscal rules and that consolidation efforts were more successful with expenditure-based rules (Amo-Yartey et al., 2012). For effective implementation of the proposed fiscal rules, genuine political commitment to fiscal discipline also will be a crucial factor.

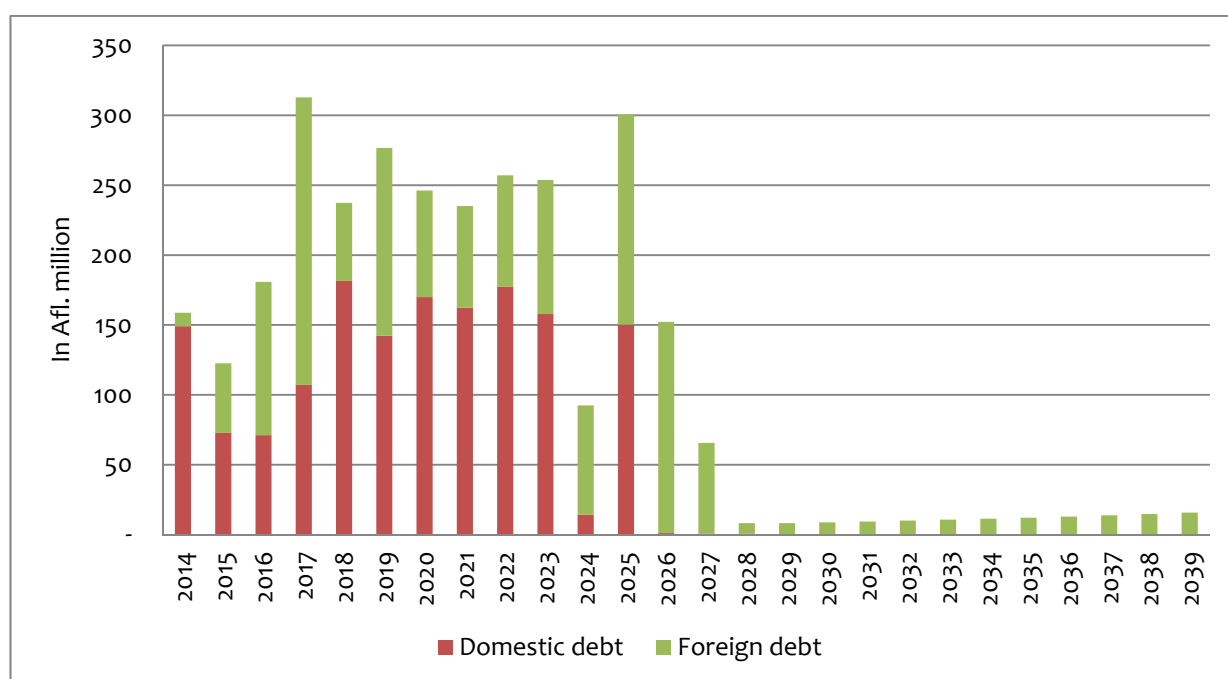
10 DEBT MANAGEMENT

The objective of this chapter is to discuss briefly the need to focus on public debt management in Aruba. The IMF (2001) defines public debt management as the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities. Public debt management covers a range of activities, including planning, the annual budgetary process, mobilization of (foreign and domestic) resources, the recording of debt, and making timely debt service payments. Public debt management has a variety of goals according to theory on optimal debt management, including macroeconomic stabilization, supporting monetary policy, minimizing costs, and minimizing risks (Wolswijk and de Haan, 2005). However, in practice the primary objective of debt-management agencies is to ensure financing of the annual borrowing at minimal (medium-term) costs at acceptable risks.

In the case of Aruba, public debt management is critical considering GOA's debt maturity profile (see Chart 10.1). In the past 27 years, GOA's debt has expanded to Afl. 3 billion or 67 percent of GDP in 2012. Chart 10.1 shows clearly the significant sums in maturing debt in the coming years. In the period 2014-2017, a total of nearly Afl. 775 million in debt will be maturing (2014: Afl. 158.7 million, 2015: Afl. 122.6 million, 2016: Afl. 180.9 million, and 2017: Afl. 312.8 million), of which Afl. 400 million is foreign debt. The debt service payments are even higher (see Chart 10.2), amounting to Afl. 1.4 billion in the same period (2014: Afl. 328.2 million, 2015: Afl. 287.9 million, 2016: Afl. 340.6 million, and 2017: Afl. 464.7 million).

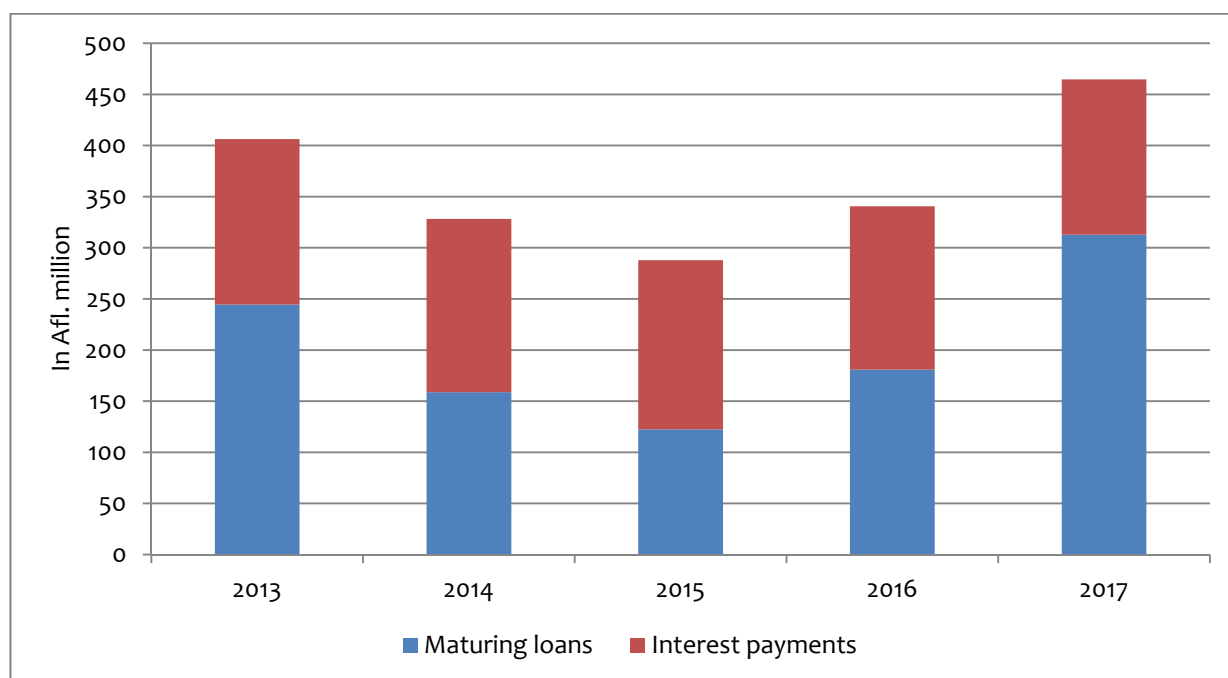
The mentioned totals in maturing debt and debt service payments do not take into consideration the expected financial deficits in the relevant period. Chart 10.3 shows the financing needs for two scenarios, one with the GOA's deficit targets and one with the financial deficits estimated in the unchanged government policy scenario presented in Chapter 2.

Chart 10.1: Maturity schedule of outstanding debt in October 2013

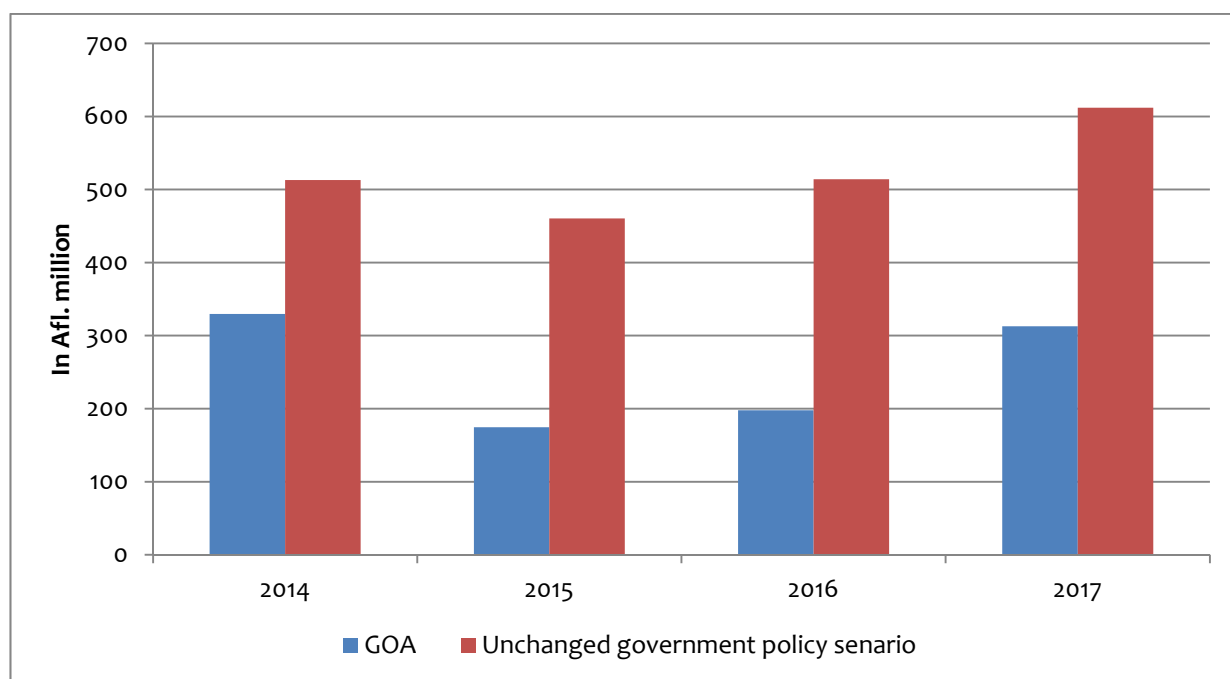


Source: DF.

Chart 10.2: Debt service payments 2013-2017, based on outstanding debt in October 2013



Source: DF.

Chart 10.3: Financing needs ¹⁾

Source: CBA staff estimates.

1) The financing needs take into account GOA's deficit targets and the financial deficits of the unchanged government policy scenario presented in Chapter 2.

When taking into account GOA's deficit targets, total financing needs amount to Afl. 1 billion in the period 2014-2017. When considering the financial deficits calculated in the unchanged government policy scenario, total financing needs equal Afl. 2.1 billion. Clearly, even using the more optimistic scenario in which the GOA achieves its deficit targets, the GOA will be challenged to find the necessary funding to cover its financing needs.

In view of the high government debt level, the maturity profile, the expected government financial deficits, and the current tight domestic liquidity conditions, the GOA should consider a debt management strategy to address the structure and composition of debt that is within Aruba's debt-servicing capacity. A debt management strategy is particularly important in the context of the outlook of the continued decline in international reserves. For the near-term, the GOA should contemplate covering its financing needs by foreign financing to mitigate the expected fall in Aruba's international

reserves. This action would extend the period needed to tackle the structural causes of the balance of payments imbalances. These new foreign loans should preferably have a longer maturity than the current loans to spread the repayments over a longer period. In addition, the GOA should consider restructuring its outstanding (foreign) debt by negotiating with its creditors with the aim of promoting a more balanced debt maturity profile. Reviewing the maturity structure is an integral part of public debt management to avoid a situation of clustering of repayments. Moreover, the debt management strategy for Aruba should include an indicative multi-year borrowing plan, especially considering the borrowing needs for the PPP projects currently in the pipeline. Excessive borrowing in the domestic market by the government and the PPP investors could ‘crowd out’ the borrowing needs of the private sector. All in all, for Aruba, the main objectives of public debt management, should be minimizing the costs of borrowing and preventing high maturing loans in specific years in order to reduce rollover/financing risks.

ANNEXES

ANNEX 1 MAIN ECONOMIC PROJECTIONS BY THE CBA

	2013	2014	2015	2016
Real GDP (percentage change)	2.9	3.4	1.9	1.9
Nominal GDP (percentage change)	0.7	4.9	3.3	3.0
CPI Inflation (period average)	-2.3	1.2	1.6	1.8
Stay-over visitors (percentage change)	6.1	4.0	4.4	4.6
Tourism receipts (percentage change)	4.6	5.8	4.1	4.1
Net foreign assets (in Afl. million, including revaluation differences)	1,253	1,121	919	688
Merchandise import coverage ratio (in months)	8.3	6.7	5.9	4.6
Current account coverage ratio (in months)	4.4	3.7	3.2	2.5

ANNEX 2 IMF ARTICLE IV RECOMMENDATIONS

On April 25th, 2013 the International Monetary Fund (IMF) wrapped up its bi-annual staff consultation mission in Aruba. In its concluding statement, the IMF noted that Aruba has weathered two major shocks in recent years that resulted from the global financial crisis and the shutdown of the oil refining operations. Nonetheless, real GDP contracted by a cumulative 15 percent during 2009-10. These shocks have substantially eroded the authorities' fiscal policy space and public debt has climbed to 67 percent of GDP at end-2012. Tourism, the mainstay of Aruba's economy, has rebounded quickly, partly due to strong policy actions. The banking sector has also withstood the recession well, and unemployment has significantly decreased. Nonetheless, the overall economic recovery is progressing gradually, and output is still 12 percent below its pre-crisis level. The IMF expects that this level will be reached only in 2018. Aruba faces the challenge of rebuilding its lost fiscal space without jeopardizing a relatively weak recovery. Both expenditure and revenue measures will be needed to achieve the envisaged consolidation. Fiscal deficit is projected to decline in 2013, and a daunting task remains ahead. Ensuring a steady recovery will require maintaining competitiveness through further diversification of tourism markets and keeping wage growth in line with productivity developments.

The IMF noted that a large part of the fiscal consolidation should come from expenditure reduction, but revenue measures are also needed. The following recommendations were presented:

1. Expenditure cuts should focus on public sector wage bill through a combination of a permanent reduction in the number of government employees and a review of the wage compensation policies in the public sector.
2. The government should improve spending efficiency. The latter comprises also the rationalization of transfers and subsidies.

3. Spending on goods and services should decline in line with the reduction in the number of public sector employees.
4. The government should consider raising more revenues from indirect taxes. The introduction of a VAT is one potential measure. More feasible near-term measures could include: (i) raising the BBO rate back to its original level of 3 percent; and (ii) increasing excise taxes and import duties that would produce an additional 1 percent of GDP in revenues.
5. Possible reform measures with regard to AOV and AZV could include:
 - a. Raising the statutory pension age;
 - b. Increasing the old-age insurance contribution rates;
 - c. Reducing the replacement rate;
 - d. Increasing revenues and containing costs of the health care system.

ANNEX 3 CONCLUSIONS OF THE RATING AGENCIES

In 2013, Standard & Poor's Rating Services (S&P) downgraded the long-term foreign and local currency ratings, while Fitch Ratings (Fitch) revised the outlook to negative from stable.

On June 14th, 2013, S&P released an update on the long-term foreign and local currency sovereign credit ratings of the government of Aruba to 'BBB+', down from 'A-'. The outlook is noted as stable. Similarly, on August 22, 2013, Fitch revised its outlook on Aruba's ratings to negative from stable and affirmed the long-term foreign and local currency Issuer Default Ratings (IDRs) at 'BBB'.

S&P stated that its downgrade reflected deteriorating fiscal and external balance sheets, whereas Fitch also mentioned fiscal imbalances, as well as continued growth underperformance and uncertainty related to the scope and pace of the fiscal consolidation process as the rationale behind its revision to a negative outlook. On the fiscal side, S&P noted that large fiscal deficits over the last three years raised gross general government debt (excluding public sector pension holdings of government debt) to an estimated 60 percent of GDP in 2013. Fiscal deficits are projected at 4 to 5 percent of GDP for the next few years. The closure of the island's oil refinery and spending pressures in health care and pensions are deemed to have contributed to weakening Aruba's public finances in recent years. Fitch also cited that weak growth due to the refinery suspension, as well as spending pressures coming from the pensions and health care systems, prompted fiscal deterioration that resulted in a widening of the fiscal deficit to 8.5 percent of GDP in 2012 from 7.9 percent in 2011. Furthermore, it stated that persistent and material deviations from the official growth and deficit reductions targets have weakened fiscal policy predictability and led to deteriorating debt dynamics.

The S&P's stable outlook reflects the expectation that the government will continue its dialogue with unions and employers after the election in order to agree on further measures to address long-term weaknesses in public finances, reduce general government

deficits over the next three years, and stabilize its debt burden. Such measures would include additional reforms to the public sector health and pension systems as well as efforts to raise additional government revenues and contain current expenditures.

Fitch's 'BBB' ratings are supported by Aruba's impeccable debt repayment record, its continued access to domestic and international capital markets that have provided sufficient fiscal financing flexibility. In addition, Aruba's contingent support from the Netherlands to borrow externally enhances investor confidence and could reduce rollover and interest rate risks. Furthermore, its adequate reserve coverage maintains confidence in the exchange-rate peg.

Both agencies noted that a failure to improve the fiscal profile and debt sustainability prospects could result in a downgrade of the ratings. In addition, Fitch also mentioned the emergence of financing constraints or the deterioration in the institutional relationship between Aruba and the Netherlands as risk factors for a downgrade. On the other hand, both agencies could consider an upgrade in the case of an economic recovery with a positive impact on fiscal prospects, and progress towards fiscal deficit reductions.

ANNEX 4 FITCH RATINGS BENCHMARKS

	2012					Last 10 years	
	San Marino	Slovenia	Aruba	Bahrain	Panama	BBB	A
	BBB+	BBB+	BBB	BBB	BBB	median	median
Real GDP (5yr average % change)	-6.3	-1	-2.5	3.7	8.6	2.9	3
GDP per capita (USD, market exchange rates)	56,944	22,346	24,127	24,667	9,990	10,576	18,539
External debt service ratio (% current account receipts)	3.0	17.9	7.3	13.9	14.4	15.6	10.8
External interest service ratio (% current account receipts)	0.8	3.3	2.4	7	5.8	4.2	2.2
Liquidity ratio ¹⁾	145.1	29.6	207.2	69.2	118	136.1	128
Current account balance (% GDP)	21.5	2.3	4.7	7.2	-9	-1.8	1.5
Sovereign net foreign exchange debt (% GDP) ²⁾	-	-1.9	-6.9	-1.4	-9.7	-6.1	-12.6
Budget balance (% GDP)	-0.8	-4	-8.5	-3.2	-3.1	-2.6	-2.1
Primary balance (% GDP)	-0.7	-1.9	-5.3	-1.9	-1.1	-0.2	-0.2
Revenues and grants (% GDP)	36.1	45	22.4	26.6	25	32.4	35
Volatility of revenues/GDP ratio ³⁾	13.7	2.7	11.5	10	8.4	6.1	6.8
Interest payments (% of revenues)	0.2	4.7	14.8	4.9	8.2	6.7	4.7
Debt (% revenues) ⁴⁾	54.2	120.3	246.7	137.9	156.9	123.2	138.9
Debt (% GDP) ⁴⁾	19.6	54.1	55.3	36.6	39.3	35.6	38.5
Net debt (% GDP) ⁴⁾⁵⁾	-14.9	45	50.7	16.8	23.5	28.9	28.2
Foreign currency debt (% total debt)	100	0.2	34.4	45.2	0	35.9	16.3

Source: Fitch Ratings

1) Calculated as the ratio of liquid external assets to liquid debt liabilities owed to non-residents. Liquid external assets consist of official international reserve assets and deposit money banks' foreign assets at the end of the previous calendar year. Liquid external liabilities consist of scheduled external debt service in the current year, plus the stock of short-term external debt and all non-resident holdings of marketable medium and long-term local currency debt at the end of the previous calendar year.

2) Net sovereign FX debt is central government plus central bank foreign-currency-denominated (or indexed) debt (irrespective of the residency of the holder), less foreign-currency-denominated (or indexed) assets (typically official international reserves and the foreign currency assets of sovereign

wealth funds), expressed as percentage of (US dollar) GDP. A negative figure indicates that sovereign foreign-currency assets (debt claims) are greater than foreign-currency-denominated (or indexed) debt liabilities.

3) The volatility of (general) government revenues (including grants) to GDP is measured by "the coefficient of variation" (the standard deviation divided by the mean multiplied by 100) on a trailing 10-year basis.

4) Consolidated general government debt excludes the holdings of central government debt by APFA and AOV.

5) Net debt is derived by subtracting the government deposits (including development funds) held with the financial system from the gross debt.

ANNEX 5 FISCAL COUNCILS AROUND THE GLOBE

Box 1 (Concluded)
Table. List of Fiscal Councils in the Dataset

Country	Fiscal Council	Conventional Acronym	Start of activity	Type
Australia	Parliamentary Budget Office	...	2012	Parliamentary Budget Office
Austria	Government Debt Committee	...	2002	Attached to the Central Bank
Belgium	High Council of Finance - Section "Public Sector Borrowing Requirement"	HCF	1989	Attached to the Executive
Belgium	Federal Planning Bureau	FPB	1994	Attached to the Executive
Canada	Parliamentary Budget Office	PBO	2008	Parliamentary Budget Office
Croatia	Fiscal Policy Council	...	2013	Attached to the Executive
Denmark	Danish Economic Council	...	1962	Attached to the Executive
Finland	National Audit Office of Finland	...	2013	Audit Office performs tasks of fiscal council
France	High Council of Public Finance	...	2013	Attached to the Audit Institution
Georgia	Parliamentary Budget Office	...	1997	Parliamentary Budget Office
Germany	German Council of Economic Experts	...	1963	Stand-alone
Hungary	Fiscal Council	...	2009	Stand-alone
Ireland	Irish Fiscal Advisory Council	IFAC	2011	Stand-alone
Italy ¹	Parliamentary Budget Office	...	2014	Parliamentary Budget Office
Japan	Fiscal System Council	...	1950	Attached to the Executive
Kenya	Parliamentary Budget Office	...	2009	Parliamentary Budget Office
Mexico	Center for Public Finance Studies	...	1999	Parliamentary Budget Office
Netherlands	Netherlands Bureau for Economic Policy Analysis	CPB	1945	Attached to the Executive
Portugal	Portuguese Public Finance Council	CFP	2011	Stand-alone
Romania	Fiscal Council	...	2010	Stand-alone
Serbia	Fiscal Council	...	2011	Stand-alone
Slovak Republic	Council for Budget Responsibility	CBR	2011	Stand-alone
Slovenia	Institute of Macroeconomic Analysis and Development	IMAD	1991	Attached to the Executive
Slovenia	Fiscal Council	...	2009	Attached to the Executive
South Africa ¹	Parliamentary Budget Office ... 2014 Parliamentary Budget Office	...	2014	Parliamentary Budget Office
South Korea	National Assembly Budget Office	NABO	2003	Parliamentary Budget Office
Sweden	Swedish Fiscal Policy Council	FPC	2007	Stand-alone
United Kingdom	Office for Budget Responsibility	OBR	2010	Attached to the Executive
United States	Congressional Budget Office	CBO	1974	Parliamentary Budget Office

¹The South African and Italian PBOs are being established and expected to be fully operational by the end of 2014. Chile has established a Fiscal Advisory Council in April 2013

Source: IMF (2013b).

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