**Curaçao: Main Conclusions of the IMF Staff Visit**

June 7, 2019

*Curaçao is facing the fourth year of recession as its economy has been hit by spillovers from the Venezuela crisis. The spillovers are exposing long-standing structural challenges and weaknesses in public finances and contribute to external vulnerabilities. Implementing quality measures that produce a lasting change in the public finances is important for medium-term sustainability and regaining economic growth. Gradual fiscal adjustment coupled with credible policy measures would help protect growth while restoring medium-term sustainability.*

**Curaçao’s ongoing recession since 2016 deepened in 2018 due to continued spillovers from the crisis in Venezuela.** GDP declined by an estimated 2¾ percent in 2018, bringing the cumulative contraction in the past 3 years to 5½ percent. Declines in refining, oil transshipment, and related services were the main contributors: the refinery effectively shut down production during the first half of 2018 while keeping employees and continuing to pay wages from small-scale batches of production with the remaining stock of oil.[[1]](#footnote-1) Disruptions in the oil sector have spread to supporting sectors, reducing employment and fiscal revenue. The switch to more expensive fuel suppliers in the second half of 2018 and the bankruptcy of the local airline—related to its inability to collect payments from Venezuela—contributed to the external current account deficit to nearly 29 percent of GDP and pushed up inflation (Table 1). Historically strong trade linkages with Venezuela dropped sharply (Figure 1).

**The economic outlook is challenging, despite rapid growth in the tourism sector**. GDP is expected to contract by about 2 percent this year with a large negative contribution from the refinery (estimated at 3-3½ percentage points of GDP) and supporting activities, which would be only partially offset by a positive contribution from tourism: stayover arrivals are likely to show double-digit growth in 2019. Ongoing and planned hotel construction is expected to increase room capacity from 7,500 in 2018 to almost 10,000 in 2022. Tourism from Venezuela has been largely replaced by more tourism from Europe, the U.S., and Latin American countries. The outlook is subject to significant downside risks—a permanent shutdown of the refinery would deepen the recession considerably and exert significant pressure on public finances via higher social spending.[[2]](#footnote-2) While finding a new operator for the refinery would improve the outlook, it may prove difficult. The inflow of undocumented Venezuelan immigrants is generating additional pressure on public finances.

**The deep recession has heightened challenges in public financial management and led to a deviation from the current fiscal rule despite adjustment measures.** As tax revenue fell by 1 percent of GDP in 2018, the authorities compressed expenditure and reduced the current fiscal deficit (in authorities’ definition) to 1.4 percent of GDP (Tables 2-3).[[3]](#footnote-3) At the same time, the stock of uncollected tax assessments has increased considerably and difficulties with expenditure control led to some spending overruns. Central government debt increased from about 51 percent of GDP in 2016 to close to 55 percent of GDP in 2018.

**The authorities have elaborated plans to restore economic growth and improve public finances.** Their strategy aims at increasing potential growth, enhancing public financial management and improving the functioning of the public sector. Theyenvisage important structural reforms to reduce red tape and improve the business climate. To improve revenue administration, they have appointed a special manager to lead various tax compliance projects and are expecting to start fully utilizing a new IT system installed in 2018. Regarding tax policy, they are planning to increase sales tax and excises from July 1, 2019 followed by a deeper overhaul of the tax system next year. To reduce expenditures, they have introduced a wage and hiring freeze and tightened expenditure controls. The supplementary budget, which is expected to be approved in the summer, introduces additional cost-cutting measures, including voluntary early retirement for civil servants aged 59-62 (which entails upfront costs in 2020 followed by savings in the following years) and also cost-saving measures in the health sector such as reducing costs within sickness insurance through transferring more responsibility from the social insurance system to the employers. Additionally, they have developed a roadmap for improving public financial management aiming at an unqualified auditor’s opinion in 2021.

**The baseline scenario (Figure 2 and Tables 1-5) incorporates the implementation of the authorities’ announced measures: short-term tax increases, hiring and wage freezes, early retirement package and savings in the health area.** These measures would reduce the current fiscal deficit to 0.9 percent of GDP by 2021, short of the authorities’ own balanced budget target, on account of still weak revenues and higher social protection expenditures partly due to higher operational costs at the new hospital. As a result, the stock of government debt would increase to 62 percent of GDP by 2024.Reaching the authorities’ objective of a balanced budget by 2021 would require not only strong implementation of existing plans but also some additional measures as illustrated by the staff’s adjustment scenario (Tables 6-9). Whereas this gap could be partially filled by better revenue administration and stronger expenditure controls, new measures are likely to be needed.

**In staff’s view, consistent implementation of quality measures is more important for reaching medium-term sustainability than the speed of adjustment.** It is important to proceed expeditiously with implementing durable measures to tighten expenditure controls and improve overall public financial management, strengthen revenue mobilization and address significant fiscal risks, especially health insurance and pensions. Expenditure cuts would need to be accompanied by changes in legislation to ensure their durability. As long as the implementation of these measures is on track, a gradual adjustment path, reaching fiscal balance by 2021, would be viable. This gradual approach differs from the more frontloaded adjustment proposed by the Dutch-led supervisory authority (Cft), in order to minimize the negative impact on growth.[[4]](#footnote-4) The large upfront fiscal adjustment entailed by the Cft proposal (about 3.4 percent of GDP in 2020), would require large expenditure cuts, including on social spending, and could further undermine growth and make restoring medium-term sustainability more difficult. At the same time, for the more gradual path to be credible, the authorities should legislate measures upfront and remain committed to continuing the adjustment over the medium term and to reaching a primary surplus in 2022-24 in order to place government debt firmly on a downward path, as illustrated in the staff’s adjustment scenario.

**The large external current account deficit in Curaçao is a significant vulnerability and requires urgent attention.** The deficit, together with excess liquidity in the banking system, poses risks for the Union’s reserves, which have declined from 3.8 to 3.5 months of projected imports of goods and services between December 2018 and mid-May. The Central Bank of Curaçao and Sint Maarten is considering options for addressing the excess liquidity and has requested IMF technical assistance in this area. Fiscal adjustment would help reduce the external current account deficit although a strong structural reform is required to increase exports and reduce the deficit more durably. It is important to take steps to bolster medium-term external sustainability.

**It is very important to follow through on economy-wide structural reforms to support potential growth and increase exports.** Cumbersome regulations and red tape, e.g. lengthy permit processes, need to be addressed. The authorities’ plans to simplify and speed up administrative procedures for business and work permits should be implemented without delay. Procedures for terminating employment contracts appear cumbersome and costly and impede labor mobility and job growth. The authorities’ plans to promote “flexicurity” (a combination of labor market flexibility and adequate worker protection) could be a step in the right direction. Labor market mismatches need to be addressed through retraining, and improvements in educational and vocational training programs.

**The authorities are planning to combine existing development institutions in Invest-Curaçao and capitalize it with privatization proceeds.** This scheme would include two guarantee funds: one for uncollateralized parts of loans and another for equity. These funds, especially the equity guarantee fund, involve significant risks and would require proper risk management and strong supervision capable of assessing the risks. Considerable caution is warranted. If the authorities do proceed with setting up Invest-Curaçao, it would need to adhere to best practices of good governance and transparency.

*The IMF mission wishes to express its gratitude to the authorities and all stakeholders for the open and constructive discussions during its visit to Curaçao.*

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| **Figure 1. Curaçao: External Trade by Trading Partner, 2012-18**(millions of U.S. dollars) |
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| **Figure 2. Curaçao: Fiscal Scenarios, 2018-28** |
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| **Table 1. Curaçao: Selected Economic Indicators 2016-24 – Baseline Scenario** |
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| **Table 2. Curaçao: Government Operations 2016-24 - Baseline Scenario**(Millions of NAf unless otherwise indicated) |
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| **Table 3. Curaçao: Government Operations 2016-24 - Baseline Scenario**(Percent of GDP unless otherwise indicated) |
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| **Table 4. Curaçao: Balance of Payments, 2016-24 - Baseline Scenario**(Percent of GDP unless otherwise indicated) |
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| **Table 5. Curaçao and Sint Maarten: Balance of Payments, 2016-24 - Baseline Scenario**(Percent of GDP unless otherwise indicated) |
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| **Table 6. Curaçao: Selected Economic Indicators 2016-24 – Illustrative Adjustment Scenario** |
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| **Table 7. Curaçao: Government Operations 2016-24 – Illustrative Adjustment Scenario**(Millions of NAf unless otherwise indicated) |
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| **Table 8. Curaçao: Government Operations 2016-24 – Illustrative Adjustment Scenario**(Percent of GDP unless otherwise indicated) |
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| **Table 9. Curaçao: Scenario Comparison, 2018-2024** (Percent of GDP unless indicated otherwise) |
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1. Before the decline in production (2014-16), the refinery accounted for about 7 percent of GDP and employed about 1000 staff and 750 contractors (about 3 percent of total employment in Curaçao), although the total share of the petroleum sector in GDP and employment was larger due to related activities such as oil transshipment and storage. [↑](#footnote-ref-1)
2. The contract with PDVSA expires in end-2019. Given the very high uncertainty regarding finding a new operator for the refinery, staff assumed a zero contribution to GDP from the refinery starting from 2020. [↑](#footnote-ref-2)
3. In this note, the quoted current fiscal deficits follow the authorities’ definition. [↑](#footnote-ref-3)
4. The Cft proposes to compensate the cumulative current fiscal deficit from 2017-19 over three years by achieving current surpluses of equal size in each year over 2020-22, effectively frontloading the entire adjustment to 2020. For example, if the 2019 current deficit is 1.7 percent of GDP as projected in the staff’s baseline scenario, this approach would require surpluses of about 1.7 percent of GDP in 2020-22. However, in 2020, this would imply an adjustment of about 3.4 percent of GDP. An adjustment of this magnitude in an environment of continued economic weakness can be counterproductive as it could lead to further contraction (estimated at 1½ percent in 2020). [↑](#footnote-ref-4)