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## **Kingdom of the Netherlands—Aruba: Recent Economic Developments**

This Recent Economic Developments report on Aruba was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with this member country. As such, the views expressed in this document are those of the staff team and do not necessarily reflect the views of the Government of Aruba or the Executive Board of the IMF.

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Kingdom of the Netherlands-Aruba

**Recent Economic Developments**

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Approved by the European I Department

April 12, 1999

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## I. INTRODUCTION

1. Aruba is a small island economy located some 19 miles north of Venezuela in the Caribbean Sea. Favorable climatic conditions and a deep water natural harbor along trade routes have been key to Aruba's economic development, which has seen a progressive transition from oil-processing and transshipment to a tourism-based economy.
2. This background paper chronicles economic and financial developments in Aruba during 1997-98. Chapter II reviews real economic activity, employment, and domestic price movements. Chapter III covers public finances and fiscal policy, including the budget for 1999. Chapter IV addresses monetary and exchange policy and developments. Finally, Chapter V presents an analysis of recent trends in the external current and capital accounts. An appendix offers some international comparisons of the public sector's wage bill in Aruba and in three groups of comparator countries.

## II. THE REAL ECONOMY<sup>1</sup>

### A. Growth and Economic Structure

3. **Assessment of economic developments is hampered by lack of timely national accounts.** National accounts data are only available for 1994. GDP estimates are made by the staff, but are based on partial information only, and are unlikely to be very accurate (see Box 1). Comprehensive employment and unemployment data are also not current and reliable, as they are compiled only once every three years.

#### Box 1. Aruba: Estimating Aruban GDP

The absence of reliable data on private consumption and investment makes an accurate assessment of recent GDP developments difficult. Data on other GDP components, viz., net exports and government consumption, do exist, but quantitatively they are not as important, as in most economies the share of private consumption and investment in GDP is well over 80 percent.

GDP is estimated separately for the oil sector and the non-oil sector:

- GDP for the non-oil sector is estimated in an iterative process. Using private investment estimates of the central bank, balance of payments data for the non-oil sector, and data on government spending from the fiscal accounts, GDP is adjusted iteratively until the growth rates of both GDP and consumption are in accordance with information being provided by a host of other economic indicators, often of a qualitative character.
- GDP for the oil sector is estimated by adding the estimated wage bill of the oil refinery to an estimate of the domestic component of its investments. Assessing value added through the balance of payments is more difficult, because the oil sector's trade balance is extremely volatile, as a result of large changes in stocking—for which no data are available.

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<sup>1</sup>Prepared by Bas Bakker.

4. **Following a period of declining world oil prices, Aruba's oil refinery was closed in March 1985.** Petroleum refining and transshipment, at the Lago Oil refinery, were major economic activities from the late 1920s to the beginning of the 1980s. Employment at the refinery peaked at some 8,300 workers in the 1950s (roughly, a third of the workforce), and despite significant reductions resulting from automation and efficiency measures, activity in the sector still accounted for about a quarter of Aruba's GDP in 1982-83. At that time, the refinery paid profit taxes equal to about 40 percent of government revenue. In the three-year period leading up to the closure of the oil refinery, Aruba's GDP fell by about one third with the direct loss of 1,300 jobs (about 5 percent of employment) and an indirect loss of 6,000-7,000 jobs. The resulting 20 percent unemployment rate helped to spark a net emigration of some 5,300 residents (6 percent of the 1984 population) during 1985-87.

5. **In the decade following the closure of the Lago oil refinery, Aruba was transformed into a predominantly tourism-based economy,** in part through a policy of fiscal incentives and guarantees. Between 1985 and 1995, the number of hotel rooms more than tripled, from 2,000 to 6,500 (Figure 1); and by 1995 more than half of all foreign exchange earnings came from tourism. The ensuing investment surge turned around a deep GDP contraction and led to real growth at an average annual rate of 12 percent throughout the early 1990s (Figure 2). Other important industries are warehousing and transshipment, centered in a "Free Zone," and financial services. The refinery was reopened in 1989, but the importance of this sector for the Aruban economy is rather limited, as the oil refinery is tax exempt, imports its capital and technology (and part of its workforce), and employs only a limited number of workers.

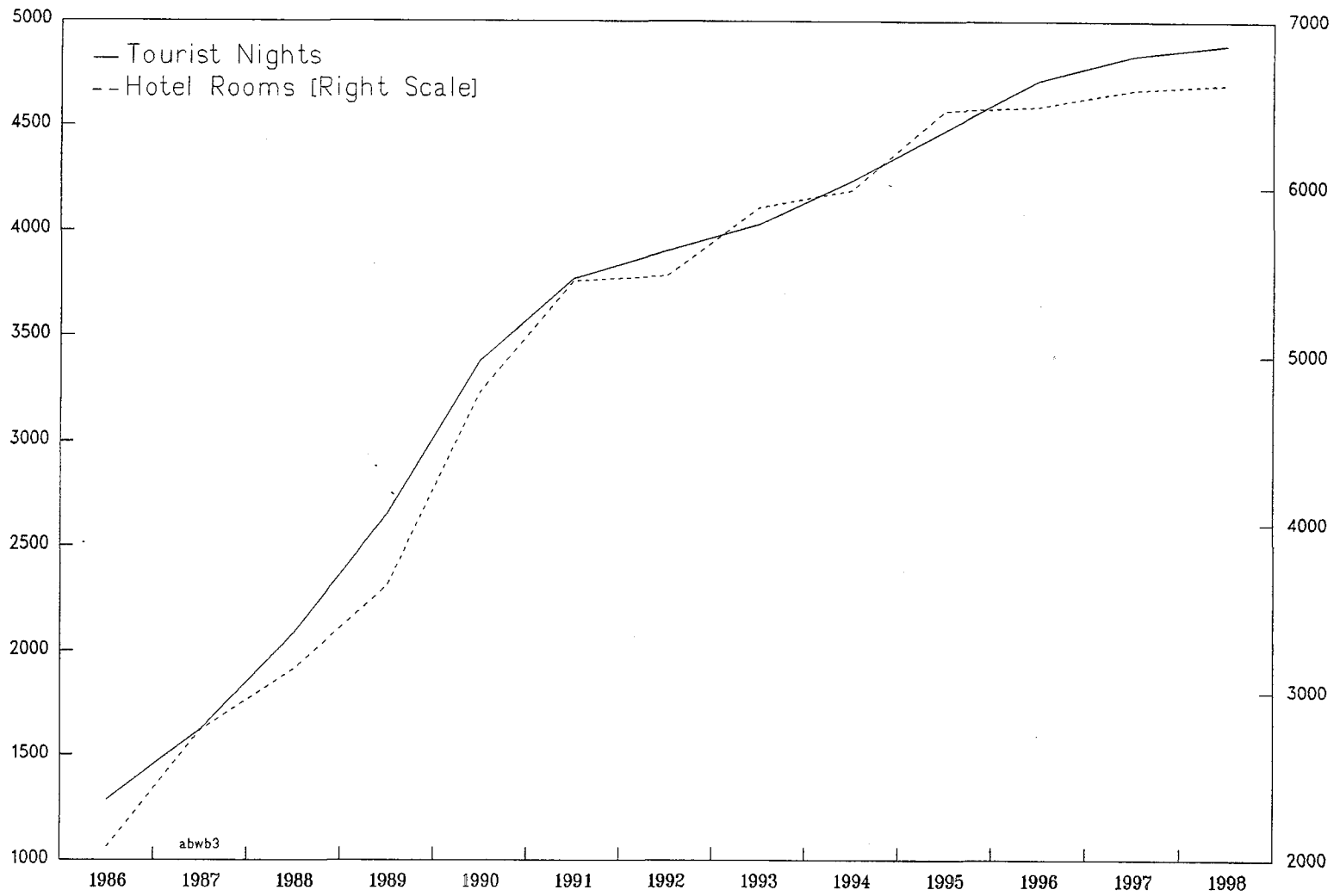
6. **In the mid-1990s, the boom in the hotel sector came to an end,** and the economy started to grow at a more sustainable pace. A moratorium on new hotels was put in place, and since 1995 only one, small, hotel has been built. As a result, real GDP growth decelerated to about 4 percent on average during the 1995-98 period. Inflationary pressures receded, and the inflation difference with the United States, which was almost 4 percentage points in 1994, started to decline.

7. **In 1997 and 1998, the economy is estimated to have expanded by about 3-4 percent.** In 1997, growth was driven by domestic demand; the contribution of the external sector was negative, as the nonfactor services balance deteriorated as a result of a strong increase in travel abroad by Arubans. In 1998, growth was almost entirely externally driven; a shift in fiscal policy reduced the contribution of domestic demand to close to zero. All in all, the economy is likely to have grown by about 4 percent in 1997 and 3 percent in 1998, but considerable uncertainty surrounds these estimates.

## **B. Developments in Tourism**

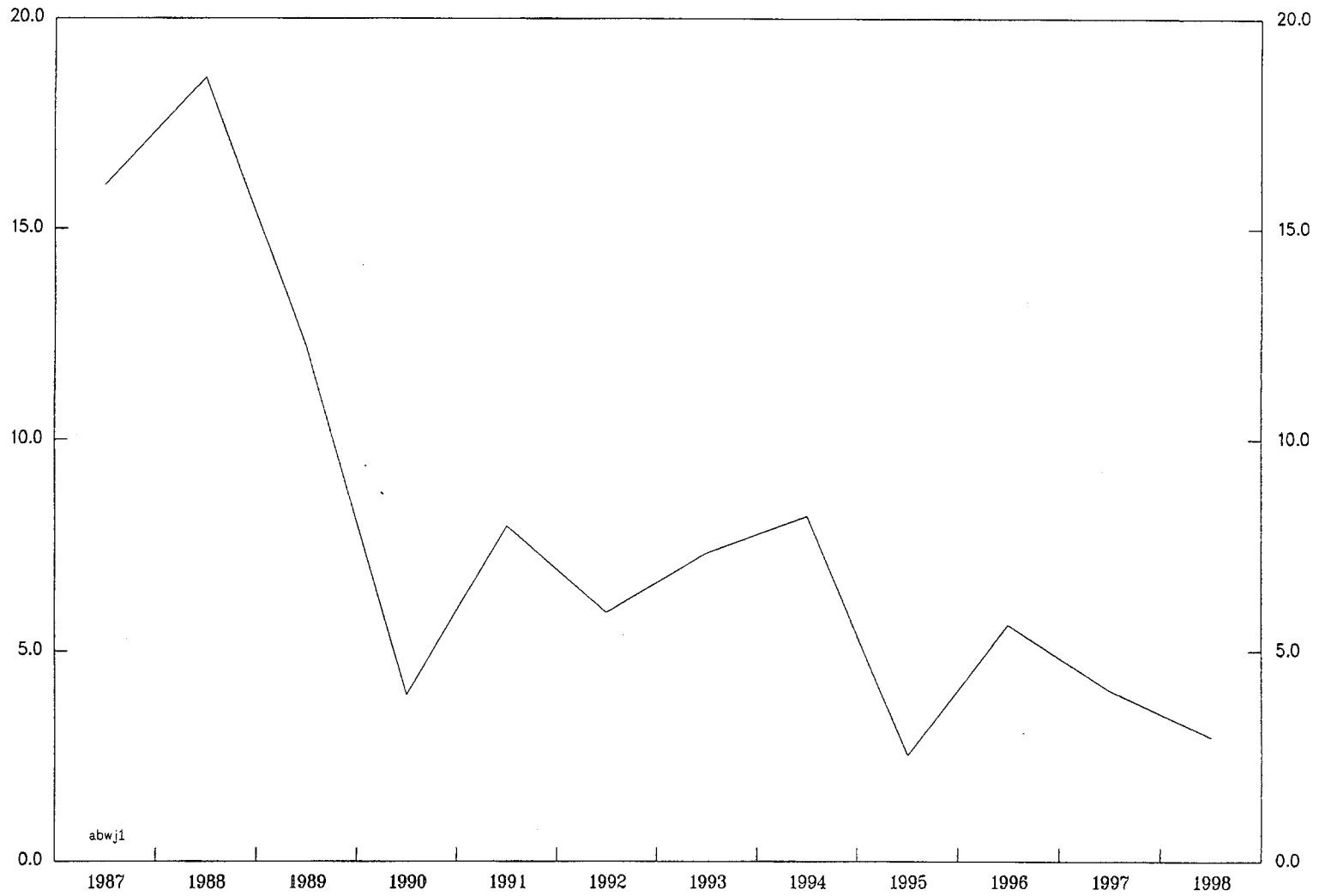
8. **Three quarters of all tourists come from the United States and Venezuela (Table 1).** The main competitors of Aruba are Barbados, Jamaica, the Bahamas, Cayman, Cancun, Dominican Republic, and Margarita. After Cancun, Aruba has the largest number of visitors from Latin America (162,000).

FIGURE 1  
ARUBA  
Tourism Indicators  
(In Levels)



Sources: Data provided by the authorities; and staff estimates.

FIGURE 2  
ARUBA  
Real GDP Growth  
(In Percent)



Sources: Data provided by the authorities; and staff estimates.



Table 1. Aruba: Stay-Over Tourists by Origin

|                             | USA  | Other North<br>America | Venezuela | Other Latin<br>America | Netherlands | Other<br>Europe | Other | Total |
|-----------------------------|------|------------------------|-----------|------------------------|-------------|-----------------|-------|-------|
| (Percent of total tourists) |      |                        |           |                        |             |                 |       |       |
| 1995                        | 55.7 | 4.4                    | 13.8      | 11.9                   | 5.4         | 2.9             | 5.9   | 100.0 |
| 1996                        | 58.0 | 3.8                    | 11.7      | 11.8                   | 5.6         | 2.9             | 6.2   | 100.0 |
| 1997                        | 56.3 | 3.9                    | 13.6      | 11.7                   | 5.1         | 3.5             | 5.6   | 100.0 |
| 1998                        | 58.2 | 3.8                    | 15.3      | 9.8                    | 4.8         | 2.8             | 5.3   | 100.0 |
| (Growth rate, in percent)   |      |                        |           |                        |             |                 |       |       |
| 1995                        | 6.3  | 15.2                   | 13.9      | 2.1                    | 3.2         | -5.7            | 2.2   | 6.3   |
| 1996                        | 7.7  | -9.6                   | -12.6     | 2.9                    | 8.8         | 2.4             | 8.8   | 3.5   |
| 1997                        | -2.1 | 2.2                    | 17.1      | -0.1                   | -9.8        | 34.9            | -8.5  | 0.8   |
| 1998                        | 3.7  | -2.6                   | 13.1      | -16.5                  | -5.2        | -27.9           | -4.2  | 0.2   |

Source: Central Bank of Aruba, Quarterly Bulletin.

9. **With stable hotel capacity as a result of the moratorium on new constructions, stay-over tourist arrivals have leveled off in recent years.** Tourist arrivals increased by less than 1 percent in 1997 and 1998, well below the growth rates experienced previously (Table A1). Arrivals were adversely affected by an economic crisis in Colombia, reduced airline service with Brazil (Brazil no longer has direct flights to Aruba, only charters), and a decline in marketing efforts by the Aruba Tourist Association resulting from a cut in government funding. The availability of hotel rooms hardly expanded; thus, the occupancy rate went up in both 1997 and 1998.

10. **Tourism revenues, however, have increased,** as the average length of stay and spending per tourist have gone up.<sup>2</sup> Aruba is increasingly marketed as an upscale tourist destination; half of all visitors in 1998 earned more than US\$75,000 a year, and another fifth

<sup>2</sup>The data on expenditure per tourist presented here are from the Central Bank of Aruba, and are based on data provided by commercial banks. The Central Bureau of Statistics (CBS) also compiles data on expenditure, based on surveys. CBS data would suggest that expenditure per tourist has declined in recent years. However, these data include only expenditures that took place while the visitors were in Aruba, thus excluding anything spent on pre-paid vacation packages.

between US\$50,000 and US\$75,000. The tourists who spend the most come from Latin America, especially Venezuela.

11. **Cruise tourism declined in 1997 and 1998.** Aruba was dropped as a destination by a cruise ship that experienced difficulties in Venezuela; with no visit to Venezuela, Aruba was considered too far away from the rest of the Caribbean ports of call to merit a separate cruise call.

12. **The profitability of the tourism sector is low** in comparison with other countries. Gross operating profits are only 1.4 percent of sales, compared with 13.6 percent in the Caribbean on average and well below any other country--in spite of the highest occupancy rate in the region (Table 2). In absolute amounts, revenue per room is among the highest, while profits are among the lowest—indicating the high operating costs in Aruba.

Table 2. Aruba: Hotel Profitability in Selected Caribbean Countries

|                      | Average<br>Occupancy<br>Rate<br>(In percent) | Average<br>Daily<br>Rate<br>(in US\$) | Average<br>Daily<br>Revenue<br>per room<br>(in US\$) | Annual<br>Revenue<br>per room<br>(in US\$) | Gross Operating<br>Profit after<br>Management<br>Fees<br>(in US\$) | Idem, in<br>percent of<br>Sales |
|----------------------|--|---------------------------------------|--|--|--|---------------------------------|
| Aruba                | 79.5   | 107                                   | 85   | 57,270                                     | 4,992  | 1.4                             |
| Dominican Republic   | 72.8   | 27                                    | 20   | 18,508                                     | 2,207  | 8.6                             |
| Netherlands Antilles | 63.6   | 131                                   | 83   | 43,299                                     | 1,773  | 9.2                             |
| Bermuda              | 61.7   | 148                                   | 91   | 69,654                                     | 5,989  | 9.3                             |
| OECS 1/              | 67.0   | 81                                    | 54   | 48,701                                     | 7,715  | 12.5                            |
| Bahamas              | 61.3   | 93                                    | 57   | 39,275                                     | 7,547  | 13.0                            |
| Total Caribbean      | 71.2   | 83                                    | 59   | 40,469                                     | 6,604  | 13.6                            |
| French West Indies   | 58.6   | 202                                   | 118  | 53,872                                     | 8,835  | 22.4                            |
| Puerto Rico          | 76.2   | 155                                   | 118  | 74,674                                     | 11,293   | 23.5                            |
| Cancun/Cozumel       | 73.9   | 97                                    | 72   | 42,761                                     | 16,401   | 37.0                            |

Source: Caribbean Hotel Industry Study 1998.

1/ Organization of Eastern Caribbean States. The member states of the OECS are Antigua and Barbuda, Grenada, Montserrat, Dominica, St. Kitts and Nevis, Saint Lucia, and St. Vincent and the Grenadines. The British Virgin Islands and Anguilla are associate members.

### **C. Developments in the Oil Sector**

13. **Aruba's oil refinery is owned by the U.S.-based company, Coastal Oil.** It fills a specialized niche in the industry by distilling heavy crude oil (sulfur-rich Maya crude) from Mexico, Iraq, and Venezuela into kerosene and diesel fuel for export to the United States and Europe. It does not produce any gasoline. It produces about 210,000 barrels/day, and plans to increase this to 278,000 barrels/day by the end of the current upgrade in April 2000. This upgrade involves investment of about Af. 250 million over two years in maintenance, upgrading of the current operation, increasing of capacity, and building of a "cracking plant" to process byproducts of the refining.

14. **Coastal does not contribute much to the local economy.** It is not labor intensive (700 workers compared with 5,000 at Lago), produces its own electricity, imports almost all the inputs, and exports all the output. Locally, it only supplies fuel to the utilities company and kerosene for aircraft. In addition, it enjoys a tax holiday until 2011. Because of the international scope of its operation, Coastal Oil does not draw on the domestic banking system for financing: the oil-related current account deficits are covered by private capital flows and do not affect the reserve position of the banking system.

### **D. The Free Zone**

15. **The Free Zone is an independent agency wholly owned by the government.** It groups together 45 companies involved in transshipment, warehousing, and light manufacturing, employing 325 employees. It has a turnover of US\$400 million a year. It levies a stamp tax that contributes about 1 percent of total tax revenues, and a 2 percent profit tax.

16. **The existing Free Zone is going to be moved to a new site,** adjacent to the Barcadera harbor and near the airport. This move is being financed mainly by the private sector, with a small contribution (about Af. 2 million over two years) from the government. The total cost is about Af. 40 million for the Free Zone (financed by a consortium of banks, without any government guarantee) and Af. 80 million to upgrade the harbor. To recover the interest cost, the Free Zone plans to substitute the stamp charge by a facility charge of 0.85 percent of turnover. The expected growth of the Free Zone will increase employment to about 2,000 jobs, and feasibility plans forecast that profits will appear in about two years.

### **E. Labor and Employment**

17. **The boom in the hotel sector in the late 1980s and early 1990s led to a sharp decline in the unemployment rate,** and then to large-scale immigration. Registered unemployment dropped from 15.8 percent in 1987 to 0.6 percent in 1991. From 1990 onward, labor demand was increasingly met by immigration. Net immigration jumped from less than 600 in 1989 to 3,000 in 1992 and almost 6,000 in 1993—or 7.4 percent of the 1993 population.

18. **In recent years, employment growth has continued to be strong, albeit less so than before.** Between 1994 and 1997, employment grew by 4 percent annually, compared with 8 percent in the 1991–94 period (Table 3).<sup>3</sup> Associated with this, immigration has slowed down, from an annual inflow of 5 percent of the population in 1991–94, to 3 percent in 1994–97.

Table 3. Aruba: Labor Market Indicators

|                              | 1991         | 1994   | 1997   | 1991–94              | 1994–97 |
|------------------------------|--------------|--------|--------|----------------------|---------|
|                              |              |        |        | (Annual growth rate) |         |
| Population                   | 66,687       | 79,686 | 91,345 | 6.1                  | 4.7     |
| Working age population       | 50,283       | 61,315 | 71,485 | 6.8                  | 5.2     |
| Labor force                  | 31,012       | 39,303 | 44,840 | 8.2                  | 4.5     |
| Employment                   | 29,127       | 36,776 | 41,501 | 8.1                  | 4.1     |
| Unemployment                 | 1,885        | 2,527  | 3,339  | 10.3                 | 9.7     |
|                              | (In percent) |        |        |                      |         |
| Participation rate           | 61.7         | 64.1   | 62.7   |                      |         |
| Employment rate              | 57.9         | 60.0   | 58.1   |                      |         |
| Unemployment rate            | 6.1          | 6.4    | 7.4    |                      |         |
| Memorandum item:             |              |        |        |                      |         |
| Registered unemployment rate | 0.6          | 0.5    | 0.7    |                      |         |

Source: CBS, Labor Force Survey 1994 and 1997.

19. **While the registered unemployment rate is less than 1 percent, this rate may underestimate labor market slack.** There are two published unemployment rates, *registered unemployment*, and *the unemployed labor force*. The latter statistic is based on a labor force survey and points to an unemployment rate of 7.4 percent. Registered unemployment probably *underestimates* unemployment because it does not take into account non-Arubans, and it takes into account only the unemployed who are registered, although not all of the unemployed have an incentive do so.<sup>4</sup> By contrast, the labor force survey is likely to *overestimate* unemployment, as it is held in October, during the low tourism season when demand for labor is traditionally

<sup>3</sup>No data are available for employment in 1998.

<sup>4</sup>There are no unemployment benefits. Unemployed heads of households are eligible for welfare.

subdued and when a relatively large number of school leavers enter the labor market. An important group within the unemployed consists of women who want to reenter the labor market. Long-term unemployment does not seem to be a problem; 70 percent of all unemployed have been unemployed for less than 8 months, and 75 percent less than a year.

#### F. Price and Wage Developments

20. **CPI inflation in Aruba has decelerated in recent years.** Inflation dropped from 6½ percent in 1993 to 2¾ percent in 1997 and 1½ percent in 1998. The drop in inflation was partly associated with a decline in oil prices, which led to reductions in prices of water and electricity, transport, and communications.<sup>5</sup> Additional factors have been favorable movements in commodity prices, the appreciation of the U.S. dollar—and, consequently, of the florin—and a weakening of U.S. export prices.

21. **Price controls are in place for goods and services constituting 18.2 percent of the consumer price index basket.** The most important regulated items are electricity (4.4 percent weight), water (3.2 percent weight), gasoline (3.9 percent weight) and telephone calls (2.5 percent weight). Controls on prices take the form of ceilings on markups relative to costs. As such, it is not clear whether they have much impact on inflation. Utility prices, for instance, have been following changes in world market prices closely since 1997, when utility companies decided to adapt their prices every three months to changes in oil prices.

22. **Real wage increases in recent years seem to have been moderate.** While no time series exist on wages, some information can be obtained from the 1994 and 1997 Labor Force Surveys. According to these surveys, the nominal average wage increased by 4.2 percent annually between 1994 and 1997, and the median wage by 3.3 percent—slightly above the inflation rate of 3.0 percent. In 1997, the *average* monthly wage was Af. 2,186, the *median* wage was Af. 1,735, and the *minimum* wage Af. 1,060.<sup>6</sup> The highest median wage was earned in education (Af. 4,000); the lowest by household personnel (Af. 528), wholesale and retail trade (Af. 1,400), and hotels and restaurants (Af. 1,408).

23. **Aruba's competitiveness does not seem a problem, although it may have deteriorated somewhat in the 1990s.** An assessment of the shift in Aruba's competitive position is hampered by a lack of data on movements in wages and producer and wholesale prices.

---

<sup>5</sup>In Table A4, these are included in the item "housing."

<sup>6</sup>For household personnel, there is a separate, lower minimum wage.

Nevertheless, since 1990, inflation in Aruba has exceeded inflation in the United States during every year (Figure 3). As a result, during this period, the real exchange rate is-à-vis the United States appreciated by 10 percent (Figure 4). The inflation differential has, however, been narrowing, and in 1998 was only 0.3 percent. In spite of the appreciation, cost competitiveness may not yet be a problem, as higher outright costs of tourism in Aruba are compensated by the availability of complementary goods and services (e.g., low crime, clean surroundings, and good health care), which are important in making Aruba attractive as an upscale tourist destination and lower the price elasticity of the demand for recreational travel.

### III. FISCAL POLICY<sup>7</sup>

#### A. Structure of Government Administration

24. **The government of Aruba combines functions that in other countries are split between the central government and local governments.** It is, however, only responsible for internal affairs; defense and external affairs are a responsibility of the Kingdom of the Netherlands.<sup>8</sup> There is an independent central bank, which issues its own currency. The social security schemes are managed by the Social Insurance Bank (SVB) and the civil servants' pension scheme, by a separate pension fund (APFA).

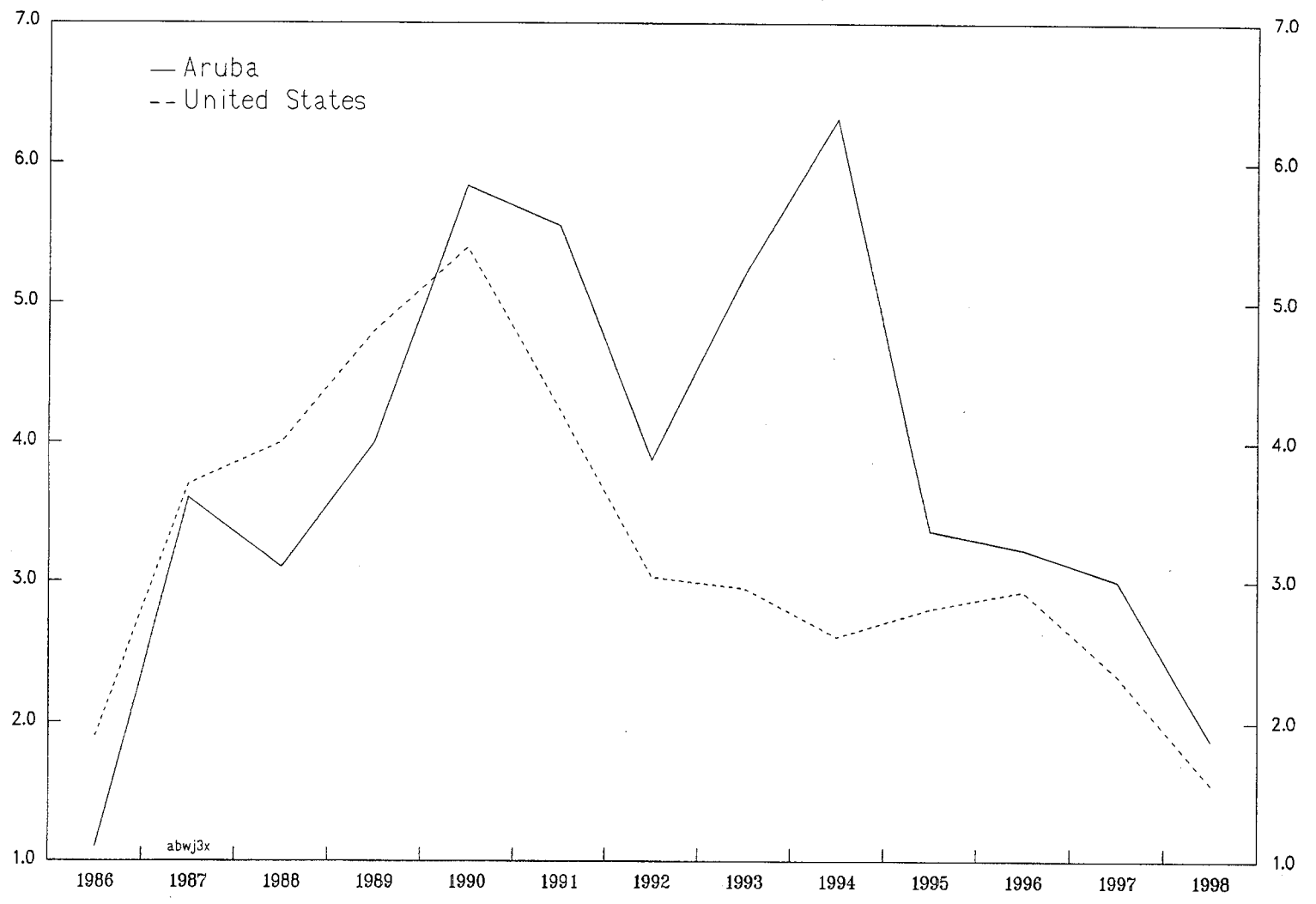
25. **The government has holdings in several companies** (Table 4). These include an airline (Air Aruba), a bus company (Arubus), a harbor (Aruba Port Authorities), an airport (Aruba Airport Authorities), a utilities company (Utilities Aruba), the Free Zone, a broadcasting company (Tele Aruba), and a hotel (Radisson). In 1998, the government sold 70 percent of the shares in Air Aruba to a Venezuelan airline, while it retained 9 percent.

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<sup>7</sup>Prepared by Bas Bakker.

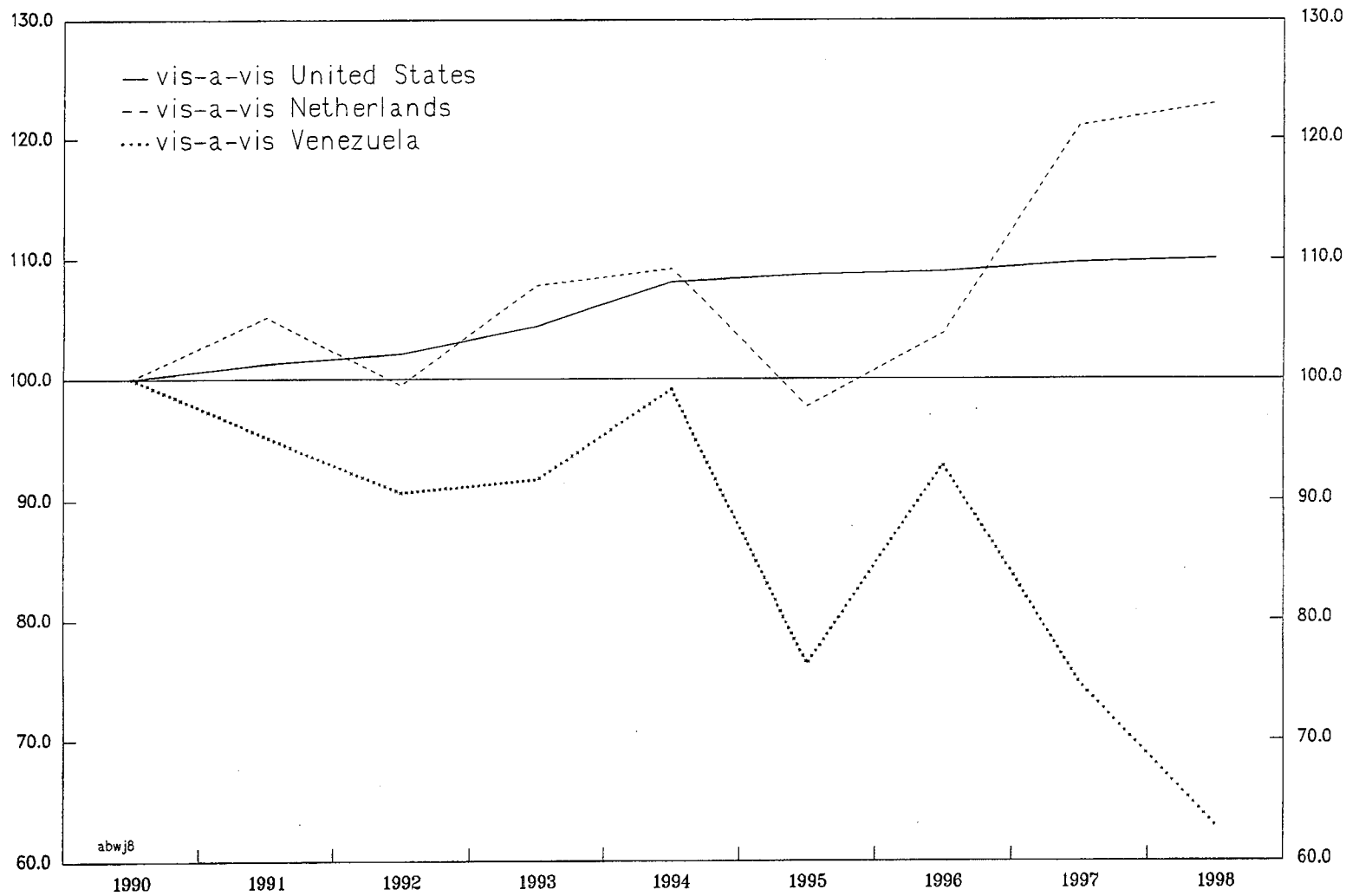
<sup>8</sup>There is a court of first instance on the island, appealing to a High Court of Justice operated jointly with the Netherlands Antilles; High Court justices are appointed by the Dutch Crown in consultation with the Council of Ministers.

FIGURE 3  
ARUBA  
CPI Inflation  
(Annual Averages, In Percent)



Source: IMF, International Financial Statistics.

FIGURE 4  
 ARUBA  
 Bilateral CPI-Based Real Exchange Rates  
 (Index, 1990=100)



Sources: IMF, IFS, and Fund staff calculations.



Table 4. Aruba: Government Holdings, Companies, and Participations

---

**Holdings**

Air Aruba N.V. (airline)  
Aruba Airport Authorities N.V. (airport)  
Aruba Ports Authorities N.V. (harbor)  
Arubus N.V. (bus company)  
Aruven N.V.  
Dutcho N.V. (investment Radisson)  
Free Zone Aruba N.V.  
Tele Aruba N.V. (broadcasting)  
Utilities Aruba N.V. (water and electricity)

**Government Companies**

Algemeen Pensioen Fonds Aruba (civil servants' pension fund)  
Aruba Investment Bank (investment)  
F.C.A.A. (housing)  
Postspaarbank (bank)  
S.E.T.A.R. (telephone)  
Sociale Verzekeringsbank (social insurance)  
Sociale Verzekeringsbank AOV-fonds (social insurance)  
Sociale Verzekeringsbank Cessantia-fonds (social insurance)  
Stichting Aruba Hospitality Trade & Training Center (hotel school)  
Stichting Ziekenverpleging Aruba (hospital)  
Uitvoeringsorgaan Algemene Ziektekostenverzekering (health care)  
Universiteit van Aruba (university)  
Volkskredietbank (bank)

**Participations**

Aruba Beachfront Resorts Ltd. Partnership (Hyatt)  
Aruba Beachfront Resorts N.V. (Hyatt)

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Source: Data provided by the authorities.

26. **The government has extended loan guarantees to several hotels.** These guarantees were given in the late 1980s and early 1990s to stimulate development of the tourist sector. During 1990–92, three of the hotels covered by guarantees failed, and the government assumed the counterpart liabilities and assets, creating an ad hoc corporation to dispose of the acquired properties. In 1996, it bought another failed hotel (Radisson) which is currently under renovation. Three guarantees are at the time of this writing still outstanding and under litigation, for a total amount of about US\$150 million.

## B. Government Finances

27. **The share of government spending in GDP in Aruba is similar to that of other countries in the Caribbean** (Table 5). Excluding social security, it stood at 23 percent in 1997; including social security (financed through the Social Insurance Bank SVB), at 27 percent. About 40 percent of government spending consists of wages, which is also in line with the regional average.

Table 5. Aruba: Government Expenditure in Selected Caribbean Countries  
(In percent of GDP)

|                             | Excl. Social<br>Security Funds | Incl. Social<br>Security Funds | Share of Wages<br>in Expenditure<br>(In percent) |
|-----------------------------|--------------------------------|--------------------------------|--|
| Netherlands Antilles (1996) | 35                             | ...                            | 51   |
| Belize (1997)               | 29                             | ...                            | 37   |
| Grenada (1995)              | 28                             | ...                            | 42   |
| Trinidad and Tobago (1995)  | 26                             | 28                             | 33   |
| St. Kitts and Nevis (1993)  | 25                             | 29                             | 39   |
| Aruba (1997)                | 23                             | 27                             | 40   |
| Bahamas (1993)              | 22                             | ...                            | 48   |
| Dominican Republic (1996)   | 14                             | 16                             | 27   |

Sources: IMF; and Fund staff estimates.

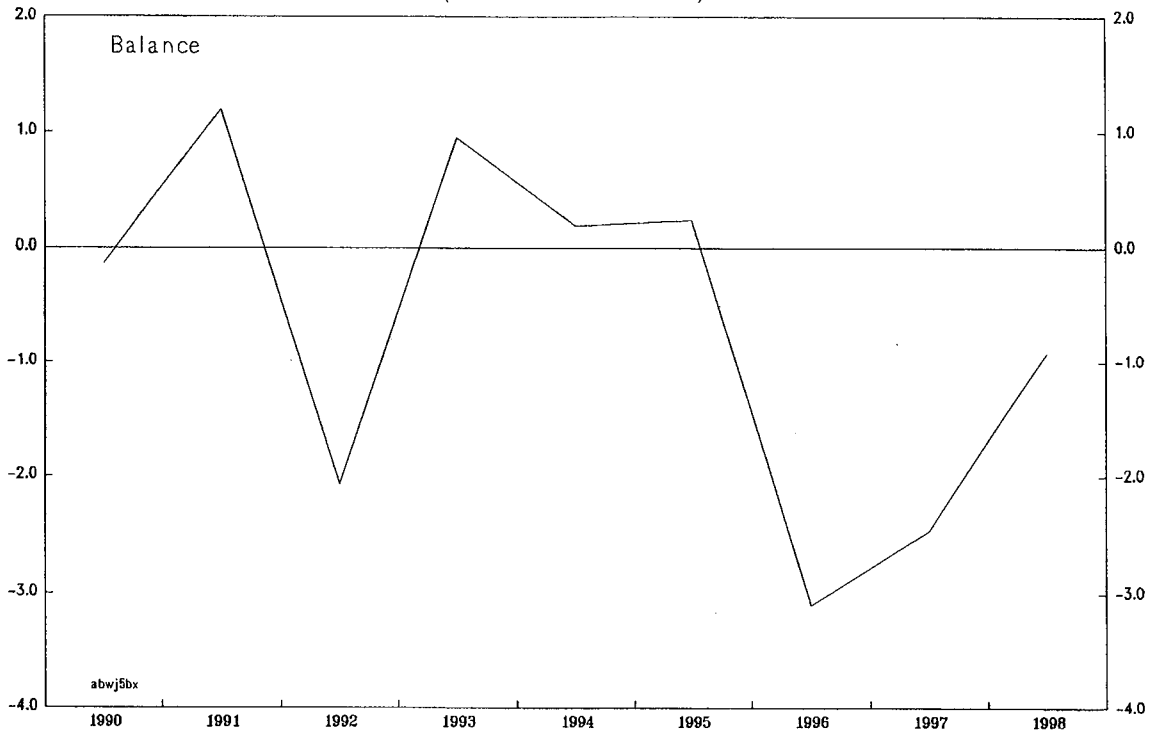
28. **Revenue performance has been hampered by a low tax base, and, in recent years, poor collection.** Tax revenues suffered from an erosion of the tax base, as tax holidays were given to many hotels and to the oil refinery. Tax revenues were also hurt by a buildup of arrears in assessments, associated with retroactive changes in the tax system.<sup>9</sup> Nontax revenues suffered from poor collection as well, as little effort was made to send out bills in time.

29. **After small surpluses in the 1993–95 period, in 1996 a surge in expenditure led to a fiscal deficit of over 3 percent, part of which was financed by a build-up of arrears (Figure 5).** Expenditure increased by 3 percent of GDP, or 22 percent in nominal terms. As

<sup>9</sup>Most important among these changes was the change in joint filing of couples. Before 1995, husband and wife had to file together; in October 1995, this was changed retroactively until 1991. In 1990, this change was announced; from 1991 onward, processing of tax returns was postponed until the law was actually changed.

FIGURE 5  
ARUBA

Public Finance  
(In Percent of GDP)



Sources: Central Bank of Aruba; Ministry of Finance; and Fund staff estimates.

no full breakdown of expenditure exists for 1996, it is not possible to identify the main source of this increase.

30. **In 1997 and early 1998, the buildup of payment arrears continued** as a partial claw-back of expenditure was offset by shortfalls in revenues. The fall in nontax revenue was especially pronounced, in part because of little attention was paid to the collection of these revenues. Tax revenues decreased as well, as a backlog of tax assessments piled up. At 2.5 percent of GDP, the 1997 deficit was little smaller than in 1996, in spite of a decline in expenditure of 3 percentage points.

31. **By mid-1998 the stock of payment arrears had reached Af. 190 million, or 6 percent of GDP.** Of this, about 30 percent was due to outside suppliers, 40 percent to the civil servants' pension fund, and the remaining 30 percent to earmarked government accounts. The government was also in arrears to two earmarked accounts: a sinking fund account that provisioned for the amortization of government debt, and a hotel guarantee fund that provisioned for guarantees still outstanding.

32. **A new government changed tack in mid-1998,** and took action to restore fiscal discipline. Various cost-cutting measures were implemented: overtime was reduced, a freeze on new hiring was enforced, limits were set on costs to travel abroad and on consultancy; telephone usage was limited, and new investment was put on hold. Also, a committee was installed to advise the ministry of finance on the financial consequences of all budgetary proposals. Overall, expenditure declined by 1½ percentage points, the deficit declined sharply, to less than 1 percent of GDP, and the amount of arrears to suppliers was reduced.

33. **Fiscal consolidation is to continue in 1999.** Tax revenues will be increased under a program (SAB) to fully eliminate the backlog in tax assessments and tax collection.<sup>10</sup> Nontax revenues will be increased by clearing the backlog in assessments, and speeding up collection of outstanding bills. Expenditure growth will remain restrained with a continuation of the measures that were put in place in 1998. With a government deficit that could end close to zero, the government plans to eliminate the outstanding payment arrears. Arrears to the pension fund will be cleared partly by converting arrears into a loan, and partly by selling land and shares in a utility company to the pension fund. Arrears to earmarked government accounts will be cleared by a reducing the amounts the governments wants to set aside in these accounts, while arrears to suppliers will be cleared through both cash payments and swaps with tax arrears.

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<sup>10</sup>The backlog in tax assessments is scheduled to be eliminated by mid-1999; and that in tax collection by mid-2000.

## Government debt

34. **At end-1998, government debt amounted to Af. 1,053 million, 34 percent of GDP.** A third of the debt is owed to external creditors, primarily the Netherlands government. Most of the foreign debt is on concessional terms—about 80 percent has interest rates of 2.5 percent or lower.

35. **Of the domestic debt, about three quarters is nontradable.** A large part of it is owed to APFA and SVB, and was accumulated with the creditors of these institutions in 1986, or as the result of contribution shortfalls and accumulated deficits during 1986–98. Only Af. 187 million of Aruba's domestic debt is tradable. Most of it is long-term debt, and only Af. 32 million carries a maturity of less than five years. The tradable debt has been contracted at market rate—the interest rate on this stock averaged 7<sup>7</sup>/<sub>8</sub> percent at end-1998.

36. **In late 1998, the government borrowed US\$38 million in the American market.** The loan, a private placement, was brokered by ABN-AMRO, had a maturity of seven years and an interest rate of about 8 percent—350 basis points over U.S. rates.

## C. Social Benefits and Insurance

37. **The Aruban social security benefits system consists of old age pensions, widow and orphan insurance, severance pay, accident insurance, and health care.** The schemes are managed by the government, the Social Insurance Bank (SVB) and the civil servants' pension fund (APFA).

### Old-age benefits and widows/orphans insurance

38. **There is a universal old age pension (AOV) and widows/orphans insurance (AWW) for all residents.** These schemes are managed by the SVB. Participants become eligible for an old age pension at age 60, and benefits depend on the number of years that the participant has contributed,<sup>11</sup> with the maximum monthly AOV pension currently at Af. 1,516 for a couple, and Af. 900 for a single person. In early 1998 some 8,350 retirees and 1,145 widows and orphans were drawing benefits (Table 6). The number of benefit recipients has been increasing rapidly in recent years, although the number of contribution payers has too, the result of substantial immigration.

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<sup>11</sup>The contribution for AOV is 11.5 percent of wages (8.5 percent paid by employers, and 3 percent by employees); and for AWW 2.0 percent (equally shared between employers and employees). The maximum yearly income on which contributions are due is Af. 49,454 per year.

Table 6. Aruba: AOV/AWW Benefit Recipients

|                        | 1994   | 1995   | 1996   | 1997   | 1998  |
|------------------------|--------|--------|--------|--------|-------|
| AOV-insured            | 52,105 | 53,543 | 55,756 | 57,197 | ...   |
| (Percent increase)     |        | 2.8    | 4.1    | 2.6    | ...   |
| AOV-benefits           | 6,895  | 7,261  | 7,664  | 8,000  | 8,351 |
| (Percent increase)     |        | 5.3    | 5.6    | 4.4    | 4.4   |
| Benefits/insured ratio | 0.132  | 0.136  | 0.137  | 0.140  | ...   |
| AWW-insured            | 70,417 | 72,357 | 75,288 | 76,191 | ...   |
| (Percent increase)     |        | 2.8    | 4.1    | 1.2    | ...   |
| AWW-benefits           | 981    | 989    | 1,023  | 1,060  | 1,145 |
| (Percent increase)     |        | 0.8    | 3.4    | 3.6    | 8.0   |
| Benefits/insured ratio | 0.014  | 0.014  | 0.014  | 0.014  | ...   |

Source: Data provided by the authorities.

39. **In recent years, a reduction in the retirement age and a doubling of benefits have led to a marked increase in pensions.** The retirement age was reduced in 1992, from 62 to 60, while the pension was increased in 1993 (by 40 percent) and 1994 (by 60 percent) and subsequently indexed to inflation (Table 7). The AOV pension is currently rather generous, at 140 percent of the minimum wage, and 100 percent of the average wage.

Table 7. Aruba: Pension Benefits  
(In Aruban florins per month)

|                    | Jan-94 | Dec-94 | Jan-96 | Jan-97 | Jan-98 | Jan-99 |
|--------------------|--------|--------|--------|--------|--------|--------|
| AOV-married        | 871    | 1,384  | 1,427  | 1,476  | 1,516  | 1,516  |
| (Percent increase) |        | 58.9   | 3.1    | 3.4    | 2.7    | --     |
| AOV-single         | 610    | 822    | 847    | 876    | 900    | 900    |
| (Percent increase) |        | 34.8   | 3.1    | 3.4    | 2.7    | --     |
| AWW                | 610    | 822    | 847    | 876    | 900    | 900    |
| (Percent increase) |        | 34.8   | 3.1    | 3.4    | 2.7    | --     |

Source: Data provided by the authorities.

40. **For civil servants, there is an additional pension scheme, administered by APFA.** The public employee pension system is restricted to full-time regular staff of public

institutions. At end-1998, some 4,400 employees were enrolled in the program and about 1,550 retirees were receiving pensions. The government pays 26 percent of the employee's salary as a premium. Employees with families contribute 8 percent of salary, while employees without families contribute 5 percent. Upon reaching the age of 55 or after 20 years of service, retiring employees receive a pension equal to 50 percent of their average salary over the preceding two years of work. In addition, for each year of work beyond 20 years of service, the pension is increased by 2 percent of salary, with a maximum pension of 70 percent of last salary. As this pension comes on top of the AOV-pension, the total retirement income for civil servants is extremely generous.<sup>12</sup>

41. **The finances of APFA have deteriorated in recent years.** This is partly the result of large wage increases associated with a multi-annual back pay scheme, and partly of an increase in the share of the civil servants' pension that was funded by APFA.<sup>13</sup> At end-1997, APFA's pension liabilities (Af. 931 million) exceeded its assets (Af. 701 million) by Af. 230 million, or over 7 percent of GDP.

42. **The government aims to make the civil servants' pension scheme less generous.** Under the new scheme, the retirement age would be increased from 55 to 60 years; the number of years served needed to get the maximum pension increased from 30 to 35 years, and the AOV pension would be built in, i.e., the APFA pension would be such that after 35 years of service, the *sum of the maximum APFA pension and the AOV pension* (rather than the maximum APFA pension alone) would be equal to 70 percent of salary. The adjustment in the pension scheme would lead to a reduction in pension contributions, from 34 percent of salary, to 20 percent.

#### **Severance pay (*cessantia* benefits)**

43. **In case of a firm's bankruptcy, employees receive a lump sum severance pay,** equal to 1 week of salary per year for the first ten years of work; 1¼ per year for between 10 years and 19 years; and 2 per year for the years exceeding 20. Severance is paid by the Cessantia fund to which employers contribute 40 guilders per employee per year.

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<sup>12</sup>As an illustrative (albeit somewhat extreme) example, for a married civil servant with a nonworking spouse and earning the minimum wage total retirement income would equal 210 percent of his pre-retirement income, consisting of an AOV-pension of 140 percent of the minimum wage and an APFA pension of 70 percent.

<sup>13</sup>In the past, part of the civil servants' pension was financed by APFA, on a capital funding basis, and part by the government on a pay-as-you-go basis. In recent years, the part that was financed on a pay-as-you-go basis has been virtually eliminated, leading to a sharp increase in the amount of capital needed by APFA.

### **Accident insurance**

44. **There is a compulsory accident insurance plan for private sector employees.** The scheme is administered by the Social Insurance Bank. Contributions differ by sector, and range from 0.5–5.0 percent of salary (up to a maximum income of Af. 49,300), fully paid by employers.

### **Health care**

45. **At end-1998, separate health insurance programs existed for current and retired civil servants, welfare recipients, private sector's employees, and the privately insured.** Overall, 61 percent of health care costs were incurred by government, 24 percent by the Social Insurance Bank (SVB), and 15 percent by private insurances and out-of-pocket expenses.

46. **The government provides health care for working and retired civil servants and their families, poor people, and family members of employees who are not insured elsewhere** (the latter two groups are referred to as "PPK-patients"). The number of insured civil servants including family members amounted to 18,000, while the number of PPK-patients was 15,000.

47. **The SVB provides health care for private sector employees.** It only insured the employees themselves; it did not insure their family members—who were covered by either private insurance or the government under the PPK-program. The scheme not only covered medical costs, but also sick leave. The contribution was 8.0 percent, fully paid by employers. Contributions have not been sufficient to cover costs, and shortfalls have been cross-subsidized by other SVB funds, especially the widows and orphans insurance (Table 8).



**Table 8. Aruba: Balances of Social Insurance Bank Schemes**  
(In millions of Aruban florins)

|                                     | 1993  | 1994 | 1995 | 1996  | 1997  |
|-------------------------------------|-------|------|------|-------|-------|
| <b>Old age insurance</b>            | 2.3   | 5.6  | 5.1  | 4.1   | 2.3   |
| Contributions                       | 50.5  | 66.6 | 94.6 | 100.2 | 103.7 |
| Benefits                            | 48.1  | 61.0 | 89.5 | 96.1  | 101.5 |
| <b>Widows and orphans insurance</b> | 2.5   | 6.7  | 8.9  | 9.6   | 9.7   |
| Contributions                       | 6.7   | 12.2 | 16.7 | 17.7  | 18.3  |
| Benefits                            | 4.2   | 5.5  | 7.8  | 8.1   | 8.6   |
| <b>Accident insurance</b>           | 2.3   | 3.3  | 5.0  | 8.7   | 4.1   |
| Contributions                       | 4.6   | 7.2  | 9.2  | 12.7  | 10.6  |
| Benefits                            | 2.3   | 4.0  | 4.2  | 4.0   | 6.4   |
| <b>Sickness insurance</b>           | -13.6 | -1.5 | 1.1  | 7.3   | -4.8  |
| Contributions                       | 13.7  | 29.9 | 36.8 | 49.7  | 43.5  |
| Benefits                            | 27.3  | 31.4 | 35.7 | 42.5  | 48.3  |
| Sick leave benefits                 | 10.8  | 10.1 | 11.5 | 14.2  | 17.3  |
| Medical costs                       | 16.5  | 21.3 | 24.2 | 28.2  | 31.0  |

Source: CBS, Statistical Yearbook, 1997.

**48. The government aims to introduce a general health insurance fund (AZV) providing health coverage for the entire population.** This insurance would gradually replace all existing health care schemes according to legislation first defined in the early 1990s. A first step would involve the consolidation of administrative functions. So far, the AZV administers health care for retired and current civil servants, and the ex-employees of the Lago refinery. The next step will be to transfer the SVB and PPK-patients; the AZV standard package will be determined at the moments these groups are transferred to the new fund.<sup>14</sup> The insurance plan will be funded through a premium paid by employers and the insured (employees), as well as by a contribution from the government. The premium rate had not yet been decided at the time of this writing.

<sup>14</sup>Health care coverage for civil servants remained unchanged when they were transferred to the AZV.

#### IV. MONETARY POLICY AND BANKING DEVELOPMENTS<sup>15</sup>

##### A. Monetary Policy Developments

###### Objectives and instruments

49. **Aruba's monetary policy is anchored in the long-standing fixed exchange rate of the Aruban florin with the U.S. dollar.**<sup>16</sup> In order to enhance the confidence in the peg, the central bank follows a currency-board like approach to monetary policy, avoiding any monetary financing of public deficits and maintaining an adequate level of net foreign assets of the domestic banking system, at 5 to 6 months of non-oil merchandise imports.<sup>17</sup> This target is intended to provide a safety margin in view of the vulnerability of Aruba's foreign exchange earnings owing to the limited diversification of its production base.<sup>18</sup>

50. Since its establishment, **the central bank has primarily relied on direct instruments of monetary policy** to ensure an adequate level of net foreign assets through domestic credit targeting. Until recently, bank-by-bank credit ceilings were imposed by the central bank, contributing on the whole to a satisfactory buildup in net foreign assets. However, the limits of this approach, including allocative distortions, were highlighted by the surge in private credit and the violation of ceilings in 1994.

51. After introducing some degree of flexibility in the system of direct credit control in 1995-96,<sup>19</sup> **the central bank replaced, in January 1997, the approach of individual credit ceilings with an aggregate credit ceiling** reinforced by moral suasion, with the objective of

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<sup>15</sup>Prepared by Angel Ubide-Querol.

<sup>16</sup>The Aruban florin has been pegged at Af. 1.79 per US\$1 since its accession to the *status aparte* in 1986. Before that, Aruba used the Netherlands Antillean guilder, which had been fixed at the same parity since 1971.

<sup>17</sup>This informal target for the medium term is based on a 12-month moving average of non-oil merchandise imports. The inclusion of imports from the Free Zone, where transactions are largely in dollars, reinforces the conservative nature of the target.

<sup>18</sup>Although in terms of "usable reserves" the target would be better defined for the net foreign assets of the central bank, the foreign exchange law provides the central bank with a priority claim on the foreign assets of commercial banks. In addition, because of the B-9 regulation (see below), the central bank holds about 75 percent of the net foreign assets of the banking system.

<sup>19</sup>Banks were authorized to exceed their individual ceilings against payment of compensating fees, and to trade unused portions of their available credit among themselves.

containing private credit growth at or below nominal GDP growth. This aggregate credit ceiling was set at 7 percent in 1997 and 6 percent in 1998. For operational purposes, the central bank monitors developments in bank lending, foreign exchange reserves, and the inflation differential with the United States on a weekly and monthly basis.

**52. The central bank also has some indirect instruments of monetary control at its disposal, but has used them sparingly in recent years.** The most important is the cash reserve requirement for deposit money banks. Introduced in 1991, this requirement was raised in April 1995 and in April 1998 to sterilize excess liquidity and reinforce the accumulation of net foreign assets. Currently, commercial banks are required to hold monthly interest-bearing deposits equivalent to a minimum of 7 percent of their outstanding current savings and time deposits of maturities shorter than two years. Banks falling short of the cash requirement are required to pay compensating fees as determined by the cash reserve requirement penalty rate set by the central bank. In January 1997, the penalty rate was reduced from 7.5 percent to 5.5 percent in order to ease the high effective costs of such drawings.

**53. The introduction of the reserve requirement contributed in the past to the emergence of a small interbank call-money market in which banks exchanged liquidity surpluses and deficits at below-penalty rates, with the central bank frequently acting as an informal broker.** However, the lack of a wide menu of liquid assets to be pledged as collateral precluded the development of an active market, and this practice has faded out over time.

**54. The central bank also sets rediscount and advance rates for commercial bank access.** These have been maintained at 8.5 percent and 9.5 percent, respectively, since 1986. The discount facility has not been used and the advance rate is specifically reserved for the lender of last resort facility. In addition, the transmission mechanism of interest rate changes is very poorly developed in Aruba, owing to the ample bank liquidity, the limited competition among financial institutions, and the underdevelopment of capital markets. As a result, official interest rates have had a very limited influence on commercial banks' interest rates in recent years and deposit and lending rates have not varied significantly over time, allowing for the maintenance of large deposit-lending spreads.

**55. The scope for strengthening the role of other indirect monetary policy instruments is rather limited at present.** In particular, the small size of domestic money and capital markets, together with the oligopolistic structure of the Aruban banking system, complicates the introduction of a stable and efficient system of open market operations.

**56. An important feature that constrains monetary policy is the extensive dollarization of the economy.** The precise magnitude of co-circulation of the U.S. dollar is unknown, but there are indications that it is large. The share of dollar-denominated deposits in the money supply stands at about 10 percent; however, the low ratio of Aruban banknotes to nominal GDP suggests that the fraction of currency that is dollars is significantly higher. Most

tourist transactions are in U.S. dollars, ATM machines supply dollars to nonresidents, price labeling in dollars is pervasive in the tourism and retail sectors, and trade with the United States and several South American countries (partly via the Free Zone) has intensified, thus bringing more cash dollars into circulation. In February 1997, the central bank proposed to promote the use of the florin by encouraging businesses to provide change for tourism and retail transactions in Aruban florins. However, this proposal has not yet led to noticeable results. The existence of a fee for the conversion of florins into foreign exchange may in addition inhibit the conversion of U.S. dollars into florins.

### **Developments in money and credit**

**57. The central bank's credit targeting policy proved relatively successful until the early 1990s, as domestic credit growth considerably trailed the change in nominal GDP (Table 9), facilitating the steady accumulation of net foreign assets in the banking system (Figure 6).** In 1993–94, however, commercial banks experienced marked excess liquidity, owing to buoyant economic activity and the lack of significant investment opportunities other than domestic loans. This prompted a sharp acceleration in bank lending in 1994–96 which reversed the upward trend in net foreign asset accumulation.

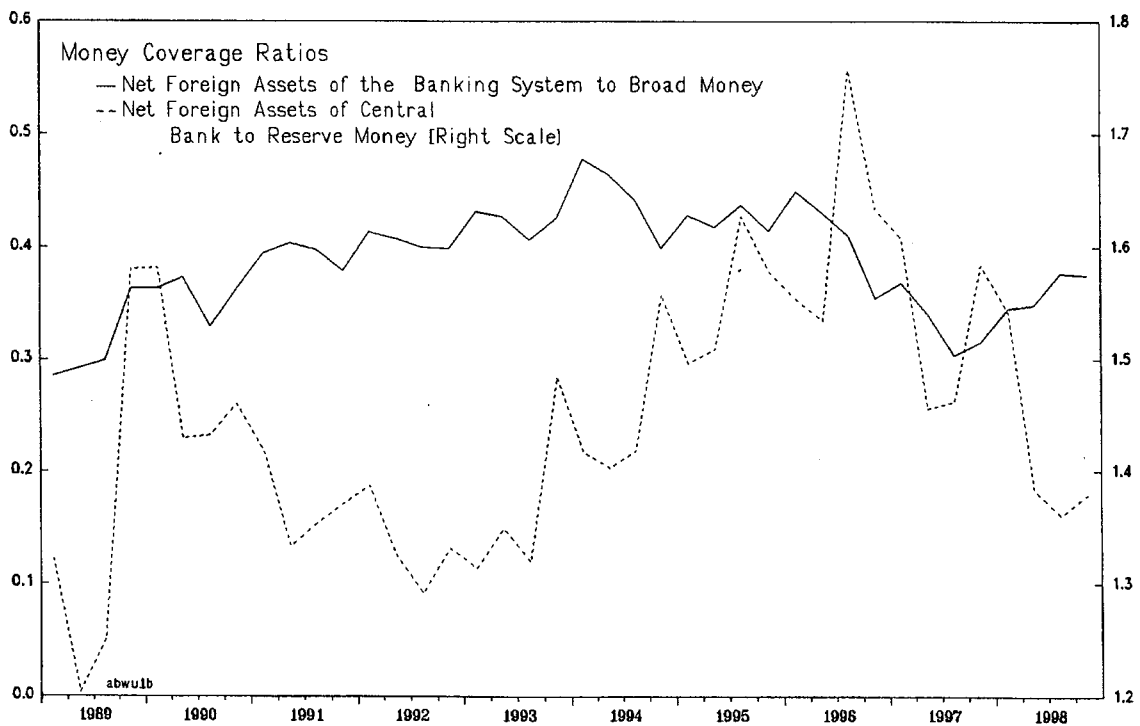
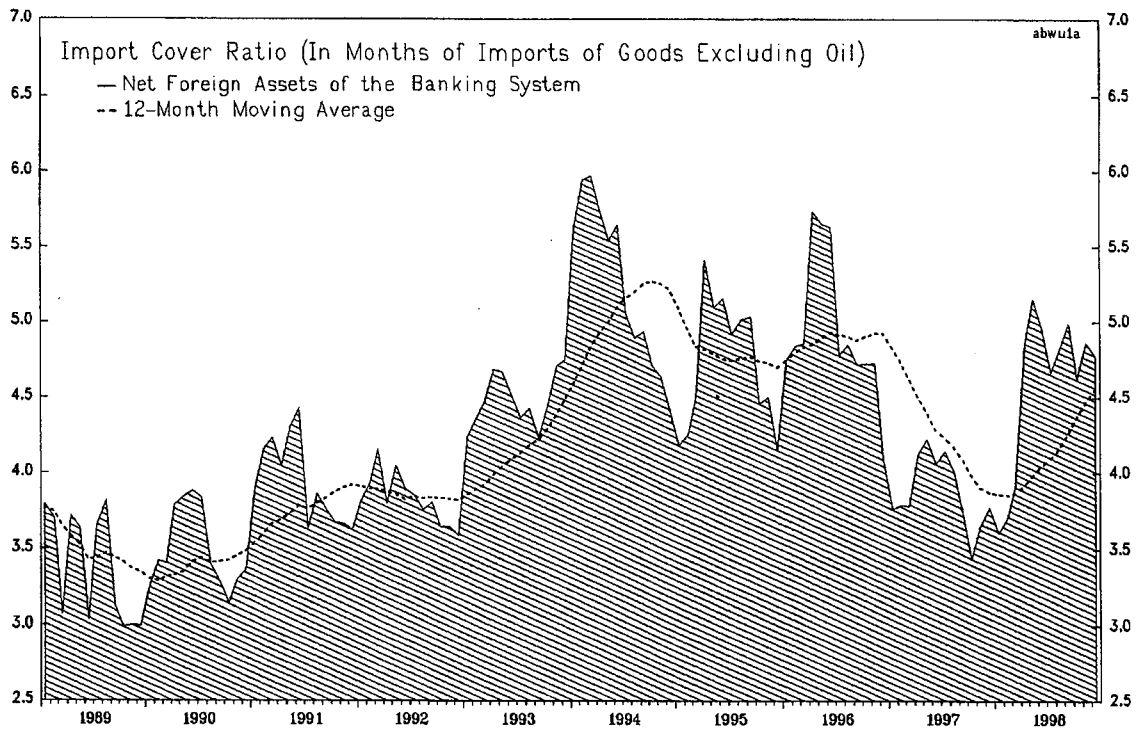
**58. Reflecting the adequate level of international reserves, the virtual disappearance of the inflation differential with the United States and confidence in its management of domestic liquidity, the central bank eliminated the individual credit ceiling system in 1997, setting an aggregate net domestic credit ceiling in line with nominal GDP growth, or about 7 percent.** This ceiling was breached, however, although by a small margin, for net domestic credit grew by about 8 percent.<sup>20</sup> Net foreign assets declined by an additional 9 percent, in part because of the slowdown in oil exports during the maintenance work at the refinery, and the import-coverage ratio sank to less than four months of imports at end-1997.

**59. In 1997, net domestic credit increased by Af. 97 million, or 8.3 percent.** Consumer and mortgage lending were again the main sources of private credit growth, in a context of high demand for residential construction and intensified promotional campaigns by banks, especially for car loans. The slowdown in business activity led to a subdued growth in loans to enterprises, which grew by only about 2.5 percent. At the same time, private sector credit to

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<sup>20</sup>Actual growth of credit to the private sector was 5.5 percent (Table 9). However, this includes a large divestment of a commercial bank in the former Inter-Ohra Hypotheekbank, which masks the growth of loans to the private sector, the target of interest for the central bank.

### Foreign Reserve Position



Sources: Central Bank of Aruba, Quarterly Bulletin and staff calculations.

Table 9. Aruba: Monetary Survey

|  | 1992    | 1993    | 1994    | 1995    | 1996    | 1997    | 1998    |
|--|---------|---------|---------|---------|---------|---------|---------|
| (In millions of Aruban florins; end of period) |         |         |         |         |         |         |         |
| Net foreign assets                             | 363.1   | 417.2   | 449.8   | 478.3   | 433.3   | 393.6   | 553.5   |
| Central bank                                   | 264.2   | 323.4   | 319.8   | 396.3   | 349.2   | 316.4   | 408.3   |
| Commercial banks                               | 98.9    | 93.8    | 130.0   | 82.0    | 84.1    | 77.2    | 145.2   |
| Net domestic credit                            | 761.1   | 781.2   | 915.4   | 956.9   | 1,085.2 | 1,175.8 | 1,244.0 |
| Public sector                                  | 7.1     | -30.5   | -34.1   | -60.6   | -38.8   | -9.7    | -8.9    |
| Central government                             | 24.3    | -17.8   | -26.1   | -51.9   | -36.2   | 0.1     | 0.9     |
| Development aid                                | -17.2   | -12.7   | -8.0    | -8.7    | -2.6    | -9.8    | -9.8    |
| Private sector                                 | 754.0   | 811.7   | 949.5   | 1,017.5 | 1,124.0 | 1,185.5 | 1,252.9 |
| Enterprises                                    | 517.8   | 514.8   | 577.0   | 608.8   | 620.0   | 635.8   | 635.4   |
| Consumer credit                                | 133.8   | 164.4   | 211.4   | 214.6   | 233.2   | 269.2   | 290.8   |
| Housing mortgages                              | 91.2    | 123.3   | 152.7   | 185.9   | 243.1   | 263.2   | 299.0   |
| Other  | 11.2    | 9.2     | 8.4     | 8.2     | 27.7    | 17.3    | 27.7    |
| Other items (net)                              | -123.5  | -133.8  | -166.5  | -173.9  | -214.7  | -208.6  | -258.7  |
| Money supply (M2)                              | 1,000.7 | 1,064.6 | 1,198.7 | 1,261.3 | 1,301.1 | 1,360.8 | 1,538.8 |
| Money (M1)                                     | 331.3   | 377.9   | 441.5   | 435.4   | 445.0   | 473.1   | 537.1   |
| Quasi-money                                    | 669.4   | 686.7   | 757.2   | 825.9   | 856.1   | 887.7   | 1,001.7 |
| (12 month percentage change)                   |         |         |         |         |         |         |         |
| Memorandum items                               |         |         |         |         |         |         |         |
| Net foreign assets                             | 22.1    | 14.9    | 7.8     | 6.3     | -9.4    | -9.2    | 40.6    |
| Central bank                                   | 18.1    | 22.4    | -1.1    | 23.9    | -11.9   | -9.4    | 29.0    |
| Commercial banks                               | 34.6    | -5.2    | 38.6    | -36.9   | 2.6     | -8.2    | 88.1    |
| Net domestic credit                            | 9.8     | 2.6     | 17.2    | 4.5     | 13.4    | 8.3     | 5.8     |
| Public sector                                  | -888.9  | -529.6  | 11.8    | 77.7    | -36.0   | -75.0   | -8.2    |
| Central government                             | 118.9   | -173.3  | 46.6    | 98.9    | -30.3   | -100.3  | 800.0   |
| Development aid                                | 43.3    | -26.2   | -37.0   | 8.7     | -70.1   | 276.9   | 0.0     |
| Private sector                                 | 8.6     | 7.7     | 17.0    | 7.2     | 10.5    | 5.5     | 5.7     |
| Enterprises                                    | 5.1     | -0.6    | 12.1    | 5.5     | 1.8     | 2.5     | -0.1    |
| Consumer credit                                | 7.1     | 22.9    | 28.6    | 1.5     | 8.7     | 15.4    | 8.0     |
| Housing mortgages                              | 35.7    | 35.2    | 23.8    | 21.7    | 30.8    | 8.3     | 13.6    |
| Other  | 21.7    | -17.9   | -8.7    | -2.4    | 237.8   | -37.5   | 60.1    |
| Other items (net)                              | 22.2    | 8.3     | 24.4    | 4.4     | 23.5    | -2.8    | 24.0    |
| Money supply (M2)                              | 12.5    | 6.4     | 12.6    | 5.2     | 3.2     | 4.6     | 13.1    |
| Money (M1)                                     | 5.5     | 14.1    | 16.8    | -1.4    | 2.2     | 6.3     | 13.5    |
| Quasi-money                                    | 16.3    | 2.6     | 10.3    | 9.1     | 3.7     | 3.7     | 12.8    |

Sources: Central Bank of Aruba Quarterly Bulletin; and Fund staff calculations.

the government increased by Af. 29 million, almost double that in 1996, contributing 2.2 percentage points to the growth of broad money.

60. **In the event, broad money expanded by 4.6 percent, fueled by strong domestic credit growth.** Reversing the trend of past years, both money and quasi money contributed equally to broad money creation. Narrow money grew by Af. 28 million, or 6.3 percent, and quasi money grew by Af. 32 million, or 3.7 percent, reflecting increases in time and saving deposits.

61. **In order to reverse the downward trend in net foreign assets, the central bank tightened monetary policy in 1998.** The aggregate net domestic credit ceiling was lowered to 5–6 percent, and the cash reserve requirement was raised from 6 percent to 7 percent as of April 1998. The strategy proved successful and the accumulated Af. 85 million decline in 1996–97 was more than offset by an Af. 160 million, or 41 percent, increase in 1998, which set the foreign exchange coverage at about 4.5 months of imports at end-1998. At this level, total net foreign assets of the banking system amounted to about 180 percent of reserve money, of which about 80 percent was in the hands of the central bank. This turnaround was brought about by capital imports to finance several projects in the oil, utilities, and hotel sectors, a foreign loan to the government,<sup>21</sup> subdued growth in bank lending, and the absence of net domestic monetary financing by the government.

62. **The growth in net foreign assets was the main contributor to broad money expansion, which increased by 13.1 percent during 1998.** Net domestic assets rose by Af. 68 million, or 5.9 percent. The trends in private sector credit continued, as both consumer credit and mortgage credit grew strongly by 8 percent and 14 percent, respectively, whereas loans to enterprises shrank by about 2 percent. Expenditure restraint contributed to a small increase in credit to government of about Af. 0.8 million. Both narrow money and quasi-money grew by about 13 percent.

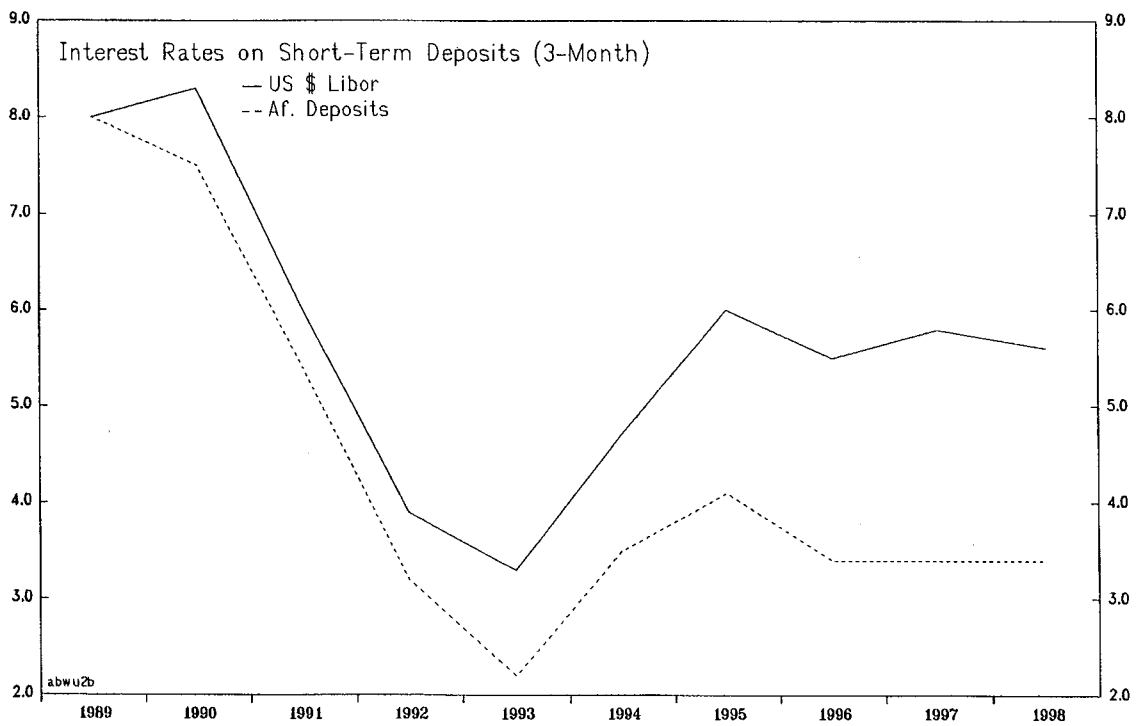
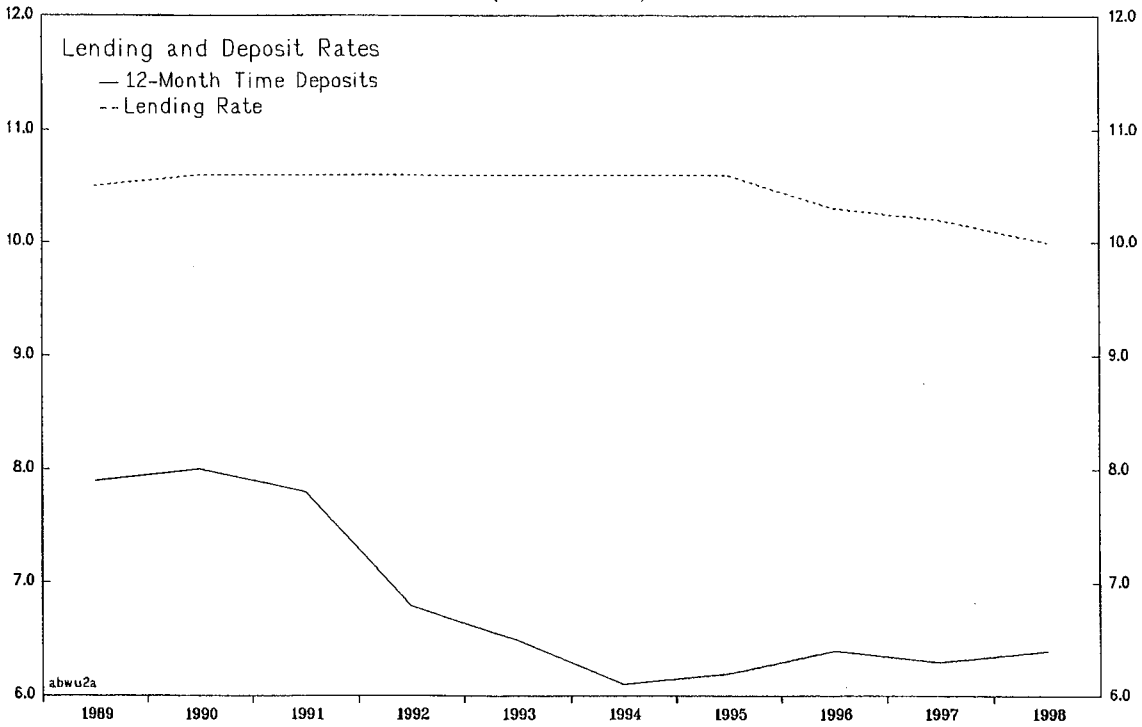
63. **Official and bank interest rates varied little during 1997–98.** The negative interest rate differential vis-à-vis the United States on time deposits fluctuated somewhat, although owing solely to fluctuations in U.S. interest rates. Bank lending rates decreased slightly as competition for consumer loans increased, but remained significantly higher than those in the United States. On the whole, the spread between lending and deposit rates was still high by international standards (Figure 7).

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<sup>21</sup>See paragraph 41.

FIGURE 7  
ARUBA

### Interest Rates of Commercial Banks (In Percent)



Sources: Central Bank of Aruba, Quarterly Bulletin.



## **B. Banking Sector Developments**

### **Background and recent developments**

64. **The financial sector in Aruba is relatively small** and consists of six local commercial banks—three of which are branches or subsidiaries of banks established in the Netherlands or the Netherlands Antilles—two offshore banks, two mortgage banks, other financial institutions specialized in project finance and personal and mortgage loan activity, insurance companies, and investment funds. In addition, there is a small nonbank offshore financial sector.

65. **The aggregated balance sheet of the domestic commercial banks amounted to Af. 2,095 million (US\$1,170 million) at end-1998.** These banks are principally involved in traditional lending activities. They obtain their funds mainly from domestic deposits, invest almost 95 percent of their assets in domestic loans, and try to balance the currency composition of their portfolio. A selection of indicators of the soundness of the sector appears in Table 10. Profits are high, with a (before-tax) return on capital averaging 38 percent over 1994–98. Banks generally comply with the central bank regulations on provisioning and capitalization, and the aggregate risk-based capital adequacy ratio has remained above the 8 percent recommended by the Basle Committee—most of the banks having adequacy ratios larger than the 10 percent required by the central bank. The scope for systemic risk in the local banking system is limited by the narrow scope of banks' activities: investment in securities is low, foreign exposures are hedged, and the risk of spillovers is trimmed by the very limited interbank activity. In addition, and probably because of the lack of investment opportunities, banks maintain an adequate liquidity position, as indicated by a liquid assets ratio well over the 20 percent required by the central bank.<sup>22</sup>

66. **Because of the recent slowdown in business activity, banks have shifted their attention toward the more lucrative mortgage and consumer lending businesses.** In addition, banks have upgraded their technology systems to cope with rising competition, the number of ATMs and point of sale systems has increased considerably, and new retail banking products have been introduced. In June 1997 a new electronic clearing system entered into operation. It complies with the rules of the U.S. National Automated Clearing House Association, and allows for twice-daily batch settlements. Aruba has the first Caribbean banking system with such an electronic clearing system.

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<sup>22</sup>However, liquidity has recently been unevenly distributed among banks, and those that are not part of larger international groups have had difficulties in complying with the liquidity requirements.

Table 10. Aruba: Indicators of Commercial Banks' Soundness

|                                      | 1994                           | 1995  | 1996  | 1997  | 1998  |
|--------------------------------------|--------------------------------|-------|-------|-------|-------|
| <b>Vulnerability Indicators</b>      |                                |       |       |       |       |
|                                      | (In percent)                   |       |       |       |       |
| Foreign assets/Foreign liabilities   | 148.1                          | 128.2 | 126.1 | 119.9 | 150.6 |
|                                      | (In percent of total assets)   |       |       |       |       |
| Investment in domestic securities    | 2.7                            | 2.4   | 4.3   | 3.6   | 3.6   |
| Investment in foreign securities     | 1.5                            | 2.0   | 1.3   | 1.0   | 0.6   |
|                                      | (In percent)                   |       |       |       |       |
| <b>Solvency Indicators</b>           |                                |       |       |       |       |
| Return on Capital                    | 40.6                           | 39.1  | 43.5  | 36.3  | 30.7  |
| Return on Assets                     | 1.8                            | 1.8   | 2.3   | 2.0   | 1.5   |
| Capital Adequacy Ratio (CAR)         | 10.1                           | 10.6  | 10.8  | 11.2  | 10.2  |
|                                      | (Number of banks)              |       |       |       |       |
| Institutions not meeting minimum CAR | 1                              | 1     | 1     | 1     | 1     |
|                                      | (In percentage of total loans) |       |       |       |       |
| <b>Provision for loan losses</b>     |                                |       |       |       |       |
| Allocated                            | 6.1                            | 7.0   | 5.6   | 5.1   | 5.5   |
| Unallocated                          | 2.7                            | 2.5   | 1.9   | 2.1   | 2.3   |
|                                      | (In percent)                   |       |       |       |       |
| <b>Liquidity Indicators</b>          |                                |       |       |       |       |
| Loan/Deposit                         | 66.5                           | 67.8  | 73.2  | 72.9  | 69.7  |
| Liquid Assets ratio                  | 32.3                           | 30.4  | 24.2  | 24.6  | 29.7  |
| <b>Memorandum items</b>              |                                |       |       |       |       |
| Number of Institutions               | 6                              | 6     | 6     | 6     | 6     |

Sources: Central Bank of Aruba; and Fund staff calculations.

67. **There are two offshore banks operating in Aruba.**<sup>23</sup> They are a branch and a subsidiary of Citibank, and fall under the consolidated supervision of the Federal Reserve System and the United States Comptroller of the Currency. Total assets of the offshore bank sector grew significantly in 1997-98, and are now somewhat bigger than those of commercial banks, totaling Af. 2,294 million (US\$1,282 million) as of September 1998. This growth corresponded to a surge in lending funded mainly by demand deposits. As the offshore banking sector was exempt from domestic prudential supervision laws until recently, the central bank adopted a strict admission policy in 1993, under which no new banks have been licensed. The admission requirements include: satisfactory and comprehensive consolidated supervision of parent companies by home country supervisors; a strong financial position and a solid reputation, together with an irrevocable guarantee of the parent company in favor of the offshore bank; and an acceptable minimum (A-) rating from a major rating agency (such as Moody's or Standard and Poor's).

68. **In addition to the banking institutions, ten life insurance companies, nine pension funds, and one saving fund operate in Aruba, with total assets of Af. 1,258 million as of end-December 1996.** All of these institutions are supervised by the central bank. Insurance companies expanded significantly their activities in recent years, especially in holdings of bonds and the mortgage business, and their aggregate assets grew by 16 percent in 1996. Pension funds increased their assets by 10 percent in 1996, following conservative investment strategies: of their total investments, more than half consist of government bonds and time deposits, whereas the share of stocks amounted to about 16 percent.

69. **In the late 1980s, the government decided to put on hold the development of the offshore (nonbank) financial sector. However, in its attempts to diversify the economy, the Aruban authorities have recently decided to resume the development of offshore activities.** A government office was created for this purpose, the Aruba Financial Center, headed by a High Commissioner who will be in charge, once appropriate legislation is enacted, of the supervision of the offshore nonbank financial sector. Currently the offshore financial sector is rather small, comprising about 6,000 AVVs (Aruba tax-exempt companies) in activities such as real estate, pension and investment funds, collections, royalties, and so forth.<sup>24</sup> Future expansion is sought in rendering services to Latin American corporations, especially in the area of captive insurance, offshore mutual funds and leasing companies, placing the emphasis on quality rather than on quantity. Proper regulation has been developed, giving priority to ensuring the transparency and integrity of the operations of trust companies, and it is expected to be implemented in the course of 1999.

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<sup>23</sup>Owing to the banking crisis of 1994 in Venezuela, five offshore banks affiliated with Venezuelan banks ceased their activities in 1995.

<sup>24</sup>AVVs cannot be used as a legal entity for a bank and for certain insurance activities.

## **Prudential regulation and supervision**

70. **Together with the primary task of maintaining the value of the national currency, the central bank of Aruba is responsible for promoting soundness and safeguarding the financial integrity of the domestic financial system.** The central bank is accordingly entrusted with the execution of prudential supervision for banks and institutional investors, including life insurance companies and pension funds. The total amount of institutions supervised was 39 as of end-1998.

71. **In May 1998, the authorities introduced a new State Ordinance on the Supervision of the Credit System.** It is based on the Dutch Act on the Supervision of the Banking System and is largely in compliance with the Basle Committee *Core Principles for Effective Banking Supervision*. This new legislation replaces the prior supervisory framework that was based on the Banking Act of 1972. The new act provides the central bank with a modern legal supervisory framework, formalizes most of the methods already applied in practice, and places offshore banks under the supervision of the central bank.<sup>25</sup> A system of gradual intervention, similar to the U.S. Prompt Corrective Action program, is available to avoid any spillover from an individual bank's to the rest of the banking system. New legislation has also been prepared for the supervision of the insurance industry, which would bring general insurance companies (in addition to life insurance companies, which are already supervised on the basis of an informal agreement) under the central bank's supervision.

72. **The central bank is responsible for granting bank licenses, in the course of which it imposes a comprehensive range of requirements** concerning inter alia the financial position and reputation of shareholders; the consolidated supervision and the agreement of the supervisory authorities of the country of the parent corporation; the qualifications and management record; and administrative organization and internal control systems. Among other things, local banks have to report on their financial situation on a monthly basis; provide the central bank with their annual report and a management letter certified by an external auditor; inform the central bank and obtain its approval for any change in their management, supervisory board, composition of shareholders, or for any participation in another company.

73. **Commercial banks also have to comply with several solvency, liquidity, and exposure ratios.** The most important are the risk-weighted capital adequacy ratio, set to a minimum of 10 percent; the liquidity ratio, which requires banks to keep at least 20 percent of their total assets in liquid form (i.e., cash, demand and time deposits at the central bank and other banks, and treasury bills and bonds with residual maturity of less than one year); the loan-to-deposit ratio, which requires that total net loans cannot exceed 80 percent of total deposits; and the large-loans ratio, which stipulates that credit extension to a group of connected customers do not exceed 25 percent of total capital (in addition, banks have to

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<sup>25</sup>An important difference with respect to the previous supervisory framework is the enhanced operational independence of the supervisory authority from the government.

report loans exceeding 15 percent of total capital or Af. 500,000).<sup>26</sup> The central bank also limits the aggregate credit extension to insiders to 2 percent of total capital, and 1 percent for individual credits. As for foreign exchange exposure, commercial banks cannot maintain negative open positions, and must limit their positive open positions to 10 percent of their deposits (the B-9 rule, see paragraph 98 below).

**74. In practice, prudential supervision for local banks is executed through continuous off-site surveillance and periodic on-site examinations.** Surveillance consists mainly of analysis of the monthly reports submitted by banks and the certified annual report and management letter prepared by the external auditor. During on-site examinations, the central bank evaluates specific risk areas, such as the quality of the loan portfolio, the adequacy of the loan loss provisions, the quality of the administrative organization and internal controls, and the anti-money laundering procedures.<sup>27</sup> The central bank's findings are discussed with the banks' management and recommendations or directives can be issued.

**75. With three of the six local banks being subsidiaries or branches of foreign banks, the central bank of Aruba places much emphasis on exchanging information and cooperating with foreign supervisors,** from the Netherlands and the Netherlands Antilles in particular. In this regard, the central bank has endorsed the reports on the minimum standards for the supervision of international banking groups and their cross-border establishments (1992) and on the supervision of cross-border banking (1996) issued by the Basle Committee. The central bank applies these minimum standards when exchanging information with foreign supervisors or when evaluating an application of a foreign bank to operate in its jurisdiction. In light of the increasing complexity and growing internationalization of financial markets, the central bank also places emphasis on membership of regional and international supervisory organizations.

**76. The Aruban authorities have implemented new measures against money laundering in recent years.** The central bank issued in March 1997, and revised in 1998, the "Directives for Deterring and Detecting Money Laundering," which update a set of guidance notes issued in March 1995. These directives implement the legislation enacted in February 1996 on the reporting of unusual transactions and identification for rendering financial services, and set clear standards for the establishment of internal controls and the identification of customers and transactions in the banking sector. Banks must report to an independent entity, the Reporting Center for Unusual Transactions, which transmits its findings to the law enforcement agencies. With this new legislation, comparable to the Dutch law in this area, Aruba complies with the most important recommendations of the G-10 Financial Action Task

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<sup>26</sup>Compliance with the EU Directive on capital requirements for aggregated large exposures is informally monitored during on-site examinations.

<sup>27</sup>Banks use their own internal guidelines for loan classification and provisioning rules. In general, a loan is classified as nonperforming after having been in arrears for six months.

Force (FATF) against money laundering. Aruba has also endorsed the recommendations of the regional Caribbean FATF, and the new legislation enacted on the supervision of the banking and insurance industry provides the central bank with additional means to ensure the stability and the integrity of the financial system.

77. **The central bank began to address the Y2K problem in 1997.** It issued a directive to all supervised organizations regarding the time frame that must be followed, and forwarded relevant information supplied by international organizations concerning issues such as project organization, testing of automated systems, and contingency planning. To monitor the process, the central bank conducted two surveys, in August 1997 and 1998, and evaluates the Y2K file during on-site examinations. Most institutions have already upgraded their systems to a Y2K-compliant version, but as of December 1998 they had not yet completed the testing of the most critical systems. The central bank is confident that supervised institutions will solve the problem on time. The remaining risks include three main issues: branches and subsidiaries are highly dependent on their head offices; the small size of Aruban financial institutions removes them from the priority list of international suppliers in case of calamity; mission-critical systems at the Aruban utility companies could fail.

## V. DEVELOPMENTS IN BALANCE OF PAYMENTS AND EXCHANGE RESTRICTIONS<sup>28</sup>

### A. Developments in Balance of Payments<sup>29</sup>

78. **Recent movements in Aruba's balance of payments have been dominated by large swings in the accounts of the oil sector and, to a lesser extent, in the Free Zone.** External transactions in these two sectors have been heavily influenced by a combination of large investments, inventory adjustments, and specific commodity flows. Because their operations are largely outside the domestic banking system, movements in the external current account of these sectors may not reflect underlying trends in the savings and investment balances of the Aruban economy, nor may they have a durable impact on the level of foreign exchange reserves.

#### Background and overview

79. **Following the closure of the Lago Oil refinery and the accession to *status aparte* in 1986, Aruba posted large and persistent current account deficits during the second half of the 1980s, which peaked at more than 20 percent of GDP in 1990–91 as a result of the extensive investment program underway in the tourism sector.** As investments were being completed, receipts from oil exports and tourism increased strongly, thus reversing the trend

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<sup>28</sup>Prepared by Angel Ubide-Querol.

<sup>29</sup>The Central Bank of Aruba has adopted the recommendations of the fifth *IMF Balance of Payments Manual* for the presentation for its balance of payments.

and posting a current account surplus of about Af. 61 million (2.8 percent of GDP) on average in 1992–94. The temporary shutdown of the refinery for maintenance work in 1995–96 resulted in a large deterioration in the trade balance of the oil sector, and the current account balance turned into deficit, which amounted to Af. 111 million (4 percent of GDP) in 1996 (Table 11).

**80. The capital and financial account largely mirrored the fluctuations of the trade balance of the oil sector.** Current account deficits were in general adequately financed by capital inflows, generating balance of payments surpluses until 1993. The reduction in foreign investment, the purchase of the Radisson hotel by the government, and some profit repatriation led, however, to overall balance of payment deficits in 1994 and 1996.

#### **The current account in 1997–98**

**81. In 1997, the overall current account deficit stood at Af. 351 million (11.9 percent of GDP), almost three times higher than in 1996.** This widening deficit was predominantly caused by a turnaround in the trade account of the oil sector from an Af. 180 million surplus to an Af. 21 million deficit. Its export receipts from refined oil products and goods procured in ports fell by 4 percent, owing to both a decrease in export volume during the works to increase capacity in the refinery and a drop in international prices. In contrast, import payments for crude oil and other goods, as well as transportation and insurance costs related to these inputs, increased by about the same percentage. The surplus of the Free Zone declined in 1997 to Af. 19 million, from Af. 34 million in 1996, reflecting a large dividend payment of Af. 14 million to nonresident shareholders. The current account deficit of the rest of the economy widened to Af. 49 million in 1997. This deterioration was caused by an Af. 33 million decrease in the services account surplus mainly related to the restructuring of the airport and the slowdown in net tourism revenues. The merchandise account deficit shrank by Af. 29 million to Af. 763 million.

**82. The resumption of normal activity in the oil sector and strong tourism receipts brought the overall current account to a Af. 39 million surplus (1.3 percent of GDP) in 1998.** The oil sector current account posted a small deficit of 47 million, thanks to the completion of maintenance work and the subsequent recovery of trade activities that turned its merchandise account from an Af. 21 million deficit in 1997 to a surplus of Af. 159 million in 1998. The surplus of the Free Zone declined further to Af. 13 million, as imports increased significantly more than exports. The rest of the economy achieved a current account surplus of Af. 74 million, with the services account surplus, boosted by strong tourism receipts, more than compensating for a widening merchandise account deficit.

Table 11. Aruba: Balance of Payments by Sectors

|                                 | 1992   | 1993   | 1994   | 1995   | 1996   | 1997   | 1998 1/ |
|---------------------------------|--------|--------|--------|--------|--------|--------|---------|
| (In millions of Aruban florins) |        |        |        |        |        |        |         |
| Current Account                 | 38.8   | 38.7   | 107.6  | -27.6  | -110.8 | -350.9 | 39.2    |
| Trade balance                   | -355.3 | -334.7 | -147.1 | -446.7 | -539.8 | -700.1 | -589.7  |
| Oil sector                      | 222.3  | 241.3  | 496.9  | 277.4  | 186.0  | -6.5   | 158.5   |
| Free zone                       | 21.1   | 51.5   | 24.0   | 28.3   | 71.7   | 84.4   | 61.0    |
| Other                           | -598.7 | -627.5 | -668.0 | -752.4 | -797.5 | -778.0 | -809.2  |
| Services                        | 412.3  | 403.7  | 298.6  | 385.4  | 456.7  | 399.8  | 628.2   |
| Travel and tourism              | 699.3  | 724.4  | 718.5  | 794.8  | 907.2  | 957.5  | 1,034.2 |
| Transportation                  | -204.9 | -239.8 | -225.4 | -219.9 | -290.4 | -332.0 | -207.3  |
| Government services             | -33.3  | -28.9  | -20.3  | -34.3  | -25.5  | -39.8  | -25.0   |
| Other services                  | -48.8  | -52.0  | -174.2 | -155.2 | -134.6 | -185.9 | -173.7  |
| Income                          | -17.3  | -21.3  | -25.1  | -16.5  | -21.2  | -30.8  | 9.6     |
| Current Transfers               | -0.9   | -9.0   | -18.8  | 50.2   | -6.5   | -19.8  | -8.9    |
| Financial and capital account   | 18.1   | 12.5   | -71.5  | 62.4   | 53.6   | 315.7  | 125.9   |
| Private Capital                 | -17.9  | -3.8   | -92.6  | 34.3   | 41.8   | 293.4  | 69.6    |
| Oil sector                      | -75.5  | -52.2  | -169.4 | -23.2  | 110.8  | 326.3  | 120.8   |
| Non-oil sector                  | 57.6   | 48.4   | 76.8   | 57.5   | -69.0  | -32.9  | -51.2   |
| Government capital              | 36.0   | 16.3   | 21.1   | 28.1   | 11.8   | 22.3   | 56.3    |
| Inflows                         | 50.3   | 28.0   | 38.3   | 47.3   | 27.9   | 38.3   | 72.4    |
| Grants                          | 18.1   | 15.3   | 20.3   | 27.1   | 27.9   | 38.3   | 15.7    |
| Loans                           | 32.2   | 12.7   | 18.0   | 20.2   | 0.0    | 0.0    | 56.7    |
| Outflows                        | 14.3   | 11.7   | 17.2   | 19.2   | 19.0   | 20.0   | 21.0    |
| Banking sector                  | -25.4  | 5.1    | -36.2  | 48.0   | -2.1   | 6.9    | -68.0   |
| Errors and omissions            | 8.9    | 3.5    | -3.5   | -6.3   | 12.2   | -4.5   | -5.2    |
| Change in monetary gold         | 0.0    | 0.0    | 0.0    | -1.2   | 3.0    | 0.0    | 0.0     |
| Change in reserves 2/           | 40.4   | 59.8   | -3.6   | 75.3   | -44.1  | -32.8  | 91.9    |
| (In percent of GDP)             |        |        |        |        |        |        |         |
| Memorandum items:               |        |        |        |        |        |        |         |
| Current Account                 | 2.1    | 1.9    | 4.5    | -1.1   | -4.0   | -11.9  | 1.3     |
| Oil sector                      | 12.1   | 11.7   | 20.9   | 11.0   | 6.8    | -0.2   | 5.1     |
| Free zone                       | 1.2    | 2.5    | 1.0    | 1.1    | 2.6    | 2.9    | 2.0     |
| Other                           | -32.7  | -30.3  | -28.1  | -29.8  | -29.0  | -26.4  | -26.2   |
| Financial and capital account   | 1.0    | 0.6    | -3.0   | 2.5    | 1.9    | 10.7   | 4.1     |
| Private Capital                 | -1.0   | -0.2   | -3.9   | 1.4    | 1.5    | 9.9    | 2.2     |
| Oil sector                      | -4.1   | -2.5   | -7.1   | -0.9   | 4.0    | 11.1   | 3.9     |
| Non-oil sector                  | 3.1    | 2.3    | 3.2    | 2.3    | -2.5   | -1.1   | -1.7    |
| Government capital              | 2.0    | 0.8    | 0.9    | 1.1    | 0.4    | 0.8    | 1.8     |
| Banking sector                  | -1.4   | 0.2    | -1.5   | 1.9    | -0.1   | 0.2    | -2.2    |
| Errors and omissions            | 0.5    | 0.2    | -0.1   | -0.2   | 0.4    | -0.2   | -0.2    |
| Change in reserves              | 2.2    | 2.9    | -0.2   | 3.0    | -1.6   | -1.1   | 3.0     |

Source: Central bank of Aruba

1/ Preliminary estimates by the central bank.

2/ Increase (+) in official reserves, excluding revaluation of gold and official foreign exchange holdings.



### **The capital and financial account in 1997–98**

83. **As in the case of the current account, recent developments in Aruba's capital and financial account have also followed the erratic fluctuations in the oil sector.** Its current account imbalances are largely compensated for by opposite movements in (inter-company) financial accounts, which are classified as direct investment flows in the balance of payments. In fact, the large deterioration in its current account deficit in 1997 was matched by an increase of Af. 215 million in its capital account surplus. In 1997–98, the capital account of the rest of the economy was positively influenced by capital inflows to finance building activities at the Radisson and Phoenix Divi hotels. In 1997 the deficit in this account narrowed, owing to an increase in sales of domestic debt securities to nonresidents related to the financing of investments in the airport. In 1998 the deficit widened slightly, with portfolio investment overseas more than compensating lower external bank balances of residents and a foreign loan secured by the government. As regards capital transfers, the surplus increased in 1997 by Af. 10 million to Af. 38 million, while repayments on foreign official debts fell by Af. 3 million to Af. 16 million. In 1998, official capital transfers declined markedly—by Af. 22 million—to Af. 16 million, because of the drastic cut in Dutch official financing.

84. **In 1997, foreign borrowing by the private sector continued to grow, largely to finance the investment activities related to the renovation and extension of the airport.** This trend was maintained in 1998, when the central bank approved Af. 931 million in licenses for external private loans, compared with Af. 305 million in 1997. This notable increase is explained by an Af. 659 million loan for the construction of a new “coker” unit in the refinery. Excluding this loan, foreign borrowing decreased by Af. 33 million to Af. 272 million. Borrowing for the financing of infrastructure projects, such as the upgrading of the water plant facilities, amounted to Af. 62 million, compared with Af. 151 million in 1997. Other types of foreign loans granted to the private sector rose by Af. 102 million to Af. 135 million, owing largely to the renovation of the Radisson hotel.

85. **In 1997, net official reserves held by the central bank shrank by Af. 29 million to Af. 356 million, representing 83 percent of the net foreign assets of the monetary system.** In 1998, they rose to Af. 437 million, or 75 percent of total net foreign assets. The 12-month moving average import coverage ratio increased from 3.9 months in December 1997 to about 4.6 months in December 1998. The end-of-period import coverage reached 4.8 months at end-1998, compared with 3.8 a year earlier. Both the active management of monetary policy and the heavy investment activity financed with foreign funds are at the heart of this rebuilding of international reserves.

### **B. Exchange Restrictions**

86. **Aruba follows an open exchange and trade policy, in the context of a gradual liberalization of the capital account.** While specific restrictions on payments for invisibles were maintained until 1997, the comprehensive system of licencing requirements for capital

transactions has been significantly relaxed, although limitations on large capital inflows were retained as a potential instrument of monetary policy and as a tool against money laundering. This section reviews the remaining exchange restrictions, after the central bank eliminated all restrictions on current transactions and further eased capital controls in January 1997.

### **Provisions for foreign exchange and current transactions**

87. **There are no statutory taxes or subsidies on purchases or sales of foreign exchange**, but a commission of 1.3 percent is levied on all payments made by residents to nonresidents, except when they are settled in Netherlands Antillean guilders and when they are intended for purchases of foreign exchange by resident companies with a special nonresident status for foreign exchange control. As for the legislation on cross-border financial accounts, nonresidents must report the (otherwise free) opening of accounts in any foreign currency, and are permitted to hold accounts in Aruban florins up to Af. 200,000. Residents must report the opening of accounts with nonresidents, including foreign bank accounts, to the central bank, and are not allowed to open accounts in domestic currency convertible in foreign currency.

88. **With the exception of a small negative list of imports banned for health and security reasons, practically all goods may be imported without restriction since January 1991, and payments for imports are also made freely.** The only remaining quantitative restriction covers the importation of eggs, which is administered flexibly depending on domestic supply conditions. Similarly, exports do not require any license. Unless specifically exempted, proceeds from exports of goods and invisibles must be converted into local currency within eight working days or be credited to a foreign currency account with a local bank or deposited in a foreign bank account with the approval of the central bank.

89. **Most restrictions on the payments for invisibles were removed as of January 1997.**<sup>30</sup> The only remaining restriction refers to investment-related payments. Interest payments on all types of loans can be executed if a license has been obtained from the central bank to conclude the loan. As regards profits and dividends, documents should be submitted to the central bank with respect to the amount involved. Authorization may proceed only if a license was obtained for the loan. In the case of depreciation of direct investments, a special license is required. In addition, the exportation of Aruban banknotes remains prohibited.

### **General capital controls**

90. **On capital movements, the central bank has maintained a system of licensing requirements for the following transactions:** purchases from or sales to nonresidents of domestic and officially listed foreign securities and of domestic and foreign real estate;

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<sup>30</sup>In particular, all restrictions on foreign exchange purchases for payments related to services, alimentation, scholarships, travel, and insurance were eliminated.

proceeds from the liquidation of direct foreign investments; loans received from or extended to nonresidents; and other short- and long-term investments by residents abroad or by nonresidents in Aruba.

91. **The central bank manages this system of licenses liberally, and controls on capital outflows have been substantially relaxed in recent years.** Since January 1997, outward transactions of less than Af. 200,000 a year for natural persons and Af. 500,000 a year for legal entities (excluding commercial banks and institutional investors, see paragraph 98 below) have been liberalized. Furthermore, as of July 1998, these ceilings are not only applicable to investments but also to all capital transactions with nonresidents. Thus, a central bank license is required only for capital transactions in excess of these ceilings.

92. **Following a policy of orderly capital account liberalization, the central bank has maintained, but significantly relaxed, the licensing requirements on external borrowing by residents.** Presently, a special license is required only if the amount of the transaction exceeds the relevant maximum. With the gradual increase in the ceilings, the number of licenses granted has declined substantially. The present system of licenses on large transactions allows the central bank to control the effects of these transactions on the economy and on the level of international reserves. These licenses are granted on the basis of criteria covering the feasibility of the project, the terms of the loan and the financial background of the parties involved, following the "know-your-customer" principle. To conclude the process of liberalization, the State Ordinance that regulates foreign exchange transactions, based on the so-called negative system for capital transactions, will be eventually replaced by a positive system defining what is permitted rather than what is prohibited.

### **Capital restrictions on financial institutions**

93. **There are separate prudential regulations that indirectly contribute to limiting the capital transactions of commercial banks and institutional investors.** In particular, the foreign exchange position of commercial banks is subject to a ceiling—the "B-9" rule—for prudential reasons and in order to concentrate the bulk of international reserves in the central bank.<sup>31</sup> According to this rule, the net foreign exchange position of banks (foreign currency claims on nonresidents minus liabilities to nonresidents in foreign exchange) must be positive and less than 10 percent of total deposits. This regulation has been eased in recent years, both by raising the ceiling (from 6 to 10 percent) and by widening the base (by including deposits by nonresidents). In addition, banks have been allowed by the central bank to marginally and temporarily exceed this ceiling in extraordinary circumstances, against payment of a fee linked to the prevailing U.S. Federal Funds rate.

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<sup>31</sup>In addition to giving credibility to the pegged exchange rate, this rule secures an important source of revenue for the central bank.

94. **Institutional investors, including life insurance companies, pension funds, and saving funds, are also subject to specific investment restrictions (the “40–60 percent rule”).** These institutions are required by the central bank to invest 40 percent of the first Af. 10 million of outstanding liabilities (excluding their own capital equity), 50 percent of the second Af. 10 million, and 60 percent of the remaining liabilities in domestic assets. Given the limited domestic financial investment opportunities available in Aruba, these institutions hold most of the government securities issued in recent years.

### Aruba: Civil Service

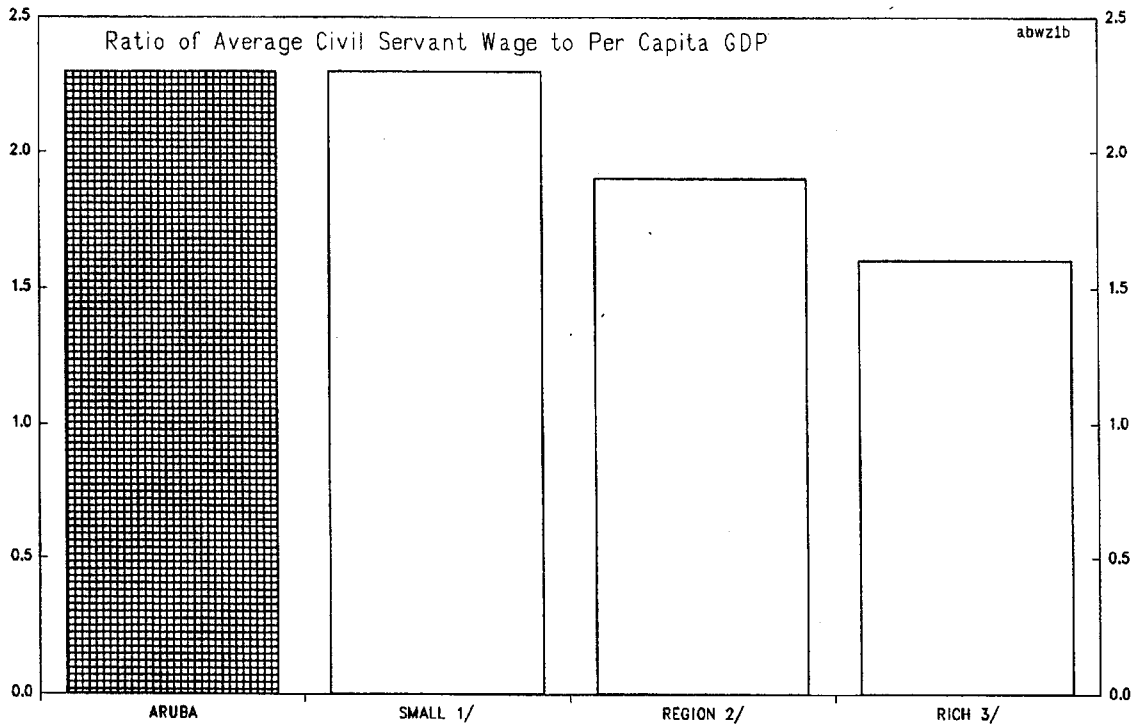
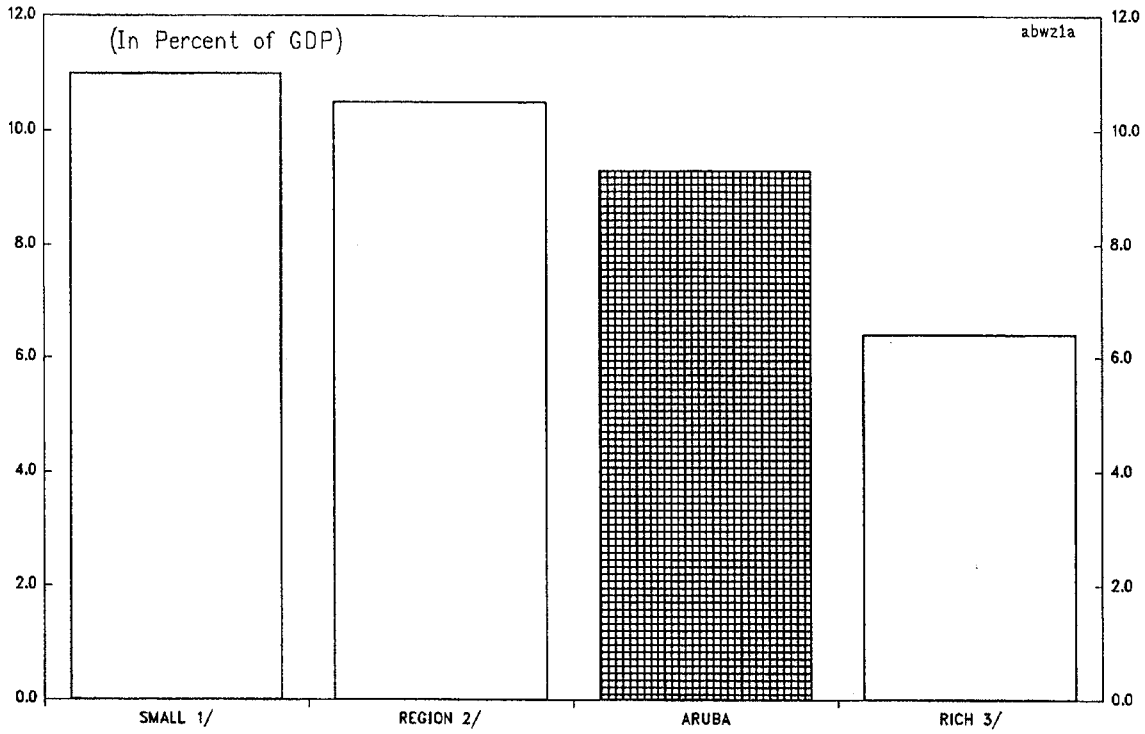
Does Aruba have an atypically large civil service in comparison with other countries? One way of looking at this question is comparing the share of the government wage bill in GDP with that in other countries (Figure 8). There are three natural comparator groups to use in this assessment:

- In comparison *with other countries in the region*, Aruba appears to be below average (Table 12): most countries have a larger government payroll.
- The same holds when the comparison is made *with other small countries* (defined as countries with less than three hundred thousand inhabitants, Table 13).
- However, within the group of *rich countries* (defined here as countries that have a GDP per capita of more than 10,000 US\$), Aruba's wage bill is sizeable (Table 14). Nonetheless, of the *small* rich countries Aruba has the smallest wage bill.

While the *total wage bill* may not be high in comparison with other countries, the *average wage of the civil servant* is. The average civil servant in Aruba earns 2.3 times GDP per capita, which is significantly above the level in other rich countries (Figure 8).

FIGURE 8  
ARUBA

Government Wage Bill Compared With Other Countries



Source: IMF and World Bank Publications.

1/ Average for selected countries with less than 300,000 inhabitants - see Table 13.

2/ Average for selected countries in the Caribbean - see Table 12.

3/ Average for selected countries with GDP per capita greater than US\$ 10,000 - see Table 14.

Table 12. Aruba: Government Wage Bill in Comparison  
with Other Caribbean Countries

|                                     | Wages as<br>Percent of GDP | Average<br>Government Wage/<br>Per Capita GDP |
|-------------------------------------|----------------------------|---|
| Dominican republic (1995)           | 4.2                        | ...   |
| Barbados (1989)                     | 6.2                        | 1.7   |
| Aruba (1997)                        | 9.3                        | 2.3   |
| Trinidad and Tobago (1995)          | 9.6                        | ...   |
| St. Lucia (1991)                    | 9.7                        | ...   |
| The Bahamas (1993)                  | 10.6                       | ...   |
| Belize (1995)                       | 11.0                       | 1.6   |
| St. Kitts and Nevis (1993)          | 11.2                       | ...   |
| Grenada (1995)                      | 11.7                       | ...   |
| Antigua and Barbuda (1995)          | 12.5                       | 0.9   |
| Netherlands Antilles (1998)         | 12.5                       | 2.8   |
| St. Vincent & the Grenadines (1995) | 13.1                       | ...   |
| Dominica (1990)                     | 15.3                       | ...   |
| Average                             | 10.5                       | 1.9   |

Sources: World Bank, World Development Indicators; World Bank Policy Research Paper 1806; and IMF, various Fund staff reports.

Table 13. Aruba: Government Wage Bill in Comparison 1/  
with Other Small Countries

|                                     | Wages as<br>Percent of GDP | Average<br>Government Wage/<br>Per Capita GDP |
|-------------------------------------|----------------------------|---|
| Barbados (1989)                     | 6.2                        | 1.7   |
| Maldives (1995)                     | 7.3                        | ...   |
| Aruba (1997)                        | 9.3                        | 2.3   |
| St. Lucia (1991)                    | 9.7                        | ...   |
| The Bahamas (1993)                  | 10.6                       | ...   |
| Solomon islands (1991)              | 10.6                       | 4.6   |
| Belize (1995)                       | 11.0                       | 1.6   |
| St. Kitts and Nevis (1993)          | 11.2                       | ...   |
| Grenada (1995)                      | 11.7                       | ...   |
| Antigua and Barbuda (1995)          | 12.5                       | 0.9   |
| Netherlands Antilles (1998)         | 12.5                       | 2.8   |
| St. Vincent & the Grenadines (1995) | 13.1                       | ...   |
| Malta (1993)                        | 13.2                       | ...   |
| Dominica (1990)                     | 15.3                       | ...   |
| Average                             | 11.0                       | 2.3   |

Sources: World Bank, World Development Indicators; World Bank Policy Research Paper 1806; and IMF, various Fund staff reports.

1/ Less than three hundred thousand inhabitants.



Table 14. Aruba: Government Wage Bill in Comparison  
with Other Rich Countries 1/

|                             | Wages as<br>Percent of GDP | Average<br>Government Wage/<br>Per Capita GDP |
|-----------------------------|----------------------------|---|
| Switzerland (1995)          | 1.4                        | 1.5   |
| United States (1996)        | 2.0                        | 1.5   |
| Sweden (1995)               | 2.4                        | 0.8   |
| Germany (1996)              | 2.7                        | 1.3   |
| United Kingdom (1995)       | 3.6                        | 1.5   |
| Netherlands (1996)          | 4.5                        | 2.0   |
| Barbados (1989)             | 6.2                        | 1.7   |
| Belgium (1995)              | 7.4                        | ...   |
| France (1996)               | 7.6                        | 1.0   |
| Aruba (1997)                | 9.3                        | 2.3   |
| The Bahamas (1993)          | 10.6                       | ...   |
| Netherlands Antilles (1998) | 12.5                       | 2.8   |
| Malta (1993)                | 13.2                       | ...   |
| Average                     | 6.4                        | 1.6   |

Sources: World Bank, World Development Indicators; World Bank Policy Research Paper 1806; and IMF, various Fund staff reports.

1/ GDP per capita more than 10,000 US\$.

Table A1. Aruba: Indicators of Tourism Activity

|  | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  |
|--|-------|-------|-------|-------|-------|-------|-------|
| Total revenue (Af. million)                      | 796   | 835   | 838   | 932   | 1,098 | 1,196 | 1,256 |
| (Change in percent)                              | 14.5  | 4.9   | 0.3   | 11.2  | 17.8  | 8.9   | 5.0   |
| (Idem, in real terms)                            | 10.7  | -0.3  | -6.0  | 7.8   | 14.6  | 5.9   | 3.1   |
| Stay-over visitors (thousands)                   | 541.7 | 562.0 | 581.1 | 618.9 | 640.8 | 646.0 | 647.4 |
| (Change in percent)                              | 8.1   | 3.8   | 3.4   | 6.5   | 3.5   | 0.8   | 0.2   |
| Tourist nights (thousands)                       | 3,902 | 4,028 | 4,234 | 4,473 | 4,714 | 4,835 | 4,890 |
| (Change in percent)                              | 3.6   | 3.2   | 5.1   | 5.7   | 5.4   | 2.6   | 1.1   |
| Average stay (nights)                            | 7.2   | 7.2   | 7.3   | 7.2   | 7.4   | 7.5   | 7.6   |
| Expenditure per tourist per day (Aruban florins) | 204.1 | 207.4 | 197.9 | 208.3 | 233.0 | 247.4 | 256.9 |
| Hotel occupancy rate (percent)                   | 71.7  | 71.4  | 74.5  | 72.0  | 71.5  | 73.8  | 77.9  |
| Hotel capacity                                   | 5,476 | 5,885 | 5,985 | 6,462 | 6,483 | 6,586 | 6,619 |
| (Change in percent)                              | 0.6   | 7.5   | 1.7   | 8.0   | 0.3   | 1.6   | 0.5   |
| Cruise tourists (thousands)                      | 216.6 | 251.1 | 257.1 | 294.0 | 316.7 | 297.7 | 257.8 |
| (Change in percent)                              | 62.6  | 15.9  | 2.4   | 14.3  | 7.8   | -6.0  | -13.4 |
| Contribution to foreign exchange earnings 1/     | 52.2  | 54.9  | 56.2  | 51.3  | 55.8  | 55.7  | 58.2  |

Sources: Central Bank of Aruba, Quarterly Bulletin; Aruba Tourism Authority; and Fund staff estimates.

1/ Tourism revenues as percentage of current account revenues.

Table A2. Aruba: Estimated GDP and Components

( In millions of Aruban florins at current prices)

|                                       | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  |
|---------------------------------------|-------|-------|-------|-------|-------|-------|-------|
| Gross domestic product                | 1,832 | 2,070 | 2,381 | 2,524 | 2,751 | 2,949 | 3,094 |
| Private absorption non-oil sector     | 1,462 | 1,629 | 1,954 | 2,046 | 2,148 | 2,315 | 2,418 |
| Consumption                           | 1,262 | 1,429 | 1,654 | 1,746 | 1,848 | 1,974 | 2,066 |
| Private investment                    | 200   | 200   | 300   | 300   | 300   | 341   | 352   |
| Government absorption                 | 336   | 386   | 431   | 491   | 530   | 567   | 518   |
| Consumption                           | 290   | 337   | 402   | 433   | 452   | 494   | 470   |
| Investment                            | 46    | 49    | 29    | 58    | 79    | 73    | 47    |
| Trade and nonfactor services, non-oil | -22   | -8    | -65   | -88   | 12    | -2    | 78    |
| Trade balance                         | -578  | -576  | -644  | -724  | -726  | -694  | -748  |
| Nonfactor services                    | 556   | 568   | 579   | 636   | 738   | 691   | 826   |
| Value added oil sector                | 56    | 64    | 61    | 74    | 61    | 70    | 80    |

Source: Staff estimates based on data supplied by the authorities.

Table A3. Aruba: Components of GDP

(In percent)

|                                       | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  |
|---------------------------------------|-------|-------|-------|-------|-------|-------|-------|
| Gross domestic product                | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Private absorption                    | 79.8  | 78.7  | 82.1  | 81.1  | 78.1  | 78.5  | 78.2  |
| Consumption                           | 68.9  | 69.0  | 69.5  | 69.2  | 67.2  | 66.9  | 66.8  |
| Private investment                    | 10.9  | 9.7   | 12.6  | 11.9  | 10.9  | 11.6  | 11.4  |
| Government absorption                 | 18.3  | 18.6  | 18.1  | 19.5  | 19.3  | 19.2  | 16.7  |
| Consumption                           | 15.8  | 16.3  | 16.9  | 17.2  | 16.4  | 16.7  | 15.2  |
| Investment                            | 2.5   | 2.4   | 1.2   | 2.3   | 2.9   | 2.5   | 1.5   |
| Trade and nonfactor services, non-oil | -1.2  | -0.4  | -2.7  | -3.5  | 0.4   | -0.1  | 2.5   |
| Trade balance                         | -31.5 | -27.8 | -27.0 | -28.7 | -26.4 | -23.5 | -24.2 |
| Nonfactor services                    | 30.3  | 27.4  | 24.3  | 25.2  | 26.8  | 23.4  | 26.7  |
| Value added oil sector                | 3.1   | 3.1   | 2.5   | 2.9   | 2.2   | 2.4   | 2.6   |

Source: Staff estimates based on data supplied by the authorities.

Table A4. Aruba: Contributions to Real GDP Growth

(In percent)

|                                       | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---------------------------------------|------|------|------|------|------|------|------|
| Private absorption non-oil sector     | 1.6  | 4.7  | 10.1 | 1.1  | 1.4  | 3.6  | 2.0  |
| Consumption                           | 4.9  | 5.3  | 6.1  | 1.5  | 1.7  | 2.5  | 1.8  |
| Private investment                    | -3.3 | -0.5 | 4.0  | -0.4 | -0.4 | 1.1  | 0.2  |
| Government absorption                 | 2.0  | 1.7  | 0.9  | 1.9  | 0.9  | 0.7  | -2.0 |
| Consumption                           | 0.9  | 1.7  | 2.0  | 0.7  | 0.2  | 1.0  | -1.1 |
| Investment                            | 1.1  | 0.0  | -1.1 | 1.2  | 0.7  | -0.3 | -0.9 |
| Trade and nonfactor services, non-oil | 2.4  | 0.8  | -2.5 | -0.8 | 3.9  | -0.5 | 2.7  |
| Trade balance                         | 5.1  | 1.6  | -1.4 | -2.4 | 0.8  | 1.9  | -1.4 |
| Nonfactor services                    | -2.8 | -0.9 | -1.1 | 1.5  | 3.1  | -2.4 | 4.1  |
| Value added oil sector                | -0.2 | 0.2  | -0.3 | 0.5  | -0.6 | 0.2  | 0.3  |
| Growth real GDP                       | 5.8  | 7.4  | 8.2  | 2.6  | 5.6  | 4.1  | 3.0  |
| Memorandum items:                     |      |      |      |      |      |      |      |
| Nominal growth rate                   | 9.9  | 13.0 | 15.0 | 6.0  | 9.0  | 7.2  | 4.9  |
| GDP deflator                          | 3.8  | 5.3  | 6.3  | 3.4  | 3.2  | 3.0  | 1.9  |

Source: Staff estimates based on data supplied by the authorities.

Table A5. Aruba: Changes in the Consumer Price Index

(Annual percentage change)

|                              | 1992             | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|------------------------------|------------------|------|------|------|------|------|------|
|                              | (End of period)  |      |      |      |      |      |      |
| Total                        | 4.5              | 6.4  | 4.7  | 3.1  | 3.1  | 2.8  | 1.5  |
| Food                         | 4.8              | 4.4  | 4.9  | 4.4  | 4.0  | 2.0  | 2.1  |
| Beverage and tobacco         | 2.6              | 5.8  | 5.4  | 3.9  | 1.1  | 2.7  | 0.5  |
| Clothing and footwear        | 5.6              | 15.1 | 7.9  | 5.6  | 7.0  | 4.4  | 7.5  |
| Housing costs                | 6.9              | 10.2 | 5.2  | 2.0  | 1.5  | 6.1  | -1.5 |
| Housekeeping and furnishings | 7.4              | 5.2  | 5.7  | 4.3  | 3.1  | 1.7  | 2.4  |
| Recreation and education     | 3.2              | 2.2  | 1.2  | 5.3  | 5.5  | 0.5  | 0.5  |
| Miscellaneous                | 4.1              | 3.1  | 2.5  | 1.1  | 1.7  | 1.1  | -0.8 |
| Medical care                 | 3.6              | 3.0  | 5.4  | 4.2  | 3.4  | 2.4  | 1.5  |
| Transport and communications | 0.4              | 6.2  | 3.3  | 1.6  | 2.0  | 2.0  | 1.1  |
|                              | (Period average) |      |      |      |      |      |      |
| Aruba                        | 3.9              | 5.2  | 6.3  | 3.4  | 3.2  | 3.0  | 1.9  |
| United States                | 3.0              | 3.0  | 2.6  | 2.8  | 2.9  | 2.3  | 1.6  |
| Netherlands Antilles         | 1.4              | 2.0  | 1.8  | 2.8  | 3.6  | 3.3  | 1.0  |

Source: Central Bank of Aruba, Quarterly Bulletin.

Table A6. Aruba: Legal Minimum Wages 1/

(In Aruban florins per month)

|                     | 1992 | 1993 | 1994 | 1995 | 1996  | 1997  | 1998  |
|---------------------|------|------|------|------|-------|-------|-------|
| Category            |      |      |      |      |       |       |       |
| Household personnel | 379  | 413  | 436  | 464  | 478   | 495   | 508   |
| Other               | 925  | 925  | 925  | 995  | 1,025 | 1,060 | 1,089 |

Source: Ministry of Labor.

1/ Per January 1st.

Table A7. Aruba: Summary of Trends in Public Finance

(In millions of Aruban florins)

|                                   | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  |
|-----------------------------------|-------|-------|-------|-------|-------|-------|-------|
| Revenue                           | 448.1 | 486.1 | 531.4 | 602.7 | 645.3 | 619.4 | 647.6 |
| Taxes                             | 338.1 | 401.8 | 440.6 | 458.6 | 491.6 | 499.7 | 535.5 |
| Nontax revenue                    | 91.9  | 69.0  | 70.5  | 117.0 | 125.8 | 89.8  | 95.6  |
| Grants                            | 18.1  | 15.3  | 20.3  | 27.1  | 27.9  | 29.9  | 16.5  |
| Expenditure                       | 486.0 | 466.5 | 526.9 | 596.7 | 730.4 | 691.9 | 676.1 |
| Current Expenditure               | ...   | ...   | ...   | ...   | ...   | 600.4 | 593.7 |
| Wage costs                        | 185.0 | 238.4 | 217.0 | 247.7 | 233.5 | 274.0 | 273.2 |
| Goods and services                | 104.8 | 98.3  | 129.9 | 130.0 | 163.6 | 161.5 | 124.1 |
| Interest                          | 15.5  | 12.1  | 17.3  | 17.0  | 20.0  | 23.6  | 31.3  |
| Subsidies                         | ...   | ...   | ...   | ...   | ...   | 3.8   | 4.5   |
| Transfers                         | ...   | ...   | ...   | ...   | ...   | 118.3 | 132.3 |
| Other current expenditure         | ...   | ...   | ...   | ...   | ...   | 19.2  | 28.3  |
| Capital expenditure               | ...   | ...   | ...   | ...   | ...   | 91.5  | 82.4  |
| Investment                        | 45.9  | 49.0  | 28.6  | 58.2  | 78.6  | 72.8  | 47.5  |
| Capital transfers                 | ...   | ...   | ...   | ...   | ...   | 0.0   | 0.9   |
| Net lending                       | ...   | ...   | ...   | ...   | ...   | 18.7  | 34.0  |
| Balance                           | -37.9 | 19.6  | 4.5   | 6.0   | -85.1 | -72.5 | -28.4 |
| Financing                         | 37.9  | -19.6 | -4.5  | -6.0  | 85.1  | 72.5  | 28.4  |
| Change in arrears to suppliers 1/ | ...   | ...   | ...   | 2.0   | 36.4  | -1.2  | -26.7 |
| Change in arrears to APFA         | ...   | ...   | ...   | -17.0 | 0.0   | 28.6  | 43.5  |
| Regular financing                 | 37.9  | -19.6 | -4.5  | 9.0   | 48.7  | 45.1  | 11.6  |

Source: Data provided by the authorities.

1/ Including intergovernmental arrears.



Table A8. Aruba: Public Finances

(In percent of GDP)

|                                   | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|-----------------------------------|------|------|------|------|------|------|------|
| Revenue                           | 24.5 | 23.5 | 22.3 | 23.9 | 23.5 | 21.0 | 20.9 |
| Taxes                             | 18.5 | 19.4 | 18.5 | 18.2 | 17.9 | 16.9 | 17.3 |
| Nontax revenue                    | 5.0  | 3.3  | 3.0  | 4.6  | 4.6  | 3.0  | 3.1  |
| Grants                            | 1.0  | 0.7  | 0.9  | 1.1  | 1.0  | 1.0  | 0.5  |
| Expenditure                       | 26.5 | 22.5 | 22.1 | 23.6 | 26.5 | 23.5 | 21.9 |
| Current Expenditure               | ...  | ...  | ...  | ...  | ...  | 20.4 | 19.2 |
| Wage costs                        | 10.1 | 11.5 | 9.1  | 9.8  | 8.5  | 9.3  | 8.8  |
| Goods and services                | 5.7  | 4.7  | 5.5  | 5.2  | 5.9  | 5.5  | 4.0  |
| Interest                          | 0.8  | 0.6  | 0.7  | 0.7  | 0.7  | 0.8  | 1.0  |
| Subsidies                         | ...  | ...  | ...  | ...  | ...  | 0.1  | 0.1  |
| Transfers                         | ...  | ...  | ...  | ...  | ...  | 4.0  | 4.3  |
| Other current expenditure         | ...  | ...  | ...  | ...  | ...  | 0.7  | 0.9  |
| Capital expenditure               | ...  | ...  | ...  | ...  | ...  | 3.1  | 2.7  |
| Balance                           | -2.1 | 0.9  | 0.2  | 0.2  | -3.1 | -2.5 | -0.9 |
| Financing                         | 2.1  | -0.9 | -0.2 | -0.2 | 3.1  | 2.5  | 0.9  |
| Change in arrears to suppliers 1/ | ...  | ...  | ...  | 0.1  | 1.3  | 0.0  | -0.9 |
| Change in arrears to APFA         | ...  | ...  | ...  | -0.7 | 0.0  | 1.0  | 1.4  |
| Regular financing                 | 2.1  | -0.9 | -0.2 | 0.4  | 1.8  | 1.5  | 0.4  |

Source: Data provided by the authorities; and Fund staff projections.

1/ Including intergovernmental arrears.

Table A9. Aruba: Tax Revenue 1/

(In millions of Aruban florins)

|                      | 1992         | 1993         | 1994         | 1995         | 1996         | 1997         | 1998         |
|----------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Taxes</b>         | <b>338.1</b> | <b>401.8</b> | <b>440.6</b> | <b>458.6</b> | <b>491.6</b> | <b>499.7</b> | <b>535.5</b> |
| Direct taxes         | 188.9        | 221.3        | 233.3        | 258.7        | 277.3        | 283.6        | 311.0        |
| Wage taxes           | 100.2        | 116.1        | 124.2        | 141.6        | 150.5        | 159.9        | 176.3        |
| Income taxes 2/      | 18.8         | 18.8         | 15.1         | 14.2         | 10.6         | 8.8          | 13.1         |
| Profit taxes         | 34.3         | 43.9         | 52.0         | 52.0         | 52.0         | 52.0         | 52.0         |
| Solidarity tax       | 1.9          | 1.2          | 1.2          | 1.2          | 1.2          | 1.2          | 1.2          |
| Other                | 33.7         | 41.3         | 40.8         | 47.6         | 54.0         | 52.0         | 59.3         |
| Land tax             | 2.8          | 6.0          | 2.9          | 8.1          | 8.8          | 9.4          | 12.1         |
| Hotel room taxes     | 10.9         | 14.3         | 14.5         | 14.9         | 19.0         | 17.4         | 18.8         |
| Gambling taxes       | 12.6         | 12.9         | 14.3         | 14.9         | 15.7         | 14.5         | 15.2         |
| Motor vehicle taxes  | 7.4          | 8.1          | 9.1          | 9.7          | 10.5         | 10.7         | 13.1         |
| Indirect taxes       | 149.2        | 180.5        | 207.4        | 199.9        | 214.2        | 216.1        | 224.6        |
| Excises              | 71.2         | 76.6         | 86.8         | 94.3         | 92.2         | 95.4         | 98.9         |
| Gasoline             | 37.3         | 40.9         | 49.2         | 56.0         | 54.8         | 54.9         | 58.4         |
| Tobacco              | 9.3          | 9.3          | 8.8          | 10.2         | 9.7          | 9.8          | 9.9          |
| Beer                 | 16.1         | 17.4         | 19.1         | 18.9         | 17.7         | 19.7         | 20.1         |
| Liquor               | 8.5          | 9.1          | 9.7          | 9.2          | 10.1         | 11.0         | 10.5         |
| Import duties        | 63.5         | 77.6         | 89.4         | 77.5         | 87.3         | 88.1         | 88.8         |
| Foreign exchange tax | 10.7         | 11.6         | 14.4         | 10.9         | 18.9         | 16.8         | 20.2         |
| Other taxes 3/       | 14.5         | 26.3         | 16.8         | 17.2         | 15.8         | 15.8         | 16.7         |

Source: Ministry of Finance, Tax Department.

1/ Cash basis.

2/ Include income surtax.

3/ Includes property transfer tax and stamp duties.

Table A10. Aruba: Tax Revenue 1/

(In percent of GDP)

|                       | 1992        | 1993        | 1994        | 1995        | 1996        | 1997        | 1998        |
|-----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Taxes</b>          | <b>18.5</b> | <b>19.4</b> | <b>18.5</b> | <b>18.2</b> | <b>17.9</b> | <b>16.9</b> | <b>17.3</b> |
| <b>Direct taxes</b>   | <b>10.3</b> | <b>10.7</b> | <b>9.8</b>  | <b>10.3</b> | <b>10.1</b> | <b>9.6</b>  | <b>10.1</b> |
| Wage taxes            | 5.5         | 5.6         | 5.2         | 5.6         | 5.5         | 5.4         | 5.7         |
| Income taxes 2/       | 1.0         | 0.9         | 0.6         | 0.6         | 0.4         | 0.3         | 0.4         |
| Profit taxes          | 1.9         | 2.1         | 2.2         | 2.1         | 1.9         | 1.8         | 1.7         |
| Solidarity tax        | 0.1         | 0.1         | 0.1         | 0.0         | 0.0         | 0.0         | 0.0         |
| Other                 | 1.8         | 2.0         | 1.7         | 1.9         | 2.0         | 1.8         | 1.9         |
| Land tax              | 0.2         | 0.3         | 0.1         | 0.3         | 0.3         | 0.3         | 0.4         |
| Hotel room taxes      | 0.6         | 0.7         | 0.6         | 0.6         | 0.7         | 0.6         | 0.6         |
| Gambling taxes        | 0.7         | 0.6         | 0.6         | 0.6         | 0.6         | 0.5         | 0.5         |
| Motor vehicle taxes   | 0.4         | 0.4         | 0.4         | 0.4         | 0.4         | 0.4         | 0.4         |
| <b>Indirect taxes</b> | <b>8.1</b>  | <b>8.7</b>  | <b>8.7</b>  | <b>7.9</b>  | <b>7.8</b>  | <b>7.3</b>  | <b>7.3</b>  |
| <b>Excises</b>        | <b>3.9</b>  | <b>3.7</b>  | <b>3.6</b>  | <b>3.7</b>  | <b>3.4</b>  | <b>3.2</b>  | <b>3.2</b>  |
| Gasoline              | 2.0         | 2.0         | 2.1         | 2.2         | 2.0         | 1.9         | 1.9         |
| Tobacco               | 0.5         | 0.4         | 0.4         | 0.4         | 0.4         | 0.3         | 0.3         |
| Beer                  | 0.9         | 0.8         | 0.8         | 0.8         | 0.6         | 0.7         | 0.6         |
| Liquor                | 0.5         | 0.4         | 0.4         | 0.4         | 0.4         | 0.4         | 0.3         |
| Import duties         | 3.5         | 3.7         | 3.8         | 3.1         | 3.2         | 3.0         | 2.9         |
| Foreign exchange tax  | 0.6         | 0.6         | 0.6         | 0.4         | 0.7         | 0.6         | 0.7         |
| Other taxes 3/        | 0.8         | 1.3         | 0.7         | 0.7         | 0.6         | 0.5         | 0.5         |

Sources: Tax Department; and Fund staff estimates.

1/ Cash basis.

2/ Include income surtax.

3/ Includes property transfer tax and stamp duties.

Table A11. Aruba: Government Debt

|                                 | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998    |
|---------------------------------|-------|-------|-------|-------|-------|-------|---------|
| (In millions of Aruban florins) |       |       |       |       |       |       |         |
| Total                           | 699.6 | 766.8 | 840.4 | 961.5 | 972.6 | 986.4 | 1,053.3 |
| Domestic debt                   | 351.3 | 421.9 | 451.4 | 559.6 | 619.0 | 690.0 | 710.5   |
| Tradeable                       | 39.6  | 90.0  | 90.6  | 139.7 | 194.9 | 220.6 | 186.8   |
| Short-term                      | 31.6  | 32.0  | 32.0  | 32.0  | 32.0  | 32.0  | 32.0    |
| Long-term                       | 8.0   | 58.0  | 58.0  | 107.7 | 162.9 | 188.6 | 154.8   |
| Non-tradeable                   | 311.7 | 331.9 | 360.8 | 419.9 | 424.1 | 469.4 | 523.7   |
| Short-term                      | 77.7  | 84.1  | 96.7  | 99.1  | 133.4 | 100.8 | 117.6   |
| Long-term                       | 234.0 | 247.8 | 264.1 | 320.8 | 290.7 | 368.6 | 406.1   |
| Foreign debt                    | 348.3 | 344.9 | 389.0 | 401.9 | 353.6 | 296.4 | 342.8   |
| Netherlands                     | 327.5 | 319.4 | 362.0 | 373.2 | 328.4 | 275.9 | 278.2   |
| European investment bank        | 11.2  | 14.0  | 18.2  | 22.4  | 21.5  | 19.0  | 19.5    |
| Other                           | 9.6   | 11.5  | 8.8   | 6.3   | 3.7   | 1.5   | 45.1    |
| (In percent of GDP)             |       |       |       |       |       |       |         |
| Total                           | 38.2  | 37.0  | 35.3  | 38.1  | 35.4  | 33.4  | 34.0    |
| Domestic debt                   | 19.2  | 20.4  | 19.0  | 22.2  | 22.5  | 23.4  | 23.0    |
| Tradeable                       | 2.2   | 4.3   | 3.8   | 5.5   | 7.1   | 7.5   | 6.0     |
| Short-term                      | 1.7   | 1.5   | 1.3   | 1.3   | 1.2   | 1.1   | 1.0     |
| Long-term                       | 0.4   | 2.8   | 2.4   | 4.3   | 5.9   | 6.4   | 5.0     |
| Non-tradeable                   | 17.0  | 16.0  | 15.2  | 16.6  | 15.4  | 15.9  | 16.9    |
| Short-term                      | 4.2   | 4.1   | 4.1   | 3.9   | 4.8   | 3.4   | 3.8     |
| Long-term                       | 12.8  | 12.0  | 11.1  | 12.7  | 10.6  | 12.5  | 13.1    |
| Foreign debt                    | 19.0  | 16.7  | 16.3  | 15.9  | 12.9  | 10.1  | 11.1    |
| Netherlands                     | 17.9  | 15.4  | 15.2  | 14.8  | 11.9  | 9.4   | 9.0     |
| European investment bank        | 0.6   | 0.7   | 0.8   | 0.9   | 0.8   | 0.6   | 0.6     |
| Other                           | 0.5   | 0.6   | 0.4   | 0.2   | 0.1   | 0.1   | 1.5     |

Sources: Data provided by the authorities, and Fund staff estimates.

Table A12. Aruba: Balance of Payments Summary

(In millions of Aruban florins)

|                                      | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998  |
|--------------------------------------|------|------|------|------|------|------|-------|
| <b>Current Account</b>               | 39   | 39   | 108  | -28  | -111 | -351 | 39    |
| Trade balance                        | -355 | -335 | -147 | -447 | -540 | -700 | -590  |
| Oil sector                           | 222  | 241  | 497  | 277  | 186  | -7   | 159   |
| Free zone                            | 21   | 52   | 24   | 28   | 72   | 84   | 61    |
| Other                                | -599 | -628 | -668 | -752 | -798 | -778 | -809  |
| Services                             | 412  | 404  | 299  | 385  | 457  | 400  | 628   |
| Travel and tourism                   | 699  | 724  | 719  | 795  | 907  | 958  | 1,034 |
| Transportation                       | -205 | -240 | -225 | -220 | -290 | -332 | -207  |
| Government services                  | -33  | -29  | -20  | -34  | -26  | -40  | -25   |
| Other services                       | -49  | -52  | -174 | -155 | -135 | -186 | -174  |
| Income                               | -17  | -21  | -25  | -17  | -21  | -31  | 10    |
| Current Transfers                    | -1   | -9   | -19  | 50   | -7   | -20  | -9    |
| <b>Financial and capital account</b> | 18   | 13   | -72  | 62   | 54   | 316  | 126   |
| Private Capital                      | -18  | -4   | -93  | 34   | 42   | 293  | 70    |
| Oil sector                           | -76  | -52  | -169 | -23  | 111  | 326  | 121   |
| Non-oil sector                       | 58   | 48   | 77   | 58   | -69  | -33  | -51   |
| Government capital                   | 36   | 16   | 21   | 28   | 12   | 22   | 56    |
| Inflows                              | 50   | 28   | 38   | 47   | 28   | 38   | 72    |
| Grants                               | 18   | 15   | 20   | 27   | 28   | 38   | 16    |
| Loans                                | 32   | 13   | 18   | 20   | 0    | 0    | 57    |
| Outflows                             | 14   | 12   | 17   | 19   | 19   | 20   | 21    |
| Banking sector                       | -25  | 5    | -36  | 48   | -2   | 7    | -68   |
| Errors and omissions                 | 9    | 4    | -4   | -6   | 12   | -5   | -5    |
| Change in monetary gold              | 0    | 0    | 0    | -1   | 3    | 0    | 0     |
| Change in reserves                   | 40   | 60   | -4   | 75   | -44  | -33  | 92    |

Sources: Central Bank of Aruba; and Fund staff estimates.

Table A13. Aruba: Balance of Payments Summary

(In percent of GDP)

|                                      | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  |
|--------------------------------------|-------|-------|-------|-------|-------|-------|-------|
| <b>Current Account</b>               | 2.1   | 1.9   | 4.5   | -1.1  | -4.0  | -11.9 | 1.3   |
| <b>Trade balance</b>                 | -19.4 | -16.2 | -6.2  | -17.7 | -19.6 | -23.7 | -19.1 |
| <b>Oil sector</b>                    | 12.1  | 11.7  | 20.9  | 11.0  | 6.8   | -0.2  | 5.1   |
| <b>Free zone</b>                     | 1.2   | 2.5   | 1.0   | 1.1   | 2.6   | 2.9   | 2.0   |
| <b>Other</b>                         | -32.7 | -30.3 | -28.1 | -29.8 | -29.0 | -26.4 | -26.2 |
| <b>Services</b>                      | 22.5  | 19.5  | 12.5  | 15.3  | 16.6  | 13.6  | 20.3  |
| <b>Travel and tourism</b>            | 38.2  | 35.0  | 30.2  | 31.5  | 33.0  | 32.5  | 33.4  |
| <b>Transportation</b>                | -11.2 | -11.6 | -9.5  | -8.7  | -10.6 | -11.3 | -6.7  |
| <b>Government services</b>           | -1.8  | -1.4  | -0.9  | -1.4  | -0.9  | -1.3  | -0.8  |
| <b>Other services</b>                | -2.7  | -2.5  | -7.3  | -6.1  | -4.9  | -6.3  | -5.6  |
| <b>Income</b>                        | -0.9  | -1.0  | -1.1  | -0.7  | -0.8  | -1.0  | 0.3   |
| <b>Current Transfers</b>             | 0.0   | -0.4  | -0.8  | 2.0   | -0.2  | -0.7  | -0.3  |
| <b>Financial and capital account</b> | 1.0   | 0.6   | -3.0  | 2.5   | 1.9   | 10.7  | 4.1   |
| <b>Private Capital</b>               | -1.0  | -0.2  | -3.9  | 1.4   | 1.5   | 9.9   | 2.2   |
| <b>Oil sector</b>                    | -4.1  | -2.5  | -7.1  | -0.9  | 4.0   | ...   | ...   |
| <b>Non-oil sector</b>                | 3.1   | 2.3   | 3.2   | 2.3   | -2.5  | ...   | ...   |
| <b>Government capital</b>            | 2.0   | 0.8   | 0.9   | 1.1   | 0.4   | 0.8   | 1.8   |
| <b>Inflows</b>                       | 2.7   | 1.4   | 1.6   | 1.9   | 1.0   | 1.3   | 2.3   |
| <b>Grants</b>                        | 1.0   | 0.7   | 0.9   | 1.1   | 1.0   | 1.3   | 0.5   |
| <b>Loans</b>                         | 1.8   | 0.6   | 0.8   | 0.8   | 0.0   | 0.0   | 1.8   |
| <b>Outflows</b>                      | 0.8   | 0.6   | 0.7   | 0.8   | 0.7   | 0.7   | 0.7   |
| <b>Banking sector</b>                | -1.4  | 0.2   | -1.5  | 1.9   | -0.1  | 0.2   | -2.2  |
| <b>Errors and omissions</b>          | 0.5   | 0.2   | -0.1  | -0.2  | 0.4   | -0.2  | -0.2  |
| <b>Change in monetary gold</b>       | 0.0   | 0.0   | 0.0   | 0.0   | 0.1   | 0.0   | 0.0   |
| <b>Change in reserves</b>            | 2.2   | 2.9   | -0.2  | 3.0   | -1.6  | -1.1  | 3.0   |

Sources: Central Bank of Aruba; and Fund staff estimates.

Table A14. Aruba: Monetary Survey

(In millions of Aruban florins; end of period)

|                     | 1992  | 1993  | 1994  | 1995  | 1996  | 1997  | 1998  |
|---------------------|-------|-------|-------|-------|-------|-------|-------|
| Net foreign assets  | 363   | 417   | 450   | 478   | 433   | 394   | 554   |
| Central bank        | 264   | 323   | 320   | 396   | 349   | 316   | 408   |
| Commercial banks    | 99    | 94    | 130   | 82    | 84    | 77    | 145   |
| Net domestic credit | 761   | 781   | 915   | 957   | 1,085 | 1,176 | 1,244 |
| Public sector       | 7     | -31   | -34   | -61   | -39   | -10   | -9    |
| Central government  | 24    | -18   | -26   | -52   | -36   | 0     | 1     |
| Development aid     | -17   | -13   | -8    | -9    | -3    | -10   | -10   |
| Private sector      | 754   | 812   | 950   | 1,018 | 1,124 | 1,186 | 1,253 |
| Enterprises         | 518   | 515   | 577   | 609   | 620   | 636   | 635   |
| Consumer credit     | 134   | 164   | 211   | 215   | 233   | 269   | 291   |
| Housing mortgages   | 91    | 123   | 153   | 186   | 243   | 263   | 299   |
| Other               | 11    | 9     | 8     | 8     | 28    | 17    | 28    |
| Other items (net)   | -124  | -134  | -167  | -174  | -215  | -209  | -259  |
| Money supply (M2)   | 1,001 | 1,065 | 1,199 | 1,261 | 1,301 | 1,361 | 1,539 |
| Money (M1)          | 331   | 378   | 442   | 435   | 445   | 473   | 537   |
| Quasi-money         | 669   | 687   | 757   | 826   | 856   | 888   | 1,002 |

Source: Central Bank of Aruba, Quarterly Bulletin.

Table A15. Aruba: Monetary Developments

(Percent change over same period year earlier)

|                     | 1992   | 1993   | 1994  | 1995  | 1996  | 1997   | 1998  |
|---------------------|--------|--------|-------|-------|-------|--------|-------|
| Net foreign assets  | 22.1   | 14.9   | 7.8   | 6.3   | -9.4  | -9.2   | 40.6  |
| Central bank        | 18.1   | 22.4   | -1.1  | 23.9  | -11.9 | -9.4   | 29.0  |
| Commercial banks    | 34.6   | -5.2   | 38.6  | -36.9 | 2.6   | -8.2   | 88.1  |
| Net domestic credit | 9.8    | 2.6    | 17.2  | 4.5   | 13.4  | 8.3    | 5.8   |
| Public sector       | -888.9 | -529.6 | 11.8  | 77.7  | -36.0 | -75.0  | -8.2  |
| Central government  | 118.9  | -173.3 | 46.6  | 98.9  | -30.3 | -100.3 | 800.0 |
| Development aid     | 43.3   | -26.2  | -37.0 | 8.7   | -70.1 | 276.9  | 0.0   |
| Private sector      | 8.6    | 7.7    | 17.0  | 7.2   | 10.5  | 5.5    | 5.7   |
| Enterprises         | 5.1    | -0.6   | 12.1  | 5.5   | 1.8   | 2.5    | -0.1  |
| Consumer credit     | 7.1    | 22.9   | 28.6  | 1.5   | 8.7   | 15.4   | 8.0   |
| Housing mortgages   | 35.7   | 35.2   | 23.8  | 21.7  | 30.8  | 8.3    | 13.6  |
| Other               | 21.7   | -17.9  | -8.7  | -2.4  | 237.8 | -37.5  | 60.1  |
| Other items (net)   | 22.2   | 8.3    | 24.4  | 4.4   | 23.5  | -2.8   | 24.0  |
| Money supply (M2)   | 12.5   | 6.4    | 12.6  | 5.2   | 3.2   | 4.6    | 13.1  |
| Money (M1)          | 5.5    | 14.1   | 16.8  | -1.4  | 2.2   | 6.3    | 13.5  |
| Quasi-money         | 16.3   | 2.6    | 10.3  | 9.1   | 3.7   | 3.7    | 12.8  |

Source: Central Bank of Aruba, Quarterly Bulletin.



Table A16. Aruba: Changes in Sources of Broad Money

(Change in percent of broad money at the beginning of the period)

|                     | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
|---------------------|------|------|------|------|------|------|------|
| Net foreign assets  | 7.4  | 5.4  | 3.1  | 2.4  | -3.6 | -3.1 | 11.8 |
| Central bank        | 4.5  | 5.9  | -0.3 | 6.4  | -3.7 | -2.5 | 6.8  |
| Commercial banks    | 2.9  | -0.5 | 3.4  | -4.0 | 0.2  | -0.5 | 5.0  |
| Net domestic credit | 7.6  | 2.0  | 12.6 | 3.5  | 10.2 | 7.0  | 5.0  |
| Public sector       | 0.9  | -3.8 | -0.3 | -2.2 | 1.7  | 2.2  | 0.1  |
| Central government  | 1.5  | -4.2 | -0.8 | -2.2 | 1.2  | 2.8  | 0.1  |
| Development aid     | -0.6 | 0.4  | 0.4  | -0.1 | 0.5  | -0.6 | 0.0  |
| Private sector      | 6.7  | 5.8  | 12.9 | 5.7  | 8.4  | 4.7  | 5.0  |
| Enterprises         | 2.8  | -0.3 | 5.8  | 2.7  | 0.9  | 1.2  | 0.0  |
| Consumer credit     | 1.0  | 3.1  | 4.4  | 0.3  | 1.5  | 2.8  | 1.6  |
| Housing mortgages   | 2.7  | 3.2  | 2.8  | 2.8  | 4.5  | 1.5  | 2.6  |
| Other               | 0.2  | -0.2 | -0.1 | 0.0  | 1.5  | -0.8 | 0.8  |
| Other items (net)   | -2.5 | -1.0 | -3.1 | -0.6 | -3.2 | 0.5  | -3.7 |
| Broad money         | 12.5 | 6.4  | 12.6 | 5.2  | 3.2  | 4.6  | 13.1 |
| Money (M1)          | 1.9  | 4.7  | 6.0  | -0.5 | 0.8  | 2.2  | 4.7  |
| Quasi-money         | 10.6 | 1.7  | 6.6  | 5.7  | 2.4  | 2.4  | 8.4  |

Source: Central Bank of Aruba, Quarterly Bulletin.