

The Kingdom of the Netherlands—Aruba: 2002 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with the Kingdom of the Netherlands—Aruba, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **December 10, 2002**, with the officials of the Kingdom of the Netherlands—Aruba on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on February 6, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **February 20, 2003** updating information on recent developments.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its February 24, 2003 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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KINGDOM OF THE NETHERLANDS—ARUBA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation
with the Kingdom of the Netherlands—Aruba

Approved by Ajai Chopra and Martin Fetherston

February 6, 2003

The 2002 Article IV consultation discussions were held in Aruba during December 3-10, 2002. The team—Ms. Detragiache (Head) and Moreno Badia and Mr. Hofman (all EU1)—met with the Prime Minister and the Council of Ministers, the Central Bank President; officials of the Ministries of Economics and Finance and Labor, the Social Security Funds, and the Tourism Authority; and representatives of the financial sector, labor unions and employer associations. Mr. Nijssse (Advisor to the Executive Director) attended the meetings.

As part of the Kingdom of the Netherlands, Aruba has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 (Appendix II). Aruba does not subscribe to the SDDS. Economic statistics have improved over the past year, but weaknesses in government and labor market statistics still hamper surveillance (Appendix III). Parliamentary elections were held in September 2001, and the next are scheduled for 2005.

At the conclusion of the last Article IV Consultation on August 22, 2001, Directors commended the performance of the Aruban economy during the 1990s but expressed concern over the deteriorating budgetary position. They encouraged the authorities to gradually liberalize the financial system while strengthening prudential regulation and supervision, also in view of bolstering AML-CFL efforts, and to improve the provision of statistics. The authorities have expressed their intention to publish this report.

CONTENTS

	Page
Executive Summary	3
I. Overview of Recent Economic Developments	4
II. Policy Discussions	7
A. Economic Outlook	7
B. Fiscal Policy	8
C. Monetary and Financial Policies	11
D. Other Issues	12
III. Staff Appraisal	13
 Figures	
1. Real Sector and Balance of Payments Indicators	16
2. Inflation Rate	17
3. Monetary Developments	18
4. Budgetary Operations	19
5. Real Exchange Rates with Respect to the Dollar	20
6. Tourism Performance	21
 Tables	
1. Estimated GDP and Components	22
2. Balance of Payments Summary, 1995-2005	23
3. Income Per Capita in Selected Caribbean Countries, 2000	24
4. Monetary Developments, 1997-2003	25
5. Summary of Trends in Public Finance	26
6. Indicators of External and Financial Vulnerability	27
 Text boxes	
1. The Structure of the Aruban Economy	4
2. Policy Recommendations and Implementation	6
3. Fiscal Sustainability	9
 Appendices	
I. Basic Data	28
II. Fund Relations	30
III. Statistical Issues	31
 Annex	
1. The New Fiscal Regime	33

**Kingdom of the Netherlands—Aruba
Staff Report for the 2002 Article IV Consultation**

Executive Summary

Background: GDP contracted by an estimated 1.2 percent and 3.8 percent in 2001 and 2002 respectively, as the downturn in the United States and the terrorist attacks of September 11 took a toll on tourism. For 2003, a surge in investment and a moderate revival in tourism should push growth to over 4 percent. Inflation accelerated in the second half of 2002 reaching 4.5 percent in November, in part because of higher excises and energy prices. The slower economy and newly introduced universal health care compounded existing fiscal imbalances, with the government deficit (including health care) reaching an estimated 4.9 percent of GDP in 2002.

Policy discussions: Concerning monetary and financial policies, there is agreement that the monetary stance will need to be tightened soon if the current inflation differential with the U.S. dollar (to which the Aruban currency is pegged) persists. The authorities view the financial sector as sound and are continuing to strengthen risk supervision (also following the recent OFC assessment). Plans to introduce indirect instruments of monetary control are being pursued.

On fiscal policy, the mission endorsed the authorities' objective of a balanced budget by 2007. The draft 2003 budget does not make sufficient progress towards budgetary balance, as the necessary structural reform on the spending side (in health care, civil service, and pensions) will remain unaddressed. On the revenue side, a new system of corporate income taxation will result in a more uniform level of taxation than before, particularly as the old offshore and tax holidays regimes are being phased out. A new indirect tax is also planned for 2003. Beyond the objective of budget balance in 2007, more needs to be done to address population ageing.

Data provision improved substantially with the publication of national accounts for 1995–2000. The mission, however, stressed the need for better statistics in the areas of government finances and the labor market.

I. OVERVIEW OF RECENT ECONOMIC DEVELOPMENTS

1. **Aruba experienced its first recession in over a decade in 2001 and 2002, when the economy contracted by a cumulative 5 percent (Table 1 and Figure 1).**¹ In 2001, tourism activity, already weak because of the U.S. recession, plunged after the terrorist attacks of September 11, while lower private and public investment also contributed to the downturn. Tourism was slow to recover during 2002, in part because economic and political difficulties in Venezuela hurt tourist arrivals from that destination. A moderate revival in private investment and a steady expansion in government consumption, however, sustained economic activity.

Box 1. The Structure of the Aruban Economy

Aruba is a small open economy with a population of about 93,000. Having grown on average at 3.2 percent since 1996, GDP per capita was estimated at US\$ 20,600 in 2001, one of the highest in the region (Table 3). The island has autonomous status within the Kingdom of the Netherlands since 1986, when it seceded from the Netherlands Antilles.

Real sector. The economy is highly dependent on tourism, originating predominantly from the United States. Other economic activities include an U.S.-owned oil refinery, a duty free zone and an offshore sector, consisting mainly of non-financial corporate entities. The labor force is of about 45,000 individuals, 41 percent of whom are non-Arubans. The unemployment rate was 6.9 percent in 2000.

Monetary policy. The Aruban florin has been pegged at a rate of 1.79 per U.S. dollar since its introduction. To support the peg, the central bank targets a 5-6 months of imports coverage ratio for net foreign assets of the monetary system, and reserves are typically well above 100 percent of money base. Monetary policy relies on direct instruments, comprising moral suasion, a liquidity reserve requirement, credit ceilings (currently suspended), and capital controls. Banks cannot hold a negative foreign asset position, and positive positions are capped at 10 percent of deposits. For non-bank corporates and individuals, licenses are required for capital outflows above a certain threshold, but they are granted liberally.

Trade regime. The standard import duty is 7.5 percent. Primary foodstuffs are exempt from duties and higher tariffs apply to luxury items. There are no quantitative trade restrictions. Import duties account for about 16 percent of tax revenues.

Financial sector. There are five commercial banks operating in Aruba with a combined balance sheet of Afl. 2.6 billion (76.4 percent of GDP) and activities primarily in the traditional retail sector. Other financial institutions include two mortgage banks, two credit unions, a finance company, a development bank, several insurance companies and pension funds.

¹ Background information on the Aruban economy is in Box 1, and on previous Fund policy recommendations and implementation in Box 2. GDP data for 2001 and 2002 are estimates by the Central Bureau of Statistics.

2. **The external accounts and official reserves remain comfortable (Table 2).** The operations of the oil refinery, large relative to the rest of the economy, strongly affect Aruba's external accounts. In 2001, a favorable oil balance and an improved non-oil balance because of lower imports contributed to a sharp rise in reserves. In 2002, falling tourism and oil revenues were offset by higher external borrowing by the government and other inflows, resulting in further strengthening of official reserves to an estimated U.S. \$391 million (7.1 months of non-oil imports).

3. **Despite weak economic activity, inflation accelerated in the second half of 2002, reaching 4.5 percent in November (Figure 2).** Over the 1990s inflation has remained relatively low, averaging 2.7 percent per year, resulting in a moderate real appreciation of the exchange rate relative to the U.S. dollar. After a surge in 2000, in 2001 weak economic conditions and favorable energy shocks brought about a decline in inflation. With slow credit demand, credit ceilings were suspended in early 2002. The ensuing acceleration in domestic monetary aggregates rekindled inflationary pressures in the second half of 2002, and increases in water and electricity tariffs, gasoline prices, and indirect taxes in the fall exacerbated the problem (Figure 3 and Table 4). Wage developments remained subdued, with private sector collective contracts allowing for growth of 1-3 percent.

4. **The public finances worsened considerably in 2001–02 (Figure 4 and Table 5).** Sharply rising current spending and a declining tax revenue-to-GDP ratio pushed the central government deficit up in 2001 (see table below).² The deficit of the newly introduced health care fund added to the imbalances. Most of the financing came through arrears to suppliers and the public employee pension fund (APFA). For 2002, although data weaknesses make estimates tentative, staff projects a deficit of 4.9 percent of GDP, 1.0 percentage points of GDP above the budget.^{3,4} This deterioration was caused mainly by lower revenues, while spending growth remained moderate as wage indexation was frozen and discretionary spending was kept low by delays in approving the budget. In addition, off-budget financial obligations of about 5.9 percent of GDP arising from past guarantees to private investors were incurred in 2002. Other claims on outstanding guarantees and similar transactions of around 3.6 percent of GDP are at various stages of litigation.

² Fiscal data are on a cash basis, but to provide a more accurate picture of expenditures staff includes arrears on the spending side.

³ While information on revenues and financing (excluding arrears) is fairly accurate and timely, that on spending and arrears is available with longer delays and revised frequently.

⁴ Excluding a grant from the Netherlands, which was received in late 2002 and will be spent in subsequent years, the shortfall reaches 6 percent of GDP. This grant is the second installment of the Netherlands' contribution to the *Fondo Desarrollo Aruba* (FDA), a development fund that finances projects in areas such as education, health, and governance.

Aruba: Recent Fiscal Developments
(In percent of GDP)

	2000	2001	2002
Balance excluding arrears	0.7	0.4	-2.6
Balance including arrears	-0.2	-2.6	-3.6
Balance including the health care fund	-0.2	-3.9	-4.9
Off-budget liabilities 1/	...	...	5.9

Sources: Ministry of Finance; Central Bank of Aruba; and staff calculations and projections.

1/ These liabilities will be covered through an existing guarantee fund, resources from the telecommunication company, and a loan from the beneficiary of the settlement.

5. **The main fiscal policy initiative for 2003 is a new indirect tax on imports and services.** According to a preliminary draft of the 2003 budget, the new levy would be introduced in mid-year and would yield about 1 percent of GDP. A freeze in wage indexation (in place through 2005) will restrain current spending, while capital outlays will increase. Financing will come mainly through foreign commercial loans. Based on this program, the mission projects a deficit of 4.5 percent of GDP, a modest reduction from 2002.⁵

Box 2. Aruba: Policy Recommendations and Implementation

In the past five years, the Fund has advised Aruba to improve the public finances by reducing current spending through civil service, pension, and—more recently—health care reform. On the revenue side, the Fund has recommended increasing reliance on indirect taxation, simplifying income taxes, and improving the tax administration. The Fund has also recommended that the supervision and regulation of the financial onshore and offshore sectors be strengthened. Improvements in data provision have also been suggested.

Concerning fiscal policies, key reforms on the spending side remain largely at the design stage. The new corporate income tax should lead to more uniform taxation, while personal income taxation has not yet been reformed. Financial supervision and regulation and the anti-money laundering framework have been considerably strengthened in recent years, and a specific plan to introduce indirect instruments of monetary policy is now being discussed. Data provision has improved, notably through the compilation of national accounts in current prices, but deficiencies remain, particularly in government and labor market statistics.

⁵ A new fiscal regime for corporations has been introduced (see Para. 16), though its effects are not included in the draft budget.

II. POLICY DISCUSSIONS

A. Economic Outlook

6. The staff and the authorities agreed that a strong recovery is likely in 2003.

While macroeconomic prospects are uncertain in the U.S. and poor in Venezuela, tourism bookings for the first quarter of 2003 (the most active part of the year) are favorable, and a modest increase in arrivals of 3-5 percent for the year is expected. The main engine of growth should be investment, as several large projects in the tourism sector are coming on stream and the public investment program has been revamped. Based on current investment plans, the mission projects growth of 4.4 percent for the year. A war in the Middle East and possible related terrorist attacks are major risks, although Aruba is likely to remain a relatively safe destination.⁶ Other risks to the outlook are that weak demand could delay planned private investments, or administrative difficulties could slow public investment projects.

7. Increased capacity in the tourism sector and higher public investment would support growth in the medium term, but would not help the economy diversify. After years of moratorium, the current government favored further growth in hotel capacity, but feared that an excessive dependence on tourism, like that on oil refining in earlier years, made the economy vulnerable. The mission agreed that diversification was desirable, but observed that the economy had been fairly resilient after the recent large adverse shocks, with no large-scale layoffs or bankruptcies.⁷ Also, other areas of comparative advantage were not immediately evident.

8. The authorities were worried that continuing immigration placed high demands on education, housing, and infrastructure. The government had begun to tighten immigration rules. The mission acknowledged these concerns, but noted that higher labor demand, especially in the construction sector, would have to be met mainly through immigration, as unemployment seems mostly frictional.⁸ It also observed that immigrants in Aruba do not rely disproportionately on the social safety net, and continuing immigration might help reduce population aging (see Para. 14).⁹

⁶ A scenario with U.S. tourism remaining at the current depressed level and arrivals from Venezuela declining a further 30 percent would result in GDP growth of 2.3 percent in 2003.

⁷ An important stabilizing factor for the tourist sector is the large proportion of time-share units (about 40 percent).

⁸ According to the 2000 census, the unemployment rate was 6.9 percent, and 66.1 percent of the unemployed found a new job within one year.

⁹ Immigrants have the same unemployment rate as that the native population and are not entitled to welfare payments.

9. **There was agreement that the current pace of monetary expansion was excessive, and a tightening may be required soon.**¹⁰ The authorities stressed the potential threat to the reserve position, as the suspension of credit controls had released pent-up demand for consumer credit which was fueling import growth. While reserves were in a comfortable position now, this was partly because of external borrowing by the government. The mission, on the other hand, expressed concerns about the high inflation differential with the U.S. and the associated loss of competitiveness.¹¹ It also noted the risk that price increases from higher indirect taxes in the middle of 2003 could trigger a wage-price spiral.

B. Fiscal Policy

10. **The authorities acknowledged the structural fiscal imbalances and had adopted the goal of achieving budget balance by 2007.** Plans on how to reach this objective, however, remained uncertain. The mission welcomed the goal as striking an appropriate balance between the need for adjustment and the desire not to stifle growth, and noted that it was compatible with debt sustainability in the medium run, although in the long run unfunded pension liabilities would require further adjustment (Box 3). The mission also observed that spreading the adjustment evenly over time would require a deficit reduction of about 1 percentage point of GDP per year. From this perspective, the 2003 draft budget—envisioning a decline in the deficit of only 0.4 percentage points of GDP—needed strengthening, preferably by initiating reforms to restrain expenditure growth.¹²

¹⁰ Despite the fixed exchange rate, capital controls and other barriers to international capital mobility create scope for an independent monetary policy. For example, the monetary tightening in March 2000, achieved through the reimposition of credit controls, was successful in curbing monetary growth.

¹¹ In recent years the Aruban florin has gradually appreciated relative to a number of other Caribbean competitors, but the island has maintained its share of the tourism market (Figures 5 and 6).

¹² Since these reforms may take time to yield savings, a more front-loaded path of adjustment would be difficult to achieve. If the downward macroeconomic risks materialize in the form of a limited temporary shock, the authorities could let the automatic stabilizers operate without compromising the structural fiscal adjustment path.

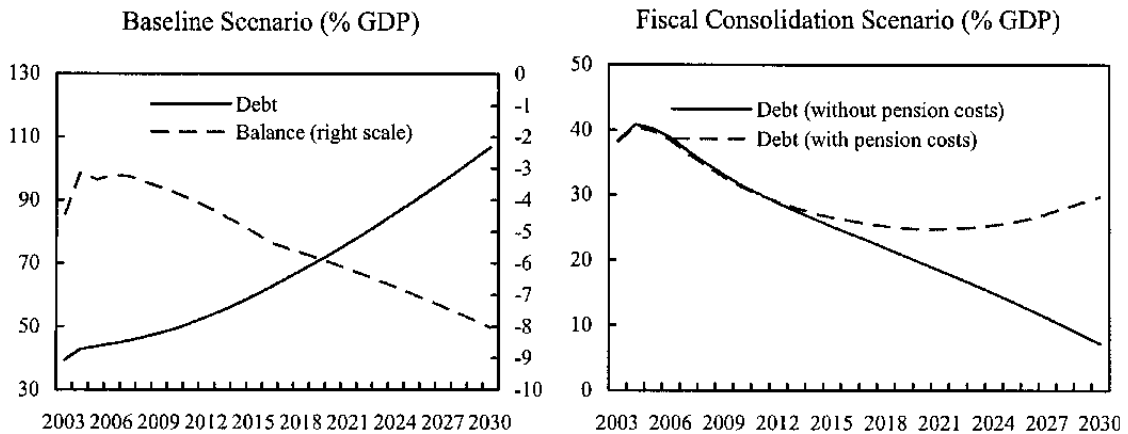
Box 3. Fiscal Sustainability

To assess the sustainability of the public finances, the mission compared its baseline projection against scenarios based on the fiscal adjustment currently under consideration by the Aruban authorities. The methodology used is broadly in line with that recently endorsed by the Executive Board.

The baseline scenario illustrates that with unchanged policies the path of the government debt would be unsustainable (see figure below). This scenario uses the mission's projections through 2007 (which incorporate the effects of realized off-budget liabilities on public debt and debt service). After 2007, it assumes GDP growth gradually declining to capture the effect of population aging on labor supply, and a constant primary balance (as a share of GDP). Under this scenario, the public debt ratio rises steadily, reaching over 100 percent of GDP by 2030.

Baseline Scenario

	2002	2007	2010	2020	2030
Real GDP growth (in percent per year)	-3.8	3.3	2.8	2.2	1.9
Average real interest rate on public debt (In percent)	0.0	1.7	2.5	4.0	4.0
Overall balance, including health care (Percent of GDP)	-4.9	-3.2	-3.8	-6.0	-8.0
Primary balance (Percent of GDP)	-3.7	-1.6	-1.6	-1.6	-1.6
Debt (Percent of GDP)	37.9	45.4	49.3	73.3	106.8



A fiscal consolidation scenario in which budgetary balance is achieved by 2007 and the primary surplus remains constant thereafter, results in debt sustainability. To balance the budget in 2007 without further tax increases, real expenditure (including health care) must be kept at -1.1 percent. In this scenario, the fiscal balance registers a small surplus after 2007. These scenarios, however, do not take into account the effects of population aging on the unfunded pension regime for which the government is ultimately financially responsible. Based on partial information on the evolution of the number of pensioners and assuming pensions remain constant in real terms, staff constructed a third scenario including pensions. Initially the fiscal position improves, but an unfavorable dynamics eventually sets in. To achieve debt sustainability with upfront fiscal adjustment and no pension reform, an overall surplus of 0.5 percent of GDP by 2007 would be necessary.

11. **Civil service reform will be central to curtailing spending and addressing fiscal imbalances.** A forthcoming “core business analysis” is intended to guide the streamlining of the civil service, whose ranks have increased by 16 percent since 1996. At the same time, though, the authorities stressed the need for increased staffing in education and security. A three-year freeze of wage indexation would control costs, while a project funded by the FDA would review the compensation structure in some functions. The mission welcomed these initiatives. On the wage freeze, it noted that permanent savings would be achieved only if wages were not allowed to fully catch up after the freeze, and the authorities stated that no firm commitment had been made in that regard.

12. **Reform of the expensive public employee pension system (APFA) is under consideration.**¹³ Measures under review include raising the retirement age, limiting inflation indexation, and calculating the benefit based on earnings during the entire career rather than the last two years of work. The mission welcomed the reform plans, but observed that preparatory studies had already been conducted in the past (including with Fund assistance) without reaching the implementation stage.

13. **The health care fund has experienced sizable cost overruns, especially in the areas of medicines and specialist care.** To tighten financial discipline, the fund management structure has been redesigned to give the government’s representatives more power. Stricter control on hospital admissions and laboratory tests has also been introduced, and a maximum reimbursement for specialists was planned. Limiting coverage to a basic benefit package and fostering the use of generic drugs is also under consideration. The mission favored introducing co-payments and deductibles, possibly income tested, but the authorities considered this measure too complex to administer.

14. **The authorities were also concerned about the solvency of the universal PAYGO pension system.** The old-age dependency ratio is projected to rise from 21.9 percent today to 63.4 percent in 2030, resulting in a significant rise in pension spending. Reform options include raising the retirement age from 60 to 65 years and individualizing the pension.¹⁴ The mission shared the authorities’ view that the already low benefit (about 70 percent of the minimum wage) should not be reduced, as only about 20 percent of private sector workers had a complementary pension.

¹³ APFA pensions complement the universal pension (AOV), and the combined replacement rate can exceed 100 percent of the base wage. The retirement age is 55, versus 60 in the private sector. Contributions to the fund represent around 28 percent of the base wage.

¹⁴ Currently, a retiree who is married receives a larger pension even if the spouse is not retired.

15. **On the revenue side, there was agreement that an indirect tax on imports and services (the ABB) would be useful to raise revenue in the short run.** A tax of this nature, while less broad-based than a VAT or a sales tax, is easy to collect, a key advantage given weaknesses in tax administration.¹⁵ The authorities remarked that the tax administration planned to improve efficiency by hiring more qualified personnel, improving computerization (with FDA funds), and reorganizing the office along client-based lines. Measures to simplify the income tax to reduce collection costs were not being considered at the moment.

16. **The mission viewed the new corporate profit tax as a step in the right direction, but expressed concern about some aspects.** The phasing out of the offshore tax regime and the tax holiday system are useful improvements, in line with previous Fund advice, as are the unification of the corporate tax rate and introduction of a withholding tax (see Annex). The use of an imputation to reduce corporate taxes for selected corporations, however, appears to be non-transparent and possibly complex to administer.¹⁶ The authorities remarked that the new regime would improve the international acceptability of the Aruban system while still attracting international business.¹⁷ The mission observed that an impact study would have been useful, and noted the short calendar for parliamentary discussion (the draft law was presented to Parliament on December 10 and approved on December 28).

17. **The stock of unmet obligations appears to be growing, continuing to hinder the transparency of the fiscal accounts.** The authorities noted that financial obligations towards suppliers had been reduced, while outstanding obligations towards APFA would be consolidated into a loan at a market interest rate.

C. Monetary and Financial Policies

18. **There was agreement that the exchange rate regime remains appropriate.** Given the small size of the economy and the strong commercial ties with the United States, the peg to the U.S. dollar continues to serve Aruba well. The authorities were aware of the need to restore fiscal sustainability and keep external borrowing low to preserve the peg.

¹⁵ With no domestic production of most import goods, this tax does not have the usual distortionary effects of an import tariff. In some cases, however, special measures may be necessary not to discriminate against foreign producers.

¹⁶ In other countries, imputations are used to reduce the double taxation of dividends across the board, rather than for selected companies. Since the tax administration will have to process and verify claims for the imputation credit, the NFR may raise the administrative burden.

¹⁷ Aruba is committed vis-à-vis the OECD to remove its harmful tax practices by 2005.

19. **Reliance on direct instruments of monetary control distorts credit allocation and, by freezing market shares, stifles bank competition.** The authorities received technical assistance from the Dutch Central Bank on a plan to introduce indirect instruments, such as central bank securities and an interbank market. The mission welcomed this initiative, which is in line with previous Fund recommendations.¹⁸ On fostering more entry in the banking sector, the authorities observed that there were no formal restrictions, but the lack of growth opportunities discouraged new entrants despite the high profitability.

20. **The banking system remains liquid and highly profitable in spite of the economic downturn (Table 6), and the supervisory framework is improving.** According to the authorities, banks had lent conservatively and, despite declining real estate prices, collateral values were still adequate.¹⁹ On supervision, following the recommendations of the recent Offshore Financial Sector (OFC) assessment, more targeted on-site examinations of bank asset quality are being conducted, and draft guidelines on interest rate, foreign exchange, and market risk have been circulated to market participants for comment. The new insurance supervision law has been implemented successfully.

21. **Anti-money laundering (AML) regulatory tools are being strengthened.** A draft law to supervise Company Service Providers (CSPs) of offshore non-financial companies is being revised to reflect the OFC assessment, particularly concerning AML. The government has meanwhile designated the central bank as the supervisor. In addition, detailed AML guidelines for money transfer companies have been issued, and pending legislation would bring these companies under central bank supervision.²⁰ There was agreement that quick progress on these initiatives was important.

D. Other Issues

22. **Following the compilation of national accounts for 1995–2000, the authorities are moving forward with plans to improve the statistical data base for Aruba.** The main current initiatives are the development of national accounts in constant prices and input-output tables. To address the mission's concerns regarding large discrepancies between national accounts and balance of payments data on exports, the authorities noted that a new methodology to bridge such differences is being developed. A joint initiative with other

¹⁸ The introduction of indirect instruments should not *per se* reduce capital market segmentation and, thus, the scope for an independent monetary policy.

¹⁹ The resolution of a weak bank through a takeover in 2001 explains the significant improvement in system-wide vulnerability indicators in 2002.

²⁰ The latest FATF evaluation in 1999 concluded that the Aruba was in substantial compliance with most of the agency's 40 recommendations.

Caribbean countries and the ILO is also underway to improve labor market statistics. The mission acknowledged the progress in these areas, but stressed the need to also improve government financial statistics.

23. **Competition has been introduced in the mobile phone market, hitherto monopolized by the state telecommunication company SETAR.** A license has been granted to a second company, and there are plans to grant a third one. In addition, SETAR has become a private law company, although the government remains the only shareholder. The mission questioned whether operational autonomy could be achieved under this arrangement. There are also plans to turn into private companies other activities, such as the post office, waste management, and the medical laboratory.

III. STAFF APPRAISAL

24. **Adverse shocks to tourism and slower investment caused the economy to contract in 2001 and 2002, but economic activity should pick up significantly in 2003.** A dynamic tourism sector, macroeconomic stability, and good institutions have underpinned the economic success of Aruba, and these same strengths allowed the island to withstand recent adverse shocks relatively well. In 2003, sharply higher private and public investment and a revival in tourism should support economic expansion, although further shocks to tourism remain a source of downside risk. As the investment boom peters out, growth is expected to return to a more sustainable rate in the medium run.

25. **Rapid monetary growth is supporting the economic recovery, but if the recent acceleration in inflation does not reverse itself, monetary policy will have to be tightened.** The exchange rate peg to the U.S. dollar remains appropriate, but narrowing the current inflation differential with the U.S. is necessary to preserve Aruba's external competitiveness. A tighter monetary stance is also advisable because likely increases in indirect taxes in the middle of the year may undermine current wage moderation.

26. **Macroeconomic stability and future growth opportunities cannot be ensured unless the public finances return to a sustainable path.** The government's objective to reach budgetary balance by 2007 is appropriate. To make sufficient progress towards this objective, the 2003 budget should envisage an adjustment of at least one percentage point of GDP. This requires strengthening the current draft budget through additional measures to restrain spending growth. To this end, long-delayed reforms in the areas of the civil service, pensions, and health care should quickly move to the implementation stage.

27. **Civil service and health care reform would help durably reduce fiscal imbalances.** A reform of the costly pension scheme for public employees to reduce the benefit and increase the retirement age would lower wage costs, as would a reversal of the recent expansion of public employment. This process should be facilitated by the forthcoming "core business analysis" of public sector activities. In health care, defining a more affordable basic benefit package (including medicines) would control costs without

undermining the basic goal of universal insurance. This approach may limit the need for extensive supply controls, which are costly to administer. Co-payments and deductibles, preferably differentiated based on income, would discourage waste on the demand side.

28. **Beyond 2007, ensuring the solvency of the universal, pay-as-you-go pension system will be key to the long-term sustainability of the public finances.** Pension costs could be lowered through a gradual increase in the retirement age (as life expectancy lengthens) and through the individualization of the benefit. The further development of second pillar pensions would help ensuring an adequate retirement income for private sector workers.

29. **On the revenue side, the planned new tax on imports and services will help raise revenue in the short run.** A VAT or a sales tax would be preferable, as it would widen the tax base further, but its introduction would require improvements in the tax administration first. Simplifying the income tax, as recommended by the Fund in the past, would help conserve administrative resources, while lowering the high marginal income tax rates might be considered down the road, when the fiscal position improves.

30. **The new corporate tax regime will usefully make corporate taxation more uniform.** The phasing out of the tax holiday and offshore regime, which allowed important sectors to escape taxation altogether, is welcome. However, the use of an imputation to effectively lower corporate taxation for selected companies is not transparent, and may be complex to administer.

31. **Strengthening transparency and accountability in the budgetary process would facilitate fiscal consolidation.** Improving the timeliness and quality of the fiscal data, particularly on expenditure would enhance accountability. In addition, transparency (and confidence in the government) would improve if the practice of financing the deficit through arrears was abandoned. A timetable for the elimination of the existing stock of unpaid obligations (now reaching over 6 percent of GDP) would be an important first step.

32. **Plans to introduce indirect instruments of monetary policy should improve the efficiency of the credit market and foster competition in the banking sector.** However, to avoid losing monetary control, these plans should be pursued at a gradual pace. The authorities should be commended for their efforts to improve financial supervision and regulation. These achievements will enhance financial stability as liberalization proceeds.

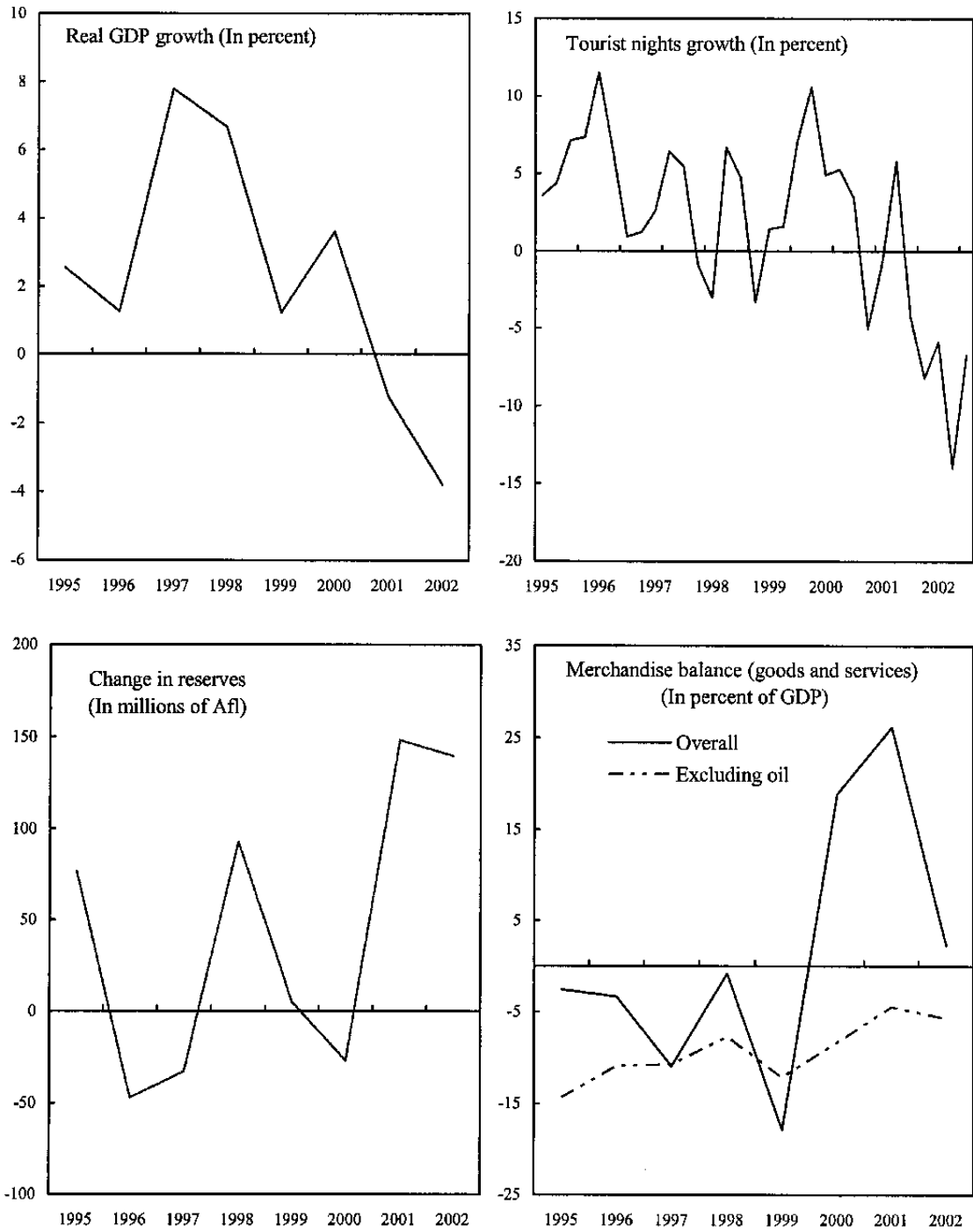
33. **Quick approval of the new law to supervise and regulate Company Service Providers would increase Aruba's ability to fight money laundering.** The decision to assign the supervisory function to the central bank, an institution with the necessary expertise and independence, is welcome. Bringing money transfer companies under the supervision of the central bank would also strengthen AML capacity.

34. **Efforts to increase the operational autonomy of public enterprises should improve economic efficiency.** The transformation of the telecommunication company SETAR into a private law company is an important step forward, and plans to do the same with other public sector activities are welcome. To increase operational autonomy, these actions should be followed by the opening up of capital to private investors, and, eventually, full privatization.

35. **The compilation of national accounts data from 1995 to 2000 will provide valuable help to surveillance and policy analysis.** The authorities are to be commended for this important achievement. Nonetheless, data provision still falls short of requirements, hampering Fund surveillance. Developing national accounts in constant prices, improving labor market data, and enhancing the provision of government statistics would go a long way toward addressing existing deficiencies.

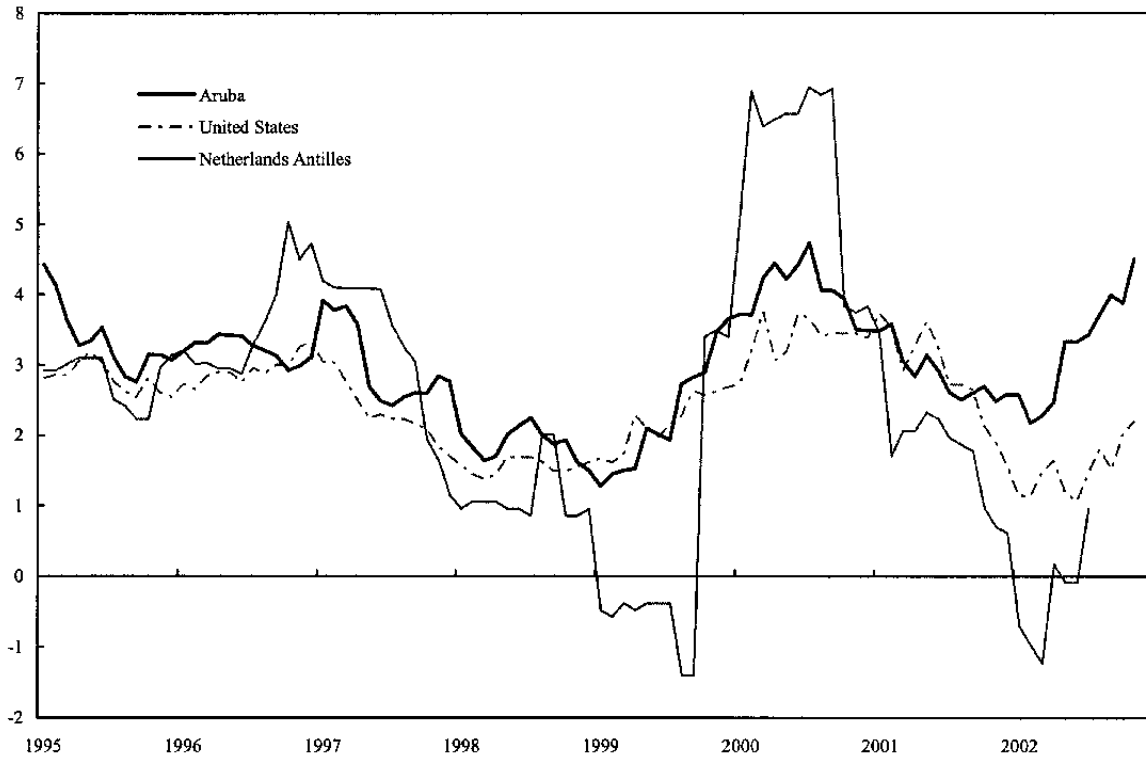
36. It is proposed that the next consultation be conducted on the standard 24-month cycle.

Figure 1. Aruba: Real Sector and Balance of Payments Indicators



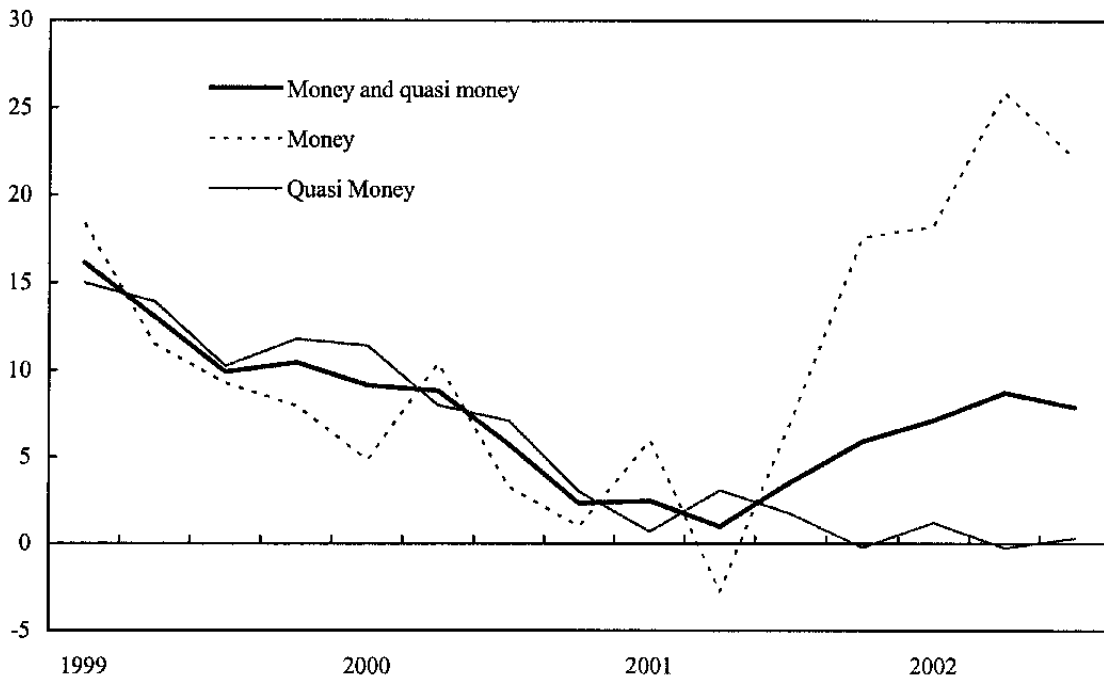
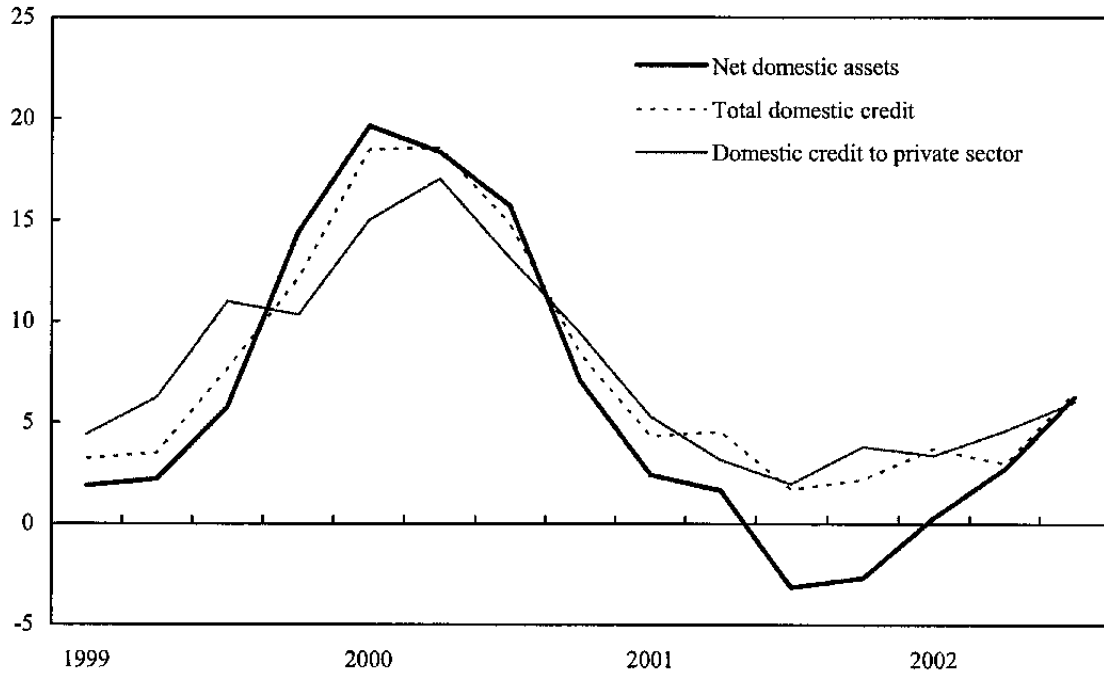
Source: CBA; and IMF, International Financial Statistics.

Figure 2. Aruba: Inflation Rate
(In percent)



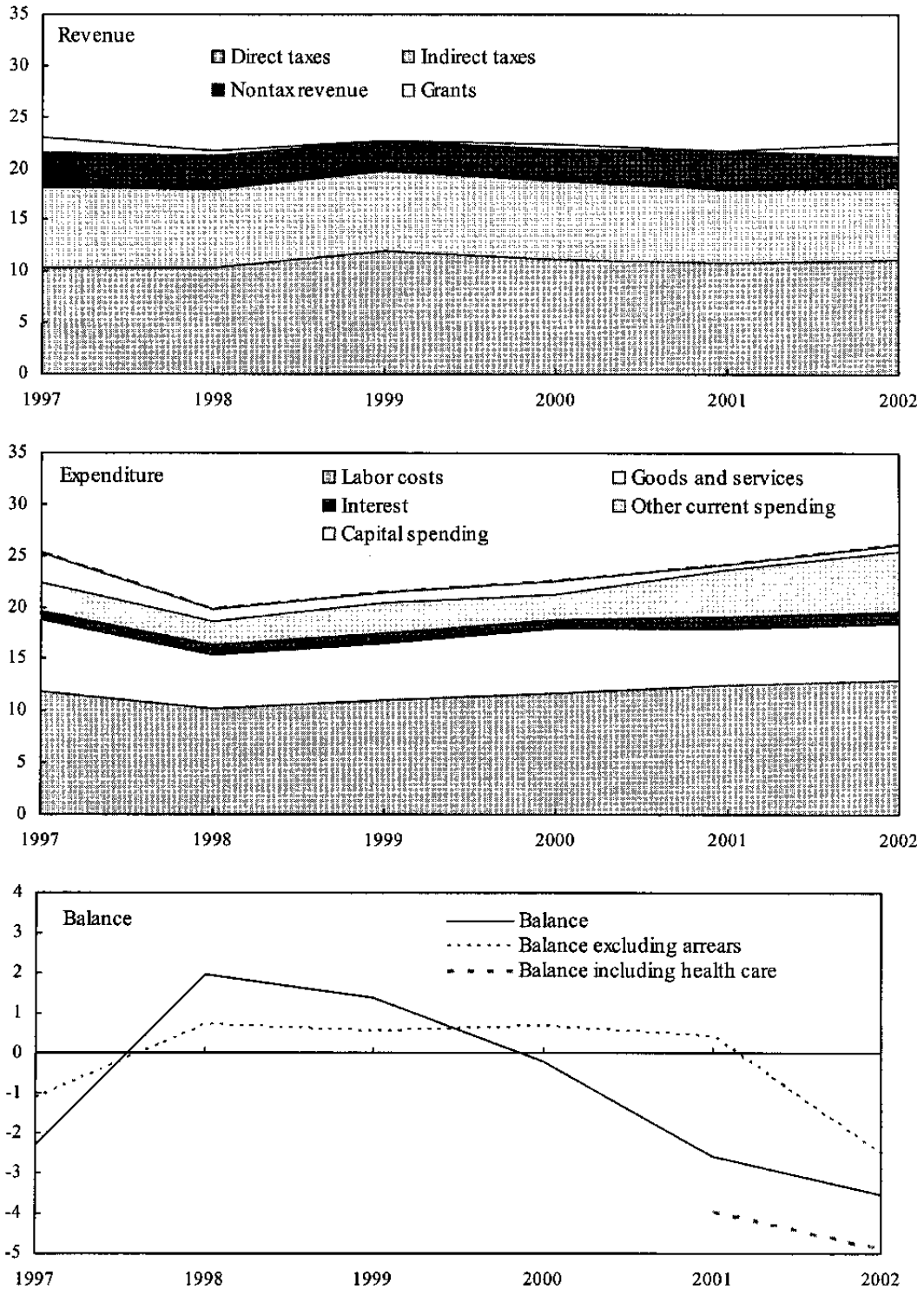
Source: IMF, International Financial Statistics.

Figure 3. Aruba: Monetary Developments
(Percentage change)



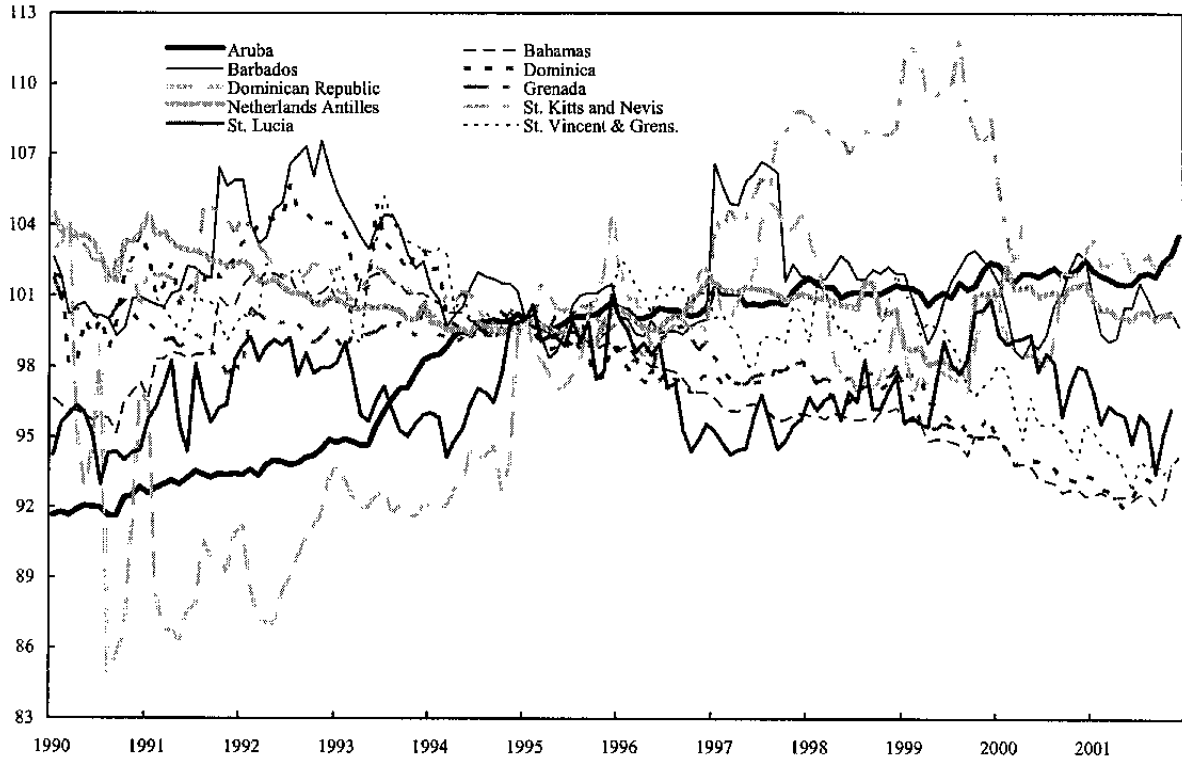
Source: Central Bank of Aruba.

Figure 4. Aruba: Budgetary Operations
(In percent of GDP)



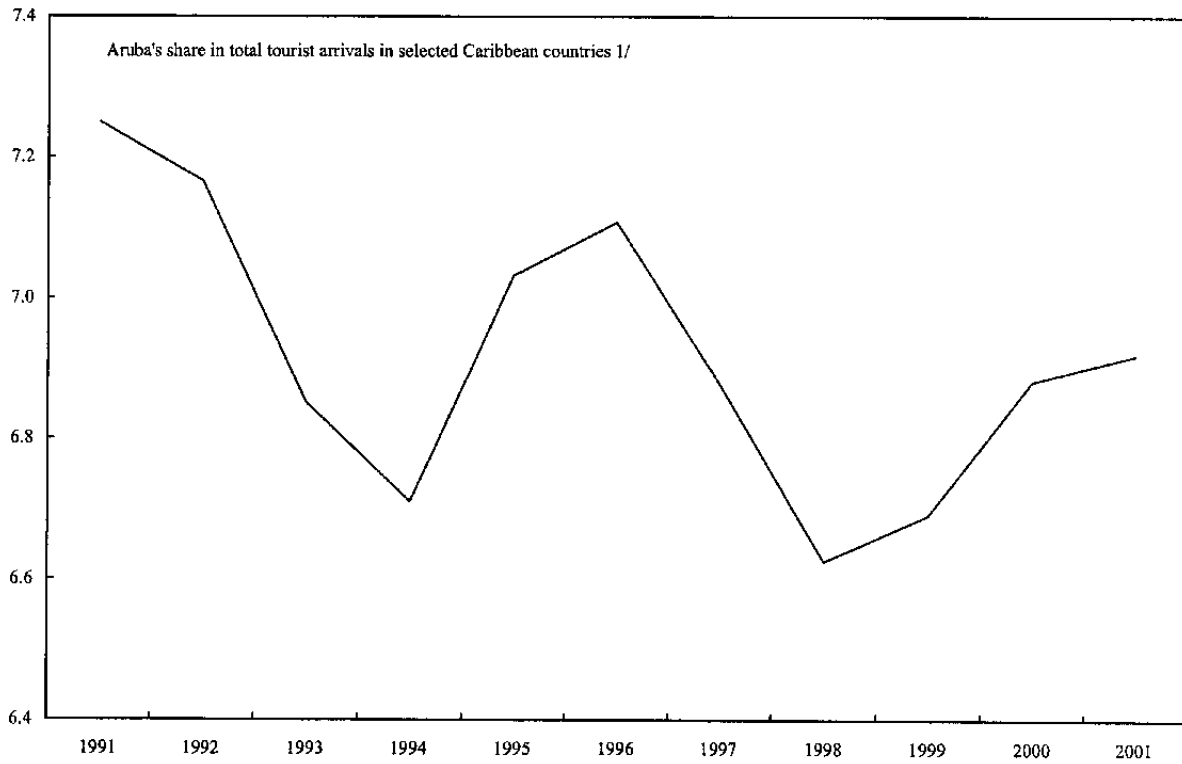
Sources: Directorate of Finance; Central Bank of Aruba; and staff calculations.

Figure 5. Aruba: Real Exchange Rates with Respect to the Dollar
(January 1995 = 100)



Source: IMF, International Financial Statistics, and staff calculations.

Figure 6. Aruba: Tourism Performance



Sources: National Tourism and Statistical Offices, CTO Estimates; and Central Bureau of Statistics.

1/ The Caribbean countries considered in this figure are Anguilla, Antigua and Barbuda, Bahamas, Barbados, Belize, Bermuda, Bonaire, British Virgin Islands, Cayman Islands, Cuba, Curacao, Dominica, Grenada, Guyana, Jamaica, Martinique, Montserrat, Saba, St. Kitts and Nevis, St. Lucia, St. Maarten, St. Vincent and the Grenadines, Trinidad and Tobago, Turks and Caicos Islands, and U.S. Virgin Islands.

Table 1. Aruba: Estimated GDP and components, 1995-2007
(In millions of Aruban florins at current prices)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Final consumption expenditure ^{1/}	1,665	1,819	2,014	2,155	2,307	2,321	2,550	2,726	2,862	3,029	3,205	3,371	3,542
real percentage change		5.8	7.5	5.0	4.7	-3.3	6.8	3.6	1.3	2.5	3.2	3.0	3.0
Household final consumption expenditure	1,193	1,320	1,367	1,500	1,617	1,659	1,783	1,871	1,983	2,108	2,228	2,345	2,466
real percentage change		7.2	0.5	7.7	5.5	-1.4	4.5	1.7	2.3	2.9	3.1	3.1	3.1
Government final consumption expenditure	472	498	647	655	689	662	768	855	879	921	977	1,026	1,075
real percentage change		2.4	26.1	-0.7	2.9	-7.7	12.6	7.9	-0.8	1.4	3.5	2.9	2.7
Gross capital formation ^{1/}	736	703	830	945	889	839	713	757	1,081	1,059	1,034	1,036	1,080
real percentage change		-7.4	14.5	11.8	-8.0	-9.3	-17.4	3.0	37.8	-5.2	-4.7	-1.9	2.2
Private gross capital formation	680	645	758	905	873	792	692	740	991	967	943	959	1,008
real percentage change		-8.1	14.1	17.2	-5.7	-12.8	-15.1	3.6	29.2	-5.5	-4.9	-0.4	3.0
Public gross capital formation	56	58	71	40	16	47	21	17	90	92	91	77	72
real percentage change		1.1	19.3	-45.1	-60.1	174.1	-57.0	-19.1	403.9	-1.4	-2.8	-17.5	-8.0
Exports of goods and services ^{1/2/}	2,007	2,140	2,263	2,374	2,496	2,489	2,439	2,229	2,291	2,441	2,603	2,777	2,943
real percentage change		3.3	2.7	3.0	2.8	-4.2	-4.7	-11.4	-0.8	3.1	4.0	4.5	3.9
Of which: tourism exports of goods and services	1,024	1,097	1,159	1,210	1,278	1,474	1,485	1,372	1,488	1,657	1,817	1,978	2,129
real percentage change		3.8	2.5	2.5	3.2	10.9	-2.1	-10.5	4.7	7.8	7.0	6.6	5.5
less: Imports of goods and services ^{1/}	2,044	2,191	2,365	2,493	2,605	2,323	2,321	2,356	2,603	2,699	2,795	2,915	3,065
real percentage change		3.9	4.8	3.5	2.2	-14.3	-2.9	-1.6	6.7	0.4	1.0	2.1	3.1
Gross domestic product at market prices	2,364	2,470	2,742	2,981	3,087	3,326	3,381	3,357	3,630.789	3,830	4,047	4,270	4,500
real percentage change		1.2	7.8	6.7	1.3	3.6	-1.2	-3.8	4.4	2.1	3.1	3.3	3.3
CPI	3.4	3.2	3.0	1.9	2.3	4.0	2.9	3.2	3.6	3.3	2.5	2.1	2.0

1/Real percentage changes are computed using consumer price inflation.

2/Trade data exclude the imports of crude oil and exports of refined petroleum products. However, an estimation of the net value added of the Coastal oil refinery is included in the exports data.

Table 2. Aruba: Balance of Payments Summary, 1995-2005
(In millions of Aruban florins)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Current Account	-27.6	-110.8	-350.9	-25.6	-622.8	527.9	734.3	-135.1	-238.6	-230.7	-179.6
Merchandise balance	-446.7	-539.8	-700.1	-632.5	-1,063.5	-62.7	138.7	-628.9	-729.9	-839.4	-909.2
Exports of goods	2,411.5	3,102.4	3,087.3	2,085.0	2,533.6	4,618.2	4,369.4	3,180.0	4,040.0	3,641.5	3,609.6
Imports of goods	2,858.2	3,642.2	3,787.4	2,717.5	3,597.1	4,680.9	4,230.7	3,808.9	4,769.9	4,480.9	4,518.7
Services	385.4	456.7	399.8	607.7	512.1	690.7	745.9	704.8	700.6	829.4	963.0
Exports of services	1,175.8	1,377.5	1,466.8	1,596.8	1,784.8	1,881.2	1,899.9	1,860.8	1,947.8	2,111.8	2,280.8
Imports of services	790.4	920.8	1,067.0	989.1	1,272.7	1,190.5	1,154.0	1,156.0	1,247.1	1,282.4	1,317.9
Income and current transfers	33.7	-27.7	-50.6	-0.8	-71.4	-100.1	-150.3	-211.0	-209.3	-220.8	-233.3
Financial and capital account	62.4	53.6	405.1	184.0	658.9	-561.2	-580.2	264.7	198.6	210.7	174.6
Of which: Direct investments	...	150.6	353.7	147.1	715.8	-278.6	-592.1	...	...	...	...
Portfolio investment	...	-11.2	80.0	-85.1	-86.0	-72.3	35.7	...	...	...	...
Loans to central government	...	-19.0	-16.0	39.7	13.4	60.8	22.2	...	...	...	...
Banking sector (net increase in liabilities)	48.0	-2.1	6.9	-67.7	-14.0	19.9	13.2	0.0	0.0	0.0	0.0
Errors and omissions	-6.3	12.2	-4.5	2.2	-16.9	-13.5	-19.0	10.0	0.0	0.0	0.0
Change in reserves (=increase) 1/	-76.5	47.1	32.8	-92.9	-5.2	26.9	-148.3	-139.6	40.0	20.0	5.0
	(In percent of GDP)										
Current Account	-1.2	-4.5	-12.8	-0.9	-20.2	15.9	21.7	-4.0	-6.6	-6.0	-4.4
Merchandise balance	-18.9	-21.9	-25.5	-21.2	-34.5	-1.9	4.1	-18.7	-20.1	-21.9	-22.5
Exports of goods	102.0	125.6	112.6	70.0	82.1	138.8	129.2	94.7	111.3	95.1	89.2
Imports of goods	120.9	147.4	138.1	91.2	116.5	140.7	125.1	113.5	131.4	117.0	111.7
Services	16.3	18.5	14.6	20.4	16.6	20.8	22.1	21.0	19.3	21.7	23.8
Exports of services	49.7	55.8	53.5	53.6	57.8	56.6	56.2	55.4	53.6	55.1	56.4
Imports of services	33.4	37.3	38.9	33.2	41.2	35.8	34.1	34.4	34.3	33.5	32.6
Income and current transfers	1.4	-1.1	-1.8	0.0	-2.3	-3.0	-4.4	-6.3	-5.8	-5.8	-5.8
Financial and capital account	2.6	2.2	14.8	6.2	21.3	-16.9	-17.2	7.9	5.5	5.5	4.3
Of which: Direct investments	...	6.1	12.9	4.9	23.2	-8.4	-17.5	...	...	...	...
Portfolio investment	...	-0.5	2.9	-2.9	-2.8	-2.2	1.1	...	...	...	...
Loans to central government	...	-0.8	-0.6	1.3	0.4	1.8	0.7	...	...	...	...
Banking sector (net increase in liabilities)	2.0	-0.1	0.3	-2.3	-0.5	0.6	0.4	0.0	0.0	0.0	0.0
Errors and omissions	-0.3	0.5	-0.2	0.1	-0.5	-0.4	-0.6	0.3	0.0	0.0	0.0
Change in reserves (-) 1/	-3.2	1.9	1.2	-3.1	-0.2	0.8	-4.4	-4.2	1.1	0.5	0.1
Memorandum items											
Non-oil trade balance (goods and services)	-14.3	-10.9	-10.7	-7.7	-12.1	-8.3	-4.5	-5.7	-10.4	-8.4	-6.3
Non-oil current account	-12.9	-12.0	-12.6	-7.8	-14.4	-11.4	-8.9	-12.0	-16.1	-14.2	-12.1
Non-oil financial and capital accounts	3.6	-2.3	-0.3	2.6	0.0	-4.3	-0.1	4.4	3.1	3.0	1.9
Oil sector balance	10.8	12.0	11.5	10.5	15.7	14.7	13.6	11.5	12.0	10.7	10.1

Sources: Central Bank of Aruba; and staff estimates.

1/ Including gold, excluding revaluation differences.

Table 3. Aruba: Income Per Capita in Selected Caribbean Countries, 2000

	GDP per capita (In U.S. dollars)
Bermuda	47,678
Aruba	20,435
Bahamas, The	16,238
Puerto Rico	10,906
Netherlands Antilles	10,086
Barbados	9,736
Antigua and Barbuda	9,702
St. Kitts and Nevis	8,011
Trinidad and Tobago	5,920
St. Lucia	4,486
Grenada	4,187
Dominica	3,700
Jamaica	3,410
Belize	3,157
St. Vincent & Grens.	2,933
Cuba	2,468
Dominican Republic	2,355
Guyana	936

Sources: IMF, EIU

Table 4. Aruba: Monetary Developments, 1997-2003
(In millions of Aruban florins, end of period)

	1997	1998	1999	2000	2001	2002 ^{1/}	2003 ^{2/}
Net foreign assets	397.3	557.9	577.1	530.4	665.3	804.9	764.9
Central bank 1/	320.1	413.0	418.2	391.4	539.5	636.6	610.0
Commercial banks	77.2	144.9	158.9	139.0	125.8	168.3	154.9
Net domestic assets	963.4	980.9	1121.7	1207.8	1175.3	1235.5	1336.3
Domestic credit	1175.8	1244.1	1394.4	1512.1	1545.0	1624.1	1756.7
Public sector 2/	-9.7	-8.9	12.3	-1.1	-25.8	-75.3	-81.4
Central government 2/	0.1	0.9	21.7	21.5	5.5	-4.2	-4.5
Development aid 2/	-9.8	-9.8	-9.4	-22.6	-31.3	-71.1	-76.9
Private sector	1185.5	1253.0	1382.1	1513.2	1570.8	1699.4	1838.1
Enterprises	635.8	636.3	670.0	730.0	741.2	797.7	862.8
Consumer credit	269.2	287.9	335.6	357.3	366.7	400.6	433.3
Housing mortgages	263.2	300.8	350.4	400.5	444.8	481.4	520.7
Other	17.3	28.0	26.1	25.4	18.1	19.7	21.3
Other items (net)	-212.4	-263.2	-272.7	-304.3	-369.7	-388.6	-420.3
Money supply (M2)	1360.8	1538.8	1699.1	1738.3	1840.7	2040.5	2101.2
Money (M1)	473.1	547.0	590.4	596.3	701.1	823.0	890.2
Quasi-money	887.7	991.8	1108.7	1142.0	1139.6	1217.5	1211
	(Contribution to broad money)						
Net foreign assets	-2.6	11.8	1.2	-2.7	7.8	8.6	-2.0
Central bank 3/	-2.2	6.8	0.3	-1.6	8.5	6.7	-1.3
Commercial banks	-0.4	5.0	0.9	-1.2	-0.8	1.9	-0.7
Net domestic assets	7.2	1.3	9.1	5.1	-1.9	3.0	4.9
Domestic credit	7.2	5.0	9.8	6.9	1.9	4.9	6.5
Public sector	2.4	0.1	1.4	-0.8	-1.4	-3.5	-0.3
Central government	3.0	0.1	1.4	0.0	-0.9	-1.3	0.0
Development aid	-0.6	0.0	0.0	-0.8	-0.5	-2.2	-0.3
Private sector	4.7	5.0	8.4	7.7	3.3	8.4	6.8
Enterprises	1.2	0.0	2.2	3.5	0.6	3.9	3.2
Consumer credit	2.8	1.4	3.1	1.3	0.5	1.9	1.6
Housing mortgages	1.5	2.8	3.2	2.9	2.5	2.6	1.9
Other	-0.8	0.8	-0.1	0.0	-0.4	0.0	0.1
Other items (net)	0.0	-3.7	-0.6	-1.9	-3.8	-1.9	-1.6
Money supply (M2)	4.6	13.1	10.4	2.3	5.9	12.4	3.0
Money (M1)	2.2	5.4	2.8	0.3	6.0	10.5	3.3
Quasi-money	2.4	7.6	7.6	2.0	-0.1	1.1	-0.3
Memorandum items							
Official reserves of the central bank (in US\$ million) 3/	172.3	222.2	219.9	208.0	293.7	390.8	364.2
Ratio of official reserves to base money 3/	1.4	1.3	1.2	1.2	1.3	1.2	1.2
Ratio of net foreign assets to broad money	0.3	0.4	0.3	0.3	0.4	0.4	0.4
Ratio of net foreign assets to non-oil imports (months)	2.5	3.5	4.4	4.8	6.2	7.1	6.2
Inflation differential with the United States	0.7	0.3	0.1	0.7	0.0	1.7	...
Velocity of money	2.0	1.9	1.8	1.9	1.8	1.6	1.7

Sources: Central Bank of Aruba, Quarterly and Monthly Bulletins.

1/ Data for 2002 refer to November. Rates of growth are relative to the same period in 2001.

2/ Staff projection

3/ Excluding gold and revaluation differences.

Table 5. Aruba: Summary of Trends in Public Finance
(In millions of Aruban florins)

	1997	1998	1999	2000	2001	2002		2003	2004	2005	2006	2007
						budget 1/	staff prj.					
Revenue	629.5	646.4	701.5	742.2	731.8	792.7	753.8	814.4	886.7	924.9	963.7	1011.1
Taxes	499.9	535.4	608.6	624.5	606.3	646.5	611.6	681.4	755.8	794.7	834.2	874.6
Non-tax revenue	91.3	95.3	91.5	100.8	125.5	121.4	103.5	109.0	109.8	112.0	114.2	120.4
Grants	38.3	15.7	1.4	16.9	0.0	24.8	38.8	24.0	21.1	18.2	15.3	16.1
Expenditure	692.8	588.5	658.7	749.1	818.9	891.7	873.2	943.2	970.4	1023.0	1061.6	1114.5
Current spending	612.6	556.7	632.5	703.9	800.5	830.9	851.4	904.3	930.4	981.6	1017.5	1068.0
Labor costs 2/	325.2	304.3	342.0	385.6	424.1	431.9	435.3	431.4	451.2	481.6	507.5	530.6
Goods and services 3/	189.7	155.0	166.7	211.4	184.5	157.2	184.5	167.0	175.9	183.8	191.3	201.6
Interest	23.9	29.0	33.4	30.2	35.7	46.2	40.1	50.0	65.6	73.6	70.7	74.5
Other current spending	73.8	68.4	90.5	76.8	156.2	195.6	191.5	255.9	237.8	242.7	248.0	261.4
Capital spending	80.2	31.8	26.2	45.2	18.4	60.8	21.8	38.9	40.0	41.4	44.1	46.5
Balance	-63.3	57.9	42.8	-7.0	-87.1	-99.0	-119.4	-128.8	-83.7	-98.1	-97.9	-103.4
Statistical discrepancy	0.4	7.2	3.8	0.1	0.1	...	...	...	...	...	...	...
Financing	63.7	-50.8	-39.0	7.1	87.2	99.0	119.4	128.8	83.7	98.1	97.9	103.4
Foreign	-16.0	39.7	13.3	24.1	27.9	...	42.0	...	...	...	...	...
Domestic	79.7	-90.5	-52.3	-17.0	59.3	...	77.4	...	...	...	...	...
Monetary system	31.8	0.8	21.3	-13.4	-24.7	...	21.6	...	...	...	...	...
Non-monetary sectors	31.0	-22.7	-10.5	-16.8	14.2	...	6.2	...	...	...	...	...
Change in unmet payment obligations 4/	32.0	-36.7	-25.7	29.4	101.8	-48.3	35.1	...	...	...	...	...
Net lending	15.1	31.9	37.4	16.2	32.0	...	-14.6	...	...	...	...	...
(in percent of GDP)												
Revenue	23.0	21.7	22.7	22.3	21.6	23.6	22.5	22.4	23.2	22.9	22.6	22.5
Taxes	18.2	18.0	19.7	18.8	17.9	19.3	18.2	18.8	19.7	19.6	19.5	19.4
Non-tax revenue	3.3	3.2	3.0	3.0	3.7	3.6	3.1	3.0	2.9	2.8	2.7	2.7
Grants	1.4	0.5	0.0	0.5	0.0	0.7	1.2	0.7	0.6	0.4	0.4	0.4
Expenditure	25.3	19.7	21.3	22.5	24.2	26.6	26.0	26.0	25.3	25.3	24.9	24.8
Current spending	22.3	18.7	20.5	21.2	23.7	24.8	25.4	24.9	24.3	24.3	23.8	23.7
Labor costs 2/	11.9	10.2	11.1	11.6	12.5	12.9	13.0	11.9	11.8	11.9	11.9	11.8
Goods and services 3/	6.9	5.2	5.4	6.4	5.5	4.7	5.5	4.6	4.6	4.5	4.5	4.5
Interest	0.9	1.0	1.1	0.9	1.1	1.4	1.2	1.4	1.7	1.8	1.7	1.7
Other current spending	2.7	2.3	2.9	2.3	4.6	5.8	5.7	7.0	6.2	6.0	5.8	5.8
Capital spending	2.9	1.1	0.8	1.4	0.5	1.8	0.6	1.1	1.0	1.0	1.0	1.0
Balance	-2.3	1.9	1.4	-0.2	-2.6	-2.9	-3.6	-3.5	-2.2	-2.4	-2.3	-2.3
Statistical discrepancy	0.0	0.2	0.1	0.0	0.0	...	...	...	...	...	...	...
Financing	2.3	-1.7	-1.3	0.2	2.6	2.9	3.6	3.5	2.2	2.4	2.3	2.3
Foreign	-0.6	1.3	0.4	0.7	0.8	...	1.3	...	...	...	...	...
Domestic	2.9	-3.0	-1.7	-0.5	1.8	...	2.3	...	...	...	...	...
Monetary system	1.2	0.0	0.7	-0.4	-0.7	...	0.6	...	...	...	...	...
Non-monetary sectors	1.1	-0.8	-0.3	-0.5	0.4	...	0.2	...	...	...	...	...
Change in unmet payment obligations 4/	1.2	-1.2	-0.8	0.9	3.0	-1.4	1.0	...	...	...	...	...
Net lending	0.6	1.1	1.2	0.5	0.9	...	-0.4	...	...	...	...	...
Memorandum items:												
Stock of unmet payment obligations 4/ 5/	3.8	2.3	1.4	2.2	5.2	...	6.2	...	...	...	...	...
Balance including AZV 6/	...	...	...	...	-3.9	-3.9	-4.9	-4.5	-3.1	-3.4	-3.2	-3.2

Sources: Ministry of Finance; Central Bank of Aruba; and staff calculations and projections.

1/ Data based on budget information from the authorities adjusted by staff to match standard reporting.

2/ Including arrears to APFA.

3/ Including arrears to suppliers.

4/ Includes a downward revision of arrears of Afl. 23.6 million assumed to be distributed equally over 1998-2000.

5/ Stock of domestic payment obligations at end of period as a percent of (estimated) annual GDP.

6/ The health care fund (AZV) was introduced in 2001.

Table 6. Aruba: Indicators of External and Financial Vulnerability

	1997	1998	1999	2000	2001	2002
External indicators						
Exports goods and services (annual percent change, in US dollars) 1/	5.8	4.9	5.1	-0.3	-2.0	-8.6
Imports goods and services (annual percent change, in US dollars) 1/	7.9	5.4	4.5	-10.8	-0.1	1.5
Current account balance (percent of GDP) 1/	-12.8	-0.9	-20.2	15.9	21.7	-4.0
Capital and financial account balance (percent GDP) 1/	14.8	6.2	21.3	-16.9	-17.2	7.9
Inward portfolio investment (percent of GDP)	2.9	-2.9	-2.8	-2.2	1.1	...
Inward foreign direct investment (percent of GDP)	12.9	4.9	23.2	-8.4	-17.5	...
Official reserves (in Afl, millions) 1/	308.5	397.7	393.6	372.3	525.7	699.5
Official reserves (in US dollars, millions) 1/	172.3	222.2	219.9	208.0	293.7	390.8
Broad money to net foreign assets (ratio) 2/	3.4	2.8	2.9	3.3	2.8	2.5
Central bank foreign liabilities (in US dollars, millions) 3/	1.4	0.9	0.1	1.3	1.5	0.1
Foreign assets of the banking sector (in US dollars, millions) 3/ 4/	432.6	496.6	503.0	509.5	590.6	577.2
Foreign liabilities of the banking sector (in US dollars, millions) 3/ 4/	218.5	191.7	191.2	220.2	228.1	188.9
Official reserves in months of imports 5/ 6/	2.8	3.4	3.8	3.9	5.7	7.5
Total external debt (percent of GDP) 1/			35.8	37.8	38.1	42.9
Total external debt to exports (ratio in percent) 1/ 6/			25.6	19.3	20.5	25.1
Exchange rate (per U.S. dollar, period average)	1.79	1.79	1.79	1.79	1.79	1.79
Financial Market Indicators						
Public sector debt (percent of GDP) 1/	39.4	30.6	30.1	30.3	34.1	37.9
Public commercial external debt (percent of GDP) 1/	1.4	3.1	3.9	4.7	5.9	9.2
Financial Sector Risk Indicators 7/						
Mortgage credit to total assets (in percent)	13.5	14.0	14.7	15.3	15.4	...
Capital Adequacy						
Risk -weighted capital ratio=regulatory capital ratio	10.6	9.1	7.9	8.2	10.5	10.5
Tier 1 capital ratio	5.7	6.4	5.1	3.8	4.1	5.0
Asset Quality						
Non-performing loans (net of provisions) to gross loans	...	2.9	2.0	2.5	3.0	1.7
Non-performing loans (net of provisions) to regulatory capital	...	32.2	27.0	32.8	30.0	17.6
Large loans to regulatory capital	1.6	1.7	2.6	2.8	1.4	1.4
Earnings and Profitability						
Return on assets (before taxes)	1.7	0.7	0.9	1.9	2.0	...
Return on assets (after taxes)	1.1	-0.1	0.2	1.2	1.5	...
Return on equity (before taxes)	31.2	16.0	23.6	49.9	39.3	...
Return on equity (after taxes)	20.6	-2.0	5.3	30.1	28.6	...
Interest margin to gross income	67.4	71.3	68.8	66.2	63.5	63.4
Non-interest expenses to gross income	86.1	101.3	97.1	85.4	77.9	71.3
Liquidity						
Loan-to-deposit ratio	72.9	69.7	73	78.5	73	70.7
Prudential liquidity ratio	...	...	29.6	24.3	27.5	29.8
Liquidity assets to short-term liabilities	85.9	94.8	99.1	78.5	85.4	88.5
Sensitivity to market risk						
Interest rate margin	...	6.9	6.8	5.8	6.3	8.2
Net foreign assets to regulatory capital	63.4	119.0	150.0	128.2	102.2	96.1

Sources: Data provided by the authorities, and IMF, International Financial Statistics.

1/ Data for 2002 are projections.

2/ For 2002, data are estimates for end of November.

3/ For 2002, data are for end of June.

4/ excluding gold, including revaluation differences.

5/ For 2002, official reserves are for October.

6/ Imports and exports are from the balance of payments.

7/ For 2002, data are for September.

Aruba - Basic Data

Area	180 square kilometers
Population (2001)	93 thousand
GDP per capita (2001)	US\$ 20.6 thousand
Social indicators (2000)	
Literacy rate (1995)	97 percent
Life expectancy	73 years
Infant mortality	0.7 percent

	1997	1998	1999	2000	2001	2002	2003 Staff. Proj.
--	------	------	------	------	------	------	----------------------

	(Percent change)						
Real economy 1/							
Real GDP	7.8	6.7	1.3	3.6	-1.2	-3.8	4.4
Nominal GDP	11.0	8.7	3.6	7.8	1.7	-0.7	8.2
Real final consumption	7.5	5.0	4.7	-3.3	6.8	3.6	1.3
Real investment	14.5	11.8	-8.0	-9.3	-17.4	3.0	37.8
Real exports (excl. oil)	2.7	3.0	2.8	-4.2	-4.7	-11.4	-0.8
Real imports (excl. oil)	4.8	3.5	2.2	-14.3	-2.9	-1.6	6.7

Inflation (period average)							
CPI (Aruba) 2/	3.0	1.9	2.3	4.0	2.9	3.2	3.6
CPI (Curaçao) 3/	3.3	1.1	0.4	5.8	1.8	-0.1	...
CPI (U.S.) 2/	2.3	1.6	2.2	3.4	2.8	1.5	...
Real exchange rate index (1995=100) 2/4/	100.9	101.2	101.3	102.0	102.0	103.7	...

	(In Millions of U.S. dollars)						
Balance of payments 1/							
Current Account	-196.0	-14.3	-347.9	294.9	410.2	-75.5	-133
(In percent of GDP)	-12.8	-0.9	-20.2	15.9	21.7	-4.0	-6.6
<i>Of which: non-oil</i>	-192.4	-129.4	-249.1	-211.1	-168.8	-224.7	-327.4
<i>(In percent of GDP)</i>	-12.6	-7.8	-14.4	-11.4	-8.9	-12.0	-16.1
Merchandise balance	-391.1	-353.4	-594.1	-35.0	77.5	-351.3	-407.8
Oil sector	-3.6	115.1	-98.8	506.0	579.0	149.3	194.1
Free zone	47.2	23.9	27.9	5.9	10.0	6.6	4.5
Other	-434.6	-492.3	-523.2	-546.9	-511.5	-507.3	-606.3
Services	223.4	339.5	286.1	385.9	416.7	393.7	391.4
Of which: tourism revenues	534.9	603.8	647.9	707.9	745.0	697.8	762.7
Income	-17.2	4.9	-29.1	-5.8	-37.8	-53.1	-66.7
Current Transfers	-11.1	-5.3	-10.8	-50.2	-46.1	-64.8	-50.3
Financial and capital account	226.3	102.8	368.1	-313.5	-324.1	147.9	111.0
Errors and omissions	-2.5	1.2	-9.4	-7.5	-10.6	5.6	0.0
Change in reserves (=increase) 5/	18.3	-51.9	-2.9	15.0	-82.8	-78.0	22.3

Aruba – Basic Data (concluded)

	1997	1998	1999	2000	2001	2002	2003
	(Percent change)						
Monetary aggregates 6/							
Net foreign assets	-7.9	40.4	3.4	-8.1	25.4	25.8	-5.0
Net domestic assets	10.8	1.8	14.4	7.7	-2.7	5.1	8.2
Domestic credit	8.6	5.8	12.1	8.4	2.2	5.3	8.2
To private sector	5.5	5.7	10.3	9.5	3.8	8.3	8.2
Money and quasi-money	4.6	13.1	10.4	2.3	5.9	12.4	3.0
Money	6.3	15.6	7.9	1.0	17.6	25.6	8.2
Quasi-money	3.7	11.7	11.8	3.0	-0.2	5.0	-0.5
	(In percent of GDP)						
Public finances central government							
Revenue and grants	23.0	21.7	22.7	22.3	21.6	22.5	22.4
Expenditure	25.3	19.7	21.3	22.5	24.2	26.0	26.0
Balance	-2.3	1.9	1.4	-0.2	-2.6	-3.6	-3.5
Government debt							
External	12.1	13.1	11.9	11.3	11.6	15.2	...
Domestic	27.2	17.5	18.2	19.0	22.4	22.8	...
	(In percent)						
Interest rates 7/							
Deposit rate	4.4	4.8	6.2	6.2	5.8	4.1	...
Lending rate	10.2	10.4	13.1	12.1	12.1	13.6	...
Exchange rates							
U.S. dollar	1.79	1.79	1.79	1.79	1.79	1.79	1.79
SDR (end of period) 8/	2.42	2.52	2.46	2.33	2.25	2.37	...

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

1/ Data for 2002 are staff estimates

2/ Data for 2002 are for January-November. Rates of growth are relative to the same period in 2001

3/ Data for 2002 are for January-August. Rates of growth are relative to the same period in 2001.

4/ Relative to the U.S. dollar. CPI based. Period average.

5/ Including gold, excluding revaluation differences

6/ Data for 2002 are for November. Rates of growth are relative to the same period in 2001.

7/ Data for 2002 refer to August.

8/ Data for 2002 refer to November.

KINGDOM OF THE NETHERLANDS—ARUBA: FUND RELATIONS
As of January 21, 2003

I. **Membership Status:** The Kingdom of the Netherlands is an original member of the Fund. On February 15, 1961, the Kingdom accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Articles of Agreement for all territories.

II.	General Resources Account:	<u>SDR million</u>	<u>%Quota</u>
	Quota	5,162.4	100.0
	Fund holdings of currency	3,067.2	59.4
	Reserve position in Fund	2,095.2	40.6
III.	SDR Department:	<u>SDR million</u>	<u>%Allocation</u>
	Net cumulative allocation	530.3	100.0
	Holdings	512.9	96.7

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None

VII. **Exchange Arrangements:**

The Aruban florin has been pegged to the U.S. dollar at Af. 1.79 per US\$1 since January 1, 1986. No restrictions are imposed on payments related to current transactions.

VIII. **Article IV Consultation:**

The Board concluded the last Article IV consultation discussions for Aruba on August 22, 2001 (EBM/01/84) on the basis of staff report SM/01/241 (8/1/01) and statistical appendix SM/01/243 (8/1/01). Consultations are conducted on a bi-annual cycle.

IX. **OFC Assessment:**

The Offshore Financial Sector Assessment was published in June 2002 (SM/02/214).

X. **Technical Assistance:**

Aruba participated in the Coordinated Portfolio Investment Survey (CPIS) in 2000–01 with assistance of the Statistics Department. To assist the authorities in a self-assessment of the financial standards of its offshore center activities, a special mission from the Monetary and Exchange Affairs Department visited Aruba in late 2000 and early 2001.

Aruba—Statistical Issues

1. Real sector

Aruba produces CPI data and the CBS recently published National Accounts for 1995 through 2000, as well as preliminary estimates for 2001 and 2002. More detailed Sector Accounts have been made available for the years 1995–2000. There are plans for the compilation of input and output tables and for a detailed tourism satellite account. The CBS is interested in developing deflators and trade price data, also in order to be able to compile National Accounts in constant prices. A joint Caribbean labor market survey should improve the availability of labor market data this year.

2. Fiscal sector

Aruba does not report government finance statistics to STA, neither for publication in the *GSF Yearbook* nor for the *IFS*.

3. Monetary sector

There are no major outstanding issues for money and banking statistics. The CBA reports monetary data to STA on a timely basis.

4. External sector

The CBA reports quarterly balance-of-payments data. However, it would be useful to publish a more detailed breakdown of exports and imports, for example by economic use (consumer goods, fuels, raw materials and capital goods) or by commodities. Also, it would be desirable to narrow – to the extent possible – the differences between trade data from the CBA and those in the National Accounts.

Aruba publishes monthly data on the official reserve position, with a lag of one month, providing a breakdown in holdings of gold and foreign currency. As prescribed by the SDDS, data on foreign liabilities of the monetary sector—including a breakdown by maturity (long and short term) and instrument—and the central government are published on a quarterly basis, with a lag of about one quarter. Data provision on foreign debt of the non-financial private sector, however, is on an annual basis only. A debt survey covering both the public and private sector debt provides information on the amount, average maturity, and currency denomination of foreign debt outstanding. There is no disaggregation by instrument nor information on forthcoming amortization payments coming due.

Kingdom of the Netherlands—Aruba: Core Statistical Indicators
as of January 13, 2003

	Exchange Rates 1/	Int'l Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Gov't Balance	GDP/GNP 3/	External Debt 2/	Debt Service 2/
Date of Latest Observation	9/1/03	10/02	10/02	10/02	10/02	Q3/02	10/02	Q3/02	Q3/02	Q3/02	2000	Q3/02	Q3/02
Date Received	9/1/03	12/2/02	12/2/02	12/2/02	12/2/02	12/2/02	12/2/02	12/2/02	12/2/02	12/2/02	12/02	12/2/02	12/2/02
Frequency of Data	Daily	Weekly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Irregular	Quarterly	Quarterly
Frequency of Reporting	Daily	Weekly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Irregular	Quarterly	Quarterly
Source of Update	CBA 4/	CBA	CBA	CBA	CBA	CBA	CBS	CBA	CBA	CBA 5/	CBS	CBA 5/	CBA 5/
Mode of Reporting	—	6/	6/	6/	6/	Electronic	6/	6/	6/	6/	6/	6/	6/
Confidentiality	No	No	No	No	No	No	No	No	No	No	No	No	No
Frequency of Publication	—	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Irregular	Quarterly	Quarterly

1/ Fixed exchange rate against the U.S. dollar since 1986; the Fund would be notified of a parity change.

2/ For government only.

3/ The Central Bureau of Statistics (CBS) also provides preliminary estimates for 2001 and 2002.

4/ Central Bank of Aruba = CBA.

5/ Publication.

6/ In consultation with the Directorate of Finance.

The New Fiscal Regime

A New Fiscal Regime (NFR) for corporate income will come into effect in 2003. Under the previous regime, corporate profits were taxed at a progressive marginal rate ranging from 31.05 percent to 39.10 percent, and dividends paid to individuals were subject to income tax with a top marginal rate of 55.9 percent (although with a deductible of up to 12 percent of dividends received). Profits from offshore or resident companies benefiting from a tax holiday (including many hotels and the oil refinery) were mostly exempt from profit and income taxes.

Under the NFR, two new regimes have been created, while the offshore regime will be phased out by 2008, and no new tax holidays will be granted (existing tax holidays will continue until their expiration). Under the first new regime, companies will pay a flat profit tax of 35 percent and a 10 percent dividend withholding tax (5 percent if listed on a stock exchange). At the individual level, dividends will be taxed at a flat rate of 30 percent. Hence, for low-profit companies and low-income individuals taxation will increase, while for others it will decrease.

The second regime, with sharply lower tax rates, will apply to selected companies. The criteria to qualify for this status will be determined through future implementing legislation, and will likely include operating in an export-oriented or financial activity (including tourism), a minimum of one resident director, and satisfying certain financial disclosure requirements. These companies will pay the same corporate profit tax and withholding tax as other companies, but the flat dividend tax will be only 25 percent. In addition, shareholders will be entitled to an imputation of about half of dividends received, to be paid in cash by the tax administration. This effectively reduces the corporate profit tax to 2 percent, as illustrated below.

Profit:	100.0
Profit tax (35 percent)	35.0-
	<hr/>
	65.0
Imputation (33/65)	33.0+
	<hr/>
	98.0
(Effective corporate profit tax 2.0 percent)	
Withholding tax (10 percent)	9.8-
	<hr/>
Income tax (25 percent of 65+33, minus withholding)	14.7-

After tax dividend 73.5
(Effective overall tax rate 26.5 percent)

Thus, these companies will be taxed at a higher rate than under the offshore or tax holiday regime, but at a significantly lower rate than the previous standard regime. Concerning foreign companies, those who qualify for the imputation will be taxed in Aruba at a rate of 6.9 percent (11.8 percent if they are not listed on a stock exchange), but the ultimate effect on their taxation depends on how the tax authorities in the home country will treat the imputation.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No. 03/20
FOR IMMEDIATE RELEASE
March 3, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

**IMF Concludes 2002 Article IV Consultation
with the Kingdom of the Netherlands—Aruba**

On February 24, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Aruba.¹

Background

After growing at over 4 percent per year in 1996-2000, the Aruban economy experienced two years of retrenchment, with GDP falling an estimated 1.2 percent in 2001 and 3.8 percent in 2002. This downturn reflected a lull in investment activity, but especially weak tourism following the U.S. recession and the terrorist attacks of September 11, 2001. In 2003, sharply higher private and public investment and a modest revival in tourism should boost economic growth to over 4 percent. With higher tourism capacity and continued sustained investment, economic growth should remain around 3 percent in the medium-term.

With the exchange rate pegged to the U.S. dollar, inflation has been low, averaging 2.7 percent in the 1990s. Higher energy prices, indirect taxes, and faster credit growth as a result of controls being suspended, caused inflation to accelerate in the second half of 2002, reaching 4.5 percent in November. The external accounts remain in a comfortable position, and net foreign assets are above the central bank target of 5-6 months of imports. The banking sector is highly liquid and well capitalized despite the downturn, but interest rates remain high because of a lack of competition.

Weak growth and the introduction of universal health care exacerbated existing fiscal imbalances in 2001-02, resulting in a marked worsening of the government deficit, from

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

0.2 percent of GDP in 2000 to an estimated 4.9 percent in 2002 (including health care). Off-budgetary outlays of almost 6 percent of GDP related to past guarantees to foreign investors were also realized in 2002. To stem this deterioration, the government froze public sector wage indexation for three years and raised excise rates in the second half of 2002. A new indirect tax on imports and services is planned for 2003. A New Fiscal Regime for corporate income was also introduced, which will result in more uniform taxation of corporate profits and dividends. Although the previous offshore and tax holiday regime will be phased out, incentives for export-oriented activities will remain through an imputation system.

Executive Board Assessment

Directors commended the authorities for their record of sustained economic growth and low inflation, which has enabled Aruba to achieve one of the highest per capita incomes in the region. While unfavorable external shocks to the tourism sector and a pause in investment had caused a decline in economic activity, Directors expected that, barring new adverse shocks, growth would resume this year, spurred by sharply higher private and public investment and a modest recovery in tourism. Looking ahead, Directors emphasized the importance of improving public finances and strengthening the economy's resilience as a basis for sustained macroeconomic stability and future growth.

While considering the current exchange rate regime appropriate, Directors noted that the high inflation differential with the United States could threaten competitiveness, and welcomed the authorities' decision to tighten monetary policy by reemploying credit controls. Directors also encouraged the authorities to move forward with plans to switch from direct to indirect instruments of monetary policy, so as to ensure a better allocation of credit and more effective competition in the banking sector. Directors cautioned, however, that the transition to indirect instruments should be gradual in order to avoid losing monetary control, and encouraged the authorities to avail themselves of technical assistance to support these efforts.

Directors agreed that the main policy challenge was to strengthen public finances. They viewed the authorities' objective of a balanced budget by 2007 as appropriate in the medium term, although more adjustment would be required in the long run to address population ageing. Directors also saw the need to make greater progress towards balance in the 2003 budget, including through measures to durably restrain growth in current spending. Specifically, they encouraged the authorities to implement as soon as possible reforms of the public employee pension system and the civil service, and actions to curb the growth of health care spending. Directors also noted that fiscal consolidation would be facilitated by improving the transparency of the fiscal accounts, particularly through the regular provision of government financial statistics. In this connection, they also underscored that the authorities should abandon the practice of financing the deficit through the accumulation of arrears.

Noting that Aruba's revenue-to-GDP ratio was low, especially relative to the region, Directors encouraged the authorities to address weaknesses in tax administration, an

important prerequisite for introducing a broad-based indirect tax, and also to simplify the income tax. They noted the recent decision to delay the introduction of the new tax on imports and services, and most Directors encouraged its implementation as soon as possible. Directors welcomed the New Fiscal Regime for corporations, as it would lead to more uniform taxation of corporate income, including through the phasing out of the offshore and tax holiday regime. Directors also noted that overall, simplicity, equity, and transparency in the tax system should be priority objectives.

Directors commended progress in strengthening financial sector supervision and regulation, in line with the recommendations of the recent Offshore Financial Sector assessment. To strengthen anti-money laundering regulation, Directors encouraged the authorities to quickly pass legislation to bring money transfer companies and company service providers in the offshore sector under the supervision of the central bank.

Directors agreed that the decision to turn the telecommunications company into a private law company and introduce competition in the mobile phone market would increase economic efficiency. They underscored the need to continue along this path, by increasing the operational autonomy of other public sector activities and, at a later stage, by selling shares to private investors.

Directors commended the authorities for the publication of national accounts in current prices, which greatly improves available information on the Aruban economy. They urged the authorities to intensify efforts to fill statistical gaps in the areas of labor markets and government finances, as well as to further develop national accounts data.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Kingdom of the Netherlands—Aruba: Selected Economic Indicators

	1998	1999	2000	2001	2002
	(Percent change)				
Real economy					
Real GDP	6.7	1.3	3.6	-1.2	-3.8
Nominal GDP	8.7	3.6	7.8	1.7	-0.7
Real final consumption	5.0	4.7	-3.3	6.8	3.6
Real investment	11.8	-8.0	-9.3	-17.4	3.0
Real exports	3.0	2.8	-4.2	-4.7	-11.4
Real imports	3.5	2.2	-14.3	-2.9	-1.6
Inflation (period average)					
CPI (Aruba)	1.9	2.3	4.0	2.9	3.2
Real exchange rate index (1995=100) ¹	101.2	101.3	102.0	102.0	103.7
	(In millions of U.S. dollars)				
Balance of payments					
Current account	-14.3	-347.9	294.9	410.2	-75.5
(In percent of GDP)	-0.9	-20.2	15.9	21.7	-4.0
Non-oil current account	-129.4	-249.1	-211.1	-168.8	-224.7
(In percent of GDP)	-7.8	-14.4	-11.4	-8.9	-12.0
Financial and capital account	102.8	368.1	-313.5	-324.1	147.9
Errors and omissions	1.2	-9.4	-7.5	-10.6	5.6
Change in reserves (- = increase) ²	-51.9	-2.9	15.0	-82.8	-78.0
	(Percent change)				
Monetary aggregates					
Net foreign assets	40.4	3.4	-8.1	25.4	25.8
Net domestic assets	1.8	14.4	7.7	-2.7	5.1
Quasi-money	11.7	11.8	3.0	-0.2	5.0
	(In percent of GDP)				
Public finances central government					
Balance	1.9	1.4	-0.2	-2.6	-3.6
External debt	13.1	11.9	11.3	11.6	15.2
Domestic debt	17.5	18.2	19.0	22.4	22.8
U.S. dollar	The Aruban florin is pegged to the U.S. at Af. 1.79=US\$1				
SDR (end of period)	2.52	2.46	2.33	2.25	2.37

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

¹Relative to the U.S. dollar. CPI based. Period average.

²Including gold, excluding revaluation differences.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—ARUBA

**Staff Report for the 2002 Article IV Consultation
Supplementary Information**

Prepared by the European I Department

(In consultation with the Policy Development and Review Department)

Approved by Ajai Chopra

February 20, 2003

1. This supplement provides an update on the authorities' monetary and fiscal policy plans outlined in the staff report for the 2002 Article IV Consultation. The staff's revised macro-economic projections for 2003–04 due to these policy changes are also presented. The revisions do not change the thrust of the staff appraisal. However, they strengthen the case for including additional measures in the 2003 draft budget to ensure substantial early progress towards fiscal consolidation.
2. Following an acceleration in monetary aggregates and consumer price inflation at the end of 2002, the central bank has reimposed credit controls; specifically, the ceiling on the growth of bank lending to the private sector has been set at 7 percent. This monetary tightening is in line with the recommendations in the staff report and was already broadly reflected in the staff projections presented there.
3. The new indirect tax on imports and services (the ABB) will not be introduced by mid-2003 as planned because the authorities judge the technical preparations to be insufficient. In addition, they are concerned about the effect of higher indirect taxes on inflation. The current draft government budget will be revised accordingly, resulting in a revenue shortfall of Afl. 35 million (1 percent of GDP) relative to original plans. Compensatory measures have not been announced.
4. Macroeconomic and fiscal projections for 2003 and beyond have been revised to reflect these policy announcements (Table 1).¹ The projections assume that the ABB (or an equivalent revenue-raising measure) will be introduced in early 2004 rather than mid-2003. Under this assumption, the fiscal deficit (including health care) would grow to 5.4 percent of GDP in 2003, but decline to 3.1 percent of GDP in 2004 as the new tax boosts revenues. If the tax increase is canceled rather than postponed, then reaching the target of budgetary balance by 2007 would become very difficult.

¹ The projections also incorporate small revisions in the estimates of inflation and fiscal revenues for 2002 reflecting new data releases.

Table 1. Aruba: Revised Projections

	Staff Report			Revised		
	2002 Est.	2003 Proj.	2004 Proj.	2002 Est.	2003 Proj.	2004 Proj.
	(Changes in percent)					
Real economy (constant prices)						
GDP	-3.8	4.4	2.1	-3.8	4.5	2.0
Private consumption	1.7	2.3	2.9	1.7	2.5	2.6
Public consumption	7.9	-0.8	1.4	7.9	-0.6	1.1
Gross fixed investment	3.0	37.8	-5.2	3.0	37.8	-5.2
Exports of goods and services (excl. oil)	-11.4	-0.8	3.1	-11.4	-0.8	3.1
Imports of goods and services (excl. oil)	-1.6	6.7	0.4	-1.6	6.8	0.2
Inflation (period average)	3.2	3.6	3.3	3.3	3.4	3.6
	(In percent of GDP)					
Public finances, central government						
Revenue	22.5	22.4	23.2	22.3	21.5	23.1
<i>Of which:</i>						
Tax revenue	18.2	18.8	19.7	18.2	17.8	19.7
Expenditure	26.0	26.0	25.3	26.0	26.0	25.3
Balance (including health care)	-4.9	-4.5	-3.1	-5.0	-5.4	-3.1

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