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Sint Maarten stepping out of the monetary union

The Social Economic Council Sint Maarten ("Sociaal Economische Raad", referred to below as "SER") is an independent advisory body to the government of Sint Maarten. The SER advises upon request by one or more Ministers (solicited) or on its own initiative (unsolicited) on all important social economic issues.

The SER was established by law ("Landsverordening Sociaal- Economische Raad") in 2010.

The SER consists of representatives of employees' and employers' organizations as well as independent experts. The objective of the SER is to achieve a broad concept of wealth in Sint Maarten by offering quality advice and reaching consensus on social economic issues.

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Introduction

Ongoing discussions on the deteriorating financial situation of Curaçao which has a negative influence on the financial health of that island and indirectly on the entire monetary union could weaken investor's confidence and adversely impact the growth perspective for both Curaçao and Sint Maarten. This should be avoided. An ongoing situation of uncertainty must be recognized as a problem in itself. It is obvious that a clear vision is needed on the future of the monetary union to foster stability and to avoid undermining confidence in our economy and in the Netherlands Antillean Guilder.

The Social Economic Council of Sint Maarten studied the consequences of stepping out of the monetary union: opting for our own new legal tender and the benefits and costs of dollarizing the economy of Sint Maarten. The outcome of the study, reflected in this report, offers recommendations for policy makers of Sint Maarten. The SER drafted this report at its own initiative. The opinions expressed herein are held by the majority of its members[1]. The unsolicited advice in this report shall be presented to the Minister of Finance: Minister Roland S. Tuitt, to the Minister of General Affairs: Prime Minister Sarah A. Wescot- Williams and to the Minister of Tourism, Economic Affairs, Transport and Telecommunication: Minister Romeo F. Pantophlet. This report also considers the proposals of the CBCS "Eind Rapportage Programma Splitsing CBCS en Dollarisatie Sint Maarten" of February 2012.

Upon dissolution of the Netherlands Antilles on 10-10-10, Curaçao and Sint Maarten both voluntarily chose to enter into a currency union (or monetary union) sharing one common coin, the Netherlands Antillean Guilder, and one Central Bank, the Central Bank of Curaçao and Sint Maarten (CBCS) responsible for the monetary policy in both countries. Leading-up to the dissolution of the Netherlands Antilles a debt restructuring program was extensively discussed and negotiated. In the context of this debt restructuring program, agreements were made by Curaçao and Sint Maarten with the Netherlands about the public finances of both islands and the supervision thereof. These agreements have been laid down in the Kingdom Act Financial Supervision Curaçao and Sint Maarten. Close policy coordination between Curaçao and Sint Maarten is a necessity for the monetary union and having one Central Bank requires a synchronized monetary and budget policy. However the future of this common Central Bank of Curaçao and Sint Maarten is uncertain at this moment with both countries reassessing its feasibility.

The BES islands have chosen to introduce the US dollar as legal tender the moment their new status took effect on 10- 10- 10, while Sint Maarten is already largely dollarized[2]. The US dollar is in widespread use in daily transactions in Sint Maarten, alongside the Netherlands Antillean Guilder. It is suggested, therefore, that it would not be such a big step to formally dollarize Sint Maarten.

[1] In the SER board meeting of February 14th, 2013, it was agreed upon that the feelings of the minority will be mentioned in this advice according to Article 22 paragraph 3 of the "Landsverordening Sociaal- Economische Raad".
[2] According to the CBCS nearly 67% of Sint Maarten's economy is already de facto dollarized.

Dollarization has become a popular topic in recent years amongst economists, government officials, and those in the private sector in Sint Maarten. But what is dollarization?

What will it actually mean for the people of Sint Maarten in their (everyday) cost of living? Hence, what are the costs and benefits of dollarization? If Sint Maarten steps out of the monetary union and chooses to dollarize, what are the consequences of that break- up? And, is dollarization the only alternative?

Dollarization is the legal adoption of the US dollar. (Or more generally, currency conversion is the legal adoption of any strong foreign currency as domestic legal tender.) Full dollarization for Sint Maarten then would mean taking the next step from informal, limited dollarization to the full official use of a foreign currency in all transactions.

The adoption of full dollarization responds to diverse factors: in Panama, political and historical factors contributed to the decision to implement full dollarization. In Ecuador full dollarization represented a policy to avoid economic collapse and restore economic stability. In El Salvador full dollarization was meant to support structural reforms boosting investment for continued economic growth and stability. As for Sint Maarten the decision whether or not to dollarize should take place after careful evaluation of the pros and cons of alternative arrangements on the short- term cost involved with Sint Maarten departing the monetary union.

If Sint Maarten chooses to step out of the monetary union with Curaçao, the eventual decision to be made is what Sint Maarten will then choose as legal currency.

2.1 The Central Bank of Curaçao and Sint Maarten

In the constitutions (Staatsregeling) of Curacao[3] and Sint Maarten[4] the legal foundation can be found for a Central Bank to exist on Curaçao as well as in Sint Maarten. Currently one Central Bank governs both countries with its headquarters in Curaçao and a smaller branch on Sint Maarten.

The political and legal basis for the monetary union of Curaçao and Sint Maarten is established in:

- the “Slotverklaring van het bestuurlijk overleg over de toekomstige staatkundige positie van Curaçao en Sint Maarten” of November 2nd, 2006.
- Mutual agreements on the Charter of one common Central Bank for Curaçao and Sint Maarten.
- Mutual agreements on a common currency system and exchange rate.
- Mutual agreements on coordinated fiscal economic policies between Curaçao and Sint Maarten.

[3] Article 88 “ Staatsregeling van Curaçao”
[4] Article 103 “Staatsregeling van Sint Maarten”

The CBCS is responsible for[5] a sound monetary policy on Curaçao and Sint Maarten in order to support a healthy economy, for issuing paper money and circulating coins in the countries Curaçao and Sint Maarten, managing the foreign exchange reserves, acting as the government's treasurer by receiving and making payments from and to the public and advising the governments of Curaçao and Sint Maarten on financial and economic matters. The CBCS is further entrusted with the prudential supervision of credit institutions, insurance companies, investment institutions and trust service providers.

As evident from the experience of the European Monetary Union (EMU), forming a monetary union is a complicated project and there is a non- negligible risk of failure. It is therefore important to ensure that the pre- conditions[6] for forming a monetary union are adequate. This entails ensuring that economic, political and institutional requirements are in place before launching the monetary union, since there is a risk that it might collapse and the costs of the termination could be substantial, both in economic and political terms.

A monetary union requires a high degree of fiscal and economic coordination and harmony to ensure a balanced and effective monetary policy. In addition, a well-functioning monetary union requires the integration of goods and services: in our case, free movement of goods, services, capital, and labor between Curaçao and Sint Maarten. These requirements seemed difficult to adjust with the desire for more autonomy by Curaçao and Sint Maarten since this desire was the main driving force behind opting for country status.

But the creation of a monetary union is primarily a political task. The political will among policy makers is a key factor, taking into consideration that a change of government and a change in government's policy towards the CBCS for example, could have some serious consequences for the monetary union. Thus strong political commitment is required to relinquish a certain degree of policy autonomy in the interest of a stable and effective monetary union, conducive to growth and stability.

Not fully acknowledging this, has led both the governments of Sint Maarten and Curaçao to prefer their own separate Central Bank and thus, for dissolving the current monetary union.

[5] Article 3- 18 "Centrale Bank- statuut voor Curaçao en Sint Maarten", also relevant national ordinances and decrees regarding the supervision in Curaçao (A.B 2010, no 102) and Sint Maarten (A.B. 2010, no. 30).
[6] Mundell, Robert A. (September 1961) "A Theory of Optimum Currency Areas" *The American Economic Review*, Vol. 51 No. 4.

2.2 Dissolving the Central Bank of Curaçao and Sint Maarten

The government of Sint Maarten articulated its desire for this country to have its own Central Bank, so did the Parliament of Curaçao, expressing its aspiration to separate the current joint CBCS, leaving the currency union no viable option for the long term. In fact, Curaçao's new government has committed to discussing a Central Bank split in its governing accord, though Sint Maarten has yet to be formally approached on this.

At this moment each country may choose to step out of the monetary union whenever they desire to do so, without the consent of the other party, under the condition that both parties must carry on with their responsibilities towards each other within the monetary union, until its liquidation has been finalized.

If Sint Maarten wishes to step out of the monetary union and decides to dollarize its economy, the CBCS will no longer be a reality in its current form. Needless to say that the current structure of the CBCS will then have to be liquidated.

The consequences thereof will be as follows:

- The Netherlands Antillean coins and banknotes will cease to be the legal tender; hence both Curaçao and Sint Maarten will have to decide separately on a new legal tender for each country.
- Curaçao and Sint Maarten will have to divide all Central Bank assets and liabilities between themselves.
- Both countries will have to develop fiscal and monetary policies suitable to their own country.
- Both countries will be responsible for their own reserves.
- Curacao and Sint Maarten will have to create a new, full-fledged and independent Central Bank
- Each country will have to adapt existing legislation and draft its own new laws.

As affirmed above, upon liquidation of the CBCS, both Sint Maarten and Curaçao will have to choose their new exchange rate system independently, since the Netherlands Antillean Guilder will cease to be the legal tender.

Sint Maarten then has two alternatives:

- opt for full dollarization with the US dollar as the legal tender, or
- replace the Netherlands Antillean Guilder with a newly to be developed legal tender, which in this advice we propose to call the Sint Maarten Dollar.

3. History: Our Current Legal Tender

Stepping out of the monetary union with Curaçao and dollarizing Sint Maarten will lead to economic as well as social consequences. Before discussing the first option of dollarization, we will first review the financial history of Curaçao and Sint Maarten.

The Antillean Guilder has been pegged[7] to the US dollar since 1971, while a fixed exchange rate of 1 US dollar= 1.79 Antillean Guilder has been in use. The reason for pegging the Antillean Guilder to the US dollar is that the majority of the international trade relations of the former Netherlands Antilles and especially of Sint Maarten is with the United States or with other countries trading in US dollars. In other words, our economy is predominantly dollar- oriented.

As it is impossible for a small island like Sint Maarten to produce a large range of different goods ourselves, Sint Maarten relies heavily on imports. This implies that Sint Maarten has to deal with imported inflation[8].

The trade balance of the Netherlands Antilles has, unfortunately, consistently been in deficit, to a great extent because imports have always exceeded exports or consumption exceeds production. The absence of export manufacturing industries as well as significant production of raw materials makes for a very one-sided trade balance. Export of goods, at present, consists mainly of transitory trade and the 'hub' function that Sint Maarten has developed in the north-eastern Caribbean. This is compensated to a great extent, of course, by the export of services, predominantly of tourism, and to a decreasing extent of financial services. Nevertheless, the current account of the balance of payments still shows a structural deficit. For a country in development however, this may very well be an acceptable situation, as long as the necessary investments are attracted to even out the overall balance of payments. This is especially true of direct investments that contribute to the long term capacity of generating currency income. In reality the balance of payments of the monetary union has been cosmetically improved by the inflow of Dutch development funds and the effects of debt relief. These effects are temporary in nature, the underlying structural deficit is slowly coming to the surface now and it will continue to do so in the coming years, making structural adjustments necessary.

In 2006 the governments of the Netherlands, the former Netherlands Antilles and the island territories of Curaçao and Sint Maarten agreed that the government of the Netherlands would take over the debt of the entities which formed the Netherlands Antilles. Debt relief was based on 2005 data and an interest burden rule[9]. There were strict conditions and control attached to operating the debt relief program among others: a balanced budget rule and financial supervision by the "College Financieel Toezicht" (CFT).

[7] When a country decides to pegs its currency to the US dollar, it means that that country intends to control the value of its currency so that it rises and falls as the dollar does.
[8] Imported inflation is inflation due to an increase in the price of imports. As the price of imports increase, the general prices of all goods and services also increase. Imported inflation may be caused by foreign price increases or depreciation of a country's exchange rate.
[9] The interest burden rule stipulates a yearly interest ceiling of 5% of government revenues. These conditions are designed to prevent the unrestrained build-up of forthcoming debts and so contributing to macroeconomic stability.

The worsening of the current account imbalance was covered by the inflow of the net current transfers connected to the implementation of the debt relief program and development funds, as part of dismantling the Netherlands Antilles. In fact, the current account deficit continued to widen to such a point that the Central Bank of Curaçao and Sint Maarten (CBCS) resorted to a complete freeze on the provision of private consumer credit. For the first time in eleven years, the overall balance of payments of the monetary union recorded a deficit in 2011 as reflected by a decline in net foreign assets[10] caused by a lack of confidence in the economic outlook.

A sudden reversal of capital inflows ("capital flight") could deplete the foreign exchange reserves quickly, which may undermine confidence in the common currency. If such a balance of payments crisis occurs, the exchange rate might have to be adjusted (devalued).

Meanwhile, the government of Curaçao failed to implement much needed reforms to reduce health care spending, which was one of the reasons of the budget deficit 2011 for Curaçao[11]. On July 15th, 2012, only two years since obtaining the new status the Kingdom government ordered Curacao to get their unbalanced 2012 budget in order, while Sint Maarten has been working hard to keep up with the benchmarks set in the Kingdom. Reality is that offshore, tourism and the refining sectors in Curaçao are declining and there is an urgency to address the risks or possible severe adverse outcomes if continuing the monetary union with Curaçao in this same way. A complete analytical separation of the current account deficit between Curaçao and Sint Maarten is not possible, because of unavailable data, but the information that is at hand, demonstrates that the widening is primarily due to Curaçao[12].

Although the situation had already been unfavorable when the instruction was given, that situation has only worsened, based on the current data. According to most estimations, the current deficit on the budget for 2012 will increase to 300 million guilders in 2013 and as much as 420 million in 2014 and 2015. The equity capital of Curaçao – possessions such as buildings – cannot be used to cover those deficits, according to Eric Daalder[13], but in addition to that it is also not sufficient because the value of these possessions is not real. In the books from the government it is estimated at 500 million Euros, but is worth approximately 315 million less when considering overdue maintenance, he said. "The equity capital depleted late 2011. Curaçao is heading for bankruptcy towards the end of 2013 if no measures are taken", said Daalder during a hearing of the Council of State in The Hague on Friday September, 21st 2012. At the beginning of October 2012, the interim Prime Minister of Curaçao, Mr. Stanley Betrian, revealed that the actual financial situation of Curaçao is even worse than the CFT thought.

Consequently, if no adequate cost reducing and revenue increasing measures are taken an inevitable, sudden devaluation and inflation will follow for the entire monetary union.

Sint Maarten is a small highly-open economy with considerable success in tourism. However, growth rate is low. Small economies like ours are easily affected by external shocks, because of

[10] Central Bank of Curaçao and Sint Maarten President Emsley Tromp addressing Members of Parliament in a Central Committee Meeting dealing with the bank's annual report for 2011 on Wednesday 4 July 2012.
[11] Report of the President of the CBCS, in the Annual Report 2011 Centrale Bank van Curaçao en Sint Maarten.
[12] 2011 IMF Country Report No. 11/342 Article IV Report Kingdom of The Netherlands- Curaçao and Sint Maarten, December 2011, see page 21 under 36.
[13] Eric Daalder is the legal representative (Government Prosecutor) of the Kingdom Council of Ministers.

their openness, size of domestic markets, lack of economic diversification and their high reliance on food and oil imports. The trade deficit has both real and financial effects. Real effects refer to impacts on employment, incomes, and manufacturing capacity. Financial effects refer to the impact of accumulated indebtedness resulting from borrowing to finance the deficit. The heavy reliance on imports could potentially expose Sint Maarten to global economic disruptions.

It is safe to conclude that our trade deficit goes hand in hand with our underperforming productivity. Either lowering consumption or increasing productivity is thus key to long run prosperity.

According to the President of the CBCS, Emsley Tromp, the widening deficit on the current account increases the vulnerability to external shocks. Therefore Mr. Tromp came to the decision that dollarization can be a practicable alternative monetary system for Sint Maarten, as it eliminates this vulnerability and can contribute to sound and sustainable economic development.

In order to come to a conclusion on Mr. Tromp's view on dollarization for Sint Maarten, we will first analyze all benefits and costs with reference to dollarization.

4.1 Dollarizing Sint Maarten

The first option to be examined is the possibility of dollarization: choosing the US dollar as the legal tender for Sint Maarten. The Central Bank or supervisory authority will be solely responsible for supervising the financial sector.

Benefits associated with dollarizing the economy of Sint Maarten:

1) Dollarizing the economy of Sint Maarten will completely eliminate any risk of currency devaluation in case of a balance of payment crisis: no domestic currency means no exchange rate adjustment to the US dollar, hence our balance of payments would be less sensitive to an economic downturn or reversal of capital flows turning into a currency crisis. A trustworthy economic environment reduces Sint Maarten's country risk, which means that Sint Maarten will be able to borrow at more advantageous terms, benefit from more investments and stronger sustainable growth.

2) By adopting the US dollar, the financial system becomes more open to international capital flows (capital mobility) as growth rates for Sint Maarten are highly correlated with major trading partners particularly the United States. Capital mobility advances competition between foreign and local financial institutions on Sint Maarten, which will benefit the average citizen on Sint Maarten for example by contributing to lower interest rates. These rates will be acquired through the reduction of the competitive insulation that the commercial banks currently enjoy. In short: the integration of the domestic financial system with the rest of the world (cross- border investments).

3) Reduction of transaction costs:

- Common currencies between trading partners will lead to a reduction of transaction costs[14] by eliminating the inflation and exchange rate devaluation premia. This will benefit trade. With dollarization, importers would no longer have to pay commissions and other fees associated with currency conversion. Thus, if trade transaction costs are reduced, import costs will be lowered.

- The currency conversion fees familiar to tourists and businesses will disappear: There will be no more extra costs to be paid, when exchanging Netherlands Antillean Guilders for US dollars or vice versa.

- Because the US dollar will be the only currency in use, customers will not risk an unfavorable exchange rate as they now sometimes do.

- Dollarization will bring an end to the dual currency aspect in Sint Maarten, hence, cost saving for businesses.

4) Dollarizing Sint Maarten's economy eliminates the possibility of 'printing' money to finance fiscal deficits. By eliminating the government's power to create inflation, dollarization requires budgetary discipline. The government becomes aware that the option of issuing more currency to cover a budget deficit no longer exists, so it adopts a policy of low budget deficit or a policy of a balanced budget. Thus restrictions on increasing the money supply could improve Sint Maarten's policy credibility. Basically, the ability to print money when needed is what allows a central bank to guarantee beyond any doubt that all claims in domestic currency will be fully met under any circumstances, even in case of a detrimental demand shock for instance, when Sint Maarten tourism would collapse because of a destructive hurricane. The monetary authority (Central Bank) then has to make sure that even though there is no money coming into Sint Maarten, there is enough to circulate and keep our island running.

5) In case Sint Maarten dollarizes, there is no further need to keep and maintain international reserves for exchange rate stability purposes[15].

6) The government of Sint Maarten will have a more prominent responsibility in legally establishing fiscal rules and benchmarks.

[14] The costs incurred when importers buy US dollars for payment of foreign goods and services.
[15] However, the amount that has been set aside for exchanging Netherlands Antillean Guilders into US dollars should now be used as sufficient financial reserves to react on economic/ fiscal shocks and to support liquidity and solvability of commercial banks.

Costs associated with dollarization:

1) By adopting the US dollar, the monetary authority gives up control of independent monetary and exchange rate policy (such as the interest rate, money supply or correcting macro-economic instability). Monetary policy instruments will thus no longer be accessible to alleviate external shocks, such as sudden price increase or acts of nature. We would like to emphasize here that once dollarized; Sint Maarten has no influence on the US monetary policy, but Sint Maarten will be dependent on the United States' monetary policy.

2) Printing/ minting money will no longer be a source of liquidity (lender of last resort-function). The Central Bank can provide liquidity to the banking system in the event of a systemic bank run by using its ability to create liquidity- something that it would not have in a dollarized economy.

   However, bear in mind that the ability of a Central Bank to deal with a financial crisis solely by printing money is highly inflationary and therefore inevitably limited. It is said that the lender of last resort function is already limited for the local banks in Sint Maarten, given the size of those local banks in regard to the Gross Domestic Product (GDP)[16] and the reality that almost all local banks are subsidiaries of foreign banks operating on Sint Maarten, meaning that their headquarters will be the first option to provide support to their troubled affiliates. However domestic banks[17] without a head office abroad are still depending on the Central Bank. Additionally, the tourism sector is the largest sector in Sint Maarten's economy. In case of an adverse demand shock (when, for example, a hurricane hits Sint Maarten and no tourists are visiting) there will be no new funds flowing into Sint Maarten which will lead to a downturn in government revenues, because of the inability to issue/ print money to keep it circulating (liquidity risk). In order to fulfill the role of lender of last resort in a dollarized economy, the monetary authority should ideally have foreign exchange reserves in sufficient amounts to forestall a run on dollar deposits.
   A very costly alternative to this problem is insurance for US dollar liquidity serving to lower the probability of liquidity running out.
   The main alternative proposed in policy or academic circles is the outsourcing of the lender of last resort function, which can take the form of an institutional lender of last resort function within the Kingdom or a private international agency. A private lender of last resort can be conceived as a contract between a consortium of international banks and the monetary authority, individual contracts between banks or an implicit contract between foreign subsidiaries and their parent-companies.

3) Any country adopting a foreign currency as its legal tender would lose the income from seigniorage. From an economic point of view, the right to issue currency provides the government with seigniorage revenues (resulting essentially from the difference between

[16] GDP is the market value of all officially recognized final goods and services produced within a country in a given period.
[17] There is one domestic bank in Sint Maarten: The Windward Islands Bank Ltd. (source: management WIB)

the cost of producing and distributing paper money and coins and their actual purchasing power). The Central Bank can use currency, which does not bear interest, to purchase interest-bearing assets, as foreign reserves. These seigniorage revenues show up as Central Bank profits and are transferred to government. Countries that dollarized their economies lose these revenues. Sint Maarten's seigniorage loss would be the United States' gain. First, Sint Maarten would have to buy the stock of domestic currency held by the public and banks with US dollars from its international reserves, or when that is not enough with borrowed funds. Then, Sint Maarten would give up future seigniorage earnings stemming from the flow of new currency printed to satisfy the increase in the demand for money[18].

4) Another loss for the government of Sint Maarten will be income from license fee revenues[19]. If Sint Maarten dollarizes, the license fee on US dollars withdrawal and credit cards use will be lost.

5) The one- time cost of changing cash registers, computer programs, from the Netherlands Antillean Guilder currency to the US dollar currency.

6) While removing the threat of currency crises with dollarization, this will also mean permanently removing exchange rate adjustment from the policy toolkit, leaving wages and price flexibility as the principal method to recover competitiveness. Given current weaknesses in competitiveness, dollarizing without first enhancing wage and price flexibility, risks locking in extending low growth, with unfortunate consequences on fiscal sustainability and employment[20]. Summing up: a full dollarized economy becomes more vulnerable to real and financial shocks due to the restrictions that full dollarization imposes on policy makers. However, this is only a consequence in case of devaluation, since the peg has never been used in Sint Maarten.

7) Lower interest rates for customers will lead to more investments, but also to lower income for commercial banks. With dollarization, commercial banks will also lose the revenues earned from currency conversion. Bank customers may benefit from lower lending rates, but they will encounter lower interests on their savings and higher fees and charges on bank transactions.

[18] In the current monetary union, Sint Maarten's share on seigniorage is said to be approximately NAF 4.6 million per year. These revenues from seigiorage are relatively small due to widespread unofficial dollarization in Sint Maarten.
[19] Starting January 1, 1996, a fee was introduced for the license to operate as a foreign exchange bank. This license fee is assessed on the international transactions of foreign exchange banks and replaced the foreign exchange tax in force through December 1995.
The license fee is calculated on the basis of the payments made by residents to nonresidents, with the exception of the re-investment of funds abroad, the re-exports of the free-zone companies and payments by the central government. The license fee is due in all cases thus where exchange of Netherlands Antillean guilders in foreign currency takes place or when a transfer takes place from a resident account to a nonresident account. All these transactions are charged a license fee of 1% by the commercial banks. The license fee revenues collected in Sint Maarten on the withdrawal of US dollars and credit card payments is NAF 6 million. The total amount generated by license fees is approximately NAF 24 million yearly.
[20] 2011 IMF Country Report No. 11/342 Article IV Report Kingdom of The Netherlands- Curacao and Sint Maarten, December 2011 page 21 under 32.

Taking above- mentioned into consideration, we conclude that by itself, dollarization would not improve Sint Maarten's social, economic and political environment. This can only be achieved with responsible policy decisions ensuring that short- term stability develops into long- term economic growth.

To summarize: full dollarization promotes, but does not guarantee fiscal discipline, an efficient financial system, the adoption of institutional reforms, financial and trade integration with international markets. A sustainable economy for Sint Maarten can be achieved through strengthening our economic resilience based on policies and the execution thereof.

In a social context, some people reject dollarization for symbolic reasons. For them, dollarization presents the image of wiping out the national identity. However, this is not the case for Sint Maarten, since there have been plans to replace the Netherlands Antillean Guilder for the Caribbean Guilder anyway.

Furthermore, we ask the question whether a dollarized Sint Maarten still needs a Central Bank. In a dollarized economy the "Central Bank" will have the following tasks:

Tasks/ Responsibilities	**Dollarization**
Monetary Supervision	
Economic analysis	V
Monetary and foreign exchange policy	X
Execution of monetary and foreign exchange policy	X
Supervision Financial Sector	
Policy development	V
Regulations	V
Investments of funds	V
Currency circulation	
Policy development	X
Printing and withdrawal of banknotes	X
Operations money circulation	Possible
Payment Systems	
Policy development	V
Foreign currency rates	X
Operations of national and international payments	V
V= Yes	
X= No	

As financial supervision will still have an important role in a dollarized economy, a Central Bank or another supervisory authority is needed to execute this function.

4.2 A new currency for Sint Maarten

The second option to be discussed in this report is to replace the Netherlands Antillean Guilder (and coins) with a whole new to be developed legal currency, which we could call the Sint Maarten Dollar.

In this case, Sint Maarten has the liberty to choose and design its own currency. A new Central Bank has to be established for Sint Maarten with supervision of the financial sector, monetary supervision and cash activities for Sint Maarten as its principal tasks.

The new Central Bank can maintain the existing legal infrastructure of the current CBCS and update it where necessary regarding legislation and regulations. However, building up a fully-fledged organization (a new Central Bank for Sint Maarten) will be a costly operation: from acquiring and hiring or outsourcing qualified staff to provide its personnel with the infrastructure needed. Also, focusing to keep the level and training needs of staff under constant review, given the increasing complexity of banking supervision.

Considering the presence of mainly foreign financial institutions on Sint Maarten and the lack of experienced personnel, it is recommended that agreements be formalized with other Central Banks and financial supervisory authorities as well, while establishing the necessary legal gateways to communicate and exchange information with domestic and overseas authorities, not merely banking supervisors. Additionally, the new Central Bank should exhibit broad general powers to intervene with institutions, including powers of direction and the removal of executives from failing institutions. Sint Maarten laws and regulations should provide an adequate framework for effective banking supervision.

Choosing for our own Sint Maarten Dollar forces our government to implement a very stringent fiscal- economic policy for Sint Maarten. Our government's policy actions should be capable of responding in a countercyclical manner to output fluctuation and shock persistence, since we will no longer be a part of the monetary union and thus be solely responsible for our own economy.

Another challenge will be that the new Central Bank will have to do its utmost to get the new Sint Maarten Dollar accepted as legal tender, because of the strong dominance of the US Dollar in our economy. Convincing business people, merchants, households and the average citizen of Sint Maarten of the new Sint Maarten Dollar will be very difficult, yet extremely essential for the acceptance of this new legal tender, whereas the US dollar is already widely accepted in Sint Maarten.

A breakdown of the costs for renovating the Sint Maarten office, an outline of the balance sheets, the profit and loss statements has already been calculated and presented to the government of Sint Maarten in the CBCS " Eind Rapportage Programma Splitsing CBCS en Dollarisatie Sint Maarten" of February 2012.

4.3 Financial Supervision

The financial world is a network of banks, insurers, pension funds and securities firms. If through a malfunction or malicious intent a financial institution runs into financial difficulties, it may drag down others in its fall. A supervisory authority therefore continuously monitors financial institutions and the network they operate in, in order to promote the stability of the financial system and to protect consumers' financial interests. If anything goes wrong, the supervisor will take measures to minimize the harmful effects. The chance, however small, that an institution may fail cannot be eliminated entirely. The quality of supervision depends largely on the quality of the regulatory framework. Whether Sint Maarten dollarizes or chooses for its own legal tender, supervision will always have an important role in the financial world, as all financial institutions must be sound and reliable entities. In any case, financial supervision can be outsourced, or it can be done by setting up our own supervisory authority.

5. Lessons learned

5.1 Aruba

On January 1st, 1986 Aruba obtained its status as an autonomous country within the Kingdom of the Netherlands and thus no longer formed part of the Netherlands Antilles. At that time, dollarizing Aruba's economy was not a valid option. With its newly obtained Status Aparte, not only did a new Central Bank have to be established but a new national currency for Aruba had to be designed as well. It took three years before the set of newly designed banknotes were ready and issued by the Central Bank of Aruba in 1990. Meanwhile, from 1986- 1989 transitional bank notes were issued and used.

Even though the Central Bank of Aruba was established in 1986, it took this institution approximately 22 years to find staff members with a certain level of knowledge before establishing its reputation and credibility which are critical elements for a Central Bank to achieve its key policy objectives, namely monetary and financial stability. The entire transition from going from the Netherlands Antillean Guilder to the Aruban florin took time and was a costly process.

As for Sint Maarten, when introducing the Sint Maarten Dollar we should also consider above-mentioned challenges, but bear in mind that the situation then in Aruba differs from our current situation in Sint Maarten:

Before Aruba introduced their new legal tender, the US dollar was, at that time, not co-circulating widely alongside the Netherlands Antillean Guilder as it is today in Sint Maarten, so from the beginning, there was a high acceptance of the new currency in Aruba (Aruban florin). This might not be the case for the new Sint Maarten Dollar, as US Dollar circulation is already up to 60- 70%.

5.2 British Virgin Islands

The British Virgin Islands (BVI), is a British overseas territory situated in the Caribbean to the east of Puerto Rico. The islands make up part of the Virgin Islands archipelago; the remaining islands constitute the U.S. Virgin Islands and the Spanish Virgin Islands.

The official name of the Territory is still simply the "Virgin Islands", but the prefix "British" is often used to distinguish it from the neighboring American territory which changed its name from the "Danish West Indies" to "Virgin Islands of the United States" in 1917. The British Virgin Islands consist of the main islands of Tortola, Virgin Gorda, Anegada, and Jost Van Dyke, along with over fifty other smaller islands and cays. About 15 of the islands are inhabited. The capital, Road Town, is situated on Tortola, the largest island, which is approximately 20 km long and 5 km wide. The islands have a population of about 27,800, of whom approximately 23,000 live on Tortola. The islands were part of the British colony of the Leeward Islands from 1872-1960; they were granted autonomy in 1967. The economy is closely tied to the larger and more populous US Virgin Islands to the west; the US dollar is the legal currency since 1959.

The economy, one of the most stable and prosperous in the Caribbean, is highly dependent on tourism generating an estimated 45% of the national income. The BVI performs administrative; audit; and legal services to international business companies and these supplementary services are another key component of the economy. Financial services in the BVI are otherwise somewhat limited, consisting of local banking and insurance companies.

Natural hazards: hurricanes and tropical storms (July to October).

Since there are a lot of similarities between the BVI and Sint Maarten, we took a closer look at this internal self- governing overseas territory of the UK regarding dollarization.

The government of the BVI uses fiscal policy to incentivize or de-incentivize behavior: they can lower import duties, provide rebates to local investors on certain categories of goods. Taxation (or the lack of it) can provide the fiscal tool needed to manage their economy.

Supervision of their financial services industry is done by their regulator: The Financial Services Commission. This is the agency responsible for authorizing and licensing companies or persons to conduct financial services business and for monitoring the perimeter of regulated financial services activity to safeguard the public against any illegal and or unauthorized financial services business operating in or from within the BVI. The Financial Services Commission is governed by the Board of Commissioners and has statutory authority[21] to issue legally binding codes, in order to provide a more flexible regime that can be adapted quickly to market developments. The Financial Services Commission BVI can use its enforcement powers to close a bank if it notices the balance sheet of that bank is not healthy.

Only one bank is locally owned, [22]and the rest of the system consists of highly liquid and well capitalized branches and subsidiaries of foreign banks. Having only one domestically funded bank and its close supervision has been an advantage for the BVI, since entirely domestically funded banks have no foreign head office to rely on in times of trouble, which can create a fiscal burden on the government. The United Kingdom sets fiscal restrictions on overseas territories, including a requirement to have 90 days liquidity in reserves.

Crisis management planning (like liquidity provision) is being addressed by developing a Deposit Insurance Corporation to deal with bank failures. According to the BVI, the lender of last resort function should be with the UK government, but the BVI have many stop gap measures to prevent them from getting to that point. However, the 2010 IMF Country Report[23] states that the UK has pointed out clearly that it would not help out financially when government owned banks are in trouble.

According to the BVI, the change to the US dollar as legal tender was done in order to facilitate trade between the US Virgin Islands and the British Virgin Islands. Fortunately this has worked out very well for them. The BVI finds it an advantage not to have to deal with monetary issues (central bank), and because of the profile of the United States, the BVI claims to have had a relatively trouble free history on monetary issues.

The long experience of the BVI with dollarization and the many similarities between the BVI and Sint Maarten may lead to an example for Sint Maarten. Both the BVI and Sint Maarten are small and have strong economic ties with the United States. According to the findings of the 2004 assessment under the Offshore Financial Center (OFC) program, the road has not been easy, but there has been improvement in strengthening the regulatory system and legislative framework since then.

[21] Virgin Islands Regulatory Code, 2009
[22] The National Bank of the Virgin Islands.
[23] 2010 IMF Country Report No. 10/323 British Virgin Islands: Financial Sector Assessment Program Update- Financial System Stability Assessment, see page 8.

6. Advice

It is made clear in this advice that because of the worsening of the current account imbalance on the part of Curaçao, a balance of payments crisis may take place, which, consequently, may lead to a sudden devaluation and inflation of the Netherlands Antillean Guilder for the entire monetary union. Because of this worrisome situation, the Social Economic Council of Sint Maarten strongly advises the government of Sint Maarten to step out of the monetary union which we currently form with Curaçao.

Stepping out of the monetary union leaves Sint Maarten with two choices:

- to opt for dollarization
- or to choose and design our new legal tender: the Sint Maarten Dollar

However, whatever alternative Sint Maarten chooses, financial supervision, whether exercised through a Central Bank or an outsourced supervisory authority, will still play an important role in promoting monetary and financial stability.

Dollarization as described in this advice can have a net positive influence on Sint Maarten's whole society: lower interest rates, lower transaction costs, capital mobility, more investments and the elimination of devaluation risk.

The banking sector will experience more competition from abroad and will thus feel pressure on their interest margin, losing income from currency conversion. But overall, the government of Sint Maarten will carry most costs, considering their loss of income and having no control over our own monetary policy with dollarization, as Sint Maarten accepts the monetary policy of the United States when dollarizing. Any issues with the US dollar as a currency will then be felt by Sint Maarten.

Dollarization can only have a positive effect on the investment climate as well as the standard of living, if some very important conditions are met. These conditions are first and foremost: a high level of fiscal discipline, and higher flexibility in price and wage levels. In a dollarized economy, financial institutions can still experience liquidity or solvency crises, but then the government is unable to exercise its lender of last resort function. For that reason, there must be a guarantee that there will always be sufficient US dollars available to keep Sint Maarten's dollarized economy running: some guarantee against catastrophic shocks possibly in the form of a contingency plan (like a funded deposit guarantee scheme) to be realized with a private international agency or within in the Kingdom.

As we already stated in the introduction of this advice, Sint Maarten is already de facto dollarized, the Netherlands Antillean Guilder is in widespread use alongside the US dollar, and hence, there is no loss of confidence in the Netherlands Antillean Guilder (yet). Furthermore, Sint Maarten is not exercising the choice of dollarization because of hyperinflation or macro-economic instability. Dollarizing also means totally relying on and having no control over the US monetary policy.

However, for Sint Maarten, the current peg of the Antillean Guilder to the US Dollar has brought us a credible exchange rate stability and nearly low inflation for a very long time. With the peg our economy adapts to shocks and maintains competitiveness, but there has always been the risk of a sudden, sharp devaluation of our exchange rate, while in a dollarized economy there is no control over our own monetary policy, thus no possibility to devalue our exchange rate. Sint Maarten considers stepping out of the monetary union, because the current account deficit for the monetary union has risen to worrisome levels, putting our international reserves under pressure and ultimately requiring devaluation. Therefore, immediate action to leave the monetary union is required for Sint Maarten.

Regarding our own currency, with the inception of a newly to be established Central Bank for Sint Maarten, this Central Bank will be responsible to bring the Sint Maarten Dollar into circulation. In order to peg the Sint Maarten Dollar to the US Dollar, the government of Sint Maarten should continuously make an effort to control the value of the Sint Maarten Dollar, so it rises and falls as the US Dollar does. Similarly, fiscal policy must be as highly disciplined when choosing for our own new legal currency as it must be when dollarizing. In the end, it is up to Sint Maarten to uphold solid financial management and principles of good governance.

But, taking Curaçao's new position into account regarding the CBCS, the inevitable question becomes; if politicians cannot agree on one common central bank, what will be the next best alternative for Sint Maarten? Given the current financial architecture, Curacao will probably carry forward the current central bank, although its revenue base will become smaller as a result of dividing the foreign exchange reserves with Sint Maarten and the omission of income from the issuance of banknotes and currency transactions with banks in Sint Maarten.

With respect to Sint Maarten, it is the question whether it will be able to sustain a full- fledged central bank in an effective manner. The small scale of our economy will not generate enough income to cover the operational costs. This means that the central bank will become dependent on government financing, which will undermine its independence and, hence, credibility. In general, a central bank contributes to government revenues, not the other way around. An own monetary policy and consequently an own full- fledged central bank is only necessary if you have your own currency.

Consequently the SER advises as follows:

1) For the government of Sint Maarten to decide to step out of the monetary union with Curaçao. Herein, Sint Maarten should set a realistic date, make a time schedule and start working with a professional taskforce on a strategic plan towards this goal. This professional task force can be installed with the help of The Netherlands and the BES islands who have recently gone through the process of dollarization.

2) Subsequently, since the US dollar is used so extensively on Sint Maarten and the transition to dollarization will not have a huge impact; official dollarization should be considered an efficient and achievable option for Sint Maarten, while at the same time in the dollarization process, the government is responsible to protect consumers against prices being raised or rounded off upwards to the consumer's disadvantage.

3) For government to have a definite budget available to realize the transition to formally dollarize Sint Maarten.

4) That there should be a significant shift in the areas of responsibility of the Central Bank and the government of Sint Maarten respectively: the role of the Central Bank will be limited, if not nil, while that of the government of Sint Maarten conversely will become even more prominent. As a result it will become even more critical, that fiscal rules and benchmarks are legally embedded.

5) Regarding the supervision of the financial sector, which is an ongoing process, even if Sint Maarten dollarizes the SER recommends that it would be much more efficient and effective for Sint Maarten if the financial supervision would be outsourced. This is easy to establish, considering that most financial institutions on Sint Maarten are subsidiaries or branches of foreign-based companies.

6) That the government of Sint Maarten retains an adequate level of reserves to help mitigate the effects of economic shocks or aims towards Kingdom support in case of catastrophes.

7) That the government of Sint Maarten finds a way to compensate the loss of seigniorage revenues and the license fee revenues, in total estimated at approximately 29 million NAF.

8) In order to ensure that Sint Maarten's financial supervision continues to occur in an optimal manner, that adoption and execution of the country's budgets are balanced within the agreed limitations, and that there is control of the government budget, the SER also advises that the CFT should continue its independent supervision indefinitely, even after December 31st, 2015, when this supervisory body's (first) term will be terminated.

7. Dissenting voices of the minority

As seven (7) of the nine (9) board members voted in favor of this advice, a majority advice has been established. In the board meeting of February 14th, 2013 the board members decided that this advice will indicate the dissenting views[24].

Board member William Reed, representing WICSU/ PSU stated his (minority) position as follows:

"This sensitive issue evokes emotions and we must try to react with reason and less with emotions in the Caribbean. The separation from the Antilles still plays an important role and is troublesome. A further monetary separation might end up hurting us more".

Board member Arthur Bute, representing the Chamber of Commerce explained his opinion as follows:

"Although the private sector might favor dollarization, those wishes are based on emotions and not led by numbers and reason. The current state of the Central Bank is caused by mismanagement and political problems. We have an old Central Bank which has served us well throughout the years". Therefore member Bute concludes that we should solve these problems and not jump out based on emotional reasons.

It should be noted that board member Joseph Lake Jr., representing the Chamber of Commerce, voted in favor of "stepping out of the monetary union", but does not support the option of dollarizing Sint Maarten as a consequence thereof, because of the following reasons:

- Dollarization in the BES islands led to a higher cost of living, creating more tension in that region. Member Lake is of the opinion that if Sint Maarten dollarizes, this will lead to inflation, increased taxation and ultimately into a recession.
- Because the costs of our own Central Bank have not been specified in the paper, member Lake is not convinced that setting up our own Central Bank will be too costly. And, he adds that our own Central Bank will have a positive impact by providing employment.
- Regarding the lender of last resort function, member Lake is of the opinion that Sint Maarten has to learn to depend on itself.
- If Sint Maarten dollarizes, it will be extremely difficult for local banks to compete with international banks, as the local banks are now protected by local laws.
- Member Lake is of the opinion that the CFT control should discontinue after 2015. The CFT is an undemocratic institution which was not elected by the people of Sint Maarten.
- Finally, the issue of dollarization is such a delicate subject that this should be decided in a referendum where the people of Sint Maarten can decide whether dollarization is the best option for Sint Maarten or not.

[24] According to Article 21 paragraph 3 of the "Landsverordening Sociaal- Economische Raad"

Appendix:

Stakeholders

Both the independent members and the social partners in the SER (employers' and employees' representatives) contribute a high level of expertise.

Article 17 of the Ordinance of the Social Economic Council authorizes the Council to invite stakeholders to its meetings. Insights of members together with the stakeholders serve as a valuable source of information.

In order to complete this advice, we interviewed the following stakeholders on this subject:

- Drs. Renny Maduro, Associate Professor of Economics at the University of the Netherlands Antilles.
- Drs. Roland O.B. van den Bergh, Chairman " Economen Platform Curaçao"
- Mr. Eric Matto, Deputy Director Monetary and Economic Affairs of the Central Bank of Curaçao and Sint Maarten
- Ms. Candice M. Henriquez, Head Research Department of the Central Bank of Curaçao and Sint Maarten.
- Drs. Rinke Karman, Economist at the Chamber of Commerce & Industry Curaçao
- Mr. Kenneth (Kenny) Canword, Managing Director Commercial Affairs at Orco Bank Curaçao/ Treasurer at Curaçao Bankers Association (CBA)
- Mr. Leo Rigaud, Managing Director at SFT Bank N.V., Curaçao/ Board member at Curaçao Bankers Association (CBA).
- Mr. Derek A. Downes, Deputy Managing Director at The Windward Islands Bank Ltd., Sint Maarten.
- Mr. Jan Beaujon, Managing Director at The Windward Islands Bank Ltd., Sint Maarten
- Mr. Neil Smith, Financial Secretary at the Ministry of Finance, British Virgin Islands.
- Mr. Max Pandt, Tax Attorney and owner at Fairplay International N.V.

Relevant literature

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