

The Political Economy of the Netherlands Antilles and the Future of the Caribbean

DRGTPE supplement on a Caribbean islands economy

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In the memory of A.I.V. Massizzo
An invaluable scientist of high integrity at the Dutch Centraal Planbureau

Prologue

This book intends to show:

- Some practical issues in the Netherlands Antilles can be solved, such as unemployment, the national debt, pensions, the high rate of interest
- Those solutions can be attained without splitting up the Netherlands Antilles into separate countries
- Adequate national decision making and co-ordination requires the constitutional amendment for the Economic Supreme Court, as a separate power next to the Legislative, Executive and Judicial branches. Parliament would keep the power to determine the budget, but would lose the power to manipulate information
- Instead of more fragmentation one needs more integration (with Economic Supreme Courts for co-ordination)
- This holds for the whole Caribbean, so that the advisable course is to create a Caribbean Union similar like the European Union
- These are examples for the world as the solution approach for the risk of global collapse as a result of overpopulation.

This book must be regarded as a Supplement to my “Definition & Reality in the General Theory of Political Economy” (DRGTPE), Dutch University Press 2005, and it applies its theory to the Netherlands Antilles and the Caribbean. My fellow economists would have to read DRGTPE as well but other readers would be free not to do so.

From August 2005 to September 2006 I had the honor to work as a senior policy adviser at the Research Section of the Directorate of Finance at the Ministry of Finance of the Netherlands Antilles, in Willemstad, Curaçao. I thank the minister of Finance Ersilia de Lannooy, the Director of Finance Gregory Damoen, the Adjunct Director José Jardim and my Department Head Lysette Melfor for their grace to appoint me and to introduce me into this new world for me of the Netherlands Antilles and the Caribbean. I thank my colleagues at the Directorate for their warm welcome and support and the knowledge that they imparted to me, in particular at the Research Section and Budget Inspection, Aisha, Lucien, Eugene, Shaimah, Robby, Jacques, Sharlon, Tarik, Josine, Wladimir, Jarl, Raul, Giovanni. I also thank the University of the Netherlands Antilles for some lectures I gave there, in particular Miguel Goede and Carl Camelia.

Conforming to the confidentiality of the office and my appointment, this book only uses material available from public sources. This book also relies on immutable mathematical laws and one year stay is not too short to see their effect.

These practical issues in the Netherlands Antilles can be seen as examples for other nations. Since the current imbalance of constitutional powers has many victims, it may be hoped that the parliaments of our democratic nations investigate the issues mentioned above and consider these examples, so that there is more hope for improvement in the living conditions of their peoples.

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1 USD = 1.78 ANG (Antillian Guilder), 1 ANG = 0.56 USD.

This fixed value already exists for 30 years.

In 2006, 1 EUR \approx 1.29 USD so that 1 EUR \approx 2.29 ANG or 1 ANG \approx 0.44 EUR.

The USD Big Mac exchange rate of the ANG in Punda (Curaçao) in January 2006 is 1.75, thus very close to the USD currency exchange rate.

ANG is the international label. Local labels are NAF, NAf, Naf or NA fl..

An estimate of GDP in 2005 is ANG 5,771.1 million. Officially published national debt is 84.4% of GDP – that however must be corrected to be 66.3% of GDP (this book).

In 2006, social security premiums AOV / AWW, OV and worker health insurance are levied from zero income up to the premium income limit ANG 48,438. General special health insurance AVBZ is levied from zero to its premium income limit ANG 361,667.

Graphs generally use ANG thousands, without needing to express that continuously. On occasion this book writes for example 14.512 instead of ANG 14,512 where it should be obvious from the context that ANG thousands are considered.

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I. Introduction

From a logical perspective it might seem better to first introduce the Netherlands Antilles and the Caribbean and only then proceed with our subject, but doing so tends to distract from our focus while the knowledgeable readers will tend to grow bored. Hence it is better to directly zoom in onto what this book is about. Readers unfamiliar with the Netherlands Antilles, the Caribbean or the current policy debate on these will find a short introduction in the next chapter.

1. What this book is about

This book will discuss the following propositions:

- (1) There is no need to split up the Netherlands Antilles into the separate countries of Curaçao, Sint Maarten, and a special status for the remaining islands of Bonaire, Saba and Sint Eustatius. It is better to strengthen what unites.
- (2) The national debt of the Netherlands Antilles is not 84.4% of GDP but 66.3%. The 'high debt' is a myth, and also that interest payments crowd out other expenditures.
- (3) Unemployment of 15% can be reduced by 6% to 9% by introducing an exemption for social premiums. This measure does not cost anything since it only eliminates the tax void.
- (4) Unemployment can be reduced even more by 4.5% points to 4.5% by a subsidy for low wage workers. This measure can be financed by current outlays on benefits for the permanently unemployed.
- (5) This can be done without financial support from the Netherlands. The current support from the Netherlands doesn't have to be increased. Thus the suggestion that the Netherlands would take over 30% or 50% or 100% of the national debt of the Netherlands Antilles – officially ANG 4870 million or 2.1 billion euro – to allow the new countries to make a fresh start, can be rejected.
- (6) All in all, the Netherlands Antilles are rather a success story in development economics and one should hesitate to change what has been shown to work.
- (7) The modern world economy requires changes of another kind. Reduction of bureaucracy and red tape will enhance the business climate and generate conditions for higher economic growth. This will stimulate emigrated Antillians to return. There is a range of rather obvious economic measures that are needlessly delayed or blocked by bureaucracy, such as the improvement of schools, the wider use of internet, investments in the tourist industry, more airline capacity, development of the logistics hub, restructuring of the system of health care.
- (8) Oligopoly in the banking sector and inadequate control by the Central Bank must be solved so that the rate of interest can drop to international levels.

- (9) The current retirement age of 60 years and the almost Western life expectancy lead to 19 | 23 years of poverty for a male | female pensioner – 65 or 67 years is better.
- (10) Splitting up the Netherlands Antilles into separate entities as described above and with financial support from the Netherlands will actually be detrimental to long run economic growth, since: (a) the idea of splitting up is based upon the analysis that splitting up would solve problems, while it actually doesn't, (b) financial support would continue the dependency on others while the problems are home-grown, (c) the split up entities would be too small and the costs would be too high to maintain a modern economy with all its rules and regulations, (d) the split up entities would diverge into separate and ideosyncratic ways of doing, reducing the scope for communication and trade, (e) splitting up also contains the risk that small islands will be dominated each by a small elite with the loss of democracy.
- (11) The referendum on Curaçao in April 2005 does not support a split-up, even though this is often said. A 68% vote but a 55% turn-out gives only 37% of the electorate.
- (12) The constitution of the Netherlands Antilles can best be amended with the inclusion of an Economic Supreme Court, to enhance economic and financial soundness, and with a Senate to check on fair treatment of the islands.
- (13) It would be better if Aruba would return to the Netherlands Antilles.
- (14) The Netherlands Antilles would benefit from co-operation with other Caribbean nations and territories to create a commonwealth like the European Union. The present bipolar orientation in the Caribbean on either the US or the EU causes a fragmentation of focus, and it would be better if there is a common caucus to defend the common interests, such as investments in tourism, maintenance of the ecology, mutual insurance against hurricanes, trade, higher education, economies of scale in administration, quality of jurisdiction, checks on corruption, the war on drugs, reduction of global warming, population growth and migration, and common foreign policy and defence. Holland could start talks with France and the United Kingdom to stimulate the creation of a Caribbean Union similar like the EU.
- (15) The Netherlands currently has a policy of benign neglect but might have a responsibility not to co-operate with a deterioration of conditions.
- (16) Dutch parliament is advised to have an “parlementaire enquête” (parliamentary enquiry) to investigate the possible split-up of the Kingdom, to evaluate decision making and the use of information up to now, to evaluate the economic, political and cultural ties within the Kingdom, and to advise on the best course of action. One might advise a similar enquiry by the parliaments of the Netherlands Antilles and Aruba, but these parliaments are severely constrained in their resources, and it might suffice when they discuss the results by the Dutch parliament.¹
- (17) Not only the Netherlands have their responsibility here. Also the European Union has a part to play. When the member countries fail because of fragmentation then subsidiarity requires co-ordination at the level of the Union.
- (18) These issues provide an example for a world that faces the risk of global collapse.

¹ There is no joint parliament for the Kingdom as a whole – and there indeed does not seem to be a need for that.

2. An exercise in Political Economy

With the propositions above this book thus is an exercise in Political Economy. Political economy can be understood generally as “the science of the management of the state”. Our field is economics, but applied to the state, and this subject matter requires us to also consider history, law, sociology, and so on. Politics can enter the discussion but as a phenomenon to reflect on from a scientific angle, not as something to actually do. As a scientist, this author doesn’t have an opinion whether e.g. Aruba ‘should’ return to the Netherlands Antilles or not – it are the populations and political leaders in both countries who would decide on that – but as a scientist one can identify the costs and benefits of such an event, in order that people are properly informed.

This being an exercise in political economy, we will standardly refer to DRGTPE.² This present book on the Netherlands Antilles and the Caribbean is duly presented too as a “Supplement to DRGTPE”. DRGTPE is an ‘economists’ book’, it argues at an abstract level and it depends upon the history of economic theory from Plato to Adam Smith to modern times. DRGTPE also depends upon the wide body of modern econometric research since Jan Tinbergen into the causes of unemployment, in particular for the well documented Western economies of the EU and the USA. DRGTPE does contain some summary chapters that should be accessible to lay persons and policy makers, but on the whole much in that book will remain academic. In these respects DRGTPE thus is a boat at anchor in a safe haven.

This present Supplement on the Netherlands Antilles and the Caribbean is more ambitious since it focusses in more detail on a particular economy. The data get dirty and the argument dilutes with other issues. We can treat only some aspects and will not be able to get or give a complete picture. We will consider some legal issues and regulations that are particular to that economy and less interesting for other economies, losing some generality. Issues of culture, migration and islands policies need to be addressed even though they may seem to lead away from the main story line. But the advantage is more empirical detail.

In the same line, we will not fully repeat the argument in DRGTPE and only refer to it when that cannot be avoided. An economist would be rather required to read DRGTPE as well. Others might do without and still arrive at a decent understanding of the propositions presented above and their costs and benefits.

3. Summary of DRGTPE

The basic idea of DRGTPE is that Keynes’s *General Theory* is generalised even further by including endogenous government in the model so that we arrive at a truly general Political Economy. The economic process can be understood much better if economic policy making itself is included as one of the explanatory factors, and when this policy

² The abbreviation “DRGTPE” stands for my book “Definition & Reality in the General Theory of Political Economy”, 2nd edition, Dutch University Press 2005.

making process is studied from the Public Choice perspective. DRGTPE takes unemployment as the main example of policy failure, since unemployment takes away a people's and an individual's means of existence, security of being, freedom of mind and independence of thinking. A rich economy may provide for a system of welfare, that however can create a culture of dependency on welfare that even can lock people in a situation with numerous barriers to exit. A poor economy will lock people in poverty without the means to improve their situation, barring migration or crime. The mass unemployment in Western nations in 1930-1940 and again since the early 1970s derives primarily from stagnation in economic policy making. The cause of that failure can be traced to weak checks and balances in the Western concept of democracy and structure of government, namely the "Trias Politica" of Montesquieu with its executive, legislative and judicial branches. The current model tends to fail, in all countries and over all time periods, in the safeguarding of the quality of the information. This analysis supports a constitutional amendment for an Economic Supreme Court that will extend the checks and balances within a modern democracy. DRGTPE contains a draft constitutional amendment, reproduced in the appendices below.

The analysis of DRGTPE can be applied directly to the economy of the Netherlands Antilles. Due to the heritage of Dutch colonial rule the structure of government on the Dutch Antilles has the same Trias Politica. The Netherlands still provide subsidies and real live judges to support the rule of law on the islands. As analyzed in DRGTPE this Trias Politica structure however still allows too much leeway for politics to manipulate information, with detrimental effects for essential living conditions for the population at large.



The following quote of DRGTPE is unavoidable:

It is useful to indicate in more abstract terms what this book does. Unemployment is not taken as a natural disaster like an earthquake, but regarded as the result of policy. The central questions in the political economy of employment are: *can* one solve unemployment and poverty, does one *know* how, and does one *want* to ?

Next to the *budget set* and *preferences*, it appears useful to distinguish *information*. Government policy making is not guided by prices as markets are. Perceptions play a special role. For example, when policy makers associate tax policy with income distribution policy, and in that manner overlook inefficiencies such as the tax void, then policies are blocked that would otherwise benefit everyone.

Colignatus (1990a) forecasted a revival of institutional economics. We see this happening in the literature indeed. This current book belongs to that development. An Economic Supreme Court, or the lack of it, is a topic in institutional economics, and thus has a natural position in the proposed new synthesis. [footnote]

There have been precursors to this approach indeed. Galbraith (1998:199) correctly quotes Michael Kalecki ("Political aspects of full employment"):

"The assumption that a Government will maintain full employment if only it knows how to do it is fallacious."

4. Small islands economies

Small islands economies have been a challenge for economists and administrators. Being small gives its problems and being an island historically added to that. Good reading are Burton Benedict (ed) (1967), “Problems of smaller territories”, and George Reid (1974), “The impact of very small size on the international behaviour of microstates”. This said, however, it is also important to observe that when there are no ambitions with an islands economy then the challenge of its management is greatly reduced. Events can run their course at a low level of existence and it may not be too difficult to maintain some kind of equilibrium, especially when surplus population can migrate to other areas.

A key distinction is between full independence and some form of dependence. The latter islands benefit and suffer from central decision making at a distant capital and its financial support, the former benefit and suffer from their own decision making and the winds of trade. In colonial times, colonies were a big operation and commanded prime attention of policy makers. After World War II, most colonies became independent, leaving only small areas under former-colonial rule. Apart from locations with a military function, left-overs were precisely those areas who knew that they would not make it by themselves. The status of those left-over former colonies is dubious. Generally they don’t draw much attention of senior policy makers and parliament in the former colonial country and thus they tend to become an almost private domain of the government office there, usually a small unit with career bureaucrats, restoring an almost colonial hierarchy. Often, though, the ‘home’ government office may adopt a *laissez-faire* policy, or ‘benign neglect’, so that the former colony is run by its local elite, without perhaps proper checks and balances (thus not so ‘benign’). In such a case there is perhaps not a formal but for all practical means a material independence. Interference of the former colonial power with its former colonies can meet with the invocation of the United Nations charter on self determination, with a *déjà vu* of the period of decolonization. A *laissez-faire* policy prevents that and has the advantage of silence and seeming stability.



One issue for small islands economies that graps the mind is the risk of total social collapse. Easter Island is a notorious historical case. Nowadays we think of Haiti. The factors that bring about a collapse appear to be the same for small and big cultures alike (vide the Maya), so that size is only a co-factor, and a confounding co-factor as well. This point has been established in a laudable way by Jared Diamond in his book “Collapse” (2005) where he reviews various historical cases of collapsed societies and some that were on the brink of it but escaped. One key finding is that even tiny islands with tiny populations can survive for centuries even at a low technological level (or precisely at a low technological level). In a small economy, all individuals may easier become aware of the threat of social collapse, and hence individually and freely offer to work towards a solution. In a big economy, one would require a centralized government to gather that information and to resolve the issue. On the other hand, a small economy may lack the resources to provide an effective solution once environmental degradation has gone too far, causing the recorded cases of social collapse (or lock-in of low technology). What remains from this discussion is that it helps to be big, well organized and well-connected, that is, at least if the goal is economic welfare and its growth.

Diamond's discussion does not allow a clear extrapolation to other cases, such as the Netherlands Antilles. His discussion namely is specific to his examples and general on causes and effects. Whether the Netherlands Antilles are sufficiently big, sufficiently organized and sufficiently well-connected to other economies cannot be established from Diamond's book and remains to be established by separate investigation.



As mentioned above, being an island historically added to the economic problems of being small. That additional economic burden however is being lessened in modern times by the increased efficiency of transport by both sea and air. As the price of shipment has been dropping spectacularly, it may even turn into an advantage that one is close to a sea harbour and thus can save the higher costs of transport over land. Many services nowadays are provided on the internet, further reducing the relevance of location.

Historically, it was the sea barrier around islands and the "tyranny of distance" that caused their economies to be regarded as 'small', and that caused governments to carve up the ocean into manageable bits. When this barrier falls away and the tyranny partly turns into a blessing, the scope for management is increased, so that there is less reason to think small.

5. Collapse on world scale

There are various strands that come together. Both my DRGTPE and Jared Diamond's "Collapse" were written with the risk of a collapse at world level in mind. Currently the former US Vice-President Al Gore is touring the world with his recommendable film "An inconvenient truth" discussing the risk of global warming. The pressure of population growth and environmental degradation can already be felt in the Caribbean and when the sea level would rise then not only ocean front property but also key harbour infrastructure in the Caribbean would be destroyed.



At this point a longer quote from DRGTPE is unavoidable:

The Trias Politica setting is usefully limited to the nation-state. However, if we were to limit our attention to the nation-state, could we really neglect the external conditions? One would think not. A crucial chapter in the theory of the nation-state concerns the external relations: trade and war by tradition, and then, in our age: the risks of world population growth and of environmental disaster, i.e. risks that may spill over across the border. Wise managers would not close their eyes to external risks. Hence, though this book concentrates on the situation in the Western democracies, we also regard the non-democracies in the developing world.

Projections for the future indicate such external risks:

"The Global Crisis scenario (...) explores the risks and dangers of a neglect of, and late response to regional and global challenges (...) the world may end up in the throes of widespread distress, an eco-crisis,

which can only be corrected at high cost. The policy message conveyed by this scenario is abundantly clear. Dismissing this scenario as unduly gloomy and pessimistic is in our view, absurd; such a statement would be tantamount to a complete denial of large segments of twentieth-century history.”

Centraal Planbureau, “Scanning the future”, SDU 1992:211



World population is forecasted in 1999 to rise to 9 billion around 2050, with a forecast error of 1.5 billion lower or higher. The central forecast already is a reduction from a forecast of 9.5 billion as the result of AIDS. This disease not only kills, but also reduces the quality of life for the surviving. Other diseases may well develop. Or, for AIDS itself, given the huge number of infected, a mutation could develop that can be transferred by flies or mosquitos too - that already transfer diseases. Another problem is that when policy succeeds in improving a situation, then such new room tends to be taken up for growth again. So it would be some kind of a miracle if the world would hit the ‘low’ 7.5 billion target with a healthy, well fed, educated and peaceful population.



UNDP administrator Speth correctly states:

“Fifty years after the adoption of the Universal Declaration of Human Rights, one third of the world’s people are enslaved by a poverty so complete that it denies them fundamental rights.” (UNDP 1999 internet site)

This quote usefully recalls to memory that Montesquieu’s liberty has been extended in this century with more rights, so that there is an even stronger intellectual case to test whether the system of Trias Politica serves the demands made on it.

Ending the quote from DRGTPE.



It is interesting to note how DRGTPE, Diamond and Gore are different and how those different strands meet. DRGTPE is a system-builder. It uses economic theory on the management of the state, and resolves the structure of decision making so that this structure can better deal with a score of economic problems related to the survival of civilization as we know it. Gore acts as a “go-getter”, focusses on one clear issue, targets on increasing awareness, and hopes & forecasts that existing structures work towards a solution. Gore keeps hitting on *survival* and this helps us to focus attention. Perhaps this is only an act, since many global issues are interrelated, global warming is only one of them, and in all likelihood Gore hopes that once global warming is getting tackled, also the related issues are taken along. Diamond is between DRGTPE and Gore. He focusses on the risk of collapse at world level, uses the historical cases to learn about the mechanism, and advises the solution of a change in mentality towards more co-operation. He explicitly mentions the Dutch “polder model” as the state of mind and the social convention by which representatives of various parties and interests in society essentially co-operate to arrive at mutual beneficial solutions. Such as building dikes so

that nobody drowns. It must be noted however that DRGTPE was written by a Dutch economist who observed that the Dutch decision making machine generated mass unemployment in the 1930-1940 and again since the 1970s. Holland is no exception to other Western democracies that suffered the same failure of the Trias Politica structure. Holland has a huge welfare system – financed by its resources of natural gas which resources are depleted – while that system of welfare hides unemployment and locks people into a culture of dependency. Apart from the advantages and disadvantages of the “polder model”, the clear notion is that it is not sufficient to merely keep talking to each other but what is required is an input from science. When scientific advice is neglected then disasters set in. A disaster is not just a disaster but it also becomes tragic when we knew that it could have been prevented. A recent example of the failure of Dutch society to resolve long term issues is the debate on social integration of migrants, highlighted by the murders on professor Pim Fortuyn in 2002 and the film maker Theo van Gogh in 2004. See DRGTPE for more details. My hope is that Diamond and Gore will consider the argument in DRGTPE, though the prime reaction should come from my fellow economists – whose responsibility it is to provide society with adequate economic advice.



For the Netherlands, the Netherlands Antilles and Aruba this general scope on the risk of global collapse is relevant in various ways. Though these are small political units, they could set an example by extending the Trias Politica structure with an Economic Supreme Court. They could co-operate with other nations that run the risks of global warming and collapse on a world scale. They could give their own contribution regardless of what other nations are doing. They could focus on real issues and rational policy instead of less real issues and more irrational policy.

6. The structure of this book

This Chapter I presented the general background of our discussion: the approach of political economy, the risk of global collapse, the usefulness of constitutional reform, the general problems of small islands economies. Against this backdrop we presented a number of propositions with respect to the Netherlands Antilles within the Caribbean. It may strike one as a bit curious that this huge backdrop is presented to subsequently discuss some propositions that concern a small islands economy. This might seem as first showing an elephant and then discussing a mouse. In teaching, however, examples work wonders. As a mammal, a mouse is a good example for an elephant. Most people and governments do not take the risk of global collapse as self-evident, and hence it is necessary to state that argument. This background then causes a different look at the same phenomena and it is no longer possible to proceed in ‘business as usual’. The discussion of a particular islands economy confirms the failure of the Trias Politica structure of policy making, which may cause you to wonder whether this couldn’t also be the case for the risk of global collapse. The details about the Antillian economy may be beneficial for the Netherlands Antilles, also in the way of ‘business as usual’, yet they are most useful for a larger audience that is interested in the future either for the Caribbean or for the whole world, since these details are exemplary for the larger case. For example, you may become interested in finding out the size of the tax void in your own country.

Chapter II will provide a short introduction to the Netherlands Antilles and the Caribbean for readers not familiar with those. Some facts and insights may be mentioned however that are not too commonly known also by readers familiar to the region. Subsequently the current policy debate about splitting up the Netherlands Antilles is presented, views of the Dutch are explained and the key arguments are evaluated. The chapter closes with an alternative to fragmentation, namely the formation of a Caribbean Union similar to the European Union.

Chapter III gives an introduction into the analysis of unemployment of DRGTPE. These papers are directly taken from DRGTPE and give a presentation for a general public. They refer to the Fall of the Berlin Wall, which originally motivated the analysis, but the analysis can be easily translated to the Caribbean. At first it may strike the reader as a bit strange that problems of Russia and Eastern Europe are called into this discussion on the Caribbean, but these papers are unavoidably useful here since they introduce you to the analysis, the terms used and the frame of reference. Without this introduction you might find it much more difficult to understand the next chapters. Since the 1980s inflation has been mostly under control, partly because of the power and interest of financial institutions, partly by accepting a larger amount of unemployment. A major question of macro-economics is how unemployment could be reduced without sacrificing what has been achieved for inflation.³

Chapter IV applies DRGTPE's analysis of unemployment to the economy of the Netherlands Antilles. While DRGTPE looked at Holland, the EU and the USA, the findings for the Netherlands Antilles are the same. The advantage of the repeat analysis is that it confirms that the same general abstract principles of the *reduced form* apply, while it is interesting to observe what the structural form is in a practical case. Whereas the 'structural form' contains relations and parameters of behavioural relations, the 'reduced form' solves for straightforward causes and consequences which will be dominated by mathematical laws and conditions. The analysis shows that unemployment can be tackled in the Antilles without splitting up the country. In effect, where I wasn't allowed to do the full analysis at the Dutch Central Planning Bureau in 1989-1991 for the case of Holland, the case of the Netherlands Antilles gave more scope. This new result might provide more information for economists who are less used in thinking in terms of the reduced form and who rather think in terms of structural relations. The result on the Netherlands Antilles still is not a really full analysis since there is no adequate fully developed economic model for that country to perform such an analysis.⁴ However, using the resources of *Mathematica* we will get far.

Chapter V discusses the wrong information provided by the Central Bank of the Netherlands Antilles ("Bank van de Nederlandse Antillen", BNA). It appears that the BNA has been hoarding reserves, causing an overstatement of national debt by 8.9% of GDP. The BNA also presents some other wrong economic analyses on key points. The BNA causes a high rate of interest that stifles the local economy. This chapter already starts debunking the issue of national debt and confirms the need of an Economic

³ When this book was almost finished and Chapter II was securely in place, I however was struck by the point that it are the East Europeans in the EU vide Havel e.a. (2006) who are most active against Castro's dictatorship on Cuba. There are connections that an author may come to realize slowly too.

⁴ The models Curalyse and Antiltax available at www.micromacroconsultants.com are less suited for the present analysis.

Supreme Court, that is, with a sufficiently qualified staff that can only be found in an economy of sufficient size and with a sufficiently level of development.

Chapter VI discusses the wrong information provided by the Social Security Bank (“Sociale Verzekeringsbank”, SVB). The SVB has also been hoarding reserves, causing an overstatement of national debt by 9.2% of GDP. Without the BNA noticing. In addition there are supplementary measures that can be taken to prevent deficits for national pensions, for example by raising the retirement age from 60 years to 67 years. Life expectancy in the Netherlands Antilles is close to that of Western nations.

Chapter VII discusses the wrong information provided by the Pension Fund for government officials (“Ambtenaren Pensioenfonds voor de Nederlandse Antillen”, APNA). By switching to a more rational risk profile for its investments, APNA could greatly increase its return on investment and thus save premiums by the government and its employees, improving the budget situation.

Chapter VIII reviews the results. It is not sufficient that the economy has some size and has some level of development to generate qualified staff. Both the IMF and the government of the Netherlands sent squads to investigate the Antillian economy and budget, and failed to observe above findings. The other necessary condition is that such staff must operate in the correct organizational format. Perhaps the IMF and the Dutch government have a different opinion about those findings. Or perhaps they agree that their staff should have been able to identify them. Or perhaps they will argue that their staff was sent there with different objectives. The point however is that a country needs an Economic Supreme Court since only that gives the organizational format such that qualified staff has a high likelihood of identifying such findings. Good decision making requires good information. The same holds for the risk of global collapse.

The appendices also contain review material taken from DRGTPE.



The Netherlands Antilles deserve a compliment since the data provided by their governments and institutions BNA, SVB, APNA and Central Bureau of Statistics (CBS) are such that it allows the economic analysis and the correction provided in this book. Websites are reasonably developed and authors properly refer to their sources. Note the distinction between “data” and “information”. Where this book refers to “wrong information” and “misinformation” then this is merely the proper classification and there is no implication that the misinformation would be intentional. Now that the information has been corrected, the professionals at the government branches, BNA, SVB, APNA and CBS would be the first to see its value.

This also clarifies why it is useful to put all this material in one book. To send the separate chapters to the separate institutes would disperse the applied corrections, destroy the integrated framework, and would lead to a morass of discussions with discussion partners who lack the general overview. One would only perform the ritual of the bureaucratic process, time would pass and everybody ends up with lots of frustrations. A scientist better does not partake in that approach. It is better that there is one book that all can read and study at the same time. Now that all the material has been put together, the correction for the national debt may stimulate the government to tackle unemployment, the correction for unemployment may stimulate APNA to take more risk, the correction for all these may allow the BNA to reduce the rate of interest. If the Netherlands Antilles would have had a Central Planning Bureau then the integration and

co-ordination might have done there. The comparative advantage of this book is only my CPB background and that I composed DRGTPE. But even a CPB might fail and one really needs an ESC.

The set up of this book thus also explains that my one year stay at the Netherlands Antilles still allows some strong statements. This book is based upon immutable mathematical laws, see DRGTPE for theorems and proofs and the discussion of the “Definition & Reality methodology”. Such things are the same everywhere. An analogy is a policeman from New York visiting the Netherlands Antilles and observing that cars should stop at red lights. The analogy is awkward since traffic rules are man-made while this book actually concerns mathematics. Nevertheless, the experience of one year, and what I have read from the works of others, allows to punch in data and to derive the local results.

II. The Netherlands Antilles and the Caribbean

7. The Netherlands Antilles

The Netherlands Antilles are a small islands economy within the Caribbean. The country consists of the leeward islands of Curaçao and Bonaire, some 60 kilometers off the coast of Venezuela, and the windward islands of Sint Maarten, Saba and Sint Eustatius some 900 kilometers up north closer to Puerto Rico. Its population counts 180,870 people with the cultural mixture of Western and non-Western heritage. There is also the island of Aruba, also off the coast of Venezuela. In 1986 Aruba split off from the Netherlands Antilles to become an independent country by itself but in 1990 it decided to remain within the Kingdom of the Netherlands. The Kingdom under current Queen Beatrix thus consists of the three separate countries the Netherlands (also known as Holland), the Netherlands Antilles and Aruba. The Kingdom only provides some common umbrella for foreign policy and defence.⁵ The Netherlands, located in Europe and member of the EU, politically dominates that Kingdom and also provides a home to an additional 130,000 Antillians and Arubans who have migrated there over the years. One of the major reasons for migration was overpopulation, unemployment and related poverty on the islands. Table 1 reviews the islands in terms of size, population and unemployment.

Table 1: Some key data on the Netherlands Antilles 2004⁶

	Size	Population	Unemployment
	km2	1000 persons	% labour force
Bonaire	288	10.8	9.1
Curacao	444	130.6	15.8
Sint Maarten	34	35.7	15.5
Sint Eustatius	21	2.3	8.4
Saba	13	1.5	6.1
Netherlands Antilles	800	180.9	15.0
Aruba	193	102.5	7.3
Antillians in the Netherlands		130.0	16.5
The Netherlands	41,526	16,000.0	6.0

⁵ An analogy are Great Britain, Australia and Canada that are separate countries with the same Queen. They however have separate foreign policy and defence.

⁶ Data can be found at www.cbs.an, www.centralbank.an, www.cbs.nl and wikipedia. The unemployment data for the Netherlands (both the 6% and the 16.5%) should be treated with care since those figures exclude many persons on benefit (e.g. disability) who are often included in data of the other countries. The Netherlands have an extensive system of “welfare” that locks people in dependency and bars them from the labour market. For example a mother of 20 years with two children by two different men will be on welfare with rent subsidy and health care and not be counted as unemployed.

Table 2 reviews some migration data. Around 1999 / 2000 when an austerity programme was launched (see below) a sizeable percentage of the population migrated, associated with a brain drain but also with some seeking the advantage of Dutch welfare.

Table 2: Migration

	<i>Population</i>	<i>Emigration</i>	<i>Immigration</i>	<i>Saldo</i>
1990	188,164	5,042	3,077	-1,965
1991	189,343	8,382	6,838	-1,544
1992	188,913	4,451	7,183	2,732
1993	189,278	4,752	7,622	2,870
1994	189,767	3,603	6,927	3,324
1995	190,640	4,142	6,849	2,707
1996	192,247	5,330	8,065	2,735
1997	194,499	6,616	7,845	1,229
1998	189,606	9,677	6,828	-2,849
1999	182,746	11,067	6,330	-4,737
2000	175,905	16,171	6,970	-9,201
2001	172,488	11,939	7,542	-4,397
2002	176,742	8,334	11,253	2,919

Table 3 reviews the economic status in terms of working, unemployed or not active. The decomposition for 2004 holds for the three main islands only so that the population figure differs from the one mentioned above.

Table 3: Population and economic status (3 main islands)

		2000	Census-01	Oct.-04
	1 Working	71,208	67,631	71,836
	Independent		7,887	
	Government		7,439	
	2 Unemployed	11,011	11,656	12,976
(1+2)	3 Labour force	82,219	79,287	84,812
	4 Economically inactive	48,759	48,782	48,825
	5 Population 15 years +	130,978	128,069	133,637
	Population 0-14 years	32,089	33,343	32,259
	6 Total Population	173,884	169,285	174,158
(3:6)	7 Participation (%)	47.3%	46.8%	48.7%
(2:3)	8 Unemployment (%)	13.4%	14.7%	15.3%
(1:6)	9 Working / Total population (41.0%	40.0%	41.2%

Table 4 gives the national debt, both the official rate as published by the Central Bank (“Bank van de Nederlandse Antillen”, BNA) and the true rate when properly accounting for the over-accumulation both at BNA itself and at the Social Security Bank (“Sociale Verzekeringsbank”, SVB). The determination of the true rate will be the subject of some chapters below.

Table 4: National debt, official and true rate, 2005

	% of GDP
Official rate	84.4
Surplus BNA	8.9
Surplus SVB	9.2
True rate	66.3

Table 5 reviews GDP per capita and shows that the Netherlands Antilles do well with respect to the region (Venezuela and Colombia) but still lag behind the Netherlands or the USA. Aruba appears to have caught up with the Netherlands, primarily due to its development of tourism. The Netherlands spends 170 million euro annually on the Antilles and Aruba thus about 600 euro per Antillian or Aruban. Half is spent on support of the governmental structure notably for salaries of Dutch officials both in Holland and in the Antilles, the other half is spent on development projects in the two countries.

Table 5: GDP per capita, USD 2004 ⁷

Netherlands Antilles	17,127
Aruba	28,000
The Netherlands	29,500
USA	40,100
Venezuela	5,800

Van Schaaik et al. (2004) observe that the Netherlands Antilles are an economic success story for the region. One can agree. The economy has performed well compared to other developing nations. The ‘problem’ is that the Netherlands have grown too. At the end of World War II GDP per capita of the Antilles was higher than that of the Netherlands, due to the oil industry on the Antilles, the small population, and of course the devastation in Holland. Holland has caught up while the Antilles had some set-backs due to downsizing of the oil industry while the increase in population affected the denominator. But the point remains that there is more reason for self-confidence than for self-pity. The Netherlands Antilles form an example how a small nation can develop without falling into chaos or dictatorship.

These GDP per capita figures are not in purchasing power parity (though they satisfy the Big Mac standard, using a sample of 1, from my own consumption). The tropical conditions, and the easier options for leisure on a tropical beach, might improve well-being in a manner that should also be taken into account. Retirement is at age 60 though life expectancy at 60 is up to Western standards, see *Appendix P*.



The islands have an average temperature of 27-31 degrees Celsius in the daytime and 23-26 at night. The trade winds that blow continuously bring some coolness. Sea water temperature is 25-27 degrees all year round. When a hurricane hits Florida in the USA, it may draw away all wind on the islands so that the temperature rises to above 35 degrees

⁷ For the NA see www.cbs.an and for the other see CIA, “The world factbook”, website. Curiously, the CIA has \$11,400 for the NA.

Celsius, also taking away all coolness of the wind. The leeward islands (Curaçao and Bonaire, and Aruba) are outside of the hurricane zone but the windward islands (Sint Maarten, Saba and Sint Eustatius) are in the cone and may be hit. The rain season on Curaçao used to be in December and January but due to world climate change it may already start in October and continue into February.



The islands have a number of natural resources. Their deep bays provide natural harbours that are located between oil-consumers in the US and the Caribbean and oil-producer Venezuela without such harbours. World War II was in a large extent fought with gasoline produced by the refinery on Curaçao. Its location might make Curaçao a logistics hub for the region that exploits modern cheap sea transport. The sea provides fish but there are no developed fisheries yet. The sun would allow for tropical products and solar energy, and cold water from the deep sea is getting used for cooling. The sun and the beaches finally are attractive to tourists. A well-educated population that speaks four languages (English, Spanish, Dutch and Papiamentu) could reap those benefits.⁸ Natural resources are often a two-edged sword, where a river can for example be seen as a barrier to land-based traffic or as a means for transport by water. The Netherlands Antilles have ample resources to cause some thought how to make best use of them.



When discussing economic development and unemployment we should also be aware of culture. This is wider than just the work ethic. North Europeans tend to think sequentially ('first this then that') while South Europeans and other cultures may think more synchronically (not quite 'everything at the same time' but rather 'there is no time difference' and 'time is not relevant'). Related to that is the distinction between context-free and context-dependent thinking. A North-European may simply point to 'the' living room but a person from another culture would need a description of the street, the front yard, the house, the door and the hall, and other particulars to get down to that living room. There are legion cultural differences. These are confounded by psychological differences. For example differences in learning styles are both abstract versus concrete and active versus passive, with teachers generally the abstract & active types and probably most students the concrete & passive types. It will be clear that such cultural and related properties are relevant for understanding not only the relation between the Netherlands in Northern Europe and the Netherlands Antilles in the Caribbean, but also the scope for employment, e.g. when Dutch or multinational companies would invest in a country with not only cultural differences but also often still poorly educated and trained workers. Smallness of an islands economy adds to or confounds culture. Benedict (1967:48) mentions the difference between *particularism* and *universalism*. This can already exist in Western circles, where a person can be treated for 'who he is' rather than according to more objective criteria, but this may occur more on a smaller island where people meet in all kinds of contacts and relations, and thus have to integrate all those roles.

⁸ Papiamentu is a mixture of Portuguese, African languages, Spanish, Dutch and English. In his thesis for the University of Amsterdam, Martinus (1996), "Kiss of a slave", analyzes that Papiamentu originated on the coast of Africa and on the mid-way station of Cape Verde, as the lingua franca between Portuguese slave traders and their captives. Martinus is also known under his writer's name "Frank Martinus Arion".



The Caribbean is highly fragmented, with almost each island having its own history and social structure. “Their only unity is their diversity.” That fragmentation can be found even within the Netherlands Antilles themselves.⁹ The windward islands predominantly use English and are oriented on North America. The leeward islands predominantly use Papiamentu and are more influenced by Latin America. Most Arubans tend to have Indian blood and their version of Papiamentu (o not u) tends towards Spanish. Aruba has a climate less suitable for plantations, hence there were less slaves and hence there are fewer blacks now, and those blacks are mostly English speaking due to the migration from Sint Maarten when the oil industry boomed. Only Sint Maarten and Aruba have a well-developed tourist industry. Bonaire had a more tranquil history and a slow economy, and there may be more Bonairians on Curaçao and in Holland than remaining on the island. Curaçao’s Papiamentu (u not o) tends towards (Jewish) Portuguese.



My perception on Curaçao is strongly influenced both by Hoetink (1958) on the sociological structure of old Curaçao society and by the writings of former president Julius Nyerere (1967) of Tanzania on African culture. Nyerere aspired at a Christian socialism for Africa and explained that this ideology fitted African culture. Within an African village or tribe, there was no system of property rights but a council of elders or the family grandparents that allocated duties and resources. Individuals would have some liberty to use resources to their own advantage, and of course they took that liberty, but the elders would settle disputes. The tragedy of modern Africa is that this social structure was destroyed by colonial conquest, leaving many people in the habit and frame of mind that they could take whatever they need or want, but without the social check provided by some respected elders. Hoetink shows that this check was still provided during the system of slavery, though leaving the slaves in perpetual dependency. The old Curaçao society had the common structure of racist slavery but with some additional touches. The Dutch held administrative positions, were Protestants, tended to keep apart from slaves, and let them become Catholics. Portuguese traders were Jewish or Catholics, became socially important because of their wealth, and were easier in accepting slave off-spring as their own. Slaves who were granted their freedom before 1863 tended to settle on the east part of Curaçao where they provided in their living by trade, craft and agriculture. They tended to look down on the slaves who were liberated by the abolition of 1863, who had no resources and tended to stay around the plantations where they were forced to still offer their labour but now for low pay. Agriculture wasn’t much profitable in those days. Slavery took away one’s liberty, but religion and eventually the Napoleonic “Code Noir” also gave the slave owner some duties to support his people in times of hardship – which duties and social structure fell away when slavery was abolished. Antillian society still shows the legacy of these cultural roots. Much is like in Western nations but the numbers and ratios are different. On the one hand there are people who work hard – even in the tropical heat – and who can improvise with surprising results, and on the other hand there are people who shy away from initiative in order to avoid possible blame. In the whole world criticism is not welcome but here to a stronger degree both by the smallness of the community and by the collective memory that one might be

⁹ My view has not benefitted from Sluis (2004) (“The Antilles don’t exist”); the latter reads well and seems correct on small facts but is erroneous on the economics, rather demagogical in general and thus presents a not very useful picture of the Netherlands Antilles.

whipped. There is the almost Asian tendency to avoid saying “no” in order not to displease, but with some excuse later when it appears that the thing isn’t done. For some universalism may win out over particularism, giving rise to legalism. Referring to a rule or regulation reduces own responsibility, avoids criticism and social tension, creates a sense of personal safety. Antillians can be neat in person and personal outfit and at the same time allow the environment be all junk. On the one hand there is a great tolerance for being the person who you are but at the same time there are people who know scores of names and family relations, who tend to talk and gossip about these, and who thus reduce personal freedom. Small islands are also small villages. Since Hoetink’s 1958 book, Curaçao and the Netherlands Antilles of course have changed significantly. Information and computer technology, television, cd’s, dvd’s and the internet link the country to the rest of the world, students graduate at foreign universities and international companies bring on ever new contacts.



Since the creation of the Netherlands Antilles in 1954 the Antillian parliament has also enacted a series of social laws. The social structure that was formerly lost in Africa and in the abolition of slavery thus was restored to some extent in a systematic and modern fashion. This solved some major issues, making the country one of the success stories of development economics. But the social laws did not solve all problems and actually created some new ones. A major problem is a high permanent unemployment due to the high minimum wage and a wrong premium structure (this book).

8. The Caribbean

The population of the Caribbean is some 35 million people. They share a common geography of a mostly agreeable climate but with hurricanes and some volcanos, and a common history of colonial infighting of the European powers,¹⁰ sugar plantations and slavery, “benign neglect” since the abolition of slavery in 1863 and European sugar production, the Cold War and the war on drugs, and the recent rise of the tourism industry. The distances in the arc of islands are actually not too large so that, given the common geography and history, one would expect some scope for economic and some political unity. With 35 million people there thus are ample possibilities for a thriving economy with impressive music and art and architecture, great universities and Nobel prizes for medicine and marine biology.

Looking at the political map one however is struck by the fragmentation. These are not just small islands but island *states*, either independent or still with ties to the various former colonial powers. Oostindie & Verton (1998:21) estimate that 15% of those 35

¹⁰ Particularly interesting is W. & A. Durant (1967), who explain that during the Seven Years’ War 1756-63 England (William Pitt the Elder) let (Catholic) France and (Protestant) Prussia fight on the continent while itself went out into the world and took most of their colonies, thereby creating the British Empire. When France realized this, it tried to counter by supporting the American rebels, partly by secret shipments of arms via the Caribbean and e.g. St. Eustatius. All those expenses exhausted the state finances and helped create the conditions for the French Revolution in 1789.

million still have a direct link to Europe or the USA, for example Guadeloupe to France, the UK Virgin Islands to the UK, and the US Virgin Islands (formerly Danish) and Puerto Rico to the USA. The island of Sint Maarten provides the only common border between Holland and France (Saint Martin). The political fragmentation comes with different languages, currencies, systems of education, electrical currents, business practices and so on. Each unit gives a perk to the local power elite to do as they please with perhaps the major interest to hang on to that power.



There are two islands that require special mention, Cuba and Hispaniola. Jared Diamond's (2005:329) discussion of the island of Hispaniola with the two countries of Haiti and the Dominican Republic is an eye-opener. A picture from the sky shows the island split in two, with lush green tropical forest on the Dominican side and pale often barren eroded mountains on the Haitian side. The difference is all man-made. Diamond discusses the complex history of the island and its relation to the former colonial powers France and Spain. In recent times both countries were run by dictators, but Haitian "papa doc" and "baby doc" Duvalier cared only for themselves while Dominican Balaguer also cared for nature and the population. Haiti now counts some 10 million people, some 400 per square km, who may live like animals and scrounge around to cut down the remaining trees for fire wood or charcoal. A UN peace keeping force has landed to maintain some order. The Dominican Republic has 9 million people but on two-thirds of the island, thus at half a population density. Its forests provide agreeable living conditions, wildlife, hydro-electrical power, sustainable erosion, agriculture, exports, tourism, jobs. Dominicans complain about illegal immigrants from Haiti while economic resources are sucked away to maintain border controls.

Cuba wins the prize of Caribbean tragedy. We are reminded of it by the recent appeal by Vaclav Havel e.a. (2006) against the terror of Castro. Similar like the European powers fought about in colonial times, in the recent Cold War the US and the USSR turned Cuba into a bone of contention. Given the location and different cultural roots, Castro's communist coup might have ended eventually into a mere christian-socialist or social-democratic regime, without the occurrence of an iron curtain style of isolation. History however reads as a series of escalations ending with only losers. What is surprising is the tenacity of the US in the economic boycott of Cuba. Van Bergeijk (1990, 1991) convincingly shows that economic boycotts normally have adverse effects, since they tend to hit the general public while the power elite has sufficient means to circumvent the boycott. People who struggle for survival don't have the time and energy for opposition. An economic boycott thus strengthens the power elite while economic trade would enhance the position of the general public and reduce the power of the elite. Hence it would be wiser for the US to trade with Cuba. This would corrode the power of the Cuban communist party and eventually allow for a smoother transition to a free democracy. However, counter to economic wisdom and even after Gorbachev's perestroika, the fall of the Berlin Wall in 1989 and the demise of the USSR, the US still persists in its boycott of Cuba, while European nations duly follow that lead, also to avoid a confrontation with US warships. The only explanation that one can think of is some entrenched anger about Castro's involvement in the assassination of President Kennedy in 1963, where the Cuban dictator retaliated against attempts at his own person. Recent reports are that the US already knew in 1963 about this Cuban link but were unable to go public with it since the general indignation under the US population would have required some action against Cuba, bringing about a clash with the USSR and

possibly a global nuclear war. In this reading of history, the Warren Report is only a cover-up to prevent the loss of face that Castro could kill Kennedy and get away with it. It is either this, or a more mundane explanation of bureaucratic backlog in reacting to scientific economic advice and changing conditions.

9. Further fragmentation

The Statute that created the Netherlands Antilles in 1954 likely wasn't perfect. The Dutch intention was that the Netherlands Antilles would eventually become an independent nation. But no time table was set. Suriname, the other former Dutch colony in Latin America, 1000 km to the east of Curaçao, eventually became independent in 1975. The Antilles however never aspired at leaving the Kingdom. Instead, they looked for better a position within the Kingdom. Arubans said (it is hard to prove their view objectively) that they felt dominated by Curaçao and they started to opt for a Status Aparte – becoming a separate country within the Kingdom. Some political parties like the National Party and the Democratic Party had coverage on all islands but gradually lost out to island-specific parties, so that decisions in parliament started to run less along party lines and more along island-lines, so that tensions increased. Eventually the Netherlands accepted a Status Aparte for Aruba in 1986, provided that it would become a fully independent nation by 1996, which the Arubans accepted on their part. After this brave moment of opting for independence, Aruba actually rejected it in 1990 and remained in the Kingdom as a separate country instead of returning to the fold of the Netherlands Antilles. Sint Maarten, having lost a possible balancing partner within the Netherlands Antilles, now started to say (it is hard to prove their view objectively) too that it felt dominated by Curaçao. The change of heart and opinion was gradual. A referendum in 1993-1994 showed 59.4% on Sint Maarten and 73.6% on Curaçao in favor of maintaining the Netherlands Antilles. Oostindie and Verton (1998) did an opinion poll among a sample of about 2500 Antillians and Arubans which however showed only 40.9% on Sint Maarten and 66.6% on Curaçao still in favor. On Sint Maarten 47.6% favoured the Status Aparte. By 2006 in gradual steps all islands now seem to accept the splitting up of the Netherlands Antilles in two countries Curaçao and Sint Maarten, and three remainders as “Kingdom islands”, a concept that still has to be worked out.



The information that was used in this process of fragmentation appears to have been less accurate. The Dutch-Antillian Commission Jesurun (2004:6) stated:

“There is a wide dissatisfaction about the state structure of the Netherlands Antilles. Popular support for it has almost disappeared. The double governmental layers in addition hinder an effective solution of the social questions such as poverty, crime, economic development and sound fiscal policy.”¹¹

¹¹ “Er bestaat grote ontevredenheid over het staatsverband van de Nederlandse Antillen. Het draagvlak daarvoor is nagenoeg verdwenen. De dubbele bestuurslaag belemmert bovendien een effectieve oplossing van maatschappelijke vraagstukken zoals armoedebestrijding, onveiligheid, economische ontwikkeling en beheersing van de openbare financiën.”

That term “double layer” refers to the Island Governments and the Central Government, the latter with its council of ministers and parliament. The Jesurun view however has been criticized by Boersema (2005:93-95):

“The report of the Commission Jesurun pleads for the abolition of the double governmental layers in the Antilles, because these would frustrate good government and would be too expensive. Nothing is less true. Only the selfish use of power by politicians has made that double layer impossible, by frustrating its proper functioning.”¹²

It has been observed above that the Netherlands Antilles are an economic success story with respect to the region. One thus can doubt the broad statement by the Commission. If, and wherever, there would be ‘a wasteful duplication of tasks’ then one should resolve that waste, and when processes are ‘prohibitively expensive’ then one should look for cost-effective approaches. The Commission however does neither. Given the evidence, the generalization by the Commission does not seem warranted.

It may be remarked that Holland, following its 19th century political leader Thorbecke, has three governmental layers, city, province and state. The same rule of subsidiarity is now used at the European level. The small scale of the islands should not be confused with the difference in function. That latter difference in function contributes to the checks and balances in a modern democracy. It is more effective that the different islands control each other, who are more familiar with each other’s economies and cultures. When there is a single island majority that holds key to all functions of government then there is more risk of a power elite, nepotism, friends in high places, soft treatment of friends, cover ups, corruption, and neglect of the powerless and the poor. A so-called ‘control’ by a distant bureaucracy in Holland is a worse option.

One point in this book is that it shows that the Netherlands Antilles could achieve “an effective solution of the social questions such as poverty, crime, economic development and sound fiscal policy” (the criteria of the Commission Jesurun) precisely within the structure of the Antilles itself. The Commission Jesurun didn’t prove its statement, and it is actually false.

The idea to split up actually goes against the basic sentiments of the Antillians, so that the decision to do so would find its base only in the misguided analysis. On the website of the Island Government of Curaçao one still could read in 2005:

“Independence is a regular topic of discussion but in a referendum in 1993 74% of the electorate of Curaçao voted to maintain the status quo, so that the five islands stay together and the ties with the Netherlands remain. The other four islands had a similar result of their referenda. Despite differences in language and culture, people of the Netherlands Antilles clearly feel a strong connection with each other.”¹³

¹² “Het rapport van de Commissie Jesurun pleit voor het opheffen van de dubbele bestuurslaag in de Antillen, omdat die goed bestuur zou frustreren en te duur zou zijn. Niets is minder waar. Slechts de eigenmacht van politici heeft de dubbele bestuurslaag onmogelijk gemaakt, door de werking ervan te frustreren.”

¹³ “Onafhankelijkheid is geregeld onderwerp van discussie, maar bij een referendum in 1993 sprak 74% van de Curaçaose stemgerechtigden zich uit voor behoud van de status quo, zodat de vijf eilanden bij elkaar blijven en de banden met Nederland gehandhaafd blijven. De overige vier eilanden hadden een soortgelijke referendum uitkomst. Ondanks verschillen in

The same sentiment and painful change of heart (though based upon wrong information) from a preference for national unity to a reluctant acceptance of the political reality of a split-up can be found in the autobiographical collection “Mi a purba” of Lionel Capriles, the former director of Maduro Curiel Bank.

It may be mentioned that the composition of the Commission Jesurun doesn’t convince. The Antillian members appear to be stakeholders of the governing elite that hasn’t solved those social problems and that have an interest in covering up their failure by blaming some vague “double governmental layers”. The Dutch members are (1) Mr Dr G.D. Dales, mayor of Leeuwarden, (2) P. Rosenmöller, former Member of Parliament for a small Green party, (3) Drs J.C. Blankert, former chairman of the union of employers VNO-NCW. These Dutch members are not known for their experience and research in issues of government and democracy. Neither do they know much about “an effective solution of the social questions such as poverty, crime, economic development and sound fiscal policy”. They definitely are members of the Dutch “polder model” who meet each other in meeting after meeting in different locations and set ups. They are likely to think that they know everything since they know everybody.

The report by the Commission Jesurun, and the publicity about it, however helped in the momentum towards splitting up the Netherlands Antilles.



A referendum on Curaçao on April 8 2005 gave these results, both in absolute numbers of voters and the percentage per option:

42425 = 68% Option A: Autonomous country within the Kingdom of the Netherlands (Status Aparte)

3014 = 5% Option B: Total independence

2342 = 4% Option C: Continuation of the existing Netherlands Antilles

14769 = 24% Option D: Province of the Netherlands

Invalid 474 votes. Total turnout 55.04 %.

A referendum has no legal status. Therefor, after the results were in, political parties embraced these results as their own choice, and the general conclusion was that a two-thirds majority of Curaçao chose for the Status Aparte and the abolition of the Netherlands Antilles.

What is important to see is that 68% for option A may seem like a two-thirds majority but that a turnout of 55% times 68% in actuality only means a minority of 37% of the total populace. Thus 63% of the population wants something else or had a reason not to vote. Thus there is no real majority on Curaçao to abolish the Netherlands Antilles and there are only politicians who interpret that result in that manner. A sad conclusion is that the concept of “democracy” is weakly developed on the Netherlands Antilles.

A similar sad conclusion holds true for the Netherlands as well since none of the Dutch political leaders or major political commentators mentioned the point. A factor may be that the latter don’t really mind how political parties in the Netherlands Antilles arrive at

taal en cultuur voelen mensen van de Nederlandse Antillen duidelijk een sterke verbondenheid met elkaar.” <http://www.curacao-gov.an/> under the head “Curaçao N.A.”, December 16 2005

their decisions. Predominantly, though, Dutch political leaders and major political commentators already had difficulty understanding the EU referendum on the EU constitution in that same period, see Cool (2005).



It is useful to observe the following points from the theory of voting for democracy:¹⁴

- (1) When there are more than two options then it is advisable to use rank orders and to select the Borda Fixed Point. The reason is that an option can still collect preference points e.g. when it is ranked as second best with some frequency. For the Curaçao referendum this does not seem to be the major issue since there is such a high vote for option A; the major issue here is the low voter turn-out. However, when the method of voting is deficient to start with then the result is dubious too, if only since the method affects voting behaviour. This holds especially when there is scope for confusion, e.g. when option C might be combined with other options perhaps not mentioned (e.g. independence for Curaçao or for the Netherlands Antilles).
- (2) The majority should be absolute. Thus *turn-out times the score* should be at least 50%. Taking merely 50% of the turn-out requires special considerations. It is not sufficient to always assume that the non-showers are merely indifferent. It is even worse to take only the highest score (for example a 40% score when all other scores are lower).
- (3) For constitutional changes, a more common rule is that one requires 66,7% of the total electorate (and not 37%) to be in favour.
- (4) A major issue in democracy is the protection of minority rights. As a first step in a vote people should have the opportunity to veto proposals that infringe upon their rights. Like a proposal to run a train in someone's back garden. This is the Pareto rule that only those options are considered that are an improvement for someone without negatively affecting someone else. The Pareto rule may result into a deadlock when there are more options to consider, with no criterion to select which is best. Majority voting then is a tie-breaking rule for Pareto-improving points.

When voting is done in this manner then a majority cannot impose its will on a minority. If the majority wants to convince a minority then that majority must look for compensations so that the minority drops its veto. In a parliament with two chambers (e.g. a congress and a senate) a major function of the senate is to check that a minority does not abuse its veto rights.



In this case of the Curaçao referendum it requires some consideration whether minority rights are seriously affected. E.g. by becoming a province of the Netherlands, a minority would give up all rights of independence and this might be felt as a fundamental right. Mutatis mutandis for the other options. Perhaps it is fair however that the options are put up for a vote as they are, without first allowing a veto round. In cases like these voters also have the option to vote with their feet. Already 130,000 Antillians and Arubans voted for a situation like a province by migrating to the Netherlands. One might hold that the vote is biased in that respect since their vote was not counted.

¹⁴ See also Colignatus (2001) and Colignatus & Hulst (2003)

10. The “enigma” of Dutch indifference

The situation around the Netherlands Antilles reminds of a passage in the book “The enigma of Japanese power” by Karel van Wolferen (1990). He asks Japanese whether they feel responsible for the war in Manchuria that Japan started in the 1930s. The answer is “no”. It is not merely that this in the Japanese mind would concern merely a historical episode in the distant past. The interviewed Japanese appear to be of the opinion that some generals took control over the army and started that war by their very own initiative. Thus not Japan as a whole or as an entity but just that small group that took power. For Westerners it is difficult to understand Japanese in this way. This concerns a war and not a trifle that may be subject to personal whim. Westerners might reject responsibility by referring to a different period and saying “that is history” but they would still use the concept of national unity and they would think in terms of “the government” or “the nation”. It appears that Japanese are more inclined to accept the chaos in life and the flux of power and power relations.

The latter is a way to describe the situation of the Netherlands Antilles. In this respect, the Dutch behave as Japanese. The average Dutch person doesn’t care much about these distant islands and does not see them as an issue of national concern. The islands are sufficiently developed, don’t need development assistance and should become independent as soon as possible. Case closed. In the average Dutch mind there are only a few politicians and some bureaucrats who have the fringe benefit of flying to the tropics once in while, to stay in luxurious hotels, distribute funds and get their picture on television or in the newspapers when hands are shaken.



Recently, the Antilles became a bit more interesting to the average Dutch person because of the high crime rate of Antillians in Holland. Drug transports, e.g. with cocaine pellets from Columbia carried by Antillians in their stomachs and intestines, and the crime related to drugs became a problem. Added to the basic indifference, the reaction of the average Dutch person is to cut off all ties as soon as possible.



The average Dutch politician does not think much differently from the average Dutch person on these issues. However, there are *some* politicians and government officials who express their desire to solve these issues. They don’t grab power but get appointed. Their number is small and their effectiveness is limited. They won’t conquer Manchuria but they can mess around a little bit with some tropical islands.

On these grounds it is doubtful that when the Antilles would split up that Holland would be capable of taking over the role of external controller. Perhaps some officials will have some legal tasks in that respect, but that is only printed on paper and in fact it merely means there will be some return to pre-colonial times with some officials in Holland dealing ineffectively with distant issues. Given the basic lack of parliamentary and popular interest it thus must be doubted that Holland could provide the role of democratic checks and balances on what happens on the split-up Netherlands Antilles.



Nevertheless, precisely those politicians and government officials, who express their desire to solve these issues, are the ones who insist on more Dutch control as a condition for Dutch support for splitting up the Netherlands Antilles. Thus, precisely those politicians and government officials who express their desire to solve these issues would be willing to make matters worse by allowing a split-up of the Netherlands Antilles, and subsequently they pave the way by demanding conditions that Holland itself will not and cannot maintain. It is plain magic. The great advantage of this approach is that those politicians and government officials who express their desire to solve these issues at least can show tough determination and present themselves as the ones who know about these issues and who will solve them if given some trust and freedom to do so – in that manner perhaps creating a barrier for real parliamentary involvement.



They also add a price tag. The Netherlands would have to take over perhaps 30% or 50% or 100% of the national debt of the Netherlands Antilles “to allow the new countries to make a fresh start”. Taking over debt might make some sense if indeed the Statute caused all these problems and if indeed the “double governmental layers” were the root cause. But if the analysis is different, if these so-called experts apparently don’t know what they are talking about, if the money only serves political silence and stability on the international forum where a former colonial power can be accused easily of being “neo-colonial”, then one might have second thoughts.



The Netherlands Antilles haven’t been served by the wisest of Dutch ministers of Antillian Affairs, Gijs de Vries (now the EU “czar on terrorism”) 1998-2002, Thom de Graaf 2003-2005, Alexander Pechtold 2005-2006, currently Atzo Nicolai.

When prime minister Miguel Pourier of the Netherlands Antilles started an IMF guided austerity programme, he did so with the promise of financial support by Dutch minister Gijs de Vries – but that support never came.¹⁵ The next elections on Curaçao were lost to the demagogue FOL party led by a person who at this moment serves time in jail because of corruption. Thus the Netherlands Antilles suffered from a period of austerity measures without compensation – so that there was an economic downturn and a wave of emigration to the Netherlands – and a subsequent period of a bad management on top. One might conjecture that the Antillians should be wiser, thus not blame Pourier for the failure of De Vries to back up his promise, and not subsequently elect a demagogue; yet political reality is such, and one might require De Vries to know that too.

The next Dutch minister of Antillian Affairs was Thom de Graaf. He also was the leader of a small party, 6 seats in a parliament of 150, and his prime interest was the survival of his party by getting some proposals accepted on referenda and the elections of mayors. Holland has no legal role for referenda, which is wise given the theory of voting for democracy, as discussed above. It suffices namely that parliament represents the people and can balance all issues. Holland neither has elected mayors but appoints those, which is also wise given the theory of voting for democracy, as discussed above. It is better that people vote for parties which then can arrive at a balanced selection of prime ministers and mayors. Mayors in Holland are supposed to be above party politics and to be neutral chairpersons of the council of aldermen. De Graaf and his party however are rather

¹⁵ See Schoots (1999) and BZK (2000)

American and want referenda that decide issues and elected mayors that run cities. Their ideology is that these electoral rules would improve democracy, regardless of the contrary facts from American practice and regardless of the theory of voting for democracy, as discussed above. Given De Graaf's ideological bent, he of course couldn't be critical of the referendum on Curaçao in 2005 and he helped support the momentum for the splitting up of the Netherlands Antilles. Subsequently, his proposal for elected mayors was unrealistic for the Dutch setting, and the leader of his fraction in parliament Boris Dittrich actually helped to undermine his position so that he resigned on March 23 2005. De Graaf is a more agreeable person than De Vries, and he still is widely respected in the Netherlands Antilles and he still shows up at official occasions, but in fact he hasn't done much there, has been rather ineffective, and actually furthered the momentum for the splitting up which may be seen as a negative development.

De Graaf's successor was Alexander Pechtold, of the same party. He had studied history of art and archeology, worked as an art auctioneer, became alderman in 1997, was appointed as a mayor which he very likely would never become if there would be elections, and he left his city to take over De Graaf's ministry. Pechtold managed to become highly unpopular on the Netherlands Antilles, made vague promises such as that Holland would give a "substantial contribution" to the reduction of the national debt, but in fact he hasn't done much there, has been rather ineffective, and actually furthered the momentum for the splitting up. On June 29 2006 Pechtold and his two party colleagues in the cabinet stepped down on an affair relating to Ayaan Hirshi Ali, so that he was only 15 months in office.

With elections coming up on November 22 2006, the interim minister is Atzo Nicolai, the former secretary for European Affairs. Nicolai also was responsible for this cabinet's position on the Referendum on the EU Constitution in 2005. The information that the government gave about that draft constitution was highly misleading, see Cool (2005). It is a great blessing for mankind that the people of Holland and France still managed to reject that draft. Currently, Nicolai seems very busy to arrange all kinds of issues to split up the Netherlands Antilles, so that this could be decided upon either before the November 22 2006 elections or in the subsequent talks on the new coalition. In both cases, the role for parliament would be limited. Sometimes in politics one meets people who don't think much for themselves and who only want the job done.

Had these political leaders studied more on the subject they might have stumbled upon one of Reid's (1974:47) "Hypothesis 3.3.3. Where domestic opportunities appear to be limited, the decision maker will give disproportionate attention to foreign policy issues."

11. The future of the Caribbean

The future of the Caribbean is a difficult subject to consider. Each island seems unique and often its history is unique. Michener (1990), the romantic writer, has tried to paint the kaleidoscope. Ferguson (1996) is more factual and for example contrasts British Barbados with French Martinique. Yet the differences need not be exaggerated. Europe has also various cultures, even within each country, and even a small country as Holland has a great variety of cultures and dialects amongst its provinces and even within its provinces. For the Caribbean there is also the common history of slavery and colonial rule under the various European powers while there are the beckoning benefits of a

possible common future. As the Europeans unite, perhaps their former colonies might consider that too. It may be noted that it is advisable for European unity that the EU extends with Russia and Turkey, forming a commonwealth rather than a nation like the US. This same idea of limited but effective co-operation would hold for the Caribbean.



The European Union tries to co-ordinate the ties of its member states with their distant territories. The former colonies are offered the choice between the status of *Overseas countries and territories* (OCT) or *outermost regions* (OMR), where the first is similar to a “most favoured nation” trading partner and the latter effectively means integration within the EU. It is not clear what this policy is based upon, except historical inertia.

Maintaining close relations with distant Caribbean islands, to the extent of offering special conditions to some islands and even fully integrating some other islands into the EU blocks their possible co-operation within a Caribbean commonwealth, and reduces the scope for success of such a commonwealth.

Also, the war on the Falklands between the United Kingdom and Argentina, with Argentina using French exocet rockets from a former Dutch airlift carrier, reminded the world of the dangers of imperial overstretch. It is not that a war in the Caribbean is imminent but there are clearly concerns like with Haiti, Cuba and the general war on drugs and its related crime. Remember the risks of global warming, the rise of world population to 8 billion people by 2025 and the risk of a global collapse. Maintaining close relations with distant Caribbean islands increases the policy problems of the EU where these problems rather belong to the Caribbean or the United Nations.

It is often mentioned that an advantage of a EU foothold in the Caribbean is the smoother trade with Latin America. That continent provides minerals, oil, products from agriculture and forestry, and various products of cheap labour. The Caribbean with its mixed culture and command of languages would provide a intermediate role in logistics to support this trade. This argument is of doubtful value. Countries in the EU and in Latin America are quite capable of maintaining their trade relations. This argument of trade relations rather reminds of the history of triangular trade – glass beads going to Africa, slaves going to the West, and sugar going back to Europe – and little more.



Caribbean islands with links to the EU or the USA generally do better economically. The link generally provides for a democratic structure and political stability. There is an inflow of funds, either as government transfer or as foreign direct investment due to that stability and system of justice. The population may also be more internationally oriented than independent islands economies left to themselves. Opinion polls consistently show that the populations of such linked island economies prefer to keep the link with the former colonial power, see Oostindie & Verton (1998:22). The analogy comes to mind of the youngster who doesn’t want to leave the parental home.



Considerations like these cause one to also consider the option to unilaterally cut the ties with the distant territories. Do EU countries or the EU itself however have the right to that unilateral act? There is the issue of minority rights. Do the voters in Guadeloupe or the UK Virgin Islands have the right to veto any infringement upon their passport? If those distant territories are left to themselves, how would they pay for the sudden cost of

military defence ? And would a unilateral change not cause political instability and possibly violence, for example when Venezuela would step into the power void and annex Aruba, Bonaire and Curaçao ?

All these issues seem manageable. The right of self-determination of a nation also includes the right of a former colonial power to disengage itself from a former colony once that colony has reached a degree of self-sufficiency. The transition can be planned and gradual, and partly be bargained.



In itself, when Venezuela would annex those leeward islands, one wonders what would be problematic about that. Venezuela is a big and beautiful country, a relatively rich oil producer, its people are perhaps friendlier than the Dutch, they speak Spanish, which is a first class world language, and various of its women have won beauty contests. On these considerations perhaps all countries could benefit from joining up with Venezuela. Yet, that is not the argument, only that those leeward islands might benefit from such a union when financial and military support from Holland runs out. One could imagine a 10 year transition period to do so. Yet when those leeward islands don't prefer to join up with Venezuela then they might consider the other options.



Formation of a “United States of the Caribbean” is less feasible since most independent states are naturally hesitant to give up their independence. The best option is a Caribbean Union modelled after the EU so that independent states feel safe to join up. This however runs into the problem that most EU territories in the Caribbean are not autonomous states. The French *Départements d’Outre Mer* and the British *Dependent Territories* are still governed from Paris and London. Hence one would get the strange construct that France and the UK would become members of such a Caribbean Union as well.



Interestingly though, precisely given that Paris and London still have that decision power means that there is scope for unilateral action. The EU might consider this scheme:

- (1) The Kingdom of the Netherlands, France and the UK form the kernel of a Caribbean Union modelled after the EU. Once that Union is founded, the French *Départements d’Outre Mer* and the British *Dependent Territories* are transformed into one or more independent states that by charter belong to that Caribbean Union. These decisions can be taken unilaterally by Paris and London. Similarly the Netherlands Antilles and Aruba become independent states, no longer part of the Kingdom of the Netherlands, and will belong by charter to that Caribbean Union. For those states the transformation depends upon a bargaining process, with in the background a possible unilateral secession by Holland from the Kingdom of the Netherlands.¹⁶ With the independence of these states and their participation in the Caribbean Union, the Kingdom of the Netherlands (cq. Holland), France and the UK leave that Union, as can be established by the foundation charter.

¹⁶ The Dutch thus could leave Queen Beatrix with the Netherlands Antilles and Aruba, and then create a “New Kingdom” with the current Prince of Orange. However there is a small republican movement in Holland that might take advantage of such a change. The Prince of Orange might be elected as a first president of such a republic.

- (2) Given geography, the capital of that Caribbean Union can be on Sint Maarten (N) and Saint Martin (F) and Anguilla (UK).
- (3) On request, the Caribbean Union can provide more centralized decision making than the EU, to serve its member states. For example, it could harmonize educational standards for member states that request so, without the need for other or prospective members to adopt those same standards. The possibility of such centralized decision making would be particularly useful for the (new) founding state(s) to replace the co-ordination by their former EU partners.¹⁷
- (4) With agreement by the Caribbean Union, member states could reorganize their state structure provided that all territories remain part of the Union. For that reason the Caribbean Union might also contain “dependent territories”, with the head of state provided by the president of the Caribbean Union.¹⁸
- (5) The EU cuts off links with that Caribbean Union. Use a few years for links such as passports and use a gradual transition period of some 10 years to cut off support for the democratic process and national defence.
- (6) The funds saved are set aside as a bonus fund for other independent islands economies who decide to join up with that Caribbean Union.
- (7) Caricom now has 15 members and 5 associate members, but not the Netherlands Antilles and Guadelope. The Caribbean Union would be a member of Caricom, and could form a core within Caricom of countries that are in closer co-operation.
- (8) Set up talks with the US and its territories to join up, where the US might make available similar funds to stimulate the creation of such a Caribbean Union.

One realizes that some Gordian knots are cut here. But looking at the result, it can work. The crucial point is that states are essentially free to join or not, and the only thing that is done is that conditions are facilitated so that they get that option. The history of decolonization since World War II shows that these distant islands economies cling on to a big entity – and with no agreeable big entity available in the neighbourhood they select their former colonial power. The solution is to create something (a) big, (b) in the neighbourhood, (c) agreeable. Nothing should stop Holland from bringing up this option with France and the United Kingdom.¹⁹ It might be wise to include the US in the talks at an early moment. A tentative option is to make Haiti a protectorate of the Union. It was the first country with colonial slavery to gain independence. Such an experiment is not necessarily a success and the world might better admit a clear failure.

¹⁷ The same effect might be reached by simple treaties between states. However, the advantage of requesting centralized decision making is that the CU also gets the role of arbiter, cutting knots, such that participating member states accept some loss for the greater benefit of more uniformity. Also, having various treaties between various states would create a forest of differences, difficult to oversee. Having a central register of centralized decisions helps to keep things manageable.

¹⁸ For example, if the island of Sint Maarten aspires at a Status Aparte, away from the influence of Curaçao, the CU might accept it either as an autonomous member or consider it too small so that it may become one of the Dependent Territories. A similar thing might happen with Saint Martin, so that the CU might gradually integrate those two territories. These are issues that can best be settled in the Caribbean, not in the EU.

¹⁹ After completing this analysis I checked the internet and found that Oostindie & Klinker (2003) already renewed the discussion on regional integration. See also Jan Pronk (2004).

III. Explanatory expositions taken from DRGTPE

(Whole chapter taken “as is” from DRGTPE.)

In March / April 1996 I put two presentations for the general public in the Economics Working Papers archive at the Washington University at St. Louis. In August 1998 there was a third paper.²⁰ These papers are directed to a general audience, and to teachers and students. Since this current book basically addresses economists and uses quantitative methods, I doubted whether I should include these texts here, also since there is some overlap that can be distracting. There however are two good arguments to include them with little adaptation: (i) Once a fellow economist is starting to grow convinced of the value of my analysis, then he or she will face the same problem of explaining it to others. These texts then can be of use. (ii) The historical date of these texts underlines the co-ordination problem. Even when a good summary was available, and even when the moral imperative facing Western nations was clearly formulated, our failing systems of economic policy making limped along, and caused misery upon misery for many of its citizens.

12. Unemployment solved !

A breakthrough in economic theory

Since the early 1970s Western economies have been plagued by mass unemployment and the threat of inflation. Over the years since then various economists have proposed various possible solutions, but never quite convincing ones. Now there is a novel analysis that means a breakthrough in economic theory. The present author is quite certain that the “missing link in the model” has been found. If true, this analysis offers guidelines for full employment under price stability, just as Western economies enjoyed in the 1950s. The main point is: don’t tax lowly productive labour. Why ? To keep it competitive so that more productive labour will not demand inflationary pay rises. Though this new analysis is only in the stage of presentation and introduction at the scientific fora, there is no reason to withhold the present rough sketch for a general public.

It is well-recognised these years that Western economies have a problem with jobs with a low level of productivity and thus a low level of market-earned income. The United States tolerate more poverty - the working poor - while Europe sets its minimum wage much higher so that Europe has more unemployment.

This problem with low productivity jobs finds various explanations, notably those of technology, globalisation, and inflexibility - the latter ornate for “welfare state sclerosis”. Policies based on these latter explanations have been enacted for some time now. For

²⁰ In general <http://econwpa.wustl.edu>. More specifically Colignatus (1996a, c) at <http://econwpa.wustl.edu/months/get/9604.html>, and Colignatus (1998a) at <http://wueconb.wustl.edu/eprints/get/papers/9808/9808002.abs>

quite some time, in fact; while little is being achieved. It is proper that we pose the question: why is it that we don't achieve much ?

Unemployment obviously has a much longer history than the current problem. Also, the Western track record on unemployment can only be understood when the record on inflation is taken into account too. Economic science has much to say on the complex relationship between inflation and unemployment. Now, we are forced to be brief here. We will concentrate on what is new and on why it is new.

We set out with the empirical evidence since 1950. This track record can be divided in meaningful decades:

- The 1950s had low unemployment and low inflation.
- The 1960s had the threat of unemployment, and governments accommodating inflation in order to actually prevent it.
- The 1970s nevertheless had mass unemployment bursting into the open, and governments accommodating high and accelerating inflation to battle it.
- The 1980s-till-now had governments come down hard on inflation, and accepting high levels of unemployment as the price for stability.

One sees a certain “trade-off” between unemployment and inflation. From the 1950s till the end of the 1980s the common view among economists and policy makers was that the unemployment in the trade-off was “general” unemployment. Nowadays we tend to link unemployment to lowly productive labour. For us it may be obvious, but compared to the earlier view it is revolutionary that the once-thought-to-be “general” unemployment now turns up as a rather specific type. To make the revolution specific: we will hold that the unemployment in the trade-off has *always* been related to the distribution of productivity across labour.

The crucial insight is that the people who can demand pay rises need not be the people who run the risk of unemployment thereof. High productivity workers run less risk of unemployment and can more easily demand pay rises, while low productivity workers run the larger risk of unemployment. High productivity workers are more versatile and are able to shift the risk of unemployment to the lower income groups. When jobs are scarce, the high productivity workers even crowd out others from the labour market.

Now obviously, when this is new, then it has not been recognised before, and then it has likely been missing in policy. And policy that was based on a wrong analysis, is likely to have been the cause of the very problem that it wanted to solve.

Let us see how it went wrong. Regard the legal minimum wage and note that people are not allowed to work below that minimum. Note too that there *hence* will be no earnings that can be taxed in that range. We can call this range the “tax void” or “tax vacuum”. However, tax statutes are defined in that range anyhow. Tax statutes in that void are actually used to define the gross minimum wage. In Europe, the high gross wage will cause unemployment and its related benefit burden. In the US, the void is reduced a bit by accepting poverty. In common economic terms: tax policy and social-economic policy are badly co-ordinated.

How this has come about is a story of a more technical nature. First note that OECD countries adjust their taxes for inflation. Tax exemption in 1996 will often be close to the inflation-adjusted real value of 1950. On the other hand, research in social psychology

shows that subsistence tends to rise with the general level of income, the growth of which consists of inflation and real growth. So there is “differential indexation”. In the 1950s exemption was pretty close to subsistence, so that there was no void to speak of. Since then, exemption has lagged behind the standard of living. The inflation-adjusted subsistence of 1950 may be only a third of 1996 subsistence. When tax exemption lags behind net subsistence, then there is a multiplier effect on gross subsistence, with a fast increase of the tax void.

The alternative and new policy would be to scratch taxes in that void and to allow people to earn their own - decent and untaxed - living. This alternative policy reminds of an old rule. The Dutch economist Cohen Stuart proposed in 1889 to put tax exemption at the level of subsistence. To drive the point home he drafted the following analogy: “A bridge must [bear] its own weight before it can carry a load.” In 1996 there is the additional argument that abolishing void taxes will not cost anything, and that nations will save benefit payments due to more employment.

More employment.... Does that not fuel inflation ? The pieces of the puzzle fall into their places when the tax void is related to the unemployment & inflation problem. The steady rise of the void explains the track record of unemployment and inflation. The 1950s have been characterized by relatively low taxes on low income earners, and this allowed for full employment and low inflation. From the 1960s onwards the lagging tax exemption started causing problems with unemployment. The tax policy since at least 1965 enhanced the imbalance of the internal bargaining positions of labour instead of counterbalancing it. Hence inflation was persistent, and high levels of unemployment were required to achieve price stability.

How governments reacted depended upon the view of the day. Since the proper solution was not known, the problem did not go away. The differential indexation of tax exemption and the social minimum did not draw attention to itself. Each year adds only a slight gap which is hard to see. But over the years the gap has accumulated, and with huge consequences. And the problem will remain with us in the future unless policy changes.

Current policy is based upon other explanations. Notably those of technology, globalisation and flexibility. The ineffectiveness of current policy can be explained by the fact that these views are not entirely logical. The arguments of technology, globalisation and flexibility run up against contradictions. Technology is a source of wealth, and it boosts the productivity of the lowly productive jobs, making the problem of poverty and unemployment less serious than it would otherwise have been. “Globalisation” is a scare word for “trade”. Trade however is another source of wealth, and it too has been with us for ages. Rising wealth in distant countries means rising wages over there, and trade itself thus puts limits to foreign competition. Japan over the last 40 years is a prime example of this phenomenon, but every rich nation has had the same experience. Finally the “flexibility” or “welfare state sclerosis” argument can only explain that the US has poverty and Europe unemployment, but it does not explain that there is a problem with low productivity jobs in the first place.

The present situation bears another surprise. We diagnose current unemployment as inefficient. Be sure that you see what inefficiency means: it means that there is a solution that is beneficial to some and that does not hurt others. Having a bright idea always means a “win-win” situation or a free lunch. In this case it is the move to full employment under price stability. The present unemployed will find jobs. The higher

productivity group will have a theoretically larger risk of unemployment, but in practice this risk will be modest as in the 1950s. Their real gain will come from the services that will be provided by the jobs of the present unemployed.

Policy makers will be hesitant about an overhaul of the tax system. Note, then, that the tax system defines our notion of a subsidy. A wrongly levied tax, in this case the tax void, can be compensated for by a wage cost subsidy. Abolishing the tax void is more sensible in the long run, but when this can only be done gradually, then some general subsidy directed at lowly productive jobs would speed up short term adjustment. If only those subsidies are reduced when tax exemption rises towards subsistence.

This was it, in a nutshell. Now I beg your understanding. My analysis is more complex than can be stated in these few lines. Both tax policy and social policy are quite complex themselves, and this certainly holds for their interaction with inflation and unemployment. For example, you may ask why I haven't discussed income redistribution effects. Actually, this is because the alternative policy could be neutral to the income distribution. The reason for this is that the analysis focusses only on the link between wage costs and productivity. But you might want to hear more about this. Also, you might ask whether above explanation covers all possible cases of unemployment and inflation. Of course it doesn't. The analysis does help to clarify that other types of unemployment need other types of policy, such as education and so on. But you might want to hear more on that too. These are just examples of issues, and there are many more issues that need to be dealt with. Which space forbids. However, given that my model amends existing economic models, much of the required explaining is 'common economics'.

There remains one major point. That tax exemption is low, is defended by OECD governments with the argument that it keeps marginal rates down. And the attractiveness of low marginal rates is that they spur economic activity. My finding however is that the latter claim is only true when the marginal rate has been defined properly. Thus I agree with the claim, but it must concern the proper marginal tax rate. There is a difference between the proper rate, which is dynamic, and the rate used by OECD governments, which is the static and statutory rate. Dynamic analysis shows that the proper marginal rate will be close to the average rate. This part of my analysis is important for economic growth. Having less unemployment will mean lower average taxes, and thus lower proper marginal rates, and thus more incentives for sustainable growth. For many of my fellow economists it is this part of my analysis that will come as the greatest surprise of all. However, this is not an issue that can be settled in this review, and here I definitively have to refer to my extensive analysis.

This novel explanation is in the tradition of Keynes and Tinbergen while it fits in with mainstream economics. When my fellow economist check and confirm these findings, our economies are likely to enter into a new high growth path with full employment and low inflation.

Allow me to add the personal note that I am overjoyed by these findings.

(March 1996)

13. Enable Russia to help itself

World developments in the 1990s show a worrystime parallel to the 1930s with the Great Depression. Present-day Russia reminds of the pre-war Weimar republic, where a devastated economy and weak democracy allowed Hitler to take power. Western nations in the 1990s hinder trade with Russia and the Eastern nations for fear of unemployment at home, as they did in the 1930s with Germany. If trade were stimulated instead of hindered, Russia could regain economic and political stability by itself. The moral problem is not external and does not concern whether Russia would need financial aid. The moral problem is internal, and concerns whether Western political leaders are willing to face their own errors that cause the present mass unemployment at home.

Russia is shrouded in a veil of doom. A nation once proud about its achievements, is now, as so many feel, humiliated in the face of history. A loss of empire, a collapse of economic security, some coup attempts in both Kremlin and Duma, a rising reign of violence by a mafia in the main cities and by full-blown fighting at the geographical fringes, and a political arena that smells more of fear than of confidence. Like the Weimar republic in pre-war Germany, Russia has been subjected to the rules of chaos, and yet again the odds are risky - and risky for the world at large.

Something needs to be done. Something smart, something humane, something effective and efficient, and something courageous. Therefore, something which is not likely to happen quickly. However, there is one single possibility that is very much worth of our attention. It is something what we actually could do. And what - given the risks of this moment - we should do

It is *trade* that will help Russia and the Eastern nations to recapture economic security and thereby regain political stability. And, since it is our fear of unemployment that motivates us to block that trade, Western nations should tackle unemployment at home directly.

Parallel

Our comparison of present-day Russia with pre-war Germany is no coincidence. World developments in the 1990s show a worrystime parallel to the 1930s. The 1930s suffered from the Great Depression. In the 1990s the world is again plagued by mass unemployment. Again there is a major region that is economically devastated and that desperately needs access to the world market, and yet again the other wealthier nations hinder that entry, while concentrating shortsightedly on their own problems at home, and neglecting the consequences of neglect. The West might want to reduce the risk of a Russian disaster, but not at the cost of jobs at home. Trade barriers are there to keep cheap Eastern products from “flooding” its home market. Europe throws in huge subsidies for its agricultural exports. Western tariffs or quality requirements are pitted against Eastern exchange rates, in a war on trade whatever its consequences on economic and political stability.

The West is digging in and seems to repress the recognition that history is repeating itself. Again the world finds itself in a deadlock, and yet again chaos feeds on it.

But we should remember the trade war of the 1930s and the rise to power of Adolf Hitler ! In the 1930s the same mechanism of trade, unemployment and political instability

applied. In this period it was Germany that was the weak nation. The Versailles Treaty of 1919 that ended World War I put Germany under a huge reparations bill. The world forgot that the war had been started by an autocratic Kaiser and that Germany now had a new, fledgling democracy. To pay that bill, this weak democracy was obliged to cut imports and to spur exports. The reparations bill worked like a foreign tariff that took away funds that could have been invested otherwise. By the end of the 1920s Germany defaulted on its international debt - and thereby indirectly caused the Wall Street Crash of 1929. Thereafter, all nations scrambled for the life-boats. Nations feared for their home markets and employment, and defended themselves by exchange rates and tariffs. In their fear they made things only worse. The German economy collapsed, and on the tectonic waves of resentment its weak democracy toppled and Hitler took power.

Let us now compare: Is the Russian democracy anything other than new and fledgling? Have its generals not tried to seize power? Have its tanks not roared against its very own Parliament building? Has its economy not dropped by a third? Or conversely, have all its nuclear weapons and uranium stores been safely secured? Have the Western nations done their utmost in opening their markets?

Risk not chance

Of course, there is a glimmer of hope. The Russian capacity for suffering is impressive. Few nations could sustain this suffering and national disgrace without lapsing into resentment, cruelty and violence on a much larger scale than we actually see in Russia. The West has provided some funds and done something more. The world is not at war and may not be at war for some time. The probability that things go right is large, and there is only a small chance that things go wrong.

But please consider: If the only glimmer of hope is that *the world is not at war*, then the situation is quite depressing. Hope is not the point, and neither likelihood nor expectation. The point is risk. Risk comes from the arithmetic of loss multiplied by chance. Thus: $\text{risk} = \text{loss} * \text{chance}$. If things go wrong in Russia then the consequences will be huge, and a small chance *times* a huge loss gives *a risk too large*.

Internal not external

The West should open its eyes and see the economic logic. Eastern nations need to take part in the international economy and thus need modern Western equipment. To buy the latter goods they need the proper currency. Either someone *gives* them that foreign currency, the dollars, yen or marks, or they have to *earn* it themselves by exporting. To simply give them credit, on the scale required, is absurd. Therefore it is access to Western markets that is essential for those nations and for political stability. Indeed, if they had access, and if the flow of trade were to start, then the World Bank and IMF could extend credits and thereby fuel the process towards stability.

At the same time, economic science tells us that it is not trade that has caused present Western unemployment. Marking trade down as the culprit, and using trade barriers to solve a situation that trade has not caused, only makes things worse.

The moral problem is internal and not external. The cause of present-day unemployment in Western economies is internal management and not external trade. There is a failure within the internal co-ordination of macro-economic policy, a failure by our very own governments. Western nations could tackle their unemployment problem at home - if only our political leaders were willing to take a hard look at their own internal policies.

The historic parallel also concerns the current lack of attention for the internal question. Policy makers that concentrate on an external trade war neglect the internal opportunities. There is the following sobering story about the economist John Maynard Keynes. From the early 1930s Keynes advanced his solutions to the Great Depression, and this culminated in his 1936 book that changed macro-economics. Policymakers could have reacted already in the early 1930s, ... but only did so after World War II had already begun.

Conclusion

We might ask: Do we care about the peoples of Russia and the Eastern nations ? And should we act with economic sense ? However, those questions are imprecise. The real question is whether our leaders care so much that they will reschedule their busy agenda's and really look into a problem that they cause themselves.

There is every reason to believe that political leaders are quite deaf on this. So pray that there will not be a new world war. So shout to your political leaders: Stop that trade war!

Do something about external trade tariffs and internal unemployment. Enable Russia to help itself.

(March 1996)

14. Will the West repeat Versailles ?

Asia and the Eastern European nations are in a state of economic turmoil. An important element for improvement is that Western nations open their markets to more trade. This is in fact what the West could have done after the fall of the Berlin Wall. But petty shortsightedness of the governing elites in the West blocks this kind of solution. The situation reminds one of the Versailles peace conference after World War I that fostered a lot of resentment and helped cause World War II. The basis conclusion is that sound economic advice is not listened to. The best advice on how to steer out of the current world macro-economic mess is that every parliament installs a committee to enquire into the process of economic advice. They could study the books by Paul Krugman, and possibly also my analysis on unemployment and my suggestion for an Economic Supreme Court.

Western nations show an inadequate reaction towards the Eastern nations since the fall of the Berlin Wall, and this inadequate reaction is repeated with respect to the current economic throes of Asia. The West displays disinterest in the hardship and actual physical pain inflicted on millions of our fellow human beings, and a neglect of the long run effects of this egotistic behaviour. Part of this inadequate reaction however is also caused by wrong applications of economic theory, so that true compassion that is out there doesn't get the chance to show itself. One lesson is that Western nations are advised to restructure their policy making process so that governments are better served with proper economic advice.

The negligent way that the Western nations treat the other nations reminds one of the Versailles peace conference after World War I. Historians agree about the sad Western

attitude at the Versailles conference. The Western Allies humiliated Germany and subjected that country to decennia of economic hardship, purposely crippling its economy. These events caused a huge resentment in Germany, and this fostered the rise of Adolf Hitler. Also, Germany's defaults on its financial obligations were a major cause for the 1929 Crash and the subsequent Great Depression. This episode is another example that two wrongs don't necessarily make a right, and it also shows how wrongs can backlash at the wrong-do-er.

The lesson of Versailles is that opponents can often best be allowed to grow into a relationship of companionship and economic competition and co-operation for the betterment of all. Rather than subdue them or take advantage of temporary weaknesses, they could be helped so that they could help us. This lesson should now be applied to the current situations of Asia and Russia.

It is useful to recall that Western nations were not without proper advice at the time of Versailles. They were warned, and by nobody less than J.M. Keynes. As Paul Krugman recently stated about Keynes: "After that war he became famous as the author of *The Economic Consequences of the Peace*, an eloquent condemnation of the vindictive terms imposed on the defeated Germans; his concern was vindicated by the rise of Adolf Hitler, and the memory of his warnings helped convince a victorious America to aid, not punish, its prostrate enemies after World War II."

Indeed, after World War II the Allies helped Germany and Japan to reorganise their countries and to prosper again. While the average citizen may be deluded by sentiments of nationalism, religion or ideology, it normally is a governing elite that abuses those sentiments for purposes of its own grandeur - and once a decent government is in place, there often appears little reason to blame that average citizen for the errors of its country. In the same way post-communist Russia deserves our sympathy, and the same holds for Asia with its different history.

But why has the West forgotten this valuable lesson ? Why do Western governments neglect Nobel Prize winner Jan Tinbergen's work on the Optimal Economic Order, and why do we again have a show of petty egotism and shortsightedness ?

The reason is that the West is not immune to the same 'governing elite' processes that can be at the detriment of common welfare. The governing elites and bureaucracies in the West have agenda's of their own, and though they are restrained by democratic rules, these rules are not as strong as they could be. Our systems of checks and balances are a product of history, and not necessarily of the quality required. Politicians and bureaucrats often still can lie and get away with it. The United States e.g. had David Stockman on the budget deficit, and it took too long before that matter was settled. In general, sound economic advice still is obstructed by political processes, and policies and the electorate itself then grow misguided in their choices.

To better understand the failure of Western democracies on the issue of economic advice, one can best start by reading Paul Krugman's books "The Age of Diminished Expectations" (1990), "Peddling prosperity" (1994), "Pop Internationalism" (1996), and "The accidental theorist" (1997). For example, when Krugman discusses US majority leader Arney's book "The Freedom Revolution", he states: "Arney is no fool. He cannot be unaware that he is fudging his numbers. Possibly he regards a small fib as justifiable in the service of a higher truth. Or possibly he has managed to achieve a state of doublethink, in which the distinction between what is politically convenient to believe and the objective facts no longer exists [sic]. The end result is the same: His book is an

effort to obscure the stark realities (...)” (1997:60). Similarly, one can read in the American Economic Review that the US Council of Economic Advisers is rather proud of its achievements in the last decades, but we should be aware that this council is a bureaucratic body, and it hasn’t the independent position that could have protected the US economy from the events and errors as are related by Krugman in his “Peddling prosperity” saga or shown by the record of mass unemployment.

Let us now regard what the West could have done with regards to Russia after the fall of the Berlin Wall and the first free elections there - and what could be done now also with respect to Asia. I take my own 1996 paper “Enable Russia to help itself”, and quote from its summary: “Western nations in the 1990s hinder trade with Russia and the Eastern nations for fear of unemployment at home, as they did in the 1930s with Germany. If trade were stimulated instead of hindered, Russia could regain economic and political stability by itself. The moral problem is not external and does not concern whether Russia would need financial aid. The moral problem is internal, and concerns whether Western political leaders are willing to face their own errors that cause the present mass unemployment at home.”

Clearly, with this being the state of affairs, one can imagine the strength of the forces that prevent a proper discussion of these issues. Western companies embrace tariff barriers to cheap imports - and raise their own prices. Bureaucrats embrace barriers since these give a sense of control, and these also justify the very existence of this bureaucracy. Labour unions will fight unemployment at home with whatever misguided argument it takes. Governments embrace economic tales about ‘globalisation’ and ‘competition from cheap labour countries’ since these distract attention from home grown errors, and these governments neglect economists who tell them that ‘globalisation’ and ‘competition from cheap labour countries’ are rather like fairy tales indeed. Krugman again uses the term ‘globaloney’ - and have you heard your President or Prime Minister adopting that critical attitude too ?

The best economic advice for the current situation is as follows - and I urge upon my fellow economists to adopt and spread that advice too: *Every parliament could install a committee that will enquire into the process of economic advice.* This committee could study Krugman’s books and my suggestions for a solution of mass unemployment and for an Economic Supreme Court amendment to the national constitution(s). Nothing less will do. Note, by the way, that when countries start installing these committees, the markets will be quick to anticipate the directions of their conclusions, and economic recovery would already set in.

We all know Lincoln’s words: “You can fool all of the people some of the time, and you can fool some of the people all of the time, but you cannot fool all of the people all of the time.” Let us act upon it, or show Lincoln wrong. (August 1998)

Notes in 1999: (1) A 1999 UNDP report describes the Eastern European situation as disastrous, and calls for a quick joining up to the EU (De Volkskrant October 16 1999). It is courageous that an international body speaks up like this - and it indicates the seriousness of the situation. (2) The journalist Peter Michielsen in NRC-Handelsblad October 30 1999 rightly calls attention to the original borders between the empires of Rome and Byzantium. The Eastern European countries that are doing relatively well belong to the Roman area, the others to Byzantium. He mentions that this cultural distinction has also been noted by Andreas Oplatka of the Neue Zürcher Zeitung 1994, who again refers to George Kennan in 1945. I was a bit surprised by this, hadn’t thought about it in this way. (3) These points however nicely fit what I have been arguing for ten years now. Enabling people to help themselves starts with taking account of the local conditions; and overall the barriers to trade should go.

IV. Solving unemployment in the Netherlands Antilles

15. Introduction and summary

Current unemployment is about 15% but can be reduced to 4.5% in particular with jobs at the low productivity & income end of the labour market where the problem of poverty is located. The reduction by 10.5% points consists of two measures, namely the elimination of the tax void (6% or 5200 jobs) and the use of wage cost subsidies (4.5% or 3900 jobs). Both measures leave net minimum wage income intact so that workers do not suffer a loss of living standards. Elimination of the tax void would only be an administrative measure that does not cost anything. Secondly, for workers with a productivity below the minimum wage it is possible to transform unavoidably permanent benefits into wage cost subsidies, at the cost of those benefits. By the first measure GDP would grow by 1%, by the second measure by 0.5%, thus in total by 1.5%.

An important feature in this analysis is the concept of the *tax void*. That void is the *tax wedge at the level of the minimum wage* while the tax wedge is the difference between labour costs and net income. The wedge holds for everyone but the void only at the minimum wage. The tax void differs from the normal wedge as a result of the legal condition that workers are not permitted to work below that wage – which rule does not exist for other wage levels. On Curaçao the minimum wage in 2006 is ANG 5.98 per hour, labour costs are 6.98 and net income is 5.48 per hour, hence the tax void is ANG 1.50 per hour. The “tax” in “tax void” stands for both taxes and premiums. For those people who depend on paid labour for a living the effect of the tax void is that when they don’t work then they cannot pay taxes and premiums. The Netherlands Antilles already have an exemption for the income tax at the level of the net minimum wage. This exemption doesn’t apply yet for the premiums for social security (including worker security). Up to now the country adheres to the principle that social security is an insurance and not a general provision so that who wants to be insured also has to pay the premiums. However, premiums have the same effect of raising the cost of labour and of reducing employment at the low end of the labour market. At the same time the levy of premiums up to the minimum wage level does not generate any revenue. Hence the term “tax void”: the premiums are levied on paper in the official statute but are not levied materially since those workers are unemployed due to the minimum wage.

Eliminating the tax void is neutral in principle and the new employment is for free. For workers who already work at the current minimum wage in principle nothing changes. They already work and already pay the premiums. For a new group of workers the level of the minimum wage however can be reduced. On Curaçao for example the wage costs can be reduced from ANG 6.98 to ANG 5.48 per hour, so that one can start working for net income = gross income = wage costs. The new employment comes without costs due to a somewhat special operation. When the exemption for the income tax (at ANG

11,392 per annum) also applies for the premiums for social security then the tariffs above that exemption up to the existing premium income limits can be rebased such that total revenue will not change. Subsequently, the rates of the income tax can be rebased too so that the sum of both levies at the micro level will remain the same for each individual. The total revenues of income tax and premiums then will not change, and since the revenue of the premiums will not change, also the revenue of the income tax will not change.

The target value of approximately 5200 jobs for the tax void finds support in an estimate based upon the productivity distribution, determined from the labour market survey of the Statistical Office (CBS).

Eliminating the tax void can be a measure that would not cost anything. However, this measure on itself implies a 100% tariff from net to gross minimum wage. Since this may be unattractive, one may also opt for a lower tariff. In the discussion below we consider a variant with a tariff of 56.1% between ANG 11,392 till 17,090, while above ANG 17,090 per annum we keep the tariffs at the current level. This revision of the premiums and income tax is restricted to employees who are legally insured under the Social Security Act, and thus other citizens are not affected.

In addition, for employees whose level of productivity is even below the hourly wage of ANG 5.48, and who thus are permanently on benefit, it is possible to enact a wage cost subsidy. Companies can be certified for proper use so that the scope for abuse will be limited. The break-even point of permanent dependency on benefits plus VAT gives a maximal subsidy level of ANG 4,278 per annum so that labour costs for those workers could drop to ANG 3.43 per hour. The effect on the labour market derives from the same productivity distribution.

The following discussion reviews these concepts from DRGTPE and then applies them to the Netherlands Antilles data.

16. Concepts used

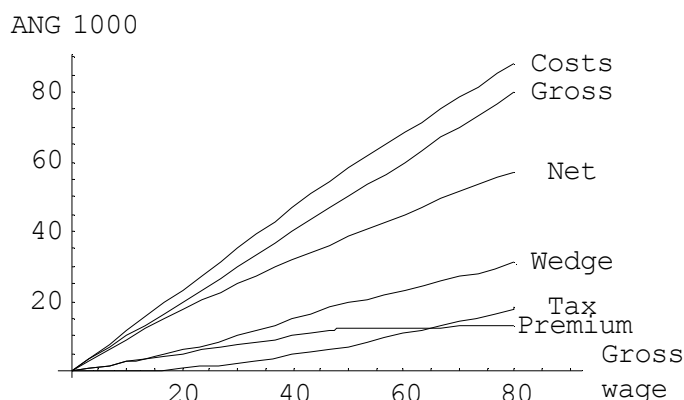
This analysis uses the following concepts:

- Wage = wage costs = net + levy
- Levy = tax + premium = wedge
- Employer levies = wage – gross income = wage – gross wage
- Employee levies = wedge – employer levies = gross – net

Wage, taxes and premiums depend in complex ways upon the gross wage that the employer and employee agree upon. For example, while the Central Government sets the tax structure, the Island Governments use different surtaxes. This chapter takes Curaçao 2006 as the main case. Figure 1 gives a graphical review of the different components of the wage, with the gross wage on the horizontal axis. A way to understand this chapter is that we keep the same wedge but we reallocate taxes and premiums within it.

Note that the line with the label “Gross” is also a so-called 45-degrees line. It maps the gross wage on the horizontal axis directly onto the identical value on the vertical axis. Many of the graphs below will use such a 45-degrees line to allow for a fixed reference for reallocations of taxes and premiums. See also *Appendix A* on taxes and premiums.

Figure 1: Wage costs and net income (1000 ANG) – Curaçao 2006



Subsequently, Table 6 gives the minimum wages of the different islands in 2006. The law sets the minimum hourly wage and presumes a contract that not only gives working hours per week but also holidays. The annual wage data in the table all presume a working week of 40 hours and a month of 4.33 weeks. Regulations actually distinguish four sectors of the economy with different maximum working hours: manufacturing (40), services (48), trade (40) and domestic servants (55 hours). In the past the minimum hourly wage rates were also different per sector but these have now been set equal. Using the minimum hourly wage of Curaçao for the 55 hours of the domestic servants gives an annual gross wage of ANG 17,090, which is a figure that we shall be using below too. It is perhaps not a realistic wage but it provides a useful yardstick.

Table 6: Minimum wages 2006 (40 hours per week) ²¹

ANG	Bonaire	Curaçao	Saba	St. Eustatius	St.Maarten	Gov. 1.1
Per hour	6.08	5.98	5.94	5.65	6.54	7.42
Per month	1,053	1,036	1,029	979	1,133	1,286
Per year	12,637	12,429	12,346	11,743	13,593	15,429

17. Productivity and laws & regulations

There are two avenues to reduce unemployment. The best way is to increase productivity so that employers will want to hire those workers. The realistic way is to recognize that there are limits to productivity improvement, often related to the time required for schooling, investment, and combining those two. When we have to accept that productivity may tend to remain at its present level and even be a bit low, then laws and

²¹ Source: Directorate of labour. Valid for workers of 21 years and older. For the age group of 16 - 20 years a youth minimum wage is applicable for each specific age: 16/17: 65%; age 18: 75%; age 19: 85% and age 20: 90% of the indicated minimum wage. PM. "Gov. 1.1" means the lowest salary scale (1.1) of the Central Government

regulations better support the use of that labour, rather than making its use impossible. However, the current laws and regulations of the Netherlands Antilles do the latter. It is not just one law but it is the interaction of taxes, premiums and social security that causes the rise of labour costs above the level of productivity. The way to solve this is to reduce labour costs. This remains only a necessary condition and it may not be sufficient. Other aspects that are relevant are culture, work ethic, poverty background, personal histories of crime, and the like. Measures to deal with the latter however are ineffective if the prime problem of labour costs is not solved. The best approach there is to reduce costs and not reduce living standards.

Table 7 reviews the decomposition of the annual minimum wage for industry and trade (40 hours), code label M1. Net income is 2006 ANG 11,392, a rise of 5,3% compared to 2004 (ANG 10,821). Premiums are paid by employers (label “er”) and employees (label “ee”). There are premiums that only apply to workers (below some wage level), namely sickness (ZV) and accidents (OV). The OV premium depends upon the industry so that this table uses an average. Other premiums are of a general nature, namely old age and widows and orphans (AOV / AWW) and special sickness (AVBZ). The government provides for the health premium of spouses and kids which premiums are not included in total wage costs. “Cessantia” is a small premium for dismissed workers. Tax allows the deduction of costs to acquire the job but this is included in net income. The tax credit is 1548. “VAT” is actually a cascade sales tax. The official rate is 5% and the effective rate is 6.6%.

Table 7: Minimum wage Curaçao 2006, 40 hours

Year 2006, ANG	Employees market sector (40 hours), M1		
Number of employees 1746	rate	minimum wage	sum value
Gross wage		12,429	21,700,737
ZV (ee)	0.021	261	455,715
ZV (er)	0.083	1,032	1,801,161
ZV (govt., co-insured)	0.021	261	455,715
OV (er) (average tariff)	0.019	236	412,314
Cessantia		40	69,840
Acquisition costs		500	
Base social security		11,929	20,827,737
AOV/AWW (ee)	0.050	596	1,041,387
AOV/AWW (er)	0.060	716	1,249,664
AVBZ (ee)	0.015	179	312,416
AVBZ (er)	0.005	60	104,139
Taxable income		11,332	19,786,350
Tax	0.130	0	0
	1548		
Net income (incl. acq. costs)		11,392	19,891,219
Wage costs (excl. govt.)	0.215	14,512	25,337,855
Tax void (excl. VAT)		3,119	5,446,637
VAT	0.05	726	1,266,893
Tax void (incl. VAT)	0.252	3,845	6,713,529

Table 8 reviews the decomposition of the fourth sector of domestic servants with a maximum of 55 working hours, code label M4. Domestic servants are not insured at SVB for sickness (ZV) and accidents (OV), presumably since their employers are not employers in the ‘normal’ sense of registering at the Chamber of Commerce. The table thus approximates their position. The implied net income is ANG 15,152, a rise of 19,7% compared to 2004 (ANG 12,661). That rise is explained by the equalization of the hourly rate from 4.97 to 5.98 per hour and by the recent reduction in taxes.

Table 8: Minimum wage Curaçao 2006, 55 hours

Year 2006, ANG	Employees market sector (55 hours), M4		
Number of employees 2006	rate	minimum wage	sum value
Gross wage		17,090	35,648,906
ZV (ee)	0.021	359	748,627
ZV (er)	0.083	1,418	2,958,859
ZV (govt., co-insured)	0.021	359	748,627
OV (er) (average tariff)	0.019	325	677,329
Cessantia		40	83,440
Acquisition costs		500	
Base social security		16,590	34,605,906
AOV/AWW (ee)	0.050	829	1,730,295
AOV/AWW (er)	0.060	995	2,076,354
AVBZ (ee)	0.015	249	519,089
AVBZ (er)	0.005	83	173,030
Taxable income		15,760	32,875,610
Tax	0.130	501	1,044,076
	1548		
Net income (incl. acq. costs)		15,152	31,606,819
Wage costs (excl. govt.)	0.241	19,951	41,617,918
Tax void (excl. VAT)		4,799	10,011,099
VAT	0.05	998	2,080,896
Tax void (incl. VAT)	0.277	5,797	12,091,995

18. The levy plot

A key tool to understand these concepts and tables is the “levy plot”. It combines Figure 1 with the minimum wage and then gives Figure 2. Instead of the gross wage, the horizontal axis now uses wage costs, or “the wage”, i.e. the figure that economists worry about (see *Appendix A*). The levy plot uses the minimum wage 1 (M1) as “the” minimum wage, thus wage (costs) $M = M1 = 14,512$. The graph uses $B =$ subsistence = the net minimum wage = ANG 11,392. The subsistence-line is parallel to the 45-degrees line. The minimum wage M arises from the combination of subsistence and the required levy of taxes and premiums, thus the intersection of the subsistence-line and the levy-line.

Figure 2: The minimum wage follows from the intersection of subsistence (net income) and the levy of taxes and premiums (1000 ANG) ²²

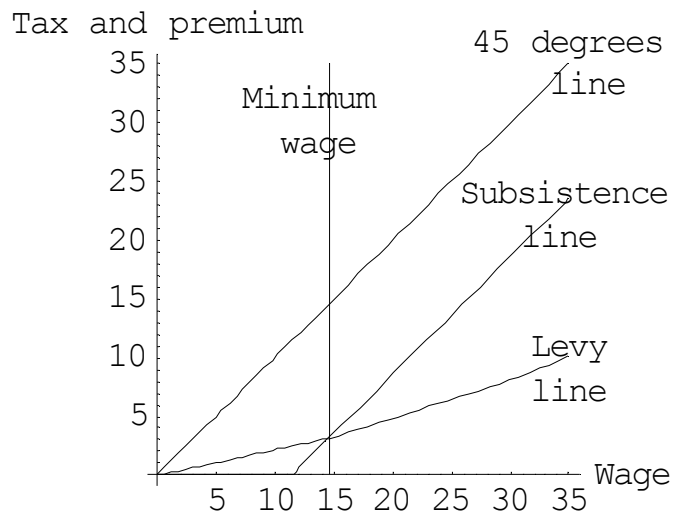
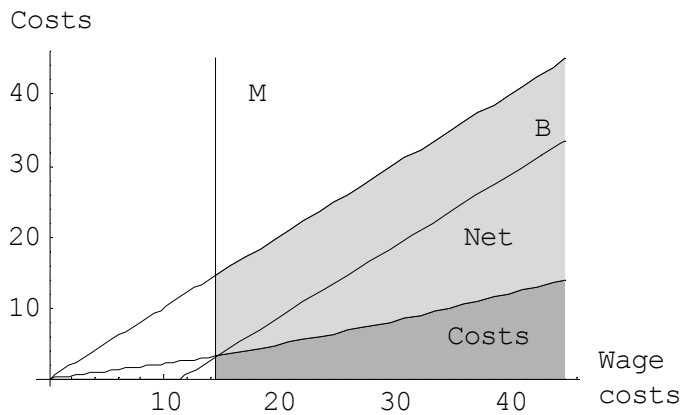


Figure 3 may clarify more clearly that there are no levies collected below the minimum wage since market sector employees are not allowed to work below that level.

Figure 3: Levies generate no revenues below M



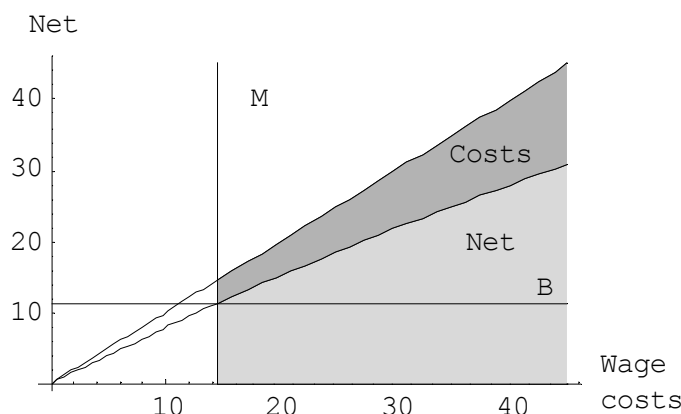
The wedge is defined as the burden in *vertical* direction that gives a disincentive to work. The tax void is the *horizontal* cost trajectory between wage costs at the level of net

²² With wage costs w and subsistence B the subsistence line is $w - B$. Minimum wage costs M follow from the intersection $w - B = \text{levy}(w)$, which solves as $w = M$.

minimum income (ANG 11,392) and legally required minimum wage costs (ANG 14,512). The size of the tax void thus is ANG 3,119, which is 27% of net income or 21% of the wage. When we also consider VAT that raises the total cost of labour too then the tax void is even larger. Note that the B-line cuts off a section of net income between that line itself and the 45-degrees line. Who cannot earn at least as much net income has to apply for a benefit (“B” from “benefit”).

Figure 4 depicts the same situation but with net income on the vertical axis.

Figure 4: Levy plot with net income on the vertical axis



19. The distribution of productivity and the size of the tax void

There is a group of workers within the tax void who might work for those wages but who are not allowed to work because of the higher minimum wage. We get a grip on the size of that group by considering the productivity distribution in society.

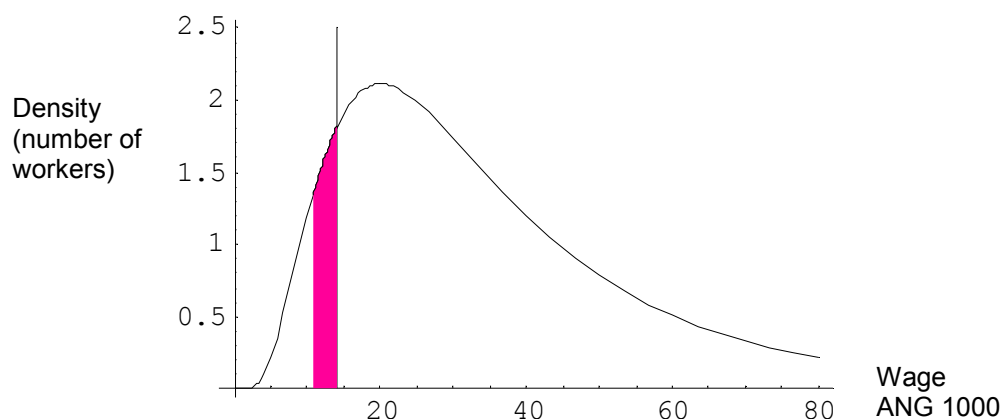
Appendix B discusses the CBS labour force survey 2004, the latest year for which there are complete data on all the angles that we are considering. The survey for Curaçao allows us to estimate a smooth productivity distribution for workers in the market sector working at least 40 hours per week, see *Appendix C*. We then extrapolate that distribution to the productivity levels that are not observed in that survey (since those workers are unemployed). Figure 5 gives that estimated distribution. The minimum wage (ANG 14,002 in 2004) cuts off an area to the left, consisting of workers whose levels of productivity are not inviting to employers. The tax void has been shaded. Its volume can be found to be 3600 jobs. Extrapolating these Curaçao data to the other islands shows that Sint Maarten is rather special. Thus we arrive at some 4010 jobs in total for the Antilles exclusive of Sint Maarten. The calculations below on cost-benefit analysis and the recalculation of taxes and premiums assume 10% of the SVB participants, meaning 3722 jobs.

It may be noted that productivity should be measured as the value added that is produced, consisting of wage, complementary investments such as uniform or desk, a part of profits and taxes like VAT. When these are proportional then the productivity distribution simply shifts to the right. It may also happen that employers accept that

lower paid workers contributed less to profits, also in a lower proportion. For such unproportional effects a lognormal distribution result still remains likely.

Figure 5: Productivity distribution and the minimum wage Curaçao 2004

The shaded area gives the tax void between net minimum income and wage costs ²³



The tax void has the property that levies can be eliminated there without any cost:

- (1) workers are not allowed to work below the minimum wage
- (2) when people don't work and have to rely on work for income then they don't pay taxes and premiums
- (3) when people don't pay taxes and premiums then the government and the SVB don't have such receipts.

20. Employment effect per island

Taxes and premiums are decided upon at the national level but the Island Governments determine surtaxes. The minimum wage for an island is set by the minister of Labour but only after a request by that Island Government. The employment effect for the Netherlands Antilles thus depends upon the way how the different islands will implement things. If exemption for premiums is chosen at the level for Curaçao of ANG 11,392 (and if the other measures are adopted that we will discuss shortly) then Table 9 reviews how the islands might adapt their minimum wages. For the Antilles exclusive of Sint Maarten the rounded effect is 4000 jobs. Sint Maarten is a special case since its minimum wage is already high at ANG 6.54 while the recent "social accord" requests ANG 7.79 per hour. ²⁴

²³ *Appendix D* contains a decomposition of the minimum wage 2004. Its value has been averaged over the year due to the midyear change.

²⁴ *Appendix E* contains a decomposition of the Sint Maarten minimum wage 2006.

Table 9: Current and possible minimum wage per island ²⁵

See *Appendix C* for estimation and calculation.

The effect of –250 is an estimate of raising the minimum from 6.54 to 7.79 (or 7.76).

	2006	annual 2006		annual 2007		2007	Effect
	per hour	gross	net	net	gross	per hour	jobs
Bonaire	6.08	12,637	11,583	11,583	11,616	5.59	310
Curaçao	5.98	12,429	11,392	11,392	11,392	5.48	3600
Saba	5.94	12,346	11,317	11,317	11,317	5.45	35
St. Eustatius	5.65	11,743	10,766	10,766	10,766	5.18	65
St. Maarten	6.54	13,593	12,388	12,388	12,811	6.16	50
	2007				2007		
				12,873	13,593	6.54	0
St. Maarten	7.79	16,191	14,441	14,441	16,122	7.76	-250

For Sint Maarten we thus take into account that:

- (i) keeping the same net minimum income allows a wage of ANG 6.16 per hour
- (ii) keeping the same gross wage allows a rise of net income from 12,388 to 12,873
- (iii) if the recent request of ANG 7.79 per hour is adopted, actually targetting a net income rise to ANG 14,441 under the current system, then the wage rise may (only) be limited to 7.76 per hour.

The point is that Sint Maarten has a larger tax void due to its higher minimum wage, while it does not have the power to adjust national taxes and premiums. Possible approaches are:

- (1) When the nation would set exemption for premiums at the level of Sint Maarten then the costs would be too high.
- (2) Setting other premiums for Sint Maarten would be complex for SVB and the Inspectorate of Taxation (that determines the income base).
- (3) Wait till after the split-up of the Netherlands Antilles. This situation might actually be used, though fallaciously so, as an argument for the split-up. ²⁶
- (4) Use subsidies to compensate for wrongly levied premiums. Part could be income suppletion, allowing a lower gross wage, and part could provide for the premiums that employers and employees have to pay to SVB and AVBZ.

The latter seems most promising. The discussion itself is postponed to the general discussion on subsidies below.

First, we need to consider what measures are required on taxes and premiums.

²⁵ The minimum wage on French Saint Martin has the French value of about EUR 1000 per month. The analysis on the tax void can also be applied to the French minimum wage.

²⁶ Another argument might be to allow Sint Maarten all kinds of decisions in anticipation of the split-up. The counterargument however is that this would set a bad example, such as high minimum wages, for the other islands, deteriorating their start position.

21. Solutions via taxes and premiums

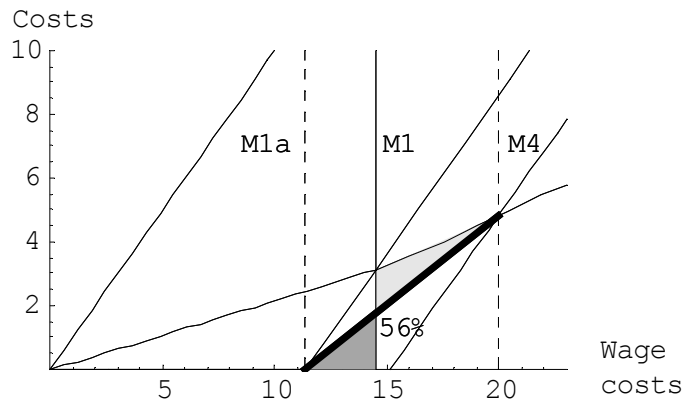
The solution is to introduce an exemption for premiums at the same level as the exemption for taxes, and then adjust taxes so that the total levy remains the same, both individually and in sum total.

(1) The base case has a 100% tariff from the net minimum wage to the minimum wage (costs), at M1. The minimum wage then can be set at that net minimum value, $M1a = 11.392$. Workers who already earn M1 can continue to do so but the less productive in the range M1a to M1 can start working now too.

This variant has not been drawn since the 100% tariff follows the subsistence line *B*. This base case shows that the solution is essentially free of costs. But the 100% tariff is so high that one wishes to see other variants.

(2) The most interesting variant connects exemption 11.392 to the minimum labour costs for sector 4, domestic servants, $M4 = 19.951$. The implied marginal rate or tariff appears to be 56.1% (in terms of wage costs), see Figure 6. The variant causes some new tax revenue in the tax void below M1 (dark shade) but loses some revenues above M1 (light shade). We need to investigate how big those changes are.

Figure 6: 56.1% tariff for wage costs from 11.392 to 19.951



The 56.1% rate only applies to the total levy. We distinguish two main subvariants that deal with the allocation of taxes and premiums. In both cases we can define a rule for premiums and then taxes have to correct for the total revenue:

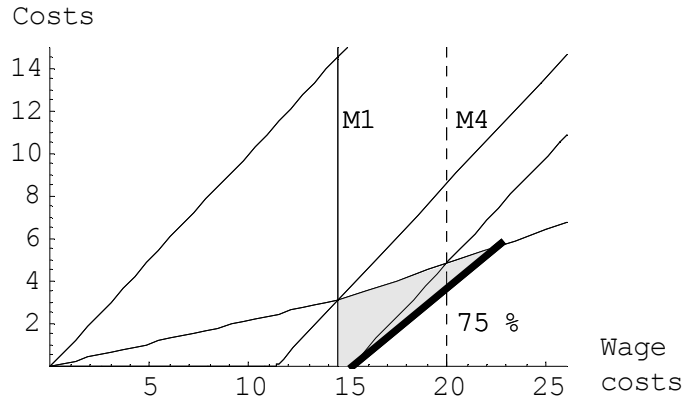
(2a) Premiums have a “take-over” bracket till gross wage 17.090 and thereafter keep them the same as current premiums

(2b) Premiums are constant (but higher) from 11.392 till the premium income limit.

(3) An expensive variant takes the net minimum income of M4 of 15.152, applies a 75% take-over tariff, and joins up to the existing levy at 22.759, see Figure 7. The light shaded area again indicates the costs, in this case rather large, and we may expect that they cannot be compensated. But the variant can be mentioned to enlighten the issue.

Note that variants 2 and 3 have the property that workers at the current minimum wage M1 actually have an increase in their net income. As rates for taxes and premiums generally are established for a fiscal year, with a particular structure that is not changed inbetween, then the elimination of the tax void might be sufficient to raise net wages so that no additional New Year increase of the gross minimum wage is required.

Figure 7: 75% tariff from ANG 15.152 to 22.759



22. Complications

The solution approach above comes with some complications that make the issue a bit difficult, both conceptually and with respect to interest groups involved. But the discussion below will show that these complexities can be overcome.

(1) *Parttime workers.* Some workers can have an annual income below the minimum wage, not because their hourly wage is low, but because they make less hours. They would of their own volition fall under exemption and thus not contribute to social security but still enjoy its potential benefits. It is an option to exclude these people from social security arrangements since they willingly choose a low income. An alternative between these two extremes is to let exemption depend upon hours worked, say, no exemption at a parttime factor lower than 60% and a gradual build-up to 100% exemption at 40 hours or more. *Appendix F* gives a further explanation. Best seems to accept that parttime workers also are insured and to avoid the red tape of additional rules and costs of inspection and such.

(2) *Young people.* As the minimum wages for young people depend on the wage for adults, one could accept that they would fall in exemption too. There are no data though.

(3) *The “Pro Pauper” free insurance (PP-card), co-insured and former employees.* The current rules may be summarized as follows:

- (a) Who is unemployed and who never worked below the “premium income limit”, which is ANG 4,036.50 per month for 2006, has the right to a PP-card that gives free health insurance, paid by the Island Government. Also people of age 60+ can

apply. A person with an income above ANG 1,500 per month however will not get a PP-card.

(b) The government pays 2.1% health insurance for co-insured at SVB.²⁷

(c) An employee is insured at the SVB when the gross wage is below the “premium income limit”. When such an insured worker loses the job then he or she remains insured till age 60 (retirement) if these conditions apply: be a resident, have no other income than sourced in the Netherlands Antilles, have no rights to other insurance than SVB, no longer be counted as an employee in the sense of the law on the SVB. In that case the government pays a premium of 4.2%, consisting of 2.1% for the co-insured and 2.1% to compensate for the dropping away of the employer.

Given these rules the following can be observed:

(3.1) Elimination of the tax void with the new employment will bring more costs to the SVB than just those new workers. Who becomes insured at the SVB brings along co-insured, and, can become a “former employee” who remains insured. And there will be no new revenue since those new workers will fall under exemption. Thus (a) we may proportionally allocate additional costs for co-insured and former employees, (b) savings can be found in new workers who already have a PP-card and who have the national benefit for the poor and/or unemployed (“onderstand”).

(3.2) SVB should investigate what blocks the former employees from returning to the labour market. If they would ask too high a wage then they are unemployed out of volition and then they could be induced to become more realistic.

(3.3) When reorganizing taxes and premiums then we may take along the issue of the co-insured. The 2.1% should actually be paid by the employee and then taxes can be adjusted to make this reassignment neutral. (A similar reassignment for the 2.1% for compensation for the loss of employer premium is less obvious to arrange.)

(3.4) The current rules thus hinder or block the entry of unemployed persons into the job market in some ways. A PP-er or former employee now has health insurance for free but can only start working when these costs are paid out of wage costs. It is an option to say that once one has insurance then it is no longer necessary to pay for a new one. That would be the logical thing to do for persons who would be permanently unemployed due to their level of productivity. For persons who have a higher productivity and who are only between-jobs, it is logical to ask for a contribution in costs. Thus the point is that the current arrangements do not efficiently separate the permanent and temporary cases. The simplest approach is to link permanent dependency to the income level. The notion would be that health insurance is free for the lowly paid, perhaps for social reason, but at least to reduce wage costs. This in fact would be a general rule: when a collective arrangement is created then this should be offered for free for the minimum wage workers otherwise they would become unemployed.

(4) Marginal rates. The above rate of 56.1% in Variant 2 (Figure 6) is expressed in terms of the wage. From Table 8 we can deduce that if the gross wage is 17,090 and

²⁷ In 2004 SVB registered a premium base of ANG 1,062 million and charged the government 2.1% of this. At the same time companies may fail to pay. The factual base on which SVB collects premiums is 966 million. One might suggest to reduce the base for the government by 9% too but then SVB might argue that the premium rate should be higher.

when the wedge is $4799 + 359$ (now including the co-insured) then the take-over marginal rate becomes, when expressed in terms of the gross wage, $(4799 + 359) / (17090 - 11392) = 90.5\%$. Many people will be shocked by marginal rates so high but we must remember that this is only a take-over rate and that some tolerance gives 4000 free jobs.

(5) *Sales tax, value added tax, income tax.* The Netherlands Antilles have a sales tax with the official rate of 5% but due to the cascade effect the average rate on GDP (value added) is 6.6%. For calculation of total wage costs the use of the 5% is more adequate since it concerns the marginal worker. For that reason the tables that decompose the minimum wages contain a row “VAT 5%” rather than “Sales tax 6.6%”. The present analysis also provides an angle on the choice between the cascade sales tax, VAT and the income tax. The sales tax is known to be distortionary since tax accumulates in sales. The choice between VAT and income tax may be less obvious. The general rule is that one aspires at marginal rates that are as low as possible to minimize distortion of decisions at the margin. On the other hand, subsistence workers require an exemption to prevent wage costs becoming too high. The economic question of optimizing social welfare thus is not a problem of *optimization without conditions* but it is a problem of *optimization with conditions*. Some economists manage to derive an unconditional solution and plug it into a model with conditions. The notion of low marginal rates derives from the first approach but the notion of exemption derives from the second. VAT has no exemption. Optimizing with conditions suggest that the income tax is the preferred tax. The sales tax could be abolished and not replaced with VAT. However, for administrative purposes, to prevent avoidance of income tax, it is useful that inspectors have access to sales and company accounts so that a VAT of say 1% is still useful.

(6) *Grossing up.* Adjustment of employer premiums means that wage costs could change. To neutralize this effect – to keep wages the same – the gross wage could be adjusted too. This operation is called “grossing up”. *Appendix H* contains an explanation. It is conceivable to have an “integral grossing up operation” such that the new gross wage is made identical to the wage (wage costs) such that all premiums are paid by the employee and such that these premiums have the wage as the base. In fact, *Appendix A* has done that rebasing of taxes and premiums. This operation has advantages in itself, both because all premiums now have the same base and because economic theory holds that premiums are always based upon productivity and thus are basically paid by the employee anyway. However, in terms of the business cycle, employer premiums allow the government to adjust wage costs without affecting net income in the short run. Also, a grossing up operation can be more complex when also pensions depend upon the gross wage. Thus, in the following we restrict the grossing up of premiums, primarily by keeping employer premiums the same after exemption and assign all changes to the employee premiums (which are then compensated in taxes).

(7) *Transition.* A change of regime causes transition phenomena. Current minimum wage earners have already proven their productivity and enjoy some legal protection against dismissal so that they in principle need not fear the transition. It can happen however that an employer dismisses current workers and hires anew at the lower new minimum wage. The probability that this happens is not too large because the productivity of the new workers has not been proven yet. If it would happen then one would basically accept it since it would be an adjustment on the labour market and the precise intention of the measure is that the new workers indeed find a job. The current workers who become unemployed would find jobs at other employers, and they can prove their salary level. Of course there is the potential for abuse such that an employer

wants to make a quick profit and does not act in the spirit of the labour contract and the rules against improper dismissal. For that reason it seems wise to check all requests for dismissal during the transition period, and to pre-announce that more intensive check. A determined employer can always cause that labour relations are severely deteriorated so that a judge will grant the dismissal. But that tends to cause severance pay while the worker should be glad to be released from such an employer. It may be expected that such cases will be few yet the risk cannot be fully avoided, also because the true reasons for a dismissal may always remain hazy.

(8) *Complexity of taxation.* The tax system is so complex that it is not easy to enact changes. For example, government officials can deduct the health insurance that they pay for retired government officials, and early retired people still pay AOV premiums that they can deduct. Viewing the battlefield it appears that the elimination of the tax void wins in clarity if it is limited to precisely that. The reassignment of taxes and premiums can best be limited to the employees who are legally insured at the SVB. It is this group to which the minimum wage law applies. Administratively this causes a separate tax and premium table. This might seem to add to the complexity, but this is true only in a limited sense. The criterion to be legally insured at SVB is already applied, and the applied change in the tax and premium tables is clear. Needless to say, one would work to harmonize and simplify tax and premium rules over time, so that one could return to one single tax and premium table again. But it is too ambitious to try that just now.

(9) *Experiments.* These complexities cause the question whether it would be feasible to experiment on a small scale with some of these variants before actually overhauling the whole system. This appears factually impossible and actually undesirable. The only feasible experiment is to give wage cost subsidies that compensate for wrongly levied premiums. In that case one would create additional bureaucracy where one hand takes what the other hand gives, while there will be red tape and inspections and controls that employers abhor so that they are not likely to participate. The basic point is that one doesn't need to experiment with measures that are sound in themselves. It is a good system to impose levies only after exemption. The old adagium of Cohen Stuart is that a bridge must bear its own weight before it can carry a load.²⁸ That idea is already being used in taxation, it only needs to be applied for premiums.

Appendix G gives relevant complications that are less relevant for the main text.

23. The new state structure

The complications mentioned cause the question whether it would be wise to complicate the current discussion on the new state structure and the splitting up of the Netherlands Antilles with a new policy on taxes, premiums and the minimum wage.

One argument is that already a lot would change for the new entities so that eliminating the tax void might be *too* much. Such decisions might also be left to the new entities.

On the other hand there are arguments to tackle the tax void as soon as possible. It is the most effective and efficient measure conceivable to do something about unemployment.

²⁸ "Een brug moet eerst zijn eigen gewicht dragen voordat hij belast kan worden." Cohen Stuart (1889) in H.J. Hofstra, *Inkomstenbelasting*, Kluwer 1975

If unemployment is reduced and the new entities are provided with an adequate structure of taxes, premiums and minimum wage then they get a good position at start. The measure is so concrete and well-developed that it is easy to implement.

In addition it is not clear that splitting up the Netherlands Antilles would be a wise decision – or that it would even happen. There are plans to try to do so but these mention conditions that may not be satisfied. Hence, valuable resources would be lost with continued human misery (for there are really poor people in the Netherlands Antilles) if one would wait till these issues on state structure are resolved.

24. Development of variants 2a and 2b

When the solution method and the mentioned complications are considered in unity then variant 2 can be selected and the following two practical subvariants **2a** and **2b** suggest themselves, see Table 10. **2a** has three brackets (exemption, take-over, as now) and **2b** has two brackets (exemption, constant rate). *Appendix H* discusses the relations for the micro burden, *Appendix I* the macro conditions, *Appendix J* calculates the tariffs for **2a** and *Appendix K* does a cost-benefit analysis for **2a** (thus **2b** not shown) .

Table 10: Premium variants (exclusive of tax)

<i>Aspect \ Label</i>	2a	2b
Core issue	Three brackets	Two brackets
Premium base	Gross wage GW	Gross wage GW
Exemption	ANG 11,392	ANG 11,392
Connection point CP	ANG 17,090	Premium income limit
Take-over tariff till CP	56.1% or 90.5%	-
Tariff after CP	The same as now	-
Employer premiums	From CP same as now	From exemption same as now
Employee premiums	From CP same as now	Compensate total
Co-insured	By employees	By employees
Taxes	Compensate micro burden	Compensate micro burden
Range for grossing up	$12,428 \leq GW \leq 17,089$	$12,428 \leq GW \leq 48,438$
New gross wage	$0.77 GW + 3,915$	$GW + ANG 1,630$
Parttimers	Exempt	Exempt
Numbers	Independent	Dependent

Both variants **2a** and **2b** have a take-over tariff of 56.1% in terms of wage costs W in the range $11,392 \leq W \leq 19,951$. For **2a** the take-over happens both in taxes and in premiums. For **2b** premiums have a constant premium above exemption and then taxes must compensate (thus most take-over happens in taxes).

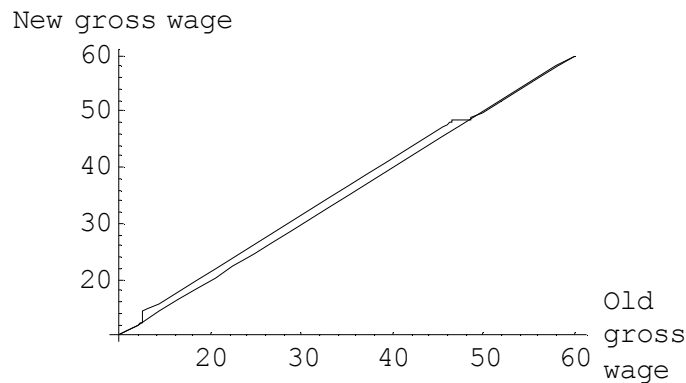
In both variants employees will start paying the premium for co-insured, which cause a saving for the government. However, premium raises are compensated in taxes. Also, the insurance for accidents OV does not have a premium for employees, thus they cannot compensate for changes in the employer premium, thus the government has to step in.

There is also the grossing up of wages. Seen from the current situation, variant **2b** can be understood easiest. Gross wages are raised with the amount that compensates for the advantage of the new exemption. The total current employer burden is 16.7% of the gross wage. The amount for grossing up a wage can be found via $\text{ANG } 0.167 * 11392 / 1.167 = 1630$. For variant **2a** there is a similar calculation but using the new take-over tariff. The grossing up is restricted to the middle bracket. The grossing up methods are shown in Figure 8 and Figure 9. Note the different origins of the graphs.

Figure 8: Grossing up in variant 2a (below gross 17.090)



Figure 9: Grossing up in variant 2b (above gross 12.429)



For variant **2a** the grossing up in the area $12,428 \leq \text{GW} \leq 17,089$ with $0.77 * \text{GW} + 3,915$ means that the gross minimum wage rises to $0.77 * 12,428 + 3,915 = 13,485$. The wage costs remain the same. Factually though the minimum wage per hour for current workers is adjusted from ANG 5.98 to ANG 6.49 such that the whole range from ANG 5.49 to 6.49 per hour becomes available for new workers. For variant **2b** the grossing up in the area $12,428 \leq \text{GW} \leq \text{premium income limit}$ with $\text{GW} + \text{ANG } 1.630$ means that the whole range from ANG 5.49 to 6.76 per hour becomes available.

For both variants the highest cost item is the exemption of parttimers with an income that falls in exemption. One avoids administrative complexities by accepting this. Both variants thus need to find compensation. This will be found in saved benefits and PP-cards of the currently unemployed.

Variant **2a** is actually independent of the number of workers. The loss of premiums is limited mostly by keeping premiums the same above the connection point and a little bit by the grossing up below that point. Variant **2b** requires a recalculation of the premiums for which the numbers appear very relevant in particular since the range is so large.

Table 11 reviews the current and the new premium tariffs. Remember that these tariffs only apply for workers legally insured at the SVB. For variant **2a** after the connection point one would expect the same rates as at the baseline. However, due to the exemption for parttimers the tariff is a bit higher. And employees start paying for the co-insured. The premiums paid (and no longer paid) by the government are not mentioned here.

Table 11: Premium rates, baseline, variants 2a and 2b

	Baseline	2b	2a (mid)	2a (from CP)
ZV (ee)	0.021	0.113	0.147	0.049
ZV (er)	0.083	0.083	0.249	0.083
OV (er)	0.019	0.019	0.057	0.019
AOV / AWW (ee)	0.050	0.128	0.182	0.057
AOV / AWW (er)	0.060	0.060	0.192	0.060
AVBZ (ee)	0.015	0.029	0.051	0.016
AVBZ (er)	0.005	0.005	0.016	0.005
Total marginal	0.253	0.437	0.894	0.289
From	0.000	11.392	11.392	17.090
Premium income limit	48.438	48.438	48.438	48.438
AVBZ pr. income limit	361.677	361.677	361.677	361.677

25. Consequences for taxes

When the premiums are set according to Table 11 then tax rates must be adjusted to maintain the same micro burden. In variant **2a** the taxes shift more or less parallel, in variant **2b** there will be an “intermediate plateau”. Table 12 gives the rates, Figure 10 plots for the range till the premium income limit and Figure 11 plots for a wider range.

The tax rates appear to remain the same after taxable income at (about) the premium income limit of ANG 48 thousand. Below that value the structure is quite different. Thus, the issue cannot be solved by a simple additional tax credit. Thus two tax statutes are required, one for workers legally insured at SVB and another one for the other tax payers (other workers, entrepreneurs, government employees, retired). The tax statute for the workers legally insured at SVB still contains rates above the premium income limit since people can have income from other sources than labour.

Table 12: Tax rates, baseline (current), variants 2a and 2b

Bracket boundary and the rate (incl. 30% surtax) valid to the next bracket boundary.

The tax credit has been translated into an exemption of ANG 11.910.

Baseline		Variant 2a		Variant 2b	
Bracket	Rate	Bracket	Rate	Bracket	Rate
11.910	0.130	23	0.173	11.392	0.250
23	0.208	34	0.238	17	0
34	0.273	45	0.273	48	0.351
48	0.351	48	0.351	72	0.416
72	0.416	72	0.416	101	0.494
101	0.494	101	0.494		

Figure 10: Income tax, baseline, variants 2a and 2b

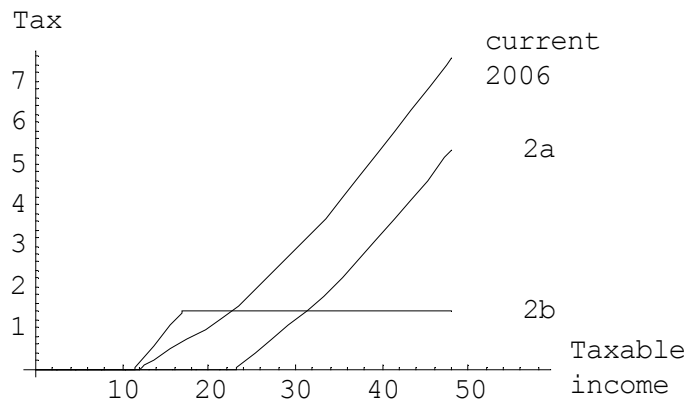
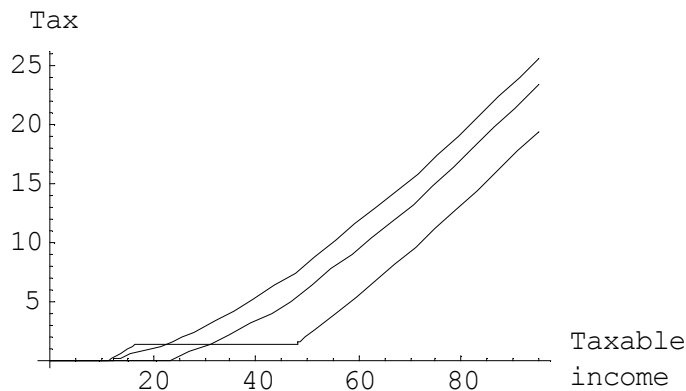


Figure 11: Income tax, baseline, variants 2a and 2b (wider range)



As a result of rounding off of grossed up incomes, bracketts and rates, there arise small differences at the micro level. *Appendix L* contains a numerical comparison of the current situation (baseline) and the results of variant **2a**, for the various components of income and levy. Note that the gross wage will not always remain the same but can be grossed up. The most important rows are wage costs and net income, where we can see only small differences as it should be. In rounding off, it has been chosen that the error

shows up as a rise of net income. Figure 12 and Figure 13 compare net income in a graphical manner, where the baseline is dashed and the variant is the drawn line.

Figure 12: Net wage of variant 2a (drawn line) versus baseline (dashed)

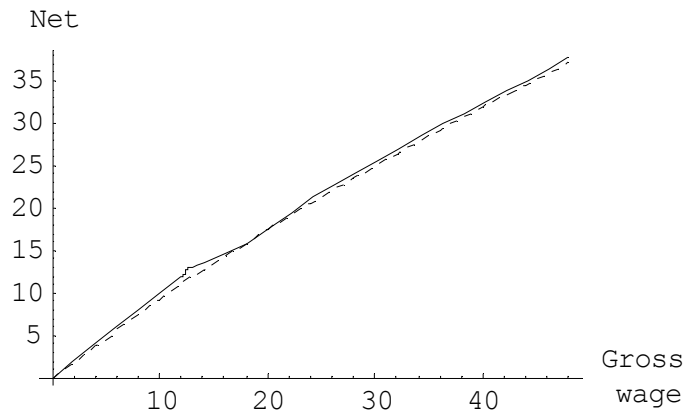
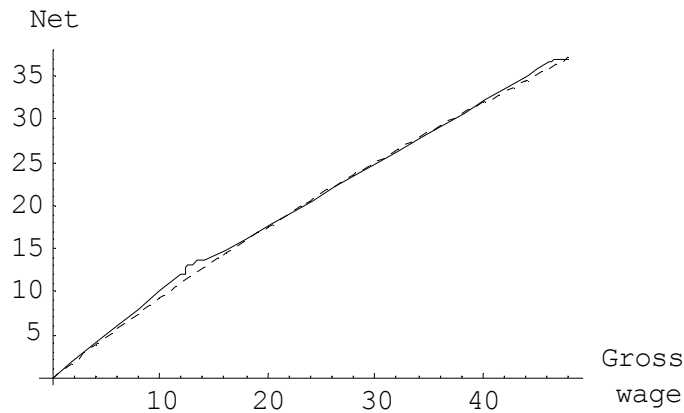


Figure 13: Net wage of variant 2b (drawn line) versus baseline (dashed)



These tables and graphs give only the brackets & rates and they show that the operation could be done. Next, there is the question of administrative feasibility. It appears that employees already have a different regime, the “wage tax”, which is an advance levy collected for the government by employers. If no special conditions apply then the advance tax becomes the final tax. If it appears at the end of the year that the worker has special deductions and sources of income then he or she can send in an “general income tax” form, on a personal basis. Thus it appears feasible to adjust the wage tax for workers legally insured at SVB. Those workers who apply for a general income tax correction generally have a higher wage, notably above ANG 17,090, and will not suffer much of a difference between the advance tax and the final general income tax, as shown by these graphs.

26. Earnings and speed of adjustment

From the Cost Benefit Analysis (in *Appendix K*) it appears that variant **2a** generates annual savings for the government of ANG 4 million. Variant **2b**, that is complexer and more subject to rounding off errors, and that is not shown here, generates ANG 1.5 million (so that the other savings fall to agents in the economy).

These savings only appear when all 4000 jobs are taken (in the Antilles exclusive of Sint Maarten). It will require some time before this happens. How fast will that be ? Creation of the new system of taxes and premiums actually causes a frontloading of costs while the expected savings will show up more slowly. Note that it was a conscious choice to allow for such costs. Variant 1 has a 100% tariff that doesn't cost anything and we might still resort to that approach, i.e. let the employment come about first and then gradually reduce the tariff to 56.1%. However, for various purposes, notably the expectations of market agents, it is better to see if we can directly go for the 56.1% regime.

Table 13 reviews the frontloading costs and their gradual reduction as a result of increasing savings as more and more unemployed find a job. It considers two scenarios. In the first scenario we assume a speed of adjustment of 4000 jobs in two years, evenly distributed as 50% per year. In the second scenario we need three years, with the 4000 jobs evenly distributed again. After the adjustment period, the savings have reached their maximal value. This also allows us to calculate the pay back period, i.e. how long it takes to pay back the costs made earlier (neglecting a rate of interest).

Table 13: Cost and pay back, depending upon the speed of adjustment²⁹

ANG million	Year 1	Year 2	Year 3	Total	Profit p.y.	Pay Back Period
Speed 1/2	50%	50%		100%		
Variant 2a	9.6	3.2		12.8	4	3.2 Years
Variant 2b	13.2	4.4		17.6	1.5	11.7 Years
Speed 1/3	33.3%	33.3%	33.3%	100%		
Variant 2a	13.3	6.4	1.5	21.2	4	5.3 Years
Variant 2b	15.8	8.8	2.7	27.3	1.5	18.2 Years

What is the likely speed of adjustment ? The measure consists of the elimination of an artificial blockage of the economic process. At other wage levels there are no such blockages and we see that employers and employees take the opportunity to create jobs and do them. There is nothing special about the new wage levels we are considering here. For that reason we may expect that those new jobs will be created and taken fairly quickly. The most likely outcome is that it will take only two years for this to happen (though it will not be precisely 50/50).

The government thus requires ANG 12.8 (variant **2a**) or 17.6 (variant **2b**) million to get this done. Since the precise intention of the operation is to change taxes and premiums, it makes more sense to finance not by taxation but by capital reallocation. The deficit may temporarily rise since it will eventually decrease. Unless we can find idle reserves.

²⁹ Result from filling in different numbers of newly employed in the CBA in *Appendix K*.

27. Choosing either variant 2a or variant 2b

The properties of the two variants may now be summarized. Variant 2a leaves much intact above ANG 17,090 and thus is neutral for a large section of the population. Variant 2a has a much smaller range for the grossing up of wages. This also prevents problems with pensions that are based upon the gross wage. Variant 2a brings more savings. Variant 2a requires a smaller investment in frontloading of costs. Variant 2a also appears easier in terms of control (*Appendix M*), precisely for the property that premiums above ANG 17,090 are similar to proportional premiums. Note that the exemption applies for everyone, but due to the take-over rate in the mid range that exemption is essentially eliminated. Though variant 2b was designed to mimic the present idea of a “constant rate” and was naively expected to be easier to control, it turns out that 2a is better. In sum, variant 2a scores best on all points and can be advised without hesitation.

This also causes that this book only presents the results and graphs of variant 2b but does not present the actual calculation of premiums and the cost benefit analysis of variant 2b. These are quite similar to those for variant 2a so that adding more such appendices would only cause superfluous tables and pages.

28. The additional option of subsidies

The elimination of the tax void does not yet use wage cost subsidies. There are implied “subsidies” that correct for wrongly levied premiums – but there is no subsidy window. The situation becomes different when one creates an office window that actually hands out subsidies. The negative properties of subsidies are distortion of competition, red tape and the risk of fraud. Thus it is better to first eliminate the tax void and then work from there. The following discusses an approach once the tax void no longer exists.

Productivity levels are such (see Figure 5) that some subsidy seems unavoidable. We assume that such subsidies are required on an annual base too since there are persistent problems with productivity. An exhaustive approach gives freedom for the willing and blocks free-riders to evade their responsibilities. Elements are personal coaching to reduce barriers to the job market, and some provisions for meals, clothing and housing. Current benefit for the unemployed (“onderstand”) is ANG 3,552 per year, quite low, which implies a replacement rate that flashes that the barriers to the labour market are of a different nature than mere monetary disincentives. Adding the sales tax (taken as VAT) of ANG 726 gives ANG 4,278. We neglect the PP-card since health costs are provided with or without work. Thus coaching and subsidy costs of ANG 4,278 can be spent annually and still make the operation economically profitable once the person finds a job. Notably, the subsidy would only be used in a job situation. With the new minimum wage set at ANG 11,392, these subsidies reduce wage costs to ANG 7,114 per annum or ANG 3.43 per hour. The estimated productivity distribution shows that the new employment in the range between ANG 7,114 en 11,392 would be another 4.5%, about 3000 on the Antilles exclusive of Sint Maarten. The wage sum of ANG 7,114 for 3000 jobs is about ANG 21 million or 0.4% of national income.

Note that ‘traditional’ or ‘conventional’ calculations of subsidy requirements introduce an element of double counting. To reach a lowly productive worker, those calculations first count the subsidy to remove the tax void for that person and then add the subsidy to go below exemption. This gives a sizeable overestimate of the required subsidies. The elimination of the tax void is gratis and shouldn’t figure in such calculations.

This argument directly applies to Sint Maarten. If we assume that Sint Maarten sets the minimum wage at the higher value of ANG 16,122, then we may still assume that it imposes a subsidy that has two effects: (1) to eliminate the tax void for wages above the net minimum, with a similar employment effect of 6%, and (2) a pure subsidy for wages below the net minimum, with a similar employment effect of 4.5%. The wage cost boundaries for Sint Maarten are a bit different from those on Curaçao but for convenience we take the effects to be the same. What is important is that the first effect doesn’t come with a real cost since the subsidy is again collected as a premium.

Table 14 then gives the overview of the overall effect. As national income rose by 0.8% for the elimination of the tax void on the Antilles exclusive of Sint Maarten, its inclusion now causes an overall rise by $0.8 / 4000 * 5200 = 1.04\%$. Similarly, the effect of the subsidy is $0.4 / 3000 * 3900 = 0.52\%$. In sum national income will rise by 1.5%.

Table 14: General employment effects (1000s) ³⁰

	Labour force	Effect void		Effect subsidy	
Curacao	60	6.0%	3.6	4.5%	2.7
Sint Maarten	20	6.0%	1.2	4.5%	0.9
Other	7	6.0%	0.4	4.5%	0.3
Total	87	6.0%	5.2	4.5%	3.9



To reduce distortion of competition, red tape and fraud, the best approach is to certify companies for the use of such subsidies. The Ministry of Labour would do the certification and do inspections. Certification means that the company can freely use the subsidy without more red tape. One works in trust, in business as usual, and with only marginal external inspection. If inspection shows abuse of subsidies, for example when an existing worker is fired to be replaced by subsidized workers without economic reasons for the survival of the company, then the certification will be repealed.

Table 15 reviews company sizes in terms of number of employees and turnover. Certification is relevant for the medium and larger companies. It appears that there is ample scope for certification: 1838 companies with 48,000 workers. If half of these companies have adequate systems of administration and can be found to work with subsidies in trust, then the administrative load for 3000 jobs on the Antilles exclusive of Sint Maarten and 2100 jobs on Sint Maarten seems manageable.

³⁰ The effect of elimination of the tax void on Sint Maarten is achieved by a wage cost subsidy, which is not counted as belonging to the last two columns since it only compensates for wrongly levied premiums. The 9100 jobs thus are composed of 5200 by the tax void and 3900 by subsidies, or 4000 by the “tax void” and 5100 by “subsidies” (note the quotes).

Table 15: Companies by size (CBS Business census 1998)

Company size	Number of employees	Turnover in mln ANG	Number of companies	Total employment
Micro	<5	<0.5	4107	7945
Small	5-<10	<0.5	685	4207
Medium	10-<50	0.5-<5	1704	28569
Large	>50	>5	134	19634
Medium or Large	>= 10	>= 0.5	1838	48203
Total	> 0	> 0	6630	60355



Is it wise to introduce wage cost subsidies at the same time with the elimination of the tax void ? Doing so might tempt employers to also require a subsidy for workers who could already be employed merely by the elimination of the tax void. Thus it might seem more prudent to first eliminate the tax void, then wait the two years mentioned above, and then introduce the subsidy. On the other hand, this would prolong the period of grave poverty for the 3900 persons involved (assuming that the 1200 on Sint Maarten in the tax void will be served anyhow). This would make it attractive to introduce the measures simultaneously. Perhaps there could be misallocations in the short run, but in the longer run the levels of productivity would show themselves and allow to see who can earn his or her own income and who would remain dependent on a subsidy. It is a choice on which there is, in general, no clear advice. However, if the economy would enter a dynamic period then the second approach would be most suitable.

The current system of taxes and premium might be maintained by introducing a subsidy rather than eliminating the tax void. This might even be a short run solution if it doesn't appear feasible to manage the changes. But making people's work depend upon subsidies clearly is second best compared to the basic job market process. It makes a difference whether 9100 or 5100 people rely on such a system of subsidies.

29. Co-ordination and implementation

The tax void came about from an insufficient degree of co-ordination. We have been considering social security laws, worker health and accident insurance, general special health insurance, social benefits, taxation, surtaxes of the Island Governments, their PP-cards, minimum wage regulations, vacation and holidays, collective bargaining, government contributions on co-insured and former employees, rules on parttime workers, and administrative systems of tax and premium collection. Somewhere in this "morass" the shining clarity of exemption of minimum wage workers was lost.

Repairing this will be quite some legal enterprise. The issue is dispersed over various laws, rules and regulations. One can consider to change them entirely or merely add new ones stipulating the exceptions. One may also have to solve issues of competence, for example in the choice of tariffs. Subsequently, the whole package must traverse the channel of advice, from the various ministers and the Council of Ministers, to the

government Departments, Islands, Institutes, Social Economic Council, unions of employers and employees, the State Advisory Council, and, of course, Parliament.

In addition, there are some other proposals in the pipeline that compete for attention. One may think of national health insurance, adjustment of the retirement age, extending insurance packages, changes on the minimum wage, claims by SVB that premiums are too low and need to be raised. Some of such measures might be taken along in the elimination of the tax void, but, the risk is that the measure on the void loses its clarity of focus. The attractiveness of only eliminating the tax void is that it is a Pareto improvement, a win-win situation, such that some can benefit without others losing out. Mixing such a measure with other measures that are not win-win may prevent it from happening.

It will require effective management to bring a change about. Note that while premiums and minimum wage levels might be changed somewhere in the year, taxes are generally levied on a yearly basis. Thus one must target to enact the elimination of the tax void for a fiscal year. A government wishing to do something about unemployment thus would need to focus on this – and allow some delay for other measures.

Unemployment by the tax void provides one example of the failure of co-ordination on an issue that is crucial for living conditions of large sections of the population. There will be other examples. This highlights the need for adequate co-ordination.

V. National debt and the Central Bank (BNA)

Mr. Emsley Tromp, President of the Central Bank of the Netherlands Antilles (BNA), presented a plan for the solution of the public debt – i.e. Central Government and Island Governments – at an University of the Netherlands Antilles conference November 12 2005, see Tromp (2005). This chapter is based upon my “A reply to the speech by Mr. Emsley Tromp of the BNA on the solution of the public debt of the Netherlands Antilles”, January 12 2006, see my website. That reply is updated now using the BNA Annual Report 2005. Since this present book is for an international audience that is less interested in the distinction between Central Government and Island Government debt, the terms “national debt” and “public debt” can be used as identical. For historical comparisons it is important to observe that the CBS started using the UN System of National Accounts SNA 1993 methodology in 2005, finding that national income is higher so that the public debt ratio is much lower than the 96% as previously thought. Now it is 86.8% of GDP in 2004 and 84.4% in 2005. Tromp (2005) accepts this change. At the time of the speech his adjusted highpoint is 90% in 2007, still quite high.

30. Over-accumulation of assets at the BNA

Public debt is actually lower since the common calculation of the debt does not include the assets at the BNA itself. It also appears that BNA has been over-accumulating 8.6% of GDP since 2004, see Table 16. The BNA uses three months of imports on the trade balance as a criterion for its foreign exchange reserves, complicating the discussion by the distinction between all assets and only those in the form of foreign exchange and by the distinction between the trade balance and all imports (including services). There are also the two separate norms on the national debt and on import coverage.

Table 16: Assets, imports, three months imports, GDP

	2000	2001	2002	2003	2004	2005
BNA foreign exchange reserves	466.7	539.0	714.1	667.5	748.8	822.2
BNA Assets (total)	849.4	1023.3	1148.1	1164.7	1378.2	1477.5
Trade balance imports	2964.7	3126.6	2859.9	2992.3	3500.6	4090.6
Three months = imports / 4	741.2	781.7	715.0	748.1	875.2	1022.7
BNA For-Ex in % Imports/4	63.0%	69.0%	99.9%	89.2%	85.6%	80.4%
BNA For-Ex as import months	1.9	2.1	3.0	2.7	2.6	2.4
BNA Assets in % Imports/4	114.6%	130.9%	160.6%	155.7%	157.5%	144.5%
GDP, market prices	5009.2	5161.8	5199.8	5373.6	5514.1	5771.1
BNA Assets in % of GDP	17.0%	19.8%	22.1%	21.7%	25.0%	25.6%

Thus we need to discuss the following issues:

- Can all BNA assets be deducted from national debt ? In that case the debt would drop by 25.6% points from 84.4% to 58.8%.

- Would it be possible to directly transfer 8.6% points of those assets to the Central Government, reducing BNA's "official figure" of national debt to 75.8% ?
- BNA gold reserves are ANG 305 million (on December 31 2005). Why is gold not included in the foreign exchange reserves ?
- Why so much gold anyway ? It doesn't generate any interest. In a fiduciary system of money there is no place for gold.
- Why only imports from the trade balance (commodities) and why not services ?
- Why holding foreign exchange and why not a smarter way to insure against exchange rate crises, like contracts with the IMF and the DNB ("De Nederlandsche Bank") ?
- Can we find more cases of over-accumulation ?

To discuss these questions, the BNA Annual Reports will be valuable. However, it must be noted that there is a different style in reporting between the US Federal Reserve and the European Central Bank, and that unfortunately the BNA follows the European mold. The US Fed reports separately on its monetary function and its functioning as a company. That allows a better distinction between its monetary activity, reserves and obligations ("Statement of conditions") and the pure business data and indicators ("Balance sheet"). In Europe all assets and liabilities are consolidated. The disadvantage of the EU method is that it allows less insight in the different activities.

The BNA is an expensive operation. The "general expenses" rise by 15% from ANG 28 to 32 million (in 2003 25 million). The Annual Report however does not provide data on the number of employees, their salaries tabulated by function, facility costs and the like. Neither does the BNA report how much it costs to store and guard its stock of gold.

31. Over-accumulation of gold

Gold doesn't pay interest, only changes in value, and costs in storage and security. Gold has no place in a system of fiat money, see Colignatus (2005d), here also *Appendix O*.

In 2005 gold forms 21.1% of the BNA assets, a percentage of East European size. By comparison, the Dutch Central Bank (DNB) in 1996 sold a third of its gold stocks and switched to interest earning assets. A US Federal Reserve Study suggests the same, see Henderson et al. (1997). Table 17 reviews the situation at some Central Banks in 2004. It appears that Europe still holds relatively much gold while the US Fed is in line with the concept of fiat money.

Table 17: Assets and gold for some Central Banks, 2004

All in millions	BNA (ANG)	US Fed. Res. (\$)	ECB (EUR)	EUsys (EUR)
Total Assets	1378.2	814,946	90,212	884,324
Gold	271.7	11,041	7,928	125,730
% Gold in Assets	19.7%	1.4%	8.8%	14.2%

The Eurosystem consists of the ECB and 12 national Central Banks

BNA values gold in the following manner.

“Gold is valued at the average market price in the three years preceding the date of valuation. Gold is revalued every year. Unrealized gains from revaluations are added to the special reserves after approval by the Minister of Finance. Unrealized losses are deducted from the special reserves. If these losses are greater than the reserves, the difference will be deducted from the result.” BNA (2006:21).

The “special reserves” are booked as a liability to balance the gold assets, meaning that they are only an accounting entry. The rule above is also used for foreign exchange reserves, but the change in the special reserves from 2004 to 2005 was likely determined mostly by gold, see Table 18. Since the BNA reports no buys or sales, the average rise in the price of gold over 2003-2005 thus was 12.4%. This must be related to the price of oil and the need of oil producing countries to invest their receipts. From 2005 to 2006 the price of gold rose about 20% due to unrest in the Middle East and then dropped again somewhat. A main conclusion is that the stock of gold of the BNA thus is more valuable than actually reported.³¹ The BNA was “lucky” with respect to the “unluck” of the rest of the world. A Central Bank however should not speculate but stick to sound policy, which should be based upon the notion of fiat money (unless one wants to back up notes by gold).

Table 18: Gold (asset) and the special reserves (liability)

ANG	2004	2005	Difference
Gold	271,727,664	305,452,117	33,724,453
Special reserves	214,741,510	248,360,908	33,619,398

The very method of valuation strikes one as rather bureaucratic. It requires a statistician to calculate a three year average and it requires a signature of the minister of Finance as if this was some act of importance. It has the appearance of prudence but real prudence is to be found in policy rather than bureaucratic ritual. The real cause for the ritual seems to be that the gold stock is oversized so that it creates some nervousness and the need ‘to do something’. Not knowing what to do, one resorts to ritual. Ritualistic behaviour already shows from keeping on to gold anyway. Gold has traditional value and contributes to the trust of those who do not believe in fiat money. All in all, prudence suggests:

- (1) Follow the US Fed so that gold is 1.5% of assets. That means that a stock of ANG 21.7 million can be kept (market price).
- (2) The remaining ANG 283.7 million (BNA price) can be sold (for a higher price). The impact on the world market will be small. A gradual sale, say spread out over three years, will not be needed unless gold futures suggest a different course.
- (3) Gold can be valued at the market price of December 31 without the need of averaging and the signature of the Ministry of Finance. The Annual Report should also record the stock composition (bullion or historical coins) and the cost of storage and security.
- (4) The proceeds of the sale can be invested in USD paper that might generate 6% interest or an annual revenue of ANG 17 million. (a) This revenue would be

³¹ See for example www.kitco.com for the latest price and historical graphs.

predictable compared to the fluctuating price of gold. (b) Note that the ANG is linked to the USD. Gold fluctuates independently from the USD so that holding USD paper has the added value of supporting the currency link. (c) USD paper could be added to the foreign exchange reserves relevant for the import-norm. (d) There is scope for a reduction of the rate of interest in the country. (e) It becomes easier to develop norms for asset management, thus for the return on investment and the size of assets (which is artificial for gold that merely fluctuates on the world market).

32. Holding on to other reserves

When the BNA holds on to reserves then there must be a good reason for them. Either because these BNA reserves mean lost interest, or cause interest payments on the national debt, or these cause a rise of national debt when they are not deducted from the national debt.

BNA (2006:60) mentions “undistributed earnings” and a “reserve fund”, with a total of ANG $24 + 30 = 54$ million. These could be transferred to the Central Government. The “reserve fund” is based upon the law created in P.B. 1985 no 1983, to increase the financial solidity next to the foundation capital. However, that solidity might also be achieved by a minimum reserve requirement – and the BNA has ample reserves.

33. Seigniorage

For this section and the next one you would benefit from Colignatus (2005d), “A better way to account for fiat money at the Central Bank”, here also *Appendix O*.

New money created by seigniorage can be transferred to the Central Government, that subsequently spends it and brings it into circulation. Where nominal GDP grew by 4.3% in 2005 and assuming a constant velocity of money, the transfer from seigniorage should also be 4.3% of the stock of money. A problem is the definition of that stock. If only bank notes in circulation to the value of ANG 284 are taken then seigniorage is ANG $284 * 4,3\% = 12,2$ million, which indeed approximates the growth of that stock of money with respect to 2004. The transfer to the Central Government was 58 million, of which 52 million was for the “license fee” (actually a tax on money exchange). Thus only 7 million has been transferred from other causes, including interest receipts.

M1 and M2 grew by 11.7% and 9.4%, BNA (2006:30) table 16. This growth was much higher than 4.3% so that not the government but commercial banks had the advantage of seigniorage and the growth of money.

A difficulty is the use of the US dollar in the economy. Are dollars in M1 ? As the BNA holds dollars, can commercial banks borrow its dollars ? BNA (2006) doesn't discuss the issue.^{32 33}

34. Fiat money and government bonds

There is a general problem within the circles of Central Banking and monetary policy on perceptions how to account for the stock of fiat money. A point to see is that government bonds that are said to 'cover' the stock of fiat money should not be counted as part of the national debt, see Colignatus (2005d), here also *Appendix O*.

BNA has ANG 186 million on government bonds in 2005, notably an increase from the 110 million in 2003. This amounts to 4.5% of national debt, 10.5% of Central Government debt, and 3.4% of GDP.

BNA (2006:62) explains that these holdings are "mainly" for monetary activities. This seems partly right. However, another part might be "monetary finance" or "using the printing press".

(a) The monetary mechanisms are the following. By buying bonds and thus putting money into the economy, the value of bonds rise and the yield falls. By selling bonds and thus taking money out of the economy, the value of bonds drops and yield rises. The monetary effects can also be attained by adjustment of the reserve requirements for commercial banks, both for liquid deposits at the Central Bank and for solvability. The amount of money also tends to affect inflation. Another important consideration is that the market for government bonds (also with a long maturity) should be 'liquid' so that investors feel secure about buying and selling.

(b) An accounting practice is that government bonds (part of national debt) (an asset to the Bank) are balanced by currency in circulation (seen as a 'liability' to the Bank). See Colignatus (2005d), here also *Appendix O*, that this practice is ill-founded. Thus, this coverage is not required. (It would also be strange that the government would not be able to pay of all of its debt since it would have to 'cover' currency in circulation.)

³² A related issue is money laundering. It is mentioned by BNA (2006:55) paragraph 6.2, but no data are presented. For this economy it might be an important phenomenon, for example when money is laundered via casino's.

³³ A related issue is dollarization, for example for the smaller countries after a split up of the Netherlands Antilles. In Spring 2006, this idea caused some national debate. The basic issue is to balance the benefit of seigniorage of an own currency with the risk of abuse of the printing press. Using the US dollar means the loss of seigniorage but has the advantage that one cannot use the printing press (though Caribbean pirate islands might think differently, and that might even be an interesting monetary compromise). It must be noted though that a Central Bank has more functions, such as the regulation, inspection and control of commercial banks and pension and insurance funds. This means that the Bank should be staffed by capable professionals with a high level of integrity anyway. This means that the risk of abuse of monetary financing will also be low. See further the appendix on the Central Bank in DRGTPE:281. PM. Trust works as a quantum leap. You either trust people and then lots of things are possible, or you don't trust people and then hardly anything is possible.

- (c) It is strange that government debt held by the Central Bank is not deducted from the official figure for debt. The nation has a debt to a Bank that it owns. The government pays interest to the Bank, that the Bank submits as profit back to the government.
- (d) A norm for holding government bonds should be derived from norms for inflation and the rate of interest. Open market operations (selling and buying bonds) can sometimes be faster than changing reserve requirements. The two measures can have different distributional effects on the commercial banks.
- (e) A trading stock of bonds doesn't have to be large. If the BNA wants to buy more bonds it could print more money, and if the BNA wants to sell more bonds then it could print more bonds. In that sense open market operations are only the management of printing and storage costs, with the objective to affect inflation and the rate of interest via the term structure of outstanding instruments. If a trading stock of bonds of ANG 10 million is required then the BNA can transfer ANG 176 million back to the government.

35. The norm for national debt

Appendix N contains the formulas for the norms for the national debt. Table 19 reviews a scenario of growth of per capita income and national debt, assuming that the latter becomes sustainable under those growth conditions. The table takes per capita income as the indicator of the technology frontier (though it is an inferior measure) and assumes that the Netherlands Antilles (NA) might be at 80% of the USA in 20 years, while assuming that public debt in 2009 is 100% of GDP. For example if real growth per capita in the NA is 5.5% in 2009, if population grows by 1% and inflation is 4%, then a sustainable budget deficit (not enlarging the debt) is 8.5%. If the condition is that sustainable national debt could be 60% in 2024 then 40% of redemption in 15 years means a reduction of the deficit by 2.7% points any year. The reduction from 8.5% must be larger if growth slows too, due to getting closer to the technology frontier. Once the 60% has been reached then the new sustainable deficit is 3% provided that nominal growth is 5%. Note that a horizon of 20 years is economically more useful than 10 years. For example fully catching up with the USA (when it grows 2% per annum) in 20 years would require a real growth of 5.1% per annum.

Table 19: Growth of income per capita and sustainable debt

Income per capita	2004	2009	2014	2019	2024
NA (\$)	17127	22374	27738	32965	36963
USA (\$)	31094	34330	37903	41848	46204
NA / USA	55%	65%	73%	79%	80%
average growth / capita NA		5.5%	4.4%	3.5%	2.3%
average growth / capita USA		2.0%	2.0%	2.0%	2.0%
growth population + inflation		3.0%	3.0%	3.0%	3.0%
nominal growth NA		8.5%	7.4%	6.5%	5.3%
Debt as percentage of GDP		100%	90%	80%	60%
Sustainable budget deficit		8.5%	6.7%	5.2%	3.2%

A core question in finance and economics is how high growth can be. The allowable deficit then only follows from debt and the rate of interest. The finance and monetary approach turns this around so that debt, interest and deficit determine the room for growth. It is important to balance these views, and to keep in mind that investments could enhance growth and indirectly finance themselves.

The President of the BNA (in Tromp (2005:8)) refers to a 40% - 50% norm: “*Based on an IMF study*, (italics are added / TC) the Debt Committee (“Rapport Schuldenproblematiek” / TC) estimated a sustainable debt ratio for the Netherlands Antilles on the order of magnitude of 40% - 50% of GDP. This ratio is about half the current value.”

The following is necessary to understand this norm:

- (a) The IMF study referred to is IMF (2003), but this is on low resource economies. The definition for those economies is that there is little room for productive investments, so that they should not borrow, or at the most 35%-40% of GDP.
- (b) The highly developed nations in the EU have adopted a norm of 60% of GDP. (With a sustainable deficit of 3% provided that nominal growth is 5%.)
- (c) *Based upon these two data*, the mentioned Debt Committee selected its 40% - 50% norm.

Thus the Debt Committee has not really researched that norm. It assumes that the Netherlands Antilles are between “highly developed” and “low resources”. However, the NA are only “low income” and not “low resources”. The NA have ample scope for productive investments.

Note that IMF country report No 03/159 mentions that islands economies do not fundamentally differ from other economies, especially in a globalizing world economy. Thus there is no reason why the NA economy couldn't grow faster. The NA economy is at an appreciable distance from the technology frontier of the highly developed economies of the USA and EU, so that, in fact, with its potential, investments can have a high rate of return. These profitable investments can be done not only in the market sector but also in the public sector. Education creates an educated work force. Health care creates a healthy work force that has the energy for the work place. Infrastructure and internet links create a base for industry and services. A decent government structure creates the secure environment for the free play of market forces. While the main problem is to strike the proper balance between public and market investments, the conclusion remains that the scope for growth is large. And while market investments are lagging, not-investing for fear of the national debt means merely saving with no real return.

Thus, national debt might be 100%. The only point is that the money should be spent productively and rather not on high salaries, perks, graft, and so on.

Two final aspects may be mentioned:

- (1) A sizable part of public debt is to the government pension fund APNA, 1.6 billion or 47%. For some vague reason government pension funds are not considered part of the concept of ‘being public’ so that their assets are not consolidated with public debt. This kind of debt nevertheless is rather special. In an abstract manner it does not matter much whether the government pays pension premiums or debt plus interest on debt to the pension fund. Consider: (a) Internationally, there are

governments that finance government pensions “pay as you go” and others, like the Netherlands and the Netherlands Antilles that are capital funded. International comparisons (and norms) must be corrected for these different approaches. It would be ironic that a decent way of financing, from capital, would be punished by counting it as debt. (b) The issue of pensions can become more manageable when the pension age goes to 67 for men and 69 for women, and when the additional pensions (on top of the national retirement AOV) switch from “defined benefit” to “defined contribution”. Rather than merely saying that the national debt is too high, policy advisers could identify what are feasible measures for the real economy.

- (2) Adam Smith observed in the “Wealth of Nations” that the degree of specialisation is determined by the size of the market. It thus is important to have a population of some size in order to allow for specialisation, i.e. the economies of scale. An important investment in the Netherlands Antilles is in population growth. In the Netherlands Antilles, a sizable part of national resources is absorbed by the raising of children and their education. In an “income per capita” calculation, the size of the population reduces the indicator, while in fact the population increase can be seen as an investment that creates opportunities for growth. There are four points here: (a) It is argued sometimes that some Islands do not have a sufficient size of population: this partly proves the point. (b) Julian Simon is known for a related argument for the world population. (c) As for the world population, its size is perhaps sufficient, at least from the viewpoint of the environment. But it does not necessarily follow that the Netherlands Antilles are sufficiently populated. (d) With the migration to Holland (and elsewhere) there has been an important “reverse development aid”.

36. National debt restructuring

Tromp (2005) indicates that the Dutch Government could refinance the debt at a lower rate of interest. This issue of “asset and liability management” (ALM) for the national economy is a bit similar to such ALM for the BNA itself, see below.

- (a) Refinancing at a lower rate would seem to be the normal state of affairs and not a special favour as part of a reconstruction to split up the country. Both nations form part of the Kingdom of the Netherlands and thus have a base for joint operation.
- (b) The NA economy is located in the US dollar sphere. The Netherlands Antilles guilder (ANG) has been linked to the US Dollar for about 30 years. The probability of breaking this link is negligible. One would suppose that the Netherlands supports this linkage so that *loans* of the Netherlands Antilles from the Netherlands can be in US Dollars and so that the risk of the Dollar / Euro exchange rate (which is an issue of the giant economies) should fall on the strongest partner. There is no *need* for the Netherlands Antilles to borrow euro’s. Thus, the NA itself can restructure its public debt, at the US interest rate level of 5%, while the Netherlands and De Nederlandsche Bank would only be involved in co-operative agreements (but need not be).
- (c) If the NA wishes to hold *assets* in euro denomination, when it fears a US dollar slide or even a hard landing (see Rajan (2005)) then this might be considered in relation to the economic contacts with the Dutch economy. Note, thus, that an exchange rate loss on an asset is less worse than an exchange rate loss on a loan. Yet, in an integrated framework,

if there would be a loss on the euro, and the euro would rise in value, then also tourism receipts from Europe would rise, so such things need to be taken into account.

(d) The rate of inflation in the Netherlands Antilles is primarily determined by the rate of inflation in the US. The influence is direct for imports (by direct exchange) and more indirect for exports (by expectations, notably that prices charged to tourists should be in line to their expectations). It is interesting to observe that The Economist (2005) recently suggests that inflation rates in the world as a whole are more influenced by international factors. Useful reading on world inflation still is Adam Smith (1981), “Paper money”.

NB. Important is the level of taxation. Even the recent December 2005 IMF visitation advised that the 12.5% reduction of taxes is repelled and that the former level of taxation is restored.³⁴ The reduction of taxes means that the same amount now must be borrowed from those same rich tax payers, at a higher rate of interest, exempt from taxes. This seems like a strange way to ‘restructure’ debt.

37. The “Tromp plan”

Assuming the crowding out of private investments by public borrowing, Tromp (2005) suggests that the Netherlands, subsequent to restructuring the debt, completely takes over *all* NA public debt. There should be a special foundation to hold this debt. Also, the BNA suggests that the NA, in exchange, should forgo future development aid from the Netherlands. The NA would save about ANG 280 million of interest payments (and non-mentioned redemption) and would lose ANG 170 million in aid. PM. This aid is about half of what the Netherlands spends on the Netherlands Antilles: the other half goes to support of essential government functions, and would remain intact.

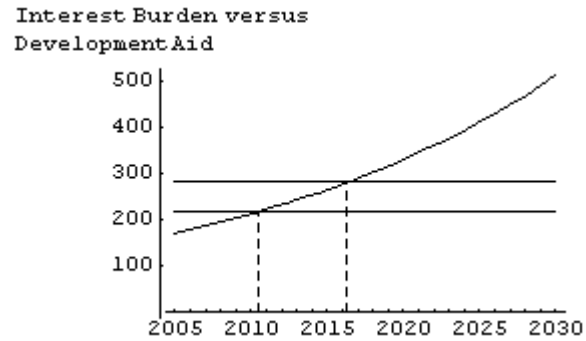
(a) There are times when it can be a bit awkward when such ideas are launched. There is a risk that the Netherlands adopts the idea of stopping future development aid, but does not adopt the debt.

(b) There is a risk that the numbers don’t quite match, since the ANG 280 million is based upon high interest rates (some 10% of some years ago), but a refinanced debt at lower rates makes for lower interest payments, while development aid might actually rise in the future. Indeed, the debt base is corroded by inflation while aid rises with general welfare (inflation and real income).

This latter point can be clarified by Figure 14 that uses the data of page 7 of Tromp’s speech and comparative figures as they were known in autumn 2005: total debt is ANG 4.7 billion and interest payments are ANG 280 million, so that the implied rate of interest is 5,957 % (which is low, but there can be interest free loans). US Treasury bonds (20 years maturity) do about 4.6% in 2005. Refinancing the debt thus saves ANG 63.8 million per year. Let us also assume that the development aid of ANG 170 million grows annually with 4.5% consisting of about 2% inflation and 2.5% real growth (or other mixtures). This development aid will have grown to the equal level of unreconstructed debt in 2016 and to the equal level of reconstructed debt in 2010.

³⁴ <http://www.centralbank.an/tables/misc/IMF%202005%20Consultation.pdf>

Figure 14: Interest burden versus development aid



(c) If the pension fund APNA would receive lower interest payments on the public debt that it holds, the NA government bodies would have to pay more premiums. There can be more such hidden effects.

(d) Indeed, one such hidden effect applies where the BNA states: “this proposal does not imply that we will not or cannot receive any development aid from the Netherlands in the future. However, such aid will be of an incidental nature for specific projects and/or in the case of natural disasters, external shocks, or periods of severe crisis.” It is obvious that the threshold for such aid will become extremely high, as it is high already.

(e) The suggestion has been based upon the argument that national debt would not be sustainable. Those arguments are not convincing.

(f) Taking all this into account, the BNA suggestion is not convincing.

38. APNA and SVB

Apart from the issue of accounting for government pension funds in public debt, we must observe that the BNA does not present the analysis given below which are another reason why one starts to think differently about the national debt, namely (a) the APNA investment portfolio and (b) the SVB capital accumulation.

In itself it is a bit strange that the BNA doesn’t make these analyses. The Debt Commission presented a summary table with all debts, of which Table 20 is a selection on the national creditors of public debt (leaving 19% to foreign creditors), *in the precise format as presented there*. This clarifies that it was already highlighted by the Debt Commission that the BNA and SVB held 5% and 9% in 2002. It may be the difference between an accountant who presents data and an economist who thinks about them. Or perhaps there was ‘groupthink’ or other conventional reasons why an institution can go astray.

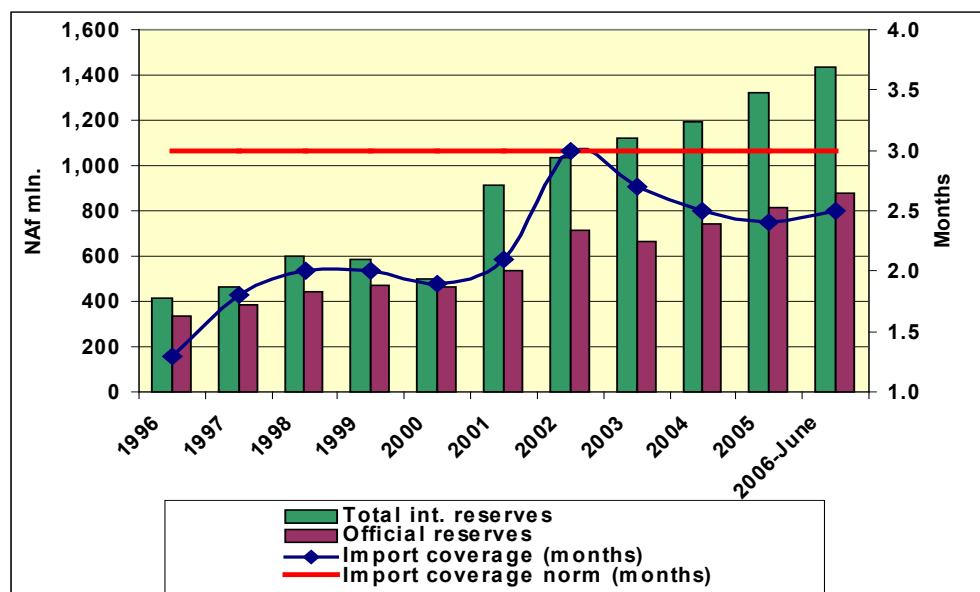
Table 20: National creditors of national debt 2002 (ANG million)

National creditors (81%)	3,123.7
Central Bank	143.5
Commercial Banks	409.3
APNA	1,183.1
SVB	268.1
Institutional and private investors	906.8
Other	212.9
Public investors	1,594.7
Market investors	1,529.0
Central Bank	5%
Commercial Banks	13%
APNA	38%
SVB	9%
Institutional and private investors	29%
Other	7%
Public investors	51%
Market investors	49%

39. The norm of import coverage

Figure 15, on the norm for import coverage, can be found in the power point presentation on the BNA website and not in the PDF of the Annual Report 2005.

Figure 15: Import coverage (BNA Annual Report 2005)



The BNA report on import coverage happens to be a bit convoluted. Official policy is, amongst others: “attaining a level of official reserves consistent with three months of merchandise imports” BNA (2006:5). The term “official reserves” is not defined in the Annual Report but can be found on the website in the Statistical Bulletin, table 1.1, and there it consists of both the foreign exchange reserves and the stock of gold. However, for the norm of import coverage it appears that gold is not included (while also a small item on international liabilities are deducted). Thus, the norm on import coverage is not complete and also requires a norm on gold. (But this becomes simpler if gold stocks are sold.)

The issue is actually more complex since there are also other assets, like government bonds, that might be turned into foreign exchange, so that they also become “official reserves”. Agents in the economy holding dollars might co-operate.

The norm neglects services that are becoming more important. Table 21 reproduces the balance of payments. If services would be included then the reserves should be 35% higher.

Table 21: Balance of payments 2005 (ANG million)

Trade balance	-2,352.4
Exports	1,738.3
Imports	4,090.6
Services balance	1,828.1
Receipts	3,283.7
Expenses	1,455.3
Income balance (labour and capital)	-7.4
Current transfers balance (public and private)	243.0
Current account balance	-288.7
Capital & financial account balance *)	121.7
Net errors & omissions	167.0

Source: BNA (2006:26) table 13

Figures may not add up due to rounding.

*) A minus sign implies an improvement in the foreign financial position

The norm using goods only and at least three months coverage seems to derive from some older European rules of thumb. Though the literature on exchange rate management and currency crises is huge, there is no obvious reference for this norm. It is important however to be aware of some basic relations. If there would be a currency crisis, with the ANG losing value, imports will become more expensive, causing their real reduction, and exports would become cheaper, causing their increase, so that the economy provides a natural resistance. Similarly for a crisis of the dollar. Hence the import norm, without or with services, seems too strict anyway, in particularly if one considers the cost (the ‘insurance premium’).

Merely holding on to foreign exchange causes a loss of interest. If the reserves were invested then there would be a return on investment. To what extent should such reserves be liquid ? There doesn’t seem to be a good reason for a high degree of liquidity. A general investment rule is that liabilities must be covered by assets of at least the same term. But three months of imports are not a liability in that respect and are no such issue

of matching maturities. As said, when the BNA holds on to reserves, and when these are not deducted from the national debt, then one would require good reasons for holding on to them. It could be well feasible to switch from coverage by reserves to coverage by insurance. Such insurance might not be costly, only require contracts with e.g. the IMF or the DNB.

40. Monetary policy

When the BNA warns that national debt might not be sustainable then investors in public paper may require a higher risk premium, causing a rise of the rate of interest for the whole economy, reducing economic activity. One may thus hope for prudence.

The rate of interest is already high and hinders economic growth. Table 22 reproduces the BNA data on the development of interest rates. There appears to be a wide margin between 4.6% (US) and 6.8% (NA) for government bonds in 2004. The pledging rate, charged by the BNA to its borrowers, rose in 2005 from 2.75% to 4.5%.³⁵ Business loans in the NA in 2006 do 10.8% and the penalty rate on overdrafts on current accounts (which overdraft is important for small business when in problems) is 18%. Consumer credit is 14.7% (where the commercial bank states that interest is 7.5% and then adds a “risk premium” which in other countries is already included in the rate of interest).

Table 22: Developments in domestic interest rates (in %)

	2002	2003	2004	2005
Central bank				
Pledging rate	3.5	2.25	2.75	4.5
Maximum CD rate	2.5	1.25	2.64	4.36
Commercial bank borrowing rates				
Passbook savings	3.6	3.4	2.8	2.8
Time deposit (12 months)	5.5	4.9	4.1	4.1
Commercial bank lending rates				
Mortgages	9.4	9.5	8.9	8.6
Time loans	12.4	12.5	12	10.8
Government securities				
Government bonds (5-year effective yield)	7.3	6.9	6.8	6.3
Treasury bills (1 month)	2.9	3	3.7	4.5

Source: BNA (2006:31) Table 17

There is a distinction between the rate of interest and the change in the rate. Given that the ANG has been linked to the USD for 30 years at the same rate, the rates of interest should be almost the same, and not the changes in the rates. Recently the BNA followed the US Federal Reserve in its raising of the pledging rate, but the US and NA starting

³⁵ The government would not borrow at that 4.5% but pays 6.3% on bonds since it apparently expects the pledging rate to rise significantly above 6.3% in the next 5 years.

values were different, so that this does not seem prudent in the light of the scope for more US rises and the need for a NA reduction. The BNA is vague about why it followed the US. This suggests that monetary policy could be reconsidered.³⁶

BNA (2006) explains that there is too much money in the economy, with the danger of inflation, so that the BNA increased reserve requirements by 20% in absolute value (page 35 table 20). The higher rate of interest also allowed, in the opinion of the BNA, the sale of (more) government bonds. The higher rate however also benefitted commercial banks. Their absolute margin rose from ANG 301 to 407 million (table 19 on page 33). This rise is labelled “positive” (paragraph 3.8.1 on page 20), which may be intended as a purely numerical and not normative statement. But it is not correct, also purely numerically, since this concerns a negative amount for consumers and companies. The banking structure actually is rather oligopolistic. Part of monetary policy is to improve competition among banks and to reduce costs for customers. Then one could neutralize money without large rises of the rate of interest. But the Annual Report does not go into this issue.

To make a profit, commercial banks borrow cheaply from the public and loan dearly to customers. This is the market system, but there appears also an implied subsidy of the BNA to commercial banks, since commercial banks can borrow at the low pledging rate and re-loan this at 10.8%. The amount of such loans and the implied subsidy cannot be found in the Annual Report.

41. Crowding out of public investments

Tromp (2005:9) suggests that current interest payments crowd out essential public investments “especially on education, infrastructure, and social safety nets”. It is useful to observe that the BNA agrees that social expenditure such as education and social security can be investments – though not always. And it is true that there is more room for those investments if there would be no interest payments. However, one should take care to note: (a) that there are other ways to improve the national budget (b) even when debt is high then a (social) investment still might have a higher return than the interest on debt. Thus, we should be critical about the idea that cutting down on expenditure to reduce the debt is the only way to release resources for such expenditures. What we rather need are novel improvements in social outlays.

(i) A key example are the regulations on the minimum wage. Given the unemployment for low skilled workers and job entrants, these regulations may have to be reconsidered, which can be done without reference to public debt.

(ii) Another key example are the housing market and mortgages. Banks in the NA expect mortgages to be fully repaid at the age of 60 years, at 8.6% interest, while banks in the Netherlands allow redemption free loans until high old age, at 5% interest. The difference is not only convention but also competition and Central Bank regulation.

³⁶ As John Taylor (1999) observes, monetary economics has been developing its theory and standards over the decades and there still seems room for improvement.

A better conclusion is also that the problem rather consists of the oligopoly of commercial banks. There are various ways to deal with that. For example if the BNA would allow the Netherlands Antilles to become more open to the world then the rate of interest could drop.

42. Asset and liability management

The BNA is not just a monetary authority but also a bank so that we expect some Asset and Liability Management (ALM) to minimize costs and maximize profits. The Annual Report however is vague on its portfolio, the term structure and one cannot check that it charges a higher rate than it pays.

(1) On assets. BNA has assets of about ANG 1000 million of interest bearing paper. When the gross interest revenues of ANG 45 million are assigned to those then the implied return on investment (ROI) of 4.5% is rather low.

The BNA does not report the composition of this portfolio (other than the national yield curve). One supposes that a large section will be held in short term titles which causes the low ROI, though it should be possible to increase yields. For example, above, we discussed ways to restructure debt and other ways to insure for import coverage. We also discussed what to do with interest bearing government bonds.

Thus consider the entry of ANG $822 + 28 = 850$ million. Assume a ROI of 4.5%. Keep ANG 200 as a liquid foreign exchange reserve without any ROI (just for now). Then 650 can be invested at the international rate of 6% and thus with a gain of 1.5%. Annual profits of the BNA can be higher by ANG $1.5\% * 650 = 9.75$ million.

(2) On Liabilities. Most liabilities are without interest, such as currency in circulation and cash reserve requirements of commercial banks. For the time deposits of ANG 174 million (almost ANG 100 million more than 2003) the BNA would pay some interest to the banks. The Annual Report is unclear here. Interest payments are ANG 6.9 million which would imply a rate of about 4% but this causes the question how this relates to the rule that CD's are paid with 1% point below the pledging rate.

(3) Overall profit. BNA (2006:60-61) shows a net income of ANG 57.4 million on total assets per December 31 2004 of ANG 1378, so that the overall return on investment is 4.2% which is low. It is important to realize that this income mostly derives from the license fee, which is actually a tax and cannot be seen as a return on some investment.

It may be granted that the BNA is not a commercial outfit so that calculation of a ROI has some limits. Commercially the ROI on total assets might be less relevant than the ROI on own capital while here we would be more interested in all operational assets. By comparison, commercial banks (BNA (2006:32-33) table 18 and 19) apparently have a profit of ANG 206.5 million on their own capital of ANG 580.8 million, which is a ROI of 35.6%. The BNA however does not present these returns. Preferably in the future all returns are presented and some norms should be developed for the return of the BNA itself.

43. Overview of released resources

Table 23 gives an overview of the resources that we have released above for transfer to the Central Government.

Table 23: Overview of released resources at BNA

Released assets	ANG million		
Reserve funds held onto	54		
Gold	283 (excl. the rise in 2006)		
Government bonds	176		
Total	513		
Increase in ROI	Assets	ROI	Annual income
International reserves	850	4.5%	38
A part to keep this way	200	4.5%	9
A part to invest better	650	6.0%	39
Improvement			10

One part of the released resources are reserve funds that can be transferred only once and that can be used to reduce the national debt. ANG 513 million amounts to 8.9% of GDP. If these earn an average of 6% per annum then these represent a flow of ANG 31 million per annum. The other part consists of reserve funds that the BNA can keep but that get a higher return on investment and thus a higher annual transfer to the Central Government.

This overview neglects the other aspects that we have discussed, such as on the reduction and the reconstruction of the national debt, the reconsideration of the import coverage rule and better monetary policy. On the last two topics we need not extend here. On the first topic the following can be added. As said, BNA holds assets to the amount of 25.6% of GDP and we have released only 8.9% now. The reason to do so lies in the ambiguity of international conventions. For the bigger nations that do not need import coverage such as the USA or the Euro system the convention may hold that Central Bank assets are not consolidated with national debt, while such assets may also be limited with respect to the size of the economy so that consolidation would not have a big effect. For smaller nations that protect themselves with import coverage the latter convention might turn out to be awkward. The jury is still out on what would be the best approach for international comparisons. That said, it remains good to know that the official debt figure may be too pessimistic.

Another point to note is that the norm on debt should be based upon the right IMF study.

44. Other elements in the Tromp speech

There are some other elements that can be mentioned.

(1) The President of the BNA suggests a new Budget Chamber “to safeguard the integrity of the budgetary process”, Tromp (2005:13). This new body would assist the governmental bodies of the Netherlands Antilles.

Aspects are:

(a) DRGTPE has discussed the issue in general. A point of consideration is that the Netherlands Antilles do not have a Central Planning Bureau (CPB) as the Netherlands. Such a CPB is already an improvement. But also the Dutch budgetary process has been in dire straits. The suggestion of DRGTPE has thus been to promote this CPB to an “Economic Supreme Court” with a constitutional function to safeguard the quality of the information that is used for the budget.

(b) The suggestion of a Budget Chamber goes further, in that this body could actually take decisions within that process, and goes less further, in that this change is not at the constitutional level. Such a Budget Chamber takes away allocative power from Parliament but is less subject to the ballot. The BNA also suggests only a “Kingdom’s act” and not constitutional law, so that, in severe cases, such an act might be repealed more easily.

(2) The President of the BNA refers uncritically to the “Committee of Wise Men” who “stated that the central government bureaucracy had created a wasteful duplication of tasks and become prohibitively expensive”. Tromp (2005:11)

This Commission Jesurun has been discussed in Chapter II section 9.

(3) The President of the BNA refers uncritically to the “result” of the Referendum of April 8 2005 on Curaçao. To him it is that the different Islands in the Netherlands Antilles ‘want to go their own way’. Above Chapter II section 9 has already shown this to be a fallacy. One would hope that policy advisers remain critical of the democratic base of such political processes. It is a bit unbalanced to suggest a Budget Chamber to control the political process but to uncritically follow that process on other misguided projects. Policy advisers who can calculate should be able to explain to the general public that 37% runs short of 50% and runs even shorter of the 67% normally required for constitutional change.

VI. National debt and the Social Security Bank (SVB)

45. Over-accumulation of assets at the SVB

The SVB (2006) Annual Report 2005 shows that the accumulated assets of the bank are ANG 679 million, reflecting 1.72 years of premium payments of ANG 394 million, while the legal requirement is only 0.44 years of premium payments (on average) which for 2005 amounts to ANG 174 million. The SVB is designed as a “pay as you go” system and not as a funded system. This means that the SVB has been accumulating ANG 679 – 174 = 505 million, without necessity, and also at a low rate of return.³⁷ Table 24 reviews the situation for the various funds managed at the bank: AOV = national pensions, AWW = widows and orphans, Other = employees sickness (ZV) and accidents (OV). Curious is the AWW. Premiums are 20 million while some 15 million is transferred to its reserves, for some years now, so that reserves are now 215 million, thus 10 times normal receipts. The bank does not provide an explanation – but perhaps it fears an imminent war with subsequent lots of widows and orphans.

Table 24: SVB reserves, legal and actual, 2005

Million ANG		Legal requirement		Actual situation	
	Premiums	Capital	Capital/Premiums	Capital	Capital/Premiums
AOV	203	99	0.49	163	0.80
AWW	20	7	0.35	215	10.75
Other	171	68	0.40	301	1.76
Total	394	174	0.44	679	1.72

The over-accumulation of ANG 505 million represents 8.8% of GDP. It may be noted that only ANG 415 million consists of short and long term loans to the Central Government, i.e. 7.2% of GDP. In this book we take the latter figure as a safer estimate of overfunding, since the other 90 million may be more difficult to handle administratively. It also appears that the legal reserve requirements are overly strict so that they can be reduced to ANG 58 million, releasing another ANG 116 million. Thus over-accumulation is ANG 531 million or 9.2% of GDP. For international comparisons of national debt figures there is the convention that “pay as you go” systems are not included in those figures. Of course there will be obligations in an intergenerational table

³⁷ Portfolio investments are ANG 571 mln of which 136 mln short term. There are 410 mln Central Government bonds of which 337 mln a loan from 2001 at 7.5%. Total return is 38 mln dus 7.1% (apparently gross so that costs still must be deducted).

of accounts, yet that is a different statistic than the figure for national debt. Hence the 9.2% should be deducted from the officially published figure of 84.4% of national debt.

This also means that the annual payment of interest by the Central Government to the SVB actually is a “transfer payment” and not “interest”. Indeed, without this transfer (“interest”) the SVB would show a deficit. This transfer is paid out of general taxation and not premiums. That kind of transfer by the Central Government is correct in itself since the Central Government is legally obliged to provide for any SVB deficit.³⁸

BNA (2006:25) gives the most recent estimate of GDP and its composition, which thus can be corrected by re-accounting for these two entries, reducing interest payments and raising transfers, see Table 25 and its shaded areas.

Table 25: Correction of GDP for SVB over-accumulation³⁹

	2004	2005	*2005*
Gross Domestic Product (GDP)	5514.1	5771.1	5771.1
Central Government			
Revenues	692.3	912.6	912.6
Tax revenues	577.2	607.4	607.4
Nontax and other revenues	115.1	305.2	305.2
Expenditures	898.4	991.7	991.7
Wages and salaries	292.9	282.7	282.7
Goods and services	107.2	123.5	123.5
Transfers	324.3	427.9	467.7
Interest payments	142.0	145.6	105.8
Capital	30.3	12.0	12.0
Budget balance	-206.1	-79.1	-79.1
% GDP	-3.7%	-1.4%	-1.4%
Interest payments (% GDP)	2.6%	2.5%	1.8%
Central Govt. versus SVB			
Over-payment of interest (7.5%)		39.8	0.0
Over-debt		531.0	0.0
Total debt (all governments)	4786.9	4870.8	4339.8
% GDP	86.8%	84.4%	75.2%

There are two clear alternative ways to arrive at this correction – and much of the subsequent discussion is devoted to providing more background so that we can evaluate these two options.:

- (a) The Central Government (that creates the law on the SVB) and the SVB agree that the SVB annuls the loans and sends back funds to the Central Government, to the sum of ANG 531 million, while the Central Government confirms the rule that it will provide for any SVB deficit.

³⁸ Frequently heard warnings about deficits at the SVB thus are of an academic nature.

³⁹ The interest sum of 39.8 covers the 31 actually paid on the loans of 415 to the Central Government, implying an average rate of interest of 7.5%. This same rate is then applied to the reduction of the reserve requirement by 116.

- (b) One tries to develop a scheme to do this gradually, say over ten years. One would also raise premiums and reduce taxes so that the transfer (“interest”) now financed by general taxation is replaced by premium income. Since the gradual adaptation has no quick impact on the officially published figure of national debt, the BNA should agree that it will publish a “corrected figure of national debt” (or both, one with and one without the SVB over-accumulation).

46. Confidence and trust

One important feature in macro-economics is the state of confidence, given by the psychology of markets, consumer confidence, business expectations, Keynes’s “animal spirits” and their influence on the level of investments. It matters a great deal whether the published figure for the national debt is 84.4% or 75.2% (or 66.3% when also correcting for the BNA over-accumulation). When the official figure is high then this negatively affects perceptions of national and international markets, and, subsequently also the very economy: with lower growth and more unemployment.

It is of great interest to a country that it has no reputation of having a high and/or unsustainable debt. Such a reputation increases the risk premium in the rate of interest, while a higher rate of interest reduces business confidence and investments, and causes higher interest payments for the government itself.⁴⁰

Indeed there are comments that have a negative impact on the state of confidence. The president of the Central Bank:

“The public finances are characterized by structurally high deficits and a high and rising debt ratio. As a result, interest payments are absorbing an increasing part of revenues, crowding out funds for important policy areas such as education, crime reduction, and poverty alleviation.” BNA (2005:4)

Statements like these often have little impact on policy makers but more on markets.

Another important condition is that statistical figures should be accurate and that the public – and policy makers alike – can trust that those are accurate. When the published figure for the national debt overestimates the true figure by an inordinate amount, then policy makers shift their attention from ‘positive measures’ such as ‘where to invest’ to ‘negative measures’ such as ‘where to cut down’. The latter is unavoidable when the national debt really is too high but it becomes a costly mismatch if the figure is not correct. The distribution of pain causes longer discussions and bureaucratic battles than the shower of goodies, implying more stagnation.

The BNA again provides an example:

⁴⁰ One element is that the government of the Netherlands Antilles created a tax exemption for individuals buying government bonds. This raised the implied rate of interest, confounding the published statistics on interest payments and the rate paid. It also raises questions of equity. Normally only rich individuals are able to buy such bonds, who thus receive a subsidy. The Netherlands Antilles have a less developed capital market so that the government also provided the service of a relatively safe investment opportunity.

“The old age pension fund (AOV) is facing increasing deficits that should be funded by the government, raising the claims on the budget. To eliminate these deficits, major reforms, of which a gradual increase of the retirement age is an inevitable ingredient, cannot be postponed any longer.” BNA (2005:5)

These reforms have been under discussion for some time. One might conjecture, though with some hesitation, that the reforms might have been easier to achieve if there had been more resources to create an attractive package.

Finance is important but issues are not only financial. The economist considers the real economy. For example, when the greying of society hits the Antilles in twenty years then it will be too late to start building adjusted homes and facilities, since builders will be in short supply and be costly. One should plan ahead and start building now to be ready in time. The argument for doing so is not the “deficit” at the SVB but the total carrying capacity of the nation as well as the fairness and the allocative efficiency of the distribution of costs and benefits between workers and pensioners.

As an expert center on national pension the SVB could be expected to take the lead in taking initiatives and designing proposals. Rather, a frequent request by the SVB is that premiums should be increased – which only the government has the authority to do. It is too easy an excuse however to point to the government in that manner.⁴¹ It is the lure of financial statements and accounting that distracts from the real economy and that seduces the administrator to think that one is seriously engaged and doing a good job. Rather than losing time on premium raises and portfolio management the SVB should focus on reduction of costs and development of its expert function, supporting policy making with data and analyses, working on prevention of sickness, actively informing its customers that the pension age should be higher, stimulating them to take a private supplementary pension, and the like. If the SVB had considered its job from the angle of economics, it might have discovered the ideas in this book 20 years ago.

47. A note on the theory of social expenditure

Provisions like national pension (AOV) were introduced historically in the format of “insurance” for the main reason that people and policy makers were accustomed to that format for existing pensions. That format depends upon earlier views and not necessarily upon modern views. The notion has grown that such provisions actually are of a general nature such that they also should be financed by general taxation. SVB went that road already by not fully financing with premiums but accepting the transfer (“interest”) from the government. It can also be observed that measures are proposed using the language of “insurance”⁴² while they are not based upon actuarial analysis and while they don’t

⁴¹ It is often forgotten in arguments for an increase of premium rates that the premium base already may rise, notably with the rise of wages, so that premium revenue rises proportionally. SVB (2006) is vague on the development of the premium base.

⁴² Vide the extensions of “the premium base” by increasing “maximum premium income” or the introduction of an “additional bracket” or the inclusion of “other incomes” (and even pensions). Such measures would only be actuarially correct if the extended premium is balanced by a higher benefit, which generally is not true for a uniform national pension.

rely on true premiums. It can also be seen that target groups benefit from tax-based expenditures while that support might also have been given via premium-based provisions; an example is the “old age tax credit” that runs via taxes rather than via the AOV.⁴³ Transfers from tax receipts thus can have a good reason.

It is conceivable to finance national pension and the other provisions fully from general taxation. It is better however not to do so. National tax compliance benefits if contributions are earmarked for popular goals. The size of the premium also provides a yard stick for individual pension or health arrangements. It thus suffices when tax funds have a limited role. Similarly, national pension better isn’t a funded system. It would lead too far to go into detail. It remains useful that there is a legal reserve requirement at the SVB, merely to cover the liquidity risk for pensioners and other benefit recipients.

The core issue are costs. The main objective is to control costs and it is less relevant how these are financed, though preferably along international conventions so that the figures are accurate and don’t reduce confidence in the economy.

48. Size of the reserve requirement

The legal reserve requirement now takes a coverage of a half year. This might be reconsidered. The reason for this requirement is the liquidity risk for benefit recipients. It may be observed that there are also other ways to insure against that risk. Storing money seems a bit overly straightforward. The SVB could also come to agreements with the government, the Central Bank and possibly international organizations. One point to observe is that the total assets mentioned above of ANG 679 million are inclusive of outstanding claims at the end of the year of ANG 38 million, since premiums levied in November and December may be slow to arrive in January, which also provides a buffer.

With sufficient insurance in the background, a legal reserve requirement of two months suffices, releasing another ANG 116 million.

49. Method and speed of correction

The most desirable method for correction is the first method mentioned above: directly at one moment. The alternative of slower redemption creates needless accounting (and increased confusion). For example, if the ANG 531 million are redeemed in ten years with an annuity of ANG 78 million per year, then Table 26 ensues.

⁴³ This tax credit has no meaning for pensioners who only receive AOV and who thus don’t earn enough to pay taxes. It is an example of a measure that came about historically and that better could be retargetted to pensioners with few resources. This is not an argument for a shift to premiums but an argument for better use of tax money.

Table 26: Annuity table for ANG 531 million in 10 years at 7.5% interest

ANG mln	Capital	Interest 7.5%	Redemption	Annuity
2007	531.0	39.8	38.2	78.0
2008	492.8	37.0	41.0	78.0
2009	451.8	33.9	44.1	78.0
2010	407.7	30.6	47.4	78.0
2011	360.2	27.0	51.0	78.0
2012	309.3	23.2	54.8	78.0
2013	254.5	19.1	58.9	78.0
2014	195.5	14.7	63.3	78.0
2015	132.2	9.9	68.1	78.0
2016	64.1	4.8	64.1	68.9

Disadvantages of slower redemption are: (a) the labour hours spent on annually transferring ANG 78 million in liquid funds from the Central Government to the SVB and transferring the same amount in bonds back to the government, with accountants checking out, (b) it is not likely that BNA will publish the adjusted figure; it is likelier that it holds on to the idea 'a debt is a debt' than to the idea 'a "pay as you go" system doesn't use funding'; or if it does accept the latter then publishing two figures may remain confusing for some with continued reputation costs, (c) ANG 78 million is too much money in the first years, so that the SVB must invest that again, while later it might not be enough, (d) the premium and tax rates don't match the real pattern of expenditure and thus send wrong signals to the economic agents, (e) policy makers and bureaucrats could spend hours in discussing the capital sum, maturity and the rate of interest, and how these affect the premium and tax rates; so that they are distracted from the proper social-economic issues.

One way to redeem the debt might be to use it for wage cost subsidies. In that case SVB would create exemption without adjusting the premium rates, and cover the costs by selling bonds back to the government. This however would confuse the issue of finance with the issue of subsidies.

50. Agency costs

Total agency costs are 28.3 million on total expenditure of 380.5 million which is 7.4%, which is high. Since the laws on social security are comparable to those of the Netherlands, with comparable names, we may try to compare the agency costs, see Table 27. This comparison may be too quick but it does suggest that there could be room for improvement.

Table 27: Agency costs as a percentage of expenditure, two SVB's

Neth. Antilles	AOV	AWW	ZV	OV
2005	2.5	2.5	12.7	17.2
Netherlands	AOW	AnW	ZFW	
2004	0.44	2.14	5.2	

From 2004 to 2005 agency costs rose 8.8% but this figure is uninformative since there was the acquisition of FZOG (the health insurer for retired government officials). More significant is that the wage sum per employee (there are 249 employees) is ANG 76,700 which is high. Perhaps an organization like the SVB requires highly educated personnel, that require wages at an internationally competitive level, but still. The wage sum per employee rose 10.3% over two years, which is high during an austerity period, and much higher than inflation. The Annual Report does not provide much information on level and change and one would be interested in more detail.⁴⁴

Some costs (not mentioned in the Annual Report but implied) are in the premium collection system. It appears that the Central Government Inspectorate of Taxation determines individual annual income and possible deduction items, so that a person's taxable income can be related to the premium base and the maximum premium income. Subsequently taxes and premiums are collected by Central and Island Government Revenue Services. For one fund the SVB has its own collection system since it thinks that it can do the job better than these Services. There have been discussions about making this whole system more efficient. It seems advisable to do so, given the small size of the population and the administrative burden both on the public institutions and the individual tax payer. The Netherlands Antilles have a strong traditional role for jurists, with a focus on legal arrangements, but apparently without much idea about costs.

51. Overview of released resources

The remittance of ANG 531 million to the government clearly release resources. The impact is only on the national debt figure since there remain ANG 39.8 million of continued transfers from the government to the SVB.

However, in the next discussion on APNA we will find that there are additional resources of ANG 33 million per year, without changes in capital, so that the combined effect is similar to a true capital relocation.

We also indicated further cost savings at SVB.

We did not consider yet the AVBZ general insurance for special health costs. This is managed by the BZV ("Bureau Ziektekostenvoorzieningen") that however has not published any accounts since 2002 (though perhaps it has by now). Considering those old accounts one surmises that there is scope for more accuracy and efficiency as well.

⁴⁴ The number of employees rose by 5.6% while total employment costs rose 8.5%, so that the wage sum per employee rose 2.7%, in 2005. Taken over two years since 2003 the number of employees rose by 7.3% while the wage sum rose by 18.4%.

VII. Portfolio management at the Pension Fund (APNA)

52. Introduction

APNA only publishes an APNA (2005) Annual Statement 2004, which is a financial statement targetted at accountants and not a full Annual Report targetted at policy makers. Annual premium receipts are ANG 107 million, about as much as current pension payments, so that the assets basically lay about in the background as a reserve for future liabilities. In the consolidated Balance Sheet on the first page we find total assets ANG 3,378 million for which we can calculate a return on investment of 6.4%. However, in a short analysis in the back we find total assets of ANG 3,312 billion in a “simplified account” where the difference of 66 million is not explained. That account also states an official “return on investment” of 7.4% though on a smaller sum. The point arises how “investments” are defined. If “portfolio management” is defined as, and limited to, transferring funds to international managers such Smith & Barney or Goldman & Sachs then our discussion would actually evaluate the performance of those banks, which is not our objective. A key element in the discussion below is that APNA is accountable not only of what it invests but also what it doesn’t invest.

A common statement by APNA is that it is constrained in various ways both by laws and regulations and by local conditions so that it cannot reap the profits of modern capital management.

- (1) In the past there was an “investment rule” that investments should be 60% in the national economy. This rule has been laxed recently but APNA holds that it effectively still is 60%. This investment rule is enforced by BNA that clearly also has an objective with respect to its foreign exchange target.
- (2) APNA is not allowed to invest in derivatives such as hedge funds. The law that regulates what APNA can invest in belongs to one of the most changed laws, PB 1997 no 311, article 16.
- (3) A sizeable part of APNA assets are in claims on (island) governments who are slow to pay. Those claims are just there and do not earn interest, unless this is arranged when settling the claim. Thus there is no law that allows APNA to legally charge interest on its claims (if that would actually require a law).
- (4) The Netherlands Antilles do not have a stock market.
- (5) The local real estate market hasn’t followed the US and Europe yet, actually suffered downturns. Europeans had mortgages in EUR but then they suffered the exchange rate changes and there was a wave of sales reducing home prices.
- (6) Due to lack of investment opportunities APNA is forced to hold on to liquidities.

Since we are considering ANG 3.4 billion it is useful to evaluate those issues.

53. Portfolio management

While the two former chapters showed that the official figure for national debt should be corrected, releasing funds and inadvertently gaining an emphasis on “treasure hunting”, this chapter will have a higher emphasis on annual revenue. Assets will still be relevant, since our topic now is (a) portfolio management by (b) a government (c) pension fund. Not quite Asset Liability Management since we will neglect the pension obligations and presume that these can be properly matched once there is a sound system for investments. Pensions are paid from premiums and returns on investments. If the portfolio is inadequately managed then premiums have to rise, reducing the paycheck of government employees and increasing the tax burden on the economy or the deficit. Note that the government pension fund actually will buy government bonds as part of its portfolio, and with the receipts of those sales the government might pay pension premiums. Thus there is some arbitrariness. The prime objective is that the fund is sufficiently liquid so that it can pay the pensions, and then it doesn’t matter much if the liquidity comes from premiums or returns on investment (on government paper). Generally, company pensions are capital funded and not “pay as you go” since the company may not exist once the pensions are required. Also, there is a general notion that pension funds should not be run by the same company that people work for, since that company might be tempted to use the capital for its own purposes, take too much risk or simply misuse the funds. For government pension funds these issues are a bit different. As the government exists ‘forever’ there is more scope for “pay as you go” while a government might be tempted in a funded system to let inflation reduce the value of outstanding debt. For this moment it suffices that we mainly consider portfolio management at APNA. To do so, it is useful to first review some investment theory. Recommended reading is Luenberger (1997).

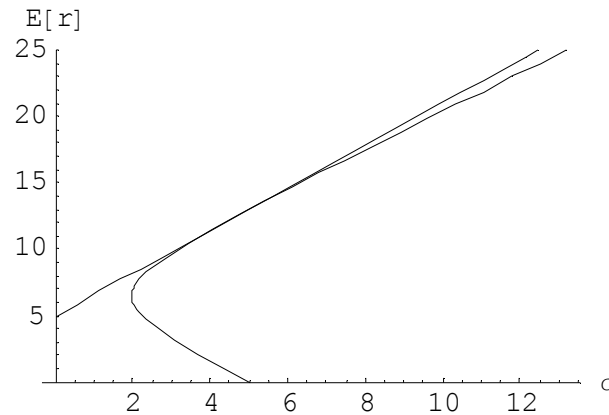
54. Markowitz efficiency frontier

Figure 16 gives a theoretical example of the “Markowitz efficiency frontier” and the “capital market line”. The horizontal axis gives the spread (standard deviation σ) as a measure of risk while the vertical axis gives the expected return ($E(r)$) which can also be seen as the mean value of all returns.⁴⁵ The parabola surrounds and contains all possible risky investments and all possible combinations of risky investments. The top section of the parabola is the efficiency frontier (identified by Markowitz) such that (a) with a given spread one cannot get a higher expected return and (b) with a given expected return one cannot get less risk. On the vertical axis we find $\sigma = 0$ and there is one “risk free” rate r_f , in this example taken at 5%, normally taken as a government bond. Admittedly government bonds might default but one could estimate an implied risk free rate. The line from the risk free rate tangent to the efficiency frontier is the “capital market line”. All optimal portfolio’s choose a point on that line, with some percentage of assets allocated to the risk free rate and the complementary percentage allocated to the

⁴⁵ See DRGTPE and my website, for the spread is actually a problematic indicator of risk.

market portfolio (the point of tangency) of risky assets. By borrowing money and investing it in risky assets one moves along the line to the right of the point of tangency.

Figure 16: Markowitz Efficiency Frontier and Capital Market Line



When the interest rate on national government bonds is 6% rather than the international 5% then this model gives some ambiguity whether the 1% differential is a risk premium or a local aberration caused by institutional barriers. Assuming the latter, the point of tangency moves to the right. In that case APNA could combine national government bonds at 6% as well with higher risk on foreign markets. With a portfolio of the same spread σ APNA should be able to achieve a higher expected return. In that case APNA would neither hold international bonds only such stocks.

55. Reinvestment horizon

When constructing a portfolio one should account for the covariance, for example since a lower rate of interest might increase the value of stocks, and conversely. A “risk-adjusted” measure is $(E(r) - r_f) / \sigma$, the Sharpe index.⁴⁶ This measure has only conditional meaning since the spread actually depends upon the time horizon considered. When the horizon is T years then the spread of the period average reduces with the root value, thus $\sigma[T] = \sigma / \sqrt{T}$, for the reason that bad results in one year are compensated by better results in another year, and conversely. Since the expected return would not change essentially, the correct period-dependent measure is $(E(r) - r_f) / \sigma * \sqrt{T}$. An important issue therefor is the length of the period to consider, and management over that period.

The length of the period tends to be determined by the moment when the investment is sold off to pay for pension benefits. Older investors or a “grey pension fund” will invest

⁴⁶ WM Company <http://www.wmcompany.com/> and Cost Effectiveness Measurement, nowadays CEM Benchmarking Inc. <http://www.costeffectiveness.com/> (“what gets measured, gets managed”)

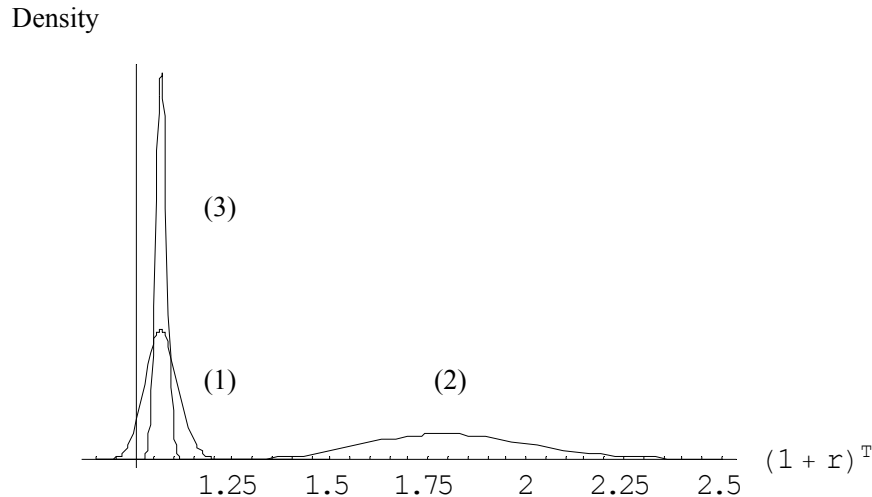
more in risk free assets while young investors or a “green pension fund” will invest more in stocks with higher risk. The latter can even borrow to increase their return. A pension fund can be seen as a construct by which youngsters indeed borrow from elders to realize such risky investments.

Figure 17 creates an example based upon some data from the APNA (2003) Asset Liability Management (ALM) study on their $E(r)$, σ and T .

- (1) The expected rate of return is assumed to be 6.9% so that the return factor is 1.069. The spread is 4.2% (distribution 1). The vertical axis is at 1, with a 4.6% probability that the return factor is below 1.
- (2) After 9 years the results spread out to a flatter distribution (distribution 2).⁴⁷ The spread is of $(1 + r)^9$ around the average factor of $1.069^9 = 1.82$
- (3) When these results are averaged to get the period-average then we see a smaller spread (distribution 3). The distribution has a mean 1.06827 with a spread of $4.2\% / 3 = 1.4\%$ (where $3 = \sqrt{9}$).

For a pension fund that has more staying power than an individual it is relevant that after thirty years ($T = 30$) the period average return is 6.82% but the spread 0.77%.

Figure 17: Re-investment and period-average



56. International comparison

In the following we will use comparable data from the Dutch government pension fund ABP and the California Public Employees Retirement System (CalPERS).⁴⁸ These funds are about 100 times larger than APNA but the mechanisms are basically the same.

⁴⁷ In a simulation, investment capital may be seeded in the course of one year, so that one needs ten years to generate nine sets of data for the realized returns on investment.

⁴⁸ <http://www.abp.nl> and <http://www.calpers.ca.gov>. “CalPERS provides retirement and health benefits to more than 1.4 million public employees, retirees, and their families and more than 2,500 employers.”

CalPERS can be more relevant for APNA since it also belongs to the US dollar area and because portfolio management by this fund is highly developed. See the CalPERS website for its “investment facts at a glance”.⁴⁹ For Dutch readers the ABP website e.g. contains a useful summary on hedge funds.⁵⁰

De Vries (2005), the former chairman of ABP, contains a critical review of Dutch policy making on pension funds.⁵¹ In the Netherlands and the Netherlands Antilles, pension funds are controlled by the Central Banks, DNB for ABP and BNA for APNA. Recently, DNB developed a new financial framework “Financieel toetsingskader” (FTK) that will be in force starting January 1 2007.⁵² There has been some debate in ESB, a Dutch economics magazine, whether this FTK is pro-cyclical. In an economic downturn the returns on stocks and their capitalized value will drop, causing pension funds (by regulation) to raise premiums and to further squeeze aggregate demand.

Colignatus (2005c) discusses these macro and micro conditions for pension funds. A key notion in economics is that real pensions must always be based upon real labour at the same moment of consumption. It may seem as if pensions are financed by “investment income” but the burden still rests upon labour shoulders that generate the profits. As funds are invested over periods of 30-50 years, pension funds should also care about sustainable environmental development, since it doesn’t help much if invested funds are used to deplete environmental resources such that living conditions are destroyed once you retire, see also Colignatus (2005e). Financial rules should facilitate a smooth transfer and not complicate issues. Many pensions now are “Defined Benefit” (DB), stating end conditions such as a pension at the level of 70% of last salary or the salary over some average period. The approach causes separate rules and discussions on indexation. Indexing on only inflation causes that one loses out on real economic growth. Increasingly, pension funds switch to “Defined Contribution” (DC) taking individual investment and their accumulated wealth as the available capital to calculate what the pension shall be. This switches the focus to the return on investment, which automatically follows economic growth. To judge on the choice between DB and DC there are two pairs of criteria: (a) own freedom and responsibility versus distributive justice, (b) macro-economic stability versus efficiency and growth. Economists who have written on the *life cycle* (and its impact on macro-economics) are Milton Friedman, Franco Modigliani and William Vickrey. Their work and intergenerational accounts e.g. by Ter Rele (2005) clarify that collective involvement is only needed to care for the poor (old or not) while the rich can look after themselves.^{53 54} The best system thus is a

⁴⁹ <http://www.calpers.ca.gov/index.jsp?bc=/investments/assets/assetallocation.xml>

<http://www.calpers.ca.gov/eip-docs/about/facts/investme.pdf>

⁵⁰ “ABP – strategie voor beleggingen in hedge funds”, by Tom Dunn, manager hedge fund team ABP Investments (New York)

⁵¹ De Vries for example states that employers shouldn’t be on pension fund boards.

⁵² The FTK can be downloaded at <http://www.dnb.nl>.

⁵³ This holds even stronger given that conventional accounts tend to neglect private investments in durable consumer goods and services. In the National Accounts it is counted as “consumption” when an elder person provides for better old age living conditions e.g. by insulating the house or by following a course in the use of internet and email. These actually are investments that can have a higher internal rate of return than a pension fund. From this point of view one should be hesitant to impose collective arrangements.

⁵⁴ Another common neglect is the wealth effect of actually dying. The DB system causes that people who die younger (often with dangerous or taxing jobs) contribute to the pensions of

national pension (AOV) as a basic provision with DC's on top. The national pension would be financed out of general tax income rather than premiums. When there are premiums then this is basically to earmark taxes to enhance tax compliance or to give an informational standard about pensions. In fact, also the national pension could be partly modelled after the DC such that an early death would cause a partial inheritance from the contributions, see Colignatus (2005c) for a graduated scheme.

Van Rooij *cs.* (2004) investigated individual preferences and behaviour with panel data, the scores are 63% DB, 12% DC, 10% indifferent and 15% don't know, and they conclude "The vast majority of respondents (...) favours a defined benefit pension system" while they also indicate a possible bias: "Insofar considerable increases in premium size would be necessary to maintain the current system the DB system may have been presented too favourable." Whatever this be, it is important to observe that a majority of preference does not imply a majority that can impose its preference. Given minority rights the better conclusion is that at least 12% would like to have the liberty to use a DC system. APNA should provide for that option.

There is a tendency among jurists and lawyers to nicely arrange matters on paper and there is a similar tendency among the average civilian to think that things thus are nicely arranged, even when the real economic base falls away. People think that they have 'rights' while these are false promises in fact. They send claims to a government that once promised too much and that lives forever to suffer its mistakes. The DB came about in an optimistic period with a demographically young population, modelled after luxurious arrangements for state officials. The DB is continuously being dressed down, with high management costs, and in fact it starts looking more and more like a DC. The DB by its nature is procyclical though one might try to design additional complex policy rules so that it behaves like a DC and becomes neutral to the cycle. It is better to switch to a DC, to focus on portfolio management, including sustainable environmental growth. A decision on this is drawn out and delayed since the decision making structure of our society has some basic flaws, see DRGTPE.⁵⁵

57. Agency costs

Table 28 gives the APNA agency costs. These costs are not easy to find since the costs of (foreign) portfolio management are subtracted from the returns, and these costs then are not included again in the profit & loss account. It would be an accounting norm but it would be better to show all costs. The 25.1% costs rise causes questions, not only about portfolio management (by a foreign investment bank) but also the 5% rise of general costs in a period of austerity. The Annual Statement doesn't give information about employees and the average costs per employee and a breakdown of those.

the survivors (often with plush jobs such as pension fund managers). In a DC system the invested sums at death are available for the descendents.

⁵⁵ Not unimportant is the suggestion of Colignatus (1989) at the Dutch Central Planning Bureau to raise the AOW retirement age by one month per cohort year, so that it could rise from age 65 to age 67 in 24 years. Had this started in 1990, the retirement age in 2006 would have been 66 years and 5 months. The problem is not that decision makers cannot choose between 0 months, 1 month or 2 months etcetera; it is the issue discussed in DRGTPE.

Table 28: APNA agency costs

	ANG million		Growth
	2003	2004	%
General costs (p21)	12.7	13.3	5.0
Passed on to others	-2.7	-3.0	10.4
Costs portfolio management	2.2	4.9	122.7
Total	12.2	15.2	25.1
% assets	0.38	0.45	17.1

58. Return on investment

Table 29 reviews the available data on the return on investment by APNA, ABP, a universe of 162 Dutch pension funds and CalPERS. The 3 year average has 2003 as the end point so that it includes the previous downturn. The comparison with Holland is dubious since it is a euro zone and since Dutch pension funds traditionally have few stocks. Pre-2004 returns by APNA concern what APNA calls “investments” and thus do not apply to all assets. The 2004 score is the current calculation on all assets.

Table 29: Comparison of the return on investment (%)⁵⁶

	10 yr	5 yr	3 yr	2003	2004
APNA	7	4.8	3.7	11.8	6.4
Dutch universe	7	3.4	-0.4	10.7	?
ABP	7	3.7	0.8	11.0	11.8
CalPERS	9.7	4.7	7.8	23.3	13.4
APNA-CalPERS	-2.7	0.1	-4.1	-11.5	-7.0
ABP-CalPERS	-2.7	-1.0	-7.0	-12.3	-1.6

CalPERS’s higher returns – such as 13.4% in 2004 – derive partly from a portfolio of 24.5% bonds and 62.8% stocks. As shown with the Markowitz Efficiency Frontier and the Capital Market Line the composition of the portfolio trades *return* with *risk*. Table 30 gives more detail and reviews the norms and realisations of APNA and ABP for 2002, 2004 and 2005. The table still suffers from the tendency (also with me sometimes) to compare the Netherlands Antilles (US dollar area) to the Netherlands (euro zone). We may presume though that the international risks and returns would be the same for both funds (see the international risks and returns in table 4 on page 10 of the ALM study).

⁵⁶ Source: the websites of ABP and CalPERS, APNA 2004 my calculation, and pre-2004 the Netherlands Antilles Report of the Commission on pensions, “Rapport Commissie versterking financiële positie pensioenfondsen”. Pre-2004 APNA doesn’t use all assets.

Table 30: Comparison of APNA and ABP

%	Capital allocation			Return				APNA to ABP Reallocation	
	capital APNA			capital ABP		return 2004		capital	return
	2002	2002	2004	2005	2005	APNA	ABP	with same	with same
Instruments	norm	fact	fact	norm	fact	fact	fact	return	capital
Column	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[6]*([3]-[5])	([7]-[6])*[5]
Fixed rate	48.0	52.5	40.1	40	43	7.2	6.8	0.2	-0.2
Business	31.2	21.1	42.4	60	55	6.8	16.0	0.9	5.1
of which								0.0	0.0
Stocks	28.0	16.8	28.5	40	42	8.1	12.3	1.1	1.8
Real estate	3.2	4.3	13.9		10	4.1	30.5	-0.2	2.6
Commodities			0.0		3	0.0	18.8	0.0	0.6
								0.0	0.0
Gov. claims	20.0	20.1	9.5			0.0	0.0	0.0	0.0
Liquidities	0.8	6.3	8.0			3.9	3.9	-0.3	0.0
Rest	0.0	0.0	0.0		2	0.0	5.8	0.0	0.1
Total	100.0	100.0	100.0	100	100	6.5	11.8	0.8	5.0

APNA compared to APB: **-5.3**

PM. The 6.5% return for APNA comes from rounding off, it is 6.4%

Findings for 2004 are:

- (1) APNA's return is 5.3% below ABP's, amounting to ANG 175 million of which ANG 130 million for stocks. This is a significant amount also given that premium receipts are ANG 107 million. With a similar return all premiums could stop.
- (2) If APNA would reallocate its capital to the structure at ABP (while keeping its same returns) then its return would rise by 0.8%.
- (3) To perform like ABP APNA would also have to increase its return by 5% (including small errors of mixture of measures).
- (4) If the investment rule limits APNA to 40% foreign investment then one would expect this 40% to be fully invested in foreign stocks – but we find only 28.5%.
- (5) APNA benefitted a bit from a higher rate on its government bonds, which interest payments however are similar to premiums received from the government, while the rate may also be a distortionary side effect from the oligopolistic market structure discussed in the chapter on the BNA.
- (6) APNA underperformed notably on real estate and commodities, and somewhat on stocks. It requires an explanation why ABP gets 12.3% and APNA only 8.1% but perhaps that relates to the euro / dollar area's.
- (7) A large fraction of APNA assets are in claims on the government for which it doesn't record a return. This instrument appears to affect APNA's portfolio policy as well. The capital allocation norm is applied not to 100% of assets but to 100% minus those claims on the government. (Likely, though it is not sure, those claims are also excluded in the investment rule, implying that this rule is actually stricter.) It is actually not clear what the status of those claims is. Are they accepted by the

governments, or is the figure on the national debt $9.5\% \times 3.4$ billion too low ? If they would be accepted, then they should better be included in the fixed rate investments. Also, when APNA excludes specific instruments such as these claims from the calculation of its investment performance then it may be explained that Table 29 shows that APNA outperforms CalPERS in its 5 years average.

(8) Another large fraction is in liquidities.

The findings tend to fit the APNA statements reviewed at the beginning of this chapter. However, there are also the following (intermediate) conclusions:

- (a) We still are discussing ANG 3.4 billion and it would be much better if we get more detail than just the general view above. Economics is the science of the allocation of scarce resources over alternative ends, and as we are taught to think in terms of unlimited wants, it strikes one as *particularly odd* that an institution sits upon a treasure of hundreds of millions, and doesn't know what to do. What has APNA done to improve the situation ? What has it done on the claims on the government ? What has APNA done on the "investment rule" ? What has it done on the limitation on hedging ? For an economy depending upon tourism it might be useful to have some hedge on that. Stating that there is no stock market is not an excuse to sit down and do nothing. Develop the capital market ! Hunt down companies that are capital constrained, train them to work with stocks, and so on. Of course APNA is a pension fund and not a government investment bank to develop the economy, but it has funds to invest and it might take some action. Note that the argument 'we are a pension fund and thus we cannot take risks for our pensioners' has limited value, vide CalPERS, vide investment theory.
- (b) Given the constraints APNA could already raise foreign stocks to 40%.
- (c) Holding ANG 120 million in deposits and other liquid instruments is a curious solution for the problem of having too much money. It seems like a subsidy for the commercial banks. What are the alternatives considered ?
- (d) If the BNA has a double role as pension fund supervisor (overseeing the (laxed) investment rule) and as foreign reserve supervisor (blocking the laxer rule) then this problem needs to be tabled with policy makers. Why is there only a *Annual Statement* and not an *Annual Report* where such things could be explained and emphasized ? What suggestions are there to change the institutional set-up ?
- (e) Remarkably APNA invests in euro stocks while the ANG and pensions are linked to the USD. According to the ALM study (table 4 page 10), the $(E(r) - r_f) / \sigma$ Sharpe measure for euro stocks is $(8.2\% - 6\%) / 26.9\%$ and for US stocks $(8\% - 6\%) / 17\%$. Clearly the risk of European stocks is larger. Thus APNA takes more risk while hedging is not allowed. Of course there is the notion of diversification, ABP and CalPERS also spread their risks, and we have to take account of covariance. Yet APNA could well answer the question why taking more risk when there is hardly much more return ?
- (f) APNA deals with mortgages via the CHB mortgage bank. There are various aspects. One aspect is that participants in the fund pay premiums and then borrow their own money to buy a house. Perhaps this discourages home ownership. Especially interesting is the group that cannot get a loan just after deduction of premiums, since banks tend to look at net disposable income. This is a bit awkward since owning a home is a good investment for retirement. E.g. not paying a rent could allow for a lower pension. There are various issues to consider here. An alternative is that APNA owns the homes and gets the rise in home values but arranges for a lower rent, since all is financed by premiums

paid by the residents; and the participant knows that he or she needn't buy a home since a low rent is guaranteed. Such options could be considered.

(g) Though this chapter basically considers portfolio management it may still be useful to mention the wider ALM angle, and consider the matching of risks related to premiums, pensions to pay, the numbers of pensioners, pension rights such as indexation. The ALM study is weak on that, and, it would be nice to see a statement on the adoption of a (voluntary) Defined Contribution scheme. One would suppose that pensioners who prefer a DC scheme also have the option to select their own pension fund.

59. The “investment reserves”

One notes that it is rather difficult to criticize APNA since they have a rather strong case when they point to the legal rules and regulations that restrict their activity. This is not a coincidence, there is a system in that. APNA is a rather traditional fund that actually relies on legal rules and other regulations to create a sense of ‘security’. It is not entirely clear whether this tendency serves the psychological sense of security of its participants and its pensioners or rather the very real security of the fund managers who can always point to those rules and regulations to defend themselves against criticism of underperformance. By comparison, in a modern fund the sense of security is provided by adequate management, good performance and customer service.

One regulation that APNA proposes concerns the “investment reserves”. Consider first the notion that the coverage of a fund is the ratio of assets to liabilities. If assets are insufficient and the ratio drops below a target value then the fund must raise premiums. APNA sets its target coverage to 115%. The latter however sounds prohibitively high and thus APNA proposes the new concept of “investment reserves”, wants to set their value at 10% of liabilities, and defines the term “net coverage” as the ratio of \ll assets minus the investment reserves \gg to liabilities, thus with a target value of 105%. The investment reserves thus are not relevant for investment policy, they only form a mere accounting figure to reduce assets in the coverage ratio. Where we had only “coverage” before, APNA now creates an artificial distinction between “gross” and “net” coverage. It only has an effect on the rule that if the “net coverage” drops below 105% then the fund has the power to raise premiums. The use of the term “reserves requirement” thus achieves three goals: (a) the word “reserves” imparts a sense of wisdom and security, and if you don't accept its use then you are ignorant and risk-prone, while the word “investment” suggests some real activity, (b) it reduces the harsh condition of 115% to a seemingly agreeable and reasonable condition of 105%, (c) it insulates fund managers from criticism: if the fund accumulates too much funds then they can point to the regulation, and if the government doesn't accept the reserve requirement rule then fund managers can argue that the government isn't following their wise advice. The “reserve requirement” already is mentioned in the 2004 Balance Sheet though it has no legal status yet. It better disappears there and from history. It would be a mistake to think that there is a difference between “gross” and “net” coverage; there is only coverage.

Whether premiums should be adjusted is a decision. That would use an ALM. The current ALM study of 2003 uses a horizon of 10 years while 30 years is more suitable for a pension fund. In recent years coverage has been around 100% without any problem.

Perhaps these two issues hang together, in that with reduced risk over a 30 year horizon it becomes acceptable to accept coverage of 100%. But a better return on investment should allow for premium reduction or pension improvement.

60. Improving the return on investment

The Netherlands Antilles actually should be an ‘emerging market’ with high rates of return on investment (see also Table 19 on income per capita growth) but for now we may assume the current low rates and consider how a reallocation of the portfolio towards foreign investments might be used to improve the overall rate of return. It could be an option to let all APNA assets be managed by a foreign investment bank, so that the only role of APNA is to pay out pensions. There always remains a board and staff however that must check on overall performance, even of that foreign bank. The following might contribute to some yardsticks.

Allocating reserves to foreign investments may have the following effects – that may also provide the reasons why BNA is hesitant on changing the investment rule:

- (1) ANG are converted into USD, reducing the foreign exchange reserves at BNA. Note that transferring funds to foreign countries is primarily an intertemporal shift. Eventually, when the foreign assets are transferred back for pensions, the ANG flow back into the economy. This may take a long while since current premium inflows are almost equal to pension outflows. The reserves just sit about earning returns.
- (2) The local market is deprived of ANG, with less opportunities for mortgages and business loans. The impact of such a relocation on the economy might be small since APNA currently holds so much idle funds – but these currently are employed by the local commercial banks (which may imply a subsidy for those).

Thus it seems indeed that APNA and BNA are up to some barriers. Yet, there can be a smarter way to arrange things. If the government is willing to borrow in USD in New York, it can transfer the funds to APNA or the foreign investment bank that handles the APNA portfolio, so that they can buy stocks. This approach does not affect foreign exchange reserves and doesn’t come with conversion costs.

Let us try to see how the portfolio reallocation would look like. Table 31 gives a stylized summary of the current APNA portfolio. It uses conservative values for the rates of return while these are also rounded off to allow quick calculation.

If the government would borrow USD abroad then it will benefit by paying the lower international rate of 5% instead of the current national rate of 6% to APNA. Government debt to APNA is about ANG 1.6 billion, this is 47% of the 3.4 billion and can be rounded for ease of calculation to 50%. The 1% point reduction amounts to ANG 16 million. The government gain is a loss to APNA. Table 32 arises where we shift 20% points of fixed rate assets plus 10% points of “other” to foreign stocks. The loss of the 16 million for APNA is compensated by higher returns from stocks so that the overall rate of return of APNA actually rises with 0.5% points, or ANG 17 million of ANG 3.4 billion. Together, the government and APNA earn ANG 33 million. Better even, APNA reduces pension premiums by 17 million so that all benefits accrue to the government.

Table 31: Stylized APNA portfolio (as it is)

Instrument	Portfolio (%)	Return (%)	Contribution [2] * [3]
Fixed rate	50	6	300
Foreign stocks	30	8	240
Other	20	4	80
Total	100	6.2	620

Table 32: Stylized APNA portfolio (improved)

Instrument	Portfolio (%)	Return (%)	Contribution [2] * [3]
Fixed rate	30	5	150
Foreign stocks	60	8	480
Other	10	4	40
Total	100	6.7	670

Figure 18 and Figure 19 present the analysis and the tables in a graphical manner. Arrows show the flow of money.

Figure 18: Stylized APNA portfolio (as it is)

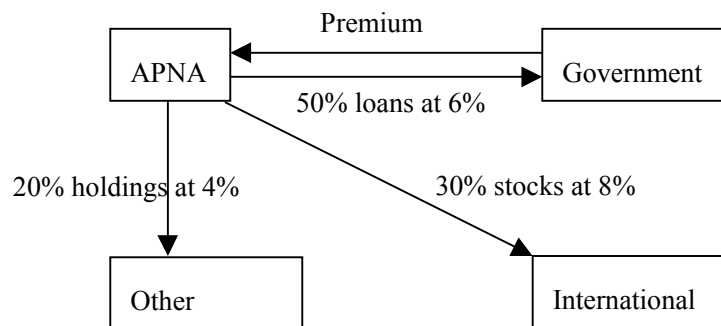
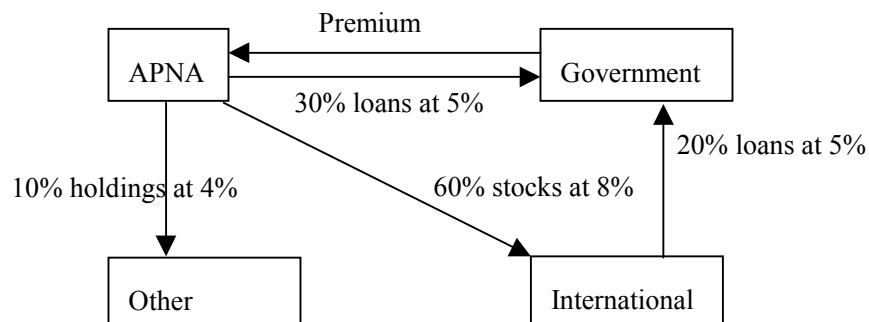


Figure 19: Stylized APNA portfolio (improved)



The following aspects are necessary to bring about the reallocation.

First of all:

- (a) The government still pays ANG to APNA since APNA needs to pay pensions.
- (b) There is no significant risk premium when the government borrows internationally.
- (c) APNA accepts that there is an international rate of interest that is lower than the local rate used to be and accepts that rate also for its local loans. PM. Note that APNA doesn't run an exchange risk, firstly because of the link of ANG to the USD, secondly because the overall guarantee of the government for APNA, thirdly since in this case the government makes the international loans.

Secondly:

- (d) From APNA's assets of ANG 3.4 billion, 20% or ANG 680 million must be borrowed by the government in USD, or \$ 382 million. The USD are transferred to APNA (or to the foreign investment bank representing APNA) while APNA sends back ANG 680 million in bonds to the government. APNA's holdings of ANG 1.6 billion of government bonds drop to ANG 0.92 billion. Thus, rather than reducing the foreign reserves at BNA and running the cost of the exchange (and running them twice), it suffices to borrow the sum in New York.
- (e) Note that the government by borrowing in USD hardly runs an exchange risk. Once the moment arrives that it has to renew the loan and conditions are uninviting, then there can be the arrangement with APNA (now agreed upon) that it sells off its stocks to the required amount, whereby the government and APNA swap again USD and ANG. This implies a temporary set-back of APNA to its current condition of holding on to too much of local government paper, yet, it is good to know that we thus are not discussing an exchange rate risk, only this fallback position. The only real risk involved is a collapse of stock markets with an explosion of the USD interest rate, which would be a world phenomenon that would be so severe that international policy makers will do their best to correct.
- (f) By consequence there are (a) the annual payment of interest by the government of 5% on \$ 382 million = \$ 19.1 million to international lenders, (b) the annual earnings by APNA of 8% on its \$ 382 million of stocks = \$ 30.6 million. The latter earnings are dividends and capital gains. Presumably the APNA earnings are such that the government can borrow \$19.1 million from APNA to pay off its interest, so that APNA can reinvest the remainder \$11.5 million. Instead that the government builds up a USD account at APNA, the government and APNA agree to record the \$19.1 million as a loan in ANG at the fixed exchange rate and without conversion costs. The sum merely is added to the existing loans.
- (g) APNA must also release 10% of other assets for investment in foreign stocks, thus ANG 340 million or \$191 million. Since 8% are kept in liquidities there are only 2% required from again other sources. APNA might consider to directly exchange that sum into dollars, reducing the foreign exchange reserves at the BNA. An option is that the government borrows the sum from APNA, so that the scheme above can be duplicated. That means that the government would borrow a total of \$573 million in New York. Borrowing ANG 340 million from APNA would increase the figure on national debt by 5.9% points however. It would provide funds for the government to invest in infrastructure and the like. Or one could pay off loans at commercial banks.

In sum, the swap means that the Netherlands Antilles borrow at a fixed rate from the international community and invest the proceeds in risky assets. This is precisely what a “green” pension fund would do. Are there international partners that would be willing to lend to the Netherlands Antilles? It may be noted that many Western pension funds are “grey” and thus want to invest in fixed rate instruments. There could be such a fund (like ABP) that might consider such a loan. (Actually, it might be an option that APNA enters into a strategic alliance with such a grey fund, as pension funds could do anyway. It leads too far to develop this.)

The prime conclusion is that the total impact remains manageable and does not imply a drain on the economy and the reserves of foreign reserves.

It also means that raising the rate of return on business investment within the Antillian economy has little to do with the “investment rule”. The scheme presented above is merely a “swap” of reserves, which is paper lying about and collecting a return. In so far there is a connection, it actually runs the other way, since neutralizing the 10% liquid assets of APNA by a government loan would make those funds more active. When APNA is not a suitable agent to allocate its liquid assets, the government might be a better agent.

61. Privatization

APNA management is in favour of privatizing APNA along the lines of ABP in Holland. It is advisable not to do this yet. Current proposals would isolate APNA from government policy, making it a fortress of traditional bureaucratic behaviour – risk-averse to possible criticism, shifting the costs to premiums and pensioners, raising management salaries and agency costs to reflect its importance, wisdom and good performance (witness the lack of criticism). It would be better to first enact above policy changes, subsequently consider shifts to Defined Contribution – with the possibility of opening ways of competition – and finally reconsider the question after some time again. If APNA were to be privatized in the future, one is advised to improve its democratic structure and the role of scientific advice in its decision making and operations.

62. Overview of released resources

In this chapter we have not released reserves, though we have indicated that APNA claims 10% “investment reserves”, raising national debt by 5.9% points, which now seems unnecessary. Our main result is the release of an annual sum of ANG 33 million coming available for the government budget. This is actually a conservative and low estimate, since we also observed an upper limit that APNA might earn ANG 175 million more if it had the same overall rate of return as foreign pension funds. The proof of the pudding is in the eating. We are seeing so many millions in this book that we become a bit spoiled and a difference between 33 and 175 million annually doesn’t shock us anymore. But it will remain worthwhile to try to hit the upper mark.

VIII. Conclusions

63. Democracy and the right kind of co-operation

The only good answer to the issues considered here is local democratic control. The Netherlands Antilles are a democratic nation and the people get the government that they deserve. They have the choice to vote for political leaders who work seriously towards advancement or for those who promise the sky and hand out money. This is a choice that requires intimate knowledge of local conditions.

It would be confusing when the Netherlands would step in and do all kinds of things. The Netherlands namely doesn't have intimate knowledge of local conditions. The Netherlands and the Netherlands Antilles are two countries, foreign to each other. These two countries share the same Queen and a long history, and ties can still be seen, but the decolonization of 1954 with the adoption of the Statute meant separate ways. It is always possible to see this as an error and to reunite, but doing so from misguided notions and fears doesn't give a sound base, while there are also other options to consider, such as the creation of a Caribbean Union.

Virtually all political parties in the Netherlands Antilles currently propose that the country is split up and that the Netherlands take over the national debt of about EUR 2.1 billion 'so that the new countries can make a fresh start'. This proposal forgets that there already was such a fresh start in 1954. Cancelling the debt gives the wrong signal for generations of Antillians that they are incapable of governing their own country – and actually don't need to be capable of. It would confirm the continued dependence on the colonial power of old and it would enhance a mentality to let things run their course until Holland comes to the rescue. It enhances the position of those politicians who created the national debt and who can argue that they were rather smart to do so since it now is paid by someone else. It destroys the position of those politicians who tried good policies to prevent such debt and who might have become unpopular because of that.

The wise course of action is to allow the Netherlands Antilles their lesson. Who makes errors learns best from suffering them. Only children and irresponsible adolescents might need the helping hand. Who sets things right himself will gain the pride of independence, has learned how to do things properly, and will face the future with confidence and the power to get things done. Seen from the angle of long term development the Antillian request to cancel the debt should be rejected. This should be a message that should be heard loud and clear for the whole population to note.

There is a clear difference between the elite with high incomes and the poor who have no work, little education, not enough food and whose teeth may rot away from sweet rum. The request to cancel the debt comes along with the suggestion that education, health and work will come available for more people. A cynic might note that it pays to keep some poor around to request aid. The national debt clearly is a consequence of bad policy but

cancelling the debt does not solve the problem that policy still is bad. The Netherlands appears to demand a strict financial framework but that doesn't help much either since the problem is not finance but management. The problem is not that one ought to check that the same amount of money comes out as has gone in, or that every item bought has a proper receipt. The true problem is good economic policy and management that make that education, health and jobs really come about. But these can only be attained by local agents in the local situation. Policy making and implementation is the task of the local politicians and cannot be done in The Hague. If the Netherlands would think that creating a financial framework would be sufficient, then the local elite can find other ways to pursue bad policy and squander its resources.

That being said, it appears that the situation actually isn't too bad. The way that the national debt has been calculated may have stopped politicians to spend even more. Unemployment can be solved, the national debt when recalculated is much lower, and there is ample scope for growth, that will also cause Antillian emigrants in the Netherlands to return home to reunite with their families and friends.

64. Unemployment can be solved

One of the ideas that most stifles policy making is that unemployment cannot be solved. However, we have shown that unemployment is actually created by policy making itself, so that there are ways to undo it. It can be recommended to eliminate the tax void, such that wage costs are reduced without reducing net income, while tax revenue isn't reduced either and while society saves on unemployment benefits.

The new workers can go working for a net income = gross minimum wage = minimum wage costs = exemption in taxes and premiums. The system of taxes and premiums can be adapted so that exemption holds for all workers legally insured at SVB. This makes for fairness and equality for the law. It leads too far to introduce exemption for other income groups. They don't require it on short notice and it would be a more complex operation. One might gradually introduce such an exemption over the course of ten years while adapting other arrangements as well.

Elimination of the tax void is essentially costless, as is shown by variant 1 with a 100% take-over tariff between ANG 11,392 and ANG 12,429. This would be quite feasible. Yet, a 56.1% tariff in terms of wage costs might be more agreeable with common conceptions on marginal rates. Resources to do this are available. The connection point then is at ANG 17,090 after which things remain the same as they are now.

65. Overview of all released financial resources

Table 33 gives an overview of all preceding chapters on all released financial resources. The overview is actually quite conservative since it neglects the various possibilities for cost reduction and efficiency improvement that we have also indicated. Now we only consider the more sizeable sums. These consist of both capital (a transfer at a single moment) and annual transfers. For BNA we released not only a sum of ANG 513 million (that might represent ANG 31 million per year if we impute a return of 6% per annum), but next to that we improved profitability by 10 million. We noted an accounting

problem at SVB of ANG 531 million but in this case there are no transfer savings. At APNA we didn't change the capital base but we could increase profitability by 33 million. In sum, national debt reduces to 66.3% of national income while government savings improve by ANG 74 million annually. This forms a 7.1% rate of return on the reduction of national debt. If unemployment is tackled then GDP rises by 1.5% so that the debt to GDP ratio drops to 65.3%.

Table 33: Overview of released resources ⁵⁷

	Capital		Annual return	
	ANG mln	% GDP	ANG mln	% base
Official	4871	84.4	?	?
BNA	513	8.9	31	6.0
BNA	0	0	10	{6.0}
SVB	531	9.2	0	{7.5}
APNA	0	0	33	{6.7}
Correction	1044	18.1	74	7.1
True	3827	66.3	?	?

The national debt is one of those other ideas that stifles policy making. Having shown that it has a proportion that can be managed, the conclusion is warranted that the Netherlands Antilles can deal with the national debt themselves, while there is also scope for better policies furthering (environmentally sustainable ⁵⁸) economic growth.

66. Other aspects

There are some aspects that are useful to point to but that couldn't justify a whole chapter. *Appendix Q* contains those aspects on the Netherlands Antilles. *Appendix R* contains a note on the 2006 Nobel Prize in economics for professor Edmund Phelps. His recent papers and book on job subsidies and 'rewarding work' generally support the analysis on unemployment here. *Appendix S* discusses the photographs on the cover.

67. Final conclusion

Considering all these arguments, I think that it is best that economists advise their parliaments to investigate these matters. The television cameras should not focus on the debate between the parties, for a while, but on the didactic discourse between politicians and scientists. Parliaments of our democratic nations are advised to have a "parlementaire enquête" (parliamentary enquiry). See *Appendix T*.

⁵⁷ This assumes that APNA can exchange 10% points of its idle ANG holdings into USD and invest these in international stocks. If the BNA would hold that this causes too large a drop in foreign exchange reserves then the alternative is that the government borrows that sum from APNA after which the same "loans for stocks" swap is done as with the other debt. Either the national debt figure rises again with 5.9% points or other loans are paid off.

⁵⁸ See Van Ierland e.a. (2001) on the approach of Huetting on sustainable growth.

Epilogue

Next to the thanks expressed in the prologue in particular for the Netherlands Antilles, I also must express some thanks to the international community.

I thank Stephen Wolfram and the people at Wolfram Research Inc. (WRI) for creating *Mathematica*, a system for doing mathematics on the computer. Without this, this book would have looked quite different, or not have been there at all. I thank Leendert van Gastel and André Heck of the - now no longer existing foundation - Computer Algebra Nederland (CAN), and Dick Verkerk of the - very existent - CANdiensten for the opportunity to visit CAN at that time. I thank Asahi Noguchi (1993) and Silvio Levy for originally creating the *Mathematica* package on Applied General Equilibrium analysis, and for giving their permission to rework it and to include it in my own *Economics Pack* (1999), that this book uses.

Specific thanks are also due to Bob Parks of the Economics Working Papers Archive (EconWPA) of the Washington University at St. Louis. Over the course of the years much of DRGTPE has been put there, and this has been very useful. By coincidence, when I entered my short note on money on December 31 2005, it appeared that this was also the last day of that archive: it is still there but does no longer accept new entries. It has been a wonderful service thanks to Bob and his university, and one must hope that someone else takes it over.

I am also indebted to my close friends and family, both Dutch and American and Antillian, without whose support this work could not have been created.



Since Curaçao is a small town it is not always clear whether people like to be mentioned, as they may prefer the little privacy that they have. But gratitude wins out. I thank Sonia Garmers for the welcome that she gave in August 2005. My handicap of not having a drivers licence unfortunately limited our contact later on. Stanley Brown and his wife Annemarie Braafheid welcomed me too and gave me an introduction to the island for which I am very grateful. When I stayed at Hotel Mira Punda (now sold) the owner José Rosales became a good friend and offered me the use of his library on Curaçao. The doormen Nelson Juliana and Nel Whinston guarded well against “chollers” (drug addicts). Helen Molina remained a good friend after the modpor event. Pleincafé was a steady visit, a welcome place to be. Finally, Ton Massizzo jr. of Kunstkwartier became like a brother and I cherish the birthday present of Soublette et fils [1900] and the party with Alex and Marc. I won’t forget all this.



There are two other Dutch economists studying the Netherlands Antilles, dr. M. van Schaaijk (of www.micromacroconsultants.com) and dr. M. de Ruyter van Steveninck (also a former editor of the Dutch economists magazine ESB). Up to now they have not studied DRGTPE, for whatever good reason. It would give a good return on investment when the government of the Netherlands Antilles would hire these economists, each separately, to write a public review of DRGTPE and this Supplement.

I usefully state again that I protest against the abuse that has been inflicted onto me by the directorate of the CPB and that has hindered the due course of science.

Not that I entertain any illusion. Most people and organisations that I contacted have been particularly uninterested. Policy makers do not like the idea that the government itself contributes to stagnation. Voters seem to accept unemployment as a natural phenomenon. Academic economists are mainly interested in their own line of research and the possibility of publishing in some journal. Scientific truth, and the interest in scientific integrity in the policy making process, somewhere gets lost. So, having this experience since 1989, an educated guess would be that it might take many more years before my analysis is accepted and before there is any chance that the abuse can be corrected. The main worry of course is that unemployment and poverty hang in here too.

Appendices

A. Tariffs for taxes and premiums 2006

Taxes and premiums have differed bases so that it difficult to get a clear view. It appears possible to rebase all tariffs such that the following three principles apply: (1) the employer pays all wage costs (in economics “the wage”) and the employee pays all taxes and premiums, (2) all premiums are rebased to that wage, (3) all taxes are rebased to the wage minus premiums. After doing this the following graphs of the marginal rates result.

Figure 20: Premiums, rebased to wage costs (gross wages + employer premiums)

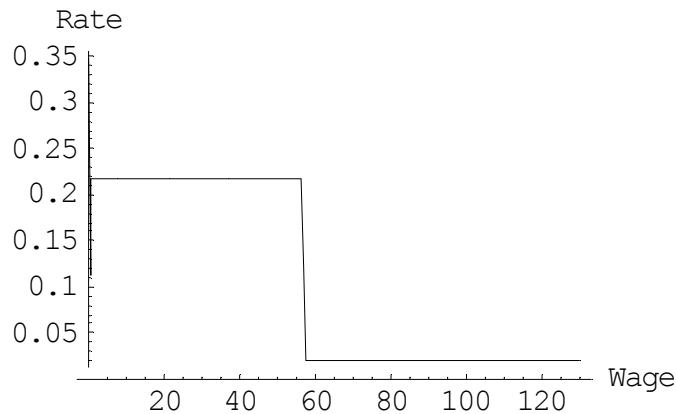


Figure 21: Taxes Curaçao, rebased to wage costs minus all premiums

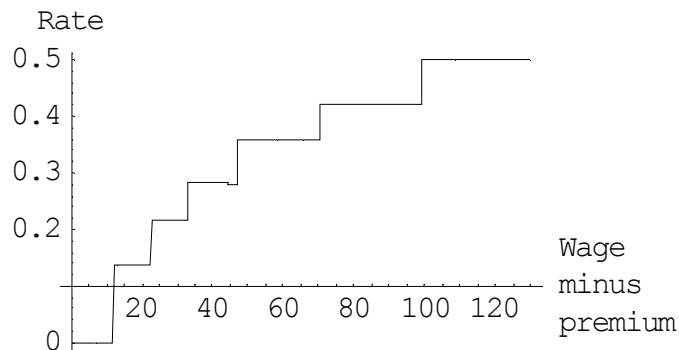
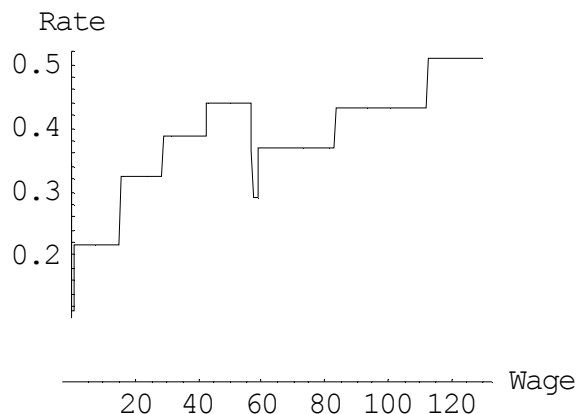


Figure 22: Taxes and premiums combined, rebased to wage costs



B. Distribution of productivity

Where the minimum wage applies to an island we must use employment data per island too. For the time being we remain on Curaçao. Table 34 contains a selection of the CBS labour force survey for that island, 2004. “All workers” contain workers with permanent and temporary jobs, employers, single person firms, government officials, education and households. Next there is the “market sector” defined as “all workers exclusive of government, education and households”. Parttime workers are confusing for our analysis since they don’t represent the typical worker who has to work 40 hours or more to make a living. Hence we focus our attention on the last column.

The survey gives a “one time” observation somewhere in autumn. Thus we do not need to worry about aggregation over the year, for example whether or not to determine an average income when a student finishes education (no income from work) and then gets a job. In the survey workers state their own income from work. This allows ample room for error, for example mixing up net and gross income, or earned income and other income. CBS trains its surveyers to get data as accurate as possible. Rows and columns may not add up anyway due to nonresponse on specific questions. CBS produces the data in nicely rounded classes for gross income but we are interested in wage costs that reflect the level of productivity of the worker. To the gross wage we thus impute the employer premiums. This introduces another error, in particular for incomes above the premium limit, for which we record no additional insurance though employers might provide such. Another error is that we don’t include VAT (differently dispersed).

The survey uses a sample of about 2500 persons and CBS has scaled up the results to the population level using factors depending upon age and sex. The average scale factor is 22.05. For statistical purposes one likes to see at least 5 observations per cell so that the scaled up minimum is 110. This means that some first cells and the last cell can be dropped as unreliable. The first 8 cells in the last column are unreliable anyhow since it is odd that one would have to work 40 hours per week for only 800 guilders per month. Dropping these cells leaves us with $30448 / 22.05 = 1380$ observations in the target group.

Table 34: CBS labour force survey Curaçao 2004

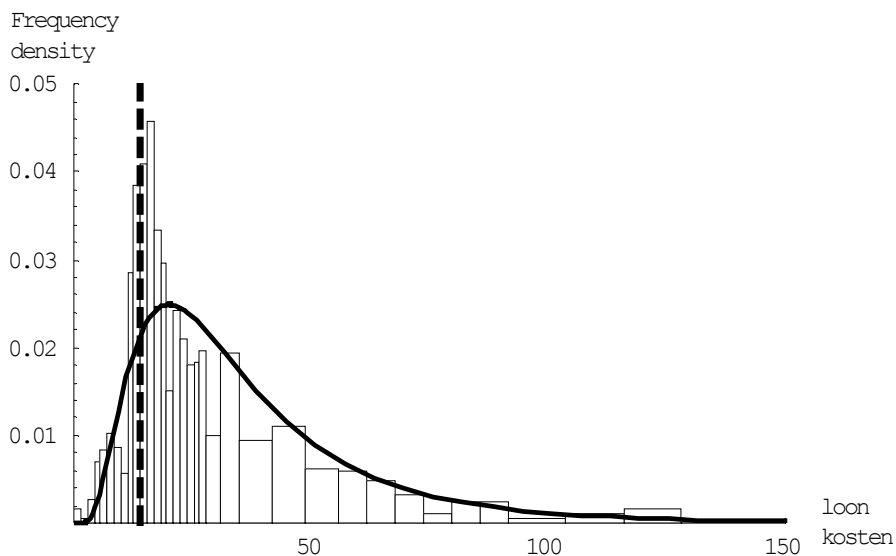
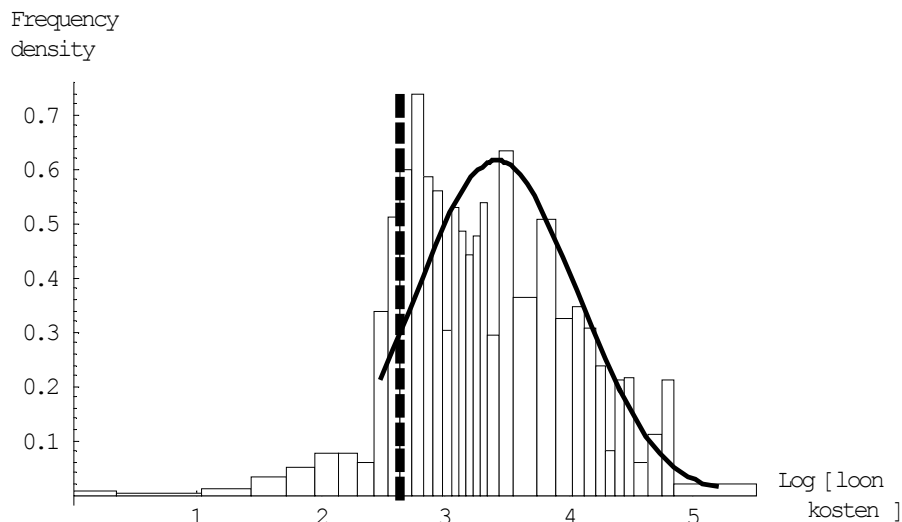
Number of persons, by working hours, gross wage and implied wage costs (ANG 1000)

Income from y[-1] to y	Implied wage costs per year	Number All workers Hours per week			Number Market sector Hours per week		
		Total	0-40	40+	Total	0-40	40+
Per month	Totaal ->	51474	11167	39051	43267	8434	33801
ANG 0-100	1.408	235	166	69	212	143	69
200	2.808	466	423	22	353	310	22
300	4.209	779	588	170	424	299	125
400	5.609	1237	852	339	935	572	318
500	7.010	1451	973	406	1066	634	383
600	8.410	1774	1033	722	1134	651	463
700	9.810	1288	636	631	903	489	393
800	11.211	509	115	349	374	92	258
900	12.611	2286	715	1459	1964	577	1297
1000	14.012	2311	442	1819	2188	417	1746
1100	15.412	2227	232	1970	2092	211	1857
1200	16.812	2574	349	2200	2392	281	2086
1300	18.213	1890	275	1568	1820	252	1521
1400	19.613	1673	205	1443	1581	205	1350
1500	21.014	997	182	770	909	182	681
1600	22.414	1245	117	1106	1223	95	1106
1700	23.814	1238	88	1081	1090	88	958
1800	25.215	981	93	888	913	93	820
1900	26.615	1013	105	907	918	83	835
2000	28.016	1150	162	988	1011	116	894
2200	30.816	1211	95	1093	1025	95	908
2500	35.018	3449	405	2953	3059	363	2628
3000	42.020	3114	469	2601	2549	373	2152
3500	49.022	3432	412	2979	2916	340	2534
4000	55.748	1944	275	1648	1602	231	1351
4500	61.778	1992	256	1715	1268	94	1151
5000	67.808	1445	287	1158	1114	181	933
5500	73.838	1046	112	934	745	90	655
6000	79.868	350	65	284	210	0	210
6500	85.898	802	115	687	543	47	497
7000	91.928	632	43	544	560	43	472
8000	103.988	404	64	340	308	64	243
9000	116.048	582	21	535	444	21	397
10000	128.108	795	21	774	704	21	683
20000	248.708	600	46	530	528	21	483
Infinite	Infinite	41	24	17	17	0	17

The data are depicted in Figure 23. The dashed vertical line gives the 2004 minimum wage costs of ANG 14,002. The graph also plots the estimated smooth productivity distribution. This is a lognormal distribution, such that the logs of the data show a normal distribution. The estimation consists only of the determination of the weighted average and weighted standard deviation of the logs of the data, using the densities as weights. These two estimated parameters then provide the lognormal distribution. In the upper part of the graph (logs) the distribution is only drawn for the classes that are used in the estimate. In the lower part of the graph (levels) the distribution is drawn from zero.

The data in Figure 23 show the typical property seen in studies on productivity: there is a pike just above the minimum wage. The minimum wage compresses wages just above it, and a rise of the minimum wage by national legislators will cause a cascade of rises just above it, though decreasing and quickly petering out. An employer will not make as much profit for each wage group and could accept this in particular for the lowest groups also for social reasons.

Figure 23: Data and estimated productivity Curaçao 2004
(wage costs per year, above: logarithm, below: level)



C. Estimation of the employment effect

Though *Appendix B* already depicted the smooth distribution, it is better to present the estimated parameters here where we estimate the employment effect, since it are those parameters that determine the size of the effect. The estimation has actually be done for both the gross wage data and the imputed wage costs. Table 35 contains the two results, including the estimated tax void, both as the percentage and as the number of jobs involved. For the gross wage data the classes are closer together, and for the wage costs the classes are more spread out – and unevenly so due to the premium income limit.

Table 35: Parameter results Curaçao 2004 (ANG 1000) ⁵⁹

Data \ Prms	Mean	Spread	Mode	Median	Mean / Median	Void %	Jobs
Gross wage	32.920	24.593	16.927	26.373	1.24823	2.78	1670
Wage costs	37.621	27.177	20.039	30.496	1.23364	5.99	3600

The relevant labour market consists of the labour force of Curaçao 2004, 60062 persons. The estimate of the distribution excluded government, education and households but it would be inadequate to leave such categories out of consideration for the labour force. The precise intention is to allocate the total labour force to the various categories. If someone for example doesn't have the productivity level required for the government salary scale 1.1 then this person will have to look for a market sector job.

The tax void between net minimum income and wage costs in 2004 is 5.99% or 6% and the number of jobs is $60062 * 5.99\% \approx 3600$. Note that we have no (reliable) observations below the minimum wage so that this is an extrapolation of the range for which we have data. Our estimate actually is conservative since we have not included the pike-effect that will be relocated. This result should be seen as a long-run result since the creation of the jobs will require some time (see elsewhere).

For the effect on the other islands we must account for their own minimum wages and productivity distributions. Curaçao has the highest average wage.⁶⁰ When the distribution estimated for Curaçao is taken as an approximation for the whole of the Antilles then the total error likely isn't large. The prime impact comes from the minimum wages. The values of 2004 are a bit complex since those were adapted in the middle of the year. The point remains that the high minimum wage on Sint Maarten

⁵⁹ CBS did not provide information on total income per class, as these could have been summed in the micro data. Total income in a class cannot truly be determined from multiplying its number of people with the average income of the class boundaries, since the class itself will have a distribution. If CBS had provided this total income then we could use a split-cell estimation procedure to maintain density weights. However, given the lack of information on total income we have assumed the total from the said multiplication anyway.

⁶⁰ CBS National Accounts Survey 2001, CBS Statistical Yearbook 2003, page 44, table 16 "Average wage-costs per employee by industry 2001"

severely limits the impact. If its minimum wage of 6.54 is lowered to 6.16 then this may generate 50 jobs. However, Sint Maarten has the tendency to aspire at a higher minimum wage and likely they prefer a rise in net income. For the other islands the minimum wages and the impact are similar to Curaçao. Thus for Bonaire, Saba and Sint Eustatius the joint effect is 410 jobs. For the Antilles excl. Sint Maarten the rounded effect is 4000.

For the cost-benefit analysis below it is relevant that $3600 / (3600 + 410) = 90\%$ of the new jobs will take place on Curaçao. For the calculations of costs for SVB and AVBZ and the recalculation of taxes and premiums, we require a target value. The value of 4000 jobs is acceptable, though, in fact, actual calculations below have assumed 10% of the SVB participants, meaning 3722 jobs.

D. Decomposition of the minimum wage, Curaçao 2004

Table 36 contains the decomposition of the minimum wage 1 (industry and trade) for Curaçao 2004. This will help to understand those parts of the discussion that feature 2004 rather than 2006, namely the estimation of the employment effect and the recalculation of taxes and premiums.

Table 36: Minimum wage Curaçao 2004, 40 hours

Year 2004, ANG	Employees market sector (40 hours), M1		
Number of employees (2006) 1746	rate	minimum wage	sum value
Gross wage		11,992	20,938,032
ZV (ee)	0.021	252	439,699
ZV (er)	0.083	995	1,737,857
ZV (govt., co-insured)	0.021	252	439,699
OV (er) (average tariff)	0.019	228	397,823
Cessantia		40	69,840
Acquisition costs		500	
Base social security		11,492	20,065,032
AOV/AWW (ee)	0.050	575	1,003,252
AOV/AWW (er)	0.060	690	1,203,902
AVBZ (ee)	0.015	172	300,975
AVBZ (er)	0.005	57	100,325
Taxable income		10,917	19,061,780
Tax	0.156	172	300,512
	1531		
Net income (incl. acq. costs)		10,821	18,893,595
Wage costs (excl. govt.)	0.227	14,002	24,447,778
Tax void (excl. VAT)		3,181	5,554,184
VAT	0.05	700	1,222,389
Tax void (incl. VAT)	0.264	3,881	6,776,573

E. Decomposition of the minimum wage, Sint Maarten 2006

Table 37 contains the decomposition of the minimum wage 1 (industry and trade) for Sint Maarten 2006. It highlights the dilemma. The higher gross minimum wage on this island causes a higher tax void, but taxes and premiums are national issues that Sint Maarten can do about little. And it actually wants a higher (net) minimum wage.

Table 37: Minimum wage Sint Maarten 2006, 40 hours

Year 2006, ANG	Employees market sector (40 hours), M1		
Number of employees 1700	rate	minimum wage	sum value
Gross wage		13,593	23,108,100
ZV (ee)	0.021	285	485,270
ZV (er)	0.083	1,128	1,917,972
ZV (govt., co-insured)	0.021	285	485,270
OV (er) (average tariff)	0.019	258	439,054
Cessantia		40	68,000
Acquisition costs		500	
Base social security		13,093	22,258,100
AOV/AWW (ee)	0.050	655	1,112,905
AOV/AWW (er)	0.060	786	1,335,486
AVBZ (ee)	0.015	196	333,872
AVBZ (er)	0.005	65	111,291
Taxable income		12,438	21,145,195
Tax	0.130	69	116,765
	1548		
Net income (incl. acq. costs)		12,388	21,059,288
Wage costs (excl. govt.)	0.219	15,871	26,979,903
Tax void (excl. VAT)		3,483	5,920,615
VAT	0.05	794	1,348,995
Tax void (incl. VAT)	0.257	4,276	7,269,610

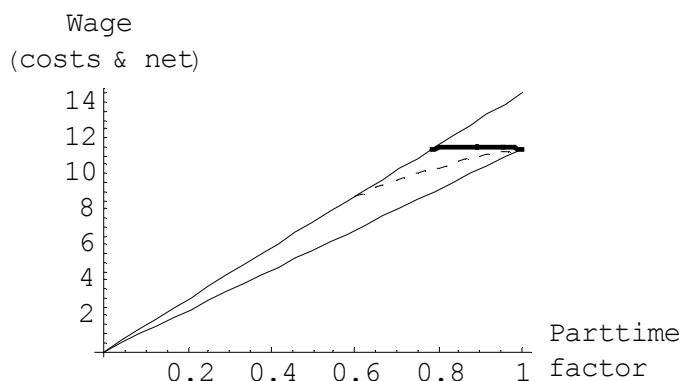
F. Parttime workers

This book develops the suggestion to introduce an exemption for premiums for workers who are legally insured at SVB – thus those workers in the market sector with an income below the premium income limit. Parttimers make the analysis a bit more complex. The CBS labour force survey (Table 34) shows that about 10% of those employees are working parttime. If workers with a high hourly wage but few hours fall under exemption then that may seem unfair since they would not contribute to capacity but still have full benefits. If one would try to restrict exemption for parttimers then there may however also exist handicapped persons who can work only part of the time, and then

those persons would be exempted from that restriction again. These extra complexities better are avoided. The easiest approach is to let everybody fall under exemption and not go into administrative checks on the parttime factor.

Nevertheless, it may remain useful to see how one might restrict exemption for parttimers. Figure 24 explains the case. It considers parttime work at the level of the minimum wage itself. The costs of the fulltimer are ANG 14.512 thousand which is in the top right corner. Working less reduces costs proportionally, which gives the main diagonal line. Net income of the fulltimer is ANG 11.392 and working less gives the lower diagonal. When exemption is introduced at the level of ANG 11.392 then the wage costs line becomes the net income line from 0% to 80% and the same worker needs to work only 80% to earn the same net income (horizontal bold line). To prevent such an abrupt difference one can introduce a gradual fading in of exemption, for example with no exemption at 60% and full exemption at 100% (dashed line). The scheme adjusts only costs so that net income remains at the original diagonal.

Figure 24: Wage costs and net income depending upon the time factor



The general situation is complex since the above only discusses the situation at the minimum wage itself while there are all wages to consider. A possibility is to restrict the exemption to wages of ANG 8.23 per hour with a gradual fading out of exemption between ANG 5.48 to ANG 8.23. These schemes of fading in and out imply that the time factor becomes an element in the collection of taxes and premiums, with the additional checks and controls, evasion and fraud, and when control fails then the loss of the sense of fairness and justice, causing problems with tax compliance in other areas too.

G. Other complications

(1) *Union minimum wages.* It is not unusual that union wages, agreed upon in collective bargaining (CAO) between employers and labour unions, are higher than the legal minimum wage. For groups such as doctors one can imagine a high minimum indeed. For the present target group of lowly productive workers such union minima however would form a problem. It is not clear how often it happens though.

The economic theory of the labour market distinguishes between insiders and outsiders. Insiders are the workers who already have a job and who are represented by unions. Outsiders are those without a job and who have little access to unions. There can be collusion between unions and employers, where the latter might not mind a higher wage as long as they can choose the workers with the associated level of productivity and as long as other employers (the competition) have the same conditions. Thus the unemployed are not really represented at the bargaining table. In that manner unemployment can become a persistent phenomenon at a high level. It would be the task of the government to make sure, as an impartial third party, that collective agreements contain salary scales at a sufficiently low level of kind of work. One instrument that the government has is to remind employers and unions at the bargaining table of their social responsibility.

(2) *Salary scale 1.1 of the Central Government.* The government itself does not really use the legal minimum wage. That is, the lowest salary scale is above the legal minimum so that it satisfies the legal condition but it violates the economic spirit of the law that the law merely protects against abuse while it should not hinder employment. The government thus is lax in thinking about reorganizing work and processes such that it can employ more people at the legal minimum. A big employer sets an example for others.

(3) *Insurance of domestic servants.* Domestic servants are not insured at the SVB. There are about 2500 workers recorded in this sector. It could be a sector with more growth potential. The lack of insurance might be an obstacle and the situation deserves attention.

(4) *Promotion.* Labour economists tend to think that workers should have a promotion once in a while, partly because of the rise of their experience and thus productivity, partly to maintain motivation. However, there can be a category of workers who remain at the same level of productivity. One thus should be hesitant in (legally) requiring promotions for the sake of promotions only. This issue can best be seen in the light of indexation.

(5) *Indexation.* Exemption for taxes and premiums is set at subsistence (minimum net income). Subsistence is a relative phenomenon that changes annually with general welfare, i.e. the average wage growth, consisting of productivity growth and wage inflation. Thus exemption should be adjusted with the average wage growth too. An system of indexation based upon an error correction model seems best.

(6) *Lei di Bion.* An earlier initiative of the Central Government was the “Lei di Bion”.⁶¹ The law promoted the employment of unemployed persons between 18 and 30 years of age. The initiative had no success and the law never was implemented. Partly because it didn’t see the tax void and imputed costs that actually don’t exist. Partly because the Island Government had to pay those costs and did not want to. Partly because of the red tape of restricting to age groups, the unemployed, same gross wages, and to short periods for which exemption of premiums would apply. The law didn’t account for the problem that when a person is hired on lenient conditions that it may be hard to fire him or her again when those conditions fade out. The example of this law and initiative may cause one to consider a more structural approach.

⁶¹ Publicatieblad 1989 no 74, Landsverordening of December 4 1989. See also the Report of April 29 1998 from the Island Government of Curaçao.

(7) *Price level.* The islands can have a different price level, so that equal living standards require a different net minimum wage. This appears to be a sensitive political issue and “thus” the government and CBS have no statistics on the price levels. But it seems that they are in the making.

(8) *Internal subsidy.* SVB currently collects a health premium (ZV) from the minimum wage earner of $\text{ANG } 261 + 1032 + 261 = 1554$ (see Table 7) while health expenditures for an average family are $1.588 * \text{ANG } 1600 = 2541$, determined by multiplying the expenditure per person (1600) with the average number of co-insured (1.588). Thus there is an internal subsidy of about ANG 1000 from higher earners to lower earners (and from singles to families). At an income of ANG 25,000 it could be beneficial for a couple without kids to switch to private insurance for ANG 2541 per annum, instead of staying at SVB with its premium that depends upon income. This calculation is not entirely correct since SVB also insures for the loss of income when sick, so that the break even point might be higher. One may consider to externalize the internal subsidy by a donation from general taxation, such that higher earners at SVB don’t start feeling that they pay too much for lower earners (that is, by their premium).

(9) *Vacation and holidays.* The minimum wage per hour is calculated by the Department of Labour by considering a theoretical number of working hours. At the same time there is another law stipulating a right to vacation and holidays with continued pay. Total paid hours off work amount to 197.7 hours. The economically relevant costs per hour thus are higher. The implied gross wage rises from the official value of ANG 5.98 per hour to ANG 6.61 per hour while wage costs rise from nominally ANG 6.98 to the economically relevant value of $\text{ANG } 14,512 / (1881 \text{ hours}) = 7.72$ per hour. These regulations apply to a group of workers that earn a meagre wage and that have a hard time to make ends meet. They might rather work more days than be forced to enjoy the luxury of a vacation (be it on a tropical island). Also, since the employer is forced to higher costs while these are not covered by productivity then this implies that people are made unemployed – so that they must be supported by the community and spend their time in forced idleness. Economically more efficient is that the community compensates the employer for the costs of $\text{ANG } 6.98 * 197.7 = \text{ANG } 1380$ per annum. This can be included in the general considerations for wage costs subsidies, discussed elsewhere. Also, one might make more lenient rules on having less vacation and allowing people to work more.

(10) *Exception to the minimum wage.* The law on the minimum wage allows the minister of Labour to make exceptions (see the law, article 12A, www.diraz.an). If a worker has a disability or incapacity or when the employer agrees to learning and training then the minister may fix a lower minimum wage, either on request or by own act. Doing so also implies a lower net income for the worker. This exception is intended for individual cases and it would be an abuse of the law to use it to solve the issue of the tax void (i.e. to reduce all wages for lowly productive workers though keeping net income intact).

(11) *Solidarity and responsibility.* This book uses the angle of economic efficiency to highlight the elimination of the tax void. Other angles are solidarity and social responsibility. Solidarity means that the richer use their capacity to support the poor without much capacity. Social responsibility means that the poor are stimulated to contribute as much as possible, partly to reduce the burden and partly to prevent that solidarity is undermined by a fear among the richer about free-riders. This book starts with the notion that the social choice on solidarity and responsibility is expressed in the level of net minimum income, so that this level is left intact. Subsequently, it becomes an issue of economic efficiency to adjust taxes and premiums and the minimum wage such

that all workers with at least that level of productivity can start working. These workers contribute to society by supporting themselves and not requiring a social benefit. If one would stick to the notion that workers should always contribute *some* taxes and premiums, perhaps from a Calvinistic notion that people must have a burden, then this actually means a plea for a lower net income. Actually fixing the net minimum wage at a lower level still leaves the issue of the tax void. Only a net minimum wage of zero would be the other solution to eliminating the tax void while keeping proportional taxes and premiums. Thus, if one only thinks in terms of the philosophies of solidarity and social responsibility, and closes the mind to the concept of economic efficiency, then confusion can arise, at the cost of unemployment.

(12) *Advantages to the poor and the rich.* Elimination of the tax void implies an advantage for the unemployed since they will get a job, earn more, improve their social standing, increase their selfrespect by providing for themselves, and integrate socially. But not only they have the advantage. Advantages for the richer are the products of more labour, for example in the cheaper cost of painting the house, cleaning the garden, and so on.

(13) *Poor and without sufficient means.* There are grades of poverty. The poor have no means of self-support but there is a large group, such as individual entrepreneurs, without sufficient means to pay health insurance. The Bureau Ziektelastenvoorzieningen (BZV) provides these people with a ("Pro Pauper") PP-card so that they are insured.

Table 38: Number of PP-cards, Curaçao 2006 (source: BZV)

Permanent	12587
Insufficient means	11941
No means	8009
Temporary	162
Total	32699

(14) *Foreigners and illegal aliens.* Elimination of the tax void improves the position of local labour with respect to foreigners and illegal aliens. Also other measures can be used to achieve the latter, such as a higher tariff for work permits and higher sanctions for employers who are caught more times on employing without such permits. Such measures would enhance each other. In the present situation the cost of local labour may be too high so that an employer rather switches to illegal labour that is cheap or higher productivity from foreigners with working permits.

(15) *Ending social benefits.* In a situation with high unemployment it is morally more difficult to stop a social benefit. Officers at the Social Office have huge caseloads and presume that it is difficult to find work. It is also more difficult to check whether a person has received a job offer and whether this was rejected on good grounds. The lack of control causes more free-riders. However, when unemployment is low, then caseloads drop, there are more job offers, it becomes easier to check cases. When good job offers are rejected on wrong grounds then it becomes morally less difficult to stop a benefit, and there will be less free-riders.

(16) What jobs ? People often think that there is a fixed amount of work. Some people get work, some don't, and there are no more jobs to give out. Thinking in this manner, the new 5200 + 3900 jobs don't exist. The answer provided by economic theory is that employers will create jobs once it is profitable to do so. Work that currently isn't done because of labour costs that are too high will be done when labour costs are lower. It is infeasible to fully predict what kind of work that will be. Fifteen years ago nobody or perhaps a few (now rich) could predict the kinds of employment that we can observe nowadays, with call centers, sellers of telephone cards, ringtone producers, and what have you.

H. Rebasing tariffs and grossing up of wages (micro burden)

The following conditions apply for the rebasing of tariffs and the grossing up of wages:

- (1) the sum of premium revenue remains the same
- (2) the sum of tax revenue remains the same
- (3) the micro burden remains the same: each person retains an equal net income such that all changes in premiums are compensated by taxes
- (4) exemption for premiums becomes ANG 11.392 thousand; variant **(2a)** has a 56.1% take-over tariff till 17.090 and subsequently the current system; **(2b)** has a constant tariff till the premium income limit.

The first three conditions have a tense relation with the fourth condition. Keeping wage costs at the same level requires keeping employer premiums as they are, and implementing all changes by employee premiums and the income tax. However, employer wages also require an exemption. This can be solved by grossing up the wage, i.e. giving each worker a nominally higher wage such that the employer premium with its exemption results in the same wage cost. To describe the micro relations we use the following symbols:

y = gross wage, with y^* the average gross wage
 t = tariff = $a + b$ with employer tariff a and employee tariff b
 τ = the new tariff = $\alpha + \beta$, for example $\alpha = y^* a / (y^* - x)$
 $w = y + a$ y = wage costs ("wage"), with w^* the average wage costs
 $p = (a + b) y$ = premium burden for gross wage y
 x = the new exemption
 s = connection point CP at the current system of the 56.1% tariff (on w) from x
 z = the "grossed up" gross wage, so that $w = z + \alpha (z - x)$ and $p^* = (\alpha + \beta) z$
 q = the new premium burden for the employee = $\beta (z - x)$

Under the condition that wage costs remain the same it holds that "old = new":

$$w = y + a \quad y = z + \alpha (z - x)$$

and this gives the "grossed up" new gross wage:

$$z = ((1 + a) y + \alpha x) / (1 + \alpha) \text{ if } \alpha \neq a, \text{ so that } z - x = ((1 + a) y - x) / (1 + \alpha)$$

$$z = y + \alpha x / (1 + \alpha) = y + c \text{ for some } c \text{ if } \alpha = a, \text{ so that } z - x = y - x / (1 + \alpha)$$

If wages are not adjusted then $z = y$ and then $\alpha = a y / (y - x)$ which means that the new tariff would be income-depending and cannot be constant. The combined requirements that we want the same (constant) tariff and same wage costs thus implies that the gross wages must be adjusted.

The average revenue of employer premiums then is:

$$\alpha (z^* - x) = \alpha ((1 + a) y^* - x) / (1 + \alpha) \neq a y^*$$

The employee must compensate the difference:

$$q = \beta (z - x) = \beta ((1 + a) y - x) / (1 + \alpha) \neq b y + (a y^* - \alpha (z^* - x))$$

which means that the employer premium becomes income-depending. This however is no problem since we split this up in a constant tariff and a part that belongs to the income tax. The constant tariff is chosen such that total premium revenue remains the same.

PM 1. With $\alpha = 0$ there is an “integral grossing up operation” such that the new gross wage is set at the level of wage costs, such that the employer would not pay premiums anymore and where all premiums are rebased on wage costs and paid by the employee. In that case $z = w$ and $q = z (a + b)$ and $\beta = w (a + b) / (w - x)$. Again we can select an average tariff $\beta = w^* (a + b) / (w^* - x)$. See *Appendix A* for $x = 0$.

PM 2. The most relevant options is $\alpha = a$ so that $z = y + \alpha x / (1 + \alpha) = y + c$. This gives a relation that can be easily explained. It means that the employer premium does not change ‘in principle’. The grossing up of wages is merely required to adjust for the introduction of an exemption.

For 2006 $a = 16.7\%$ and using exemption $x = 11.392$ gives $z = y + 1.630$.

For 2004 $z = y + 1.549$ (to be used in the actual recalculation and cost benefit analysis).

With an average revenue of employee premiums it holds that $q^* = \beta (z^* - x) = \beta (y^* + c - x) = b y^* + a y^* - \alpha (y^* + c - x)$ from which β can be determined. Deviations from this average can be handled by the income tax.

PM 3. Choosing $\alpha = y^* a / (y^* - x)$ generally causes $z < y$ so that grossing up causes lower gross wages. Around the premium income limit there arises a section that is not ‘used’ yet. This may be explained by the ‘squeezing of income differentials’. The high costs of wages at the lower end of the labour market squeezes all incomes together. Reducing nominal wages creates more space. Yet this choice does not seem wise due to pension claims that relate to the gross wage

In sum, for the two variants:

(ad 4 and variant 2a) There are two local values of x . (1) In the first part $x = 11.392$, $\alpha = a$ and β follows from the “PM. 2” relation, considering only the values up to s . (2) From the connection point s to the premium income limit we don’t change the system. Exemption legally applies to everyone but, due to the premium over-take, from s onwards the calculation of premiums can be done proportionally as if there is no exemption. Locally $x = 0$ and $\alpha = a$ and $\beta = b$.

(ad 4 and variant 2b) We apply the “PM. 2” formulas for the whole range from the net minimum wage to the premium income limit.

I. Formulas for the tariffs (macro burden)

Appendix H explained the micro burden. This current appendix explains how the tariffs can be calculated from the wage sums (premium base) and the benefits and insurance claims that have to be financed. The outgoing payments will even rise a bit by the increased employment and their co-insured. See *Appendix J* for the actual calculation.

We use the following symbols for the averages and sums:

t = tariff = $a + b$ with employer tariff a and employee tariff b

τ = the new tariff = $\alpha + \beta$

G = premium base = sum of all gross wages

P = premium revenue = $t G$

U = benefit payments and insurance claims, such that $U \sim P$

N = number of employees (ZV / OV) or premium payers (AOV / AWW, AVBZ)

$y = y^*$ = average gross wage = G / N such that $U = P = t y N$

$z = z^*$ = the average new (“grossed up”) wage = $y^* + c$

x = the new exemption

When all wages are higher than x and when there is no grossing up, then

$$U = P = t y N = \tau (y - x) N$$

$$\tau = U / ((y - x) N) = t y / (y - x)$$

Complication 1: Grossing up. To keep wage costs w the same we choose $\alpha = a$ and the wage is grossed up such that $z = y + c$ for some c . The premium base of employers changes and the loss of premium revenue must be compensated by employees. As a result of grossing up the employees also have more income to do so. Thus.

$$U = P = t y N = \tau (z - x) N$$

$$\tau = U / ((z - x) N) = t y / (y + c - x) \quad \text{and} \quad \beta = \tau - a$$

Complication 2: As a result of parttimers some incomes will be lower than x .

F = number of fulltime workers with an average income $y_F > x$

$D = N - F$ = number of parttime workers with an average income $y_D < x$

$d = D / N$ = parttime factor, with the assumption $d = 15\%$ for ZV / OV

h = parttime income factor, such that $y_D = h x < x$, and assume $h = 80\%$

Then $y N = y_F F + y_D D$ and $U = t y N = \tau (y_F - x) F$ since parttime workers fall in exemption. Hence $\tau = U / ((y_F - x) F)$.

It is conceivable not to grant exemption to parttime workers. In that case $U = P = t y N = \tau (y_F - x) F + \tau y_D D = \tau (y N - x F)$. However it has been explained elsewhere to accept exemption.

Combination of complication 1 and 2: Grossing up at the micro level causes that wage costs remain the same but the premium base (gross wages) changes, and by the exemption of parttimers the remaining base is even smaller. In combination:

$$\tau = U / ((z_F - x) F) = U / ((y_F + c - x) F) \quad \text{en} \quad \beta = \tau - a$$

This relation holds for AOV / AWW and AVBZ.

Complication 3: The government pays premiums for the health insurance of the co-insured and former employees. Also the 4000 new jobs have their co-insured.

M = number of co-insured

V = number of former employees, VF fulltimers and VD parttimers

H = number of newly employed in the tax void

$y[i] = G[i] / i$ for $i = N, F, D, V$

A reasonable assumption is that the following factors f and u are constant:

$u = U / (N + V + M)$ health insurance claim per person

$f = 1 + M / (N + V)$ co-insured mark-up factor per originally insured

Thus the current situation $U = u f (N + V)$ and the new situation (apostrophe) is $U' = u f (N + V' + H)$ where we assume that the number of former employees will change into V' and can rise proportionally with H but can also drop since some will find work.

In fact there are different tariffs:

m = tariff that the government pays for the co-insured

v = tariff that the government pays for the former employees

$U = P = (a + b + m) G[N] + (v + m) G[V]$

We now set $m' = 0$ and assume that employees and former employees pay for the co-insured themselves, with the same percentage and with compensation in taxes.

For the former employees the government remains paying to compensate for the loss of the employer contribution. Since there are fulltimers and parttimers here as well, the relation is $v G[V] = v' (y[VF'] - x) VF'$ from which v' can be determined. The benefits of the former employees are not grossed up since they don't work and thus don't need exemption.

Then these relations allow the determination of β :

$U' = u f (N + V' + H)$

$P' = (a + \beta) (z_F - x) F + v G[V] + \beta (y[VF'] - x) VF'$

$U' = P'$

For the actual calculations in appendices below, the premium bases for full time workers are underlined so that the numbers left (current) and right (new) can be compared more easily. The increase in employment is set here at 10% of the total number of participants at the SVB. A quarter of those is taken from the former employees, such that this changes with -25% of those 10%, both as target values. A point of attention is that the number of fulltimers at ZV / OV differs from the number of fulltimers for AOV / AWW and AVBZ, since the two bases are not the same. The profit that the government makes by no longer paying part for the former employees must be used to compensate for a loss at OV (since there are no employee premiums there that can provide the compensation).

J. Calculation of the tariffs of variant 2a

Table 39: X = exemption, W = average wage, F.E. = former employee

Data 2004 in ANG 1000					Recalculation tariff		
X = Net minimum wage 2004	10.821		Effect jobs	0.10	New jobs		3,722
Parttime income factor	0.800		Effect F.E.	-0.25	Less former emp.		-392
Social security	Tariff	Prem.base	Premium	W	Tariff	Prem.base	Premium
ZV			142,062				153,063
Employees	0.021	966,173	20,290		0.049	911,500	44,893
Employers	0.083	966,173	80,192		0.083	<u>911,500</u>	75,655
Co-insured by govt.	0.021	1,062,619	22,315		0.023	452,204	10,243
F.E. by govt.	0.042	487,738	20,485		0.049	452,204	22,272
F.E. like employees					0.019	911,500	17,137
OV	0.019	966,173	18,165		0.001	911,500	1,028
OV by govt.							
ZV / OV parttimers (ee + er)	0.123	56,857	6,982			<u>911,500</u>	
ZV / OV fulltimers (ee + er)	0.123	<u>909,316</u>	111,665			take-over	
X * number fulltimers						2,184	
Grossing up estimate							
Parttimers F.E.	0.042	23,940	1,005			<u>452,204</u>	
Fulltimers F.E.	0.042	463,799	19,480	29.6		take-over	
X * number fulltimers F.E.							
Expenditure			145,287				153,063
Exp. per insured			1.470				1.470
	Factor		number		Factor		number
Number of insured			98,839				104,129
New jobs				10.8			3,722
Number of employees			43,786	22.1			47,508
F.E.			18,436	26.5			18,044
Co-insured	0.588	62,222	36,617		0.588	65,552	38,577
Fulltimers total			52,889				
Parttimers working	0.150	43,786	6,568	8.7			
Fulltimers working			37,218	24.4			
Parttimers F.E.	0.150	18,436	2,765	8.7			2,765
Fulltimers F.E.			15,671	29.6			15,279
AOV / AWW			205,166				205,166
Non-SVB (ee + er)	0.110	898,972	98,887		0.110	898,972	98,887
employees (SVB basis)	0.050	966,173	48,309		0.057	911,500	51,589
employers (SVB basis)	0.060	966,173	57,970		0.060	<u>911,500</u>	54,690
Parttimers (ee + er) (SVB)	0.110	56,857	6,254				
Fulltimers (ee + er) (SVB)	0.110	<u>909,316</u>	100,025				
			number				
number premiebetalers			55,414				
Parttimers working	0.168	55,414	9,333	8.7			
Fulltimers working			46,081				
AVBZ			55,000				55,000
Pensions	0.020	363,870	7,277	30.0	0.020	363,870	7,277
Non-SVB (ee + er)	0.020	1,419,957	28,399		0.020	1,419,957	28,399
Employees (SVB basis)	0.015	966,173	14,493		0.016	911,500	14,766
Employers (SVB basis)	0.005	966,173	4,831		0.005	<u>911,500</u>	4,558
Parttimers (ee + er) (SVB)	0.020	56,857	1,137				
Fulltimers (ee + er) (SVB)	0.020	<u>909,316</u>	18,186				
			number				
number premium payers			67,543				
number non-retired			55,414				
Parttimers working	0.168	55,414	9,333	8.7			
Fulltimers working			46,081				

K. Cost Benefit Analysis of variant 2a

This appendix will also discuss aspects of *Appendix J*. CGov = Central Government.
IGov = Island Governments. F.E. = formerly employed (insured at SVB).

Table 40: Cost Benefit Analysis 2004

Current situation	ANG 1000					
	Employees	Employers	Other	CGov	IGov	Total
ZV incl. co-insured	20,290	80,192			22,315	122,797
F.E. (without co-insured)					20,485	20,485
ZV total	20,290	80,192			42,800	143,282
OV		18,165				18,165
AOV / AWW (SVB-basis)	48,309	57,970				106,279
AOV / AWW (non-SVB)	44,949	53,938				98,887
AVBZ (SVB-basis)	14,493	4,831				19,323
AVBZ (non-SVB)	21,299	7,100	7,277			35,677
Total social security	149,339	222,196	7,277	0	42,800	421,613
Benefits unemployed					14,167	14,167
PP-cards incl. co-insured					6,518	6,518
Total costs	149,339	222,196	7,277	0	63,485	442,298

Variant 2a						
	Employees	Employers	Other	CGov	IGov	Total
ZV	44,893	75,655				120,548
F.E. with co-insured	22,272				10,243	32,515
ZV total	67,166	75,655			10,243	153,063
OV		17,137			1,028	18,165
AOV / AWW (SVB-basis)	51,589	54,690				106,279
AOV / AWW (non-SVB)	44,949	53,938				98,887
AVBZ (SVB-basis)	14,766	4,558				19,323
AVBZ (non-SVB)	21,299	7,100	7,277			35,677
Total social security	199,769	213,077	7,277	0	11,270	431,394
Grossing up	-2,184	2,184				0
Tax	-48,245			10,855	37,390	0
Tax revision				-10,855	10,855	0
Total costs	149,339	215,261	7,277	0	59,516	431,394
Direct profit (in budget)		6,935		0	3,969	10,904
Other profit (out of budget)						
Wage above benefit level	26,107					26,107
Parttimers no premium ZV/OV	1,194	5,788			2,199	3,393
Idem AOV/AWW	2,843	3,411				2,843
Idem AVBZ	853	0,284				853
Total extra benefits	30,996	6,935		0	6,168	44,100
Percentage GDP						0.8%

Parameters used						
	Benefit level (Cur.)		New jobs		Wage	Wages
	Per month	Per year	Jobs	Co-ins.		
Single person	0.296	3.549	1,532	0		
Couple	0.512	6.143	2,190	2,190		
Total			3,722		10.821	40,274
PP-expenditure per person		1.470				
% benefit and PP		75%		Share Curacao		90%

The calculation of the tariffs and the Cost Benefit Analysis use 2004, which is the year with the most recent complete data.

For Table 39 it is relevant that SVB registers a wage sum (the premium benefit base) of ANG 1062 million which is the base for the 2.1% premium which it charges the government. However, when actually collecting this, it only achieves to get ANG 996 million, which becomes the factual base for premiums ZV / OV.

In this table, the wage sum for the full time workers is underlined on both sides, since this becomes the new premium base once parttime workers below exemption drop out. We assume that 15% at SVB is such a parttime worker with an average income of 80% of exemption. On the right hand side the full timers wage sum rises a bit by the grossing up of wages between ANG 12 and 17 thousand.

We only adjust the premiums for workers insured at the SVB.

The effect on jobs is 10% of the employees insured at SVB, with an effect of –25% on former employees (who find a job). Co-insured remain at 58.8% of originally insured.

Table 40 allocates the various posts in Table 39 to costs and benefits. In the current situation costs (premiums) and benefits (expenditures) are assumed to be in balance so that we only consider the extra benefits. These can be on the budget but may also be off-budget and only relevant for the National Accounts and GDP.

Remember that variant 1 has a 100% tariff such that the measure would be totally costless. In this variant we use a 56.1% tariff such that some costs are made that must be compensated by lower unemployment benefits and PP-cards.

On budget are:

- Assumed is that 75% of the new jobs indeed had unemployment benefits and PP-cards. These savings show up with the Island Governments. This figure must be at least 65% in order to show up a positive balance. We have taken average costs at the level of SVB but in practice PP-cards might have different costs – and perhaps the new workers don't claim as much insurance expenditure as others do.
- The Island Government also get the receipts of the income tax (plus their surtax). We found that 90% of the employment effect would be on Curaçao. This is the only island that transmits part of its income tax revenue to the Central Government, namely conform ERNA article 87 item 2 this is 25% of its revenue. Thus the Central Government would for $25\% * 90\% = 22.5\%$ share in the loss of tax revenue. The table contains a "tax revision" such that the Central Government is fully compensated.
- There is discussion between CGov and IGov about who is responsible for the payment of the co-insured. Currently SVB charges CGov who enters the sum in the "balancing of debts" with IGov. Above table assumes an arrangement including that "tax revision".
- Grossing up in this variant is restricted in the range from 12 to 17 thousand. This results into an estimate of about 2 million of costs to employers. It is cashed again as premiums and thus provides part of the source for the higher premium load.

Extra benefits that are off-budget:

- The new workers will earn a wage that is significantly above their current benefit level.
- Parttimers with an income below exemption have the advantage that are being exempt from paying premiums. Both they and their employers benefit.

L. Comparing the income decomposition of the baseline and variant 2a

This appendix gives a numerical comparison of the current situation (baseline) and the results of variant **2a**, when premiums have a take-over rate between ANG 11,392 and ANG 17,090, and thereafter the same as now. Some particular values of the gross wage are interesting, namely the new exemption at 11,392, the gross minimum wage 12,428 itself, the wage costs 19,951 of the connection point, and finally the premium limit income. Some arbitrary intermediate values are 30 and 40 thousand. Note the grossing up of wages between 12,428 en 17,089. The general conclusion is that net income is slightly higher while wage costs are not too different. Such differences are caused by rounding off of all the variables and rates used..

Table 41: Comparing the income decomposition of the baseline and variant 2a, for exemption, gross minimum wage M1 and wage costs M4

	Old	New	Old	New	Old	New
Gross wage	11.392	11.392	12.429	13.498	19.951	19.951
ZV (ee)	0.239	0.000	0.261	0.310	0.419	0.978
ZV (er)	0.946	0.000	1.032	0.524	1.656	1.656
OV (er) (average tariff)	0.216	0.000	0.236	0.120	0.379	0.379
Cessantia	0.040	0.040	0.040	0.040	0.040	0.040
Acquisition costs	0.500	0.500	0.500	0.500	0.500	0.500
Base social security	10.892	10.892	11.929	12.998	19.451	19.451
AOV / AWW (ee)	0.545	0.000	0.596	0.292	0.973	1.172
AOV / AWW (er)	0.654	0.000	0.716	0.308	1.167	1.236
AVBZ (ee)	0.163	0.000	0.179	0.082	0.292	0.328
AVBZ (er)	0.054	0.000	0.060	0.026	0.097	0.103
Taxable income	10.347	10.892	11.332	12.705	18.478	18.279
Deduction	0.000	0.000	0.000	0.000	0.000	0.000
Tax	0.000	0.000	0.000	0.000	0.854	0.000
Net income (incl. acq.)	10.445	11.392	11.392	12.814	17.414	17.473
Wage costs	13.302	11.432	14.512	14.516	23.290	23.365
Wedge	2.857	0.040	3.119	1.702	5.877	5.892
Premium	2.857	0.040	3.119	1.702	5.023	5.892
Premium (ee)	0.947	0.000	1.036	0.684	1.683	2.478
Premium (er)	1.910	0.040	2.083	1.018	3.339	3.414
Wedge / wage	0.215	0.003	0.215	0.117	0.252	0.252
Wage / gross	1.168	1.004	1.168	1.075	1.167	1.171

Table 42: Comparing the income decomposition of the baseline and variant 2a, for some values and the premium income limit

	Old	New	Old	New	Old	New
Gross wage	30.000	30.000	40.000	40.000	48.438	48.438
ZV (ee)	0.630	1.470	0.840	1.960	1.017	2.374
ZV (er)	2.490	2.490	3.320	3.320	4.020	4.021
OV (er) (average tariff)	0.570	0.570	0.760	0.760	0.920	0.920
Cessantia	0.040	0.040	0.040	0.040	0.040	0.040
Acquisition costs	0.500	0.500	0.500	0.500	0.500	0.500
Base social security	29.500	29.500	39.500	39.500	47.938	47.938
AOV / AWW (ee)	1.475	1.744	1.975	2.314	2.397	2.795
AOV / AWW (er)	1.770	1.839	2.370	2.439	2.876	2.945
AVBZ (ee)	0.443	0.489	0.593	0.649	0.719	0.784
AVBZ (er)	0.147	0.153	0.198	0.203	0.240	0.245
Taxable income	28.025	27.756	37.525	37.186	45.541	45.143
Deduction	0.000	0.000	0.000	0.000	0.000	0.000
Tax	2.487	0.823	4.692	2.661	6.880	4.560
Net income (incl. acq.)	24.966	25.474	31.900	32.415	37.424	37.925
Wage costs	35.017	35.092	46.688	46.762	56.535	56.609
Wedge	10.052	9.618	14.787	14.347	19.110	18.684
Premium	7.565	8.796	10.095	11.686	12.230	14.124
Premium (ee)	2.547	3.704	3.408	4.924	4.133	5.953
Premium (er)	5.018	5.092	6.688	6.762	8.097	8.171
Wedge / wage	0.287	0.274	0.317	0.307	0.338	0.330
Wage / gross	1.167	1.170	1.167	1.169	1.167	1.169

M. A note on premium collection and controls

A premium structure with a proportional rate from zero has the easy property that the total premium that a company must pay can be based solely upon the total wage sum. The advantage is that one does not need any other information. It is a property that SVB now uses and upon which its system of control is based.

In the variants considered in this book, it becomes necessary not only to record income levels but also to track people from one company to another when they change jobs so that the correct annual income can be determined. Wages lower than exemption (notably parttimers) can be neglected. For variant 2b the number of remaining workers times exemption can be subtracted from the remaining wage sum, and this will be the new premium base. For variant 2a this can be done for the middle bracket, while the third bracket can be treated as if there is no exemption. SVB thus would have to adjust its system of control.

The point to observe is that such data are already collected by the Inspectorate of Taxation. In fact, that office already determines the level of the social security base. Thus there should be more co-operation between these two institutes.

It can also be observed that introducing an exemption for premiums does not generate more possibilities for evasion and fraud. Employers already can play around with wages

and non-wage rewards, also for higher incomes or precisely for those. It is no different with exemption. A high marginal rate does increase the marginal proceeds of evasion and fraud, but in these variants the absolute values remain the same, since these measures are essentially neutral. Thus it does not seem that there would be a need for more control. But, if so, it may be recalled that the measures generate savings so that there would be room to finance such additional controls.

N. Formulas for norms for the national debt

Conditions for a stable national debt can be deduced from basic accounting rules. With

r = rate of interest
 d = debt to GDP ratio
 b = primary balance (deficit) to GDP ratio
 b^* = total balance to GDP ratio
 g = nominal growth of GDP
 p = GDP inflation
 y = real growth of GDP

then it holds for a stable debt ratio: ⁶²

Relation (I): $(g - r) d \approx b$ so that d can grow unchecked if $r > g$ & $b > 0$

NB. This also gives an interest norm $r = g$

Relation (II): $g d \approx b^*$ with e.g. the EU-norm $d = 60\%$ and $b^* = 3\%$
so that $g = 5\%$, and with $p = 2\%$ then $y = 3\%$

These relations only give accounting rules. They seem to imply, for example, that a higher debt also allows a higher deficit, since a higher d implies a higher b^* . These accounting rules however neglect behavioural relations. For example use

y^*, p^*, r^* = norm values
 MPC = marginal productivity of capital
 I = investments
 a = growth of labour input
 λ = "total factor productivity"

then the following behavioural relations restrict one's freedom:

Taylor rule for monetary policy: $r = p + \alpha(y - y^*) + \beta(p - p^*) + r^*$

The growth rule: $y = MPC \ I / Y + \varepsilon a + \lambda$

⁶² Let D = debt, B = primary deficit, $B^* = B + r D$ = total deficit, Y = national income (GDP), then $d = D / Y$, $b = B / Y$, $b^* = B^* / Y$.

$D = (1 + r) D_{-1} + B$ and dividing this on both sides by Y gives:

$D / Y = (1 + r) D_{-1} / Y_{-1} * (Y_{-1} / Y) + B / Y$

$d = (1 + r) / (1 + g) d_{-1} + b$

A stable debt ratio implies $d = d_{-1}$:

$(1 + g) d = (1 + r) d + (1 + g) b$ in which $(1 + g) b \approx b$ so that

Relation (I): $(g - r) d \approx b$

Relation (II): $g d \approx b^*$

O. A better way to account for fiat money at the Central Bank

Taken from Colignatus (2005d), December 31 2005, ewp-get 0512014

Proper monetary accounting rules are: (1) Central Banks should conform to the practice of the US Federal Reserve to distinguish its Balance Sheet from its Statement of Conditions. (2) Fiat money should not appear as a liability in a Balance Sheet. (3) The Central Bank should not record more government bonds than required for open market operations. Surplus bonds should be accounted as being void (on loan from the government who should destroy them). If these rules are not observed, a wrong measure of government debt arises, distorting the requirements for policy making.

Introduction

The most important property of money is that it is legal tender. If person A owes to person B, then A can pay off the debt by legal tender and B cannot refuse the payment, and if A would try to pay off the debt by offering his used car or some priceless painting then B can legally refuse such a redemption. The most important aspect thus is the existence of a legal framework that provides trust and stability within the community.

Once such a legal framework is in place then it appears advantageous to the community to use fiat money instead of gold-backed paper. There is no need to worry about the value of fiat money since the legal framework already exists. The advantage is not that paper is easier to carry and handle than gold, since if that were the only advantage, then we still would be using gold-back paper. The advantages to the community however are (1) that the price level can be influenced by the Central Bank rather than by discoveries of gold veins, (2) that seigniorage falls to the Central Bank. These two advantages are two aspects of the single advantage of increased monetary control by the community.

Seigniorage can best be defined as simply the change in the stock of money. If M is the stock of money, then seigniorage is ΔM . Some authors such as Inklaar et al. (2005) and Drazen (1985) include the proceeds of productive investments from these additional resources. However, the government budget is a totality, it is arbitrary to single out line items, and thus it isn't properly possible to assign such investments to a particular resource.

Using Fisher's equation $P Y = M V$, for P the price level, Y real income, V money velocity, and assuming constant velocity, money can have the same growth as nominal income, so that seigniorage may thus amount to 5% of the stock of money (with 2% inflation and 3% real growth). This is a sizeable source of income.

If the Central Bank would not have the monopoly to issue fiat money then the seigniorage would disperse throughout the economy. Any individual with access to a printing press could try to issue IOU's ("I owe you"). It may be noted that some supermarkets print their coupons, some stores print their gift-certificates, and the like, which can function as money. Banks could issue their own paper money (as Hayek once proposed) and add the proceeds to their profits. The law that "bad money drives out good money" would tend to work, such that people would hoard the paper from good banks, so that the money in circulation would be from bad banks that apply the printing press.

The crucial observation is that the community would lose control over inflation, whence it follows that it is better to create the Central Bank monopoly.

The Central Bank controls inflation both by its system of inspection and quality control of commercial banks, and by its monetary measures. The latter are reserve requirements and open market operations. If there is too much liquidity in the system chasing too few goods, then the Central Bank sells government bonds, raising the rate of interest. If there is not enough liquidity in the system leaving too many goods on the shelves, then the Central Bank buys government bonds, lowering the rate of interest. Under a constant rate of interest, the stock of government bonds may also change due to the desire to allow some “liquidity” for the bonds themselves.

Over the years, the practice has arisen that the Central Bank realizes its seigniorage by buying government bonds. The Central Bank prints its money, or credits the current account of the government, and receives government bonds in return. In cumulation over the years, the Central Bank balances the stock of fiat money with such government bonds. Thus, who opens the Annual Report of a Central Bank and looks up the Balance Sheet, finds the stock of fiat money issued by the Central Bank under the liabilities and the stock of government bonds held by the Central Bank under the assets. In practice, the seigniorage that the Central Bank hands over to the government is called “monetary financing”. As the government must pay interest on the bonds held by the Central Bank, these are counted as Central Bank income, and the Central Bank has an additional “transfer from profit” to the government (which is not proper seigniorage, but interest on seigniorage).

Accounting for assets and liabilities

For a commercial bank it is proper to account its stock of paper money under its assets. Namely, the paper money that a commercial bank holds can be traded for other commodities and thus it forms a claim on real resources.

For a Central Bank it makes some sense to catalogue its issues of fiat money under the liabilities. Any paper bill that it prints and sends into the economic system namely represents a claim on real resources, that the Central Bank appropriates and may feel accountable for.

For the whole economy, it makes some sense that all the fiat money assets of all commercial banks, companies and households are balanced by an equal liability at the Central Bank.

However, the point that this current article tries to make, is that fiat money is not a proper claim from an economic agent upon the Central Bank.

Legally, when a person goes to the window of the Central Bank say with a dollar note of legal tender, and wishes it to be exchanged into its real value, then the Central Bank will exchange it into another dollar note of legal tender. There is no such thing as a liability of the Central Bank to exchange its fiat money notes into something real.

The crux of this analytical point is that there is no reason for a Central Bank to hoard government bonds beyond those needed for open market operations. All those surplus bonds only take up storage room and accounting time, and contribute to confusion as to what the situation actually is.

An important aspect of the confusion is that the government debt at the Central Bank is often counted as part of national debt. In particular for developing countries, who have more use of seigniorage (inflation tax) since normal tax collection is difficult, the size of the government debt can be distorted, and a wrong way of accounting for fiat money can cause wrong decisions, such as overly ambitious austerity programs.

The US Fed vs the EU monetary system

The Annual Report 2004 of the US Federal Reserve may be the exception to the rule explained above. The Fed properly distinguishes its balance sheet of itself, seen as a company, from its holdings of monetary instruments. Thus on page 266 there is the “Statement of Condition of the Federal Reserve Banks, by Bank, December 31, 2004 and 2003”, which is not called the “balance sheet” but a “Statement of Condition”. Under the “liabilities” we find the “Federal Reserve notes outstanding”, with a subtle distinction of a part that finds “collateral” in government bonds and a part that doesn’t have such a “collateral”. The latter distinction has no real meaning, since it is not clear how much would be needed to perform the open market operations.

The Annual Report 2004 of the EU monetary system conforms to the rule explained above. The monetary reserves are catalogued under a “balance sheet”, while, with fiat money, there is no reason for such “balancing”.

We thus find that the Fed is already part of the way of accepting fiat money as fiat money, but not totally, while the EU system still tends to a way of accounting as if there were a gold standard. This is also reflected in the share of gold in all assets at those Central Banks, see also Henderson et al. (1997).

2004			
All in millions	US Fed. Res. (\$)	ECB (EUR)	EUsys (EUR)
Total Assets	814,946	90,212	884,324
Gold	11,041	7,928	125,730
% Gold in Assets	1.4%	8.8%	14.2%
PM. The Eurosystem consists of the ECB and 12 national Central Banks			

Concluding remarks

In a next version of this paper it would be sensible to give an example of a rebalanced Balance Sheet. When fiat money drops out as a liability and when most government bonds drop out (as a donation to the government who then may tear up the paper), one wonders what the result would be. Properly, it would be a Statement of Conditions with less assets in the form of government bonds and more “goodwill”.

In the mean time, it seems useful that not only monetary economists and the monetary authorities themselves consider the argument, but that also economists who deal with developing countries, such as economists at the IMF and Worldbank, reconsider the issue of national debt.

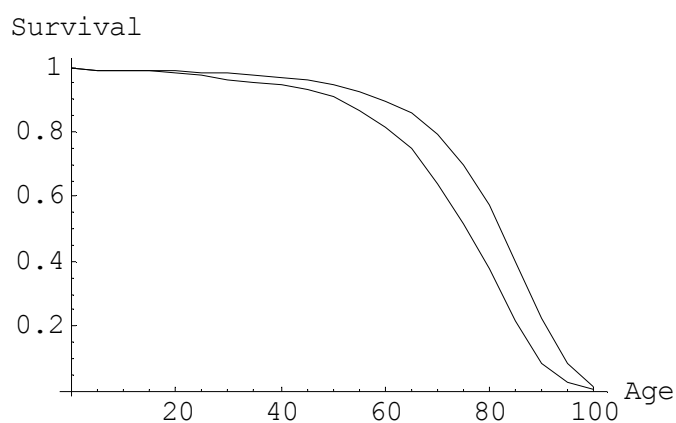
P. Life expectancy

Baby boys have a life expectancy of 72 years but at age 60 still 82% of the men are alive with an expectancy of 19 years. For girls the data are 78 years, 90% and 23 years, see Table 43 and Figure 25.

Table 43: Life expectancy in the Netherlands Antilles 1998-2002

Age	Life expectancy in years		Survival in percentage	
	Male	Female	Male	Female
0	72.1	78.7	100.0	100.0
5	67.8	74.5	99.0	99.0
10	63.0	69.5	98.7	99.0
15	58.0	64.6	98.7	98.8
20	53.3	59.7	98.2	98.7
25	48.7	54.9	97.4	98.3
30	44.2	50.1	96.4	97.9
35	39.5	45.3	95.7	97.5
40	34.9	40.6	94.6	96.8
45	30.4	35.9	93.2	96.1
50	26.2	31.3	90.6	95.0
55	22.3	27.0	86.6	92.7
60	18.5	22.8	81.6	89.8
65	15.0	18.7	74.6	86.0
70	12.1	15.0	63.9	79.6
75	9.4	11.7	51.6	70.0
80	7.0	8.7	37.4	57.5
85	5.3	6.5	21.6	39.6
90	4.4	4.7	8.8	22.0
95	3.2	3.0	2.9	8.8
100	2.3	2.1	0.4	1.0

Figure 25: Male and female survival curves, 1998-2002



Q. Some additional points to consider

The body of the text has main chapters on unemployment and the institutions BNA, SVB and APNA. This book makes the basic point that there is no need to split up the Netherlands Antilles and that the future lies in the Caribbean. To make that point one requires a well-developed argument which is provided by those chapters. There are some additional points to consider that support this general issue but for which it would take too much time to develop them here. They are briefly indicated.

- (1) The current Island Government of Curaçao has been elected in the period before the Referendum of 2005 (that is said to have ‘chosen’ for the Status Aparte). The Island Government thus has no popular mandate to deal with the outcome of the Referendum but it acts as if it has. New elections are required to select an Island Council and Government to properly interpret the Referendum result and to implement the conclusion.
- (2) Once the plans to split up the Antilles have been agreed upon between the Netherlands and the Central Government (who have the only authority to deal with those) then, before actually implementing them, another referendum is required to get a vote on the actual plans. This referendum should set the strict requirement of 2/3 of the electorate (and not the turnout).
- (3) In the mean time, all activities on ‘nation building’ like creating hymns and dressing children in ‘island costume’, and creating an atmosphere that one is not a proper islander when not participating, should be prohibited since these are premature.
- (4) In the last decade there has been a wave of privatizations, see Goede (2005), following the international trend of trying to improve the efficiency in the economy and to restrict the role of the state to core functions. A financial issue is that it is not clear how the transfer of capital affected the figure of national debt so perhaps some correction would be needed there too. More important is the risk that the privatized units become monopolies. There are many indications that these privatizations have not done wisely. Much needs to be done to improve both market orientation and democratic control.
- (5) Many norms and regulations require some indexation to prices and wages. Since the high inflations of the 1970s policy makers have become hesitant about indexation schemes. There is a tendency in the Netherlands Antilles to fix prices and delay adjustment as long as possible. However, now that inflation tends to be under control, and given the need for price adjustment, indexation schemes can smooth adaptation and reduce social tensions. A smart scheme uses an “error correction” format.
- (6) Surprisingly, the CBS and BNA do not give statistics on wage inflation and the labour income quote (the fraction of value added going to wages). These are important statistics, precisely if one wants to control inflation (and the exchange rate).
- (7) Creation of a national system of health insurance does not seem to be overly difficult given the existing systems and existing studies on this. Much can be done on prevention. The kind of diseases also indicate a Western life style and standard of living. For example obesitas causes a legion of health problems, while kidney problems (in a tropical climate) can be caused by not drinking enough water. Sex education may be a sensitive issue but education is required on sexual diseases, HPV, AIDS and birth

control. Perhaps (grand-) mothers should be awarded with ANG 5000 if their (grand-) daughter does not has a baby before age 25.

(8) The current retirement age of 60 years (some years ago actually reduced from 65) does not make much economic sense in the light of life expectancy, its costs, and income per capita. It is a recipe for poverty, drawing resources from the working population and leaving pensioners with a meagre pension. A man with only AOV and without additional pension is convicted to 19 years of continued poverty, a woman to 23 years. See *Appendix P* on life expectancy. The idea may be that early retirement makes room for youngsters on the job market but the issue of unemployment is a wholly different story. With adequate policy there are ample job opportunities, also for the elderly. Table 44 gives a scheme how the retirement age can be increased gradually again, so that people can adapt their expectations and plans. Actually it would be wise to increase the age to 67 for men and 69 for women (the latter not shown here.), allowing a raise of the pension. Needless to say, workers doing hard and dangerous labour require special attention. It would not be fair to force them to work till 67 or 69 since they have few years left compared to others. Measures are: (a) switching to better jobs at an earlier age, (b) strict disability schemes with part time work and income suppletion for the disadvantaged.

Table 44: A scheme to increase the retirement age

Birth year	Retirement age	Retirement year	Numbers (CBS 2001)
1945	60	2005	1804
1946	60	2006	2001
1947	61	2008	2155
1948	62	2010	2173
1949	63	2012	2089
1950	64	2014	2380
1951	65	2016	2562
1952	66	2018	2502
1953	67	2020	2539

(9) English has more advantages as a common language than Dutch, Spanish or Papiamentu. Historically, when the Netherlands Antilles remained within the Kingdom and became no fully independent nation, such sentiments on independence found other topics to express themselves, notably in the development of Papiamentu as a language. One can only respect that but it would still be wise to offer more opportunities to learn, specifically, good English. In kindergarten one should converse with children in the language they know but the environment may contain already a wealth of English since languages are learned best at a young age, so that there can be gradual build-up. The advantage of Dutch is only that the Netherlands provides cheap universities. The unintended consequence is that the Dutch budget of education subsidizes a misallocation of resources. Offering scholarship loans and grants for colleges and universities in the USA would be better solution, of course with the condition that after graduation one would work 5 years on the Antilles. This can be extended to Spanish and universities generally teaching in English or Spanish. For children and students with a Portuguese background the link to Portugal and Brazil would be important.

(10) In the mean time the Antilles better have a *overseas countries and territories* (OCT, LGO) than an *outermost region* (OMR, UPG) status. The prime argument is the USD area, with all due respect to Bekkers et al. (2004) who conclude differently.

(11) For the whole world, population control is a key issue.

(12) Salaries and pensions of political leaders are an issue.

(13) There might be an unfair treatment in pensions of the established participants (“baby boomers”) and the younger generation anyway. In the current rules and statistical data some provisions such as indexation might be arranged by direct payment by the government rather than via pensions such that the complete picture gets lost.

(14) On environmentally sustainable economic growth, the following could be observed. Creating more airline capacity for the Netherlands Antilles would run counter to the environment. On the other hand, if such capacity causes that fewer US tourists fly to Hawaii, Indonesia and Thailand, since they can find similar tropical beaches closer at home, then this relocation would be beneficial for the environment. Indicative planning on a world scale and the effective use of the market mechanism would work this out.

(15) The following quote is relevant: “it has been found that in many new countries there is a tremendous shortage of persons willing and qualified to participate in public life. This shortage becomes all the more important in smaller territories where the skills of the members of the ‘out’ party are not employed. The partisanship that is engendered is not only wasteful of skills already in short supply, but is dysfunctional in other respects as well. Partisanship nurtures and encourages factionalism in the society at large, and while larger societies are often able to vitiate the effects of political partisanship, smaller societies find it difficult to do so. The end result is that parties reward their friends and punish their enemies. In small underdeveloped societies where government is usually the major employer, the effects of this are widespread, and a great deal of insecurity results, particularly when there is a changes of government. This further encourages the parties and their followers when in power to accumulate enough wealth to maintain themselves when out of power.” Singham, Benedict (1967:137-138). He continues to observe that the constitutional arrangements imposed on the new small nations may be deficient. “This is not surprising since the framers were influence by their own experiences as members of large industrial societies with a constitutional system evolved over a long period. They were not particularly concerned or conversant with the peculiarities of small agricultural societies.” Colignatus & Hulst (2003) consider that the constitutions and political practices of those large industrial nations may be deficient too. They advise annual elections to increase sensitivity to the electorate and the selection of a council of ministers that mirrors parliament (and an Economic Supreme Court to provide adequate information). It is not wise to keep major sectors of the population out of ministerial practice. Parliament should check and control the ministers, not merely provide backing along political lines. Those suggestions would also apply to the Netherlands Antilles.

R. On the Nobel Prize in economics 2006 for Edmund Phelps

While I wrote this book PENAF, the “Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2006” was awarded to professor Edmund Phelps “for his analysis of intertemporal tradeoffs in macroeconomic policy”.

The NP website contains a discussion both for a general audience and professional economists. The point to observe is that the NP Committee only cites work of Phelps up to and including his 1994 “Structural Slumps” and no later work. After 1994 he wrote more extensively on job subsidies for the lowly paid. DRGTPE (p224-228) discusses “Structural Slumps” and some of his papers on such subsidies. Phelps analysis tends to support the analysis provided in DRGTPE and this current book PENAFIC, though Phelps apparently doesn’t refer to the tax void and the dynamic marginal rate, which are concepts in DRGTPE and available on the web since 1995.

In Phelps’s work the Phillipscurve features strongly. DRGTPE makes extensive use of that Phillipscurve and showed that it and the equilibrium ‘constant wage inflation rate of unemployment’ (CWIRU) changed location due to differential indexation of wages and taxes that caused the growth of the tax void.

As said, this book PENAFIC is only a Supplement to DRGTPE. My economic colleagues are advised to consider the complete analysis.

S. Note on the cover photographs

The photographs on the cover have been made, and made available, by Wim ter Hart, www.curacaoinvogelvlucht.nl, hartsite@hetnet.nl, +31-(0)33-4334216.

They depict the Juliana bridge in Punda, Willemstad, Curaçao, crossing the Saint Anna bay. The bridge is high to allow ocean ships to reach the Schottegat harbour. When constructing the bridge, it first crashed. Ter Hart shot the unique picture from the air of its sad remains. The second shot is from about the same angle and shows the existing bridge.

These photo’s give a powerful image of the adagium that the tax theorist Cohen Stuart crafted in 1889 to explain the importance of tax exemption: “A bridge must bear its own weight before it can carry a load.”⁶³ The people and the government of the Netherlands Antilles are in an excellent position to understand that point.

T. Parliament, science and ways of fostering change

Science advises and parliaments enact change. Currently, scientific advice is blocked from adequate access to parliaments. Instead of letting things run their course, possibly into chaos and undesirable changes, the only really good remedy is that parliaments *study* the material provided by science. Parliaments generally have ways to start a special enquiry by themselves, like the Dutch “parlementaire enquête”. At first they may think that they already know most of it so that an enquiry is not necessary but in the course of the study they will discover that some points really are a bit different than assumed.

⁶³ “Een brug moet eerst zijn eigen gewicht dragen voordat hij belast kan worden.” Cohen Stuart (1889) in H.J. Hofstra, *Inkomstenbelasting*, Kluwer 1975

Appendices selected from DRGTPE

These appendices are taken “as is” from DRGTPE (2005) and thus one must take account of some time difference. The word “now” indicates the time of writing at the end of 2004.

A constitutional amendment for an Economic Supreme Court

As an economic expert I advise to a parliamentary enquiry and a public debate on this issue. It are the present powers in government that must grow convinced of the need for a better balance of powers. The evidence will likely convince them, if only they study it.

The following is a text that may serve as a concept for a constitutional amendment. The text assumes the common Trias Politica. It uses the term “Parliament” for the legislative branch (e.g. US Congress), and “President” for the executive branch (e.g. the UK Cabinet). It then adds the Economic Supreme Court. The given size, terms and other properties of the Economic Supreme Court seem best to create a balance for group decision making, openness, stability and change.

This text has essentially been posted on the internet in 1996. The major current change with respect to that text is a result of Frank Sulloway’s “Born to rebel” (1996) and the subsequent reports - Van den Berg (2004) refers to *Nature* - that these findings are not accurate. Sulloway argues that first-borns tend to be less open to new ideas but more likely to have responsible positions. This causes the idea that, since the court should be sensitive to new discoveries and be critical to abuse of authority, it would seem wise to have some test on open-mindedness. This needs to be investigated upon. Since this is a constitution, we should formulate a general rule, and we should leave it to the practical times and state of scientific inquiry how this is implemented, by first-bornness or by some other verifiable criterion.



The nation has an independent and scientific Economic Supreme Court of equal status next to Parliament, the President and the Supreme Court.

1. The task of the Court is to scientifically check the economic data, assumptions, analyses and projections underlying the government’s budget and its draft statement, and then possibly veto the official adoption and publication of the budget, if the Court finds that the information used and presented, and in particular the estimates for the deficit and national debt, are not scientifically correct. The Court will publish its findings both for Parliament and for the scientific community.
2. Members of the Court are appointed by the Court itself, subject to a veto by a normal majority in Parliament.
The Court will inform Parliament about the name and credentials of the candidate for appointment. Parliament will have 50 days to discuss and possibly veto an

appointment. The appointment of the candidate becomes effective when Parliament does not veto the appointment.

3. The Court consists of 7 members. At least 5 members have a high likelihood of open-mindedness, by criteria generally accepted in the scientific community.
4. Term rules are:
 - a) Each member serves a term of 7 years. Each year the member with the longest term resigns, and a new member is appointed.
 - b) Terms run from May 1st till April 30st, 7 years later. If a member resigns before the end of the term, then the replacement will concern only the remainder of the term.
 - c) Members may only serve for two terms, which terms need not be consecutive. A part term will not count if its duration is less than 4 years.
 - d) All 7 members participate in the selection of a candidate for appointment.
 - e) The Court chooses its chairperson from among its members. Non-eligible are the newly appointed and the resigning member, so that only 5 members are eligible.
 - f) The Court determines its modus operandi further by itself.
5. Parliament may, if the occasion arises, decide to dismiss an existing Court and reappoint a new one, which decision requires a majority of two-thirds. Parliament may not override a veto by the Court, by any majority. It is up to the newly installed Court to decide if a wronged veto is repealed.
6. The means of the Court are as follows:
 - a) The Court can appoint a staff of maximally 150 persons. Minimally 50% of the staff shall have an appointment as scientist, and they shall operate under both common scientific standards and a special statute that has precedence. This special statute shall be established and published by the Court.
 - b) The Court can instruct the President to provide information. The President may refuse information only if national security is at stake. Information that the President regards as confidential will be treated as confidential by the Court and its staff too, unless the same information can be received via independent other channels too.
 - c) When State governments within the Federation install their own Economic Courts, then possible disputes shall be settled by the Economic Supreme Court.
 - d) The Court can install a council of economists and other specialists from the academia. The Court can install chambers of special competence.
 - e) The Court shall have a budget that compares favourably to the average budget of scientific research institutes of the same size.

Autobiographical note

This book completes a project that started in 1989 and that is closely related to the Fall of the Berlin Wall in that year.

At that time in 1989, and in fact from 1982-1991, I was employed as a 'economic scientific researcher' at the Dutch Central Planning Bureau (CPB), which institute can be compared to the US Council of Economic Advisers. The CPB provides the executive branch with economic projections and with evaluations of policy proposals. In 1989 I was involved in test runs for a study of the economy for the long run till 2015, later published as the CPB (1992a&b) "Netherlands in Triplo" and "Scanning the future". The test runs showed continued economic problems, and this caused me to consider some points. If the Bureau would publish bad weather projections, then these might cause the government to enact economic reforms that would self-unfulfill the projections. Secondly, my CPB colleagues Van Schaaijk (1983) and Bakhoven (1988) had presented a solution approach to unemployment that did not get the attention that it deserved. Thirdly, when the Wall fell, it was obvious that continued unemployment in Western Europe would be detrimental to economic recovery in the East, and this suddenly made unemployment much more important than it had been before. So in November I wrote an internal memo Colignatus (1989) proposing various economic reforms that might be considered as research projects not only for the final version of the long run study but also for the medium run.

Then, in December, in deciding on the annual pay rises, the CPB directorate withheld part of the normal raise for me, and my section chief informed me that it would have been better if I had not written that memo. Apart from the bizar sensation that a hundred billion dollar invention was being punished instead of rewarded, I also experienced the sensation that comes when the dime drops or when the pieces of a puzzle fall together. I could not escape the conclusion that I was confronted with a particular piece of evidence of stagnation in policy making, and that improper means were being used to influence scientific discourse. Taking stock: my career position was blemished, my creative contribution was branded as weird instead of simply creative, and I was apparently supposed to no longer judge ideas on their own value but on some line that was decided by the directorate. If these methods were used, I could understand why colleagues Van Schaaijk and Bakhoven had become silent on their important contributions to the solution approach, or had left the Bureau altogether.

So in December 1989 I easily envisaged a book that would explain both the solution to the current mass unemployment in OECD countries and the stagnation in policy making that causes it. It was my perception at that time that under normal conditions it might take ten years before this analysis would be accepted by 'the relevant circles', i.e. some years to write the book, some years to allow my fellow economists to digest it, and some years for the percolation into public and political discourse.

But life is not such that if a scientist decides that a book should be written, that his environment will let him do it. Instead, there was the pressing need to find a proper answer to the abuse inflicted on me, and to collect and safeguard the evidence of that abuse. Given the triad of Voice, Exit or Compliance ('compliance' since 'loyalty' is the precondition - and the Exit and Compliance options already used by my two colleagues) I decided to Voice. I filed an appeal, and started writing a paper where I clearly stated my

conclusion as a scientist that the return to full employment could be much speedier if Parliament would have an enquiry in the policy making process. Not quite to my surprise, I saw myself moved to a separate room in April 1990, and my paper was blocked from circulation. Only after some trouble it was allowed to appear as an internal note Colignatus (1990ac), but was further blocked from internal discussion and eventual publication. And I was finally fired in October 1991. And neither quite to my surprise, the courts allowed the directorate to do all this. The court deemed it an abuse of power that the directorate had moved me to a separate room, but the dismissal was deemed acceptable. The legal position of a scientist within the government is not that strong, the popular stories to the contrary.

These lines clarify that this book has not been written under the conditions that benefit science. I have been mauled by the bureaucracy, I have been on the run from one short temporary job to another, always job hunting, a longer while unemployed and in dire financial straights. But I was happy that I had kept my integrity, and it was a joy to occasionally read some economics again and to write a piece of the analysis. I published a collection in 1992 and another collection in 1994. I discovered *Mathematica*, January 1993, and there was hope again. The internet became accessible to me, and I was able to enter my papers in the Economics Working Papers Archive (EconWPA) at the Washington University in St. Louis.

One factor that caused a shift in the plan of the book was that I no longer had the resources of the CPB at my disposal. No database, no model, no easy access to the literature, no participation in professional discussion, and no professional position that would give easier access to the other research institutes and organisations like the OECD, World Bank or IMF. It was curious, to say the least, not to have access to the model that I had helped designing and that I in fact normally maintained and had sitting at my computer. My situation caused me to rethink methodology. What could I prove, if I did not have the means that I had grown accustomed to? But by 1991 I had solved that problem and life became a bit more agreeable. But of course, it took longer, much longer, to work it all out.

Please be aware that it was not all misery and gloom. Over these 15 years I could go to 7 Dutch economics ‘research days’, visit 3 European Economic Association congresses and visit the occasional colleague and professor. There are also nice events that happen when you approach people with some novel ideas. I still enjoy the tour of Cambridge that Richard Layard gave to Assar Lindbeck and me; this was in 1991 when Layard, Nickell & Jackman (1991), “Unemployment”, had just appeared. Mr. Emile van Lennep, former head of the OECD, then retired as Minister of State but still at the Dutch Treasury, agreed to talk to me, and afterwards helped me to get an interview at the US Treasury in the Summer of 1993: but to no avail, the person that I talked to was too absorbed by the Clinton Health Plan, and said something like ‘Well, if Europe wants to adapt its constitution, be my guest’. It also appeared that the OECD did not have information on tax exemption in the member states. It was worth a try, and fun to do. I also have had great fun developing my “Economics Pack”, applications for *Mathematica*. It is good software, it brings me in contact with interesting economists all over the world, and of course it includes, amongst other projects, also some of the material of this book - which should do something for the spread of the ideas as well.

So now the book is here. It collects and combines the various articles written since 1989, and gives the final twists that come from integration.

Note that I as a researcher claim ‘novel results’, while I at the same time say, at the risk of an inconsistency, that ‘*either* governments already knew how to solve unemployment and then neglected human suffering, *or* they could find out how to do it and then at least failed in co-ordination’. ‘Novelty’ and ‘it was known’ are at risk of being inconsistent. I have removed this risk (a) by making the novel results available since 1990, which was 10 years ago at the first edition of this book in 2000 and now in 2005 is 15 years ago, (b) by gathering information about the abuse afflicted on myself, and making this information available to others, and (c) by showing that important parts of the whole analysis (without my contributions) were already known before. Cohen Stuart in 1889, and policy makers in the 1950s already knew that tax exemption should be at the subsistence level. One does not really need a CWIRU concept to see that. While this was known, my novel contribution then has become to analyse the ‘loss’ of this information as an institutional and Public Choice problem - or bad co-ordination between the Treasury and the Ministry of Labour. As a ‘novel contribution’ it has its limits - though in the 1980s it took me a decade of eliminating other causes before I discovered, and indeed with surprise, how dumb and insensitive these bureaucrats can be. But other novel insights have a more enduring character, and that is a relief.

Yes, some friends have advised not to tell all of this, others have advised to do so. I once entertained the thought to skip my Dutch examples, and concentrate on, say, the US. This might enhance the argument, since readers would be less inclined to think that I am partial to the argument. I hesitated doing that, since (a) I am not partial anyway, and (b) it would eliminate that very example of the current structural deficiencies in economic policy making.

What is new in this analysis ?

‘New’ is taken here in comparison to others, and thus includes points also made in my earlier publications on this analysis. New is:

- 1) clarification that if you don’t index subsistence for average income, then you create poverty
- 2) clarification that minimum ‘income’ is not an ‘income’ but a mechanism (with multiplier)
- 3) the concept of the Tax Void
- 4) the dynamic marginal tax rate, and its relation to labour supply and macro-economics
- 5) these explanations for the shift of the Phillipscurve:
 - a) by the minimum wage and tax void, or poverty
 - i) directly, and caused by differential indexation of exemption and subsistence
 - ii) indirectly, by the crowding out effect, shifting of the tax burden etc.

- b) by misguided macro-economic policy (not understanding taxes, fighting inflation with the wrong means)
- 6) clarification that ‘there is no poverty trap’
- 7) suggestion for a simple nonlinear tax function, clarification for households
- 8) suggestion of a possibly ‘dromedary shaped’ labour supply
- 9) clarification on the concept of a ‘free lunch’
- 10) proper definitions of risk and uncertainty
- 11) clarification for the impact of the minimum wage (tax void) on sheltered and exposed sectors
- 12) clarification on the Definition & Reality methodology
- 13) the theorem on the possibility of full employment, via the reduced form
- 14) integration of deontic logic with preference theory
- 15) the proper interpretation of Arrow’s Theorem
- 16) the Borda Fixed Point method
- 17) the theorem on the possibility of co-ordination, via the reduced form
- 18) description of actual bureaucratic processes on these subjects, so that we better understand how the Great Stagflation came about (comes about)
- 19) the concept of the Economic Supreme Court, in its political and historical relation to both the Trias Politica and economic science, and a draft constitutional amendment to start thinking about
- 20) clarification of the moral imperative with regards to Russia and Eastern Europe
- 21) positioning this analysis with respect to a standard small macro model and the work of other authors.

Abstract of DRGTPE

This is the abstract of Colignatus, (2005), “Definition & Reality in the General Theory of Political Economy”, Dutch University Press

The prime conclusion of this book is that Western democracies are well-advised to install an **Economic Supreme Court**. This volume includes a draft constitutional amendment that shows that such a measure can indeed enhance democracy.

The fundamental structure for current policy making in a democracy is Montesquieu’s model of the separation of powers, i.e. the Legislative, Executive and Judicial branches that form the “Trias Politica”. It appears that this structure still allows room for economic policy making that is detrimental to the life and liberty of the citizens of the state. The key issue appears to be that there is no independent protection of the quality of information. With all the social, economic and political interests involved, the current process of economic policy making allows the current constitutional powers too much

room for distortion of the information. Economic theory then suggests the creation of an Economic Supreme Court as a separate constitutional power with the task of the scientific management of information. The legislative and executive branches would still decide on policy targets and policy execution, but they would lose the power to interfere with the scientific handling of information. This argument can be developed purely theoretically. The economic experience of the last century shows that the argument is also practically relevant.

Political Economy as a science has the general objective of explaining and advising the management of the state. Two hallmark reference points exist in the *General Theory* by Keynes (1936) and the analysis by Tinbergen (1956) on the principles and design of economic policy making. These studies show that the state can be subject to long periods of economic recession and even depression if not properly managed. Since the end of World War II, application of these ideas has allowed spectacular economic growth while depression has been prevented indeed. However, the economic record especially since the 1970s is mixed, with issues like stagflation, problems with the welfare state and continued poverty and also with the issue of sustainable development and protection of the environment. It can be shown beyond reasonable doubt that economic policy has been detrimental to the life and liberty of many of its citizens while this came about by mismanagement of the available information.

An element of self-reference arises when economic policy uses economic theory itself, so that theory should include theory. Increasingly over the years, economic theory has gotten a role in the management of the state, and developments in the real economy cannot be properly understood without reference to the economic ideas adopted for national policy. Since economic theories give conflicting advice, part of the management problem of the state is the selection of the appropriate theory, and this selection is more and more the key management problem. At the next higher level of abstraction, the process of selection becomes the focus of attention. The problem then becomes what that process is, what criteria of transparency and fairness it satisfies, and how the process itself affects the economy. The current structure gives too much room for political elites and bureaucrats to neglect the basic rights of the population at large. The criterion to judge an optimal improvement in the structure of economic policy making is not just economic growth but can be taken in the concept of democracy itself and the citizen's right to be properly informed.

Keynes's *General Theory* can be generalised even further by the inclusion of endogenous government in the model, and in particular economic policy making itself as that is guided by economic theory. Keynes clearly anticipated this line of thinking, where he wrote: "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back." (GT:383) The new point now is that this does not only concern "practical men" but economists themselves too, and the whole institutional framework for economic advice. When economic policy making itself is part of the model, economic stagnation can be explained as stagnation in that realm, and the solution for economic stagnation can be found there too.

OECD nations had full employment in the 1950-1970 period, and Japan and Sweden had it much longer. So it would seem that full employment at least is feasible. However, after the period of full employment, all nations showed the phenomenon of stagflation, which is a worsening trade-off between inflation and unemployment (represented as the shift of

the Phillipscurve), frequently associated with stagnating growth. Instead of full employment and a steady growth of welfare, OECD nations suffered a long period of insecurity from 1970-2005.

This volume analyses the different periods and finds the likely cause. The fundamental cause is the common Trias Politica structure of economic decision making that all OECD nations share over time and space. At an operational level, stagflation can be explained by the tax policy that OECD nations have in common as well.

The common tax policy is based upon a particular economic theory that has become the conventional economic view of our time. This conventional theory sees tax as a penalty on work effort and holds that statutory marginal rates have major disincentive effects. Marginal tax rates are a useful penalty on (inflationary) wage claims in wage-bargaining, but the conventional view is that the disincentive effect dominates. Following this theory, policy has been to reduce marginal rates at the cost of lower exemption. Another measure was to switch from the income tax to a Value Added Tax (VAT) that has no exemption at all.

The common tax policy has static and dynamic components. Statically, exemption is low. Dynamically, there is the tendency of reducing exemption even further. The low and ever lower exemption causes rising tax levels and hence either poverty or higher labour costs in the lower wage brackets, causing unemployment, and causing higher taxes to pay for the benefits. What is crucially wrong about current policies is the phenomenon of differential indexation. Exemption is indexed on inflation, while subsistence, by social psychological causes, rises with inflation and real income. This differential indexation causes ever increasing problems with poverty and unemployment.

The OECD countries have been pursuing this policy now for more than three decades, and rather little is being achieved. It is time to seriously wonder whether policy is on the right track. This book shows where the conventional theory goes wrong.

A first feature is the **tax void**. The tax void is the region of productivity and income between the net minimum wage and the gross minimum wage. The difference between net and gross is normally called a 'tax wedge', but this term is inadequate since a wedge is commonly thought to apply *at* a particular level while the void is a *range*. The income range between the net and gross minimum wage is a void since there are official tax statutes for that range but no true revenues. People are not allowed to work below the gross minimum and thus cannot pay taxes there (that is, for full timers). Ideally, as in the 1950s, the net minimum should be equal to the gross minimum so that the void is zero, and so that such workers can start earning their own living without paying taxes. Because of the current practices for tax indexation, the tax void has grown over time so that the gross minimum wage has risen much more than the net minimum wage. By result, more and more low wage workers are subject to that excessively high gross minimum and are effectively removed from the labour market. The shift of the Phillipscurve can be explained partly by this growing component of minimum wage unemployment. This analysis also points to a solution. For the tax void, no taxes are collected (on full timers), thus abolishing such void taxes will not cost anything. The argument is not quite that lowering the minimum wage will create new job opportunities, but rather that not raising the gross wage costs so excessively would not have destroyed the opportunities that already existed. This argument designs an experiment at no cost.

The tax void causes needless unemployment for millions of people all over the world and its plain bureaucratic stupidity is a blow to naive ideas about democracy (that the current democratic structure would be adequate and provide adequate information).

The second feature in the new analysis concerns the **dynamic marginal tax rate**.

Marginal tax rates are important - since economic theory indeed assumes optimising economic agents - but these marginal rates should be properly computed. This analysis not only considers the partial effect, assuming other things constant, but rather considers the total effect that includes all simultaneous changes. A change in a marginal tax rate is usually accompanied by a change in exemption, and both generally happen at the same time, either annually or in computer policy simulations. Private and national income change at the same time too. Individuals are frequently aware that their own fortunes are linked to the fortunes of the national economy and they will be sensitive to their relative position in the distribution of income. Work incentives may be more guided by the average tax rate rather than the statutory marginal tax rate. Hence, 'incentives' may not be a convincing argument against higher marginal tax rates, even though policy makers have been advancing that argument forcefully. That, in fact, the converse is true, fits perfectly with the experience of the last decades. The reduction of the statutory marginal rates, as the policy was, appears to have had little incentive effects, since the true incentive effect depends more on the average tax over time, and this average has remained high due to the problems of unemployment, poverty and lower growth.

This book concludes that macro-economic policies in OECD nations have not countered stagflation but have actually increased it. Current policies add to labour costs, reduce incentives, fuel forward shifting of the tax burden, and worsen the trade-off between inflation and unemployment.

The new analysis points directly to a policy that will be successful and that will allow a return to full employment under stable prices like in the the 1950s. If exemption is put at subsistence, then jobs can be created at the low end of the labour market, which would save benefits and reduce average taxes, which again would increase incentives. The alternative structure and policy would also be beneficial for inflation. If low productivity labour has a stronger position in the labour market, then the risk of unemployment is spread more evenly, and trend-setting high productivity labour will be cautious about wage claims.

A welfare state is defined as a state that doesn't let people die and thus provides benefits for the lowly productive *anyway*. The welfare state can be run more efficiently by using those resources, instead of going into benefits, to instead reduce labour costs and to price the lowly productive into jobs. The analysis on inflation and unemployment thus results into the proposition that, since the present situation is inefficient, an improvement is possible from which everybody can benefit.

This book provides theorems in mathematical economics to prove its points. The central questions in the political economy of employment in the welfare state are: *can* one solve unemployment, does one *know* how, and does one *want* to ? The book presents a model that satisfies the stylized facts and thus serves theoretical and empirical uses.

- The first result is a possibility theorem (*can*) that there are two regimes of either full employment or unemployment.
- The second theorem explains the choice by *know* and *want* causes. Full employment results from conscious choice or chance (while lacking knowledge). Unemployment

results from conscious choice or wrong co-ordination (where a Pareto optimising change is blocked only by lack of knowledge - and a lack of knowledge not by the economists but by the incompetent or insensitive policy makers).

The analysis shows mathematically that democratic goals indeed can be blocked by special interests or neglect, for example within the bureaucracy. A policy conclusion is to improve informational (planning) procedures.

The discussion of taxes, unemployment and inflation is basically just a minor point of the book. The major point of the book concerns the co-ordination problem. Western democracies apparently allow long periods like the Great Depression or the Great Stagflation that are detrimental to the economic well-being and security of large sections of their populations. Ideas of economists that point the way to recovery are only slowly accepted. Key examples are the ideas of Tinbergen and Keynes: for them it took World War II before they got listened to. Eventually, the political powers of that time accepted that they had to redesign the structure of economic policy making, and they gave more room to the scientists, but did not dare to give up their ultimate power to meddle with the information. Currently, the world faces the challenge of the growth of the world population from 6 billion people around 2000 to likely around 8 billion people around 2025. To manage this process, mankind would benefit from a structure of economic decision making that is both democratic and that respects the citizen's right to know.

Literature, abbreviations and index

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List of abbreviations

ABP	Algemeen Burgerlijk Pensioenfonds (Dutch government employee pension fund)
ALM	Asset and liability management
ANG	Antillian Guilder
AOV	Algemene Ouderdoms Voorziening (national pension)
APNA	Algemeen Pensioenfonds van de Nederlandse Antillen (Government Pension Fund)
AVBZ	Algemene Voorziening voor Bijzondere Ziektekosten (general special health insurance)
AWW	Algemene voorziening voor Weduwen en Wezen (widows and orphans)
BNA	Bank van de Nederlandse Antillen (Central Bank)
BZK	Ministerie van Binnenlandse Zaken en Koninkrijkszaken (Dutch Ministry dealing with Kingdom issues (the Netherlands Antilles and Aruba))
BZV	Bureau Ziektekostenvoorzieningen (government health insurer)
CalPERS	California Public Employees Retirement System
CAO	Collectieve Arbeidsovereenkomst (collective bargaining)
CBS	Central Bureau of Statistics (either Antillian or Dutch)
CGov	Central Government
CP	Connection point
CPB	Central Planning Bureau
CU	Caribbean Union (concept)
DB	Defined Benefit
DC	Defined Contribution
DNB	De Nederlandsche Bank (Dutch Central Bank)
DRGTPE	Colignatus (2005)
ECB	European Central Bank
ESB	Economisch Statistische Berichten (Dutch economists magazine)
ESC	Economic Supreme Court (concept)
EU	European Union
EUR	Euro
F.E.	Former employees, insured at SVB

FTK	Financieel Toetsingskader (Dutch regulations on pension funds)
GDP	Gross Domestic Product
KIT	Koninklijk Instituut voor de Tropen (Royal Tropical Institute)
IGov	Island Government
IMF	International Monetary Fund
LGO	Landen en gebieden overzee (see OCT)
M1	Minimum wage 1 or stock of money M1
M1a	Net M1
M2	Stock of money M2
M4	Minimum wage 4
n.a.	Not available
NA	Netherlands Antilles
NAF	ANG
NP	Nobel Prize
OCT	Overseas countries and territories
OMR	Outermost regions
OV	Ongevallen Verzekering (worker accident insurance)
PENAFIC	This book
ROI	Return on investment
SNA	United Nations System of National Accounts
SVB	Sociale Verzekeringsbank (Social Security Bank)
UN	United Nations
UNA	University of the Netherlands Antilles
UPG	Ultra perifeer gebied (see OMR)
USD	US Dollar
VAT	Value added tax
ZV	Ziekte Verzekering (health insurance for workers)

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