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August 2003
IMF Country Report No. 03/239

Kingdom of the Netherlands—Netherlands: 2003 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion for the Kingdom of the Netherlands—Netherlands

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with the Kingdom of the Netherlands—Netherlands, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **May 19, 2003,** with the officials of the Kingdom of the Netherlands—Netherlands on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 7, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **July 24, 3004** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its July 30, 2003 discussion** of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

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

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

Staff Report for the 2003 Article IV Consultation

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July 7, 2003

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I. Introduction

1. A staff team comprising Mr. Ford (head), Ms. Detragiache and Zhou, and Mr. Hofman (all EU1) visited Amsterdam and the Hague during May 9-19, 2003. The mission met with the finance minister, the governor of the central bank (DNB), the head of the pension supervisor (PVK), the head of the Social and Economic Council (SER), the staffs of several ministries and government agencies, employer and labor representatives, banking economists, and academics.

2. Following elections in May 2002, the government collapsed and new elections were held in January 2003, and a center-right coalition (Christian Democrats, Liberals, and D66) was sworn in on May 27. The coalition agreement, which outlines the government's economic policies for its four-year term (to 2007) was published on May 16.

3. At the conclusion of last year's consultation (Public Information Notice: http://www.imf.org/external/np/sec/pn/2002/pn0263.htm), Directors commended the authorities on prudent economic policy, and argued for further fiscal consolidation in view of population aging. They also agreed that a renewed commitment by the new government to a multi-year fiscal framework would be essential in this regard. Directors underscored the need to press forward with labor and product market reforms.

4. The policies of the Dutch authorities have long been broadly consistent with Fund advice. Considerable fiscal consolidation took place in the 1980s and 1990s, reducing expenditures and taxes as a fraction of GDP, and eliminating the deficit in 1999. As discussed below, however, a substantial deficit opened up again in 2002. Structural reform and wage moderation delivered one of the best labor market outcomes among advanced economies, with rising participation and employment rates, and very low unemployment rates. In the past year, the absence of a stable government resulted in a pause in the implementation of a series of needed reforms to rein in the disability scheme, reduce poverty traps, and further liberalize product markets.

5. Data provision is timely and adequate for surveillance purposes (Appendix I). The Netherlands has accepted the obligations of Article VIII (Appendix II). An FSAP is scheduled for completion in the first half of 2004. The authorities intend to publish this staff report.

II. Background

6. **The strong economic expansion of 1996-2000 has given way to a period of very little growth** (Table 1, Table 2, and Figure 1). This slowdown reflects in part an unwinding of imbalances that had built up during the boom. Wage and price inflation rose, threatening profits and international competitiveness (Figure 2); rapid asset-price rises, which had boosted domestic demand by an estimated ½ percent a year, ended as the stock market collapsed and house prices flattened out (Figure 3); saving rates rebounded after falling earlier as asset price increases bolstered household balance sheets (Figure 4); and investment

rates fell from very high levels. As a result, business investment has been falling since 2001, and household consumption was nearly flat in 2002. Exports have also been very weak, owing mainly to the worldwide economic slowdown (Figure 5). International competitiveness has eroded gradually, but the trade balance, export market shares (until end-2000, after which there are indications of erosion), and inward direct investment (a proxy for the attractiveness of locating in the Netherlands) have proved robust. This somewhat surprising development may reflect the still strong competitive position that had been established in the 1980s and early 1990s and possibly also a lag due to pricing-to-market by Dutch exporters.

7. **The slowdown has eased inflationary pressures.** In 2001, employment growth began to fall, and the unemployment rate to rise, although firms, with the memories of labor shortages during the boom period still fresh, appear to have been reluctant to shed workers (Figure 6). In the first months of 2003, however, the unemployment rate rose sharply, to 5.3 percent in March. With labor-market pressures easing, the social partners agreed to wage increases of no more than 2.5 percent in 2003, an agreement that is, by all accounts, being respected. Inflation is also falling, and converging to the (lower) euro-area average.[1]

8. **The fiscal position has deteriorated sharply, from a surplus of 2.2 percent of GDP in 2000 (1.5 percent excluding UMTS proceeds) to a deficit of 1.2 percent of GDP in 2002** (Table 3). This reflected both the automatic stabilizers and a weaker structural balance, and helped to cushion demand. The extent of the deterioration in 2002 was unexpected. As late as December the authorities were predicting a deficit of only 0.7 percent of GDP. Relative to the 2002 budget, tax inflows proved much lower than anticipated, with most of the shortfall in direct taxes stemming from the corporate profits tax (see Table). The shortfall was due to weak profits and to provisions allowing firms to carry back losses. In any event, the revenue buoyancy associated with the boom of the late 1990s was, in retrospect, unsustainable and not likely to re-occur. In addition, spending was about 1 percent of GDP higher than budgeted, reflecting in part health-care spending, which rose nearly 9 percent in volume terms. The expenditure ceiling was nevertheless respected owing to higher non-tax revenue (which, under the rules, offsets spending) and profits from the central bank.

Deterioration in the Fiscal Position

	2001	2002	2003
	(Percent of GDP)		
Change in the budget balance, of which:[1]	-1.1	-1.6	-0.9
Structural	-0.6	-0.8	0.2
Change in structural expenditure	-0.4	0.3	-0.6
Change in structural revenue, of which:	-0.9	-0.5	-0.4
measures	-1.2	0.2	0.5
autonomous	0.3	-0.7	-0.9

Source: Ministry of Finance, CPB, and Fund staff calculations.
[1]Figures exclude UMTS revenues in 2000 and the purchase of gas rights from DSM in 2001.

[1] Transitory factors pushed up prices in both 2001 (a consumption tax increase) and 2002 (the introduction of the physical euro).

2002 Budget				
	Budget	Outturn	Difference	Difference
		(Billions of euros)		(Percent of GDP)
Central government				
Tax revenues, of which:	112	105.0	-7.0	-1.6
Corporate profit tax	19.1	15.4	-3.7	-0.8
Non-tax revenues	19.5	22.1	2.6	0.6
Expenditures	129.7	131.4	1.7	0.4
Balance	1.8	-4.3	-6.1	-1.4
Social Security Funds				
Social Security contributions	61.7	61.2	-0.5	-0.1
Expenditure[1]	60.2	62.8	2.6	0.6
Balance	1.5	-1.6	-3.1	-0.7
Local Governments				
Balance	1.0	0.4	-0.5	-0.1
EMU Balance	4.3	-5.5	-9.8	-2.2

Source: Ministry of Finance and staff calculations.
[1]Net of other revenues.

9. **The authorities took strong measures to contain the deficit in 2003**. The 2003 budget and a spring budget bill included spending restrictions and revenue increases amounting to some 1¼ percent of GDP, in part to offset rising health-care expenditure growth. The required measures are being implemented, and the staff expects a deficit of 2¼ percent of GDP and a modest improvement in the structural balance. Despite the best efforts of the authorities, it is possible that significantly weaker growth than now expected, a further collapse in corporate tax revenues, or substantially higher health-care spending could yield a worse outcome.

III. Policy Discussions

10. Against this backdrop, the fiscal situation dominated the discussions. The key fiscal challenges are to reverse the deterioration of the public finances and, to prepare for population aging, move toward a structural surplus by 2007. Discussions also covered second-pillar (occupational) pensions, the evolution of labor relations, labor and product market reforms (also partly motivated by population aging), financial sector supervision, trade policy, and overseas development assistance.

A. The Short-Term Outlook

11. **Activity is projected to rise somewhat in the second half of 2003, and strengthen further in 2004** (Table 2). In view of the two quarters of decline at the turn of the year, this pattern translates into a year-on-year fall in real GDP of 0.2 percent in 2003, and a rise of 1.4 percent in 2004.[2] A recovery in the United States and Europe would boost Dutch exports.

[2] The central bank's real GDP growth projections, published in June, are -0.4 percent in 2003 and 0.8 percent in 2004. The June Consensus Forecast is zero growth in 2003 and 1.6 percent in 2004. The CPB Netherlands Bureau for Economic Policy Analysis (CPB) projections, released in early July, are zero growth in 2003 and 1¼ percent in 2004.

Monetary conditions have eased substantially in the euro area, despite the adverse effects of the recent appreciation of the euro (Figure 7). While the authorities did not comment directly on the appropriateness of the ECB's policy stance, they agreed with the mission that there was scope for further easing from the point of view of the Dutch economy. The ECB cut its intervention rate a further 50 basis points on June 5. Domestically, the correction of asset price, labor market, and inflationary imbalances, as well as the end of a substantial drawdown in inventories, should set the stage for recovery.

12. **The authorities and the staff agreed that the outlook was fraught with uncertainty and risks.** Most risks are common to Europe as a whole, where the projected recovery is far from certain. There are no concrete signs of stronger growth, and consumer and business sentiment remain weak in most countries, including in the Netherlands (Figure 8). A protracted adjustment of corporate balance sheets,[3] needed fiscal retrenchment, and, for the euro area, the currency appreciation are all important downside risks. The key domestic risk is a possible sharp fall in house prices, which rose rapidly to historically high levels during the boom period. The authorities argued this was unlikely because housing is thought to still be in short supply. If it occurred, however, the effect could be substantial. The CPB has estimated that a 13 percent fall in house prices in 2003-04 would cut aggregate demand by 0.6 percent.

B. Fiscal Policy

13. **The widening deficit raised concerns about the underlying fiscal situation.** In the absence of corrective measures, the deficit had been projected to reach 2.3 percent of GDP in 2004 (assuming real GDP growth of ¾ percent in 2003 and 1¾ percent in 2004), uncomfortably close to the Maastricht ceiling. Moreover, analysis by the Bureau for Economic Policy Research (CPB) pointed to an erosion of the tax base in the coming years, due to proposed tax cuts, more deduction of mortgage interest, and higher second-pillar pension contributions, which are tax deductible. The mission, while noting that, on the staff's standard assumptions, fiscal sustainability was not in jeopardy,[4] argued for measures to restrain spending and protect the tax base in order to restore a sound fiscal position over time.

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[3] For an analysis of balance sheet issues in the euro area, see Albert Jaeger "Corporate Balance Sheet Restructuring and Investment in the Euro Area," IMF Working Paper WP/03/117.

[4] Appendix III presents the Fund's standard fiscal vulnerability analysis, assuming a no-policy-change baseline (that is, not taking the coalition agreement into account) and the current staff macroeconomic projection. The horizon of the analysis means that the long-term demographic shock is not captured. Under these assumptions the debt-GDP ratio would fall under nearly all the assumed shocks. In two cases (a large rise in real interest rates and an increase in debt-creating flows) the ratio in 2007 is above its 2003 level, but falling.

This would imply a steady improvement in the underlying fiscal position, and allow the automatic stabilizers to play.

14. **The coalition agreement contained a host of measures to reverse the deterioration, a package that was supported by the mission.** These have been incorporated in the recent Stability Program, and will be fleshed out in the 2004 budget.[5] They comprise mainly spending cuts and some tax increases, amounting 2½ percent of GDP over the government period. Important measures include holding public-sector wage growth 1 percent below the standard linkage with private-sector wages and limiting wage drift; indexing social security benefits to public rather than an average of public and private-sector wages, cutting back unemployment benefits, housing subsidies, and certain labor-market programs; and imposing spending cuts on some ministries and public agencies. For 2004, the proposed tightening of ¾ percent of GDP would, taking account of downward revisions to projections, still result in a deficit to 2.4 percent of GDP, but in a small reduction of the structural deficit (Table 4).

15. **During the four years ending in 2007, the authorities and staff project the fiscal position to improve significantly**. The authorities assumed the fiscal package would have adverse demand effects, yielding growth of 2 percent a year, which is below potential. On this basis, the CPB projected a deficit of ½ percent of GDP in 2007, and a structural surplus of ½ percent of GDP (using the CPB method). The CPB noted that this structural surplus would fulfill the long-term objective of a surplus of 1 percent, because it includes the effects of a temporary increase in tax-deductible second-pillar pension contributions (expected to be reversed in 2011; see below), which will reduce revenues by ½ percent of GDP. The staff argued that the fiscal outcome might prove better than officially projected. In particular, whereas the authorities' assumptions imply a substantial output gap, the staff medium-term scenario assumes real GDP returns to potential by 2008, resulting in real GDP growth of 2.6 percent in 2004-07 and a surplus of ¼ percent of GDP in 2007 (Table 4).

16. **The authorities and the mission agreed on the importance of renewing the multi-year fiscal framework, and of devoting budgetary windfalls to deficit reduction.** The mission viewed this as particularly important given the possibility that the medium-term fiscal outturn might prove better than officially projected. The key features of past successful frameworks—real expenditure ceilings and the separation of expenditures and revenues—are to be put in place. The mission argued that devoting windfalls on both the revenue and expenditure sides to deficit reduction would help solidify the medium-term fiscal position. The coalition agreement was silent on expenditure windfalls, but the authorities agreed that room under previous spending ceilings should not be used to raise structural spending. In addition, the mission again proposed aligning the spending ceiling with national accounts concepts to improve transparency. The authorities agreed, but noted that the ceilings

[5] See "Stability Program, 2001-2007" June 2003, which however assumes real GDP growth of ¾ percent in 2003 and 1½ percent in 2004.

were tied to budgetary concepts, which differed in some respects from those in the national accounts.

17. **The coalition agreement also proposes measures to protect the tax base, some of which should improve supply-side incentives.** Tax deductibility of mortgage interest is to be further restricted by excluding capital gains on a previously owned house, a planned elimination of a property tax is to be scaled back, and contributions to second-pillar early-retirement programs (prepensions) will no longer be deductible. The mission welcomed these initiatives, agreeing in particular that the first measure reduces a distortion in capital taxation, and the last would reduce the attractiveness of early retirement schemes and could thus boost labor-force participation of older people. The mission argued that further reduction of mortgage interest deductibility is warranted. One step would be to eliminate the tax advantage of spaarhypotheken, as a step toward ultimately abolishing the deduction.[6] While agreeing in principle, the authorities noted that this is a politically difficult issue, as more than half of households own houses.

18. **Accelerating health-care costs pose a challenge for expenditure control.** Following court decisions that guaranteed access to a range of services in the "care" sector (long-term care, home care, and so forth), top-down budgetary controls were relaxed and health-care spending—which had previously been well contained—rose sharply. The authorities noted that controls on prices remained, and argued that increased copayments (which are low in the Netherlands) and deductibles would blunt demand pressures. Nevertheless, the coalition agreement reserved the possibility of reimposing budget controls. Later in the coalition period, a comprehensive reform will, among other things, replace centralized controls by competitive, regulated insurance providers who, it is hoped, will also hold down costs. The mission expressed strong concern that such measures might not be sufficient, noting strong cost pressures in virtually all countries, particularly in the United States, which has copayments, deductibles, and competitive insurers (Figure 9).

19. **Population aging looms over the long-term fiscal outlook, and action on a number of fronts becomes increasingly urgent with each passing year**. Two key fiscal responses are to contain, through program reform, the budgetary costs of aging and to finance additional costs while stabilizing tax rates by running a sustained budget surplus of some 1 percent of GDP (see the Selected Issues from the 2002 Article IV staff report: http://www.imf.org/external/pubs/cat/longres.cfm?sk=15903.0). The authorities continued to support the goal of long-term budget surpluses, despite the recent setbacks, a position supported by the mission. They also noted that while first-pillar pensions were not especially generous, together with the second pillar the maximum replacement rate was 70 percent of

[6] Spaarhypotheken involve a separate account for principal payments, which is used to clear the mortgage at maturity. As a result, interest payments appear to remain at high levels throughout the life of the mortgage, maximizing the tax deduction.

final earnings.[7] The mission suggested reducing this rate and, in light of longer life spans, raising the retirement age, perhaps from 65 to 67. The authorities considered the current focus to be on reforming second-pillar plans.

Performance of Dutch Pension Funds
(In percent)

	1990-94	1995-99	2000	2001	2002e
Returns (annual average)	7.3	11.6	2.5	-2.8	
Contribution rate (% of wages)	8.5	9.0	9.5	10.0	
Asset-liability ratio (% of liabilities)	107	135	128	118	105
Equity holding (% of portfolio)	19	46	41	44	

Source: CPB.

20. **The authorities emphasized that second-pillar plans, which have recently faced difficulties, remained a strength of the Dutch system.** The recent stock market collapse revealed a long-term underfunding situation of these defined-benefit plans, and caused a sharp decline in coverage ratios (assets divided by the present value of liabilities; see Table). The pension supervisor (PVK) moved to correct this situation in September 2002 by requiring each fund to attain a coverage ratio of 105 percent by end-2003. In addition, depending on the riskiness of each fund's portfolio, the PVK has required that substantial buffers be built up by 2011 which according to CPB estimates will result in average coverage ratios of 130 percent. Consequently, absent reform, contribution rates are expected to rise by some 4 percentage points, to about 15 percent of the wage bill, about half of which is needed only temporarily until buffers are restored.

21. **The authorities have been concerned that higher contribution rates needed to assure long-term financing and build up buffers would raise labor costs and depress employment.** The CPB estimated that raising contribution rates from 11.1 percent to 15.4 percent would cut market-sector employment by 0.8 percent. The mission argued that treating contribution rates as a labor-cost wedge overstates employment effects. To a large extent, higher contributions are needed to fulfill past obligations, which firms cannot now avoid by reducing employment—that is, they are not a marginal cost of labor.[8] In addition, the alternative to higher contributions is not business as usual, but rather a steady decline in assets relative to pension liabilities, which would in itself surely eventually have adverse macroeconomic consequences.

[7] This assumes a 40-year career. The after-tax replacement rate is higher, since pension income is not subject to pension contributions.

[8] See Chapter I of the Selected Issues paper. This argument does not apply to sector-wide funds, which account for some 40 percent of assets, because payments of a (small) firm rise with its own employment, but the reduced costs to others is probably not internalized.

22. **Second-pillar funds are undergoing gradual reform, with a view to reducing long-term liabilities**. Consideration is being given to reducing pension generosity by reducing the degree of indexation of benefits, and switching the base for benefits from end-of-career to career-average earnings is already underway. The mission raised the issue of a possible rise in defined-contribution plans, as has occurred in other countries. The authorities expected some movement in this direction, but felt that the tradition of solidarity would preserve defined-benefit plans as the norm. Finally, the government, in close cooperation with the PVK, is seeking legislation to codify and modernize the rules regarding the prudential supervision of pension funds. Regarding early retirement plans, a more actuarially fair system is being phased in, though the process will not be complete until 2022. The mission suggested that further gains along these lines could be made by integrating all second-pillar systems, to reward working up to 65 years of age and beyond. In addition, as mentioned, the tax deductibility of contributions to early retirement plans is to be abolished.

C. Financial Markets

23. **The financial sector has suffered from the economic downturn**. As already noted, the collapse in stock markets sharply reduced the assets and coverage ratios of second-pillar pension funds, although their liquidity position remained strong. Banking income and profits also fell in 2001 and 2002, reflecting poor commission income and higher provisioning (see Table). Nonetheless, capital-asset ratios remain strong and banks are moving to reduce costs by shedding labor. Regarding mortgage exposure, the authorities have been keeping close watch on the situation, as in recent years banks have tended to relax lending criteria and have developed exotic and tax-efficient products (spaarhypotheken and beleggingshypotheken).[9] The authorities argued that the sector was not at risk, because a sharp fall in house prices was unlikely, mortgage defaults have been historically quite low, and banks are well provisioned. The FSAP scheduled for 2004 should shed further light on potential vulnerabilities in the sector.

Bank Performance
(Percent changes over previous year)

	2000	2001	2002
Total income	17.5	-0.2	-1.8
Interest	6.3	6.6	7.0
Commissions	28.9	-9.9	-8.2
Total expenses	16.7	7.4	1.8
Corporate costs	19.8	2.5	-2.7
Provisions	-18.4	92.2	41.5
Operating profits	21.5	-19.3	-14.5

Source: Dutch central bank.

24. **Reform of financial supervision is continuing**. Last year, prudential supervision was vested in the central bank (for banks) and the PVK (for insurance and pensions), and the AFM was charged with conduct-of-business supervision (consumer protection, for example) and supervision of stock markets. A key feature of the new structure was a closer relationship between the central bank and the PVK, embodied by the cross-appointment of senior officials. The staff has long supported such closer links, because they would improve oversight of the large conglomerates which dominate banking and insurance.

[9] Rabobank (41 percent of loans) and ABN-AMRO (23 percent of loans) are the most exposed to mortgages.

The reform has been taken a step further, with the full merger of the central bank and the PVK to be completed by January 2004. The implementation appears to be smooth, although concerns linger in the private sector of too much overlap, or too little coordination, among supervisors.

D. Labor Markets

25. **It was agreed that long-term increases in employment rates would be an important part of the response to population aging.** Although the Netherlands scores relatively well in terms of overall employment rates (Figure 10), the authorities noted that disincentives had curtailed labor supply, thus aggravating shortages during the boom period. Particular efforts are underway to increase the participation of those over 55 years old, a relative weak point and one of increasing concern as this group is expected to expand rapidly in the next few years. Perhaps most important will be the changes to early retirement plans described above, which will tend to reduce the attractiveness of early retirement. In addition, those over 57½ years old will now be required to search for work to qualify for unemployment benefits. A new labor-tax credit has been introduced for workers over 57. Finally firms are to be penalized for firing older workers, although as the mission pointed out this measure might also discourage firms from hiring them.

26. **The authorities intend to reform the disability program,** which has beneficiaries equivalent to about 13 percent of employment. The previous government had decided to implement some parts of the reform package proposed last year by the SER: restricting eligibility to those deemed fully disabled, strengthening medical examinations, and eliminating top-up agreements between social partners (which often raised replacement rates to 100 percent for the first year or two of benefits). Other parts of the package, notably raising the replacement rate and eliminating firms' experience-rated premiums (PEMBA), are to be implemented only if inflows fall satisfactorily. The mission supported this approach. It argued further that PEMBA should be retained and, if necessary, replacement rates should be cut, not raised. Inflows into the program already dropped substantially in early 2003, although the cause is not yet known. The authorities tentatively attributed this development to a new "gatekeeper" system designed to move people back to employment, or to experience-rated premiums, both of which came into full effect at the turn of the year. The authorities and the mission concurred that this development did not vitiate the need to press ahead with reform.

27. **A number of other measures to sharpen work incentives has been proposed.** The coalition agreement calls for abolishing short-term unemployment benefits (for those not eligible for regular benefits) and follow-up benefits (for those who have exhausted regular benefits). And a longer employment period will be required to qualify for regular unemployment benefits. In addition, indexation of the minimum wage and social security benefits will be reduced by restrictions on civil-service wage rises. Noting the very high prevalence of part-time work, the mission raised the possibility of increasing work hours of this group. It agreed with the authorities, however, that part-time work should not be discouraged because it is an important factor in the overall good labor-market performance in the Netherlands.

28. **Reducing the significant disincentives to work at the low wages (poverty and unemployment traps) remains a difficult policy challenge.**[10] Rent subsidies, which are an important component of the problem, are to be reduced. However, the authorities argued that reducing poverty and unemployment traps would be difficult without increasing poverty (if benefits were cut excessively) or raising taxation elsewhere, with damaging incentive effects. While agreeing that the best approach would be to reduce the overall tax burden, the mission noted that marginal effective tax rates are extremely high at the low end, and that reducing them here, even at the expense of some increase at higher incomes, might well have net positive benefits.

29. **The so-called "polder model" has come under strain in recent years.** This model emphasizes cooperation and consensus among the social partners and the government, and embraces both labor relations and broader social policy issues (reform of the disability scheme, for instance).[11] Wage moderation, a key benefit of the model, was undermined during the boom of the 1990s, when labor shortages resulted in increasingly high settlements. And the labor representatives expressed concern that the reform agenda of the new government might signal a period of reduced cooperation and increased labor strife.

30. **However, the model still enjoys wide support.** It was revived by the 2003 wage agreement, although the innovation of setting a national wage-growth ceiling is not likely to be repeated. The authorities and social partners pointed to the advantage of a very low incidence of labor disputes. The mission suggested that the centralizing aspects of labor relations in the Netherlands—embodied in institutions, national level negotiations between employers and trade unions, and automatic extension of contracts[12]—may have limited wage differentiation, resulting in efficiency losses. The authorities argued that cultural factors were largely responsible for the narrow wage dispersion and noted that, in any case, economic outcomes had been quite good.

E. Product Markets

31. **The authorities considered further product market reform vital to raise productivity.** Liberalization of the energy sector (gas and electricity) is proceeding rapidly, with medium and large businesses able to choose suppliers since January 2002. The aim is to liberalize entirely by July 2004, although concerns have arisen about the uneven playing field

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[10] Marginal effective tax rates (including lost benefits) often exceed 100 percent for incomes between 1 and 1½ times the minimum wage. See the Selected Issues from the 2002 Article IV staff report: http://www.imf.org/external/pubs/cat/longres.cfm?sk=15903.0

[11] See Chapter II of the Selected Issues paper.

[12] Automatic extension affects less than 10 percent of contracts, but is an incentive for employers to participate in central bargaining to ensure their interests are reflected.

in the EU due to differing paces of reform. More broadly, the MDW program, an umbrella for a wide range of product-market reform projects, has been succeeded by new programs involving several ministries, which are to focus on reducing government administrative burden and red tape, improving the delivery of public services, and increasing choice.

32. **However, for various reasons enthusiasm for reform has waned.** A few liberalizations in other countries had turned out badly, increasing political skepticism. In the Netherlands, falling standards of service led the government to put considerable pressure on the independent management board (ownership had never been relinquished). And various difficulties encountered by electricity suppliers cast doubts over liberalization in this sector. The authorities themselves were reconsidering the approach to reform, with a view to shifting the emphasis from producer to consumer benefits. The mission supported such an initiative, and noted that political support might be further increased by ensuring that regulation, while promoting the gains from reform, protected consumer interests.

33. **Initiatives to strengthen corporate governance are also being put in place.** The authorities argued that, overall, corporate governance was sound and not in need of radical overhaul. Nevertheless, in the wake of prominent scandals, including at the Dutch company Ahold, the authorities are increasing public oversight of accounting standards and auditing by increasing the role of the Authority for Financial Markets (which is responsible for conduct-of-business supervision) in this area. The code of corporate governance will also be strengthened, although compliance will remain voluntary. Shareholders are to be given more rights, including approval of options and shares schemes for executive directors and the ability to appoint and dismiss members of the supervisory boards of large companies. The mission argued that shareholder rights could prove important in the Netherlands, given the presence of large institutional pension-fund investors. The authorities noted that pension funds had become somewhat more active in this respect, although not to the degree seen in the United States.

F. International Trade and Development Assistance

34. **The authorities expressed strong support for multilateral tariff reduction, and argued for strengthening aspects of the current system.** They fully approved of the goals of the Doha round, which should benefit the Dutch economy.[13] But they were concerned that the window for successful negotiation was closing, identifying agricultural trade liberalization as the key roadblock. The authorities strongly supported agricultural liberalization and CAP reform. They felt the effects on the Netherlands would be limited, because Dutch agriculture was not specialized in those products now subject to the greatest protection. While strongly in favor of the rules-based international trade system, because it protected the weakest countries in particular, the authorities argued for some reform. They

[13] See "The Economic Benefits of the Doha Round for the Netherlands," Ministry of Economic Affairs, January, 2003.

felt the system of "special and differential treatment" should be restricted to truly poor countries, and not based on various national preferences. They also felt the WTO dispute mechanism was too slow, and found it anomalous that the remedy for illegal trade restrictions was retaliatory trade restrictions (while admitting that alternatives were difficult to find).

35. **Regarding development assistance, the government continues to review its effectiveness and coherence.** Dutch assistance is generous by international standards at 0.8 percent of GNP. It is also in the process of being reformed to focus on a few countries, adopt a sectoral (rather than a project) approach, and ensure as much as possible coherence between trade, development, agricultural, and investment policies.

IV. Staff Appraisal

36. **Following the boom in the late 1990s, the economy is in its third year of weak performance.** This protracted weakness can be traced to both domestic and external factors, and reflects to some extent the unwinding of imbalances that had built up in the boom period of the latter half of the 1990s. Business investment declined, as high wage increases threatened profits and external competitiveness. Household consumption growth fell sharply as the large house and equity price increases, which had been boosting wealth, came to an end. And exports fell, mainly due to a slump in the Netherlands' trading partners, but competitiveness was also eroded. While the labor market initially reacted slowly to these developments, unemployment began to rise sharply in the first half of this year. On the other hand, wage and price inflation has fallen, and is converging on euro-area levels, reflecting both softer market conditions and the cooperative attitude of the social partners.

37. **The outlook, which is subject to a number of risks, is for a very gradual increase in growth in the second half of this year, and a stronger pickup in 2004.** Recovery will depend critically on a broader firming of economic conditions in the rest of the world, especially the euro area. This outcome is far from assured, however, as business and household confidence are low, corporate balance sheets remain weak, and, for the euro area, the currency appreciation poses a downside risk. In this regard, the recent cut in interest rates by the ECB is welcome from the viewpoint of Dutch economic prospects. Also, the social partners need to continue to act responsibly to contain costs, and household consumption would suffer if a correction in housing prices materialized.

38. **The key immediate policy need, which the new government is addressing, is to restore the health of the public finances.** The fiscal position has deteriorated sharply and, in part, unexpectedly in the past two years. This reflects in part the operation of the automatic stabilizers, and to that extent has been an appropriate response to the economic slump. But there has also been a significant structural deterioration which, if not corrected, would jeopardize longer-term prospects. In particular, it would throw in doubt the policy to maintain a budget surplus, of about 1 percent of GDP, to reduce the debt and free budgetary resources to deal with population aging.

39. **The measures taken in the 2003 budget and proposed in the new government's coalition agreement are therefore welcome.** In 2003, the widening of the deficit is expected to reflect only the automatic stabilizers. For 2004-07, the strong measures in the coalition agreement should reverse the deterioration and, by the end of the coalition period, generate a structural surplus. At the same time, they allow substantial play to the automatic stabilizers in the short run, which is appropriate given the still uncertain pace of recovery. The commitment to devote revenue windfalls to deficit reduction is commendable. Expenditure windfalls (spending below expectations) should also be used to cut the deficit, in part to avoid the prospect that cyclical gains are used to fund structural programs. More broadly, the multi-year framework with spending ceilings and separation of expenditures and revenues will, as in the past, help to ensure fiscal discipline.

40. **Expenditure control will be a difficult challenge, especially given the prospects of continuing large increases in health-care spending.** Long-term reductions in the tax burden, which are needed to sharpen work incentives, will require expenditure growth well below output growth. The emphasis in the coalition agreement on spending cuts, rather than tax increases, is therefore wise, and the focus on durable measures explicitly designed to strengthen public finances through 2007 and beyond is welcome. However, policy changes in the wake of court decisions have had the effect of allowing very high increases in health care spending. Raising co-payments and deductibles, and reducing the scope of coverage, will help to contain pressures, but even so medical services must be offered at far below their true marginal cost. The statement in the coalition agreement that budgetary controls may be re-imposed if necessary is therefore welcome. The more sweeping reforms scheduled for later in the government period should improve the efficiency and responsiveness of the medical care system. However, close attention will have to be paid to their cost implications if the health sector is not to crowd out other public expenditures.

41. **There is room to broaden the tax base in ways that could improve allocative efficiency.** The planned elimination of the tax deductibility of contributions to early retirement schemes should both raise revenue and, by ending the subsidy to such schemes, promote the continued employment of older workers. The authorities intend to further limit mortgage interest deductibility, but additional steps are warranted. Removing the tax advantages of the spaarhypotheken and eventually eliminating the deduction altogether would result in more uniform treatment of different forms of saving. Such fundamental reforms would also tend to depress the level of house prices, and such initiatives should therefore be introduced in a predictable manner to avoid a disorderly market response.

42. **The key medium-term structural challenge is to further increase labor-force participation and employment rates, in part to mitigate the effects of population aging.** Recent and proposed measures to increase the labor-force participation of those over 55-years old are welcome, especially as that age group is about to grow substantially as the population ages. Requiring job search for unemployment benefits and reforms to early retirement schemes should improve incentives. The proposal to penalize firms who fire older workers may, however, cut both ways, as firms may be less willing to hire such workers. The

proposed scaling back of unemployment insurance benefits should also stimulate employment. More needs to be done to reduce very high marginal effective tax rates (including the loss of benefits) at the low end of the earnings scale. Reducing rent subsidies would be a useful step, but, in the final analysis, the problem would be best attacked by reducing the overall tax burden, which will in turn require medium-term spending restraint.

43. **The determination to reform the large disability program is commendable.** The authorities' approach of introducing first those measures designed to curtail inflows is prudent. Even after these measures are in place, however, the program will remain quite generous relative to other income support schemes. A key to containing it is rigorous medical screening of applicants, a task that should be made easier by restricting eligibility to the fully disabled. Nevertheless, in the past this screening has not been fully effective, pointing to the need to adjust economic incentives as well. In this regard, retaining experience-rated premiums and possibly reducing the replacement rate may prove necessary in the longer run.

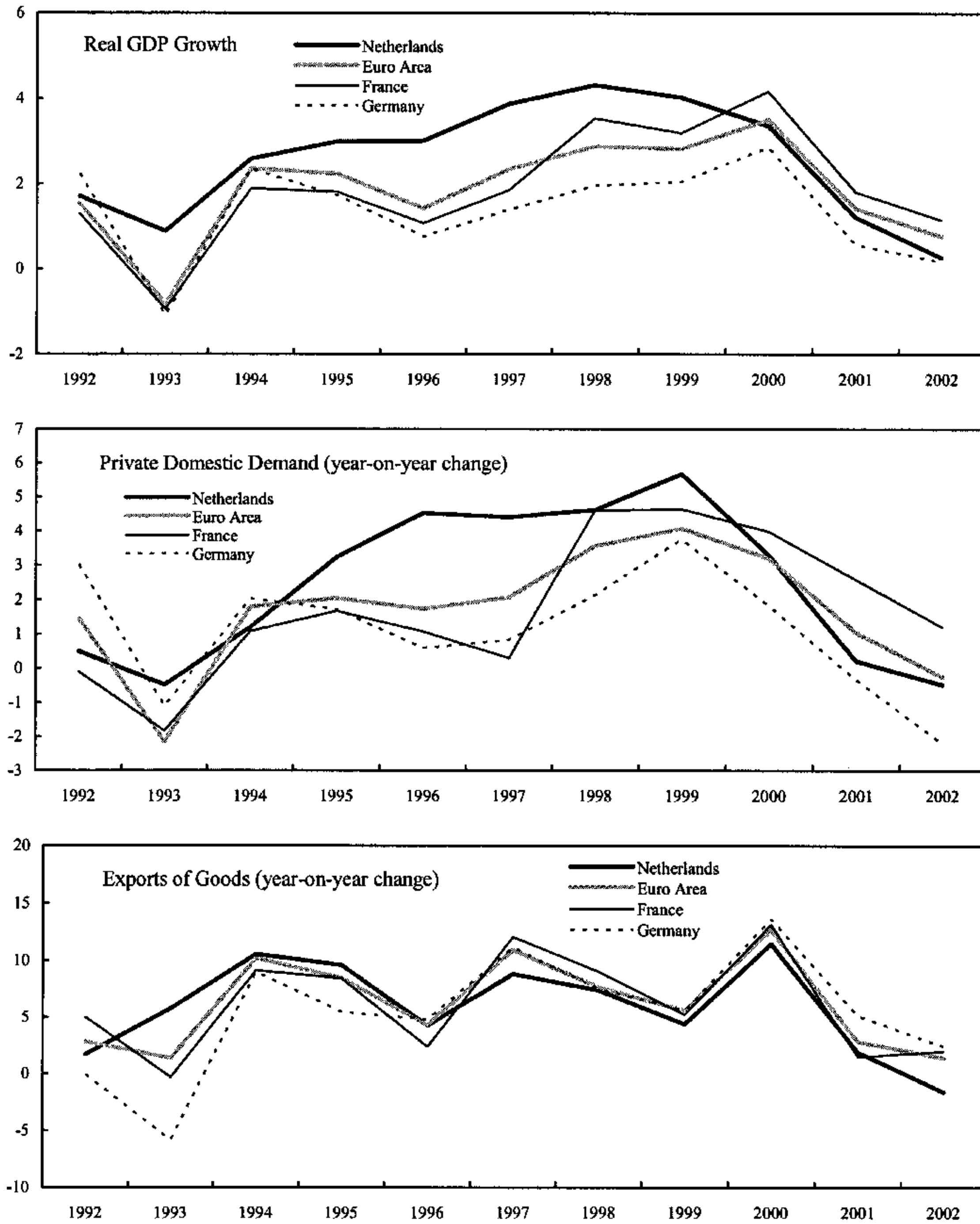
44. **Further product-market reform will be critical to enhancing productivity**. The Netherlands enjoys high productivity per hour, on a par with the United States, and has been a leader in the liberalization of telecommunications, electricity, and gas. Nevertheless, the new government should work to build momentum to continue progress on liberalization and privatization, reduce the administrative burden faced by firms, and strengthen corporate governance. Building public support will be critical, and care must therefore be taken to ensure that benefits to consumers and households are clear, and are clearly understood.

45. **Though the financial sector appears strong, continuing reforms to supervision are welcome**. Financial-sector performance has been somewhat weakened by the cycle, but institutions have responded with cost-cutting measures and, in the pension sector, higher contributions. In this regard, prompt action by the pension supervisor was appropriate. A sharp fall in house prices would add further stress, but the large institutions which dominate the sector are well positioned to weather such an event. The merger of the banking and insurance-pension supervisors should further strengthen oversight of the conglomerates. The key challenges for the immediate future are to ensure smooth integration at management and working levels, and to minimize possible overlap and duplication in supervision. Proposals to clarify pension regulation and the responsibilities of the supervisor also merit support, particularly in view of the significant role of second-pillar funds in financial and labor markets.

46. **The authorities' support for multilateral trade liberalization is commendable.** They are encouraged to continue their efforts to strengthen support for the Doha round, to enhance the role of developing countries in multilateral negotiations, and to improve the system of trade disputes. Their substantial effort in terms of overseas development assistance, which exceeds the United Nations target of 0.7 percent of GNP, is also noteworthy.

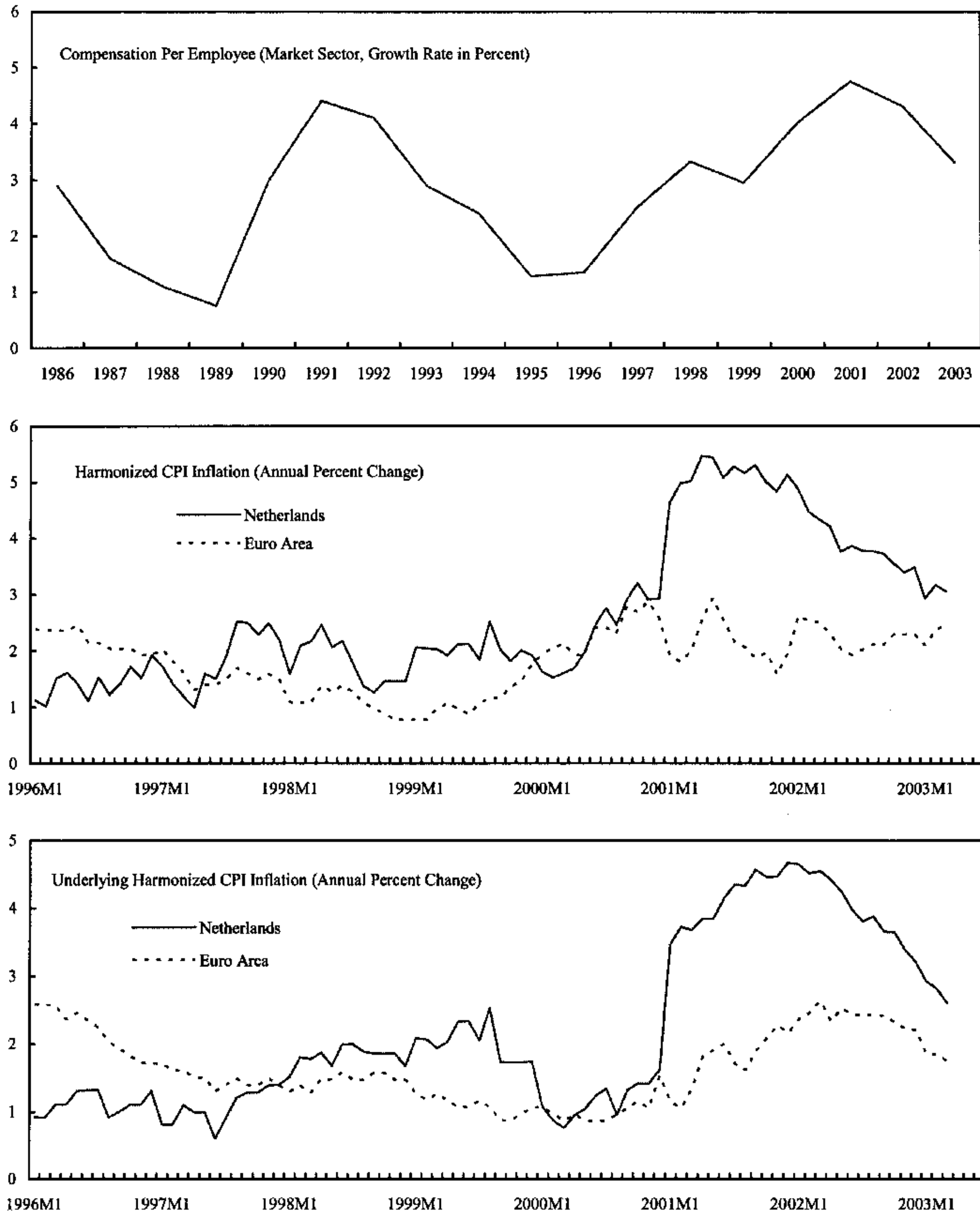
47. It is proposed that the next consultation be held on the normal 12-month cycle.

Figure 1. Netherlands: Growth Performance Comparison



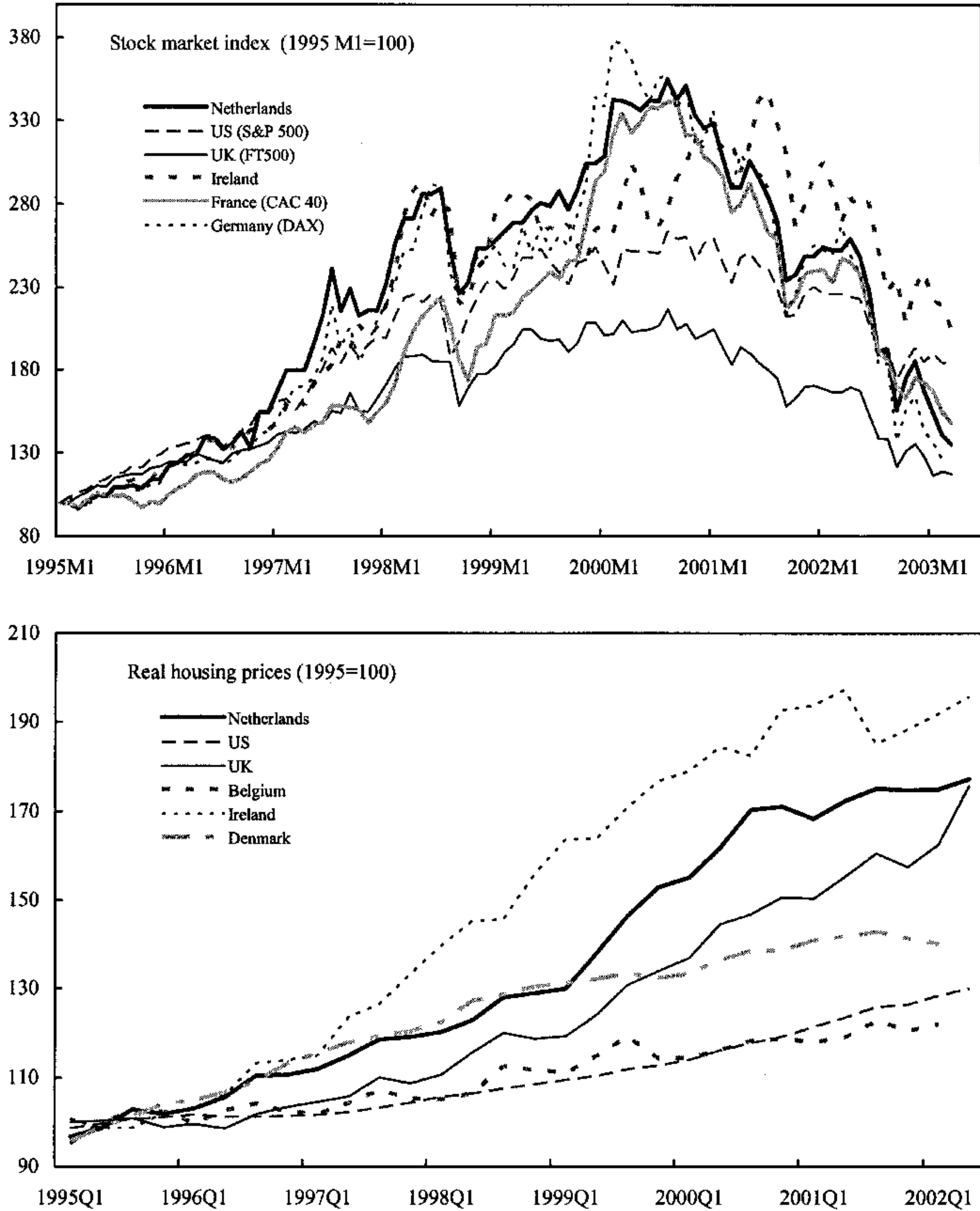
Source: WEO.

Figure 2. Netherlands: Prices and Wages



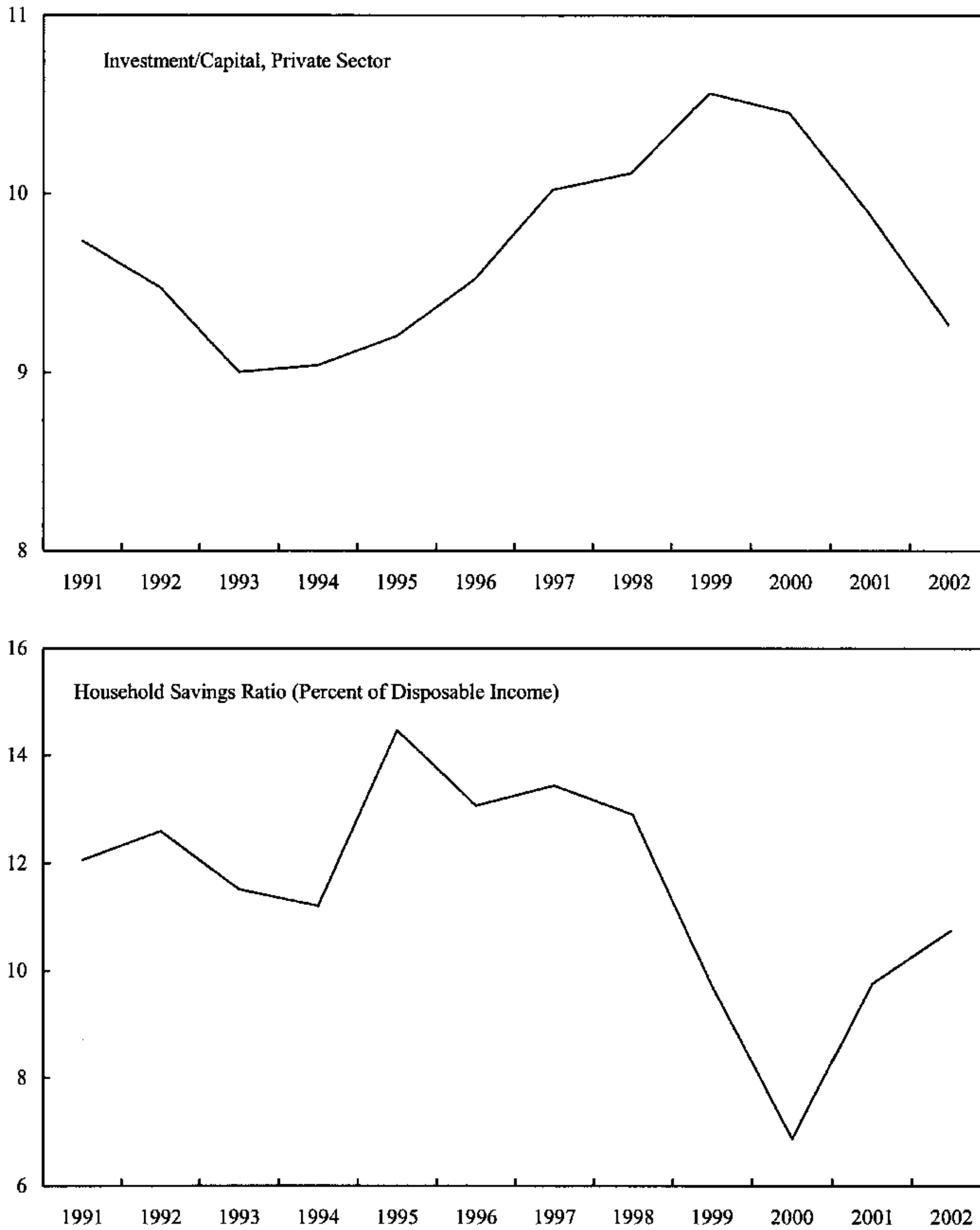
Sources: Eurostat; CPB; and IMF, IFS and staff estimates.

Figure 3. Netherlands: Development of Asset Prices



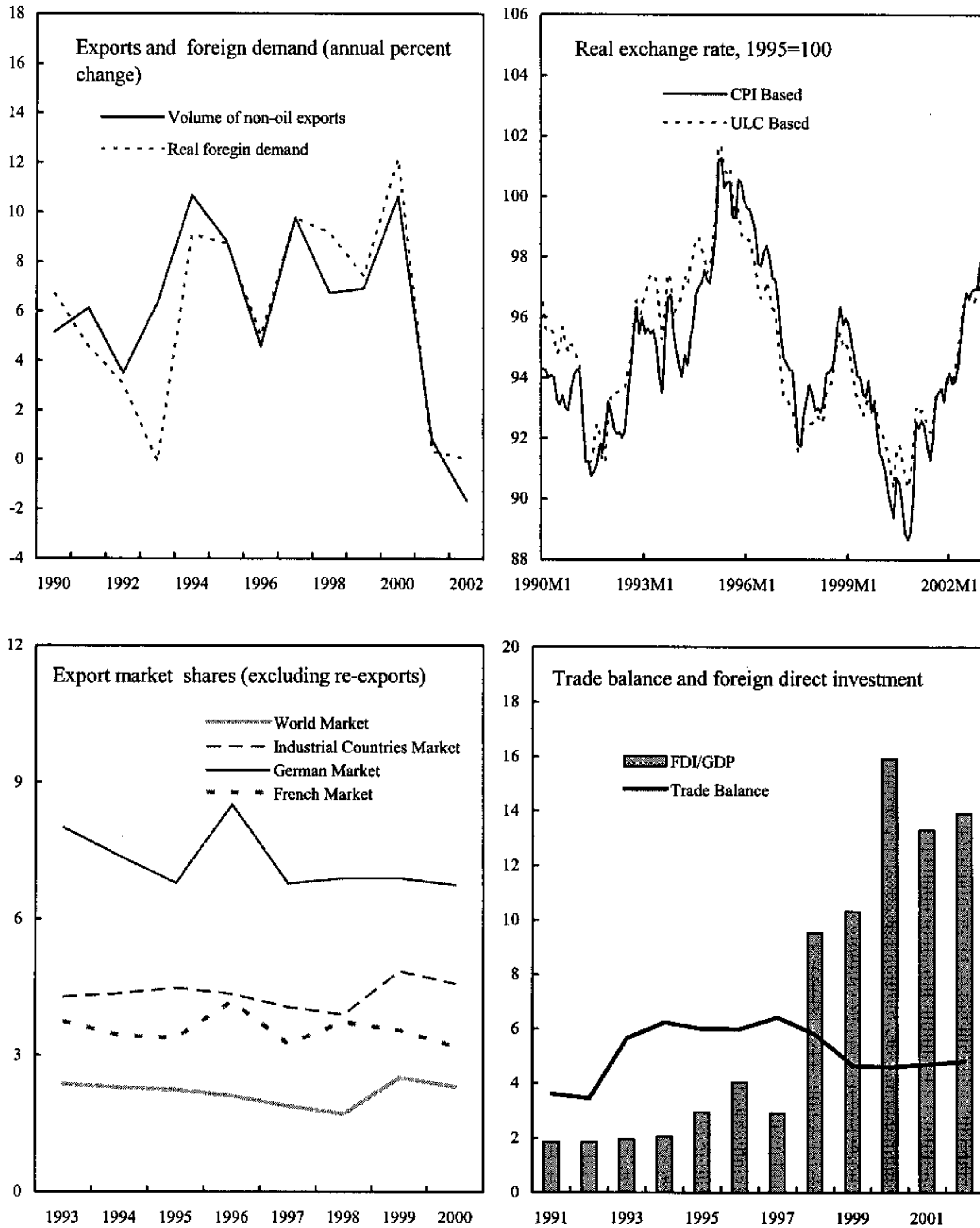
Source: BIS, WEFA, and IMF staff estimates.

Figure 4. Netherlands: Saving and Investment Adjustment Over Asset Price Cycle



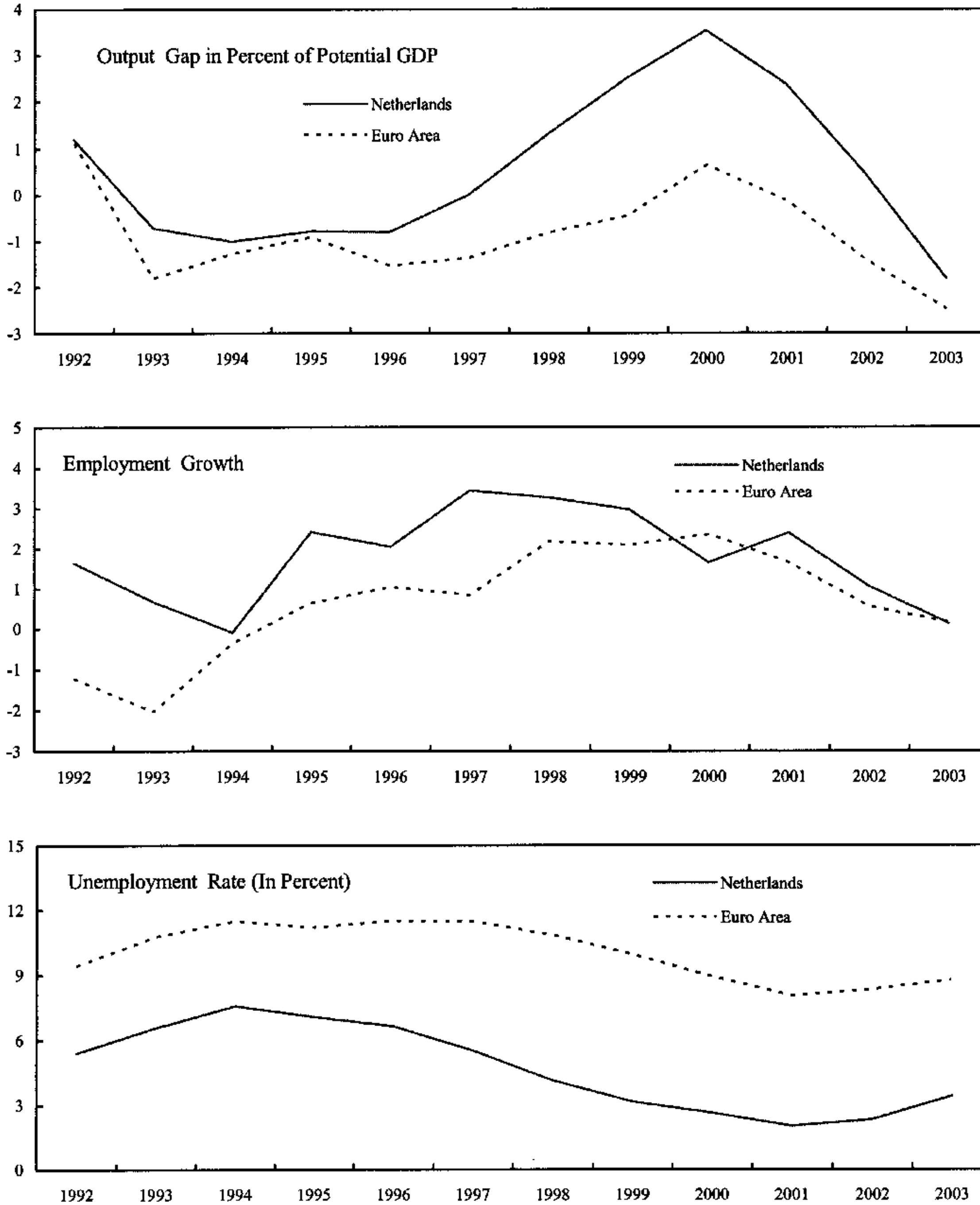
Source: OECD and IMF Staff estimates.

Figure 5. The Netherlands: External Performance



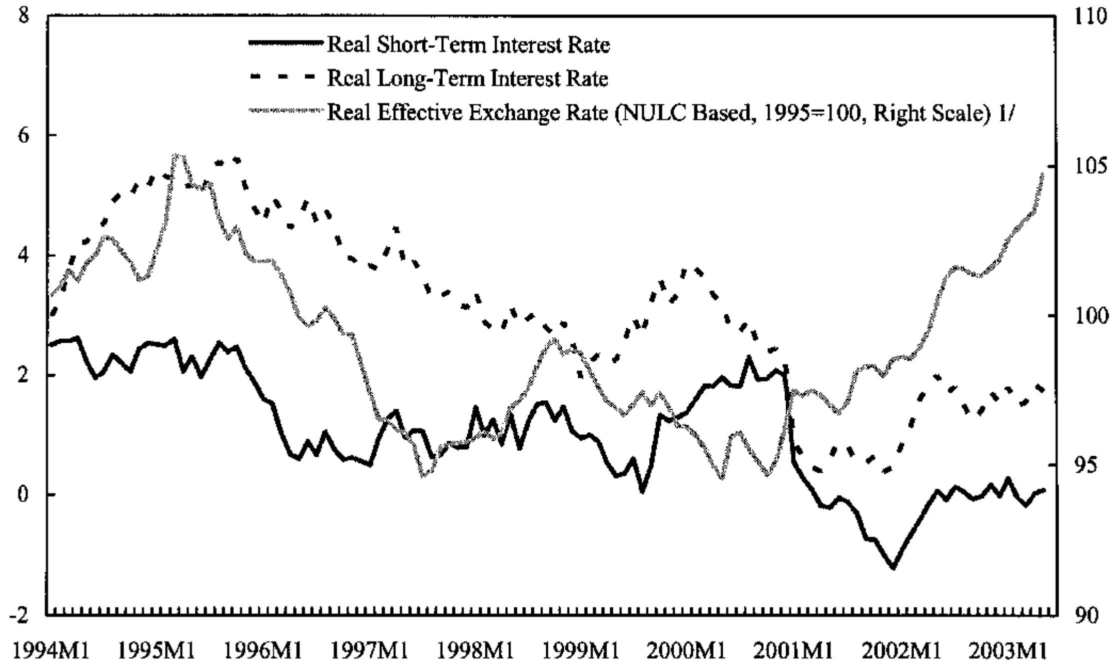
Source: WEO, IFS, and DOT.

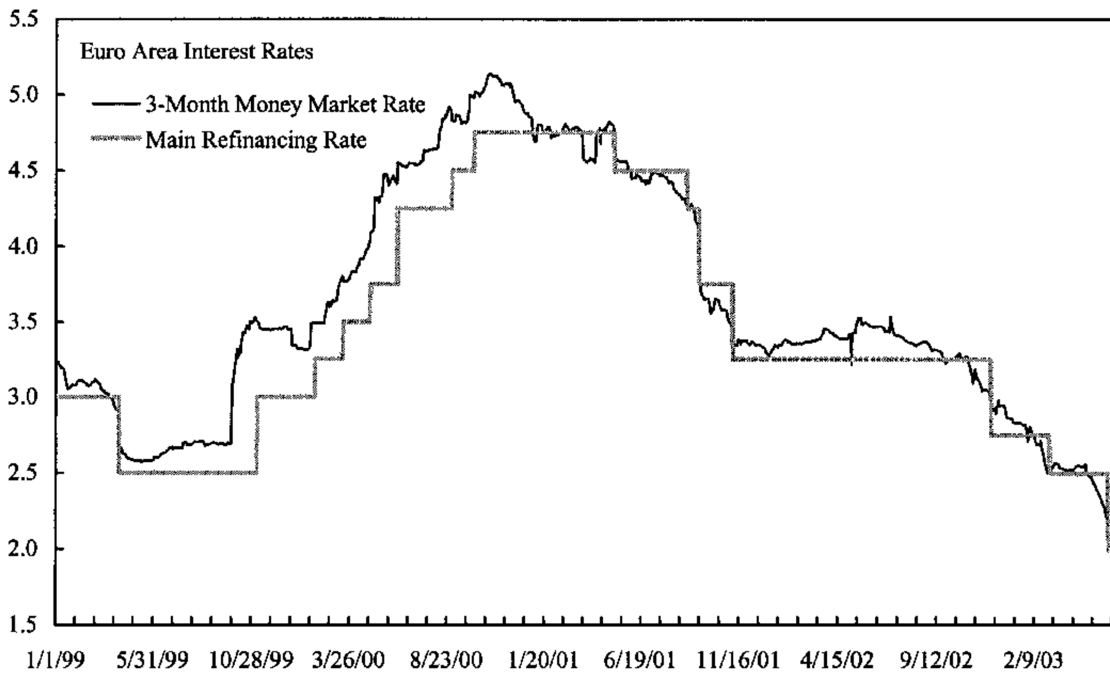
Figure 6. Netherlands: Output Gap and the Labor Market



Source: IMF, WEO.

Figure 7. Netherlands: Monetary Conditions

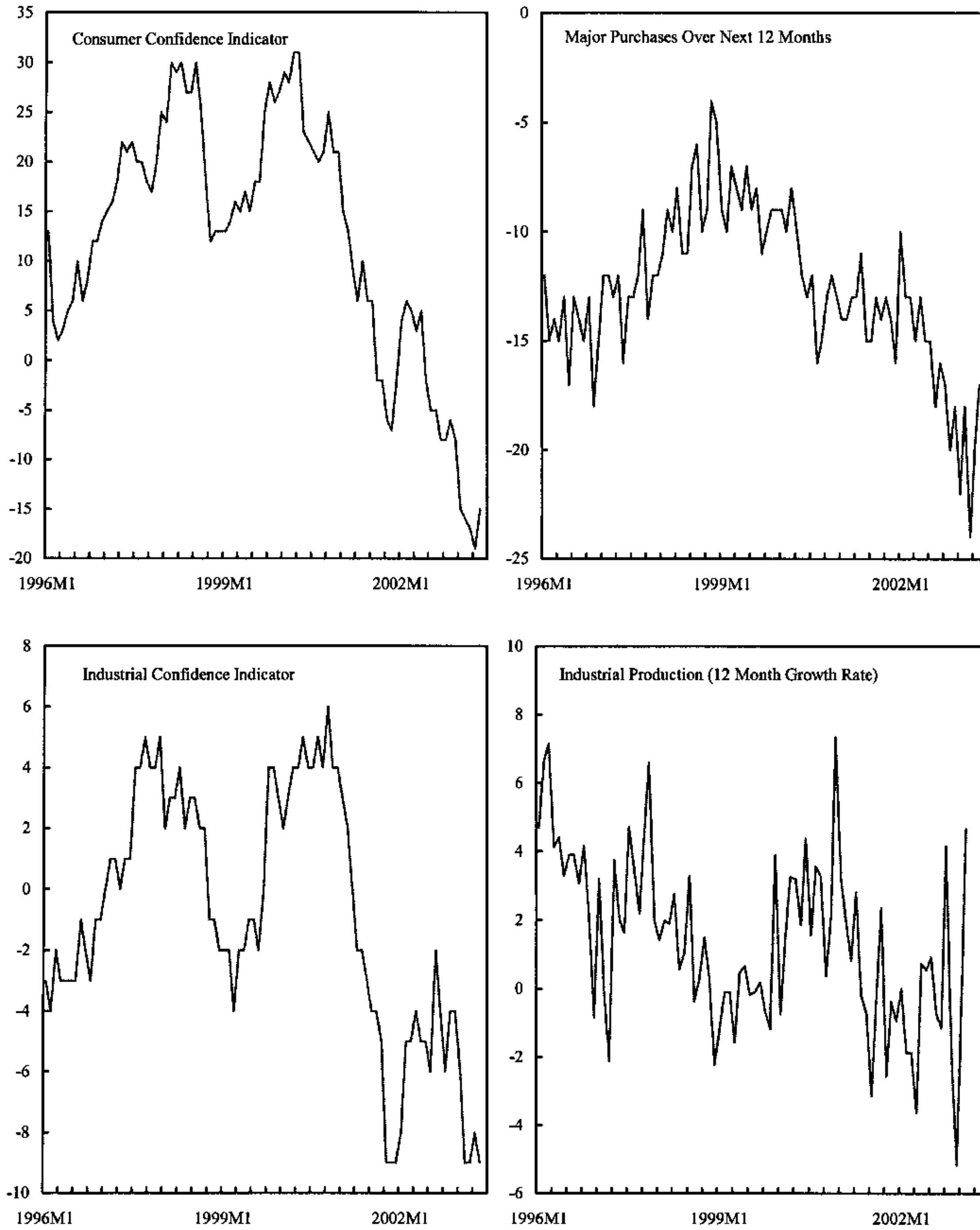




Source: IMF, IFS.

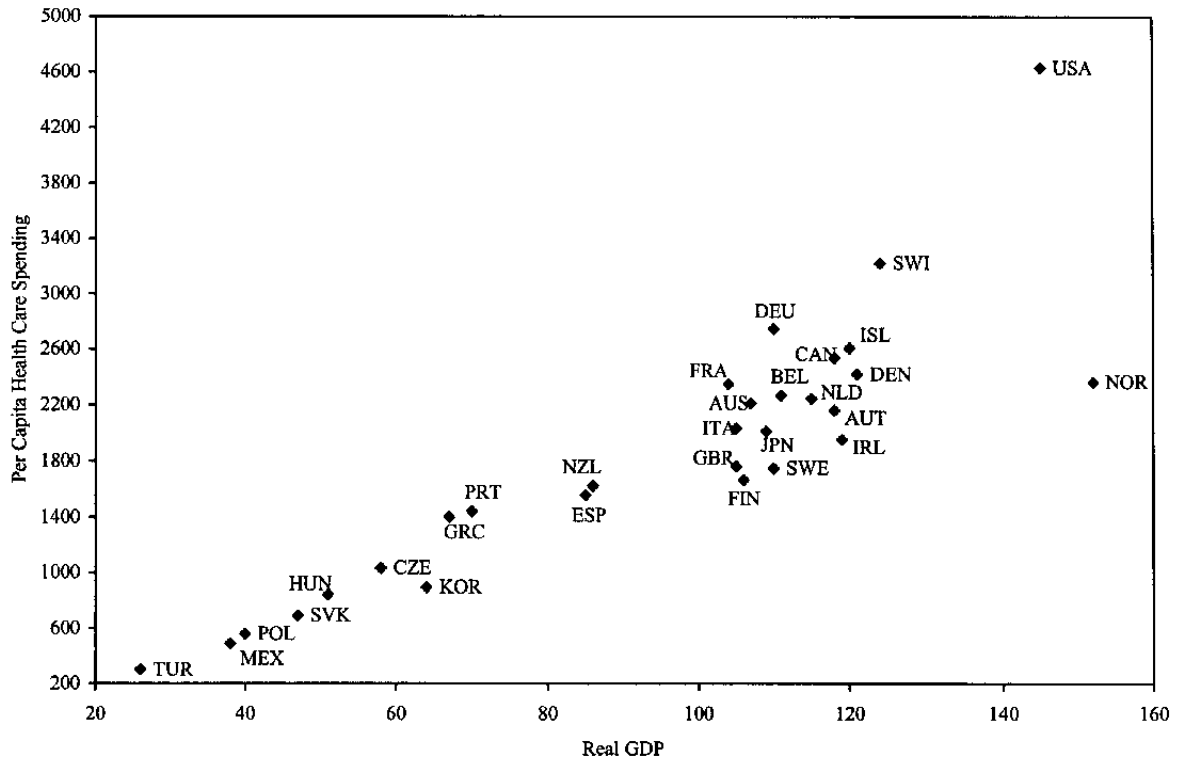
1/ An increase implies less accomodative conditions.

Figure 8. Netherlands: Cyclical Indicators



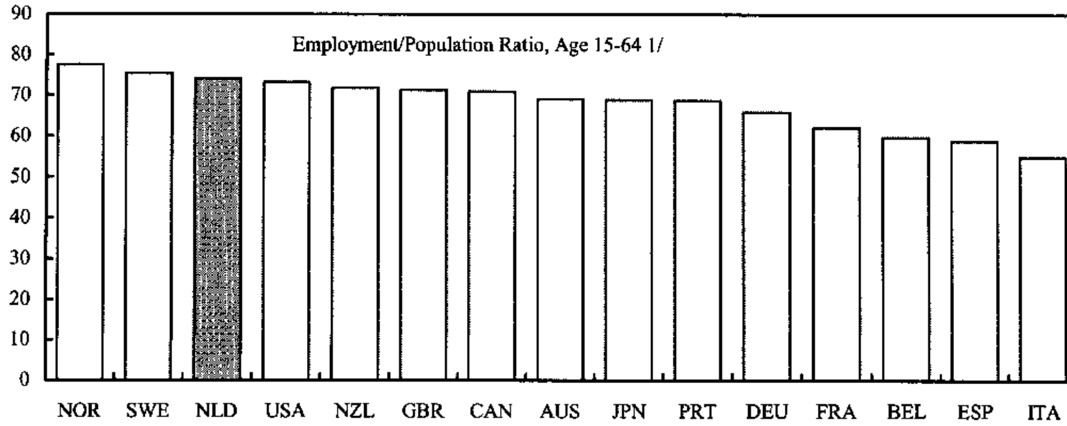
Source: WEFA, Intline Database; and IMF, IFS.

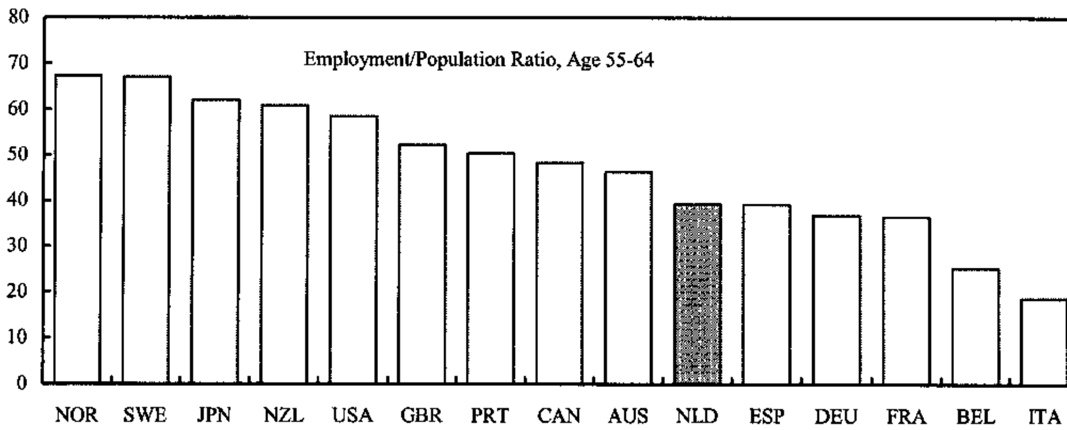
Figure 9. Netherlands: Health Care Spending and GDP (2001, PPP-Based)

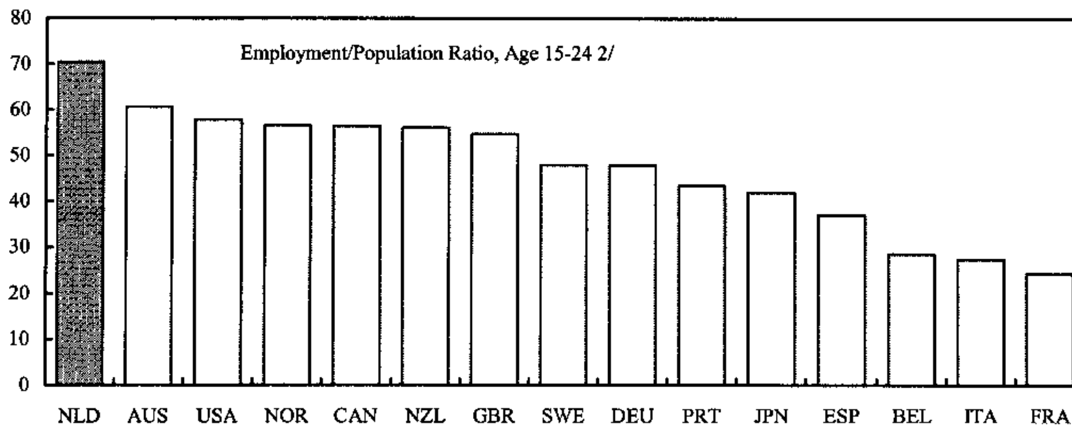


Source: OECD, Health Data 2002 4th ed.

Figure 10. Netherlands: Labor Market Indicators (2001)







Source: OECD, Employment Outlook, July 2002.
1/ Refers to persons aged 16 to 64. (ESP, GBR, NOR, SWE, USA)
2/ Refers to persons aged 16 to 24. (ESP, GBR, NOR, SWE, USA)
Countries are: AUS=Australia, BEL=Belgium, CAN=Canada, FRA=France, DEU=Germany, ITA=Italy, JPN=Japan, NLD=Netherlands, NZL=New Zealand, NOR=Norway, PRT=Portugal, ESP=Spain, SWE=Sweden, GBR=United Kingdom, USA=United States.

Table 1. Netherlands: Basic Data

Land area (2002)	41.5 thousand sq. km.
Population (2002)	16.1 million
Population characteristics and health:	
Life expectancy at birth (2000)	75.3 (male), 80.6 (female)
Fertility rate (2001)	1.7 children/woman
Infant mortality rate (2001)	5.4 per 1,000 live births
Population per sq. km. of land area (2002)	388 persons

National accounts (2001 at current prices)	(In billions of euros)	(In percent of GDP)
Private consumption	212.9	49.6
Public consumption	99.5	23.2
Gross fixed investment	94.1	21.9
Stockbuilding	-0.1	0.0
Exports of goods and nonfactor services	280.2	65.3
Imports of goods and nonfactor services	257.4	60.0
GDP	429.2	n.a.

	1997	1998	1999	2000	2001	2002 Est.	2003 Proj.	2004 Proj.
(percentage changes unless otherwise noted)								
National accounts (constant prices)								
Private consumption	3.0	4.8	4.7	3.6	1.2	0.9	1.2	1.6
Public consumption	3.2	3.6	2.5	1.9	3.1	3.7	1.1	0.8
Gross fixed investment	6.6	4.2	7.8	3.5	-0.8	-3.7	-4.0	1.7
Total domestic demand	3.9	4.8	4.3	2.8	1.4	-0.2	1.0	1.3
Exports of goods and nonfactor services	8.8	7.4	5.1	10.9	1.7	-1.4	1.1	2.8
Imports of goods and nonfactor services	9.5	8.5	5.8	10.6	1.9	-2.1	3.1	2.7
Net foreign balance 1/	--	-0.2	--	--	--	0.4	-1.1	0.2
Gross domestic product	3.9	4.3	4.0	3.4	1.2	0.2	-0.2	1.4
Output gap (in percent of potential output)	--	1.3	2.5	3.5	2.4	0.4	-1.8	-2.6
Prices, wages, and employment								
Consumer price index (year average)	1.9	1.8	2.0	2.3	5.1	3.9	2.6	2.0
GDP deflator	2.0	1.7	1.5	4.1	5.3	3.2	3.0	2.2
Hourly compensation (manufacturing)	3.0	3.2	2.9	3.7	4.2	3.8	3.3	2.3
Unit labor costs (manufacturing)	-0.7	1.3	0.9	0.1	5.0	2.8	2.1	0.3
Employment	3.4	3.3	3.0	1.6	2.4	1.1	-0.4	0.3
Unemployment rate (in percent)	5.5	4.2	3.2	2.6	2.0	2.3	3.8	4.4
NAIRU	5.5	5.4	4.8	4.4	3.9	3.4	3.3	3.1

Table 1. Netherlands: Basic Data (concluded)

	1997	1998	1999	2000	2001	2002 Est.	2003 Proj.	2004 Proj.
Personal sector								
Real disposable income	3.4	4.5	1.0	2.1	4.0	1.5	0.3	1.1
Household savings ratio 2/	13.4	12.9	9.7	6.9	9.8	10.8	10.2	9.8
External trade								
Exports of goods, volume	9.2	7.4	5.3	10.3	1.7	-0.7	0.8	2.6
Imports of goods, volume	10.5	8.3	6.4	9.8	1.0	-2.6	2.8	2.4
Terms of trade	0.5	0.1	-1.5	0.0	1.0	0.2	0.4	0.4
Merchandise balance (percent of GDP)	5.6	5.2	4.0	4.7	5.4	6.1	5.2	5.5
Current account balance (percent of GDP)	6.6	3.3	3.2	1.2	2.1	2.2	3.5	3.4
Public sector accounts (percent of GDP)								
Revenue	47.1	46.4	47.6	47.4	46.5	46.1	45.6	44.9
Expenditure	48.2	47.2	46.9	45.3	46.4	47.3	47.8	47.3
General government balance	-1.1	-0.8	0.7	2.2	0.1	-1.2	-2.1	-2.4
Structural balance 3/	-1.1	-1.4	-0.6	-0.1	-0.7	-1.5	-1.3	-1.1
Primary balance	3.3	3.4	4.5	5.4	3.0	1.6	0.4	0.1
Structural primary balance 3/	3.4	2.8	3.3	3.2	2.2	1.3	1.2	1.2
General government gross debt	70.0	66.8	63.1	55.8	52.8	52.6	52.5	53.7

Sources: Dutch official publications; International Monetary Fund, International Financial Statistics; and Fund staff estimates.

1/ Contribution to GDP growth.

2/ In percent of disposable income.

3/ For 2002, the purchase of gas rights from DSM (0.3 percent of GDP) is excluded.

Table 2. The Netherlands: Quarterly Real GDP Growth

(Changes from previous quarter; seasonally adjusted)

	2001					2002					2003 (Projections)					2004 (Projections)				
	1 Qtr	2 Qtr	3 Qtr	4Qtr	4 Qtr[2]	1 Qtr	2 Qtr	3 Qtr	4Qtr	4 Qtr[2]	1 Qtr	2 Qtr	3 Qtr	4Qtr	4 Qtr[2]	1 Qtr	2 Qtr	3 Qtr	4Qtr	4 Qtr[2]
Real GDP	**0.3**	**0.2**	**-0.2**	**-0.1**	**0.3**	**0.1**	**0.3**	**0.1**	**-0.2**	**0.3**	**-0.3**	**-0.1**	**0.2**	**0.3**	**0.1**	**0.3**	**0.5**	**0.6**	**0.6**	**2.0**
Private Consumption	-0.6	0.7	0.4	0.6	1.0	-0.2	0.1	0.5	0.0	0.4	0.4	0.3	0.3	0.4	1.4	0.4	0.4	0.5	0.6	1.9
Government consumption	1.2	0.7	0.6	0.8	3.2	0.9	2.1	0.1	0.6	3.7	-0.2	0.2	0.2	0.2	0.4	0.2	0.2	0.2	0.2	0.8
Fixed investment	0.0	-0.4	-0.8	0.3	-0.9	-1.3	-0.9	-2.0	-1.9	-6.0	-1.1	-0.5	0.1	0.2	-1.3	0.4	0.6	1.0	1.1	3.1
Change in stocks 1/	0.5	-0.1	0.1	-1.2	-0.6	-0.1	0.3	0.2	0.4	0.7	0.6	-0.2	0.0	0.0	0.4	-0.1	0.0	0.0	0.0	-0.1
Total domestic demand	**0.5**	**0.3**	**0.2**	**-0.7**	**0.4**	**-0.3**	**0.6**	**0.1**	**0.1**	**0.5**	**0.6**	**-0.2**	**0.2**	**0.3**	**1.0**	**0.2**	**0.4**	**0.5**	**0.6**	**1.8**
Foreign balance 1/	-0.5	0.2	-0.3	0.4	-0.2	0.4	-0.3	0.0	-0.2	-0.1	-0.9	0.0	0.0	0.0	-0.9	0.0	0.1	0.1	0.0	0.3
Exports	0.0	-1.5	-0.9	-1.1	-3.5	-0.8	1.1	0.6	-0.4	0.5	0.2	0.3	0.5	0.6	1.6	0.7	0.8	0.9	0.9	3.3
Imports	0.8	-2.0	-0.5	-1.8	-3.5	-1.6	1.7	0.8	-0.1	0.7	1.7	0.3	0.5	0.6	3.2	0.7	0.7	0.8	0.9	3.1
Statistical discrepancy 1/	0.4	-0.3	-0.1	0.2	0.1	0.0	-0.1	0.1	-0.1	0.0										

Sources: Statline online database; and IMF staff estimations.

[1]Contribution to GDP growth.

[2]Year-on-year percentage change.

Table 3. Recent Developments in the General Government Accounts

	1997	1998	1999	2000	2001	2002 [1]	2003 [2]	2004 [2]
				(Percent of GDP)				
Revenues	47.1	46.4	47.6	47.4	46.5	46.1	45.6	44.9
Tax revenues and social sec. contr.	39.6	39.4	40.7	40.6	39.1	39.3	39.7	38.4
Tax revenues	24.2	24.1	24.7	24.6	24.9	...	...	...
Social security contributions	15.5	15.3	16.0	16.0	14.2	...	...	...
Nontax revenues	7.5	7.1	6.9	6.9	7.4	...	...	...
Expenditure	48.2	47.2	46.9	45.3	46.4	47.3	47.8	47.3
Social security and social assistance benefits	19.9	19.0	18.5	17.9	17.9	...	...	...
Social security	16.0	15.1	14.8	14.4	14.6	...	...	...
Social assistance	3.8	3.9	3.6	3.4	3.3	...	...	...
Subsidies and other current transfers	2.7	2.8	3.0	3.1	3.1	...	...	...
Other current spending	1.3	1.3	1.3	1.2	1.2	...	...	...
Other taxes on production	0.1	0.1	0.1	0.1	0.1	...	...	...
Unfunded employee social benefits	1.2	1.2	1.1	1.1	1.1	...	...	...
Capital formation (gross)	2.9	2.9	3.0	3.2	3.4	...	...	...
Capital transfers	0.4	0.7	0.6	0.6	0.8	...	...	...
Net acquisitions of non-financial assets	-0.6	-0.7	-0.4	-1.0	-0.2	...	...	...
Consumption								
Compensation of employees	10.2	10.1	10.2	10.0	10.1	...	...	...
Intermediate consumption	6.2	6.2	6.4	6.3	6.6	...	...	...
Property income	5.2	4.9	4.5	3.9	3.5	...	...	...
Unemployment insurance	1.4	1.1	1.0	0.8	0.8	...	...	...
Welfare	1.4	1.2	1.1	1.0	0.9	...	...	...
Defense spending	1.7	1.6	1.6	1.6	1.6	...	...	...
Balance (Net lending) [3]	-1.1	-0.8	0.7	2.2	0.1	-1.2	-2.1	-2.4
Interest receipts	0.7	0.7	0.7	0.7	0.6	...	...	...
Interest payments	5.2	4.8	4.5	3.9	3.5	...	...	...
Net interest payments	4.4	4.2	3.8	3.2	2.9	...	...	...
				(In percent)				
Nominal expenditure growth [4]	2.9	3.9	5.0	5.4	6.9	6.2	3.8	3.2
Real expenditure growth [4]	0.9	2.1	3.4	1.2	1.5	2.9	0.7	1.0

Source: National accounts, Ministry of Finance, CPB, and Fund staff calculations.

[1] Estimates.

[2] Projections.

[3] For 2000 includes UMTS receipts (0.7 percent of GDP) and for 2001 includes purchase of gas rights from DSM (0.3 percent of GDP).

[4] For 2000 excludes UMTS receipts (0.7 percent of GDP) and for 2001 excludes the purchase of gas rights from DSM (0.3 percent of GDP).

Table 4. Netherlands: Medium-Term Macroeconomic Forecast

	2001	2002	2003	2004	2005	2006	2007
Growth rates, in percent							
National accounts (constant prices)							
Real GDP	1.2	0.2	-0.2	1.4	2.6	3.3	3.0
Priv. consumption	1.2	0.9	1.2	1.6	2.5	2.6	2.5
Grs. priv. fixed investment	-2.5	-4.5	-5.1	1.5	4.0	6.7	5.4
Domestic demand	1.4	-0.2	1.0	1.3	2.6	3.2	2.9
Contrib. of dom. demand	1.3	-0.2	0.9	1.2	2.4	3.0	2.7
Exports goods & serv.	1.7	-1.4	1.1	2.8	5.5	5.7	5.0
Imports goods & serv.	1.9	-2.1	3.1	2.7	5.6	5.7	5.0
Foreign contribution	-0.1	0.4	-1.1	0.2	0.2	0.3	0.3
Prices, wages, and employment							
Consumer price index (year average)	5.1	3.9	2.6	2.0	2.0	2.0	2.0
GDP deflator	5.3	3.2	3.0	2.2	2.2	1.9	1.9
External trade							
Imports of goods and services, volume	1.9	-2.1	3.1	2.7	5.6	5.7	5.0
Merchandise balance (percent of GDP)	5.4	6.1	5.2	5.5	5.8	5.8	5.8
Current account balance (percent of GDP)	2.1	2.2	3.5	3.4	3.6	3.6	3.5
Public sector accounts (percent of GDP)							
Revenue	46.5	46.1	45.6	44.9	45.4	45.2	45.1
Expenditure	46.4	47.3	47.8	47.3	46.8	45.6	44.8
General government balance	0.1	-1.2	-2.1	-2.4	-1.4	-0.4	0.3
Structural balance [1]	-0.7	-1.5	-1.3	-1.1	-0.3	0.2	0.5

Sources: Dutch official publications; International Monetary Fund, International Financial Statistics; and Fund staff estimates. and Fund staff estimates.

[1]For 2001, the purchase of gas rights from DSM (0.3 percent of GDP) is excluded.

Table 5. Netherlands: Indicators of External and Financial Vulnerability[1]
(In percent of GDP, unless otherwise indicated)

	1997	1998	1999	2000	2001	2002	2003	
							Latest estimate	Date
External Indicators								
Exports goods and services (annual percent change, in U.S. dollars)	-1.8	3.2	1.0	2.4	0.7	3.1		
Imports goods and services (annual percent change, in U.S. dollars)	-1.8	4.2	3.0	4.0	-0.5	2.3		
Terms of trade goods (annual percent change)	0.5	0.1	-1.5	0.0	1.0	0.2		
Current account balance	6.6	3.3	3.9	2.1	2.1	1.3		
Inward portfolio investment	4.7	7.7	25.2	15.0	19.4	11.8		
Inward foreign direct investment	2.9	9.4	10.3	16.4	13.3	7.0		
Official reserves (in US dollars, billions)[2]	35.4	32.6	19.2	17.8	17.0	17.0		
Foreign assets of the banking sector (in U.S. dollars, billions)[3]	272.5	...	165.0	162.3	214.6	230.0		
Foreign liabilities of the banking sector (in U.S. dollars, billions)[3]	300.6	...	205.8	204.1	253.9	274.4		
Official reserves in months of imports	2.0	1.8	1.0	0.9	0.9	0.8		
Exchange rate (per U.S. dollar, period average)	1.95	1.98	2.07	2.39	2.43	0.91	1.14	3-Jul
Financial Market Indicators								
Public sector debt (Maastricht definition)	70.0	66.8	63.1	55.8	52.8	52.6		
Government bond yield	5.8	4.9	4.9	5.5	5.2	5.0		
Government bond yield (real)	3.6	2.9	2.7	3.0	0.6	1.5		
Stock market index	195.3	261.6	284.6	335.5	257.0	183.7		
Spread of government bond yield with Germany	0.73	0.48	0.66	0.27	0.47	0.39		
Financial Sector Risk Indicators								
Mortgage credit to total assets (in percent)	n.a.	22.2	20.3	18.4	19.3	21.3		
Provisioning/total assets	1.6	0.8	0.8	0.7	0.7	0.7		
Classified loan to total loans (in percent)[4]	2.4	2.6	2.7	2.3	2.4	...		
Provisioning to classified loans (in percent)[4]	12.4	15.5	10.0	8.0	14.3	...		
Exposure to emerging markets/own funds[5]	n.a.	66.4	61.2	58.5	55.1	46.3		
Contingent and off-balance-sheet accounts to total assets (in percent)	17.7	18.6	21.6	21.8	20.3	19.5		
Risk based capital-asset ratio	11.5	11.4	11.2	11.3	11.4	11.9		

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

[1]The interpretation of some indicators is affected by the launch of monetary union in 1999.

[2]Reserves and foreign liabilities refer to the Dutch central bank, both before and after EMU. End-of-period.

[3]From 1999 onward claims on/liabilities to non Euro Area countries only.

[4] Average of the three largest banks.

[5]Emerging markets: Africa, Latin America, Middle East (excluding Israel), and Asia (excluding South Korea, Taiwan, Province of China, Hong Kong S.A.R., and Singapore).

Netherlands: Fund Relations

As of April 30, 2003

I. **Membership Status**: Joined December 27, 1945; Article VIII.

II.	**General Resources Account**:	**SDR Million**	**Percent of Quota**
	Quota	5,162.40	100.00
	Fund holdings of currency	3,018.01	58.46
	Reserve position in Fund	2,144.40	41.54
	Operational budget transfers (net)	113.00	

III.	**SDR Department**	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	530.34	100.00
	Holdings	536.23	101.11

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

V. **Financial Arrangements**: None

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

VII. **Exchange Rate Arrangements**:

The Netherlands entered the final stage of European Economic and Monetary Union on January 1, 1999, at a rate of 2.20371 guilder per euro.

VIII. **Article IV Consultation**:

Discussions for the 2002 Article IV consultation were held in Amsterdam and the Hague in March 15–25, 2002. The staff report for the 2002 Article IV consultation (SM/02/151, 5/17/02) was considered by the Executive Board on June 10, 2002 (EBM/02/58). The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle.

IX. **Exchange Restrictions**:

The Netherlands maintains exchange restrictions vis-à-vis Iraq (notified to the Fund under Decision 144-(52/51) in EBD/90/267 (8/27/90) and EBD/94/83 (5/13/94)); and the Socialist People's Libyan Arab Jamahiriya (see EBD/94/83).

Netherlands: Statistical Data Issues

The Netherlands publishes a wide range of economic and financial statistics. Specifically, annual and quarterly national account data are provided by the Central Bureau of Statistics; financial and balance of payments data are provided by De Nederlandsche Bank; and fiscal data are provided by the Ministry of Finance. These data are increasingly available in electronic form. Macroeconomic data are generally of high quality.

The frequency and timeliness of the availability of the core statistical indicators for Fund surveillance purposes are summarized in the attached table. The authorities subscribe to the Special Data Dissemination Standard, providing information about their data and data dissemination practices on the IMF Dissemination Standards Bulletin Board.

Netherlands: Core Statistical Indicators
As of June 6, 2003

	Int'l Reserves 1/	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	External Government Debt	GDP/GNP
Date of Latest Observation	5/03	5/03	5/03	4/03	6/6/03	5/03	4/03	Q1/03	4/03	1996	Q1/03
Date Received	6/6/03	6/6/03	6/6/03	6/6/03	6/6/03	6/5/03	5/15/03	5/14/03	5/28/03	9/97	5/15/03
Frequency of Data	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Annually	Quarterly
Frequency of Reporting	Monthly	Weekly	Weekly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Annually	Quarterly
Source of Update	DNB	DNB	DNB	DNB	Reuters	CBS 2/	CBS 2/	DNB	MoF	MoF	CBS 2/
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Monthly	Monthly	Monthly	Weekly	Daily	Monthly	Monthly	Quarterly	Monthly	Annually	Quarterly

1/ De Nederlandsche Bank = central bank.
2/ Central Bureau of Statistics.

Netherlands: Public Sector Debt Sustainability Framework, 1992–2007
(In percent of GDP, unless otherwise indicated)

	Actual											Projections				
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
I. Baseline Medium-Term Projections																
Public sector debt[1]	80.0	81.2	77.9	77.2	75.2	70.0	66.8	63.1	55.8	52.8	52.4	52.4	53.3	52.9	51.3	49.3
o/w foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in public sector debt	80.0	1.2	-3.3	-0.7	-2.0	-5.2	-3.2	-3.6	-7.3	-3.0	-0.4	0.1	0.8	-0.4	-1.6	-2.0
Identified debt-creating flows (4+7+12)	n.a.	n.a.	n.a.	1.4	-1.1	-2.5	-3.1	-4.2	-6.5	-3.8	-0.5	0.1	0.5	-0.7	-1.9	-2.0
Primary deficit	-2.3	-2.9	-2.0	-1.7	-3.9	-3.6	-4.0	-4.8	-5.9	-3.6	-2.2	-1.3	-0.2	-0.7	-1.7	-2.3
Revenue and grants	50.9	51.5	48.9	47.3	47.8	47.1	46.4	47.6	47.4	46.5	46.2	46.1	45.2	44.5	44.6	44.7
Primary (noninterest) expenditure	48.6	48.6	46.8	45.6	43.9	43.5	42.5	42.8	41.6	42.9	44.1	44.8	45.0	43.8	42.8	42.4
Automatic debt dynamics[2]	0.0	3.9	1.8	2.1	2.4	1.0	0.8	0.9	-0.6	0.0	1.6	1.7	1.1	0.3	0.1	0.3
Contribution from interest rate/growth differential[3]	0.0	3.9	1.8	2.1	2.4	1.0	0.8	0.9	-0.6	0.0	1.6	1.7	1.1	0.3	0.1	0.3
Of which contribution from real interest rate	0.0	4.5	3.8	4.4	4.7	3.7	3.6	3.5	1.4	0.7	1.8	1.6	1.8	1.6	1.8	1.8
Of which contribution from real GDP growth	0.0	-0.7	-2.0	-2.2	-2.2	-2.7	-2.8	-2.5	-2.0	-0.6	-0.1	0.1	-0.7	-1.3	-1.7	-1.5
Contribution from exchange rate depreciation[4]	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other identified debt-creating flows	n.a.	n.a.	n.a.	0.9	0.3	0.2	0.1	-0.4	-0.1	-0.2	0.0	-0.4	-0.3	-0.3	-0.3	0.0
Privatization receipts (negative)	n.a.	n.a.	n.a.	0.9	0.3	0.2	0.1	-0.4	-0.1	-0.2	0.0	-0.4	-0.3	-0.3	-0.3	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3)	n.a.	n.a.	n.a.	-2.1	-0.8	-2.8	-0.1	0.6	-0.8	0.8	0.1	0.0	0.3	0.3	0.3	0.0
Public sector debt in percent of revenues[1]	157.4	157.7	159.5	163.3	157.4	148.5	143.7	132.6	117.6	113.5	113.3	113.8	117.9	118.8	115.1	110.2
Gross financing[5]	n.a.	n.a.	n.a.	n.a.	9.0	8.5	9.5	16.2	7.8	7.0	10.1	12.2	11.8	11.0	8.2	7.6
in billions of U.S. dollars	n.a.	n.a.	n.a.	n.a.	37.3	32.1	37.3	64.5	29.1	26.9	42.4	60.5	60.6	59.3	46.8	45.8
Key Macroeconomic and Fiscal Assumptions																
Real GDP growth (in percent)	1.7	0.9	2.6	3.0	3.0	3.9	4.3	4.0	3.4	1.2	0.2	-0.2	1.4	2.6	3.3	3.0
Average nominal interest rate on public debt (in percent)[6]	7.9	7.7	7.3	7.9	7.5	7.3	7.3	7.1	6.6	6.6	6.7	6.1	5.7	5.5	5.6	5.5
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.6	5.9	5.0	5.9	6.3	5.3	5.6	5.6	2.5	1.3	3.5	3.2	3.5	3.3	3.6	3.6
Nominal appreciation (increase in US dollar value of local currency, in percent)	6.2	-5.5	2.2	13.2	-4.8	-13.5	-1.6	-4.1	-13.4	-3.0	5.4	15.3	0.1	0.2	0.2	0.2
Inflation rate (GDP deflator, in percent)	2.3	1.8	2.3	2.0	1.2	2.0	1.7	1.5	4.1	5.3	3.2	2.9	2.2	2.2	1.9	1.9
Growth of real primary spending (deflated by GDP deflator, in percent)	2.4	0.9	-1.2	0.3	-0.7	2.9	1.8	4.9	0.3	4.6	2.9	1.5	1.8	0.0	1.0	2.0
II. Stress Tests																
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2007											**52.4**	**49.5**	**47.1**	**44.5**	**42.0**	**39.3**
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004											**52.4**	**55.0**	**58.4**	**58.0**	**56.4**	**54.4**
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004											**52.4**	**52.1**	**53.5**	**53.1**	**51.5**	**49.4**
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004											**52.4**	**52.8**	**53.0**	**52.6**	**51.0**	**49.0**
5. Combination of 2-4 using one standard deviation shocks											**52.4**	**52.3**	**52.6**	**53.0**	**52.4**	**51.2**
6. One time 30 percent real depreciation in 2003[7]											**52.4**	**52.4**	**53.3**	**52.9**	**51.3**	**49.3**
7. 10 percent of GDP increase in other debt-creating flows in 2003											**52.4**	**62.4**	**63.5**	**63.1**	**61.6**	**59.6**
8. Impact on **debt-to-GDP ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04											**52.4**	**53.9**	**55.3**	**54.9**	**53.3**	**51.3**
8a. Impact on **debt-to-revenue ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04											**113.3**	**120.7**	**123.8**	**123.3**	**119.6**	**114.7**

Historical Statistics for Key Variables (past 10 years)	Historical Average	Standard Deviation
Primary deficit	-3.5	1.3
Real GDP growth (in percent)	2.8	1.2
Nominal interest rate (in percent)[6]	7.3	0.5
Real interest rate (in percent)	4.9	1.6
Inflation rate (GDP deflator, in percent)	2.4	1.3
Revenue to GDP ratio	48.1	1.7

[1] Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

[2] Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

[3] The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as $-g$.

[4] The exchange rate contribution is derived from the denominator in footnote 2/ as $\alpha\varepsilon(1+r)$.

[5] Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

[6] Derived as nominal interest expenditure divided by previous period debt stock.

[7] Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

Staff Report for the 2003 Article IV Consultation
Supplementary Information

Prepared by the European I Department

Approved by Michael Deppler

July 24, 2003

1. This supplement reviews economic developments since the preparation of the staff report for the 2003 Article IV consultation with the Netherlands (SM/03/236). These developments do not change the thrust of the staff appraisal.

National Accounts Data

2. **The 2002 national accounts indicate a larger imbalance in the fiscal accounts for 2002 than previously estimated.** The provisional national accounts confirm the previous estimate of GDP growth of 0.2 percent in 2002 (see table), while the general government deficit was revised upwards, from 1.2 percent of GDP to 1.6 percent, owing to larger imbalances in local government accounts.

2002 National Accounts - Key Indicators

	2000	2001	2002
	(Rates of growth in percent)		
Private consumption	3.5	1.4	0.8
Public consumption	2	4.2	3.8
Gross fixed investment	1.4	-0.1	-4.5
Exports of goods and nonfactor services	11.3	1.7	0.1
Imports of goods and nonfactor services	10.5	2.4	-0.2
Gross domestic product	3.5	1.2	0.2
General government balance (Percent of GDP)	2.2	0	-1.6

Source: Central Bureau of Statistics.

3. **The economic contraction in the first quarter of 2003 year was less pronounced than previously estimated.** New estimates indicate that in the first quarter of 2003 GDP fell by 0.1 percent, smaller than the 0.3 percent estimated in May (Table 1). Growth for the fourth

quarter of 2002 was also revised up slightly. Government consumption and, to a lesser extent, investment turned out to be stronger than previously estimated, while the growth in inventory was smaller. These developments may lead to a small upward revision in the growth projection for 2003 in the forthcoming WEO round.

Cyclical Indicators, Unemployment, and Inflation

4. **Cyclical indicators remain weak**. Consumer and producer confidence, already near historic lows, continue to fall. Unemployment rose to 5.5 percent in May, an increase of over one percentage point since the beginning of the year. Inflationary pressures continue to unwind, with consumer price inflation, at 2.5 percent in June. With signals of an economic recovery still mixed in the rest of the world, downside risks to the outlook remain.

Revised CPB Fiscal Outlook

5. **The CPB has revised upwards the projected fiscal deficit over the coalition period because of lower expected growth in 2003 and 2004.** The new macroeconomic forecast for the coalition period updates the previous scenario developed in January-March and used in the June update of the Stability Program. The new forecast envisages lower growth in 2003 and 2004 than previously projected (0 and 1¼ percent respectively, rather than ½ percent and 1¾ percent), while average growth over the 2004–07 continues to be forecast at 2¼ percent per year. As a result, the level of output in 2007 is lower in the new scenario, and the fiscal deficit larger (see Table). This revision does not affect the staff's fiscal forecast.

General Government Balances – CPB Projections

	2003	2004	2005	2006	2007
Stability Program	-1.6	-1.7	-1.2	-0.8	-0.5
July 2003	-1.9	-2.6	-1.8	-1.1	-0.9

Netherlands: Quarterly Real GDP Growth

(Changes from previous quarter; seasonally adjusted)

	2001					2002					2003
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	4th Qtr[1]	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	4th Qtr[2]	1st Qtr
Real GDP	**0.3**	**0.2**	**-0.1**	**0.0**	**0.3**	**0.1**	**0.2**	**0.1**	**-0.1**	**0.3**	**-0.1**
Private consumption	-0.6	0.7	0.4	0.6	1.0	-0.2	0.1	0.5	0.0	0.4	0.5
Government consumption	1.0	0.7	0.6	0.9	3.3	0.7	2.1	0.2	0.7	3.7	0.3
Fixed investment	0.0	-0.3	-0.8	0.4	-0.8	-1.5	-0.7	-2.1	-1.8	-6.0	-0.7
Change in stocks[2]	0.7	-0.1	0.0	-1.3	-0.7	0.1	0.2	0.1	0.3	0.7	0.2
Total domestic demand	**0.6**	**0.3**	**0.2**	**-0.7**	**0.4**	**-0.2**	**0.6**	**0.0**	**0.1**	**0.5**	**0.5**
Foreign balance[2]	-0.6	0.2	-0.3	0.4	-0.2	0.3	-0.2	0.0	-0.1	0.0	-0.6
Exports	0.0	-1.5	-0.9	-1.1	-3.5	-0.9	1.1	0.6	-0.4	0.5	0.3
Imports	0.9	-2.0	-0.6	-1.9	-3.5	-1.5	1.6	0.7	-0.2	0.6	1.3
Statistical discrepancy[2]	0.3	-0.3	0.0	0.2	0.1	0.0	-0.1	0.1	-0.1	-0.1	0.0

Sources: Statline online database; and IMF staff calculations.

[1]Year-on-year percentage change.

[2]Contribution to GDP growth.

INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/92
FOR IMMEDIATE RELEASE
August 8, 2003

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

IMF Concludes 2003 Article IV Consultation with the Kingdom of the Netherlands—Netherlands

On July, 30, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Netherlands.[1]

Background

Following several years of expansion, the Dutch economy is now in its third year of weak growth. Real GDP rose only 0.2 percent in 2002, and is projected to fall by 0.2 percent this year. However, activity is expected to begin to pick up later in the year, and to grow by 1.4 percent in 2004. Domestic demand growth stalled as rapid house and equity price increases, which had been boosting demand, came to an end. Profits and international competitiveness were threatened by high wage and price inflation during the boom of the late 1990s, and corporate balance sheets came under pressure. Export growth also collapsed, reflecting mainly the worldwide economic slowdown. The labor market initially reacted only gradually to the slack pace of activity, as firms hoarded labor, but in the first half of this year the unemployment rate began to rise sharply. Softness in labor and product markets moderated wage and price inflation, which are now converging on euro-area rates.

Substantial risks to economic recovery remain. To a large extent, the Netherlands shares these risks with the rest of Europe. There are as yet no concrete signs of stronger growth, and consumer and business sentiment are weak. Adjustment of corporate balance sheets may take

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

longer than expected, and the fiscal retrenchment needed in many countries may hinder short-term growth. For the euro area, the recent currency appreciation is an additional risk. Domestically, a key risk is the possibility of sharp falls in house prices, which rose rapidly to historically high levels during the boom period. While the continuing shortage of housing may sustain prices, substantial declines could cut domestic demand significantly.

The fiscal position has deteriorated sharply, from a surplus of 2.2 percent of GDP in 2000 (1.5 percent of GPD excluding UMTS proceeds) to a deficit of 1.6 percent of GDP in 2002. This reflected in large part the operation of the automatic stabilizers, but also involved a significant structural weakening. Measures taken in the 2003 budget and the new coalition agreement should arrest and, over the next four years, partly reverse this deterioration. A strong medium-term fiscal position of a surplus of some 1 percent of GDP has been recommended by a high-level advisory body to deal with the fiscal strains of population aging. Health-care spending has emerged as an important source of budgetary pressure in the wake of a relaxation of top-down controls in favor of a more demand-driven system.

The substantial improvements in labor-market performance in the past two decades are attributable mainly to increased flexibility and sustained wage moderation. As a result, the Netherlands has enjoyed high employment and very low unemployment rates. Policy initiatives are nonetheless needed to address remaining weak points. The authorities are committed to reform of the large disability program (the beneficiaries of which amount to 13 percent of employment) and are introducing measures to raise labor-force participation of those in the 55-65 year age bracket. A start is to be made in reducing work disincentives at low earnings levels by reining in income-linked rent subsidies. Although the Netherlands is still generally in the forefront of EU countries with regard to product-market reform, momentum appears to have flagged.

Executive Board Assessment

Executive Directors commended the authorities on a longstanding record of sound fiscal and structural policies that had delivered an extended period of strong economic growth and very low unemployment. However, since 2000 economic activity has slowed considerably owing to declining growth in the United States and the euro area and an erosion of external competitiveness, as well as to weak domestic demand which can be traced to the end of rapid house price increases, falling equity prices, and concerns by firms regarding profitability and the state of their balance sheets.

While Directors expressed concern about these developments, they also referred to the past record of reform and the tradition to seeking social consensus to keep labor costs under control. They were confident that the Dutch authorities would succeed in meeting the new challenges.

Directors looked forward to a gradual recovery late this year and into 2004. Growth is expected to be stimulated by monetary easing in the euro area and the expected recovery in the United States, and wage and price inflation are falling toward euro-area levels. However, Directors also referred to the downside risks. Concrete signs of recovery had yet to materialize, and business

and household confidence remained weak. Moreover, the appreciation of the euro could hinder growth and a possible correction in house prices could further undermine consumption. Directors noted the sharp deterioration of the fiscal position. While this, to some extent, reflected the appropriate operation of the automatic stabilizers, Directors observed that the underlying position had also deteriorated. In the absence of corrective measures, this development risked jeopardizing the long-term fiscal goal of reducing the national debt over time to help pay for pension and health-care costs associated with population aging.

Directors thus commended the new government for taking measures to strengthen the public finances over the medium term. In view of the uncertainties regarding the economic recovery, they endorsed the approach of the authorities to allow the substantial operation of the automatic stabilizers in the short run. They also welcomed the emphasis on spending control and on durable measures to strengthen the medium-term fiscal position. Directors noted that spending could prove difficult to control, especially if the recent rapid increases in health-care outlays were not reined in. They agreed that the authorities' medium-term fiscal framework, based on expenditure ceilings and using windfalls to reduce the deficit, would be a key to achieving the fiscal objectives, which include a return to structural surpluses. Some Directors recommended to apply this framework flexibly if growth should turn out to be weaker than expected.

Directors also noted that the tax base could usefully be broadened. They welcomed the planned elimination of the tax deductibility of early retirement schemes, which should also help to increase the labor-force participation of older workers. Most Directors considered that narrowing and ultimately eliminating mortgage interest deduction would both raise revenue and remove a distortion to the allocation of savings. Other Directors, however, cautioned that such measures could undermine the policy to promote broad home ownership and adversely affect house prices.

Directors agreed that the Dutch financial sector remained sound and well supervised. The cyclical slowdown had cut banking profits, but margins and capital ratios remained high and institutions were vigorously reducing costs. Occupational pension funds had suffered from the collapse in stock markets, but the supervisor responded appropriately by requiring coverage ratios to be bolstered. Directors welcomed the authorities' decision to codify and modernize pension supervision, and a few Directors observed that a strengthening of the pension system was needed to protect the solvency of "second pillar" funds. Directors also considered that the merger of the prudential insurance and pension supervisor with the prudential banking supervisor—which follows an extensive reorganization of financial market supervision completed last year—would strengthen oversight, especially of the large conglomerates that dominate the Dutch market. Directors looked forward to the results of the Financial Sector Assessment Program exercise which will be conducted next year. They suggested that the exercise should assess the new supervisory structure and the risks associated with a possible downturn in housing prices.

Directors emphasized that the key medium-term structural challenge would be to further increase employment rates. They welcomed a number of measures to stimulate employment among those over 55 years old. Measures to sharply reduce inflows of beneficiaries into the very large disability program should also promote employment, although in future high

replacement rates might have to be lowered to reduce the program's attractiveness. Directors noted, however, that more needed to be done to strengthen incentives to work by reducing high effective marginal tax rates (including the effect of lost benefits) at low earnings levels.

Directors agreed that further product market reform would be the key to raising productivity in the medium term. They welcomed the continuing liberalization of the network industries, and some Directors saw scope for further efforts to improve the regulatory framework and strengthen corporate governance. Directors noted that, overall, momentum for reform seemed to have faded. To reinvigorate the process and build public support, the benefits to consumers of reform should be made as clear as possible.

Directors commended the authorities' support for multilateral trade liberalization, and praised them for their generous level of official development assistance which exceeds the United Nations target of 0.7 percent of GNP.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2003 Article IV Consultation with the Kingdom of the Netherlands—Netherlands is also available.

Kingdom of the Netherlands—Netherlands: Selected Economic Indicators

	1999	2000	2001	2002	2003[1]	2004[1]
Real economy (change in percent)						
GDP	4.0	3.4	1.2	0.2	-0.2	1.4
Domestic demand	4.3	2.8	1.4	-0.2	2.8	1.3
CPI (year average)[2]	2.0	2.3	5.1	3.9	2.6	2.0
Unemployment rate (in percent)	3.2	2.6	2.0	2.3	3.8	4.4
Gross national saving (percent of GDP)	26.6	27.6	25.2	22.6	24.2	24.0
Gross domestic investment (percent of GDP)	22.6	22.3	21.9	20.2	20.5	20.4
Public finance (percent of GDP)						
General government balance	0.7	2.2	0.1	-1.6	-2.2	-2.4
Structural balance	-0.6	-0.1	-0.7	-1.9	-1.6	-1.1
Structural primary balance	3.3	3.2	2.2	0.9	0.9	1.2
General government debt	63.1	55.8	52.8	52.6	52.5	53.7
Money and credit (end of year, percent change)						
Domestic credit[3]	14.2	16.4	8.6	8.3	...	...
M3[4]	10.1	8.7	12.5	7.1	...	...
Interest rates (percent)						
Money market rate	3.0	4.4	4.3	3.3	2.6	...
Government bond yield	4.9	5.5	5.2	5.0	4.3	...
Balance of payments (percent of GDP)[5]						
Trade balance	4.0	4.7	5.4	6.1	5.2	5.5
Current account	3.2	1.2	2.1	2.2	3.5	3.4
Official reserves, excl. gold (US$ billion)[6]	9.9	9.6	9.0	9.6	...	...
Reserve cover (months of imports of GNFS)	0.5	0.5	0.5	0.5	...	...
Exchange rate						
Exchange rate regime			Member of euro area			
Euros per U.S. dollar (July 31, 2003)			1.12			
Nominal effective rate (1990=100)	92.1	89.0	89.6	90.3	...	...
Real effective rate (1990=100)[7]	93.3	91.3	93.1	95.8	...	...

Sources: International Financial Statistics; Dutch authorities; and IMF staff estimates.

[1] IMF staff projections.

[2] In 2001, an indirect tax increase is estimated to have increased inflation by 1.2 percentage points.

[3] Credit to euro area residents.

[4] Dutch contribution to euro areas M3.

[5] Transactions basis; does not correspond to national accounts.

[6] Data for 2002 are through March 2002.

[7] Based on relative normalized unit labor costs.