July 2005
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Kingdom of the Netherlands—Netherlands: 2005 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 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 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 11, 2005, 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 May 25, 2005. 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 statement of June 29, 2005 updating information on recent developments.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 29, 2005 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.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives
For the 2005 Consultation with the Netherlands

Approved by Ajai Chopra and Michael T. Hadjimichael

May 25, 2005

The 2005 Article IV discussions were held in Amsterdam and The Hague during March 31–April 11, 2005. The staff team comprised Messrs. Feldman (head), Hofman, and Nadal De Simone (all EUR), and Mr. Walsh (ICM). It met with the minister of finance, the governor and other representatives of the central bank (DNB) and financial supervision, senior staff of several government ministries and agencies, including the Bureau for Economic Policy Analysis (CPB), the Competition Authority (NMa), and the head of the Social and Economic Council, representatives of labor unions and employer organizations, parliament, the financial sector, including banks and pension funds, and academics.

After early elections in January 2003, a center-right coalition government comprising the Christian Democrats, Liberals, and the center-left D66 took office in May 2003. Its term is through 2007. While a deputy prime minister from the small D66 party resigned in late March, testing the cohesion of the coalition government, his party did not break away.

In concluding the 2004 Article IV Consultation on September 8, 2004, Executive Directors expressed concern over the depth of the recent downturn, the significant weakening of the public finances in recent years, and the prospect of falling potential growth. While commending the authorities' efforts to restore fiscal balance, they emphasized the need to sustain such efforts and continue with labor and product market reforms to raise potential output.

The Netherlands has accepted the obligations of Article VIII (Appendix I). It subscribes to the SDDS, and economic data are adequate to conduct effective surveillance (Appendix II).

The authorities released the mission's concluding statement and agreed to the publication of the staff report.

Contents Page

Main Websites for Dutch Data

Statistics Netherlands (CBS).. http://www.cbs.nl

De Nederlandsche Bank (DNB)... http://www.dnb.nl

Ministry of Finance... .... http://www.minfin.nl

Bureau for Economic Policy Analysis (CPB).. http://www.cpb.nl

Additional information on Dutch economic statistics can be found at the Fund's SDDS website http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=NLD

and at the Statistics Netherlands Data Portal: http://statline.cbs.nl/StatWeb/Start.asp?lp=Search/Search&LA=EN&DM=SLEN.

EXECUTIVE SUMMARY

Background: The recovery has so far failed to gather steam, and growth is expected to remain significantly below potential this year, with large uncertainties over confidence and its effect on consumption. However, fundamentals are showing improvement, and the expansion is expected to gather pace in 2006. After breaching the Maastricht deficit ceiling by a small margin in 2003, the fiscal deficit was reduced to 2.3 percent of GDP in 2004—the result of significant expenditure-led structural adjustment of about 1¼ percentage points of GDP. Raising participation and productivity are important for boosting the economy's potential and reducing pressures on the public finances in the face of population aging. The authorities are moving ahead with various reforms in this regard, though political compromise tends to affect the pace and final design of some policies.

Policy discussions focused on the following areas:

- ***Fiscal policy.*** There was broad agreement on the merits of sustaining fiscal consolidation in the medium term, with a view to preparing for aging and buttressing confidence. While part of the way there, further measures are needed to ensure cumulative fiscal adjustment of ¾ percentage point of GDP during 2005–07 as recommended by staff. Moreover, in light of elections scheduled in 2007 and the need to bolster confidence, early action would be beneficial. Recommended measures exploit the synergies between fiscal consolidation and structural reforms that raise employment rates and potential growth—for example by rationalizing and restraining unemployment benefits and rent subsidies.

  Staff found that the CPB, as an independent economic forecaster and evaluator of public sector policies, plays an important role in disciplining fiscal policy. Recent measures to improve coordination between various levels of government also strengthen fiscal policy, but such coordination should be made a permanent feature of the fiscal framework. Refinements to the expenditure ceilings would further enhance their transparency and effectiveness.

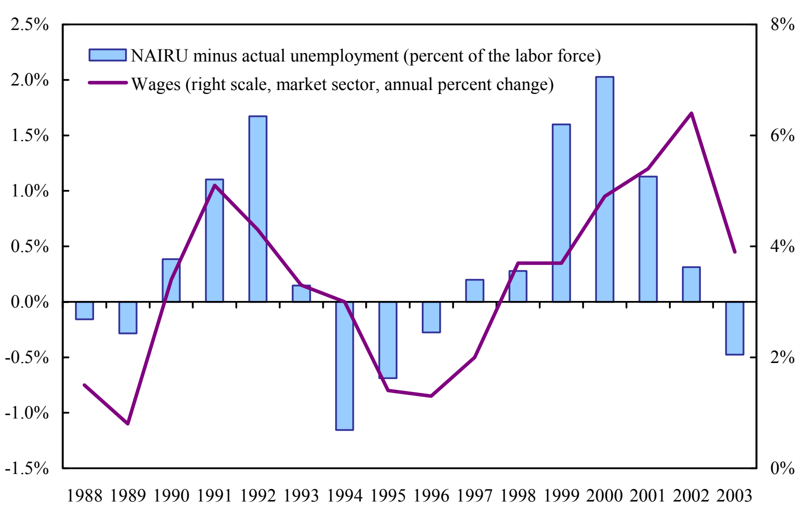
- ***Structural reforms.*** The authorities have implemented or are in the process of implementing key reforms, including by tightening disability and unemployment benefits and early retirement arrangements, lessening inactivity traps, enhancing competition, and reducing the administrative burden. While welcoming the progress being made, staff urged greater ambition, notably by cautioning against a potential weakening of disability reform and actions that offset the impact of eliminating fiscal incentives for early retirement, and by further shortening the duration of unemployment benefits. Staff also recommended additional measures to enhance innovation and productivity.

- ***Financial sector.*** The financial system remains sound, resilient to potential adverse shocks, and well supervised. The authorities' efforts to preserve financial stability are welcome, including their responsiveness to the recommendations made in the Fund's Financial Sector Stability Assessment of last year.

I. BACKGROUND

1. **After a long period of comparatively strong economic performance** (Figure 1), **the Netherlands hit a difficult stretch going into the new millennium** *(Figure 2).* Growth was relatively poor during 2000–03 (Table 1). It turned negative in 2003 for the first time in 20 years. A weakening external environment contributed to the sharp slowdown of activity. Wealth effects amplified the cycle, as the positive effects of equity and house price increases before 2000 were later reversed when equity prices fell sharply while the momentum of house price increases moderated. Pension fund exposure to equities also amplified the cycle, with contribution rates being cut during the stock market boom of the late 1990s, only to be hiked during the bust in recent years.

2. **Deteriorating external competitiveness has also been restraining export performance and overall growth.** Wage pressures put upward pressure on consumer prices (with inflation peaking at over 5 percent in 2001) and, along with a later appreciation of the euro, weakened external competitiveness. Wage pressures reflected tightness in the labor market that had built up in the second half of the 1990s (Text Figure). Although the Netherlands still had a considerable labor reserve, it went untapped for lack of reform. This was especially the case with respect to disability, a long-acknowledged haven of hidden unemployment. The loss in export competitiveness has not been especially apparent in aggregate market share data, but more detailed assessments using constant market share analysis raise warning flags.[1] In addition, falling market shares have been in evidence in volume terms (Figure 3).



Sources: Ministry of Finance; and CPB.

[1] Constant market share analysis controls for possible biases because a country exports certain goods or exports to certain markets for which demand is growing at a different pace than the overall average. An accompanying selected issues paper discusses external competitiveness.

3. **A recovery that looked reasonably firm at the start of 2004 failed to gather steam.** The pickup in growth in 2004 was much weaker than during past upswings (Figure 4). While fiscal tightening withdrew stimulus, the weak performance was mostly due to the behavior of private consumption, which remained unusually lackluster. Disposable income and (un)employment cannot fully explain the sharp fall in consumption growth since 2000. In addition to wealth effects, less tangible factors affecting confidence, partly related to policy uncertainty, have clearly been at play.[2]

4. **Inflation is now subdued, and there is little pressure from wages looking ahead.** Despite the increases in energy prices, year-on-year CPI inflation was only 1½ percent in March 2005. A special factor has been the ongoing "supermarket war," in which increased competition has contributed to a 3½ percent decline in food and beverage prices in 2004. Wage growth was subdued in 2004 (about 1½ percent), reflecting the two-year economy-wide wage moderation agreement of the social partners that aimed at improving competitiveness. Although the agreement allows for somewhat more discretion in 2005, the strength of the euro, moderate pace of economic activity, and slack labor market conditions are expected to keep a lid on wage pressures.

5. **Public finances deteriorated markedly during 2000–03, but there was a significant reversal in 2004.** The general government balance worsened by almost 5½ percentage points of GDP during 2000–03 as a result of both cyclical and structural effects (Table 2). Structural effects—amounting to roughly 2 percentage points of GDP—included the 2001 tax reform and increases in health care and education spending. The 3 percent Maastricht deficit ceiling was unexpectedly breached in 2003, also reflecting a surprise deterioration in local government accounts to a deficit of 0.6 percentage point of GDP after years of running close to balance. The deficit was then reduced in 2004 to 2.3 percent of GDP, primarily through expenditure restraint (see below).

6. **Monetary conditions have tightened in the last few years** *(Figure 5).* They were loose through much of the late 1990s, contributing to the boom. They tightened after 2000, compounding the downturn.[3]

II. Report on the Policy Discussions

7. **The discussions focused on key measures to bolster confidence and enhance growth prospects while ensuring fiscal sustainability and resilience to population aging.** The marked deterioration in the public finances during 2000–03 underscored the benefits of ensuring significant fiscal consolidation during an economic upturn and the confidence it

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[2] See "The Dutch Consumer: From Shopaholic to Enthusiastic Saver," *DNB Quarterly Bulletin*, September 2004. An accompanying selected issues paper analyzes the behavior of consumption.

[3] Indeed, with inflation below the EU average in recent years, real interest rates have correspondingly been higher.

would bring. On top of strengthening fiscal policy and confidence, restoring external competitiveness was seen as an essential element of sustaining economic recovery. A key goal of structural reforms was to stimulate high employment and growth, with a view to generating the resources without which it would be virtually impossible to keep the public finances sound while maintaining social expenditure in the face of an aging population. Box 1 summarizes the implementation of previous IMF recommendations.

Box 1: Past Fund Policy Recommendations and Implementation

Fiscal Policy: Past recommendations included structural fiscal adjustment of at least ½ percentage point of GDP per year during the government's term, closer coordination between the central government and the local governments, and refinements to enhance the transparency of the fiscal framework. Fiscal consolidation in 2004 of about 1¼ percentage points of GDP, in structural terms, represents substantial progress. The authorities have improved coordination between various levels of government. Any decisions on the fiscal framework would not be taken before a new coalition agreement, although some preparatory analysis is being considered.

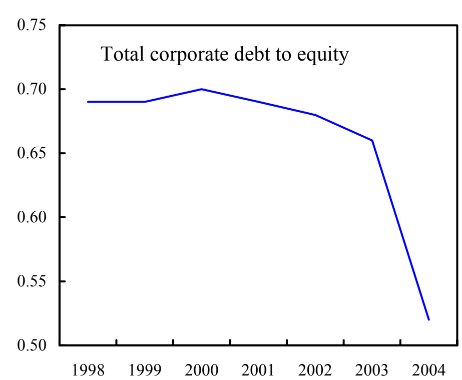
Labor Market Reform: Broadly in line with Fund advice, fiscal incentives for early retirement were abolished; reform of the disability scheme has started, with further reforms planned for 2006; the authorities have been gradually raising the labor tax credit to reduce inactivity traps; reform of employment legislation is being discussed; and decisions on tightening the unemployment scheme are expected soon (but will probably be less ambitious than Fund recommendations). Recommendations not yet taken on board include adjusting the minimum wage and taking into account life expectancy in determining the retirement age. Calls for greater wage differentiation have not resulted in notable changes.

Product Market Reform: The Fund has generally supported the authorities' liberalization program. The government remains committed to a 25 percent reduction of the administrative burden by 2007, a new corporate governance code was introduced in 2004, and the powers of the competition authority are gradually and continually being increased.

Financial Sector: The authorities are making significant progress in implementing the recommendations from last year's Financial Sector Stability Assessment (FSSA).

A. Near-Term Outlook

8. **Although there was major uncertainty over confidence and its effect on private consumption, there was consensus that fundamentals had shown improvement.** Corporate balance sheets had strengthened, and profit margins were starting to turn up, boding well for investment (Text Figure). The foreign sector was seen as the main near-term driver of growth. Both the authorities and staff saw wage moderation bringing the deterioration in external competitiveness to an end, with competitiveness then starting to improve in 2006. With respect to the outlook for consumption, the considerable margin of uncertainty was



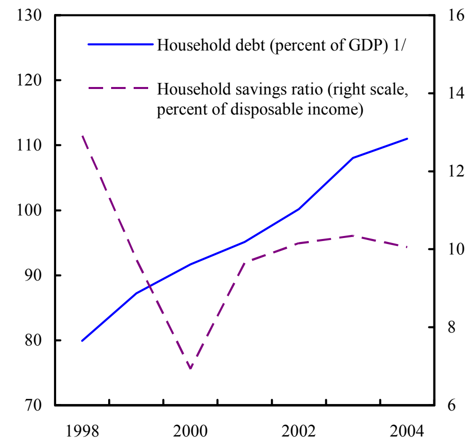
Source: DNB.

reflected in the range of official forecasts (Text Table). The CPB projected negative private consumption growth in 2005 in light of an estimated drop in disposable income. The DNB's more optimistic view reflected recent favorable indicators showing rising temporary employment growth and vacancies, and consumption smoothing as forward-looking consumers saw growth accelerating in 2006. Indeed, official forecasts and staff's forecast put growth in the range of 2.2 to 2.5 percent for 2006 (above potential growth of 2 percent).

Growth Projections for 2005

	GDP	Consumption
CPB	1.0	-0.5
DNB	1.7	0.5
Staff	1.3	0.3

9. **All agreed that certain downside risks would bear close watching.** Higher-than-expected oil prices, a significant further appreciation of the euro, and slower-than-expected growth in trading partners were downside factors. Staff recognized, relative to its baseline, that the DNB's and CPB's projections of private consumption suggested both upside and downside risks.[4] However, there was a particular concern that a possible decline in house prices, resulting from an increase in interest rates, could have a negative effect on consumption.[5] Staff emphasized that this downside risk was accentuated by high household debt, which could result in a renewed increase in household saving (Text Figure). Mitigating the risk from falling house prices, the authorities pointed to empirical work at the CPB suggesting that house price adjustments were more sluggish when prices were falling than when they were rising.[6]



Source: DNB.

1/ BIS data for 2002 show that the level of household indebtedness in the Netherlands was very high from an international perspective.

10. **Separately, as a statistical matter, the authorities identified several institutional changes that would have a significant impact on economic data** (Appendix II). The authorities and staff agreed that the impact would have to be communicated effectively to avoid misunderstandings. For example, while the statistical adjustments required to reflect the institutional changes would produce significant movements in expenditure components, it would need to be made clear that overall GDP growth would not be affected.

[4] The DNB, at the time of the discussions, was, however, starting to update its projection for June publication and indicated it might revise its 2005 forecast, especially for private consumption.

[5] An accompanying selected issues paper on house prices indicates a high sensitivity to interest rates, broadly in line with empirical work by the CPB.

[6] In addition, the concentration of debt is toward high-income earners, which may also serve to mitigate some of the risk.

B. Fiscal Policy

11. **Recent developments give reason for optimism.** The deficit reduction to 2.3 percent of GDP in 2004 resulted in a structural narrowing by about 1¼ percentage points of GDP, of which 0.9 percentage point was from discretionary spending measures.[7] The fiscal effort reflected a virtual freeze of public sector wages and social security benefits, a reduction in the coverage of public health insurance, the abolition of a disability insurance scheme for the self-employed, and many smaller measures. It also helped that government departments did not exhaust their budget ceilings. A somewhat lower-than-expected deficit of local governments and unexpected windfalls from tax and gas revenues and social security spending contributed as well.[8]

12. **The discussion turned to fiscal policy for the remainder of the government's term.** Staff pointed to the considerable benefits of structural fiscal adjustment of at least ½ percentage point of GDP per year, on average, during the government's term (2004–07), which is broadly consistent with the original amount implied by the coalition agreement.[9] Adjustment of this magnitude would help to return to a sustainable path for the public finances and help prepare for population aging (also see ¶16). However, the authorities had recently diverged from the 2005 budget in response to increasing demands for additional spending and acknowledged that the political environment made new spending cuts difficult going forward. Nevertheless, there was margin under the spending ceilings, and structural adjustment of about 0.4 percentage point of GDP had already been embedded in the government's plans and was therefore in the pipeline. In all, current fiscal plans would still fall short of the above-mentioned average structural adjustment of ½ percentage point of GDP per year objective (Text Table), and staff recommended further expenditure measures to make up the difference. It was also recognized that new windfalls could arise during an economic upturn. Staff and the authorities agreed on the merits of using any windfalls for deficit and debt reduction.

Structural Fiscal Adjustment
During Government Term (2004-07)

(In percentage points of GDP)

Staff recommendation	2.00
Adjustment in 2004	1.25
In the pipeline	0.40
Remaining adjustment	0.35

Source: IMF staff calculations.

[7] While estimating the structural deficit has its difficulties (see Table 2), a much smaller part of the structural adjustment here was from the revenue side, which is where the breakdown of cyclical and structural components is the most problematic.

[8] As analyzed in *Recent Fiscal Developments in the Netherlands,* IMF Country Report 04/301, temporary windfalls were in the past used to fund permanent spending increases, contributing to earlier fiscal difficulties.

[9] When a new government is formed, the coalition partners negotiate a detailed policy program outlining the measures to be implemented during the government's term in office and including expenditure ceilings.

13. **While noting the strengths of the Dutch fiscal framework, staff pointed to possible refinements.**[10] Strengths include multi-year real expenditure ceilings, the specification of measures to achieve them, and the play of automatic stabilizers on the revenue side (subject to the Maastricht deficit ceiling). However, the local government accounts are compiled on a different basis than those of the central government, which has allowed relatively wide fluctuations in local government fiscal balances when put in EMU-consistent terms. Therefore, ensuring timely information-sharing and close coordination between central and local governments was deemed essential for avoiding the adverse fiscal surprises of the past. To this end, the authorities explained that they were experimenting with a kind of "national stability pact"—aimed at improving the coordination of policies at various levels of government—with a view to putting durable measures in place. To enhance the transparency of the expenditure ceilings and their accessibility to a broader audience, staff recommended aligning the ceilings more closely to national accounts concepts and broadening their coverage, while focusing strictly on spending by ending the practice of treating nontax revenue as negative expenditures. The authorities expressed interest in these recommendations, but changes to the framework would not be made before the next coalition agreement.

14. **The CPB plays an important role in keeping fiscal discipline.** The authorities explained that the CPB is a highly valued independent bureau providing macroeconomic forecasts and economic policy analysis. One of its key roles is to publicly assess consistency between the government's policies and its fiscal and other economic objectives, thereby fostering accountability and fiscal discipline. While the CPB does not explicitly prescribe fiscal targets or policy measures, its analysis strongly influences perceptions—on the part of a range of economic players including representatives of parliament, the business sector, and the public at large—of what constitutes "good policy." This is especially the case because the CPB has established a strong reputation for high standards and impartiality, and thus enjoys considerable credibility.

15. **Over the longer term, the Netherlands is in a relatively favorable position to deal with population aging.** In addition to lower dependency ratios (Text Table), the Dutch pension system has built up large reserves through the fully-funded second pillar. Private sector pension income is also taxable and provides a substantial offset to the fiscal cost of aging. Consequently, pressures on Dutch tax and premium rates may be lower than in other countries with more pronounced population aging (also a favorable situation from the standpoint of external competitiveness).

Elderly Dependency Ratios in Selected Countries 1/

	2000	2050
Belgium	0.28	0.50
Germany	0.26	0.53
France	0.27	0.51
Italy	0.29	0.67
Netherlands	0.22	0.40
United Kingdom	0.26	0.46
EU-15	0.27	0.53

Sources: Eurostat; and CBS.

1/ People over 65 as a share of those between 20-64.

[10] An accompanying selected issues paper discusses the fiscal framework and the CPB's role.

16. **Staff analysis suggests that fiscal pressures from aging should be manageable.** In their earlier analysis, the authorities had developed a strategy to cope with aging, involving a swift buildup of fiscal surpluses by 2007 and a corresponding run-down of debt, thus generating savings on the interest bill that would be used to cover the cost of aging.[11] However, the fiscal balance has been worse than the strategy envisaged. Recognizing this, the authorities were beginning to update their aging strategy. Appendix III presents long-term debt and fiscal sustainability scenarios prepared by staff, and the standard debt sustainability analysis template. In finding that the situation is manageable, the analysis also shows the need for sustained fiscal adjustment (with staff recommending continued adjustment in structural terms after the government's term) and illustrates the importance of undertaking structural reforms.

C. Raising Participation and Productivity

17. **Raising participation and productivity are important not only for boosting the economy's growth potential, but also for reducing pressures on the public finances.** Structural reforms aimed at these goals would therefore help avoid undesirable tax increases in the future (which would impair economic activity and burden later generations) or unduly sacrifice public services (including those related to population aging). While overall employment rates in terms of workers are at about the European average, the Netherlands has the lowest employment rate when measured in hours (Figure 6). In addition, there have been considerable pockets of inactivity, with a large portion of the potential labor force on the disability rolls. Against this background, the discussions focused on efforts to lower inactivity. In addition, while the overall level of productivity is high, it was recognized that productivity growth was an important second plank for boosting the economy's potential.

18. **Staff was encouraged by the already favorable effects of disability reforms.** The authorities explained various contributing factors. First, as the result of a more effective "gate-keeper" and the impact of firm-level experience rating in premiums, inflows into disability were falling (Text Table). Second, the extension of the duration of sickness benefits from one to two years in 2004 extended employers' responsibilities for trying to reintegrate workers (and temporarily halted the inflow into disability for 2005). Third, as a consequence of the application of a stricter definition of full disability, ongoing reassessments had frequently resulted in a reduction or elimination of benefits.

Inflows into the Disability Scheme

(In thousands of persons)

Average 1991-95	83,900
Average 1996-00	88,700
2001	104,100
2002	92,400
2003	66,300
2004	59,167

Source: Ministry of SZW.

[11] Details are in *Aging and the Public Finances in the Netherlands*, IMF Country Report 04/300 (Appendix III).

19. **While further reforms of disability are expected to be introduced in 2006, there was some question about their effect.**[12] The new reforms aim to restrict access to those that are fully disabled while strengthening work incentives for the partially disabled—goals welcomed by staff. However, staff noted that, under current proposals, the replacement rate for the fully disabled may be increased and experience rating of disability premiums abolished, depending on certain criteria with regards to new disability inflows. As evidenced by studies by the CPB, such actions run the risk of weakening the overall effect of the disability reforms and putting additional pressure on public resources.

20. **The abolition of fiscal incentives for early retirement should help to raise participation, though some recent actions would appear to have a dampening effect.** Staff emphasized that moving to actuarially neutral pension arrangements would, over time, boost participation because pension entitlements would fairly reflect each additional year of work. In this sense, removing the fiscal incentives for collective early retirement arrangements—which had unduly favored older workers—was a step in the right direction. However, the effects in the near term depended on the extent to which the social partners would offset the intent of the reform in new collective agreements. In addition, the authorities were introducing a new "life-course scheme,"[13] whose impact on participation was uncertain. The broad objective of this individual time-saving scheme, which would receive favorable tax treatment, was to increase personal and career flexibility. This, various officials noted, could advance economic objectives, by having a positive effect on investment in human capital and enhancing the attractiveness of the workplace, thus raising the supply of labor. However, this scheme subsidizes time off work, as some officials noted. In addition, there is still a significant risk that the scheme—including because prefunding could be a part of collective bargaining agreements—will be used as a subsidized route to early retirement. In a broader context, staff continued to emphasize that changes in life expectancy should be taken into account in determining the official retirement age.

21. **Though more is needed to lessen significant poverty and inactivity traps, recent measures have moved in the right direction.** The authorities noted that recent changes to the real estate tax and the planned amendments to the child credit,[14] due to come into effect in 2006, should reduce spikes in marginal effective tax rates.[15] In addition, the scheduled increases in the earned income tax credit for 2005–06 would further reduce poverty traps. However, more could be done on this front. Staff also indicated that reform of rent subsidy

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[12] While the reforms still await approval by parliament, it is considered highly likely given the coalition's parliamentary majority.

[13] The scheme is a voluntary savings arrangement that allows individuals to save to fund leave, in agreement with their employers, for various activities like child care and mid-career training, or for early retirement.

[14] These amendments already passed a first reading in parliament.

[15] Marginal rates above 120 percent reflect the impact of withdrawal of income-dependent credits, the child tax credit in particular.

arrangements could have a particularly large effect in making work pay for lower-income earners. Rent subsidy arrangements, as some officials noted, entail large budgetary costs and, due to abrupt withdrawal, contribute to high marginal effective tax rates. To balance housing market benefits across income groups, this could be combined with a withdrawal of mortgage interest tax relief, implemented in a way that avoids disruptive macroeconomic effects. Staff also encouraged the authorities to examine the minimum wage and its links to several social benefits, with an eye toward finding ways of further lessening traps and stimulating the demand for low-skilled labor.

22. **The merits of reducing the generosity of unemployment benefits was widely recognized.** The importance of comprehensive benefit reform to avoid shifts from one category of inactivity to another was widely recognized, too. Staff emphasized that while high replacement rates can be justified in the initial months of unemployment, over time benefits should decline quickly to encourage a rapid return to employment and avoid benefit dependency. In addition, staff expressed the view that a maximum period much shorter than three years would seem sufficient for unemployment benefits to serve their purpose from the standpoint of job search. Subsequent to the mission, on April 15, the Social and Economic Council proposed, among other things, to reduce regular benefit duration from 5 years to 3 years and 2 months, a period longer than recommended by staff.

23. **To raise productivity growth, labor market reforms would need to go beyond the narrow focus of raising participation.** Productivity depends, in part, on innovation, and the authorities' "Innovation Platform" emphasizes the need to improve the innovation potential of the Netherlands, including by creating a more favorable climate for entrepreneurs and knowledge workers. Staff noted that innovation is related to the ease in undertaking experimentation and exiting when appropriate—a process that works best when resources can be reallocated smoothly.[16] Thus, staff suggested that the agenda include an assessment of employment protection legislation, which is among the most restrictive in Europe according to information compiled by the OECD and acts as a tax on new hiring and labor reallocation.[17] Staff also encouraged the social partners to allow for greater wage differentiation in collective labor agreements. This would help to attract labor to higher productivity companies and sectors, while strengthening the incentives for human capital investment. As the authorities have noted, it would, however, be difficult to implement in light of traditional preferences for an egalitarian wage distribution.

24. **Product market reform was seen as another avenue for boosting productivity growth.** Although the Netherlands has made significant progress in improving the functioning of product markets—including through the liberalization of network industries—the benefits of enhanced competition have not yet reached all markets. In this context, the

[16] See *Recent Productivity Trends in the Netherlands*, IMF Country Report 04/301.

[17] A survey of SMEs, published a month after the discussions, indicated that a prime concern on their part was that such legislation hampered their ability to adjust quickly enough to market conditions.

increasingly effective enforcement efforts of the competition agency (the NMa) are most welcome. Looking ahead, the NMa will be made formally independent in July of this year. The NMa's powers could also be extended to assess fines on members of associations (in restricting competition), implement structural remedies against abuse of dominance, and introduce criminal penalties and individual sanction.

25. **The authorities are progressing in their goal to reduce the administrative burden by 25 percent.** They were confident that this ambitious goal would be met, aided by estimates of the size of the administrative costs from which the reduction would take place.

D. Financial Sector[18]

26. **The financial system continues to be sound, resilient to potential adverse shocks, and well supervised** (Table 3). Despite reduced interest margins, banks' returns improved last year as credit (especially for mortgages) increased. Insurance firms and pension funds, like banks, also benefited from higher security prices, though the current low-yield environment, especially if prolonged, poses challenges. However, the quality of supervision is high, and stress tests under the FSAP have demonstrated the resilience of the financial system. The new supervisory arrangements for pensions improve transparency and represent a more risk-based approach than before. In addition, with respect to solvency requirements, the flexibility in the timeframe for making up shortfalls in the coverage ratio is welcome.[19] This timeframe rightly tries to balance the goal of avoiding procyclical effects without unduly prolonging adjustment. Supervisors and policymakers will, nevertheless, have to monitor the macroeconomic implications of any changes in contribution rates that result from new solvency requirements, and the risks taken by banks and insurance companies in a low-yield environment, including in view of high loan-to-value ratios.[20] In addition, it is

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[18] This section draws on the more detailed material in an accompanying selected issues paper on the financial sector.

[19] Under the new arrangements, scheduled to come into effect in January 2006, the anticipated payout to beneficiaries with respect to indexation will be made clearer, and pensions funds will be required to achieve a coverage ratio (i.e., the ratio of the present value of assets over liabilities) implied by a 97½ percent probability of meeting their obligations. In cases where indexation is not guaranteed, the latter implies a coverage ratio, on average, of 130 percent (the current average is 124 percent), to be met within a period agreed on with the supervisor not exceeding 15 years. However, if the ratio falls below 105 percent, it has to be restored within one year, except at times of severe macroeconomic downturns or systemic risk, in which case more latitude would be given.

[20] As mortgage lending has picked up, loan-to-value ratios (LTVs) for new loans have reached an average of about 105 percent—though the average for all loans is considerably lower. While LTVs are not regulated directly, supervisory regulations generally pertain to the ratio of income to value—that is on the ability to pay rather than on the ability to reclaim value. High LTVs reflect the tax deductibility of mortgage interest payments.

important to ensure that the solvency requirements for health insurance funds after the planned reforms in 2006 are at an appropriate level.[21]

27. **Staff recognizes the authorities' efforts to help preserve financial stability with their responsiveness to the recommendations made in last year's FSSA.** As shown in Box 2, actions have already been taken on virtually all of these recommendations. The authorities' desire to move to a risk-based solvency framework for the insurance sector, broadly analogous to what has been done in the banking sector, was also welcomed. While they felt that current supervisory practice met high standards, the authorities considered that the prudential norms being discussed under the so-called Solvency I framework were not sufficiently risk-based. Thus, they wanted to accelerate the development and introduction of recommendations for prudential supervision of insurance under the Solvency II framework.

Box 2. Status of Implementation of Key FSSA Recommendations

Key FSSA Recommendations	Actions Taken
Spell out clearly the role of the minister of finance, as applicable in those few areas where autonomy is not fully delegated to the supervisor.	Starting in 2004, the approval of the minister of finance is only needed if one of the five largest banks or insurers takes a participation in each other.
Ensure that the Authority for Financial Markets has the power to cooperate with securities supervisors internationally even when there is no "domestic interest."	In the new Financial Supervision Act to be enacted on January 1, 2006.
Continue to work with cross-border counterparts to further improve securities settlement arrangements.	Improvements being made through promoting the use of delivery of securities against payment and supporting Euroclear's single settlement platform. The market infrastructure part of the new Financial Supervision Act is expected to come into effect on July 1, 2006.
Ensure that the new pensions supervisory arrangements allow sufficient flexibility in the specified timeframe for making up shortfalls in the coverage ratio to prevent procyclical effects, but without allowing unduly prolonged adjustment.	Implemented (see paragraph 26).
Continue the development of the framework for dealing with crisis situations both through (i) further work with other supervisors internationally; and (ii) completing the review of the domestic deposit guarantee scheme.	(i) Bilateral discussions and coordinating at the EU level. (ii) The authorities are completing a review of the domestic deposit guarantee scheme, including considering the introduction of prefunding and possibly risk-based premia.
Continue the development of macro prudential surveillance to help strengthen the early identification of risks and vulnerabilities.	DNB established a new division, improved its models and indicators, developed an analytical framework for financial stability, and started producing stability reports.
Over the medium term, phase out tax deductibility of mortgage interest, avoiding disruptive effects.	As of January 1, 2005, fiscal incentives for paying off mortgages were strengthened. No further actions currently planned.

[21] Currently, insurance funds have a solvency ratio of 24 percent or 8 percent depending on whether they are private or public. When basic health insurance is moved from state to private provision in 2006, the implicit government guarantee affecting those health funds now in the public sector domain may eventually disappear. Ensuring solvency requirements at an appropriate level will require taking this into account, along with trying to establish a level playing field in circumstances in which different funds will start with different solvency ratios.

E. International Trade and Development Assistance

28. **The authorities enthusiastically support overseas development assistance.** Even when under budgetary pressure, the Netherlands has still exceeded the United Nations' ODA target of 0.7 percent of GNI. While expressing disappointment at the slow rate of progress at the Doha round of multilateral trade negotiations, the authorities, also with an eye to development in LDCs, supported the Doha objectives of agricultural trade liberalization, market access, and trade facilitation.

III. Staff Appraisal

29. **Coming out of a difficult period, the challenge in the Netherlands is to support and sustain economic recovery.** The recovery in 2004 failed to gather steam. This was largely due to lackluster private consumption, with low consumer confidence a key factor, partly related to policy uncertainty. Against this background, there is a need to bolster confidence while enhancing growth prospects and ensuring fiscal sustainability. This underscores, after the marked deterioration in the public finances during 2000–03, the benefits of securing significant fiscal consolidation during an economic upturn. This also underscores the advantages of quickly making further advances on the structural front. The successes of the 1980s and 1990s—buttressed by synergies between fiscal discipline, structural reforms, and wage moderation that improved external competitiveness—amply demonstrate the benefits of strong policies and the ability of the Netherlands to deliver them.

30. **While the prospects for consumer spending are subject to uncertainty, fundamentals have improved in other respects.** Corporate balance sheets have strengthened, and profit margins have turned up. This augurs well for investment, as does favorable prospects for exports unless the recovery in trading partners falters or the euro appreciates significantly further. The recent moderation in wage increases has been helping to restore external competitiveness; such moderation must continue if exports are to be a sustained driver of growth.

31. **The authorities succeeded in reining in the fiscal deficit in 2004.** After unexpectedly breaching the Maastricht deficit ceiling in 2003, the 2004 deficit was reduced significantly thanks in large part to considerable expenditure restraint. This contributed to a structural narrowing of about 1¼ percentage points of GDP—an impressive accomplishment that brought the deficit to 2.3 percent of GDP. At the same time, unexpected windfalls from tax and gas revenues and social security spending were saved. This avoided the pitfalls of the past, when windfalls were used to fund structural expenditures, later compounding fiscal deterioration when the cycle turned around.

32. **Building on recent fiscal success, continued vigilance is needed in consolidating the public finances to ensure fiscal sustainability, and resilience to population aging—with significant benefits from early action.** With additional cumulative structural adjustment of ¾ percentage point of GDP for 2005–07, the authorities would meet the target recommended by staff of adjustment of at least ½ percentage point of GDP per year

structurally, on average, during the government's term. This would also be broadly consistent with the original intentions in the coalition agreement. Achieving this goal would provide further impetus for returning to a sustainable fiscal path in the face of an aging population. It would also help to build a buffer against unanticipated shocks and the continuing risks in containing health care costs. Indeed, with the benefit of hindsight, earlier fiscal problems reflected insufficient adjustment during an upturn. In this light, and with elections scheduled in 2007 and the need to bolster confidence, there is considerable merit to early action to secure the recommended adjustment and using any future windfalls for deficit reduction. In identifying measures, the authorities are encouraged to exploit synergies between fiscal consolidation and structural reforms that aim to raise employment rates and potential growth—for example by rationalizing and restraining unemployment benefits and rent subsidies.

33. **The Dutch medium-term framework has many favorable features—though some refinements would be helpful.** Multi-year real expenditure ceilings along with specified measures to achieve them provide a commendable anchor to the framework. In addition, the CPB, as an independent economic forecaster and evaluator of public sector policies, plays an important role in disciplining fiscal policy, including by ensuring that the government is not overly optimistic in its analysis and projections. While recent measures to improve coordination between various levels of government strengthen fiscal policy, such coordination should be made a more permanent feature of the fiscal framework. Moreover, enhancing the transparency and coverage of the expenditure ceilings would increase their accessibility and buttress the discipline in the system.

34. **Raising labor participation is a key element for enhancing potential growth and sustaining sound public finances as the population ages.** The visible positive effects of a tightening of the disability scheme are most welcome, and the reforms planned for January 2006 should aim for further significant progress. However, the possible increase in replacement rates may dampen progress, as would the elimination of experience-rated premiums in light of their documented success. Moreover, it remains crucial that the stringent gate-keeper and assessment processes not be relaxed. While the removal of fiscal incentives for early retirement is also a positive step, care is needed to avoid offsetting actions. In this context, the impact of the new "life-course scheme" on participation is uncertain. Careful monitoring will be essential to ensure that it is not solely used as a route into early retirement. In addition to dealing with various inactivity traps and taking into account changes in life expectancy in determining the official retirement age, it is especially important to significantly reduce the generosity of unemployment benefits. This would help avoid shifts from one category of inactivity to another. To serve their purpose from the standpoint of job search, a duration much shorter than three years is appropriate. As the transfer of responsibility for social assistance to municipalities shows, improving incentives can quickly lead to significant reductions in benefit dependency and fiscal outlays.

35. **Raising productivity growth is another key element, so structural reforms will need to go beyond raising participation.** One aim is to facilitate a smoother reallocation of labor. While an important goal on the authorities' agenda is to improve innovation, the

agenda could usefully include an assessment of employment protection legislation. It acts as a tax on new hiring and can stand in the way of the reallocation process and therefore productivity raising entrepreneurial activity. Greater wage differentiation would be helpful in attracting labor to higher productivity companies and sectors, while strengthening the incentives for human capital investment. In other areas, the government's commitment to reduce the administrative burden by one-quarter is welcome. Although the Netherlands has made significant progress in improving the functioning of product markets, the benefits have not yet reached all sectors, particularly those where competition has been weak. Against this background, the powers of the competition authority should be reinforced.

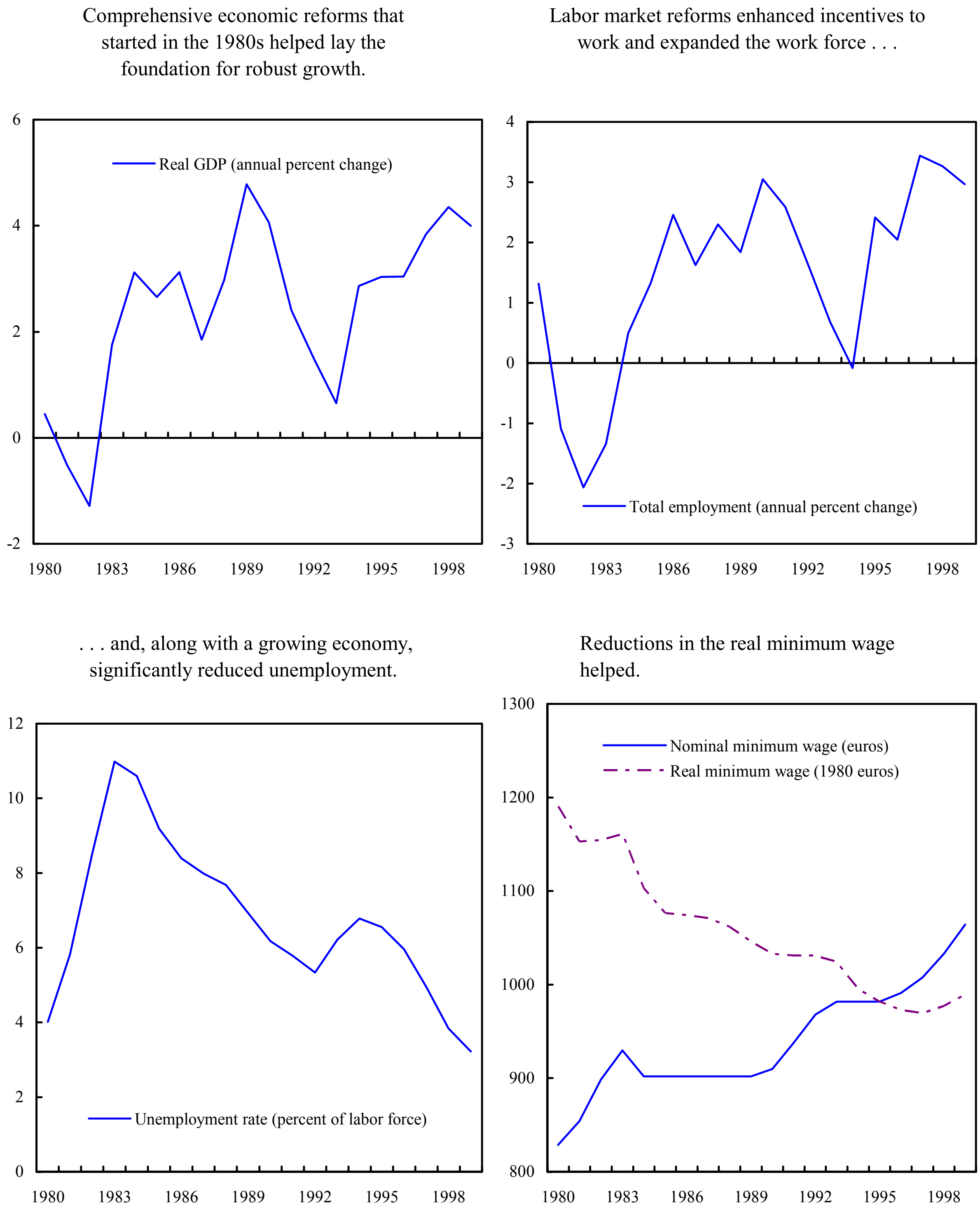
36. **The financial sector is in good shape.** Supervisors and policymakers will, nevertheless, need to monitor the risks associated with the current low-yield environment, especially if prolonged, and with the possibility of falling house prices. Fortunately, stress tests under last year's FSSA have demonstrated the resiliency of the financial system. In addition, the authorities' responsiveness to the FSSA's recommendations demonstrates their resolve to preserving financial stability over time. The macroeconomic implications of changes in pension contributions will be important in deciding on the time path for meeting new solvency requirements for pension funds.

37. **While data are adequate for surveillance, the impact of institutional changes on upcoming data will be quite visible.** These changes in the economic data must be effectively communicated to avoid misunderstandings, making it clear, for example, that overall GDP growth will not be affected.

38. **The authorities' enthusiastic support of overseas development assistance is commendable.** They have continued to exceed the United Nation's ODA target, even in the face of budgetary pressures.

39. It is recommended that the next Article IV consultation with the Netherlands remain on the 12-month cycle.

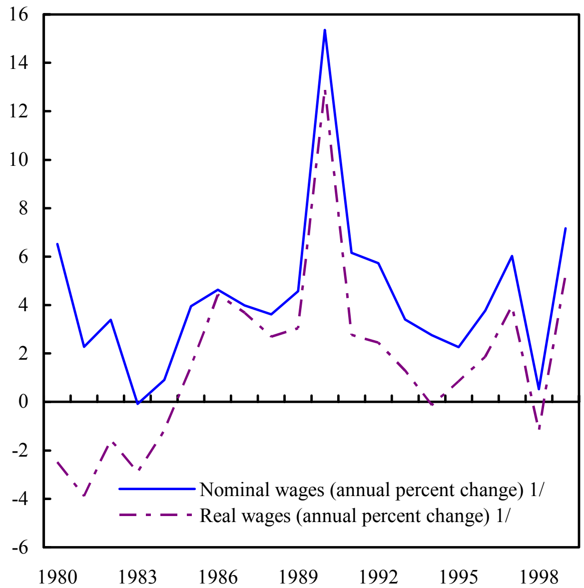
Figure 1. Netherlands: The Successes of the 1980s and 1990s



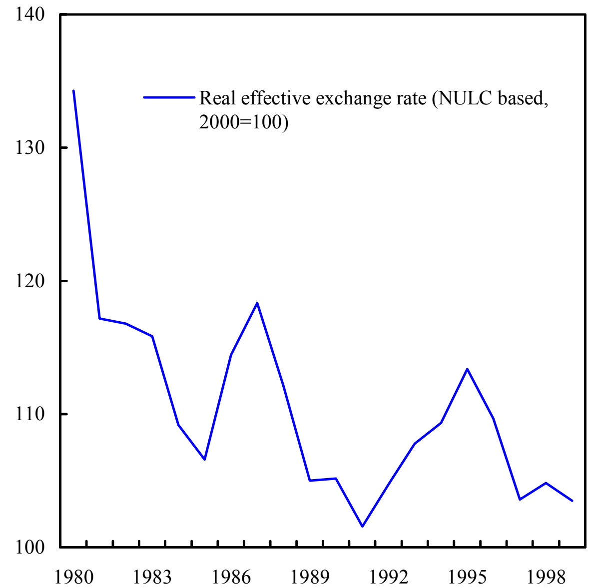
Source: IMF, WEO.

Figure 1. Netherlands: The Successes of the 1980s and 1990s (concluded)

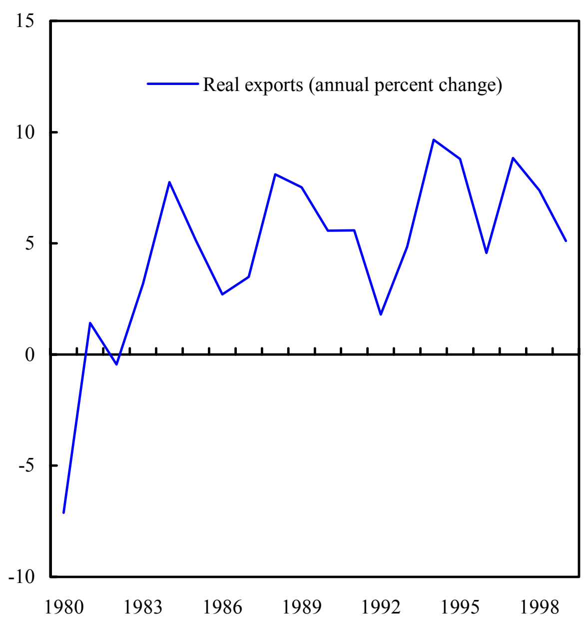
Cuts in taxes and contributions, made possible by tight public expenditure control, also supported wage moderation, ...



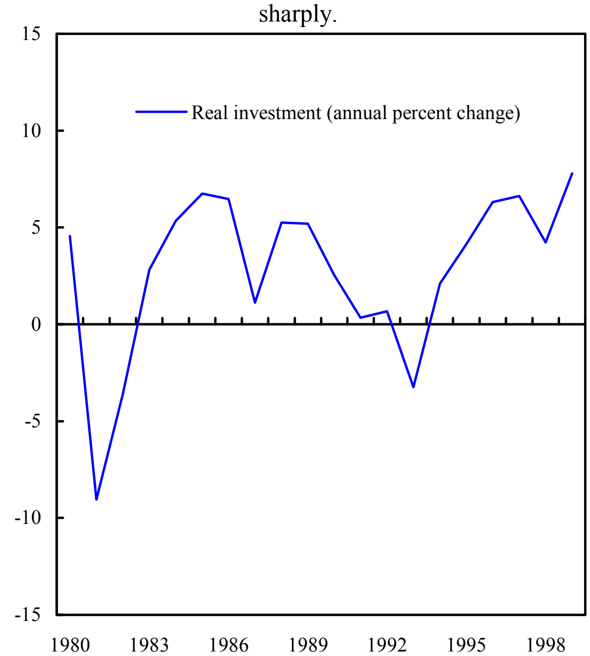
. . . which buttressed external competitiveness . . .



. . . and contributed to buoyant export growth, . . .



. . . while capital spending expanded sharply.

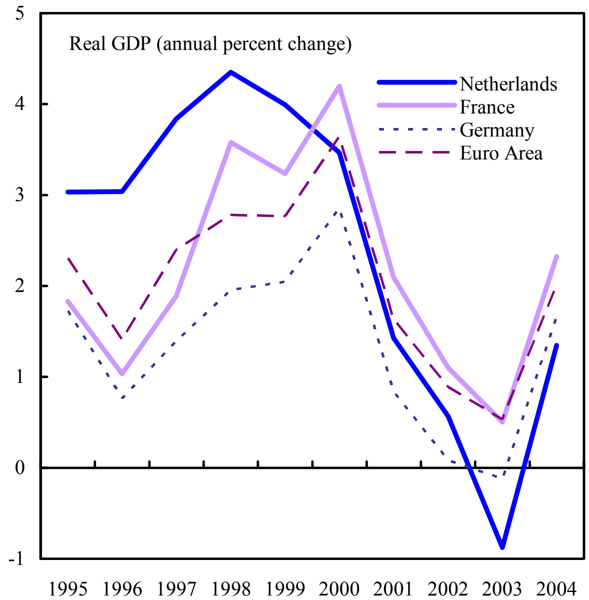


Source: IMF, WEO.

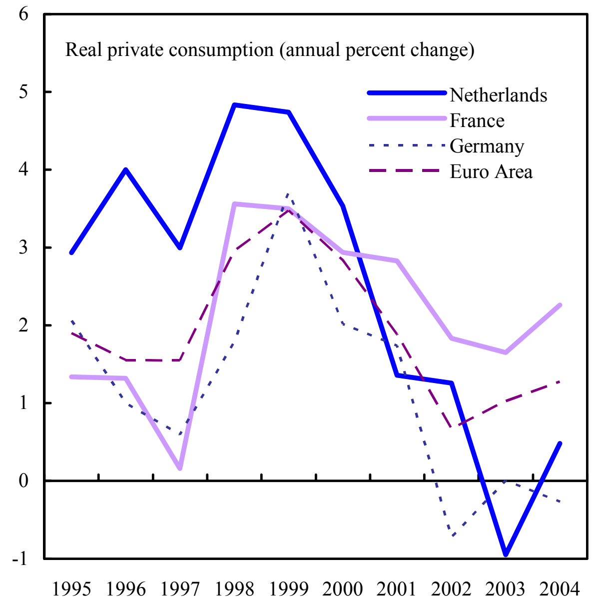
1/ Gross wages spiked in 1990 mainly due to a shift in social security contributions from employers to employees in the context of an overhaul of the tax system. This did not affect either net wages of workers or total wage costs to employers.

Figure 2. Netherlands: Recent Economic Developments

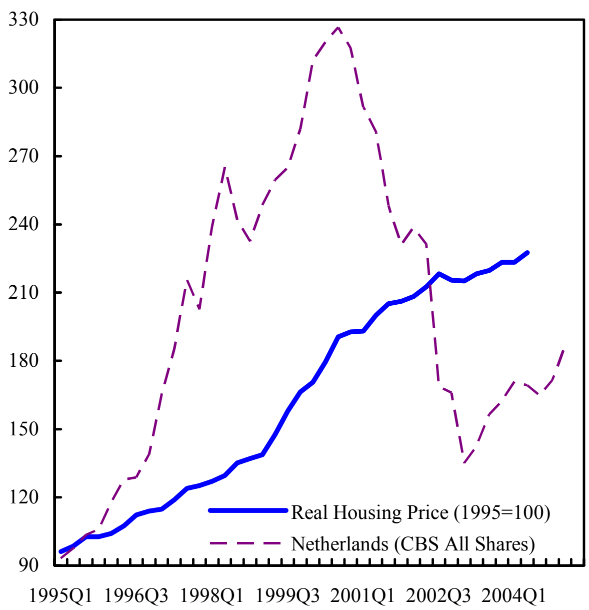
While a posterchild in the late 1980s and 1990s, the Dutch economy has performed relatively poorly since 2000.



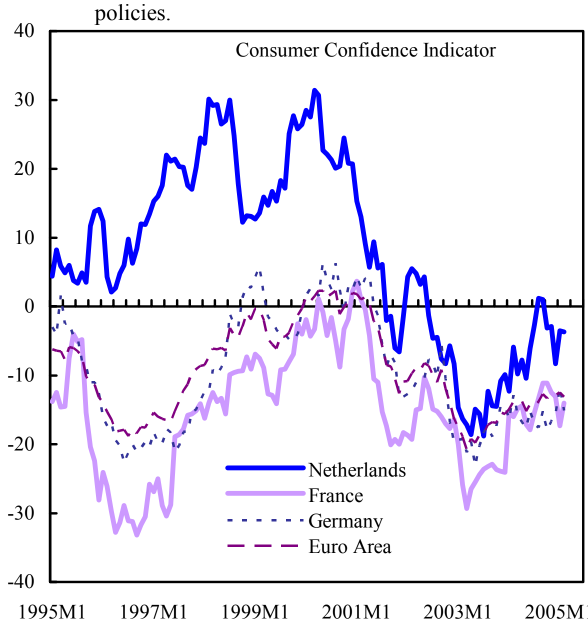
The main reason is weak private consumption, reflecting most recently modest growth of wages and social security benefits.



The collapse of equity prices early in the new century and slowdown in house price increases contributed. . .

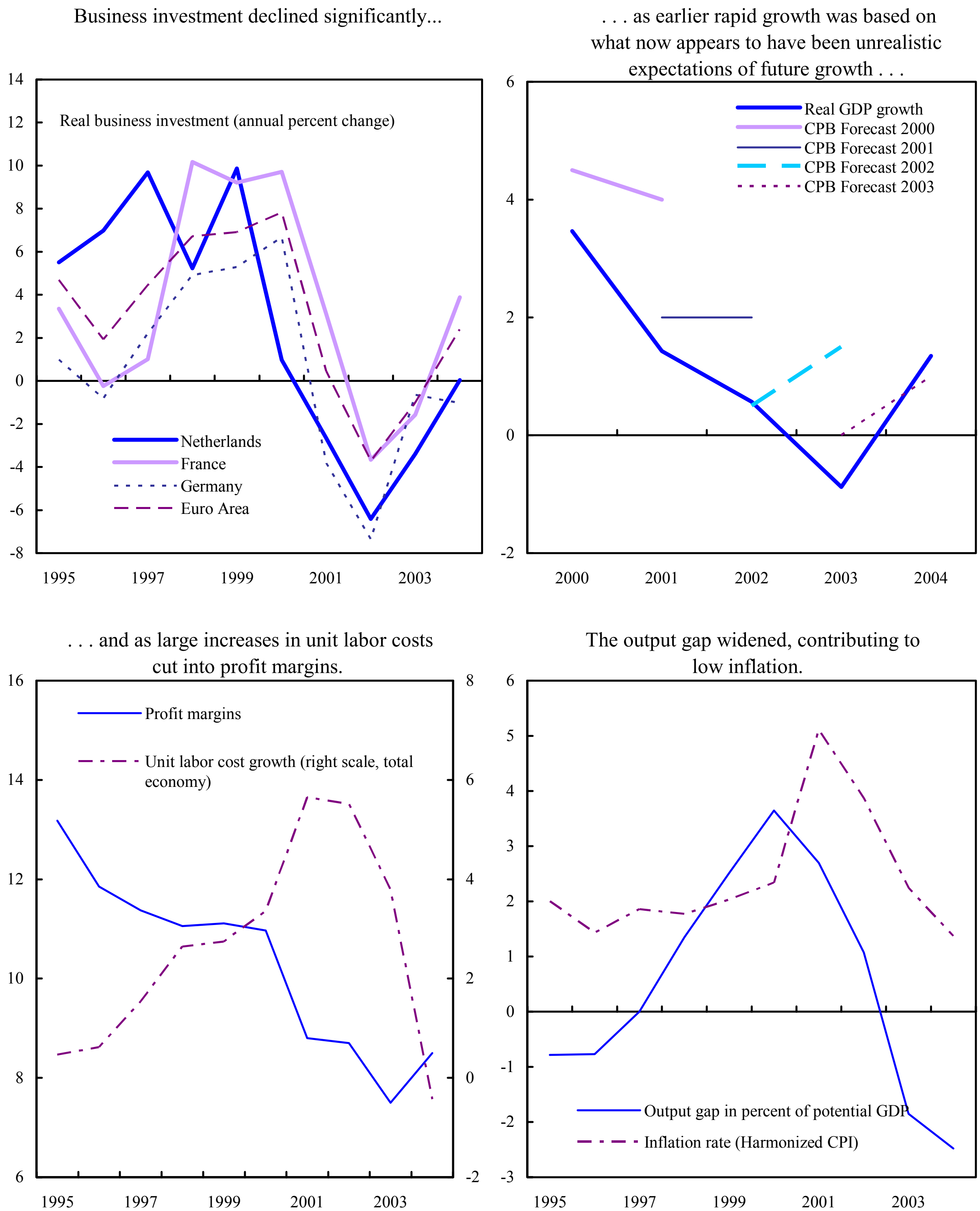


...as did an erosion of consumer confidence, which was also affected by rising unemployment and uncertainty about pensions and other policies.



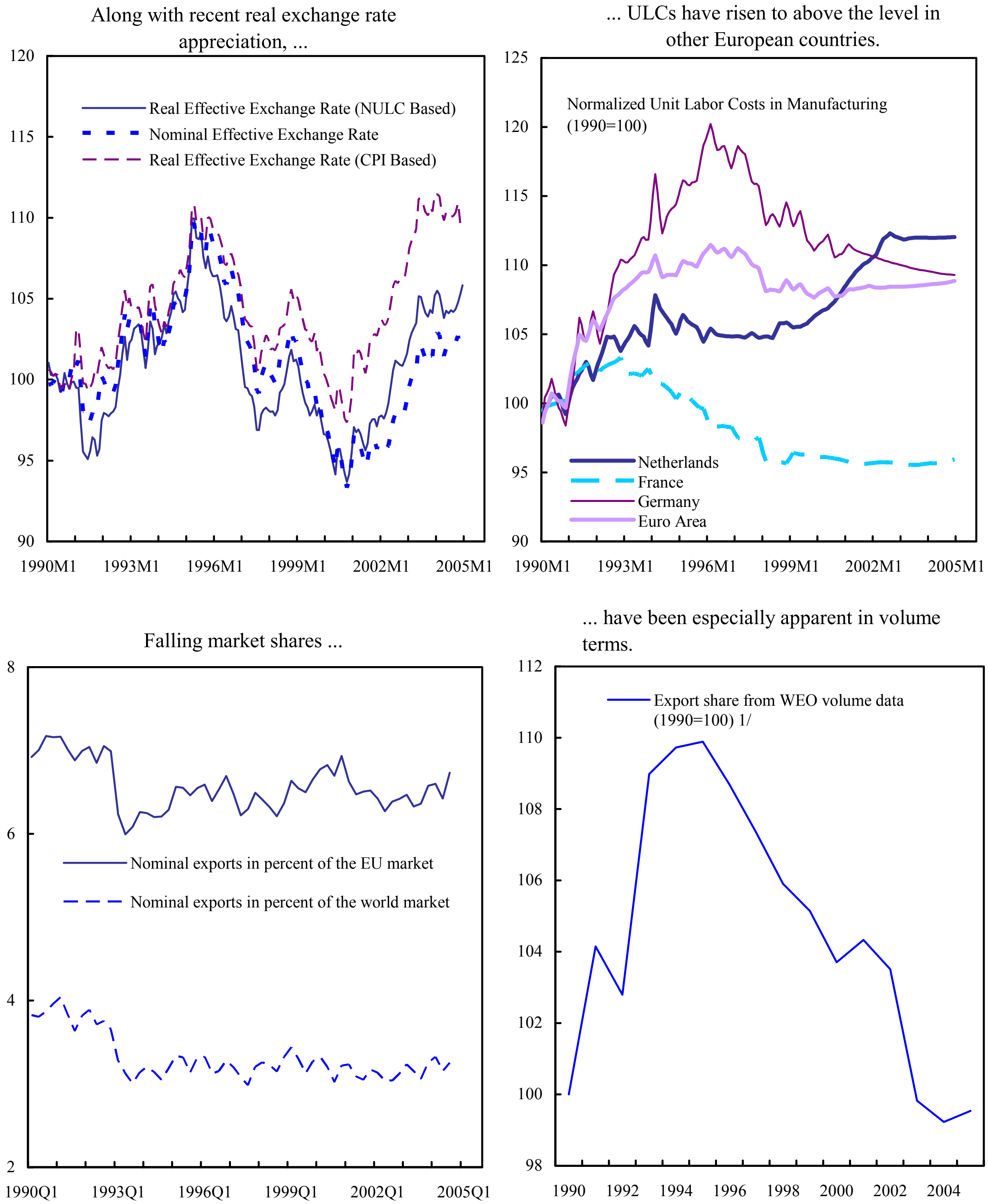
Sources: WEFA; Dutch authorities; and IMF, *IFS* and WEO.

Figure 2. Netherlands: Recent Economic Developments (concluded)



Sources: WEFA; Dutch authorities; and IMF, *IFS* and WEO.

Figure 3. Netherlands: Competitiveness Indicators

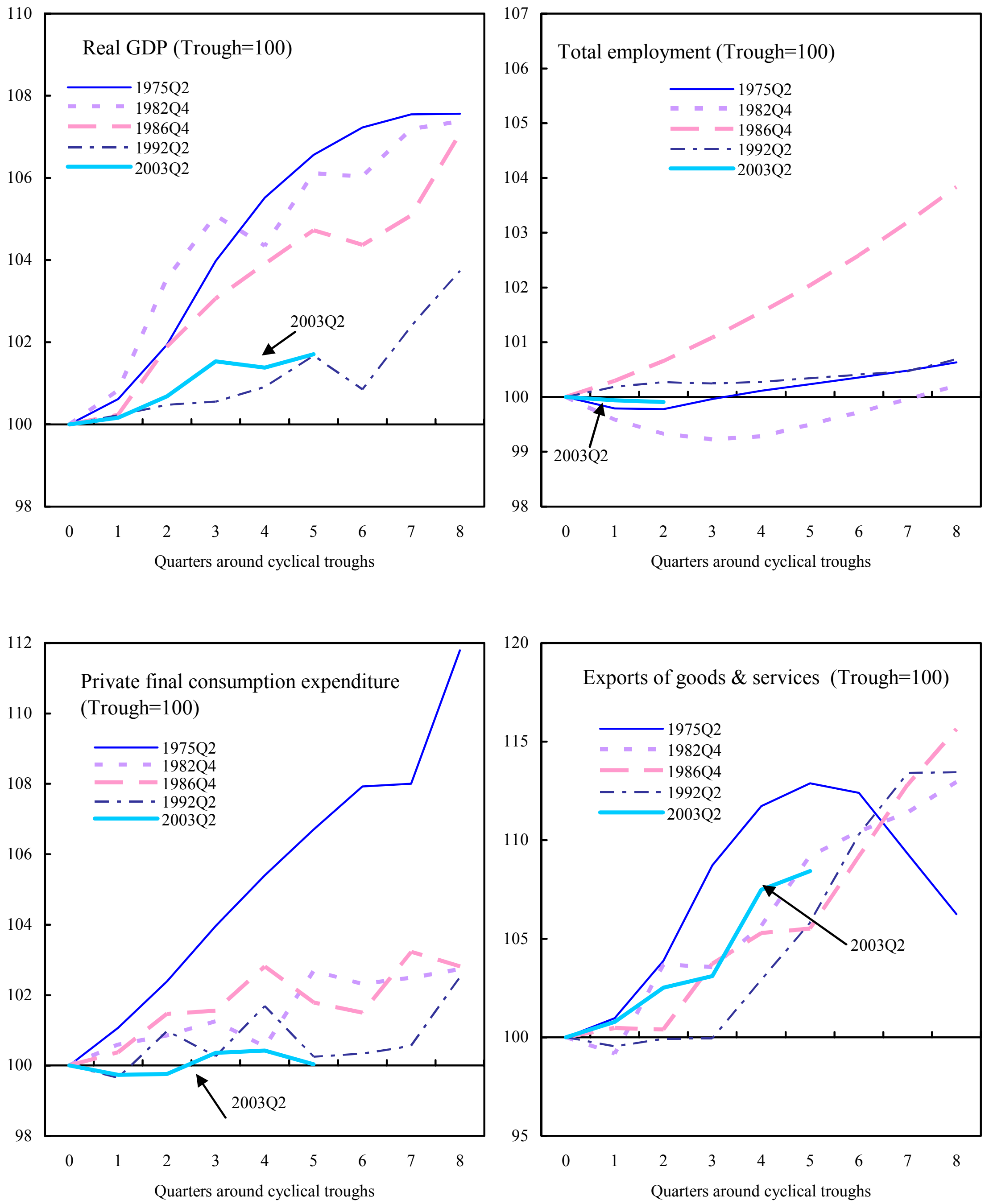


Sources: CPB; and IMF, INS, DOT, and WEO.

1/ As derived from the real growth of exports and the growth of import demand in partner countries.

Figure 4. Netherlands: Cyclical Comparisons (Dates indicate cyclical troughs for GDP) 1/

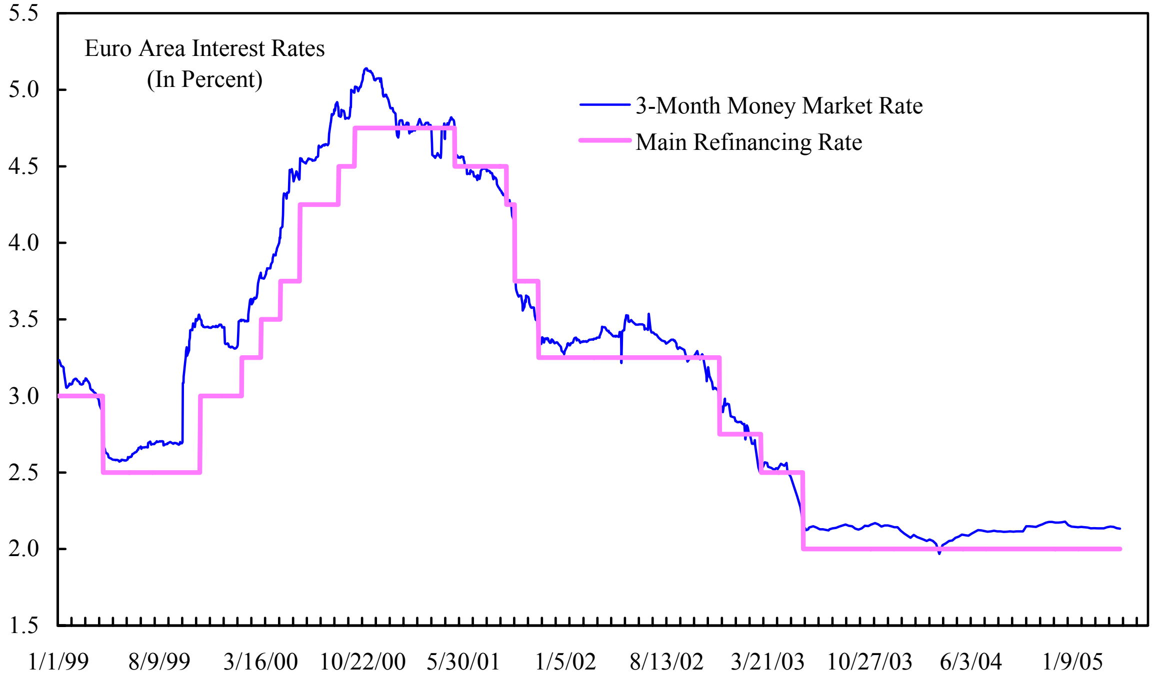
A strong recovery is not yet firmly established: output, employment, and consumption are especially weak compared to their position during previous expansions.

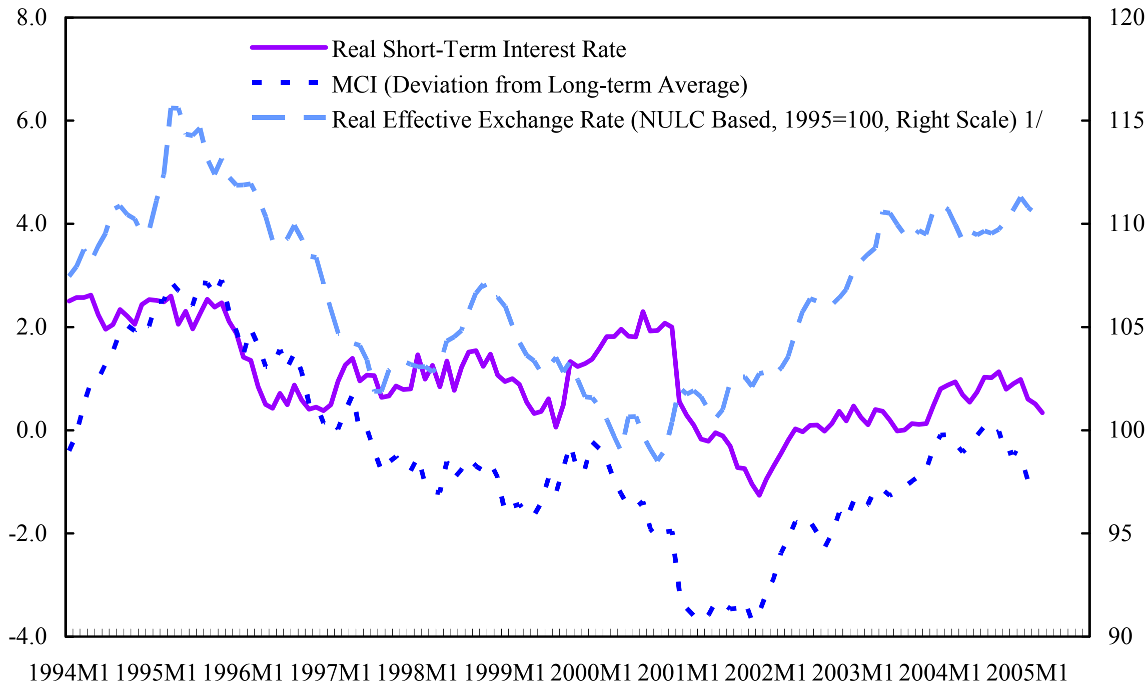


1/ Troughs were indentified using the methodology of Harding and Pagan (2002), "Dissecting the Cycle: A Methodological Investigation," *Journal of Monetary Economics* .

Figure 5. Netherlands: Monetary Conditions

The tightening of monetary conditions after 2000 initially reflected the impact of a lowering of inflation on real interest rates and subsequently an appreciating euro.

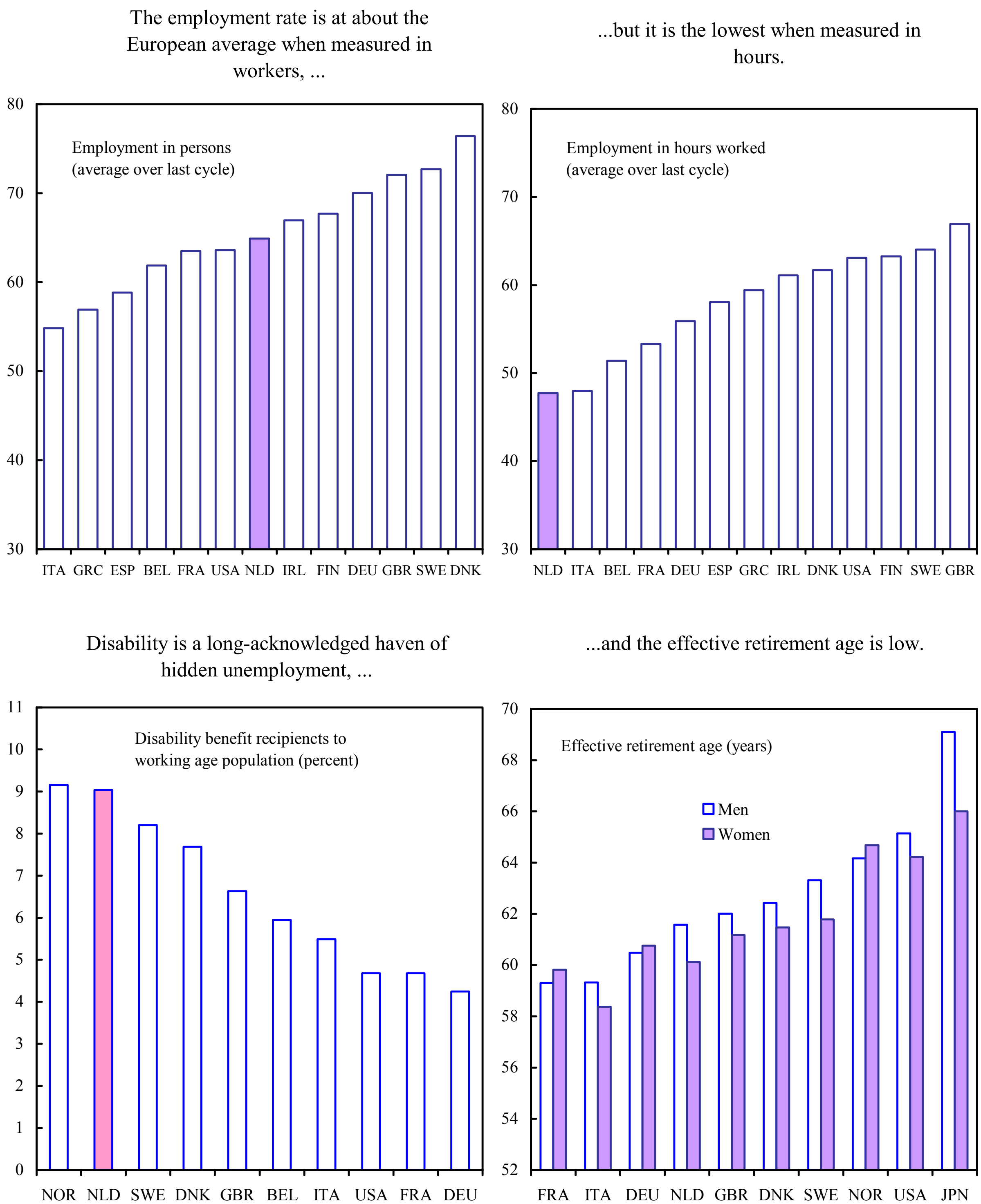




Source: IMF, *IFS* .

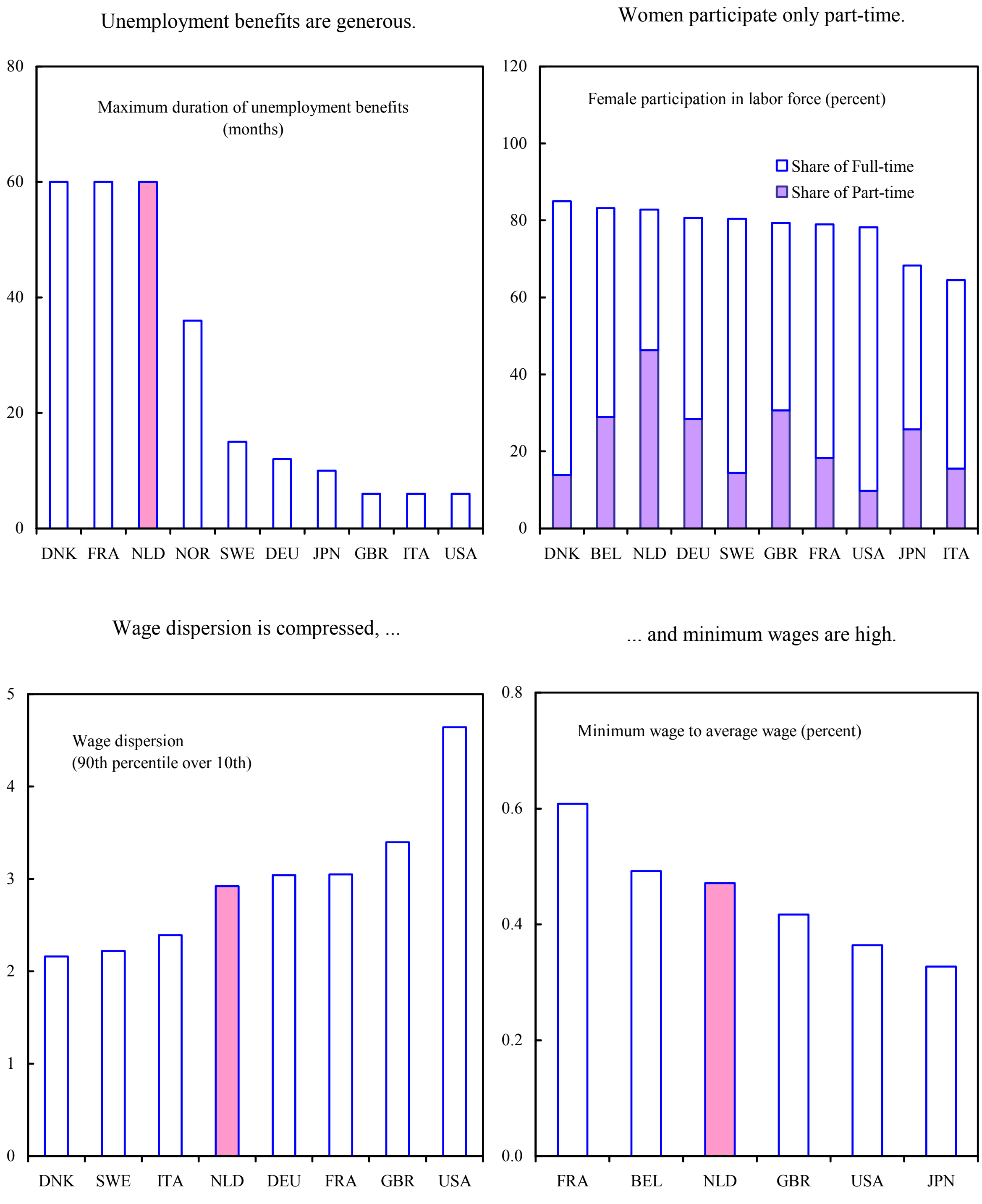
1/ An increase implies less accommodative conditions.

Figure 6. Netherlands: Labor Market Indicators



Source: OECD.

Figure 6. Netherlands: Labor Market Indicators (concluded)



Source: OECD.

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 2003	(In billions of euros)	(In percent of GDP)
Private consumption	224.3	49.4
Public consumption	115.3	25.4
Gross fixed investment	91.6	20.2
Stockbuilding	0.1	0.0
Exports of goods and nonfactor services	279.4	61.5
Imports of goods and nonfactor services	256.6	56.5
GDP	454.3	100.0

				Est.	Proj.	Proj. 1/	Proj.
	2001	2002	2003	2004	2005	2006	2007
	(Annual percentage change; unless otherwise indicated)						
National accounts (constant prices)							
Private consumption	1.4	1.3	-0.9	0.3	0.3	-2.2 1/	2.7
Public consumption	4.8	3.6	1.8	-0.2	0.9	8.2 1/	1.6
Gross fixed investment	0.2	-3.6	-3.1	2.5	2.7	3.5	3.4
Total domestic demand	1.8	0.5	-0.5	0.5	0.7	1.7	2.6
Exports of goods and nonfactor services	1.6	0.8	--	8.3	6.5	6.4	5.9
Imports of goods and nonfactor services	2.2	0.8	0.6	7.5	6.1	6.1	5.9
Net foreign balance 2/	-0.3	0.1	-0.4	0.9	0.7	0.7	0.4
Gross domestic product	1.4	0.6	-0.9	1.4	1.3	2.2	2.9
Output gap (in percent of potential output)	2.7	1.1	-1.9	-2.4	-3.0	-2.8	-2.0
Prices, wages, and employment							
Consumer price index (HICP)	5.1	3.9	2.2	1.4	1.4	-2.9 1/	1.8
GDP deflator	5.2	3.1	3.0	1.0	1.4	1.4	1.8
Hourly compensation (manufacturing)	4.2	3.7	2.6	1.7	0.5	2.0	2.3
Unit labor costs (manufacturing)	5.0	2.8	3.0	-0.6	-0.3	1.0	1.0
Employment	2.1	1.1	-0.6	-1.2	0.6	1.2	1.6
Unemployment rate (in percent)	2.0	2.3	3.5	5.0	5.7	5.5	5.0
NAIRU	3.2	2.6	3.0	3.7	4.4	4.4	4.3
Personal sector							
Real disposable income	3.9	0.7	-0.6	0.2	0.5	-1.3 1/	2.5
Household savings ratio 3/	9.7	10.2	10.3	10.2	10.4	11.3	11.2
External trade							
Exports of goods, volume	0.8	-0.5	1.6	6.0	6.2	6.1	5.8
Imports of goods, volume	1.2	0.2	1.3	5.1	5.5	5.9	5.9
Terms of trade	1.2	0.0	0.9	-0.7	0.9	0.1	0.4
Merchandise balance (percent of GDP)	5.0	4.4	4.9	5.1	6.0	6.4	6.6
Current account balance (percent of GDP)	2.5	3.1	2.9	3.5	4.2	4.6	4.9
Public sector accounts (percent of GDP)							
Revenue	46.6	45.9	45.8	46.1	46.0	47.9 1/	47.9
Expenditure	46.7	47.8	49.0	48.3	48.1	49.8 1/	49.6
General government balance	-0.1	-1.9	-3.2	-2.3	-2.1	-1.9	-1.7
Structural balance 4/	-1.1	-2.5	-2.4	-1.1	-0.6	-0.5	-0.7
Primary balance	2.6	0.5	-0.9	0.2	0.3	0.6	0.7
Structural primary balance 4/	1.7	--	--	1.3	1.7	1.9	1.7
General government gross debt	52.9	52.6	54.3	55.4	58.0	58.2	58.4

Sources: Dutch official publications; IMF, IFS; and IMF staff estimates.

1/ The introduction of the new health insurance scheme in 2006 will cause a significant shift in health care expenditure from private to public consumption, thereby lowering private and raising public consumption growth without changing overall GDP. In a related vein, government revenues will rise and private disposable income fall, without affecting the financial position of the public sector or households net terms. This is because public expenditure for health care also rises, while the fall in private disposable income is offset by a similar fall in private health consumption, which is now taken care of in the public domain. In addition, the shift will lower HICP inflation, but only in 2006, as private health expenditures drop out of the consumption basket; otherwise inflation would be positive.

2/ Contribution to GDP growth.

3/ In percent of disposable income.

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

Table 2. General Government Accounts

(In percent of GDP)

	1999	2000	2001	2002	2003	2004	2005 1/	2006 1/ 2/
Revenues	47.6	47.5	46.6	45.9	45.8	46.1	46.0	47.9
Tax revenues and social security contributions	40.7	40.6	39.1	38.8	38.7	38.8	38.9	40.9
Tax revenues	24.7	24.6	24.9	25.0	24.2	...	...	...
Social security contributions	16.0	16.0	14.3	13.9	14.5	...	...	...
Nontax revenues	6.9	6.9	7.4	7.1	7.1	...	...	...
Expenditure	46.9	45.3	46.7	47.8	49.0	48.3	48.1	49.8
Social security and social assistance benefits	18.5	17.9	18.0	18.8	19.8	...	...	...
Social security	14.8	14.5	14.6	15.4	16.3	...	...	...
Social assistance	3.6	3.4	3.4	3.4	3.5	...	...	...
Subsidies and other current transfers	3.0	3.2	3.2	3.3	3.2	...	...	...
Other current spending	1.3	1.2	1.2	1.2	1.2	...	...	...
Other taxes on production	0.1	0.1	0.1	0.1	0.1	...	...	...
Unfunded employee social benefits	1.1	1.1	1.1	1.1	1.1	...	...	...
Capital formation (gross)	3.0	3.1	3.3	3.6	3.6	...	...	...
Capital transfers	0.6	0.6	0.8	0.5	0.6	...	...	...
Net acquisitions of nonfinancial assets	-0.4	-0.9	-0.2	0.0	0.0	...	...	...
Consumption								
Compensation of employees	10.2	10.0	10.1	10.5	10.8	...	...	...
Intermediate consumption	6.4	6.3	6.8	6.9	7.0	...	...	...
Property income	4.5	3.8	3.4	3.1	2.9	...	...	...
Unemployment insurance	1.0	0.8	0.8	0.9	...	...	...	...
Welfare	1.1	1.0	0.9	0.9	0.9	...	...	...
Defense spending	1.6	1.6	1.6	1.5	1.5	...	...	...
Fiscal balance 3/	0.7	2.2	-0.1	-1.9	-3.2	-2.3	-2.1	-1.9
Interest receipts	0.7	0.7	0.7	0.6	0.6	...	...	...
Interest payments	4.5	3.8	3.4	3.1	2.9	...	...	...
Net interest payments	3.8	3.1	2.7	2.5	2.4	...	...	...
Memorandum items:								
Primary balance	4.5	5.3	2.6	0.5	-0.9	0.2	0.3	0.6
Structural balance (in percent of GDP) 4/ 5/	-0.7	-0.2	-1.1	-2.5	-2.4	-1.1	-0.6	-0.5
Nominal expenditure growth (in percent) 5/	5.0	5.4	7.6	7.0	4.5	1.4	2.0	7.3 6/
Real expenditure growth (in percent) 5/	3.4	1.4	2.2	3.8	1.5	0.4	0.6	5.8 6/

Sources: National accounts; ministry of finance; CPB; and IMF staff calculations.

1/ Projections.

2/ The introduction of the new health care system in 2006 will have an upward effect on both expenditures and revenues, with no effect on the overall balance.

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/ The calculation of the structural balance is based on the standard methodology, which uses fixed elasticities with respect to GDP. Biases can occur, in particular in the context of asset price boom and busts (as discussed for the Netherlands in IMF Country Report 05/301), but also when the components of GDP move differently than the overall aggregate.

5/ 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).

6/ The increase in expenditure growth in 2006 largely reflects the introduction of the new health care system, as in footnote 2.

Table 3. Netherlands: Financial Sector Indicators

Indicator	1998	1999	2000	2001	2002	2003	2004
Deposit-taking institutions 1/							
Regulatory capital to risk-weighted assets	0.11	0.11	0.11	0.11	0.12	0.12	0.12
Regulatory Tier I capital to risk-weighted assets	0.09	0.09	0.09	0.09	0.09	0.10	0.10
Nonperforming loans net of provisions to capital 2/	0.30	0.32	0.31	0.31	0.31	0.24	...
Nonperforming loans to total gross loans 2/	0.03	0.02	0.02	0.02	0.02	0.02	...
Sectoral distribution of loans to total loans							
Households	0.50	0.51	0.50	0.51	0.51	0.50	0.50
Nonfinancial companies	0.38	0.36	0.36	0.34	0.33	0.32	0.30
Insurance companies and pension funds	0.01	0.01	0.01	0.02	0.01	0.01	0.02
Other financial institutions	0.11	0.12	0.13	0.13	0.15	0.17	0.19
Total	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Return on assets (percent)	0.44	0.57	0.60	0.42	0.35	0.46	0.54
Return on equity (percent)	10.89	14.29	14.74	10.76	9.17	12.27	13.81
Interest margin to gross income	0.60	0.57	0.52	0.56	0.60	0.61	0.58
Noninterest expenses to gross income	0.79	0.74	0.73	0.79	0.82	0.75	0.71
Net open position in foreign exchange to capital	0.08	0.09	0.06	0.05	0.04	0.06	0.04

1/ These may be grouped in different peer groups based on control, business lines, or group structure.

2/ Three largest banks.

Netherlands: Fund Relations
As of March 31, 2005

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	3,692.07	71.52
Reserve position in Fund	1,470.33	28.48

III. **SDR Department**	SDR Million	Percent of Allocation
Net cumulative allocation	530.34	100.00
Holdings	503.29	94.90

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

V. **Latest Financial Arrangements**: None

VI. **Projected Obligations to Fund** (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal					
Charges/interest	0.52	0.71	0.71	0.71	0.71
Total	0.52	0.71	0.71	0.71	0.71

VII. **Exchange Rate Arrangements**:

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

VIII. **Article IV Consultation**:

Discussions for the 2004 Article IV Consultation were held in Amsterdam and The Hague from May 27–June 7, 2004. The staff report for the 2004 Article IV Consultation (IMF Country Report 04/300) was considered by the Executive Board on September 8, 2004. The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle.

IX. **Exchange Restrictions**:

In compliance with the relevant UN Security Council Resolutions and/or EU regulations, the Netherlands maintains exchange restrictions vis-à-vis the former government of Iraq; Somalia; Libya; specific persons and entities of Myanmar and Zimbabwe; specific individuals associated with the previous government of the former Republic of Yugoslavia; and certain persons and entities with a view to combating terrorism; Osama Bin Laden, the Al-Qaeda network, and the Taliban. These restrictions are solely for the preservation of national or international security and have been notified to the Fund in accordance with EBD No. 144-(52/51).

The 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.

As a one-off matter, a number of upcoming institutional reforms is expected to have a significant impact on national accounts and other data in 2006. Most importantly, the envisaged reform of health care insurance will cause a significant reclassification of private consumption into public consumption. This shift will have a big impact on the growth rates of the components concerned, but overall GDP will not be affected. In the same vein, the removal of health care purchases from the private consumption basket will also have a large negative fall on harmonized inflation in 2006.

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: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(as of May 9, 2005)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	05/06/05	05/09/05	Daily	Daily	Daily
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/05	4/21/05	Monthly	Monthly	Monthly
Reserve/Base Money[2]	03/05	4/14/05	Monthly	Monthly	Monthly
Broad Money[2]	03/05	4/27/05	Monthly	Monthly	Monthly
Central Bank Balance Sheet	03/05	4/14/05	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	03/05	4/27/04	Monthly	Monthly	Monthly
Interest Rates[3]	05/06/05	5/09/05	Daily	Daily	Daily
Consumer Price Index	03/05	4/07/05	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	03/05	04/29/05	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	03/05	4/29/05	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt	Q1 2005	4/15/04	Quarterly	Quarterly	Quarterly
External Current Account Balance	Q4 2004	2/14/05	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q4 2004	2/14/05	Quarterly	Quarterly	Quarterly
GDP/GNP	Q4 2004	2/14/05	Quarterly	Quarterly	Quarterly
Gross External Debt[6]	Q4 2004	3/31/05	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Pertains to contribution to EMU aggregates.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.

Netherlands: Fiscal Sustainability

Like other advanced countries, the Netherlands will face an aging-related increase in fiscal pressures over the next decades, while potential output growth slows. The CPB has estimated that the gross fiscal cost of aging would amount to about 7 percentage points of GDP between 2000–50.[22] Some 4 percentage points would be offset by the taxation of pension income,[23] leaving a net cost of about 3 percentage points of GDP. To take stock of needed fiscal adjustment, three scenarios are presented.

For illustrative purposes, **Scenario A** shows the dynamics if no further adjustment were achieved beyond 2007. Clearly, this is unrealistic, but it gives an indication of the problems if policy were passive. Doing nothing after 2007—i.e., allowing nonaging expenditures to rise with GDP while aging-related costs rise—would result in unsustainable debt dynamics and in triple-digit debt levels after 2030.

Scenario B presents a sustainable scenario using the CPB's growth assumptions (i.e., potential GDP growth declining gradually to about 1.5 percent by 2030 as the labor supply falls, then rising to 1.8 percent by 2050). Under these assumptions, achieving a surplus of about 1 percent of GDP by 2009 (implying structural adjustment of almost 2½ percentage points of GDP during 2005–09) would result in a sustainable path. In this scenario, government debt would be reduced from its current level of about 56 percent of GDP to about 25 percent.

However, the favorable growth assumptions of Scenario B cannot be taken for granted. They are based on an assumed increase in the participation rate by 5 percentage points between 2000–20 and on an average annual rate of productivity growth of 1¾ percent, which is high in comparison to recent trends. This underscores the need for structural reforms that ensure that favorable future growth performance materializes. Otherwise, growth could turn out lower, in which case more fiscal adjustment would be needed to achieve sustainability. **Scenario C** illustrates the point, assuming ¼ percentage point lower average annual GDP growth than in the previous scenario. This case implies a surplus of 1.5 percent of GDP in 2009 to stabilize the debt, albeit at a low level.

The standard debt sustainability analysis template is attached to this Appendix.

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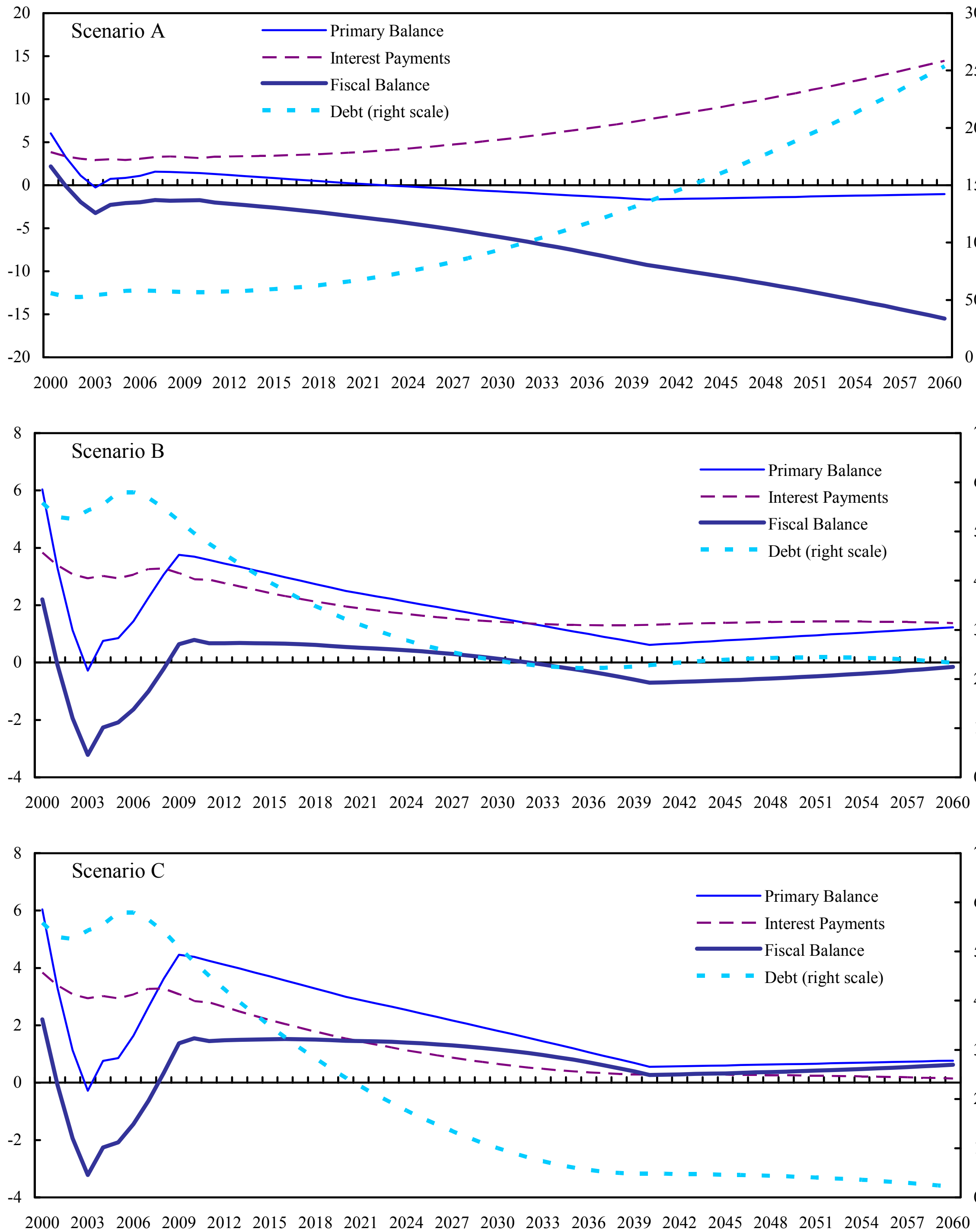
[22] Assumes that new medical techniques and above-average price increases in the health care sector have a significant effect on raising aging-related expenditure.

[23] The CPB calculated that revenues from the taxation of pensions would rise in line with the expected increase in the number of pensioners. Meanwhile, taking into account the expected increase in the population, the ratio of taxable labor income to GDP would fall only slightly, so the overall revenue ratio would rise.

Netherlands: Fiscal Scenarios, 2000-60
(In percent of GDP)



Source: IMF staff calculations.

The Netherlands: Public Sector Debt Sustainability Framework, 1999-2009

(In percent of GDP; unless otherwise indicated)

	Actual							Projections						
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010	
								I. Baseline Projections						**Debt-stabilizing primary balance 10/**
1 **Public sector debt 1/**	55.9	52.9	52.6	54.3	55.4			**58.0**	**58.2**	**58.4**	**57.1**	**55.8**	**54.8**	**-0.5**
Of which: 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	
2 Change in public sector debt	-7.2	-3.0	-0.3	1.7	1.2			2.6	0.2	0.3	-1.4	-1.3	-1.0	
3 Identified debt-creating flows (4+7+12)	-6.7	-3.6	0.1	1.8	0.6			0.3	-0.5	-1.3	-1.7	-1.5	-1.2	
4 Primary deficit	-5.3	-2.6	-0.5	0.9	-0.2			-0.3	-0.6	-0.7	-1.1	-1.3	-0.7	
5 Revenue and grants	47.5	46.6	45.9	45.8	46.1			46.0	47.9	47.9	47.9	47.8	48.0	
6 Primary (noninterest) expenditure	42.2	44.0	45.4	46.6	45.9			45.7	47.3	47.2	46.8	46.6	47.2	
7 Automatic debt dynamics 2/	-1.3	-0.9	0.6	1.3	1.2			0.9	0.4	-0.2	-0.3	0.0	-0.2	
8 Contribution from interest rate/growth differential 3/	-1.3	-0.9	0.6	1.3	1.2			0.9	0.4	-0.2	-0.3	0.0	-0.2	
9 *Of which:* contribution from real interest rate	0.8	-0.1	0.9	0.8	1.9			1.6	1.7	1.4	1.3	1.4	1.1	
10 *Of which:* contribution from real GDP growth	-2.0	-0.7	-0.3	0.5	-0.8			-0.7	-1.3	-1.6	-1.6	-1.4	-1.4	
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0			...	...	...	...	...	...	
12 Other identified debt-creating flows	-0.1	-0.2	0.0	-0.4	-0.3			-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	
13 Privatization receipts (negative)	-0.1	-0.2	0.0	-0.4	-0.3			-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	
14 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	
15 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	
16 Residual, including asset changes (2-3) 5/	-0.5	0.7	-0.3	-0.1	0.6			2.3	0.7	1.5	0.3	0.3	0.3	
Public sector debt-to-revenue ratio 1/	117.6	113.6	114.7	118.6	120.4			126.0	121.3	121.9	119.2	116.7	114.3	
Gross financing need 6/	-2,194.1	97.3	1,953.5	3,225.9	2,272.6			2,093.6	1,876.8	1,701.5	1,402.8	1,202.7	1,357.2	
In billions of U.S. dollars	-8,155.9	374.0	8,213.0	16,571.5	13,153.4			13,162.4	12,229.5	11,608.4	10,039.3	8,989.6	10,580.5	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	3.5	1.4	0.6	-0.9	1.4	2.4	1.7	1.3	2.2	2.9	2.9	2.6	2.6	2.4
Average nominal interest rate on public debt (in percent) 7/	5.4	5.1	4.8	4.6	4.7	5.6	0.8	4.5	4.4	4.4	4.5	4.5	3.9	4.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.4	-0.1	1.7	1.6	3.6	3.1	1.8	3.0	3.0	2.5	2.5	2.6	2.2	2.6
Nominal appreciation (increase in US dollar value of local currency, in percent)	-13.4	-3.1	5.4	19.7	9.9	0.8	11.1	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	3.9	5.2	3.1	3.0	1.0	2.5	1.3	1.4	1.4	1.8	2.0	1.9	1.7	1.7
Growth of real primary spending (deflated by GDP deflator, in percent)	1.2	5.8	3.7	1.8	-0.2	1.7	2.4	1.0	5.9	2.6	2.0	2.1	4.0	2.9
Primary deficit	-5.3	-2.6	-0.5	0.9	-0.2	-2.2	2.1	-0.3	-0.6	-0.7	-1.1	-1.3	-0.7	-0.8
								II. Stress Tests for Public Debt Ratio						**Debt-stabilizing primary balance 10/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 8/								**58.0**	**56.5**	**55.9**	**54.0**	**52.2**	**50.3**	**0.1**
A2. No policy change (constant primary balance) in 2005-09								**58.0**	**58.4**	**59.1**	**58.5**	**58.1**	**57.6**	**-0.5**
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation								**58.0**	**58.2**	**58.4**	**57.1**	**55.8**	**54.8**	**-0.5**
A4. Selected variables are consistent with market forecast in 2005-09								**58.0**	**58.2**	**58.4**	**57.1**	**55.8**	**54.8**	**-0.5**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**58.0**	**60.3**	**63.0**	**61.6**	**60.4**	**59.4**	**-0.5**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**58.0**	**61.6**	**67.8**	**69.8**	**72.0**	**74.4**	**-0.6**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**58.0**	**60.7**	**63.6**	**62.2**	**60.9**	**59.9**	**-0.5**
B4. Combination of B1-B3 using one standard deviation shocks								**58.0**	**60.6**	**64.3**	**62.9**	**61.6**	**60.6**	**-0.5**
B5. One-time 30 percent real depreciation in 2005 9/								**58.0**	**58.2**	**58.4**	**57.1**	**55.8**	**54.8**	**-0.5**
B6. 10 percent of GDP increase in other debt-creating flows in 2005								**58.0**	**68.2**	**68.4**	**67.0**	**65.7**	**64.7**	**-0.5**

1/ Gross debt of the general government.

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 numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

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

7/ Derived as nominal interest expenditure divided by previous period debt stock.

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

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

10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year. In addition, this calculation does not take into account population aging and its impact on potential growth and public finances after 2010.

Statement by the IMF Staff Representative
June 29, 2005

1. This staff statement provides information on economic developments that has become available since the preparation of the staff report for the 2005 Article IV Consultation. The new information does not alter the thrust of the staff appraisal.

2. **On GDP data and projections:** Downside risks to the growth outlook appear to have materialized with much weaker-than-expected activity in the first quarter of 2005. Preliminary data for that quarter show that GDP fell by 0.1 percent (quarter-on-quarter), mainly reflecting a sharp fall in investment (of 3.1 percent, following a 4.7 percent rise in the fourth quarter of 2004) and a negative contribution of the foreign sector (with exports declining by more than imports). Meanwhile, private consumption remained lackluster.

The weak first quarter, combined with a markdown in export market growth, gives rise to a substantial revision of the staff forecast for 2005 and—to a lesser extent—2006. This is shown in the table below.

The revised forecast of the Dutch central bank (DNB), released on June 15, also reflects the weak first quarter (see table). The reduction in the DNB's growth projection for 2005 results especially from downward revisions of private consumption and net exports. For 2006, the revision predominantly reflects a more pessimistic view of private consumption than before.

Revised GDP Growth Projections
(in percent)

	2005	2006
Original staff projection	1.3	2.2
Revised staff projection	0.5	1.9
Original DNB projection	1.7	2.5
Revised DNB projection	0.4	1.8

3. **On structural reforms:** Parliamentary approval of further disability reforms is still pending. The plans that were discussed at the time of the mission may be amended, and implementation could be delayed beyond January 2006.

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

IMF Executive Board Concludes 2005 Article IV Consultation with the Kingdom of the Netherlands

On June 29, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands.[1]

Background

After a long period of comparatively strong economic performance, the Netherlands hit a difficult stretch going into the new millennium. Growth was relatively poor during 2000–03, turning negative in 2003 for the first time in 20 years. A weakening external environment contributed to the sharp slowdown of activity. On the side of domestic demand, wealth effects (associated with developments in equity and house prices) and changes in pension fund contributions (stemming from the exposure of these funds to equities) amplified the cycle.

Deteriorating external competitiveness has also been restraining export performance and overall growth. Wage pressures, reflecting tightness in the labor market that had built up in the second half of the 1990s, weakened external competitiveness. This was later compounded by an appreciation of the euro. The loss of competitiveness has not been especially apparent in aggregate, value-based, export market share data. However, falling market shares have strongly been in evidence in volume terms. More detailed analysis of sector trade shares has also raised warning flags about competitiveness.

[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.

The recovery has so far been weaker than during past upswings. Growth was significantly below potential in 2004. It is expected to remain that way this year, with large uncertainties over confidence and its effect on private consumption, which has been unusually lackluster. Disposable income and unemployment cannot fully explain the sharp fall in the growth of private consumption since 2000, and less tangible factors affecting confidence, in addition to wealth effects, have clearly been at play. Fundamentals have been showing improvement, however, and the expansion is expected to gather pace in 2006.

Inflation is now subdued, and there is little pressure from wages looking ahead. Wage growth was about 1½ percent in 2004, reflecting the two-year economy-wide wage moderation agreement of the social partners that aimed at improving competitiveness. The agreement allows for somewhat more discretion in 2005, but the strength of the euro, moderate pace of economic activity, and slack labor market conditions are expected to keep a lid on wage pressures.

After the public finances deteriorated markedly during 2000–03, there was a significant reversal in 2004. The general government balance worsened by almost 5½ percentage points of GDP during 2000–03 as a result of both cyclical and structural effects, the latter amounting to roughly 2 percentage points of GDP. While the 3 percent Maastricht deficit ceiling was unexpectedly breached in 2003, the deficit, primarily through expenditure restraint, was reduced to 2.3 percent of GDP in 2004.

In addition to the near-term outlook, the discussions focused on key measures to bolster confidence and enhance growth prospects while ensuring fiscal sustainability and resilience to population aging. In this context, restoring external competitiveness as an essential element of sustaining economic recovery was an important topic of the discussions. Measures to raise participation and productivity were also important topics. The authorities had implemented or were in the process of implementing key reforms, including by tightening disability and unemployment benefits and early retirement arrangements, lessening inactivity traps, enhancing competition, and reducing the administrative burden. Finally, the financial sector, including a follow-up of the recommendations made in the Fund's Financial Sector Stability Assessment of last year, was another key topic.

Executive Board Assessment

Executive Directors noted that the successes of the 1980s and 1990s—underpinned by synergies between fiscal discipline, structural reforms, and wage moderation—amply demonstrate the benefits of strong policies and the Netherlands' ability to deliver them. They were also encouraged by the improvement in some key economic fundamentals. However, Directors expressed concern that the recovery has so far failed to gather steam. In this regard, they noted that downside risks appear to be materializing, delaying the anticipated acceleration of Dutch economic growth.

Against this background, Directors agreed that the Netherlands' main challenge ahead is to support and sustain the economic recovery. In this regard, they stressed the need to restore external competitiveness after its deterioration in recent years so as to take full advantage of future export market growth. While commending the authorities' efforts to rein in the fiscal deficit and strengthen the structural underpinnings for growth, Directors emphasized the importance of sustaining efforts in these areas, with a view to boosting confidence and ensuring that the fiscal pressures of an aging population remain manageable.

Directors welcomed the positive underlying developments that should support recovery, noting in particular the strengthening of corporate balance sheets and turn-up in profit margins that should favor future investment. Directors also applauded the impact of the recent moderation in wage increases in helping to restore external competitiveness. They stressed, however, that such moderation needs to continue if exports are to be a sustained driver of growth.

Directors welcomed the authorities' commitment to fiscal consolidation, reflected in the quick response to bring the fiscal deficit back into line with the Maastricht criteria. They stressed that continued fiscal adjustment over the medium term will provide further impetus for returning to a sustainable fiscal path as the population aged, while also helping to build a buffer against unanticipated shocks and the continuing risks in containing health care costs. Directors attached particular importance to those fiscal consolidation measures that would help raise employment rates and potential growth, and thereby exploit synergies with structural reforms—for example, by rationalizing and restraining unemployment benefits and rent subsidies.
In addition, Directors supported the authorities' commitment to use any future windfalls for deficit and debt reduction. At the same time, Directors supported the full use of automatic stabilizers. While most Directors also emphasized that in the short run the need for fiscal tightening and reform should be balanced against the objective of strengthening the fragile cyclical upswing, they supported the authorities' choice to underpin confidence with strong fiscal consolidation and a well-sequenced structural reform program.

Directors lauded the many favorable features of the fiscal framework, including the use of multi-year expenditure ceilings as an anchor and the disciplining role of the Bureau for Economic Policy Analysis (CPB). However, they encouraged the authorities to enhance the transparency and coverage of the expenditure ceilings. While welcoming recent measures to improve coordination of policies at various levels of government, Directors also encouraged the authorities to make such coordination a permanent feature of the fiscal framework. Directors looked forward to the results of the forthcoming fiscal Reports on the Observance of the Standards and Codes.

Directors noted that raising labor participation is a key element for enhancing potential growth and sustaining sound public finances. Thus, they welcomed the many structural reforms the authorities have implemented or that are underway. These include tightening disability and unemployment benefits and early retirement arrangements, and lessening inactivity traps. Nevertheless, looking ahead, Directors cautioned against a potential weakening of disability reform and urged continued progress to deal with inactivity traps. They also noted that the shortening of the duration of unemployment benefits could be more ambitious.

Directors agreed that structural reforms should focus on raising productivity growth, in addition to boosting labor participation. They therefore supported the authorities' efforts to reduce the administrative burden on business and urged them to persevere with efforts to broaden competition, including by reinforcing the powers of the competition authority. Directors supported the authorities' objective of spurring greater innovation. In this latter context, with a view to facilitating more efficient resource allocation, they urged the authorities to review employment protection legislation, noting that overly stringent protection acts as an implicit tax on new hiring and can stand in the way of productivity raising entrepreneurial activity. Directors also urged greater wage differentiation, with a view to attracting labor to higher productivity companies and sectors and to strengthen the incentives for human capital investment.

Directors noted that the financial system appears to remain sound, resilient to potential adverse shocks, and well supervised. They welcomed the authorities' responsiveness to the recommendations made last year in the Financial System Stability Assessment, which demonstrates the authorities' resolve to preserve financial stability over time. They encouraged the authorities to monitor closely the risks associated with a possibly prolonged low-yield environment, the increase in household indebtedness, and the possibility of a decline in house prices. Directors also welcomed the authorities' efforts to strengthen cross-border financial supervision, and the steps taken in recent years to further strengthen the regime to combat money laundering and terrorism financing.

Directors strongly commended Dutch development assistance, and the Netherlands' support for the Doha Round objectives of agricultural trade liberalization, market access for developing countries, and trade facilitation. They noted that even in the face of budgetary pressures, the Netherlands have exceeded the United Nations official development assistance target.

Directors noted that while data are adequate for surveillance, the impact of institutional changes, in particular in healthcare reform, on upcoming data will be quite visible. They therefore stressed that these changes in the economic data must be effectively communicated to avoid misunderstandings, making it clear for example that overall GDP growth will not be affected.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Netherlands: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005 1/	2006 1/
Real economy (change in percent)							
Real GDP	3.5	1.4	0.6	-0.9	1.4	0.5	1.9
Domestic demand	2.6	1.8	0.5	-0.5	0.5	0.9	1.5
CPI (harmonized, year average) 2/	2.3	5.1	3.9	2.2	1.4	1.4	-2.9
Unemployment rate (in percent)	2.9	2.5	2.7	3.8	4.6	5.4	5.3
Gross national saving (in percent of GDP)	27.1	25.4	23.3	22.8	23.5	24.2	24.8
Gross domestic investment (in percent of GDP)	22.2	21.6	20.6	20.2	20.4	20.6	20.8
Public finance (percent of GDP)							
General government balance	2.2	-0.1	-1.9	-3.2	-2.3	-2.4	-2.4
Structural balance	-0.2	-1.1	-2.5	-2.4	-1.1	-0.6	-0.5
General government debt	55.9	52.9	52.6	54.3	55.4	58.7	59.7
Interest rates (percent)							
Money market rate	4.4	4.3	3.3	2.3	2.1	...	...
Government bond yield	5.5	5.2	5.0	4.9	4.9	...	...
Balance of payments (in percent of GDP; unless otherwise indicated) 3/							
Trade balance	4.8	5.0	4.4	4.9	5.1	5.5	6.0
Current account	2.0	2.5	3.1	2.9	3.5	4.0	4.4
Official reserves, excluding gold (in US$ billion)	9.6	9.0	9.6	11.0	10.1	...	...
Reserve cover (in months of imports of GNFS)	0.5	0.5	0.5	0.5	0.4	...	...
Exchange rate							
Exchange rate regime			Member of EMU				
Euros per U.S. dollar (June 20, 2005)						1.22	
Nominal effective rate (1990=100)	100.0	100.7	101.9	107.8	107.0	...	...
Real effective rate (1990=100) 4/	100.0	101.9	105.1	110.6	109.6	...	...

Sources: *International Financial Statistics*; information provided by the Dutch authorities; and IMF staff estimates.

1/ IMF staff projections. Reflects revisions to the GDP projections made after the preparation of the staff report and described in the staff statement for the Executive Board meeting for the 2005 Article IV Consultation with the Netherlands.

2/ In 2001, an indirect tax increase is estimated to have boosted inflation by 1.2 percent points. In 2006, as a statistical effect, the introduction of the new health care system will lower inflation (but only in that year), as private health expenditures drop out of the consumption basket; otherwise inflation would be positive.

3/ Transactions basis.

4/ Based on relative normalized unit labor costs.