June 2007
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Kingdom of the Netherlands—Netherlands: 2007 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for the Kingdom of the Netherlands—Netherlands

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2007 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 2007 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 10, 2007, 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 21, 2007. 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 13, 2007 updating information on recent developments;

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 13, 2007 discussion of the staff report that concluded the Article IV consultation; and

- a statement by the Executive Director for the Kingdom of the Netherlands—Netherlands.

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

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KINGDOM OF THE NETHERLANDS—NETHERLANDS

Staff Report for the 2007 Article IV Consultation

Prepared by the Staff Representatives
For the 2007 Consultation with the Netherlands

Approved by Juha Kähkönen and Michael T. Hadjimichael

May 21, 2007

Executive Summary

Background. A three-party coalition government—comprising the Christian Democratic Party, the Labor Party, and a small Christian Party—took office in February 2007. The recovery is firmly entrenched, and recent growth has been above the euro area average. In addition, inflation is low, the external position is strong, and financial sector stability is continuing to benefit from the macroeconomic upswing. Though the general government balance moved into surplus in 2006, a deficit is projected for 2007, injecting significant fiscal stimulus at a time of emerging capacity constraints.

Key issues and recommendations.

● ***Near-term outlook.*** Growth prospects are bright, with staff and official projections falling within a narrow range: 2.8–3.0 percent for 2007 and 2.7–2.8 percent for 2008. Inflation is expected to stay in check.

● ***Fiscal policy.*** Staff broadly supported the new government's target of a general government structural surplus of 1 percent of GDP by 2011. Staff and most interlocutors acknowledged the benefits of identifying and implementing other sustainability-enhancing measures as quickly as possible to close the remaining fiscal "sustainability gap" (about 2½ percent of GDP). In circumstances of political compromise, in which the coalition parties span a wide political spectrum, the new government intends to take additional structural measures to close about one-third of the remaining gap. With a significant portion of the gap left unfilled, and to lessen resource pressures and take advantage of robust economic growth, staff recommended erring on the side of a higher-than-targeted surplus in executing fiscal policy, also urging a frontloading of fiscal adjustment by locking in any unexpected saving in 2007 and in the context of the 2008 budget.

● ***Structural policies.*** The authorities plan to raise the rewards from work and further reduce the cost of doing business. However, with an eye toward closing the sustainability gap faster and easing the tight labor market, staff suggested additional structural measures. In particular, further measures to boost labor supply and enhance labor market flexibility merit serious consideration.

● ***Financial sector issues.*** Stress tests indicated that the sector could weather adverse macroeconomic shocks. In addition, the design and implementation of the risk-oriented, cross-sectoral, approach to financial supervision are, in many respects, international best practice. Nevertheless, high household indebtedness and housing market distortions are among the key concerns. The code of conduct on mortgage lending is meant to prevent households from overborrowing. While there was insufficiently broad political support for housing market reform, staff believes that such reform should remain on the discussion agenda.

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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.

I. BACKGROUND

1. **The discussions took place against a background of strong economic performance.** The recovery is firmly entrenched (Figure 1 and Table 1). Recent economic growth compares favorably in a European context (Figure 2). Economic expansion and rising stock prices have contributed to a cyclical strengthening of the financial sector, especially pension funds and insurance companies (Figure 3).

2. **With the large current account surplus, and exports and overall growth doing well, external competitiveness would appear to be satisfactory** (Figure 4). Improvements in the macroeconomic and business environments and technological innovation have contributed positively to Dutch competitiveness (Table 2). In terms of export components, domestically produced exports have lost market share in recent years. However, this loss of market share is overstated (Box 1), the growth of reexports has been very strong, the loss of market share for total exports has been smaller than in most regional peers, and the external sector is contributing positively to economic growth. Importantly, staff's multilaterally-consistent measures of equilibrium exchange rates suggest that the real exchange rate for the Netherlands is broadly in equilibrium, if not undervalued (Text Table).[1]

Equilibrium Real Exchange Rate Estimates Using the CGER Methodology
(Level relative to equilibrium in percent;
minus indicates undervaluation)

Methodology	
Macroeconomic balance approach	-4
External sustainability approach	-16
Equilibrium real exchange rate approach	+4

3. **Recent fiscal performance was impressive** (Table 3). The general government balance shifted from a deficit of 3.1 percent of GDP in 2003 to a surplus of 0.6 percent of GDP in 2006. This adjustment had a large structural component, estimated by staff at over 3 percentage points of GDP. The adjustment reflected contributions from expenditure cuts (including nearly a percentage point of GDP reduction in transfers and a ½ percentage point reduction in the wage bill) and revenue measures (including higher excise duties, social insurance contribution rates, and environment taxes); larger gas revenues also contributed.

[1] For background on methodology, see IMF policy paper, Methodology for CGER Exchange Rate Assessments, 2006, available at www.imf.org/external/np/pp/eng/2006/110806.pdf.

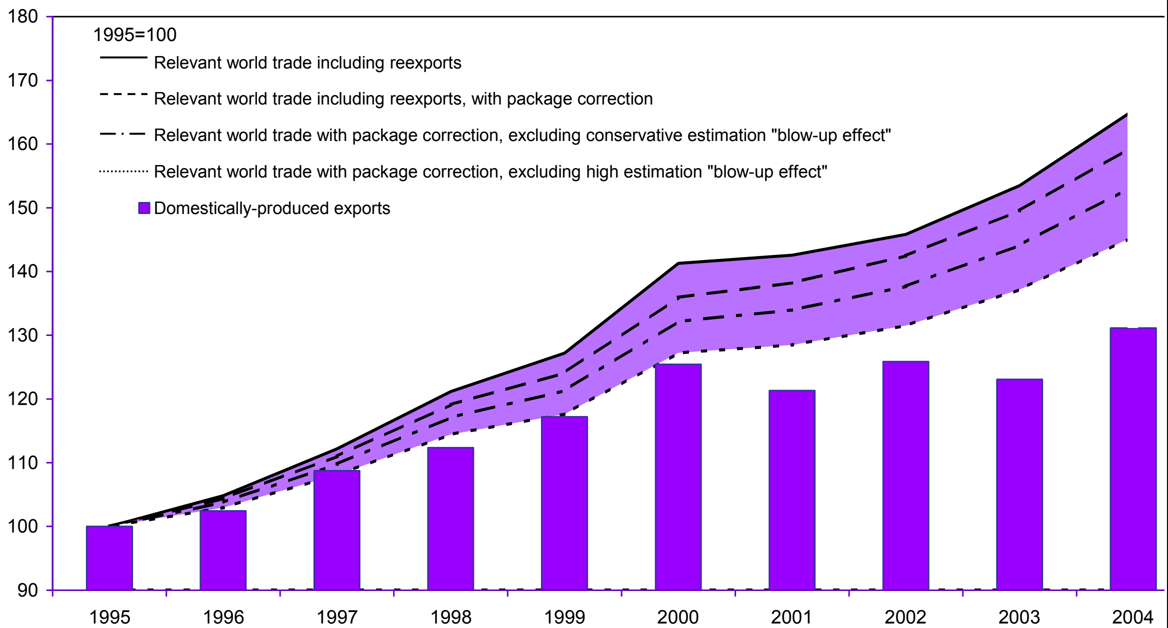
Box 1. The Netherlands: Competitiveness

- A CPB study[1] adjusts market growth for total exports in two ways: including only those goods in domestically produced exports ("package correction"); and adjusting (using rough estimates) for the overestimation of market growth because of double counting due to reexports generally when calculating the relevant world trade for the Netherlands ("blow-up effect").

- As the figure below shows, domestically produced exports were broadly in line with adjusted market growth until 2000. Afterward, market share declined, but by considerably less than an "unadjusted" analysis would suggest.

- It is difficult to assess the competitiveness of Dutch reexports, because many countries do not have reliable statistics related to reexports. In addition, because competition is based on the prices and quality of the associated services provided by shipment centers, analysis based on comparing export growth to the growth of trade is problematic.

- Nevertheless, reexports—which account for about half of total exports and mostly represent machinery, computers, and chemical products sold in Europe—would appear very competitive in light of their strong growth; reexports also generate services income.



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[1] Mellens, M.C., H.G.A. Noordman, and J.P. Verbruggen, 2007, "Wederuitvoer: Internationale Vergelijking en Gevolgen voor Prestatie-Indicatoren," CPB Document No. 143.

4. **While one of the major challenges facing policymakers is addressing population aging, the Netherlands is in a comparatively favorable position to deal with it.** Two contributing factors are the Netherlands' favorable initial fiscal position and demographics (Text Table). In addition, the existence of a large, fully funded, second pension pillar helps mitigate the burden of aging. The CPB has calculated, as a benchmark, that achieving fiscal sustainability would require either a structural general government surplus equivalent to nearly 3½ percent of GDP by 2011 or other sustainability-enhancing measures to close the "sustainability gap"—that is, to compensate in present value terms for any shortfalls from achieving the surplus of 3½ percent.[2]

The Netherlands: Comparative Fiscal Position and Demographics Against Selected Countries

	2006 General Government Balance	Dependency Ratio 1/ 2004	2050
Netherlands	0.6	20	41
Germany	-1.7	26	52
France	-2.6	25	46
Italy	-4.4	28	62
Belgium	0.0	26	47

1/ The source is *European Commission: The Long-Term Sustainability of Public Finances in the European Union (no 4/2006)*.

5. **Monetary conditions tightened in 2006.** This reflected both a rise in interest rates and real exchange rate appreciation (Figure 5).

6. **The financial sector has benefited from the economic recovery, but some vulnerabilities remain.** Bank capital adequacy is well above minimum requirements, and pension funds and insurance company's coverage ratios have recovered to around 2001 levels (Tables 4 and 5 and Figure 3). Nonetheless, low profit margins in the banking sector and EU measures to promote pension mobility suggest that foreign penetration of the Dutch financial system could increase, posing challenges for supervision. High indebtedness in both the nonfinancial corporate and household sectors (the latter prompted by the tax deductibility of mortgage interest payments) makes them vulnerable to rising interest rates. It has also led to the introduction of a code of conduct setting limits on mortgage lending to prevent households from overborrowing, but the code's effectiveness remains to be seen. The

[2] The benchmark figure in the text was revised up since the previous consultation, mostly reflecting an increase in life expectancy. Details of the CPB's analysis, including the incorporation of intergenerational equity, were summarized in the staff report for the 2006 Article IV consultation, IMF Country Report No. 06/283 (July 2006), Appendix IV.

housing market, more broadly, is also impacted adversely by distortions affecting supply (e.g., rent control).

7. **Issues arise in the labor market** (Figure 6). In particular, the employment rate measured in hours is low, and employment protection is high.

II. Report on the Discussions

8. ***Besides the near-term outlook, the discussions focused on: (i) fiscal policy during the new government's term, including assessing policies to address population aging and achieve fiscal sustainability; (ii) safeguarding financial stability; and (iii) reviewing progress in structural reforms to raise participation and productivity, which would also have favorable effects on potential growth and fiscal sustainability.*** Annexes II and III summarize, respectively, past analytical work by staff and the implementation of previous IMF recommendations.

A. Near-Term Outlook

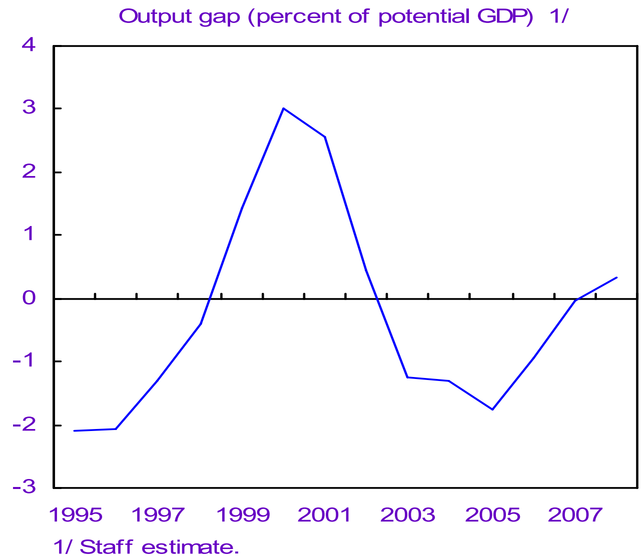
9. **Projections for 2007 fell within a relatively tight range** (Text Table). Export growth is expected to remain strong provided external competitiveness, as projected, does not deteriorate significantly. With high consumer and business confidence, the momentum of domestic demand is expected to carry into 2008. Output is expected to rise above potential (Text Figure), providing further impetus to investment while exerting upward pressure on inflation. Staff projects inflation around 2 percent by 2008. The CPB projection is lower, largely because it assumes lower oil prices.

The Netherlands: GDP Growth and Inflation (HICP) Projection

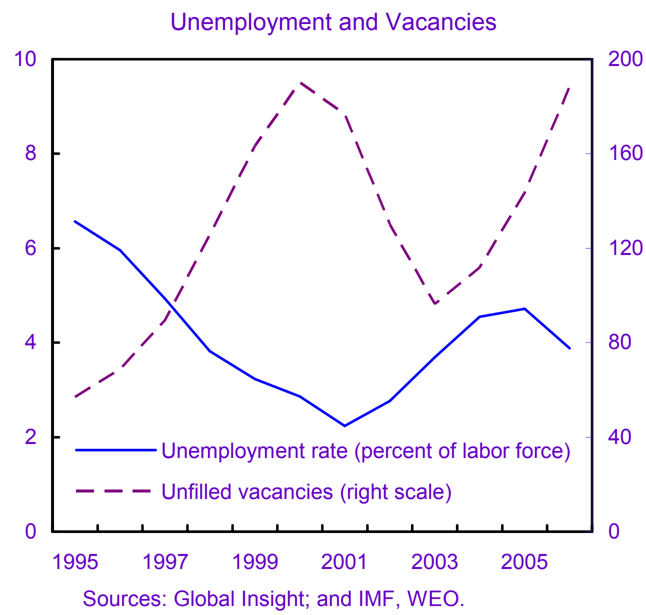
(In percent)

	GDP Growth Projections		Inflation Projections	
	2007	2008	2007	2008
Staff	2.9	2.7	1.8	2.1
CPB (Apr. 2007)	2.8	2.8	1.3	1.3
DNB (Dec. 2006) 1/	3.0	2.8	1.7	2.3

1/ The DNB's inflation projections are based on the national definition of consumer price index, which has tended to show only slightly different inflation in recent years than using the HICP.



10. **Upward pressure on wages seemed inevitable.** The unemployment rate has declined over the past year to 4.1 percent, while vacancies have been increasing (Text Figure). Moreover, it was noted during the discussions that when conditions tightened during the previous economic cycle, high wage increases (and the lagged response of wages to the cyclical downturn) undermined external competitiveness and contributed to the weak economic growth earlier in the decade.[3] Against this background, staff stressed the importance of wage moderation to take full advantage of the favorable economic environment. The authorities agreed, underscoring the point by noting that wage growth in competitor countries was expected to be moderate.



11. **Other risks to the baseline were apparent.** All agreed that the possibility of higher-than-projected oil prices, a further significant euro appreciation, and slower-than-expected trading partner growth could dampen the upswing. While the authorities saw downside risks predominating, staff noted that the strong world economic outlook presented upside potential, too. For example, reexports (and related services income) could be higher than

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[3] See "Wage Bargaining in the Netherlands" in IMF Country Report No. 03/240 (August 2003).

anticipated. And, with a favorable domestic economic outlook, private consumption could also be higher than projected—though resulting higher inflation would dampen real incomes and domestic demand.

B. Fiscal Policy

12. **The new government announced a target of a general government structural surplus of 1 percent of GDP by the end of its term (2011).** While staff supported the target, which was consistent with Fund recommendations during the previous Article IV consultation, a sustainability gap of some 2½ percent of GDP remained. As before, staff stressed the benefits of identifying and implementing other sustainability-enhancing measures as quickly as possible to close this gap. Doing so, by avoiding bigger interest payments than would otherwise occur from higher debt, would provide a larger margin for addressing the aging problem, in addition to better protecting intergenerational equity. The Study Group on the Budget Margin and the Social and Economic Council (SER) made the same recommendation.[4]

13. **Measures proposed by the new government envisage closing part of the sustainability gap.** The proposed measures—aimed at raising participation (through a more effective design of the income tax credit and especially by gradually reducing the transferability of the general tax credit from a non-working to a working partner), limiting increases in health care spending, and introducing a special tax on higher-income pensioners—would close 0.7 percentage point of GDP of the gap. The new government is basing its policy on the CPB's calculations and expects the next two cabinets to take remaining measures to close the gap. While staff would have preferred measures to close the gap more rapidly, and greater specificity on policy details (many parts of the coalition agreement are general, and policy details were only starting to be determined during the mission), it also viewed favorably the widespread acceptance of the need to contain health care expenditure and increase the supply of labor. Nevertheless, staff felt that several additional labor market reforms (discussed in Section D) deserved serious consideration, partly with a view to raising participation further.

14. **Staff urged the authorities to take any available opportunities to lock in a higher-than-targeted surplus by 2011.** Staff indicated that a higher structural surplus would lessen resource pressures and act as insurance against the uncertainties inherent to long-term projections and analysis, also noting that the case for a higher surplus was stronger because a significant portion of the sustainability gap remained unfilled. At the same time, staff recognized the difficulty in overhauling the fiscal target after the complex negotiations to finalize the coalition agreement in circumstances in which the coalition parties span a wide

[4] The study group comprises representatives from various government ministries and the central bank. It prepares recommendations on fiscal policy in advance of a new government taking office.

political spectrum. Moreover, the plans of the authorities, as they noted in the discussion, compare favorably with those of other European countries in terms of feasibility and ambition. The countries in the Text Table below have fiscal targets mostly below the Dutch target. While it is difficult to compare the remaining needs for measures to achieve sustainability (estimates of the sustainability gap, similar to the one calculated for the Netherlands, are unavailable), the Netherlands seems relatively well placed, needing comparatively less adjustment to achieve its 2010/11 target. Also, projected debt levels in 2050 are, for the most part, lower in the Netherlands.[5] In addition, Dutch analysts have identified and quantified specific measures needed to achieve sustainability (Appendix I)—though the current government plans would close only part of the gap.

15. **From a near-term perspective, the fiscal stance seemed to be moving in the wrong direction.** Following the fiscal surplus in 2006, staff projected a small deficit in 2007 (about 0.1 percent of GDP), implying significant stimulus (Table 3). This was in line with the authorities' projections of a deficit of 0.1–0.3 percent of GDP. The projected deterioration mainly reflected lower nontax revenues.[6] The authorities noted that some budget components—related, for example, to gas revenues, health spending, and local government activities—were either inherently volatile or not fully under central government control in the given year. Thus, some of the outcome for 2006 reflected higher oil, and therefore gas, prices, and revenues that would start to unwind in 2007. Also, with information limited, they assumed that the better-than-expected outturn for local governments in 2006 reflected one-off items that would not recur in 2007.

16. **The importance of the 2008 budget returning to a course of fiscal consolidation was well recognized.** The coalition agreement includes specific revenue measures frontloaded for 2008, broadly offset by (unidentified) revenue reductions in later years. From this standpoint, it seemed highly likely that the fiscal balance would revert to a significant surplus. Indeed, the CPB projected a surplus of 0.7 percent of GDP without incorporating measures in the coalition agreement, with higher revenues reflecting both cyclical factors and an increase in health insurance premia. On the expenditure side, the forthcoming budget for 2008 will define the annual expenditure ceilings through 2011. While the coalition agreement envisages specific measures over 2008–11 that would increase expenditure by 1.1 percent of GDP, this was to be mostly offset by a commitment to reductions in other expenditures, with an important role for significant efficiency savings in the civil service. While there is a risk that the latter could yield more modest savings than expected, it is encouraging that ministry-level planning has already begun.

[5] Detailed debt sustainability analysis was contained in the staff report for the 2006 Article IV consultation, IMF Country Report No. 06/283 (July 2006), Appendix IV.

[6] The reduction in the corporate income tax rate from 29.6 percent to 25 percent is offset by a broadening of the tax base, including by limiting deductions.

The Netherlands: Comparative Strategies to Deal with Aging

	Authorities' Medium-Term Budget Target (In percent of GDP)	Debt-to-GDP Level in 2050 1/	Comments
Netherlands (2011)	1.0	10.0	Target requires comparatively less structural fiscal adjustment than for other countries (especially compared with 2006, but about 1 percentage point of GDP from staff's estimate of 2007); other measures, equivalent in present value terms to 2½ percent of GDP, are needed to deliver sustainability.
Germany (2010)	-0.5	97.0	Target requires structural fiscal adjustment of 1.9 percentage points of GDP from 2006; looking at the government's balance sheet, staff calculations suggest negative net worth of 30 percent of GDP (achieving a balanced budget by 2011); thus additional measures are needed to achieve sustainability.
France (2010)	0.0	20.0	Target requires structural adjustment of 0.5 percentage point of GDP per year from 2006; sustainability requires structural reforms to boost potential growth by ¼ percentage point, assuming both non-age related spending and revenues are held constant in percent of GDP after 2010.
Italy (2010)	0.1	55.0	Target requires structural fiscal adjustment of about 3.2 percentage point of GDP from 2006; additional structural reforms that boost labor productivity growth by ¼ percentage point per year will be necessary to achieve sustainability.
Belgium (2011)	1.1	10.0	Target requires structural fiscal adjustment of 1¾ percentage points of GDP from 2006; to achieve sustainability, structural measures to boost labor productivity growth by ¼ percentage point per year are needed, assuming both non-age related spending and revenues are held constant in percent of GDP after 2010.

Sources: IMF staff reports; and country desks.

1/ Staff projections based on a sustainable path, except for Germany (see comments column), which reflects a normative scenario with aging costs at 4 percent of GDP (IMF Country Report No: 06/438). Net worth calculations were only readily available for Germany; staff projections based on a sustainable path were only available for the other countries.

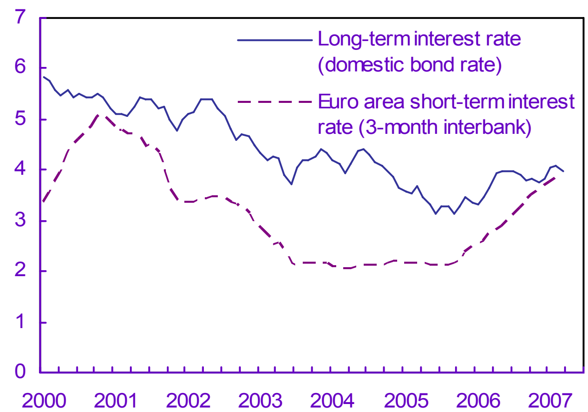
17. **The importance of tight spending control was also recognized for continued improvement in the underlying fiscal position.** Thus, while the coalition agreement envisages broadly offsetting revenue and expenditure measures, deficit-reducing measures would be frontloaded. The authorities also saw considerable room to save on health care costs, in light of the variation across health care providers. Against this background, the

authorities were working on the details of what they called "yardstick competition," which would regulate average prices per hospital (not individual prices), with scope for hospitals and insurers to negotiate prices.

18. **The authorities remain committed to their fiscal framework.** The framework is anchored by multiyear real expenditure ceilings and set with reference to the targeted structural fiscal balance. The authorities emphasized that the framework had served them well, providing discipline to fiscal policy and preventing "big policy mistakes." For its part, staff reiterated that the 2006 fiscal ROSC (Report on the Observance of Standards and Codes) found that the Netherlands achieves or exceeds good practice standards. Moreover, many of the new refinements to the framework—for example, enlarging the safety margin for the Maastricht deficit ceiling, placing interest payments outside the expenditure ceilings, and better management of the resources of the budgetary fund on gas revenues and reporting of tax expenditure—are in line with earlier staff recommendations.

C. Financial Sector Issues

19. **Discussions with the authorities and financial sector participants highlighted both cyclical and structural improvements in the stability of the financial sector** (Figure 3 and Tables 4 and 5). Pension fund and insurance company balance sheets have especially benefited from increases in equity prices and long-term bond yields (Text Figure). Most pension fund coverage ratios are now above the long-term requirement set under the 2006 FTK (Financial Assessment Framework) regulations governing pension funds.[7] This is likely to reduce the procyclicality of pension premiums seen in the past. Insurers have also seen a further strengthening of positions, notwithstanding the downward pressure on premiums resulting from health care reforms. In the banking sector, capital ratios remain well above required levels, but profitability has declined as a flattening of the yield curve has eroded interest income.



Source: IMF, IFS.

20. **DNB stress tests suggest that most financial sector participants could weather even fairly sharp adverse macroeconomic shocks.** The tests also indicate, however, that pension sector portfolios are particularly sensitive to interest rate and asset price

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[7] Pensions are required to achieve a coverage ratio sufficient to meet nominal obligations with a 97.5 percent probability. In practice, this implies a coverage ratio of 125–130 percent. Additional details are reported in the staff report for the 2006 Article IV consultation.

developments, underscoring the need for high coverage ratios. DNB also noted that real coverage ratios (i.e., assuming full inflation indexation of benefits) were substantially lower than the nominal ratios (excluding indexation), again arguing for aiming for high coverage ratios.

21. **Discussions also addressed potential concerns related to mortgage lending and private equity funds.** The mortgage code of conduct, which came into effect in January 2007, is intended to limit household mortgage debt service to 25–30 percent of borrower income, in order to protect borrowers from becoming over-leveraged.[8] Despite a shift towards long-term fixed rate mortgages, around one-third of households remain exposed to interest rate risks, and all are exposed to capital risks. DNB indicated that it is still too early to tell whether the code will be effective and that, if it is not, a more obligatory approach may be needed. Private equity finance in the Netherlands is not seen as a significant concern at this stage, reflecting the small scale of such financing, the due diligence that private equity firms are exercising, and the limited credit risk to lending banks. Nonetheless, DNB is preparing guidelines to ensure that institutional investors exercise due diligence with regard to their investment in such funds.

22. **Beyond the cyclical improvement in the position of the financial sector, institutional developments are making deeper structural improvements in financial stability.** The new financial sector supervisory framework, giving prudential supervision to DNB and conduct of business supervision to the AFM (Authority for Financial Markets), has already begun to improve the quality of supervision and risk management practices of financial firms.

23. **In many respects, the design and implementation of the supervision in the Netherlands represents best international practice.** In particular, the discussions revealed that: (i) supervisors and financial institutions agree that both are benefiting from the integration of macro-prudential financial stability analysis with risk management; (ii) DNB has developed and begun using a systematic risk-based supervision framework (FIRM).[9] It allows supervision to be tailored to the specific risk characteristics of institutions, and in line with DNB's overall risk management strategy for the sector; (iii) the AFM has developed self-assessment templates for financial firms to identify their own performance on conduct of business issues, and for use in prioritizing supervision across issues and firms; (iv) DNB and the AFM coordinate supervision under a covenant agreement. Some "teething troubles" experienced early in the implementation of the new framework were resolved under the covenant, and supervised institutions praised the openness of the supervisors to suggestions

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[8] Calculations are based on the long-term bond rate to prevent mortgages with very low initial rates from having an advantage over other mortgages.

[9] Financial Institutions Risk Analysis Method.

for improving the efficiency and effectiveness of supervision; and (v) the Dutch financial sector is ahead of most countries in implementing new standards for capital adequacy, risk management, and auditing, including Basel II, Solvency II, and IFRS (International Financial Reporting Standards).

24. **Although the overall strength of the financial sector is high and the supervisory framework commendable, staff flagged a few areas:**

- The AFM has had a substantial expansion of responsibilities in response to both domestic legislation and EU directives. Improving the execution of its core responsibilities risks being delayed if it is given additional responsibilities too quickly. The authorities acknowledged the point, but suggested that no new major responsibilities were expected to be given to the AFM.

- The potential cross-border merger of a large Dutch bank would have important supervisory implications. For example, if a cross-border bank were established, the relocation of important bank functions could entail corresponding changes in supervisory arrangements and, as the Dutch authorities have acknowledged, necessitate close cooperation between home and host supervisors.

- EU directives may lead to increased competition from foreign-based providers in the pension sector. Staff emphasized that a high degree of transparency and mechanisms to provide comparability between plans would help employers and unions to make well-informed choices. The authorities agreed, but also noted that the sectoral organization of pension funds might protect the Dutch industry from foreign competition.

- The plan to provide a simple rating of pension plans is likely to benefit consumers. However, it is important to ensure that the ratings are based on prudent assessments of financial strength and take into account the degree of inflation indexing to which each fund is committed. The ratings may be assuming excessively high returns on equity investments, which could be reconsidered at the next review.

25. **The housing market is affected by several major distortions, with adverse effects on housing access and affordability, labor mobility, and household financial leveraging.** Staff argued that mortgage interest deductibility promotes high mortgage debt and boosts housing prices, harming access and affordability for low-income earners. These effects are compounded by supply measures such as rent controls and other restrictions on the supply of new housing. These distortions lead to a chronic shortage of housing, impeding labor mobility. The authorities acknowledged this view, but also indicated that, at this point, there was insufficiently broad political support for such reforms.

D. Structural Reforms and Other Policies

26. **All agreed on the importance of addressing inactivity traps and making work pay.** As the authorities noted, the coalition agreement contains several measures to raise participation.

27. **The discussions highlighted the need to carefully design measures.** For example, various measures focus on particular groups, whether low-income, women, or senior workers. In implementing tax breaks for these groups (for example, through earned income tax credits), the labor supply incentives facing other groups must be taken into account to avoid unintended side effects. Potentially, one of the most effective measures to raise the rewards from work is the phasing-out of the transferability of the general tax credit from a low or no income partner to the higher earner. However, reflecting political compromise, the phase-out period is 20 years.

28. **While a range of structural measures has been aimed at boosting productivity and sustainable growth, staff saw scope for further measures to promote both higher participation and productivity.** In addition to summarizing recent reforms, Table 6 highlights staff recommendations in various areas.

29. **The authorities enthusiastically support overseas development assistance (ODA), continuing to exceed the United Nations' target of 0.7 percent of GNI.**

III. Staff Appraisal

30. **The Dutch economy is performing well.** The recovery is firmly entrenched, while economic expansion and rising stock market values have contributed to a cyclical strengthening of the financial sector. Much has been achieved on the fiscal front: since breaching the Maastricht deficit ceiling in 2003, significant structural fiscal adjustment contributed to a general government surplus in 2006. In addition, competitiveness is satisfactory, though continued wage moderation is important for maintaining it. The strong macroeconomic environment provides a favorable backdrop for dealing with the important challenges that lie ahead.

31. **One of the major challenges facing policymakers remains an aging population.** Thankfully, the authorities are well aware of the policy requirements for securing fiscal sustainability in the face of aging based on the extensive background work by the CPB.

32. **While the new government's target of a general government structural surplus of 1 percent of GDP by 2011 is broadly appropriate, other sustainability-enhancing measures are needed to ensure fiscal sustainability.** Moreover, identifying and implementing measures as quickly as possible to close the sustainability gap would minimize the cost of aging from the standpoint of lowering debt and interest payments, and provide greater assurance of achieving the policy goal of intergenerational equity. Significant

progress has been made recently in several, oftentimes difficult, structural areas, among them reform of health care and disability benefits, and the strengthening of the administration of social benefits. But it is important to build on this progress: indeed, the current situation of robust economic growth and a tightening labor market offers a favorable environment for further fiscal consolidation and additional measures to enhance labor market flexibility and participation. From this standpoint, a more ambitious approach to closing the sustainability gap would have been welcome.

33. **The near-term fiscal stance is a concern.** Fiscal stimulus this year would be unhelpful in a context of emerging resource constraints. Thus, it is advisable to tighten the fiscal stance as soon as possible, both by locking in any unexpected saving in 2007 and in the context of preparing the budget for 2008. It is important that the 2008 budget return to the course of fiscal consolidation, making decisive and significant progress toward securing the 2011 fiscal surplus target. The electoral cycle only strengthens the case for early action toward securing this target.

34. **Continued improvement in the underlying fiscal position requires tight spending control—including, in the context of preparing the 2008 budget, setting prudent expenditure ceilings through 2011.** The commitment to the highly commendable fiscal framework provides reassurance that fiscal policy will stay disciplined and transparent. However, before the envisaged spending increases are implemented, the offsetting expenditure-reducing measures should preferably be in place, with a view to minimizing the risk of underperformance. Moreover, spending overruns remain a perennial risk in the health sector. While the efforts to restrain costs—through introducing greater competition and "yardstick benchmarking"—are welcome, careful monitoring will be required, with a view to timely remedial actions if needed.

35. **Longer-term considerations warrant erring on the side of higher surpluses in executing fiscal policy and setting the expenditure ceilings.** A higher structural surplus would help lessen resource pressures and act as insurance against the uncertainties surrounding key macroeconomic and reform parameters of the long-term projections and analysis of aging. The case for a higher surplus is strengthened because a significant portion of the sustainability gap remains unfilled.

36. **The stability of the financial sector is continuing to benefit from the macroeconomic upswing as well as improvements in supervision and risk management.** While pension funds have seen a marked recovery in financial positions, further increases in their coverage ratios would, as noted by the authorities, better protect the real value of pensions. Overall, the implementation of the risk-oriented, cross-sectoral approach to financial sector supervision is impressive: in many respects, the design and implementation of supervision in the Netherlands are international best practice.

37. **The lack of progress in reforming the housing market stands in sharp contrast with the Netherlands' willingness to tackle other difficult areas.** The adoption of the mortgage code of conduct to limit excessive household indebtedness is welcome, but does not address the underlying tax incentive to maximize mortgage debt. More generally, beginning the task of reforming the numerous distortions adversely affecting the housing market would be beneficial for the economy.

38. **Efforts on a broad front to increase labor supply are of considerable urgency, and there is scope to further boost sustainable growth by raising productivity.** Such labor supply efforts would help to ease the tight labor market and address aging-related challenges. While phasing out the transferability of the general tax credit is potentially one of the most effective measures to raise the rewards from work, this measure would have a significant and more immediate impact if phased out over a much shorter period than the envisaged 20 years. More generally, it is important to address other inactivity traps with carefully designed measures that avoid unintended side effects. Although politically difficult, other policies—including a shorter duration for unemployment benefits and raising the retirement age in line with increases in life expectancy—merit serious consideration. The success of official efforts to encourage productivity and innovation will depend, fundamentally, on taking further steps to provide an environment conducive to entrepreneurship and competition. The successes in increasing the role of market forces in various sectors, strengthening the investigative powers of the competition authority, and reducing red tape are welcome, as is the new government's goal of a further red tape reduction of 25 percent. Further efforts to reduce employment protection legislation would be beneficial, as this acts as a tax on new hiring, not only reducing labor participation, but also hampering the movement of labor toward areas of high productivity and innovation. Finally, greater wage differentiation would help attract labor to higher productivity companies and sectors, while strengthening the incentives for human capital investment, one of the government's goals.

39. **The demonstrated commitment to ODA, by continuing to exceed the United Nations' ODA target, is highly commendable.**

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

Table 1. Netherlands: Basic Data

Land area (2006)	41.5 thousand sq. km.	
Population (2006)	16.3 million	
Population characteristics and health:		
Life expectancy at birth (2006)	76.4 (male), 81.7 (female)	
Fertility rate (2006)	1.7 children/woman	
Infant mortality rate (2006)	4.96 per 1,000 live births	
Population per sq. km. of land area (2006)	483 persons	
National accounts 2006	(In billions of euros)	(In percent of GDP)
Private consumption	248.6	47.1
Public consumption	133.6	25.3
Gross fixed investment	105.9	20.1
Stockbuilding	-0.9	-0.2
Exports of goods and nonfactor services	391.6	74.2
Imports of goods and nonfactor services	350.8	66.5
Nominal GDP (at market prices)	527.9	100.0

	2001	2002	2003	2004	2005	2006	Proj. 2007	Proj. 2008
	(Annual percentage change; unless otherwise indicated)							
National accounts (constant prices)								
Private consumption	1.8	0.9	-0.2	0.6	0.7	-1.2 1/	1.7	1.8
Public consumption	4.6	3.3	2.9	0.1	0.3	8.7 1/	1.0	1.4
Gross fixed investment	0.2	-4.5	-1.5	-0.8	3.6	6.1	4.5	4.9
Total domestic demand	2.3	-0.4	0.4	0.6	0.9	2.7	2.5	2.5
Exports of goods and nonfactor services	1.9	0.9	1.5	8.0	5.5	7.5	6.7	5.5
Imports of goods and nonfactor services	2.5	0.3	1.8	6.4	5.1	7.9	6.9	5.6
Net foreign balance 2/	-0.2	0.5	-0.1	1.5	0.7	0.3	0.3	0.3
Gross domestic product	1.9	0.1	0.3	2.0	1.5	2.9	2.9	2.7
Output gap (in percent of potential output)	2.6	0.4	-1.3	-1.3	-1.8	-0.9	--	0.3
Prices, wages, and employment								
Consumer price index (HICP)	5.1	3.9	2.2	1.4	1.5	1.7	1.8	2.1
GDP deflator	9.2	3.8	2.2	0.7	1.7	1.5	1.8	2.1
Hourly compensation (manufacturing)	3.9	3.7	2.7	1.6	0.9	1.8	2.0	2.6
Unit labor costs (manufacturing)	4.1	2.8	1.9	-1.5	-0.8	-0.5	0.2	1.1
Employment	2.1	0.4	-0.6	-1.4	-0.4	1.5	1.3	1.0
Unemployment rate (in percent)	2.4	2.9	4.1	4.9	5.0	4.1	3.4	3.3
Personal sector								
Real disposable income	6.2	-0.3	-0.3	2.1	0.1	-1.5 1/	2.2	2.1
Household savings ratio 3/	6.8	6.5	6.3	8.2	7.5	7.3	7.7	8.0
External trade								
Exports of goods, volume	-2.0	1.0	6.6	9.0	4.5	7.8	7.5	6.8
Imports of goods, volume	0.4	3.2	2.3	8.5	7.4	7.9	7.5	6.8
Terms of trade	3.3	1.5	1.4	-0.4	1.8	0.8	0.2	-0.5
Merchandise balance (percent of GDP)	4.8	4.2	6.6	7.1	7.0	7.7	8.2	8.2
Current account balance (percent of GDF	2.4	2.5	5.4	8.9	6.3	7.1	7.4	7.3
Public sector accounts (percent of GDP)								
Revenue	45.0	43.9	43.8	44.4	45.1	46.8 1/	45.8	46.7
Expenditure	45.2	45.9	46.9	46.2	45.4	46.3 1/	45.9	46.0
General government balance	-0.2	-2.0	-3.1	-1.8	-0.3	0.6	-0.1	0.7
Structural balance 4/	-1.1	-2.2	-2.5	-1.2	0.5	1.0	-0.1	0.5
Primary balance	2.9	0.8	-0.5	0.7	2.1	2.8	2.1	2.9
Structural primary balance 4/	2.1	0.6	0.1	1.3	2.9	3.2	2.1	2.7
General government gross debt	50.7	50.5	52.0	52.7	53.8	53.2	53.3	52.7

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

1/ The introduction of the new healthcare system in 2006 resulted in a shift in health care expenditure from private to public consumption, thereby lowering private and raising public consumption without changing overall GDP. In a related vein, government revenues rose and private disposable income fell, without affecting the financial position of the public sector or households in net terms. This is because public expenditure for health care also rose, while the fall in private disposable income was offset by a similar fall in private health consumption, which is now taken care of in the public domain.

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. The Netherlands: Competitiveness Rankings

	2002-03	2006-07
World rankings		
Growth competitiveness		
Overall index	13	9
Macroeconomic environment	10	8
Public institutions	10	9
Technological innovation	19	11
Business competitiveness		
Quality of business environment	8	6
Europe rankings		
Growth competitiveness		
Overall index	9	7
Macroeconomic environment	7	4
Public institutions	6	6
Technological innovation	11	6
Business competitiveness		
Quality of business environment	7	5

Source: World Economic Forum, Global Competitiveness Report, various issues.

Table 3. The Netherlands: General Government Accounts, 2001–08

(In percent of GDP)

	2001	2002	2003	2004	2005	2006 1/	Proj. 2007	Proj. 2008
Revenues	45.0	43.9	43.8	44.4	45.1	46.8	45.8	46.7
Tax revenues and social security contributions 2/	38.3	37.7	37.4	37.7	38.2	40.2	39.7	40.4
Tax revenues	24.7	24.5	23.6					
Social security contributions	13.7	13.3	13.8					
Nontax revenues	6.6	6.2	6.3	6.8	6.9	6.7	6.1	6.3
Expenditure	45.2	45.9	46.9	46.2	45.4	46.3	45.9	46.0
Direct expenditure	26.8	28.2	29.1	28.5	28.4	29.4	29.3	29.5
Compensation of employees	9.6	9.8	10.1	10.0	9.9	9.5	9.4	9.6
Goods and services (excluding capital formation)	6.9	7.1	7.3	7.1	7.1	7.1	6.8	6.8
Fixed capital formation	3.3	3.5	3.6	3.2	3.2	3.1	3.1	3.1
Social benefits in kind	7.1	7.8	8.2	8.2	8.2	9.8	10.0	10.0
Transfers	15.2	15.0	15.2	15.2	14.6	14.6	14.4	14.4
Subsidies (including EU)	1.7	1.8	1.7	1.7	1.5	1.5	1.5	1.5
Other transfers	13.5	13.2	13.5	13.5	13.1	13.1	12.9	12.8
Households	10.5	10.6	11.1	11.0	10.4	10.5	10.2	10.2
Corporations	0.7	0.5	0.5	0.4	0.3	0.2	0.4	0.3
Rest of the world	2.3	2.1	1.9	2.1	2.4	2.4	2.3	2.3
Interest	3.2	2.8	2.6	2.5	2.4	2.3	2.2	2.2
Fiscal balance	-0.2	-2.0	-3.1	-1.8	-0.3	0.6	-0.1	0.7
Memorandum items:								
Primary balance	2.9	0.8	-0.5	0.7	2.1	2.8	2.1	2.9
Structural balance (in percent of GDP) 3/	-1.1	-2.2	-2.5	-1.2	0.5	1.0	-0.1	0.5
Output gap	2.6	0.4	-1.3	-1.3	-1.8	-0.9	0.0	0.3
Nominal expenditure growth (in percent) 4/	7.6	5.5	4.7	1.3	1.3	6.4	3.5	5.0
Real expenditure growth (in percent) 4/	2.4	1.7	2.5	0.5	-0.4	4.9	1.7	3.0

Sources: The Netherlands' Bureau for Economic Policy Analysis (CPB); Ministry of Finance; and Fund staff calculations and estimates.

1/ The introduction of the new healthcare system in 2006 did not affect the overall balance, but permanently increased both revenue and expenditure by 1.6 percentage points of GDP.

2/ Personal income taxes and social contributions are collected together. Although data on the aggregate is reliable, an accurate breakdown between the two items is available only with a lag of four years.

3/ 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 No. 04/301). Progressiveness in the tax system can also result in an overstatement of structural adjustment when GDP growth is high.

4/ The increase in expenditure growth in 2006 largely reflects the introduction of the new health care system, as in footnote 1.

Table 4. The Netherlands: Indicators of External and Financial Vulnerability, 2001-06

(In percent of GDP; unless otherwise indicated)

	2001	2002	2003	2004	2005	2006
External indicators						
Exports goods and services						
(annual percent change, in U.S. dollars)	-0.7	4.4	16.9	17.7	7.7	12.2
Imports goods and services						
(annual percent change, in U.S. dollars)	-0.3	4.4	22.7	19.3	7.6	12.1
Terms of trade goods (annual percent change)	3.3	1.5	1.4	-0.4	1.8	0.8
Current account balance	2.4	2.5	5.4	8.9	6.3	7.1
Inward portfolio investment	-3.4	3.4	-4.3	5.2	-11.9	0.4
Inward foreign direct investment	13.0	5.7	4.0	0.1	6.5	7.2
Official reserves (in billions of U.S. dollars)	16.9	19.0	21.6	21.2	20.5	23.9
Foreign assets of the banking sector						
(in billions of U.S. dollars)	211.4	256.2	308.2	376.9	409.0	554.7
Foreign liabilities of the banking sector						
(in billions of U.S. dollars)	250.1	305.8	328.2	392.5	418.0	550.2
Official reserves in months of imports	0.8	1.0	1.0	0.9	0.7	0.8
Exchange rate (per U.S. dollar, period average)	1.12	1.06	0.88	0.80	0.80	0.80
Financial market indicators						
Public sector debt (Maastricht definition)	50.7	50.5	51.8	52.5	52.8	52.3
Government bond yield	5.2	5.0	4.2	4.1	3.4	3.8
Government bond yield (real)	0.1	1.1	1.9	2.7	1.9	2.1
Stock market index	81.6	62.9	46.7	52.6	60.9	73.7
Spread of government bond yield with Germany	0.47	0.39	0.37	0.34	0.19	0.05
Financial sector risk indicators						
Residential mortgage loans to total loans (in percent)	0.8	0.8	0.8	0.8	0.8	…
Nonperforming loans to total gross loans (in percent)	2.3	2.4	2.0	1.5	1.2	…
Foreign credit exposure (in percent of own funds)						
Central and Eastern Europe	16.6	17.1	17.3	16.2	18.4	…
Latin America	19.0	14.8	11.9	9.3	11.6	…
Asia	25.6	23.5	26.1	27.6	25.2	…
Contingent and off-balance-sheet accounts						
to total assets (in percent)	20.3	19.5	16.7	15.3	14.6	…
Risk-based capital-asset ratio	11.7	12.0	12.3	12.3	12.6	11.7 1/

Sources: Data provided by the authorities; and IMF, *IFS.*

1/ Data is for the third quarter.

Table 5. The Netherlands: Financial Soundness Indicators, 2001–06

(In percent; unless otherwise indicated)

Indicator	2001	2002	2003	2004	2005	2006 1/
The Core Set of Financial Soundness Indicators						
Deposit-taking institutions						
Regulatory capital to risk weighted assets	11.7	12.0	12.3	12.3	12.6	11.7
Regulatory Tier I capital to risk weighted assets	8.6	9.1	9.6	9.9	10.3	9.4
Nonperforming loans to total gross loans	2.3	2.4	2.0	1.5	1.2	…
Sectoral distribution of loans to total loans						
Residents	72.1	73.8	74.0	73.7	68.7	64.6
Banks	13.2	14.2	14.6	15.1	1.3	1.6
Central Bank	0.9	0.8	1.1	0.9	1.2	0.9
Other financial institutions	6.7	8.1	9.2	10.2	12.8	11.5
General government	3.1	3.2	3.0	2.8	3.1	2.7
Nonfinancial companies	19.9	19.0	17.4	16.3	18.1	17.5
Other domestic sectors	28.3	28.6	28.8	28.5	32.3	30.4
Nonresidents	27.9	26.2	26.0	26.3	31.3	35.4
Return on assets	0.5	0.5	0.5	0.4	0.4	0.4
Return on equity	14.7	10.9	14.0	16.0	16.0	11.9
Interest margin to gross income (ratio)	0.6	0.6	0.6	0.6	0.5	0.5
Noninterest expenses to gross income (ratio)	0.8	0.8	0.8	0.7	0.7	0.7
Net open position in foreign exchange to capital	4.8	4.2	6.1	4.1	0.8	…
Encouraged Financial Soundness Indicators						
Deposit-taking institutions						
Large exposures to capital (number)	95	95	84	62	72	109
Trading income to total income	8.5	5.9	6.9	7.9	11.4	11.2
Personnel expenses to noninterest expenses	53.7	51.4	51.1	53.6	49.8	46.9
Customer deposits to total (noninterbank) loans	34.2	30.3	26.0	24.4	17.2	16.5
Foreign currency denominated loans to total loans	34.3	32.4	35.8	35.0	26.6	27.8
Foreign currency denominated liabilities to total liabilities (deposits)	27.6	24.1	21.5	20.1	25.2	25.9
Net open position in equities to capital	89.4	77.0	59.9	79.6	80.6	89.2
Households						
Household debt to GDP	84.7	91.3	99.0	104.6	113.3	...
Real estate market						
Real estate price growth	11.2	8.5	4.9	4.2	4.8	4.2
Residential real estate loans to total loans	...	...	25.2	25.1	28.6	27.1

Source: Data provided by the authorities.

1/ Data are for the third quarter.

Table 6. The Netherlands: Structural Measures to Raise Labor Participation and Enhance Productivity: Recent Actions and Recommendations for the Future

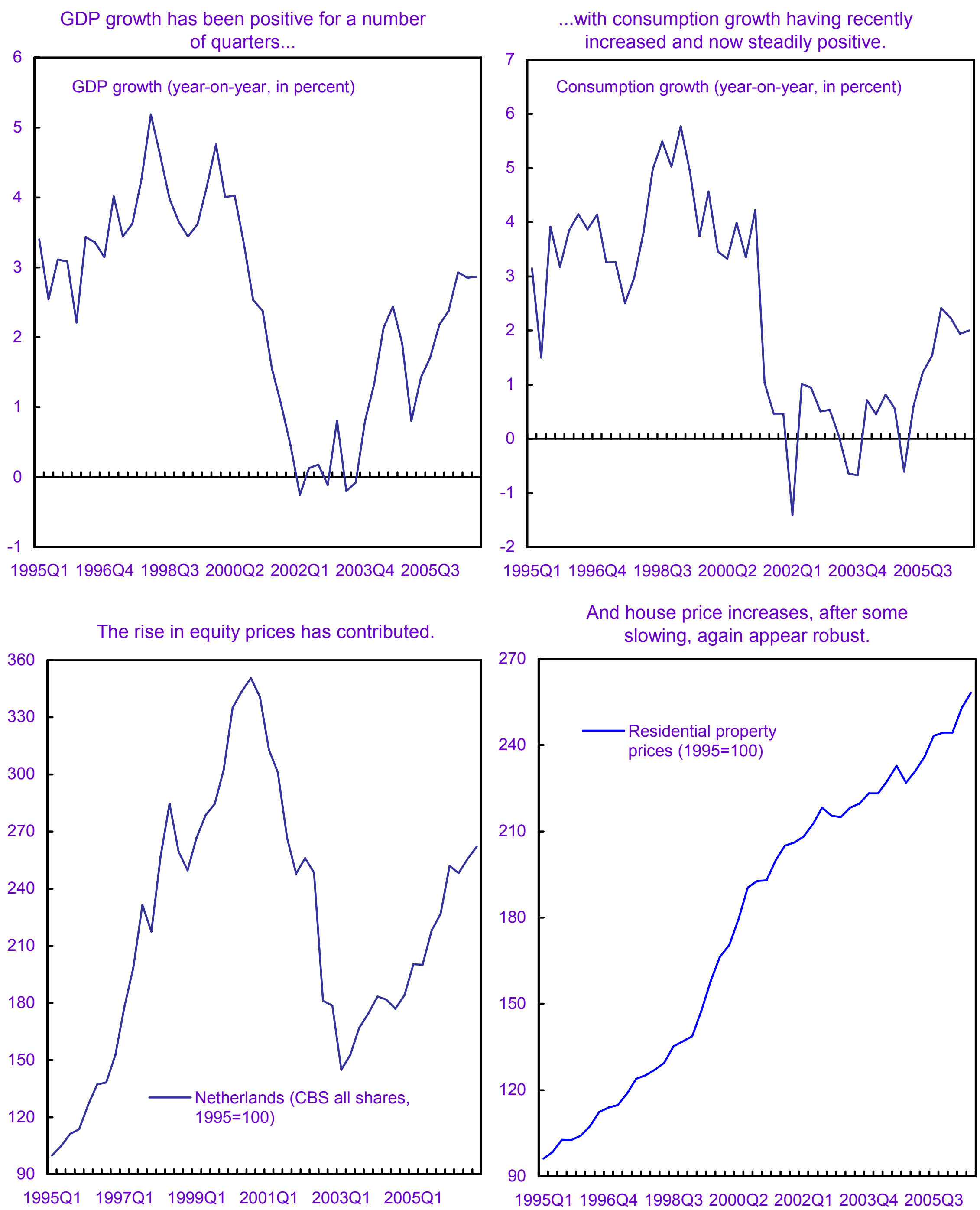
Area	Actions Taken	Staff Position and Recommendations
Disability	Further reform came into effect in January 2006, aimed at introducing a distinction between fully disabled and partially disabled. Reform entails: strengthened eligibility criteria, including a medical definition of full disability and strengthening work incentives for partially disabled.	While staff accepts that the replacement rate for the fully disabled may be increased, in line with social preferences for a “true” disability program, it has recommended, in light of past abuses, reassessment of the existing stock of disabled, rather than only those younger than 45 years.
Unemployment benefits	Effective October 2006, the maximum duration was cut from 60 to 38 months. Existing (non-means tested) benefits at the social assistance level when the right to the initial unemployment benefits ends was altered for people becoming unemployed at an age over 60 in the sense that this benefit is no longer partner-income tested.	The shortened duration limit remains high by international comparison, and staff has recommended consideration of a maximum period much shorter than three years, which would be sufficient for unemployment benefits to serve their purpose from the standpoint of job search. In addition, while high replacement rates can be justified in the initial months of unemployment, a decline in benefits over time would encourage a rapid return to employment and avoid benefits dependency. The additional benefits instead of and above social assistance further weaken incentives to find a job.
Poverty and inactivity traps	To lessen significant traps, changes in the real estate tax and amendments to the child credit (which came into effect in 2006) reduced spikes in marginal effective tax rates. Scheduled increases in the earned income tax credit are expected to further reduce poverty traps. Furthermore, the tax credit for working parents was raised as were childcare subsidies (see below).	Reform of rent subsidy arrangements could have a particularly large effect in making work pay for lower-income earners. It is also important to examine the minimum wage, which is high, and its links to several social benefits, with an eye to finding ways of further lessening traps and stimulating the demand for low-skilled labor.
Female participation	To increase female participation in circumstances in which full-time participation is low and the cost of childcare facilities has increased significantly, the government increased childcare subsidies by €130 million in 2006 and a further €125 million in 2007. Another important development concerns the provision of preschool and after-school childcare. The cabinet will introduce legislation requiring primary schools to make arrangements for child supervision between school hours and the opening hours of certified childcare providers from the beginning of the 2007–08 school year.	The phasing of childcare subsidies is important, to lessen the implicit tax on the middle class by instituting a more gradual fading-out of the subsidies as income increases. The authorities should also take into account the effects of a high minimum wage on the demand for labor and costs of childcare.

Table 6. Structural Measures to Raise Labor Participation and Enhance Productivity: Recent Actions and Recommendations for the Future (concluded)

Area	Actions Taken	Staff Position and Recommendations
Early retirement	Fiscal incentives were removed as of January 2006.	Care needs to be taken that the new "life-course scheme" does not merely substitute for past subsidized routes to early retirement.[1] In addition, taking into account changes in life expectancy in determining the official retirement age deserves serious attention.
Employment protection legislation (EPL)	Effective October 2006, the LIFO principle for worker dismissal was eased. Also, effective March 2007, the need for dismissal for economic reasons no longer has to be checked by the Centers for Work and Income (CWI) if employer and employees have agreed on the necessity of the dismissal. Effective October 2006, dismissed workers no longer have to prove they resisted being laid off to get unemployment benefits. At the time of the 2006 Article IV consultation, the EPL was under active discussion in the Social and Economic Council (SER). Though the different parties could recognize the benefits from less strict EPL (for unions, up to a certain extent), no consensus was reached on reforms because of different views on how to proceed.	EPL on regular contracts remains high by international comparison. Because such legislation can hamper firms' ability to adjust quickly enough to market conditions, act as a tax on new hiring, and hamper innovation, staff urges a further easing of EPL.
Productivity	Significant progress has been made to improve the functioning of product markets, and the competition agency (NMa) has been increasingly effective, becoming formally independent in July 2006. Significant progress was made towards meeting the previous government's goal of reducing red tape by 25 percent by the end of its term (2007), including by reducing the number of permits and license system that can adversely affect innovation and experimentation.	Measures are needed to further reduce barriers to entrepreneurship and innovation. Thus, staff supports efforts to reduce license and permit procedures, and continued government efforts to reduce red tape, including the new government's goal of another 25 percent reduction. It also sees the NMa as important and therefore welcomes efforts to strengthen its investigative powers. In addition, staff encourages the social partners to allow for greater wage differentiation in collective labor agreements, with a view to helping attract labor to higher productivity companies and sectors, while strengthening the incentives for human capital investment.

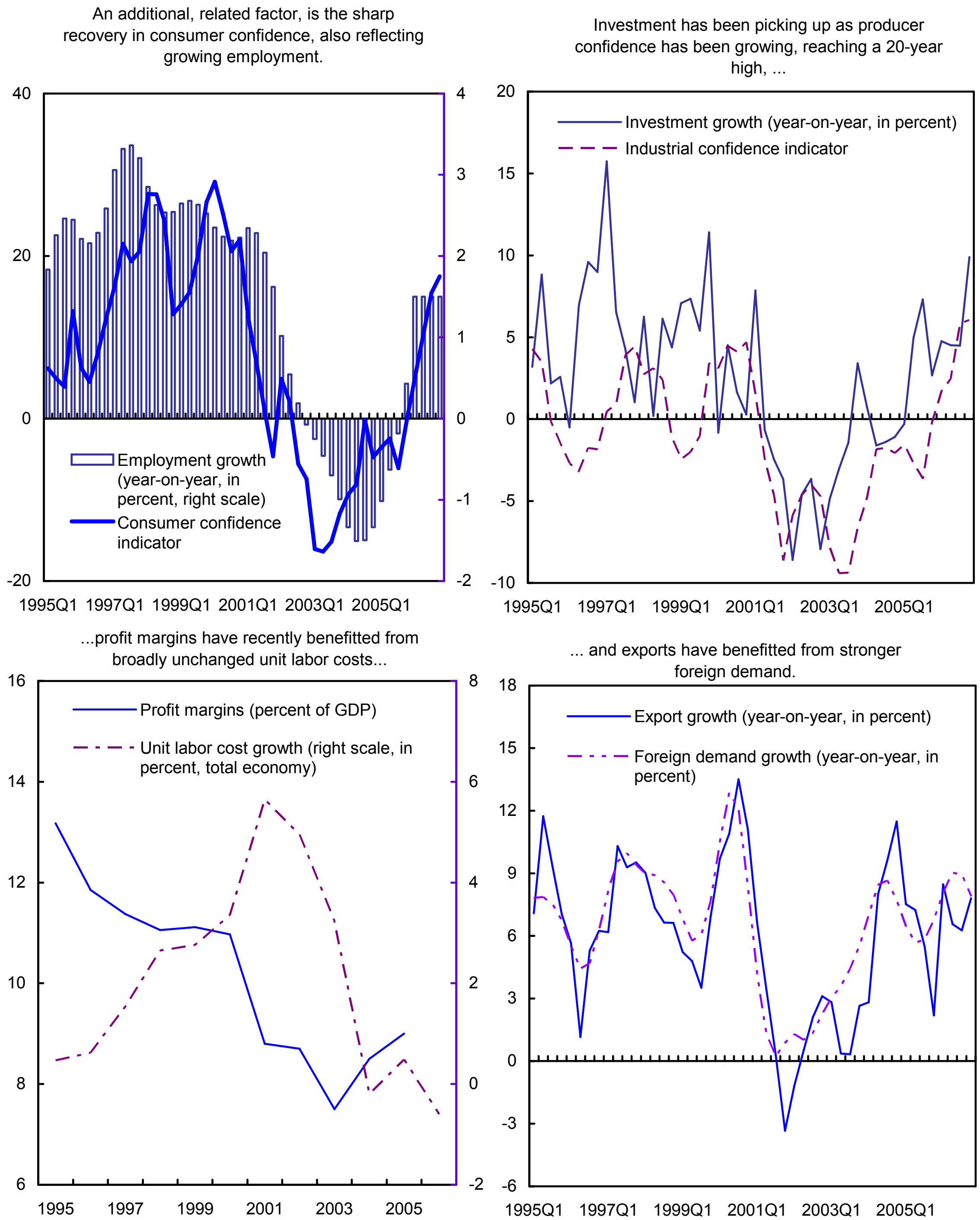
1/ The scheme is a voluntary savings arrangement that allows individuals to save to fund leave, in agreement with their employers, for various activities like childcare and mid-career training, or for early retirement.

Figure 1. Netherlands: The Economic Recovery Is Firmly Entrenched



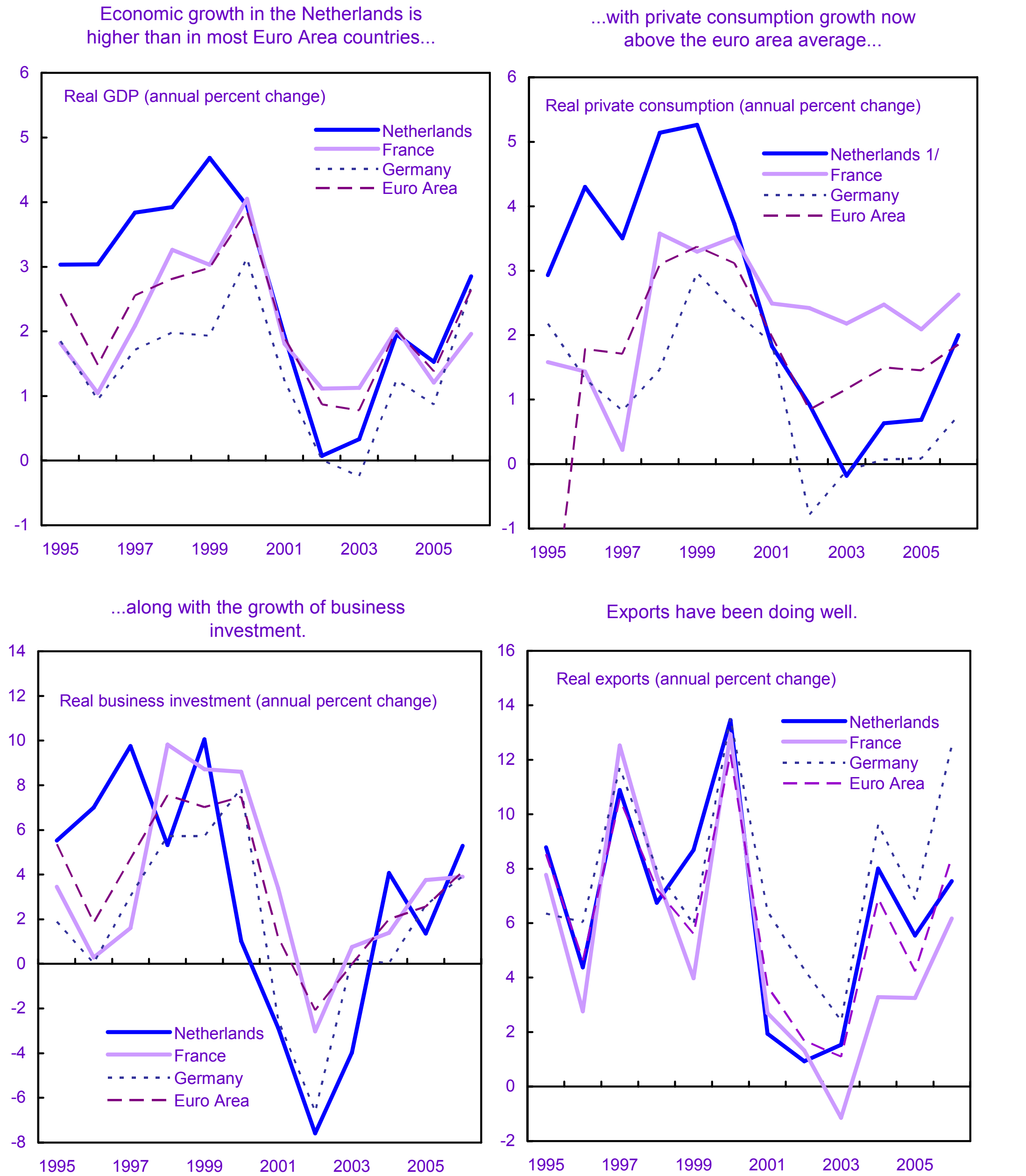
Sources: Global Insight; Netherlands authorities; and IMF, I*FS and WEO*.

Figure 1. Netherlands: The Economic Recovery Is Firmly Entrenched (concluded)



Sources: Global Insight; Netherlands authorities; and IMF, *IFS* and *WEO*.

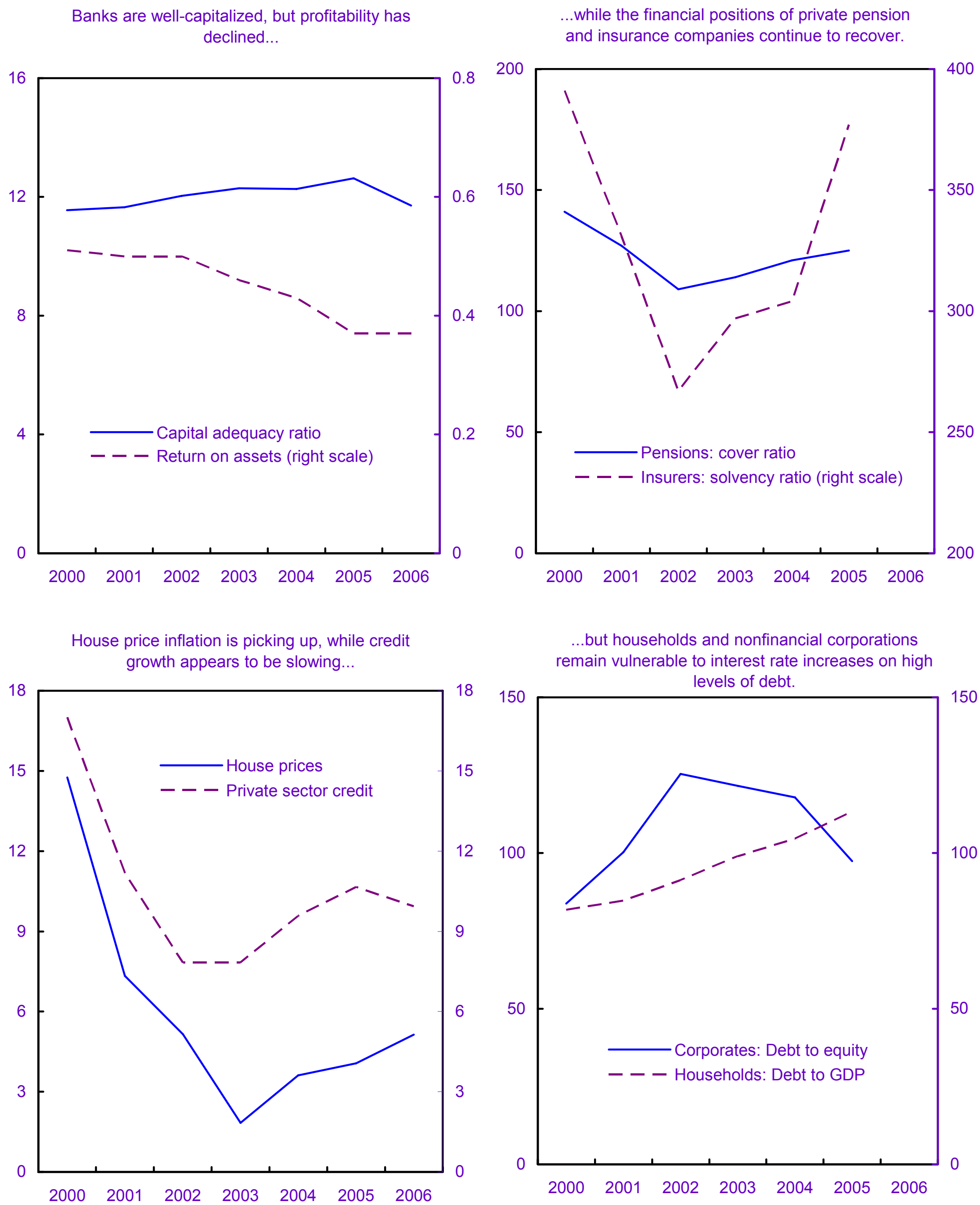
Figure 2. Netherlands: Comparative Economic Performance Has Recently Been Strong With Growth That Is Broad Based



Sources: Global Insight; Netherlands authorities; and IMF, *IFS and WEO*.

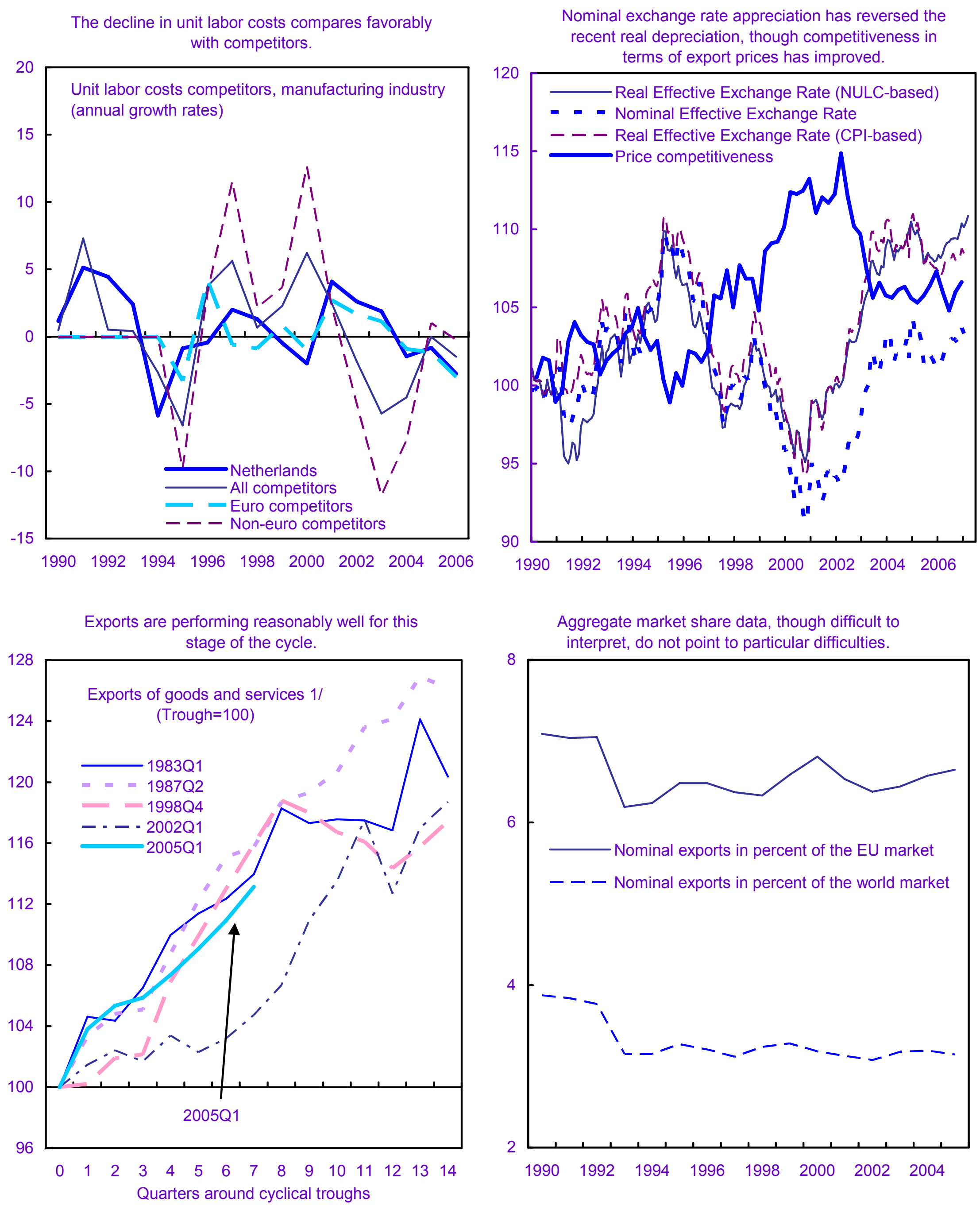
1/ The consumption growth in 2006 is adjusted for the health care reform. The reform of the health care system at the beginning of 2006 resulted in a shift of health care expenditures of about euro 8.0 billion (1.5 percent of GDP) from private to public consumption, distorting private consumption downward by about 3 percentage points in 2006.

Figure 3. Netherlands: Financial Stability Indicators
(In percent)



Sources: Global Insight; data provided by the authorities; and IMF, *IFS*.

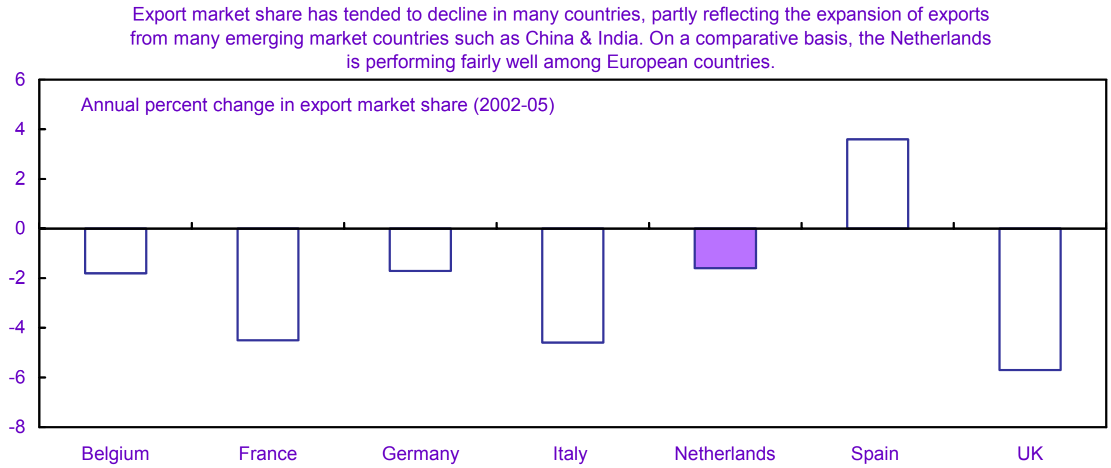
Figure 4. Netherlands: External Competitiveness

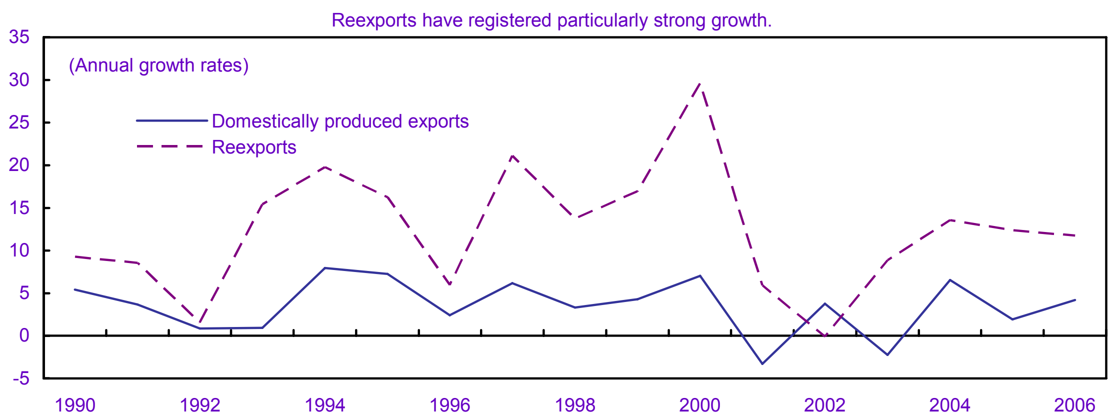


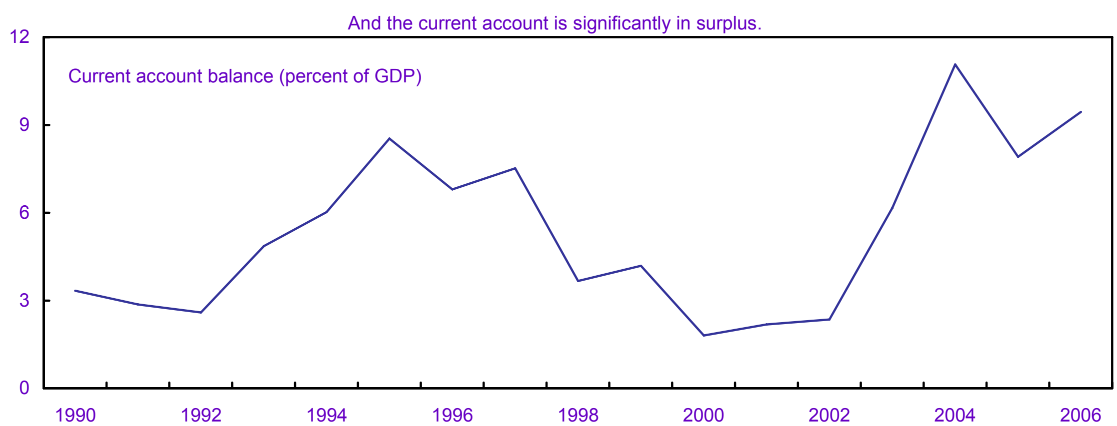
Sources CPB; DNB, OECD, analytical database and economic outlook; IMF, *INS*, *DOT*, and *WEO*.

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

Figure 4. Netherlands: External Competitiveness (concluded)



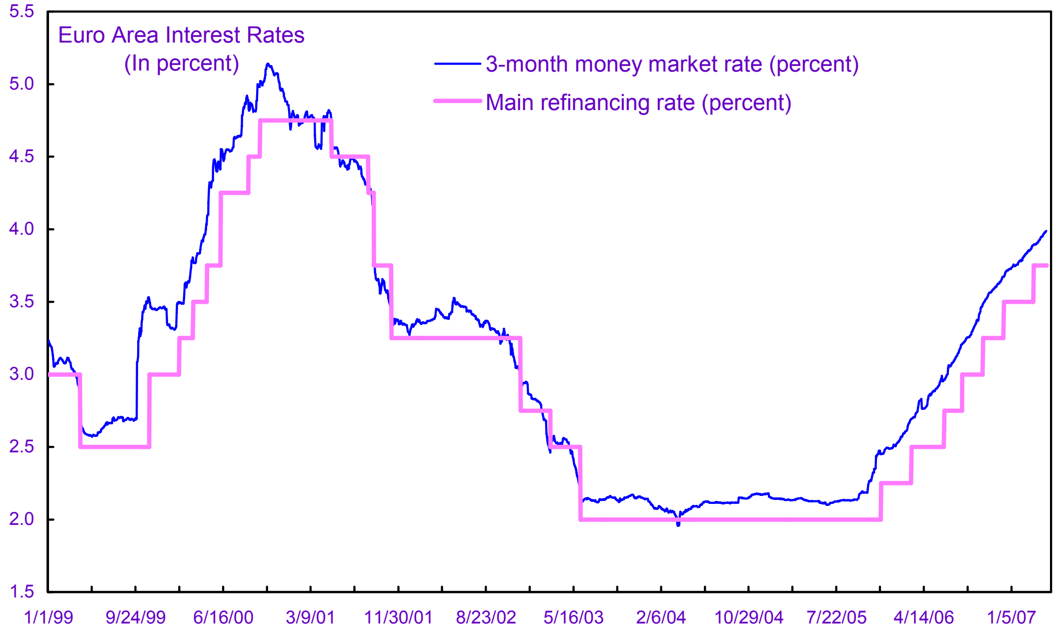




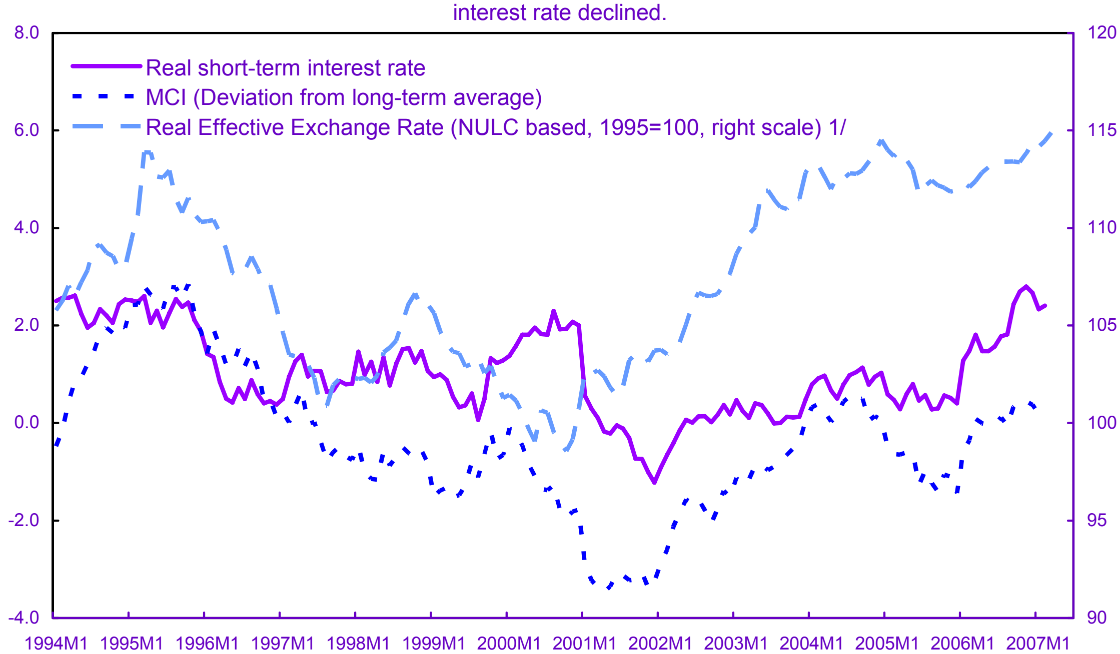
Sources CPB; IMF, INS, DOT, and *WEO* .

Figure 5. Netherlands: Monetary Conditions

Interest rates have increased steadily since the end of 2005.



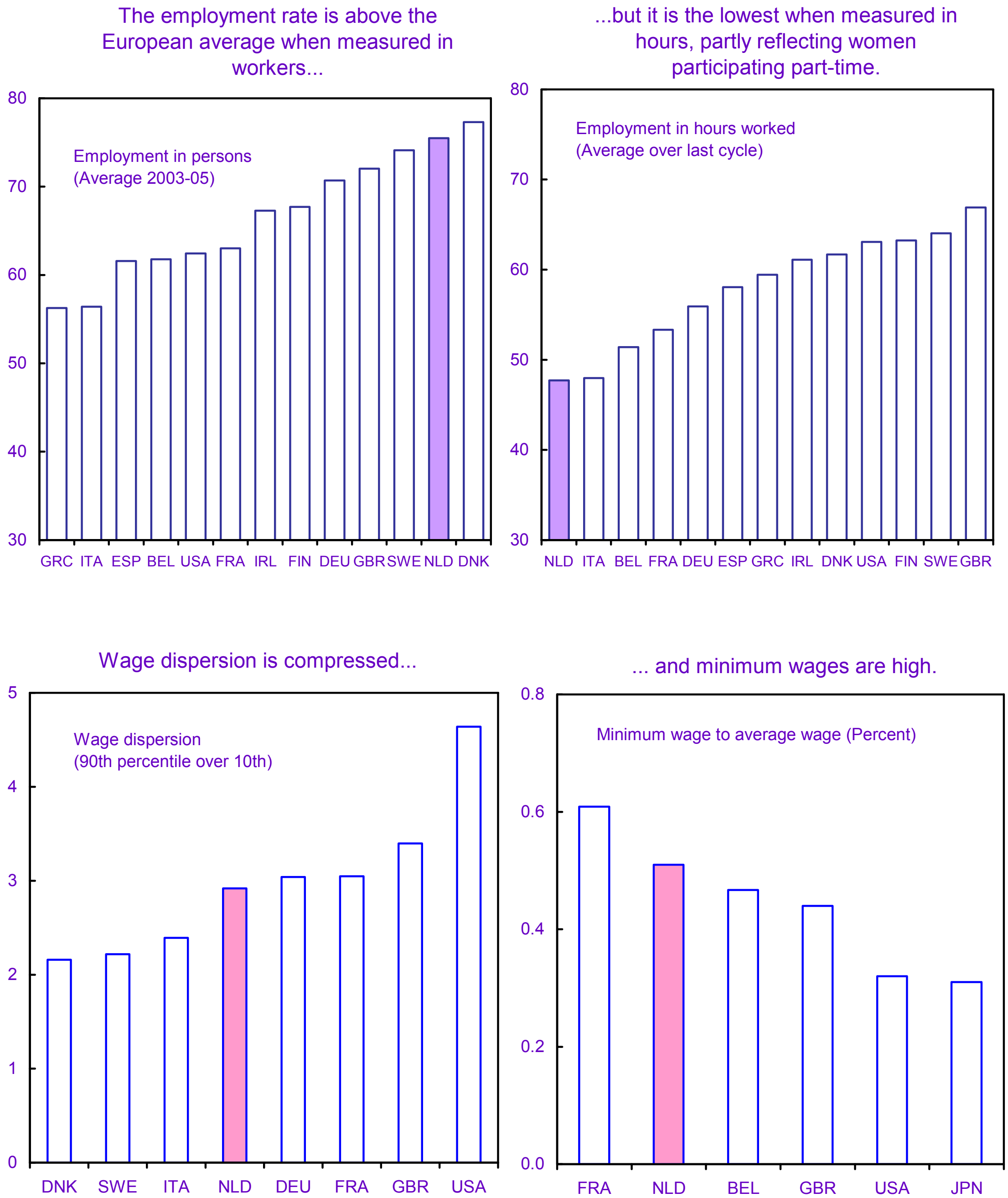
Monetary conditions tightened in 2006, easing somewhat toward the end of the period as the real interest rate declined.



Sources: Global Insight; and IMF, *IFS*.

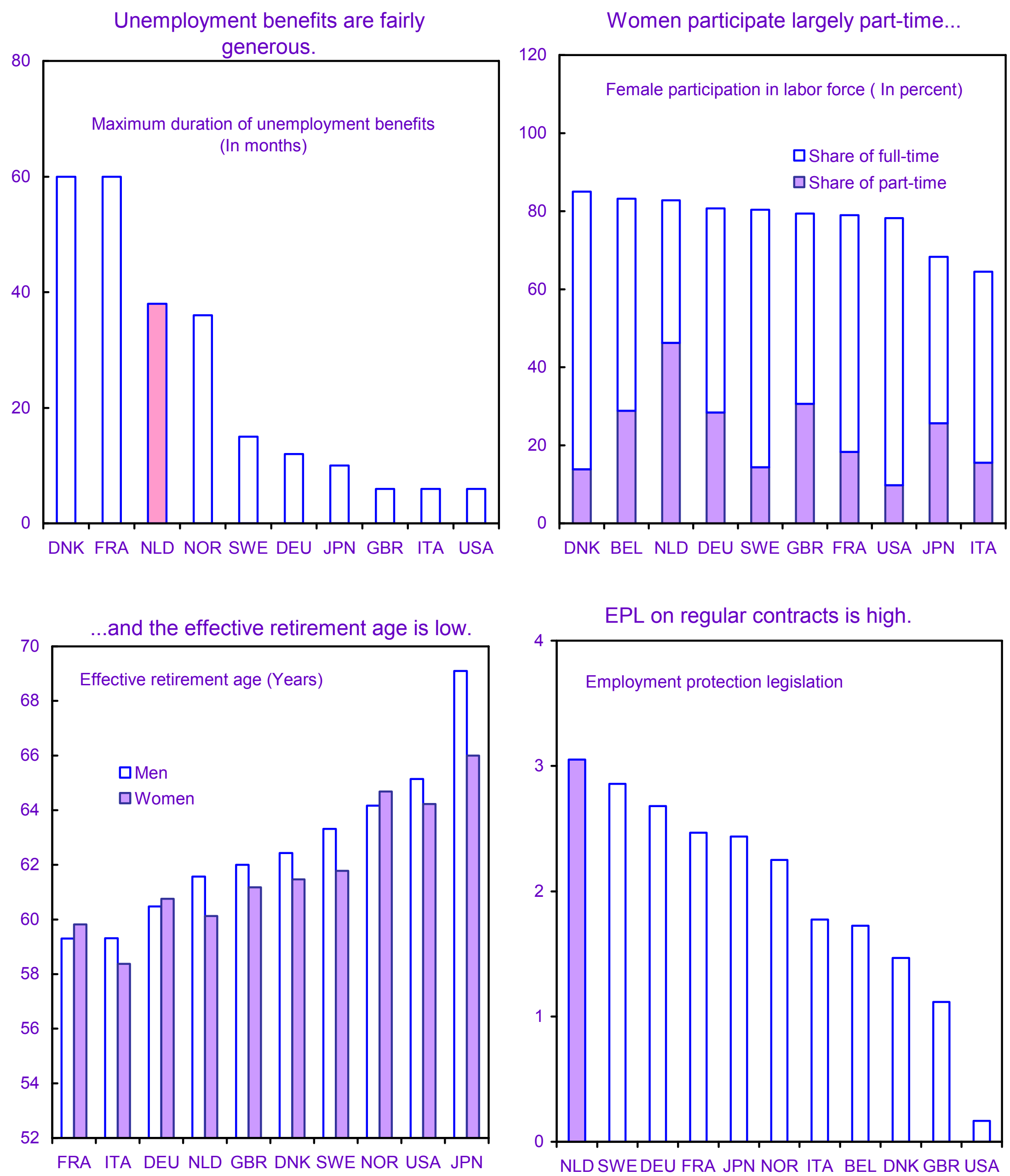
1/ An increase implies less accommodative conditions.

Figure 6. Netherlands: Selected Labor Market Indicators



Source: OECD.

Figure 6. Netherlands: Selected Labor Market Indicators (Concluded)



Source: OECD.

Appendix I. The Netherlands: Possible Measures to Reduce the Sustainability Gap

In light of the wide-ranging political debate on aging in the Netherlands, various measures that would more than close the sustainability gap have been suggested by different political parties and evaluated by the CPB. These measures and their effects are shown in the table below.

The Netherlands: Possible Sustainability-Enhancing Measures and Their Effects in Reducing the Sustainability Gap

(In percent of GDP)

Reforming aging-related institutions	
Increase of retirement age from 65 to 67 years	0.6
Reduction of the old-age related deduction in income tax	0.7
Reduction of cost of health care (higher contribution rates)	0.7
Increasing labor participation	
Shortening of unemployment benefit from 3 to 1.5 years	0.2
Individualization of the general tax credit 1/	0.4
Phasing out tax deductibility of mortgage interest payments 2/	0.1–0.2
Raising savings	
Fiscalization of pension savings (for high income) 3/	0.2
Cutting government consumption by 0.5% of GDP	0.5

Source: CPB and the Study Group on the Budget Margin.

1/ In the present tax system, only one person in each household—the one with the lowest income—has the right to the general tax credit (i.e., an allowance up to €1,990 per person). This acts as a disincentive for the lower income member of the household to participate fully on the labor market if the combined income tax of the household is then above the threshold of the allowance. By individualizing the general tax credit, both partners can get the allowance while lessening the disincentive to increased labor participation.

2/ Full details not available.

3/ This measure calls for high income earners to pay social contributions on their pension savings (presently, pension savings are not subjected to social insurance premiums in the Netherlands).

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

Staff Report for the 2007 Article IV Consultation—Informational Annex

Prepared by the European Department

May 22, 2007

Contents | Page

ANNEX I. THE NETHERLANDS: FUND RELATIONS

(As of April 30, 2007)

The 2007 Article IV discussions were held in Amsterdam and The Hague during March 29–April 10, 2007. The staff team comprised Messrs. Feldman (head), Nadal De Simone, Moore (all EUR), and Roger (MCM). 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 Social and Economic Council (SER), representatives of labor unions, employer organizations, and parliament, the financial sector, including banks and pension funds, and academics.

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

The authorities released the mission's concluding statement, organized a press conference at the end of the mission, and agreed to the publication of the staff report.

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	4,768.24	92.36
Reserve position in Fund	394.17	7.64

III. **SDR Department**

	SDR Million	**Percent of Allocation**
Net cumulative allocation	530.34	100.00
Holdings	558.76	105.36

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			
	2008	2009	2010	2011
Principal				
Charges/interest	0.03	0.03	0.03	0.03
Total	0.03	0.03	0.03	0.03

VII. **Exchange Rate Arrangements**:

The Netherlands' currency is the euro, which floats freely and independently against other currencies.

VIII. **Article IV Consultation**:

Discussions for the 2006 Article IV Consultation were held in Amsterdam and The Hague from April 27–May 9, 2006. The staff report for the 2006 Article IV Consultation (IMF Country Report No. 06/283, 07/31/06) was considered by the Executive Board on July 26, 2006. The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle.

IX. **Exchange Restrictions**:

The Netherlands' exchange regime is free from exchange restrictions and multiple currency practices, except for restrictions imposed solely for security reasons, notified to the Fund under Executive Board Decision No. 144-(52/51) and in compliance with the relevant UN Security Council Resolutions and/or EU regulations. In this regard, the Netherlands maintains exchange restrictions, with certain exemptions and often only for certain persons, vis-à-vis Belarus, Bosnia and Herzegovina, the Democratic Republic of the Congo, Côte d'Ivoire, Croatia, Iran, Lebanon, Liberia, Sudan, Syria, and Zimbabwe; specific individuals associated with the previous government of the former Republic of Yugoslavia; Myanmar; and certain persons and entities with a view to combating terrorism, Osama bin Laden, the Al-Qaeda network, and the Taliban.

ANNEX II. THE NETHERLANDS: STAFF ANALYTICAL WORK ON THE KINGDOM OF THE NETHERLANDS—NETHERLANDS, 2000–06

Fiscal Policy

- *Volatility of Tax Revenues in the Netherlands,* IMF Country Report No. 06/284.
- *Budgetary Policymaking in the Netherlands*, IMF Country Report No. 05/225.
- *Recent Fiscal Developments in the Netherlands*, IMF Country Report No. 04/301.
- *Medium-Term Fiscal Policy,* IMF Country Report No. 02/123.
- *Health Care Reform*, IMF Country Report No. 02/123.

The Financial Sector

- *House Prices in the Netherlands: Determinants, Concerns, and Considerations Related to Phasing Out the Tax Deductibility of Mortgage Interest Payments,* IMF Country Report No. 06/284.
- *The Financial Sector in the Netherlands: A Health Check and Progress Report on the FSSA Recommendations,* IMF Country Report No. 05/225.
- *House Prices in the Netherlands,* IMF Country Report No. 05/225.
- *Second Pillar Pensions, Stock Market Returns, and Labor Demand,* IMF Country Report No. 03/240.

Labor Markets

- *Wage Bargaining in the Netherlands,* IMF Country Report No. 03/240.
- *Inactivity and Poverty Traps,* IMF Country Report No. 02/123.
- *Reform of the Disability Program,* IMF Country Report No. 02/123.
- *The Labor Income Tax Credit in an International Perspective,* IMF Country Report No. 01/96.

Growth, Productivity, and Related Cyclical Issues

- *Potential Growth and Total Factor Productivity in the Netherlands,* IMF Country Report No. 06/284.
- *The External Competitiveness of the Dutch Economy: A Short Note on Evidence from both Aggregate and Disaggregate Data,* IMF Country Report No. 05/225.
- *Long-Run Household Consumption Equilibrium in the Netherlands,* IMF Country Report No. 05/225.
- *Recent Productivity Trends in the Netherlands,* IMF Country Report No. 04/301.
- *Estimating Potential Growth and Output Gaps for the Netherlands,* IMF Country Report No. 03/240.
- *Dealing with Cyclical Tensions,* IMF Country Report No. 00/88.

ANNEX III. THE NETHERLANDS: 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 previous government's term (2004–07), closer coordination between central and local governments, and refinements to the fiscal framework. Structural fiscal consolidation of over 3 percentage points of GDP was achieved in 2004–06. The authorities have improved coordination between various levels of government. In addition, the new government announced a target of a structural fiscal surplus of 1 percent of GDP by 2011, broadly consistent with IMF recommendations during the 2006 Article IV consultation. The new government also made several refinements to the fiscal framework in line with staff recommendations.

Labor Market Reform: Broadly in line with Fund advice, but sometimes to a lesser extent than recommended, unemployment benefits were tightened; fiscal incentives for early retirement abolished; inactivity traps gradually reduced; disability revamped; and reform of employment protection legislation (EPL) is being discussed. Recommendations not yet adopted 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, including the unbundling of the energy market, the reduction in required licenses and permits, and, more generally, the efforts to increase competition. The powers of the competition authority have been increased. It is expected that the administrative burden will have been reduced by the targeted 25 percent by 2007; the new government is aiming for a reduction of the same size during its term.

Financial Sector: The authorities have made substantial progress in stress testing and implementing risk-based supervision.

ANNEX IV. THE NETHERLANDS: STATISTICAL ISSUES

April 26, 2007

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 institutional reforms had a significant impact on national account and other data in 2006. Most importantly, the reform of health care insurance caused a significant reclassification of private consumption into public consumption. This shift had a big impact on the growth rates of the components concerned, but overall GDP was not affected.

The frequency and timeliness of the availability of the statistical indicators required 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. In addition, they have committed to a ROSC data module mission tentatively set for later this year.

NETHERLANDS: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(as of April 26, 2007)

	Date of Latest Observation	Date Received	Frequency of Data	Frequency of Reporting	Frequency of Publication
Exchange Rates	Current	Current	Daily and Monthly	Daily and Monthly	Daily and Monthly
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/07	4/10/07	Monthly	Monthly	Monthly
Reserve/Base Money[2]	02/07	04/07	Monthly	Monthly	Monthly
Broad Money[2]	02/07	04/07	Monthly	Monthly	Weekly and Monthly
Central Bank Balance Sheet	02/07	4/07	Monthly	Monthly	Monthly
Consolidated Balance Sheet of the Banking System	02/07	4/07	Monthly	Monthly	Monthly
Interest Rates[3]	Current	Current	Daily and Monthly	Daily and Monthly	Daily and Monthly
Consumer Price Index	03/07	4/18/07	Monthly	Monthly	Monthly
Revenue, Expenditure, Balance and Composition of Financing[4,5] – General Government[6]	Q4 2005	Jun.05	Quarterly	Quarterly	Quarterly
Revenue, Expenditure, Balance and Composition of Financing[4,5]– Central Government	02/07	4/07	Monthly	Monthly	Monthly
Stocks of Central Government and Central Government-Guaranteed Debt[7]	Q1 2007	Apr. 07	Quarterly	Quarterly	Quarterly
External Current Account Balance	Q4 2006	Apr. 07	Quarterly	Quarterly	Quarterly
Exports and Imports of Goods and Services	Q4 2006	Apr. 07	Quarterly	Quarterly	Quarterly
GDP/GNP	Q4 2006	4/13/07	Quarterly	Quarterly	Quarterly
Gross External Debt	Q4 2006	Apr. 07	Quarterly	Quarterly	Quarterly

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Pertains to contribution to EMU aggregate.
[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] While data on total revenues and expenditures and the fiscal balance of the general and central governments are available on a monthly basis, detailed breakdowns are not available on that high frequency.
[6] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[7] Including currency and maturity composition.

Statement by the IMF Staff Representative
June 13, 2007

1. This staff statement provides information on developments that has become available since the preparation of the staff report for the 2007 Article IV Consultation. The new information does not alter the thrust of the staff appraisal.

2. **Recent data are broadly in line with staff projections.** Real GDP in the first quarter of 2007 was 0.6 percent higher than in the previous quarter (2.5 percent higher than a year earlier). Meanwhile, consumer and producer confidence have remained strong through May 2007; unemployment has continued to fall, with the number of unemployed in April 2007 reaching the lowest level in four years; and year-on-year CPI inflation in May (HICP basis) was 2.0 percent.

3. **The 2007 fiscal deficit is now officially projected to be larger than reported in the staff report.** In particular, in the Spring Memorandum (a document sent by the ministry of finance to parliament in late May that contains a midyear overview of the current budget), the authorities project a 2007 general government deficit of 0.7 percent of GDP (versus their earlier projection of a deficit of 0.1–0.3 percent of GDP as noted in the staff report). This widening of the projected deficit mainly reflects lower natural gas revenues and health sector overruns. The revision strengthens the staff report's case for early remedial actions to tighten the fiscal stance and return to a course of fiscal consolidation.

Statement by Age Bakker, Executive Director for
Kingdom of the Netherlands—Netherlands
June 13, 2007

I thank staff for their to-the-point assessment and I would like to convey the appreciation of the authorities for the open and in-depth discussions during the mission.

After several years of headwind, the Dutch economy has been advancing above potential growth since last year. Although major structural reforms have been carried out in the past years, challenges remain. The new coalition government, which took office in February, is well aware of these challenges. It has put forward several additional measures, focused on increasing labor participation and improving the long-term sustainability of public finances.

Economic outlook

Following a kick-start driven by exports in the first part of the cycle, economic growth is now broad based, with domestic demand fuelled by increasing consumer and producer confidence. Although it has not yet reached the levels that were registered at the turn of the century, consumer confidence has steadily increased since 2003. Household consumption is forecasted to grow rapidly this year, but is still only marginally above its long-term average. Investment grew rapidly in 2006, bolstered by a steady positive trend in producer confidence, increasing profits, and accelerating production. This year, investment growth is expected to decelerate somewhat, before picking up again to high levels. In general, the short term outlook for the Dutch economy is positive: economic growth is forecasted to remain well above potential and the output gap is expected to turn positive in 2008.

Fiscal policy

The Netherlands has a well-developed pension system, including a significant (funded) second pillar, and is, as rightly noted by staff, relatively well-placed to cope with the budgetary cost of ageing. Nevertheless, the government is committed to further improve the long-term sustainability of public finances. Budgetary consolidation, in combination with structural reforms, is planned to deliver such an improvement and to reduce the so-called sustainability gap.

Previous governments have achieved a reduction of the debt ratio from close to 80 percent in the mid-nineties to well below 50 percent nowadays. The new government is committed to build on this achievement and has defined its budgetary policy agenda in light of an ageing population. The authorities have decided to set a target of a structural surplus of 1 percent of GDP in 2011, as previously recommended by staff. In conjunction with the measures aimed at higher labor participation, this is expected to lead to a decrease in the sustainability gap by approximately one third.

The Coalition Agreement of the new government provides for concrete measures to improve the fiscal position. On the revenue side, environmental taxes will be increased and the tax system will be revised with a view to enhance labor participation. On the expenditure side, gains are to be realized mainly through efficiency-enhancing measures. The most eyecatching example is the significant reduction in the number of civil servants by approximately 13,000, to be achieved before 2011. This figure amounts to 7 percent of the work force of the government, resulting in an expenditure reduction of € 630 million.

Since the completion of the Article IV mission, short-term setbacks in the fiscal position have appeared, resulting in a reversal from a budgeted surplus to an expected deficit of 0.7 percent GDP in 2007. Compared to the budget in September, this means a worsening of the balance by 0.9 percent of GDP. This can mainly be explained by lower gas revenues (0.5 percent of GDP) and expenditure overruns in the health care sector (0.2 percent of GDP). These setbacks in the fiscal position do, however, not alter the medium-term outlook. The government's aim is to once again register a budgetary surplus in 2008. To this end, the upcoming budget will include, among other things, measures to contain health care expenditures. Moreover, the authorities have reiterated their commitment to a structural surplus of 1 percent of GDP in 2011.

In the 2006 fiscal ROSC, the budgetary framework of the Netherlands was found to meet or exceed the principles of the fiscal transparency code. To achieve further improvement, the authorities have recently implemented some of the recommendations of the 2006 article IV consultation and the fiscal ROSC. These measures include a larger safety margin to avoid a breach of the EMU budgetary rules by lowering the signal value for the deficit from 2.5 percent of GDP to 2 percent of GDP. Moreover, interest payments have been brought outside the expenditure ceilings, the tradition of cautious growth assumptions has been replaced by using best (realistic) forecasts, and measures have been taken to improve the management of the resources in the government's savings fund for infrastructural outlays.

Financial sector

The report gives an accurate overview of the current state of the financial sector and financial stability in the Netherlands. I am pleased with staff's finding that the Dutch supervisory framework and implementation represents best international practice. Staff rightly expresses words of caution on the expansion of responsibilities of the Netherlands Authority for the Financial Markets (AFM) as a consequence of new domestic and EU legislation. The AFM is currently fully capable of executing its tasks, but the authorities agree that adding new large tasks could negatively impact the execution of its core responsibilities and note there is no intention to broaden the mandate of AFM.

Staff rightly notes that cross-border banks require intensified coordination with supervisors in other countries. Because of the strong internationalization of the Dutch financial sector, the authorities gained a lot of experience in this respect, both within and outside of the European Union. It is expected and needed that coordination and cooperation among supervisors and other authorities will be strengthened in the future. Staff also signals a possible increase in competition in the pension sector from foreign-based providers and the need for measures to increase transparency of pension supervision in the EU. I agree that transparency is a key issue in this matter. It is crucial that all parties involved have a complete and thorough view of the consequences of differences in supervisory regimes in EU Member States.

Structural reforms
The structural reforms of the past years, like the overhaul of the disability scheme, continue to pay off. Labor participation increased by one percentage point in 2006 compared to 2005 and is expected to increase further one percentage point in 2007. Although the effect is waning in 2007 and 2008, the additional labor supply stemming from policy measures is still estimated at 50,000 persons. Last year, the Dutch competitive position increased for the first time since 2000. The structural reforms and the improvement of the competitive position have helped Dutch companies to take full advantage of the favorable development of the world economy. The return-on-equity has steadily improved over the past few years and is currently at the highest level since the mid-eighties.

Notwithstanding the increase in labor supply, labor market tensions are reappearing in some segments. Labor market shortages which would lead to substantial wage increases would prevent a significant improvement in the Dutch competitive position and limit the extent to which the economy can grow in the current economic upswing. Further increasing labor supply by fostering labor participation is therefore of utmost importance. A key goal of the government is to increase participation in society in general and in labor markets more specifically. In the past three years labor market dynamics have already gone in the right direction. New and filled vacancies have been increasing since the second quarter of 2003.

The government plans various measures which should help to further enhance labor participation. Measures will be specifically targeted at groups currently underrepresented in the workforce, notably older workers, women, and foreign-born workers. The measures foreseen include a reduction of the possibility to transfer the general tax credit from the non-working to the working partner and the introduction of an earned income tax credit to make low-paid work more attractive. Moreover, the tax credit for the working elderly will be increased and stronger incentives in the state pension will be introduced. These measures aim to increase the attractiveness of continued employment at an older age. At the same time, the government intends to improve labor-market participation of young people in co-operation with the private sector.

Conclusion
The structural reforms implemented over the past few years continue to pay off. The flexibility and competitiveness of the economy have improved, the structural budgetary position has significantly improved, and with domestic demand picking up, economic growth is now broad based. Although the expected deterioration in the fiscal position in 2007 is disappointing, it does not change the medium-term and long-term fiscal outlook. The authorities are committed to put forward measures in the 2008 budget to again achieve a budgetary surplus. Moreover, the target of a structural surplus of 1 percent of GDP in 2011, combined with the planned structural reforms, is expected to address one third of the sustainability gap. The reforms in the labor market will also help to alleviate upward pressure on wages. All in all, this makes the Netherlands relatively well-placed to reap the benefits of the current benign international economic environment and to cope with the budgetary cost of ageing.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 07/70
FOR IMMEDIATE RELEASE
June 22, 2007

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

IMF Executive Board Concludes 2007 Article IV Consultation with the Kingdom of the Netherlands — Netherlands

On June 13, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands — Netherlands.[1]

Background

Economic performance has been strong. The economic recovery is firmly entrenched and compares favorably in a European context. The unemployment rate has declined significantly while inflation has stayed in check—though resource constraints are emerging. Economic expansion and rising stock prices have contributed to a cyclical strengthening of the financial sector, especially pension funds and insurance companies.

With the large current account surplus, and exports and overall growth doing well, external competitiveness would appear to be satisfactory. Improvements in the macroeconomic and business environments and technological innovation have contributed positively to Dutch competitiveness. Though domestically produced exports have lost some market share in recent years, the growth of reexports has been very strong, and the external sector is contributing positively to economic growth.

Recent fiscal performance was impressive. The general government balance shifted from a deficit of 3.1 percent of GDP in 2003 to a surplus of 0.6 percent of GDP in 2006. This

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[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.

adjustment had a large structural component, reflecting contributions from expenditure cuts and revenue measures; larger gas revenues also contributed.

A major challenge for policymakers is addressing population aging. As in other countries in the region, the Netherlands faces a rising dependency ratio in coming decades. The Netherlands is comparatively well placed to address aging, in the sense of having the advantages of a favorable initial fiscal position and a large, fully funded, second pension pillar. Nevertheless, ensuring fiscal sustainability still requires a combination of further fiscal consolidation and other sustainability-enhancing structural reforms.

The financial sector has benefited from the economic recovery, but some vulnerabilities remain. Bank capital adequacy is well above minimum requirements, and pension funds and insurance company's coverage ratios have recovered to around 2001 levels. Nonetheless, low profit margins in the banking sector and EU measures to promote pension mobility suggest that foreign penetration of the Dutch financial system could increase, posing challenges for supervision. High indebtedness in both the non-financial corporate and household sectors make them vulnerable to rising interest rates. It has also led to the introduction of a code of conduct setting limits on mortgage lending to prevent households from over-borrowing, but the code's effectiveness remains to be seen. The housing market, more broadly, is affected adversely by distortions, including the tax deductibility of mortgage interest payments and rent controls.

Against this background, the consultation focused on the near-term economic outlook; fiscal policy during the new government's term, including with a view to addressing population aging and securing fiscal sustainability; safeguarding financial stability; and structural reforms to raise participation and productivity, which would also have favorable effects on potential growth and fiscal sustainability.

Executive Board Assessment

Executive Directors commended the authorities for the significant fiscal adjustment achieved in recent years and for their implementation of difficult structural reforms. They also welcomed the continued strong and broad-based growth performance of the Dutch economy. In the current situation of robust economic growth and a tightening labor market, Directors stressed the importance of further fiscal consolidation, not only to reduce potential overheating risks, but also to further efforts to address the fiscal implications of population aging. In addition, they underscored the benefits of additional structural reforms to enhance labor supply and flexibility.

Directors observed that this year's fiscal stance could add stimulus at a time of emerging resource constraints. They accordingly encouraged the authorities to tighten the fiscal stance as soon as possible, locking in any unexpected saving in 2007, and ensuring that the 2008 budget makes decisive progress toward securing the medium-term fiscal surplus target.

Directors emphasized that continued improvement in the underlying fiscal position requires tight spending control. They recommended that the authorities implement offsetting expenditure-reducing measures before putting in place envisaged spending increases; set prudent expenditure ceilings through 2011, in the context of preparing the 2008 budget; and carefully monitor health care, in order to counter a tendency toward overruns in the sector.

Directors supported the new government's target of a general government structural surplus of 1 percent of GDP by 2011. They also commended the authorities' commitment to maintaining the fiscal framework, which is anchored in multiyear real expenditure ceilings and has imparted discipline and transparency. However, with planned measures closing only part of the fiscal sustainability gap, Directors underscored the importance of identifying and implementing additional sustainability-enhancing measures, in order to provide a larger margin for addressing the aging problem and better protecting intergenerational equity. In the same vein, Directors encouraged the authorities to err on the side of a higher-than-targeted surplus in executing fiscal policy.

Directors welcomed the strength and stability of the financial sector, stemming both from the macroeconomic upswing and from improvements in supervision and risk management. In this context, they commended the risk-oriented, cross-sectoral approach to financial sector supervision, pointing out that, in many respects, the design and implementation of supervision in the Netherlands are international best practice. While welcoming the adoption of the mortgage code of conduct, intended to limit excessive household indebtedness, Directors nevertheless observed that it does not address the underlying tax incentive to maximize mortgage debt. In addition, Directors generally saw benefits from rectifying distortions adversely affecting both the supply and demand side of the housing market.

Directors attached considerable urgency to efforts to increase labor supply, both to ease the tight labor market and to address aging-related challenges. They noted that the elimination of the transferability of the general tax credit would have a more significant near-term impact if phased out over a shorter period than the envisaged 20 years. Directors also encouraged consideration of other policies to boost the supply of labor—including a shorter duration for unemployment benefits and raising the retirement age in line with increases in life expectancy. Measures to enhance labor supply would contribute to a continuation of wage moderation, needed to maintain competitiveness and take full advantage of the favorable external economic outlook.

Directors saw scope to boost productivity and the sustainable growth rate. They welcomed actions to increase the role of market forces in various sectors, strengthen the investigative powers of the competition authority, and reduce administrative burdens. They urged further efforts to make employment protection legislation less stringent, with a few Directors highlighting the benefits of greater wage differentiation.

Directors commended the authorities for their commitment to Official Development Assistance.

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. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2007 Article IV Consultation with Kingdom of the Netherlands—Netherlands is also available.

The Kingdom of the Netherlands — Netherlands: Selected Economic Indicators

	2003	2004	2005	2006	2007 1/	2008 1/
Real economy (change in percent)						
Real GDP	0.3	2.0	1.5	2.9	2.9	2.7
Domestic demand	0.4	0.6	0.9	2.7	2.5	2.5
CPI (harmonized)	2.2	1.4	1.5	1.7	1.8	2.1
Unemployment rate (in percent)	4.1	4.9	5.0	4.1	3.4	3.3
Gross national saving (percent of GDP)	24.8	28.2	25.7	26.7	27.5	28.5
Gross domestic investment (percent of GDP)	19.3	19.3	19.3	19.7	20.5	21.1
Public finance (percent of GDP)						
General government balance	-3.1	-1.8	-0.3	0.6	-0.1	0.7
Structural balance	-2.5	-1.2	0.5	1.0	-0.1	0.5
General government debt	52.0	52.7	53.8	53.2	53.3	52.7
Interest rates (percent)						
Money market rate 2/	2.3	2.1	2.2	3.1	3.8	...
Government bond yield 2/	4.2	4.1	3.4	3.8	4.0	...
Balance of payments (in percent of GDP, unless otherwise indicated) 3/						
Trade balance	6.6	7.1	7.0	7.7	8.2	8.2
Current account	5.4	8.9	6.3	7.1	7.4	7.3
Official reserves, excl. gold (US$ billion) 2/	11.2	10.7	9.0	10.8	10.4	...
Reserve cover (months of imports of GNFS)	0.4	0.4	0.3	0.3	...	...
Exchange rate						
Exchange rate regime	Member of EMU					
U.S. dollar per euro	1.13	1.24	1.25	1.26	1.30	1.31
Nominal effective rate (2000=100) 2/	106.3	107.6	107.7	108.2	109.1	...
Real effective rate (2000=100) 2/ 4/	110.9	113.0	112.6	113.0	114.1	...

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

1/ Staff projections, unless otherwise indicated.
2/ As of March for 2007.
3/ Transactions basis.
4/ Based on relative normalized unit labor costs.