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# Kingdom of the Netherlands—Netherlands: 2002 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 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 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **March 25, 2002,** 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 16, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of **June 5, 2002** updating information on recent economic developments;

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its June 10, 2002 discussion** of the staff report that concluded the Article IV consultation.

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

Selected Issues Paper

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

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KINGDOM OF THE NETHERLANDS—NETHERLANDS

# Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representative for the 2002 Consultation
with the Kingdom of the Netherlands—Netherlands

Approved by Ajai Chopra and Michael T. Hadjimichael

May 16, 2002

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## I. Introduction

1. A staff team comprising Mr. Ford (head), Ms. Detragiache and Zhou (EU1), and Ms. Jaumotte (FAD) visited Amsterdam and the Hague during March 15-25, 2002. Mr. Nijsse (Advisor to the Executive Director) also attended the meetings. In concluding the 2001 consultation, Directors judged that the projected economic slowdown should ease inflationary pressures, but recommended avoiding fiscal stimulus. While welcoming strong labor-market performance, Directors urged reform of the disability program and noted that, despite recent initiatives, those with low earning power still faced large work disincentives.

2. Elections were held on May 15. Data provision is timely and adequate for surveillance purposes (Appendix II). The Netherlands has accepted the obligations of Article VIII. An FSAP is scheduled for 2003/04. The authorities have expressed their intention to publish this report.

## II. Background

3. **Five years of strong economic expansion gradually increased inflationary pressures**. Real GDP growth during 1996-2000 averaged 3.7 percent a year, compared to a staff estimate of potential growth of about 2¾ percent, and the unemployment rate fell from 6.6 percent to 2 percent (Table 1, Figure 1). Sharply rising asset prices—especially house prices—were an important factor sustaining domestic demand growth (Figure 2).[1] On staff estimates, real GDP had overtaken potential by 1998, a development that was increasingly reflected in higher labor compensation growth, a widening inflation differential with the euro area, and by 2000 rising underlying inflation (Figure 3).

4. **One consequence has been an erosion of international competitiveness, from quite strong levels**. Although the depreciation of the euro sustained overall competitiveness, the position vis-à-vis the euro area has deteriorated since 1997 (Figure 4). Wage growth remained below productivity growth during this period (as shown by the negative real wage gap), but was less restrained than in neighboring countries (Figure 5). Dutch productivity growth itself has lagged compared to the EU (Figure 6), reflecting more extensive employment growth which tended to bring lower skilled people into the workforce. Nevertheless, exports have kept pace with market growth, though not if energy and re-exports are excluded. The trade surplus also remains strong, even against the euro area and even excluding re-exports. On the other hand, there have been increasing reports that profits are being squeezed, particularly in the tradable sector.

5. **The slowdown in 2001 eased demand pressures**. In 2001, growth fell to only 1.1 percent, as worldwide economic activity faltered, oil prices rose, the stock market fell,

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[1] The authorities estimate that wealth effects boosted GDP growth by about ½ a percentage point a year.

house prices began to stabilize, and animal disease cut exports. As a result, the output gap has been essentially eliminated and the unemployment rate, though still low due to labor hoarding, edged up in the first quarter of 2002. Inflation has not fallen as much as anticipated, even after the mechanical effect of the VAT increase (which raised the price level by an estimated 1 to 1¼ percent in 2001) dropped out at the beginning of 2002. But inflation also appears to have fallen less than expected in a number of other euro-area countries, due in part to rising food prices and, to a lesser extent, the introduction of the euro; the effects of both factors are expected to be reversed.

6. **The sustained process of fiscal consolidation paused in 2001.** The commitment of successive governments to four-year fiscal frameworks had helped to reduce, as a share of GDP, expenditures and taxes over time (Figure 7). By 2000 the Netherlands enjoyed a substantial fiscal surplus, which declined sharply last year, to only 0.2 percent of GDP. This deterioration was due to slowing growth, as well as the tax reform, which contributed to a weakening of the structural balance of 0.6 percent of GDP, from a surplus of 0.2 percent of GDP to a deficit of 0.4 percent of GDP.[2]

## III. Policy Discussions

7. **Against this backdrop, discussions revolved around the near-term outlook, policies to mitigate potential demand pressures, and medium-term structural issues.** It was agreed that expansionary fiscal policy should be avoided, and structural policy should be geared to expanding the labor force and raising productivity growth. An important component of the discussions was several policy papers that had been produced during 2001 and early 2002 for consideration by the incoming government. A number of these are discussed in the Selected Issues paper accompanying this report.

### A. The Short-Term Outlook

8. **The staff projects growth to resume during 2002.** Industrial confidence, though low, appears to have turned around, although consumer confidence remains weak (Figure 8), the international climate is expected to improve significantly, and the stance of euro-area monetary policy eased substantially in 2001 (Figure 9). Indeed, although monetary conditions are broadly appropriate for the euro area as a whole, they remain somewhat expansionary for the Dutch economy, given its smaller output gap. In common with the authorities (the Netherlands Bureau of Economic Policy Analysis, or CPB) and other forecasters, the staff projects real GDP growth to pick up by the second half of this year to an annual rate of about 2¾ percent, or about potential, where it remains through 2003 (see table below, Figure 1).

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[2] The tax reform, implemented in 2001, raised indirect taxes (notably the VAT), reduced direct taxes, reformed personal capital-income taxation, and on net increased the deficit by about ¾ percent of GDP.

| Netherlands: Growth and Inflation Forecasts | | |
|---|---|---|
| | 2002 | 2003 |
| **GDP growth** | | |
| IMF | 1.4 | 2.7 |
| CPB | 1.5 | 2.5 |
| EC | 1.5 | 2.7 |
| OECD | 1.4 | 2.6 |
| Consensus forecast (April) | 1.4 | 2.9 |
| | | |
| **Consumer price inflation** | | |
| IMF | 3.4 | 2.3 |
| CPB | 3.3 | 2.5 |
| EC | 3.5 | 2.2 |
| OECD | 3.4 | 2.4 |
| Consensus forecast (April) | 3.1 | 2.3 |

9. **While inflation is projected to abate, it is likely to remain above that in the euro area**. The lagged effects of the slowdown are expected to raise unemployment further, tempering wage demands and gradually reducing inflation this year and next. But inflation will still be higher than that in the euro area, and the further erosion in competitiveness would continue the macroeconomic adjustment to demand pressures in a monetary union. That said, the mission shared the authorities' concern that the process might overshoot, particularly if this year's wage settlements did not take softening labor market conditions fully into account. The mission argued that greater wage dispersion would help to prevent settlements in sectors with particularly tight labor markets (such as construction and financial services) from spilling over to the economy as a whole.[3] The social partners appear increasingly to accept wage differentiation in response to market conditions, although the authorities pointed out that administrative extension of wage settlements is still common. Additionally, it was agreed that further structural reform would ease pressures by raising labor supply, though it would take some time for such policies, once implemented, to have an effect.

10. **The risks to the near-term growth outlook relate mainly to the evolution of house prices, the value of the euro, and oil prices**. Large falls in house prices would depress household consumption: the authorities estimate that, in the past, house-price increases on the order of 15-20 percent a year boosted annual GDP growth by perhaps 0.3–0.4 percentage points. Large falls in house prices could also lead to sharp declines in property values and rising mortgage defaults, thereby straining the banking sector; this issue is taken up below in Section D. An appreciation of the euro or higher oil prices would tend to slow growth, both directly and indirectly through effects on the euro area; based on their MORKMON model, the authorities estimate a 5 percent appreciation or a 10 percent rise in oil prices would shave about 0.1 percentage point off short-term growth.

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[3] Wage differentials are small by international standards. See van der Wiel, "Interindustry Wage Differentials in the Netherlands," CPB Bulletin 98/4.

## B. Fiscal Policy

11. **The mission welcomed the fiscal tightening expected in 2002, and there was agreement that fiscal stimulus should be avoided in 2003.** Neither the authorities nor the mission felt that the risk of overshooting warranted a discretionary fiscal tightening, which would be disruptive and contrary to the medium-term fiscal philosophy that had served the Netherlands well in recent years. However, the expected fall in the structural deficit of about ½ a percent of GDP in 2002 would be helpful in the short run, and a useful step toward the medium-term surplus objective (see the next paragraph).[4] For 2003, the CPB projected a deterioration in the deficit from balance this year to a deficit of ½ a percent of GDP in 2003, due in part to a peak in infrastructure spending and higher unemployment insurance outlays. (In the absence of a 2003 budget or a new four-year fiscal framework, this projection does not necessarily represent policy.) Although the CPB calculated that this deterioration would imply a very small structural improvement, due to long lags in tax collection, the staff calculated a structural deterioration of nearly ½ a percent of GDP.[5] The mission therefore recommended that the nominal deficit not be allowed to deteriorate. The authorities agreed with this position, but did not commit to a substantial structural tightening (although on CPB calculations budget balance in 2003 would imply a structural improvement of about ½ a percent of GDP).

12. **An advisory report recommended a medium-term surplus of 1¼ - 1¾ percent of GDP.**[6] The CPB has elaborated a fiscal program in which rapidly achieving, and then sustaining, such a surplus provides room for financing the fiscal costs of population aging—projected to be 4¼ percent of GDP in 2040—while stabilizing tax rates (see Chapter 1 of the Selected Issues paper). The mission supported such a program for two main reasons. First, it would help to ensure long-term fiscal solvency and spread the burden of the fiscal costs of aging across generations. Also, delaying action in the surplus would allow somewhat lower taxes in the short run, but only at the cost of substantially higher taxes (and corresponding economic efficiency) later on. The mission also pointed to the tradeoff between aging-related expenditures and other demands on the budget, including sustainable tax cuts to promote economic growth, arguing that pension reform—for example, reducing payout rates or

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[4] The fall in the structural deficit is largely due to the timing of measures in the 2001 tax reform, which implies a fall in the deficit of ½ percent of GDP in 2002 that only partly offsets a rise in the deficit of 1¼ percent of GDP in 2001.

[5] The CPB assumes the cyclical effect on tax collections are lagged by ¾ of a year. Thus, low growth in 2002 would affect revenues in 2003. By contrast, the Fund assumes the effect is contemporaneous, except for corporate taxes, which are lagged by a year.

[6] This is within the range of demographically motivated targets adopted by other EU countries: for Belgium, a surplus of ¾ percent of GDP; for Sweden, 2 percent; and for Denmark, 2-3 percent.

raising the age of eligibility—should not be ruled out solely because the current system would be fiscally sustainable. The authorities noted that the Dutch system, with its large funded component, was widely considered among the best in the world.

13. **It was agreed that rapidly achieving this objective would require rather greater fiscal effort than was the case in the past four years.** The 2001 tax reform had worsened the starting point, and macroeconomic conditions in the next four years are set to be less favorable than in the past, with lower growth and higher unemployment in the offing (Table 2). Reaching even the lower end of the objective during the next government period would require real primary expenditure growth be held about 1/3 of a percentage point below real GDP growth (see table below), even in the face of demands for spending on health care, education, infrastructure, and public safety. The mission argued that such a tight expenditure path would be feasible, but would require prioritization and compression elsewhere, notably in programs such as disability insurance and job subsidies. The authorities noted that such considerations gave greater urgency to implementing proposed structural reforms (discussed in the next section) to free up budgetary resources.

Netherlands: Scenario for Fiscal Adjustment[1]
(In percent of GDP)

| | Change in **last** coalition agreement[2] | Change in **next** coalition agreement |
|---|---|---|
| General Government Balance | 0.8 | 1.4 |
| Structural balance[3] | 1.3 | 1.3 |
| Tax-GDP ratio | 0.5 | 0.0 |
| Primary expenditure | 0.6 | -1.3 |
| Primary expenditure excl. unemployment | 0.8 | -1.5 |

Source: CPB and Staff estimates.
[1] Assumes spending adjustment sufficient to reach a structural balance of 1¼ percent of GDP in 2006.
[2] Data for 2001 are estimates; data for 2002 are projections.
[3] In percent of potential output.

14. **The difficulty of meeting fiscal targets in the coming years also underscored the importance of renewing the fiscal framework.** The mission supported the key recommendations of a high-level study group: real expenditure ceilings which would not be exceeded even if revenues proved more buoyant than expected; the full play of automatic stabilizers (so long as the surplus remained between 0 to 3 percent of GDP); and a sharp reduction of the "safety margin" on assumed output growth. (See Chapter 1 of the Selected Issues paper for more detail.) The mission also argued that the operation of the stabilizers should not be cut off in the event of a deficit, especially since in the next two or three years surpluses are likely to be fairly small and thus the stabilizers, if left unhindered, could well result in a justifiable deficit. The authorities explained that this provision was meant to trigger a re-examination of the assumptions underlying the fiscal rules in the event the

balance deviated substantially from the medium-term target. The mission also suggested that the ceiling on expenditures be redefined to exclude cyclically sensitive items (notably unemployment insurance), to avoid unnecessarily squeezing other spending during slumps, and that it be aligned with national accounts concepts, to improve transparency. The authorities noted that the specifics of the new framework would be negotiated by the incoming coalition partners following the election.

## C. Labor and Product Market Issues

15. **The critical structural issues are raising employment rates and productivity growth over the medium term**. Progress on both fronts would help to increase living standards, particularly as population aging acts to reduce the available pool of labor supply. The Dutch labor market is held up as an example for continental Europe, as reforms over the past two decades delivered very low unemployment rates and rising participation and employment rates.[7] Yet, significant weaknesses remain: employment rates have only recently risen above the euro-area average; participation rates remain below average; and employment rates of some groups, such as those over 55, are very low (Figure 10). In many respects, achieving political and social consensus for further progress has proved difficult. The focus is currently on three key policy areas:

- Reform of the disability program. Although the Netherlands does not have a high dependency rate (the ratio of those on benefits to total employment) by international standards, the disability program is large and growing. Beneficiaries, the bulk of whom are deemed fully disabled, amount to about 980,000 or some 13 percent of total employment; and gross inflow into the program is now about 100,000 a year (see table below).

- Reducing inactivity and poverty traps at the low end of the earnings scale (see Chapter 2 of the Selected Issues paper). When totaled up, the host of available benefits greatly reduces the net benefit of taking a low-paying job.[8] For a one-earner family, moving from social assistance to a minimum wage job would result in an 8 percent loss in net income; and for some people the break-even point is 140 percent of the minimum wage. Also, as earned income increases many benefits are clawed back; therefore, over some income ranges the effective marginal tax rate (tax rates plus the rate at which benefits are lost) exceeds 100 percent.

[7] These trend improvements are attributable to, notably, wage restraint, structural reform, and a large influx of women into the labor force. See Watson, *et al.* (1999) "The Netherlands: Transforming a Market Economy," Occasional Paper 181.

[8] In 1997, the Netherlands had the second highest replacement rates for a typical family among OECD countries, although they have since fallen somewhat (OECD, "Benefits and Work Incentives," 1999).

- Reform of subsidized and public-sector job programs, which were originally meant to stimulate employment demand but have become increasingly inappropriate in a very tight labor market.

| Netherlands: Benefit Recipients Under the Age of 65 (In thousands) | | | |
|---|---|---|---|
| | Dec-99 | Dec-00 | Dec-01 |
| Unemployment insurance | 223 | 189 | 166 |
| *Of which*: less than one year (in percent) | 43.0 | 46.0 | 48.2 |
| Income support[1] | 370 | 341 | 323 |
| *Of which*: less than one year (in percent) | 20.3 | 19.4 | 19.5 |
| Disability insurance | 926 | 957 | 981 |
| *Of which*: full disability (in percent)[2] | 73.2 | 72.9 | 70.8 |
| Total | 1519 | 1487 | 1470 |
| Employment | 7076 | 7253 | 7392 |
| Percent of employment | 21.5 | 20.5 | 19.9 |

Source: Statistics Netherlands.
[1]Data refer to September.
[2]Data for 2001 refer to September.

A fourth priority is to increase productivity growth through further product-market reform. Productivity growth will necessarily become an increasingly important contributor to rising living standards as the population ages and the labor force shrinks.

16. **Regarding the disability program, the social partners had agreed a reform package**. The plan aims to reduce inflow by restricting the program to those judged fully and permanently disabled, strengthening medical examinations, and increasing the focus on returning to work (see Chapter 3 of the Selected Issues paper). The authorities endorsed several aspects of the plan, but not those weakening incentives facing potential beneficiaries and firms. While supporting the underlying goals of the proposal, the mission expressed strong reservations regarding certain details. Tougher medical criteria had been effective in the past, but had proven unsustainable. Also, the reform proposal would raise the replacement rate, which in the mission's view was already too high, making the program excessively attractive.

17. **Reducing inactivity and poverty traps would require limiting benefits and reducing the clawback rate at the low end of the earnings scale.** Limiting benefits, even via the mission's suggestion that they be indexed to prices rather than wages, was viewed as politically unpopular. And extending benefits higher up the earnings scale, to reduce the effective marginal tax rate by reducing the claw back, would be very costly. The labor-tax credit had reduced the traps somewhat, although the credit remains quite small. Enlarging it, however, was considered by the authorities to be too costly because, unlike the practice in France, the United Kingdom, and the United States, benefits are not phased out at higher incomes. The mission argued for such a phase-out, but the authorities pointed to simulations concluding that raising the effective tax rate higher up the earnings scale would cost more jobs than would be created by expanding the tax credit. The authorities did, however, suggest

that transparency could be improved by shifting some benefit programs to the tax system, and that municipal income redistribution efforts might be reined in. They noted that some municipalities had recently applied stricter sanctions for welfare benefits (which they administer), and felt that this trend would be reinforced by expanding the use of block grants to finance this program.

18. **Several subsidized and public-sector job programs seek to stimulate employment demand, particularly for the very low-skilled** (see table below). A recent government report concluded that these programs were poorly adapted to a labor market situation dominated by labor shortages, rather than insufficient labor demand. Both the authorities and the mission agreed with this diagnosis, and the mission accordingly called again for scaling down such schemes, while noting that reintegration might prove difficult in view of the large inactivity traps. The authorities argued that some subsidized jobs had proved useful and should be retained on their merits.

Netherlands: Subsidized Job Programs, 2000

| Program | Type of activity | Number of participants | Funding (million €) |
|---|---|---|---|
| WIW-work experience jobs | Private sector; limited to one year | 5,400 | 52 |
| WIW-service jobs | The employer is a municipality, but work is performed in the private sector | 34,800 | 512 |
| Inflow/Outflow jobs | Non-profit sector | 43,000 | 755 |
| WSW protected employment | Jobs in sheltered workshops for individuals with disabilities | 90,000 | 1,860 |

Source: Ministry of Social Affairs, "Aan de Slag," 2001.

19. **There appeared to be a sense of fatigue with respect to product-market reform.** However, the authorities viewed the MDW program (which develops reform proposals to be carried out by other ministries) as a success, as it had become entrenched in policymaking. They reported an increased focus on reducing regulatory barriers to innovation. This was part of a broader effort to increase productivity, which will need to be the key source of rising living standards in the future, when population aging will inevitably need to curtail the contribution of employment growth. However, the very ambitious goal to reduce overall administrative burden by 25 percent during the current government had not been met, although progress had been made. Liberalization of the energy sector was proceeding quickly. About ⅔ of the market had already been deregulated, and full choice for small gas and electricity consumers will be introduced by next year or early 2004 (ahead of the original schedule of 2007). On the other hand, the partial liberalization of passenger railways appears to have been set back, as the performance of the partly deregulated (but still government-owned) intercity operator had deteriorated to the point where the government had replaced the management.

## D. Financial Sector Issues

20. **The authorities reported that the financial sector was strong.** There had been a cyclical downturn in profits, due largely to drops in non-interest income and increases in provisioning (see table below). However, the banking system was viewed as well capitalized and free of excessive exposure internationally or to specific sectors, such as telecoms. The mission pointed out that the exposure of banks to mortgages had increased during the housing boom (though not relative to assets; Table 3), as had households' mortgage debt loads, which have exceeded disposable income since 1998 (Figure 2). Such considerations raised the concern that a slowing economy could lead to falling house prices, a deterioration in households' ability to maintain mortgage payments, and defaults. The authorities argued that a number of factors militated against such an outcome. The risk of large declines in house prices was limited since housing was still in short supply. Also, mortgage affordability had not deteriorated markedly during the 1990s, because household incomes rose and nominal interest rates fell. The sharp acceleration in house prices at the end of the 1990s did reduce affordability, but this was partly reversed in the past two years as disposable incomes rose and house prices began to stabilize. The central bank has calculated that interest rates would have to rise to 10 percent, or household incomes fall by 30 percent—both considered very unlikely—to reduce affordability to the level prevailing before the housing crash in the late 1970s. Finally, the mortgage market has historically been very stable, and even at the time of the 1970s crash annual defaults peaked at only about 0.25 percent of mortgage values.

Netherlands: Results of Dutch Banks
(Percent changes over previous year)

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| Total income | 19.7 | 17.5 | -0.2 |
| Interest | 15.2 | 6.3 | 6.6 |
| Commissions | 23.8 | 28.9 | -9.9 |
| Total expenses | 11.8 | 16.7 | 7.4 |
| Corporate costs | 15.2 | 19.8 | 2.5 |
| Provisions | -24.3 | -14.6 | 98.0 |
| Operating Profits | 53.7 | 21.5 | -19.3 |

Source: De Nederlandsche Bank.

21. **The architecture of financial-market supervision was being substantially overhauled.** In essence, banking and insurance prudential supervision has become more closely integrated, and a separate agency has been established to supervise the conduct of business of the banking, insurance, and securities industries, notably vis-à-vis consumers (Box 1). While the key institutional changes had already taken place, fully revising legislation was expected to take two or three years. The mission supported these changes as they were appropriate to the supervision of the dominant bank-insurance conglomerates, and would enhance consumer protection in an era of increasingly sophisticated financial instruments. The mission questioned why a fully unified supervisor, along the lines of the

U.K. FSA had been rejected. The authorities argued that the costs would be too high for a small country, and that the central bank needed to retain its dual role of banking supervision and systemic supervision.

## E. Other Issues

22. **The government has also proposed a program to reform the health-care system.** The current system is characterized by a web of government control which is designed to restrain costs, but is also perceived to result in substantial inefficiencies. The proposal, which is part of a long process of change, would promote competition among insurance funds, while guaranteeing universal access to health insurance (see Chapter 4 of the Selected Issues paper). The mission supported measures to increase the efficiency of health care delivery, but expressed concern that removing quantitative and price controls could result in sharp cost increases. The authorities were accordingly proceeding gradually, allowing scope for mid-course correction in the event of unexpected and unwelcome developments.

23. **Dutch policies regarding money laundering and the financing of terrorism were discussed.**[9] The authorities explained that the three pillars of their AML/CFT policies were close supervision to ensure the integrity of the financial sector, monitoring of unusual financial transactions (coordinated by the Financial Intelligence Unit), and a strong base in the legal code for investigation and prosecution of offenses.[10] The Netherlands is also a party to all major international treaties regarding money laundering and the financing of terrorism. In its latest report, the Financial Action Task Force found the Netherlands in compliance with 27 of the 28 recommendations requiring action, and at the time of the mission legislation was being passed to fulfill the remaining one (regarding the training of employees of money transfer institutions).

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[9] This analysis is based largely on the responses to the Fund's Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) questionnaire, which the authorities completed in the weeks before the Article IV mission.

[10] To indicate the scale of enforcement activity, the authorities reported that in 2001 some 80,000 unusual transactions were identified, including all cash transactions exceeding €10,000, of which about 20,000 were deemed suspicious. The number of AML prosecutions is difficult to determine, as many cases were subsumed under other offenses, such as drug dealing.

**Box: The New Structure of Dutch Financial Supervision**[1]

In November, 2001 the Finance Minister submitted plans for a new supervisory structure based on a joint proposal of the existing supervisors, to be implemented in 2002, with formal legislation to follow as needed.

In the previous structure, the central bank (DNB) was responsible for supervising banks and investment funds, the insurance and pension supervisor (PVK) for insurance companies and pension funds, and the securities supervisor (STE) for securities markets and related supervision of parties active on those markets. Coordination was mediated through the Council of Financial Supervisors, established in 1999.

In the new structure, prudential supervision is vested in the DNB and PVK, which have been brought much closer together through the cross-appointment of senior officials. The STE has become the Authority for Financial Markets (AFM). Its main tasks are supervision of securities markets and the conduct of business supervision for all financial institutions, including consumer protection. This structure is broadly similar to that adopted by Australia, where the Prudential Regulatory Authority is the prudential supervisor and the Securities and Investment Commission deals with conduct-of-business issues.

One advantage of the new system is the closer relationship between the DNB and PVK responds to increasing integration of banking and insurance activities. In the Netherlands, such conglomerates account for about 90 percent of banking, 80 percent of securities, and 70 percent of insurance. Another advantage is that the DNB retains responsibility for both banking and systemic supervision, which in the authorities' view are closely linked. (This is not the case in the U.K., where the Bank of England deals with systemic issues and the FSA with banks, or even in Australia, where the Reserve Bank retains its systemic role.)

[1]See Annet Jonk, Jeroen Kremers, and Dirk Schoenmaker "A New Dutch Model", The Financial Regulator, December, 2001.

24. **Regarding international trade policy, the Netherlands remains a strong proponent of multilateral liberalization.** The authorities argued that the rules-based trade system, while certainly needing improvement, was of particular benefit to smaller and less developed countries, because the WTO provided a legal forum for challenging trade restrictions imposed by the large economies. A key priority, therefore, was to increase the participation of developing countries in the activities of the WTO and in the upcoming negotiations begun in Doha. Substantively, they argued for a multilateral approach, with an emphasis on further reducing barriers to exports of developing economies (which, in the Dutch case, are concentrated in agriculture). The Netherlands is a signatory to the OECD anti-bribery convention, and has anti-bribery guidelines for the overseas conduct of Dutch companies. Official development assistance, which is moving toward multi-year sectoral programs with priorities set in line with the PRSP, is 0.8 percent of GNP.

## IV. Staff Appraisal

25. **Several years of strong economic growth has resulted in building inflationary pressures.** Underpinned by fundamental structural reforms, sustained wage moderation, and substantial fiscal adjustment, employment rates have risen and unemployment rates declined to very low levels. In recent years, domestic demand has also been boosted by the wealth effect of rapid increases in house and stock prices. However, inflationary pressures have become increasingly evident in higher wage growth and, especially in the past two years, rising inflation. As a result, competitiveness within the euro area has been gradually but steadily eroding.

26. **The slowdown in economic activity that began last year has eased demand pressures.** Notably, vacancies have been falling and the unemployment rate, while still low due to labor hoarding, has recently begun to rise. Although easier monetary conditions and the pickup in the world economy are expected to raise economic growth in the Netherlands back to about potential, the softer labor market has opened the door to moderate wage increases and a decline in price inflation.

27. **Wage and price inflation, however, will probably not fall enough in the short run to halt the decline in international competitiveness.** The consequent loss of competitiveness is a normal market adjustment to labor shortages and strong aggregate demand in a monetary union, but there is nevertheless a risk of overshooting. A number of actions would mitigate this risk. In the upcoming round of bargaining, social partners need to take full account of weaker labor market conditions in the wake of the slowdown. Greater wage differentiation, which would be fostered by eliminating administrative extension of labor contracts, would limit the spillover to the economy as a whole of high wage increases warranted by acute labor shortages in specific sectors. And the government should ensure fiscal policy does not add to aggregate demand: the deficit should not be allowed to deteriorate in 2003, a year of economic recovery, and indeed some progress should be made toward a medium-term structural surplus.

28. **Looking forward, a structural fiscal surplus objective of about 1½ percent of GDP seems prudent**. Such a surplus, if reached soon and sustained, would bolster the public finances in preparation for the costs of population aging. At the same time, the option of pension (and health-care) reform with a view to reducing costs should not be ruled out. Over the longer term, a social choice must be made regarding the priority of these programs versus other calls on the public purse, including further tax cuts to encourage employment and innovation.

29. **Renewing the fiscal framework for the next government period will be crucial to achieving this goal**. Increasing the structural surplus while avoiding tax increases will require strict expenditure control, even in the face of demands for higher spending in specific areas. Thus, the new framework, like the current one, should be centered on multi-year spending ceilings, and strict separation between spending and revenues. On the revenue side, the full operation of the automatic stabilizers should be the rule, subject of course to the Maastricht deficit ceiling, which in the case of the Netherlands appears at this point to be only a remote possibility. Consideration should also be given to excluding obviously cyclically sensitive expenditure items from the expenditure ceiling (notably, unemployment insurance), and to increasing transparency by aligning the ceiling with national accounts expenditure concepts.

30. **Regarding the labor market, the authorities are urged to press forward with needed reforms**. The significant progress of the past two decades resulted in substantial improvements in labor-market performance. Addressing remaining weaknesses will require substantial, and in many respects politically difficult, reforms, including in particular:

- **A sharp reduction of the inflow of beneficiaries into the large and growing disability program**. The widespread agreement in the Netherlands on this point is welcome. The proposal agreed by the social partners has many strengths: restricting entry to the fully and permanently disabled, increased incentives for the disabled to seek work, and tougher medical criteria. It also has drawbacks, notably weaker incentives for workers and firms to curb entry into the program. Given the scale of the task ahead, it would be prudent to implement the latter only after the effectiveness of the former has been clearly demonstrated.

- **Reducing high unemployment and poverty traps**. A fundamental solution will involve a difficult combination of lower benefits and reductions in implicit tax rates by extending benefits up the earnings scale, which threatens large budgetary costs. Useful first steps would be to roll some benefits into the tax system, which would make the problem more obvious, reducing municipal income redistribution programs, and strengthening the enforcement of eligibility criteria (including by extending block-grant financing for municipalities). A start could be made on gradually reducing the growth of benefits by linking them to prices, rather than wages.

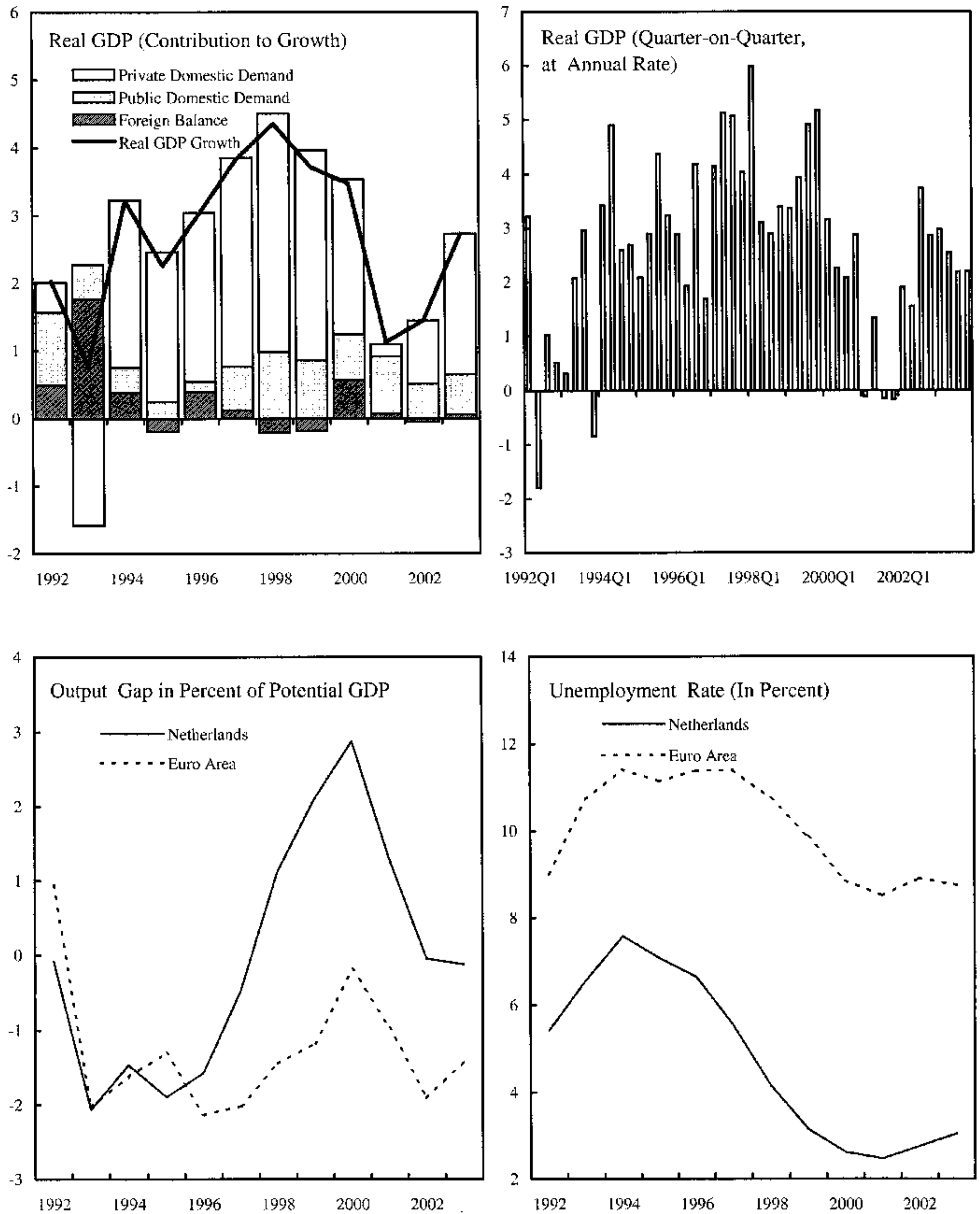
- **Re-thinking public employment policies originally aimed at raising labor demand.** Subsidized employment and public-sector job programs should be scaled back. In a situation of high labor demand, such programs are increasingly crowding out other activity rather than raising overall employment. The funds devoted to them would be better redeployed to enhancing labor supply, for example by reducing the poverty trap.

31. **Regarding product markets, a sustained increase in productivity will be key to ensuring rising living standards in the years ahead.** The leadership of the Netherlands in the liberalization of energy markets is commendable, and the process should be completed as rapidly as possible. The momentum for reform in other areas needs to be renewed, to help to ensure that markets can respond flexibly to new opportunities in the years ahead. Barriers to entry should be dismantled, including by further reducing administrative costs facing firms.

32. **Financial supervision, already of high quality, will benefit from the restructuring now underway.** Closer cooperation between the prudential banking and insurance supervisors will improve oversight of the large conglomerates that dominate the Dutch financial landscape. Over time, the underlying regulations and practices governing various lines of business should be harmonized to level the playing field and limit the scope for regulatory arbitrage. And the independent conduct-of-business supervisor, while unusual by international comparison, should give prominence to consumer protection in a world of increasingly sophisticated financial instruments. The spheres of prudential and conduct-of-business supervision should be clarified to the extent possible, to avoid unnecessary overlap. An in-depth assessment of the supervisory framework will be undertaken in the context of an FSAP scheduled for 2003/04.

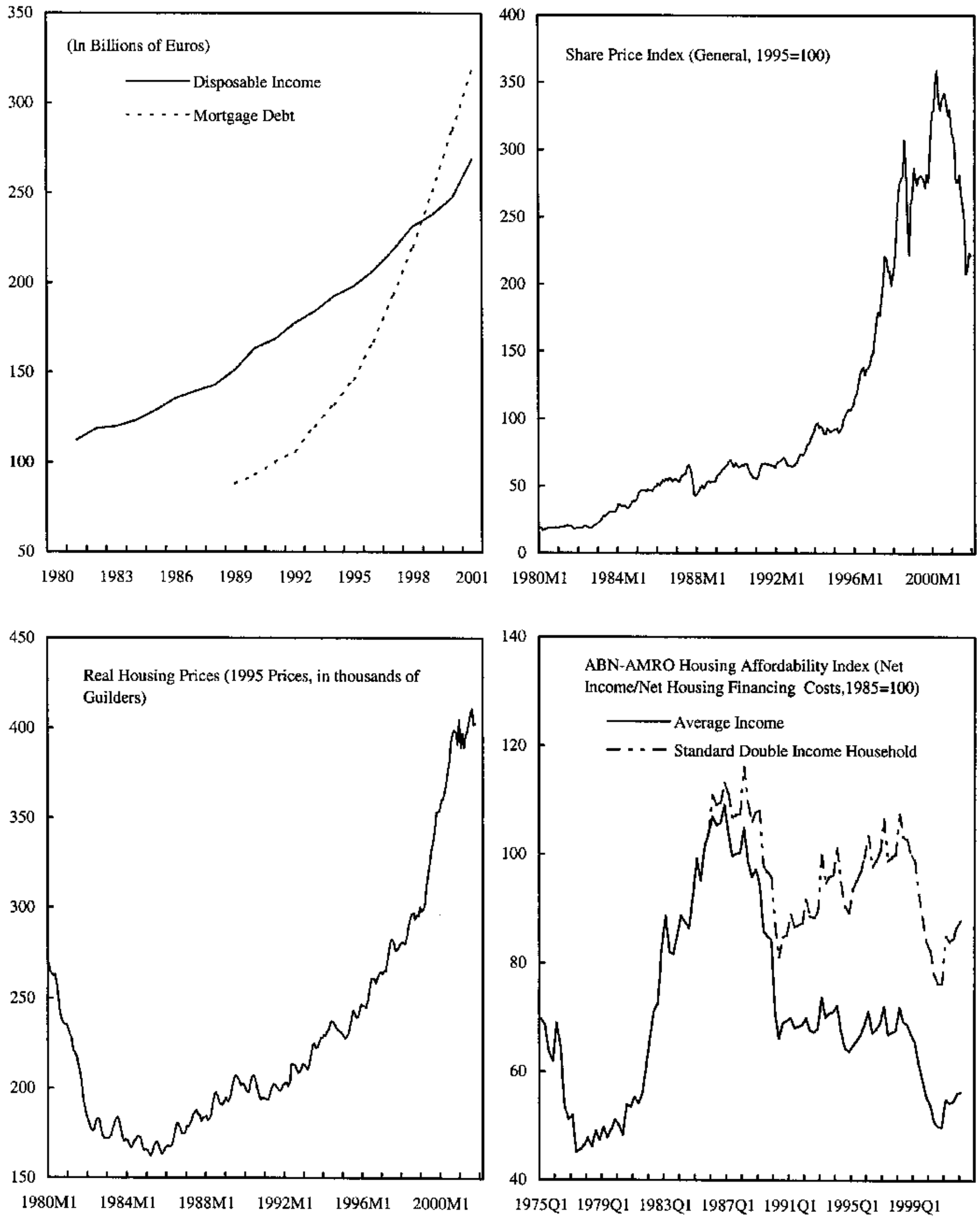
33. It is proposed that the next consultation be held on the normal 12-month cycle.

Figure 1. Netherlands: GDP and Unemployment



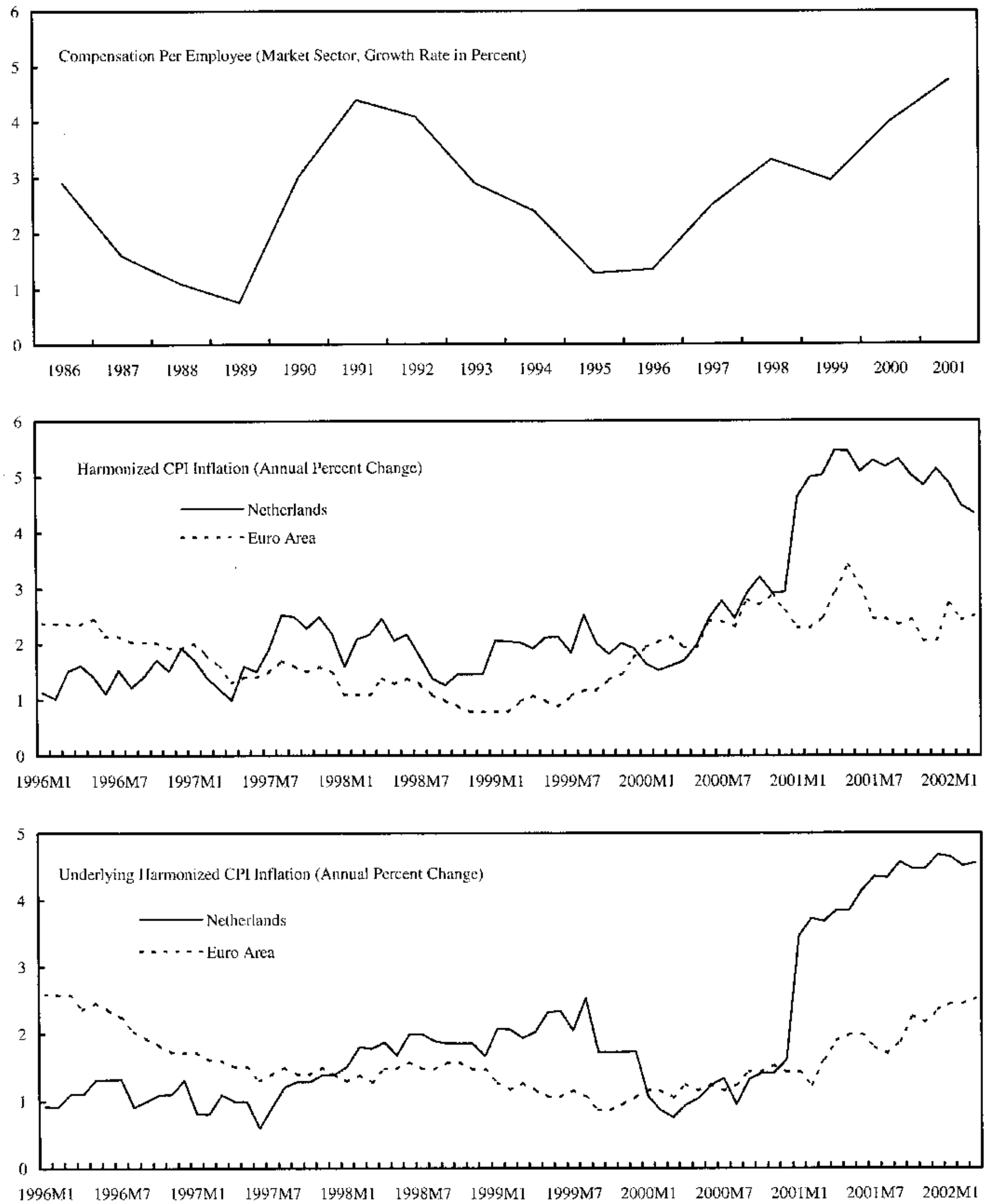

Sources: OECD, Economic Outlook Database and IMF, WEO.

Figure 2. Netherlands: Asset Prices and the Mortgage Market



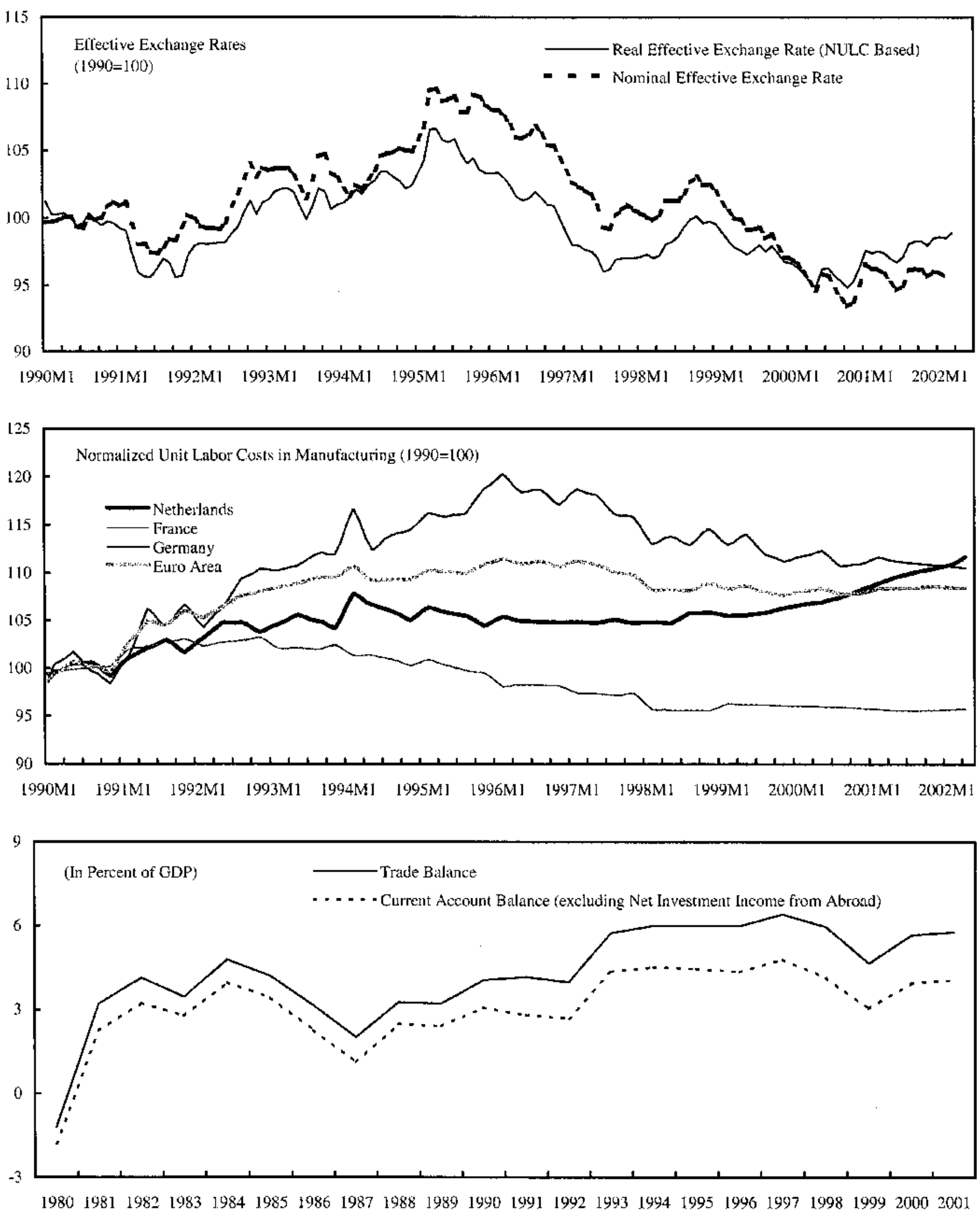

Sources: IMF, IFS and WEO; ABN-AMRO; and the Authorities.

Figure 3. Netherlands: Prices and Wages



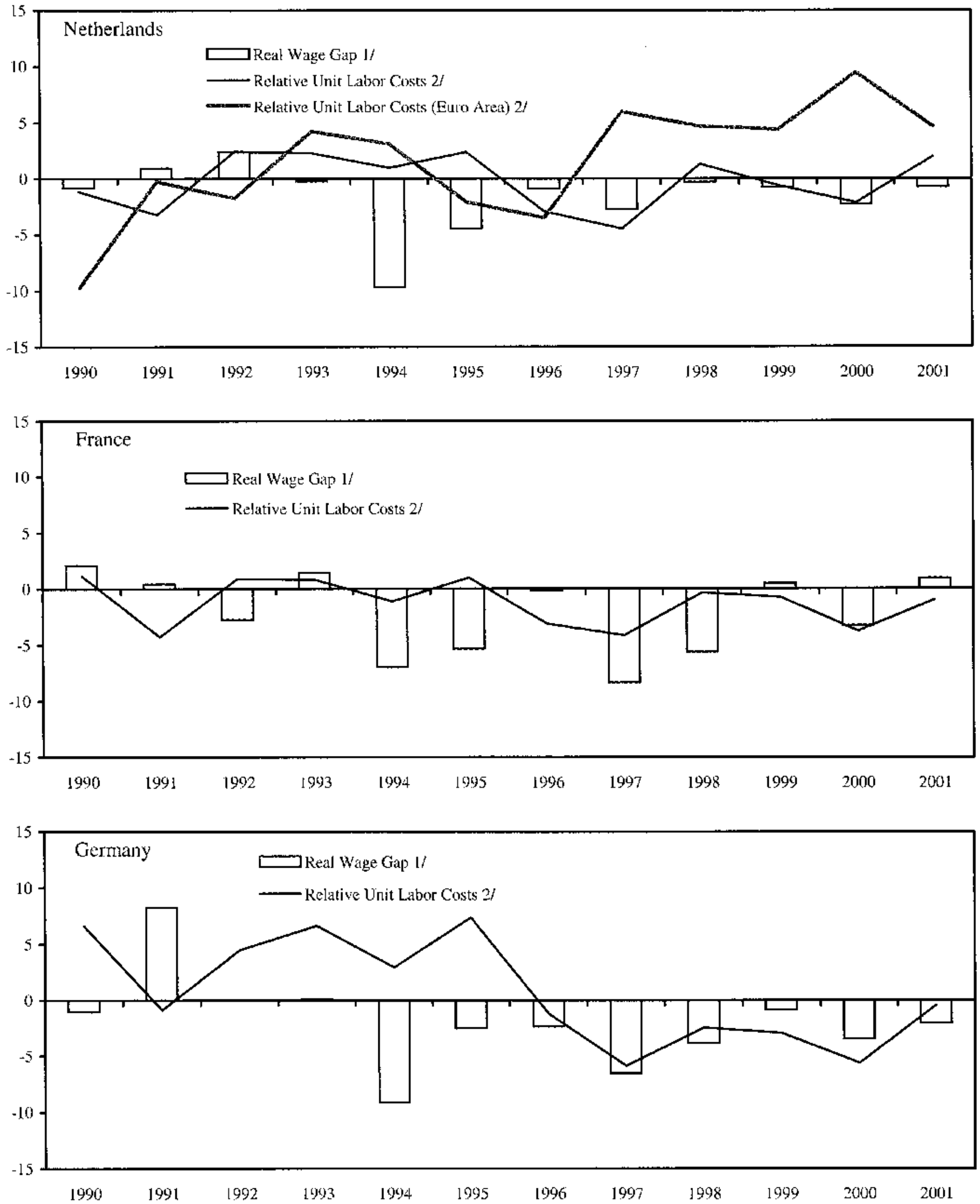

Sources: Eurostat; CPB; and IMF, IFS.

Figure 4. Netherlands: Competitiveness Indicators



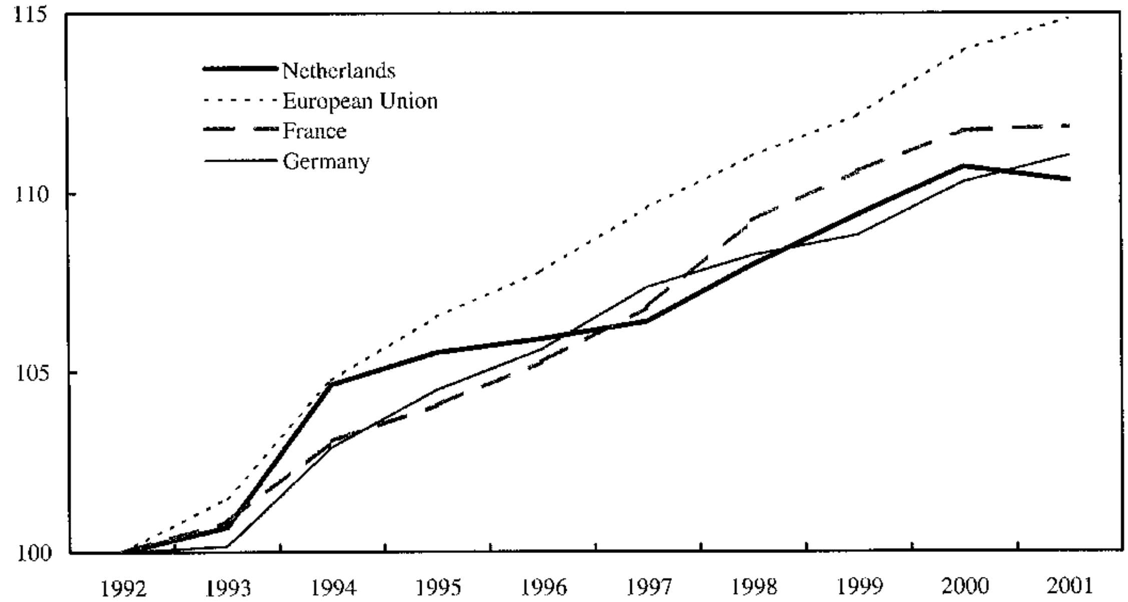

Sources: IMF, IFS and WEO.

Figure 5. Netherlands: Wages, Productivity, and Unit Labor Costs
(Percent Change)



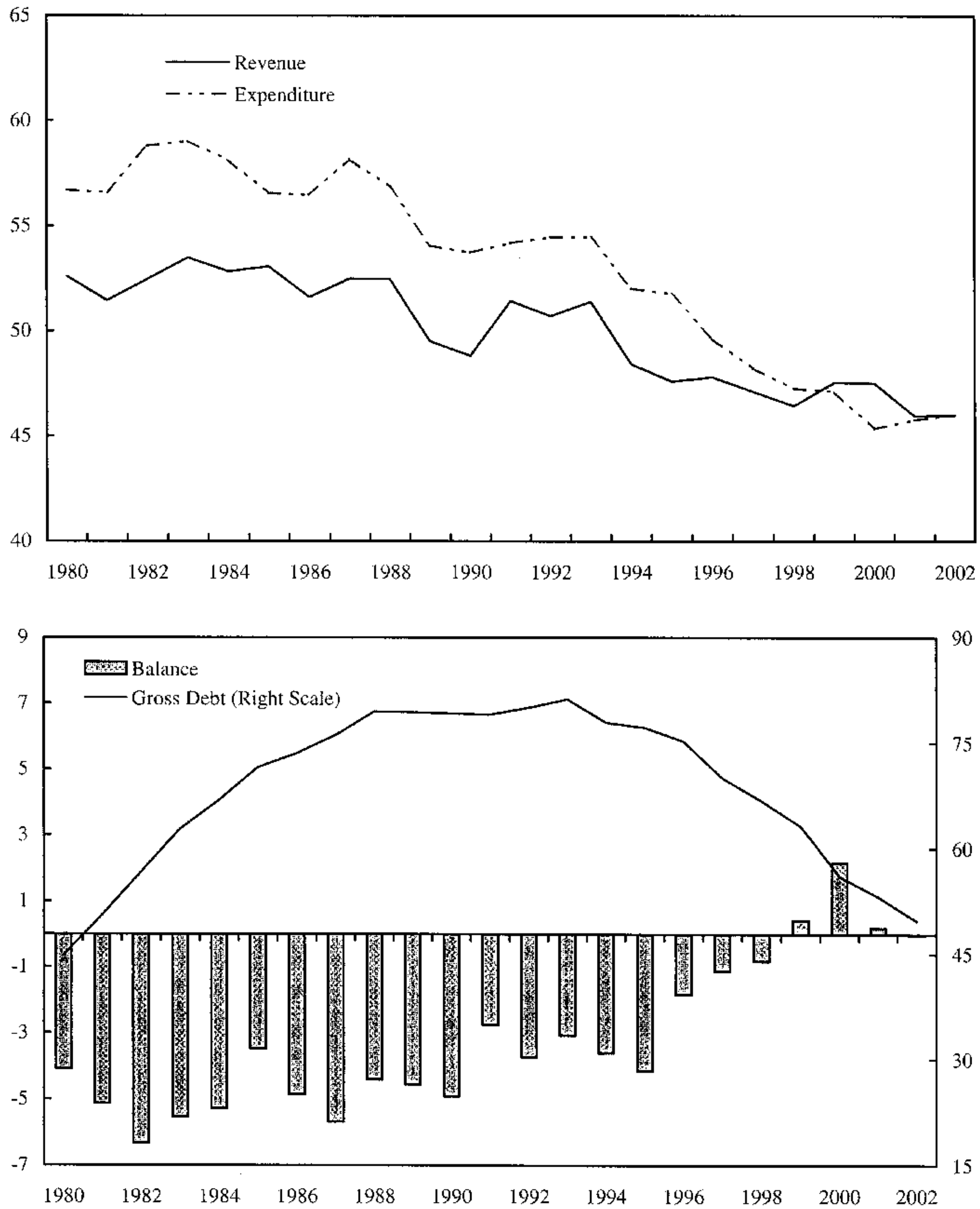

Source: IMF, IFS and WEO.
1/ Difference between the rate of growth of actual real wages (deflated by GDP deflator) and warranted real wages (labor productivity).
2/ Difference between growth of unit labor costs in each country and trading partner countries.

Figure 6. Netherlands: Labor Productivity in the Business Sector
(1992=100)



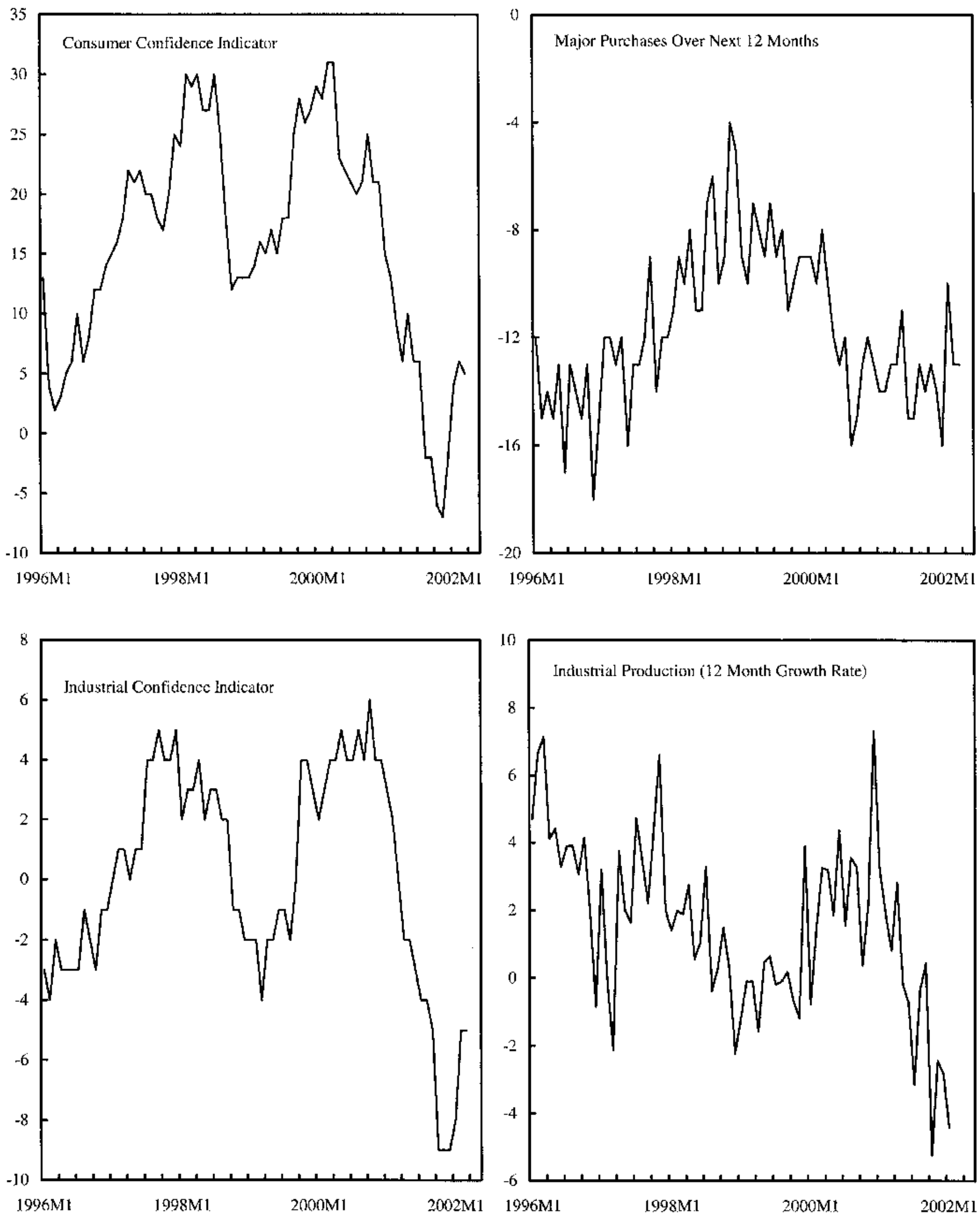

Source: OECD, Analytical Database.

Figure 7. Netherlands: Fiscal Indicators
(General Government, in Percent of GDP)



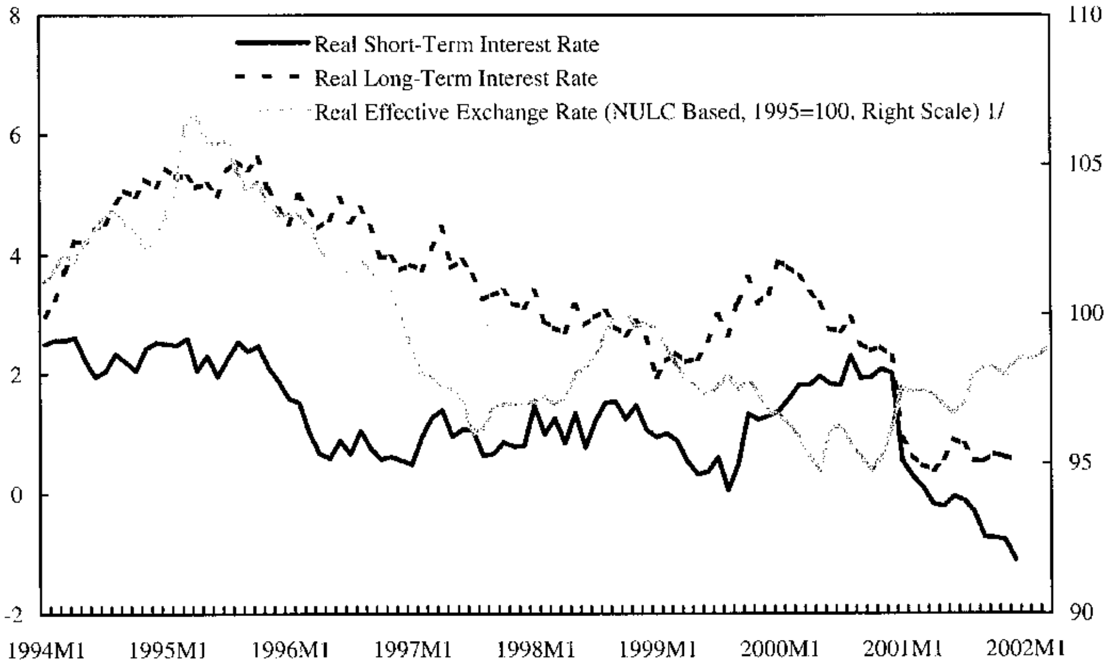

Source: IMF, WEO.

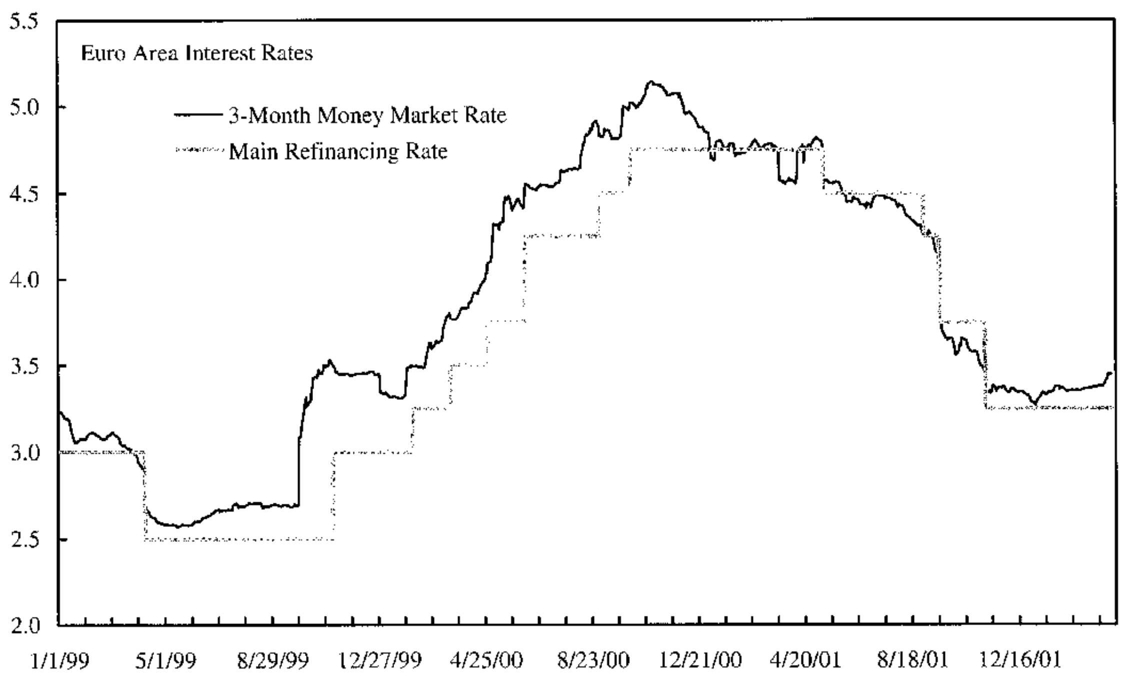
Figure 8. Netherlands: Cyclical Indicators




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

Figure 9. Netherlands: Monetary Conditions

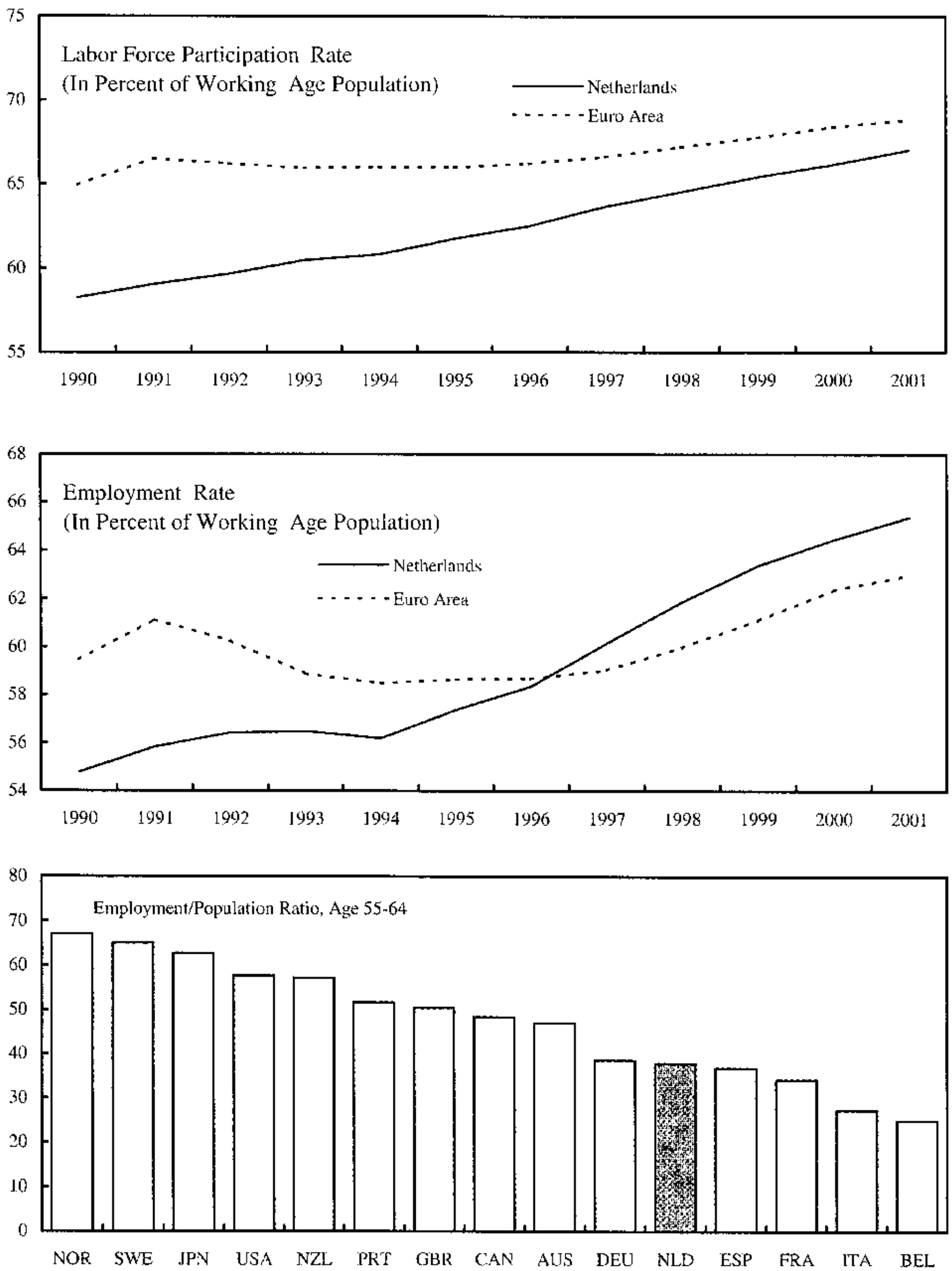



Source: IMF, IFS.

1/ An increase implies less accomodative conditions.

Figure 10. Netherlands: Labor Market Indicators




Sources: OECD, Economic Outlook Database &Employment Outlook, June 2001; and IMF, WEO.

Countries are: AUS=Australia, BEL=Belgium, CAN=Canada, FRA=France, DEU=Germany, ITA=Italy, JPN=Japan, NLD=Netherlands, NZL=New Zealand, NOR=Norway, PRT=Portugal, ESP=Spain, SWE=Sweden, GBR=United Kingdom, USA=United States.

# Table 1. Netherlands: Basic Data

| | |
|---|---|
| Land area (2000) | 41.5 thousand sq. km. |
| Population (2000) | 15.9 million |
| Population characteristics and health: | |
| Life expectancy at birth (2000) | 75.3 (male), 80.6 (female) |
| Fertility rate (2000) | 1.7 children/woman |
| Infant mortality rate (2000) | 5.2 per 1,000 live births |
| Population per sq. km. of land area (1999) | 383 persons |

| National accounts (2000 at current prices) | (In billions of euros) | (In percent of GDP) |
|---|---|---|
| Private consumption | 199.9 | 49.8 |
| Public consumption | 91.2 | 22.7 |
| Gross fixed investment | 90.9 | 22.7 |
| Stockbuilding | -0.4 | -0.1 |
| Exports of goods and nonfactor services | 269.6 | 67.2 |
| Imports of goods and nonfactor services | 250.1 | 62.4 |
| GDP | 401.1 | |

| | 1997 | 1998 | 1999 | 2000 | 2001 Est. | 2002 Proj. |
|---|---|---|---|---|---|---|
| | (Percentage changes unless otherwise noted) | | | | | |
| National accounts (constant prices) | | | | | | |
| Private consumption | 3.0 | 4.8 | 4.4 | 3.8 | 1.2 | 2.0 |
| Public consumption | 3.1 | 3.5 | 2.8 | 1.9 | 3.3 | 2.2 |
| Gross fixed investment | 6.6 | 4.2 | 7.8 | 3.7 | -1.0 | 0.1 |
| Total domestic demand | 4.0 | 4.8 | 4.2 | 3.1 | 1.1 | 1.5 |
| Exports of goods and nonfactor services | 8.8 | 7.4 | 5.4 | 9.5 | 0.9 | 1.5 |
| Imports of goods and nonfactor services | 9.6 | 8.6 | 6.3 | 9.4 | 0.9 | 1.7 |
| Net foreign balance[1] | 0.1 | -0.2 | -0.2 | 0.6 | 0.1 | -- |
| Gross domestic product | 3.8 | 4.3 | 3.7 | 3.5 | 1.1 | 1.4 |
| Output gap (in percent of potential output) | -0.5 | 1.1 | 2.1 | 2.9 | 1.3 | -- |
| Prices, wages, and employment | | | | | | |
| Consumer price index (year average) | 1.9 | 1.8 | 2.0 | 2.3 | 5.1 | 3.4 |
| GDP deflator | 2.0 | 1.7 | 1.7 | 3.7 | 4.7 | 3.4 |
| Hourly compensation (manufacturing) | 2.3 | 3.9 | 3.0 | 5.1 | 4.0 | 5.3 |
| Unit labor costs (manufacturing) | -0.7 | 1.4 | 1.0 | 1.4 | 4.0 | 3.7 |
| Employment | 3.4 | 3.3 | 3.0 | 2.3 | 2.3 | 0.6 |
| Unemployment rate (in percent) | 5.5 | 4.2 | 3.2 | 2.6 | 2.0 | 2.5 |
| NAIRU | 5.5 | 5.4 | 4.8 | 4.7 | 3.9 | 3.7 |

| | 1997 | 1998 | 1999 | 2000 | 2001 Est. | 2002 Proj. |
|---|---|---|---|---|---|---|
| Personal sector | | | | | | |
| Real disposable income | 3.7 | 4.2 | 0.8 | 1.6 | 3.3 | 3.6 |
| Household savings ratio[2] | 14.1 | 13.6 | 10.6 | 8.3 | 10.7 | 12.3 |
| External trade | | | | | | |
| Exports of goods, volume | 9.2 | 7.6 | 5.0 | 12.0 | 0.3 | 1.5 |
| Imports of goods, volume | 10.4 | 8.1 | 6.6 | 9.4 | -0.4 | 1.8 |
| Terms of trade | 0.5 | 0.1 | -1.3 | -0.1 | 0.6 | 0.0 |
| Merchandise balance (percent of GDP) | 5.6 | 5.3 | 4.0 | 5.8 | 6.2 | 5.9 |
| Current account balance (percent of GDP) | 6.6 | 3.4 | 3.2 | 3.0 | 3.1 | 3.7 |
| Public sector accounts (percent of GDP) | | | | | | |
| Revenue | 47.1 | 46.4 | 47.5 | 47.5 | 46.0 | 46.0 |
| Expenditure | 48.2 | 47.3 | 47.1 | 45.4 | 45.8 | 46.0 |
| General government balance | -1.1 | -0.8 | 0.4 | 2.2 | 0.2 | -- |
| Structural balance | -0.8 | -1.4 | -0.7 | 0.2 | -0.4 | -- |
| Primary balance | 3.3 | 3.4 | 4.2 | 5.4 | 2.9 | 2.4 |
| Structural primary balance | 3.6 | 2.9 | 3.2 | 3.5 | 2.3 | 2.4 |
| General government gross debt | 70.0 | 66.8 | 63.1 | 56.0 | 53.2 | 49.7 |

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

[1]Contribution to GDP growth.

[2]In percent of disposable income.

Table 2. Medium-Term Macroeconomic Forecast
(In percent)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|
| National accounts (constant prices) | | | | | | | | |
| Private consumption | 3.8 | 1.2 | 2.0 | 2.4 | 2.6 | 2.6 | 2.5 | 2.5 |
| Public consumption | 1.9 | 3.3 | 2.2 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Gross fixed investment | 3.7 | -1.0 | 0.1 | 3.1 | 4.4 | 4.1 | 4.1 | 4.1 |
| Total domestic demand | 3.1 | 1.1 | 1.5 | 2.8 | 2.7 | 2.8 | 2.8 | 2.8 |
| Net foreign balance 1/ | 0.6 | 0.1 | -- | 0.1 | 0.3 | 0.2 | 0.2 | 0.2 |
| Gross domestic product | 3.5 | 1.1 | 1.4 | 2.7 | 2.9 | 2.8 | 2.8 | 2.8 |
| Prices, wages, and employment | | | | | | | | |
| Consumer price index (year average) | 2.3 | 5.1 | 3.4 | 2.3 | 1.8 | 1.8 | 1.8 | 1.8 |
| GDP deflator | 3.7 | 4.7 | 3.4 | 2.4 | 2.0 | 1.9 | 2.0 | 1.9 |
| Unemployment rate (in percent) | 2.6 | 2.0 | 2.5 | 2.7 | 2.9 | 2.9 | 3.1 | 3.2 |
| External trade | | | | | | | | |
| Exports of goods, volume | 12.0 | 0.3 | 1.5 | 7.0 | 5.8 | 5.6 | 5.6 | 5.6 |
| Imports of goods, volume | 9.4 | -0.4 | 1.8 | 7.7 | 6.0 | 5.9 | 5.9 | 5.9 |
| Merchandise balance (percent of GDP) | 6.4 | 7.2 | 7.1 | 6.9 | 7.0 | 6.9 | 7.0 | 6.9 |
| Current account balance (percent of GDP) | 3.0 | 3.1 | 3.7 | 3.3 | 3.1 | 2.8 | 2.8 | 2.6 |
| Public sector accounts (percent of GDP) | | | | | | | | |
| Revenue | 47.5 | 46.0 | 46.0 | 45.1 | 44.9 | 44.7 | 44.5 | 44.3 |
| Expenditure | 45.4 | 45.8 | 46.0 | 45.6 | 45.2 | 44.6 | 43.9 | 43.4 |
| General government balance | 2.2 | 0.2 | -- | -0.5 | -0.3 | 0.2 | 0.5 | 0.9 |
| Structural balance | 0.2 | -0.4 | -- | -0.4 | -0.3 | 0.2 | 0.6 | 0.9 |

Sources: Dutch official publications; International Monetary Fund, International Financial Statistics; and Fund staff estimates.
1/ Contribution to GDP growth.

Table 3. Netherlands: Indicators of External and Financial Vulnerability[1]

(In percent of GDP, unless otherwise indicated)

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 Latest estimate | 2002 Date |
|---|---|---|---|---|---|---|---|
| **External indicators** | | | | | | | |
| Exports goods and services (annual percent change, in U.S. dollars) | -1.8 | 3.5 | 0.9 | 4.7 | -1.2 | | |
| Imports goods and services (annual percent change, in U.S. dollars) | -1.8 | 4.3 | 3.2 | 4.0 | -1.7 | | |
| Terms of trade goods (annual percent change) | 0.5 | 0.3 | -1.3 | 1.3 | 0.8 | | |
| Current account balance | 14.7 | 7.3 | 9.7 | 8.7 | 12.3 | | |
| Inward portfolio investment | 4.7 | 9.1 | 19.7 | 19.7 | 21.3 | | |
| Inward foreign direct investment | 3.0 | 9.4 | 10.4 | 15.6 | 15.1 | | |
| Official reserves (in US dollars, billions)[2] | 35.4 | 32.6 | 19.4 | 17.8 | 17.0 | | |
| Foreign assets of the banking sector (in U.S. dollars, billions)[3] | 272.5 | ... | 164.9 | 162.2 | 211.8 | | |
| Foreign liabilities of the banking sector (in U.S. dollars, billions)[3] | 300.6 | ... | 205.6 | 204.0 | 253.9 | | |
| Official reserves in months of imports | 2.0 | 1.7 | 1.0 | 0.9 | 0.9 | | |
| Exchange rate (per U.S. dollar, period average) | 1.95 | 1.98 | 2.07 | 2.39 | 2.43 | 0.90 | 24-Apr |
| **Financial Market Indicators** | | | | | | | |
| Public sector debt (Maastricht definition) | 70.0 | 66.8 | 63.1 | 56.0 | 53.2 | 49.7 | |
| Government bond yield | 5.8 | 4.9 | 4.9 | 5.5 | 5.2 | | |
| Government bond yield (real) | 3.6 | 2.9 | 2.7 | 3.0 | 0.6 | | |
| Stock market index | 195.3 | 261.6 | 284.6 | 335.5 | 257.0 | | |
| Spread of government bond yield with Germany | 0.73 | 0.48 | 0.66 | 0.27 | 0.47 | | |
| **Financial Sector Risk Indicators** | | | | | | | |
| Mortgage credit to total assets (in percent) | n.a. | 22.2 | 20.3 | 18.4 | 19.3 | | |
| Provisioning/total expenses | n.a. | 9.9 | 6.5 | 4.9 | 9.1 | | |
| Exposure to emerging markets/own funds[5] | n.a. | 66.4 | 61.2 | 58.5 | 54.5 | | |
| Contingent and off-balance-sheet accounts to total assets (in percent) | 17.7 | 18.6 | 21.6 | 21.8 | 20.3 | | |
| Risk based capital-asset ratio | 11.5 | 11.4 | 11.2 | 11.3 | 11.5 | | |

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

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

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

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

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

## Netherlands: Fund Relations

As of March 31, 2002

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

II. **General Resources Account**:

| | SDR Million | Percent of Quota |
|---|---|---|
| Quota | 5,162.40 | 100.00 |
| Fund holdings of currency | 3,255.72 | 63.07 |
| Reserve position in Fund | 1,906.70 | 36.93 |
| Operational budget transfers (net) | 70.00 | |

III. **SDR Department**

| | SDR Million | Percent of Allocation |
|---|---|---|
| Net cumulative allocation | 530.34 | 100.00 |
| Holdings | 577.39 | 108.87 |

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

V. **Financial Arrangements**: None

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

VII. **Exchange Rate Arrangements**:

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

VIII. **Article IV Consultation**:

Discussions for the 2001 Article IV consultation were held in Amsterdam and the Hague in March 2–12, 2001. The staff report for the 2001 Article IV consultation (SM/01/147, 5/14/01) was considered by the Executive Board on June 6, 2001 (EBM/01/57). The Article IV discussions with the Netherlands are on the standard 12-month consultation cycle.

IX. **Exchange Restrictions**:

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

## Netherlands: Statistical Data Issues

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

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

# Netherlands: Core Statistical Indicators
## As of April 22, 2002

| | Int'l Reserves 1/ | Central Bank Balance Sheet | Reserve/ Base Money | Broad Money | Interest Rates | Consumer Price Index | Exports/ Imports | Current Account Balance | Overall Government Balance | External Government Debt | GDP/GNP |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Date of Latest Observation | 3/31/02 | 3/24/02 | 3/22/02 | 2/02 | 4/22/02 | 3/02 | 2/02 | Q4/01 | 2/02 | 1996 | Q4/01 |
| Date Received | 4/16/02 | 4/16/02 | 4/16/02 | 3/28/02 | 4/22/02 | 4/5/02 | 4/19/02 | 4/16/02 | 3/29/02 | 9/97 | 4/11/02 |
| Frequency of Data | Monthly | Weekly | Weekly | Monthly | Daily | Monthly | Monthly | Quarterly | Monthly | Annually | Quarterly |
| Frequency of Reporting | Monthly | Weekly | Weekly | Monthly | Daily | Monthly | Monthly | Quarterly | Monthly | Annually | Quarterly |
| Source of Update | DNB | DNB | DNB | DNB | Reuters | CBS 2/ | CBS 2/ | DNB | MoF | MoF | CBS 2/ |
| Mode of Reporting | Electronic | Electronic | Electronic | Electronic | Electronic | Electronic | Electronic | Electronic | Electronic | Electronic | Electronic |
| Confidentiality | Public | Public | Public | Public | Public | Public | Public | Public | Public | Public | Public |
| Frequency of Publication | Monthly | Weekly | Weekly | Weekly | Daily | Monthly | Monthly | Quarterly | Monthly | Annually | Quarterly |

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

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

**Staff Report for the 2002 Article IV Consultation**
**Supplementary Information**

Prepared by the European I Department

Approved by Michael Deppler

June 5, 2002

1. This supplement reviews economic developments since the preparation of the staff report for the 2002 Article IV consultation with the Netherlands (SM/02/151). The key new data are the first quarter national accounts estimates. In addition, there is recent information on business and consumer sentiment, the unemployment rate, and inflation. While 2002 is likely to be weaker than had been expected (and inflation concerns correspondingly eased) the overall pattern of the projected recovery remains unchanged. These developments do not change the thrust of the staff appraisal.

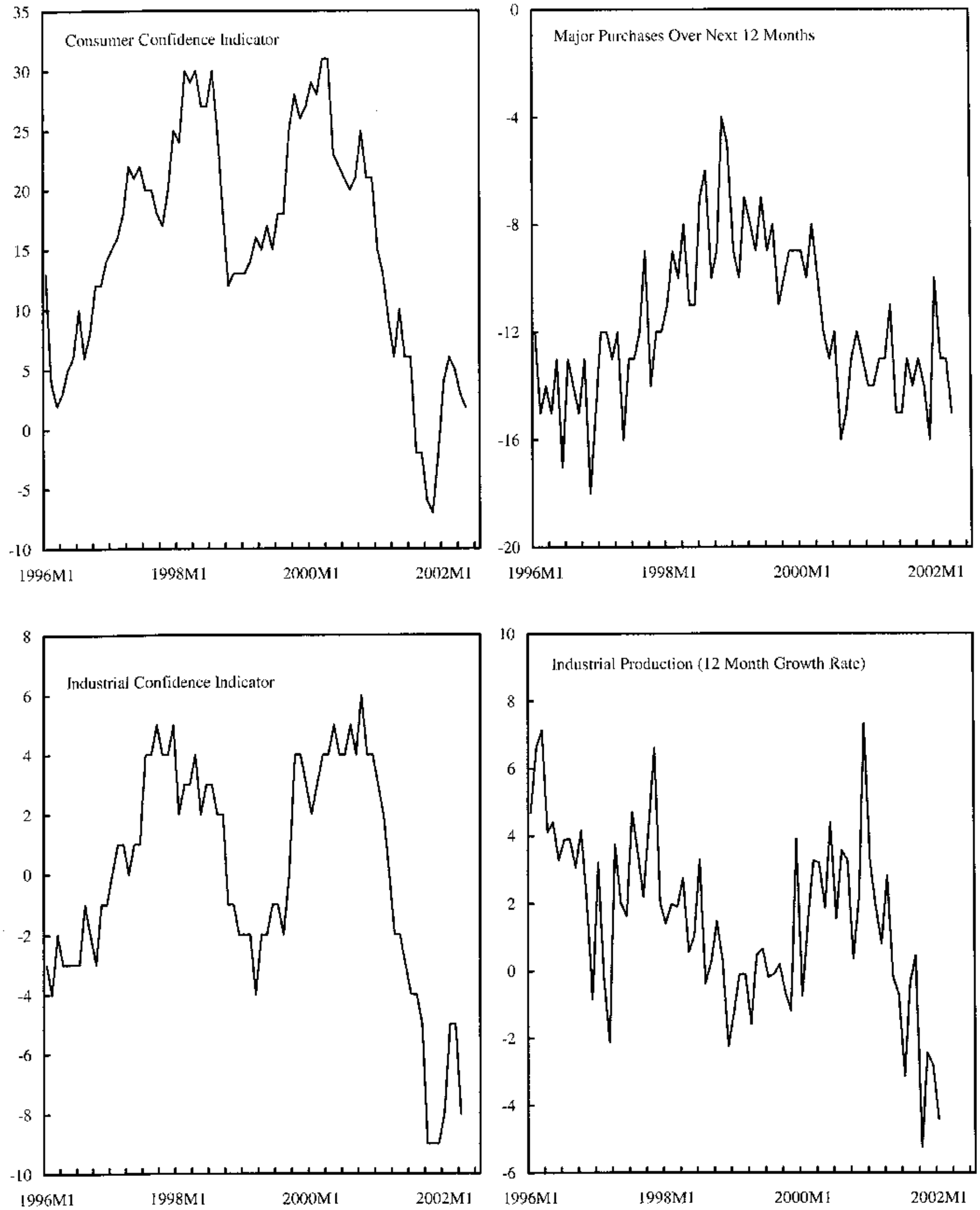
2. According to initial estimates, real GDP was flat in the first quarter of this year, less than staff had expected. Weakness was widespread, with fixed investment falling and private consumption flat; exports also fell sharply, although the contribution of the external balance to demand growth was about zero. Inventory levels continued to fall, but at a slower pace than in the fourth quarter of 2001. Growth for the fourth quarter of 2001 was also revised down.

3. Consumer sentiment fell in May for the third month running, and business sentiment, which had been recovering, edged down in April (Figure 1). Consistent with staff expectations, the unemployment rate (registration basis) has edged up for two months running, reaching 2.3 percent on the February-April average, compared to 2 percent for 2001 as a whole. Finally, inflation continued to fall, though more gradually than staff had expected, reaching 4.2 percent (year-on-year) in April.

4. As a result of these developments, the staff has cut its projection of real GDP growth in 2002 from 1.4 to 1 percent (Table 1). The revised projection represents essentially the incorporation of the national accounts estimates, and is contingent on the pickup in growth in major European countries and the United States as projected in the most recent WEO. Downside risks to growth include an unexpectedly sharp appreciation of the euro, a rise in oil prices, and, in a domestic context, a large decline in house prices (which could cut wealth and undermine consumption). Growth could prove higher if Dutch export markets recovered faster, or if the large inventory decumulations of the past couple of quarters stopped sooner than now assumed.

5. The downward revision to growth is projected to raise the budget deficit to 0.3 percent of GDP this year (compared to balance in the Staff Report), and 0.6 percent next year (compared to 0.5 percent). Inflation, has been revised up slightly in line with recent data.

Figure 1. Netherlands: Cyclical Indicators




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

# Table 1. Netherlands: Basic Data

| | |
|---|---|
| Land area (2000) | 41.5 thousand sq. km. |
| Population (2000) | 15.9 million |
| Population characteristics and health: | |
| Life expectancy at birth (2000) | 75.3 (male), 80.6 (female) |
| Fertility rate (2000) | 1.7 children/woman |
| Infant mortality rate (2000) | 5.2 per 1,000 live births |
| Population per sq. km. of land area (1999) | 383 persons |

| National accounts (2000 at current prices) | (In billions of euros) | (In percent of GDP) |
|---|---|---|
| Private consumption | 199.9 | 49.8 |
| Public consumption | 91.2 | 22.7 |
| Gross fixed investment | 90.9 | 22.7 |
| Stockbuilding | -0.4 | -0.1 |
| Exports of goods and nonfactor services | 269.6 | 67.2 |
| Imports of goods and nonfactor services | 250.1 | 62.4 |
| GDP | 401.1 | |

| | 1998 | 1999 | 2000 | 2001 Est. | 2002 Proj. | 2003 Proj. |
|---|---|---|---|---|---|---|
| | (Percentage changes unless otherwise noted) | | | | | |
| National accounts (constant prices) | | | | | | |
| Private consumption | 4.8 | 4.4 | 3.8 | 1.2 | 1.3 | 2.2 |
| Public consumption | 3.5 | 2.8 | 1.9 | 3.4 | 1.8 | 2.2 |
| Gross fixed investment | 4.2 | 7.8 | 3.7 | -1.1 | -0.2 | 3.6 |
| Total domestic demand | 4.8 | 4.2 | 3.1 | 1.0 | 0.7 | 3.4 |
| Exports of goods and nonfactor services | 7.4 | 5.4 | 9.5 | 0.9 | -1.8 | 5.4 |
| Imports of goods and nonfactor services | 8.6 | 6.3 | 9.4 | 0.8 | -2.5 | 6.4 |
| Net foreign balance[1] | -0.2 | -0.2 | 0.6 | 0.1 | 0.3 | -0.3 |
| Gross domestic product | 4.3 | 3.7 | 3.5 | 1.1 | 1.0 | 3.0 |
| Output gap (in percent of potential output) | 1.1 | 2.1 | 2.9 | 1.3 | -0.5 | -0.3 |
| Prices, wages, and employment | | | | | | |
| Consumer price index (year average) | 1.8 | 2.0 | 2.3 | 5.1 | 3.8 | 2.4 |
| GDP deflator | 1.7 | 1.7 | 3.7 | 4.7 | 3.2 | 2.3 |
| Hourly compensation (manufacturing) | 3.9 | 3.0 | 5.1 | 4.0 | 5.3 | 2.6 |
| Unit labor costs (manufacturing) | 1.4 | 1.0 | 1.4 | 4.0 | 3.6 | -0.1 |
| Employment | 3.3 | 3.0 | 2.3 | 2.3 | 0.2 | 1.1 |
| Unemployment rate (in percent) | 4.2 | 3.2 | 2.6 | 2.0 | 2.9 | 3.2 |
| NAIRU | 5.4 | 4.7 | 4.4 | 3.9 | 3.7 | 3.6 |

Table 1. Netherlands: Basic Data (concluded)

| | 1998 | 1999 | 2000 | 2001 Est. | 2002 Proj. | 2003 Proj. |
|---|---|---|---|---|---|---|
| | (Percentage changes unless otherwise noted) | | | | | |
| Personal sector | | | | | | |
| Real disposable income | 4.5 | 1.0 | 2.2 | 3.3 | 2.9 | 1.8 |
| Household savings ratio[2] | 13.6 | 10.6 | 8.3 | 10.9 | 12.8 | 12.5 |
| External trade | | | | | | |
| Exports of goods, volume | 7.6 | 5.0 | 12.0 | 1.3 | -1.8 | 5.3 |
| Imports of goods, volume | 8.1 | 6.6 | 9.4 | 0.4 | -2.5 | 6.5 |
| Terms of trade | 0.1 | -1.3 | -0.1 | 0.3 | -0.4 | -0.3 |
| Merchandise balance (percent of GDP) | 5.3 | 4.0 | 5.8 | 6.2 | 6.1 | 5.5 |
| Current account balance (percent of GDP) | 3.4 | 3.2 | 3.0 | 3.1 | 3.9 | 3.1 |
| Public sector accounts (percent of GDP) | | | | | | |
| Revenue | 46.4 | 47.5 | 47.5 | 45.9 | 46.0 | 45.2 |
| Expenditure | 47.3 | 47.1 | 45.4 | 45.8 | 46.3 | 45.8 |
| General government balance | -0.8 | 0.4 | 2.2 | 0.2 | -0.3 | -0.6 |
| Structural balance | -1.4 | -0.7 | 0.2 | -0.4 | -0.1 | -0.5 |
| Primary balance | 3.4 | 4.2 | 5.4 | 2.9 | 2.2 | 1.6 |
| Structural primary balance | 2.9 | 3.2 | 3.5 | 2.3 | 2.3 | 1.8 |
| General government gross debt | 66.8 | 63.1 | 56.0 | 53.2 | 50.0 | 47.3 |

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

[1]Contribution to GDP growth.

[2]In percent of disposable income.

Table 2. Medium-Term Macroeconomic Forecast
(In percent)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|
| National accounts (constant prices) | | | | | | | | |
| Private consumption | 3.8 | 1.2 | 1.3 | 2.2 | 2.5 | 2.5 | 2.5 | 2.6 |
| Public consumption | 1.9 | 3.4 | 1.8 | 2.2 | 2.0 | 2.0 | 2.0 | 2.0 |
| Gross fixed investment | 3.7 | -1.1 | -0.2 | 3.6 | 4.1 | 4.1 | 4.1 | 4.1 |
| Total domestic demand | 3.1 | 1.0 | 0.7 | 3.4 | 2.6 | 2.7 | 2.7 | 2.8 |
| Net foreign balance 1/ | 0.6 | 0.1 | 0.3 | -0.3 | 0.3 | 0.2 | 0.2 | 0.2 |
| Gross domestic product | 3.5 | 1.1 | 1.0 | 3.0 | 2.7 | 2.9 | 2.9 | 3.0 |
| Prices, wages, and employment | | | | | | | | |
| Consumer price index (year average) | 2.3 | 5.1 | 3.8 | 2.4 | 2.2 | 2.0 | 2.0 | 2.0 |
| GDP deflator | 3.7 | 4.7 | 3.2 | 2.3 | 2.2 | 2.2 | 2.1 | 2.1 |
| Unemployment rate (in percent) | 2.6 | 2.0 | 2.9 | 3.2 | 3.5 | 3.4 | 3.4 | 3.2 |
| External trade | | | | | | | | |
| Exports of goods, volume | 12.0 | 1.3 | -1.8 | 5.3 | 5.6 | 5.6 | 5.6 | 5.6 |
| Imports of goods, volume | 9.4 | 0.4 | -2.5 | 6.5 | 5.8 | 5.8 | 5.8 | 5.8 |
| Merchandise balance (percent of GDP) | 6.4 | 7.2 | 7.3 | 6.7 | 6.8 | 7.0 | 7.3 | 7.5 |
| Current account balance (percent of GDP) | 3.0 | 3.1 | 3.9 | 3.1 | 2.9 | 3.0 | 3.1 | 3.2 |
| Public sector accounts (percent of GDP) | | | | | | | | |
| Revenue | 47.5 | 45.9 | 46.0 | 45.2 | 45.1 | 44.9 | 44.7 | 44.5 |
| Expenditure | 45.4 | 45.8 | 46.3 | 45.8 | 45.5 | 44.8 | 44.1 | 43.5 |
| General government balance | 2.2 | 0.2 | -0.3 | -0.6 | -0.4 | 0.1 | 0.5 | 1.0 |
| Structural balance | 0.2 | -0.4 | -0.1 | -0.5 | -0.2 | 0.3 | 0.7 | 1.0 |

Sources: Dutch official publications; International Monetary Fund, International Financial Statistics; and Fund staff estimates.
1/ Contribution to GDP growth.

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# IMF Concludes 2002 Article IV Consultation with the Kingdom of the Netherlands—Netherlands

On June 10, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Kingdom of the Netherlands—Netherlands.[1]

**Background**

Real GDP is projected to rise by 1 percent in 2002, implying a return of growth to about 3 percent at an annual rate in the second half, and to rise by 3 percent in 2003. The pickup reflects an improvement in the worldwide economic climate, as well as last year's easing of monetary conditions in the euro area. The slowdown in 2001 and the first half of 2002 significantly reduced the demand pressures that had built up in the Dutch economy over the past several years, as evidenced by rising vacancy rates and an increase in the unemployment rate (though from very low levels). Inflation is accordingly expected to slow gradually from some 5 percent in 2001, to 3.8 percent this year and 2.4 percent next year.

The fiscal position deteriorated last year, reflecting both the long-planned tax reform (which reduced the surplus by an estimated 0.7 percent of GDP) and the cyclical slowdown. A deficit of 0.3 percent of GDP is projected this year, and 0.6 percent of GDP next year (which does not necessarily represent policy, since there is no 2003 budget or a fiscal framework). A government study has recommended that the fiscal framework be renewed in the coming government period, largely along the lines of the existing framework. The study has

[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.

recommended a medium-term structural surplus of between 1.3 and 1.8 percent of GDP in anticipation of the fiscal costs of population aging.

The labor market has improved greatly over the years, and the Netherlands has among the lowest unemployment rates in the industrialized world. Still, employment and participation rates are broadly similar to the EU average, suggesting that more needs to be done. A number of studies have been prepared on structural issues for consideration by the next government. A proposal for reform of the large disability program, agreed by the social partners, would restrict benefits to the fully and permanently disabled, tighten medical criteria, raise the benefit replacement rate, and eliminate experience rating for firms. Another study argues that subsidized jobs and government employment be de-emphasized, in view of tight labor-market conditions. A study examining the health-care sector envisages greater play of market mechanisms in order to increase efficiency, while still guaranteeing full insurance coverage.

**Executive Board Assessment**

Executive Directors commended the authorities on their record of sound macroeconomic policies, including sustained fiscal consolidation, and important structural reforms. Along with wage moderation, these policies have underpinned strong economic growth, rising employment, and a very low unemployment rate. The past year had witnessed a slowdown, but this was not unwelcome given the build-up in inflationary pressures. Directors expected economic growth to begin to recover in the second half of this year, since worldwide activity is recovering, monetary conditions are supportive, and the adverse effects of special factors, notably higher oil prices and livestock diseases, should dissipate.

Directors observed that the long cyclical expansion, and wage increases unmatched by productivity gains, had raised Dutch inflation above that in the euro area and reduced the economy's international competitiveness. While the economic slowdown has helped to reduce demand pressures, setting the stage for a gradual decline in inflation, continued erosion of competitiveness seems likely as Dutch inflation will possibly remain higher than in the euro area for some time, and negotiated wage agreements continue to be in excess of that in neighboring countries. To contain this erosion, Directors stressed the need for prudent fiscal policies, and for structural reforms in the labor and product markets to ensure sustained increases in productivity.

Directors saw a need for fiscal policy to remain prudent, not only to guard against a re-emergence of inflation, but to deal with long-term population aging. In the short term, fiscal policy should avoid stoking demand pressures. In particular, the deficit should not be allowed to deteriorate in 2003, a year of economic expansion. Directors agreed that, over the medium term, achieving a sustainable fiscal surplus of about 1½ percent of GDP will be an appropriate way to deal with the anticipated fiscal costs of population aging, although some observed that this would be difficult to achieve. They stressed the need for early action so as to permit dealing with these costs relatively smoothly. While noting the strong reputation of Dutch pension and health-care systems, some Directors urged that consideration also be given to further reform in these two areas to contain future costs.

Directors agreed that a renewed commitment by the new government to the existing fiscal rules will be essential. Pointing to the successful experience of the past, they emphasized the advantages of a transparent, multi-year budgeting framework and of strict spending ceilings that are independent of revenue developments. Directors supported the full use of the automatic stabilizers on the revenue side, although some agreed that some cyclically sensitive items should be excluded from the expenditure rule.

While commending past progress on labor-market reforms, Directors underscored the need to press forward with these reforms, and focused on three key areas. They were encouraged by the widespread agreement in the Netherlands on the need to reform the large and growing disability program. They noted that the proposal agreed by the social partners had a number of strengths, but that the issue of incentives to curb entry into the program remains to be addressed. Directors also pointed to high inactivity and poverty traps as impediments to further improving labor market performance. They recommended that the host of redistributive programs should be rationalized to make them more transparent and better targeted, and to continue the process of increasing the incentives to work. Finally, Directors agreed that public employment programs have largely outlived their usefulness and ought to be scaled back.

Regarding product markets, Directors welcomed the liberalization of the energy sector, and encouraged the authorities to renew the momentum for reform, to help ensure sustained increases in productivity. The government can contribute to the required increased flexibility and innovation by lowering barriers to entry, including by further reducing the administrative costs facing firms.

Directors noted that Dutch financial markets appear to be robust, despite a cyclical downturn in banking profits, and well supervised. While acknowledging that banks' high exposure to mortgages merit special attention, as a slowing economy could lead to a rise in mortgage defaults, Directors believed there was little chance of this occurring at the present time. They considered that financial supervision will be strengthened by the closer links recently established between banking and insurance supervisors. This should improve the supervision of the large conglomerates that dominate the Dutch financial system. Directors looked forward to the results of the Financial Sector Assessment Program scheduled for 2003. They commended the authorities for the decisive steps taken against money laundering and the financing of terrorism.

Directors commended the authorities for their support for the reduction of barriers to the exports of developing countries, and for their generous development assistance which, at 0.8 percent of GNP, is one of the highest among advanced economies.

***Public Information Notices (PINs)*** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with the Kingdom of the Netherlands--Netherlands is also available.

**Kingdom of the Netherlands—Netherlands: Selected Economic Indicators**

| | 1998 | 1999 | 2000 | 2001 | 2002[1] | 2003[1] |
|---|---|---|---|---|---|---|
| Real economy (change in percent) | | | | | | |
| GDP | 4.3 | 3.7 | 3.5 | 1.1 | 1.0 | 3.0 |
| Domestic demand | 4.8 | 4.2 | 3.1 | 1.0 | 0.7 | 3.4 |
| CPI (year average)[2] | 1.8 | 2.0 | 2.3 | 5.1 | 3.8 | 2.4 |
| Unemployment rate (in percent) | 4.2 | 3.2 | 2.6 | 2.0 | 2.9 | 3.2 |
| Gross national saving (percent of GDP) | 25.2 | 26.7 | 27.6 | 27.2 | 27.3 | 27.3 |
| Gross domestic investment (percent of GDP) | 22.2 | 22.6 | 22.6 | 21.8 | 21.2 | 22.1 |
| Public finance (percent of GDP) | | | | | | |
| General government balance | -0.8 | 0.4 | 2.2 | 0.2 | -0.3 | -0.6 |
| Structural balance | -1.4 | -0.7 | 0.2 | -0.4 | -0.1 | -0.5 |
| Structural primary balance | 2.9 | 3.2 | 3.5 | 2.3 | 2.3 | 1.8 |
| General government debt | 66.8 | 63.1 | 56.0 | 53.2 | 50.0 | 47.3 |
| Money and credit (end of year, percent change) | | | | | | |
| Domestic credit[3] | 16.0 | 13.0 | 13.4 | 7.8 | ... | ... |
| M3[4] | 10.3 | 8.7 | 8.5 | 12.5 | ... | ... |
| Interest rates (percent) | | | | | | |
| Money market rate[5] | 3.2 | 3.0 | 4.4 | 4.7 | 4.7 | 4.6 |
| Government bond yield[5] | 4.9 | 4.9 | 5.5 | 5.1 | 5.2 | 5.3 |
| Balance of payments (percent of GDP)[6] | | | | | | |
| Trade balance | 5.3 | 4.0 | 5.8 | 6.2 | 6.1 | 5.5 |
| Current account | 3.4 | 3.2 | 3.0 | 3.1 | 3.9 | 3.1 |
| Official reserves, excl. gold (US$ billion) | 21.4 | 10.1 | 9.6 | 9.0 | ... | ... |
| Reserve cover (months of imports of GNFS) | 1.2 | 0.5 | 0.5 | 0.5 | ... | ... |
| Exchange rate | | | | | | |
| Exchange rate regime | | | Member of euro area | | | |
| Euros per U.S. dollar (May 30, 2002) | | | | 0.94 | | |
| Nominal effective rate (1990=100) | 93.4 | 92.1 | 89.0 | 88.9 | ... | ... |
| Real effective rate (1990=100)[7] | 93.9 | 93.3 | 93.1 | 92.5 | ... | ... |

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

[1] IMF staff projections.

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

[3] Credit to euro area residents.

[4] Dutch contribution to euro area M3.

[5] Since 1999, euro rate.

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

[7] Based on relative normalized unit labor costs.