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0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/18

10:00 a.m., February 8, 1988

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	S. M. Hassan, Temporary
	C. Enoch
Dai Q.	
	A. Rieffel, Temporary
J. de Groote	
	R. Morales, Temporary
	A. M. Othman
G. Grosche	
	Hon C.-W., Temporary
	J. Hospedales
	D. McCormack
Mawakani Samba	
Y. A. Nimatallah	
	L. Filardo
J. Ovi	
H. Ploix	
G. A. Posthumus	G. P. J. Hogeweg
	I. Sliper, Temporary
	O. Kabbaj
A. K. Sengupta	
K. Yamazaki	S. Yoshikuni
S. Zecchini	

L. Van Houtven, Secretary and Counsellor
M. J. Miller, Assistant

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Also Present

European Department: P. B. de Fontenay, Deputy Director; M. C. Deppler, E. H. Gardner, M. Huybrechts, M. Z. Khan, P. M. Nagy, S. F. D. Powell, K.-W. Riechel. Exchange and Trade Relations Department: E. Brau. Legal Department: H. Elizalde. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: P. E. Archibong, J.-C. Obame, K.-H. Kleine, P. D. Péroz, M. Pétursson, A. Vasudevan. Assistants to Executive Directors: V. J. Fernández, L. Hubloue, S. King, S. Rebecchini, C. C. A. van den Berg, E. L. Walker, D. A. Woodward.

1. NETHERLANDS - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with the Netherlands (SM/88/11, 1/11/88). They also had before them a background paper on recent economic developments in the Netherlands (SM/88/20, 1/20/88) and a communication from the Netherlands Bank on interest rates in the Netherlands (EBD/88/36, 1/22/88).

Mr. Posthumus made the following statement:

The Netherlands authorities are in broad agreement with the staff appraisal. Taking into account the background information I gave last year, my introductory statement this year can be brief.

Preliminary data on 1987 indicate that GNP grew 2.4 percent, domestic demand 2.3 percent, of which public consumption 2.7 percent gross investment (excluding housing) 3.4 percent, and stock building decreased. The current account surplus was f. 8 billion (about 2 percent of GNP), down from f. 12 billion in 1986. As I indicated last year, the fiscal deficit increased, because the decrease of natural gas proceeds by about 3 percent of GNP in 1987 could not be fully compensated in the same year. The fiscal deficit for 1987 is now 7.7 percent of national income, compared with 6.4 percent in 1986. Finally, receipts of taxes and social premiums increased in 1987 because growth was better than expected, but government expenditure increased as well because of large expenditure overruns. Thus, the collective burden increased somewhat, instead of the decrease that was expected because of lower natural gas revenues from national sales--gas revenues from sales abroad are not considered part of the collective burden.

The Government will conduct a midterm review of the four-year program set out in May 1986 in the next few months. Not all the data on which this review will be based are available yet, but it is clear already that additional measures will have to be taken to attain the targets for the fiscal deficit and the collective burden in the program set in 1986. The discussion entails a renewed debate about the question of whether the target set for unemployment has the same operational status as the targets set for the fiscal deficit or the collective burden. While it is clear that an increasing deficit and/or a larger collective burden would not improve the long-term outlook for employment, pressures for additional government expenditure on short-term employment programs are rising. Because of this, I will divide my remarks in two parts: macroeconomic policies and structural policies.

With respect to macroeconomic policies, fiscal policy will continue to be directed at decreasing the fiscal deficit. A deficit of 7.2 percent of national income is targeted for 1988. The Cabinet program aims at a deficit of 5 1/4 percent in 1990, which is still unsustainable because at that level the ratio of interest payments to national income continues to increase, as shown in Table 53 of the report on recent economic developments. to attain this aim additional budgetary cuts are required in both 1989 and 1990, amounting to f. 4-8 billion. There is little concern that the balance of, on the one hand, somewhat slower increase in demand because of public sector retrenchment and, on the other hand, the increase of resources thus made available to the private sector, will be negative for growth in the short run, and certainly not in the longer run. However, the process has to be accompanied by structural measures.

Monetary policy continues to be oriented toward maintaining exchange rate stability in the framework of the European Monetary System. Excessive credit creation in 1985/86 led to an arrangement with the banks to limit money creation in 1986/87. The more satisfactory domestic liquidity situation in 1987--leading to less money outflow and therefore less pressure on the guilder than in 1985/86, which was the reason for introducing the arrangement in 1986--and the lower growth prospects of the economy for 1988 led to a discontinuation of the arrangement. The guilder's present strong position enabled the authorities to lower official rates substantially, and thus contribute to reduced interest rates in the European Monetary System in general.

While macroeconomic policies aim at a stable and sustainable economic situation, in a medium-term oriented policy context, attention to structural policies has increased substantially. The main problem, of course, is that structural problems are so difficult to solve because of the need to break through vested "rights" and interests; once the decision to break through them has been taken, however, the effects need not necessarily come only slowly, as the word "structural" seems to imply.

Because of the large share of expenditure in national income, fiscal policy itself may contribute to structural policy. Entitlement programs totaling f. 57 billion in 1988, 34 percent of government expenditure--which excludes the premium-financed social security system of f. 90 billion--caused large overruns in 1987. While political constraints are indeed a problem, some of these program, such as the investment subsidies in particular, but also housing and rent subsidies, are now under increasing scrutiny and nationwide discussion.

The staff report describes adequately the issues which have to be addressed by tax policies, in particular the problem of the wage wedge. The four-year program of the present Cabinet sets a target for the fiscal deficit and a condition that the collective burden should not be increased, and if possible decreased. Furthermore, the Cabinet decided to implement the recommendations of the Oort Commission to simplify the structure of income and wage taxes and of social security contributions. Distributional concerns continue to be of great importance, however.

Labor market policies have changed substantially over the past few years. Centralized wage negotiations have been supplemented by industry- and enterprise-level wage negotiations, which may have contributed to the wage restraint so far. Hiring and firing are subject to less restrictive rules. The legal minimum wage and its role in providing the basis for social security incomes remains a problem because of its level, but even more so because of the resulting small difference between incomes of employed and unemployed persons. The discussion about the role of the legal minimum wage is continuing, however, and the subject may come up again during the midterm review of the cabinet program.

Industrial policies have also changed, and the substantial subsidies to enterprises which still existed a number of years ago have been brought to a minimum. The maintenance of an adequate infrastructure in the field of education and research is being considered the Government's basic contribution to stimulating industrial development.

While much remains to be done, the Government's structural policies carried out during a number of years have already helped change the economic climate. This in turn strengthened efforts to decrease the existing, still substantial, rigidities that I mentioned. In my view, with these efforts, including recent monetary policies, the Netherlands is certainly no less active than others in helping to sustain global demand and redress global imbalances with fiscal expansion which is often not sustainable.

Mr. de Groote made the following statement:

Dutch economic policy continues to pursue the medium-term goals of fiscal stabilization and elimination of structural rigidities in the labor market. The imbalances confronting Dutch policymakers show striking similarities to the Belgian case and involve them in similar daily combat against the many entrenched privileges inherited from the social model established in the 1960s and maintained throughout the 1970s.

Progress on such fronts is almost inevitably slow: gradual results are obtainable only through repeated parliamentary confrontations which expose the Government to political fatigue and the risk of budget overruns. In this connection, it is interesting to note that in Belgium, the required spending discipline could be obtained only by giving the Government special powers to intervene in all major areas of the public finances and by establishing very tight controls over every stage of budget implementation. In the Belgian case, of course, political acceptance of such a straitjacket was easier to obtain, because the need to bring the public deficit within manageable limits was much greater. Apart from this difference in magnitude, however, the Dutch leaders face a similar difficult task in preparing the population for a new type of society, the merits of which may not be obvious at first glance. Apart from the formulation of clear policy objectives, the credibility and success of such a transformation will mostly depend on day-to-day perseverance in implementing the many difficult decisions required to meet the general objectives, and day-to-day success in overcoming the resistance these decisions will evoke. The inclusion in the present Coalition Agreement of a contingency clause for additional spending cuts, and the Government's present concern about the adequacy of existing budget controls, both show that the Government is fully aware of the difficulty of the task before it and has the firm intention of making its plans succeed.

What is at stake for Dutch economic policy is a fundamental transformation of society into one characterized by less government intervention and more market flexibility. The requirements of this model are by now familiar to most European countries: the level of public expenditures must be reduced, in order to contain the financing burden imposed by high government deficits, and to create room for reducing high tax levels; and the structural improvement of employment prospects flowing from the lower tax levels must be supported by actions aimed at reducing labor market rigidities and at increasing mobility and wage differentiation. There does not appear to be any argument in principle between the staff and the Dutch authorities concerning the validity of these prescriptions; the real difficulty with their more forceful implementation seems rather to arise because to some extent a large segment of the population still seems to prefer a very different kind of economic model.

Under this popular model, high taxation and large budget deficits are accepted as a reasonable trade-off for the distributional and general welfare benefits obtainable from the continuation of extensive government spending programs. The economic viability of this model is secured by a general willingness to accept the continuous wage moderation needed to offset the cost burdens imposed on the general competitiveness of industry by high taxes and heavy social security premiums. Even after the Government's recent withdrawal from the wage-setting process, real wage increases in the Dutch economy were still the lowest for any industrial country in 1987. On this point, the Dutch and the Belgian adjustment models seem to differ somewhat: in the Belgian case, acceptance of the need for wage moderation is founded on the prospect that fiscal reform will in time permit a decrease in taxes and an increase in disposable income, rather than on a hope of full preservation, in all its features, of the welfare system inherited from the 1960s.

The apparent viability of the popular Dutch model is underscored by the unquestionable economic successes which the wage moderation strategy has achieved since 1983: private sector employment, enterprise investment, and export market shares are all following a healthy upward trend, and I am particularly encouraged by the expansion of productive capacity indicated by the recent strong increase in plant investment. Taken together, these developments suggest that sustained wage restraint, coupled with the traditional dynamism of Dutch enterprises, may have moved the Dutch economy into a supply-side cycle in which improved supply effects promote capital investment spillover into stronger domestic demand, thereby reinforcing the supply-side conditions still further.

Under these conditions, the need for a radical departure from present economic relationships becomes less pressing, and the more gradual approach, now proposed by the staff, of freezing overall public spending in real terms while using real revenue increases for equiproportional reductions in taxes and the budget deficit, gains special appeal. During previous Article IV consultations with the Netherlands, I supported a similar approach by suggesting that the resources released by budgetary restraint should be applied to both deficit and tax reductions. In my view such a strategy could greatly strengthen the broad social consensus needed to legitimize sustained public spending reductions in the medium term, by explicitly conveying the notion that readjustment of the public sector directly benefits both the public and the competitiveness of Dutch industry by reducing their tax burdens.

The staff's recommendation that the taxation problem should be handled as an integral part of the broader budget reform therefore ought to be quite useful in giving the political debate a new momentum and will be even more effective if the present distribution of income produced by current taxation and social transfer patterns can be adequately protected at the same time. The common objection that this approach may not be feasible, because the reduction of taxes and social transfers would affect different income groups, may turn out, in the end, to be less valid than is commonly assumed. Studies on this issue indicate that, contrary to common belief, it is the upper-income segment of the population, in the highest tax brackets, which surprisingly often turns out to be the major beneficiary of social transfers in a number of important areas, such as education and health care. If this analysis is correct, efforts to reduce the tax burden as part of a general effort to reduce the Government's role in the economy could very well go a long way without producing unacceptable income distribution effects. In any event, the Government's desire to reduce its role is also justified by legitimate concerns about the medium-term outlook for the Dutch economy. These concerns have three sources: the financing constraints imposed by the continuous increase of public debt, the requirements imposed on Dutch industry by the proposed unification of the European market, and the role of the Dutch economy in the international adjustment process.

As to the first of these, even under the staff's recommended scenario for fiscal adjustment, its medium-term projections show the public debt ratio reaching 100 percent of national income by the early 1990s, so that from then on reductions in the fiscal deficit will become even more difficult because of the large share of resources required for debt interest service. This adds to the urgency of early and sustained action on the budget. Another future risk stressed by the staff originates with the planned unification of the European market in 1992. Though its precise scope is not yet known, it can be expected that investment and labor decisions in the unified market will become more dependent on differential tax treatments than they are today, and this will severely test the economic viability of the Netherlands' high tax rates. Finally, the staff rightly directs our attention to certain limitations which the Dutch adjustment model imposes on the Netherlands' role in the international adjustment process as a whole. This model's low wage increase/ large deficit features do not leave the Dutch economy much flexibility for protecting domestic output against possible world demand shortfalls produced by the international adjustment process, if the policy of reducing over time the size of the deficit is to be pursued. For the same reason, the model also limits the authorities' room for maneuver should they wish to place the Netherlands' strong current account position at the service of a general effort of the surplus countries to offset the risks of such a demand shortfall.

Difficult policy choices are at hand here, especially since in the near future the Dutch economy may well face a combination of continued strengthening of the current account and slower domestic growth. The staff suggests that a positive fiscal contribution to growth could be obtained by returning to taxpayers any revenue increases which might accrue from coordinated reflation abroad, and some EEC circles even suggest that the Dutch current account and inflation outlook would justify an even stronger fiscal impulse. Mr. Posthumus clearly has reservations about the sustainability of such recommendations, and I personally would agree with him that any fiscal stimulation beyond the equiproportional distribution of any real revenue increase between tax and deficit reduction would jeopardize the ongoing financial stabilization. Attempting to provide a stronger fiscal expansion would also make it more difficult for the Government to pursue its justified goal of a general and structural lowering of real interest rates by the judicious application of fiscal retrenchment and monetary relaxation.

In conclusion, present demand and investment patterns in the Dutch economy suggest that the country is now harvesting the fruits of years of sustained adjustment efforts. As a result, the Netherlands enjoys a unique opportunity to continue correcting the domestic imbalances under favorable conditions. These same favorable conditions also make it more difficult for the authorities to convince public opinion that further efforts are still needed now, to forestall the necessity of a more radical correction at a later time, when growth conditions may be less favorable. No one is better placed than our former colleague, Mr. Ruding, with his well-known clarity of vision, to lead the Dutch economy through these difficult and unpopular choices.

Mrs. Filardo made the following statement:

We are in broad agreement with the staff appraisal. The authorities should be commended for a fifth year of recovery in output and a third year of positive change in employment. Growth has been based on a continuous increase in gross fixed investment and on a very solid export performance. Furthermore, unit labor costs in manufacturing have remained constant, strengthening the economy's competitive position, and the consumer price index was negative in 1987. Nevertheless, as has been pointed out by the staff and by Mr. Posthumus in his statement, the main issues facing the authorities are the fiscal deficit and the extremely high rate of unemployment. The fiscal position deteriorated further during 1987, notwithstanding the agreement with the coalition partners to accomplish a medium-term reduction in the deficit, and an improvement in revenues. While it is true that part of the deterioration was due mainly to lower compensation measures to correct the decline in energy prices that took place in 1986, it is also true that it was fueled by cost overruns, especially those related to educational grants and investment subsidies. In addition, it is clear from the report on recent economic developments that the central government deficit is more structural in nature, as it has averaged 7.5 percent annually over the past five years.

The deficits of the Netherlands and Italy are the largest among the industrial countries. Therefore, as Mr. Posthumus has indicated, in order to redress global imbalances some of the industrial nations, including the Netherlands, cannot continue to support a situation which is clearly unsustainable in the medium term, especially given the asymmetrical distribution of financial resources in the world economy. Thus, they should be more active than Mr. Posthumus suggested in aiming to design and implement more decisive measures to correct their fiscal deficits.

Although the authorities have made some progress in correcting unemployment, generous social benefits, the wage wedge, the minimum wage, the steep rate of taxation, and substantial unemployment insurance are the main factors preventing employment growth, suggesting that unemployment is structural in nature. I agree with the staff that a lasting reduction in unemployment requires the elimination of all these distortions. Nonetheless, as Mr. Posthumus has indicated, it might be advisable to reduce these distortions gradually, given the difficulty in breaking through vested interests.

To conclude, my authorities are disappointed with the behavior of some of the industrial nations in the area of fiscal discipline. This behavior is one of the main reasons why the world economy is experiencing frequent shocks; since deficits are unsustainable, monetary policies are used to attract foreign savings. High real interest rates impose even greater burdens on developing countries, which also need to attract foreign savings and service their debt. In this respect, there is no doubt that the fiscal imbalances are endangering the stability of the international monetary system.

Mr. Sliper made the following statement:

I will make some rather critical remarks on the current state of economic policymaking in the Netherlands. However, I will preface my comments with three general points.

First, I would like to commend the staff for an excellent report. It is short, concise, and yet identifies the main policy issues and dilemmas currently facing the authorities. Also, it does not shy away from highlighting some of the inconsistencies in the economic objectives being pursued by the Government. The report does this in a straightforward way, without badgering or being unduly argumentative, but giving weight to the views and positions of both the authorities and the staff. In my view the report has good tone.

Second, the report raises the issue of the extent to which it is appropriate for Directors to comment on distributional and welfare policies. The equity and efficiency debates are obviously sensitive and go to the heart of political economy in the Netherlands. In broad terms, I consider it appropriate for the Fund to place those welfare issues in an economic context, analyzing in particular the sustainability of a tax and welfare regime, especially as it affects economic growth and employment creation over the medium term. My own comments will have this economic focus very much in view.

Third, I would like to emphasize that while some of my comments may appear a bit critical, they should not be taken as an attempt to negate or denigrate the significant achievements of the Netherlands economy over recent years. These positive features are important, but I have some real doubts about the sustainability of the present economic performance, and I wish to concentrate my remarks in this area.

With regard to recent trends, positive developments include steady growth, an enviable record of price stability, an external position coming into balance, and continuing growth in both private sector employment and investment. There are, of course, some darker clouds hanging over the economy, particularly the fiscal deficit, and the unemployment level, which remains stubbornly at about 13-14 percent of the labor force.

My questions about economic policymaking in the Netherlands center on the ability of the authorities to create an economy that will be sufficiently responsive to external events in the 1990s, thus providing sustained employment and growth. The problems are very much interrelated, but I will deal with them under three headings--the fiscal deficit, labor market rigidities, and the whole welfare/tax system.

This chair has consistently favored a fairly rapid path to reducing fiscal deficits. This follows from experiences in our own countries, along with mounting evidence that rapid reductions do not bring about employment contraction to anywhere near the degree often feared. Moreover, we have consistently seen fiscal adjustment programs in which modesty in setting targets for fiscal reduction begets modest results. This has happened and is happening in the Netherlands. Last year, the Government agreed on a target of reducing the fiscal deficit by about 1/2 percent each year over the next four years. This was blown off course in the last year. Again, this is not surprising, given the enormous pressures that exist in the budgetary process for deficits to expand, either with revenue falling short of optimistic forecasts, or expenditure growing more than expected. In our view, the target of 5 1/2 percent of net national income in 1990 remains a modest one, and signifies an approach of chipping away at the edges of, rather than coming to grips with, the fiscal imbalance. To use the language in the report, what is needed is trend breakers, rather than trend benders.

On the labor market front, some good things are occurring; the Government has stepped back from the wage-fixing process and is allowing the parties to negotiate annual wage awards more freely. I understand from the staff that this is leading to some dispersion of wages in the private sector. Second, it seems that the Government has loosened regulations concerning dismissals, and there has been significant labor shedding over the last year in consequence, with firms becoming more internationally efficient. Third, labor conditions seem to have favored more part-time employment, which has created more flexibility in the employment market. However, I am left with the overall impression that these measures again do not address the basics. If the Government is going to make a significant dent in the unemployment level, there have to be further fundamental changes in the whole welfare and taxation systems. The Government seems to be gathering resolve to undertake some major reforms in the housing area, which is welcome. Nevertheless, the Government must start to question in a radical way some of the basic principles of the welfare state in the Netherlands. This analysis and questioning should include the minimum wage, the huge personal taxation level, and the enormous array of benefits. Somehow the economic discussion has to get on to a plane higher than that represented by the protracted debates about the appropriate fee structure for dentists.

Appendix I of the background paper on recent economic developments contains some very revealing statistics on the welfare system in the Netherlands and highlights the huge dependency on the State that the current system has generated. It conjures up visions of massive amounts of money being distributed from the middle class to the middle class, with people expending lots of energy to ensure that they get the benefits which others receive. I have always been rather doubtful about some of the extravagant claims of supply siders concerning the generation of output growth following reductions in marginal tax rates and the supposed linkages to work habits and motivation. However, I also have a healthy respect for envy as a factor motivating people in seeking tax concessions and benefits which are widely available. It can be damaging, both economically and socially, when people's energies are directed at seeking tax and benefit gains rather than at more productive activities. Given the extent and the expense of the current taxation and benefit system in the Netherlands, the evidence of questionable equity gains and enormous efficiency costs seems to be mounting.

Significant change will not come about unless there are some shifts in people's attitude about what the Government can and cannot provide in a modern society. In the Netherlands there seems to be an extraordinarily high expectation as to the State's role in providing for the welfare and economic well-being of its citizens. However, many other nations have moved to the view that a vibrant and responsive private sector is the key ingredient to providing sustained economic growth and employment. There are of course signs that this is occurring in the Netherlands. The low growth outlook, the constrained fiscal position, international changes in taxation systems, and the enormous costs of current unemployment ensure that the debate about equity versus efficiency will intensify in the coming years.

While there are some signs of the debate going on, at present there are few indications of the debate being translated into meaningful action. However, the economic record of the Netherlands augurs well that the people and Government will meet the economic challenges of the 1990s in an innovative and successful way.

Mr. Grosche made the following statement:

It is difficult to add anything substantial to Mr. de Groote's and Mr. Sliper's comments. I share the views of previous speakers that in many respects the adjustment policies pursued by the Netherlands authorities since 1982 have had a considerable degree of success. GDP growth was quite stable, the current account surplus remained comfortable, and, most important, the price performance was excellent. There have also been further improvements in the supply situation, and, by and large, the business sector is profitable and quite competitive vis-à-vis the country's European trading partners.

However, despite the good progress achieved so far, the Netherlands still faces a difficult and lengthy adjustment task. The rate of unemployment remains one of the highest among OECD countries and undoubtedly contains a significant structural component. The labor market, together with the fiscal deficit which, I agree with Mr. Posthumus, is clearly unsustainable, continue to be the two major problems. Like the staff, I think that those two problems are closely interrelated.

With regard to the public sector deficit, I share Mr. Posthumus's disappointment about the larger than expected collective burden in 1987. The general government deficit remains large, and the debt ratio, which has already grown to over 75 percent of net national income, is certain to rise even further, as will debt interest payments; they already take up 15 percent of total current expenditure and are likely to narrow even further the Government's future room for maneuver.

Higher taxes, however, offer no solution. The overall tax burden is heavy already, which, together with high tax brackets, produces a large wedge between labor costs and disposable income. Tax policies, together with high subsidies, transfer payments, and minimum wages, result in a highly egalitarian income distribution. Harder work does not pay off. Moreover, high unemployment benefits reduce incentives for taking less well-paying jobs or those less conveniently located.

Considering the high priority given to equal income distribution in the Netherlands, I consider the staff's recommendations to cut the budget deficit and unemployment to be realistic, although I certainly would have preferred a less gradual approach. The staff suggests freezing overall public expenditure in real per capita terms and using additional income proceeds to reduce both the deficit and taxes. I recognize that this is much more easily said than done, and the political obstacles to reducing social expenditure and minimum wages are great. In the short run, every possible effort should be made to improve expenditure control, particularly with regard to the so-called open-ended expenditure items.

Future growth in the Netherlands will depend to a large extent on improvements in the functioning of the labor market and a reduction in the collective burden. The improvements introduced in the labor markets as described in the report are welcome, and additional like measures could help to dampen the increase in wage costs and thus help secure external competitiveness. Fortunately, this is more a matter of concern in the medium term. For the time being, the external sector's contribution to growth seems to be rather neutral. Given its comfortable situation, the authorities could indeed even tolerate some weakening in the current account position. Monetary policy has contributed markedly to the price performance. As interest rates are relatively high in real terms, the authorities should use any margin of maneuver that might be offered for a lowering of interest rates.

I noted the intention of the Nederlandsche Bank to start open market operations, which could help to better differentiate between short- and long-term interest rates. As described in the background paper on recent economic developments, the intended buildup of the open market portfolio of the Nederlandsche Bank is likely to ease money market conditions, and the Bank is discussing with banks the introduction of a cash reserve requirement that will enable the Bank to maintain effective control of the money market. It would be interesting to know whether these discussions have come to a successful conclusion.

Mrs. Ploix made the following statement:

I welcome the short length and concise discussion in the report.

The year 1987 turned out to be a better year for the Netherlands than expected, at least in terms of overall economic activity. The threat posed by the sharp decline in natural gas prices did not materialize, largely because of the rapid adjustment of the external sector to unfavorable terms of trade developments. At the same time, the negative inflation rate recorded last year was an important factor in maintaining a healthy level of domestic demand. The Netherlands was thus in a position to contribute positively to the ongoing economic coordination process.

Nevertheless, the staff is right in focusing its comments on two lingering problems, namely, the public sector's financial position, and the employment situation.

Regarding the public sector position, 1987 can scarcely be seen as a good year. Paradoxically, the serious worsening of the public sector position is not attributable mainly to the gas-related revenue shortfall; rather, the chief culprit is to be found in outlay overruns, which is much more worrying. Investment subsidies still involve significant budget transfers at a time when the private sector's profitability has been restored and capital formation remains buoyant, raising some questions. Perhaps Mr. Posthumus or the staff could clarify this point.

In general, stricter expenditure control lies at the heart of any lasting fiscal consolidation. In that sense, I support the staff's main proposal, since it spells out a direct link between the planned fiscal effort and a steady contraction of public expenditure. However, given the sensitivity of distributional concerns, this scheme may well turn out to be as difficult to implement as the authorities' present approach. In particular, the suggested freeze on overall expenditure in real per capita terms does not guarantee that the pattern of expenses will remain unchanged, thus giving rise to distributional problems. For this reason, the other suggestion put forward by the staff, that specific expenditure targets be formulated, could prove a more promising approach.

The rather disappointing outcome of the Oort Commission proposals on fiscal reform is a reminder of the political constraints under which the authorities have to operate. Yet, the crucial importance of achieving the deficit target for 1990 and beyond remains. The prospect of a single European market in 1992 should act as a strong incentive for the authorities, who should not rule out any option at this juncture, including adjustment of the level of public sector employment.

This leads me to the second issue, namely, the unemployment situation, on which my view is less pessimistic than that of the staff. First, it is acknowledged that due to the sustained rate of growth and a firm control over labor costs, a moderate but continuing improvement in the unemployment rate has been recorded. In addition, demographic trends should alleviate the pressure on the supply side of the labor market over the medium term.

With regard to income differentiation, now that wages are determined largely at sector or company levels, the authorities' role appears necessarily limited. The authorities could make a stronger case for a more differentiated approach if it were ascertained that the increase in job vacancies has more to do with relatively low wages than with inadequate qualifications of job seekers. Likewise, we hope that the strong development of part-time jobs will be conducive to a more flexible approach to wage bargaining on the part of the social partners.

I have not much to add to the staff's analysis of monetary policy, as the authorities steadily adhere to clear-cut objectives and keep firm control of liquidity growth. The only development that could be questioned is the demise of the credit restraint agreement with commercial banks and the shift to open market operations. France was faced with a similar situation when the "encadrement du credit" was terminated at the beginning of last year. However, the Dutch economy seems to be more exposed to the increased interest rate variability such a policy implies, given the scale of overall public debt. Perhaps Mr. Posthumus or the staff would like to comment on this point.

Finally, with respect to the external side, even if the balance of payments position remains comfortable, a significant contraction of the current surplus was recorded last year. The staff, noting the continued favorable labor cost developments and the slowdown anticipated for this year, appears more sanguine than the authorities on the prospects for the external sector. Personally, I would lean toward a more cautious stance in view of the sharp decline in the value of the U.S. dollar, which might hurt the Netherlands' export performance even if the bulk of its external trade is directed to Europe. Moreover, the moderate rate of growth that seems likely to prevail in some of the major European economies can also be mentioned as an adverse development for Dutch exporters. Under such circumstances, it is difficult to press for too great a contribution from the Netherlands through reflation, although the country could certainly be part of any concerted European action. The authorities would then be left in a good position to tackle the crucial problem of fiscal consolidation with all the stamina they have shown in the past.

Mr. Hospedales made the following statement:

Economic performance in the Netherlands continues to be extremely satisfactory in many important respects, especially considering the adverse revenue effects stemming from recent resource price developments, as shown in the extraordinarily well written and impressively concise report. Real GDP has grown at an average annual rate of approximately 2 1/4 percent over the past five years, and, what is very important in our view, growth is becoming much more balanced, as shown by the recent strengthening of domestic demand. Also, inflation has decelerated and wage settlements have continued to be modest. Despite these positive developments, there are two key policy concerns, namely, a fiscal deficit which may become unsustainable, and an unemployment rate which, although trending downward, is likely to remain unacceptably high for too long. These problems are obviously interconnected, and their solution will require, in our view, a coordinated policy approach.

The challenge facing the Dutch authorities, therefore, is not without risk. The process of adjustment must remain orderly and on track, yet the policy approach must be consistent with the role of the Netherlands in international economic policy coordination, especially in the light of the world economy's present fragility and the risk of an economic slowdown. To this end, the Dutch authorities' commitment to unwind the prevailing economic imbalances is both encouraging and reassuring.

With respect to fiscal policy, the authorities have correctly opted for continued corrective action to reduce the fiscal deficit by 3 percentage points of net national income by 1990, by which time the ratio of debt to net national income will also be stabilized. We caution that any slippage in policy commitment and implementation could jeopardize capital formation, which is required both for enhancing competitiveness and for restructuring the economy's productive base. In fact, we have noted an undesirable slowdown in investment spending for 1987, which is expected to continue into 1988. For this reason, we believe that strengthened efforts to accelerate fiscal consolidation will be crucial should the international environment turn in favor of the Netherlands.

Given the constraints imposed on the tax reform process by considerations of revenue and distributional neutrality, the authorities are correctly focusing their deficit reduction efforts on expenditure. Their commitment to additional action if the deficit target is threatened is therefore courageous, especially in the light of the politically sensitive areas where action would need to be taken, most notably, in the area of social transfers, where the need to balance equity versus efficiency considerations would be vital.

Reduction of the ratio of the fiscal deficit to GNP is incompatible with the essential reduction of unemployment without labor market reform, and we are encouraged by the efforts to improve the functioning of these markets. Labor market reform is crucial for facilitating downward flexibility in wages and for creating appropriate wage differentials, and its contribution to investment and employment growth cannot be overemphasized.

Finally, I commend the Netherlands for its exemplary approach to international economic cooperation, as demonstrated by its official development assistance, which has been maintained at a traditionally high level.

Mr. Enoch made the following statement:

Along with other Directors, I found the staff report commendably short and well focused; it would be a good model for others to follow. I broadly endorse the staff appraisal and many of the comments already made by other Directors. I will make a few general comments before making some more specific remarks on fiscal and monetary policies.

The economy appears to have responded positively to the adjustment efforts of recent years. This seems to reflect an improvement in the supply performance, which seems to stem in no small part from the authorities' structural reform efforts. There are several places in the staff report where this relationship is illustrated, such as the improvement in labor market conditions for young workers following the reduction in the minimum wage for that group.

Apparently, the staff is expecting some slowdown in growth this year, in part reflecting a weakening in investment. This is obviously slightly disappointing, but I do not believe that it should lead to a change in the basic thrust of the authorities' policies. To judge from the staff report, there seems to be very little evidence that the economy needs additional demand management stimulus. Instead, the prospect of a slowdown in growth seems to suggest that a faster rate of progress on the structural front would be desirable. The staff report suggests various areas where additional structural measures would appear to be clearly justified, the most obvious area probably being the labor market, where significant distortions and disincentives seem to remain. There is also clearly a possibility that further structural reform could contribute to the process of fiscal adjustment.

Although there has been important progress in reducing the fiscal deficit and in curbing the share of net national income taken by public expenditure over the past few years, there is no doubt that the deficit, at 9 percent of net national income, remains at an excessively high level, and that further reductions will be needed. However, there was some slippage on the expenditure front in 1987, and I am glad that the authorities are trying to regain this year much of the lost ground. The appendix to the background paper on recent economic developments illustrates all too clearly that substantial cuts in the deficit will be needed if the rise in the debt burden is to be brought under control. In reducing the deficit, I would strongly agree with the staff that the primary emphasis must continue to be on expenditure restraint, as the currently very high rates of marginal taxation suggest that there is little room for further tax increases. Indeed, there may be scope for reductions in order to improve the structure of incentives. The problem is how to achieve the substantial reductions in expenditure that are required; there are no easy solutions. It is also clear that the authorities' task is made much harder by the difficulty in reducing social expenditure and transfers given the authorities' concerns about distributional issues.

The importance of these issues is, of course, highlighted by the evidence in the staff paper that the very high level of social benefits and transfers and the high minimum wage have reduced work incentives, and increased unemployment. I was surprised that the authorities feel that a reduction in the minimum wage is politically unacceptable, and that they have recently increased some social benefits, including the vacation allowance. Moreover, although the minimum wage has been deindexed, I presume that it has actually risen in real terms in the past year, as the overall price level has fallen.

Of course, it is ultimately the authorities' decision as to what measures are politically acceptable, but it is equally clear that the political constraints have reduced their room for maneuver substantially, and that as a result the process of fiscal adjustment is likely to be lengthened. The overall political costs of adjustment may actually have been increased in consequence, ultimately making adjustment fatigue more likely.

With respect to the conduct of monetary policy, the authorities have traditionally made the link with the deutsche mark the centerpiece of their monetary policy. Given the present impressive inflation performance and relatively good level of competitiveness, this policy seems entirely justified. The authorities set short-term interest rates in line with their exchange rate policy objectives via short-term credit extended by the central bank to commercial banks, and seek to achieve domestic policy objectives through their monetary policy, as they have in past years by restraining the growth of credit through the use of direct controls. I was interested to see that the authorities have decided to allow the agreement with the banks to lapse, in light of the relatively subdued prospects for credit growth this year. They are also building up a modest stock of government bonds to be placed with the central bank, which would allow it to begin open market operations; this may lead to the establishment of a market in short-term paper. These moves seem to be an important step toward a more decentralized monetary policy, which would reduce the emphasis on direct controls and regulations. The establishment of a market for short-term paper, and the introduction of open market operations, should make a more market-based system of monetary control possible. I would like to know whether these developments suggest that the authorities no longer see a need for direct controls over the credit market, or whether they expect that they might be reintroduced, perhaps through another agreement with the banks on lending.

Mr. Nimatallah made the following statement:

I am in general agreement with the staff appraisal, especially with respect to the authorities' many successes on several fronts, such as growth and inflation.

I see three areas of concern in the Dutch economy. The first is about equitable income distribution, which is causing a deterioration of the incentives to work and invest. The second is the structural rigidities that are leading to further distortions in the allocation of resources. The third is the fiscal deficit, which leads to an increasing share of interest payments to national income.

With respect to the first area of concern, it seems that the Dutch people have made a deliberate choice of reducing the income gaps between societal groups. Outside observers might find it difficult to appreciate the extent of the Dutch people's happiness with their choice. However, when these outsiders try to assess the possible future impact on the Netherlands of their choice on a materialistic basis, it seems that the Netherlands might find it a little harder to catch up with the material progress of other Western countries; for example, the per capita income of the Netherlands has to grow by about 30 percent before it can catch up with the current per capita income of Germany, the country with which it coordinates its monetary and exchange rate policies. The impact of narrowing the differential between the incomes of those who work and those who do not is evident in the level of utilization of productive resources. The potential for output and growth is greater than what it is now. Not only do workers have less incentive to work because of the present wage wedge, but also employers have less incentive to employ, because of the relatively narrow profit margins. In other words, the wage wedge, which needs to be mitigated through tax measures, is not the only problem; the level of the minimum wage needs to be addressed as part of the cost structure.

The authorities are moving in the right direction by attempting to freeze the minimum wage and by looking into a tax reform package which would widen the income differential between the employed versus the unemployed. I believe that the purpose of unemployment compensation is to maintain minimum aggregate demand, and not to weaken the incentive to work, which is why it would make more sense to see an extra effort toward a widening of income differentials on an after-tax basis in the Netherlands. Meanwhile, a thorough review of unemployment benefits and eligibility criteria is needed, especially with respect to the long-term unemployed and to disability claims.

Concerning structural rigidities, I am impressed with the realistic appraisal by Mr. Posthumus that "structural problems are so difficult to solve because of the need to break through vested rights and interests." It is hard for an outsider to imagine that 34 percent of government expenditure goes to entitlement programs, excluding social security. However, I am pleased that the authorities have expressed a willingness to address these problems when they consider tax policies in the future. Fortunately, the distribution between consumption and savings seems to be in the right direction, with a national savings ratio of about 23 percent. The objective here is to enhance incentives to work and invest. A reduction of marginal income tax rates could lead to that, helping the economy in the process to be more competitive in research and high technology in the long run. The Cabinet decided to implement the recommendations of the Oort Commission to simplify the structure of income and wage taxes, and of social security contributions.

Finally, the large fiscal deficit, although partly related to the choice of big government in the Netherlands, simply indicates that this Government is spending far beyond its means, which alone suggests that the fiscal deficit should be gradually reduced. Accordingly, the authorities should adopt a course of action to that end, as the advantages of a lower ratio of the fiscal deficit to GDP are obvious.

Mr. Ovi made the following statement:

After a number of years of rather inexplicably poor economic performance, the Dutch economy grew at a substantial and steady pace in 1984-87. Private consumption grew at a moderate rate, investment increased steadily, and export and price performance were among the best in the OECD area. Furthermore, even though the unemployment rate is still very high by international standards, it declined somewhat during this period. Economic policies have certainly played a major role.

However, as noted by the staff, domestic demand started to level off in 1987. This applies primarily to investment. The outlook for 1988 indicates much slower economic growth than in recent years. Growth in GDP and private consumption will be only about one half of last year's, and investment is forecast to be virtually unchanged. One of the conclusions to be drawn from this seems to be that even though last year's adjustment problems were difficult to handle, particularly in the fiscal area, this year they may become even more difficult. At the same time, it seems that short-term economic management is now necessary in order to spur economic activity. In this respect, we very much welcome the fact that the monetary authorities are presently using all available room for reducing interest rates, given the exchange rate constraints.

The rather detailed section in the staff report on the international responsibilities of the country and what might be its best contribution to international adjustment is welcome.

The staff seems in little doubt as to the reasons for the economic slowdown and the needed medicine: due to "political fatigue," it has not proven possible to introduce cuts in public expenditures "above and beyond those necessary to meet the deficit target"; and generally the staff blames the Dutch politicians for their undue concern about the distributional impact of policies. Although it contains important elements of truth, the report's assessment of the overwhelming negative effects of the present social structure, in particular, on the distribution of income and the level of government involvement, is not particularly convincing to a representative of the Nordic countries.

The fault, of course, may be mine, but I would still like to sound one or two notes of caution, the first on labor market mobility. There are important similarities between the Netherlands and Sweden regarding the tax burden and marginal tax rates. A study last year by the Brookings Institution on Sweden found a much greater degree of labor market flexibility than in most other countries, much to the surprise of the authors. Also, although it has been the stated aim of the U.K. authorities to reduce the level of public expenditures, the Government has rather systematically failed to reduce them, yet the United Kingdom has done pretty well in recent years. So, as Mr. Sliper stated, we have to move to a higher level of discussion in this area.

The present Netherlands Government has embarked on a decisive medium-term adjustment policy effort focusing on substantial fiscal consolidation under the constraints of tax reduction and the unchanged purchasing power of social benefits. This objective may be very difficult to achieve, not least because of the loss of fiscal revenue due to the decline in energy prices and what seems a general setback in economic activity, neither of which could have been foreseen. It also appears to be an open question to what extent the fiscal impact of these revenue losses ought to be offset in the short run.

The authorities are appropriately concerned about the imbalances and rigidities in the fiscal sector. Enhanced flexibility of the fiscal instruments is clearly needed. The level of taxation appears very high by international standards, and the present tax system distorts investment and labor incentives. We therefore very much welcome the initiatives to simplify taxation and urge the authorities to proceed with a comprehensive tax reform which will also provide them with a more powerful fiscal instrument.

The change in the past few years in the overall investment profile is greatly welcome. The investment ratio has recovered from its lowest level, of about 10 percent of GNP, to about 13 percent of GNP now. The authorities introduced variable investment subsidies in the late 1970s on a wide scale in order to revive growth, and we note that they have since been reduced without noticeable impact on overall investment; further reduction is recommended. The experience of several countries in my constituency clearly shows that a subsidy of this kind has only a temporary effect on investment and in the long run may distort competitiveness and profitability. In our view, this is the first and most obvious area where fiscal expenditure can be reduced further.

The savings ratio of households is quite remarkable, with net lending of this sector amounting to between 6 percent and 7 percent of net national income. Against this background the authorities should gradually reduce involvement in the housing sector, with the aim of also decreasing government rental subsidies, thus easing the fiscal situation and contributing to labor mobility.

Efforts to create employment and to improve the flexibility of the labor market remain central and critical ingredients of the medium-term economic and social prospects. I agree with the staff that a key factor seems to be insufficient employment incentives, of which high marginal rates of taxation and high unemployment benefits are important elements. Again, this could easily be overstated. Given other structural rigidities in the labor market, we feel that a firm and decisive policy of removing the above-mentioned impediments is important--for example, through the decentralization of wage bargaining and greater labor mobility.

The effects of these structural changes will be felt only gradually. I wonder whether Mr. Posthumus feels that the outcome of the wage negotiations this year will be in line with the authorities' projections in the staff report.

Finally, I would like to congratulate the Netherlands for playing a leading role in official development assistance. Despite the need for further fiscal consolidation in the Netherlands, my authorities encourage the Dutch authorities not to reduce their valuable development assistance.

Mr. Sengupta made the following statement:

We commend the authorities of the Netherlands for the impressive economic progress they have made in recent years, especially since 1983. It has been reported that the improved supply situation is likely to be carried over into the medium term, notwithstanding the somewhat slackened economic prospects in 1988. However, it will be necessary to tackle the problems in the fiscal and structural areas for adjustment to be complete over the medium term and to achieve the Government's targets for 1990.

The fiscal imbalance is serious even now, in spite of the good progress in recent years in reducing deficits. The official projections for the medium term, provided in Appendix II of the background paper on recent economic developments, show that the debt and interest rate burdens would continue to be substantial for a number of years, at any rate up to 1995, under the baseline scenario. These burdens would increase if international interest rates go up, and if deficits widen due to unfavorable domestic economic developments prompted by deceleration in investment and appreciation of the guilder. While the uncertainty concerning interest rates is somewhat exogenous, the other factors could be influenced by policy actions. However, the staff estimates for 1988 regarding investment, domestic demand, productivity, unit labor costs, and the real GNP growth rate show that there would be a relative slackness in economic activity. There is also an indication that, owing to both the rise in unit labor costs and the appreciation of the guilder, external competitiveness will deteriorate. Under these circumstances the possibility that revenue will decline and that the level of transfers will increase is strong. It may therefore be prudent to consider a fiscal strategy that reduces deficits beyond the set targets, so that business confidence is further improved.

In this connection, the staff has made an interesting suggestion, that is, to reduce taxes so as to improve labor market incentives and to freeze overall public sector expenditures in real per capita terms over the medium term, with the revenue proceeds of real per capita growth being used to reduce the fiscal deficit as well as taxes.

The suggestion would be slow in its effect, since the portion of revenue proceeds owing to growth in real per capita income is likely to be small; but even under this scenario, the ratio of debt to net national income would be higher in 1992 and still higher in 1995 than in 1990, the last year for which official projections exist. If the debt ratio under the official projections--92 percent of net national income--is not sustainable, then this scenario would also not be sustainable. Besides, the suggestion would entail a judgment about the extent and nature of cuts in taxes and entitlements. The one benefit that we see in the staff suggestion is that base period real incomes would be protected from erosion that would otherwise occur were there to be accelerated expenditure and tax reductions. But suppose one prefers scenario C in Appendix II of the background paper on recent economic developments instead of the staff suggestion, in view of its superior outcomes. Cannot distribution concerns be taken into account even under scenario C's postulated fiscal adjustment? Or is that scenario not feasible?

In the Netherlands any discussion of fiscal correction cannot be divorced from consideration of structural measures. Similarly, unemployment has to be tackled by structural and fiscal policy measures. In this connection, it is interesting to note from Mr. Posthumus's statement that in spite of political constraints, some of the expenditure programs, such as housing and investment subsidies, are under scrutiny, as are the questions of reducing the wage wedge and the present high relative value of minimum wages.

We agree that the link between the guilder and the deutsche mark should be the guiding aim of monetary policy and that the authorities should, as far as possible, promote reduction in domestic interest rates, which are high in real terms.

Finally, we commend the authorities for their fine record in external economic relations, and for providing a large amount of official development assistance, equivalent in net terms to about 1.02 percent of GNP. We urge other industrial countries, other than Norway, which has an equally good record of official development assistance, to emulate the Netherlands in this regard.

Mr. Mawakani made the following statement:

I agree with most of the views and the assessment in the excellent staff report. The Dutch authorities consolidated in 1987 some of the economic gains achieved during the previous years, in line with their ongoing economic strategy in the context of a medium-term perspective. Economic growth was sustained and the rate of inflation continued to decelerate, due to an improvement in profitability brought about by wage restraint, a strengthening of investment, and improved competitiveness. Meanwhile, the unemployment rate is estimated to have declined and developments in the external account were still favorable. The Dutch authorities should be commended for these achievements. However, large imbalances still remain in the economy, particularly on the employment front and in the fiscal sector; I will focus my comments on these.

The authorities recognize that the unemployment rate remains relatively high despite the efforts made so far to reduce it. I welcome the Government's commitment to reduce the level of unemployment through some specific measures, such as the reintegration of the long-term unemployed into the active labor market, and job training for unskilled workers. But I agree with the staff that the unemployment situation in the Netherlands could be structural in nature due to the distortions in the labor market, relating to the wage structure (the wage wedge and the high minimum wage) and the generosity of the social insurance system. I share the staff's concern that these factors, if not properly reviewed, could undermine the authorities' basic strategy of creating employment through wage restraint. In that respect, the steps already taken by the authorities to improve the functioning of labor markets should be resolutely pursued.

The authorities are trying to achieve a fiscal deficit objective of 5.3 percent of net national income in 1990, but I wonder if it is not too ambitious given the deterioration of the central government fiscal balance in 1987 from 6.4 percent to 8 percent. It appears very difficult to reduce expenditure given the political constraints on the authorities. Also, it would seem more appropriate to adopt a gradual approach toward the medium-term fiscal consolidation objective taking into account the uncertainties related to the implementation of the tax reform, which is still under consideration and which would entail some cuts in the tax rate.

Finally, I would like to extend the appreciation of the countries in this constituency to the Dutch authorities for their good record of official development assistance.

Mr. Yamazaki made the following statement:

I generally welcome the developments that have taken place in the Netherlands economy in the past several years. The economic expansion continued at a steady pace, due mainly to a moderate increase in wages, reflecting the continuous efforts of the authorities to that end. The growth pattern since last year is more encouraging, with the main stimulus shifting from external to domestic expenditure, centering on buoyant equipment investment and on a firm increase in consumer spending. The unemployment rate, a major source of concern for the authorities, declined further, to 9.4 percent in July 1987, compared with 9.9 percent at the end of 1986. Although the current rate is still high by historical standards, it is below the average of European industrial countries. An improvement was seen in the balance between domestic savings and investment, with the relatively high rate of savings being matched by an acceleration in private sector investment. This, in turn, has contributed to reducing the current account surplus to a level more consistent with the size of the economy.

Regarding the unsustainably large fiscal deficit, I appreciate that the Netherlands authorities have pursued a policy aimed at reducing the size of the public sector, a policy which has already produced some results. Nevertheless, in order to achieve the targets specified in the Government Coalition Agreement, further efforts to restrain public expenditure are essential. Moreover, the growing need for a comprehensive tax reduction renders cutting expenditure to reduce the deficit more important than ever. The question may arise as to whether the deficit targets are too ambitious and, if so, whether some slippage should be deemed unavoidable. However, it is very important to adhere to the original target, since a slippage would not only be of great concern in itself, but would also represent a failure of the Government to fulfill its pledge. This, in turn, would undermine public confidence in the authorities who have underpinned various political achievements.

The issue of the unacceptably high level of unemployment needs to be given careful consideration. In the context of the theory of the natural rate of unemployment, which was examined in detail during the Board discussion on the 1987 Article IV consultation with Canada (EBM/88/15, 2/3/88), it was mentioned that a fairly high rate of unemployment might be within the range of the natural rate of unemployment. Viewed in that light, if the authorities were to pursue a policy of controlling aggregate demand, the Government's commitment to reduce unemployment by 200,000 in the coming four years may be difficult to attain without rekindling inflation. I fully share the staff's view that such structural rigidities as large wage wedges should be reduced to provide scope for more employment. These rigidities may be inevitable in that they stem from cultural characteristics of Dutch society, specifically, a strong concern for the even distribution of income in the context of social equity. In this regard, the proposal in the staff appraisal for a freeze on overall public expenditure merits attention.

Regarding monetary policy, I support the recent actions of the Nederlandsche Bank to alleviate tension within the European Monetary System while maintaining domestic price stability. Also, the movement toward more market-oriented policy management by the Bank is commendable, and I would like to join Mrs. Ploix and Mr. Enoch in asking the views of the Dutch chair about the implications for direct control measures.

Finally, I fully agree with the views presented in Mr. Posthumus's opening statement.

Mr. Hon made the following statement:

I generally agree with the staff assessment on the Netherlands economy. I welcome the commitment of the coalition partners to continue to pursue adjustment policy over the medium term to correct the excesses of the 1970s and early 1980s. The four targets set for 1990 reflect the authorities' efforts to meet that commitment. However, I agree with the staff that the goals might not be mutually consistent, and some of them might not even be attainable. In this regard, I will focus on two areas, the fiscal deficit and the unemployment situation.

The large fiscal deficit in the past few years has led to an ever-increasing debt ratio, rising from 49 percent of net national income in 1980 to 74 percent in 1986. With the unambitious target of reducing the deficit to 5 1/4 percent of net national income by 1990, the debt ratio is estimated to rise further, to a high level of 92 percent of net national income, certainly leading to a large share of debt service payments in the budget and rendering any further efforts to reduce the deficit all but impossible. I agree with the staff that a fiscal deficit at this level is unsustainable.

I also agree with the staff that the unemployment situation is more a structural than a cyclical phenomenon, as the authorities alleged. On the supply side, it is obvious that the very generous welfare policy, under which those who do not work have incomes of between 70 percent and 100 percent of those of minimum wage earners, has adversely affected the incentive to work. On the demand side, the very high minimum wage, along with other rigidities, has severely retarded employment growth. I very much doubt that the target of reducing the unemployment rate to 10 percent by 1990 can be achieved.

The staff's ingenious suggestion to freeze overall public sector expenditures in real per capita terms over the medium term is the best solution to the country's dilemma. The suggestion would certainly alleviate distributional concerns, and the revenue proceeds of real per capita growth could be used to reduce both the fiscal deficit and the tax burden. I urge the authorities to consider this suggestion seriously.

Finally, I note the commendable performance of the authorities in the area of development assistance, which reflects the extension of their domestic distributional concern into the international arena. I also welcome the authorities' commitment to free trade and urge them to strive to counter the rising tide of protectionism, particularly within the European Community.

Mr. Zecchini made the following statement:

Last year the Dutch economy achieved several positive results: GNP growth accelerated while the rate of inflation was very low, unemployment was reduced, and the fiscal deficit was on target. The authorities should be commended for their pursuit of a policy of gradual but continuous adjustment, which has been responsible for these achievements.

However, unemployment remains high both in historical terms and relative to other major industrial countries. Moreover, prospects for its reduction do not look encouraging in view of the expected deceleration of economic growth in 1988. This seems even more disappointing if it is considered in the light of the degree of price stability and the surplus in the current external account that the Netherlands is continuing to enjoy.

The staff paper indicates that a further deceleration in the growth of capital formation is among the main causes of the slowdown; gross fixed investment is expected to fall by 0.5 percent in 1988. Moreover, the composition of investment expenditures will continue to be biased against expansion of employment, as the share of capital-deepening investments is still significantly larger than the share of capital-broadening investments, as is shown in Chart 2 of the background paper on recent economic developments.

I agree with most of the thrust of the staff appraisal, and I will comment on demand policies and some structural issues pertaining to fiscal policy and the labor market.

It is doubtful whether the mix of tight monetary and fiscal policies envisaged for 1988 can provide adequate growth incentives to generate the necessary rise in investment, particularly at a time when external demand is projected to decline. Consequently, while the authorities' medium-term objective of fiscal consolidation seems appropriate, it should be pursued with gradualism and pragmatism, taking advantage of favorable external conditions. Meanwhile, more effort should be devoted to reducing the size of both revenues and expenditures, and to improving their composition so as to enhance growth perspectives from the supply side. In this respect, I support the staff proposals. On the revenue side, tax reductions are called for to improve incentives in the labor market. In particular, measures should be taken to reduce the large wedge between total compensation and after-tax income. To this end, income taxes and social security contributions should be lowered. This large wedge induces resource allocation distortions and negatively affects the labor supply. On the expenditure side, emphasis should be placed on reducing subsidies and tightening eligibility requirements for government programs.

Many of the proposed measures will have an impact on the priorities the authorities attach to their fiscal policy for the purpose of income distribution. However, the costs these priorities impose on the economy, in terms of forgone growth and underutilization of resources, should not be underestimated. Moreover, the effectiveness of the distributional function can also be questioned. The latest OECD economic survey on the Netherlands states that "when taking into account total government spending, there are indications that the distribution of household income in the wider sense is not appreciably changed through government intervention."

I wish to emphasize the need to utilize whatever room there is to reduce domestic interest rates. While the recent reductions made possible by the movements of international interest rates are welcome, real interest rates remain quite high by historical standards. Moreover, short-term interest rate differentials with Germany remain large considering the reversal of capital outflows and the slowdown in domestic liquidity expansion achieved in 1987.

The expiration of the credit restraint agreement at the end of 1987, and the initiative of the central bank to build a portfolio of domestic government bonds for open market operations, seem to be positive developments.

The monetary authorities remain committed to maintaining the guilder virtually pegged to the deutsche mark. It is precisely this type of commitment which tightly links the economies of different countries and makes efforts to improve policy coordination all the more effective, both in the European Economic Community and in the world economy at large.

Structural improvements in the labor market can come to play a significant role in reducing unemployment. Priority should be given to coping with the large share of the long-term unemployed in the total unemployment, which is among the highest in percentage terms in the major industrial countries, and which might be in itself an important cause of the persistence of unemployment. A reform of the system of unemployment benefits also seems warranted, in order to reduce the disincentives for adjustments in the labor supply due to the generous eligibility rules and lengthy benefit periods. Finally, there might be some scope for introducing more flexibility in the minimum wage legislation, in view of the concentration of unemployed at the lower end of the wage scale. Overall, the authorities' ambitious efforts to reduce unemployment should be supported. To this end, while I share their focus on broad structural reforms, I believe that the solution will also depend on a more courageous use of macroeconomic policies and on lessening rigidities in the labor market.

Mr. McCormack made the following statement:

The Netherlands economy has shown considerable progress under the adjustment strategy pursued since 1982, in terms of growth, price stability, and external balance. In particular, wage restraint has enhanced the competitive capacity of the economy and has led to a restoration of private investment. However, major and interrelated structural imbalances persist, particularly concerning the public finances and the labor market.

On the public finances, two targets have been set for 1990, namely, a cut in the fiscal deficit to some 5 1/4 percent of national income, and stabilization of the collective tax burden. Difficulties have been encountered in achieving these targets. In 1987, significant expenditure overruns meant that the deficit target could be achieved only at the expense of an increase in the collective burden. The staff analysis suggests that formulation of budget targets in terms of deficit reduction and target for the collective burden by leaving expenditure implicit may be a source of weakness. They suggest that explicit expenditure targets may be required. I have some sympathy for this point of view. Whatever precise form they may take, it is clear that measures to improve expenditure controls, especially on the more open-ended entitlement programs, must be a priority if the medium-term targets are to be achieved, and if there is to be a realistic prospect of alleviating the overall tax burden, which is high by international standards.

The operation of the Dutch labor market is subject to pervasive distortions arising from the interaction of the tax and social transfer systems. These are well described by the staff, particularly in Appendix I of the background paper on recent economic developments. In particular, the wedge between gross wage costs and net take-home pay, the tax wedge, is high by international standards. High replacement ratios erode the difference in rewards between work and unemployment. They also call into question the official statistics on unemployment; the staff's report, citing survey results, indeed confirms that unemployment is overstated in the Netherlands. Finally, the difference between the minimum and average wages is particularly narrow, reflecting the egalitarian stance of labor market policies over the years. I agree with the staff that if the problem of unemployment in the Netherlands is to be effectively addressed over the medium term, major additional efforts will be needed to remedy these distortions in the labor market. These are difficult issues, as they raise basic questions of social and political policy and tradition. One has the distinct sense, however, that without thoroughgoing reforms along these lines, the current targets for reducing unemployment may be overambitious.

The orientation of exchange rate policy toward stability of the guilder against the deutsche mark within the EMS has provided a strong anchor for the operation of monetary policy in the Netherlands and has contributed to the impressive record of price stability. Within that constraint, the authorities have sought to bring about reductions in the interest rate to the extent that was prudently possible. I welcome this general orientation. I also welcome the decision of the authorities to allow the credit restraint agreement program with the banks to lapse at the end of the year, and to develop their armory of policy instruments by building up a portfolio of government bonds for open market operations.

I wish to join other speakers in warmly commending the Netherlands authorities for their exemplary record of overseas development assistance.

Mr. Dai made the following statement:

The Netherlands' medium-term policy of fiscal consolidation has succeeded in bringing the excess demand of the 1970s and early 1980s under control, which has paved the way for steady growth and price stability over the past few years. In addition, progress has been made in the areas of investment, employment, and external trade. The authorities' medium-term policy, therefore, seems to be pointed in the right direction and should be commended.

However, the twin problems of relatively large fiscal deficits and a persistently high level of unemployment, which are among the largest and highest in the industrial countries, will continue to pose major challenges for the authorities in the years ahead. According to data given in the staff report, prospects for 1988 seem to be discouraging, including an overall decline in domestic economic activity. In particular, business investment is expected to show negative growth and little improvement is likely in employment. Weak consumption demand, negative growth in business investment, and a slowdown of GNP growth projected for 1988 might indicate the crowding-out effects of fiscal deficits and an inadequacy in deficit reduction. A stronger fiscal policy and, perhaps, a larger reduction of the deficit than the authorities had thought necessary, might thus be required in order to revive private economic activity and employment in the market sector. In addition, the high marginal tax rate and the large wage wedge offer little incentive for private economic activity and employment; tax reform and consolidation of the social security system seem to be two of the more important steps which would be needed to help solve these problems. In spite of the high taxation and the spending cut measures taken by the authorities, public debt continues to accumulate.

It is not very clear to me what the fundamental causes of the rising fiscal deficits are, or what specific crucial measures can be implemented on the spending side of the government budget to reduce the deficit. As noted in the staff report, the bulk of budgetary expenditure is on entitlement programs, such as housing subsidies and unemployment benefits, which perhaps account for much of the Government's budgetary burden. Does that mean that the only thing the authorities can do to carry out the Government's medium-term fiscal strategy is to tighten entitlement requirements and limit the various transfers and subsidies to households and the public sector? To what extent is this feasible in view of the political constraints?

The authorities' monetary policy seems to be appropriate and flexible. The recent cut in the official lending rate is a positive step toward stimulating domestic economic activity. However, the monetary authorities need to watch economic developments carefully and reduce high real interest rates wherever possible, in order to prevent a slowdown in economic activity.

The Netherlands' official development assistance performance, currently 1 percent of GNP, is outstanding among the industrial countries, and this chair greatly appreciates the efforts of the Netherlands in this regard.

Mr. Rieffel made the following statement:

We would like to join other Directors in commending the staff for a report that is concise, well focused on the key fiscal and labor market issues, and precise in suggesting prescriptions for ways to deal with current problems.

The two main issues which the Board stressed during the 1986 consultations still warrant its attention today. In the fiscal area, the large and pervasive role of the Government in the economy, the continued large budget deficits, and the resulting rapid growth of the public debt, have important implications for the freedom to employ fiscal policy in the future for economic and social ends and, more generally, for future growth and employment. In the labor market area, a variety of policies tends to discourage flexibility in the supply and mobility of labor, contributing to the persistence of a high level of unemployment and raising questions about the economy's flexibility in responding to changing circumstances.

Before turning to these and related issues more specifically, we would like to acknowledge some of the positive elements of the current economic situation in the Netherlands and the progress which has been made to date in solving the two major problems. For example, moderate economic growth has been achieved over an extended period, inflation is virtually nil, employment has risen for the past three years, and the current account surplus of the balance of payments has been reduced to a modest level. A coalition agreement has been struck for a reduction in the fiscal deficit over the medium term, and a renewed attempt is being made to bring the deficit back on track following overruns last year. In the labor area, the Government has withdrawn from wage bargaining, the growth of unit labor costs has been contained, profitability has been increased, business investment has grown, and a target has been set for reducing the unemployment level by 1990. We are pleased at the assurances in Mr. Posthumus's statement that the forthcoming midterm review will offer the opportunity for further consideration of Dutch policies in a number of these important areas.

With respect to the fiscal accounts, the ratio of public sector deficits to net national income on a cash basis in the period 1983-87 is very high by industrial country standards. Even the coalition's target for the Central Government's deficit in 1990 does not seem very ambitious, and Mr. Posthumus notes in his statement that additional spending cuts will be needed in 1989 and 1990 to reach the target.

The reversal last year of earlier progress in reducing the public sector deficit ratio due to expenditure overshooting highlights the chronic difficulty in containing expenditures.

Given the consensus on avoiding any increase in the collective tax burden above the 1986 level, and the high level of interest payments, it is all the more crucial that other expenditure be controlled. The staff and Mr. Posthumus suggest that investment, housing, and rent subsidies, which rose rapidly between 1980 and 1984, may no longer be justified, and we agree.

The ratio of public sector revenue to GNP remains at a high 48 percent. While the Oort Commission proposals for tax simplification may be desirable in themselves, it appears that the two "neutrality" caveats, which prevent any change in revenues or in the distribution of income, virtually guarantee that tax changes will not contribute either to a reduction of the fiscal deficit or to shifts in incentives to work.

We welcome the staff's attempt to develop some specific ideas for overcoming political constraints with the aim of reducing future deficits, including an initial attempt to find a consensus for a tax/spending trade-off, involving simultaneous cuts in some subsidies and in tax rates, and then a limitation on per capita real expenditures. We would welcome further discussion of these ideas.

With respect to labor market conditions, the unemployment level remains very high, and prospects appear very uncertain for bringing it down by 5 percentage points between 1986 and 1990 to the targeted level of 10 percent. The major problem is clearly structural. A replacement rate of 70 percent to 100 percent of the minimum wage, the 73.5 percent total marginal tax rate on labor use, and the large wedge between take-home pay and labor costs vividly illustrate current disincentives for laborers to work and for employers to hire them. Some possibilities for alleviating these problems have already been illustrated by the positive responses to the relaxation of limits on temporary employment, and to the reduction in the minimum wage for young people. Job training may also help, but more fundamental action to reduce the wage wedge and marginal taxes seems clearly required.

We recognize the limits imposed on the use of monetary policy by the close link between the guilder and the deutsche mark. But one is struck by the high level of interest rates in the context of zero inflation. Mr. Posthumus's statement refers to recent reductions in rates; we would appreciate some more information on the extent to which real rates have come down. We welcome the lapsing of the agreement with the banks on credit constraint, and the intention to use open market operations more actively in the future.

We very much welcome the explicit assessment in the staff report of the role of the Netherlands in the global balance of payments adjustment process. We recognize the medium-term limitations imposed by the large fiscal deficit, but with a strong currency, a current account surplus of between 1 percent and 2 percent of GNP, zero inflation, high unemployment, and only modest prospective growth, there should be room for macroeconomic expansion measures, complemented by structural reforms. We would welcome any further reduction in real interest rates which may become possible as interest rates in other countries come down, and we endorse the staff's suggestion that future income and revenue gains from world economic growth could be passed on to Dutch consumers and investors through progressive tax relief.

In conclusion, while there continue to be some very positive features of economic conditions in the Netherlands, two major problems remain, the fiscal deficits, and labor market rigidities. We are not certain that the medium-term targets for the fiscal deficit and the labor market situation are ambitious enough, and we share the staff's doubts about whether even those targets can be reached. It is not the Fund's business to question the social objectives of member countries, such as dedication to a very flat distribution of income brought about by high taxes and large government transfers, but we can assess the implications for the economy of such policies and their interactions with the economies of other members internationally. In the case of the Netherlands, we cannot help but wonder if some shifts in priorities and policies may be triggered in coming years as a result of internal tensions, in the form of growing limits on the free use of fiscal policy, and of difficulties in the response of the labor force to changing economic conditions at home and abroad.

The staff representative from the European Department noted the general agreement of Executive Directors with the staff assessment, in particular about the urgent need for fiscal correction. He wished to highlight that the fiscal stance had been relatively easy in 1986 and 1987 and that the Netherlands had done its part in the process of international adjustment. Since the Netherlands was self-sufficient in energy, the loss of government gas revenues underlying the weakening of the fiscal accounts had as its counterpart a gain accruing to the household sector because of the sharp decline in oil prices--signifying in effect an implicit agreement whereby the Government had lost revenues in favor of the private sector. This should be considered in assessing fiscal policy in the Netherlands and the need for continued fiscal adjustment.

With respect to Mr. Sengupta's question about the viability of scenario C in Appendix II of the staff report, the staff representative noted that this scenario was provided by the authorities to illuminate the budgetary consequence of the postulated deficit path. The structural adjustments which underlay that scenario were not clear--especially concerning the trend of expenditures and taxes--so that it was difficult to judge its medium-term viability.

With respect to Mrs. Ploix's question about the source of expenditure overruns, the staff representative explained that investment subsidies and various social allowances, in particular, were chiefly responsible. For example, there had been a significant overrun in education allowances, and its characteristics illustrated the difficulties that seemed endemic for the current subsidies and allowances system. The allowance provided by the state to students was based on whether or not they lived at home, a higher allowance being given to students who lived away from home; what had been observed was a shift from students living at home to students living away from home--a development which had less to do with education and more to do with personal preferences and the availability of subsidies. Overall, there had been a faster rate of take up in subsidies and allowances than expected, and it appeared that people were beginning to arrange their lives in ways that would bring them greater benefits from the system; in effect, the private sector appeared to be making increasing use of subsidies as a source of income.

Some questions had been raised concerning monetary policy, the staff representative recalled. With respect to credit controls, he wished to clarify that, although the agreement between the banks and the central bank had been allowed to lapse, the law behind the agreement was still in effect, so that credit controls could be reimposed; however, he did not believe that the authorities intended to reimpose them. Rather, they were moving toward more market-oriented monetary policies, as shown by the upcoming establishment of a portfolio for conducting open market operations. In that connection, the question of how to limit the liquidity effects of building up a portfolio of government bonds had been resolved satisfactorily, as an agreement had been reached with the banks to treat the purchases as reserves on which interest would be paid. Finally, the open market operations in question would be in the long-term market.

Interest rates had been reduced significantly over the past several months, the staff representative noted. The discount rate had been reduced from 4 1/4 percent at the end of October 1987 to 3 1/4 percent in February 1988, which represented a reduction both in real terms and vis-à-vis the discount rate in Germany. The differential with the German rate used to be 1 1/2 percent, whereas it was currently 3/4 of a percent.

There appeared to have been a considerable amount of agreement among Executive Directors with respect to structural policies, the staff representative remarked, Mr. Ovi being the main dissenter. Even he, however, had noted a number of points which accorded with the staff recommendations. Nevertheless, it was worth pointing out that the Swedish model, which Mr. Ovi had drawn attention to, had attracted a great deal of interest in the Netherlands, especially in relation to how a society with distributional considerations like those of the Netherlands had succeeded in achieving an unemployment rate which compared extremely favorably to that of the

Netherlands. From the Dutch viewpoint, the problem with the Swedish model was that, although people had the right to refuse the first job offer, they could not refuse the second one, so that jobs could effectively be assigned. The Dutch were unwilling to require unemployed people to accept an assigned job, and to force the creation of public sector employment which the scheme implied. Rather, they were seeking to solve their unemployment problems with more market-determined mechanisms, and although there might be disagreement about the details, the authorities were clearly tending toward improvements in the structure of work incentives. For example, minimum wages had been frozen in nominal terms for four or five years, resulting in a large real adjustment in the labor market through the effects of high inflation rates. However, with an inflation rate of zero or even a negative rate, this avenue no longer was effective and might indeed have perverse effects. Moreover, there was a political constraint on reducing the nominal minimum wage. Consequently, alternative means of adjusting labor market incentives would be needed.

Mr. Posthumus said that the authorities had never given any indication to the staff during the discussions that the distributional issue was too sensitive to touch upon. Although it would have been out of place to pass judgment on distributional concerns, the ramifications of such concerns for economic growth and the position of the Dutch economy in Europe, as well as in relation to other economic issues, could be properly considered.

With respect to the staff's proposal for a "double goal" of deficit reduction and tax reduction along with measures to reduce expenditures, concentrating on transfer incomes, Mr. Posthumus said, he considered the idea to be a helpful one which would assist thinking in the Netherlands and which represented a new approach in the staff reports. Several speakers had understood the staff proposal as representing a more gradual approach. The authorities feared that to aim for a deficit reduction and a tax reduction at the same time might be problematical, as it might not be feasible to accelerate the expenditure reductions with such a double goal in view.

The relationship between the incomes of those who worked and those who did not had been an important element in the discussions of distributional concerns, Mr. Posthumus continued, and one issue was whether it should be decided that the incomes of people who did not work ought to remain at the same level in real terms for a long time to come. A new discussion about the share, and not the level, of public expenditure had begun, and quite a number of people favored deciding that the share of public expenditure should not be below 60 percent of national income; currently it was several points above that, but 60 percent was considered by some as the minimum.

The discussion on the initiation of a portfolio of government securities to be handled by the central bank, and the related issue of open market operations, were still continuing, Mr. Posthumus noted.

With regard to Mrs. Ploix's question about the budget overruns, Mr. Posthumus said, he agreed with the staff representative from the European Department that the education allowance overruns had been significant and much higher than had been expected. The allowance was a new system, introduced only in 1986-87. However, the differentiation in the allowance for those students who lived at home versus those who lived away from home had also existed under the old system; it was not a complete explanation of the education allowance overruns.

The question had been raised by Mr. Enoch and Mr. Yamazaki whether the authorities envisaged reintroduction of the credit restraint system, Mr. Posthumus recalled. With new monetary instruments at their disposal it was unlikely that the restraints would be needed, but their reintroduction would remain a possibility. Mr. Ovi had asked whether the outcome of the wage negotiations for 1988 was likely to be in line with the staff estimates. The Central Planning Bureau was more pessimistic than the authorities about the outcome as the labor market had effectively been divided into two markets with the withdrawal of the Government from the wage negotiation process, which made the accuracy of the overall projections somewhat problematical.

The Chairman made the following summing up:

Executive Directors welcomed the relatively strong performance of the Dutch economy in the past several years. A satisfactory growth rate in real output had been achieved in 1987, while price stability had been maintained, and the high levels of investment and capacity utilization were indicative of a dynamic economy. Also, the strengthening of domestic demand had contributed to a narrowing of the surplus on current account.

Directors commended the Dutch authorities for the steady pursuit of domestic policies which had made these results possible. In particular, continued wage restraint had helped sustain the competitiveness and profitability of Dutch industry, and monetary policy had been successful both in bringing liquidity creation under control and, more recently, in reducing domestic interest rates.

However, unemployment in the Netherlands remained unacceptably high, and it seemed unlikely that the authorities' ambitious goal in this respect would be realized. It was also clear that the process of fiscal consolidation had a long way to go. Directors noted with disappointment that the fiscal deficit had risen significantly from 1986 to 1987 because the decrease in revenues from natural gas was not fully compensated, and because of large expenditure overruns. Also, the collective burden had increased, contrary to the strategy. The expenditure overruns reduced the Government's room for maneuver and compromised further tax reductions which, it was generally agreed, were greatly needed.

The combined burden of high taxes, high subsidies, and high minimum wages was generally seen to be incompatible with the need to improve economic efficiency, to reduce unemployment, and to prepare the economy for the removal in 1992 of remaining barriers on trade and movement of labor and capital within the European Community. Thus, Directors saw no alternative to the continuation, and indeed the intensification, of the adjustment strategy. They noted that additional fiscal measures would be needed to attain the targets of the 1986 program. The deficit reduction goal for 1990 was seen by a number of Directors to be insufficiently ambitious, because it would fail to stabilize, let alone reduce, the ratio of public indebtedness to national income. Most speakers, however, regarded the target to be generally appropriate but difficult to attain. It was generally agreed that it was necessary to formulate medium-term goals that would reduce the fiscal deficit to a sustainable level.

Directors agreed with the staff that the fundamental problem was on the expenditure side, and they urged the authorities to institute better controls and more explicit objectives for expenditures. These actions were considered necessary both because of the need to reduce the deficit and in view of the fact that the share of public expenditures remained significantly above corresponding levels in most other industrial countries, and the concomitant tax burden was viewed as excessive. Income tax rates, in particular, were increasingly out of line with those elsewhere. While most Directors reiterated that, in their view, priority should be attached to deficit reduction, some Directors believed that it was a matter of judgment as to what extent the results of better expenditure control should be devoted to tax reductions, versus reduction of the overall fiscal deficit.

Wage moderation had made a considerable contribution to employment creation in past years. Directors noted that a number of steps had been taken in recent years to improve the functioning of labor markets, but significant distortions remained. In particular, high minimum wages and a large "wage wedge" hampered employment creation, while liberal unemployment benefits constituted a possible disincentive to work. Directors urged the authorities to pursue tax reductions aimed at improving incentives and a further relaxation of regulations governing labor markets so as to foster a lasting reduction in unemployment.

It was generally agreed that the policy of maintaining a fixed exchange rate vis-à-vis the deutsche mark had benefited the Netherlands and should continue to guide monetary policy. A number of Directors encouraged the authorities to use available room to further lower domestic interest rates, which remain high in real terms. The lapsing of the credit control arrangement with the banks and the introduction of open market operations in government bonds were seen as appropriate moves toward market-oriented monetary management.

Directors observed that the external position remained comfortable. They generally recognized, however, that the fiscal situation severely limited the room for discretionary fiscal action on the part of the Netherlands to help sustain global demand and to redress global trade imbalances. Nevertheless, they urged the authorities to play a supportive role in this regard, in part by using any room for maneuver on the monetary side and by intensifying structural reform and supply-side policies.

Finally, Directors commended the Dutch authorities for their firm adherence to a liberal trade and payments regime, and urged them to persevere in their efforts to seek more fundamental trade reform in the European Communities. They also expressed their high regard for the Netherlands' record on development assistance, which remained exemplary.

It is recommended that the next Article IV consultation with the Netherlands be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/17 (2/5/88) and EBM/88/18 (2/8/88).

2. MAURITIUS - TECHNICAL ASSISTANCE

In response to a request from the Mauritian authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/88/47 (2/2/88).

Adopted February 5, 1988

3. SENEGAL - TECHNICAL ASSISTANCE

In response to a request from the Senegalese authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/45 (2/1/88).

Adopted February 5, 1988

4. EXECUTIVE BOARD COMMITTEES - NOMINATION

The Executive Board approves the nomination by the Managing Director for the vacant position on the Committee on Executive Board Administrative Matters and the Committee on Liaison with the CONTRACTING PARTIES to the GATT, as set forth in EBD/88/48 (2/3/88).

Adopted February 5, 1988

5. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 87/106 are approved. (EBD/88/42, 2/1/88)

Adopted February 5, 1988

APPROVED: October 24, 1988

LEO VAN HOUTVEN
Secretary