FOR AGENDA

SM/86/32

CONTAINS CONFIDENTIAL
INFORMATION

February 20, 1986

To: Members of the Executive Board

From: The Acting Secretary

Subject: Netherlands - Staff Report for the 1986 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with the Netherlands, which has been tentatively scheduled for discussion on Friday, March 14, 1986.

Mr. Van't dack (ext. 4545) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

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INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS

Staff Report for the 1986 Article IV Consultation

Prepared by the European Department

Approved by L. A. Whittome and J. T. Boorman

February 19, 1986

I. Introduction

A staff team consisting of Messrs. H. O. Schmitt, G. A. Mackenzie, J. Van't dack, and P. Beaugrand (EP)(all EUR), and Ms. P. Nivasabutr (EUR) as secretary, visited The Hague and Amsterdam from December 6-16, 1985 to conduct Article IV consultation discussions. The Netherlands authorities were represented by officials of the Ministries of Finance, Economic Affairs, and Social Affairs and Employment, of the Central Planning Bureau, and of the Netherlands Bank. The team also met with the President of the Netherlands Bank, Mr. W. F. Duisenberg, and the head of the mission was received by the Minister of Finance, Mr. H. O. Ruding. Members of the mission met with representatives of the trade unions, the Employers' Association, and the banking sector. Mr. J. de Beaufort Wijnholds, Alternate Executive Director, participated in most of the meetings as an observer. The Netherlands accepted the obligations of Article VIII, Sections 2, 3, and 4 on February 15, 1961.

At the conclusion of the Article IV consultation with the Netherlands last May, Executive Directors welcomed the improvements that had taken place in the Dutch economy in 1984, in particular the renewed expansion of domestic activity. They commended the Dutch authorities for pursuing domestic policies that had allowed the economy to take advantage of the recent pick-up in world trade. Directors warned, however, that these early successes should not become cause for complacency. They saw no alternative to the continuation of the adjustment strategy, and stressed that sustained and balanced economic growth required a steady reduction in the size of the public sector. Directors advocated reductions particularly in the field of social transfers as one means to increase flexibility in the labor market, and to reduce unemployment which remained worrisomely high. Finally, a number of Directors noted that the rapid growth of liquidity in the economy had the potential of creating inflationary pressures in the future, and recommended measures to reduce the monetary impact of fiscal deficits through appropriate debt management techniques.

II. Recent Economic Developments

The Netherlands economy in 1985 continued its gradual recovery from the most severe recession it had experienced in the post-war period. When the recession struck bottom in 1982, real GNP had fallen 2 1/2 percent below its 1980 peak, and enterprise fixed investment excluding residential construction to 18 percent below its record in 1979 (Chart 1). Registered unemployment, which had levelled out at just over 6 percent at the end of the 1970s shot up to 14 percent of the dependent labor force in 1982. The vitality of the private sector seemed to have been eroded, most obviously by a dramatic shrinking of profit margins over the preceding decade, and by the rapid growth of the public sector and its financial deficit. Thus, when world demand stagnated in 1980, the Dutch economy was particularly affected.

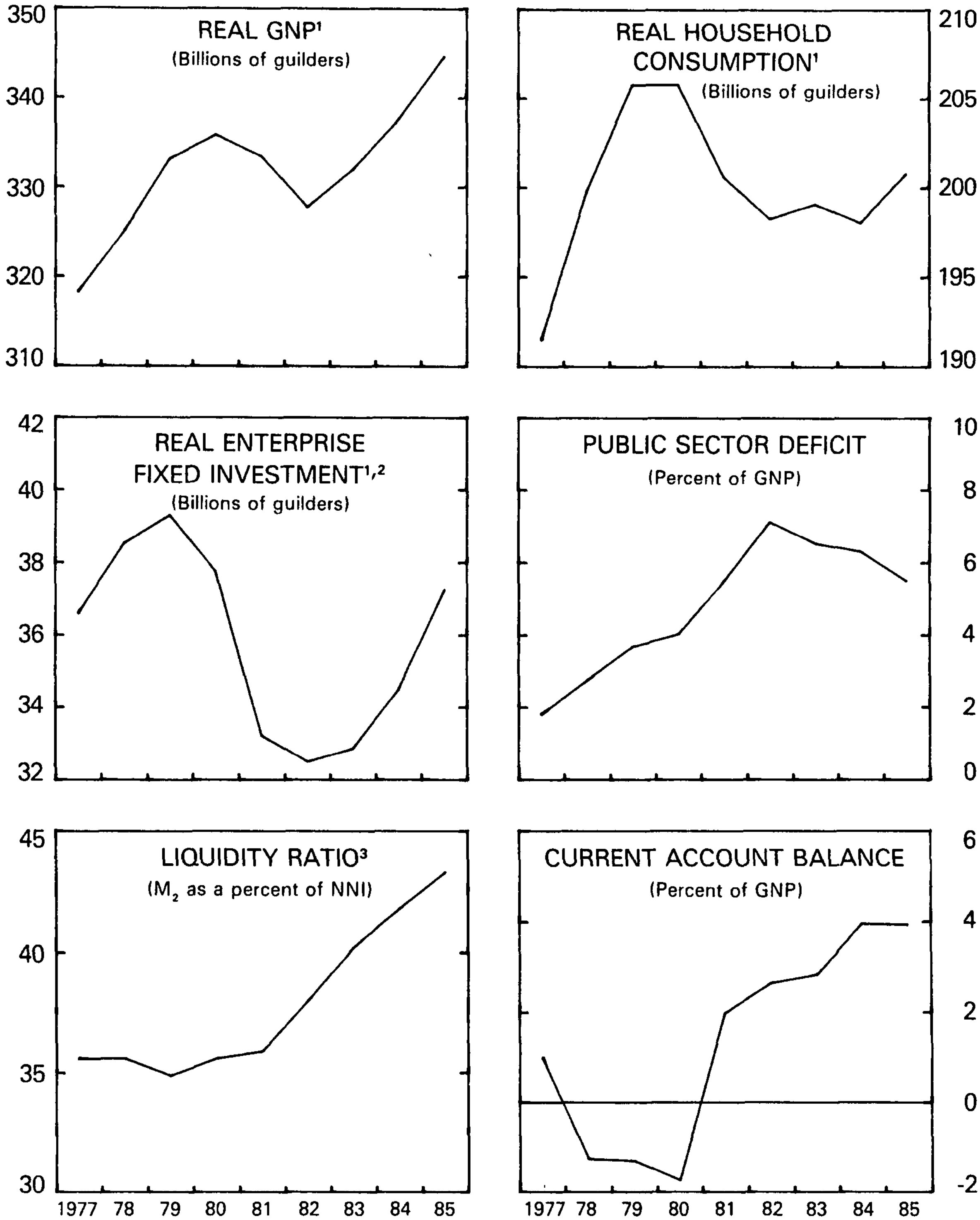
To arrest the deterioration of enterprise profitability, and regain export market shares, wage restraint had become a fundamental element of government policy. Between 1980 and 1982 this policy took the form of statutory rules which, imposed in an environment of rising unemployment, significantly slowed the growth of nominal wages. Initially, the margin it might have created for increased profits was taken up by increased social security charges, rising capital costs, and deteriorating terms of trade. Combined with soaring unemployment and faltering consumer confidence, the reduced rise in labor income caused a sharp drop in household expenditure and a strong increase in saving. Added to the drop in capital spending, the weakness in consumer demand depressed economic activity in the Netherlands well below that of its trading partners. Accordingly, the external current account balance moved into substantial surplus in 1981.

To make room for a strong recovery in private activity a vigorous program was launched in 1982 to reduce public spending and the public sector deficit. Initially, fiscal retrenchment compounded the recession, and was thus largely frustrated. Rising interest costs and transfer payments, as well as overruns in discretionary spending, offset expenditure cuts in 1983, so that the central and local government deficit failed to shrink significantly, and a further increase in the burden of public revenues had to be accepted (Table 1). Since then, helped by renewed buoyancy in markets abroad, there has been more success. Stringent expenditure cuts taken in 1984, in particular by reductions in public sector nominal wages and in social security benefits, arrested the growth of public expenditures as a share in net national income (NNI), and reduced the size of the deficit of the Central Government and the local authorities. A new series of expenditure cuts was introduced in 1985. A substantial part of budgetary saving was to be applied to reduce the burden of public revenue by lowering social security charges. The 1985 program was expected to narrow the central government deficit from 9.2 percent of NNI in 1984 to 8.5 percent in 1985, on top of a reduction in the public revenue burden by nearly 2 percentage points of NNI. The preliminary outturn for 1985 shows an improvement in central government finances even stronger than

CHART 1

THE NETHERLANDS

ECONOMIC TRENDS



Sources Central Bureau of Statistics, *Nationale Rekeningen,* The Netherlands Bank, *Quarterly Bulletin,* and staff estimates

[1] At constant 1980 prices.

[2] Excluding residential construction

[3] Seasonally adjusted

Table 1. Netherlands: Fiscal Developments

(As a percentage of NNI)

	1980	1981	1982	1983	1984 Budget	1984 Outturn	1985 Budget	1985 Preliminary outcome (Sept. 1985) 1/	1986 Budget
Public sector revenues 2/	59.0	59.7	60.4	62.4	...	61.6	...	61.3	...
Revenues affecting the collective burden	52.7	52.8	53.7	55.5	55.0	54.4	52.6	53.2	51.8
Tax burden	30.8	29.7	29.2	28.6	28.7	28.3	27.9	27.6	27.4
Social security burden	20.2	20.9	22.1	24.6	23.9	23.5	22.3	22.8	22.0
Nontax burden 3/	1.7	2.2	2.4	2.3	2.4	2.6	2.4	2.8	2.4
Other revenues	6.3	6.9	6.7	6.9	...	7.2	...	8.1	...
Public sector expenditures	-66.3	-69.3	-71.9	-72.7	...	-71.0	...	-69.1	...
Transactions	-63.5	-65.8	-68.3	-69.7	...	-68.7	...	-67.2	...
Net lending	-2.2	-2.5	-2.2	-1.8	...	-1.8	...	-1.6	-1.5
Debudgetized expenditures	-0.6	-1.0	-1.4	-1.2	-0.4	-0.5	-0.3	-0.3	-0.3
Statistical adjustment 4/	-0.2	--	0.8	0.5	...	0.6	...	--	...
Total public sector financial balance, cash basis	-7.5	-9.6	-10.7	-9.8	-12.0	-8.8	-9.9	-7.8 (-7.5)	-8.5
Central government 5/	-5.6	-7.6	-9.5	-10.2	-10.9	-9.2	-8.5	-7.5 (-7.0)	-7.3
Local authorities	-2.1	-1.6	-0.5	-0.5	-1.2	-0.1	-1.2	-0.5 (-0.7)	-0.5
Total government sector	-7.7	-9.2	-10.0	-10.7	-12.1	-9.3	-9.7	-8.0 (-7.7)	-7.8
P.M.: targeted deficit	...	...	...	...	...	...	...	...	-7.4
Social security funds financial balance	0.2	-0.4	-0.7	0.9	0.1	0.5	-0.2	0.2	-0.7
Memorandum item:									
Net national income in billions of guilders	303.3	316.0	329.4	338.3	341.9	352.8	359.6	368.1	377.1

Sources: Ministry of France, Miljoenenota 1986; Central Bureau of Statistics, Nationale Rekeningen; Central Planning Bureau, Macroeconomische Verkenning 1986; and staff estimates.

1/ End-year estimates between parentheses.
2/ Staff estimates.
3/ Mainly receipts from domestic natural gas sales.
4/ Difference cash-transactions basis.
5/ Includes debudgetized expenditures.

expected, with the deficit declining to 7 percent of NNI on present estimates. Incidental factors, such as the inflow of nontax revenues in the form of early repayments of high-interest loans, contributed to this result, as did the effects of the economic recovery and of the strength of the U.S. dollar on public revenues, on outlays for unemployment relief and debt service, and on natural gas revenues.

To induce the private sector to take advantage of the room created by fiscal retrenchment, it continued to be necessary to restore competitiveness and profitability of enterprises. Wage restraint continued to be stressed, therefore, although from end-1982 it was no longer imposed by statute as before, but on a voluntary basis. The burden of social security contributions on enterprises was also lowered. In consequence, the rise in wage costs per employee decelerated markedly between 1983 and 1985. Set alongside substantial productivity gains, achieved largely through labor shedding and extensive labor time reduction, the moderation in wage costs achieved a substantial decline in unit labor costs. Profitability improved; within manufacturing alone, the share of labor compensation in value added dropped below its 1970 level (Chart 2). Improved competitiveness allowed Dutch enterprises to respond strongly to the upturn in world market growth. Industrial activity recovered, hesitantly at first, but more forcefully in 1984 and 1985. The demand for labor continued to weaken in 1983 as productivity increased, and the unemployment rate rose by almost 3 percentage points to 17 percent of the dependent labor force in that year. A modest increase in labor demand began to materialize in 1985, however, in both the manufacturing and the services sector. By the end of 1985 the unemployment rate had receded to 15 percent, more than 1 percentage point less than a year earlier.

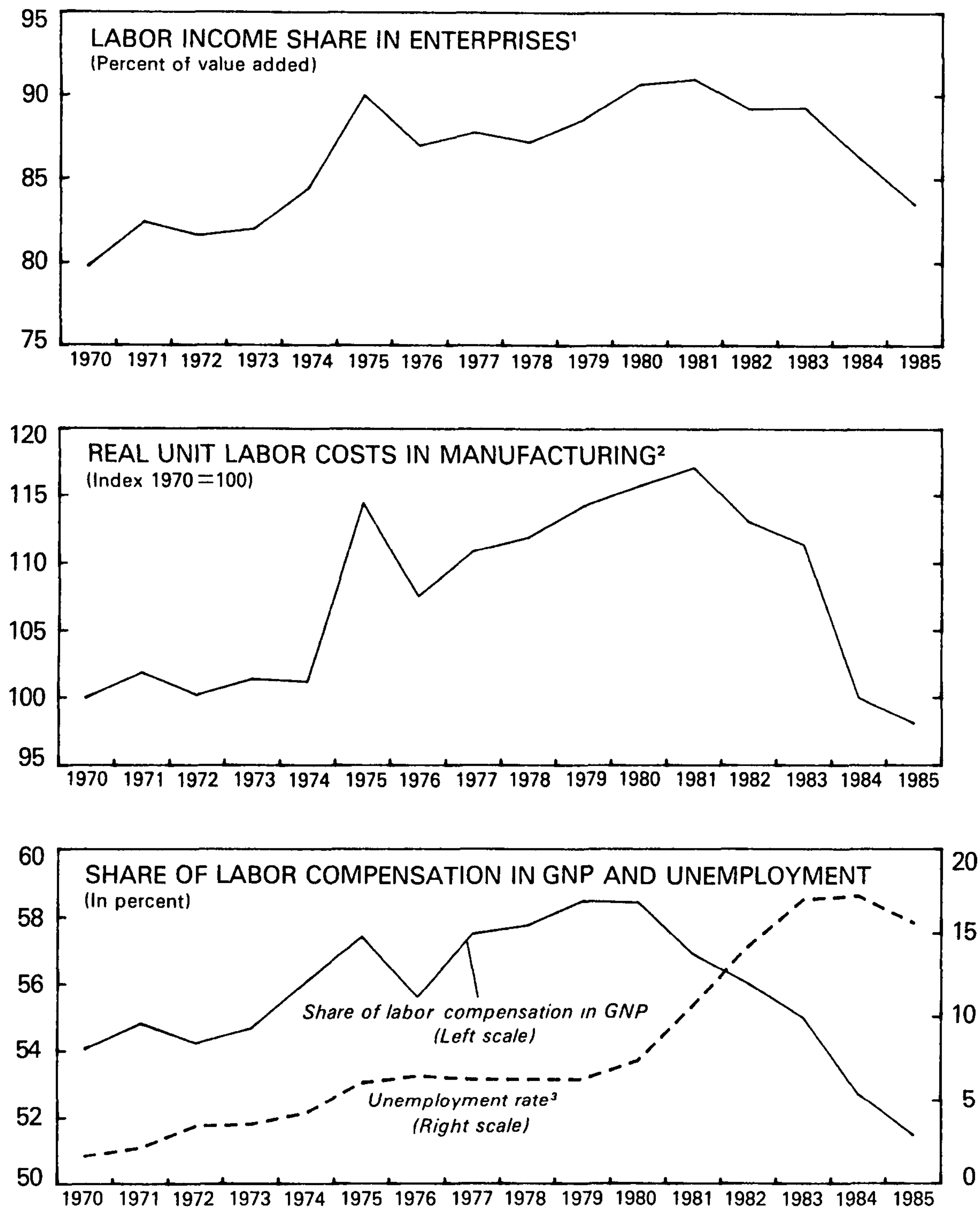
For 1984 as a whole real GDP grew by 2 percent with a similar increase estimated for 1985. The upturn in economic activity has progressively spread to all sectors of the economy. While activity was primarily supported by growing exports in 1983 and 1984, a significant impulse is now coming from domestic demand as well (Table 2). Fixed capital formation and inventory restocking were the first elements in domestic demand to show signs of recovery in 1984; by 1985 the increase in domestic demand also included more vigorous consumer spending. As the growth of enterprise investment accelerated it has begun to show an element of capacity expansion. Nevertheless, at only 3 1/2 percent of value added, net nonresidential investment of enterprises still remains modest. Private consumption rose in response to rising labor incomes and lower tax incidence; the restoration of consumer confidence was reflected in a drop in the savings ratio.

Price inflation continued to decelerate from around 6 percent in 1982 to 2.3 percent in 1985, despite a rate of monetary expansion that has consistently outstripped the growth in nominal incomes in recent years, raising the ratio of M2 to NNI--the liquidity ratio--from 35.6 percent in 1980 to 43.3 percent in 1985. A large contribution to monetary growth still came from increases in net foreign assets of the

CHART 2

NETHERLANDS

TRENDS IN FACTOR SHARES



Sources: Central Planning Bureau, *Centraal Economisch Plan 1986* (preliminary), IMF Data fund, and staff estimates

[1] Labor compensation and imputed labor income of independent workers as a percentage of value added of enterprises, excluding mining and housing

[2] Unit labor costs, divided by the value added deflator in manufacturing

[3] Unemployed persons as a percentage of the dependent labor force

Table 2. The Netherlands: Aggregate Demand

(Volume change in percent)

	1980 In billions of guilders	1981	1982	1983	1984	1985
Private consumption	205.78	-2.5	-1.2	0.5	-0.5	1.4
Public consumption	60.26	2.0	0.6	1.0	-1.5	0.3
Gross fixed capital formation	70.79	-10.4	-4.1	0.5	4.5	2.6
Of which:						
Enterprise investment, excluding residential construction	37.76	-12.7	-2.4	1.6	5.1	8.0
Stockbuilding 1/	1.72	-1.3	0.5	--	0.8	0.6
Total domestic demand	338.55	-4.6	-0.9	0.5	1.0	2.0
Contribution to GDP growth 1/	...	-4.6	-0.9	0.7	0.9	1.9
Exports of goods and nonfactor services	176.81	1.5	-0.1	3.5	7.0	3.8
Imports of goods and nonfactor services	178.62	-5.9	1.0	3.5	6.0	4.4
Foreign contribution to GDP growth 1/	...	3.9	-0.6	0.3	0.8	-0.4
GDP	336.74	-0.7	-1.5	1.0	1.7	1.7
GNP	335.81	-0.7	-1.8	1.4	1.8	2.1

Sources: Central Bureau of Statistics, Nationale Rekeningen; Central Planning Bureau, Macro Economische Verkenning 1986; and staff estimates.

1/ Changes expressed as a percent of GDP of the previous year.

banking system in 1984; this contribution declined in 1985, however, as the growth in domestic credit accelerated (Table 3). When pressure on the exchange rate developed in early 1985 the short-term interest rate differential with Germany was increased (Chart 3). At the long end of the market, however, the differential did not change appreciably, causing the yield curve in the Netherlands to flatten (Chart 4).

Owing to the success of the Dutch economy in capturing larger market shares abroad, and to its still relatively weaker cyclical position, the surplus on the external current account widened to 4 percent of GNP in 1984 (Table 4); it remained at that level in 1985. Most of the surplus was on the trade account. Export volumes grew by 5 1/2 percent in 1984 and by 4 percent in 1985, the nonenergy component exceeding market growth by about 1 percentage point. With import volumes growing at a slightly faster rate, the widening of the trade surplus reflected gains in the terms of trade. The effective exchange rate of the guilder (MERM based) depreciated 5 percent between 1980 and 1984, primarily on account of the rise in the value of the U.S. dollar, but stabilized in 1985 as the dollar weakened. The real effective rate of the guilder, as measured by trade-weighted relative unit labor costs in manufacturing, declined by 17 percent between 1980 and 1984, and by another 5 percent in the first three quarters of 1985.

III. Policy Discussions

At the time of the discussions the Dutch economy was characterized by a modest recovery in economic activity and employment, a strong external position, and an expectation of virtual price stability in the year ahead. The deficit of the public sector had come down, but at just under 8 percent of net national income (NNI) in 1985, it continued to be very large. Nevertheless, the external balance on current account also remained in substantial surplus, suggesting that although private investment had picked up smartly, it remained very low in relation to saving as well as by historical standards. With unemployment still hovering around 15 percent of the labor force, a much higher level of investment seemed called for to provide jobs for a steadily growing working population.

1. Wage restraint

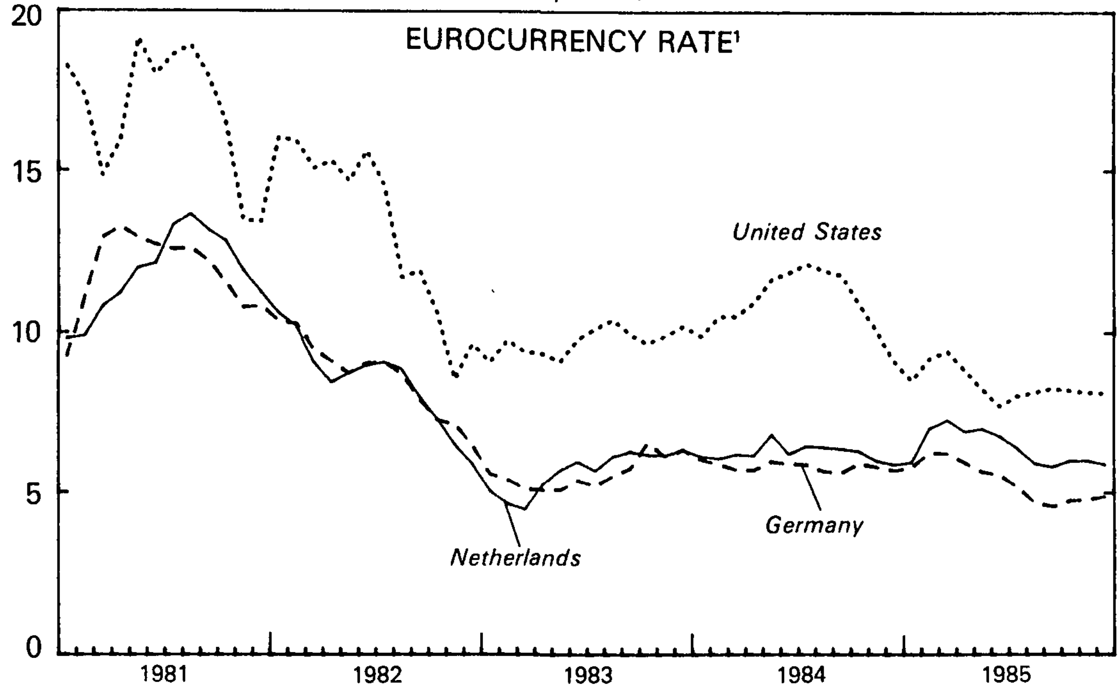
The Dutch representatives recalled that over the ten years to 1980 real wages had grown at a pace that severely compressed profit margins. The share accruing to labor in the value added by nonenergy enterprises had risen from around 80 percent in 1970 to over 91 percent in 1980; the disincentive effects of this trend had contributed to the reduction in net enterprise investment (excluding residential construction) from 11 percent to 5 percent of net enterprise value added over the same period. By 1985, however, the share of labor had fallen back precipitously, to 83 1/2 percent of enterprise value added, though only under pressure of a major increase in unemployment (Chart 2). The staff team agreed that the associated improvement in unit labor cost had placed the

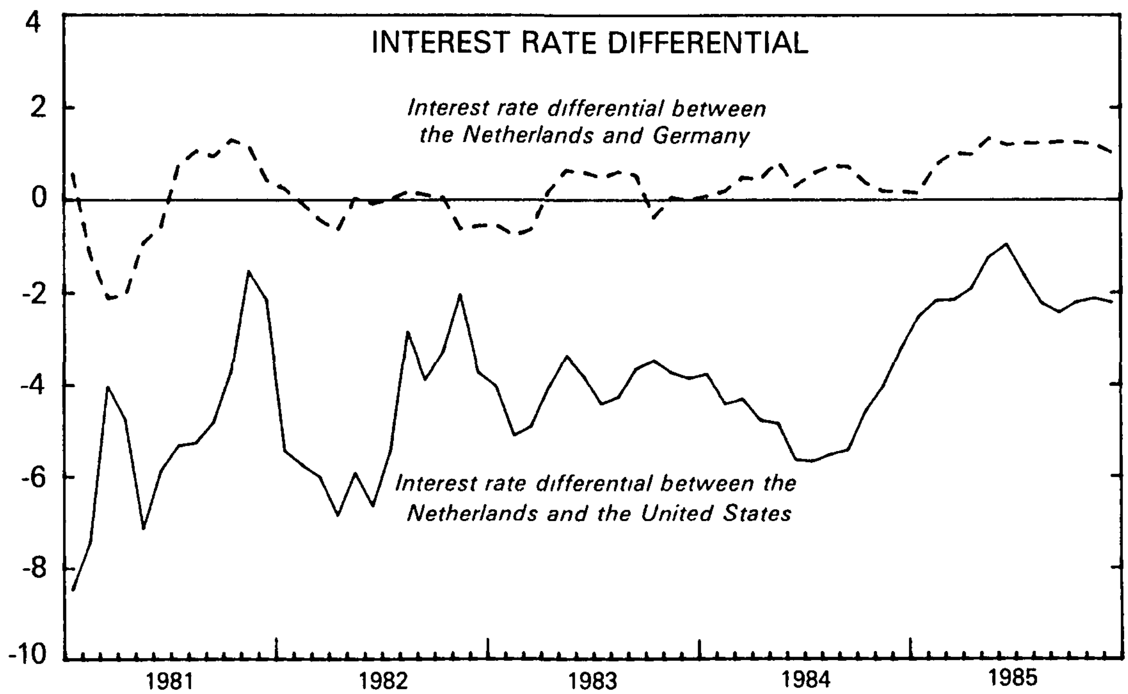
CHART 3

NETHERLANDS

SHORT-TERM INTEREST RATE DEVELOPMENTS

(In percent)





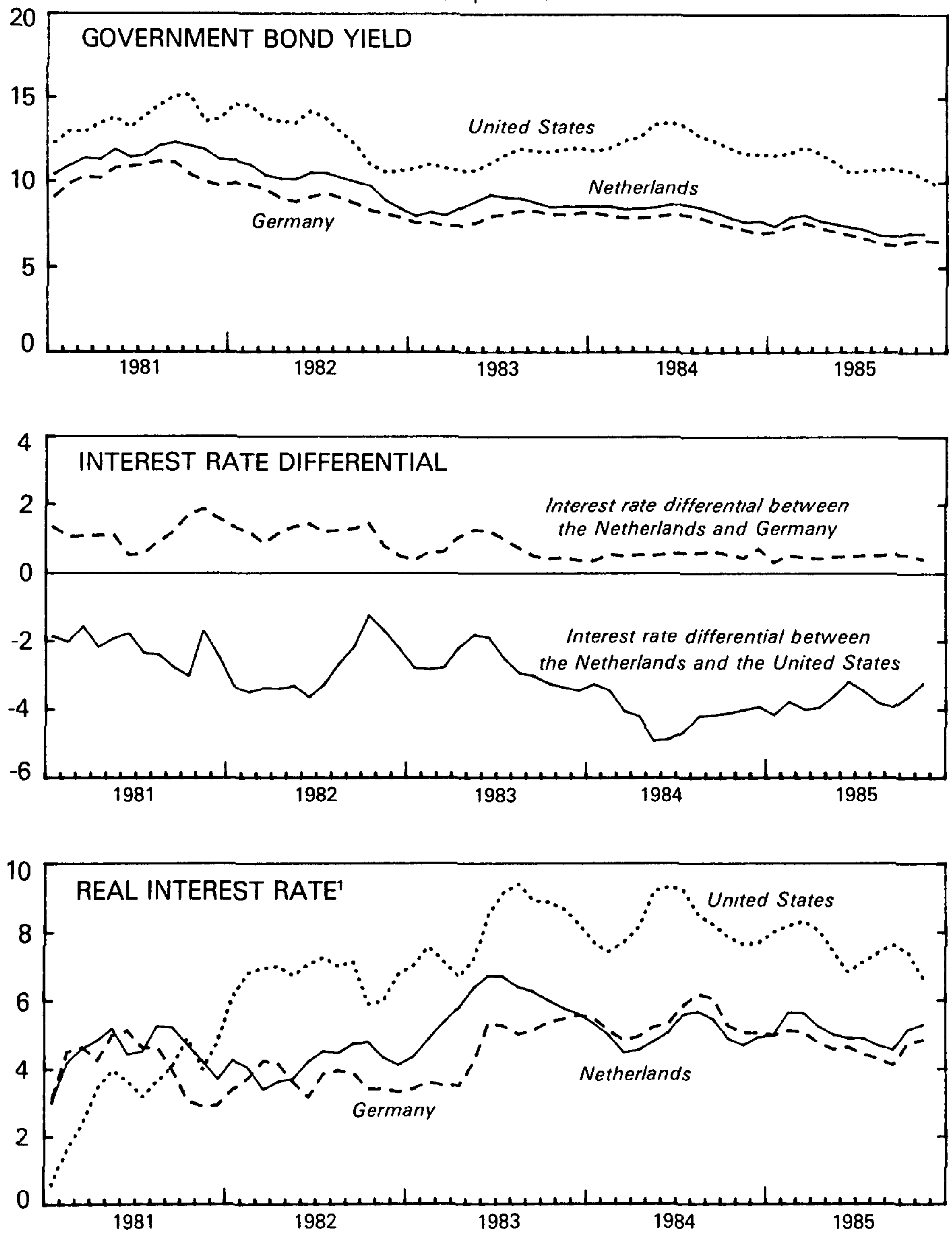
Source IMF, *International Financial Statistics.*
[1] LIBOR on three-month deposits.

CHART 4

NETHERLANDS

LONG-TERM INTEREST RATE DEVELOPMENTS

(In percent)



Source IMF, *International Financial Statistics*

[1]Government bond yield minus change in consumer prices

Table 3. Netherlands: Monetary Survey

(Increase in 12 preceding months as a percent of money supply at the beginning of the period)

	December 1981	December 1982	December 1983	December 1984	Sept. 1985
Net change in domestic assets	2.9	4.1	8.3	3.6	4.9
Short-term lending to public authorities	1.1	-2.1	-0.7	-0.2	-3.6
Lending to private sector	9.2	5.3	7.1	6.6	8.2
Other long-term operations, net	-7.3	3.1	3.6	-1.5	1.3
Miscellaneous 1/	-0.1	-2.1	-1.6	-1.3	-1.0
Net change in foreign assets	3.6	3.9	2.3	5.2	1.9
Change in money supply 2/	6.5	8.0	10.7	8.8	6.7
Adjusted liquidity ratio (end of period, in percent)	35.9	37.7	40.0	42.4	43.3

Source: Netherlands Bank, Quarterly Bulletin.

1/ Items in transit and statistical discrepancy.
2/ Adjusted for items in transit.

Table 4. Netherlands: Summary Balance of Payments

(On a cash basis; in billions of Guilders)

	1981	1982	1983	1984	1985 First 3 quarters
Merchandise trade (f.o.b.)	4.3	8.1	5.1	11.0	12.3
Nonfactor services	5.4	5.7	4.6	5.4	3.7
Net factor income	-1.2	-1.6	-0.6	-0.6	1.3
Unrequited transfers	-3.7	-3.6	-2.6	-3.3	-2.1
Current account	4.8	8.5	6.5	12.5	15.2
Current account, transactions basis	7.0	9.7	10.7	15.5	12.4
(in percent of GNP)	(2.0)	(2.6)	(2.8)	(3.9)	(...)
Long term private capital	-3.9	-5.2	-2.7	-10.6	-8.7
Other capital	-0.9	-1.7	-0.2	-1.8	-2.6
Capital balance	-4.8	-6.8	-2.9	-12.4	-11.2
Items in transit	0.5	-0.4	0.5	1.2	0.4
Banking sector capital	-2.3	3.6	-4.5	-0.8	-2.7
Allocation of SDRs	0.3	--	--	--	--
Overall balance	-1.4	4.9	-0.3	0.3	1.6

Source: Netherlands Bank, Quarterly Bulletin.

Dutch economy in a particularly strong position to take advantage of the recovery in world trade when it occurred. Nonenergy exports increased by over 20 percent between 1981 and 1985, in markets that expanded by just over 15 percent, providing a strong initial impetus to the recovery in economic activity (Chart 5). The response of investment would also have been weaker had it not been for the sharp improvement in the financial condition of enterprises. Excluding dwellings, gross fixed investment by enterprises rebounded by 15 percent in the three years to 1985.

The staff team were inclined to trace the rapid drop in real wages over the period to the sharp increase in unemployment from 7 1/2 percent in 1980 to over 15 1/2 percent of the labor force in 1985. The Dutch representatives stressed in addition the role of incomes policies. In 1980-82 a statutory incomes policy had been applied to the private as well as the public sector, with the Government insisting on partial wage de-indexation, on limitations on vacation allowances, and on setting wage guidelines. At the end of 1982 the social partners voluntarily agreed to wage moderation in 1983-84, sufficient to permit a recovery of profit margins in enterprises, in return for a program of work-sharing in order to reduce unemployment. Statutory limits continued to be applied to wages and salaries in the public sector. From 1984 wage moderation was accompanied by government policies to relieve the tax burden on wage incomes and to reduce nonwage labor costs (Chart 6). The Dutch representatives stated that incomes policy would continue to aim at a combination of wage moderation and tax reduction, to narrow the "wedge" between wage earnings gross and net of taxes. In this way opportunities would be provided for further reductions in labor time without loss of purchasing power.

The staff team noted that the Netherlands economy now disposed of a relatively large pool of unemployed labor at highly competitive wages in relation to productivity. The question was raised whether a recovery of demand, as it draws workers back into employment, might not soon again drive wages up to their former unsustainable levels. The staff team thought that the work-sharing program, which had been a factor in collective labor agreements since 1983, must have had an adverse effect from this point of view; the number of existing work places it opened up could have absorbed about 9 percent of the stock of unemployed even without an increase in demand. The Dutch representatives saw a more complex situation. On the one hand, the actual employment effect--or reoccupation ratio--turned out to be only 25 percent of potential in 1985 and was not expected to rise above 30 percent in 1986. While this outturn suggested continued overmanning in some sectors and occupations, in others bottlenecks had already begun to develop. Unfilled vacancies had grown rapidly in 1984 and 1985, with about a third of the vacancies difficult to fill because of mismatches between supply and demand. Trade unions had begun to threaten higher wage demands should employers stiffen their resistance to further reductions in labor time. It would therefore be necessary in the future to pursue worksharing in a more selective and differentiated manner.

The staff noted that nominal wage costs per unit of manufacturing output, excluding energy, were already officially forecast to rise again in 1986. The incentive to seek work would clearly have to be enhanced if unemployed labor was to be reabsorbed in a noninflationary way. The Dutch representatives agreed that the social safety net should not be so generous as to provide opportunities for driving an excessively hard wage bargain in the labor market. A reform of the social security system now before Parliament would help in this regard. The major change in the unemployment legislation as initially proposed was to reduce unemployment benefits in half-yearly steps from 70 percent of last earned income (up to three times the minimum wage) to 70 percent of the legal minimum wage over the period of entitlement (which varies with the employment record) after which welfare assistance would be provided at the lower rate. A review of the minimum wage, which in the Netherlands exceeds the level in other industrial countries by a substantial margin, is also currently in process. It had been hoped that the new unemployment legislation would come into effect in January 1985, but it has had to be substantially amended, and is now expected to become effective in mid-1986. The lowering of benefits in half-yearly steps is likely to be replaced by a shortening of the period of entitlement before welfare assistance comes into effect.

Some progress in lowering benefits has already been achieved outside the comprehensive reform. Unemployment and disability compensation was reduced from 80 percent to 70 percent of last earned income (the starting point of the reform) in 1984 and 1985 respectively, and social security benefits were frozen in nominal terms between 1983 and 1985, and are scheduled to be frozen again in 1986, thus loosening the link between benefits and wage developments. Another area of possible reassessment was the relationship between the net minimum wage and the net social benefit which are by statute set equal to each other for a standard household unit of one income earner and three dependents. That equivalence sets the reservation price for labor at the lower end of the scale. Yet another was the contribution of public expenditure to the compression of income differentials, particularly in the lower brackets. Including income-related rent subsidies and education allowances in the calculation, a 50 percent increment in gross income above the minimum wage will increase net income by barely 10 percent. More generally, wages in the Netherlands were thought to cluster too narrowly around the average both within and among sectors, causing wage increases justified in one sector to pull up the entire wage structure, with adverse effects on total employment. Greater decentralization in the wage bargaining process could help to improve the efficient functioning of labor markets in this regard.

2. Fiscal policy

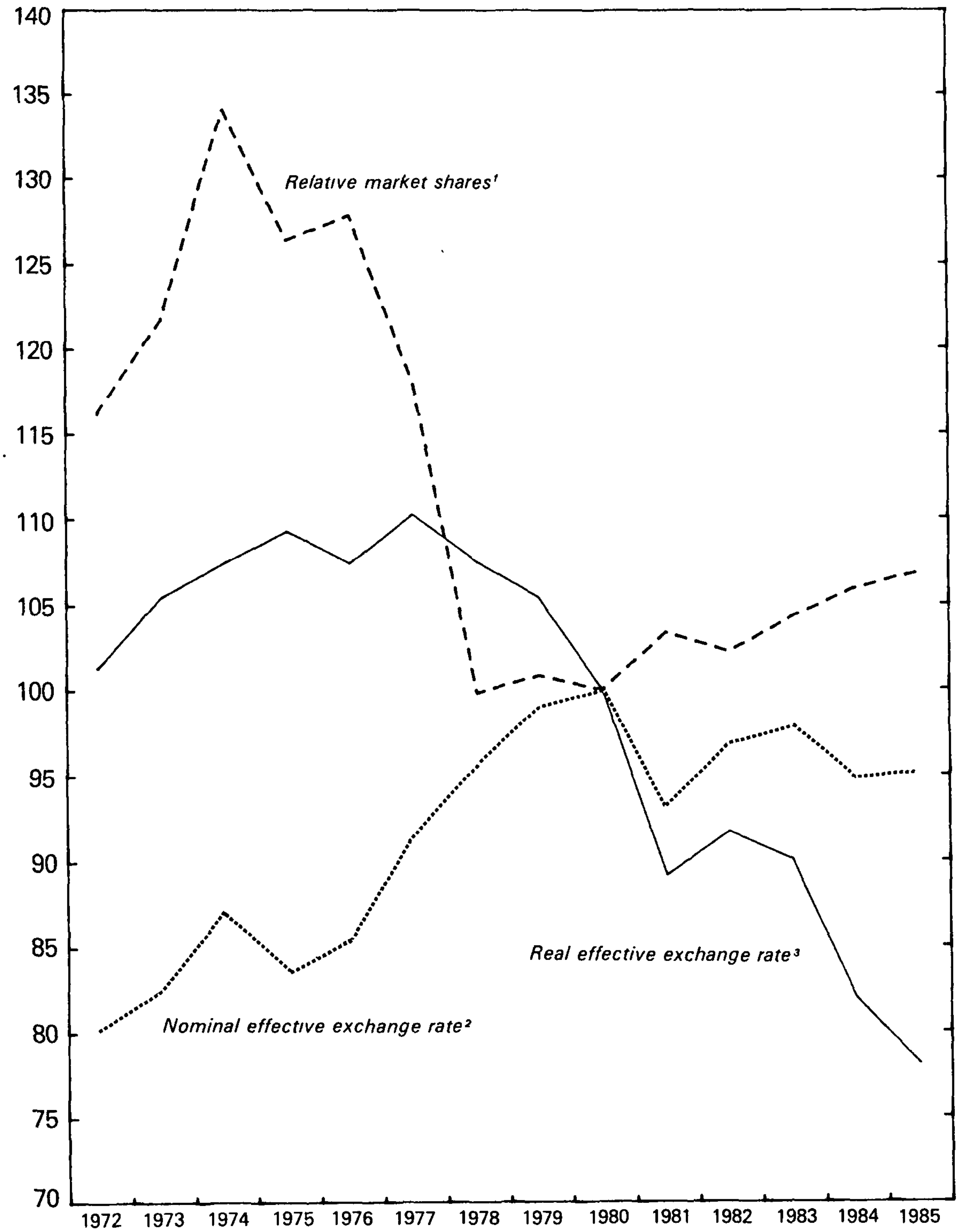
Despite the depth of the recession, fiscal policy has concentrated on correcting structural imbalances in the public finances, rather than on short-term demand management. In the ten years prior to 1980 the burden of public expenditure had risen from 48 percent of net national

CHART 5

NETHERLANDS

COMPETITIVENESS AND MARKET SHARE GAINS

(Index 1980=100)



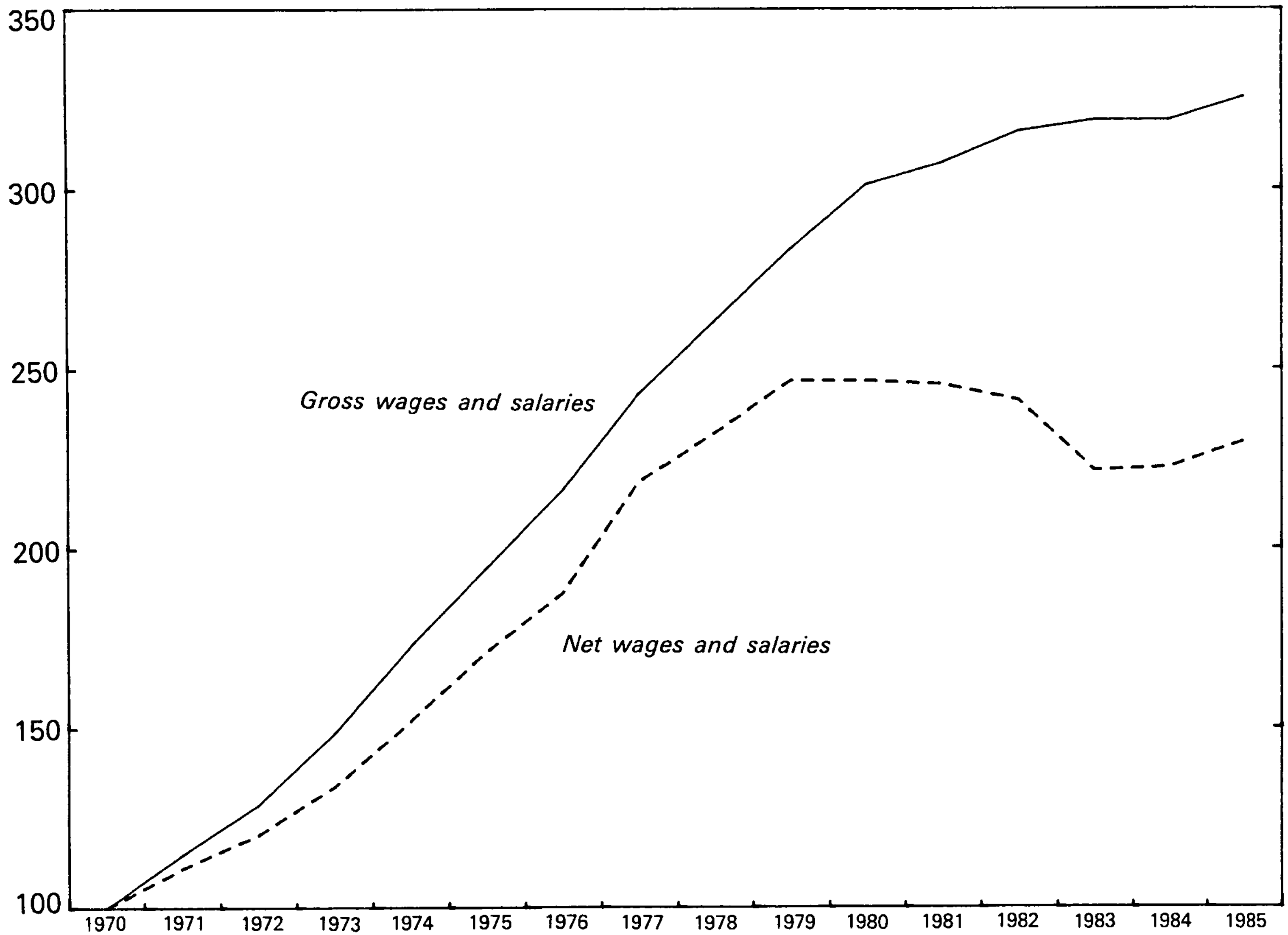
Sources IMF, *International Financial Statistics;* and staff estimates, based in part on Central Bureau of Statistics, *Maandstatistiek van de Buitenlandse Handel*

[1]Growth in nonenergy exports, relative to growth in relevant external markets An increase denotes a gain in market shares

[2]MERM-based A decrease denotes a depreciation.

[3]Export-weighted relative unit labor costs in manufacturing, corrected for exchange rate changes A decrease denotes a gain in competitiveness

CHART 6
NETHERLANDS
THE GROWTH OF THE "WAGE WEDGE"
(Index 1970=100)



Source: International Montary Fund, *International Financial Statistics*

income (NNI) to the equivalent of 66 percent. A major element in this increase was the dramatic growth in the social security system; its spending rose from 18 percent of NNI to 29 percent over the same period. Though public sector revenues also increased rapidly--through increasing social security contributions and buoyant revenues from natural gas--the public sector deficit expanded rapidly from a negligible amount in 1970 to 7.5 percent of NNI in 1980. Without the steady retreat of gross domestic investment in relation to GNP, this trend would have put even more pressure on the external current account balance, than it already did (Chart 7).

The impact of the recession raised the public sector deficit further to nearly 11 percent of NNI in 1982, or to 10 percent excluding the balance in the social security funds. It was at this point, the Dutch representatives recalled, that the authorities set themselves the target of bringing the government deficit, excluding the social security funds, down to 7.4 percent of NNI by 1986, a task that was to be achieved without raising the "collective" burden, including the social security funds, above its 1982 level in relation to NNI. 1/ The reduction in the public sector deficit was to take priority over revenue relief. This ordering reflected concerns about the effect of the fiscal deficit on the real rate of interest, considerations of budget control, and concerns about the expected future development of interest expenditure and debt redemptions of the central government. In the long run, it was said, the choice between reduction in the fiscal deficit or reduction of the collective burden was illusory; without the former the latter would become unsustainable in time.

The Dutch representatives expressed satisfaction with the degree of fiscal retrenchment that had been achieved to date. To be sure, the 1983 outturn had still been disappointing. Expenditures continued to increase in relation to NNI raising the deficit of the central and local governments to nearly 11 percent. The deficit for the public sector as a whole was nevertheless reduced, but only at the cost of a swing to a sizable surplus in the financial balance of the social security funds, which raised the collective burden. By 1985, however, strict expenditure controls had succeeded in bringing the deficit of the government sector below 8 percent of NNI, on top of revenue cuts that returned the collective burden below its 1982 ceiling. Expenditure restraint had affected four main expenditure categories: social security benefits, civil service wages and salaries, other central government expenditure, and health insurance benefits.

It was acknowledged by the Dutch representatives that the process of fiscal retrenchment has had unfavorable effects on economic activity, at least in the short run. The upswing might have been somewhat more

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1/ The "collective" burden consists of direct taxes, indirect taxes, nontax revenues from domestic sales of natural gas and social security contributions.

vigorous in the last few years without it. It was the government's firm belief, however, that a structural reduction in government spending, and thereby in the budget deficit, making a reduction of the collective burden possible, would contribute in time to sustaining and accelerating economic growth. The recent upsurge of domestic demand, and consequently of output and employment, could occur because the direct pressure exerted by the public sector on the private sector had diminished, and the flexibility of various markets had improved. Thus the policy focus on the supply side of the economy had also enhanced its demand side responsiveness.

Given the persistence of very high unemployment, combined with a still substantial surplus on external current account, the staff team wondered whether a case could not be made for easing the pace at which the public sector deficit was being reduced. The 1986 budget could in fact be read as marking just such a change in emphasis. The Dutch representatives acknowledged that the reduction in the government deficit would be rather limited in 1986 compared to the reduction in the collective burden. Indeed, the deficit for the public sector as a whole, including the social security funds, was scheduled to rise for the first time since the policy of fiscal retrenchment had been introduced in 1982, from 7.8 percent of NNI to 8.5 percent. The net stimulus to activity originating from this increase in the deficit could be estimated at about 1/4 to 1/2 percentage points of GNP. Being rather limited, this stimulus could do no harm, they thought, while a stronger stimulus had to be ruled out because, on structural grounds, the government deficit was still too high.

The Dutch representatives argued very strongly that fiscal policy had not in fact been eased for 1986. The social security funds would run a deficit that year, but only in order to run down surpluses accumulated in the preceding three, inasmuch as their accounts have to be balanced over time, with deficits in one year offsetting surpluses in another, regardless of cyclical position. It was no accident that reductions in the fiscal deficit had always been targeted for the government sector alone, leaving aside the social security funds, and in that context they would continue to be given top priority as before. Planned expenditure cuts in the government sector in 1986, consistent with targets set in 1982, were to take the form of further freezes on civil service pay, social security transfers, and child benefits in nominal terms, as well as of reductions in sickness benefits. A reduction of corporate taxes by 1 percentage point in 1986 had also been planned since 1984. The budget as a whole was therefore not to be construed as a turn to a counter-cyclical policy.

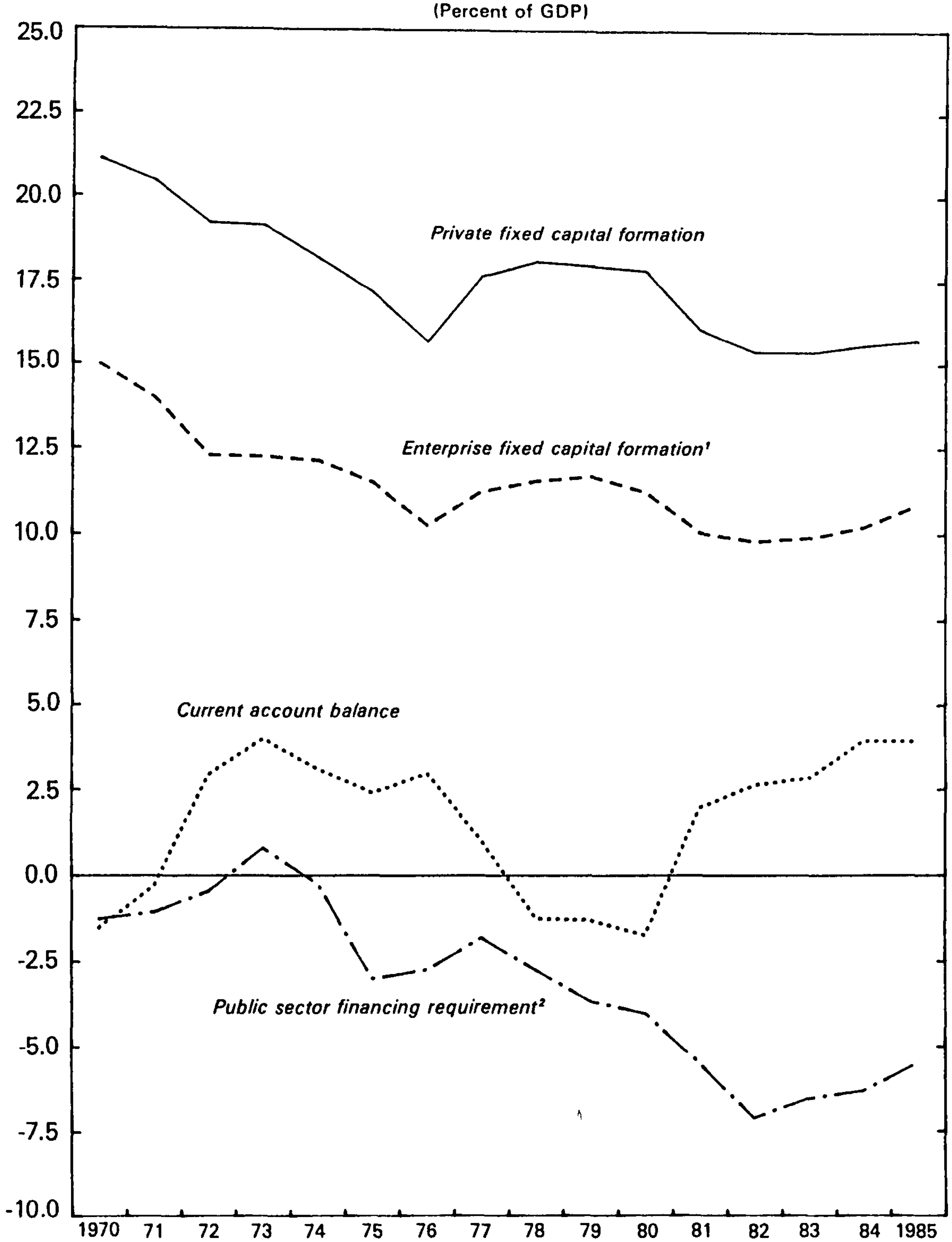
At present no quantified medium-term fiscal policy targets had been set beyond 1986. Nevertheless, in a qualitative sense, the Dutch representatives thought reductions in spending would have to continue, with stable revenues in relation to income, so as to achieve further reductions in the government deficit. They had calculated that, just to stabilize the proportion of interest payments in NNI at its 1986 level,

CHART 7

NETHERLANDS

PRIVATE INVESTMENT, PUBLIC SECTOR FINANCING REQUIREMENT AND CURRENT ACCOUNT BALANCE

(Percent of GDP)



Sources Central Bureau of Statistics, *Nationale Rekeningen;* and staff estimates.
[1]Private fixed capital formation, excluding residential construction.
[2]On a national accounts basis, excluding net lending and debudgetized expenditures.

by 1994, the government deficit would have to be reduced to about 4.5 percent of NNI by 1990. Another proposal for fixing a structurally acceptable fiscal deficit was to relate it to the value of public sector investment expenditures; the net investment and net lending of the government minus depreciation was projected to come to just under 4 percent of NNI in 1986. On either view private investment would have to be relied upon to take up the remaining gap between private saving at full employment, and any surplus on external current account deemed appropriate, perhaps to finance development assistance abroad.

The prospects for further fiscal retrenchment looked to be difficult in 1987. The recent decline in natural gas prices was estimated to reduce public revenues by an amount equivalent to 2 percent of NNI or even more. An increase in the fiscal deficit in 1987 was nevertheless out of the question in the view of the Dutch representatives, and further stringent expenditure cuts would therefore again be required. However, there clearly was a limit to expenditure cuts in social security benefits and in civil servants' pay, which had carried the brunt of retrenchment in the last three years. Two activities that offered better prospects for retrenchment were the system of education allowances (which could be replaced by a basic education grant plus loans), and the system of individual rent subsidies (the requirements for which could be tightened). However, considering the size of the problem, future economies would undoubtedly have to affect all expenditure categories.

The total of central and local government gross debt had increased from 62 percent of net national income in 1982 to 75 percent in 1984. Exact figures on the holdings of this debt were not available; there are, however, reliable estimates for some years which show that in 1984 over three quarters of the debt was held about equally by institutional investors and banks, and about 7 percent abroad. The interest payments of the Central Government increased from 2.3 percent of net national income in 1980 to 5.3 percent in 1985. The average maturity of new long-term central government loans had increased from 6.6 years in 1983 to 9.8 years in 1985. Lengthening the maturity of new issues was seen to be an important instrument for lowering the repayment burden, which came to 2.2 percent of NNI in 1985, and was estimated to rise to 7 or 8 percent in 1994. The Dutch representatives noted that the public sector had been able to finance its borrowing requirement rather smoothly thus far.

3. Monetary policy

The improvement in profit margins of enterprises, and the reduction in the fiscal deficit, created financial surpluses at a faster rate than the recovery in business investment could quickly absorb. The excess gave rise to a surplus on external current account that by 1984 had risen to 4.4 percent of net national income, where it remained in 1985 (Chart 7). Some part of this surplus was at first accumulated by banks and helped feed a steady build-up in domestic liquidity. The Dutch representatives were not entirely certain about the significance of the increase in liquidity; the normal cyclical pattern was now exaggerated inasmuch as the money supply (M2) was still increasing faster than NNI, although the economy had clearly turned up. It was felt that the increase was perhaps somewhat more rapid than it should have been, but not dramatically so as yet.

The primary objective of monetary policy continued to be the maintenance of a stable exchange rate against the deutsche mark, with money market interest rates the principal instrument to reach this objective. The monetary aggregates then adjust to meet the demand for them at a given rate of interest. The Dutch representatives noted that much of the recent growth in those aggregates reflected an increasing preference for liquidity on the part of industry. This sector, they said, was involved in bringing about a rapid restoration in its structurally impaired financial position, in anticipation of a progressive revival of investment activity. There was, however, a limit on the extent to which additional credit expansion could promote investment in advance of a complementary increase in equity financing. The recovery of investment would have to take time, therefore, and the expansion of credit needed to be paced accordingly. Any excess would merely tend to spill out abroad through the exchanges.

The authorities had not thus far resisted the growth in the money stock in large part because the investment ratio was in their judgment still too low for balanced growth. When deciding the monetary policy stance for 1985 they had hoped that a recovery of domestic investment would be the primary outlet for any surplus of liquidity. An important premise underlying this position was that the contribution to liquidity creation of domestic credit expansion would remain limited. However, it became evident in the course of the year that the rate of domestic liquidity creation was accelerating, as the banks' accumulation of net foreign assets slowed down. Externally, the tendency was for higher outgoing direct investment and increasing purchases of foreign securities. On the domestic side, there was a gradual acceleration of lending to the private sector, particularly to enterprises, and a slackening in the growth of nonmonetary liabilities of the banks.

The combination of rapid growth in the money supply and the high rate of growth of domestic credit did not pose any immediate problems, the Dutch representatives thought, but had nevertheless become worrisome because of the possible negative impact on the credibility of monetary policy. As domestic credit expansion gained momentum in early 1985, an abrupt increase in the short-term interest differential with Germany was apparently required to keep domestic liquidity from draining abroad. Though market valuation of the strength of the guilder toward the German mark had clearly changed, there was in the view of the Dutch representatives no fully satisfactory explanation for the widening of that differential when it occurred. If it was the rise in the liquidity ratio that explained the short-term differential, it was not clear why the long-term differential had not been equally affected.

The lower than expected fiscal deficit in 1985 may have helped to hold long-term interest rates down, the Dutch representatives suggested. More than three quarters of the borrowing requirement was covered in the first half year. Currently some 70-80 percent of the supply of funds on the capital market was claimed by the public sector, and, although the openness of the market would ensure a broad conformity between foreign and domestic interest rates, changes in the fiscal deficit would have to have an impact also. In their own forecasting the Dutch authorities assumed a decline of 0.4 percentage points in long-term interest rates for every decline of 1 percentage point of NNI in the fiscal deficit. Meanwhile there was no doubt that Dutch firms were more liquid than their German counterparts, and that in the process of improving their financial position out of increased profits, they might well have directed some of their resources to increased purchases of foreign securities.

The monetary authorities had in the past sought to keep a clear distinction between liquid money market paper and paper that is traded on the capital market. These efforts, the Dutch representatives pointed out, had increasingly turned out to be an impediment to institutions using the guilder in capital market transactions; international intermediation had in any case come to undermine their effectiveness. Measures were therefore announced in November of 1985 to liberalize the conditions of issue of short-term bearer paper and to increase the attractiveness of long-term paper. The deregulation measures could stimulate disintermediation of the banking system, making predictions of the velocity of money more uncertain, and thus jeopardizing the effectiveness of monetary policy. Since recent experience with the velocity of money does not indicate such changes, the Dutch representatives thought that monetary control would not diminish as a consequence of the abolition of restrictions on bearer paper.

4. Industrial policy, trade policy and development assistance

Deteriorating profitability and increased competition has narrowed the industrial base in the Netherlands considerably over the last decade and a half. While agricultural and energy production has expanded, the production of manufactures and other technologically advanced goods has shrunk. Investment spending in the industrial sector has been weak, with the consequence that the introduction of new technologies has lagged. In the face of these trends, industrial policy in the Netherlands has changed markedly, from the defensive stance of the 1970s which had been directed primarily at the management of decline and the support to ailing industries, to a more aggressive and selective stance, concerned with the development of new and profitable technologies, and the promotion of capital formation.

The Dutch representatives stressed that industrial policy was now geared to promoting greater technological advances in "priority" sectors. The Government had identified a number of these, including information processing, micro-electronics, telecommunications, biotechnology, energy, medical and environmental technology, chemicals and transportation. It had set up the necessary arrangements for subsidizing research in these areas, and for making the results available to a large number of smaller firms which traditionally have devoted few resources to this purpose. The Government thus intended to act as an intermediary or broker of research and development, in particular in the industry, by facilitating collaboration between business and the universities.

The change in the direction of industrial policy was reflected in modifications to the system of investment subsidies (WIR). This system, which had carried the main responsibility for stimulating capital formation in enterprises, is to be scaled back in 1986, by limiting the extension of subsidies to profitable enterprises. In consequence, expenditures on investment subsidies would be reduced from an average of f. 5.5 billion in 1984 and 1985 to f. 4.2 billion. To compensate, the Government had decided to reduce in 1986 the rate of corporate taxation below the 43 percent now required. The Dutch representatives reported also that the rationalization of the steel, auto, and aircraft industries was now just about complete, and that subsidies to the shipbuilding industry would cease at the end of 1986. As regards export policy, the authorities would intensify their efforts to promote Dutch products abroad--agricultural, industrial as well as tourism--through the organization of commercial fairs. Also, a number of financial instruments were now available, notably mixed credits, the subsidization of export feasibility studies and the provision of matching funds in cases where Dutch exporters were disadvantaged by the availability of below market rate financing to competitors.

The Dutch representatives stressed their commitment to a liberal trade and payments system, within the terms of the Common Commercial and the Common Agricultural Policies of the European Communities. The Netherlands had strongly supported the Community position on the rollback of the Tokyo round tariff reductions by January 1, 1986. A new round of talks within the GATT was urgently needed, and could get under way as early as the fall of 1986. The Netherlands would accept an extension of the current Multi-Fiber Agreement, which expires in July 1986, but would seek to ensure that no further extensions would be permitted.

The record of the European Community in recent years had been respectable in the view of the Dutch representatives, given the worldwide increase in protectionist sentiment and the special problems in some of the traditional manufacturing sectors, although the Netherlands had argued for a more liberal stance in a number of areas, particularly with respect to the Common Agricultural Policy and intra-community trade in services. They noted that Community steel products had met with stringent quotas from the United States. There was increasing recognition within the Community of the cost and inefficiency of the CAP. Dutch dairy farmers who were the main beneficiaries in the Netherlands of the Community's price support scheme, would still be competitive at levels of production close to current levels if prices were to be set at an economic level, although the profitability of dairy farming would be reduced.

It was felt that the service sector in the Netherlands would on the whole benefit from a liberalization of trade in services. In particular, the financial services sector would benefit significantly, and no sector would be badly hurt by such a move. However, progress within the EC on liberalization and deregulation of the services was slow, partly because the Community negotiations were on a sector-by-sector basis. A more comprehensive approach was necessary.

The Netherlands had reluctantly agreed to an increase in the Community tariff on VCRs in 1985, and had sought but failed to make the increase temporary. However, the Netherlands representatives noted that the Netherlands had not had recourse to the escape clause in Article 115 of the Treaty of Rome, and desired to limit recourse to it by EEC members.

In conformity with a 1976 decision to allocate 1.5 percent of NNI to development assistance, the aid ceiling was set at f. 4.6 billion in 1985, of which some 80 percent constituted Official Development Assistance (ODA). This compares favorably with the United Nations ODA/GNP ratio target of 0.7 percent. Dutch development aid is characterized by a high concessionary element, a high concentration on the least developed countries, a relatively high share of untied assistance and a high share of multilateral aid. For 1986, the aid ceiling is set at f. 5.1 billion.

IV. The Economic Outlook

The Dutch economy is expected to continue its slow but steady progress in the period ahead. The current outlook is for a rate of growth of GNP of just over 2 percent in 1986, with little change in the external current account balance before it narrows in 1987, and a modest decline in the unemployment rate. The same policy stance as in 1985 is expected to be maintained in the next two years. Rather than attempting to achieve quick results through short-term demand management, economic policy seeks to create conditions for a progressive recovery of investment as the basis for a sustained reduction in unemployment. Within this broad framework, some slippage in the fiscal deficit is expected, while monetary policy is likely to become somewhat less accommodating than it has been in the past. The continuity of trends is reflected in both the official and the staff projections (Table 5).

Though the staff projects a rise in real hourly wages well above the 1985 outcome--some 2.2 percent as against 1.0 percent--the rise in labor costs remains moderate. Unit labor costs in manufacturing are expected to rise modestly in 1986 and in 1987, as the growth in labor productivity should remain high even if less than in 1983-85. However,

Table 5. The Netherlands: Projections of Selected Indicators

	1985 Estimate	1986 Official projections	1986 Staff projections	1987 Staff projections
	(Annual percent changes)			
Aggregate demand 1/				
GDP	1.7	1.7	1.9	2.9
Total domestic demand	2.0	1.9	1.9	2.6
Consumer expenditure	1.4	2.4	2.6	2.9
Public consumption	0.3	0.4	0.2	--
Gross fixed investment	2.6	3.2	2.9	4.2
Public investment	-2.7	--	--	--
Residential construction	-5.5	-2.9	-2.9	--
Enterprise investment	8.0	6.6	6.3	7.0
Stockbuilding 2/	0.6	-0.3	-0.3	--
Net foreign balance 2/	-0.4	-0.1	--	0.4
Exports of goods and services	3.8	3.8	3.9	4.3
Imports of goods and services	4.4	4.2	4.1	3.8
Output, employment, and costs				
Industrial production	3.1	...	4.0	4.2
Employment	0.5	0.4	0.7	1.5
Unit labor costs 3/	-2.0	0.5	0.5	1.0
Prices				
Consumer price index	2.3	1.1	1.3	1.3
GNP deflator	2.3	0.8	0.5	0.6
	(In billions of guilders)			
Balance of Payments				
Trade balance	17.9	...	18.0	17.0
Services and transfers	-1.8	...	-1.6	-1.7
Current balance 4/	16.0	...	16.4	15.4
(In percent of GNP)	(3.9)	(...)	(3.9)	(3.5)

Sources: Central Planning Bureau, Macro Eeconomische Verkenning 1986; and staff estimates.

1/ Constant prices, 1980 base.
2/ Contribution to real GDP.
3/ Manufacturing sector.
4/ Including official transfers.

the effective appreciation of the guilder--by some 4 percent on the assumption that the U.S. dollar exchange rate remains unchanged in the course of 1986--will imply some loss of competitiveness. To be sure, real unit labor costs in manufacturing fell considerably during 1981-85, and the share of wages in value added is back to its level of fifteen years ago, which may be more than is necessary on balance of payments grounds. Still, to match continued wage moderation abroad, a lower growth in real wages relative to productivity growth may be required in the Netherlands in the longer run.

The basic conditions appear to the staff to be adequate to sustain the recovery of investment that began in 1984. Enterprise investment may slow down in 1986 but this is wholly due to a once-over decline in investment in the energy sector. From 1987 onward, enterprise investment could well grow at about 7 percent annually in real terms, bringing the investment ratio back to more traditional levels within five or six years. Though public investment seems likely to remain restrained for some time, the decline in construction activity is expected to bottom out in 1987. Thus, despite favorable profit levels and rising domestic demand, the growth of aggregate fixed investment will accelerate only slightly. In the period immediately ahead, a large share of profits will continue to help consolidate the financial position of enterprises rather than finance increases in productive capacity. At the same time interest rates are unlikely to abate much faster than inflation, offering little relief for the debt service burden of enterprises. Inflation is likely to recede further in 1986, the effect in part of the depreciation of the U.S. dollar, with virtual price stability a not impossible prospect.

Along with the Dutch authorities, the staff would have expected further reductions in the public sector borrowing requirement to contribute to a decrease in domestic long-term interest rates. Nevertheless, no progress on this score is likely in 1986, as cuts in the central government deficit are to be more than offset by a swing from surplus to deficit in the social security accounts. Moreover, because of falling natural gas prices during 1986, government revenues from gas are expected to decline in 1987 by an amount equal to possibly one third of the budgeted deficit in 1986. Any tendency for interest rates to decline further may also be arrested by some tightening of monetary conditions during 1986. To pursue a monetary policy as accommodating as in the past may not be found appropriate at a time of somewhat easier fiscal policies, particularly in view of the steady rise in the domestic liquidity ratio that has already taken place. The staff accordingly expects a somewhat tighter monetary stance to forestall possible adverse developments in the exchanges.

As growth consolidates and becomes more widespread throughout the economy, unemployment may be expected to recede slightly. The staff appears to be somewhat more optimistic on this score than the Dutch authorities, projecting a rise in employment of 0.7 percent rather than 0.4 percent in 1986, rising 1.5 percent in 1987. However, even these figures are barely satisfactory when set against the continued growth in the labor force. In the medium term much will depend on the nature of investment and, as in the recent past, on the extent of work-sharing. Most of the rise in employment, realized in 1985 and expected in 1986, is explained by the shortening of working hours. With overmanning much reduced, the reoccupation ratio is expected to rise to about 30 percent in 1986, meaning that a 1.0 percent reduction in average worktime will lead to a 0.3 percent rise in employment. More significant reductions in unemployment could probably be achieved by increasing incentives to work--for example by loosening the link between unemployment benefits and real wages--but the equivalence between net minimum wages and net minimum benefits is unlikely to be broken.

The surplus in the external current account is expected to remain large in 1986, but to shrink in 1987. Export volume growth, despite falling exports of natural gas, should remain high in 1986, and may even accelerate. The growth of import volumes, by contrast, should slow down in 1986 and into 1987 because, as the recovery matures, imports of investment goods and raw materials will grow less briskly. Import volume growth may still exceed export growth in 1986, but the trade surplus should widen somewhat as the terms of trade for both energy and nonenergy trade improve. On the energy account, the improvement reflects the fact that export prices of natural gas are adjusted to oil prices with a half-year lag. Nonenergy export prices are closely aligned to competitor prices, and should therefore be more buoyant than import prices, which will reflect the deterioration of commodity prices relative to manufacturing prices. The situation in 1987 is likely to be reversed. The staff therefore projects the current account surplus to remain at 3.9 percent of GNP in 1986, but to shrink to 3.5 percent in 1987. Nonbank capital outflows will most likely continue to provide the counterpart inasmuch as domestic interest rates are likely to be kept as low as possible consistent with exchange rate stability. Though the liberalization of capital markets in January 1986 has introduced some uncertainty, the structure of the balance of payments should not change materially in the near future.

V. Staff Appraisal

Over the last three years the Dutch economy has begun to recover from its most severe recession in the postwar period. Public policy over this period has been focussed on correcting structural impediments to long-term growth rather than on short-term demand management, rightly so, it appears. Economic activity began to pick up in 1983, hesitantly at first, but more forcefully in 1984 and 1985, with GNP currently expanding by more than 2 percent per annum, unemployment declining, and an expectation of virtual price stability in the near future.

The first impediment to long-term growth was thought to be the burden of the public sector on the economy. The deficit of the consolidated public sector has now been brought down from a peak of nearly 11 percent of net national income (NNI) in 1982 to below 8 percent in

1985. Over this period the public revenue burden remained more or less constant in relation to NNI while public sector expenditures declined from 72 percent to 69 percent. However, the budget for 1986 foresees the deficit rising again, to well over 8 percent, in consequence mainly of a cut in social security contributions equivalent to nearly 1 percent of NNI, not matched by further expenditure cuts. The staff notes that a short-term stimulus to consumer demand is thereby obtained, but perhaps at the cost of somewhat greater uncertainty regarding the long-term prospects for the public debt. Further stringent cuts in public expenditures are likely to be required in 1987, when a serious shortfall in budget revenue is expected to result from a sharp decline in revenues from gas. At some 8 percent of NNI, the staff considers that the fiscal deficit remains unsustainably high.

Another structural impediment to long-term growth has been labor costs, which by 1981 had risen to 91 percent of value added in the nonenergy enterprise sector. This ratio was by 1985 brought down to 83 1/2 percent though at the cost of a major increase in unemployment, from 7 1/2 percent of the dependent labor force in 1980 to 15 1/2 percent in 1985. The staff notes that the associated improvement in unit labor costs has helped the Dutch economy recapture market shares, as the increase in nonenergy exports substantially exceeded the expansion in external market between 1981 and 1985. That increase provided a strong initial impetus to the recovery in economic activity. Although the improvement in profitability and competitiveness was mainly devoted to an improvement in the financial position of enterprises, it contributed also to an increase in investment by enterprises, excluding dwellings, of 15 percent over the last three years, though real interest rates hardly declined at all. The staff is concerned, however, that an expansion of employment may drive up real wage costs to their former excessive levels. To avoid a resurgence of wage pressures in the labor market, careful attention should be paid to the generosity of the social security system. Recognizing that some reductions in benefits have already been introduced, the staff nevertheless fears that more needs to be done. Already nominal wage costs per unit of nonenergy manufacturing output are projected to rise again in 1986, after two years of decline, suggesting that unemployed labor is not being reabsorbed into production activity in a wholly noninflationary way.

The staff notes that the reduction in the fiscal deficit, and the improvement in profit margins, have released savings at a faster rate than the recovery in business investment could readily absorb. Some part of the external current account surplus that emerged was initially accumulated by banks and helped feed a steady build-up in domestic liquidity. The rise in liquidity has continued but, as nonbank capital outflows have caught up, it has increasingly been fed by domestic credit alone. Observing that a large part of the rise in domestic liquidity was held by enterprises, the monetary authorities had hoped that it would find its primary outlet through further increases in investment. It is recognized, however, that there is a limit on the extent to which additional debt financing can promote investment without a complementary increase in equity financing. Even with adequate profit margins it will take time to restore ratios of net worth to debt to acceptable levels. Meanwhile it would be unfortunate if the growth of domestic credit were to reach the point of threatening upward pressure on prices by placing downward pressure on exchange rates. Some slight tightening of monetary conditions does not, therefore, seem to be out of place.

The current outlook is for a rate of growth in GNP of just over 2 percent in 1986, with little change in the external current account surplus before it narrows in 1987, and a further modest decline in the unemployment ratio. In the view of the staff the fiscal deficit in the Netherlands is still unsustainably high. The effort to reduce it will of necessity have a deflationary effect on domestic demand, which should continue to be offset by an expansion of exports, and by the recovery of investment to which it can contribute.

The staff welcomes the reaffirmation of the Dutch authorities' commitment to a liberal trade and payments system. It encourages the Netherlands to use available opportunities to press within the European Communities for the rollback of existing barriers to trade in agricultural products, as well as in services.

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

Netherlands--Basic Data

Population (mid-1985)	14.5 million	
1984 GNP per capita	SDR 8,316	

National accounts (1984 at current prices)	In billions of SDRs	In percent of GNP
Private consumption	71.1	59.3
Public consumption	20.1	16.8
Gross fixed investment	22.1	18.5
Stockbuilding	0.6	0.5
Exports of goods and services	85.3	71.2
Imports of goods and services	79.4	66.2
GNP	119.9	100.0

Selected economic data	1981	1982	1983	1984	1985 1/	1986 1/
	(Changes in percent)					
Demand and output--volumes						
Private consumption	-2.5	-1.2	0.5	-0.5	1.4	2.6
Public consumption	2.0	0.6	1.0	-1.5	0.3	0.2
Gross fixed investment	-10.4	-4.1	0.5	4.5	2.6	2.9
Stockbuilding 2/	-1.3	0.5	--	0.8	0.6	-0.3
Total domestic demand	-4.6	-0.9	0.5	1.0	2.0	1.9
Exports of goods and services	3.4	--	2.1	6.5	4.1	3.6
Imports of goods and services	-3.1	1.3	1.2	5.8	3.9	3.9
Foreign balance 2/	3.9	-0.8	0.5	0.6	0.3	-0.1
GNP	-0.7	-1.8	1.4	1.8	2.1	2.1
Prices, wages, employment						
Consumer price index	6.7	5.9	2.8	3.3	2.3	1.3
GNP deflator	5.5	6.3	1.5	2.5	2.2	0.5
Wage bill per employee (private sector)	4.0	6.5	3.5	0.5	1.5	3.0
Employment, total	-1.5	-2.5	-2.0	-0.5	0.5	0.7
Employment, manufacturing	-3.2	-4.3	-4.7	-2.0	0.5	1.3
Value added, enterprises (volumes)	-0.7	-1.7	1.0	2.7	2.3	2.5
Value added, manufacturing (volumes)	0.7	-1.5	0.1	5.3	4.0	4.0
Productivity, manufacturing	4.0	3.0	5.0	7.5	3.5	3.0
Unit labor costs, manufacturing	1.5	3.5	-1.0	-5.5	-2.0	0.5
Registered unemployment (thousands)	479.8	654.6	800.6	822.4	760.0	725.0
Unemployment rate (national (definition)	10.7	14.2	17.0	17.2	15.5	...

	1981	1982	1983	1984	1985 1/	1986 1/
			(Changes in percent)			
Incomes of households						
Labor compensation	2.0	2.9	0.9	--	1.5	2.9
Other incomes	8.3	16.1	7.9	7.9	6.5	4.5
Transfers	9.3	10.0	5.4	0.5	0.4	1.3
Personal income	4.9	7.0	3.4	1.6	2.2	2.8
Direct taxes and social security premiums	3.9	6.5	7.5	-0.3	0.6	0.2
Disposable income	5.4	7.2	1.6	2.5	2.8	4.0
Real disposable income	-1.2	1.2	-1.2	-0.8	0.5	2.7
Monetary aggregates						
Money and quasi money (M2) (end-of-period)						
IFS definition	7.8	5.3	5.0	7.6	5.1 3/	...
National definition	6.5	8.0	10.7	8.8	6.7 3/	...
Liquidity ratio (end-of-year level)	35.9	37.7	40.0	42.4	43.3 3/	...
Exchange rates (period averages) 4/						
Guilders per U.S. dollar	-25.5	-7.0	-6.9	-12.4	-3.5	...
Guilders per SDR	-13.7	-0.2	-3.5	-7.8	-2.6	...
Nominal effective rate (MERM)	-6.8	4.0	0.9	-3.1	0.5	...
Real effective rate 5/	-10.4	3.2	-1.6	-8.9	-5.3 6/	...
			(In percent of NNI)			
Fiscal aggregates						
Central government balance 7/8/	-7.6	-9.5	-10.2	-9.2	-7.5	-7.3
Local authorities balance 8/	-1.6	-0.5	-0.5	-0.1	-0.5	-0.5
Social security funds balance	-0.4	-0.7	0.9	0.5	0.2	-0.7
Public expenditure 9/	69.3	71.9	72.7	71.0	69.1	...
Public sector revenues	59.7	60.4	62.4	61.6	61.3	...
Of which: Collective burden	52.8	53.7	55.5	54.4	53.2	51.8
			(In billions of guilders)			
Balance of payments						
Trade balance	4.3	8.1	5.1	11.0	...	...
Balance on invisible transactions	4.2	4.1	4.0	4.8	...	...
Unrequited transfers	-3.7	-3.6	-2.6	-3.3	...	...

	1981	1982	1983	1984	1985 1/	1986 1/
	(Changes in percent)					
Current balance						
Transactions basis	7.0	9.7	10.7	15.5	16.0	16.4
(In percent of GDP)	(2.0)	(2.6)	(2.8)	(3.9)	(3.9)	(3.9)
Cash basis	4.8	8.5	6.5	12.5	...	...
Long-term private capital	-3.9	-5.2	-2.7	-10.6	...	...
Short-term private and official capital	-0.9	-1.6	-0.2	-1.9	...	...
Banking sector	-2.3	3.6	-4.5	-0.8	...	...
Items in transit, SDR allocation	0.8	-0.4	0.5	1.2	...	...
Change in reserves (- = increase)	-1.4	4.9	-0.3	0.3	...	...

Sources: Dutch official publications, IMF, International Financial Statistics, and staff estimates.

1/ Staff estimates.
2/ Contribution to growth of GDP.
3/ End of September figure.
4/ A minus sign indicates a depreciation.
5/ Relative unit labor costs in manufacturing in common currency (total trade weighted).
6/ January to September figure.
7/ Including debudgetized expenditures.
8/ Cash basis.
9/ On a national accounts basis, and including net lending and debudgetized expenditures.

The Netherlands - Fund Relations

(As of January 31, 1986)

I. Membership Status

(a) Date of membership: December 27, 1945

(b) Status: Article VIII

A. Financial Relations

II. General Department

(a) Quota: SDR 2,264.8 million

(b) Fund holdings of Dutch guilders: SDR 1,445.7 million (63.8 percent of quota)

(c) Fund credit: None

(d) Reserve tranche position: SDR 819.1 million

(e) Current operational budget: The Dutch guilder is included in the current operational budget (December 1985-February 1986) for maximum transfers of SDR 31.3 million and maximum receipts of SDR 42.8 million.

(f) Lending to the Fund (SDR millions):

	Limits	Outstanding	Uncalled
GAB	850.0	--	850.0
SFF	78.5	78.5	--
Total	928.5	78.5	850.0

III. Current Stand-By

Not applicable

IV. SDR Department

(a) Net cumulative allocation: SDR 530.3 million

(b) Holdings: SDR 579.3 million, or 109.2 percent of net cumulative allocation

(c) Current designation plan: Maximum amount of designation in the current Plan (December 1985-February 1986) is SDR 15.7 million.

V. Administered Accounts

Not applicable

VI. Overdue Obligations to the Fund

None

B. Nonfinancial Relations

VII. Exchange Rate Arrangements

The Dutch authorities maintain a maximum margin of 2.25 percent between the guilder and the currencies of other countries participating in the European Monetary System, with the exception of the Italian lira for which the margin is 6 percent.

VIII. Last Article IV Consultation

Discussions for the 1985 Article IV consultation were held in the Hague and Amsterdam in January 1985. The staff report for the 1985 Article IV consultation (SM/85/104, 4/10/85) was considered by the Executive Board on May 1, 1985 (EBM/85/68). The Netherlands is on the 12-month consultation cycle.

Netherlands - Statistical Issues

1. Statistical Issues

There are no outstanding issues.

The 1985 issue of the GFS Yearbook includes data in the statistical and derivation tables for the consolidated central government through 1984 and, for the first time, detailed data on revenue and the economic classification of expenditure and lending minus repayments for the consolidated general government through 1984.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for the Netherlands in the February 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by De Nederlandsche Bank N.V., which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in February 1986 IFS
Real Sector	- National Accounts	1984
	- Prices: CPI	August 1985
	WPI	November 1985
	- Production: Industrial	September 1985
	- Employment: Industrial	Q2 1985
	- Earnings: Hourly rates	October 1985
Government Finance	- Deficit/Surplus	September 1985
	- Financing	September 1985
	- Debt	September 1985
Monetary Accounts	- Monetary Authorities	October 1985
	- Deposit Money Banks	September 1985
	- Other Financial Institutions:	
	Savings Banks	Q3 1985
	Life Insurance and Pension Funds	Q2 1985
External Sector	- Merchandise Trade: Values	September 1985
	Unit values	September 1985
	- Balance of Payments	Q2 1985
	- International Reserves	December 1985
	- Exchange Rates	December 1985