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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/67

10:00 a.m., May 1, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
	D. C. Templeman, Temporary
	P. Péterfalvy, Temporary
B. de Maulde	
	A. Mustafa, Temporary
H. Fujino	M. Sugita
	B. Goos
	T. Sirivedhin, Temporary
	L. Leonard
A. Kafka	
	H. Fugmann
	A. Abdallah
	B. Jensen
	J. E. Suraisry
P. Pérez	
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuáldez
	A. A. Agah, Temporary
	A. S. Jayawardena
N. Wicks	T. A. Clark
S. Zecchini	
Zhang Z.	

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

African Department: R. H. Nord. European Department: L. A. Whittome, Counsellor and Director; P. B. de Fontenay, Deputy Director; H. B. Junz, K.-W. Riechel, N. Streefkerk, J. S. Van't dack. Exchange and Trade Relations Department: J. T. Boorman. Fiscal Affairs Department: G. Blöndal. Legal Department: Ph. Lachman, J. V. Surr. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: K. A. Hansen, H.-S. Lee, G. E. L. Nguyen, G. W. K. Pickering, E. M. Taha, A. Vasudevan. Assistants to Executive Directors: I. Angeloni, W.-R. Bengs, G. Biron, Chen J., J. de la Herrân, R. Fox, V. Govindarajan, G. D. Hodgson, Z. b. Ismail, K. Murakami, W. K. Parmena, M. Rasyid, J. Reddy, A. A. Scholten.

1. NETHERLANDS - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with the Netherlands (SM/85/104, 4/10/85). They also had before them a report on recent economic developments in the Netherlands (SM/85/110, 4/17/85).

Mr. Polak made the following statement:

The 1985 Article IV consultation with the Netherlands is the third consultation since the present Cabinet came to office. Last year, in my introductory statement, I explained at some length the background of the imbalances in the Netherlands economy, and the general strategy adopted by the Government to deal with these imbalances. This strategy, which remains in force, is directed at regaining control over public finances, restoring profitability and dynamism in the market sector, and relieving the unemployment situation by a measure of labor sharing. On the basis of this strategy and helped by the international recovery, the first signs of improvement are surfacing: output is rising, enterprise profitability is increasing, labor shedding has ended, and the fiscal situation has been improved.

The authorities have benefited from the staff mission's comprehensive look at the present state of affairs in the Dutch economy, and they generally support the analysis and conclusions of the excellent staff report. It rightly focuses on the need to develop further measures to trim the social security system and to address income-related public expenditure programs. Such measures will serve the dual purpose of regaining control over public expenditures and improving the functioning of markets, in particular the labor market. The authorities are fully aware that in both areas only the first steps have been taken.

In fiscal policy, emphasis is on reducing the public sector deficit by reducing public sector expenditures. Although it still has not proven possible to halt the rise in public sector outlays completely, their share in net national income (NNI) has been lowered. After rising for more than twenty years in succession, this share is now slated to decline for the second consecutive year in 1985 to a level about three percentage points below the 1983 peak of 70 percent.

I should emphasize that improvement on the expenditure side has been responsible for recent improvements in the fiscal deficit, in terms of NNI. The second paragraph of the staff appraisal might create a different impression ("the improvement in the fiscal deficit, in terms of NNI, has been concentrated on the revenue side..."). The staff's misunderstanding might well be due to the fact that the Dutch presentation does not always make it sufficiently clear whether changes in certain variables are related to their level in the past, to their future level on the basis of present policies, or to projections that take intended measures into account. Also, it should be noted that total public sector expenditures are mostly quoted on a transaction basis, while the most widely used concept for the fiscal deficit is on a cash basis and excludes the social security funds.

In fact, from 1983 to 1985 the collective burden (total public sector revenues minus receipts from natural gas exports) will decrease in terms of NNI. Although the authorities' stated intention did not go beyond not raising the collective burden (as a ratio of NNI), this burden actually falls from slightly below 56 percent in 1983 to a projected 53 percent in 1985. This decline results primarily from a lowering of social security premiums made possible by reductions in social security benefits and by some use of capital by the social security funds. The reduction in social security outlays was not fully translated into a lower fiscal deficit because, for institutional reasons, that would have required additional discretionary tax-raising measures, which the authorities were loathe to take. A slight reduction in the ratio of total tax revenues to NNI also occurs, due to the fact that tax buoyancy is still below unity. The effect of this reduction on the collective burden is largely offset by an increase in receipts from the sale of natural gas and in other nontax revenues.

One of the most important reasons for emphasis on reducing the fiscal deficit (still expected to be at 8 1/2 percent of NNI in 1985), against the alternative of further reduction in the collective burden, lies in the present high level of interest rates. For some time they have exceeded the rate of growth of national income by a considerable margin (the current rate of interest of about 7 1/2 percent compares with an expected growth rate of NNI of 4 percent in 1985, and similar margins existed in the preceeding five years). It is of course a well-known proposition that in such circumstances any fiscal deficit threatens to become explosive. Even though one may be confident that the situation where the real rate of interest exceeds the growth rate of the economy will not last forever, it can easily be seen that deficits as high as in the Netherlands could become unsustainable even in the short run. With reference to the penultimate sentence of the staff report, it can therefore be said that lasting progress toward a reduction in the size of the public sector can only be achieved through an early and significant lowering of its deficit. It should be added here that the official target for the deficit of 7 1/2 percent of NNI in 1986 should be considered as an intermediate target; it reflects merely a realistic appraisal of what could be achieved in the four-year term of the present Cabinet, and significant reductions will be required in the years immediately beyond 1986. Therefore, a major further effort to reduce public expenditures will be necessary, the more so since receipts from the sale of natural gas could decline sharply in the years ahead.

With fiscal policy firmly geared to structural targets, monetary policy aims at facilitating the recovery of investment, which, although rising, is still very low. To this end, interest rates are kept at the lowest level compatible with a tight link between the guilder and the deutsche mark. However, the exchange rate expectations fostered by this exchange rate policy might have prevented Dutch interest rates to drop below those prevailing in the German market. In particular the external current account position of the Netherlands would not have appeared incompatible with such a development.

This observation touches on the staff remark about exchange rate policy, which shows sympathy for appreciation of the guilder vis-à-vis the deutsche mark. The idea that appreciation of the guilder might contribute to a more balanced recovery in the Netherlands has recently been discussed in the Annual Report of De Nederlandsche Bank. However, no specific reference was made to a change in the central rate vis-à-vis the deutsche mark, and, in fact, the policy objective of maintaining the exchange rate vis-à-vis the deutsche mark will be continued. In addition, it should be noted that, given the policy of firm adherence of the guilder to the European Monetary System (EMS), in practice the issue of revaluation of the guilder would be most unlikely to present itself except in the context of some future realignment of EMS central rates, which for more than two years have remained unchanged. Whether a revaluation would, over time, lead to a large or a small current account effect would depend on the degree of real effective appreciation of the guilder. In that context, many other factors would be relevant, such as the changes in the values of other EMS currencies in a realignment, the movement vis-à-vis the dollar and pound sterling, as well as wage and productivity developments in the Netherlands.

National unemployment figures show a notable decline from last year's second quarter peak of 17.6 percent of the dependent labor force to 16.0 percent in the first quarter of 1985. However, regulatory changes and other factors have temporarily impaired the reliability of these data. In all likelihood, underlying developments are less favorable. In any case, unemployment remains very high, in particular when it is noted that in addition to those unemployed, almost a tenth of the potential labor force is receiving disability benefits. All in all, the number of inactive persons of working age that receive benefits amounts to more than 40 percent of the number of employed persons.

Against this background, it is disturbing that, even with near 3 percent annual growth, employment growth until the end of the decade cannot be expected to absorb more than the increase in the labor force, which is due to be significant. It might be added that near 3 percent growth constitutes a quite optimistic assessment, much nearer the expected European average than has been the case in recent years.

In these circumstances, steps toward a more equitable division of work, through reductions in labor time, have been encouraged by the authorities, particularly insofar as at the same time use of the labor force was made more flexible. However, the authorities recognize the inherent dangers as spelled out by the staff. I may add here that it is a positive sign that the staff does pay attention to such structural issues (the appendices to the paper on recent economic developments deserve mention). Structural developments, even if they don't have an immediate macroeconomic impact, affect long-term macroeconomic performance significantly. Indeed, the neglect of these issues during the preceding decades has contributed to today's rigidities. In this context it should be noted that the mission not only met with the Minister of Finance, but also with the Minister of Social Affairs and Employment, which reflects the broadening of the surveillance function of the Fund as well as the importance attached to it in the Netherlands.

To improve the functioning of the labor market, the staff has pointed to a number of areas that require urgent attention, in particular reducing the "wage wedge" (the gap between labor costs and net earnings), widening the differential between income from labor and social security payments, as well as tilting the wage scale. These objectives are shared by the authorities. However, in devising measures to improve the Dutch labor market situation, it should be kept in mind that the extremely high unemployment level of recent years was mainly caused by a rapid rise in the labor force, which increased by 10 percent in the four recession years 1980-84. It is evident that in these circumstances the aim has to be a more labor-intensive economy. Thus, the measures cited above have to be complemented by a sustained change in the relative prices of labor and capital. Therefore, wage moderation remains essential. However, because bottlenecks reappear for some segments of the labor market, while some enterprises' profitability has been restored more fully than that of others, truly differentiated wage settlements are to be welcomed. This result can be expected from the lately much more decentralized process of wage formation. Still, wage moderation continues to be the main concern for government policy in this area. It is indeed as essential as efforts to put public finances on a sound footing and progress toward a truly common European market.

Mr. Fugmann noted that the staff report included a comparison of the Netherlands and other countries, a welcome practice that should be repeated in other cases. The staff papers had not, however, been clear about developments with respect to the government budget deficit. It was difficult to evaluate the consequences of expected expenditure overruns and revised expenditure cuts. Was there a need for improved statistics or had the information not been presented clearly?

Following a protracted period of sluggish growth and increasing economic imbalances, including poor profitability in the non-energy sector, widening budget deficits, and high unemployment rates, the authorities had successfully arrested the economic deterioration. There were signs of an improvement in the performance of the economy. Nevertheless, the adjustment process had just begun; government outlays as a percentage of GDP were among the highest, and fixed investment among the lowest, in the OECD area, and significant imbalances continued to characterize the economy, notably in the labor market and the external current account.

The implementation of measures to curb public expenditure in line with budget projections had presented substantial difficulties in the past, Mr. Fugmann recalled. Spending overruns in 1985 were already estimated at close to 1 percent of net national income, a development that might undermine private sector confidence. Although the authorities' wish to adjust gradually was understandable, given the size of public intermediation in the Netherlands and its impact on the economy, comprehensive cuts in public expenditure were called for. Indeed, such an approach, by stimulating business confidence and easing the pressure on interest rates, could encourage investment. However, as in other countries, political difficulties seemed to exclude a more radical reduction in public expenditures and the introduction of measures designed to reduce the large structural problems in the labor market.

A more active demand management policy would stimulate the economy, Mr. Fugmann considered. In particular, a fiscal policy that was based on expenditure cuts accompanied by equal revenue cuts, or, perhaps a more appealing approach, revenue cuts that were conditional upon the achievement of targeted expenditure cuts, should be adopted. A more vigorous approach to adjustment that would not compromise the authorities' overall strategy would build confidence in the economy. Such an approach would still constitute a tightening of fiscal policy, although admittedly to a lesser extent. From the point of view of the Fund's surveillance role, the inclusion in the staff paper of a simple numerical analysis and some discussion of that approach as a means of addressing internal and external imbalances would have been useful. He wondered why medium-term projections of the fiscal deficit and the external current account had not been included in the staff paper.

The authorities apparently intended to attack the large and rising external current account surplus through monetary and exchange rate policies, Mr. Fugmann observed. While he fully supported those policies, he doubted that, even with somewhat lower interest rates, they would be sufficient to bring down the external surplus. The maintenance of competitiveness of the economy should depend on internal policies, a viewpoint that was generally in line with the thinking in other countries of the European Monetary System.

The greatest imbalances in the Netherlands economy were in the labor market, Mr. Fugmann remarked. The overriding importance of increasing the efficiency of that market was clear, and the authorities already had taken significant and courageous steps in that direction. However, much more needed to be done. First, more liberal hiring and firing policies should be adopted. Based on Danish experience, liberal practices allowed enterprises to respond rapidly to changes in activity and earnings. Second, in addition to increasing wage differentiation, which was lower in the Netherlands than in any other country in the European Communities (EC), steps must be taken to reduce distortions arising from income-related expenditures and the strong progressivity of taxation. The social security system had been adjusted to increase work incentives. Thus, net income from social security supports had been reduced; they would remain among the most generous of the OECD countries, but they were not significantly out of line with those of other industrial countries. More important from a work incentive point of view was that the duration of unemployment benefits and the generosity of eligibility criteria remained broadly unchanged in the Netherlands in contrast to many other industrial countries where such criteria had been tightened, partly for budgetary reasons.

Fixed per-employee costs were higher in the Netherlands than in other OECD countries, Mr. Fugmann noted. Part-time job opportunities and demand for labor could be increased if the fixed-cost element of wages was reduced substantially, particularly given the large number of small enterprises.

He commended the authorities for their liberal trade policy and unwavering support for a liberal international trading system, Mr. Fugmann stated. Finally, the Netherlands offered a commendable demonstration of how to reduce a budget deficit without cutting official development assistance (ODA) from its high level.

Mrs. Sirivedhin endorsed the basic strategy adopted by the authorities that aimed at regaining control of the public finances, restoring profitability and dynamism in the market sector, and reducing unemployment through the introduction of labor-sharing measures. Remarkable progress had already been achieved in those key areas.

In their effort to regain control over public finances, the authorities' emphasis on reducing the fiscal deficit rather than the collective burden was particularly noteworthy, given the urgent need to ease the strain on domestic interest rates and the future interest burden of the Government, Mrs. Sirivedhin considered. The progress made in 1984 with respect to both the fiscal deficit and the collective burden was remarkable, although it had been attributable largely to the better than expected improvement in the general economic environment and to some temporary factors, which had made up for the slippages caused by expenditure overruns. With the prospects of declining natural gas revenues and poor tax performance, a further reduction in the fiscal deficit would require increasingly large cuts in expenditures. There would be little room for policy slippages. Consistent and systematic cuts in expenditures would be needed to restore confidence in the attainability of the ambitious fiscal targets for 1988.

The progress made in improving profitability and dynamism in the private sector was encouraging, Mrs. Sirivedhin commented. The favorable results were due to the effective income and labor market policies implemented since 1982, including labor sharing, wage restraint, decentralization of wage formation, and adjustments in minimum wage and social security contributions. However, the unions' large wage claims were clearly premature in light of the early stage of the economic recovery and the large labor pool. The new wage accord should not constitute a setback to the progress already achieved.

The continued growth in the liquidity ratio posed no serious problems, particularly given the increase in demand for money induced by the relatively stable interest rates and low rate of inflation, Mrs. Sirivedhin remarked. There was no need at present for the public sector to absorb liquidity through overfunding of the fiscal deficit. The staff's proposal in that respect would impinge on the longer-term objective of reducing public sector expenditures by affecting the interest burden of the Government. The skepticism mentioned by the staff regarding the success of the "operation twist" did not lend support to the staff's proposal for overfunding.

The staff's argument in favor of an appreciation of the guilder vis-à-vis the deutsche mark would have some merit in the later stages of recovery, when strains had been generated in the economy, Mrs. Sirivedhin stated. Could the staff or Mr. Polak elaborate on the likelihood that the authorities would take such action, given the present policy framework for members of the EMS? She commended the authorities for their liberal trade policy, which had been pursued within the confines of the European Community, and for their support in eliminating the subsidization of the steel sector and in liberalizing the Multifiber Arrangement. The authorities' continued adherence to the 1976 decision to allocate 1.5 percent of NNI to ODA, despite the fact that the economy was still in the initial stages of recovery, was commendable.

Mr. Pérez noted that the staff report concentrated on the structural aspects of the economy, while Mr. Polak's opening statement had included additional information about policy actions that the Cabinet was undertaking. The staff had stressed that a lasting improvement in the Netherlands economy should be linked to the improvement of the internal rigidities and that a substantial correction in the economy should, therefore, not be expected in the short run.

Two main areas of concern were the public sector and the labor market, Mr. Pérez observed. The rise in unemployment, despite the upward trend in economic growth, was discouraging and clearly indicated the existence of structural disequilibrium in the labor market, which should be tackled with stronger measures and with the collaboration of all social partners. The authorities recognized the key role that wage policy should play in their overall policy approach. A further moderation of labor costs was important. The increasing wage demands of the trade unions were worrying. The adjustment process had only recently begun in the Netherlands, and the unions' demands, arising out of the projected improvement in the economy and favorable performance of some enterprises, could interrupt that process. Greater wage differentiation was desirable to increase mobility and eliminate some of the rigidities in the labor market.

Measures introduced thus far, including the reduction in working hours and early retirement schemes, would have positive effects on the labor market in the short term but were unlikely to solve the unemployment problem in the long term, Mr. Pérez considered. Early retirement schemes represented a trade-off in the way workers were paid; retired individuals were eligible for pensions, which would, in turn, increase social security expenditures. Consequently, the problem would temporarily be shifted from the labor market to the fiscal area. Another undesirable result of that policy could be a decline in productivity as workers with more experience and greater skills would be retired early. The behavior of the labor market and the expenditure policy implemented by the authorities were closely related. Subsidies to the unemployed population represented a considerable cost for society as a whole; every ten active earners supported almost eight benefit drawers. He would appreciate comments from the staff on the projected trends for those subsidies and on the authorities' intention to reduce the level of unemployment benefits.

The policy emphasis on reducing the public sector deficit through reductions in public expenditures was welcome, Mr. Pérez commented. He noted the difference of view between the staff and Mr. Polak regarding the major factor contributing to the improvement in the deficit. A reduction in the size of the public sector seemed necessary in order to improve private investment. Therefore, efforts should be clearly concentrated on the expenditure side, particularly on the open-ended expenditures. A better outcome on the revenue side could temporarily alleviate the fiscal situation, but the structural problems would have to be resolved before a long-term improvement would be observed. How were the negotiations on the social security reform package progressing? Agreement on that package was of the utmost importance because of the consequences it could have on both the deficit and the collective burden. Finally, he commended the authorities for maintaining their support for a free trading system and for their important contribution to ODA.

Mr. de Maulde noted that the Netherlands economy had improved somewhat in 1984; GDP had increased by 2.1 percent, the current account surplus had reached 3.9 percent of GDP, and the rate of inflation had been contained at 3.3 percent. However, the considerable slack in the economy had not been eliminated, as evidenced by the high unemployment rate of 14 percent, some 6 percentage points higher than the average for OECD countries. The so-called deindustrialization process was evidently taking place in the Netherlands. Public sector expenditure as a share of NNI, at 69 percent, was still the highest of the OECD region; the public sector deficit, excluding social security, represented 9.4 percent of NNI; and structural rigidities, especially in the labor market, appeared to have reached a much higher level in the Netherlands than in neighboring countries. In sum, in spite of some favorable developments in the most recent period, only limited progress had been made toward structural adjustment.

The staff had rightly observed that exports had been prevented from fully reflecting broad-based increases in world demand, Mr. de Maulde observed. A remarkably good performance on the inflation front was associated with poor performance in terms of domestic activity. Surprisingly, however, the capacity utilization rate in industry remained extremely high at 84 percent, indicating that new plants, equipment, and activities were urgently needed to put unemployed individuals back to work. The primary goal of economic policies should therefore be to promote investment. He would appreciate hearing Mr. Polak's views on that issue.

He was of two minds regarding fiscal policy, Mr. de Maulde stated. While the size of the overall deficit was worrying, there seemed little sense in aiming to reduce it given the high rate of unemployment. On balance, he tended to agree with the authorities' objective of reducing the deficit by 2 percentage points of NNI by 1986, action that would not harm confidence and would not be too deflationary. He agreed with the staff, however, that strong efforts should be made to reduce the relative size of the public sector in the economy through cutting expenditure. Although the authorities had already made some politically difficult decisions regarding expenditure outlays, additional expenditure cuts would have to be made. Since they did not aim to reduce the deficit rapidly, it would be extremely desirable if the expenditure cuts were large enough to allow some reduction in revenues. He was alluding to the staff's comments with respect to the effects of the marginal rates of direct taxation on incentives to invest, innovate, and work.

The fundamental goal of monetary and exchange rate policies should clearly be to lower interest rates, given the importance of promoting investment, Mr. de Maulde considered. He had some doubts about the authorities' zeal concerning the parity of the guilder vis-à-vis the deutsche mark. He had even stronger doubts about the staff's suggestion in favor of an appreciation of the guilder vis-à-vis the deutsche mark. Such an appreciation would reduce the external surplus of the Netherlands, but it would also consolidate the present high level of domestic interest rates. A strong case could be made in favor of allowing the central bank to reduce its interest rates at the cost of maintaining, temporarily, the external surplus. While that surplus was excessive, it did not constitute a serious threat to the international monetary system or to the EMS. Moreover, the pickup in activity resulting from such a policy would help at a later stage to reduce that threat.

He was uncertain whether domestic demand should be stimulated further and about the stance of future wage policy, Mr. de Maulde indicated. On the one hand, the overall profitability of firms seemed to have been restored to a level that permitted some increase of household income. On the other hand, the Netherlands' exports were not overcompetitive in foreign markets. Perhaps there was a case for a selective wage policy aimed at enhancing incentives to work and to specialize. He would welcome any comments on that point from Mr. Polak or the staff. The authorities' industrial policy seemed somewhat insufficient in view of the current situation in the industrial sector. However, any judgment on that issue was hampered by the dual character of the industrial sector, which was made up of a combination of large and powerful multinational firms and a number of smaller enterprises. It was impossible to apply the same set of policies to those two segments. In conclusion, he commended the authorities for their generous provision of ODA.

Mr. Wicks observed that the staff had focused on the three persistent imbalances in the Dutch economy: the excessive fiscal deficit, high unemployment, and the large current account surplus. The staff had also appropriately focused on the principal causes of those imbalances: the structural rigidities of wage determination, the wage support system, the size of the public sector, and the priority given to maintaining the parity of the guilder and the deutsche mark.

In the past two years, the authorities had made progress in reversing the deeply ingrained structural imbalances in their economy, Mr. Wicks noted. For example, in 1984, for the first time in several years, there had been a slight fall in relation to NNI in public expenditure, the burden of taxes, social security contributions, and the government deficit. Some modest progress had been made in that year, with the first sign of a resurgence of output and profitability in the private sector and a further revival in fixed investment. Some of those encouraging developments were due, in part, to the renewed growth of world trade and the strength of the U.S. dollar. The underlying situation revealed somewhat less improvement. In particular, despite a cut in wages and salaries, spending by the Central Government had continued to increase as a share of NNI owing to overruns in a number of areas and delays in implementing some measures aimed at reducing the social security budget. There was no room for complacency; the authorities should intensify their efforts to redress the huge fiscal imbalance, particularly if they were to meet their medium-term objective of reducing the fiscal deficit as a proportion of NNI by more than one half by 1988. A radical curtailment of the scope of social outlays would be required rather than piecemeal savings, especially since the growing burden of government debt service and the probable decline in gas revenues was likely to worsen the fiscal outlook. He strongly endorsed the authorities' short-term priority of reducing the public sector deficit rather than the burden of taxation, although action on both fronts would be required in the longer term to encourage the growth of private enterprise and to reduce disincentives to work.

The authorities had made some first steps in the right direction toward addressing the problems in the labor market, Mr Wicks remarked. He fully endorsed the recommendations of the staff in that area and urged the authorities to move forward immediately on a number of different fronts. First, the price of labor relative to capital had fallen from its peak in 1980, but the downward trend had come to a halt in 1982. The declining trend in the price of labor should be re-established, in the short term, by resisting the current excessive wage claims, and, in the medium term, by promoting greater differentiation among wage scales by continuing the policy of decentralization of wage bargaining. Second, the reforms of the social security system proposed in 1984 should be implemented as quickly as possible and the criteria for eligibility tightened. Progress in that field had been delayed partly owing to pressure from unions to transfer the cost of certain benefits from the Government to employers rather than reduce the value of the benefits themselves. It would be to no one's advantage if the unions were to succeed in obtaining their demands. Despite some improvement, business profitability and investment remained low, and the last thing that the business sector in the Netherlands needed was an increase in the burden imposed upon it. Indeed, he was disappointed to learn that the planned reductions in corporate tax had been postponed and that there had been little progress in reducing the burden on industry of the pervasive regulatory system. Early progress was called for in that area. Furthermore, action was needed to improve the functioning of the labor market by reducing the impediments to labor mobility, such as rent subsidies.

The increase in the national liquidity ratio in the past year had been ascribed primarily to cyclical factors and a reduction in inflation and inflationary expectations, Mr. Wicks noted. His authorities were concerned that the increase in liquidity might give rise to inflationary pressures. For example, if investment continued to revive, the private sector demand for credit might well put further upward pressures on liquidity. In those circumstances, there might be a case for the authorities to experiment with a limited amount of overfunding. He would be interested to hear the views of the staff and Mr. Polak on that possibility. His authorities were doubtful, however, whether the so-called operation twist would have a sizable enough effect on interest rates to affect significantly capital flows and money supply.

The staff clearly favored an appreciation of the guilder against the deutsche mark, but it was unclear from the staff report how the improvement arising from that action could be sustained, Mr. Wicks observed. Could the staff elaborate on whether the onus for action lay with the Netherlands' authorities, through lowering the fiscal deficit or increasing interest rates, or with other partners in the EMS, through policy modification? He welcomed the authorities' support within the framework of the EC for a more liberal international trading system. In sum, the authorities had adopted an appropriate policy stance, and he urged them to hasten its implementation.

Mr. Leonard observed that the authorities had persevered in correcting the fiscal imbalances and restructuring the economy. The benefits of their action were beginning to show results.

There was understandably a danger of complacency on the part of the authorities, Mr. Leonard considered. Progress was being made: the fiscal deficit was being reduced, inflation was low and declining, the external current account was in surplus, and the exchange rate was strong within the framework of the EMS. The rate of unemployment, although high, was falling, and the unemployed were well cushioned by the welfare system and might even be earning valuable supplementary incomes in the gray economy. It might be asserted that in such a situation it would be tempting political providence to tamper with transfer payments, educational expenditures, and other forms of social provisions in an effort to narrow the fiscal gap more quickly and reduce the fiscal burden in the medium term. The question was whether such action might strain the cohesion of the Netherlands' society and whether structural change and flexibility would be secured at the cost of social unrest.

It was not surprising that the authorities were slow to implement the expenditure cuts associated with social reform, which was under fire from the opposition, Mr. Leonard remarked. The authorities should, however, take action expeditiously in spite of the unpopularity of their fiscal and incomes policies. The rigidities in the economy must be eased and the debt service burden reduced without further delay. If those problems were not dealt with at present, they would restrain the progress of the economy in future years. The most demanding task for the authorities was probably to take the necessary action to solve those problems while respecting the social and humanitarian values that had shaped policymaking in the Netherlands over the past decades. In containing further social and transfer expenditures, special emphasis should be given to eliminating abuses of the system and limiting the effects of a reduction in benefits on the most needy segments of the population.

The staff's view on the need to stimulate the growth of internal demand was interesting, Mr. Leonard considered. GDP growth in 1985 was projected to be low, following two years of even slower GDP growth; inflation was low; and both the external account and the guilder were strong. Unemployment, however, remained high. Those features seemed to indicate the need for expansionary action, which would help to solve the fiscal problem and would ease the modification of social policy. The staff's proposal to allow some appreciation of the guilder vis-à-vis the deutsche mark in order to provide the leeway to bring nominal interest rates closer to the inflation rate seemed a roundabout way to energize the economy, but it was appropriate given the monetary situation in the Netherlands. Mr. Polak, in his opening statement, had indicated that such exchange rate action would be unlikely. He, himself, encouraged the authorities to consider the possibility of allowing an appreciation of the guilder vis-à-vis the deutsche mark in the future. Finally, he commended the authorities on their commitment to an open trading system.

The generous provision of ODA exemplified the same social awareness of the situation in other countries that successive governments in the Netherlands had shown at home.

Mr. Fujino noted that following two years of negative growth positive gains had been made in the Netherlands economy in 1983. The positive trends had strengthened in 1984, resulting in a 2 percent growth of real GNP. Exports had continued to rise at a fairly rapid pace, helped by the recovery of world demand. As enterprises had become more profitable, reflecting a significant increase in the export profit margin and continued moderation of wages, business investment had become steadier, rising by 5 percent in 1984 and projected to increase by 6 percent in 1985. The low level of business profitability and resultant stagnation of investment had been a matter of concern at the Board's discussion of the 1983 Article IV consultation with the Netherlands (EBM/84/42 and EBM/84/43, 3/19/84). The resumption of private investment was thus a welcome development. Prices remained stable at a low level and the budget deficit had been reduced in 1984 from its high level in 1983. That progress had strengthened confidence in the future growth prospects of the economy.

The economy still suffered from deep-rooted structural problems, arising from the large public sector, the heavy collective burden of taxes, social security, and other contributions, and the large public sector deficit, Mr. Fujino observed. However, some improvements had been made during the past year: total public expenditure had been reduced by about 1.5 percent of NNI, mainly through cuts in social security benefits and a reduction in investment programs. The central government deficit had been reduced in 1984 for the first time since 1977 by more than 1 percentage point to 9.1 percent of NNI. Although the collective burden had been reduced for the first time in ten years from 55.8 percent of NNI to 54.5 percent of NNI, the improvement had been due largely to cyclical or incidental factors.

The growth rate of expenditure of 4.5 percent in 1984, excluding interest payments, had been high, and there had been expenditure overruns in several categories, Mr. Fujino noted. In addition, as the authorities rightly recognized, the size of the deficit had reached the point of imposing a debt service burden on the budget itself and constituting a severe drag on the economy in terms of its effects on the capital and monetary markets. Priority must be given to reducing the budget deficit through cutting central government expenditures in order to restore private initiative and confidence. The decline in the public sector deficit of 1 percentage point of NNI projected for 1985 was expected to come not from the correction of the underlying fiscal deficit, but from transient or incidental factors, as had been the case in 1984. In addition, some expenditure overruns in 1984 had been carried over to the 1985 budget. Enormous efforts by the authorities, including a substantial cutback in transfer payments and a further containment of outlays on the government payroll, would therefore be required to improve the fiscal position.

Considerable effort had been made to tackle the labor market rigidities, Mr. Fujino commented. On the demand side, the authorities had advocated continued moderation of labor costs. On the supply side, schemes to reduce work time and encourage part-time employment had been introduced in an effort to reduce unemployment. While some progress had been made, further steps should be taken. The distortions in the labor market and the disincentives to work were fueled by the structure and level of transfer payments and taxes in the Netherlands. Responsibility for correcting those distortions fell heavily on the Government. The level of transfer payments had created a situation where, in the extreme case, a pay increase, or even a resumption of employment, did not provide any net increase in income. Moreover, the high level and progressivity of taxation had reduced labor mobility. Although significant cuts in social security benefits had been implemented recently, more action was necessary. While priority must be given to reducing the fiscal deficit, the collective burden should be reduced gradually in the medium term in order to restore vitality in the private sector.

Since 1981 the external current account surplus had continued to widen and was to reach an estimated 3.5 percent of GNP in 1985, Mr. Fujino noted. Since the fourth quarter of 1984, however, the guilder had moved to the bottom of the EMS band. The staff proposed that, given the strong current account position, some appreciation of the guilder against the deutsche mark should be permitted. The staff's intention was not entirely clear, but it would be unfortunate if the staff's view were misinterpreted as advocating manipulation of the exchange rate. Could the staff elaborate further on that point? As the fiscal deficit was reduced and confidence in the economy was restored, the market perception of a one-way risk with regard to the exchange rate of the guilder vis-à-vis the deutsche mark would be changed, resulting in a stronger guilder. An appreciation of the guilder would be of importance because it could provide the basis for a more active interest rate policy, the scope for monetary policy in the Netherlands being circumscribed by the exchange rate regime.

An increase in the money supply, while perhaps risking the rekindling of inflationary expectations, might have helped to sustain the recovery of the economy thus far, Mr. Fujino stated. A more efficient management of the public sector debt, would, however, contribute to the containment of domestic liquidity without hindering the recovery. With respect to interest rates, he noted that the present yield curve in the Netherlands was relatively flat. He wondered why long-term interest rates had not been higher, given the large public sector deficit. According to the staff, the Netherlands Bank would like to see a more normal yield curve with higher long-term interest rates and lower short-term interest rates. There might be a risk that higher interest rates would have an unfavorable impact on private investment. In conclusion, he was in broad agreement with the staff appraisal.

Mr. Kafka wondered whether the staff might have underestimated the successes of the Netherlands authorities in 1984, although he recognized that complacency was not appropriate. For example, the authorities' successful reduction of civil service salaries should have been emphasized. It would be desirable to attack public expenditure by systemic cuts, but less because they were systemic than because they would fall on those outlays that helped to rigidify the Netherlands economy. Government expenditure reduction must often be made in small cuts here and there, a guerilla warfare approach that should not be condemned. He agreed in principle with the staff's suggestion that income-related subsidies for rent, education, and other unspecified benefits should be reduced. But the staff also claimed that such a reduction would help the society to achieve a higher return on investment in human capital. Except for possible overinvestment in education, which was not demonstrated in the staff paper, he saw no such relationship and would be grateful for a further explanation by the staff.

The effect of labor time reduction in enhancing productivity might be approaching exhaustion and might even be reducing productivity, Mr. Kafka remarked. The staff also seemed to suggest that if the demand for leisure time rose less rapidly than labor time fell in the organized sector of the economy, the underground economy would grow, which it considered would be an undesirable development. He did not follow that argument. Was underground employment less useful than organized employment to the employee? Were there indications that the social productivity of individuals employed in the underground economy was lower than that of employees in the open economy? Of course, he recognized the economic distortions caused by the nontaxation of underground activities.

The staff was in favor of an appreciation of the guilder vis-à-vis the deutsche mark, Mr. Kafka observed. Might such an appreciation reinforce the perception of a one-way risk, thereby producing the opposite effects of those expected? There were perhaps alternative ways of achieving some of the effects of an appreciation.

He congratulated the authorities for their efforts to maintain a high ratio of official development assistance to GDP in spite of the expenditure reduction program, Mr. Kafka commented. The authorities' efforts undermined the claim of some other countries that the need to reduce public sector expenditure prevented them from increasing their ODA. He welcomed the Netherlands' liberal trade policy, although it seemed to be held hostage to the EC trade policies, especially in the agricultural sector.

Mr. Goos agreed with the thrust of the staff appraisal and with Mr. Polak's opening statement. The staff had clearly identified the causes of the Netherlands' most pressing economic problems. There was no realistic alternative to the authorities' adjustment strategy which not only addressed the root causes of the problems in the most direct way, but also had been successful in achieving their objectives of reducing the public sector deficit and the collective burden, improving enterprise profitability, reviving private investment, and preventing further increases in unemployment. Nevertheless, progress in 1984 fell considerably short of expectations. Notwithstanding the remarkable recovery of economic growth and favorable price performance, the structural improvements achieved in 1984 could be considered only as the starting point toward reversing the rising trend of transfer payments and lifting the paralyzing burden of taxes and social contributions on enterprises and consumers. Insufficient progress had been made in addressing the problems of the labor market, in particular the lack of wage differentiation, low mobility of the labor force, and the size of unemployment benefits that acted as a work disincentive.

Perhaps more disturbing than the unsatisfactory pace of progress in the past year was the fact that the improvements recorded in 1984 rested, to a large extent, on an unexpectedly favorable economic environment as well as on exceptional factors, such as high profits on national gas sales, Mr. Goos remarked. He therefore agreed that the authorities had no choice but to continue and, if possible, intensify their adjustment efforts, particularly with respect to the labor market and fiscal policy, a view expressed by the EC Monetary Committee on the occasion of its last review of the Netherlands economy.

More specifically, he welcomed the moderate increase in the wage bill in 1984, which, together with lower social security contributions by enterprises, had been instrumental in improving profitability in the enterprise sector, Mr. Goos considered. Labor time reduction had also improved the labor situation. He joined the staff, however, in cautioning against further reductions of that kind, as they could easily reverse the recent improvement in labor productivity, which would be a high price to pay compared with the relatively low reoccupation ratio--the ratio of job creation to labor time reductions--at least in the private sector. The reduction in working hours, high tax burden and social security contributions, and generous health and unemployment benefits had encouraged the expansion of the gray economy. The risks involved in a further expansion of that economy were clearly spelled out in the staff report, including the prospects of further revenue losses for the Government and the social security system. In addition, further reductions in labor time might result in more rigid regulations, jeopardizing the degree of labor management flexibility gained by the enterprises.

It would be unfortunate if the recent decline in labor costs achieved through labor time reductions were reversed by unduly high wage increases, Mr. Goos went on. A renewed increase in unit labor costs would impair the improved investment climate and, hence, limit the creation of badly needed new investment opportunities. A strengthening of domestic demand through higher investment spending would be critical to achieving a rate of real growth of 2 percent in 1985. A revival of domestic demand would be desirable and, indeed, possible, in view of the increasing current account surplus accompanied by high domestic saving.

Intensified efforts were clearly needed to reduce the budget deficit further, Mr. Goos stated. Emphasis should be placed on containing expenditures, particularly the so-called open-ended expenditures, which included subsidies and some social expenditures. It was difficult to understand why the Government needed to spend twice the annual median income on education and child allowances for the large part of the population aged 26 or younger. There was apparently room for cuts in those expenditures. He urged the Government to avoid further delays in introducing the social security reform measures. In that context, he noted a disagreement between the staff and Mr. Polak on the major factors contributing to recent improvements in the fiscal deficit. While that disagreement was more a matter of emphasis than of substance, he wondered why the authorities had apparently presented an obscure picture of the budgetary situation. On a related point, he recalled that at the Board's discussion of the previous Article IV consultation with the Netherlands the lack of statistics to identify the flow of savings and the current balance of enterprises had been noted. Given the importance of such statistics for a proper assessment of the economy, he wondered whether there had been improvements in that area.

The high liquidity ratio entailed a certain risk of rekindling inflationary pressures, Mr. Goos noted. There was no immediate need, however, for a substantive change in monetary policy, particularly if the Government were to improve its management of public sector debt in line with the reduction in the fiscal deficit. That action should moderate monetary expansion as a result of further increases in investment spending, which would probably stimulate capital outflows, thereby contributing to a reduction of the liquidity overhang. A tightening of monetary policy would certainly be unavoidable if the high liquidity in the enterprise sector were to lead to inflationary pressures, a view that was shared by the central bank.

The low inflation rate and favorable external position of the Netherlands justified a stable exchange rate vis-à-vis the deutsche mark, Mr. Goos considered. If the present discrepancies regarding developments in current account balances, costs, and prices were to persist among European countries, the guilder would be part of a group of appreciating currencies. A re-evaluation of the guilder would be unlikely except in the context of some future general realignment of EMS exchange rates.

The Netherlands economy was biased toward natural gas exports, Mr. Goos observed. The large profits reaped from those exports had been a major factor contributing to the introduction of excessive social security benefits and, hence, to the widening of the public sector deficit and to structural rigidities in the labor market. Furthermore, those profits, combined with a strongly centralized wage-setting system, appeared to have harmed the profitability of other economic sectors. Given the decline in prospects for the natural gas sector in the long term, the authorities should initiate a smooth reorientation of the economy. A slight appreciation of the guilder could play a useful role in supporting the necessary structural adjustment to secure a viable external position with lower foreign exchange earnings from gas exports.

In sum, first steps had been taken toward redressing the severe structural and fiscal imbalances in the economy, Mr. Goos concluded. A shift to a more expansionary policy stance as a means of improving the unemployment situation would, in all likelihood, be self-defeating and would probably be perceived by market participants as a lack of determination on the part of the authorities to tackle the underlying causes of unemployment. Finally, he joined others in commending the authorities on their generous provision of ODA.

Mr. Templeman observed that the Netherlands offered an interesting, perhaps even an extreme, example of the effect of rigidities in the economies of some industrial economies--the subject of considerable attention at the recent Interim Committee meeting. The relatively slow growth and high unemployment in the Netherlands were the outward manifestation of such rigidities, which were especially prevalent in the labor market and fiscal accounts. Those problems had received the full attention of the authorities and some progress had been made in redressing them. In the labor area, the growth of the nominal wage bill in the private sector had decelerated, productivity in manufacturing had risen, the decline in overall employment had almost been halted in 1984, and the unemployment rate was expected to drop slightly in 1985. On the fiscal side, the ratio of public sector expenditures to NNI had declined slightly in 1984 and was expected to be reduced again in 1985. The collective burden of taxes and similar charges had fallen slightly, and the size of the public sector deficit relative to NNI had declined from its peak of about 10.75 percent in 1983. However, serious problems remained in the labor and fiscal areas that would need to be addressed forcefully if economic growth were to be sustained on the basis of domestic demand and slow export growth and if economic activity were to increase.

As the staff had correctly recognized, the distortions in the labor market and disincentives to work arising from the structure of transfer payments and taxes were at the core of the Netherlands' economic problems, Mr. Templeman commented. They had contributed to unemployment, to the large fiscal deficit, and to the growth of the underground economy. The gravity of the problem was evident from the fact that every ten active earners supported eight benefit recipients in 1984 and that one tenth of the potential labor force was receiving disability benefits. Admittedly, some important first steps had been taken in the labor market area, but others were required, and the lag in the effectiveness of those measures might be prolonged. The authorities had resorted to some work-sharing schemes even though they were aware of the limitations of such an approach, which was likely to meet with only modest success in the Netherlands, given the present characteristics of the labor market.

Some positive steps had been taken to restrain wages, Mr. Templeman observed. The relative price of labor had been declining since about 1980, although it remained high compared to earlier periods, and the disparity between labor costs and take-home pay indicated in Chart 6 of SM/85/104 was particularly revealing. Efforts aimed at greater decentralization of wage formation, with a view to increasing wage differentiation, improving work incentives, and promoting labor mobility still left room for improvement. Adjustments in the social security system and in minimum wages, particularly for young workers, should contribute to making workers more responsive to work incentives and should favor greater labor mobility. He would be interested to hear Mr. Polak's or the staff's views on the effects of the reduction in the minimum wage for youth. Despite some progress, the nature and extent of remaining labor problems could be seen in the mismatching of the supply and demand for labor with labor shortages in some areas despite high unemployment, and in the concentration of recent investment in the areas of energy and labor substitution. The staff suggested that priority should be given to full and timely implementation of the 1984 social security reform proposals, strengthened by a tightening of eligibility for access under income-support schemes. Could Mr. Polak and the staff comment on the prospects for achieving those reforms?

Industrial policy, in the broad sense, could also play a role in modernizing the economy and in job creation, Mr. Templeman remarked. The economic reorientation in recent years away from a sector-specific and industry-specific focus toward the creation of an overall favorable economic environment was appropriate. He agreed with the emphasis on deregulation, a better match between education and labor market needs, the creation of more flexible labor markets, and the reduction in the tax burden on enterprises.

Only by limiting the public sector's claims on economic and financial resources could private sector vitality be restored, Mr. Templeman indicated. Despite the modest decline in the ratio of public sector expenditures to NNI in 1984 and the further drop expected in 1985, expenditure was projected to remain high in 1985. Furthermore, there were serious rigidities in public expenditures, particularly in the form of transfer payments, which accounted for nearly one half of total expenditures in 1984, and interest payments on the public debt, which accounted for nearly 10 percent of total expenditures. Although the ratio of transfer payments to NNI might have stabilized owing to action to limit social security expenditures, the ratio of interest payments continued to rise from 43 percent in 1979 to 67 percent in 1983, in line with the rapid increase in the ratio of debt to NNI. Mr. Polak had clearly pointed out the danger of an explosive increase in debt if the real interest rate continued to exceed real economic growth. That subsidies for higher education and child allowances for a large part of the population aged 26 or younger amounted to twice the annual median income in the Netherlands was cause for concern. Also worrying was the possibility that the participation rate for rent subsidies might be as high as 50 percent.

Tax changes in 1984 involving a 5 percentage point cut in corporate tax rates, a slight decline in social security contributions, and an increase in the value-added tax constituted an appropriate shift in the composition of the tax burden, Mr. Templeman considered. The modest decline in the collective burden from nearly 56 percent of NNI in 1983 to an estimated 53 percent of NNI in 1985 represented some progress in reducing the still very high tax burden. Nonetheless, the high marginal tax rates, which were 70-90 percent on the average and could exceed 100 percent in extreme cases arising from a pay increase or a move from inactive to active employment, had considerable adverse effects on work incentives.

The staff had expressed concern that even the modest fiscal improvements achieved thus far had been due largely to transient factors, Mr. Templeman noted. Indeed, some of the factors cited could prove to be temporary, and the size of the remaining fiscal problem was so large that the authorities should not be complacent. He, therefore, endorsed the staff's suggestion that current plans to reduce income-related subsidies in rent, education, and other areas be acted on promptly in order to strengthen work incentives and relieve pressure on the budget.

With respect to the Fund's surveillance role, he welcomed the fact that the staff had been able to meet with both the Minister of Finance and the Minister of Social Affairs and Employment during its visit to the Netherlands, Mr. Templeman remarked. Also, the appendices to the report on recent economic developments in the Netherlands, particularly the sections on the scope for work sharing and on income differentiation in selected European economies, were most useful. Those analyses were of particular interest given present concerns about structural problems and rigidities in industrial countries; the staff should continue to prepare such analyses in other cases.

Mr. Wicks joined Mr. Templeman in welcoming the participation of the Minister of Finance in the Article IV consultation discussions. It would be helpful if the staff could circulate a paper indicating those industrial countries in which it had had the opportunity to meet with the Minister of Finance and other senior officials.

Mr. Péterfalvy noted that the corrective policies followed by the authorities since 1982 had finally produced noticeable results in 1984. The encouraging progress they had made in reducing the imbalances in the economy should encourage them to continue their efforts, especially as the poor results achieved in previous years had cast doubt on the wisdom of the policy mix they had chosen.

Progress had been made in all areas, Mr. Péterfalvy went on. A considerable increase in public revenues, which had offset overruns in specific categories of public expenditures, had made it possible to reduce the total fiscal deficit from 10.7 percent of NNI in 1983 to 9.4 percent of NNI in 1984, even though the performance of the Central Government had been somewhat less satisfactory than expected. For the first time in 10 years the collective burden had decreased as a share of NNI, from 55.8 percent in 1983 to 54.5 percent in 1984, partly because the stabilization of unemployment had halted the increase of unemployment benefits, and partly because social security transfers had been reduced substantially. The profitability of enterprises had been improved, leading to the resumption of investment activity and the accumulation of sufficient surpluses to improve the financial situation. Furthermore, the stabilization of unemployment, although at a fairly high level, was a sign that the measures taken to aid the private sector and improve the functioning of the markets, particularly the labor market, had begun to bear fruit. As a result of the adjustment efforts, GDP had increased by 2 percent, while consumer prices had risen by only 3.2 percent in 1984 despite the increasing strength of the dollar and the increase in indirect taxation.

Those encouraging results, however, provided no grounds for complacency, Mr. Péterfalvy stated. They fell short of the intermediate target set by the authorities and, more important, some of them were not due entirely to the pursuit of appropriate policies, but were the result of other, fortunately favorable, factors. For example, the reduction of the fiscal deficit had been due partly to the increase in gas revenues resulting from the dollar's strength and partly to the increase in tax revenue as a result of the resumption of private sector activities. The authorities had not yet brought public spending under complete control. It was uncertain as yet whether the policy mix chosen by the authorities was entirely appropriate to achieving their goals of rehabilitating the private sector and improving market mechanisms.

Major challenges faced the authorities in the coming years, Mr. Péterfalvy considered. The sustainability of the economic recovery in the Netherlands depended on reducing the public sector's share of GDP, the fiscal deficit, and the collective burden. The authorities had apparently concentrated on reducing the fiscal deficit, but they saw little room for reducing fiscal pressures further; reducing the collective burden at the same time would require an alteration of the public expenditure profile. The authorities were far from achieving the objectives they had set, the measures taken thus far being modest. The reduction of public sector salaries and cuts in social security benefits in 1984 had been absorbed by overruns in other, less controlled and more sensitive, expenditures. The volume of public expenditures therefore remained about the same as in 1983. Given the limits of wage reduction and the delay in implementing social security reforms, there was little hope of reducing the collective burden further, no matter how desirable such a reduction would be. Would a reduction in fiscal pressure in tandem with a reduction in public expenditure improve economic activity in such a way as to make further progress both easier and faster? He recognized that such a choice would be difficult as it would require a break with the revenue policies traditionally followed in the Netherlands. The authorities would have to implement the planned social security reforms and tax rate reductions rapidly, while the favorable economic environment offered the chance to do so without drastically affecting the size of the fiscal deficit.

The authorities seemed to believe that the consolidation and reinforcement of growth depended particularly on the easing of supply conditions and further reducing protectionist measures, Mr. Péterfalvy noted. Those developments could be expected to produce positive results only in the longer term, and they should be supported by, at a minimum, a moderate relief of the fiscal pressure. The worse than expected economic performance, especially in the area of private investment, indicated that policies based exclusively on supply-side measures could not produce the desired results owing to the present rigidity of the markets.

A reduction in the public sector's share of GDP would also improve the functioning of the labor market, Mr. Péterfalvy pointed out. For two years the authorities had been implementing measures aimed at restoring the flexibility of the labor market and reducing unemployment. In 1984 wage moderation had yielded positive results. The lower inflation rate, however, had narrowed the room for maneuver, unless action was taken to reduce indirect wage costs. The Government had supported work-sharing schemes, which had succeeded in slowing the loss of jobs, but the maximum benefits from such a policy had been achieved and its further implementation could increase production costs, reduce public acceptance of job sharing, and also encourage the expansion of the underground economy. Given the difficulty for the Netherlands to pursue a policy of wage differentiation under current economic conditions, a reduction of the collective burden could play a large part in easing the necessary adaptation of traditional wage policies.

The current account imbalance and its effect on the liquidity ratio led him to question the interest rate policy pursued by the authorities and their desire to maintain the present relationship between the guilder and the deutsche mark, Mr. Péterfalvy stated. The staff and the central bank seemed to agree that the current account surplus was sufficiently large to allow a reduction of interest rates in order to improve the present economic climate, but they recognized that the room for maneuver was small owing to the fixed link between the German and Dutch currencies. He would be grateful for an explanation from the staff of how an appreciation of the guilder in terms of the deutsche mark could be encouraged, so that interest rates could be lowered, in the present climate in the exchange markets, which did not seem to favor the guilder.

Mr. Suraisry commended the authorities for their determined efforts to correct the structural imbalances in the economy. In recent months, progress had been made in reducing the fiscal deficit, stabilizing the collective burden of taxes and social security contributions, and enhancing flexibility in the labor market. That progress, together with the recovery in external demand, had contributed to a revival of growth, investment, and employment opportunities in the enterprise sector. Those favorable trends were expected to continue in 1985, and the short-term outlook was relatively favorable.

There was, however, no room to relax the medium-term adjustment strategy, Mr. Suraisry considered. The imbalances in the public finances, in the distribution of national income, and in the labor market were deep-rooted. Some of the recent gains might be transitory, and some of the necessary policy changes had been delayed or implemented only partially. Sustained adjustment efforts were needed if the authorities were to achieve their growth and employment objectives in the medium term.

Action was particularly needed on the fiscal side, where expenditure overruns had continued in some areas, Mr. Suraisry noted. Improved revenue performance could be traced, in part, to cyclical factors and to windfall profits on natural gas sales as a result of the strong dollar. The underlying fiscal position was weak and the public sector borrowing requirement remained high. The high and rising level of interest payments on the public debt constituted a heavy mortgage on future revenues and domestic saving and severely limited the fiscal options.

He therefore encouraged the authorities to carry out their plans to halt the momentum of public expenditure and to reduce the size of the public sector, Mr. Suraisry remarked. Their moves to reduce income-related subsidies and social security transfers were appropriate. As the recent OECD Survey on the Netherlands pointed out, those transfers acted as a disincentive to work within the economic system and provided major incentives to work in the underground economy. It was essential to reduce those transfers to appropriate levels, which the Government could afford and which would encourage output and productivity in the private sector. Firm discipline in that area should give the authorities the scope they sought to reduce the tax burden, particularly on companies.

He also supported the authorities' continuing efforts to reduce rigidities in the labor market, where imbalances remained acute, Mr. Suraisry indicated. Both the OECD and the Fund staff agreed that profits, especially in the manufacturing sector, should be restored as rapidly as possible to encourage additional employment. To that end, continued wage moderation was vital, and he hoped that the authorities would retain a firm stand in the present wage round. Greater wage differentiation would also be necessary. While that might be difficult to achieve, linking wage increases to productivity gains could help to restore work incentives and encourage labor mobility to high growth areas.

He shared the authorities' concern about the high unemployment levels, Mr. Suraisry commented. The widespread introduction of work-sharing arrangements had been helpful, but there was a risk that those arrangements could lead to new rigidities over time. The concept of flexibility in working time would have to be closely monitored to ensure that it served the longer-term interests of the economy. In addition, there might be scope for other measures to reduce minimum wages and introduce job training schemes for young people.

Fiscal restraint and a more efficient labor market were necessary conditions for a sustained recovery in the enterprise sector, Mr. Suraisry considered. The authorities should press ahead with other initiatives to promote such a recovery. There was room for further progress toward deregulation, which could encourage the establishment of new firms in activities in which the Netherlands had a comparative advantage. He was glad to note that the authorities were considering ways to make the Capital Investment Scheme more selective. Such an approach could assist the restructuring of industry and help exporters to regain market shares abroad.

The external current account was registering a large surplus, which had added substantially to domestic liquidity and increased the risk of an acceleration in inflation, Mr. Suraisry noted. Those risks did not appear great provided that the authorities did not relax their traditionally prudent monetary policies. Although the staff considered that there was room for some appreciation of the guilder vis-à-vis the deutsche mark, he had some sympathy with the view expressed by Mr. Polak. Any change in exchange rate policy should take into consideration the Netherlands' membership in the EMS, as well as its large current account surplus and the underpinning domestic factors. It might be too early for the course of action suggested by the staff, as the current account surplus could decline, particularly if the dollar weakened. If the surplus persisted, as the staff projected, it should be dealt with either by following the staff's recommendation or through the introduction of other measures, such as those suggested by Mr. de Maulde. Finally, he commended the authorities for their continued adherence to free trade principles and for their generous record on ODA.

Mr. Abdallah indicated his broad agreement with the staff appraisal. In the recent economic and financial history of the Netherlands 1984 had marked a watershed. The progress made in a number of fields should be sustained. High and growing unemployment had become particularly worrying, and the authorities' primary objective had been to reduce the rigidities in the economy and increase its dynamism through a progressive reduction in the size of the public sector and through the enhancement of private enterprise and profitability. Modest progress had been made in the past two years, but difficulties still lay ahead.

The public sector deficit had been reduced from nearly 11 percent of NNI in 1983 to 9 percent of NNI in 1984, and was expected to be reduced by one half over the next four years, Mr. Abdallah observed. Achievement of that target depended on the authorities' ability to control public expenditure, especially those outlays that contained a high element of subsidy, including educational allowances and other social disbursements.

In addition to expenditure measures, action should be taken to stimulate and revitalize the private sector so that it might prosper and expand to absorb the growing labor force, Mr. Abdallah continued. Some improvement had been made in the past year, as the expansion of exports had raised enterprise profitability and investments, thereby arresting the process of labor shedding. Mr. Polak had pointed out that the unusually high youth unemployment rate was due to the rapid rise in the labor force, which had increased by 10 percent in 1980-84. Continued progress in increasing enterprise profitability and employment opportunities would depend on improving the competitiveness of the Netherlands' industry, requiring comprehensive and coherent measures to promote high technology industries while phasing out those industries that no longer enjoyed a comparative advantage. As the authorities were strong advocates of a free and open international trading system, the necessary measures would undoubtedly be implemented. Finally, despite a firm determination to reduce government expenditure, the Netherlands had maintained its official development assistance at 1.2 percent of GNP in 1984, a commendable example that should be followed by other industrial countries.

Mr. Zhang noted that recently Directors had tended to question whether a change in the emphasis of fiscal policy might be called for in the Western European countries, which had experienced only moderate recovery in domestic demand and a slight decline in unemployment. The Netherlands provided an interesting example of the pros and cons of such an approach. The authorities were firmly of the view that no change in fiscal policy was warranted. They considered that priority must first be given to bringing down the budget deficit through the fiscal measures already adopted and that any changes in the direction of fiscal policy could be counterproductive at present. Growth could best be achieved by improving the supply-side responses of the economy. The authorities also believed that a reduction in interest rates would raise private investment and that the best way to reduce domestic interest rates was to reduce borrowing by the public sector.

In view of the massive unemployment in the Netherlands, he wondered whether the proponents of a more active demand management policy were not correct in stressing the need to impart a greater dynamism to the economy, Mr. Zhang remarked. As unemployment had reached almost 18 percent and was still rising, he agreed with the staff on the importance of meeting the authorities' fiscal target in order to show their commitment to reducing the size of the public sector and encouraging private sector growth. He wondered if the authorities would strengthen that commitment if unemployment continued to rise. Should they forgo the option of reducing high marginal tax rates, which would strengthen economic incentives to seek employment and, if combined with the cautious shift toward fiscal stimulus, could facilitate the contraction of the public sector by reducing employment?

He was surprised by the staff's proposal that the guilder should be allowed to appreciate vis-à-vis the deutsche mark, Mr. Zhang commented. There appeared to be two main reasons for that proposal, one related to the interest rate, and the other to wages. As regards interest rates, the central bank considered that the large external current account surplus gave rise to expectations of a revaluation, thereby encouraging capital outflows. Perhaps the current account surplus should instead be reduced by strengthening domestic demand, for example, by lowering taxes. A policy of appreciating the exchange rate to lower interest rates might not necessarily encourage investment by enterprises. There was no mention in the staff papers of the effects that appreciation might have in reducing employment and investment in the import-competing sectors and in causing a renewed acceleration of the decline of employment in manufacturing, which had slowed to 2.5 percent in 1984 from over 4.5 percent in the two preceding years.

As for wages, the staff emphasis on the need to widen wage differentials in order to promote labor mobility between sectors seemed somewhat surprising in view of the high unemployment, Mr. Zhang noted. The importance of the compression of the wage scale in discouraging mobility under present conditions seemed to have been exaggerated. It was unlikely, for example, that the narrowness of the wage differential stifled the incentive to move from a loss-making firm to a profitable one. Given the fragile prospects for employment and the planned cuts in social security provisions, the incentive to move to a more secure job would be strong even without a wage incentive. The obstacles to labor mobility were great, but other factors, such as housing and availability of social security payments, were probably far more important in explaining low labor mobility.

The immediate problem was the difficulty of securing changes in relative wages, particularly between the highly profitable sectors and the less profitable sectors of the economy, under the current wage bargaining system, Mr. Zhang remarked. The authorities were thereby encouraged to pursue their highly restrictive fiscal stance, to curb the growth of domestic demand, and to favor an appreciation as a means of containing wage settlements in the export sector and lessening the risk of similar settlements in other sectors. But he questioned the success of those policies.

Mr. Jensen indicated his support for the staff appraisal. Some areas of the economy had performed well, while developments in the real economy had been worrying. The inflation rate was among the lowest in the industrial world, and the balance of payments position was strong. The structural problems that remained, however, continued to be cause for concern. He agreed with the staff that the imbalances in the public sector and the distortions in the labor market were at the core of the Netherlands' economic problems.

At the Board's discussion of the 1983 Article IV consultation with the Netherlands, Directors had voiced a particular concern about the deep imbalances in the economy and had urged the authorities to take more decisive action, Mr. Jensen recalled. They had been most encouraged by Mr. Polak's concluding statement that his authorities were adopting appropriate financial and economic policies to adjust those weaknesses. Little progress had been made in reducing those imbalances, however, and performance had fallen short of expectations. Even more worrying, the little progress that had been made in correcting the underlying fiscal deficit and reducing the size of the public sector had stemmed to a large extent from transient and incidental factors. In reflecting on those issues, he was not criticizing the authorities' efforts or ignoring their achievements--the countries in his constituency experienced similar imbalances--but, he believed that all countries could learn from the Netherlands' experience. The country had demonstrated the decisive political will to correct its economic imbalances; it enjoyed both favorable external balances and domestic price stability and was a pioneer in modern economic technology. On the other hand, the authorities were encountering significant practical difficulties in implementing some economic policies because of some long-standing, deep-rooted structural rigidities. Thus, it was impossible or highly unrealistic to expect those imbalances to be corrected at a faster pace. He understood the need to adjust gradually given the economic problems confronting the authorities and the deep social implications, which were even greater in the developing world. He congratulated the authorities for their liberal attitude toward trade policies and appreciated their support for an open world trading system. He hoped that other countries would follow the commendable record of the Netherlands with regard to official development assistance.

Mr. Jayawardena agreed with the thrust of the staff appraisal. There were clear signs of recovery in the Netherlands economy. There were also worrying signs of continuing imbalances and weaknesses that arose from the authorities' gradualist approach to adjustment. The large fiscal deficit caused by long-standing structural rigidities was the underlying problem. The correction of those fiscal imbalances should be of the highest priority. While the authorities made strong efforts to reduce the deficit, further action was called for. If the staff had presented a medium-term forecast, including scenarios under alternative economic strategies, the options available to the authorities and the trade-offs involved would have been clearer.

His constituency included low-income countries that were repeatedly urged by the Executive Board to undertake rapid and decisive rather than gradual adjustment, Mr. Jayawardena noted, and he therefore understood the difficulties faced by the authorities in moving more decisively. But drastic action by the Netherlands was likely to produce quicker and more beneficial results than by a developing country. He encouraged the authorities to muster the political courage to tackle the structural deficit. Finally, he commended the Netherlands for its strong commitment to free and open trade, within the restrictive framework of the EC. He hoped that the authorities would help to open up European markets. The authorities' strong commitment to ODA, despite their difficult domestic situation, was welcome.

Mr. Romuâldez indicated his agreement with the staff appraisal. He commended the authorities for their achievements to date and encouraged them to continue in their efforts to regain control over public expenditure, relieve the collective burden, moderate the growth of wages, and increase the flexibility of the labor market. Developments in 1984 had been in the right direction: the fiscal situation was improving, output had risen, enterprise profitability was beginning to recover, and labor shedding was coming to an end. Admittedly, progress had been limited, particularly regarding the fiscal deficit and the rate of unemployment, which at more than 14 percent was some 6 percentage points above the average of the OECD countries.

Developments in the labor market were at the heart of the fiscal problems, Mr. Romuâldez considered. Given the structural rigidities and distortions in the labor market and the social security system, which offered little incentive to work, it was essential that the authorities take measures to widen the differential between net income from employment and net income from public and social security support. Early implementation of plans to reduce income-related subsidies in rent, education, and other areas was necessary. The authorities should expedite the reform of the social security system proposed by the Government in 1984.

In formulating monetary policy, the authorities were faced with constraints arising from the Netherlands exchange rate regime, Mr. Romuáldez noted. Even though inflationary pressures seemed to be subsiding and the economic recovery remained relatively slow, the steady rise of the domestic liquidity ratio between 1980 and 1984 was worrying. He encouraged the authorities to consider seriously the staff's suggestion that some overfunding might be useful at present. A more efficient management of the public sector debt could contribute substantially to containing the liquidity ratio without adversely affecting the recovery. The operation twist proposed by the Netherlands Bank seemed reasonable and should be explored. In conclusion, he commended the authorities for maintaining a liberal trade policy within the context of the restricted Common Agricultural Policy of the EC and for their good ODA performance.

Mr. Zecchini indicated his general agreement with the staff's analysis, particularly with the emphasis placed on the imbalances in the labor market, fiscal situation, and current account. The external current account surplus was especially relevant for the international economy in light of the recent discussion in the Interim Committee meeting. There were increasing signs that the U.S. economy's contribution as a driving force in worldwide recovery might be reduced; other countries must therefore be prepared to take up the slack, particularly, those countries that had brought inflation under control and were experiencing large surpluses in their external current accounts. The Netherlands, being a small economy, could clearly not offer a significant contribution by itself. However, its position and problems were, to some extent, typical of those of other countries in central and northern Europe.

Once the authorities had recognized the need to contain the external surplus, they could focus on the management of domestic demand, which should grow at a rate exceeding that of other European deficit countries, Mr. Zecchini considered. Given the high degree of integration of the economies of the Netherlands and the Fedreal Republic of Germany, the latter's economic policy played a predominant role. In fulfilling its surveillance responsibilities, the Fund should pay greater attention to the interdependence of economic policy in various countries. In the Netherlands, that interdependence was highlighted by its participation in the EMS and by the close relationship of the guilder with the deutsche mark. In that connection, it was questionable whether the authorities had enough room for maneuver with respect to exchange rate action. Nevertheless, the present exchange rate for the guilder could clearly be moved to the upper part of the EMS band without resorting to an increase in interest rates. The adjustment of the external surplus would then be more rapid.

In fact, a stronger guilder would allow the monetary authorities to reduce real interest rates, consequently stimulating private investment.

He welcomed the progress achieved on the fiscal front in recent years, even though it had been largely due to cyclical factors, Mr. Zecchini commented. The staff had suggested that the large size of the public sector might be one factor hampering the efficiency of the economy and limiting the expansion of work opportunities. As a large part of public expenditures were in the form of transfers to the household sector, a parallel reduction in expenditures and taxation would not result in a substantial withdrawal of stimulus to the economy, provided that tax rates and expenditure cuts were managed in such a way as to avoid perverse distributional effects, thereby avoiding a fall in the national propensity to spend. The authorities were aware that further progress was needed to improve control over the size of the public sector, and they planned to continue their efforts in that direction.

The efficiency of the labor market was closely related to fiscal policy, Mr. Zecchini noted. The staff had argued that the system of public transfers, the marginal tax rate structure, other impediments to wage differentiation, and additional rigidities reduced the possibility of efficiently utilizing the labor force. Those structural difficulties had been compounded by the recent rapid growth in the labor supply and by the tendency on the part of producers to reduce the labor intensity of the production process. Such action ran counter to the need for a more labor-intensive economy as stressed by Mr. Polak in his opening statement.

It was difficult to make policy recommendations in the area of labor legislation and wage practice as there was a trade-off between strengthening efficiency and increasing competition and the desire of the labor force to ensure job security and adequate income levels, Mr. Zecchini commented. At some point, which was not always easy to identify, a judgment based on technical considerations ceased to be relevant and the realm of collective preferences was reached. The Netherlands authorities had proceeded in the right direction by favoring an expansion of work-sharing arrangements and part-time job opportunities. In addition, a greater degree of decentralization in both wage determination and labor practice in general would undoubtedly help to gradually absorb the excess labor supply.

The staff representative from the European Department remarked that the disagreement between the staff and the authorities regarding fiscal policies stemmed from the fact that the data available on fiscal policy were unclear. The staff did not intend to imply that no action had been taken on the expenditure side; if policies of expenditure restraint had not been implemented since 1982 there would clearly have been a more extreme expansion of expenditure. The expenditure cuts made in 1983 had been at the local level, and had been largely associated with investment expenditure, in part because of the completion of large investment projects. Some cuts had been made in social security contributions. But the staff was particularly concerned that the improvements had been less than targeted by the authorities. Central government expenditures had been reduced from 46 percent of NNI in 1983 to 45.8 percent in 1984, a marginal decrease that had been due largely to the better than expected cyclical performance. The deficit had been reduced primarily as a result of the increase in revenues associated with the profits on gas revenues and improved economic performance. Government expenditures in 1986 were expected to be larger than projected, resulting in only a small decrease in central government expenditure as a proportion of NNI. The staff was also concerned because the overhaul in the social security system in 1986 would result in certain expenditures being shifted from the Central Government to the social security accounts, which would result in an initial cut in expenditure but a later increase in the collective burden.

The early retirement schemes were expensive directly, both to the enterprises and to labor, and, indirectly, in terms of the losses of experienced personnel, the staff representative went on. The early retirement schemes were organized by sector, based on contributions by workers and entrepreneurs. Contributions had increased from 0.6 percent of the wage bill in the late 1970s to 2.8 percent of the wage bill in 1983. In that way, funds were being moved from those who were employed to those who were being supported by the society at large. The staff was uneasy that the data might lead to a sense of complacency before the actual "trend bending" had been achieved. The difficulties experienced by the authorities in implementing the planned expenditure cuts did not augur well for their ability to undertake even greater cuts in expenditures that would allow them to reduce taxes, as a number of Directors had suggested.

The gray economy had an important escape-valve effect, as in other countries with high unemployment that were not experiencing the social tension that usually arose as a result of high unemployment levels, the staff representative indicated. Wage compression and labor sharing encouraged individuals to hold secondary jobs, a development that had a negative effect on productivity. The lack of wage differentiation, coupled with a progressive tax scale, encouraged individuals to look for jobs in the gray economy. Social security disbursements played a more important role than wage differentiation in the rigidity of the labor market. Both problems would, however, have to be addressed.

On the exchange rate, the difference of view between the staff and the authorities was not as great as Directors had indicated, the staff representative stated. The staff had said that it would support an appreciation of the guilder if and when the opportunity arose, implying that such action would be desirable if there were to be another realignment in the EMS. An appreciation of the guilder could well have a positive effect on export performance, particularly in the nontradable goods and services sector. The staff did not anticipate an increase in market shares, but considered that an increase in enterprise profitability was likely. Investment would therefore be revived and productive capacity increased. A small appreciation of the guilder would have an effect on interest rates and the distribution of employment and investment within the country. The short-term effects of a depreciation of the dollar would be minimal, as the resulting loss of export revenues arising from lower export prices and reduction in export volume would be offset by a larger fall in import prices.

As for the medium-term projections and simulations of different policy alternatives and their effect on the economy, the staff had not included the projections of the Central Planning Bureau in its paper but would make them available to Directors, the staff representative remarked. The Central Planning Bureau had reservations about the results of the models. The staff was also concerned about the monetary side of the models, including the lack of data on the balance sheets of enterprises and on household saving as distinct from saving by enterprises. The Netherlands Bank was trying to improve data collection in those areas, but the information would not be available for some time and the staff would not be able to present a time series.

The staff had not presented a medium-term balance of payments or fiscal projection as the Netherlands authorities did not borrow in foreign currencies, the staff representative indicated. The staff report included a table on policy targets, assumptions, and estimated interim outcomes for various economic indicators. As the staff had agreed with the authorities' formulation of the targets, it had not included any further analysis in the staff paper.

It was difficult to determine the effects of a reduction in the minimum wage for youth, the staff representative commented. The minimum wage had been adjusted in conjunction with other measures aimed at stimulating youth employment, including apprenticeship schemes, which allowed firms to pay less than the minimum wage, and work-sharing agreements with the enterprises in which younger workers were hired at lower wages.

With regard to interest rates developments, the yield curve in the Netherlands was relatively flat partly owing to the exchange rate and partly to low inflationary expectations, the staff representative from the European Department remarked. The real rate of return on long-term maturities was very high. The Government was currently lengthening the maturities of its bonds, while enterprises were engaged in short-term borrowing.

Mr. Polak remarked that one of the major issues facing the authorities was how to encourage more rapid economic growth. He agreed with a number of speakers who had suggested that the Government should cut expenditures further and lower taxes and social security contributions. There were enormous difficulties, however, in reducing expenditures, and the authorities were unable to take further action in that area. Economic recovery therefore depended on a revival of investment, particularly private investment. To that end, rigidities in the labor market should be reduced, especially regarding hiring policy, and the authorities should build up the confidence of entrepreneurs with respect to the success of their present policy stance. The authorities' aim was to reduce the budget deficit; they were opposed to stimulating demand further. A reduction in interest rates would also promote investment. However, interest rates could not be reduced through a more relaxed monetary policy, as a number of Directors had suggested. He did not believe that the operation twist or overfunding would have much impact on interest rates.

With respect to exchange rate policy, Mr. Polak recalled that at the time of the previous realignment within the EMS, about two years previously, the Netherlands authorities had favored moving the guilder to the level of the deutsche mark, but the Ministry of Finance had maintained the guilder at a lower level than the deutsche mark. That action had not improved exports and had led to uncertainty on the part of foreign and domestic investors regarding the future of the guilder vis-à-vis the deutsche mark. There was general agreement in the Netherlands' Government that such action would not be repeated, but he would not go so far as to say that the guilder would be allowed to appreciate vis-à-vis the deutsche mark at present. The Netherlands Bank was of the view that there was room for an improvement in the perception of the exchange rate of the guilder vis-à-vis the deutsche mark. However, there was no intention to manipulate the exchange rate, as that could create expectations that the guilder would depreciate again. The authorities recognized that any exchange rate action would have only a marginal effect on the current account.

He welcomed Directors' comments on the problems of the labor market, Mr. Polak remarked. The proposed social security reforms would be considered by Parliament in September 1985.

Contrary to some speakers' suggestions, the authorities were not complacent, Mr. Polak commented. Unfortunately their gradual approach to expenditure cuts was overshadowed by overruns in certain categories of expenditure which could not readily be controlled under present legislation.

Moonlighting in the underground economy was not as widespread as some Directors believed, Mr. Polak indicated. Individuals working in the gray economy were generally not employed in the open economy. The underground economy softened the impact of unemployment but undermined the general scope of the tax system. There was therefore good reason for the authorities to try to reduce the large role of the gray economy, perhaps through a reduction in the high marginal tax rates and social security contributions. Little action had been taken in that regard, however, because the Government's primary aim was to reduce the government deficit.

He thanked Directors who had commented favorably on the liberal trade policy of the Netherlands authorities and their provision of ODA, Mr. Polak commented. His authorities did not take the view that cutting government expenditure must necessarily lead to a reduction in foreign assistance.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/66 (4/29/85) and EBM/85/67 (5/1/85).

2. COST OF LIVING SUPPLEMENTS FOR PENSIONERS, EFFECTIVE MAY 1, 1985

The Executive Board approves the recommendations regarding the payment to the Staff Retirement Fund of the amount required to fund the difference between the amount prefunded under the Plan and the cost of living supplement to be effective May 1, 1985, as set forth in EBAP/85/108 (4/26/85).

Decision No. 7965-(85/67), adopted
April 30, 1985

3. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 84/116 are approved. (EBD/85/106, 4/24/85)

Adopted April 30, 1985

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/85/107 (4/26/85) and EBAP/85/110, Correction 1 (4/30/85) is approved.

APPROVED: February 14, 1986

JOSEPH W. LANG, JR.
Acting Secretary