April 14, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/10-3

12:00 p.m., February 8, 2019

3. Kingdom of the Netherlands—Netherlands--2019 Article IV Consultation

Documents: SM/19/12 and Correction 1; and Supplement 1; SM/19/13; and Correction 1

Staff: Dorsey, EUR; Murgasova, SPR

Length: 1 hour, 9 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
M. Raghani (AF)	
G. Lopetegui (AG)	
N. Ray (AP)	
	P. Fachada (BR)
	Y.Liu (CC), Temporary
	P. Moreno (CE)
	A. McKiernan (CO)
	C. Just (EC)
	A. Castets (FF)
S. Meyer (GR)	
S. Gokarn (IN)	
D. Fanizza (IT)	
	Y. Saito (JA)
	M. Daïri (MD)
H. Beblawi (MI)	
	R. Doornbosch (NE)
T. Ostros (NO)	
	L. Palei (RU)
	B. Alhomaly (SA), Temporary
J. Agung (ST)	
P. Inderbinen (SZ)	
	D. Ronicle (UK)
	P. Pollard (US), Temporary

G. Tsibouris, Acting Secretary
H. Malothra, Summing Up Officer
E. Mannefred, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
European Central Bank: A. Meyler. European Department: G. Baric, R. Chen, A. Cuevas Camarillo, E. Detragiache, T. Dorsey, A. Fouejieu Azangue, J. Kozack, A. Musayev. Legal Department: N. Rendak. Strategy, Policy, and Review Department: Z. Murgasova. Alternate Executive Director: P. Rozan (FF). Senior Advisors to Executive Directors: W. Abdelati (MI), M.Gilliot (FF), N. Jost (NE), W. Kuhles (GR), R. N'Sonde (AF).

Advisors to Executive Directors: J. Corvalan (AG), A. Grohovsky (US), J. Hanson (NE), M. Josic (NE), P. Mooney (CO), M. Mulas (CE), A. Park (AP), A. Urbanowska (SZ), N. Vaikla (NO), J. Montero (CE).

3. KINGDOM OF THE NETHERLANDS—NETHERLANDS--2019 ARTICLE IV CONSULTATION

Mr. Doornbosch and Mr. Hanson submitted the following statement:

The Dutch authorities would like to thank staff for the constructive policy dialogue, their insightful report and their timely and interesting set of Selected Issues Papers.

The Dutch economy experiences an expansion which is increasingly driven by domestic demand. Private consumption was the main driver of economic growth in 2018, benefitting from real disposable income growth at its highest level since 2001. Fiscal policy also supported growth, as the 2017 coalition agreement results in an expansionary fiscal policy over the coalition period until 2021. Unemployment is expected to decrease to 3.6 percent in 2019. The authorities agree with staff that growth will moderate to its potential over the forecast horizon and share their assessment of international risks to the outlook, in particular those related to an unorderly Brexit and escalating trade conflicts.

Labor market tightness and income tax cuts translate into an increase in real disposable income. Real disposable income stagnated between 2002 and 2013, growing by 0.2 percent per year on average, but recovered between 2014 and 2017 to an average rate of 1.7 percent. Income inequality remained stable at a relatively low level over the past 15 years. The authorities expect wage growth to accelerate from 2.1 percent in 2018 to 3.0 percent in 2020. In addition, a simplification of the income tax schedule from four to two brackets, a reduction in tax rates and an increase in tax credits will substantially alleviate the tax burden for households. This will further support real disposable income, which the authorities forecast to grow by 2.0 percent on average per year between 2018 and 2020, resulting in a cumulative increase of 13 percent from 2013 to 2020.

The authorities welcome staff's analysis of reforms, which can feed into their reform agenda. Staff's analysis of pension reforms, labor market reform and the housing market is broadly in line with the priorities of the government and forms a useful input for ongoing policy debates. We would like to make the following additional remarks about the reform priorities of the government:

Working towards a more balanced labor market: Self-employment is more prevalent in the Netherlands than in other EU Member States. The group of self-employed is diverse: it includes high-skilled entrepreneurs, but also more vulnerable workers. The government aims to address bogus self-employment and will reduce tax incentives for self-employed. The government also intends to improve the balance between fixed and flexible employment by making open-ended contracts more attractive for employers and flexible work more secure.

Mitigating CO2 emissions: The authorities committed to reduce CO2 emissions by 49 percent by 2030 relative to 1990. They increased environmental taxes and a draft proposal for a Climate Agreement with further measures prepared by stakeholder organizations was presented last December. Its effects on emissions and the economy are currently analyzed. Climate risks in the financial sector are high on the agenda of the Dutch central bank.

Combating tax avoidance and tax evasion: The Dutch tax system reflects the international orientation of the economy. The system includes arrangements to prevent that the same income is taxed twice in two different countries, such as the double participation exemption mentioned by staff. This is one of various reasons that makes the Netherlands an attractive location for multinationals, alongside proximity to large markets, an educated labor force and an enabling business environment. An unintended consequence of the system is that companies abuse it to avoid paying taxes in other countries. The government is committed to address this problem. The authorities will introduce a withholding tax on interest rates and royalties to low tax jurisdictions. The authorities will also increase transparency about international tax ruling.

Improving the functioning of the housing market: The housing market tightens while mortgage debt remains elevated. Therefore, the housing market requires close monitoring and continuous efforts to maintain financial stability. To further reduce household debt, the government will significantly accelerate the phasing down of mortgage interest deductibility from 0.5 percentage point per year to 3 percentage points per year. To support housing supply in the private rental market, the government is introducing legislation to make it easier for housing corporations to build in the middle segment of the rental market alongside private parties and is exploring options on how to tackle excessively high rental prices locally.

Reforming the pension system: As staff mentions, the Dutch pension system is considered as one of the world’s strongest systems based on its high participation rates, retirement income adequacy and sustainability. The government is committed to reform the Dutch pension system to make it compatible with today's dynamic labor market, reduce tensions between generations, enhance macroeconomic stability and restore trust in the system. Therefore, the government recently announced it will start preparing legislation and guidelines for transition plans to a system that reduces intergenerational transfers.

The high current account surplus cannot be easily explained by policy distortions or the EBA model. The unexplained residual of 5.4 percent in the EBA model fully "explains" the gap of the surplus with the EBA norm range. The savings surplus is largely driven by corporate savings. Positive household net savings correspond with staff's recommendation to reduce household debt, while the positive fiscal stance aligns with the objective of cyclical stabilization. The Selected Issues Paper shows that the high corporate savings are dominated by a few multinationals. Many of these multinationals are rooted in the Netherlands but have a high share of foreign ownership, reflecting the open nature of the Dutch economy.[1] Their retained earnings are fully assigned to the Dutch savings surplus, even if they are used for investments by foreign subsidiaries, and also if their shareholders are foreign. This counterintuitive statistical treatment of multinationals complicates the economic interpretation of their savings.[2] We agree with staff that separating multinationals from the external sector assessment would benefit the analysis of underlying policy distortions and we encourage further work in this area.

Government policy supports SMEs, while their access to finance is improving. The government will reduce the tax burden for SMEs through a reduction in the corporate income tax rate, financed by broadening the tax base in a way that mainly affects large corporations. Access to finance for SMEs is improving. Credit provision to SMEs increases since end-2017 and the loan rejection rate of 12.4 percent in 2017 reported in the staff report dropped to 2.7 percent in 2018. The coalition agreement foresees a structural increase in investment in education, research and innovation, amounting to 1.9 billion euros in 2019. Sustaining and increasing public R&D over the medium-term remains a priority of the authorities.

The financial sector is resilient, but institutions should continue to build capital buffers. The 2018 EBA stress test results show resilience of the banking sector, in line with the conclusions of the 2016 IMF FSAP. The

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[1] See e.g. chart 13 in Eggelte, J., R. Hillebrand, T. Kooiman and G. Schotten (2014). "Getting to the bottom of the Dutch savings surplus". DNB Occasional Studies Vol. 12-6.

[2] Avdjiev, S., M. Everett, P.R. Lane and H.S. Shin (2018). "Tracking the international footprints of global firms" BIS Quarterly Review, March 2018.

average stress test impact of Dutch banks is similar to the EBA average and in line with peer countries. Nevertheless, low start levels lead to low absolute leverage ratios in adverse scenarios. Given the financial uncertainty and in the context of preparations for new regulation on internal risk models, we therefore support staff's recommendations to banks to further strengthen leverage ratios and to continue building buffers.

Like last year, it was difficult to have a meaningful discussion about fiscal policy, as staff's advice on the use of fiscal space disregards the Dutch fiscal framework. The Dutch fiscal framework is based on multiannual real expenditure ceilings and a multiannual revenue framework. These are determined for the full government term and allow for predictability and transparency. Automatic stabilization takes place on the revenue side of the budget. The framework complements the EU Stability and Growth Pact and has been acclaimed by international institutions including the IMF.[3] [4] The national fiscal framework limits the ability of the government to use discretionary fiscal policy during its term. Staff's focus on its narrow definition of fiscal space in discussions with the authorities made it difficult to have a substantive dialogue about fiscal priorities. In any case, available fiscal space is negligible: the authorities forecast a structural balance of -0.4 percent in 2019, against an objective of -0.5 percent under the European rules. In addition, the economic upswing warrants the build-up of buffers because the open Dutch economy is relatively exposed to external risks, as highlighted by staff, translating into a highly cyclical budget balance.

Mr. Meyer submitted the following statement:

We thank staff for their informative set of papers in the context of the Netherland's Article IV consultation. We also thank Mr. Doornbosch and Mr. Hanson for their informative buff statement.

The Dutch economy's performance has been robust with strong growth and the unemployment rate decreasing to a decade low. Banks are well capitalized and healthy, and the government has rapidly rebuilt fiscal buffers which put them in a good position to weather potential shocks. At the same time, the economy faces structural challenges. Staff adequately highlights the high current account surplus and the duality in the labor market. Households'

[3] Eyraud, L., X. Debrun, A. Hodge, V. Lledó, and C. Patillo (2018). "Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility and Enforceability" SDN/18/04.

[4] IMF (2006). "Kingdom of the Netherlands—Netherlands: Report on the Observance of Standards and Codes—Fiscal Transparency Module, and the Aide-Mémoire Regarding the Fiscal Framework", IMF Country Report, Issue 06/124.

indebtedness continues to be very high which exposes them, and indirectly banks, to developments in the real estate market. Against this background, we agree with staff that more needs to be done to reduce imbalances, promote public R&D, reduce labor market segmentation and enhance productivity growth.

Macroeconomic developments

The Netherlands is enjoying fast paced growth that is likely to continue. The Dutch economy has been growing above its potential rate for several years now, benefiting from growing external demand and, more recently, from a rapid recovery in consumption and private investment. This broad base for growth is welcome in the context of rising risks of a slowdown in global demand. Given this prospect of growth continuing to shift more towards domestic demand at the current juncture, staff projects a moderate decline in the otherwise very high current account surplus – at around 10 percent of GDP, a large part of which seems to be related to the savings and investment decisions of large multi-national companies domiciled in the Netherlands, but the household sector also plays a role. Despite the unemployment rate dropping to the low single digits, wage and price inflation have been subdued, possibly owing to the high portion of temporary employees and self-employed which makes the labor market more flexible. Staff comments suggest that they expect these dynamics to change and wages to pick up as the labor market tightens further.

Fiscal policies

The Netherlands has substantial fiscal space and we support staff's recommendation to increase households' disposable income while taking into account fiscal pressures from population aging and the fiscal rules. We concur with the Dutch authorities that economic good times should be used for rebuilding fiscal buffers and commend them for putting public debt on a rapidly declining path. The structural budget balance is set to decline from around 1 percent of potential GDP in 2017 to roughly balance or slightly negative in 2019. We note the reshuffling of tax revenues in the 2019 budget and welcome the increased spending on education and regional development. These measures could also contribute to lowering the persistent current account surplus. However, the available distance to the medium-term objective (MTO) could be smaller than staff suggests due to the uncertainty linked to potential GDP estimates and the Dutch budget's relative sensitivity to macro-economic fluctuations. Finally, while fiscal measures with the long-term goal of increasing productivity may help private sector deleveraging there is also the need to avoid pro-cyclicality and consider the fiscal implications of population aging.

Financial market policies

Banks are adequately capitalized, around euro area average, but their high exposure to wholesale funding and the real-estate sector poses challenges. Bank profitability has increased, and their capital ratios are around the euro area median. Given the financial uncertainty and in the context of preparations for new regulation on internal risk models, we support staff's recommendations to banks to further strengthen leverage ratios and to continue building buffers. It is worth noting in this regard that the current low aggregate leverage ratio according to the European Banking Authority stress test results quoted by staff are heavily impacted by the inclusion of two Promotional Banks, which to a large part have assets that consist of zero risk-weighted loans to the Dutch public sector. Apart from these two banks, the leverage ratio of all Dutch Significant Institutions remains above 4 percent in the third year of the adverse scenario. At the same time, the financial system continues to be exposed to risks emanating from the real estate sector and household indebtedness remains very high. We therefore agree with staff that further tightening of borrower-based prudential measures should be considered. More structurally, we see scope for the full and timely phasing out of the mortgage interest deductibility (MID), as this is the main policy distortion and constitutes a substantial debt bias for households. While we welcome the authorities' intention to speed up the reduction in the MID to the maximum applicable rate of 37 percent by 2023, a generous subsidy on mortgage debt would remain.

Structural policies

The current account surplus remains large and persistent, although a large part is explained by the activities of multinational companies. We welcome staff's detailed assessment, which underscores the assertion that the large and increasing savings of multinational companies (MNC), a global trend, have an important impact on the current account surplus. The Fund's EBA model itself leads to a large unexplained residual that should be taken into account when formulating policy recommendations. Against this background, we welcome the authorities' intention to further improve statistics in order to separate the impact of multinationals. This could help improve the estimates of the current account balance, which is potentially overestimated, and could also explain why Dutch MNCs spend less of their savings on domestic business investments than similar MNCs in other countries, as mentioned in the selected issues paper. At the same time, more work is needed to understand the underlying factors behind the savings behavior of Netherlands-based MNCs. Currently all institutional sectors are in surplus. While corporations make the largest contribution to the surplus over time, the government and household sectors are largely responsible for the post-crisis increase in the current account balance. The government implemented substantial fiscal consolidation, while the household sector reduced residential investment and spending following deleveraging pressures. The large pension system is likely to be another important factor that, with high mandatory contributions reducing disposable income, contributes structurally to the current account surplus and affects household consumption in a pro-cyclical way.

Given the intertwined nature of imbalances in the Dutch economy and the potentially mutually reinforcing nature of reforms it is important to pursue the right policy mix for the Dutch economy. This year's and previous Article IV reports highlight the complex impact certain tax policies and labor laws have on the Dutch corporate sector, the labor market and the pension system. For instance, exemption for the self-employed from payments to the disability and pension insurance schemes may help promote entrepreneurship and labor participation of those groups who would otherwise stay away from the labor market. Similarly, interest deductibility for households can generate additional investments in real estate. However, these policies may also contribute to the segmentation of the labor market, the indebtedness of households and the decreasing participation in social insurance schemes. Permanent contract employees receive much higher employment protection than temporary staff and the self-employed, creating labor market segmentation. We welcome efforts by the authorities to reduce the negative impact of these regimes by, e.g. simplifying and reducing personal income taxation, gradually reducing interest deductibility and trying to reform the second pension pillar. Also, a draft bill has been sent to Parliament that aims at reducing the differences between hiring under a permanent or a temporary contract. Thus, we agree with staff that the government should avail of the current favorable economic and fiscal position to enact reforms that reduce the duality of the labor market, support households' purchasing power, increase the supply of housing, promote investments and reduce the private sector's reliance on debt financing. Finally, we welcome the authorities' efforts to mitigate CO2 emissions in line with their Paris Agreement commitment.

Mr. Daïri and Mr. Osei Yeboah submitted the following statement:

We thank staff for the high-quality papers, and Mr. Doornbosch and Mr. Hanson for their insightful buff statement.

Prudent macroeconomic policies amid strong fundamentals have helped the Netherlands deliver a strong performance, with growth above euro area average, low unemployment and inflation rates, and comfortable fiscal and external buffers. The near-term outlook is for a moderation of growth toward potential, but the outlook is subject to downside risks stemming from a potential weakening of global demand, increased trade protectionism, a disorderly Brexit, and tightening of global financial conditions, which would also impact highly leveraged households, with knock-on effects on the domestic financial system. We agree that fiscal policy should remain supportive in 2019, while structural reforms should continue to focus on addressing the imbalances in the labor market and the housing sector and fostering productivity growth, which will help raise potential growth and reduce the large current account surplus. We are in broad agreement with the staff appraisal and offer the following comments.

The high current account (CA) surplus continues to feature prominently in the policy discussion, with divergent views between staff and the authorities on the available fiscal space that can be used to reduce the CA surplus. While the EBA model shows a CA surplus of 6.6 percent of GDP above the norm, staff indicates that a large part of the gap can be explained by the role of large foreign-owned multinational corporations (MNCs) that are domiciled in the Netherlands, generate the bulk of the corporate sector savings, but invest mainly in global equity, as detailed in the interesting SIP. Could staff indicate how an unorderly Brexit could impact the performance of MNCs in the Netherlands? Conversely, only a small part of the CA gap is attributable to identified fiscal policy deviation from the norm. We agree that the external sector assessment should usefully exclude MNCs from the analysis and see merit in further research to clarify their statistical treatment.

Staff argues that further procyclical expansion is needed and would not put at risk debt consolidation or macroeconomic stability, given subdued wage growth and low inflation. We note the indication by Mr. Doornbosch and Mr. Hanson that the “available fiscal space is negligible” and believe that the appropriate mix of fiscal measures and structural reforms is a matter of judgment that should take into consideration institutional constraints and long-term issues, such as population aging. That said, we welcome the planned reduction in the labor tax wedge and the unification of the VAT rates and see merit in implementing a revenue neutral rebalancing of tax policy that reduces personal income tax to boost household disposable income and lessens household indebtedness. We also support ongoing efforts to combat tax avoidance and tax evasion and applaud the authorities' environmental tax efforts.

We take a positive note of the improvement of the banking system soundness in recent years but agree that it remains exposed to several risks stemming from high leverage compared to peers, heavy reliance on whole-sale funding, and high concentration on mortgage lending in an environment of elevated housing prices. Building capital and liquidity buffers will help strengthen the resilience of the financial system as will efforts to address the high housing prices and household debt through macroprudential policy, tax measures to reduce the debt bias, and increased supply of housing units. Like staff, we underscore the importance of effective AML/CFT supervision to ensure compliance with regulations in cooperation with international partners.

Investment in infrastructure, public R&D and lifelong learning, and support of SMEs are critical to boost productivity and wage growth. Reducing the labor market dualism and reforming the pension system to provide equal social protection to part-time workers and the self-employed would be helpful.

We wish the authorities continued success in their endeavors.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

The Dutch economy continues to enjoy strong growth above the euro area average, driven by net exports and a recovery in consumption and investment. Unemployment is low, and disposable income growth has improved. Yet, the very large current account (CA) surplus reflects imbalances in the household and corporate sectors and exposes the economy to external risks. This chair has persistently highlighted the asymmetric impact of large European surpluses on euro area deficit countries and global imbalances. We broadly agree with staff's thorough analysis and policy recommendations. In particular, we fully agree that efforts to raise wages and productivity growth, strengthen the attractiveness of domestic investment, and lower household debt would help to reduce imbalances.

At nearly 10 percent of GDP last year, the Dutch CA surplus is one of the highest in the world. We appreciate staff's analytical work in the Selected Issues Paper to better understand what is driving the high corporate savings rate, which is clearly a factor in the high CA surplus. Staff conclude that the complicated holding structures of MNCs make it difficult to accurately document retained earnings outflows attributed to foreign shareholders, potentially leading to an overestimation of the surplus. We urge further work in this area, both by staff and the national authorities, to focus efforts on addressing policy distortions to reduce imbalances. Recognizing more data is needed, do staff have an estimate of the magnitude of the potential overestimation? Further, we note that the CA surplus has risen from an average of 3.7 percent of GDP from 1980 to 2008, to nearly 10 percent. Could staff provide more context on how MNC activities versus other policies contributed to the rise?

Expansionary fiscal policy has been supportive of growth. But with low financing risks and a comfortable level of gross debt, we agree with staff that the Netherlands still has “substantial fiscal space” to invest in areas that raise productivity. We fully support the assessment of fiscal space initially in economic terms without considering fiscal rules.

Messrs. Dornbusch and Hanson highlight that the Dutch national fiscal framework further binds the authorities’ spending efforts on top the Stability and Growth Pact’s MTO in the medium term. Could staff comment on whether they view the divergence between the fiscal space assessment and the Dutch national fiscal rule to be significant enough to warrant consideration of the appropriateness of the fiscal rule?

We welcome the authorities’ focus on strengthening the SME sector, which will help to increase domestic investment opportunities. The planned reduction of the corporate tax burden on SMEs is welcome. We also agree with staff that a credit bureau for businesses would further increase access to credit and that R&D support should be directed to innovative, new SMEs with growth potential.

On the household side, we recognize that the authorities are already taking action to bolster disposable incomes, address high labor market duality, and reduce household debt. We welcome the authorities’ efforts to simplify the income tax schedule, reduce tax rates, and increase tax credits, although we agree with staff that the labor tax wedge should be further reduced. We also agree with staff that harmonizing tax and social protection treatment among different groups of workers would help to reduce labor market duality. Efforts to improve housing supply, combined with a reduction in the mortgage interest deduction, are sensible to improve housing affordability. We urge the authorities to stand ready to tighten macroprudential policies if needed.

Finally, we agree that the Dutch financial sector is resilient, but financial buffers should continue to be built and continued strong supervisory attention is warranted.

Mr. Beblawi and Ms. Abdelati submitted the following statement:

We thank the staff team for a well-focused report and relevant set of analytical papers, and Mr. Doornbosch and Mr. Hanson for the informative buff statement that provided additional insights.

We welcome the continued economic expansion, driven mainly by domestic demand, which surpasses the euro area average. We welcome the recovery of real disposable income which had stagnated between 2002 and 2013 and is expected to grow by 2 percent annually between 2018 and 2020. The current account surplus remains high at close to 10 percent of GDP, owning mainly to the savings of the multinational corporations. Notably, unemployment has reached a decade low, but wage growth remains contained.

Strong fiscal performance in recent years is commendable and helped sustain a low debt ratio. Staff calls on the authorities to use the substantial fiscal space to support potential growth and rebalancing. We note that consistent with Fund advice in the last Article IV, the fiscal stance was expansionary in 2018 compared to 2017 and the 2019 budget includes further spending on infrastructure, education, and research. However, there is continued disagreement between the staff and the authorities on fiscal space, which is a reoccurring issue that was discussed during the last Article IV. The buff statement refers to the absence of meaningful discussion because the staff disregards the Dutch fiscal framework. The authorities also suggest that the available fiscal space is negligible. We would appreciate further clarification from staff.

On labor market reforms, we appreciate staff's SIP on the subject, and support the recommendation to harmonize tax benefits and social security contributions for different types of employment to reduce labor market duality. We note the relatively high prevalence of self-employment in the Netherlands, and government efforts to reduce tax incentives for self-employed and make open-ended contracts more attractive and flexible work more secure. These are welcome steps consistent with staff advice.

On the housing market, we agree with the authorities and staff that close monitoring is needed and continuous efforts to maintain financial stability. We encourage the authorities to continue to tighten macro-prudential policies to reduce household indebtedness and to expedite reforms to increase housing supply.

We take note that government policy supports SMEs and their access to finance is improving. We also welcome the decline in the SME loan rejection rate from 12.4 percent in 2017 to 2.7 percent in 2018. We trust these efforts will help revive SME dynamism and business investment.

The buff statement touches on efforts to combat tax avoidance and tax evasion. The authorities plan to “introduce a withholding tax on interest rates and royalties to low tax jurisdictions” and to “increase transparency about international tax ruling”. We would appreciate staff views on the likely effectiveness of these measures.

Mr. Saito and Mr. Minoura submitted the following statement:

We thank staff for the comprehensive reports and Mr. Doornbosch and Mr. Hanson for their informative statement. We welcome that the Netherlands’ strong economic growth above the euro area average continues, supported by strong domestic demand, and the unemployment rate has reached a historical low. However, risks and challenges still remain, including spillover from Brexit, high household indebtedness and low productivity growth. As we broadly concur with the thrust of the staff’s appraisal, we will limit our comments to the following points:

Fiscal Policy and External Position

Given slow productivity growth and fiscal costs from population aging, we concur with both staff and the authorities that fiscal policy should focus on supporting potential growth and addressing imbalances while preserving long-term fiscal sustainability and creating buffers for downside risks. In this regard, we commend that the authorities’ 2019 budget plan aims at upgrading infrastructure and strengthening human capital through higher spending on education and research. Nevertheless, regarding the fiscal space and the medium term structural balance, there are differences of the views between the authorities and staff. How does staff treat the national budgetary framework when evaluating the fiscal space?

Regarding the Netherlands’ external position, we take note of an overestimate of the CA surplus stemming from corporate saving, mainly among a few multi-national companies (MNCs). We encourage staff’s further efforts to separate MNCs' activities from the Dutch current account to evaluate the external sector more precisely, collaborating with the authorities.

Labor Market and Structural Policies

We agree with staff that policy actions should aim at reducing dualism in the labor market to support wage growth and to maintain pension system sustainability. We would invite staff's elaboration on factors behind subdued wage growth and inflation other than the labor market dualism. It is encouraging that the government plans to decrease the labor tax wedge, harmonize VAT rates and reduce tax incentives for self-employed to the basic rate. Going forward, further efforts to lower the labor tax wedge by focusing on supporting low-income and second earners are important to reduce dualism and enhance labor force participation. At the same time, we take note that a pension system reform could help bring the self-employed into regular employment. In this light, we see merits in the pension reform proposed by the government which introduces a new pension contract based on personal pension accounts, complemented by provisions aimed at preserving appropriate risk pooling, complemented by provisions aimed at preserving appropriate risk pooling. Nevertheless, the authorities express their disappointment to the outcome of the latest discussions on the pension reform with the social partners. Could staff elaborate on the outcome of the latest discussions and possible refinements on a reform to increase social acceptance?

Given the large SMEs' presence in the Netherlands economy and the existence of structural barriers to growth, it is essential to support SMEs through incentivizing R&D, investing in digitalization and lifelong learning, and facilitating access to finance.

Financial Sector Policy

High household debt and elevated house prices continue to be threats to the Netherlands' macro-economy. While households' debt has stabilized at about 250 percent of net disposable income as macro-prudential policies were tightened recently, it remains the second highest among OECD countries. Although staff do not see that household overborrowing on mortgages is a significant source of systemic risk in the financial sector, household indebtedness and developments of house prices need to be monitored carefully. In this backdrop, we agree with staff that it is necessary to increase housing supply, tighten macro-prudential policies, and further reduce the debt bias in the tax system. It is a welcome step that the authorities plan to accelerate the phasing down of mortgage interest deductibility (MID) and we encourage the authorities' further phasing down of MID to address the current debt bias of households. Meanwhile, we would also like to know how the Netherlands could strike a right balance between lowering household debt and reducing household savings to address high CA imbalances. Staff's comments are welcome.

While we welcome that banking system soundness and profitability have improved in recent years, banking sector remains highly concentrating on mortgage loans, highly leveraged and dependent on wholesale funding. We concur with staff that continued building of capital and liquidity buffers should be given a priority. It is welcoming that insurance sector solvency has improved, but insurers remain vulnerable in the current low interest rate environment. In this light, the new national recovery and resolution framework for insurance companies is a welcome step to facilitate orderly resolution of insurance companies in the event of a disruptive shock. Moreover, given the Netherlands' position as a financial and corporate center, it is essential to ensure comprehensive compliance with AML/CFT requirements for financial institutions. As development of financial technology and cryptocurrencies poses new challenges, we encourage stronger coordination between national and the European authorities, investigators and other stakeholders including at the global level.

Mr. Ray and Ms. Park submitted the following statement:

We thank staff for the informative set of papers and Mr. Doornbosch and Mr. Hanson for their helpful buff statement. The Dutch economy has been growing strongly in recent years but is vulnerable to rising global protectionism or a disorderly Brexit. High household debt remains a vulnerability and slow productivity growth and low private investment are likely to weigh on potential growth. In this context, we agree that policy priorities include measures to enhance potential growth and increase the resilience of the household and financial sectors.

We are not convinced of the case to 'fully use' available fiscal space. As in previous Board discussions, we would caution against the suggestion that the existence of fiscal space suggests that it should be spent. Spending decisions should be made separately, taking the output gap and other circumstances into account. For the Netherlands, given the volatility of the economy and its high degree of openness, we see merit in preserving some fiscal space as a buffer to deal with potential adverse shocks as they materialize. Similarly, we see a need for caution in drawing policy conclusions from the external sector assessment for the Netherlands. The presence of large unexplained residuals reinforces the value of using judgement to take country specific factors into account. In this respect, staff's paper on the role of high savings by multinational corporations in explaining the current account surplus is useful and work underway to provide more granular information should assist in developing appropriate policy responses.

We encourage efforts to strengthen the resilience of banks and households, including though the use of those macroprudential tools most appropriate to the circumstances. We share the authorities' concern that hard limits on loan to valuation ratios may not always be the most appropriate instrument given that these measures have a greater impact on first-home buyers. If there is a perception that credit growth is excessive, asset price growth is unsustainable and lending conditions are loose, making higher borrowing costs for all borrowers desirable, we agree that there may be scope to explore increased risk weights on mortgages or the activation of the countercyclical capital buffer. In addition, there may be a case to bring the taxation of investment in housing into line with other assets.

Mr. Fachada and Mr. Fuentes submitted the following statement:

We thank staff for the reports and Mr. Doornbosch and Mr. Hanson for their helpful statement. Economic activity in the Netherlands continues to expand above the euro area average on the back of recovering consumption and strong private investment. Accommodative fiscal and monetary policies are bolstering domestic demand growth in a context of favorable labor market conditions and subdued inflation. Staff projections, however, suggest growth will moderate as the economy faces domestic imbalances in the household sector amid significant external downside risks.

Households indebtedness remains elevated and closely tied to housing affordability. The combination of high household debt and stagnant disposable income is increasing the vulnerability of private consumption to shocks. Against this background, we commend the Dutch authorities for the strong actions undertaken to lower the risk of household debt distress on financial stability and on domestic demand, including enacting income tax cuts to provide some relief to indebted households. Yet, additional measures to expedite an increase in housing supply are warranted to reduce price pressures and stimulate market dynamism. Similarly, further tightening of macro-prudential policies and measures to reduce the debt bias in the tax system could complement ongoing efforts to lower household indebtedness.

Fiscal discipline continues to buttress debt reduction. Sustained primary surpluses are contributing to the rapid decline in public debt-to-GDP ratio. We take note that, considering the robustness of public finances, staff recommends a more intensive use of available fiscal space, and we support plans to increase spending on public infrastructure in 2019. Nonetheless, we sympathize with the authorities' views that the national fiscal framework limits the use of discretionary fiscal policy and restricts the operational definition of available fiscal space. We encourage further discussions between staff and the authorities to find common ground on this critical issue.

Low potential output and sluggish productivity growth warrant further supply-side reforms. Like in most other advanced economies, productivity growth in the Netherlands has slowed down considerably in the post-crisis period, and the Dutch economy requires additional reforms to boost potential output. Planned budget support aimed at strengthening human capital through higher spending on education is a welcome development. For the medium-term, structural reforms and additional investment in R&D to boost innovation are critical to elevate productivity and bolster potential output. Addressing labor market duality to elevate flexibility and foster a more efficient alignment of market incentives are also critical to increase growth.

As a very open economy with close trade and financial ties with the United Kingdom, Brexit could have major economic consequences. The Netherlands' external position remains stronger than implied by medium-term fundamentals, anchored by the large operation of multinational companies domiciled in its territory. Yet, the country is highly exposed to any increases in trade barriers due to Brexit, given the strong bilateral trade and investment linkages with the UK. We commend the government preparation for potential Brexit, including the increased budget appropriations to enhance technical capacity and hire new staff for customs activities.

Mr. Lopetegui and Mr. Corvalan Mendoza submitted the following statement:

We thank staff for the report and the selected issues paper and Mr. Doornbosch and Mr. Hanson for the comprehensive buff statement.

We welcome the continued expansion of the Dutch economy above the euro area average, increasingly supported by private domestic demand and fiscal support. The labor market has tightened, but slow productivity is constraining wage and income growth. Large savings and low domestic investment by large multinational corporations result in a strong surplus of the external current account, above an external position in line with medium-term fundamentals and desirable policy settings, as assessed by the EBA methodology. The openness of the economy to trade, financial integration, high household leverage and wholesale financing in the banking system make the economy vulnerable to shocks affecting global trade and financial conditions. Could staff comment on recent developments regarding Brexit, its potential impact on the Netherlands, and the main issues authorities are focusing on in their contingency planning? This said, the country is in a good position to address medium-term challenges related to productivity growth, duality in labor markets, and the pension system. In the short term, growth is expected to slow and converge to potential over the medium term. Yet, from the report's tables, a positive output gap of 1.2 percent is expected to open in 2019 and remain at that level until 2024. Could staff elaborate on this assumption?

We welcome the analysis on "Corporate Savings in the Netherlands", and its relationship with the large current account surplus. Multinational companies are established in the Netherlands because of the attractive business environment, including regarding taxation, and they finance FDI abroad through retained earnings. If this story is right, and results in persistent current account surpluses, it is not clear to us that there is an appropriate policy prescription to secure a convergence to a lower current account, nor that it is desirable. Offsetting large savings in the MNC sector with dissaving in others—households, SMEs, or even the public sector—will certainly reduce the external surplus. Nevertheless, this could also result in domestic imbalances that could be hard to sustain over the medium term. In fact, household debt is already high, and public-sector accounts could worsen due to aging if an appropriate pension reform is elusive. In any case, the discussion in the staff report is thought provoking and the issue deserves further attention in future reports.

The key question for fiscal policy is whether and how to use fiscal space. The strong fiscal performance will result in a continued decline of the public debt ratio, a trajectory that may be warranted by the cyclical position of the economy. In this context, while preserving buffers to face possible external shocks is important in the current global juncture, there seems to be ample room to use the fiscal space to address medium-term challenges and spur productivity growth. Against the reported disagreement with the authorities, do they believe that the structural deficit under the Stability and Growth Pact of 0.5 percent of GDP over the medium term is not appropriate? While we understand the institutional constraints to implement discretionary fiscal policy, we believe that part of the ample existing space should be used, in the timeframe that the authorities find feasible, to contribute to enhancing medium-term growth, including through a lower tax wedge, necessary harmonization to reduce any undesirable bias towards self and part-time employment, R&D investment in the corporate sector—and possibly a lower tax burden—and human capital development.

We take positive note of the authorities plan to increase the housing supply. Faster growth of housing supply should be accompanied with market liberalization (rent controls) for a better functioning of the housing market, offsetting the possible social impact with means-tested benefits. We would also encourage the authorities to strengthen macro-prudential policies to gradually reduce the level of mortgage debt and welcome their decision to reduce mortgage interest deductibility.

While the banking sector appears sound and is profitable, high leverage and reliance on wholesale funding pose vulnerabilities. Continued building of capital and liquidity buffers is important to make the financial sector more resilient to shocks.

Given the role of the Netherlands as an international financial and corporate center, maintaining a strong AML/CFT framework is essential. We support staff's call for better coordination and removing impediments to information sharing with European authorities. Are there impediments to share information with jurisdictions outside Europe? What is staff's view regarding beneficial ownership transparency in the Netherlands? We welcome the commitment of the authorities to address abuse by companies to reduce their tax liabilities in foreign jurisdictions and to increase transparency.

With these comments, we wish the people of the Kingdom of the Netherlands every success in their future endeavors.

Mr. Inderbinen and Ms. Urbanowska submitted the following statement:

We thank staff for their candid set of reports and Mr. Doornbosch and Mr. Hansen for their helpful buff statement. We would like to offer the following comments for emphasis.

The Dutch economy continues to experience robust growth, driven primarily by consumption, investment, and strong net exports. However, growth is expected to level off at its potential over the medium term due to weakening global demand, rising trade tensions, and uncertainty surrounding Brexit. Domestically, demographic challenges and weak productivity growth cloud the medium-term outlook. Against this backdrop, the strong cyclical position provides an opportunity to focus on reducing imbalances and increasing productivity growth.

The authorities' fiscal stance appears adequate. The 2019 budget plan envisages spending on infrastructure, education, and research, while rebalancing tax revenues. We also note that the current fiscal policy stance remains supportive to the economy, without undermining long-term sustainability. In view of the closed output gap and potential external risks, we share the authorities' doubts on the need for additional fiscal spending. Commitment to fiscal discipline and the build-up of buffers during the upturn puts the Dutch economy in a better position to whether potential shocks.

The increase in corporate savings as a global phenomenon requires further study to better inform policy advice on the current account. We agree with staff and Messrs. Doornbosch and Hanson that determining whether corporate savings are correctly allocated to Dutch residents is necessary before formulating policy recommendations. If not, policies aimed at reducing perceived excess savings could induce unnecessary distortions. Understanding the drivers of corporate savings is especially important for countries like the Netherlands, where MNCs with complex organisational structures dominate the external sector. To that end, we fully support staff's work on measurement issues related to the current account. There is clearly scope for further work on the sources of measurement issues – both on sources already identified and those yet unknown. In the Selected Issues Paper, staff mentions two avenues of such work, on retained earnings, and on movable tangible and intangible assets. Could staff elaborate on the mechanism through which movable (both tangible and intangible) assets might lead to a bias in the current account?

Addressing private indebtedness and structural weaknesses in the housing market should be a priority. While we welcome the authorities' recent measures to increase housing supply, these may not to be sufficient to eliminate the housing sector imbalances. Tighter macroprudential policies, such as a gradual lowering of the loan-to-value (LTV) ratio and capping the debt service-to-income (DSTI) ratio, could help reduce the still elevated debt overhang in the household sector. Moreover, a reduction of the debt bias in the tax system could be considered.

We commend the authorities for their commitment to pension system reform. The shift to a defined-contributions system combined with safeguard measures will increase the pension system's predictability and transparency. This, in turn, will help address underlying structural problems, such as population aging and shortcomings in the labor market. Furthermore, the reform should help bring more self-employed workers back into the pension system as it offers more investment choice. Nevertheless, the reform's implications for overall financial stability should be given due regard. Given the high mandatory contributions and the low interest rate environment, pension funds may be enticed to invest in higher yield- and lower quality assets. Are the pension funds sufficiently supervised to avoid any regulatory arbitrage? Staff's comments would be welcome.

Mr. Agung, Mr. Tan and Mr. Anwar submitted the following statement:

We thank staff for the comprehensive set of reports, and Mr. Doornbosch and Mr. Hanson for their informative buff statement.

We commend the authorities for their strong policies and firm commitment to macroeconomic stability. Despite persistent external and internal challenges, the Dutch economy has remained resilient and continued to grow faster than the euro area average over the past few years. However, the economic outlook is susceptible to downside risks. As noted by staff and the authorities, these include disruptions to the global trade system, a possible no-agreement Brexit, weaker-than-expected global growth, a sharp tightening of global financial conditions as well as the developments in domestic housing market and household debt. Against this background, we concur that policy priorities should continue to focus on supporting potential growth and mitigating financial sector vulnerabilities, and offer the following comments for emphasis.

We take positive note that the authorities have steadfastly been using available fiscal space in a prudent manner. It is encouraging that the authorities' planned expenditure and tax policy measures are growth-friendly and that some of the expenditures are structural in nature. We note staff's reiteration to use the Netherlands' substantial fiscal space to address household and corporate imbalances. Given their track record, we sympathize, however, with the authorities' view for prudent fiscal policy over the long-term for the considerations outlined in the staff report and buff statement. Given the increased volatility of the Dutch economy as acknowledged by staff, we remain to be convinced of the need for further fiscal expansion without jeopardizing long-term fiscal sustainability.

Continuing reforms to labor market policies, the pension framework and tax systems are encouraged to address pressures on households' disposable income. We welcome the authorities' intention to reduce dualism in the labor market. This is a step forward and our views remain for the authorities to continue to explore opportunities in this space, including allowing the wage formation process to better reflect productivity and inflation expectations. Notwithstanding the authorities' disappointment with the outcome of the latest discussions on the pension reform with the social partners, we are heartened by the commitment to reform the system and the transition plans to reduce intergenerational transfers. On tax policy measures, we appreciate that the authorities are not amenable to lowering the labor tax wedge further while staff is of the view that labor income taxes remain comparatively high even after the planned reforms. We invite staff's comments on possible alternative measures that could be taken given the specific circumstances in the Netherlands.

Macroprudential policies and housing market reforms where appropriate will improve housing affordability and reduce household debt. The continuing observations of rapid house price increases and highly indebted households reinforce the view of structural challenges in the Dutch housing market. In this regard, we welcome the authorities' latest housing reforms which include, among others, increasing housing supply while giving due consideration to possible tighter macroprudential policies and implementing the phasing down of MID by 3 percentage point per year as of 2020. We note the differing views between staff and the authorities on the maximum LTV ratio. This is not new and we would appreciate it if staff could provide more context on the evolving discussion and pragmatic suggestions to take things forward.

Increasing bank capital and liquidity buffers is critical to help weather future shocks. We continue to share staff's view that banks are profitable but still highly dependent on wholesale funding. Specifically, the loan-to-deposit ratio remains high at above 120 percent despite declining substantially. This makes banks vulnerable to sudden shifts in global financial conditions. While the banking sector appears to be resilient based on the 2018 EBA stress tests, we support the authorities' commitment to urge significant banks to raise their leverage ratios, which are relatively low compared with peers in the euro area.

With these remarks, we wish the authorities continued success in their endeavors.

Mr. Ostros and Mr. Vaikla submitted the following statement:

We thank staff for well-written a set of reports and Mr. Doornbosch and Mr. Hanson for their informative buff statement. We broadly share staff's assessments and support its recommendations. We associate ourselves with the Gray statement of Mr. Meyer, but would like to make the following points for emphasis.

While the economic outlook is solid, the risks are tilted to the downside. The Dutch economy has in recent years witnessed strong growth, record low unemployment and solid domestic demand. However, due to its openness and close links with the United Kingdom through trade and cross-border investment, the Netherlands is particularly vulnerable to an unorderly Brexit.

We support using some of the fiscal space to increase productivity while we caution against implementing too pro-cyclical fiscal policy. We agree with staff that the Netherlands have fiscal space, which should be used to boost potential growth and to increase households' disposable income while respecting the fiscal rules framework. However, we concur with the authorities that given the Dutch economy´s openness and the elevated external risks, the current positive economic expansion should also be used to exercise prudent fiscal policy and to build fiscal buffers.

We note staff´s assessment that the Dutch current account surplus is partly driven by high corporate saving, which is dominated by a few multinational corporations (MNCs). We also take note, that due to challenges regarding recording retained earnings attributed to ultimate investors, the Netherlands current account surplus could be overestimated. To identify underlying policy distortions we agree, that more work is needed to fully understand the effects from MNCs' activities on the current account.

Greater harmonization of tax and social protection treatments would reduce the labor market segmentation. We welcome the authorities' plans to lower tax incentives for self-employment at higher income levels to reduce labor market duality. We agree with staff´s appraisal that the current pension system should be made more flexible to bring the self-employed into regular employment and thereby increase households' disposable income. Moreover, increasing full-time female participation in the labor market, by expanding availability of childcare and reducing tax disincentives for second-earners, would help to support labor supply in the currently overheated labor market.

We agree with staff´s appraisal that further measures are required to reduce household debt. High level of household debt could contribute to a sharp decline in private consumption during an economic shock, therefore measures to boost housing supply and stricter macro-prudential measures are recommended. On that note, we commend the authorities for accelerating the phasing down of the mortgage interest deductibility and encourage to decrease it to even lower levels to reduce household´s debt bias. Authorities should consider to increase risk weights on mortgages and lower the LTV ratio. Finally, we note that housing market developments require close monitoring to safeguard financial stability.

While the Dutch banking system is sound, further build-up of buffers is encouraged. We take note of staff´s assessment that the banking system is highly leveraged, dependent on wholesale funding and thereby vulnerable to shocks. Against this backdrop, we recommend to strengthen banks' capital buffers and improve resilience to shocks. Regarding the insurance sector, we welcome the new national recovery and resolution framework which enables to orderly resolution and thereby ensures financial stability.

Mr. Just and Mr. Stradal submitted the following statement:

We thank staff for their informative set of reports, and Messrs. Doornbosch and Hansen for their helpful buff statement. Economic growth in the Netherlands outpaced that of its euro area peers for the third year in a row and we commend the authorities for using the favorable environment for building fiscal buffers, as well as addressing some of the structural impediments to higher potential growth. The near-term risks are skewed to the downside and are largely external, including the disorderly Brexit which would have an outsized impact on the Dutch economy, as detailed in Box 2 of the Staff Report. We associate ourselves with Mr. Meyer's statement and offer the following additional comments.

We welcome the continued decline in the public debt ratio, as well as the intended rebalancing of tax revenues from direct to indirect taxes. We also appreciate the authorities' commitment to addressing the gaps enabling the tax avoidance by multinational corporations. We concur with using the available fiscal space to upgrade infrastructure and boost spending on education and research, which will enhance the potential output in the longer term. We underscore that full compliance with the Stability and Growth Pact and the national fiscal rules is essential for maintaining the credibility of robust fiscal frameworks.

We praise staff for their insightful analysis of the corporate savings, which goes a long way towards explaining the persistence of the high current account surplus. We encourage staff to continue this type of research which adds nuance to the External Balance Assessment methodology in other relevant countries. We also support further work on improving statistics and separating multinational corporations' activities from the external sector assessment, which would ultimately improve staff's policy recommendations.

Very high household indebtedness continues to be a cause for concern. We concur with staff's recommendation to reinforce the macroprudential framework in a timely manner by lowering the loan-to-value ratio below 100 percent, and introducing debt-to-income and debt service-to-income caps. In this vein, could staff comment whether comprehensive information on household debt is available which would enable the borrower-based tools? We also encourage the authorities to further reduce the mortgage interest deductibility to weaken the significant debt bias. Comprehensive housing market reforms, including housing rental deregulation, should complement the macroprudential measures by addressing the supply-side constraints.

The banking sector is generally resilient, but high exposure to the real estate sector combined with high reliance on wholesale funding persists. The continued buildup of capital buffers is warranted. We fully concur with staff that AML/CFT is a key financial stability and integrity issue, given the favorable environment attracting multinational companies. We welcome the authorities' commitment to prioritize the AML/CFT enforcement. Removing legal and operational barriers to cross-border information-sharing, in particular at the European level, is indeed essential to support effective AML/CFT enforcement at the national level.

We welcome initiatives aimed at reducing the long-standing labor market segmentation. Reducing tax and other incentives for the self-employed, as well as facilitating employees' transitions from temporary to open-ended contracts are steps in the right direction. The intended reforms of the pension system are dependent on the outcomes of the labor market reforms and should thus be considered in a comprehensive manner.

Mr. Raghani and Mr. N'Sonde submitted the following statement:

We thank staff for a well written set of papers, and Mr. Doornbosch and Mr. Hanson for their insightful buff statement.

It is heartening to note that the Dutch economy continues to grow at a sustainable rate, above 2.5 percent annually. Activity is supported by reviving domestic demand which, in turn, is sustained by a supportive fiscal policy stance, a vivid housing market and positive labor market developments. Robust exports also contribute to the strong growth. Unemployment is at a record low. We note however that wage growth has not kept up with the vibrant economy. The Netherlands' sound budgetary framework—which notably caps expenditures over 4-year periods—contributes to positive fiscal balances and to declining public debt. While the financial sector is sound, lending to the private sector is narrowing.

Looking forward, we welcome the favorable economic prospects but call on the authorities to address actual and looming vulnerabilities. Adverse demographic dynamics and slow productivity dampen potential growth. Moreover, household and corporate balance sheets warrant adjustments. There is also a need for external rebalancing as large corporate savings with low investment contribute to significant and persistent current account surpluses.

Furthermore, we note that risks to the outlook are skewed to the downside. These include rising global protectionism, slowdown in trading partners, a no-agreement Brexit, and tightening of financial conditions—which could prove acute for this largely open economy with an exposed financial sector. That said, we note that staff's Risk Assessment Matrix lacks any reference to any domestic risk whereas the authorities stress that developments in the housing market and the continued leveraging of households constitute non-trivial threats to the outlook. Staff's comments will be appreciated.

Against this backdrop, macroeconomic and structural policies discussed by staff and the authorities are rightly focused on lowering private and external imbalances, and boosting long-term productivity. We very much welcome measures already undertaken by the authorities, including their proposed pension reform to provide more choice, bring self-employed into regular employment, and hence reduce duality in the labor market. In the same vein, we welcome the tax policy measures aimed at decreasing the labor tax wedge and unifying VAT rates. On external rebalancing, the initiatives to improve statistics of special purpose vehicles with the view to better quantify the overestimation of the current account surpluses—as highlighted in the informative Selected Issues paper—go in the right direction.

As we broadly share the thrust of staff's appraisal and recommendations, we would like to make the following specific comments:

While fiscal policy has been appropriately used to address internal imbalances, notably through expenditure and tax measures, there are nuances that need to be smoothed out. Noting diverging views between staff and the authorities on the existence of fiscal space for additional measures to tackle these imbalances, and given the depressed wage growth, we encourage the authorities to pursue a supportive fiscal policy to the extent possible to reduce household leveraging, bring down housing prices and lift disposable income. As the fiscal space in question is significant (1/2 percent of GDP annually), we would welcome staff's elaboration on the methodological differences with the authorities.

We welcome the broad convergence of views between the authorities and staff on policies required to reduce household debt and improve housing affordability. We agree that these should be achieved through expanding housing supply, phasing out mortgage interest deductibility to lower the mortgage debt bias, and tightening macro-prudential policies. The latter policies should be based on appropriate instruments to bring down private debt ratios while maintaining access to ownership including for younger households.

Reducing duality and bolstering productivity and wage growth should be priorities in labor market reforms. We encourage the harmonization of tax and social protection treatments across types of employment, the provision of incentives for women labor force participation—including through affordability of childcare and adequate parental leave policies—and more generally incentivizing work. We also encourage the authorities to put in place their envisaged supply-side reforms and investment in R&D beyond 2019 to foster productivity and higher wage growth, while remaining engaged with social partners to achieve the desired objectives of the pension reform.

A more holistic approach to boosting business investment is warranted. While we agree with the need for the country to invest in digitalization and lifelong training and improve business creditworthiness information, we are of the view that freeing up the development of SMEs beyond the start-up phase will also require: (i) addressing the cumbersome labor market regulations; (ii) alleviating skill shortages through education and vocational training; and (iii) tackling the high interest rate margins on small loans that contribute to holding back SMEs' access to credit. Staff's elaboration on the measures being envisaged on these fronts, in any, are welcome.

As an open economy and financial center, the Netherlands would greatly benefit from increased international coordination to safeguard financial stability. We also welcome the government's commitment to combating tax avoidance and tax evasion as stressed in Messrs. Doornbosch and Hanson's buff statement. We encourage the authorities to ensure that bank buffers comply with national requirements which should be aligned with international standards. Coordination with relevant European and global bodies is also needed to ensure adequate AML/CFT safeguards.

Mr. Ronicle and Miss Chen submitted the following statement:

We thank staff for a thorough set of papers and Mr. Doornbosch and Mr. Hanson for their informative buff statement. We agree with the thrust of staff's recommendation and associate ourselves with the comments of Mr. Meyer.

The Dutch economy continues to perform robustly and the outlook is positive. Growth is steady, unemployment is low and inflation is expected to settle around 2 percent. The fiscal position is strong and debt is on a steady downward path. That should stand the Netherlands in good stead in the face of rising global risks. Nevertheless, and as staff point out, the Dutch economy is subject to a number of imbalances.

Household indebtedness remains high and acted as a constraint on consumption during the Financial Crisis. In that context, we note the authorities' actions to boost housing supply and phase out mortgage interest deductibility and staff recommendations to adjust the setting of macroprudential tools and will follow developments with interest.

Population aging is a key long-term challenge for much of the Fund's membership. We therefore welcome the selected issues paper on "Self-employment and support for the Dutch Pension Reform".

We were pleased to see the detailed analysis of corporate savings and the Dutch external position in the selected issues paper. The presence of large multinational corporations can make interpreting external flows and balance sheets complicated. We find the detailed assessment presented in the paper a welcome complement to the External Balance Assessment and a valuable contribution to our understanding of the Dutch current account surplus.

Lastly, we welcome the authorities continued commitment to making AML/CFT compliance a priority.

Mr. Moreno and Mr. Montero submitted the following statement:

We thank staff for its reports and Mr. Doornbosch and Mr. Hanson for their informative buff statement. We broadly share staff's appraisal and associate ourselves with Mr. Meyer's statement. We would like to add the following comments for emphasis.

The Dutch economy has experienced a period of strong growth, above the euro area average, driven by consumption, investment and net exports, which has resulted in solid job creation and an historically low unemployment rate. Both price and wage inflation have remained moderate, while the overall fiscal balance registered a third consecutive surplus and public debt continued to decline. Banking system soundness and profitability have also improved in recent years on the back of these favorable economic developments. The current account surplus remained among the highest in the world, driven by very high corporate savings and imbalances in the household sector. Despite increasing downside risks to the outlook, the current backdrop provides favorable conditions to address key distortions that impinge upon internal and external imbalances and hamper productivity growth. We welcome the authorities' efforts to tackle these problems with a broad reform agenda, although like staff we believe that further measures are needed in some areas.

We agree with staff that strong economic growth and prudent fiscal policy have allowed the Netherlands to build substantial fiscal buffers and to boost fiscal space. Thus, we favor staff's proposals to utilize this space to address imbalances in both the corporate and the household sector, which should be complemented with investments in support of supply-side reforms that improve productivity growth. A swifter correction of these imbalances would have positive spillovers on the other euro area economies, thus helping in intra-euro area rebalancing. Lastly, we take note of the reshuffling of tax revenues in the 2019 budget and welcome the increased spending on education and regional development. However, over the medium term, corporate taxation is projected to decline because of progressively lower CIT rates and higher PIT deductions. We are concerned about the possibility that this declining taxation may exacerbate tax competition and imbalances within the euro area. Staff's comments are welcome. As an aside, we note that staff considers certain contingent fiscal costs associated with the large financial sector in the assessment of the medium-term fiscal target. Could staff comment on what these costs are and how they affect the calculation of fiscal space?

Regarding households, weak growth in disposable income and rising housing costs are limiting domestic demand. We share staff's view that, besides low productivity growth, increased labor market duality and a high labor tax wedge have also contributed to slow wage growth. Thus, greater harmonization of the tax and social protection treatment of permanent employees, temporary workers and the self-employed—while increasing overall flexibility—should be pursued and would improve equity and efficiency. We also strongly support measures proposed to incentivize full-time women employment, such as expanding the availability of childcare, reforming parental leave policies and reducing tax disincentives for second earners. Lastly, we consider that authorities and social partners should work together to make wages more responsive to domestic macroeconomic conditions.

Rising housing costs—and high household indebtedness—are driven by the existence of distortions in both housing demand and supply. We share authorities' view that the priority is to increase housing supply, while at the same time giving due consideration to possible tighter macroprudential policies. We welcome their intention to ease zoning restrictions, facilitate building permits, and to better coordinate across different government levels, as well as the gradual reduction in mortgage interest deductibility (MID). Regarding the private rental market, could staff comment on what specific measures it has in mind to liberalize rent controls in this market? This notwithstanding, we see merit in staff's recommendation to set the maximum LTV ratio at or below 90 percent and to cap the DSTI ratio. Further phasing down of MID to a more neutral level would also be highly desirable.

The large current account surplus is mostly driven by high corporate savings, which in turn are concentrated in large firms, often MNCs, while relatively weak domestic investment might be reflecting a combination of low dynamism in the SME sector and the MNCs allocation of their savings for investment globally. As stressed by staff, it is difficult to disentangle these factors without adequate statistics to separate MNCs' activities from both internal and external accounts, which also makes it difficult to elaborate policy recommendations. Therefore, we encourage further work in this area by both staff and the authorities. Lastly, we welcome the authorities' intention to reduce the scope of the Netherlands to be used as a conduit for tax optimization schemes involving low-tax jurisdictions. A withholding tax on interest rates and royalties to low tax jurisdictions will be introduced and transparency about international tax ruling will also be increased. Could staff provide a preliminary assessment of these measures? Is there anything else that could be done?

Banking system soundness and profitability have improved significantly in recent years, but as stressed by staff, the sector remains highly leveraged, concentrated in mortgages, and highly dependent on wholesale funding. Therefore, continued building of capital and liquidity buffers should remain a priority, not the least to prepare for new regulation on internal risk models. Insurance sector solvency has also improved; however, life insurers remain vulnerable in the current low interest rate environment. We thus welcome the new national recovery and resolution framework for the insurance sector, which will be key to safeguard financial stability. Could staff elaborate on the main elements of this framework? Finally, given the role of the Netherlands as an international financial and corporate center, maintaining a strong AML/CFT framework is essential. We support staff's recommendations to make this framework more effective.

Mr. Alkhareif and Mr. Alhomaly submitted the following statement:

We thank staff for a set of well-written reports and Mr. Doornbosch and Mr. Hanson for their informative buff statement. Since we are in broad agreement with staff's assessment and recommendations, we would confine ourselves to the following comments for emphasis.

The Netherlands continues to experience strong economic growth, underpinned mainly by improved consumption, which is translating into low unemployment. Nevertheless, we note that growth is expected to slow down and that risks to the outlook remains tilted to the downside, reflecting the high vulnerability to the emerging economic challenges in the euro area and the global economy. To this end, we consider the emphasis in the staff report on reducing financial sector vulnerability, enhancing the business environment, and minimizing households' debt while increasing their disposable income to be appropriate.

On the fiscal side, we note the divergence of views between the authorities and staff. We note that policy traction in this area has not improved since last year. Therefore, we encourage further efforts to improve the dialogue between staff and the authorities regarding fiscal policy going forward. On the same note, while we see the point raised by staff regarding the recommended expansionary fiscal policy that would support growth potential without jeopardizing fiscal sustainability, we seek staff elaboration on the impact of such pro-cyclical policy in a very open economy that is exposed to important external risks.

The importance of SME sector, particularly in the Netherlands where it employs the majority of workers and contributes significantly to the economic activity, cannot be overemphasized. In this regard, we agree that priority should be given to providing support to R&D and establishing a business credit bureau to improve the availability of data and improve SMEs' access to finance. In addition, the authorities' plan to reduce the tax burden for SMEs is a step in the right direction.

We see merit in the recommended measures to increase housing supply, further reduce the debt bias in the tax system, and strengthen macro-prudential policies. The weak labor productivity growth and the increased labor market duality necessitate the need to reforme the labor market. In this regard, we welcome the authorities' plan to reform the labor market, including through improving the balance between open-ended and flexible contracts. We also take positive note of the planned measures to improve housing affordability and promote a decrease in household debt by reducing mortgage interest deductibility.

Finally, it is encouraging to note the improved resilience in the banking system and insurance sector, but important vulnerabilities remain. To this end, we welcome the agreement between staff and the authorities to further strengthen leverage ratios and continue building liquidity and capital buffers. In addition, we strongly support staff recommendations detailed in ¶31 and ¶42 to address the AML/CFT supervisory challenges, particularly by enhancing information sharing.

With these comments, we wish the authorities further success.

Ms. Levonian, Ms. McKiernan and Ms. Vasishtha submitted the following statement:

We thank staff for the insightful reports, and Mr. Doornbosch and Mr. Hanson for their comprehensive buff statement. The Dutch economy has performed well in recent years. However, slow productivity growth and imbalances in the household and corporate sectors highlight the need for further policy action. We generally agree with the staff's assessment and recommendations, and acknowledge that risks are tilted to the downside, notably stemming from a possible no-deal Brexit and escalating trade tensions.

External imbalances

We take note of the authorities' view that neither the Fund's EBA model nor policy distortions adequately explain the persistently high current account surplus position. As noted by staff in the Selected Issues paper and highlighted by the Dutch central bank's research findings, the high net corporate saving is dominated by a small number of MNCs. Further research is needed to better understand corporate behavior and identify policies to reduce corporate savings. We welcome the staff's recommendation to improve the underlying data and separate MNC's activities from both internal and external accounts to help identify policy distortions.

That said, the strong cyclical position provides an opportunity for policies to focus on reducing imbalances and raising long-term productivity growth, through boosting household disposable income, repairing private sector balance sheets, and strengthening the SME sector.

Fiscal space

We note the differences in view between the authorities and staff on the degree of available fiscal space, which is partly due to the Dutch budgetary framework. Notwithstanding this, the fiscal stance should be geared to the country's economic context, consistent with the approach in the fiscal space framework. We are sympathetic to the authorities' preference to build buffers instead of further fiscal expansion, given the highly open nature of the Dutch economy, which makes it vulnerable to external shocks. Moreover, fiscal costs from population aging call for prudent fiscal policy in the long run.

Labor market

Policies should aim at raising household disposable income and consumption, including by reducing labor market duality. While the prevalence of part-time and self-employment in the Netherlands – among the highest in the world – has provided flexibility to workers and helped reduce unemployment, these forms of employment are also associated with lower wages relative to the average. Since part-time work is particularly prevalent among women, policies should focus on increasing full-time employment for women by reforming parental leave policies, expanding the availability of childcare, and reducing tax disincentives for second-earners in full-time jobs.

Further, we take note of the measures being undertaken to reduce the institutional differences between standard and non-standard work. The authorities' plans to reduce tax incentives for the self-employed are also steps in the right direction.

Housing sector and household debt

A wide-ranging package of reforms is needed to improve housing affordability and reduce domestic vulnerabilities related to high household debt. A lack of affordable rental housing has contributed to excessive household debt. As such, the authorities are appropriately focused on increasing housing supply, including in the private rental market, while giving due consideration to tighter macro-prudential policies. In this regard, we welcome the authorities' efforts to address supply-side constraints, including making it easier for housing corporations to build in the middle segment of the rental market. We also support the range of measures proposed by staff, such as liberalizing rent controls, reducing restrictions on zoning plans, and simplifying procedures for building permits.

Finally, with regard to climate-related policies, we welcome the authorities' commitment to reduce CO2 emissions and the focus on analyzing risks related to climate change, as noted in the buff statement.

Mr. Mozhin and Mr. Palei submitted the following statement:

We thank staff for their report on the Dutch economy and Mr. Doornbosch and Mr. Hanson for the clarifications of the authorities' position on the key policy issues. According to staff, the economy is growing at a healthy pace, unemployment is low at about 3.8 percent, and the labor market is expected to tighten even further.

Low inflation and anemic wage growth prevent the desirable adjustment in the external sector, with current account surplus still close to 10 percent of GDP. The EBA analysis does not offer any insights on the drivers of the current account surplus in the Netherlands. This lack of explanatory power is one of the stark manifestations of the limited usefulness of the Fund-wide exercise and the External Sector Report. We welcome the analysis in the special chapter of the Selected Issues paper of the role of multinational corporations in defining corporate savings and note that further investigation may be useful. Overall, given that the real exchange rate has depreciated even further, we believe that excessive price competitiveness remains among the key challenges in rebalancing the economy.

Like many of our colleagues, we are not prepared to support staff's call to further relax fiscal policy in order to correct external imbalances. While public debt has declined to the level below 60 percent, at this stage, the authorities' fiscal policy is somewhat procyclical. As it was explained in the BUFF statement, fiscal policy is conducted in accordance with fiscal rules coordinated with the political cycle. Given these circumstances and the relatively recent discussion of similar issues last May, we are somewhat surprised that staff continue to insist on a more aggressive use of fiscal space in the Netherlands.

The authorities and staff seem to agree that the open economy is exposed to significant external risks, including the possibility of a disorderly Brexit, disruptions in international economic relations, and tightening of financial conditions. The looming risks, in our opinion, justify not only the authorities' cautious stance in the fiscal area, but also call for extra vigilance in the banking and broader financial sector.

Finally, we noticed that the risk assessment matrix (Annex 1, page 31) referred to "uncertainties surrounding fiscal policies in other euro area countries", which supposedly make the risk of a confidence crisis high. Yet, in the "Relative Likelihood" column, staff identified this risk as "medium". We invite staff to elaborate on the seeming inconsistency in categorization of this risk.

With these remarks, we wish the Dutch authorities success in their endeavors.

Mr. Fanizza and Ms. Collura submitted the following statement:

We thank staff for their interesting set of papers and Mr. Doornbosch and Mr. Hansen for their helpful buff statement. We associate ourselves to Mr. Meyer's statement and offer the following comments for emphasis.

The cyclical position provides the Dutch authorities with an opportunity for policies aiming at reducing imbalances and increasing long-term productivity growth. We commend the authorities for the sizable fiscal buffers they have built. We believe that the authorities should use their fiscal space to complement structural policies to mitigate the high corporate net savings, the high household indebtedness, and the duality of the labor market. We share the staff assessment that a pro-cyclical fiscal policy would not risk endangering macro-economic stability at the current juncture. Furthermore, we believe this policy stance would benefit the euro area economy as a whole. We note the disagreement between staff and the authorities on the extent and the use of fiscal space. Mr. Doornbosch and Mr. Hansen's buff argues that the national fiscal rules imply a smaller fiscal space than the staff estimate. We would welcome staff comments on this issue.

The large multinational companies' savings (MNCs) explain a significant portion of the current account surplus – as analyzed in the Selected

Issues Paper. To fully understand the MNCs' role in domestic imbalances, we encourage a deeper and more granular analysis to better distinguish global factors and domestic policy distortions. We believe that a favorable business-friendly environment explains part of the MNCs' decisions to move to the Netherlands; however, tax considerations also play a role. We welcome the authorities' commitment to address phenomena of abuse of the tax system by multinationals.

Progress on reducing imbalances would increase the resilience of the economy in the face of external downside risks, namely rising global protectionism and a no-deal Brexit. We wonder why the latter is not reflected in the Risk Assessment Matrix; as the Analysis in Box 2 shows, it would have a sizable impact on the Dutch economy.

Mr. de Villeroché, Mr. Castets and Ms. Gilliot submitted the following statement:

We thank staff for their insightful set of documents and Mr. Doornbosch and Mr. Hanson for their informative buff statement. Growth decelerated slightly in 2018 but is still relatively high. The Dutch macroeconomic fundamentals remain strong with low inflation and unemployment rate at a decade low. We therefore commend the authorities for their sound management and such good performances. The current account surplus remains at a very high level reflecting Netherlands-domiciled multinational corporate savings and weak domestic investment while households' disposable income remains restrained by low wage growth and high labor tax wedge. Against this background, we concur with staff that the priority should be given to measures aiming at reducing the duality of the labor market, increasing households' disposable income and fueling domestic demand, including through higher levels of public investment. We associate ourselves with Mr. Meyer's statement and wish to add the following comments.

Outlook and risks

We concur with staff's assessment that despite a strong growth, solid fundamentals, and favorable labor market conditions, the Dutch economy is facing internal and external imbalances. Low investment and high corporate savings have contributed to the persistently large current account surplus. High labor tax wedge and relatively weak labor productivity growth have contributed to low wage growth over the past years, weighting on households' disposable income. While the generous mortgage interest deductibility policy has translated into an overborrowing leading to highly leveraged households, rising housing prices and lower wages for part-time and self-employed workers have exacerbated the constraints on consumption. In that sense, we salute the reforms' agenda as stated in Mr. Doornbosch and Mr. Hanson's buff statement and the commitments of the authorities to improve the balance between fixed and flexible employment, support housing supply and increase financing access to SMEs.

External imbalances

The current account surplus remains at a much higher level than the one required by the medium-term fundamentals and the desirable policy settings. Benefiting from a favorable taxation regime, non-financial corporate net saving has been the main driver of the surpluses since 2000. As detailed in the external sector report for 2018, the statistical treatment of earnings is different between direct and portfolio investments and not always attributed to the ultimate owner. We concur with the staff's ESR analysis that understanding the underlying motives for rising net lending will help formulate policy advice. More work is notably needed to better understand the respective impact of corporate taxation, corporate governance structures or unequal wealth distribution. Additionally, we understand that some work is underway for several years to reconcile the Dutch current account data with some of other Fund members, such as the United States. Given the importance of this issue, we would appreciate if staff could indicate the nature of the statistical work underway, its modalities and calendar.

Fiscal policy

The expansionary fiscal stance is adequate in a context of substantial fiscal space. Despite the decline in the structural budget balance from a surplus to a balance, there is still significant room for maneuver to increase further growth-enhancing expenditures (investment, research and development) and cut tax on labor to boost labor force participation. These measures would help curtail the current account surplus while boost productivity and potential growth. We encourage the authorities to use the available fiscal space under the Stability and growth Pact's medium-term objective. As the authorities put a strong emphasis on the need for small open and open economies to build buffers against adverse shocks, we see a central fiscal stabilization capacity for the euro area as part of the answer.

On the tax reform agenda, we salute the commitment to limit the use of the Netherlands as a conduit to transfer interests and royalties to low-tax jurisdictions. We look forward to measuring their effective impact on inflows and outflows levels. The 2019 budget encompasses changes in the composition and structure of taxes - namely lower CIT rates, decrease in the number of income brackets for PIT and hike in the VAT rate. Since cash retention by corporates is already very elevated and household's disposable income is constrained, those measures might appear as not tackling existing imbalances. Could staff comment on the redistributive effects of these measures? We commend the authorities for the difficult decision to raise environmental taxes and the ongoing discussion on a Climate Agreement, mentioned in Mr. Doornbosch' and Mr Hanson's buff statement. What is staff's assessment regarding the adequacy of the existing taxation tools mobilized to progress towards the commitment of CO2 emissions reduction under the Paris Climate Agreement?

Labor market

The authorities' intention to address the duality of the labor market is welcome. We agree that greater harmonization of tax and social protection treatments of permanent employees, workers with temporary employment and the self-employed is warranted to improve equity and efficiency, as well as to reinvigorate the wage dynamics. The participation of women should also be improved while greater attention should be given to better integrate the self-employed to pension scheme. The reform of the pension system should in that sense go aligned with a more balanced labor market.

Financial sector

A further tightening of borrower-based prudential measures and a close monitoring of risks related to the real estate sector and high-level households' indebtedness appear warranted.

Mr. Jin and Ms. Liu submitted the following statement:

We thank staff for the informative set of reports and Mr. Doornbosch and Mr. Hanson for the helpful buff statement. The Dutch economy remains robust, supported by private consumption and strong net export. Unemployment reached a historical low level, and public debt continued to decline. Nevertheless, external imbalances remain large, and the economic outlook is clouded with some downside risks, including uncertainties arising from trade tensions and Brexit. We broadly share staff's appraisal and offer the following comments.

We share staff's view about tightening macro-prudential policies to reduce household debt. The main domestic risks, as noted by the authorities, are related to housing market developments. Household debt in the Netherlands remains the second highest among OECD countries, and over-borrowing of mortgage has contributed to the accumulation of the household debt. High debt levels could make households vulnerable to adverse shocks, and a sudden change in economic conditions or market sentiment could also cause the housing market to turn around quickly, leading to housing prices decline and economic losses. Continued increase of household debt could also weigh on consumption and growth. In this regard, we encourage the authorities to closely monitor housing market developments and stand ready to take measures to address potential risks in the banking sector to ensure financial stability.

We welcome the detailed analysis on the Dutch's corporate saving, in particular the role of multinational corporations (MNCs) and its implications to the external sector assessment. As presented in the SIP, the Dutch's current account (CA) surplus is among the highest in the world, driven mainly by high corporate savings, particularly those by a few MNCs. MNCs' savings are used mainly for global investment rather than domestic investment in the Netherlands. We see a need to better quantify MNCs' contribution to the Dutch's high current account surplus. Excluding MNCs factors, will the Dutch's current account surplus still remain high? Staff comments are welcome. Given the complicated holding structure of MNCs, we concur with staff's view that improving statistics and separating MNCs' activities from internal and external accounts could help identify underlying policy distortions and effectively address the imbalances. Going forward, we encourage staff to do more work in this area.

We share staff's recommendations to harmonize tax benefits and social security contribution for different types of employment to reduce labor market duality while increasing overall labor market flexibility. We take positive note that the authorities have taken measures to address the related issues and work towards a more balanced labor market is well on the way. Simplifying the income tax schedules and reducing tax rates should also help increase households' disposable income and consumption which could eventually benefit the economy. In this regard, we welcome the authorities' commitment to further reforming the pension system in order to adapt to a more dynamic labor market and reduce tensions between generations.

The representative from the European Central Bank submitted the following statement:

> We would like to thank Staff for their report and Mr. Doornbosch and Mr. Hanson for their buff statement. We associate ourselves with the statement by Mr. Meyer.
>
> While economic growth in the Netherlands is expected to remain above potential in the near term, some moderation in both actual and potential growth is envisaged and ongoing efforts to address structural challenges are therefore essential. In the past two years, domestic demand has been the main supporter of growth amid supporting macroeconomic policies, high levels of business and consumer confidence and positive wealth and real income effects. Wage growth and inflation have remained subdued, possibly partly reflecting labour market dualism, but ongoing growth above potential should exert upward nominal pressures. Heightened uncertainties about the global environment, more subdued income developments and demographic factors are likely to results in growth slowing towards potential in the medium term. The persistent current account surplus, which relates in large part to structural factors, is likely to remain, but policies aimed at supporting domestic demand, such as the fiscal stimulus package and the reduction in the tax burden on labour, can be expected to contribute to a gradual reduction. Two key external risks are rising global protectionism and a “no-deal” Brexit. Given its high trade openness, any disruptions to global trade and supply chains could strongly weigh on the growth prospects of the Dutch economy. Regarding domestic factors, while the ongoing strong housing market upswing represents an upward risk for economic growth in the nearer term, an adjustment in the housing market could harm economic growth through confidence and wealth effects.
>
> Available fiscal space should be used, in compliance with fiscal rules and considering uncertainties, to support long-term growth potential. Consideration should be given to uncertainties regarding the structural position and its volatility on account of potentially reverting windfall revenues. Strong economic growth and prudent fiscal policy has enabled the Netherlands to maintain fiscal space in case negative risks materialise. Long-term growth potential could be supported by further investing in public R&D and lifelong learning. The benefits from the positive use of available fiscal space, both domestically and in in terms of positive spillover effects for the rest of the euro area, could be boosted if reforms in other areas were promoted even more forcefully. These include further reducing the household debt bias and continuing efforts to effectively implement measures to combat profit

shifting and tax avoidance in the context of the international initiatives in this area.

Given the intertwined nature of imbalances in the Dutch economy and the potentially mutually reinforcing nature of reforms it is important to pursue the right policy mix for the Dutch economy. The fiscal stimulus package and the reduction in the tax burden on labour should contribute to curbing the current account surplus and help the continued balance sheet repair by households. However, vulnerabilities remain from high household indebtedness and there is a need to maintain the impetus for further balance sheet improvements. In this respect, we agree with Staff's recommendation that comprehensive housing market reforms are required to rebalance housing supply and demand, develop the private rental sector (by supporting the supply of private rental housing, while further targeting the social housing provision), reduce household indebtedness and promote labour mobility. Notwithstanding the commendable plan of the government to accelerate the reduction of the mortgage interest tax deductibility, tax-induced distortions will remain substantial even after the implementation of this measure. Thus, we see scope for a complete phase-out of the tax deductibility and taxing housing capital similarly to other forms of capital.

Labour market dualism remains a key issue. Although the government plans to address certain features of the labour market segmentation, like Staff we consider that it is important to reduce the very strict employment protection of permanent workers and thus enhance the overall flexibility and the functioning of the labour market. Furthermore, it is important to take an integral view on labour market reforms and implement effective measures to promote adequate social protection for the self-employed. Lastly, we consider that the authorities and the social partners should work together to make wages more responsive to domestic macroeconomic conditions.

The financial sector is strong but faces some challenges. Bank profitability has increased, and bank capitalisation is around the euro area median. The characterisation and assessment of leverage ratios is nuanced by specific factors. The current low aggregate leverage ratio is heavily impacted by the inclusion of two Promotional Banks with business models entailing large, low-risk positions. Excluding these, the leverage ratio of other significant Dutch banks is around or above the European Banking Authority stress test average and all meet the minimum requirements. However, the financial system remains exposed to residential and commercial real estate risks, while household indebtedness remains very high. Despite subdued credit growth, reported lending standards have been further eased and should be monitored. We agree with Staff regarding the main risks. Considering the risks stemming from the high indebtedness level of households and strong house price dynamics, a further tightening of borrower-based measures should be considered. Such measures could be complemented by capital-based measures to strengthen the resilience of the banking sector to potential housing market stress.

The Acting Chair (Mr. Furusawa) made the following statement:

The Dutch economy is experiencing robust macroeconomic performance underpinned by domestic demand. Fiscal performance is strong, unemployment is low, and the overall banking sector is healthy. But as Directors have noted in their gray statements, despite these strong fundamentals, the very open nature of the economy makes it vulnerable to external and internal challenges. The strong cyclical position provides an opportunity for policies to focus on reducing these imbalances and raising long-term productivity growth, including through boosting household disposable income while repairing the private sector balance sheets and strengthening small- and medium-sized enterprises (SMEs).

Mr. Doornbosch made the following statement:

I would like to make a remark on the current account. There was quite some discussion on that. The Netherlands could be seen and is often seen as a textbook example of a small open economy, but as the seventeenth global economy in terms of GDP, we are actually not that small, but we are very open. The trade flows crossing our country are the sixth-highest in the world in absolute terms, and our openness is longstanding. From 1962 to 2004, the harbor of Rotterdam was the world’s busiest port, and it is still, outside the ports of Asia. But the openness and proximity to global markets makes the Netherlands an attractive location for multinationals, and many of these multinationals are rooted in the Netherlands. Our open economy enabled them to grow and establish a global presence. To give an example, the nearest Shell gas station is 1.4 miles from here on 18th Street; and the nearest bar that serves Heineken is across the street. As the staff shows, these multinationals have a major impact on our current account. The increase in net savings by large corporations in the past two decades is a trend across advanced economies, as recent Fund research shows, and this is probably also an important explanation for the difference between earlier episodes, as noted in the U.S. gray statement.

It is good to realize that there are two statistical conventions that complicate the economic interpretation of the contribution of multinationals' net savings to our surplus.

First, if a multinational uses retained earnings to invest in a subsidiary abroad, this is counted as Dutch net savings. It increased the Dutch current account surplus. One could ask why multinationals do not invest more in the Netherlands? The answer is also obvious. It makes sense that multinationals with a global presence invest abroad. Take the example of Shell. It would be strange to expect Shell to invest in oil field exploration in the Netherlands, so even if the saving investment balance of the multinational is zero—so they invest as much as they save, and they save as much as they invest, or they use their savings to invest, I should say—it would still count to our surplus and to the deficit of the rest of the world.

Second, these retained earnings of multinationals are not allocated to their shareholders. If a multinational is fully foreign owned, its retained earnings would still be fully counted as net savings in the Netherlands despite the fact that no Dutch investor would benefit, and this is relevant. As foreign shareholders, the shareholdings of Dutch multinationals are very high, up to 90 percent in the case of Shell, and retained earnings of only Shell were already around 20 percent of GDP in 2018. Therefore, we see at least two implications.

The first is better data about the effect of multinationals on the current account, and the selected issues paper has been very helpful in that respect, and the Dutch authorities continue working on this. The second is separating savings by multinationals that arise from their global activities from the External Balance Assessment (EBA). Currently the staff applies an adjustment of zero in the EBA assessment for the Netherlands, and this may result in misguided policy advice. As Mr. Lopetegui rightfully noted in his gray statement, offsetting savings by multinationals with dissavings in domestic sectors could actually decrease domestic imbalances, such as the high household debt.

Mr. Meyer made the following statement:

I have issued a comprehensive gray statement also for my EU colleagues, so I will highlight a few points for emphasis.

First, we commend the Dutch authorities for the robust performance of their economy with strong growth, an unemployment rate below 4 percent, and a healthy banking sector. At the same time, we must not ignore that the Dutch economy also faces important structural challenges. We agree with the staff that more can be done to reduce labor market duality, better understand and deal with the large and persistent current account surplus, increase the supply of housing, and reduce the private sector's reliance on debt financing.

On fiscal policies, we commend the Dutch authorities for putting public debt on a rapidly declining path. We agree that the Netherlands has fiscal space, and we support the staff's recommendation to increase household disposable income by respecting the fiscal rules. We also welcome increased spending on education and regional development. At the same time, there is a need to avoid procyclicality and to consider the fiscal implications of population aging.

I would like to comment on the current account. The staff's selected issues paper looked at the statistics in more detail and found the activities of multinationals have an important impact on the current account surplus. We, therefore, welcome efforts to further enhance statistics to separate the impact of multinationals, although with a view to better understand the underlying sectors behind the savings behaviors of multinational corporations based in the Netherlands. Moreover, we would like to highlight that the Fund's EBA model itself leads to a large unexplained residual, so one has to be cautious and use judgment when formulating policy recommendations. Apart from multinational corporations, government, and household sectors and the large pension system are also important determinants of the current account surplus.

On structural policies, we would like to emphasize that the right policy mix is important. Like the staff, we see a need for reforms that reduce the duality of the labor market that is having an impact on workers' income and on their coverage for old-age and disability risks. Increasing the supply of housing would ease price pressures and could improve conditions in the rental market.

Finally on the financial sector, we would like to highlight that despite an overall healthy banking sector, banks' high exposure to wholesale funding and the real estate sector poses challenges, and household indebtedness remains very high. We agree that a further tightening of borrower-based prudential measures and the full and timely phasing out of the distortive mortgage interest rate deductibility could be considered.

With this, let me wish the authorities all the best.

Mr. Gokarn made the following statement:

We did not issue a gray statement, so we would like to share our thoughts on two issues that have been addressed in the papers.

We commend the Dutch authorities for the performance of the economy. Growth rates are impressive, and all of the other macro indicators suggest stability, notwithstanding the risks that have been pointed out.

Coming to the issue which had a significant space in the report and the buff statement and Mr. Doornbosch's remarks—the impact of multinationals on current account assessment—I just want to point to the possible risks in the macroeconomic assessment that comes from these numbers. There is a sense that the recommendations for the greater use of fiscal space and so on, have emerged from the very high current account number that shows up. The staff is quite candid in suggesting that the numbers are now treated differently, taking account or netting out the impact of multinational, non-financial corporate savings. But in terms of the policy recommendations, this does not seem to appear. At least that is the implication that I perceive. For example, if the current account surplus is much smaller, the room for fiscal space would be more limited in terms of an expansionary stimulus to try and reduce this imbalance.

The second issue is related. There is a very useful discussion of labor markets; but there is also the comment that some of the policy recommendations may not be easy to implement because of labor market conditions being tight. This is an open economy in every respect, including labor mobility within the EU, so I just want to understand why this economy may face labor market constraints when there is the possibility of people moving in from other parts of the EU.

Mr. Moreno made the following statement:

I also thank Mr. Doornbosch and Mr. Hanson for their buff statement and the staff for the informative staff report, and I would like to associate myself with comments made by Mr. Meyer.

the starting point is to commend the authorities. There is a good start, strong growth over euro area average, historically low unemployment. They are rebuilding fiscal buffers, and poverty continues to decline, and also the banking system has demonstrated soundness and profitability.

It is important to note that the staff and the authorities have broad agreement on the challenges—low internal demand, the financial sector remaining highly leveraged, concentrated on mortgages, and highly dependent on funding and loan productivity growth—and there is also some agreement about the structural reform agenda and the financial sector.

We would stress the efforts of the authorities on the environment, the strong commitment to reduce CO2 emissions, including increasing the environmental taxes. In the banking system, we stress the need to continue constructing capital and liquidity buffers, particularly taking into account large wholesale funding and the anticipation of regulatory reform in internal risk models.

The main issue of discussion is the fiscal policy stance, and as stated by Mr. Doornbosch and Mr. Hanson, there has been almost two years of no meaningful discussion with the staff. Much of this revolves around the weakness of the internal demand, as stated by Mr. Gokarn. There is a dearth of corporate investment both in SMEs and in multinational corporations. The selected issues paper is useful with regard to the data of the multinationals, which show that investment is low not only domestically but also internationally, and referring to Mr. Doornbosch's comments, at least in relative terms to other countries.

There is also a high savings rate in households in large part due to pension system regulations and the housing markets, which are forcing savings. Taking this into account, this also drives one of the largest current account surpluses in the world. Consequently, like Mr. Meyer, we share the staff's view that the authorities fully need to use the fiscal space. There are three issues here that I think are important to highlight.

The first is the calculation of the structural deficit. This is a difficult issue, but the authorities have probably been too cautious in the calculation of the structural deficit, and I am sure that nobody will complain if they go beyond a minus 0.5 structural deficit. I would also highlight that if the concern is the need to use fiscal buffers for open economies—not small economies, I take the point made by Mr. Doornbosch—that will restrict the need for a central fiscal stabilization capacity in the euro area.

On fiscal rules, Ms. Pollard and Ms. Svenstrup made an interesting point in the preference of the Dutch fiscal rule, as it imposes additional restrictions on top of the stability and growth pact of the European Union. There might be an issue of asymmetry. We are saying to some EU countries that the policy is too lax. Maybe the question for the Netherlands is whether the policy is too strict. This is something that is worth considering by the staff.

Finally, also on fiscal policy, we are also mainly concerned about the fiscal structure. Our concern is that the tax competition may introduce a risk of a race to the bottom within the EU and marginally globally. Our question to the staff was referring to the corporate tax not to the tax wedge, so I will appreciate if the staff would elaborate on this.

Mr. Raghani made the following statement:

I will begin by thanking the staff for the responses to the questions raised by Directors in their gray statements, including how rank anchors on the relative risk posed by private indebtedness to the macro outlook and on complementary measures to foster the development of SMEs. I thank Mr. Doornbosch and Mr. Hanson for their insightful buff statement. We have issued a gray statement, so I will limit myself to three specific points.

First, the assessment of fiscal space to provide additional support to growth and rebalancing has been a longstanding issue in discussions between the authorities and the staff. We join other Directors in encouraging further efforts to reconcile the technical differences and enhance dialogue on fiscal policy and its constraints, notably the national policy frameworks and the EU fiscal rules.

Second, we welcome the Dutch government's commitment to combating tax avoidance and tax evasion. This is key to tackling illicit flows and raising budget revenues, both domestically and in countries where the flows originate.

Finally, we wish to convey to Mr. Doornbosch our country's appreciation of the Netherlands' measures to contain climate change, notably through their increasing environmental taxes and continued commitment to the Paris Climate Agreement.

Mr. Just made the following statement:

We associate ourselves with Mr. Meyer's remarks and would like to emphasize five points.

We note the tension between the staff and the authorities with regard to the fiscal space discussion. We encourage the staff to further develop the fiscal space assessment methodology so that it fully takes into account super-national and national fiscal rules. In addition, like Mr. Ray and some other Directors, we emphasize the importance of separating the identification of fiscal space from the policy advice on how to use it.

Second, we commend the staff for the insightful analysis of corporate savings in the Netherlands. We support further methodological work toward appropriately determining the level of savings of Dutch residents, which has an important bearing on formulating policy recommendations.

Third, we fully agree with the staff that further measures are needed to reduce high household debt, which as a percentage of GDP, is the second-highest among OECD countries. Lowering the maximum loan-to-value ratio (LTV), which currently stands at 100 percent, should be implemented in a timely, probably swift manner, and the macroprudential toolkit should be enhanced by introducing borrower-based tools. Comprehensive housing market reforms, including housing rental deregulation, should complement the macroprudential measures by addressing the supplies and constraints. We encourage the authorities to continue to strengthen Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) enforcement and underscore the importance of information sharing among European supervisory authorities to facilitate these efforts.

Finally, we welcome the efforts by the authorities to address the gaps that enable tax avoidance by multinational corporations.

Mr. Inderbinen made the following statement:

We commend the robust growth outcome of the Netherlands and acknowledge the strong cyclical position, and we argue that the current position should be used to reduce imbalances and address remaining weaknesses in the economy, particularly in the structural domain, the labor market duality and other inefficiencies. We have measures that are needed to lift productivity growth. We have the housing sector and the need to get a rental market going and the related issue of the high household indebtedness, and the staff's recommendations on these issues are level headed and good.

The staff nonetheless also advises for further fiscal procyclical expansion, and in our gray statement, we take issue with this and see merit in the authorities' stance and share their doubts on the need for additional fiscal spending at the current juncture. As Mr. Just has reminded us, the fiscal space concept goes in two steps. The first is assessing the space, and the second is the question of whether it should be used and to what extent it should be used. In the case of the Netherlands, all this has to be done against the background of the authorities' fiscal framework. Ms. Pollard and Ms. Svenstrup also remind us that the first step is done independently of fiscal frameworks—the assessment of space—but then the advice on its use would normally take into account the fiscal setup in a country. Giving this advice even though the authorities' framework dictates otherwise distracts from a more meaningful discussion on the fiscal space. I ask the staff to comment on the appropriateness of such advice against the background of the guidance from management on how to conduct Article IV consultations. In the 2015 Guidance Note there are many references to member countries' circumstances, and on fiscal policy in particular, it says that advice should be well articulated, and "targeted to country circumstances." I was wondering whether the staff could comment on this issue.

Coming back to the assessment leg of the fiscal space concept, that is complicated by the fact that when looking at the international balance aspect, we have these statistical anomalies in measurement that Mr. Doornbosch was alluding to, and also the big question of how these relate to actual economic reality in the Netherlands. That would argue for additional comments by the staff. The staff does say in the answers to technical questions that they cannot estimate the magnitude of the potential overestimation of the current account, so that would argue for additional caution in drawing conclusions for economic policies—fiscal and otherwise—from the current account imbalance.

Mr. Fanizza made the following statement:

I thank the staff for a good job, and Mr. Doornbosch for an interesting buff statement and the useful introductory comments. I see his point; it is important, but let me get to the main point. We fully share Mr. Meyer's gray statement.

We commend the authorities for the expansionary fiscal stance, but we tend to lean toward the staff with the idea that maybe something more could be done. Why? One good reason is that I do not have much trust in the measure of output gap, and I do not know exactly what is behind it. Even though it looks like the output gap has been closing, actually has become positive, we observe no impact on wages, so why do we care? But that is a more general point. We should not take uncertain measures of the output gap as key for deciding the stance of policies. I have seen several times—Japan and Italy are examples—that very small changes in the output gap make huge differences in the policy recommendations. We should be very cautious and not labor over this idea of procyclicality. My impression is that the risks there are not very important.

On the output gap, I had a question for the staff. The staff projects a positive output gap for the longer-term. How come? The projection stays all the time above potential. It seems instead that it should converge to a zero output gap, but that is another issue.

We sympathize with the idea that one should not build buffers by default. We tend to always recommend building buffers, even when things go well. In this case, maybe we are not sure about the dimensions of the imbalance, but there is an imbalance, and one of our tasks should be advising how to address it.

Finally, I have a question for the staff on the bailout costs. The staff says that bailout costs have been estimated based on the previous crisis, but I understand that under the European rules, the bailout costs are very limited. How did the staff take that into account if the past experience was used to estimate the possible costs?

Mr. Ostros made the following statement:

I will start by saying that I associate myself fully with the statement made by Mr. Meyer both in written form and orally today.

It is a well-written report. It is an important report, not least when it comes to the discussion on the connection between the assessment of the current account, the imbalances, and what type of advice we give when it comes to fiscal policy. It is an important contribution in the report to try to understand how multinational corporations and their savings can affect the current account. It shows once again that the EBA model, important as it is, is only partly true, meaning that the residual is very substantial, and not least in the case of the Netherlands. It is another illustration of how difficult it is to use the EBA model mechanically and derive some conclusions on fiscal policy, for instance. It is not only corporate savings, merchant trading is also such an issue where it is difficult to capture the effects when there are multinationals in a country, and the statistics might be misleading. Still, the staff comes to the conclusion that there is fiscal space. We all agree on that. That is there is no doubt about that, but it should be used more extensively than the authorities think.

There are grounds for doing as the authorities are doing, using some of the fiscal space to invest in R&D and education. That is a wise thing to do. We should take more into account the intertemporal judgment that we have to make when it comes to fiscal policy.

Considering that the Dutch economy is strong, I commend the authorities for that, but it is also vulnerable in some aspects. They have a very high household debt situation. It is a very open economy. There are Brexit risks. There are trade tensions. There is a history of swings in the economy that we have to take into account, and they have a very large financial sector.

Given that the issue of high household debt is connected to the housing market, it is important to think about it in an intertemporal sense. If there is a sharp downturn in the housing market in the future, the banks will probably be able to handle that, but households will reduce consumption, probably severely, to handle that situation. That means we need fiscal space in a crisis situation, and we should think hard about using that fiscal space now and not saving it for a rainy day. That is why I have sympathy for the authorities' view that they should be careful in conducting overly procyclical fiscal policy. It is also important for the region. There are countries that have depleted their buffers to a large extent, and we need countries that in the next downturn have fiscal space to use, also for the good of the regional economy. I have sympathy for authorities' views on that and would also like to thank the staff for the good reports.

Mr. Saito made the following statement:

We have issued a gray statement, so I would like to offer a few comments on the external balance.

The cyclically adjusted current account surplus decreased to 10 percent of GDP, which is 66 percent above the EBA norm. Turning to the highest balance, the household, government, and corporate sectors are all in surplus. Let me comment on each sector.

First, on the household sector, we welcome the authorities' initiative to reduce labor market duality to support household disposable income. Having said that, concerning high household indebtedness, there would be limited room for reducing their net savings further.

Second, on the government sector, we note that there are differences of views between the authorities and the staff regarding fiscal space. We encourage the staff to continue to discuss an appropriate level of fiscal buffers with the authorities. At the same time, as Mr. Just and Mr. Inderbinen rightly pointed out, the existence and the use of fiscal space should be distinguished, and the use of fiscal space needs to take into account the cyclical economic conditions, the fiscal implication of the long-term demographics, and other country-specific circumstances.

Third, on corporate sector, we appreciate the staff's insightful analysis in the selected issues paper on the corporate savings in the Netherlands and note that the corporate savings mainly among the few multinational corporations lead to overestimates of the current account surplus. Other more granular information of multinationals' activity would be needed to quantify it. We encourage the staff to collaborate with the authorities and continue efforts to separate multinationals' activities from the current account to evaluate the external sector more precisely. At the same time, the effect of multinationals' savings on the current account balance is not only relevant to the Netherlands, so we encourage the staff to do future work on defining the EBA model so that it separates the influence of the multinational companies' activities, making use of the stocktaking for Netherlands.

Mr. Castets made the following statement:

I associate myself with Mr. Meyer's oral remarks this morning and his written statement and just wish to make a few additional remarks.

First, on the macroeconomic framework, we commend the authorities for the strong performance of the Dutch economy, which is currently sustained by favorable labor market developments and also a supportive fiscal stance. Nonetheless, as also remarked by others, downside risks have increased in the context of uncertainty, notably Brexit, trade tensions, and the growth slowdown in the euro area. Against this background, it seems that the current favorable juncture is the right time to tackle some structural imbalances, notably the persistently high external current account surplus caused partly by multinational savings behavior but also households' constrained disposable income.

We see two major changes going forward to rebalance the economy toward more domestic demand and make it less exposed to external shocks. First, changes to improve household disposable income, and thus the staff's analysis on the potential impact of the increased duality of the labor market on wage dynamics is useful, given the rapidly rising share of the workforce engaged in either part-time or self-employment. Also, measures to tackle the household indebtedness and remove the bottlenecks in the housing market will be key in this regard.

The second change is to deal with the persistent current account surplus, so we support the necessary rebalancing within the euro area, but beyond that, it will also directly benefit the Dutch economy by limiting the risk of losses in case of a global downturn. The use of the existing substantial fiscal space will therefore help in reaching a double dividend by boosting potential growth and supporting a rebalancing.

On fiscal space, I would like to add a few remarks to Directors' comments. The first one is to recall that, indeed, the methodology as it exists is a two-step approach where there is first an assessment, and then we take into account the fiscal rule. It is important to keep that in mind and also to maintain some space for the staff to have a purely macroeconomic assessment beyond the regulatory frameworks. Also, the great distance between some European rules with domestic rules does not facilitate this assessment.

On the fiscal space methodology and reacting to Mr. Saito's point, it is very important to keep in mind that it already includes the consequence of aging in the way it is projected.

On the current account, our understanding is that the low taxation regime for international corporates is part of the significant current account surplus, and in that sense the selected issues paper produced by the staff is helpful. Nonetheless, we were a bit surprised by the staff's answer to our written question regarding the ongoing work to reconcile data between the Netherlands and other Fund members. We feel it is an exercise in which the Fund should take a role, so we would appreciate if the staff could elaborate on this specific issue.

Reacting to the staff's answer to our question on taxation reforms, we were a bit surprised to read from the staff's analysis that the package that is planned will contribute to decreasing income revenue inequality, so I ask the staff to elaborate on that as well.

On the financial sector, we also encourage the authorities to further strengthen the AML/CFT framework.

Finally, like Mr. Raghani and Mr. Mouminah, we commend the authorities for the introduction of environmental taxes and the launch of the climate agreement. We note that these are not easy questions.

Ms. Pollard made the following statement:

I want to make two points. One is on the fiscal space issue. We look forward to the staff's answer to our question about fiscal space and fiscal rules in the Netherlands. On the current account balance, we appreciate the staff's work on the factors driving the Netherlands' large and persistent current account surplus, and this issue of multinational corporations and how they fit into current accounts is important and something that we encourage staff in the Research Department (RES) to do much more work on in the context of the EBA, and I agree with Mr. Saito that this is not an issue only in the Netherlands, but there are other countries where multinational corporations play an important role, and it should be looked at holistically.

That being said, I was a little confused by the argument that retained earnings or the lack of accounting for retained earnings in the Netherlands played an important role in the current account surplus, because when I looked back at the External Sector Report (ESR) from last July, where staff had a technical paper on the revisions to the methodology for the EBA models, they had a chart there and a box that looked at the effects of mismeasurement and bias of retained earnings on current accounts for the countries in the ESR, and for the Netherlands, the estimation was zero, whereas for a few other countries it was quite large. I am trying to reconcile the work of RES with the work of the authorities and the country team and think this is something where there needs to be greater coordination and I encourage far more work on this issue.

Mr. Ray made the following statement:

Like others I thank thestaff for a very good set of papers. Indeed, I am not a big fan of selected issues papers for advanced economies, but this is a good example of where they are very useful. Both of them were excellent, partly because they are timely and highly policy relevant. We would also like to thank Mr. Doornbosch and Mr. Hanson for their buff statement, and Mr. Doornbosch's excellent intervention this morning was helpful.

I just wanted to make three points. The first is to associate this chair with others on the need for caution around a country having fiscal space, which then leads to a recommendation to fully use it. In this case, we tend to agree with the Dutch authorities that some fiscal space should be preserved as a buffer to deal with potential adverse shocks, many of which are mentioned in the staff paper. And the broader point is that it is important to differentiate the staff’s assessment of how much fiscal space a country has and whether and how the country should use that space.

That second question does go to some fairly traditional things about setting the fiscal stance in the medium-term framework and taking into account the cyclical state of the economy and the balance of risks rather than just maybe saying that a country has fiscal space and should spend it. It is not good to tell politicians to spend usually.

On the EBA, we agree with Mr. Meyer and Mr. Ostros that this is a good example where one needs to be careful about mechanically linking the EBA to fiscal policy recommendations, particularly given the large residuals.

I wanted to ask one question. For some time, I have been struck by the magnitude of the staff’s projections of the impact of Brexit on the Netherlands. Out of the CGE model, these numbers are very big, and there is a a long-run reduction in the level of real GDP between 0.7 and 1 percent. That is a very big number out of the CGE model. The question I have is what is it about the Netherlands that is muting what would normally be the flexibility and adjustment to this sort of shock over time so that the level of real GDP in the long run basically gets back to what it would have been without the shock? I would be interested in the staff’s views on that because these numbers are very large, and there have been cases—I can think of cases when the United Kingdom joined Europe—where economies had to face big shocks because of changes in their trade patterns; and the analysis that has been done of that is, if anything, the countries benefited. I would be interested in the answer to that question.

Ms. McKiernan made the following statement:

I would also like to associate ourselves with the comments and the gray statement submitted by Mr. Meyer, and I will touch on a few issues this morning.

One is on the current account surplus and the activities of multinational corporations. We found Mr. Doornbosch’s comments setting out the broader picture of multinational corporations and the challenges that they raise in small open economies to be helpful, and we also found the analysis of corporate savings presented in the selected issues paper insightful. There are big challenges in disentangling the various factors that influence the activities of multinational corporations, and we encourage both the staff and authorities to undertake further work in this area and to identify the policies that can help in reducing corporate savings. We would add that as another small open economy with a large multinational sector, Ireland has done a lot of work in how one can amend or come up with a variant on the usual indicators like GDP and the net external assessment to try and deal with these issues. There are lessons to be learned across the membership on this question.

We appreciate the authorities' commitment to address tax avoidance and plans to improve transparency around international tax rulings, as was mentioned in the buff statement. We also believe it is important to improve the underlying data in separating multinationals' activities from both internal and external accounts.

My second point is on Brexit, and I would just echo Mr. Ray's question. We were probably coming at the same issue but from a different mindset regarding the downside risks, and we would appreciate more information on what underlies the estimate and particularly out in future years past the period of the withdrawal agreement.

Finally, we commend the authorities for their leadership in climate-related matters, including on environmental taxes and others and the analysis that they have carried out on financial system aspects, which many other countries have benefited from.

The staff representative from the European Department (Mr. Dorsey), in response to questions and comments from Executive Directors, made the following statement:[5]

The questions in the gray statements were largely technical, and we tried to answer as many as we could in writing. However, there is a group of multifaceted questions relating to fiscal space and the fiscal stance that raise a number of policy issues as well as technical issues relating to Dutch, European, and Fund fiscal frameworks. There are too many issues in this constellation to cover concisely here, so we will focus on some key issues and also some of the questions raised this morning.

However, let me state up front that the staff view does not disregard the Dutch fiscal framework. We understand that the authorities set a four-year fiscal plan at the beginning of the government and a new legislature and are reluctant to change this plan thereafter, particularly on the expenditure side. As part of our usual annual surveillance, as was the case last year, this report highlights where we agree and where we disagree with the authorities'

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[5] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

multiyear fiscal plans. On this, let me clarify that we see the medium-term objective under the Stability and Growth Pact of a half percent of GDP structural deficit as appropriate. The staff estimates that the current fiscal plan will overperform this target in the medium term on the revenue side, and the structural position is projected to be balanced at the end of the four-year term.

We believe that there is no reason to overperform and that this space could be usefully employed including through measures on the revenue side. The difference in views is therefore not about the fiscal framework but about the desirable medium-term position. These in turn may derive from different approaches surrounding the sustainable balance approach.

In the Dutch authorities' view, the fiscal balance associated with public sector sustainability must ensure that over a very long-term, the current fiscal arrangements are kept unchanged. This means that future generations will benefit to a similar level from public services at a similar tax burden as present generations. The sustainable fiscal deficit includes policy announcements or measures that are still to be implemented. In the Dutch framework moreover, gross debt-to-GDP is set to continue declining in the projection period to very low levels.

The Fund Debt Sustainability Analysis (DSA), which is one of the elements at the core of the fiscal space exercise, has a medium-term—six years to be precise—horizon in which the debt ratio stabilizes at the level observed in 2024. The Fund framework assumes that from that point on all variables observed in the last year of the projection period remain constant as a share of GDP. The horizon is shorter, but also no policy or behavioral change are envisaged.

On the third, the European Commission methodology assumes a constant share of indirect tax revenues in terms of GDP. The Dutch estimate projects an increase due to household dissavings, reduction of the savings surplus due to pension payouts.

On some of the other questions that came up, with a fully open labor market, why is it that there are labor shortages? Part of it is that both the Dutch authorities and the staff agree that spending priorities should be focused on human capital building, R&D, education, and other issues. Meeting spending targets on this in a useful way would not be done by importing unskilled or semi-skilled labor. For example, if we are talking about education and primary and secondary schools, one has to know Dutch, and apart from part of Belgium, nobody else knows Dutch, so that is one constraint. In general, the sort of labor we are talking about needing to meet the spending priorities is skewed toward the top end of the skill range.

On corporate income taxes, the staff shares the concern raised and therefore suggests lowering labor taxation, particularly in an employment-friendly way to support households. The personal income tax measures in the current budget support redistribution.

On the output gap, it is a little unusual to have an output gap stay positive over a persistent period, but in the circumstances, where the Netherlands is part of a currency union and is relatively strong compared to the rest of the currency union, we expect policies will be relatively loose, monetary policy for example, and that this will result in a positive output gap persisting for longer than it might in a country that was not part of such a union.

On bailout costs, we do not include these in our estimates, but we note their importance. We do not have a view on exactly how the new framework will change these one way or another, but the Dutch financial system is large, and it could be significant.

On the staff's role in data reconciliation, particularly for multinationals, we are working with the authorities. We are putting resources into this and have been for some time. The authorities are putting considerably more resources into this since they have them, and this is a topic of great interest to them. When it comes to international comparisons, or even resolving problems of adding up or top-down, bottom-up consistency within the Netherlands, there are many confidentiality concerns. For example, the Dutch have what amounts to a census of corporate Netherlands with something on the order of a few million entries. One can identify without their names individual companies in this. Similarly, if they are comparing results with another country for the same companies, this raises serious confidentiality concerns and would involve a very restricted number of people working on the issue.

On Brexit, the estimate of 1 percent of GDP is based on trade channels and does not consider innovations that could improve GDP over the long term, but the size of such impacts would be hard to estimate.

The tax reform in the current budget consists of an increase in a tax credit, including for low-income families. We have not analyzed this ourselves, but the authorities have, and that is behind our statement about progressivity.

The staff representative from the Strategy, Policy, and Review Department (Ms. Murgasova), in response to questions and comments from Executive Directors, made the following statement:

> I would like to clarify a few issues regarding the Fund's framework on assessment of fiscal space. In this framework, fiscal space has a specific definition, it is defined as the room to raise spending or lower taxes relative to a preexisting baseline without endangering market access and debt sustainability. Under the framework, a fiscal space assessment is made both with and without considering fiscal rules, and this is in part to examine whether fiscal rules may constrain use of available fiscal space. Now, policy recommendations on use of the fiscal space are outside of the framework for fiscal space assessment, and therefore the availability of fiscal space does not necessarily mean that it should be used or whether it should be further expanded.

Mr. Castets made the following statement:

> On data reconciliation, we understand that the authorities' led the exercise, and we understand the reasons for that, but it would be helpful if the staff could present us with a calendar and maybe give us a flavor of the direction of this work and if we can expect it to be successful in trying to answer to this puzzle.
>
> I mention that because it is not the first year that we have had the discussion. In fact, this year the selected issues paper was helpful, but it was not fully conclusive on the Dutch puzzle. Once again, we would like to underline the importance of this work on data reconciliation.
>
> On the confidentiality issue, I understand the staff's answer, but it is only specific to the Netherlands, so we understand the sense of the answer, but I guess it is the same for all of the Fund members.

The staff representative from the European Department (Mr. Dorsey), in response to further questions and comments from Executive Directors, made the following additional statement:

> We did not provide a forecast of how the reconciliation work on statistics would be implemented and when it would be resolved because had

we done so in the past, it would have been wildly optimistic. Nonetheless, the Dutch authorities and the staff are interested, will continue to be interested, and will work on this. But when one does not know what the underlying problems are, it is difficult to say when one can resolve them.

On the confidentiality issues of dealing with company-specific information, this is not a Dutch-specific issue. This is an issue in many countries, and it is part of the reason why so little of this actually ends up taking place. It is also very labor intensive as well.

Mr. Doornbosch made the following concluding remarks:

I would like to start by thanking Directors for their interesting comments and remarks. This was very useful. In closing, I would like to provide some comments on three issues. First, on reducing the tax wedge; second, the discussion on fiscal space; and finally, I have a short remark on corporate taxation and some concerns expressed by Directors on that.

On reducing the tax wedge to support disposable income, this is something we tried to achieve or will achieve by the reduction in our personal income tax in 2019, 2020, and 2021. At the same time, our tax wedge is already close to the OECD average and significantly below the EU average. What is true is that compulsory payments are relatively high, and this mainly reflects pension contributions and also health care premiums. However, reducing these is not a free lunch. In international comparisons, the Netherlands scores high in terms of pension adequacy and health care outcomes. We are also close to the efficiency frontier when contributions are compared to outcomes, so it is not obvious that it would be beneficial to lower health care or pension contributions to support disposable income. The government is committed to reforming the pension system. This reform is about making intergenerational transfers more transparent and fair and aligning the system with a more flexible labor market, and it is not about reducing contributions. It is good to be explicit about the tradeoff here. Lowering the tax wedge or compulsory payments would free up room for disposable income, but something has to give.

On the fiscal space discussion, it is clear that when Fund staff is making a recommendation on whether to use fiscal space, the fiscal framework needs to be taken into account. Our fiscal framework is clear that there is no room for additional fiscal spending next year. I thought the clarification by the staff that the key policy recommendation one, which reads fully use substantial fiscal space to support potential growth and rebalancing, actually refers to the medium term, and that is an important clarification of the policy recommendation that was made by the staff, because that was not the way we initially interpreted this recommendation when we read it.

On corporate taxation, the reduction in the corporate income tax results in a statutory rate of 15 percent, but that is only for small companies, so up to EUR 200,000. It will be 20.5 percent for the large companies in 2020-21, and the latter is most relevant when one considers tax competition and is, in fact, close to the average for high-income countries. But it is also clear that taxes are only one of many factors that companies take into account when making their location decisions. A significant amount of research, including from the World Economic Forum, has looked at this, and it becomes clear from that. When companies do look at taxes, it is the effective tax rates that they look at. It is good to point out that the reduction in our corporate income tax rate is financed completely by broadening the tax rate, so the effective tax rate stays the same. More importantly, it is financed to a large extent by the reduction in the interest deductibility for corporations, that is the so-called earnings stripping measure, so this base-broadening measure aims to combat tax avoidance, and the Netherlands has even decided to impose stricter standards than those agreed in the EU. We hope this will address harmful tax competition by reducing the statutory rate for finance by broadening the tax base.

Finally, and most importantly, I would like to thank Mr. Dorsey for his work. This is his last Board meeting as a mission chief for the Netherlands. His track record has been excellent. Economic growth has been more than 2 percent since he started work on the Netherlands, so that is very good, and across the years the authorities have always welcomed the reports. We know Dutch authorities have outspoken opinions, but he was always forthcoming, and with his pleasant demeanor, he ensured that discussions, even those about fiscal space, would take place in a constructive manner. I thank the team. I look forward to continue working with them.

The Acting Chair (Mr. Furusawa) noted that the Kingdom of the Netherlands is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended the authorities for the sound macroeconomic management and welcomed the Netherlands' robust economic performance that is increasingly driven by domestic demand. Growth rates have been above the euro area average, the fiscal position is strong, unemployment is low, and the banking sector is healthy overall. However, Directors noted that structural imbalances in the household and corporate sectors and uncertainties in the global environment, including from rising global protectionism and spillovers from a disorderly Brexit, weigh on potential growth in the medium term. Directors recommended that policy priorities should focus on addressing the imbalances, including through boosting household disposable income and reducing household debt, and strengthening the small and medium-sized enterprises (SMEs) sector to help long-term growth and build resilience to shocks. Policies to reduce the imbalances would also help reduce the large current account surplus.

Directors commended the authorities' policy to use the economic upswing to build fiscal buffers. Noting the available fiscal space, many Directors recommended using this opportunity to further reduce labor taxation and increase spending on priorities such as human capital and research and development (R&D). This would help support potential growth and rebalancing without jeopardizing long-term fiscal sustainability. At the same time, many Directors sympathized with the authorities' cautious fiscal framework and saw merit in preserving some fiscal space as a buffer to deal with potential adverse shocks, given that the Dutch economy is relatively exposed to external risks.

Directors encouraged higher wage growth to boost households' disposable income and welcomed the authorities' planned decrease in the labor tax wedge. They emphasized that labor market duality should be reduced, as part-time workers and the self-employed have on average lower wages. Directors agreed that a pension system reform that provides more choice could help reduce the prevalence of self-employment, thereby supporting higher wages.

Directors encouraged efforts to improve housing affordability and reduce household indebtedness. They supported the authorities' plan to lower the mortgage interest deductibility to reduce mortgage debt bias for households. In addition, they recommended further tightening of macroprudential policies, including loan-to value and debt-service-to-income ratios. Directors encouraged the authorities to further liberalize rent controls, improve mean-testing for social housing, and simplify procedures for building permits, to help boost supply of housing and further reduce household mortgage debt. Directors welcomed ongoing efforts to improve coordination among main stakeholders involved in this process.

Directors recommended policies to support SMEs and boost investment, including expending direct public support to R&D. They welcomed the steps being taken to increase access to finance for SMEs and saw merit in establishing a credit bureau that would help improve availability of information and facilitate access to finance.

Directors observed that banking sector soundness and profitability have improved. However, noting that banks remain highly leveraged, concentrated, and vulnerable to shocks, they encouraged the authorities to continue to build buffers and further strengthen supervision. Given the Netherlands' position as a financial and corporate center, Directors considered that maintaining a strong AML/CFT framework will be essential for effective banking supervision.

It is expected that the next Article IV consultation with the Kingdom of the Netherlands will be held on the standard 12-month cycle.

APPROVAL: April 21, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and risks

1. ***We would invite staff's elaboration on factors behind subdued wage growth and inflation other than the labor market dualism.***

- Slow labor productivity growth is another driver of the lower wage growth. Labor productivity has remained subdued in the past few years.

- Domestic consumption picked up in 2018, but consumption growth was lower on average in the past few years compared to, e.g. 2010–2013, and much lower compared to the pre-crisis period. Both public and private consumption grew at a slower pace, resulting in lower price increases.

2. ***In the short term, growth is expected to slow and converge to potential over the medium term. Yet, from the report's tables, a positive output gap of 1.2 percent is expected to open in 2019 and remain at that level until 2024. Could staff elaborate on this assumption?***

- Staff expects the ECB monetary policy to remain loose for the Netherlands given its cyclical position in the currency union. Therefore, the output gap will not be closed by the end of the projection period.

3. ***Could staff indicate how an unorderly Brexit could impact the performance of MNCs in the Netherlands? Could staff comment on recent developments regarding Brexit, its potential impact on the Netherlands, and the main issues authorities are focusing on in their contingency planning?***

- Staff's analysis (Box 2) shows that a disorderly Brexit could reduce the Netherlands' output by 1 percentage point over the long-run, mainly through trade channels. Over the short-term, there would be additional transition costs to the economy. Given the large trade activities conducted by MNCs, staff believes the disorderly Brexit would have large effects on MNCs, including the transition costs in the near term. However, no detailed analysis focusing on MNCs was conducted by staff.
- The authorities are preparing for enhancing capacity at the customs and the Department of Agriculture, Nature, and Food Quality. Additional budget allocation has been reserved.

4. ***That said, we note that staff's Risk Assessment Matrix lacks any reference to any domestic risk whereas the authorities stress that developments in the housing market and the continued leveraging of households constitute non-trivial threats to the outlook. Staff's comments will be appreciated.***

- Staff notes that high household debt contributes to consumption volatility. However, the probability of household defaults destabilizing the macroeconomy is low. Moreover, the ample fiscal space provides the authorities with tools to counteract this development.

5. ***Finally, we noticed that the risk assessment matrix (Annex 1, page 31) referred to "uncertainties surrounding fiscal policies in other euro area countries", which supposedly make the risk of a confidence crisis high. Yet, in the "Relative Likelihood" column, staff identified this risk as "medium". We invite staff to elaborate on the seeming inconsistency in categorization of this risk.***

- The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The high risk of confidence crisis refers to the implication of such uncertainties but does not follow the same classification as in the "relative likelihood" column.

6. ***Progress on reducing imbalances would increase the resilience of the economy in the face of external downside risks, namely rising global protectionism and a no-deal Brexit. We wonder why the latter is not reflected in the Risk Assessment Matrix; as the Analysis in Box 2 shows, it would have a sizable impact on the Dutch economy.***

- The risk of no-deal Brexit is summarized in the first category of risk "Rising protectionism and retreat from multilateralism".

Fiscal policy

- There were several questions regarding the amount of fiscal space and the approach. While there are technical issues, the key aspects of the assessment are fundamentally policy questions and will be answered orally.

7. ***Against the reported disagreement with the authorities, do they believe that the structural deficit under the Stability and Growth Pact of 0.5 percent of GDP over the medium term is not appropriate?***

- The staff cannot speak for the authorities' views on the appropriateness of having the MTO for the structural deficit at 0.5 percent of GDP.

8. ***On the same note, while we see the point raised by staff regarding the recommended expansionary fiscal policy that would support growth potential without jeopardizing fiscal sustainability, we seek staff elaboration on the impact of such pro-cyclical policy in a very open economy that is exposed to important external risks.***

- We do not see the pro-cyclicality as a problem because of low wage growth and moderate inflation, and because public debt levels are comfortably below the Maastricht target and projected to decline in the medium-term below 40 percent of GDP.

9. ***As an aside, we note that staff considers certain contingent fiscal costs associated with the large financial sector in the assessment of the medium-term fiscal target. Could staff comment on what these costs are and how they affect the calculation of fiscal space?***

- We do not have specific estimates of the cost of a potential bail-out of banks. We are keeping this in mind qualitatively when we recognize the need to maintain buffers given the experience of the last financial crisis.

10. ***On tax policy measures, we appreciate that the authorities are not amenable to lowering the labor tax wedge further while staff is of the view that labor income taxes remain comparatively high even after the planned reforms. We invite staff's comments on possible alternative measures that could be taken given the specific circumstances in the Netherlands.***

- The authorities are amenable to lowering the labor tax wedge further; however, their fiscal framework does not allow them to make any policy adjustments that are not agreed upon by the coalition agreement during the term of the government. These changes may be considered by the next government.

11. ***We are concerned about the possibility that this declining taxation may exacerbate tax competition and imbalances within the euro area. Staff's comments are welcome.***

- The Netherlands has a high labor tax wedge comparatively which may be one of the factors contributing to the increasing share in self-employed in the labor market. At the same time, pension savings are high but illiquid, while households are indebted, and their consumption is compressed and volatile. A lower labor tax wedge would support employment in regular contracts and increase disposable income thus boosting consumption and/or contributing to deleveraging. Lowering labor taxation would also be in line with the global trend of shifting the burden of taxation away from income and towards indirect taxation. This may indeed boost the Netherlands' international competitiveness and contribute to attracting companies, along with other equally attractive features of the business environment.

12. ***The 2019 budget encompasses changes in the composition and structure of taxes - namely lower CIT rates, decrease in the number of income brackets for PIT and hike in the VAT rate. Since cash retention by corporates is already very elevated and household's disposable income is constrained, those measures might appear as not tackling existing imbalances. Could staff comment on the redistributive effects of these measures?***

- Staff shares the concern raised; therefore, we suggested further lowering the labor taxation to support households. The PIT measures in the current budget support redistribution.

13. ***The authorities plan to "introduce a withholding tax on interest rates and royalties to low tax jurisdictions" and to "increase transparency about international tax ruling". We would appreciate staff views on the likely effectiveness of these measures.***

- See answers below.

14. ***A withholding tax on interest rates and royalties to low tax jurisdictions will be introduced and transparency about international tax ruling will also be increased. Could staff provide a preliminary assessment of these measures? Is there anything else that could be done?***

- Based on the analysis conducted by the CPB (Netherlands Bureau for Economic Policy Analysis), the authorities' plan would reduce the tax avoidance through royalties given that tax havens are the primary destinations. However, such policies would have lower impact on interest and dividends since these flows are more diverse.
- Staff welcomes the authorities' plan to address tax avoidance. However, such policies are unlikely to reduce the high corporate saving as the targeted outflows generally match the corresponding inflows.

External Sector

15. ***Recognizing more data is needed, do staff have an estimate of the magnitude of the potential overestimation? Further, we note that the CA surplus has risen from an average of 3.7 percent of GDP from 1980 to 2008, to nearly 10 percent. Could staff provide more context on how MNC activities versus other policies contributed to the rise? We see a need to better quantify MNCs' contribution to the Dutch's high current account surplus. Excluding MNCs factors, will the Dutch's current account surplus still remain high? Staff comments are welcome.***

- Lacking details on geographic distribution of MNCs' investment or their ultimate investors, staff cannot estimate the magnitude of the potential overestimation. Based on the public available information, large MNCs' net saving is estimated to be more than 3 percent of Dutch GDP which assumes that all investment is in the Netherlands if geographic distributions are not available.
- The Netherlands' high CA balance (more than 5 percent of GDP) started around mid-90s with slightly drop around 2000. However, the surplus has switched from the household sector to corporate sector. The rise in corporate saving started in early 2000s. After the GFC, both household and public sectors contributed to the further increases of the CA surplus.

16. ***Meanwhile, we would also like to know how the Netherlands could strike a right balance between lowering household debt and reducing household savings to address high CA imbalances. Staff's comments are welcome.***

- On the net basis, the household sector contributes a small amount to the CA surplus in the Netherlands. Staff's policy recommendations anchor on reducing households' vulnerabilities. It would be hard to estimate how policy combination would affect household net saving.

17. ***In the Selected Issues Paper, staff mentions two avenues of such work, on retained earnings, and on movable tangible and intangible assets. Could staff elaborate on the mechanism through which movable (both tangible and intangible) assets might lead to a bias in the current account?***

- That moveable assets could be subject to profit shifting is based on a note prepared by the Dutch statistic office. The note mentioned that the legal ownership of movable assets could be assigned to a leasing company resident in a low tax jurisdiction, similar to the use of intangible assets.

18. ***Additionally, we understand that some work is underway for several years to reconcile the Dutch current account data with some of other Fund members, such as the United States. Given the importance of this issue, we would appreciate if staff***

could indicate the nature of the statistical work underway, its modalities and calendar.

- Staff does not know the details.

Financial sector

19. ***AML: Are there impediments to share information with jurisdictions outside Europe? What is staff's view regarding beneficial ownership transparency in the Netherlands?***

- The Dutch Financial Intelligence Unit (FIU) collaborates and exchanges information with other national FIUs, including outside Europe, and upon request. For example, in 2017, 64 requests from foreign FIUs were made to the Netherlands, while the Dutch authorities sent 34 requests to foreign FIUs relating to money laundering and/or financing of terrorism (2017 FIU annual report).

- In staff's view, there is room for improving international cooperation, for example by systematically alerting the relevant foreign authorities when companies operating in their jurisdictions are suspected to be involved in fraudulent activities.

- According to the 2017 Transparency International report on the Netherlands, the Dutch authorities have a good understanding of AML risks and strong legal framework regarding ultimate beneficial owner (UBO) identification and verification. However, UBO information remains fragmented and should be given stronger attention in the law. For example, it would useful to create a central register for shareholders to facilitate access to information and increase transparency.

20. ***Regarding the private rental market, could staff comment on what specific measures it has in mind to liberalize rent controls in this market?***

- A possible policy action could be to gradually align rents in the regulated rental housing with market rates, while targeted allowances would be used to protect the most vulnerable households. Such a measure would increase investment incentives in the middle segment rental market, supporting housing supply.

21. ***We note the differing views between staff and the authorities on the maximum LTV ratio. This is not new, and we would appreciate it if staff could provide more context on the evolving discussion and pragmatic suggestions to take things forward.***

- Given the very high household debt (the second highest among OECD countries), staff recommend further lowering the LTV ratio to no more than 90 percent. This is also in line with the latest FSAP recommendations. The authorities recognize the risks related to high household debt but have also emphasized the fact that further tightening macroprudential policies may disproportionally affect the most vulnerable households by reducing access to housing. However, further lowering the LTV ratio would be considered as measures to increase housing supply become effective.

22. ***We concur with staff's recommendation to reinforce the macroprudential framework in a timely manner by lowering the loan-to-value ratio below 100 percent and introducing debt-to-income and debt service-to-income caps. In this vein, could staff comment whether comprehensive information on household debt is available which would enable the borrower-based tools?***

- Data on individual loans, by type and maturity, are collected by the authorities and are available. The current borrower-based tools are based on loan level data.

23. ***We thus welcome the new national recovery and resolution framework for the insurance sector, which will be key to safeguard financial stability. Could staff elaborate on the main elements of this framework?***

- The framework provides new instruments and gives more power to the central bank to intervene in case insurance companies are under distress. Especially, the framework requires medium-sized and large insurance companies to compile preparatory crisis plans specifying measures to be taken in case of sharp deterioration of their financial positions. The central bank is also responsible for preparing resolution plans for large companies. These measures aim at insuring the resilience of the insurance sector.

Structural reforms

24. ***Could staff elaborate on the outcome of the latest discussions on the pension reform and possible refinements on a reform to increase social acceptance?***

- The pension reform negotiation stalled when the team was in the field in November and there has been no progress thereafter. Some of the political economy considerations are described in our SIP which lays out the interest and demands of the parties involved in the negotiations. It would be premature to anticipate the outcome of the ongoing discussions, however, in staff's view, the final package will include some measures to compensate older workers who would be otherwise negatively affected by a shift to variable premium and regressive accrual rates. Possible changes to the recently reformed first pillar pension may also be part of future discussions.

25. ***Given the high mandatory contributions and the low interest rate environment, pension funds may be enticed to invest in higher yield- and lower quality assets. Are the pension funds sufficiently supervised to avoid any regulatory arbitrage? Staff's comments would be welcome.***

- The Netherlands has over 300 occupational pension funds. Each of them must always have sufficient liquidities available to pay the pensions. A pension fund's minimum regulatory coverage ratio is 105 percent. In addition, a pension fund must hold sufficient equity to cope with financial shocks. The size of these buffers depends on many factors, but for an average pension fund the required coverage ratio including the required buffers is approximately 125 percent (the greater the investment risks and the higher the average age in the pension fund, the higher the buffer requirements). In case of a funding shortfall, the fund must submit a recovery plan to the central bank to regain the coverage ratio of 105 percent within 3 years. The fund subsequently has a total of 15 years to rebuild equity. The regulators use very conservative interest rate assumptions to construct these ratios. The aggregate coverage ratio stood at 103 percent in 2018 while the average funding ratio was 108 percent.

26. ***While we agree with the need for the country to invest in digitalization and lifelong training and improve business creditworthiness information, we are of the view that freeing up the development of SMEs beyond the start-up phase will also require: (i) addressing the cumbersome labor market regulations; (ii) alleviating skill shortages through education and vocational training; and (iii) tackling the high interest rate margins on small loans that contribute to holding back SMEs' access to credit. Staff's elaboration on the measures being envisaged on these fronts, in any, are welcome.***

- In line with staff recommendations, the authorities are contemplating measures aiming at reforming labor market regulations to reduce duality (e.g. making fixed contracts less fixed, and flexible contracts less flexible).

- In authorities' views, there is no skill mismatch in the labor market. In addition, the Netherlands has a long history of a well-performing education system (including vocational education). However, staff raises the concern that part-time workers may benefit less from vocational training, which could reduce mobility in the labor market and affect career progression.

- On the SMEs' access to credit, staff recommends the creation of the credit bureau, which could improve access to information and reduce risk perception.

27. ***We commend the authorities for the difficult decision to raise environmental taxes and the ongoing discussion on a Climate Agreement, mentioned in Mr. Doornbosch' and Mr. Hanson's buff statement. What is staff's assessment regarding the adequacy of the existing taxation tools mobilized to progress towards the commitment of CO2 emissions reduction under the Paris Climate Agreement?***

- The selected issues paper in 2018 Article IV consultation discussed policies that could help the authorities reach their commitment under the Paris Climate Agreement. The paper was written before the Climate Agreement. Staff has not assessed the new Climate Agreement.