

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 16, 1965

Recent Economic Developments in the Netherlands:
July-September 1965

24 pages

Rosemary A. Darlington
and
Helen B. Junz

This paper reflects the personal opinion of the author and must not be interpreted as representing the opinion of the Board of Governors. It was prepared primarily for internal circulation within the Federal Reserve System, and must not be cited, quoted, or reprinted without permission.

November 16, 1965.

Rosemary A. Darlington
Helen B. Junz

Recent Economic Developments in the Netherlands: July-September 1965

Summary

So far in 1965, the Dutch economy has performed better than the authorities had expected earlier in the year. Both demand and output have been growing about as fast as in the preceding year and the Central Planning Bureau estimates that Gross National Product in 1965 will exceed the 1964 figure by 5 per cent (in real terms). This rather fast growth so far has apparently been achieved without appreciable additions to inflationary strains on resources.

Domestic supplies--except for agriculture where output has fallen below 1964 levels because of bad weather conditions--have been growing at an annual rate of about 6.5 per cent. This rate of growth could be achieved because of rather larger increases in productivity than estimated earlier. In addition, domestic supplies have begun to be supplemented by imports to a larger extent than in late 1964 and early 1965.

Nevertheless, with demand growing apace, the earlier signs of some relaxation of the acute labor market strains disappeared again during the summer. The bargaining position of labor therefore remains strong and it appears that the agreement reached in October 1963, which preserved the existing wage-setting machinery, has not succeeded in stemming pressures for policy revisions. Contracts in 1965 have been written

with two entirely new features: they are to run for longer periods than the one year for which guidelines are issued, and they have included escalation clauses. So far, contract rates have averaged about 6.3 per cent above 1965, therefore exceeding the 5 per cent guidelines. On the whole, it is estimated that hourly earnings in 1965 will rise 11 per cent above the preceding year's level, partly because of wage drift, but primarily because of the bonus of 2 per cent of the annual wage granted workers in recognition of the better-than-expected performance of the economy.

It is now generally accepted that far-reaching changes towards a freer wage bargaining procedure will be made. The main problem remaining to be solved is the extent to which the Government's role in the wage-setting procedure is to be reduced. If the Government's powers were to be curtailed severely in the field of wage-setting, it would also become increasingly difficult for the authorities to continue to pursue an effective price policy.

Basic price trends continue to point upward, although price indicators have been moving slightly downward in recent months. These downward movements largely represented the return to more normal levels of food prices after the adjustment to spring and early summer crop failures had taken place. However, for the first eight months of the year, consumer prices were an average of 5 per cent higher than they were in the comparable period of 1964. This is a larger increase than that of 4.5 per cent which was originally anticipated for the full year. The Government, therefore, moved to effect roll-backs of price increases in certain areas and is studying price behavior in broad sectors of the economy.

The Dutch external position has been improving despite the continued pressure on costs and prices. Largely because of the favorable development of the trade balance, the current account balance in 1965 is expected to be in surplus by \$138 million, an improvement of almost \$340 million over the 1964 results. With the restrictive monetary actions of the Netherlands Bank leading to capital market yields of over 6 per cent, Dutch long-term securities have become attractive to foreigners. As a result, there also has been an appreciable inflow of foreign capital into the Dutch market.

The new Budget for 1966 takes cognizance of this fact and states that monetary policy instruments for the combating of inflationary pressures are limited by the extent to which they may lead to inflationary inflows from abroad. Therefore, the Minister of Finance decided to use a new mix of fiscal and monetary measures to curtail private domestic spending. Higher Government expenditures in 1966 are to be financed by increases in indirect and some direct taxation; the second half of the income tax-cut which is to become effective next year will be neutralized through the issuance of compulsory savings certificates to about the total estimated amount of the tax cut. The bulk of the remaining financing requirements is to be raised from public pension and insurance funds so as not to add to pressures on the capital market.

There was a temporary easing of Dutch financial markets in August and September reflecting seasonal movements and the speculation against sterling in August. However in October financial markets tightened again. Two Bank for Dutch Municipalities, loans carrying yields

of 6 per cent and 5.88 per cent were heavily oversubscribed in August and September, but in October a State loan yielding 5.83 per cent attracted a smaller volume of total subscriptions. Since industrial bonds already yield 6 to 6-1/4 per cent, the relatively modest attention aroused by the latest State loan is interpreted as an indication that a 6 per cent coupon will in general become increasingly necessary to attract funds.

Demand and supply continue strong

Demand continued to expand strongly into the fall. New domestic orders to the consumer and investment goods industries remained at high levels during the summer and foreign orders continued to grow. According to a survey conducted by the Central Bureau of Statistics, industry judged its order position in July to be about unchanged from the previous three months, with 80 per cent of the respondents considering it normal, 5 per cent larger and 15 per cent smaller than normal.

In July consumption demand received a strong stimulus as the first tranche of the income tax reduction (amounting to fl 500 million at an annual rate) became effective and workers at the same time received a bonus amounting to 1 per cent of annual wages. In addition, demand for durable goods was further stimulated by the continued increase in residential construction: with the housing shortage still serious there remains considerable pent-up demand for household goods. The strong expansion of consumption demand thus offset any slowing in the growth of either foreign or investment demand. Foreign demand in recent months

has not been growing at quite the fast pace set earlier in the year, partly because of a slow-down in import demand from Germany connected to a large degree with the ending of certain military contracts. Investment demand may have begun to be slowed down somewhat by the restrictive monetary policies pursued by the Netherlands Bank since October, 1964. Small firms particularly appear to be having some difficulties in obtaining financing for their investment projects. The running-down of inventories of the past months may also reflect some financing difficulties and also a reaction to the building up of overly large stocks last year when price increases were anticipated.

The continued growth of demand was met by a steady expansion of supply. Industrial production continued to grow strongly over the past months. (See Table 1.) Barring seasonal variations--which are particularly pronounced during the summer months--industrial output appears to have grown steadily at an annual rate of about 6 per cent.

Construction activity recovered from the lower levels of earlier months which had resulted from bad weather conditions and residential construction continued to set new records. Only agricultural output fell below 1964 levels, reflecting the unusually wet summer.

The growth in industrial output was sufficiently strong to keep pace with the expansion in demand. According to the Central Bureau of Statistics order back logs have stopped growing since May, and order books for the consumer goods sector were seasonally reduced in June and July. (See Table 2.)

Table 1. Netherlands: Industrial Production 1964-August 1965 ^{a/}
(index numbers 1960=100 and percentage change)

		<u>Index</u>	<u>Percentage change from preceding year</u>			<u>Index</u>	<u>Percentage change from preceding year</u>
1964	Jan.	117	+11.0	Oct.	134	+9.5	
	Feb.	119	+10.8	Nov.	135	+8.0	
	Mar.	123	+10.4	Dec.	131	+6.5	
	Apr.	123	+ 7.3	1965	Jan.	126	+7.7
	May	127	+10.0		Feb.	129	+8.4
	June	123	+ 2.7		Mar.	128	+4.0
	July	112	+ 4.8		Apr.	131	+6.5
	Aug.	114	+6.6		May	134	+5.5
	Sept.	124	+ 7.9		June	133	+8.1
			July		116	+3.6	
			Aug. <u>e/</u>		118	+3.5	

a/ Adjusted for number of working days.

e/ Estimated.

Source: OECD.

Labor situation

The continued economic expansion was reflected in a renewed tightening of the labor market. Earlier in the year it had appeared that the acute labor shortage was easing slightly, but in July and August it became clear that this had only been a temporary situation. (See Table 3.) Improved weather conditions allowed work in the construction and agricultural sectors to move forward again after heavy rainfall had enforced reduced levels of activity during the second quarter. As a result of expanded activity in these sectors and continued high levels of activity in others, the demand for labor grew and job vacancies (after seasonal adjustment) again exceeded unemployment by more than four to one.

Table 2. Netherlands: Order Backlog, 1963-August 1965
(orders in terms of months of production, end January 1964=100)

End of month	All Industries ^{1/}			Consumer Goods Sector			Investment Goods & All Other		
	1963	1964	1965	1963	1964	1965	1963	1964	1965
January	100	100	97	96	100	95	101	100	98
March	99	101	95	95	102	95	100	101	95
May	101	100	97	100	105	99	101	99	97
June	100	99	97	98	103	98	100	99	97
July	103	99	96	96	99	95	105	99	97
August	100	98	96	95	97	n. a.	101	98	n. a.
October	100	100		98	102		101	99	
December	103	99		102	96		103	99	

^{1/} Excluding the chemical industry.

n. a. Not available.

Source: Centraal Bureau voor de Statistiek.

The labor market situation continued to be relieved somewhat by the recruitment of foreign labor. At the end of the third quarter there were 72,000 foreigners employed in the Netherlands. Despite the search for new labor resources, however, the Government is continuing its policy of subsidizing emigrants and the domestic labor force is annually reduced by about 8,000 workers through an efflux abroad.

Changes in Wage Policy

The long-standing labor shortage has given unions a strong bargaining base, as has the better-than-expected adjustment of the economy to the large wage increases of 1964. Workers so far in 1965 have obtained increases in contract rates averaging about 6.3 per cent rather than the authorized 5 per cent increase. In addition, unions obtained a bonus of 2 per cent of annual wages because the growth of the economy outstripped earlier estimates. One half of this amount was paid

in July; the second half becomes due at the end of the year. Furthermore, approval was won for contracts running for a longer period than the customary one year (the length of time for which the Central Planning Bureau projections provide guidelines) and the first contracts with escalator clauses allowing for cost-of-living adjustments were written.

Table 3. Netherlands: Labor Market 1963-August 1965
(in thousands, monthly averages, seasonally adjusted)

	<u>Unemployment</u>	<u>Vacancies</u>	<u>Ratio of vacancies to unemployment</u>
1963 I	38	115	3.0
II	31	121	3.9
III	29	123	4.2
IV	28	126	4.5
1964 I	27	126	4.7
II	27	130	4.8
III	28	135	4.8
IV	30	134	4.5
1965 I	32	127	4.0
II	33	120	3.6
June	32	125	3.9
July	32	133	4.2
August	32	134	4.2

Source: OECD.

With these break-throughs it became increasingly clear that the Wassenaar agreement of October 1963^{1/} which preserved the existing wage setting machinery had provided only a temporary solution. It is now generally accepted by labor and management as well as government that a freer wage policy must be worked out. Unions are demanding bargaining by unions on an industry or individual firm basis and the virtual end

^{1/} See: "Recent Economic Developments in the Netherlands, May-October 1963," dated November 27, 1963, p. 10-14.

of government interference in wage setting. Employers, on the other hand, want to see the government retain a deciding voice in the wage-setting process.

So far, employers and unions have agreed that contract wages will in the future be considered as minimum rather than maximum wages as heretofore. Wage payments could, on an individual basis, exceed contract rates by a "reasonable" level which was set in the neighborhood of 10 per cent. The main remaining problem, therefore, is the role that government ought to play in wage setting.

Adoption of the new measures would virtually eliminate the existence of "black wages." However, after relinquishing its control over wages, the Government would find it increasingly difficult to retain its price control policies and therefore would have to rely primarily on the conventional instruments of fiscal and monetary policy for the control of inflationary pressures.

Price trends continue up

Basic price trends were obscured by unseasonal price increases caused by crop failures in the spring and early summer. In late summer, food prices returned to more normal levels, resulting in a slight decline in the consumer and wholesale price indexes in July. (See Table 4.) However, basic price trends appear still to be upward. For the first eight months of the year, consumer prices were an average of 5 per cent higher than they were in the comparable period of 1964. This is a larger increase than that of 4.5 per cent originally projected for the entire year. Consequently the Minister of Economic Affairs

moved to contain the advance of prices and in September announced that certain hotel and restaurant price increases were to be rescinded. The Government further announced that prices in broad sectors of industry, wholesale and retail trade would be examined with the intent of enforcing further price reductions if such action appeared necessary.

Table 4. Netherlands: Selected Price and Wage Indicators, 1964-August 1965
(Index numbers, 1958=100, monthly averages and month)

	Hourly wages rates	Wholesale Prices		Cost of living	Export prices	Import prices
		Total	Manufactures			
1964						
I	157	106	107	113	100	98
II	163	107	109	116	101	98
III	165	107	109	116	102	98
IV	166	109	110	116	104	98
1965						
I	173	109	111	117	102	99
II	174	112	112	122	103	99
March	174	110	111	119	103	100
May	174	114	112	122	103	100
June	174	111	112	123	104	99
July	174	110	112	122	106	100
August	174	n.a.	n.a.	121	106	99

n.a. Not available.

Source: Centraal Bureau voor de Statistiek; OECD.

The price advance in agricultural products, which make up a large part of the Netherlands' exports, has shown up not only in increased domestic prices but has led also to a rise in the level of export prices. Export prices rose markedly in June and July and at the end of August stood 3.9 per cent above their first quarter level.

Further expansion of imports

The continued existence of demand pressure in the Dutch economy was reflected in the trade results of recent months. Contrary to the pattern which prevailed during the first half of the year, imports in the third quarter rose faster than exports and the seasonally-adjusted trade deficit rose to an average of \$97 million as compared with \$67 million for the second quarter. (See Table 5.) In contrast to imports, exports remained at their second quarter level during the third quarter. This may partly be the result of some slowdown in economic growth in countries which are the Netherlands' major trading partners, and may partly reflect the completion of military shipments to Germany. The coverage of imports by exports dropped from 88.5 per cent in the second quarter to an estimated 84.6 per cent in the third. Nevertheless, the somewhat enlarged third quarter trade deficit was smaller than that realized in the third quarter of 1964.

Balance of payments continues favorable in second quarter

The good performance of the Netherlands foreign trade account in the second quarter was the chief factor behind the continued favorable development of the country's balance of payments in that period. The overall balance closed with a deficit of only fl 474 million (\$131 million) in the second quarter, fl 125 million smaller than the deficit realized at the same time last year. For the first half of the year, therefore, (a period when the Dutch balance of payments is traditionally weak) the total deficit, at fl 491 million (\$136 million), amounted to less than half of that realized in the first half of last year.

Table 5. Netherlands: Merchandise Trade, 1963-September 1965
(millions of U.S. dollars, monthly averages, seasonally adjusted)

		<u>Exports</u> <u>f.o.b.</u>	<u>Imports</u> <u>c.i.f.</u>	<u>Balance</u>	<u>Exports as %</u> <u>of imports</u>
Year	1963	414	497	- 83	83.3
	1964	484	588	-104	82.3
1964	I	460	567	-108	81.1
	II	475	595	-119	79.8
	III	486	586	-100	82.9
	IV	506	595	- 89	85.0
1965	I	513	577	- 64	88.9
	II	530	599	- 67	88.5
	May	511	581	- 71	88.0
	June	551	601	- 50	91.7
	July	551	648	- 97	85.0
	August <u>1/</u>	500	586	- 86	85.3
	September <u>e/</u>	542	650	-108	83.4

1/ Preliminary.

e/ Estimated.

Source: OECD.

The improvement in the trade account as compared with the very unfavorable results of the second quarter of 1964 amounted to fl 343 million as the trade deficit was reduced to fl 555 million. (See Table 6.) A favorable turn in payments related to investment income further improved the current account balance. Substantial dividend and interest payments to foreign owners of Dutch securities usually lead to a large outflow of such funds in the second quarter of each year. This year, however, the outflow was almost entirely offset by receipts, as increased dividend payments by American companies accrued in favor of Dutch security holders. Consequently, the net outflow of investment income amounted

Table 6. Netherlands: Balance of Payments, 1964-Second Quarter 1965 ^{1/}
(in millions of Dutch guilders)

	1 9 6 4 ^{a/}				1 9 6 5	
	I	II	III	IV	I	II a/
Goods and Services						
Merchandise	-792	-898	-683	-403	-623	-555
Investment income	195	-135	291	383	223	-45
Other services	298	438	419	430	408	296
Total	<u>-299</u>	<u>-595</u>	<u>27</u>	<u>410</u>	<u>8</u>	<u>-304</u>
(on transaction basis)	(-542)	(-820)	(284)	(420)	(100)	(-250)
Private Capital						
Transactions in domestic securities	-62	44	190	153	183	90
Transactions in foreign securities	-36	16	73	12	-84	-94
Direct investment	-139	-32	-44	14	-87	-100
Long-term credits	158	56	34	78	139	107
Other	14	-83	152	131	18	1
Total	<u>-65</u>	<u>1</u>	<u>405</u>	<u>388</u>	<u>169</u>	<u>4</u>
Commercial Banks Capital						
Total	<u>-110</u>	<u>45</u>	<u>110</u>	<u>-27</u>	<u>-168</u>	<u>-148</u>
Official Payments						
Debt repayments	-1	-20	--	-21	-1	--
Other	-8	-30	21	-18	-25	-26
Total	<u>-9</u>	<u>-50</u>	<u>21</u>	<u>-39</u>	<u>-26</u>	<u>-26</u>
(Errors and omissions)	(243)	(225)	(-257)	(-10)	(-92)	(n.a.)
Surplus or Deficit (-)	<u><u>-483</u></u>	<u><u>-599</u></u>	<u><u>563</u></u>	<u><u>732</u></u>	<u><u>-17</u></u>	<u><u>-474</u></u>
Financed by:						
Special transactions						
Debt prepayments	--	--	--	--	--	--
Commercial banks						
Foreign exchange, net (Increase-)	260	496	59	-133	-19	466
Central bank						
Drawing rights on IMF (Increase-)	-72	--	-91	-63	-13	-217
Consolidated credits (Receipts-)	3	1	4	1	4	--
Gold & foreign exchange (Increase-)	292	102	-535	-537	45	225
Total	<u>223</u>	<u>103</u>	<u>-627</u>	<u>-599</u>	<u>36</u>	<u>8</u>
Total financing	<u><u>483</u></u>	<u><u>599</u></u>	<u><u>-563</u></u>	<u><u>-732</u></u>	<u><u>17</u></u>	<u><u>474</u></u>

1/ Data are shown on a cash rather than a transactions basis. This affects primarily the current account balance and the commercial banks' capital flows

a/ Preliminary.

Source: Netherlands Ministry of Finance.

to only fl 45 million as compared with an outflow of fl 135 million during the second quarter last year. Despite a reduction in receipts from other services, the year-to-year improvement in the current account amounted to fl 291 million for the second quarter and fl 598 million for the first half of the year. As a result, despite the somewhat less favorable third quarter trade results, the Central Planning Bureau has revised its estimate of the current account balance for the year from a deficit of fl 100 million to a surplus of fl 500 million and estimates a current account surplus of fl 750 million for next year.

An inflow of private capital continued to reinforce the favorable Dutch balance of payments position. Long-term credits flowed into the Netherlands in substantial volume during the second quarter and foreign purchases of Dutch securities continued, attracted by the yields on the Dutch capital market. These inflows were large enough to more than offset larger amounts--as compared with 1964--placed abroad by Dutch investors for the purchase of foreign securities and direct investment.

The second quarter balance of payments deficit was financed almost entirely by a reduction in commercial banks' net foreign exchange assets, which fell by fl 466 million over the quarter. Official foreign exchange holdings were also reduced, but the overall change in official reserves was small because of an improvement in the Netherlands' IMF position.

Official reserves rise in third quarter

There was a substantial rise of fl 94 million (\$26 million) in official reserves during the third quarter and a further rise of fl 15 million in October as the Dutch balance of payments entered its period of seasonal strength. (See Table 7.)

The Dutch reserve accruals were reflected by upward movements in the guilder exchange rate, which moved from an average of 27.735 cents in June to an average rate of 27.761 cents in July and 27.791 cents in August. (See Table 8.) The particularly strong upward pressure on the guilder in August was connected with the repatriation of sterling balances during the sterling crisis. The rate declined in September after preparations for the mid-September tax date were completed and declined further in October as a result of strong commercial demand for dollars.

Temporary easing in financial markets

There appeared to be a temporary easing in Dutch financial markets in August and September but markets tightened again in October. The easing was connected with a seasonal reduction of money in circulation following the vacation period, with an inflow of funds from abroad as a result of speculation against sterling in August and September tax date preparations.

The call money rate declined from 4.25 to 2.0 per cent during August and the rate remained at this level through the end of September

Table 7. Netherlands: Changes in Official Reserves 1963-October 1965
(In millions of U.S. dollars, end of period figures)

Annual change:		<u>Gold</u>	<u>Foreign exchange</u>	<u>Total</u>	<u>IMF</u>	<u>Total</u>
1963		20	136	156	--	156
1964		87	98	185	62	247
Quarterly change:						
1963	I	--	7	7	--	7
	II	--	88	88	-5	83
	III	--	15	15	5	20
	IV	20	26	46	--	46
1964	I	--	-66	-66	20	-46
	II	--	-47	-47	--	-47
	III	--	174	174	25	199
	IV	87	37	124	17	141
1965	I	35	-50	-15	4	-11
	II	33	-92	-59	60	1
	III	--	64	64	30	94
Monthly change:						
	July	--	32	32	29	61
	August	--	11	11	1	12
	September 1/	--	21	21	--	21
	October 1/	--	15	15	--	15

1/ Estimated.

Source: International Financial Statistics; Netherlands Bank.

except for a brief tightening in the first half of the month as a result of the mid-September corporate tax date. (See Table 9.) The tendency towards greater ease was confirmed by the fact that from mid-July on, commercial banks' extensions of new credits exceeded the permissible ceiling by progressively smaller amounts. As a result, penalty deposits

Table 8. Netherlands: Exchange Rate in U.S. Cents
per Guilder, January-October, 1965 ^{1/}

Par value	27.624
Lower limit	27.42
Upper limit	27.84

<u>1965</u>	<u>Monthly average</u>		<u>End of week</u>		
	January	27.831	August	6	27.812
	March	27.827		13	27.806
	June	27.735		20	27.793
	July	27.761		27	27.780
	August	27.791	September	3	27.774
	September	27.781		10	27.778
	October	27.772		17	27.771
				24	27.788
			October	1	27.798
				8	27.779
				15	27.770
				22	27.757
				29	27.750

^{1/} Noon buying rates in New York.
Source: Federal Reserve Board.

of commercial banks with the central bank declined steadily from fl 202 million in July to fl 111 million in September and fl 70 million in October. The permissible expansion of bank lending for the period from September through the end of the year has been set at 6 per cent of the average amount of credits granted in the first half of 1963. This increase in credit expansion allowed in the last quarter of 1965 is somewhat larger than the 5 per cent limit set for the last quarter of 1964 because of the expansion of the economy in 1965.

The high yields on Dutch long-term securities, now exceeding 6 per cent, have proven attractive to both domestic and foreign investors. In August, a fl 100 million loan of the Bank for Dutch Municipalities, issued at par with a coupon of 6 per cent, was heavily oversubscribed and allocations reportedly had to be scaled down considerably. Large foreign demand was reported for this issue. Encouraged by the success of this loan, the Bank for Dutch Municipalities brought out another fl 100 million issue with an effective yield of 5.88 per cent in September which was also heavily oversubscribed. In October, however, the Government issued a loan offering an effective yield of 5.83 per cent, leaving the total amount of the issue open in order to obtain an accurate picture of the tone of the capital market. The fact that only fl 140 million was subscribed to this issue is generally interpreted as an indication that a 6 per cent coupon is becoming increasingly necessary to attract funds.

Table 9. Netherlands: Selected Interest Rates,
January 1964 - October 1965
(per cent per year)

<u>Monthly Average</u>		<u>Call ^{1/}</u> <u>money rate</u>	<u>3-month</u> <u>treasury</u> <u>bill rate</u>	<u>Government</u> <u>bond yield</u>	<u>Industrial</u> <u>bond yield</u>
1964	January	1.67	2.31	4.83	n.a.
	April	2.48	3.00	4.71	n.a.
	July	3.72	4.26	5.02	n.a.
	October	3.24	3.80	4.84	n.a.
1965	January	2.43	3.29	4.98	n.a.
	March	3.05	3.39	4.95	n.a.
	April	3.39	3.54	5.02	n.a.
	May	3.67	4.05	5.12	n.a.
	June	2.69	4.08	5.27	n.a.
<u>Week Ending</u>					
July	23	4.13	4.13	5.27	n.a.
	30	3.00	4.13	5.28	5.45
August	6	4.25	4.19	5.25	5.83
	13	2.50	4.13	5.24	5.79
	20	2.00	4.00	5.25	5.69
	27	2.00	4.00	5.24	5.62
September	3	2.50	4.00	5.23	5.65
	10	3.75	4.06	5.21	5.68
	17	2.00	3.97	5.14	5.67
	24	2.00	4.00	5.18	5.69
October	1	3.25	4.06	5.16	5.85
	8	4.25	4.06	5.22	5.83
	15	3.00	4.06	5.27	5.94
	22	2.00	4.06	5.30	5.98
	29	4.25	4.13	5.38	6.12

1/ Unofficial rate.

n.a. Not available.

Source: Netherlands Bank.

Budget for 1966 announced

The budget proposals for the year 1966 were presented to Parliament by Finance Minister Vondeling and are now under discussion. They call for an increase in expenditures of fl 1.7 billion (or 10 per cent) over the estimated outcome of 1965. (See Table 10.) Thus the principle that Government expenditures must not be allowed to rise more quickly than the national income has been temporarily abandoned. The Government has justified this greater increase on the grounds that larger social expenditures are important for the proper accommodation of social needs, especially in this period of growth. However, the Government has recommended a number of tax measures as a means of raising the necessary additional revenues; consequently the 1966 budget, as proposed, would leave a deficit about fl 0.4 billion lower than that estimated for 1965.

The Government plans to finance most of the increased expenditures by raising excise taxes on a broad range of consumer goods as well as by raising dividend and corporation taxes. Moreover, although the second phase of the income tax reduction is still scheduled to take place, the Government intends to delay the effects of the tax cut by issuing compulsory non-negotiable tax certificates. As a result of the tax cut, persons who owed less than fl 100 per annum in taxes would be entirely exempt from tax in 1966 and the assessments of all other taxpayers would be reduced by fl 100. However, according to the Government's plan, people who remained liable to income tax would be obliged to take up

Table 10. Netherlands: Budgets for 1965 and 1966
(millions of guilders)

	<u>1965</u>		<u>1966</u>
	<u>As proposed</u>	<u>Estimated Results</u>	
Expenditures	15,006	16,439	18,150
Revenue	<u>14,090</u>	<u>14,951</u>	<u>17,065</u>
Deficit	916	1,488	1,085

non-negotiable tax certificates with a face value of fl 100 which will be redeemed in 5 years at fl 130. This plan would defer the effect of the tax cut until 1970 and would reduce revenue losses by approximately fl 425 million in 1966.

The Government proposes to cover the budgeted deficit of fl 1.1 billion by borrowing fl 900 million from pension and insurance funds and raising only fl 200 million on the public capital market, thus leaving more room for private borrowers. However an additional fl 400 million still needs to be raised on the capital market in either the remainder of this year or next year to finance the 1965 budget deficit. The Finance Minister expressed concern that greater government recourse to the capital market, under the current strained conditions, would only lead to capital inflows. These would add to inflationary pressures and limit the restrictive monetary policy pursued so far.

Economic performance in 1965 and expectations for 1966

The performance of the Dutch economy in 1965 exceeded expectations as it had in 1964. The Central Planning Bureau in its assessment

of the performance to date revised its estimates upward for virtually all economic sectors. Gross National Product in 1965 is now expected to grow by 5 per cent (in real terms) as compared with earlier estimates of 4 per cent. (See Table 11.) Consumption expenditures, exports and residential construction all are rising faster than expected. The larger final demand was accommodated without producing greater strains on capacities. Industrial production is growing at a 6.5 per cent rate rather than at 6 per cent mainly because productivity increased more rapidly than was anticipated earlier. But wages have also risen faster than estimated--earnings in 1965 are estimated to increase by 11 per cent as compared with 1964--and labor costs per unit of output will increase by 7 per cent. Because of these increases in cost and to some extent because of the effects of the bad weather in spring and early summer on food prices, consumer prices are expected to rise by 5 per cent.

Despite the faster growth of demand and price advances, balance of payments results are expected to show a considerable improvement. The current account is expected to close with a fl 0.5 billion surplus--a fl 1.25 billion improvement over 1964.

The Central Planning Bureau's estimates for 1966 reflect the new economic developments as well as the new trends in economic policy. For the first time, wage developments are treated as endogenous rather than as exogenous variables, reflecting the trend towards freer wage bargaining procedures.

Table 11. Netherlands: Projections and Results of the
Economy's Performance, 1964-1966
(percentage change over previous year)

	1964	1965		1966
		April estimate	Sept. estimate	
Industrial production	7.5	6	6.5	7.5
Private consumption expenditure <u>1/</u>	5.5	6	6.5	3
Gross fixed investment by enterprises <u>1/</u>				
housing	28	9	10	7
other	14	4	3.5	8
Exports <u>1/</u>	12	8	10	12
Imports <u>1/</u>	15	5	4.5	11.5
Gross national product <u>1/</u>	8.5	4	5	5.5
Productivity in enter- prises	7.5	3.5	4	5
Wage sum per worker (incl. social charges)	15	n.a.	11	9.5
Investment good prices	6	4	3	3
Consumer prices	6.5	4.5	5	4.5
Export prices	2.5	1.5	1	0.5
Current account balance (fl billions)	-0.73	-0.10	0.50	0.75

n.a. Not available.

1/ Volume increase.

Source: Central Planning Bureau.

Gross National Product is estimated to grow somewhat faster than in 1965, by 5.5 per cent as compared with 5 per cent. Private consumption expenditures are expected to grow more slowly, mainly because of large anticipatory expenditures in 1965 connected with once-for-all increases in disposable incomes. The basic trends in investment expenditures and export demand are not estimated to change much; but inventory accumulation and Government spending are to expand faster than in 1965.

Supplies are estimated to increase also faster than in the current year; agricultural output should be larger, assuming normal weather conditions; industrial output should reflect the heavy investment outlays of the past two years; and imports should add to domestic resources to a greater extent than in 1965. Despite the larger supply availabilities, prices are expected to rise at about the same rate as in the current year, but these increases are largely connected with the increases in indirect taxation proposed in the 1966 budget and an already agreed-upon rent increase. Wages, determined by the over-all growth expectations, are estimated to go up by 9.5 per cent, giving rise to an increase in unit labor costs of 4.5 per cent. No relaxation of labor market tensions is expected. The fast economic expansion is expected to result in an excess demand of about fl 300 million which will be reflected in the current account of the balance of payments. However, because of a favorable change in the terms of trade, no deterioration, but actually a small improvement, is foreseen for the current account balance.