87| *Cf. European Commission, Council recommendation on the National Reform Programme 2011 of France and delivering a Council opinion on the updated Stability Programme of France, 2011-2014, SEC(2011) 806 final, Brussels, 7 June 2011, p. 7.*
88| *Cf. IMF, France Sustainability report, report drawn up at the request of the G20, Washington DC, 23 November 2011, p. 13.*
89| *Cf. interview with the minister for the budget, public accounts and state reform, "Précresse: "Nous avons déjà fait voter l'essentiel des mesures pour atteindre l'équilibre en 2016", Les Echos, 8 February 2012.*
90| *P. Artus, L'écart entre les situations démographiques peut-il expliquer l'écart entre les positions dominantes de politique économique en France et en Allemagne?, Natixis, Flash Economie, n° 212, 21 March 2012.*
91| *Cf. P. Artus, Contrairement à l'idée répandue, la France a mené une politique de la demande et non une politique de l'offre depuis la fin des années 1990, Natixis, Flash Economie, n° 763, 14 October 2011, and article by N. Baverez, "Fin de partie" (Le Monde, 29 November 2011) and editorial by H. Gibier, "Bas les masques" (Les Echos, 16 January 2012).*

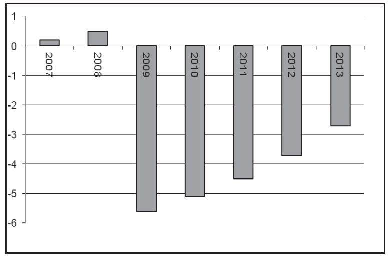
FISCAL STABILITY IN THE NETHERLANDS

Raymond Gradus | Hubert Beusmans

1. FISCAL POSITION OF THE NETHERLANDS

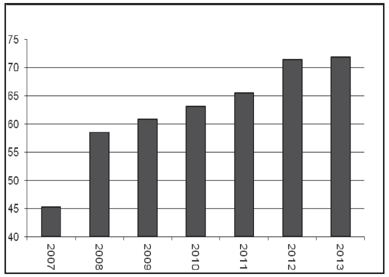
Prior to the financial crisis, the Dutch government could present sound finances. Just before the bankruptcy of Lehman Brothers in September 2008, the national budget was expected to be balanced in 2009 as it was also in 2007 and 2008. Furthermore a reduction in the public debt/GDP ratio to 38 percent , the lowest level in 35 years.[1] However, economic developments have changed dramatically, thereby causing substantial damage to the Dutch economy. In 2009, the deficit/GDP ratio decreased by almost 6 percent points to minus 5.6 percent and has only slightly improved in 2010 towards 5.1 percent (graphic I). Due to a late revision of budget forecast for 2009 that still referred to a positive economic outlook implying that wages and disposable income continued to rise, austerity measures set in too late. Therefore the debt/GDP ratio increased by nearly 15 percentage point from 45 percent in 2007 to almost 60 percent in 2008 mainly caused by financial interventions to save the large Dutch financial sector (graphic II). In order to stimulate the economy after the 2008 economic downturn the former government of Christian Democrats (CDA) and Social Democrats (PvdA) activated the so-called automatic stabilisators.[2] In addition, the government stimulated the economy by initiating and fastening procedures for extra infrastructure works, these measures also concerned local government.

Graphic I: Dutch deficit/GDP ratio



Source: CPB (2012a)

Graphic II: Dutch debt/GDP ratio



Source: CPB (2012a)

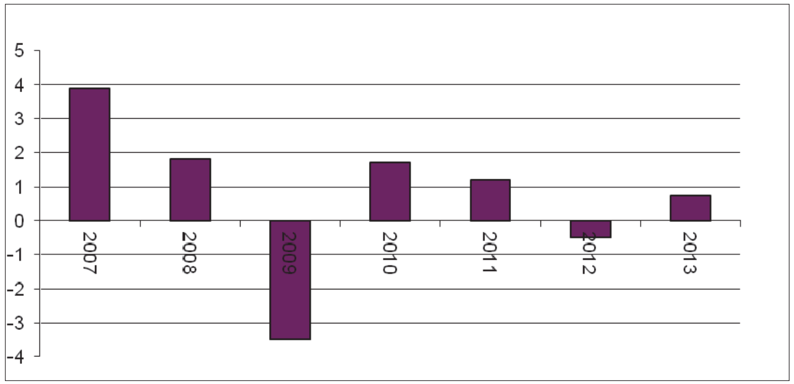
Nevertheless, the unexpected increase in public debt does not even include a potential loss of resources that might occur if some of the contingent liabilities to the financial sector materialise. However, the cabinet Balkenende IV (2007-2010) took some measures to fill the budget gap. It proposed an increase of age at which people receive first pillar state-subsidized old-age pension in two steps: from 65 to 66 in 2020 and then to 67 in 2025. However, before sending the legislation for this new scheme to parliament the Balkenende government broke down in February 2010.

After elections in June 2010 a government between Christian Democrats (CDA) and Liberals (VVD) supported by the populistic PVV took office at the end of 2010. It agreed on an austerity package of 18 billion euro's (3 percent GDP) in the period between 2011 and 2015. In addition, the government took the same measures on the old-age state pension. After consulting the social partners in 2010/2011 the government decided to raise the pension age to 67.[3] The agreement and the sustainability measures were not supported by the PVV, but by the Social Democrats (PvdA). Despite these austerity measures and reforms, Dutch deficit/GDP ratio in 2011 was 5.0 percent and will only be slightly better in 2012 with 4.6 percent (graphic I).

2. ECONOMIC GROWTH

The current European recession has effected the Dutch economy badly again and seems to hit the Netherlands harder than for example Germany and Finland. Especially the German economic development is interesting as it was at the beginning of the century "der kranke Mann" in Europe and at this moment Germany according to Van Paridon is the strongest economy of Europe.[4] What kind of reforms Germany made last decade? According to Van Paridon three factors (i.e. structural reforms in entrepreneurship, moderate wage development and reforms in the welfare state) seem to be important for the positive growth figures of Germany. These structural reforms of German economy started in the aftermath of the reunification in the 1990s. For the Netherlands the 1990's were years of high consumption levels, there was no stimulus for any long term reforms. According to the March forecast of the Dutch Central Planning Bureau (CPB), in 2012 the Dutch GDP will decrease by 0.75 percent after a modest growth in 2010 and 2011. In addition, the Dutch economy will slightly improve in 2013 with a GDP growth of 0.75 percent (graphic III).

Graphic III: Dutch GDP growth rate



Source: CPB (2012a)

Interestingly, in the beginning of this century the Dutch GDP growth rate was comparable with the GDP growth rate in Germany. Nowadays the Dutch GDP growth is substantially lower. Especially, the domestic spending of the Dutch economy is weak. In 2012 Dutch consumption decreases by -1 percent points and for 2013 it is assumed to increase by

0.7 percent points. This is totally different from the last decades, where consumption was one of the main drivers of Dutch growth. According to the CPB lower income and wealth effects are the cause for this weak consumption figure.[5] Also other elements of private spending such as capital and property investments are weak.

By the end of the 1990s, when many women joined the labour market and housing prices raised quickly, family consumption contributed to GDP growth by more then 1 percent a year (consumption as percentage of total GDP growth was 1.4 percent during the period 1996-2000, 0.4 percent during the period 2001-2005). After 2000 this effect was significantly smaller and by 2006 private consumption did not contributed to GDP growth anymore. During the financial crisis it was mainly public spending which influenced internal expenditure and had a positive impact on GDP growth.[6]

Lower income effects are caused by the current modest increase in employment. Wealth effects are mainly caused by the current state of the housing market. Dutch unemployment will rise from 4.5 percent in 2011 to almost 6 percent in 2013. More important, labour supply will shrink in 2013 due to labour hoarding effects. In addition, prices in the Dutch housing markets have decreased by more than 10 percent points since 2008 and the number of house selling is dropping dramatically as well. Therefore, structural measures for labour and housing market reforms must be necessarily introduced by the Dutch government.

Based on the coalition agreement in 2010 (CDA/VVD), the deficit ratio for 2013 was forecasted to fall to roughly 2 percent. However, the CPB estimate in March 2012 predicted a 2013 deficit ratio of 4.6 percent, implying additional austerity measures of 2½ percent GDP in order to meet the 3 percent target of the Stability and Growth Pact (CPB 2012b). This figure takes into account second round effects. However, the negotiations between the government and the PVV on additional measures for the remainder of the coalition period broke down in April 2012 and new elections were scheduled to take place in September 2012. Fortunately, on April 26th, only a few days before the deadline for the Stability Programme,[7] the caretaker government managed to agree on a 12 billion austerity package for 2013 after winning the backing of three left-leaning opposition parties.[8] In addition according to estimations of CPB (2012) the deficit/GDP ratio fell to -2.7 percent GDP.

3. PUBLIC OPINION

Let us consider the opinion of Dutch public towards 3 percent target in 2013. The poll of Maurice de Hond weekly carried out in the Netherland serves as reference.

Table I: Pole Dutch voters and SGP-targets.

	Voting behavior elections 2010							
	All	PVV	VVD	CDA	D66	PvdA	SP	Groen links
	in %							
The Dutch Government should commit to the 3 percent rule of the SGP.	77	70	92	94	81	62	52	66
It's a letdown for the Netherlands that we now have an excessive budget deficit our self.	65	70	66	49	79	64	61	67

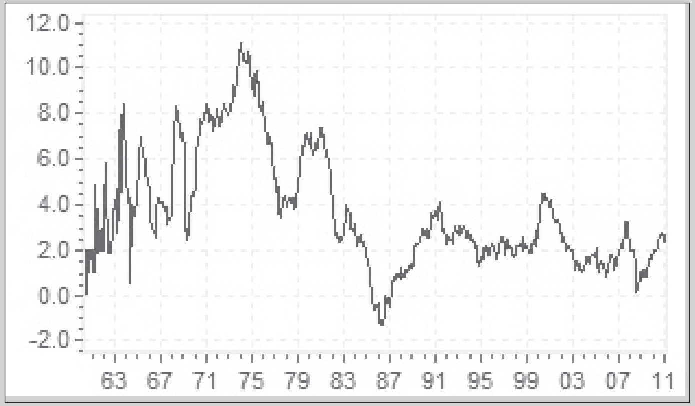
Source: www.peil.nl (March 2012)

Interestingly, 77 percent of Dutch population wants to reach the 3 percent-target. In addition, 65 percent stated, it's a letdown for Dutch government not reaching the 60 percent debt/deficit. Between political parties some remarkable differences should be emphazised. Voters of Christian Democrats (CDA) and Liberals (VVD, D66) support the SGP targets in a large majority. Voters of Social Democrats (PvdA), Green Left (Groenlinks), Socialistic party (SP) and Populists (PVV) are less convinced that the goals of the SGP in 2013 should be reached. When appointed in 2010 the government set the goal to reach a balanced budget again in 2015. However, by the new debt crisis it is hard to reach this goal in 2015. Too many austerity measures can harm Dutch economic recovery. In order to foster our reputation we must present the European Commission a solid and realistic plan to reach the 3 percent rule in 2013 and a balanced budget in the medium term.

Inflation

Inflation is not heavily debated in the Netherlands and seems to be of greater concern for Germany than it is for the Netherlands. However, it is interesting to see that Dutch inflation, although it has been relatively stable around 2 percent since the beginning of the 1980s, raised between 1999 and 2001 to 4.2 percent.

Graphic IV: CPI Dutch Long Term[9]



Source: Global-rates.com

High economic conjuncture dominated the Netherlands in the 1990s. The main reasons were the internet bubble and the substantial increase in housing prices. This was followed by a period of low economic conjuncture which in the Netherlands seems to be deeper and longer than in many Western countries. One of the reasons for this was he government policy in the 1990s. The Government used incidental revenue of windfalls for structural expenditure. It was mainly spent on internal healthcare, education and structural expenditure in security and caused tensions in the labour market. As a result government spending was structurally too high. By the time unemployment and inflation raised and consumption decreased, economic growth stagnated.

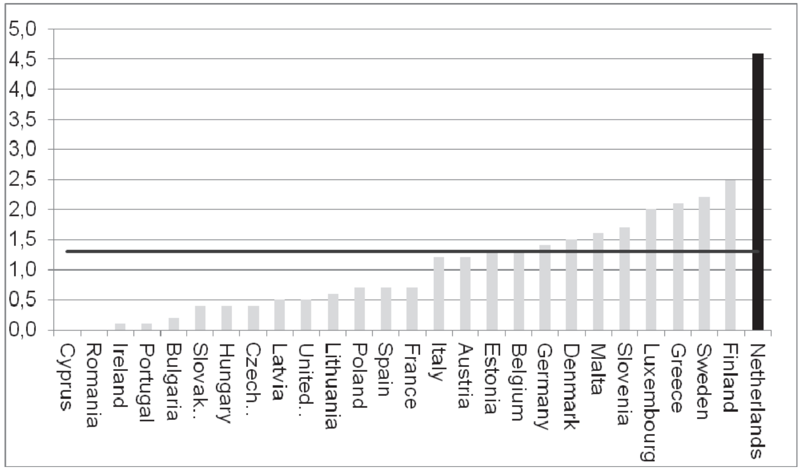
4. STRUCTURAL REFORMS

However, the negotiations between the government and the PVV about additional measures for the remainder of the coalition period broke down in April 2012 , the Dutch government and PVV disagreed about reforms and additional austerity steps for the remaining part of the coalition period and new elections will take place in September. Based on a temporary agreement between CDA, VVD, D66, GL and CU some austerity measures implying 3% in 2013 and short-term reforms on housing and labour market were taken in the last week of April.[10]

Yet, the figures presented above show the urgency of a long-term austerity package combined with structural reforms. The German case shows that especially labour market reforms can be helpful in order to stimulate economic growth. A more activating welfare system will reduce public spending and is also conductive to labour force participation. Labour market reforms must have high priority and are necessary in order to modernise the Dutch labour market. However, such reforms are very difficult to implement since the populistic PVV and opposition parties such as the Social Democrats and Socialistic Party are opposing any reforms. Also further reforms on the housing markets are hard to enforce. Nevertheless, the Dutch economy faces both households and the bank sector in debt, which should be tackled as well. The mortgage debt being very high in the Netherlands may become a source of instability, for example if interest rates go up or if unemployment rises drastically.

Finally, there are long term problems which the Dutch government has to deal with. First, according to 2009 EU forecasts of the costs for Dutch long-term care will raise by 4.5 percentage point of GDP between 2010 and 2060, more than three times the EU average and much larger than for example in Germany (graphic V). The Dutch personal responsibility and responsibility of the family for long-term care is very limited, and this is not sustainable in the long run.

Graphic V: Change in long-term care 2010-2060 (% GDP)



Source: EU (2009)

Second, a rising demand for care will also face a tighter labour market. The need for medical and educational professionals will grow rapidly in the coming decades thereby facing a shrinking supply due to an ageing society. Regarding this outlook a labour market reform appears to be highly necessary. Moreover, the need for a more efficient organisation of health care is not only based on costs, but also on social causes.

Third, tax and housing market reforms. Dutch debt culture, related to the housing market, will be fundamentally broken by introducing a social flat tax. For this reason the Dutch fiscal system should be drastically reformed. This should be done by setting-up a flat tariff and a rise for top incomes (solidarity levy). Importantly, mortgage will be deducted against the marginal flat rate. There are several advantages to this reform. The tax system will become more simple. Flat tax will make it more attractive to lend less. Different tax boxes of the Dutch fiscal system will be brought nearer to each other. It concerns tax on labour income and tax on assets capacity. This means that the pivot of financing your own house or company with as much as possible borrowed money will be less. It is therefore stimulated to redeem the mortgage debts. Therefore, it creates economic growth and employment.

5. CONCLUSION

Public finances have deteriorated since the crisis started in 2008. The Dutch agenda for the long term should be one of sound public finance and clever structural policies especially focused on the labour market, a more focused role of the state for health care and restraining trust in the housing market. In the budget agreement from April 2012 the first necessary steps towards a recovery of public finances have been taken. However it will be import that additional reforms will follow.

1| *Proposed national budget (Miljoenennota): presentation of the financial position of the nation for a specified period (often a year), based on detailed estimates of planned or anticipated expenditure during that period and proposals for financing it.*
2| *Also the (orthodox) Protestant party, CU, supported this government.*
3| *Pension agreement June 2011 between social partners and government.*
4| *Van Paridon K., "Duitse economie: krachtig herstel, nu sterk genoeg", in: Internationale spectator (March 2012) pp. 141 – 145.*
5| *Wealth effect is an increase (or decrease) in spending that accompanies an increase (or decrease) in perceived wealth.*
6| *CPB, Centraal Economisch Plan (2012), p. 53*
7| *This concerns the Stability Programme that needs to be submitted as part of the requirements for the Stability and Growth Pact.*
8| *These parties are Groenlinks (Green Left), D66 and the CU.*
9| *CPI refers to the rate of inflation based on the consumer price index. CPI shows the change in prices of a standard package of goods and services which households purchase for consumption. In order to measure inflation, an assessment is made of how much the CPI has risen in percentage terms over a give period compared to the CPI in a preceding period. If prices have fallen this is called deflation (negative inflation).*
10| *Reforms highlights of Stability programme on 26th of April 2012: a step-wise increase in the retirement age starting in 2013 and leading to a retirement age of 66 in 2019 and of 67 in 2024, employers are expected to pay unemployment benefits for the first six months and steps are taken by simplifying dismissal procedures and in house market only mortgages based on an annuity schedule over a period of 30 years are deductible. In addition, the transaction tax for houses will be lowered.*