Mr. Wellink discusses recent developments in the Dutch economy Address given by the President of the Netherlands Bank, Dr. A.H.E.M. Wellink, at the XXIst European meeting of the Trilateral Commission in The Hague on 25/10/97.

Recent success

As you all know, the Dutch economy has been doing remarkably well lately. Over the past three years, Dutch GDP has grown by an annual average of 3%, i.e., considerably more than was the case in most major continental European countries. For this year and the next, the prospects for growth are even better. Growth has furthermore been attended by considerable job creation, averaging nearly 100,000 man-years per annum, or 1.8%, since 1995. The Dutch unemployment figure has consequently dropped to around 6%.

All this is in sharp contrast to the picture presented by most countries on the continent of Europe. Until very recently, they were seeing no more than a moderate cyclical recovery. Still, this year the growth of output in these countries would seem to be accelerating substantially. This has not yet, unfortunately, fed through to the employment situation. In Germany and France, for instance, unemployment is expected to rise even further this year. The unemployment figure there is about twice that in the Netherlands.

The Dutch upturn has drawn widespread attention, and has come to be known in some circles as the Dutch model. In my speech today, I will guide you through the roots of the Dutch success. Let me start by saying that the recent favourable economic development is definitely not a miracle. It simply boils down to sound macro-economic policies and deregulation, in particular of labour markets (including some country-specific deregulation policies). Every country in the world can effectively copy it. The implementation of these policies was possible because of a broad consensus in the Netherlands on their necessity. This is lacking in many of our neighbouring countries. But to my mind this consensus among all relevant parties was not caused by the so-called consensus model -- on the contrary. The consensus emerged after the consultative framework -- which had led to paralysis in the 1970s -- was made much leaner. I will come back to that later. Let my first give you an overview of the facts and figures surrounding the so-called “Dutch miracle”.

Making up for lost ground

To see the developments of the last few years in their proper perspective, we must take a look at the situation in the early 1980s. In those years, Dutch business was in serious trouble. The international recession, when it struck, hit the Netherlands much harder than its neighbours, because in the 1970s business sector profitability here had been structurally eroded by excessive rises in wage costs and the consequent deterioration of competitiveness. A vicious circle of labour shake-out set in, leading -- via the social security system -- to higher social insurance contributions and thus contributing to further job destruction. The problem was compounded by an inappropriate policy reaction to the two oil crises, in the form of an expansive budget leading to unsustainable deficits (of over 10% of GDP) and, after some delay, to soaring central government indebtedness.

The figures show only too clearly that in those years the Netherlands was much worse off than other countries. In 1970, the Netherlands had still held the sixth place in Europe in terms of per capita GDP (10% above the European average). But by 1988 it had fallen to below that average, and the Netherlands had dropped to the eleventh place. Looking at the figures for subsequent years, we see that the Netherlands has since regained some of the ground which it had lost earlier. In 1996, per capita GDP held the seventh place (at nearly 5% above the European average). A similar pattern is in evidence for the employment situation; between 1972 and 1983, job losses were much worse than in the rest of Europe. But here the relative recovery set in around 1985. In other words, the Dutch success has until now been no more than an exercise in making up for ground lost earlier. In fact, we still have not caught up with Europe in all respects.

Explanatory factors

In my view, the turnaround which began in 1982-1983 can be ascribed to a combination of sound macroeconomic policy, as well as specific measures aimed at improving the operation of markets.

- The gradual restructuring of public finance, starting in 1982 and resulting in a deficit of 2.1% of GDP in 1997, compares favourably with those of most countries in the vicinity. The introduction of real expenditure ceilings at the start of this Cabinet has proved instrumental to this success. Also, the better control of the budgetary process contributed to the outcome. It is gratifying that our efforts to achieve healthier public finances have mainly taken the form of expenditure cuts. The cuts have also made it possible to alleviate the burden of taxation and social insurance contributions. The positive evaluation made by the ECOFIN Council this spring is a good incentive to strive over the next few years for a balanced budget. I will be going into the need for that later.

- The fact that since 1983 monetary policy has given absolute priority to stability of the guilder/Deutsche mark exchange rate is another contributing factor. That has enabled us to import, as it were, the usually favourable price climate prevailing in Germany. Because of moderate wage developments at home, this exchange rate policy provided for real exchange rate stability as well, resulting in a favourable competitive position of our business sector. This contrasted sharply with Germany, where excessive wage increases during the reunification boom contributed to a substantial real appreciation of the German mark of about 12% between 1990 and 1995. The real guilder appreciation was instead negligible. The policy also enhanced confidence in the financial markets, which in turn contributed to a sustained decline of (the risk premium contained in) interest rates. For over a decade, Dutch capital market rates have been among the lowest in Europe, making for an improved investment climate as well.

- The wage restraint -- I mentioned it already -- ensuing from the much cited accord of Wassenaar (1982) was the third factor. This entailed a trade-off between the employers' organizations and the trade unions, the latter relinquishing automatic price compensation for a shorter working week. A condition was that business costs should not increase. It was furthermore agreed that wage negotiations would be decentralized. The process of wage moderation was boosted further by the government-initiated alleviation of taxation and social insurance contributions. In the longer term, the results can be seen to be truly impressive. Over the past fifteen years, unit wage costs have remained well-nigh stable in the Netherlands, allowing a recovery of profitability, and an improvement of the business sector's competitiveness.

- The economy has moved towards greater market orientation, a goal which has been high on the political agenda since the beginning of the 1990s. The labour market was the first to be targeted, with social security legislation being amended to give the market mechanism greater leeway. In the period from 1983 to 1990, minimum wages and social insurance benefits had been delinked from the general development of wages. A wide range of measures was directed at the lower end of the labour market, the aim being to stimulate businesses to employ low-skilled personnel by way of a reduction of social insurance contributions payable by employers, wage cost subsidies and subsidized jobs. Furthermore, society has come to accept flexible forms of labour, such as part-time working and temporary staffing, which have boosted the expansion of the number of jobs in the services sector. In this respect, the Netherlands holds a vanguard position internationally, with 40% of all work now being done on flexible contracts. Not only does this greater flexibility meet the needs of the business sector, employees, too, seem to find it suits their changing preferences. Global calculations show that the potential employment gains for other countries, if part-time jobs had developed to the same extent as in the Netherlands, could be sizeable (around 3 million jobs in both Germany and France). These calculations are highly mechanical and therefore one should be cautious in interpreting the outcome. Nevertheless, I think that part-time work arrangements could be helpful in addressing a serious unemployment situation, under strict conditions, i.e., they are applied tailor-made and do not increase businesses' operating costs. So far the main result in the area of product market improvement has been the 1996 liberalization of the statutory establishment rules for businesses. With boundaries disappearing and new technology being developed all the time, we cannot but go with the grain of the market on an increasing scale. We must always keep in mind that all countries around us are doing exactly the same thing. Introducing new rules and amending old ones may be painful at first, apart from being time-consuming, but there seems to be nothing for it but to go on doing so, if we wish to maintain our prosperity in the longer term.

With so much praise being heaped on the Netherlands and its consensus economy, people tend to forget that consensus about how a recovery should be brought about did not materialize out of the blue; in fact, it was enforced by the unfavourable economic developments during the 1980-81 recession, which, as I noted before, hit us much harder than others. Ultimately, it was that very fact which compelled the employers' organizations and the trade unions to give up their entrenched views, views which had been characteristic of the 1970s. That episode illustrates only too vividly that having a consultative framework for employers and employees does not guarantee fruitful negotiations. The consultative process has been streamlined in the meantime. One could say that the "consensus model" of the 1970s has given way to the consensus of the 1990s.

Where do we go from here?

For all our fifteen years of conducting a policy aimed at recovery, we cannot afford to indulge in complacency. Things may be going in the right direction, but we still have several major long-standing problems to see to:

- First, there is the continued high rate of economic inactivity. The low participation rate of our population in general is a major factor underlying our internationally modest position in terms of prosperity. This applies especially to the older members of the labour force. More than half of those aged between 50 and 65 do not hold a job. We should really be seeking to reduce our rate of economic inactivity to the levels prevailing in neighbouring countries.

- Secondly, there is our considerable public debt. Although it has been falling in recent years, our debt ratio (of over 70% of GDP) continues to be more than 10 percentage points above the EMU criterion. A rapid further reduction to well below 60% is called for if we wish to be able to cope with the growing burden which the imminent ageing of the population will impose on public finance. In addition, as we have seen in the past, high debts make us more vulnerable in the event of interest rate rises. European interest rates are currently low, but they will not stay that way for ever.

Our fundamentals are favourable. One major advantage is our structurally high savings surplus, indicating that macro-economically there are no financial impediments to higher growth. Furthermore, we seem to have scope for further growth, provided we succeed in harnessing the current labour reserve. To complete our recovery, we will need further budgetary restructuring and continue on the path toward greater market orientation.

Policy conclusions

This brings me to the concluding part of my speech: what can we learn from the Dutch experience? There are five lessons which can be drawn from it.

Firstly, monetary stability is an important ingredient of a stable economic climate. However, not only nominal but also real exchange rate stability matters. If relative price and labour cost developments are out of line, a country’s competitiveness is seriously affected, even if the nominal exchange rate remains stable. This is an important lesson with a view to EMU when nominal exchange rate stability is a given factor.

Secondly, sound budgetary policy is not only about deficit reduction and cutting expenditure. It is about redefining the role of the public sector in an economy.

Thirdly, more market pays off. We should not forget that the private sector is the engine of our economy. So why not give the market sector more leeway? Of course, always on the basis of a good analysis of what can and can’t be done by the market.

The fourth lesson is related to the latter. Policies geared at increasing labour market flexibility work. However, it is important to note that -- as far as labour market policies is concerned -- there is no overall recipe which can be applied. Policies should be tailor-made depending on frictions on certain parts of the labour market.

Last, but not least -- and related to the fourth lesson -- reduction in working hours can, under conditions, play an important role in an economy. In the short term, it simply boils down to a redistribution of work, without affecting the performance of an economy. However, redistribution of work can (in return for moderate wage claims) contribute to the necessary consensus between employee and employers organizations in an economy. And the latter does improve the performance of the economy in the longer run, as the Dutch experiences teach us.

To conclude, there is not really anything new under the sun. The combination of economic policies which the Netherlands have opted for have been advised by -- for instance -- the International Monetary Fund for a long period. The issue is how to make society embark on these policies; in other words, how to create consensus. Not by forcing all relevant parties into a stalemate, but by creating an awareness that a certain combination of policies -- the five lessons which I mentioned before -- is beneficial for all parties involved.