In the Netherlands, change is for now!

By Christophe Blot

While France has just reaffirmed that it will meet its commitment to reduce its budget deficit to below 3% by 2014 (see Eric Heyer), the Netherlands has announced that it is abandoning this goal on the grounds that additional austerity measures could jeopardize growth. The country plunged into recession in 2012 (-1%), and GDP will fall again in 2013 (see the analysis of the CPB, the Netherlands Bureau for Economic Policy Analysis). In these circumstances, the social situation has deteriorated rapidly, with a 2 percentage point rise in unemployment in five quarters. In the first quarter of 2013, 7.8% of the workforce was out of work. Beyond the implications for the Netherlands itself, could this rejection of austerity (finally) signal a shift in Europe's strategy of fiscal consolidation?

Up to now, the coalition government elected in September 2012 and led by the Liberal Mark Rutte had followed the general strategy of consolidation, with expectations of rapidly bringing the deficit below 3%. However, the austerity measures already being implemented together with an adjustment in the housing market and the general decline in activity throughout the euro zone led the Netherlands into a new recession in 2012 and put off the prospects of meeting the budget target in 2013. In view of the European Commission's projections for growth and for the budget deficit in 2013, it does however seem that the Dutch government would have been able to achieve a deficit of 3% in 2014, but like France, at the cost of taking additional measures.

The budget deficit is expected by the Commission to come to 3.6% in 2013. The CPB expects an even slightly lower deficit

(3.3%), using growth forecasts similar to those of the Commission. In these conditions, the fiscal effort required to reach the 3% target in 2014 would amount to between 3.5 and 7 billion euros. In comparison, for France this would require the approval of additional austerity measures for 2014 amounting to 1.4 GDP points, *i.e.* just under 30 billion euros (see France: holding to the required course).

However, under pressure from the social partners, the Dutch government ultimately abandoned the plan announced on March 1 that provided for savings of 4.3 billion euros, which mainly consisted of a wage freeze in the public sector, a freeze in the income tax scale and the stabilization of public spending in real terms. Putting austerity on hold like this should give a small boost to the economy without calling into question fiscal sustainability, as the improved prospects for growth should reduce the cyclical component of the budget deficit.

While the 3% target will of course not be met, it is not at all clear that the markets will make much out of this infringement of the rules. In fact, the difference in interest rates vis-à-vis the German rate has stabilized since it was announced that the plan had been abandoned, whereas the difference had tended to increase in the previous weeks (see figure).

While this decision should not upset the economic and financial stability of the Netherlands or the euro zone, it does nevertheless send a strong anti-austerity signal from a country that had hitherto favored fiscal consolidation. It is therefore one more voice that is challenging the effectiveness of this strategy and emphasizing the economic and social risks associated with it (see here for an overview of the case against austerity and the 2013 iAGS report for more specific points concerning an alternative strategy for Europe). It is also a decision that should give France inspiration.

Credibility is not necessarily gained by sacrificing one objective (growth and employment) for another (the budget deficit). It is still necessary to await the response of the European Commission in that the Netherlands, like most countries in the euro zone, is subject to an excessive deficit procedure. If the decision of the Netherlands is not challenged, then this will represent a significant shift in European macroeconomic strategy.