

# 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 Hoyer](#)), 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.

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## France's Stability Programme: the missing line

By [Eric Heyer](#)

On April 17, the government presented its Stability Programme for 2013-2017 for the French economy. For the next two years (2013-2014), the government has relied on the projections of the European Commission in forecasting growth of 0.1% in 2013 and 1.2% in 2014. Our purpose here is not to revisit these forecasts, though they do seem overly optimistic, but rather to discuss the analysis and outlook for France for the period 2015-2017 that is explicit and sometimes implicit in this document.

According to the document provided to Brussels, the government is committed to maintaining its fiscal consolidation strategy throughout the five-year period. The structural effort will lessen over the years, representing only 0.2 percent of GDP in 2017, *i.e.* nine times less than the effort required of citizens and business in 2013. Under this assumption, the government expects a return to 2% annual growth during the

period 2015-2017. The deficit will continue to shrink, reaching 0.7 percent of GDP in 2017. This effort would even lead for the first time in over 30 years to a structural fiscal surplus in 2016, rising to 0.5 percent of GDP in 2017. For its part, public debt would peak in 2014 (at 94.3 GDP points) then begin to decline from 2015 to a level of 88.2 GDP points by the end of the five-year period, which is lower than the level when the Socialists came to power (Table 1). It should be noted, however, that in this official document nothing is said about the changes in unemployment that the government expects will result from its policies by the end of the five-year period. This is the reason for our introduction of a missing line in Table 1.



Based on assumptions similar to those of the government for fiscal policy as well as for the potential for growth, and starting from the same short-term situation, we have attempted to verify the analysis provided by the government and to supplement it by integrating the changes in unemployment related to its Programme.

Table 2 summarizes this work: it indicates that growth would accelerate gradually over the period 2015 to 2017, to over 2% in 2017. Growth over the period would average 1.8%, a rate close to but slightly lower than the 2% expected in the Stability Programme [\[1\]](#).

At end 2017, the deficit would be close to the government target, without however reaching it (1 GDP point instead of 0.7 GDP point). The public debt would also fall to a level comparable to that in 2012.

In this scenario, which is similar to that of the government, the trend in unemployment will not reverse until 2016; by the end of the five-year period, the unemployment rate is expected to be 10.4% of the working population, *i.e.* a level higher

than that prevailing at the time François Hollande assumed office.



The scenario proposed by the government in the Stability Programme seems optimistic in the short term and misses the goal in the medium term. On this last point, it seems surprising to want to stick to a policy of austerity after the economy has seen the public finances balanced in structural terms and while the unemployment rate is rising above its historical peak.

A more balanced approach could be considered: assume that from 2014 the euro zone adopts a “reasonable” austerity plan aimed at both restoring the structural balance of the public finances and reducing the unemployment rate. This alternative strategy would involve rolling back the planned fiscal stimulus in all the euro zone countries and limiting it to 0.5 GDP point [2]. This would constitute a fiscal effort that could be sustained over time and allow France, for example, to eliminate its structural deficit by 2017. Compared to the current plans, this would provide a greater margin for maneuver that would spread the burden of the adjustment more fairly.



Table 3 summarizes the results of simulating this new strategy. Less austerity leads to more growth in all the countries. However, our simulation also takes into account the impact of economic activity in one country on other countries via international trade. In 2017, in the “less austerity” scenario, the public finances would be in the same state as in the baseline scenario, with the additional growth offsetting the reduced effort. However, in this scenario, unemployment would decline in 2014, and by 2017 would have fallen to a level comparable to the 2012 level.

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[1] The difference in growth can arise either because of not taking into account the impact of foreign trade due to the austerity plans being implemented in other partner countries, or because the fiscal multiplier used in the Stability Programme is lower than in our simulation, where it is around 1. Indeed, we believe that in a period of low economic activity, adopting policies of fiscal restraint that are applied simultaneously in all the European countries and when there is little maneuvering room for monetary policy (real interest rates are close to zero) leads to pushing up the value of the multiplier. There is also now [a broad consensus on the fact that the short-term multipliers are high](#), especially given that full employment is still out of reach (see [Heyer \(2012\)](#) for a review of the literature on multipliers).

[2] This strategy has already been simulated in previous OFCE work, such as that by [Heyer and Timbeau in May 2012](#), by [Heyer, Plane and Timbeau in July 2012](#) and by the [iAGS report in November 2012](#).