Chapter 3
The Dutch Miracle

> [W]e have been swamped in recent months by requests from foreign visitors/journalists who want to know about the "Dutch Polder Model". A sense of euphoria is growing among politicians and the trade unions, no doubt partly as a result of foreign admiration.
>
> — VNO-NCW (1997b)

Introduction and Overview

Much Dutch commentary on the nation's strong economic performance contains something like a sense of wonder – just 15 years ago the economy was one of the worst performing in western Europe and now it is the star of the continental class. The story is similar to Ireland's. Government cut its expenditures and reduced taxes. Unions, business, and government signed a series of wage-moderation pacts explicitly targeted at increasing profits in the Dutch economy. One additional ingredient is found in the Netherlands's success. Unlike Ireland, the Netherlands had established a heavy overhang of regulations, increasing costs in the economy. Government has launched a deregulation effort and begun a privatization programme.

The Netherlands has been so successful that a touch of exasperation may accompany comments about the horde of policymakers, politicians, journalists, and economists descending on the Netherlands in an attempt to learn the secret of what is variously called the Tulip Miracle, the Dutch Model, or, often, the Polder Model.[1] These commentaries then almost inevitably point out that there is no such model, just a series of realistic consensual

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1. *Polder* simply means land claimed from the sea through dikes.

decisions sparked by the disastrous shape of the Dutch economy in the early 1980s and a repeat performance of economic troubles in the early 1990s.

This is correct. While the Netherlands's recent economic growth and, most particularly, employment generation have resulted from a significant ongoing policy shift, on a deeper level the Dutch success is not a model in itself. It is rather a set of policy alternatives within the larger corporatist model or structure. And the Dutch experience shows the strengths and weaknesses of this model. The evolution of the Dutch economy highlights what may be the time-limited nature of successful growth policies in a corporatist setting.

The Dutch have been through what might be thought of as the corporatist cycle. In the immediate aftermath of World War II, a society-wide consensus – one involving labour, business, and government – held down costs, particularly wage costs, throughout the economy. Dutch economic growth was strong and unemployment vanishingly low in the post-war period. Although this consensus began to unravel in the 1960s, Dutch economic growth remained strong into the 1970s, in part boosted by a large natural-gas find that topped up both the economy and government coffers.

But, as we shall see, this natural-resource wealth turned out to be a curse in disguise. "On the one hand, this discovery reduced [the Netherlands's] energy import dependency. On the other hand, it contributed to the unsustainable expansion of the welfare state, which set the stage for a serious crisis at the end of the seventies and early eighties" (CPB 1997, 14). It is worth noting that the CPB – the Central Planning Bureau – is a joint labour/business/government body, and this statement reflects a broad consensus in the Netherlands.

These developments laid the groundwork for the disaster about to befall the Dutch economy in the 1970s. As the Dutch consensus on wages restraint fell apart, wages soared through the 1970s and into the 1980s. As wage costs got out of hand, unemployment – which had not been a serious problem to this point in the post-war period – skyrocketed to over 17 per cent in 1984. Between 1981 and 1983, nearly 300,000 jobs were lost. In 1984, 10,000 people were added to the unemployment rolls each month, until the number reached 800,000. Economic growth hovered close to zero through much of the 1980s.

Government played a perverse role in these unfolding events. Encouraged in part by the flow of natural-gas revenues, government expenditures grew spectacularly through the 1970s and early 1980s, from 40 per cent of GDP in 1973 to 58 per cent in 1983. This crowded out private-sector activity. Generous government social-assistance programmes provided the foundation for the escalation in wages. People could choose not to work and accept social assistance if wages did not meet their expectations. This pushed up the reservation wage – that is the wage workers require before they will accept a job. And, despite natural-gas revenues, the government's fiscal position rapidly deteriorated.

As in Ireland, nothing concentrates the mind better than economic disaster. In 1982, the Netherlands took the first step down the road to controlling costs and economic recovery. Much to everyone's surprise, labour and business signed an agreement designed to restrain wages. Market forces had already begun to put downward pressure on wages. Wage growth continued to cool until the late 1980s. Through the same period, government began to rein in expenditures. With the exception of a blip upward in 1987, government expenditures as a percentage of GDP glided downward until about 1990, and then began to creep upwards again.

In the late 1980s and early 1990s, the corporatist consensus was once again unravelling. Not only was government expenditure on the rise, but danger signs began to warn about problems with labour costs. Dutch unit labour costs moved up from 1985 to 1992 almost as sharply as they had from the early 1970s to 1980. Job growth came to a halt in the early 1990s, and the unemployment rate once again began to grow. Dutch per capita GDP started to dip relative to U.S. and OECD per capita GDP. The early 1990s began to look like the early 1980s, with rising costs suppressing economic growth and job creation.

But the lessons of the 1980s were still fresh. A new labour compact negotiated in 1993 and implemented in 1994 stabilized Dutch unit labour costs. In fact, unit labour costs sharply declined in 1993 and 1994. Employment growth, which had fallen to zero in 1993, recovered. Dutch per capita GDP began to grow strongly again. A new left–right (purple) coalition, led by a former labour leader, began a serious attack on government spending, pushing it down toward 50 per cent of GDP.

Dutch monetary policy through most of the period after World War II tended to be passive. In times of inflation, monetary growth typically accommodated increased government expenditures and rising wage demands. Nor did the authorities typically attempt to spur economic activity through monetary expansion. Through the Netherlands's weakest economic period in the 1970s and early 1980s, already high levels of inflation ruled out this course of action.

The Corporatist Cycle

The Dutch have been through the corporatist cycle several times – consensus on controlling costs, particularly wage moderation, in the immediate post-war period, leading to strong economic growth; bickering in the 1960s, followed by out-of-control costs and economic decline in the 1970s; a weak social agreement on wage moderation in the early 1980s, which led to increased economic growth in much of the 1980s; a near breakdown of the social consensus on wages in the early 1990s, threatening the Dutch economic revival; and, more recently, a much stronger agreement on wage moderation and tax reduction. This led to period often termed the "Dutch miracle", characterized by strong economic growth and job creation. "Like the economy, the Dutch consultation process has gone through various upward and downward trends throughout its development" (van Empel 1997, 13).

Another factor separates the Irish corporatist experiment from the Dutch. Ireland took extremely strong measures across the board in restraining taxes and wages in 1987. Ireland's economic take-off was also extremely powerful. The first round of the Dutch cure in 1982 was much less radical for both wages and government taxes/expenditure. As a result, the cure was considerably less robust. The Dutch took a much more vigorous course of treatment in 1993-94, with a stronger commitment to hold down wage costs, reduce government expenditures, reform and privatize social programs, and vitalize market forces. The result was also more vigorous. It led to the strong economic growth and job creation known today as the "Dutch miracle".

Another difference is that the Irish seem to believe their work is almost done, save for some revamping of the tax code and income-support system to make work more rewarding and social assistance less appealing. The Dutch still have an ambitious agenda of market reforms and government-expenditure cuts before them.

The reason is partly because the Dutch reforms on the government side remain less deep than Irish reforms. Dutch government expenditures are higher as a percentage of GDP than Irish expenditures. However, Dutch expenditures continue to decline relative to GDP, while Irish expenditures are now rising. And the Dutch have a heavy regulatory build-up to tackle, while the Irish economy has never been overly regulated. The questions for the future in the Netherlands are: Will these corporatist reform plans wither with the good times when reform simply seems unnecessary? Will the corporatist cycle continue to turn?

Birth of the Corporatist Model

Consensual decision-making has long been part of the Dutch character, going back several centuries to the development of the Dutch merchant society. The foundation for the current corporatist state was laid in the 1920s, if not earlier. Nearly 40 per cent of all employees were members of a trade union by 1920. Unions became increasingly involved in decision-making – including wage negotiations – at the national and sectoral levels. However, unions had less influence at the level of the firm, due to employer opposition.

At the national level, the *Hooge Raad van Arbeid* (Supreme Labour Council) was established in the 1920s as a consultative council involving labour, employers, and government. In 1927, the collective-agreement act was passed, giving stronger legal status to collective agreements. In 1937, a new act allowed government to extend collective agreements in one sector to all employees of that sector, regardless of whether workers or their companies had participated in the negotiations. These developments formed the basis for the post-war experience.

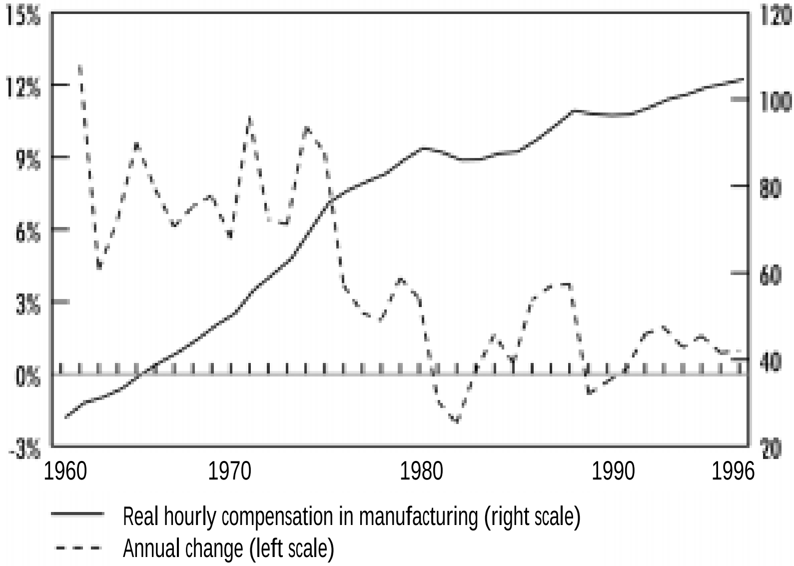
The construction of the Dutch corporatist state was completed in the early post-war period. The Netherlands had been slow to industrialize in the pre-war period, and much of its industrial base and infrastructure had been destroyed in the war. Dutch policymakers, faced with a small home market, decided on a course of rapid industrialization and export growth. The engine for this growth would be a low-cost economy. "It was therefore necessary to restrain wages and produce more cheaply than in neighbouring countries. In the first decade after the war there was a near complete consensus about this strategy ..." (Visser & Hemerijck 1997, 92).

In May 1945, employers and employees established the Labour Foundation (STAR)[2] as a consultative forum for the two groups. It was meant to aid in sharing of information and ideas, and to help create a bond between employers and employees. It remains a key anchor of the corporatist state. The Labour Foundation, in partnership with the government, negotiated wage guidelines, which were formally issued by the Board of Government Mediators (CvR).

In 1950, the Labour Foundation was supplemented by the formation of the Social and Economic Council (SER), which included employers, employees, and economic experts appointed by the government. These structures effectively and almost without opposition set wages and maintained wage moderation from 1945 until the 1960s, a period of strong growth and effectively zero unemployment. The strength of these arrangements can be seen

2. Acronyms are, of course, of Dutch words and will not usually match the English translation.

Chart 3-1 Real Hourly Compensation in Dutch Manufacturing (1992 = 100)



Source: U.S. Bureau of Labor Statistics

in a 1951 agreement under which labour, business, and government jointly agreed that nominal wages should be pushed down by 5 per cent.

The Netherlands was a low-cost economy. This led to a remarkable burst of economic growth and job creation. That held the seeds to the unravelling of the social agreement. The economy overheated, and that, combined with low-cost wages, led to labour shortages. The labour shortage was such that employers began to use “black wages” – under-the-table payments above and beyond the wages levels established by the CvR – to attract workers. The necessity of maintaining a low-cost economy seemed to evaporate. Wages exploded. Real-wage increases averaged about 8 per cent a year (chart 3-1). Unions simply could not tell members to accept CvR guidelines when employers were willing to pay more.

> During the first long, steady economic upswing after the Second World War, the consultation model was at least as successful as it is today. Indeed, so great was this success [in holding down costs to boost economic growth] that it almost spelled the end of the consultation model. Wages were so restrained, and the competitive powers of Dutch trade and industry grew so dramatically that tension began to rise in the labour market.... The summer of 1962 saw the start of a long period of large wage hikes and labour unrest which would only come to an end in the early eighties. (van Empel 1997, 13-14)

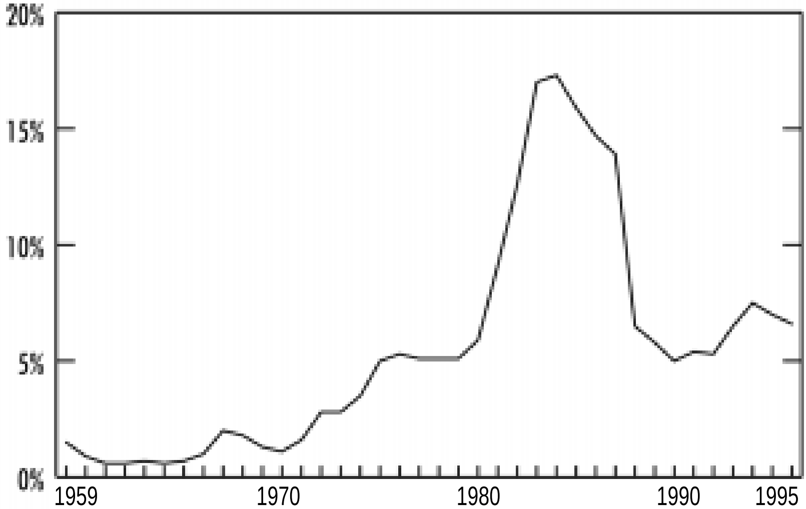
Acrimony became common in industrial relations. The major Catholic and Protestant labour federations, later united in the FNV, temporarily withdrew from both STAR and SER in 1970, in protest against a wage act that attempted to restore wage moderation. Although industrial unrest remained lower in the Netherlands than in most European nations, the number of strikes grew, and a split emerged between moderate union leadership and a new generation of more radical leaders. Both wages and the Dutch unemployment rate crept up through the 1970s. Unemployment exploded late in the decade, peaking at 17 per cent in 1984 (chart 3-2).

Increasing government expenditure played a role in the Netherlands's emerging economic problems, particularly under the centre–left government of Joop den Uyl (1974-77), though, as with Ireland, the process really got under way with the first oil crisis.

> A number of countries, including the Netherlands, reacted by Keynesian demand policy, but they found that this medicine did not have substantial influence any more on economic growth and employment. At the same time, government expenditures increased and inflation took off. Economic policy seemed to have lost control. (CPB 1997, 81)

Government, itself, even before transfer payments, was consuming an ever greater portion of GDP (chart 3-3).

Chart 3-2 Dutch Unemployment Rate



Source: U.S. Bureau of Labor Statistics

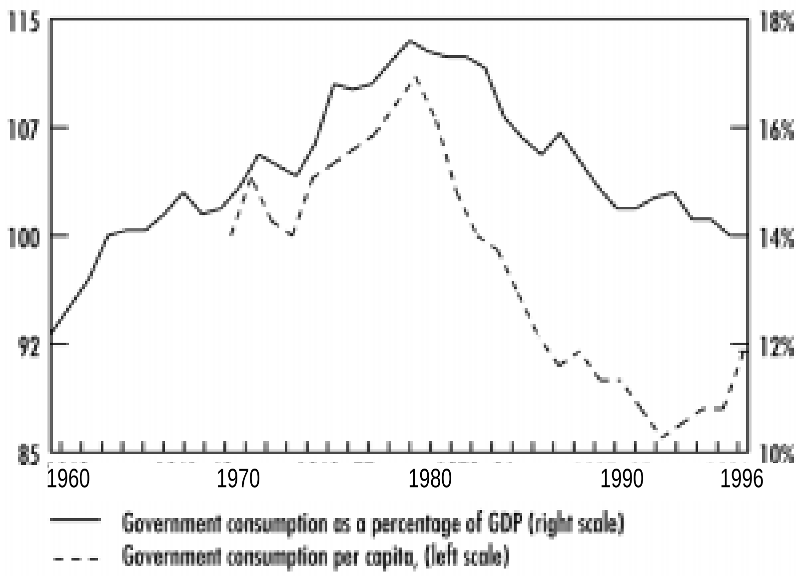
The 1970s were the era of "Dutch disease", when government expenditures, fuelled by large natural-gas revenues, took off.

> The Dutch government introduced an expansionary policy, financed by the abundant revenues from natural gas. The 1970s are the era of the Dutch Disease, characterized by inflation, expanding government expenditures and sharply declining profits. (Nickell & van Ours 1999, 18)

A key area of expenditure was the development of rich social programmes, which created an incentive for Dutch workers to leave the work-force to collect benefits, something we'll look at in more depth later in this chapter. This development added to the wage pressure created by the breakdown in consensual bargaining. The Netherlands was becoming an increasingly expensive place to do business.

Expenditures had soared under the den Uyl government, and they continued to rise under succeeding governments, including the badly divided centre–right coalition of Andries van Agt (1977–

Chart 3-3 Dutch Government Consumption



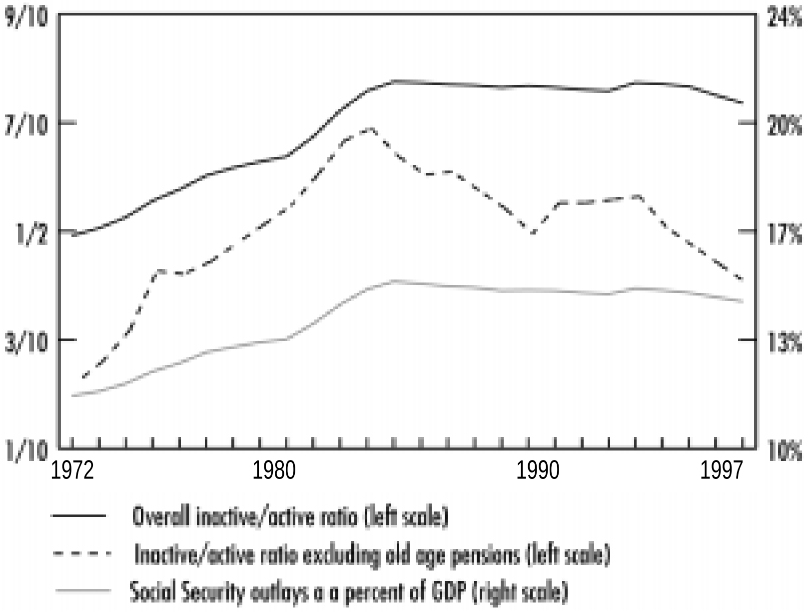
Source: OECD National Accounts

81) and the unstable centre–left coalition, also under van Agt, which followed. By early 1982, government expenditures equalled more than 55 per cent of GDP. Rising taxes fuelled the wage explosion, as workers attempted to make up in higher pay their increasing losses to government.

Unfortunately, much of this spending only went to distort further the labour market and to add to wage inflation. The government established a number of social programmes which enabled Dutch workers to leave the labour market or refuse to join it unless employers bid well above the level of social assistance available through a number of different programmes, particularly the nation-wide disability scheme. Such systems take on a life of their own. Over the years, they attract more and more people into the social net and discourage people from leaving. This pushes up expenditures years after the measures were passed.

By the mid-1980s, social-security payments alone reached 20 per cent of GDP. At the same time, for every five people employed, four people were collecting some form of benefit. If one

Chart 3-4 Inactive/active Ratios & Social Security Outlays



Source: Visser and Hemerijck (1997)

excludes old-age-pension payments, which often went to relatively young people who had retired early, the ratio was still above two people on benefits for every five employed. Chart 3-4 plots these inactive/active ratios. It also shows social-security outlays. These outlays as a percentage of GDP begin to decline prior to declines in the inactive/active ratio. This is because of reductions in real terms in benefits.

Nonetheless, the social-security system still provided relatively high levels of benefits and continued to draw people out of the work-force. High taxes made wage work even less desirable. All this also meant the official unemployment rate greatly understated the combined rate of involuntary and voluntary unemployment. And it pulled less-skilled workers out of the job market into long-term unemployment, meaning skills would further erode and those involved in this trap would become less and less employable. A key part of the problem was

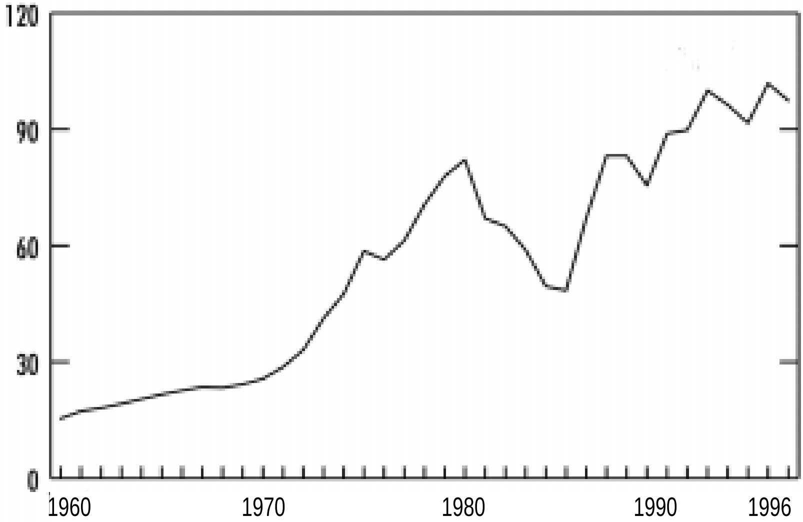
> a wrong wage differentiation, brought about by a policy of leveling incomes. The statutory minimum wage and minimum social benefits were substantially raised in respect to the average wage level. The victims were the low-skilled workers. Existing jobs became too costly and were scrapped. New ones were blocked. (Klaver 1997, 3)

These factors drastically cut the number of low-skill, entry-level jobs in the Netherlands. At the same time, generous social assistance discouraged low-skill workers from taking what employment was available. This led in the Netherlands, as it did in Ireland, to the creation of a pool of long-term unemployed. Even today, as job growth soars in the Netherlands, half the unemployed have been without work for a year, and fully four-fifths for more than six months. This compares with 10 and 17 per cent of the unemployed in the United States,[3] even though job growth has been greater in the Netherlands than in the United States in recent years. And these unemployment figures, as we shall see, don't include huge numbers of Dutch on various disability and income-support schemes.

A high-cost economy had replaced a low-cost economy. By the mid-1970s, the textile, clothing, and shipbuilding industries were all in trouble, despite large government subsidies meant to rescue them. Wage costs were soaring out of control, and unit labour costs were rising rapidly compared to those of the Netherlands's competitors (charts 3-5, 3-6 and 3-7). Inflation and its assorted costs were on the rise (chart 3-8). Taxes were increasing, and the ballooning debt and deficit promised even more taxes down the road. Just as forward-looking expectations can help an economy grow when tax reduction is on the horizon, it can damage GDP growth when tax increases are expected. All these factors contributed to weaken GDP growth. Dutch GDP fell relative to that of most other advanced economies. It would not rise again until measures were put back in place to control costs in the economy (charts 3-9 and 3-10).

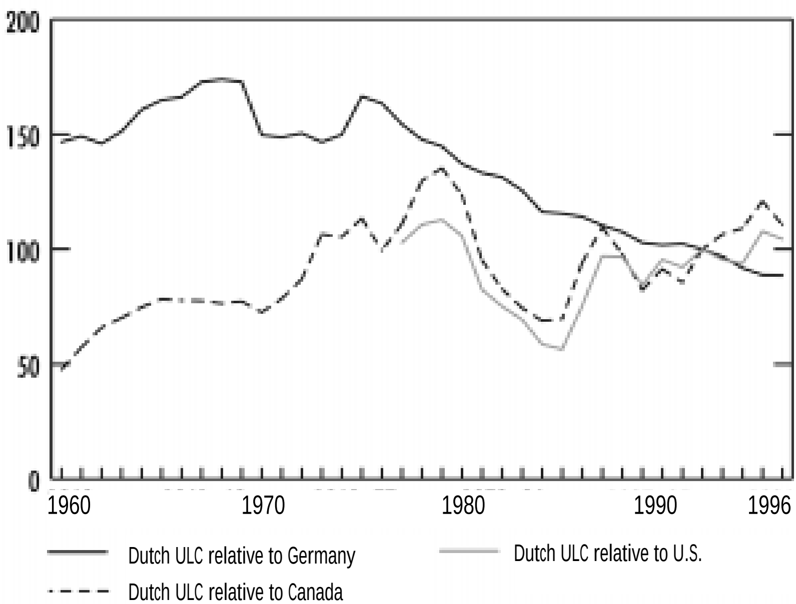
3. These numbers can be found in Netherlands (1997, 190).

Chart 3-5 Dutch Unit Labour Costs (1992 = 100)



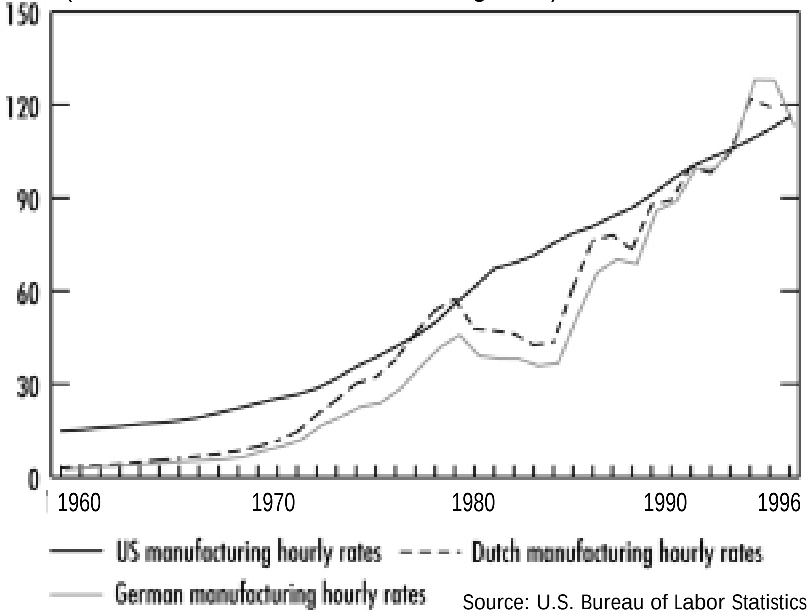
Source: U.S. Bureau of Labor Statistics

Chart 3-6 Evolution of Dutch Unit Labour Costs



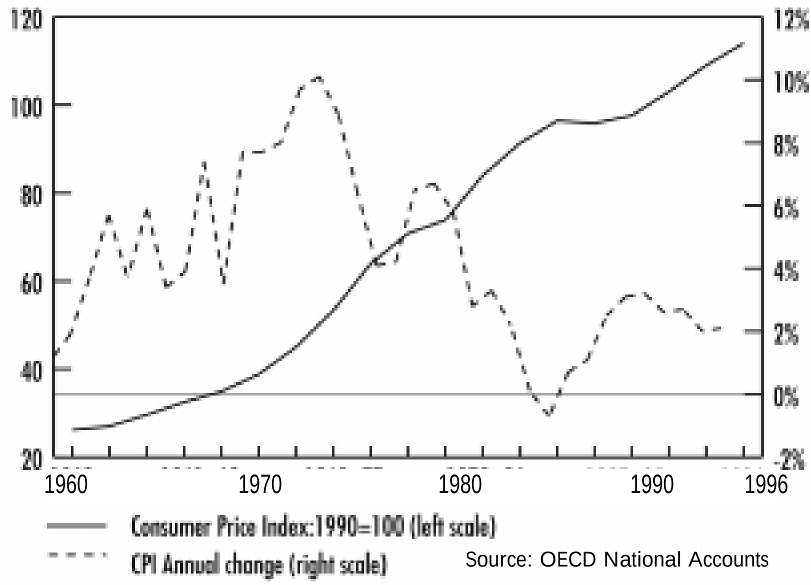
Source: U.S. Bureau of Labor Statistics

Chart 3-7 Evolution of Hourly Manufacturing Wages (1992 = 100; based on U.S. exchange rate)



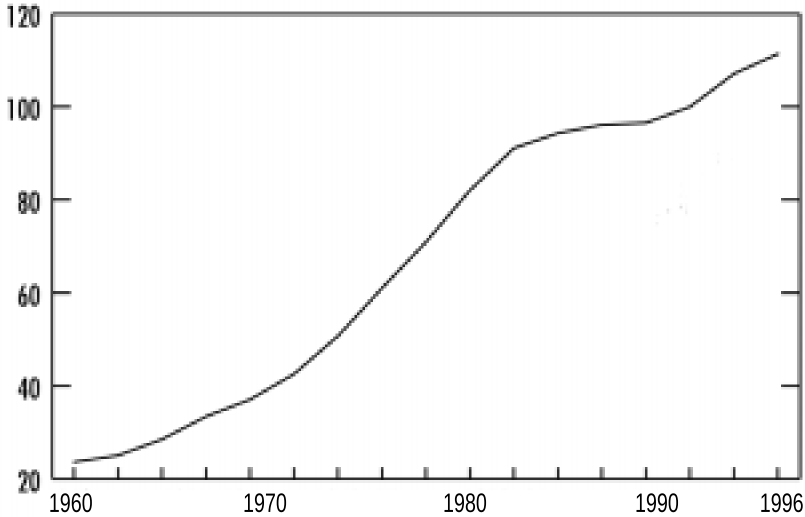
Source: U.S. Bureau of Labor Statistics

Chart 3-8 Dutch Consumer Price Index (1990 = 100)



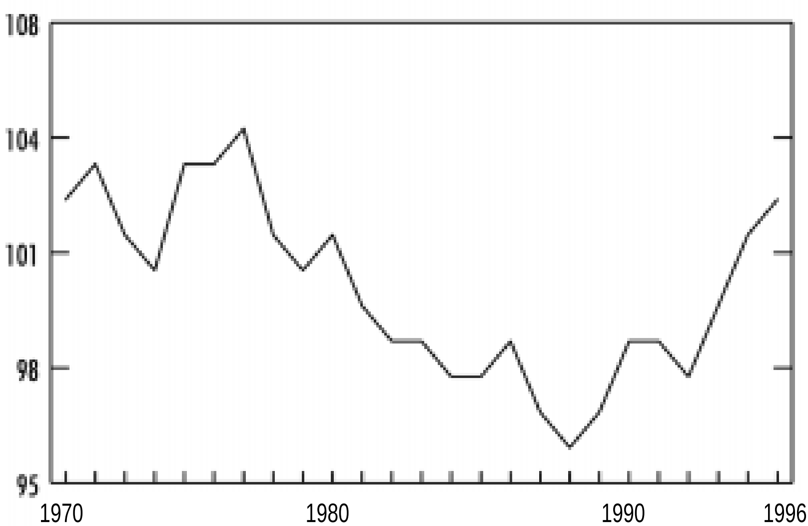
Source: OECD National Accounts

Chart 3-9 Dutch Real GDP (1990 = 100)



Source: OECD National Accounts

Chart 3-10 Dutch Per Capita GDP (OECD = 100)



Source: OECD National Accounts

This high-cost, big-government economy, characterized by union militancy, was "Dutch disease" at its most virulent. Given the Dutch history of economic success, the negative consequences were dramatic. Not only did unemployment rise, but hundreds of thousands of jobs were destroyed. Dutch per capita GDP declined relative to that of other advanced nations. Dutch policy-makers began to understand the negative consequences of a high-cost economy, even for those it was supposed to benefit, well-paid union members. Not only were jobs disappearing, but real wages were stagnant or declining. The next two decades would be spent trying to reverse Dutch disease. When wage moderation was restored to the economy and tax cuts introduced, prosperity and job creation were quickly restored to the Dutch economy.

Wassenaar

The Dutch economy was particularly hard hit by the energy crisis of 1979. This was in part because generous social-assistance schemes kept wages high and limited the economy's ability to adjust to reduced demand in Europe, which was also reeling from the oil crisis. The Netherlands's petrochemical wealth was a curse despite high energy prices. It enabled the Dutch to continue funding perverse programmes. Unemployment rose, GDP growth was often negative, and the deficit rose despite natural-gas revenues. The Dutch economy seemed set for a long-term downward spiral. This bout of Dutch disease was a big contrast with what was to come. "Whereas the term 'Dutch disease' was coined 20 years ago for the practice of using natural gas sales to build a generous social security system, nowadays, the 'Dutch Model' is held up as an example for other continental European economies" (VNO-NCW 1997a, 45).

Bad times can lead to desperate measures, including the willingness to compromise for the greater good and to make hard decisions. A number of attempts to re-establish nationwide wage guidelines had failed. But then, to virtually everyone's surprise, the Wassenaar pact emerged in 1982. Chris van Veen was head of the Dutch employers' organization (the Confederation of Netherlands Industry and Employers, VNO-NCW). He shared child-rearing responsibilities with his working wife and frequently had to stay at home. Thus it was that he often held meetings at his home in Wassenaar, outside The Hague, with his labour counterpart – someone who will emerge later in another, even more important role – Wim Kok, head of the Dutch Trades Unions, the FNV, the largest federation of unions in the Netherlands. The Wassenaar agreement was pounded out on van Veen's kitchen table.

The agreement focused on wage moderation and on improving private sector profits. Profits had fallen to a level that suppressed the funds available for investment and virtually eliminated the incentive to invest. The income share of capital fell from 19 per cent in 1970 to 7 per cent in 1983. (In 1998, the capital income share is expected to be 21 per cent.) (Klaver 1997). The SER's outlook paper, *Socio-economic policy 1998-2002*, stresses the significance of maintaining a healthy return on capital. The report's English summary says it is important "that the labour income ratio is maintained at a level of around 80 percent in the coming years" (SER 1998, 9).

As in Ireland, bad times were credited with creating a new sense of reality:

> Why did the Netherlands turn the corner ahead of the rest of Europe? Three factors explain this: [1] The considerable shock to Dutch society of the severe economic recession in the early 1980s, when the budget deficit and unemployment boomed and the old Dutch occupation of making profit threatened to disappear: at the time the situation in the Netherlands ran far more out of control than elsewhere. [2] The greater openness of the Dutch economy, which meant the Netherlands felt the cold winds of international competition sooner than many other European countries .... [3] The ability of the Dutch consultative economy to change ..., despite the fact it had moved in completely the wrong direction for 10 or 15 years ... (VNO-NCW 1997b, 20)

But hopes for the Wassenaar agreement were low. Instead of a nationwide pact which could be used to enforce wage moderation throughout the economy, the Wassenaar agreement devolved bargaining to the local level, where wage moderation was to be negotiated between employers and employees rather than set by national negotiations, as had been the case while the corporatist model was functioning well during the 1950s. Wassenaar and future national pacts, in effect, provided broad guidelines, while specific wage agreements were worked out on the sectoral level.

The Wassenaar agreement may have been a surprise. The fact that it worked, at least to some extent, was an even greater surprise. About two-thirds of all collective agreements were renewed within two years. By 1985, fully paid cost-of-living clauses – a prime cause of the wage explosion – had disappeared from all but 10 per cent of labour agreements. Average real wages fell by 9 per cent (Visser & Hemerijck 1997, 101; N.B., chart 3-7, as well as other charts of compensation statistics, covers only manufacturing wages[4]).

In exchange for wage restraint, the unions negotiated agreements to reduce the working week in order to share work, or at least got the employers to agree to talk about shortening the work week. Yet the Wassenaar agreement remains the foundation of all further, and more successful, attempts to revitalize the Dutch economy.

> All considered, the "wage moderation for jobs" approach pioneered in the Wassenaar agreement may have been the single most important element of the "Dutch model". It ensured pay restraint and social peace, with Dutch wages

4. Manufacturing wages should be taken only as a loose proxy for wages through the economy. The Dutch, like other nations, have shed manufacturing employment, and the remaining jobs tend to be high-wage jobs. The numbers also do not reflect the opening of the Dutch economy to jobs in the service sector which have arisen due to wage moderation, increasingly flexibility in the Dutch labour market, and the late entrance of women into the labour market. The pool for these jobs has also been increased by stricter administration of social programmes and benefit reductions, which have made such employment more desirable.

> increasing less than in partner countries on average, and the Netherlands losing proportionately fewer days to strikes than any other European country. This set in motion a "virtuous circle" of good international competitiveness, high profitability, strong investment and rapid job creation, with feedback effects on household confidence, asset prices and private consumption. ... Tax relief has underpinned disposable income, making wage moderation more acceptable, and reduced non-wage labour costs. (OECD 1998, 41)

Also in 1982, a new government was elected. Led by Ruud Lubbers, it was committed to getting public finances in order. Lubbers "started as head of government in the Netherlands with a severe and unpopular austerity policy.... [Yet] Lubbers became the longest ruling prime minister in the Netherlands, and resigned only in 1994" (CPB 1997, 83). The Lubbers government immediately froze public-service salaries, social benefits, and the minimum wage. In the spring of 1983, it went further. It announced it would cut public-service salaries, minimum wages, and social benefits by 3.5 per cent across the board. The public-sector unions organized their biggest strike since the war, but, lacking public support, they eventually settled for a 3-per-cent wage cut and a commitment to reduce the working week to 38 hours in 1986.

Government cut-backs succeeded in reducing expenditures as a percentage of the economy from 1984 to 1986. Then, following two years of expenditure increases, the downward path was again re-established. By 1990, government expenditures had fallen from the equivalent of 57.8 per cent of GDP in 1983 to 51.7 per cent of GDP.

Things Fall Apart

Government spending started to creep up again. From 1990 to 1993, government expenditures, in part because of a recession, rose to 53.4 per cent of GDP. Trouble was also brewing in the labour arena. The late 1980s were beginning to look a lot like the late 1970s. The consensus to trade shorter hours for jobs was falling apart. In 1986, the VHP (a union of white-collar workers) broke away from the FNV coalition to press for higher wages. Within the FNV, the public servants' union, in effect, abandoned wage restraint.

Dutch real compensation, after stabilizing in the early 1980s, began to rise again. Job creation flattened, though not as badly as in the early 1980s (chart 3-11 and 3-12). And GDP growth weakened.

> By 1987 the campaign for shorter working hours was dead. A year later the will to continue wage restraint seemed exhausted. The international economic upswing between 1988 and 1991 encouraged unions to raise their aspirations and renewed membership growth helped restore confidence. (Visser & Hemerijck 1997, 104)

This clearly shows the fragility of the corporatist model, when lessons so recently learned can be so quickly forgotten. It also highlights the fact that the Dutch miracle itself is not a model but rather a set of policy possibilities within the corporatist setting.

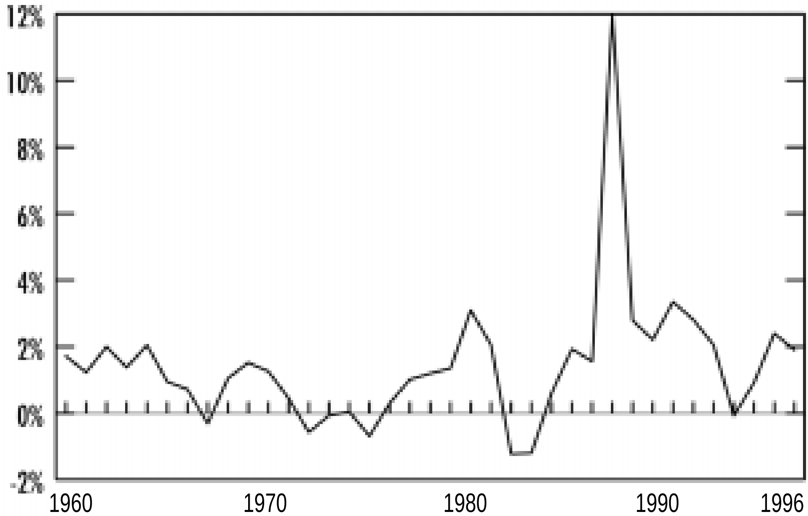
Back to the Future

Yet the message did get through to the social partners, though only with a lag. By 1992, the Dutch economy was in recession. A number of firms, including the giant electronics firm Philips and aircraft manufacturer Fokker, faced serious problems. One-tenth of the Netherlands's one million manufacturing jobs disappeared between 1992 and 1994 (Visser & Hemerijck 1997, 105).

The unions expressed a willingness to return to wage restraint, but the government was impatient. In 1992 and 1993, the government threatened to impose a wage freeze. This got everyone's attention. Employers were already alarmed. They warned of tough times ahead and called for zero wage growth. Still, wage settlements continued to outpace inflation.

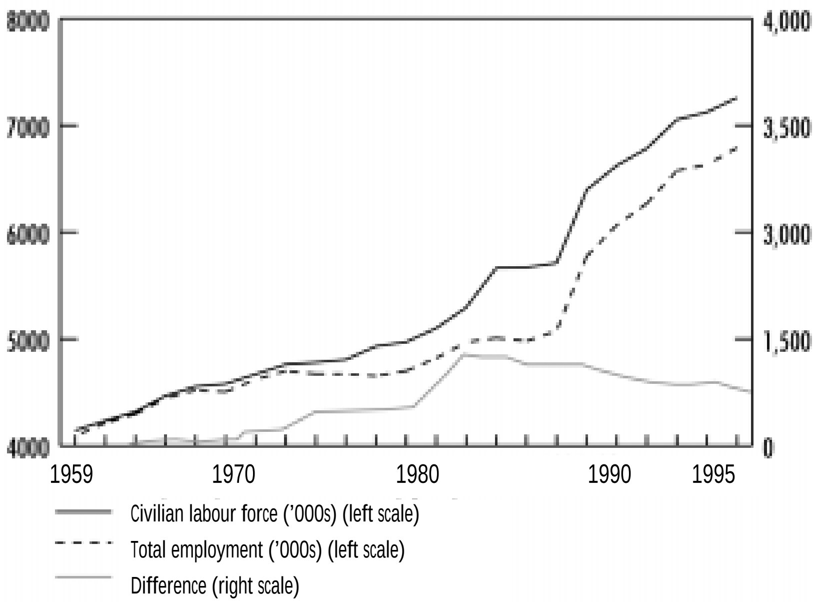
Yet the signs of economic damage were clearly visible. The unions and employers, in part because of the threat of govern-

Chart 3-11 Annual Rate of Change in Employment



Source: U.S. Bureau of Labor Statistics

Chart 3-12 Civilian Labour Force and Employment (‘000s)



Source: U.S. Bureau of Labor Statistics

ment action, negotiated a two-month "breathing space" to cool down wage demands. Negotiations were suspended, expiring contracts were extended, and the social partners stepped back to view the impact of the world recession and to build a perspective on the recent Dutch economic experience.

The breathing space had a surprisingly strong impact on wage settlements. After the two-month time-out, wage increases fell to less than half what they had been. In 1993, prior to the breathing space, wage settlements averaged a 4.6 per cent increase; after the breathing, the average increase fell to 2.2 per cent[5] (Visser & Hemerijck 1997, 106). The government maintained the pressure on unions and employers to hold wages down. By mid-1993, the government was preparing wage-freeze legislation for 1994. It was also examining the idea of fundamental reform to the wage-bargaining structure. In particular, the government was prepared to review key provisions from the 1937 legislation which extended agreements negotiated in one sector to workers and employers in that sector who had not participated in the negotiations. Government officials began to argue that elimination of the extension provisions could bring increased flexibility to the labour market.

Just as economic bad times focus the mind, so do threats to privilege. Neither the union federation nor the employers federation, which negotiate the centralized agreements, wanted to see the position of these agreements down-graded or wage settlement taken out of their hands. That, as much as the economic difficulties, led to a joint defence of the extension provisions and to a new labour-management agreement, *A New Course: Agenda for Collective Bargaining in 1994,* signed in December 1993 and brought into effect in 1994. Although the extension provisions remained active, wage negotiations were further decentralized under this agreement. And, as in 1982, the unions accepted wage moderation in exchange for shorter working hours.

The impact on wages of the *New Course* was substantial. Even before the agreement was negotiated, increases in wage settlements

5. This is calculated on the change between agreements on an annual basis, regardless of when the agreement took effect.

Chart 3-13 Average Negotiated Wage Increases

1993A: before ‘breathing space’; 1993B: after ‘breathing space’
1994A: before ‘new course’; 1994B: after ‘new course’

Source: Visser & Hemerijck (1997, 106)

had continued to fall. As noted earlier, following the “breathing space”, negotiated wage increases had fallen from 4.6 per cent to 2.2 per cent. Even prior to the implementation of the *New Course* agreement, wage increases in early 1994 had been again halved, to 1.1 per cent. After *New Course*, they were halved again, to 0.5 per cent. Wage moderation continued. In 1995 and 1996, wage settlements averaged increases of 1.4 per cent and 1.8 per cent respectively (chart 3-13).

Yet, over the longer term, as was the case in Ireland, *real* wages were boosted by wage moderation. Dutch real wages declined at the end of the 1970s and early 1980s. They began to rise again after Wassenaar, until wage moderation began to deteriorate in the late 1980s and early 1990s, which itself fed back into union militancy. But, after wage moderation was once again established in 1993-94, real wages resumed their upward course (chart 3-1).

Government Changes Direction

Consensus on holding down costs in the Dutch economy had again been re-established. Nothing demonstrates this better than the government which emerged out of the 1994 elections. It was the Netherlands's first right–left coalition, named the purple coalition for the mixture of its blue and red political elements.

The new prime minister was Wim Kok, whom we met before as the FNV leader who negotiated the Accord of Wassenaar. For a coalition headed by a former labour leader, the government launched a remarkable series of reforms. These reforms were designed to cut government expenditures, reduce taxes, increase market forces in the Dutch economy, lower regulation, and reform the welfare/social system to move people off dependence and into the work force. Further privatization, including large chunks of the social-security system, was also part of the new government's agenda.

All of these policies would, in effect, lower costs in the Dutch economy

- by reducing government spending and ultimately taxes
- by increasing the active labour pool though social program reform, thus reducing pressure on wages
- through de-regulation, and
- by reducing uncertainty related to the government expenditures, future taxation and inflation.

These measures, combined with the new consensus in labour–management relations to moderate wage costs – signified by the *New Course* agreement – led to the "Dutch miracle", as it is known today.

The Ministry of Economic Affairs report on bench-marking the competitiveness of the Dutch economy stresses the importance of a competitive fiscal structure in today's global economy:

> [T]ax bases – consumption, income and capital – are increasingly mobile. The responses evoked by fiscal policy will become even stronger in the future. Relative advantages in the fiscal infrastructure will be exploited even

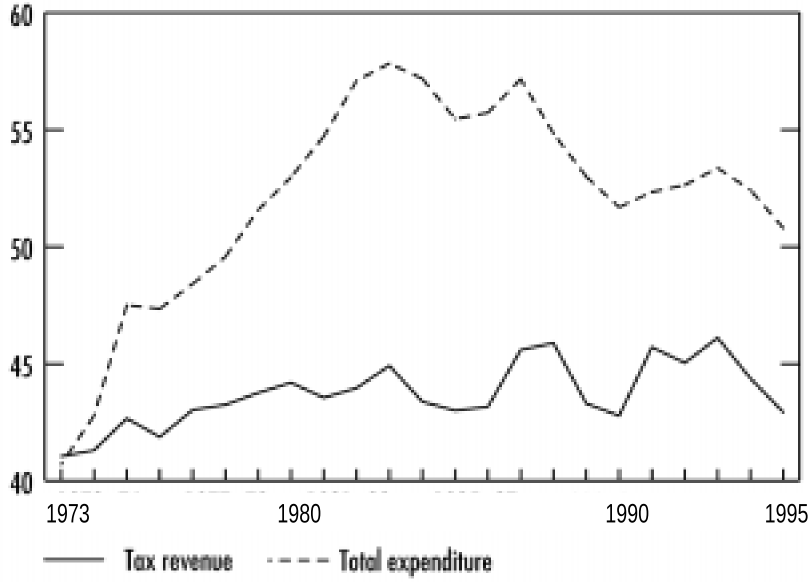
> more, and weaknesses punished more heavily. As a result, the fiscal infrastructure will increasingly become an autonomous factor in decisions on investment, saving, consumption, work and domicile.... Since the government will lose its grip on tax bases, a country's prosperity and employment opportunities will increasingly come to depend on the "attractiveness" of the fiscal policy in that country compared with competing countries. Even more than before, the structure of the tax and social insurance contribution system will have to be examined in light of its implications for the labour market, capital market, and competitiveness and adaptability. (Netherlands 1997, 47)

The government pledged it would cut central government expenditures by 6 per cent between 1994 and 1998. Savings would be used to reduce the deficit and lower taxes. The government budgeted conservatively, mindful of the fact that previous attempts to bring the deficit under control had floundered when economic projections proved overly optimistic.

But economic growth, spurred by the reforms and new labour attitude, was a percentage point higher than anticipated. Between 1994 and 1995, GDP growth averaged 3.25 per cent a year (VNO-NCW 1997a). This started a virtuous circle and enabled the government to bring the deficit down to 2 per cent of GDP in 1996 and 0.9 per cent in 1997. It has remained under 1 per cent of GDP (*Dutch Economic Indicators*, various issues, 1998 and 1999). Economic growth helped in bringing this ratio down both by increasing revenues and by increasing the size of the divisor. Similarly, the debt ratio was projected to drop from 77.2 per cent of GDP in 1996 to about 70 per cent in 1998.

The government exceeded its target tax reduction, cutting taxes by 20 billion guilders (about $1.4 billion Canadian, or just over $1 billion U.S.), about 2.5 per cent of GDP, twice the amount promised. According to the World Bank Development Indicators (1997), tax revenues fell from 46.1 per cent of GDP in 1993 to 42.9 per cent in 1995 (chart 3-14). The VNO-NCW (1997a), the

Chart 3-14 Dutch Government Revenue and Expenditure (% of GDP)



Source: World Development Indicators (World Bank 1997)

source of the statistics in this paragraph, projects the tax take will decline to 42.5 per cent of GDP in 1998, the lowest level in nearly a quarter-century. Yet, as in Ireland, over the longer term, tax cuts only increased revenues as increased GDP growth more than made up for the reductions. Statistics Netherlands (August 1999) estimates that revenues grew by 8.8 per cent in 1998 alone.

The impact of tax cuts through the whole period should not be understated in considering the Netherlands's improved cost competitiveness. To understand the impact of tax reductions, they must be put in a comparative context. In the Netherlands, the average tax burden decreased by 2.8 per cent between 1982 and 1997. Although Ireland, one of the smallest European nations, reduced its taxes after 1987, the only large European economy that achieved tax reduction was the United Kingdom, and its tax-cutting performance did not match the Netherlands's. Between 1982 and 1997, the U.K. tax burden fell by 1.9 per cent. On the other hand, the German tax burden increased by 2.6 per cent and the French tax burden by 2.3 per cent. Overall, the average tax increase across the European Union was 2.6 per cent. This alone goes a long way in explaining the Netherlands's strong economic and employment growth. Similarly, it helps explain why Ireland and the United Kingdom also stand out from other European countries in job creation and economic growth.

The Netherlands also saw a decline in the tax wedge – that is, the difference between what employees earn and what they take home after taxes. The pattern is similar to the overall tax burden. While Ireland also reduced its tax wedge, once again only the United Kingdom among the major European nations succeeded in lowering its average tax wedge, but less than in the Netherlands, 0.5 per cent compared to 4.7 per cent in the Netherlands. Again, Germany and France increased their tax wedge, by 1.2 per cent and 4.7 per cent respectively (VNO-NCW 1997b, 14).

Reducing the tax wedge, particularly at the lower end of the scale, is a key to getting people back into the labour market in the Netherlands, as in Ireland. This is captured by the SER's 1998 recommendations to government: "In the Council's opinion, an important task of the next government will be to make low-skilled work more attractive, in particular by further reducing the tax wedge between labour costs and the net wage" (SER 1998, 13).

The 1994–98 government also made efforts to get social spending under control. The Sickness Benefits Act was privatized in 1996 to remove perverse incentives in the system. Prior to 1994, sickness benefits were paid out of a large public scheme. Employers had little incentive to ensure employees did not abuse the system, since the scheme, not the employer, picked up the cost. In 1990, over seven out of every hundred working days in the Netherlands was lost to sickness leave. That compared to 2.6 days in the United Kingdom and five days in Germany (OECD 1998, 90). In 1994, small firms were required to continue paying wages during the first two weeks of sickness; large firms for six weeks, creating an incentive for firms to reduce abuse of the system.

In 1996, the system was privatized. Employers were required to continue paying wages for the first year of an employee's sickness. Employers may either cover those costs directly or take out insurance from a private company. As with auto insurance, the cost of this insurance increases with the amount of insurance payout. Thus, whether companies pay the costs themselves or take out insurance, they have an incentive to reduce sickness leave. This is not merely a punitive measure. To reduce sick and disability leave, employers have increased incentives to keep employees healthy and happy at their work. Between 1994 and the end of 1997, absenteeism fell by 25 per cent.

After a year on sickness leave, employees are shifted to another programme, the State Disability Scheme (WAO). Here, immense problems have built up. For years, employers in the Netherlands had a perverse incentive to move redundant or poorly performing employees to the WAO permanently. Firing or laying-off employees can be exceedingly expensive under the Dutch system. The state-funded WAO provided a free way out for employers. Provided the employee claimed to be disabled, regardless of the reason, acceptance by the WAO, until fairly recently, was routine.

Employees too could initiate this action. Those in low-paid or unsatisfying jobs or employees near retirement had an incentive to move to the disability rolls or into early retirement. They were provided an income with no pressure to return to work. And, because of the high level of payments and the Dutch tax system, the difference between disability pay and work-related income could be quite small. By the early 1990s, the Netherlands – one of the healthiest nations on the planet – had 1 million of its 6 million workers classified as disabled.

The numbers have been reduced through tighter screening – at one point the sole effective criteria for disability was a claim to be disabled – and a reduction in pay-out which makes the scheme less attractive. As of early 1998, the government was planning further reforms of the WAO to create something like a standard insurance scheme, leading to further privatization. Under the proposed single disability scheme, employers will be charged insurance-like fees, which will be pro-rated by risk of disability in individual companies, based on costs related to employees' first five years of disability leave. Companies can opt out from the pro-rated premium scheme if they agree to cover the costs of disabled employees themselves for the first five years of eligibility either directly or through a private insurer. This, of course, gives employers an incentive to encourage employees to continue working. After five years, employees would be transferred to a national disability system financed by a uniform premium.

Still large problems remain. As disability qualifications were tightened, increasing numbers of Dutch workers entered early retirement schemes, once designed to open employment for younger workers. Now that the government has moved to restrict early retirement, pressure is building on the unemployment insurance scheme. Despite the pressure on these social assistance programs, Dutch companies now face a shortage of workers, including less skilled workers. A recent survey revealed that two-thirds of Dutch companies have difficulties finding staff (VNO-NCW 1997a, 34).

Economic-development Policy

Economic-development policy was changed through the period under discussion. In the 1970s, the government got into the business of protecting failing industries. This is politically tempting. Politicians and governments have a strong incentive to attempt to save existing job and industries, which have an existing political constituency. The resulting distortions may damage growth in other sectors through a misallocation of resources, but these are the yet-to-be-created, unknown jobs with no existing constituency. Because of the political dividends, subsidies to floundering industries are halted only when failure is too apparent to ignore. By the late 1970s, the failure of this policy was clearly evident in the Netherlands.

Government also faces the temptation to pick winners, since it may assume credit for the resulting jobs. Dutch industrial policy in the 1980s shifted from subsidizing declining industries to directing subsidies to industries the government decided were strong growth candidates. In other words, the government got into the business of “picking winners” and rewarding its choices with government help.

The conceptual support for this is found in the idea of market failure. The market may simply not be willing to provide appropriate amounts of capital to new economic activity. Moreover, the market will undervalue, and therefore underfund, many worthwhile activities because of externalities. Market participants will only finance activities in response to potential gains the investor can realize. But many forms of investment have strong positive externalities. In other words, the economy and society gain benefits not captured by the investor. Thus, the argument goes, society, through the government, should play a role in funding these activities in order to benefit from the externalities they produce.

Whether or not these assumptions are correct and whether or not the policy produces benefits can be judged from the outcome of these policies. As it turns out, the Dutch decided private investors, putting up their own money, are far more effective at spotting opportunities than the government. Government bodies have little history, in the Netherlands or elsewhere, of effectively picking winners. Moreover, government support for apparent winners may only weaken growth, by misallocating resources. The Dutch found that the best road to development is found by creating market conditions were the most successful companies can flourish without the diversion of resources caused by concerns about seeking government support, or the risk that a government-favoured competitor could undermine the market. Interestingly, the reduction of active, subsidy-style economic-development programmes was part of the reform package which led to stronger growth in other jurisdictions examined in this book.

The Dutch industrial policy went through these phases, with the best economic results occurring after the idea of an active economic-development policy had been abandoned.

After 1982, the government decided it could no longer

> step in to rescue loss-making enterprises as she used to in the seventies.... In the eighties industrial policy changed from supporting losers to picking winners. Special attention was given to specific fields of technologies that were thought to be the most promising and rewarding ones for the Dutch economy. However in the nineties government changed that attention towards a far more generic and market driven approach: A move from "picking the winners" to "let the market pick the winners." (Klaver 1997, 8)

The CPB – in comparing Germany and the Netherlands – broadens the argument against all but the most cautious of government economic-development intervention:

> [G]overnment intervention does not constitute an universal remedy [to market failure]. On the contrary, recent insights emphasize government failure and state that in some case government intervention may even aggravate market failure. ... Because it lacks price signals, the government may have less information than the market, which may make the consequences of government failure worse than those of market failure .... In other words, in these cases the transaction costs of government intervention outweigh the costs of market coordination. Government intervention may generate transaction costs through the potentially high costs of gathering information by the government, through rent seeking behaviour by the private sector and through compliance costs. Rent seeking brings about social costs when agents engage in unproductive activities to capture artificial rents created by government policies. (CPB 1997, 54-55)

The Dutch negative experience with economic-development programmes has led to a change in attitudes. "Company closures of loss-making activities are now much better understood and accepted by trade unions, the public and politicians than they were during the 1970s" (Klaver 1997, 5).

Market Reforms

In the mid- and late 1990s, the Dutch government launched a series of market reforms: a programme of privatization of government corporations, deregulation, and moves to encourage competition. The postal system has been privatized, and the monopoly on delivering printed material and letters ended. The telecom market is being partially deregulated and privatized. Two new national telephone operators were allowed to enter the market in 1997. Regulations on store hours were liberalized in mid-1996. A new competition act prohibits arrangements between companies that inhibit competition. Market dominance by an individual firm or group of firms is also restricted under the new act. The SER urges the government to go further in these areas:

> [T]he Council calls in the first place, for a further reduction in red tape for companies and individuals, also bearing in mind the burden imposed by obligations towards local governments. The next government should formulate specific targets for the reduction of red tape. Secondly, the Council refers to the introduction of competition in (quasi) public sectors ... effective competition does not come about by itself and it is above all essential to avoid replacing public monopolies with private ones. The Council further stresses the need to strive for increased effectiveness and efficiency in the performance of public tasks by making proper use of the market as an instrument. ... Thirdly, the Council refers to the "Market and Government" project, which is designed to ensure that through a clear separation of public tasks and market activities private companies do not suffer unfair competition from organisations with public tasks which operate in the market. The Council affirms this goal and calls for careful step-by-step implementation. (SER 1998, 14)

The Dutch Ministry of Economic Affairs claims the weight of Dutch regulation – as measured in five key sectors (electricity, aviation, road transport, telecommunications, and distribution) – reduces Dutch GDP by about 4 per cent.[6] The ministry turns to Sweden, of all places, to trumpet the benefits of privatization and deregulation. Swedish public transport was deregulated and partially opened to competition in 1989. By 1993, unit product costs had fallen 20 per cent. The result is particularly striking in bus transportation. According to the ministry, bus drivers in Sweden spend 70 per cent more time behind the wheel than bus drivers in Amsterdam (Netherlands 1997, 223).

The Dutch Miracle and Assessment

By 1993–94, the Dutch economy had developed all the ingredients that would lead to the "Dutch miracle". The consensus on wage moderation had been re-established. Government expenditures were dropping. Tax relief was implemented and further relief promised. Reforms had started to the Dutch social system which were designed not just to save the government money, but also to increase flexibility and reduce wage pressure in the labour market. A promising start had begun to regulatory reform. And the government had increased its use of market mechanisms and promised further reforms. All these measures had the impact of reducing costs in the Dutch economy.

The Dutch economy responded. Economic growth was stronger than anticipated. Dutch economic indicators for December 1998 indicate a growth rate of 3.8 per cent in 1998, on top of the strong growth already discussed in the years after 1993. Inflation remained low. Prices rose by 1.4 per cent in the first 10 months of 1998, just a shade over the EU average.

Unemployment fell to 6.4 per cent in 1997. By mid-1999, it had fallen to 4 per cent. The fall in unemployment occurred even while the participation rate continued to increase, from an average of 56.3 per cent of the 15- to 64-year-old population in the first three years of the 1990s to 60.6 per cent in 1997. Employment growth has been remarkable, particularly when compared to other periods

6. Netherlands (1997, 214), citing *The OECD Report on Regulatory Reform* (OECD 1997).

of recent Dutch economic history. From 1985 to 1996, employment increased 39 per cent, from 4.98 million jobs to 6.92 million. Job growth has been even stronger in the post-1993 period. Between 1972 and 1983, employment increased by just under 6 per cent, from 4.67 million to 4.95 million. From 1959 to 1971, the number of jobs grew 15 per cent, from 4.1 million to 4.7 million, before declining through 1971, as the social consensus was beginning to come unravelled (chart 3-12).

Patterns and Comparisons

When the Dutch corporatist state has reached consensus on holding down costs in the economy, the Netherlands has performed remarkably well. These periods include the post-war period until the 1960s, a brief period in the early and mid-1980s, and the post-1993 period, which gave rise to the idea of a "Dutch miracle". Some economists, however, argue the Dutch success in current years is less a function of good policy now and more a function of bad policy in the 1970s and 1980s that suppressed economic growth in the Netherlands, leaving it behind the European average. Correcting the policy errors, according to these economists, simply unleashed the convergence effect for the lagging Dutch economy, speeding growth (van Ark & de Haan 1997; OECD 1998, 19-29). As noted in the previous chapter, economists have made similar observations about the Irish economy. So, as with Ireland, there are several ways to view the Dutch experience: that policy which inflates costs suppresses growth, allowing powerful catch-up growth when economic distortions are removed; or that policy which controls costs spurs unusually strong growth; or some combination of the two.

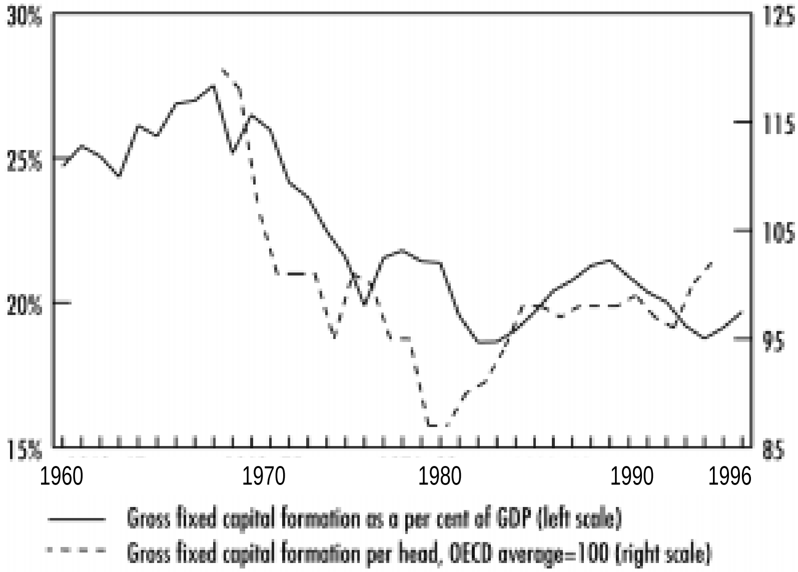
Whichever way one views the Dutch experience, it clearly shows the benefits of keeping costs in the economy under control, and it exposes the fragility of the corporatist structure. Powerful unions and a potentially interventionist government can overcome market signals, allowing wages to grow at a faster rate than economic conditions warrant. Through most of the 1970s and in the 1980s, unions pushed wages to levels that virtually eliminated profits and thus the incentive to invest and create jobs. In fact, Dutch fixed-capital formation closely follows the evolution of wages and government spending in the Netherlands (chart 3-15). It falls as wage costs and government spending rise through the 1970s. Following the Wassenaar agreement and attempts to rein in government spending, investment increases. It falls off again as costs rise in the early 1990s. Following the election of a government pledged to fiscal responsibility and the signing of the *New Course* agreement, fixed-capital formation again increases.

Job creation follows a similar pattern, though with more of a lag (charts 3-2, 3-11, and 3-12). It weakens noticeably through the 1970s, becoming negative in some years. After a brief upward blip in 1980 and 1981, job growth again turns negative. Growth turns positive and becomes strong in the late 1980s, but this leads to wage pressures and increasing wage costs. Job growth flattens in the early 1990s, before again accelerating after the 1993-94 reforms.

The same pattern is found in Dutch GDP and per capita GDP, though with two interesting twists. Dutch per capita GDP grew more slowly relative to overall GDP than was true in other European countries because of the Netherlands's strong population growth. For instance, between 1960 and 1997, Dutch population grew by 32 per cent, while German population grew by only 17 per cent (CPB 1997, 81).

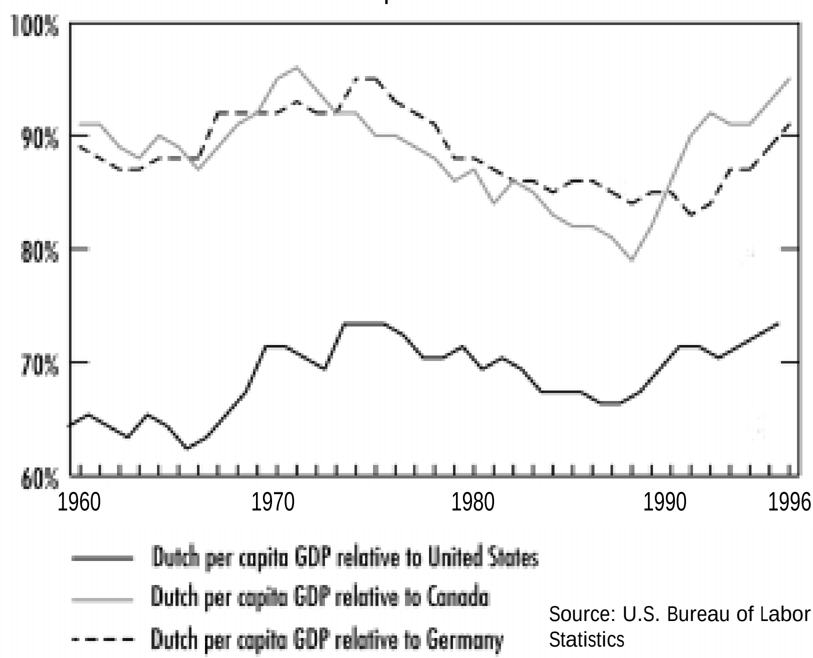
Dutch per capita GDP slid against benchmark nations through most of the 1970s and the first part of the 1980s. Then growth, retrenchment, and renewed growth follow the patterns of cost movements in the Dutch economy (chart 3-16). The second interesting twist becomes apparent in examining Dutch GDP per employee (charts 3-17 and 3-18.) The same patterns are apparent, but, just as per capita GDP growth is more muted than overall GDP growth, per employee GDP growth is lower than per capita GDP growth, because the number of people employed in the Netherlands is growing faster than the population as an increased percentage of the Dutch enter the labour market and find jobs (chart 3-19).

Chart 3-15 Dutch Gross Fixed Capital Formation (OECD=100)



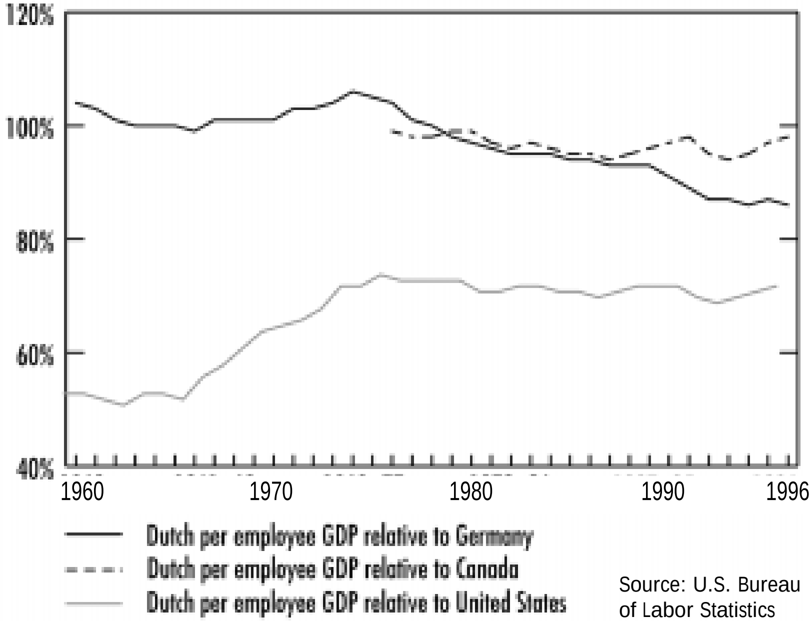
Source: World Development Indicators (World Bank 1997)

Chart 3-16 Dutch Relative Per Capita GDP



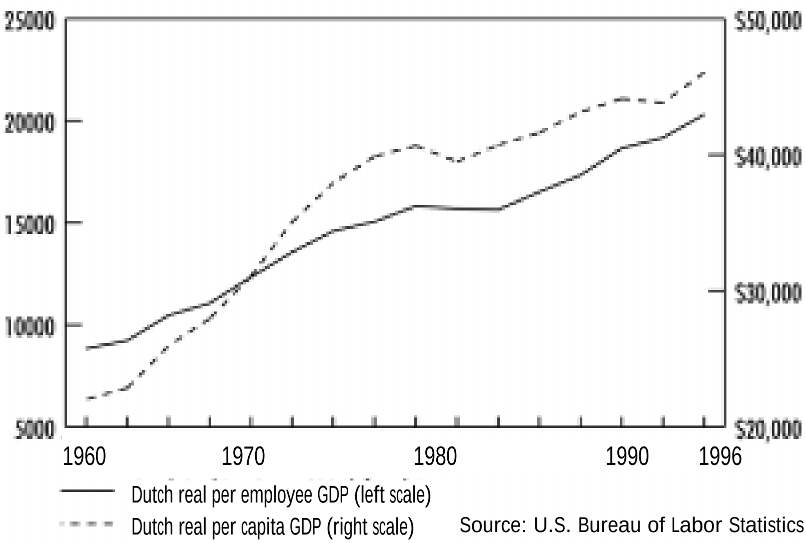
Source: U.S. Bureau of Labor Statistics

Chart 3-17 Relative Dutch GDP Per Employee



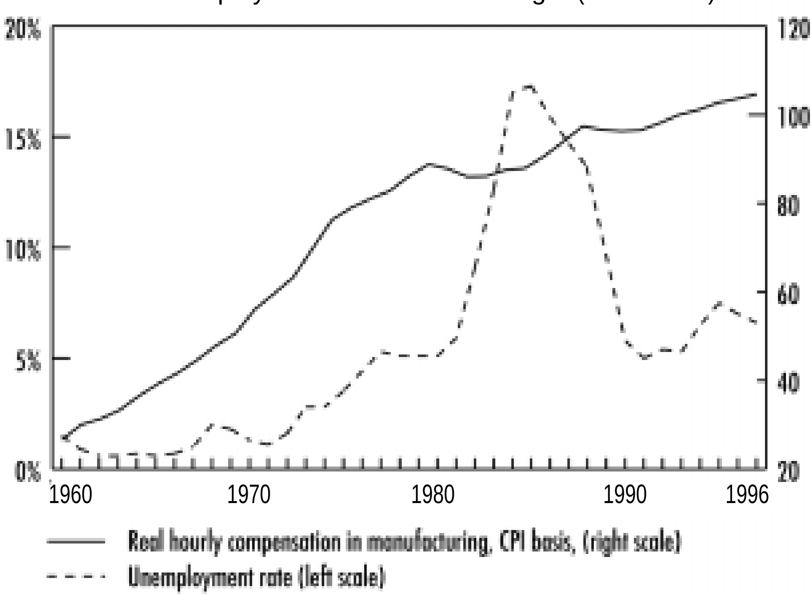
Source: U.S. Bureau of Labor Statistics

Chart 3-18 Dutch GDP Per Employee and Capita (1996 US$)



Source: U.S. Bureau of Labor Statistics

Chart 3-19 Unemployment Rate and Real Wages (1992=100)



Source: U.S. Bureau of Labor Statistics

Moreover, many of the new jobs are low-productivity jobs, reflecting the increasing number of part-time and lower-skilled workers in the economy. The growth of part-time work has been a world-wide phenomenon, but it has been particularly strong in the Netherlands through the 1980s and 1990s for several reasons. The Dutch labour market has become somewhat more flexible in recent years, drawing in new participants. As well, the social pacts, which attempted to reduce the work week, opened the door to part-time workers to make up lost hours. Reforms to the minimum-wage law and social programmes increased the number of jobs and workers at the low end of the wage scale.

The most important factor, however, was the late entrance of women into the Dutch work-force. This is a relatively recent phenomenon. In a relatively short period, it boosted the number of part-time workers in the economy, something which occurred over many years, and thus more slowly, in most other advanced economies.

As the SER (1998, 3) notes in a slightly different context: “Labour productivity is still relatively high; the slower growth in recent years is partly due to a conscious choice in favour of expanding participation in the labour force, especially by those at the bottom of the labour market.” One impact of the wage-moderation measures has been an opening of the Dutch service sector, where wages and productivity are routinely lower than in the manufacturing sector.[7]

Yet both Dutch policy-makers and the general population show high approval of the creation of part-time jobs. This is seen as giving workers greatly flexibility in ordering their own priorities in terms of leisure and income. It also brings flexibility to the family structure, allowing either or both parents to mix part-time work with child rearing. Finally, it reflects a late-coming change to the Dutch society and economy, the late entrance of women into the work-force. Dutch policy, especially tax policy, was focused on the single-income family. Social change, the increased openness of the Dutch economy, and changed institutional arrangements in the economy which created more flexibility for part-time work all helped boost part-time work and brought more women into the work-place. The availability of part-time and low-skill jobs also helps those entering or re-entering the work-force by providing a first job and enabling them to build skills for higher-paying work.

Will It Last?

> Nowadays learning [from past mistakes] is stronger than forgetting. There may come a situation where it will be very difficult to explain to our members why we have to have a moderate wage policy. We are approaching that stage. We now have strong growth and employment is being brought back. (Cor Inja, chief labour economist for the FNV)[8]

7. As noted earlier, this means statistics based on manufacturing wages, as found in this chapter, understate wage moderation in the Netherlands.
8. In conversation with the author in June 1998.

A question I constantly asked in both Ireland and the Netherlands was – given the weakness of market mechanisms in setting wages and the need to maintain consensus to keep costs under control – will the Irish/Dutch miracle last? The responses were invariably pessimistic for the long term. Inja noted that, from labour's perspective, too-rapid profit growth or managers who, United States style, awarded themselves huge pay increases could cause labour's rank and file to rebel against wage moderation.

Yet, as noted earlier, a policy to increase profit margins was and is a key and explicit part of the social agreements. But there is problem with society-wide negotiations determining wealth distribution – or at least having a large say in it – rather than market forces. Who determines the proper distribution between profits and wages? Senior government officials suggest an 80/20 split in return to labour and capital is about right. Inja says his union doesn't explicitly look at profit levels but rather examines the costs producers face in other countries, as well as productivity and inflation in the Netherlands to set wage demands. The idea is not to take as much as possible in any given year – and kill the golden goose – but rather to set a fair division while maintaining the Netherlands as an attractive locale for investment and providing existing companies with the profits to generate further investment. The need for healthy profits is not questioned by the labour unions.

> We [the union movement] didn't immediately accept the relation between wages and job creation. But, you know, enterprises can't operate without a profit, and we saw big enterprises had to close their doors without a profit. We had to bring back the total number of people working. We learned [the relation between wages and profits] at a fairly late stage of the development. In the 70s, unemployment started to rise and we acted not early in 1982. You may need a crisis to achieve this understanding.[9]

9. In conversation with the author.

Certainly, the current generation of Dutch labour leaders not only understands the relation between job creation, moderate wage costs, and profits but are also willing to promote it vocally. Johan Stekelenburg was chairman of the FNV from 1988 to 1997 – when the federation faced some of its most difficult problems – and he successfully ran on the labour platform to become mayor of Tilburg. In 1997, he described the Dutch experience to a group of foreign journalists:

> In the past 13 years, wage costs per unit of product rose almost 30 per cent in France and even 40 per cent in Germany. Here, on the other hand, they fell by over 1 per cent! Then we have employment. Employment rose by no less than 21 per cent in the Netherlands; that's 10 times more than in France and four times more than in Germany.[10]

It is worth noting that this is a key union leader and labour politician emphasizing the relation between wage moderation and job creation, something many North American unions vocally reject. Wage moderation and, to a lesser extent, government cutbacks are almost universally credited in the Netherlands with that nation's remarkable economic and job growth.

> The Netherlands has set an example, for Europe in particular, with its low wage costs, increasingly strong competitive position and sharp rise in employment. ... The economics editors of virtually every renowned international journal and television net work travelled to Holland to view for themselves the mixture of wooden shoes, tulips and wage moderation. ... Fifteen years ago, these very same international journals and dailies told a different story. Instead of *Dutch delight* they spoke of *Dutch disease*. ... The Netherlands was cited as a prime example of

10. Quoted in van Empel (1997).

> a country where growing government spending and rising wage costs had the economy in a stranglehold, causing unemployment to skyrocket. (van Empel 1997, 5)[11]

As in the Irish example, a number of factors must be counted in the mix. Efforts to reduce the tax burden have made lower wages more acceptable for union members. At the lower end of the income scale, government deregulation, greater labour-market flexibility, greater competitiveness, and reform of social programmes have created both a demand for and supply of lower-skilled workers, reducing wage pressure and creating new jobs. “The Social Partners [labour and business] have since [the early 1980s] restrained the wage development ... and contributed to a more flexible labour market. The government supported these policies by lowering taxes and social premiums, by means of reforms of the Social Security System and by a deregulation and competition drive.” (VNO-NCW 1997a, 32)

Yet, because market signals are muted and can be overridden by the social partners, the corporatist model remains vulnerable, particularly when new market signals emerge but are not fully accepted by the social partners. Moreover, for the corporatist state to respond effectively to a new situation – whether changing international conditions or an internal economic boom that creates new pressures through the economy – all the social partners must come to share a common view of the situation, and this view must be *correct*. The main Dutch economic agency, the Central Planning Bureau, puts the problem succinctly and warns of the dangers ahead:

> [Corporatism] is easily made ineffective by external changes that affect the choices of the bargaining partners. This may explain why the Dutch economy was so badly hurt in the seventies, when it took a long time for the

11. It is worth pointing out that that statement is in a publication of the Labour Foundation, a joint business/labour body. The publication was signed by the co-chairs, one representing labour and the other business.

> main social-economic players to regain a common view of the world. Still today, several arrangements in the Dutch institutional system lack in effectiveness, because the underlying values and norms have eroded. (CPB 1997, 541)

Conclusion

The Dutch and the Irish economies followed similar roads to economic ruination. Then they took strikingly similar paths to economic salvation. Outside Ireland, no one much noticed the Irish decline because Ireland *always* seemed mired in economic problems. The glimmer of hope in the 1960s had quickly been forgotten. So, to outside observers, Ireland's bleak times seemed to be nothing out of the ordinary.

But the Dutch troubles were another matter. They attracted world-wide attention, and a new phrase entered economic dictionaries, "Dutch disease". The Dutch decline was startling because the Netherlands had been one of Europe's strongest performers after World War II. Moreover, the Dutch had an energetic history, many centuries old, of wealth creation and trading vigour. This just shows how quickly even the strongest economy, regardless of the depth of its traditions, can be thrown off track.

The Dutch early post-war strategy of economic growth through cost competitiveness based on wage moderation came apart through the 1970s. At the same time, government hubris increased. Both taxes and expenditures skyrocketed. Unfortunately, expenditures had the faster take-off. The Netherlands began running huge deficits, which increased the cost of capital and costs related to uncertainty — fear of inflation and worry about high future taxes to pay off the debt. What followed was the worst period in Dutch peacetime economic history.

Slowly, through fits and starts in the 1980s and 1990s, the Dutch got their economic house back in order. Although a breakthrough labour agreement in 1982 ultimately failed in its goal of establishing durable wage moderation, further work in 1993 and 1994 succeeded in building a strong basis for moderation. Similarly, the

Dutch attack on government spending in the early 1980s faltered late in the decade. And it was never accompanied by a firm commitment to reduce taxes. The Wim Kok government, elected in 1994, changed all that, though Kok himself was the leader of the leftish Labour party. The new government forcefully tackled both expenditures and taxes. It has had considerable success in bringing both down.

It's the period after the aggressive reforms initiated in 1993 and 1994 which moderated wage growth and reduced taxes that became known as the time of the "Dutch miracle". As costs were reduced and profits restored in the Dutch economy, strong economic growth resumed. Real wages have increased. The Netherlands has gone from having one of the highest unemployment rates in Europe–not even counting the absurdly high number of people classified as disabled–to one of the lowest unemployment rates anywhere in the world. As Dutch commentators like to point out, there may be no Polder Model, but there are a lot of clear lessons to be learned from the Dutch economic experience, and economic growth is again strong.

The question is whether the lessons will be remembered or forgotten. The "Dutch miracle" has persisted only four or five years. That means it may well be premature to call this a miracle. Time will tell.