A macro-economic lesson from Holland

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Abstract

The US and Europe have welfare states that cause stagflation but they have been repressing this stagflation by financial deregulation. Holland has been repressing its problems with the welfare state also by a low wage policy. The Dutch economy has been running a surplus on the external account for years in the same way as China and Japan. The focus by policy makers on finance is misguided and does not solve the real problem in the current crisis. The basic problem in the world is how to structure the welfare state. Next to the structural solution, a temporary solution of a reduced working week is superior to the rise of unemployment.

Introduction

Obscured in international statistics, Holland has been creating sizeable surplusses on the external account (graph). The country thus is much like China and Japan, and it is only that it is so much smaller so that this does not draw attention. The reason for the Dutch surplus is basically the same as for China and Japan too. To fight unemployment at home, the Dutch have resorted to a low wage policy. Thus they not only export Heineken, cheese and flowers but also unemployment.

As Spilimbergo e.a. (2008) explain, a single country may escape from the current economic crisis by exports but it is a bit difficult for all countries to do so. By implication, it is interesting to find out what caused this Dutch reliance on exports. When we can determine what caused the economic imbalance then the world might avoid the same mistake.

Source: calculated from CPB (2009).

Exposed versus sheltered sectors

Van Schaaijk (1983) provides the basic step. The Dutch policy to fight unemployment consisted of a general wage restraint. This general restraint implied too little restraint for the sheltered sectors and too much restraint for the exposed sectors. That is, in the exposed sectors, mostly Dutch agriculture and manufacturing, workers are very productive and their incomes might grow faster. However, a general restraint blocks that faster growth. A better policy alternative would have been a tax policy, to support the net incomes of the lower productive sheltered workers (services), so that one could allow higher wages for the more productive exposed workers. This however never got sufficient attention apparently since there was no clear need for an alternative.

The same conclusion now holds for China and Japan. They would be wise to develop their home markets and divert resources away from exports. Indeed, exports generate foreign exchange reserves but those need not keep their value. The Dutch and their pensioners have been big investors in the US as well but those investments haven't quite kept their value.

Extension to the world as a whole

Colignatus (1990, 1996, 2005) digs deeper into the Van Schaaijk (1983) analysis. The problem in Dutch society has been caused more fundamentally a bit by the mismanagement of the "Dutch disease" following the discovery of large resources of natural gas but much more importantly by mismanagement of the welfare state. This analysis actually can be extended to the world at large, for all countries that developed a welfare state. General misconceptions caused the problems of Stagflation, the unfavourable combination of inflation and unemployment.

The period since 1970 can be called the Great Stagflation, and the last period is one of "repressed stagflation". While the Dutch have been fighting stagflation by a recourse to exports, the US has relied on deregulation and financing the Iraq war by borrowing from China.

The path towards recovery consists of three elements: (a) institutional safeguards, (b) restoration of the optimal path, (c) measures to get to that path. Colignatus (2009a) considers element (a), the institutional setting. Colignatus (2009b) considers elements (b) and (c), i.e. the macro-economics of the recovery.

The key point is to keep people in jobs

The key point for the current situation is to keep people in jobs. A good solution is a temporary reduction of the working week. A reduction of working hours is inappropriate when there are structural problems e.g. with the level of wages but now that we know what happened it follows that a job (at reduced hours) is better than an unemployment benefit.

The analysis by Spilimbergo e.a. (2008) and the review by Lane (2009) rely too much on the notion that "there will be unemployment" that "hence" must be tackled with "fiscal or monetary policy". That approach puts huge sections of the public through periods of high personal insecurity and financial distress, and quite unnecessarily so.

Obviously, we need to restructure the financial system as well. A separation between savings banks, investment banks, and insurance is obvious, while hedge funds can be put into a public utility until the finance community knows better how to regulate them. And fiscal and monetary policy undoubtedly will play a role. But there is no need to put people into a state of unemployment. It is a source of amazement that economists are trained to think so.

A word of caution

The basic cause lies with the structure of taxation and welfare state. Unfortunately, the epiphenomenon in the US is a financial crisis. By consequence, the team composed by President Obama is weighted heavily with advisors from the world of finance, and subsequently they develop plans on finance, with apparently also a bias to protect shareholders of banks rather than the (future) unemployed. Krugman (2009) and The Economist (2009) rightly point to the overall risks of this. The Economist calls nationalisation "politically unpalatable in America" but this is precisely because of the bias of the team picked. And they apparently lock themselves up in isolation and groupthink. The G20 meeting was intended to make a difference but is already being toned down or may highlight rifts between the major regions that can upset the markets. It is regrettable. President Obama started out with great promise but sees himself confronted with a failing restructuring of the financial system, soaring national debt, a dropping dollar, rising inflation and unemployment, a loss of confidence, and a loss of strength to fulfill the promise. Europe can help Obama by clarifying what advice he needs, yes, we can.

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