Country Profile

The Netherlands

Rabobank Economic Research Department website:
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Contents

Introduction

The Netherlands, Gateway to Europe

The Netherlands is one of the European Union's founding member states, favourably located on the North Sea, bordered by Belgium and Germany. It is one of the smaller European nations, with a total area of only 42 thousand km^2 (including the Dutch Antilles), 16.5 million inhabitants, and a GDP of 570 bn euro (2009). It is a relatively affluent country with GDP per capita amounting to 35 thousand euro in 2009. In 2009 only four OECD countries had a higher GDP per capita (Luxembourg, Norway, United States and Switzerland).

The Netherlands has always been an active international player, and many large multinationals have their home base in the Netherlands. The country's dependence on international trade and cross-border relationships has made it an active member in a large number of international organisations, including NATO, the UN, and the European Union. Since January 1999, the country has participated in Europe's Economic and Monetary Union (EMU) and from 2002 onwards it has been part of the single currency Euro area.

This booklet provides the reader with relevant background information about Dutch history, demographics and economic structure. Furthermore, an overview is given of the main economic challenges facing the Dutch economy. Taken together, the information offers a bird's-eye view on the Netherlands.

General information

Geography

The Kingdom of the Netherlands consists of the Netherlands and its six dependent island States in the Caribbean. Aruba, Curaçao and St Martin are autonomous countries within the Kingdom of the Netherlands. The other three islands (Bonaire, Saba and St Eustatius) are municipalities of the Netherlands with a 'Special Status'.
The total land area of the Kingdom of the Netherlands is 42,324 km^2. The Netherlands itself is a relatively small European country with a land area of only 33,756 km^2 if inland and coastal waters are excluded. With 489 people per square km, it is densely populated. The Netherlands is bordered to the north and west by the North Sea (451 km), to the east by Germany (577 km), and to the south by Belgium (450 km) (Figure 1). The country is favourably situated at the estuaries of three major European rivers: the Rhine, the Meuse, and the Schelde, allowing it to successfully develop a role as the main transportation gateway to the heart of Europe.
The economic centre of the country is often referred to as the Randstad. This is the metropolitan agglomeration in the west of the country, which includes the four largest Dutch cities: Amsterdam, Rotterdam, The Hague, and Utrecht. The population of this agglomeration totals 10 million. About a quarter of the Dutch land area, particularly the Randstad, is below sea level, but is fully protected from the sea by an extensive system of dykes, modern drainage mills, and hydraulic engineering works. The North Sea contains oil, while natural gas was discovered on land in the North-East part of the Netherlands. These are the Netherlands' main natural resources.

Figure 1: The Netherlands in Europe

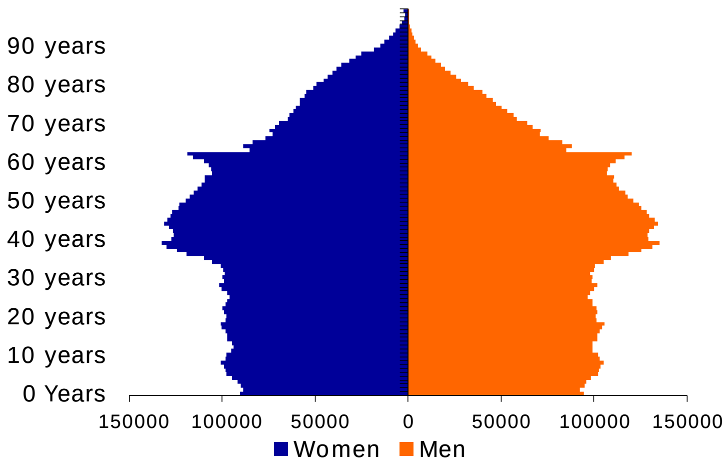
Source: Rabobank

Demographics

At the end of 2009, the population of the Netherlands numbered 16.5 million inhabitants. The majority (13.2 million) are native Dutch, while over 3.3 million inhabitants are of foreign origin. In 2009 the total Dutch population increased by over 91,825: 184,824 babies were born (on average women in the Netherlands currently give birth to 1.8 children) and 134,174 people died. In addition, the population had a net immigration surplus, since 110,830 people left the Netherlands and 147,308 arrived. The Netherlands has been having a surplus in ten of the last fifteen years. The average surplus of these fifteen years was a little more than 16.500.

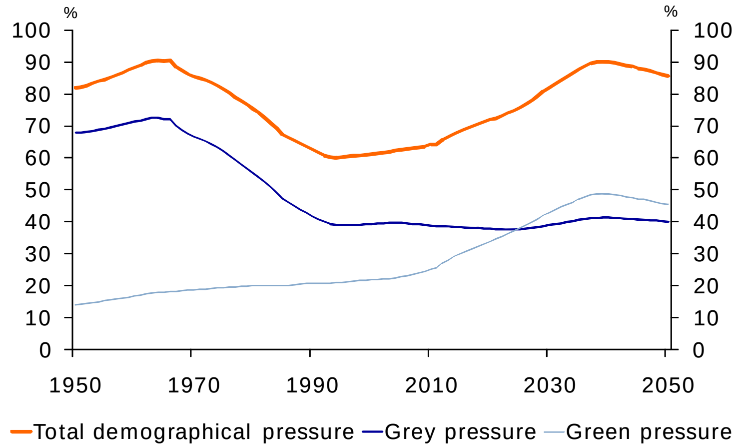
The population is gradually ageing, albeit slower than in most other European countries. Elderly people (over 65 years old) make up the fastest growing population group. Nowadays, 2.5 million people aged 65 years or older live in the Netherlands (15% of the total population). Shortly after 2010, an acceleration of this group's share in total population is expected. Currently, the largest age cohort of the Dutch population (35%) comprises people between ages 40 and 65 (partly the post-World War II Baby Boomers). By 2030, this age group will number 4.1 million people (23% of the total population). The age-profile of the population will then differ completely from the one of today. By then, more than 55% of the population will be between 20 and 65 years old, and 21% will be younger than 20 years (Chart 1 and 2).

Chart 1: Population distribution by age



Source: Statistics Netherlands

Chart 2: The effects of population ageing



Source: Statistics Netherlands

History

The present Dutch state, nowadays officially called the Kingdom of the Netherlands, was created in 1830, after Belgium seceded from the combined northern and southern Netherlands and became an independent country. This event signalled the end of a turbulent period.

In the second half of the 16th century, the Dutch revolted against the authority of the King of Spain. The leader of this revolt was the nobleman William of Orange, ancestor of the current Dutch royal dynasty. This uprising resulted in the 1648 Treaty of Münster, leading to the independence of the Northern provinces, which would later become the present-day Netherlands. The early 17th century saw the emergence of an era of great commercial prosperity, the so-called Dutch Golden Age. Amsterdam flourished as a hub for European and intercontinental trade. As a result, it also became the world's most important financial centre and pioneered the trading of financial securities and derivates. Its economic power grew strongly, mainly because of the trade with Asia. The Dutch East India Company (VOC) became the first public limited liability company in 1602. By the mid-17th century, the Netherlands was the foremost commercial and maritime power in Europe. Culture and science flourished apace. Famous painters like Rembrandt and Vermeer lived in this period. Despite economic prosperity, political turmoil developed. Four wars took place between the Dutch and the English. In particular the fourth English war (1780-1784) was an economic disaster for the Dutch Republic. Many Dutch patriots fled to the North of France. With their help, revolutionary France declared the war on the Dutch Republic in 1793. The Dutch Republic collapsed when the armies of Revolutionary France imposed a pro-French government in 1795.

At the end of the Napoleonic era, William Frederik became the first Dutch monarch - King William I. He ruled both the northern and southern Netherlands from 1815 onwards. In 1830, the opposition of Belgium to unification and the reestablishment of the monarchy resulted in a revolt where Belgium proclaimed its independence. The remaining Kingdom of the Netherlands developed from an agricultural economy into an industrial economy in the second part of the 19th century. Political changes also took place, such as the rise of liberal ideology. The dominance of the liberal movement came to an end at the end of the 19th century, when sectarianism became the most important determinant of the Dutch society. Political parties, schools, sport clubs and newspapers were all based on the religious background of the people. The '60s and '70s of the 20th century is seen as the period of the removal of the traditional religious and socio-political barriers. Another significant change was the introduction of political voting right. In 1917 Dutch men got the right to vote. In 1919 this right was extended to women.

The country was spared the horrors of the First World War due to its self-declared neutrality. Nazi Germany, however, violated this neutrality by invading the Netherlands in May 1940 and occupied the country for five years during the Second World War (WWII). Since WWII, the Netherlands has actively participated in a large number of international economic, political, and military agreements. For example, the Netherlands was one of the six founding members of the European Coal and Steel Community (ECSC), the predecessor of the European Economic Community (EEC) and later the European Union (EU). Its sound economic structure has also ensured that the Netherlands was among the founding countries of the Economic and Monetary Union (EMU). Besides this European dimension, the Dutch international orientation is reflected in the numerous organisations in which it participates.

Political system

The Netherlands has been a parliamentary constitutional monarchy since the revision of the Dutch constitution in 1848. The government of the Netherlands consists of the reigning sovereign (presently Queen Beatrix) and the council of ministers. The reigning sovereign's role is limited to the formation of government and she does not actively participate in daily decision-making, nor does she have political responsibility. She therefore cannot be held accountable for her actions by parliament. Queen Beatrix is expected to descend from the throne within the next five years. Her eldest son, crown prince Willem-Alexander, is expected to be her successor.

Executive power is exercised by the prime minister and a cabinet consisting of ministers and junior ministers (staatssecretarissen). Legislative power is exercised by a Parliament that comprises two chambers. The more important Lower House has 150 members, who are elected by proportional representation for a four-year term. It monitors the actions of the cabinet directly and has the right to initiate or amend new laws. Laws that are passed by the Lower House are sent for ratification to the Upper House. The Upper House has 75 members who are elected by the twelve provincial legislatures, which in turn are elected by popular vote. Its role is to reflect on the laws passed by the Lower House and to examine any implementation issues that may arise. Once a law passes the Upper House it is thereby enacted. The executive power is accountable for its actions to the legislative power.

As a large number of political parties participate in the elections and no party has ever been able to obtain an overall majority, the Netherlands is traditionally governed by coalitions of parties from the centre of the political spectrum. The Christian Democrats (CDA), the Labour Party (PvdA) and the Free-Market Liberals (VVD) have been the largest political parties in recent decades, with two of the three participating in every Dutch cabinet during this period.

The multiparty system and the lack of an overall majority contribute to the ongoing stability and continuity of policy that are typical for the Dutch political environment. This does not mean that the country is unfamiliar with political wrangling. In 2002 the political landscape changed due to a new party, the LPF. The party was led by Pim Fortuyn, a far right-wing politician. His electorate consisted mostly of people who felt unrepresented by the existing political parties, which were thought to have become complacent and overconfident. The assassination of Pim Fortuyn, the week before the elections, and the break up of the cabinet (including the LPF) were responsible for the collapse of the LPF in 2006. The political gap left by the LPF has since been filled by the Freedom Party (PVV). This party is lead by Geert Wilders, again a far right-wing politician. In 2010 the PPV became the third largest party after the Free-Market Liberals and the Labour Party.

After four (relatively short) coalitions headed by Prime Minister Jan Peter Balkenende (CDA), new elections were held in June 2010. Voting was fragmented. Remarkably, the result for the Party for Freedom (PVV) almost tripled their presence in parliament (24). The Christian Democrats headed by Balkenende lost half their seats (21), while the Labour Party (PvdA) and the Free-Market Liberals (VVD) remained relatively stable, with 30 and 31 seats respectively.

A minority cabinet was formed by the VVD and the CDA after four months of negotiations. The cabinet has accepted the support of the PVV. This new cabinet is headed by Mark Rutte (VVD). Having a minority cabinet is unique for the Netherlands and comes as a consequence of the fragmented election result and the disagreement on the position of Islam- whether it is a religion or political ideology. To form this minority cabinet, a coalition agreement has been written by the CDA and the VVD. An additional 'approval' agreement was written with the PVV. The CDA and the VVD will introduce stricter immigration rules as agreed upon with the PVV. In return the PVV will support the cabinet with their policies as stated in the coalition agreement (e.g. the government's planned austerity measures).

Table 1: Key figures The Netherlands (2009)

Land area (in square kilometers)	41524
Total area (in square kilometers)	33756
Population (million)	16.5
Population growth (in thousands)	90
Population per square kilometer land	489
Gross Domestic Product (bn EUR)	570
GDP per capita (in EUR)	34704
Unemployment (% total labour force) (ILO definition)	4.9 (3.7)
Private saving rate (% GDP)	10.0
Investment (% GDP)	13
Current Account (% GDP)	6.3
Government budget balance (% GDP)	-5.3
Import value (% GDP)	68
Export value (% GDP)	76

Source: Statistics Netherlands, Netherlands Bureau for Economic Policy Analysis and OECD

Note: Netherlands Antilles are excluded

Economic conditions

Historical developments

After World War II, the Dutch economy was geared towards reconstruction and development. The discovery of natural gas in Slochteren in 1959 boosted the national income and the balance of payments considerably. The positive economic development was disrupted by the two oil shocks in the 1970s. The government worsened the situation by responding with inflationary policies. Soon the country had to deal with what is now known as the ‘Dutch disease’: the deindustrialization of a nation’s economy that occurs when the discovery of a natural resource raises the real value of that nation’s currency, making manufactured goods less competitive vis à vis other countries, thus increasing imports and decreasing exports. Despite all this, the Dutch have had a surplus on the current account balance almost every year since the second world war.

A big change in the unfavourable economic situation came in 1982, when employer and employee representatives signed the so-called Wassenaar agreement. The unions agreed to wage moderation and more decentralised bargaining, in exchange for a new emphasis on job growth and reduced working hours. The government began to sort out its fiscal situation and lowered taxes. Furthermore, it provided incentives to people to rejoin the labour market. In 1994 the Wassenaar agreement was adapted in the so called ‘Nieuwe Koers’ (new direction). This new policy decentralised decision making further, to be able to cope with the need for more flexible labour and capital, as a result of increased globalisation and international competition. The Wassenaar agreement and the ‘Nieuwe Koers’ contributed towards turning the ‘Dutch disease’ of the 1970s into the ‘Dutch miracle’ in the late 1990s.

The Wassenaar agreement was a powerful illustration of the ‘Polder Model’. Characteristic for this system is the desire for consensus and agreement between the social partners. The Polder Model attracted widespread foreign interest, particularly during the second part of the 1990s, when many countries struggled with low growth, high unemployment, rigid labour markets and an overly generous welfare state. The Dutch managed to address these problems through negotiations within the ‘Polder Model’. Although the limitations of the ‘Polder Model’ became visible during the last decade, it still plays in important role in wage negotiations and the raising of the retirement age.

Economic structure

Analysis of the economy by sector

Total Gross Domestic Product (GDP) in 2009 was over 570 bn Euro, making the Netherlands the sixth largest economy in the EU. As in most western economies, the Dutch production structure has changed significantly in the last few decades. Primary agriculture nowadays only accounts for 2% of total gross value added. The manufacturing industry has declined to 24% while the services sector has increased to 74%. In terms of employment the services sector stands out even more. Agriculture represents 3% of total employment while industry and services represent 17% and 81% respectively (chart 3).

Chart 3: Gross value added and employment by sector

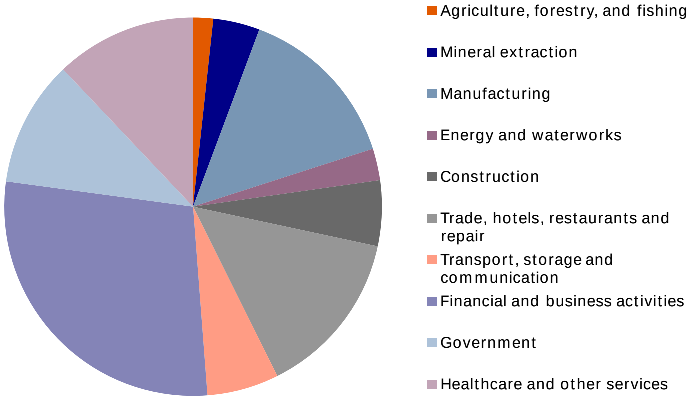
Gross value added	*1970*	*1990*	*2000*	*2009*
Agriculture	6%	4%	3%	2%
Industry	38%	29%	25%	24%
Services (incl. government)	57%	66%	72%	74%
Total	**100%**	**100%**	**100%**	**100%**

Employment	*1970*	*1990*	*2000*	*2009*
Agriculture	6%	4%	3%	3%
Industry	36%	23%	19%	17%
Services (incl. government)	58%	72%	77%	81%
Total	**100%**	**100%**	**100%**	**100%**

Source: Statistics Netherlands

Despite the decreasing share of the narrowly defined agricultural sector, agribusiness as a whole (i.e. including the food industry, supply sector and trade and distribution) is a relatively important sector in the Dutch economy. Food represents 13% of the total amount of Dutch exports. The Netherlands is the world's fourth largest exporter of agricultural products and the seventh largest importer. In addition, 41 percent of the trade surplus is due to food related trade. Placed in a European context, the Dutch agricultural sector is very efficient with comparatively high value added.

Chart 4: Sector shares in gross value added in 2009 (in basic prices)



Source: Statistics Netherlands

However, despite the strong agricultural orientation (that still characterises the Dutch economy, and in particular Dutch exports today), the Netherlands has clearly evolved into a services-oriented economy (chart 4), with financial and business activities (28%) making the largest contribution to GDP. Within services, the share of non-commercial services has declined gradually during the past fifteen years, while the share of the post and telecommunications sector as well as other business activities (such as ICT services, accountancy and consultancy) has increased.

The relative contribution of the manufacturing sector has declined over the years. However, many former manufacturing activities are now included in the services sector, such as security, catering, or design. In addition, many services sector activities are specifically geared towards the manufacturing industries, such as transportation and business consultancy. Some industrial sectors (e.g. chemicals, industrial machinery, shipbuilding, and the food industry) clearly stand out internationally. Moreover, the manufacturing sector is accountable for a big chunk of the country's surplus in the trade balance.

Furthermore, due to their age-old fight against the sea, the Dutch have become the world's leading experts in dredging, drainage, hydraulic engineering, and water management.

Final expenditure

Besides looking at GDP from the production side, it is also interesting to take the perspective of final expenditure. Private consumption is the single largest demand component, representing almost 46% of GDP in 2009. Compared to other countries, the Netherlands is a very open economy. The relatively high shares of exports and imports of goods and services in GDP, which amounted to 76% and 68% respectively in 2009, reflect this openness. Only three other OECD countries have economies that are more open, namely Luxembourg, Belgium, and Ireland. Total fixed business investment represents 19% of GDP. Usually, the Dutch government budget balance is in a deficit. In only eight years since 1960 the budget balance managed to post a (small) surplus. However, this deficit is abundantly compensated by the savings surplus of the private sector. In 2009, private savings as a percentage of GDP amounted to 10% (by definition the private saving surplus is equal to the current account balance plus the government budget balance). With relation to the private saving account, the Netherlands ranks third amongst the OECD countries, behind Ireland and Switzerland. The major reason for this large and continuous flow of private savings is the widely subscribed and well developed (capital-based) pension system.

Small and Medium Enterprises

In 2009, 844,000 companies were active in the Netherlands. Most of these firms (837,000) can be found in the Small and Medium Enterprises (SME) sector. Only 8,000 companies are considered large, employing over 100 people (Table 2).

In 2009, SMEs were responsible for 45% of the total revenue in the business sector and for 39% of the total gross value added. Over 3 million full time equivalents find employment in SMEs. This is more than 48% of total employment in the Netherlands.

Many SMEs are active in the financial and business services sector. In the past decade most sectors experienced good times, due to sales growth and cost reductions. However, recently the profitability of SMEs has developed negatively. Particularly the construction, transport and trade sector experienced hard times during the economic downturn. Halfway 2010 both the transport and trade sector are showing better results, while the construction sector is still struggling.

A relative new phenomenon is the group self employed without having personal. This group has increased considerably in size during the last decade, from 465 thousand in 2001 to 703 thousand halfway 2010. Positive side-effect of this development is that the flexibility of the labour market has increased.

Table 2: Key figures of SMEs compared to the total business world in 2009

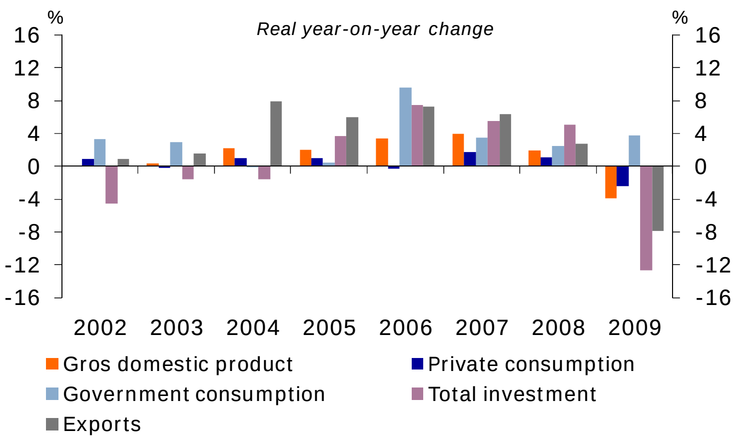
	SME	Large enterprises	Total businesses
Revenue (bn EUR)	688	831	1519
Operating profit (mln EUR)	38696	6425	45122
Gross value added (bn EUR)	224	351	575
Manpower (x 1000)	3192	3413	6606
Companies (x 1000)	837	8	844
Revenue %	45	55	100
Operating profit %	86	14	100
Gross value added %	39	61	100
Manpower %	48	52	100
Companies %	99	1	100

Source: Rabobank en Statistics Netherlands

Economic outlook

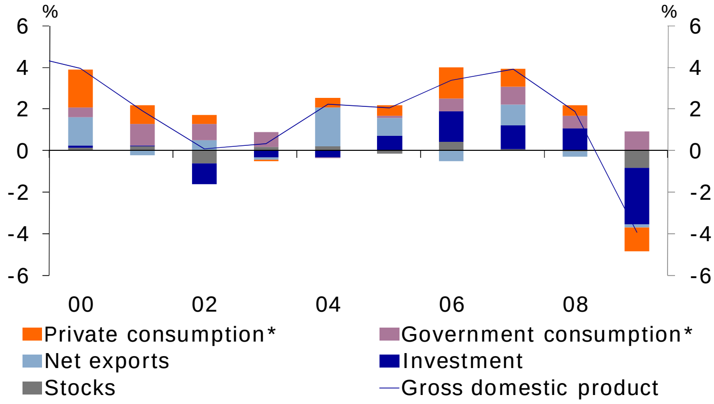
The prospects for the Dutch economy are improving after the financial crisis. The financial crisis resulted in a economic contraction of 3.9 percent in 2009. However, since the third quarter of 2009 the economy has been recovering gradually. The 8.4% decline in exports was the main contributor to the economic decline but also consumption (-2.4%) and investments (-17.7%) decreased considerably. Only the government sector contributed positively to overall GDP, with a growth of 3.0% (chart 5 and 6).

Chart 5: Change in GDP



Source: Statistics Netherlands

Chart 6: Contribution to GDP change



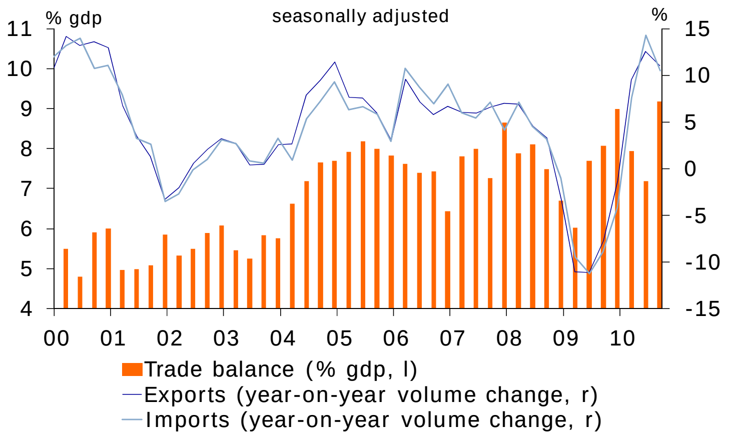
* Corrected for administrative effects of the implementation of the new health care

Source: Statistics Netherlands

Until the third quarter of 2010 the Dutch economy has grown modestly. This can be attributed to the fact that the Netherlands, with its small and open economy, has benefited to a relatively large extent from the global trade recovery (Chart 7). In particular, the increase in trade with neighbouring countries had positive effects on Dutch (re)exports. This is in contrast with private consumption and business investment, which hardly contributed to economic growth. For 2010 it is expected that the economic growth will amount to 1¾%.

We expect the growth rate for 2011 to be slightly lower due to an expected slowdown in growth of international trade. This is partly caused by the austerity measures governments will put in place. Firms are, however, expected to increase their investment level slightly. In sum, the economy is expected to grow by 1½% in 2011. Although this growth rate is below trend, it will be slightly higher than the average of the eurozone.

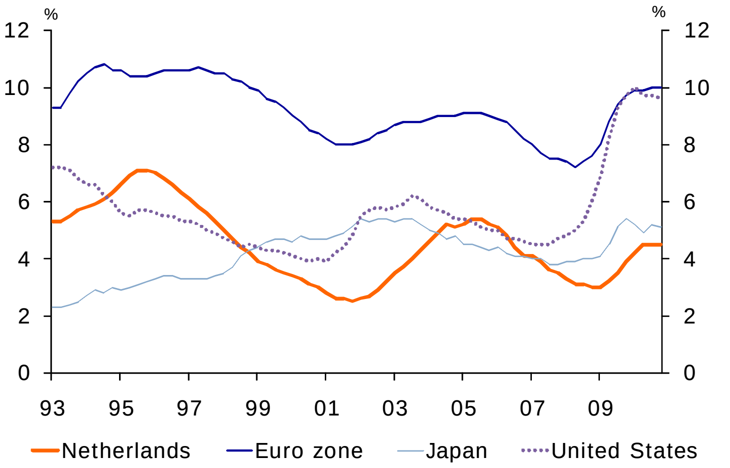
Chart 7: Exports and imports



Source: Statistics Netherlands

Compared to other OECD countries the unemployment level in the Netherlands is low. Halfway 2010 South Korea, Norway and Switzerland are the only OECD countries which have a lower unemployment rate. Despite the economic contraction of 3.9%, unemployment rose according to the standardized ILO-definition in the Netherlands only slightly to 3.7% of the labour force in 2009 (on average) and to 4.5% halfway 2010 (Chart 8).

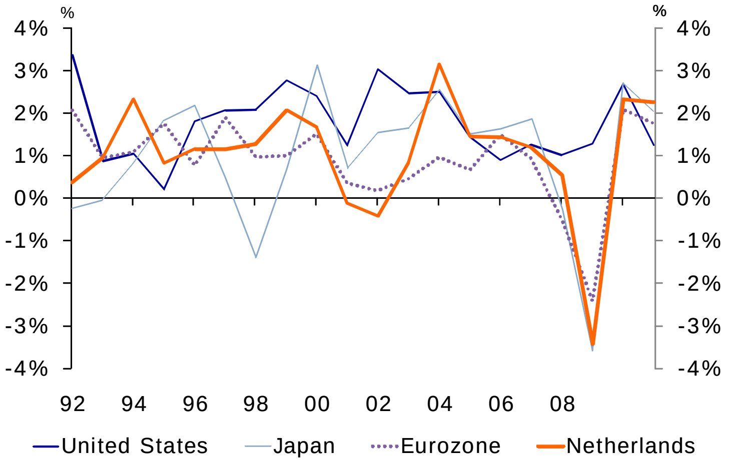
Chart 8: Unemployment remains low



Source: OECD

However, owing to the lower production levels and this relatively small increase in unemployment, productivity has declined considerably (Chart 9). Greater flexibility in the labour market would therefore be welcome.

Chart 9: Labour productivity growth



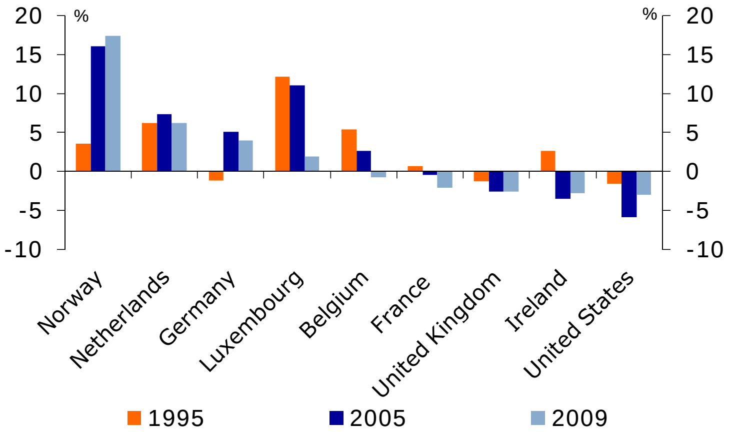
Source: OECD

International position

Openness of the Dutch economy

Because the Netherlands has a relatively small home market, many companies concentrate on exports and expansion outside the country (Chart 10).

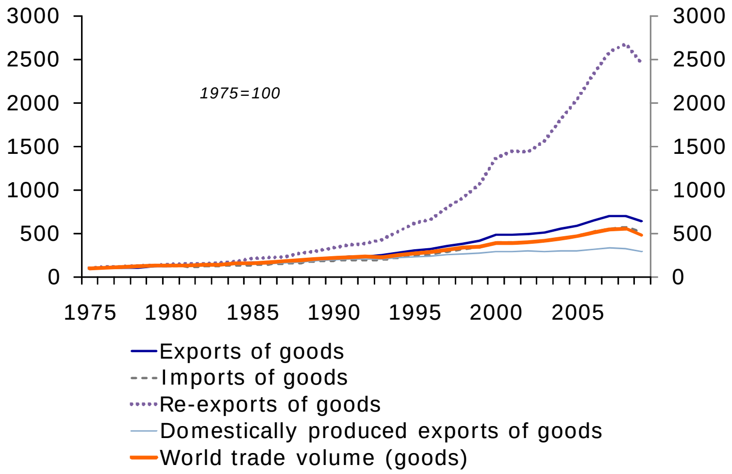
Chart 10: Current Account Balance (% of GDP)



Source: OECD

This is represented by the fact that the Dutch economy is the OECD's sixth largest exporter and the seventh largest importer when both goods and services are included. The transport sector accounts for more than 6% of gross value added. With exports accounting for such a large percentage of GDP, any change in exports volumes has an enormous knock-on effect on the rest of the economy. The almost continuous increase in exports in the last 35 years has mostly been due to the growth of re-exporting of goods produced elsewhere, such as in China. After minor processing in the Netherlands, these products are redistributed to other parts of Europe. The re-exporting of goods has grown four times faster than domestically produced export goods since 1975 (Chart 11). Re-exports now account for 38% of the total export value. This characterises the Netherlands as a distribution country and confirms its status as Gateway to Europe.

Chart 11: World trade and Dutch export growth (1975-2009)



Source: Netherlands Bureau for Economic Policy Analysis

Trading partners

The main Dutch trading partners (both imports and exports) are Germany, Belgium, the United Kingdom and France (75% of all Dutch exports in 2009 were destined to EU members), the United States, and China. With 22% of all imports and exports involving Germany, this neighbour is a particularly prominent trading partner.

Trade with non-EU countries such as China, India and Russia has been growing rapidly in the last decade. After the United States, China now accounts for the largest share of Dutch imports among the non-EU countries (Table 3). The Netherlands imported products valued at more than 22 bn euro from China in 2009.

Table 3: Geographical distribution of Dutch exports and imports in 2009

	Exports (%)	Imports (%)
Belgium	11.03%	9.96%
Germany	24.10%	19.63%
France	8.93%	4.93%
Italy	5.18%	2.34%
UK	8.45%	6.11%
Rest of EU	16.80%	12.61%
Total EU	74.50%	55.58%
US	4.54%	8.41%
Japan	0.78%	2.64%
China	1.49%	7.95%
Other	18.70%	25.43%
Total	100.00%	100.00%

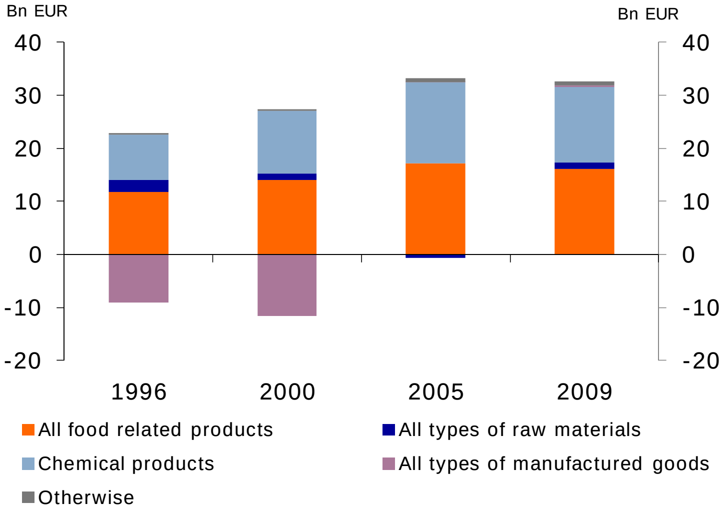
Source: Statistics Netherlands

Trading products

In the last 30 years the Netherlands has been a net exporter of products (Chart 12). In the last decade more than half of Dutch imports and exports consisted of food-related products, chemical products and machines. In addition, mineral fuels were an important trade category as well. Until 2008 mineral fuels outweighed agricultural products in export value; however food-related products have since outpaced mineral fuels (probably temporarily) as being the third export category, due to a drop of 33 percent in 2009 in the exports of mineral fuels.

Considering the balance of trade over the last ten years, all product categories for both imports and exports have increased significantly, except for exports of beverages and tobacco. Food-related products, beverages and tobacco, raw materials, animal & vegetable oils, chemical products and manufactured goods are net exporters. Only mineral fuels and miscellaneous manufactured articles are net importers. The product categories that are net exports or net imports do remain stable over time, except for the machinery and transport equipment category which has shifted from a net importer to a net exporter.

Chart 12: Net trade balance

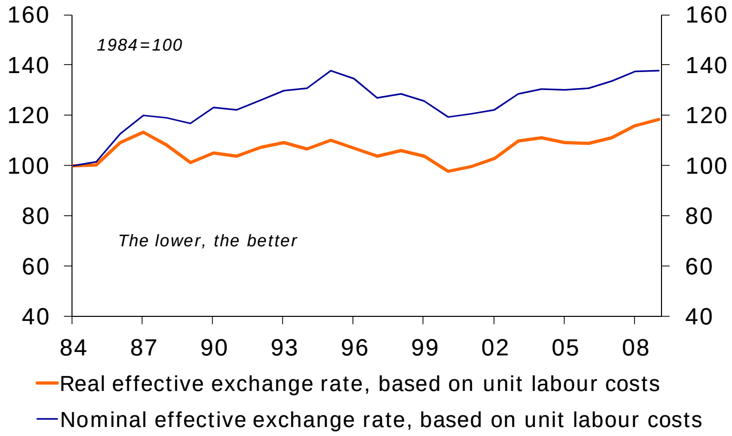


Source: Statistics Netherlands

Dutch competitiveness

During the '80's and the early '90's the Dutch trade-weighted exchange rate appreciated (blue line in Chart 13). This was however compensated by a decrease in unit labour costs relative to the main trading partners so on balance Dutch price competiveness remained roughly constant over time (orange line). The appreciation of the euro against the dollar since early 2002 has however caused a loss in competitiveness. It is, however, apparent that the decrease in competitiveness has been rather moderate in a historical perspective (Chart 13).

Chart 13: Competitiveness

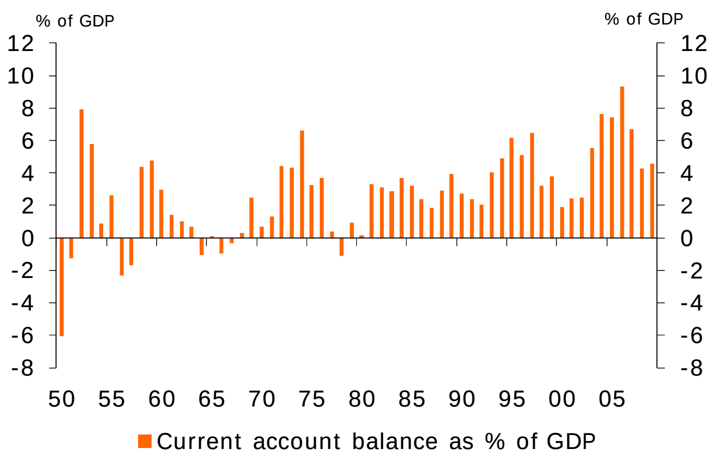


Source: IMF

External position and balance of payments

The Dutch current account balance has shown a considerable surplus in recent decades (Chart 14). The surplus amounted to 4.6% of GDP in 2009, the seventh largest surplus in the OECD, behind Norway, Switzerland, Sweden, Luxembourg, South Korea and Germany. Furthermore, it has increased considerably over the last few years. Between 2002 and 2009, the surplus rose from €12 billion to over €26 billion. The strength of this surplus is mostly the result of the exports of chemicals and food related products. The Netherlands' largest bilateral trade surplus is with Germany and the largest deficit with China. Due to public transfers to developing countries and private international transfers by immigrants, net transfer payments have shown a deficit for several years.

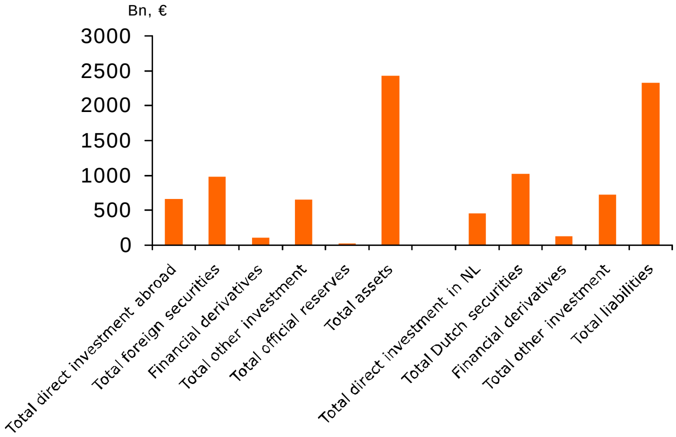
Chart 14: Current account balance



Source: Statistics Netherlands and Dutch Central Bank

The overall external position is also influenced by the financial account of the balance of payments. The annual total net foreign direct investments (FDI) show on average a net outflow of capital. The Dutch are accumulating foreign assets faster than foreign investors are buying Dutch assets (Chart 15).

Chart 15: Assets and liabilities

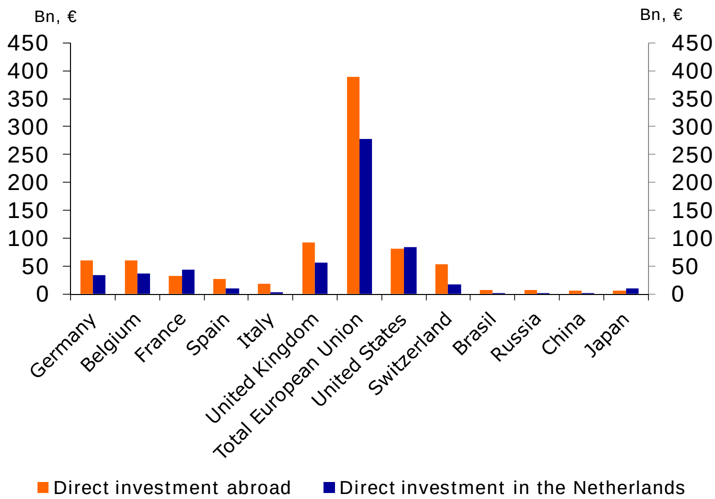


Source: Dutch Central Bank

Nevertheless, the Netherlands is a very attractive location for foreign investors because of its strategic geographic location within the European Union and the sophisticated infrastructural connection to the hinterland. Half of all European consumers are within 500 kilometres of the Netherlands. Many foreign multinationals have taken the opportunity to invest in the Netherlands in order to exploit these advantages.

FDI can be very useful for the host country. It creates a capital inflow and new jobs. Moreover, it facilitates a transfer of technology, distribution, markets and management. This also applies to the Netherlands. In 2005, 14 percent of the workers in the services sector were employed by foreign affiliates. In the manufacturing industry this amounts to 25 percent.
Next to FDI, portfolio investments generate a large and continuous accumulation of foreign assets by, for example, life insurance companies and pension funds. With the ageing of the Dutch population, we can expect these investments to be liquidated over time, as pensions and life insurances pay out. This will influence the balance of payments position.

Chart 16: Foreign Direct Investment in 2009 (in EUR bn)



Source: Dutch Central Bank

In 2009, the Netherlands' gross wealth in foreign assets amounted to 2441 bn euro (DNB 2009). At the same time, foreigners had accumulated a gross wealth of 2335 bn euro in Dutch assets. Therefore, on balance, the Netherlands had a net wealth position of 106 bn euro in 2009 (Chart 16).

Multinationals

In line with the spirit of commerce of the people of the Netherlands, many large Dutch corporations are world famous. The best known companies include (Anglo/Dutch) Shell, Unilever, Philips, Heineken, Akzo Nobel and Ahold. The Dutch are also renowned for their dredging activities, by companies such as Boskalis, Van Oord, and Ballast Nedam. KPN Nederland is a well-known player in the field of international tele- and data communications. It participates in many international corporations. ASML is a leading provider of machines that are used for the production of integrated circuits or chips in the semiconductor industry. A Dutch international newcomer is TomTom, a company that builds navigation system for cars. Dutch products are sold all over the world. Dutch companies have subsidiaries in many other countries and have formed strategic alliances with foreign companies. This is most visible in the gas and oil sector, chemicals, metals, and in the food industry.

Monetary Policy

EU integration

The Netherlands was one of the six founding members of the European Coal and Steel Community (ECSC), the predecessor of the European Economic Community (EEC) which was born in 1957. After years of effort towards monetary integration, eleven member states of the Economic and Monetary Union (EMU), including the Netherlands, took the final step in 1999 to introduce the euro. At that time, these countries handed over their monetary policy to the independent European Central Bank (ECB). By the time the euro was introduced to consumers (Jan. 1st 2002), Greece had joined the EMU as well. Since January 2007, Slovenia and later Slovakia, Malta and Cyprus have also joined the eurozone. As mentioned, the member states no longer have power to implement their own monetary policy. As such, individual countries can only respond to (short-term) economic shocks through fiscal policy. This development has also increased the importance of local wage and price flexibility and the mobility of production factors in weathering economic shocks.

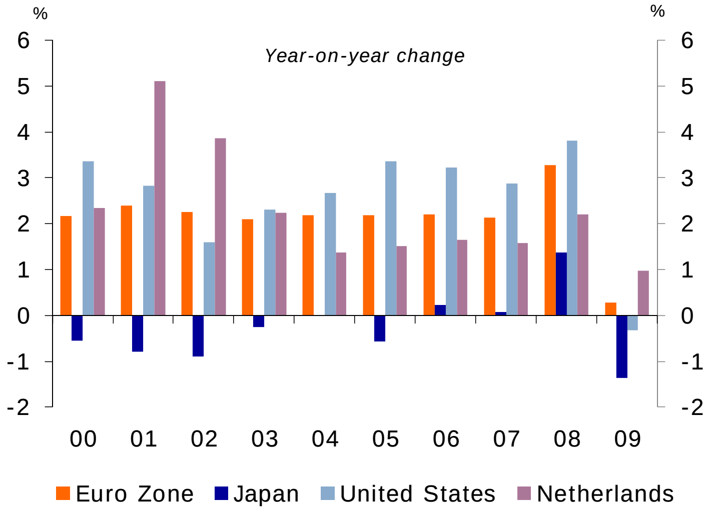
European Central Bank

Before the start of the EMU and the official introduction of the euro on January 1st 1999, the traditionally independent Dutch Central Bank (DNB) conducted monetary policy in the Netherlands. From 1983 on, the central bank targeted the Deutschmark/guilder exchange rate. Thus, the Netherlands imported the success of Germany's anti-inflation credibility and, as a result, the guilder became one of the strongest currencies in the world. With the start of the EMU, DNB became part of the European System of Central Banks (ESCB), which consists of the national central banks and the ECB. The President of DNB is a member of the governing council of the ECB. The ECB's main policy objective is to maintain the euro's internal purchasing power and thus achieve price stability in the euro area. The ECB aims to maintain inflation below, but close to 2%, over the medium term. The single monetary policy has a forward looking, medium term, and euro area-wide perspective. The policy strategy rests on two pillars. The first pillar is based on monetary aggregates. The ECB has announced a reference value for M3 (broad money) growth of 4.5%. Second, unlike the pre-EMU official strategy of the German Bundesbank, the ECB also bases its monetary policy on inflation targeting, using a wide range of indicators for a broad assessment of future price developments.

Inflation

During the eighties, the Netherlands, like most EMU member states, managed to bring down inflation. The driving forces behind this development were countries' efforts to comply with the Maastricht convergence criteria in the run-up to the EMU. At the beginning of the 21st century, however, Dutch inflation rose to higher levels due to strongly increasing labour costs. Since the peak of 4.2% in 2001, inflation started to fall gradually, reaching a level of 1.2% in 2004. In the period 2005-2008, inflation rose slightly from 1.2% to 2.5%. Compared to other European countries, the Netherlands has one of the lowest inflation rates and is well capable of keeping the inflation rate on average below the target of 2 percent (Chart 17). In 2009 inflation dropped to 1.2% again, mainly due to lower prices for transport and fuels.

Chart 17: Change in inflation (%)

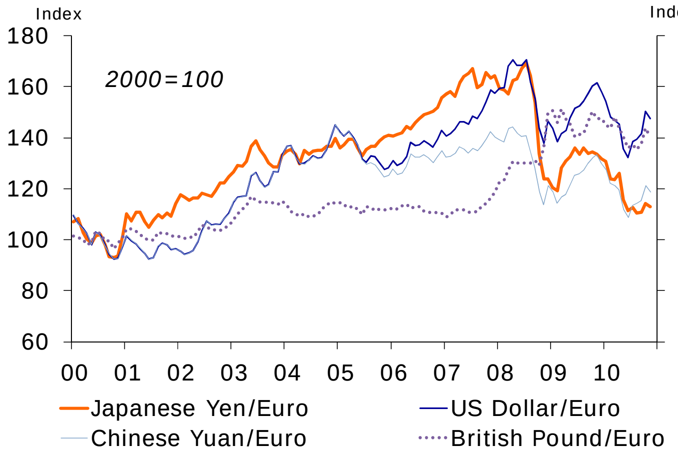


Source: OECD

Exchange rate

Until the start of the EMU, the Netherlands participated in the ERM, whereby the Dutch exchange rate policy was aimed at anchoring the guilder to the Deutschmark. With the official introduction of the euro, the exchange rates of the currencies of the twelve participating countries were irrevocably fixed. In 2002, euro coins and banknotes were introduced and national currencies completely disappeared. The ECB does not conduct a policy of exchange rate targeting. The Maastricht Treaty does not mention any exchange rate targets for the euro. The ECB, however, has stated that it does take the exchange rate of the euro into consideration when determining its monetary policy insofar as it has an impact on its main goal (price stability in the medium term).

Chart 18: Changes in the exchange rates



Source: Reuters EcoWin

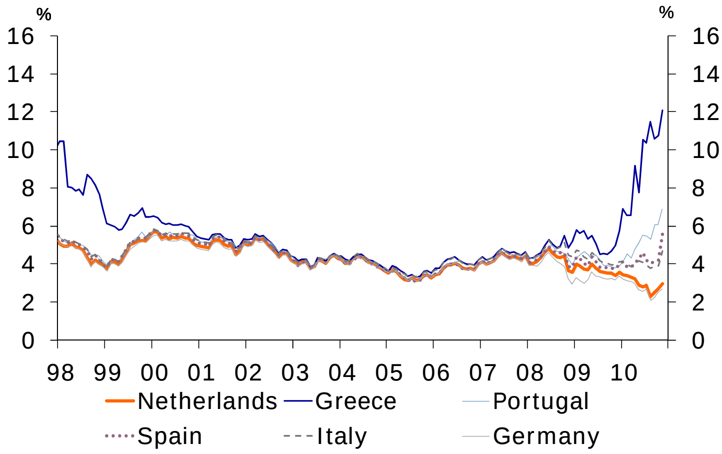
In the first years after its introduction the euro's performance in the international financial markets was disappointing, which was partly due to the attractiveness of assets in dollars to foreign investors. Since the end of 2000, the euro has appreciated against the US dollar, Chinese Yuan, British Pound and the Japanese yen. At the end of 2000, 1 euro was worth 0.90 US dollar and 101 yen. In November 2010, 1 euro was worth 1.36 US dollars and 113 yen. So nowadays, the euro is stronger than the US dollar and the Japanese yen compared to 10 years ago (Chart 18). Therefore, US and Japanese products are relatively cheap compared to European products.

Interest rates

The well established reputation of the Dutch monetary authorities combined with modest inflation rates and a stable Deutschmark/guilder exchange rate enabled the Dutch short and long term interest rates to stay below the EMU average in the past. In the run-up to the introduction of the euro, money market rates in the eurozone converged in anticipation of the EMU, with a single monetary policy and just one set of official interest rates determined by the ECB. In 1999, the Dutch AIBOR (Amsterdam Interbank Offered Rate) was replaced by EURIBOR (Euro Interbank Offered Rate). Now, only one ECB tariff exists, one money market, and one swap market.

Long-term bond yields in the current euro area also converged in the run-up to the euro, as a result of the convergence of inflation rates and the elimination of exchange rate risk. Against this backdrop, bond yield spreads are solely determined by differences in liquidity and creditworthiness of the participating countries' governments. This is the reason why the government bond yields of the European periphery started to rise dramatically as financial markets became more aware of sovereign risks in the euro zone (Chart 19).

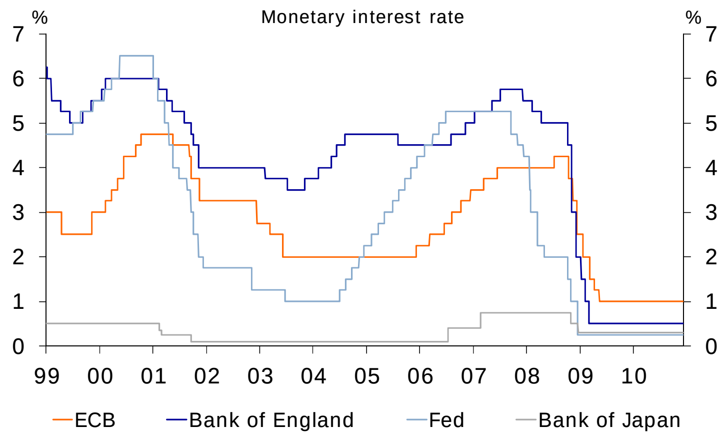
Chart 19: 10 year bond yields



Source: Reuters EcoWin, Rabobank

The turmoil that hit the financial markets in the summer of 2007 as a result of the subprime mortgage crisis in the US, has led to considerable movements in interest rates and bond yields. The Fed responded to the crisis and the deteriorating economic figures by cutting the federal funds target rate in several steps to a range between 0% and 0.25%. In Europe the situation is very similar, except that the rate of the ECB is 1%. Both central banks are not likely to increase the policy rates until end 2011, owing to the downside risks to growth (Chart 20).

Chart 20: Refinance rate and Federal fund rate



Source: Reuters EcoWin, Rabobank

The interest rate on the Dutch government bonds has since the financial crises only been declining. This is caused by the fact that financial markets are looking for safe investments. The Dutch can fully comply with this request due to its relatively low debt-to-GDP ratio and low budget deficit. Beside the Dutch government has a good reputation which results in a high creditworthiness. Therefore it is expected that the interest rate on Dutch governments bonds will remain low.

Financial sector

New Challenges

For many years the Dutch financial sector was characterized as being highly concentrated and solid. It consisted of four large banks – ABN AMRO, ING, Fortis and Rabobank. Their position was underpinned by strong domestic franchises, a sound financial position, and the maturity and stability of the Dutch financial landscape. However, the financial crisis of 2007-2009 (followed by the deep economic recession) has shaken the global financial system, including that of the Netherlands. Many banks have incurred losses and have had to write down substantial amounts worldwide. Government interventions and extraordinary support measures were necessary in order to safeguard financial stability and to avoid a credit crunch. All in all three out of the four major banks has received government support.

The Dutch part of the old ABN AMRO[1] and Fortis Nederland (Fortis retail banking and corporate activities in the Netherlands of the old Fortis S.A[2]) were nationalized, while other financial players (among others ING, SNS Reaal) needed government support in the form of capital injections or corporate-guaranteed financing programmes. Rabobank did not need any government support due to it's co-operative business model[3] (stakeholders focus) which differs from the mainstream banking model (shareholder focus). Its resilience and solidity (AAA-rating) are important assets to the Dutch financial system in these turbulent times (Table 5). However, Rabobank too suffered from losses and incurred write-downs but it has been hit less hard than private banks.

[1] Just before the financial crisis broke out ABN AMRO was taken over (and split-up in three parts) by Fortis S.A. (Belgium), Banco Santander (Spain) and RBS (UK). Fortis S.A. retained ABN AMRO corporate and retail banking activities in the Netherlands and Private clients (international). The integration of ABN AMRO Nederland and Fortis Nederland has been started in April 2010 and will be finished in 2012.

[2] The other apart from Fortis S.A. was sold to BNP (France).

[3] The co-operative business model is strongly focussed on customers and members, long term orientation and unique capital and governance structure.

Table 5: Key figures of the four main financial conglomerates in the Netherlands (Halfway 2010)

	Rabobank	ABN Amro	ING Group
Balance sheet total (EUR bn)	676	405	1273
Equity (EUR bn)	40.5	11.4	47.6
Equity/ balance sheet total (in %)	6.0	2.7	3.7
Bis ratio (in %)	15.3	17.0	11.8
Net profit (EUR bn)	1.7	-1.0	1.1
Cost/ income ratio	60.4	119.0	55.0
Tier 1 ratio (in %)	14.9	12.3	11.2
Rating (S&P/ Moody's)	AAA/Aaa	A/Aa3	A/A1
Number of domestic branches	950	500	200

Source: Multiple sources

After the bubble burst in 2007 governments and monetary authorities took a broad range of drastic measures to avoid a further collapse of the global financial system. The restoration of public confidence in the banking industry had top priority in the short term, while the need for remodelling the global financial architecture to make the financial system more resilient against future shocks became apparent. Measures are: stricter banking rules, greater transparency and more stringent supervision at an international level. As one of society's most important (economic) institutions, banks have to engage in greater self-reflection, more customer focus and corporate social responsibility, and should adopt a long-term perspective instead of having a dominant focus on short-term profit.

In 2008-2009 many banks reconsidered their strategy and engaged in the reoganisation of their business to become 'lean and mean' and to return to classic banking focusing on the Dutch market. An important consequence of receiving government support are the conditions imposed by the European financial authorities, namely that the banks have to split-up in order to balance competition in the financial sector and risk. According, ING has to sell its insurance activity, while ABN AMRO must sell about 10% of its corporate business (sold to Deutsche Bank, 2010). A small Dutch bank (DSB) went bankrupt due to insolvency.[4]

Since the second half of 2009 most Dutch private banks started to make profit again and had to pay off part of the state support received. ABN AMRO, which has received €30 billion of state support, made its first profit since nationalisation in the first quarter of 2010. In de coming period the bank will be engaged in completing the integration of Fortis Nederland and ABN AMRO Nederland and will probably not be sold before 2012.

Regulation and supervision

The supervision of the Dutch financial sector is divided between 'prudential supervision' (monitoring the health of financial institutions and the financial

[4] Savers have lost their trust in the bank overnight because of large claims due to exorbitant banking practices and mismanagement.

sector) and ‘conduct-of-business supervision’ (assessing the actions of players in the financial markets). Prudential supervision is a duty of the Dutch central bank (DNB). Conduct-of-business supervision is performed by the Financial Markets Authority (AFM).[5]

Having learned from the lessons of the 2007-2008 financial crisis, stricter banking rules, greater transparency to customers and more stringent supervision at international level are being put in place. Compensation schemes of banks will be adjusted to provide adequate incentives for a responsible balance between risk and capital position. A revision of the Deposit Guaranty Scheme, which will be harmonised with other European schemes, is one of those adjustments. The Capital Accord (Basel II) arrangements will be tightened in the near future (Basel III) concerning both capital and liquidity requirements, and improved risk management will be required. Governments are also considering the imposition of additional rules and guidelines for the banking sector, such as constraints on bonuses and a banking tax to compensate for potential losses in future financial crisis.

All the measures to meet the requirements of the new financial system will result in higher demand for capital (buffer), less funds for granting credit and keener competition in the (retail) banking market; ultimately a higher price for bank services for customers.

[5] In 2006, the Financial Services Act (WFD) came into effect. This law prescribes that all organisations operating in the financial sector as intermediary, advisor, or sales person, need a license from the AFM. One of its requirements is that the financial service provider must have sufficient knowledge about its clients’ financial positions.

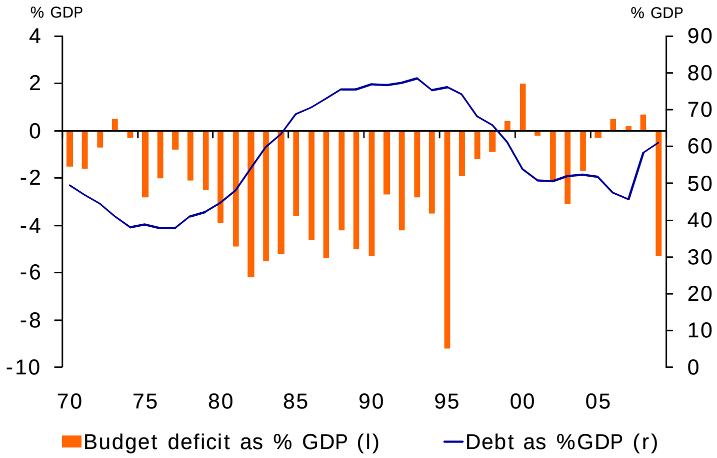
Government finances

Still relatively healthy

The economic downturn in 2009 put a strain on the Dutch government finances. Tax revenues and social security contributions declined while at the same time government expenditure on social security payments increased. Beside these temporary shortfall in income and rise in expenses, the economic downturn also caused some lasting (i.e. structural) damage. As we do not expect the economy to make up for the losses during the downturn, GDP is bound to remain lower for some time to come. And this will lead to structurally lower tax revenues. In addition, the government has to take measures to cover the rising expenditure on the back of an ageing population.

In 2009 the budget deficit (5.4% of GDP) exceeded the Maastricht criterium (Chart 21). Since the budget deficit is partly explained by the business cycle (i.e. it can be qualified as exceptional and temporary), the European Commission (EC) stated that the Netherlands must meet the Maastricht Criterium by 2013 at the latest.

Chart 21: Government debt and budget balance



Source: Statistics Netherlands and Dutch Central Bank

Government expenditure

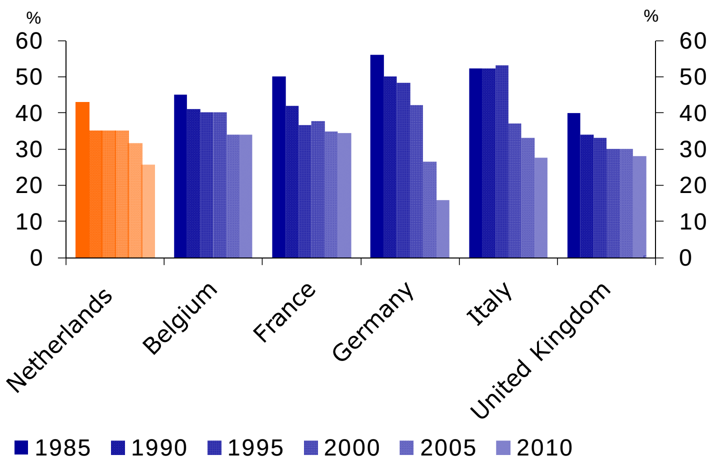
After a few years of little change, government expenditure rose in 2006-2008 at a pace slightly above its 25 year trend. In 2009 the government increased its spending further to soften the consequences of the financial crisis. This was to a large extent due to the so-called automatic stabilizers in the economy. The social benefits system in the Netherlands is relatively extensive, leading to an automatic increase in the unemployment benefits costs during an economic downturn. Beside the fundamental increase in spending, the government enlarged its expenditure temporarily by introducing a (temporary) unemployment act. Businesses were given the opportunity to partly lay off workers, if income dropped significantly. Employees who consequently had to work part-time were compensated by the government through this (temporary) unemployment act.

Government income

The most important sources of government income are taxes (two-thirds) and social security contributions (one-third). In 2009, government income amounted to 42% of GDP. Of the tax take, the largest contribution was made up by income tax (36%), value added tax (VAT)(31%), and corporate tax (9%).

In all major European countries corporation tax has decreased over time, and the Netherlands forms no exception (Chart 22).

Chart 22: Corporate tax rates



Source: OECD

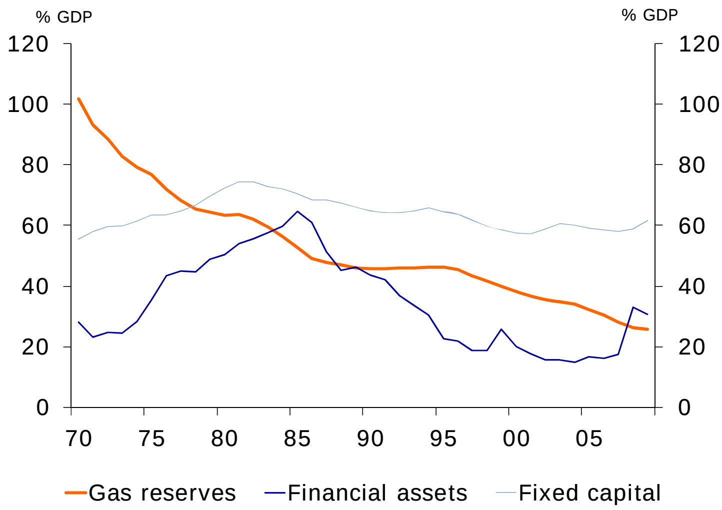
The last significant change in the corporate tax rate regime came into effect on January 1st, 2007. The decision to reduce corporation tax rates was motivated by the need to improve Dutch international competitiveness. The rate decreased from 29.1% to 25.5%. For all profits up to €25,000, the rate will be only 20%, whereas profits between € 25,000 and €60,000 will be taxed at 23.5%. In addition, dividend tax has decreased from 25% to 15%. In 2010 the new cabinet has decided to lower their income from corporate tax with half a billion euro's, as compensation for the lower amount that will be spend on subsidies.

Government debt

Gross government debt has shown enormous variation over the last 60 years. It decreased from 136% of GDP in 1950 to 37% in 1977. During the 1980s, the debt ratio expanded to more than 70% of GDP, but diminished during the nineties again to below 46% of GDP by 2007(Chart 21). Due to stimulation packages for both the economy and the financial sector, in combination with the recession, the debt ratio increased to 60.8% of GDP in 2009. This is slightly above the EMU public debt norm of 60% of GDP as defined by the Growth and Stability Pact.

The Dutch government's main assets are its natural gas reserves, fixed capital, and financial assets. The value of the gas reserves declined from 100% of GDP in 1970 to 20% in 2009. Fixed capital such as infrastructure and buildings amounts to about 60% of GDP. The worth of government financial assets fell from about 45% during the 1990s to 20% of GDP in 2005. The interventions in the financial sector led to a renewed increase of financial assets to around 30% of GDP in 2009 (Chart 23).

Chart 23: Possessions by the Dutch Government

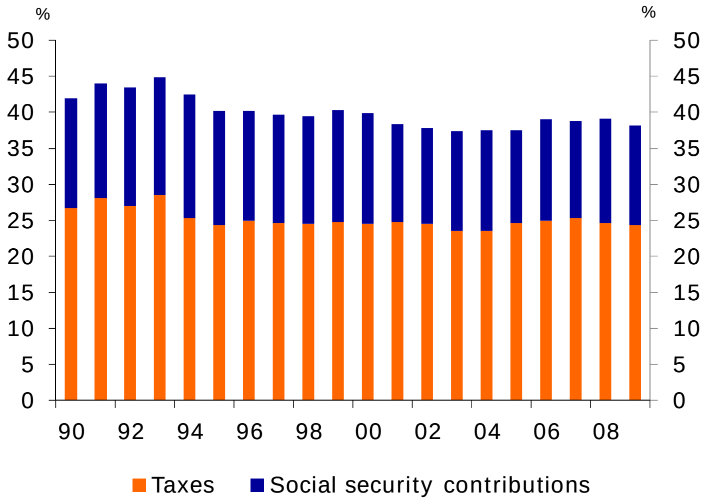


Source: Netherlands Bureau for Economic Policy Analysis

Although government debt has grown in the last two years, compared to other eurozone governments the Dutch authorities have been relatively successful in keeping the general government budget balance under control. It is fair to say that the Netherlands are in a better overall fiscal position than many other countries in the eurozone.

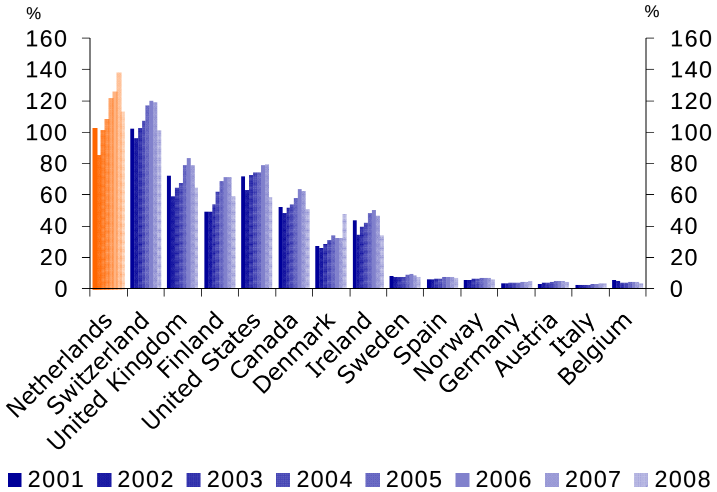
In the coming decades the challenge for the government will be to decrease the debt-to-GDP ratio. Owing to its extensive public pension scheme and the ageing population the Dutch government scores relatively low by international standards on the sustainability of public finances. However, both employees in the public and private sector have accumulated savings during their working live for their pension. Government employees and most workers in the educational system for example, have built up a pension in the ABP civil service pension fund. The ABP has invested 200 bn euro to meet present and future pension obligations. When the government debt is netted with the total amount of assets accumulated in the pension funds, a surplus amounting to 282 billion euros remains. This situation is unique in Europe (Chart 24 and 25). However, due to the crisis the equity of these pension funds has not build up, while the real present value of their future obligations increased. In the near future the ratio need to be rebalanced by lowering the allowance (obligation) or by increasing the premiums. Lowering the allowance can also mean that like in most other countries the people have to work until the age of 67 instead of 65.

Chart 24: Tax and premium burden (% of GDP)



Source: Netherlands Bureau for Economic Policy Analysis

Chart 25: Pension wealth in several countries (% of GDP)



Source: OECD

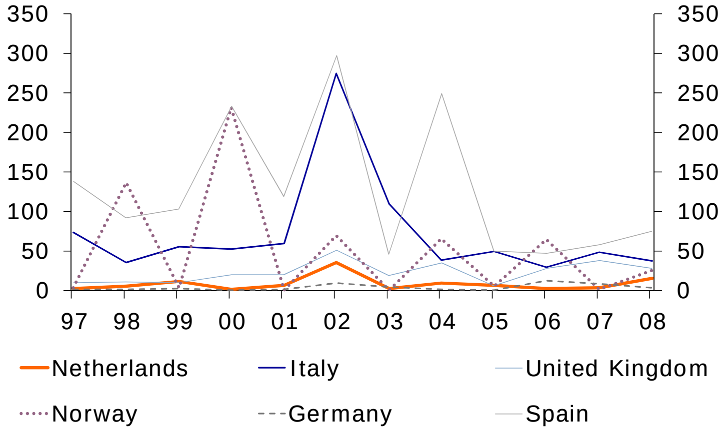
Labour market

New shortages may arise in the near future

Social embeddedness

One of the main characteristics of the Dutch labour market consists in the regular tripartite constructive consultations between representatives of employers, employees (labour unions) and the government. Major socio-economic issues, such as wage increases, international competitiveness, reform of the social security and pension system and job creation are discussed within this setting. Consensus decision-making is the main goal. Additional advice can be obtained from the Social Economic Council (SER), in which employers, employees, and independent experts are represented. For many decades, this harmonious model has led to a minimal number of working days lost due to strikes (Chart 26).

Chart 26: Working days lost per 1000 workers



Source: Eurostat

Preference for part-time employment

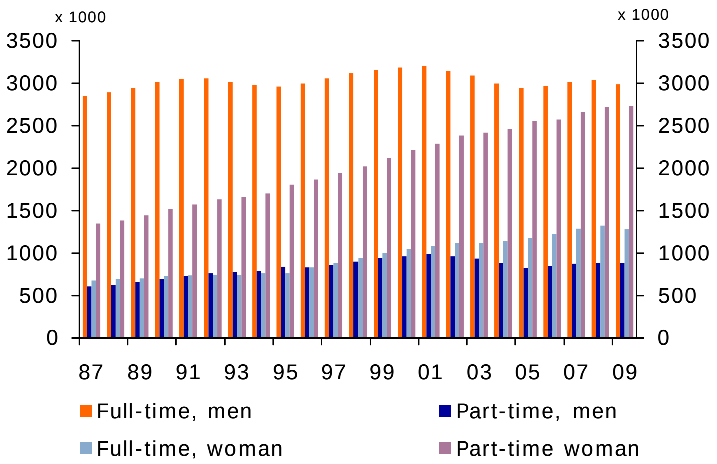
Since the 1980s, labour market policy has been aimed at the activation and reintegration of the unemployed, women, ill people, the disabled and foreigners. The main aims were to increase labour market participation and reduce the number of inactive benefit recipients. These policy reforms in combination with the Wassenaar agreement paid off during the 1990s, as it led to a substantially lower unemployment rate combined with large scale job creation and an increase in participation.

Part-time work became the solution for a large proportion of Dutch employees in the 1990's, particularly for women. A good illustration for this increase is the rise in their participation rate. This additional supply of labour was very welcome due to an increase in demand for labour in mainly the health care, educational and services sectors.

Furthermore, the Dutch economy is increasingly service driven. At the same time, employment opportunities and the preferences of employers are becoming more and more varied. People no longer necessarily seek for lifetime employment, but want jobs that match the current phase of their lifecycle. This is reflected in the growing number of self-employed workers. This group of workers have started their own business and outsource themselves to other businesses.

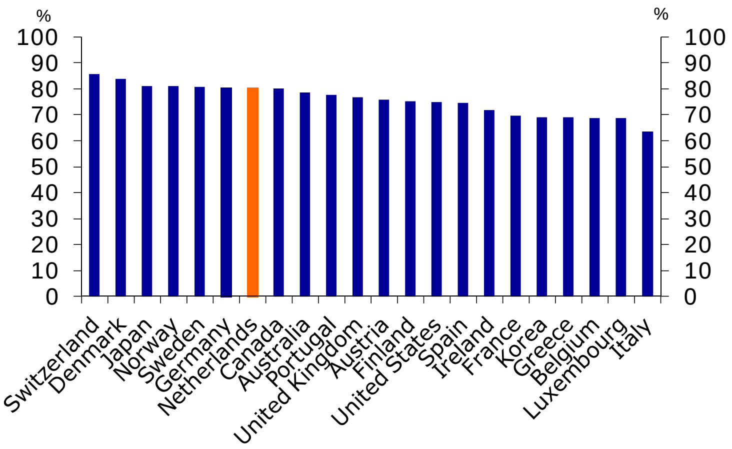
Flexible employment contracts are typical in the Dutch labour market. The Netherlands has a thriving (temporary) employment agency that has managed to meet this new demand. All in all, the labour participation rate in the Netherlands is high by international standards and unemployment is among the lowest in Europe.

Chart 27: Number of jobs



Source: Statistics Netherlands

Chart 28: Participation rate in 2009



Source: OECD

Present labour force

In 2009, the total labour force comprised 8.7 million people and the participation rate was over 80%. More than 85% of men and 74% of women participate in the labour market (Chart 27 and 28). The majority of active people work in commercial (*4.2 million*) and non-commercial (*2.8 million*) services, the remaining workers (*1.7 million*) are active in the manufacturing industry and the agricultural sector.

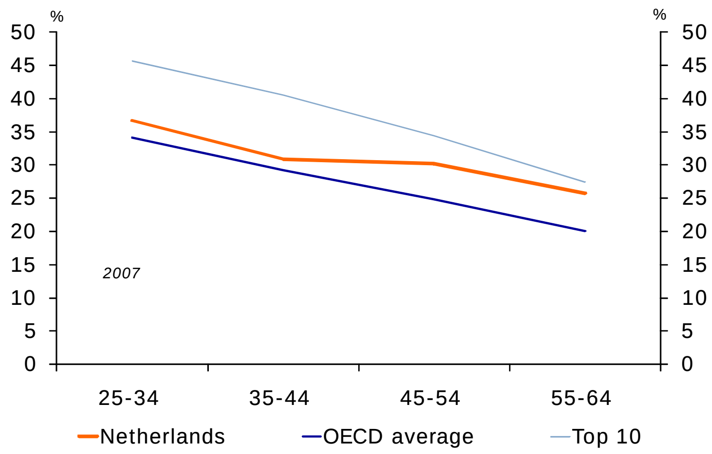
The financial crisis has only caused a temporary rise in unemployment. Since halfway 2010 the unemployment rate has steadily declined, and is now only 1½-percentpoint higher than before the crises. In the near future a further decrease is expected as a consequence of the ageing process. All sectors will be confronted with a decline in the labour supply, which will lead to shortages especially in the industrial, agricultural and technical sectors. Nowadays, the jobs in these sectors are mostly filled by workers approaching retirement age.

Younger workers are scarce, since few people have opted for training in these fields in recent decades. Besides, there is greater emphasis on highly-educated (knowledge-based) workers and this demand will continue to increase over time. In many sectors, an upgrading of qualification levels in taking place. In addition, these sectors are growing faster than others, leading to additional demand. If no measures are taken to address the shortages, significant wage increases may result, to the detriment of the overall Dutch competitive position.

Future challenges

To comply with both structural and cyclical changes, more tailor-made education is necessary. The education level of the Netherlands is in line with the OECD average. Almost 30% of the Dutch population is highly educated. Unfortunately, the relative position of the Netherlands is declining (Chart 29). The younger generation has lost ground to the average OECD educational level. The older generation ranks 8th on the list of OECD countries, compared to 15th place for the younger generation. This has resulted in a challenge for the Netherlands to improve the educational system or otherwise to extend a cordial welcome to foreign employees in the future. This is especially needed for the preservation and improvement of our competitiveness.

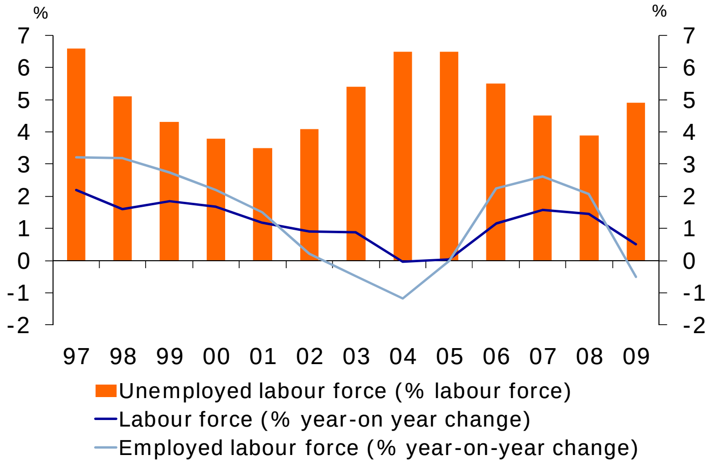
Chart 29: Education level of generations



Source: OECD

Breakdown of unemployment data

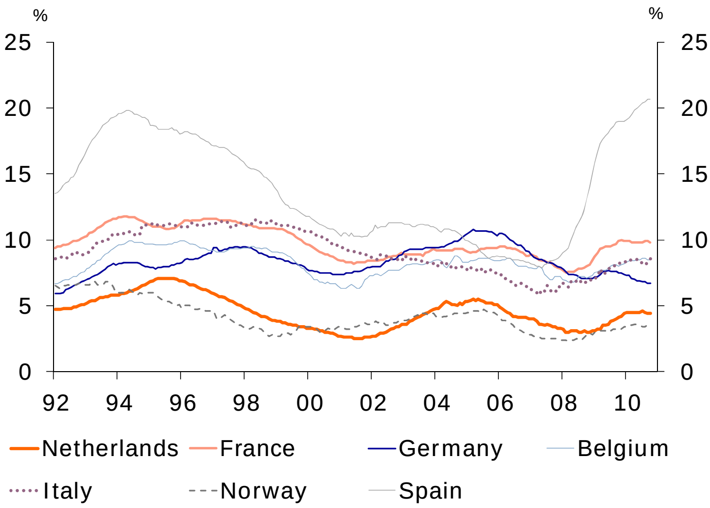
Chart 30: Unemployment, employment, and labour force



Source: Statistics Netherlands

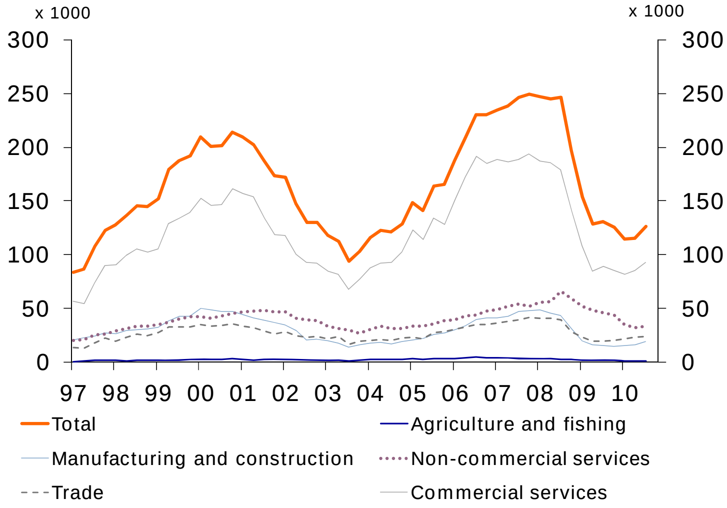
That the unemployment rate is relatively low by international standards is due to the shortage of supply in the years before the crisis. Overall unemployment increased from 3% before the crisis, to 4.5% of the total labour force halfway 2010 (international definition) (Chart 30 and 31). This rise is the result of the economic downturn in 2009 and the modest recovery in 2010 and as a consequence the lower demand for labour (Chart 32).

Chart 31: Unemployment rate



Source: OECD

Chart 32: Number of vacancies



Source: Statistics Netherlands

The Dutch labour market is characterised by a shortage of supply, this has lead to historically low levels of unemployment in the past 15 years. Since it takes a lot of time and money to find employees, employers are reluctant to lay off these workers during an economic downturn. However, when it became clear in 2003 that a quick revival of the Dutch economy was not to be expected, mass layoffs occurred, and unemployment rates increased very rapidly within a period of mere months. In 2009 the situation was different; mass layoffs did not appear, instead unemployment has risen steadily and is already declining. Three arguments seem to be most plausible for the difference. First, the labour supply is dwindling due to the ageing population. In addition, the number of self-employed workers has grown in the past few years. This group of workers has increased the flexibility of the labour force, and as a consequence has absorbed part of the drop in demand. Besides, the government introduced a temporary part-time unemployment benefit scheme. Businesses who lost more than 30 percent of their revenue were allowed to reduce the number of worked hours per worker. Workers were compensated by the government for their loss in income. In this way the government anticipated by the temporary loss of work, and no knowhow was lost when production picked up again.

Employment opportunities are not evenly spread throughout the Netherlands. Groningen and Drenthe (provinces in the north of the Netherlands) and Limburg (a province in the south of the country) have the highest unemployment rates. The reason is the relatively low demand for labour in these provinces. The provinces of Utrecht, Gelderland and Zeeland have the lowest unemployment rates. As in Groningen, Drenthe and Limburg the demand for labour in Zeeland is low, this is however compensated by an additional low supply of labour. In the case of Utrecht and Gelderland both demand and supply are high.

Opportunities in the labour market appear to be unequal for people with certain characteristics. Those with only minimal education experience more difficulty finding employment. In addition, younger people are more frequently unemployed. The unemployment rate among young people is around two times higher than for the average adult male, seen as a proportion of the labour force. To improve their future prospects, young people tend to stay in school longer, increasing their overall qualifications. Dutch youth unemployment (age 15-24) in comparison to other OECD countries is actually very low. Besides education and age, ethnic background is another factor. People from ethnic minorities are more often unemployed than natives. Among minorities, non-western people are more frequently unemployed than western minorities. This is not a discrimination issue, but can be attributed to other factors, such as the average education level.

Residential property market

Characteristics of the Dutch housing sector

The Dutch housing market is characterised by a relatively large supply of social housing (35%). In some cities, for instance Amsterdam, an even larger share of social housing is present. To qualify for social housing a means test is conducted. Once housing has been allocated, no additional income checks are carried out. This explains why households stay relatively long in their houses even when their income rises. The consequence is that the flow from rented houses to owner-occupied property is very low and the waiting list for social housing is several years. The cabinet Rutte will introduce new regulation that must result in shorter waiting lists. This will be done by obliging social housing organisations to increase the rent by inflation plus an additional 5 percent per year if the household income amount to 43.000 euro's or more. Social housing in the Netherlands is provided by more than 500 social housing corporations, who are permitted by the government to allocate affordable rental homes to households.

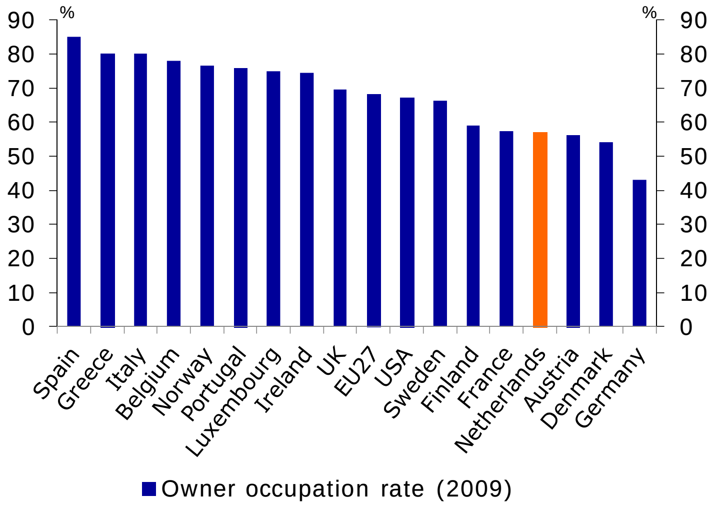
Despite this scenario, the home-ownership ratio in the Netherlands has risen from 28% in 1950 to 57% in 2009. Although this increase is large, the level of home owners is still relatively low compared to other European countries (Chart 33). Ever since the late nineteenth century the Dutch government has encouraged private ownership of dwellings, with a fiscal regime that is friendly to owner-occupiers. In recent years mortgage interest tax deductibility has been restricted to a period of 30 years and applies only to the primary residence. Furthermore, when moving, additional equity that has been built up in the previous residence has to be invested in the new home to bring down the overall mortgage debt, in order to qualify for tax relief. More recently a governmental commission proposed to cut back on subsidies for housing costs. The new cabinet decided however to leave the tax deductibility regime intact, and to cut down other spending.

Parallel to the growing home-ownership ratio, the impact on the Dutch economy resulting from developments in the housing market has increased significantly in recent decades. Due to the shift from rental to house ownership, the effects of price and interest fluctuations have been transferred to consumers. In the case of lower interest rates and rising house prices, the wealth of householder expands, which leads to additional spending.

At 105.6%, the Dutch mortgage debt-to-GDP ratio is among the highest in the world (Chart 34). It is, for instance, almost twice the EU average of 51.9%. This figure is however biased. Because of the fiscal regime it is customary among

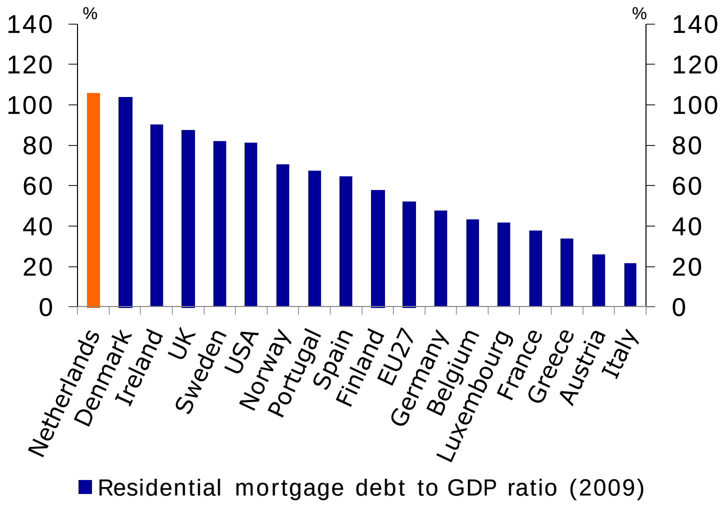
Dutch households to accumulate financial assets such as shares, bonds and savings for the amortization of their debt at the end of the loan term. Therefore the Dutch mortgage debt-to-GDP ratio would show a significant decrease if debt and capital were netted (Chart 35). The Dutch mortgage market is largely deregulated and very competitive (more than half of the mortgages are not sold directly by suppliers of mortgage loans, but via intermediaries).

Chart 33: Home ownership ratio



Source: European Mortgage Federation

Chart 34: Gross mortgage debt to GDP ratio

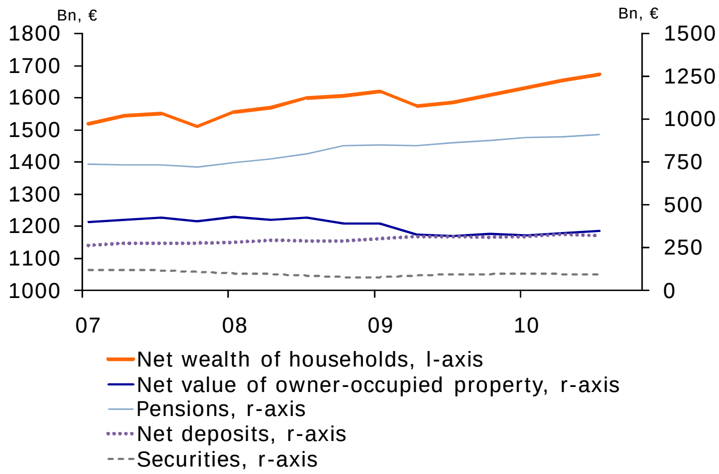


Source: European Mortgage Federation

The mix of mortgage products driven by tax deductibility has led to relatively high loan-to-values (LTV) in the Netherlands (at 73%) compared to other European countries. LTV is calculated as a de facto Loan To Foreclosure Value (LTFV) rather than to market value, when foreclosure values are typically at 85-90% of the market value. The legal maximum LTFV for existing property in the Netherlands is 125%. Because of legislation this maximum will change to 112% of the market value from 2011.

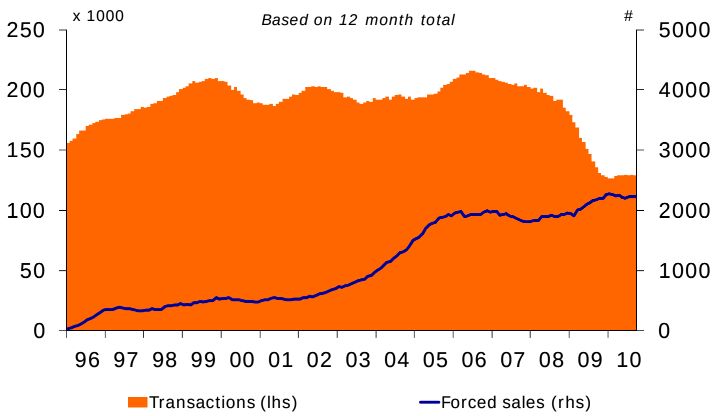
The economy remains fairly well shielded from fluctuations in the interest rates and house price developments. This is firstly due to the Dutch tendency to use mortgages with a long-term fixed interest rate. This has kept the number of forced sales throughout the latest recession almost constant (Chart 36). Secondly, the major part of Dutch residential mortgages is adequately covered by surplus value. Typical first time buyers of the past years are in a less favourable position. They paid a high price for their house and have not profited from the buoyant price developments of the past.

Chart 35: Wealth of households



Source: Statistics Netherlands and the Dutch Central Bank

Chart 36: Forced sales

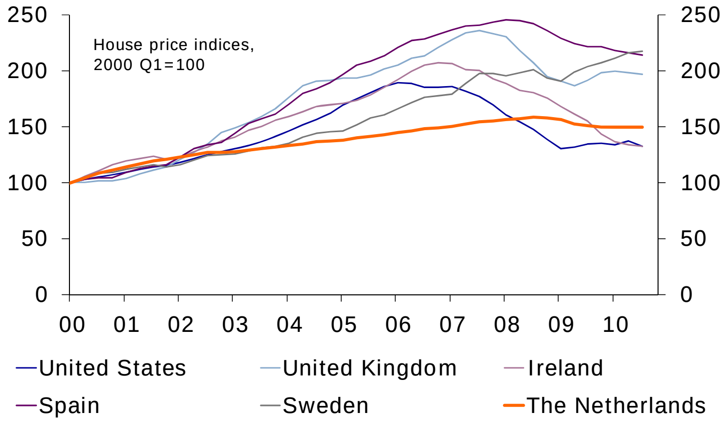


Source: Dutch Land Registry and Statistics Netherlands

Recent developments

At the beginning of this decade house prices rose moderately, in both a historical and international perspective. However, as in most countries the Dutch housing market suffered from the international financial crisis. Although most properties decreased in value, by international standards this decline is moderate (Chart 37). The number of transactions declined by a third and the average selling price has fallen by approximately 6%, from 259 to 244 thousand. In the Netherlands a lack of confidence seemed to be the main problem. Households were afraid of (i) double housing costs when moving (ii) weaker purchasing power because of unemployment (iii) a lower disposable income due to the austerity measures of the new government and (iv) the debate generated by the Dutch financial markets' supervisor (AFM) about maximum mortgages banks are allowed to provide. The discussion on whether the fiscal regime that is friendly to owner-occupiers had to be restricted or not did not boost confidence either. The new government, as mentioned above, decided to leave the regulation intact. Now that the discussion on the tax deductibility has ended and the unemployment rate is falling, confidence is getting a boost. Until the end of 2010 the number of transactions remained however low and the housing market has not recovered.

Chart 37: Housing prices, international



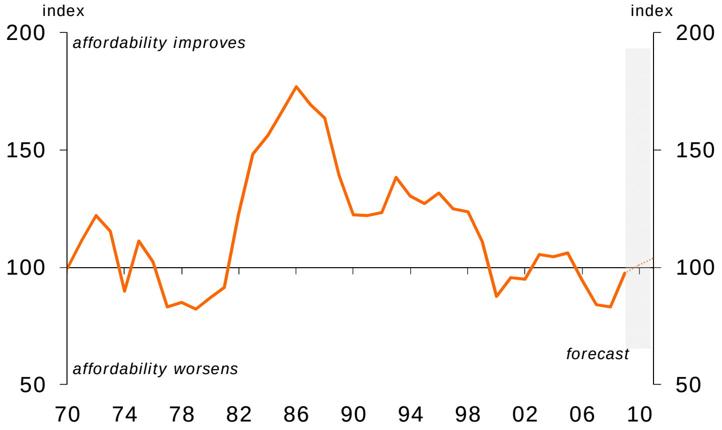
Source: Multiple sources

Housing market outlook: gradual recovery

The Dutch housing market is slowly recovering from the blow of the financial crisis. On the one hand the market is picking up again. The downward trend in transaction numbers has been broken and house prices are stabilising. On the other hand there are still a lot of houses for sale and the average selling time has risen significantly. It is not expected that these burdens of the crises will fade away within a few months, due to a lack of confidence and the fact that disposable income is under constrain.

The mortgage market has suffered a lot from the financial crisis. However, from autumn 2009 mortgage interest rates have declined and it is expected that mortgage interest rates will remain low in 2011, as we do not expect that rising capital and money market interest rates to start rising. Parallel to this, we expect the affordability of purchasing a house to improve in 2011 (Chart 38).

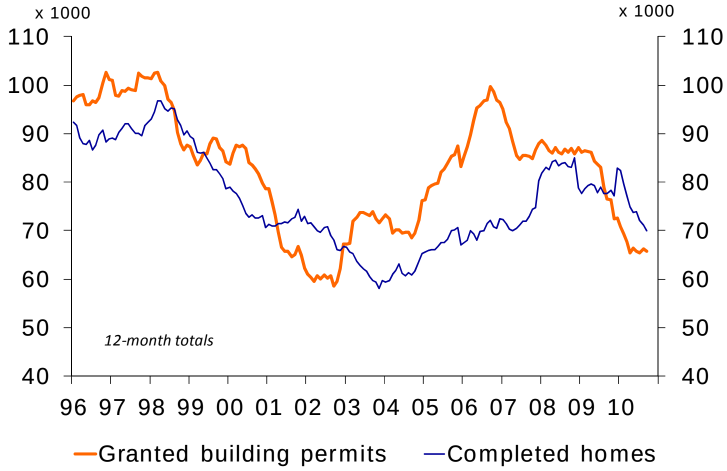
Chart 38: Rabobank affordability index for purchased properties



Source: Land Registry, Reuters EcoWin, Rabobank

In addition the number of permits has been declining, which will lead to a temporary decline in the number of housing completions in the near future (Chart 39).This may give some upward pressure on the number of transactions, and support the current price level.

Chart 39: Number of building permits



Source: Statistics Netherlands, Rabobank

Policy challenges

New cabinet headed by Rutte (2010-now)

The central government, headed by prime minister Balkenende, which came to power in 2007, left office at the beginning of 2010. The reason for the early exit was that the cabinet could not agree on the optional extension of the military mission in Afghanistan. New elections were held in June 2010, and the outcome was fragmented. The winner of the elections, and now the biggest party (the liberal party VVD), will hold only 31 out of the 150 seats in parliament.
On the 30th of September, after four months of negotiations, a new (minority) cabinet was formed. The new cabinet consists of two parties, the liberal party (VVD) and the Christian Democrats (CDA), headed by Mark Rutte (VVD). The coalition is supported by the Freedom Party (PVV).

A coalition cabinet is no exception in the Netherlands, and contributes to the ongoing stability and continuity of coalition cabinets that are typical for the Dutch political environment. However, this is the first minority cabinet since the early 80's.

Fresh challenges for the new cabinet

Rebalancing the budget deficit

The Netherlands have, like most all western countries governments, to rebalance their budgets. All the Dutch political parties showed awareness of the importance of measures to cut government spending or to increase revenues. Each party came up with proposals to reduce the government deficit by at least 1½ percent points of GDP by 2015 and maintain a neutral deficit in the long term.

The cabinet announced an additional austerity plan of €14.8 billion on top of the 3.2 billion euros of spending cuts announced by the previous government. The main cuts will be on public administration (€6.1 bn), income transfers (€4.3 bn), and health care (€2.1 bn). The cuts are partly compensated by extra spending on health care (€0.9 bn) and education (€1.3 bn) among others. This sums up to budget cuts of 2.8 percent of GDP in 2015, and will lead to a budget deficit of 0.7 percent of GDP in 2015. The approval of Dutch citizens for these cutbacks will increase the chance of success.

In our view, the austerity measures are a good start to improve the governments financial position. On the other side more structural measures should have been taken to get rid of some bottle necks, in order to prepare the Netherlands for the future. We believe the following areas (in no particular order of importance) should be prioritised in government policy for the coming years.

- Greater flexibility on the labour market
- Education
- Infrastructure
- Health care
- Sustainability of the energy supply
- Efficiency and effectiveness of the government

Greater flexibility on the labour market

Currently, the Dutch labour market is characterised by high and increasing participation of both men and women, representing most age groups and different ethnic backgrounds. The weaknesses of the present situation are the preference for part-time employment – that at the same time facilitates the combination of work and family life – and for early retirement. Labour protection is high, and laying off redundant employees is both a lengthy and an expensive procedure. In addition, most Dutch people would rather work in a steady job than assume the risk and rewards of being an entrepreneur.

To meet the challenges of globalisation and population ageing, the Dutch labour market must increase its level of flexibility. In many respects, the Dutch jobs market is already very flexible. The temporary employment sector is well developed and there are countless different ways of employing staff flexibly. However, in the future, people will need to change jobs or employer more often during their career than in the past. In some cases this will be a voluntary matter, prompted by better opportunities elsewhere. In many cases, however, there will be forced job changes. This flexibility must be matched by adequate social provisions. These should serve not only as a social security blanket, but mainly as a launch pad for a new start in a different job.

Greater flexibility should also be introduced in working hours. Efficiency would improve significantly if working hours could be adjusted to the rhythm of demand development, without immediately having to pay for overtime. In several sectors this is already common practice, and is catered for in collective labour agreements.

In addition, employers have asked for a relaxation of the employment-protection laws, to make layoffs easier and less costly. However, the social partners are diametrically opposed to these proposals. An innovative solution to this problem is needed, for example in the private insurance sector.

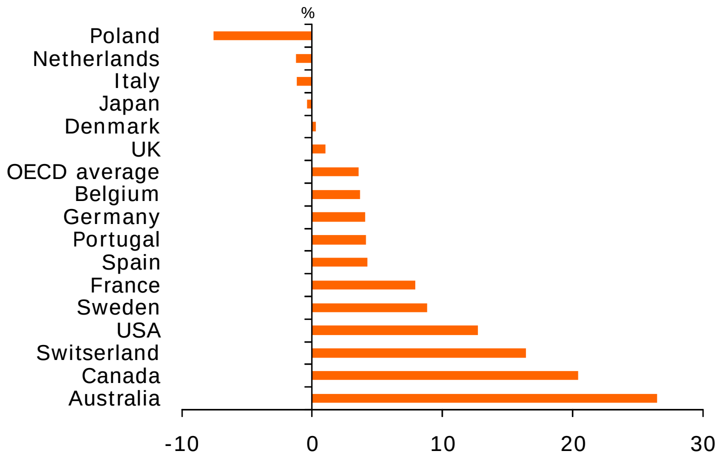
Another problem is that the Dutch population is ageing. The labour force will therefore decline in the coming years. Educated staff in particular will therefore be in ever-shorter supply, inevitably putting upward pressure on wage costs. Large, undifferentiated wage increases should however be avoided. Ideally, the rise in wage costs should follow productivity development. Higher wage costs for less productive staff will decrease the overall competitiveness of Dutch production and services and will push less productive jobs out of the

Netherlands, resulting in unemployment among the most vulnerable labour population and the disappearance of entire sectors.

To lower the impact of the ageing population, workers should have incentives to work beyond the normal retirement age. The new government has written in their coalition agreement that the retirement age will shift from 65 to 66 in 2020. What's more, the coalition will come up with a proposal to link the retirement age to the life expectation, as agreed by the labour unions and the employers' organisation.

The future labour force structure should also match market demand in terms of quality and education. A frequently cited bottleneck is the shortage of technically qualified staff. Even when they are educated in the Netherlands, technical staff often find employment outside the industrial sector. If we wish to prevent industrial jobs from disappearing abroad en masse, policy changes are necessary. Firstly, the supply of technical staff must be expanded by opening the borders more freely to technically qualified foreign manpower (also in an attempt to reverse the present brain drain of knowledge workers from the Netherlands, see Chart 40). Secondly, industries will have to place more emphasis on innovation and on increasing the capital intensity of production, so that labour productivity will rise.

Chart 40: Net highly educated migrants in 2000[6]



Source: OECD

Education

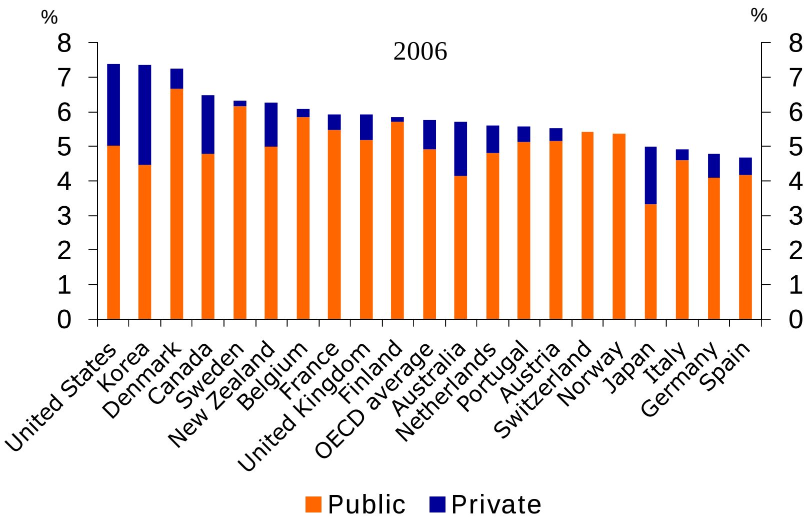
The education system plays a very important role in the quality of society. Education facilitates the integration of different population groups and acts as a vehicle for transmitting social norms and values. The quality of education is a critical factor for the innovative capacity of the country, and hence for the development of labour productivity. Keeping up the overall quality of the education system is a necessity if future standards of living are to be kept at the present high levels even when population ageing hits society.

[6] New data is published every 10 years

Presently, the Netherlands spends less than the OECD average on education (Chart 41). There are also increasing signs that the quality of its education is not improving, while the rest of the world is catching up (Chart 42). In addition, the quality of teacher training is debated. Becoming a teacher is less attractive in a tighter labour market. In general, salaries in the business sector are higher and fairer thanks to performance-related income systems. Furthermore, career opportunities in the business sector are greater than in teaching. Future education policy should therefore include better income for teachers and the introduction of modern performance related income systems.

The future tightness of the labour market makes maximum labour force participation a necessity. Strong emphasis on educational attainment is therefore a must. Drop-out rates need to be drastically reduced, particularly in vocational secondary education.[7] The process of combined learning and working may go a long way towards preventing dropout at lower education levels. A greater number of entrepreneurs should take up the gauntlet by accepting places in consultation bodies and supervisory boards of schools, in order to improve the continuity between education and the labour market.

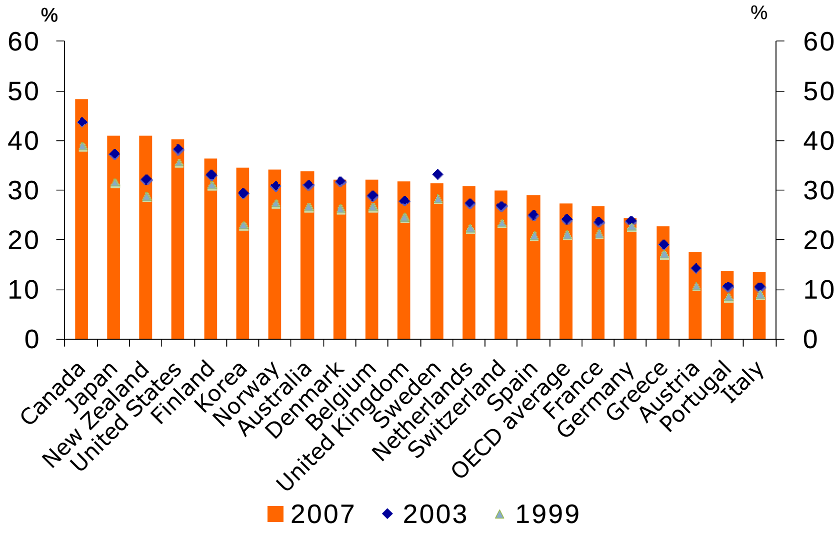
Chart 41: Expenditures on educational institutions (in % of GDP)



Source: OECD

[7] In 1999, pre-vocational education and junior general secondary education schools introduced pre-vocational secondary education (VMBO). This form of education takes 4 years and is attended by children between 12 and 16 years old.

Chart 42: Percentage of higher educated people



Source: OECD

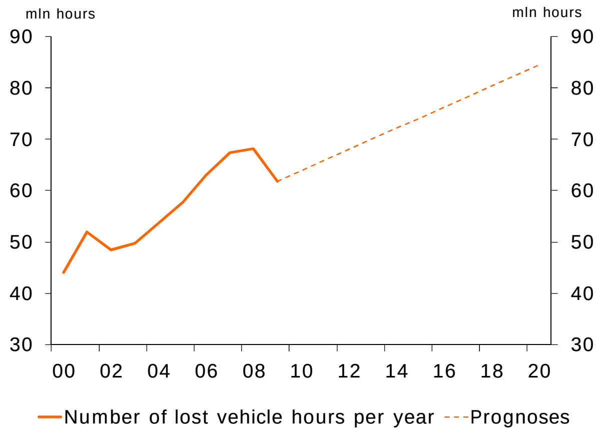
Infrastructure

Part of the Dutch economic success is determined by its favourable location within the European Union and the ease with which goods can be transported to and from the Netherlands. The majority of goods entering Europe, especially from Asia and the USA, pass through the port of Rotterdam or through Amsterdam's Schiphol Airport. The Netherlands is therefore often considered the Gateway to Europe. To maintain and reinforce this role the Netherlands has developed and continually improved its infrastructure. In response to growing demand, significant infrastructural investments should be made to maintain the present high quality level of roads, railways, waterways, and air traffic.

During the economic recession traffic jams got shorter and pressure on infrastructure was lowered. However, in the long run additional infrastructural programs are a necessity to maintain the country's position as an attractive location (chart 43). The OECD is therefore calling for early policy reforms regarding the Dutch transportation system, particularly in the *Randstad* area.

New projects are hindered by past experiences with large infrastructural projects such as the *Betuwelijn* (railway between Rotterdam and the hinterland of Germany) and the HSL (the High Speed Line running from Amsterdam via Schiphol and Rotterdam to the Belgian border, with connections to The Hague and Breda) that have turned out to be far more expensive than originally calculated. The Dutch government is therefore extremely cautious about embracing new projects, and decision-making and consultation processes take up enormous amounts of time. Decision-making on projects such as the so-called *Zuiderzeelijn* and the A6/A9 motorways must be accelerated if the Netherlands wants to keep up its competitive strength in the near future.

Chart 43: Number of lost vehicle hours



Source: Ministry of Transport, Public Works and Water Management

Health care

In the coming years expenditure on health care will rise at an expected rate of 4 percent per year. The main reason is the ageing population, with baby boomers reaching an age when they need more medical care, combined with rising life expectancy. Economic growth will lag behind the rise in health care costs, with an expected growth rate of around 1¾ percent. The consequence is that the Netherlands will spend more on health care in both absolute and relative terms. To reduce this acceleration of health care costs, measures must be taken by the government. Options are to increase the private contribution of individuals via a pay as you go system or by a rise in insurance premiums. Another option is to lower the standard package. Efficiency gains are of course the best alternative, but efficiency gains will not be enough to break the cost acceleration.

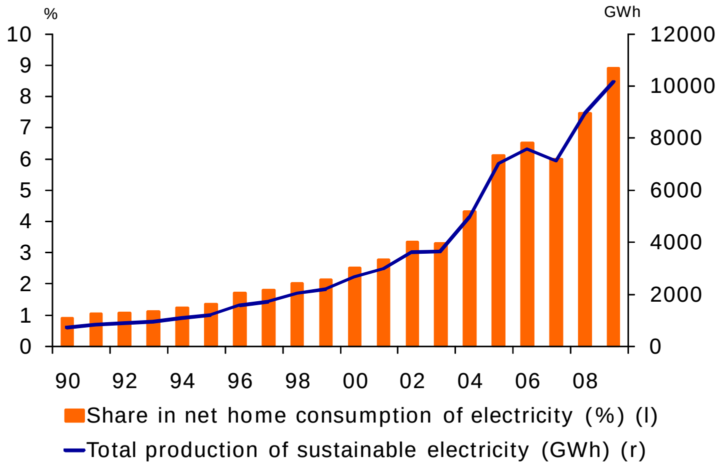
Sustainability of the energy supply

In 1959, natural gas reserves were discovered in the north of the Netherlands (in Slochteren and its environs). Currently, natural gas meets almost half of Dutch domestic energy requirements and is a major export commodity. Although the natural gas reserves will run out sooner than was expected (probably in 2030), they currently make the Netherlands less dependent on the energy supply of other countries. This explains why some analysts have nicknamed the Netherlands a 'semi-OPEC country'.

An adequate and reliable energy supply is an essential precondition for economic growth and prosperity. To date, the Netherlands is greatly dependent on energy from fossil fuels, resulting in two serious problems. The first is that the limits of current global energy reserves are gradually coming into view, although scientists have diverging opinions on the rate at which this process is occurring. Furthermore, these reserves are mainly located in non-democratic countries that are characterised by geopolitical tension, making their supply potentially unreliable.

The second problem concerns the CO_2 emissions and pollution which go hand in hand with burning fossil fuels, resulting in global warming. The Dutch have signed the charters on the reduction of greenhouse gasses. To achieve the overall goals, more sustainable energy sources are needed. Furthermore an overall reduction of energy consumption should be achieved. So far the Netherlands has made little progress in this field, with only marginal declines in energy use. In addition, to date only a small proportion of the entire energy demand is being met by sustainable sources (Chart 44 and 45).

Chart 44: Sustainable electricity production

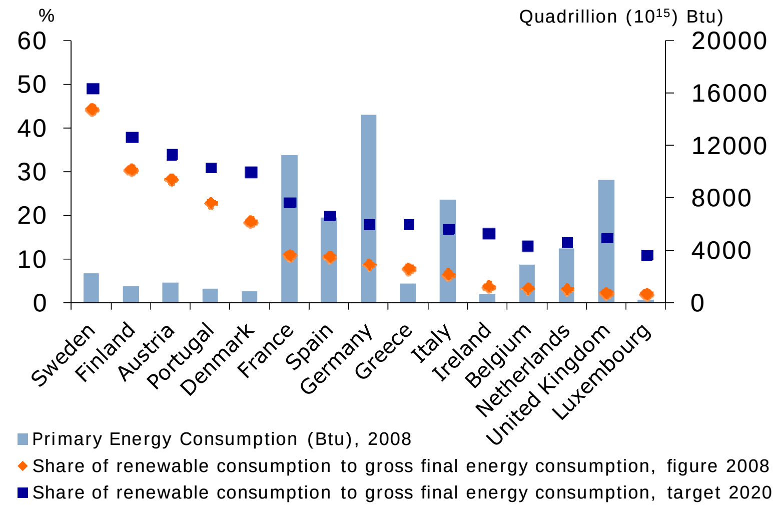


Source: Statistics Netherlands

Even in a European perspective, the Netherlands lags behind, although a lot of technical knowledge is at our disposal and could even be exported and turned into a competitive strength. Government policy should target and perhaps subsidise a faster dissemination of the available knowledge on sustainable energy supplies. In addition, it should discourage the use of polluting and energy-inefficient transport vehicles, and at the same time promote the use of clean engines.

If the process of global warming continues or accelerates during the decades ahead, sea levels will rise further. This poses a threat to the safety of the people living in the Netherlands and to the Dutch economy if no measures are taken. About 60% of the population resides and 70% of GDP is produced in areas below sea level. So special attention is needed in the decades ahead to maintain and repair sea walls and river dykes even though the costs will be enormous.

Chart 45: Consumption of electricity



Source: Energy Information Administration and Europe's Energy Portal

Efficiency and effectiveness of government

The large changes in the economic environment also challenge the Dutch government and its organisation. Due to population ageing and the resulting smaller labour force, there will be fewer people available for jobs in the public sector. It is therefore essential that the overall efficiency of the public sector is evaluated and improved. Whenever reasonable and possible, the market sector should take over activities.

The necessity to restructure the public sector is well understood by all political parties. The challenge will be to change fundamentally the perception on which tasks the government should fulfil. In any case, the effectiveness of the government must increase in the long run. Multiple structural options were put forward during the last elections, including downsizing the number of municipalities and removing the provinces from general governmental level. The new cabinet will start a program to improve government efficiency and rethinks its tasks as a consequence of its austerity measures. As mentioned above, the goal of the government is to spend 6.1 billion euro's less on public governance in 2015.

In addition, to improve the overall efficiency of the government, its decisiveness should improve. As we have seen, decision-making processes concerning, for instance, large infrastructural projects, take long periods of time - up to decades - whereas in emerging markets in Asia they are taken in just months. If the Netherlands wants to remain competitive, the government cannot afford to waste so much time on urgent policy decisions.

Economic institutions and useful websites

Agency for international business and cooperation	*www.evd.nl*
Association of real estate brokers (NVM)	*www.nvm.nl*
Dutch government	*www.government.nl*
EIM Business and Policy research	*www.eim.nl*
European Central Bank (ECB)	*www.ecb.int*
European Union	*http://europa.eu*
Dutch Land registry (Kadaster)	*www.kadaster.nl*
Ministry of Economic Affairs	*www.minez.nl*
Netherlands Authority for the Financial Markets (AFM)	*www.afm.nl*
Netherlands Bureau for Economic Policy Analysis (CPB)	*www.cpb.nl*
Netherlands Central Bank (DNB)	*www.dnb.nl*
Netherlands Competition Authority (NMa)	*www.nma.nl*
Netherlands Foreign Investment Agency	*www.cbin.nl*
Organisation for Economic Co-operation and Development (OECD)	*www.OECD.org*
Rabobank	*www.rabobank.com*
Statistics Netherlands (CBS)	*www.cbs.nl*

Colophon

The Country Profile is a publication of the Economic Research Department (KEO) of Rabobank Nederland. The vision presented in this publication has been based on data from sources we consider to be reliable. Among others, these include Reuters EcoWin, OECD, Land Registry Office, Association of real estate brokers (NVM), DNB, Netherlands Bureau for Economic Policy Analysis (CPB) and Statistics Netherlands (CBS).

The Economic Research Department can also be found on the internet:
www.rabobankgroep.com/kennisbank

For other information, please call the KEO secretariat on tel. 030 – 2162666
or send an email to economics@rn.rabobank.nl.

Contributors:
Maarten van der Molen
Shahin Kamalodin
August Sjauw-Koen-Fa, AR

Editorials:
Hans Stegeman, Head Dutch Macro Economic Research
Wim Boonstra, Chief Economist Rabobank Nederland

Printing:
GrafiPrint B.V. Eindhoven

Production coordination and graphics:
Roy de Haan
Christel Frentz
Reinier Meijer

Closing date: December 2010

Economic Research Department online
www.rabobank.com/kennisbank

Postal address
Rabobank Nederland
Economic Research Department (UEL A.00.02)
P.O. Box 17100
3500 HG Utrecht
The Netherlands

Office address
Rabobank Nederland
Eendrachtlaan 10
3526 LB Utrecht
The Netherlands

Rabobank